

# **CONSTRUCTING THE PUBLIC-PRIVATE DIVIDE**

**Historical perspectives and the  
politics of pension reform**

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**Noel Whiteside  
Zurich Financial Services Fellow**

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## **Abstract**

In contrast to many European countries, UK pension policy has long sought to preserve private pension provision, initially through the promotion of occupational pension schemes and more recently with the development of state-sponsored personal pensions. This paper examines the record theoretically, historically and comparatively. It argues first, that arguments favouring public choice as the basis for old age income security are inherently flawed because they fail to recognise the role played by convention and law in sustaining and developing common knowledge and confidence – the essential bases for economic action on which individual choice relies. As conventions of market activity vary by place, by product and over time, there is a constant need to define and refine their public legitimacy, without which the collective confidence necessary for economic action disappears. Second, the paper offers an historical account of how public-private pension ‘partnerships’ were first established in the UK in the 1960s. Contrary to what we might expect, Old Labour was more conscious of the importance of preserving established conventions governing occupational and private provision than their New Labour successors have been. Recent extensions in regulatory surveillance expose the contradictions that result when governments attempt to extend market solutions as a substitute for public services. Finally, contrasting UK experience of earnings-related schemes with their European counterparts, the paper shows how different conventions have shaped different roles for the state in earnings-related pension provision, resulting in varied typologies of public-private mix. Under recent demographic and fiscal pressure, previous divisions between public and private have become increasingly complex as governments move to regulate personal pension savings as a necessary supplement to statutory schemes. However, in contrast to careful collective negotiation found elsewhere, changing conventions imposed by recent British governments have shattered public confidence and provoked inaction. Future pensioner poverty appears very likely unless politicians first accept that private provision will never replace public pensions and (secondly) are prepared to negotiate a settlement that promotes collective confidence among all agencies and the whole population.

## **1. Introduction**

In recent years, member states in the EU have adopted various policies designed to contain future public liability for old age security. Diverse measures – the extension of the contributory period for full pension rights and the number of base years for calculating defined benefit payments, the raising of pensionable age, the introduction of means tests – have reduced (or at least contained) public liability for future pension finance (Bonoli and Palier, 2000). At the same time, there has been positive encouragement for current workers to take out private provision to supplement the public pension. In Britain, this transformation started in 1986 with the problematic introduction of personal pension plans and culminated in the creation of ‘stakeholder’ pensions that came on-line last autumn. However, this trend is hardly unique to the UK. Sweden, long characterised as a high-tax, high-spend welfare state, now means-tests public pensions and has introduced a system of personal private supplementary pensions. Germany has followed a similar pattern (Hinrichs, 2000). At first glance, therefore, there appears to be a degree of convergence within the EU towards a common approach, involving a revised public-private divide in the provision of old age security.

Much of the literature on pensions is concerned with the future financial viability of current and proposed pension systems, the degree to which they redistribute resources from rich to poor, the debates within specific countries concerning the relationship between work and pension rights and so on. This paper takes a different tack. Its principal focus is on the changing relationship between public obligation and private responsibility in guaranteeing income security in old age. The main focus is on Britain, where the question has become central to pension policy in the recent past. However, this paper analyses a different dimension by putting the issue of public-private division of provision for old age security into historical perspective. Its object is to question current assumptions about divisions between public and private sectors: less to argue that one side or the other should be the proper providers of old age security than to contest the reality of a separation between state and market. For, in establishing how the two are inter-related, the plausibility of mixed solutions becomes more readily apparent and more positively feasible.

To prove its case, the paper divides into three main sections. The first addresses theoretical assumptions underpinning much Anglo-Saxon argument concerning the reality of a public-private divide. Using perspectives developed within the theory of the convention, it demonstrates first, that such a division is more apparent than real and second, that the extension of state regulation of financial services bears witness to the way in which a neo-liberal state comes to contradict its own premises. The second section comprises a detailed historical study, describing how the public-private division in earnings-related pension provision became established in British policy in the course of the 1960s and early 1970s. The purpose here is to show that policies designed to sustain public-private ‘partnership’ in pensions predates the creation of New Labour by several decades and has, from its inception, generated complicated administrative issues for both state and industry. This earlier story of attempted partnership is all but forgotten. It falls between well-documented histories of Beveridge’s welfare state and the historical perspectives offered on the current crisis, which usually start from the decision of the Thatcher government to abandon the State Earnings-Related Pension Scheme (SERPS) introduced in 1978. Finally, the third section locates British perspectives within a European context. It demonstrates how, thanks to the absence of a strong liberal tradition, divisions between state and market were never central to the pension question in EU economies – where questions of funded pensions and the growth of individual provision are far more controversial. However, the acceptability of a public-private mix under the rubric of law has permitted the restoration of collective confidence. It is this absence of confidence that is provoking inaction (and potential future crisis) in UK pension provision.

## **2.Theoretical perspectives on the public-private divide**

In order to analyse current Anglo-Saxon divisions between public and private pension provision, we must understand the premises on which recent policy has been based. In the UK, both Conservative and New Labour policy has recently assumed that old age protection will be most effectively secured by returning to the individual the freedom to choose the saving scheme best suited to his/her future. The assumption that action based on individual interest offers the best way forward rests on neo-liberal tenets of political economy; these argue that markets, untrammelled by state intervention, automatically operate to secure the most efficient distribution of goods and services. This in turn rests on the premises of rational choice. Rational individuals, left to their own devices, base their actions on optimising personal interests, seeking out and

utilising perfect information to secure this end. Within this framework, public sector interventions should be minimal and confined to residual provision for those who, through no fault of their own, are unable to take up this responsibility. Otherwise, the market becomes distorted: high taxation (to fund collective welfare) distorts price signals and the belief that the state will offer universal protection against risk breeds social dependency. At best, market provision offers choice and market competition guarantees that those choices are available at optimally efficient prices. Within an ordered and tractable analytical logic, collective choice thus permits the perfection of efficient provision. This (admittedly crude) summary of collective decision-making, based on a rational utility maximising model, is applied extensively in the social sciences to analyse labour productivity, industrial organisation – even public policy formation – as well as personal and collective social protection.

