

## United Kingdom

Britain has a complex pension system, which mixes defined-benefit and defined-contribution formulae and public and private provision. The public scheme has two tiers (a flat-rate basic pension and an earnings-related additional pension), which are complemented by a large voluntary private pension sector. Most employee contributors “contract out” of the state second tier into private pensions of different sorts. A new income-related benefit (pension credit) has recently been introduced to target extra spending on the poorest pensioners.

### Qualifying conditions

Pension age, currently 60 for women and 65 for men, will be equalised at 65 from 2010. The eligibility age for the minimum income guarantee/pension credit is 60, and will increase in line with the women’s pension age. The new savings credit is only available from 65 for both men and women.

To qualify for the basic state pension, people need to pay social security contributions or have credits for around nine-tenths of their potential working lives (44 years). A proportionally reduced pension is available for people who do not meet the full condition, but only to a minimum of 25% (i.e., 11 years).

### Benefit calculation

#### Basic

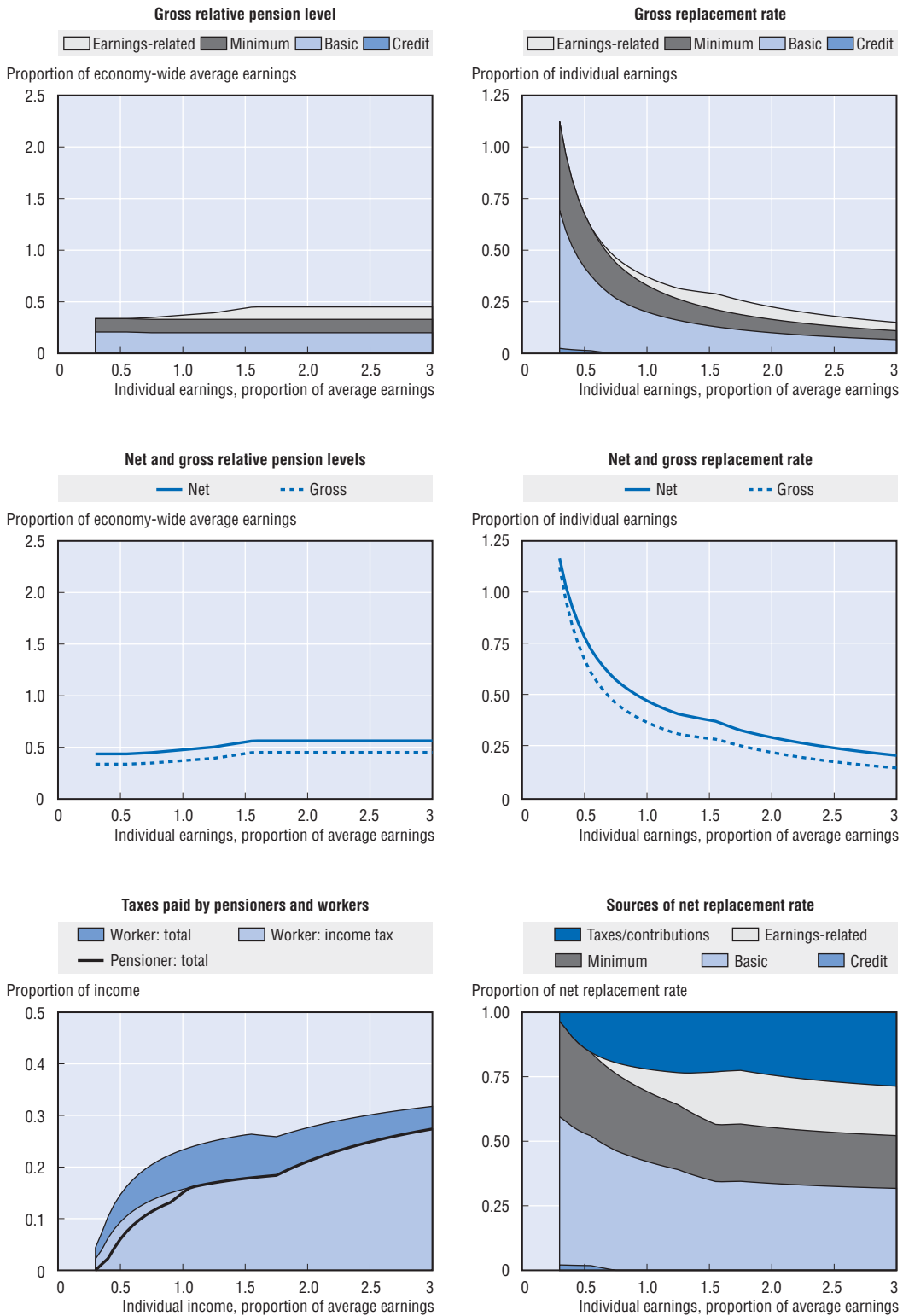
The full basic state pension for a single person was GBP 75.50 per week in 2002-03 (GBP 72.50 in 2001-02 giving an annual total for 2002 of GBP 3 896).

