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The Guarantee Credit and state pension age: A PPI paper for the TUC

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Contents

This paper makes use of the Family Resources Survey 2004/5, which was supplied by the UK Data Archive, University of Essex, and is funded by the Department for Work and Pensions (DWP). The UK Data Archive and the DWP bear no responsibility for further analysis and interpretation.

This paper makes use of the Quarterly Labour Force Survey, January – March 2006, which was supplied by the UK Data Archive, University of Essex, and is sponsored by the Office for National Statistics and Northern Ireland Department of Enterprise, Trade and Investment. The UK Data Archive and the sponsors bear no responsibility for further analysis and interpretation.

Executive Summary

1. The Government proposed in the recent White Paper that state pension age (SPA) should be increased to age 66 by 2026, 67 by 2036 and age 68 by 2046. One concern often expressed about increases in SPA is that there is variation in life expectancy by social class. This suggests that any change in SPA will disproportionately affect these individuals.

2. Eligibility for means-tested Guarantee Credit (GC) is currently set at age 60 but is intended to rise to 65 by 2020, and then to rise in line with SPA from 2024. The TUC commissioned the PPI to provide an independent assessment of potential implications of retaining a lower eligibility age for the means-tested GC as SPA increases.

3. Life expectancy varies by social class. Professional people live longer than manual workers. However life expectancies for all socio-economic groups are usually understated.

4. Future life expectancy is uncertain, and measuring life expectancy by social class is difficult. If there is no change in the gradient in life expectancy by social class between now and 2026, a man in Social Class V reaching age 65 in 2026 would on average be expected to live to age 83. The average man in Social Class I reaching age 65 in 2025 would be expected to live to age 89.

5. Similarly, life expectancy can vary by area. However, the gap in life expectancy between the most deprived and least deprived areas is smaller than the gap by social class.

6. The gap in life expectancy by social class or area should decrease if the Government is successful in reducing health inequalities.

7. If SPA increases as proposed in the White Paper and life expectancy continues to improve as expected, people in all social classes can expect no fewer years above SPA, and probably slightly more.

8. Raising SPA would mean that low income individuals (who are more likely to be in lower social classes) could be worse off at age 65 than they would have been with no change in SPA. Given that this group may also have a lower life expectancy, they may not get the full value from the higher state pension also proposed in the White Paper.

9. Keeping the eligibility age for Guarantee Credit at 65 as SPA increases has been suggested as a safety-net for those with no other means of support (most likely those in lower social classes).

10. Current claimants of Guarantee Credit aged below state pension age are predominantly disabled, with little attachment to the labour market. Guarantee Credit is a safety-net benefit, rather than an early-retirement benefit.

11. If the eligibility age for Guarantee Credit were kept at age 65, the most likely claimants would still be those incapable of work.

12. There is a wide funnel of doubt for how many individuals could qualify for Guarantee Credit if the eligibility age was kept at 65. However, the additional cost is likely to be small relative to total spending on state pensions, building up to around 0.1% of GDP a year by 2046. Even in a pessimistic scenario, the maximum likely cost is only 0.2% of GDP.

Introduction

1. The Pensions Policy Institute (PPI) is independent and does not make policy recommendations. It exists to contribute facts and analysis to help all commentators and policy decision makers. The PPI has extensively analysed state pension reform options.

2. The Government proposed in the recent White Paper[1] that state pension age (SPA) should increase to age 66 by 2026, 67 by 2036 and age 68 by 2046.

3. One concern often expressed about increases in SPA is that there is variation in life expectancy by social class, and that individuals in lower social class groupings have lower life expectancy. This suggests that any change in SPA will disproportionately affect these individuals.

4. The PPI has suggested that the impact of increasing SPA on individuals in lower social class groupings could be cushioned by setting the age at which individuals qualify for Guarantee Credit (GC) below SPA[2]. This partially reflects the current situation, where SPA for men is 65, but the qualifying age for GC is 60. Under current legislation, the minimum qualifying age for GC is linked to women's SPA which will increase from 60 to 65 between 2010 and 2020[3].

5. The Trades Union Congress (TUC) has commissioned the PPI to provide an independent assessment of the potential implications of keeping the eligibility age for GC at 65 as SPA increases from 2024.

6. Chapter 1 of this assessment provides an independent analysis of the most recent data on the longevity gap by social class and area of deprivation, and the implications of increasing SPA. Chapter 2 examines the characteristics of current GC claimants aged below SPA, and considers how these may change if the policy of a minimum age for GC below SPA were maintained. Chapter 3 provides a broad analysis of the potential number of individuals who may be eligible for GC if the qualification age were kept below SPA, and the potential cost of implementing such a policy.

[1] DWP (2006) ***Security in retirement: towards a new pension system***
[2] PPI (2005) ***Submission from the Pensions Policy Institute in response to the Pensions Commission's First Report.*** The idea has also been suggested by the Pensions Commission (2005, p.340) and is kept open as a possibility by the Government (DWP (2006) ***Security in retirement: towards a new pension system,*** p.18).
[3] HM Government (2002) ***State Pension Act 2002,*** Chapter 16, Section 1, The Stationary Office

Chapter 1: Life expectancy and social class

7. In the recent Government White Paper, ***Security in retirement: towards a new pension system,*** proposals were made to increase incrementally state pension age from 65 to 68 between 2024 and 2046. This first chapter examines:
   - The gap in life expectancy between different social classes and geographical areas of deprivation, and how these gaps are often understated.
   - How these gaps may change through government action to reduce inequalities.
   - The implications of raising state pension age.

