The Nuffield Foundation

PENSIONS POLICY INSTITUTE

PPI

Should earnings-related pensions be compulsory or voluntary?

Seminar 4 in the series: *Shaping a stable pensions solution*

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Should earnings-related pensions be compulsory or voluntary?

A Discussion Paper by the Pensions Policy Institute

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The Nuffield Foundation is a charitable trust established by Lord Nuffield. Its widest charitable object is 'the advancement of social well-being'. The Foundation has long had an interest in social welfare and has supported this project to stimulate public discussion and policy development. The views expressed are however those of the authors and not necessarily those of the Foundation.

Introduction

Pension policy is at a critical juncture. Previous PPI research has shown that there is consensus on the UK's pensions problems and that reform of the state pension system is needed. Yet Government was preoccupied with private pension provision until *Principles of Reform*, published in February 2005, set out the Government's commitment to seeking a consensus for reform. The pensions community wants a simple and sustainable solution.

The aim of *Shaping a stable pensions solution* is to build up a picture of the possible shape of a consensus pension solution that could work for the long-term, through a series of seminars to debate the most critical pension issues on the interaction of state and private pensions. Expert individuals from a wide range of backgrounds, and who between them have a variety of perspectives, will be able to make an important contribution to the debate.

Each seminar will examine a critical and topical pension policy question. This paper provides the background to the fourth issue to be considered ***Should earnings-related pensions be compulsory or voluntary?***

Should earnings-related pensions be compulsory or voluntary?
Concerns over the future adequacy of the state pensions system have reinvigorated debate as to whether the state should be directly involved in providing an earnings-related pension or compelling people to save in a private earnings-related saving scheme.

This PPI paper compares the arguments in favour of compulsory and voluntary earnings-related pensions, focussing on:
- The effectiveness of the current compulsory system
- The different advantages of compulsory and voluntary provision
- The limitations of a purely voluntary system

Other seminars in the series tackle other current major issues such as:
- What should be the balance between state and private pensions?
- How does the interaction of state and private pensions affect incentives to work and save?
- Should state pensions be contributory or universal?
- What should be the role of means-testing in state pensions?

Feedback from the papers presented at each seminar, and each seminar discussion will be consolidated into a report to be published in 2006. The report will contribute new facts, analysis and insights to the public debate highlighting where consensus lies and where and why the areas of disagreement exist.

Summary of conclusions

The UK currently has a compulsory state earnings-related pension. The first such model was introduced in 1961:

- To compensate for an inadequate Basic State Pension.
- To provide a state alternative to occupational pensions, which had low and unequal coverage.

With the future adequacy of pensions doubt, the debate over whether we should have a compulsory earnings-related pension today has been reinvigorated. But if the state does have a continued role in earnings-related provision, it does not necessarily have to be a compulsory system.

Compulsory earnings-related provision is argued by some to be the way to avoid inadequate retirement incomes. They suggest that such provision:

- Could minimise the risk of future disappointment by providing a pension that relates to individuals' pre-retirement income.
- Could reduce the need for means-tested benefits and the resulting impact on state expenditure, so is good for the individual and the taxpayer.
- Could encourage growth in the voluntary private pension sector.
- Could provide a positive effect on the economy, along with a clear incentive to work.
- Will maintain the status quo and avoid disrupting the existing pension provision framework.

An alternative point of view is that the main role of the state in pension provision is poverty prevention, a role that is best served by providing as high a flat-rate pension as possible, alongside voluntary earnings-related provision.

Supporters of this point of view argue any additional provision is unlikely to be affordable without undermining poverty prevention, and suggest that compulsory earnings-related provision:

- Is unable to guarantee an adequate pension income.
- Could increase the need for means-testing and other Government costs.
- Could undermine voluntary private saving through added complexity, increased regulation and consequently higher costs.
- Would not have a significant impact on the economy.
- Does not have consensus support (especially compulsory <u>private</u> provision), so is unlikely to be a practical policy option.

Properly encouraged and regulated, voluntary earnings-related provision on top of a reformed state foundation pension scheme might be able to meet the objectives of a compulsory scheme.

Chapter 1: Why do we have a compulsory earnings-related pension today?

The UK currently has a compulsory state earnings-related pension. This chapter explains why it was introduced, why it is now in decline, and what the future options are.

Even if the state does have a continued role in earnings-related provision, it does not necessarily imply mandating or delivering. A range of voluntary methods have been proposed.

Why was a state earnings-related pension introduced?
An earnings-related pension, the Graduated Retirement Scheme (GRS), was introduced in the UK in 1961[1]:

- To compensate for an inadequate Basic State Pension (BSP), which stood at only 20% of National Average Earnings (NAE), having been increased in the past on an ad hoc basis.
- To provide an alternative to occupational pension coverage, which covered only 35% of the workforce, with concerns that 'blue collar' workers were being disadvantaged compared to professionals and management.

GRS also had to meet political and economic concerns. Contributions to state pensions were changed from flat-rate to earnings-related to help fund existing pension payments. Earnings-related benefits were seen as a necessary 'sweetener' for higher earners making higher contributions.

The GRS was limited in scope and effect and in 1978 was replaced by the State Earnings-Related Pension Scheme (SERPS). SERPS was intended to provide a more generous 25% of band earnings[2] after 20 years contributions. The pension would be higher for higher earners, but capped.

SERPS was cut back soon after it was introduced
By the time SERPS was introduced, the two main reasons for an earnings-related scheme had been diminished. The BSP had risen to 25% NAE by 1978 and was indexed to the higher of earnings and prices. Occupational pension coverage had increased to 49% of the workforce.

Later governments considered earnings-related provision to be too expensive and SERPS was cut back in 1986 and again in 1995. This was despite a reduction in the value of BSP, which from 1980 became linked only to prices. As a result, the scheme never managed to achieve 25% NAE on top of a BSP of 25% NAE as envisaged.

[1] See PPI (2005 BN20)
[2] Annual earnings up to a maximum of 53 times the weekly Upper Earnings Limit (UEL), and less a deduction of 52 times the weekly Lower Earnings Limit (LEL)

Despite cutbacks, higher earners could gain significantly more through SERPS than moderate and low earners. The maximum amount of SERPS paid in 2001/2 was 30% NAE compared to 19% NAE for someone on average earnings[3].

Earnings-related pensions, compulsory and voluntary, are in decline
In 2002, SERPS was replaced by the State Second Pension (S2P) which was intended to provide a more generous pension for low to moderate earners and people not earning.

S2P is less earnings-related than SERPS was. If current indexation plans are maintained[4] S2P will become even less earnings-related, becoming a flat-rate benefit over the next 50 years.

This is all the more salient due to the decreasing value of the price-indexed BSP, which currently stands at a low of 16% NAE. The increasing generosity of S2P for low earners only partially makes up for the shortfall in BSP, still does not cover everyone and takes time to come fully into effect.

As a result BSP and S2P are likely to combine to produce a range of outcomes for the next 40 years before becoming in effect a flat-rate pension, irrespective of earnings, for people with a full contribution record. In 20 years time BSP and S2P combined will produce a pension worth between 15% of NAE for people with consistently low earnings and 30% of NAE for people with consistently high earnings (Chart 1). In 50 years time, everyone with a full contribution recode will receive around 20% of NAE (Chart 2). People with time not qualifying for BSP or S2P will receive less than these amounts[5].

[3] PPI (2005 PP)
[4] The Lower Earnings Threshold (LET), which marks the upper bound of the flat-rate part of S2P, is currently indexed to earnings. The Upper Earnings Limit (UEL), which marks the maximum earnings on which benefit is accrued, is indexed to prices. Over time, assuming earnings grow faster than prices, the LET catches up with the UEL.
[5] These figures assume that people work continuously from age 16 to age 64. See PPI (2005 SEM3) for a discussion of the impact of working fewer years.

