Title: The single-tier pension: a simple foundation for saving	**Impact Assessment (IA)**
	Date: 15 January 2013
IA No: DWP0028	**Stage:** Final
Lead department or agency: DWP	**Source of intervention:** Domestic
	Type of measure: Primary legislation
Other departments or agencies: HMRC, HMT	**Contact for enquiries**: Joseph Clease, 020 7449 7362

Summary: Intervention and Options

RPC Opinion: Not in scope

What is the problem under consideration? Why is Government intervention necessary?

The Government is concerned that the current state pension will not provide the best foundation to support people in taking greater personal responsibility for saving for their retirement. Levels of private saving are in decline and almost 11 million people are estimated to be not saving enough for an adequate retirement income. To address this challenge of under-saving, eligible workers will be automatically enrolled into workplace pensions from 2012. However, there is still substantial complexity in the current state pension system and reliance on means testing results in less clear savings incentives. Within the context of automatic enrolment, a reformed state pension would provide a clear foundation for individuals in making savings decisions. Reform is also needed to ensure the cost of the system remains sustainable.

What are the policy objectives and the intended effects?

To deliver a simpler and fairer state pension that provides a better foundation for saving and is sustainable for future generations. The intended effects of state pension reform are:

- individuals have a better understanding of the state pension system and their entitlement, and therefore engage more actively with planning for retirement;
- inequalities of state pension outcomes within the current system are reduced;
- individuals have reduced interaction with means-tested benefits in retirement;
- the state pension system is more affordable and sustainable in the long-term.

What policy options have been considered, including any alternatives to regulation? Please justify preferred option (further details in Evidence Base)

This impact assessment examines the fiscal costs and benefits of the following options:

Option 1: Do nothing (baseline): Under this option, the state pension system will remain unchanged.

Option 2 (preferred): A single-tier state pension, combining basic State Pension, State Second Pension, Pension Credit and some other complex elements of the current system into one single-tier flat-rate state pension for new pensioners. This is the preferred option as it best meets the principles for reform as explained in the evidence base.

Option 3 (alternative): Speeding up flat rating of the State Second Pension (no change to means-tested benefits). This option goes some way towards improving simplicity and reducing inequality, but a complicated two tier system of basic State Pension and State Second Pension would remain.

Will the policy be reviewed? It will be reviewed. **If applicable, set review date:** April 2021

Does implementation go beyond minimum EU requirements?			N/A		
Are any of these organisations in scope? If Micros not exempted set out reason in Evidence Base.	**Micro** Yes	**< 20** Yes	**Small** Yes	**Medium** Yes	**Large** Yes
What is the CO_2 equivalent change in greenhouse gas emissions? (Million tonnes CO_2 equivalent)			**Traded:** n/a	**Non-traded:** n/a	

I have read the Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs.

Signed by the responsible Minister: Steve Webb Date: 15/01/2013

Contact for enquiries: Joseph Clease, 020 7449 7362

Single-tier pension: a simple foundation for saving

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List of Abbreviations

ASHE	Annual Survey of Hours and Earnings
ASP/AP	Additional State Pension
BSP	Basic State Pension
COSR	Contracted-Out Salary Related
CTB	Council Tax Benefit
DB	Defined Benefit (pension)
DC	Defined Contribution (pension)
DWP	Department for Work and Pensions
GAD	Government Actuary’s Department
GDP	Gross Domestic Product (a measure of the total size of the economy)
LEL	Lower Earnings Limit
MDR	Marginal Deduction Rate
NICs/NI	National Insurance contributions
NEST	National Employment Savings Trust (an automatic enrolment pension scheme for UK employers of any size).
ONS	Office of National Statistics
OPSS	Occupational Pension Schemes Survey
S2P	State Second Pension
SDAA	Severe Disability Additional Amount
SERPS	State Earnings-Related Pension Scheme
SMG	Standard Minimum Guarantee
SPA	State Pension age
UAP	Upper Accrual Point

Executive Summary

1. Over the past few years, the Government has announced and introduced radical reform of working-age benefits. Universal Credit, due to be launched in 2013, will dramatically simplify the welfare system, bringing together a range of means-tested benefits into a single streamlined payment. These changes will help ensure that work pays and tackle the root causes of poverty and welfare dependency.

2. The introduction of **automatic enrolment** will ensure that around 11 million people will have access to a low cost, workplace pension scheme, many for the first time. This is expected to result in between six and nine million people newly saving, or saving more, in workplace pensions. It is therefore time for the Government to refocus the state pension on providing a clearer and simpler foundation for saving.

3. The Government now wants to reform the state pension system so that it provides a **simpler, fairer foundation** that better supports pensioners in saving for their retirement and is sustainable for future generations.

4. Despite recent reform, a number of problems persist in our state pension system:

   - Substantial **complexity and uncertainty** remain. This means that many do not know what they will get from the state when they retire and so do not have a clear starting point on which to plan and save for their retirement. Many people find the current system difficult to understand, which makes it harder to plan for retirement. A single-tier pension will provide a firmer foundation to support planning and saving for retirement by delivering a simpler, single flat-rate pension set above the basic level of the means test;

   - A long-term decline in the relative value of the basic State Pension has led to an increasing **reliance on means testing,** resulting in unclear saving incentives for many people. Currently 40 per cent of pensioners are eligible for Pension Credit, although around a third of those eligible do not claim it: missing out on an average of £34 a week[1]. A single-tier pension will help to reduce the need for means testing to deliver a higher income in retirement and will also clarify incentives to save. Under the single tier, eligibility for Pension Credit for new pensioners is halved overnight, and ultimately falls to around 5 per cent by 2060;

   - **Inequalities remain** in the system. Despite the 2010 state pension reforms, the proportion of women in Great Britain qualifying for a full basic State Pension is not expected to catch up with men until around 2020, and without further reform it is expected to take a further 30 years for State Second Pension outcomes to equalise. A single-tier pension will help to address inequalities in the system for women and the low paid and bring the self employed fully into the state pension system for the first time since the 1960s;

   - There is a continual need to ensure that the state pension system remains **affordable and sustainable** in the face of demographic change, while still treating people fairly. Life expectancy for both men and women, already at a record level, continues to increase contributing to a rising dependency ratio. The costs of supporting a larger pensioner population are being mitigated by increases to the State Pension age; however, without further reform costs will rise substantially as a proportion of GDP over the longer term. A single-tier pension will retain the contributory principle, while reducing the rate of increase of spending on state pensions, particularly after 2050.

5. On 4 April 2011 the Government launched a public consultation on two options for reform to deliver a simpler, fairer state pension that better supports saving for retirement:

   - The ‘faster flat rating’ option would accelerate changes already under way to deliver a flat rate, two tier pension more quickly; and

   - The ‘single tier’ option was a more radical reform to a single-tier pension set above the basic level of the means test.

[1] DWP, Income Related Benefits: Estimates of Take-up in 2009-10, 2012

6. Over 75 per cent of the organisations who responded to the consultation preferred the concept of single tier. The Government has decided to introduce a single flat-rate state pension set above the basic level of the means test for future pensioners to simplify the state pension and better support saving for retirement. This choice was confirmed by the Chancellor in the Autumn Statement 2012, and the Government intends to implement the single-tier pension in April 2017 at the earliest.

Single-tier reform

7. The key design principles of the single-tier pension are that it introduces a simple, flat-rate amount that ends the current two-tier system of basic and additional State Pension. The key features of the single-tier pension are:

- A flat-rate payment set above the basic level of the means test, allowing the abolition of means-tested Savings Credit;
- The State Second Pension, contracting out and outdated additions will end;
- 35 qualifying years for the full amount. Those with fewer than 35 years, but above a minimum qualifying period (of between 7 and 10 years), will get a proportionally smaller amount;
- Everyone will qualify individually, ending inheritance of, and derived rights to, a spouse or civil partner's pension. Transitional protection measures will be put in place;
- Self employed people are brought fully into the state pension for the first time since the 1960s;
- It will still be possible to defer claiming state pension and receive an increased weekly pension in return, albeit at a more actuarially fair rate. There will be no lump sum option, and no inheritance of a deferred single-tier pension.

8. The single tier will be of most benefit to individuals who would not have been able to build up as much entitlement to State Second Pension under the current system. The reforms benefit women and enable them to reach comparable state pension outcomes with men more quickly than otherwise would have been the case. The median female state pension reaches parity with the male median state pension fifteen years earlier under single tier, compared with the current system.

9. The Government has made it clear that it will recognise National Insurance contributions and credits prior to the implementation of single tier in managing the transition from the current system. A key challenge of reform is to recognise contributions that have already been made in a way that is fair, while also delivering the simplicity and clarity of single tier as quickly as possible as a basis to support planning and saving for retirement.

10. Since the Green Paper, the Government has developed an alternative approach to transition that delivers the simplicity and clarity of single tier more quickly but also recognises contributions made prior to the implementation of single tier. Under this approach, for those not yet retired the amount of state pension an individual would be awarded under the current rules is valued at the point single tier is implemented, based on their NI contribution record up to that point (we refer to this as their 'foundation amount'*)*. This increases the proportion of people qualifying for the full amount of single-tier pension in the early years of implementation.

11. In a 'pay as you go' system, funding liabilities are borne by the working age population. Future governments will want to consider the level of the single-tier pension and uprating in light of the wider economic factors that are relevant at the time and the legislation will provide this flexibility, underpinned by a statutory requirement to uprate by at least earnings. Decisions on these variables will be made by the Government shortly before implementation, alongside a decision on the minimum number of qualifying years.

12. For illustrative purposes, this paper assumes that the single tier will be implemented in 2017, with a starting level of £144 per week and uprating of the single tier by the triple lock (the highest of growth in average earnings, CPI price inflation or 2.5 per cent) until 2060, in line with assumptions used by the Office for Budget Responsibility to project forward costs of basic State Pension. We present the impact that different assumptions about the start level and uprating would make to the overall cost and impact of reform in Annex B.

Main impacts of single-tier reform

13. A single-tier pension will deliver greater certainty of income in retirement. The large majority of pensioners (over 80 per cent) will receive the full single-tier pension by the mid 2030s. This will make it much easier to provide those of working age with a clear idea about what their state pension will be worth when they retire, providing a firm foundation to support people in saving for retirement.

14. The single-tier will incentivise saving for retirement. The proportion of single pensioners on a marginal deduction rate of 20 per cent or less would improve significantly, particularly among the poorest fifth of pensioners, so that they can keep more of any additional saving or earnings. To be conservative, we have not modelled any behavioural change arising from the policy.

15. Reform will help to reduce reliance on means-testing, with eligibility for Pension Credit for new pensioners halved overnight and ultimately falling to around 5 per cent by 2060. In the long-term the impact of the reforms is to reduce eligibility to any means-tested benefit by around 400,000 pensioner benefit units, by 2040.

16. A single-tier pension will be fairer: by delivering parity for women's state pension outcomes fifteen years sooner than under the current system. Around 750,000 women who reach State Pension age in the first ten years after the single-tier pension is introduced will receive an average of £9 per week more in state pension because of the single-tier valuation (in 2012/13 prices).

17. It will help to ensure that the pensions system remains affordable in the longer term. Under single tier, the rate of increase in spending on pensioner benefits will be slowed down. The single-tier system is projected to cost broadly the same as the current system until the mid 2040s. From the late 2040s the rise in pensions expenditure as a proportion of GDP reduces compared to the current system (from 8.5% of GDP to 8.1% of GDP by 2060)[2].

18. In 2017, the assumed first year of reform, most people receive the same level of state pension income as they would have had the current system continued, however 20% of people will get a higher outcome. By 2020, around 75% of new pensioners have higher outcomes under single tier, which gradually diminishes but even by 2060 around 40% of pensioners have higher outcomes. People that would have built up large amounts of additional State Pension in the baseline are the main group who have notionally lower outcomes.

19. The end of 'contracting out' will mean that people in DB schemes will lose their NIC rebate. However, under single tier, around 90 per cent of people who start to pay higher National Insurance contributions (NICs) from implementation and reach State Pension age over the first two decades of single tier are likely to see an increase in their State Pension. This will be enough to compensate them for effects both of paying higher employee NICs and of accruing lower pension benefits in their occupational pension scheme.

[2] These figures are based on DWP projections. These differ from projections in the OBR Fiscal Sustainability Report 2012. See Chapter 8 for further details.

Chapter 1) The problem and rationale for intervention

1.1 Overview

20. In 2002, the Government established an independent Pensions Commission to consider the long-term challenges facing the UK pension system and whether the existing voluntary pension saving regime represented an adequate response. The Commission concluded that the existing system would have to be reformed to ensure it would meet several long-term challenges[3]:

- Demographic and social change: the proportion of the population aged 65 or over is rising rapidly because of increasing life expectancy and lower fertility rates.
- Under-saving for retirement: millions of people are not saving enough to deliver the income they are likely to want or expect in retirement.
- Complexity: the complexity of the state pension system stopped people from making informed decisions about whether, when and how much to save.
- Inequalities in the pension system: concerns that some groups, in particular women, have reduced opportunities to save for a decent income in retirement.

21. In order to address these concerns, a range of reforms improved state pension coverage and provided a simpler and fairer state pension system, as well as setting a timetable for future increases in State Pension age.

22. The past year has seen the introduction of automatic enrolment into workplace pension schemes. This should result in millions more saving in workplace pensions, many for the first time. The Government considers that further reform is needed to the state pension system in order to provide a clear and simple foundation to encourage current generations of workers to save for their retirement. It is also an opportunity to make further progress in tackling inequality.

1.2 The challenge of the ageing population

Demographic change

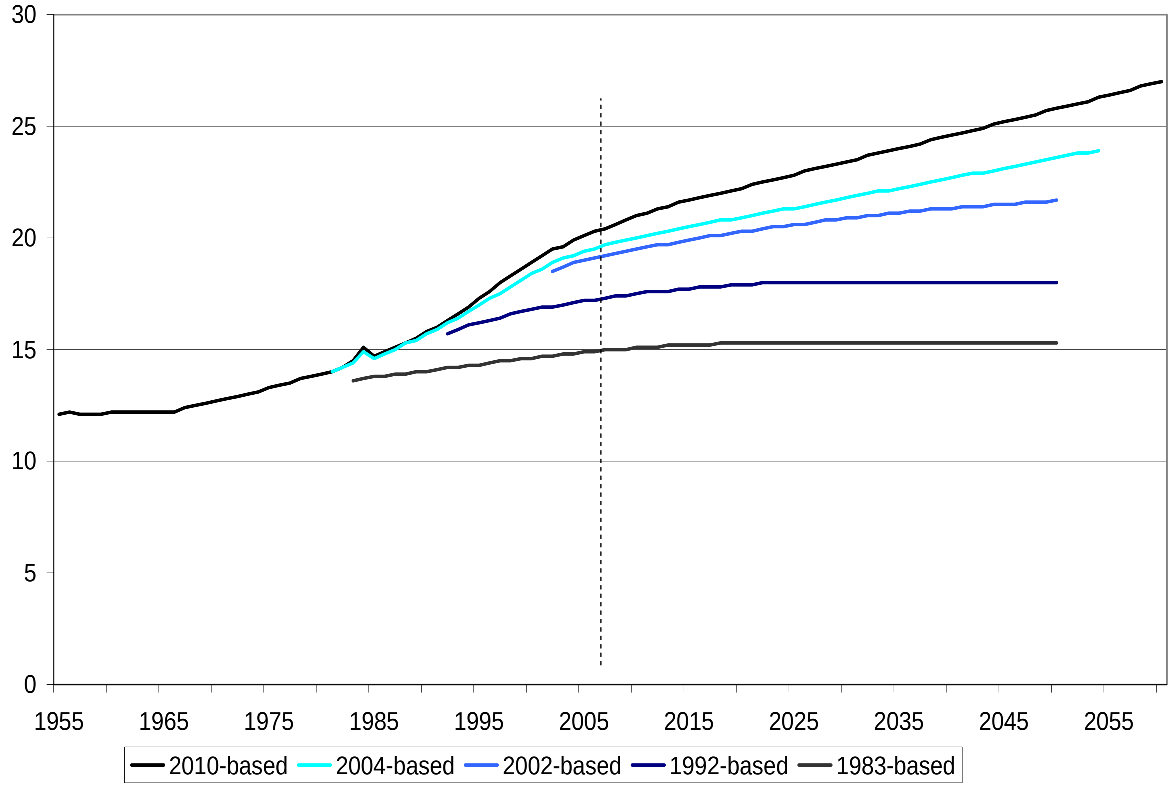
23. The population is projected to rise most quickly for the oldest age groups. The pensioner population is projected to increase from an estimated 12.2 million in 2010 to 15.3 million in 2035, and 18.3 million in 2060[4]. Cohort life expectancy at age 65 is projected to increase from 21.0 in 2010 to 24.0 in 2035 for men and from 23.7 in 2010 to 26.6 in 2035 for women[5].

24. Life expectancy in the UK has reached its highest level on record for both men and women, and is projected to continue to increase. In 2007, for the first time, the number of pensioners exceeded the number of children under 16 in the UK[6].

25. The rate at which life expectancy is increasing has accelerated. It took 70 years, between 1920 and 1990, for male life expectancy at 65 to increase by 5 years. The next five year increase took just 20 years, between 1990 and 2010. Each set of life expectancy projections has shown a greater increase than its predecessor (see Chart 1.1). Since the original timetable to increase State Pension age was agreed 5 years ago, according to the most recent forecasts, a man retiring in 2012 can expect to spend more than an extra year in retirement.

[3] The Pensions Commission, 2004, *Pensions: Challenges and Choices: The First Report of the Pensions Commission* and 2005, *A New Pension Settlement for the Twenty First Century: The Second report of the Pensions Commission.*
[4] Office for National Statistics, 2011, 2010 population estimates. Includes the announced increase to SPa 67 between 2026 and 2028, and the SPa equalisation to 65 (for women), and rises to 66 and 68 as set out in legislation.
[5] *Ibid*
[6] Office for National Statistics, 2009, *2008-based national population projections*.

Chart 1.1: Cohort life expectancy for a 65 year old male, 1955-2060

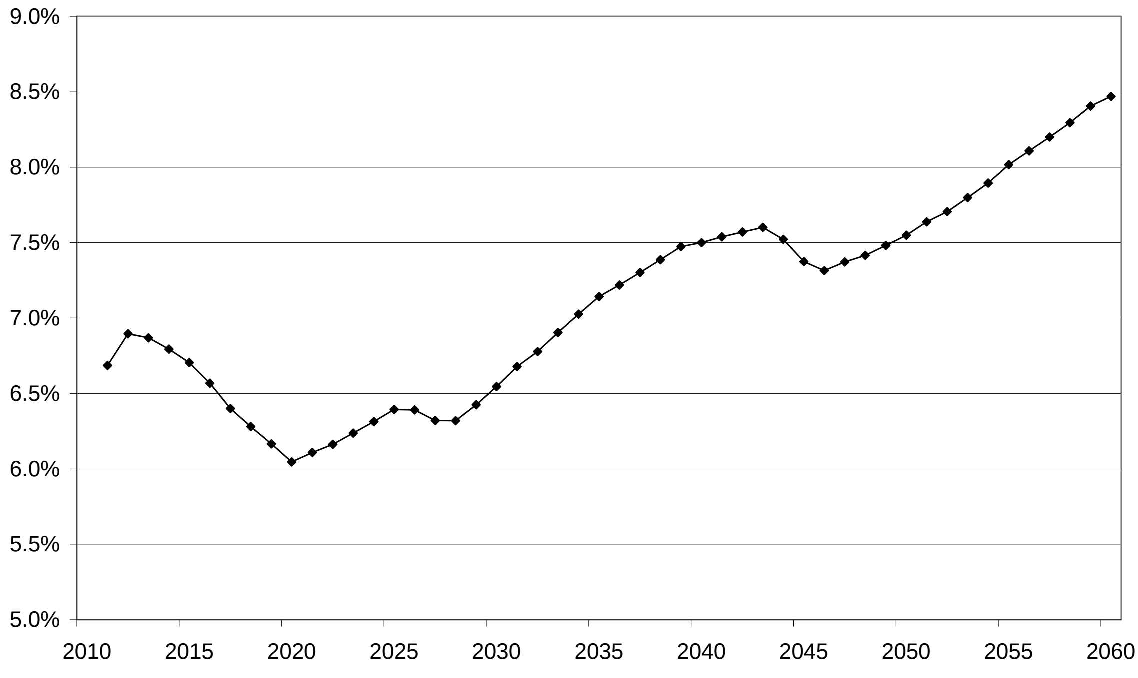


Source: ONS, Period and cohort expectation of life tables (various releases) and GAD, Period and cohort expectation of life tables (various releases)

26. Given these increases in longevity, the Government has already acted, legislating to increase the State Pension age to 66 by October 2020 and proposing to increase the State Pension age to 67 by April 2028 to ensure that the state pension remains sustainable and affordable over the long term. The Government is also proposing a regular review process to ensure that further increases in State Pension age reflect increases in life expectancy.

27. Nevertheless, despite the increases to the State Pension age already announced, without further reform state pension spending as a proportion of GDP is forecast to rise significantly (Chart 1.2).

