

## **PPI Projections of future eligibility for means-tested benefits**

December 2007

1. The PPI published projections of future eligibility to Pension Credit in February 2007.<sup>1</sup> The models used to produce these projections have since been updated for new data, as well as extended to produce projections of eligibility for Housing Benefit and Council Tax Benefit. This note presents the updated projections (Table 1).
2. Future levels of eligibility for means-tested benefits are very uncertain, especially when looking as far as 40-50 years into the future. The projections are therefore presented as a range. As before, a central scenario is given, which is based on a detailed underlying projection of pensioners' incomes, as well as an optimistic and pessimistic scenario (Table 2 and Chart 1).
3. **Pension Credit:** In the central scenario, the proportion of pensioner benefit units eligible for Pension Credit is projected to fall slightly from 45% in 2005 to 40% by 2050. This compares to the previous projection, which showed levels of eligibility remaining level at around 45% until 2050. The projection has been updated for new data, including new population projections from the Office for National Statistics, new data on current and projected entitlements to Basic State Pension and an updated set of projections for private pensions.
4. The projected range of levels of eligibility for Pension Credit in 2050 is 25% to 55%. This compares to the previous projection, which showed a range of 30% to 65%.
5. **Housing Benefit:** The proportion of pensioner benefit units eligible for Housing Benefit is projected to fall from 20% in 2005 to 15% by 2050 in the central scenario. The projected range of levels of eligibility for Housing Benefit in 2050 is 10% to 15%.

<sup>1</sup> Pensions Policy Institute (2007) *Incentives to save and means-tested benefits*

6. **Council Tax Benefit:** The proportion of pensioner benefit units eligible for Council Tax Benefit is projected to fall from 55% in 2005 to 40% by 2050 in the central scenario. The projected range of levels of eligibility for Council Tax Benefit in 2050 is 25% to 55%.
7. **Overall levels of eligibility:** Overall levels of eligibility for any means-tested benefit are projected to fall from 60% of pensioner benefit units in 2005 to 50% by 2050. The projected range of levels of eligibility for means-tested benefits in 2050 is 35% to 65%.

**Table 1:<sup>2</sup> Projected proportion of pensioner benefit units eligible for means-tested benefits under the central scenario**

	<b>Pension Credit</b>	<b>Housing Benefit</b>	<b>Council Tax Benefit</b>	<b>Any means-tested benefit</b>
2005	45%	20%	55%	60%
2012	45%	20%	50%	55%
2020	45%	15%	45%	55%
2030	40%	15%	45%	55%
2040	40%	15%	45%	55%
2050	40%	15%	40%	50%

**Table 2:<sup>3</sup> Projected proportion of pensioner benefit units eligible for means-tested benefits in 2050 under different scenarios**

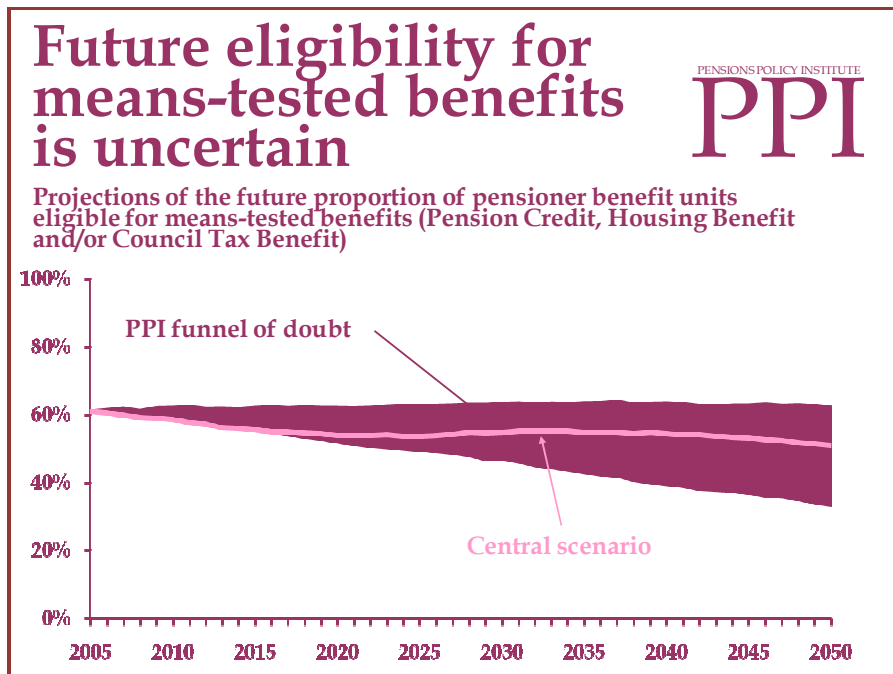
	<b>Pension Credit</b>	<b>Housing Benefit</b>	<b>Council Tax Benefit</b>	<b>Any means-tested benefit</b>
Optimistic scenario	25%	10%	25%	35%
Central scenario	40%	15%	40%	50%
Pessimistic scenario	55%	15%	55%	65%

<sup>2</sup> PPI analysis using the Aggregate and Distributional Models. All figures are rounded to the nearest 5%.

<sup>3</sup> PPI analysis using the Aggregate and Distributional Models. All figures are rounded to the nearest 5%.

