

Institute for  
Fiscal Studies

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## Pensioner incomes in the UK

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Presentation to first CEPAR annual conference, July 2  
2013

UNSW Sydney

# Pensioners and their incomes

- The UK has traditionally had low state pension provision
  - And high levels of pensioner poverty
- Much policy towards current pensioners seems to be predicated on this model of the world
  - Pensioners almost wholly protected from current austerity measures
- But what has actually been happening to pensioner incomes over the last decades?
  - And why
- And what about the future?

# Background to the UK system (state)

- We spend about 7% of GDP on state benefits for pensioners
  - Well below European average
- Basic state pension at 15% of average earnings
- Additional earnings related pension.
  - Average receipt about a third of basic pension
- Significant means tested benefits
  - A fifth of pensioners receive “pension credit”
  - Also receipt of support for housing costs and local taxes
- Additional universal add-ons
  - Winter fuel payment
  - Free bus travel
  - Free TV licences

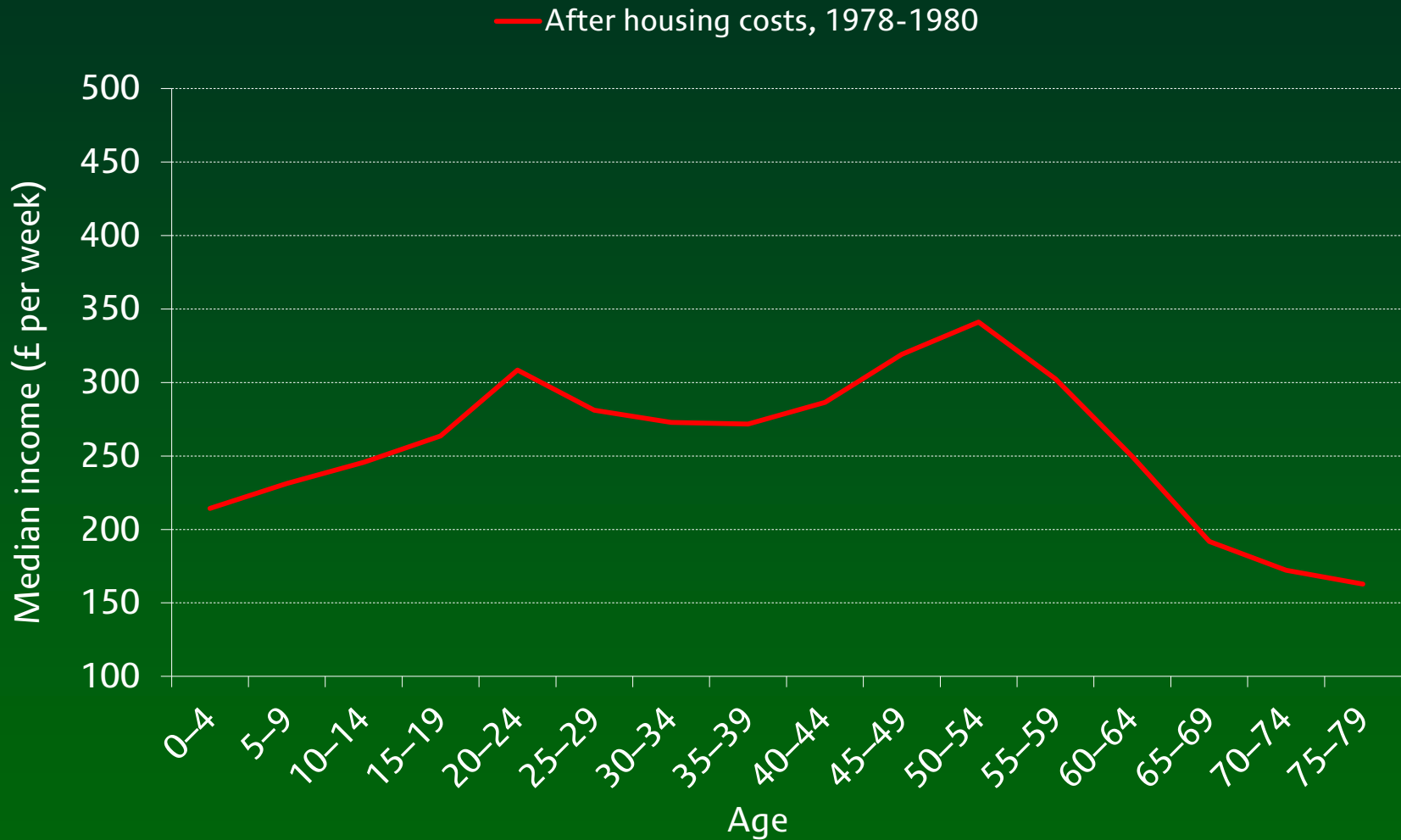
# Background to the UK system (private)

- Historic high levels of occupational pension coverage
  - Average private pension receipt about £6,500 a year
- Defined benefit schemes in private sector almost all closed to new members
  - Public sector still provides generous coverage
- Around half of private workforce in some form of DC scheme
  - Should increase rapidly with auto enrolment
  - But contributions – and hence future benefits – much lower than DB

# The world 30 years ago

- Pensioner incomes were on average only about half those of the working age population
- Note – throughout incomes are household incomes, net of taxes and receipt of benefits, and equivalised. Also generally net of housing costs
  - Using Family Resources Survey and Family Expenditure Survey data

# Median income by age (GB)

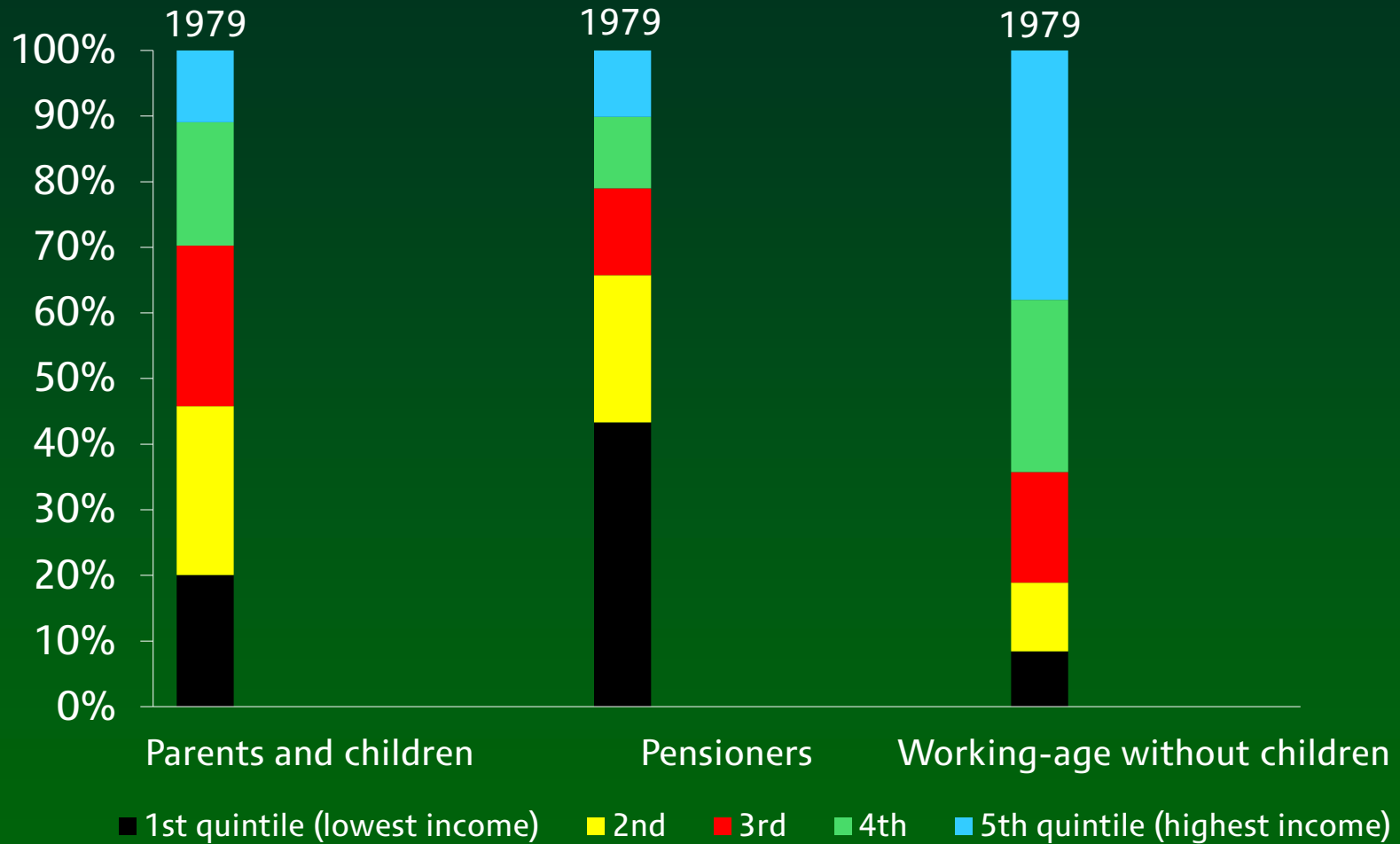


Notes and source: see Figure 5.6 of *Living Standards, Poverty and Inequality in the UK: 2013*

