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A New State Pension

A call to all parties

Edited by **Patricia Hollis & Alexandra Kemp**

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Contents

	Preface	3
1.	Patricia Hollis A new state pension	5
2.	Dr Ros Altmann UK state pensions need urgent reform	7
3.	Adrian Boulding A Citizens Pension will help Occupational Pension Schemes	9
4.	Jon Cruddas & Jonathan Rutherford A brief history of pension reform	11
5.	Alexandra Kemp Capturing the Zeitgeist – the Citizens pension	13
6.	Mervyn Kohler One Milestone passed, many Miles to go	16
7.	Malcolm Small Retirement – the Need for Urgent Reform	18
8.	Joanne Segars A View from the National Association of Pension Funds	21
9.	Steve Webb A Citizens Pension	23
10.	Howard Reed Costing a Citizens Pension	25
	Notes on contributors	30

Preface

The issues we raise in this pamphlet are not new, though some of the proposals for their solution may be. The Turner Commission in its First Report (2004 p.226) identified the problem. Our state pension structure – National Insurance state pensions topped up by a means-tested pension credit – has helped those with an incomplete state pension (mainly women with family responsibilities) to be lifted to a more adequate pension. However for those who can expect a full state pension, it has reduced their incentive to save, including into the Commission’s proposed Personal Accounts.

Lord Turner pondered whether it was possible for everyone to have a non-means-tested state pension, £95 p.w. for 2009/10, raised to the pension credit figure of £130 p.w., thus removing the need for means-testing, and thus protecting the incentive to save. The Report was sympathetic to the proposal, but it judged that this would need either increased public spending or a sharp rise in the retirement age.

However, in his Second Report, a year later, he called for three things - a state pension linked to earnings; making that state pension universal, based on residency, while perhaps helping those over 75 first; and for the State Second Pension to become flat rate. Over time, the two pensions could be run together so that incrementally they could become an Enhanced State Pension, a Citizens Pension. This would, he says, “ensure that all people, including those with interrupted paid work records and caring responsibilities can be certain of a significant floor of non-means tested state provision ... in order to create clear incentives and an understandable base on which private pension saving looking forward can build”. (p.10)

Since the Turner Report, the Pensions Acts of 2007 and 2008 have made the move to a new enhanced state, or citizen’s, pension, very much easier. The legislation has greatly widened access to the state pension (ensuring that far more women in future will retire with a full state pension); has brought carers more fully into the State Second Pension, meaning that the two state pensions increasingly cover the same people, though at different accrual rates; and begun preparation for the Commission’s low cost auto-enrolled Personal Accounts (renamed NEST, the National Employment Savings Trust) which aims to enrol the low paid into a private pension. But Lord Turner’s dilemma remains. There is still little incentive to save now unless your savings can spring you clear of means-testing. So why bother?

The contributors to this pamphlet come from across the political spectrum and from industry. Some of us would move forward faster than others. What we all insist on, however, like Turner, is that without a non-means-tested state pension platform at pension credit level, private pension savings will remain risky for the low paid. Yet without private savings, pensioners will not be able to enjoy a comfortable retirement.

What to do?

Jon Cruddas & Jon Rutherford trace the history of pension reform since the 1980s, and describe the erosion of both state and secure occupational pensions. *Ros Altmann*

argues that the Government has failed to separate the social welfare function from the savings function of pensions, and we therefore need to move away from a contributory to a full citizens pension as of right. We currently have “by far the most complex” system in the world and “one of the least generous”. She is supported by *Steve Webb* who shows how the National Insurance model of state pension has become something of a fiction, and a “single, simple, decent state pension” is within our grasp. *Mervyn Kobler* believes that such a pension is the next step on from Turner, that it could be targeted on older pensioners first, and calls for a “firm date for when it can be achieved”.

Patricia Hollis suggests, following Turner, how this might be done – by combining the basic state pension with a flat-rate capped State Second Pension, future pensioners could enjoy a new state pension, whether universal or contributory, which springs them off means-tested benefits, and makes it safe to save. *Joanne Segars* calls for a new vision for both state and occupational pensions; she too believes that combining the basic state pension with the state second pension is the way forward. Agreeing with her, *Malcolm Small* insists that we need both state and private pension reform, to build “a new architecture for the 21st century”. *Adrian Boulding* encourages us to believe that such simplification would “unleash a new torrent of demand” for private pensions. *Alexandra Kemp* illustrates the difficulties in encouraging pensioners to claim means-tested benefits in rural W.Norfolk and how pensioner poverty would be reduced by universal entitlement.

And the key question - How much will it cost, Can we afford it - is explored by *Howard Reed*, in our final, and deliberately lengthier, piece. He argues that a Citizens Pension delivers “huge advantages over the current system – the eradication of pensioner poverty, an end to the disadvantage suffered ... by people who have to spend time out of the labour market, and a substantial reduction in complexity and administrative burden – for only a modest cost increase, at most.”

As we each conclude, a new enhanced state pension, addressing pensioner poverty (particularly of women), floating pensioners off pension credit and encouraging them to save, a pension that is decent, simple, transparent, and affordable, is an idea whose time has come. Whats not to like?

Patricia Hollis

Patricia Hollis

A new State Pension

We all agree that we need to encourage the low paid, especially women, to save for their retirement. They cannot rely on either a husband or a short life, to see them through old age. They need to carry their own pension. They perhaps have incomes around half median earnings, some £11,000 to £15,000 a year. Outside the public sector, few will be in final salary schemes, a few more may be in money purchase schemes, most will be in no private provision at all, until NEST (the National Employment Savings Trust, formerly Personal Accounts) begins to roll out in 2012. Mention pensions and women will understandably reply that they cannot afford them, and in any case that there is no point in saving as they would be no better off than on means tested benefits.

So with the best of intentions we have built a perverse structure. We have a national insurance basic state pension (BSP) that will cover more people, thanks to the admirable pension reforms of 2007 and 2008 which reduced the number of qualifying years after 2010 down to 30 (from 39 for women, 44 for men) and brought more carers into coverage; but whose level (at £95 for 2009/10) is not enough to live on, and, until it is linked to earnings and not prices, tends to fall in value every year. This is then topped up by an earnings-linked but means-tested pension credit to £130 pw.

As the State will fill that gap for you between £95 and £130, there is little point in you doing it for yourself, unless you can save so much (unlikely if you are low paid) that you spring free of means testing altogether. It is estimated that a third of all pensioners will still need means tested benefits in the future, and a third of those won't actually claim what they are entitled to – and will remain in very real poverty. Pension credit has lifted millions of *existing* pensioners out of profound poverty, a huge achievement, but at the price of discouraging *future* pensioners from saving.

So we cannot safely ask people to save more for their old age including in NEST unless we reform the state pension platform underneath private provision and remove the means-testing trap. Otherwise, we risk mis-selling to people who have no margins of safety.

Yet there is a way forward, at broadly similar cost to what we now pay in state pensions and pension credit, which would ensure that by the 2020s perhaps 90% plus of future pensioners had a state pension of £130 in today's prices as of right. This would lift them off pension credit, and leave them free without risk or penalty to enjoy any savings or private pension, including NEST, that they had built up. A higher pension income for a couple. Earnings linked. Means test free (unless you have special needs.) Simple to administer and to understand. Encouragement to save more. And all for much the same cost as now. Whats not to like? Can it be done?

