UNITED KINGDOM

United Kingdom: pension system in 2006

The United Kingdom has a complex pension system, which mixes public and private provisions. The public scheme has two tiers, (a flat-rate basic pension and an earnings-related additional pension), which are complemented by a large voluntary private pension sector. Most employee contributors "contract out" of the state second tier into private pensions of different sorts. An income-related benefit (pension credit) targets extra spending on the poorest pensioners.

Key indicators

		United Kingdom	OECD
Average earnings	GBP	31 500	19 300
	USD	58 000	35 800
Public pension spending	% of GDP	5.7	7.2
Life expectancy	at birth	79.1	78.9
	at age 65	83.3	83.4
Population over age 65	% of working-age population	26.8	23.8

Qualifying conditions

State pension age, currently 60 for women born on or before 5 April 1950 and 65 for men, will gradually be equalised from 2010 reaching 65 in 2020. As a result of the Pensions Act 2007, state pension age will increase to 66 between 2024 and 2028; to 67 between 2034 and 2036 and 68 between 2044 and 2046. The eligibility age for the guarantee credit element of the pension credit is 60, and will increase in line with the women's state pension age. The new savings credit element of pension credit is only available from 65 for both men and women.

To qualify for the basic state pension, people need i) to pay or ii) have been treated as having paid social security contributions or iii) have credits for around nine-tenths of their potential working lives (39 years for women with a state pension age of 60; 44 years for men and women with a state pension age of 65). A proportionally reduced state pension is available for people who do not meet the full condition, but only to a minimum of 25% (*i.e.*, 10 years for women with a state pension age of 60; 11 years for men and women with a state pension age of 65). As a result of the Pension Act 2007, the number of years of contributions or credits required for entitlement to a full basic state pension will be reduced to 30 with proportionally reduced state pensions available where a person has a minimum of one year's contribution or credits for people reaching state pension age on or after 6 April 2010.

Benefit calculation

Basic

The full basic state pension for a single person is GBP 84.25 per week in 2006/07, equivalent to nearly 14% of average earnings.

Earnings-related

For earnings between the lower earnings limit (GBP 4 368 per year in 2006/07) and the low earnings threshold (GBP 12 500), the replacement rate is 40% of the difference. The lower earnings limit is worth nearly 14% of average earnings while the low earnings threshold is 40%. This also applies to people covered by credits. This is equivalent to treating people earning below the low earnings threshold as if they had earned at this level. Over the next range, the replacement rate is 10%, ending at GBP 28 800 in 2006/07. Between this threshold and the ceiling, the replacement rate is 20%. The ceiling is GBP 33 540 in 2006/07. The upper threshold is worth around 91% of average earnings and the ceiling is 106% of average earnings.

The benefit value is calculated on average lifetime salary, with earlier years' pay uprated in line with average economy-wide earnings. The benefit is then price-indexed after retirement.

As a result of the Pensions Act 2007, from 2010 the income bands will reduce to two. Between the lower earnings limit and the low earnings threshold, the replacement rate will be 40% of the difference. Between the lower earnings threshold and the ceiling, the replacement rate will be 10%. From a date to be set, Band 1 income will provide a flat-rate entitlement of GBP 1.60 a week for each qualifying year (in 2008/09 earnings terms). Furthermore, from April 2009 the cap on accruals will be frozen through the introduction of an upper accrual point at GBP 770 a week.

Voluntary private pensions

Some 47% of employees are members of an occupational pension scheme and around 19% have personal plans. Because some people have both plan types, overall coverage of voluntary private pensions is 59%. The defined-benefit plan modelled pays a pension of 1/80th of final salary for each year of service, equivalent to an accrual rate of 1.25%. When people change jobs, the value of the deferred occupational pension is indexed to price inflation.

However, most private-sector occupational plans have changed to defined-contribution provision, some for new members only and some for existing members. The government will also introduce a new national pension savings scheme. Using the same principles as New Zealand's KiwiSaver, this will have a default contribution rate of 8%, which is a little below the 9% average contribution rate to existing defined-contribution occupational schemes. The modelling assumes a contribution of 8% of earnings.

Targeted

The Pension Credit, introduced in 2003, is a tax free weekly benefit for people aged 60 or over who are living on low incomes and guarantees all pensioners an income above a certain level. The Pension Credit is an income related benefit and is not based on National Insurance contributions. There are two elements to the Pension Credit, the guarantee credit and the savings credit. The guarantee credit ensures a minimum level of income by providing financial help for people aged 60 and over whose income is below the standard minimum guarantee amount. In 2006/07 this was GBP 114.05 for individuals and GBP 174.05 for couples (these amounts may be higher for people with severe disabilities, caring responsibilities or certain housing costs).

