



A state pension for
the 21st century
Green Paper

Response from the
National Pensioners Convention
June 2011

Summary and recommendations

- The UK state pension system has not tackled the scandal of poverty in retirement. Just under half of all older people are eligible for the means-tested Pension Credit, yet even this, when added to the basic state retirement pension, provides an income below the poverty level.
- Means-testing has failed in its attempt at getting money to the very poorest pensioners in society, because they remain amongst those who do not claim, and has at the same time unfairly penalised those with income just above the eligibility threshold.
- Women and ethnic minorities are disproportionately represented amongst the poorest pensioners; largely because of broken work records, low paid employment and a lack of recognition of their domestic responsibilities.
- The economic situation has highlighted the weakness of private pensions and their inability to provide a guaranteed income in retirement. Changes to occupational schemes will result in a transfer of investment risk onto individuals.
- One of the inherent weaknesses of the Green Paper is that neither of its two options for state pension reform would abolish the need for the means-tested Pension Credit or address its well documented limitations.
- Whilst Option 1 does little more than to keep the existing pension system and accelerate the changes to the state second pension, Option 2 actually provides for less pension income for future retirees than is currently available. It would also effectively create three variable pension schemes that would be in place until around 2080; all of which would have different qualifying conditions and offer different levels of support. This will do little to simplify an already complicated UK pension system.
- In addition, Option 2 raises serious questions over how a single, flat-rate pension would relate to eligibility for additional support with housing and other costs. If these were also reduced or removed the impact of Option 2 on overall pensioner income would be devastating.
- The basic state pension provides the most obvious and effective method of tackling pensioner poverty, both now and in the future. It should be set above the officially recognised poverty level and paid universally to all pensioners, based on residency. This could be easily afforded by introducing a number of changes to the National Insurance, taxation and pension systems.
- The state second pension should be maintained as a good earnings-related pension for all workers, maintaining the higher replacement rate for the low paid.
- The proposal to introduce either an automatic or review-based increase in the state retirement age is unnecessary. Evidence shows that longevity and income are inextricably linked. Any attempt to therefore raise the retirement age will have the greatest impact on the poorest in society. From 2020, the state retirement age of 65 for men and women should be retained.

Introduction

1. 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. At the heart of this Green Paper is the proposal to introduce a flat-rate single or two-tier state pension, which will support the introduction of the voluntary National Employee Savings Trust, alongside putting in place an automatic mechanism for raising the state pension retirement age. Whilst these proposals might 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 today's and tomorrow's older generation.

2. Despite the claims, since coming to power in June 2010 the government has already 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) is not about appropriateness or fairness. It is about cutting costs with the effect of dramatically reducing the retirement income of millions of pensioners. 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.

3. One of the major weaknesses of the Green Paper is its assertion that any reforms must be cost neutral in each and every year¹. However, it is unclear how this can be achieved, and whether or not the proposed increase in the state pension age is included in order to provide additional money to finance the other changes. Given that none of the proposed reforms will seriously reduce the need for means-tested support for pensioners up to 2016, and yet will create a complicated and bureaucratic pension system that has to operate for at least the next 70 years, it is unclear how any changes would actually be financed. By fully honouring accrued pension rights, whilst making a commitment not to increase spending, it must surely be the case that there will have to be both pension winners and losers under the new system. However, the Green Paper remains relatively silent on this important detail.

4. This lack of detail unfortunately runs throughout the document, and reveals a distinct absence of coherent policy. For example, whilst the Green Paper continues to advocate the payment of National Insurance as the distinct qualifying criteria for a state pension, the 2011 Budget statement in March indicated a desire to merge it with income tax. Given the need for accurate records of National Insurance payments, it is completely unclear how this could be done under a merged system. The Green Paper however makes no mention of this.

¹ A state pension for the 21st century, DWP, 2011

5. Much of the rationale behind the Green Paper 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 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. If the UK's pension system really is at a crossroads, these proposals are therefore extremely unlikely to take us in the right direction.

SECTION ONE

The current pension system

6. For decades, successive governments have relied on a pensions policy based on two key pillars:

- (i) The widespread use of means-tested benefits for existing pensioners with otherwise inadequate incomes
- (ii) The availability of good occupational pension schemes to take future generations of pensioners out of poverty and the need for additional support

However, these two pillars are now beginning to seriously crumble.

7. The basic state pension remains amongst the lowest and least adequate in Europe, supplemented by a means-tested benefit Pension Credit, that despite all recent efforts, fails to reach around a third of those who are entitled to make a claim². The latest figures show that in 2008/09 between £1.6bn and £2.9bn was unclaimed, with pensioners on average missing out on around £34 a week³. The fact that just under half of all pensioners (5m) are eligible for means-tested support to supplement their state pension proves that it is currently inadequate. In fact, Government Actuary's Department estimates show that if previous policies were to continue, the basic state pension as a proportion of average earnings - which in 1980 was around 23.5% - is likely to fall from around 14% today to just 6% by 2050⁴.

