

**The Definition of Pensioner Units**

**The Pensioners' Incomes Series  
Methodological Paper No. 7**

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## **Executive summary**

All results in the Pensioners' Incomes Series (PI) are based on the "pensioner unit" level of analysis. This term refers to the 'benefit unit' or family that the pensioner lives in - typically a single pensioner or a pensioner couple. There are many ways in which pensioner units could be defined (as distinct from non-pensioner benefit units). This paper examines the current definition and looks at the main alternatives.

There are two main approaches to defining individuals as pensioners – the state benefit approach and the labour market approach. Due to the uncertainties surrounding the labour market approach, and to the high interest among users of the publication in people receiving state benefits for the elderly, the paper favours a state benefit approach. It is recommended that the PI Series continues to define individuals as pensioners if and only if they are over state pension age (SPA).

The definition of a "pensioner unit" depends on the status of all individuals in the family. The paper looks at whether couples should be defined as pensioner units if only one partner is over SPA. Under the current definition, those where only the man is over SPA ("male-pensioner couples") are included, but those where only the woman is over SPA ("female-pensioner couples") are excluded.

The paper finds that there are historical factors justifying the different treatment of these couples, and these are currently reflected in the different patterns of income between the two groups. However, there are some similarities, and the female-pensioner couples are likely to become more similar to male-pensioner couples (and pensioner couples in general) over time. Therefore, it is recommended that the current definition of pensioner units is retained, but the situation is monitored at regular intervals. For completeness, female-pensioner couples will continue to be analysed in a separate section of the PI publication.

## **Comments**

Any comments on this paper would be gratefully received:

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## **1. Introduction**

All results in the Pensioners' Incomes Series (PI) are based on the "pensioner unit" level of analysis. This term refers to the 'benefit unit' or 'family' that the pensioner lives in. Typically this will comprise a single pensioner or pensioner couple, but it will also include any dependent children living with them. It does not include other members of the household, regardless of whether or not they are related. Thus, average incomes in PI refer to the average per 'pensioner unit' or family.

This paper considers the definition of pensioner family units used in PI. The existing definition was based partly on historical factors and it has remained unchanged over the years in order to maintain a consistent time series. The paper considers whether the current definition is still appropriate in terms of:

- (a) the criteria used to define an individual as a pensioner, and
- (b) how the statuses of the individuals in the family are used to define it as a pensioner unit.

## **2. Current definition**

The current definition of pensioner units defines individuals as pensioners if they are over the state pension age (SPA). Single people over SPA are obviously defined as a pensioner unit. Couples are only defined as a pensioner unit if the man (defined as the head) is over state pension age. In summary, the definition includes:

- Single men aged 65 or over;
- Single women aged 60 or over;
- Couples (married or cohabiting) where the man is aged 65 or over.

### 3. Classifying individuals as pensioners

#### 3.1 The state benefit approach

State pension age was initially used to define individuals as pensioners as part of a **state benefit** approach. A significant part of the interest in pensioners' incomes revolved around the question of how the state provided for the elderly and how they could also provide for themselves. This is still very much the case, with pension reform high on the political and social agenda. The most common view of a 'pensioner' is of someone who is (to some extent) dependent on the state Retirement Pension (RP).

By defining all individuals over SPA as pensioners, we include all those receiving RP. Likewise, almost everyone who is included in this definition is receiving RP. The small number of people over SPA who are not receiving RP will typically be dependent on other state benefits for the elderly anyway.

There are other state benefits for the elderly that are based on different age limits and so do not fit as closely with the current definition of a pensioner unit. The most obvious example is Minimum Income Guarantee (MIG) – Income Support for the elderly – which is available to people on low incomes once they reach the age of 60. Defining all individuals over 60 as pensioners in the Pensioners' Incomes Series would be more comprehensive in including people on state benefits for the elderly. However, it would also include a large number of people who would not consider themselves retired – possibly working full-time and not drawing any form of pension.

An important consideration is which state benefits better 'characterise' perceptions of pensioners are. State Retirement Pension is the most prevalent (near-universal among those over SPA) and also represents the largest share of pensioners' incomes (£95 a week to those pensioner units in receipt in 1999/00). In comparison, income-related benefits (including MIG) were received by around a third of pensioner units in 1999/00 at an average of £45 a week.