Indeed it can, because of the roll out of the State Second Pension (S2P) (introduced in 2002 to replace SERPS). Until the 2007/8 pension reforms, S2P was largely confined to wage-earners. It is now increasingly covering the same people as the BSP, including

carers. From 2030 S2P will no longer be earnings related but will build up at a flat rate until the 2040s when it hits its cap. If instead we flat-rated and capped it by around 2020, the resulting financial headspace would allow us to finance a new State Pension, which combined BSP and S2P and paid £130 pw., or £13,000 pa a couple. Pension credit would wither. This surely is the next step on, a new enhanced state pension. from the Turner consensus.

Yes, it is the case that somewhat higher earners who, if they are fully aware of how S2P calculations work, could expect an S2P to build up to, say, £160 in 30 years time. would now find it capped (in around 10 years time) at £130 pw. That's the down-side. But the upside is that the partners of such earners would be carrying a much higher enhanced state pension themselves, and household income should be much the same. And the prize is huge - to lift nearly all pensioners, apart from those with special needs, free of pension credit means-testing, confident that they had a simple and predictable pension on which they could build their retirement finances.

Who would not be eligible for this new State Pension? Three groups. Those on JSA which doesn't give entitlement to S2P, but few people are on JSA for long. Those in contracted out DB schemes, but not only are they declining sharply but even DB providers increasingly favour contracting back in to S2P as it is simpler and better value. And those who are self-employed, but work by the Pensions Policy Institute for the National Association of Pension Funds in 2005 suggested that they could be brought within S2P for an additional £5 a week premium.

At the moment, S2P, unlike potentially BSP, and currently pension credit, is prices rather than earnings linked. It too would have to be earnings linked if over time pensioners were not to fall back on pension credit. But as S2P would increasingly displace pension credit, a full earnings linked citizens pension should remain within the overall cost envelope.

Eventually this new enhanced state pension could, if so wished, become a universal citizens pension, based on residency, once 90% or more of our people were receiving it. Test of residency? We keep electoral registers now for 15 years, and these could be supplemented if necessary by NI, medical or tax records. NI would still be collected, but there would be useful gains in administrative costs and simplicity.

The result? To begin with, a decent and predictable new state pension, available to men and women equally, free of means testing, and a safe platform for further saving. With all-party support and the backing of the industry, it could be in place from 2020. And the possibility that this new state pension could become a universal citizens pension in the years beyond that.

Dr Ros Altmann

UK state pensions need urgent radical reform.

Until the late 1990's, the UK's pension system was considered a model for others to follow. We had a strong retirement savings culture which offered the potential of good private pensions to supplement very low state pensions. Either employer final salary schemes, or personal pensions, were expected to deliver good retirement incomes and, despite the ageing population, successive UK Governments forecast that state spending on pensions would remain low.

Unfortunately, this model has failed. At the moment, we have a falling state pension coupled with falling private pensions and final salary schemes giving way to much less reliable and far less generous money purchase arrangements. Despite a succession of pension reforms in recent years, each of which has added complexity, policy has failed to address the inadequacy of pension incomes for those coming up to retirement over the next decade or two.

The latest reform proposals, for both state and private pensions, are based on the Government's assessment that we do not actually have a pensions crisis at the moment, but that we will have one perhaps around 2020 or so without policy change. This assessment is, in my view, fundamentally mistaken.

We do have a pensions crisis now. What we will have around 2020, as a result of the present pensions crisis, will be a *pensioners* crisis, as millions of older workers try to retire without sufficient income to support themselves.

Pensions policy has failed and radical reform is long overdue. We cannot rely on private pensions to supplement the inadequate National Insurance pension, which has been cut time and again over the last few decades and is about the lowest in the developed world.

Not only is the state pension too low, it is also mind-bogglingly complex. We have a basic state pension (BSP), second state pension (S2P), plus many other benefits, each with different qualification, contribution and accrual criteria. Even after a lifetime of 'contributions', a full BSP pays only around £95 a week. Some pensioners have S2P, but for many this will still not bring them above the £130 a week pension credit level, so that between 40% and 50% of pensioners need means-tested benefits to avoid poverty.

In fact, the national insurance contributory principle has been heavily undermined by the mass means-testing in our state pension system. Anyone who has never contributed at all can still receive £130 a week from age 60 (as long as they do not have any other private income), making the BSP of just £95 a week irrelevant - and also resulting in a significant disincentive to pension saving.

The current pensions crisis is partly due to confusion of the objectives of pensions. The word 'pension' relates to two very different things.

On the one hand, 'pensions' are social welfare - money paid to older people to avoid penury when they cannot work. This would normally be a Government role.

On the other hand, we also use the word 'pension' to relate to a special kind of long-term savings - money locked away by workers until later life to provide a better retirement. This would normally be the private individual's responsibility.

However, these two roles of pensions have become confused.

Part of the reason for the confusion is that 20th century employers established final salary pension schemes that covered both these aspects of pensions. Increasingly, Government transferred additional pension responsibility onto employers and, over the years, employer final salary schemes were required to provide spouse cover, revaluation and inflation-linking that are taken care of by the state in other countries. Final salary schemes also collected contributions from workers, who were then not allowed by Government to have any other pension savings. Workers thought their futures were taken care of.

For many years, our system was considered a success. Cuts in UK state pensions were predicated on having good private pensions and these good private pension expectations were based on investing for the long-term in the stock market with high equity returns delivering generous pensions.

Unfortunately, this system has failed. Governments relied too heavily on employers and stock markets to provide good pensions. But, with increasing longevity, constant corporate change and unreliable equity returns, employers and private pensions cannot provide enough income.

The Government's latest reforms are an improvement, but not a solution. Much more radical change is needed.

We should separate the social welfare function of pensions from the long-term savings aspects. If the state takes care of basic social welfare, without mass means-testing, then individuals can safely choose to save in a pension, or keep working, without fear of being penalised by a means-test.

I believe all pensioners should receive a decent state pension, irrespective of their so-called 'contributions' via the waged labour force or complex credits. The reforms underway will not wholly address the disadvantages for women and carers, or the extent of means-testing.

These problems could be overcome by merging BSP and S2P and paying every pensioner at least the pension credit level, linked to average earnings increases every year - a simple, uniform payment at least at pension credit level for every resident over a certain age, without complex form filling, or qualification criteria.

We can afford these changes within the envelope of current spending, if we redesign other parts of our pension system. For example, if abolishing contracting out, would save several billion pounds a year. We could pay the resident's pension from age 70 or 75, and at least end the means-test for the oldest pensioners, as well as ending the mandatory requirement for pensions to be annuitised.

Because our state pension is by far the most complex in the world and one of the least generous, it does not provide a stable base on which private savings or part-time earnings can safely be built. We need to radically reform pensions before today's pensions crisis turns into a pensioners crisis. With the baby boomers about to hit pension age, the time to rise to this challenge is now, not in 20 years' time.

Adrian Boulding

A Citizen's Pension Will Help Occupational Pension Schemes

We are at a cross road for occupational pensions. Once dubbed “the undoubted welfare success story of the last century” by Frank Field MP, these schemes are now caught rather uncomfortably between employers who are keen to reduce their financial exposure and legislation that introduces compulsory automatic enrolment and employer contributions from 2012.

