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Citizen's Pension: Lessons From New Zealand

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Citizen's Pension: Introduction

The PPI is following a programme of work evaluating possible reform models for the UK state pension system. The reasons why this is needed, the approach being used, and the models to be reviewed can be found in *A Guide to State Pension Reform*[1].

One of the models to be assessed is the Citizen's Pension. This is a basic amount payable to all citizens who pass a residency test.

This simple system removes the need for national insurance to keep track of entitlement to state pension based on contributions made during working life. It treats residents the same whether they were high or low earners, or whether they had spells of not earning. If set at a high enough level, the Citizen's Pension removes the need for extensive means-testing.

New Zealand has had a Citizen's Pension for around 65 years, so should be a useful role model. This paper puts the lessons for the UK from the New Zealand experience into the context of the PPI's state pension review process.

New Zealand provides a valid role model, as although the economy and population are much smaller, the ageing trend is quite similar to that in the UK. Further, the pension policymaking process in New Zealand offers some lessons for the UK to improve long-term stability in pension policy.

Chapter 1 describes the New Zealand pension system.

Chapter 2 shows how the Citizen's Pension could be afforded in the UK over the next 50 years.

Chapter 3 assesses the Citizen's Pension against the ten PPI tests for state pension reform.

Chapter 4 discusses some lessons for the UK from New Zealand's pension policymaking process.

Chapter 5 lists some of the questions remaining to test a practical Citizen's Pension for the UK.

[1] O'Connell (2003a)

Citizen's Pension: Summary of conclusions

A Citizen's Pension of around 22-25% of national average earnings is a possible model for the UK. This level of benefit is not generous, but it would mean that hardly any pensioners need to be means-tested for their basic income.

The Citizen's Pension (CP) passes the PPI tests for pension reform:

1. A CP could be **politically sustainable** over the long-term.
2. There should be less **pensioner poverty** with a CP than with the current system.
3. The CP is **affordable now**, within current pension spending.
4. It could continue to be **long-term affordable** over the next 50 years, even within currently planned pension spending. One way to achieve this would be to restructure tax relief on private pension saving and plan to raise state pension age in future.
5. The CP is as **robust to life expectancy trends** as the current system.
6. The CP is much **fairer** than the current system in the sense that it is neutral to work history. This means that a CP is good for women, the majority of pensioners.
7. The CP is probably the **simplest** pension system.
8. The CP does not disadvantage the **oldest pensioners**.
9. A CP could make **private pension saving** easier and better value, with no means-testing trap.
10. **Transition** to the CP could be straightforward. Accrued rights could be maintained, no pensioner need suffer a drop in income and every pensioner's income could be boosted to at least the CP level overnight.

The trade-off inherent in the Citizen's Pension is that it dampens the way the current state system favours high, consistent earners and instead simply gives senior citizens a basic income just above the poverty level. It suggests that the role of the state is to ensure that people have enough to live on in old age, leaving personal and occupational pensions to meet individuals' own ambitions for total retirement income.

There appears to be no 'show-stopper' against the Citizen's Pension, so it should not be discarded as an option. Indeed, there could be significant advantages compared to the current pension system from adopting a Citizen's Pension in the UK, and it appears practically and economically feasible. It should be investigated further.

The PPI would welcome feedback on the ideas in this paper, views for and against, as it continues to test the Citizen's Pension, and other pension models.

Chapter 1: The New Zealand pension system

The New Zealand state pension, called New Zealand Superannuation (NZS) is a flat-rate, universal state pension payable to people aged over 65 who are resident, and have lived in the country for ten years since age 20, five of which must be since age 50.

NZS is not income- or asset-tested. From 1985, a 'surcharge' on super-annuitants' other income over an exempt amount reduced the value of NZS for richer pensioners. It was unpopular and was removed in 1998.

The level of NZS benefit is reviewed each year, but has to be kept between 32.5% and 36.25% of the net average wage. This is usually described by '65 at 65', that is, at age 65 a married couple will receive at least a net 65% (two times 32.5%) of the net average wage. The lower thresholds for single pensioners living alone and single people sharing accommodation are set at 65% and 60% of that for a married couple rate respectively.

Table 1: Amount of NZS before tax, per week, from April 2003, NZ$, by type of recipient[2]

Each married person, both qualifying	224.76
Single person living with others	272.58
Single person living alone	296.46

NZS is based on individual, not household, entitlement. 93% of people over pension age receive it. Means-tested income support is available, on the same basis as people of any age. Other state assistance is available to older people such as help with the costs of visiting a doctor and getting prescriptions, but there is no free National Health Service as in the UK.

NZS is intended to be sufficient to cover living costs in retirement for people who own their own home. An additional means-tested supplement for people with high accommodation costs is available.

The role of the state in pensions consistent with the NZS-style Citizen's Pension is described as follows[3]:

> *…the ability to retire in a degree of personal comfort, without worry and with dignity, is the least that citizens can expect in a modern, developed economy…..it is also most they can expect. They cannot expect the state to maintain in retirement the incomes people became accustomed to during their working lives.*

[2] Adapted from Work and Income Service information. Since April 2003, on average NZ$2.77=£1
[3] Taken from a speech by Hon Dr. Michael Cullen, New Zealand's Deputy Prime Minister and Minister of Finance to a Retirement Commission Symposium 13 June 2003

NZS is paid for from general taxation. The gross cost of NZS approximates to 5% of GDP in 2001 and 10% of GDP by 2051[4].

There are no tax or other incentives to encourage pension saving. The Retirement Commissioner promotes voluntary private saving for retirement, through information and education about retirement income issues[5].

Information on NZS is easily available[6]. The entire legislation for NZS, including current and future benefit levels, takes 16 pages[7]. In contrast, a simplified description of the multi-component UK state pension system takes 39 pages[8].

[4] Creedy & Scobie (2002). Net of tax, these figures are around 4% to under 8% of GDP, PRG (2003).
[5] See www.sorted.org.nz
[6] See St John (1999); St John & Gran (2001); St John & Willmore (2001); Office of the Retirement Commissioner (2001); NZ Ministry of Social Development (2003) and PPI (2003b) for more detail
[7] New Zealand Superannuation Act 2001, Part I
[8] *The Pensions Primer*, PPI (2003a)

Chapter 2: Affording the Citizen's Pension in the UK

This chapter explores the affordability of a Citizen's Pension in the UK as the number of people of pensionable age increases over the next 50 years.

The means-tested Guarantee Credit (GC)[9] currently provides a benefit of around 22% of National Average Earnings (NAE), or £105 per week[10]. If a Citizen's Pension were set at this level in the UK, only a small minority of low-income pensioners who would not qualify by residency would need to apply for GC. A state pension at this level would be at the lower end of 'reasonable'[11] and is consistent with the Citizen's Pension proposed by the NAPF[12].

A Citizen's Pension at 25% of NAE, or £115 per week, would be similar to NZS, around the level Age Concern suggests is needed by a single homeowner aged 65-75 for a 'Low Cost but Acceptable' living standard[13]. It is at the lower end of the range proposed by the Pensions Reform Group[14] and roughly equivalent to 60% of the median income of a single pensioner in the UK, which is used as an 'official' poverty line[15].

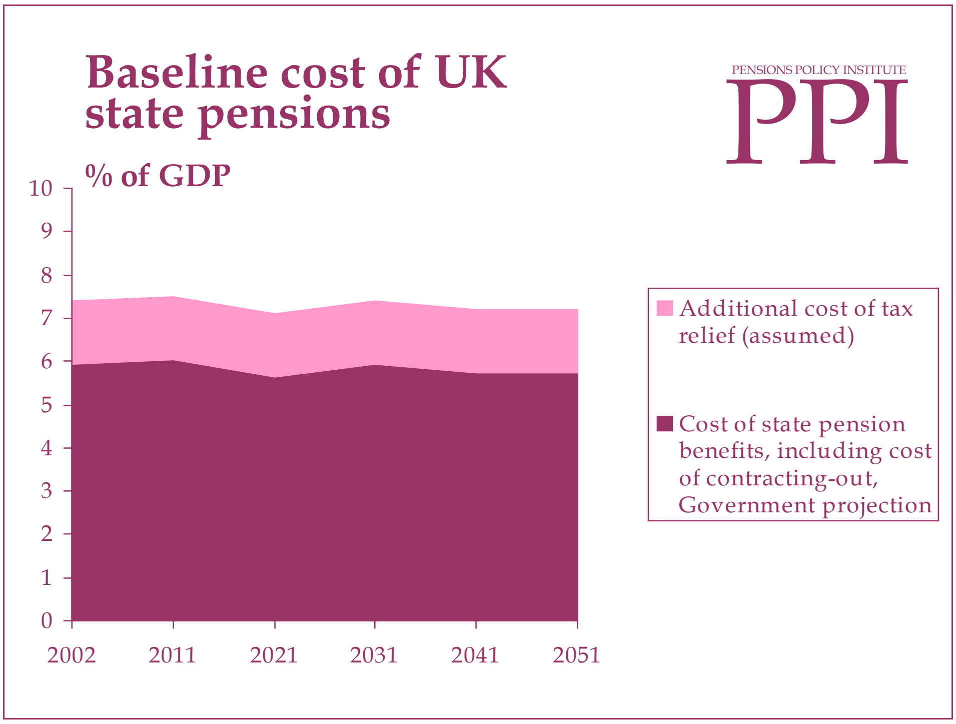
In comparing the current and future costs of this system with those of the current UK system, a baseline cost for the next 50 years is needed (Chart 1). This comprises three elements:

- **State expenditure on pension benefits paid out** (including means-tested income supplements that are only available to people of pensionable age - Pension Credit). This is expected to rise slightly from 5.0% of GDP currently to 5.3% of GDP in 2052 although the projection is subject to a wide funnel of doubt, depending on how fast private saving increases
- **The cost of rebates paid by the state to schemes or individuals contracting out of State Second Pension** (S2P) is currently around 1% of GDP a year, expected to fall to around 0.4% of GDP by 2041.
- **Net of tax liable on private pensions in payment, tax-related relief on private pension saving** costs the state around 1.5% of GDP in the current year. No projections of future cost are made. It could decrease as large amounts of accrued private pension rights start to be received as retirement income. However, pension saving is expected to increase under current policy of switching the majority of pension provision from the state to the private sector. Pending further analysis, the net cost of tax relief is illustrated as remaining level.

[9] Pension Credit comprises Guarantee Credit (a flat benefit that tops up income) and Savings Credit (which gives additional income to certain people who have some savings). It is income-and asset-tested, although the first £6,000 of assets are ignored, as is the value of the main owned residence.
[10] From April 2004
[11] St John & Willmore (2001) defined a range of one-third to one-half of GDP per capita as a reasonable state pension
[12] NAPF (2002)
[13] Family Budget Unit (2003) for Age Concern England
[14] Pensions Reform Group (2002)
[15] For example, in DWP (2003 HBAI), DWP (2003 CP)

The dark shaded area in Chart 1 shows the sum of the first two elements above; the light shaded area line adds the increased cost when the third element (tax relief) is included.

Chart 1[16]:



<u>**If**</u> the position is taken that any new pension system should not cost more than the current system – and that tax relief continues on the same basis - then the cost of a new CP would need to remain within the dark shaded area.

If the cost of the new CP rises above the dark shaded area but is still within the light shaded area, then it could be afforded within current total spend provided tax relief were restructured, and the money saved in doing so channelled into the new state pension.

If the cost of the new CP rises above the light shaded area, then more money would have to be found on top of saving all the money currently spent on tax relief. All tax relief would have to be recouped <u>and</u> other changes made.

Tax relief is considered in more detail in the next chapter. Even moving to the New Zealand approach of no tax incentives would not recoup all of the current cost. People could still put money into other tax-advantaged savings. An alternative approach is to keep some tax advantage for pensions, such as that applying to ISAs[17].

[16] HMT (2003 PBR); GAD (2003 QR); PPI Briefing Note Number 3 *Future Government spending on pensions*. Note the term 'state' means that financed by taxpayers – whether from the NI fund or general taxation.
[17] The cost of this could be less than one-half of the cost of the current pension tax basis

Whether or not savings from the tax relief system are found, there are other sources for the additional cost of a new state pension system:
(1) Make net savings from sources not analysed here
(2) Spend more state money on pensions (and less on something else)
(3) Raise taxes, and spend the amount raised on pensions
(4) Raise state pension age

The approximate costs of a CP at 22% and 25% of NAE are summarised in the following, and more detail is in Appendix 1. The costs are for an immediate transition to the CP, with state second pension accruals stopping, but past accruals continuing to be paid where total state pension is above the new CP. Other transition models are considered in the next chapter.

These costs are estimated using a simple model, which cannot take into account the possible savings on non-pension means-tested benefits after the Citizen's Pension is introduced (mainly Housing Benefit and Council Tax Benefit), and any increase in the taxes paid by pensioners. An estimate of the immediate amount of these savings is available, and is discussed below.

Short-term cost
The UK could afford an NZS-style Citizen's Pension now at the GC level (22% of NAE), within current spend, without restructuring tax relief or making other changes. The additional cost indicated by this estimation of 0.3% of GDP in the first year (around £3 billion) would be covered by savings from other means-tested benefits and increased income tax revenues[18].

A Citizen's Pension of 25% of NAE could also be possible if an immediate additional cost could be covered. The additional cost indicated here of 0.9% of GDP would be mitigated by at least one-third by other savings. The remaining extra cost would need to be paid, or found by making other changes such as saving around one-fifth of the amount spent on tax relief.

Long-term cost
A Citizen's Pension in the UK at 22-25% of NAE could continue to be afforded within current spend of 7.5% GDP up to 2021, when the ageing of the population accelerates (Chart 2). This is provided there is a gradual decrease in the amount spent on tax relief on private pensions, or the additional cost is found from other sources.

The UK could afford to maintain a Citizen's Pension thereafter, provided further policy changes are made. For example, raising state pension age to 70, say, for men and women, by 2031 has a marked effect (Chart 3)[19].

[18] Calculated from Parliamentary Question Mr Webb, House of Commons *Hansard*, 4 February 2004: Column 956W
[19] See O'Connell (2002) and (2003b) for a longer discussion of the issues around raising state pension age

Chart 2[20]

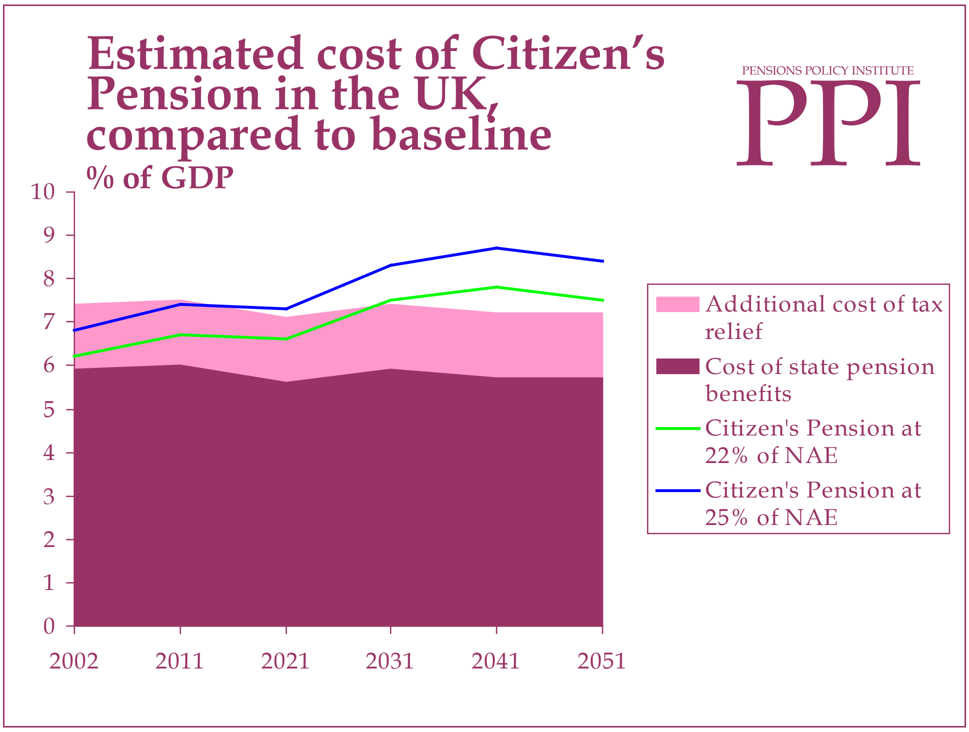
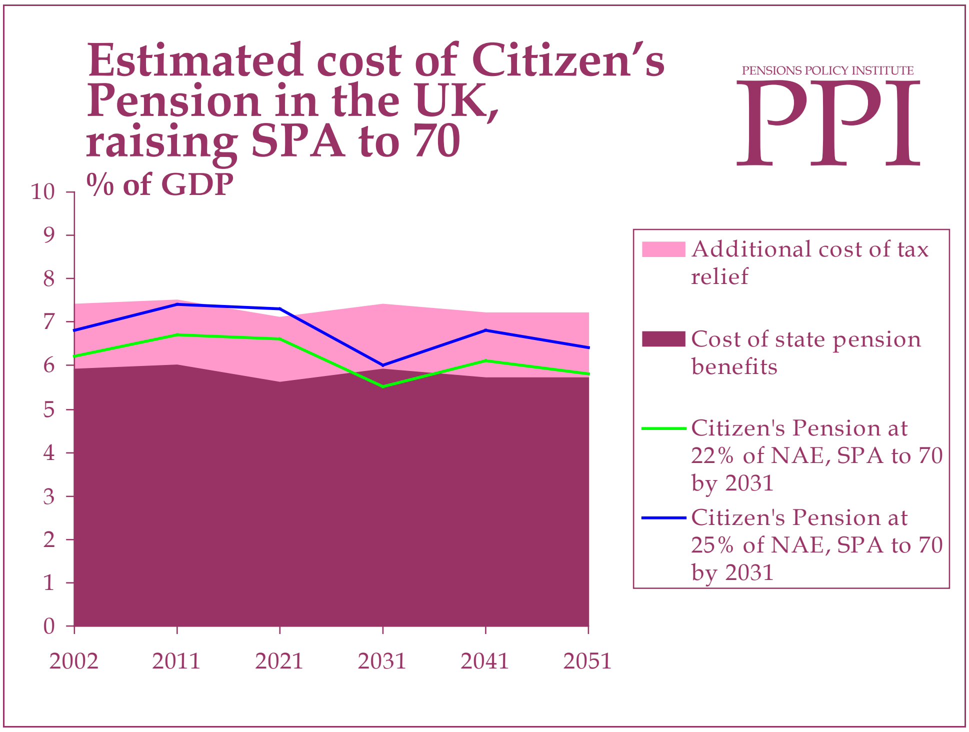