There is a social class gap in life expectancy, but life expectancy for all socio-economic groups is often understated

8. Life expectancy varies by social class. Professional people live longer than manual workers. However, life expectancies for all socio-economic groups are usually understated.

9. For example, it has been reported[4] that the life expectancy of Social Class V is 71 years, whereas, those in Social Class I can expect to live to 79.

10. Box 1 gives example of the types of occupations that fall within each social class grouping and the problems with the classification system used.

[4] For example, BBC News (12/10/2004) ***Millions face pension hardship*** and Age Concern (2005) ***Poorest must not pay cost of pension reforms*** Press Release (18/11/05)**.** These figures come from the Office for National Statistics (ONS) Longitudinal Study and are based on the period 1972 to 1999

Box 1: Defining social class

There are various ways to define social class and various methods used to allocate people to social class categories. The most common method used by Government and researchers classifies people according to their occupation. One scale that has often been used to calculate life expectancy by social class is referred to as Social Class by Occupation, and has the following categories[5]:

Class	Description	Examples
Non-manual		
I	Professional	Doctors, chartered accountants
II	Managerial and technical / intermediate	Managers, school teachers
III (N)	Skilled non-manual	Clerks, cashiers, retail staff
Manual		
III (M)	Skilled manual	Plumbers, electricians
IV	Partly skilled	Security guards, care assistants
V	Unskilled	Labourers, cleaners

This scale is no longer used in official statistics and surveys. It is used here because it is used in the main study on life expectancy and social class, which is based on survey evidence from the Office for National Statistics (ONS) Longitudinal Study (LS)[6].

There are various problems in using this survey's results, and various generic problems in defining social class, such as:

- ***Social mobility:*** people move between the classes. However, the LS assigned people to a social class using this scale when it began measuring in 1972.
- ***Changing socio-economic make-up of the UK:*** the scale is no longer considered to reflect current class 'divides'.
- ***Distinction between manual and non-manual:*** with the decline of the 'old' manufacturing industries and the increase of the service and technological industries, this delineation is no longer so helpful.

[5] From DWP (2006) ***Security in retirement: towards a new pension system*** p.180
[6] Donkin et al (2002) ***Inequalities in life expectancy by social class, 1972-1999*** Office for National Statistics

11. Although these reported lifespans, 71 and 79 years for people in Social Class V and I respectively, give an indication of the gap that exists, they are not the best measure of life expectancy to use in consideration of changes to state pension age (SPA) because[7]:
    - ***Age 65 not birth.*** They show life expectancy from birth rather than from age 65. People who live to age 65 would be expected to have longer lifespan than their expectation of lifespan was at birth.
    - ***Cohort not period mortality rates[8].*** The figures are based on period rates which uses data from all ages in a specific time or period to provide a snapshot of trends and existing conditions. Cohort measures look at specific age groups and take into account future changes in mortality rates and so are more relevant and accurate when predicting life expectancy.
    - ***Future not past.*** The figures refer to people who have reached age 65 in the past[9]. To assess the consequences of changing SPA in future, they should relate to people reaching SPA in say, 20 years from now, when the SPA increase will come into effect.

12. Taking these factors into account[10], the most appropriate estimate of life expectancy to use when considering the impact of the proposed change in SPA starting in 2024 is the cohort-based life expectancy for people reaching age 65 in 2026 (by which time the phased increase in SPA will be complete). Assuming that there is no change in the life expectancy gap between now and 2026, a man in Social Class V reaching age 65 in 2026 would on average be expected to live to age 83 on the 'best estimate' cohort basis (Table 1). The average man in Social Class I reaching age 65 in 2026 would expect to live to age 89.

[7] PPI (2005) Briefing Note Number 17 and Pensions Commission (2006) ***A new pensions settlement for the 21st century: The second report of the Pensions Commission*** p.338
[8] Mortality rates refer to the ratio of deaths in relation to the total population in a particular group
[9] "Age 71" quote is from data covering the period 1997-99
[10] See Appendix 1 for a detailed breakdown of how each of these factors affects the estimate of life expectancy

Table 1[11]: 'Best estimate' of expected lifespan in years, at age 65, on future dates (cohort basis)

	2026	2036	2046	2054
Men				
All	~87	~87	~88	~89
Social Class V	~83	~84	~85	~86
Social Class I	~89	~89	~90	~91
Gap (years)	~5	~5	~5	~5
Women				
All	~89	~90	~91	~91
Social Class V	~87	~88	~89	~89
Social Class I	~91	~92	~93	~93
Gap (years)	~4	~4	~4	~4

These estimates may still be unrepresentative

13. There are fewer than 5% of men in Social Class V, and declining (expected to reach 3% in 2050[12]). A similar proportion is in Social Class I. The measures for Class I and V are therefore looking at the very outer limits of the range and exclude 95% of the population. The data on female longevity is even patchier than that for men, as assignment of women to the correct social class is more problematic[13].

