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Minimum pensions and older women's poverty

Comment Paper, United Kingdom



On behalf of
European Commission
DG Employment, Social Affairs and Equal Opportunities

Minimum Incomes and Older Women's Poverty

Intro

1. This paper describes the operation and effect of Pension Credit, and the effect it has had on low income statistics in The UK¹. The UK Government recently published proposals on Pension Reform which affect the evolution of the Minimum Pensions.

Background – UK Pension System

2. The Pension System in the United Kingdom is composed of:
 - The basic State Pension, which is paid to those over State Pension Age (currently 65 for men and 60 for women) who have paid National Insurance Contributions through their working life. People can be credited with contributions, for example through caring. Those who have not paid a full working lifetime of contributions will get a partial basic State Pension.
 - The additional State Pension - currently the State Second Pension (S2P) which replaced State Earnings Related Pensions (SERPs) in 1998. S2P provides some earnings related provision, but carers, those earning less than £12,000 and the disabled are credited as if they earned £12,000. This element is slowly becoming more flat rate.
 - An income related entitlement which provides a minimum income to pensioners. Entitlement to this is based on other income and wealth.
3. Private pensions also provide a significant portion of pensioners' income. For families where the head is over State Pension Age around 40% of income comes from private pensions and investments².
4. The Government's white paper on pension reform proposed a number of changes to this system. This note will only go through these where it is relevant to the minimum pensions.

Pension Credit

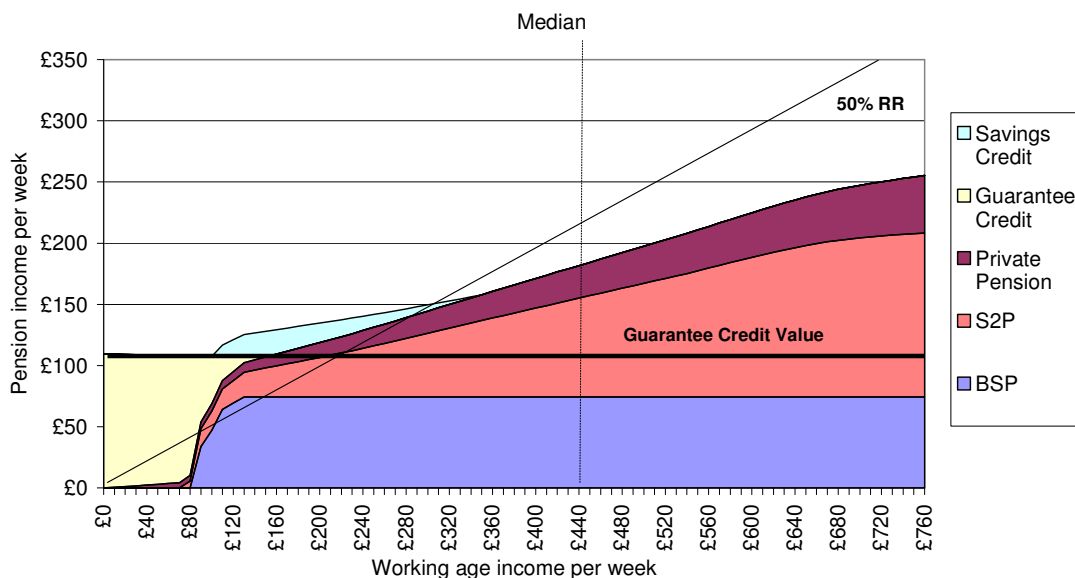
5. The current Government has taken a number of steps to increase the minimum pensions available to pensioners. This included raising the benefit level by around a third in real terms. Other changes were made, including simplifying the structure (so pensioners of all ages get the same amount, where previously younger pensioners had been entitled to lower amounts).
6. In October 2003 the Government introduced the Pension Credit. This is a tax free entitlement, paid from general taxation, and not dependent on previous contributions. The Pension Credit has two elements:

¹ Most Statistics quoted here are for Great Britain: some statistics are only available for Great Britain. Results for the United Kingdom, where they exist, show a very similar picture.

² Source: Pensioners' Incomes series 2004/5.

