Towards a Citizen's Pension
Final Report

This report is published by the National Association of Pension Funds (NAPF). Analytical work was carried out for the NAPF by the Pensions Policy Institute (PPI).

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An Appendix with further details of the analysis is available on-line at www.napf.co.uk and www.pensionspolicyinstitute.org.uk

Introduction

In the three years since the NAPF first proposed a Citizen's Pension, debate about reform of the UK's pension system has developed apace.

Most commentators now support the idea of a simple, adequate, first-tier state pension which would lift the vast majority of people above means-testing and provide a better platform for a flourishing funded system. This shows how far the debate has moved on.

This Report builds on the Interim Report we published last December and sets out in more detail exactly how, in practical terms, we could transition the current complex and confusing state pension system to a simpler, saner, more stable basis.

Such a change could be afforded now, and our MORI research shows that most people would regard it as a fairer deal from the state than the current system.

Whether the system should be based on residency or on contributions with non-earners credited in is, to some extent, a second order issue. We believe a residency test is a simpler way of getting to virtually the same end point as a more complex, costly process involving crediting-in carers and others who do not have full contribution records. Government should choose the simplest, most cost effective method of implementing a reformed state pension that is most in keeping with the ethos of 'better regulation'.

We call on all those interested in seeing a simpler, fairer, more durable pension system to read this report and engage with the crucial debate on UK pension reform over the coming months.

We face an unprecedented opportunity to make lasting changes to improve the pensions system for our children and grandchildren. They will not thank us if we conclude it is all too difficult.

Christine Farnish

Christine Farnish
September 2005

The NAPF is grateful to all the many people who gave feedback on the Interim Report, and also to the members of the Steering Group, who all served in a personal capacity and not on behalf of their respective organisations:

Tom Ross (Chair)	Former Chairman, NAPF
Adrian Boulding	Legal & General
Ronnie Bowie	Hymans Robertson
John Hawksworth	PricewaterhouseCoopers
Paul Johnson	London School of Economics
Stewart Ritchie	Scottish Equitable
Rhoslyn Roberts	GUS plc

Steering Group members have reviewed this report and commented on it. Whilst not every member of the Steering Group is entirely in agreement with everything in this report, the broad thrust of it commands their support.

Towards a Citizen's Pension – Final Report Executive Summary

Everyone involved in pensions has concerns with today's pension system. Many reform proposals seek to improve the state pension system to give a more secure future to those who will mostly rely on the state and to provide a firmer foundation for those employers and individuals who can make additional pension provision on top.

This report recommends a Citizen's Pension to achieve these objectives. It explains how the Citizen's Pension has clear advantages compared to continuing with the current system, and compared to other possible reforms.

It tackles poverty
The Citizen's Pension will mean over 10 million fewer future pensioners need to claim means-tested benefits. While Pension Credit has been an important tool in reducing pensioner poverty in the last few years, continuing with it will accumulate complexity, cost and uncertainty in future.

Instead, the Citizen's Pension provides a more secure guarantee against poverty in later life. The transition to a Citizen's Pension should target resources to lower income people and over time, a fairer redistribution of state pension across income groups will emerge.

People will understand it
The current UK pension system has been called 'the most complex in the world' by the Pensions Commission and others. In contrast, the Citizen's Pension is very easy to describe, and it is much more likely that people will be able to understand correctly what they will get from the state pension: simply, everyone eligible gets £109 a week in today's money, indexed to earnings.

The simplicity is achieved by no longer requiring so many complicated elements of the current system. State Second Pension, contracting-out and Savings Credit would end, and Guarantee Credit would be needed by a very small minority.

It encourages private provision
The growing reliance on means-tested benefits is widely recognised as a barrier to saving. This barrier would simply not exist with a Citizen's Pension, as no-one able to save would be caught in the means-testing trap.

Further, the Citizen's Pension simplifies the demands the state needs to place on the private sector, which can then flourish without so much costly and intrusive regulation.

In particular, the ending of contracting-out could breathe new life into employer-based provision, and could mean some Defined Benefit schemes continue when they would otherwise close.

Some concerns about the ending of contracting-out have been expressed by others. Evidence gathered by the NAPF suggests a more optimistic view, and that overall the Citizen's Pension would provide an easier and more secure environment for voluntary employer and individual pension provision.

It is affordable
Any better pension system will cost more than the current system. For this report the Citizen's Pension has been very carefully costed. It can be introduced in 2010 at no extra cost, then the cost increases as the number of people over state pension age increases, up to an additional 1.7% of GDP by 2050. There are different ways to cover this additional cost, for example, state pension age could be increased to 67 by 2030 with either an increase in National Insurance contributions of up to 1.5%, or a further increase in state pension age to 69 by 2040.

The future costs of the Citizen's Pension system are predictable with more certainty than the costs of the current system. And the simplification that a Citizen's Pension would introduce should mean administration cost savings in state and private pensions.

It is fair, especially to women and carers
The Government recognises that fairness to women, carers, and others out of the labour market or on a low income should be a key part of pension reform. But even amending the rules for qualifying for the current contributory state pension will still mean that people in these groups are likely to get less from the state system than others. The Citizen's Pension treats every individual equally, regardless of gender, work history or income level.

Some believe that the contributory system is more 'fair'. But research by MORI for the NAPF found that 80% of people think that women should have the same state pension as men, even if they did not go out to work. This suggests very strong public endorsement for the key principle underlying the Citizen's Pension.

The criticisms that have been made of the Citizen's Pension – that it costs too much, that it is regressive, that a residency criterion would be dangerous, that it would destroy private pensions – have been carefully investigated in this and the Interim Report. A more positive picture emerges. A Citizen's Pension could make a real improvement to the retirement prospects of millions of British people and put the whole pension system on a more secure foundation.

1. A Citizen's Pension – what and why

This chapter describes the key points of a Citizen's Pension, and highlights the advantages the NAPF sees in the model, compared to the current system. Some issues are developed in more detail in subsequent chapters.

Key points

- A 'Citizen's Pension' is a flat amount payable to every individual over state pension age who passes a residency test.
- A prudent starting level for a Citizen's Pension would be £109 a week, indexed to earnings. While not generous, this would still make a positive difference to current and future pensioners. A desirable long-term target could be a benefit of around £125 a week.
- With a Citizen's Pension, the state can achieve its primary role of poverty prevention better than it can under the current pension system. There would be much less means-testing.
- With a Citizen's Pension women would, for the first time, have in their own right a first-tier pension equal to that of men.
- By giving the same level of state pension to everyone, the Citizen's Pension would be more progressive than the current pension system which gives more to better off people.
- A Citizen's Pension would be much simpler and easier to understand than the current pension system.
- A Citizen's Pension is likely to be less prone to future political interference than the current pension system.
- A Citizen's Pension has strong support from the public and other organisations involved in pensions.
- The NAPF believes that a Citizen's Pension would be good both for employer-provided pensions and individual retirement saving, so that private pensions would be expected to grow.
- A Citizen's Pension will help Government initiatives supporting employer pension provision and individual saving to succeed. It is consistent with the Government's Principles for Reform.

A flat amount with eligibility by residency
The key features that describe a Citizen's Pension are as follows:

- A Citizen's Pension is paid to every eligible individual in his or her own right, whether single or married, and regardless of the number of National Insurance contributions paid or credited.
- It would replace both Basic State Pension (BSP) and State Second Pension (S2P), so simplifying the system for the future while preserving entitlements already accrued.
- The benefit is paid from state resources, and would continue to be paid out of revenues generated from National Insurance contributions.
- The eligibility criterion is set by a residency test. A practical criterion for the UK could *be 10 years in a continuous 20 year period before or after state pension age* (see Chapter 2).
- Agreements with other countries would continue to allow for mobile workers and retirees on the same basis as today.

Level of benefit: at least £109 a week
The Citizen's Pension needs to be at least £109 a week to ensure everyone eligible is automatically above the level of the means-tested Guarantee Credit.

Further, the benefit needs to be indexed to National Average Earnings, so the minimum pensioner income keeps pace with incomes in the rest of society, and with the means-tested threshold.

A higher benefit of around £125 would be preferred, and would be more consistent with what is available from Savings Credit. Savings Credit awards already in payment would be protected in transition and the higher level of benefit could be a long-term target once transition has completed (see Chapter 2).

Reduces means-testing
Largely because of the higher level of benefit and better indexation, the Citizen's Pension would substantially reduce the extent of pensioner income that is means-tested.

£109 a week is the level of the Guarantee Credit, so sets a poverty line which the state aims to prevent older people falling below. But as the current contributory state pensions BSP and S2P become over time lower and flat-rate, they give £109 a week to fewer and fewer people (Charts 1 and 2).

Chart 1[1]

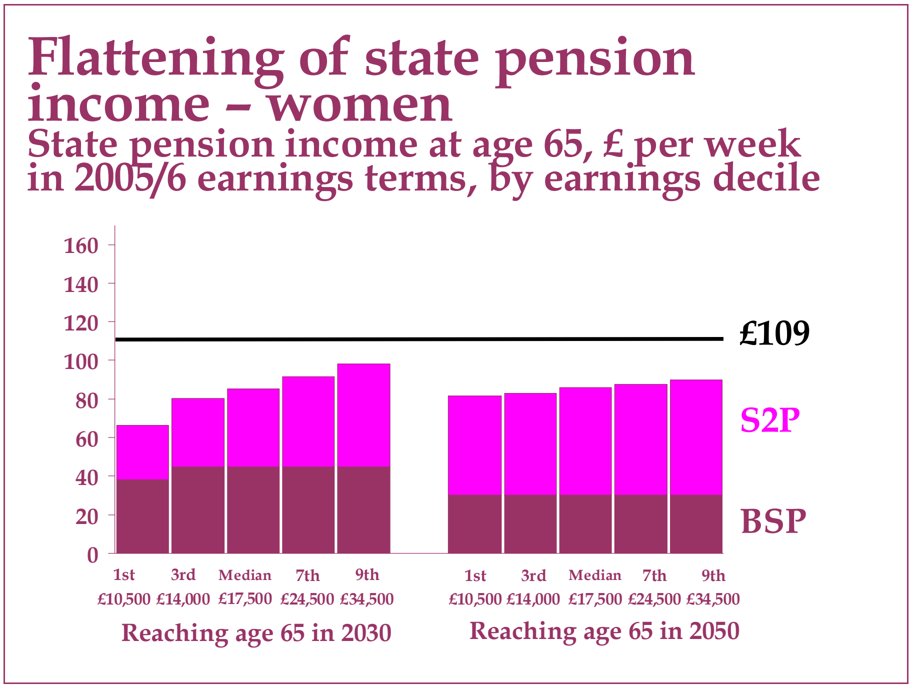
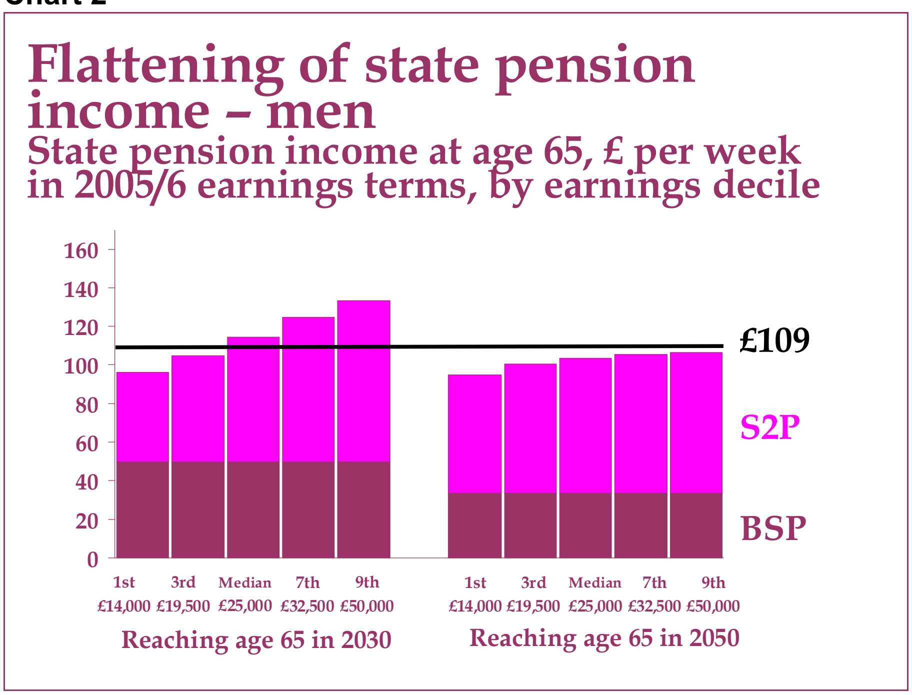


Chart 2[2]



[1] PPI analysis using the Individual Model. For illustration, all individuals are contracted-in to S2P. Earnings shown are earnings at age 50 in 2005/6 earnings terms.
[2] Notes as Chart 1

The pattern shown by Charts 1 and 2 is that:

- Basic State Pension (BSP) and State Second Pension (S2P) together already give less than the equivalent of £109 a week to most people newly reaching state pension age[3].
- By 2030, only those earning consistently above male median earnings throughout a full career are expected to receive more than the equivalent of £109 from BSP and S2P. By 2050, no-one is expected to do so.
- As pensioners age, the value of their price-indexed state pension erodes still further relative to earnings and the poverty level.

