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STATE PENSION MODELS

State Pension Models

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Introduction

The PPI has identified the need for a fundamental review of state pensions in the UK, and proposed an agenda for an independent review taskforce[1]:

1. Understand the current pressure points in UK pensions
2. Develop the key tests against which a proposed new state pension system can be measured
3. Focus on a few possible models for a new state pension system
4. Test each model, analysing the tradeoffs in each
5. Develop transition plans for each model
6. Present a comparison between the different models so that a choice can be made with consistent and objective information

This document provides background information on possible models for a new state pension policy.

Included here are summary descriptions of working systems in selected countries and proposed reform models for the UK system put forward by a variety of organisations. Models from other countries cannot easily be transplanted into the UK system. The proposed UK models need further analysis and comparison before a solution is found.

This document aims to inform the debate on reform in the UK. *A Guide to State Pension Reform*, published by the PPI, gives further analysis for that debate.

[1] See, for example, the PPI's submissions to the House of Lords Select Committee on Economic Affairs (February 2003) and to the Department of Work and Pensions Green Paper (March 2003) www.pensionspolicyinstitute.org.uk.

State pension systems in selected countries

In this report, the following terms are used to describe the design of state pensions[2]:

Universal: The benefit is available to everyone meeting certain criteria, usually based on age and citizenship or residency, but not based on income.

Contributory: The amount of benefit paid depends in some way on how many contributions were made while of working age (but <u>not</u> that the benefit paid is the accumulation of contributions).

Flat-rate benefit: Everyone receiving the benefit gets the same amount for the same number of contributions paid (if contributory) or for the same criteria fulfilled (if universal).

Earnings-related benefit (has to be contributory): The amount of benefit received is dependent not only on how many contributions were made but on how much those contributions were – as these are usually a percentage of salary, people who earned more while in work receive more pension.

Means-tested: An income test (and usually an asset test) is used to determine who should get all or part of a benefit; those people with most income will not receive the benefit. The means-test is a test of eligibility which people on low income need to go through to apply for the benefit; **affluence-testing** looks to identify the most affluent people from whom to withhold benefits.

Pay-As-You-Go (PAYG): Current taxes (or contributions) pay for current pensioners' benefits. The alternative is **funded**, where designated funds are accumulated from contributions, and benefits paid from these funds.

[2] There are a number of good summaries of alternative pension system designs, for example: Disney R, Johnson P. (eds) (2001) *Pension Systems and Retirement Incomes across OECD Countries*, Evason E. (1999) *British pensions policies: Evolution, outcomes and options*, in Ditch J. (ed.) *Introduction to Social Security: Policies, benefit and poverty*, and Littlewood M. (1998) *How to create a competitive market in pensions – the international lessons*

The state pension systems covered in this document can be broadly described using these terms:

Table 1: Make-up of state pension systems in selected countries[3]

	AUS	DK	F	D	IRL	I	NL	NZ	E	S	UK	US
Universal flat-rate PAYG pension							*	*				
Universal flat-rate funded pension												
Affluence-tested flat-rate PAYG pension	*	*								*		
Means-tested flat-rate PAYG pension		*	*		*	*	*		*		*	*
Contributory flat-rate PAYG pension					*						*	
Contributory flat-rate funded pension												
Contributory earnings-related PAYG pension			*	*		*			*	*	*	*
Contributory earnings-related funded pension										*		

A number of countries have compulsory or extensive private pension provision while in other countries there is very little private pension provision.

An evaluation of the varying outcomes of these models can be found in *A Guide to State Pension Reform.*

[3]AUS (Australia), DK (Denmark), F (France), D (Germany), IRL (Ireland), I (Italy), NL (Netherlands), NZ (New Zealand), E (Spain), S (Sweden), UK (United Kingdom), US (United States)

Summary of the Australian state pension system

Australia's state pension is the Age Pension (AP), an affluence-tested, non-contributory, flat-rate pension. In addition there are compulsory employment-based superannuation pensions. Policy objectives are to increase the numbers with non-state pensions, and reduce the numbers reliant on AP.

Affluence-tested flat-rate PAYG state pension
Men aged 65 and women aged 62 are eligible for AP provided they have lived in Australia for a minimum of ten years. Equalisation to age 65 is now in process and will be complete by 2013[4].

AP is subject to an affluence test, which measures whether income and assets are above a limit set each year. In July 2003, to qualify for the maximum AP (AU$220.15[5] per week), the income test requires a weekly income of no more than AU$60 per week for a single person. Income over this limit reduces the pension rate by 40 cents for each dollar of income. If income reaches AU$618 per week then no pension is payable[6].

The limit for assets for a single homeowner is AU$149,500 (July 2003). AP is reduced by AU$1.50 per week for every AU$1000 of assets above the limit. Assets over AU$298,250 result in no pension being payable. The assets test does not take into account owner-occupied housing[7].

The rate of AP is indexed to the Consumer Price Index, and is adjusted every March and September. Alongside this is the commitment that the benefit for a single pensioner should be maintained at a minimum of 25% of male total average weekly earnings.

Non-pension universal cash benefits and services
Pensioners have a number of cash benefits and services available to them. These include rent assistance, medicine and telephone allowance, as well as a pensioner concessionary card for local authority services.

Compulsory occupational tax-incentivised pension
In 1992 Australia introduced a compulsory system of employer contributions. The Superannuation Guarantee (SG) can be paid out as a lump sum or in the form of an annuity, and cannot be accessed until age 55. This is being increased gradually to age 60 by 2025.

[4] Commonwealth Department of Family and Community Services (FACS) (2002) *Submission to Senate Select Committee Inquiry into Superannuation and Living Standards in Retirement – July 2002* p. 132 www.facs.gov.au/internet/facsinternet.nsf
[5] AU$1 = GB£0.3947 (30 May 2003)
[6] *A Guide to Commonwealth Government Payments* (July – September 2003) Centrelink www.centrelink.gov.au/internet/internet.nsf/filestores/co029_0306/$file/co029_0306en.pdf
[7] *A Guide to Commonwealth Government Payments* (July – September 2003)

The SG requires employers to make contributions to superannuation funds on behalf of the majority of employees, at a rate of 9% of earnings. There are exemptions including people on low incomes and part-time employees under 18. The self-employed do not have to make SG contributions. Both SG and voluntary superannuation are subject to tax, with some concessions, at all three stages: contributions, investments and benefits.

Characteristics include[8]:

- Employer contributions are tax-deductible up to certain age-related limits
- Employees with low wages (below 85% of male average weekly earnings) qualify for a tax rebate
- Investment earnings and contributions are generally taxed at a rate of 15% compared to the corporate tax rate of 30% and a top personal marginal rate of 47%
- The amount of superannuation that can receive tax concessions is restricted by 'Reasonable Benefit Limits'[9].

Voluntary private tax-encouraged pension

Voluntary superannuation pensions, with tax concessions, are payable as a lump sum or an annuity, and cannot be accessed until age 55. The Government also makes a Superannuation co-contribution of up to AU$1,000 per year to low-income earners who make voluntary contributions[10].

Minimum pension level[11]

AU$11,448 (£4,518) for a single pensioner per year from the full rate Age Pension (2003)

State Pension (full AP) income compared to average earnings[12]

24% (2002)

Pension coverage[13]

82% of pensioners receive AP (2002)
67% of pensioners receive the maximum rate of AP (2001)
97% of permanent employees have some superannuation coverage (2000)

State pensions spend as a percentage of GDP[14]

2.9% (2002)
4.6% (2042)

[8] These main features of the tax treatment of superannuation have been selected from Bateman and Piggott (1997) in Disney R, Johnson P. (eds) (2001) *Pension Systems and Retirement Incomes across OECD Countries*
[9] Reasonable Benefit Limits (2002/03) were AU$562,195 when taken as a lump sum, and AU$1,124,384 where at least half was taken as a pension or annuity www.national.com.au/Business_Solutions/0,,22463,00.html
[10] FACS (2002)
[11] *A Guide to Commonwealth Government Payments* (July – September 2003) CentreLink
[12] PPI calculation based on full AP and full time adult ordinary time weekly earnings
[13] FACS (2002)
[14] FACS (2002)

Summary of the Danish state pension system

The Danish system is characterised by an affluence-tested state pension, which the majority of people receive. This is supplemented by a means-tested pension.

