PENSIONS POLICY INSTITUTE

PPI

PRESS RELEASE
EMBARGOED TO
00.01 Wednesday 16 June 2010

Pensions Policy Institute publishes evaluation of NAPF proposals for a Foundation Pension

The Pensions Policy Institute (PPI) today publishes its assessment of the NAPF's proposals to introduce a Foundation Pension.

The Foundation Pension proposed by the NAPF is a simple, single pension worth £8,000 a year which combines the current Basic State Pension and State Second Pension, payable to every individual over state pension age if they have accumulated at least 30 years of National Insurance contributions. The report looks at the potential benefits and costs of implementing a Foundation Pension.

Commenting on the research findings, Chris Curry, PPI Research Director, said "A Foundation Pension, set at a level of £8,000 a year, would build on the progress made in the recent state pension reforms in providing more equal pensions for everyone, in particular women and carers. The Foundation Pension would also reduce, though not remove, the need for means-tested benefits and improve the incomes of low-income pensioners."

"A single state pension could also be more predictable than the current two state pension system and so could help with retirement planning."

"These benefits come at a higher cost to the Exchequer than the current system. However, a combination of measures could be used to off-set the additional cost of the Foundation Pension. For example, a faster increase in the State Pension Age and an increase in National Insurance contributions could potentially reduce the initial cost of a Foundation Pension introduced for all pensioners in 2017 from £25bn (1.5% GDP) to £6bn (0.3% GDP)."

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A summary of conclusions from the report follows on the next page. The full report *The Foundation Pension: An evaluation of NAPF proposals*, funded by the NAPF, can be downloaded from the PPI website www.pensionspolicyinstitute.org.uk from 8.30 am on Wednesday 16 June.

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Notes for editors
The PPI is an independent research organisation, focused on pension provision. Its aim is to improve information and understanding about pensions (state and private) through research and analysis, discussion and publication. It does not lobby for any particular issue, but works to make the pension policy debate better informed.

The National Association of Pension Funds (NAPF) is the UK's leading body providing representation and other services for those involved in designing, operating, advising and investing in all aspects of pensions and other retirement provision. We speak for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

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A Foundation Pension: A PPI evaluation of NAPF proposals - Summary of conclusions

The Foundation Pension is a simple, single pensions payable from state pension age.
The current pension system in the UK was regarded by the Pensions Commission in 2005 as 'the most complex in the world'. The Foundation Pension is a single pension combining the current Basic State Pension and State Second Pension, payable to every individual over state pension age if they have accumulated at least 30 years of National Insurance contributions. This means that it is more likely that people will be able to understand what they will receive from the state pension. Once the Foundation Pension has been introduced, individuals would no longer accrue S2P entitlement, or the contracted-out equivalent. Guarantee and Savings Credit would be needed by fewer people, depending on the level of the Foundation Pension. NAPF has proposed introducing a Foundation Pension worth £8,000 a year (in 2010 earnings terms) in 2017.

The Foundation Pension provides more equal outcomes to everyone, especially women and carers
In the past few years, the current state pension system has been reformed to make the state pension system fairer to everyone. In the past many women or carers failed to qualify for a full Basic State Pension due to taking time out of the labour market for caring responsibilities. Changes in the Pensions Act 2007 will make it easier for carers and women to qualify for a full Basic State Pension.

Despite recent reforms to the current state pension system, women, carers and people in a low income group are still likely to get less from the state pension than others because of the different qualification criteria and indexation policies for S2P and BSP. The Foundation Pension is wholly based on the broader qualification criteria for BSP and so more people would be eligible for the full Foundation Pension.

The Foundation Pension could help to reduce pensioner poverty
Pension Credit has been an effective tool in reducing pensioner poverty; however, there is some debate as to whether the Guarantee Credit level is high enough. Pensioners are also required to 'claim' Pension Credit and currently around 20% of pensioners who are eligible for Pension Credit do not claim it.

Introducing the Foundation Pension in 2017 at £8,000 per year (in 2010 earnings terms) could see pensioners in the lowest 25% of the income distribution improve their income by 27% by 2030 compared to the current system. The Foundation Pension at £8,000 per year could take around 2 million pensioners out of means-testing by 2050. Under the current system, by 2050 around 45% of pensioner households could be eligible for pension credit. Under the Foundation Pension system at £8,000 (in 2010 earnings terms) this could reduce to 25%.