There will, therefore, be increasing reliance on Pension Credit to get pensioners over £109 a week, with 70%-80% of people over state pension age estimated to be eligible in 2050[4]. Inevitably some will not claim. Currently take-up of Guarantee Credit is around 80%[5], so the state is not guaranteeing to prevent poverty. In contrast, the Citizen's Pension at £109 a week will give this level of poverty prevention to nearly all people.

Guarantee Credit will still be needed, for an estimated 5% of people over state pension age who would not qualify for the Citizen's Pension (because they have not lived long enough in the UK and have no other income)[6]. Other means-tested benefits for specific circumstances such as Housing Benefit, Council Tax Benefit, disability and caring would still be needed, but would also be less widespread than they will be with the current system.

Equal pension for men and women

The wider coverage of a Citizen's Pension will mean it is better for women, particularly those with periods of caring responsibilities[7].

- Under the current contributory pensions, BSP and S2P, women get less than men. This is because they are more likely to have gaps in contribution history. Women's diverse life histories are more likely to include periods of low earnings or caring for which the contributory system is a poor match.
- These gaps will not all close in future. Women are always more likely to have to claim Pension Credit than men are.
- A Citizen's Pension is the only way in which the different life patterns of women can be securely rewarded in the same way as men's earnings patterns are. The alternative of improving the contributory system (for example, giving weekly credits for caring) will still leave gaps that will affect women more than men, and will introduce yet more complexity to the pension system.

[3] DWP (2005 SPSS) Table SP0
[4] Disney & Emmerson (2004) Table 4.2; PPI analysis based on Distributional Model
[5] DWP data, see PPI (2005 PC) for more details
[6] PPI (2005 CU) p. 30
[7] PPI (2005 CU)

More progressive

A Citizen's Pension would help to resolve some of the income inequality inherent in the current pension system.

- Disadvantage in the current pension system for poorly off people, compared to better off people, comes from: being less likely to have a full contributory record, having lower benefits from the State Second Pension; being more likely to have to claim means-tested benefits; having less from employer pensions and private savings; and, having received less tax relief for every pound saved.
- A flat-rate Citizen's Pension removes the first three of these sources of disadvantage. The potential for better off people to do better from employer and individual private provision remains.
- As a result, a Citizen's Pension flattens the distribution of incomes of people over state pension age. Poorer people gain the most (Charts 3 and 4).

Simpler and easier to understand

The current contributory system is defined by over 30 parameters[8], and with Pension Credit the total is over 100. In contrast the Citizen's Pension is much simpler, and can be defined by just two parameters (level of benefit and state pension age).

Much of the simplification comes from having just one state pension and ending contracting-out of the State Second Pension. This means the administration of state benefits and occupational pensions becomes more efficient, and the cost of selling personal pensions could be significantly reduced (see Chapter 4).

Less political interference

Because the Citizen's Pension is so simple and transparent to voters, it will be hard for Governments to change it in future without a public debate.

In addition, mechanisms can be set up to safeguard the Citizen's Pension from political interference, while still reflecting trends such as increasing longevity. The NAPF has suggested a Pensions Standing Commission to give independent advice to Government on pensions issues.

Because the future cost of a Citizen's Pension is more predictable than the very uncertain future cost of the current system, it is much less likely to suffer from ad hoc tweaks in future (see Chapter 3).

[8] PPI (2005 CU) p. 33. Examples of the parameters defining the current contributory system include: the level of four basic state pensions (A to D); earnings level is needed for State Second Pension, as well as three accrual rates for different slices of earnings; and, type of employment or caring situation is needed for calculating qualifying years.

Chart 3[9]

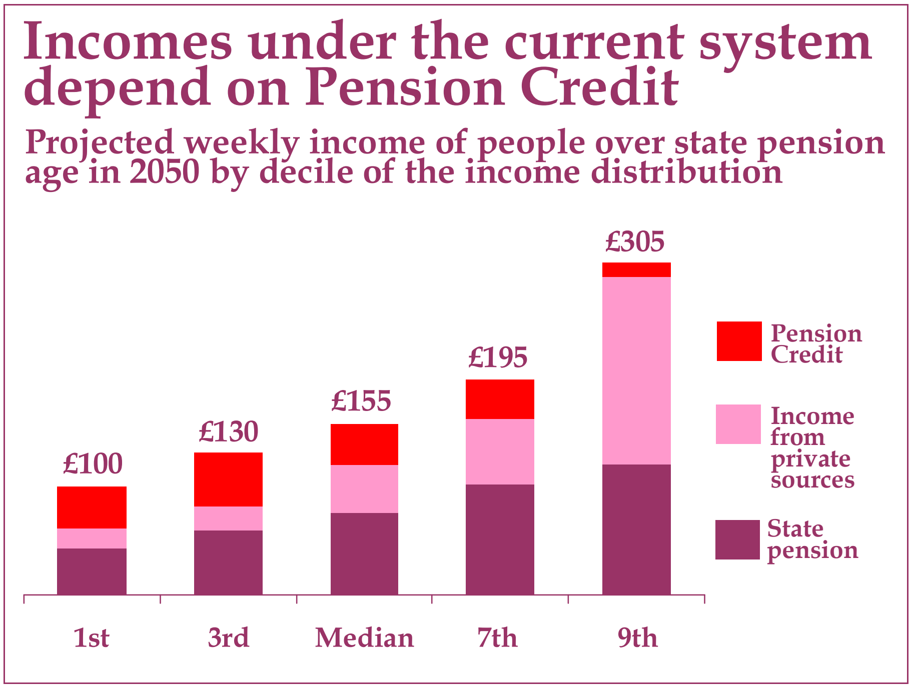
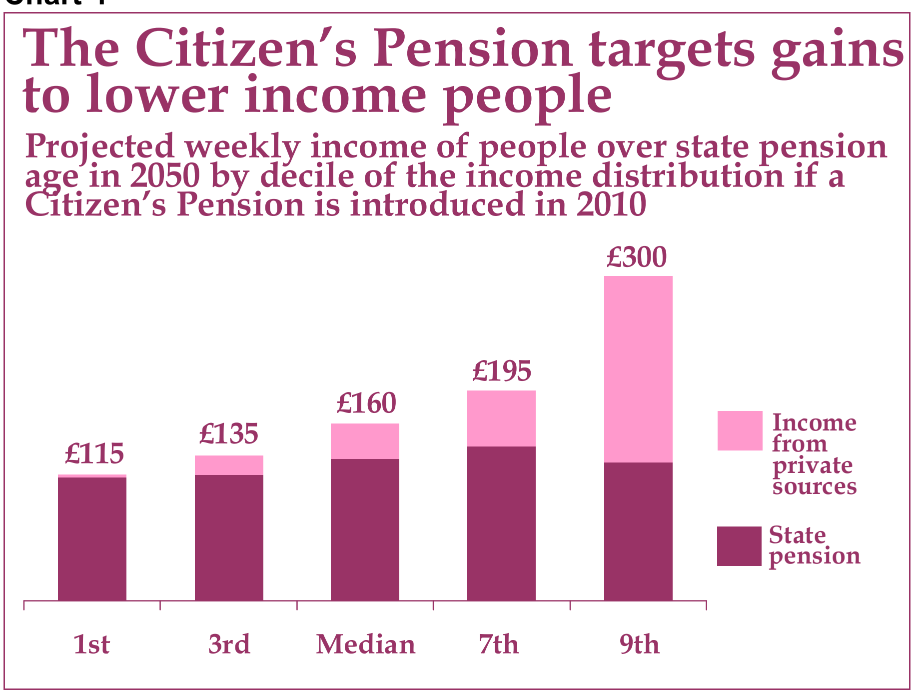


Chart 4[10]



[9] PPI analysis using the Distributional Model. Pre-tax income in 2005/6 earnings terms.
[10] PPI analysis using the Distributional Model. Pre-tax income in 2005/6 earnings terms. Citizen's Pension introduced in 2010 at the earnings-linked equivalent of £109 a week today. See Appendix for further details.

Strong support

Recent public opinion research carried out by MORI for the NAPF found strong support for the principles underlying the Citizen's Pension[11]. This survey sheds some light on how the public may prefer the type of 'fairness' embodied in a flat residency-based pension compared to a contributory pension.

- 80% agreed that *women should get the same state pension as men, even if they stayed at home instead of going out to work*.
- 57% support a flat level of state pension rather than a variable amount reflecting *whether people earned a little or a lot*.
- The leading reason for supporting a flat state pension is for 'fairness' which 28% of those with an opinion chose. The leading reason for opposing a flat amount was expressed by just 12% of those with an opinion who said *people should get back what they paid for*.
- 51% of today's workers said they would save more than they do now if a Citizen's Pension at £109 a week, guaranteed to everyone, was paid by the state, compared to 9% who said they would save less.
- 42% said they would be more likely to work beyond state pension age, compared to 17% who said they would be less likely to do so.

Out of 31 organisations who have made proposals for state pension reform, 14 support a residency eligibility criterion for the state first-tier pension, with 6 supporting the retention of eligibility by National Insurance contributions. 11 either did not express a view or proposed further assessment of the Citizen's Pension[12].

Organisations who have expressed support for a Citizen's Pension include: the British Chambers of Commerce, the Institute of Directors, the Pensions Management Institute, Help the Aged, the National Consumer Council, insurers such as Norwich Union and Friends Provident, and consulting actuaries such as Watson Wyatt and Hewitt.

[11] NAPF (2005)
[12] PPI Briefing Note Number 18, updated

Good for private pensions
With the model of a Citizen's Pension described in this paper, an earnings-related pension (which is higher for people who have earned more) is achieved through personal savings and employer provision.

The NAPF believe the Citizen's Pension should help private pensions to flourish:

- A simple Citizen's Pension would be an easy to understand, reliable foundation for further saving. There need be less intrusive regulation which should make it easier for employers and individuals to increase occupational or personal pensions (see Chapter 4).
- The NAPF supports economic incentives for private pensions and assumes these will continue (possibly in a different and more effective form) in order to encourage employer pension provision and individual saving.

Alternative ways to provide earnings-related pension on top of a Citizen's Pension are by a second state pension, or compulsory private savings. Either way, the high cost is likely to be unaffordable, and would tend to favour higher income people at the expense of lower income people (see Chapter 3).

Consistent with the Government's Principles for Reform
Because of its simplicity and freeing up of the private savings sector, the Citizen's Pension will make it more likely that important Government pensions initiatives will succeed. These include: Informed Choice, Better Regulation, auto-enrolment and longer working lives.

As explained in this chapter, and detailed in following chapters, the Citizen's Pension is consistent with the Government's six Principles for Reform of the pension system[13] (Box 1).

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In summary, a Citizen's Pension has widespread support for its simplicity and likely effectiveness as a foundation income guaranteed by the state to ensure society's oldest residents are free from poverty. The following chapters explain the practical implementation details, how it can be afforded and why a Citizen's Pension will strengthen second-tier provision.

[13] DWP (2005 PFR)

Box 1: Assessment of a Citizen's Pension against the Government's Principles for Pension Reform

Principle for Reform	How a Citizen's Pension measures up
(1) Tackling poverty	Guarantees nearly all people over pension age get £109 a week without means-testing. The current system cannot guarantee this.
(2) Enabling private provision	Provides a secure, reliable foundation on which to build further provision. The current system has many uncertainties, and private provision seems to be shrinking not growing.
(3) Ensuring affordability and economic stability	A Citizen's Pension can be self-financing in the short-term provided transition is managed appropriately. Future costs can be met, and can be predicted with more certainty than the current system.
(4) Ensuring fairness for women and carers	A Citizen's Pension treats everyone equally. The current system disadvantages women, carers and others.
(5) Making sure people understand the system	A Citizen's Pension is extremely easy to understand. The current system is very complicated.
(6) Achieving a broad consensus	The objectives of a Citizen's Pension are widely shared, and many support the Citizen's Pension model set out in this report. No reform proposal has universal support, although every political party and pensions organisation believes the current system needs significant reform.

