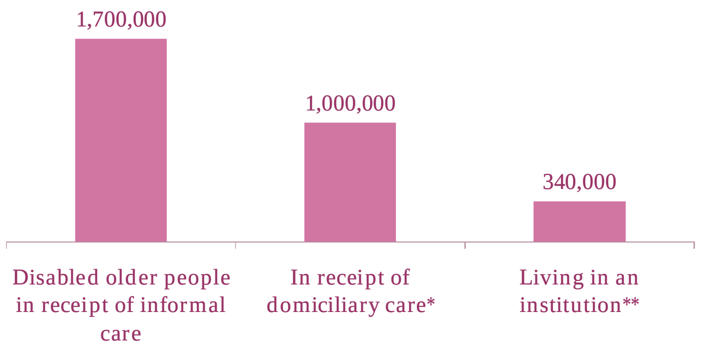
How much will pensions and long-term care cost in the future?

Introduction

For countries with ageing populations, the costs of pensions and long-term care are likely to increase. In the UK, the Pensions Act 2007 together with the Pensions Bill 2007/8 (currently making its way through parliament) would complete the Government's reforms to state and private pensions. The Government recently promised a Green Paper to set out options for change for the provision of long-term care for older people[1]. However, there has been little consideration of the combined effects of such reforms. For example, the potential for extra spending in one of these areas to be offset by savings in the other has not been addressed.

Chart 1: Most long-term care for older people is provided by informal carers

Estimated number of people aged 65 and over in England receiving informal care, domiciliary care and living in an institution



*Here we define domiciliary care as publicly funded home care and private domestic help.
** Meaning, either living in a residential home, nursing home or in a long-stay hospital.

To help improve our understanding of the complex relationship between pensions and long-term care, the New Dynamics of Ageing programme is funding the Modelling Ageing Populations to 2030 Research Group[2], an inter-disciplinary team, bringing together the PPI with experts from the London School of Economics, the University of East Anglia, the University of Leicester and the London School of Hygiene and Tropical Medicine. The project aims to produce long-term projections of expenditure on pensions and long-term care up to 2030 and beyond, on a consistent basis, which should help inform public debate and the development of future policy. This Briefing Note sets out some preliminary results and highlights the importance of considering both policy areas together.

What is long-term care?

'Long-term care' is usually taken to mean help with domestic tasks, such as shopping and preparing meals, assistance with personal care tasks, such as dressing and bathing, and nursing care. In broad terms, there are three types of care (Chart 1)[3]:

- Informal care: most long-term care for older people living at home is currently provided by informal carers, usually relatives and friends providing unpaid help with everyday tasks. One estimate suggests there are around 1.7 million elderly people receiving informal care with domestic tasks[4].
- Domiciliary care: around 13% of people aged 65 and over receive domiciliary services (around 1 million people), including publicly funded home care and private domestic help[5]. This figure would be higher if services such as day centre care, meals and district nursing were also included.
- Care homes: around 4% of people aged 65 and over live in residential or nursing homes or in long-stay hospitals (around 340,000 people). This increases to 20% for people 85 and over[6].

PPI Briefing Notes clarify topical issues in pensions policy.

Support for long-term care costs

Measuring the economy-wide contribution of informal carers is problematic. One approach would be to measure what it would cost to replace informal care inputs with formal care but such an estimate would be sensitive to the assumed unit costs[7]. Alternatively, one could attempt to quantify the income and leisure forgone due to caring; this approach could give a figure close to £10 billion[8].

There is some state support for unpaid carers. Full-time carers on low or no income can claim Carer's Allowance, which had a basic benefit rate of £48.65 per week in 2007/8. There are around 460,000 people claiming the benefit, which costs the Government around £1.2 billion per year[9]. The Pensions Act 2007 also made it easier for carers to receive credits towards their state pension.

Formal care is provided by a range of agencies and the cost is shared between the user and the state. Although data is limited and depends on which services are included, one estimate is that the state spends around £13 billion per annum on formal care while individuals contribute around £4 billion[10].

Formal care costs refer to the nursing and personal care fees that may be charged to older people receiving these services from care homes or from their own homes. In care homes specifically, costs related to accommodation and living costs are often referred to as 'hotel costs'.

People requiring state support with the cost of formal care are generally subject to a means test. The exception is if their primary need is health-related, in which case the NHS is responsible for providing all their needs, including accommodation. This means that people with certain conditions, such as cancer, can receive their care for free through the NHS while others who need care for conditions such as dementia are subject to a means test.

The system of means-testing varies across the constituent countries of the UK. People entering residential and nursing homes must first be assessed as needing such care before they can receive state help with meeting care home fees. If they are assessed as needing nursing care in a nursing home, the NHS pays a non means-tested contribution. In England, Wales and Northern Ireland the user pays a means-tested contribution to the remainder of the cost (in respect of the non-nursing care component of care home fees).

