Single Tier State Pension

National Pensioners Convention Briefing

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Introduction

On 14 January 2013, the Coalition government published a White Paper on the reform of the state pension system entitled *A Single-Tier Pension: A simple foundation for saving*. Following the Queen's Speech in May, a Pension Bill has now been produced and will shortly be making its way through Parliament. This paper therefore offers an outline of the main proposals contained within this Bill, alongside an analysis of the issues raised and the next stages in the debate.

Background

In April 2011, the government published a Green Paper entitled *A State Pension for the 21st Century*, which contained the suggestion of introducing a single-tier state pension, created by combining the existing basic and second state pensions, and set above the level of the means-tested Pension Credit. Much of the Pension Bill therefore draws on these original proposals, with a few noticeable exceptions.

It should also be recognised that successive governments have tinkered with our pension system – reluctant to grasp the need for substantial reform of the state pension, whilst being overly optimistic as to the ability of private occupational pensions to deliver prosperity for all. Whilst these new proposals might therefore change the basic structure of the state pension system, they are far from radical enough to tackle the serious problem of pensioner poverty and hardship facing millions of both current and future pensioners.

Since coming to power in June 2010 the government has weakened the UK pensions system as a result of its decision to alter the indexation arrangements of the basic and second state pensions, all public sector pensions and as many as 60% of private occupational schemes. The move from using the Retail Price Index (RPI) as the accepted measure of inflation, to the usually lower Consumer Price Index (CPI) has already started to reduce the retirement income of millions of pensioners, and even the welcome decision to restore the link between the basic state pension and earnings is seriously undermined by the change to CPI, the failure to raise substantially the level of the basic state pension and the current near-zero increases in wages.

Much of the rationale behind the Bill is also based on a number of flawed assumptions. Contrary to the government's view, the complexity of the current state pension system is less of a barrier to saving than the lack of spare capital which individuals can put aside for their retirement and the risks associated with defined contribution occupational pensions which are wholly reliant on the performance of the financial market. Life expectancy projections and the capability to continue working well beyond 65 have also been grossly over exaggerated, and bear little relation to actual experience. Therefore, if the UK's pension system really is at a crossroads, these proposals are destined to take us in the wrong direction.

Summary of proposals

1. Introducing a single-tier state pension

- From April 2016 (at the earliest), those with a minimum of 35 years of National Insurance contributions will receive a state pension of at least £144 a week (at today's prices and estimated to be around £160 by 2017). For these retirees the current basic and second state pensions (State Second Pension S2P) will no longer exist.
- However, those who retire after April 2016 will have a combination of the existing state pension system and the new single tier state pension. Many will have already built up an entitlement to more than £144 a week, and they will still receive this higher amount. However, those who start work and begin making National Insurance contributions after the new pension comes into force will only be able to build up entitlement to £144 a week.
- To receive a full state pension under the new system an individual will be required to have paid National Insurance or have credits for 35 years, compared to 30 years for those who retired after April 2010. Anything less than that will give a pension on a pro-rata basis. Those with less than around 7-10 years National Insurance contributions will not receive any pension.

2. The effect on existing pensioners

- Anyone who has already drawn their state pension prior to April 2016 will not be included by the new proposals. Whilst there will be a number of existing pensioners who receive more than £144 a week through their basic and second state pensions (such as SERPS), many older women in particular do not.
- After April 2016 the first £144 of the state pension will be uprated annually in line with at least earnings and anything above that figure will be linked to the Consumer Price Index (CPI). It is unclear at the moment whether an existing pensioner would (on today's prices) have an earnings or 'triple lock' link on the first £110 and a CPI link on any state second pension above that level or whether they too will have the same arrangement as those under the new scheme.

3. The future of means-testing

- Those currently in receipt of means-tested Pension Credit will continue to do so after the new system comes into force. Likewise, it is assumed that anyone retiring after April 2016 that doesn't get a state pension of £144 a week will also be entitled to a means-tested top-up (but the exact details of this are unclear).
- Under the new scheme, Savings Credit will be abolished and for those who would have previously been entitled to Housing and Council Tax benefit, there will be a five year transitional arrangement to allow them to get extra help with these costs. However, the details of this have yet to be published.

4. The cost of the new pension

- The White Paper shows that as a percentage of Gross Domestic Product (GDP), by 2060 the new scheme will cost 0.4% less than if the existing system were left unchanged.
- The government has made it clear that there is no new money going into the state pension system under these proposals. In fact, the Institute for Fiscal

Studies predicts that the reform is actually likely to net the Treasury an annual windfall of at least £9.2bn in extra National Insurance contributions from employers. This is in addition to the £28bn surplus balance that is already in the National Insurance Fund, which the government is using to pay off the national debt rather than fund better state pensions.

