

Introduction

The Government's White Paper proposals contain a new contributory principle intended to solve the problems of gaps in coverage and to give women a fairer entitlement to the Basic State Pension. This Briefing Note examines the reality of this new contributory principle and assesses how good a deal the proposals are for women.

The Government suggests their proposals are better than the Pensions Commission's proposals for a residency-based Basic State Pension because: personal responsibility will be promoted by retaining the contributory principle which has public support; reforming the contributory system is more practical; and, more women will benefit faster.

White Paper proposals

The White Paper proposes reducing the number of qualifying years required for full Basic State Pension (BSP) from 44 for men and 39 for women to 30 for all. The number of qualifying years needed for maximum State Second Pension (S2P) will increase from 49 to 52, as state pension age increases.

Technical changes are also proposed for ways in which credits are granted for BSP (Chart 1) and S2P to people not working. Some differences between the credit rules in the two pensions are removed¹. For example, credit is currently granted in BSP for someone at home caring for a child under 16 and in S2P only if the child is aged under 6. Credits will in future be given in both pensions in respect of children under 12. Credits for caring will be granted on a weekly rather than annual basis and the minimum required number of hours caring a week will be reduced from 35 to 20. All of these changes will apply overnight, for people reaching state pension age on or after 5 April 2010.

Chart 1: Summary of proposed changes to qualification for Basic State Pension

Basic State Pension	Before	After
Qualifying years	44 years for men and 39 years for women for full Basic State Pension.	30 qualifying years for full Basic State Pension.
Minimum contribution conditions	First contribution condition and 25% de minimis rule apply.	No minimum contribution conditions.
Credits for parents and foster carers	Home Responsibilities Protection available to a parent until the child turns 16 and to registered foster carers.	Weekly credits awarded until children turn 12 for Basic State Pension.
Credits for provision of care for the sick or disabled	State Pension protected through Carer's Allowance or Home Responsibilities Protection, where someone provides 35 hours weekly care.	Weekly credits available to those caring for 20 or more hours a week.

The new 'contributory' test: principle or practicality?

The contributory principle

The key reason the Government chose a revised contributory system over a residency test is that it *believe[s] the contributory principle promotes personal responsibility and positively rewards people's contributions to society*². Reward for 'social contributions' is increased, but the contributory principle is weakened by the reduction in the number of years contributions—cash or social—needed for a full BSP. Fewer people actually qualify for BSP each year (Chart 2 - because of the reduction in age for child credits to 12), but more people will get full BSP because fewer qualifying years are needed. If the system ever was an incentive to work, that incentive no longer exists once an individual has 30 qualifying years.

The Secretary of State believes that the contributory principle *commands overwhelming public support*³. However, evidence is mixed. Half of participants in National Pensions Day preferred a residency test with only one-third preferring contributory⁴. Two-thirds of another sample prefer a system where the more somebody contributes, the more they get back⁵. Other studies suggest that people might be positive about the idea of the contributory principle only because they think it is something other than it actually is: *'National Insurance' is still a good brand name....There is much to be said for a system that conveys this idea [of redistribution across people's lifecycles.] Given the imperfection of the system, this is close to saying that the system is a myth, but a useful myth for the population to believe in.*⁶

The White Paper proposals result in a number of anomalies that are incompatible with the contributory principle. For example: someone reaching state pension age (SPA) in 2009 who has 43 qualifying years would get less BSP than someone with 30 qualifying years reaching SPA in 2010. Individuals who have made voluntary contributions to the BSP will not see any additional benefit from having done so if they have 30 'compulsory' qualifying years. Individuals from overseas who work for short periods of time in the UK will now presumably accrue 1/30th of a full BSP for each year they work rather than 1/44th. The White Paper suggests similar anomalies as a reason not to move to a Citizen's Pension⁷. Any system to improve eligibility will have some perceived unfairness of this type.

So is the contributory principle still a useful rationale for a policy choice? The view that women should get the same state pension as men now seems generally accepted. So the research may reflect that the public are no longer interested in the contributory myth: they are more interested in a good state pension for all. If this is so, then policy choices can quite reasonably be made less on principle and more on the most practical way to achieve a near-universal BSP.

Which is more practical?

A near-universal BSP could be achieved with either a residency or a contributory test⁸. Different people will be excluded in each. For example, a parent caring for a child aged 13 and/or earning under the Lower Earnings Limit (£84 pw) would qualify under a residency but not the new contributory test.

Government stresses administrative difficulties with proving past residency, because there is no one database of residency records. However, National Insurance records would provide past residency information for most people, and other sources of self-certification (such as GP/NHS records or passports could be used for others). Future residency seems easy to record, for example by the addition of a postcode field in the National Insurance system.

To recognise any remaining difficulties past residency could be subject to a more lenient test (say, 10 years) compared to the test for future accrual (20 or 30 years have been proposed). This would be compatible with both the Pensions Commission's proposals to make the BSP universal immediately for the over-75s, and the existing Category D pension⁹.

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Or, the new 30 qualifying years rule could be used for past accruals on a contributory basis, while putting future accruals on a residency test; that is, implement both the White Paper and Pensions Commission's proposals to benefit both current and future pensioners.

No system is free from administrative difficulties. For example, the White Paper leaves for consultation how a system of certification will work to claim new carers' credits for each week that someone cares for 20 hours for more¹⁰. Who would certify hours each week? Would hours caring for more than one person all be counted?

