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Case studies for the  
Runnymede Trust



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**A PPI Technical Paper**

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## Introduction

The Government published proposals for reform of the state pension system in May 2006<sup>1</sup>.

As part of a study into the impact that these reforms will have on individuals from Black and Minority Ethnic (BME) groups in the UK<sup>2</sup>, the Runnymede Trust has commissioned the Pensions Policy Institute (PPI) to produce a series of case studies illustrating the potential impact of the reforms on the amount of state pension income received by individuals with characteristics similar to those seen in many BME households.

The case studies used in this report are not representative of any particular BME group, or of BME households as a whole. They illustrate some of the types of lifestyle and work patterns that exist in the BME community.

For each case study the amount of state pension income<sup>3</sup> that would be received is calculated assuming that the current state pension system continues, and then that the proposals outlined in the White Paper are introduced. Comparisons are made at state pension age, and also 10 years after state pension age to illustrate how the amount of state pension income received varies through retirement. The state pension amounts in the case studies are also compared to the income level needed to qualify for Pension Credit under each pension system.

The case studies show that:

- Only people reaching state pension age after 2010 would initially see a gain from the White Paper proposals.
- All of the case studies analysed could have a higher state pension at some point in retirement, even if not at state pension age.
- Some of the case studies have a state pension of below the Guarantee Credit level, even after the reforms. This means that they are unlikely to see gains from the White Paper proposals, unless they have income other than their state pensions.
- Not everybody who is eligible for Guarantee Credit claims it, so a risk of poverty remains for some.
- State pension incomes remain low for the lifetime self-employed. The case study family analysed would have to release more than £70,000 from their business to be above all Pension Credit at state pension age.
- Some of the married individuals analysed do not work outside the home. They would receive a Basic State Pension in their own right under the White Paper reforms, unlike in the current system, although they would not qualify for the full amount.

<sup>1</sup> Department for Work and Pensions (2006) *Security in Retirement: towards a new pension system*

<sup>2</sup> Barnes (2006) *Proposals for Pensions Reform - Implications for Black and Minority Ethnic Communities*

<sup>3</sup> Basic State Pension and SERPS/ State Second Pension or contracted-out equivalent

### Assumptions

There are a number of common assumptions used in the case studies, for example how different parts of the state pension system are updated, rates of inflation and rates of earnings growth. These are outlined in the appendix to this report.

For each case study a number of specific assumptions are made, for example whether individuals work, their age-specific earnings and whether they are married. These are outlined in the case studies themselves. Further details are available on request.

### Pension Credit

Pension Credit consists of two elements, Guarantee Credit and Savings Credit. When Pension Credit was first announced, the Government's aim in introducing Guarantee Credit was stated as ensuring that the poorest people over age 60 have a minimum level of income, while the aim in introducing Savings Credit was stated as rewarding saving<sup>4</sup>.

Both Guarantee Credit and Savings Credit are means-tested benefits, so amounts depend on how much income people have. They are awarded on a household basis, so for couples living together the appropriate income to consider is the combination of the two partners' incomes.

The calculation of both Guarantee Credit and Savings Credit eligibility is based on combined state and private income. Some types of capital can also count as 'notional income' in the calculation. So whether the households are eligible can depend on how much they save for retirement and work past state pension age.

The calculation of Guarantee Credit and Savings Credit is complicated. Broadly<sup>5</sup>:

- If the households in the case studies have an income of less than the Guarantee Credit level (as shown in the tables, see below), they would be eligible to have their income topped up to that level.
- For every £1 of income between the lower threshold for Savings Credit and the Guarantee Credit level, households are eligible for 60p of Savings Credit. Savings Credit is slowly withdrawn for those with incomes between the Guarantee Credit level and the upper threshold for Savings Credit, at the rate of 40p for each additional £1 of income.

If households are eligible for Guarantee Credit but not Savings Credit (for example, if their income is below the lower threshold for Savings Credit), then they face a marginal withdrawal rate of 100% on additional saving. £1 of additional saving will mean £1 less of Guarantee Credit, so no overall gain.