# The world 30 years ago

- Pensioner incomes were on average only about half those of the working age population
- Pensioners were concentrated in the bottom quintiles of the income distribution

## Two thirds of pensioners in bottom two quintiles (AHC)



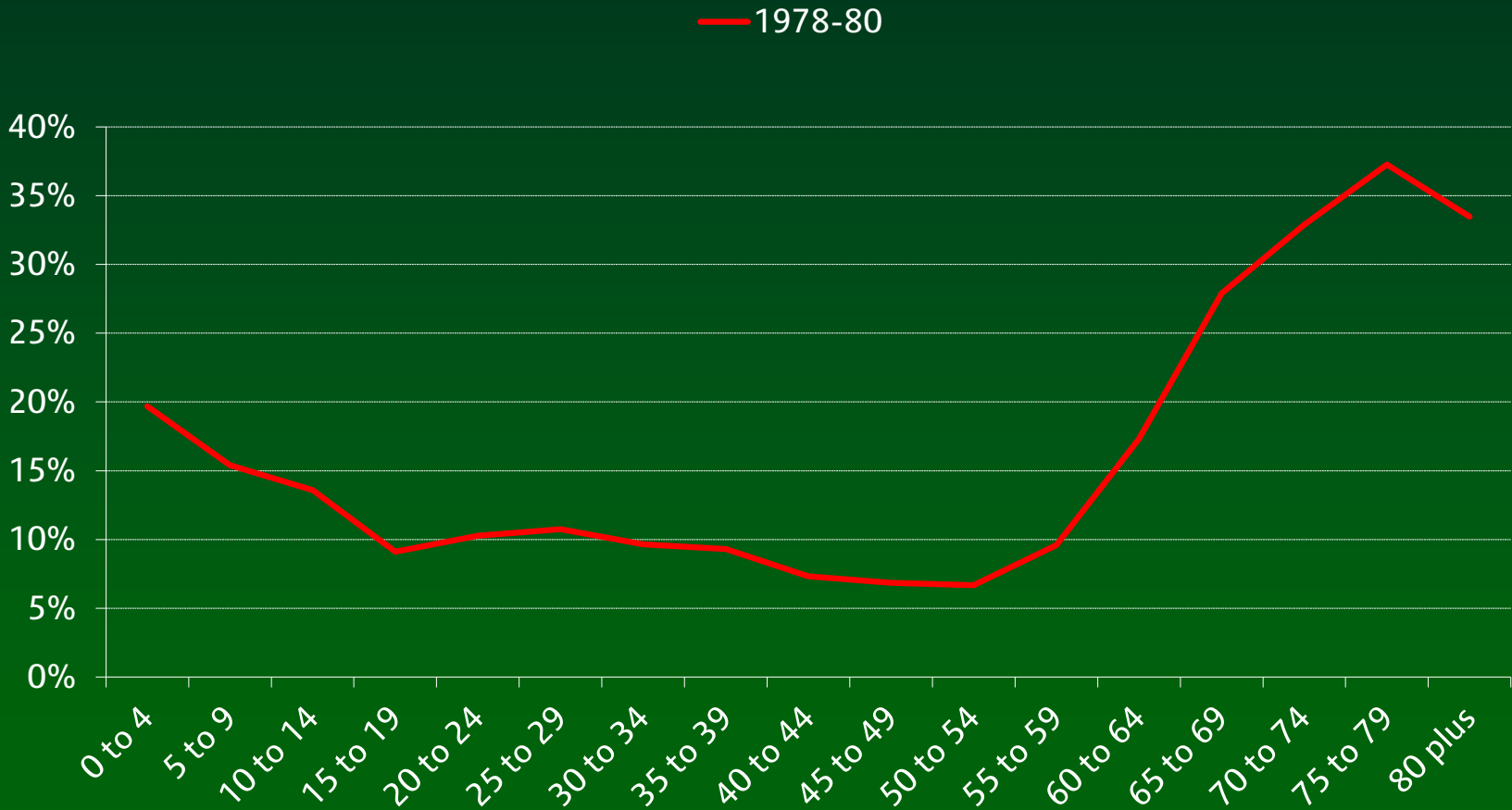
Notes and source: see Figure E.1 of *Living Standards, Poverty and Inequality in the UK: 2013*



# The world 30 years ago

- Pensioner incomes were on average only about half those of the working age population
- Pensioners were concentrated in the bottom quintiles of the income distribution
- And pensioner poverty rates much higher than for rest of the population