Supplementary non-state occupational pension scheme take-up has increased in recent years and stronger incentives now exist for older people to remain in the labour market.

The Danish national pension (folkepensionen) is made up of 2 elements, both financed through general revenues.

Affluence-tested flat-rate PAYG state pension
This is a basic sum which is reduced only for those who have an income over DKK210,600 (£20,426)[15]. 95% of the pensioner population receive some pension.

Means-tested flat-rate PAYG state pension
This is payable to top up a pensioner's income. The supplement has a maximum value of roughly half the basic sum.

For both elements eligibility is from age 65 and depends upon minimum residency of 30 years. The pension is adjusted annually on the basis of wage trends in the private sector.

In 1998 the folkepensionen accounted for 50% of pensioners' gross incomes. This is reducing with an increased prevalence of occupational pensions, but by 2045 will still be the chief source of income for half of pensioners.

Means-tested cash benefits and services
Particular benefits exist for those over age 65 in the form of needs- and income-tested cash supplements. In addition free health and long-term care, favourable housing benefit rules and access to cheaper recreational activities are available.

Compulsory occupational pensions
ATP was set up in 1964 and is a mandatory supplementary pension for salaried workers. The benefit is dependent on the number of hours worked and not on the salary - it is contribution - and not earnings-related. ATP totals a maximum DKK19,000 per year (£1,843) and is received by 68% of all pensioners.

[15] DKK1 = GB£0.097 (30 May 2003)

SP is an additional mandatory savings scheme with a requirement to pay 1% of gross salary annually, receiving it back (as 10 years of monthly payments of the average of all contributions) at age 65. SP was introduced in 1999 and is anticipated to have the same value as ATP once contribution histories are complete.

Voluntary occupational tax-incentivised schemes cover 80% of the workforce. These make up a significant proportion of pensioner income and contributions are tax deductible.

Private tax-incentivised savings. Supplementary private schemes, which benefit from tax breaks, are not widespread.

Minimum pension level[16]
DKK98,700 (£9,573) for a single pensioner per year from the basic and means-tested elements of folkepensionen (2002)

Average total income of people aged 65+ as a percentage of income of people aged 0-64[17]
68% (2002)
90% (2050)

Average state pension income as a percentage of take home pay of an average worker[18]
47% (2003)

Pension coverage[19]
99% of pensioners receive the basic element of folkepensionen
64% of pensioners receive full amount of means-tested element of folkepensionen
26% of pensioners receive a reduced amount of means-tested element of folkepensionen

State pensions spend as a percentage of GDP[20]
10.5% (2000)
13.3% (2050)

At-risk-of-poverty rate (less than 60% of median income)[21]
31% of those aged 65+ (1999)
7% of those aged 0-64 (1999)

[16] Missoc (2001) *Old Age in Europe - Denmark* p. 20 www.europa.eu.int/comm/employment_social/missoc2001/missoc_info_en.htm
[17] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable pensions* p. 117 www.europa.eu.int/comm/employment_social/soc-prot/pensions/index_en.htm
[18] EC (2003) p. 117
[19] *National Strategy Report on the Danish pension system* (2002), appendix 2, p. 7 www.europa.eu.int/comm/employment_social/soc-prot/pensions/index_en.htm
[20] EC (2003) p. 117
[21] EC (2003) p. 117

Summary of the French state pension system

France has a complex, fragmented pension system. It is a compulsory PAYG, contributory system, made up of a number of schemes based around occupational groups. Pensions are not run by the state, but instead managed by the social partners (management and unions) through private insurance funds. These pension systems aim to maintain a worker's income into retirement[22].

Contributory earnings-related PAYG pension

The system has 26 compulsory PAYG schemes, based on occupational groups[23]. They are largely funded by contributions from both employers and employees. Although schemes are not run or financed directly by the state[24] they are regarded as public pensions and included in public administration costs[25].

The largest 'general' scheme covers all wage-earners in the private sector. The basic benefit level from the 'general' scheme is a fraction of the average wage over the best years of the working life. The 'general' scheme includes numerous PAYG, compulsory additional pensions, which increase the main basic pension level. The complementary pensions are based on contributions that are converted into points. The social partners decide the value of these points, which, when calculated over the working life, give the value of the pension[26]. The total pension is made up of both the basic and complementary pensions.

Those working in the public sector are covered by 'special' schemes. They do not include a complementary pension, though the main pension is normally more generous than the 'general' scheme. The pension is defined as a fraction of the last wage, based on the number of contributory years, and a specific accrual rate of 2% for each year worked. The self-employed also have their own schemes, with almost all covered by complementary schemes.

A number of schemes use the 'old age solidarity fund' (FSV), introduced in 1993. This provides additional funds financed directly by the state from taxes to meet 'solidarity' elements, which include a minimum old age allowance, child care and years of national service[27].

[22] Palier B. (2002) *Facing Pension Crisis in France*, working paper WP302, Oxford Institute of Ageing
[23] MISSOC (2001) *Old Age in Europe – France* p. 34
[24] Except the civil servants scheme which is explicitly included in the state budget
[25] Palier B. (2002)
[26] Palier B. (2002) p. 4
[27] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 134 and Missoc (2002) *Old Age in Europe - France*
www.europa.eu.int/comm/employment_social/missoc2001/missoc_info_en.htm p. 34

Means-tested flat-rate PAYG pension ('minimum vieillesse')
A minimum pension is payable to those over age 65 with low incomes from other sources. It currently covers around 8.1% of those over age 65[28], but this coverage is reducing as more retired people are covered by the compulsory pension schemes[29].

Voluntary occupational tax-incentivised pension
These pensions are becoming increasingly more common. They may be either PAYG or funded, depending on the occupational group and provider.

Voluntary private tax-incentivised pensions
There is little scope for voluntary private schemes, despite financial incentives, due to the high coverage and relative generosity of the compulsory PAYG state sector[30].

Minimum pension level[31]
€6,835 (£4,922) for a single pensioner per year from Minimum Viellesse (2002)

Average total income of people aged 65+ as a percentage of income of people aged 0-64[32]
90% (1999)

Pension coverage[33]
70% of the economically active workforce is contributing towards a 'general scheme' pension (1999)
20% of the economically active workforce is contributing towards a 'special scheme' pension (1999)
10% of the economically active workforce is contributing towards a 'self-employed scheme' pension (craftsmen, traders, professionals, farmers) (1999)

State pensions spend as a percentage of GDP[34]
12.1% (2000)
15.8% (2050)

At-risk-of-poverty rate (less than 60% of median income)[35]
19% of people aged 65+(1999)
14% of people aged 0-64 (1999)

[28] EC (2003) p. 25 and PPI calculation based on population projections from Institut national d'etudes demographiques (INED) www.ined.fr/englishversion/figures/france/index.html
[29] Disney R, Johnson D. (eds) (2001) *Pension Systems and Retirement Incomes across OECD Countires*
[30] EC (2003) p. 132
[31] €1 = GB£0.72 (30 May 2003)
[32] EC (2003) p. 135
[33] Caisse Nationale d'Assurance Vieillesse www.cnav.fr/1qui/f_syst.htm
[34] EC (2003) p. 135
[35] EC (2003) p. 135

Summary of the German state pension system

Although there is only one component to the German state pension there is variety between former East and West Germany and across a number of historic occupational schemes and conditions. In 1999, 96% of those over age 65 were receiving income from publicly funded pension schemes. State pensions are the most widespread, accounting for 80% of the total benefits in former West Germany and 99% in former East Germany.

