The Proposed State Second Pension

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Abstract

The UK government has recently proposed radical changes in second-tier pension provision, with the existing State Earnings-Related Pension Scheme (SERPS) being replaced by a new State Second Pension (SSP). This paper sets out how the proposed scheme differs from its predecessor and describes the distributional effects of this reform. It shows that the SSP greatly increases the pension entitlements of low earners while maintaining existing benefit levels for higher earners. However, the higher contributions needed to pay for the new scheme mean that, after taking financing into account, people earning more than around £12,000 a year will lose out. Because of the upper limit to National Insurance contributions for employees, these losses will be greatest for people earning at the contribution ceiling.

JEL classification: H55.

I. INTRODUCTION

The pensions Green Paper (DSS, 1998) proposes substantial changes to second-tier pension provision in the UK. In particular, the government plans to replace the State Earnings-Related Pension Scheme (SERPS), introduced barely 20 years ago by the last Labour administration, with a new State Second Pension (SSP). According to the Green Paper, this will result in ‘dramatically better pension provision for those earning less than £9,000 a year’ and, through increased payments to private pension schemes, will also provide ‘extra help to those on middle incomes (£9,000–£18,500 a year)’.

This paper describes how the new scheme differs from its predecessor and calculates the distributional effects of the reform. Sections II and III look at the

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detailed operation of SERPS and the SSP, describing the rather complex administrative procedures involved and showing how pension entitlements differ under the two schemes. The analysis shows that, because the new scheme will be partially flat-rate, low earners will receive significantly higher pensions than they would have got from SERPS. However, as described in Section IV, because the SSP will be financed from National Insurance contributions (NICs), the burden of paying for the new scheme will be heaviest for people earning at the upper earnings limit. Section V then briefly concludes.

II. SERPS

The benefits provided by SERPS are fairly simple to describe. As reformed by the 1979–97 Conservative government, the scheme provides all employees with a second pension worth 20 per cent of their average lifetime earnings between a lower and an upper limit (set at £64 and £485 a week (£3,300 and £25,000 a year) respectively in 1998–99). At present, these earnings limits are statutorily linked to the level of the basic pension, which has been increased in line with movements in prices (rather than earnings) since 1980. Consequently, the lower and upper limits have fallen from, respectively, 18.5 per cent and 133 per cent of male average earnings (MAE) in 1980–81 to their current levels of 15 per cent and 115 per cent of MAE (ASD, 1999). Given that the Green Paper rejects restoring the link between the basic pension and earnings, a continuing decline in the relative value of the earnings limits might have been expected. However, the March 1999 Budget altered this prognosis by aligning the lower limit with the personal tax allowance (from 2001–02) and by raising the upper limit. As the level of the personal allowance has more or less kept pace with earnings over the last 20 years, it seems reasonable to assume that, under the Chancellor’s proposals, an earnings link for the contribution base for National Insurance will be (re-)established. Therefore, while the analysis in this paper is based on the lower and upper NIC limits for 1998–99, it assumes that these limits will both increase in line with earnings in the future.

Figure 1 illustrates the value of the pension provided by SERPS on this basis, showing the first- and second-tier pension entitlements accumulated by individuals with complete (49-year) work histories and constant earnings (as a proportion of the male average) throughout life. For convenience, the figure also

1These earnings limits similarly apply to the contribution side of National Insurance. In keeping with the spirit of social insurance, SERPS benefits directly reflect contributions to the scheme (via NICs) and, therefore, the same upper and lower limits are used to calculate both benefits and contributions.

2Note, however, that the Green Paper assumes that the NIC limits will remain tied to prices, and hence the illustrations of the effects of the SSP and SERPS provided here are not directly comparable to the government’s estimates.
Value of SERPS and the Basic Pension in 2050, by Lifetime Earnings

![Graph showing the value of SERPS and the Basic Pension in 2050, by Lifetime Earnings.](image)

More precisely, the figure shows the value of first- and second-tier pension benefits that would be paid on retirement in 2050 to someone with a complete (49-year) work history who had unchanging earnings throughout their life (relative to the male average). People earning less than the lower limit for NICs are assumed to qualify for credits towards the basic pension (Johnson and Stears, 1996). The figure also assumes that, henceforth, the basic pension is increased in line with prices while the earnings limits for NICs, and income support for pensioners, are increased in line with earnings.

shows the value of income support, the means-tested benefit that effectively acts as a minimum income standard for pensioners. This is set at 17.5 per cent of MAE, the level which it would have been in 1998–99 had the increase to £75 a week announced in the 1998 Budget been implemented immediately (rather than delayed until April 1999). In common with the Green Paper, it is assumed that income support is indexed in line with earnings while the basic pension remains tied to prices. If the government’s assumption of 1.5 per cent real earnings growth proves accurate, the relative value of the basic pension will therefore have halved from 15 per cent to 7.5 per cent of MAE by 2050. Accordingly, the expected gap between the basic pension and the minimum income standard in 2050 is 10 per cent of MAE.