8. As a result, the number of older people considered to be living below the officially recognised poverty line of 60% median population income (estimated at £178 a week before housing costs in 2011) is a staggering 2.5m⁵ or nearly one in four. At least 15% of pensioners – over 1.5m older people – are living in persistent poverty (defined as living below 60% median population income for three out of the last four years) and around 61% of pensioner couples have an annual income of £15,000 or less, and 45% of all single pensioners have an annual income of £10,000 or less⁶.

² A state pension for the 21st century, DWP, April 2011

³ Income related benefits: Estimates of take-up in 2008/09, DWP, 2010

⁴ GAD Report 2007

⁵ Households Below Average Income 2007/08, DWP, 2009

⁶ Family Resource Survey, DWP, 2006/7

9. Britain currently spends around 6.5% of Gross Domestic Product (GDP) on state pensions, 0.5% less than the OECD average and is third from bottom of 43 countries offering higher pensions⁷. Our pensioner poverty rate is also among the highest in Europe and pensioners in the UK receive on average a state retirement income worth just 31% of their salary – compared to a European average of 60%⁸ (see Table 1).

10. The present UK pension system has also failed to address inequalities in retirement income. At least three quarters of existing women pensioners do not qualify for a full basic state pension in their own right, because they lack the required number of National Insurance contributions or credits. Recent figures show that on average women tend to get around £40 a week less state pension than men⁹ and those who have to rely on their husband's contributions receive just 60% of a full state pension. Persistent poverty is also concentrated among older women, with the proportion experiencing such poverty being three times that of the population as a whole¹⁰. On average, their total personal income is only 57% of men's; hence the poorest pensioners, those eligible for means tested Pension Credit, are mainly women.

Luxembourg	88.3%
Netherlands	81.9%
Spain	81.2%
Denmark	79.8%
Italy	67.9%
Sweden	62.1%
Average for the EU	60%
France	51.2%
Germany	39.9%
Estonia	32.9%
Ireland	32.5%
UK	30.8%

11. The main reasons for these partial pensions are women's typically low earnings, part-time work and broken career patterns often associated with domestic responsibilities. Whilst the Pensions Act 2007 will help more working age women in the future obtain a full basic pension after 30 years of contributions or care credits, the changes will do nothing to help existing women pensioners who have already lost out significantly under previous

⁷ Pensions at a Glance, OECD, 2011

⁸ Aon Consulting, November 2007

⁹ Gross State Pension Entitlement, DWP, 2011

¹⁰ Households Below Average Income, DWP, 2006/7

policies. Even future generations of women will have to wait until 2050 before they reach comparable outcomes with men in the state second pension¹¹.

12. In private (occupational or personal) pension schemes, women's typically restricted careers also place them at an even greater disadvantage. While around 71% of older men receive some private pension income, only 43% of older women do so. For those lucky enough to receive a private pension, women's pensions are on average 53% of their male counterparts¹².

13. In a similar way, black and minority ethnic pensioners also experience a greater risk of poverty. For example, 39% of Pakistani and Bangladeshi, 33% of Indian and 29% of Black Caribbean pensioners live in households with incomes below 60% of the median population income¹³. These pensioners are more likely to have experienced unemployment during their working lives, limiting their chances to save and were disproportionately found in low-paid jobs, with very limited access to occupational pension schemes.

14. However, if the current pension system is failing existing pensioners, the outlook for future generations is little better. When occupational pension schemes were first introduced into the workplace more than 50 years ago, there were more contributors than those retired members drawing a pension. However, over the decades little consideration was given as to whether the amount going into the schemes, from either employers or employees, was sufficient to cover their long-term obligations. For example, today the deficits of the BT and British Airways pension schemes are greater than the value of the companies to which they belong.

15. For those currently paying into an occupational pension scheme, the future also looks rather bleak. Millions of people nearing retirement already face a pensions' disaster because of the recent economic crisis. An estimated 5m workers are currently paying into defined contribution/money purchase schemes. These defined contribution pensions invest in a mix of shares, property, cash and bonds, but more than 90% of people opt for the default fund, where between 75 to 100% of investment is in shares.

16. With share values plunging over the last few years, a £100,000 pension pot which would previously have bought a monthly income of £620, will now buy just £490. For the average worker, their pension pot is more likely to be around £25,000 and their monthly income closer to £160¹⁴. For those in their late 50s or early 60s who had been hoping to retire within the next five years, the fall in share prices will therefore have undoubtedly damaged their pension prospects.