Chart 1.2: Pensioner benefit expenditure as proportion of GDP



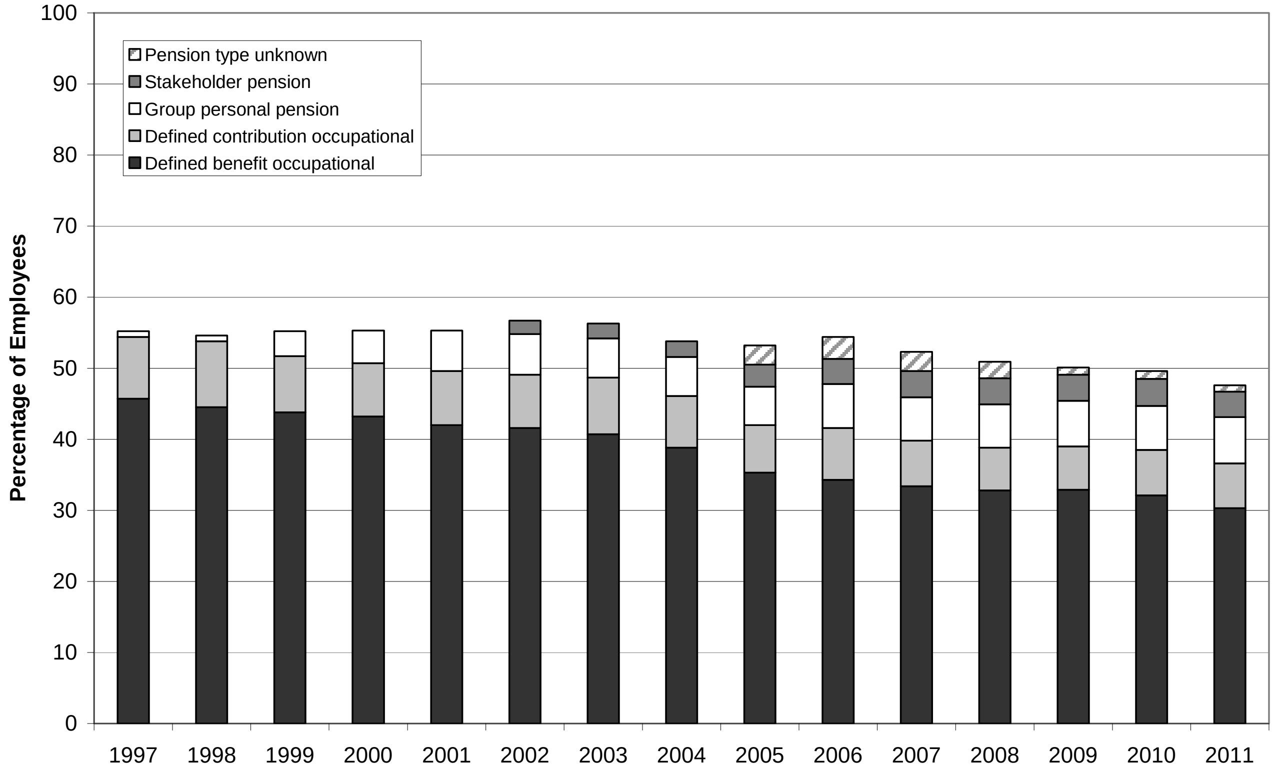
Source: DWP expenditure projections. Includes the announced increase to SPa 67 between 2026 and 2028, and the SPa equalisation to 65 (for women), and rises to 66 and 68 as set out in legislation.

1.3 The challenge of the undersaving for retirement

28. Despite the fact we are living longer, fewer people are saving for their retirement. The numbers contributing or having contributions paid into a scheme (active members) continues to fall. In 2011 there were 8.2 million active (employee) members of occupational pension schemes compared with 12.2 million at the peak in 1967[7].

29. Within that overall decline there has been a move away from Defined Benefit schemes. Chart 1.3 shows the proportion of employees in the UK who belong to an employer sponsored pension scheme. The chart shows that the proportion of employees in a DB scheme has fallen from 46 per cent in 1997 to 30 per cent in 2011. However, this has been partly offset by a rise in Group Personal Pensions and Stakeholder schemes. This means that the risk associated with ensuring that pensions deliver a particular level of income in retirement is being increasingly borne by individuals rather than employers.

Chart 1.3: Employee membership of an employer-sponsored pension scheme: by pension type, 1997 to 2011



Source: ONS Pension Trends, 2012, Chapter 7, figure 7.6

30. There are around 11 million people of working age who could have inadequate retirement incomes[8]. Just under a third of 45-64 year olds have no private pension wealth and this number rises to over a half of 25-34 year olds[9]. The high number with no private pension provision, against a backdrop of increasing longevity, is a concern, as evidence suggests that on its own the state pension will not provide the retirement income that many people want.

31. Accessible forms of tax-relieved saving have become more popular: an estimated 15.4 million people saved into an Individual Savings Account (ISA) in 2010-11. But over half of ISA owners approaching retirement (aged 45-64) have less than £9,000 saved in their ISA, an amount which is unlikely to go far in covering retirement expenditure[10].

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7 Office for National Statistics, 2012, *Occupational Pension Schemes Survey 2011*. ONS

8 "Estimates of the number of people facing inadequate retirement incomes", DWP Ad-hoc analysis, July 2012 (Figures predate implementation of Automatic Enrolment.)

9 Office for National Statistics, 2009, *Wealth in Great Britain: Main Results from the Wealth and Assets Survey 2006/08*.

10 HMRC ISA Statistics (2009-10), Tables 9.4 and 9.11

32. To tackle these problems the Government is introducing Workplace Pension Reform. A central feature is that employers will be required to automatically enrol their eligible employees into a qualifying workplace pension and make a minimum contribution. The reforms are expected to offset the decline in private pension membership and to increase the number of people newly saving or saving more in all forms of workplace pensions by between six and nine million. Private pension savings are estimated to increase by around £11 billion a year (2012/13 earnings terms) once the reforms have been fully implemented in 2018[11].

33. With this context of a changing pensions landscape brought about by Workplace Pension Reform, state pension reform will help provide the right foundation to support people in taking greater personal responsibility for saving for their retirement. Therefore the State Second Pension will no longer be required to provide those outside of occupational pension schemes with the opportunity to enjoy an enhanced income in retirement.

1.4 Complexity and uncertainty in the current state pension

34. Whilst the Pensions Act 2007 reforms provided improvements to the state pension system, the following problems remain:

Complexity and uncertainty

35. There is still substantial complexity and uncertainty in the system. Many people are unsure what their state pension will be worth when they retire. Two in three people interviewed by the DWP Attitudes to Pensions Survey agreed that "sometimes pensions seem so complicated that I cannot really understand the best thing to do" and only 31 per cent said they had either a "good" or "reasonable, basic knowledge" of pension issues[12]. The complex current system means it is very difficult for working people to know how much income they will get from the state in retirement and understand how best to prepare for retirement.

Unclear savings incentives

36. The uncertainty in state pension outcomes in the current system feeds directly through to savings incentives. The amount of state pension that someone receives will determine both whether, and the extent to which, other sources of income are subject to withdrawal due to interaction with the means-tested system.

37. Interaction with means-tested benefits can also reduce the perceived reward for any saving. Someone in receipt of just Housing Benefit in retirement will keep 35p for every additional £1 of pension income, and a person in receipt of Pension Credit (both Guarantee Credit and Savings Credit) would keep 60p for every extra £1 of pension income.

Reliance on means testing

38. Means testing also adds to confusion around what income an individual can expect to have in retirement. Pension Credit, Housing Credit and Council Tax Benefit all have different rules and withdrawal rates and it can be difficult for an individual to know how much income they might have in retirement.

39. Means-tested benefits may not always be the most effective way to ensure that all poorer pensioners receive the minimum available because some do not take up benefits to which they are entitled. In 2009/10, the percentage of people entitled to Pension Credit who did not take up the support was estimated to be between 32 per cent and 38 per cent[13].

1.5 Inequality in the current state pension system

40. As part of the Pensions Act 2007, reforms were taken forward to help reduce inequalities for women in the current state pension system. However, it will take time for these measures to translate into improved pension entitlement. Both state and private pension outcomes are lower for women than for men. The proportion of women reaching State Pension age entitled to a full basic State Pension

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11 "Workplace pension reform: digest of key analysis", DWP 2012,

12 *Attitudes to Pensions 2012,* DWP

13 DWP, February 2012, Income Related Benefits: Estimates of Take-up in 2009-10.

will not catch up with men until around 2020 and the overall state pension outcomes of men and women are not expected to equalise until after 2050[14].

41. From 2012, eligible workers will now be automatically enrolled into workplace pensions. This is likely to benefit many women currently without private pension provision, for example those with fragmented working histories, in part-time work or on low pay who may not have access to a suitable occupational scheme. We need to provide a foundation to support saving decisions.

42. In the current system the self-employed pay National Insurance contributions on a different basis from employees, with the implication that some low earners that are self-employed could receive less state pension than if they earned the equivalent sum as a wage. We wish to simplify the system and treat the National Insurance contributions of the self employed in the same way as employee contributions for state pension purposes.

[14] DWP Modelling.

Chapter 2) Policy objective and options considered

2.1 Consultation and state pension reform objectives

43. In April 2011 the Government launched a consultation on state pension reform entitled "*A state pension for the 21st century*"[15]. In this, the Government set out the guiding principles for reform:

- **Personal responsibility** – enabling individuals to take responsibility for meeting their retirement aspirations in the context of increased longevity.
- **Simplicity** – simplifying the state pension so that it is easier for people to plan and save for retirement (particularly within the context of Workplace Pension Reform).
- **Fairness** – ensuring an adequate level of support for the most vulnerable; ensuring everyone with a full contribution record should be entitled to a state pension above the standard level of means-tested support[16]; and treating all groups more fairly.
- **Affordability and sustainability** – given the longer-term pressures on the public finances, state pension reform must be affordable. Furthermore, as longevity projections continue to increase, Government has a responsibility to ensure the costs of increasing longevity are shared fairly between generations. In addition, state pension reforms need to retain trust and confidence in a sustainable deal for the long term.

44. The consultation on state pension reform ran from 4 April, 2011 to 24 June, 2011. The summary of responses to the consultation was published on 27 July, 2011[17]. In total DWP received 101 responses from stakeholder organisations and approximately 1,600 from individuals. The Minister for Pensions hosted four roundtable discussions on specific aspects of the proposed reform and officials met thirty five stakeholder organisations during the consultation period.

45. In general, the consultation demonstrated broad support among stakeholder organisations for the single-tier option, with around three quarters of organisations who responded saying they support the single-tier in principle. There is widespread consensus among stakeholders, whether or not they support the single-tier option itself, that the current state pension system is not fit for purpose, largely because of its complexity.

2.2 Description of options considered

46. Three options were considered as follows:

Option 1: 'Do nothing' - the baseline

47. The Government's Green Paper set out the rationale for why doing nothing is not an option[18]. Without reform to the current state pensions system:

- complexity in the state pension system will still remain and add to uncertainty for individuals about their retirement income;
- inequality between different groups, for example men and women, will still remain;
- concern around sustainability of the pension system given increased life expectancy projections would remain;
- the introduction of Workplace Pension Reform will not be supported by a state pension which provides a clear foundation for private saving.

15 The consultation document can be viewed here http://dwp.gov.uk/docs/state-pension-21st-century.pdf

16 This is defined as the level of income provided by the Pension Credit standard minimum guarantee (SMG) which in 2012-13 tops up pensioners' income to £142.70 per week for singles, and £217.90 per week for couples.

17 The summary of responses to the consultation can be viewed here http://dwp.gov.uk/docs/state-pension-21st-century-response.pdf.

18 http://www.dwp.gov.uk/docs/state-pension-21st-century.pdf

Option 2: Preferred option - single-tier package of reform

48. Single-tier reform aims to provide a clear and simple foundation to encourage current generations of workers to save for their retirement, thus making the pensions system more sustainable in the long term. It also makes further progress in tackling inequality, while retaining the contributory principle.

49. The key features of the single-tier pension are:

- **A flat rate payment set above the basic level of the means test**
  The full rate of the single-tier pension will be above the level of the means test for the Standard Minimum Guarantee (£142.70 per week for a single person in 2012/2013). The current legislative requirement to increase the basic State Pension at least in line with average growth in earnings will also apply to the single tier. An individual with a full contribution record of 35 years could expect to retire on a state pension that lifts them clear of the basic level of the means test and keeps them above it throughout their retirement. This is because the full single-tier amount would be uprated at least in line with earnings, so would hold its value relative to the means test, which is also uprated by earnings. The precise starting value and approach to uprating of single tier will be set shortly before implementation taking account of the fiscal context at the time.

- **The State Second Pension, contracting out and other additions will end**
  The State Second Pension and contracting out for Defined Benefit schemes will end when the single-tier pension is implemented. The Savings Credit element of Pension Credit will be removed and the Category D pension and the 25p Age Addition will also end, with the savings recycled into the single-tier pension. This will rationalise the different sources of pensioner income from the state, into a simpler, single payment. It will make it much easier for people to understand how much they need to save to get the income in retirement they want.

- **35 qualifying years for the full amount, those with fewer than 35 years, but above a minimum qualifying period, will get a proportionally smaller amount**
  In order to get the full amount of single-tier pension, an individual will need 35 qualifying years. Crediting arrangements will be brought forward to protect the single-tier pension position of those who cannot work for certain specific reasons, for example due to caring commitments. People reaching State Pension age under single tier will need to have a minimum number of qualifying years to become eligible for state pension (assumed to be 10 years for the purpose of the analysis in this paper, with a final decision to be taken nearer to implementation).

- **Everyone will qualify individually, ending inheritance of, and derived rights to, a spouse's or civil partner's pension**
  Current provisions in the existing pension system for the inheritance or derivation of the pension and contribution records of a spouse or civil partner are out of step with changes that have taken place in society. For a person reaching State Pension age under single tier, there is no longer any rationale for carrying forward provision for using the National Insurance contribution record of their spouse or civil partner to get a basic State Pension or higher rate of basic State Pension. This will end under single tier, with transitional arrangements put in place.

- **Self-employed people will be brought fully into the state pension**
  Under the current system, National Insurance contributions paid by the self-employed do not count towards additional State Pension. The Government believes that we should treat all forms of National Insurance contributions equally in the calculation of state pension and not disadvantage those who work on their own account often in entrepreneurial activities. The rate of National Insurance that is payable by the self-employed will be a matter for the Government to decide closer to implementation.

- **Individuals will still be able to defer claiming their state pension and receive a higher weekly state pension in return**
  The ability to defer claiming the state pension will be retained under single tier, but the deferral reward will change to more closely reflect the value of the income foregone by the delay in drawing a single-tier pension, and it will no longer be possible to receive a lump-sum payment. In the analysis we assume that state pension will increase by 1 per cent for every 10 weeks that it is deferred. This rate will be finalised closer to the planned implementation date, taking into account the value of the income foregone by the delay in drawing a single-tier pension and the Government's agenda for supporting people who wish to work for longer.

50. A single-tier pension would therefore be a substantial simplification of the system. Many complex and outdated elements of the current system would be abolished. A single flat-rate state pension would give people much greater certainty and clarity over what their state pension will be worth, providing a much firmer foundation on which to base decisions around saving for retirement.

51. Ending contracting out from Defined Benefit occupational pension schemes is another aspect of moving to a single-tier pension system and will contribute to simplifying the state pension system. The Government will continue to work closely with stakeholders to understand the likely impacts that ending contracting out will have on individuals, employers and pension schemes. Chapter 5 provides further analysis.

52. The single-tier pension will commence in 2017 at the earliest. For illustrative purposes the impact assessment assumes that the single-tier pension will start in April 2017:

- Those who reach State Pension age prior to this date will continue to receive their state pension in line with current rules.
- For people who reach working age or enter the labour market for the first time after April 2017, all their National Insurance contributions or credits will be dealt with under the single-tier rules.
- People who reach State Pension age after 2017 will receive a single-tier pension upon retirement, based on National Insurance contributions or credits dealt with under rules that reflect both the current system and single-tier system (and in some cases, previous pension systems).

53. The Government has made it clear that it will recognise contributions that have been made prior to commencement in managing the transition from the current system to single tier through the foundation amount. Where on reaching State Pension age an individual's pre-commencement contribution record gives rise to an entitlement of more than the full amount of single tier, the additional amount would be recognised in their start valuation as a 'protected payment' (uprated annually by prices).

54. A key challenge of reform is to do this in a way that is fair, while also delivering the simplicity and clarity of single tier as quickly as possible, as a basis to support planning and saving for retirement. In the consultation paper on reform, the Government outlined an approach to transition that would have meant that even by 2050 half of pensioners would still not receive the full single-tier amount despite having a full quota of qualifying years. Such a lengthy transition period would undermine the key objective of providing people with clarity over what their state pension will be when they retire.

55. The Government has therefore developed an alternative approach to transition that delivers the simplicity and clarity of single tier more quickly but also recognises contributions people may have prior to commencement. The majority of people of working age will have made National Insurance contributions prior to the implementation of the single-tier pension. Each record will be different, depending on the person's history of work or credits. A key challenge of the single-tier reform is to translate these records into a single-tier start valuation – or foundation amount – at the date of the introduction of the new scheme.

56. Subject to an individual satisfying the minimum contribution requirement, the foundation amount will be the minimum weekly amount of state pension an individual will receive when they reach State Pension age. This applies in the following ways:

- where an individual's National Insurance contributions record leads to a foundation amount which is **greater than the full level of the single-tier** weekly pension, the amount above the single-tier pension will be protected, and added to the full single-tier weekly payment;
- where this foundation amount is **lower than the full level of the single-tier** weekly pension, individuals will be able to increase their single-tier pension up to the full £144 per week, by gaining further qualifying years; and
- where an individual has **previously been contracted out** of the additional State Pension, a deduction will be made to reflect private pension benefit accrued through contracting out.

57. Under this approach, the contributions people have made prior to commencement, including during periods of contracted-out employment, are consolidated as the starting point for a much simpler single-tier system. By the mid 2030s, around four out of five people reaching State Pension age will receive the full single-tier weekly amount. (See Chapter 4 of the White Paper for case studies).

58. This approach to transition will provide an immediate boost to the incomes of some of the least well off pensioners to above the level of the Guarantee Credit. Therefore Savings Credit would be removed at the point of implementation as the system will no longer rely on Pension Credit to guarantee a minimum income level. Eligibility for Pension Credit among new pensioners would be halved overnight to around 10 per cent. Support will be retained for a period of 5 years for those people who may have received more support for housing costs by virtue of their eligibility for Savings Credit.

59. The Government would also change additional State Pension inheritance rules from the point of implementation, with transitional arrangements for couples in specific circumstances (details are in the White Paper). Chapter 4 of this impact assessment provides further analysis of the impact on means-tested benefits.

Option 3: Faster flat rating of additional State Pension

60. An alternative state pension reform option which incrementally builds upon reforms legislated in the Pensions Act 2007 was outlined within the Green Paper '*A state pension for the 21st century*'. Currently, the basic State Pension is a flat-rate payment worth £107.45 a week and the State Second Pension is partly flat-rate and partly linked to earnings.

61. Under current legislation, the earnings-related element of the State Second Pension is set to be phased out in the late 2030s, at which point the State Second Pension will be valued at £1.70 a week for each qualifying year. This leaves the state pension system to consist of two flat-rate tiers. The transition to a flat rate State Second Pension could be speeded up by phasing out the earnings-related component of the State Second Pension more quickly.

62. However, the Government does not believe that faster flat rating would provide the clear foundation that is needed to support current generations in taking greater personal responsibility for saving for their retirement. Most significantly, it would retain a much greater variation in outcomes than single tier, and retain much of the complex architecture of the current system. The Government believes that a single-tier pension is the only option that would meet the principles for reform and provide the foundation that is needed to support saving for retirement. The Government therefore intends to introduce a single-tier pension in April 2017 at the earliest.

63. Further discussion and analysis to explain why we have rejected this option can be found in Annex C of this impact assessment (and also in Annex 2 of the White Paper).

Chapter 3) Single tier: impact on individuals

64. This chapter looks at the effect of the single-tier reform package on the various types of income pensioners receive from the state compared to the current system. The impact analysis presented throughout this report uses as a baseline the current benefit system, including changes enacted in the Pensions Act 2007 and the Welfare Reform Act 2012. The baseline also includes the planned rise in State Pension age to 67 between 2026 and 2028.

65. We consider how outcomes change under the single tier, assuming a starting level of £144 per week and where single tier is uprated by the triple lock. As the final value of these variables will be set by the Government of the day, analysis of the proportions with notionally higher or lower outcomes from the single tier under different starting levels, economic assumptions and uprating assumptions are given in Annex B. The analysis in this chapter is mainly based on the Department's pension simulation model 'Pensim2', the details of which can be found in Annex A.

66. The analysis in this chapter only includes people who reach State Pension age after any reform has been implemented and only includes pensioners in Great Britain[19]. Amounts being received by current pensioners are not affected by the reform. Pensioners living overseas may receive less state pension than they would have done under the current system because of the introduction of a 7-10 year minimum qualifying years rule (with a final decision to be taken closer to implementation) and might experience a notional change in outcome due to other changes as a result of the implementation of the single tier. This is discussed in Section 3.3.

67. As contributions under the current system will be recognised by applying similar rules to the current system, subject to the minimum qualifying requirements no person reaching State Pension age under the single tier will get a lower state pension than they could have become entitled to based on their own pre-commencement contributions under the current system's rules, so all impacts are **notional**. This is as outcomes under the current system for individuals will remain uncertain until near the point of retirement (e.g. due to the impact of their future earnings on additional State Pension - hence we have to model these outcomes), and also as future changes to outcomes are assessed on the assumption that we were to maintain a pension system that remained unchanged over the coming decades.

68. Notional impacts also arise because **total net income** received from the state and National Insurance paid under the single tier might be different from income that would notionally have been received under the current system. For example, some people may pay higher National Insurance contributions due to the end of contracting out, yet they may also receive more state pension than they would have otherwise accrued. In this chapter, we consider the impact on pensioner incomes. Changes to National Insurance are discussed in chapters 5 and 6.

69. The transition from the old system to the new system means that different cohorts of single-tier pensioners will be affected in different ways.

