The pension solution

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FAST FACTS

- Over the next 25 years there is expected to be a 79% increase in pensioners aged over 75. There is also projected to be a fall in those of working age, between 16 and 64.
- Across the UK, there is projected to be a 31% increase in the number of pensioners, but only a 7.8% increase in the working age population.
- In the UK state pension system, today's workers pay the pensions of today's pensioners; they *do not* contribute to their own future pensions.
- So a big shift in the age distribution carries Implications for the affordability of pensions.
- Changes have already been made to the age of eligibility for the state pension; the system carries no guarantees for current taxpayers.
- Reform Scotland proposes that National Insurance should be phased out, with individuals instead paying a mandatory percentage of salary into defined contribution pension instead.
- To avoid poverty in old age a means tested minimum guaranteed income should be provided along the lines of the Pension Credit.
- The population projections should serve as a reality-check to politicians of all parties to exercise moral and political leadership and build a sustainable pension system.

CONTEXT

In October 2017 the National Records of Scotland published its latest projected population for Scotland, looking ahead to 2041. It projects that, over the next 25 years, there would be a large increase in the number of pensioners in Scotland alongside a decline in the number of people aged between 16 and 64.

Living longer is a cause for celebration, but with that advancement comes an existential challenge to our pension system. Despite many pensioners remaining economically active, whether by working past the State Pension Age, as consumers and increasingly by caring and volunteering contributions to society, the question of how to fund retirement will not go away.

Our State Pension system requires today’s tax receipts fund today’s pension payments. Working age people generate most of the tax paid, hence the challenge posed by the new population statistics. In other words, today’s workers are not saving for their own future through National Insurance, rather they are simply paying another tax to fund today’s pensions.

Although the pension system is reserved to Westminster, the problems apply equally in Scotland, and Reform Scotland believes that the system needs radical overhaul, whether by Westminster or by Holyrood. We need to face these issues now, when there is time to plan.

Reform Scotland looked at moving to a fully funded pension scheme in our 2014 report “The Pension Guarantee”. This briefing summarises that paper and highlights how our solutions could fix this pension conundrum.

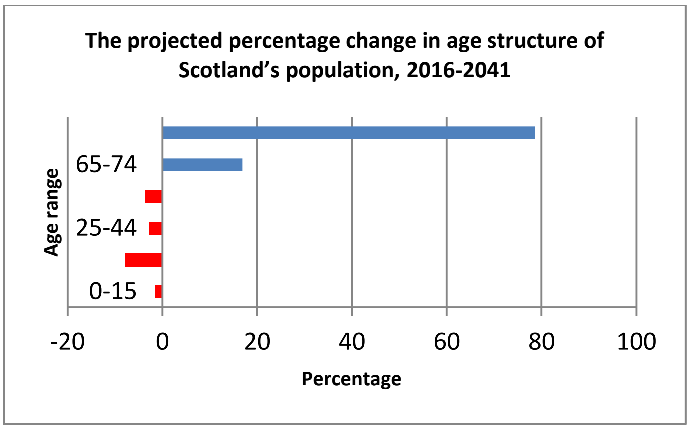
BACKGROUND

The National Records of Scotland published Scotland's Population 2016 – the Registrar General's Annual Review of Demographic Trend on 2 August 2017. The report covered a range of demographic issues from migration to marriage. However, this briefing focuses on the age and population projections and the following were some of the key points from that report:

- The estimated population of Scotland on 30 June 2016 was 5,404,700 - the highest ever recorded for the seventh year running.
- The age of the population of Scotland was as follows:
  - 17% of people were aged under 16;
  - 65% of people were aged 16 to 64; and
  - 18% of people were aged 65 and over.
- There were 610 (1.1%) fewer births in 2016 than in 2015 and 13,455 (19.8%) fewer births than in 1975. This is lowest annual total since 2005. In the last decade there was a peak of 60,041 births in 2008 followed by a mainly downward trend to the 2016 level.
- The trend of ageing in Scotland's population is projected to continue into the next two decades.

In October 2017 the National Records of Scotland then published its latest population projections.[1]

It stated that the 65-74 age group was projected to increase by 17% over the next 25 years while the 75 years and above age group was projected to increase by 79%. All other age categories were projected to see a decline in population over this period, as illustrated below:



It goes without saying that it is good news that people are living longer. Older people contribute a great deal to society, both economically and socially, so that alone is a cause for celebration, not for concern.

However, regardless of the contribution to society or health of individual older people, the one thing they will all have in common is that they will expect to receive a State Pension.

Again, this of itself need not be a problem in some jurisdictions, but the way that the UK's state pension system works makes it an existential problem here, which must be addressed now, when we still have time.