2. Moving to a Citizen's Pension

The Interim Report explained in some detail how the transition from today's pension system could be achieved. This chapter discusses further some aspects of moving to a Citizen's Pension.

Key points

- C-Day, the date of transition to a Citizen's Pension, could be as soon as 6 April 2010.
- On C-Day, accrual of future State Second Pension and contracted-out benefits would stop. Past accrued rights would be maintained, and 'offset' against the new Citizen's Pension. Savings Credit awards would be protected.
- The transition would be redistributive. No-one would have less pension. 8 million people over state pension age (including the poorest) would gain immediately; a further 3.5 million would stand to gain in future.
- Future 'winners and losers' among the current working age population are mixed, but overall the Citizen's Pension is progressive.
- Slower transition paths could be considered, but would have drawbacks of increased complexity and risk of political interference.
- National Insurance contributions should be retained as the way in which revenues are collected to pay for the Citizen's Pension.
- A fair Citizen's Pension could work efficiently in the UK, using an existing eligibility criterion based on residence and current agreements with other countries to allow for migrants.

C-day on 6 April 2010

A possible timetable for moving to a Citizen's Pension is shown in Table 1. The Pensions Standing Commission suggested by the NAPF[14] could be set up almost immediately and could help advise on the transition. More detail on the steps suggested in preparation for the policy change is set out later in this chapter.

[14] NAPF (September 2005)

C-Day, the date of an overnight transition to a Citizen's Pension, could be on 6 April 2010, assuming that the Pensions Commission's Final Report is published as announced in November 2005, and Government reform plans are published swiftly afterwards, by Spring 2006. Enough time would then be available to complete legislation in the current parliamentary term, before the likely date of a General Election.

Table 1: Timetable for reform to a Citizen's Pension

Date	Milestone
November 2005	Pensions Commission report on recommendations for long-term savings and indications on state pension reform
Spring 2006	Green Paper with Government pension reform plans Pensions Standing Commission appointed
Summer 2006	Consultation period on Green Paper ends
Spring 2007	White Paper with draft Bill
Summer 2008	Legislation through Parliament, Royal Assent Cross-party agreement signed
Spring 2009	Possible General Election
APRIL 2010	**Possible C-Day for transition to a Citizen's Pension**
Possible steps in preparation of policy change[15]	
April 2007	Stop additional Savings Credit awards
During 2008/9	Crystallise accrued state pension data
By April 2010	State pension forecasts sent to all over 50s
By April 2011	State pension forecasts sent to all under 50s

[15] See later in this chapter for explanatory details

What happens on C-Day

The suggested process of transition to a Citizen's Pension was outlined in some detail in the Interim Report[16]. The following summarises what was said in that report.

A Citizen's Pension replaces the contributory pensions: Basic State Pension (BSP) and State Second Pension (S2P, or its predecessor State Earnings Related Pension Scheme, SERPS).

The S2P element can be delivered in one of two ways:

- By the state, if the individual has been contracted-in throughout his or her life and/or,
- By a private scheme (either an occupational scheme or a personal pension) if the individual has been contracted-out.

As a result, many people will accrue some pension on a contracted-in basis and some on a contracted-out basis. In what follows, reference to S2P covers both contracted-in and contracted-out portions, and 'accrued state pension' refers to BSP, S2P and contracted-out S2P equivalent.

On C-Day, when transition to a Citizen's Pension begins, there are three straightforward steps in respect of the contributory pensions:

- Accruals to BSP and S2P would stop.
- The value of pension already accrued in BSP and S2P would be maintained for each individual.
- The Citizen's Pension would replace accrued BSP and S2P pension. This was referred to in the Interim Report as 'Offset'. Others have used the term 'Roll up'. The Citizen's Pension paid is the higher of £109 (indexed to earnings) and the accrued state pension (indexed, as under current policy, to prices). This means that:
  - Any individual over state pension age receiving less than £109 from accrued state pension would immediately have that income increased to £109. Any pensioner receiving more than £109 from accrued state pension would carry on receiving the higher amount.
  - Any individual of working age would expect to receive at state pension age more than the Citizen's Pension only if accrued state pension under the current system is already worth more than that (see later).

Whatever voluntary private provision has been or is being made continues unaffected.

[16] Interim Report pp.12-19

The NAPF strongly recommends this method of transition ('offset'), as:

- It is the most progressive way to change to a Citizen's Pension, as improvements are targeted at lower income pensioners.
- The offset avoids the 'deadweight' cost inherent in the alternative method where accrued S2P continues, and BSP is increased to the new Citizen's Pension level. This alternative gives more new money to higher income pensioners, and would cost more[17].
- The offset transition method will make administration of the state pension and private pensions easier for the future[18]. Contracted-out accrued pension will continue to be paid from the contracted-out occupational or personal pension, so an individual may receive the total of £109 from different sources. But the total amount of state benefit given up by contracting-out is known and stored by the Inland Revenue. On C-Day, the past accrued state pension can therefore be crystallised to two numbers for each individual: the contracted-in and contracted-out amounts. Further record keeping will not be required.

After transition to a Citizen's Pension, Guarantee Credit would continue to operate and supplements to Guarantee Credit received by 0.75 million people because of disability or caring would be maintained[19]. But any reform to pensions policy intended to reduce means-testing would reform Savings Credit, which was introduced only in 2003.

Future awards of Savings Credit are not set in legislation, and so subject to considerable uncertainty. Current Government plans for Savings Credit lead to a high future cost (as the number may grow by up to half over 10 years[20]) so it is highly likely that future Governments would scale it back. **There is therefore no imperative for a Citizen's Pension to match the currently expected <u>future</u> levels of Savings Credit.**

To ensure that the 2 million people receiving Savings Credit do not lose out, then either transitional protection for Savings Credit awards already granted could be introduced (i.e. current awards maintained), or, the new Citizen's Pension should be high enough to avoid most Savings Credit issues. This could mean a Citizen's Pension of around £125 a week.

This report suggests setting the initial level of a Citizen's Pension at £109 a week and protecting existing Savings Credit awards, while setting a long-term target of a Citizen's Pension at £125 a week. One way to do this could be to set the Citizen's Pension in a range, say 20 to 25% of National Average Earnings, with Government discretion to vary the actual level each year (subject to minimum indexation).

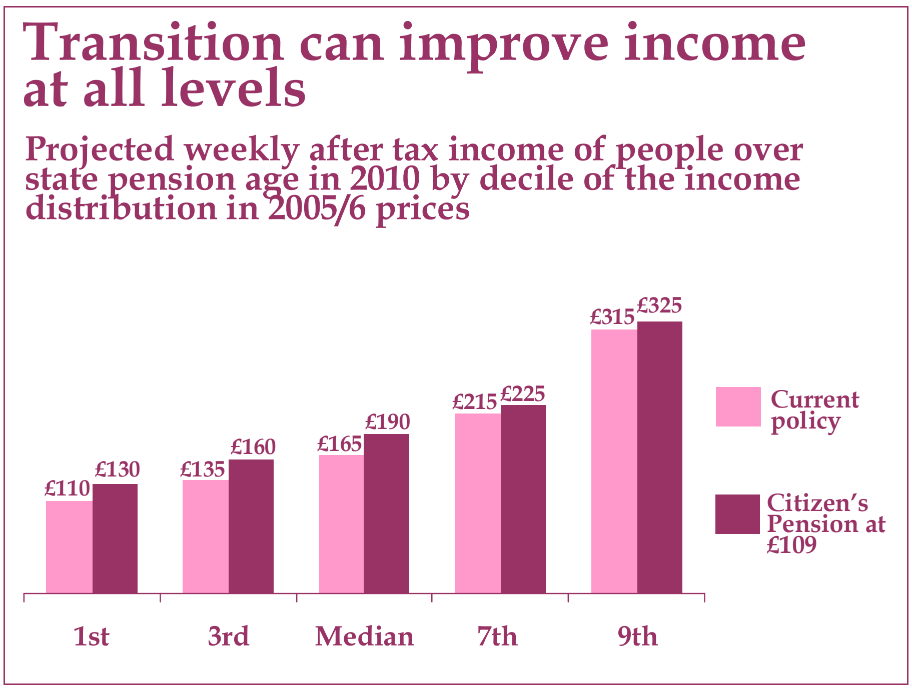
[17] See Appendix
[18] See Chapter 3 and Interim Report p. 37
[19] DWP (2005 PCQS)
[20] PPI (2005 PC)

Transition is redistributive

Everyone already over state pension age at transition to a Citizen's Pension would have at least as good a pension after C-Day as they did before, and many would automatically be entitled to more. The gains would be targeted at poorer people (Chart 5).

- Pensioners who are receiving accrued state pension lower than the new Citizen's Pension would receive a state pension at the new Citizen's Pension level. They will no longer need to claim Pension Credit. For those currently eligible for but not claiming Pension Credit (around 1 million people) there would be an immediate financial gain.
- 8m people currently over state pension age would be in a low income position and gain with a Citizen's Pension of £109 a week.
- Pensioners who are receiving accrued state pension higher than the new Citizen's Pension would carry on receiving the higher amount. With a Citizen's Pension of £109 a week 3.5m people currently over state pension age would be in this position[21].

Chart 5[22]



Examples of how transition to a Citizen's Pension would affect people at state pension age at the transition date in 2010 are in Box 2.

[21] PPI analysis from DWP (2005 SPSS) Table SP9

[22] PPI analysis using the Distributional Model. Assumes offset and transitional protection for Savings Credit as described in this report. Lowest decile gains as these are the people not claiming Pension Credit. People in higher income deciles gaining include those with disability benefits and low income individuals with better off partners.

Box 2[23]: How a Citizen's Pension would affect different pensioners on 6 April 2010

Maria had two part time jobs as a cleaner, from age 35, each of which paid less than the Lower Earnings Limit.

Bob was a self-employed plumber. He paid £100 per month into a personal pension.

Samantha worked in a factory and earned the equivalent of the current National Minimum Wage. She worked 40 hours per week. There was a stakeholder pension where she worked but it did not have an employer contribution and Samantha could not afford to join it.

Kate worked as a care assistant in a care home. She worked full time and earned £14,000 a year. She was a member of a 60ths final salary scheme. She had 3 children and took 20 years out of the labour market to look after them. She returned to work aged 45.

David was a manager in a financial services company. He earned £50,000 a year. He had 6 jobs over the course of his career but was always a member of a contracted-out occupational pension scheme.

Weekly pension received on 6 April 2010 (when all the example individuals reach state pension age) if the current system continued and if a Citizen's Pension were introduced
£, relative to the average earnings level of 2005

	Current*	Citizen's Pension	Gain*
Maria	0 to 109	109	n/a
Bob	103 to 128	154	20% to 49%
Samantha	108 to 131	131	0% to 21%
Kate	125 to 141	153	9% to 23%
David	343	343	0%

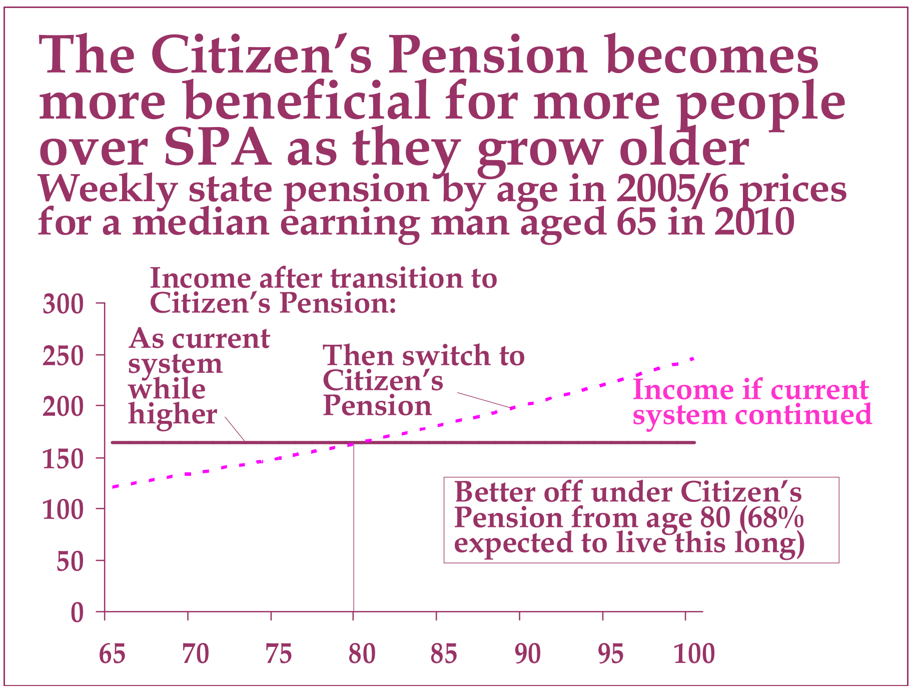
*A range is shown where under the current system, Pension Credit is available. Because of the uncertainty in what Pension Credit will be in future, or whether individuals will claim it, the actual amount of future pension cannot be specified for these individuals. It will be at the lower end of the range if either the individual does not claim it, or future Governments remove Pension Credit, and at the higher end if the individual claims it and Pension Credit is increased in future according to current conventions.

