

Introduction

Many recent reform proposals have called for an improvement in the first tier of state pension provision. These have tackled three different ways to improve the Basic State Pension (BSP): improve the coverage, increase its level, and maintain its relative value by indexing in payment to earnings¹.

This Briefing Note considers why coverage should be improved and the possible ways of achieving this. Reforming just the BSP level has limited impact if inadequate coverage means that there are still people who are not receiving the full benefit.

BSP coverage is incomplete

BSP is based on an individual's National Insurance contribution record. Entitlement is based on the number of years in which people 'qualify'. To receive a full pension men need to qualify for 44 years and woman for 39 (increasing to 44 by 2020). Partial pension can be paid to someone with fewer than the full number of years.

To be entitled for a qualifying year, a person must earn above the Lower Earnings Limit (LEL) in that year². In 2002/3, 20.2 million people qualified by earning enough to contribute (Chart 1)³.

A system of credits exists to 'count' people who do not contribute through earnings, but are

Chart 1: 5m people do not qualify for a contribution to BSP each year

The number of working age people who have accrued a qualifying year for the BSP by method of accrual (2002/3)

	Number of people (millions)		
	Qualifying through earnings	Qualifying through credits, including HRP	Not qualifying
Men	11.4	5.6	2.1
Women	8.8	6.2	2.8
Total	20.2	11.8	4.9
Total as a % of working age people	54.7%	32.0%	13.3%

deemed to be contributing in some other way. For example, credits cover people who are receiving certain benefits and/or caring for children or disabled people in certain circumstances.

11.8 million people qualified in 2002/3 through such credits or received Home Responsibilities Protection (HRP). Although HRP is not fully a credit, it reduces the number of qualifying years needed to get a full BSP.

The credit system has become very complex and does not include everyone. 4.9 million people did not qualify for the BSP in 2002/3.

Why there are gaps in coverage

There are rules to define who gets credited and inevitably some people fall into gaps without a

credit. For example, someone who cares for two different people, for 20 hours each week does not qualify for HRP. This is because HRP is granted when caring for one person for 35 hours each week. Someone who works in more than one part-time job, individually not paying enough for contributions to the BSP to be payable, would not qualify.

There are legitimate different points of view on where the line should be drawn to define a credit, for example, over how many hours someone would need to care. But the net result is that some people who may be considered 'deserving' do not qualify for BSP.

Due to the work-based nature of the BSP women have been disadvantaged as they have been more likely to take time off work for caring responsibilities

Will coverage of the Basic State Pension improve over time?

PPI Briefing Note Number 24

Page 2

and to work part-time. Even though a husband's record can be used to improve his wife's entitlement, currently only half of women over state pension age receive the full BSP, compared to 9 out of 10 men⁴.

As women increasingly participate in the labour market, it is often assumed that everyone will have full pensions in future. But PPI analysis of Government estimates suggest that even by 2020, up to 19% of people will not qualify in each year, and up to 40% will only qualify through the credit system (Chart 2)⁵. Even the most optimistic assumptions imply that only 67% of people qualify solely through earnings and 7% do not qualify at all⁶. This is reflected in Government projections of women, of state pension age in 2030, receiving on average only 88% of the full BSP (compared with men receiving 97%)⁷.

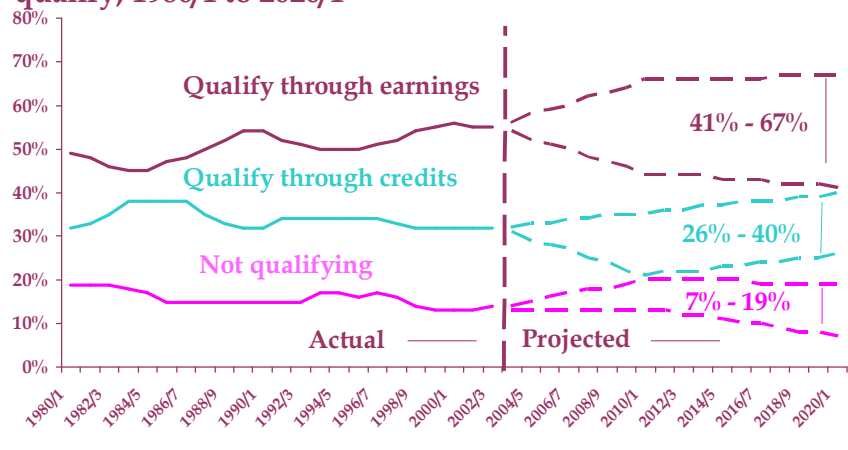
Various ways have been investigated to close the gaps

Incremental improvements could be made to the current contributory system, for example, by reducing the amount of earnings needed to qualify and/or expanding the credit system⁸.

Adding another layer of rules and credits would increase the complexity of the system. Gaps in coverage would remain, and it would be difficult to make such reforms retrospective.

Chart 2: In future, there will still be people who do not qualify for BSP

Proportion of working age people who qualify for BSP through earnings or credits, or do not qualify, 1980/1 to 2020/1



An alternative would be a citizenship or universal model, which would aim to give the same state pension benefit to every person over state pension age who passes a residency test.

This model provides the widest coverage, can be retrospective, and is easy to understand. However, concerns that this is too radical and questions regarding transitional practicalities and cost mean that reforming the current system may seem like the less risky option.

Is there a third way?

Coverage could be increased by reducing the number of qualifying years used in calculating a pension, from 44, to say, 20. This reform should be able to be made retrospective more easily than incremental improvements.

Some concerns and uncertainties would remain. How low would the reduction in qualifying years need to go to make a significant difference to the level of coverage? And is it necessary to retain complex rules and administration to determine eligibility for the BSP if the aim is for virtually everyone to become eligible?

¹£4,264 for 2005/6

²PPI (2005) *A commentary on the pension reform debate*

³PPI estimates derived from DWP (2005) *Contributions and Qualifying Years for State Pension 1978/79 to 2002/03*, the latest year in which complete figures are available. The chart shows entitlement only in one year but the BSP received depends on lifetime history.

⁴House of Commons *Hansard* 17 March 2005 Column 425W

⁵PPI estimates derived from DWP (2005) *Contributions and Qualifying Years for State Pension 1978/79 to 2002/03*

⁶Variation is due to potential overlap with those earning and receiving credits

⁷GAD (2003) *Government Actuary's Quinquennial Review of the National Insurance Fund*

⁸See PPI (2005) *Should state pensions be contributory or universal?*

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