- Older individuals are more likely to be (or have been) in a Defined Benefit scheme and are therefore more likely to be affected by the ending of contracting out. However under single tier they will also have an opportunity to gain additional entitlement to state pension up to the full amount of the single-tier pension.
- Younger people (particularly median and higher earners) will be less able to become entitled to large notional amounts of additional State Pension, which will be protected for those older people that have already accrued entitlement. However, as they will retire in the later years of single tier, they will have had the chance to build up a significant private pension income by this point, due to the operation of automatic enrolment.
- The majority of people reaching state pension age in the next 40 years and after single tier is implemented will have a higher pension income over the course of their retirement as a result of the reforms.

[19] Pensim2 only models Great Britain but under the 'parity principle' we have anticipated that NI will introduce equivalent measures.

3.1 Difference in outcomes under single tier compared with the current system

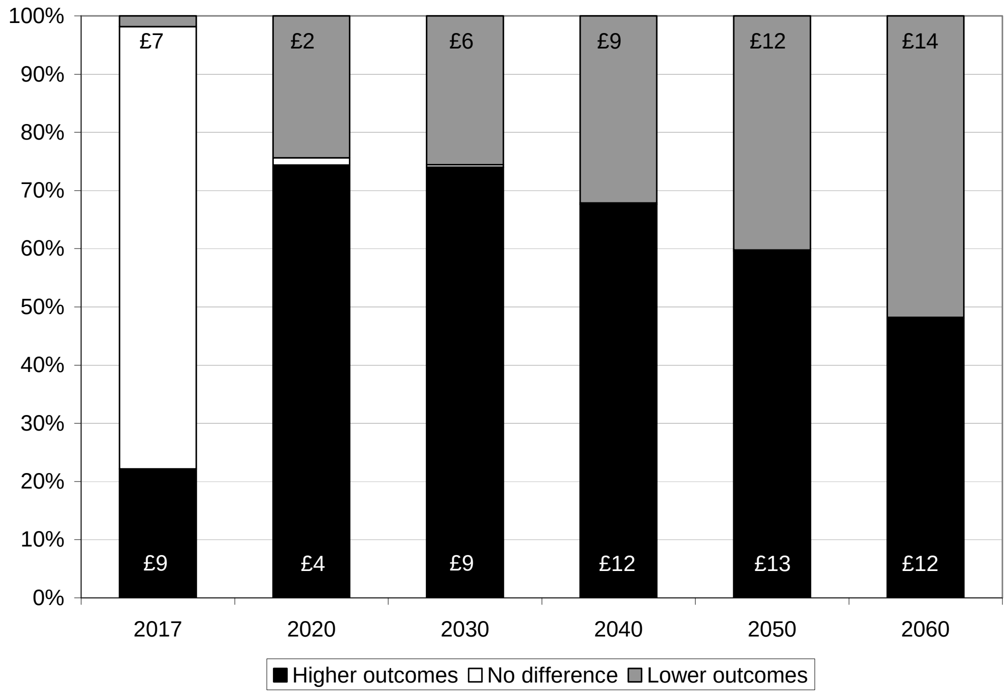
70. This section compares outcomes under single tier to the baseline of the current system rolled forward. As is the case throughout this impact assessment, the impacts presented are notional. We first look at state pension outcomes for individuals, before considering overall state support at benefit unit (household) level. This is as state pension is an individual award, whereas income related benefits are assessed and awarded at household level.

71. In the charts the 'proportion with changed notional outcomes' represents both a 5p increase and a £10 increase equally as one person 'benefiting'. For this reason we also display the median changes to show the size of the average impact.

a) Impact on state pension outcomes (individuals)

72. Chart 3.1 shows that within a few years of implementation, single-tier reform leads to a greater proportion of people with a higher state pension than under the baseline of the current system. For each year the chart shows all pensioners who reach State Pension age after the implementation of the single-tier pension.

Chart 3.1: Proportion of pensioners with changed notional state pension outcomes under single tier compared to baseline; median weekly change for those with higher or lower notional outcomes (in 2012/13 earnings terms)



73. In 2017, the assumed first year of reform, most people receive the same level of state pension income as they would have had if the current system continued. Around 20 per cent of people will have a better outcome due to the 'better of' calculation.

b) Impact on overall state support for pensioners (households)

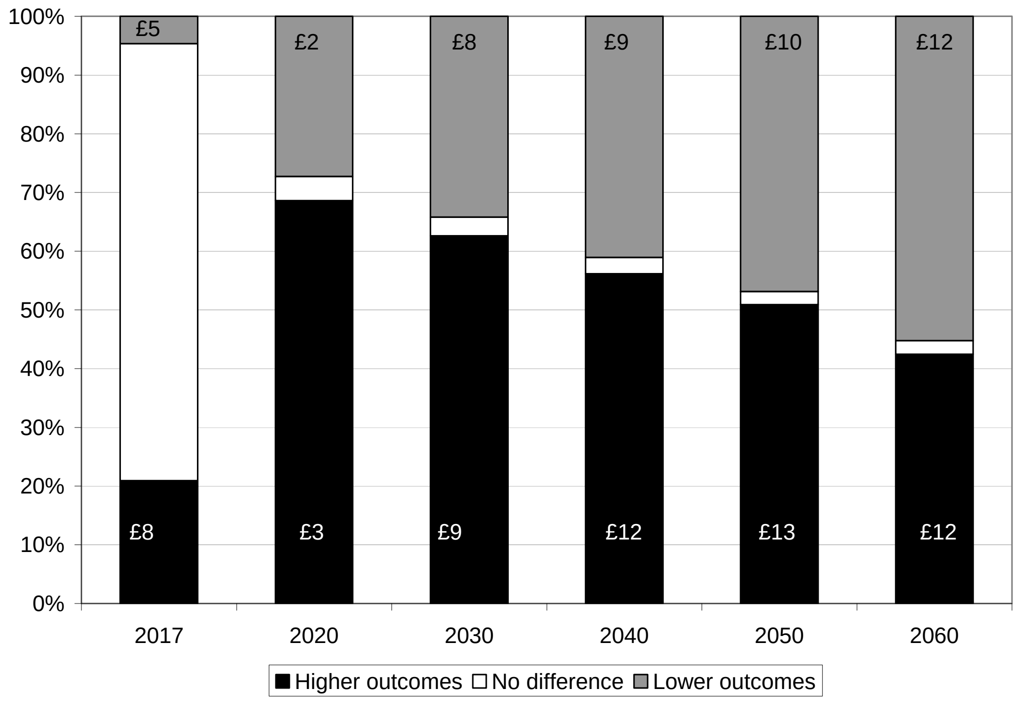
74. We now widen the picture to include the impact of means-tested benefits (MTBs). As eligibility for means-tested benefits is assessed at benefit unit level, this means that the unit of analysis is now households instead of individuals as above[20].

75. Chart 3.2 below shows that a majority of households reaching State Pension age after implementation have notionally higher outcomes than in the baseline of the current system rolled forwards, until the mid 2050s. Some households see a notionally reduced income from the state as a result of the removal of Savings Credit, but many of these gain from other aspects of the reform package.

[20] 'Benefit unit' is a standard DWP term and can be defined as a single adult or a married or cohabiting couple and any dependent children; since January 2006 same-sex partners (civil partners or cohabitees) have been included in the same benefit unit (FRS 2010/11)

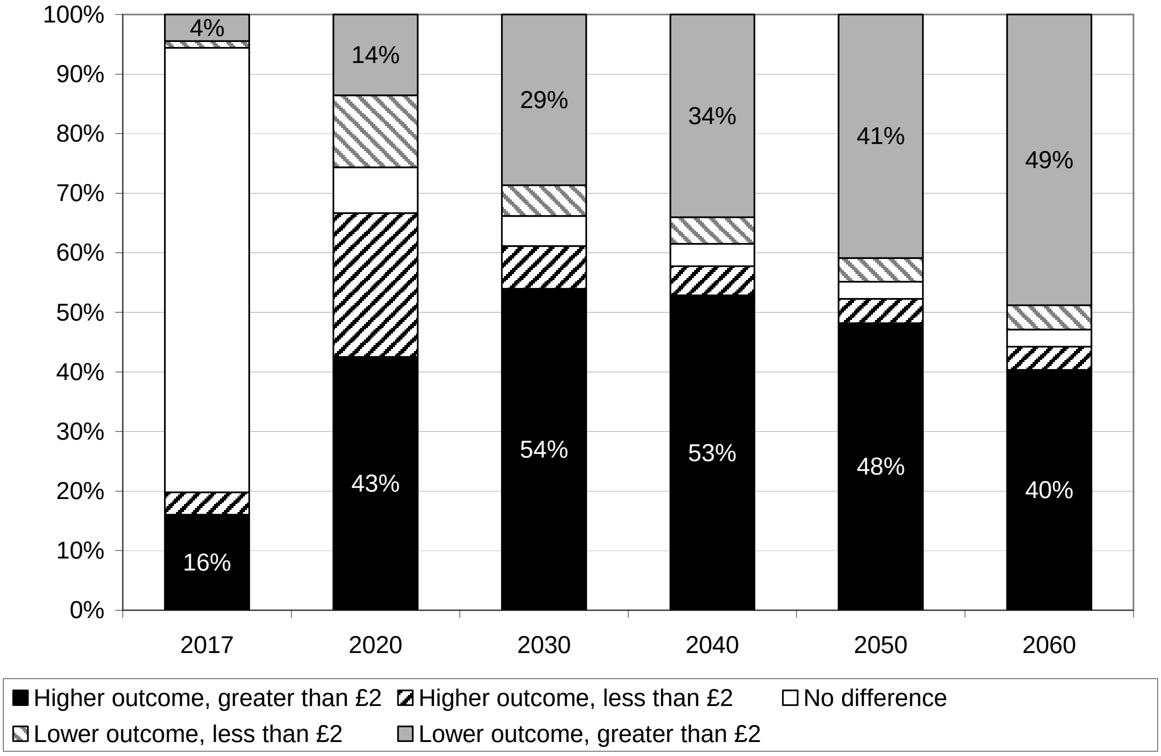
76. The median changes to outcomes are relatively modest, for example a £12 per week higher outcome in 2040 represents a median 4 per cent rise in household income, and a reduced outcome of £9 per week in 2040 is a 3 per cent fall.

Chart 3.2: Proportion of benefit units with changed notional outcomes (State Pension + MTBs) due to single-tier reform compared to current baseline, median weekly change for those with higher or lower notional outcomes (2012/13 earnings terms)



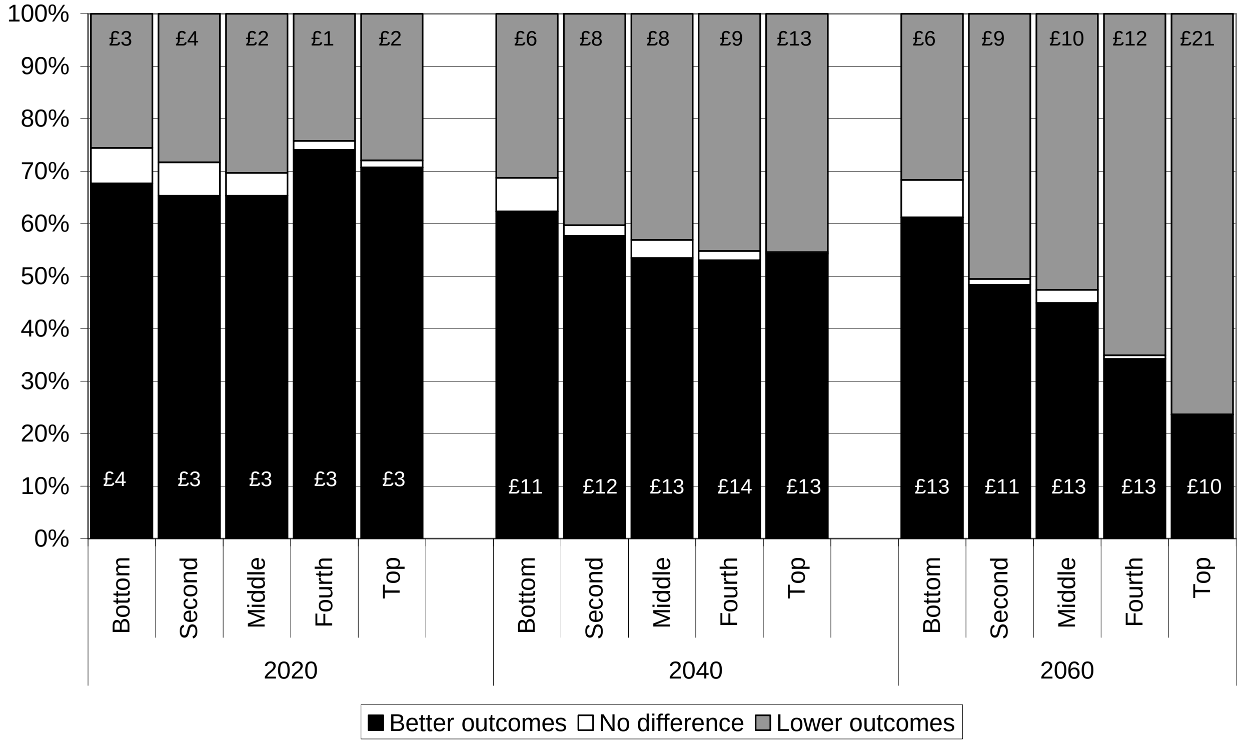
77. Chart 3.3 below shows additional detail on the size of impact on those with higher and lower outcomes.

Chart 3.3: Proportion of benefit units with changed notional outcomes (net incomes) due to single-tier reform compared to current baseline, broken down to show impacts of more than or less than £2 per week, 2012/13 earnings terms.



78. Chart 3.4 below shows the proportion of households with notionally changed outcomes by income quintile: the reform has a progressive impact in later years. Section 4.2 shows how single-tier reform also supports lower income quintiles by significantly increasing the proportion of any pension savings they keep.

Chart 3.4: Proportion of benefit units with changed notional outcomes (net incomes) due to single-tier reform compared to baseline, by income quintile. Median weekly change (2012/13 earnings terms)



3.2 Impact of reform on outcomes for women

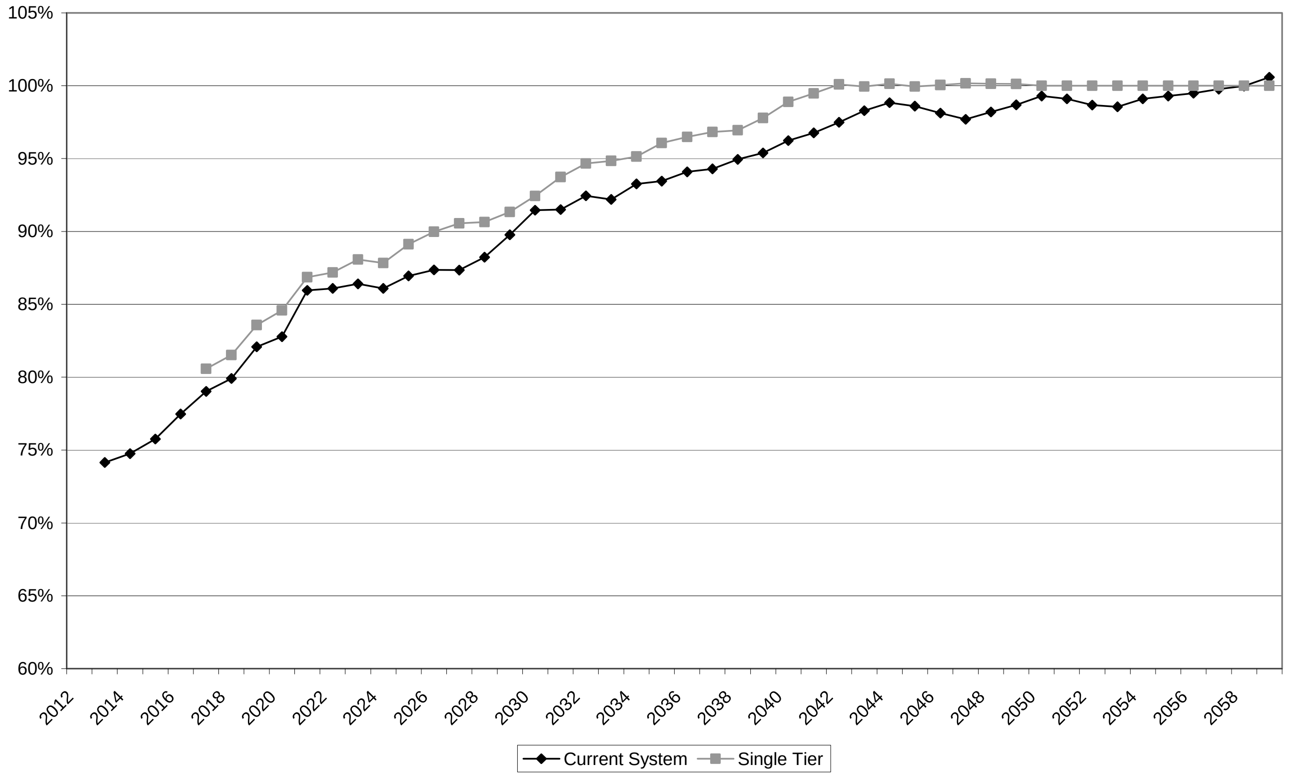
79. Historically, women have tended to get lower outcomes from the state pension system. While the 2007 Pensions Act delivered improvements for women, they still lag behind men in overall state pension outcomes. Despite reforms, the proportion of women in Great Britain qualifying for a full basic State Pension is not expected to catch up with men until around 2020, and it is expected to take more than a further 30 years for State Second Pension outcomes to equalise (according to DWP forecasts).

80. The main reason for this inequality is that women are more likely to take time out of the labour market or work part-time, and earn less than their male counterparts. Since 2002 those with caring responsibilities have been able to earn credits towards the State Second Pension, but it will be some time before their outcomes catch up with men.

81. The single tier will go some way to reducing the current gender inequality in the state pension outcomes of men and women by providing a single flat-rate pension for all those reaching State Pension age with 35 years of National Insurance contributions (or credits). Since women are more likely to take time out of the labour market, or to work part-time, they are more likely to benefit compared to men.

82. Single tier brings forward by over a decade the point at which women get equivalent state pension outcomes to men, as illustrated in Chart 3.5. As there is a period of transition from the old system, inequalities take time to be fully removed.

Chart 3.5: Median female gross state pension income (excluding MTBs) as a proportion of median male gross state pension income, for those reaching State Pension age in each year, under current system and single tier



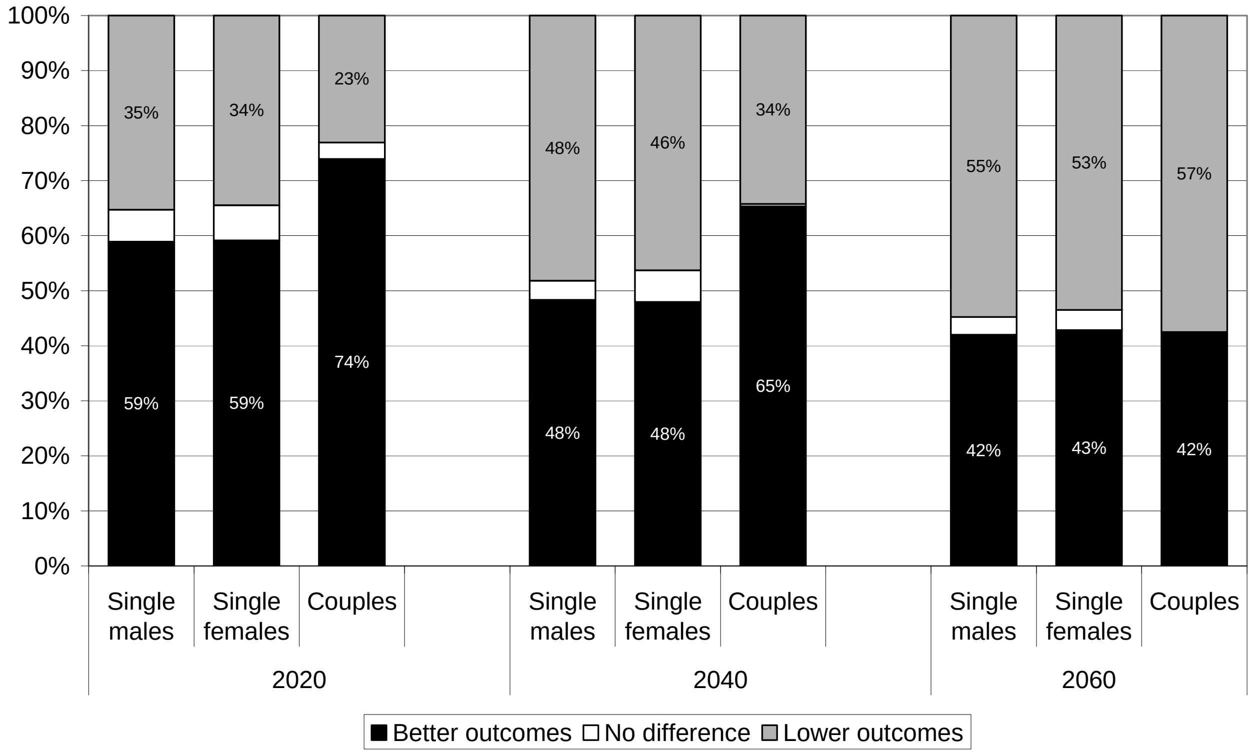
83. The gap closes due to the end of the earnings-related State Second Pension, and also because a new single-tier year is worth more than a current basic State Pension year. As a consequence, the median female state pension is projected to align with the male median state pension around fifteen years earlier under single tier, compared with the current system (in 2042 compared to 2057).

84. The main reason that notional outcomes for women improve more quickly in the early years is because the single-tier valuation most benefits lower paid and part time workers, who are predominantly women. In 2017, almost half of women reaching State Pension age would get a notionally higher state pension as a result of the single-tier valuation, with around 1 in 7 men also benefiting from this element of the reform. This mechanism results in the gap between average pension outcomes for men and women closing more quickly for early cohorts.