[23] PPI analysis using the Individual Model. See Appendix for details.

Although higher income pensioners may not gain at transition, the Citizen's Pension becomes more beneficial for them as they grow older.

- The Citizen's Pension is indexed to earnings, but accrued state pensions are indexed to prices, which tend to grow more slowly.
- The 3.5m pensioners who had accrued state pension higher than the Citizen's Pension of £109 a week will continue to receive that higher pension, indexed to prices. At some point the earnings-linked Citizen's Pension will overtake the slower growing accrued pension. At this point, the pensioner will switch to getting the then current full Citizen's Pension, and continue to receive it for the rest of his or her life.
- The 'switchover' will happen by age 80 for a typical pensioner in this situation (Chart 6). More than two-thirds of people in this situation are expected to live this long.
- The longest time to wait for 'switchover' is for those with maximum possible S2P and BSP. In this case it would take over 30 years for the Citizen's Pension to overtake the accrued state pension. In 85% of cases, switchover will happen within 10 to 15 years.

Chart 6[24]



[24] PPI analysis

For <u>people who are not yet pensioners</u>, the calculation is exactly the same as the examples above, using accrued state pension up to C-day.

- When people reach state pension age, their accrued state pension is compared to the equivalent of the earnings-increased £109 of the day.
- Over time, fewer new pensioners will have accrued rights worth more than the earnings-indexed future equivalent of £109, and eventually every new pensioner will get the Citizen's Pension immediately on reaching state pension age.
- By 2025, no-one reaching age 65 should have accrued rights above a Citizen's Pension at £109 a week, so every new pensioner is immediately on the new system.

There would be no impact on the value of savings made voluntarily above any contracted-out slice in occupational or personal pensions. These would continue unaffected after transition, for people above or below state pension age.

Provided transitional protection is as described above, no-one would lose current pension rights from this Citizen's Pension policy on transition.

It is possible that a contracted-out portion in a Defined Contribution pension is in practice not as high as the S2P benefit given up. Any such loss is not caused by the transition to the Citizen's Pension but by the decision made previously to contract-out. However, any loss could become more apparent on C-Day. The number of people affected is unclear. Recent reports suggest that it may be significantly more than the c.1 million people previously suggested by industry analysis for the Interim Report[25]. Possible ways of dealing with this situation were set out in the NAPF Interim Report[26].

Examples of how transition to a Citizen's Pension would affect people who reach state pension age in 2030 - 20 years after the transition in 2010 - are in Box 3. These examples illustrate what the situation might be for the sons and daughters of the individuals shown in Box 2.

[25] OAC (2005) for FSA, Which? (2005)
[26] Interim Report pp. 17-18

Box 3[27]: How a Citizen's Pension would affect different people currently of working age who reach state pension age on 6 April 2030

Maria has two part time jobs as a cleaner, from age 35, each of which pays less than the Lower Earnings Limit.

Bob is a self-employed plumber. He pays £100 per month into a personal pension.

Samantha works in a factory and earns the National Minimum Wage of £5.05 per hour. She works 40 hours per week. There is a stakeholder pension where she works but it does not have an employer contribution and Samantha cannot afford to join it.

Kate works as a care assistant in a care home. She works full time and earns £14,000 a year. She is a member of a 60ths final salary scheme. She has 3 children and is taking 20 years out of the labour market to look after them. She returns to work aged 45.

David is a manager in a financial services company. He earns £50,000 a year. He has had 6 jobs over the course of his career but has always been a member of a contracted-out occupational pension scheme.

Weekly pension received on 6 April 2030 (when all the example individuals reach state pension age) if the current system continued and if a Citizen's Pension were introduced in 2010
£, relative to the average earnings level of 2005

	Current*	Citizen's Pension	Gain*
Maria	0 to 109	109	n/a
Bob	62 to 126	136	8% to 118%
Samantha	78 to 138	111	-19% to 41%
Kate	97 to 151	146	-4% to 50%
David	252 to 308	280	-9% to 11%

*A range is shown where under the current system, Pension Credit is available. Because of the uncertainty in what Pension Credit will be in future, or whether individuals will claim it, the actual amount of future pension cannot be specified for these individuals. It will be at the lower end of the range if either the individual does not claim it, or future Governments remove Pension Credit, and at the higher end if the individual claims it and Pension Credit is increased in future according to current conventions.

[27] PPI analysis using the Individual Model. See Appendix for details.

Future distribution is progressive

The overall impact of changing to the Citizen's Pension in the way described would be progressive, both immediately (as discussed in the details of transition above) and in the long-term. Charts 3 and 4 in Chapter 1 and Box 3 illustrate this longer-term redistributive impact of the Citizen's Pension.

- A Citizen's Pension will be best for anyone with low income and interrupted work histories as they will not need to depend on Pension Credit. This particularly applies to women. For example, Kate and Samantha could gain, and Maria receives the same amount as of right, without needing to claim.
- It would be good for people over state pension age as they will be at least as well off, with the potential for higher benefits in later life because of the earnings indexation of the Citizen's Pension.
- A Citizen's Pension will (so far as future contributory benefits are concerned) give less than expected under the current system only to the highest income people who have a full work record (Charts 1 and 2).
- A Citizen's Pension get progressively more advantageous for cohorts of younger people, as it gets better relative to the current state pension over time.
- Where there is a possible reduction in income shown as a result of a Citizen's Pension (for example Samantha, Kate and David in Box 3), it will only result if Savings Credit continues according to current policy. But it is highly unlikely that Savings Credit will be uprated in future as this suggests – because increases are not set in legislation but instead subject to short-term decisions. The Citizen's Pension would be more secure for individuals, because the benefit would be set in legislation.

Slower transition: possible but drawbacks

The NAPF considers that an immediate transition to a full Citizen's Pension, as described above, is the more desirable course. Slower transition paths (as described in the Interim Report) may be easier politically and legislatively. They would still help with some of the issues the full Citizen's Pension is aiming to resolve.

However, the temptations of a slower implementation will have to be balanced against the potential remaining problems. In particular, there would need to be to safeguards against the risk of diversion from the planned course part-way through the transition period.

Introducing a Citizen's Pension at a higher age first, for example at age 75 has the advantage of first focusing on the pensioners most at risk of poverty, the oldest.

However:

- The problems of the current system continue for people below age 75, for example, means-testing would still be prevalent.
- The system becomes more complicated rather than less, as no simplification is introduced below age 75 when a step change to a new system occurs.

Putting the Basic State Pension (BSP) on a citizenship basis would be a way of testing the residency criterion before rolling in S2P later. It would have the advantage of ensuring that every resident over state pension age is entitled at least to a minimum level of income, regardless of National Insurance contribution history. This could help the current oldest women. However:

- The BSP is currently around £82 a week, indexed to prices, and so would not be adequate to prevent poverty compared to £109 a week indexed to earnings. Means-testing would remain prevalent.
- The system becomes more complicated rather than less, as a residency-based BSP adds another eligibility system while still needing National Insurance contribution history for continuing State Second Pension accruals.

NI contributions retained

Currently, state pensions are paid for by revenues collected through National Insurance contributions (NICs). The Citizen's Pension would continue with this approach, and with the National Insurance Fund. Introducing the Citizen's Pension could provide the opportunity to reshape NICs, for example, including the self-employed at the same full rate as employed people. The Interim Report gave more details[28].

Eligibility by residency

Although NI contributions would continue to be collected, an individual's history of NI contributions paid (or credited) would not be used as the basis for determining eligibility for the Citizen's Pension. Instead, the eligibility criterion to receive the Citizen's Pension would be based on how long an individual has lived in the UK.

[28] Interim Report pp. 20-24

A state pension with eligibility based on NI contributions does not fully cover everyone. For example, many women with periods of low earnings, or caring responsibilities have gaps in their NI record. Amendments could be made to the current NI eligibility system, but there would still be gaps in coverage, and there would be practical administrative problems[29].

- Various rules for NI credits could be refined, such as changing Home Responsibilities Protection to a weekly credit. But such changes could not easily be made retrospective, so may not make things better for the current generation of older women. They would also make the system much more complicated.
- The number of NI contributions or credits needed for a full pension could be reduced, say from 44 years to 20. This would be fairly simple, and would be closer in principle to a Citizen's Pension. But some carers may still not be included, and there would have to be some consideration of how to deal with people who live in different countries during working age, so that they do not receive a disproportionately large total state pension.

In contrast, a Citizen's Pension with a residency-based eligibility criterion is an easy to understand way of avoiding the pitfalls of either of the alternatives to amending the NI system.

There are many ways in which an eligibility criterion based on residency could be framed. One is that used by other EU countries (Denmark, the Netherlands) where each year of residency over a 40 or 50 year period gains a right to a portion of pension. The NAPF is not wedded to one particular criterion, but set out a possible way forward in the Interim Report, summarised in Box 4.

Box 4: Proposed eligibility criteria for a UK Citizen's Pension

1. **Minimum residency criterion to acquire a Citizen's Pension**
   The full Citizen's Pension would be paid to those UK residents over State Pension Age (SPA) who have had at least 10 years residency in the UK during a continuous 20-year period before or after SPA.
2. **The amount paid to eligible people over SPA who reside outside the UK**
   Existing Social Security Agreements should continue to work with the new Citizen's Pension.
3. **The amount paid to people living in the UK aged over SPA who do not qualify for the full Citizen's Pension**
   SSAs should cover the cases of people moving to the UK at or after SPA without meeting the UK's Citizen's Pension full eligibility criterion. Foreign state pension payments from outside the EU could trigger a £ for £ reduction from the full Citizen's Pension.

[29] See PPI (2005 CU) for more details

This proposal was chosen because[30]:

- A criterion for 10 years would be easier to administer than a longer period especially after first implementation (as records would be more easily available), and is not expected to lead to 'unfair' additional liability for the UK. 80-90% of people over state pension age would be expected to qualify even on a lifetime residency rule, so shortening the residency criterion would not have a significant effect on numbers eligible.
- A 10-year criterion already exists in UK legislation, for a Category D Basic State Pension.
- People who live and work in other countries, including the EU, before or after state pension age would be treated for a Citizen's Pension as they would now be under the current system, by means of Social Security Agreements.
- The risk of 'benefit tourism' would not be expected to increase with a 10-year criterion. Over 90% of people migrating to the UK (and over 80% of people migrating out) do so before age 45, even though benefits such as Pension Credit are available without having to be resident for 10 years to be eligible.
- All accrued rights under the existing system, whether paid to people living in the UK or overseas, would be paid as expected.

A test of residency already exists in the UK (the 'Habitual Residency Test'). Years of residency can be proven from different existing records: tax, National Insurance, social security records, the electoral register, NHS/GP registration, council tax records and/or passport records.

The NAPF is not in a position to detail more than this on how the residency criterion would work, as this can only be done by Government officials. But on the basis of the work done to date, the NAPF believes that administering a residency-based pension would be practical and should be able to be done more efficiently than the current system.

With any system, and certainly with the current contributory system, there are administrative complexities. The NAPF would welcome further work to detail the administrative process for a residency-based criterion.

[30] For more detail and case examples for how it would work, see Interim Report Chapter 4 and Appendix 4

3. Affording a Citizen's Pension

Since the Interim Report, more detailed work on the costing of the Citizen's Pension has been carried out. This chapter shows the affordability of different models of the Citizen's Pension. More detail is available in the Appendix[31].

Key points

- A Citizen's Pension at £109 a week can be self-financing immediately by rolling future accruals of S2P into the Citizen's Pension, while preserving accrued rights.

- The future costs of a Citizen's Pension will be more certain than the future costs of the current system which are very uncertain.

