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"Government decisions on the state pension and benefits paid to pensioners will determine future levels of pensioner poverty" says Pensions Policy Institute

Government decisions on the state pension and means-tested and other benefits paid to pensioners will determine future levels of pensioner poverty according to a research report published today by the Pensions Policy Institute (PPI).

The report, *The implications of Government policy for future levels of pensioner poverty*, was commissioned by Age UK and projects future levels of pensioner poverty under the current state pension system and under a range of alternative Government policies. Policies considered in the research include changes to the level of existing means-tested and other benefits paid to pensioners and under the introduction of a single-tier state pension of £140 a week as proposed by the Government in a recent Green Paper.

Chris Curry, PPI Research Director said:

"Pensioner poverty has been falling over the last three decades in the UK. At its peak in 1989, 39% of pensioners lived in households with incomes below the relative poverty line of 60% of median income, after housing costs (AHC). By 2009 this had fallen to 16% of pensioners living in poverty, partly as a result of the previous Government's decision to introduce the Minimum Income Guarantee and its successor benefit Pension Credit."

"Assuming that current state pension policy continues and that the Government continues to index the Guarantee Credit to growth in average earnings, the percentage of pensioners living in households with income below the poverty line is projected to fall from 16% of pensioners in 2009 to 11% of pensioners by 2025."

"If the Government continues with current state pension policy but were to decide to index the Guarantee Credit to the Consumer Price Index instead of to average earnings then the percentage of pensioners living in households with incomes below the poverty line is projected to rise, from 16% of pensioners in 2009 to 19% of pensioners by 2025."

"The introduction of a single-tier state pension of £140 a week as set out by the Government in a recent Green Paper is projected to reduce the proportion of pensioners living in households with income below the poverty line from 16% of pensioners in 2009, to 10% of pensioners by 2025."

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The Executive Summary of the report is attached**.** From 3pm on **Monday 11th July 2011** the full report can be downloaded from www.pensionspolicyinstitute.org.uk

Notes for editors

1. The Pensions Policy Institute (PPI) is an independent research organisation, with a charitable objective to inform the policy debate on pensions and retirement provision. Its aim is to improve information and understanding about pensions and retirement income through research and analysis, discussion and publication. It does not lobby for any particular policy, but works to make the pension policy debate better informed.

2. This research report has been commissioned by Age UK. Age UK is the new force combining Age Concern and Help the Aged, dedicated to improving later life. It provides free information, advice and support to over five million people; commercial products and services to over one million customers; and research and campaign on the issues that matter to people in later life.

age UK
Improving later life

3. The Government's Green Paper: A State Pension for the 21st Century can be downloaded from the DWP's website at www.dwp.gov.uk/state-pension-21st-century

4. The report uses a range of measures to describe pensioner poverty but the main measure used in the proportion of pensioners living in households where the income of the household is less than 60% of the median income level of the population as whole, after adjusting for housing costs and household size. This is a measure of relative income poverty.

5. The research has considered the potential impact of the following policy options for future projections of pensioner poverty:

   a) Continuation of Current Policy includes the following policy assumptions:-

      - From April 2011, the Basic State Pension (BSP) will be uprated by the higher of earnings growth, growth in the Consumer Prices Index (CPI) or 2.5%, a mechanism known as the triple lock.

      - In the current policy scenario the report assumes that the Government continues to index Guarantee Credit to earnings, as has been recent practice and as set out in the Pensions Act 2007, although the Government has not made any specific commitment on the future of means-tested benefit indexation. This assumption is varied in some of the alternative policy scenarios considered (see b below).

      - From April 2011, the State Second Pension (S2P) is uprated by the growth in the Consumer Prices Index and by the mid 2030s S2P becomes a flat-rate benefit.

      - The State Pension Age (SPA) is assumed to increase from 65 to 66 for both men and women by 2020 and then follows the SPA increases legislated in the 2007 Pension Act.