The savings credit is an extra amount for people aged 65 or over who have made modest provision for their retirement. It is designed to reduce the effective withdrawal rate of benefits from 100% under its predecessors to 40%. People, whose income (excluding any guarantee credit) is below their guarantee credit minimum guarantee and above the savings credit threshold, GBP 84.25 for individuals and GBP 134.75 for couples respectively in 2006/07, receive 60% of the difference between their income and the threshold up to a maximum of GBP 17.88 for individuals and GBP 23.58 for couples, respectively. For people with incomes above their guarantee credit minimum guarantee (that is they are not entitled to the guarantee credit), the maximum savings credit is reduced by 40% of their income over their guarantee level.

Variant careers

Early retirement

A state pension will not be paid before state pension age.

Late retirement

Until April 2005, deferral of the state pension was possible for up to five years after state pension age. This earned an increment of about 7.4% for each year. From April 2005, the time limit for deferral was removed and the increment increased to about 10.4% for each full year of deferral. Also, it is possible instead to take a taxable lump sum provided the deferral has been for a minimum of 12 consecutive months. The lump sum is made up of the state pension foregone during the deferral period, plus interest which is guaranteed to be at least 2 percentage points above the repo rate (the Bank of England base rate). The choice has to be made when the state pension is eventually claimed.

Childcare

Both tiers of the public pension scheme (basic state pension and state second pension) provide protection for periods of child care. This covers both people not in paid work and those working but earning below the lower earnings limit who therefore do not contribute to the system. For the basic state pension, this is called Home Responsibilities Protection (HRP), and covers years spent caring for at least one child under 16. HRP reduces the number of years required for a full pension so that, with sufficient HRP, only 20 years' work (including periods when national insurance contributions may be credited) is required to receive the full basic state pension. For the state second pension, years caring for a child under age six are credited; caring parents are deemed to have earnings at the low earnings threshold: GBP 12 500 per year in 2006/07.

As a result of the Pensions Act 2007, people attaining SPA (State Pension Age) after 2010 will able to build up entitlement to S2P (State Second Pension) if they are caring for children up to the age of 12.

Unemployment

Periods of unemployment on insurance or assistance benefits are credited for the basic state pension. There are no credits for periods on these benefits for the state second pension.

Personal income tax and social security contributions

Taxation of pensioners

A single person under 65 has an income-tax allowance of GBP 5 035 per year in 2006/07, compared with GBP 7 280 for 65-74 year olds and GBP 7 420 for people 75 or over. Once a pensioner's total income exceeds GBP 20 100, the additional allowances are withdrawn at 50% of the excess, so that high-income pensioners have the same tax allowances as people of working age.

Taxation of pension income

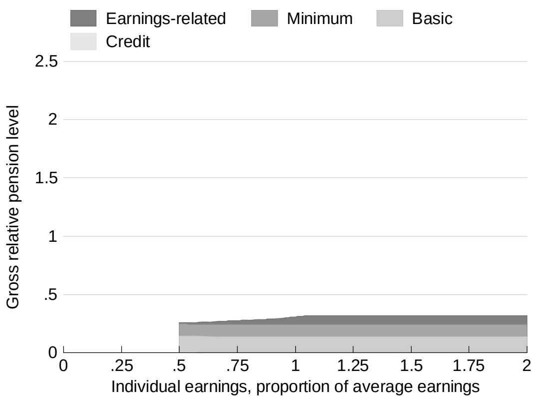
No special relief is available for pension income.

National insurance contributions paid by pensioners

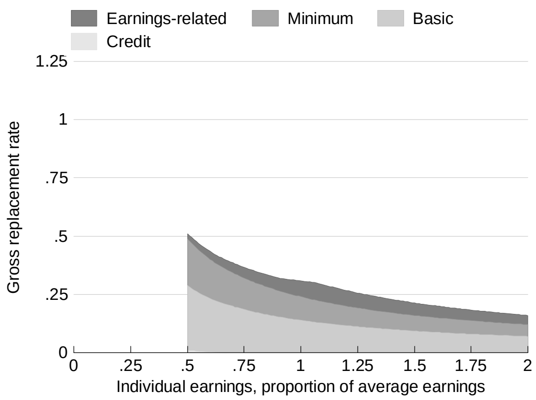
National insurance contributions are not levied on the income of those over state pension age.