<sup>4</sup> Department of Social Security (2000) *Pension Credit: A consultation paper*

<sup>5</sup> For more information, see DWP (2005) *A Guide to Pension Credit*

If households are eligible for Savings Credit, whether or not they are eligible for Guarantee Credit (for example, if their income is between the lower and upper thresholds for Savings Credit), then they face a withdrawal rate of 40% on additional saving.

Pension Credit is a benefit that has to be claimed. Not everybody claims the benefit to which they are eligible:

- Around three-quarters of households who are eligible for the Guarantee Credit element (whether or not they are also eligible for the Savings Credit element) take up their benefit.
- Take-up is lower for households who are only eligible for the Savings Credit element. Less than one-half of such households take up their benefit.

This imperfect take-up means that some households do not receive as much as the Guarantee Credit level.

The tables in this paper show both state pension income and the thresholds for Pension Credit, as indicated below.

The sum of Basic State Pension (BSP), State Earnings-Related Pension (SERPS) and State Second Pension (S2P) received by X

The sum of BSP, SERPS and S2P received by X's husband

**Example Table: State pension income under the White Paper proposals and under the current system, in £ per week, 2006/7 earnings terms**

	At state pension age		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for X				
State pension income for X's husband				
Combined state pension income				
<b>Pension Credit levels</b>				
Guarantee Credit				
Lower threshold for Savings Credit				
Upper threshold for Savings Credit				

The family could be entitled to Guarantee Credit if their combined income is below this level

The family could be entitled to Savings Credit if their combined income is between these two levels

<sup>6</sup> Midpoints of ranges of take-up estimates by caseload in DWP (2006) *Pension Credit Estimates of Take-Up in 2004/2005*

## Case Studies

### **Example 1: A moderate-income large family**

S was born and brought up in the UK. She left school at 18 and worked in retail jobs until the age of 22, when she married. She worked until the birth of the first of her four children, at 24. She did not do paid work until the youngest of her children went to secondary school, by which time she was 41. She then did a part-time job in a local community centre. By her mid 50s, S had some health problems. She was starting to take more and more sick leave, and agreed to leave her job on the grounds of ill-health at 57. She qualified for Incapacity Benefit until reaching state pension age (60) in 2009.

S's husband is older than her, reaching state pension age (65) in 2009. He has a good work record, earning the median amount for men of his age.

#### **Impact of the White Paper proposals**

This family would initially not see any change in state pension income under the White Paper proposals, as the proposals to increase the coverage of the Basic State Pension do not come into effect until 2010.

However, 10 years after state pension age, their state pension income would be higher under the White Paper proposals than under the current system. Their combined state pension income would be around £223 per week under the White Paper proposals rather than £199 per week under the current system (Table 1). This is due to the earnings uprating of Basic State Pension from 2012.

The White Paper reforms to S2P do not affect this family because the reforms are proposed only for S2P accruals after 2010.

#### **Pension Credit**

Under the current system, S and her husband would be eligible for a small amount of the Savings Credit element of Pension Credit at state pension age, if they had no other income than their state pensions.

Although the family initially have the same state pension under the White Paper proposals as under the current system, they would be above Pension Credit at state pension age under the White Paper proposals. This is because the Savings Credit element of Pension Credit is made less generous under the White Paper proposals from 2008, compared to the current system.

However, under both pension systems, their state pension income would decline relative to average earnings during their retirement, because income from S2P is increased with prices rather than with average earnings. This means that, under the White Paper proposals, they would be eligible for the Savings Credit element of Pension Credit within 10 years of state pension age, if they had no income other than their state pensions.

**Table 17: State pension income under the White Paper proposals and under the current system, if state pension age is reached in 2009, in £ per week, 2006/7 earnings terms**

	At state pension age		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for S	£91	£91	£86	£74
State pension income for S's husband	£153	£153	£137	£125
Combined state pension income	£244	£244	£223	£199
<b>Pension Credit levels</b>				
Guarantee Credit	£174	£174	£174	£174
Lower threshold for Savings Credit	£132	£127	£136	£104
Upper threshold for Savings Credit	£237	£245	£231	£279

#### Reaching SPA in 2010 rather than 2009

If S and her husband reach state pension age in 2010, rather than in 2009, they would still not receive any higher state pension under the White Paper proposals at state pension age than under the current system. This is because they both already have full BSP under the current system and so do not gain from the proposed improvements to BSP coverage.

