

# **Towards a Citizen's Pension: Interim Report December 2004**

## **Appendix Five: Assumptions and further detail on the costing calculation in Chapter 5**

*These appendices should be read together with the main report*

**Produced by the Pensions Policy Institute  
for the National Association of Pension Funds**

## **Appendix 5: Assumptions and further detail on the costing calculation in Chapter 5**

The potential cost of a Citizen's Pension is an important factor in determining the feasibility of moving to a new state pension system. Estimating this cost requires detailed information on current and future individual state and private pension entitlements. Not all of this information is available, so a number of assumptions have been made when estimating the costs. Some of these have deliberately been 'pessimistic' assumptions, and are likely to overestimate the cost of a Citizen's Pension. Where possible, these estimates will be refined in phase 2 of this project, and different options investigated.

### **Estimating the short-term cost**

This report contains new estimates of the short-term costs of introducing a Citizen's Pension of £105 a week. These are based on:

- Estimates of the 'gross' costs of paying everybody over State Pension Age a Citizen's Pension of £105 a week.
- Adjusting this for the 'offset' method of transition, where accrued state pension rights are offset against the Citizen's Pension.
- Allowing for knock-on savings from Housing Benefit, Council Tax Benefit and higher income tax receipts.
- Allowing for the abolition of Pension Credit, and not accruing any further rights in State Second Pension (S2P).

The gross cost of paying a Citizen's Pension of £105 a week rises from £14.8 billion in 2005/6 to £25.6 billion by 2015/6. These are government estimates, published in response to a Parliamentary Question (PQ) (Table A5.1).

**Table A5.1: Gross cost of a Citizen's Pension of £105 a year, £bn in 2004/5 price terms<sup>1</sup>**

	<b>£bn</b>
2006/7	19.4
2007/8	20.7
2008/9	22.1
2009/10	23.5
2010/1	25.0
2011/2	26.6
2012/3	28.6
2013/4	30.5
2014/5	32.4
2015/6	34.2

The PQ assumes that:

- The Savings Credit is abolished.
- No new rights are accrued in the state second pension.
- All other minor benefits (such as the Winter Fuel Allowance and free TV licenses for the over-75's) remain in payment.

<sup>1</sup>Parliamentary Question Steve Webb 29 April 2004 House of Commons *Hansard* column W1243

The PQ also assumes all accrued S2P rights (including SERPS and contracted-out equivalents) are paid in full *in addition to* the Citizen's Pension. However, this report is based on the principle that accrued state pension rights<sup>2</sup> are *offset* against the Citizen's Pension. This means that only those over State Pension Age with accrued state pension rights of less than £105 per week would see any change in state pension income<sup>3</sup>. This significantly reduces the cost of transitioning to a Citizen's Pension from that in the PQ.

The size of the offset is estimated using the distribution of entitlements to accrued state pension rights<sup>4</sup>:

- The amount of Citizen's Pension paid out is reduced by the amount of gross SERPS/S2P<sup>5</sup> paid below the level of £105 a week. The 8 million people receiving less than £105 a week in BSP and gross SERPS/S2P combined have all of their gross SERPS/S2P offset. The 3.5 million people with BSP and gross SERPS/S2P of more than £105 have the amount between £105 and the BSP offset. (Table A5.2).

**Table A5.2: Distribution of gross SERPS/S2P rights and amount of accrued rights offset**

<b>Amount of gross SERPS/S2P available to offset</b>	<b>Number of people (million)</b>
<b>Zero</b>	4
<b>Less than £5</b>	1.5
<b>£5 - £9.99</b>	0.5
<b>£10.00 - £19.99</b>	1
<b>£20.00 - £29.99</b>	1
<b>More than £30</b>	3.5
<b>Total</b>	11.5
<b>Number with accrued state rights of less than £105 (those with gross SERPS/S2P of less than £30)</b>	<b>8</b>
<b>Number with accrued rights of more than £105 (those with gross SERPS/S2P of more than £30)</b>	<b>3.5</b>

<sup>2</sup>Accrued state pension rights are the Basic State Pension and State Second Pension (including SERPS and contracted-out equivalents)

<sup>3</sup>See Chapter 2

<sup>4</sup>Data is based on the State Pension Summary of Statistics (March 2004), table SP9

<sup>5</sup>Gross SERPS/S2P includes accrued contracted-out rights as well as those remaining within SERPS/S2P

This is a broad brush calculation, and there are a number of difficulties:

- No data is published on total accrued state pension rights. Information is available on the distribution of amounts of Basic State Pension and S2P/SERPS separately, but it is not possible to link data on S2P/SERPS and contracted-out equivalents to Basic State Pension entitlement. As a simplification, each individual is assumed to have a full Basic State Pension. This will under-estimate the size of the offset; as more SERPS and contracted-out equivalent will be offset for people who have a lower Basic State Pension entitlement.
- Only historic figures (up to March 2004) are available, while estimates of the gross cost are based on pension entitlement are based on accrued rights in 2005/6. Given the increasing gap between the Basic State Pension level and the proposed Citizen's Pension level, more accrued state pension rights may be offset by 2005/6.

Because of the uncertainty surrounding the offset, and in line with using conservative assumptions throughout this project, it is assumed that not all of the offset could be realised. The offset has been reduced by £1.5 bn, or around 20% in 2006.

To work out the size of the offset in future years, it is assumed that the same proportion of total future SERPS expenditure (assuming no future accruals) is below the offset level. This is likely to be an underestimate because:

- When in payment, SERPS is price indexed and the Citizen's Pension is earnings indexed, so the proportion of SERPS in payment from a specific point in time that is below the Citizen's Pension level increases in later years. For example, more of the SERPS payable in 2005/6 will be below the Citizen's Pension level in 2010/1 than it was initially.
- The gap between the Citizen's Pension and the Basic State Pension level increases faster than earnings over time<sup>6</sup>, so SERPS entitlement would need to grow fast to keep pace with the gap. Although new SERPS coming in to payment will be broadly linked to earnings growth, this is capped by the Upper Earnings Limit which has been linked to prices.

This methodology is therefore likely to underestimate the size of the offset of the Citizen's Pension against accrued state pension rights. The size of the offset is estimated to increase over time, from £5.5bn in 2006/7 to £9.3bn by 2015/6 (Table A5.3).

<sup>6</sup> As the Basic State Pension (the bottom of the gap) increases in line with prices and the Citizen's Pension (the top of the gap) increases in line with earnings, the actual gap between them increases faster than earnings

**Table A5.3: Estimated gross cost of a Citizen's Pension of £105 a year adjusted for an offset against accrued state pension rights, £bn in 2004/5 price terms**

	Initial gross cost	Offset	Adjusted gross cost
2006/7	19.4	5.5	13.9
2007/8	20.7	5.9	14.8
2008/9	22.1	6.4	15.7
2009/10	23.5	6.8	16.7
2010/1	25.0	7.2	17.8
2011/2	26.6	7.6	19.0
2012/3	28.6	8.1	20.5
2013/4	30.5	8.5	22.0
2014/5	32.4	8.9	23.5
2015/6	34.2	9.3	24.9

The PQ which estimated the initial gross cost of a Citizen's Pension of £105 a week also estimated the knock-on savings in reduced expenditure on Housing Benefit and Council Tax Benefit, and increase income tax receipts.

These estimates are not directly applicable to estimates of the adjusted gross cost of a Citizen's Pension, allowing for an offset against accrued state pension rights. However, the PQ answer suggests that the proportion of the gross cost offset by Housing Benefit, Council Tax Benefit and income tax is broadly constant throughout the 10-year period for which estimates have been made:

- Reductions in Housing Benefit and Council Tax Benefit expenditure are projected to be reduced by 8% of the gross cost of introducing a Citizen's Pension.
- Income tax receipts are projected to increase by 28% of the gross cost of a Citizens Pension.

