

The state pension reforms in the recent White Paper are intended to *make the State Pension fairer and more widely available* and to *provide a solid foundation on which people can save*¹.

To see the effects of the reforms on individuals, complex calculations are needed. This Briefing Note provides some preliminary case studies. More PPI analysis will follow. So far, it is clear that outcomes for men and women would become more similar, but many could still be eligible for Pension Credit, making the value of saving uncertain. Concerns about adequacy remain.

The White Paper reforms

The Government plans to reform state pensions by:

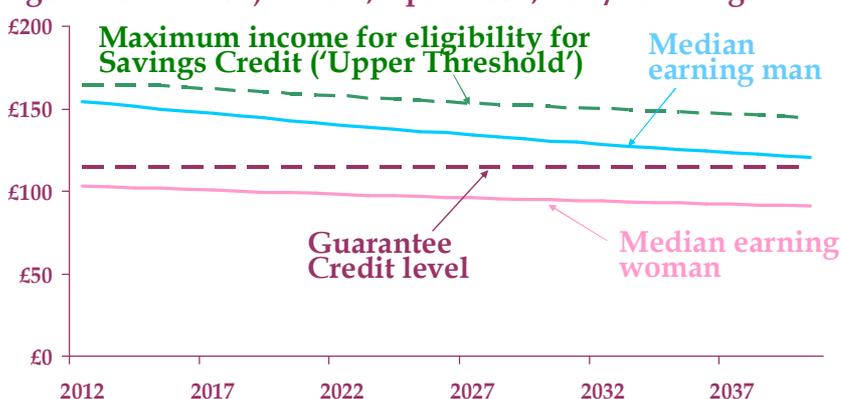
- A. Restoring the link between Basic State Pension (BSP) and earnings.
- B. Accelerating the transition of State Second Pension (S2P) into a flat-rate rather than earnings-related pension.
- C. Making technical changes to the crediting system and reducing the number of years needed for a full BSP.
- D. Making Savings Credit (SC) less generous.
- E. Gradually increasing State Pension Age (SPA) to 68.

The case studies

State pension is estimated for men and women reaching SPA in 2012, 2030 and 2050. State pension is BSP plus SERPS/S2P.

Chart 1: Outcomes are currently unequal

Income from BSP and SERPS/S2P for median earning men and women reaching state pension age (age 65 for men and age 61 for women) in 2012, £ per week, 2006/7 earnings



To try to be realistic², the women spend some time caring and working part-time. The men are unemployed for 2 years. Otherwise, they work full-time to SPA, at median earnings (around £25,000 a year for men and £18,000 a year for women³).

Caring is assumed to qualify for credits under the new system. In reality, not all caring will qualify. Many people earn less than these individuals. So many people will receive less state pension than these examples do.

A fairer state pension?

Charts 1 to 3 suggest that the reforms have potential to make state pensions fairer, as state pension levels for the illustrative men and women would converge. However, it takes a long time for outcomes to be equal.

Of the pair reaching SPA in 2012, the man has around £50 a week more state pension than the woman (Chart 1). This difference would reduce to around £17 a week for those reaching SPA in 2030 (Chart 2), and to around £3 a week for those reaching SPA in 2050 (Chart 3).

Outcomes converge because the pension system becomes more flat-rate (Reforms A and B) and more of the women's caring qualifies for state pension (Reform C). But as not all caring will qualify, there is still potential for women to have lower state pensions than men.

A foundation for saving?

Anybody whose total income (state pension plus any other income, such as saving) is less than the Pension Credit (PC) 'Upper Threshold' (the higher of the two dashed lines in Charts 1 to 3) would be entitled to PC.

The impact of the White Paper state pension reforms

Being eligible for the means-tested PC means that £1 of extra saving results in a net gain of 60p, or less. So which side of the Upper Threshold you are on affects the value of saving.

The Government intends to make future Guarantee Credit (GC) levels more certain⁴. But the Upper Threshold would remain uncertain.