# Relative poverty rates by age group (AHC)

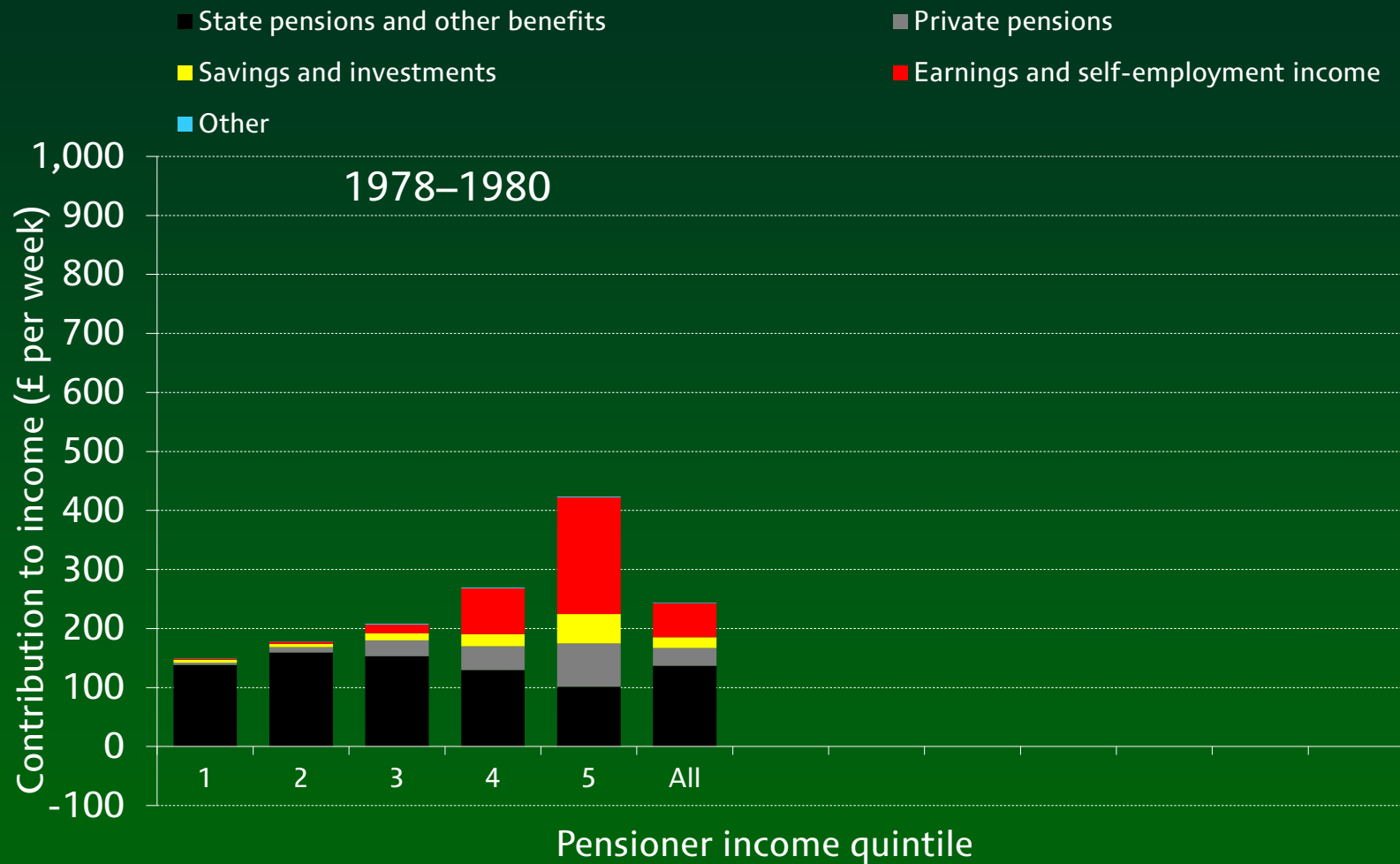


Source: Figure 6.3a of Living Standards, Poverty and Inequality: 2013

## This state of affairs driven by:

- Low flat rate basic pension at around 20% of average earnings
  - To which many, especially women, did not have full entitlement
- Minimal earnings related top ups
- Minimum means-tested benefits well below poverty line
- Significant private incomes available only to a small minority
  - Related to rules of DB pension schemes more than coverage
  - Little or no protection against inflation, or for early leavers

# Pensioner income sources (GB)



Notes and source: see Figure 5.3 of *Living Standards, Poverty and Inequality in the UK: 2013*

# Things have changed dramatically since then

- Median pensioner incomes are now similar to those of the working age population

# Median incomes vary little by age

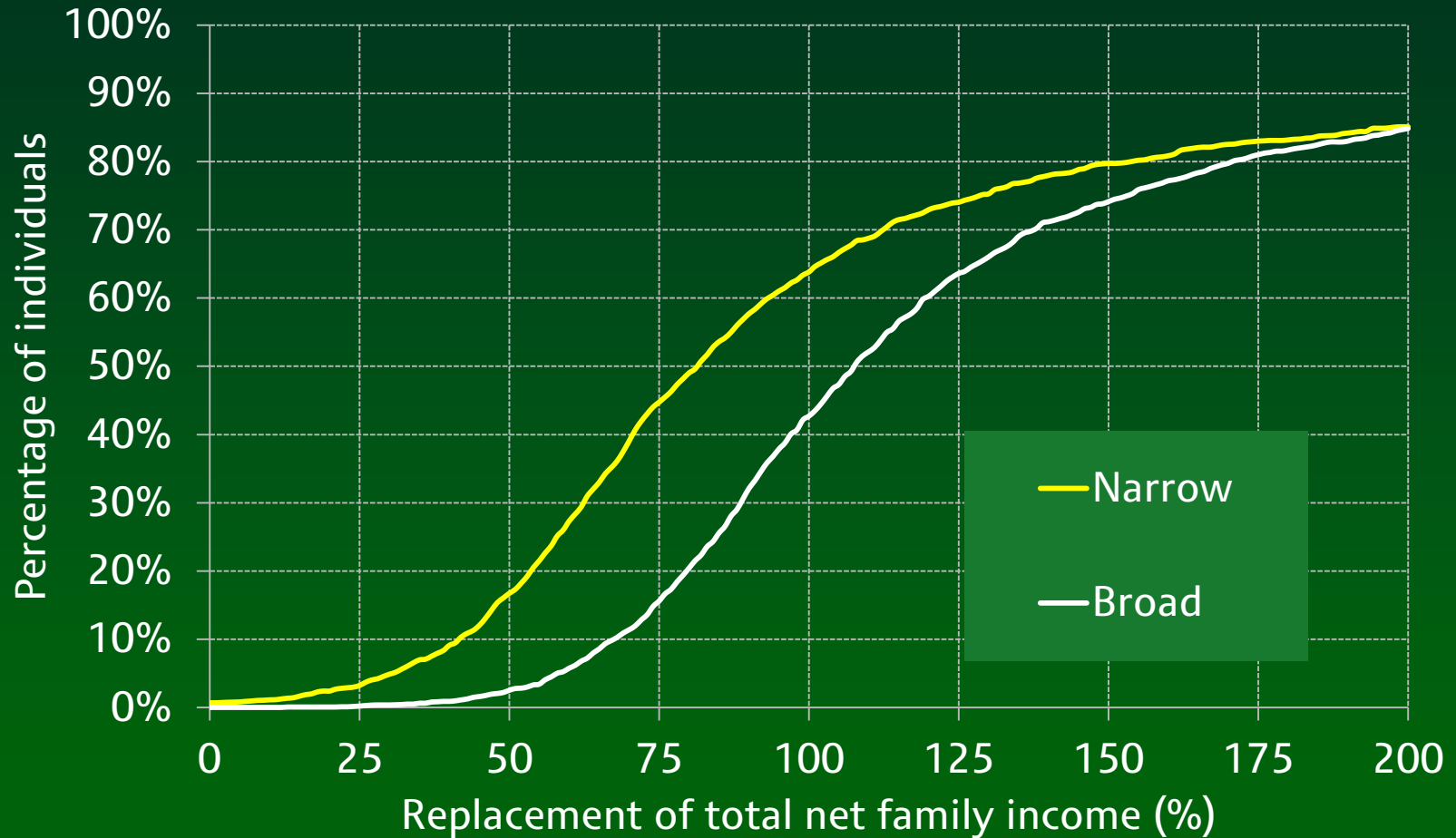


Notes and source: see Figure 5.6 of *Living Standards, Poverty and Inequality in the UK: 2013*

## A short digression

- So far we have only been comparing current pensioners with current workers
  - What about actual replacement rates
- We can look at those using ELSA
- And we can define different measures of income
  - Taking account, or not, of the possibility that wealth might be annuitised
- Replacement rates are high

# Distribution of replacement rates 2008/09



Notes: One observation per individual, individuals aged 50 to SPA, assumes probabilistic selection into retirement





# Proportion at risk of 'inadequate' resources

Income coming from:		Proportion falling below thresholds		
		PCG	67%	80%
(1)	Pension wealth only			
(2)	(1) plus non-housing wealth			
(3)	(2) plus other wealth			
(4)	(3) plus expected inheritances			
(5)	(4) plus pension credit			
(6)	(5) Replacing annuitised housing wealth with consumption flow			

# Proportion at risk of 'inadequate' resources

Income coming from:		Proportion falling below thresholds		
		PCG	67%	80%
(1)	Pension wealth only	12	41	53
(2)	(1) plus non-housing wealth			
(3)	(2) plus other wealth			
(4)	(3) plus expected inheritances			
(5)	(4) plus pension credit			
(6)	(5) Replacing annuitised housing wealth with consumption flow			

# Proportion at risk of 'inadequate' resources

Income coming from:		Proportion falling below thresholds		
		PCG	67%	80%
(1)	Pension wealth only	12	41	53
(2)	(1) plus non-housing wealth	10	30	42
(3)	(2) plus other wealth			
(4)	(3) plus expected inheritances			
(5)	(4) plus pension credit			
(6)	(5) Replacing annuitised housing wealth with consumption flow			