Similar proportionate offsets can be assumed for a Citizen's Pension based on an offset against accrued state pension rights:

- As an offset Citizen's Pension better targets additional expenditure on those who are most likely to be in receipt of Housing Benefit and Council Tax Benefit, the proportion of expenditure offset by reductions in these benefits may be higher under an offset method. However, in line with making pessimistic assumptions about the potential costs of a Citizen's Pension, it is assumed that 8% of the adjusted gross cost is offset.
- Conversely, the better targeting of additional expenditure will lead to a smaller increase in income tax as a proportion of the adjusted gross cost. For this reason, an offset of 20% has been used as opposed to the 28% found in the PQ answer. There is little evidence on which to base this assumption, which may therefore over- or under-estimate the increase in income tax receipts.

These knock-on savings reduce the cost of introducing a Citizen's Pension at £105 a week still further (Table A5.4).

**Table A5.4: Estimated net cost of a Citizen's Pension of £105 a year adjusted for an offset against accrued state pension rights and allowing for knock-on savings in Housing Benefit, Council Tax Benefit and income tax, £bn in 2004/5 price terms**

	<b>Adjusted gross cost</b>	<b>Savings in Housing and Council Tax Benefit</b>	<b>Increased income tax receipt</b>	<b>Net cost after Housing and Council Tax Benefit and income tax</b>
<b>2006/7</b>	13.9	1.1	2.8	10.0
<b>2007/8</b>	14.8	1.2	3.0	10.6
<b>2008/9</b>	15.7	1.3	3.1	11.3
<b>2009/10</b>	16.7	1.4	3.3	12.0
<b>2010/1</b>	17.8	1.4	3.6	12.8
<b>2011/2</b>	19.0	1.5	3.8	13.7
<b>2012/3</b>	20.5	1.7	4.1	14.8
<b>2013/4</b>	22.0	1.7	4.4	15.9
<b>2014/5</b>	23.5	1.9	4.7	16.9
<b>2015/6</b>	24.9	2.0	5.0	17.9

Finally, the PQ also contained estimates of the savings arising from the abolition of both Pension Credit and future accruals of State Second Pension from 2005/6. Taking these into account gives a final estimated net cost of the introduction of a Citizen's Pension at £105 a week in 2005/6 of around £7bn (Table A5.5).

**Table A5.5: Final estimated net cost of a Citizen's Pension of £105 a year, £bn in 2004/5 price terms**

	<b>Net cost after Housing and Council Tax Benefit and income tax</b>	<b>Savings from Pension Credit</b>	<b>Savings from State Second Pension</b>	<b>Final net cost</b>
<b>2006/7</b>	10.0	3.1	0	6.9
<b>2007/8</b>	10.6	3.3	0	7.3
<b>2008/9</b>	11.3	3.5	0.1	7.7
<b>2009/10</b>	12.0	3.7	0.1	8.2
<b>2010/1</b>	12.8	3.9	0.2	8.7
<b>2011/2</b>	13.7	4.1	0.3	9.3
<b>2012/3</b>	14.8	4.3	0.4	10.1
<b>2013/4</b>	15.9	4.6	0.6	10.7
<b>2014/5</b>	16.9	4.8	0.7	11.4
<b>2015/6</b>	17.9	5	0.9	12.0

These costs can be compared against the projected cost of contracted-out rebates. With the introduction of a Citizen's Pension, contracting-out would no longer be required and some or all of the money expected to be spent on contracted-out rebates could be re-directed to paying the increased benefit costs of a Citizen's Pension<sup>7</sup>. This would more than cover the estimated costs for the first 8 years of a

<sup>7</sup> See Chapter 2 for further details

Citizen's Pension, and save more than £5bn in the first year of operation (Table A5.6).