Chart 1[6]

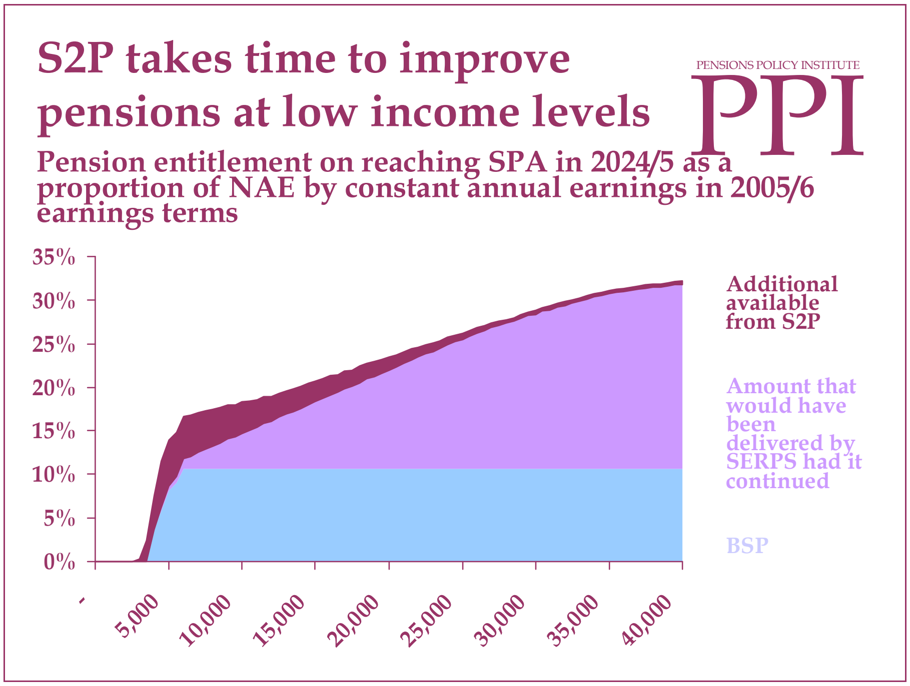
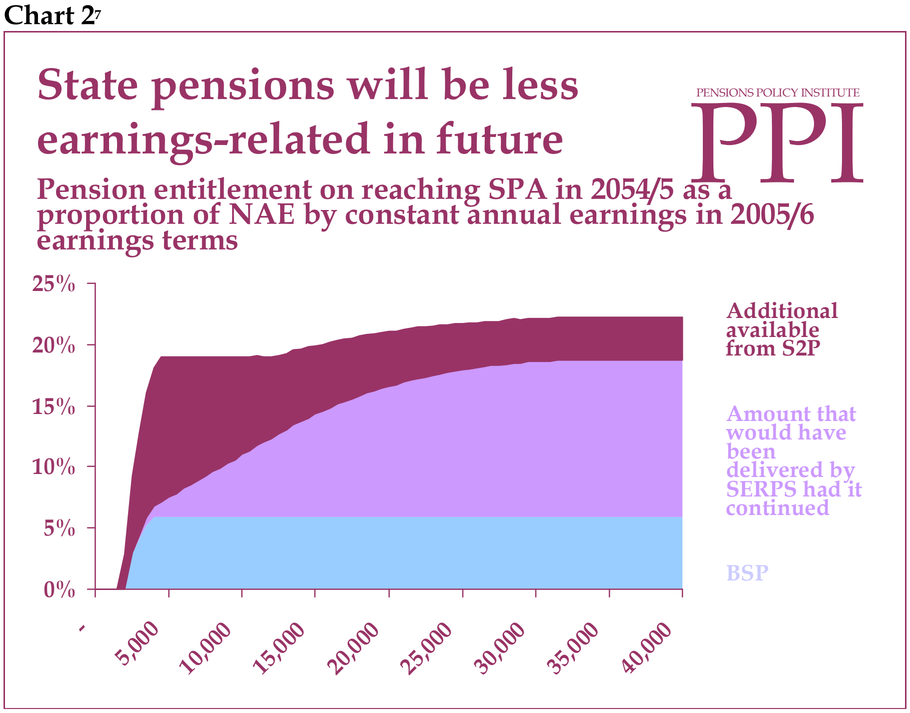


Chart 2[7]



[6] PPI calculations, assuming working continuously from age 16 to age 64
[7] PPI calculations, assuming working continuously from age 16 to age 64

With a low, flat-rate state pension system, voluntary provision needs to increase. Many people still do not have voluntary pension provision:

- Only 44% of people of working age are making contributions to an occupational or personal pension[8].
- 4 million people with access to an occupational pension do not join[9].
- 7.8 million people are not working[10], and 13.6 million[11] people are working but do not have access to an occupational pension scheme.
- Employers appear to be reducing the generosity of occupational pensions in light of low investment returns, increasing longevity and increasing regulation[12].

Therefore, the main issues for extending coverage further are how to increase take-up rates and the level of contributions, and how to include non-earners.

The future of earnings-related pensions

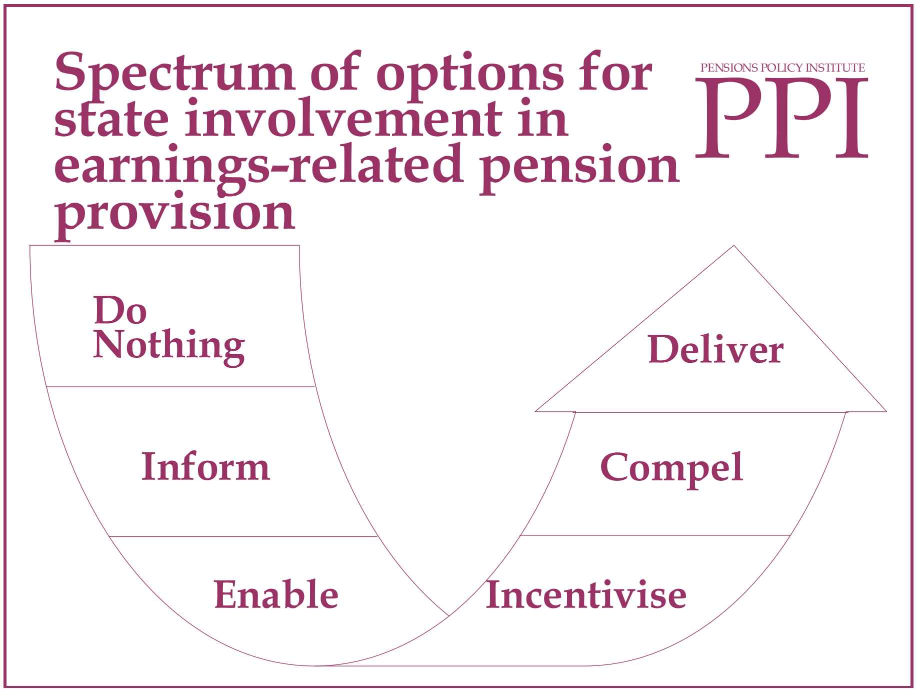
As a consequence of declining state and voluntary pension provision and long-term demographic changes the future adequacy of the entire system is now in doubt. This led to the appointment of the Pensions Commission, who have been asked: *to keep under review the regime for UK private pensions and long-term savings, and to make recommendations to the Secretary of State for Work and Pensions on whether there is a case for moving beyond the current voluntarist approach*[13].

This has focussed debate on the future of earnings-related pensions, and in particular, the role of the state.

There are a wide range of options for state involvement in earnings-related pensions (Chart 3). At one end of the spectrum, the state could have no involvement at all. At the other end is the original role envisaged for SERPS, where the state delivers an earnings-related pension directly.

[8] DWP (2004 STPP) and PPI estimates. See PPI (2005 SEM2).
[9] DWP (2004 SSC)
[10] ONS (2005)
[11] PPI analysis from DWP (2004 STPP) and ONS (2005)
[12] See PPI (2005 SEM2)
[13] Remit of the Pensions Commission as set out in DWP (2002 GP)

Chart 3



Between these extremes there are a range of alternatives, including:

- Inform - for example, provide a state pension forecast showing how much state pension might be received at state pension age and how different saving rates could improve retirement income.
- Enable – through removing barriers to voluntary private saving. For example, facilitating auto-enrolment into occupational pension schemes to make it easier for people to save voluntarily.
- Incentivise – for example, give tax relief on pensions contributions.
- Compel – for example, compelling all employers and /or employees to contribute a certain amount to an occupational pension scheme.