17. Research from private pension provider Scottish Widows also shows that 47% of those aged between 30 and 50 are not saving enough for their

¹¹ Gross State Pension Entitlement, DWP, 2011

¹² Arber and Ginn, Social Trends No 34, 2004

¹³ DWP Households Below Average Income 2006/7

¹⁴ NAPF Annual Survey, October 2008

retirement, with a fifth saving absolutely nothing¹⁵. It is suggested that individuals would need to build up a pension pot of around £425,000 in order to have an annual private pension income of £24,000, but for millions of workers this is simply not possible. The Department for Work and Pensions estimates that around seven million people are not saving enough for their retirement, but the real savings barrier they face is that they lack sufficient income to put aside at the end of the month after having paid their normal living expenses¹⁶.

18. For those with a defined benefit/final salary scheme, the picture is very similar. Most commentators have already begun to acknowledge the end of the final salary scheme, with the National Association of Pensions Funds reporting that 87% of final salary schemes have closed to new entrants including many high street names such as Boots, Barclays, Morrisons, Royal Bank of Scotland, the Post Office, IBM and Rentokil. 18% are also closed to existing staff – and this is likely to rise shortly to 39%¹⁷.

19. According to the Department for Work and Pensions, the average amount received from an occupational pension per week is £68 for a single pensioner and £153 for a couple; many of whom have little or no additional state pension¹⁸. Therefore, given the switch from final salary to less generous and volatile money purchase schemes, the scale of the shortfall in many existing pension funds and the high level of those who are not currently putting aside sufficient additional savings, it is imperative that the state pension system be radically reformed.

SECTION TWO

Options for state pension reform

20. The Green Paper offers two options for reform of the state pension system which would only apply to those retiring after 2015/16:

Option 1 – accelerated transition to flat-rate two-tier pension

- Thirty years of National Insurance payments/credits required to qualify for full Basic State Pension
- Basic State Pension at today's level and uprated each year by triple guarantee (higher of earnings, CPI or 2.5%)
- State Second Pension worth £1.60 a week for each qualifying year up to a maximum of 49/50 years, revalued each year in line with earnings and uprated in retirement by CPI (30 years would give £48 a week additional pension)
- Earnings-related element to be withdrawn between 2013-2020
- Pension Credit Guarantee and Savings Credit would continue

¹⁵ 7th Annual Scottish Widows UK Pensions Report, June 2011

¹⁶ Security in retirement: towards a new pensions system, DWP, 2006

¹⁷ The Politics of Pensions, NPC, 2010

¹⁸ The Pensioners' Income Series 2007/8, DWP, 2009

Option 2 – flat-rate single-tier pension

- Thirty years of National Insurance payments/credits required to qualify for full State Pension of around £140 a week (at today's prices)
- State Pension uprated each year by triple guarantee (higher of earnings, CPI or 2.5%)
- Minimum qualification of 7 years of National Insurance or credits required to receive a proportion of the £140 a week
- No special rules for marriage, bereavement or divorce – everyone would qualify as an individual
- State Second Pension, contracting out and Savings Credit would end
- Some form of means-tested support would continue for those unable to meet the 30 year contribution rule, but this is not outlined in the Green Paper

21. Option 1 merely continues with existing pensions policy, albeit in a slightly accelerated fashion, and whilst not necessarily introducing further complication to either the existing or future pension structure, it equally will not address the fundamental problem of pensioner poverty because it fails to raise significantly the level of the state pensions. Option 2 by comparison goes much further and raises some very serious concerns. It might actually put many future pensioners in a position that is even worse financially than current retirees. However, it remains very difficult to properly quantify because the Green Paper does not provide sufficient detail.

22. The decision to introduce a new state pension system just for those that retire after 2015/16 will effectively create three different pension schemes based on year of birth. Existing retirees will have a combination of first and second state pensions based on either 30, 39 or 44 years' worth of National Insurance contributions, those retiring after 2015/16 for the next few decades will have a combination of the existing system and that outlined in the Green Paper and those retiring around 2080 will be among the first with a state pension income based purely on the new system. It therefore suggests well over half a century of bureaucracy and complication before any real form of simplification is introduced.

23. The setting of a combined basic and second state pension at around £140 a week is already less than a majority of pensioners are currently getting with a basic, Graduated and SERPS based pension. In addition, it is even less than would be available under Option 1 – which on current figures would give someone with 30 years' worth of national insurance contributions a combined basic and second state pension of around £150 a week.

24. The Green Paper remains unclear as to the impact that a single flat-rate pension of £140 a week would have on the entitlement to housing related benefits. It could be assumed that anyone qualifying for the new pension at the full-rate would no longer be eligible for additional help with council tax and

housing benefit; dramatically reducing the additional support available to some of the country's poorest pensioners.

25. Despite some of the claims, none of the proposals would end the means-tested Pension Credit system for those who were unable to reach 30 years' worth of National Insurance contributions. In effect this will mean maintaining some form of means-tested support even after the single flat-rate pension has become established. In this respect the Green Paper does not specify at what level the means-tested support would operate, and in theory it could be less generous than the current system.