**Table A5.6: Estimated net cost of a Citizen's Pension of £105 a year compared to projected expenditure on contracted-out rebates, £bn in 2004/5 price terms<sup>8</sup>**

	<b>Net cost of a Citizen's Pension of £105 a week</b>	<b>Projected expenditure on contracted-out rebates</b>	<b>Difference</b>
<b>2006/7</b>	6.9	12.0	-5.2
<b>2007/8</b>	7.3	11.2	-4.0
<b>2008/9</b>	7.7	11.2	-3.5
<b>2009/10</b>	8.2	11.2	-3.0
<b>2010/1</b>	8.7	11.1	-2.4
<b>2011/2</b>	9.3	11.2	-1.9
<b>2012/3</b>	10.1	10.9	-0.8
<b>2013/4</b>	10.7	10.8	-0.1
<b>2014/5</b>	11.4	10.8	0.6
<b>2015/6</b>	12.0	10.8	1.2

The PQ used as a basis for the short-term costs of the introduction of a Citizen's Pension assumes that it is introduced in April 2006. The earliest date a Citizen's Pension could realistically be introduced is April 2010<sup>9</sup>.

The cost of a Citizen's Pension introduced in April 2010 may not be significantly different than the estimates for 2010/1 shown in tables A5.1–A5.6, which assume introduction in 2006. This is because:

- Although the gap between the Basic State Pension and Guarantee Credit levels would be wider than today (assuming current up-rating conventions continue), this is already accounted for in the estimates of the gross cost.
- As State Second Pension (and contracted-out equivalent) continues to accrue for an extra 4 years, future payments will be higher. However, as the gap between the Basic State Pension and the new Citizen's Pension level increases, an increasing proportion of newly accrued state second pension rights will be offset against the Citizen's Pension. This would increase the size of the offset above that shown in the tables above.
- Additional State Second Pension rights that are payable above the new Citizen's Pension level will give rise to additional costs. This could counterbalance the increase in the offset.
- Savings from abolishing the Savings Credit and changes in Housing Benefit, Council Tax Benefit and income tax are unlikely to be significantly different from those shown above.

<sup>8</sup> Rebate figures from Parliamentary Question David Willetts 26 May 2004 House of Commons *Hansard* column W1718, adjusted to 2004/5 price terms and assumed to remain constant in 2004/5 price terms after 2013/4. This table shows the data underlying Chart 14 in the main report.

<sup>9</sup> See Chapter 6

**Protecting Savings Credit payments would avoid cash losers**

Because the PQ estimates (and the revised estimates based on the PQ) assume that payments of Savings Credit are abolished overnight, some people currently receiving Savings Credit could see a cash reduction in income.

One way of avoiding this is to pay the Citizen's Pension at a higher level.

Alternatively, existing Savings Credit payments could be protected, and remain in payment throughout the retirement of the individuals receiving the benefit. The benefit could continue to be updated as in the current system, frozen in cash terms, or frozen in real terms. In the estimates made in this report, payments are assumed to be frozen in real terms.

The initial cost of preserving Savings Credit awards is the amount currently spent on Savings Credit. In 2006/7, this is estimated to be just over £1bn<sup>10</sup>.

To estimate the cost of future years, estimates are required of how long benefits are likely to remain in payment. This will depend on who is in receipt of Savings Credit, and in particular their age and gender:

- Two-thirds of current expenditure on Savings Credit is on women.
- Almost half Savings Credit expenditure is on those aged 80 or older.

Using gender specific cohort mortality estimates<sup>11</sup>, broadly adjusted for social class<sup>12</sup>, the cost of paying existing Savings Credit awards is projected to fall rapidly (Chart A5.1).