Contributory earnings-related PAYG state pension
This is financed by compulsory contributions and federal subsidies. Contributions of 19.5% of salary (50/50 from employer and employee) are paid up to a set salary level which is adjusted annually. The contributions ceiling is €61,200 (£44,064) per year in former West Germany and €51,000 (£36,720) in former East Germany. In addition federal subsidies provide 37% of pensions expenditure (2002). The benefit is indexed to net wages.

The state pension covers those who have been employed or been carers. Others, such as the self-employed, can make voluntary contributions. State pension age is 65 but pensions can be taken early or deferred with a corresponding decrease or increase in benefit.

Voluntary occupational/private tax-incentivised savings
Voluntary company pension schemes cover 50% of men (but fewer women) and along with individual personal pensions are encouraged through payments being tax-free up to a specified cap. 21% of men and 9% of women receive some private pension benefits.

Means-tested cash benefits and services
There is no minimum pension. Those with insufficient pension entitlements have their income raised through social assistance as part of the national welfare system (Sozialhilfe) available to working people as well. At the end of 2000, 1.4% of those over 65 claimed via Sozialhilfe to supplement the state pension. Housing benefit, care assistance and health care are also available for pensioners with limited income or resources.

Pension level[36]
The average annual state pension for a hypothetical individual with 45 years of contributions is €12,868 (£9,265) in former West Germany and €11,296 (£8,134) (2003) in former East Germany. Most pensioners receive less benefit.

Average total income of people aged 65+ as a percentage of income of people aged 0-64[37]
97% (1999)

Average state pension income as a percentage of average annual net pay[38]
70% (2003)

Pension coverage
1.4% of pensioners receive means-tested Sozialhilfe (2002)[39]

State pensions spend as a percentage of GDP[40]
10.8% (2000)
15.9% (2050)

At-risk-of-poverty rate (less than 60% of median income)[41]
11% of people aged 65+ (1999)
11% of people aged 0-64 (1999)

[36] *Germany National Strategy Report on old-age pension provision* (NSR) (2002) Annex 1 p. 14 www.europa.eu.int/comm/employment_social/soc-prot/pensions/index_en.htm. €1 = GB£0.72 (30 May 2003)
[37] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable pensions* p. 122 www.europa.eu.int/comm/employment_social/news/2002/dec/joint_pensions_report_en.pdf
[38] EC (2003) p. 120
[39] NSR (2002) Annex 5 p. 18
[40] EC (2003) p. 122
[41] EC (2003) p. 122

Summary of the Irish state pension system

Ireland has a PAYG, contributory, flat-rate state pension system. It does not have any compulsory earnings-related pension schemes in the state or the private sector.

Contributory PAYG flat-rate state pensions
Old Age Contributory Pension (OACP) is payable at age 66 and Retirement Pension (RP) is payable at age 65 (if retiring from qualifying employment or self-employment). Both are financed through pay-related insurance contributions from employees, employers and the self-employed. The percentage of retirement pension recipients receiving a contributory pension has risen to 68% in 2002 from 50% in 1990[42]. The rates of OACP and RP are dependent on having met the contribution conditions.

Means-tested flat-rate PAYG state pension
A non-contributory (social assistance) pension - the Old Age (non-contributory) Pension (OAP) - is paid on the basis of the claimant satisfying a means-test[43]. 32% of retirement pension recipients receive an OAP[44].

Non-pension age-related state cash benefits and services
Schemes include the gas/electricity allowance, free television licences, telephone allowance and fuel allowance. They are available to all those over age 70 regardless of income. In addition, all those over age 66 are entitled to free public travel and those over age 70 are entitled to free medical services[45].

Voluntary occupational tax-incentivised pensions
All occupational pensions are voluntary and usually provided by individual employers. 68% of members are in defined benefit (DB) schemes and 32% in defined contribution (DC) schemes[46]. These schemes are encouraged through tax incentives in contributions and tax returns.

Voluntary private tax-incentivised pensions
Private pensions are encouraged through tax incentives on contributions and investment returns, as well as through regulation that safeguards pension entitlements. Personal Retirement Savings Accounts (PRSAs) were introduced in 2003. They provide limits on charges and prevent charges for those who change or cease employment. They are voluntary, but employers without an occupational scheme are obliged to inform and provide access to these for employees.

[42] Department of Social and Family Affairs www.welfare.ie
[43] It is feasible that a partial contributory pension is lower than the non-contributory pension. In this case an individual can apply and replace it with the non-contributory pension. However, of course, the non-contributory pension is means-tested.
[44] Department of Social and Family Affairs www.welfare.ie
[45] *Ireland's National Strategy Report to the EU on its Pension System* (NSR) (2002) p. 33 www.europa.eu.int/comm/employment_social/soc-prot/pensions/index_en.htm
[46] NSR (2002)

Minimum pension level[47]
€7,488 (£5,390) for a single pensioner per year from (non-contributory) OAP (2003)[48]

Average total income of people aged 65+ as a percentage of income of people aged 0-64[49]
69%

Income from contributory old age pension as a percentage of 'gross average industrial earnings'[50]
31% (1999)

Pension coverage[51]
68% of pensioners receive a contributory-based pension
51% of the working population has an occupational or personal pension

State pensions spend as a percentage of GNP[52]
4.6% (2000)
9% (2050)

At-risk-of-poverty rate (less than 60% of median income)[53]
34% of people aged 65+ (1999)
17% of people aged 0-64 (1999)

[47] €1 = GB£0.72 (30 May 2003)
[48] 2003 figures from Department of Social and Family Affairs www.retired.welfare.ie/rates/index.xml#9
[49] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 140
[50] NSR (2002)
[51] EC (2003) p. 25 and Department of Social and Family Affairs www.welfare.ie
[52] EC (2003) p. 140
[53] EC (2003) p. 140

Summary of the Italian state pension system

The Italian state pension system is highly fragmented. It has undergone radical transformation over the last ten years. The system retains its PAYG nature but will eventually mimic a funded scheme in basing pension levels on contributions made throughout the working life, life expectancy and economic growth.

Contributory earnings-related PAYG state pension
Italy currently has a compulsory PAYG, earnings-related system that covers all registered workers. It is made up of over fifty different schemes based on occupation, though the five largest schemes cover around 80% of total state pension expenditure[54].

Italy is gradually moving from defined benefit (DB) schemes to a defined contribution (DC) schemes. The first pensioners to have a state pension based fully on the DC scheme will reach pension age in approximately 2035. Transitional arrangements exist until then. The reforms have the effect of reducing pension levels, should early retirement persist.

The new pension is based on the total amount of contributions accrued over the working life. Each year the contribution amounts are adjusted, based on the average growth rate of GDP over the last five years. At the end of an individual's working life the value of the pension is then calculated by multiplying the adjusted contribution amounts by an actuarial factor that varies according to age. The age in which the pension can be drawn is flexible (between ages 57 and 65), with a higher pension level given to those closest to the official pension age of 65. However, this flexibility is only open to those whose pension level is at least 1.2 times the social pension[55].

Means-tested flat-rate PAYG state pension
The Social Pension (Pensione Sociale, replaced by Assegno Sociale in 1996) guarantees a minimum income to all people aged 65 and over. It currently covers 6.2% of those aged 65 or over. For those pensioners with entitlement to a contributory-based pension below €5,105 (£3,676) in 2002 income is topped up to this level through a higher minimum income pension (Integrazione al minimo). This covers approximately 39% of those aged 65 or above[56].

[54] Economic Policy Committee (EPC) (2001) *Budgetary challenges posed by ageing populations- Country Fiche Italy* www.europa.eu.int/comm/economy_finance/epc/epc_ageing_en.htm p. 1
[55] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 141 and Missoc (2002) *Old Age in Europe - Italy* www.europa.eu.int/comm/employment_social/missoc/2002/it_part6_en.htm
[56] EC (2003) and Ministry of Welfare (2002) Rapporto sulle strategie nazionali per i futuri sistemi pensionistici p. 21 www.minwelfare.it/documentazione/default.htm

Voluntary occupational tax-incentivised pensions
There are two main funds: 'closed' funds for employees, which are based on collective agreement between employers' associations and trade unions and 'open' pension funds which are open to employees and the self-employed, managed by banks and insurance companies. They are all voluntary in nature and generally on a defined-contribution basis[57].

