

Spinning Pensioner Poverty Figures

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Introduction

Poverty statistics are a sensitive topic for governments and it is not surprising that there are many ways of measuring poverty, producing different rates and identifying different population groups as poor. This article considers variation in reported poverty rates in the UK and EU, using examples from statistics on older people's income; it challenges some of the statistics contained in the UK 2005 National Strategy Report on Pensions; and comments briefly on the Pensions Commission proposals.

The prevalence of poverty, like unemployment and hospital waiting lists, can be used as a political tool, the statistics spun to present a flattering picture of successful policies. If we are to make sense of poverty statistics, we need to know how they were produced, including the questions asked in the relevant surveys, what data was imputed, on what basis and what other assumptions were involved.

Recently the questions of pension adequacy has been much debated. The Pensions Commission Report (2005, the 'Turner Report') concluded that an immediate increase in the basic pension was unnecessary on the basis of current pensioners' income. But pensioner organisations and charities concerned with older people argue that the extent of pensioner poverty is unacceptable, especially among women. They campaign for a much improved basic state pension, indexed to national earnings. Because of the low level of state pensions, over half of pensioners receive means tested supplements, while as many as a third are eligible but do not claim. The means tested Guarantee Credit (£114 per week for a lone pensioner in 2006) provides an income that is still below poverty level. It is also below the minimum needed for older people to maintain health. This has recently been calculated as £122 per week for a lone pensioner and £192 for a couple (excluding rent and Council Tax). A healthy diet is calculated to cost at least £32 per week, but pensioners in the bottom 40% of the pensioner income distribution spend only £23 per week on average, thus risking their health (<http://tinyurl.com/leh35>).

Last winter, nearly 32,000 older people in Britain died from the cold. While state and private pensions are pegged only to inflation, the cost of fuel has increased much more than this. Other unavoidable costs have also risen faster than inflation. Between 2002-5, state pensions have increased by 2.2% pa while the average annual increases for utilities were: Water 3.2%, Council Tax 5.7%, electricity 8.0% and gas 12.2% (NPC 2006).

In terms of social participation, low income is a barrier for a large minority of pensioners. A recent study shows that a third of pensioners say they

cannot afford a day out with family or friends, nor to go out for a meal, spend an evening in the pub, entertain at home, nor pursue a hobby. Two fifths said they could not afford a holiday (Age Concern 2006).

In sum, the UK pension system has failed to protect many older people from poverty, jeopardizing their social networks, their well-being, their health and shortening their life. Individuals become poorer as they age, due to living expenses rising faster than pensions. Under current policy, the next generation of pensioners will fare no better. As the Pensions Commission (2004) concluded; *'The UK state pension system is among the least generous in the developed world.'*

For campaigners to argue their case effectively they need reliable information on the proportions of older people at risk of poverty or near-poverty; how these proportions vary according to the definitions of poverty; how pensioner poverty rates have changed over time; the extent to which pensioners have been excluded from state pensions due to past caring roles; how this is changing (or not) in later cohorts; and the cost of alternative policies. Such activity of and for vulnerable groups is an essential element of a democracy but is hampered by the lack of independent, robust and transparent statistics concerning pensioners' income, as discussed below.

In measuring income, findings may depend on whether weekly, monthly or annual income is recorded, how missing data are treated (whether omitted or imputed), whether and how weighting is used, which equivalence scale is used to adjust for household size, whether measurement is before or after housing costs and whether the assumption is made that household members share income equally. Where the latter assumption is used in statistics, as in the Pensioners Income Series produced by the Department of Work and Pensions, gender inequality of personal income cannot be assessed. For those aged over 65, the measured poverty rate rises if the analysis is restricted to those reporting they are 'retired'. Poverty rates are, of course, dependent on the income threshold chosen in defining poverty.

EU concern with social policies in member states

Within the last decade, poverty rates of vulnerable population groups – mainly children and pensioners - have been compared within the EU, giving the possibility of evaluating the relative success of social policies in the member states. However, cross-country research on pensioner poverty faces formidable obstacles in ensuring genuine comparability – notably the problems of ensuring that equivalent sources of income are included in each country, appropriate survey questions used and the same techniques applied in any weighting and imputation. Will the involvement of the European Commission help to ensure that suitable indicators are established and appropriate statistics produced for comparison of pension system performance?

Under the EU's Open Method of Co-ordination, member states signed up in 2001 to 11 objectives for social protection systems (mainly pensions), under the headings of adequacy, sustainability and modernisation to meet changing societal needs. Suitable indicators were to be developed to compare countries and to measure progress towards the objectives.

Under 'Adequacy', Member states agreed to:

Ensure that older people are not placed at risk of poverty and can enjoy a decent standard of living; that they share in the economic well-being of their country and can accordingly participate actively in public, social and cultural life;

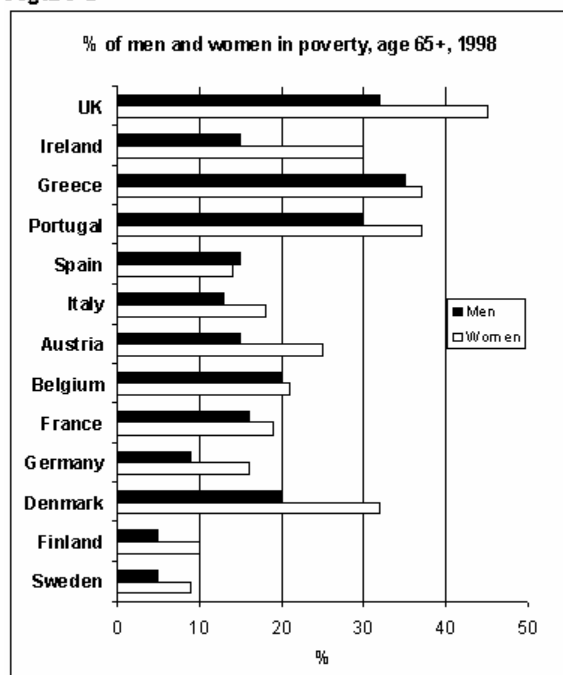
They also agreed that individuals must be able to *maintain, to a reasonable degree, their living standard after retirement*, that is, to have a sufficient income replacement rate.

Measuring poverty among older people

The main indicator of the 'at risk of poverty' rate is defined as the proportion of those aged 65+ with individual income less than 60% of national median income. Individual income for those living with others is based on household income shared equally among members and adjusted for household size.

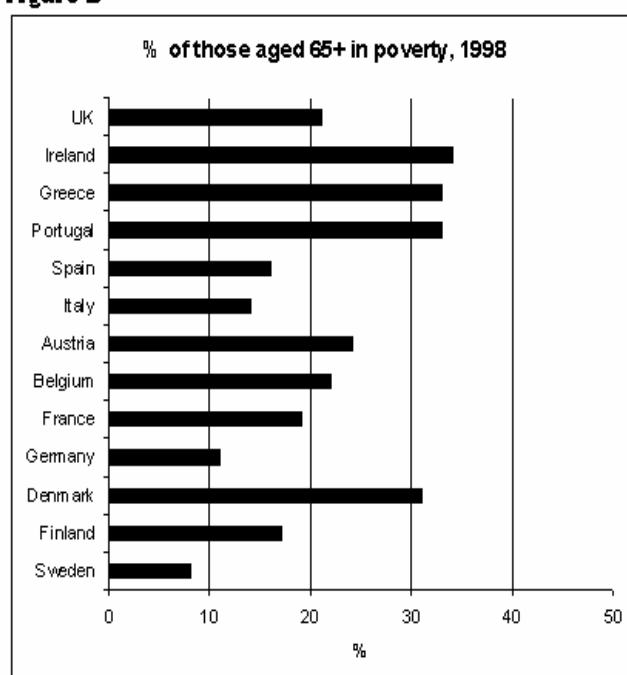
The first EU-wide cross-country data on pensioners' income was available in 1998, and was published by Eurostat (2001) using data from the European Community Household Panel (ECHP). The ECHP comprised all the national surveys carried out in the 15 EU countries, based on the methodology of the British Household Panel Survey (BHPS).

Figure 1



Source: Eurostat 2001. Based on ECHP 1998

Figure 2



Source: CEC 2003a, Table 2. Based on ECHP 1998

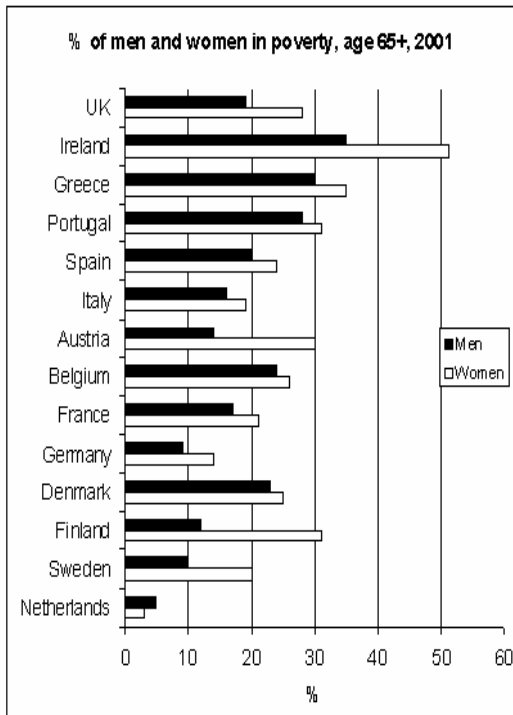
This comparison showed the UK with the highest poverty rate for older people in the EU - (see Figure 1). However, at the insistence of the UK government, the 1998 data were 're-worked' during 2002, almost halving the UK pensioner poverty rate (see Figure 2). Poverty rates were also changed in a few other countries, being reduced in Ireland and increased in Austria, Finland and Denmark. (Danish academics are sceptical about their country's increased pensioner poverty rate and the method of measurement used - personal communication). The UK poverty rate for older people was reported as 24% for 2001 and 25% for 2003 (see Figures 3 and 4 and Table 1). In interpreting the poverty rates in Figure 4 for the ten new member states, it is important to remember that it is older people's income relative to the rest of the national population that is measured. There is debate as to whether poverty should be measured relative to an EU-wide median household income. This would produce very high poverty rates in the new member states for almost all population groups.

Table 1 Summary: Poverty rate for UK population aged 65:

<u>Data</u>	<u>Men</u>	<u>Women</u>	<u>All</u>
1998 BHPS	32	45	38% (Eurostat 2001)
1998 BHPS	-	-	21%(CEC2003a, revised figure)
2001	19	28	24% (CEC 2003b)
2003 New Cronos database	-	-	25% (EOSS 2005)

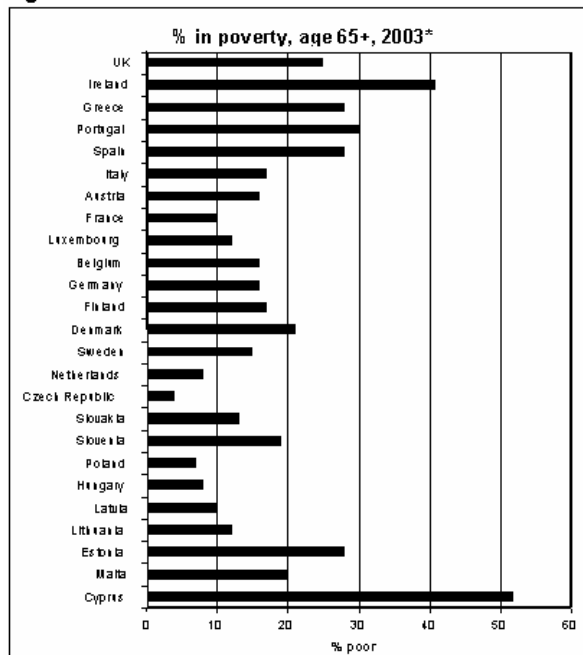
Source: Figures 1,2,3 and 4.

Figure 3



Source: CEC 2003b

Figure 4



Source: European Observatory on the Social Situation (2005), Figure 1.9.
* except FR NL SE LV LT HU PL SL (2002); IT PT (2001); MT (2000)

The poverty rates for those aged 65+ in the UK are summarized in Table 1. Why did the reported rate fall from 38% to 21%, using the same BHPS data for 1998? Perhaps there was some error in the Eurostat analysis that gave the very high poverty rates in the UK (32% for older men and 45% for older women). Independent analysis of the 1998 BHPS by a researcher at the University of Manchester showed that the poverty rate drops by about 10 percentage points if weekly income averaged over the previous 12 months is used (personal communication). This drop may be due in part to including the Winter Fuel Payment of £200 per household, introduced in 1997, in the annual income but not in the current weekly income. However, that would still leave a large gap between 30% and 21% to be explained. Could the 21% poverty rate depend on a particular method of imputing data or on how weighting factors were used? If so, how can pensions researchers, let alone the general public, know which figure – 38% or 21% – was closer to reality? Since there is no further information available to this author, readers must draw their own conclusions as to the ‘real’ poverty rate in 1998.

Minor adjustments in statistics would not be a cause for concern but the magnitude of the change in the pensioner poverty rate based on 1998 data undermines confidence in these statistics and raises questions about the reliability of subsequent reports of poverty rates.

Assessing EU pension systems in 2005

Each EU member state is expected to produce a National Strategy Report (NSR) on pensions so that progress towards meeting the common objectives can be monitored. Such reports were produced in 2002 for the EU15 countries and in 2005 to include the ten new member states that joined in 2004. The Commission of the European Community set up an Indicators Sub Group (ISG) to devise a suitable set of precisely-defined indicators for member states to use. Member states are also asked to define a target level of ‘pension adequacy’ for their own population.

Indicators for 2005 include:

1. Poverty rate for those aged 65+
2. Actual replacement rate
3. Theoretical replacement rate
4. Income inequality

1. **Poverty rate** (*proportion of those over 65 with median income less than 60% of median national income*). The figure reported in the 2005 NSR for the UK was 26% (DWP 2005). If the statistics were reliable, we might conclude that the pensioner poverty rate had risen from 21% in 1998 – an increase of five percentage points in 7 years of a Labour government.

Unlike other countries, the UK NSR provides no target for pension adequacy, stating that beyond the guaranteed minimum income, ‘it is for individuals and families to decide for themselves what income they wish to receive in retirement’. The first problem with this approach is that the full

(single) basic pension is now £30 per week below the guaranteed minimum and about £70 per week below the maximum amount at which eligibility for Pension Credit ceases. Thus a second tier pension has to be substantial in order to avoid means testing and many who have saved for their retirement find they are no better off than if they had spent their money in other ways. Second, the NSR statement assumes that all individuals have the opportunity to save and achieve a preferred level of retirement income. In particular, it ignores the impact of women's labour market disadvantages on their state and private pension entitlements (Ginn 2003). Third, the statement insults the half of pensioners who are eligible for means tested benefits, by implying they 'decided' to have a low pension income. How could they have foreseen the cuts in the basic and second tier state pensions implemented by both Conservative and Labour governments since 1980? How could workers have foreseen the collapse of stock market prices in 2000 and the subsequent losses in both money purchase and final salary pension schemes? Neither pension providers nor governments warned workers how insecure private pensions are. Indeed, as the Parliamentary Ombudsman recently concluded, in relation to the 85,000 workers who lost their pension as well as their job when their company collapsed, the government misled workers by encouraging them to remain in or join occupational pension schemes that were in fact under funded (Jones 2006). The uncertainties inherent in private pensions and the political interference in state pensions make it impossible for anyone to make rational decisions about retirement saving.

2. Actual replacement rate (*median income of retirees aged 65-74 / median earnings of those employed aged 50-59*). This is intended to provide an empirical measure of how far pensions maintain living standards in retirement, against which the theoretical calculation can be checked; 'the empirical measure can give, for some countries, an indication on how representative the current theoretical replacement rates are in respect of current generations of pensioners' (ISG, 2004: 2-3).

Despite the importance of the actual replacement rate in contextualising the theoretical rate (see below), it does not appear to have been calculated for the UK 2005 NSR.

3. Theoretical replacement rate (*simulated pension income in first year of retirement / average full time earnings in previous year*).

a) *Base case*. The assumptions to be used in simulating pension income for the base case were specified by the ISG (2005) as follows:

- 40 yrs full time employment, on average earnings throughout
- Most common pension second tier scheme for private sector employees
- Retirement at 65 in 2005
- Single status, male if there is a gender difference

In the UK NSR, assumptions were made that gave an unrealistic picture of income from second tier pension schemes (which include state,

occupational and personal pensions). The NSR calculated the replacement rate assuming a man with 30 years in a defined benefit (DB) occupational pension scheme, replacing 50% of final salary (see Table 2). This gave a total replacement rate of 66%, including state pensions.

Table 2 Theoretical Replacement Rates (gross) UK, from National Strategy Report 2005

a) Base case: 40 years FT employment in private sector on average earnings	
Assumes 30 years in final salary occupational pension scheme	
RR from basic state pension	17%
RR from occupational pension	50%
RR, total	66%
b) Interrupted career: 30 years on average earnings	
Final salary occupational pension scheme (20 years implied)	
RR from basic state pension	17%
RR from occupational pension	33%
RR, total	50%
<i>Source: DWP (2005) Appendix 2. Statistical information.</i>	

However, 30 years continuous membership of a final salary pension scheme is far from typical. A recent survey of employers' pension schemes finds that among private sector employees only 34% belonged to an employer's scheme in 2005, a decline from 38% in 2003 (McKay 2006). More important, however, is the fact that only a fraction of these belong to a DB scheme. The Pension Commission (2004: 98) shows that only about 25% of private sector employees belong to such a scheme. Although it is difficult to estimate years of membership from cross-sectional data, the NSR's leap from 25% actual current membership to the assumption of 30 years continuous membership is a heroic one.

A recent survey of 1,140 UK employees found that on average men's state and private pensions would replace 47% of final earnings. Among men belonging to a final salary pension scheme the expected total replacement rate would be a generous 81% but for those in a defined contribution scheme the replacement rate would be only 38% (Fidelity International 2006). Thus the distinction between a DB scheme and one based on defined contributions, where the eventual pension depends on stock market returns and annuity rates, is a crucial one.

The NSR's replacement rate is also considerably higher than that estimated by the independent Pensions Policy Institute (PPI 2003b). For a man with 44 years of full time employment on median age-specific earnings, contributing throughout to a private pension, the replacement rate on retirement at 65 is calculated as 42% (£202 per week).

Thus the two independent sources estimate a replacement rate for men as 47% and 42%, indicating that the NSR's base case man with 66% replacement is far from representative; A misleading picture is given of the adequacy of the British pension system for men.

b) Variant case: Interrupted career. Member states were also asked to calculate a replacement rate for variants on the base case, including an interrupted career of 30 years employment, intended to reflect more closely a woman's working life.

Again, the UK NSR assumed membership of a final salary occupational pension scheme, but this time replacing 33% of final earnings (which implies about 20 years continuous membership in 30 years employed). Including state pensions, the total gross replacement rate calculated by the UK NSR for the interrupted career is 50%.

As noted above, only 25% of private sector employees belong to a final salary scheme (Pensions Commission 2004: 98). For a woman to belong to such a scheme for 20 of the 30 years employed would be unusual, especially since about half of UK employed women work part time, where occupational pension scheme membership is lower than for full timers. Even for women with 20 years membership, lack of continuity and the need to transfer between private pension schemes would reduce pension entitlements.

The PPI (2003b) estimate that an illustrative woman would receive total pensions worth 32% of national average earnings (£154 per week). They assume she was employed for 35 years, of which 11 years were part time, on median age-specific earnings for hours worked and retiring at age 62 with 5 years of private pension contributions. While this is not strictly a replacement rate, it does suggest that somewhat less than 40% of final earnings would be replaced. The Fidelity survey estimated women's replacement rate as 40% of final earnings (Fidelity International 2006). Thus the NSR figure of 50% is an optimistic one for women.

The NSR comments that it 'does not show a "typical" or average theoretical replacement rate, although the assumptions made are reasonable'. We question whether the assumptions are 'reasonable' for individuals retiring in 2005. But they are even more unlikely to be reasonable in 2050, given the rapid retreat of British employers from pension provision. Most private sector employers are closing final salary schemes to new members and reducing their contribution rate, while some are freezing accruals for existing members. 'Between 2003 and 2005 there was a considerable reduction in the proportion of employees in open occupational schemes – from 16% to 10% in open defined benefit schemes and from six to four per cent in open defined contribution schemes' (McKay 2006: 1). Thus membership of final salary schemes is becoming the preserve of a small minority in the UK, mainly those in public sector occupations. If the

replacement rates calculated for 2005 are over-optimistic, the same rates for 2050 are simply incredible.

4. Income inequality statistic (*top 20th percentile / bottom 20th percentile*)

The NSR reports the pensioner inequality statistic as 4.03. It is difficult to interpret this in terms of pension policy without having a time series for the UK.

Neither the statistic for income inequality nor the poverty rate tells us which population groups are most at risk of poverty. Gender inequality is obscured in poverty rates by the assumption of equal income sharing among adult household members. Thus the personal poverty of partnered women, who generally have a much lower income than their partner, is rendered invisible. Research has shown how receipt of income support – a measure of poverty – varies with gender and marital status, as reported in a previous Radical Statistics article (Ginn 2004). Women are more likely to be poor than men, especially if divorced. Median individual income also varies with marital status, age group, previous occupational class and ethnicity (Ginn 2003). As individuals, women over 65 have only 57% of men's income (Arber and Ginn 2004) and prospects for the next generation of women are no better.

Despite the genuine efforts of the EC's Indicator Sub-Group to tease out strengths and weaknesses of national pension systems in the EU, the Open Method of Co-ordination has yet to prove its worth in terms of encouraging better state pensions where these are minimal. The statistical basis for cross-country comparisons leaves much room for improvement. The ECHP will no longer be used as a source for EU official comparative statistics and it is to be hoped that its replacement – the EU-Survey of Income and Living Conditions – will provide more reliable statistics.

Pensions Commission proposals

The Commission provided a comprehensive analysis of pensions in the UK, including acknowledging women's longstanding pension disadvantage (Pensions Commission 2004). Their approach was in line with the consensus among those most concerned with pensions policy (NGOs, academics and industry): What is needed is a higher, simpler basic state pension with less means testing and wider coverage for those with interrupted work histories (PPI 2006a).

The recommendations represent some improvement on current policy (Pensions Commission 2005). It is proposed that the basic state pension (BSP) be re-linked to average earnings from 2010, increasing the full BSP (above inflation) by £1.36 per week in that year. But since the full BSP is some £25 per week below the means tested minimum, this provides little or nothing for pensioners receiving means tested benefits and only a trivial gain for those who are not. It is suggested that, if and when feasible, the government might consider making the BSP universal for those aged over

75. But unless the BSP were increased to above the level of means testing, making it universal would bring no financial gain to the majority of older pensioners.

For those of working age, the recommendations would bring slightly more improvements relative to current policy. First, earnings-linking the BSP from 2010 would halt its otherwise projected decline, so that means testing would be maintained at about 45-50% of pensioners by 2050 – still very high by international standards, but preventing the rise to 80% that would occur if current policies were maintained. Second, a proposal to base future accruals of BSP on residence instead of employment would eventually bring equality between men and women in the BSP without the need for Home Responsibilities Protection. Third, the State Second Pension (S2P) would become more inclusive of carers. However, the proposal that S2P should gradually become flat rate by 2030 would have mixed effects for women. It would benefit the low paid, who are mainly women. But it would also deprive women of a carer-friendly defined benefit earnings-related pension, leaving them with no alternative to a private pension in which their opportunities to accumulate earning-related entitlements are much poorer than men's.

The proposed new National Pension Savings Scheme (NPSS) would provide a personal pension with lower charges, auto-enrolment, and the right to an employer contribution of 3 per cent of relevant earnings. A danger is that those employed in small and medium enterprises (mainly women) would be pressured by their employer to opt out of the NPSS. For those who remained in NPSS, the well-known drawbacks of personal pensions would apply: Market risk placed entirely on the worker, difficulty for low earners in affording the extra contributions on top of NI, disproportionately heavy pension losses for missed contributions in the early years and a lower annuity rate for women than for men.

The proposed rise in state pension age to 67-69, intended to limit costs, would be unfair to working class men and women because of their poorer health and lower life expectancy.

Overall, the Pensions Commission produced an excellent analysis but disappointingly cautious proposals for state pensions, even if these were implemented in full. Despite the rhetoric of paying attention to women's needs, the pensions problem for women – how to build adequate independent pensions while undertaking the essential tasks of childrearing and eldercare – persists because of the continuing inadequacy of state pensions.

New proposals from the Equal Opportunities Commission are more redistributive to those providing childcare or informal care to other relatives. These would largely remove means testing and would cost no more than the Pensions Commission's proposals (PPI 2006b).

Conclusions

The EU, through its agencies, aims to raise reasonable aspirations for affordable but better pensions by compiling cross-country comparative data from periodic National Strategy Reports. But there is some way to go in achieving comparability, partly because governments have an interest in defending their current policy as successful and may use statistics for this purpose. In the case of the UK, there is uncertainty over the pensioner poverty rate. But there is a suggestion of some rise in poverty since 1998, despite the use of mass means testing to counter the effect of cuts in state pensions. The official preference for private (occupational and personal) pensions continues, and the evidence that such pensions cannot fill the gap left by diminishing state pensions, especially for women and the low paid, is obscured in the National Strategy Report by assumptions that are unreasonably optimistic for 2005 and unbelievable for the future.

If there is to be an informed public debate on pension reform, reliable and gender-sensitive statistics on pensioner poverty and typical replacement rates are essential.

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