These options are not mutually exclusive. Indeed the state already offers information as part of the Informed Choice programme, guidelines for auto-enrolment and incentives through tax relief[14].

[14] See Chapter 4 for further details

Reform options

Reform options that have been proposed for the pension system can be categorised into two groups, depending on which part of the state pension system they aim to reform:

- Reforms to abolish compulsory earnings-related provision and concentrate state resources on providing as high a flat-rate state pension as possible.
- Reforms to retain and/or improve compulsory earnings related-provision (through either the state or private pension sector). Most reform proposals including these options also usually include an improved flat-rate first-tier state pension.

The following chapters in this paper explore the arguments put forward to support and oppose each type of reform.

Compulsory earnings-related pension provision could be in either the state or private pension sectors[15]. Some of the arguments in this paper refer to both types of compulsory provision, while others are only relevant to one or other of them. Different arguments for different types of provision are highlighted throughout the paper.

[15] In the current system the compulsory pension is into the State Second Pension (S2P) but employers or individuals can choose to place this tier of compulsory provision into a private pension through the mechanism of contracting-out

Chapter 2: Arguments for compulsory earnings-related pensions

Compulsory earnings-related provision is argued by some[16] to be the way to avoid inadequate retirement incomes. They suggest that such provision:

- Could minimise the risk of future disappointment by providing a pension that relates to individuals' pre-retirement income.
- Could reduce the need for means-tested benefits and the resulting impact on state expenditure, so is good for the individual and the taxpayer.
- Could encourage growth in the voluntary private pension sector.
- Could provide a positive effect on the economy, along with a clear incentive to work.
- Will maintain the status quo and avoid disrupting the existing pension provision framework.

Some argue that compulsion avoids disappointment in retirement
A compulsory earnings-related pension could prevent people being disappointed in retirement by reducing the likelihood that individuals experience a big drop in living standards. This could happen for a number of reasons:

- If people have no access to a voluntary private pension[17], and so rely heavily on the state pension.
- Because people are 'myopic' about saving, and inertia keeps them from saving.
- Because reliance on private saving involves risk.

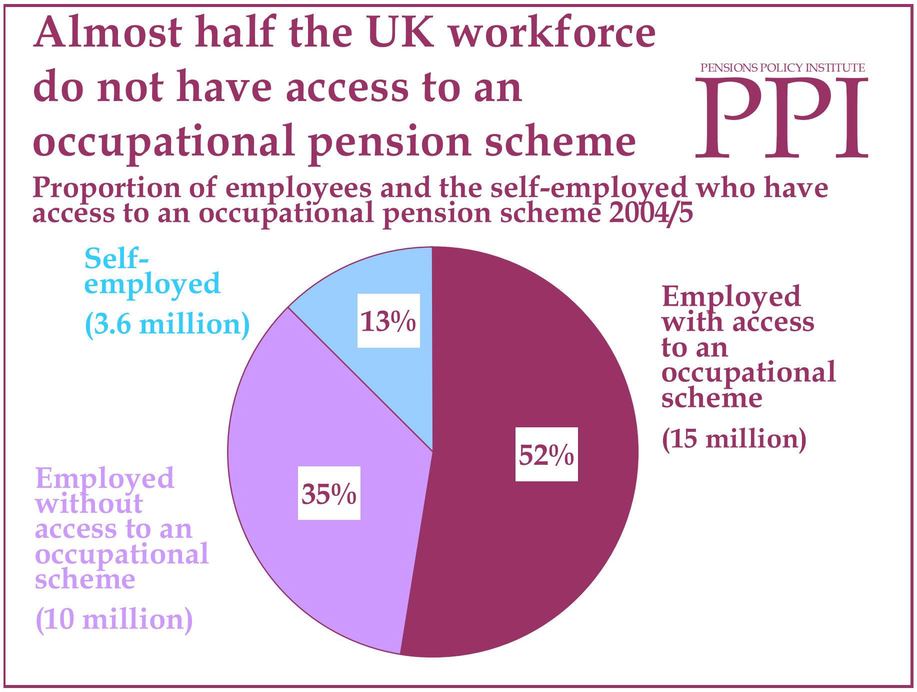
Access to the voluntary pension sector can be restricted
A compulsory state earnings-related pension allows people to benefit who would otherwise have little opportunity to access voluntary private schemes. Access to the voluntary pension system can be blocked because:

- Some individuals may only be able to afford small contributions and so are unlikely to be targeted by personal pension providers. A compulsory scheme would include everyone automatically, either through state provision or a compulsory private contribution, and so costs could be reduced overall and spread over more accounts.
- Almost half of people in work do not have access to an occupational pension scheme (Chart 4), although they will still have access to stakeholder and personal pension schemes.

[16] Those who support private compulsion include: EEF, Help the Aged, GMB, TUC and Which? Those who support retaining / improving S2P include: Aegon, Association of British Insurers, Age Concern, CBI, Equal Opportunities Commission, GMB, Legal and General, Society of Pension Consultants, TUC and Which?
[17] As any state earnings-related provision is likely to be compulsory, voluntary provision is assumed in this paper to always be in the private sector

- People not working have limited access to voluntary provision, but can be 'credited-in' to compulsory earnings-related provision (as happens in the State Second Pension). This means that people undertaking a particular unpaid activity (for example caring) can be rewarded with contributions to a pension as though they are being paid a particular wage. This can help people not in paid work to build-up an additional pension.

Chart 4[18]



People are 'myopic' by nature

Some argue that because people are 'myopic'[19], the state has a duty to intervene in people's pension saving. This short-sightedness hinders people's ability to make rational decisions about their saving needs and future income requirements.

When faced with complex decisions that have long-term consequences, people may prefer a trusted, external body to compel them to act and effectively take the decision for them[20]. Although there seems to have been an erosion of public trust in the state and financial service providers, trust in employers could lend support to compulsory private pension provision through the workplace. For example, two-thirds of surveyed employees with a pension organised through the workplace said that

[18] PPI analysis based on ONS, GAD and DWP data
[19] That is, people place less emphasis on future events than on what is happening in the present
[20] Pensions Commission (2004)

they trust their employer more than they trust the state or the financial services industry[21].

It is also thought that with more savings choices available, fewer people would make a positive decision[22]. Compulsion reduces or removes choice.

Even if people do have some idea about what to do, they may not act on it. This 'inertia' or lack of action can be caused by a number of reasons and is exacerbated by the complexity and uncertainty inherent in planning for the future. Causes of inertia vary among individuals but tend to focus on[23]:

- A difficulty imagining the future.
- A general unwillingness to consider a long way into the future.
- A fear of tempting fate or being disappointed should plans not reach fruition.

Low earners may be more strongly affected by risk
Investing in a voluntary private sector earnings-related pension can incur higher risks than saving in a compulsory state scheme. The inherent risks of the private pensions market include[24]:

- Investment risk: from Defined Contribution schemes.
- Provider risk: the likelihood of a provider failure.
- Longevity risk: increasing life expectancy lowers the annual income from a given amount of pension saving.

Low earners are particularly vulnerable to private pension sector risk. They can be deterred from building private pensions, or see disproportionate falls in overall retirement income if they suffer from, for example, provider failure or poor investment.

A compulsory state scheme removes these risks. A compulsory private pension scheme can also be designed to minimise private sector risks. For example, a compulsory private scheme may be more beneficial than a voluntary scheme if the state acts as the 'provider of last resort' for compulsory private savings, so guaranteeing a minimum level of risk protection.

21 ABI (2004)
22 Pensions Commission (2004) p. 209
23 Rowlingson (2002)
24 NAPF (2004)

Compulsory earnings-related provision could save the state money
It is argued that a compulsory earnings-related state scheme is more cost effective than a voluntary system, because it could:
- Reduce the likelihood of political moral hazard.
- Reduce means-testing and tax relief.
- Be cheaper to administer.

Compulsion could reduce the likelihood of political moral hazard
'Political moral hazard' refers to the risk that people become lobbyists for ad hoc increases in the state pension if they are allowed to make bad savings decisions that they later come to regret[25]. By compelling earnings-related pensions provision, this risk may be reduced as pension income should be closer to the level that people want[26]. Therefore, the risk that state expenditure will have to increase at short notice in future may be reduced.

