Department
for Work &
Pensions

Long term projections of pensioner benefits

17 January 2017

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Background

The Office for Budget Responsibility (OBR) published long-term projections of pensioner benefit expenditure in their January 2017 Fiscal Sustainability Report on 17th January 2017[1].

This note and the accompanying tables update projections of pensioner benefit expenditure published in June 2015[2]. These projections include the new State Pension which became law as part of the Pensions Act 2014 and has begun to be paid to those claimants reaching State Pension age from April 2016. For more information, see: https://www.gov.uk/new-state-pension/overview

These are illustrative projections, in that they are designed to show the overall fiscal sustainability of benefit policy, as it stands at 2021/22 (the end of the current medium-term forecasts), along with any future changes to benefits that have been announced at or before the 2016 Autumn Statement, 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 are expected to fluctuate around the trend shown.

Tables LT1 and LT2 assume that disability benefits (Disability Living Allowance, Attendance Allowance and Personal Independence Payment) will continue to be uprated in line with consumer prices (CPI) over the long term and that Winter Fuel Payments and Christmas Bonus 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 medium term Benefit Expenditure tables are published at:
https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2016

[1] http://budgetresponsibility.org.uk (Accessed via the "Fiscal sustainability report" link on the right hand side of the page)
[2] https://www.gov.uk/government/statistics/benefit-expenditure-and-caseload-tables-2015

Methodology: Summary of key assumptions

These assumptions are consistent with the OBR's approach in the Fiscal Sustainability Report January 2017, except where stated.

Demographic trends

Underlying all of the individual benefit projections are the Office for National Statistics 2014-based population projections[3]. As with the Fiscal Sustainability Report central projection, the principal variant of the ONS population projections is used here.

Economic assumptions

Labour market and productivity assumptions used in these projections are detailed in the Fiscal Sustainability Report and November 2016 Economic and Fiscal Outlook (Autumn Statement 2016); these projections assume productivity growth in the longer term is 2.0% per year[4]. 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 introduced a regular and structured method for considering future changes in SPa by introducing, under the Pensions Act 2014, the requirement for regular reviews of the timetable that will take place every Parliament, with each report published within six years of its predecessor.

The first review is taking place this Parliament, and the Secretary of State is required to publish a report on the outcome before the 7th May 2017.

The review of the State Pension age will be based on the principle that people should spend a given proportion of their lives receiving a State Pension and will take into account information from:

- the analysis by the Government Actuary's Department of the proportion of their adult life that individuals in the future can expect to spend receiving State Pension; and
- an independently-led body, commissioned to produce a report on the wider factors that should be taken into account when setting State Pension age, such as variations in, for example, healthy life expectancy, and differences in life expectancy between socio-economic groups.

Any future changes to SPa will, as now, require primary legislation and will be subject to the full scrutiny of Parliament. Any such changes will seek to give individuals affected by changes to their SPa at least 10 years' notice from their expected SPa.

[3] http://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections
[4] http://budgetresponsibility.org.uk/docs/dlm_uploads/Long-term_economic_determinantsNov16.pdf

State Pension age in these projections

The core principle to guide the assumptions within these projections 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 of a change and changes being phased in over two years.

These projections are based on what this core principle would imply if life expectancy evolved in line with the ONS's latest (2014) principal population projections. The details of these new projections are available at the ONS website. They imply that changes to SPa will occur slightly later than under the 2012-based projections. So, in these tables, the increase in the SPa to 68 currently legislated to take place between 2044 and 2046 would be brought forward to between 2039 and 2041. This is followed by a further increase to 69 in the early 2050s. 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; and Attendance Allowance, which rises with men's State Pension age.

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

The latest information about State Pension age 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 replaced 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 of 0.34 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.