85. As a result of the single-tier valuation, around 750,000 women who reach State Pension age in the first ten years after the single-tier pension is implemented will receive an average of £9 per week more in state pension (in 2012/13 prices). As a consequence, reliance on means-tested benefits to provide a minimum level of income would fall.

86. To analyse the proportion of men and women who have notionally increased or lower outcomes from the reform overall, the rest of the analysis below looks at benefit units as means-tested benefit entitlement is assessed for benefit units (households) rather than individuals. Furthermore, total household pension income is often a more relevant indicator of whether people benefit overall from the reform. Chart 3.6 below looks at the overall impact by benefit unit type, when all elements of the reform are included (changes to state pensions and means-tested benefits).

Chart 3.6: Notional impacts on the cumulative stock of post 2017 pensioners, by gender



87. In 2020 and 2040 couples are more likely to get a notionally increased income from the reform than either single men or single women. This is due to receipt of means-tested benefits: couples are less likely to receive means-tested benefits and are therefore less likely to get a reduced notional income as a result of the removal of Savings Credit.

88. Disabled people's eligibility for means-tested benefits is less affected by changes, since those with a severe disability who are in receipt of a qualifying disability benefit may still be able to receive Guarantee Credit which will also passport them to full Housing Benefit and Council Tax Benefit. This is because the minimum income guarantee is higher for those in receipt of a qualifying disability benefit[21].

3.3 Individual outcomes not fully modelled in the impact assessment

89. Pensim2 is not able to fully model three aspects of the single-tier reform package: the introduction of a minimum qualifying period ('De Minimis'), changes to deferral policy and the impact of the reforms on overseas pensioners. In order that these aspects of policy are not left out of the assessment of the costs or impacts of the single-tier pension, the Department has estimated these impacts separately (although it is still not possible to estimate the distributional impact on overseas pensioners). This section outlines the main results from this analysis (Further information about the methodology used is found in Annex A).

90. The main impacts estimated outside of the main modelling are:

    a. <u>De minimis</u>: there will be a 7-10 year qualifying period for the single-tier pension, (which is modelled as a 10 year condition in this assessment, with a final decision to be taken closer to implementation). In Pensim2 we are unable to fully model the impact of this policy on the sub-set of pensioners that will migrate internationally. However, our modelling suggests that only pensioners that migrated from GB early in their working lives to live in 'frozen rate' countries will be affected by the *de minimis* (90 per cent of these pensioners live in Australia, Canada, New Zealand or South Africa). Individuals that settle into GB later in life may not lose out overall as a result of the minimum qualifying condition, for example if they claim Guarantee Credit.

[21] The current system of means-tested support for pensioners is due to change in April 2013 with the localisation of council tax support. The implementation of the Welfare Reform Act 2012 will also bring changes to means-tested support for pensioners (from 2014 on latest planning assumptions).

- Numbers affected and savings in the early years of the policy are expected to be relatively low (rising from zero to around 35,000 people in 2020).
- In 2040 it is estimated that the *de minimis* rule could affect around 380,000 people with a GB state pension living overseas.
- The expected savings from the *de minimis* condition in 2040 are around £600m in 2012/13 prices.

b. Deferrals: the ability to take a lump sum will be ended, and the rate of increment for deferral will be set closer to implementation and so for illustrative purposes, this paper assumes a rate of 1 per cent for every ten weeks' deferral. We expect that between 10,000 and 25,000 people will be affected each year by the end of the ability to take a lump sum and the change to the rate of return for deferrals. We estimate this component to save around £150m in 2020, rising to £300m by 2030 (in 2012/13 prices).

91. It is important for the reader to note that, while both policies are included in the exchequer impact presented in Chapter 6, one should not combine these estimates with the numbers set out elsewhere in the report, for example as someone notionally affected by changes to deferrals or *de minimis* rules may get a higher outcome overall from the reform, or might have a partner who has a higher outcome after reform.

Chapter 4) Single tier: changes to means-tested benefits

4.1 Reliance on means-tested benefits

92. This chapter looks at the effect the single-tier package has on means-tested benefits for pensioners. As with Chapter 3, most of the analysis in this chapter is focused on the population reaching State Pension age after the implementation of the single tier (referred to as the single-tier population). Analysis of means-tested benefits is presented for benefit units (households) rather than individuals, as this is the basis on which eligibility is assessed.

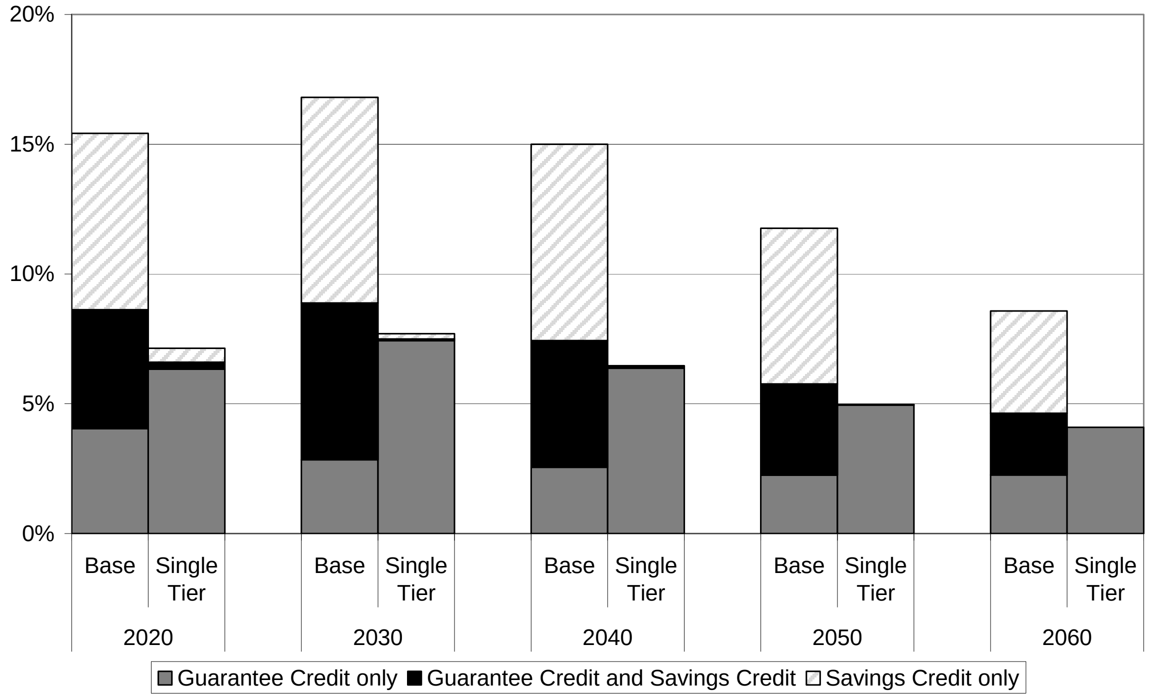
93. The current system of means-tested support for pensioners will remain until April 2013 but is due to change with localisation of council tax support from April 2013 and the implementation of the Welfare Reform Act 2012. From 2013, some pensioners with a working age partner will claim Universal Credit rather than Pension Credit or Housing Benefit. The baseline for this impact assessment includes these reforms. For simplicity, the small numbers of possible Universal Credit claims are treated as being eligible to Guarantee Credit (and Housing Benefit where there is an element of support with rent). The analysis assumes that in future localised council tax support for pensioners will be similar to the current Council Tax Benefit system.

94. This chapter shows that the proposed single-tier reforms lead to a reduction in the proportion of people eligible for Pension Credit, mainly due to the removal of the Savings Credit in the context of an increased basic State Pension for most people. The single tier also reduces eligibility for Guarantee Credit and Council Tax Benefit but has little effect on Housing Benefit. By 2040, overall eligibility for means-tested benefits falls by around 3 percentage points, or around 400,000 benefit units, as a result of the single-tier reforms.

a) Reliance on Pension Credit within single tier

95. Single tier leads to a reduction in reliance on Pension Credit for two reasons. A higher state pension means that fewer pensioners require Guarantee Credit to top up their income under the single tier, and Savings Credit is no longer required to ensure that people benefit from additional saving. The scale of the expected reduction in eligibility is shown in Chart 4.1.

Chart 4.1: Eligibility for Pension Credit from 2020 to 2060 amongst population reaching State Pension age after implementation of single tier



“Base” represents the flow of pensioners under the current system rolled forward, so is not comparable to figures elsewhere for entitlement that include pensioners reaching State Pension age before 2017. Guarantee Credit figures include small numbers entitled to Universal Credit

96. Under the current system, eligibility for Pension Credit (or Universal Credit where one member of a couple reaches State Pension age post 2017) amongst the single-tier population is expected to peak at between 15 and 20 per cent in the mid 2020s and fall to around 10 per cent by 2060. Under the single tier, eligibility for Pension Credit is approximately halved immediately, and ultimately falls to around 5 per cent by 2060. Further explanation of the factors driving change can be found later.

97. Ending Savings Credit is the main driver of the reduction in the number of people qualifying for Pension Credit, although there is also a reduction in the proportion of pensioners eligible for Guarantee Credit. The reduction in the numbers within scope of the Guarantee Credit is the result of most pensioners under the single tier having a state pension above the level of the 'standard minimum guarantee'.

98. There are a number of reasons why a small number of pensioners remain eligible for Pension Credit under single tier, despite the single-tier pension being above the 'standard minimum guarantee':

- Have less than 35 qualifying years and so not have a full single-tier pension.
- Pensioners may receive an additional amount in Pension Credit, such as the Severe Disability Additional Amount[22].
- The Pension Credit caseload will also include some couples still receiving Savings Credit because one member retired before it was removed.
- It will also include some other couples who may have full single-tier entitlement, yet are still entitled to Guarantee Credit or Universal Credit during the period when only one member has reached State Pension age and the other is still below State Pension age and has little or no income.

99. By 2060 the most common reasons for entitlement to Pension Credit will be having less than 35 qualifying years or being entitled to an additional amount. Entitlement to an additional amount becomes more important in explaining the continued scope of Pension Credit in later years. This change is due to the ageing of the single-tier population: as the single-tier population ages, there are greater numbers of older pensioners who are more likely to be entitled to the Severe Disability Additional Amount.

b) Support with housing costs and council tax

100. Housing Benefit (HB) provides means-tested support for households on a low income needing help with their rent and Council Tax Benefit (CTB) provides means-tested support for council tax bills. Entitlement to HB and CTB amongst the single-tier population is shown in Table 4.1, with and without the single tier. Entitlement to HB is not expected to change significantly. However, these estimates should be treated with caution as responsibility for council tax support will be localised from 2013 and therefore the scope of support may change.

Table 4.1: Reliance on Housing Benefit and Council Tax Benefit (amongst the population reaching State Pension age after implementation of single tier)

		2020	2030	2040	2050	2060
Housing Benefit	Base	12%	16%	15%	12%	10%
	Single tier	12%	15%	14%	12%	10%
Council Tax Benefit	Base	35%	37%	32%	28%	23%
	Single tier	34%	34%	30%	26%	23%

Source: Pensim2; numbers rounded to the nearest 1 per cent. Figures shown are based upon entitlement.

101. Housing Benefit and Council Tax Benefit receipt is affected by the implementation of the single tier because an increase in state pension income means that individuals are less likely to need help with housing costs and because the removal of Savings Credit reduces the starting point above which income is tapered in the calculation of HB and CTB. Despite the average HB award falling, these changes have a limited effect on the overall number of people claiming HB. This is because it takes a lot of additional income to be taken out of HB entitlement altogether, and we are proposing

[22] Additional amounts are added to Guarantee Credit to help with the costs of caring, disability and additional housing costs.

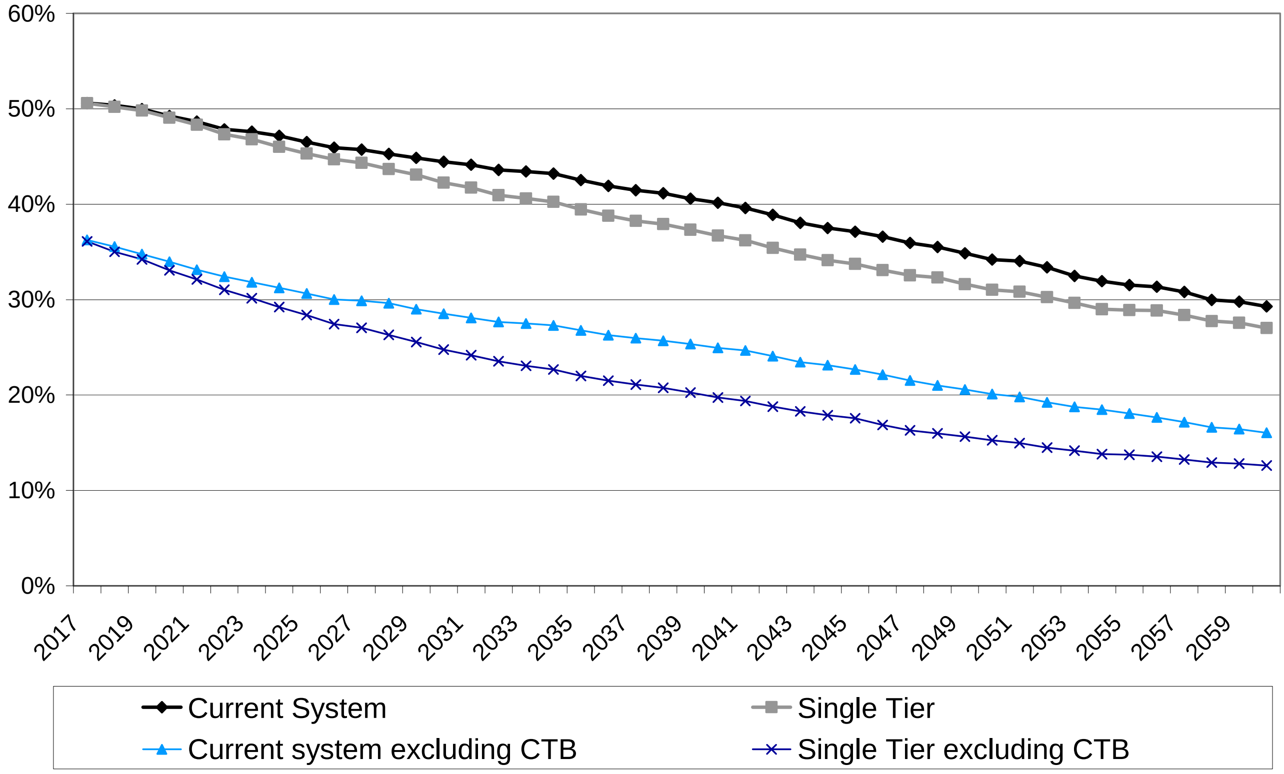
to protect the outcomes of those who would otherwise lose rent support for people reaching State Pension age up until 2022. So even where people may cease to receive Savings Credit (whether through abolition or higher state pension income) some entitlement to HB/CTB may remain.

102. By 2040 the average weekly entitlement to Housing Benefit is notionally around £7 lower than in the current system, and notionally around £2 lower for Council Tax Benefit. However, many HB/CTB recipients will see an increase in their state pension award and so may be better off overall.

c) Overall scope of means-tested benefits

103. Chart 4.2 below shows that overall eligibility for means-tested benefits is expected to fall over time for pensioners. This reflects growth in pensioner incomes associated with the triple lock, automatic enrolment, female labour market participation and previous state pension reforms. It is also partly driven by the reduced scope of Savings Credit under current uprating policy and by the introduction of Universal Credit. In the early years the impact is small since changes only apply to new pensioners. In the long-term the impact of the reforms is to reduce eligibility by 3 percentage points, or around 400,000 pensioner benefit units, by 2040. The bottom two series on Chart 4.2 show eligibility excluding Council Tax Benefit, which will be locally administered from 2013.

Chart 4.2: Eligibility for any means-tested benefit (all pensioners), with and without Council Tax Benefit



104. Pensioners from ethnic minority groups are more likely to draw part of their income from means-tested benefits compared to white pensioners. For example, the latest Pensioners' Income Series shows that between 2008 and 2011 53 per cent per cent of black or black British pensioners drew part of their income from means-tested benefits compared with 30 per cent per cent of white pensioners[23]. Research undertaken to understand why DWP's Pensions Service consistently get poorer feedback from their ethnic minority customers shows that ethnic minority customers have additional difficulties in understanding the benefits system, and that they may be disproportionately impacted by complexity[24]. We may therefore expect some ethnic minority people to benefit from the increased simplicity and reduced means testing that the single-tier system offers, either in terms of their take-up of benefits or satisfaction with the process.

[23] The Pensioners' Income Series 2010-11. Department for Work and Pensions.
[24] Ethnic minority customers of the Pensions, Disability and Carers Service: An evidence synthesis.' DWP Research Report. 684. (2010)

4.2 Means-tested benefits and rewards for saving

105. Means-tested benefits can reduce the reward from saving or working, since income from saving and working is taken into account when calculating entitlement. Marginal Deduction Rates (MDRs) give a measure of the effect that means-tested benefits have on the reward from saving or earning. The MDR is the proportion of each additional £1 of income (after tax) that a person loses once their means-tested benefit award has been calculated. For example, if a person is on a 100 per cent MDR then every £1 of private income (including state pension) reduces their benefit income by £1 and they see no additional reward for saving or working. The lower the MDR the higher the potential rewards from saving or working.

106. The removal of Savings Credit under single tier will reduce the number of different deduction rates that pensioners face at different income levels and so reduces complexity. This will simplify the pension system and reduce the interaction that any additional income may have with means-tested benefits for those with modest incomes, which will enable these pensioners to see greater benefits from saving or working past State Pension age. Despite this positive feature, it is possible that overall incomes for some benefit units may not be notionally better overall (if their specific circumstances mean that the benefit from the reduced MDR is offset by a change from another aspect of the reform).

107. Charts 4.3 and 4.4 show how the single-tier reforms affect MDRs for pensioners reaching State Pension age after 2017. The proportion facing a marginal deduction rate of 20 per cent or less would rise significantly, particularly for the poorest single pensioners, so that they can keep more of any additional saving or earnings. The single tier has less impact on the MDRs of couples since they are less likely to interact with means-tested benefits and as a consequence are not as affected by high MDRs.

Chart 4.3: Proportion of single-tier pensioners with Marginal Deduction Rate at or below 20 per cent in 2020

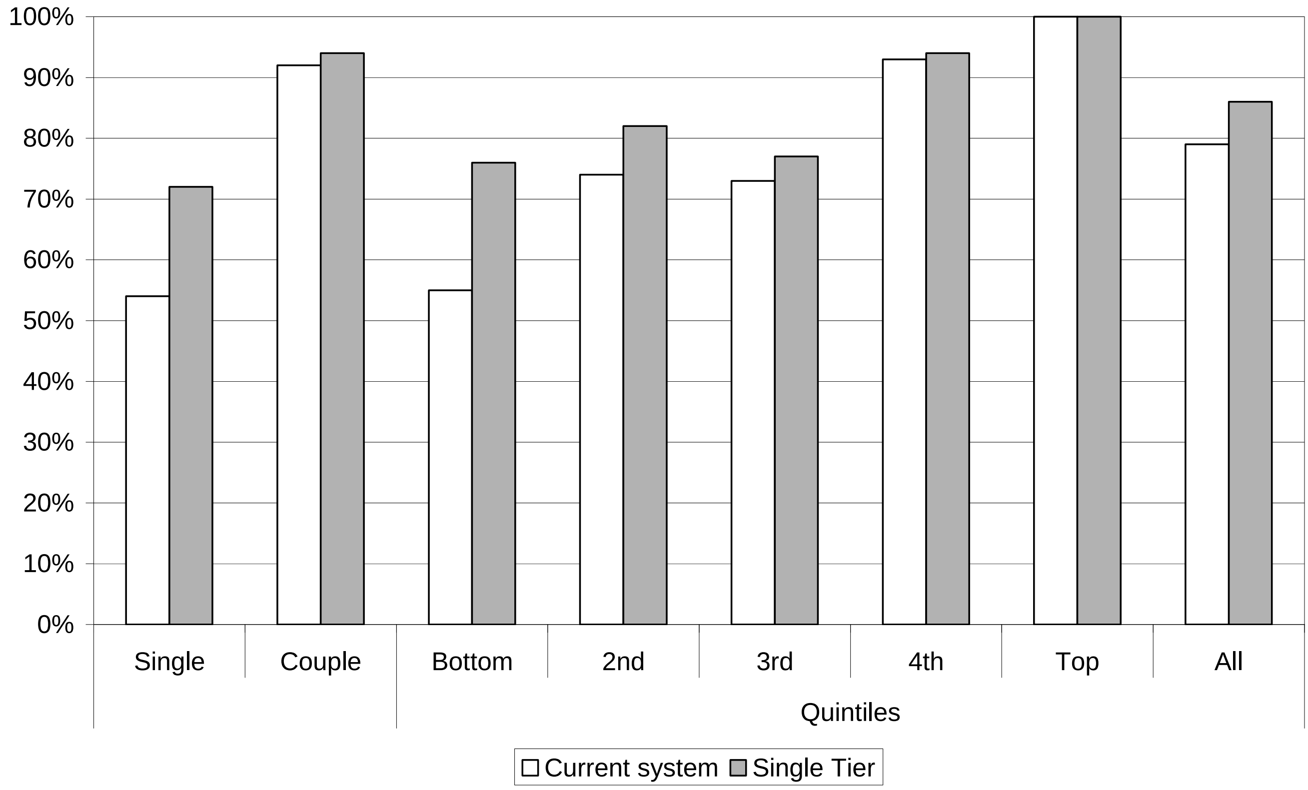
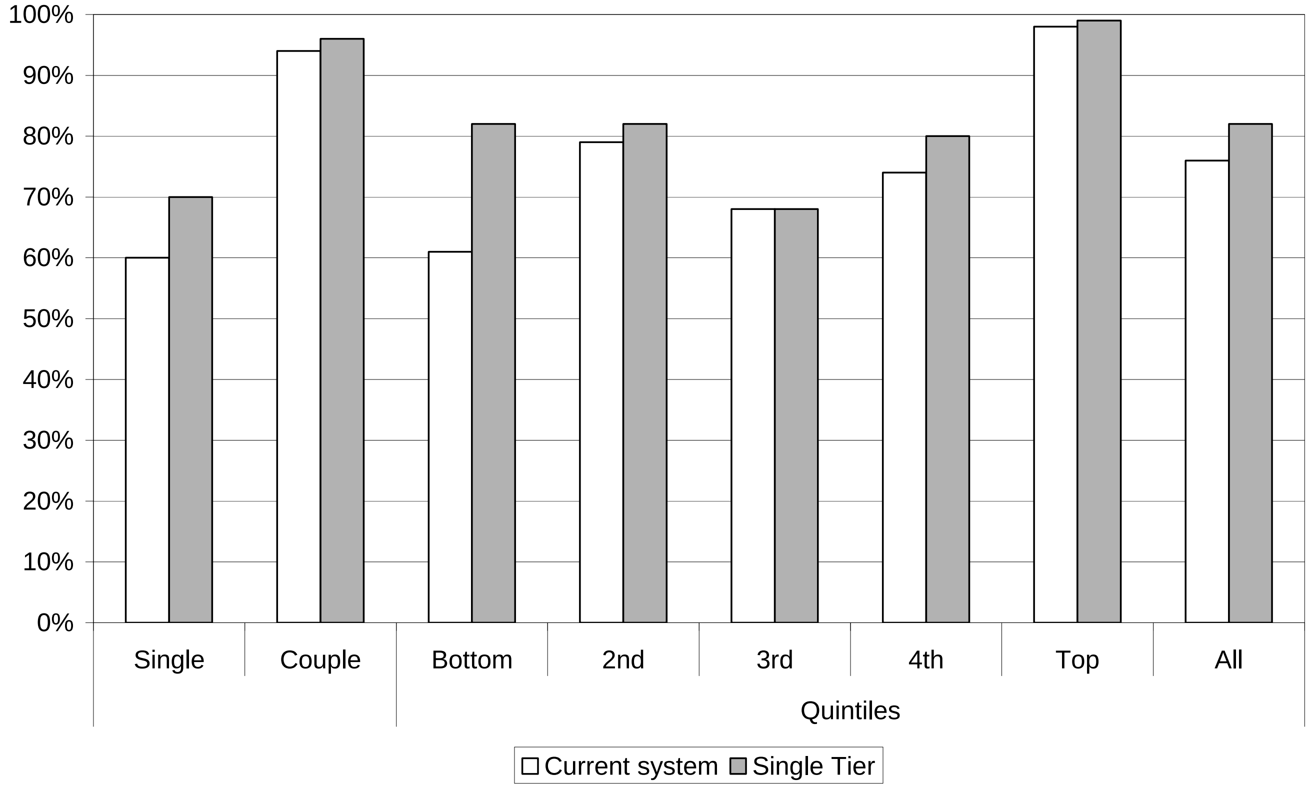


