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PPI Written Evidence to the Scottish Parliament Finance Committee: The potential impact of Scottish Independence on State Pensions in Scotland

Summary

On 18 September 2014 Scotland will hold a referendum as to whether Scotland should become independent from the rest of the UK. If there is a "Yes" vote and Scotland does become independent, there will be far reaching consequences. This Briefing examines the implications for Government spending on State Pensions, and the implications for pensioners in Scotland.

The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision. The PPI does not make policy recommendations or lobby for any particular policy.

The Pensions Act 2014 implements a new single-tier state pension from April 2016 that will replace the current Basic State Pension (BSP) and the State Second Pension (S2P). It also makes proposals for future increases to the State Pension Age.

There are significant differences in estimates of life expectancy within the UK. While for England, 2032 is the trigger year in which the SPA would need to increase to 68 to avoid more than 33% of adult life being spent in retirement, the first year in which this would happen in Scotland is 2045.

There are also variations in life expectancies within each country**.** While the average life expectancy in Scotland may be lower than in other parts of the UK, there are parts of Scotland with better life expectancies than parts of the rest of the UK.

Despite lower life expectancy levels overall for Scotland, the population is ageing more quickly in Scotland than the rest of the UK. The old age dependency ratio is expected to increase more quickly in Scotland than in the UK as a whole.

A higher old age dependency ratio can indicate that a certain level of expenditure is less affordable, as there is potentially a smaller National Insurance and income tax base available to fund the expenditure.

An independent Scotland, keeping the same State Pension Age and state pension policy as the rest of the UK, may therefore find it more difficult than the UK as a whole to afford state pension expenditure.

This does not mean that it would be unaffordable. Rather the Scottish Government would need to either raise higher revenues (for example through taxation), reduce spending in other areas (for example where demographic pressures are less), or have higher Government debt levels.

State pension spending in the UK is projected to increase in the coming decades, allowing for the reforms in the Pensions Act 2014, which introduces a new single-tier state pension for individuals reaching SPA from April 2016 onwards.

Annual pensioner benefit expenditure per head of the working age population is currently higher in Scotland than it is in the UK, and is expected to increase further in the future. In 2014, pension benefit expenditure per working age individual is estimated to be £2,260 across the UK population, but £2,290 for Scotland (2014 earnings terms). The gap is set to increase between Scotland and the rest of the UK up until around 2045, after which the gap will reduce as differences between the dependency ratios narrows. In 2055, pension benefit expenditure per working age individual is estimated to be £3,230 across the UK population, and £3,330 for Scotland (2014 earnings terms).

The current Scottish Government:

- has stated that in an independent Scotland they would reserve judgement as to when the SPA in Scotland would increase from 66 to 67.
- proposed that it would retain the single-tier state pension as introduced by the Pensions Act 2014, set at a level of at least £160 per year (matching the figure for the rest of the UK if it is higher than £160 per week),
- committed to increase the level of the pension each year in line with the triple lock (that is, the higher of average earnings growth, CPI inflation or 2.5%).
- would allow those expecting a pension based on their spouses contributions to still do so for people reaching state pension age in the 15 years after implementation.
- would retain the Savings Credit element of Pension Credit.

Each of these policy proposals would impact on the level of expenditure on pensioner benefits in Scotland if they were to be introduced.

The overall impact of the Scottish Government policy proposals on annual pensioner benefit expenditure would be to further increase expenditure per working age individual in Scotland. By 2055, compared to pension benefit expenditure per working age individual estimated at £3,230 across the UK population, pension benefit expenditure per working age individual in Scotland is estimated to be £3,400 allowing for the Scottish Government policy proposals (2014 earnings terms).

After allowing for expected changes in earnings, and focussing on the difference between Scotland under the Scottish Government proposals and the UK as a whole, the difference peaks at £330 per individual of working age in 2032, where Scotland would still have a lower SPA than the rest of the UK. £180 of this is due to the policy changes, with the remainder due to underlying demographic differences.

Although the proposals put forward by the Scottish Government would increase expenditure on pensioner benefits, if implemented they could also lead to higher state pension incomes for pensioners in Scotland compared to the rest of the UK, depending on the final level of the single-tier pension on introduction in 2016 and the rate at which it is increased.

A median earning man aged 44 in 2014 and reaching State Pension Age (67) in 2037, who is automatically enrolled into a workplace pension at the minimum contribution level from October 2012, could have income from state and private pensions over £1 a week higher under the Scottish Government proposals than in the current UK system (in 2014 earnings terms).

The difference in outcomes could be greater for lower income individuals. For example, a low earning woman with career breaks, aged 44 in 2014 and reaching SPA at 67 in 2037, who is automatically enrolled in a workplace pension at the minimum contribution level when she is in work, could have an income from state and private pensions £14 a week higher under the Scottish Government proposals than in the current UK system (in 2014 earnings terms).

The majority of this increase in income is due to the availability of Savings Credit, as this particular individual has a low level of private pension income as a result of having relatively low earnings and spending time caring rather than in paid employment.

However, the relative generosity of Savings Credit means that the median earning man could be entitled to Savings Credit less than 5 years after reaching State Pension Age. This would increase his state and private pension income further under the Scottish Government proposals, compared to in the current UK system.

Although Savings Credit leads to a higher income in retirement, it can also reduce the relative value of remaining automatically enrolled in a workplace pension scheme. If the median earning man opted-out of his workplace pension as a result of being able to claim Savings Credit in retirement, his income from state and private pensions would be significantly lower (although his disposable income when working would be higher). However, he would receive £15 a week (2014 earnings terms) of Savings Credit per week under the Scottish Government proposals.

The old age dependency ratio, and therefore estimates of pensioner benefit expenditure per individual of working age, is sensitive to a number of assumptions, such as life expectancy, birth rates and in particular migration assumptions. In the ONS high migration population scenario the assumed increase in the number of people in working age in Scotland means that from 2040 onwards expenditure per individual of working age is lower in Scotland, even with the Scottish Government policy proposals, than in the UK under current UK Government policy.

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Introduction

On 18 September 2014 Scotland will hold a referendum as to whether Scotland should become independent from the rest of the UK. If there is a "Yes" vote and Scotland does become independent, there will be far reaching consequences. This Briefing examines the implications for Government spending on State Pensions, and the implications for pensioners in Scotland.

The PPI published a briefing note on 19 February 2014 which covered variations in life expectancy between the different constituent countries of the UK, and the implications of the planned UK-wide State Pension Age increases as set out in the Pensions Act 2014. This highlighted the differences between life expectancy in Scotland and the rest of the UK. The key findings are described at the start of this Briefing.

This Briefing builds on the earlier analysis to consider how much the UK Government would spend on State Pensions in Scotland under current plans, and how this would compare to the spending by an independent Scottish Government if they were to implement the plans set out by the current Scottish Government in September 2013, which highlighted a number of changes that would make State Pensions more generous in Scotland than in the rest of the UK. The note will also consider the impact of the changes on the incomes of individual Scottish pensioners, relative to their counterparts in the rest of the UK. The note will go on to consider (at a high level) potential wider implications on other areas of Government spending, taxation and the economy.

About the PPI

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The Pensions Act 2014 – UK SPA implications

The Pensions Act 2014 implements a new single-tier state pension from April 2016 that will replace the current Basic State Pension (BSP) and the State Second Pension (S2P). It also makes proposals for future increases to the State Pension Age.

The SPA for women has been increasing from April 2010 in a series of steps to reach age 65 by November 2018 when it will be equal for both men and women. The SPA for women is increasing to 62 in 2014. Both men and women will then see their SPA increase to 66 by 2020.