5. The impact on occupational pension schemes

- As the state second pension is being abolished and merged with the basic state pension, employees in defined benefit (final salary) occupational pension schemes in both the public and private sector will no longer be able to contract-out of paying full National Insurance. After April 2016, employees will be expected to pay an additional 1.4% and their employers 3.4% in National Insurance.
- The Bill recognises that some employers may wish to make changes to their pension schemes as a way of off-setting the requirement to pay the additional National Insurance contributions. The government proposes to therefore give private sector employers powers for a five year period to change scheme rules without the consent of the scheme's trustees. This will mean either reducing future pension rates or increasing employee contributions. In the public sector, the employer will not be able to pass on the cost of their additional 3.4% contributions through reductions in future pension rates or increased employee contributions – but will still be expected by the Treasury to fund the extra costs through other measures (eg. wage freezes or reductions in staffing).

6. The State Pension Age

- Legislation is already in place to raise the state pension age for men and women to 65 by 2018, 66 by 2020 and 67 by 2028. In addition, the White Paper proposes a review of the retirement age every five years, with the first report coming out no later than May 2017.

What's wrong with the Pension Bill?

- Whilst it has been hailed as a radical reform of the UK state pension system, it has failed to address the current injustices and unfairness experienced by existing pensioners. In particular, the current basic state pension remains completely inadequate – as demonstrated by the need to provide additional support through the means-tested Pension Credit. The Bill will not put a single additional penny into the pockets of existing pensioners despite 1 in 5 older people still living below the official poverty level. Even £144 is still over £30 a week less than the poverty level for older people (£178 a week before housing costs in 2012).
- The introduction of a cut-off date in April 2016 for the new pension scheme will create a two-tier system. As a result, some will be getting simplified state pensions whilst others will be left to claim complicated means-tested benefits. Already millions of existing pensioners have missed out on the reduction in National Insurance which now only requires 30 years of contributions to get a full state pension, whereas many of them retired when the rules were 39 years for a woman and 44 for a man. Perpetuating such differences in the pension schemes across different generations of pensioners is simply unfair.
- The Bill also proposes further reforms to the pension system, before existing reforms have been put in place. The equalisation of the State Pension Age for

men and women will not be finalised until 2018 – but introducing the single-tier pension in 2016 means that 350,000 women born between April 1952 and July 1953 will retire on the old system just before the new proposals come into force, whereas a man born on the same day will retire slightly later, but receive a pension under the new arrangements. Such haste only adds to the unfairness and complexity that already exists.

- Despite recognising that the means-tested Pension Credit is ineffective, the government is prepared to maintain it for existing pensioners for at least another 60 years and sees no contradiction in continuing with a benefit that 1.8m people don't claim, despite being entitled to do so.
- Future pensioners will be asked to pay five years extra National Insurance contributions, get a state pension than is less than they could earn under the current system and be forced to work longer before they can draw it.
- Those with defined benefit (final salary) occupational pensions in the private sector will have the terms of their scheme unilaterally changed – which could lead to either lower pensions in retirement or higher contributions from salary. This could signal the end of the final salary pension scheme in the private sector altogether. Whilst those in the public sector will not be affected in this way, employers will still be looking to find other means of off-setting the extra 3.4% National Insurance contributions they will have to pay. This could potentially be through wage freezes or job cuts.
- According to the Institute for Fiscal Studies (IFS), most people born after 1970 could expect to receive less from the state pension. The IFS said: "It is important to be clear that – while there will be a fairly complex pattern of winners and losers from the reform in the short term – the main effect in the long run will be to reduce pensions for the vast majority of people, while increasing rights for some particular groups, most notably the self-employed".
- Anyone who has already accrued a combined basic and second state pension (S2P) of more than £144 a week will, after 2016 still have to contribute additional National Insurance of 1.4% until they retire without any chance of building up additional S2P as a result.
- The Bill proposes automatically linking the state pension age to life expectancy, without any acknowledgement that longevity is affected by profession, income, region and other factors. Whilst as a society we are able to keep people alive for longer now, that does not in itself mean that people are able to work longer. In addition, there are serious concerns as to the health of future generations and the urgent need to enable younger people to get into the workplace. None of this can therefore be addressed by simply raising the retirement age.

Alternatives to the White Paper

- There is an urgent need to strengthen the existing state pension by moving towards a Citizen's Pension funded through National Insurance, but based on residency of say at least 30 years, rather than years of contributions as the most effective way of tackling pensioner poverty, both now and in the future. Increasing the basic state pension for all existing pensioners to the official poverty level (estimated as £178 a week in 2012) continues to be the most effective way of covering the day-to-day needs of older people.
- This would largely remove the need for means-tested Pension Credit support for all but a very small number of individuals unable to meet the citizenship criteria and the main gainers would be those, particularly women, who do not currently

have a full 30 years contributions/credits record. Even those that are currently in receipt of means-tested support would not be financially disadvantaged by raising the state pension above the official poverty level (providing housing and council tax benefit remained available).