- **The Guarantee Credit**, which ensures pensioners have a guaranteed minimum weekly income. There is a higher guaranteed minimum for severely disabled people and carers.
 - **The Savings Credit**, rewards people over 65 who have made some additional provision for their retirement above a threshold (currently the level of the basic State Pension). It accrues at the rate of 60p for every pound of qualifying income above the threshold to a maximum of £17.88 for a single person, and is then reduced by 40p for every pound of income above that level. It reduced the number of pensioners facing 100% marginal deduction rates.
7. Receipt of the Guarantee element of Pension Credit entitles the recipient to full help with reasonable rental costs (via Housing Benefit) and local taxes (via Council Tax benefit).
 8. The graph below shows the pension outcomes for someone retiring in 2010 depending on their levels of earnings in working life. So, for example, someone on median income in working life (£440) would get the basic State Pension worth £74, State Second Pension worth £80.80 and private pensions (given the assumptions on saving) of £26.00 (in 2005/6 earnings terms).

**Forecast results from State and private pension in 2010.
Amounts in 2005/6 earnings terms.**



Notes:

1. Assumes 49 years of saving 5% of salary between the Primary Threshold and Upper Earnings Limit.
2. In 2005/06 earnings terms.
3. State Second Pension includes other forms of additional State Pension

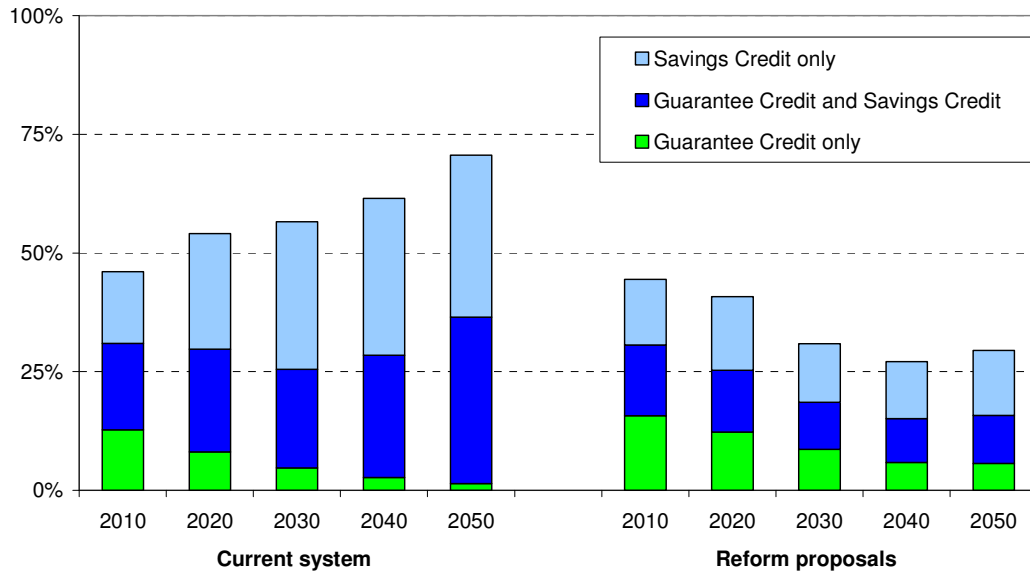
Source: DWP modelling

Future Path

9. The current indexation arrangements means that the Savings Credit will spread up the income distribution. In the long term, if these indexation arrangements continue, the proportion of people entitled to Pension Credit could rise to around 70 per cent in 2050. Problems with incentives to save, and working longer, could develop if a pensions system evolved in which a significant majority of pensioners were entitled to Pension Credit. This was never the intention of the Government.
10. On May 25th the UK Government published proposals for reform of the UK pensions system³. The aim of these proposals was to provide a solid foundation on which people can save. The reforms announced included:
 - **Uprating the basic State Pension with earnings.** Subject to affordability the Government aims to do this from 2012, but in any event by the end of the next Parliament (around 2015) at the latest.
 - **A commitment to uprate the Guarantee Credit in line with earnings over the long term** (previously the Government had committed to uprate the Guarantee Credit in line with earnings until 2008).
 - From 2008 uprating the Savings Credit threshold with earnings, and then from 2015 fix the maximum amount of Savings Credit in real terms. As State Second Pension matures more and more low earners will have built up State Second Pension entitlement above the level of the basic State Pension. Changes to the Saving Credit will help to focus the Savings Credit on people with small amounts of saving, and stop it spreading up the income distribution.
11. The effect of the above reforms will be to reduce the proportion of pensioners eligible for Pension Credit to about a third by about 2030. Changes to the State Second Pension (S2P) will make it more generous to lower earners. This will have the effect of roughly halving the proportion of pensioners eligible for the Guarantee Credit only by 2040. The graph below shows the proportion of pensioners eligible for different elements of Pension Credit under current uprating arrangements, and under the reform policies.