      - It was announced in Budget 2011 that the additional increases to Winter Fuel Payments (WFP) paid in 2010 will not be paid in 2011. This means that, from April 2011, Winter Fuel Payments for households in which one of the members is aged 60 or over will be £200, compared to £250 in 2010. For households in which one member is aged 80 or over, WFP will be £300, compared to £400 in 2010. Winter Fuel Payments are assumed to remain fixed in cash terms at the 2011 levels. This assumption is varied in an alternative policy scenario (See b below).

b) Three policy options consider the impact of changes to existing benefits within the current system:
   - Increasing the Guarantee Credit to £140 a week (in 2010/11 earnings terms) from 2012 and indexing it in line with the 'triple lock.'
   - Uprating the current level of Guarantee Credit in line with the Consumer Price Index from 2012.
   - Setting Winter Fuel Payments back to their 2010 levels and indexing them by the 'triple lock' from 2011.

c) Three variants of a single-tier pension of £140 a week in 2010 earnings terms have been considered
   - Introducing a single-tier pension of £140 per week for new pensioners from 2016. This is similar to the one of the Government's proposals in the Green Paper. This option would apply only to new pensioners reaching State Pension Age and retiring from the implementation date – here assumed to be 2016.
   - Introducing a single-tier option for all pensioners (both current and future) from 2016.
   - Introducing a single-tier pension for new pensioners from 2016 combined with an increase in the Guarantee Credit to £140 per week (in 2010/11 earnings terms) for existing pensioners from 2012 and uprated by the 'triple lock' of the highest of earnings growth, growth in the CPI or 2.5%.

Executive Summary

Pensioner poverty has been falling over the last three decades in the UK. At its peak in 1989, 39% of pensioners had incomes below the relative poverty line of 60% of median income, after housing costs (AHC). By 2005 this had fallen to around 18% of pensioners living in relative income poverty. This reduction in the level of pensioner poverty can be attributed partly to falls in the relative after housing cost income of working-age people and partly as a direct result of Government policy through the introduction of means-tested benefits, most notably, Minimum Income Guarantee (MIG) in 1999, and its successor, Pension Credit since 2003.

However, in more recent years, pensioner poverty levels have remained steady and the Government's most recent figures suggest that in 2009/10 around 1.8 million pensioners were living in households with household income below the relative poverty line of 60% of median income, after housing costs (AHC). This represented 16% of a total of 11.5 million pensioners living in the UK.

Further state pension reforms may have an impact on the income of current and future pensioners and hence on future levels of pensioner poverty. However, some measures will have a short-term impact on the household incomes of current pensioners, while others will have a long-term impact on the incomes of future pensioners.

This report examines the potential impact of a range of alternative policy options that Government could adopt on future levels of pensioner poverty. The report does not aim to suggest which policy the Government should adopt, but rather aims to highlight the implications of policy choices for possible future levels of pensioner poverty.

All of the results must be interpreted with care. The results on the percentage of pensioners living in households with household income below 60% of median income are particularly sensitive to changes in the long-term median income growth assumption for the UK population as a whole. In the main report we have conducted sensitivity analysis of the results to this and other assumptions.

The Government's current pensions policy is to index the Basic State Pension (BSP) to the higher of growth in earnings, in the Consumer Prices Index (CPI) or 2.5% - the triple-lock, and to make the State Second Pension (S2P) flat-rate by the mid 2030s. In the current policy scenario, the report assumes that the Government continues to index Guarantee Credit to earnings, as has been recent practice and as set out in the Pensions Act 2007, although the Government has not made any specific commitment on the future of means-tested benefit indexation.

Table A1 sets out the projections of the percentage of pensioners living in households with household income below 60% of median income, after housing costs, under a continuation of current policy. It also sets out projected Government expenditure on state pensions and other benefits paid to pensioners.

Table A1: Implications of current pension policy for future levels of pensioner poverty and Government expenditure on state pensions and other benefits

		2011	2017	2025
Current policy – BSP triple-locked, S2P flat-rate mid-2030s, Guarantee Credit indexed to earnings. Assumes current levels of take-up of means-tested benefits	**Percentage of pensioners living in households with household income below 60% of median income, after housing costs (UK)**	15%	14%	11%
	Government spending on state pensions and other benefits (% of GDP)	5.1%	5.3%	5.7%

Under a continuation of current Government policy this report has found that:

- The projected percentage of pensioners living in households with household income below 60% of median incomes AHC, is projected to continue to decrease over the long-term. The report suggests that under a continuation of current policy assuming current levels of take up for means-tested benefits, around 11% of pensioners are projected to be living in relative income poverty by 2025, compared to the Government's latest official estimates of 16% of pensioners in 2009/10. Under this option the Government is projected to spend around 5.7% of GDP in state pensions and other benefits by 2025. The projected reduction in pensioner poverty is partly due to the Government's policy of indexing the BSP to the triple-lock.
- Under a continuation of current policy but assuming full take-up of means-tested benefits, this report has found that by 2025 around 6% of pensioners are projected to be living in relative income poverty by 2025. However, this option would increase Government spending on state pensions and other benefits to around 5.9% of GDP by 2025. It should also be recognised that it is very difficult to achieve 100% take-up.
- The ratio between the income of pensioners in the top and the bottom of the income distribution tends to decrease over the long-term. This declining ratio suggests a decreasing income inequality among pensioners.

- The percentage of pensioners eligible for means-tested benefits tends to decrease over the long-term.

The report has analysed the impact on pensioner poverty of implementing policy options that would entail some changes to the benefits that are paid to pensioners within the current system. The three policy options considered include:

- As current policy but with the Guarantee Credit indexed to the higher of growth in earnings, CPI or 2.5% - the triple-lock from 2012;
- As current policy but with the Guarantee Credit indexed to the Consumer Prices Index (CPI) from 2012;
- As current policy but with Winter Fuel Payments re-instated to their 2010 levels and then indexed in line with the higher of growth in earnings, CPI or 2.5% - the triple-lock from 2011.

Table A2: The implications of changes to the level of benefits paid to pensioners for future levels of pensioner poverty and Government expenditure

	Percentage of pensioners living in households with household income below 60% of median income, after housing costs (UK)			Government Spending on state pensions and other benefits (% of GDP)
	2011	**2017**	**2025**	**2025**
Current policy – BSP triple-locked, S2P flat-rate mid-2030s, Guarantee Credit indexed to earnings.	15%	14%	11%	5.7%
As current policy but Guarantee Credit increased to £140 a week in 2010/11 earnings terms, indexed to "triple-lock" from 2012	15%	14%	9%	5.8%
As current policy but current level of Guarantee Credit indexed to CPI from 2012	15%	18%	19%	5.4%
As current policy but Winter Fuel Payments re-instated to 2010 level and indexed to "triple-lock" from 2011	15%	14%	10%	5.8%

The report concludes that under the policy options that change some benefits within the current system:

- Two of the policy options could further reduce future levels of pensioner poverty compared to current policy, but indexing the Guarantee Credit in line with the CPI could increase future levels of pensioner poverty to around 19% of pensioners by 2025, compared to 11% under current policy. This option would decrease Government spending on state pensions and other benefits to 5.4% of GDP by 2025, compared to 5.7% under current policy.

- Increasing the Guarantee Credit to £140 per week from 2012 and indexing it by the 'triple-lock' reduces the projected percentage of pensioners living in households with household income below 60% of median income to 9% by 2025, compared to 11% of pensioners under current policy. Under this option the Government is projected to spend around 5.8% of GDP on state pensions and other benefits, compared to 5.7% under current policy.
- Setting the Winter Fuel Payments (WFP) to 2010 levels from 2011 and indexing them by the 'triple-lock' is also likely to decrease the projected percentage of pensioners living in households with household income below 60% of median income to around 10% of pensioners by 2025, compared to around 11% under current policy. Under this option the Government is projected to spend around 5.8% of GDP on state pensions and other benefits by 2025, compared to 5.7% of GDP under current policy.
- These findings highlight the key role played by the level of the Guarantee Credit in determining future levels of pensioner poverty.

The Coalition Government has issued a Green Paper to consult on possible further state pension reforms. The Green Paper proposes two options for further state pension reform. The first option proposes to accelerate the flat-rating of the State Second Pension (S2P) by 2020 so that accrual becomes flat-rate by 2020 instead of by around 2030. The second option would entail the replacement of the current BSP and the S2P with a flat-rate single-tier pension, estimated at £140 per week in 2010 earnings introduced for future pensioners who reach State Pension Age (SPA) from the date the new system is implemented.