As Figure 1 shows, because SERPS is earnings-related it provides only rather modest benefits for people with low lifetime earnings and hence is of little help in lifting such people above the minimum income standard. Indeed, as the Green Paper recognises, any pension system that links benefits directly to earnings (and, by implication, to contributions) will inevitably be of little assistance to low lifetime earners. In essence, this is the reason why the government has

3The government now refers to income support for pensioners as a ‘minimum income guarantee’, though no changes to the structure of the benefit, or indeed its name, have yet been proposed.
rejected calls to extend the proportion of workers’ salaries that they are forced to contribute to an earnings-related pension scheme (the ‘compulsion’ strategy outlined in Agulnik and Le Grand (1998)). If the objective of pension policy is solely to secure a minimum income standard, then compulsory saving is of very limited benefit, as the people one is most concerned about (low lifetime earners) gain least.

Similarly, restoring SERPS to the structure envisaged by the last Labour government would also be of little benefit to the worst-off as, even under its original guise, the scheme was almost wholly earnings-related. In a revenue-neutral reform, raising the flat-rate basic pension would be more redistributive than improving the benefits provided by SERPS (Creedy, Disney and Whitehouse, 1993). As the next section shows, in a sense this is precisely what the SSP does — it increases spending on flat-rate benefits, rather like an increase in the basic pension but with a 50-year time-lag.

III. THE STATE SECOND PENSION

Analysis of the SSP, and of second-tier pensions in the UK more generally, must take into account the fact that provision is divided between the public and private sectors. This division operates through the system of ‘contracting-out’, whereby people in private pension schemes pay NICs at a reduced rate or, equivalently, receive a rebate paid direct to their pension scheme. The contracted-out NIC rate — currently 4.6 percentage points less than the full rate — reflects the actuarial value of the SERPS rights that individuals would have enjoyed had they remained in the state scheme. At least in theory, this system therefore ensures that all employees accumulate second-tier pension entitlements of the same value as SERPS, but with some people receiving benefits directly from the state and others receiving benefits via private schemes.

This split between the public and private sectors will be retained under the SSP, but it will take a somewhat different form. Rather than the incentive to opt out of state provision being neutral (i.e. actuarially fair), there will be a built-in incentive for individuals to stay with the state scheme if their earnings are below £9,000 a year but to opt out if their earnings are above this level. This is because, under the SSP, SERPS will effectively become a flat-rate scheme providing pensions for people earning less than £9,000 a year (and for some non-earners such as carers).

The equivalence between SERPS and the second-tier pension entitlements earned by people in private pension schemes relies on the Government Actuary accurately assessing likely investment returns, charges and annuity rates. If assumptions about these turn out to be too optimistic, then people in private schemes will, in retrospect, have been better off remaining in SERPS. Conversely, if investment and annuity rates exceed assumed levels, people who chose to opt out will end up with higher pension benefits than those who stayed in SERPS.
The value of the pension provided by the new scheme will be substantial — twice that which someone on £9,000 a year would currently be entitled to under SERPS. Nevertheless, people earning more than £9,000 a year will have a strong incentive to opt out as, above this level of earnings, the value of contracted-out rebates will exceed the actuarial value of the benefit provided by the state scheme. This in turn reflects changes to the structure of rebates that the Green Paper proposes. In place of the simple proportionate structure of SERPS, a three-tier system will operate:

- on the first tranche of an individual’s earnings, between the lower limit and £9,000, rebates will be paid at twice their current rate;
- on the next tranche (between £9,000 and £18,500), rebates will be paid at half their current rate;
- on the final tranche (between £18,500 and the upper limit), rebates will continue to be paid at the same rate as now.

