Fiscal Studies (1996) vol. 17, no. 1, pp. 105-112

Should the Basic State Pension be a Contributory Benefit?

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I. INTRODUCTION

The basic state retirement pension is payable irrespective of means but it is a contributory benefit, *not* a universal benefit. Individuals who do not have enough National Insurance contributions when they reach state pension age are not entitled to a full state pension. They may receive a proportion of the pension or just the dependant's addition to a spouse's pension. This reflects the fact that the pension system in the UK, and the system of unemployment and sickness benefits, were designed around the *contributory principle*.

As Dilnot, Kay and Morris (1984) pointed out in their comprehensive review of social security policy, 'The Beveridge report took the contributory principle extremely seriously. Contributions were to be levied on an actuarially calculated basis to reflect the benefits received'. But 'the retreat from this principle has been comprehensive ... The National Insurance fund was reduced to meaningless accounting and the actuarial link between contributions and benefits abandoned'. In this strong sense, we have never operated a contributory principle.

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The authors would like to thank the Retirement Income Inquiry for funding the work on which this paper is based. Further details of the pension system can be found in the main report produced on the basis of that programme of work (Johnson, Disney and Stears, 1996). The authors would also like to thank Richard Disney and an anonymous referee for useful comments and the Central Statistical Office for providing Family Expenditure Survey data on which some of the analysis is based. All responsibility for interpretation of the data rests with the authors.

But there is also a weaker sense in which the contributory principle might be understood — just that receipt of benefit requires some link to payments made. This could be either in terms of a certain number of years of contributions or in terms of an amount of money paid in. In any case, it can only be meaningful if some people are excluded from the benefits offered by membership of the contributory club.

In this note, we argue that while among current pensioners significant numbers are (rightly or wrongly) excluded from the club because of their incomplete insurance records, changes to the system mean that within 30 years, the degree of exclusion will be minimal. *Any* relationship between contributions and benefits will have been lost and so, therefore, will any residual purpose of the contributory principle.

We start by looking at the current contributory conditions, move on to consider the pension rights of current pensioners and then look into the future to the situation that will face people retiring in 2020.

II. BACKGROUND AND CONTRIBUTORY CONDITIONS

The full basic pension, set at £61.15 per week for 1996–97, is paid to only 7 million of the 10 million people over state pension age. Almost all those who do not receive the full pension are women, largely married women who receive a 'dependant's addition' of £36.60 on the basis of their husband's contributions.

Entitlement to the full level of benefit depends on National Insurance contributions (NICs) having been made, or credits received, for about 90 per cent of a working life. A person's working life starts with the tax year in which he or she reaches the age of 16 and ends at death or in the year of reaching state pension age. This is equivalent to 49 years for a man and 44 years for a woman — though this will rise to 49 years between 2010 and 2020 as a state pension age of 65 for women is phased in. Contributions of 44 or more years (for men) and 39 or more years (for women) provide entitlement to the full basic pension.

Among earners, since 1978, Class 1 contributions on earnings of at least 52 times the weekly lower earnings limit (LEL) must have been paid in any tax year for that year to count as a qualifying year for the purposes of pension entitlement. Prior to that, when flat-rate contributions were in operation, at least 50 flat-rate contributions per year would have had to have been paid.

But many people not in employment at all can also gain entitlement. For example, credits equivalent to contributions at the LEL are available to individuals who sign on as unemployed or are recipients of a number of social security benefits, including unemployment benefit and invalidity benefit. Men over 60 but under 65 also receive automatic credits.

There are also special provisions for those who have caring responsibilities, primarily for children but also for the sick and disabled. The main provision is known as home responsibility protection (HRP) and it works by reducing the required number of qualifying years. So five years covered by HRP means that the number of qualifying years for a woman would be reduced from 39 to 34. The number of qualifying years cannot be reduced below 20. A year of home responsibility is any tax year since 1978 throughout which the person met one of a number of conditions. The main one is receipt of child benefit for a child under 16. Time spent looking after other dependent persons, largely the disabled, also counts.

It is important to note that it is only for years since 1978 that HRP has counted towards reducing the number of qualifying years. Prior to that, any year spent out of work and looking after children would have resulted in a loss of pension entitlement for that year. This is one of the major reasons for current female pensioners not being entitled to a full basic pension in their own right, especially given that the chances of women working while bringing up children were much lower in the past than they are now.

