Pensions at a Glance 2015

UNITED KINGDOM

OECD

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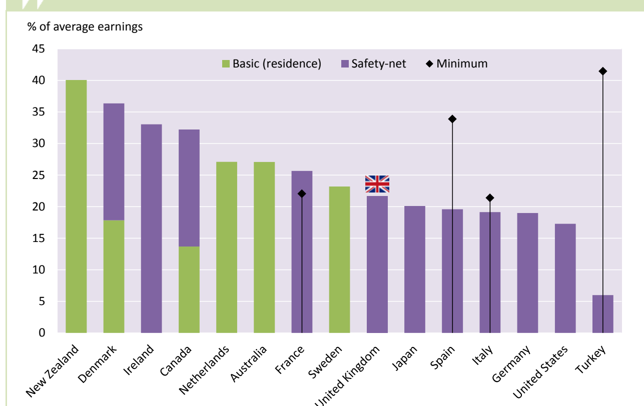
Key findings

- **The level of the current basic pension is low in comparison to the benefit level from mandatory schemes in most OECD countries.** Average earners without a private pension have the third lowest replacement rate in the OECD, high earners the lowest and low earners are in the middle of the range.
- **Eligibility for the final year of full basic pension is around the OECD average**, but at 16% of average earnings the current level of benefit is low in comparison to many countries, with the OECD average being equal to 20.5%. However, the value of the pension credit safety-net benefit is around the OECD average.
- **The introduction of the new state pension from April 2016 should increase the basic pension for the majority of future pensioners.**

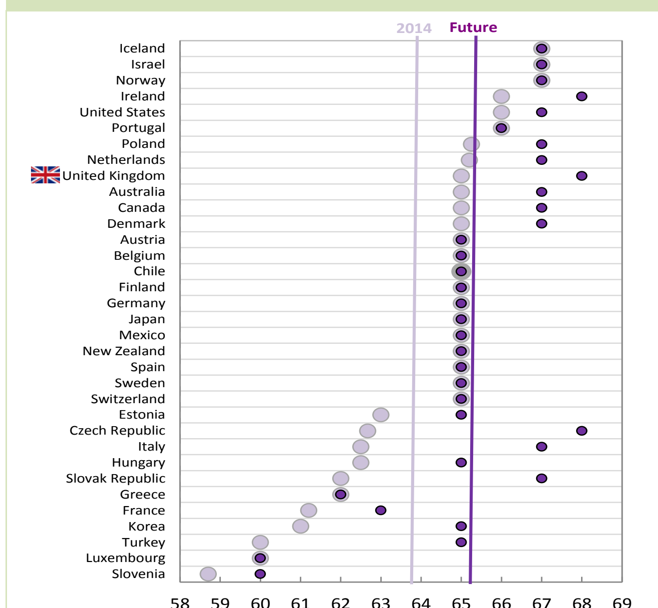
  Public pension expenditure as a share of GDP is forecast to increase from 7.7% to 8.4% over the next 50 years, under EU economic assumptions. Increasing the retirement age by 5 years by 2060 would almost fully offset this increase, unless productivity gains are low enough to make the triple-lock condition unaffordable.
- **Relatively long periods of unemployment or childcare as well as later entry into the labour market do not have an impact on future pensions from mandatory schemes**, as only 35 years are required for the full new state pension. However, any voluntary (both occupational and personal) pensions, which are not included in the analysis, would be affected by contributing for shorter periods.
- **The United Kingdom is one of the few countries that still have different retirement ages for men and women** with women retiring at 62 ½ years in 2014 compared to 65 for men, although the ages are converging to 65 by 2018. Future retirement ages will be amongst the highest in the OECD, reaching 67 by 2028 and being regularly reviewed thereafter to account for changes in life expectancy.

Figure 1: Value of first –tier pensions



[PAG2015 Figure 2.6]

Figure 2: Retirement ages, current and future



[PAG2015 Figure 1.5]

Why is it important for the United Kingdom?

