The history of state pensions in the UK: 1948 to 2010

IFS Briefing Note BN105

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The history of state pensions in the UK: 1948 to 2010

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Abstract

This Briefing Note describes state pension provision in the United Kingdom from the inception of the basic state pension in 1948, following the Beveridge Report, to Pensions Act 2007 and the plans of the Conservative/Liberal Democrat coalition government. The main objective is to provide a comprehensive description of the rules that currently determine pension benefits as well as those that have been in place in the past. However, we also provide a brief historical overview of the dilemmas facing policymakers when contemplating pension reforms and a summary of the most recent reforms. The history of the UK pension system is the story of a mainly non-contributory system, periodically tempted by the higher replacement rate of social insurance schemes, but always frightened once the costs become apparent. Recent reforms have tilted the system further in the direction of a universal flat-rate benefit, abandoning any social insurance design. This confirms that the main objective of the UK state pension system is to reduce poverty at old age. These flat-rate pensions will also reduce the reliance of the system on means-tested benefits, somewhat reinforcing the Beveridgean design of the system. Given these clarifications, it is unfortunate that the latest reforms have still sought to maintain much of the complex structure of the pre-existing system instead of reforming and rationalising it. However, once issues of transition have been dealt with, there may yet be scope for simplifying the presentation of the rules.

[*] This paper was funded by the ESRC Centre for the Microeconomic Analysis of Public Policy at the Institute for Fiscal Studies (RES-544-28-5001). The authors would like to thank Carl Emmerson for useful comments on an earlier draft of this Briefing Note and Judith Payne for copy-editing. All remaining errors are the responsibility of the authors.

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ISBN: 978-1-903274-77-4

Contents

'The scheme proposed here is in some ways a revolution, but in more important ways it is a natural development from the past. It is a British revolution.'

Sir William Beveridge[1]

1. Introduction

Pension provision inherently has a historical dimension. There is a gap of at least a few decades between the time contributions are first paid and the time benefits are received, with rights accruing in the interim. Then benefits are paid for another one or two decades according to rules that are usually no longer in place and forgotten to all but a few specialists.

It should be mentioned from the start that this Briefing Note is not a history of pension policy as it might be understood by historians or political scientists. The first objective is to provide practical information on pension rules to allow researchers, and especially economists, to be able to compute pension rights, measure incentives and assess the impact of pension provision on individual behaviour. As such, this document will not dwell on the political debate about pensions.

The UK system of support for pensioners that exists today is a complicated one, with four main components – the basic state pension (BSP), earnings-related benefits, flat-rate non-contributory benefits and means-tested benefits. Each of these has been tinkered with or reformed over time and, as new systems and rules have been introduced, entitlements under previous systems have sometimes been preserved. This means that individuals retiring today can still be affected by pension systems and rules that existed over 40 years ago. The pension benefits available to a given individual depend not just on their National Insurance contributions history but also, crucially, on the dates they made these contributions and the date at which they reach state pension age (SPA), which itself depends on the individual's date of birth.

Apart from producing complex and abstruse rules, the historical dimension of pension provisions has another, more important, consequence: any future pension reform is bound to depend on past choices. Much more than for any other public policy, pension provisions cannot escape the promises that were made in the past. When individuals are entitled to contributory benefits, it is not just the current system that matters, but also any previous systems under which an individual accrued an entitlement. This makes it all the more important to have a clear

[1] Beveridge, 1942, page 17.

overview of the long-term history of pension provisions in the UK since the major contribution of the Beveridge Report (published in 1942).

This Briefing Note will start by providing a very brief overview of the history of the UK pension system (Section 2). In short, the history of the UK pension system is the story of a mainly non-contributory system, periodically tempted by the higher replacement rate of social insurance schemes, but always frightened by their cost.[2]

Section 3 presents the features of the BSP – the cornerstone of the UK pension system since 1948. It discusses its ambivalent position as an apparently contributory scheme that offers flat-rate benefits with only weak links to contributions.

Section 4 looks at the various earnings-related state pension schemes that have been attempted and discusses their evolution towards flatter benefits. As these contributory state pensions have never provided all older individuals with sufficient income to avoid poverty, other (principally means-tested) benefits for pensioners have always played a significant role. Section 5 therefore considers the evolution of non-contributory, non-means-tested benefits for pensioners, while Section 6 describes the various means-tested elements that have been available to older individuals.

Section 7 discusses the changes to the various elements of the state pension system that are due to come into force over the next few years. Section 8 examines trends over time in state spending on payments to pensioners, including projections for the future, and Section 9 contains some concluding remarks.

As a companion to this Briefing Note, parameters of the UK pension system since 1948, including benefit levels, are available in an Excel file from the IFS website.[3]

[2] Private pension provisions are outside the scope of this Briefing Note, but readers keen on international comparisons should keep in mind the importance of this missing piece in UK pension provision. For more specific information on occupational pensions, see, for instance, Hannah (1986).

[3] http://www.ifs.org.uk/bns/bn105figs.xls

2. Overview of 60 years of state pensions in the UK

2.1 What are state pensions meant to achieve?

The public provision of retirement income can take many forms, as is evidenced by the variety of state pension schemes that exist around the world and even that have existed in the UK over the last 60 years. The form and design of public old-age provision depend largely on the motives behind state intervention. Public economists have long identified different rationales for such policies.[4]

First, one might want to avert poverty in old age. Older individuals might not be able to do paid work any longer and so they might have to rely on family support, charity or the state if they have insufficient savings to care for themselves. Depending on the reasons why individuals enter old age in poverty, state intervention might take different forms. If one thinks that they do so essentially because of myopia (in other words, they saved insufficiently during their working lives because they lacked self-control, underestimated their life expectancy or lacked the ability to plan appropriately), then public policy should seek to make some saving mandatory and introduce some form of annuitisation requirement.[5] If, however, one thinks that the poverty of older individuals is not the result of irrational behaviour but rather is the consequence of adverse shocks (which are difficult to insure against privately) or lifelong low incomes, then public intervention should take the form of means-tested income support or universal flat-rate benefits. Which system predominates will depend on the trade-off between the negative incentive effects of means testing and the high cost of universal coverage, which requires funding through higher taxes which typically also distort incentives in an undesirable way.

Second, one might want, as a policy objective, to ensure that all individuals have a decent replacement rate in retirement – in other words, that individuals' income in retirement is at least a certain proportion of the income they enjoyed while working. Failure to achieve such an 'adequate' level of income in old age might come from either myopia or market failures in insurance or financial markets. In either case, policymakers could use either mandatory retirement saving or social insurance in the form of earnings-related benefits (which can replicate mandatory saving provisions) to guarantee a minimum replacement rate for the covered

[4] See, for example, Creedy and Disney (1995) and Pestieau (2006).