The second-tier pension benefits provided by the SSP and rebates are illustrated in Figure 2. For the reasons outlined above, it is assumed that people earning more than £9,000 a year opt out (and hence accumulate earnings-related pensions) and that people earning less than this amount opt in. As in Figure 1 earlier, it is also assumed that earnings levels remain a constant proportion of the male average throughout life. Note that the ‘bend-points’ in the scheme at £9,000 and £18,500 correspond, respectively, to 40 per cent and 85 per cent of male average earnings.

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5A little arithmetic shows that someone on £9,000 a year for the whole of a (49-year) working life would get a SERPS pension of £22 a week (in terms of today’s earnings), assuming that the earnings limits are increased in line with earnings in the future. The SSP will provide a pension for all its members (including those earning less than £9,000 and non-earners) of twice this level, i.e. £44 a week for someone who remains in the scheme throughout their working life. Uncoincidentally, £44 a week is fractionally more than 10 per cent of MAE, the gap between the basic pension and income support in 2050.

6Note that, for this incentive to hold for everyone, the level of rebates will need to vary with the age of the recipient: as older people are closer to retirement, and hence benefit from fewer years of investment growth than younger workers, they require higher rebates to be persuaded to opt out (see Government Actuary (1995a)).

7Presumably, the point of this structure is to ensure that no one sees their pension benefits reduced relative to their position under SERPS (ignoring the better benefits that some women would have been entitled to under home responsibilities protection — see written parliamentary answer 1.3.99). Note, though, that the point at which people would start losing from the reduction in rebates on the tranche of earnings beyond £9,000 a year is in fact £20,000, not £18,500. Everyone will therefore enjoy higher benefits as a result of the Green Paper’s proposals, albeit only very marginally so for people earning more than £18,500. This discrepancy within the scheme is recognised by the DSS and is likely to be corrected in the government’s final proposals. Therefore, to simplify analysis, it is effectively assumed here that the benefits received by people on earnings above £18,500 are the same as they would get under SERPS.
As can be seen from this and the previous figure, the flat-rate SSP fills the
gap between the basic pension and income support much more effectively than
SERPS. Indeed, Figure 2 well illustrates the fact that the SSP has been designed
to plug rather neatly the gap between the level of the basic pension and the
minimum income standard in 2050. However, the seeming elegance of this
outcome is just that — a fortuitous feature of the date chosen to illustrate the
scheme rather than an inherent property of its design. Peering a little further into
the future, we can already predict that, unless the lower contribution limit falls
steadily in relation to earnings, the gap between the combined value of first- and
second-tier pension benefits and income support will re-emerge (Rake,
Falkingham and Evans, 1999).

Moreover, irrespective of the time horizon chosen for analysis, the figure
gives a rather false impression of the true effects of the scheme. The assumption
that individual earnings will remain a constant proportion of the average
throughout life is clearly unrealistic; in practice, we all experience considerable

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8It should, however, be borne in mind that the figure refers to the first- and second-tier pension entitlements
that individuals will accumulate in their own right and, similarly, the level of income support for a single
pensioner (aged 65–74) is shown. As the level of income support for couples is significantly less than twice
that for single people, the combined first- and second-tier pension entitlements of couples should lift them
substantially above the minimum income standard even beyond 2050. Note also that, under the government’s
proposed ‘shadow’ lower NIC limit (see the 1999 Budget), an element of ‘dynamisation’ will be built into the
scheme, as the £9,000 figure will be increased in line with earnings while (presumably) the entry-point for the
SSP will be tied to prices.
The Proposed State Second Pension

changes in our labour market status and earnings over time (see Gardiner and Hills (1999) or Gregg (1997)). Allowing for this, a rather less elegant pattern for the benefits provided by the SSP would emerge, with almost all women, and a significant number of men, benefiting from the flat-rate, state-provided element of the scheme at some point in their lives (for instance, during years spent caring). This is because the SSP works through crediting pension rights on an annual basis — there is no ‘claw-back’ from people with high lifetime earnings.

Precisely how this will affect the distribution of SSP benefits is difficult to estimate, and a complete analysis would require detailed simulation of individual work histories. Though the DSS possesses a microsimulation model capable of such a task (see Curry (1996) and Kumar and Ward (1999)), the fact that the model only produces estimates until 2025 limits its usefulness in this context, as the scheme will not reach maturity until 2050 and will only have fed through to the entire pensioner population some 30 years after this. Moreover, in the intervening period, people will accumulate benefits under both SERPS and the SSP, and hence the distribution of second-tier pensions will be in transition for many years. Given this, Figures 1 and 2 are perhaps best seen as illustrating the effects of SERPS and the SSP on a hypothetical population, where everyone has constant earnings throughout life (in relation to the average) and where everyone lives their entire life under one pension system. Similar caveats apply to the next section’s calculation of the redistributive effects of replacing SERPS with the SSP.