In many respects, this model is less than satisfactory; we have to recognise that it is not possible for the state to absent itself from market relations. The vision of efficient and effective economic activity resulting from rational individuals using perfect information to secure optimal personal choice through contractual relations in a free market environment assumes an unlikely degree of systematic and focused action. To secure specified outcomes, individuals make decisions based on their expectations concerning the consequences of their actions and the relationship of these to their desired goals. This implies the pre-existence of a collective understanding about right and proper behaviour within specific environments. In market relations, the conventions underpinning the drawing up and fulfilment of contracts – the very identity of what a contract means and what contractual obligations imply – have to be mutually understood and respected to enable any type of economic action to take place at all. This framework of common understanding (or common knowledge) is built up over time. It structures the rules, norms and conventions governing economic and social co-ordination. The state, solely sovereign in such matters, acts as an economic co-ordinator of last resort: guaranteeing collective social justice by establishing the rules of the game, by identifying fraudulent behaviours, and by protecting the polity from external threat or the sudden alien imposition of new rules.

In this respect, a market is a co-ordinating mechanism much like any other. However, the rules of competition and contract, of agency and its just remuneration, have to be known and accepted for a type of market to function efficiently (and typologies vary

widely in accordance with differences in product, place and time). Institutional arrangements must be put in place to guarantee that such rules are observed. Regulatory arrangements are present in all market societies; should markets fail, the public turns to government for more legislative protection, not less. When seen from this angle, opposition between ‘state and market’ becomes impossible, for the state – through the law – is charged with underwriting market performance to secure the necessary confidence to enable all to participate in economic action.

As economic commentators have noted (Salais and Storper, 1999; Dore, 2000; Hall and Soskice, 2000), contractual relations and their underpinning conventions vary – between nations, between products as well as over time. Hence market systems require a conventional agreement on the definition of the common good: the common good being those rules particular markets must respect to secure the necessary collective confidence that enables participation in economic activity. There exist, in summary, different ‘possible worlds’ of economic co-ordination, each reflecting sets of expectations held by participants concerning the principles of justice applicable to their situations. Institutional judgements concerning the legitimacy (or otherwise) of particular initiatives are based on past and future actions within these spheres: these judgements should be incontestable, acceptable and foreseeable so that all actors can understand their pertinence to themselves. This removes inaction that is the consequence of uncertainty (Salais, 1999). Far from being external or absent from market activities, therefore, the state is bound up in their daily operation: as guarantor of a collective good that is not realised *a priori*, but is continually modified and developed in the course of collective economic and social activity. By common consent, the state is charged with securing collective confidence in conditions of economic engagement within which all can realise their personal objectives. For, in the absence of such a guarantor, it is not possible for individuals to participate in collective action or to secure their life projects and objectives.

Viewed from this perspective, individual action appears based less on rational choice *tout court* than on trust and confidence based on collective expectations about the form and content of rational market behaviours. Empirical research derived from a variety of academic disciplines (history, anthropology, cultural studies) all demonstrate that apparently irrational behaviour and decision-making is widespread. Social identity and social or family commitments – the attributes and links that

underpin social life – help set parameters of individual choice. Passing fashion, the ‘desire to belong’, means that personal choice is also expected to reflect and reinforce more transitional loyalties; this also plays havoc with assumed rationality in individual behaviour. (Clark and Marshall, 2002). Careful observation of long-term behaviour in commercial markets demonstrate how personal contacts and experience play a major role in establishing confidence and trust that determine the selection of market products; this is much more significant than simple evidence of ‘best value’ (Whiteside 1997). Underpinning the construction of these social loyalties and the formation of confidence lie a complex of social conventions that permit all of us to identify friend from foe, intimate from stranger, the trustworthy from the fraudulent (Storper, 2000)

This emphasis on how socio-political features shape market behaviours by establishing networks of trust and confidence, the vital foundation to the operation of any market system, has several important implications. First, it explains why markets in similar products operate in different ways in different countries. Institutional frameworks differ in accordance with collective expectation about how security is to be guaranteed. In one situation, the payment of money to an intermediary will be considered a bribe: in another it is a required fee for service. In one situation, the customer is expected to negotiate the final price, in another, such behaviour is considered unacceptable. In simple terms, to do the same business in different environments requires a sophisticated understanding of both written and unwritten conventions about how business is done. It does not suffice to understand the competitive process in the pure economic sense of ‘best value’. A process of acclimatisation (or the acquisition of a local partner) is required to make progress. Second, official institutional arrangements that reinforce economic transactions do not translate easily between different countries. Even when their frameworks of action appear similar, they incorporate different historical trajectories concerning the role of state agencies and corporations in the operation of economic and social transactions. In a very real sense, economic relations and market systems are more readily understood as socio-political products than as outcomes of collective rational choice. Hence the preference both within and outside government for dealing with agencies they know – and who themselves implicitly understand the ‘rules of the game’. To deal with outsiders invites at best misunderstanding, at worst what Williamson labels ‘opportunism’.