Therefore, state pension age appears to be the most appropriate criteria for defining pensioners using the state benefit approach.

#### 3.2 The labour market approach

One disadvantage of the state benefit approach is that the definition based on age will inevitably include some individuals who continue working past SPA. The alternative approach is to look at **labour market** behaviour. Individuals could be defined as pensioners according to their attachment to the labour market, such that we only include people who have genuinely retired from work. This would exclude some people over SPA and include some people under SPA.

However, there are many 'grey areas' concerning retirement from work:

- An older person who has stopped work may be defined as a pensioner, but we cannot be sure whether they will return to work at a later point. This might include people who have stopped working on health grounds or because they do not believe that jobs are available ('discouraged workers').

- On the other hand, some people will have carefully planned when they stopped working and may rely on an income from private pensions or savings.
- A further complication is that retirement is not always a discrete change. Some individuals move from full-time work to retirement gradually, via part-time, temporary or irregular work. There is no obvious point at which these people should be defined as retired.

By using an arbitrary fixed level of labour market attachment to define a pensioner, many of the advantages of the labour market approach would be lost. A more flexible approach would be to use people's own perceptions of whether they have retired or not. This will help where people have a clear idea of when they retire, but there will still be uncertainty surrounding those who retire gradually and those who may return to work under different (unforeseen) circumstances. The subjectivity of this approach is also a major problem for time series analyses. Even if labour market behaviour remains constant, changing perceptions will influence our definition of pensioners, causing changes in income estimates over time that are to some extent 'artificial'.

Another alternative might be to use private pension receipt as a proxy for labour market attachment. This approach assumes that if someone is drawing their private pension (typically at a lower rate than if they had started receiving it at an older age), they are effectively retired, even if they maintain a reduced attachment to the labour market. However, this approach is also subject to many 'grey areas'. For example, not all early retirees will have a private pension. Some people may be receiving a private pension as part of a voluntary redundancy package, even though they are fully attached to the labour market in some other job. Some people may be receiving a small private pension which has little impact on their income, while their partner is still fully attached to the labour market.

### **3.3 Recommendation 1**

Using state pension age to define pensioners is imperfect, in that it includes some people who are still working and excludes some people who have retired. However, the labour market approach offers only a partial solution to this problem, while introducing inconsistencies of its own. In contrast, the SPA definition is much closer to the common perception of a pensioner as someone who relies (to some extent) on the state retirement pension. It is also more relevant for those users who are interested in pensioners' incomes in the context of social security policy.

This definition is based on objective and easily understood criteria, which will maintain a certain degree of consistency over time. Therefore, it is recommended that the Pensioners' Incomes Series should continue to define individuals as pensioners if and only if they have reached state pension age.

## 4. Classifying families as pensioner units

### 4.1 Current practice

Once each individual has been classified as a pensioner or a non-pensioner, we need to decide whether the family that they live in should be classified as a pensioner unit. In most cases, this is straightforward: all single pensioners, and couples where both partners are pensioners, should be classified as pensioner units. It is less obvious how to define couples where only one partner is over state pension age.

As mentioned above, the current definition includes couples where only the man is over SPA, but excludes those where only the woman is over SPA. In other words, there is a subgroup of women pensioners excluded from the definition. [For completeness these couples are analysed separately and included in a separate chapter of the Pensioners' Incomes Series].

For simplicity, couples where *only* the man is over SPA are referred to below as "male-pensioner couples" and couples where *only* the woman is over SPA are referred to below as "female-pensioner couples".

The reasoning behind the current definition was that the status of the family should be based on the 'head'. The income of the family was likely to be depend on the head – in particular whether the head was still working and whether the head was claiming state Retirement Pension. For many families, this reasoning still holds true today, but there is more uncertainty due to the increase in two-worker families.

An important aspect of the definition was that the head of a couple was always defined as the man. This was unavoidable because the man was automatically defined as the head of a couple in the source data (the Family Expenditure Survey, FES). But it was also consistent with the patterns of older pensioners' incomes at the time:

While there had already been significant increases in labour market participation among women, this tended to be among younger generations and so those couples reaching SPA still tended to be reliant on the man's earnings (before retirement) and pensions based on the man's contributions (after retirement).