All of the examples would be near to the Upper Threshold, unless they already have substantial savings. So changes to the Upper Threshold could affect the future value of saving for many people.

Since at least 1-in-3 pensioners could be on PC⁵, even after the state pension reforms have almost worked through in 2050, uncertainty in the value of saving remains a problem.

An adequate state pension?

Anybody whose total income is less than the GC level (the lower of the two dashed lines) would need to claim GC to have a minimum adequate income.

The value of BSP would be maintained, but S2P would be uprated with prices in payment. So people can still slip onto GC during retirement (Charts 2, 3). All the women analysed could have a state pension of less than the GC level at some point.

Chart 2: The value of saving could be affected by changes to Savings Credit

Income from BSP and SERPS/S2P for median earning men and women reaching state pension age (age 66) in 2030, £ per week, 2006/7 earnings

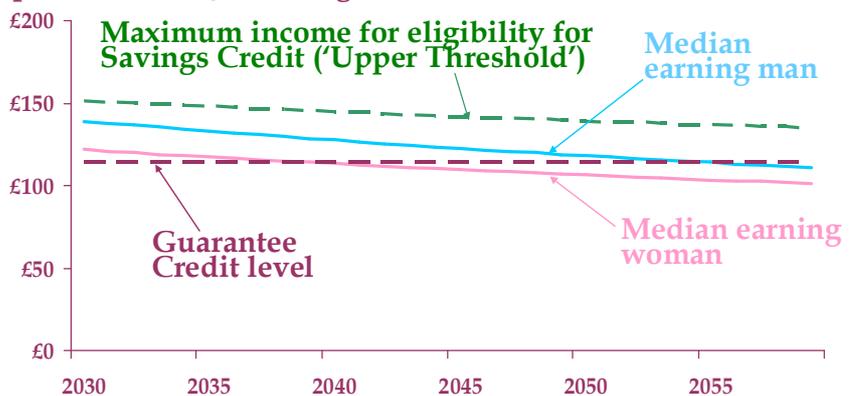
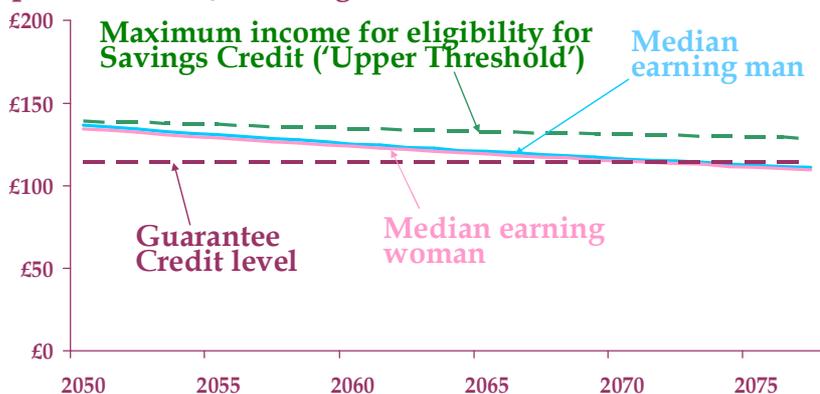


Chart 3: State pension still falls during retirement, potentially below adequacy

Income from BSP and SERPS/S2P for median earning men and women reaching state pension age (age 68) in 2050, £ per week, 2006/7 earnings



Inadequacy remains a problem. Over 15% of pensioners could have to claim GC⁶. Some would not claim and so be left with an inadequate income.

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¹ DWP (2006) *Security in retirement: towards a new pensions system* page 17

² Consistent with previous PPI work, such as, PPI (2006) *Shaping a Stable Pensions Solution*

³ ONS (2005) *ASHE 2005 Table 1.1a*. Assumed earnings vary by age so these are averages.

⁴ DWP (2006) page 103

⁵ DWP (2006) para 3.65. PPI Briefing Note 30 shows the proportion could be higher. Briefing Note 30 assumes the Pensions Commission's rather than the White Paper proposals, but outcomes for PC are likely to be similar.

⁶ DWP (2006) figure 3.v