³ Security in retirement: towards a new pensions system': Department for Work and Pensions.

Proportion of pensioners eligible for Pension Credit over time



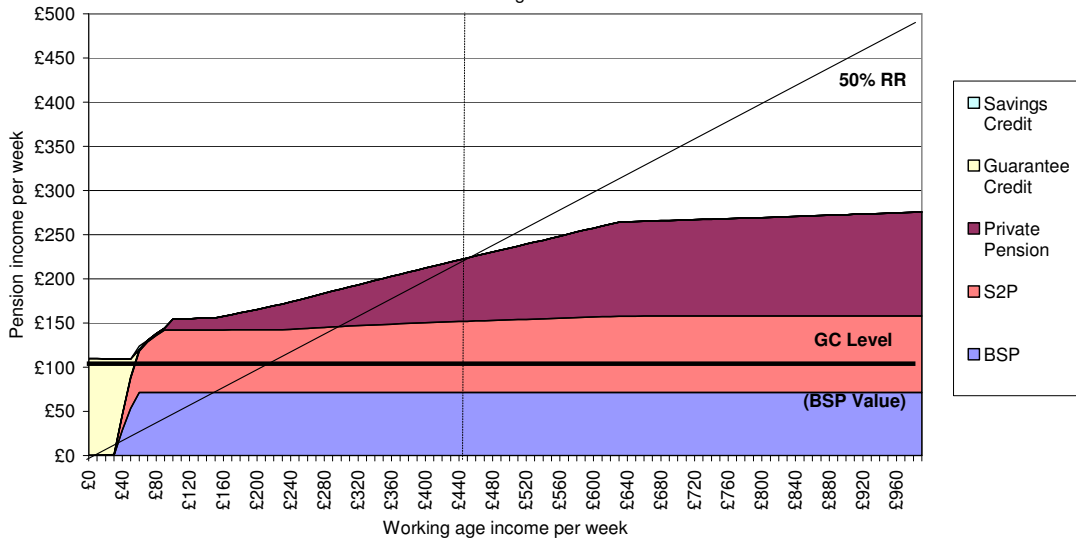
Source: DWP projections, using micro-simulation modelling.

Notes

1. The estimates indicate that over time the reform proposals will reduce the proportion of pensioners eligible for Pension Credit, although the size of the reduction is sensitive to the modelling assumptions and projected changes in the distribution of pensioner incomes.
2. The estimates shown here are the mid-points of projections taken from two separate micro-simulation models.
3. Modelling of reform proposals does not include any increase in private saving from the introduction of personal accounts, which would further reduce the numbers eligible for Pension Credit.
4. Projections under current policies are consistent with the long-term expenditure projections for Pension Credit.
5. Projections under reform will depend on the policy detail.

12. The graph below shows pensions outcome for someone retiring in 2050 with the results of the Government's reform package. Again this is heavily assumption based, but shows:
 - A guaranteed minimum income for those at the bottom end of the income distribution who had not managed to build up rights to either a Second State Pension or a private pension.

Forecast results from State and private pension in 2053.
Works 16-68
Amounts in 2005/6 earnings terms.
Median earnings



Notes:

1. Assumes 52 years of saving 8% of salary (which includes a 3% employer contribution) between the Primary Threshold and Upper Earnings Limit.
2. In 2005/06 earnings terms.
3. State Second Pension includes other forms of additional State Pension.

Source: DWP modelling

Effects on Low Income

13. The low income figures for Great Britain are published in Households Below Average Income⁴. Low income numbers are produced based on household net income, both before housing costs (BHC) and after housing costs (AHC). Over the last decade an increasing proportion of pensioners are living in accommodation that is owned outright (and so face relatively low housing costs), and fewer pensioners live in rented accommodation.