The Foundation Pension would increase state spending and may require other changes in policy to help offset the costs involved

The analysis in this paper was completed in March 2010, before the General Election and the introduction of the coalition Government. Therefore, the spending projections under the current system refer to the system that was set in place by the Labour Government. Overall, the costs of the proposals in the report remain broadly the same after considering the impact of the Coalition Government's proposed changes

Any pension system that provides a more generous benefit to pensioners will be more expensive to provide. For this report we have assumed that the Foundation Pension would be introduced overnight in 2017 at £8,000 per year, in 2010 earnings terms. This could cost an extra £25bn per year in 2017 (in 2010 earnings terms) compared to the current state pension system. This is approximately 1.5% of GDP. By 2050, the extra cost of introducing a Foundation Pension in 2017 at £8,000 per year in 2010 earnings terms could be £17bn per year (in 2010 earnings terms) or 0.9% of GDP.

If the Foundation Pension was introduced at the Guarantee Credit level, this could cost an extra £17bn per year in 2017 (1.0% of GDP), or an extra £45bn per year in 2017 (2.7% of GDP) if it was introduced at £10,000 per year.

The NAPF has proposed a number of different funding options to bridge the gap between the projected level of spending under the current state pension system and the projected level of spending under the Foundation Pension system. These options include:

- Increasing the State Pension Age
- Increasing National Insurance contributions for employers and employees
- Extra revenue from Contracted-Out Rebates from the removal of contracting-out of S2P.

Summary Table: Overall additional Government Expenditure from introducing a Foundation Pension at £8,000 (2010 earnings terms) allowing for different funding options, £ bn (2010 earnings terms), and % GDP

	2017	2030	2050
Additional cost of introducing a Foundation Pension at £8,000 (2010 earnings terms)	£25bn (1.5% GDP)	£21bn (1.2% GDP)	£17bn (0.9%GDP)
FP and faster increases in SPA, reaching 70 by 2046	£25bn (1.5% GDP)	£13bn (0.8% GDP)	£3bn (0.2% GDP)
FP and 1% increase in NI for employers and employees	£14bn (0.8% GDP)	£9bn (0.5% GDP)	£4bn (0.2% GDP)
FP and extra revenue from contracting-out	£17bn (1.0% GDP)	£16bn (0.9% GDP)	£13bn (0.7% GDP)
FP and faster increases in SPA AND 1% increase in NI for employers and employees AND extra revenue from contracting-out	£6bn (0.3% GDP)	-£5bn (-0.3% GDP)	-£17bn (-0.9% GDP)

The SPA is currently legislated to increase from 65 to 68 for men and women between 2024 and 2046. If the rate of increase of SPA were to double, i.e. the SPA reaches 70 by 2046, the cost to the Government of introducing the Foundation Pension at £8,000 per year in 2010 earnings terms in 2030 would be an extra £14bn (0.8% GDP), rather than an extra £21bn (1.2% GDP) without the change. By 2050 the additional cost of introducing the Foundation Pension would be an extra £3bn (0.2% GDP), rather than an extra £17bn (0.9% GDP) without the change.

The National Insurance contributions for employers and employees could be increased to help offset the higher state spending on the Foundation Pension. The following scenarios have been proposed by the NAPF:

- Increase the NI contribution rate between the Primary Threshold (PT) and the Upper Earnings Limit (UEL) from 11% to 12% for employees, and increase the contribution rate above the UEL from 1% to 2% for employees; or
- Increase the contribution rate from 12.8% to 13.8% for employers.

If both employee and employer contributions were increased by 1% in 2017, to coincide with the introduction of the Foundation Pension at £8,000 per year, and the additional revenue was used to fund the introduction of the Foundation Pension, the additional cost of the Foundation Pension could be reduced to an extra £14bn (0.8% GDP) in 2017 rather than £25bn (1.5% GDP) without the change, £9bn (0.5% GDP) in 2030 and £4bn (0.2%) in 2050.

The introduction of a Foundation Pension would result in the end of the State Second Pension (S2P) and therefore, the ability to contract-out of S2P. By then, contracting-out for DC schemes will already have ended and if current trends continue relatively few DB schemes would be contracted-out in the private sector. However this still provides a small amount of extra revenue (£8bn, 0.5% of GDP in 2017) as all employers and employees would need to pay the full level of National Insurance Contributions.

If the State Pension Age, National Insurance Contribution and contracting-out changes are all introduced alongside a Foundation Pension, the additional extra cost in 2017 would be reduced to £6bn (0.3% of GDP). By 2030 there would be a net saving compared to the current system of £3bn (0.2% GDP), and by 2050 a net saving of £14bn (0.7% GDP).

The transition to the Foundation Pension is a complicated process
The transition to a Foundation Pension is complex, mainly due to the interaction with contracted-out pensions, though it is not necessarily any more complicated than the current system. The transition to a Foundation Pension could take a long time, although by 2031, 95% of pensioners could be receiving a state pension at the Foundation Pension level. However, it would take much longer for the remaining contracted-out pensions to cease payment.