

Around half of older people in the UK are eligible for the means-tested Pension Credit (PC). PC is widely seen as problematic, so the number of people eligible for it will be a critical measure of success for the proposals in the forthcoming Government White Paper.

The Pensions Commission estimated how many people would be eligible for PC after their proposals for pension reform. This number is uncertain. PPI modelling shows there could be more people eligible in future than previously thought.

In any case, the number eligible for PC would remain historically high, which may not be desirable. This Briefing Note therefore gives three examples of affordable reforms which would reduce the number eligible for PC to below historical levels.

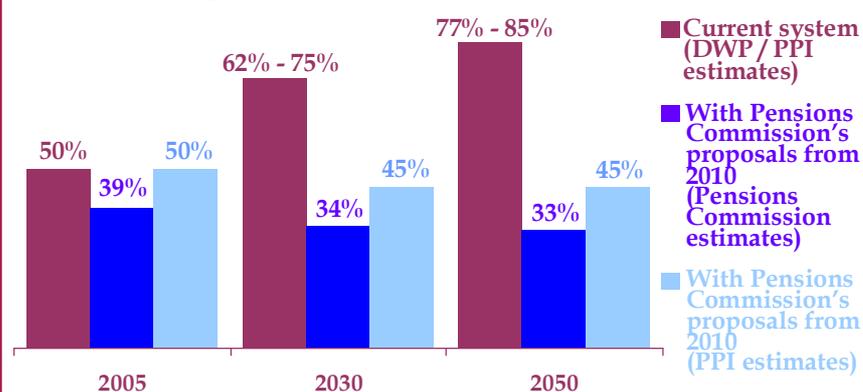
Extensive PC is not sustainable
Pension Credit was introduced to target extra spending where need was greatest.

However, many people believe extensive Pension Credit is not a sustainable policy for the long term. The main argument against is that people remain uncertain about what they will get from the state and the value of saving. The level of Pension Credit is set annually and even small changes can make a big difference to eligibility.

PPI Briefing Notes clarify topical issues in pensions policy.
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Chart 1: There could be more Pension Credit in the Pensions Commission's proposals than previously estimated

Proportion of pensioner benefit units eligible for Pension Credit



In addition, Pension Credit:

1. Suffers from imperfect take-up and so not does guarantee against poverty.
2. Is difficult to understand.
3. Can be seen as 'something for nothing'.
4. Involves a claims process which, while improved, is still disliked by many.

What is an acceptable level?

There is not a single 'right' answer for how many people 'should' be eligible for PC. This is because its problems are about public perceptions of the value of saving and of fairness.

Less PC will become more important if employees are auto-enrolled into something like the Commission's National Pensions Savings Scheme (NPSS). The possibility of being on PC

would make the decision to stay-in or opt-out more difficult.

Official statistics show that currently around half of pensioner benefit units¹ are eligible for PC. If current indexation continues, up to 75% of pensioner benefit units could be eligible by 2030.

The Commission asserted that maintaining the current proportion of pensioners eligible for PC is acceptable², and that the problem is the future spread of PC.

However, many pension experts would go further than the Commission, thinking it desirable to reduce the proportion eligible for PC from current levels³.

One guide for acceptability is the historical level of means-testing. For most of the 1990s fewer than 30% of pensioner benefit units were eligible for means-testing for basic income⁴.

The Commission's estimates may be too low

The Pensions Commission estimated how many pensioner benefit units would be eligible for PC after their proposals.

The Commission started from an estimate that 39% of pensioner benefit units are eligible in 2005⁵. However, official statistics published since the Commission reported show the proportion was between 44% and 51% in 2003⁶.

This future proportion of pensioners eligible for PC is uncertain and depends on future income from private pensions and earnings. But because the Commission's modelling started with an underestimate of current eligibility, there is a risk that the Commission's estimates are underestimates for future years too.

The Commission estimated that once their proposals for state pensions and NPSS have almost worked through, by 2050, around one-third of benefit units could be eligible for PC.

The PPI has made new estimates. They start from within the official range for current eligibility. They suggest that the proportion in 2050 would be around 45% under the Commission's proposals (Chart 1)⁷.

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Chart 2: Affordable systems exist that reduce reliance on Pension Credit

	Short transition: Increase BSP to the Guarantee Credit (GC) level in 2010. Stop S2P accruals.	Medium transition: Increase BSP faster than earnings to reach the GC level by 2030. Stop S2P accruals.	Long transition: Replace accruals to BSP and S2P with accruals to a new pension at GC level
Proportion eligible for PC	10% from 2010	10% from 2030	25% by 2050 10% from 2060
Possible ways of affording it	Use revenue from contracting-out and offset S2P from BSP	Use revenue from contracting-out or increase NICs by 1%	n/a
Remaining cost in 2010 (£1 bn for P Comm. proposals)	£1 bn	£6 bn saving	£1 bn
Remaining cost in 2020 (£10 bn for P Comm. proposals)	£7 bn	£2 bn	£1 bn

A reduction is possible

Although uncertainties remain, both the Commission's estimate of one-third and the PPI's estimate of 45% are higher than the levels many experts suggest are acceptable.

Affordable solutions do exist which reduce the proportion eligible for PC, even below historical levels. For example, a single-tier pension set at the Guarantee Credit level (£114 a week for singles) would reduce the proportion of pensioner benefit units eligible for PC to around 10%.

Three possible transitions to this new system are in Chart 2⁸. A short transition reaches 10% by 2010, a medium transition reaches it by 2030 and a long transition reaches it by 2060.

All three could cost less than the Pensions Commission's proposals by better targeting state spending. Longer transitions give less to today's pensioners but may be easier to afford.

A forthcoming PPI paper explores these and other issues further⁹.

¹ A single or couple over state pension age.

² Pensions Commission (2005) *A New Pension Settlement for the Twenty-First Century* p.233

³ PPI (2006) *Shaping a stable pensions solution* p.2

⁴ PPI analysis of DWP data

⁵ Pensions Commission (2005) p.11. The Pensions Commission Secretariat has told the PPI that the numbers in the report (and in the spreadsheets on their website) are actually estimates of the proportion eligible for PC, even though they are referred to as the proportion 'on' and 'receiving' PC (pp. 10, 11, 240).

⁶ House of Lords *Hansard* 25 April 2006 Column WA15. Increases are likely since 2003.

⁷ Midpoints of ranges in House of Commons *Hansard* 18 April 2006 Column 432W; Pensions Commission (2005) p.11; PPI modelling.

⁸ PPI modelling. Costs shown are on top of current spending plans. £1bn is less than 0.1% of GDP and less than 1% of the health budget. The costs for the Commission's proposals include making BSP universal for the over 75s. Pensions Commission (2005) *Estimated Cost of Pensions Commission Proposals*

⁹ PPI (Forthcoming) *Transition trade-offs: Options for state pension reform*