

IS THERE STILL A CASE FOR THE STATE PENSION?

Even though the government has announced a substantial rise in the State Retirement Pension (SRP) next April, it continues to insist that future increases should be linked to prices rather than earnings. At the same time, it is also promoting the means-tested Minimum Income Guarantee (MIG) as the tool to tackle pensioner poverty. Worth much more than the SRP and linked to earnings, a vigorous MIG represents a very different way of providing pensioners with a basic income. In this briefing paper, **Peter Kenway** and **Mohibur Rahman** assess the differences between the SRP and the MIG and consider what the implications might be of the course that the government has now set.

The MIG tops up pensioners' incomes to the guaranteed minimum

Pensioners get their income from a variety of sources: the SRP, private pensions, investments and employment. If this income falls below the 'guaranteed minimum' level, the MIG provides the top-up. This amount is calculated through a means test which assesses the financial circumstances of the pensioner and their spouse.

Introduced in April 1999, the MIG is a version of Income Support specially for pensioners.. As well as being worth much more than mainstream Income Support, the MIG is due to rise in future in line with earnings rather than prices.

The MIG is the government's principal weapon for combating pensioner poverty. In April 2001, when it rises to £92 a week for a single pensioner and £141 a week for a couple, the MIG could lift almost all single pensioners, and pensioner couples living in rented accommodation, above the key 'half average income' threshold. The reality will not be quite this good, for

example due to a lack of take-up, but this certainly represents a huge step towards eradicating poverty among the current generation of pensioners.

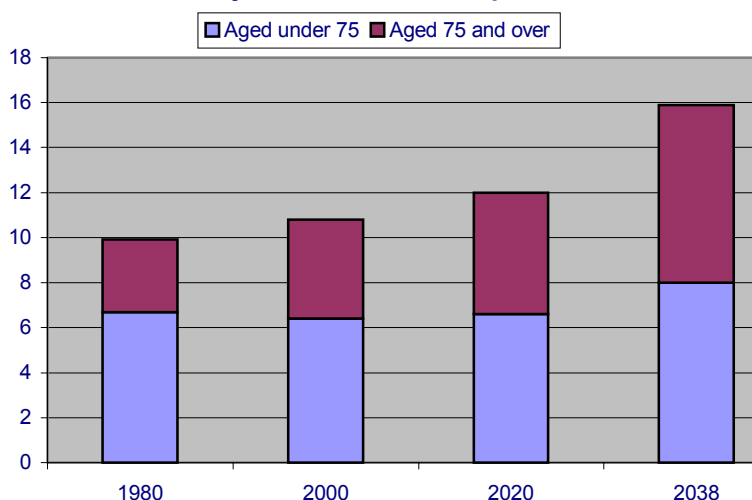
The SRP is an earned entitlement, based on contributions to national insurance

There are two basic differences in the way that the MIG and the SRP work. First, whereas the amount received under the MIG depends directly on what other income the pensioner may have, rising or falling in line with other income, the SRP is independent of other income.

Second, whereas entitlement to MIG depends on low income, entitlement to the SRP depends on the national insurance contributions made by the individual or their spouse during their working life.

Provided contributions (including sometime national credits) have been kept up, and subject to the proviso that on a per head basis single pensioners receive more than pensioner couples, every pensioner gets the same SRP, rich and poor alike.

Projected Pensioner Population



THE RISING PENSIONER POPULATION

- Over the next 40 years, the population of pension age will grow by 50%, rising from 10 million now to 15 million in about 2040. Four fifths of that growth will occur among pensioners aged over 75.
- This extra 5 million accounts for virtually all the projected growth in the total population of the UK over that period – so the proportion of pensioners in the population is therefore set to rise.
- Source: Government Actuary Department, and ONS. Pensionable age is 60 for women and 65 for men. This is due to change between 2010 and 2020 to 65 for both sexes.

The MIG and the SRP tackle pensioner poverty in quite different ways

In dealing with pensioner poverty, the fact that the SRP gives money to rich and poor alike is usually seen as a great weakness. For a given pot of money, so the argument runs, means testing ensures that it goes to those who need it most.

If the aim is to relieve pensioner poverty now, the means-tested approach is bound to be the most cost effective. But this is not an argument against the SRP, because the aim of the SRP is not merely the relief of pensioner poverty today, but the prevention of it tomorrow too.

The problem that the SRP is trying to prevent is people retiring without a sufficient pension. It does this by obliging employees and the self-employed to save, via national insurance. The fact that rich and poor alike get the SRP reflects the fact that they have all had to pay national insurance. Put another way, while the MIG aims to treat the symptoms of inadequate pensions, the SRP aims to treat the causes. The fact that means testing may be the cheapest way to treat symptoms says nothing about whether it is the best way to treat the causes.

The SRP has some fundamental advantages, which are relevant today

Since the SRP does not automatically apply to anyone who is retired, a MIG will always be needed. There are number of important reasons, however, for preferring a strategy that maximises the importance of the SRP, thereby reducing the need for a safety net to a minimum.

