

PPI publishes *A Guide to State Pension Reform*

Pressure has been building for the Government to recognise that reforming **state** pensions is the highest priority in tackling the major pensions issues facing this country. Today, the Pensions Policy Institute (PPI) publishes *A Guide to State Pension Reform* to provide a constructive, unbiased way forward.

The PPI is one of many organisations to identify the need for state pensions to be reformed. PPI research published in *The Pensions Landscape* could not identify any signs that future pensioners will be any better off than today's. *A Guide to State Pension Reform* adds new insights to the analysis of the problems, and starts to look for the solution.

Alison O'Connell, Director of the PPI said, "Reforming state pensions is the most important step in solving the growing discontent with our pensions system. State pension benefits are the only income the poorest sector of the population will have to live on in retirement. But the state system is widely criticised for being complex and inadequate. It is widely thought that the policies underlying the system are unsustainable. And private pensions only stand a chance of flourishing if they can be placed on a secure foundation."

Emphasising the need for fact-based debate, the PPI today publishes its 'pensions agenda' for the reform process.

Step 1 - Understand the current pressure points in UK pensions

Step 2 - Develop the key tests against which a proposed new state pension system can be measured

Step 3 - Focus on a few possible models for a new state pension system

Step 4 - Test each model, analysing the tradeoffs in each

Step 5 - Develop transition plans for each model

Step 6 - Present a comparison between the different models so that a choice can be made with consistent and objective information

**PRESS RELEASE
EMBARGOED TO
00.01 THURSDAY 10 JULY 2003**

The paper published today provides details for the first three steps in the process. It reviews the current problems in UK pensions, suggests key tests for a reformed system and proposes the five reform options worth focusing on as possible future models for UK state pensions.

The key conclusions from each of these three first steps can be seen at a glance in the attached summary pages.

O'Connell continued, "I hope that by developing and progressing a sensible and thorough process for considering such an important reform, with input from all interested parties, the PPI can help to increase the chances of successful reform actually taking place".

The PPI will seek input and comment on this paper, and keep working its way through the reform agenda.

- ENDS -

For further information please contact -

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Notes For Editors -

- A copy of the complete report, and information on the PPI can be found at: www.pensionspolicyinstitute.org.uk/. Copies can be obtained from the PPI on 020 7848 3744 or info@pensionspolicyinstitute.org.uk
- The PPI also publishes today a digest of summary descriptions of state pension systems in selected countries and proposed reform models for the UK system. *State Pension Models* is available at www.pensionspolicyinstitute.org.uk/.
- The Pensions Policy Institute is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions (state and private) through research and analysis, discussion and publication. 70 governors from a wide range of pension-related backgrounds support the PPI.
- Alison O'Connell, the first Director of the PPI since January 2002, has over 15 years experience in financial services and in pensions policy.

A Guide to State Pension Reform: Summary

This paper starts the PPI's review of the UK's state pension system.

The analysis in this paper confirms the case for reform by comparing the UK system to a minimum objective standard and to state pension systems in other countries, and by considering how state pensions are interacting with private pensions. A review of UK state pensions is needed because there are serious pressure points in the current system.

Summary of current pressure points in the UK state pension system

1. The UK has an uncomfortably high number of pensioners in poverty.
2. With no change, UK state pensions will become less adequate.
3. The UK currently spends less than most other countries on state pensions.
4. The forecast of future UK spend on state pensions is likely to prove unrealistically low and socially unacceptable.
5. The UK state pension system has become separated from the significantly improved capacity for longer working lives.
6. The UK state pension system works particularly badly for some groups, especially women.
7. The complexity of the UK state pension system makes it harder than it need be for people to understand what they are likely to receive from the state during later life.
8. The combination of low price-indexed state pensions and extensive means-tested benefits means that the UK state pension system disadvantages people as they grow old.
9. Private pensions are not filling the gap left by low state pensions, and many of the causes of this can only be resolved once state pensions have been reformed.

A major programme of work is required to move state pensions policy forward in the most positive way. A clear sense of where the reform is heading (the long-term objective) needs to be balanced with ideas for how to get there (the transition practicalities). There are no 'off the shelf' solutions available from other countries.

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The PPI proposes these questions by which possible models for state pension reform should be tested. It is unlikely that any solution will score a clear 'yes' on all tests. Choosing future pension policy is about making tradeoffs to find the best balanced solution.

Tests for a reformed state pension system

1. Is the reformed policy capable of being sustained for at least 30 years, and preferably 40 years?
2. How would the number of pensioners at risk of poverty in the UK change? How would pensioner poverty compare with that in other countries and with that in other age groups in the UK?
3. How much would the total 'economic cost' to the state - including state pension benefits, contracting-out rebates and tax relief - be in the short term?
4. By how much would the total 'economic cost' to the state increase in the long term?
5. Does the reformed UK state pension system recognise past and likely future improvements in health and longevity and is it flexible for different working arrangements and retirement choices?
6. Is the reformed UK state pension system fair to all groups?
7. Is the reformed UK state pension system simple? Does it help people to understand what income they will receive from the state during later life?
8. Does access to the reformed UK state pension system become easier (or at least not harder) for people as they grow old?
9. Does the reformed UK state pension system enable individuals to meet their personal objectives for additional retirement income through occupational and personal private pensions?

By making international comparisons and building on proposals made by other UK organisations, the PPI proposes five models of state pension reform to be evaluated against the proposed tests.

State pension reform models to be tested in the PPI review

1. **Status quo:** A multi-component system with extensive means-testing. The current system with minor changes should be compared with other possible reform models.
2. **Reform S2P:** Make the State Second Pension flat-rate and/or increase accruals to it for lower earners. This would keep the overall system structure, but increase redistribution to the poorest during their period of working age.
3. **Much higher BSP, scrap S2P:** Keep the contributory link and the structure of the Basic State Pension, but at a much higher rate, so that there is less means-testing. Stop accruals to the State Second Pension, so that the system is simplified to one main component.
4. **Citizen's Pension:** As the previous option, but instead of eligibility being built up by contributions during working life, eligibility is based on citizenship or residency criteria. This would be particularly beneficial to women, and others who spend time out of the labour market, or working at low levels of earnings.
5. **Age additions:** Increase Basic State Pension to the means-tested level (Model 3 or 4 above) but only for the oldest pensioners, say, age 80 and over. This reflects that people get poorer as they get older.

This document invites input on three areas:

- Is the analysis of the current **pressure points** in the UK state pension system correct?
- Are the proposed **tests** appropriate to guide the debate and analysis?
- Has a useful set of reform **models** to be tested been identified?

Input will be gathered over the coming months to inform the next stage of work. Comments are welcome.