Legislation to increase the SPA to age 67 in the mid 2030s and 68 by the mid 2040s for both sexes was enacted in 2007, although this will be superceded by the new provisions in the Pensions Act 2014. This development reflects changes in the life expectancy of the general population. As life expectancy increases, the state pension would be paid to people for an increasing number of years if the SPA remained unchanged.

To account for expected continued changes in life expectancy, the 2014 Act has set out a review process for SPA. The principle informing future changes to the SPA is that on average an individual should spend 'up to a third of their adult life in retirement'. For this purpose adult life is defined as starting at age 20. In the Autumn Statement 2013, the Chancellor illustrated this principle as implying that the SPA would now increase to 68 by the mid 2030s and to 69 by the late 2040s.

Other factors likely to be taken into account include healthy life expectancy, socio-economic, regional variations and economic concerns such as labour market conditions for older workers. The 2014 act specifies that, as part of the review process, both the Government Actuary's Department and an independent committee must submit reports, which must be published before the end of the period of 6 years beginning with the day on which the previous reports were published, with the first reports being published before 7 May 2017.

Chart 1 provides estimates of the year in which a third of adult life would be spent in retirement for the given State Pension Age (SPA). This indicates the trigger year, for each SPA, where future life expectancy would be around a third of total adult lifetime (assumed to start at age 20). For instance, if these estimates are accurate and the principle is applied, we might expect the SPA in the United Kingdom (UK) to rise to 68 in 2033, provided no allowance is made for regional variations or other factors. These figures are based on PPI analysis of ONS cohort life expectancies.

Chart 1

Year in which SPA would increase if the principle as set out in the Pensions Act 2014 were applied

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First year in which 33% of adult life* would be spend in retirement					
New SPA	United Kingdom	England	Scotland	Wales	Northern Ireland
66	2010	2009	2020	2012	2012
67	2021	2019	2033	2023	2024
68	2033	2032	2045	2036	2037
69	2046	2045	2057	2049	2050

* Adult life starts at age 20
Source: PPI analysis of ONS population projections

The indication by the UK Government that SPA might increase to 68 by the mid 2030s and to 69 by the late 2040s is consistent with these estimates. The trigger year in which the SPA would need to increase to 68 to avoid more than a third of adult life being spent in retirement is 2033. The trigger year in which the SPA would need to increase to 69 to avoid more than a third of adult life being spent in retirement is 2046.

These figures mask differences between the sexes; for instance, for women the trigger year in which the SPA would need to increase to 67 to avoid more than a third of adult life being spent in retirement is 2010, while the equivalent year for men would be 2032.

In addition, these figures apply to the UK as a whole, and there are significant differences in estimates of life expectancy within the UK. While for England, 2032 is the trigger year in which the SPA would need to increase to 68 to avoid more than 33% of adult life being spent in retirement, the first year in which this would happen in Scotland is 2045. For Wales and Northern Ireland, the trigger year in which the SPA would need to increase to 68 to avoid more than 33% of adult life being spent in retirement is 2036 and 2037 respectively.

The trigger year in which the SPA would need to increase to 69 to avoid more than 33% of adult life being spent in retirement ranges from 2045 (England) to 2057 (Scotland).

The review process outlined in the Pensions Act 2014 provides for regional differences to be taken into account. However, it is unlikely that there would be different SPAs for different areas of the UK as this may be unpopular and would be difficult to administer. If there continues to be one SPA throughout the UK, individuals in Scotland, Wales and Northern Ireland, who retire at SPA, may experience shorter retirements and may, on average, spend a greater proportion of their retirement in ill health than individuals in England. In addition, there may be significant variation in life expectancy across regions and localities within each country of the UK as well as between the countries. For example, ONS reported that healthy life expectancy was higher in the South of England than in the North of England.

However, regional differences in life expectancy and healthy life expectancy are themselves a significant issue that could be addressed by other policies. For example, organisations such as those that work in the field of public health are responsible for designing strategies to address health inequalities that could also affect life expectancy. Inequalities in life expectancy between different sections of the population could be addressed alongside changes in SPA and are not necessarily a reason not to increase SPA.

If Scotland were to vote for Independence, the Scottish Government would be able to set its own SPA for Scotland. The analysis presented here suggests that even if the new Scottish Government followed the same policy as is currently in place for the UK as a whole, the formula and review process set out in the Pensions Act 2014 would result in the SPA in Scotland increasing more slowly than in the rest of the UK (Chart 1).

There are also variations in life expectancies within each country. Official figures are estimated for period expectation of life (which do not take account of future improvements in mortality) in local areas. Although period life expectancies are not necessarily as good indicators of how long a group of individuals might live compared to cohort projections (which do allow for future improvements in mortality), they are good measures for comparing differences between regions on a consistent basis.[1]

[1] See PPI (2014) *PPI Single Tier Series Paper No. 5 – Changes to the State Pension Age* for a description of the difference between cohort and period life expectancies.

The period life expectancies for men from age 65 during 2010-12 in Scotland range from 14.9 years in Glasgow City, up to 19.4 years in the Orkney Islands. English local government areas also have varying period life expectancies for men from age 65 during 2010-12, with the lowest being 15.8 years in Manchester, up to 20.9 years in Harrow. Similarly Wales has period life expectancies for men from age 65 during 2010-12 ranging from 16.5 years in Blaenau Gwent, up to 19.4 years in Ceredigian. This shows that while the average life expectancy in Scotland may be lower than in other parts of the UK, there are parts of Scotland with better life expectancies than parts of the rest of the UK.[2]

There are also other demographic differences between the population in Scotland and rest of the UK. One demographic measure often used is the old age dependency ratio, which shows the number of people over age 65 as a proportion of people age 16 – SPA[3] . This ratio, in conjunction with estimates of the total costs of spending on state pensions, can be used to help give an indication of the relative affordability of state pension expenditure.

In principle, the lower the old age dependency ratio, the easier it is to afford a certain level of expenditure. This is because there is a relatively larger working age population to fund the expenditure through National Insurance Contributions and taxation.

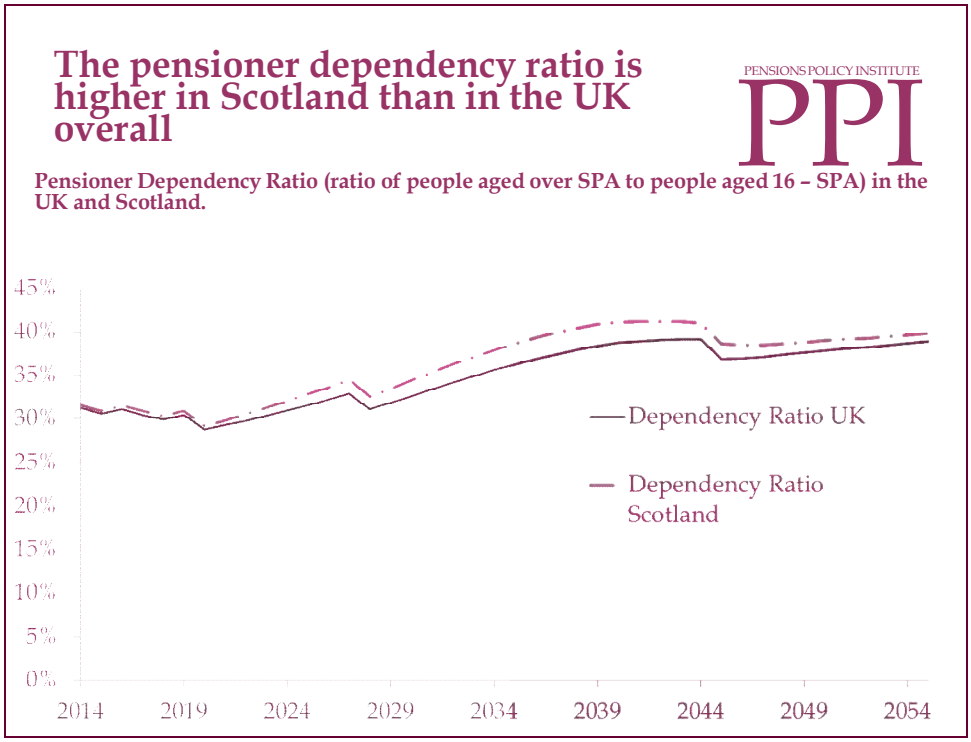
In practice, the old age dependency ratio is only an approximate measure of relative affordability, as it does not consider actual employment or activity rates within the respective age groups. For example, if the number of people working who are older than SPA increases, or economic inactivity rates of people aged below SPA reduce, state pension expenditure would be more affordable even though the old age dependency ratio has not changed. However, as detailed projections of employment and activity rates by age over the next 40 years are not available, the old age dependency ratio is a useful proxy measure.