Chart 4.4: Proportion of single-tier pensioners with Marginal Deduction Rate at or below 20 per cent in 2040



4.3 Impact on the take-up of means-tested benefits

108. Until this point the analysis of the scope of means-tested benefits has focused on how the proposed reforms change entitlement. However, not all pensioners will take up benefits to which they are entitled. Savings Credit has a low take-up rate, estimated to be between 43 per cent and 48 per cent in 2009/10[25]. As the single–tier pension will result in many people automatically getting a pension set above the level of the Guarantee Credit threshold without having to claim, it may help to alleviate poverty for some individuals who would otherwise not have claimed a means-tested top-up.

109. Take up of Guarantee Credit, Housing Benefit and Council Tax Benefit is not expected to change significantly because these benefits are not changing with the single tier. In the baseline it is assumed that the reforms introduced in the Welfare Reform Act 2012 will mean that anybody who would claim one of Pension Credit or Housing Benefit under today's system will claim both under the reformed system. This takes no account of the decisions that may be made following localisation of Council Tax Benefit.

4.4 Passported Benefits

110. Receipt of Pension Credit can 'passport' pensioners to automatic entitlement to a number of other benefits. If pensioners are no longer eligible for Pension Credit as a result of the single tier then they could lose eligibility to some of these. Support will be retained for a period of five years for those people who may have received more support for housing costs by virtue of their eligibility for Savings Credit.

111. Receipt of Guarantee Credit passports pensioners to the full amount of Housing Benefit and Council Tax Benefit, if the pensioner is eligible for these benefits. There is little reduction in Guarantee Credit eligibility resulting from the single tier (less than 2 percentage points), so this has a limited impact on the proportion of pensioners that are eligible to be 'passported' to the full amount of HB/CTB benefit. Those who have no income other than the single-tier pension will often

[25] DWP, February 2012, *Income Related Benefits: Estimates of Take-up in 2009/10.*

still be entitled to an award. Again it should be remembered that responsibility for Council Tax Benefit will be localised from April 2013.

112. Receipt of Pension Credit can lead to qualification to certain other benefits. Most of these are linked to receipt of Guarantee Credit and so pensioners no longer entitled to Guarantee Credit as a result of the single tier may also lose eligibility to these other benefits (However, there is only a small impact of single tier on entitlement to Guarantee Credit).

- **Health benefits:** receipt of Guarantee Credit passports claimants to free dental treatment, and to vouchers for glasses, wigs and fabric support (However, free prescriptions and sight tests are available to all individuals over the age of 60).
- **Free school meals:** recipients of Guarantee Credit with dependent children are eligible for free school meals. However, this is estimated to affect less than 1 per cent of single-tier recipients (before the removal of Savings Credit).
- **Social Fund Payment:** Pension Credit acts as a passport to certain elements of the Social Fund. Guarantee Credit and Savings Credit both act as a passport to maternity grants, funeral expense payments, cold weather payments and budgeting loans.
- **Local benefits**: further ‘passports’ may also be available from the local authority, such as grants to help with home insulation; or from education institutions. However, rules governing eligibility for these schemes will vary for different local authorities/education institutions.

Chapter 5) Single tier: ending Defined Benefit contracting out – impact on individuals, scheme sponsors and pension industry

113. Under the single-tier pension, the State Second Pension – the earnings-related element of state provision – will close. This means that the system whereby Defined Benefit (DB) pension schemes can contract out of the State Second Pension will also come to an end.

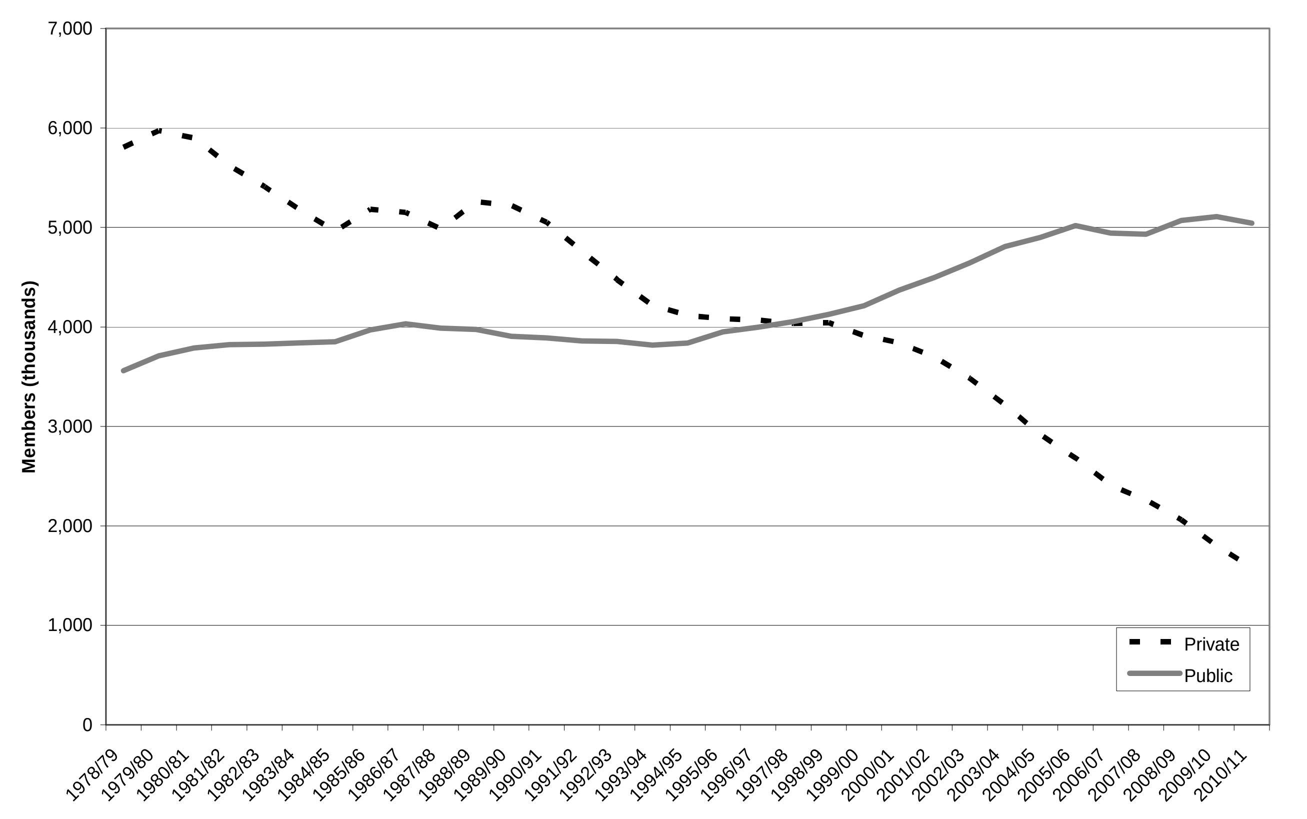
114. Ending contracting out is a key consequence of a single-tier pension system and will contribute to simplifying the state pension system. It will remove the connection between state and private pension schemes that can cause misunderstanding and confusion for individuals, difficulty in providing accurate estimates of state pension and that adds to the administrative burdens for both pension schemes and HMRC. It will harmonise National Insurance rates paid by both employers and employees and ensure people are able to claim the same amount of state pension.

115. Note that ***the costs and benefits in this chapter relate only to the ending of DB contracting out***. No interactions with the rest of the state pension reform are taken account of. However, this does not matter when considering the impacts on sponsoring employers of DB schemes, as the only impact of the reform on them comes through the ending of contracting out.

5.1 Contracting-out demographics

116. Chart 5.1 below shows the number of individuals in contracted-out Defined Benefit (DB) schemes since 1978, split by whether they are in the public or private sector.

Chart 5.1: Contracted-out DB scheme membership by sector, 1978 – present



Source: Second Tier Pension Provision 2010/11 – DWP statistics

117. The chart clearly shows that membership of private sector DB contracted-out schemes has been in decline since 1978 – this simply reflects the wider decline in DB schemes in the private sector[26]. Meanwhile, membership of contracted-out DB schemes in the public sector has grown steadily, in line with general employment growth in the public sector.

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[26] See for example '*Pensions: Challenges and Choices, -The First Report of the Pensions Commission*', 2004.

118. According to the 2011 Occupational Pension Schemes Survey[27], there are currently 1.6 million contracted-out active[28] members of private sector DB schemes and 5.3 million active members of contracted-out DB schemes in the public sector.

119. Table 5.1 below shows how active membership is distributed by scheme size. It shows that unsurprisingly, most members are in the biggest schemes. It also shows the number of contracted-out DB *schemes* in the public and private sectors in 2010. Together with the active membership data this shows that while the public sector will be more affected in terms of membership, the number of different schemes involved is much larger in the private sector.

Table 5.1: Number of active members of contracted-out DB schemes, and number of schemes, by size of membership and whether in public or private sector, 2011

Membership size	Membership of DB schemes (millions)		Number of DB schemes	
	Private[1]	Public[2]	Private[3]	Public[4]
5,000+	1.2	5.3	140	132
1,000 to 4,999	0.2	0.1	450	69
100 to 999	0.1	0	1,600	63
12 to 99	0	0	..	37
2 to 11	0	0	..	30
Total	**1.6**	**5.3**	**3,290**	**331**

Source: OPSS data 2011

5.2 Impact on individuals

120. Under DB contracting out, the individual scheme member receives a rebate of National Insurance contributions of 1.4 per cent of the relevant band of earnings. The precise increase in National Insurance will vary across individuals and will depend on their level of earnings in each year.

121. DWP does not forecast active membership of DB schemes in the public and private sectors. However, the National Insurance forecasts used to estimate costs and benefits of ending DB contracting out do contain some implicit assumptions about future proportions of DB contracted-out membership in both sectors. These assumptions have been provided by the Government Actuary's Department and are explained in more detail in Annex A.

122. When the single-tier pension is implemented and contracting out ends, all employees who were members of a contracted-out scheme immediately before implementation will cease to receive the 'contracted-out rebate' and will start to pay full National Insurance contributions (NICs). This will mean an increase in the rate of NICs that they pay equivalent to 1.4 per cent of their earnings (between the LEL and the UAP[29]), bringing them into line with the rate of National Insurance that is paid by other employees. In return, contracted-out employees will be brought fully back into the state pension.

123. In addition, DB scheme sponsors will cease to receive their 3.4 per cent rebate. DWP has sought the views of sponsoring employers in the private sector affected by the ending of DB contracting out on how they would react. Many respondents to our consultation indicated that employers thought it unreasonable that they had to bear the cost of paying higher National Insurance contributions whilst maintaining the same scheme benefits. They therefore wished to reduce the level to which they must fund their scheme by the same amount as the increase in National Insurance contributions, reflecting the fact that employees would be brought back fully into the state pension system when contracting out ends. This could be done by reducing future pension benefits or by increasing employee contribution rates to their pension schemes.

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[27] Occupational Pension Schemes Annual Report 2011, ONS.

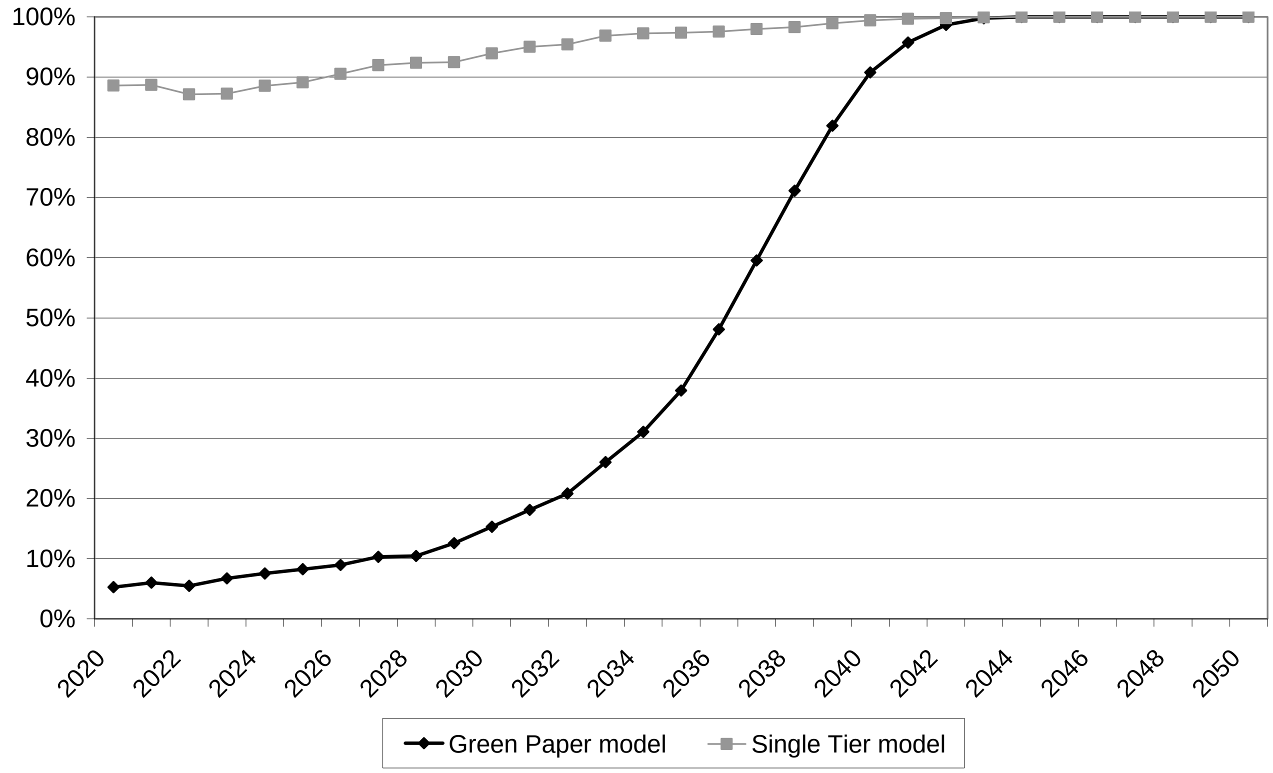
[28] Active members are those that continue to accrue new pension rights in a scheme.

[29] Lower Earnings Limit and Upper Accrual Point

124. On the basis of the employer consultation, and as the Government therefore proposes to give employers limited powers to change scheme rules for this purpose without trustee consent, we have therefore assumed that the cost is passed on to employees in the private sector immediately and in full by increasing employee contribution rates to their pension schemes. Since this policy is being announced a number of years in advance of implementation, it is not unreasonable to assume that scheme re-designs can be completed before the ending of DB contracting out actually happens.

125. As Chart 5.2 below shows, under the single-tier pension the vast majority of those who will pay a higher rate of National Insurance as a result of the ending of contracting out will be able get extra state pension for years worked or credited after 2017, up to the full amount of single-tier pension.

Chart 5.2: Proportion of those who pay higher NI contributions who increase state pension entitlement after 2017, by year they reach State Pension age



Note: 5 year moving average

126. Under single tier, around 90 per cent of people who start to pay higher National Insurance contributions (NICs) from implementation and reach State Pension age over the first two decades of single tier are likely to see an increase in their State Pension. This will compensate them for effects both of paying higher employee NICs and of accruing lower pension benefits in their occupational pension scheme.

127. All public service schemes are contracted out. With the decline in membership of Defined Benefit schemes in the private sector, by 2017 the vast majority of people who are contracted out are likely to be in public service.

128. In 2010, the Government invited Lord Hutton to undertake a fundamental structural review of public service pension provision. His Independent Public Service Pensions Commission set out recommendations for reform in March 2011, which formed the basis of extensive consultation with trade unions and other representative bodies to develop new scheme designs. Final Proposed Schemes Designs have been announced, and the Public Service Pensions Bill which was introduced to Parliament on 13 September 2012 sets out the framework for these new schemes.

129. The Government has given a commitment to Parliament that the reforms to public service pensions should endure for 25 years, setting a high bar for future scheme changes in the Public Service Pensions Bill. Public service employers will therefore not be able to pass the cost of increased National Insurance contributions onto their employees by reducing the value of pension scheme benefits or by increasing employee contribution rates to their pension schemes.

5.3 Impact on DB scheme sponsors and the pension industry

130. The abolition of DB contracting out will affect any employer sponsoring a contracted-out DB scheme that still has active members. Schemes with no active members are not affected.

131. DB provision in the private sector has been in long term decline, with many schemes being replaced by DC arrangements. This trend has been the result of significantly increased financial pressures on sponsoring employers as a result of running these schemes. Unexpected increases in longevity, low investment returns and increased regulatory protection for members have increased the cost to sponsors of DB provision, while changes in pension accounting rules have made scheme funding positions more visible and volatile. The response of many private sector sponsors has been to close schemes.

132. In this context, the removal of the contracted-out rebate without any mitigating response may create the need for additional funding from DB sponsors. However, it is the Government's intention to provide employers with a limited override in order to allow them to fully recoup the cost of the lost rebate – so as for the influences on the future of DB schemes discussed above, the overall impact on DB sponsors should be small. The loss of the rebate on its own should not, in general, trigger scheme closures.

133. The arithmetic of the contracted-out rebate demonstrates why this is a reasonable assumption. It is estimated that the sponsor's element of the contracted-out rebate makes up approximately 5-6 per cent of funds flowing into funded DB schemes in any given year[30] - approximately £2.5 billion a year. To put this into context, fluctuations in bond yields, which are not uncommon even over short periods of time, can radically change a scheme's funding position in a short space of time; just a 0.1 percentage point reduction in gilt yields is required to increase scheme liabilities by around 2 per cent[31] – currently around £27 billion. So, routine movement in bond yields can cause a much bigger change to a scheme's financial position than loss of the contracted-out rebate.

134. This makes clear that, while losing the rebate may require the sponsor to provide additional funds to the scheme, it should not be a major factor in deciding whether to keep the scheme open. However, it should be recognised that combined with all the factors outlined above, the loss of the rebate may be taken as a reason for some sponsors to close their DB scheme, particularly as sponsors will be reviewing their schemes in light of the end of contracting out.

135. It should be noted that any changes made to pension schemes under this option will most likely come with associated actuarial and legal costs. The value of such costs is unknown, but will be small. Furthermore, re-designing the scheme is a voluntary endeavour and any costs incurred by the sponsor in doing so would be in the expectation that these would be outweighed by the benefits of making these changes.

[30] Source: DWP analysis of ONS data on income for self-administered pension schemes. Data source is '*MQ5: Investment by insurance companies, pension funds and trusts: 1st quarter 2011*'. Available to download from http://www.statistics.gov.uk/pdfdir/iipt0611.pdf

[31] The 2010 Purple Book, Pension Protection Fund. Available at http://www.pensionprotectionfund.org.uk/Pages/ThePurpleBook.aspx

Chapter 6) Single tier: impact on the exchequer

136. The cost of the state pension system is one of the main pressures driving up the costs of supporting an ageing society. State pension expenditure is expected to rise from 6.9 per cent of GDP in 2012/13 to 8.5 per cent in 2060/61 according to DWP forecasts[32], despite direct action to help keep the pension system sustainable through changes to the State Pension age.