IV. THE REDISTRIBUTIVE EFFECT OF THE SSP

The redistributive effect of the SSP can be calculated as the increase in second-tier pension entitlements enjoyed by people on different earnings levels (which, as noted earlier, is positive or zero for everyone) minus the loss of income resulting from the increased contributions needed to finance the scheme. This section looks at each part of this equation in turn, showing how the benefits of the scheme can usefully be expressed in present value terms and calculating the change in NIC rates needed to finance additional provision. The overall redistributive effect of the scheme is then illustrated in Table 3 and Figure 3.

1. Benefits

As described above, the SSP works on an annual basis, in the same way as SERPS. Anyone earning below £9,000 (but more than £3,300) in a particular year will receive a credit for the state scheme, whether or not their earnings (and hence pension entitlements) subsequently increase. Therefore, though they

9The SSP is therefore rather different from the minimum pension guarantee systems outlined by Atkinson (1995), Hills (unpublished) and Fallickingham and Johnson (1995), which, in effect, all act as a lifetime means test.
receive a pension promise rather than a cash payment, the system may be likened to the rebates that people earning more than £9,000 will receive. Ignoring the fact that people in the state scheme receive a pension promise rather than cash, if future pension entitlements are discounted to their present value (PV), the benefits of public and private provision may be compared directly. Table 1 illustrates, showing the PV of benefits (equivalently, the value of rebates) under SERPS and the SSP.

As can be seen from the table, the transformation of SERPS into the SSP will greatly increase pension benefits for low and moderate earners. For instance, someone earning £5,000 a year will be nearly £450 better off as a result of the change, as the PV of their future pension benefits rises from £78 under SERPS to £525 under the SSP. This, in turn, reflects the fact that they would have only got a pension worth 1.5 per cent of MAE from SERPS (assuming they had constant earnings throughout life), while they will get a pension of just over 10 per cent of MAE from the SSP. However, gains fall away as earnings rise, and people on more than £18,500 receive no additional pension benefits as a result of the government’s proposals (again assuming their earnings do not fluctuate).

2. Contributions

The SSP will be ‘paid for’ out of the National Insurance Fund, in the same way as the basic pension, SERPS and other National Insurance benefits are currently. As the SSP offers better pension benefits than SERPS for low and moderate earners, and equivalent pension benefits for high earners, it follows that the NIC rate must rise if the Fund is to remain in balance (which, under current policy, it

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**TABLE 1**

<table>
<thead>
<tr>
<th>Earnings</th>
<th>Earnings between the NIC limits</th>
<th>PV of SERPS benefits</th>
<th>PV of SSP benefits / Value of rebates</th>
<th>Change in benefits</th>
</tr>
</thead>
<tbody>
<tr>
<td>£5,000</td>
<td>£1,700</td>
<td>£78</td>
<td>£525</td>
<td>+£447</td>
</tr>
<tr>
<td>£10,000</td>
<td>£6,700</td>
<td>£308</td>
<td>£548</td>
<td>+£240</td>
</tr>
<tr>
<td>£15,000</td>
<td>£11,700</td>
<td>£538</td>
<td>£663</td>
<td>+£125</td>
</tr>
<tr>
<td>£20,000</td>
<td>£16,700</td>
<td>£768</td>
<td>£768</td>
<td>0</td>
</tr>
<tr>
<td>£25,000</td>
<td>£21,700</td>
<td>£998</td>
<td>£998</td>
<td>0</td>
</tr>
</tbody>
</table>

The PV of SERPS benefits is calculated using the Government Actuary’s economic assumptions, and hence is equivalent to the rebate that would be payable under contracting-out. At present, SERPS rebates represent 4.6 percentage points of the total NIC rate (averaging across all ages). However, this is set to fall over time to around 3.5 percentage points, as the ‘accelerated accrual’ provisions within SERPS gradually die out (Government Actuary, 1995b). As the SSP contains no accelerated accrual provisions, the comparisons in the table should really be calculated with reference to this steady-state rebate rate. The results of the analysis would, though, be little different, and, for ease of exposition, the current reduction of 4.6 percentage points is used.
must). Nevertheless, for analytical purposes, whether NIC rates are set to fall or rise is irrelevant — the question is who wins and who loses from the SSP relative to current policy.