Despite lower life expectancy levels overall for Scotland, the population is ageing more quickly in Scotland than the rest of the UK. The old age dependency ratio is expected to increase more quickly in Scotland than in the UK as a whole (Chart 2).

[2] Office for National Statistics (2014) *Life expectancy at birth and at age 65 by local areas in the United Kingdom, 2006-08 to 2010-12*

[3] SPA as defined in current UK legislation, before the impact of the reviews included in the Pensions Act 2014

Chart 2[4]



A higher old age dependency ratio can indicate that a certain level of expenditure is less affordable, as there is potentially a smaller National Insurance and income tax base available to fund the expenditure.

An independent Scotland, keeping the same State Pension Age and state pension policy as the rest of the UK, may therefore find it more difficult than the UK as a whole to afford state pension expenditure.

This does not mean that it would be unaffordable. Rather the Scottish Government would need to either raise higher revenues (for example through taxation), reduce spending in other areas (for example where demographic pressures are less), or have higher Government debt levels.

The old age dependency ratio is sensitive to a number of assumptions, such as life expectancy, birth rates and in particular migration assumptions. The population projections used in this analysis are based on the ONS low migration variant population projections, which are the projections used by

[4] Based on ONS low migration variant estimates, as used by the UK Government and the Office for Budget Responsibility. To see the impact of assuming higher migration levels for Scotland see the end of this Briefing.

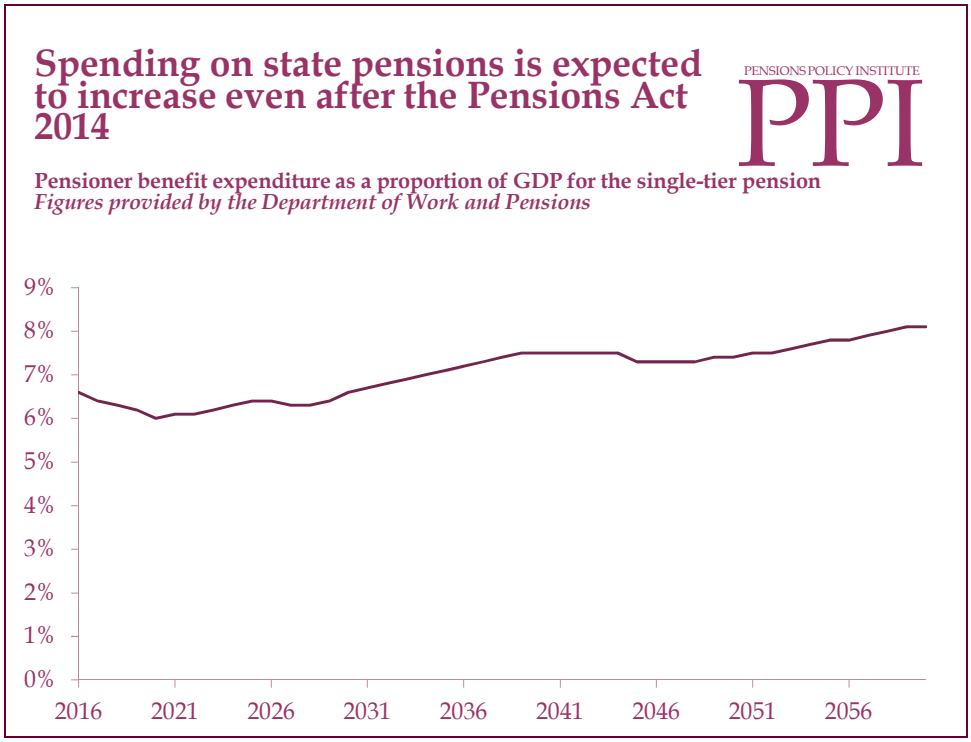
the UK Government and the Office for Budget Responsibility. The Scottish Government may have policies to increase the level of migration to Scotland compared to the rest of the UK. The impact of higher migration levels to Scotland are illustrated at the end of this Briefing.

Expenditure on state pensions

State pension spending in the UK is projected to increase in the coming decades, allowing for the reforms in the Pensions Act 2014, which introduces a new single-tier state pension for individuals reaching SPA from April 2016 onwards.

The final details of the new state pension are still not known. In particular, the initial level of the single-tier pension and how it will be increased in future will not be decided until the next Parliament. However, based on the details used in the Impact Analysis accompanying the 2014 Pensions Act as it went through the UK Parliament, expenditure for the UK as a whole is projected to increase from 6.6% of GDP in 2016 to 8.1% of GDP by 2060.

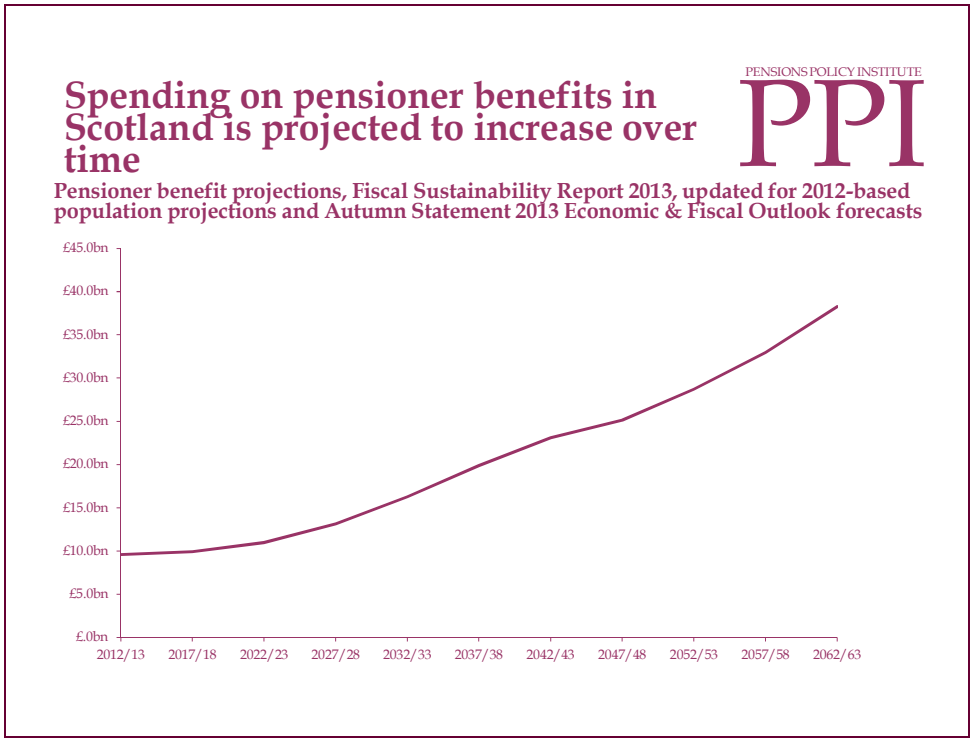
Chart 3[5]



[5] From PPI (2014) *PPI Single Tier Series Paper No. 6 – The long-term cost and spending implications of the single-tier pension*, figures originally provided by the DWP

Recent analysis by the DWP separately identified state pension expenditure for Scotland. The analysis suggested that in 2012/13 just under 9% of UK state pensioner benefit expenditure, £9.6bn, related to Scotland. By 2062 this is expected to increase to £38.3bn in 2012/13 prices (Chart 4). However, as a percentage of total UK pensioner benefit expenditure, Scotland's share is projected to fall to just under 8%.