26. Option 2 also calls for an early end to contracting-out of occupational schemes. This would hit members, and sponsoring employers, by increasing their contributions. In turn this would lead to higher opt-out rates and remove a major incentive for employers to provide defined benefit (DB) pensions. The Green Paper recognises the sharp increase in National Insurance contributions that employers and employees in contracted-out schemes would face - 3.4 per cent of band earnings for employers and 1.4 per cent of band earnings for employees. Given this it is likely that employers would simply scale down their schemes to compensate for this loss. In reality, it would be yet another reason for employers to review the pension provision that they offer to their employees. The result could be the final nail in the coffin for defined benefit provision in the private sector, as employers move to defined contribution provision.

A more detailed analysis of the likely impact of Option 2 is shown as Appendix 1.

SECTION THREE

Means-tested safety net

27. The Green Paper accepts the need for the government to maintain a means-tested safety net for those who do not have sufficient income in retirement. Under Option 1, it is easy to see how this would continue, but one of the biggest omissions from the proposals is how the payment of the Option 2 single-tier state pension of £140 a week would relate to the Pension Credit. Set at £2.65 more than the existing level of the Pension Credit, individuals on the new pension would clearly cease to be eligible for additional support. However, Pension Credit Guarantee is currently a 'passported' benefit that entitles the recipient to automatic help with their council tax and housing costs. If this entitlement were to be removed, the £2.65 gained under the new single-tier pension would be significantly overtaken by the huge loss incurred through the removal of council tax and housing benefit.

28. The proposal to introduce a state pension set a just above the level of Pension Credit, rather than significantly higher, therefore does little to tackle the inherent problems created by the country's complicated system of means-testing. Since the early Victorian days of means-testing and the concept of a 'deserving poor', governments have struggled to achieve a 100% take-up of benefits. It is widely understood that people's income declines as they get older, often as a result of poor pension indexation and rising costs of living.

Whilst someone may therefore begin retirement above the threshold of means-tested support, over time it is likely they could become eligible, yet the targeted approach often focuses on those entering retirement rather than older pensioners. Moreover, the very poorest in society who were supposedly meant to gain from a targeted approach, are often the very ones who do not claim. For reasons that have been well documented such as complexity, inaccessibility, social stigma and a reluctance to deal with officialdom, it is clear that means-testing and pensioners simply do not mix.

29. One of the main side effects of means-testing has been the unfairness it creates for those whose incomes are just above the eligibility threshold. For example, whilst those in receipt of Pension Credit can also gain access to council tax benefit, those ‘nearly poor’ have to find the money to pay these bills in full. The net effect is that their disposable income may end up being well below such poverty or benefit thresholds. A more radical approach would therefore be to award the state pension in a way and at such a level that no longer required the Pension Credit to continue.

SECTION FOUR

State Pension Age

30. Alongside the two options to change the state pension system, the Green Paper also contains a further two options for introducing an automatic mechanism for raising the state pension age in line with life expectancy. These are summarised as follows:

Option 1 – formula linked to life expectancy

- Automatic adjustment of state pension age without oversight of Parliament

Option 2 – review of state pension age

- Regular review, at pre-determined intervals, undertaken by Parliament

31. Since the recommendations in the Turner Commission’s final report in 2005 and the subsequent legislation in the Pensions Act 2007, the argument for raising the state pension age has been promoted by those who see it as a way of tackling the scale and complexity of the demographic challenges posed by an ageing population. Some have described this challenge as being as significant as global warming – claiming that an ageing population will place an intolerable financial burden on the working population. What is worrying is that these widely expressed ideas are shaping and influencing future social policy; yet they are seriously flawed.

32. Much of the information that surrounds this debate tends to use data and statistics to support – either implicitly or explicitly – the case for rationing or cutting public spending, rather than as a justification for improving services. The ageing population is now cited widely by politicians, the media and other commentators as one the main reasons why the government has to introduce widespread cuts. However, although Britain, like most industrialised countries

has an ageing population, this is by no means a new development. Since the early 20th century, improvements in medicine and public health have led to a steady increase in the proportion of older to younger people. During this time technological and economic advances have raised both the employment rate and the productivity of the working population generally, and as a result the nation's wealth, measured by the Gross Domestic Product (GDP), and that of individuals, has also increased. To argue that an improved state pension system is unaffordable simply by looking at the age structure of the population is therefore both simplistic and historically inaccurate.

33. The 'panic' surrounding the prospect of an ageing population has also been over stated. The UK is expecting a 2% increase in the number of people over retirement age between 2009 and 2050; which will take the number of pensioners to 16m; representing 21% of the entire population over a forty year period¹⁹. It is therefore highly questionable that such a relatively minor change is being used to introduce such far reaching and detrimental policies.

