Why are older pensioners poorer?

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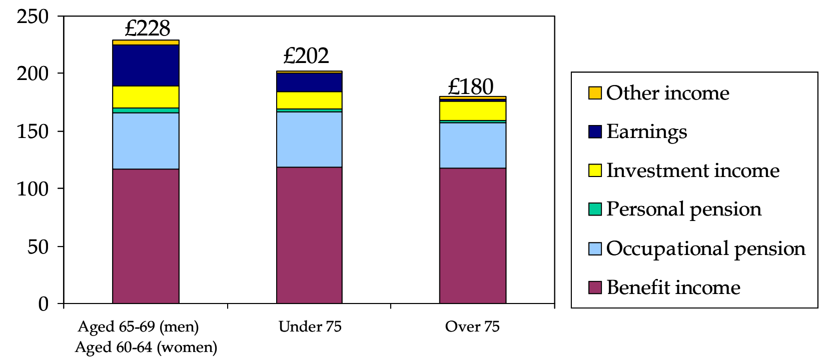
PPI Briefing Note Number 6

Chart 1: Sources of gross income of single pensioners by age
(£ per week, 2001/2 prices)



Introduction
Older pensioners are poorer. Their income, on average, is significantly lower than that of younger pensioners (Chart 1)[1]. Older female pensioners are particularly badly hit: the median gross weekly income of the 1 million females aged over 80 is £109[2].

If part of the role of the state pension system is to provide guaranteed security for old age, the current system is failing. But why are older pensioners poorer? And will this change?

Is it a generational matter?
It can be argued that each cohort reaching 65 is more likely to be placed in a better financial position. This **cohort effect** is mostly due to three reasons.

First, younger cohorts have been able to take advantage of the State Earnings-Related Pension Scheme (SERPS, established in 1978 and recently replaced by State Second Pension—S2P) on top of the Basic State Pension (BSP).

Second, younger cohorts have had better access to occupational pension schemes. 50% per cent of recently retired pensioners in 1979 received some occupational pension income, compared to 65% of the recently retired in 1996/7[3].

Finally, incomes have significantly, and almost constantly, risen over the last half century. Total real gross disposable income has risen by a factor of about 70 over the period 1952-2002[4]. So, younger cohorts were able to save (in private pensions, for instance) and invest in assets (housing, for instance) more than older cohorts.

Is each pensioner likely to get poorer as he or she lives longer?
Another factor at work, distinct from the cohort effect, is the **age effect**. This affects individuals of all generations.

First, retirement pension forms a larger fraction of pensioners' income with age. This is because **younger pensioners are more likely to have other forms of income, mainly from earnings**. In 2001, 13% of the 65-69 age band group was economically active, against less than 5% of the age band 70 and over[5]. The earnings of the recently retired are 18 times larger than earnings of those aged 75 or over (Chart 1).

Second, the Guarantee Credit (GC)[6] level is indexed to earnings, whereas pension income, whether public or private, is usually indexed to prices at best. This means that over time more older pensioners will become relatively poorer and qualify for GC or Pension Credit (PC). Even if someone retired at state pension age today with an income of £100 per week in addition to BSP he or she would be entitled to receive PC after 10 years. This is despite starting retirement with an income significantly above the PC level (Chart 2)[7].

Third, many eligible pensioners will not be aware of PC (perhaps they have never claimed a benefit before), or will not be able to go through the process to claim it. An estimated 22-36% of eligible pensioner households did not claim Minimum Income Guarantee (MIG)[8] and there is evidence that **older people are less likely to claim**[9].

PPI Briefing Notes clarify topical issues in pensions policy.

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The imperfect take-up of benefits may be due to perceptions of stigma and the 'hassle' of making a claim[10]. These difficulties in claiming are likely to rise with age.

Fourth, **the costs of older pensioners are likely to be higher** than younger pensioners,. This is partly a consequence of older pensioners being more likely to be single[11].