The future of the corporate pension scheme and how to comply with the 2012 legislation will figure prominently in company board meetings over the next two years.

Much is at stake in these meetings. The erosion of State pension provision since the earnings link was abandoned and the advances of pensioner longevity mean that having a good company pension to supplement the State pension is as important as it ever was. Yet the damage that over-generous and under-funded final salary pensions have done to company balance sheets have made pensions fair game to be trimmed, closed or replaced by less generous schemes.

When dealing with firms standing at this crossroads, I find it essential to help the employer to get across to the workforce just how valuable the company pension scheme is. Because only then, when the staff really value employer pension contributions, does it make financial sense for the employer to pay them.

And we are making progress on this front. The quality and frequency of communications about the pension scheme have improved. Both with traditional printed copy and also with face to face presentations or new media such as email, intranet and podcasts.

I was delighted when NAPF launched the Pension Quality Mark last year, providing a benchmark for good schemes. As it achieves widespread recognition, PQM will prove to be a really helpful tool for employers wishing to recruit and retain good staff.

But our biggest barrier to progress remains the complexity of State pensions. The weekly level of the Basic State Pension is fairly well known, but not the fact that over 10% of the population (rather higher for women) don't qualify for the full amount.

Beyond that is a sketchy and dangerous knowledge of the State Second Pension, the earlier Graduated Pensions and means tested top ups. Far too many people are clinging to the false hope that the State will provide enough.

If only we could sweep these away and replace them all with a simple Citizen's Pension. The widespread coverage it would get in the popular media would deliver a huge increase in the understanding of pension benefits. The Citizen's Pension would empower ordinary men and women to see for themselves whether their pension provision was adequate for their personal lifestyle, or not.

The awakening would unleash a new torrent of demand for company pensions, with workers checking that their employer was indeed helping them on the road to a retirement of the standard they want.

This is just what we need to make the 2012 pension reforms a success. Seeing how private pension builds on the clear foundation of a Citizen's Pension, people will welcome the forthcoming automatic enrolment and opt-out rates will be low. This will help the new NEST scheme being created by Government for employers without a pension scheme. And it will also provide a wave of support to existing pension schemes, pushing back the tide of scheme cut-backs we have seen recently.

The concept that citizens are stakeholders in society and as such should bear some responsibility for their own welfare was championed by New Labour in 1997. Today the prospect of a Citizen's Pension offers them a realistic chance to do so.

Jon Cruddas and Jonathan Rutherford

A brief history of pension reform

The future of Britain is an ageing population. Life expectancy is increasing dramatically, if unevenly, across the classes. The proportion of the population aged over 65 has risen to 12 million and is predicted to be 21 per cent of the population by 2050. Longevity is creating a new third age of life. We have begun a cultural revolution in ageing which will transform the political agenda and economy of the country.

This is an historic opportunity to begin living another stage of life. But the future of ageing for many is destined to be a time of financial insecurity and exclusion. Help the Aged report that 2 million older people live in poverty (a decline from 2.9 million in 1999). The basic state pension is below the official poverty line. The means tested Pension Credit that makes up the shortfall is unclaimed by many.

There is a growing recognition that pension reform is a major political issue and not just the concern of actuaries, civil servants and financial risk managers. The kind of provision government makes for pensions will shape the nature of our society. In the last few decades pension reform has been driven by a neo-liberal agenda which has redistributed public assets from labour to capital, from the poor to the rich, and from the public sector to the financial markets. Pension funding is fundamentally about who gets to claim future surpluses of capital. In the last few decades the winner has been a wealthy elite.

Elected in 1979, the Tories quickly turned their attention to pensions.

In his first budget, Geoffrey Howe, the Chancellor of the Exchequer, changed the rules by which state pensions were annually updated, from earnings to prices. The change would slow the rate of growth of the basic state pension. The purpose, said Howe, was, 'to reduce the burden of financing the public sector, so as to leave commerce and industry to prosper.'¹

Then, in 1986 the Conservatives reduced the benefits from the State Earnings Related Pension Scheme (SERPS), and individuals were instead encouraged to opt out, either into existing defined benefit (DB) pensions run by a company for its employees with a guaranteed investment returns, or into a defined contributions (DC) scheme, more flexible but with its value dependent on contribution levels and investment returns. Responsibility and risk within DC schemes is carried by the employee.

By April 1991, and much to the governments surprise, 4.3 million private pensions had been sold. The following year, David Clark, the deputy secretary for pensions, issued a warning: the government had spent £9 billion on tax rebates between 1988 and 1993, but the move to private pensions was only cutting the cost of SERPS by £3.1 bn.² The

reform was being heavily subsidised by the tax payer and was ruinously expensive. Worse was to come. The Securities and Investment Board audit revealed a shocking scandal. Sales forces had been employed on high bonuses to sell pension schemes regardless of their suitability, leaving their owners at risk of being impoverished in retirement.

The estimated cost of this mis-selling scandal was £13.5bn, to be met by insurers and financial advisers.³ The great majority of companies forced to pay compensation took the money from policyholders by underpaying the full returns on investment.⁴ By 2007, the average private pension fund was calculated to be worth £24000. The median weekly amount received by the 14 per cent of pensioners who owned one was a meagre £40, a little over £2000 per annum.⁵

As for the Basic State Pension, it is now worth only 16 per cent of National Average Earnings and despite the decision of the Labour Government to restore the link to earnings in 2012 it will continue to fall to 15 per cent by 2035. As the ageing population grows, total spending on state pensions and other benefits for pensioners will only rise from 4.9 per cent of GDP to 6.8 per cent in 2035.⁶ In comparison the European average is forecast to rise to 13.3 per cent in 2050.⁷

Neo-liberal reform has run down the value of the public provided state pension, and promoted DC in place of DB schemes. The aim has been to capture long term financial flows for profit, by transferring public pension assets and tax revenues to the stock market through the promotion of personal accounts. The shift has been spurred on by the underfunding and subsequent closure of growing numbers of DB pension schemes run by individual companies, vital to the proper functioning of the pension system. Their collapse has been more precipitous than in the US.

The Government's response to the pensions crisis is the National Employment Savings Trust, a revised version of personal accounts for low and moderate earners. But the future of pensions and the prosperity of tomorrow's older citizens will depend on building a more durable economy. A model capable of sustainable productive wealth creation and its equitable distribution across regions and across the population. Pension Funds will need to play a vital role in its development. The proposal for a Citizens Pension is the first vital step in the long march to win back pensions for the people.

Notes

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2. Norma Cohen, 'A Bloody Mess', The American Prospect Online, 2005, www.prospect.org
3. Rupert Jones, 'Mis-selling bill tops £13bn', The Guardian, December 2, 2000
4. Patrick Collinson, 'Insurers duck mis-selling bill', The Guardian, February 7, 2001
5. Pension facts December 2009, Pensions Policy Institute, www.pensionpolicyinstitute.org.uk
6. Ibid
7. Economic Policy Committee Working Group on Ageing Population, 'The impact of ageing populations on public finances: overview of analysis carried out at EU level and proposals for a future work programme', 2003, p6,

Alexandra Kemp

Capturing the Zeitgeist: The Citizen's Pension

A revolutionary idea to re-ignite democratic imagination and popular engagement? A catalyst for a new conviction politics? Could a Citizen's Pension inspire public trust and win the wide support necessary to turn a dream of welfare reform into an enduring reality? Is the Citizen's Pension a bold blueprint for the future whose time has come?