14. Because of these problems of assigning people to classes, the ONS suggest that the social class data are uncertain; instead using only the two categories "Manual" vs. "Non-Manual" would be more reliable. In this case, the gap in period life expectancy between manual and non-manual male workers is 2 years[14].

Life expectancy also varies by area

15. Life expectancies have also been found to vary by area. However, these studies are also often based on out-of-date, period data.

16. One recent study maps geographical areas in the UK onto a deprivation scale, from 1 being the least deprived to 10 being the most

[11] PPI analysis based on ONS (2006) ***Trends in life expectancy by social class 1972 - 2001*** and GAD (2005) 2004-based cohort expectation of life tables
[12] DWP (2006) ***Security in retirement: towards a new pension system*** p179
[13] Women are assigned to their husband's Social Class if they have no occupation of their own
[14] Donkin et al (2002) ***Inequalities in life expectancy by social class, 1972-1999*** Office for National Statistics

deprived[15]. The level of deprivation for each area is calculated using census data, for example, the proportion of people in households in the area headed by a person from Social Class IV or V, or the number of individuals living in overcrowded accommodation.

17. As with social class the figures for area deprivation can be adjusted to a more up to date, cohort basis. Using the most recent cohort data, Table 2 shows the estimated gap between expected lifespan in the most and least deprived areas. However, the gap between the most and least deprived areas at age 65 is only around 2 to 3 years. This is less than the gap between Social Class I and V for both men and women.

Table 2[16]: 'Best estimate' of expected lifespan in years, at age 65, in 2006

	All	Most deprived area	Least deprived area
Men	85	~83	~86
Women	87	~86	~88

Government action may reduce the gap in life expectancy

18. Certain assumptions must be made in order to consider future changes in the life expectancy gap. For instance, past changes in the gap show that it may be increasing slightly but Government policy on inequalities could help close the gap[17].

19. As part of a health equality programme, the government has a target to reduce the longevity gap between areas. ***The target is a 10% reduction in the relative gap (i.e. percentage difference) in life expectancy at birth between the fifth of areas with the worst health and deprivation indicators (the Spearhead Group) and England as a whole[18].*** However, the latest government data for the period 2001-03 shows that there has been a small increase in inequality. The gap in life expectancy at birth between England as a whole and the fifth of local authorities with the lowest life expectancies grew by less than 5% between 1997-99 and 2001-03.

[15] Bajekal (2006) ***Healthy life expectancy by area deprivation: magnitude and trends in England, 1994 – 1999*** Office for National Statistics
[16] PPI analysis based on Bajekal (2006) and GAD (2006) 2004-based cohort life expectancy projections
[17] Donkin et al (2002) ***Inequalities in life expectancy by social class, 1972-1999*** Office for National Statistics
[18] Department of Health (2005) ***Tackling Health Inequalities: Status Report on the Programme for Action***

If SPA rises in line with improvements in life expectancy, lifespan after SPA would remain constant

20. All other things being equal, increasing SPA will reduce the number of years people can expect to receive state pension. If SPA increases more quickly than life expectancy, then future cohorts of people will receive their state pension for a shorter average time than current cohorts do. If this is the case (and assuming that the gap does not change), then those in lower social classes will lose out proportionately more than those in higher social classes.

21. Table 3 provides a 'best estimate' of expected lifespan in years at different state pension ages as proposed in the Government's recent White Paper. In 2006, the life expectancy of a man in Social Class V at age 65 is around 17 years compared to 22 years for a man of Social Class I. If the Government increases SPA to 66 in 2026 then male life expectancy at age 66 will be around 18 years for Social Class V compared to 23 years for Social Class I.

22. This suggests that even as SPA increases over time[19], people in all social classes can expect no fewer years above SPA, and probably slightly more.

Table 3[20]: 'Best estimate' of expected lifespan in years, at different state pension ages and in different years

Year	2006 current SPA	2020 SPA at 65	2026 SPA at 66	2036 SPA at 67	2046 SPA at 68	2055 SPA at 68
Men						
All men	20.1	21.6	21.1	21.1	21.0	21.8
Social Class V	~17	~18	~18	~18	~18	~18
Social Class I	~22	~24	~23	~23	~23	~24
Women						
All women	28.3	24.5	24.0	23.8	23.6	24.4
Social Class V	~26	~22	~22	~22	~22	~22
Social Class I	~30	~26	~26	~26	~26	~26

[19] After allowing for the equalisation of male and female state pension age between 2010 and 2020

[20] PPI analysis based on GAD (2005) 2004-based cohort expectation of life tables and ONS (2006) ***Trends in life expectancy by social class 1972 – 2001.*** Consistent with Table 3.ii, p. 114, in DWP (2006) ***Security in retirement: towards a new pension system.***

23. There is some debate about whether the increased years after SPA are getting more or less healthy, and whether there is a gap between the health expectancies of different socio-economic groups. However, the number of years in 'Healthy Life Expectancy'[21] appears to have been increasing. As the number of years of life after age 65 has been increasing, the proportion of those years in good health has remained broadly constant, at around 75% and 70% for men and women respectively[22]. There is some evidence for a difference in Healthy Life Expectancy by area of deprivation[23], although more analysis is needed in this area.

24. Men and women at age 65 are currently expected to have on average around 13 and 11 years of Healthy Life Expectancy respectively[24]. A rise in SPA of one or two years is therefore well within the average expected span of Healthy Life Expectancy.

