"The Government's state pension reforms would lead to winners and losers" says Pensions Policy Institute

The Pensions Policy Institute (PPI) publishes new research which provides an independent assessment of the potential impact of the state pension reforms set out in the Government's Green Paper: A State Pension for the 21st Century. The research was commissioned by the National Association of Pension Funds who asked the PPI to consider the potential impact of the reforms on Government spending on pensions and on means-tested benefits, on the winners and losers of the reforms, and on the potential wider impact on private pensions.

On the implications of the Government accelerating the pace of existing state pension reforms, Niki Cleal, PPI Director said:

"If the Government were to accelerate the pace of existing state pension reforms so that the state pension is flat-rate by 2020, instead of by 2030 as in current plans, no pensioner would gain any extra pension income and 5 million pensioners could lose out by 2034."

"Accelerating the pace of current state pension reforms would save the Government money but overall pensioners would be worse-off. However, this reform may put less pressure on existing private pension schemes than the introduction of a single-tier pension. "

On the implications of the Government introducing a flat-rate single tier pension of £140 a week (in 2010 earnings terms) for pensioners who reach State Pension Age after 2016, Niki Cleal, PPI Director said:

"The introduction of a single-tier state pension as proposed by the Government of around £140 a week could be broadly cost neutral, but would lead to winners and losers. Some 7 million pensioners could see their household pension income increase under the single-tier reform by 2034, but 5 million pensioners could see their household's pension income reduce."

"A single-tier pension is likely to be beneficial for some women, carers and some low earners who tend not to qualify for a high amount of state pension in the current system. The self-employed may also benefit, although they may have to pay higher National Insurance contributions in the future."

"Those individuals who would have qualified for large amounts of state pension in the current system could lose out the most under a single-tier pension – often moderate to higher earners with an expected full career and National Insurance contribution record."

"A single-tier pension could also significantly reduce the percentage of pensioner households eligible for Pension Credit from 35% under the current system, to around 5% of pensioner households by 2055."

"The single-tier pension could place additional burdens on employers and employees in Defined Benefit schemes in both the public and private sectors as National Insurance contributions would increase. The final impact on private pension scheme members would depend on how employers reacted to the Government's state pension reforms. "

ENDS

A summary of conclusions and a summary table of key findings from the report follows on the next pages.

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The full report can be downloaded from the PPI's website at www.pensionspolicyinstitute.org.uk from 08.30am on Tuesday 28th June 2011.

Notes for editors

1. The PPI is an independent research organisation, with a charitable objective to inform the policy debate on pensions and retirement provision. Its aim is to improve information and understanding about pensions and retirement income through research and analysis, discussion and publication. It does not lobby for any particular policy, but works to make the pension policy debate better informed.

2. The National Association of Pension Funds (NAPF) is the UK's leading body providing representation and other services for those involved in designing, operating, advising and investing in all aspects of pensions and other retirement provision. We speak for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

NAPF
Securing the future of pensions

3. The Government's Green Paper: A State Pension for the 21st Century can be downloaded from the DWP's website at www.dwp.gov.uk/state-pension-21st-century

   The Government's two state pension reform options are:

   - **Option 1** - to accelerate the pace of existing reforms so that the state pension evolves into a flat-rate two tier structure more quickly, by 2020 instead of by 2030 as currently planned. The state second pension and the ability to contract-out of the state second pension is retained in this option.

   - **Option 2** – the introduction of a flat-rate single tier pension at a level of around £140 a week (in 2010 earnings terms) introduced for pensioners who reach State Pension Age after the implementation date (assumed to be 2016 in the research). The state second pension and the ability to contract-out of the state second pension is abolished in this option.

An Assessment of the Government's Options for State Pension Reform

Summary of Conclusions

The Government has issued a Green Paper: *A State Pension for the 21st century* which contains two proposals for reform of the state pension system:

1. An acceleration of the flat-rating of the State Second Pension (S2P) so that the state pension evolves into a two-tier flat-rate pension by 2020, instead of by the mid-2030s.
2. The creation of a single-tier flat-rate pension set above the current level of the Guarantee Credit element of Pension Credit (for example £140 per week in 2010 earnings terms), introduced for pensioners retiring after the implementation date.

This report provides a fact-based assessment of the implications of the two alternative reform options:

- For individuals – in terms of exploring who the gainers and losers of the reforms might be;
- For Government expenditure - in terms of analysing what costs and savings may arise from introduction of the reforms;
- For pension schemes – in terms of exploring what wider consequences the reforms may have on occupational pension schemes in both the public and private sectors.

This report estimates the number of pensioners who 'gain' or 'lose' in terms of household income as a result of the reforms. The Government has made a commitment that no individual will lose state pension rights that they have already built up. The gains and losses shown in this report reflect the different amounts that pensioners might build up in future under the alternative reforms compared to how much they would build up if the current system continues.

Option 1: Accelerating the flat-rating of S2P
In the absence of any other reforms, accelerating the flat-rating of S2P into two-tier flat-rate state pensions by 2020 could lead to:

- No pensioners gaining any extra income from the state pension as a result of this reform and some pensioners receiving lower state pension incomes compared to the current system.
- Those individuals who would have accrued higher S2P under the current system between 2013 and 2033 could lose on average a relatively small amount of state pension income under this reform.

- Overall in 2034, 5.3 million pensioners could see lower household income (losing an average of £0.50 per week in 2011 earnings terms).
- By 2055 the number of losers increases to 6.7 million pensioners (losing an average of £1.50 per week).
- A negligible difference in the numbers of pensioner households eligible for means-tested benefits
- Marginal reductions in future Government expenditure on state pensions and means-tested benefits, saving up to £0.6bn (2011 earnings terms), or less than 0.1% of GDP, each year by 2055.
- An increase in the amount of National Insurance contributions collected by the Government in every year between 2013 and 2033, peaking at an additional £3bn (2011 earnings terms), or 0.1 % of GDP, in 2020. In 2016 the increase would be £1bn (£0.8bn from the public sector, £0.2bn from the private sector).
- Some additional pressure on employers running Defined Benefit schemes (including those in the public sector) who would have to pay higher National Insurance contributions than in the current system and still meet the costs of providing contracted-out pensions.

