

The Pension Credit

PPI Briefing Note Number 1

Introduction

Means-tested benefits are an increasingly significant part of pensioner incomes.

The number of people eligible for a means-tested income supplement is projected to grow significantly when the Minimum Income Guarantee (MIG) is superseded by the more generous Pension Credit (PC) in October 2003. Around a quarter of pensioner households currently qualify for the MIG¹, and 43% are expected to qualify for PC². By 2050 it is projected that at least two-thirds of pensioner households will be entitled³.

PC has two components. The Guarantee Credit (GC) is effectively the MIG relabelled and provides all single pensioners with a guaranteed income of at least £102.10 a week (2003/4).

The second component is the new Savings Credit (SC). For each pound of income that a pensioner aged 65 or over has between the full BSP and GC the SC provides an additional 60p. SC then gradually reduces for total weekly income beyond the GC level. For single pensioners with an income up to £139 a week, the SC can provide up to £14.80 a week.

Households (singles and couples) entitled to the PC will on average receive an extra £7.70 a week. (all figures for 2003/4)⁴.

PPI Briefing Notes clarify topical issues in pensions policy.

The total cost of government spending on PC is estimated to be £5.3 billion in 2003/4 (0.5% of GDP). The cost of PC is expected to more than double in the next 50 years while the cost of BSP will halve (Chart 1)⁵.

Why is the Government in favour of increasing the scope of means-testing?

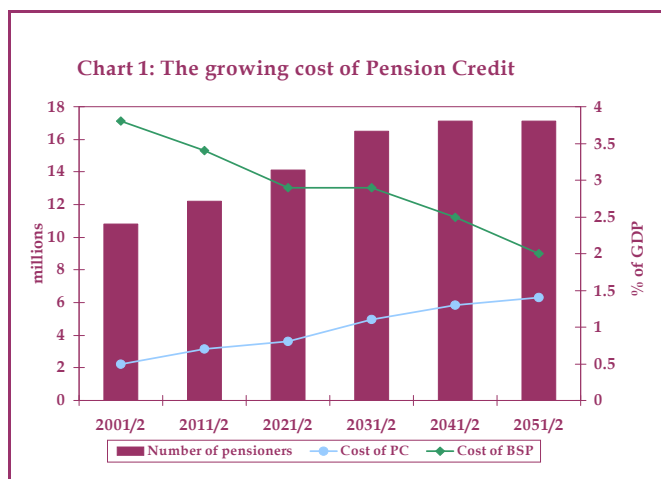
The Government's priority has been to *focus resources on those pensioners who need them the most and help those with little or no additional resources but who are penalised for having additional resources*⁶.

SC aims to *reward pensioners who have done what successive Governments have asked and saved*⁸.

What are the issues for current pensioners?

The introduction of the PC will add to the **complexity and administrative cost** of the state pension system. The system already provides pensioners with 23 potential entitlements, which are linked in 36 ways.

Means-tested benefits require individual attention and take more time to process. MIG



The PC is seen as the mechanism for delivering on both fronts.

The poorest third of pensioners are £600 per year better off on average than had the equivalent amount been solely used to raise the Basic State Pension (BSP) for everyone⁷.

Beyond poverty prevention, the

costs £53.70 per case to administer compared to the BSP at £5.40⁹.

Means-testing **misses a significant number of pensioners through low take-up**. Of those thought to be eligible for MIG, between 24% and 32% in 2000/1 did not claim the benefit, a very slight improvement from 1999/2000. On average £22 a week of MIG was unclaimed¹⁰.

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The government has introduced for the very first time a take-up target for the PC. But it is modest, at 73% of eligible pensioners, much the same take-up rate for MIG. This prompted the House of Commons Select Committee on Public Accounts to request *the Department make the target progressively more stretching*¹¹.

It is the oldest pensioners who are most at risk of pensioner poverty and need to claim PC (Chart 2)¹².