Finally, the perspective developed by supporters of the theory of the convention (Orleans, 1994, Wagner 1999, Storper 2000) invites the conclusion that there is no such thing as ‘the market’ standing in opposition to the state. Rather there is a myriad of varied arrangements organising economic activity in which the law (and hence the state) is closely involved as an essential collaborator. This much has become apparent in the UK in recent years. The privatisation of publicly owned services witnessed an elaboration of regulatory rules under which new markets were to operate, as governments have sought to guarantee that market operations fulfilled political expectations. Much of this activity has been dedicated to the creation of new market agencies and the stimulation of new forms of competition, with (arguably) some success in telecoms and energy supply but rather less in public broadcasting and rail transport. As for pensions, however, British governments have been less concerned with the creation of new markets than with the adaptation (or colonisation) of old ones to serve public purposes as defined by state policy. The results are familiar: the multiplication of regulatory agencies, burgeoning amounts of new rules and requirements – all designed to clarify procedures for customers and to promote collective confidence in the ‘free market’ as an agency for social amelioration.

This approach implies that the divide between public and private (or state and market) cannot be logically sustained, even though this vocabulary still plays a significant role in shaping political debate. Within the UK, compulsory motor vehicle insurance (supplied through commercial companies) is commonly viewed as ‘private’. Yet politicians and their officials apparently believe that compulsory old age insurance supplied in the same way somehow would not be so. Much of the discussion is driven by conventions of public accounting, themselves the product of liberal arguments concerning economic efficiency, its relationship to market mechanisms and the limitations thus necessarily imposed on the state as an economic agent. Similar arguments are also embedded in the rationale underpinning global financial markets and their regulatory agencies. As globalisation proceeds, so different sets of market principles are brought into conflict with each other, requiring the negotiation of new agreements and the establishment of new conventions. Nowhere is this more apparent than within the EU: as witnessed in the agonised and prolonged labour preceding the birth of a single market in financial services and recent negotiations over the directive on supplementary pensions. Agreement on the meaning of ‘liberalisation’ of markets

can only be achieved if we understand that this necessarily means a collective renegotiation of established rules – not their unilateral removal. Only then can confidence be restored and economic progress attained.

This section has outlined an alternative approach to rational choice theory for analysing the public-private divide in pension provision. It argues that state ownership (and provision) have offered one method of promoting confidence in old age security. Publicly funded schemes are now less favourably viewed than market-based systems. This does not (and cannot) mean the removal of state intervention in shaping how these markets operate. Charged with the promotion of confidence to secure personal or collective saving for old age security, both past and present UK governments have been preoccupied with defining a separate sphere for private operations and establishing its relationship to public provision. The post-war notion that the state should supply a subsistence level pension for all did not last very long: plans for a public-private pension partnership date back to the 1950s. The following section traces the history of how the UK's current system was originally established, drawing attention to the longevity of British faith in a viable public-private divide.

### **3. Promoting Partnership: pension reform in the 1960s**

*'The growth of private pension schemes is to be encouraged; it produces social stability. In the long run, moreover, it should reduce the individual's dependence on the Government scheme and perhaps even enable the Government to get away from the expensive doctrine of "universality" – and perhaps lead to the adoption of benefit payments according to need.'* **Treasury memo, October 1960**

The first real ‘pension panic’ in the UK (and France) occurred not in the 1980s, but in the late 1950s. In Britain, official forecasts concluded that, thanks to demographic change and the impact of inflation, state expenditure on pensions was due to double between 1960 and 1970, at a point when Exchequer contributions to National Insurance (NI) were being cut from 33% to 14%. In the late 1950s, in Germany, pensions graduated according to earnings were introduced on a universal and compulsory basis. Such developments provoked criticisms of the Conservative government from the Labour party on the grounds that the British welfare state was ‘falling behind’. A scheme developed by Professor Richard Titmuss (London School

of Economics) advocated the introduction of inflation-proofed, universal, state-run, earnings-related pensions based on funded principles; this was first adopted as official Labour Party policy in 1957. The pensions industry opposed this because it aimed to wipe out private provision (Hannah, 1986, 56). In response, the Conservatives proposed a non-indexed, earnings-related state pension with incentives for firms offering occupational pensions to ‘contract out’ of the state scheme.<sup>2</sup> Following the Conservative election victory of 1959 this alternative was put in place. The new scheme raised graduated contributions well above the sums justified by the introduction of a meagre graduated state pension with a view to diverting surplus contributions to underwrite the rising cost of the Beveridge flat-rate state pension. However, under regulations governing the 1959 legislation, NIC contributions were substantially reduced for those electing to contract out. An additional financial incentive thus supplemented established tax concessions to employers who offered occupational or company pension schemes. Thus stimulated by tax concessions and general government sponsorship, pension funds came to represent over one-third of private savings in the British economy by the mid-1970s: a proportion substantially above that found in the United States (Hannah, 48-51)

Conservative policy, throughout the 1950s, promoted occupational provision: in this regard, the legislation of 1959 was a success. Numbers covered by private schemes rose: from 7.5 million workers (1956) to 9 million (1960) to 11 million (1963) to 12 million (1966) (of whom 4 million were in the public sector), peaking in 1967 at 49% of the employed population (Hannah, 67). In the course of the 1960s, occupational pensions expanded rapidly. By the middle of the decade, contributions to private schemes were running at £1 billion p.a., with employers funding two-thirds of this sum<sup>3</sup>. This trend, bolstered by high returns on equities in the 1950s and 1960s, fostered official actuarial optimism: predictions forecast further growth and private scheme cover was estimated to reach 13-14 million employees by 1980.<sup>4</sup> As the quote cited at the beginning of this section indicates, such rates of expansion also raised hopes that occupational schemes might come to replace (in part at least) universal state provision. Not all such schemes contracted out of the 1959 Act, however. Of the

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<sup>1</sup> Collier to Robertson, 13 Oct 1960: on file T 227/1426, Public Record Office [PRO]

<sup>2</sup> The 1959 Act raised graduated contributions considerably higher than required to fund graduated pensions; the scheme was thus concocted as a subsidy to the general NI fund. MPNI circular to Official Committee on Occupational Pensions, 14 July 1965: T 227/1425 PRO.