- A Citizen's Pension at £109 a week for each individual would be an additional cost of around 1.4% GDP by 2030 and 1.7% GDP by 2050 (£20bn in today's earnings terms), compared to a reasonable estimate of the future costs of the current system.

- This additional cost in 2050 could be covered by a combination of raising state pension age to 67 between 2026 and 2030 and either increasing NI contributions for employers and workers by around 1% to 1.5% or increasing state pension age further to 69 by 2040.

- This report recommends single and married individuals receive the same level of a Citizen's Pension. Reducing the benefit level for a married individual could reduce the overall cost by around 0.5% of GDP by 2050, but is not recommended for equity reasons.

- Other models of a Citizen's Pension are not recommended. A Citizen's Pension plus a second-tier state pension would either cost too much, or, if the level of the Citizen's Pension were set lower than £109 a week, it would disadvantage women, carers and low earners.

- A Citizen's Pension would be easier and cheaper to administer than the current system of National Insurance contributions and means-tested benefits. Possible administration cost savings have not been taken into account, so the cost estimates for a Citizen's Pension are conservative.

[31] Available on-line at www.napf.org.uk and www.pensionspolicyinstitute.org.uk

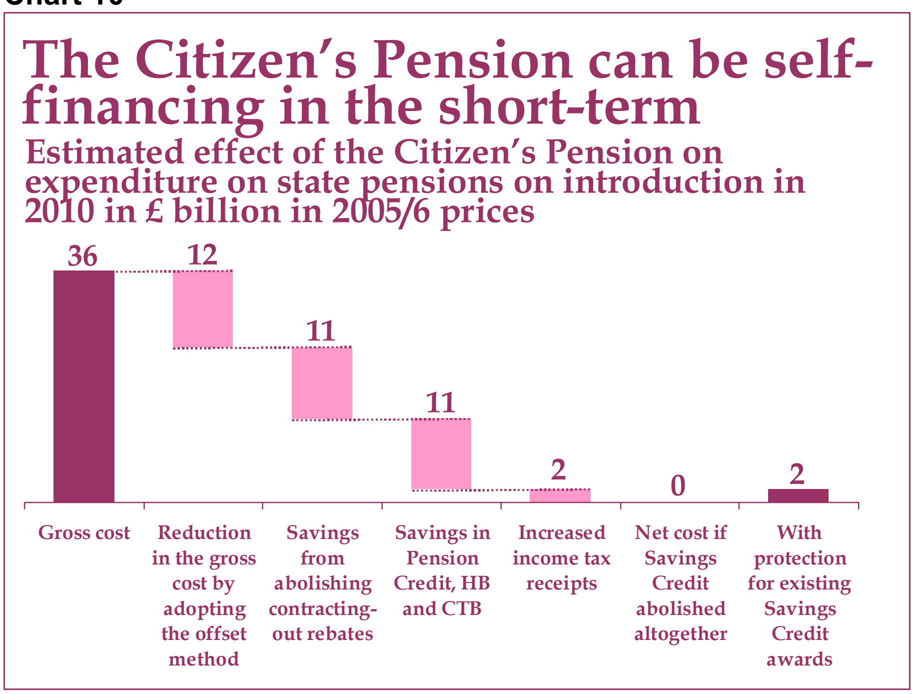
Self-financing in the short-term

A Citizen's Pension at £109 a week can be self-financing immediately (Chart 10).

- The immediate gross cost of introducing a Citizen's Pension in 2010 would be around £36 billion.
- Adopting the 'offset' method of transition would reduce the gross cost by around £12 billion.
- £11 billion would be saved from no longer paying contracted-out rebates.
- More generous state pension provision would result in savings of around £11 billion from lower Pension Credit, Housing Benefit and Council Tax Benefit expenditure.
- More generous state pension provision would mean that more income tax is collected from people over state pension age. This could be a saving of around £2 billion.
- This results in no short-term cost, so the transition to a Citizen's Pension at £109 a week can be self-financing.

If Savings Credit awards were given full transitional protection, then this would cost up to an additional £2 billion.

Chart 10[32]



[32] The costs shown are on top of government estimates of the future cost of the current system

Future costs more certain

The future cost of a Citizen's Pension can be calculated with some certainty, as there is only one real uncertainty: the number of people over state pension age.

This contrasts with the current system, where there are many additional uncertainties largely due to the complexity of Pension Credit. This results in a wide 'funnel of doubt' for the future cost of the current pensions system.

The future cost of Pension Credit is extremely sensitive to the amount of income older people have in future (which sets the number eligible for the different elements of Pension Credit) and to the proportion of those eligible who take up the benefit[33].

- Current Government assumptions are that income taken into account in Pension Credit will increase in line with average earnings and take-up will remain at current levels[34]. Using these assumptions, the Government estimates that state pension expenditure in 2050 will be around 5.8% of GDP (Table 2).
- These assumptions may turn out to be too optimistic. Average state pension income is projected to increase more slowly than earnings in the future and private pension income is expected to decline. There is considerable doubt over whether non-pension saving and/ or earnings will be enough to make up the difference[35].
- A 'pessimistic' scenario is that state pension income will grow as Government projections predict; while other income will grow with prices rather than average earnings, and 100% of those eligible claim Pension Credit. Under this scenario, the future cost in 2050 would be around 1.7% of GDP higher, at around 7.5% of GDP.
- A more likely (but still conservative) scenario is that state pension income grows more slowly, reflecting its indexation to prices, private pension income grows slightly less than earnings[36], while non-pension saving / earnings grow with earnings. Allowing for a conservative increase in Pension Credit take-up as Pension Credit becomes a larger part of people's income, the cost of the current pension system, including Pension Credit, in 2050 increases to around 6.6% of GDP.

Because this latter scenario seems more reasonable (although still cautious), this is used as the 'base case' for the long-term projections in this report (Table 2 and Chart 11).

[33] All numbers from PPI analysis using Aggregate and Distributional Models

[34] The current average take-up rate for Pensions Credit as a whole is 75%. Take up of Guarantee Credit is higher, and for Savings Credit lower.

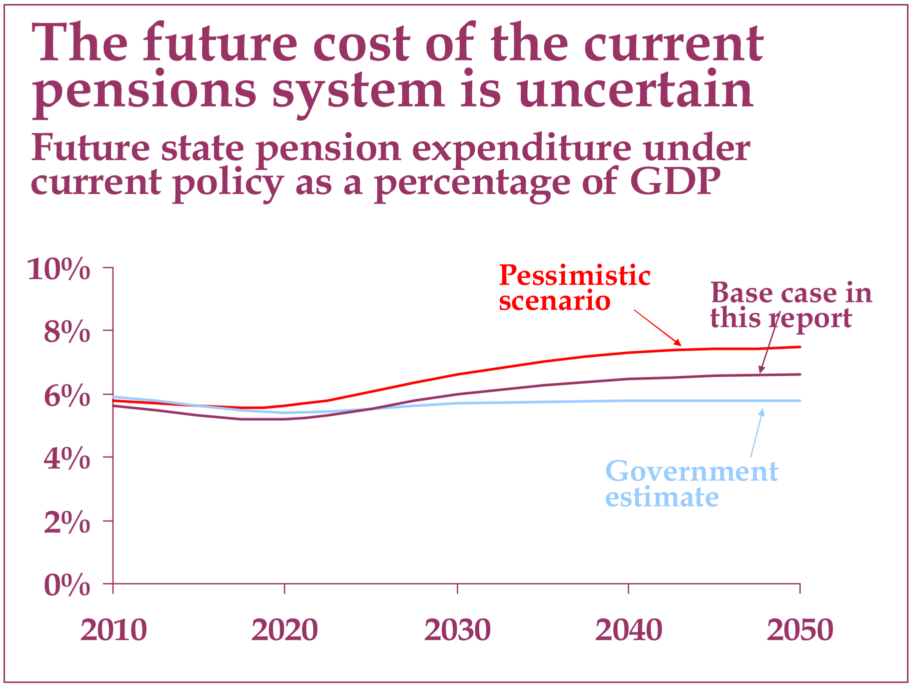
[35] For example, PPI (2005 PC)

[36] Reflecting an assumption that the Defined Benefit / Defined Contribution shift will lead to a reduction in contributions to private pension schemes, similar to the central estimate in Pensions Commission (2004)

Table 2[37]: Estimates of the future cost of the current pensions system as a percentage of GDP

	Government estimate	Pessimistic scenario	Base case
2010	5.9%	5.8%	5.6%
2020	5.4%	5.6%	5.2%
2030	5.7%	6.6%	6.0%
2040	5.8%	7.3%	6.5%
2050	5.8%	7.5%	6.6%

Chart 11[38]



[37] Government estimate from DWP long-term expenditure projections (2005). PPI estimates based on the Aggregate Model and the Distributional Model. Costs include Basic State Pension / Citizen's Pension, State Second Pension, other state pensions (such as winter fuel allowances), Pension Credit and the cost of contracted-out rebates. See Appendix for more details.
[38] Notes as Table 2

Long-term extra cost of a Citizen's Pension is around 1.7% of GDP
In the long-term, state expenditure on pensions under a Citizen's Pension at £109 a week and indexed to average earnings is projected to be around 8.3% of GDP by 2050 (Table 3). This is around 1.7% of GDP more than the reasonable base case, £20bn in today's earnings terms.

Table 3: Estimated expenditure on pensions as a percentage of GDP[39]

	Current system (Government estimate)	Current system (base case)	Citizen's Pension at £109 a week with no future accruals to S2P
2010	5.9%	5.6%	6.0%
2020	5.4%	5.2%	6.1%
2030	5.7%	6.0%	7.4%
2040	5.8%	6.5%	8.2%
2050	5.8%	6.6%	8.3%

Paying for the Citizen's Pension long-term
The additional costs of a Citizen's Pension could be absorbed by reducing the amount paid in other areas of state spending. But more likely is that ways are sought to cover the cost of the Citizen's Pension. There are two most likely sources: raising the State Pension Age (SPA) over time, so that the number of people receiving the pension does not increase as fast as expected, and, increasing the level of National Insurance contributions.

Options for paying the additional cost in 2050 of a Citizen's Pension at £109 a week include (Table 4): an increase in SPA to 67 between 2026 and 2030 (which is consistent with expected improvements to life expectancy between now and 2030), and

- Either an increase in National Insurance contributions for employers and workers of between, roughly, 1% and 1.5% over the period, or,
- A continued increase in SPA to 69 by 2040.

[39] PPI estimates based on the Aggregate Model and the Distributional Model. Costs include Basic State Pension / Citizen's Pension, State Second Pension, other state pensions (such as winter fuel allowances), Pension Credit and the cost of contracted-out rebates. See Appendix for more details.

Table 4[40]: Illustrative increase in National Insurance contribution rates for each of workers and employers (as % of all earnings above the Earnings Threshold) to finance a Citizen's Pension at £109 a week

No change to State Pension Age from 65	2.5%
Increase State Pension Age to 67 by 2030	1.5%
Increase SPA to 67 by 2030 and to 68 by 2040	1%
Increase SPA to 67 by 2030 and to 69 by 2040	-

The higher level of Citizen's Pension considered in this report of £125 a week at today's level would cost an additional 2.6% of GDP by 2050 (£30bn in today's earnings terms), compared to the reasonable base case of the future cost of the current system. One option for paying for this is an increase in state pension age to 68 by 2030 and an increase in National Insurance contributions of around 2% over the period[41].

Lower benefit for married people reduces cost, but not recommended

To ensure at least as good a pension for couples as in the current system, the Citizen's Pension for an individual in a couple would have to be at least 85%[42] of that for a single person.

Setting the Citizen's Pension for an individual in a couple at 85% rather than 100% of the level for single people would reduce the overall cost by around 0.5% of GDP in 2050 (from 8.3% of GDP to 7.8% of GDP).

This would make the Citizen's Pension more affordable, but it would increase complexity and uncertainty. It would maintain the principle of an equal right to a benefit for men and women (of the same marital status) and would pay that benefit to each individual, rather than to one member of the couple.

However, it does not give single and married individuals the same amount of benefit, and therefore it would dilute the powerful message of a true Citizen's Pension. The NAPF recommends that married and individual people eligible for the Citizen's Pension receive the same amount of benefit.

[40] PPI analysis using the Aggregate and Distributional Models. Allows for Incapacity Benefit payable from 65 to the new state pension age. Assumes that the extra National Insurance contributions shown will be shared between the worker and the employer equally. The figures would vary if the worker : employer split were significantly different. Assumes that any savings through Pension Credit, income tax, Council Tax Benefit and Housing Benefit resulting from reform can be used to reduce the amount of National Insurance contributions needed. Assumes that contribution rates for the self-employed are increased to the same level as that for employees. These figures illustrate the possible increases in NICs needed, but the actual will depend on how any change is phased in.