8. There is a wide range of possible outcomes when projecting eligibility for means-tested benefits so far out into the future. Future eligibility will depend on decisions taken by future governments, and the future growth and distribution of pensioners' incomes. These projections assume that existing means-tested benefits are available in their current form in the future. Chart 1 shows the funnel of doubt that exists around projections of future eligibility to means-tested benefits<sup>4</sup>.

Chart 1



### Returns from saving

9. When interpreting these figures, it is important to note that eligibility for means-tested benefits does not necessarily lead to a low return from saving. Returns from saving depend on a wide range of factors, including the level of employer contributions, tax relief, investment returns, charges and income tax paid in retirement, as well as eligibility for means-tested benefits.

<sup>4</sup> See paragraph 18 for details of how this range is estimated

10. It is the people who face the very high marginal deduction rates<sup>5</sup> – for example through housing benefit or a combination of more than one means-tested benefit - that are potentially of most concern.
11. The analysis shows that 15% of pensioner benefit units could be eligible for Housing Benefit in 2050 in the central scenario. Previous PPI research has shown that people eligible for housing benefit can be at high risk of not receiving good value for saving in a personal account<sup>6</sup>.
12. There will be other people who could be at medium risk of not receiving good value from saving in a personal account – for example, low earners in their forties or fifties in 2012 who have not yet started saving. These people may lose eligibility to pension credit, council tax benefit or housing benefit as a consequence of their saving depending on their circumstances.

#### Technical notes

13. All figures are on the basis of current policy continuing without change. They include the impact of the state pension reforms in the 2007 Pensions Act and the private pension reforms in the 2007 Pensions Bill. The re-indexation of the level of the Basic State Pension to national average earnings is assumed to begin in April 2012.
14. **Future levels of eligibility for means-tested benefits are very uncertain, especially when looking as far as 40-50 years into the future.** This is because whether or not pensioners will be eligible in future will depend on their income. There is considerable uncertainty involved in projecting future pensioners' incomes over such a long time period:
  - Future incomes from Basic State Pension are more certain now that individuals need only 30 qualifying years to be eligible for the full amount
  - There is more uncertainty about future eligibility to State Second Pension. Future incomes from State Second Pension will depend on the number of years in work, earnings when in work and the number of credits received for caring.

<sup>5</sup> The marginal deduction rate is the proportion of a marginal change in a pensioner's income from private pensions that is offset by lower entitlement to means-tested benefits. A higher marginal deduction rate can mean that an individual has a lower return from saving, although returns are influenced by other factors besides the marginal deduction rate.

<sup>6</sup> Pensions Policy Institute (2006) *Are Personal Accounts suitable for all?*

- Future incomes from private pensions will depend on the number of years and levels of contributions made, earnings, investment returns, charges and life expectancy.
  - The amount of income from earnings after state pension age will depend on the availability of employment opportunities and willingness to work.
  - Future Pension Credit entitlement also depends on future levels of capital, such as saving in bank accounts and ISAs. This will depend on how much people save and how these are invested.
15. The PPI central projection is based on detailed projections of incomes from the PPI's Aggregate and Distributional Models. Further technical details of the models can be found on the PPI's website.<sup>7</sup> The models have been updated for new data and assumptions, including:
- The new, 2006-based, set of population projections from the Office for National Statistics.
  - New data on current and projected entitlements to Basic State Pension.
  - An updated set of projections for private pensions, incorporating new data on private pension contributions, assets and incomes.
  - New surveys of household incomes for 2005/6.<sup>8</sup>
  - An updated assumption of investment returns in private pensions, of 3.5% a year in excess of price inflation.
  - A decrease in the assumed amount of contracting out from S2P. Membership of Defined Benefit schemes in the private sector is now assumed to reduce by two-thirds by 2050, rather than one-half as previously assumed.
16. From 2012 and the introduction of auto-enrolment and personal accounts, employers who already run a work-based pension scheme with more than a 3% employer contribution are assumed to automatically enrol new employees into it on existing terms.<sup>9</sup> One-third of workers automatically enrolled into work-based pension schemes are assumed to opt out.

<sup>7</sup> See Pensions Policy Institute (2007) *Incentives to save and means-tested benefits*

<sup>8</sup> Family Resources Survey 2005/6 and Pensioners' Incomes Series 2005/6

<sup>9</sup> This is the 'employers enrol on minimum terms' scenario used in Pensions Policy Institute (2007) *Will Personal Accounts increase pension saving?*

17. When projecting future eligibility to Housing Benefit, the proportion of pensioner households renting accommodation is assumed to reduce over time in line with the observed trend of increasing levels of home ownership for pensioners. Rents are assumed to increase in line with average earnings in the central scenario. When projecting eligibility to Council Tax Benefit, council tax rates are assumed to increase in line with average earnings in the central scenario.
  
18. To analyse the potential range of eligibility for the different means-tested benefits in 2050, the standard optimistic and pessimistic income growth scenarios have been used, based on varying the average annual growth rate of overall pensioners' incomes by +/- 0.5%, as in previous work.<sup>10</sup> This is a broad approach designed to illustrate the general uncertainty of these projections rather than any particular detailed scenario. In addition, rents and council tax rates are assumed to increase 0.5% a year more slowly in the optimistic scenario, and 0.5% a year more quickly in the pessimistic scenario.

<sup>10</sup> Pensions Policy Institute (2007) *Incentives to save and means-tested benefits*