The Pensions Act 2007 captured the spirit of egalitarianism and a wide consensus to restructure the contributory national insurance system and credit in the social and economic contributions of women and carers. Gender poverty in retirement results from women wrapping working lives around caring responsibilities and from the gender pay gap's impact on pension contributions.

The success of Pension Credit, introduced as the Minimum Income Guarantee in 1999 as the means-tested answer to pensioner poverty, was to lift 1.9 million pensioners out of absolute poverty and 900,000 pensioners out of relative poverty. A gender-friendly benefit, Pension Credit helped 1,470,000 single women pensioners in 2007-8, 620,000 pensioner couples and 540,000 single male pensioners (DWP statistics). Pension Credit is a necessary, after-the-event solution to pensioner poverty for pensioners who could not afford to save or whose pension does not reflect their social contributions.

The ethos of the new Pensions Act 2007 is individual entitlement. For the first time, 75% of women will retire on a full Basic State Pension in their own right in 2010, up from 30% before reform. By 2025, 90% of men and women should retire on full Basic State Pensions.

But a £35 gap between the full Basic State Pension and the Guarantee Credit remains. Though the Second State Pension from 2002 allowed more generous rates of accrual for lower earners, carers and mothers with children under 6, it could take carers till 2040 to experience state pension outcomes equivalent to employees with full work histories. The self-employed, still excluded from the Second State Pension, will also struggle to bridge the gap to lift themselves above means-testing. (ONS, Pension Trends, Chapter 5, June 2009)

On the eve of the new reforms, it is time to think a stage further to 2025 and beyond, about a universal Citizen's Pension as the ultimate solution to pensioner poverty. A new contract between citizen and state. A new philosophy of citizen entitlements and universal benefits, pooled risk and mutual insurance. But how much should the Citizen's Pension be?

Joseph Rowntree Foundation's seminal work defining Minimum Income Standards for citizens, extensively debated during the Child Poverty Bill, endorses the Guarantee Level as an acceptable minimum basis for pensioner income. Rowntree's democratic public consultation exercise compiled a basket of essential goods and services according

to contemporary norms of what people need to maintain a decent standard of living and the means to participate.

A Citizen's Pension at the level of the Guarantee Credit, £130 a week for a single pensioner, is nearly what the Basic State Pension would now be – just above £135 a week – without the replacement of the link to earnings with prices in 1980 which heralded its 30-year decline in value.

A decade on, the uptake of Pension Credit has reached a plateau with Guarantee Credit take-up at between 72%- 81% of entitled recipients. The average amount of unclaimed Guarantee Credit is as high as £68 per week. 81% of entitled non-recipients are owner-occupiers as against 14% of entitled non-recipients who are social-rented sector tenants. Poorer owner occupiers are less likely to claim because they are generally less conversant with the benefits system than poorer tenants and can struggle to afford repairs which tenants have paid for by their landlords. In small rural communities, entitled pensioners are statistically less likely to claim Pension Credit than in towns or cities. (Commission for Rural Communities, Uptake of Pension Credit Report, December 2007)

The universality of a Citizen's Pension would be the best way of targeting help on poorer pensioners who do not claim Pension Credit. Rural pensioners are still discouraged from claiming by stigma, poor proximity or accessibility of advice, lack of literacy which is itself associated with lower earnings, and by popular misconceptions that pensioners with savings, or who own their own home, or still work or were self-employed during their working lives, cannot claim.

In 2009, West Norfolk Women and Carers' Pensions Network set up a Pension Credit Uptake Pilot, in partnership with the Pensions Service and the Post Office, to help overcome barriers to claiming Pension Credit in the sparsely populated area of West Norfolk using face-to-face communication, an important factor in encouraging pensioners to claim – 70% of older people have never used the internet (Help the Aged) and uncorrected hearing issues in the elderly can prevent people making claims unaided over the telephone (The Deaf Association).

Using a series of triggers to identify pensioners in need, postmasters flag up Pension Credit's existence (and disability and carers' benefits) and the advisability of periodic re-claiming, and make referrals, if people wish, to the King's Lynn Pension Service Outreach Team for a confidential assessment and home visit. The Network 's own poster/ leaflet, sponsored by the West Norfolk Partnership, challenges popular myths about entitlement.

A Citizen's Pension could tackle rural exclusion. In November 2009, the capital disregard for the Guarantee Credit increased from £6,000 to £10,000: with diminishing returns from savings, it is more important than ever that entitled pensioners claim.

Fairness between the generations - today's pensions are paid by the current working population - means the Citizen's Pension should be *funded as far as possible within the existing costs framework*. The cessation of the Savings Credit element of Pension Credit, a reward for saving, would be an acceptable trade-off.

The Citizen's Pension's certainty of outcome would encourage retirement saving by ending means- testing for pensions – though not for Housing Benefit and Council Tax Benefit, now passported by Guarantee Credit – and mitigate mis-selling risks for NESTS, the universal company pension scheme starting in 2012 designed for lower-earners.

Redistributive, gender-friendly, egalitarian and inclusive, the Citizen's Pension would reach out to pensioners who do not claim Pension Credit, and enable all to live a healthy life style and participate as citizens in retirement. A reaffirmation of security, dignity, solidarity and the ties that bind.

Mervyn Kohler

One milestone passed, many more to go

The consensus skilfully built on the recommendations of the Pensions Commission Report was grounded on two political concessions: it was a framework for phased action rolling forward into the future so did not require immediate actions, and it left to one side the legitimate concerns of the current pensioner cohort. If that consensus is now showing some signs of fraying, it is because both those concessions are now catching up with us.

The future is now arriving. The State Pension accrual rates are being reformed, and the implementation dates for its indexation to earnings and for the introduction of auto-enrolment into workplace pensions are approaching. This will increase the costs both to Government and to employers in decidedly unpropitious economic circumstances, as well as requiring contributions from the rather flat incomes of low-paid employees. Some delays have been agreed in the implementing of NEST schemes, but it remains important that the carefully constructed timetable does not slip any further. The full benefit of the reforms will not emerge for two or more decades, and it is vital that we make a resolute and determined start. As William Beveridge said, 'a revolutionary moment in the world's history is a time for revolutions, not for patching.'

It is also apparent that today's pensioners will still be going forward mired in means-testing. The IFS has shown that even with the reform programme, levels of pensioner poverty for the next decade will remain stubbornly static, at least in part because of the inefficiency of mean-tested benefits to reach the people they are intended to help. Work by the Pensions Policy Institute suggests that the proportion of pensioners eligible for means-tested benefits in the future will stay in the range of 35-40%. A key reason for under-claiming (and Pension Credit reaches only 70% of entitled recipients, and Council Tax Benefit only 60%) is that people do not understand that they may be eligible. The result is that £5bn goes unclaimed (by roughly 5m pensioners) every year. So we need to develop a system which is more automatic. If it is public policy to target support on the poorest pensioners, it is vital that the system reaches them effectively.