<sup>7</sup> PPI analysis using the Individual Model. State pension income includes BSP and SERPS/ S2P and contracted-out equivalent. Pension Credit thresholds assume that S is not considered to be severely disabled for the purposes of the calculation of Pension Credit eligibility. See the Appendix for further details on the assumptions used. Figures are rounded to the nearest £1.

### Example 2: A low-income family

Born in 1944, L came to the UK in his early 20s. He worked in the textile industry, until his early 50s when he was made redundant. He never got another job.

His wife has never worked in the UK. She has always stayed at home to care for their five children. Later, she stayed at home to care for her elderly parents. She is five years younger than L.

#### Impact of the White Paper proposals

This family would initially not see any change in state pension income, as the White Paper proposals to increase the coverage of the Basic State Pension do not come into effect until 2010.

However, their state pension is higher 10 years after state pension age than it would under the current system. Their combined state pension income would be around £163 per week under the White Paper proposals rather than £145 per week under the current system (Table 2). This is due to the earnings uprating of the Basic State Pension from 2012. The White Paper reforms to S2P do not affect this family because the reforms are proposed only for S2P accruals after 2010.

Table 2: State pension income under the White Paper proposals and under the current system, if state pension age is reached in 2009, in £ per week, 2006/7 earnings terms

	At state pension age		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for L	£130	£130	£118	£107
State pension income for L's wife	£47	£47	£45	£38
Combined state pension income	£177	£177	£163	£145
<b>Pension Credit levels</b>				
Guarantee Credit	£174	£174	£174	£174
Lower threshold for Savings Credit	£132	£127	£136	£104
Upper threshold for Savings Credit	£237	£245	£231	£279

<sup>8</sup> PPI analysis using the Individual Model. State pension income includes income from Basic State Pension and SERPS / State Second Pension and contracted-out equivalent. See the Appendix for further details of the assumptions used. Figures are rounded to the nearest £1. Pension Credit thresholds assume that the wife's caring for her parents does not qualify for a higher Guarantee Credit level.

If they had no other sources of income, L and his wife would be eligible for the Savings Credit element of Pension Credit under both the White Paper proposals and the current system at state pension age.

The Guarantee Credit element of Pension Credit aims to top up income to £174 per week for couples. Even under the White Paper proposals, L and his wife would have a state pension income of below £174 per week within 10 years of state pension age. This means that, if they have no other income, they would have to claim Guarantee Credit to reach this minimum level of income. It is possible to fall onto Guarantee Credit during retirement under the White Paper proposals because income from S2P is increased with prices rather than with average earnings.

#### Reaching SPA in 2010 rather than 2009

The proposed improvements in BSP coverage come into effect for people reaching state pension age from 2010 but not for those reaching state pension age in 2009. If L and his wife reach state pension age in 2009, then their state pension income at state pension age would be around £177 a week under the White Paper proposals (Table 2). However, if they reach state pension age in 2010, one year later, the proposed improvements would mean they receive £183 per week (Table 3).

**Table 3<sup>9</sup>: State pension income under the White Paper proposals and under the current system, if state pension age is reached in 2010, in £ per week, 2006/7 earnings terms**

	At state pension age		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for L	£131	£129	£120	£106
State pension income for L's wife	£52	£47	£51	£38
Combined state pension income	£183	£176	£171	£144
<b>Pension Credit levels</b>				
Guarantee Credit	£174	£174	£174	£174
Lower threshold for Savings Credit	£132	£124	£137	£102
Upper threshold for Savings Credit	£237	£248	£230	£282

<sup>9</sup> See footnote to Table 2. State pension income under the current system is slightly lower at state pension age than in Table 2 because the BSP is uprated with prices between 2009 and 2010.