Compulsion could reduce means-testing and tax relief
A compulsory earnings-related pension could reduce the number of people requiring means-tested top-ups by forcing individuals to reduce income during working life in order to fund adequately their retirement. By limiting the number of individuals not saving, the impact of means-testing could be reduced, and the state would need to pay out less in means-tested benefits.

Compulsory private earnings-related provision could also reduce the cost of providing incentives for private pension saving through tax relief, currently paid on all private pension contributions at a net cost of over £11 bn a year[27]. If compulsory contributions did not attract tax relief (as no 'incentive' is needed) and voluntary private pension contributions are replaced by compulsory contributions, overall tax relief would fall.

A compulsory state scheme would be cheaper to administer
The costs of the voluntary savings system are, to a large extent, dictated by the need for advice, marketing and regulation[28]. Compulsory state pay-as-you-go systems are lower cost, incurring administration costs of less than 0.1% of the total fund[29]. A compulsory private scheme should be cheaper to administer than current voluntary savings if the need for advice, marketing and regulation are reduced, and from economies of scale.

[25] Turner (2005)
[26] Assuming that individuals are myopic and would end up with a lower income than desired if left to save voluntarily
[27] PPI (2004 ACE)
[28] Turner (2005)
[29] Pensions Commission (2004) p. 217

Compulsion could encourage work and economic growth
Pensions are perceived by some to be a fundamental component of the employment contract between state, employer and employee. Contributing to a purely earnings-related pension may give a sense of accrual and personal ownership (particularly in a private sector scheme), and could therefore be more likely to be perceived as 'saving' rather than as a tax or a reduction in pay. Therefore, it may be less likely to discourage working as say, higher income tax could[30].

It is also argued that compelling people to save in a private pension can boost the economy if this leads to an increase in total saving. Although not guaranteed, a subsequent increase in investment and/or increase in work could lead to increased output[31].

Compulsory earnings-related provision could improve the balance between state and private provision
The compulsory earnings-related state scheme aims to get people as close as possible to achieving their appropriate replacement rate in retirement. Getting people closer to their target rate could act as an incentive to make additional private provision in order to close the gap[32].

It is argued that retaining a compulsory earnings-related pension could lead to a revitalised voluntary private sector, particularly if at least part of the system were funded (for example through contracting-out)[33]. For example:
Contracting-out of the S2P has an important role to play, as a stepping stone for those wishing to move from total reliance on the state to a mix of state and private retirement provision. In the past, contracting-out rebates have helped the Personal Pension accounts of new savers to reach critical mass. Contracting-out could do so again for another generation of savers, but this will require an increase in the level of National Insurance rebates, to restore once again the situation of positive bias in favour of contracting-out[34].

30 PPI (2005 SEM1)
31 See PPI (2005 SEM1), though this may be unlikely in an open economy where any requirements for capital could be met from overseas
32 Katona (1964) found that people save more when covered by a private pension. He explained his findings by borrowing the 'goal gradient' hypothesis from psychological research: according to this theory 'effort is intensified the closer one is to one's goal' (1964, p 4).
33 ABI (2005)
34 Legal and General (2005)

Maintaining the status quo
Support, ranging across employees, employers and various organisations, exists for the current level of state compulsion in the delivery of an earnings-related scheme.

Some organisations raise concerns over state pension reform proposals that suggest abolishing S2P. These concerns focus on:

- Losing the contracting-out rebate: *If contracting out were abolished, the amount being paid into private funded pensions would fall by between £7bn and £8bn… This sends the completely wrong message to those the Government would like to see saving more for their own retirement*[35].
- The fact that other countries have one: *…a generous flat-rate pension, but with no government responsibility for providing pensions linked to earnings…is not the approach traditionally taken in the majority of rich developed countries*[36].
- The ability of crediting-in to include those not working: *The state needs to be directly involved in providing a second pension for those who are unable to work and save due to caring or disability. A full basic pension and a full S2P should be sufficient to ensure people can build up a 'modest but adequate' income*[37].
- The inclusivity of those whose employer is too small to provide an occupational pension: *Many SMEs do not have the expertise to be involved in pensions and would wish the state to take responsibility*[38].
- Achievement of replacement rates: *Even with an advanced BSP, many individuals will not reach the common target replacement rate of between half and two thirds of earnings and therefore need to make additional provision*[39].
- Offering a low risk option for low earners: *Those, primarily women, who have mostly been low or moderate earners, cannot afford to take risks with their retirement savings*[40].

The TUC believes that the current level of compulsion should not only be strengthened, but also extended to employer and employee contributions to an occupational pension scheme: *We have said that the case for compulsion should apply not only to companies, but to workers as well. The level of contribution needed to produce a reasonable income and those results suggest that over a lifetime you need a contribution in the order of 15%. We think a reasonable balance would be 10% for the employer and 5% for the worker. For the lowest paid, you have to look at something else, but the basic idea of compulsion is sound*[41].

There appears to be general support for compulsion amongst the public. For example, 71% of employee survey respondents thought that they should be compelled to make pension contributions, and 63% believed that employer contributions should be compelled[42].

35 Aegon (2005)
36 Pensions Commission (2004) p.247
37 Age Concern (2005)
38 CBI (2005)
39 CBI (2005)
40 EOC (2005)
41 Brendan Barber (2005) Article in Pensions Management 1st March 2005
42 Vidler (2002)

Chapter 3: Arguments for voluntary earnings-related pensions

An alternative point of view is that the main role of the state in pension provision is poverty prevention, a role that is best served by providing as high a flat-rate pension as possible, alongside voluntary earnings-related provision. This is largely because compulsory earnings-related provision (state or private) is likely to increase costs, which could be politically difficult to meet. Any reduction in the flat-rate state pension to help make compulsory earnings-related provision more affordable would undermine poverty prevention.

Supporters of this point of view[43] argue against the perceived attractions of compulsory earnings-related pension provision outlined in Chapter 2. They suggest compulsory earnings-related provision:

- Is unable to guarantee an adequate pension income.
- Could increase the need for means-testing and other government costs.
- Could undermine voluntary private saving through added complexity, increased regulation and consequently higher costs.
- Would not have a significant impact on the economy.
- Does not have consensus support (especially compulsory private provision), so is unlikely to be a practical policy option.

Compulsory earnings-related pension provision is unlikely to be affordable without undermining poverty prevention

Over the next 50 years the number of people over state pension age (SPA) is expected to increase by 50%. With an ageing population, the Government must decide what to do with its limited resources and what should be the balance between voluntary and compulsory provision.

Different possible social policy objectives of pensions policy can be ranked according to how generous they are, and how much they cost (Chart 5).

Supporters of compulsory earnings-related provision place a strong emphasis on the state meeting all of the possible objectives through compulsory provision. However:

- Trying to meet all objectives is expensive. If there is a limit to how much can be afforded, more earnings-related provision has to result in a lower first-tier state pension.
- The distribution of earnings-related provision is different: higher income people get more than lower income people.

[43] Supporters include: British Chambers of Commerce, Friends Provident, Help the Aged, Hewitt, Liberal Democrat party, National Association of Pension Funds, National Consumer Council, Norwich Union, Pensions Management Institute, TUC and Watson Wyatt

Chart 5[44]

Trying to meet all objectives is expensive
Historically, despite the introduction of SERPS in 1978, UK state pensions have never provided (on average) much more than 20 - 25% of National Average Earnings. Even affording this into the future will prove expensive. For example, a simple flat-rate pension[45] paid at a rate of 21% of National Average Earnings (the current level of the Guarantee Credit, £109 a week and aimed at preventing poverty) would cost in the region of 8% of GDP per year by 2040, compared to PPI estimates of current expenditure on pensions of 6.5%. Any compulsory earnings-related provision on top of this increases costs, unless the flat-rate pension is reduced (Table 1).

