Analysis of the Liberal Democrats Citizen’s Pension

The Liberal Democrats have announced that for those aged 75 or over they would introduce a Citizen’s Pension that is more generous than the existing contributory Basic State Pension: whereas the full Basic State Pension is currently worth £79.60 for a single pensioner and £127.25 for a couple, the Citizen’s Pension would be set at the same level as the Pension Credit Guarantee, which is £105.45 for a single pensioner and £160.95 for pensioner couples. Like the Pension Credit Guarantee, the intention is that the Citizen’s Pension would be indexed to growth in average earnings.

Would the Pension Credit still exist for those aged 75 or over?
The Pension Credit Guarantee would remain for those aged 75 or over who did not have full entitlement to the Citizen’s Pension and for those on low incomes who qualified for the enhanced disability premia in the Pension Credit Guarantee. In addition the Liberal Democrats have said that “to ensure that pensioners do not lose out we would guarantee that those who receive enhanced amounts through the Pension Credit are protected”. As a result, the Pension Credit Savings Credit would also be retained, since otherwise some of those pensioner couples where the partner with the lowest entitlement to the Basic State Pension receives more than the current dependents’ addition would have lost from their policy.

The number of families aged 75 or over eligible for any Pension Credit would be greatly reduced under the Liberal Democrats proposal.

Who gains from the policy?
Those aged 75 or over who do not claim the means-tested benefits to which they are entitled – the poorest of this group – would benefit by the difference between their entitlement to the new Citizen’s Pension and their entitlement to the Basic State Pension. In percentage terms, individuals in this group would on average gain the most.

The other large gainers among those aged 75 or over would be those on higher incomes who do not qualify for the full Basic State Pension but who did meet the residency criteria of the Citizen’s Pension. This latter group will include many married women: in particular woman who spent periods out of paid employment (perhaps bringing up children) and therefore do not currently qualify for a full Basic State Pension. Those married women who contracted out of the Basic State Pension in return for paying reduced National Insurance Contributions would also benefit.

Those aged 75 or over who currently receive means-tested benefits (primarily the Pension Credit, Housing Benefit and Council Tax Benefit) would gain less in cash terms due to the withdrawal rates on these benefits. Those on the lowest incomes who are taking up the Pension Credit would not gain financially at all as their new Citizen’s Pension would simply replace their Pension Credit award.
How much would the policy cost?

A costing for this policy, but including the abolition of the Pension Credit Savings Credit and assuming that all individuals aged 75 or over meet the residency criteria of the Citizen’s Pension, has been estimated by the Department for Work and Pensions (DWP). Choosing to retain the Pension Credit Savings Credit would increase the cost of the Liberal Democrats policy compared to the one modelled by the DWP. On the other hand, having residency criteria, which some families currently in the UK do not meet, would reduce the cost of the Liberal Democrats policy compared to the one modelled by the DWP.

The costings produced by the DWP are set out in Table 1. The second column shows the increase in spending on the Citizen’s Pension, net of savings, from reduced expenditure on means-tested benefits. The third column shows the increase in tax revenue under the assumption that this remains a constant proportion of the overall increase in spending. This increase in tax revenue arises from the fact that the Citizen’s Pension, like the Basic State Pension, would be taxable. The fourth column gives the net cost to the exchequer. The net cost in the first year is £2.7bn. Over time the cost increases because of the earnings-indexation of the policy and also because of the increase in the number of older pensioners. Over the first four years (i.e. the possible duration of one parliament) the average cost is £3.1bn a year.

Table 1. DWP estimates of paying the Liberal Democrats’ proposed Citizen’s Pension to all individuals aged 75 or over (regardless of whether they would meet the residency criteria) and with also the removal of the Pension Credit Savings Credit for those aged 75 or over (£bn).

<table>
<thead>
<tr>
<th>Year</th>
<th>Increase in spending</th>
<th>Increase in tax revenues</th>
<th>Net cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006–07</td>
<td>3.1</td>
<td>0.4</td>
<td>2.7</td>
</tr>
<tr>
<td>2007–08</td>
<td>3.4</td>
<td>0.4</td>
<td>3.0</td>
</tr>
<tr>
<td>2008–09</td>
<td>3.7</td>
<td>0.5</td>
<td>3.2</td>
</tr>
<tr>
<td>2009–10</td>
<td>4.0</td>
<td>0.5</td>
<td>3.5</td>
</tr>
<tr>
<td>Total</td>
<td>14.2</td>
<td>1.8</td>
<td>12.4</td>
</tr>
<tr>
<td>Average annual cost</td>
<td>3.6</td>
<td>0.5</td>
<td>3.1</td>
</tr>
</tbody>
</table>

Note: Figures are in 2004–05 prices. Additional tax revenues only estimated for 2006–07 and assumed to be a constant proportion of the gross cost of the policy thereafter.


Would the policy increase private retirement saving?

The Liberal Democrats have announced an aspiration to extend the Citizen’s Pension to all pensioners. Were this to happen, there would be a large reduction in the number of pensioners entitled to means-tested benefits. This would increase the reward to each pound that an individual saves for retirement and hence would tend to increase incentives for individuals to undertake such saving. Working in the opposite direction is the fact that providing a Citizen’s Pension to all pensioners would increase the amount of income provided from the state in retirement, which would serve to reduce the need for individuals to save for their retirement.

Initially, at least, the Citizen’s Pension is only to be provided to pensioners aged 75 or over. As a result any impact on retirement saving is likely to be small, as working age individuals who expect to be shifted off means-tested benefits as a result of the reform might well expect to be eligible for means-tested benefits prior to reaching age 75.

******** ENDS ********

Notes to Editors: