PENSION POLICY NOTES

UNITED KINGDOM

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- **Reconsider the policy to allow pension withdrawals as lump sums**
- **Harmonise pension systems between public- and private-sector workers**

Mandatory pensions will provide low replacement rates for private-sector workers. The average income of people older than 65 years relative to the whole population is among the lowest within OECD countries. Moreover, the relative old-age poverty rate is above both the OECD average and the poverty rate for the total UK population. The new State Pension (nSP), introduced from 2016 - a contribution-based basic pension depending on years of contribution rather than earning level - provides a more effective safety net than the old basic pension, but overall benefits may be lower, especially for high earners, because of the removal of the earnings-related scheme (state second pension). A minimum of 35 years of contributions, five more than previously required, is needed for the full rate nSP, the level of which is very close to that of the means-tested safety net (Pension Credit supplement). Overall, future replacement rates from mandatory pensions are very low in international comparison. The private component consists of an automatic enrolment scheme into voluntary occupational pension plans, including the National Employment Savings Trust (NEST). NEST is a low-cost, workplace, defined contribution “master-trust” scheme that can be used by any employer for their automatic enrolment duties. Assuming a steady participation in voluntary pensions, the higher basic pension (nSP) leads to long-term replacement rates that are high for low-wage earners with long-enough careers, but decline with wages as the impact of the nSP benefit fades away.

Key indicators: United Kingdom and OECD average

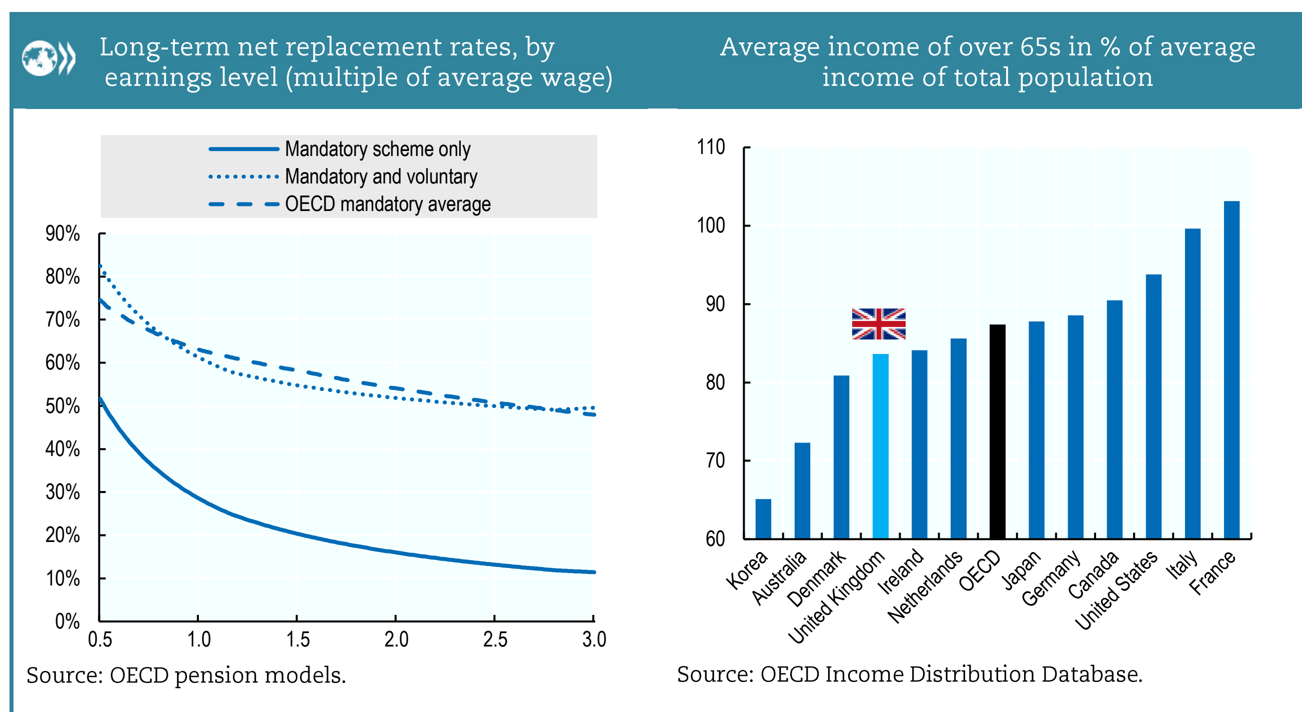
	Mid-1980s	Mid-1990s	Mid-2000s	Latest available	Latest OECD	Long-term	Long-term OECD
Normal retirement age for a full-time career starting at the age of 22	65 (60)	65 (60)	65 (60)	65 (62.7)	64.2 (63.5)	68.0	66.1 (65.7)
Statutory retirement age	65 (60)	65 (60)	65 (60)	65 (62.7)	64.5 (63.8)	68.0	66.5 (66)
Net replacement rate, average earner						28.4	58.6 (57.6)
Effective contribution rate (average earner)							20.4
Total pension spending, % of GDP	8.6	9.1	9.8	11.6	10.0		
Public pension spending, % of GDP	5.6	5.1	5.6	6.6	8.5		
Public debt, % of GDP	43	49	48	112	80		
Employment rate 55-64, %	62.3 (32.7)	56.1 (39.2)	65.6 (48.0)	70.2 (60.2)	68.5 (54.8)		
Labour-market exit age	62.8 (60.8)	62.0 (60.7)	63.1 (61.5)	64.7 (63.6)	65.4 (63.7)		
Old-age poverty rate, %	8.1	10.7	10.6	15.3	13.5		
Life expectancy at 65, years	13.6 (17.5)	15.1 (18.4)	17.4 (20.1)	18.7 (20.9)	18.1 (21.3)	23.1 (24.7)	22.5 (25.2)
Old-age to working-age ratio	0.26	0.27	0.27	0.32	0.31	0.52	0.58
Fertility rate	1.8	1.7	1.9	1.8	1.7	1.8	1.7