If this family reach state pension age in 2010, they would gain from the White Paper proposals. At state pension age, their combined state pension income would be around £183 per week under the White Paper proposals rather than around £176 per week under the current system (Table 3).

This increase from £176 to £183 per week is mostly due to an increase in state pension income for L's wife. L would receive a slightly higher BSP (by around £1 per week) because of the reduction in the number of qualifying years needed for a full BSP to 30.

Under the current system, L's wife does not qualify for a state pension in her own right. This is because the Home Responsibilities Protection (HRP) that she gains from looking after her children is not a positive credit but only reduces the number of qualifying years needed for a full BSP<sup>10</sup>. She would be entitled to a 'category B' Basic State Pension, by virtue of L's National Insurance record. Although L has an almost complete National Insurance record, the 'category B' pension payable to L's wife is around 60% of the full amount for an individual.

Under the White Paper proposals, HRP would be converted to a positive credit for those reaching state pension age from 2010. L's wife would therefore qualify for a BSP in her own right. The amount of BSP she would receive is slightly higher than she would receive under the current system (£52 per week at state pension age rather than £47 per week). However, she would not qualify for the full amount of BSP because she has fewer years of credits than the 30 needed for a full pension.

She is not entitled to any SERPS or S2P on top of this amount under either system. This is because her caring for her children was done before S2P was introduced and because her caring for her parents did not qualify for credits under the rules that applied at the time.

Like the 2009 examples, L and his wife would be eligible for the Savings Credit element of Pension Credit under the White Paper proposals at state pension age, if they have no income other than their state pensions.

Further, like the 2009 examples, their state pension income would be below the £174 level of the Guarantee Credit within ten years of state pension age, even under the White Paper proposals. They would therefore need to claim Guarantee Credit to reach this minimum level of income. It is possible to fall onto Guarantee Credit during retirement under the White Paper proposals because income from S2P is increased with prices rather than with average earnings.

<sup>10</sup> See PPI (2006) *The Pensions Primer* for more information about the current pensions system

### Example 3: A low-income single man

M came to the UK in his early 30s, as a refugee. He had a limited amount of education and had only ever worked in a relative's shop. It took him four years to confirm his citizenship and learn English. From his late 30s he worked in restaurants and shops on the minimum wage (some above the lower earnings limit and so qualifying for state pension accrual), but he had many gaps where he was briefly between jobs and did not sign on, or worked cash in hand. M has never married, and lives alone. He was made redundant at 48, and has now been unemployed for 3 years. Although he has tried to get work, at 51 he now doubts whether he will find work again. M reaches state pension age (65) in 2020.

#### Impact of the White Paper proposals

M receives a significantly higher state pension income under the White Paper proposals than under the current system. At state pension age, his state pension income would be around £81 per week under the White Paper proposals rather than £51 per week under the current system (Table 4). Both of these amounts are less than the Guarantee Credit level so whether he is better off under the White Paper proposals than under the current system depends on how much other income he has, as described in the next section.

Table 4<sup>11</sup>: State pension income under the White Paper proposals and under the current system in 2020, in £ per week, 2006/7 earnings terms

	At state pension age		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for M	£81	£51	£80	£42
<b>Pension Credit levels</b>				
Guarantee Credit	£114	£114	£114	£114
Lower threshold for Savings Credit	£86	£64	£91	£52
Upper threshold for Savings Credit	£156	£189	£149	£207

The higher state pension income (BSP, SERPS and S2P) under the White Paper proposals than under the current system is due to a combination of the indexation of the BSP to average earnings and the reduction in the number of qualifying years required for a full BSP to 30.

<sup>11</sup> PPI analysis using the Individual Model. State pension income includes income from Basic State Pension and SERPS / State Second Pension and contracted-out equivalent. See the Appendix for further details of the assumptions used for the current system and the White Paper proposals. Figures are rounded to the nearest £1.

During retirement, M's state pension income falls only slightly under the White Paper proposals, because most of his state pension is earnings-uprated BSP rather than price-uprated S2P. State pension income would fall faster under the current system. 10 years after state pension age, his state pension income would be around £80 per week under the White Paper proposals rather than £42 per week under the current system.

M's S2P is not affected by the White Paper reforms.

#### **Pension Credit**

In either pension system, M would be eligible for the Guarantee Credit element of Pension Credit, if he did not have any other income than his state pension. In this case, he would receive the same weekly amount under either pension system (£114 per week), assuming he claimed Guarantee Credit. If he did not claim Guarantee Credit, he would be better off under the White Paper proposals but would have an income below the minimum income level of £114 per week.

Under either pension system, M's state pension income is too low for him to be eligible for the Savings Credit element of Pension Credit. Additional income would therefore be subject to a 100% marginal withdrawal rate.

If M returned to his country of origin, Pension Credit would no longer be payable. If he had no state pension entitlement in his home country, the amount of his UK state pension income would be payable. He would therefore receive more under the White Paper proposals than under the current system: £81 under the White Paper proposals or £51 under the current system, at state pension age. The amount of state pension paid in subsequent years would depend on M's country of origin. In some countries state pension income is increased every year as it would be if M had remained in the UK, while in others the amounts are not increased.

### **Example 4: A business-owning family with mother not in paid work**

A is 38 and a graduate, with his own business, and has been working since he was 21. He is married and has 3 children aged 10, 12 and 15 who still live with him. He does not have a private pension. He has a good income<sup>12</sup> and plans to sell the business when he retires at state pension age (in 2034 under the White Paper proposals). His wife, aged 38, does not work outside the home.

#### **Impact of the White Paper proposals**

Both A and his wife would receive a higher state pension under the White Paper proposals (Table 5). The family's combined state pension at state pension age income increases from £78 per week under the current system to £131 per week under the White Paper proposals. Both of these amounts are less than the Guarantee Credit level so whether the family is better off under the White Paper proposals than under the current system depends on how much other income they have, including income from their business, as described in the next section.

Both A and his wife would receive more state pension income (i.e. more BSP, SERPS and/or S2P) under the White Paper proposals at state pension age.

A's state pension income at state pension age is £76 per week under the White Paper proposals rather than £48 per week under the current system. As A is self-employed, he is not entitled to any SERPS or S2P, and all of the increase in his state pension income is due to the earnings uprating of the Basic State Pension.

His wife's state pension income at state pension age is £55 per week under the White Paper proposals rather than £30 a week under the current system. This increase is due to a combination of proposals for BSP and S2P:

- In the current system, A's wife would not be entitled to a Basic State Pension in her own right. This is because the Home Responsibilities Protection (HRP) that she gains from looking after her children is not a positive credit but only reduces the number of qualifying years needed for a full BSP<sup>13</sup>. Instead, her pension is calculated based on her husband's National Insurance record. Although A has a complete National Insurance record, the 'category B' pension payable to A's wife is 60% of the full amount for an individual.

<sup>12</sup> As the self-employed are not eligible for SERPS/S2P, the level of his earnings will not affect his state pension income, provided he earns more than the Lower Earnings Limit (£4,368 a year in 2006/7) and so qualifies for BSP

<sup>13</sup> See PPI (2006) *The Pensions Primer* for more information about the current pensions system

- The White Paper proposals to turn HRP into a positive credit means that A’s wife receives a Basic State Pension in her own right. With the combination of the reduction in the number of qualifying years to 30 and the earnings uprating of BSP, the amount of BSP received under the White Paper proposals is higher than she would receive under the current system, although she would still not receive the full amount of the BSP.
- A’s wife is also entitled to a higher State Second Pension under the White Paper proposals than under the current system. This is because she could receive credits to State Second Pension for caring for her children up until her youngest child is aged 12, rather than until her youngest child is aged 6 under the current system.

Although state pension income is higher for A and his wife under the White Paper proposals, this needs to be set against the pension being payable from age 66 rather than age 65 as in the current system.

