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Citizen's Pension: An Introduction

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Citizen's Pension: An introduction

A Citizen's Pension is a basic amount payable to all people over state pension age that pass a residency or citizenship test.

This system would seem to be able to solve many of the problems of the current UK system as it is simple, and it removes the need for extensive means-testing.

The NAPF has recommended that the UK state system should be reformed to a Citizen's Pension model[1]. Other organisations agreeing with this include: the Liberal Democrats, British Chambers of Commerce and the Equal Opportunities Commission. Other organisations agree that there should be one simple basic state pension, but have not detailed the form that should take.

The Pensions Policy Institute (PPI) analysed in depth the Citizen's Pension in New Zealand, and concluded that such a model could be adopted and afforded[2].

New Zealand is the only country to have a Citizen's Pension as the single state pension, and is a valid role model:

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Why New Zealand?

- A Citizen's Pension since 1938; the single state pension since 1977
- A small economy compared to the UK, but a similar ageing trend
- Stability and consensus in state pensions
- 55 pages of pension legislation (state and private); 3,500+ in the UK
- Much less pensioner poverty
- No apparent savings gap…although no tax relief for private pensions

[1] NAPF (2002) *Pensions Plain and Simple* www.napf.co.uk
[2] O'Connell (2004 CPNZ) *Citizen's Pension: Lessons from New Zealand*, www.pensionspolicyinstitute.org.uk

The New Zealand model of a Citizen's Pension is described very simply as "65 at 65". This means a couple over the state pension age of 65 receive a total net Citizen's Pension of 65% of net National Average Earnings (two times 32.5%). A single person, living alone, receives about two-thirds of the married couple's pension.

Key features of a New Zealand style Citizen's Pension

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- One flat benefit, set at or above the means-testing level
- Indexed to national average earnings
- Paid to every eligible individual over state pension age, single or married
- Eligibility is set by how long the individual was resident in NZ: 10 years since age 20, 5 since age 50

The level of benefit is, in New Zealand spending and earnings terms, enough to live on provided you own your own home (supplements are available for low income people in high rent housing).

93% of over 65s qualify and there is therefore hardly any means-testing for basic income.

In the UK, a similar level of benefit in our earnings and spending terms for a single person might be 25% of National Average Earnings (NAE). This would be **£115 per week**.

The lowest the Citizen's Pension should be in the UK is £105 per week or 22% NAE, as this is the level of the Guarantee Credit – the minimum income a person over pension age should have to live on.

By giving this level of benefit to eligible residents – as of right, with no means-testing – there would no longer be the need for Pension Credit. Around half of UK pensioners are currently eligible for Pension Credit, and this will extend still further in future.

- Means-testing is thought by many to be complex, costly and demeaning. Around a quarter of eligible pensioners do not claim the means-tested benefit they should, so they are poorer than they need to be.
- And the means-testing system makes it harder to save in an occupational pension scheme or personal pension: it is difficult to work out what you will get from the state in future, and how much value you would get from saving.

A Citizen's Pension should solve these problems.