[5] This is, in essence, the view of Singapore's Central Provident Fund, which imposes mandatory saving into funded pension funds.

population.[6] The advantage of a social insurance scheme over one of mandatory saving is that one can add some redistribution within the scheme based on lifetime earnings (rather than annual income, as happens with a traditional income tax and welfare system). In this case, the social insurance scheme can depart from the principles of actuarial fairness.[7]

The long-lasting dilemma over which is the most desirable form for the pension system can also be framed in a version of the traditional 'impossibility triangle' of anti-poverty policies: it is not possible to have a policy that removes income poverty without disincentives and at low cost. For instance, a universal flat-rate benefit can prevent poverty in old age with relatively little direct effect on incentives, but implies a large cost for the state.[8] By contrast, means-tested benefits prevent poverty at a lower cost (since they target those in need), but they can create strong disincentives for individuals to save (since they know the state will help if they cannot provide for themselves).

The history of the UK pension system is the story of one mainly designed to avert poverty at older ages, which has been at times tempted by the higher replacement rate of the earnings-related social insurance systems of its continental neighbours. This ambiguity about the objectives of the UK pension system, and the difficulty of balancing different objectives in the impossibility triangle, largely explain the complexity of the current system. The remainder of this section traces the history of the UK pension system and considers the objectives and rationale behind the introduction of its main components. The most recent reforms are also discussed, and some comments are made about how these will again alter the design and apparent objectives of the system.

2.2 In the beginning was Beveridge

The UK state pension system originally consisted only of means-tested non-contributory benefits that were introduced by the Old Age Pensions Act 1908 (Gilbert, 1966). The first contributory benefits scheme emerged in the Widows, Orphans and Old Age Contributory Pensions Act 1925. This scheme was not universal in coverage, however, and was only compulsory

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[6] Notional accounts in the form in place in Sweden since 1998 represent textbook examples of earnings-related schemes, based on actuarially fair design even in the case of unfunded schemes.

[7] This is roughly the rationale behind the social insurance schemes available in France and Germany, as influenced by Bismarckian design, though redistribution can also take place alongside notional accounts systems.

[8] To the extent that this cost must be met by raising taxes elsewhere, such a system would indirectly distort incentives elsewhere in the economy.

for manual and other low-wage workers. It was the 1942 Beveridge Report – *Social Insurance and Allied Services* – that marked a major break with the past because of the introduction of universal coverage based on a social insurance model.

From the outset, the objective was not to provide a high replacement income for most wage-earners but to provide a safety net against old-age deprivation. Beveridge's proposal was that individuals would be provided with a flat-rate income in old age that would be just sufficient to lift them above an absolute measure of poverty. This income was to be funded through contributions paid during working life. These contributions were to be calculated on an actuarially fair basis. In other words, the weekly amount paid would be that which, over the course of a working life, would finance the proposed retirement pension (and also finance the average expected incidence of sickness and unemployment, which were also to be insured through Beveridge's new system).

The National Insurance Act 1946 introduced the BSP, with effect from 1948, but right from the start it differed from the proposals of the Beveridge Report. Political considerations made it impossible to implement the fully funded scheme that Beveridge had envisaged because such a scheme made no provision for pensions for those already older individuals who had suffered through the Great Depression and contributed to the war effort. Faced with the significant immediate bill of paying pensions to individuals who had not made contributions, the government opted to introduce a 'pay-as-you-go' system rather than a funded one. Individuals paid contributions (known as National Insurance (NI) contributions), but instead of the level of these being related to an individual's own future pension benefits (as Beveridge had envisaged), they were related to what was needed to fund the benefits of current pensioners. Over time, the link between a person's contributions and the pension income that person receives has become even weaker, as NI rates are now set simply according to the overall budgetary needs and distributional objectives of the government and are not directly related to either future pension benefits or current pension funding needs.

The BSP is often called 'contributory' because entitlement to the pension requires individuals to satisfy some conditions on their NI contribution histories. However, since the pension benefit received increasingly depends very little on an individual's years of contributions and not at all on the actual *level* of contributions made, the pension cannot really be considered to be contributory in the usual sense. As a result, the BSP is not, whatever its appearance, a social insurance scheme. Its design and implementation are described in detail in Section 3.

2.3 The temptation of social insurance

The flat-rate BSP provided a basic retirement income, but because the level of this did not keep pace with growth in average earnings, a parallel system of private, earnings-related occupational pensions began to evolve alongside. Though these types of schemes had existed before the Second World War, they became much more prevalent afterwards – in the tight labour market of the post-war era, many more employers started to offer workers such pension promises. However, by the late 1950s, about two-thirds of employees remained dependent on the flat-rate state pension. This laid the ground for pressure on the state to provide an earnings-related top-up to the BSP for those who did not have access to an occupational pension.

The first earnings-related state pension to be implemented, in 1961, was the graduated retirement benefit (GRB).[9] The idea was that wage-earners would have to make mandatory contributions up to a certain level of earnings; these contributions would allow workers to buy 'units of pension' that would be convertible into a weekly income according to the value of these 'graduated pension units'. However, to reduce the cost, the government did not increase the nominal value of pension units between 1961 and 1978, despite cumulative inflation over this period of nearly 300%. Thus this social insurance scheme died almost at birth because of the government's refusal to accept its inherent cost.

GRB was superseded, in 1978, by the State Earnings-Related Pension Scheme (SERPS),[10] which in turn was replaced by the state second pension (S2P)[11] in 2002. The additional pension from these schemes meant individuals accrued different entitlements to a state pension depending on how much income they earned and when they earned it, moving the system away from one of flat-rate benefits. However, an important concern to each set of politicians involved in implementing and operating these systems was the implied future cost to the state of providing such pensions. As Hemming and Kay (1982) pointed out, the implied future cost of the original SERPS system did not appear to have been properly calculated by the government before the reforms were introduced in 1975. Once the true costs of the scheme became clear, subsequent governments sought to water down the commitments.

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[9] Graduated retirement benefit was introduced through the National Insurance Act 1959.

[10] The State Earnings-Related Pension Scheme was introduced by the Social Security Act 1975.

[11] State second pension was introduced through the Child Support, Pensions and Social Security Act 2000.

As a result of ongoing concerns about the costs of earnings-related pension schemes, the UK state pension system has never provided the high level of earnings replacement that has existed and continues to exist in many continental European countries, despite the introduction of schemes that were originally intended to do this before they were subsequently watered down. The details of these various attempts at earnings-related social insurance schemes are described in Section 4.

2.4 Means-tested benefits: mitigating relative poverty

The other major critique of the Beveridge Report is that it assumed that old-age poverty was an absolute income problem (as opposed to one of relative income). As incomes increased, the accepted minimum standard of living also rose and hence so too did the levels of benefit needed to sustain a 'subsistence' level. The cost implied by promising to pay all pensioners, now and in the future, a flat-rate income sufficient for them to avoid relative poverty was deemed too high, and the BSP fell below the subsistence level. This inability of the BSP to provide all pensioners with an adequate level of income means there has been a continuing need for means-tested benefits to ensure that pensioners are spared from relative income poverty.