This report has analysed the impact on pensioner poverty of implementing a single-tier pension under three different variants:

- A single-tier pension as proposed in the Government's recent Green Paper, set at £140 a week in 2010, and introduced from 2016 for future pensioners retiring after that date only;
- A single-tier state pension at the level proposed by the Government, but introduced more widely, for all future and current pensioners from 2016;
- A single-tier pension as proposed in the Government's recent Green Paper, set at £140 a week in 2010 and introduced from 2016 for future pensioners only, along with an increase in the Guarantee Credit to £140 from 2012 and indexing it by the triple-lock.

Table A3: The implications of alternative single-tier state pension policies for future levels of pensioner poverty and Government expenditure

	Percentage of pensioners living in households with household income below 60% of median income, after housing costs (UK)			Government Spending on state pensions and other benefits (% of GDP)
	2011	**2017**	**2025**	**2025**
Current policy – BSP triple-locked, S2P flat-rate mid-2030s, Guarantee Credit indexed to earnings.	15%	14%	11%	5.7%
Single-tier pension as in Green Paper introduced for future pensioners from 2016	15%	14%	10%	5.7%
Single-tier pension introduced for all pensioners (current and future) from 2016	15%	9%	7%	5.9%
Single-tier pension for future pensioners only and Guarantee Credit indexed to the "triple-lock" from 2012	15%	13%	8%	5.8%

The report concludes that:

- Under all three of the single-tier options modelled the percentage of pensioners living in households in income poverty tend to further decrease over the long-term, compared to a continuation of current policy.
- Introducing a single-tier pension as proposed in the Government's recent Green Paper for future pensioners only, reduces the percentage of pensioners projected to live in households with household income below 60% of median income to around 10% by 2025, compared to 11% of pensioners under a continuation of current policy. This option costs broadly the same as current policy.
- Introducing a single-tier pension for all pensioners from 2016 has the most significant impact on reducing the percentage of pensioners living in households with household income below 60% of median income. Under this option pensioner poverty is projected to reduce to 7% of pensioners by 2025, compared to 11% under current policy. This option also leads to a sharp fall in relative poverty levels immediately after its introduction in 2016, which reflects the immediate effect that it would have in reducing pensioner poverty. However, this option is the most expensive of the single-tier options for Government to implement, increasing Government spending on state pensions and other benefits to around 5.9% of GDP by 2025, compared to 5.7% under

current policy.

- Introducing a single-tier pension as proposed in the Government's recent Green Paper for future pensioners only from 2016, along with a commitment from the Government to increase the Guarantee Credit in line with the triple-lock could reduce future levels of pensioner poverty to 8% of pensioners by 2025, compared to 11% under current policy. The Government is projected to spend around 5.8% of GDP on state pensions and other benefits by 2025 under this option, compared to 5.7% under current policy.
- The percentage of pensioner households entitled to means-tested benefits under any of the single-tier options is projected to be lower than under current policy over the long-term.

The report highlights the trade-offs faced by all Governments in terms of the potential effect on poverty reduction of alternative policies and the costs of the different policy options. The policy options examined in this report that appear to be most effective at reducing future levels of pensioner poverty – such as the introduction of a flat-rate single-tier pension for all pensioners – are also the most expensive for the Government to implement. All Governments will have to decide where the balance lies between aiming to reduce pensioner poverty and controlling Government expenditure.

Summary of poverty projections and Government expenditure under alternative policy scenarios

	Percentage of pensioners living in households with household income below 60% of median income, after housing costs (UK)			Government Spending on State Pensions and Benefits (% GDP)
	2011	2017	2025	2025
Current Policy – BSP triple-locked, S2P flat-rate mid 2030s, Guarantee Credit indexed to earnings	15%	14%	11%	5.7%
1. As current policy but Guarantee Credit indexed to triple-lock, instead of earnings from 2012	15%	14%	9%	5.8%
2. As current policy but Guarantee Credit indexed to CPI, instead of earnings from 2012	15%	18%	19%	5.4%
3. As current policy but Winter Fuel Payments re-instated to 2010 level and indexed to triple-lock.	15%	14%	10%	5.8%
4. Single-tier pension as in Green Paper introduced for future pensioners only from 2016	15%	14%	10%	5.7%
5. Single-tier pension introduced for all pensioners (current and future) from 2016	15%	9%	7%	5.9%
6. Single-tier pension for future pensioners only and Guarantee Credit indexed to "triple-lock" instead of earnings from 2012	15%	13%	8%	5.8%