Voluntary private tax-incentivised pensions
Individual supplementary pensions with tax advantages come in the form of individual pension plans (PIP) through life insurance policies. By 2002 there were roughly 300,000 PIPs.

Minimum pension level[58]
€4,557 (£3,281) for a single pensioner per year from the Social Pension (2002)

Average total income of people aged 65+ as a percentage of income of people aged 0-64[59]
96% (1999)

Average state pension income as a percentage of 'average earnings in industry'
72% (1998)[60]

Pension coverage[61]
State pensions and benefits account for between 55% and 86% of the income of people aged 65 or over[62]
10.3% of the employed population had complementary (non-state) pension provision (2002)[63]

State pensions spend as a percentage of GDP[64]
13.8% (2000)
14.1% (2050)

At-risk-of-poverty rate (less than 60% of median income) [65]
14% of people aged 65+ (1999)
19% of people aged 0-64 (1999)

[57] EC (2003) p. 141
[58] NSR (2002). €1=GB£0.72 (30 May 2003).
[59] EC (2003)
[60] Hypothetical figure assuming a full working life with 'average earnings in industry'. Disney R, Johnson D. (eds.) (2001) *Pensions Systems and Retirement Incomes across OECD Countries*
[61] EC (2003)
[62] EC (2003)
[63] Sviluppo del Mercato dei fondi pensione (MEFOP), Bulletin 9. (May 2003)
[64] EC (2003) p. 144
[65] EC (2003) p. 144

Summary of the Dutch state pension system

The Netherlands operates a system of integrated public and private mandatory pension provision. All citizens are guaranteed a certain minimum income which is not means-tested. Entitlement is based on residency. The current system was introduced in 1957 and a transitional arrangement still exists. Under this, until 2007, around 10% of pensioners receive a reduced benefit. This affects women in particular.

Universal flat-rate PAYG state pension
Algemene Ouderdomswet (AOW) is a flat-rate guaranteed benefit which provides an equal pension for all residents at a net minimum wage level. AOW is funded through contributions from income of 17.9% up to a maximum of €27,897 (£20,086)[66]. Deficits in the AOW fund are balanced by government grants funded from tax revenue.

In each year of residency from ages 15-65 a 2% entitlement is built up. AOW level is set at 100% of net minimum wage for a pensioner couple, 70% for a single pensioner and 90% for a single parent with an unmarried child under 18. The statutory minimum wage is 55% of the average wage. AOW Pension is provided from age 65. Deferment or early retirement is not possible. Other benefits cease at age 65.

Means-tested flat-rate PAYG state pension
Those who receive a reduced benefit have it brought up to a minimum level through the SABW- Social Assistance Act if no other income exists.

Universal cash benefits and services
In May pensioners also receive an additional 8% of yearly benefit as a holiday allowance. Means-tested subsidised health-insurance is paid for by a surcharge on the health premiums of the non-elderly and by pensioner contributions (7.6% of AOW and 5.9% of other income). Most of the costs of home care and nursing homes are covered through this system.

Compulsory/voluntary tax-incentivised occupational pensions
These covered 91% of employees in 2001. Although not nationally compulsory they are mandatory within some industries. They are fully funded and increasingly important as a proportion of pensioner incomes. Contribution rates vary by industry. 2/3 of contributions paid by the employer and 1/3 by the employee is common. The aim of most schemes is to pay a benefit to take total income (including AOW) to 70% of last earned salary after 40 years of participation. Contributions are tax deductible and pensions payments are taxable. 63% of supplementary occupational plans are based on final salary although many schemes are changing to be based on average pay.

[66] €1 = GB£0.72 (30 May 2003)

Voluntary occupational/private tax-incentivised savings
Various schemes exist but have a less widespread take-up to due to strong occupational pension provision. Contributions are tax deductible up to a limit.

Minimum pension level[67]
Rate of means-tested pension (SABW) is roughly equal to level of AOW.
€9,904 (£7,132 per year) for a single pensioner per year from AOW (2003)

Average total income of people aged 65+ as a percentage of income of people aged 0-64
93% (2002)[68]

Average state pension income as a percentage of National Average Earnings (NAE)
38.5% (1999)[69]

Pension coverage[70]
1% of pensioners receive full means-tested element of pension

State pensions spend as a percentage of GDP[71]
7.9% (2000)
13.6% (2050)

At-risk-of-poverty rate (less than 60% of median income)[72]
7% of those aged 65+ (2002)
11% of those aged 0-64 (2002)

[67] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 150
www.europa.eu.int/comm/employment_social/news/2002/dec/joint_pensions_report_en.pdf
[68] EC (2003) p. 153
[69] Missoc (2002) *Old Age in Europe - Netherlands* (State pension 70% national minimum wage, national minimum wage 55% NAE)
www.europa.eu.int/comm/employment_social/missoc2001/missoc_info_en.htm
[70] Disney R, Johnson D. (eds) (2001) *Pensions Systems and Retirement Incomes across OECD Countries*
[71] EC (2003) p. 153
[72] EC (2003) p. 153

Summary of the New Zealand state pension system

New Zealand has a flat-rate, universal pension alongside tax-neutral occupational and private pensions.

Universal flat-rate PAYG state pension
The universal pension, New Zealand Superannuation (NZS), is payable to all people from age 65 who meet the residency requirements (have lived in NZ for ten years since age 20, five of which must be since aged 50)[73]. Currently 93% of those aged 65 or over are in receipt of NZS[74].

NZS is payable at different rates for married couples, singles sharing and singles living alone. The level of benefit is reviewed each year, but the married couple rate must stay between 65% and 72.5% of average 'ordinary time earnings after tax'[75]. From this figure the threshold for the single living alone and single sharing rates are set, at 65% and 60% of the married couple rate respectively.

A means-tested income supplement is available for those without NZS, on the same basis as for other age groups.

Age-related state cash benefits and services
Of those in receipt of the NZS, 3.6% receive the Accommodation Supplement. Claimants receive help with the cost of renting, boarding or owning a home. 21.8% receive the Disability Allowance that helps towards the costs of ongoing visits to the doctor or hospital, medicines, extra clothes or travel. 71.1% had a Community Services Card that reduces the costs of doctor appointments and prescriptions[76].

Voluntary occupational tax-neutral pensions
Occupational pensions are available, but membership is small and declining. In some schemes, employers add money to the amount the employee saves; in other cases the employer meets some of the costs of the scheme, such as bank fees. New schemes are increasingly defined contribution. There are no tax incentives or restrictions on the amount an employer may contribute or how the pension is received.

Voluntary private tax-neutral pension
Private pensions are available to all. New Zealand is the only OECD country not to provide tax incentives to private pensions.

[73] www.sorted.org.nz
[74] The other 7% are made up of tourists, visitors, new immigrants, those without a pension from abroad who have applied for the NZS. Ministry of Social Development (2003) *Briefing to the incoming Minister for Senior Citizens* www.msd.govt.nz/publications/a-d.html
[75] The gross total payout to all employees, less any overtime payments.
[76] *Briefing to the incoming Minister for Senior Citizens* (2003) and NZ Work and Income Ministry website www.workandincome.govt.nz/

Minimum pension level[77]
NZ$11,462 (£4,014) for a single pensioner (sharing) per year from NZS (after tax) (2002)

Pension coverage[78]
14.7% of pensioners receive private pension income (1995/6)
19% of employed people are in an employment-based scheme (1997)

State pension net income (single, sharing) as a percentage of average net earnings[79]
40% (2002)

State pension net income (couple) as a percentage of average net earnings[80]
67% (2002)

State pensions spend as percentage of GDP[81]
5% (2000)
10% (2020)

[77] 1 NZ$ = GB£0.35
[78] Disney R, Johnson P. (eds) (2001) *Pension Systems and Retirement Incomes across OECD Countries*
[79] *Briefing to the incoming Minister for Senior Citizens* (2003)
[80] *Briefing to the incoming Minister for Senior Citizens* (2003)
[81] Creedy J. and Scobie G.M. (2002), *Population Ageing and Social Expenditure in New Zealand: Stochastic projections*, New Zealand Treasury Working Paper December 2002

Summary of the Spanish state pension system

State pensions are made up of two elements - a contributory earnings-related pension and a non-contributory means-tested pension. The most widely received part of state pension is the earnings-related PAYG scheme.