For those with capital above £21,500 (in 2007/8), the user contribution is 100% for as long as capital remains above this level. The value of an older person's home is excluded from capital for the first twelve weeks. After that, it is taken into account unless the older person has a partner or a qualifying relative who continues to live in the property. For those with capital below the threshold, the contribution is an amount that leaves the resident with income of no less than a 'personal expenses allowance'. In Scotland, on the other hand, all older people can benefit from free nursing and personal care, although state support for hotel costs is still subject to a means-test.

The arguments for reform

Rising longevity and an ageing population have raised concerns about future affordability of the long-term care system. Official projections show that the number of people in the UK aged 85 and over will increase from around 1.2 million in 2006 to 4.9 million by 2051, an increase of nearly 300%[11]. This is particularly important because the need for long-term care is greatest among the very elderly.

Under the current system, state spending on long-term care would need to double in real terms over the next 20 years just to keep pace with the growing number of older people and the rising costs of care provision. Even today some local councils are struggling to fund formal services. Recently, the Commission for Social Care Inspection found that councils have been setting higher thresholds of eligibility for care in response to increased demand[12].

But it is the perceived inequalities in the current system that provide the main impetus for reform[13]. Concerns about fairness of the current funding system have several dimensions. One issue relates to the differences between care which is available without charge under the NHS and care that is subject to means-tested user charges. A separate issue is whether the means test results in a fair distribution of public expenditure on social care for older people.

The treatment of housing wealth is another source of resentment for some. Unlike the pensions system, where housing wealth is ignored in the calculation of Pension Credit, it is taken into account in determining contributions to care home fees.

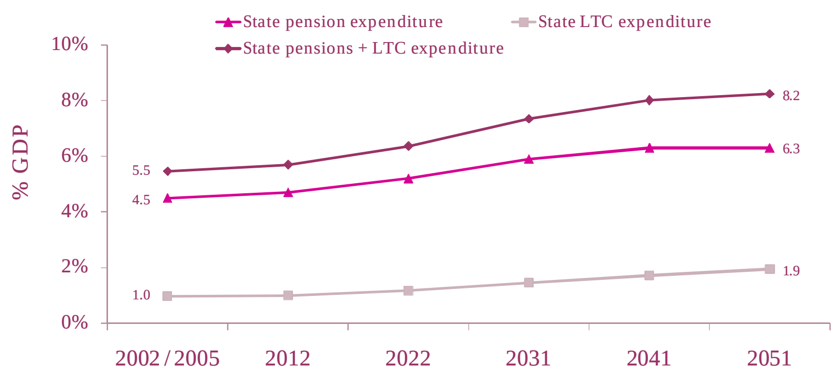
Demographic trends will mean more will need to be spent each year to maintain existing long-term care services. Most proposals for reform, however, imply more, rather than less, public spending.

How much will pensions and long-term care cost in future?
The MAP2030 project will produce consistent projections of state spending on pensions and long-term care under different policy options. Several interactions between the two areas may affect combined spending:

- Pension income is taken into account in the means test for long-term care, so increased levels of state and private pension (for example, that will result from the recent pension reforms) will decrease state spending on long-term care.
- Housing wealth is also taken into account in the means test for long-term care, however, it has also been suggested as a way of funding retirement.

Chart 2: State spending on long-term care is projected to almost double as a proportion of GDP by 2051

Projections of public expenditure on long-term care and pensions: English long-term care system applied to the UK, post-reform pension system



The MAP2030 project is due to be completed at the end of 2009. In the meantime, this note uses existing projections of pensions and long-term care expenditure. Summing separate projections in this way is useful to illustrate potential outcomes but ignores the interactions mentioned above.

The long-term care projections were made using two linked models; the PSSRU and CARESIM models[14], which for this work, assumed the continuation of current policy. The pension projections were made using the PPI's Aggregate Model. They account for the state reforms in the Pensions Act 2007 and include the Government's proposals to introduce auto-enrolment into a personal account or an alternative occupational pension scheme by 2012[15]. These pension reforms, however, are not factored into the long-term care projections.

Chart 2 shows that public expenditure on long-term care is projected to increase by nearly 1% of GDP by the middle of this century. Public expenditure on state pensions is projected to increase by nearly 2% of GDP over the same period. Given the much lower proportion of GDP represented by state spending on long-term care compared with pensions, this shows how the relative importance of long-term care is set to grow.

The increase in long-term care state spending is driven largely by growing numbers of people at ages where the care needs are greatest, combined with an assumption of unchanged age-specific disability rates and rising unit costs of care.

