Department
for Work &
Pensions

Long term projections of pensioner benefits

July 2014

Contents

Background

The Office for Budget Responsibility (OBR) published long-term projections of pensioner benefit expenditure in their July 2014 Fiscal Sustainability Report published on 10th July 2014[1].

This note and the accompanying tables update projections of pensioner benefit expenditure published in July 2013[2] and in April 2014 (for UK and Scotland)[3]. These projections include the new State Pension reforms which became law as part of the Pensions Act 2014. For more information, see:
https://www.gov.uk/government/policies/making-the-state-pension-simpler-and-fairer/supporting-pages/introducing-a-simple-single-tier-state-pension

These are illustrative projections, in that they are designed to show the overall fiscal sustainability of benefit policy, as it stands at 2018/19 (the end of the current medium-term forecasts), along with any future changes to benefits that have been announced at or before the 2014 Budget, under a particular set of reasonable assumptions.

The projections show a broad path of expenditure over the next fifty years; results for any particular year will, in practice, be affected by cyclical factors in the economy and other areas, which it is not possible to predict, so the actual figures would fluctuate around the trend shown.

Tables LT1 and LT2 show DWP's preferred assumption that disability benefits (Disability Living Allowance, Attendance Allowance and Personal Independence Payments) and Over 75 Television Licences will continue to be uprated in line with consumer prices (CPI) over the long term and that Winter Fuel Payments, over 75 Television Licences, Christmas Bonus and Cold Weather Payments will continue to be fixed in cash terms. The OBR assume that over the long term, expenditure will grow as if these benefits were uprated in line with growth in earnings. These assumptions are used in tables LT3 and LT4.

The projections shown are for the United Kingdom and overseas, unlike the DWP's medium term forecasts, which exclude Northern Ireland. The latest Benefit Expenditure tables are published at:
https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2014

[1] http://budgetresponsibility.org.uk/fiscal-sustainability-report-july-2014/
[2] https://www.gov.uk/government/publications/benefit-expenditure-and-caseload-tables-2013
[3] https://www.gov.uk/government/publications/long-term-projections-of-social-security-expenditure-in-the-united-kingdom-including-scotland

Methodology: Summary of key assumptions

Demographic trends

Underlying all of the individual benefit projections are the Office for National Statistics 2012-based population projections[4]. As with the Fiscal Sustainability Report central projection, the low migration variant of the ONS population projections is used here; the reasons for adopting this projection are discussed in the Fiscal Sustainability Report and other associated documents.

Economic assumptions

Labour market and productivity assumptions used in these projections are detailed in the Fiscal Sustainability Report and March 2014 Economic and Fiscal Outlook; these projections assume productivity growth in the longer term is 2.2% per year. In the pension projections the productivity assumption is relevant both for earnings growth (which is assumed to follow productivity), and growth of the nominal GDP figures used as the denominator for spending as a share of GDP.

Changes to State Pension Age

The Government has legislated for a review of the State Pension age (SPA) to take place at least once every six years. This review would be based on a technical assessment by the Government Actuary and an additional report considering other relevant factors. Details of the core principle to guide that review were set out alongside Autumn Statement 2013: that people should expect to spend on average a third of their adult life (beginning from age 20) in receipt of the state pension, with at least ten years' notice provided and changes being phased in over two years[5].

These projections are based on what this core principle would imply if life expectancy evolved in line with the ONS's latest principal (low migration) population projections. These imply that the increase in the SPA to 68 currently legislated to take place between 2044 and 2046 would be brought forward to the mid-2030s, to be followed by further increases to 69 in the late-2040s and to 70 in the early-2060s. As well as affecting eligibility for state pensions, these changes also affect the qualifying ages for Pension Credit and Winter Fuel Payments (which are tied to women's State Pension age).

These assumptions are consistent with the OBR's approach in the Fiscal Sustainability Report 2014.

Of course, these State Pension age assumptions are illustrative, based on the life expectancy estimates from the 2012 population projections and the principle outlined above. In practice, any changes to State Pension age will take place following a review as outlined in the Pensions Act 2014, and would require primary legislation.

