

# The effect of the Conservative Party's pension policy

## PPI Briefing Note Number 5

### Introduction

The benefit levels of the Basic State Pension (BSP) and the second state pension (SERPS for people retiring now) increase each year at least in line with the retail price index. There is also a means-tested top-up income available, the Guarantee Credit (GC), which has replaced the Minimum Income Guarantee (MIG), and a Saving Credit (SC) which rewards saving above the BSP. GC is expected to increase each year at least in line with average earnings, although this is not a statutory requirement. It is assumed to do so in all recent government long-term projections.

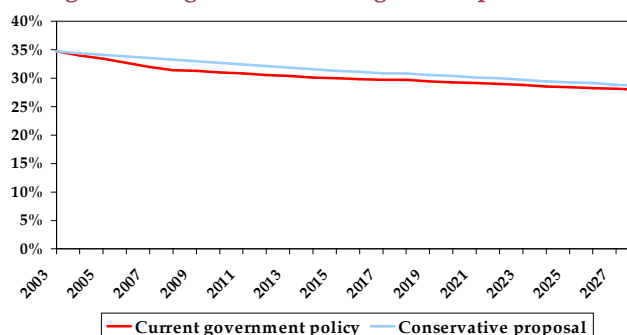
Because BSP is currently lower than the GC limit, many pensioners have to claim GC. Because earnings tend to grow 1.5 to 2 percentage points faster than prices, the gap between BSP and GC is widening over time, so that an increasing number of pensioners will fall back on the means-tested GC, or be entitled to SC.

The Conservative Party has put forward new proposals aimed at stopping the spread of means-testing<sup>1</sup>. They propose to reverse the index-linking practice: index the BSP to earnings, and the GC to prices<sup>2</sup>. This note compares the outcome of this proposal to the outcome of continuing current policy.

Table 1: Weekly Income	Basic State Pension	SERPS/S2P	Private Pension	
Average man	£73	£21	£70	Actual Averages
Average woman	£60	£8	£39	
Higher earner	Full £77	Full £67	£100	Constructed example

### Chart 1: The average man would see little change in retirement income

Pension income over time as a proportion of National Average Earnings for the average male pensioner



### The individuals tested

The PPI has modelled the impact of the proposed indexation changes on individuals that represent typical profiles of pensioners today (Table 1)<sup>3,4</sup>.

The 'average man' is representative of the average male pensioner. He receives slightly less than a full BSP (around 95%), and a small amount of SERPS / S2P. On top of this he receives a reasonable sum from occupational and private pensions.

The 'average woman' is representative of the average female pensioner. She receives considerably less than the full BSP, and little SERPS. Her private pension income is just over half that of the average man.

The 'higher earner' is someone who has a full BSP, full SERPS and a private pension income of £100 a week. While this might sound like the expected outcome from the pension system, it is in fact representative of someone in the richest one-third of single pensioners<sup>5</sup>.

PPI Briefing Notes clarify topical issues in pensions policy.

# The effect of the Conservative Party's pension policy

## PPI Briefing Note Number 5

### The impact on individuals

The income for the average man will be little different under the Conservative policy compared to current policy (Chart 1). Once he becomes entitled to SC under current policy, some indexation to earnings is maintained.

The average woman will lose under the proposed policy, as part of her income will be indexed to prices. Under current policy she becomes eligible for the GC, so in effect all of her income is earnings-linked (Chart 2).

High earners who remain well above the GC limit for the duration of their retirement gain from the policy as the full effect of the increase in state pensions feeds through directly (Chart 3).

### Discussion

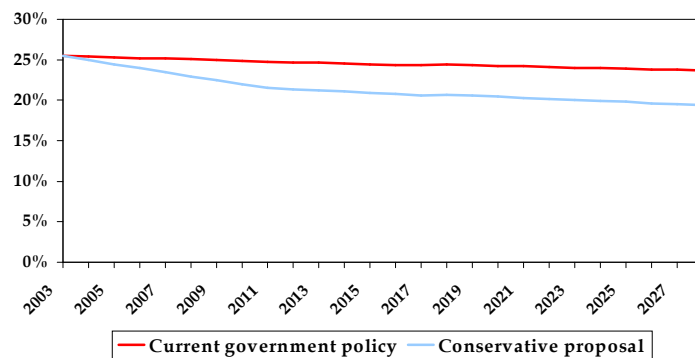
Most pensioners will become eligible for SC, and many will also be eligible for the safety net of the GC, at some point in their retirement. It is for this reason that the new Conservative policy on indexing has been proposed. But as the GC limit would be indexed to prices, instead of earnings, the relative value of the safety-net would fall. This means that the financial position of most pensioners would worsen relative to a continuation of current indexing policy.

**Contact: Alison O'Connell**

0207 848 3751 alison@pensionspolicyinstitute.org.uk

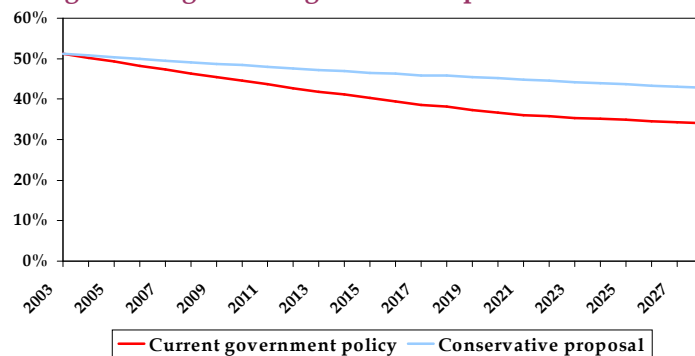
### Chart 2: The average woman loses under the proposed changes

Pension income over time as a proportion of National Average Earnings for the average female pensioner



### Chart 3: The higher income pensioner gains from the proposed changes

Pension income over time as a proportion of National Average Earnings for a higher income pensioner



There are two groups who would gain financially from the proposed Conservative policy. The first are higher earners who would see the full impact of the faster increase of state pensions. The second are those poorer pensioners who do not claim their GC now, although these people would be worse off compared to their situation if they did claim GC now. A third group of pen-

sioners, who would not have the hassle of claiming GC or SC because their higher state pension takes them above the limit, may have no or little financial gain.

<sup>1</sup> Willetts D., Yeo S., *A Fair Deal for everyone on Pensions*, Available [www.conservatives.com](http://www.conservatives.com)

<sup>2</sup> The Conservative Party also propose to scrap the state second pension in the longer-term, and increase incentives for private pension saving. This note does not look at the impact of these proposals.

<sup>3</sup> The RPI is assumed to increase at 2.5% each year and average earnings at 4.5% each year. Private pension income is assumed to increase each year in line with the RPI.

<sup>4</sup> BSP and SERPS figures derived from DWP (2003) *State Pension (SP) Summary of Statistics March 2003*. Private pension income derived from DWP (2003) *Pensioners' Income Series 2001/2*.

<sup>5</sup> PPI estimates based on DWP (2003) *Pensioners' Income Series 2001/2*

Charts 1-3: PPI calculations