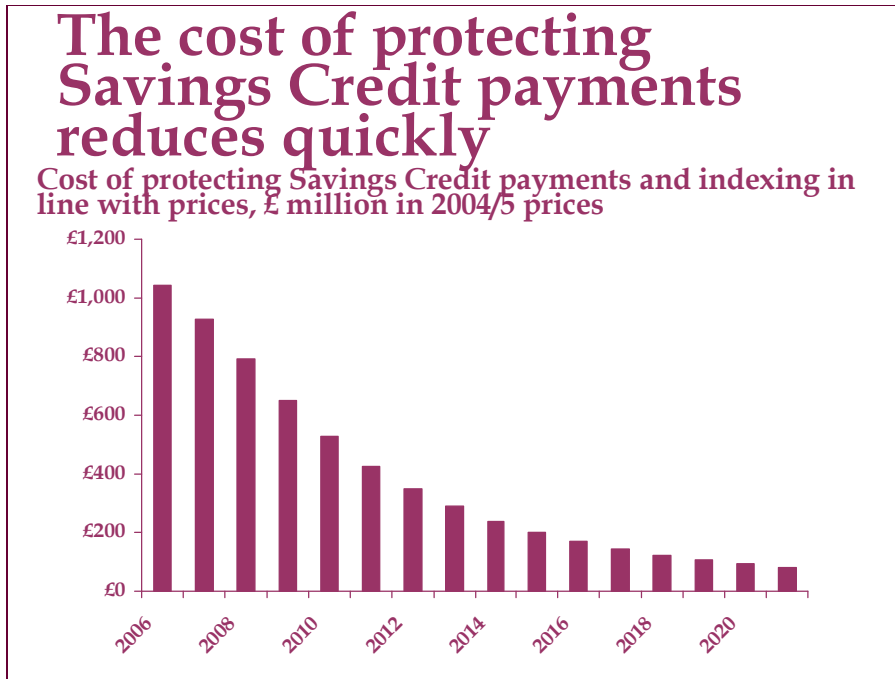
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<sup>10</sup> PPI estimate based on DWP projected expenditure on Pension Credit in 2004/5 price terms, and the proportion of current Pension Credit expenditure that is on Savings Credit

<sup>11</sup> Government Actuary's Department 2002 - based estimates for England and Wales

<sup>12</sup> Savings credit recipients have lower incomes than the population as a whole, and so are likely to have higher mortality rates. The 2002-based mortality rates have been broadly adjusted based on social class differentials highlighted in Donkin A, Goldblatt P, Lynch K. (2002) *Inequalities in Life Expectancy by Social Class 1972-1999* Health Statistics Quarterly 15. Savings Credit recipients are assumed to experience the mortality levels of the general population cohort roughly 4 years older than them to account for these differences.



Chart A5.1<sup>13</sup>

The estimated cost of paying existing awards is based on scrapping the Savings Credit in 2006. The initial cost is likely to be higher if Savings Credit were not abolished until 2010, as entitlement to Savings Credit will increase as the gap between the Basic State Pension and Guarantee Credit level increases. Entitlement would also be likely to extend to younger pensioners, meaning that Savings Credit awards may stay in payment for longer.

<sup>13</sup> PPI calculations based on DWP Pension Credit statistics and GAD 2002-based mortality assumptions adjusted by PPI for social class

## Estimating the Long-Term Costs

As well as estimating the short-term costs of introducing a Citizen's Pension, it is important to compare the long-term cost of a Citizen's Pension against the long-term cost of the current system.

### The long-term costs of the current system

In the current system, costs are projected to increase only slightly over the next 50 years (Table A5.7).

However, there is a large degree of uncertainty surrounding these estimates, and in particular estimates of the future cost of Pension Credit<sup>14</sup>:

- Projections assume that the take-up of Pension Credit remain at current levels (75%) throughout the 50 year period. If take-up increases, costs will increase. At the upper limit, if take-up increased to 100% costs could increase by one-third<sup>15</sup>.
- Projections assume that income from sources other than Pension Credit – mainly state pensions, private pensions, earnings and investment income – grows in line with average earnings growth. This does not appear to be consistent with projections of spending on state pensions, or with recent projections of the amount of money likely to be provided by private pensions<sup>16</sup>.
- If income from other sources of income grew by less than assumed, the costs of the Pension Credit would be higher in future. For example, if income grew in line with prices rather than earnings, the cost of Pension Credit could increase by 2% of GDP by 2053.
- These effects may reinforce each other. As people become dependent on Pension Credit for an increasing proportion of their income, take-up is likely to increase.