Contributory earnings-related PAYG state pension
This is part of Public Social Protection and covers all those in employment (self-employed and employed) on a pay-as-you-go basis. Contributions from employers and employees make up 65% of the fund with state allocations making up the remaining 35%. Contributions to fund the state pension are at a rate of 23.6% of salary from the employer and 4.7% from the employee.

Special schemes exist for certain occupations and qualifying in all schemes has similar conditions. Amounts are adjusted annually in line with price inflation. The full benefit is available from age 65, although there are some conditions for early/partial retirement with a reduced pension. The benefit is means-tested for those under age 65.

Benefits are paid as a percentage of a 'base pension' calculated on the earnings-related contributions paid during the 15 years prior to retirement. The percentage is based on the number of years of contributions and age on retirement. The pension is paid in 14 instalments across a year.

Means-tested flat-rate PAYG state pension
The non-contributory level of state funding covering those over age 65 who are not entitled to benefits from the contributory scheme and whose income does not reach a certain level (€3,763, £2,710)[82]. Recently, new pensions have been higher from the contributory pension because of higher employment rates - particularly for women. There is therefore less need to top up to the minimum pension from the non-contributory element.

Universal and means-tested cash benefits and services
Pensioners have the right to health care, free medicines and a range of social services including rest homes.

Voluntary occupational and private tax-incentivised pensions
Supplementary schemes are voluntary and carry incentives from the state in the way of tax relief on contributions and benefits received. The number of occupational pension plans has increased through collective bargaining. Individual pension plans make up 62% of the total private plans and occupational plans the remaining 38%. In 2002, 5.9 million people (21.6% of the working age population[83]) had private pension plans.

[82] €1 = GB £0.72 (30 May 2003)
[83] Calculated from www.cia.gov/cia/publications/factbook

Minimum pension level[84]
€5,608 (£4,038) for a single pensioner per year (2003)
€6,604 (£4,755) for a pensioner with a spouse per year (2003)

Average total income of people aged 65+ as a percentage of income of people aged 0-64[85]
91% (1999)

Average state pension income as a percentage of previous average earnings[86]
65% (2001)

Pension coverage[87]
20% of those aged 65+ receive the means-tested element of the state pension

State pensions spend as a percentage of GDP[88]
8.4 % (2000)
16.3% (2050)

At-risk-of-poverty rate (less than 60% of median income)[89]
16% of those aged 65+ (1999)
19% of those aged 0-54 (1999)

[84] www.seg-social.es/inicio/
[85] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 131
www.europa.eu.int/comm/employment_social/news/2002/dec/joint_pensions_report_en.pdf
[86] Economic Policy Committee (EPC) (2001) *Budgetary challenges posed by ageing populations- Country Fiche Spain* p5 www.europa.eu.int/comm/economy_finance/epc/epc_ageing_en.htm
[87] EC (2003) p. 128
[88] EC (2003) p. 131
[89] EC (2003) p. 131

Summary of the Swedish state pension system

Sweden recently introduced radical changes to its pension system which came into full effect in 2003. The new state pension system, partly PAYG and partly funded, is intended to be more stable, sustainable and actuarially fair.

The new public pension system is made up of three components: Income Pension, Premium Pension and Guaranteed Pension.

Contributory earnings-related PAYG state pension
The Income Pension is a PAYG system, based on lifetime earnings and financed by contributions of 16% of pensionable income. The rate of pension is based on average wage growth and is designed to withstand demographic pressures. When a person retires his or her aggregate pension assets in the PAYG system are divided by a factor, based on both the cohort-specific life expectancy from the date of retirement and the growth of average earnings under a 'flexible indexation' system[90]. The retirement age is flexible with a minimum age of 61. However, the calculation, which takes account of both lifetime contributions and cohort-specific life expectancy, means a lower pension is payable the earlier it is taken.

Contributory earnings-related funded state pension
The Premium Pension sees a contribution of 2.5% of pensionable income go into an individual pension account. The value of the account will vary in accordance with the return generated by the underlying investment. Individuals may actively choose their own private fund(s) or, as a default, they will be deposited with the National Fund Board. In 2000 around two-thirds of working age people made an active choice over their funds[91]. At retirement the fund can either be used to buy an annuity or remain in the funds and claim a pension through income drawdown.

Affluence-tested flat-rate PAYG state pension
The Guaranteed Pension (GP) provides a minimum pension to those who have no or small earnings-related pension(s). It is financed through general taxation. Only the earnings-related pension is considered in the affluence test. To qualify for the full GP a person must be at least age 65 and have been resident in Sweden for 40 years, starting from age 25. The amount is reduced by one-fortieth for each year below the full 40 years required.

Non-pension age-related state cash benefits and services
Sweden provides both cash benefits and subsidised services. These include means-tested assistance with housing costs, subsidised travel, pharmaceutical products, dental and medical care. In addition there is means-tested Maintenance Support that aims to provide a 'reasonable' standard of living for

[90] Flexible indexation is adjustments based on average income growth, minus the 'norm'. The 'norm' for increase in average wages is 1.6 per cent. If actual wage increases fall under this 'norm', full indexation will not take place.
[91] Palmer E. in House of Commons Select Committee on Work and Pensions (2003), paragraph 480 www.parliament.the-stationery-office.co.uk/pa/cm200203/cmselect/cmworpen/92/3012203.htm

recent immigrants who do not qualify for the GP.

Voluntary occupational tax-incentivised pension
Occupational pensions are characterised by high coverage and centralisation. Around 90% of workers are members of an occupational pension scheme, regulated by collective agreements between employers and employees, with the four largest schemes covering around 80% of these workers. They tend to provide a supplementary income of around 10% of final salary[92].

Voluntary private tax-incentivised pension
Such pensions supplement the public and occupational pension systems and are tax deductible, dependent on individuals' earned income. The number of people saving into a personal pension increased from 1.36 million in 1996 to 1.94 million in 2001, roughly half the working age population[93].

Minimum state pension[94]
SEK82,200 (£6,461) for a single pensioner per year from the GP (2003)

Average total income of people aged 65+ as a percentage of income of people aged 0-64[95]
83% (1999)

Median state pension income as a percentage of median working population income[96]
51% (1999)

Pension coverage[97]
30% of pensioners receive some income from the Guarantee Pension (2003)

State pensions spend as a percentage of GDP[98]
9% (2000)
10.7% (2050)

At-risk-of-poverty rate (less than 60% of median income)[99]
8% of people aged 65+ (1999)
10% of people aged 0-64 (1999)

[92] *National Strategy Report on the Future of pensions (*NSR) (2002) Annex 1 www.europa.eu.int/comm/employment_social/soc-prot/pensions/sv_pensionreport_en.pdf
[93] NSR (2002) pp. 6-7 and calculation based on population projections from Institut national d'etudes demographiques www.ined.fr/englishversion/figures/france/index.html
[94] SEK1 = GB £0.08 (30 May 2003)
[95] EC (2003)
[96] PPI calculation based on median gross public pension income, NSR (2002)
[97] Palmer E. in House of Commons Select Committee on Work and Pensions (2003), paragraph 480 www.parliament.the-stationery-office.co.uk/pa/cm200203/cmselect/cmworpen/92/3012203.htm
[98] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 170 ww.europa.eu.int/comm/employment_social/news/2002/dec/joint_pensions_report_en.pdf
[99] EC (2003) p. 170

Summary of UK state pension system[100]

The UK system has a contributory, flat-rate, PAYG state pension; a contributory, earnings-related, PAYG state pension and a non-contributory means-tested top-up. The UK has a large and established private pensions sector. Pensions policy is directed towards encouraging greater voluntary private provision.