The SSP will add to NIC rates (or, rather, prevent NIC rates from falling) for two reasons:

1. the cost of rebates will grow, necessitating an increase in the NIC rate to maintain revenue to the Fund;
2. as the scheme matures, expenditure from the Fund will rise relative to expected spending under SERPS.

The cost of rebates will grow both because the SSP produces higher pension benefits than SERPS for people earning less than £18,500 a year (through employees on such earnings receiving bigger rebates) and because more people are likely to contract out of state provision under the new scheme. In combination, the effect will be to increase the total cost of rebates by £4.1 billion in 2050, when the new scheme will be fully phased-in (written parliamentary answer 15,2,99). Making up for this lost revenue will, in turn, require NIC rates to be 0.9 of a percentage point higher than would otherwise be the case.

The expenditure effects of the SSP will be even greater than this. The government estimates that, by 2050, spending will be £10.5 billion higher on the new scheme than it would have been under SERPS (written parliamentary answer 11,2,99). This will add a further 2.25 percentage points to the NIC rate (under the same assumptions as earlier). In the long run, therefore, the NIC rate

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10In the normal course of events, NIC rates are set so that they yield sufficient revenue to meet expected expenditure from the National Insurance Fund. Administratively, this operates through the Government Actuary estimating (on a five-year basis) the NIC rate needed to keep the Fund in balance (see, for instance, Government Actuary (1995b)). A zero Treasury grant is assumed and, at least in recent years, payments to the Fund from this source have been negligible.
11To simplify the analysis, the following assumes that employee NICs bear the full adjustment needed to keep the NI Fund in balance (i.e. employer and self-employed NICs are ignored). It should also be borne in mind that the projected fall of 4.25 percentage points is based on the assumption that the contribution limits will increase in line with prices, not earnings. As it was assumed earlier that these limits will be linked to earnings in the future, the analysis here should really be based on the NIC rate that would apply under earnings indexation of the contribution base. However, for ease of exposition, the following looks only at the change in NICs caused by the SSP relative to the 4.25 percentage point reduction expected under a price-linked contribution base.
12Under the SSP, there will be a clear incentive to opt in below £9,000 and to opt out above this level of earnings (see Section III). The number of people contracted out is therefore likely to increase, reflecting the fact that there are more moderate and high earners (on over £9,000 a year) currently in SERPS than there are low earners who have opted out.
13Assuming that employer and self-employed contribution rates do not change. Note that the £4.1 billion estimate is in real price terms and hence, if one allows for the increase in the tax base for NICs resulting from earnings growth, the necessary increase in the NIC rate is half that which would be required today.
will be a little under 3.25 percentage points higher under the SSP than it would have been under SERPS. In other words, rather than falling by 4.25 percentage points, the NIC rate will only be around 1 percentage point lower in 2050 than it is today.

However, this does not quite give the full story. Though the new scheme will increase the cost of NI benefits, it will also reduce spending on means-tested benefits. The government estimates that the introduction of the SSP will lead to savings on income support of £4.3 billion in 2050 (written parliamentary answer 11,2,99).14 Assuming that this saving is used solely to reduce income tax rates, a fall of around 0.6 of a percentage point might be expected as a result (assuming the higher, basic and lower rates are all reduced by the same amount). For ease of analysis, this is shown in Table 2 as an offset to the increase in the NIC rate, reducing the necessary rise to about 2.5 percentage points.

### Overall Distributional Effect

The net effect of the government’s proposals on people at different earnings levels may be calculated using Tables 1 and 2. This is done in Table 3, which shows the gross cost of the 2.5 percentage point increase in NICs (including the offsetting decrease in tax), the additional pension benefits that the SSP produces and the overall (net) effect.