These means-tested benefits were initially provided through National Assistance, when a single householder was entitled to means-tested benefits of £1.20 compared with the full BSP entitlement of £1.30. National Assistance was then replaced by supplementary benefit in 1966 and later income support (IS) and then the minimum income guarantee (MIG). In 2003, the government replaced the MIG with pension credit (PC). In 2009–10, a single pensioner is entitled to means-tested benefits of £130 through PC, compared with the full BSP entitlement of just over £95. These means-tested benefits are discussed in Section 6. Over time, these means-tested pensioner benefits have been supplemented by other universal pensioner benefits, which are discussed in Section 5.

2.5 Looking forward: toward a flat-rate state pension system?

The most recent set of reforms to the state pension system was the Pensions Act 2007. This made a number of important changes:

- The SPA is to be increased in order to improve the long-run financial viability of the system.

- Entitlement to the full BSP is to be made more widespread in order to reduce the number of pensioners relying on means-tested benefits. This is to be achieved mainly by reducing the number of years of contributions required to gain full entitlement.

- The BSP is to be increased in line with average earnings (rather than prices), which will halt the decline in the value of pensions relative to average earnings.

- S2P is set gradually to become a flat-rate benefit, which will, in the very long term, return the state pension system to something more like the flat-rate system suggested by the Beveridge Report.

In essence, the latest legislative changes have increased the coverage of the BSP and reduced the earnings-related nature of the S2P. Ultimately, both the BSP and the S2P will end up being near-universal,[12] flat-rate benefits, with the aim of reducing poverty for all pensioners, but departing from any objective of providing all individuals with a decent replacement rate. As will be seen in Section 7, if the planned policies are implemented in full, the reliance of the system on means-tested benefits will be reduced compared with what was implied by previous policy, but the system is also likely to be more expensive.

Alongside these proposed policies, the last government also built on previous initiatives by introducing additional policies to encourage individuals to provide privately a reasonable level of earnings replacement for themselves. Reforms along these lines, legislated in the Pensions Act 2008, include the introduction of 'automatic enrolment' by employers of most employees into a private pension.[13] Such policies could be considered to represent the first steps towards some form of mandatory private insurance.

In relation to the historical dilemma of the UK pension system between social insurance and assistance, recent reforms provide a relatively coherent approach. State pensions will be aimed at alleviating poverty in old age, while automatic enrolment into private pensions aims to curb myopic behaviour. However, these reforms still fall short of following this logic to its end, i.e. to abandon entirely the apparent contributory character of the state pensions. Once the transition phases are over, the futility and the administrative cost of presenting the UK state pension system as being in any way one of social insurance will be more obvious than at any time before.

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[12] The current plans do not imply a completely universal flat-rate state pension because it is still possible for individuals to spend too few years during their working lives engaged in activities that earn credit towards the BSP or the S2P. Examples of activities that do not earn credit towards the BSP and the S2P are living abroad, or being out of paid work and not receiving a qualifying benefit (such as those available for looking after young children, caring for a disabled individual, being unemployed or being disabled).

[13] For more information, see Emmerson and Wakefield (2009).

3. The basic state pension

The main benefit available to pensioners is the BSP, also known as the retirement pension, which was legislated for by the National Insurance Act 1946 and introduced in 1948. The general set-up has remained largely unchanged since its introduction, although some rules about how the pension benefit and entitlement are calculated have been changed over time.

3.1 Overview of the basic state pension

A BSP is payable on a weekly basis to an individual if they are over the SPA and have made a certain minimum number of NI contributions. The amount of BSP income received each week depends on how many years during an individual's *working life*[14] they have been credited with accrual to the BSP (activities that result in credits towards the BSP are discussed in Section 3.2).

If the individual has been credited with the *requisite number* of *qualifying years* out of their *working life*, they will receive a BSP at the full rate. If they have fewer *qualifying years* than this, a pension may be payable at a pro-rata rate. The pro-rata rate is found by multiplying the full BSP rate by the proportion of the *requisite number* of years for which an individual had a qualifying contribution record. This is shown in equation 3.1, where Y_{BSP} is the weekly BSP income to which the individual is entitled, *Rate* is the full weekly rate of the BSP, Q is the number of *qualifying years* already accrued and R is the *requisite number* of *qualifying years*.

$$(3.1) \quad Y_{BSP} = Rate \times \min\left[\frac{Q}{R},\ 1\right]$$

For those reaching SPA before 6 April 2010, a pro-rata pension is only payable if the individual is entitled to at least a quarter of a full BSP. This rule was reformed by the Pensions Act 2007 and, for those reaching SPA from 6 April 2010 onwards, this minimum contribution requirement has been abolished.

A BSP based on one's own past contributions is known as a category A pension. Over the last 60 years, the ways of building up entitlement to a category A pension have evolved (these are discussed in detail in Section 3.2). Individuals who are not entitled to a full BSP on the basis of their own

[14] There are numerous terms that appear in the state pension contribution rules, which are complicated and have been altered over time. These terms are italicised in the text of this document and are described in more detail in Section 3.2. Where they are defined in the text, the term is shown in bold italics.

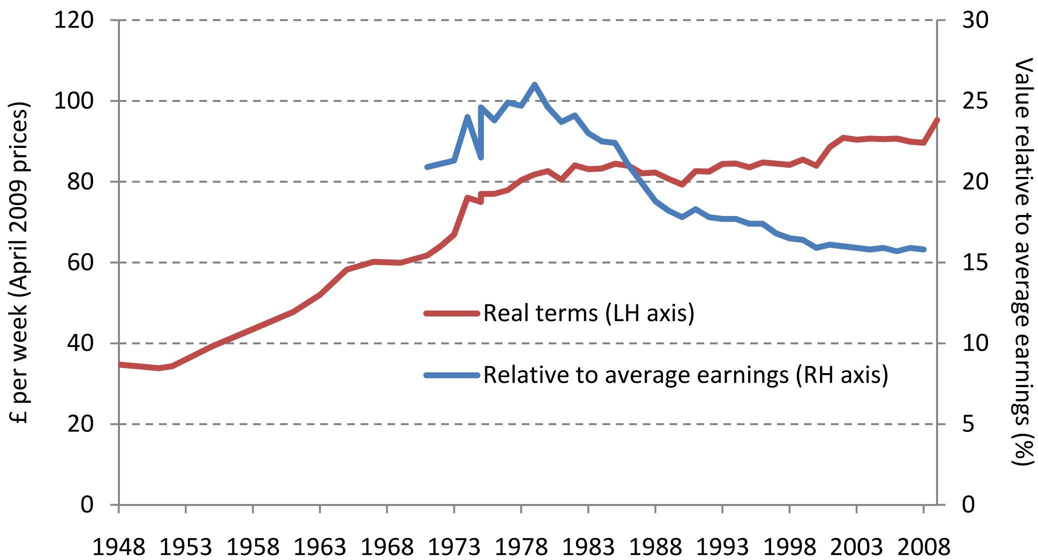
contribution record may instead be entitled to a pension based on their partner's record – a category B pension (this is discussed in Section 3.3).