Chart 3[21]



[20] PPI analysis; see Appendix 1
[21] PPI analysis; see Appendix 1

After raising SPA to 70, the 2031 baseline cost of a Citizen's Pension at 22% of NAE would be lower than the current expected cost, at 5.5% of GDP. The cost then hardly rises above the current baseline cost of around 6% of GDP, even at the expected peak of the population ageing in 2041. This level of Citizen's Pension could therefore be afforded without making any change to tax relief on private pensions, and with minimal additional cost through 2011-2021.

The cost of the more generous Citizen's Pension of 25% of NAE, after the rise in SPA, never rises above the current total cost of 7.5% GDP. The additional cost therefore could be afforded if all tax relief on private pensions could be recouped, or by a combination of other sources.

Therefore, a New Zealand style Citizen's Pension at the means-testing GC level of 22% of NAE is affordable in the UK, now. It could continue to be afforded as the population ages by a combination of partial implementation of each of the following:

(1) **Make net savings** from likely sources not yet fully analysed, such as means-tested benefits other than Pension Credit and increased tax paid by pensioners after the introduction of the CP. There should also be some administration cost savings from switching from the resource-intensive National Insurance-based system to a residency test;
(2) **Switch some state spending from other areas** to pensions. At the peak in 2041 the additional spend is around 2 percentage points of GDP – 40% of the spend on education or 20% of that on health;
(3) **Raise taxes**. If this were the only lever used, the total tax take would have to increase by less than 5% (with all the increase allocated to pensions);
(4) **Raise the state pension age.** If this were the only lever used, SPA would have to rise to 70 by 2031; or
(5) **Restructure tax relief for private pension saving** gradually. If this were the only lever used, even if it raised the current full cost, a small additional cost would need to be found from other levers for the peak year of 2041.

A more generous Citizen's Pension at 25% of NAE could also be afforded now, for example by saving around one-fifth of the cost of tax relief. To continue affording this level of Citizen's Pension, either there would need to be some increase in the share of state money spent on pensions, or both raising state pension age and restructuring tax relief on private pensions would be needed.

Put another way, if it is accepted that the removal of tax relief on pension savings is an integral part of an NZS-style system, then the UK could afford to sustain a Citizen's Pension of up to:

- 22% of NAE with a very small additional spend through the peak of the ageing society in 2041, or,
- 25% of NAE, provided state pension age increases to 70 by 2031.

A more realistic approach for the UK might be to transition to a Citizen's Pension of at least 22% NAE with a package of incremental changes: keep some tax advantage in private pension savings by changing to the ISA tax regime and increase slightly state spend on pensions until a future increase in state pension age to, say 67, can take effect.

A Citizen's Pension is therefore affordable, and economically sustainable in the UK provided some trade-off decisions are made on level of pension, tax rates, tax relief on private pensions and state pension age. But is it worth confronting these trade-off decisions?

The next chapter investigates the impact a Citizen's Pension could have, and finds it passes the PPI tests for pension reform. Not only is the Citizen's Pension feasible, it could have significant advantages for the UK. A Citizen's Pension is worth investigating further.

Chapter 3: Testing the Citizen's Pension for the UK

The PPI has outlined nine tests by which a state pension reform model should be assessed. The following sets the Citizen's Pension against these tests, adding the practical issue of transition as the tenth test. In summary, the Citizen's Pension can be structured to pass these tests and could bring many advantages relative to the current UK system.

1. *Sustainability*

It might be thought that a universal Citizen's Pension will be politically unsustainable, given an ageing society. But this is not the case. The potential issues of **reliance on pay-as-you-go, intergenerational conflict and risk of government changes** are in practice less of a threat with a Citizen's Pension than with the current UK system. The New Zealand pension seems to encourage more **social cohesion** than the UK pension. The future cost of a Citizen's Pension is far more certain than the possible future cost of the current UK system, so that **policy planning** is more secure. With any system, there will be **future cost management** issues to face, which may be unpopular.

1.1 Reliance on pay-as-you-go (PAYG)

The World Bank model of a pension system described three legs: a mandatory state pension, mandatory private saving and voluntary private savings. The New Zealand system has only 'two legs', the first and the third. The argument for having the second leg is largely one of diversity: that it is best to have a mixture of PAYG (in the state scheme) and funding (in private savings)[22]. Then risks are diversified: the political risk with state PAYG that successive governments change what was thought to be a pensions promise during a lifetime; and loss of investment value through market risk with private funded schemes. This argument was used particularly with the view that because of the 'old age crisis', PAYG would become unsustainable.

However, many commentators have pointed out that funding does not have any special advantages over PAYG, and it is not a panacea for the increasing cost of pensions in ageing populations. The more important issues are policy design: how big the first tier should be, how redistributive and how it can be made fiscally sustainable in the context of likely future economic growth[23].

With a fiscally sustainable state pension that has broad political support, the risk argument recedes at the level of a country, but may still be important for individuals. However, not everyone can afford to save privately, and, arguably, low-income individuals should not be exposed to the volatility of equity investments only in order to diversify political risk (although lower-risk saving may be more appropriate).

[22] World Bank (1994); St John & Willmore (2001)
[23] Barr (2000); Littlewood (1998)

In one respect, the New Zealand 'two legs' system is not so different from the UK. There are no mandatory private funded savings in the UK. The UK's second tier is a mandatory PAYG state scheme (S2P), from which individuals can choose to opt out in order to save in private pension schemes. In this respect, there is similar reliance on PAYG and political risk in the two countries; although more market risk is held by individuals in the UK.

1.2 Intergenerational conflict

Intergenerational conflict is not the inevitable consequence of an NZS-style state pension, but in the case of New Zealand, problems may emerge as, while NZS is generous, other welfare benefits are highly targeted. Bringing back some form of surcharge which reduces the amount of NZS received according to income has been suggested as a way of making NZS seem more of an entitlement to a safety-net or floor, rather than a flat-rate pension which is available whatever other resources are owned[24].

NZS does ensure at least a minimum living standard in old age, and therefore removes the burden of needing to save from low-income working age people. In this way it allows working age people the choice to spend their income on the health and education of their children. It also removes any need to support parents in poverty[25]. So the NZS-style Citizen's Pension at a reasonable level can be a positive force for the avoidance of poverty at all ages – there does not have to be a policy choice between solving child poverty or poverty among older people. The Citizen's Pension in an otherwise fair welfare system therefore need not cause intergenerational conflict.

1.3 Risk of government policy changes

The continuation of a Citizen's Pension into the future could be seen as a moral obligation only, compared with the system in the UK (and other countries) where entitlement is based on contributions built up through working life.

However, the existence of the contributory link in the UK state pension system has not stopped successive governments changing the system. For example, reductions in the accrual rate for SERPS legislated for in 1986 and 1995 reduced the level of the final benefit receivable by an individual with a full employment record by 15-20%[26], yet there was little attention given to these changes. And with the planned extension of means-tested pension benefits to a large majority, the contributory link to work history is anyway being diluted.

[24] St John (1999)
[25] St John & Willmore (2001)
[26] PPI (2003a)

New Zealand has had a form of NZS since 1938, and has been in its current form for 25 years. There has been change over that period, for example the removal of the surcharge and the removal of tax relief for private savings, but the basic structure of the state pension has endured.