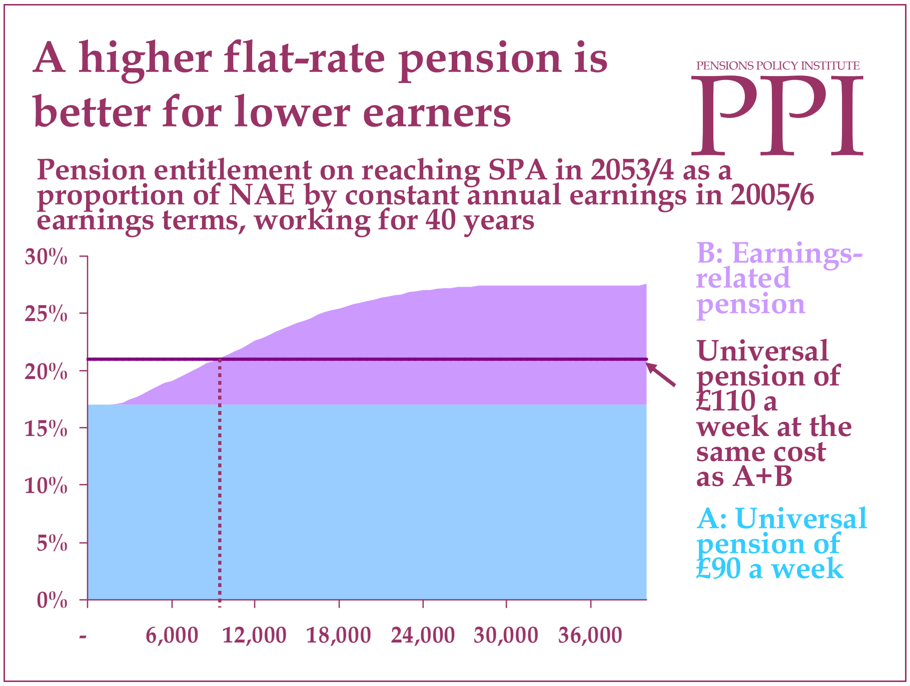
Table 1[46]: Estimated illustrative cost in 2040 of alternative state pension systems

	% GDP in 2040
Current system	6.5%
Simple flat-rate pension of £109 a week uprated in line with earnings	8.2%
Flat-rate pension of £109 a week uprated in line with earnings **and** an earnings-related pension	9.5%
Flat-rate pension of £90 a week uprated in line with earnings **and** an earnings-related pension	8.3%

44 PPI (2005 PC)
45 This could be awarded on a residency-basis, or through contributions (like the Basic State Pension)
46 PPI estimates using the Aggregate Model and Distributional Model. In all options (apart from the current system) Savings Credit is abolished. Reforms are assumed to be introduced in 2010.

Higher income people get more from an earnings-related pension
Spending money on an earnings-related pension provides a higher income for high earners (Chart 6). This is because more of the money spent on the earnings-related pension is directed towards higher earners. People earning less than £10,000 each year (and those with interrupted work histories) would receive more state pension from a single flat-rate system.

Chart 6[47]

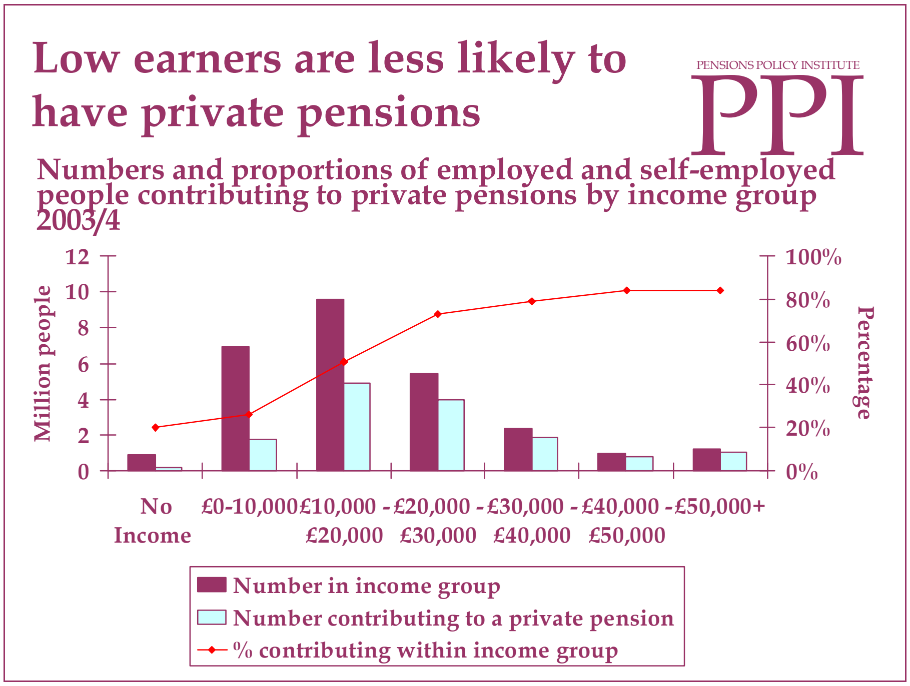


By redistributing resources throughout an individual's lifetime, compulsory earnings-related provision dilutes the redistribution from lifetime rich to lifetime poor that only the state can do.

This not only has implications for how pension income is shared among different types of individuals, but also potentially for income during working life. For example, compulsory private saving is likely to hit low earners harder than high earners, as they are less likely to already have private pensions, and low earners are therefore more likely to have to find the money for new compulsory pensions from existing consumption (Chart 7).

[47] PPI analysis, assumed that individuals remain at the same earnings level and work for 40 years – see appendix for further details

Chart 7[48]



An earnings-related state pension can also actively undermine the long-term security of the flat-rate first-tier of state pension provision. The introduction of SERPS in 1978, with its apparent increase in the generosity of the state pension system, may have made it easier to change the indexation of the Basic State Pension in 1980. Those with the lowest lifetime earnings lost the most from this switch, as they were more affected by the reduction in the Basic State Pension than the introduction of SERPS[49].

Compulsory earnings-related pension provision could increase the need for means-testing and other Government costs

If having compulsory earnings-related pension provision is only affordable with a flat-rate pension below the current Guarantee Credit level, there will still be a significant role for means-testing in preventing pensioner poverty (Table 2).

This is because:

- Low earning people are more likely to rely on means-tested benefits when reaching state pension age.
- Government may need to underwrite compulsory private pension provision (including contracted-out contributions).

[48] PPI analysis of the Family Resources Survey 2003/4
[49] Hills (2004) p. 358

Table 2[50]: Illustrative number of pensioners entitled to Pension Credit in 2040 under alternative state pension systems

	Number (and proportion) of pensioners in 2040
Current system	13 million (75%)
Simple flat-rate pension of £109 a week uprated in line with earnings	1 million (5%)
Flat-rate pension of £109 a week uprated in line with earnings **and** an earnings-related pension	0.5 million (5%)
Flat-rate pension of £90 a week uprated in line with earnings **and** an earnings-related pension	3 million (20%)

Lower income individuals are more likely to rely on means-testing
Lower income individuals who do less well from earnings-related provision are least able to build up voluntary saving, and so would need to rely on means-tested benefits to avoid poverty. This increased reliance on means-testing leads to uncertainty over future pension income for individuals[51], and uncertainty over future costs for the state, increasing the risks of both economic and political moral hazard:

- Individuals may choose not to save but to rely on means-testing, further increasing state expenditure.
- If lower and moderate income individuals receive less from an earnings-related system and are more likely to be subject to means-testing than they would have been under a higher flat-rate pension, there may be more political pressure for an increase in pension or benefit levels at short notice.
- If individuals are compelled to save or contribute, and in doing so lose entitlement to means-tested benefits, it could make them disgruntled and therefore more likely to lobby Government[52]. People expecting a decent earnings-related state pension may be more likely to be more disappointed than people expecting a certain flat-rate one; refuting the 'political moral hazard' argument for supporting compulsory earnings-related provision.

Providing a state tax-financed earnings-related pension scheme that gives higher state pensions to higher earners, and/or increases the overall tax burden is likely to be difficult in the current political climate for focussed welfare spending and a lower tax burden.

[50] PPI estimates using the Aggregate Model and Distributional Model. In all options (apart from the current system) Savings Credit is abolished. Figures are rounded to the nearest 0.5 million / 5%. Reforms are assumed to be introduced in 2010.
[51] As means-tested benefits depend on voluntary savings behaviour and the performance of investments
[52] Brooks (2004). And for example the recent backlash against the Minimum Income Guarantee that led to the introduction of the Savings Credit.