137. For illustrative purposes, and in line with the White Paper, a start level of £144 and uprating by the triple lock is assumed in the analysis below, with final decisions to be taken before implementation. The Government has made it clear that any options for pension reform must cost no more than the current system overall, to avoid placing an unsustainable burden on future taxpayers. In order for the single tier to remain affordable the Government of the day may need to adjust some of the parameters, such as the starting level and approach to uprating. The impact that changing these makes to costs is shown in Annex B.

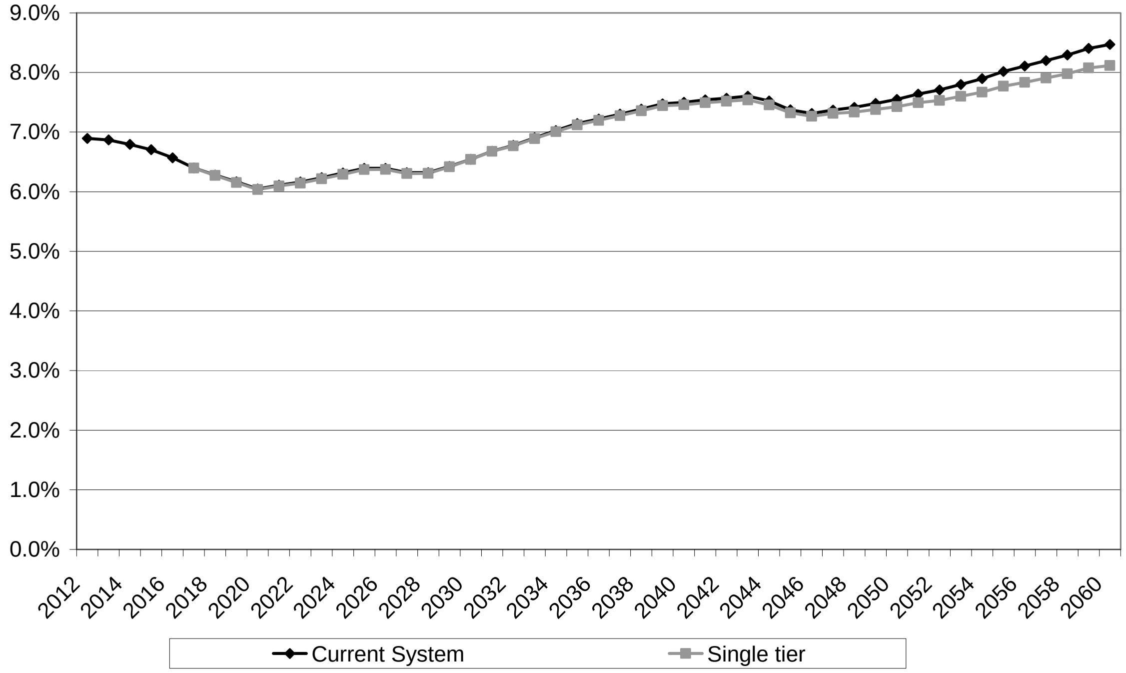
6.1 Overall impact of single tier on pensioner benefit expenditure

138. The single-tier reform package has elements that increase costs to the Exchequer, such as the value of each qualifying year being worth more under single tier than basic State Pension, but also elements that decrease costs, for example the removal of Savings Credit and changes to inheritance rules.

139. This section presents the total impact on **overall expenditure** on pensioner benefits from the state. The results in this section cannot be derived by adding together analysis in subsequent parts of this report as there are a range of other aspects of the reform package that are not included in the earlier analysis that are included here (for example, the minimum qualifying years condition and changes to deferrals policy).

140. Chart 6.1 below shows the projected spending on pensions and pensioner benefits under the current system and under single tier (using the assumed £144 start level and uprating by the triple lock), as a proportion of GDP.

Chart 6.1: Overall expenditure on pensions and pensioner benefits versus single tier (£144 start level, triple lock), as a proportion of GDP



Note: The baseline includes BSP, AP, Pension Credit, Universal Credit (where paid to households where someone is over State Pension age), HB/CTB, AA/DLA, other benefits (Winter Fuel Payments, free TV licences, Christmas bonus, Age Addition, Category D pensions).Includes the announced increase to SPa 67 between 2026 and 2028, and the SPa equalisation to 65 (for women), and rises to 66 and 68 as set out in legislation. NICs impacts are excluded.

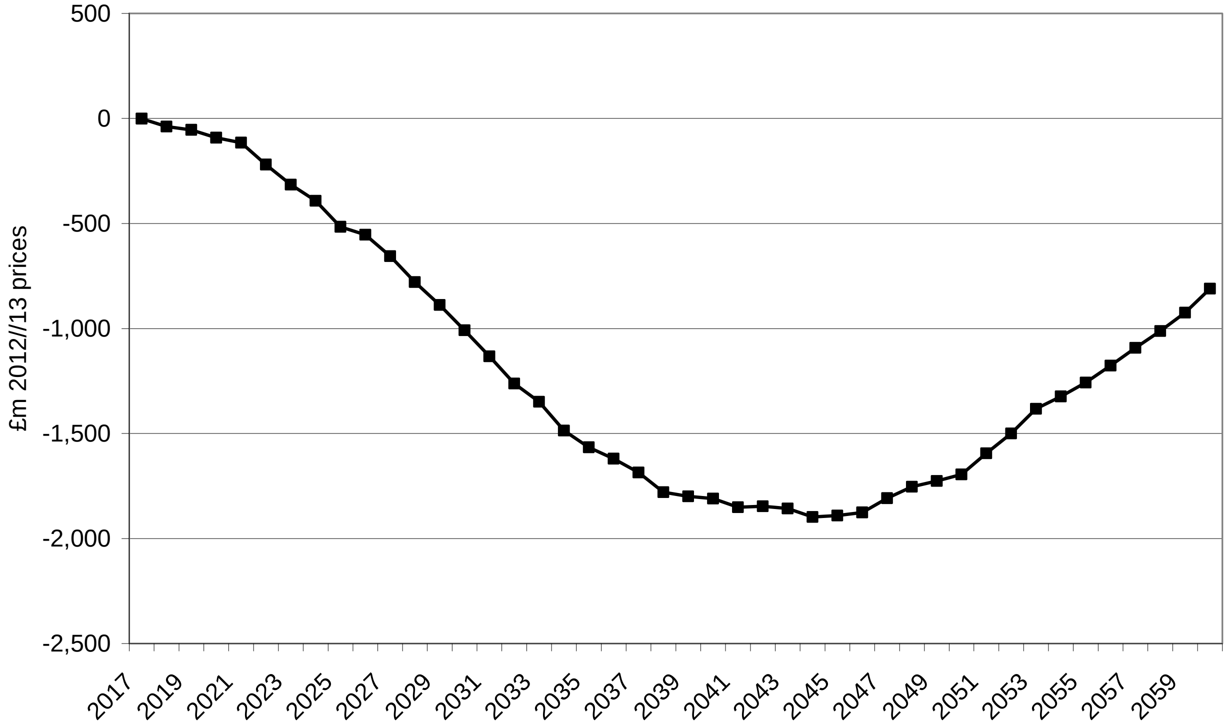
[32] Note that DWP forecasts differ slightly from OBR forecasts, see Chapter 8.

141. The chart shows that the overall costs for single tier are broadly in line with expenditure on the current system as a proportion of GDP until the late 2040s. From the late 2040s, the rise in pensions expenditure is smaller under the single-tier than under the current system (pensions expenditure is reduced from 8.5 per cent of GDP to 8.1 per cent of GDP by 2060)[33], primarily because it will no longer be possible to build up large amounts of State Second Pension.

6.2 The impact of single tier on means-tested benefits expenditure

142. Single tier will reduce dependency on means-tested benefits to provide a minimum level of income, leading to a reduction in expenditure on Pension Credit, Housing Benefit and Council Tax Benefit. Chart 6.2 demonstrates the saving on means-tested benefits compared with the current system.

Chart 6.2: Additional expenditure on means-tested benefits under the single tier (£144 start level uprated by the triple lock) compared with the current baseline, £millions, 2012/13 prices



143. Expenditure on Pension Credit will fall because many single-tier recipients will no longer be eligible to receive Savings Credit and because fewer pensioners will be dependent on the Guarantee Credit to top up their income.

144. The single tier will also reduce expenditure on Housing Benefit and Council Tax Benefit because the majority of pensioners eligible for these benefits will have a higher state pension income and because the removal of the Savings Credit reduces the point at which income is tapered for these benefits. See Chapter 4 for more detail.

[33] These figures are based on DWP projections. These differ from projections in the OBR Fiscal Sustainability Report 2012 because they are based on Great Britain only, use different uprating assumptions for some pensioner benefits, and use the OBR Autumn 2012 medium term economic forecast. See Chapter 8 for further details.

6.3 Reform implications for the National Insurance rebate

145. Chapter 5 described the impacts of ending Defined Benefit contracting out as a result of the ending of the State Second Pension under single-tier reform. The chapter details the increase in National Insurance for employers and individuals as a result of the ending of DB contracting out. The result of these increases is a rise in National Insurance revenue for the Exchequer. The profile of the increase in National Insurance is shown for selected years in Table 6.1 below. These estimates are dependent on a 2017 start date, and decisions on the treatment of revenues from these changes will be taken in due course in the context of the relevant spending review and budget discussions.

Table 6.1: Increase in National Insurance revenues accruing to the Exchequer, selected years, GB, £ billion, 2012/13 prices

	2017	2020	2030	2040	2050	2060
Public sector employers	3.7	3.6	3.0	2.6	3.3	4.1
Public sector employees	1.5	1.5	1.2	1.1	1.3	1.7
Private sector employers	0	0	0	0	0	0
Private sector employees (includes private sector employers passing on costs)	0.7	0.4	0.1	< 0.1	0	0

Note: this is a DWP estimate and final costings and methodology will need to be discussed with the OBR. These impacts have not been included in the other charts or figures unless explicitly discussed. Assumes a net neutral impact on private sector employers from NICs rise (see chapter 5).

6.4 Single tier: administrative burden

146. The estimated costs of implementing single tier are around £265m in 2012/13 prices. These are best estimates of implementation costs (including IT expenditure) for both the Department for Work and Pensions (DWP) and HM Revenue and Customs (HMRC).

Table 6.2: Estimated cost of implementing the single-tier pension and changes to Pension Credit, (£millions; 2012/13 prices)

	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	Total
Estimated IT Costs	1	6	35	65	78	62	17	**265**

Note: This is only a guide as the project is in the early stages of planning and IT options are still being investigated.

147. The running costs for the new platform are estimated at £10-20m per annum. The running costs would be incurred from December 2016 when the Department starts to take new claims to state pension. These costs do not include any cost for moving the stock onto the new platform and the additional running costs that this may incur. It is possible that in the longer term administration costs may reduce as the running costs for the new departmental platform become clearer.

148. Estimates of ongoing administrative costs or savings are not available at this stage. Detailed design and planning work is required before the impact on ongoing administrative costs can be established. However, under this option, the reduction in the number of customers claiming means-tested benefits, the abolition of contracting out for Defined Benefit schemes and the overall simplification of the retirement pension are expected to deliver administrative savings in the longer term. In the short-term, some additional administrative costs may result from operating transitional arrangements.

149. Implementation and ongoing costs/savings will be refined as further design and development work is taken forward, and included in future publications of this impact assessment, or related publications, as appropriate.

Chapter 7) Direct costs and benefits to business (single tier and faster flat rating)

7.1 One-in-one-out methodology

Option 1: Do nothing

150. No impact

Option 2: Single tier

151. The abolition of DB contracting out would result in greater National Insurance contribution costs on sponsoring employers of private sector DB schemes – although as discussed in Chapter 5, these costs are expected to be passed on to members of these schemes. However, as National Insurance is classified as a tax by the Office of National Statistics, it is out of scope as a regulatory cost to business. The equivalent annual net cost to business of this policy is therefore zero.

Option 3: Faster Flat Rating of additional State Pension

152. Faster flat rating lowers the National Insurance rebate received by private sector employers of DB schemes and therefore has a cost to business. However, as the only cost to business is from greater National Insurance contribution costs, the equivalent annual net cost to business of this policy is zero as above.

7.2 Impact on small businesses

Single tier and Faster Flat rating

153. The abolition of DB contracting out and faster flat rating will affect any sponsoring employer with a contracted-out DB scheme. However, DB provision is virtually non-existent among small and micro-employers. According to data provided by the Pensions Regulator, as of March 2011 there were just 111 private sector DB schemes with 2-9 members that may be contracted out and have active members. These schemes covered just 534 members. It is highly likely that the vast majority of these schemes are 'top-hat' schemes – small schemes set up exclusively for senior executives of companies. Even in these cases, the sponsoring employer is typically large. So it is expected that there will be no impact on small business.

154. As far as single tier is concerned, the options for mitigating the impact on employers discussed in Chapter 5 of the White Paper will ensure that no employer, of any size, is left without options to mitigate the impact of the loss of the contracting-out rebate.

Chapter 8) Risks and assumptions in the impact assessment

8.1 Assumptions

155. The main assumptions used in the modeling are detailed below.

Differences from OBR Fiscal Sustainability Report

156. The GDP ratios in this paper are based on DWP projections. DWP projections have been updated to reflect OBR's latest medium term forecasts which were released alongside the 2012 Autumn Statement. However, DWP current system estimates for pensioner benefit expenditure by 2060 are around 1 per cent of GDP lower than OBR estimates because of:

a) **Different uprating of some benefits:** DWP policy is to uprate Attendance Allowance and Disability Allowance by CPI to 2060 whereas OBR assume earnings uprating in the longer-term (there are similar differences with some other smaller benefits). This has the effect of reducing DWP estimates of pensioner benefit expenditure by around 0.7 per cent of GDP by 2060 compared to the OBR approach.

b) **GB instead of UK:** The Bill is for Great Britain only, so these costs are presented. This reduces DWP estimates by around a further 0.2 per cent of GDP by 2060 compared to the OBR estimate.

157. Note that Council Tax Benefit expenditure beyond 2013 is no longer presented in DWP benefit expenditure publications, as it will be locally administered, but it is still included in the analysis in this Impact Assessment and in the White Paper.

Economic assumptions

158. The medium and long-term economic assumptions used in the modelling are consistent with those forecast by the Office of Budget Responsibility (OBR). The long-term economic assumptions used in the modelling are as follows:

- CPI is 2 per cent in the long-term
- RPI is 3.4 per cent in the long-term
- Earnings growth is 4.76 per cent in the long-term

159. A triple lock of 0.26 percentage points above earnings has been used. This is consistent with GAD modelling based on historical figures which suggest that in the long-term the triple lock should be modeled as being on average worth 0.26 percentage points above earnings.

160. All values that are shown in 2012/13 prices have been deflated using the GDP deflator.

Demographic assumptions

161. The demographic assumptions for fertility, life expectancy and migration are consistent with the latest ONS population projections. For fertility and life expectancy the central projection is used but for migration the lower estimated is used, as consistent with the projection used by the OBR.

Policy assumptions

162. The proposed increases in State Pension age are included in the modelling. This includes the announcement that the rise to 67 will be phased in between 2026 and 2028.

163. The introduction of automatic enrolment to workplace pension saving is included in the baseline, as are the reforms legislated for in the 2007 Pensions Act.

164. The Government is replacing a number of working-age benefits with Universal Credit, and will be reforming Pension Credit and Housing Benefit for pensioners, as legislated for in the 2012 Welfare Reform Act. These changes are included in the baseline for the impact analysis.

Behavioural assumptions

165. In Pensim2 it is not possible to model whether state pension reform will lead to an increase in saving as it does not account for behavioral change in response to a change in policy. However, we would expect that a simpler state pension system, along with the reduction in marginal deduction rates shown in Chapter 4, will send out a message that it is worth saving for retirement.

166. The proportion of pensioners that take up means-tested benefits to which they are entitled is not assumed to change as a result of the single-tier reforms. The baseline does include an assumed increase in take-up of Housing Benefit and Pension Credit as a result of the changes in the Welfare Reform Act 2012, under which the two benefits will be assessed jointly. The level of fraud and error as a proportion of the total expenditure on Pension Credit is also assumed to remain constant. These are cautious assumptions.

167. For single tier, the additional cost to business is based on the assumption that additional costs accruing to private sector employers are passed onto employees in full immediately (see chapter 5 for the rationale). For faster flat rating the additional cost to business is based on the assumption that additional costs accruing to private sector employers are passed onto employees with a three year adjustment period (see Annex C).

8.2 Risks

168. The costs presented in this impact assessment are sensitive to the above assumptions and will vary as these assumptions change. Annex B presents analysis which looks at how changing the main policy assumptions would alter the costs of the preferred option.

169. The expenditure estimates in this impact assessment are based on current policies remaining unchanged. However in the long term there may be changes to policies that alter these costs. Demographic change is another variable that could affect projected costs.

8.3 Monitoring and Evaluation

170. Any state pension reform undertaken by the Government will be subject to thorough formal evaluation. Through analysis of administrative data, surveys and other sources, DWP will continue to monitor:

- state benefit and pensions caseload and take-up;
- the level and distribution of pensioners' total incomes; and
- the level of understanding of the state benefit and pensions system.

171. DWP will also continue to report on progress against its performance in its annual and Departmental reports.

ANNEX A: METHODOLOGY

A1. Modelling capabilities

Pensim2

1. Pensim2 is a dynamic micro-simulation model that has been developed in DWP to inform analysis of likely future trends in pensioner incomes. Pensim2 builds up a picture of the future pensioner population by modelling future life events and work histories for a representative sample of individuals.
2. The model starts from a set of base data representative of the GB household population in 2006. This base data includes detailed information on the characteristics of individuals and their employment and pension histories to date. For each subsequent year, sets of equations are used to model, for each individual, the probability of certain events occurring, based on estimates from current data. The calculated probabilities are then used within the model to determine what happens to each individual in a given year.
3. The key elements that are simulated include:
    - partnership formation and dissolution;
    - mortality;
    - fertility;
    - education;
    - labour market status and earnings;
    - accrual and receipt of occupational and personal pensions;
    - accrual and receipt of state pensions and pensioner benefits.
4. The individual labour market and pension histories generated by the model are used to calculate estimates of pensioner incomes in each year of the simulation. For contributory state pensions, the rules of the state pension are used to calculate someone’s entitlement given the extent to which they work or participate in activities that are credited. Entitlement to Pension Credit is then calculated based on all relevant income sources. Pensim2 is used to simulate up to 2100.

How Pensim2 works

- In each year from 2007 to 2100 the model simulates the individual incomes for a representative sample (1 in 1000) of the whole GB population.
- The model starts with a sample of 60,000 individuals across all ages in 2006.
- Each individual is dynamically given a life and labour market history, which is simulated using a large set of input assumptions.
- Important life events and processes are modelled, including birth, marriage, pension contributions and income, work patterns, changes of partners and death.
- The model uses probability-based processes with random number generation to create a life history for each member of the dataset, for each year to 2100. However, estimates after 2060 should be treated with caution and so are not used in this impact assessment.
- Based on this simulated life history, each individual accrues state and private pension according to the rules set out in the model.
- Children born in the model become new working-age people who are also modelled forward
- The size of the population is only changed via births and deaths from the base population, using the ONS population projections. Immigration and emigration are not simulated.

- Because Pensim2 models how people build up state and private pension rights over their working lives it is possible to explicitly model the impact of pension reforms on individuals over time and therefore on the future income distribution for pensioners.

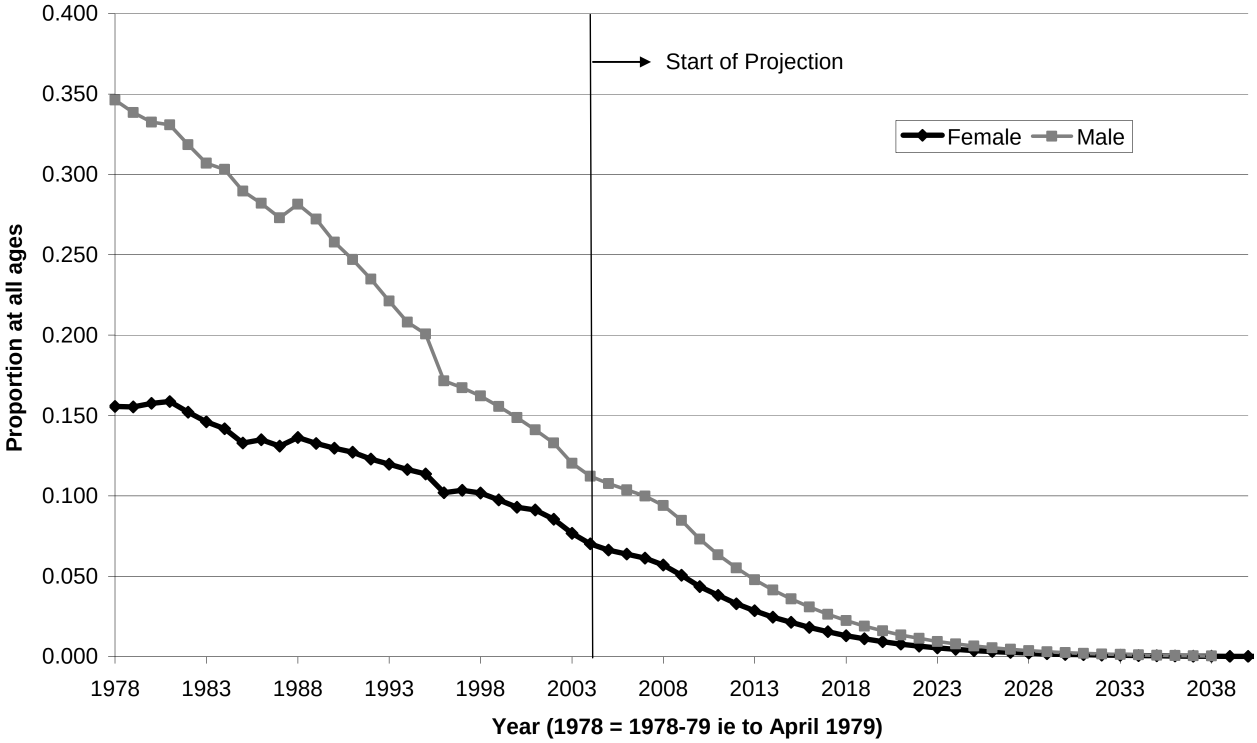
Limitations of Pensim2

- The key limitation of Pensim2 is the same as for all long term models – the model estimates future outcomes under a set of assumptions including mortality, fertility, partnership rates, etc, which may be hugely uncertain.
- Detailed analysis is limited by sample size. The model is based on a 60,000 sample of individuals, splitting this population into specific groups will soon lead to sample size issues; the smaller the sample size the larger the margin of error or uncertainty attached to the estimate.
- Other issues include limited treatment of non-pension savings information (Pensim2 does not model housing wealth, investments, assets, etc), and unsophisticated disability modelling.
- Pensim2 does not currently model deferral policy. International migration is still being developed in Pensim2 so is not included in the modelling. To account for these limitations outputs from Pensim2 are calibrated to DWP long-term projections of pensions expenditure and off-model adjustments are made to adjust for changes in deferrals policy and overseas expenditure.
- Pensim2 is not designed to model the potential behavioural changes in response to changes in pension policy so individuals' decisions do not respond to changes in policy, unless the user explicitly changes the input assumptions.