The value of the new state pension (nSP) will be set at GBP 155 per week from April 2016, equivalent to the value of the pension credit safety-net (22% of average earnings). Despite this the benefit from mandatory pensions will remain low for average earners in comparison to most OECD countries. The old-age dependency ratio in the United Kingdom will increase

from 0.31 to 0.51 over the next 60 years, compared to an increase of the OECD average from 0.27 to 0.55. As future pension ages will be more closely aligned with increases in life expectancy the current triple-lock indexation policy for the basic pension may not lead to an increase in public spending under the OECD modelling assumptions. However, if there is negative wage growth or deflation then the triple lock commits to an increase of 2.5% every year, which would increase expenditure.

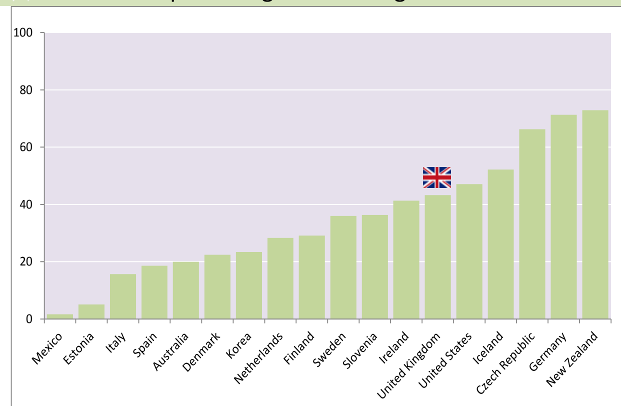
Eligibility for the full basic pension currently requires 30 years of contributions, four years less than the OECD average, with a minimum period of 1 year for any benefit (11 years on average). This will increase to 35 years for the full benefit and 10 years for minimum eligibility under the nSP rules. Basic pensions are equal to 20.5% of average earnings on average across OECD countries, with a high of 40% in New Zealand. Safety-net benefits across countries average 22% of average earnings, the same as in the United Kingdom, again reaching a high of 40% in New Zealand and a low of 6% in Korea and Turkey.

As the nSP not only replaces the basic pension, but also the state second pension, there are no longer any mandatory earnings-related contributions, meaning the United Kingdom joins Ireland and New Zealand as the only countries without a mandatory second tier. Consequently future benefits will be lower than today's level for those who would have continued to contribute to the state second pension. However they will be higher for those that either opted out of, or made small contributions to, the state second pension as the new state pension is at a higher level.

Currently just over 40% of those aged 15 to 64 are contributing to an occupational or personal pension. With the recently introduced auto-enrolment scheme it is hoped that the level of coverage will increase substantially following the example of the KiwiSaver auto-enrolment scheme in New Zealand, where coverage is now well over 70%. Difficulties triggered by insufficient coverage are compounded when careers are incomplete. However, as 35 years of contribution are required for the full nSP benefit, a few years of unemployment or childcare absence will not affect the benefit level.

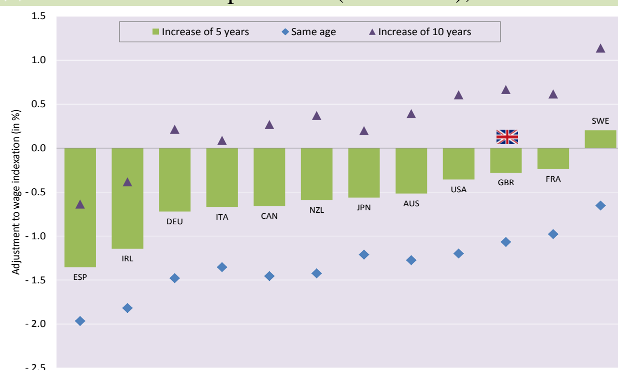
With pension ages set to increase to age 67 by 2028, with regular reviews thereafter to account for life expectancy changes, the labour market will need to adapt. Currently, men exit at age 64 and women at 62 on average, both slightly below the current state pension ages and the OECD average exit ages. As life expectancy at exit age is around the average, the current expected duration in retirement is only just above the OECD average for both men and women.