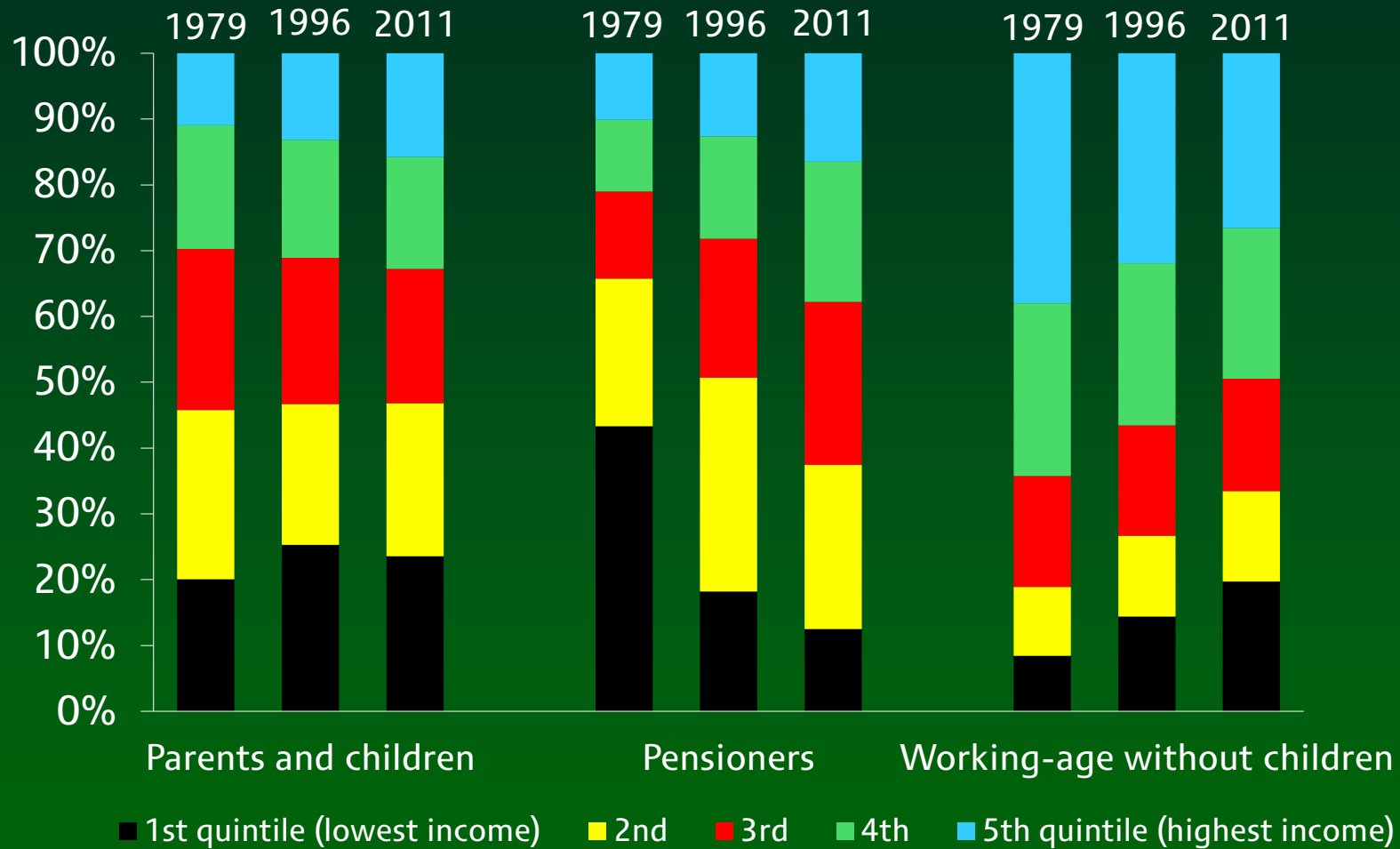
# Proportion at risk of 'inadequate' resources

Income coming from:		Proportion falling below thresholds		
		PCG	67%	80%
(1)	Pension wealth only	12	41	53
(2)	(1) plus non-housing wealth	10	30	42
(3)	(2) plus other wealth	7	20	30
(4)	(3) plus expected inheritances	7	18	28
(5)	(4) plus pension credit	-	12	22
(6)	(5) Replacing annuitised housing wealth with consumption flow	-	10	21

# Things have changed dramatically since then

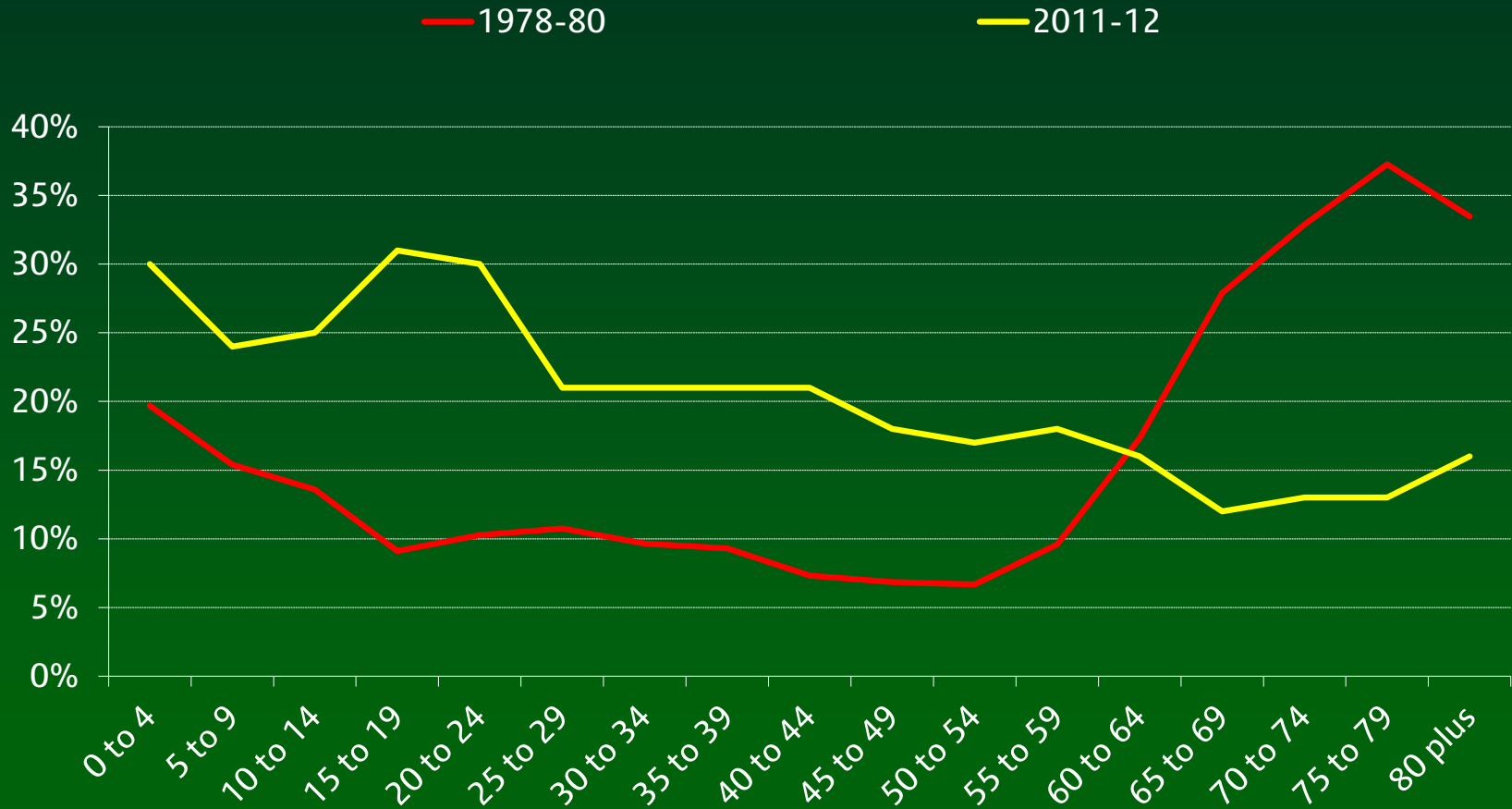
- Median pensioner incomes are now similar to those of the working age population
- And pensioners are distributed across the income distribution

# Pensioners now least likely to be in bottom quintile



Notes and source: see Figure E.1 of *Living Standards, Poverty and Inequality in the UK: 2013*