Table 5<sup>14</sup>: State pension income under the White Paper proposals and under the current system in 2034, in £ per week, 2006/7 earnings terms

	At White Paper state pension age (66)		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for A	£76	£48	£76	£40
State pension income for A’s wife	£55	£30	£54	£25
Combined state pension income	£131	£78	£130	£65
<b>Pension Credit levels</b>				
<i>Note that Pension Credit would be calculated based on the household’s income including earnings or income from their business, and not just the state pension amounts above</i>				
Guarantee Credit	£174	£174	£174	£174
Lower threshold for Savings Credit	£146	£77	£151	£63
Upper threshold for Savings Credit	£216	£319	£209	£340

<sup>14</sup> PPI analysis using the Individual Model. State pension income includes income from Basic State Pension and SERPS / State Second Pension and contracted-out equivalent. See the Appendix for further details of the assumptions used for the current system and the White Paper proposals. Figures are rounded to the nearest £1.

### **Pension Credit**

Whether or not A and his wife are better off under the White Paper proposals or the current system depends on how much income they have other than their state pensions, and so whether they are eligible for Pension Credit.

In a pessimistic scenario, if A and his wife have no income from their business in retirement, then their combined state pension income would be below the Guarantee Credit level under both pension systems. In this scenario, A and his wife could be eligible for the Guarantee Credit element of Pension Credit. This would take their combined income up to £174 per week. In addition, A and his wife would be eligible for a very small amount of the Savings Credit element of Pension Credit under the current system (less than £1 a week) but not under the White Paper proposals. If they claimed Pension Credit, A and his wife would therefore receive more or less the same under either pension system.

If A's business is the only other source of income that A and his wife have after state pension age, it would need to be substantial to provide an income high enough to keep them completely above Pension Credit. It would need to be worth over £70,000 in today's earnings terms to provide an annuity income of £85 per week, necessary to be above Pension Credit at state pension age<sup>15</sup>.

One consequence of the family not being eligible for Savings Credit under the White Paper proposals is that additional income would be subject to a 100% marginal withdrawal rate. This could make the decision about whether they should sell their business difficult.

<sup>15</sup> This assumes a level annuity, i.e. one in which the payments are fixed in cash terms over the course of retirement. As the annuity is level, A and his wife may fall back onto Pension Credit after state pension age, even if his business sells for £70,000. The annuity is assumed to be single-life, so that it is not inheritable by A's wife on A's death. If a joint-life annuity, which is inheritable, is bought, then more than £70,000 would be required to be above Pension Credit.

### **Example 5: A lone parent**

M is a lone parent, and worked full-time from age 22 to age 28, when she had her first child. She stayed at home for ten years, during which time she had another child, in her early 30s. She then works full time (from age 38), and joins her employers' pension scheme (the Local Government Pension Scheme or LGPS), until reaching state pension age (in 2046 under the White Paper proposals). When in work, M earns the median amount for women of her age.

#### **Impact of the White Paper proposals**

M's state pension is higher under the White Paper proposals (Table 6). M would receive a state pension at state pension age of around £139 a week under the White Paper proposals, rather than the £100 a week she would receive under the current system<sup>16</sup>.

The biggest increases in state pension income are from earnings uprating of the Basic State Pension, as she would already receive a full Basic State Pension under the current system. Her State Second Pension is not largely affected by the reforms because she is in work for most of her life before state pension age.

Although state pension income is higher under the White Paper proposals, this needs to be set against the pension being payable from age 68 rather than age 65 as in the current system.

<sup>16</sup> Because LGPS is contracted-out, part of her State Second Pension is effectively delivered through her employer. This "contracted-out S2P" is included in her state pension amounts, for consistency with the other examples.

