

Cost of paying £140 a week State Pension to all pensioners retiring before 2016/17

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Contents

Background 3

Methodology 4

Results 5

Background

The State Pension is a regular payment people can claim when they reach State Pension age. Most people build up some State Pension, but the amount they get varies.

The State Pension is comprised of two main parts - basic State Pension and Additional Pension.

The amount of basic State Pension someone receives depends on how many qualifying years of National Insurance they have built up.

Additional Pension includes entitlement built up under the State Earnings-Related Pension Scheme (SERPs) and the State Second Pension. Some people will not receive all of their State Pension directly from the state as they will have contracted out of Additional Pension.

For people in contracted out employment Additional Pension received directly from the state is known as 'net Additional Pension'. On the other hand, where figures include the Additional Pension someone is entitled to from the contracted out element through their private pension the whole amount is called 'Gross Additional Pension'.

Widows and widowers can also receive extra state pension based on their deceased spouse's state pension entitlement.

Depending on their individual circumstances and overall level of income pensioners can also receive certain income-related benefits (IRBs) in addition to State Pension such as Pension Credit, Housing Benefit and Council Tax Benefit.

Further information on the State Pension can be found at the following links:

<http://www.direct.gov.uk/en/Pensionsandretirementplanning/StatePension/index.htm>

<http://www.dwp.gov.uk/publications/specialist-guides/technical-guidance/>

This note extends previous DWP analysis on state pension entitlement.¹

¹http://research.dwp.gov.uk/asd/asd1/adhoc_analysis/2011/Average_State_Pension_of_Women_below_140.pdf

Methodology

The DWP's medium-term State Pension projection model has been used to estimate the cost of topping-up the State Pension of all pensioners reaching State Pension age before 2016/17 to a flat-rate value of at least £140 (in 2010/11 cash terms) from 2016/17. This start date is used purely to illustrate the costs of introducing a single flat-rate pension at some point during the course of the next Parliament. We would expect the costs to be similar if the policy were to be introduced from a start date one or two years either side of this date.

The model provides estimates of gross State Pension income in each year between today and 2050 of a sample of pensioners who reach State Pension age in 2020/21 or earlier taken from the Lifetime Labour Market Database (L2). The L2 is a 1% sample of the National Insurance Recording system containing information up to 2009.

Data for pensioners already retired in 2009/10 (the latest year for which data is available) from the DWP Information Directorate 5% sample admin data is merged with this information to provide estimates of gross State Pension outcomes in 2009/10. For cohorts of pensioners retiring between 2010/11 and 2020/21 the L2 data is projected forwards to calculate expected gross State Pension entitlement at State Pension age.

Assumptions on mortality and bereavement based on ONS population projections are then used to roll this population forwards. State Pension entitlement is recalculated in future years by increasing benefit rates in line with projections of price and earnings growth and in line with OBR assumptions and taking account of changes in entitlement due to inheritance.

As with all modelled results outcomes are sensitive to the assumptions made. Similarly the model and outputs are based on a sample of the population, giving uncertainty in the outcomes. In addition, the model is a 'closed system', so only includes estimates of the Great Britain (GB) population.

In each year total gross State Pension entitlement² is compared to the flat-rate value. If an individual has less than this flat-rate amount the cost of topping-up to this level is calculated. These costs are summed for all pensioners in the sample and scaled up to give a cost for the GB population.

This modelling gives the additional expenditure on contributory State Pension. To get an estimate of total costs, we need to adjust this expenditure by taking into account the fact that some pensioners are also entitled to IRBs. For such pensioners

² In this calculation gross State Pension is the sum of an individual's own basic State Pension, derived rights to basic State Pension, gross Additional Pension and inherited Additional Pension.

an increase in their contributory State Pension may be offset to some degree by a decrease in their income from IRBs. This offset could not be calculated directly from model as this would require future projections of all income, not just State Pension. To calculate this offset we therefore modelled the State Pension policy in 2009 and used DWP admin data on IRBs for this year to calculate the value of the offset³. It was found that the expenditure with this offset included is reduced by about 20% in 2009. For future years we assumed that this was also the case (i.e. the IRB offset reduces expenditure by 20%).

These costs can be expressed as the increase in the basic rate of income tax required to generate this additional revenue. The HMRC ready reckoner⁴ shows that an increase of 1p on the basic rate of income tax would generate revenue of £3.9 billion in 2011/12, rising to a cash value of £4.5 billion by 2013/14. The ratio of the cost of the policy to this additional revenue is used to scale up the 1p increase.

Results

The analysis shows that the cost of topping-up the State Pension of all pensioners reaching State Pension age before 2016/17 to a flat-rate value of at least £140 (in 2010/11 cash terms) starting from 2016/17 would cost around £10bn per year in the early years.

This is equivalent to an increase of around 2p on the basic rate on income tax.

Table 1: Cost of topping up gross State Pension of all pensioners retiring before 2016/17 to the equivalent of £140 a week in 2010/11 cash terms

Year	Annual Cost, £billion, 2011/12 prices terms
2016/17	11
2017/18	10
2018/19	10
2019/20	10
2020/21	9

Source: DWP medium-term State Pension projection model

Notes:

1. These overall costs include a 20% reduction to the modelled contributory State Pension costs to take account of the IRB offset.
2. Amounts are rounded to the nearest £1 billion to account for uncertainties around assuming a constant offset in future years and combining different data sources.

³ Using Pension Credit information from DWP admin data and Housing Benefit and Council Tax Benefit data from the Single Housing Benefit Extract.

⁴ http://www.hmrc.gov.uk/stats/tax_expenditures/menu.htm

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Melanie Bowden (Melanie.Bowden@dwp.gsi.gov.uk)

Department for Work and Pensions

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