25. This chapter has showed that:
    - There is a gap in life expectancy at state pension age between the social classes, with people in Social Class I living longer than people in Social Class V.
    - Future life expectancy is uncertain and measuring life expectancy by social class is difficult.
    - "Best estimates" of expected lifespan at the state pension ages proposed in future suggest that across all social classes lifespan after SPA will not reduce from current levels and may increase slightly.

[21] This is a self reported measure, whereby 'healthy' refers to being in good or fairly good health, some years of which may be with a limiting long-standing illness. However, there are many other measures for determining health expectancies, for example, years free of disability or free from a specific disease.
[22] Office for National Statistics (2005) ***Healthy Life Expectancy at birth and at 65 in Great Britain and England, 1981 – 2001.*** Figures are for men and women in the UK reaching age 65 in 2001.
[23] Bajekal (2006) ***Healthy life expectancy by area deprivation: magnitude and trends in England, 1994 – 1999*** Office for National Statistics
[24] Office for National Statistics (2005) ***Healthy Life Expectancy at birth and at 65 in Great Britain and England, 1981 – 2001.*** Figures are for the UK.

Chapter 2: Guarantee Credit and state pension age

26. This chapter examines the characteristics of current Guarantee Credit (GC) claimants aged below state pension age (SPA), and considers how these may change if the eligibility age for GC is kept at age 65 as SPA increases from 2024.

27. The previous chapter showed that life expectancy varies by social class and that manual workers die younger than professionals. This has been used to argue that SPA should not be raised as lower income groups would be disproportionately affected[25].

28. However, general improvements in life expectancy mean everyone is living longer. Various factors mean that poorer people could actually be advantaged by increasing SPA[26]:
    - Raising SPA would be accompanied by higher state pensions a the White Paper proposals suggest indexing the Basic State Pension to earnings rather than prices.
    - A higher SPA with a state pension that is better indexed could allow for a better state pension for older pensioners, who are more likely to be poorer and in poor health.
    - A higher SPA might be expected to encourage people to remain in the labour market for longer, which would in itself change income levels at older ages.

29. However, these factors do not address all the inequality issues. In particular, individuals who may be unable to work before reaching the new SPA may find themselves with low incomes.

30. To address this, GC could be extended to people with low income problems before SPA. Extending GC to individuals below SPA could act as a cushion for those individuals not able to participate fully in the labour market. This possibility is examined in more detail in the rest of this paper.

31. The rest of this chapter looks at the types of people that are currently eligible for GC, and how this could change if the age of GC were kept at 65 from 2024 when SPA starts rising. It also looks at the potential interaction with the proposed system of Personal Accounts.

[25] For example Age Concern ***Poorest must not pay cost of pension reforms*** press release 18 November 2005
[26] See O'Connell (2004) ***Raising State Pension Age: An update*** for a full discussion

Guarantee Credit is currently available to men below state pension age

32. The means-tested GC is payable to people aged 60 and over. This means that men with low income aged between 60 and 65 receive the same level of minimum income as people over the male SPA of 65. GC provides a higher minimum income level than that available from Income Support. It therefore provides an additional safety net to men who cannot work in the five years prior to male SPA.

33. As state pension age for women increases from age 60 to age 65 between 2010 and 2020, the age of eligibility for GC is also scheduled to increase to age 65. However, if SPA rises above age 65 from 2024 as suggested in the White Paper proposals[27], the eligibility age for GC could remain at age 65. Although this is likely to mean more means-testing before SPA, this could be a more acceptable outcome than the current system[28] of SPA remaining at age 65 but with extensive means-testing of most pensioners[29].

Most current Guarantee Credit claimants report being disabled

34. In November 2005 there were 200,000 men aged 60 to 64 claiming Guarantee Credit[30]. This is 10% of the total population of men aged 60 to 64.

35. Of these 200,000 men receiving Guarantee Credit:
    - 55% were single, 45% were married or cohabiting.
    - 75% reported themselves as being disabled[31], though only 45% received any disability benefits[32].
    - Fewer than 10% had any attachment to the labour market[33].
    - 20% reported receiving income from a private pension.

[27] DWP (2006) ***Security in retirement: towards a new pension system*** p.18
[28] Before the initiation of any of the proposals in the White Paper
[29] See PPI (2006) ***An evaluation of the White Paper state pension reform proposals,*** chapter 4, for more details
[30] DWP administrative data for November 2005, estimated using the DWP Tabulation Tool www.dwp.gov.uk/asd/tabtool.asp
[31] Disabled is classified as having a disability as defined for the purposes of the Disability Discrimination Act
[32] This (and following information on claimant characteristics) is not available from DWP administrative data, but is estimated from the Family Resources Survey (FRS) 2004/5. The FRS records a smaller total number of Guarantee Credit claimants aged 60 to 64, so only the proportion of the FRS-recorded claimants are reported here. Figures are rounded to the nearest 5%.
[33] Reporting themselves as employed, self-employed or unemployed

36. Because GC is available before SPA but is not conditional on seeking work it could be considered to act as a disincentive to work[34]. However, almost half of people who are currently claiming GC are also claiming disability benefits, with more self-reporting themselves as disabled. Given that less than 10% of men in the 60 to 64 age group claim GC, this suggests that any disincentive effect is currently small.