The Government may need to underwrite compulsory private pension provision
With compulsory earnings-related private pension provision, the Government would need to provide some safeguards for the forced contributions, covering investment risk, provider risk, and longevity risk. This is illustrated by the additional regulation of contracted-out pensions.

Without significant state protection, private investment risk would be felt disproportionately by those who are least able to cope with it. Providing this protection would have a cost. For example:

- The Pension Protection Fund offers only partial protection from underfunded schemes when the employer becomes insolvent. It is likely that the government would have to provide enhanced protection[53], and that potentially more employers could become insolvent if all employers had to provide schemes.
- With compulsory earnings-related private coverage, the pressure for government protection of poor Defined Contribution scheme performance would increase.
- If investment returns were low for a long period of time, the government may need to top-up low pension incomes (either directly or through means-tested benefits).

Compulsory earnings-related provision is unable to guarantee an adequate pension
Even with compulsory earnings-related pension provision there is no guarantee that people will achieve an adequate income in retirement. This is because:

- Different individuals will have different requirements and strategies for building up retirement income.
- A compulsory earnings-related system will not be generous enough to meet the income requirements of everyone.

Different individuals have different pension income requirements
In a compulsory earnings-related system the state assumes the responsibility for determining replacement rates and then achieving them. But it is not obvious that the state is in a better position than an individual to decide what constitutes an adequate retirement income or pattern of saving, and it is very unlikely that the system would be able to deliver the right one for any particular individual:

- People may prefer to work for longer or shorter periods than assumed.
- Less conventional working patterns, such as down-grading after a period spent in a high-flying job, or irregular phases due to cyclical work[54] can increase retirement income, but an earnings-related system may not account for this in setting the pension income it will provide.

[53] PPI (2004 PC)
[54] PPI (2004 PC)

- Significant life events, such as buying a first home or bringing up children, can change patterns of work, saving and expectations. They can also change the 'ability to save' at different stages of life. For example, any level of compulsory contributions might be 'too difficult' for young parents, but 'too easy' for those later in life.
- Compulsory provision is inflexible. It determines the strategy and the mechanism (pensions) chosen for individuals to accrue an adequate retirement income. There may be equally viable alternative strategies to be pursued, for example using different savings vehicles, such as property or ISAs, opting for a personalised risk profile, or sharing the saving responsibility with a partner.

A compulsory system will not be generous enough to meet all income requirements
Compulsory earnings-related provision is very unlikely to be high enough to allow most people to achieve a desired level of retirement income with no other saving or other form of income. This lack of generosity occurs in:

- The level of the pension, which is not high enough to reach a target replacement income. This leads to the danger that people come to see the compulsory minimum level of provision as the correct amount of provision, and take no other action. This may be particularly true for compulsory private provision (see for example, the Australian system as described in Box 1). In this case, the compulsory scheme becomes a ceiling to provision, rather than a floor on which to build further provision.
- The coverage of the pension, where for example the self-employed and people not in work are not covered by the schemes. In some cases individuals who would prefer not to pay compulsory contributions can avoid doing so by changing their labour market status (as has happened in Latin America, see Box 1)

There are a number of different international models of compulsory private pension provision (Box 1). Each has a different level of reliance on compulsory contributions, but each has problems with one or more of:

- The level of the pension.
- The coverage of the pension.
- The high costs of provision.

Box 1: International models have some problems

Australia

System characteristics: A compulsory occupational pension was introduced in 1992 on top of a basic flat-rate state pension that is affluence tested. Employer contributions to the Defined Contribution, often industry wide, pension schemes have risen to 9% of earnings and cover about 90% of the working population[55].

Advantages: The reform is considered successful in increasing private pension coverage and reducing reliance on the means-tested basic state pension. Evidence suggests that the level of national savings has been raised; with every Au$1 of compulsory contribution made there has been a 38 cent offset from other forms of savings[56].

Disadvantages: Costs are high, accounting for 1.28% of assets annually[57]. Evidence suggests that additional pension saving is limited and that employer-based schemes have reduced their contributions back to, or closer to, the minimum compulsory level[58]. Pension inadequacy is likely as the minimum level has to be set low enough to be politically feasible[59].

Chile

System characteristics: Reforms in 1981 introduced compulsory funded individual retirement accounts.

Advantages: Reforms are based on a far more sustainable social contract than the previous system. This was largely achieved by a long period of fiscal preparation prior to reform[60].

Disadvantages: Incomplete coverage remains an issue and is partly due to the prevalence of the informal sector. 34% of the working age population are contributing[61]. Target replacement rates have been set relatively low[62].

[55] Timmins et al (2004)
[56] Connolly and Kohler (2004) cited in Pensions Commission (2004)
[57] Coleman, Esho and Wong (2003)
[58] Pensions Commission (2004) p. 254
[59] Timmins et al (2004)
[60] Holzmann and Hinz (2005)
[61] Palacios (2004)
[62] Holzmann and Hinz (2005)

Germany
System characteristics: The German pension system consists of one component, that of a compulsory, earnings-related, pay-as-you-go (PAYG) scheme. Contributions of 19.5% of salary (50/50 from employee and employer) are paid up to a set salary level that is adjusted annually. The state pension covers all those who have been employed and carers.

Advantages: Replacement rates are high, averaging 70% of pre-retirement income in 2003[63].

Disadvantages: Over-reliance on the state scheme and a bulging state deficit led to reforms in 2001 to encourage voluntary pension provision[64].

Italy
System characteristics: Reforms to the current PAYG earnings-related state pension will eventually lead to a PAYG funded scheme with levels based on earnings history, life expectancy and national economic performance.

Advantages: The average relative household income of the over 65s are close to that of the under 65s[65].

Disadvantages: Despite a public pension bill currently standing at 14% of GDP, reforms are only expected to create a 0.7% of GDP increase in national savings from 2013 to 2030[66].

Sweden
System characteristics: Employers and employees contribute a combined 16% of pensionable earnings to a compulsory Defined Contribution scheme. Rates of benefit are linked to life expectancy at the point of retirement. A further 2.5% of earnings are paid into compulsory private funded accounts, managed by the individual or the state if preferred.

Advantages: Pensioners are at lower risk than the rest of the population of living in low income households[67]. Private pension costs are kept down by the imposition of variable ceilings on charges.

Disadvantages: Relatively high public pension expenditure at 9% of GDP in 2000 (compared to 5.5% in the UK)[68]. System complexity seems high. Most individuals do not actively manage their portfolio[69].

[63] PPI (2003 SPM)
[64] Timmins et al (2004)
[65] Pensions Commission (2004)
[66] Timmins et al (2004)
[67] Pensions Commission (2004)
[68] Pensions Commission (2004)
[69] Sunden (2004)

Compulsory private pension provision could undermine voluntary saving through increased complexity and cost

Some argue that a compulsory earnings-related pension would continue, or even add to, the complexity of the current pension system:

- BSP and S2P have numerous different eligibility and contribution rules.
- Contracting-out is poorly understood and adds to the regulation required for private pension administration and sales.
- A system including a compulsory earnings-related pension is likely to retain a significant level of means-testing.

This line of argument suggests that complexity should be avoided, as it:

- Increases inertia and acts as a barrier to saving.
- Can increase the costs of voluntary provision for individuals.

Complexity increases inertia and other barriers to saving

The complex pension system is itself a cause of inertia and increases the risk of political moral hazard. Uncertainty and complexity are at the root of many people's saving behaviour[70]. For example, the existence of significant levels of means-testing can lead people to believe that it is not in their best interest to save, or prevent people being targeted for pension sales.

Compulsory earnings-related provision can increase the costs of voluntary provision

Any earnings-related system increases complexity from having another set of rules, or element to a set of rules. In the UK, the continuance of an earnings-related state pension is likely to mean the continuance of contracting-out, and if so, the continuance of a complexity that many organisations – including those involved with employers, occupational pension schemes and personal pensions - want to be rid of[71]. Complexity increases the costs of administration for pension schemes, and leads to higher levels of regulation on advice, marketing and the sales process.