[41] See Appendix for more details

[42] See Appendix for more details

Other models of a Citizen's Pension not recommended
Two other models of a Citizen's Pension have been considered and costed:

- Retaining State Second Pension (S2P) in addition to a Citizen's Pension of £109 a week is likely to be too expensive. The same would be true of compulsory private saving of the same amount.
- Reducing the level of Citizen's Pension benefit to afford S2P would compromise adequacy for lower income people.

Increasing the first tier to the level of the Guarantee Credit and retaining State Second Pension would cost over 10% of GDP by 2050 (Table 5). This seems unacceptably high.

Table 5[43]: Estimated expenditure on pensions as a percentage of GDP with no increase in state pension age

	Current system (Base case)	CP at £109 a week, no S2P	CP at £109 a week and retain S2P
2010	5.6%	6.0%	7.4%
2020	5.2%	6.1%	7.5%
2030	6.0%	7.4%	8.9%
2040	6.5%	8.2%	9.8%
2050	6.6%	8.3%	10.1%

Reducing the level of Citizen's Pension benefit to afford S2P would compromise adequacy for lower income people:

- The combination of a Citizen's Pension at the level of the Basic State Pension (£82 a week) and S2P would not be as good for the less well-off, even if the BSP were indexed to earnings. The poorest 10% of pensioners would receive around £10 a week more with a Citizen's Pension at £109 a week than they would get with Citizen's Pension at £82 a week and S2P (Chart 12).
- In the long-term, the maturing of S2P will mean that it is more generous to lower earners but the problem of imperfect credits would remain.
- There would be more uncertainty with the combination of a lower Citizen's Pension and S2P, and extensive means-testing would remain. There would be over 6 million more people on Pension Credit than under a Citizen's Pension at £109 a week by 2050 (Table 6).

[43] PPI analysis using the Aggregate and Distributional Models

Chart 12[44]

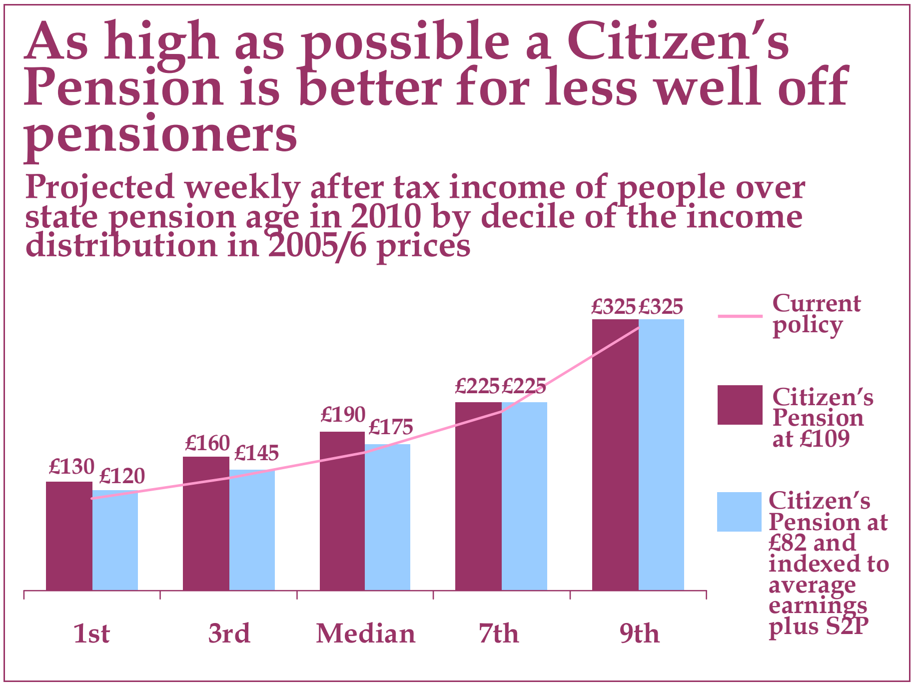


Table 6[45]**: Estimated number of people entitled to Pension Credit**

	Current system (Base case)	Citizen's Pension at £109 a week	Citizen's Pension at £82 a week indexed to earnings and retaining S2P
2030	10.5m	1.0m	7.0m
2040	13.0m	1.0m	8.5m
2050	14.0m	1.0m	8.5m

44 PPI analysis based on the Distributional Model. Income shown is from all sources, including state pensions, private pensions, earnings and investments, and after tax. The estimates are for all people over state pension age, whether single or married, assuming that partners in a couple are each counted as receiving half of the household's income. Assumes take-up of Pension Credit remains at its current level.

45 PPI analysis using the Distributional Model. For the Citizen's Pension, these figures are estimates of the number entitled to additional Guarantee Credit because of severe disability or caring. The additional number of people who are entitled to Pension Credit because they do not pass the residency criterion and do not have other sources of income to take them above the Guarantee Credit level has not been estimated because of lack of data but is expected to be comparatively small (around 0.5 to 1.0 million). All figures are rounded to the nearest 0.5 million. Differences for the current system and the Citizen's Pension at £82 a week in 2030 and 2040 are too small to identify because of rounding.

Citizen's Pension cheaper to administer

A Citizen's Pension without contracting-out would be easier and cheaper to administer than the current system of National Insurance contributions and means-tested benefits.

- The reduction in Pension Credit payments would be one source of administration cost savings. The Department for Work and Pensions administration costs of paying benefits to pensioners is expected to be £455 million a year in 2005/6. This is £200 million a year more than the costs in 1998/9, before the introduction of the Minimum Income Guarantee and then the Pension Credit[46].
- Calculating eligibility for, and paying, means-tested benefits is expensive. The annual cost of administering a means-tested benefit for 1 year (£54) is 10 times more expensive than paying a basic state pension (£5.40)[47].
- Although administering contributory benefits in payment is inexpensive, the detailed system of record-keeping and monitoring contributions for each individual over a full working-life, and calculating entitlement at the point of retirement is complex and subject to error.
- Ending contracting-out would also mean that the Government systems handling the contracting-out administration can be 'turned off', potentially making large cost savings.
  - Contracting-out increases complexity, and requirements for record-keeping. Around 1,500 Inland Revenue staff are needed to maintain records of contracting-out[48]. One-third of these provide support to contracted-out pension schemes[49].
  - Inland Revenue receive 2 million paper forms each year, containing information about terminations of contracted-out periods or transfers of contracted-out rights. In recent years, the proportion of forms submitted incorrectly has ranged from one-third to one-half[50].
  - The complexity and high error rate are caused by contracting-out requiring two independent sets of full records to be kept, then matched using three or four different numbers as identifiers.

Given the lack of data to quantify the administration cost savings possible with a Citizen's Pension, none have been taken into account in the above cost estimates. This means that the costing of a Citizen's Pension in this report is conservative.

[46] PPI analysis, see Appendix 5 of the Interim Report
[47] As reported in evidence by the Department for Work and Pensions reproduced in the House of Commons Committee of Public Accounts (2003)
[48] PPI analysis, see Appendix 5 of the Interim Report
[49] Employed in the National Insurance Service to Pensions Industry (NISPI), IR (2004)
[50] Information from NISPI

4. How a Citizen's Pension supports second-tier provision

With the combination of the Citizen's Pension model proposed in this report, and the state playing a key role in encouraging and incentivising individual and employer-based pension provision, a strong funded pensions sector should develop. This chapter looks at how a Citizen's Pension could help to improve and strengthen pension savings.

Key points

- As the Citizen's Pension replaces State Second Pension, contracting-out will end. This does not mean that anyone accrues less pension – just a change in the way some pension is delivered that will mean less risk for individuals.

- Ending contracting-out will mean an immediate drop in contributions to funded pensions (of around 15%). But the NAPF believes that the amount in funded pensions could then grow faster than it would if the current system continued. The risk to funded provision appears greater with the current system than with a Citizen's Pension.

- Contracting-out is declining in both occupational and personal pensions, probably more quickly than the official figures suggest.

- Ending contracting-out will significantly simplify the administration, regulation and member communication of occupational and personal pension schemes, so making such provision easier and less expensive.

- A Citizen's Pension at the level of £109 a week would not be generous enough to make workplace and personal pensions redundant. A flourishing private pensions sector will still be needed, but reshaped as lower income people will need to save slightly less and higher income people slightly more.

- The Citizen's Pension would enable workplace pension arrangements and individual retirement savings to flourish, because of the simplification potential, because it scales back means-testing, and it sends a clear reliable message: *The state will provide £109 per week, and the saving you do on top of that is yours.*

- The risk of 'political moral hazard' – where people reach retirement with less income than they expected – seems considerably lower with a Citizen's Pension than with the current pension system.

Ending contracting-out does not mean less pension
As the Citizen's Pension replaces future accruals of both the Basic State Pension (BSP) and the State Second Pension (S2P), accruals of contracted-out benefits would end on C-Day.

Ending contracting-out means that a slice of pension moves, for someone currently contracted-out, from being provided by an occupational or personal pension to the state. No-one has less pension overall, but the source of it changes:

- Although occupational and personal pensions would no longer receive revenue from contracting-out rebates, the funds would also no longer have to provide the equivalent future benefit, which would be shifted back to the state.
- The 'lost' revenue would not be retrospective. It would be matched by the occupational or private pension no longer having to provide the equivalent of the contracted-in S2P benefit for future accruals. This means the funds are in an 'actuarially neutral' position, but their *future* risk profile has improved.
- The cash flow to the NI fund will improve short-term, as rebates of current value £10.5bn[51] will no longer be paid to schemes or personal pensions, but the state will take on more liability for paying pensions in future.

The future size of currently contracted-out Defined Benefit (DB) schemes will be smaller, as compared to a continuation of the status quo. As a result, the future risks of providing pensions that employers have to bear through a DB scheme will be reduced. This is likely to be something that some employers prefer, and might help keep some schemes going that would otherwise close.

Future risk would also be reduced for an employee in a contracted-out scheme (who has not had choice about being contracted-out) or an individual who has chosen to be contracted-out through a personal pension.

- The risks for individuals that are inherent in contracting-out are:
    - **Investment risk,** where the benefit is on a Defined Contribution (DC) basis;
    - **Insolvency risk** of loss of contracted-out benefit from a failed provider or employer;
    - **Rebate risk**, where the rebates turn out to be lower than they should be to provide the equivalent S2P benefit[52]; and,
    - **Political risk** of the contracting-out rules being changed to the detriment of the contracted-out individual.

[51] PQ Mr. Frank Field 27 June 2005, House of Commons *Hansard* Column 1253W
[52] As appears to be the case currently: Watson Wyatt (2005). Defined Benefit schemes bear this risk on behalf of their members.

- Contracting-out can turn out to be a worse deal than remaining contracted-in because of these risks (as recent research, for example for the FSA, has shown[53]). So ending contracting-out may be better for individuals, especially for lower income people who are less able to bear these risks than higher income people.
- Some individuals choose contracting-out because they have a preference for taking these risks: because they seek a higher investment return on that part of their pension or because they prefer the non-financial product design benefits of contracting-out into the private sector[54].
- However, even for someone contracted-out throughout his or her working life (which would be unusual), the contracted-out slice is at most 20-30% of total retirement income. Those individuals who wish to satisfy their preference for the private sector can do so by voluntary saving.

If contracting-out ended, then the pattern of paying National Insurance contributions (NICs) would change. The simplest change would be if people contracted-out started to pay the contracted-in rate, that is, a higher NI contribution, commensurate with the lower amount going into the occupational or personal pension. But the opportunity to reshape NICs could be taken, for example, to include self-employed people at the same rate as employees. Other options were explored in the Interim Report[55].

Amount in funded pensions would drop

As explained in the last section, the ending of contracting-out does not mean any reduction in the overall amount of expected future pension for any individual, or in total pension provision. But there are concerns about the reduction in **funded** provision, even though it would be compensated for by an increase in future state provision.

The total amount of contracting-out rebates (the amount the state pays in lieu of S2P benefits given up) is currently around £10.5bn a year. Of this, around £2.5bn is due to the contracting-out of unfunded public service occupational pensions[56]. This leaves around £8bn split evenly between the funded pensions: occupational Defined Benefit schemes and individual or group Defined Contribution pensions.