An individual can increase their weekly pension income by deferring their pension (in other words, not starting to claim it as soon as they reach the SPA). The rules governing this are described in Section 3.5. An individual may also be entitled to some additions to their BSP if they have higher needs – for example, increases are payable for dependants and if the pensioner is aged 80 or over. These additions are explored in more detail in Section 3.4.

3.1.1 The level of the basic state pension

In its first year in payment, 1948, the BSP amounted to £1 6s per week (or £1.30 in new money, which is equivalent to about £34.72 in April 2009 prices). Regular uprating of the BSP was introduced in 1973. From 1975 to 1980, the state pension was uprated by the higher of national average earnings growth and price inflation. However, the Social Security Act 1980 changed this so that pensions were uprated, by default, only in line with prices thereafter. As national average earnings have risen faster than prices since 1980, the generosity of pensions relative to the incomes of the rest of the population has gradually been eroded; this is shown in Figure 3.1.

Figure 3.1. The level of the basic state pension deflated by growth in the price level and compared with average earnings, 1948–2009



Source: Department for Work and Pensions, 2009.

The full BSP rate is now usually increased once a year at the start of the new tax year in April. Since 2003, the government's policy has been to increase the state pension by at least 2.5%, regardless of the level of inflation. Up to 2009, the measure of inflation used (the annual change in the retail price index – RPI – to the preceding September) exceeded 2.5% every year in any case. However, in September 2009, the change in the RPI over the previous 12 months was –1.4%, meaning that the increase in the level of the BSP in April 2010 (from £95.25 to £97.65) will be higher than inflation.[15]

In response to the declining value of the BSP relative to average earnings and as part of the larger package of pension reforms, the Pensions Act 2007 made provision for the state pension to return to average earnings indexation. At the time the Pensions Act was passed, the intention was that this would be implemented by 2015 at the latest, and earlier if the government deemed it to be affordable. The Conservative/Liberal Democrat coalition government has now committed to increasing the level of the BSP by the greatest of growth in average earnings, RPI inflation and 2.5% every year from April 2011 onwards.[16]

3.1.2 State pension age

The BSP is payable from the SPA. The SPA is 65 for men and was 60 for women between 1948 and April 2010. Between April 2010 and March 2020, the SPA for women will increase by one month every month (by date of birth) until the SPA for women reaches 65 (this was legislated in the Pensions Act 1995).

The Pensions Act 2007 announced further increases in the SPA for both men and women in order to help ensure the financial sustainability of the state pension system in the face of increasing life expectancy. This was justified on the basis that longevity has increased significantly since 1948 and so it is not unreasonable to expect the length of *working life* to increase. The SPA is currently scheduled to be increased to 66 between 2024 and 2026 (again, one month every month), to 67 between 2034 and 2036 and to 68 between 2044 and 2046. These phased increases in the SPA are described in more detail in Appendix A. The Conservative/Liberal Democrat coalition government plans to hold a review of the appropriate date at which the SPA for men and women should start increasing to 66, with a view to bringing this forward from 2024; however, it has said that the increase would start no sooner than 2016 for men and 2020 for women.[17]

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[15] The government was forced to amend the provisions of the 1992 Social Security Administration Act in October 2009 to allow it to increase the level of the BSP in this way, even though RPI inflation was negative.

[16] HM Government, 2010.

[17] HM Government, 2010.

3.2 Entitlement based on one's own contribution history: category A pensions

As shown in equation 3.1, the amount of weekly (category A) state pension income that an individual is entitled to when they hit the SPA depends on the number of *qualifying years* accrued during *working life* and the *requisite number* of *qualifying years* for a full BSP, which depends on the length of their *working life*. This section defines each of these terms and explains how one can (and previously could) build up entitlement to the BSP.

For those reaching SPA before April 1975, there was one key condition (known as the ***first contribution condition***) that had to be satisfied if an individual was to be entitled to any BSP income at all: the individual had to have actually paid at least 156 weeks' NI contributions of any class before reaching SPA (104 weeks' if the insurance for pension began before 30 September 1946).[18]

For those reaching SPA between April 1975 and 5 April 2010, the *first contribution condition* can be fulfilled if the individual has paid:

- in any one tax year since 1978–79, class 1, 2 or 3 NI contributions on earnings equal to 52 times the NI lower earnings limit (LEL); or
- in any tax year from 1975–76 to 1977–78 inclusive, class 1, 2 or 3 NI contributions on earnings equal to 50 times the LEL; or
- at least 50 flat-rate contributions at any time before 6 April 1975.

For those reaching SPA from 6 April 2010 onwards, this contribution condition does not apply. These individuals instead only have to meet the conditions on the total number of *qualifying years* described below.

Certain special conditions applied to those who were within 10 years of pensionable age in 1948. These individuals were called ***late-age entrants***. Those who entered the previous scheme[19] before 30 September 1946 had to pay contributions for five years from their entry before qualifying for a pension. Those who entered the scheme after that date or those who first became insured when the BSP scheme began in 1948 had to pay contributions for 10 years. If upon reaching the SPA the qualifying period was not complete, they had a choice between (a) paying class 3

[18] See the HMSO series of *Everybody's Guide to National Insurance*.

[19] This was the scheme introduced by the Widows, Orphans and Old Age Contributory Pensions Act 1925.

contributions to make up the deficit and (b) claiming a refund with interest on the contributions.

For the purposes of BSP entitlement, a ***qualifying year*** is defined as:

- a tax year since 1978–79 in which an individual paid (or is credited as having paid – see Section 3.2.2) class 1, 2 or 3 NI contributions on earnings of at least 52 times the LEL;[20] or
- any tax year from 1975–76 to 1977–78 inclusive in which class 1, 2 or 3 NI contributions were paid on earnings equal to 50 times the LEL; or
- for tax years prior to 1975–76, the total number of flat-rate contributions divided by 50 gives the number of *qualifying years*. However, the number of *qualifying years* from this calculation cannot exceed the total number of years of *working life* before 1975–76.

Working life is defined as the period from the tax year in which the individual reaches the age of 16 to the year before the one in which they reach SPA or die (inclusive). Those who were already aged over 16 on 5 July 1948 had their *working life* measured either from 6 April 1948 or from 6 April of the year between 1936 and 1948 when (and only if) contributions were first paid.[21]

The ***requisite number*** of *qualifying years* for those reaching SPA before 6 April 2010 is approximately 90% of *working life* but varies with the length of *working life* as shown in Table 3.1. Since April 1978, individuals have been able to use home responsibilities protection (HRP) to reduce their *requisite number* of *qualifying years*, so that it excludes those tax years throughout which they were looking after children or, in some cases, caring for a disabled person – see Section 3.2.3. However, HRP cannot be used to reduce the *requisite number* of years below 20.