This is because other state and private pension income decreases during retirement relative to the PC. Other pension income is likely to be price-linked and so will grow slower than the earnings-linked PC thresholds. This will result over time in many becoming entitled to PC even if they were not at the point of retirement¹³.

However, it is the **oldest who are least likely to claim**¹⁴. They may be less able to go through the claims procedure or be less aware that they are entitled to benefits¹⁵.

What are the issues for the current working population?

For current workers there may be negative long-term effects on savings incentives.

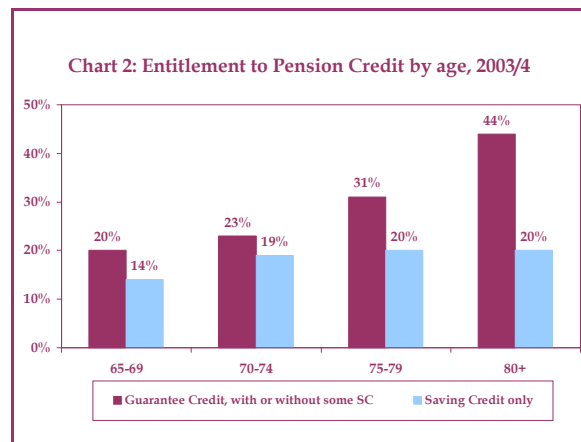
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report that the introduction of the PC, for example, *is a direct disincentive to the majority of today's working population to make discretionary savings for retirement*¹⁶.

This is because the PC means many people will see only small increases in pension income after significant amounts of saving.

Increasing coverage of PC may be **encouraging a perception that saving for a private pension need not be a priority**. People of working age seeing current pensioners entitled to PC that provides a safety net and more, may assume that an adequate pension will be provided by the state.



Some will see no increase at all in pension income for savings made¹⁷.

It is therefore **difficult to advise if it is in an individual's interest to start or continue saving**. To calculate the financial benefits of saving towards a private pension requires some confidence in knowing an individual's future entitlement to state benefits. But entitlement to PC depends on the amount of saving made and its investment return. This uncertainty is reflected in the new Combined Forecast (of state and private pensions) which cannot include an estimation of future PC entitlement.

Unlike the contributory-based pensions, where minimum pension indexation is enshrined in legislation, PC levels **remain vulnerable to short-term change**. For instance, it cannot be assumed that PC levels will remain linked to earnings.

¹ PPI analysis from DWP (2003) *Income-related benefits estimates of take-up 2000/01*

² DWP data (2003)

³ PPI (2003) *The Pensions Landscape* p. 30

⁴ DWP (2003) Press Notice, 14th July 2003

⁵ DWP (2003) *Green Paper* and HM Treasury (2003) *Financial Statement and Budget Report*

⁶ Rt Hon I McCartney MP in Work and Pensions Select Committee (2003) *The Future of UK Pensions* p. 25

⁷ HM Treasury (2003) *Financial Statement and Budget Report* chp. 5

⁸ DWP (2003) *Green Paper* p. 1

⁹ Public Accounts Select Committee (2003) *Tackling Pension Poverty: Encouraging Take-up of Entitlements* p. 10

¹⁰ DWP (2003) *Income-related benefits estimates of take-up 2000/01* p. 16

¹¹ Public Accounts Select Committee (2003) *Tackling Pension Poverty: Encouraging Take-up of Entitlements* p. 6

¹² PPI analysis from DWP data (2003)

¹³ PPI (2003) *The Pensions Landscape* p. 30

¹⁴ DWP (2003) *Income-related benefits estimates of take-up 2000/01* p. 20

¹⁵ See National Audit Office (2002) *Tackling Pensioner Poverty: Encouraging Take-up of Entitlement*

¹⁶ Stewart Ritchie in *The Financial Advisor*, 10 April 2003 p. 39

¹⁷ See Clark and Emmerson (2002) and Association of British Insurers (2001) response to the Pension Credit Consultation