Chart 4[6]



It can be difficult to interpret estimates that are based in today's price terms – earnings and economic growth over a period of time mean that even if expenditure is increasing in price terms it is not necessarily unaffordable. Given that expenditure is increasing for the UK as a whole, it is the additional expenditure in Scotland that is of most relevance to the debate concerning the cost in pension benefit expenditure terms of Scottish Independence. The following PPI analysis therefore considers expenditure in 2014 earnings terms, so allowing for future expected increases in earnings to give a more meaningful comparison.

It is possible to combine expenditure projections with demographic data, by analysing expenditure per person in the population, or subset of the

[6] DWP long-term benefit expenditure projections including Scotland, March 2014

population. Ideally, to get a good indication of the affordability of expenditure levels, an estimate of the expenditure per worker would be made. However, given the uncertainty about future employment levels in Scotland and the rest of the UK, an estimate of expenditure per member of the working age population can be a useful proxy indicator. This measure has been used by the Department for Work and Pensions and in other analyses of Scottish expenditure.[7]

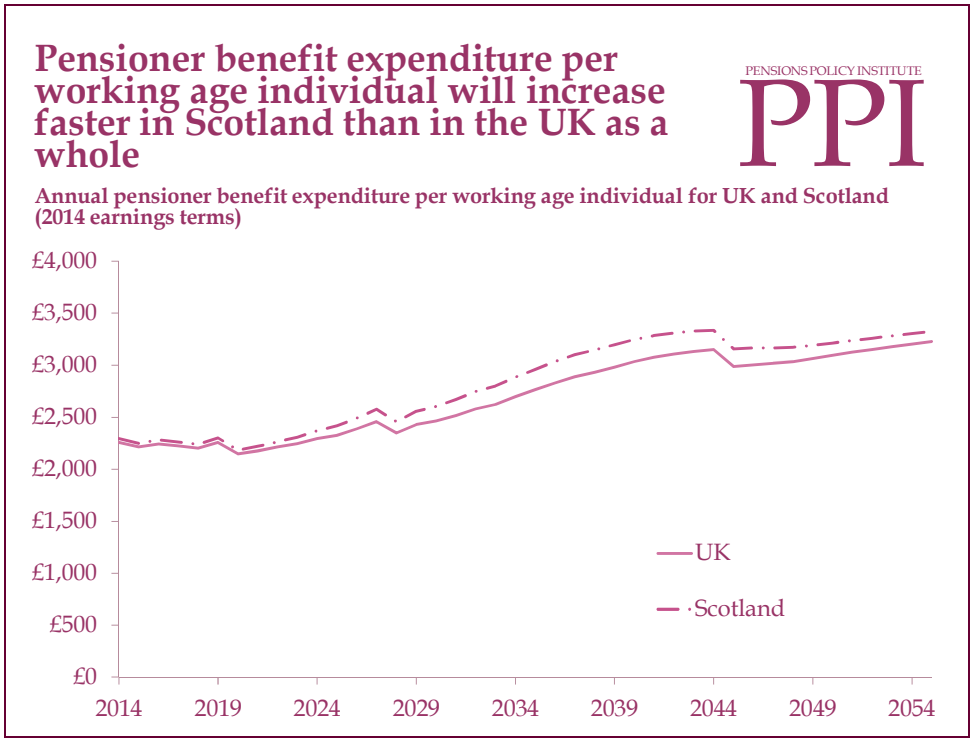
Annual pensioner benefit expenditure per head of the working age population is currently higher in Scotland than it is in the UK, and is expected to increase further in the future (Chart 5).

In 2014, pension benefit expenditure per working age individual is estimated to be £2,260 across the UK population, but £2,290 for Scotland (2014 earnings terms)[8]. The gap is set to increase between Scotland and the rest of the UK up until around 2045, after which the gap will reduce as differences between the dependency ratios narrows. In 2055, pension benefit expenditure per working age individual is estimated to be £3,230 across the UK population, and £3,330 for Scotland (2014 earnings terms).

The initial increase is despite lower total expenditure relative to the rest of the UK, and is as a result of the proportion of the adult population who are of working age falling more quickly in Scotland.

[7] See for example DWP long-term benefit expenditure projections including Scotland, March 2014,
[8] Figures rounded to the nearest £10.

Chart 5[9]



The impact of potential Scotland-specific policy changes

The current Scottish Government has stated that, in light of concerns of Scots already receiving fewer years of state pension on average than pensioners in other parts of the UK due to lower life expectancy, in an independent Scotland they would reserve judgement as to when the SPA in Scotland would increase from 66 to 67. An Independent SPA commission would be set up and tasked to report back within the first 2 years of independence.

[9] PPI estimates based on PPI modelling. The aggregate costs of pensions within an independent Scotland were calculated using the PPI aggregate model which projects current pension expenditure forward taking into account labour market, economic changes and population projections. The aggregate model was adapted to calculate aggregate costs in an independent Scotland using the 2012 Scottish population projections from the ONS for future entitlements. We have not assumed any difference in activity rates between Scotland and the UK as a whole. Projected BSP and AP entitlement in Scotland has been calibrated to actual figures for Scotland in 2012. Average earnings are assumed to increase in line with the July 2013 OBR fiscal sustainability report and both the basic state pension and single-tier pension are assumed to be uprated by the triple-lock. For further information on the assumptions used please contact the PPI.

The current Scottish Government has also proposed that it would retain the single-tier state pension as introduced by the Pensions Act 2014, set at a level of at least £160 per year (matching the figure for the rest of the UK if it is higher than £160 per week), and with a commitment to increase the level of the pension each year in line with the triple lock (that is, the higher of average earnings growth, CPI inflation or 2.5%). Although the impact assessment for the Pensions Act 2014 has shown expenditure if the single-tier pension is triple locked, the legislative requirement is still increases in line with average earnings, which would over time give lower levels of pension. Provision would also be made to allow those expecting a pension based on their spouses contributions to still do so, for people reaching state pension age in the 15 years after implementation.

The current Scottish Government has also said that it would retain the Savings Credit element of Pension Credit. They have also stated that this will be increased with increases in average earnings. The Pensions Act 2014 abolishes Savings Credit for those reaching SPA after April 2016 (with some protection for those retiring in the first 5 years after implementation who would otherwise lose support with housing costs).

Each of these policy proposals would impact on the level of expenditure on pensioner benefits in Scotland if they were to be introduced.

Delayed increase in SPA

If the planned increase in SPA from 66 to 67 by 2026 was not introduced, and instead was introduced at the point at which 33% of an average individual's working life is spent in retirement (2033 for Scotland)[10], there would be implications for the number of people over SPA, expenditure on pension benefits, and also on the number of people in work and level of economic growth in Scotland.