<sup>3</sup> This draws on a report of the Government Actuary, in 1964. National Joint Advisory Council [NJAC] ‘Report of the Committee on the Preservation of Pension Rights’, Dec. 1965, p. 3: EW 25/219, PRO.

8 million covered by occupational or private schemes in 1966, only 4.5 million (in 24,000 schemes) were formally so exempted<sup>5</sup>, with the rest simply ‘topping up’ to offer a pension ‘package’ commonly calculated on a defined benefit basis. Treasury fears that extensive state regulation of private superannuation would ‘drive out’ occupational schemes, kept official regulation to a minimum<sup>6</sup>. The requirements of the Inland Revenue aside, non-contracted out schemes were subject to no additional regulation (even though employees might be required to contribute to a firm’s scheme as a condition of employment). The Revenue itself was more interested in Exchequer receipts than in actuarial verification of occupational pensions [Hannah, 52-6]. Schemes that did contract out had to guarantee retirement pensions at equivalent age and level to the state scheme and to protect the rights of workers of 5 years standing who transferred employment – hardly onerous requirements taken the low level of state benefits introduced by the 1959 act<sup>7</sup>.

This ‘light touch’ regulation might have been popular with employers and the pensions industry, but the 1959 settlement was not problem-free. First, inflation eroded the value of the state’s graduated pensions, forcing those with no additional cover to apply for means-tested national assistance. This lack of index-linking had been deliberate: another measure designed to foster private contracted-out schemes that would have been ‘driven out’, had they been required to guarantee the value of post-award pensions under the equivalent pension rule. However, this meant that the Conservative scheme was widely criticised as a swindle and popular interest in Labour’s alternative proposals was thereby stimulated. Second, graduated pensions covered very few women (2 million out of 12 million by 1966) and contracted out schemes were not obliged to offer cover for widows. Hence reform did nothing for those who lived longest and who, according to Able-Smith and Townsend, were most likely to suffer old age poverty. Third, efforts to guarantee the pension rights of transferees (from contracted out to non-contracted out firms, between public sector and private sector employment) proved inadequate and confusing. Only 8% of employees who recovered previous contributions on leaving reinvested the money for pension purposes and the obligations of transferring firm to secure future pension rights of departing employees remained haphazard and uneven, particularly between

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<sup>4</sup> Government Actuary to Menner (Social Security) 22 August 1966: ACT 1/1554, PRO

<sup>5</sup> National Joint Advisory Council (Ministry of Labour), ‘Report on Occupational Pensions in the UK’, p.9 (Feb 1966): EW 25/219, PRO

<sup>6</sup> Collier (Treasury) memo, Oct 1960: T 227/1426, PRO

contracted out and non-contracted out schemes<sup>8</sup>. In the public sector alone, 500 different administrations covered 1,500 employing authorities and schemes involved different retirement ages, varying contributory obligations and retirement rights<sup>9</sup>.

Finally, the solvency of some private schemes was distinctly dubious. Although the Inland Revenue required employers to demonstrate that a retirement fund existed and was ‘viable’, this did not necessarily guarantee its solvency. In 1960, a report by the Government Actuary pointed out that only 50% of non- contracted out schemes were insured and only 50% of the non-insured were actuarially certified. Many were extremely small; 75% of 40,000 private schemes had fewer than 50 members<sup>10</sup>. This provoked demands, within Whitehall and outside, for more extensive state regulation. ‘If the State allows compulsory deductions to be made from employees’ pay packets for occupational pension purposes’ a Ministry of Social Security official minuted the Treasury, ‘then arguably the state has a duty to see that the employee gets ‘value for money’ for what he pays.’<sup>11</sup> At this point, such demands fell on deaf ears. On the grounds that privately provided pensions represented deferred salary, Treasury officials argued that collective bargaining – not state regulation - was responsible for negotiating improvements in private schemes. Funded occupational pensions could not factor in variable rates of inflation in advance. Further, withdrawal of state approval for occupational schemes would hurt workers covered by them more than employers who ran them<sup>12</sup>. However, such arguments concealed the fundamental reasons for unquestioning Treasury support for private pension provision: occupational schemes contained demands on the public purse and provided the wherewithal for private sector investment. By 1966, annual contributions under private schemes offered significant sums both for internal investment in UK equities and for the growing London market in financial services and products<sup>13</sup>. This placed governments of both parties under considerable pressure to sustain and promote retirement security in the private sphere.

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<sup>7</sup> NJAC, ‘Report …’, op. cit., p. 3.

<sup>8</sup> In a memo sent by the Inland Revenue Superannuation Office o the Government Actuary (20 Feb 1968) pointed out how defined benefit private schemes meant that sums accrued by Company A were insufficient at payout time at Company B, particularly when a lump sum on retirement was involved.

Questions of who could claim tax relief for what were also provoked. Papers on file ACT 1/1639, PRO  
<sup>9</sup> Ministry of Housing and Local Government to Government Actuary, April 1966, ACT 1/1554, PRO.

<sup>10</sup> Collier memo, Oct 1960, T 227/1426, PRO.

<sup>11</sup> On file ACT 1/1555, PRO. A Treasury official wrote ‘ooh’ in the margin beside this comment.