[20] Since 2000–01, an individual who earns at least the LEL (but not more than the primary earnings threshold) is deemed to have paid class 1 contributions. Self-employed people with sufficiently low earnings may be granted a Small Earnings Exemption by HM Revenue and Customs (formerly the Inland Revenue), meaning they do not have to pay any class 2 contributions; these individuals can, however, elect to pay class 2 contributions if they want to build up entitlement to the BSP.

[21] Therefore, at the start of the scheme (though not since), it was possible for young workers to have started contributing before they reached 16.

Table 3.1. Rules to compute the *requisite number* of years for those who reach SPA before 6 April 2010

Length of 'working life'	*Requisite number of years*
1–10 years	Length of *working life* minus 1
11–20 years	Length of *working life* minus 2
21–30 years	Length of *working life* minus 3
31–40 years	Length of *working life* minus 4
More than 40 years	Length of *working life* minus 5

Source: Social Security Act 1975, schedule 3, paragraph 5(4).

The Pensions Act 2007 reduced the *requisite number* of *qualifying years* for entitlement to the full BSP to 30 years for both men and women reaching SPA from 6 April 2010 onwards. This change in the *requisite number* of *qualifying years* was introduced in order to make it easier for individuals – particularly those with broken work histories, who are typically women with children – to qualify for a full BSP. It is hoped this will reduce pensioner poverty and the reliance on means-tested benefits.

So, to summarise, an individual will receive a full BSP if, upon reaching SPA, they have made (or have been credited with making) NI contributions during the *requisite number* of *qualifying years* of their *working life*. If they have made less than the required number of contributions, they will receive a pension income on a pro-rata basis, according to equation 3.1. For those reaching SPA before 6 April 2010, the minimum pro-rata BSP income payable is 25% of the full rate; this condition is being abandoned for those reaching SPA from 6 April 2010 onwards.

3.2.1 Married women's reduced rate (the 'half stamp')

Married women who were married before 6 April 1977 were allowed to elect to pay a reduced rate of class 1 NI contributions (or, if self-employed, not to pay class 2 contributions) if they were in work, in return for not building up any entitlement to a BSP in their own right. This is sometimes known as the married women's NI rate or the 'half stamp'. Any tax years during which a woman chose to pay reduced-rate NI contributions do not count as *qualifying years*. Women who married on or after 6 April 1977 were not able to pay reduced-rate contributions, and women married before 6 April 1977 had to have started paying reduced-rate contributions before 12 May 1977 in order to be eligible.

Even women who originally chose to pay reduced-rate NI contributions will lose the right to continue doing so if:

- they get divorced or the marriage is annulled; or
- since 6 April 1978, there are two consecutive tax years during which they have not:

- paid, or been treated as paying, class 1 NI contributions, or
- been self-employed at any time.

3.2.2 Credits for non-paid work activities

It is possible to earn or buy credits towards BSP entitlement even during periods when one is not paying NI contributions as a result of being employed or self-employed. The Social Security (Credits) Regulations 1975 introduced a provision to credit individuals with earnings in periods when it was felt they had an 'acceptable' reason for not making contributions, in order that their pension entitlement should be protected. These regulations have been subject to several amendments over time, changing the credits from annual to weekly, adding credits for new activities and removing others. Some of these credits credit earnings at the LEL level (and constitute a class 1 NI contribution), others are credited as a class 3 contribution – the distinction is unimportant as far as final BSP entitlement is concerned. Weekly credits can be combined with weeks of contributions from earnings in order to create a full *qualifying year*. Women paying NI contributions at the reduced rate (see Section 3.2.1) are not entitled to *earnings credits*. A full list of the *earnings credits* currently available is provided in Appendix B.

For those reaching SPA before 6 April 2010, these credits cannot be used to meet the *first contribution condition* (outlined at the start of Section 3.2).

Finally, if an individual has a week during which they are neither paying class 1 or 2 NI contributions as a result of being in employment or self-employment nor engaged in an activity that will earn them credits (as described above), they can choose to pay class 3 NI contributions instead in order to improve their contribution record.[22] Class 3 contributions are paid at a flat weekly rate. These class 3 contributions can be used to meet the *first contribution condition*. Prior to the Social Security (Contributions) Regulations 2001, it was possible to pay class 3 contributions retrospectively at any time in order to fill in previous gaps in one's contribution record. However, since 2001, individuals usually have only six years from the end of the tax year in question in which to make class 3 contributions retrospectively, although there are some exceptions to this six-year limit:

- Additional class 3 contributions in up to any six past tax years from 1975–76 onwards, if the individual reaches SPA between 6 April 2008 and 5 April 2015 and already has 20 *qualifying years* or HRP. They have

[22] Women who were paying reduced-rate NI contributions during the whole of the tax year in question are not allowed to pay class 3 contributions to improve their contribution record for this period.

until six years after reaching SPA to make these retrospective contributions. (For those reaching pension age before 6 April 2010, at least one of the 20 *qualifying years* must consist of paid, rather than just credited, contributions.) This provision has been in place since 6 April 2009.[23]

- Class 3 contributions relating to the tax years 1996–97 to 2001–02, if the individual did not receive notice before 1 November 2003 that they were entitled to pay these. If they reached SPA before 24 October 2004, they have until 5 April 2010 to pay. If they reach SPA on or after 24 October 2004, they had to pay these by 5 April 2009.[24]

- Voluntary class 2 and 3 contributions for the tax years 1993–94 to 2007–08, if credits that were awarded to an individual as a result of an official error were removed from their record on or after 1 July 2007. The time limit for payment of these missing contributions is extended to 5 April 2014.

It is also possible to make voluntary class 3 contributions on behalf of a deceased individual, provided they would have been able (according to the above-outlined regulations) to make them on their own behalf were they still alive. This can be used to increase the rate of BSP received by the surviving partner.

3.2.3 Home responsibilities protection

Many individuals, particularly women, spend significant periods of their *working lives* caring for children. This is one of the notable activities for which one does not earn credits towards BSP entitlement in the way described above. Instead, from the 1979–80 tax year onwards, complete tax years during which one is caring for a child (or disabled person) qualify for home responsibilities protection. This section describes how HRP operates and the changes that have been legislated for for those reaching SPA from 6 April 2010 onwards.

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[23] See paragraph 135 of Pensions Act 2008. Any contributions paid on or before 5 April 2011 will increase BSP income from the date the individual reaches SPA (with back-payments being made if the individual reached SPA before this date). However, any contributions paid after 5 April 2011 will only increase BSP income from the date they are paid onwards (or from the individual's SPA, if this is later).

[24] Regulation 50(A) of the Social Security (Contributions) Regulations 2001, No. 1004; regulation 6A of Social Security (Crediting and Treatment of Contributions, and National Insurance Numbers) 2001, No. 769; Social Security (Contributions) (Amendment No. 3) Regulations 2004.