Based on the ONS low migration variant 2012 population projections, there would be an extra 73,000 people in Scotland above SPA in the period from 2027 to 2033. Pensioner benefit expenditure in Scotland would be £0.5 bn a year higher in the period between 2028 and 2032 due to a delay in state pension age rise (2014 earnings terms). [11]

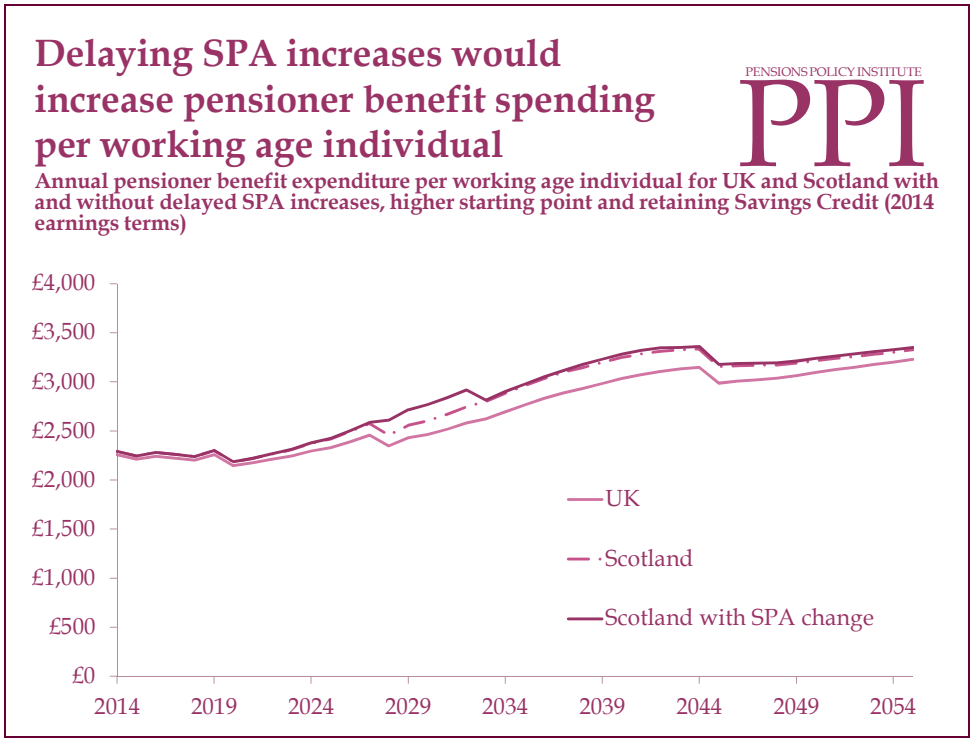
As a result of delays to state pension age, there would be a more pronounced impact on pensioner benefit per member of the working age population, as pensioner benefit expenditure is increased and the size of the working age

[10] See Chart 1

[11] PPI estimates based on PPI modelling

population is reduced (Chart 6). In 2030, pension benefit expenditure per working age individual is estimated to be £2,460 across the UK population, and £2,620 for Scotland if Scotland had the same increases in SPA as the rest of the UK (2014 earnings terms). However, if SPA was still 66 in Scotland (compared to 67 in the rest of the UK), pension benefit expenditure per working age individual in 2030 would be £2,770 (2014 earnings terms).

Chart 6[12]



Papers by The Department for Work and Pensions[13] and by Bell et al[14] also considered the cost in economic terms of delaying the increase in the state pension age to 67. Bell et al calculated the annual cost to the Scottish government of delaying the increase to be around £750 million (in 2011/12 prices) for each year of that the increase is delayed; this consists of £550 million in additional pension costs paid to 66 year olds, and £200 million reduction in tax revenues. The DWP calculated the cost to the Scottish economy of around £9 billion (in 2013/14 prices) over 10 years as a result of a reduced workforce if employees retire at age 66 instead of 67. These figures are not directly

[12] PPI estimates based on PPI modelling
[13] Department for Work and Pensions (2014) *Long term projections of social security expenditure in the United Kingdom, including Scotland*
[14] Bell et al (2014) *Funding pensions in Scotland: Would independence matter?*

comparable to the PPI estimates of pension benefit expenditure presented in this Briefing, as they are calculated using different data, methodology and presented in different price terms. However, they do give an indication of the costs above direct pension benefit costs that would arise from delaying increases in SPA.

The cumulative impact of policy changes

Based on the figures used by the Department for Work and Pensions in the Impact Assessment accompanying the 2014 Pensions Act, the level of £160 a week proposed by the Scottish Government would be higher than the level illustrated as being in place for the rest of the UK from April 2016 (estimated to be £158.70 per week). This would lead to a higher state pension level in Scotland than in the rest of the UK, and potentially lead to higher retirement incomes.

The commitment of the Scottish Government to increase the single-tier pension in line with the triple lock is more generous than the minimum provision contained in existing UK legislation. However, the Pensions Act impact assessment is based on the assumption that the single-tier pension would be increased by the triple lock. In this analysis, it is assumed that the triple lock would also be used to increase the single-tier pension across the UK. If the UK Government used only the minimum legislated increase for the single-tier pension of average earnings, over time the single-tier pension would grow more quickly under the Scottish Government proposals than in the rest of the UK. [15]

The Scottish Government propsals to retain Savings Credit for individuals reaching SPA after April 2016 would also, all other things remaining equal, increase the value of pensioner benefits, leading to higher incomes and higher expenditure. Retaining Savings Credit will also impact on entitlement to HB and CTS which are taken account of in the analysis of expenditure.

However, despite in the first instance increasing pension incomes, retaining Savings Credit would also lead to greater reliance on means-testing benefit for basic income. Considering Pension Credit alone, the current UK Government policy introducing the single-tier pension in the UK is expected to lead to a significant reduction in the proportion of pensioner households entitled to Pension Credit (Savings Credit and/or Guarantee Credit). Under the proposed reforms in Scotland, retaining Savings Credit would mean a much

[15] The OBR estimates that the triple lock would add the equivalent of 0.3% a year above earnings growth to the level of the single-tier pension. This is the assumptiomn used in this paper.

smaller fall in the proportion of Scottish pensioner households eligible for Pension Credit, despite the introduction of the single-tier pension. [16]