Attraction of a Citizen's Pension for the UK

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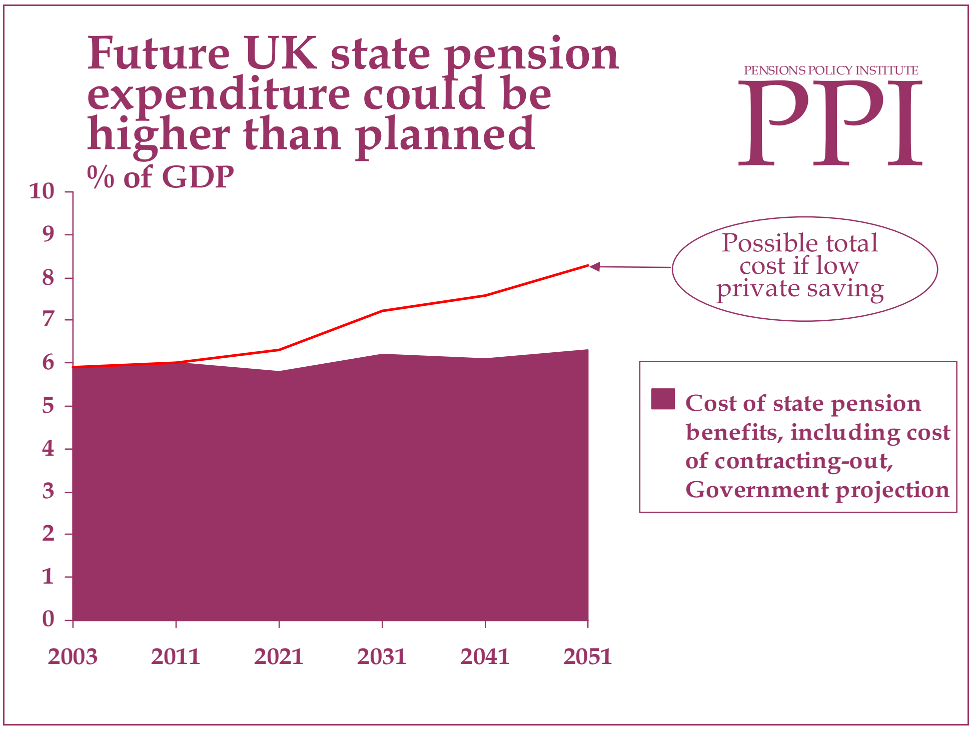
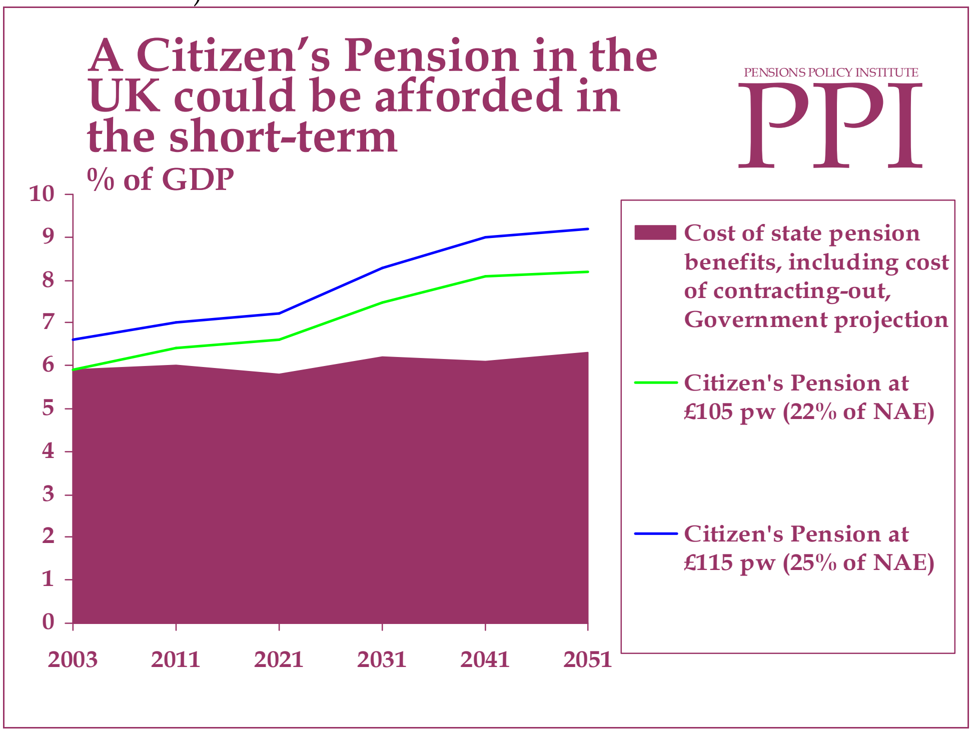
- Should dramatically reduce pensioner poverty
- Simple to understand
- Encouragement to save
- Cheap to run
- Fair – all life histories treated equally
- Future cost to the state is more certain

It would be fairer in the sense that it puts everyone on a level playing field. Under the current system, people who did well at work (high, regular income) get more out of the state pension system. With a Citizen's Pension everyone eligible gets the same from the state and the benefits of doing better at work accrue through private pensions.

The future cost of the Citizen's Pension would be more certain as it depends only on the future number of people above state pension age. The cost of the current system depends on many more factors, some important ones of which are not under the control of the government, such as how much people save and the amount they claim from means-tested benefits.



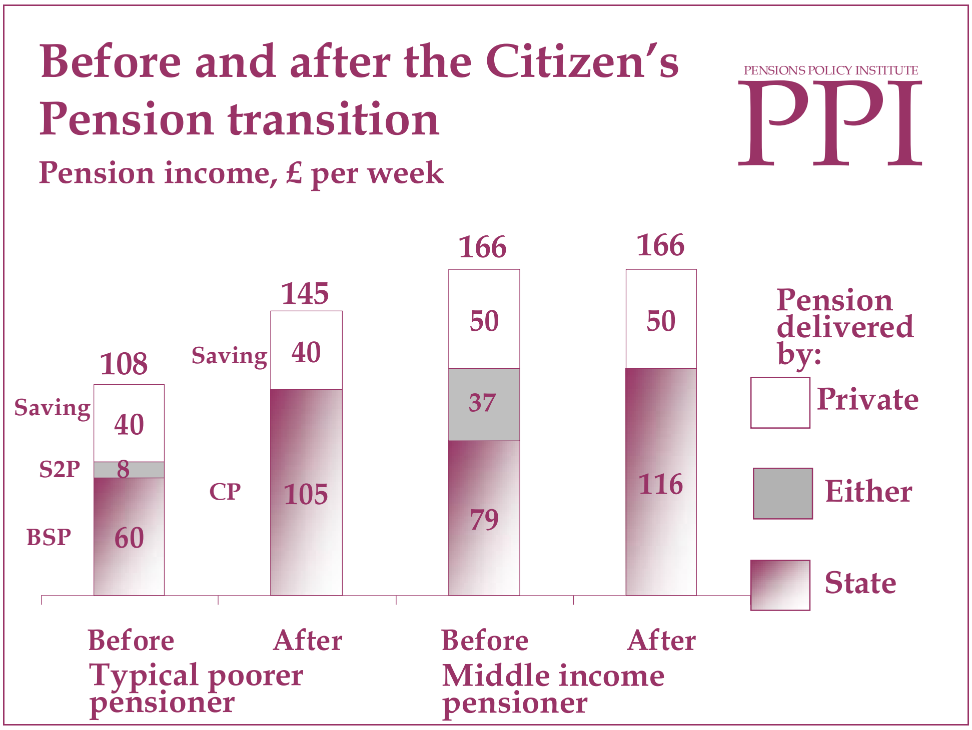
A Citizen's Pension could be afforded in the short-term, within current planned state spending on state pension benefits (the CP costings are over-estimates)[3].