Future Guarantee Credit claimants

37. As GC is a 'safety-net' the characteristics of those people eligible to receive GC in future are likely to be similar to those today:
    - Those unable to work for health or disability reasons.
    - Those with little income from other sources, such as savings or private pensions.

38. If the eligibility age for GC is kept at age 65 as state pension age increases, there will be some important differences in the characteristics of those eligible for GC aged 65 to SPA compared to those eligible for GC today aged 60 to SPA:
    - Future claimants will be older (at least age 65 compared to 60 to 64 today).
    - Some future claimants will be women. In the current system women become eligible for Guarantee Credit at SPA, which is 60 for women[35].

39. This might suggest that people over the proposed GC age but below SPA in future may be more likely to be eligible for GC than today's 60 to 64 year old men, as:
    - 65 year olds are less likely to be in work than 60 to 64 year olds today. 53% of men aged 60 to 64 are employed or self-employed compared to 28% of men aged 65[36].
    - Women aged 65 are less likely to be in work than men aged 65[37].
    - The prevalence of disability increases with age.

[34] Pensions Commission (2005) and House of Commons Work and Pensions Select Committee (2006) ***Pension Reform,*** Fourth Report of Session 2005 – 06, Volume 1
[35] Increasing to 65 between 2010 and 2020
[36] PPI analysis of the Labour Force Survey June – March 2006
[37] PPI analysis of the Labour Force Survey June – March 2006

40. However, the characteristics of 65 year olds in 2024 are likely to be different from the characteristics of 65 year-olds today:
    - Government policy is to increase working at older ages (target of 1 million additional people over 50 in work as part of a larger target to reach an employment rate of 80%)[38].
    - Employers may be more willing to employ older workers due to legal and societal changes such as:
        - The introduction in October 2006 of a default retirement age of 65, and the duty on employers to consider requests to work beyond age 65 in 2007. The mandatory retirement age will be reviewed in 2011.
        - A relative fall in the number of younger workers due to lower fertility rates.
    - Improvements in health at all age groups should mean that 65 year olds in 2024 are likely to be healthier, and more capable of work, than 65 year olds today.
    - The number of men aged 65 in employment today will be affected by being able to claim state pension.

41. The labour market facing 65 year-olds in 2024 and beyond is therefore likely to be very different from that facing 65 year-olds today. Although there is little evidence that Guarantee Credit acts as a significant disincentive to work today, continuing initiatives such as the recent extension of back-to-work help to men claiming Guarantee Credit[39] could help to ensure that keeping the age of eligibility for Guarantee Credit at 65 does not encourage people to retire before state pension age.

42. Future Guarantee Credit claimants may also be more likely to have private pension income if Personal Accounts are successful, though initially the amounts produced by Personal Accounts will be very small[40]. This could have the 'perverse' impact of leading to a £-for-£ reduction in the amount of Guarantee Credit received. Box 2 examines whether there is a case for disregarding income from Personal Accounts.

[38] DWP (2006) ***A new deal for welfare: Empowering people to work***
[39] DWP (2006) ***A new deal for welfare: Empowering people to work***
[40] As people reaching 65 in 2024 will not have had a long time to make contributions, and those contributions will not have had long to accrue interest. In addition, individuals with income low enough to qualify for Guarantee Credit are unlikely to have high earnings before age 65 and so will most likely have only made small contributions to Personal Accounts, if any.

Box 2: Could Personal Accounts be ignored for Guarantee Credit?

If income is low enough to qualify for Guarantee Credit (GC), any income from Personal Accounts or any other saving will reduce the amount of GC received, and could even remove eligibility to GC completely. The reduction in GC would be £-for-£ i.e. £5 received from Personal Accounts would reduce GC by £5.

People would not gain from not taking any income from Personal Accounts: 'Notional income' rules in GC mean that if any Personal Account fund held had not been converted into income, the individual would still be assumed to be receiving an income from the Personal Account and so receive a lower amount of GC[41]. This could:

- Reduce the attractiveness of Personal Accounts, particularly to those with low lifetime incomes. This could act as a barrier to saving in Personal Accounts (although these are least likely to be able to save).
- Lead to 'unfairness' as individuals who have made voluntary savings receiving the same income (and less from the State) as someone who has made no savings (one of the issues that led to the introduction of Savings Credit (SC)). The unfairness effect would be 'age limited[42]', as eligibility for state pensions and SC from SPA could change the additional amount of income received from Personal Accounts.

One way of avoiding these problems would be to exclude any income from Personal Accounts (or potential income if individuals would prefer not to convert the find built up in Personal Accounts) in the calculation of GC, either completely or until state pension age. This would remove the disincentive and unfairness effects described above.

However, this would:

- Treat saving in Personal Accounts more favourably than other forms of saving, and other pensions such as occupational pension schemes. This would distort the pensions and savings market.
- Increase the number of people eligible for and the total costs of GC.
- Mean that GC is no longer a safety net, as some people with total incomes (including income from Personal Accounts) above the 'minimum level' would still receive GC.

There is therefore a trade-off between the barrier to saving and unfairness effects on one side and distortion of savings and extending the role, coverage and costs of Pension Credit on the other.

[41] The Pensions Service (2005) ***A guide to Pension Credit*** (PC10S)
[42] Initially eligibility for Guarantee Credit would only begin 1 year below state pension age in 2026, though by 2046 it could be 3 years below state pension age.

