

PPI Briefing Note Number 7

Introduction

After reaching retirement, income for a typical pensioner household does not change significantly. Incomes tend, at best, to increase in line with the RPI, though some of the poorest pensioners receive increases linked to earnings through means-tested benefits.

Pensioners are therefore exposed to rapidly rising council tax rates, whose growth has significantly outpaced the RPI. Further, the relief that could be provided by council tax benefits is not always claimed.

What is the RPI and how is it measured?

Until December 2003 (when it was replaced by the Consumer Prices Index—CPI), the main measure of price inflation used in the UK was the Retail Prices Index (RPI). This measures the change in the average cost of buying a shopping basket containing all the purchases of a 'typical' UK household¹. However the RPI is not representative of some particular types of household.

The expenditures of those pensioner households for whom at least three-quarters of income comes from state pensions and benefits are specifically excluded from the calculation of the RPI². These pensioners represent 40% of all pensioners and 9% of all households³. Separate indices, based on the spending of all

pensioners, are constructed for single and pensioner couple households.

How have the pensioner price indices increased?

Over the last 10 years, pensioner price indices have risen less than the RPI (Chart 1)⁴. The single pensioner price index has risen on average by 1.6% per year, compared to 2.6% for the RPI. However, pensioner price indices omit housing costs (such as council tax), so do not fully capture how all living costs of pensioners change. Even so, pensioner price indices exceeded the RPI in 1992, 1993, 1996 and 1999⁵.

How have state pensions increased?

The real value (relative to the RPI) of the Basic State Pension (BSP) has fluctuated over the past 10 years. Compared to 1993/4 the BSP is now 7% higher than if it had simply kept pace with the RPI (Chart 1). Much of this is due to above-RPI increases in 2001, 2002 and 2003.

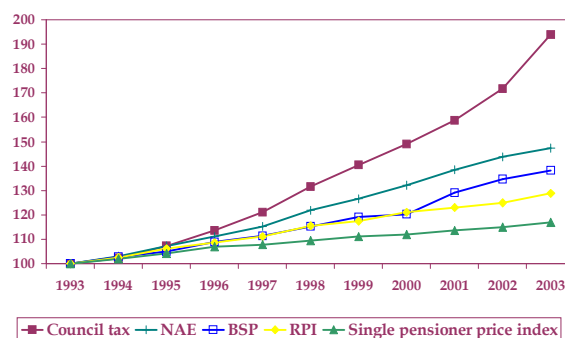
Pensioners also receive income from other benefits. In May 2001, one-quarter of pensioner households were receiving Minimum Income Guarantee (MIG), with one-quarter and one-third receiving Housing Benefit (HB) and Council Tax Benefit (CTB) respectively⁶.

The Guarantee Credit (GC), successor to the MIG, is expected to rise in line with National Average Earnings (NAE)⁷, which generally outpaces the RPI (Chart 1). HB and CTB thresholds for pensioners are linked to GC.

How do private sources of pensioner income increase?

Between 1996 and 2000, occupational pensions-in-payment increased roughly in line with the RPI⁸. For income from personal pensions, 69% of pension annuities bought in 2002 were level annuities, paying a regular, fixed income, but subject to erosion from inflation. Only 5% were indexed annuities, linked to the RPI⁹.

Chart 1: Council tax rate growth has outpaced that of the BSP and the various consumer price indices, 1993=100



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What has happened to council tax levels?

The average band D council tax has almost doubled since it was first introduced in 1993¹⁰, growing much faster than the RPI and average earnings (Chart 1). Although council tax increases feed in to RPI increases, and are offset by smaller increases in the cost of other goods and services, some pensioners are still affected disproportionately.

Are pensioners hardest hit?

Council tax accounts for a higher proportion of total spending in pensioner households than in other households. 8.7% of expenditure of pensioners mainly reliant on state benefits is on council tax, compared to 3.1% for all households¹¹.

There is also a lag effect, in that the pension increases awarded in 2003 are based on the RPI (and council tax increases) in 2002, not the current increase. For example, the 13% increase in council tax in 2003 will not feed into higher pensions until 2004.

Council tax varies from council to council. While pensioners in some areas have seen council tax rises higher than the average, all get the same state pension increases.

What about council tax benefit?

2.4 million pensioners are entitled to CTB. However, only two-thirds of entitled pensioners

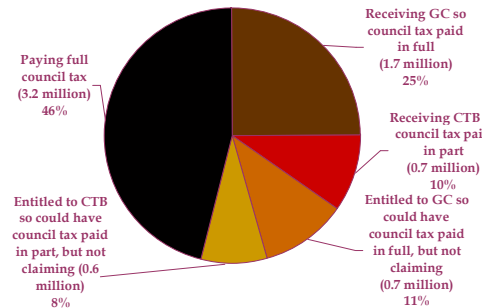
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Chart 2: Pensioners with different levels of protection from council tax increases, 2001

100% = 6.9 million pensioner households



claim CTB. Pensioners who do not take up benefits tend to be the poorest¹¹. Some pensioners who receive CTB still have to pay some of their council tax. Every £1 of income above the GC level reduces CTB by £0.20.

Which pensioners fare worst?

The 1.7 million pensioner households who receive GC (and are therefore entitled to have all council tax paid for by CTB) see incomes rise to compensate fully for council tax rises (Chart 2)¹².

Another 0.7 million CTB recipients, who have to pay some council tax, see CTB increase less than their council tax.

3.2 million pensioner households with higher income do not receive any extra help with council tax payments.

Those worst affected are the 1.3 million pensioner households entitled to GC or CTB, but not claiming, who have low income but pay their council tax in full.

Will this change?

Changes announced in December 2003¹³ will help 25,000 CTB recipients in large properties who have to pay part of their council tax, and may also help take-up.

If GC continues to be increased in line with earnings, an increasing proportion of pensioners will be entitled to GC and, if they claim, will have all their council tax paid through CTB. If council tax levels increase, more pensioners will become entitled to CTB.

Increasing BSP in line with earnings would help those who pay full council tax. However, if GC and CTB thresholds were not increased with earnings, some of those currently paying no or little council tax would have to pay more themselves, increasing exposure to council tax increases.

¹ONS Retail Prices Index – A Brief Guide

²ONS (1998) *The Retail Price Index Technical Manual*

³PPI calculations based on ONS (2003) *Family Spending 2001/2*

⁴PPI calculations based on data from ODPM and ONS. Figures are for April of each year (Q2 for single pensioner price index).

⁵Crawford I and Smith Z (2002) *Distributional Aspects of Inflation* Institute of Fiscal Studies

⁶PPI estimates based on DWP statistics

⁷PPI Briefing Note 3 *Future Government spending on pensions*

⁸GAD (2003) *Occupational Pension Schemes 2000*

⁹ABI (2002) *Annuities – The Consumer Experience*

¹⁰New Policy Institute (2003) *The impact of Council Tax on Older People's Income*

¹¹DWP (2003) *Income Related Benefits: Estimates of Take-Up 2000/2001*

¹²PPI estimates based on DWP statistics

¹³Hansard 15 December 2003 Column125WS