The other major reason for the current generation of female pensioners not having full rights to the basic pension is associated with the ability, prior to 1978, for married women to opt to pay NICs at a specially reduced rate known as the married women's rate of National Insurance. Payment at this rate did not confer rights to a basic pension. Women continuously employed since 1978 have been able to continue to pay at this reduced rate, but no new women have been entitled to start paying at it. Around half a million women continue to pay this lower rate. This number has fallen steadily since 1978, when 4.1 million women took advantage of the option to pay lower contributions.

III. WHO DOES NOT RECEIVE THE FULL PENSION?

There are two ways of considering the effects of the lack of full entitlement on current pensioners. The first is simply to describe from administrative statistics the numbers receiving and not receiving the full benefit. The second is to look at the effects of simply giving all pensioners entitlement to the full benefit. We look at each approach in turn.

In 1993, of 3.3 million male pensioners, 3.1 million were receiving the full basic pension. But of 6.1 million female pensioners, only 1.7 million were receiving the full pension on the basis of their own contributions. A further 1.8 million widows received the full pension as a result of their deceased husband's contributions. Of the remainder, 1.9 million were wives receiving only the dependant's addition to their husband's pension. About two-thirds of a million received some basic pension in their own right, but not the full amount. So whereas virtually all men receive a full basic pension, this is true of fewer than 60 per cent of women; and the majority of those are only receiving the full amount on the basis of contributions made by their deceased husband. These figures are set out in Table 1.

TABLE 1

Entitlements to Basic Pension[a]

Million

	Men	*Women on own insurance*	*Wives on husband's insurance*[b]	*Widows on husband's insurance*
Total number	3.3	2.4	2.0	1.8
Number receiving full amount	3.1	1.7	1.9	1.8
Number receiving less than full amount	0.2	0.7	0.1	<0.1

[a] These figures exclude individuals over pension age who receive no contributory benefit.
[b] Receipt of dependant's addition only.
Source: *Social Security Statistics 1994*, Table B1.09.

It is worth noting though that this pattern of receipt among women is changing. In 1979, only around 1.6 million female pensioners received any basic pension payment on the basis of their own contributions (2.4 million in 1993), while 1.8 million were wives dependent on their husband's insurance and about 2.2 million were widows on their deceased husband's insurance. The proportion of women with some receipt on the basis of their own contributions has risen steadily over that period.

This situation for current pensioners could simply be ended by giving them all full entitlement to the basic pension irrespective of their contribution history. A number of strong arguments have been put forward for putting in place such a 'citizen's pension'. For instance, those individuals who have had poor contribution records during their working lives tend to be poor pensioners in retirement; it would provide an independent income for women; and it would treat the current generation of retired women more like future generations who will be able to benefit from HRP. On the other hand, there are women who benefited from paying the reduced rate of NICs and it might be inequitable to treat them in the same way as those who paid the full rate of contributions.

Here we just consider the cost and distributional effects of introducing such a reform by modelling the change on the IFS tax and benefit model (see Giles and McCrae (1995)). If such a policy were implemented so that all pensioners received the equivalent of a full basic pension, the current cost of the retirement pension would increase by around £3.1 billion per annum. The total cost to the exchequer, once the reduction in means-tested benefits and higher income tax receipts were taken into account, would, however, be around £2 billion annually.

Such a policy would benefit spouses of those pensioners who are already relatively well off. Poorer pensioners, on the other hand, are likely to be left no

TABLE 2

The Distributional Effect of a Universal Citizen's Pension

Original weekly income	*Number in range (million)*	*Percentage gaining (%)*	*Average gain (£ per week)*
Below £10	2.7	11	1.60
£10–£99	3.0	23	5.80
£100–£249	1.2	31	8.00
£250+	0.6	34	7.55
All	7.5	21	4.85

Note: Original income is defined as all income before any taxes have been paid or benefits received.
Source: IFS tax and benefit model.

better off, as their income support payments would be reduced pound for pound for any increase in pension that they might receive. The distributional effects of a universal pension are shown in Table 2, where it can be seen that those pensioner benefit units with little or no original income gain on average much less than those pensioners who have larger amounts of original income. The table also shows that the proportion of pensioners benefiting from a citizen's pension increases with original income.

The costs and distributional impact of such a reform suggest that it is unlikely to receive support as a cost-effective way of spending money. One could think of numerous better-directed ways of spending £2 billion on pensioners.