Contributory flat-rate PAYG state pension
The Basic State Pension (BSP) delivers a flat-rate pension to men from age 65 and women from age 60. A reduced pension is payable if a sufficient contributions record has not been achieved. Credits are available if contributions are not paid in certain circumstances. Equalisation of pension age to 65 will occur between 2010 and 2020. Between 1979 and 2000 the BSP was increased in line with the Retail Price Index (RPI). Since 2001 the increases have been higher, and from April 2004 will be increased by the greater of 2.5% and RPI[101].

Contributory earnings-related PAYG state pension
The State Earnings Related Pension Scheme (SERPS), introduced in 1978, was designed to provide a pension related to the level of earnings during a working life. The State Second Pension (S2P) replaced SERPS in 2002/3. S2P focuses resources at the lower paid and some individuals who cannot work due to disability or caring responsibilities. It provides a minimum level of benefit for years of low earnings, caring or disability. For higher earners the earnings-related benefit will continue. The UK system is unusual in that there is the option to contract-out of S2P into an occupational or personal pension.

Means-tested flat-rate PAYG state pension
The Minimum Income Guarantee (MIG) is a means-tested flat-rate pension, payable from general taxation. Those aged over 60 can claim, dependent on their income and assets. The MIG is set at a higher level than the full rate of BSP and is increased in line with average earnings.

MIG is to be superseded by the Pension Credit (PC) in October 2003. It comprises the Guarantee Credit (GC), the same as the MIG (but payable from 65 coincident with equalisation of SPA), and the Savings Credit (SC) (payable from age 65). SC rewards those with modest pension provision, by paying 60p per £1 of weekly income for any income between the full BSP and GC. SC gradually reduces for total weekly income above the GC.

Non pension age-related cash benefits and services
These include a Christmas bonus (£10), a Winter Fuel Payment (£200 a year per household, with an additional £100 for those households with a pensioner aged 80 or over), free NHS prescriptions, eye tests for those over 60, free TV licences for those over 75 and concessions for local public transport.

[100] All details and figures, unless otherwise stated, are derived from *The Pensions Primer*, PPI (2003)
[101] Department for Work and Pensions (2002 GP) *Simplicity, Security and Choice: Working and saving for retirement* p. 21

Non pension age-related means-tested cash benefits and services
This includes housing and council tax benefits, paid on a means-tested basis.

Voluntary occupational tax-incentivised pension
Occupational pensions are financed through employer contributions, and in many cases employee contributions are also required. Most large schemes are DB schemes, though the number of DC schemes is growing.

Voluntary private tax-incentivised pension
Personal pensions have been available to some since 1988, and to all since 2001. Contributions towards a personal pension are invested and the accumulated fund is used to provide an annuity that must be purchased by age 75. Contributions are tax-free; funds accumulated are partially exempt from tax. The proceeds from an annuity are taxable as earned income but up to 25% can be taken as a tax-free lump sum. Stakeholder pensions were introduced in 2001. These are a type of flexible private pension, limited to a maximum fund management charge of 1% per annum.

Minimum pension level[102]
£5,309 for a single pensioner per year from the MIG (2003) (to be replaced by the Guarantee Credit in October 2003)

Total income of people aged 65+ as a percentage of income of people aged 0-64[103]
78% (2002)

Actual average state pension income as a percentage of National Average Earnings (NAE) for a single pensioner[104]
27% (2001/2)

Pension coverage
91% of all men receiving a state pension receive a full BSP (2002)[105]
50% of all women receiving a state pension receive a full BSP (2002)
43% of the pensioner households are expected to qualify for Pension Credit[106]

State pensions spend as a percentage of GDP[107]
5.1% (2000/2)
4.8% (2051/2)

At-risk-of-poverty rate (less than 60% of median income)[108]
21% of people aged 65+ (1999)
19% of people aged 0-64 (1999)

[102] DWP (GP 2002)
[103] European Commission (EC) (2003) *Joint report by the Commission and the Council on Adequate and Sustainable Pensions* p. 175
www.europa.eu.int/comm/employment_social/news/2002/dec/joint_pensions_report_en.pdf
[104] PPI calculation using ONS (2002) *New Earnings Survey* and DWP (2003) *Pensioners' Income Series 2001/2*
[105] PQ Derek Wyatt MP 7 July 2003, House of Commons Hansard Col 604 W
[106] DWP estimates
[107] DWP (GP 2002)
[108] DWP (GP 2002)

Summary of the US state pension system

The US pension system depends on state and private provision. A means-tested benefit administered separately from social security is available for those who have insufficient income or resources.

Contributory earnings-related PAYG state pension
The state pension part of the US social security program - Old Age, Survivors and Disability Insurance (OASDI) operates on a pay-as-you-go basis. The program is funded by payroll taxes, taxes on self-employment income, income from the taxation of benefits and interest. Eligibility for Old Age Insurance (OAI) requires 40 quarters of work in covered employment. Benefit paid is based on annual taxable earnings averaged over most of a worker's adult years.

OAI is payable at Normal Retirement Age (NRA) which is rising from age 65 to age 67 by 2027. OAI is available earlier or later with a corresponding deduction or increment (the increment is 6.5% per year from NRA**).** For those up to age 69 the amount receivable is reduced if earnings exceed a specific limit.

OAI is automatically adjusted in line with price inflation rather than according to wages so the income of pensioners declines relative to that of workers during the time that the pension is received. OAI is received by 95% of households aged 65 and over and for 16% it is the sole income.

Means-tested flat-rate PAYG state pensions are payable to those aged over 65 under a separate program: Supplementary Security Income (SSI), which is also available to the blind and disabled. This is a federal income funded from general tax revenues that pays monthly benefits to those with limited income or resources. The maximum benefit payable is $6,372 (£3,823)[109] per year to an individual living in their own home and provided 'countable' resources[110] do not exceed $2,000 (£1,200). Some states supplement the federal benefit.

Those aged 65 and over currently receive roughly half their non-earned income from state provision, one quarter from employer provided pensions and one quarter from private saving. Not surprisingly OAI and SSI account for virtually all the income at the low-end of the income scale and income from private sources for the majority of income at the high end of the income scale.

Cash benefits and services are available to those over age 65 through Medicare (PAYG providing for medical needs of those over age 65), Medicaid (social assistance programme providing basic medical services to the poor - 30% is paid to those 65+) and other means-tested benefits such as food stamps and specific benefits.

[109] US $1 = GB £0.60 (30 May 2003)
[110] 'Countable' resources exclude home, car, household goods, personal and life insurance

Voluntary occupational/private tax incentivised savings. In 2000, 48% of the civilian work force participated in employer-provided supplementary pensions. These and individual savings benefits are exempt from employment taxes (Medicare and social security) but not from federal tax[111].

Minimum pension level
Means-tested pension (SSI) pays a maximum $6,624 (£3,974) for a single pensioner per year (2001)[112]
The average annual payment from OAI to a pensioner is $10,740 (£6,444) (2001)[113]

Median total income of people aged 65+ as a percentage of income of people aged 15-64[114]
65%

Average state pension income as a percentage of previous earnings[115]
41% (2002)

Pension coverage
95% of pensioners receive some earnings-related pension (OADSI) (2001)[116]
5.7% of pensioners receive some means-tested pension (SSI) (2001)[117]

State pensions spend as a percentage of GDP[118]
4.4% (Earnings-related state pension) (2002)
6.3% (Earnings-related state pension) (2050)

[111] www.irs.gov
[112] www.ssa.gov
[113] Social Security Bureau, 2001, p. 22
[114] US Census bureau www.census.gov
[115] Alicia H Munnell, Centre for Retirement Research (Feb 2003) *The Declining Role of Social Security*
[116] SSB, 2001, p. 9
[117] US Census bureau- July 2001 population over 65 is 30 million, 2 million receiving SSI (SSB)
[118] www.socialsecurity.gov

UK state pension reform models

This section summarises state pension reform models put forward by a number of organisations.