First, the SRP neither undermines the individual's dignity or self-respect nor obliges them to apply for help. Receipt of the SRP does not mark a pensioner down as poor; it is not a sign of having failed to provide for one's old age; neither does it require exposing one's personal affairs to the prying eye of the state. Means-tested benefits, by contrast, certainly do some of these things – and may do all of them. Second, the SRP is easy to understand and easy to obtain. Problems of take-up resulting either from practical difficulties or from a reluctance to being seen in need of 'help' are few and occasional.

Third, the SRP (like schooling and the NHS) involves all kinds of re-distribution –for example, from younger generations to older ones, from higher paid to lower paid and from couples to single people. Redistribution here is pervasive, expressing a wide range of obligations between members of a society. Means testing, on the other hand, which restricts the role of re-distribution to that of 'helping the poorest' tends to divide the poor from the rest.

Finally, the fact that the SRP is paid irrespective of other income means that it provides a solid base on which to build a private pension, however small. In view of the its distinctly redistributive tinge (unequal contributions leading to uniform outcomes) it may seem surprising that far from undermining individual endeavour and self-help, the SRP creates the conditions in which additional saving for a private pension, at whatever level, receives its full and fair reward.

| | Minimum Income Guarantee | Half Average Income (Before Housing Costs) | 'Low Cost But Acceptable' |
|---------|--------------------------|--|---------------------------|
| Singles | £92 | £92 | £123 |
| Couples | £141 | £167 | £184 |

MIG at April 2001 prices, HAI at 1998/99 rates, 2000 prices and LCA at 2000 prices.

HOW WELL DOES THE MIG TACKLE POVERTY?

- For all single pensioners the MIG would bring their income up almost exactly to the key 'half average income' threshold. Although it still falls £30 short of the 'low cost but acceptable' level – the amount independent researchers estimate to be the necessary minimum - housing benefit (for pensioners who are tenants) and council tax benefit would reduce this difference, particularly for tenants.
- For couples, the MIG still falls short of the half average income threshold, by £17 a week – although for couples living in rented accommodation, housing benefit is likely to reduce this gap considerably.
- Source: DSS; Households Below Average Income 1994/5-1998/9 (2000); and Parker (Ed). Low Cost but Acceptable incomes for older people (2000).

A strong MIG and a weak SRP creates problems

The advantages of a pension system based on the SRP are called into question if too large a gap opens up between the SRP and the MIG. This is exactly what is now in prospect.

The danger comes not from the MIG itself but from the combination of a strong MIG and a weak SRP. At present, the single pensioner's SRP is worth about £11 less than the MIG. In April 2001, that gap will rise to £20, despite the SRP itself rising by £5. With future increases in the MIG linked to earnings, that gap will grow, to around £70 (in current money) by 2030.

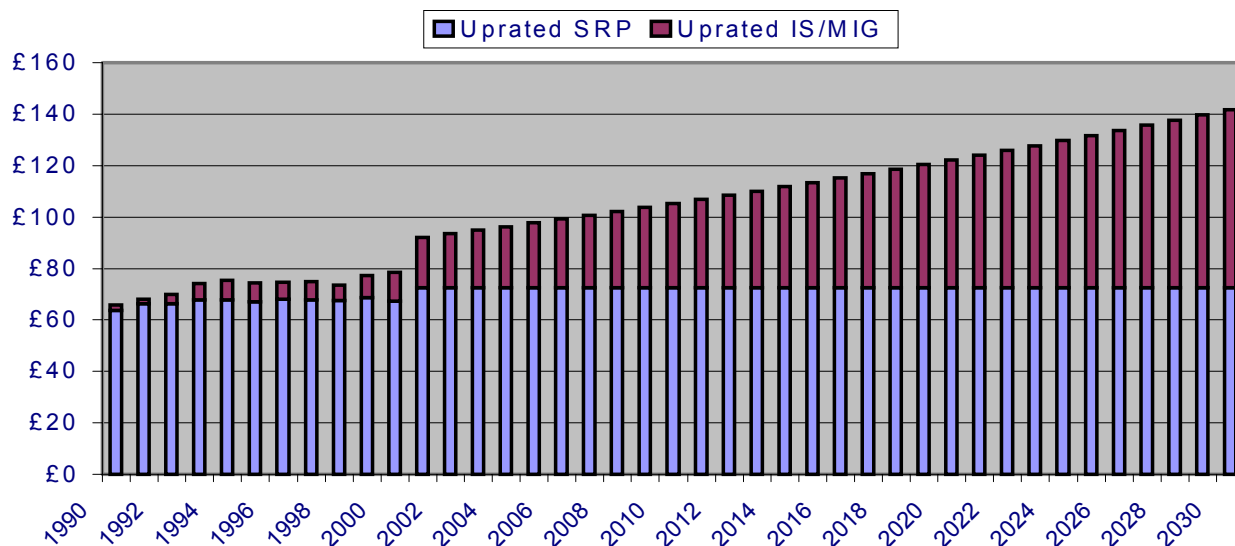
One problem with this is the sheer number of pensioners reliant on the MIG which currently benefits some two million pensioners. As the level of the MIG rises, so do the number of pensioners entitled to it. So, from April, that number will rise, perhaps by half a million, extending eligibility to more

than a quarter of pensioners. It is uncertain what will happen to this number in future as some factors will push it up and some push it down. If the proportion stays at the 2001 level, that would make 3½ million pensioners in 30 years time.