Note. The figures for women appear in parenthesis where they differ from those for men.
Long term: Around 2060 based on all legislated reforms up to mid-2019.

Taking pensions as a lump sum could lead to pensioners having insufficient resources later during retirement. NEST was introduced in 2012 to ensure that all employers have access to a workplace pension scheme, as it is mandatory to enrol all employees (with the possibility to opt out) aged between 22 and State Pension age, earning more than GBP 10 000 per year. Currently around 72% of employees

have a workplace pension scheme. When it comes to retirement time, the government has given retirees more choice over how to use their pension accumulated assets. Currently the pot can be withdrawn as a lump sum from age 55, with 25% being tax-free. This withdrawal age will increase in line with legislated increases in State Pension age. However, granting these choices comes with many risks, as individuals need to accurately assess their future needs and longevity. Given biases induced by short-sighted views, individuals may be tempted to take their pension as a lump sum. This may work for some but could cause serious financial pressures for many when aged in their late 80s or 90s. They will then have to rely solely on the nSP. Currently this benefit is protected by the triple-lock condition – higher of inflation, wage growth or 2.5%. The 2.5% threshold is questionable because at times of low inflation and wage growth, beyond the cost for the public purse, it is difficult to justify why pensioners should be advantaged compared with workers for example. The March 2018 report from the UK Office for Budget Responsibility forecast spending would increase by 2.3% of GDP by 2067-68, but only by 1.8% of GDP if pensions were only increased by earnings rather than maintaining the triple lock promise.

The retirement age may increase at a faster rate. Currently the pension age is legislated to increase to age 68 between 2044 and 2046. However, the timeframe for increasing to age 67 has already been brought forward by eight years, to 2028. The government introduced a 5-yearly review process for considering future changes in the State Pension age, with possible links to changes in life expectancy under the 2014 Pension Act. The first report released in July 2017 proposed bringing forward the increase to age 68 to the period 2037-2039. The effective age of labour market exit is currently 65 for men and 64 for women on average.



Source: OECD pension models.

Source: OECD Income Distribution Database.

Harmonising workplace pensions across all sectors would increase transparency and fairness. Eligible private-sector workers are covered by the auto-enrolment workplace pension scheme highlighted above, unless they already have a workplace pension above the minimum standard. Within the public sector, workers are covered by numerous alternatives depending on when they started their career, but new workers are covered within the mandatory Alpha system. This scheme gives an annual accrual of 2.32% enabling full-career average-wage workers to achieve future gross replacement rates over 100% as they also receive the nSP. By comparison, private-sector workers without a workplace pension receive around one-fifth of this level and even if fully enrolled within the workplace pension scheme can only expect a pension around half this level, despite contributing at similar levels. Including workers from all sectors within one pension system would therefore remove this disparity in future pension entitlements.

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