Chapter 3: The impact of a lower starting age for Guarantee Credit

43. This chapter provides a broad analysis of the potential number of individuals who may be eligible for Guarantee Credit if the qualification age were kept below state pension age, and the potential cost of implementing such a policy.

The number of claimants and the future costs of keeping eligibility for Guarantee Credit at age 65 are uncertain

44. The cost of keeping the qualification age for Guarantee Credit lower than state pension are uncertain. The costs depends on:
    - The number of people who would be eligible for Guarantee Credit, and the amount of benefit they would be entitled to receive. As discussed in Chapter 2 this will depend on:
        - The availability of employment opportunities for older workers.
        - Levels of health and disability.
        - Levels of private saving and other income.
    - Levels of take-up of Guarantee Credit. Currently between 19% and 31% of all people eligible for Guarantee Credit but not Savings Credit do not claim the benefit that they are entitled to[43].
    - The amount that would be received of other benefits that Guarantee Credit increases eligibility for, such as Housing Benefit and Council Tax Benefit. There could also be other additional costs for benefits-in-kind, such as free eye tests and prescriptions.
    - How much would have been spent on paying benefits in the absence of Guarantee Credit. For example, how many would be entitled to Job Seekers Allowance (income related), and how much would they receive from these benefits[44].

45. For many of these factors there are no detailed, reliable future projections. Given the high degree of uncertainty about these factors, it is sensible to produce a range of estimates as well as a central estimate. The range provides a useful indication of the potential order of magnitude of costs.

[43] DWP (2006) ***Pension Credit estimates of take-up in 2004/5***. Take-up estimates are presented as ranges within which it can be assumed true take-up lies. These 'ranges of true take-up' account for possible biases inherent in estimates from data that are less than perfect. These ranges also account for the effects of sampling variation.

[44] This has not been allowed for in the estimates of the cost of keeping the eligibility age for Guarantee Credit at age 65, as it is not clear what levels benefits will be between 20 and 40 years in the future. Current uprating conventions would suggest that they would increase broadly in line with prices each year, but this would lead to them being worth very little relative to Guarantee Credit. As no allowance has been made for entitlement to existing benefits, the costs in Table 4 are overstated.

46. The central estimate is based on a 'no change' scenario, where the characteristics of those aged between 65 and state pension age in the years examined are similar to men aged 60 to 64 today[45]. The relationship between characteristics (such as employment and disability) and claiming Guarantee Credit is assumed to remain the same, so for example in future the same proportion of individuals with disabilities are assumed to claim Guarantee Credit as they do today. They are also assumed to claim the same average amount[46].

47. The optimistic scenario assumes that in future employment rates are higher than in the central scenario, and disability rates are lower. This could be consistent with the Government policies being successful in increasing the number of older workers and improving health outcomes. This scenario also includes a reduction in the average amount of benefit claimed, in response to other income sources being higher (for example, income from Personal Accounts). Take-up is assumed to fall by 10 percentage points, reflecting the smaller amounts that people are entitled to.

48. The pessimistic scenario assumes that in future employment rates are lower than in the central scenario, and that there is a higher rate of disability. This could be consistent with the characteristics remaining closer to today's 65 year-olds, rather than 60 to 64 year olds, or with Guarantee Credit acting as a disincentive to work. This scenario also assumes that the average amount that is claimed is higher than today. This could occur if, for example, other benefits such as disability benefits increased by less than Guarantee Credit over time. Take-up is assumed to increase by 10 percentage points, reflecting the larger amounts that people are entitled to.

49. If the qualifying age for Guarantee Credit (GC) remained at age 65 as state pension age (SPA) increased, in 2026 around 120,000 households aged 65 might be receiving GC, costing around £0.6 billion in the central scenario(Table 4). As SPA increases, the number of people eligible for GC below SPA would rise, potentially reaching 370,000 households under SPA by 2046, at a cost of £1.8 billion, 0.1% of GDP.

[45] The characteristics of women aged between 65 and SPA in future are assumed to be similar to those aged 58 and 59 today. Eligibility to Guarantee Credit has been simulated by comparing income with Guarantee Credit limits.
[46] Adjusted for price and earnings growth

Table 4[47]: Number of claimants and additional cost as a percentage of GDP and £ billion in 2006/7 earnings terms of keeping the qualification age for Guarantee Credit at 65 after 2020

	2026	2036	2046
Number of claimants			
Optimistic scenario	90,000	200,000	280,000
Central scenario	120,000	270,000	370,000
Pessimistic scenario	160,000	350,000	480,000
Cost % GDP			
Optimistic scenario	*	0.1%	0.1%
Central scenario	*	0.1%	0.1%
Pessimistic scenario	0.1%	0.2%	0.2%
Cost £billion 2006/7 earnings terms			
Optimistic scenario	£0.4	£0.8	£1.1
Central scenario	£0.6	£1.3	£1.8
Pessimistic scenario	£0.9	£2.0	£2.8
Total spend on pensions under the White Paper proposals as a % of GDP	5.3% (£75 bn)	6.0% (£85 bn)	6.1% (£85 bn)

50. The estimated number of households receiving GC vary widely under the different scenarios used, particularly further in the future. The estimates of number of households aged under SPA in 2046 range from a quarter of a million households in the optimistic scenario to almost half a million households in the pessimistic scenario.