Despite the diversity of organisations there is a high degree of consensus on reforming the state pension system. All address its complexity and the current dominant role of means-tested pensions. Most suggest a more generous, simplified, contributory-based, flat-rate state pension, with some element of means-tested support acting as a safety-net.

Table 2: Summary of UK state pension components after proposed reforms

Models	**Current UK system**	**ABI**	**Help the Aged**	**IPPR**	**Mercer**	**NAPF**	**PRG**	**TUC**
Universal flat-rate PAYG pension						*		
Universal flat-rate funded pension								
Affluence-tested flat-rate PAYG pension								
Means-tested flat rate PAYG pension	*	*	*	*	*	*	*	*
Contributory flat-rate PAYG pension	*	*	*	*	*		*	*
Contributory flat-rate funded pension							*	
Contributory earnings-related PAYG pension	*							*
Contributory earnings-related funded pension								

Beyond this broad consensus on state pension coverage and levels, differences of detail remain, for example, raising the state pension age (SPA), increasing National Insurance Contribution (NIC) rates, the role of private provision and the nature of transition from the old to the new system.

Association of British Insurers

Adequacy, affordability and incentives: a better future for state pensions (2003) [119]

Objective

Containment of public expenditure, with expenditure no greater than under the Government's current plans; an adequate minimum income for all pensioners, above the level of the Minimum Income Guarantee (MIG), and a sound basis on which all pensioners can plan their retirement income; the protection of incentives to save, and clarification of the message that those who can save, should save.

State pension characteristics:

- Leave the Basic State Pension (BSP) and Guarantee Credit (GC)[120] unchanged.

- Leave State Pension Age (SPA) unchanged.

- Phase out the Savings Credit (SC). The SC would be payable to those retiring up to twenty years from the introduction of the State Second Pension (S2P) going flat-rate[121]. Once phased out, all savings (earnings or private pension) beyond the GC would be kept in full.

- The implementation of a more generous flat-rate S2P, continuing with earnings-related contracted-out rebates. The low earnings threshold for the new S2P would be increased from £10,800 to £15,000 (2002/3) and made flat-rate at this level.

- The objective of the combined BSP and new S2P is to provide an adequate pension above the GC for low earners while providing a clear incentive, through rebates, for modest and higher earners to contract-out of S2P. When introduced, the new rate for S2P would apply to all those with at least twenty years before reaching SPA.

- The self-employed (under the age of 45) would be brought into the new flat-rate S2P system, under much the same terms as current employees.

State pension levels

- The GC would remain linked to earnings. Those with incomplete records, and the very poorest could expect to receive £102.10 per week (2003/4).

[119] www.abi.org.uk
[120] From October 2003 the Guarantee Credit, a component of the Pension Credit, will replace the Minimum Income Guarantee. The other component of Pension Credit, Savings Credit (SC), will be introduced in October 2003.
[121] The government has not made any firm commitment that S2P will become a flat-rate benefit, although it is expected to do so.

- The combination of the BSP and the new S2P (assuming a minimum NI record of 40 years for someone earning less than £15,000) would be worth around £110 per week (2003/4).

- The new contributory-based state pensions (BSP and S2P) would (assuming close to a full - 40 years - working/caring life) guarantee an income above the MIG level. Those working beyond 40 years (maximum 49 years) would have a higher level of state pension income.

- Couples where both have a full working life will benefit from the new more generous contributory pension. Their joint income, around £200 per week (2003/4), will be considerably higher than the current couple's rate of GC, £155.80 per week.

Cost
- The new S2P would cost around 30% more by 2050.

- Some of the additional expenditure for S2P would be offset by greater numbers contracting-out. This could add 0.2-0.3% of GDP to contracted-out rebate expenditure.

- PC expenditure would fall with the phasing out of the SC. The retained GC is assumed to cost the same proportion of GDP as now.

- Total state expenditure to be maintained at current levels and in line with projections.

Help the Aged

A future we can trust – Pensions or pin money? (2002) [122]

Objective

The state pension should match or better the basic social security arrangements in order to provide everyone – pensioners today or in the future – with a more-or-less predictable, and easily accessed, bottom line without the need to claim for a basic income.

State pension characteristics

- The maintenance of the Basic State Pension (BSP) at a higher level.

- The new increased state pension would lift pensioners away from means-tested benefits, which would remain but would become a residual benefit.

- The state pension should be an individual entitlement, and not paid according to a person's marital status. However, initially, the new pension would have to accommodate the currently different rates between married couples and single persons, perhaps by the new state pension being paid at a 75% rate to each person in a shared household.

State pension levels

- The BSP should be immediately raised at least on a par with the current Minimum Income Guarantee (MIG) level, a value of roughly 22% of National Average Earnings (NAE), but preferably to around 25% of NAE.

Non-state characteristics

- The simplification of second-tier pensions which, through minimum levels of compulsion for employers and employees[123], should aim to provide for an average working life around 35% of NAE. This, together with the more generous BSP, would provide a target pension income of 60% of NAE.

- The establishment of a norm where employer contributions are paid on behalf of both permanent and contracted employees.

[122]www.helptheaged.org.uk
[123] Decided by an independent pensions authority

Other issues

- The creation of an independent pensions authority, which includes all stakeholders, which acts as the centre point of the *triangular relationship between state, employers and individuals*. It would have the role, amongst other things, of researching the appropriate level and costing (level of National Insurance (NI) rates) of the BSP, simplifying second tier pensions and fixing compulsory NI rates for both employers and employees. Like the Bank of England's Monetary Policy Committee it would operate under policy guidelines set by government, and would report annually to Parliament.

Institute for Public Policy Research (IPPR)

A new contract for retirement (2002) [124]

Objective

- *Ensuring that all receive an income in retirement that is at least adequate to lift them clear of the poverty line.*

- *Constructing a system that is clear enough for people to understand its main features so they can plan with some confidence for their retirement needs.*

- *Adequately rewarding and incentivising people to save for themselves.*

- *Not setting up future costs that are unaffordable in the sense that they imply a sharp and ongoing rise in spending as a proportion of GDP.*

State pension characteristics

- The Basic State Pension (BSP) would be retained at a rate higher than the current income-tested Guarantee Credit (GC)[125]. GC would become a residual benefit for those without a full BSP.

- Abolition of the Savings Credit (SC). It would not be introduced at all in October 2003, or introduced as an interim measure to be phased out by 2010/1.

- State Second Pension (S2P) would be phased out, as would contracting-out, perhaps from 2007. With the higher level of BSP, the S2P is regarded as redundant and its removal will allow significant simplification of the pensions system.

- The state pension age (SPA) would be increased to age 67 by 2030, the decade after the SPA for women has increased from 60 to 65.

[124] www.ippr.org.uk

[125] From October 2003 the Guarantee Credit, a component of the Pension Credit, will replace the Minimum Income Guarantee. The other component of Pension Credit, Savings Credit (SC), will be introduced in October 2003.

State pension levels

- BSP would be raised to the level of the GC (£102.10 for a single pensioner in 2003/4) between 2002/3 and 2010/1 and then indexed in line with earnings.

- IPPR calculates that this provides a BSP that by 2007/8 is higher than the combined current estimated level of BSP and S2P.