Furthermore, the system of National Insurance contributions meant that for some couples pension income depended solely on the man's contributions, even if the woman also worked. The "married woman's opt out rate" (or "reduced rate") gave many women the opportunity to pay a reduced rate of NI contributions, while losing their own entitlement to state Retirement Pension. Their entitlement was then calculated on the basis of their husband's contributions.

Thus, in 1979, just 28% of female pensioners received a 'Category A' state Retirement Pension (i.e. paid on the basis of their own contributions).

Therefore, it is likely that the age of the man was a reasonably strong indicator of whether the couple was more reliant on earnings or pension income. This definition has been retained over time for consistency reasons, although the source data for more recent estimates (the Family Resources Survey, FRS) can now record either the man or woman as head of a couple.

## 4.2 The case for change

There have been significant changes in the labour market in recent decades. Labour market participation has continued to rise among women; each successive cohort tends to include more women who have worked for significant periods; and it is more common for both partners in a couple to work.

Furthermore, women are increasingly likely to earn pension income in their own right. Those who are working are more likely to contribute to an occupational pension. The married woman's opt-out rate was closed to new entrants in 1977, which means that women are now more likely to qualify for the state pension in their own right.

**Figure 1** shows that by March 2001, the proportion of women pensioners with a 'Category A' state pension (i.e. based on their own contributions) had risen to 44%. Furthermore, the proportion with 'Category ABL' pensions (i.e. based on a combination of their own and their spouse's contributions) had increased from virtually none in 1979 to 15% in March 2001.

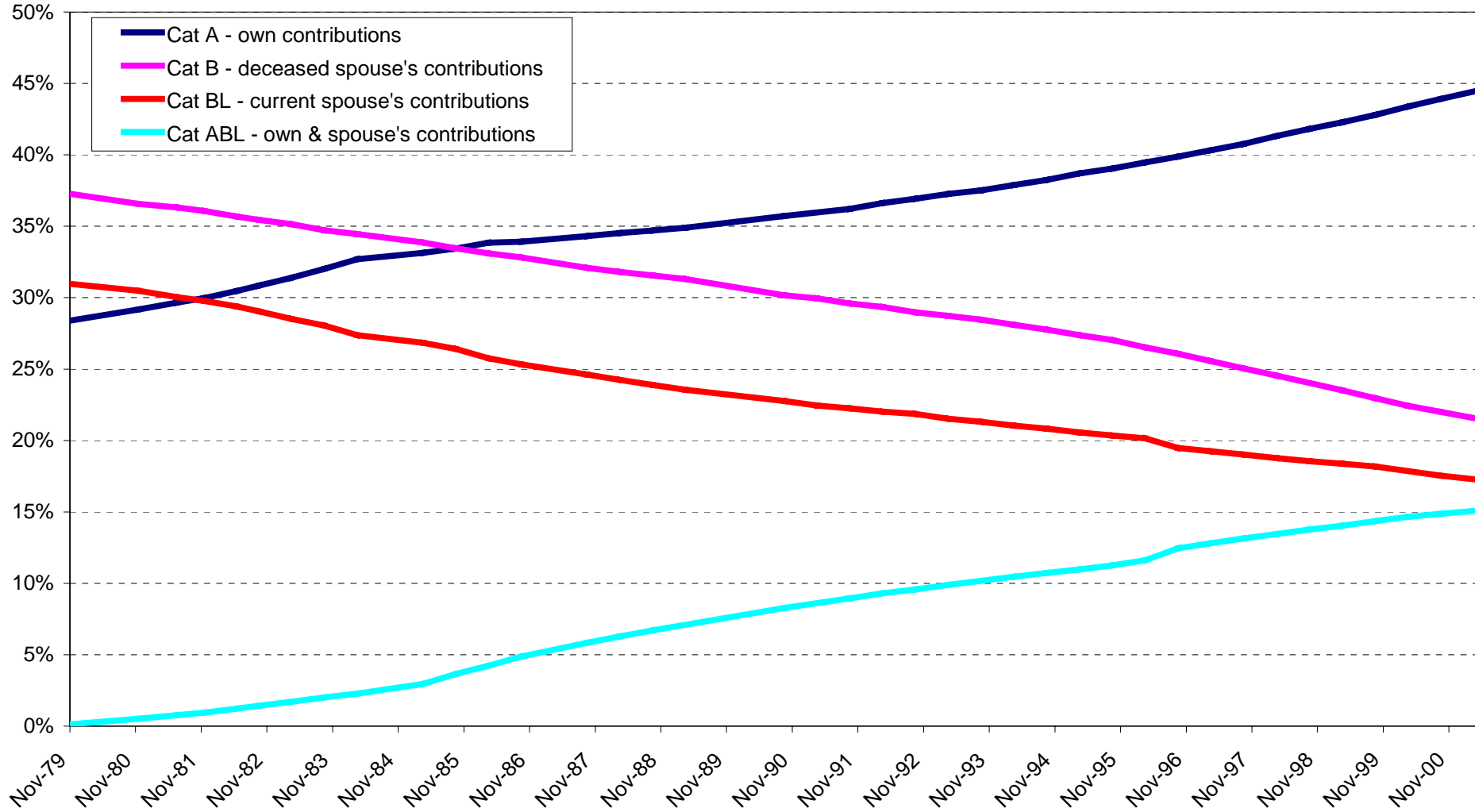
Clearly there is less justification now for defining couples as pensioner units based solely on the age of the man. However, it takes a long time for labour market changes to feed through to pensioners' incomes, so some justification for unequal treatment remains. Earnings and pension incomes are still higher on average for men in couples than for women. Also, the proportion of women pensioners receiving a state pension in their own right is still less than half (44%), with 39% receiving the state pension on the basis of their deceased ('Category B') spouse's or current ('Category BL') spouse's contributions (Figure 1). In contrast, over 99% of male pensioners receive a 'Category A' pension based on their own contributions.