Further, there is a high level of voter engagement with pension policy. For example, in a 1997 referendum there was 80.3% voter response in a postal ballot with a 91.8% 'no' vote against replacing NZS with a compulsory private savings system, an unprecedented turnout and majority vote[27]. As a result of this public engagement, the probability of government policy changes seems if anything to be much higher in the current UK situation than in New Zealand.

As the Citizen's Pension is defined by very few parameters, any change to these would be obvious to the electorate. This may not be a guarantee against change, but it may make a difference. One reason why the changes to SERPS noted above did not attract more attention was that it was difficult to see the real impact in such a complicated system.

In New Zealand there is also a mechanism that reduces the risk of sudden, hidden policy change. Legislation lists those political parties that have signed up to the '65 at 65' structure of NZS[28]. The government has to consult formally with those parties if any change to that structure were contemplated. Any change to the key parameters would therefore be highly transparent.

1.4 Social cohesion

Older people in New Zealand benefit from *an environment of social inclusion and cohesion*[29] because of the women-friendly aspects of NZS and its simplicity and fairness. NZS is paid for out of general taxation (so can be as progressive as the tax system is) and guarantees security in old age without links to earnings that dilute the extent of redistribution from rich to poor.

From observation, despite reviews of NZS continuing (see Chapter 4), the New Zealand pension environment looks remarkably stable compared to that in the UK, and New Zealanders seem fond of their state pension – a sentiment very far from the case in the UK. As recently as December 2003, an independent report concluded that the basic structure of NZS and voluntary private provision was working well and that there was no strong interest in departing from the current model[30].

27 St John (1999)
28 Schedule 4 New Zealand Superannuation Act 2001. Four parties have signed up, the main one that has not has indicated agreement with the 65% NAE level, but not the eligibility age 65.
29 St. John & Willmore (2001)
30 Periodic Report Group (2003)

1.5 Policy planning

The cost of an NZS-style Citizen's Pension (not including any transition cost) is a direct function of the number of older people. Because the cost of NZS is easy to calculate, it has the advantage of transparency – to recipients, tax payers and to policy planners. In the UK system, each of the many components of the cost of the pension system can be changed, much less transparently.

Future cost estimates of NZS are sensitive to demographic changes only, and variant projections for different scenarios of the proportion of people that are of pensionable age can be easily tested.

In the UK system there are three additional major areas of future cost uncertainty:

- The amount paid in state **means-tested benefits** in future (Pension Credit as well as other benefits such as Housing Benefit) depends on the amount of non-state income pensioners have. This is a function of individuals' savings behaviours over lifetimes and investment performance on those savings. It is extremely difficult to forecast, and has a wide degree of uncertainty over long projection periods.
- The projected cost of **contracted-out rebates** is subject to some uncertainty because of the many recent changes in the private pensions sector. These factors include: the introduction of stakeholder personal pensions, and their disappointing take-up[31], the recommendations of several financial institutions not to contract-out[32], and anecdotal reports of many schemes contracting back in. Further, there is only provisional information on the actual numbers of people contracting-out since 1998/99[33].
- Projections of the future cost of **tax relief** on pension contributions in the UK are not made. This is consistent with the definition of tax relief as revenue foregone that can be removed or changed at short notice by a Budget. Government policy - to encourage private saving - suggests that the cost of tax relief could grow[34].

Because of these major uncertainties in the future cost of each component of the UK pension system, the NZS-style Citizen's Pension model has a real advantage in the ability to plan policy with greater certainty of future costs.

[31] ABI (2002, 2003)
[32] For example, Axa Sun Life, reported in *Financial Times* 21 June 2003
[33] DWP (2003 STPP)
[34] Sinfield (2003)

1.6 Future cost management issues

Whatever the choice of pension system, the increasing cost of pensions as people live longer needs to be faced. If the UK pension system were reformed to a Citizen's Pension, it is unlikely that the debates will end there. Managing future increasing cost will inevitably mean making some hard choices. Raising state pension age is one way to keep costs flat in future, as is restructuring tax relief on private pension saving, but neither is a universally popular policy.

Another cost management approach is to introduce some form of affluence-testing for the state pension benefit. This would not be the same as the current means-tested approach for Pension Credit in the UK, which requires that half the people of pension age need to go through a separate process to see if they can get more money.

Instead, there could be a more 'dignified' approach[35] of withholding some CP from the richest pensioners, identified by the tax system, so not requiring a separate process. As people grow older, and use up their assets, the amount of CP to which they are entitled would increase, and would be paid automatically.

In New Zealand, this approach is seen not just as a potential cost management lever in future but also as consistent with targeted welfare at younger ages. In the UK the approach might be suggested as a more efficient way of redistribution than the current Pension Credit approach. As the New Zealand experience with the surcharge showed, it can still be an unpopular policy, and there can be much debate about the appropriate withholding rate.

[35] St John (1999)

2. *Risk of pensioner poverty*

A Citizen's Pension can be, like NZS, defined by a percentage of net average earnings, which is deemed to give an adequate pension. As in effect this indexes the pension to average earnings, it would not fall behind earnings inflation.

The range of outcomes available from the UK state pension system does not guarantee an adequate pension. If contributory pensions and private benefits do not give sufficient income, then means-tested benefits can be claimed. However, between one-quarter and one-third of pensioners do not claim the benefits they are entitled to, so their income is inadequate. Further, the indexation of state pensions in payment is mostly relative to prices, so that the pension falls behind relative to average earnings, which tend to increase faster than prices[36].

A Citizen's Pension defined as a percentage of national average earnings would resolve these issues in the current UK system.

New Zealand demonstrates a very different pensioner income profile than the UK. A recent investigation into the living standards of older New Zealanders found that:

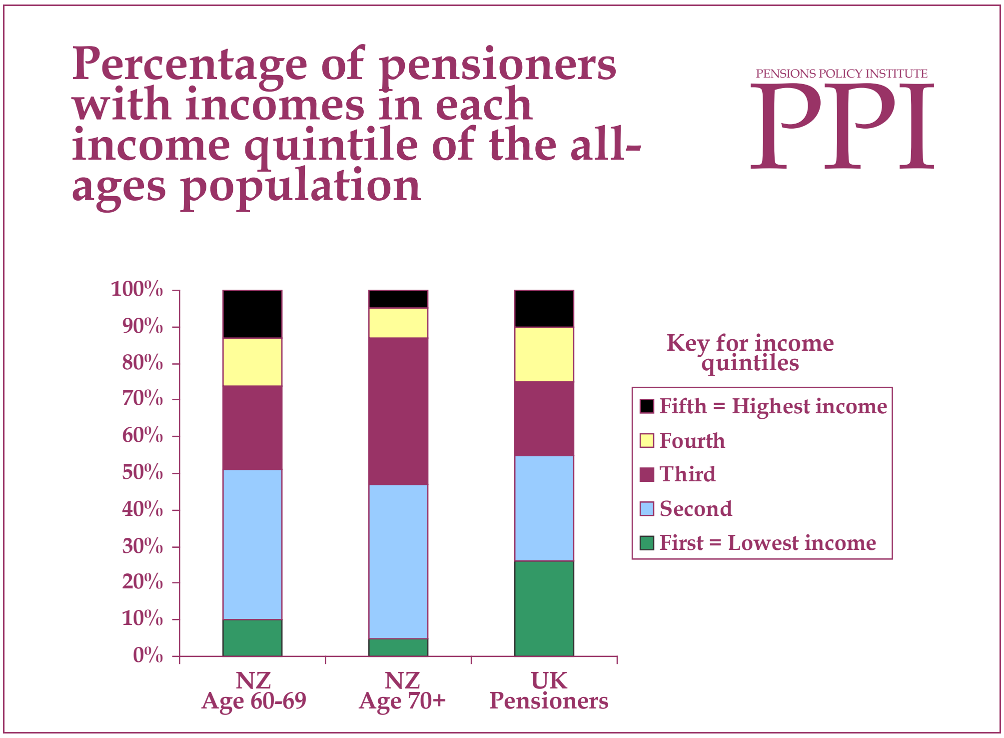
…most older people are doing well and had relatively few material restrictions and difficulties. A minority (around 5% of the sample) had quite marked material hardship, and a further 5-10% has some difficulties[37]

In contrast, 22% of UK pensioners are in relative poverty according to official measures[38].

The incomes of pensioners in New Zealand are more evenly distributed than those in the UK, where there tends to be relatively more poor and more rich pensioners (Chart 4).