Cost

- IPPR expects that their package of reforms would be cost neutral. It would cost no more than the current government's (2002) proposals, in both in the short- and long-term. The raising of the BSP to GC levels and its indexing to earnings would be paid for through the abolition of the SC, the phasing out of S2P, the end of contracted-out rebates and the increasing of SPA to 67.

Mercer Human Resource Consulting
Proposals for UK pension reform (2002) [126]

Objective
To *provide a platform from which nearly everyone will be encouraged to make appropriate savings, get best value from these and have their basic needs secured*

State pension characteristics
- Reformulate the State Second Pension (S2P) so that when combined with the Basic State Pension (BSP), it provides a flat-rate pension above the means-tested Guarantee Credit (GC). Eventually these combined benefits will form the Integrated State Pension (ISP).

- Minimum Income Guarantee (MIG)/Pension Credit (PC) to be withdrawn for those receiving the ISP (those aged 45 and under age 65).

- Support for retirement being gradual, where people have the freedom to continue working part-time while drawing out part of their pension provision.

State pension levels
- The combination of a reformed S2P and BSP (eventually to merge into the ISP) to provide at age 65 (for those aged 45 and under) a flat-rate pension of £140 per week in 2002/3 (30% of National Average Earnings), higher than the GC.

- In the long-term the ISP will be linked to earnings. For transitional purposes the ISP can be linked to the minimum of earnings and prices as long as the full link to earnings is the long-term goal.

Non-state pension characteristics
- The state should not be obliged to provide an earnings-related pension. Earnings-related provision should be voluntary, with tax incentives retained, though limited to restrict the power the state has to control how the savings can be used. Employers should not be compelled to offer pensions, and should have the freedom to offer either a DB or DC scheme.

- The abolition of contracting-out, with currently contracted-out employees being brought back into the S2P.

[126] www.mercerhr.com

Costs

It is estimated the proposed system will increase state costs in the future from 6.25% of GDP in 2003 to 10.25% of GDP in 2040. This extra cost could be met by either raising National Insurance contributions by around 10% or by raising the state pension age.

National Association of Pension Funds (NAPF)

Pensions – Plain and Simple (2002) [127]

Objective

to simplify and clarify the retirement 'deal from the state' by merging the BSP and S2P into a new pension that would be universally available to UK citizens who met a residency test

State pension characteristics

- The Citizen's Pension (CP) is a universal, residency-based, state pension that would provide an income from 2010/1 onwards.

- For transitional purposes the Guarantee Credit (GC) would increase in line with earnings up to 2010. Basic State Pension (BSP) would be increased to the earnings-related GC level and renamed CP from 2010 onwards.

- The State Pension Age (SPA) would be raised to 70 from 2020 to 2030.

- The CP would replace both the BSP and the flat-rate State Second Pension (S2P), so there would be no more contracting-out.

- The CP would be introduced on or after the date when the S2P may become flat-rate[128] (2006/7). S2P will then be phased out and abolished for all accruals from 2010/11 onwards.

State pension levels

- The level of Citizen's Pension would be approximately £100 per week (2002/3). It would be retained, through its earnings link, at around 22% of NAE.

Cost

- The CP would broadly stay in line with the current projections of expenditure on state pensions (including Pension Credit) as a percentage of GDP.

- The CP could be financed by National Insurance contribution rates at a level broadly similar to expectations under current policy.

Other issues

- Tax-incentivised occupational and personal pensions would remain.

[127] www.napf.co.uk
[128] The government has not made any firm commitment that S2P will become a flat-rate benefit, although it is expected to do so.

National Consumer Council

Response to the DWP Green Paper (2003)[129]

Objective

We believe state pension provision should have an increased, not a reduced, role in a revised pensions framework, if the disadvantage suffered pre-retirement by consumers on low incomes is not to be increased after retirement

State pension characteristics

- The abolition of contracting-out from S2P should be considered.
- The role of the Second State Pension (S2P) should be clarified, in particular whether it should remain an earnings-related pension or become flat-rate at some point in the future.
- The Pension Credit (PC) should reward all income above an individual's BSP entitlement, regardless of whether an individual has the full rate of BSP. Currently any savings that provide a total income below the full rate of the BSP are disregarded.

State pension levels

- The extension of means-testing should be reversed. The following two options should be considered:
    - BSP to rise in line with earnings and the Guarantee Credit to rise in line with prices. This would be a reversal of the uprating mechanisms that currently exist.
    - Universal increases in the Basic State Pension (BSP) for older pensioners.

Other issues

- More progressive and simple incentives for consumers to save in pensions.
- All consumers to have access to independent and affordable financial advice.

[129] www.consumercouncils.org.uk

Pensions Reform Group

Universal Protected Pension – Modernising Pensions for the Millennium (2001)
Universal Protected Pension – The Follow-Up Report (2002) [130]

Objective
…so that everybody ending a working life – or those who have qualified through, for example, caring for others – is guaranteed an income above the poverty line throughout retirement.

State pension characteristics
The Universal Protected Pension (UPP) is designed to maintain and build upon the current Basic State Pension (BSP) with a new, funded scheme.

- UPP comprises two compulsory elements. Firstly, a funded, flat-rate pension financed by earnings-related contributions. Secondly, a PAYG flat-rate pension financed by earnings-related contributions. The end result would be a higher BSP which would rise with earnings.

- UPP would be earned through each year's contributions giving entitlement to a specified percentage of National Average Earnings (NAE). Full entitlement to the UPP will require 40 years of contributions.

- UPP would be compulsory for all workers (including the self-employed). Carers of children under 5 and unpaid carers for the sick and disabled would be financed by other members.

- The UPP is estimated to reduce the number reliant on means-tested benefits (Minimum Income Guarantee). However means-testing would remain for those with gaps in their UPP contributory record, and who would fall below the poverty level, e.g. newly arrived immigrants.

State pension levels
- UPP would provide a pension (assuming full entitlement) of 25-30% of NAE throughout retirement when the scheme matures. UPP would rise in line with earnings. This will ensure an income above the poverty line for all those with sufficient contributions throughout their life.

[130] www.universalprotectedpension.org

Cost

- The UPP would lift most above the means-tested level. The money saved from this will offset some of the costs of the UPP.

- All workers would *pay a similar proportion of their income for a flat-rate pension*, as with the BSP. It is estimated that the UPP would require each member (employee) to pay an extra 2% on employee National Insurance (NI) contributions as well as the equivalent of their contracted-out rebates. No additional taxation will be needed to finance UPP.

- Costs would also be saved by making the pension age 70 for all new entrants to the scheme from age 25.

Other Issues

- UPP would be managed separate from government, through a governance model 'democratic trusteeship'. Trustees would have the power to alter contributions rates and the level of pension, within the 25 – 30% NAE target.

- The UPP would still provide scope for occupational and personal pensions. Contracted-out rebates would no longer be available to private pensions.

Trades Union Congress
Prospects for Pension (2002) [131]

Objective
The fundamental principle on which the TUC's pension policy rests is that all workers must have a secure income in retirement that enables them to maintain a decent standard of living allowing for full participation in society. The state pension is the foundation stone of the system. To guarantee that all workers have a decent minimum retirement income, the link between increases in earnings and the basic state pension should be restored

State pension characteristics
- Retain the current state system but with the Basic State Pension (BSP) indexed to earnings.

Non-state pension characteristics
- Employers to be compelled to contribute to their employees' retirement savings - a compulsory employer contribution, set at 10 per cent. This would be done gradually with the phasing in of compulsory contributions over a 'reasonable' period of time from 4 to 10 per cent. This statutory obligation need not apply for the lowest paid employees who would be better off relying on Pension Credit and State Second Pension (S2P).

- It should be made a condition of employment that employees must become members of their employer's occupational pension scheme.

[131] All details from TUC (2002) *Prospects for Pensions* and TUC (2003) *Response to the Pensions Green Paper*. www.tuc.org.uk

Acknowledgements and Contact Details

This document provides a description of the various systems as input to evaluation and interpretation of possible reform models for the UK state pension system.

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