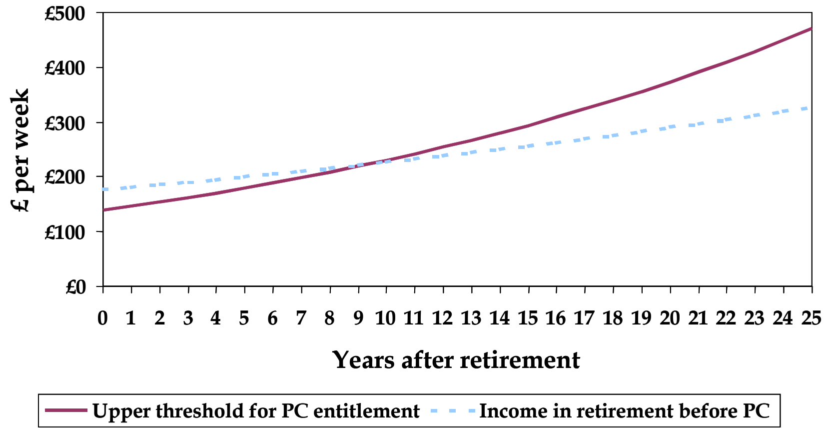
Finally, the **oldest pensioners will have lived longer than actuarial forecasts had predicted** for them. So, they may have made insufficient provision for the length of age that they turned out to have lived, running down any savings they may have had[12].

What are the policy issues?

Even if the cohort effect continues (and one could argue that it is slowing)[13], the age effects will persist. In addition, because of improved longevity, there will be more older pensioners. A man aged 65 in 2005 has a probability of 9% of reaching age 95. For a man aged 65 in 2045, the probability is 12%. For women, the jump is from 16% to 19%[14].

So, there are good reasons to seek to provide better for the oldest pensioners. One way[15] would be to consider **age additions** for the oldest. Increasing the BSP to the means-tested level for those aged over 80 would eliminate the imperfect take-up of MIG/PC for this group. It uses age as a simple, practical proxy to target poorer pensioners and would cost approximately 0.2% of GDP in the first year (rising thereafter as the means-tested threshold is indexed to earnings)[16].

Chart 2: Income and PC threshold for an average single pensioner retiring at state pension age in 2003



Age is an approximate proxy for poverty as there are 'rich' older pensioners as well as 'poor' older pensioners. But rich older pensioners are less well off than rich younger pensioners. For example, the richest fifth of single pensioners aged 75 and over have incomes 13% lower than the richest fifth of pensioners aged under 75. For couples the ratio is 34%[17].

The flat-rate £200 Winter Fuel Payment made to each over-60 household has been supplemented by £100 a year for households with someone aged over 80. This suggests that the rationale for age additions has been accepted, although the level will clearly be insufficient to take older people off means-testing. The age-related Winter Fuel Payment is only guaranteed for the current Parliament's lifetime and is not statutorily indexed[18].

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[1]DWP (2003) *Pensioners' Income Series 2001/2*
[2] Curry C and O'Connell A. (2003) *The Pensions Landscape* PPI
[3]See footnote 1 Table A12. 'Recently retired' denotes pensioners not more than 5 years older than state pension age.
[4]National Statistics (2003) *Household Sector: Secondary Distribution of Income Account 1955-2003*
[5]Smeaton D & McKay S. (2003) *Working after State Pension Age: Quantatative Analysis*
[6]MIG will be relabelled Guarantee Credit (GC) in October 2003 and, with the Savings Credit, will form the Pension Credit (PC)
[7]See footnote 2 (Chart 20)
[8]NAO (2002) *Tackling Pensioner Poverty: Encouraging Take-Up of Entitlements*
[9]DWP (2003) *Income Related Benefits: Estimates of Take-Up in 2000/2001*
[10]Hancock et al. (2003) *Stigma, Claim Costs and Means-Tested Pensioner Benefits* Nuffield Community Care Studies Unit
[11,12] Dash A and Webb S. (1999) *A New Future for the Basic State Pension* Centre for Reform
[13]See footnote 1 (Table 14)
[14]O'Connell A. (2002) *Raising State Pension Age – Are we ready?* PPI
[15]O'Connell A. (2003) *A Guide to State Pension Reform* PPI
[16]House of Commons Public Accounts Select Committee (2003) *Tackling pensioner poverty: encouraging take up of entitlements*
[17] DWP analysis of *Family Resources Survey 2001/2*
[18]H M Treasury (2003) *Budget Report 2003*

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