

Introduction

The Pre-Budget Report (PBR) on 9 October 2007 contained a number of measures that will directly affect pensions and pensioners. This Briefing Note highlights these measures, and analyses some of the potential impacts.

This Briefing Note covers:

- Changes to State Second Pension (S2P)
- Increases to Pension Credit
- The annuities Open Market Option review; and
- A review of long-term care charging policy

Changes to S2P

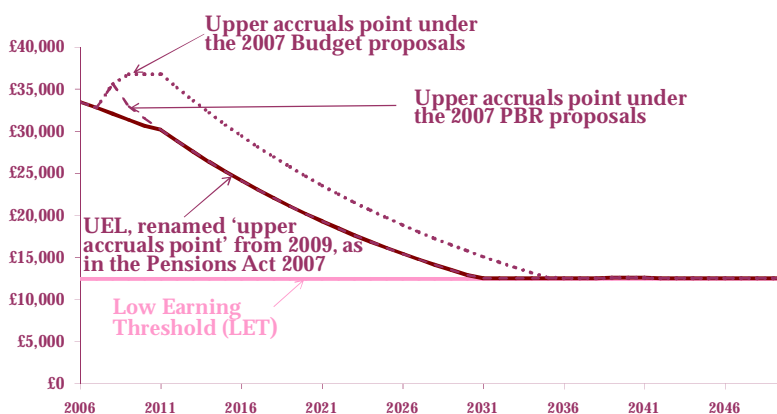
In the PBR speech the Chancellor announced that *We will bring forward the start date for flat rating the State Second Pension to 2009.*¹

While this may sound like a significant policy change, widely reported to save the Exchequer £2 billion², it in fact refers to a technical change introduced to restore the flat-rating of S2P back towards the path originally envisaged in the Pensions Act 2007.

Budget 2007 announced the alignment of the Upper Earnings Limit (UEL) for National Insurance Contributions (NICs) with the threshold for paying higher rate tax from 2009. Previous PPI analysis³ highlighted that this would mean that higher paid individuals would become entitled to higher amounts of S2P, and that S2P would potentially still not be flat rate by 2030

Chart 1: The PBR change to S2P restores the original policy intention

Projected S2P thresholds, in 2006/7 earnings



(Chart 1).

The announcement in the PBR reverses this change, and brings the 'flat rate path' back in to line with the Pensions Act intention. The 'Upper Accruals point' (the new name for the top of the earnings band for S2P contributions) will now be different to the top of the band for paying NICs from 2009. In 2009 it will be set at the level it would have reached in 2012 before the changes in Budget 2007.

So from 2012, S2P will be payable on the same earnings as originally envisaged in the Pensions Act 2007, becoming flat rate around 2030 (Chart 1).

Compared to the position before Budget 2007, people earning above around £33,000 will receive higher S2P accruals be-

tween 2009 and 2012. Compared to the situation after Budget 2007, people earning above the new Upper Accruals point will receive less S2P.

Estimates in the PBR suggest that this measure will save £440 million in 2010⁴, and adding the annual figures between 2009 and 2014 gives a cost of around the £2bn figure quoted in the press. This is not less paid out in S2P, but less paid out in rebates to the pension schemes of those who have contracted-out of S2P.

More than two thirds of this would have been paid to Defined Benefit (DB) occupational pension schemes⁵. This would not have increased the pension income payable by the scheme⁶, but would have meant that employers and employees could have made lower contributions to the DB pension scheme.

Increases to Pension Credit
Pension Credit (PC) consists of Guarantee Credit (GC) and Savings Credit (SC). The Chancellor announced that the level of the GC will increase by £5 a week for a single person (from £119.05 to £124.05), and by £7.65 a week for a couple (from £181.70 to £189.35). This is an increase of 4.2%, in line with the announcement made in Budget 2007.

The PBR increase is higher than would have been awarded if GC had been updated in line with average earnings, the increase the Government has committed to⁸. In July 2007 average earnings growth was 3.6%⁹.