[53] OAC (2005) for the FSA

[54] Including: availability of benefit before state pension age; the potential for a tax-free lump sum; choice of level or increasing annuity and reduction of the political risk inherent in state pensions (this may be a philosophical preference for market risk)

[55] Interim Report pp. 20-24

[56] PPI estimate based on PQ Mr. Frank Field 19 July 2005, House of Commons *Hansard* Column 1644W

This suggests that ending contracting-out will reduce the revenue going into the **funded** occupational and personal pensions sector by around £8bn in the first year. But there are some important points of context:

- The £8bn possible reduction on the ending of contracting-out is only 15% of total funded pension provision made each year[57].
- Currently, 11% of the total contributions into occupational schemes, and 26% of those going into personal pensions are contracting-out rebates[58]. So providers of personal pensions would be proportionately affected most. Contracted-out personal pension business is often profitable as the rebates provide a regular income with minimal administration required.
- Contracting-out is declining naturally, as will be explained later, so any drop in funded provision is likely to be less than £8bn by the time any policy to end contracting-out could be implemented.

The potential reduction in funded provision has given rise to three separate concerns.

First, there is a concern that the amount invested in funded provision (part of gross household saving and therefore included in the household Savings Ratio) would for macro-economic reasons be better kept high rather than reduced. To retain the same level of funding in the system, some pre-funding could be introduced into the state system. For example, although not necessarily straightforward, part of the NI fund could be invested into a reserve fund, similar to that operating in Ireland, New Zealand, Canada and Norway.

The second concern is that the ending of contracting-out prompts a reduction in the amount of voluntary funded pension provision being made, beyond that caused by the ending of contracting-out itself. This would mean that total pension provision does reduce.

But, for the reasons explained in this chapter, a Citizen's Pension without contracting-out would be expected to provide a better environment for pension saving than is currently the case. Therefore funded provision would be expected to grow faster in the new environment, increasing the amount of total pension provision. It is difficult to predict what will happen, however:

- One pessimistic estimate suggests that ending contracting-out might trigger <u>new</u> funded pension provision in the order of £2bn a year[59].
- One survey suggests that 16% of people would increase their contributions if contracting-out ended, while 13% would reduce contributions[60].

57 PPI calculation based on ONS (2005)
58 PPI estimates
59 PwC for ABI (2005 SG) p.18. The estimate is pessimistic as it also assumes the ending of tax relief (which is not being proposed here).
60 61% would do nothing; 10% said 'Don't know', YouGov in ABI (2005 SG)

Third, some have concerns that a Citizen's Pension would hasten the decline in private sector Defined Benefit (DB) schemes. Based on the discussions the NAPF has had, and on feedback to the Interim Report, it seems to be the case that most scheme managers and consultants, some finance directors and some insurers support the ending of contracting-out. Those taking the opposite view tend to be insurers. Others say that they have concerns until the details are ironed out[61].

Private sector DB schemes are declining as employers re-evaluate their approach to the increasing cost and risks of providing pensions (stemming mainly from increased longevity, lower investment returns and increased regulation). The new regulatory regime of tougher scheme funding and the Pension Protection Fund (PPF) levy are likely to make further impact.

A major change such as a Citizen's Pension and the end of contracting-out might prompt the timing of scheme redesign, perhaps to a hybrid or a Defined Contribution plan. But this would not necessarily mean a reduction in funded pension provision, which would depend on the level of benefits in the new schemes.

All three of these concerns are valid, and highlight the risks of ending contracting-out. Provided careful preparations are made, the NAPF is positive about the future of funded provision with a Citizen's Pension and without contracting-out. Indeed, the NAPF believes that the risk to funded provision from such a policy would be smaller than the risk to funded provision from continuing with current policy.

Contracting-out is declining

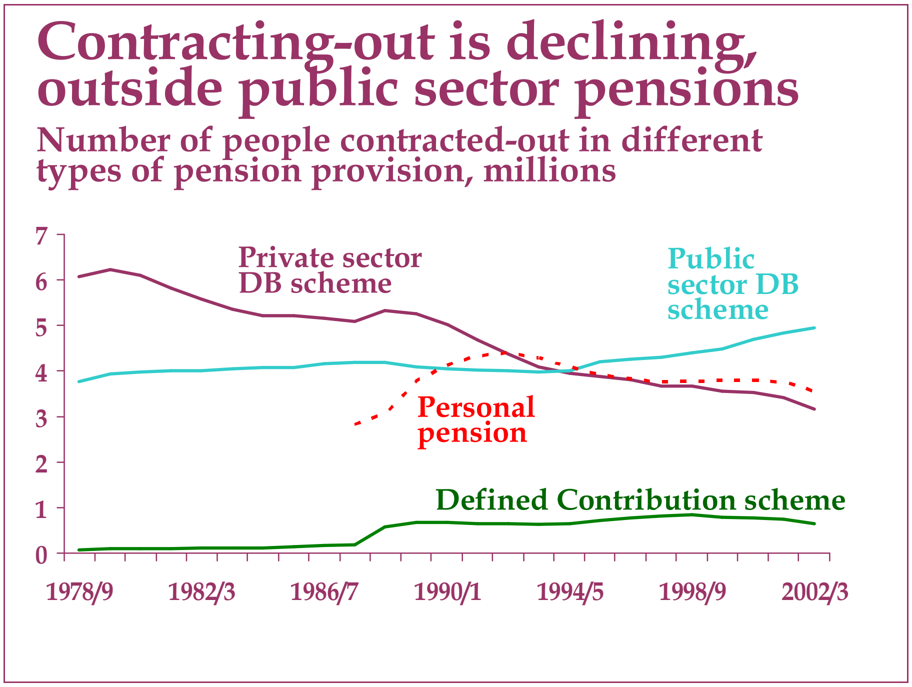
Contracting-out has been declining for some time.

- Of people who have the option to contract-out, 56% do so. This is the lowest level since personal pensions were introduced in 1987, and compares to 70% in the early 1990s.
- The decline is almost entirely due to the reduced number of private sector Defined Benefit schemes, which tend to be contracted-out. Only just over 3 million people are members of contracted-out private sector occupational pension schemes, compared to over 6 million in 1978. Just 14% of people who could contract-out are now in a Defined Benefit private sector scheme, compared to 34% in 1978[62].
- Defined Contribution schemes tend to be contracted-in (for simplicity). There are practically no new contracted-out occupational pension schemes and very little new individual contracted-out pension business. There were less than 90,000 new contracted-out memberships of personal and stakeholder pensions in 2002.

[61] PPI Briefing Note Number 18; NAPF and PPI interviews
[62] DWP (2004 STPP), PPI Briefing Note Number 12

This all means that contracting-out is declining except in public sector schemes (Chart 7).

Chart 7[63]



Since these figures were collected, further evidence has emerged suggesting a faster downward trend in the number of people contracting-out.

- Since 2003, insurers have been recommending individuals actively reconsider their contracted-out status, with some recommending contracting back in[64].
- More recently, some major insurers have contracted some customers back in automatically, having decided that it would be in those customers' best interests. For example: Norwich Union (non-IFA customers, 2005), Prudential (older customers, 2004) and HSBC (2003).

[63] DWP (2004 STPP). Defined Contribution also includes a small number of members of mixed benefit schemes.
[64] ABI (2004 CO); PPI interviews

- The NAPF has learned of some individual Defined Benefit schemes – open and closed – which have contracted-in (see Box 5 for a case study). Some reasons given include simplicity for the scheme and the individual, a reduction in balance sheet risk for the sponsoring employer and a desire to act in the best interests of employees. As contracting a scheme back in is not a trivial administrative exercise, such a decision would not be taken lightly.

Box 5: A case study of a Defined Benefit scheme contracting in

Scottish & Newcastle Plc (S&N) operate two pension schemes:

- A contracted-in Career Average Revalued Earnings Defined Benefit scheme for new employees with 3,500 active members, and,
- A contracted-in final salary scheme, closed to new members, with 3,500 active members.

The final salary scheme, which was originally contracted-out, was closed to new members in 2003 and the career average scheme was introduced for new employees. As part of the review a decision was taken that the career average scheme should be contracted-in because:

- The rebates no longer represented good value for the state benefits given up through contracting-out.
- The benefits structure could be more flexible. For example S&N were able to offer a higher accrual without dependants' benefits which was more attractive to new employees, who were generally single.
- The administration of contracting-out could be removed.

The final salary scheme, which was non-contributory, remained contracted-out at that stage, in order to avoid confusion among scheme members about the introduction of the new career average scheme.

However, a year later, in 2004, S&N decided to surrender its contracting-out certificate in respect of the final salary scheme. Future benefit accrual was adjusted by increasing the deductible from pensionable salary in respect of state pensions from once the Lower Earnings Limit (LEL) to two and one half times for service after the date of change. This change meant that the overall pensions cost (i.e. National Insurance plus future service cost) to S&N remained the same.

As a result of the contracting back in employees' net pay was reduced as they now had to pay 1.6% of pay in higher National Insurance contributions, but S&N was able to demonstrate that the extra contributions delivered a better overall pension than before.

One way of reversing the decline of contracting-out might be to increase the level of the rebates so that the contracted-out slice is clearly better than the equivalent S2P given up. There would then be less concern about the risk/return benefit to individuals from contracting-out. However, this is not likely to be a practical policy option.

- It would only result in more pension overall from the extra margin in the rebate and if there were better than expected investment returns, which also has a risk of under-performance.
- The extra margin would be an additional subsidy for funded pension provision. Roughly, it would be shared 30% to public sector schemes, 35% to Defined Benefit schemes and 35% to insurers for personal pensions. It would be an extra cost to the public purse to be borne by all taxpayers.
- Any extra subsidy would be in addition to the already high level of tax incentives for private saving: the net cost is at least £11bn a year[65]. As there are concerns about the effectiveness of existing tax incentives[66], it is unlikely any Government would increase spending on incentives unless there were clear advantages.
- Any extra subsidy in contracting-out rebates would be difficult for consumers to understand, as it would be confused with choices about state pension. The value of such a subsidy may therefore not be appreciated.

Simplification from ending contracting-out

There is a natural reluctance to disturb current arrangements. But although change itself adds work, changing to a Citizen's Pension and ending contracting-out would have very significant simplification advantages in regulation, administration and communication for private pensions.

Contracting-out puts private pensions 'in competition' with the state for a slice of pension. Contracted-out private pensions provide an alternative to what is in effect a welfare benefit. The state therefore intervenes in contracted-out private pensions, to ensure that the contracted-out pension is at least as good as the state alternative.

- The state imposes detailed benefit design rules (e.g. on indexation, and survivor benefits) on contracted-out personal plans and especially on occupational schemes. This has knock-on complications for the scheme design above the contracted-out part, restricts employer choice on what pension benefits to offer and may not be best for individual employees.
- Since 2003, solvent employers have had to <u>guarantee</u> contracted-out benefits. This has increased the risks for which employers with Defined Benefit plans are liable, with no additional financial compensation.

[65] PPI (2004 ACE) Table 1
[66] PPI (2004 ACE)

The administrative complexities that contracting-out imposes were identified in the Pickering Report[67]:

The existing rules on contracting-out make this element of pensions among the most complex to administer…symptomatic is the need for employers and commercial providers to undertake double record keeping because of the different rules pertaining to pension derived from contracted-out National Insurance Contribution rebates, compared with pension derived from other sources….

Contracting-out also increases the time needed to sell a personal pension, as in order to give best advice the contracting-out option has to be explained. If there were no contracting-out option, selling cost could reduce by up to two-thirds or £250 a sale, which should lead to better value products for the consumer[68].

The transition at C-Day also brings the opportunity to simplify the 'legacy management' of Defined Benefit schemes.

- Each individual's accrued state pension rights at C-Day would be crystallised into two numbers: contracted-out and -in. The contracted-out amount may be split between different schemes or providers if an individual has been contracted-out with different employers. The amount of accrued right(s) can then be handed from the Government either to the individual (for a personal pension) or to the employer(s) for workplace arrangements.
- Contracted-out Defined Benefit schemes would find this especially helpful to their legacy management. It would mean they can in future provide transfer values and benefit statements to members without having to access the data held by the Inland Revenue; a process often subject to long delays.

There is a perceived difficulty in the ending of contracting-out, which applies to a few schemes where the employer was a nationalised industry before privatisation in the 1980s and 1990s. It concerns potentially up to 100,000 individuals who were active members at the time of privatisation and are still active members of the same scheme[69]. Their future pension rights cannot generally be changed without a vote, or without a 'significant event' which a change to a Citizen's Pension would be. Statutory change as part of the introduction of a Citizen's Pension should resolve this issue.