<sup>12</sup> Response by Government Actuary, June 1967, ACT 1/1555, PRO

<sup>13</sup> NJAC, ‘Report …’ op. cit, pp.3-5.

Even so, with Labour's return to office in 1964, official policy was set to change tack. Labour's own plans had been modified since Titmuss' original proposals: the 1964 manifesto promised to introduce wage-related pensions at 50% of average lifetime earnings for all, on a partially funded basis; but 'contracting out' of approved occupational schemes would continue<sup>14</sup>. To prevent earnings related NI contributions being used to subsidise the basic flat-rate state pension (by 1966 c. £1million p.a. was converted in this fashion<sup>15</sup>), Labour aimed to abolish the flat rate element and to weight earnings-related pensions to help the low paid to rise above Supplementary Benefit levels.<sup>16</sup> The pension element of NI contributions was to be separated, creating a National Superannuation Fund, to be managed by Trustees, who would be charged with its investment in equities, not government stocks:

*'Trustees ... will have the same opportunities to carry out profitable investment of their funds as the trustees of private pension schemes and insurance companies. Thus they will ... ensure that the national savings piling up in the Pension Fund will be used to help our national capital investment programme.'*<sup>17</sup>

The new funded scheme would offer an earnings-related pension calculated on the basis of lifetime earnings. It promised quick maturity (full earnings-related pensions would be available within ten years), cover for widows and dependants, pre- and post-award dynamism (linked to average earnings). While retaining contracting out, it aimed to extend cover to the 7 million workers still excluded from occupational schemes. To help the low paid, a degree of redistribution was incorporated and the basic state pension was raised, to remove means testing of the poor.<sup>18</sup>

Such changes carried huge implications for established pension schemes as well as UK investment finance; from the start, it stimulated opposition from insurance companies, inside Whitehall and within the Labour movement. Treasury officials could find no merit in the scheme, which – in the words of one official – was viewed

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<sup>14</sup> Summarised in Imp. Inst. Report pp 19-20: EW 25/219, PRO

<sup>15</sup> Figure calculated by TUC: 'Note for meeting with Ministry of Social Security' 10 Nov. 1967, p.4: MSS 292B/166.51/1, MRC.

<sup>16</sup> Retaining a flat rate element required the raising of existing pension levels: this was an expensive option that would undercut the possibility of funding the whole. Ministry of Social Security, 29 July 1968, 'Question whether the new scheme pensions should contain a flat-rate element ...' MSS 292B/166.51/1, Modern Records Centre [MRC] University of Warwick.

<sup>17</sup> Labour Party, *New Frontiers for Social Security*, (1963): copy on file EW25/219, PRO

<sup>18</sup> 'The new Earnings-Related Pension Scheme', Ministry of Pensions confidential memo, 14 June 1966: T 227/2223

as ‘piecemeal nationalisation by the back door’<sup>19</sup>. The main objections focused on the implications for inflation, for private investment and for the public finances. First, although much higher contributions (estimated in 1964 at 15% of earnings) would initially be deflationary, the likely effects on wage demands, production costs and higher consumption among the elderly would stimulate inflation and endanger exports, the balance of payments and confidence in sterling. Second, in the context of the Labour government’s other welfare spending commitments (higher family allowances and basic state pensions), there was the question whether such extensive resources should be devoted to a scheme whose benefits were skewed in favour of the better off. Third, there were unanswered questions associated with the Superannuation Fund’s investment. If placed in equities, as Labour originally intended, market prices would be inflated and interest rates on gilt-edged would be forced up, raising the cost of government borrowing. As the government planned expenditure on new universities, road building and general industrial modernisation, this was no joke. Further, state investment in equities set an unfortunate precedent for other departments, who would demand similar freedom: ‘.. if government are going to join in the rush to get out of gilt-edged,’ one Treasury official noted ‘it is difficult to see who can be expected to stay in.’<sup>20</sup> Conversely, if vested in government securities (as required by Labour’s capital building programme), the Fund’s future obligations would eventually become another additional burden on the public accounts. Finally, the scheme posed a threat to established occupational pension funds: by displacing private investment, it might undermine London’s capital markets as well as internal investment for industry. In an era of public expenditure restraint, and with the Fund’s obligations due to increase over time, all this appeared infinitely resistible.

As might be expected, the insurance industry and its clients argued that Labour’s proposals would initiate a decline of private pension provision. As the government promised widows’ pensions, index-linking, early maturity and superior transferability for mobile workers, the life industry feared that higher NICs would inevitably squeeze contributions to private schemes<sup>21</sup>. It could also point out that the state proposals did not offer such good value to the contributor himself as established occupational

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<sup>19</sup> The following points are taken from papers and memoranda of the Treasury Economic Section, on files T 227/ 2223-2224, PRO

<sup>20</sup> Baird, Treasury memo: National Insurance Review Committee, ‘National Pensions Fund’ (14 Feb 1966): EW 25/219

<sup>21</sup> Life Offices Association: ‘National Pensions: occupational schemes as a major factor in the national economy’, Jan 1968: MSS 154/3/SP/2/3, MRC

schemes and commercial alternatives, (because the government diverted more help to dependants). In view of the expanding number of defined benefit occupational pensions – and in view of the higher contributions required by Labour’s scheme – objections to a state take-over also carried a certain resonance in wage-earning circles. Some trade unions had won occupational pensions through collective bargaining from employers in lieu of higher wages, which had been held back during periods of wage restraint. Not surprisingly, therefore, the TUC itself opposed any interference with occupational or company pensions, while supporting a rise in the basic state pension<sup>22</sup>. Both sides of industry were thus united in favour of contracting out of the government’s plan. Finally, the Co-operative movement, whose multiple schemes covered 2.25 million members, was firmly opposed to any reform that allowed state superannuation funds to invest in its commercial competitors.