51. However, the cost as a proportion of GDP remains relatively small in all scenarios, with a most likely maximum annual cost of 0.1% of GDP. Even in the pessimistic scenario the maximum cost is only 0.2% of GDP from 2036.

[47] PPI estimates, based on data from the Family Resources Survey 2004/5. Number of claimants rounded to the nearest 10,000, costs rounded to the nearest 0.1% GDP. * represents less than 0.05 % of GDP. Costs include additional allowances for entitlement to other benefits and benefits-in-kind. See Appendix 1 for further information. Total spending under the White Paper proposals are PPI estimates and include spending on Basic State Pension, SERPS / State Second Pension, Pension Credit, and other pension benefits (such as winter fuel payments). PPI estimates are used as DWP estimates have not been published for the required years. See PPI (2006) ***An evaluation of the White Paper state pension reforms*** for further details and how PPI estimates of the cost of the state pension system under the White Paper proposals compare to DWP estimates.

Technical appendix

1. This technical appendix contains two parts:
   - The first examines the impact of each of the 3 separate adjustments made to ONS estimates of life expectancy by social class to realistically reflect the impact of a change in state pension age (SPA)
   - The second describes in more detail the assumptions made in estimating the cost of keeping the eligibility age for Guarantee Credit at 65 as SPA increases.

Adjusting ONS estimates of life expectancy by social class

2. The average life expectancy of a man in Social Class V is often quoted as 71 years, compared to 79 years for a man in Social Class I. However, this estimate is misleading. Although these figures give an indication of the gap that exists, they are not the best measure of life expectancy to use in consideration of changes to state pension age. There are three factors to account for in adjusting ONS data on life expectancy by social class to fully reflect the potential impact of an increase in SPA:
   - Age 65 not birth.
   - Cohort not period mortality rates[48].
   - Future not past.

Age 65 not birth

3. "71" is a measure of life expectancy at birth, rather than at age 65. Calculating life expectancy for all individuals on this basis incorporates the shorter life spans of those who die before age 65. Life expectancy at age 65 is an estimate of the number of additional years expected of someone who has already reached age 65, so excludes all those who have not reached 65.

4. People who live to age 65 would be expected to have a longer lifespan than their expectation of lifespan was at birth. People who die before reaching age 65 will not be affected by future changes in SPA.

5. On this measure, the same ONS data gives the expected ages at death of those aged 65 as 78 years for men in Social Class V, rather than 71, and 83, not 79, for Social Class I (Table A1).

[48] Mortality rates refer to the ratio of deaths in relation to the total population in a particular group

Table A1[49]: Expected lifespan in years, period basis, 1997-01

	Average	Social Class V	Social Class I	Gap (years)
Men				
At birth	77.1	71.0	79.4	8.4
At age 65	81.4	78.3	83.3	5.0
Women				
At birth	80.1	77.6	82.2	4.6
At age 65	83.8	81.9	85.6	3.7

Cohort not period

6. The figures "71" and "79" are given by longevity studies which have used 'period' rather than 'cohort' mortality rates. Period data measures the chance of dying for someone aged 65 in 1997/9; 66 in 1997/9; 67 in 1997/9…etc. Period measures are used because all that can actually be measured are deaths in a population at each age in a time period.

7. A better measure to use is on a 'cohort' basis: what is the expected lifespan of the cohort of people aged 65 at a point in time, based on the expectation that so many of them will die this year aged 65; next year aged 66; next year aged 67…etc.

8. Cohort measures have to be estimated, making assumptions on future changes in mortality rates. Because longevity is improving (and expected to continue to improve, especially in the near term for older people), life expectancies are longer for all social classes when calculated on a cohort basis.

9. Using a cohort basis shows that the average expected lifespan for men aged 65 is more than 3 years higher than estimated using the period based measure[50] (Table A2).

[49] PPI estimates based on ONS (2006) ***Trends in life expectancy by social class 1972 – 2001*** and GAD (2005) 2004-based cohort expectation of life tables
[50] Cohort estimates are for 2004 from the GAD 2004-based projections

Table A2[51]: Expected lifespan in years, at age 65

	Period basis	Cohort basis
Men	81.4	84.7
Women	83.8	87.3

10. To estimate the socio-economic gap in life expectancies using recent cohort data, we can take the gap between the expected age at death of men in Social Class V and the same for men in Social Class I from Table 1 and apply it to the most recent figures in Table A2.

11. The quoted "71" years expected lifespan for people in Social Class V is therefore more like 82 years for those reaching age 65 (Table A3).

Table A3[52]: 'Best estimate' of expected lifespan in years, at age 65 in 2004

		Estimated for Social Class V	Estimated for Social Class I
Men	84.7	~81	~87
Women	87.3	~85	~89

Future not past

12. It is important not only to look at life expectancies of those people retiring today, but also to consider the life expectancies of people retiring in, say, 20 years from now, who will be more affected by the policy changes.

13. The gap shown in Table A3 can be applied to GAD projections of life expectancy at the relevant SPAs for future years.

14. Assuming that there is no further change in the life expectancy gap between now and 2026, a man in Social Class V reaching age 65 in 2026 would on average expect to live to age 83 (Table A4). The average man in Social Class I reaching age 65 in 2026 would expect to live to age 89.