34. Government ministers have been keen to suggest that that life expectancy "is a staggering 89 for men and 90 years for women." However, they are slow to point out that this figure refers to life expectancy for those born in 2008 – not existing adults.²⁰ By contrast, the Office for National Statistics only last October issued data showing that life expectancy in the UK at age 65 in 2006-08 was 17.4 years for males and 20 years for females. Therefore, men could be expected to live to 82.4 years and women to 85, not exactly their late 80s in either case.

35. There is also a difference between life expectancy at birth and life expectancy at 65 – as well as a difference between healthy life expectancy and disability-free life expectancy. In fact, all the figures show that disability-free life expectancy is not rising anywhere near as fast as life expectancy itself. It is therefore vital that some of the arguments used to support the existing approach to an ageing population are scrutinised more closely.

36. A Department for Work and Pensions' (DWP) discussion document, *Preparing For Our Ageing Society*, published in 2008, stated:

*"Within 20 years half of the adult UK population will be over 50. One in four children born today will live beyond 100. These are dramatic shifts that have far-reaching consequences for us all, and our ageing population will change our society in many ways."*²¹

However, researchers from the Open University have pointed out how this debate is often framed to suit a particular view. Specifically, they suggest the personalisation implicit in the claim that one child (in four) born 'today' will live to reach 100, overlooks the future of the other three. There is no qualification

¹⁹ www.gad.gov.uk, ONS, 2006

²⁰ The Guardian, 22 September 2010

²¹ *Preparing For Our Ageing Society*, DWP, 2008

regarding the predictions being made, but they are given as a statement of fact that they will happen²².

37. Similarly in 21 August 2008, the Office for National Statistics issued a press release regarding the rise in UK population figures. Within it was, on first glance, the rather innocuous statement that:

“For the first time ever, there are more people of state pensionable age than under 16s.”

However, it is quite clear that the political implications of such claims are that an ageing population implies increased costs in providing health care, pensions and housing. This in turn can then be used as justification for making changes to welfare and other state support. We are led to believe that we should be concerned that for the first time ever, there are more old people than children – all depending on people of working age to support them. But in reality the reverse is often the case: people of working age depending largely on the unpaid work undertaken by pensioners to provide childcare and voluntary organisations depending on them to maintain the functioning of our civil society.

38. For example, a recent survey showed that almost half of all employees depended on their parents to help with childcare so that they could go out to work²³. The truth is that the unpaid financial contribution that older people make to the economy is never taken into account. New research by the Women’s Royal Voluntary Service shows that the net contribution made by older people to society is £40bn every year in taxes, unpaid caring and voluntary work²⁴. The report also revealed how older people are often the social glue - making an active contribution to their local communities through volunteering.

39. Despite numerous reports in the media and statements from politicians of all shades, the issue of longevity is more complex than the way it is often portrayed. There is an unsupported claim that everyone is living longer, healthier lives and that life expectancy is, and will always, continue to increase.

40. However, evidence suggests this is far too simplistic a way of looking at the issue. Recent figures from the Office for National Statistics (ONS) show that life expectancy at state pension age is expected to level off between 2021 and 2051 for both sexes. During this period, the number of extra years at 65 are projected to be 22 for men and 25 for women (see Table 2):²⁵

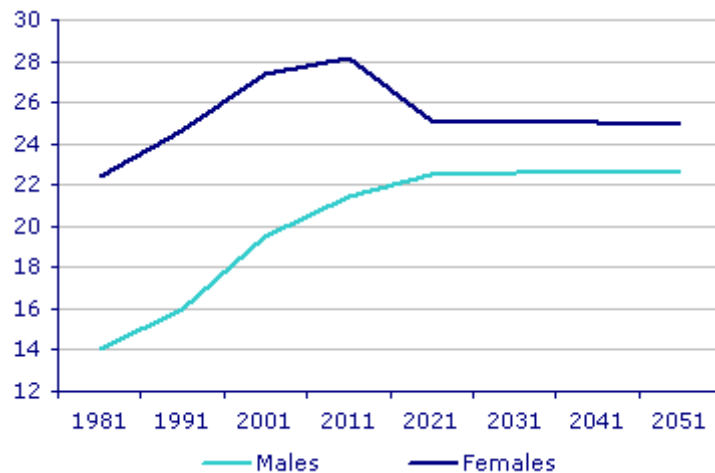
²² Bill Bytheway and Julia Johnson, Centre for Ageing and Biographical Studies, Open University, Radical Statistics 100, 2010

²³ www.workingmums.co.uk, 2010

²⁴ Gold Age Pensioners, Prof Robert McNabb, Cardiff Business School, WRVS, 2011

²⁵ ONS, Pension Trends, Life Expectancy and Healthy Ageing, Chapter 3, 25 June 2010

TABLE 2



Projected principal period of life expectancy at State Pension Age: by sex, 1981 to 2051
Source: ONS

41. Obviously, whilst life expectancy has increased over the last 50 years, there is still a limit to longevity because of the physical ageing process. Similar ONS data also shows that the period of average life expectancy at birth in 2006-08 in the UK was 77.4 years for a man and 81.6 years for a woman²⁶.