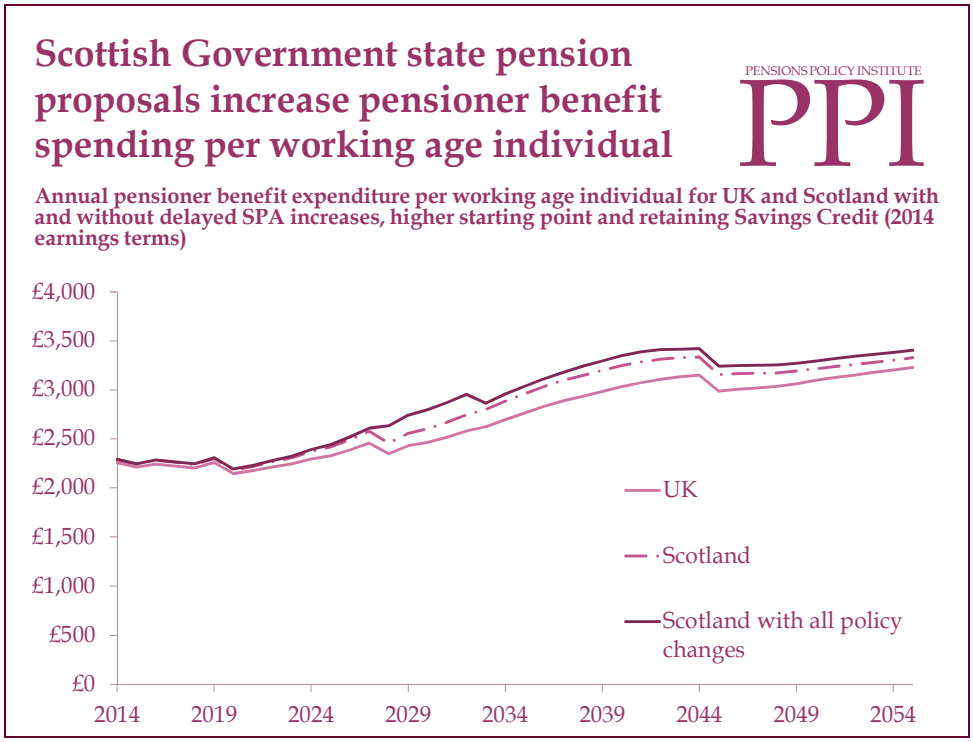
Reducing the reliance on means-tested benefits of this kind is one of the rationales behind the introduction of the single-tier pension and setting it above the level of the Guarantee Credit in the UK. Higher levels of means-testing has the potential to impact on the perceived value of private pension saving for individuals, and complicate the interaction with automatic enrolment into workplace pensions.

Without further detail it is not possible to estimate the impact of the Scottish Government's proposal to protect pensions based on spouses contributions for those reaching SPA in the first 15 years after implementation of the single-tier pension. However, this would also have the impact of improving incomes for some, and increasing expenditure on pensioner benefits.

The overall impact of the Scottish Government policy proposals on pensioner benefit expenditure would be to further increase expenditure per working age individual in Scotland (Chart 7). By 2055, compared to pension benefit expenditure per working age individual estimated at £3,230 across the UK population, pension benefit expenditure per working age individual in Scotland is estimated to be £3,400 allowing for the Scottish Government policy proposals (2014 earnings terms).

[16] PPI estimates based on PPI modelling. This includes Pensioner Households who reached SPA before 2016 and so still have entitlement under the pre- single-tier state pension system.

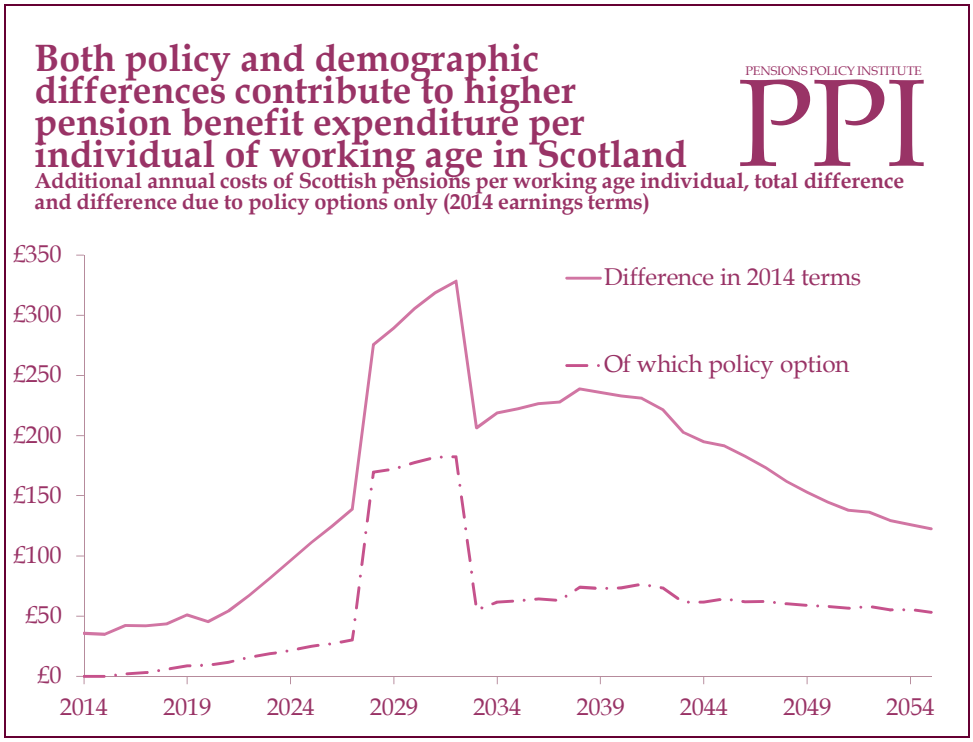
Chart 7[17]



After allowing for expected changes in earnings, and focussing on the difference between Scotland under the Scottish Government proposals and the UK as a whole, the difference peaks at £330 per individual of working age in 2032, where Scotland would still have a lower SPA than the rest of the UK. £180 of this is due to the policy changes, with the remainder due to underlying demographic differences (Chart 8).

[17] PPI estimates based on PPI modelling

Chart 8[18]



The impact on individuals of policy changes

Although the proposals put forward by the Scottish Government would increase expenditure on pensioner benefits, if implemented they could also lead to higher state pension incomes for pensioners in Scotland compared to the rest of the UK, depending on the final level of the single-tier pension on introduction in 2016 and the rate at which it is increased.

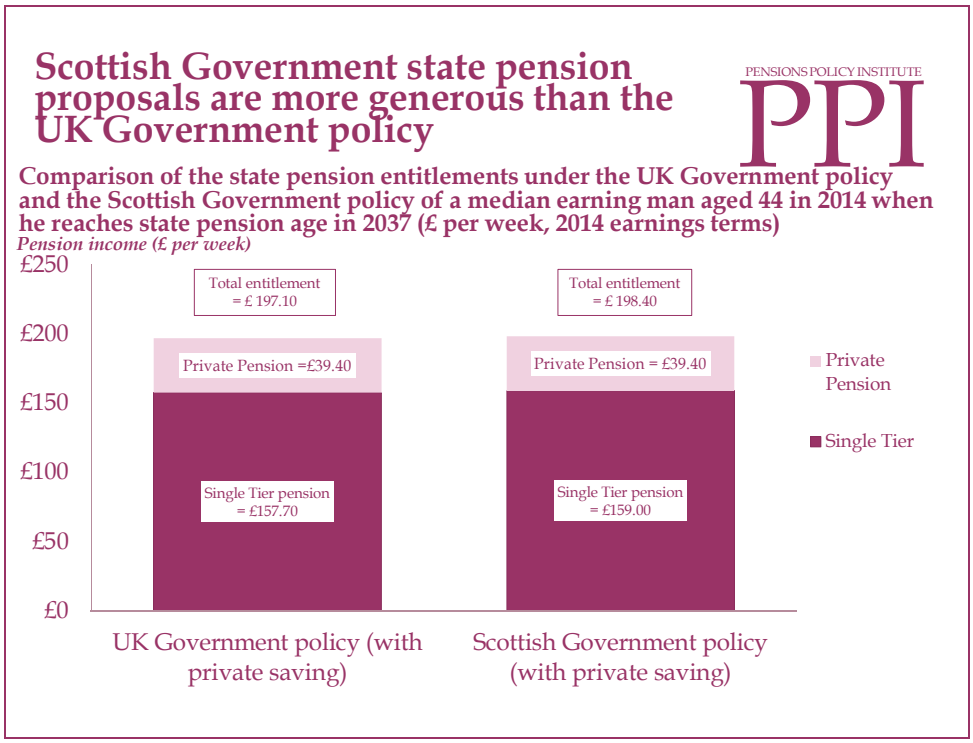
This can be illustrated using hypothetical individuals. The examples used in this Briefing are assumed to be 44 in 2014, reaching a State Pension Age of 67 in 2037. This is to show the longer term policy impact of the Scottish Government proposals and the current UK Government policy to be considered, rather than the more complex transition arrangements. Using these examples also allows some of the impact of automatic enrolment into workplace pensions to be considered. For the purposes of this comparison, it is also assumed that the State Pension Age is 67 in both Scotland and the rest of the UK.

For example, based on a single-tier pension level of £158.70 in 2016 in the current UK system, compared to £160 a week under the Scottish

[18] PPI estimates based on PPI modelling

Government's proposals, and assuming both are uprated by the triple lock after 2016, a median earning man aged 44 in 2014 and reaching State Pension Age (67) in 2037, who is automatically enrolled into a workplace pension at the minimum contribution level from October 2012, could have income from state and private pensions over £1 a week higher under the Scottish Government proposals than in the current UK system (in 2014 earnings terms) (Chart 9).

Chart 9[19]



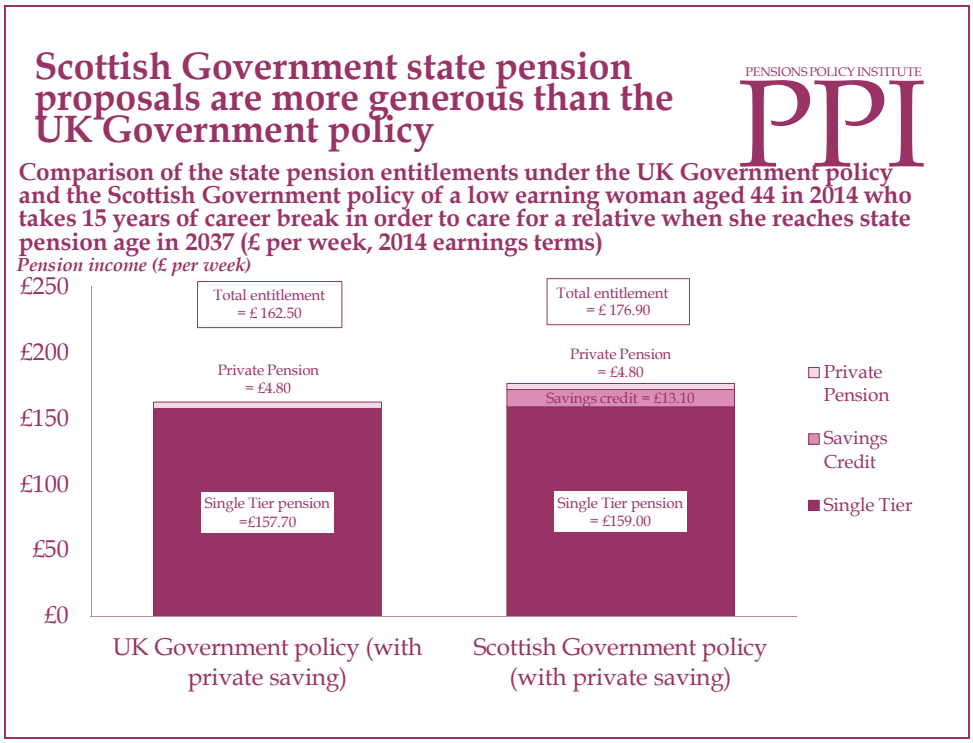
The single-tier pension amount in Scotland is shown as £159 per week rather than £160 per week in the following charts as the value of the pension in 2037 (£160 in 2016 in cash terms and then increased each year in lie with the triple lock) is shown in today's earnings terms rather than the cash value in 2016.

The difference in outcomes could be greater for lower income individuals. For example, a low earning woman with career breaks, aged 44 in 2014 and

[19] Earnings are assumed to be in line with age specific median earnings, for example a median earning for 44 year-old man in 2014 is assumed to earn around £30,000 a year. He is assumed to take 25% of his fund as an tax-free lump sum at retirement and convert the remaining fund into a level, single-life annuity. Figures rounded to the nearest £0.10. For further information on the assumptions used please contact the PPI.

reaching SPA at 67 in 2037, who is automatically enrolled in a workplace pension at the minimum contribution level when she is in work, could have an income from state and private pensions £14 a week higher under the Scottish Government proposals than in the current UK system (in 2014 earnings terms) (Chart 10).

Chart 10[20]



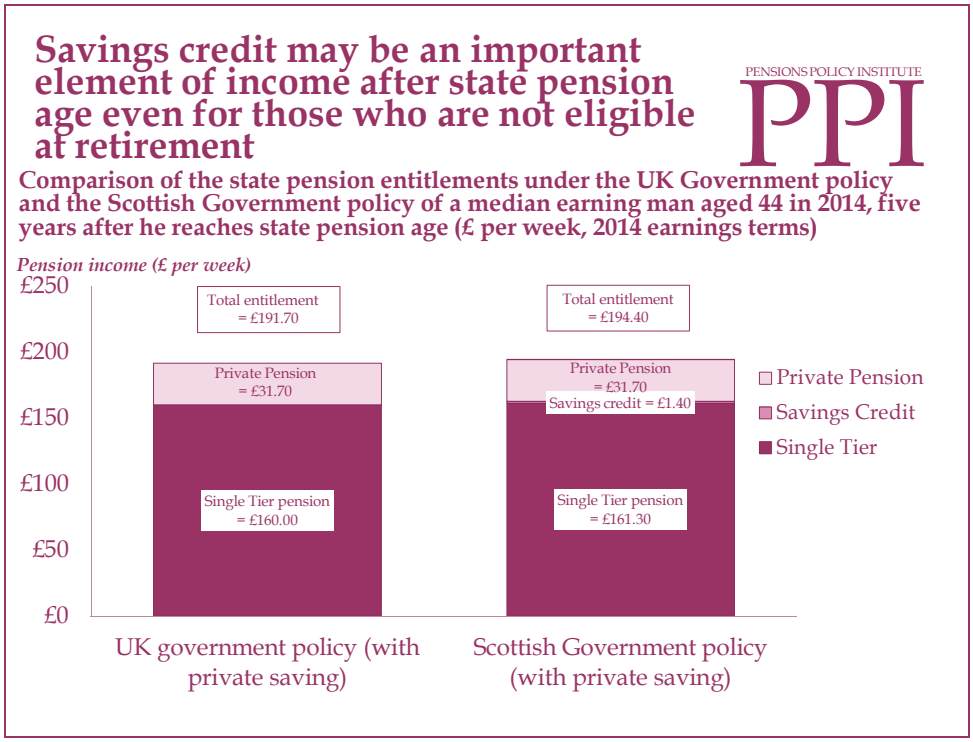
The majority of this increase in income is due to the availability of Savings Credit, as this particular individual has a low level of private pension income as a result of having relatively low earnings and spending time caring rather than in paid employment.

However, the relative generosity of Savings Credit means that the median earning man could be entitled to Savings Credit less than 5 years after reaching State Pension Age. This would increase his state and private pension

[20] Earnings are assumed to be in line with age specific earnings for an earner at the tenth percentile, for example a 44 year-old woman earning at the 10th percentile point in 2014 is assumed to earn around £12,000 a year. She is assumed to take 25% of her fund as an tax-free lump sum at retirement and convert the remaining fund into a level, single-life annuity.

income further under the Scottish Government proposals, compared to in the current UK system (Chart 11).