[51] Period based estimates are for 1997-2001 from ONS (2006) ***Trends in life expectancy by social class 1972 – 2001*** and cohort estimates from GAD (2005) 2004-based cohort expectation of life tables

[52] PPI estimates based on ONS (2006) ***Trends in life expectancy by social class 1972 – 2001*** and cohort estimates from GAD (2005) 2004-based cohort expectation of life tables

Table A4[53]: 'Best estimate' of expected lifespan in years, at age 65, on future dates (cohort basis)

	2026	2036	2046	2054
Men				
All	~87	~87	~88	~89
Social Class V	~83	~84	~85	~86
Social Class I	~89	~89	~90	~91
Gap (years)	~5	~5	~5	~5
Women				
All	~89	~90	~91	~91
Social Class V	~87	~88	~89	~89
Social Class I	~91	~92	~93	~93
Gap (years)	~4	~4	~4	~4

The cost of keeping the eligibility age for Guarantee Credit at 65

15. The cost of keeping the qualification age for Guarantee Credit at 65 as SPA increases is uncertain. The cost depends on the number of people who would be eligible for Guarantee Credit, and the amount of benefit they would be entitled to receive. Chapter 3 lists the factors that will affect these numbers.

16. For many of these factors there are no detailed, reliable future projections. Given the high degree of uncertainty about these factors, it is sensible to produce a range of estimates as well as a central estimate. The range provides a useful indication of the potential order of magnitude of costs.

[53] PPI estimates based on ONS (2006) ***Trends in life expectancy by social class 1972 - 2001*** and GAD (2005) 2004-based cohort expectation of life tables

Central scenario

17. The central estimate is based on a 'no change' scenario, where the characteristics of men aged between 65 and SPA in the years examined are similar to men aged 60 to 64 today. The characteristics of women aged between 65 and SPA are assumed to be similar to those of women aged 58 and 59 today. To calculate the costs, it is assumed that:
    - The population aged between 65 and SPA grows as projected by GAD, split into legal marital status[54].
    - The relationship between characteristics (such as employment and disability) and claiming Guarantee Credit is assumed to remain the same, so for example in future the same proportion of individuals with disabilities are assumed to claim Guarantee Credit as they do today. For women, eligibility for woman aged 58 and 59 today is simulated by comparing incomes (excluding means-tested and other non qualifying benefits) with Guarantee Credit levels.
    - Individuals in future are also assumed to claim the same average amount, adjusted for indexation.
    - Take-up is assumed to remain at the same level as today.
    - An additional cost of 10% is assumed for increased entitlement to Housing Benefit (HB) and Council Tax Benefit (CTB). This broad adjustment reflects the fact that individuals would be passported onto full HB and CTB as a result of receiving Guarantee Credit.
    - No adjustment is made for the Income Support (IS) that might be received if Guarantee Credit were not available. This is because it is difficult to predict the level of IS in future in the absence of long-term policy commitments. If current uprating conventions continue[55], IS is likely to be low relative to Guarantee Credit. Not making any adjustment means that the estimates potentially overstate the additional cost of Guarantee Credit.

[54] Using GAD 2004-based projections, with marital status based on the 2003-based marital status projections. As Guarantee Credit entitlement is based on living arrangements rather than legal marital status this may underestimate the number of 'couples' in future. Given that couples are less likely to be eligible for Guarantee Credit, the cost estimates shown here may be overestimated.

[55] IS is uprated each year in line with the ROSSI index, the RPI adjusted for some housing costs.

18. Cost and caseloads estimates are based on figures for the number of people eligible derived from the Family Resources Survey (FRS) 2004/5, and the average amount of Guarantee Credit received in Pension Credit administrative statistics for November 2005. The FRS is used in order to look in more detail at the characteristics of claimants.

19. However, the FRS underestimates the number of Guarantee Credit recipients compared to administrative data. The costs and caseloads are therefore adjusted upwards in the final estimates to be consistent with the administrative data figures.

20. Given the uncertainty surrounding these estimates, a range has been estimated using an optimistic and pessimistic scenario. Although these scenarios can be justified using potential trends in different characteristics, the real use is in demonstrating that even if assumptions are varied significantly, the overall cost of keeping the age of eligibility for Guarantee Credit at age 65 is relatively small.

21. The caseloads and costs under the optimistic and pessimistic scenarios are calculated using the same assumptions, with the exception of:
    - Employment rates are assumed to be 10 percentage points higher in the optimistic scenario, and 10 percentage points lower in the pessimistic scenario.
    - Disability rates are assumed to be 5 percentage points lower in the optimistic scenario, and 5 percentage points higher in the pessimistic scenario. These changes are consistent with the changes in employment rates assumed.
    - The average amount of benefit claimed is 20% lower in the optimistic scenario, and 29% higher in the pessimistic scenario.
    - Take-up is 10 percentage points lower in the optimistic scenario (consistent with take-up reducing as the amount entitled to falls[56]) and 10 percentage points higher in the pessimistic scenario.

[56] Hancock R, Pudney S, Sutherland H, Barker G, Hernandez, M (2005) ***What should be the role of means-testing in state pensions?*** Paper for PPI/ Nuffield Foundation seminar series ***Shaping a stable pensions solution***