The differences between men and women in state Retirement Pension receipt are likely to persist. Although closed to new entrants since 1977, some 340,000 women were still paying NI contributions at the reduced rate in 1995/6, and so were not accruing rights to RP. This included one fifth of women over 50, and more than a quarter of women over 55, who were making ('Class 1') contributions as employees. These figures do not include women under SPA who no longer work, but only made contributions at the reduced rate. So the numbers of women reaching retirement with no entitlement to RP in their own right will be even greater.

In the longer term, the impact of this historical factor will dramatically decrease. For example, in around 20 years time, the numbers of women making National Insurance contributions at the reduced rate (and not accruing rights to state Retirement Pension) will be negligible.

Therefore, it is not clear whether female-pensioner couples should be defined as pensioners. One way of examining this is to look at the sources of income for couples where only one partner is over SPA. The extent to which they rely on earnings or pension income acts as a rough guide as to whether they should be defined as pensioners under the state benefit approach outlined above.

**Figure 1: Women Retirement Pension recipients - by pension category**



**Figure 2** shows the gross income received from each source, for each of three groups:

- female-pensioner couples (currently excluded from the definition),
- male-pensioner couples (currently included), and
- couples where either or both partners are over SPA (including the two categories above).

Due to small sample sizes, these estimates can be subject to large random sampling fluctuations, so the results for two years have been combined and presented as an average over the period 1998/9-1999/0.

Occupational pension income is similar for all three groups, which in isolation might suggest that all groups should be treated as ‘retired’. However, it is not uncommon for people to start drawing an occupational pension before reaching SPA. Therefore, while receipt of occupational pension is an (imperfect) indicator of retirement using the labour market approach, it does not tell us much about whether people are retired under the state benefit approach.

Benefit income (the largest component of which is state Retirement Pension) for male-pensioner couples is very similar to the average for all couples including a pensioner. Female-pensioner couples receive a little over half as much benefit income as the overall average. The fact that a considerable number of these couples receive RP suggests that we should consider defining them as pensioner units. However, it is clear that their level of reliance on this source is much lower than male-pensioner couples, and the overall average.

This is borne out by the greater reliance on earnings among female-pensioner couples (25% higher than their ‘male’ counterparts). Both these groups had considerably higher earnings than couples as a whole. It could be argued that their higher earnings suggest that *both* groups should be excluded from the definition of pensioner units, but this is closer to a labour market approach than a state benefit approach.

