

Briefing Paper

The Forthcoming “Flat Rate” State Pension is Helpful

Government has published a White Paper and a draft Pensions Bill to introduce a single-tier pension of £144 a week at today's prices paid to every qualifying new pensioner from April 2016 at the earliest.

People become eligible for the existing state pension once they are in their 60s, with the age currently being equalised for men and women, 66 for both sexes by 2020, 67 by 2028. The most anyone currently receives in state pension is £107.45 a week, but some also receive an earnings-related additional pension, called the State Second Pension (SSP2), or Serps. A person's SSP2 depends on how long they have worked and the number of National Insurance (NI) qualifying years they have.

There is also a top-up for people with low wealth called the Pension Credit, or Minimum Income Guarantee. Those who qualify are guaranteed a weekly minimum £142.70 for a single person, £217.90 for couples. A person's eligibility is determined by means testing.

The means test has long been controversial. Some claim its effect has been to exclude a significant sized cohort of working people from long-term saving. This is because the means test focuses on a band of personal wealth, set relatively low, and within this band a higher

level of personal wealth leads to less Pension Credit and a lower total State Pension. Discouraging working people from long-term saving is particularly unhelpful all the while that workplace pension reforms are trying stimulate long-term saving through workplace pension autoenrolment and employer and employee pension contributions. Government knows a consistent message is needed, and making the state pension system simpler by removing all means tested sections for people retiring from April 2016 may help.

There is to be a universal payment of £144 a week at today's prices for those who reach their state pension age and have 35 years of NI contributions.

Most of all this will help those on low to middle incomes who can now save for retirement knowing that doing so will not count against them. A flat rate pension is also a potentially powerful means of helping people to plan ahead. Anybody can take their known State Pension and add this to their separate savings and private pension forecasts. This will help people to read across their different entitlements and understand what their retirement income might be – and whether they should be saving more.

Behavioural finance finds that people who plan make better savers, so removing impediments to planning should make it is easier for people to plan, which of itself may contribute to greater savings over the long-term. For people on low to middle incomes this may make a significant difference. Workplace pensions autoenrolment helps get people started on a savings journey, a flat rate pension makes it easier to plan, and having a plan makes it more likely that people will continue on the savings journey.

Other benefits are that people who are out of the workplace for 7 and in some circumstances 10 years to care for children, or people with disabilities, will still access the enhanced single-tier pension. The self-employed, who have traditionally received a relatively small total state pension, will also qualify.

Not all people will gain from this change. Some people with a final-salary pension scheme pay less NI because their SSP2 is "contracted out". They are to receive a reduced flat-rate pension to acknowledge the fact that they have not been contributing to SSP2 in the preceding years. This especially affects people with defined benefit, or final salary schemes, but the relative generosity of this type of scheme means that those affected are of low concern to Government. Existing pensioners at April 2016 remain in the old system, and could also be slightly worse off than new pensioners.

In summary, Government's intention for a flat rate state pension provides a consistent message in support of long-term savings and will make it easier for many people to adopt a savings mindset.

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