	1996/7	2000/1	2004/5
Rented	30%	26%	23%
Owned with mortgage	9%	9%	8%
Owned Outright	59%	63%	68%

Source: Households Below Average Income

14. For some pensioners in rented accommodation income will include Housing Benefit – which is designed to contribute to rental costs. This will have the effect of increasing income of pensioners in rented accommodation relative to owner occupiers, without reflecting differences in living standards.

⁴ Household Below Average Income, published by the Department for Work and Pensions, at www.dwp.gov.uk/asd/hbai.asp

15. Because of the trend away from pensioners renting accommodation, for pensioners, the UK Government often focuses on measures of low income measured after deducting housing costs.

16. The table below shows the proportions of pensioners in low income. In particular, measured after housing costs:

- The proportion of pensioners in low income, measured after housing costs, fell from 27% in 1998/9 to 22% in 2002/3. (The Minimum Income Guarantee (MIG) – a previous increase to the income related top up - was introduced in April 99. MIG has now been incorporated into Pension Credit)
- The proportion of pensioners in low income, measured after housing costs, fell from 22% in 2002/3 to 17% in 2004/5. (The two years when the introduction of Pension Credit would show in the figures.)

	Income measured before deducting Housing Costs	Income measured after deducting Housing Costs
1994/5	22%	27%
1995/6	22%	26%
1996/7	22%	28%
1997/8	23%	27%
1998/9	24%	27%
1999/0	23%	26%
2000/1	22%	24%
2001/2	23%	23%
2002/3	22%	22%
2003/4	21%	20%
2004/5	19%	17%

Source: Households Below Average Income publication – this uses a slightly different methodology from EU publications. (E.g. based on McClements equivalence scales)

17. The Institute for Fiscal Studies have looked at cohort effects, and incidence effects on the fall in the proportion of pensioners in low incomes⁵. This research found that:

- Cohort effects – include younger pensioners retiring with more private income than older pensioners - account for roughly a quarter of the fall in the proportion of pensioners in low income.
- Incidence effects – which include increased benefits, including Pension Credit – account for roughly three quarters of the fall in the proportion of pensioners in low income.

⁵ Poverty and Inequality in Britain 2006, pages 39-40 http://www.ifs.org.uk/publications.php?publication_id=3575

18. The table below shows the number and proportion of pensioners in low income. The proportions of men and women in low income have both fallen - the proportion of women in low income has fallen further, and the number of women is greater.

Number and Percentage of Pensioners in Low income

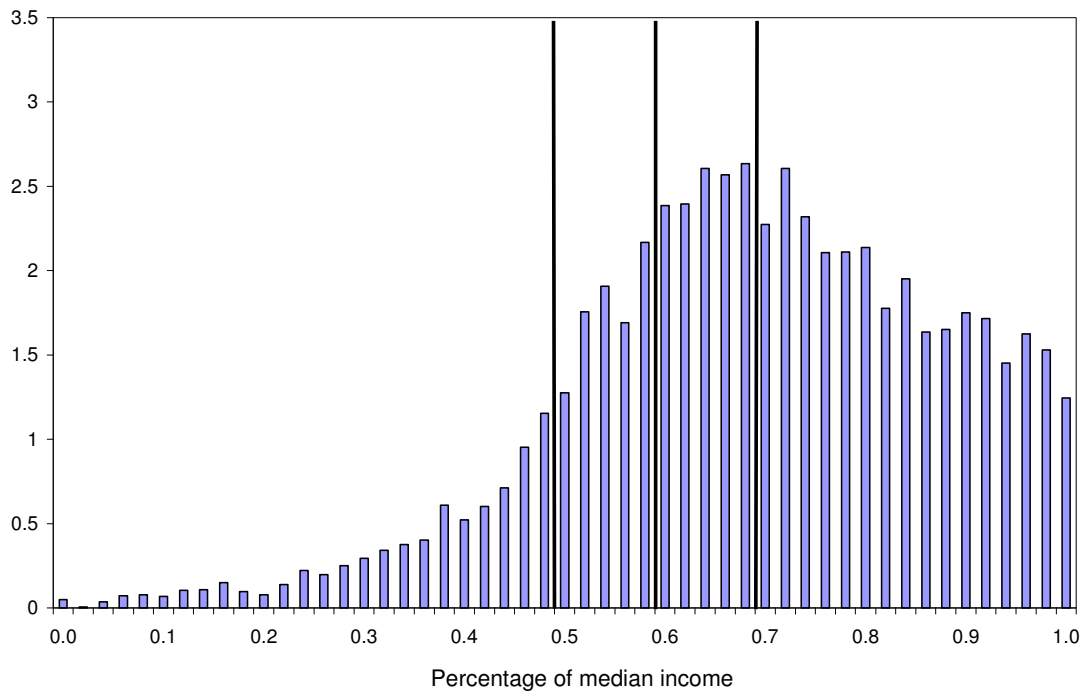
Based on income measured after housing costs.