In our State Pension system, today's workers pay today's pensions; they do not 'pay in' to their own future pot, which has long been a mythical assertion. Although people pay National Insurance, in reality it is just another tax, paying current government expenditure, just as Income Tax does. National Insurance Contributions (NIC) do not go toward an individual's pension pot in the way private pension contributions do. With NIC the individual does not build up a personal pension pot, so has no claim on when and what they can draw as a state pension. All those decisions are

[1] https://www.nrscotland.gov.uk/files//statistics/population-projections/2016-based-scot/pop-proj-2016-scot-nat-pop-pro-pub.pdf

made by the UK Government which can, and has, moved the goalposts at any time. No guarantee can be made.

This is already a troublesome situation and Reform Scotland finds the lack of certainty individuals have about their financial security in old age alarming and unsustainable.

However, the projected Scottish demographics make a bad situation event worse; there will be proportionally even fewer working age people to pay the pensions of even more pensioners.

Currently pensions are reserved to Westminster. However, that does not lessen the need to address the fundamental flaws within the current State Pension system, especially as the UK is facing similar demographic changes.

The Office for National Statistics population projections[2] for the whole of the UK has indicated that the old age dependency rate (the number of people of State Pension Age per 1,000 working age) will increase from 305 in 2016 to 370 in 2041. This increase is despite changes to the Stage Pension Age over that period. The number of working age people will increase by 7.8% over the period, but the number of pensioners will increase by 31%.

The National Records for Scotland has projected[3] that in Scotland the old age dependency ration will increase from 307 to 380.

The tables below illustrate how much has been raised by National Insurance Contributions in Scotland in recent years compared to how much has been spent on pensions, while the second table shows the same information for the UK. Although in each instance the amount raised in NIC is marginally more than the amount spent in pensions, it is also worth remembering that NIC revenue is supposed to fund a range of other social protection measures as well as the State Pension.

Scotland	2011/12	2012/13	2013/14	2014/15	2015/16
NIC revenue £m[4]	8,270	8,581	8,798	9,077	9,383
Pension expenditure £m[5]	7,974	8,511	8,730	9,025	9,185

UK	2011/12	2012/13	2013/14	2014/15	2015/16
NIC revenue £m[6]	101,597	104,483	107,306	110,260	114,061
Pension expenditure £m[7]	93,725	102,213	104,181	108,016	110,059

POLICY RECOMMENDATIONS

The Pension Guarantee

Reform Scotland believes that all workers need to have a personal defined contribution funded pension to pay for their old age. This does not happen at present.

We believe that *instead* of employees paying National Insurance under the myth that they are paying towards their future, but with no guarantee of what they will receive, if anything, they should pay a mandatory percentage of salary into a defined contribution scheme of their choice. This scheme could be run by the state, the third sector or the private sector.

[2] https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/bulletins/nationalpopulationprojections/2016basedstatisticalbulletin

[3] https://www.nrscotland.gov.uk/files//statistics/population-projections/2016-based-scot/pop-proj-2016-scot-nat-pop-pro-pub.pdf

[4] Government Expenditure & Revenue Scotland 2016/17 detailed spreadsheets

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/629968/PESA_2017_Chapter_10_Tables.xlsx

[6] Government Expenditure & Revenue Scotland 2016/17 detailed spreadsheets

[7] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/629960/PESA_2017_Chapter_5_Tables.xlsx

The money that individuals pay into their mandatory pension scheme of their choice, in addition to the tax-relief paid by Government, would become their pension pot. Every individual would know how much their pot was worth. In addition the pot would be fully transferable should someone die before they reach retirement.

It would take approximately 45 years to phase out the State Pension altogether. Everyone who has up until now paid NIC would be entitled to some level of state pension, depending on what they had paid in. As a result, over time the dependence on the state pension would reduce, as individuals relied more on their own pot.

No-one would be left behind as the Government would still pay the Pension Credit to guarantee a minimum income in retirement.

Reform Scotland's report, *The Pension Guarantee*, sets out in detail how such a proposal could be afforded.

Benefits of the Pension Guarantee over the State Pension:

- **People will have their own pension pot; they will know what it is worth and can make decisions based on their own circumstances.** *In contrast currently everyone is treated the same, regardless of the type of work they do or life expectancy.*
- **People have knowledge of, as well as security and control over, the assets that will provide them with retirement income.** *Currently there is no guarantee of what your State Pension will be or when you can draw it.*
- **People can choose when they start taking their pension from the age of 60.** *Currently there is one State Pension Age, which can, and has been, increased at any time. But people have different life experiences and expectation.*
- **People own their pension pot, and as such if they die before retirement it can be passed on to someone else.** *The Government used to pay Widowed Parents Allowance to married parents whose spouse had died and children were in full time education. This was based on the fact the deceased had paid NIC but would not draw a pension. In April 2017 the UK Government radically reduced this payment.*
- **It would remove the burden placed on future generations as each generation would start providing for its own retirement.** *Currently today's workers pay for today's pensioners. With an ageing population that is setting up a problem for the future.*

Time is tight but there is enough to make important and positive changes. The population projections look forward thirty years from now. Changed birth rates or migration numbers would have big impacts. But the underlying challenge cannot be ignored. The figures represent a reality-check to politicians of all parties to exercise moral and political leadership and build a sustainable pension system.