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Press Release

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Women approaching retirement and the self-employed to gain from single-tier pension reforms, employees in their thirties to lose

From 2016 the existing two part state pension system is to be replaced by a new single-tier system. The new state pension is expected to be set at around £146 per week; restoring the state pension to the same level of generosity relative to average earnings as it was in the early 1970s.

A new report published today by researchers at the IFS, funded by the Joseph Rowntree Foundation (JRF), examines how the proposed reforms affect different types of individuals and contrasts the short- and long-run effects of the proposed reforms which are found to differ dramatically.

<u>Short run</u>
The report finds that very few of those close to the state pension age (just 17%) will be entitled to a state pension worth exactly the single-tier amount. 23% would be entitled to a state pension worth more than that, while 61% would receive less than £146. The main reason that so many people will have a single-tier pension worth less than the full amount is that a large fraction of people have chosen in the past to take advantage of the option to pay lower National Insurance contributions in return for not building up entitlement to the second tier state pension (known as 'contracting out') .

Many of those close to state pension age see no change in the state pension income they can expect to receive at the state pension age. Some, however, are set to experience significant changes in their state pension income:

- 43% would see some increase in their state pension income at state pension age and 19% would see a decrease, although most of these losses would be recouped later in retirement through more generous indexation of state pension income. Across this group as a whole, the average change in state pension income at state pension age would be an increase of £2.74 per week with 13% seeing an increase of £10 per week or more.
- The biggest gainers on average are those who have spent long periods out of work or doing low paid work – a group which disproportionately comprises women – and the long-term self-employed. Women on average gain £5.23 per week, compared to £1.62 for men. Those with more than 10 years in self-employment will gain £7.51 per week on average, compared to £2.19 among those who have never been self-employed.
- Those who chose to contract out of the earnings-related state pension who will, on average, see larger gains than otherwise equivalent individuals who did not choose to contract out.
- Low wealth groups are set to experience a larger increase in state pension income on average than higher wealth groups. The poorest wealth quintile will gain £3.97 per week on average, compared to £2.18 for those in the richest wealth quintile. However, some of these gains for the poorest will be offset by a reduction in entitlement to means-tested pension credit, including the plan to abolish the pension credit savings credit. As a result, while 40% of individuals in the poorest fifth of the population gain from the reforms, 62% of the richest fifth gain.

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Long run

For later cohorts – in particular those born after the mid-1980s – the reforms represent a reduction in state pension income for almost everyone. The only major exception are the long-term self-employed. These reductions will be larger for the higher earners. As an example, someone who was born in 1986 who spends 35 years as a low earner would receive nearly £1,000 per year less under the proposed new system than under the current system. This figure could be nearly £2,300 per year for a high earner of the same age. These groups will therefore have a greater need to save privately for their retirement.

The reduction in generosity in the longer-run will reduce the cost of the system as a whole and therefore help meet the costs placed on the public finances of an ageing population. As a result these reforms will avoid the need for some other future policy to reduce spending or increase taxes that would also adversely affect these later cohorts.

Gemma Tetlow, a Programme Director at the IFS and one of the authors of the report said:

"This is the latest step in a long, tortuous and rather circular journey for state pension policy in the UK; a journey which started in the early 1970s with a basic state pension equivalent to about £145 a week and which has finally ended up in much the same place. In between we have seen a system of earnings-related state pensions, which were first legislated for in 1975 and which successive governments have spent over 30 years gradually unpicking as the unsustainable cost of the system became increasingly apparent. The major difference between the proposed single-tier pension and the system that was in place in 1974 is that the new system will be considerably more generous to those engaged in unpaid activities or self-employment."

Soumaya Keynes, a Research Economist at the IFS and one of the authors of the report added:

"The single-tier pension proposals will boost the state pension entitlements of some of those who are close to state pension age, particularly those who have spent time caring for children or who had long periods of self-employment. However, for most of those now in their twenties and thirties, although these reforms should make it easier for people to predict how much state pension income they will get, the reforms will also reduce the state pension income that they can expect to get. They will need to save more privately for their retirement to make up for this."

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Notes to Editors:

1. For embargoed copies of the report or other queries, contact:
   Bonnie Brimstone at IFS: 020 7291 4800, bonnie_b@ifs.org.uk.

2. "A single-tier pension: what does it really mean?" will be launched at lunchtime on Thursday 11th July 2013. Please contact Bonnie Brimstone (020 7291 4800, 07730 667013 or bonnie_b@ifs.org.uk) for details if you would like to register to attend the event.

IFS hosts two ESRC Research Centres.