**Table 6<sup>17</sup>: State and private pension income under the White Paper proposals and under the current system in 2046, in £ per week, 2006/7 earnings terms**

	At White Paper state pension age (68)		10 years later	
	White Paper proposals	Current system	White Paper proposals	Current system
State pension income for M <i>Including contracted-out S2P paid with LGPS</i>	£139 <i>£44</i>	£100 <i>£43</i>	£128 <i>£36</i>	£82 <i>£35</i>
Contracted-in income from LGPS	£81	£82	£66	£67
Combined state and LGPS pension	£220	£182	£194	£149
<b>Pension Credit levels</b>				
Guarantee Credit	£114	£114	£114	£114
Lower threshold for Savings Credit	£97	£38	£100	£31
Upper threshold for Savings Credit	£139	£228	£135	£238

### Pension Credit

M would be eligible for the Savings Credit element of Pension Credit under the current system, from state pension age, if she had no other income besides her state pension and her LGPS pension.

Under the White Paper proposals, her state pension income is higher and the maximum level of income for eligibility to Pension Credit is lower. The combination of her state pension and her LGPS pension would take her completely above Pension Credit.

<sup>17</sup> PPI analysis using the Individual Model. State pension income includes income from Basic State Pension and SERPS / State Second Pension (S2P). As LGPS is contracted-out of S2P, part of her LGPS pension replaces the S2P that would have been accrued in a contracted-in scheme. For consistency with the other examples, this "contracted-out S2P" is included in the figures for her state pension income, although in practice it would be paid with her LGPS pension, and is also shown separately in italics. Her contracted-out S2P is slightly higher under the White Paper proposals than under the current system because the higher state pension age means it has been increased with prices in payment for three more years. Income from LGPS is assumed not to be affected by the White Paper reforms: the £1 extra received in contracted-in LGPS reflects the effect of the White Paper proposals on contracted-out S2P. LGPS is assumed to remain an 1/80ths final salary scheme. Normal Retirement Age is assumed to be 65 in LGPS and the "rule of 85" is assumed to be abolished. M would be entitled to a one-off lump sum payment from LGPS equal to three times the initial rate of her pension. This lump sum is not shown in the table but, depending on how it was spent, could reduce her entitlement to Pension Credit. See the Appendix for further details of the assumptions used. Figures are rounded to the nearest £1.

## Appendix

The case studies assume that:

- Prices grow by 2.5% each year.
- Average earnings grow by 2.0% each year in excess of prices.

The projections for the current system in the paper assume that the current state pension system continues without reform, with the same uprating conventions as are used today:

- The Basic State Pension (BSP) and State Second Pension when in payment are increased in line with prices. The BSP remains the minimum level of entitlement to Savings Credit.
- The Guarantee Credit continues to be increased in line with average earnings.
- The Lower and Upper earnings limits for State Second Pension increase in line with prices. The Lower Earnings Threshold (the LET – the ‘flat-rate’ part of State Second Pension) continues to be increased in line with average earnings. The Upper Earnings Threshold continues to increase to reflect the changes in the LET, ensuring that higher earners receive the same in State Second Pension as they would have received in SERPS. However, when the Upper Earnings Threshold overtakes the Upper Earnings Limit, it is assumed to be uprated in line with prices.

Projections for the White Paper proposals assume:

- Uprating BSP in line with earnings from 2012.
- It becomes easier to qualify for BSP and State Second Pension (S2P).
- State pension age increases to 66 by 2026, 67 by 2036 and 68 by 2046,
- S2P becomes flat-rate more quickly than in the current system by freezing the Upper Earnings Limit in cash terms.
- Savings Credit (SC) becomes less generous than in the current system from 2008, when the minimum level of income needed for entitlement increases in line with earnings. From 2015, the minimum level of income needed to qualify for SC increases faster than earnings so that the maximum possible entitlement to SC increases in line with prices.

Typical policy analysis tends to assume that individuals stay on a percentage of the median or average earnings of all workers throughout their working life. The earnings levels used here are instead ‘age-specific’, that is, based on the earnings received at different ages. For example, a median earning woman would be assumed to have the median earnings of all full-time employed women aged 21 when she is aged 21, and the median of all full-time employed women aged 22 when she is aged 22. As earnings tend to be higher in the middle of working life than at younger and older ages, using age-specific earnings in this way should give a more realistic picture. The earnings are based on the Quarterly Labour Force Survey, for the period January to March 2006.

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The PPI takes responsibility for remaining errors.

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