# And less likely to be poor than the working age



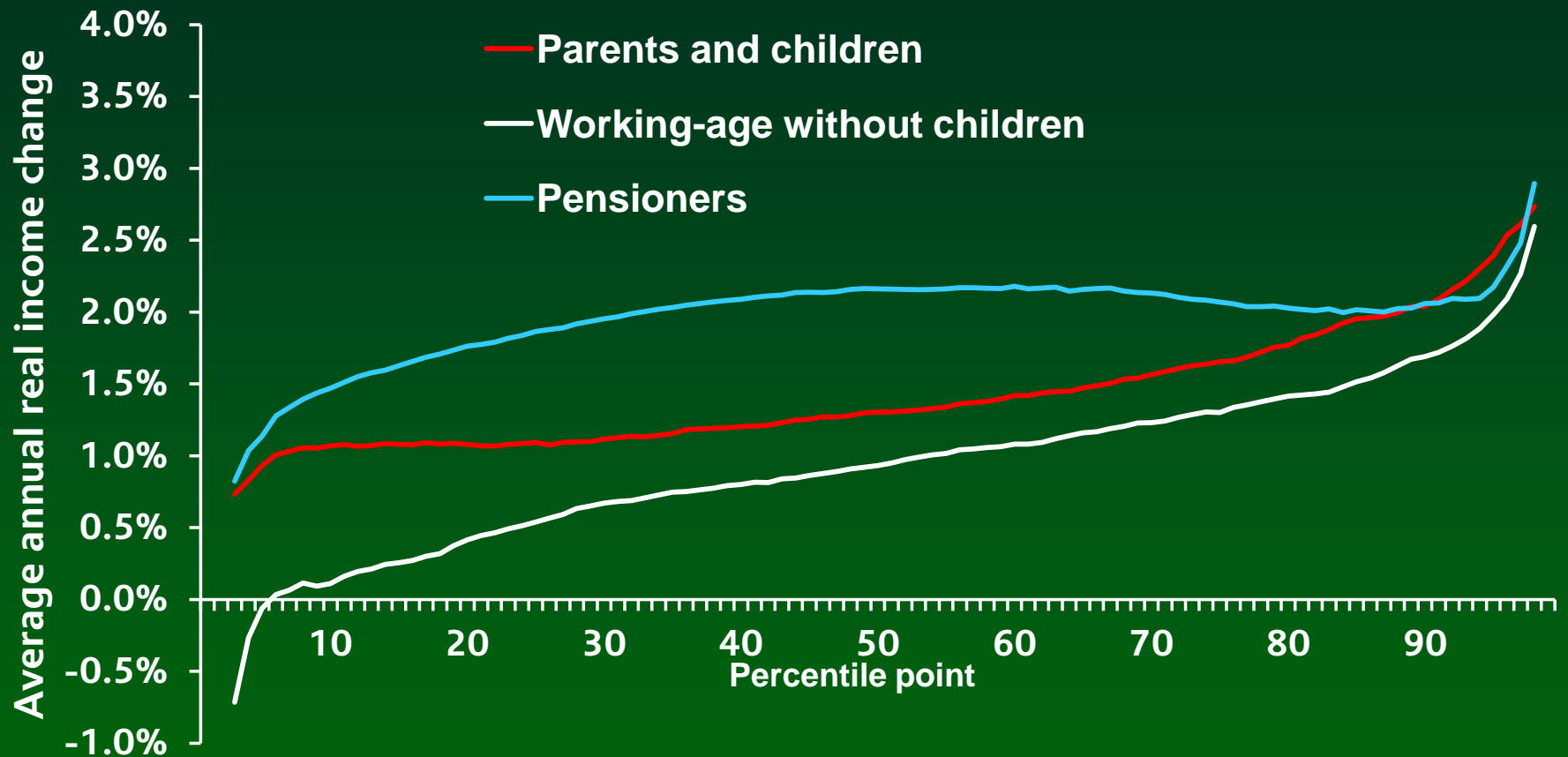
Source: Figure 6.3a of Living Standards, Poverty and Inequality: 2013

# Things have changed dramatically since then

- Median pensioner incomes are now similar to those of the working age population
- And pensioners are distributed across the income distribution
- Driven by increases in income across the pensioner distribution