Chart 11[21]



Although Savings Credit leads to a higher income in retirement, it can also reduce the relative value of remaining automatically enrolled in a workplace pension scheme. This is because increased private pension saving can lead to reductions in the amount of Savings Credit received. In some cases this could lead to individuals deciding to opt-out of workplace pensions, even if it would be in their best interests to remain saving – the employers contribution and tax relief received on individual contributions means that in many cases there is likely to be a good return on workplace pension saving, even for those already close to retirement.[22] The initial evidence from automatic enrolment suggests that opt-out rates are very low, at less than 10%. [23]

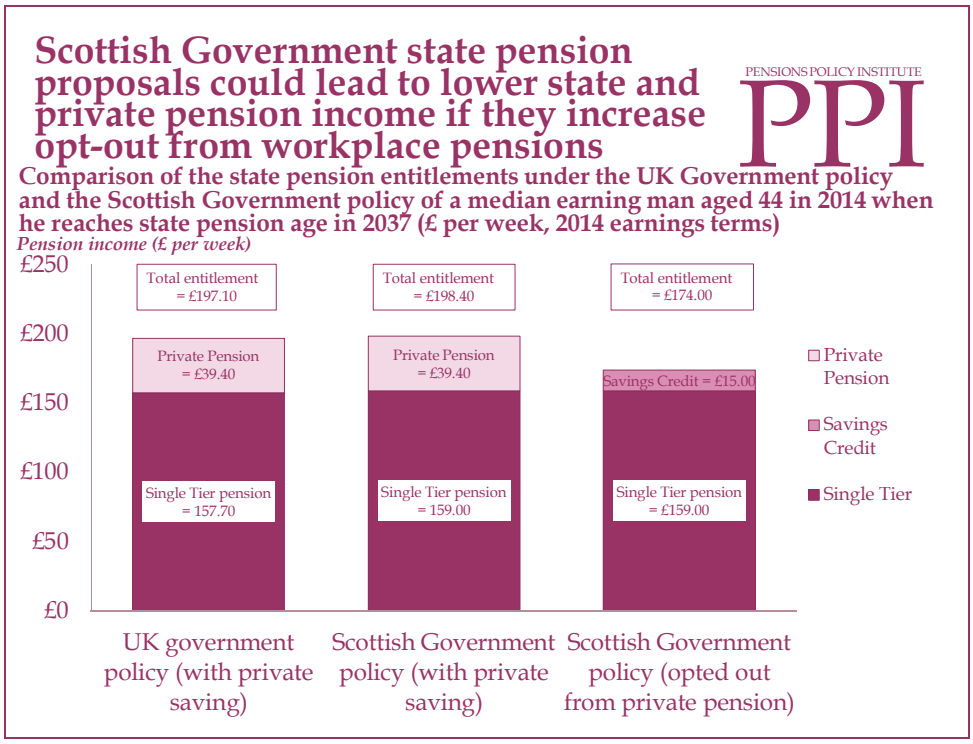
[21] Earnings are assumed to be in line with age specific median earnings, for example a median earning for 44 year-old man in 2014 is assumed to earn around £30,000 a year. He is assumed to take 25% of his fund as an tax-free lump sum at retirement and convert the remaining fund into a level, single-life annuity.

[22] See for example PPI (2014), The benefits of automatic enrolment and workplace pensions for older workers.

[23] DWP (2013), *Automatic Enrolment opt out rates: findings from research with large employers*

If the median earning man did opt-out of his workplace pension as a result of being able to claim Savings Credit in retirement, his income from state and private pensions would be significantly lower (although his disposable income when working would be higher). However, he would receive £15 a week (2014 earnings terms) of Savings Credit per week under the Scottish Government proposals (Chart 12).

Chart 12[24]



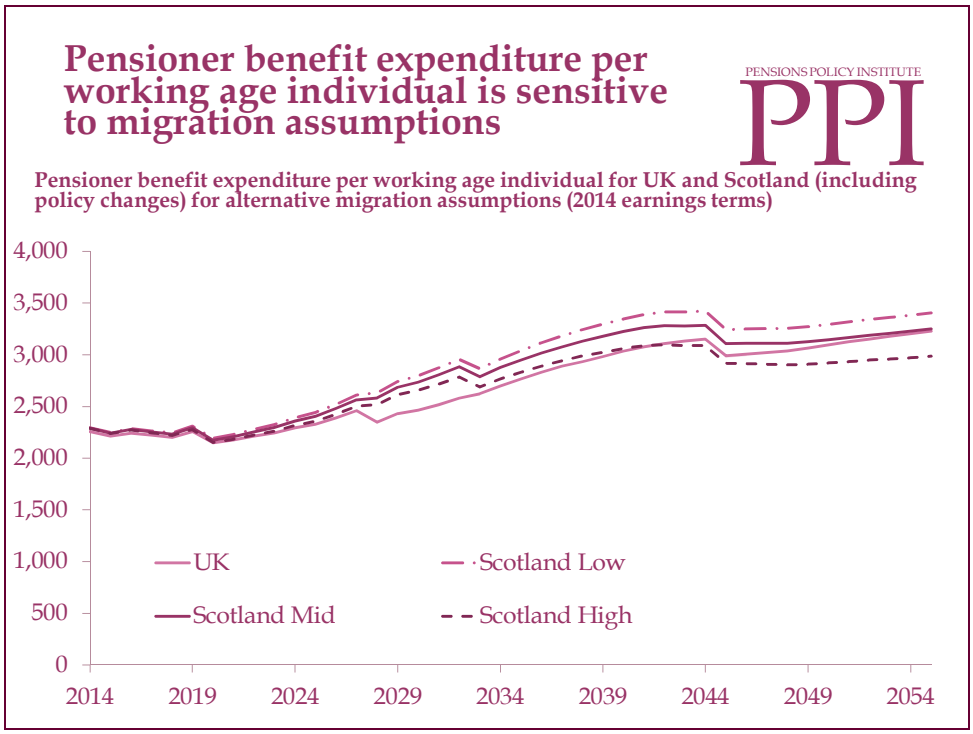
Estimates of pensioner benefit expenditure per individual of working age are sensitive to migration assumptions

The old age dependency ratio, and therefore estimates of pensioner benefit expenditure per individual of working age, is sensitive to a number of assumptions, such as life expectancy, birth rates and in particular migration assumptions. The population projections used in this analysis are based on the ONS low migration variant population projections, which are the projections used by the UK Government and the Office for Budget Responsibility. The

[24] Earnings are assumed to be in line with age specific median earnings, for example a median earning for 44 year-old man in 2014 is assumed to earn around £30,000 a year. He is assumed to take 25% of his fund as an tax-free lump sum at retirement and convert the remaining fund into a level, single-life annuity.

Scottish Government may have policies to increase the level of migration to Scotland compared to the rest of the UK. The ONS also produce population estimates for Scotland based on alternative estimates of migration. Under the mid-range migration scenario, the working population will be 3% higher in Scotland by 2030 than under the low-migration scenario, and 10% higher by 2055. In the high migration scenario, the working age population will be 6% higher in 2030 and 20% higher in 2055 than in the low-migration scenario. Chart 13 shows the impact on estimates of pensioner benefit expenditure per individual of working age of these alternative assumptions, while keeping the assumption of low migration for the results of the UK overall.

Chart 13[25]



Pensioner benefit expenditure per individual of working age is estimated as remaining higher in Scotland (assuming the implementation of the Scottish Government proposals) in both the low and mid migration scenarios, although expenditure is broadly equivalent in the UK and in Scotland by the 2050s under the mid migration scenario. However, in the high migration scenario the assumed increase in the number of people in working age in Scotland means that from 2040 onwards expenditure per individual of

[25] PPI estimates based on PPI modelling

working age is lower in Scotland, even with the Scottish Government policy proposals, than in the UK under current UK Government policy.