Government and individuals may have different views on which system is more practical. Changing the existing system may be easier for a Government department to administer, but would not appear any easier to individuals trying to understand their state pension forecast. And, in particular, it may seem easier to the Department for Work and Pensions to reform the existing contributory system rather than use a residency test as residency decisions are the responsibility of another department¹¹.

Which gives the best outcome?

The Government's changes for eligibility to BSP will come in overnight in April 2010, so the benefit will be felt only by women reaching state pension age after then¹². The Pensions Commission's approach was based on making future accruals more generous. The different transition approach means that possibly 200,000 more women will get a full Basic State Pension by 2020 under the White Paper than under the Pensions Commission's proposal¹³.

However, the Commission's proposals for the over 75s which could have given around 840,000 of the oldest pensioners a full BSP for the first time¹⁴. This would have cost around £800 million in 2010¹⁵. The White Paper proposals are therefore better for women aged 45–60 than the Pensions Commission's proposals which would have been better for women over 60.

Chart 2: There will still be gaps in contributions

Number of working age people accruing a qualifying year for BSP/S2P under the current system and the White Paper proposals, UK, 2004/5

	Current system		WP proposals	
Basic State Pension				
Earning enough	24.2		24.2	
Caring for children	1.7		1.3	
Other caring	0.1		0.2	
Other credits	4.4		4.4	
<i>Not qualifying</i>	4.7	13%	5.1	14%
State Second Pension				
Earning enough	21.7		21.7	
Credits	3.7		4.7	
<i>Not qualifying</i>	9.6	27%	8.6	25%

The new 'contributory' test: principle or practicality?

While BSP becomes near-universal, a quarter of people will still not qualify for S2P each year (Chart 2). This matters as BSP is low: by 2012 only 14% of National Average Earnings. The new credits recognise around 1 million carers but the overall eligibility for S2P is little changed.

Gaps in S2P arise because although there will be 19 ways to earn a credit for BSP, only 7 of these apply to S2P¹⁶. Female employees (who earn less) are still less likely to qualify for high amounts of S2P than male employees, although men are more likely to miss out on S2P because of being self-employed.

The actual financial gain from the proposals for any individual will depend on the detail of his or her own circumstances. For some people, any extra pension received will mean less Guarantee Credit so they will be no better off overall. Some people will also lose out from the squeeze on Savings Credit.

The actual improvement in state pension money received for many individuals as a result of improvement to eligibility will be slight. This is demonstrated by the net cost of the reforms to eligibility criteria being a small part of the total White Paper reform bill – less than 10%¹⁷ – and by there being no additional money for improving pensions for current pensioners.

Summary

The Government is very clear that it selected its policy for the Basic State Pension primarily because it believes in the contributory principle. Yet the proposals weaken the contributory principle and the aim is near-universality anyway¹⁸.

Either a contributory or residency test could make the BSP near-universal. So making the choice based on which test is easier to administer and understand is not a bad approach, although there are different views on which test would be most practical.

As a result of the changes to eligibility for state pensions in the White Paper, the already closing gap between some women's and men's state pensions will close more quickly, but the real cash benefit for many women will be small.

¹ Department for Work and Pensions (2006 RIA) *Regulatory Impact Assessment* page 116

² See DWP (2006 WP) *Security in Retirement: Towards a new pension system* page 125 and John Hutton MP in uncorrected oral evidence to the Work and Pensions Select Committee, 7 June 2006, Question 282

³ John Hutton MP in uncorrected oral evidence to the Work and Pensions Select Committee, 7 June 2006, Question 282

⁴ DWP Feedback from National Pensions Day 18 March 2006

⁵ Kelly M (2006) *Public attitudes to pension reform* Department for Work and Pensions Research Summary

⁶ Hills J (2004) *Heading for Retirement? National Insurance, State Pensions, and the future of the Contributory Principle in the UK* in *Journal of Social Policy* pp. 353-4 Cambridge University Press

⁷ DWP (2006 WP) Box 3a page 118

⁸ Curry and Steventon (2006) *Transition Trade-offs: Options for state pension reform* PPI pages 20-24, PPI (2005) *Should earnings-related pensions be compulsory or voluntary?* and PPI Briefing Note Number 24 (January 2006) *Will coverage of the BSP improve over time?*

⁹ Curry and Steventon (2006) page 23

¹⁰ DWP (2006 WP) Paragraph 3.94 page 132

¹¹ See for example The Pensions Service (2005) *A guide to Pension Credit* page 67 concerning 'Right to reside' rules

¹² PPI Briefing Note Number 31 (June 2006) *The impact of the White Paper state pension reforms*

¹³ DWP (2006 WP) Paragraph 3.79 page 128

¹⁴ PPI analysis based on PQ David Laws *Hansard* 9 January 2006: Column 98W

¹⁵ Pensions Commission (2005) *Brief note on the cost to the Exchequer of the Pensions Commission's proposed reforms*

¹⁶ PQ Lord Oakeshott of Seagrove Bay *Hansard* 19 June 2006: Column WA62

¹⁷ PPI estimate based on figures in DWP (2006 WP) Figure 9, page 24

¹⁸ DWP (2006 WP) paragraph 3.74 page 125

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