#### Earnings-related

The state second pension replaced the state earnings-related pension scheme (Serps) from 2002-03. This has a more redistributive schedule than its predecessor does. For earnings between the lower earnings limit (GBP 3 910 per year in 2002-03 and GBP 3 744 in 2001-02) and the first threshold (GBP 10 800, GBP 10 400), the replacement rate is 40% of the difference. This also applies to people covered by home responsibilities protection. This is equivalent to treating people earning below the first threshold as if they had earned at this level. Over the next range, the replacement rate is 10%, ending at GBP 24 650, GBP 23 710). Between this threshold and the ceiling, the replacement rate is 20%. The ceiling was GBP 30 505 in 2002-03 and GBP 29 900 in 2001-02.

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

### Pension modelling results: United Kingdom



Source: OECD, based on information provided by the countries.

### **Contracting out**

Some 55% of employees, however, are “contracted out” of the state second pension, into either an occupational plan (provided by an employer), a personal pension or a stakeholder plan (both provided by financial-services companies). Occupational schemes are mainly defined benefit, but there has been rapid growth since the mid-1980s in defined-contribution occupational plans, albeit from a very low base. The other plans are defined contribution.

Both employers and employees pay a lower rate of social security contributions when contracted out and the employee foregoes their state second pension entitlement. In return, defined-benefit schemes must meet minimum standards and defined-contribution plans must levy a minimum contribution.

The government sets the social security rebate, usually every five years, on the advice of the Government Actuary. The rebate is designed as fair compensation for the loss of state pension rights. As the Government Actuary’s assumptions about investment returns and administrative costs are reasonable, the value of a contracted-out pension should be equivalent to the state benefit foregone. In a given year, around 45% of personal pension members contribute only the mandatory minimum to their plan.

### **Targeted**

The minimum income guarantee (Mig) is, from 2003-04 onwards, converted into a “pension credit” which tops up low pensions. For consistency, the pension credit has been modelled using the 2002 calendar year parameters for the Mig. The target income level was GBP 98.15 per week for 2002-03 (GBP 92.15 for 2001-02) for a single person. The 2002 calendar year value for the Mig was GBP 5 041. There is no requirement to have paid social security contributions to receive Mig.

The pension credit also includes a new “savings credit” in addition to the “guarantee credit” that replaces the Mig. This is designed to reduce the effective withdrawal rate of benefits from 100% under the Mig to 40%. Individuals whose income (apart from the pension credit) is less than the target minimum income but more than a “starting point” receive a top up. The starting point is equal to the full value of the basic pension. The top up is 60% of income above the starting point. For people with incomes above the target minimum income, the benefit is reduced by 40% by the amount of the excess. The maximum credit for 2004-05 is therefore  $(\text{GBP } 105 - \text{GBP } 80) \times 60\% = \text{GBP } 15$  per week.

## **Personal income tax and social security contributions**

### **Taxation of pensioners**

A single person under 65 had an income-tax allowance of GBP 4 615 per year in 2002-03, compared with GBP 6 100 for 65-74 year olds and GBP 6 370 for people 75 or over. Once a pensioner’s total income exceeds GBP 17 900, the additional allowances are withdrawn at 50% of the excess, so that high-income pensioners have the same tax allowances as people of working age.

### **Taxation of pension income**

No special reliefs are available for pension income.

**Social security contributions paid by pensioners**

Social security contributions are not levied on the income of those over state pension age.

**Pension modelling results: United Kingdom**

Men	Individual earnings, multiple of average					
	0.5	0.75	1	1.5	2	2.5
Women (where different)						
Gross pension level <i>(% of average earnings)</i>	33.7	34.8	37.1	43.9	45.1	45.1
Net pension level <i>(% of average net earnings)</i>	43.6	44.9	47.6	55.1	56.3	56.3
Gross replacement rate <i>(% of individual earnings)</i>	67.4	46.4	37.1	29.3	22.5	18.0
Net replacement rate <i>(% of individual net earnings)</i>	78.4	57.7	47.6	38.2	29.8	24.7
Gross pension wealth <i>(multiple of average earnings)</i>	5.0 5.8	5.2 6.0	5.5 6.4	6.6 7.5	6.7 7.7	6.7 7.7
Net pension wealth <i>(multiple of average net earnings)</i>	6.5 7.5	6.7 7.7	7.1 8.2	8.2 9.4	8.4 9.6	8.4 9.6

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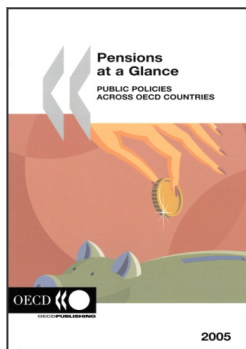
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