	1997/8	1998/9	1999/0	2000/1	2001/2	2002/3	2003/4	2004/05
Male Pensioners								
Number (millions)	0.9	0.9	0.9	0.8	0.8	0.8	0.7	0.6
Percentage	25	25	24	22	22	22	18	16
Female Pensioners								
Number (millions)	1.9	1.8	1.8	1.6	1.5	1.4	1.3	1.1
Percentage	29	29	28	26	24	22	21	17

Source: Family Resources Survey based on Household Below Average Income methodology
 Due to rounding the numbers of male and female pensioners may not sum for the total for all pensioners.

Low Income measures and the distribution

19. The exact results of low income thresholds – especially numbers below 60% of median income, can be heavily influenced by the shape of the pensioners’ income distribution, and the equivalence scales used in the compiling the statistics.
20. The graph below shows the distribution of net household income for pensioners (measured after housing costs) with the three vertical lines showing 50%, 60% and 70% of net median income. It shows the strong peak between 60% and 70% of median income.



Source: based on 2004/5 Family Resources Survey data based on Household Below Average Income methodology.

21. In particular results can be very sensitive to differences between:
 - equivalisation scales used to adjust for relative needs of singles and couples in compiling the statistics; and
 - the relative needs of singles and couples in the benefit system.

22. Because of these differences we might not want to use the low income statistics to ‘fine tune’ policy. In particular the equivalence scales used to compile the statistics and the implied equivalence scales (the relative benefit levels for singles and couples) in the benefit system are slightly different.

Take Up

23. Estimates of Take-up are published by the Department for Work and Pensions. These estimates use survey data to estimate eligibility for benefits (making adjustments to account for underreporting of capital and savings) and compare that with data on actual payments. By their nature these estimates are subject to a considerable margin of error. They are normally published as ranges rather than point estimates. The following tables show the range of estimates for take up of Pension Credit, for caseload (proportion of entitled families that are claiming), and expenditure (proportion of benefit that is claimed).

24. The table below shows caseload and expenditure percentage take up. Take up is lower for those who are entitled to small amounts. For example, the average weekly amount claimed is £40.70, whereas the estimated average amount unclaimed is £23.40.

		Caseload Take-up	Expenditure Take-up
All Pension Credit	2003/4	58% : 66%	68% : 76%
	2004/5	61% : 69%	72% : 79%
Guarantee Credit Only	2003/4	69% : 81%	71% : 82%
	2004/5	70% : 81%	74% : 83%

Source: "Income Related Benefits, estimates of take up" (www.dwp.gov.uk/asd/irb.asp). Pension Credit was introduced in October 2003, estimates for 2003/4 relate to October 2003 to March 2004.

25. There have been a number of changes to the design of Pension Credit to make it simpler and so encourage take up. In particular once a Pension Credit award has been made, fixing receipt at the same level for the next five years unless there are significant changes of circumstances.
26. The Government has taken a number of steps to maximise take up of Pension Credit. This includes:
- Writing to every pensioner household to tell them about Pension Credit.
 - The latest direct mail initiative "You're Missing Out" has targeted around 1.5 million customers from October 2005 to February 2006. It contains a much stronger message and is targeted using outcomes of data matching exercise. Initial response rates are 11% that compares favourably with the 4% response rate to previous mailings.
 - A "reminder" postcard mailing programme to non-responders to above (who are therefore still missing out) which also sells the new integrated Pension Credit, Housing Benefit / Council Tax Benefit service offering from Pension credit Tele-Application Line (PCAL). Over 1million households were mailed Mid-February to end March 2006.
 - 'You're missing out' campaign extended to national press with some regional weighting through mid January to mid March period. Press activity includes paid for press adverts, feature-link press inserts and ethnic press advertising.
 - Local Service benefit entitlement checks to around 23,000 households each week-selected as the most likely to be eligible and with likely guarantee entitlement bias.
 - Joint work between Regional Press Offices and Local Service Managers to generate free media coverage throughout the first quarter utilising the missing out theme and full benefit health check initiative to secure coverage and drive additional demand.
 - Local Service works closely with local partners (e.g. Help the Aged, Age Concern) to help ensure pensioners' take-up their entitlement to Pension Credit. The rural/urban mix and ethnic mix has been factored into staffing levels for Local Service.
 - Since December 2005 customers who contact the Pension Credit Application Line to make an application for Pension Credit are also be able to claim Housing Benefit and Council Tax Benefit during the one phone call. The Pension Service completes a new 3-page shortened form on the customer's behalf and sends it to them to check, sign and