One way of summarising these effects is to look at the *proportion* of gross income coming from each source (**Figure 3**). This shows a more gradual shift from the average couple including a pensioner (more reliant on benefits than earnings) through male-pensioner couples (with significant reliance on benefits and earnings), to female-pensioner couples (significantly more reliant on earnings than benefits).

### **4.3 Recommendation 2**

There are genuine historical reasons why female-pensioner couples have very different patterns of income to their ‘female’ counterparts – linked to labour market behaviour and the National Insurance contribution system. This is borne out in the incomes of couples currently in these groups, although there is evidence of the two groups becoming more similar as the impact of these historical factors dissipates over time.

Therefore, it is recommended that *at the current time* the definition of pensioner units used in PI should remain unchanged, i.e. including male-pensioner couples but excluding female-pensioner couples. The latter group should continue to be analysed in a separate section of the PI Series.

Figure 2: Gross income of selected groups of couples, 1998/9-1999/00

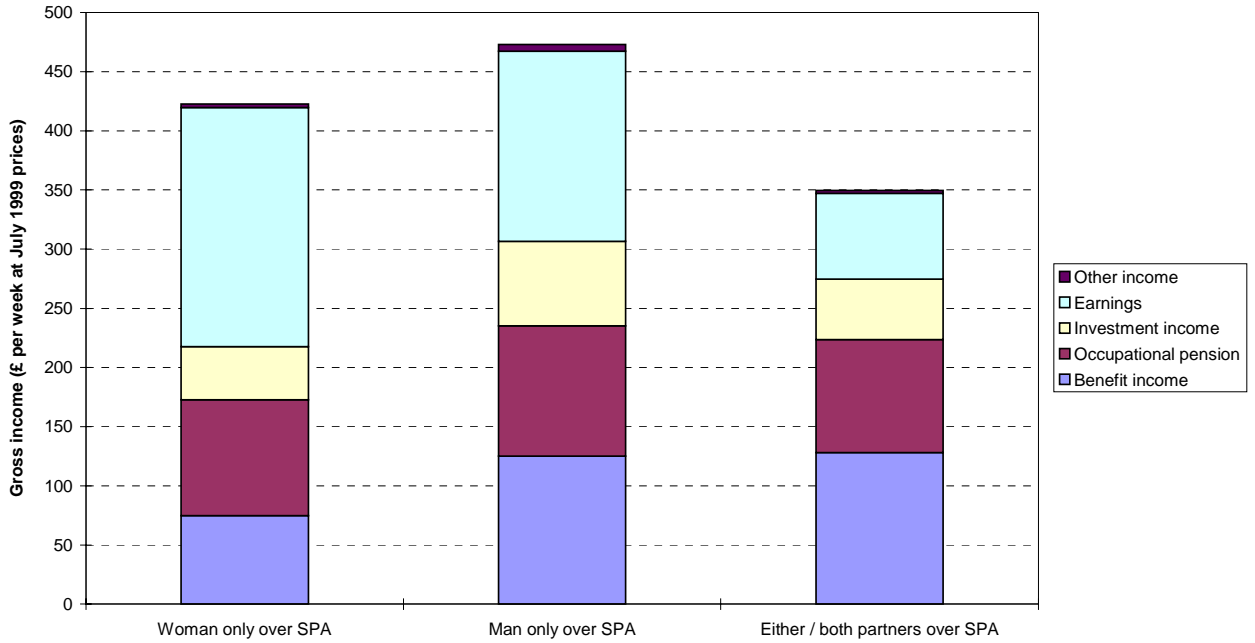
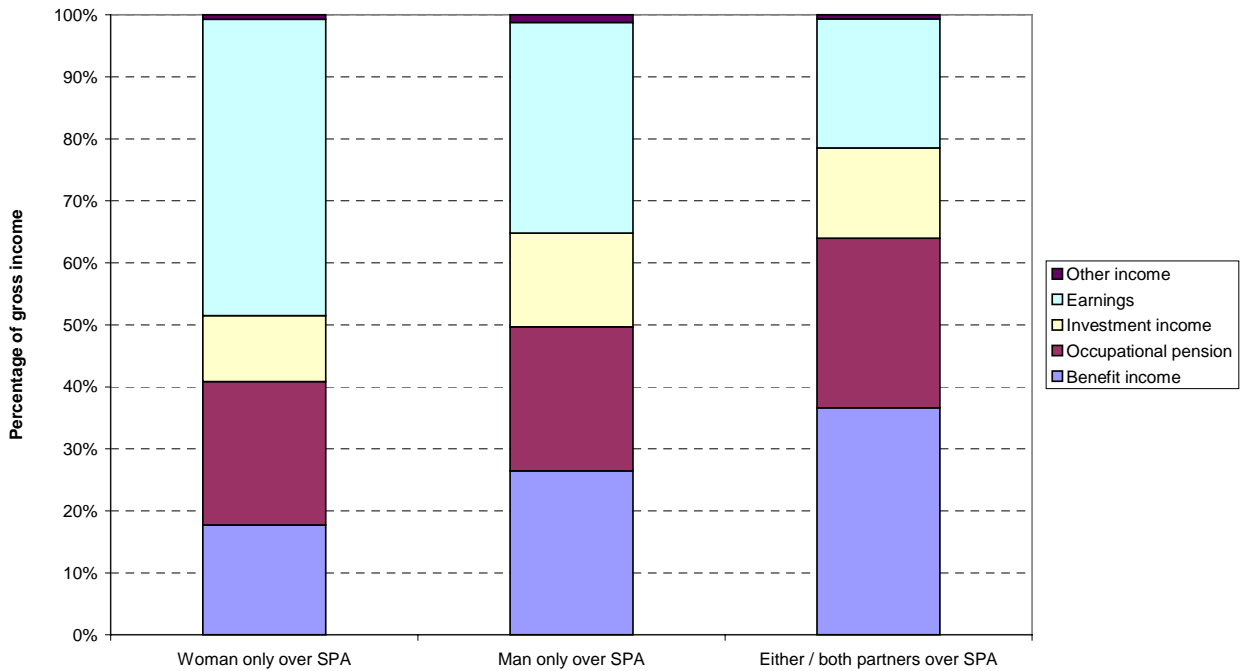