[36] For example, the government assumes earnings grow by 2% p.a. more than prices from 2002/3 for the 50-year period of their projection of the cost of state benefits DWP (2002 GP)
[37] Fergusson et al (2001)
[38] DWP (2003 HBAI)

Chart 4[39]



There are proportionately many more UK pensioners in the bottom income quintile of the UK population (26%) than there are New Zealanders aged over 60 in the bottom quintile of New Zealand (10% aged 60-69; 5% 70 and over). This reflects the adequacy concerns of the UK system.

A higher proportion of New Zealand pensioners are in the middle income groups. This reflects the egalitarian nature of a Citizen's Pension.

A higher proportion of UK pensioners are in the top income group (10%), compared to New Zealanders aged 70 and over (5%). As many of the New Zealand 60-69 years olds will be earning, having not yet reached pension age, this may also be true for 60-69 year olds on the basis of pension income alone. This reflects the potential for some pensioners in the UK to have very good private income on top of very high state earnings-related benefits.

[39] Calculated from Statistics NZ Personal Incomes, Table 3 for 1998/9 tax years and DWP (2003 HBAI) Table 6.1, data from 2001/2

3. Short-term cost

As Chapter 2 showed, a change to a Citizen's Pension of 22%-25% of NAE in the UK could be afforded now, within the current total spend on pensions.

4. Long-term cost

As Chapter 2 showed, a change to a Citizen's Pension in the UK could be afforded over the next 50 years with some additional spending, or within the current total spend on pensions, provided further policy changes are made.

5. Robust to life expectancy trends

The current UK state pension system has not changed to reflect trends in living longer (except to raise the female state pension age from 60 to the male age of 65)[40], and has tended to encourage early retirement.

In New Zealand, the state pension age was raised from 60 to 65 between 1992 and 2001, having been reduced from 65 to 60 in 1977.

The cost of the NZS-style Citizen's Pension is a direct function of the number of pensioners, so raising state pension age makes a big difference to being able to afford a good level of CP in the long-term. Because the Citizen's Pension is simple to explain, it should be easy to ensure that people of working age know well in advance how a schedule of planned future rises in state pension age would affect them.

In the more complicated UK system, there are more levers to pull to keep costs down in future, but they will involve other trade-offs. The consequences for individuals are not likely to be as easy to understand.

[40] This was legislated for in 1995 and will be implemented between 2010 and 2020

6. Fairness

The New Zealand pension system has been described as *beacon of hope to women in other countries, demonstrating the viability of a women-friendly model of pension provision…*[41]. As the Citizen's Pension is an individual right, it treats all residents in the same way, regardless of gender, work history, marital status, ethnicity, or whether disabled or not. Arguments that have been used to say that such a system is not sufficiently redistributive have been misleading.

6.1 Fairness for both genders

NZS achieves nearly complete coverage, with 93% of those eligible by age fulfilling the residency requirements and receiving it[42].

In the UK, coverage of state pensions is lower, even leaving aside means-testing take-up issues. Of those who receive some Basic State Pension (BSP), 90% of men but only 50% of women receive the full amount in their own right[43], reflecting the earnings-related contributory system in the UK, and the potential for women to receive some BSP based on their husband's contributions. Each female pensioner receives on average a 30% lower BSP and a 55% lower SERPS benefit than the average male pensioner[44].

In New Zealand, men are more likely to receive more private pension income than women. Private pensions are usually obtained through work, and the amount received is proportionate to salary. The gender pay gap and restricted access to occupational pensions (because of, for example, career interruption for caring) disadvantage women insofar as private pensions are concerned, but this is true in many other countries, including the UK.

Where the New Zealand system has the advantage is that women and men are equally guaranteed to receive the same level of basic state pension from NZS – it is gender neutral, with the age and residency eligibility criteria applying in exactly the same way to men and women. This means that any disadvantage in private pensions need not translate into poverty in later life. But in the contributory (and so work-based) UK system, with the safety-net accessed only though the means-testing process, poverty for a female pensioner is far more likely.

Other women-friendly aspects of NZS include: supplements for living alone (older women are more likely to do so than older men) and the fact that it is financed from general tax revenues (which is more progressive, and less of a burden on women who on average earn less than men, compared to the UK system of capped NI contributions).

41 Ginn et al (2001)
42 NZ Ministry of Social Development (2003)
43 Parliamentary Question Mr Wyatt, House of Commons *Hansard*, 7 July 2003: Column 604W
44 *State Pension Summary of Statistics*, published regularly by the Department for Work and Pensions

Gender has not been found to be related to material well-being among pensioners in New Zealand. Factors such as ethnicity, educational status, and age are significant and the risk of being materially disadvantaged increases where a combination of these factors operates. Being female does not appear, by itself or in combination with other factors, to make a significant difference to the likelihood of material disadvantage[45].

In contrast, there is concern over the risk of poverty for women in the UK. 66% of pensioners in 'low income households' are female, although females make up 62% of pensioners. The average total income for single women over state pension age is 20% lower than that for single men and the average income for women pensioners in couples is 45% of that for men in couples[46]. In New Zealand, there is no such marked difference between married or single women, as each individual receives pensions in his or her own right. The average female pension income is just 6% below that of the average male pensioner income[47].

6.2 Fairness whatever the individual's circumstances

Because eligibility to a Citizen's Pension is based on residency criteria as applied to the individual, it endures regardless of family and marital changes. Each person's pension is totally independent of his or her marital status, and the eligibility to pension of his or her spouse. This can be a particular advantage to women, relative to the UK, where women are more likely to be dependent on the pension of a husband.

The flexibility to family and marital change is an advantage for each individual, regardless of gender. It is one less item to have to consider on divorce (an important consideration as it becomes more likely that people will divorce at some point in their lives, if they marry at all). It creates a sense of individual ownership that is not dependent on maintaining a particular family set-up. And (with a simple system of amount determined on the basis of living alone or sharing accommodation) it is neutral as to whether people are married, in partnerships (same sex or not) or single. It therefore means that the state pension need not intervene when personal life choices are being made, or if widowhood occurs.

[45] Fergusson et al (2001)
[46] Curry (2003) p. 6
[47] Statistics New Zealand, 2001 Census Snapshot 9

6.3 Redistribution inefficiency?

An argument has been used that to give a generous state pension to every person of state pension age is not sufficiently redistributive, and that to focus resources on the poorest pensioners (through means-testing under current UK policy) is a better use of state money.

For example, for the same increase to the total annual cost of state pension benefits, the level of the Basic State Pension (BSP) could be increased by a certain amount, or the level of the Pension Credit (PC) could be increased in such a way that the current poorest pensioners would see larger proportionate increases in their total income. It has been argued that it is fairer to give more via PC than BSP to focus resources on the poorest[48].

This argument can be misleading as it applies only to the effect of incremental money being spent <u>next year</u>. If a CP were introduced, there would still be pensioners receiving relatively generous benefits from old SERPS accruals, for which transition arrangements would be required (probably maintaining those benefits). Then the amount of accruals would diminish over time. The change to a new system has to be considered to see if the <u>long-term</u> outcome would be overall more beneficial for society.

If it was decided that the introduction of a universal NZS-style state pension needed to be made less generous for richer pensioners, then ways to make the model more redistributive could be found. For instance, if tax relief on private pensions were restructured, richer people of working age would be most affected. An affluence test or surcharge could be introduced to withhold some of the state pension for richer pensioners, as discussed earlier.

Switching to a Citizen's Pension should mean that winners outweigh losers[49]. People not claiming the means-tested income supplements for which they are entitled would gain immediately. People with a reduced entitlement to pension for work history reasons (mostly women) would also gain. The number of 'losers' is reduced when a new flat pension is at least as high as the means-tested limit, but there need be no losers if transition is managed to maintain accrued rights.

[48] House of Commons Work and Pensions Select Committee (2003)
[49] As found by modelling work by Sutherland (1998) which investigated the distributional impact of an NZS-style Citizen's Pension

7. *Simplicity*

Many organisations have criticised the excessive complexity of the UK pension system[50]. There are 23 different potential entitlements for pensioners with 36 different linkages between 16 of them. This leads to high administration costs: each means-tested benefit costs 10 times more than a Basic State Pension (BSP) to deliver[51].

Complexity also means that people find it difficult to know how much state benefits they are likely to receive in later life, so do not feel comfortable about starting any private pension saving, even if they could afford to do so[52].

It may also be the case that there is too much scope for each successive government to change some part of the system, adding more complexity.

In contrast, the NZS has been almost entirely described in one phrase '65 at 65', meaning a state pension for a married couple from age 65 at the rate of 65% of National Average Earnings. The entire set of rules for eligibility to NZS and level of pension, including indexation over time, can be described in 16 pages of legislation[53].

A Citizen's Pension in the UK would mean that future accruals of BSP and the State Second Pension (S2P) would cease. The National Insurance contributory system would be redundant where it relates to pensions, and records of past contributions would not need to be held at all. There would no longer need to be a Pension Credit claiming system. Many of the 23 current benefits would no longer be needed, or claimed to such an extent. The Citizen's Pension therefore offers the potential for a much simpler pension system in the UK, easier to understand and access, and cheaper to run.

