

# SHARING IN THE NATION'S PROSPERITY? PENSIONER POVERTY IN BRITAIN

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*Alissa Goodman*  
*Michal Myck*  
*Andrew Shephard*

**Sharing in the Nation's Prosperity?**  
**Pensioner Poverty in Britain**

**Alissa Goodman**

**Michal Myck**

**Andrew Shephard**

*Institute for Fiscal Studies*

**The Institute for Fiscal Studies  
7 Ridgmount Street  
London WC1E 7AE**

**Published by**

The Institute for Fiscal Studies  
7 Ridgmount Street  
London WC1E 7AE  
Tel: +44-20-7291 4800  
Fax: +44-20-7323 4780  
Email: [mailbox@ifs.org.uk](mailto:mailbox@ifs.org.uk)  
Internet: [www.ifs.org.uk](http://www.ifs.org.uk)

© The Institute for Fiscal Studies, March 2003

ISBN 1-903274-30-3

**Printed by**

KKS Printing  
The Printworks  
12–20 Rosina Street  
London E9 6JE

## **Preface**

Financial support from the ESRC-funded Centre for the Microeconomic Analysis of Public Policy at IFS (grant number M535255111) is gratefully acknowledged. Data from the Family Resources Survey and the Households Below Average Income data-sets were made available by the Department for Work and Pensions, which bears no responsibility for the interpretation of the data in this Commentary. Material from the Family Expenditure Survey was made available by the Office for National Statistics through the ESRC Data Archive and has been used by permission of the Controller of HMSO. Any errors and all opinions expressed are those of the authors.



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## Executive summary

The government has redistributed significant resources towards pensioners with the aim of ‘abolishing pensioner poverty’. The overall 1997–2004 policy package directed at changing pensioner incomes increases them in total by about £7 billion per year, of which about £4.1 billion should have fed through to the latest poverty statistics.

Resulting falls in pensioner poverty, measured in relative terms, have not been as substantial as some might have expected. The proportion of pensioners with incomes below 60 per cent of the median (after-housing-costs) income stood at about 22 per cent (or about 2.2 million pensioners) in 2001–02. This represents a fall of about one-fifth (or around 400,000 pensioners) since 1996–97, though the numbers below other poverty lines have not fallen by as much.

The main reason why relative poverty has not fallen further is that the median income across the whole population has risen, and thus so has the relative poverty line. If pensioner incomes had risen by the same amount but the median income had not changed, we would have seen a drop of 1.6 million pensioners in poverty, a reduction of almost 60 per cent.

The changes in relative poverty are much more impressive when considered in the context of a longer period of time and when compared with other population groups:

- During similar periods of growth in the past, pensioner incomes have tended to fall further behind other groups, only to catch up again when the economy slows down. The fact that this time there has been no fall behind is notable.
- Average pensioner incomes are now a higher proportion of the average income amongst non-pensioners than at any time in the last 40 years. In the last 10 years, lower-income pensioners have seen steady or increasing incomes relative to non-pensioners, and pensioner income inequality – which has been below non-pensioner income inequality for most of the last 25 years – has not increased.
- Poverty rates amongst pensioners are now the same as those amongst non-pensioners, and single pensioner poverty has fallen considerably faster than child poverty.

From this point of view, pensioners can indeed claim to have been ‘sharing in the nation’s prosperity’. But pensioner poverty measured in relative terms is still far from being ‘abolished’. Although non-take-up of benefits is partly responsible for this, we estimate that if all pensioners took up the benefits to which they are entitled, there would only be between 100,000 and 200,000 fewer pensioners classified as poor according to the 60 per cent median AHC income definition.

Government policy towards pensioners affecting their incomes after 2001–02 (the latest date covered by the poverty figures) is likely to contribute to a further reduction in pensioner poverty. However, because of likely continued income growth across the population, we would expect any future reductions in relative poverty resulting from policies already announced to be fairly modest.



## 1. Introduction

*Our aim is to end pensioner poverty in our country*

Gordon Brown, speech to Labour Party conference, 30 September 2002

*At this election, we repeat our commitment to pensioners – we will ensure that you share fairly in the nation’s rising prosperity*

Labour Party election manifesto, 2001

The out-turn for pensioners contained in the government’s latest set of official low-income and poverty figures<sup>1</sup> has been keenly awaited. Reducing poverty amongst pensioners has become a prominent aim of government policy in recent years. Increasingly strong words – such as those of the Chancellor cited above – have not been accompanied by explicit quantified policy targets. But they have been accompanied by historically large increases in the generosity of state benefits for pensioners, particularly those on lower incomes. At the same time, efforts have been devoted to easing the benefit claim process and improving take-up of means-tested benefits amongst pensioners.

The government has been keen to emphasise the importance of these measures in reducing pensioner poverty. For example, the recent pensions Green Paper<sup>2</sup> describes tackling pensioner poverty as the ‘immediate priority’ for pensions policy when this government took office, whilst the Secretary of State for Work and Pensions, Andrew Smith, has claimed within the context of pensions policy that pensioner poverty was the ‘single biggest challenge’ the government faced when it came to power.<sup>3</sup>

Despite the immediacy of this priority, there were no major reforms implemented affecting pensioners’ incomes in the first two years of the Labour government. But the 1999 Budget saw the start of a series of reforms designed to increase pensioner incomes, through increases in the level of both means-tested and non-means-tested support.

The latest poverty figures released by the government now provide us with the best test we have had so far of the government’s success in tackling poverty amongst current pensioners.<sup>4</sup> Figures published a year ago on relative poverty amongst pensioners showed little change over Labour’s first four years.<sup>5</sup> But with an extra year’s data now released (taking us up to the end of 2001–02), the first of the two large increases in the minimum income guarantee (MIG), which took effect in April 2001, will have fed through to the low-income figures.

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<sup>1</sup> Department for Work and Pensions, 2003.

<sup>2</sup> Department for Work and Pensions, 2002c.

<sup>3</sup> Andrew Smith, article for the *Financial Times*, 13 December 2002.

<sup>4</sup> We do not consider policy changes that are designed to improve the retirement incomes of future pensioners who are now below pension age. For a review of this, see Clark and Emmerson (forthcoming).

<sup>5</sup> Department for Work and Pensions, 2002b.

In the light of this, this Commentary reviews the government's tax and benefit reforms affecting pensioners to date, and examines the evidence from the latest official low-income figures on the government's record on pensioner poverty so far.

The layout of the Commentary is as follows. Chapter 2 explains the measures of relative and absolute pensioner poverty and living standards described in the rest of the report. Chapter 3 then discusses the Labour government's main policies directed at reducing pensioner poverty in the period between 1997–98 and 2001–02, and provides estimates of their impact on pensioner incomes, assuming full take-up of benefits.

Chapter 4 describes the headline figures – the actual changes in pensioner poverty that have taken place over the last five years – and shows the changes in the income distribution of pensioners underlying these trends. Chapter 5 throws a different light on the changes in poverty, by setting these trends in the context of a longer period of time and by comparing them with those of other groups.

Chapter 6 then analyses why there are still significant numbers of pensioners in poverty, despite benefit levels that would appear to take a large proportion of pensioners out of poverty. We examine the issue of benefit take-up and estimate the amount by which poverty could fall if all pensioners took up the benefits to which they appear to be entitled.

Chapter 7 looks to the future, setting out the likely impact of already-announced policies, such as the pension credit. Chapter 8 concludes.

Box 1.1 first sets out what we mean throughout the Commentary when we refer to a 'pensioner'. The definition we use, by necessity, varies somewhat according to the analysis, though none of the results we present is very sensitive to the exact definition used.

#### **Box 1.1. Who is a pensioner?**

If we are to say anything about pensioner poverty, it is first necessary to define exactly what we mean by a pensioner. For the majority of the Commentary, the definition of a pensioner is based on the status of the individual only. We count as pensioners all those who are of state pension age, i.e. all men aged 65 or above, and all women aged 60 or above. Likewise, someone is counted as a person in a pensioner couple if they are of pension age and in a couple (regardless of the age of the partner).

But for some analyses, we have to depart from this definition based on the status of the individual and define pensioners according to the household unit in which they live. The analysis of the effect of government reforms on incomes is largely based on changes in incomes at the household level. For this, we need to define a 'pensioner household'. For our analysis, a pensioner household is one that includes at least one person of pension age.

Notice that, under these definitions, we do not take into account whether or not individuals are actually retired.

## 2. Pensioner living standards and poverty

There is no consensus on the best measure of pensioner poverty. In this Commentary, we focus on pensioners' incomes and present evidence on changes in both relative and absolute income poverty. The poverty measures we present are some of those set out in the government's annual audit of poverty, *Opportunity for All* (see, most recently, Department for Work and Pensions (2002a)). Following the government's own practice for monitoring pensioner poverty represents just one approach to tracking progress, but it provides an important check on the government's performance to date against its own criteria.

The measures used all rely on household income derived from the latest official Households Below Average Income (HBAI) statistics (see Department for Work and Pensions (2003)). In this chapter, we describe briefly the main features of the HBAI income measure on which our analysis is based, and discuss some of the advantages and disadvantages of measuring poverty in this way. First, we set this approach in the context of some of the alternative methods used to measure pensioner poverty.

### 2.1 Measures of pensioner poverty

A large number of alternative methodologies can be used to assess changes in pensioner poverty and some of these are described in Box 2.1. In this Commentary, we follow one strand of the approach to monitoring pensioner poverty taken by the government in its annual publication *Opportunity for All*. There, the government monitors the proportion of pensioners living in households whose income falls below a range of income poverty lines, all based on some measure of median household income.

Such 'headcount ratio' measures based on incomes have strong advantages – chiefly that they are transparent and simple to track over time – but they also have some serious drawbacks. On their own, they do not take account of either the depth or the persistence of poverty, though they can be adapted or extended to take these dimensions into account. More fundamentally, they are based on income lines that have been set to some extent arbitrarily, and without reference to any underlying principle such as how much income someone needs to reach a certain standard of living. There is no sensible reason why 60 per cent of the median, for example, is a better cut-off point for whether a pensioner is poor than 59 per cent, though the choice of cut-off point can make a big difference to the numbers measured as poor. The choice of income, rather than consumption, as the means of measuring living standards can also be criticised (for more on this issue, see Appendix A).

Recent 'budget standards' estimates of the amount of income pensioners need to achieve a minimum standard of living – a so-called 'low-cost but acceptable' (LCA) budget standard – (such as those cited in Box 2.1) have also been very influential. This is because the poverty thresholds calculated are linked directly to the concept of how much money an individual needs to reach a pre-defined standard of living. Deprivation indices also provide a different perspective on poverty. These again are linked more directly to a concept of need than are the *Opportunity for All* measures, since they attempt to capture

the number of people who lack what are considered to be a critical number of necessities.

A comparison of recent estimates of pensioner poverty using some of these different methodologies is set out in Appendix B. It shows that for single pensioners, these recent estimates give remarkably similar results. But for couples, there are some important differences. However, for both single pensioners and couples, the trends are unlikely to be similar over time using different methods to measure poverty.

### **Box 2.1. Alternative approaches to measuring pensioner poverty**

#### **The low-income indicators in *Opportunity for All***

*Opportunity for All* contains a set of low-income indicators often called ‘headcount ratios’ since they are based on a simple count of people below a given income line. They are simple to understand and easy to track over time. But they are often criticised, both because they present an ‘all or nothing’ picture of poverty and because they are based on poverty lines defined in terms of arbitrary proportions of the average income.

#### **Budget standards**

The budget-standard approach addresses directly the question of how much money is required to meet people’s needs, by calculating the cost of a carefully constructed basket of goods – including food, housing and other items. People are defined as poor if they fall below the income level required to buy this basket. Such an approach has a long historical pedigree in the UK, with the pioneering studies of Rowntree (1901) based on this method. Most recently, the Family Budget Unit has published budget standards for families with children (Parker, 1998) and pensioners (Parker, 2000 and 2002). The poverty measures derived through these methods are also primarily headcount ratios. Though transparent and explicitly related to need, deciding on the contents of the basket of goods involves thousands of individual decisions by social scientists.

#### **Deprivation indices: inability to afford particular necessities**

This approach identifies people as in poverty if they lack a critical number of socially perceived necessities (usually two or three), which have been identified through large-scale surveys of the public. Examples of items that a majority of the population consider to be necessities include a damp-free home, a warm waterproof coat and two meals a day (see Gordon et al. (2000)). This approach combines a concern with relative poverty and a focus on need, and captures the longer-term circumstances of families rather than just their current income status. But there are also serious problems with this approach. It is a much less transparent method of gauging poverty than many of its alternatives; the process of determining what is a necessity and the approach’s reliance on people reporting that they lack certain things because they cannot afford them introduce a strong degree of subjectivity into the results.

#### *The headcount ratios in Opportunity for All*

In this Commentary, we provide evidence on two separate sets of indicators from the *Opportunity for All* publication (Box 2.2 has more detail about the indicators). The measures we use fall into two categories. First, there is a set of relative measures. These judge whether a pensioner is poor by how his or her income compares with society’s as a whole. When incomes amongst the population change, so too can the poverty line. The second set of measures contains more ‘absolute’ measures. These judge if a pensioner is poor according to a fixed income benchmark, which does not change over time in real

terms. In this case, the fixed income benchmark monitored is defined against the median income across the population in 1996–97, uprated each year in line with inflation.<sup>6</sup>

In the analysis that follows, we focus slightly more on the relative measures of poverty as a judge of government performance to date. Though the government has not been explicit about whether its aim is to reduce relative or absolute pensioner poverty, it has been very clear in setting out a short-term child poverty target that is relative. There seems no obvious reason why the same principle should not be followed for pensioners. Government emphasis on concepts such as social exclusion also tends to weigh in this direction (see Brewer, Clark and Goodman (2002) for a fuller discussion of these points).

But, as we shall see when we set out the trends in Chapter 4, there are some problems with interpreting the short-term changes in relative poverty amongst pensioners. For this reason, we also look at changes in absolute poverty and present evidence on the movements in the pensioner income distribution that underpin these trends.

We also briefly consider some measures of the ‘poverty gap’. This measures the depth of poverty by calculating the average (or sometimes the aggregate) distance from the poverty line of everyone below the line. Evidence on the persistence of poverty – derived using longitudinal data-sets that track the same people over time – is not provided here but can be found in *Opportunity for All* (Department for Work and Pensions, 2002a) and the HBAI publication (Department for Work and Pensions, 2003).

**Box 2.2. The government’s current approach: *Opportunity for All***

Although no explicit targets have been set for reducing pensioner poverty, each year the government sets out a number of ‘indicators of progress’ which it uses to monitor poverty and social exclusion amongst pensioners. These are published in its annual audit of poverty, *Opportunity for All*, which sets out three indicators of low income amongst pensioners in Great Britain – namely:

- **Relative low income:** The proportion of pensioners with household income below 50, 60 or 70 per cent of the national median income. Measured on both a before-housing-costs (BHC) and an after-housing-costs (AHC) basis.
- **Absolute low income:** The proportion of pensioners with household income below 50, 60 or 70 per cent of the national median income in 1996–97 held constant in real terms. Measured on both BHC and AHC bases.
- **Persistent low income:** The proportion of pensioners living with persistent low household incomes, defined as having incomes below 60 or 70 per cent of national median income for three of the last four years. Measured on BHC basis only.

As well as the low-income indicators for pensioners, *Opportunity for All* also sets out indicators relating to health, independent living, housing and fear of crime amongst current pensioners, and indicators relating to contributions to non-state pensions amongst the working-age population.

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<sup>6</sup> We do not consider the third strand of the *Opportunity for All* low-income indicators – the proportion of pensioners on persistent low incomes. These relative measures are derived from longitudinal data sources and cannot be calculated using the Family Resources Survey data on which this Commentary is based.

## 2.2 Using income to measure pensioners' living standards

Before describing the trends in pensioner poverty in Britain in recent years, we discuss briefly the measures of pensioner living standards that underpin all the results that follow.

The analysis in this Commentary is based on two measures of living standards constructed in the government's official low-income statistics, Households Below Average Income. These are calculated using information collected from the annual Family Resources Survey (FRS), a representative survey of around 45,000 people in 25,000 households in Great Britain.<sup>7</sup>

Both HBAI income measures capture weekly household income, including benefits and net of direct taxes. One measure captures income before housing costs are deducted (BHC) and the other is a measure after housing costs have been deducted (AHC). Both income measures have been adjusted ('equivalised') to take account of differences in need due to family size and structure, and in general they are expressed as the equivalent income of a couple with no dependent children, in 2001–02 prices. Appendix A describes a number of important features of the measures, which should be borne in mind when interpreting the results that follow.

In the next chapter, we consider the degree of government redistribution towards pensioners over the first five years of the Labour government, and how this could potentially have affected pensioner incomes. Subsequent chapters then go on to consider the actual changes in pensioner poverty and incomes that have taken place.

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<sup>7</sup> The results we present for years prior to 1994–95 are derived from the Family Expenditure Survey (FES), a sample of 7,000–8,000 households.

### 3. Government policy towards pensioners

Two broad groups of families have benefited most from tax and benefit reforms since Labour's coming to power in 1997: pensioners and families with children (see Brewer, Clark and Wakefield (2002)). The overall 1997–2004 policy package directly affecting incomes and designed to assist these two groups amounts to £19.5 billion per year (about 2 per cent of GDP).<sup>8</sup> Of this, £7.3 billion has been directed at pensioner families. In this chapter, we discuss the major reforms that have directly affected the incomes of pensioner households and assess the extent of the government's generosity towards them by putting the pension reforms in the context of the overall reform package.

As we will show in this chapter, the reforms aimed at pensioners have been designed to improve the living standards of the poorest the most. This has been achieved by very significant increases in means-tested benefits. Support for the poorest pensioners has been accompanied by smaller real increases in non-means-tested benefits (the basic state pension and introduction of winter fuel payments) and supplemented by the introduction of new in-kind support (TV licence subsidies). At the same time, the government has also introduced policies that have sought to benefit taxpaying pensioners, or at least to minimise the cost of some tax increases for the pensioner population.

Our analysis focuses entirely on policies that affect incomes; therefore it excludes reforms to expenditure taxes (VAT and duties). A more complete analysis, which goes beyond the scope of this Commentary, would include the effect of these on pensioner purchasing power. Various other tax measures – for example, company taxation – are also excluded from the analysis since we cannot directly assign them to individual households.<sup>9</sup> Since April 1999, the Labour government has also substantially increased spending on areas such as education and healthcare, and any improvements in the quality of public services as a result of these would have a positive effect on people's well-being. From the point of view of the pensioner population especially, healthcare-related expenditures could prove an important determinant of the level of welfare.

However, this document focuses on the effect of government policies on the incomes of pensioners and on changes in pensioner poverty. Since the poverty measures we consider (set out in Chapter 2) also do not pick up improvements in pensioners' living standards from the above reforms, the subset of reforms we analyse here (listed in Table 3.1) seems to be the right one for comparison.

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<sup>8</sup> Not including reforms that have affected all households – for example, changes in income taxation. Source: HM Treasury, *Financial Statement and Budget Report*, various years; values presented in 2003–04 prices, uprated by the GDP deflator.

<sup>9</sup> For example, if we were to allocate the cost of measures that cannot be directly allocated to households in such a way that it would have an equal proportionate effect on all households, it would imply a cost of about 1.7 per cent of disposable income. See Bond and Wakefield (2003).

**Table 3.1. The cost of the overall ‘pensioner package’**

Policy	Effective from:	Annual total cost	Reflected in 2001–02 data?
Winter fuel payments	November 1997, later increased	£440m	Yes
Above-indexation increases in personal income tax age-related allowances	April 1999	£110m	Yes
Introduction of MIG (first increase in rates) + uprating with earnings in April 2000	April 1999, April 2000	£460m	Yes
TV licence subsidy	October 2000	£380m	Yes
Increase in pensioner capital limits	April 2001	£150m	Yes
‘Pensioner package’ (increases in MIG and basic state pension)	April 2001	£2,580m	Yes
Increase in basic state pension	April 2002	£175m	No
Above-indexation increases in personal income tax age-related allowances	April 2003, April 2004	£175m	No
Pension credit	October 2003	£2,000m	No
State pension increase of 2.5% (0.8% real increase)	April 2003	£170m <sup>a</sup>	No
Earnings uprating of pension credit guarantee and personal income tax age-related allowances in 2004	April 2004	£690m <sup>a,b</sup>	No
<b>Total</b>		<b>£7,330m</b>	<b>£4,120m</b>

<sup>a</sup> Estimates using the IFS tax and benefit model.

<sup>b</sup> Assumes 2.4 per cent real earnings growth in 2003–04.

*Source:* HM Treasury, *Financial Statement and Budget Report*, various years; values presented in 2003–04 prices, uprated by the GDP deflator.

### 3.1 The 1997–2001 reforms that changed pensioner incomes

The main measures benefiting pensioners during the first five years of the Labour government came relatively late. The first set of major reforms affecting pensioners’ incomes directly were introduced in the 1999 Budget. The government rebranded income support premiums as the minimum income guarantee (MIG) and increased the rates of support for the poorest group of pensioners in line with earlier announcements. It also committed to increasing the MIG with earnings in April 2000. Also in the 1999 Budget, the government increased pensioners’ income tax personal allowances and



limited the effect of the abolition of the married couple's allowance by keeping it (at the 1997 level) for all those aged over 64 at the time.<sup>10</sup>

The second stage of increases in pensioner means-tested support was announced in the November 1999 Pre-Budget Report and confirmed in April 2000. The three stages of above-indexation increases in the MIG, between 1999 and 2001, meant that a single pensioner aged 65–74 in April 2001 received £92.15 per week, almost £18.20 more than had means-tested support only been indexed for inflation. A pensioner couple on the MIG gained almost £26.00 per week.

Since April 2001, the government has also increased the pensioner capital limits that apply to means-tested support, with the intention to 'reward pensioners who have managed to save something for their retirement' (*Financial Statement and Budget Report, 2000*). Savings over the level of the capital limits reduce benefit entitlement (by £1 per week for every £250 of savings) and thus, by raising the thresholds, the government reduced the 'savings penalty'.

On top of the increases to means-tested support, and in line with the aim of 'ensuring continuing security for pensioners who are above benefit levels' (*Financial Statement and Budget Report, 2000*), in April 2001 the government increased the basic state pension to £72.50 per week, a real increase of over £3. Although this increase would have almost no real effect on pensioners claiming the MIG (because every extra £1 of income from state or private pension reduces MIG eligibility by £1), it could have had a positive effect on the poorest pensioners by reaching those who, although eligible, did not claim means-tested support.

Pensioners also benefited as a result of the introduction of winter fuel payments in 1997. Winter fuel payments were initially set at £20 per year (£50 for income support claimants) but were increased, first to £100 in 1999 and then to £200 in Winter 2000.<sup>11</sup> Since October 2000, those aged 75 or over can also receive a TV licence subsidy worth about £2 per week.

Table 3.2 demonstrates the extent of the increases in means-tested and non-means-tested support after 1997. We present the maximum levels of support for those pensioners who claim means-tested support (MIG) and for those who do not claim. Both groups are eligible to receive winter fuel payments. The table presents the rates operational in 2001 for pensioners under 75 and the real growth in benefits in the periods before and after 1997, since the introduction of income support in 1988. (In April 2001, incomes of

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<sup>10</sup> This means that new cohorts of pensioners will no longer be able to take advantage of the married couple's allowance (MCA) and that, with time, this form of assistance will cease. The cost to the government of maintaining the MCA for pensioners will therefore most likely decrease each year. It will depend on how many people in couples who were over 64 in April 1999 continue to take advantage of the MCA. For this reason, this cost is not included in Table 3.1.

<sup>11</sup> Since 1999, the value of winter fuel payments has been the same regardless of whether people claim means-tested support or not. The value of winter fuel payments is the same for single pensioners and for couples.

pensioners aged 75 and over were £2 per week higher as a result of the TV licence subsidy.<sup>12)</sup>

Compared with the changes in pensioner support that took place between 1988 and 1997, the increases since Labour came to power have clearly been very high. Single pensioners below the age of 75 who claim means-tested support have seen their incomes rise by almost 30 per cent between 1997 and 2001, while couples received 25.8 per cent more (in real terms) in 2001 than in 1997. Percentage gains among those aged 75 or over who receive means-tested support have been very similar.

**Table 3.2. Maximum benefit awards for pensioners**

	April 2001	Real increase, 1988–92	Real increase, 1992–97	Real increase, 1997– 2001	Real increase, 2001– 04 <sup>a</sup>
<i>Pensioners claiming means-tested benefits:</i>					
Single pensioner under 75	£96.00	0.4%	2.6%	29.8%	6.7%
Pensioner couple under 75	£144.40	1.5%	2.5%	25.8%	8.3%
<i>Pensioners not claiming means-tested benefits:</i>					
Single pensioner under 75	£76.30	0.3%	2.4%	10.4%	2.9%
Pensioner couple under 75	£119.70	0.3%	2.2%	8.3%	3.0%

<sup>a</sup> The means-tested benefits figures correspond to the ‘pension credit guarantee’, i.e. a pensioner with no private income. Assumes real earnings growth of 2 per cent for increases in the pension credit in 2004.

*Notes:* Real increases in means-tested benefits calculated using the ROSSI index. Real increases in the basic state pension calculated using the RPI. The level of benefits for pensioners aged 75 or over is £2 per week higher because of the TV licence subsidy. Rates of growth for them have been very similar to those among the younger groups of pensioners. Those in households with more than one pensioner family unit will gain less since winter fuel payment entitlement is assessed at the household level.

*Source:* Based on Kaplan and Leicester (2002).

Pensioners who are not eligible for or who do not claim the MIG benefited from reforms to the system of non-means-tested benefits. Among these, younger pensioner couples gained 8.3 per cent and single pensioners gained 10.4 per cent. While younger pensioners have seen their incomes rise due to levelling-up of MIG rates for pensioners of all age groups, those aged 75 or over gained additional support in the form of the TV licence subsidy.

### 3.2 The effect of the 1997–2001 reforms on pensioner incomes

The 2001–02 HBAI figures released on 13 March 2003 by the Department for Work and Pensions should reflect the changes in pensioner incomes resulting from the reforms described above. We could expect that such a generous package would have a significant effect on the absolute level of pensioner incomes. As we will see in Chapter 4, its impact

<sup>12</sup> Since TV licences are paid for the household overall, the subsidies apply to households. Therefore a one-person pensioner household (where the pensioner is 75 or over) will gain as much in cash terms as a household that includes a pensioner aged 75 or over and that is made up of more people.

on the relative position of pensioners in the overall income distribution and on relative poverty will depend not just on these income changes, but also on how they compare with those experienced throughout the population.

In this section, we present micro-simulation results using the IFS tax and benefit model to show the effect of government tax and benefit measures on pensioners' disposable incomes.<sup>13</sup> The model allows us to single out the effect of policy reforms between 1997 and 2001, abstracting from all other changes that have influenced the income distribution (such as changes in people's gross incomes and demographics) over this period. Our estimates tell us how much better off people would be today relative to a world in which the government had introduced no reforms directly affecting the level of taxes and benefits in this period, and uprated them only to reflect changes in prices.<sup>14</sup> Our estimates give the impact of policy reforms under the assumption of perfect take-up of benefits.

#### *The effect of reforms on living standards and incomes*

Our simulation results show that as a result of the 1997–2001 reform package, a single pensioner would have gained, on average, £14.40 per week (or 9.0 per cent), while pensioner couples would have seen their weekly incomes rise by an average of £15.30 (5.0 per cent), assuming full take-up. Figure 3.1 presents the effects of changes to the tax and benefit system between 1997 and 2001 on pensioner households' incomes according to their position in the overall income distribution. The graph shows the average percentage changes in disposable income under the assumption of perfect take-up of benefits, and reflects the progressiveness of the pensioner reform package. We can see that pensioners in all income deciles have gained from the reforms on average, but that the poorest pensioners have gained proportionally most (16.1 per cent).<sup>15</sup>

The estimated gains in cash terms have been substantial across the whole income distribution, although we must note that, especially at the lower end of the income distribution, they are likely to overstate the actual changes in incomes experienced, because of non-take-up of benefits. Our simulation suggests that the entitlement of the poorest pensioners (those in the bottom income decile) has risen by £17.30 per week, and pensioners in the top income group saw their entitlement rise by £13.10.

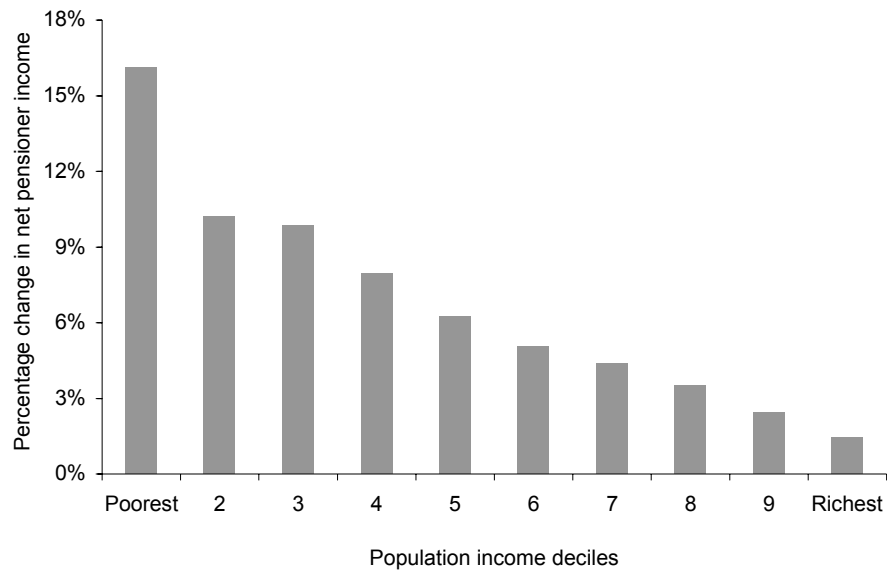
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<sup>13</sup> The definition of income considered here is slightly different from the HBAI definition. Incomes are measured before housing costs and only council tax payments are deducted. The incomes are calculated from TAXBEN, the IFS tax and benefit model, based on the 2001–02 Family Resources Survey.

<sup>14</sup> To do this, we simulate incomes using the most recent 2001–02 FRS data-set, on which we then 'impose' a chosen tax and benefit system. In the exercise, we compare simulated incomes under the actual 2001–02 tax and benefit system and under a counterfactual system representing an indexed April 1997 system. Such an exercise singles out the effect of changes in the level of direct taxes and benefits on net incomes in the 2001–02 population.

<sup>15</sup> There are several reasons why these gains are lower than the maximum gains presented in Table 3.2. First of all, according to our model, only about 70 per cent of pensioner benefit units in the bottom income decile are eligible to receive the MIG. The others either have income high enough to make them ineligible for the MIG or have eligibility restricted as a result of capital limits. Secondly, the capital restrictions mean that not all families would gain by the maximum amount. Finally, a third of those who were eligible for the MIG under the 2001–02 system would receive no MIG under the 1997–98 system. The newly entitled pensioner households, because of higher incomes and lower absolute gains, found their incomes rising by 18 per cent on average, while those entitled to the MIG under both systems gained over 23 per cent on average.

**Figure 3.1. Distributional effect of the 1997–2001 tax and benefit reforms on pensioner households**



*Notes:* Income deciles are derived by dividing all families (not only pensioners) into 10 equally sized groups according to AHC income adjusted for family size using the McClements equivalence scale. Decile 1 contains the poorest tenth of the population, decile 2 the second poorest and so on, up to the top decile (decile 10), which contains the richest tenth. Pensioner households are defined as households that contain at least one person of pension age.

*Source:* IFS tax and benefit model, TAXBEN, based on 2001–02 Family Resources Survey.

It is interesting that the absolute gains from the reform package are so high at the top of the income distribution. Since the most commonly used poverty line – 60 per cent of median AHC income – lies in the lower half of the third income decile, it is clear that a large proportion of the reform package has been directed at pensioners who are not poor according to the most often-used criterion.

Increases in incomes of pensioners at the top of the income distribution have been mainly due to a more generous treatment of pensioner incomes for tax purposes and to changes in non-means-tested benefits (basic state pension, winter fuel payments and the TV licence subsidy). The choice of the latter instruments may have been dictated by the fact that take-up of means-tested benefits among pensioners is low (see Chapter 6), and therefore it may be that the only way to increase the incomes of the poorest pensioners is through more universal support, leading to increases in incomes across the whole pensioner population.

### **3.3 The effect of the 1997–2001 reforms on pensioner poverty**

It is natural to expect that such big simulated increases in the level of incomes among pensioner households would be reflected in poverty reduction among this group of the population. Before we move on to the next chapter and its discussion of actual changes

in poverty, we must note that there are several factors that would limit the extent of this reduction.

First, there is non-take-up of benefits, which is especially important for the poorest pensioners. If benefits are not taken up, then increases in their entitlements, no matter how large, will not be reflected in the data. Secondly, changes in the value of the median income and, related to these, changes in the relative poverty line could limit the reduction of pensioner poverty. Median income will grow as a result of changes in the level of earnings and other sources of gross income between 1996–97 and 2001–02, as well as as a result of changes in the tax and benefit system that affect the value of net incomes in the lower half of the income distribution.

On top of this, we must note that a significant proportion of the cost of the 1997–2001 reform package benefited households that were not in poverty at any time over the period. We estimate that only about 35 per cent of the package that affected pensioner households was directed at those who were in poverty in 1996–97.

As we will see in the next chapter, the reforms described above have had a significant effect in reducing absolute poverty among pensioners. However, the changes in relative poverty that occurred over Labour's first five years have been fairly small on most measures, despite the large potential increases in pensioner incomes we have presented above.

## 4. Pensioner poverty under the Labour government

With the policies implemented between April 1997 and April 2001 in mind, we now turn to what has actually happened to relative pensioner poverty in Great Britain over this period. To do this, we use the relative low-income indicators from official government statistics we described in Chapter 2. In the next chapter, we set the changes in historical context.

As we have seen, the government has raised benefits substantially for the poorest pensioners, and government statements have increasingly emphasised tackling pensioner poverty as a primary goal. The last chapter showed that, all else being equal, government policies towards pensioners should have increased the living standards of the poorest, and this should have contributed to a reduction in poverty rates amongst pensioners.

### 4.1 Changes in relative pensioner poverty, 1996–97 to 2001–02

Despite the significant degree of redistribution towards the poorest pensioners, the changes in relative poverty that have taken place have in fact been fairly modest. Table 4.1 sets out the changes in the proportion of pensioners in relative poverty over the first five years of the Labour government. It shows that there has been little change in most measures, though the proportion with incomes less than 60 per cent median AHC income – the most frequently highlighted of the *Opportunity for All* indicators – has fallen, from 27 per cent of all pensioners (or about 2.7 million pensioners) in 1996–97, to around 22 per cent in 2001–02 (about 2.2 million pensioners). This means that there are about 400,000<sup>16</sup> fewer pensioners in poverty on this measure and represents a drop of almost one-fifth. It is interesting to note that this fall has occurred entirely since 1999–2000, coinciding with the first of the large increases in means-tested benefits for pensioners.

Looking at the other AHC poverty measures, there have been much smaller drops in pensioner poverty, also occurring since 1999–2000 (though the apparent fall on the 50 per cent median measure is not significantly different from zero).

The picture for changes in poverty using the BHC income measures is less clear. Though none of the changes in the BHC measures of relative poverty between 1996–97 and 2001–02 shown in Table 4.1 is big enough to be statistically significant, pensioner poverty appears to have risen over the first two years of the last parliament on these measures, and then dropped slightly over the following three – leaving poverty levels slightly higher on the 50 and 60 per cent of median BHC measures and slightly lower on the 70 per cent of median BHC measure than before the Labour government came to power.

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<sup>16</sup> These numbers do not sum due to rounding.

**Table 4.1. Relative pensioner poverty: percentage of pensioners with incomes below various fractions of contemporary median income**

	<i>AHC income</i>		
	50% median	60% median	70% median
1996–97	12	27	39
1997–98	12	27	38
1998–99	12	27	38
1999–2000	12	25	37
2000–01	11	24	36
2001–02	11	22	36
<i>Change</i>			
Since 1996–97	(–1)	–4	–3
<i>of which:</i>			
1996–97 to 1998–99	(0)	(0)	(–1)
1998–99 to 2001–02	–1	–4	(–2)
	<i>BHC income</i>		
	50% median	60% median	70% median
1996–97	10	21	35
1997–98	11	22	35
1998–99	12	23	36
1999–2000	11	22	35
2000–01	11	21	34
2001–02	11	22	34
<i>Change</i>			
Since 1996–97	(1)	(1)	(–1)
<i>of which:</i>			
1996–97 to 1998–99	1	(2)	(1)
1998–99 to 2001–02	(–1)	(–1)	–3

*Notes:* Reported changes may not equal the differences between the corresponding percentages due to rounding. Changes in parentheses are not significantly different from zero at the 5 per cent level.

*Source:* Authors' calculations based on Family Resources Survey.

## 4.2 Why didn't relative pensioner poverty fall further?

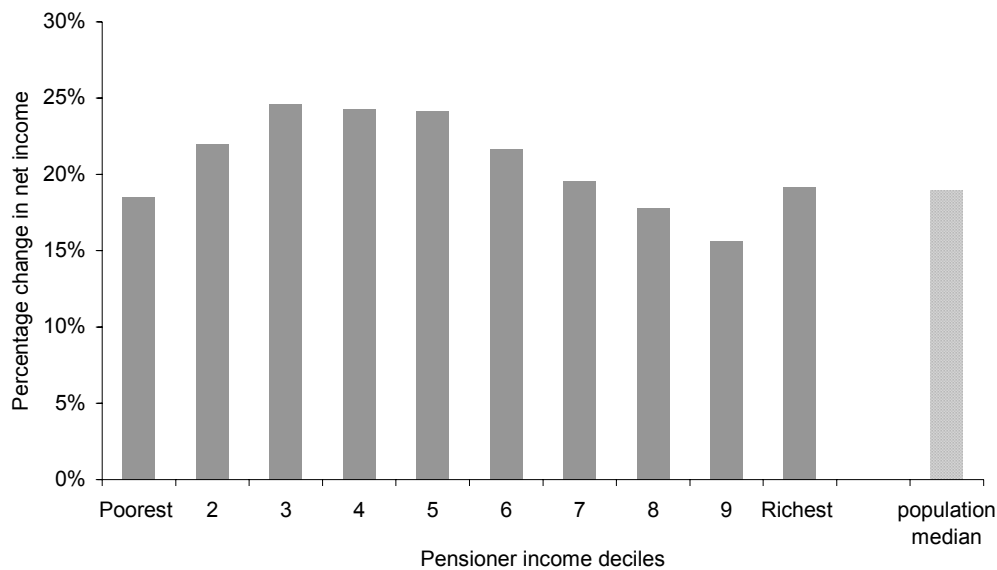
One obvious question to ask is why relative poverty did not fall further over this time, given the large amount of redistribution to the poorest pensioners we outlined in Chapter 3. The main reason is that the relative measures of pensioner poverty we consider here depend not just upon changes in pensioner incomes themselves, but also upon how pensioner incomes have moved relative to the median income in the population as a whole. Whilst the poorest pensioners have seen substantial income gains, these have been sufficient simply to maintain their incomes roughly in line with, or at just a bit more than, the population median income as it has grown. This section examines this further.

*Changes in the pensioner income distribution, 1996–97 to 2001–02*

Pensioner incomes rose considerably over the first five years of the Labour government. Figure 4.1 shows the actual income growth between 1996–97 and 2001–02 at different points in the pensioner income distribution. It shows that the income of the bottom tenth of pensioners – corresponding to around the poorest 1 million pensioners – was around 19 per cent higher in real terms in 2001–02 than the income of the poorest tenth in 1996–97. Income growth was highest amongst the middle third of pensioners – with real growth of almost 25 per cent (in the 3rd, 4th and 5th decile groups) – and slightly lower again at the top end of the distribution. The graph also shows that the median income growth across the whole population (including non-pensioners) was at a similar level to the changes in pensioner incomes, although income growth in half of the pensioner income groups shown here (deciles 2 to 6) was somewhat higher than growth in the population median income.

The growth in median AHC income of roughly 19 per cent in real terms over the five years has meant that the relative poverty lines pegged to the AHC median have risen by the same percentage. For example, 60 per cent of median AHC income has risen from £138 per week in 1996–97 to £165 per week in 2001–02.<sup>17</sup>

**Figure 4.1. Real income growth across the pensioner income distribution (AHC), 1996–97 to 2001–02**



*Notes:* Income deciles are derived by dividing all pensioners into 10 equally sized groups according to AHC income adjusted for family size using the McClements equivalence scale. Decile 1 contains the poorest tenth of all pensioners, decile 2 the second poorest and so on, up to the top decile (decile 10), which contains the richest tenth. The graph shows the real increase in the median income of each decile group, i.e. the change in the 5th, 15th, 25th, etc. percentile points.

*Source:* Family Resources Survey, 1996–97 and 2001–02.

<sup>17</sup> As in previous chapters, these income amounts are expressed in terms of the equivalent income for a couple with no dependent children, in 2001–02 prices. For a single pensioner with no children, these lines represent cash incomes of £76 and £91 respectively.

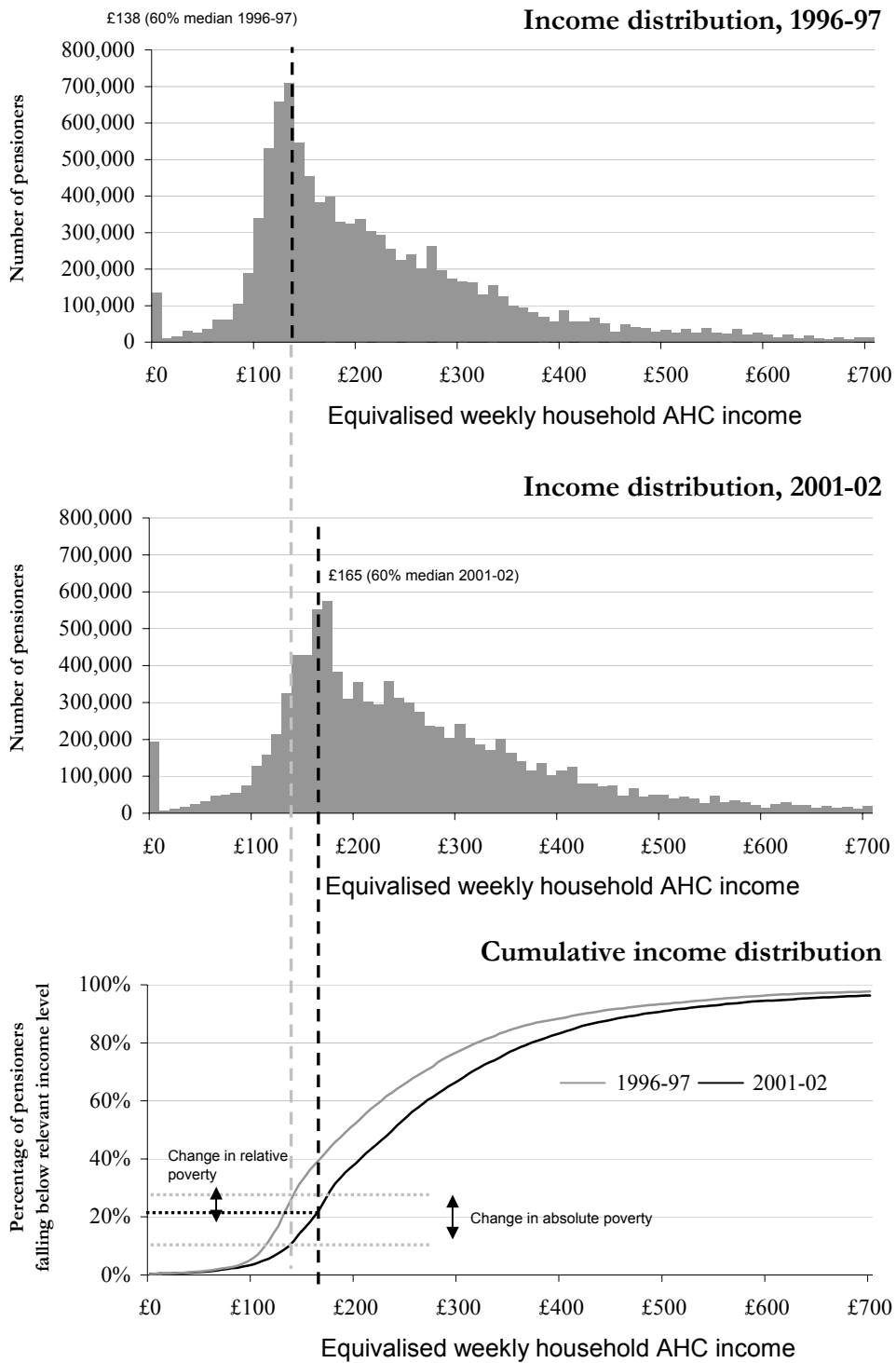


We can illustrate the impact of this moving poverty line on the number of pensioners in relative poverty graphically. Figure 4.2 shows the distribution of pensioners' AHC incomes in 1996–97 (top panel) and in 2001–02 (middle panel). These panels show the number of households falling into £10 income bands in each of these years. Looking at the pensioner income distribution in 1996–97, the first point to note is that there was a large cluster of pensioners in the £120–£150 income range, with a peak (at the mode of the income distribution) of roughly 700,000 pensioners with incomes between £130 and £140 per week. These are pensioners living largely on state benefits, with just a small amount of additional private income (if any). The second point to notice is that the 60 per cent median poverty line in 1996–97, at £138 per week, was situated in the very densest part of the 1996–97 pensioner income distribution. This means that with pensioner incomes unchanged, any move in the line could potentially result in a large change in the number of pensioners in poverty. For example, if the 60 per cent median mark had been just £1 higher in 1996–97 (at £139 per week), roughly 100,000 extra pensioners would have fallen below this line.

The middle panel of Figure 4.2 shows the distribution of pensioner incomes in 2001–02. The general rightward shift in the distribution of income between 1996–97 and 2001–02 illustrates the substantial increase in living standards amongst the pensioner population over this time, with the mode of the distribution now at £170 to £180 per week. The position of the 1996–97 poverty line shows that a much smaller tail of the distribution were now on incomes below this line compared with five years previously, illustrating that there has been a large drop in absolute poverty (discussed further below). But because of median income growth over the five years, the new 60 per cent of median poverty line (at £165 per week) still cuts the main cluster of relatively low-income pensioners down the middle.

The bottom panel of Figure 4.2 illustrates more directly the changes in pensioner poverty resulting from these shifts in the pensioner income distribution and the changing poverty line. The curves in this panel show the percentage of pensioners falling below different income levels in 1996–97 and in 2001–02. The rightward shift of the curves between these two years illustrates the increase in pensioner living standards over the period. As can be seen from this graph, approximately 27 per cent of pensioners in 1996–97 had incomes below 60 per cent of the contemporary median. The percentage of pensioners with incomes below this same threshold in 2001–02 was much lower, at 11 per cent (again illustrating the large drop in absolute poverty we discuss below). But the increase in the poverty line over the same period meant that the overall drop in relative poverty was much smaller than this: in 2001–02, 22 per cent of pensioners remained on incomes below the new, higher 60 per cent median poverty threshold, a drop of 400,000 pensioners compared with five years earlier.

**Figure 4.2. Pensioner income distributions (AHC), 1996–97 and 2001–02**



*Note:* The distributions are truncated at incomes above £700 and below £0 per week.

*Source:* Authors' calculations based on Family Resources Survey, 1996–97 and 2001–02.

### 4.3 Changes in absolute pensioner poverty, 1996–97 to 2001–02

Pensioner poverty measured in absolute terms fell sharply over the first five years of the Labour government, reflecting the substantial rise in the incomes of the poorest pensioners over this period.

Using the income benchmark followed in the *Opportunity for All* indicators, the proportions of pensioners whose incomes fell below various fractions of the 1996–97 median income all showed large and statistically significant declines. For example, the proportion of pensioners below 60 per cent of the 1996–97 AHC median fell from 27 per cent in 1996–97 to just 11 per cent in 2001–02. This represents a drop of 1.6 million pensioners and means that poverty on this measure fell by as much as 60 per cent over the five years. The proportions below other fractions of AHC median income and the BHC income measures also showed substantial drops (see Table 4.2).

**Table 4.2. Absolute pensioner poverty: percentage of pensioners with incomes below various fractions of 1996–97 median income**

	<i>AHC income</i>		
	50% median	60% median	70% median
1996–97	12	27	39
1997–98	11	26	37
1998–99	10	24	35
1999–2000	8	19	31
2000–01	6	15	27
2001–02	6	11	21
<i>Change</i>			
Since 1996–97	–6	–16	–18
<i>of which:</i>			
1996–97 to 1998–99	–1	–3	–3
1998–99 to 2001–02	–5	–12	–14
	<i>BHC income</i>		
	50% median	60% median	70% median
1996–97	10	21	35
1997–98	11	21	34
1998–99	10	20	33
1999–2000	9	18	29
2000–01	7	15	26
2001–02	6	14	23
<i>Change</i>			
Since 1996–97	–4	–8	–12
<i>of which:</i>			
1996–97 to 1998–99	(0)	(–1)	–2
1998–99 to 2001–02	–4	–7	–10

*Notes:* Reported changes may not equal the differences between the corresponding percentages due to rounding. Changes in parentheses are not significantly different from zero at the 5 per cent level.

*Source:* Authors' calculations based on Family Resources Survey.

Since the only difference between the relative and absolute poverty measures we consider is the position of the poverty line, the difference between the changes in relative and absolute poverty we have shown gives us the exact effect of the moving poverty line on the numbers in relative poverty. Had the poverty line remain fixed at 1996–97 levels, the number of pensioners below 60 per cent of median AHC income would have fallen by 1.6 million. But the rising relative poverty line has put as many as three-quarters of these pensioners back into relative poverty, with the resulting fall in the number of pensioners in relative poverty on this measure being just 400,000 (from 27 per cent to 22 per cent).

This chapter has shown how sensitive the number of pensioners in relative poverty has been to increases in the poverty line. It has also shown that despite large increases in benefits to pensioners, their incomes have only just managed to keep in line with, or move slightly ahead of, the median income enjoyed by the population as a whole, resulting in little change in relative poverty on most measures. But, as we argue in the next chapter, when we set these changes in the context of a longer period of time, the fact that pensioner incomes have kept in line with non-pensioner incomes during this period of rapid median income growth has been unusual, and pensioner incomes relative to non-pensioner incomes are higher than they have been at any time over the last 40 years.

## **5. The changes in context: pensioner incomes and poverty over 40 years**

This chapter sets the changes in pensioner poverty we saw in the last chapter in historical context and compares poverty rates amongst pensioners with those of other groups in the population. We argue that in the context of the last 40 years, and compared with the changes in poverty seen amongst non-pensioners, these trends are more remarkable than they appear at first glance.

First, we show that at similar times of rapid median income growth in the recent past, pensioner incomes have tended to fall considerably further behind those of non-pensioners, only to catch up again during periods of slower economic growth. But since 1996–97, pensioner incomes have kept up with non-pensioner incomes, even at the lower end of the income scale. As a result of these changes, the median pensioner income is now a higher proportion of the median non-pensioner income than it has been at any time over the last 40 years (on an AHC measure of income). In contrast to the pattern over much of the 1970s and 1980s, pensioner income inequality remains lower than income inequality amongst non-pensioners.

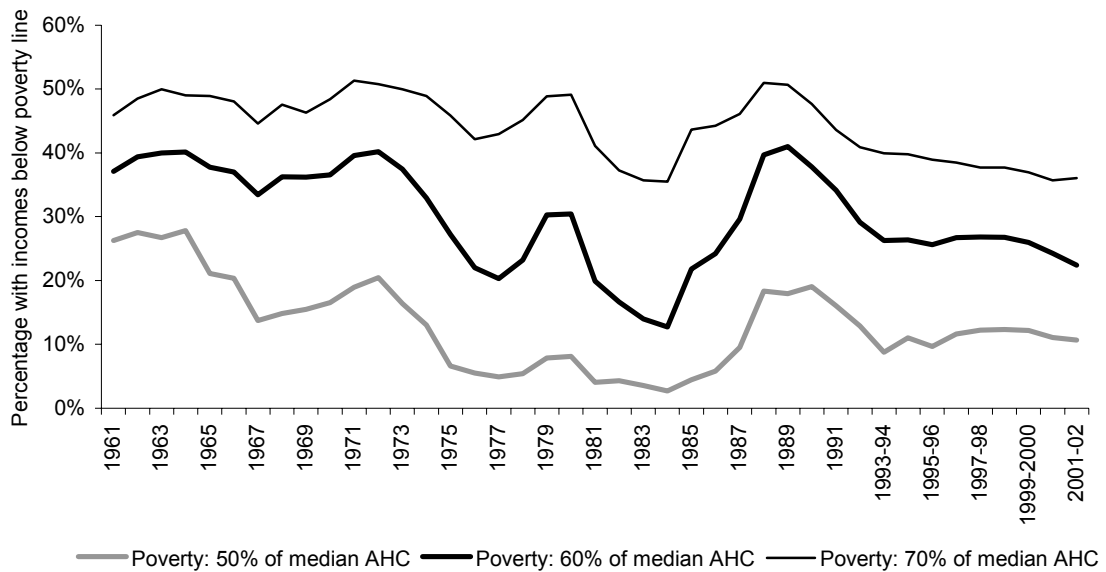
The rate of poverty amongst pensioners is now roughly the same as that amongst most non-pensioner groups. Whilst this has been the case for pensioner couples for several years, both the drop in poverty amongst single pensioners and the convergence in poverty rates between single pensioners and other demographic groups are notable. Indeed, relative poverty amongst single pensioners has fallen considerably faster than child poverty.

### **5.1 Changes in relative poverty amongst pensioners, 1961 to 2001–02**

We start by considering how the pattern of rather small changes in relative poverty amongst pensioners over the last five years compares with changes over recent decades. Figures 5.1 and 5.2 show how relative pensioner poverty has changed in Britain over the last 40 years. The most striking thing about these graphs is the very strong pro-cyclical pattern in pensioner poverty. During periods of strong economic performance, pensioner poverty has tended to rise very sharply, and it has then fallen sharply again during periods of recession. Over the second half of the 1980s, for example, relative pensioner poverty – measured by the proportion of pensioners on incomes below 60 per cent median AHC income – more than tripled, from around 13 per cent in 1984 to about 41 per cent in 1989. The rate then fell back sharply again over the early 1990s to about 26 per cent in 1993–94.

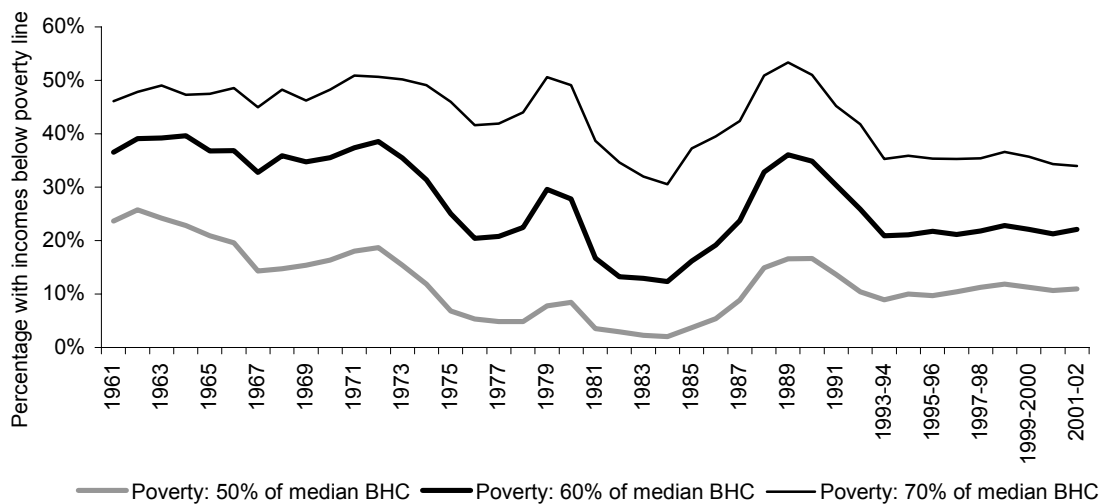
But the last five years represent a strong break from this pattern. We have not seen the big cyclical rise in pensioner poverty we might have expected during this period of strong economic performance. Instead, we have seen a roughly constant or slightly falling rate of pensioner poverty since the early to mid-1990s on all of these poverty measures. In the context of change over recent decades, the fact that pensioner poverty has ‘stood still’ over the last five years is noteworthy.

**Figure 5.1. Relative pensioner poverty: percentage of pensioners with incomes below various fractions of median AHC income**



Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

**Figure 5.2. Relative pensioner poverty: percentage of pensioners with incomes below various fractions of median BHC income**



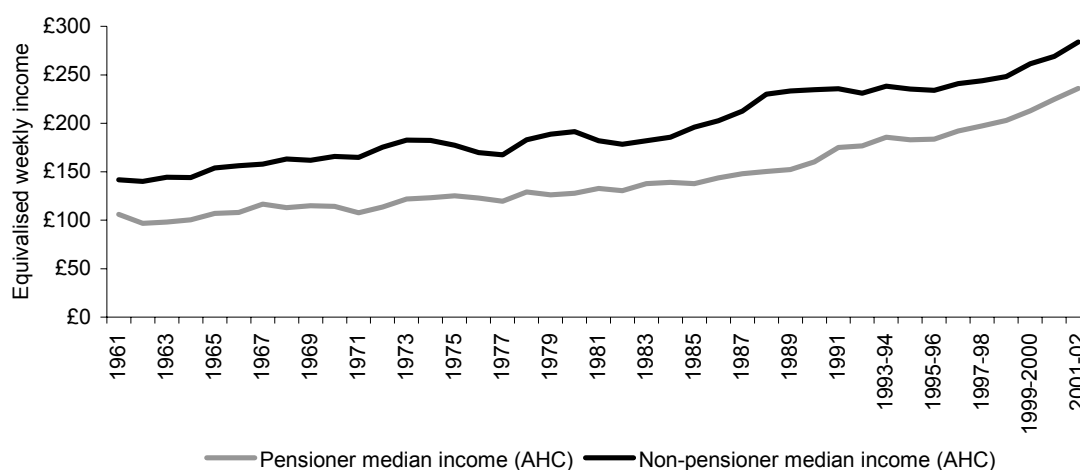
Source: Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

Two factors explain the very distinctive pattern of changes in relative poverty we have often seen across the cycle. First, as we have seen (Figure 4.2 illustrated this for the pensioner income distribution in recent years), there are a large number of pensioners, mostly dependent on benefits, grouped very close to the range of poverty lines we

consider here. This means that even small changes in the poverty line due to changes in the median income have often translated into big changes in the poverty rate.

Secondly, pensioner incomes – largely derived from state benefits, private pensions and other investments – do not typically move up and down automatically in line with the economic cycle in the same way as typical income sources of working-age families, such as earnings and self-employment income. This can be seen from Figure 5.3, which shows the median AHC income for pensioners and non-pensioners since 1961. It shows that pensioner incomes are, on average, lower than non-pensioner incomes. But it also shows that pensioner incomes have tended to show less fluctuation across the economic cycle than non-pensioner incomes do. It is interesting that the rate of median income growth amongst pensioners has been slightly faster than that for non-pensioners since the mid-1990s.

**Figure 5.3. Median incomes (AHC) of pensioners and non-pensioners**



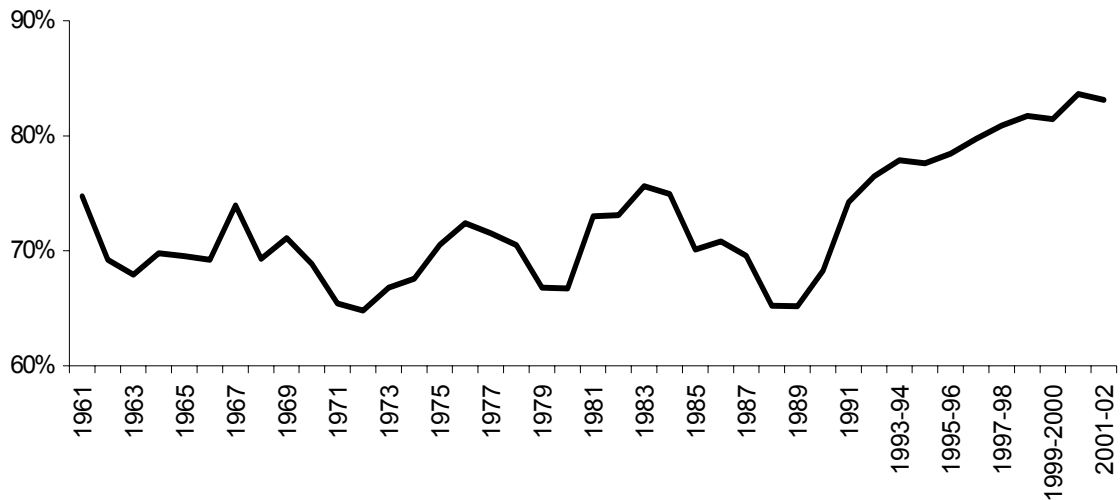
*Note:* Incomes are expressed in 2001–02 prices.

*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

This point is brought out more clearly in Figure 5.4, which shows the ratio of pensioner to non-pensioner median incomes on the AHC measure. This graph shows that the median pensioner income is now closer to median non-pensioner income than at any time over the last 40 years.<sup>18</sup> More strikingly, it shows that the ratio of pensioner to non-pensioner incomes has fluctuated quite strongly over time, tending to rise when non-pensioner median income growth has been slow or negative and to fall when non-pensioner median income growth has been faster. Changes in the most recent years are an important exception to this, since average pensioner incomes have maintained their share in relation to non-pensioner incomes despite fairly rapid income growth amongst non-pensioners.

<sup>18</sup> The ratio was higher in 2000–01 than in 2001–02, but not significantly so.

**Figure 5.4. Median pensioner income  
as a percentage of median non-pensioner income (AHC)**



*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

Why are pensioner incomes less sensitive to the economic cycle than non-pensioner incomes? First, from the early 1980s, state benefits have been formally indexed to inflation (not earnings), and so only move in line with incomes through discretionary policy changes. Secondly, most private pension income is not indexed in line with earnings, and so will not move automatically with the cycle. Indeed, a considerable amount of private pension income is not even indexed for inflation. For example, as much as 80 per cent of the annuities market relies on annuities that are flat (i.e. nominal), though a rising proportion is now indexed in some way (see Department for Work and Pensions / Inland Revenue (2002)). For older cohorts in particular, imperfectly price-indexed pensions have even meant falling real incomes at periods of high inflation, which have often coincided with periods of fast economic growth. Finally, since relatively few pensioners are in employment, their incomes are also less sensitive to changes in employment opportunities across the economic cycle.

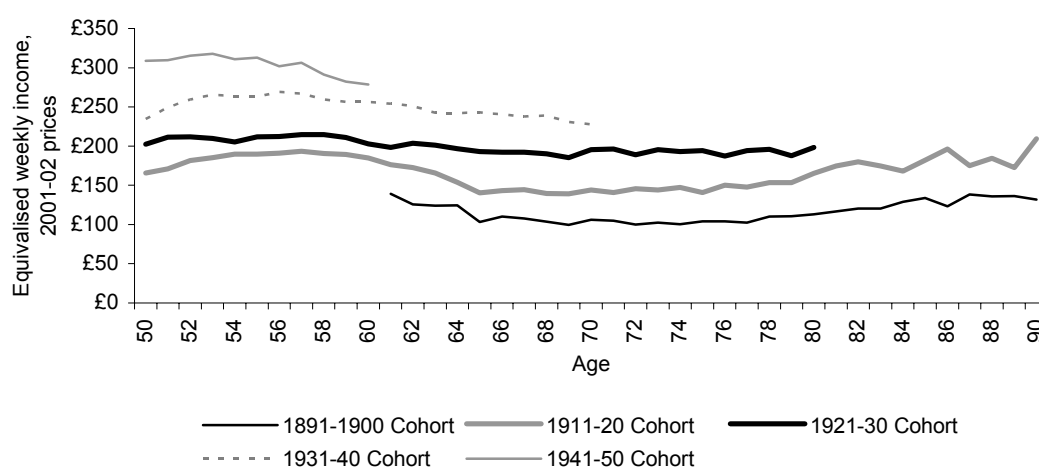
Instead of moving cyclically, pensioner incomes have tended to rise more steadily over time, as younger (richer) cohorts retire and older (poorer) cohorts gradually die out. The general growth in pensioners' incomes across cohorts can be seen in Figure 5.5, which shows how the median AHC income of individuals at different ages (over 50) has changed across 10-year birth cohorts. The graph shows that each cohort has median income successively higher than the income of the preceding generation. These changes have arisen because younger cohorts of pensioners have benefited from both higher average incomes across their working lives and access to higher private pension income in retirement. Some increases in state benefits will also have contributed to this trend (see Department of Social Security (2000)).

Figure 5.5 also gives important information about changes in average incomes within cohorts as they get older. Most cohorts see a drop in median income around retirement



age, followed by a period when incomes are relatively stable across time. But amongst older cohorts, a slight rise in the median income is also apparent when these cohorts reach their late 70s and early 80s. This is a reflection of a number of factors, including differential mortality: since richer individuals tend to live longer (see Attanasio and Emmerson (forthcoming)), the average income of the cohort tends to go up over time.<sup>19</sup> Despite the obvious human costs associated with widowhood, it is also possible that this transition could lead to increases in equivalised income which would contribute to this trend, though this depends on specific pension arrangements and state benefit receipt.<sup>20</sup> Increased receipt of disability benefits with age could also result in rising income as members of a cohort age.

**Figure 5.5. Pensioner cohort income dynamics**



*Note:* Shows median AHC income by 10-year birth cohort and age.

*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

Returning to our argument about the cyclical pattern in relative pensioner poverty, we have seen that pensioner incomes do not tend to move strongly in line with the economic cycle, compared with non-pensioner incomes. This means that in times of economic growth when the average income of the working-age population goes up relatively fast, pensioner incomes have tended not to rise as fast as this, resulting in an increasing rate of relative pensioner poverty. Similarly, when the median income is

<sup>19</sup> The evidence we have suggests that differential mortality by income sets in at an earlier age than the late 70s and 80s, although the rise in the median income within cohorts only becomes apparent at these ages on Figure 5.5. This suggests that in the absence of differential mortality, the stable income pattern shown here over much of a cohort's 60s and 70s would in fact show a gentle decline. There is also increased sampling variability in average incomes of these groups as their numbers dwindle over time – resulting in the spiky nature of the series at the older ages shown.

<sup>20</sup> An individual will see an AHC income rise at widowhood if the household income on the death of the spouse drops to a level more than 55 per cent of the original income of the couple. This is because the equivalence scales used to calculate the income statistics assume that a single person needs 55 per cent of the AHC income of a couple to attain the same standard of living. The MIG for a single pensioner is around 66 per cent of that for a pensioner couple. So if housing costs remain unchanged, a shift from the couple to the single MIG would represent a rise in living standards. The state pension for a single pensioner is about 63 per cent of that for a couple, whilst, until recently, inheritance of SERPS has been at 100 per cent (though this is being reduced to 50 per cent).

constant or falling, pensioner incomes tend to catch up, and the number of pensioners below various fractions of the median falls.

But the fact that recent years' changes have not followed this pattern is notable. In particular, the impact of the large discretionary benefit increases introduced for pensioners on low incomes has been to allow their incomes to rise roughly in line with (and, as we saw in Chapter 4, for some groups a little faster than) the median income growth.

The strongly pro-cyclical pattern in these relative pensioner poverty measures also suggests that we should be cautious in how we interpret these trends. They do show that during periods of economic growth, pensioners tend to fall further behind the rest of society, and they tend to catch up when growth is slow or negative – this is exactly what relative poverty measures are designed to capture. But it is also the case that some of the largest changes in poverty have been the result of fairly small changes in the underlying pensioner income distribution. Likewise, small changes in poverty, such as those occurring in the last five years, have actually been due to quite big shifts in underlying incomes. This difficulty underlies the interpretation of all poverty figures measured this way (for example, the government's high-profile child poverty targets) and is inherent in trying to capture a relative notion of poverty. But it is particularly problematic with pensioners because of how closely they are grouped around the poverty lines.

## **5.2 The position of pensioners in the distribution of income**

The fact that relative poverty more or less stood still on most measures over the first five years of the Labour government is impressive. It means that pensioners across the income scale have seen their incomes on average either being maintained or increasing relative to average non-pensioner incomes.

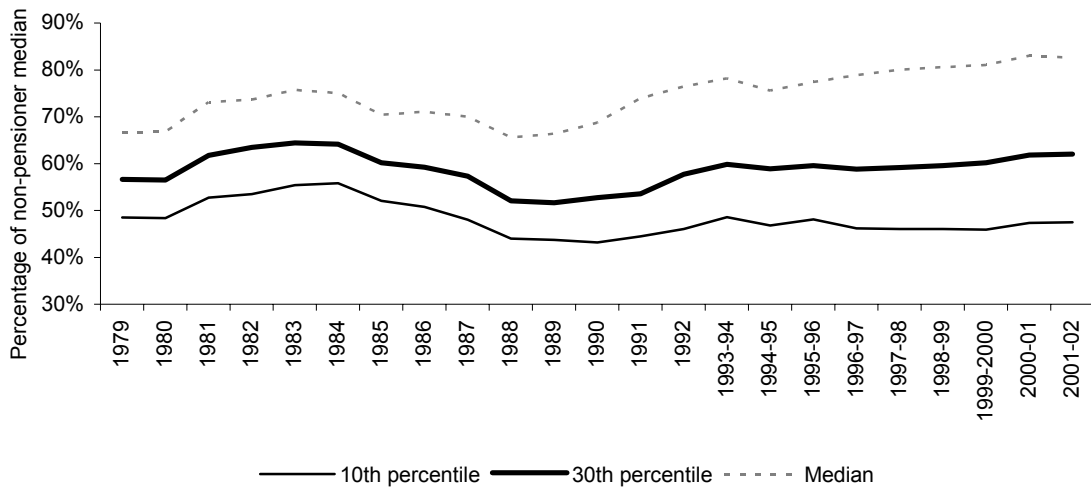
As we saw in Figure 5.4, the gap between pensioner and non-pensioner incomes has been closing over recent years, despite the fact that average non-pensioner incomes have been rising. The median pensioner income (AHC), at £236 per week in 2001–02, was around 83 per cent of the median non-pensioner income, the highest ratio for 40 years.

Figure 5.6 shows that the incomes of pensioners lower in the income distribution (here, the 10th percentile of the pensioner income distribution and the 30th percentile are shown for comparison with the median) have also maintained their relative position compared with the median income amongst non-pensioners since the late 1980s (although, unlike for the median, this is not the highest proportion of the non-pensioner median that has been seen).

As a result of these changes in pensioner incomes, pensioners as a group have steadily moved up in the overall income distribution over time. Though pensioners are a lower income group on average than non-pensioners, they no longer predominate at the very bottom of the income distribution as they have in previous decades (for more on this, see Goodman and Shephard (2002) and Goodman, Johnson and Webb (1997)). Figure 5.7 shows the proportion of pensioners falling into different deciles of the overall income distribution in 2001–02. It is clear from the graph that pensioners are over-represented in the 2nd, 3rd, 4th and 5th decile groups (since more than 10 per cent of

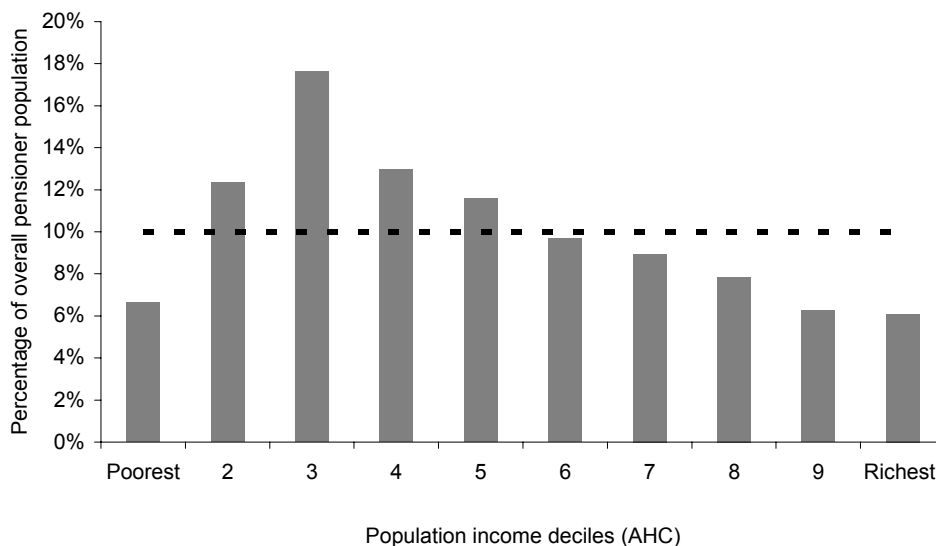
pensioners are to be found in each of these groups), but are under-represented at the very bottom of the income distribution. It is also clear that although pensioners make up less than 10 per cent of the richest income deciles, there are still considerable numbers of pensioners in the top half of the income distribution. In fact, as many as 40 per cent of pensioner couples and 36 per cent of single pensioners are to be found there.

**Figure 5.6. Pensioner incomes relative to the non-pensioner median income**



*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

**Figure 5.7. Position of pensioners in the overall income distribution, 2001–02**



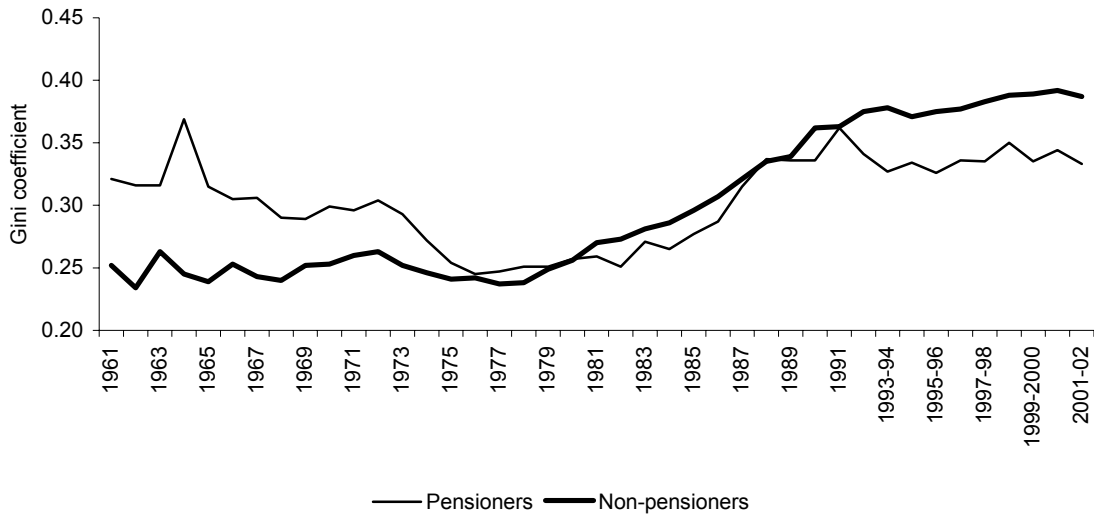
*Notes:* Income deciles are derived by dividing all families (not only pensioners) into 10 equally sized groups according to AHC income adjusted for family size using the McClements equivalence scale. Decile 1 contains the poorest tenth of the population, decile 2 the second poorest and so on, up to the top decile (decile 10), which contains the richest tenth. The horizontal line across the graph at the level of 10 per cent marks the line of equal distribution of pensioners. If the actual proportion of pensioners in a given decile is below this line, it means that pensioners are under-represented in this decile relative to the rest of the population. A proportion above 10 per cent implies over-representation of pensioners in a given decile.

*Source:* Authors' calculations based on Family Resources Survey, 2001–02.

### 5.3 Pensioner income inequality

It is also interesting to note that pensioner incomes are now less unequal than non-pensioner incomes, and have remained so despite rising incomes amongst the richest pensioners. Figure 5.8 shows what has happened to income inequality amongst pensioners and non-pensioners over time by plotting the Gini coefficient for AHC income.<sup>21</sup> It shows that pensioner income inequality has been relatively stable since around 1992, despite continuing inequality growth amongst the non-pensioner population. As a result, pensioner incomes are now considerably less unequal than non-pensioner incomes.

**Figure 5.8. Pensioner and non-pensioner AHC income inequality**



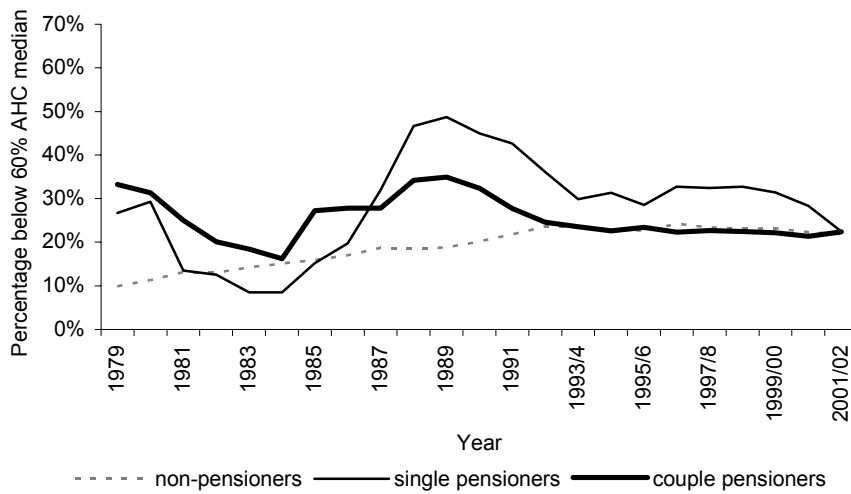
*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

### 5.4 Changes in pensioner poverty compared with other groups

Another reason why the trends in relative pensioner poverty over the first five years of the Labour government are more remarkable than the 'little change' picture we showed in Chapter 4 might suggest is that there is now little difference in the poverty rates of pensioners compared with those of non-pensioners on some of the most frequently cited measures of pensioner poverty. For example, the proportion in poverty on the 60 per cent of median AHC income definition was 22 per cent in 2001-02 among pensioners and non-pensioners alike (although the proportion of pensioners below the 70 per cent of median mark is still considerably higher than that of non-pensioners).

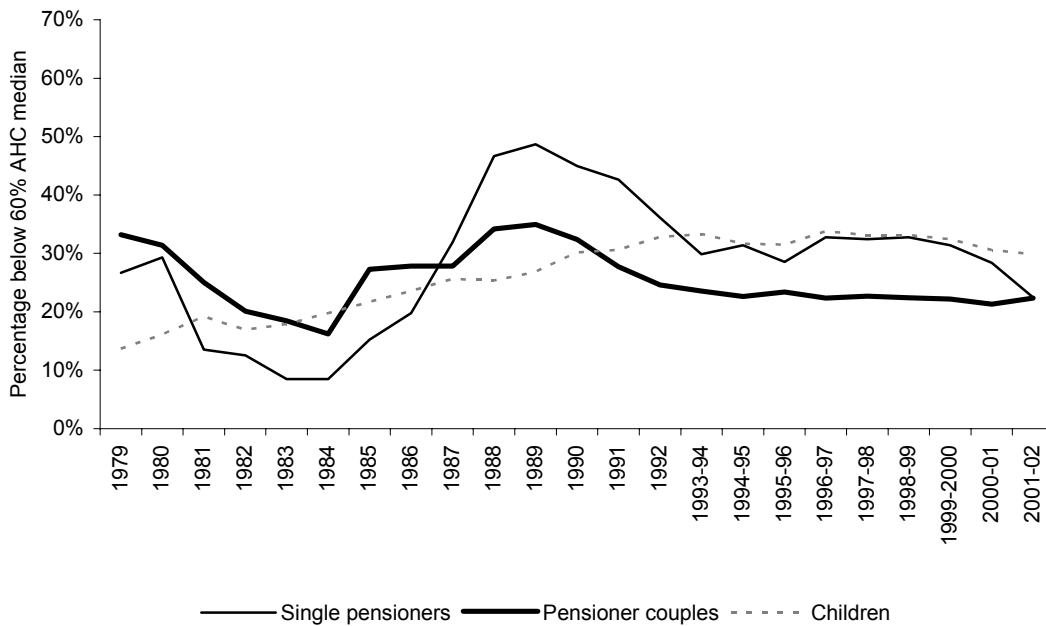
Much of this convergence is due to a drop in relative poverty amongst single pensioners. Though pensioner couples have had a similar relative poverty rate to non-pensioners since the early 1990s, the rate of poverty amongst single pensioners only converged with that of non-pensioners in the last year of the data (see Figure 5.9).

**Figure 5.9. Pensioner and non-pensioner poverty rates  
(60 per cent median AHC measure)**



*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

**Figure 5.10. Child and pensioner poverty rates  
(60 per cent median AHC measure)**



*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

<sup>21</sup> This is an inequality measure that ranges from 0 to 1 and is based on the income shares of individuals at different points in the income distribution (see Goodman, Johnson and Webb (1997) for further details). The higher the Gini coefficient, the higher the degree of income inequality.

Since tackling child poverty has been at least as prominent a goal of the present government as tackling pensioner poverty, Figure 5.10 shows how pensioner and child poverty changes over recent years compare. The drop in poverty amongst single pensioners is fairly remarkable set in this context. Whilst single pensioner and child poverty rates were very similar over much of the 1990s, since 1999–2000 the single pensioner poverty rate has dropped much faster than the child poverty rate.<sup>22</sup>

In this chapter, we have shown that although relative pensioner poverty did not fall by much on most measures over the first five years of the Labour government, the fact that it did not rise over this time is quite remarkable in the context of recent history. This is because pensioner incomes (across the income scale) have been rising in line with non-pensioner incomes, even during this period of relatively strong economic performance. As a result, the rate of pensioner poverty is now similar to the poverty rate amongst most non-pensioner groups.

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<sup>22</sup> The decline in the proportion of the population below 70 per cent of AHC median has also been faster amongst single pensioners than amongst children. But the decline in the proportion below 50 per cent of the AHC median has been slightly faster amongst children than amongst single pensioners over this period.

## 6. Why is pensioner poverty not eradicated yet?

Despite the large benefit increases introduced in the last five years described in Chapter 3, a significant core of pensioners remain in relative poverty. This is particularly striking since the level of the MIG is now above the 60 per cent median AHC income for single pensioners and above the 50 per cent median AHC line for pensioner couples (see Table 6.1).

**Table 6.1. The maximum benefit award for those claiming means-tested benefits, compared with median income, 2001–02**

	£ per week (2001–02 prices)	Percentage of median AHC income
Single pensioners under 75	£96.00	64%
Pensioner couples under 75	£144.40	53%

*Note:* Amounts are those set out in Table 3.2 and include the value of the MIG and winter fuel payments.

*Source:* Authors' calculations based on Family Resources Survey.

In this chapter, we ask why it is that one in five single pensioners have living standards below the level of the safety net provided by the government (22 per cent of single pensioners were below 60 per cent median AHC income in 2001–02), and why around one in ten pensioner couples have incomes below the level of the safety net for them (10 per cent of pensioner couples were below 50 per cent median AHC income in 2001–02). One particular issue we identify is the non-take-up of benefits amongst pensioners who are eligible for them.

We first describe the depth of the problem by setting out the average amount by which pensioner incomes lie below these lines: half of all single pensioners below the 60 per cent median AHC poverty line (close to the level of the MIG for single pensioners) were more than £16 per week below the line (expressed in cash, not equivalised income, terms). The mean value of this gap was around £25 per week. For couples below 50 per cent of median AHC income (which is close to the MIG for couples), the median poverty gap was around £21 per week and the mean poverty gap was around £34 per week.

So why do these shortfalls exist when benefit levels appear to be sufficient to bring pensioner incomes above these poverty lines? We first consider why even those who are receiving their maximum benefit entitlement could fall below these poverty lines. We then go on to consider the extent to which low-income pensioners do not receive the maximum amount of means-tested benefits available, even though their incomes are low. To do this, we attempt to distinguish between those on low incomes who do not receive full benefits because they are not entitled (mostly because they may have savings that take them above the prevailing capital limits) and those who appear not to be taking up their full entitlement. It is this latter group that is potentially of the most policy concern.

## 6.1 People receiving benefits: income definitions and household composition

The first reason why pensioner incomes could fall short of the relevant poverty line (50 per cent median for couples and 60 per cent median for single pensioners) is a simple one of income definition. In order to calculate living standards and poverty rates, HBAI incomes are measured net of some deductions, the most important of which are council tax payments, housing costs, lump-sum tax payments and self-employment losses.

Even those who are claiming the full amount of the MIG – which is above the level of the poverty lines we highlighted – could have measured incomes below the poverty line once these certain deductions from income are accounted for. For example, a pensioner on the full MIG, winter fuel payments, TV licence subsidy, housing benefit and council tax benefit could still find themselves with income below the relevant poverty line if some of their housing expenses were not fully met by benefit receipt. For example, some housing-related deductions (such as water charges) are not subject to refund in the form of housing benefit. Moreover, because of restrictions on the value of housing benefit, the receipt does not always cover the full cost of rent. Because of the latter, and as a result of benefit withdrawal among pensioners with incomes below 60 per cent of AHC median income who receive housing benefit, 62 per cent of these people still make positive contributions towards rent. Around 3 per cent of pensioners who live in poverty report self-employment losses, which in many cases are responsible for taking incomes below the poverty line.<sup>23</sup>

Another potential explanation for why a pensioner who is receiving the full MIG could still be below the poverty line relates to their household composition. Suppose that a single pensioner who is receiving at least the MIG is living with his or her adult children. If the income of the adult children is relatively low, then once incomes have been adjusted for need (i.e. equivalised), the household income level could fall below the poverty line. Of course, by the same argument, pensioners who have incomes below the MIG could be lifted above the poverty line if the income of other household members is relatively high. In Appendix C, we demonstrate that considering tax-unit-level income, rather than household-level income, leads to little difference in the implied poverty rate, though it can have implications for the depth of poverty. The particular problem discussed here is therefore unlikely to be very large.

## 6.2 Non-receipt of benefits

By far the most important explanation for why some pensioners still lie below the relevant poverty line concerns non-receipt of benefits. For some, this is because they are not eligible to receive benefits. Means-tested benefits receipt is subject to capital limits and, as Table 6.2 shows, almost 8 per cent of single pensioners and over 9 per cent of couples with incomes below 60 per cent of the median report savings above £12,000 which make them ineligible for the MIG. The entitlement of a further 4 per cent of single pensioners and 7 per cent of couple pensioners is reduced because savings exceed £6,000. Recent research carried out for the Department for Work and Pensions suggests

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<sup>23</sup> The median self-employment loss among pensioners with incomes below 60 per cent of AHC median income is £15.35 per week in 2001–02.



that there may be significant under-reporting of capital holding within the Family Resources Survey (see Department for Work and Pensions (2001)). If this is the case, then these percentages could be underestimates of the extent of non-receipt due to ineligibility.<sup>24</sup>

**Table 6.2. Capital of pensioners with income below 60 per cent median, 2001–02**

	Capital less than £6,000	Capital £6,000–£12,000	Capital more than £12,000
Single pensioners	88.1%	4.0%	7.9%
Pensioner couples	83.9%	6.7%	9.4%

*Source:* Authors' calculations based on Family Resources Survey.

The second, and potentially most serious, problem concerning non-receipt of benefit relates to non-take-up of benefits by pensioners who are entitled to them. This applies to all means-tested benefits but in particular the MIG. Official statistics suggest that between 22 per cent and 36 per cent of pensioners entitled to the MIG did not claim in 1999–2000.<sup>25</sup> Official statistics also suggest that as many as one-third did not claim the council tax benefit to which they were entitled and one in ten did not claim their housing benefit entitlement. (See Department for Work and Pensions (2001) and National Audit Office (2002).) These rates of benefit take-up amongst pensioners are substantially lower than those amongst the non-pensioner population.

Non-take-up is higher amongst those who are only entitled to small amounts of benefit. The same official statistics show that non-take-up amongst pensioners was the highest amongst those with less than full MIG entitlement – around half of all single pensioners in 1999–2000 who appeared to be entitled non-recipients had access to other income of over £75 per week, and half of all such pensioner couples had other income of over £100 per week.

Non-take-up of benefits may be related to several factors, which can be classified into three main categories: lack of information concerning eligibility, the cost of claiming (for example, the time necessary to fill in the application and the need to report to the benefit office) and stigma associated with claiming means-tested support. Department of Social Security (1999) classifies pensioners who do not take up the benefits they are entitled to into three groups according to their attitude towards claiming means-tested support – namely, low, medium and high resisters. Amongst entitled non-recipients, 40 per cent were classified as low and 22 per cent as high resisters. This research finds that while the reason for the first group not claiming is usually lack of information, the latter group tend not to claim because of their attitude towards means-tested support and the anticipated claim process.

<sup>24</sup> Reforms introduced by the government as part of the pension credit package in October 2003 will significantly relax the capital limit restrictions. Around 15 per cent of pensioners with incomes below 60 per cent of median income will potentially gain from this element of the reform (for more on the pension credit reform, see Chapter 7).

<sup>25</sup> These same official estimates provide insufficient evidence to determine whether or not take-up differs amongst pensioner couples, single male pensioners and single female pensioners.

Official statistics on benefit take-up are produced with some delay and, as we saw, the latest figures available relate to the year 1999–2000. Since the figures are based on a combination of administrative and survey-based information, we are not able to reproduce them here for the most recent year of data.

What we show below is the likely effect the level of take-up has on the extent of poverty among pensioners. To do this, we combine the FRS information used to construct the official HBAI poverty measures and the simulated entitlement to benefits from our tax and benefit model. The analysis shows the effect on poverty rates of increasing take-up among pensioners from the 2001–02 level (as recorded in the FRS) to 100 per cent. The exercise is conducted for two scenarios: first, we assume full take-up of the MIG and maintain take-up of other benefits at the reported level; secondly, we assume full take-up applies to both the MIG and housing benefit.<sup>26</sup>

Table 6.3 gives details of the simulated effects on pensioner poverty of 100 per cent take-up of benefits among pensioners. It shows that the increase in take-up would have a relatively strong effect on pensioner poverty defined as the proportion with incomes below 50 per cent of the median (AHC) income. The effect of full take-up on the rate of poverty defined as either 60 per cent or 70 per cent of the median (AHC) income is relatively small. With 100 per cent take-up of the MIG and housing benefit, the number of pensioners in relative poverty defined by the 60 per cent median income poverty line would fall by only between 100,000 and 200,000 (1–2 percentage points).

**Table 6.3. Reduction in poverty  
as a result of increasing take-up among pensioners, 2001–02**

	<i>Pensioners in households below:</i>		
	50% median	60% median	70% median
<i>100% take-up of MIG</i>			
Percentage point reduction in poverty	2.1%	1.2%	1.0%
Proportion of pensioners who would be in poverty	9%	21%	35%
<i>100% take-up of MIG and housing benefit</i>			
Percentage point reduction in poverty	3.6%	1.7%	1.3%
Proportion of pensioners who would be in poverty	7%	21%	35%

*Notes:* Take-up of 100 per cent is simulated only for pensioner families. Income is measured after housing costs.

*Source:* Authors' calculations based on Family Resources Survey.

<sup>26</sup> For the purpose of the exercise, we calculate actual and simulated disposable incomes before certain payments and benefits related to them. For example, the simulation of 100 per cent MIG take-up was conducted in the following way. We compared simulated and actual (HBAI) incomes excluding housing costs and various other payments (principally the council tax) of pensioner tax units. For those pensioner families that had no record of MIG and a positive simulated amount, and as a result higher simulated income, we replaced income before housing costs and payments in the data with the simulated amount. The HBAI procedure was then applied in the standard way to arrive at equivalised AHC household income. A similar procedure (though conducted at household level) was used for simulation of housing benefit take-up.

Our simulations therefore suggest that while increasing take-up to 100 per cent would not have a large effect in reducing the number of pensioners living below 60 per cent of the median income, it would have an important effect in reducing the 'depth' of poverty (since the numbers below lower thresholds would fall by more). While the government has not said much about its concern with the poverty gap among pensioners, the aim of abolishing pensioner poverty implicitly assumes a concern with the minority whose incomes fall significantly short of the poverty line.

Chapter 7 discusses the government policies that have taken effect since April 2002 or are yet to take effect. These include an important change in the administration of means-tested benefits which can be understood as the government's response to the problem of low take-up.

## 7. The future: how much difference will future reforms make?

This chapter discusses the potential for further poverty reduction amongst pensioners from the reforms that are not yet reflected in the official low-income statistics. We first outline the major reforms and then look at the possible effect of these changes on pensioner incomes and poverty.

### 7.1 Reforms affecting incomes of pensioner households after April 2002

The proportional increases in benefits presented in Table 3.2 suggested that the largest increases in pensioner benefits announced since 1997 were already in place by March 2002. But at the same time we can see from Table 3.1 that over 40 per cent of the 1997–2004 reform package has been or will be spent after March 2002. The reason for this seeming discrepancy is a change in means-tested benefits that is more fundamental than just a simple increase in the MIG.

In October 2003, the pension credit will replace the MIG as the main instrument of means-tested support for pensioners. Details of the reform have been discussed in Clark (2002). Apart from increasing the maximum rate of the MIG (relabelled as ‘pension credit guarantee’), the pension credit brings important changes to the administration and functioning of means-tested support for pensioners. The reform will:

- Reduce the benefit withdrawal rate from 100 per cent to 40 per cent on income beyond the level of the basic state pension (before means-testing) for those aged 65 or over (and their partners).
- Simplify the rules determining the operation of means-tested support and make the claim procedure less burdensome, with the hope of increasing take-up. The most important change is a move from a weekly to a five-yearly period of assessment, with the possibility of reassessment if income drops and a requirement for reassessment only if circumstances change significantly.
- Increase the generosity of housing benefit and council tax benefit to ensure that pensioners claiming these benefits see their incomes rise with the introduction of the new withdrawal rate.
- Reform the capital rules by abolishing the upper capital limit above which no MIG can be received and doubling the amount of capital deemed equivalent to £1 of weekly income (from £250 to £500).

It is important to note that the highest gains from the first element of the reform will apply to those currently just on the edge of MIG eligibility. Single people with incomes before means-testing of £100 (the basic state pension plus private income of £23 per week) will potentially gain £13.80 per week, while couples on £154 will potentially gain £18.60. We estimate that about 8 per cent of pensioners will also potentially benefit from changes to the capital rules. Their median gain in entitlement will be £4.30 per week, which means that (under full take-up of MIG) about 400,000 pensioners will gain more than this amount.

The introduction of the pension credit, and especially the move to a five-yearly assessment, might have a positive effect on the proportion of pensioners who take up their entitlements. Take-up might also increase as a result of eligibility extending further up the income distribution if this contributes to a reduction of the stigma associated with claiming means-tested support.<sup>27</sup>

In addition to increases in means-tested benefit levels, the government has already raised the basic state pension above the level of statutory indexation in April 2002. The basic state pension will rise in real terms again this year, although by a very small amount.<sup>28</sup> April 2003 will see an increase in the age-related personal tax allowances by £240 (over and above indexation), which will imply a tax relief of about £1 per week for pensioners paying the basic rate of tax (22 per cent). The government has also committed to increasing the age-related allowances and the pension credit guarantee with earnings for the remainder of this parliament.

## **7.2 The effect of direct tax and benefit measures on pensioner incomes, April 2002 to March 2005**

Figure 7.1 presents the effect of personal tax and benefit measures that only affect pensioner incomes from April 2002, i.e. those that are not yet reflected in the most recent HBAI data. We separate the effects between the measures that have been in place since last April and those that will take effect in 2003–04 and 2004–05. We can see that the reforms to be introduced after this April will represent a significant increase in the incomes of pensioner households in the lower half of the income distribution. The pension credit will make a considerable number (around half) of pensioners better off. The total effect of the 2002–04 reforms announced so far on a single pensioner will be about £10.00 per week on average, assuming full take-up. Pensioner couples should see their incomes rise by about £12.00 on average.

The changes in income as a result of the reforms described above are once more based on the assumption that pensioners take up all benefits they are entitled to, both in the 2001–02 system and in the system that includes the overall reform package. How the reforms will actually change the level of pensioner incomes will depend not only on the changes in levels of benefits to which they will be entitled but also on the extent of change in the rates of take-up of means-tested support. This is especially important in the case of the poorest pensioners, who fall far below the poverty line largely because they do not claim their entitlements.

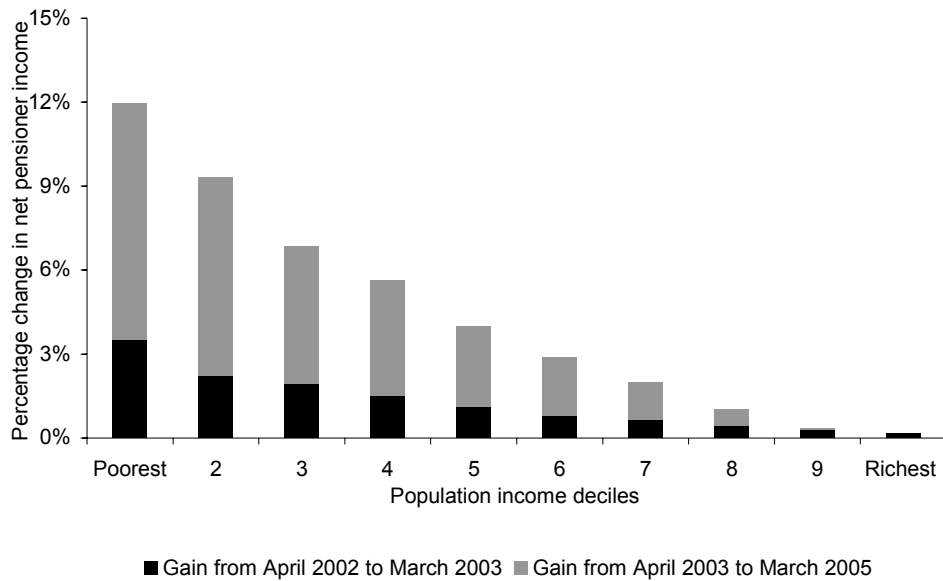
The extent of any reduction in relative poverty among pensioners will also depend on the overall changes in the income distribution and the level of median income. These will

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<sup>27</sup> On the other hand, take-up rates could fall if a significant number of newly entitled pensioners (i.e. those entitled to small amounts) fail to take up their entitlements. However, such a drop in take-up would be less important for future movements in poverty than if take-up amongst the poorest increases as a result of the reforms.

<sup>28</sup> The basic state pension will go up by 0.8 per cent in real terms, which is equivalent to about £0.60 per week for a single pensioner and £0.95 per week for couples.

**Figure 7.1. Distributional effect of 2002–04 tax and benefit reforms on pensioner households**



*Notes:* Income deciles are derived by dividing all families (not only pensioners) into 10 equally sized groups according to AHC income adjusted for family size using the McClements equivalence scale. Decile 1 contains the poorest tenth of the population, decile 2 the second poorest and so on, up to the top decile (decile 10), which contains the richest tenth. Pensioner households are defined as households that contain at least one person of pension age.

*Source:* IFS tax and benefit model, TAXBEN, based on 2001–02 Family Resources Survey.

include changes in the underlying distribution of gross incomes and the effect on net incomes of the overall package of government reforms to the tax and benefit system.<sup>29</sup>

Table 7.1 presents simulated pensioner poverty figures under the assumption of full benefit take-up, but making different assumptions about earnings growth between 2002–03 and 2004–05. We simulate the change in net incomes resulting from the overall government reform package and present the reduction in the proportion of pensioners below poverty lines calculated as 50 per cent, 60 per cent and 70 per cent of AHC median income (which changes as a result of earnings growth).

First, assuming a 0 per cent rate of earnings growth (i.e. a static simulation), we find that the reforms would result in a fall in pensioner poverty (measured by 60 per cent median income) of roughly 1 million pensioners, or about 10 per cent of the overall pensioner population. This figure is likely to be close to the change in the level of absolute poverty we will see between 2002–03 and 2004–05, i.e. the change in poverty relative to the 2001–02 poverty line.<sup>30</sup> As our simulations show, the number of pensioners living in

<sup>29</sup> The income distribution will also depend on other demographic changes, such as changes to the pensioner population as older cohorts gradually die out and younger pensioners replace them.

<sup>30</sup> In fact, our simulation on the 1996–97 data of reforms that took effect between 1996–97 and 2001–02 on the assumption of constant earnings produces a 1.6 million reduction in the number of pensioners in poverty. This turns out to be the actual change in absolute poverty over the five years taking the poverty line to be 60 per cent of the median AHC income in 1996–97.

poverty is very sensitive to the assumptions we make about the growth of gross earnings. Any increase in earnings is likely to limit significantly the effect of the 2002–04 pensioner reform package on pensioner poverty.

**Table 7.1. Simulated changes in pensioner poverty as a result of the 2002–04 tax and benefit reforms**

Annual rate of real earnings growth for the period 2002–03 to 2004–05:	<i>Reduction in the proportion of pensioners with incomes below various fractions of median AHC income:</i>		
	50% median	60% median	70% median
0.0%	2.3 ppt	9.6 ppt	10.5 ppt
2.3%	1.9 ppt	6.1 ppt	6.3 ppt
3.0%	1.7 ppt	4.1 ppt	4.9 ppt

*Note:* ppt = percentage points.

*Source:* Authors' calculations based on Family Resources Survey. Assumes cumulated earnings growth over the three years. All earnings (and self-employment income) grow at the same rate.

If in the three years 2002–03 to 2004–05, real earnings grow at about the same rate as they did in the period between April 1998 and April 2001 (i.e. on average at about 2.3 per cent per year),<sup>31</sup> the proportion of pensioners in poverty (defined as 60 per cent median AHC income) would be reduced by about 6.1 percentage points (around 600,000 pensioners) by the end of the financial year 2004–05. As Table 7.1 shows, faster growth of real earnings, at an average of 3 per cent per year, would limit the effect of the reforms further, to about 400,000, or 4.1 per cent of the pensioner population.<sup>32</sup>

<sup>31</sup> This same assumption about average earnings growth was made in the context of predicting future child poverty changes in Brewer and Kaplan (2003).

<sup>32</sup> We must note that because of high sensitivity of the number of pensioners falling below the poverty line to changes in it, the results of these simulations must be treated with a degree of caution. We believe that the degree of precision in the case of simulations of poverty changes among pensioners is lower than that in the case of other family types.

## 8. Conclusions

In this Commentary, we have shown that for the first five years of the Labour government, low- and middle-income pensioners have, on average, ‘shared in the nation’s prosperity’. Quite unlike during other periods of strong economic performance over the last 40 years, pensioner incomes across the distribution have kept pace with the growth in non-pensioner incomes. This has been due, in large part, to big increases in the generosity of state benefits – particularly means-tested benefits – for pensioners. These have allowed pensioner incomes, even amongst the poorest, to rise substantially.

Though these changes have been reflected in rapidly falling absolute poverty, they have not resulted in big falls in relative poverty amongst pensioners (though for single pensioners the falls have been notable). This is because for relative pensioner poverty to fall significantly, the incomes of the poorest pensioners would have to rise faster than the incomes of the overall population and not only keep up with general income growth.

For families of working age, changes in employment and earnings amongst the poorest can help to contribute to faster-than-average earnings growth, and so reduce relative poverty on the sorts of measures we have considered in this Commentary. But for today’s pensioners, the scope for reducing relative poverty by these means is much more limited. Further reductions would therefore demand an even larger degree of redistribution than that which has already taken place.

The introduction of the pension credit, and other reforms that have been announced but are yet to be reflected in the official poverty statistics, could have a similar impact on poverty to that of the reforms already reflected in the figures. These changes are unlikely to have a much bigger effect than this if income growth across the non-pensioner population remains strong. Possible increases in benefit take-up would also be unlikely to affect poverty rates to any significant extent, though they could reduce the depth of poverty among those at the very bottom of the income distribution. This suggests that increasing the level of non-means-tested benefits – where non-take-up is less of a concern – to the level of means-tested benefits would be unlikely to reduce headcount measures of pensioner poverty significantly further. Given the cost of such a policy,<sup>33</sup> we believe this is an unlikely route for the government to take.

All this highlights the difficulty of the task of ‘abolishing’ pensioner poverty defined in relative terms. Indeed, the analysis we have presented in this Commentary brings into question how sensible such a target – at least, measured in the way in which the government currently measures relative poverty amongst pensioners – would be. It suggests that to achieve the task would require either much more redistribution towards pensioners or a large drop in non-pensioner incomes. The latter would not be desirable for obvious reasons, whilst the former, to be on a sufficiently large scale to abolish relative poverty altogether, could be extremely expensive and would require a radical change in policy direction to achieve it.

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<sup>33</sup> Emmerson (2002) estimates that the cost of increasing the basic state pension to the level of the minimum income guarantee would be around £5.5 billion. This costing is for 2002–03 and is based on the assumption of 100 per cent take-up of means-tested benefits, which makes it an underestimate of the true cost.



Increases in the future private pension incomes of today's workers are also very unlikely to abolish relative pensioner poverty in the medium term. So long as economic growth ensures that younger generations see rising lifetime incomes compared with the generations preceding them, or if people continue to choose to take drops in income on retirement, there is always likely to be some gap between the incomes of pensioners and non-pensioners. And as long as there is inequality among individuals of working age, there is likely to be inequality among those over the state pension age. The scope for private pensions to eliminate this is limited, since private pension schemes can only be expected to reallocate an individual's income from their working life to their retirement, and not to redistribute from, for example, rich to poor.

Perhaps all this means is that it is important not to take grand political statements about the eradication of poverty too literally or too seriously, particularly in the absence of a clear definition of poverty. If the government is able to ensure that pensioner living standards continue to rise fast enough for relative pensioner poverty to stand still, or to fall somewhat, across all stages of the economic cycle into the longer term, history suggests that this will already be an important achievement in itself.

## Appendix A. Measuring pensioner poverty using Households Below Average Income measures

The Households Below Average Income measures have a number of features that should be borne in mind when interpreting the results in this Commentary. Here, we present a discussion of the most important of them.

### A.1 Income rather than spending or assets

Most fundamentally, by using poverty measures based on the HBAI statistics, we choose *income* as our way of measuring pensioners' (and others') living standards. Though this is a common choice, it is not the only – nor necessarily the best – measure of well-being. The amount a pensioner *spends* in a given week might provide a more direct guide to their standard of living (thought of in terms of the consumption of goods and services) if they are saving, running down their savings (in a way not reflected in their income – see below) or borrowing.

This is especially important since many pensioners – even those on low incomes – tend to save, either as a precautionary measure or because they want to leave a bequest (see Banks, Blundell and Tanner (1998)). In this case, their current income may overstate their actual standard of living (in terms of immediate consumption). On the other hand, many others run down the savings that they have accumulated over their lifetimes, consuming more than their immediate incomes allow. If individuals' incomes change over time, and people respond by smoothing their spending around expected longer-run incomes,<sup>34</sup> then their expenditure will tend to provide a longer-run view of living standards than a snapshot picture of income will. A study of pensioner poverty based on pensioners' expenditure rather than their income could therefore tell a rather different story from the one based on incomes set out in this Commentary (see Blow, Leicester and Smith (forthcoming) and Hancock and Smeaton (1995)).

Similarly, looking at the amount of assets or wealth held by different pensioners could provide an important additional perspective on pensioners' financial well-being (see Banks, Smith and Wakefield (2002) for information about financial assets and Disney, Johnson and Stears (1998) for information about total wealth).

In fact, the income measures that we consider here do partly (but inconsistently) reflect the drawing-down of wealth or savings by households. The value of private pension income to an individual, for example, is made up of both some asset draw-down from pension wealth and some 'pure' income, i.e. that generated by the pension wealth. Similarly, pension income from the state (in the form of SERPS) can be thought of as the draw-down of social security wealth. But such asset draw-down is not treated in an entirely consistent way across all assets. If someone ran down their financial assets simply by withdrawing money from a savings account, for example, or in any other way that did not generate an income stream, this would not be reflected in their income measure.

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<sup>34</sup> As economic theory would predict; see, for example, Friedman (1957), Hall (1978), Campbell (1987) or Attanasio (1999).

Also, the treatment of housing wealth is effectively different depending on whether a before- or after-housing-costs income measure is used (for more on this choice, see Section A.4 below).

## **A.2 Household rather than family income**

Another important point to bear in mind is that the income of the entire household is used to measure living standards in the analysis in this Commentary. Most would agree that considering individuals' incomes in isolation from the income of the people they live with would be unlikely to provide an accurate picture of their living standards because people tend to share resources within the family. But where several families live together in one household, a decision has to be made as to whether to consider the resources of all the household members collectively – effectively assuming that income is shared across the entire household – or to treat each family unit (defined as a single adult or couple, together with any dependent children) as separate entities. This decision is particularly relevant in the case of pensioners, since 18 per cent of single pensioners and 10 per cent of pensioner couples live in multiple-family-unit households, where, for example, there are several pensioner family units or where an elderly parent lives together with his or her adult children.

As it turns out, the analysis of pensioner poverty over recent years is not too sensitive to the choice between a household and a family-unit income measure. But the choice does become important when considering trends in pensioner poverty over a longer period of time. This is because there has been a sharp decline in the proportion of pensioners living together with their younger family members. We set out more details about the trends in pensioner poverty using a family-unit income measure, and how these compare with our main household income measure, in Appendix C.

## **A.3 Income adjusted for family size, but not for age, disability or other differences in need**

Another important feature of the income measure used in this Commentary is that although incomes have been adjusted to take into account family size and composition,<sup>35</sup> other differences in needs between pensioners and non-pensioners have not been taken into account. For pensioners, differences in need due to disability may be particularly important. In the HBAI statistics, those who receive additional social security benefits due to disability will appear better off than those who do not have such disabilities. If this extra income is given purely to cover the expenses for the extra needs that the disability generates (for extra care, transport and heating costs, for example), then the extra money would not truly represent an advantage in terms of living standards.

Acknowledging that this is an issue, the HBAI publication provides some sensitivity analysis of its results to various equivalence scales, including one where the presence of a disabled adult adds 10 per cent to household needs (and another where a disabled child adds an additional 10 per cent). Not surprisingly, employing these latter equivalence

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<sup>35</sup> Following the HBAI methodology, incomes are adjusted by the McClements equivalence scale (see appendix 2 of Department for Work and Pensions (2002b)).

scales increases the number of pensioners falling below the poverty line (see appendix 2 of Department for Work and Pensions (2002b)).

There may be other differences in needs between pensioners and non-pensioners not accounted for in the equivalence scales used to calculate the HBAI statistics. For example, pensioners tend not to work, and so tend not to face work-related costs. On the other hand, many pensioners, especially those with lower mobility, may face additional costs from staying at home – for example, higher heating costs. However, unless there are significant changes over time in the incidence of disability or these other differential needs between pensioners and non-pensioners, this should not affect the trends in pensioner poverty over time, which are the main subject of this Commentary.

#### **A.4 Income before or after housing costs**

The poverty figures in this Commentary are given both on a before-housing-costs (BHC) and an after-housing-costs (AHC) income basis. The BHC measure gives the amount of disposable income available to the household after income taxes and council taxes have been paid but before housing costs have been paid. The AHC measure deducts these housing costs, providing a measure of disposable income left to be spent after housing costs are paid for. As we show in the Commentary, the trends in pensioner poverty using these two measures are different. In general, poverty rates measured using the BHC measure are lower, but they have come down less over the last five years than poverty rates measured on an AHC basis.

Which is the best measure to use? There is no clear-cut answer to this question. If we think that housing is a consumption good like any other, then it would make no more sense to consider income after housing than income after clothing or motoring expenses or food. However, some argue that housing is different from other commodities because some people – particularly social tenants – have relatively little choice over their housing expenses. If this is the case, then any increase in housing costs – with accommodation unchanged – will mean a fall in living standards. This will not be captured with a BHC income measure but will be captured with an AHC measure. A large proportion (around 22 per cent) of pensioners are local authority tenants, so this argument would apply particularly to them (see Johnson and Webb (1992) for a fuller discussion).

Another argument for considering an AHC measure, particularly for pensioners, is that housing is an asset from which those who own their own homes benefit (65 per cent of pensioners own their homes outright). The BHC income measure treats as equally well off two people who are similar in all respects except that one of them has already paid off their mortgage (and hence has zero housing costs) and the other has rent or a mortgage to pay. The AHC measure draws a clearer distinction between them since the owner-occupier with no costs will have a higher AHC income, and thus will be considered better off than the tenant or mortgager.

But the AHC measure is not a perfect solution since it does not allow any distinction in living standards between owner-occupiers with housing of different values. An alternative solution to this problem (which would allow for this distinction between owner-occupiers) would be to impute an income from owner-occupation, but the HBAI

statistics do not make any attempt to do this. One clear feature of the income distribution in Britain is that housing costs make up a higher proportion of the incomes of poorer families than of families higher up the income scale (meaning that poverty rates are considerably higher on the AHC measure than on the BHC measure). There have also been considerable changes in the incidence of housing ownership over time and across cohorts, which means that the trends over time in these measures also differ.

#### **A.5 Income including some items but not others**

The exact definition of income used in the official low-income statistics also has its own quirks which should be borne in mind. The basic methodology used to derive the household income measure is to sum all sources of income – including earnings, social security benefits, investment income, private pension income and income from self-employment – across all members of the household. However, this is not an exact science, and a series of choices, some of them somewhat arbitrary, have to be made. For example, for the most part, the value of benefits in kind provided by the government, such as healthcare, is not included in this income measure. Pensioners are disproportionate users of healthcare: spending on those aged 65 or over accounts for 39 per cent of hospital and community health services spending, while 16 per cent of the population are 65 or over (see Department of Health (2002)). The value of some specific concessions to pensioners, such as free bus passes, is also not included in the income measure. However, for pensioners, the HBAI income definition does include the value of free TV licences given to those aged 75 or over. Though this does not represent a large amount of income (the subsidy is worth approximately £2 per week to a household with a colour television), it illustrates the arbitrary nature of some of the measurement choices made.<sup>36</sup>

#### **A.6 Incomes uprated by general, not pensioner-specific, inflation**

In order to compare incomes across a number of years, all of the incomes in this Commentary are expressed in a common year's prices (generally, the average prices prevailing during 2001–02). To do this, we use a set of price indices based on the all-items RPI.<sup>37</sup> By using the population-wide RPI, we do not take into account the impact of any differential cost-of-living changes for pensioners and non-pensioners. Crawford and Smith (2002) show that over the long run (since 1976), pensioners have experienced slightly lower inflation than non-pensioners. This means that the increase in pensioner living standards we report over this period will be a slight understatement of the 'true' increase. Crawford and Smith show that over the 1990s, pensioner-specific price inflation has differed from non-pensioner price inflation, but there has been no consistent pattern in these differences and the sign of them has changed frequently.

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<sup>36</sup> Our own modelling of the impact of tax and benefit changes on pensioners in Chapter 3 is consistent with this definition, since we also include the value of the free TV licence but not the value of extra government spending on other goods and services.

<sup>37</sup> For uprating BHC incomes, we use an 'RPI less council tax' index; for the AHC measure, we use the 'RPI less housing' (also known as the ROSSD) index.

### **A.7 Incomes of pensioners in private homes but not those in institutional care**

One final, and important, consideration in analysing the trends in pensioner poverty is that they are all derived from information from private household surveys, which do not collect information from people living in residential institutions such as care homes. Approximately half a million, or one in twenty, of those aged 65 or over in the UK live in care homes, while as many as one in five of those aged 85 or over are in institutional care (see Royal Commission on Long Term Care (1999)). We have relatively little evidence on the incomes of those in institutional care, though we know that the residential care population is made up disproportionately of previous tenants (rather than owner-occupiers) and that those in care are less likely to have a surviving spouse than those who remain in their own homes (see Wittenberg et al. (1998)).

## Appendix B. Alternative measures of pensioner poverty

Chapter 2 described a number of different methodologies that have been used to measure pensioner poverty. This appendix compares some poverty lines and the number of pensioners who are judged to be poor under some of these alternative methodologies. All of the estimates we compare (see Table B.1) have been calculated for slightly different times and to slightly different definitions, which makes the comparisons complicated. For this reason, they should be taken as indicative only.

**Table B.1. Alternative measures of pensioner poverty**

	60% AHC income (2001–02) <sup>a</sup>	Low-cost but acceptable (LCA) <sup>b</sup>	Maximum benefit award for pensioners claiming means- tested benefits (April 2001) <sup>c</sup>	Deprivation scores (1999) <sup>d</sup>
<i>Threshold (£, per week)</i>				
Single pensioner	91.00	91.00	96.00	n/a
Pensioner couple	165.60	139.00	144.40	n/a
<i>Proportion 'poor'</i>				
Single pensioner	23%	23%	26%	21%
Pensioner couple	23%	12%	15%	

<sup>a</sup> Expressed in average 2001–02 prices. *Source*: Family Resources Survey, 2001–02.

<sup>b</sup> Amounts given are budgets for homeowners, not including council tax and housing costs. Even after housing costs, homeowners are calculated to need a higher budget than tenants to avoid poverty, so these figures are at the upper end of the LCA budgets. Figures have been updated from January 1999 to 2001–02 prices. Proportions below the line are derived from the Family Resources Survey on the basis of 2001–02 AHC incomes. *Source*: Authors' calculations based on Parker (2000) and Family Resources Survey, 2001–02.

<sup>c</sup> Includes MIG together with winter fuel payments expressed in weekly terms. Expressed in April 2001 prices. Proportions below the line are derived from the Family Resources Survey on the basis of 2001–02 AHC incomes. *Source*: Authors' calculations based on information from the Department for Work and Pensions website ([www.dwp.gov.uk](http://www.dwp.gov.uk)) and Family Resources Survey, 2001–02.

<sup>d</sup> This is the proportion of respondents aged 65 or over who could not afford two or more socially perceived necessities in the 1999 Poverty and Social Exclusion Survey of Britain. Since there is no 'poverty line' for this sort of measure, there is no threshold to compare against the other methodologies. *Source*: Gordon et al., 2000.

Assuming the price of the basket of goods a pensioner needs to be able to afford to avoid poverty has increased only in line with inflation, Table B.1 shows that the LCA poverty line calculated using budget-standards methods (with housing costs and council tax deducted for comparability) is about the same as the 60 per cent median AHC line for single people, and quite a bit below this line for couples. The maximum benefit award for single pensioners claiming means-tested benefits is now above both poverty lines shown here for single people. However, for pensioner couples, it still lies below the level of the 60 per cent median AHC poverty line for couples, although it is above the LCA threshold for couples.

The proportions in poverty are similar under most of these methodologies, though the poverty rate amongst pensioner couples is lower when looking at benefit awards and the LCA line than when looking at the 60 per cent median AHC line.



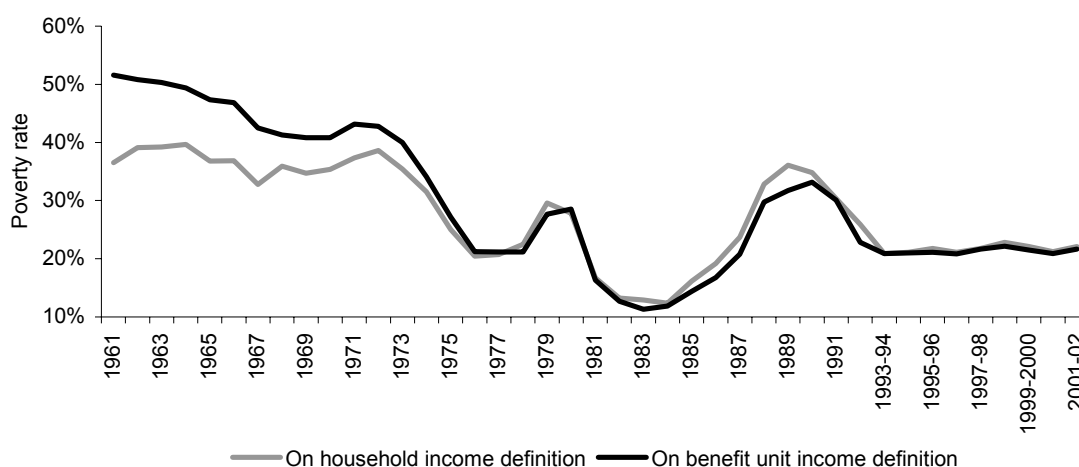
## Appendix C. Family rather than household incomes

Our analysis throughout this Commentary has focused on household equivalised income as the appropriate measure of individual welfare. Implicit in this is the assumption of complete income-sharing within each household. In practice, we would expect the degree of income-sharing within households to vary considerably and we would ideally like to capture this. Unfortunately, data constraints prevent us from doing so.<sup>38</sup>

An alternative assumption to adopt is that there is complete income-sharing *within* a benefit unit but no income-sharing *between* the different benefit units of a household. If this were the case, then the appropriate measure of individual welfare becomes benefit unit equivalised income. What this means is that if we have a couple of working age living with an elderly parent, then, as distinct benefit units, it is assumed that income is not shared between the couple and the parent.<sup>39</sup>

There is always a danger that results will be sensitive to the precise assumptions made. However, in the context of pensioner poverty, there is currently very little difference between the poverty rates under the two measures outlined above. The simple reason for this is that with relatively few pensioners living with their adult children, the two definitions almost coincide. This is shown in Figure C.1. Note that because housing costs, by definition, correspond to a household, we focus on BHC income measures.

**Figure C.1. Pensioner poverty under household and benefit unit income definitions**



*Note:* The definition of the poverty rate used is the proportion of pensioners falling below 60 per cent of median AHC income.

*Source:* Authors' calculations based on Family Expenditure Survey and Family Resources Survey.

<sup>38</sup> If expenditure data were available in the FRS, then in principle we could impute some form of income-sharing rule.

<sup>39</sup> An even more extreme assumption would be to assume that there is no income-sharing between individuals of the same benefit unit (i.e. within the couple, in the example in the text) either.

The difference between the two series in Figure C.1 reflects the changing composition of households over time, though the two series almost coincide since the mid-1970s. If we break these results down by the marital status of the pensioners, then we find that, historically, there have not been large differences between the two measures for pensioner couples. For single pensioners, the measures have converged, driving the pattern in Figure C.1. Around half of all single pensioners were living in multiple-tax-unit households (typically with their adult children) in the early 1960s, with this proportion falling to fewer than one in five (18 per cent) in recent years. Although the decline has not been as dramatic for pensioner couples, the downward trend remains, with the proportion falling from around 22 per cent at the beginning of the 1960s to its present value of little over 10 per cent.

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