National Insurance contributions (NIC) Model

- The National Insurance contributions (NIC) model produces a forecast of National Insurance Contribution accruals and receipts. Owned and developed by the Government Actuary's Department (GAD) and HMRC, it is an aggregate collection of input spreadsheets which can be changed to model different policy scenarios.
- Built into the model are projections of employment produced by HMT's long-term employment model, earnings distributions derived by GAD from Annual Survey of Hours and Earnings data, mortality and marital status assumptions derived from ONS projections, contracting out assumptions derived from GAD projections and economic assumptions in line with those published by the Office for Budget Responsibility.
- Chart 1 shows GAD projections for contracting out amongst men and women in the private sector. These show that contracting out in the private sector is projected to fall away by 2038. These projections feed into the National Insurance contributions model and underlie the National Insurance rebate projections shown within relevant analysis in this IA.

Chart 1: Men and women contracted out in private sector contracted-out salary related schemes as a proportion of the workforce



A2. Methodology

Calibration

5. Both the single tier and faster flat rating policy options have been modelled in Pensim2 to analyse how these policies change the state pension and means-tested benefits of those retiring once the policies have come into being. Calibration is then used to produce accurate projections of the additional costs of the reforms.

6. Expenditure estimates are calibrated to the Department's medium and long-term forecasts for expenditure on pensioner benefits in order to ensure consistency between the two estimates.

7. Calibration is done by taking the ratio of the baseline and single-tier expenditure figures estimated in Pensim2 and applying this ratio to the baseline forecasts. Calibration is done separately for state pension and the different means-tested benefits.

8. As well as ensuring consistency between the Pensim2 model and the Department's forecasting models, calibration also accounts for migration and take-up of income-related benefits.

9. It is not possible to calibrate the distributional analysis in the same way and retain the ability to make worthwhile comparisons of who might experience changed outcomes from the reform. The calibration of costs reduces the cost of the single-tier package compared to the raw Pensim2 estimates. This implies that a lower proportion of people may get higher outcomes from the reforms, or the average size of the change might be lower or higher than implied by the distributional analysis.

10. The impact of calibration on estimates of expenditure increases over time. Calibration reduces estimates of the expenditure impact of single tier by around half a percent of baseline pensioner expenditure by around 2040 and by around 1 per cent by 2060.

11. The analysis in Annex B also uses calibration to analyse how changes in demographic and economic assumptions change the cost of the single-tier reforms. The change, for example to the uprating assumptions, is first modelled in Pensim2. The new Pensim2 outputs for the baseline and the single tier are then measured against the Pensim2 outputs for the base and the policy option with the standard assumptions. The ratio between the different baselines and the different single-

tier expenditure figures is then applied to the baseline forecasts to analyse how the change in the assumptions changes both the baseline and the single-tier costings.

Overseas expenditure and the De Minimis (minimum qualifying condition)

12. Pensim2 does not model overseas pensioners, so a different approach is used to estimate the impact of the single tier on expenditure on pensioners with a GB pension living overseas. As the information on overseas pensioners is limited, the modelling is less detailed compared to the Pensim2 based analysis, for example it does not allow distributional analysis. So the distributional analysis in this Impact Assessment excludes the impact on pensioners living overseas.

13. DWP's Forecasting Division provide estimates of overseas expenditure on basic State Pension and additional State Pension under the current system. Overseas expenditure on basic State Pension and additional State Pension is then scaled up using the ratio between current system expenditure and single-tier expenditure derived from Pensim2, consistent with the calibration methodology described above.

14. Overseas expenditure is also affected by the minimum qualifying period. To adjust the overseas estimates to account for the minimum qualifying condition the Work and Pensions Longitudinal Survey (L2) is used to get historical data on the proportion of people who have less than 10 qualifying years (single tier) or 7 qualifying years (faster flat rating). This proportion is applied to single-tier expenditure, assuming that changes to inflows broadly mirror changes to expenditure.

15. Using this method it is estimated that approximately 10 per cent of expenditure on overseas people reaching SPA from 2017/18 would be saved under the single-tier scheme if a minimum qualifying period were introduced.

16. A minimum qualifying period would also apply to GB residents. However, it is assumed that those residents who do not qualify for a single-tier pension would instead receive Guarantee Credit. Therefore most savings that would accrue from a minimum qualifying condition would be offset by an increase in income related benefit expenditure and the net impact on GB expenditure would be zero.

Uprating of basic State Pension and single tier – safeguard in the triple lock

17. To estimate the future expenditure on the basic State Pension and single tier, the triple lock is applied using the Office for Budget Responsibility's (OBR) published medium term Economic Assumptions. In the long run the central assumption is that the triple lock will be equal to earnings growth plus 0.26 per cent. This has recently been revised from earnings growth plus 0.20 per cent owing to new economic data.

18. There have been periods of volatility when earnings growth has been lower than price growth or 2.5 per cent. Therefore, simply uprating the basic State Pension or single tier by earnings growth for the long term may be underestimating the future state pension expenditure.

19. The additional 0.26 per cent growth is derived from applying the triple lock and earnings growth to the value of the basic State Pension and single tier over recent decades and then calculating the average difference at the end of the period. Restricting the analysis to the past 20 years[34] gives a sufficient time series of data on which to base future projections and is consistent with the inflation-targeting period introduced after the UK's exit from the European Exchange Rate Mechanism.

[34] Note that this derivation does not include the most recent inflation and earnings growth statistics, which have led to the triple lock being invoked in the April 2013 uprating of BSP.

ANNEX B: SENSITIVITY ANALYSIS

This section shows how some of the assumptions around the start level and uprating of the single-tier pension affect overall costs and the value of the single-tier pension.

Chart B1: Single-tier costs as proportion of GDP under different start levels for the single tier (£143.50, £144, £144.50 per week in 2012/13 earnings terms).

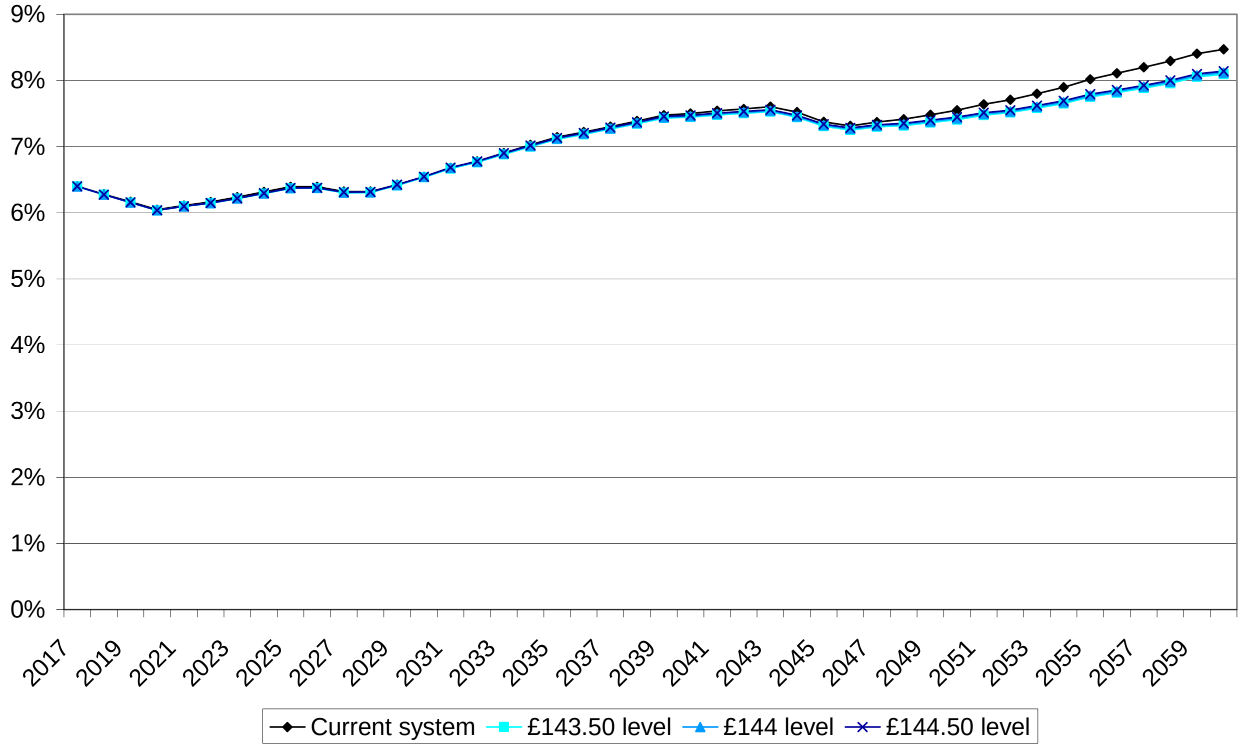


Chart B2: Single-tier costs as proportion of GDP under different uprating assumptions for the single-tier pension

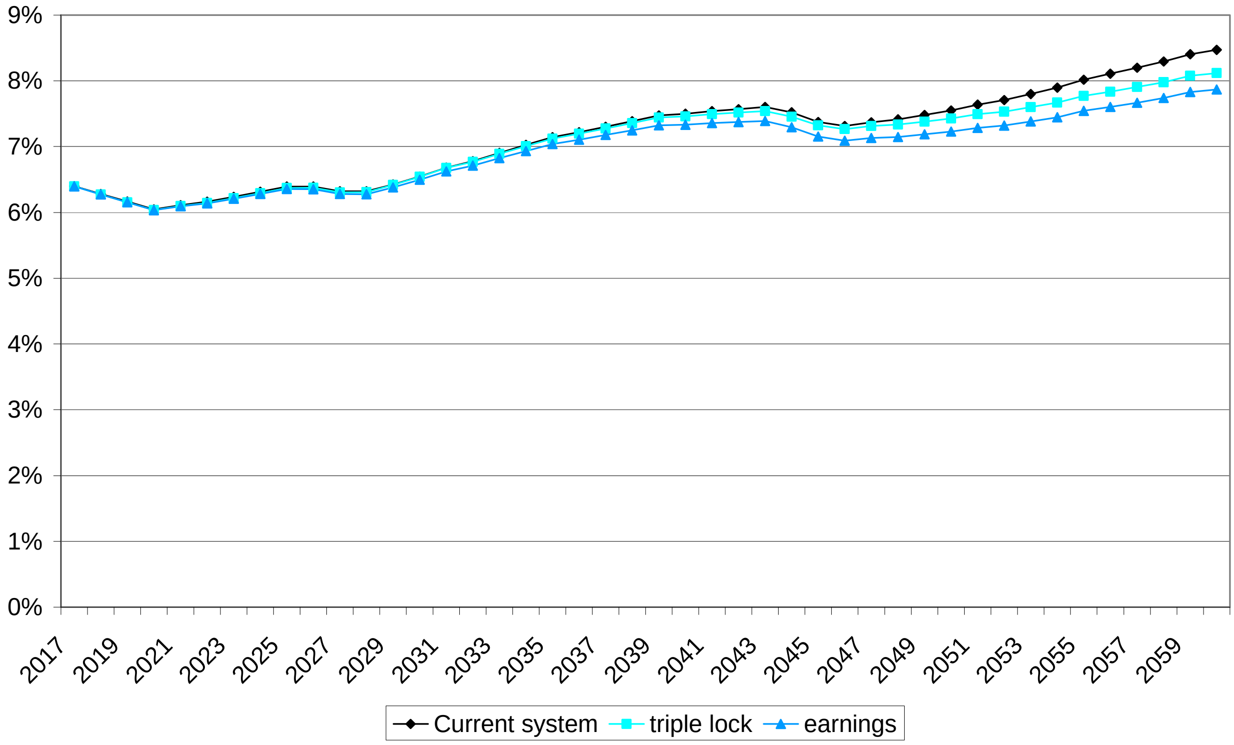
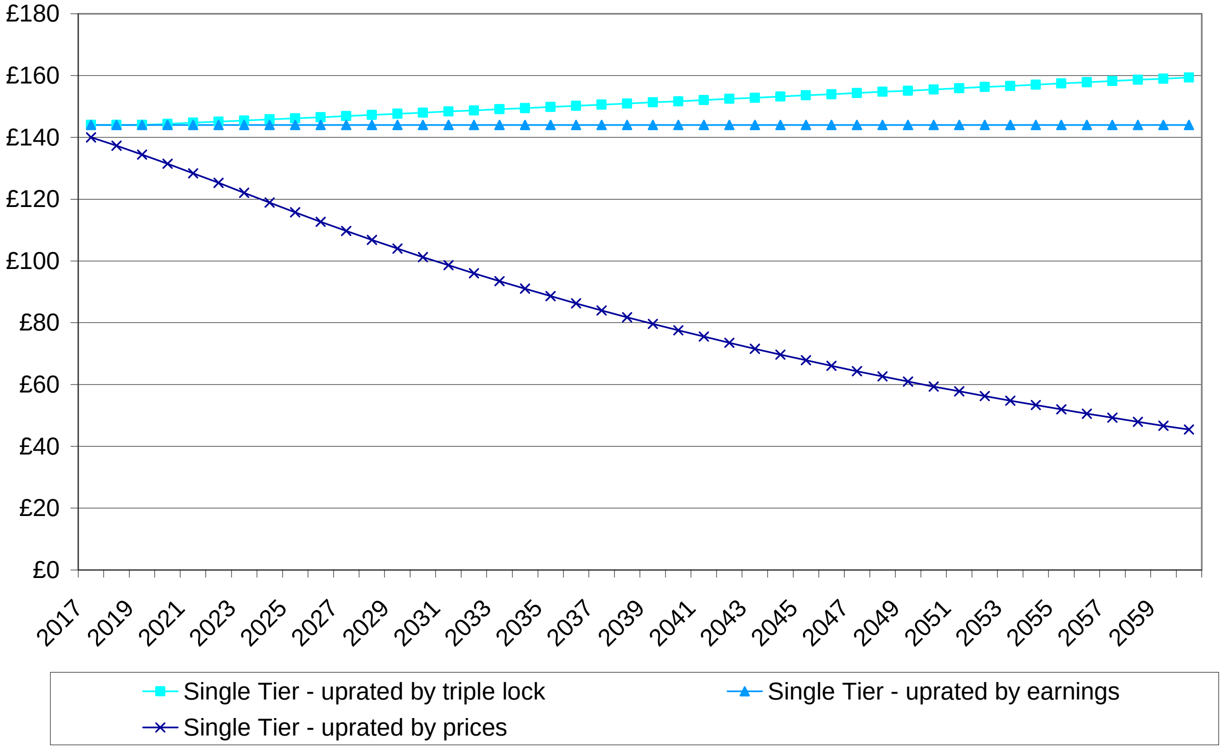


Chart B3: Weekly value of the single-tier pension in 2012/13 earnings terms under different uprating assumptions.



ANNEX C: OPTION 3 – FASTER FLAT RATING OF ADDITIONAL STATE PENSION

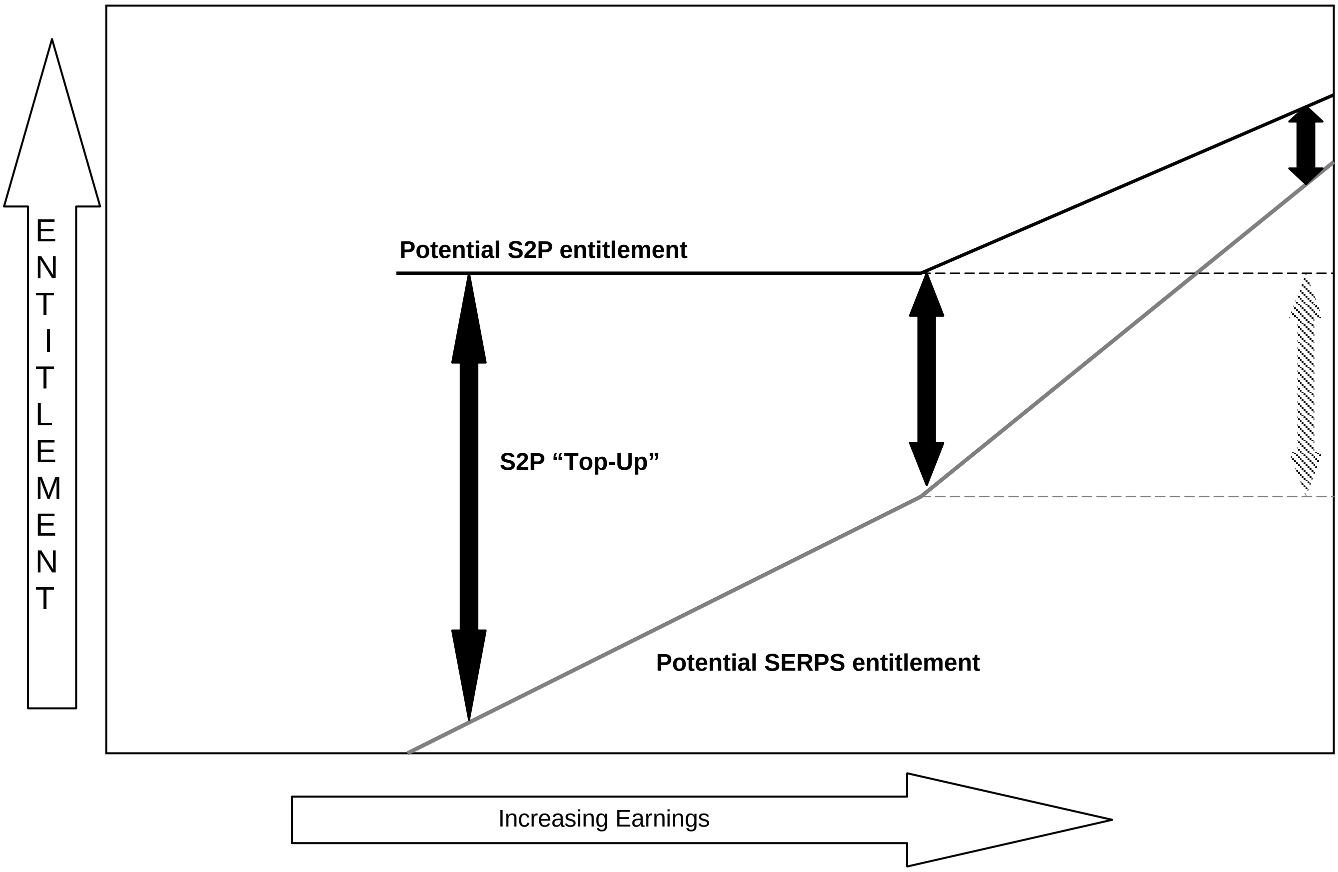
1. Under current legislation, the earnings-related element of the State Second Pension is set to be phased out in the late 2030s, at which point the State Second Pension will be valued at £1.70 a week for each qualifying year. This leaves the state pension system to consist of two flat-rate tiers. The transition to a flat rate State Second Pension could be speeded up by phasing out the earnings-related component of the State Second Pension more quickly.
2. Faster flat rating mainly affects entitlement to contributory state pensions. This option therefore does not contain a section on means-tested benefits as this option does not make any changes to the system of means-tested support, and has only a marginal impact on overall eligibility.
3. This chapter looks at the effect of the faster flat rating reform package on the total income pensioners receive from the state compared to the current system. The income of current pensioners is not affected by the reform.
4. The analysis in this chapter only includes cohorts that reach State Pension age after any reform has been implemented and only includes pensioners in Great Britain. Pensioners living overseas may receive less state pension than they would have done under the current system because of the introduction of the 7 year minimum qualifying years rule.
5. The analysis in this chapter is all based on the Department's pension simulation model, Pensim2, the details of which can be found in Annex A. The analysis presented assumes that the self-employed experience no change in National Insurance contributions as a result of faster flat rating. Analysis of change to outcomes is presented on a benefit unit rather than an individual basis.