There is therefore a wide funnel of doubt surrounding the projected cost of Pension Credit and state pension expenditure overall<sup>17</sup> (Table A5.7).

The actual cost is likely to fall somewhere within the range shown in Table A5.7.

<sup>14</sup> For further details see PPI Briefing Note number 14 *State Spending on Pensions: An Update*

<sup>15</sup> This will be an overestimate, as people projected as not claiming entitlement to Pension Credit may have smaller entitlements than the average, and even if take-up is very high it is very unlikely to reach 100%

<sup>16</sup> Pensions Commission (2004) *Pensions: Challenges and Choices* Chapter 4

<sup>17</sup> It could be that the overall cost is lower than is projected – if, for example, there were large increases in private saving or investment returns. But the balance of probabilities suggests that the current projections are too low rather than too high.

**The projected gross cost of a Citizen's Pension is within the funnel of doubt of the current system.**

Estimates of the long-term costs of a Citizen's Pension are less detailed than the short term costs.

- No allowance has been made for savings in Housing Benefit and Council Tax Benefit, or increased income tax receipts. Applying the same methodology used in the short-term estimates to the long-term could be misleading, as the costs of these benefits and the amount of tax collected will depend on factors not directly considered in this analysis<sup>18</sup>. But assuming a similar proportion of the amount spent on Housing Benefit and Council Tax Benefit is saved in future, and a similar ratio of savings from income tax receipts, allowing for these knock-on savings could reduce the cost in 2050 by up to 0.5% of GDP.
- The long-term estimates also assume that the Winter Fuel Allowance, free TV-licenses for the over-75s and the age addition are abolished. However, as these benefits are worth relatively less in future than they are today<sup>19</sup> adding expenditure on these benefits would not significantly alter the estimated gross cost.
- For simplicity, the calculation assumed every individual over state pension age resident in the UK qualifies for the Citizen's Pension. In practice, some will not, depending on the residency qualification chosen (see Chapter 4). However, there could be an additional cost if the Citizen's Pension increased the number of eligible overseas residents. In practice the overall impact would be determined by the precise residency criteria used, and the rules for payment overseas. In the estimates shown here, these effects are assumed to offset each other<sup>20</sup>.
- Even before allowing for knock-on savings on Housing Benefit, Council Tax Benefit and higher income tax receipts, the gross cost of a Citizen's Pension is within the funnel of doubt of the costs of the current system (Table A5.7).

<sup>18</sup> Such as pattern of renting, council tax levels and income from earnings and private pensions

<sup>19</sup> There is no automatic up-rating of these benefits

<sup>20</sup> Currently 8% of people receiving UK state pensions live abroad (DWP (2003) *Work and Pensions Statistics 2003*, while in New Zealand 8% of pensioners do not qualify for a Citizen's Pension (O'Connell (2004) *Citizen's Pension: Lessons from New Zealand* Pensions Policy Institute