42. But longevity is not an issue that affects everyone equally. The ONS also states that in 2002-5, people at age 65 in the top social class group (professionals such as doctors, accountants and engineers) could expect to live 4.2 years longer than those in the bottom social class group (unskilled manual labourers)²⁷.

43. In the recent Marmot Review, researchers also found a clear link between affluence and length of life. The review found that in England, people living in the poorest neighbourhoods will on average die seven years earlier than those in the richest neighbourhoods, and the average difference in disability-free life expectancy is 17 years. Those in poorer areas not only therefore die sooner, but they will also spend more of their shorter life with a disability. The report concluded: “The higher one’s social position, the better one’s health is likely to be”²⁸.

44. This view is echoed by recent district by district NHS figures which show that men in Blackpool live on average to 73.2 years – 10.5 years fewer than their counterparts in Kensington and Chelsea, whilst women in Hartlepool have the lowest life expectancy of 78.1 years; 9.6 years less than women in Kensington and Chelsea²⁹. It is therefore clear that life expectancy rates are rising much faster in affluent areas.

²⁶ ONS, News Release, 21 October 2009

²⁷ ONS, Pension Trends, Life Expectancy and Healthy Ageing, Chapter 3, 25 June 2010

²⁸ Fair Society, Healthy Lives, The Marmot Review, February 2010

²⁹ The Politics of Pensions, NPC, 2010

45. Much more therefore needs to be known about the years of healthy life expectancy rather than simply length of life. Contrary to popular perceptions, healthy life expectancy has not increased at the same rate as life expectancy and a greater proportion of retirement is now spent in ill-health³⁰. The Department for Work and Pensions' own figures show that 47% of retired people have a disability, including those with a limiting long standing illness, and of the existing working-age population, a staggering 23% are permanently sick or disabled³¹. This is clearly not a generation that has the ability to simply keep working. Current concerns about the rate of obesity amongst young children, the prevalence of poor diets, lack of exercise and increased stress must also surely raise doubts as to the health of future generations and the likelihood that they will live longer than today's retirees.

46. In fact, on closer examination, there is no solid reason to assume that the trends of medical advances, increased affluency and increased longevity will continue at their current rate. Indeed there is evidence that advances in health are now going into reverse³².

47. In a modern society people in different social circumstances experience avoidable differences in health, well-being and length of life. The evidence is quite clear that any attempt to raise the state pension age will therefore have a disproportionate impact on those members of society with the lowest incomes and the poorest health. It is simply unfair to therefore build a retirement policy which fails to take account of this important issue, alongside the rate of unemployment and availability of work, the rights of younger people to find a job and the loss to wider society if pensioner volunteers (currently undertaking unpaid caring and charitable work) were otherwise in paid employment.

48. Rather than raising the retirement age, we should be addressing the problem of low income through an improved pension system. In effect, by removing the right to a decent period of retirement for ordinary working people, we are accepting the myth that increased longevity necessarily enables people to work longer, and that an individual's only worth is measured through their ability to be economically productive.

SECTION FIVE

An alternative to the Green Paper

49. The Green Paper expresses a desire to fundamentally alter the structure of the state pension system, extend its fairness and strengthen its ability to provide a decent income for all in retirement. However, as it stands, the limited proposals it contains will be unable to achieve such worthy aspirations.

50. The current economic crisis provides an almost unique opportunity to reassess how, as a society, we provide for our retirement. Like many other

³⁰ Increasing Longevity and the Economic Value of Healthy Ageing and Working Longer, L Mayhew, Cass Business School, 2010

³¹ Family Resources Survey 2008-09, DWP, 2010

³² Today's teenagers are less healthy than their parents, J Laurance, The Independent, 27 March 2007

European countries, it is time we recognised the inherent weaknesses of our over reliance on means-testing and the private pensions system, and instead concentrate on strengthening the existing National Insurance based state pension as the most effective way of tackling pensioner poverty, both now and in the future.

51. We propose the following key improvements to the state pension system:

- Increasing the basic state pension for all existing pensioners (regardless of contributions) to the official poverty level (60% of median population income, which is estimated to be around £178 per week in 2011). This would remove the need for means-tested support for all but a very small number of individuals unable to meet the citizenship criteria³³. The main gainers would be those, particularly women, who do not currently have a full contribution record. A more detailed analysis of the effect of this policy on incomes is given in Appendix 2.
- Introducing a new form of indexation for the basic and second state pension, linking it annually to average earnings, RPI, CPI 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.
- Retaining the State Second Pension (S2P) 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.
- Maintaining the state retirement age for men and women at 65 from 2020.