Chart 3: A greater proportion of pensioner incomes may need to be spent on long-term care in future

Projections of private and public expenditure on long-term care and pensions: English long-term care funding system applied to the UK, post-reform pension system

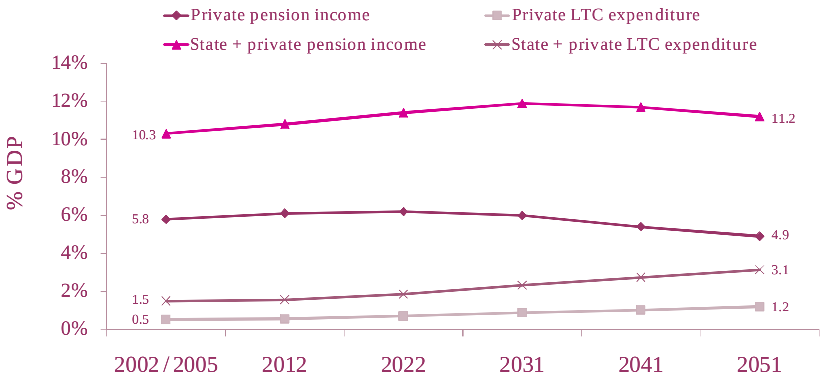


Chart 3 shows that private spending on long-term care is projected to double as a percentage of GDP from 0.5% to 1.2% by 2051. Total pension income (i.e. state plus private) is projected to rise from 10.3% of GDP to 11.2%. This suggests that a greater proportion of total pensioner income could be spent on funding long-term care in future[16].

A joint consideration of pensions and long-term care using separate models can therefore allow us to obtain useful insights into aggregate trends on expenditure and income. Fully linked models, however, will also allow us to test different reform ideas for pensions and long-term care, and the interactions between them. For example, some reform options often make suggestions about where extra resources might be found. But the need for resources in one area needs to take account of the use of those resources in the other.

This is exemplified by the growth in home ownership among older people. The increasing housing wealth held by older people has been suggested as a source of extra income in retirement. But if people draw more on their housing wealth to fund their retirement before needing care, the state will eventually have to meet a higher proportion of their care costs.

When considering potential reforms, it is important to analyse how the aggregate changes discussed earlier would affect individuals in different income groups. This is where a joint consideration of pensions and long-term care policy becomes particularly important, since their interaction is likely to have different effects in different parts of the income distribution.

Conclusion

This note explains the importance of considering both long-term care and pensions together. Using projections from existing models, it shows that around 8% of GDP will be spent by government providing pension income and care to older people by 2050, compared to less than 6% of GDP today. Further work to help develop a more holistic understanding of the interactions between long-term care and pensions will be forthcoming through the MAP2030 project.

For more information on this topic, please contact:
Adam Steventon 020 7848 3675 adam@pensionspolicyinstitute.org.uk
www.pensionspolicyinstitute.org.uk

1 HMT (2007) ***PBR and CSR*** page 100
2 See www.lse.ac.uk/collections/MAP2030/
3 Figures for England only are shown. PSSRU models can produce projections for the UK by making the assumption that the English system applies to all constituent countries
4 Estimate for 2004; see Wittenberg, R., Pickard, L., Comas-Herrera, A., King, D. and Malley, J. (2007) ***PSSRU Bulleting No. 17,*** page 14. See www.pssru.ac.uk/pdf/b17/b17.pdf
5 Estimate for 2004 provided by PSSRU
6 Estimate for 2002; see Wittenberg, R., Pickard, L., Comas-Herrera, A., King, D. and Malley, J., Darton, R. (2006) PSSRU DP2330, page 14. See www.pssru.ac.uk/pdf/dp2330.pdf
7 For example, see Counsel and Care (2008) ***A Charter for Change*** who suggest a figure of £61 billion
8 King's Fund (2006) ***Securing good care for older people*** page 145. £9.4bn estimate relates to the cost to society from all those caring for people over 65
9 DWP expenditure tables for 2006/7
10 See King's Fund (2006) ***Securing good care for older people*** page 101, Table 25 and Table 26
11 PPI analysis of 2006-based ONS population projections
12 BBC (Tuesday 29th Jan 2008) ***Needy face social care struggle***
13 For example, see ***Right to care Right Deal*** campaign by Counsel and Care, Help the Aged and Carers UK, which calls for a radical new system of social care in England
14 Hancock, R., Steventon, A., Comas-Herrera, A., Curry, C., King, D., Malley, J., Pickard, L. and Wittenberg, R. (2007) ***Paying for pensions and long-term care: combining separate projections of long-term care and pension costs and the distributional consequences of reform options***
15 State pension projections include spending on BSP, SERPS/S2P, other state benefits such as the winter fuel allowance but not contracted-out rebates, so as to focus on the resources that are available to pensioners
16 The fall in private pension income is mainly driven by our assumption of the decline in DB pension schemes, which offsets the aggregate gains from increased saving as a result of auto-enrolment and the new personal accounts scheme