**Table A5.7: The long-term cost of a Citizen's Pension in the UK<sup>21</sup>**

	2006	2013	2023	2033	2043	2053
<b>Estimate of state spend on pensions as % GDP</b>						
<b>Benefits</b>	4.8%	5.1%	5.1%	5.7%	5.7%	5.9%
<b>Contracting-out rebates</b>	1.0%	0.8%	0.7%	0.5%	0.4%	0.4%
<b>Sum – Baseline</b>	5.8%	5.9%	5.8%	6.2%	6.1%	6.3%
<b>Sum – Upper bound</b>	5.8%	6.1%	6.7%	7.9%	8.6%	9.5%
<b>Cost of Citizen's Pension, offsetting accrued state rights</b>						
<b>£105 a week</b>	5.3%	5.8%	6.5%	7.6%	8.0%	8.2%
<b>£115 a week</b>	6.5%	7.0%	7.1%	8.4%	8.9%	9.2%
<b>Additional cost of a Citizen's Pension above Baseline</b>						
<b>£105 a week</b>	-0.4%	-0.0%	0.7%	1.4%	1.9%	1.9%
<b>£115 a week</b>	0.7%	1.2%	1.3%	2.2%	2.8%	2.9%
	2006	2013	2023	2033	2043	2053
<b>Estimate of state spend on pensions, £ billion 2004/5 prices</b>						
<b>Benefits</b>	£60	£73	£89	£115	£137	£164
<b>Contracting-out rebates</b>	£12	£11	£12	£10	£10	£11
<b>Sum – Baseline</b>	£72	£84	£102	£125	£146	£175
<b>Sum – Upper bound</b>	£72	£87	£118	£159	£205	£263
<b>Cost of a Citizen's Pension, offsetting accrued state rights</b>						
<b>£105 a week</b>	£66	£84	£113	£153	£191	£228
<b>£115 a week</b>	£80	£101	£125	£168	£212	£256
<b>Additional cost of a Citizen's Pension above Baseline</b>						
<b>£105 a week</b>	-£6	£0	£12	£28	£45	£53
<b>£115 a week</b>	£9	£17	£23	£43	£66	£80

<sup>21</sup> Figures for 2006 and 2001 are based on short-term estimates of the cost of the Citizen's Pension and allow for savings from means-tested benefits and income tax. Later estimates are broader estimates, and do not allow for these savings. Current system estimates are taken from GAD (2003 QR) Table 5.6 and [www.dwp.gov.uk/asd/asd4/Table3\\_Long\\_Term\\_Projections.xls](http://www.dwp.gov.uk/asd/asd4/Table3_Long_Term_Projections.xls). All estimates of the costs of a Citizen's Pension are PPI analysis. Cost of SERPS/S2P and COD accruals estimated from GAD (2003) *Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000* Table 15.9 and DWP (2004) *State Pension Summary of Statistics March 2004*. Figures are overestimates, see text. This table is the same as Table 1 in Chapter 5 of the main report. Figures in £bn have been shown in constant price terms to be comparable with published DWP long-term projections.

**There are options for affording a Citizen's Pension in the future**

A Citizen's Pension at the Guarantee Credit level of £105 a week is affordable in the UK, now. Further, the future long-term costs could be within the future cost of the current system. This means that ways to pay for the increasing cost of a Citizen's Pension in future will need to be found. But this will need to happen under any plausible pension system, including the current one, as the population ages. The (over-) estimate of the long-term cost of a Citizen's Pension at £105 a week is that at the peak in 2041 the additional spend is up to 2 percentage points of GDP (Table A5.7). This could be afforded by one of the following, or a combination of partial implementation of each:

- **Switch some state spending from other areas to pensions.** Finding all the extra cost would be difficult. To illustrate the order of magnitude, 2% of GDP is 40% of the spend on education or 20% of that on health;
- **Raise taxes.** If this were the only lever used, the total tax take would have to increase by less than 5% by 2041 (with all the increase allocated to pensions);
- **Raise the state pension age.** If this were the only lever used, SPA would have to rise to 70 by 2031 (Table A5.8); or
- **Restructure tax relief for private pension saving gradually.** A change to the system of tax relief may be desirable to rebalance the current bias towards higher rate tax payers. Such a restructuring may also reduce the overall cost of tax relief (around £20bn or 1.8% of GDP<sup>22</sup>). Even if restructuring raised the current full cost (which is unlikely), a small additional amount would need to be found from other levers for the years after 2041 (Table A5.8).