The mean weekly rent eligible for Housing Benefit support is assumed to grow in line with average earnings. Assumptions have been made about the evolution of home ownership, based on the Labour Force Survey, using an analysis by birth cohort. In the medium term, this leads to a decrease in the proportion of pensioners renting, as the rise in working age owner-occupation up to the mid 2000's feeds through into the older age groups. In the longer term, the proportion who rent is assumed to increase; as today's younger age groups are assumed to have lower levels of owner-occupation by pension age than were achieved by recent cohorts of new pensioners

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 2021/22 level (£200, with an additional £100 for those over 80) throughout the projection period, as is Christmas Bonus (£10). 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 (2016/17 prices) and as a share of GDP, and with caseloads for the main benefits. The charts below show pensioner benefit expenditure as a share of GDP for both DWP and OBR uprating assumptions.

Pensioner benefit expenditure projections

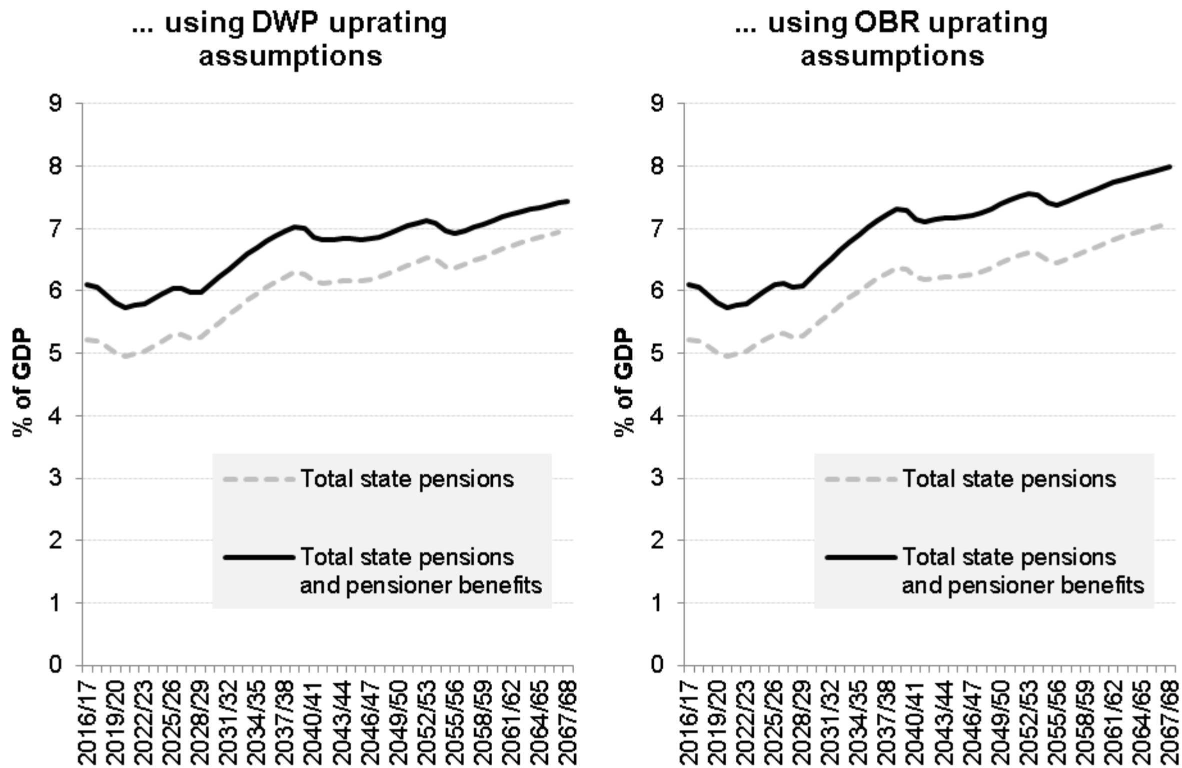

Table LT1 shows total state pensions and pensioner benefits spending rising from 6.1% of GDP in 2016/17 to 7.4% in 2067/68, if uprating is continued using DWP's current approach (see Note 2 to the tables)

Table LT3 shows total state pensions and pensioner benefits spending rising from 6.1% of GDP in 2016/17 to 8.0% in 2067/68, if uprating uses OBR's assumptions after 2021/22 (see Note 2 to the tables). Total state pension rises from 5.2% of GDP in 2016/17 to 7.1% in 2067/68. It is this projection that is shown as the principal projection in the OBR Fiscal Sustainability Report January 2017.

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