An alternative way forward is to build on the state pension, which has a very good take-up record. Over (quite a long) time, the combination of the reformed Basic State Pension and the State Second Pension will deliver a better state pension package - a replacement income of about 30% of average earnings. The next ambition for pension reform must be to get there more quickly, and prevent another generation of pensioners having to eke out their lives in poverty. Speeding up the period during which S2P entitlement will reach its 'full' value is an attractive and potentially self-funding option, and a reform which could also address the anomaly that the Basic State Pension and S2P are accrued on different criteria, as are their respective up-rating regimes. From the

combined BSP and S2P package, it is a relatively small step to re-badging it a Citizens' Pension and paying it as an automatic entitlement.

If this was adopted as an agreed public policy objective, with a firm date for when it can be achieved, we could begin to think of how to introduce it in stages (as finances allow) and target the most vulnerable groups of pensioners at earlier points of the process. For instance, the incidence of pensioner poverty increases with older age and living alone. This is recognised in the provision of the Winter Fuel Payment, which escalates with age and is paid on a household basis. Obviously the idea of moving to a full Citizens' Pension for every pensioner is wildly optimistic today in the current economic circumstances, but the challenges begin to look more manageable if we plan its initial introduction to apply (say) to those over 80 living alone, with further targets spelt out for its future extension.

Whilst acknowledging that cost and affordability are limiting factors, we should not allow our thinking to be constrained by our accountancy skills. Paying decent pensions is not a deadweight cost: pensioners will spend that money on goods and services. And it will contribute to improving their self-esteem and probably their health, to their ability to contribute to their family's welfare, and to their participation in the local community. The arguments against increasing the universal state pension offer focus on the 'undeserving' rich, rather than addressing the needs of the much larger group of pensioners on or near the poverty line.

Economists tend to build models on the presumption that people behave rationally to maximise their potential. Perhaps instinctively more than rationally, people on low earnings or with the expectation of low career earnings actually have behaved in this way, and chosen not to save for a pension. Small pension entitlements are of no value for a person likely to be eligible for means-tested benefits in retirement. This is the main ground for anxiety about auto-enrolment and NESTs. But if our planning for the future could envisage a Citizens' Pension at about 30% of average earnings by 2025 (as the pension age moves to 66), it would send an unequivocal message to anyone under 51 today that it will pay to save. In itself, this would support the auto-enrolment part of the current pension reform programme, and reduce the potential risk to the scheme of post propter hoc charges of mis-selling. Seen in this light, the move towards a Citizens' Pension could be portrayed as a continuation of the reforms prompted by the Pensions Commission report.

The recession and the new levels of Government debt are obstacles which make travelling down this road more difficult. But the prize will be a better-off and happier pensioner population making a greater contribution to the country's economy and well-being. We need to encourage our accountants to think of the fifteen or twenty year future. Or in the words Barack Obama's Chief of Staff Rahm Emanuel - 'Never allow a serious crisis to go to waste'.

Malcolm Small

Retirement: The Need For Urgent Reform

It's a sad reflection on the state of British social policy over the last couple of decades when we can look at almost any aspect of our current retirement framework and see prospective or current retirees faced with poor outcomes. From long term care provision to the current state retirement benefit systems, complexity, confusion and indifferent financial outcomes are the order of the day. Much needs to be done to restore clarity and confidence in our retirement architectures, whichever purpose they serve. Not least, it needs to be realised that the state retirement benefit system cannot be reformed without reform of the private pension saving structure; the two are inextricably linked. Inadequate policy design and implementation in one area will adversely affect another, made worse by the arcane complexity of both as they stand now.

First, however, a perhaps uncomfortable truth needs to be aired.

Longevity improvements are to be welcomed. We are all leading longer, healthier, lives than we have done in the past and this is, of course, a cause for celebration. However, longevity is truly the "elephant in the room" for retirement policy. When the Basic State Pension was introduced in 1948 with a State Retirement Age of 65 for men, average male life expectancy was 66. If that one-year differential between average male life expectancy and State Retirement Age were to be preserved today, then male retirement age in the UK would be 78 now. Projections suggest that a 25 to 30 year "retirement" will be commonplace soon, and is already a reality for hundreds of thousands of people. However, the state retirement system was not designed to deal with a large proportion of the prospective retiree cohort actually living until retirement age, and then living a long time in retirement when they got there.

The same is true for private pension saving; it is probably not realistic for the vast majority of people to be able to save enough from an, effective, 35 year working life to fund a 25 to 30 year retirement. This means that State Retirement Age must go up and indeed, provision is already in place to raise it to 68 in 2046, and in stages up to then. However, this now looks like "too little, too late", and we would argue that the State Retirement Age needs to move towards 70, sooner than this, if we are to enjoy adequate state and private support in an economically inactive retirement. This means working for longer, which of course many already do, with over 1.4 million people past retirement age continuing in work. For some, through disability or illness, this will not be an option – and we must put in place adequate support for them. However, we need to start a national debate around healthy ageing, and the financial and health benefits that can flow from longer working lives.

Second, we need to look at the State Retirement Benefit system. Until the reforms introduced with the advent of the Welfare State, the state pension was only available from age

70, and was means tested as well as being miserly. Beveridge established a Basic State Pension (BSP) built up by entitlement to provide a target income of 25% of national average earnings – nothing exciting, but enough to live on, with clear incentives to save for retirement beyond that. In the 62 years since, a hotch-potch of statutory and means-tested benefits have been added, while the value of BSP has slipped to just 19% of national average earnings or less. Pension Credit, Savings Credit, State Second Pension, Winter Fuel Allowance, supplementary cold weather payments, Christmas bonuses, Council Tax benefit and Housing benefit result in a bamboozling morass introduced by successive governments of whatever hue. In particular, the adverse interaction of means tested income benefits such as Pension Credit with private saving can act as a reward for the spendthrift and a disincentive to save for the prudent. Worse, it is estimated by the Department for Work and Pensions that between 30% and 40% of those entitled to claim Pension Credit, for example, are not doing so, meaning the benefit system is not reaching a large proportion of those in most need. Misplaced pride or the perceived complexity of the claims process are most likely the culprits here, but such factors are almost axiomatic in any means tested benefit system.

We need to return, as far as possible, to the principle of universality established in the last century, to provide a decent, universal, Basic State Pension for all at, or above, the current income level provided by the combination of BSP and Pension Credit. We believe that scrapping Pension Credit and State Second Pension – the latter is to move to flat rate in any case, destroying its original earnings link and effectively ending it – would go a long way to providing the savings needed to fund this move. Further support for this would come from implementation of the move to a State Retirement Age of 70, not least from increased national Insurance and income tax receipts.

Finally, we need to look at the current private pension saving “proposition” – tax relieved contributions, locked up until retirement age, then some tax free cash and an annuity income subject to tax. As with the State system, this has grown arcanelly complex over the years, which pension “simplification” in 2006, and more recent changes, have done little to dent. Almost impenetrable to consumers, and last designed, effectively, in 1956, it is delivering increasingly poor outcomes for many. Its complexity is closely linked to protecting the system of tax reliefs on contributions from “abuse” and the “quid pro quo” of this relief is the effective requirement to buy an annuity with the fund to provide a lifetime income.