Pension modelling results: United Kingdom

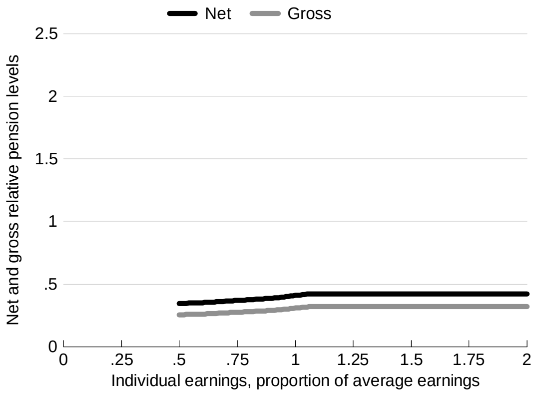
Gross relative pension level



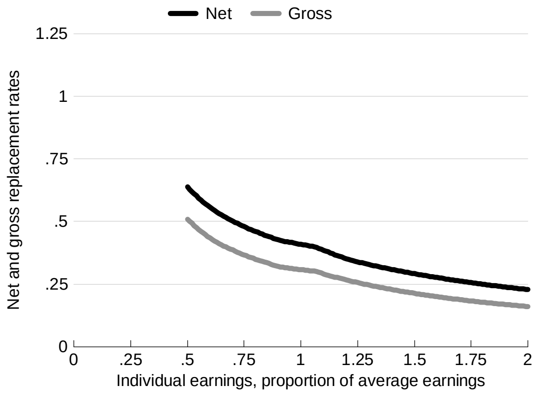
Gross replacement rate



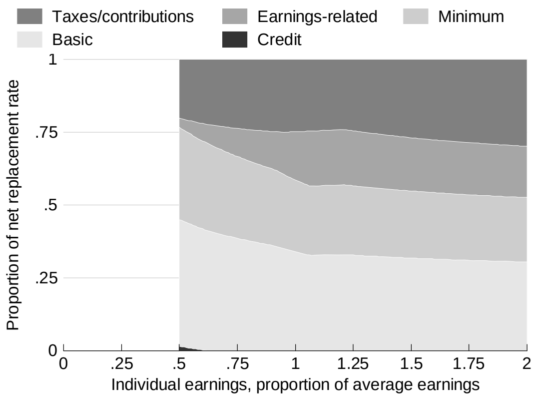
Net and gross relative pension levels



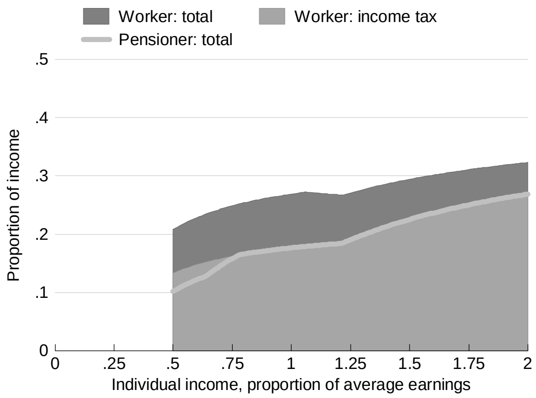
Net and gross replacement rates



Sources of net replacement rate



Taxes paid by pensioners and workers



Men *Women* (where different)	*Median earner*	*Individual earnings, multiple of average*				
		0.5	*0.75*	*1*	*1.5*	*2*
Gross relative pension level (% average gross earnings)	28.4	25.5	27.5	30.8	32.0	32.0
Net relative pension level (% net average earnings)	38.2	34.5	37.0	40.9	42.2	42.2
Gross replacement rate (% individual gross earnings)	33.5	51.0	36.6	30.8	21.3	16.0
Net replacement rate (% individual net earnings)	44.3	63.8	48.0	40.9	29.2	22.8
Gross pension wealth	4.5	6.8	4.9	4.1	2.9	2.1
(multiple of average gross earnings)	*5.2*	*7.8*	*5.6*	*4.7*	*3.3*	*2.5*
Net pension wealth	4.4	6.8	4.8	4.0	2.8	2.1
(multiple of average net earnings)	*5.1*	*7.8*	*5.5*	*4.6*	*3.2*	*2.4*