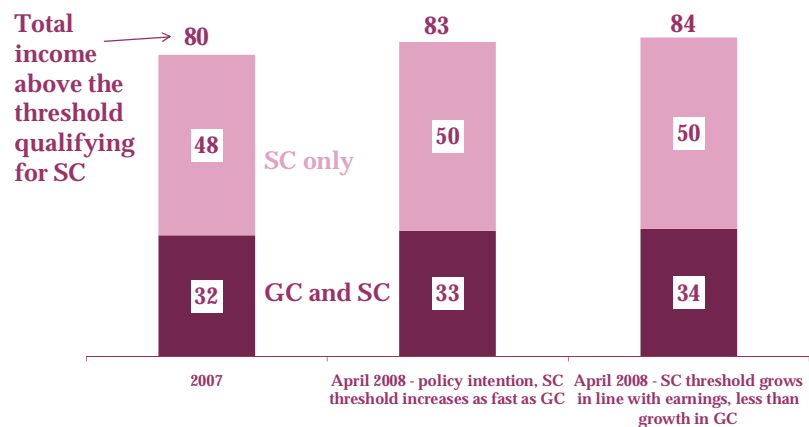
The increase in GC is also above the increase in the Basic State Pension (BSP), which will be increased next April by 3.9% in line with the September RPI¹⁰.

The Government has committed to increasing the threshold above which SC is paid (currently the BSP level) in line with earnings from April 2008¹¹. This is to stop the band of income that SC is payable on growing quickly, which would increase SC eligibility.

However, if the Savings Credit threshold is increased by less than RPI, which could be the case as average earnings growth is currently below the RPI, SC would become payable on a larger band of income (Chart 2), and on part of the BSP.

Chart 2: SC entitlement could increase if RPI grows faster than earnings

Income above the SC threshold potentially eligible for Savings Credit, £ per week



It is possible that the government will increase the SC threshold by more than average earnings next April, to prevent eligibility to SC growing so quickly.

The annuities Open Market Option review

In PBR 2006 the Treasury announced a review of the workings of the open market for annuities¹². The outcome was published in PBR 2007, with a series of measures to be undertaken by DWP, HMRC and the FSA, alongside a new web-based advisory tool to be set up by The Pensions Advisory Service (TPAS). These include better use of management information, clarification of legislation and encouragement of best practice.

Long-term Care review

It was also announced in the PBR that there will be a Green Paper in

2008 proposing reform of the system of charging for long-term care in England¹³. As the ability to meet the private costs of long-term care depend on the availability of pension income, pension policy and long-term care policy are closely linked.

The PPI is part of the Modelling Ageing Populations to 2030 (MAP2030) project¹⁴, which will produce consistent projections of pensions and long-term care. This will provide useful evidence for the consultation process.

¹ www.hm-treasury.gov.uk/pbr_csr/pbr_csr07_speech.cfm

² See for example politics.guardian.co.uk/economics/story/0,,2187573,00.html

³ PPI (2007) Briefing Note number 37 *Was Budget 2007 good for pensioners?*

⁴ HMT (2007) *Meeting the aspirations of the British people* CM7227 page 11

⁵ PPI estimates

⁶ Depending on whether the Reference Scheme Test for contracting out would have required an increase in pension scheme benefits to reflect the higher value of S2P

^{7,8} www.hm-treasury.gov.uk/budget/budget_07/bud_bud07_speech.cfm

⁹ www.statistics.gov.uk/cci/nugget.asp?id=10. The July figure is usually used for uprating PC.

¹⁰ www.dwp.gov.uk/mediacentre/pressreleases/2007/oct/drc043-181007.asp.

¹¹ DWP (2006) *Security in retirement: towards a new pensions system* p122

¹² HMT (2006) *The annuities market*

¹³ HMT (2007) p100

¹⁴ <http://www.lse.ac.uk/collections/MAP2030/>

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