An annuity, as more and more private sector workers save into Defined Contribution structures, will become the retirement income vehicle of default. However, annuity rates have been in structural decline for many years and are delivering increasingly low incomes from any given fund – and the size of those funds themselves have taken considerable “hits” in recent years. For a man aged 65, it will take 17 years of annuity payments to break even on the fund invested. Sadly, there is a correlation between life expectancy and level of income both in work and retirement, meaning many lower earners will fail to get their money back. Admittedly, the newer underwritten, “lifestyle” and flexible annuities can go some way towards lifting annuity incomes for those eligible, as can exercise of the Open Market Option. Those of us

inside the pension debate can recognise their value, although some Equitable Life annuitants might dispute that, but consumers increasingly view “their” fund as being subject to tax, and incapable of transmission across the generations, even if subject to tax. Two factors have combined to bring this debate to the fore. First is the restriction of tax relief for higher earners, which has rippled down negatively even to those not caught by the changes. The second is the welcome arrival of higher annual limits for ISA saving. We need to start the journey to find a new private pension saving architecture fit for the 21st century.

In all this, we should not lose sight of two things. First, no-one disputes the policy objective of getting more people to save more for the long term through auto-enrolment into saving through the workplace. The question is, into which architecture? Second, we need to recognise that pension policy is to some extent an outcome of employment and wider social policy. If people are genuinely unable to save, needing every pound of a modest income for the day-to-day, we cannot expect them to do so. This is why a decent basic provision from the State is so vitally important.

Joanne Segars

A View from the National Association of Pension Funds

For the NAPF, pensions work best when they are provided through the workplace. Only collective workplace pensions can deliver the key ingredients of successful private pensions: trust, economies of scale, good governance, reach and risk-sharing. The alternatives expose individuals to unacceptable risks and costs, and above all the risk of retiring on an inadequate income.

We have spent the past decade reforming workplace pensions, introducing auto-enrolment and mandatory contributions. However, workplace pensions cannot do all the work of providing retirement income, the state must play its part; only the state can effectively redistribute, especially to those who have had broken career patterns; and a decent state pension will make it more likely, not less, that people will state saving – and saving above the statutory minimum. So if they are to succeed and flourish, workplace pensions need to rest on a floor of a solid, sustainable – and above all adequate – state pension provision.

The current Government deserves credit for its state pension reforms. Reducing to 30 the number of years needed for a full state pension and restoring the earnings link are changes not to be dismissed lightly. They will help millions of people, and women in particular. But despite these reforms, the UK's state pension system will fail its most basic function – namely to provide security for all and ensure that everyone in society has an adequate income in retirement to enable them to live in financial security and with dignity.

- We have one of the lowest state pensions in the developed world. According to the OECD, the gross replacement rate for a median earner in the UK was just 30.8%, compared to an OECD average of 59.¹
- Today almost 3 in 5 (58%) pensioners will need some form of income-related benefit in old age. Even after the latest round of reforms, that number will fall only slightly to 53% – still unacceptably high.

Inadequate benefits are not the current system's only failings. The system is complex (comprising two separate pensions – the Basic State Pension and the State Second Pension and a maze of legacy and income-related benefits each with different rules and qualification criteria). It is unsurprising, therefore, that it is poorly understood by individuals. And the system will fail to keep pace with social, demographic and labour market changes. For example, while over time men and women will begin to experience similar outcomes from the state pension system, it will still take decades for the difference to equalise.

A new, more radical approach is needed.

That is why, later this month, the NAPF will be setting out its ‘Vision for Pensions’ – including proposals to radically reform and improve state pensions. We are part of the growing consensus that believes the sensible way forward is to combine the Basic State Pension and the State Second Pension into a single, flat rate benefit. We believe if we are to have meaningful state pension reform, the benefit available from the new combined pension must be set some way above today’s Pension Credit Guarantee level of £6,800 a year. Only then can we start to significantly reduce the numbers of pensioners requiring some form of means-tested benefits. We believe it would be possible to reduce by 10% the numbers retiring onto means-tested benefits.

Some tough choices lie ahead for politicians and voters if this objective is to be realised. If spending on state pensions is not to be increased beyond its current share of GDP, how should a higher state pension be paid for? Will state pension ages have to be increased – perhaps to 70? Should age-related benefits such as winter fuel allowances and TV licences for the over 70s be sacrificed? Or should we simply accept that an ageing population and the societal and economic imperative of a decent state pension requires us to face up to the fact that spending on our older population will have to increase also, requiring either taxes to rise or spending to be diverted from other parts of the welfare budget.

Lets us not make the mistake of assuming voters are not ready for these choices. NAPF consumer research shows that people would be prepared to work for longer if they could be certain of receiving a higher state pension. And – importantly – they would be prepared to save more too. As we prepare to enter uncharted territory of statutory minimum contributions to workplace pensions, we need to have some incentives in place to encourage people to save beyond the minimum. A decent state pension that will not be chipped away through means testing so that – finally – it really does “pay to save” must surely be part of the solution to delivering pensions adequacy for all.

Perhaps when it comes to delivering a decent state pension voters are ahead of the politicians – and not for the first time.

Whoever holds the keys to 10 Downing Street on May 7 cannot ignore this issue.

Note

- 1 The OECD replacement rates quoted here consider all mandatory sources of income relative to individual earnings.

Steve Webb

A Citizen's Pension

Back in 2004, the National Association of Pension Funds commissioned a piece of research from the Pensions Policy Institute into the feasibility of a Citizen's Pension¹. The report showed "how the transition to a Citizen's Pension from the current system can be managed in a practical and affordable way" and concluded that it should be given careful consideration. Interestingly, it suggested that "C-Day, the date of an overnight transition to a Citizen's Pension, could be on 6 April 2010."

That date is almost upon us, and there will indeed be an overnight reform of the state pension system. Under the new scheme, people will only require 30 years' worth of national insurance contributions to receive a full pension, rather than the current 44 years for men and 39 years for women.

These reforms are a step in the right direction, because they will ensure that many more women, who have consistently been seen as second-class citizens when it comes to pension provision, will receive a full state pension in their own right for the first time.

However, the 2010 reforms are not nearly as far-reaching as a Citizen's Pension would be. There are still legacy issues in the system, relating to the married woman's stamp and pre-1978 childcare, so it will still take until 2025 for more than 90 per cent of both men and women to receive a full basic state pension.²

Yet even at this point, and with the anticipated restoration of the earnings-link, the pension will still be well below the level of the means-test. The Government estimates that around 40 per cent of pensioner households will still be entitled to one or more income related benefits by 2050.³

So in 40 years time, the grand pensions plan is for a state pension that requires almost half of pensioners to jump through complicated means-tested hoops to claim additional top-ups that will boost their income to the level of the poverty line.

This in turn will still be propped up by a system of national insurance contributions that will keep tens of millions of separate records for every living person of working age (plus those of many who have deceased, to calculate widows' benefits), simply in order to exclude a few people from receiving a full pension.

The beauty of a citizen's pension, which to be credible must ultimately be set at the level of the Pension Credit, is that it would instantly sweep away the bureaucracy and expense of maintaining both these systems. Everyone would be entitled to a pension based on a simple residency entitlement.