52. These proposals could be financed in a number of ways, including:

- Using 83.2% of the existing surplus balance of around £41bn in the National Insurance Fund, which has been paid in by today's employees and employers, as part of the pay-as-you-go system. This would still leave the legally required 16.8% balance to cover any additional expenditure.
- Abolishing the Upper Earnings Limit of £42,484 on National Insurance contributions, ending the injustice in which the higher paid contribute a smaller proportion of earnings than the lower paid. This would raise an estimated £10bn every year.
- Reforming the higher rate tax relief on private pensions which allows higher earners to pay less than the lower paid for a given contribution to their pension schemes. This currently costs the Treasury around £37bn a year – with the top 1% of taxpayers receiving around 25% of the rebate, whilst the average employee receives just £330 a year. This is neither the most effective nor equitable way of using public money, giving a massive incentive to save to those who least need it.
- Abolishing the means-tested Pension Credit, and substantial demands for Council Tax and Housing Benefit would raise around £10bn annually.
- Enabling additional contributions planned for the National Employee Savings Trust to go towards an enhanced State Second Pension for those

³³ The need for the means-tested Pension Credit, Council Tax and Housing Benefit would be removed. The state pension would move towards becoming a Citizen's Pension funded through National Insurance, but based on residency of say 30 years, rather than contributions

currently without an occupational pension, rather than into the private pensions industry. This would raise an estimated £18bn.

- The current equalisation of women's state pension age at 65 in 2020 is also set to save up to £10bn in delayed payments.
- Up to £120bn a year is currently uncollected, avoided or evaded in taxation, mainly from large corporations and businesses³⁴. Where necessary, Treasury grants can be made into the National Insurance Fund to pay for expenditure.

SECTION SIX

Conclusion

53. The Green Paper has failed to grasp the need for socially just, radical reform of our pension system, despite the fact that all the evidence supports the case for a stronger state pension. There are very striking inequalities and disadvantages for millions of existing and future pensioners contained in the Green Paper, but a strengthened state pension system could ensure real financial security for everyone in retirement, and end the reliance on means-testing and the private pension industry. How we provide for ourselves in later life is a crucial test of how well society is organised. The principle of social insurance and shared collective provision is one which best protects us all from the scandal of pensioner poverty. That is why a universal citizen's pension set above the poverty level, coupled with a strengthened state second pension and a retirement age of 65 for men and women is the way to create a decent state pension system for the 21st century.

CITIZEN'S PENSION: All existing and future pensioners, with 30 years' residency, would qualify in their own right for a flat-rate basic pension set at the official poverty level (60% median population income before housing costs, estimated to be around £178 a week), with those paying National Insurance Contributions also qualifying for an additional state second pension.

OUTCOME: Providing additional support with housing costs was still available, all pensioners would receive a boost in income. Only those without 30 years' residency would need additional means-tested support.

VERDICT: Likely winners

APPENDIX 1

Impact of Green Paper Option 2

³⁴ There is an alternative – the case against cuts in public spending, PCS, 2010

Single flat-rate state pension for those retiring after 2015/16 (£140 a week at 2011 prices)

EXAMPLE A: Single pensioner in receipt of Pension Guarantee Credit, but not Savings Credit. Total income currently £137.35 a week plus Council Tax/Housing Benefit of up to £170.

OUTCOME: Those with at least 30 years' worth of National Insurance contributions/credits would gain £2.65 a week in pension, but may lose all or partial entitlement to Council Tax Benefit/Housing Benefit if flat-rate pension were to rule out passport to other support. May not be as generous as Option 1.

VERDICT: Likely loser

VERDICT: Likely loser

EXAMPLE B: Single pensioner, not in receipt of Pension Credit or other means-tested support. Total income currently over £140 a week.

OUTCOME: Those with at least 30 years' worth of National Insurance contributions/credits would be unaffected by the proposal due to their accrued rights to a higher state second pension than would be available under the single flat-rate pension.

VERDICT: No change

EXAMPLE C: Single pensioner, eligible but not claiming Pension Credit or other means-tested support with a total income currently less than £140 a week.

OUTCOME: Providing they had at least 30 years' worth of National Insurance contributions/credits they would receive the single flat-rate pension of £140 a week. It is unclear what support will be available for those with less than 30 years' worth of National Insurance contributions/credits.

VERDICT: Likely winners (estimated at 120,000-250,000 individuals)

EXAMPLE D: Single pensioner, retiring in the future (circa 2080) solely on the single flat-rate pension of £140 a week with no accrued rights.

OUTCOME: £140 a week is around £10 less than the individual would have got under the existing system or Option 1 proposed in the Green Paper. They may also lose out on additional means-tested support with housing costs.

VERDICT: Likely loser

will each qualify for a single flat-rate pension of £140 a week in their own right, but they may lose their entitlement to Council Tax Benefit/Housing Benefit. It is unclear what support will be available for those with less than 30 years' worth of National Insurance contributions/credits.