Those reaching state pension age before 6 April 2010

For those who reach SPA before 6 April 2010, a year of HRP is any tax year between 1979–80 and 2009–10 (inclusive) throughout the whole of which the individual was precluded from regular employment and:

- received child benefit for a child under 16; or
- received income support on the basis of caring for a disabled person; or
- spent at least 35 hours a week, 48 weeks a year caring for a person receiving a qualifying benefit (attendance allowance, the middle or highest rate of disability living allowance, or constant attendance allowance paid with an industrial or war disablement pension); or
- was an approved foster parent (from 2003–04).

Individuals entitled to HRP have these years of HRP deducted from their *requisite number* of years (see Table 3.1), unless their earnings for that year were in any case at or above 52 times the LEL. This reduction cannot, however, lead to a *requisite number* of years below 20 years or half of what it would otherwise have been, whichever is lower.

Women are not entitled to HRP for any year in which they pay reduced NI contributions. By paying reduced NI contributions, they are choosing to accrue a pension entitlement based only on their husband's contribution record. Since their own contribution record is now irrelevant, they are deemed not to need HRP to protect their pension entitlement (see Section 3.2.1 for details of eligibility to pay reduced-rate contributions).

Those reaching state pension age from 6 April 2010 onwards

For those reaching the SPA from 6 April 2010 onwards, HRP years accrued in tax years up to 2010–11 will be converted to class 3 credits (up to a maximum of 22 years). These will then constitute *qualifying years* rather than being used to reduce the *requisite number* of years for the BSP. Particularly for those (often women) who have a large number of years of HRP but few years of earnings, this change could significantly increase the amount of BSP to which they are entitled.

To illustrate this point, take the somewhat extreme example of a woman who has 19 years of HRP but has never been in paid employment. Under the old system, she would have her *requisite number* of years reduced by 19, but she would still not be entitled to any BSP because her total years of NI credits (zero) divided by her *requisite number* of years (20) is still equal to zero. In contrast, under the new system, she will now earn 19 years of credits; her BSP entitlement is therefore equal to her total number of credits (19) divided by the *requisite number* of years (30, for those reaching SPA from 6 April 2010), which is equal to 63% of a full BSP.

In order to make the system more flexible, for tax years from 2010–11 onwards two further changes will be made to the system for HRP:

- HRP will be received as a weekly (class 3) credit rather than requiring an individual to qualify for an entire tax year.
- These weekly credits will be able to be combined with weekly contributions from earnings to create full *qualifying years*. The maximum number of tax years that a person can be credited with contributions is 22.

Both of these changes will make it easier for individuals to accrue *qualifying years* for the BSP.

The rules for entitlement to HRP will also be changed slightly. From the 2010–11 tax year onwards, HRP will be received if an individual is not in regular employment and is:

- awarded child benefit for a child under the age of 12 for any part of that week; or
- a foster parent for any part of that week; or
- engaged in caring for a sick or severely disabled individual for 20 hours or more in that week.

The first of these changes will actually reduce the number of people who can qualify for HRP, since at the moment an individual can qualify for HRP if they are receiving child benefit for a child under the age of 16. The third condition, however, reduces the stringency of the requirement to qualify on the grounds of caring for a sick or severely disabled adult.

3.2.4 Improving one's own record

If an individual does not have full entitlement to a category A pension based on their own contribution record, even after taking into account credits and HRP (as described in Sections 3.2.2 and 3.2.3), the contributions of a deceased spouse or civil partner – or of a divorced spouse or former civil partner where the partnership has been dissolved – may be able to be used.

The contribution record of a deceased/former spouse/civil partner can be used if:

- the claimant has been married (or in a civil partnership); and

- in respect of the tax years up to and including the year the marriage or civil partnership ended (through death, divorce, dissolution or annulment), the claimant does not satisfy the contribution conditions for a category A pension based on their own contributions; and

- the claimant did not remarry (or form a new civil partnership) before reaching the SPA.

The contribution record of a deceased or former spouse could not, however, be used if the individual had reached SPA before 1979–80 and the marriage ended before that date. If a claimant has had more than one marriage or civil partnership, then these provisions only apply to the last marriage or civil partnership.

If an individual has been married or in a civil partnership and, in any tax year up to and including the year in which the marriage or civil partnership ended, the individual does not satisfy the contribution requirements to accrue a *qualifying year* for BSP, then the contribution record of the former spouse or civil partner may be able to be counted as the individual's contributions instead.

The combined contribution record is taken as whichever is the most beneficial of equations 3.2 and 3.3:

$$(3.2) \quad Q = \sum_{s=t}^{PE} Q_{Ps} + \sum_{s=PE+1}^{T} Q_{Os}$$

$$(3.3) \quad Q = \sum_{s=t}^{PS-1} Q_{Os} + \sum_{s=PS}^{PE} Q_{Ps} + \sum_{s=PE+1}^{T} Q_{Os}$$

where Q is the number of *qualifying years* when the contribution records are combined, Q_{Os} is an indicator of whether the individual earned a *qualifying year* in year s, Q_{Ps} is an indicator of whether the individual's former or deceased spouse/civil partner earned a *qualifying year* in year s, t is the first year of the individual's *working life*, PS (PE) is the tax year in which the marriage/civil partnership started (ended) and T is the year before an individual reaches SPA, which is substituted for PE if the marriage/civil partnership ends after the individual reaches SPA.

3.3 Entitlement based solely on one's partner's contribution history: category B pensions

An individual who is not entitled to a category A pension because they do not satisfy the contribution conditions (even after substituting a former partner's contribution record as described in Section 3.2.4) may be able to get a category B pension based on the contributions of their current or deceased spouse or civil partner instead.

3.3.1 Widows, widowers and surviving civil partners

A widow, widower or surviving civil partner qualifies for a category B pension if their deceased spouse or civil partner satisfied the contribution conditions outlined in Section 3.1 (or died as a result of industrial injury or disease) and the following conditions also apply.

For a widow whose husband died before she reached SPA and before 9 April 2001, she must:

- not have remarried or formed a civil partnership before reaching SPA; and
- have been entitled to (or treated as entitled to) a widow's pension or widowed mother's allowance immediately before reaching SPA.

These women will receive a category B pension at the same rate as their widow's pension.[25] The rate of widow's pension payable is worked out based on her late husband's contributions. If these women wish to defer their state pension in order to earn entitlement to extra weekly income or a lump sum (see Section 3.5), they have to give up their widow's pension / widowed mother's allowance during the period of deferral as well as not claiming their BSP.

Category B pensions are only payable once the claimant themselves reaches SPA. Women widowed before 9 April 2001 and entitled to a category B pension based on their late husband's contribution record can continue to receive this category B pension even if they enter into a new marriage or civil partnership after reaching SPA.