<sup>22</sup> Curry and O'Connell (2004) *Tax Relief and Incentives for Pension Saving* A PPI report for Age Concern England

**Table A5.8: The potential for using state pension age or tax relief for private pension saving to fund a Citizen's Pension<sup>23</sup>**

<b>Estimated expenditure on tax relief and incentives for private pension saving</b>						
	1.8%	1.8%	1.8%	1.8%	1.8%	1.8%
	<b>2006</b>	<b>2013</b>	<b>2023</b>	<b>2033</b>	<b>2043</b>	<b>2053</b>
<b>Additional cost of a Citizen's Pension as a proportion of estimated expenditure on tax relief for private pension saving</b>						
<b>£105 a week</b>	-25%	0%	37%	76%	104%	105%
<b>£115 a week</b>	39%	66%	74%	120%	153%	160%
<b>Cost of Citizen's Pension, offsetting accrued state rights and assuming state pension age rises to 70 by 2030</b>						
<b>£105 a week</b>	5.3%	5.8%	6.5%	5.5%	6.3%	6.3%
<b>£115 a week</b>	6.5%	7.0%	7.1%	6.1%	7.1%	7.1%
<b>Additional cost above Baseline</b>						
<b>£105 a week</b>	-0.4%	-0.0%	0.7%	-0.3%	0.1%	0.2%
<b>£115 a week</b>	0.7%	1.2%	1.3%	0.3%	0.9%	1.0%

There could be ways of designing the Citizen's Pension so that the long-term cost is less than 2% of GDP. This would mean that the measures to be taken to pay for it will not need to be as strong as described above.

For example, if individuals in a couple each received a lower Citizen's Pension than a single individual, the cost could be significantly reduced. If a Citizen's pension were paid to each member of a couple at 80% of the full rate (so a couple received 160% of the single rate) gross costs could be 0.5% of GDP lower initially, and up to 1% of GDP lower in the long-term.

The next phase of this project will examine the impacts of using the different levels in different ways.

<sup>23</sup> Figures for 2006 and 2001 are based on short-term estimates of the cost of the Citizen's Pension and allow for savings from means-tested benefits and income tax. Later estimates are broader estimates, and do not allow for these savings. Current system estimates are taken from GAD (2003 QR) Table 5.6 and [www.dwp.gov.uk/asd/asd4/Table3\\_Long\\_Term\\_Projections.xls](http://www.dwp.gov.uk/asd/asd4/Table3_Long_Term_Projections.xls). All estimates of the costs of a Citizen's Pension are PPI analysis. Cost of SERPS/S2P and COD accruals estimated from GAD (2003) *Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000* Table 15.9 and DWP (2004) *State Pension Summary of Statistics March 2004*. Figures are overestimates, see text. There are no long term projections of the cost of tax relief and tax incentives for private pension saving, so the cost is assumed to stay constant as a proportion of GDP.

**The surplus in the National Insurance fund cannot be used to pay higher benefits**

In recent years more has been paid in to the National Insurance fund in contributions than has been paid out in benefits. This has resulted in the National Insurance fund having assets of almost £30 billion above the amount paid out annually in benefits. The Government Actuary<sup>24</sup> recommends that £10bn of assets should be reserved in this way. Therefore there is a surplus of £20bn in the National Insurance fund<sup>25</sup>.

- In theory, the surplus could be ring-fenced to help pay the costs of transition to a Citizen's Pension.
- However, in practice, the surplus does not remain within the National Insurance fund. The surplus is invested in Gilts, and so reduces the Government borrowing requirement. If the surplus was spent, Government borrowing would be increased, in exactly the same way as any other increase in expenditure.

<sup>24</sup> The Government Actuary views a surplus of 1/6 of annual benefit expenditure to be a 'reasonable working balance' for the National Insurance fund (Paul Flynn MP in the Westminster Hall debate on the National Insurance Fund, House of Commons *Hansard* 21 October 2003 column 217WH)

<sup>25</sup> Estimate for 2004, Paul Flynn MP in the Westminster Hall debate on the National Insurance Fund, House of Commons *Hansard* 21 October 2003 column 217WH