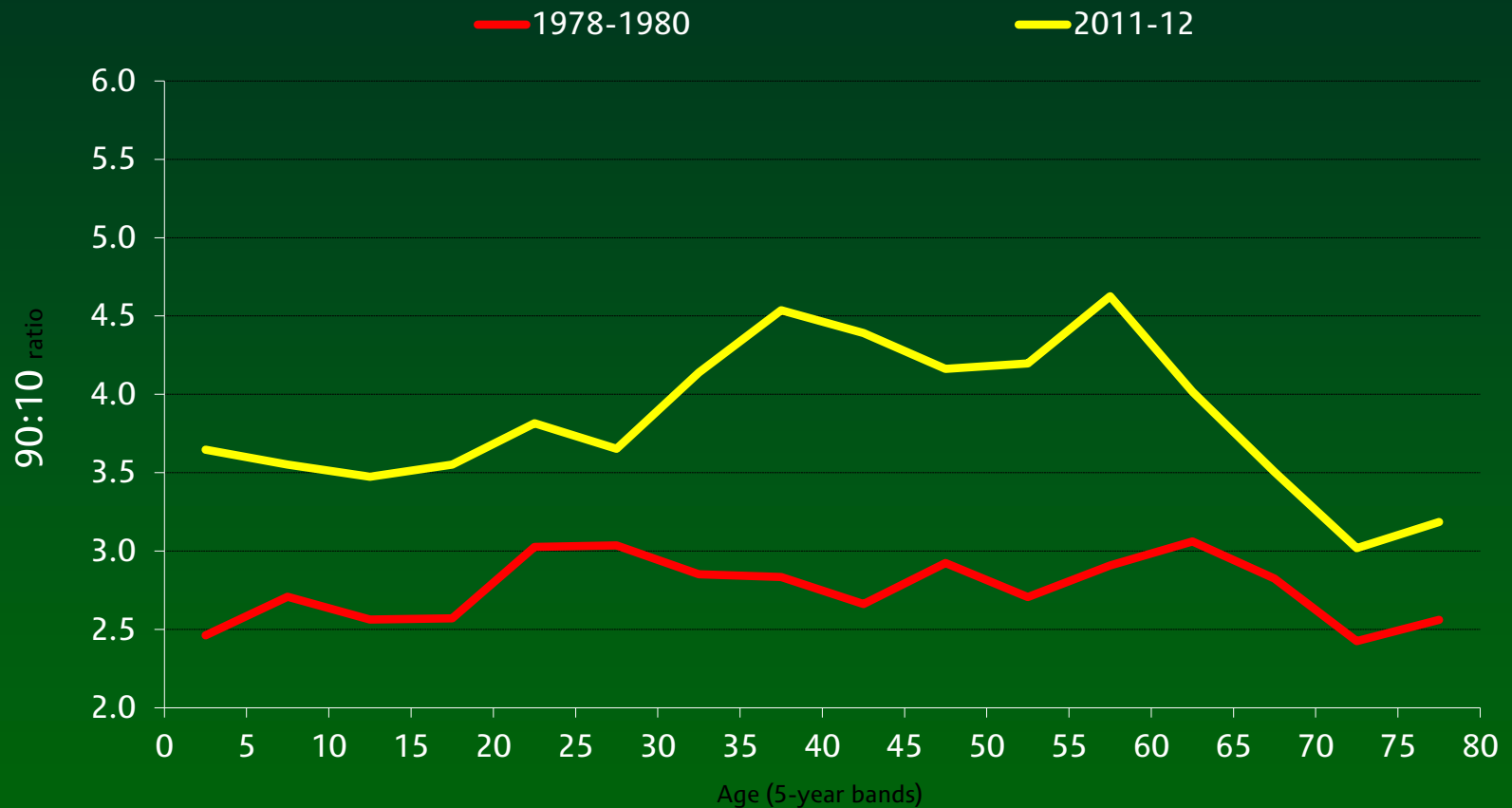


# With annual growth greater and more even than for others (1978-1980 to 2011-12)

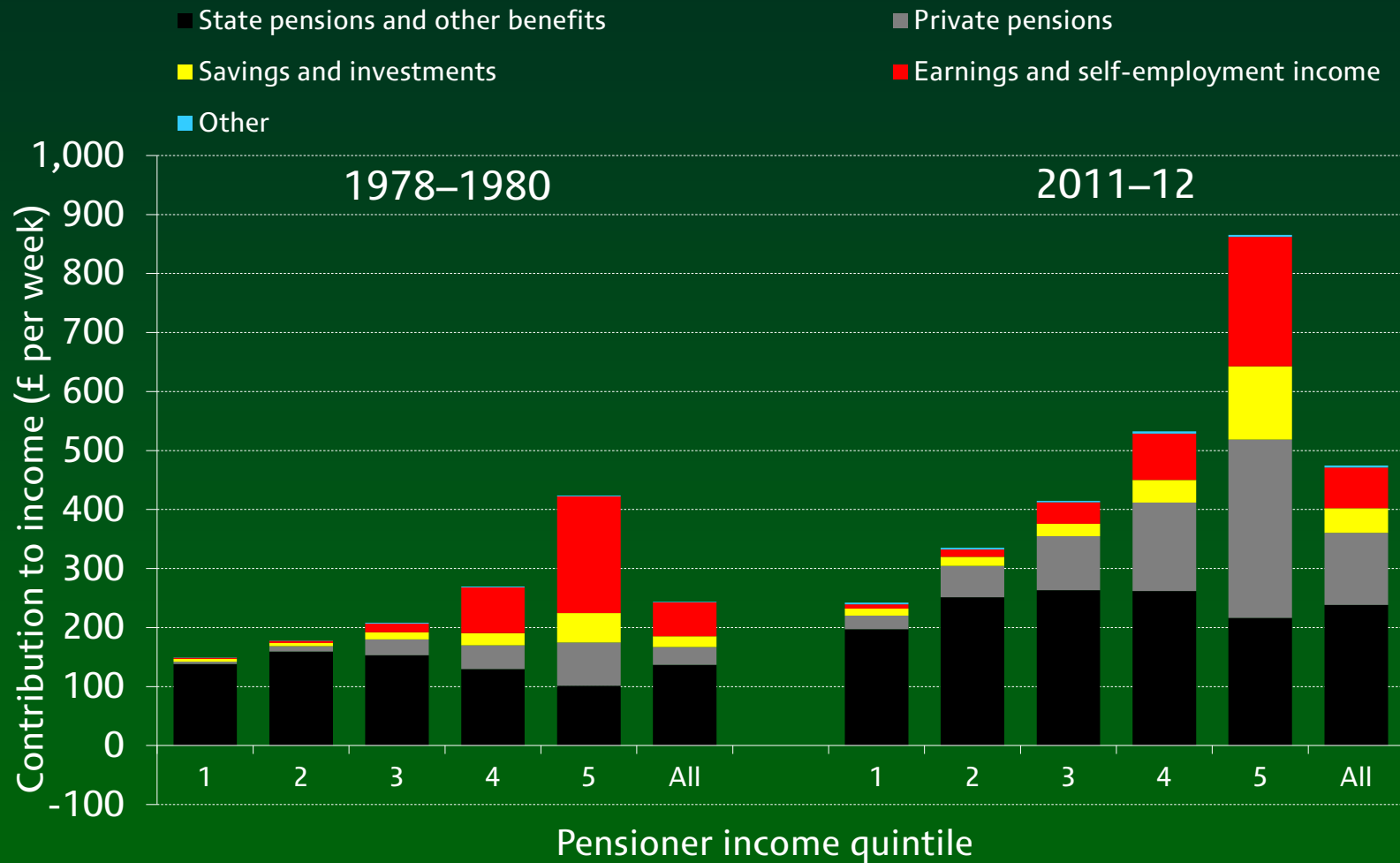


Notes and source: see Figure 5.2 of *Living Standards, Poverty and Inequality in the UK: 2013*

# Inequality now lower among pensioners than any other age group

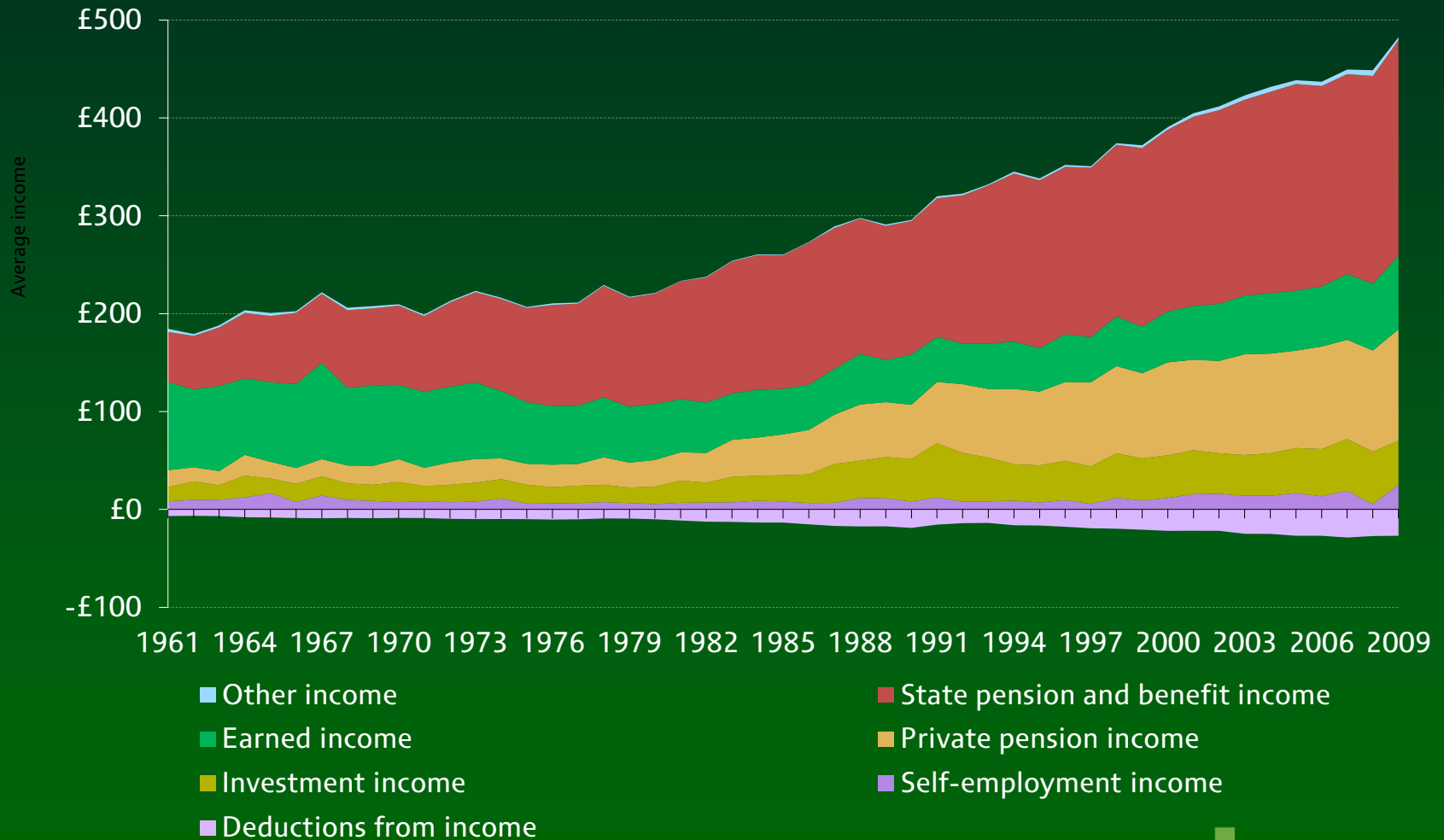


# All income sources more important



Notes and source: see Figure 5.3 of *Living Standards, Poverty and Inequality in the UK: 2013*