The only support for a comprehensive, universal, state-run scheme of earnings-related superannuation along the lines proposed by Titmuss was found in the Ministry of Social Security. Here, the division of social security and the investment of a national superannuation fund in equities found its fullest endorsement<sup>23</sup>. A single state-run national fund, based on earnings-related contributions and concomitant benefits in old age, would reinforce collective belief in the need to save: this would probably help (rather than harm) private savings for the same purpose. Further, this department had extensive experience of the complexities involved in administering the existing contracting out system. However, this was among the lowest of spending departments in the Whitehall hierarchy and its views were easily ignored. Richard Crossman, appointed as Secretary of State to the newly created Department of Health and Social Security in 1968 and charged with hastening the much-delayed legislation on pension reform, found political opposition to a Titmuss approach altogether too formidable to be contemplated:

*... it was obvious that if we introduced our scheme without any provision for contracting out, all the good private schemes would have to be cancelled and there would be a terrible row ... They [the insurance industry] would tell their members that the wicked Labour government was depriving them of their pensions. This was*

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<sup>22</sup> TUC: Social Insurance and Industrial Welfare Committee: Minutes, 1 July 1968, p.2: MSS 292B/166.51/1, MRC.

<sup>23</sup> Ministry of Social Security ‘N.I. contributions: indivisible or divided?’, July 1968: MSS 292B/166.51/1, MRC

*politically very dangerous indeed ... So I announced we wanted a genuine partnership between public and private pensioneering ... in months of negotiation we did work out an enormously complicated way of fitting some 60,000 private schemes alongside our new earnings-related state pension. No other country has tried to do it.*<sup>24</sup>

Two White Papers, published in January and November 1969<sup>25</sup> laid down the terms of ‘partnership’; partial contracting out would prevent private schemes cutting back to accommodate the new state scheme. Every effort was made to preserve, even to extend, occupational provision<sup>26</sup>. Interestingly, the option of securing universal earnings-related old-age security through commercial agencies was rejected:

*It would be impracticable ... the control of a universal network of private schemes, even if one could be set up, would create formidable administrative problems both for the government and for the schemes themselves*<sup>27</sup>

This judgement, perhaps pertinent to current discussion on compulsory stakeholder pensions, guaranteed that policy would continue to consolidate provision along partnership lines.

Although private pension schemes offered a vast range of different types of old age security, few new regulations were imposed on schemes wishing to contract out. State officials bent over backwards to avoid any interference with the private sector: there was to be no central registry of occupational schemes, no state inspectorate, no central fund to guarantee solvency. ‘The danger is’ a Department of Employment memorandum proclaimed ‘that the establishment by the State of a central fund or agency might be regarded as inconsistent with the general desire that, to the greatest possible extent, occupational pension schemes should be left to manage their own

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<sup>24</sup> Rathbone Lecture *The Politics of Pensions* (delivered University of Sheffield, 1971: published by Liverpool University Press, 1972), pp. 20–1

<sup>25</sup>; *National Superannuation and Social Insurance*, Cmnd 3883 *Terms for Partial Contracting Out of the National Superannuation Scheme*, Cmnd 4195.

<sup>26</sup> DHSS Press Service, 28 Jan 1969, p. 4 ‘The White Paper emphasises that occupational pension schemes have an important part to play in partnership with the state scheme ... the new scheme is designed to assist in the long-term development of occupational schemes.’ MSS 292B/166.51/2, MRC

<sup>27</sup> Cmnd 3883, op. cit., p. 35 para 116.

affairs.<sup>28</sup> Richard Crossman could not have tried harder to shore up the public-private divide.

The new scheme did not completely abandon Labour's original intentions. National Superannuation balances were still to be invested, to create a partially – and temporarily – funded scheme. However, it had proved hard to raise pension provision without helping other long-term claimants (the disabled and the long-term unemployed); their benefit levels were upgraded accordingly and this, together with income lost by contracting out, ate into future balances available for investment. In the White Paper of January 1969, the Government Actuary calculated that the surplus of income over expenditure would only last until 1987-8, when the Fund's expenditure would exceed its income and a review of contributory rates would be required<sup>29</sup>. The White Paper contained little information on how, in the interim, balances were to be invested, or about who was to be charged with their investment<sup>30</sup>. In the event, the issue proved purely academic: the National Superannuation and Social Insurance Bill emerged from its committee stage in May 1970, only to fall when Prime Minister Wilson brought the General Election forward from October to June that year and subsequently the Labour government fell.

Sir Keith Joseph picked up the idea of funded state-sponsored superannuation in legislation passed in 1973. This also established the Occupational Pensions Board (less a regulatory agency than a source of information to inform future policy). Following the fall of the Conservative government in 1974 (and Labour's rejection of Joseph's pension legislation), Crossman's old bill was extensively revised by Barbara Castle. New legislation, passed in 1975, introduced the State Earnings Related Pension Scheme (SERPS) in 1978. This was both more extensive (and more generous) than the earlier pension proposals. The state not only permitted contracting out, but underwrote the viability of established schemes that chose to do so – a move that extended public liability in an unprecedented fashion (thanks to the fact that SERPS pensions were index-linked), which governments have been trying to reduce ever since. Such extensive public commitments effectively founded a new public-

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<sup>28</sup> Department of Employment and Productivity memo: 'Preserving Occupational Pension Rights' 31 March 1969, p. 36, T 277/2250-11. PRO.

<sup>29</sup> Cmnd 3883, op. cit., Appendix 2

<sup>30</sup> The Actuary's calculations simply assume interest of 3% from 1972 – 1987. Ibid.

private partnership that, in its turn, was superseded by the social security legislation of 1986. And, from then on, the story has been told many times (eg Bonoli, 2000).

Renewed faith in market mechanisms as the most efficient and effective way to distribute goods and services, together with mounting concern about the rising liabilities of the state, caused the Thatcher government to turn to the financial services industry to solve the problem by providing personal earnings-related pensions for all. The subsequent history of this initiative is well known and will not be rehearsed here. By and large, individual private pensions have not had a good press. Racked by scandal and accused of mismanagement, the industry has become subject to ever growing amounts of official regulation under a multiplicity of new regulatory authorities, in an effort to iron out its problems. In the process, distinctions between ‘public’ and ‘private’ have become blurred. During the 1990s, under the Major administration and subsequently under New Labour, the state has moved to reconstruct market behaviours of firms and their agents across the whole range of financial service products, with the object of securing individualised social protection for all in a reformed market. In so doing, public officials have been attempting to rewrite the established conventions governing pension provision in the hitherto private sector. What has emerged is a public-private hybrid as officials attempt to force the market to secure their political objectives.

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This thumbnail sketch of official responses to earlier pension panics establishes how successive governments re-thought and re-negotiated a public-private divide in old-age security. First, and perhaps we need reminding of this, this account demonstrates that the ostensible contrast between Old Labour and New Labour is, in this area of policy, something less than we might imagine. If anything, Old Labour Crossman promised less state surveillance of private sector behaviours than New Labour Darling has subsequently imposed. Second, and in contrast to other major European economies, at no point – even in the heyday of Keynesian economic management – did a British government ever try seriously to rationalise earnings-related complementary pensions within an overall policy. Even SERPS, the most left-wing measure introduced during the post-war years, made no attempt to rationalise (less still nationalise) earnings-related provision and company pensions. In this at least, a

left-wing British government did not go as far as a right-wing German one managed to in 1957. Unlike continental Europe, company pension funds remained the property of the employer, workers transferring jobs or employed by a company that changed hands had no guarantee of pension continuity. The complications resulting from contracting out, partial funding, changing tax law and so on have generated an administrative nightmare only penetrable by the highly experienced and whose administrative public and private costs remain unknowable – and unknown. The public-private divide remained sacrosanct

#### **4. Conclusions and prospects: the European dimension**

The preceding section outlines how a public-private divide was initially constructed within British pension policy. Policy outcomes in the UK stand in stark contrast to contemporary developments elsewhere in Western Europe. As Richard Crossman noted, no other country tried to weave a state-run earnings-related pension scheme over and around 60,000 private, more or less autonomous alternatives – creating, in the process an administrative nightmare for both government and industry whose repercussions survive into the twenty-first century. Elsewhere in Europe, earnings-related provision was largely extended and rationalised under the over-arching umbrella of labour law.

The fundamental difference between European and Scandinavian welfare and pension policies in the post-war era and their UK counterparts is rooted in traditions of joint or tri-partite decision making and the role of labour law (and the state) in guaranteeing (and extending) employment contracts and collective agreements (Gamet, 2000). The foundations of much continental labour law rest on principles of social public order: these determine norms governing employment, laying down the rights and obligations of employers and employed (including compliance with social security rules and legislation). Formal collective agreements set minimum standards. The state may rationalise these agreements by extending their terms and coverage to all in the same economic sector. During the 1960s at least, European governments played a more subsidiary role in determining the nature, scope and administration of social insurance (including pensions), whose funds were commonly jointly managed by the social partners. Occupational or professional pension schemes that had, earlier in the century, developed under purely private agreement (much like some of their British counterparts), were extended – and incorporated within a framework of legal

obligation designed to rationalise their coverage and guarantee their financial viability.

Naturally, this provision took very different forms. For example, in the Netherlands, state-sponsored collective negotiation in the 1950s allowed the consolidation of occupational pensions into different funds encompassing all firms in pre-defined sectors of employment, with compulsory membership for all. These were, from their inception, run on a funded basis and offer earnings-related pensions. Operating under co-management by employers and employed, the funds are professionally invested in financial markets. They are now among the largest pension funds in continental Europe. In France, white-collar and technical workers (*cadres*) fought from the inception of French social security to operate their own, independent ‘top-up’ scheme to the *regime générale* under an independent authority (AGIRC). The proliferation of private occupational schemes in the 1950s led (in 1963) to the ratification of a co-ordinating authority (ARRCO) to rationalise contributions and benefits, to extend and unite coverage within sectors and to underwrite the solvency of the separate schemes. From their inception, these schemes operated on a PAYG basis. Membership of a complementary pension fund, under ARRCO or AGIRC, became compulsory in 1973 for all private sector employees. In Germany, the legacy of co-determination in industrial affairs has long extended to corporate management of earnings-related state social insurance funds, again funded on a PAYG basis. And the legacy of worker representation on works councils is also translated into their representation on the management of company pension funds, traditionally used to provide German firms with long-term investment finance.