The rules applying to widowers bereaved before reaching SPA and before 9 April 2001 are very similar to those outlined above for women, provided that the widower will reach SPA on or after 6 April 2010 and has not remarried or formed a civil partnership before reaching SPA. The only difference is that men were not actually eligible to receive widow's pension or widowed mother's allowance. Therefore, widowers will be deemed eligible for a category B pension, payable at the rate of widow's pension that his late wife's contribution record would have entitled him to had he been able to claim one, if:

- he was over 45 but under SPA when his wife died (or over 40 but under SPA if he was bereaved before 11 April 1988); or

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[25] Note that when the BSP starts to be uprated in line with average earnings, the widow's pension will continue to grow in line with prices.

- he had children when he became a widower and was over 45 but under SPA when he ceased to be entitled to child benefit for those children (or over 40 but under SPA if he was bereaved before 11 April 1988); and

- his late wife had met the same conditions that a man would need to have met to entitle his widow to a widow's pension.

Widowers and surviving civil partners, like widows, are only eligible to receive a category B pension once they themselves reach SPA.

For a widow, widower or surviving civil partner whose husband/wife/civil partner died before the surviving partner reached SPA but on or after 9 April 2001 to be entitled to a category B pension, they must:

- not remarry or form a civil partnership before reaching SPA; and

- be getting widowed parent's allowance immediately before reaching SPA, or have been entitled to widowed parent's allowance when over the age of 45 but it had ceased before they reached SPA, or have been getting bereavement allowance at any time before SPA.

These individuals get a category B pension equal to the rate of widowed parent's allowance they were getting immediately before SPA, if they were getting it.

If the widow/widower/surviving civil partner is not receiving widowed parent's allowance immediately before reaching SPA and instead had either (i) been entitled to widowed parent's allowance when over 45 but it had ceased before SPA or (ii) been receiving bereavement allowance at any time before SPA, their category B pension will not include any BSP; they will only be eligible to inherit their late husband/wife/partner's additional state pension entitlement (see Section 4.5.2 for details of inheritance of SERPS and S2P). However, they may instead be able to use their late husband/wife/partner's NI record to improve their own entitlement to a category A pension (see Section 3.2.4 for details). This latter option is also open to those who were widowed before the age of 45, who were therefore not eligible for bereavement allowance.

Women widowed on or after reaching SPA qualify for a category B pension, payable at the same rate as their late husband's category A pension.

Widowers or surviving civil partners bereaved after reaching SPA are currently only eligible for a category B pension, payable at the rate of their late wife/partner's category A pension, if their late wife/partner was also aged over SPA at the time of her/his death. Widowers and surviving civil partners bereaved after reaching SPA and on or after 6 April 2010 may also be entitled to a category B pension if their late wife/partner died before reaching SPA themselves. The category B pension will be based on the category A pension the deceased had built up before she/he died.

Note that the new contribution conditions for the BSP that will apply to people reaching SPA from 6 April 2010 onwards, which were legislated for in the Pensions Act 2007 (see Section 3.2), will not apply to bereavement benefits. These will continue to be worked out based on the existing contribution conditions, which are broadly the same as the pre-2010 contribution conditions for a category A pension – for example, for a widow to qualify for the full BSP component of widowed mother's allowance, her late husband will normally have to have built up *qualifying years* through actual payment of contributions and have built up *qualifying years* through paid or credited contributions for about 90% of his *working life*.

3.3.2 Those who are currently married or in a civil partnership: category BL pensions

An individual who is married or in a civil partnership qualifies for a category BL pension if:

- their spouse or civil partner is entitled to a category A pension (he or she satisfies the contribution conditions outlined in Section 3.1); and
- both the individual and the spouse or civil partner are aged over the SPA.

Until 6 April 2010, individuals will not be able to receive a category BL pension until their partner actually starts claiming his/her category A pension. From 6 April 2010 onwards, individuals will be able to claim a category BL pension if they are aged over SPA as soon as their partner becomes eligible for his/her category A pension, regardless of whether he/she actually claims it.[26]

A husband (civil partner) can only qualify for a category BL pension based on the contributions of his wife (his/her civil partner) if the wife or civil partner was born on or after 6 April 1950. The first year a man or woman in a civil partnership will be able to claim a category BL pension is, therefore, the 2010–11 tax year.

The amount of category BL pension received is (roughly) equal to 60% of the category A pension that the spouse or civil partner receives. The 'married person's rate' is set as close to 60% of the full rate as possible,

[26] Pensions Act 2007, part 1, paragraph 2.

subject to rounding weekly pension income figures to the nearest 5p. The individual will receive the same fraction of the married person's rate as the spouse or civil partner receives of the full BSP rate. So, for example, if a woman's husband receives a full category A pension, she will receive the full married person's rate.

If the spouse or civil partner subsequently dies, this category BL pension becomes a category B pension, payable at the full BSP rate (or pro rata if the deceased spouse or civil partner did not have full entitlement) – see Section 3.3.1.

3.3.3 Composite pensions

An individual with a reduced entitlement to a category A pension (in other words, not enough *qualifying years* to be entitled to the full category A pension) can increase their pension by combining it with whatever category BL or category B pension they are entitled to based on the contribution record of their current spouse or civil partner (known as an ABL pension) or their deceased spouse or civil partner (known as an AB pension) – see Sections 3.3.1 and 3.3.2 for details of the qualifying criteria.

In these cases, the claimant's own category A pension will be increased by the lesser of:

- the difference between the full category B pension rate and what they are entitled to based on their own contributions; and
- the amount of the category B (or BL) pension payable based on the spouse's or civil partner's contributions.

A category A pension with entitlement increased by taking into account the contribution record of a deceased spouse or civil partner (described in Section 3.2.4) is considered before any composite pension.

3.4 Additions to the basic state pension

To take account of the fact that certain individuals have higher expenditure needs than others, there are a number of flat-rate additions to the BSP that can be claimed by qualifying individuals.

3.4.1 Increases for dependants

Almost all increases to the BSP for dependants have been or are being phased out. However, these increases used to be more widely available and some individuals retain entitlement. The amount of and rules governing these increases are described below.

Spouse

A man can claim an increase on a category A pension for his wife if:

- the wife does not receive a state retirement pension, other state benefit or training allowance; and
- the husband does not receive a benefit for the wife from the industrial injuries or war pension schemes; and
- either:
    - the wife does not live with the man and he has to pay her maintenance of at least the amount of the dependants' increase, and she does not earn more than that amount; or
    - the wife lives with the man but earns less than a weekly earnings limit (for those who became entitled to the benefit after 16 September 1985).

If the wife receives a benefit that is less than the dependants' increase, then the husband can claim the difference.

Prior to 1985, if the wife lived with the man and earned above the earnings limit, then the dependants' increase was reduced on a tapered basis. The dependants' increase was reduced by 5p for every 10p of earnings above the earnings limit (a 50% taper) and by 10p for every 10p of earnings above the top earnings limit (a 100% taper). Since 1985, the dependants' increase has been subject to a 100% taper for earnings above the earnings limit, although if a man has been entitled to the dependants' increase continually since 14 September 1985 then he may be entitled to a dependants' increase at a lower taper rate.