Compared to a higher flat-rate pension system, lower income people would have to save more voluntarily to achieve a target income level if they receive less from a compulsory earnings-related pension. Higher income people would need to save less voluntarily. This:

- Increases the overall cost of voluntary saving, as it is more costly for the private sector to access and 'sell' pensions to lower income groups.
- Increases the risk that lower income groups are not able to participate in the voluntary pensions market offered by the private sector, and so miss their target replacement ratio.

[70] See PPI (2005 PC2)

[71] Including the Association of Consulting Actuaries, British Chambers of Commerce, Help the Aged, National Association of Pension Funds, Norwich Union and Watson Wyatt. See PPI (2005 BN18).

Compulsion would not encourage economic growth
Economists take different opinions as to whether compulsory private pension saving gives any boost to the economy[72]. Some suggest that:
- The evidence as to whether compulsory private saving leads to higher total saving is mixed.
- There is not necessarily a direct link between higher saving and economic growth.

This line of argument suggests that a better voluntary approach alongside a simpler state pension system could result in a system with as much saving in private pensions as a compulsory system, and therefore be just as good for economic growth.

Consensus for private pension compulsion is lacking, so it is unlikely to be a practical policy option
Opinion within the business community and the general public regarding compulsion is inconsistent and unclear. Developing consensus around compulsory earnings-related provision would therefore be difficult.

The Pensions Commission's First Report has invigorated the debate on compulsion. This is reflected in the reform proposals of various organisations who responded to the Commission's consultation period. Analysis of the pension reform proposals of 33 of these organisations, including employee and business groups, insurers and others with an interest in pensions policy, showed little consensus for compulsory private pension provision[73].
- Only 5 out of the 33 suggested that employers should be compelled to contribute, with 4 of those also supporting compulsory employee contributions.
- The evidence suggested rather that consensus is emerging around the need to encourage voluntary saving.

Support for employer compulsion among employers is more difficult to ascertain. Although there does seem to be some growing support, this is predominantly among small to medium employers who already provide an occupational pension scheme[74]. This suggests demand rather to create a 'level playing field' and fairer competition for employer pension provision.

[72] For example see PPI (SEM1) and Barr (2000)
[73] PPI (2005 BN18)
[74] EEF/AON (2004)

Opinion within the general public is contradictory. Although there is support in principle, it is heavily qualified:

- People who are already saving in a private pension scheme are more likely to support compulsion. For example, of 73% of survey respondents who support compulsion, only 26% support a level that would make a difference to their own behaviour[75].
- Preference for compulsion is reduced if compelled saving is perceived as a trade off with wages or salary[76].
- Opposition to compulsion is strongest amongst the self-employed, people without private pensions and part-time workers.

[75] ABI (2004)
[76] ABI (2004)

Chapter 4: Can a voluntary system meet the objectives of a compulsory system?

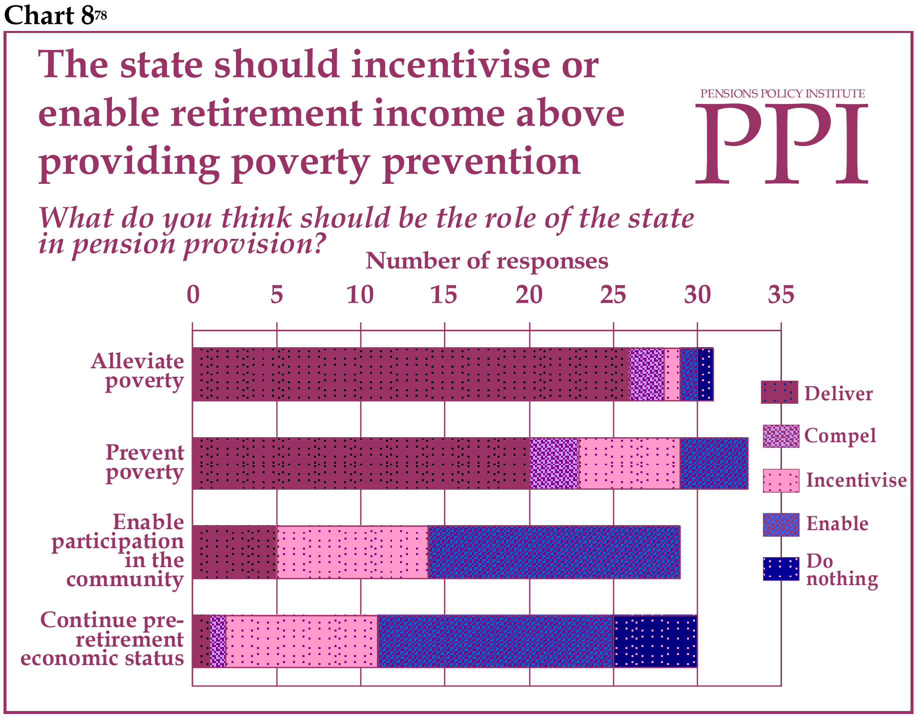
Properly encouraged and regulated, voluntary earnings-related provision on top of a reformed state foundation pension scheme might be able to meet the objectives of a compulsory scheme.

The voluntary system could be reformed to replace compulsory provision
As highlighted in Chapter 3, a flat-rate state pension high enough to prevent poverty could be expensive enough to rule out compulsory earnings-related provision, leaving the voluntary private sector to help individuals achieve the higher incomes necessary to meet higher social policy objectives.

That does create a risk that many people will make inadequate provision by relying too heavily on the basic pension. That risk, however, can be mitigated by the system's simplicity. Governments of successive colours could spell out clearly and repeatedly just what the limited nature of the pension promise is, while underlining that, beyond that, people are on their own[77]*.*

In a small group of pensions experts, most supported just such a twin role for the state: providing a state pension to alleviate poverty, and enabling or incentivising voluntary provision on top (Chart 7).

Chart 8[78]



[77] Financial Times (2005)
[78] PPI survey of 29 multi-disciplinary people involved in pensions at a Nuffield seminar May 2005

The state is already implementing a number of different policies to encourage and incentivise voluntary-earnings replacement on top of S2P, including the Informed Choice Programme, support for auto-enrolment and tax relief on pension contributions (Box 2). These policies might need to be improved on, or added to, if S2P were abolished.

Box 2: Recent Government initiatives

Options under consideration within the Informed Choice programme include[79]:

- Active decisions – where new employees are required to make a decision whether to join their employers pension scheme or not.
- Commitment to save more in the future – where employees commit potential future earnings to their pension savings.
- Automatic enrolment – where new employees become members of their employer's pension scheme with the option to opt out.
- Efforts to increase financial understanding through the National Curriculum.
- The setting up of an integrated retirement planning service to include telephone helplines and a web-based retirement planner.
- Issuing combined pension forecasts, to bring together an individual's state and private pension forecast.

Initiatives introduced in the Pensions Act 2004 aim to increase the security of private pensions, and therefore bolster confidence and trust. Measures introduced in April 2005 include:

- The Pensions Protection Fund – to offer compensation should a defined benefit scheme become insolvent.
- A more proactive Pensions Regulator – to focus on areas of greatest risk to people's pension savings.
- The extension of Transfer of Undertakings regulations – to increase the security of pension rights when transferred.

Further initiatives from the Pensions Act 2004, due to be introduced in April 2006, include:

- New rights for early leavers of occupational schemes.
- The relaxing of some restrictions on contracted-out benefits.
- Greater freedoms for schemes to change their rules, adapt to changing circumstances, and reduce administration costs and complexities.
- Safeguards for scheme members if schemes change their rules.
- Increased responsibility and regulation of trustees.

[79] DWP (2004 SSC)

Commitment has also been made to reducing regulation and complexity within the voluntary pension market through reform of the tax system. Measures introduced in the Finance Act 2005, and due for implementation in April 2006, include[80]:

- Less specific restrictions on the amount paid in or out of a pension through the introduction of a new Lifetime Allowance and Annual Allowance.
- The ability for individuals to take their entire pension fund as a lump sum, with up to 25% tax free.
- The ability to withdraw funds between ages 55 and 75, and make forms of withdrawal other than an annuity after age 75.