IV. FUTURE POSITION OF WOMEN

This analysis, though, is just based on a snapshot of current pensioners. It should be clear from the description of contributory conditions that the position of women retiring in the future will be significantly better than that of those who have retired in the past, from the point of view of entitlement to the basic pension. This improvement will, nevertheless, take some time to pass through the system. The Government Actuary's Department (GAD) estimates that 70 per cent of women reaching minimum pension age in 1995–96 will have some entitlement to their own pension at an average rate of 73 per cent of the full benefit. Both these figures are significantly above the corresponding ones for the female pensioner population as a whole. GAD suggests that, in the future,

> the increase in past years in female activity rates, the phasing out of the married women's contribution option and the introduction of home responsibility protection mean that not

TABLE 3

Assumed Percentage of Women at Minimum Pension Age who have Their Own Entitlement to Retirement Pensions, and Average Rate of Entitlement as a Percentage of the Standard Rate

Year of reaching pension age	*Percentage with own entitlement (%)*	*Average rate of benefit (%)*
1995–96	70	73
2000–01	80	75
2005–06	90	78
2010–11	100	83
2015–16	100	88
2020–21	100	91

Source: Government Actuary's Department, 1995, Table D7.

only will more women be entitled to pensions based on their own contributions but also that the average rate of their pension will rise.

Table 3 indicates how GAD believes these rates will rise.

By 2020, it is expected that all women retiring will have entitlement to some basic pension at an average rate of over 90 per cent of the full rate. This will put them in a position that is not greatly different from that in which men currently find themselves; and, given the credits for time spent unemployed, the abolition of the option to pay the reduced rate of NICs and the effect of HRP, this gradual approach towards full coverage is not surprising.

The major remaining groups not covered by the system will be those earning below the National Insurance LEL who do not have children under the age of 16, those not in work and neither registering as unemployed nor looking after children, and those who have continued to opt to pay the reduced rate of NICs. Exactly how many people are in this position and who they are are hard questions to answer, given the available data, but some indications can be gleaned from the Family Expenditure Survey (FES).

Analysis of the FES suggests that, in 1993, there were around 600,000 childless women in employment and under state pension age earning less than the LEL. Half of these women were over the age of 50. There were a further 800,000 married childless women who declared themselves to be unoccupied. Some of them might have been looking after disabled relatives or other invalids, but this could not be easily determined from the data. Again, this was largely a relatively old group, with 80 per cent of them being over the age of 45. As we have already seen, there are also around half a million women still paying the lower rate of National Insurance, and these are bound to be largely older women.

These numbers are very small when set against the total of 16 million women under pension age. And the exclusions are becoming increasingly arbitrary. Why somebody earning £50 a week should be excluded from benefit when the unemployed are not is a question to which it is hard to find a coherent answer.

What is clear is that the effect of abolishing contributory conditions for those retiring in the future will be very different from the effect of a retrospective abolition for those already retired. The costs would be very small because so few people are predicted to lack full entitlement. Receipt of the flat-rate pension will bear no relation at all to contributions made. This calls into question the need for keeping the contribution records of all employees. The Contributions Agency, which administers these records, costs nearly £200 million a year to run.

V. CONCLUSIONS

Given the complex array of credits and protection for most of those out of the labour market, it is not surprising to find that the Government Actuary's Department is predicting that the position of women retiring in 25 years' time will, as regards entitlement to the basic state pension, be very different from the position of women retiring today. As with men today, the vast majority will be retiring with their own entitlement to a full basic pension.

This fact raises two questions. The first is 'what is the point in having a complex set of contributory requirements to determine eligibility for the basic pension when there are so many special provisions that virtually everyone becomes eligible, no matter what their employment and contribution history?'. The obvious alternative would be to get rid of the contributory requirements and make a certain number of years of residence in the UK the only requirement for entitlement to a full basic pension. It is clear that this would make only a trivial difference to future pension costs if it were introduced for years of residence from now.

The second question could be characterised as being about intergenerational equity. If women retiring in the future have better pension rights, not because of extra contributions, but because of more generous rules governing eligibility, is there a case for doing something about basic state pension payments to the currently retired? The answer to this is complicated by the fact that some of the currently retired women made the choice not to pay the full rate of NICs. The costs and distributional effects of such a policy also militate against its immediate implementation. But for the future, there seems to be no case for maintaining the fiction of a contributory benefit.

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