It would also be an opportunity to remove the complexity of contracting-out once and for all. Rather than have a basic pension that everyone is part of and a second one, with a completely different set of rules, from which some people can opt out, we could eventually combine the two into a single decent state pension. Abolishing contracting out would provide up-front revenue to boost the state pension now. The transition to

a decent basic pension could be further accelerated by freezing new accruals to the state second pension and adding the money saved to the basic pension.

The CP was rejected by the Government, not on grounds of cost, but on principle, where they argued: *“it is right for people to receive state pensions in return for making economic or social contributions during their working lives.”*⁴ The problem with this argument is that we have already recognised that being a wage earner is not the only valuable contribution to society. Contributions are credited for those who are raising children, those who care for a disabled person, those who are unable to work because of unemployment or sickness and so on. And under the new rules someone who leaves school at 16 and retires at 66 can miss out on 20 years of contributions and still get a full pension. The National Insurance scheme has simply become a complex and expensive way of excluding dwindling numbers of people from a pension that is hardly worth having.

A single, simple, decent state pension must be the goal of all pension policy. It would mean that no-one would miss out through not taking up complex means-tested benefits. It would put men and women on the same footing for the first time. It would be cheaper to administer so that more of the available money was spent on pensions and less on form-filling. And it would mean people could save with confidence, knowing that their savings would not be clawed back through means-testing. If we are looking for an all-party consensus for long-term pension reform, the Citizen's Pension is an idea whose time has come.

Notes

- 1 National Association of Pension Funds (2005), Towards a Citizen's Pension
- 2 Written Answer, 12 May 2009, Hansard columns 683-4W
- 3 Written Answer, 1 June 2009, Hansard columns 104-5W
- 4 http://collections.europarchive.org/tna/20080305124627/http://www.dwp.gov.uk/pensionsreform/pdfs/white_paper_complete.pdf, box 3c

Howard Reed

Costing a Citizen's Pension

This chapter provides approximate costings for the introduction of a Citizen's Pension (CP) in the UK for the next four decades, from the present day to 2050. The calculations are based on the introduction of a CP in 2010¹ with the following characteristics:

- The CP pays £130 per week to every person aged 65 or over in the UK. This figure is used because it is the current level of Pension Credit Guarantee for a single pensioner. Hence a CP of £130 lifts every pensioner clear of means-testing - meaning that the Pension Credit Guarantee is no longer necessary². Pensioner couples receive a total of £260 per week, each significantly more generous than the current level of Pension Credit Guarantee for couple pensioners³.
- The CP is uprated in line with average earnings growth each year.
- No previous National Insurance contributions are necessary to receive the CP. The only qualifications are being aged over 65, and being resident in the UK for a minimum period (say, ten years).
- When the CP is introduced, new accruals of Basic State Pension (BSP) and Additional Pension (AP⁴) cease. Individuals maintain their entitlement to BSP and/or S2P accrued up to 2010⁵. Existing pensioners, and people who reach pension age in future, receive either the CP or the combined level of BSP, S2P and State Earnings Related Pension (SERPS) entitlement which they are entitled to – whichever is higher. Because CP payments increase

- 1 In reality it would take a few years to prepare for the introduction of a CP. However I have assumed in this paper that CP is introduced immediately as it makes it easier to compare how costs evolve under the CP compared with the current pensions system.
- 2 In fact, if the CP is introduced with a residency criterion (say, ten years' previous residency in the UK) then a small number of pensioners would not be eligible. This would mean that means-tested Pension Credit would continue to be used for people who did not meet the residency criterion. However, the costings here assume that all UK resident pensioners are paid the CP. Hence we can safely assume for the purposes of this paper that PC expenditure would be zero under the new system as there would be no residual of pensioners not receiving CP. This is a slightly unrealistic assumption but it makes it easier to cost the CP accurately.
- 3 Some of current Pension Credit spending is Savings Credit spending rather than Guarantee spending. The Savings Credit was introduced in 2003 to incentivise people to save for retirement by ensuring that pensioners with modest amounts of incomes from private pensions or other savings were not subject to a 100% taper on Pension Credit. However, because CP would be non-means-tested, pensioners would be able to keep any income from private savings or pensions in retirement without facing a means-test on it. Hence I have assumed that Savings Credit could be abolished if the CP were introduced. It would also be important to make sure that income tax thresholds were high enough to avoid penalising pensioners with modest amounts of savings under the CP – the current system includes a higher level of personal allowance for people aged over 65 to help incentivise savings for retirement, and I have assumed that this would be unaffected by the introduction of CP (although I have not tried to model changes in Income Tax receipts resulting from the introduction of CP in Table 1 below).
- 4 AP includes State Second Pension (S2P) which has existed since 2001 and State Earnings Related Pension (SERPS) which was its predecessor.
- 5 This means that the system of contracting out of S2P – whereby individuals pay a slightly lower rate of National Insurance contributions if they are not enrolled in S2P – would also cease in 2010. However, under current legislation contracting out will end in 2012 anyway, so this makes little difference to the overall costings.

in line with earnings whereas AP payments only increase in line with prices, over time, AP is gradually phased out as CP entitlements outstrip combined BSP and AP entitlements.

- The qualifying age for receiving CP rises from 65 to 68 between 2024 and 2046 in line with current government policy on raising the state pension age.
- Aside from Pension Credit (which is rendered redundant by CP), other benefits which some pensioners are entitled to are assumed to carry on under the same rules as currently apply. This includes Council Tax Benefit, Housing Benefit, Disability Living Allowance and Attendance Allowance.

Implemented in the way described here, the CP would have the following benefits:

- **Poverty alleviation.** The number of pensioners in the UK living below the Government's official poverty line – defined as an income of less than 60% of median household income, controlling for the number of people in the household – has fallen from 2.9 million in 1998/99 to 2.0 million in 2007/08⁶. The CP is set at a high enough level to take every pensioner household out of poverty. Because it is not means-tested, take-up is likely to be higher than the current Pension Credit, which is means-tested. Also, because CP would be uprated in line with earnings, it would continue to do the job of alleviating relative poverty in the future.
- **A better deal for pensioners with incomplete National Insurance contribution records.** Although the rules for qualification for BSP have been amended in the last decade to make it easier for people with periods of their working age lives spent out of the labour market (women and men looking after children full time, carers, unemployed people, and long-term sick and disabled people) to accumulate full contribution records, there are still millions of pensioners – and people who will become pensioners in the future – who will not be entitled to full BSP. The Citizens Pension would eliminate the disadvantage that these men and women face in retirement.
- **Administrative simplicity.** The UK's current system of state pension entitlements is extremely complex, featuring a means-tested safety net and contributions-based BSP and AP, all with different entitlement conditions, as well as "legacy" elements accumulated from previous decades. CP would eventually replace this with the simplest possible system – a flat rate payment per pensioner, generous enough to place all pensioners above the poverty line – while maintaining transitional support for accumulated contributions-based rights so that pensioners who have accrued significant amounts of earnings-related state pension would not lose out from the introduction of CP.
- **Incentivisation of savings.** Because the CP would not be means-tested, people of working age could make additional provision for retirement – either through private pension plans or saving schemes such as ISAs – without the worry that retirement income from these sources would reduce their entitlement to state provision.