[3] PPI work in progress

Despite the conventional wisdom that it would be too expensive, a Citizen's Pension (at £105 for all over state pension age) is affordable:

- There would be immediate savings in Pension Credit and other means-tested benefits.
- Accruals to State Second Pension would stop, so that the 1% of GDP (£11bn) currently spent on contracted-out rebates each year could be spent on the Citizen's Pension.
- Transition can be managed to give more to poorer pensioners, but no more to richer pensioners, by offsetting the new Citizen's Pension benefit against accrued state pension rights.



Any pensioner with state pension benefit below the new Citizen's Pension would immediately have benefit lifted to the new Citizen's Pension level. People with state pension benefit higher than the Citizen's Pension would continue to receive the higher amount.

No-one would receive less than their accrued entitlement to state pension (basic and second tier).

The new Citizen's Pension gives a decent minimum to everyone, so it would be very expensive to continue to give a state second pension as well. There would be no more accruals to the State Second Pension (S2P).

Higher income people, instead of expecting to accrue in future a high Basic State Pension and a high State Second Pension (or contracted-out equivalent) would instead be eligible for the same Citizen's Pension as other people.

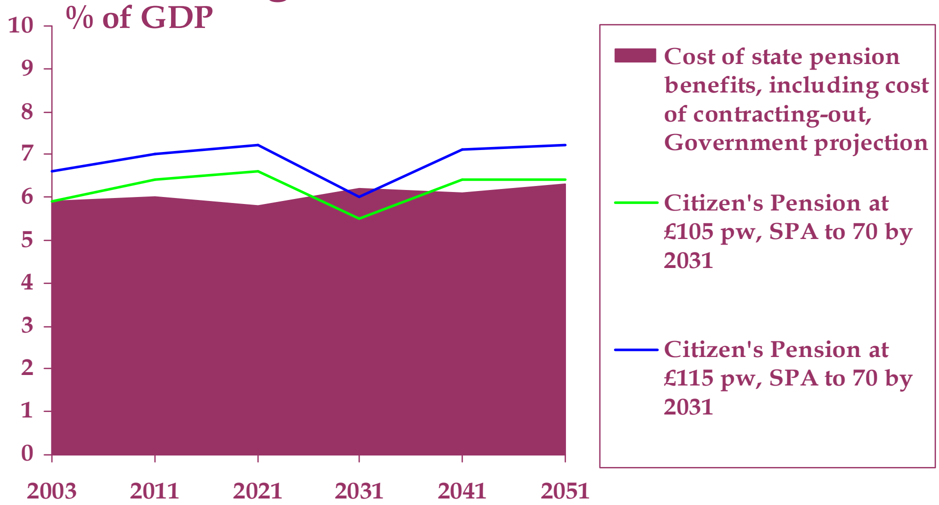
In future, as the number of people over state pension age increases, the Citizen's Pension could still be afforded by making other changes. An increase in state pension age to 70 by 2030 would, by itself, be enough to keep spending within the current state expenditure 'funnel of doubt'.

Many ways of paying for a Citizen's Pension at 22% NAE

- Spend more on pensions and less on something else: 2% of GDP = 40% education or 20% health budget
- Raise taxes: increase tax take by 5%
- Increase state pension age: to 70 by 2030
- Restructure tax incentives for private pension saving: but would not be enough on its own

A *combination* of the above is most likely

The long-term cost of a CP could be mitigated by increasing SPA



So, is a Citizen's Pension possible in the UK? There are many issues raised:

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So is it possible?

1. **Too expensive, especially as we age?** Could be brought in now at no cost. Future increasing cost needs to be met with any system.
2. **Regressive?** Not if offset accrued S2P.
3. **'Citizenship' too difficult to define?** But NZ, Denmark and the Netherlands have a residency-based pension.
4. **Too difficult to transition?** Could be done overnight, maintaining accrued rights, although issue of Savings Credit.
5. **Political risk of future change?** Probably less than now, but a cross-party 'Accord' would help.
6. **Too controversial?** Some believe in the contributory system.
7. **Private sector suffers?** But complexity and savings disincentives removed.

To each issue, there appears to be a possible answer. The NAPF project *Transition to a Citizen's Pension* is looking at the details.

The PPI Members' Debate on 5 October 2004 will concentrate on the last issue in the above list: *will the private sector suffer, or will there be savings benefits from a Citizen's Pension*?