[67] Pickering (2002) pp. 11 to 18
[68] PPI analysis from FSA (2004)
[69] Based on responses to an NAPF survey

Flourishing private pensions sector still needed
A Citizen's Pension at the level of £109 a week would not be generous enough to make workplace and personal pensions redundant. A flourishing private pensions sector will still be needed, but reshaped as lower income people will need to save slightly less and higher income slightly more to get to the same income level overall.

In comparing the effect on saving of a Citizen's Pension, we need to look at the future pension prospects of working age people under the continuation of the current system and under a Citizen's Pension system. ***Note that this is not a sudden change in the value of accrued rights, but a change in future expectations.***

Identifying the amount typical individuals need to save under the current system to reach a certain level of retirement income is not straightforward, as the amount any individual will receive from the contributory pensions, and especially from Pension Credit, is uncertain. Charts 8 and 9 attempt to make a comparison between the savings 'needed' under the current system to reach a target retirement income and that 'needed' with a Citizen's Pension. The target used, for illustration, is that suggested by the Pensions Commission.

After a change to a Citizen's Pension people will have a new expectation of their future income from the state. The amount of savings needed for the same level of retirement income changes, but only slightly.

- To achieve the same replacement rate with a Citizen's Pension as with the current system, higher income people will still need to save more than lower income people.
- With a Citizen's Pension, only the highest earning men may need to save a slightly higher percentage of salary.
- Some lower-middle income people may need to save more with a Citizen's Pension at £109 as compared to the current system of Pension Credit continuing in the future on as generous terms as now. This is a risky assumption, given the state of pension policy, and it also assumes the individual claims the Pension Credit then available.
- Under current policy, a woman needs to save a higher portion of income in a private pension to reach the same retirement target as a man. This is in part because a woman tends to have a lower state pension, as she misses out on accruing full contributions. A man is more likely to have a full state pension. Under a Citizen's Pension, both the man and woman receive the same amount, so their saving requirements come closer together.

Chart 8[70]

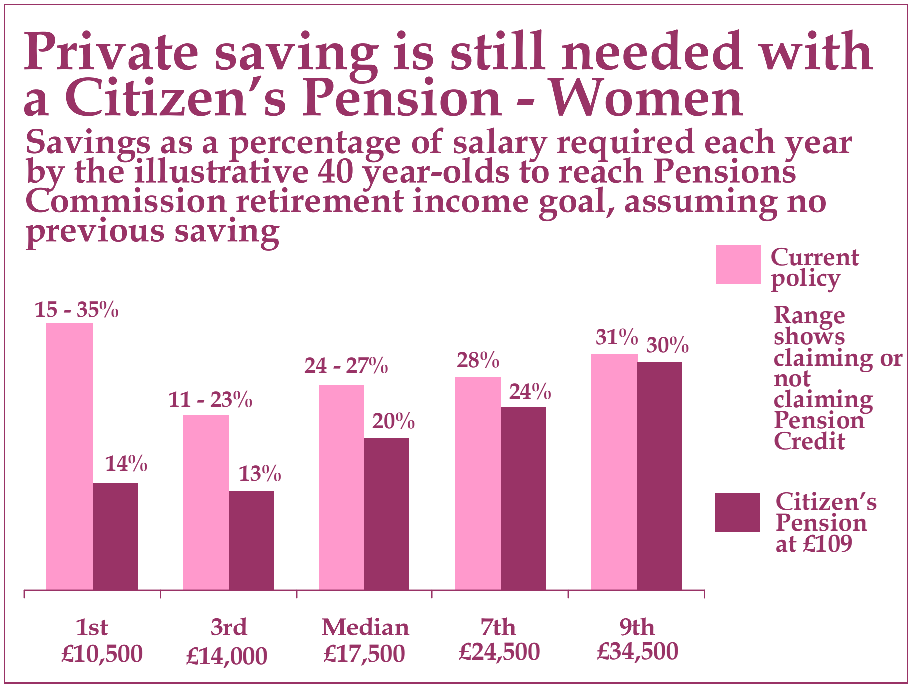
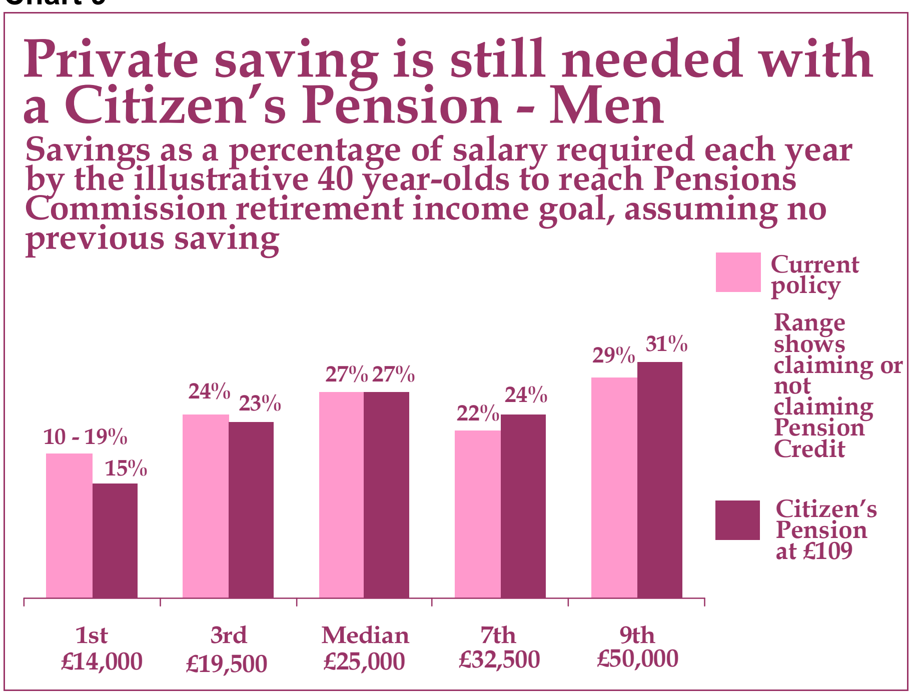


Chart 9[71]



[70] PPI analysis using the Individual Model. Earnings shown are earnings at age 50 in 2005/6 earnings terms. Replacement rates from Pensions Commission (2004) p. 143.
[71] Notes as Chart 8

Citizen's Pension enables private pensions to flourish
At the moment contributions to occupational and personal pensions are at best flat, or in decline[72]. There are a number of reasons for this, but all – including the NAPF and the Government – agree that pension reform should aim to improve the opportunities for employers and individuals to make pension provision.

Reforming to a first tier of a Citizen's Pension may not provide ***sufficient*** conditions for healthy second-tier pension provision through occupational or personal pensions. Further savings incentives and other Government initiatives such as encouragement for auto-enrolment may also be required.

But the Citizen's Pension could provide the ***necessary*** conditions to make the savings system work effectively, which the current system does not. There are three key reasons for this:

- The potential for deregulation and simplification of private pension provision.
- The reduction in means-testing that would follow from the introduction of a Citizen's Pension.
- The message from the state that will enable individuals to make better informed choices on what saving to do for their own retirement aspirations.

Deregulation and simplification of private pension provision
As discussed earlier, the ending of contracting-out (which is not fundamental to a Citizen's Pension, but is a logical part of the package) would simplify the regulation, administration and member communication of employer-based pensions.

Because the Citizen's Pension would be much more effective at preventing poverty, the private sector would no longer be seen as a welfare alternative. With protection legislation (the PPF) now in place, there would be less need for Governments to legislate so heavily in workplace-based or personal provision.

- There would no longer be any Government mandate on the design of the contracted-out slice of pension, so no 'knock-on' intervention in the design of benefits above the contracted-out slice.
- Many employers, who have expressed unease at the frequent regulatory changes for workplace pensions, may be more likely to stay in pension provision if the regulatory environment were more stable.

[72] Pensions Commission (2004) p. 144

Reduction of means-testing

Many groups involved in pensions suggest that the first-tier state pension should be increased to the level of the Guarantee Credit, and coverage of the pension be extended in order to reduce the number of people at risk of needing to claim means-tested benefit in future[73].

One reason for this is that the current spread of means-tested benefits – particularly Pension Credit - makes it difficult to sell or provide a pension at modest income levels.

- The 'means-testing trap' is where an individual is at risk of some savings being 'wasted' as if he or she had not saved, a mean-tested benefit would have provided the same income.
- Because there is uncertainty about the future of Pension Credit, and how and at what levels it will apply in future, the means-testing trap means an adviser cannot recommend saving in the secure knowledge that he or she is following regulatory requirements to give best advice, and an employer cannot be sure whether full value will be obtained from an occupational pension.
- This 'regulatory reticence' is reported to be slowing provision of individual and employer-based pensions, especially to low to middle-earners.

A Citizen's Pension as described in this report would give as of right a pension income above the means-testing level. This could reduce the proportion of people over state pension age needing to claim Pension Credit from 50% today (and predicted to rise to 70%-80% by 2050) to around 5%[74]. 'Regulatory reticence' would disappear, removing the current barrier to advisers selling or employers providing pensions.

Even reducing dependency on Pension Credit by itself is likely to increase levels of voluntary pension saving significantly. One recent estimate[75] suggests that removing Pension Credit could increase voluntary pension contributions by around £3.5 billion a year[76].

73 See for example, PPI Briefing Note Number 18, Brooks and Denham (2005)
74 PPI (2005 CU) p. 30, Disney and Emmerson (2004) Table 4.2, PPI analysis using Distributional Model
75 PwC for ABI (2005 SG) p. 19
76 Though other saving could fall by around £1.5 billion, leaving a net increase in total saving of around £2 billion

Better informed choices on retirement saving

A Citizen's Pension will make it easier for people to understand what they will get as a state pension in future.

- **Simplicity**: A Citizen's Pension means the state system can be described in one phrase with two parameters: level of benefit and state pension age, so it would be easily understood.
- **Reliability**: Notwithstanding the political risk of change with any state pension, the Citizen's Pension allows the state promise to be more certain than it is under the current system. The calculation of an individual Citizen's Pension benefit depends on significantly fewer parameters, so the risk that future pension for any individual will turn out differently to how he or she expected is reduced.
- **Consistency**: There is a mixed message inherent in current policy. Government wants people of working age to save, yet also encourages the take up of Pension Credit. A Citizen's Pension clarifies this mixed message. Government can give a consistent message to all age groups: *The state will provide £109 a week, and the saving you do on top of that is yours.*

A Citizen's Pension brings the opportunity to boost the Government's Informed Choice programme.

- It is clearly important that people have the opportunity to make informed choices about future pension saving at C-day as the mix of their state and private benefit changes. There is in particular a risk that individuals saving in personal pensions would, through inertia, not increase their contributions to replace the lost rebate[77].
- By C-Day, or one year either side, a state pension forecast and private pension forecasts should be sent to each person of working age, to encourage appropriate future savings choices.

[77] Note that such individuals would not be losing out financially (as the 'lost' rebate is staying with the state to provide a better state pension), but the individual may prefer more private saving

Less 'political moral hazard'

It has been suggested that a Citizen's Pension could raise the risk of 'political moral hazard', that is: in the absence of a state or compulsory earnings-related pension, people do not make sufficient private provision, reach retirement with less pension than they expect or want, and then put political pressure on the Government to increase the state benefit[78].

The NAPF believes this argument cannot be supported.

- The absence of a state or compulsory earnings-related pension is not unique to a Citizen's Pension. If the argument is to be applied, it should be to any system where there is just a single flat state pension – whether that is a residency-based or contributory pension.
- It is inevitable with any system that people over state pension age will pressurise the Government to increase the level of state benefit.
- If there were a state or compulsory earnings-related benefit, there could be a higher risk of political moral hazard, as the more generous state promise would raise expectations.
- The more generous state promise in an earnings-related pension would be more costly, and therefore more at risk of being cut back. This is exactly what happened with SERPS[79]. Indeed it has been suggested that the existence of SERPS enabled the Basic State Pension to be cut back[80]. And because this happened, there is now extreme pressure on the Government to make the first tier more generous.
- A Citizen's Pension as described in this report allows Government to spell out clearly what people can expect from the state in future, so that realistic expectations can be set and individual responsibilities are more likely to be understood.
- Further, as this chapter explains, there is every likelihood that occupational and personal saving would flourish with a Citizen's Pension. This means that compared to the current environment, the risk that people reach retirement with less pension than they expected could be reduced.

[78] For example, Adair Turner speech to the NAPF conference May 2005
[79] PPI Briefing Note Number 20
[80] Hills (2004) pp.357-358

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