As can be seen, when the effect of financing additional benefits is taken into account, the SSP creates both winners and losers. An individual on £5,000 a year gains substantially — the increase in contributions has little effect on their current income while their expected pension benefits rise substantially. Conversely, someone on £25,000 a year loses out, as they see no increase in

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14This figure is relative to the level of expenditure expected under a policy of increasing the minimum income standard with earnings but retaining SERPS in its existing form (i.e. as in Figure 1). Note again that this estimate is in real price terms, and hence in relation to today’s tax base is half as large as indicated. Also note that there are good reasons for thinking that income tax rates may be higher in the future than they are today, as the ageing of the population is likely to have a very significant impact on NHS spending (Cardarelli, Sefton and Kotlikoff, 1998).
benefits but their contributions nevertheless increase. Figure 3 illustrates diagrammatically.

The figure shows the redistributive effect of the SSP more precisely — people earning less than about £12,000 a year gain at the expense of those with earnings above this amount. However, it is worth bearing in mind that the figure only looks at people with earnings between the lower and upper limits, and therefore omits ‘very high’ earners. For such individuals, NICs operate as a lump-sum tax and, as can be seen from the figure, the cost of this tax will be larger under the SSP (contributions having risen while benefits stay the same).

**TABLE 3**

<table>
<thead>
<tr>
<th>Earnings</th>
<th>Earnings between the NIC limits</th>
<th>Increase in contributions</th>
<th>Increase in benefits</th>
<th>Net gain (+) or loss (–)</th>
</tr>
</thead>
<tbody>
<tr>
<td>£5,000</td>
<td>£1,700</td>
<td>£42.5</td>
<td>£447</td>
<td>£404.5</td>
</tr>
<tr>
<td>£10,000</td>
<td>£6,700</td>
<td>£167.5</td>
<td>£240</td>
<td>£72.5</td>
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<tr>
<td>£15,000</td>
<td>£11,700</td>
<td>£292.5</td>
<td>£125</td>
<td>–£167.5</td>
</tr>
<tr>
<td>£20,000</td>
<td>£16,700</td>
<td>£417.5</td>
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<td>–£417.5</td>
</tr>
<tr>
<td>£25,000</td>
<td>£21,700</td>
<td>£542.5</td>
<td>0</td>
<td>–£542.5</td>
</tr>
</tbody>
</table>

**FIGURE 3**

Overall Winners and Losers from the SSP
But, precisely because NICs act as a lump-sum tax once the upper limit is exceeded, the burden of this increase (i.e. as a proportion of earnings) will be heaviest for people earning at the limit. As earnings increase above the upper limit, the proportionate impact of higher NICs will fall. Moreover, at extremely high earnings, the effect of the assumed decrease in income tax rates will outweigh the loss resulting from the increase in NICs.

It is also worth briefly commenting on the SSP’s effect on the distribution of lifetime income. From one perspective, the scheme is unambiguously positive: low earners benefit from considerably higher pensions than they would have got under SERPS but only pay a small fraction of the financing costs. However, this conclusion subtly alters if it is assumed that the minimum retirement income (income support) would in any case have risen in line with earnings. If the scheme is looked at in this way, its effect is not to increase pensioners’ incomes but to reduce the bill for means-tested benefits, in which case it could be argued that the main gainers from the SSP are better-off people who now receive pension credits for periods outside the labour market. However, it is questionable whether a policy of increasing income support with earnings but leaving other areas of pension policy untouched would have been feasible. As shown by Figure 1, under existing policies many people would fail to accumulate first- and second-tier pension entitlements sufficient to lift them above the minimum income standard, assuming the level of the minimum keeps pace with earnings. A severe problem of ‘moral hazard’ is therefore likely to arise, causing benefit spending to be higher, and personal saving lower, than would otherwise be the case. By countering this moral hazard — through increasing automatic pension benefits for low earners — the SSP in effect makes it possible to link income support to earnings while allowing the relative value of the basic pension to decline.

V. CONCLUSION

This paper has shown that the distributional implications of the proposed State Second Pension are broadly positive: it increases the level of benefits provided for low earners through raising the rate of earnings-related contributions. Low earners (and non-earners benefiting from SSP credits) therefore gain at the expense of better-paid workers. However, the burden of losses for better-off people will be highest for those earning at the upper limit for NICs.

This rather unusual feature of the reform reflects the fact that the SSP will be a National Insurance benefit, and hence the contribution base is narrower than would be the case if additional benefits were financed out of taxation. It follows that placing more of the burden of paying for pensions on income tax, and reducing reliance on NICs, would be a straightforward way of making state pension provision more progressive. However, if a switch from NICs to income
tax reduced politicians’ willingness to raise revenue, thereby constraining benefit levels, the distributional advantages of tax finance would be less clear-cut.

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