Figure 3: Coverage of private pension schemes as a percentage of those aged 15-64



[PAG2015 Table 10.1]

Figure 4: Indexation of first-tier pensions to stabilise expenditure (% of GDP), 2015-60



Note: In the United Kingdom, to stabilise expenditure, the basic pension could be indexed to annual wage growth -0.3% if the effective age of retirement was increased by five years. No change in the effective retirement age would require indexing to wage growth -1.1% while an increase of 10 years would allow wage growth + 0.7%.

[PAG2015 Figure 2.11]

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2015 Pension Policy Notes

UNITED KINGDOM

- **Reconsider the policy to allow full pension withdrawals**
- **Develop professional training for workers in physically demanding jobs to improve their job prospects as they get older**

The newly designed system could provide both an adequate retirement income and be financially sustainable. Overall, the relative average income of people aged 66 and over (versus that of the whole population) is currently among the lowest within OECD countries. However, the old-age poverty rate is well below the OECD average and is only slightly above the poverty rate for the total population. In order to improve adequacy, the basic and state second pensions will be replaced from 2016 by the new state pension (nSP). It will provide a more effective safety net for those who would have been unable to achieve a full state second pension (self-employed, low earners or workers with interrupted careers), but benefits will otherwise be lower, especially for high earners. A minimum of 35 years of contributions, five more than currently required, will be needed for the full rate nSP which will be set at a higher level than both the current basic pension and the means-tested Pension Credit supplement. The private component consists of an automatic enrolment scheme into voluntary occupational pension plans, including the National Employment Savings Trust (NEST). NEST is a low-cost, workplace, defined-contribution pension "master-trust" scheme that can be used by any employer. The combination of a higher basic pension and a substantial voluntary pension generate long-term replacement rates that are potentially high for low-wage earners but decline with wages as the impact of the nSP benefit fades away.

Key indicators: United Kingdom and OECD average

	Mid-1980s	Mid-1990s	Mid-2000s	latest available	latest OECD	long-term	long-term OECD
Pensionable age for a full-time career starting at the age of 20	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	65.0 (62.0)		68.0	
Retirement age	65.0 (60.0)	65.0 (60.0)	65.0 (60.0)	65.0 (62.0)	62.9 (61.8)	68.0	64.6 (64.4)
Net replacement rate, avg earner						38.3	63.0 (62.6)
Total mandatory contribution rate	No separate pension contribution				19.1		
Total pension spending, % of GDP	9.1	10.3	10.7	11.4	10.3		
Public pension spending, % of GDP	5.9	5.7	6.0	6.2	8.4		
Public debt, % of GDP	47	48	50	113	115		
employment rate 55-64, %	62.3 (32.7)	56.1 (39.2)	65.6 (48.0)	67.7 (54.3)	66.1 (49.1)		
Labour-market exit age	62.8 (60.8)	62.0 (60.7)	63.3 (61.4)	64.1 (62.4)	64.6 (63.1)		
Old-age poverty rate, %	8.1	10.7	10.6	13.4	12.6		
Life expectancy at 65, years	13.6 (17.4)	15.0 (18.4)	17.4 (20.1)	18.6 (21.1)	18.4 (21.5)	23.5 (25.3)	22.9 (25.9)
Old-age dependency ratio	0.26	0.27	0.27	0.30	0.28	0.50	0.57
Fertility rate	1.8	1.7	1.9	1.9	1.7	1.9	1.8