C1 Faster flat rating: Impact on individuals

6. Currently, individuals are entitled to additional State Pension at different rates, depending on their level of earnings. People with weekly earnings between £107 and £283 are entitled to a flat rate of around £1.70 per week (though this would be revalued each year until the person reaches State Pension age). People with weekly earnings above £283 are entitled to the flat rate and an additional earnings-linked component equal to 10 per cent of earnings over £283 (though the earnings-linked component itself is flat rated at weekly earnings above £770)[35].
7. Faster flat rating will reduce this earnings-linked component so that individuals will only be entitled to the flat rate element – the same as those with earnings in the lower band[36]. This means that some individuals (those with earnings further up the income distribution) will receive less additional State Pension when they reach retirement.
8. A feature of State Second Pension which will affect the number of people with notionally higher outcomes from this option is S2P 'top-up'. As contracting out was introduced at the same time at SERPS, some contracted-out individuals have a shortfall between their SERPS-linked contracted-out entitlement and what they would have received from S2P. The S2P 'top-up' balances out this short-fall.
9. Faster flat rating increases the differential between SERPS and S2P for those higher up the income distribution as illustrated in Figure C1 below. This results in a number of people with higher outcomes due to the 'top-up'.

[35] The additional State Pension thresholds of £107, £283 and £770 per week and the flat rate £1.70 entitlement are 2012/13 values.
[36] From April 2012 the flat rate 40% band will be converted into £1.70 a week pension for year of National Insurance contributions.

Figure C1: S2P top-up for contracted-out individuals:



10. Entitlement under the current system is shown by solid lines. The S2P top-up is illustrated by the black arrows. As we move to a flat rate, the sloped portion of potential S2P entitlement and the steeper sloped portion of potential SERPS entitlement move towards the dashed lines. This results in a larger amount of top-up for people further up the earnings distribution (shown by the hatched arrow).

11. Chart C1 and Table C1 below show the proportions of people reaching State Pension age after the introduction of the faster flat rating option (in 2014) who would see a notional change in their weekly state benefits, no change, or a notional loss in their weekly state benefits. The table also shows the average change in weekly state benefits.

12. The changes are entirely notional as the new policy would not impact on benefits previously in payment before reaching State Pension age.

Chart C1: Proportion of pensioners reaching State Pension age after the introduction of faster flat rating in 2014 that experience a changed notional outcome

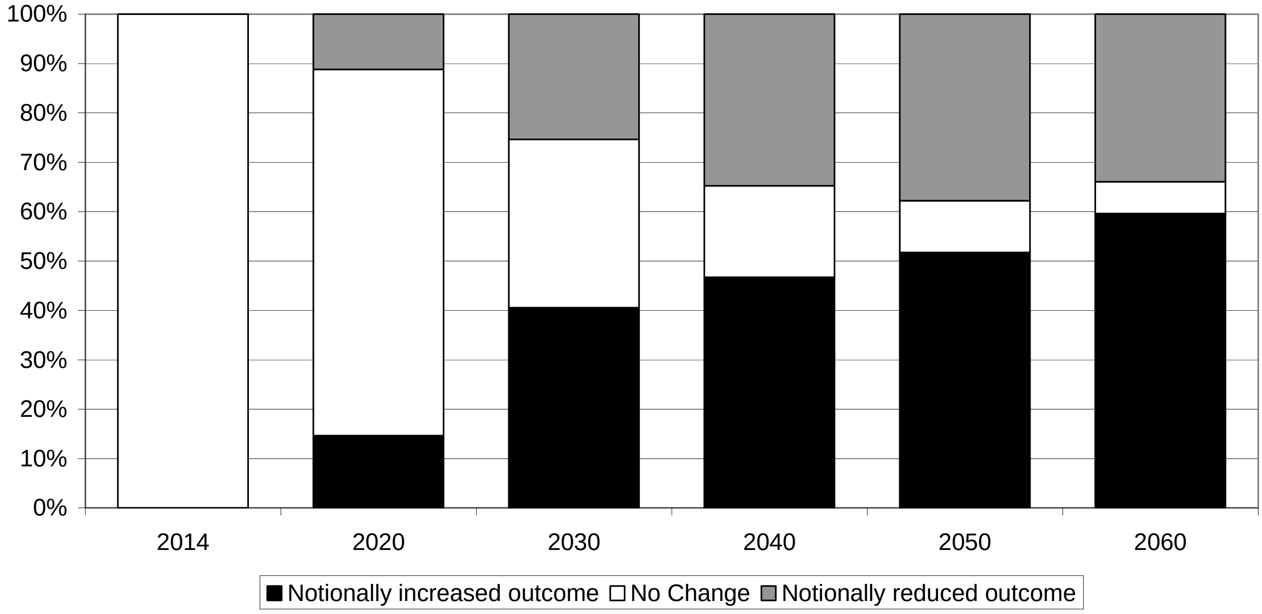


Table C1: Average notional weekly change in state benefits, by year

	Average Weekly Change (£ per week, 2012 earnings terms)					
	2014	2020	2030	2040	2050	2060
Notionally increased outcome: due to coverage	£0	£0	£1	£1	£1	£2
Notionally reduced outcome	£0	£0	-£1	-£1	-£1	-£2

13. The faster flat rating reform option has different impacts on individuals in different parts of the income distribution – this is understandable, as the earnings-linked entitlement that is being flat rated by the option are at the upper end of the income distribution. Chart C2 and Table C2 below show the proportion of people with changed outcomes in each income quintile in 2020 and the average change. Quintiles are defined by the pensioner population only. This is shortly after flat rating is achieved, and so most additional State Pension will have been derived from national insurance contributions paid prior to the change from the current system (i.e. prior to 2014).

Chart C2: Proportion of people with changed notional outcomes in 2020, among pensioners reaching State Pension age after the introduction of FFR, split by income quintile

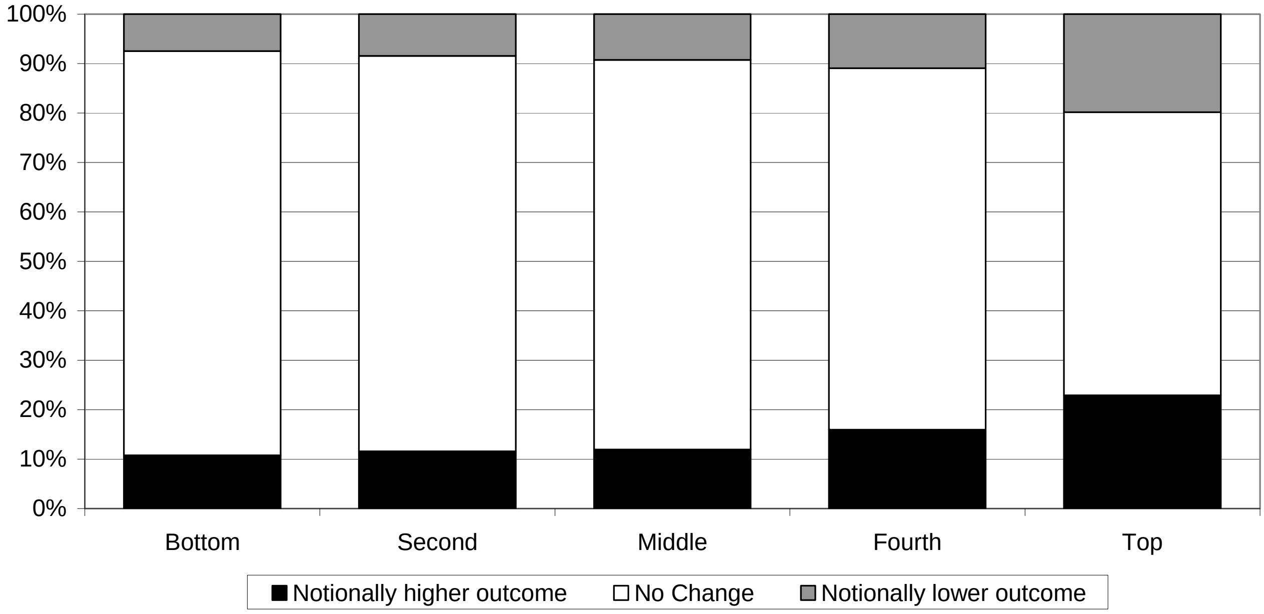


Table C2: Average notional weekly change in state benefits, by quintile

	Average Weekly Change (£ per week, 2012 earnings terms)					
	Bottom	Second	Middle	Fourth	Top	All
Notionally increased outcome: due to coverage	£0	£0	£0	£0	£0	£0
Notionally reduced outcome	£0	£0	£0	£0	£0	£0

14. In 2020, across all income quintiles there is only a small amount of change. This is as 2020 is only two years after the reform option achieves a flat rate of entitlement, so the majority of additional State Pension will still be linked to the pre-reform system.

15. The changes that we do see are concentrated at the upper end of the income distribution – as noted above, those with earnings at the upper end of the distribution and who are 'contracted out' will have an increased outcome from the increased S2P top-up, and those in the same position in the earnings distribution but who are 'contracted in' will get a notionally reduced additional State Pension entitlement.

16. Although contracted-out people would get an increased outcome from the S2P top-up, they might get a notionally lower outcome overall due to the lower National Insurance rebate. These losses are not included in this analysis as they are modelled separately.

17. Chart C3 and Table C3 below show the same income quintile information, but looks forward to 2060. Most additional State Pension is derived from National Insurance contributions paid after the faster flat rating has been completed in 2018.

Chart C3: Proportion of people with changed notional outcomes in 2060, among pensioners reaching State Pension age after the introduction of faster flat rating, split by income quintile

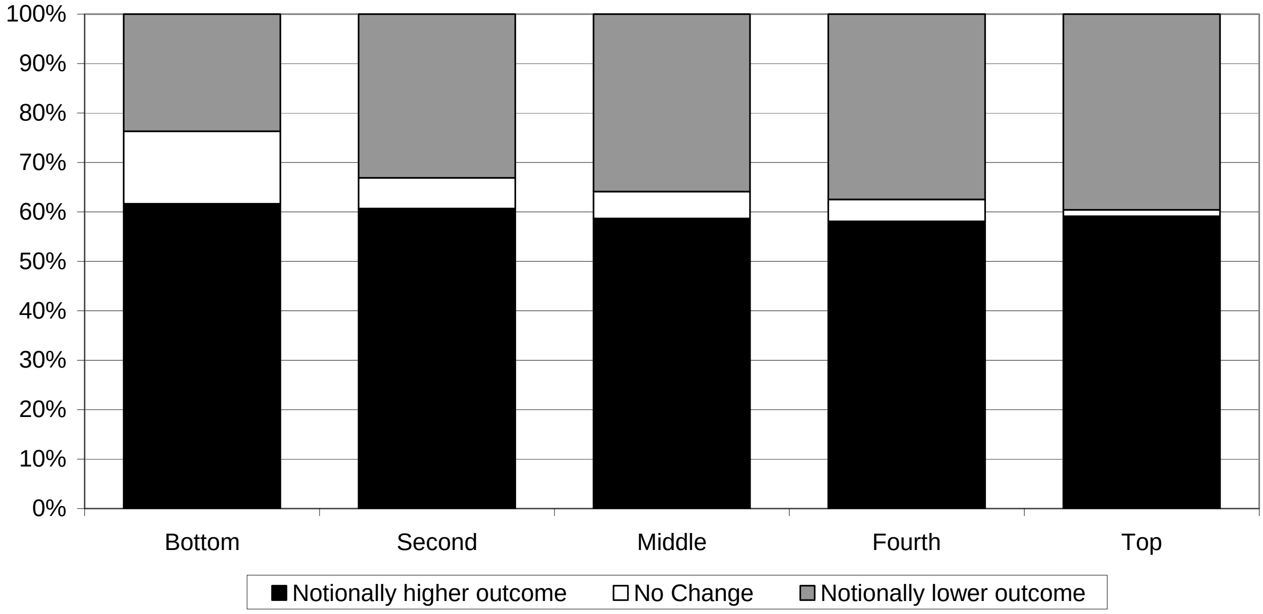


Table C3: Average notional weekly change in state benefits, by quintile

	Average Weekly Change (£ per week, 2012 earnings terms)					
	Bottom	Second	Middle	Fourth	Top	All
Notionally increased outcome	£1	£1	£1	£1	£1	£1
Notionally reduced outcome	-£1	-£1	-£1	-£2	-£2	-£2

18. The 2060 quintile distribution reflects the position some 42 years after the reform option achieves the flat rate of entitlement. As such, the majority of additional State Pensions will be based on the post-reform system rather than the pre-reform system.

19. People at the upper end of the earnings distribution are more likely to get a lower notional outcome as the additional State Pension that they will be entitled to post-reform will be smaller in value than they would have been under the current system. Conversely, people in the lower income quintiles are more likely to get an increased notional outcome from an increase in the flat rate compared to the current system in 2018. However, the bottom quintile is reasonably balanced between those with increased or reduced notional outcomes.

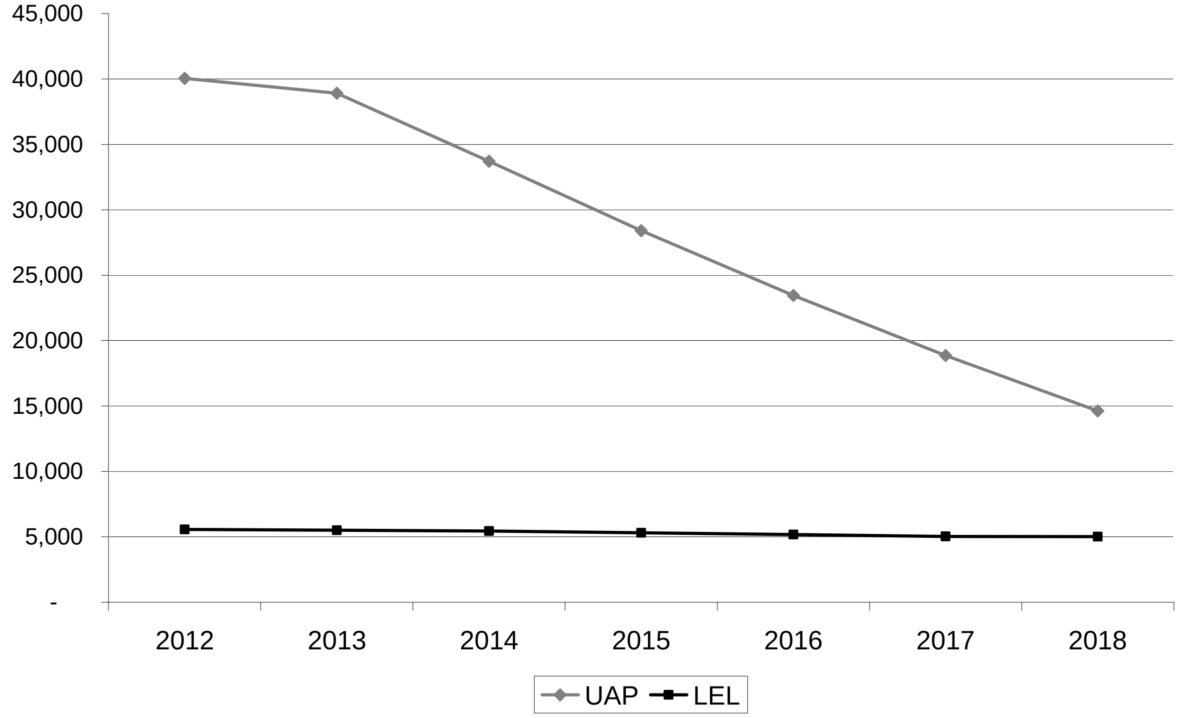
C2 Faster flat rating: Impacts of National Insurance contribution changes on individuals, Defined Benefit schemes and sponsors

20. Unlike for single tier, under the alternative option of faster flat rating of State Second Pension, the State Second Pension would be retained. Under the existing up-rating rules the system would naturally become a flat rate system, although not until the mid 2030s. The policy option considered was to accelerate the date at which the system becomes flat rate to 2018 – so bringing forward the outcome that would have been achieved in the mid-2030s.

21. This is achieved by lowering the level of the Upper Accrual Point – which is currently frozen at £40,040 – beginning in 2014. The consequence of this will be that those with earnings above the Lower Earning Threshold will accrue less State Second Pension than under the current system if their income exceeds the level of the reduced Upper Accrual Point.

22. This means that the system whereby DB pension schemes can contract out of the State Second Pension would remain, but contracted-out rebates would be lower than under the current system to reflect the lower value of the State Second Pension. This is shown in Chart C4 below, which shows the evolution of the earnings band on which the rebate is paid, during the period 2014-18, over which accelerated flat-rating of S2P takes place.

Chart C4: Evolution of the earnings band on which the rebate is paid, 2012/13 earnings terms



Source: DWP estimates

23. It can be clearly seen that the value of the contracted-out rebate, which is paid on the band of earnings between the Lower Earnings Limit (LEL) and the Upper Accrual Point (UAP), shrinks as this earnings band narrows.

24. Employers are required to fund an earnings-related pension in return for contracting out. In a fully flat rate system, employers continue to contract out on the basis that they must provide an earnings-related pension, but the state pension that is now being replaced is no-longer earnings-related. So a fully flat rate S2P creates a mismatch between the contracted-out private pension and the contracted in state pension.

25. Under DB contracting out, the individual scheme member receives a rebate of National Insurance contributions of 1.4 per cent of earnings between the Lower Earnings Limit (LEL) and the Upper Accrual Point (UAP). In the current tax year, this roughly corresponds to the annual earnings band £5,564 - £40,040. Under the faster flat rating policy, individuals will continue to receive the same *rate* of National Insurance rebate, but the *amount* of that rebate will shrink because the band of earnings on which the rebate is paid will shrink.

26. The faster flat rating of State Second Pension will affect the contracted-out rebate, which only active members[37] of contracted-out DB schemes receive. The 2011 Occupational Pension Schemes Survey records that there are currently 1.6 million active members in private sector contracted-out DB schemes and 5.3 million in the public sector. Given expected further declines in active DB membership the number affected by this policy will almost certainly be lower than the current 7 million. Further information on the demographics of contracting out can be found in Chapter 5 which covers the impact of the single-tier pension on DB contracting out.

27. Under faster flat rating of State Second Pension, individuals will see the rebate applied to a smaller band of income and a consequent rise in their National Insurance contributions if their earnings exceed the reduced Upper Accrual Point. The same applies to DB scheme sponsors, who will see an increase in their National Insurance contributions in respect of each employee affected on the band of earnings between the Low Earnings Threshold and the lower of the employee's earnings or the existing Upper Accrual Point – effectively an increase in their labour costs. It would be expected that over some period of time sponsors will respond to this increase by passing those costs onto workers through reductions in the level of remuneration. This is a standard result in economics and

[37] Active members are those that continue to accrue new pension rights in a scheme.

Chapter 5 covers the evidence for this in some detail when discussing employer responses to the end of contracting out under the single tier.

28. Unlike single tier, where employers indicated the costs would be passed on through the pension scheme, DWP's assessment for faster flat rating is that a complete scheme redesign is not the appropriate response to a policy that incrementally reduces the rebate and leaves the structure of contracting out intact. It is more plausible to assume that employees bear the full incidence through lower wage increases, which was the mechanism described by employers. However, DWP has therefore built some caution into its estimates of the impact on private sector employers by assuming that it takes three years before the impact of the increased employer National Insurance is fully passed on to individuals.

29. The Government has given a commitment to Parliament that the reforms to public service pensions should endure for 25 years, setting a high bar for future scheme changes in the Public Service Pensions Bill. Public service employers will therefore not be able to pass the cost of increased national insurance contributions onto their employees by reducing the value of pension scheme benefits. The consequence is that, while in accounting terms there is an increase in private sector employer National Insurance payments, in economic terms the total burden (employer plus employee contributions) of the increased National Insurance in the private sector is borne by individuals in full after three years.

30. This difference between the public and private sectors simply reflects the assumed decline in private sector DB membership in future years. In the counterfactual described above, the current system would have become flat rate in the mid 2030s. Once this happens, the individual faces an identical system both in the counterfactual and in the alternative policy environment – as a result there is no additional impact on the individual as a result of the policy option once flat rating is achieved in the counterfactual.

C3 Faster flat rating: impact on Exchequer

31. The faster flat rating option has aspects that reduce costs to the Exchequer and aspects that increase costs.

32. The flat rate is lower than the current maximum of the earnings-related rate. As such, speeding up the flat rating means that future additional State Pension awards will be lower for some individuals, generating savings when compared to the baseline of the current system.

33. The faster flat rating option also introduces a 7 year minimum qualifying condition on entitlement to basic State Pension. This primarily affects overseas pensioners, as GB pensioners with fewer than 7 qualifying years will be able to claim Pension Credit in place of the basic State Pension that they would no longer receive. This also generates savings when compared to the baseline.

34. A key component of the reform option is a step-change in the value of the flat rate in 2018 (once the flat rating has been achieved). This higher level propagates through future additional State Pension expenditure due to up-rating and as such this aspect of the reform will generate costs when compared to the baseline. It has been assumed that the value of the flat rate would increase by around 6 pence per week compared to the current system in 2018 (in 2012/13 earning terms).

35. The faster move to a flat rate of additional State Pension and the introduction of a seven year minimum qualifying period for basic State Pension both generate savings over the current system. The savings from the de minimis and flat rating mean that the reform option generates a steadily growing saving to pensioner benefits until around 2040. However, the step-change in the value of additional State Pension in 2018 has growing cost implications and by the late 2050s this effect dominates, leading to small costs compared to the current system.

36. The fall in the value of the National Insurance rebate also generates savings. However, flat rating of additional State Pension is part of the baseline (though it will take until the mid 2030's to achieve), and so the savings to be made from the rebate are not permanent – after peaking in 2018 the savings reduce over time, reaching zero at the point where flat rating would have been achieved in the baseline.

37. No additional implementation or ongoing administrative costs have been assumed for this option as delivery does not require significant changes to existing systems or processes. It is very unlikely that there would be any administrative savings in the long term of this option.