8. *Easy access for the oldest*

The Citizen's Pension gives the same amount to everyone at state pension age and older. Because it is pegged to NAE, the first-tier income of older pensioners does not fall behind that of younger pensioners.

Currently in the UK state pensions are linked to prices, so older pensioners are more likely to have to claim means-tested benefits. Access to state pension income is made harder the longer one lives[54]. With an NZS-style Citizen's Pension, there is no such inbuilt disadvantage for the oldest.

50 O'Connell (2003a), House of Lords Select Committee on Economic Affairs (2004) Conclusion 11.41
51 House of Commons Public Accounts Select Committee (2003)
52 Disney (2003); Curry & O'Connell (2003)
53 New Zealand Superannuation Act 2001, Part I
54 See PPI Briefing Note Number 6 *Why are older pensioners poorer?*

9. *Enable private saving*

A Citizen's Pension could be good for pension saving, by making it easier to understand what income can be expected from the state in retirement and by removing the means-testing trap. There are no special tax provisions for private pension saving in New Zealand, but it is not necessary to adopt that regime in order to move the UK to the Citizen's Pension. However, restructuring the current UK pension tax regime, perhaps to that applying to ISAs, could help make private pension saving become more flexible and better value.

9.1 Extent of private pension saving in the UK and New Zealand compared

Private pensions in the UK are a large component of overall pension provision: mainly occupational (employer-based) schemes, and some individual personal pensions. 43% of pensioners' non-earnings income comes from private pensions and other savings, the remainder coming from state benefits[55]. Over half of single pensioners receive income from occupational pension schemes[56]. Just under half of employees are accruing rights in employer-based pension schemes, and 12% have individual pension arrangements. 41% of self-employed people have some kind of personal pension[57].

Growing this segment still further is a major component of current government policy[58].

In New Zealand the private pension market is much smaller. 15% of people aged over 65 receive income from private pension arrangements[59]. Fewer than 15% of the workforce belonged to an occupational pension scheme in 2002, down from 22.5% in 1990[60].

One reason that has been suggested for the low penetration of occupational schemes in New Zealand is that tax relief for corporate or individual pension investment was removed between 1987 and 1990. During that period, pension fund assets in New Zealand fell from around 18% of GDP to less than 16%[61].

However, the absence of tax relief cannot be the only reason for low occupational scheme coverage. Occupational pension provision was much lower in New Zealand in 1987 than it was in the UK at that time, where pension fund assets totalled 60% of GDP[62].

55 DWP (2003 PIS).
56 Curry & O'Connell (2003) p.14
57 Curry & O'Connell (2003) pp.33-38
58 DWP (2002 GP)
59 Statistics NZ Census 2001
60 ASFONZ (2003)
61 Sandler (2002) p. 148
62 PPI estimate

There are other possible reasons for the difference in occupational scheme coverage between New Zealand and the UK:

- There are far fewer large employers in New Zealand. Fewer than 40% of New Zealander full-time equivalents (FTE) who do not work on farms work in organisations of 100 FTEs or greater. Nearly 70% of UK employees are employed in such organisations[63].
- Occupational pension provision may be seen as less valuable than higher immediate pay in the relatively low earnings environment of New Zealand.
- Personal pensions have become more popular in New Zealand, so that total membership of all superannuation schemes (employer, private and retail) increased by 28% in the last ten years[64].
- The most popular method of saving in New Zealand is housing[65]. There is no capital gains tax in New Zealand and the family 'bach' or holiday cottage is a feature. About 75% of people aged 65 and over own or partly own their usual residence in both countries[66].

In both the UK and New Zealand, most saving occurs in high-income households while the lowest income households are in debt[67]. The extent of saving seems to depend more on having the resources to do so than whether tax incentives exist.

Gross household saving as a percentage of disposable income is around 6.2% in the UK and 3.4% in New Zealand[68]. However, there are many differences in what is counted in these statistics, and there are many differences in savings behaviour between the two countries. For instance, in New Zealand, many people are self-employed and 'save' in their businesses.

There is no consensus on what the 'right' level of household or national savings 'should' be. What matters for retirement policy is whether people have good levels of wealth in retirement, at an appropriate cost to tax payers, taking into account the total cost of state pension benefits and tax incentives[69].

The evidence for whether people are saving enough for retirement is scanty in both countries and highly subjective as such analysis requires a general judgement on what is 'enough'. The most recent detailed study in New Zealand found no evidence to suggest that, taking into account all savings and wealth, including housing and NZS, New Zealanders aged 45-55 as a group are under-saving[70]. In other words, there is no evidence for a 'savings gap' in New Zealand.

[63] Calculated from Statistics New Zealand Business Demographics Statistics as at February 2002 and UK SME statistics for 2001 from the Office of National Statistics
[64] NZ Ministry of Social Development (2003)
[65] Goss & Duncan (1999)
[66] Statistics NZ Census 2001; General Household Survey, 2000/1
[67] Curry & O'Connell (2003); NZ Treasury (2001)
[68] OECD latest comparable statistics, as at September 2003
[69] Barr (2002)
[70] Scobie & Gibson (2003)

9.2 New Zealand and UK tax regimes compared

The current tax regime for private pension saving in the UK is generally thought of as EET: pension contributions attract tax relief at the individual's then marginal rate (**E**xempt); investment returns roll up tax-free (**E**xempt); and the pension income is **T**axed when received at the individual's then marginal rate.

As a tax-free lump sum can be taken instead of some of the pension income, the final 'T' is only partial. The roll-up is also not fully 'E', because since the removal of dividend tax credit was removed in 1997, income from equities has been taxed at a Corporation Tax rate, although capital gains remain tax-free. The UK tax regime for private pension has been described as[71] E T^{plus} $T^{partial}$. Depending on the investment mix, this could be an overstatement of the middle 'T'. For brevity, in what follows, the UK regime is referred to as EtT.

The current tax regime for private pension saving in New Zealand is TTE, that is, savings are funded out of **T**axed income, returns on savings are **T**axed and withdrawals of savings are **E**xempt.

TTE is considered the right choice for private pension saving in the New Zealand environment[72]. The general arguments used in favour of TTE instead of immediate tax incentives such as the UK pension system of tax relief on pension contributions can be summarised as:

1. **There is no evidence that tax incentives are effective** in increasing the amount of saving, although they may move funds to particular products[73].

2. **They cannot be applied fairly** to different savings products.

3. **They tend to benefit higher income people** who are likely to save anyway. In the UK, 55% of the tax relief on pension saving goes to 2.5 million people who are earning enough to be paying the highest rate of income tax[74]. These higher-rate taxpayers gain even more if they pay tax on the pension benefits in retirement at a lower rate.

   The remaining 45% of tax relief on pension contributions goes to 13 million lower rate taxpayers. 9 million taxpayers are estimated to receive no tax relief, as they are not saving in pensions.

4. **They are costly for the taxpayer**. There should, therefore, be an advantage from replacing government provision of public pensions with government provision of tax incentives, yet such an advantage is not obvious, especially given it is richer people who gain but all taxpayers pay for the incentives.

71 Booth and Cooper (2002), (2003)
72 Periodic Report Group (2003), (1997); Goss & Duncan (1999); Littlewood (1998)
73 See also Sandler (2002) pp. 147-148
74 Parliamentary Question Mr. Webb *Hansard* 11 February 2004: Column 1491W

Arguments that have been used in the UK for retaining EtT are:

1. **It sends a strong signal about the benefits of saving**, and **rewards the locking-in of benefits** until they can be accessed at retirement[75]. This implies that it is the role of government to incentivise people to save, and to save one way rather than other available ways.

2. Extra incentives to save should mean that later **government expenditure on means-testing is minimised**[76]. This argument has been somewhat undermined by the introduction of the Savings Credit part of Pension Credit which gives additional means-tested benefit to pensioners who have some savings, including pension savings for which they received tax relief at the time of saving. But the argument would not apply if an NZS-style Citizen's Pension at the means-tested level or higher were introduced in the UK.

3. A system where benefits in payment are promised to be exempt runs the **political risk** of a future government imposing a new tax, which would in effect be double taxation if tax had been already been paid on contributions. So, TTE may involve some disincentive to save, based on mistrust about a future government imposing retrospective changes. A mechanism to assure people of no such intention would be necessary.