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[4] http://www.ons.gov.uk/ons/rel/npp/national-population-projections/2012-based-projections/stb-2012-based-npp-principal-and-key-variants.html
[5] https://www.gov.uk/government/publications/future-state-pension-age-rises-dwp-background-note

The latest information about current State Pension age policy can be found at: https://www.gov.uk/government/publications/state-pension-age-timetable.
Information about future reviews can be found at:
https://www.gov.uk/government/policies/reviewing-the-state-pension-age

State Pension

The State Pension projections are largely driven by demographic trends – the numbers reaching state pension age each year and the mortality rates. They also take account of increased Basic State Pension entitlements as a result of the Pension Act 2007 reforms and higher entitlements of younger pensioners who have had longer to accrue more State Second Pension entitlement.

The Pensions Act 2014 contains provisions to implement the single-tier state pension, hereafter called the "new State Pension". These projections include the effect of the new State Pension, which will replace the current basic State Pension and additional State Pension with a flat-rate pension that is set above the basic level of means-tested support for people who reach State Pension age on or after 6 April 2016.

Both basic State Pension and new State Pension are assumed to be uprated by the "triple guarantee" (highest of average earnings increases, CPI inflation or 2.5%), and it is assumed that on average this means increases by 0.30 percentage points per year above average earnings. State Second Pension is uprated by CPI when in payment, but by earnings during the accrual phase.

Pension Credit and Housing Benefit

These are modelled using DWP's long-term dynamic simulation model, Pensim2. Average earnings inflation is used to uprate the Pension Credit Guarantee level.

The key elements of the projections include the new State Pension, the impact of the maturing of the State Earnings Related Pension Scheme (SERPS) and the State Second Pension (S2P), and the future evolution of incomes from private pensions, including the National Employment Savings Trust (NEST). These determine the evolution of income brought to account in the assessment of means-tested benefits. The projections also include the removal of the Savings Credit element of Pension Credit for new pensioners from April 2016 as part of the Pensions Act 2014 reforms.

Additionally, key assumptions behind the Housing Benefit projections are the future increases in rents. Broadly speaking, in the main projection presented here rents rise in line with earnings in the long term.

Additionally, assumptions have been made about the evolution of home ownership, using an analysis by birth cohort, based on the Labour Force Survey. This leads to a marginal increase in the proportion renting initially due to the increased renting seen amongst those due to reach State Pension age but over the long term we assume renting will gradually decrease back to previous levels as home ownership recovers for older ages.

Council Tax Benefit was replaced by localised support in April 2013 and is no longer included in the projections.

Disability benefits

The projections for Attendance Allowance, Disability Living Allowance and Personal Independence Payment assume that after the medium-term the proportion of remaining life after age 65 spent receiving these benefits remains constant. Under this assumption, the per head rate at any given age falls over time due to increasing life expectancy.

Other pensioner benefits

Winter Fuel Payments in LTP1 and LTP2 are assumed to remain at their 2018/19 level (£200, with an additional £100 for those over 80) throughout the projection period, as is Christmas Bonus (£10). Free TV Licences for the Over 75s are assumed to increase in line with CPI after 2015/16. Tables LTP3 and LTP4 assume that over the long term expenditure will grow as if these benefits were uprated in line with growth in earnings.

Results

The resulting projections are summarised in the tables – expressed in real terms (2014/15 prices) and as a share of GDP, and with caseloads for the main benefits.

Table LT1 shows total state pensions and pensioner benefits spending rising from 6.8% of GDP in 2013/14 to 8.1% in 2063/64, if uprating is continued using DWP's current approach (see Note 2 to the tables)

Table LT3 shows total state pensions and pensioner benefits spending rising from 6.8% of GDP in 2013/14 to 8.8% in 2063/64, if uprating uses OBR's assumptions after 2018/19 (see Note 2 to the tables). Total state pension rises from 5.8% of GDP in 2013/14 to 7.9% in 2063/64. It is this projection that is shown as the principal projection in the OBR Fiscal Sustainability Report 2014.

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