- The basic and second state pensions should be uprated annually in line with average earnings, RPI (Retail Price Index), CPI (Consumer Price Index) or 2.5% (whichever is the greater) so that its value is maintained for the future and pensioners share in the rising prosperity of the nation.
- The State Second Pension (S2P) should be retained as a good earnings-related pension for all workers, maintaining the higher replacement rate for the low paid. This would be paid to everyone with a minimum of 7 years and a maximum of 50 years' contributions or credits.
- The state pension age (SPA) for men and women should be maintained at 65 from 2020 without any automatic linking of SPA to life expectancy.
- There are a range of measures that can be used to raise the necessary funds required to improve the state pension system, including abolishing the upper earnings limit on contributions, using part of the surplus (accrued and annual) in the National Insurance fund, reforming tax relief on private pension contributions and tightening up on tax avoidance and evasion.
- Government should do more to maintain and strengthen good occupational pension schemes, in both the public and private sector, and recognise that placing the provision of a decent income in retirement for future generations of pensioners in the hands of the financial markets through auto-enrolment could be an expensive risk for millions of low paid workers.

Comparison between the existing state pension and the single tier

	Existing state pension system	White Paper proposals
Calculation of state pensions	Employees get £3.58 a week basic state pension for every year of National Insurance contributions and £1.46 a week second state pension. This gives a full basic state pension of £107 and a second pension of £43 – equal to £150 a week	Employees will get £4.10 a week single-tier state pension for every year of National Insurance contributions. This will give a full pension of £144 a week
Number of qualifying years	Since April 2010, new retirees require 30 years of National Insurance contributions or credits to gain a full state pension. There is no minimum number of years that employees have to pay to receive a state pension	From April 2016, new retirees will require 35 years of National Insurance contributions or credits to gain a full state pension. The minimum number of years employees will have to pay National Insurance will be 7-10 years
Indexation	The basic state pension is 'triple locked' to the higher of wages, CPI or 2.5%. The second state pension is linked to CPI	£144 will be linked at least to wages, but it has yet to be decided if it will also be 'triple locked'. Any pension above £144 will be linked to CPI
Means-tested benefits	Pensioners with less than	The Pension Credit for new

	£142.70 a week can claim Pension Credit to take them up to that level. Those with modest savings can also apply for additional Savings Credit to a maximum of £18.54 (single) and £23.93 (couple). Pension Credit is a 'passport' benefit which also automatically entitles recipients to Council Tax and Housing benefit	retirees will be unnecessary providing they have £144 a week state pension. If they have less than this amount, there will continue to be some form of means-tested support. Savings Credit will be abolished. There will be five years of transitional arrangements for those who would have got Council Tax and Housing benefit under the old scheme, but as yet there are no details as to how this will apply
Credits for carers and others	Those who are caring, unemployed or disabled can get National Insurance credits towards the number of qualifying years needed to get a state pension	There will be a system of credits for carers and others, but as yet there are no details as to how this will apply
Relationship to occupational pensions	Employees in contracted-out final salary pension schemes receive a 1.4% rebate on National Insurance because they receive less state second pension when they retire. Their employers also receive a 3.4% rebate	Contracting-out will cease. Employees in private and public sector final salary schemes will have to start paying 1.4% extra in National Insurance. Employers will also have to pay 3.4% extra National Insurance contributions, but those in the private sector will be able to unilaterally change their pension rules to either force employees to pay more to cover the cost or receive lower pensions. Public sector employers will not be able to do this, but will still be expected to find savings to pay for the additional 3.4% National Insurance bill
State Pension Age	Legislation already exists to equalise men and women's state pension age at 65 by 2018, 66 by 2020 and 67 by 2028	Introduce a review of the state pension age every five years beginning no later than May 2017, linked to life expectancy (more details to be published in due course)
Other aspects of state pension system	Those who reach 80 without sufficient National Insurance contributions automatically get a Category D pension of 60% of the basic state pension. All those over 80 also get a 25p a	The Category D pension and the 25p Age Addition at 80 will be abolished

	week Age Addition	
Cost of scheme	8.5% of GDP in 2060	8.1% of GDP in 2060
Impact on existing pensioners	Those that have drawn their state pension before April 2017 will not be included in the new scheme. All existing arrangements, including level of pension, will continue until the death of the last of the existing 11m pensioners	All those drawing their state pension after April 2017 will be affected by the changes. The first person to retire solely on a pension under the new rules is likely to do so around 2085

Next steps

The NPC is now discussing the Pension Bill with a number of other organisations to see if there is any support for an alliance of working-age and pensioner groups to oppose the plans. In particular, we will be focussing on:

- The exclusion of existing pensioners from the new scheme (eg. those who would benefit from being included)
- The level of the state pension continuing to be inadequate
- The abolition of the state second pension and contracting-out, whilst giving powers to private sector employers to unilaterally alter their occupational pensions rules
- The plans to increase the state pension age
- Other items such as the loss of inherited rights to spouses' pensions and the new requirement for 35 years' worth of National Insurance contributions or credits

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National Pensioners Convention
Walkden House
10 Melton Street
London
NW1 2EJ
www.npcuk.org