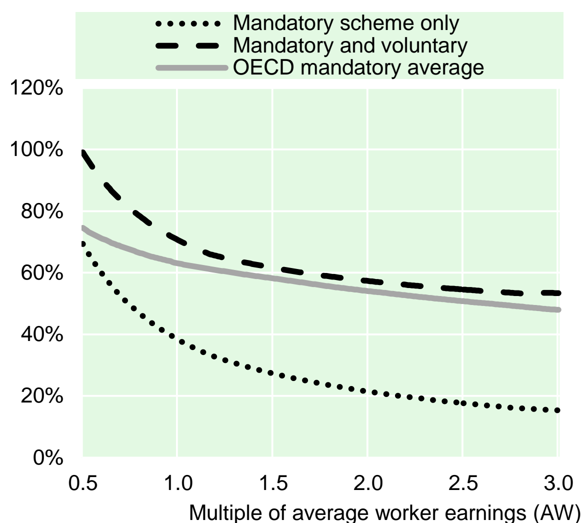
Note: The figures for women appear in parenthesis where they differ from those for men.
Long-term: Around 2060 based on all legislated reforms up to mid-2015.

Taking pensions as a lump-sum could lead to pensioners having insufficient resources long after they have retired. NEST was introduced in 2012. The government has announced that retirees will have more choice over how to use their pension pots. Currently 25% of the pot can be withdrawn as a tax-free lump-sum from age 60. This withdrawal age was reduced to 55 in April 2015 and will then

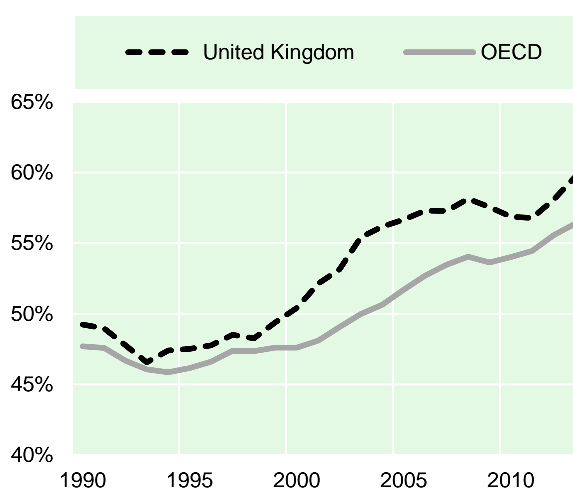
increase in line with retirement age. It will be possible to withdraw the entire pot as a lump-sum of which 25% will still be tax-free. Policy makers will need to ensure that people fully understand that by not taking an annuity they will not be guaranteed a steady income flow in later life, as once the lump-sum has been spent it will no longer provide any financial security.

With retirement ages being linked to any future increases in life expectancy, working to age 70 will become more common. The State Pension age is will be 66 for both men and women in 2020 and 67 by April 2028. The government has introduced a review process for considering future changes in the State Pension age, with the first report by May 2017. Subsequent reviews will take place within each 5-year parliamentary period. The effective age of labour market exit is currently 64 for men and 63 for women on average.

Long-term net replacement rates (%), by earnings level



Employment rate for those aged 55-64



Sources: OECD pension models; OECD Employment Outlook

Increasing pension knowledge and adapting labour markets are the key policy issues. The design of the pension system ensures a safety-net for low earners or those unable to make sufficient contributions, whilst encouraging independence and individual control over the retirement choice. However, enabling individuals to have such control over assessing their future pension adequacy comes with many risks. Without sufficient understanding of financial markets and costs, as well as the complexity of investments and annuities, individuals may be more tempted to take their pension as a lump sum. This of course may work for some but could cause serious financial pressures for many when aged in their late 80s or 90s. Moreover, the labour force participation rate of those aged 55 to 64 is currently 70% for men and 55% for women, only slightly above the OECD averages. With higher retirement ages in the future this rate should rise naturally, particularly for women due to the initial equalisation period. However to ensure that older workers are able to fully participate in the labour market policy makers will need to consider options to ensure that workers, particularly those in physically demanding occupations, are either able to remain in their current job or have sufficient training to enable them to transfer during later life.

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