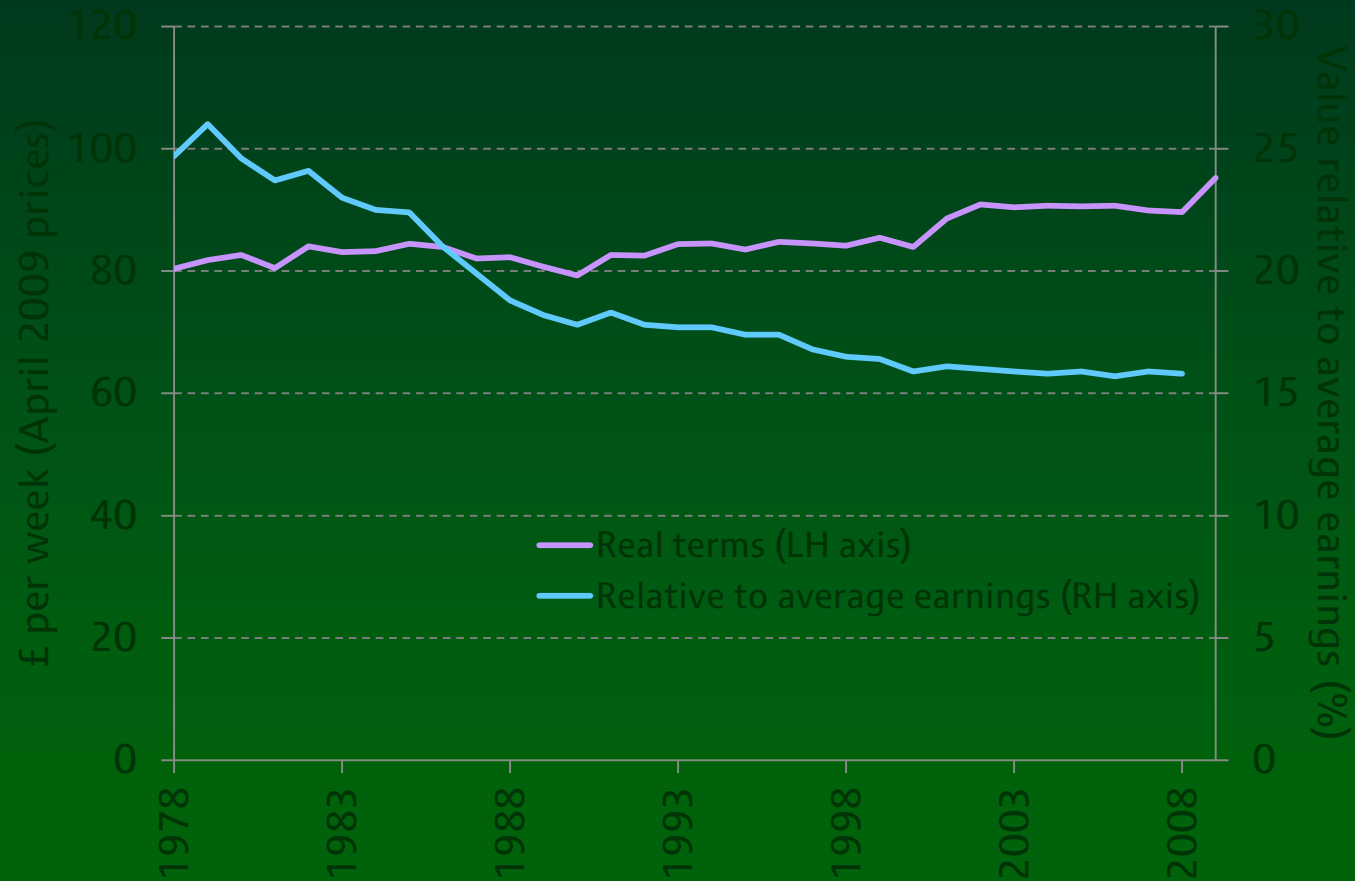
# Components of pensioner income



# What has driven these changes – state incomes?

- 75% increase in real benefit receipt
  - But NOT driven by increases in level of basic pension

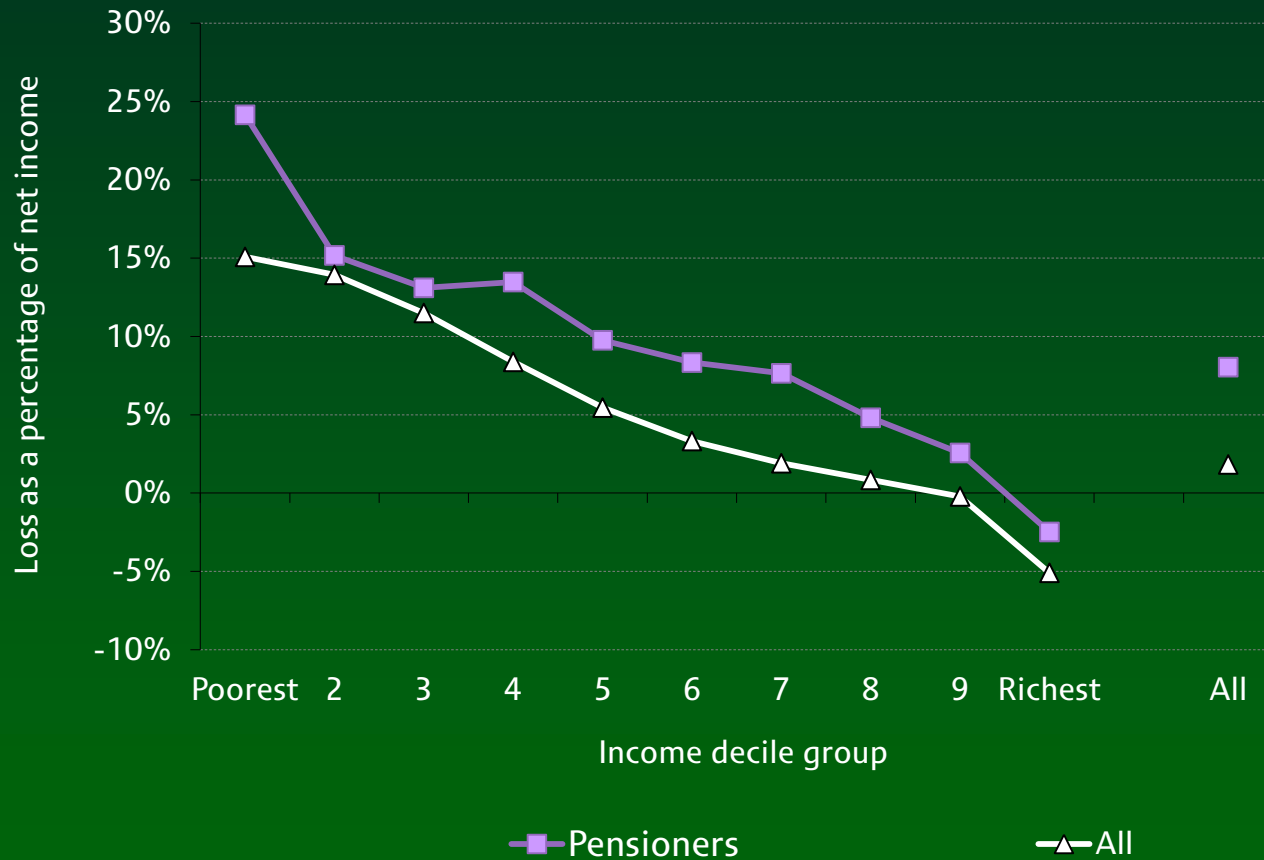
# Basic pension fell relative to average earnings



# What has driven these changes – state incomes?

- 75% increase in real benefit receipt
  - But NOT driven by increases in level of basic pension
- Bigger proportional increases at top than bottom
- Increase in benefit incomes driven by
  - Increased entitlement to basic pension
  - Maturation of SERPS
  - Introduction of new universal benefits
  - Big increases in means-tested benefits

# Tax benefit changes 1997-98 to 2010-11





# What has driven these changes – state incomes?

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- Bigger proportional increases at top than bottom
- Increase in benefit incomes driven by
  - Increased entitlement to basic pension
  - Maturation of SERPS
  - Introduction of new universal benefits
  - Big increases in means-tested benefits
- Tax changes have also benefited pensioners