9.3 Implications for the Citizen's Pension in the UK

A Citizen's Pension could be good for pension saving, by making it easier to understand what income can be expected from the state in retirement and by removing the means-testing trap. Restructuring the tax regime for private pensions would be controversial in the UK. However, changing to a TtE system - like ISAs but with a higher annual limit[77] - maintains some tax advantage. Pension saving could then become more flexible and better value:

- **A Citizen's Pension makes the need for private pension saving easier to understand**. A CP of 22-25% of national average earnings is not generous, and this level will itself encourage many people to save for a higher standard of income in retirement, and employers to provide savings plans. The 'sell' for private pensions would be made much easier as it will be absolutely clear what the income the state would provide for each individual in later life.

[75] NAPF (2002); Periodic Report Group (1997).
[76] Booth & Cooper (2002)
[77] £5,000 can be invested each year in Individual Savings Accounts, with no withdrawal restrictions. The middle t in TtE describes the situation from April 2004 when dividend tax credit will be abolished, so investment returns will be taxed in the same way as UK private pensions. Most of the points made in the above are still true for TTE, i.e. the pure New Zealand system, but it is assumed here that, given the existing ISA regime in the UK, TtE would be preferred over TTE, even though TtE would be more costly.

- **The means-testing trap would be removed with a Citizen's Pension.** Many people currently considering private saving cannot know whether their saving will be partially or totally 'wasted'. Someone who did not save could receive in retirement as much from state means-tested benefits as the person who did save receives from his or her own resources.

  While Pension Credit tries to solve this dilemma, it is only a partial solution, and adds greatly to the complexity of the system, making pensions seem even more difficult to a potential investor.

  This means-testing trap is widely thought to be a barrier to private saving in the UK, not only preventing individuals and employers from knowing that all saving (including an occupational pension) will be worthwhile, but also preventing advisers from giving clear savings advice. Lower-middle income people in particular are affected by these difficulties.

  With a Citizen's Pension set at least at the level of the means-tested benefit, the means-testing trap disappears. It may also mean a better distribution of savings as more lower-middle income people find it easier to save and get the full value of those savings.

- **A Citizen's Pension with the ISA tax regime should allow totally flexible private pension arrangements**. In the UK, an annuity has had to be taken to convert a defined contribution private pension fund to income by age 75. More flexibility is being introduced, but restrictions and conditions will remain[78]. This rule exists so that tax can be paid on the income (the last 'T' of EtT), and so that the individual does not fall back onto state benefits having spent all the pension savings.

  With a TtE system, removing the distinction between pension and ISA saving, there need be no regulation on how the private pension money is taken. With an NZS-style Citizen's Pension at the means-tested limit, there need be no further state benefit for people who have spent their private pension savings. Therefore, the combination of a Citizen's Pension and a TtE system gives choice to the individual, to save or not during working life, knowing that they can access the benefits in the short-term if needed.

[78] HM Treasury (2003 TAX)

- **A Citizen's Pension with the ISA tax regime should make private pension savings better value**. In the UK there are significant administration costs because of regulation, largely directed at ensuring that individuals do not claim too much in tax relief. There are 1,300 pages of tax regulations and Inland Revenue Practice Notes relating to pensions[79]. While there are current initiatives aimed at simplifying this legislation[80], it becomes largely redundant with the TtE system. The entire legislation for the New Zealand occupational pension scheme sector takes 39 pages[81]. There should therefore be significant savings in state bureaucracy and the administration costs of employers and financial service providers with a TtE system.

- **A Citizen's Pension with the ISA tax regime would still be tax-advantaged.** The TtE system is tax-advantaged through the middle 't' and by the prospect of tax-free income in retirement. The tax advantages in roll-up may help to encourage people to stay with their savings long-term, while the potential for accessing the money before pension age would be attractive to many people put off by the lock-in of pensions. A mechanism to ensure people trusted future governments to retain the final 'E' would also help.

[79] NAPF (2002) paragraph 3.22
[80] See HM Treasury (2003 TAX)
[81] Superannuation Schemes Act 1989 and Amendment Act 2001. The Act covers the registration of schemes, operation of Trust Deeds, ownership of assets and information to scheme members.

10. Transition

As with any change to the pensions system, there would be transition issues and options with starting an NZS-style Citizen's Pension in the UK. Many of these require more detailed examination, but there seems to be no insuperable problem. An overnight transition seems possible and may be the simplest option.

With any pension change, there are two extreme transition paths: either change overnight, for everyone; or phase in the new system with transitional arrangements during an initial period. The first approach would take a great deal of political courage. With the second approach fewer people are initially affected, so political engagement is difficult, and with a long implementation period there would be many opportunities to change the intention.

10.1 Overnight

With an overnight transition, BSP and S2P accrual would cease on a certain day. There need not be any immediate 'losers'. Current or future pensioners who receive more than the new Citizen's Pension, because they have accrued rights from the State Earnings Related Pension (SERPS) or State Second Pension (S2P), will expect to continue to receive this pension. Past SERPS/S2P accruals would be crystallised, and could be projected forward with some certainty. In honouring some or all of these additional accrued rights, there will be additional costs as the new model is phased in[82].

Current pensioners who receive less than the Citizen's Pension will immediately gain. Many pensioners will not have to go through a means-testing approach to receive the same level of benefit.

Some pensioners who currently receive Savings Credit (SC) could face a drop in income. Which pensioners are affected, by how much, depends on the level at which the CP is set and on the amount of SC they receive, which in turn depends on their other income over the full BSP amount. Around 2.7 million pensioner households are eligible for SC, and the average amount claimed is around £8 per week. If those current SC claims which take total income above the new CP level are allowed to continue (but no new claims allowed), a maximum additional amount of £1.1bn (0.1% of GDP) would need to be paid in the first year of transitioning to a CP of 22% NAE. SC has only been available since October 2003; if a Citizen's Pension had been introduced before then, this issue would not have arisen.

It might be perceived that introducing a Citizen's Pension overnight could be unfair to the younger generation who will receive the new Citizen's Pension, but also have to pay for the accruals of the older generation. This argument is not in fact correct – it is the paradox of a contributory system that allows people to build up perceived rights to future benefits that are in fact paid for by current taxation.

[82] A high-end estimate of these costs was included in the costing of the new system in Chapter 2 and Appendix 1

However, ring-fencing part of the National Insurance fund to pay for these future rights could help to minimise this perception.

Occupational schemes may need to change their benefit formula (for younger people) where the pension benefit is expressed as a function of state benefit (for example X% of final salary less state pension receivable). In addition, as S2P would cease accruing, contracted-out rebates would cease to exist. This means an immediate fall in the state money going into private pensions, but there would also be no contractual obligation to provide the pensions those rebates were providing. In any event, these changes are likely with any change to the state pension system. At least the Citizen's Pension is easy to define so that many of the current complexities of the state/private interface would no longer exist.

A decision to adopt the ISA system for private pension savings at the same time may be perceived as unfair to the younger generation. In fact, it would largely be a change in the timing of exemption from tax (from EtT to TtE), so how attractive that turned out to be would depend on individual circumstances. It could also have other advantages, outlined in section 9 of this chapter.

In New Zealand, on making the change to TTE from ETT, the income flowing from private pension savings existing prior to the change was not taxed. It is estimated to have cost at least NZ$1-2 billion in terms of potential revenue foregone on a present value basis[83]. In any UK transition, the amount of potential tax liability would be much bigger. Although no future estimates exist, there is around £6.6bn of tax collected from private pensions already in payment each year[84]. Under the integrity of the prior tax system, tax should continue to be paid. It is not a necessary policy to decide, as the New Zealand government did, to forego that revenue.

Records would have to be kept of which private pension was accrued before and after the change day so that the former could be taxed, and the latter received tax-free. This is an added complexity in record keeping, but because there have been many changes to private pension legislation, there are precedents for keeping such separate records. An alternative which avoids such record-keeping is to charge a one-off tax levy on pension funds and personal policies, estimated to be roughly equivalent to the future tax payable.

[83] Goss & Duncan (1999)
[84] Inland Revenue statistics Table T7.9

10.2 Phase in

Alternative structures for the Citizen's Pension are possible, and these could also be ways to transition to a full CP of 22-25% of NAE for everyone over state pension age. Two options are considered here:

- **The Basic State Pension (BSP) is put on a citizenship basis**. This was suggested by the House of Lords Select Committee on Economic Affairs as a way of ensuring that everyone over state pension age is entitled to a low minimum income, regardless of work history. The Committee also recommended a long-term goal of a non-means-tested Citizen's Pension, paid from an age higher than 65[85].

  The BSP is currently around 15% of national average earnings (NAE). Therefore, many people just receiving a Citizen's Pension at the BSP level would still have to claim Pension Credit, in order to receive the minimum income of 22% of NAE. Further, the BSP is indexed to prices, so over time falls behind average earnings, and an increasing number of people would need to claim Pension Credit. Therefore, this approach would need a gradual increase in the level of the CP to at least 22% NAE in order to take people off means-tested benefits.