But while all these advantages of CP are important, it is necessary to show that the CP is **affordable** – both in the short and long run – before it can be recommended as a reasonable alternative to current government policies. Table 1 below compares my estimates for the costs of a Citizens Pension (introduced in the manner detailed above) with the UK government's

own calculations of its current intended pensions policy, which is:

- (a) to continue to raise Pension Credit in line with earnings;
- (b) to raise BSP in line with earnings after 2012 (after 32 years in which it has been raised only in line with prices);
- (c) to convert AP to a flat-rate additional component by 2030.

Table 1 compares the costs of a CP with figures from the DWP's Pension Trends publication which show the government's current intended policy for the next 40 years⁷, between 2010 (assuming that the CP were introduced immediately at £130 per week) and 2050. The analysis makes the following assumptions:

- The amount of CP payments is worked out using the ONS's population projections for the number of people old enough to qualify for CP between 2010 and 2050 (taking account of the raising of the state pension age from 2020 onwards)⁸. The implicit assumption here is that take-up of CP is 100%. As CP would be a universal rather than a means-tested benefit this seems a reasonable approximation.
- As explained above, I assume that Basic State Pension and Additional Pension accruals cease after 2010, and there follows a transitional period in which pensioners are paid the higher of either CP or their accrued entitlement under BSP plus AP. The Pensions Policy Institute worked out the costs of a Citizens Pension in a research paper for the National Association of Pension Funds in 2005, using a similar transition rule. They found that while it would take around 30 years after the introduction of CP for everyone to be better off under CP than their accrued BSP and AP (and hence for AP to be phased out entirely), "in 85% of cases, switchover will happen within 10 to 15 years"⁹. I have worked out AP expenditure if the CP were introduced in 2010 using the DWP's online Tabulation Tool to establish what percentage of AP expenditure is currently being paid to individuals receiving £130 or more per week in total state pension payment: the answer is around 60 percent of current AP expenditure of £13 billion. I have assumed that this declines linearly to £1 billion by 2030 and then to zero by 2040, in line with the findings in the NAPF paper.
- Expenditure on Pension Credit (PC) is assumed to be zero under CP (because, assuming 100% take-up, all pensioners reach the PC Guarantee level of income anyway)¹⁰. In practice there would be some residual expenditure on PC because some pensioners qualify for additions to pension credit based on disability (the current disability premium rate for a single pensioner is £52.85 per week). However, DWP does not produce figures for the

7 Department for Work and Pensions, *Pension Trends*, chapter 5. Note that the figures here are expressed in 2009/10 prices whereas the figures in Pension Trends were expressed in 2007/08 prices.

8 I use the ONS's 2006-based population projections rather than the more recent 2008-based projections because these are the same ones that DWP used when calculating future expenditure under the current system as reformed by the Pensions Act 2007 (see DWP, *Pension Trends* (2009), Chapter 5).

9 National Association of Pension Funds (2005), *Towards a Citizen's Pension: Final Report*

10 I have assumed that the Savings Credit element of PC – which tapers PC entitlements so that pensioners with small amounts of private saving do not have their PC reduced pound-for-pound as their savings income increases – would be unnecessary after the introduction of CP, as CP is not means-tested and so pensioners would be able to keep any private savings income on top of it.

amount of current PC expenditure on the disability premium compared with the main rate, so I am unable to produce accurate costings for the residual amount of expenditure on PC for disabled pensioners which would remain under the CP. As it is likely to be a small percentage of total current PC expenditure I have disregarded it here.

- Expenditure on means-tested benefits for pensioners are not affected by the introduction of CP. In practice, there would certainly be a reduction in HB and CTB payments, resulting from higher take-up of CP compared with Pension Credit. However, it is impossible to calculate the precise reduction in HB and CTB expenditure without doing a full micro-simulation analysis, which is outside the scope of this paper. This creates an upward bias in our overall costings, whereas the omission of PC disabled premia creates a downward bias.
- Other (non-means tested) benefit expenditure is unchanged after the introduction of CP.
- Other pension benefits – the Winter Fuel Payment, free TV licences for over-75s and the Christmas Bonus – are unaffected by the introduction of CP.

Table 1: Cost of Citizens Pension compared with Government's Current Intended Pension System, 2010-2050 (all figures in £bn, 2009/10 prices)

Current system (including 2007 Pension Act reforms)	2010	2020	2030	2040	2050
Basic State Pension	54	72	103	137	163
Additional Pension (SERPS/S2P)	13	19	27	40	58
Pension Credit	9	8	7	6	5
Other pension benefits	3	2	3	3	3
Housing Benefit and Council Tax Benefit	8	8	8	9	13
Attendance Allowance and Disability Living Allowance	9	11	13	16	17
Total	96	119	161	210	259
Total as % of GDP	6.2	6.1	6.8	7.2	7.2
Citizen's Pension: proposed system					
Citizen's Pension	70	104	147	191	236
Additional Pension (SERPS/S2P)	8	4	1	0	0
Pension Credit*	0	0	0	0	0
Other pension benefits	3	2	3	3	3
Housing Benefit and Council Tax Benefit**	8	8	8	9	13
Attendance Allowance and Disability Living Allowance	9	11	13	16	17
Total	98	129	172	218	268
Total as % of GDP	6.4	6.7	7.3	7.6	7.6

Source: Current system – DWP Pension Trends (2009) Chapter 5, updated to 2009-10 prices. Citizen's Pension: author's own calculations. Costings assume earnings growth of 2% per year in real terms.

* does not include disabled premia for Pension Credit

** does not take into account the reductions in HB and CTB resulting from higher take-up of CP compared with Pension Credit

The results show that, assuming that HB and CTB payments are unaffected by the introduction of the CP (and they should in practice reduce), total benefit expenditure on pensioners is between £8 billion and £11 billion higher each year from 2020 to 2050 under the CP compared with the current pensions system (as modified by the Pensions Act 2007). Although the CP itself is considerably more expensive than the BSP it replaces, the savings from the phasing out of Additional Pensions and the savings in Pension Credit expenditure largely offset the additional cost of CP. Also it should be borne in mind that there would be administrative savings from the simplification of the system¹¹.

Overall, the version of the Citizen's Pension which I have modelled in this chapter delivers huge advantages over the current system – the eradication of pensioner poverty, an end to the disadvantage suffered in the current system by people who have to spend time out of the labour market, and a substantial reduction in complexity and administrative burden – for only a modest cost increase. While it would not solve all the problems in the current UK pensions system, it is an obvious starting point in the process of creating a pensions system fit for the 21st century

11 To reduce short-run costs, the CP could be phased in over a twenty year period rather than being introduced as soon as possible. For example, Baroness Hollis has suggested changing the accrual rules for S2P so that it becomes flat-rate by 2020 instead of by 2030 (which is the government's current plan), and rolling S2P and BSP into a single contributory state pension which would pay the equivalent of £130 per week in 2010 prices (uprated according to earnings growth by 2010). This would be cheaper than CP in 2020 because it provides a flat-rate entitlement at the equivalent of £130 per week rather than paying additional S2P above this for new claimants. Also its coverage would not be universal (self-employed people and those in contracted-out Defined Benefit pension schemes would not be included, for example). The scheme could be upgraded into a full Citizens' Pension at a later date.

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