Second, the gap between the MIG and the SRP represents a huge disincentive to modest saving that would yield only a small, private pension. The proposed tax credits will ameliorate (but by no means eliminate) this problem for today's pensioners. But whether the uncertain perception of tax credits 30 or 40 years hence will persuade a young adult with a modest income to start saving for a private pension is an altogether different matter.

Finally, if the level of the MIG is roughly the minimum that pensioners need, an SRP that is worth around half that by 2020 is clearly inadequate. While the SRP does not have to be equal to the MIG, a large gap means that the SRP is failing to meet its objective of ensuring that no one enters retirement without an adequate pension.

The SRP - And How Much Extra The MIG Gives



HOW MUCH MORE WILL THE MIG BE WORTH?

- During most of the 1990s, the MIG and the SRP moved in line with one-another, the MIG typically being worth around £6 or £7 a week more than the SRP – about 10%.
- In 2001, the MIG will be worth more than £20 a week more than the SRP. That gap is due to rise steadily from then on. In 30 years time, it will be worth £70 a week more, i.e. double the SRP.
- Source: Government Actuary Department (GAD). From 2001 onwards the value of the MIG has been calculated to grow at a rate of 1.5% over inflation (this is the GAD's estimated growth rate). Hence the value of the SRP stays constant in real terms. All figures are shown at April 2000 prices.

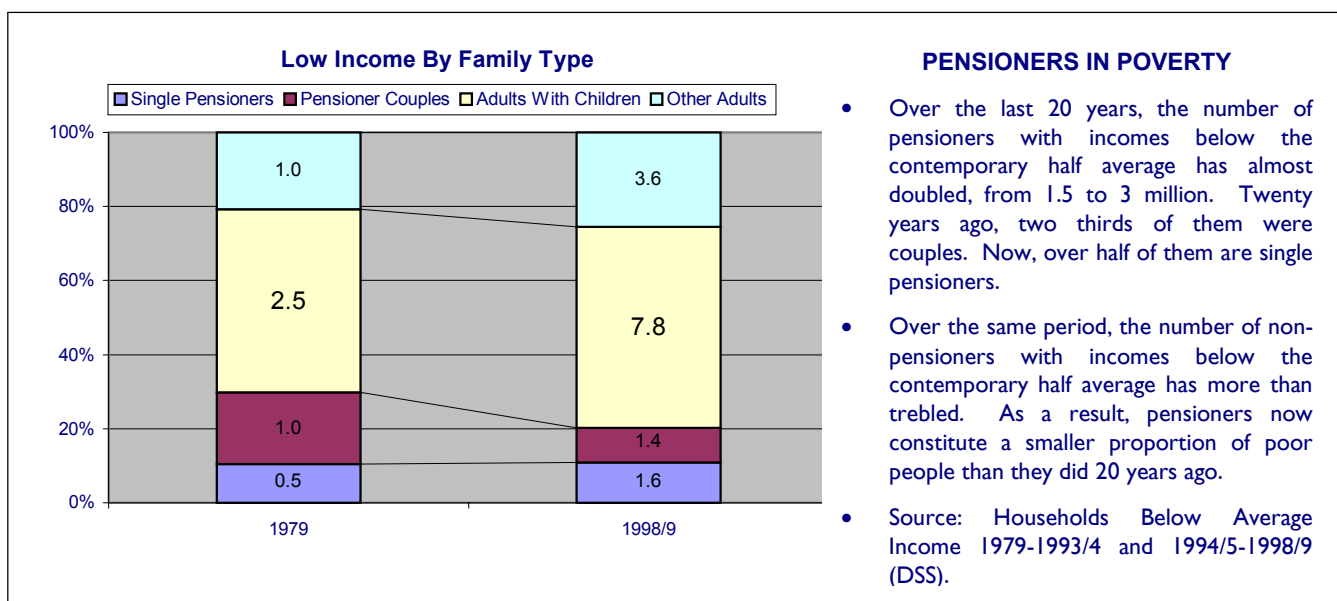
Key Questions

Is the long term course the government has set for pensions a good idea or not? We suggest that the answer to this should depend on the answers to three more specific questions.

1. **How desirable is it to have so many pensioners reliant on a means-tested 'safety net' for a decent pension? Pensioners' leaders view means testing as humiliating – but is that view shared or understood by younger people?**

2. **Won't the ever widening gap between the MIG and the SRP be a huge disincentive to save for small scale private pensions?**

3. **If the SRP rose in line with earnings, it would be worth about £40 a week more than under the government's plan by 2030. Would the extra additional insurance contributions for a person on average earnings be more or less than the contribution needed for a £40 a week private pension?**



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Comments on this policy brief are welcome. To get in touch, please email: analysis@npi.org.uk

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