  Without stopping the state second pension (S2P) then individual histories of national insurance contributions remain important. This means that a citizenship-based BSP adds another eligibility system without making any other systems redundant. A Citizen's Pension of at least 22% NAE replaces the contributory system (BSP and S2P) and the means-tested system with only one system based on residency.

- **The Citizen's Pension is introduced for the oldest pensioners first, say age 75 or 80 and over**. This option reduces or removes the disadvantage of the current system that pensioners are more likely to have to claim Pension Credit the longer they live.

  If introduced at the level of the minimum income, 22% of NAE, then a CP at age 80 would mean that the oldest people in society receive a safety-net income without means-testing. The initial cost would be around 0.2% GDP per year[86].

  As with the previous option, means-testing would still be prevalent (below the CP age) and multiple systems would have to continue. A gradual decrease in the eligibility age would be required to gain all the possible benefits of a CP for all pensioners.

[85] House of Lords Select Committee on Economic Affairs (2004) Conclusions 11.8, 11.30, 11.37 and 11.45.

[86] See O'Connell (2003a) p. 53 and House of Lords Select Committee on Economic Affairs (2004) Conclusion 11.46

Chapter 4: Pension policymaking in New Zealand

The New Zealand pension policy reform process has been described by UK commentators as *especially unhappy, protracted and frankly absurd* and *a rollercoaster of reforms*[87]. However, this partly reflects that pensions were in the way while New Zealand experienced a frantic period of political activity while getting used to the new system of proportional representation. New Zealand has had a universal pension for around 65 years.

There are many aspects of the pension policymaking process that, quite separate from the design of the NZS system, provide useful lessons for the UK.

First, there have been some real efforts to get political consensus – important for stability in a long-term issue like pensions. In 1993, the 'Accord' was signed by the three major political parties (and subsequently by one other). This established an agreed framework for the pension system, intended to provide some certainty and security for planning. Although the Accord later broke down, again as the political parties fought for position in the new electoral system[88], there is still a transparent formal sign up to the eligibility age and level of NZS. As described earlier, this is a simple way by which political parties could signal their consensus on the fundamental long-term structure of state pensions.

Second, there have been successful attempts to involve the electorate. As discussed earlier, the 1997 referendum threatening to replace NZS received unprecedented levels of voter turnout and size of majority (against).

Third, there is a regular open pension policy review process enshrined in legislation. The Retirement Income Act 1993 requires that a Periodic Reporting Group (PRG) is set up every 6 years to report on the retirement income policies of the New Zealand government. The first PRG reported in 1997; the second in December 2003. The commitment to a regular, independent review of pension policy should provide better discipline in the pension policy process than the current UK system of ad hoc government reviews.

Another feature of the New Zealand pension environment is the Retirement Commission, an organisation funded by but at arms' length from government. It is responsible for raising awareness of the need to plan for retirement and for publishing material to make it easy for people to find out about and understand personal financial management. A friendly website www.sorted.org.nz is the main source of information. The Retirement Commission is also responsible for monitoring and reporting on savings levels, so acts as a permanent independent source of information for policy makers[89].

87 St John & Willmore (2001); Ginn et al (2001)
88 St John (1999)
89 See www.retirement.org.nz/

Chapter 5: Some questions remaining

There appears to be no 'show-stopper' against the Citizen's Pension, so it should not be discarded as an option. Indeed, there could be significant benefits from adopting a Citizen's Pension in the UK, and it appears practically and economically feasible. It should be investigated further.

Further analysis is necessary to compare the balance of cost and benefits for the UK from the Citizen's Pension model to that for other possible reform models. The PPI work programme is continuing to enable this, including different levels of the CP and different transition paths.

More work is needed on the practical application of the Citizen's Pension, for example, whether to use the residency-based criteria similar to the New Zealand model, or citizenship-based criteria. Reciprocity arrangements for people who work for spells in the UK but retire to other countries, and vice versa, would also be required.

The PPI is also working on the economic modelling necessary to give a better indication of the costs of the Citizen's Pension in the UK (compared to the current UK state pension system and other possible systems).

This modelling can only be as good as the data inputs. Data is particularly lacking in order to estimate the future costs of the current UK pension system, for example:

- The projected future cost of tax relief on private pension saving, net of tax receipts from private pensions in payment
- Savings in assets other than pensions, and the contribution of wealth to standards of living in retirement.

More analysis would be useful on the factors that drive saving – for example whether people would change their savings behaviour if there were a state pension system from which it could be understood how much an individual is likely to receive in future.

The PPI would welcome feedback on the idea of the Citizen's Pension, views for and against, and further questions to continue testing the model.

Appendix 1: Costing the Citizen's Pension in the UK

	2002	2011	2021	2031	2041	2051
Estimate of state spend on pensions as % GDP						
Benefits[1]	5.0%	5.1%	4.9%	5.4%	5.3%	5.3%
Contracting-out rebates[2]	0.9%	0.9%	0.7%	0.5%	0.4%	0.4%
Sum – 'Baseline'	**5.9%**	**6.0%**	**5.6%**	**5.9%**	**5.7%**	**5.7%**
Tax relief[3]	1.5%	1.5%	1.5%	1.5%	1.5%	1.5%
Total	**7.4%**	**7.5%**	**7.1%**	**7.4%**	**7.2%**	**7.2%**
At current SPA						
Cost of flat-rate pension, including honouring past SERPS accruals, excluding savings from means-tested benefits other than Pension Credit[4]						
22% NAE (GC level)	6.2%	6.7%	6.6%	7.5%	7.8%	7.5%
25% NAE	6.8%	7.4%	7.3%	8.3%	8.7%	8.4%
Additional cost above Baseline 1 (spend on benefits and contracted-out rebates)						
22% NAE (GC level)	0.3%	0.7%	1.0%	1.6%	2.1%	1.8%
25% NAE	0.9%	1.4%	1.7%	2.4%	3.0%	2.7%
Proportion of tax relief (1.5% GDP) needed to mitigate extra cost, at current SPA						
22% NAE (GC level)	18%	50%	69%	107%	141%	120%
25% NAE	60%	93%	112%	159%	199%	180%
SPA to 70 by 2031						
Cost of flat-rate pension, including honouring past SERPS accruals						
22% NAE (GC level)				5.5%	6.1%	5.8%
25% NAE				6.0%	6.8%	6.4%
Additional cost above Baseline 1 (spend on benefits and contracted-out rebates)						
22% NAE (GC level)				-0.4%	0.4%	0.1%
25% NAE				0.1%	1.1%	0.7%
Proportion of tax relief (1.5% GDP) needed to mitigate extra cost, SPA to 70 by 2031						
22% NAE (GC level)				-26%	26%	3%
25% NAE				10%	70%	50%

[1] HM Treasury (2003 PBR)
[2] GAD (2003 QR) Table 5.6
[3] See text. Current actual figure assumed to stay level over projection period.
[4] For all calculations, PPI analysis. Cost of SERPS accruals estimated from GAD (2003 QR) Table 15.9 and *State Pension Summary of Statistics* (DWP, March 2003). Assumes all pensioners eligible, so an over-estimate.

Appendix 2: New Zealand economy and demographics

New Zealand is tiny compared to the UK, and is not such a rich nation. Both its population and its Gross Domestic Product (GDP) are around 5% of the UK's, but per capita measures, adjusting for purchasing power parity, are closer. The GDP per capita in New Zealand is approximately 20% lower than that in the UK and the average disposable income in New Zealand 25% lower than in the UK.

Table 2: Key economic and demographic figures for New Zealand and the UK[90]

	New Zealand	UK
Population, 2001/2	3.9 million	59 million
GDP current prices and current PPPs, US$, 2001	81.7	1550.2
GDP per capita, current prices and current PPPs, US$, 2001	21,218	26,369
Disposable income per capita, current prices and current PPPs, US$, 2000	12,240	16,667
Number of current pensioners as a percentage of the total population	12%	18.5%
Number of people aged 65 and over as a percentage of the total population, 2051, medium scenario	25%	23.6%

Despite the different size of population, by 2051 the UK and NZ populations are expected to look remarkably similar on the dimension that matters most for pension policy – the relative size of the working age and pensionable age groups.

The total NZ population is projected to grow around three times faster than the UK's for the next 50 years (up by 24% compared to 8% for the UK). The total population peaks in 2041 in the UK and 2046 in New Zealand. The population over 65 is expected to grow faster than the total population in both countries, the rate of growth for the age group being over twice as fast for New Zealand. The end result is that the over 65s are expected to form around one quarter of the total population in both countries by 2051, with New Zealand starting from a lower proportion[91] .

[90] OECD latest comparable statistics, as at September 2003
[91] Statistics New Zealand; the UK Government Actuary's Department (GAD), 2001-based projections for both

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