As a result, the distinction between public and private, so central to the development of British pension policy, never emerged during the post-war decades in many northern European economies – although each country developed its own idiosyncratic system of guaranteed earnings-related supplementation for all. In each of the situations cited above, we can observe how, historically, ostensibly private agencies (managed by the social partners) became charged under the law with public responsibilities, forging a public-private mix of immense complexity. Where, as in Germany or the Netherlands, traditions of co-determination are strong, the management of funded schemes – run on sectoral, occupational or company lines – is vested with the representatives of both employers and employed. It is not possible for

governments (or employers) to alter the terms and conditions of these pension schemes unilaterally. In law, the social partners of both these countries are charged with safeguarding the financial viability of the schemes under their care and they develop initiatives designed to protect future equilibrium when faced with potential crisis. Even in France, the reform of complementary pension schemes (to guarantee future viability) required government to prompt the social partners in ARRCO and AGIRC into negotiating a new agreement, incorporated within private sector pension reform in 1993. In all cases, unlike the UK, pensions and pension funds (where such exist) are not the property of either the state or the employers, but are held in common – being regarded as collective savings or deferred salary.

The complexity of the situation is manifest in recent judgements by the European Court of Justice, which had been called to decide which of these multiple schemes and agencies are part of a national welfare state and are therefore not required to be subject to EU competition law. Recent decisions have focused principally on questions of legal compulsion. Under these criteria, both Dutch pension funds and the ARRCO and AGIRC schemes are deemed to be part of their respective welfare states. On the other hand, COREVA (similar complementary pension insurance offered to French farmers) is excluded because its membership is voluntary. In European discussions, the attempted division between public and private invites complex legal debates concerning the status of specific institutions under national and EU law. In the UK this division is largely driven by conventions of audit: what is (and what is not) paid from the public purse, thus by-passing awkward issues about the status of funds and schemes that receive direct or indirect public subvention (tax breaks) for the welfare purposes. In both UK and Europe, therefore, the construction of a public-private divide is an extremely complicated question, provoking disagreement and controversy. So, in the Netherlands, privately invested pension funds, in whose management government has no say, are deemed to form part of the Dutch welfare state. In Britain, publicly subsidised company, occupational and personal funded pensions have been subject to an increasing amount of state direction and control – but form no part of the British welfare state. The logic becomes tortured and hard to follow.

When examining the public-private divide in a comparative historical framework, it is worth looking behind the terminology to reveal the real concerns that this conceals. In

legal terms, the issue of compulsion has formed a cornerstone for defining responsibility for risk. In principle, if a government requires compulsory contributions and the source of old age security fails, then government becomes liable for picking up the pieces to repair the damage. The converse is supposed to follow. In the UK, policy has been largely driven by the desire to minimise responsibility of the public sector. Even so, Equitable Life policy holders at one stage thought that they had a case for compensation from government for regulatory failure to warn investors about the dangers of purchasing financial products from a company about to default on its contractual obligations. This is the thin end of a much bigger wedge. Who bears responsibility, for example, when future ‘stakeholder’ pensioners discover that their annuity offers less than the Minimum Income Guarantee (or its equivalent)? Current UK regulation demands that the financial services industry bear responsibility for guaranteeing perfectly informed individual choice: witness the barrage of regulations governing marketing and disclosure. To secure rational choice among bemused (and irrational) consumers, public subsidy identifies and promotes the ‘best value’ product that all should select for preference (the stakeholder pension). Monopoly returns by the back door: the validity of both consumer choice and market competition as a source of efficiency is denied.

Hence the neo-liberal state contradicts its own original premises. Government intervenes more and more in industry practice, demanding an ever-larger say in business operations in order to convert the public to the merits of free market operations that are, in fact, anything but free. On the contrary, they are becoming deeply politicised: the state supports the market as a co-ordinating mechanism, but it must be a market that is reshaped to serve political ends. This is not to claim that state supervision of market mechanisms is automatically undesirable: on the contrary, as this paper has argued, government is the co-ordinator of last resort and it is impossible to envisage a market mechanism in the absence of a state. However, recent events (not just problems in global financial markets, but changing taxation of pension funds, growing regulatory demands and new accountancy requirements) are reshaping established conventions of pension provision in radical ways. The fear voiced in the 1960s about state intervention ‘driving out’ private provision appears to be coming true. Facing uncertainty and losing confidence, employers reduce their company pension commitments or close their schemes. Stakeholder pensions fail to attract new customers. The result is not so much a public-private partnership as a public-private

mess. All sides are currently trying to minimise their future liabilities. In the absence of a negotiated settlement, the pension question has become a hot potato, juggled between multiple players. The division between state and market, between public and private spheres of responsibility has become impossible to discern.

Common strains and problems have generated similar discussion about pension futures in other EU member states. As statutory schemes have been progressively contained in the 1990s, so greater political interest has come to focus on personal funded pensions: not least because these appear to offer a solution to problems posed by more flexible work patterns and more varied forms of employment status. Further, the development of pension funds as investment capital also appear to offer advantages within countries that believe themselves deficient in the where with all to invest in the so-called new economy.

New ‘mixes’ between funded and PAYG provision have recently emerged in Sweden and Germany. What distinguishes the UK is a determination to distinguish public from private in the field of occupational and earnings-related pension provision: a sector that, in many countries, has required collective participation in determining its sphere, governance and coverage. For over forty years, British politicians have chased the chimera of universal provision offered through the private sector, hoping to confine state provision to a residual role. It is high time that this objective was abandoned.

Instead, it would be wise to return to first principles. The more successful European policy initiatives adapted to solve new pension problems have required carefully negotiated solutions involving all interested parties. The advantage of this type of policy process is that it permits new conventions underpinning adjustments to a new era to permeate beyond a small political elite, to be extensively debated, modified and interpreted by all involved in their implementation. This forms the foundations for future collective confidence, the essential basis for effective action and policy delivery. If a new settlement between public and personal, funded and tax-based pensions is to be established in Britain, top-down regulatory adjustment of an already incredibly complex system will not serve the purpose. It is only by accepting that participation rests on confidence and trust (that the system offers a just protection to all participants) that a new settlement can be effective and durable.

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