return. This simplified process means that new customers applying for Pension Credit only need to provide financial details once to claim both Pension Credit and Housing and Council Tax Benefits.

Annex A – Some Key Figures

Basic State Pension:

In 2006/7 the basic State Pension is worth:

Single pensioners	£84.25 (about 123 euros)
Pensioner couple	£134.75(about 198 euros)

11.6 million pensioners receiving the basic State Pension (7.2 million women, 4.4 million men) – nearly all pensioners.

Around 85% of men are entitled to full basic State Pension, around half of women are entitled.

Pension Credit:

In 2006/7 the Guarantee Credit is worth:

Single pensioners	£114.05(about 167 euros)
Pensioner couple	£174.05(about 254 euros)

	Total	Type of Pension Credit in payment		
		Guarantee Credit (GC) only	GC & Savings Credit (SC)	SC only
Number of Claims	2,706,200	769,220	1,339,100	597,870
Average Award	£43.60	£75.40	£40.16	£10.40

The claims in the table are families rather than individuals, so includes 0.6 million couples, 1.6 million single women, and 0.5 million single men.

Annex B – Workings of Pension Credit: Assessment of Income

27. The Pension Credit takes account of income and capital and any notional income someone is entitled to. Income includes money from most sources, including:
- State Pension;
 - An occupational or private pension scheme;
 - The Pension Protection Fund or Financial Assistance Scheme;
 - Annuities;
 - Most social security benefits, including industrial injury benefits and similar foreign benefits;
 - War Disablement, War Widow's or War Widower's Pensions (or foreign equivalents) and Overage Infirm Allowances;
 - Guaranteed Income Payments (and payments to adults for whom a Child Payment had been paid) from the Armed Forces Compensation Scheme;
 - Maintenance from a spouse or civil partner or former spouse or civil partner;
 - Earnings;
 - Working Tax Credit;
 - payments from lodgers, boarders or people renting part of your home (subtenants);
 - regular payments from an equity release scheme;
 - royalties or public lending rights payments; and
 - regular payments from trust funds.
28. Capital is taken into account and includes money held in whatever form – cash, bank and building society accounts, Premium bonds, investment trusts, shares etc. – and from whatever source – savings, inheritance, redundancy payments, lump-sum grants etc. It also includes the net market value of land and property (except the home someone lives in).
29. Capital is worked out as deemed income from capital. The first £6,000 of capital is ignored (£10,000 if someone lives in a care home) and a deemed income of £1 per week for each £500 or part of £500 over this amount is taken into account.
30. Certain things are disregarded when calculating income and capital. Certain incomes are completely disregarded including certain social security benefits, for example Housing Benefit and Council Tax Benefit. Other incomes have a partial disregard applied to them for example earnings and income from letting a home.

References and other documents

Security in retirement: towards a new pension system.

Government proposals for pension reform: www.dwp.gov.uk/pensionsreform/whitepaper.asp

Women and pensions: The evidence (DWP)

Government publication on key evidence on women's retirement income:
www.dwp.gov.uk/publications/dwp/2005/wp/women-pensions.pdf

Households Below Average Income (DWP)

Containing low income statistics for different population groups: www.dwp.gov.uk/asd/hbai.asp

Pensioners' Incomes (DWP)

Statistics on pensioners' incomes: www.dwp.gov.uk/asd/asd6/pensioners_income.asp

Income related benefits: estimates of take-up (DWP)

Statistics on take-up of income related benefits, including details of the methodology behind the estimates: www.dwp.gov.uk/asd/irb.asp