# Average income tax and NI rates paid by workers and pensioners by income level



# Average income tax and NI rates paid by workers and pensioners by income level



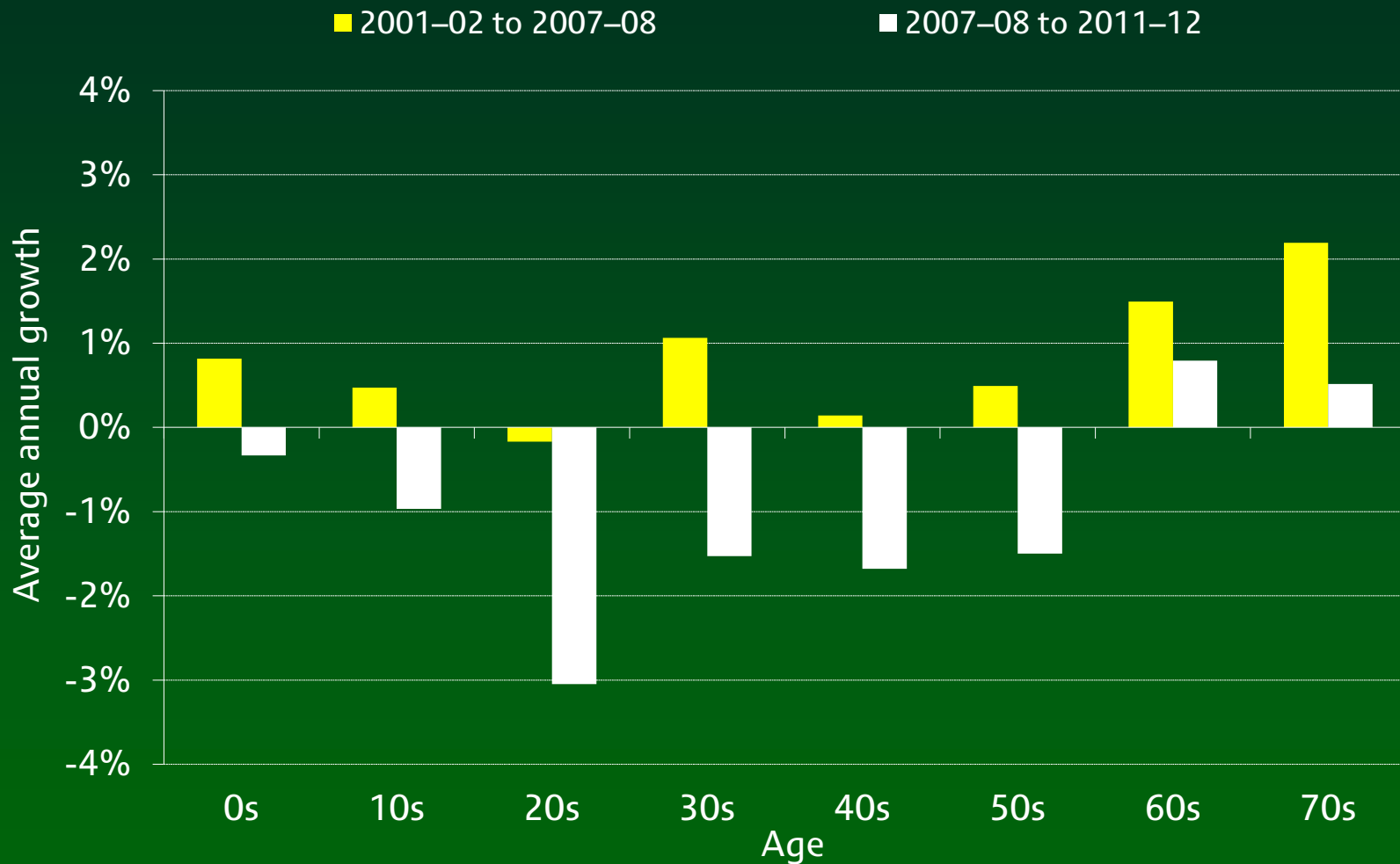
# What has driven these changes – private incomes?

- Driven largely by a four-fold increase in incomes from private pensions
  - Increases right across the distribution
  - Account for 10% of income even for poorest quintile
  - Most important income source for top quintile
- This resulted in large part from a range of new protections against inflation and for job changers
  - Accommodated by strong stock markets
- But for the future private DB schemes are dead or dying
  - And DC schemes will offer much less

# Pensioners have done especially well recently

- Their incomes have continued to grow since 2008
  - In sharp contrast to those of other age groups

# Growth in median income by age (BHC, GB)



Notes and source: see Figure 5.7 of *Living Standards, Poverty and Inequality in the UK: 2013*

# Pensioners have done especially well recently

- Their incomes have continued to grow since 2008
  - In sharp contrast to those of other age groups
- Tax and benefit changes have largely protected pensioners
  - “Triple lock” on state pensions
  - No cuts to means-tested benefits – in contrast to those of working age
  - As yet no reduction in additional universal benefits

# Changes January 2011 to April 2014

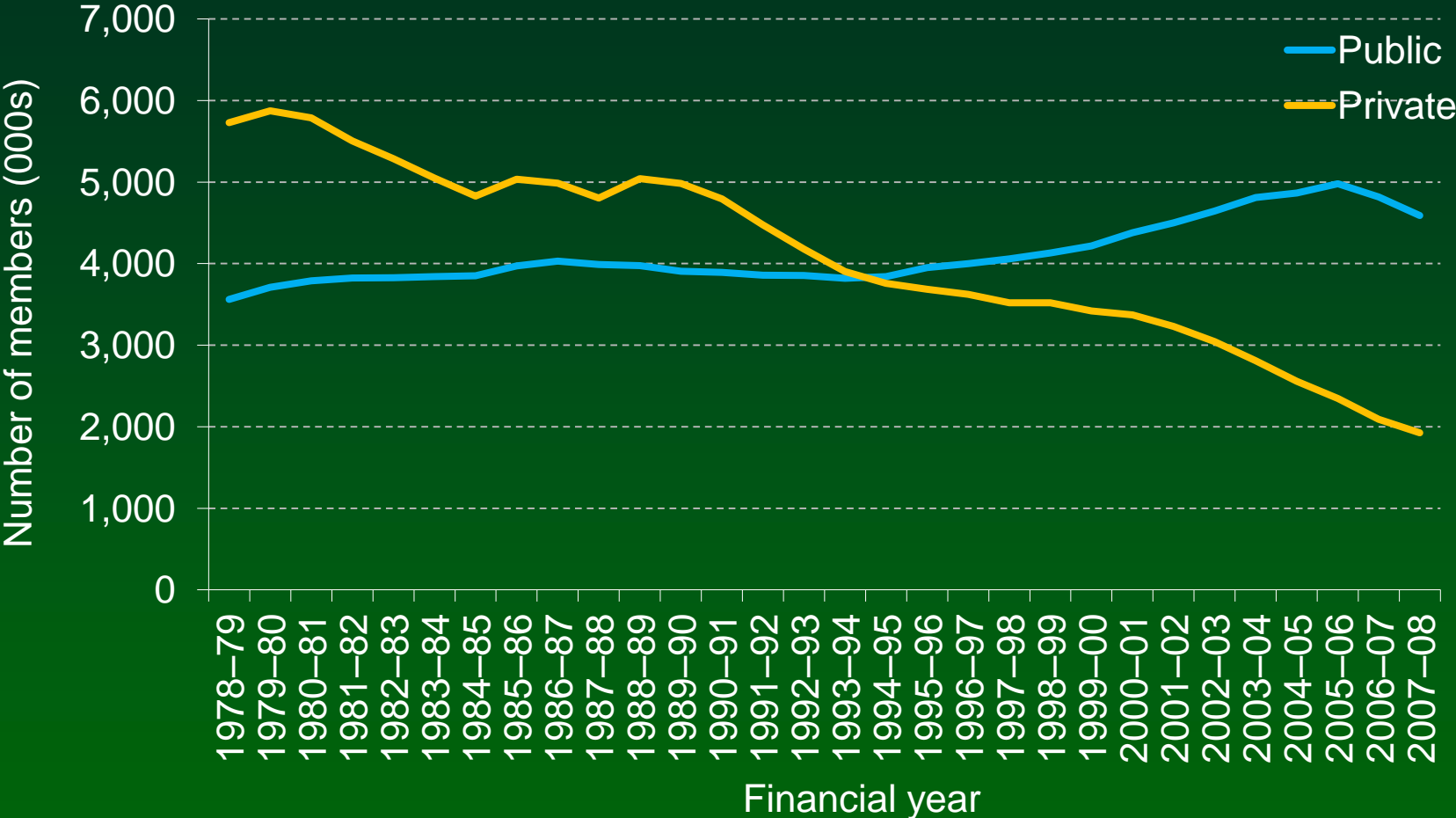




## But the future may not be so rosy

- SERPS and S2P are disappearing and being replaced by much less generous single tier pension
- Private sector DB schemes are disappearing
  - fewer than 10% of private sector employees are now active members of a DB occupational scheme
  - Down from a third in 1997

# Recent trends in DB coverage



## But the future may not be so rosy

- SERPS and S2P are disappearing and being replaced by much less generous single tier pension
- Private sector DB schemes are disappearing
  - fewer than 10% of private sector employees are now active members of a DB occupational scheme
  - Down from a third in 1997
- DC schemes are typically much less generous
- Auto-enrolment will make only a modest difference

# Conclusions

- In many ways the last three decades have been a triumph. Pensioner poverty has fallen dramatically
- Down to expansion in both occupational and state pensions
- Current policy continues to protect current and soon to be pensioners
- But the model is not being sustained
  - Generous occupational schemes in the private sector are gone
  - State pensions for the future will be lower
- The present is no guide to the future