Figure 3: Gross income of selected groups of couples , 1998/9-1999/00



#### **4.4 Recommendation 3**

In each successive cohort of retirees, prior labour market participation will be more common among women and fewer women will have been able opt out of full National Insurance contributions. This will lead to much more similar patterns of income between male-pensioner couples and female-pensioner couples in future.

Therefore, it is recommended that the situation be reassessed at regular intervals (say every five years) until such time as female-pensioner couples can be included in the definition of pensioner units used in the PI Series.

#### **5. Equalisation of state pension age for men and women**

One further issue concerning the state benefit approach to defining pensioner units is the planned gradual increase in state pension age for women, from 60 to 65, between 2010 and 2020. This will not impact on the Pensioners' Incomes Series for some time, but we should be aware of the potential for problems in the future when deciding on the current definition of pensioner units.

Maintaining a definition based on state pension age would lead to a gradual reduction in the number of women defined as pensioners. This could affect estimates of changes in pensioners' incomes over time. Such changes will reflect a combination of changes in individuals' incomes and changes in the composition of the pensioner group. This has always been the case for the PI Series, however, with changes in average income influenced by the 'replacement' of older cohorts of pensioners by younger cohorts with very different characteristics.

On the one hand, income estimates will be a true reflection of what is happening to people dependent (to some extent) on the state Retirement Pension. Indeed, it is highly likely that women will change their labour market behaviour as a result of the change in SPA. On the other hand, changes in labour market behaviour may lag behind the changes to SPA.

Therefore, the potential analytical problems that will accompany the equalisation of state pension age do not favour any particular definition of pensioner units and so have not influenced the recommendations in this paper. This issue will clearly require more detailed analysis nearer the time.

#### **6. Summary of recommendations**

- 1. That the PI Series should continue to define individuals as pensioners if and only if they have reached state retirement age.*
- 2. That the definition of pensioner units used in PI should remain unchanged, i.e. including male-pensioner couples but excluding female-pensioner couples. The latter group should continue to be analysed in a separate section of the PI Series.*
- 3. That the situation be reassessed at regular intervals until such time as female-pensioner couples can be included in the definition of pensioner units used in the PI Series.*