In 2002, the Sandler Review recommended the introduction of simple stakeholder saving products aimed at low to medium earners. The intended benefits of Stakeholder Pensions include[81]:

- Better value due to a shorter, simpler and cheaper sales process.
- More flexible and portable.
- Accessible to people who do not have access to an occupational pension scheme.
- Sufficiently tight regulation, so customers could safely be sold them without the need for regulated advice.

As at June 2004, 2 million stakeholder pensions had been sold[82].

Properly encouraged and regulated, voluntary earnings-related provision on top of a reformed state foundation pension scheme might be able to meet the objectives of a compulsory scheme. For example[83]:

- A higher flat-rate pension system should minimise disappointment for low earners and increase voluntary saving for higher earners.
- A national auto-enrolment scheme could widen access to retirement saving.
- Savings incentives might work better if they were more transparent and better targeted.
- Better information can play a role in reducing myopia and inertia in a simpler system.

[80] See PPI (2005 PP)
[81] Sandler (2002)
[82] DWP (2004 OA)
[83] See PPI (2005 PC2)

A higher flat-rate pension system should minimise disappointment for low earners and increase voluntary saving for higher earners

Chapter 3 has shown how a flat-rate state pension system provides a better income for low earners, reducing means-testing, and so is better placed to avoid disappointment in retirement for this group. Chapter 3 also suggested that the simplicity and certainty of a single flat-rate state pension system would make it easier to understand how much voluntary saving would be necessary. Reduced complexity and regulation would also lower costs and so provide a further boost to voluntary saving.

In addition, compared to an earnings-related system, low earners will need to save less to achieve a target replacement income, and high earners will need to save more[84].

This is more in line with:
- The ability of individuals to save. High earners are more likely to be able to afford voluntary saving.
- The attractiveness of business to providers. Providers are more likely to want to sell pensions to individuals making large contributions.

These improvements will offset at least some of the loss of the contracted-out rebates in the private pension system. It is possible that overall saving may not be significantly reduced, or could even be increased, by moving to a single flat-rate pension system[85].

A national auto-enrolment scheme could widen access to retirement saving

Auto-enrolment into employer-based schemes is being encouraged. It could also be extended to those without access to an occupational pension scheme, for example through a vehicle similar to the proposed KiwiSaver, an auto-enrolment savings vehicle that operates through the workplace and is planned to be introduced in New Zealand in April 2007[86] (Box 3). Some or all of the benefits of a KiwiSaver could apply in the UK context.

[84] NAPF (2004)
[85] NAPF (2004)
[86] New Zealand Government (2005)

Box 3[87]: KiwiSaver – Key points

- KiwiSaver takes a holistic approach to encouraging long-term saving habits. Help for homebuyers and an increase in financial education are also part of the KiwiSaver package.
- Employers must offer KiwiSaver, but do not have to contribute.
- Employees are automatically enrolled when they start a new job, and have three weeks to decide whether they wish to remain members. Existing employers, the self-employed and beneficiaries can opt in.
- Contributions of 4% or 8% of gross salary are made to a savings fund chosen by the individual and are deducted automatically from pay.
- Costs to the private sector and employers are therefore kept low by running the scheme through one interface with the existing PAYE system for the collection and distribution of contributions, and potentially a 'panel' of few providers setting up and maintaining accounts.
- As a visible, flat-rate incentive, the Government adds NZ$1,000 to each individual's KiwiSaver account on joining. This is locked in till age 65 or for 5 years minimum in exceptional circumstances. The government also increases the rate of return for the saver by providing a fee subsidy.
- An estimated 25% of the eligible labour force expected to be members by 2013.

Savings incentives might work better if they were transparent and targeted

The Government spends at least £11 bn (1% of GDP)[88] on providing tax relief on pension saving each year (net of tax paid on pensions in payment), but effectiveness is unproven. There is no evidence that tax incentives increase the overall level of saving, though they can encourage pension rather than other types of saving[89].

The current system of tax relief is also regressive, in that higher earners receive a higher rate of tax relief, and so receive more state support for a given level of private pension contribution. Higher earners are also more likely to belong to private pension schemes[90], and so be making contributions that attract tax relief.

A number of proposals have been put forward to redistribute tax relief, including using a system of 'matching contributions'[91] to incentivise private pension saving, or private saving more generally. These could be used instead of, or on top of, the current system of tax relief. This would mean that:

[87] PPI (2005 BN 21)
[88] Hills (2005 PPI AGM)
[89] PPI (2004 ACE)
[90] Curry and O'Connell (2003)
[91] A matching contribution system works by giving every individual the same saving incentive for the same level of contribution. This is achieved by Government paying a fixed monetary amount for each personal contribution, rather than using a marginal tax rate. For example, a 25p Government contribution for each £1 of personal contribution.

- Lower earners receive a large incentive to save, so incentives would be better targeted on those who currently do not save.
- The incentive is much clearer, and presented in a way that is easier to understand.
- The system could be more progressive than the current system, if matching levels are high over a relatively small band of income.

There are complexities surrounding matched contributions and Defined Benefit pension schemes that would make it difficult for them to replace the existing system of tax relief[92], but they could have a role to play as an additional savings incentive[93]. This would be at an extra cost on top of the existing 1% of GDP already spent on tax incentives.

Other models of incentives could also be introduced with the same caveat on cost. For example, proposals have been made for:
- Workplace advice credit[94].
- Employer Pension Contribution Tax Credit[95].
- Lump sum incentives such as in KiwiSaver or the UK's Child Trust Fund.

Better information can play a role in reducing myopia and inertia in a simpler system

The government already provides a wide range of education and information services on voluntary saving, and is introducing more through the Informed Choice agenda. These include:
- State pension forecasts and combined pension forecasts.
- Statutory money purchase illustrations.
- Encouraging the provision of advice through the workplace, for example through pension information packs.
- Development of a new web-based financial planner.

All of these initiatives are designed to help overcome myopia, and help people to make the correct decision in their own best interests. The effectiveness of these programmes would be enhanced by moving to a flat-rate state pension system, where the system itself (or at the least the potential outcome of the system for each individual) is easiest to see and understand[96].

Notwithstanding the fact that inertia and myopia will exist in any voluntary system[97], in a simpler state pension system the Informed Choice initiatives would help individuals make better (if not perfect) decisions.

[92] See PPI (2004 ACE) for further details
[93] For example in a BritSaver type model
[94] ABI (2005)
[95] ABI (2005)
[96] PPI (2005 PC2)
[97] As described in Chapter 3

Appendix: Pension payable at different earnings levels

This appendix looks at how the amount of pension income that alternative pension systems deliver depends upon the number of years of contributions as well as earnings.

The following pension systems would cost broadly the same in 2040:

- A universal pension paid at the level of the Guarantee Credit (21% of National Average Earnings (NAE), currently £110 a week) uprated in payment in line with earnings growth.
- A universal pension paid at £90 a week (17% of NAE) uprated in payment in line with earnings growth, and an earnings-related pension based on the SERPS scheme that was in place immediately before the introduction of State Second Pension in 2002.

However, each system has different distributional consequences:

- Under the higher flat-rate system, lower earners and higher earners receive the same.
- Under a lower flat-rate system supplemented with an earnings-related pension, higher earners receive more than lower earners.

When comparing these alternative systems, there is therefore a 'pivotal' earnings level (See Chart 6 in Chapter 3):

- People earning more than this will get more from the earnings-related system.
- People earning less than this will get more from the flat-rate system.

Assuming everyone works for 40 years (from age 20 to age 59) at the same earnings level, the pivotal earnings level would be £10,000 a year. Currently 49% of the working age population[98] (including the self-employed[99] and those with no earnings at all) earns less than this.

The pivotal earnings level is sensitive to the number of years that people have earnings:

- If people earn for more years, the pivotal earnings level is lower, as the earnings-related system gives a higher pension to people who work for longer. If people work for 45 years (20 to 64), the pivotal earnings level would be £9,000 a year. Currently 46% of the working age population earns less than this.
- If people earn for fewer years, the pivotal earnings level is higher, as the earnings-related system gives a lower pension to people who work for longer. If people work for 35 years (20 to 54), the pivotal earnings level would be £11,000 a year. Currently 51% of the working age population earns less than this.

[98] Age 20 to state pension age
[99] The self-employed do not qualify for SERPS / S2P

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