Option 2: A single-tier pension
Introducing a flat-rate single-tier pension at a level of £140 a week (2010 earnings terms) introduced for pensioners who reach State Pension Age from 2016 could lead to:

- An increase in the state pension income for some pensioners, but a decrease in state pension income for others.
- A single-tier pension could lead to higher state pension incomes for:
    - Some women and carers, particularly those who have taken time out of the labour market before 2002 or have had very low earnings and didn't qualify for the current state pension.
    - The self-employed, although the self-employed may have to pay higher National Insurance contributions in the future.
    - The unemployed claiming Job Seekers Allowance.
    - Older pensioners and those pensioners who do not claim the means-tested benefits they are entitled to.
    - Pensioner couples
- A single-tier pension could lead to lower state pension incomes for:
    - Individuals who would have qualified for more than 30 years of S2P under the current system.
    - Individuals who have less than seven years of National Insurance contributions.
    - Individuals who would have been eligible for Savings Credit.
- Overall by 2034, the single-tier reform could increase the household incomes of 6.8 million pensioners (gaining an average £23 a week in 2011 earnings terms) but could reduce the household incomes of 5.2

million pensioners (losing an average £18 per week), compared to the current system.

- By 2055 the number of pensioners with higher household incomes under the single-tier system could increase to 11 million (gaining an average £24 per week) and the number of pensioners with lower household incomes could reduce to 5 million pensioners (losing an average £17 per week).
- The reform would dramatically reduce the number of pensioners reliant on means-tested benefits. The proportion of pensioner households eligible to claim Pension Credit could fall from 35% of pensioner households (4.4 million pensioners) in the current system to only 5% of pensioner households (0.8 million pensioners) by 2055.
- The reform would be broadly cost neutral to introduce, depending on exactly how the system is implemented. PPI estimates suggest the single-tier would be broadly cost neutral, costing less than the current system by less than 0.1% between 2019 and around 2050, and costing more than the current system by about 0.1% by 2055.
- The reform would increase the Government's National Insurance revenue by £6bn in 2016, £5bn of which would come from public sector pension schemes and £1bn from private sector schemes.
- As a result a single-tier pension could place additional pressure on employers and employees in Defined Benefit schemes in both public and private sectors as NI contributions would increase.
- Employers with DB schemes would pay higher NI contributions (£3.4bn public sector employers, £0.8bn private sector employers in 2016, 2011 earnings terms), and would have to choose whether to reform their schemes in response to the reform.
- Employees in DB schemes would pay higher NI contributions (£1.4bn public sector employees, £0.3bn private sector employees in 2016, 2011 earnings terms), but the impact on their pension incomes would depend on how employers react to the abolition of contracting-out.

Summary results table: comparing the impact of the Government's alternative state pension reforms compared to the current system

Impact on:	**Option 1: Accelerating the flat-rating of S2P**	**Option 2: A single-tier pension**
Pensioner incomes	Would not increase state pension incomes for any pensioners. Could reduce state pension incomes for some pensioners. • In 2034, 5.3 million pensioners would see lower household income (losing an average of £0.50 per week in 2011 earnings terms). • By 2055 the number of losers increases to 6.7 million (losing an average of £1.50 per week).	Would increase state pension incomes for some pensioners, and reduce incomes for others. • Increase the household incomes of 6.8 million pensioners by an average £23 a week (2011 earnings terms) and could reduce the household incomes of 5.2 million pensioners (losing on average £18 per week) in 2034. • By 2055 the number of pensioners with higher household incomes under the single-tier system could increase to 11 million (gaining on average £24 per week) with 5 million pensioners having lower household incomes (losing on average £17 per week).
Means-tested benefits	Negligible	Substantially reduce eligibility to Pension Credit. By 2055 only 5% of pensioner households (0.8 million pensioners) would be eligible to Pension Credit in the single-tier system, compared to 35% (4.4 million pensioners) in the current system.
Government expenditure	Save the Government up to £0.6bn (2011 earnings terms), or less than 0.1% of GDP, each year until 2055.	Broadly cost neutral to introduce, depending on exactly how the system is implemented. Costs within 0.1% of GDP of the current system from introduction until at least 2055.
NI revenues	Increase Government NI revenue in every year between 2013 and 2033, peaking at an additional £3bn (2011 earnings terms), or 0.1 % of GDP, in 2020. In 2016 the increase would be £1bn (£0.8 bn from the public sector, £0.2bn from the private sector).	Increase Government NI revenue in every year after introduction. In 2016 increase would be £6bn (2011 earnings terms), £5bn of which would come from public sector employers and employees, £1bn from private sector employers and employees.
DB schemes	Could place some additional pressure on employers running Defined Benefit schemes (including those in the public sector) who would have to pay higher NI contributions and still meet the costs of providing contracted-out pensions.	Could place additional pressure on employers and employees in Defined Benefit schemes in both public and private sectors as NI contributions would increase. Employers with DB schemes would pay higher NI contributions (£3.4bn public sector employers, £0.8bn private sector employers in 2016, 2011 earnings terms), and would have to choose whether to reform their schemes and how in response to the reform. Employees in DB schemes would pay higher NI contributions (£1.4bn public sector employees, £0.3bn private sector employees in 2016, 2011 earnings terms), but the impact on their pension incomes would depend on how employers react to the abolition of contracting-out.