VERDICT: More detail needed

EXAMPLE F: Pensioner couple, not in receipt of Pension Credit or other means-tested support. Total income over £209.70 a week.

OUTCOME: At present a married couple where one partner has up to 30 years' worth of National Insurance contributions/credits and the other a full record and an occupational pension, may be over the qualifying threshold for Pension Credit. In this case, under the new system, a 30 year contribution of the lower income partner would qualify for a full pension of £140 a week – rather than 30/39ths (as at present for women).

VERDICT: Likely winners (lower income partner) but more detail needed

EXAMPLE G: Pensioner couple, eligible but not claiming Pension Credit or other means-tested support with a total income currently less than £209.70 a week.

OUTCOME: Providing they both had at least 30 years' worth of National Insurance contributions/credits they would receive the single flat-rate pension of £140 a week each. It is unclear what support will be available for those with less than 30 years' worth of National Insurance contributions.

VERDICT: Likely winners (estimated at 50,000-120,000 couples)

APPENDIX 2

Effect that raising the Basic State Pension above the official poverty level would have on eligibility for means-tested benefits (2010 levels)

Example A: Single Pensioner on full Pension Credit

1. Working assumptions:

Council Tax is £1050 per annum (£1400 less 25% for single occupancy)

Rent is £150 a week

2. Individual receives (weekly):

Basic State Pension: £97.65

Savings income/SERPS/Occupational Pension etc: £0

Maximum Pension Credit (Guarantee): £34.95

Savings Credit: £0

Maximum Council Tax Benefit: £20.19

Maximum Housing Benefit: £150

3. Basic state pension is then increased from £97.65 per week to £175 (estimated poverty level in 2010)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the individual would lose:

£34.95 Pension Credit (Guarantee)

£4.28 Council Tax Benefit (but still receive £15.91)

£13.02 Housing Benefit (but still receive £136.07)

Example B: Single Pensioner on full Savings Credit

1. Working assumptions:

Council Tax is £1050 per annum (£1400 less 25% for single occupancy)

Rent is £150 a week

2. Individual receives (weekly):

Basic State Pension: £97.65

Savings income/SERPS/Occupational Pension etc: £34.95

Pension Credit (Guarantee): £0

Maximum Savings Credit: £20.97

Maximum Council Tax Benefit: £20.19

Maximum Housing Benefit: £150

3. Basic state pension is then increased from £97.65 per week to £175 (estimated poverty level in 2010)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the individual would lose:

£20.97 Savings Credit

£11.28 Council Tax Benefit (but still receive £8.91)

£36.68 Housing Benefit (but still receive £113.32)

Total loss £68.93 per week

5. However, this would be offset by an increased basic state pension of £77.35, resulting in a net gain of £8.42 a week

Example C: Pensioner Couple on full Pension Credit

1. Working assumptions:

Council Tax is £1400 per annum

Rent is £150 a week

2. Couple receives (weekly):

Basic State Pension: £156.15

Savings income/SERPS/Occupational Pension etc: £0

Maximum Pension Credit (Guarantee): £46.25

Savings Credit: £0

Maximum Council Tax Benefit: £26.92

Maximum Housing Benefit: £150

3. Basic state pension is then increased from £156.15 per week to £350 (2 x £175)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the couple would lose:

£46.25 Pension Credit (Guarantee)

£23.97 Council Tax Benefit (but still receive £2.95)

£77.90 Housing Benefit (but still receive £72.10)

Total loss £148.12 per week

5. However, this would be offset by an increased basic state pension of £193.85, resulting in a net gain of £45.73 a week

Example D: Pensioner Couple on full Savings Credit

1. Working assumptions:

Council Tax is £1400 per annum

Rent is £150 a week

2. Couple receives (weekly):

Basic State Pension: £156.15

Savings income/SERPS/Occupational Pension etc: £46.25

Pension Credit (Guarantee): £0

Savings Credit: £27.75

Maximum Council Tax Benefit: £26.92

Maximum Housing Benefit: £150

3. Basic state pension is then increased from £156.15 per week to £350 (2 x £175)

4. Under the existing tapering rules for means-tested benefits (Pension Credit, Council Tax and Housing) the couple would lose:

£27.75 Savings Credit

£26.92 Council Tax Benefit

£110.40 Housing Benefit (but still receive £39.60)

Total loss £165.07 per week

5. However, this would be offset by an increased basic state pension of £193.85, resulting in a net gain of £28.78 a week

Additional notes

- All examples are based on 2010 figures
- All examples assume tapering of means-tested benefits remains at current thresholds
- All examples provide an income that is below the current personal tax allowance threshold
- Examples of housing costs assume £150 rent for a two bedroom, semi detached property in Reading. Further modelling work is planned

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