A married woman can only receive an increase on her category A pension for her husband if:

- she was receiving an increase for him on employment support allowance (formerly, incapacity benefit) immediately before reaching SPA; or
- she was receiving an increase for him on (the now defunct) unemployment benefit (prior to 7 October 1996).

The increase for an adult dependant is equal to 60% of the claimant's category A pension.

The Pensions Act 2007 abolished all adult dependency increases for individuals retiring from 2010–11 onwards. For those already in receipt of the increase, this will be protected until either 2020 or when entitlement ceases (whichever is sooner).

Children

Before 2003–04, an individual could claim an increase in benefit for each child for whom they were entitled to receive child benefit. Either the child had to live with the claimant or the claimant had to contribute a certain amount to maintenance payments for the child. Receipt of this extra benefit was subject to any cohabiting partner of the claimant not earning more than a set amount per week (which was increased for additional children).

For instance, in 2002–03, the earnings limit was £155 and it was increased by £20 for each additional child. So a claimant whose partner earned less than £155 per week would have been entitled to claim a child addition for each child he or she had. A claimant whose partner earned between £155 and £175 a week would be able to claim for one fewer children than the number that he or she actually had, while a claimant whose partner earned between £175 and £195 per week could claim for two fewer children than he or she actually had. Increases in benefits for children were not affected by the claimant having an insufficient contribution record. Since 1999–2000, the child addition has been £11.35 per child, although the addition for the first child is reduced if the higher rate of child benefit is being claimed for that child.

Increases for children were abolished from 2003–04 when they started to be paid through other parts of the benefits system. However, individuals who were already in receipt of a child dependency increase prior to April 2003 (or who claimed for one after April 2003 but had been entitled to one before this date) will still be paid the child dependency increase until they are no longer entitled to it.

Other dependants

An individual can claim an increase on their category A pension for a person (who is not the spouse/civil partner or a child) who looks after a child or children for whom the individual is entitled to receive child benefit if:

- they are not claiming an increase for a dependent spouse; and
- the individual's spouse or civil partner is not entitled to a category B pension based on the individual's contribution record; and

- either the child minder lives in the same house as the individual or the weekly cost of the child minder (either through maintenance or employment) is greater than the standard rate of the increase; and

- the child minder who lives with the individual does not have weekly earnings above the weekly earnings limit (excluding any earnings from looking after the child or children).

The increase for a child minder will be abolished for those reaching SPA from 6 April 2010, although there will be some protection for existing beneficiaries (either until 2020 or until entitlement ceases, whichever is sooner).

3.4.2 Age addition

Since 1971, individuals aged 80 and over have been paid an additional 25p per week. This is paid in addition to any BSP, or with some other benefits (industrial disablement pension, war disablement pension, widow's pension, severe disablement allowance, carer's allowance, pension credit). If a couple are both aged 80 or over and the woman is not receiving a pension or any of the above benefits, then her husband will receive her age addition (in addition to his own) on her behalf.

This age addition represented an increase of 4.2% in 1971 when it was introduced. Keeping the amount fixed in nominal terms has now made the gain somewhat ridiculous: in 2008, it represented an increase of 0.3% of the BSP.

3.5 Receiving the basic state pension

3.5.1 Pension deferral

To encourage pension-age individuals to stay economically active and provide for themselves, the amount of BSP can be increased if the individual does not start to claim it as soon as they reach SPA. This applies to the BSP, but not to any increases for dependants or to the age addition.

Rules have changed at various points in time, but the option to defer was always (up to 2005) limited to deferment between SPA and 'retiring age' (which was five years later); after five years, no further increases in weekly income were accrued. Since 2005, there has been no cap on the period for which individuals can defer their pension. Prior to 1975, individuals had to pay NI contributions during the weeks they deferred in order later to be eligible for the higher pension income. This contribution condition was abandoned in 1975.

The additional income to which an individual was entitled if they deferred claiming has changed over time:

1948 to 1951: Pension increased by 1 shilling per week for every 25 contributions paid in the five years between SPA and retiring age. This applied to weeks before 16 July 1951.[27]

1951 to 1959: Pension increased by 1s 6d per week for every 25 contributions paid in the five years between SPA and retiring age. This applied to weeks before 2 August 1959.

1959 to 1967: Pension increased by 1s per week for each group of 12 flat-rate NI contributions paid after SPA and before retiring age. This applied to weeks before 30 October 1967.[28,29]

1967 to 1970: Pension increased by 1s (5p) per week for each group of nine flat-rate NI contributions paid after SPA and before retiring age.

1971 to 1974: Pension increased by 6p per week for every nine flat-rate NI contributions paid after SPA and before retiring age.

During the period from 1948 to 1974, the increment did not increase with the level of pension. This meant that throughout each period in which the deferral bonus remained fixed in cash terms, the deferral rate (as a percentage of pension income) declined. For instance, in 1961 it amounted to 7.3% p.a. but by 1966 it was just 5.25%. Similarly, after the changes introduced in 1967, the rate rose again to 6.7%, but by 1970 it had declined to 5.6%. Changes in 1971 raised this slightly again to 5.7%, but by 1974 it had fallen to 3.4%.

Since 1975, the bonus for deferral has been expressed as a fraction of weekly pension income, and thus the deferral rate has remained constant, barring the explicit policy changes to raise the deferral rate outlined below.

[27] For those who are not familiar with pre-decimal sterling (£sd), there were 12d (12 pence) in a shilling and 20s (20 shillings) in a pound, making 240d in a pound. So, with five years of deferment (260 weeks), there were a maximum of 10 groups of 25 weeks, and therefore 10 shillings' additional pension at age 70 (men) or 65 (women), meaning £0.50. In 1948, the pension for a man aged 65 was £1.30, which increased to £1.40 (7.7% annual increase) if he retired at 66 or £1.80 if he retired at 70.

[28] A man retiring at age 70 had five years of deferment (260 weeks), so 21 groups of 12 weeks, and therefore 21 shillings' increase per week, meaning £1.05 (21p per week extra for each year of deferment).

[29] Hackett (1970) quotes a study – the 1966 Annual Report of the Ministry of Social Security – that gives statistics about the number of pensioners who defer the claim of their pension. In 1966, 27% claimed an increment (32% for men only). Of those, the average increment of 10 shillings corresponded to about 2½ years of deferment, which is not negligible.

1975 to 1979: $^{1}/_{8}$ of 1% per week (≈ 6.5% p.a.) until retiring age.

1979 to 2005: $^{1}/_{7}$ of 1% per week (≈ 7.4% p.a.) until retiring age, with a minimum of seven weeks' deferment.

Since 6 April 2005: $^{1}/_{5}$ of 1% per week (≈ 10.4% p.a.),[30] with a minimum of five weeks' deferral but no upper limit.

Since 6 April 2006: It is now possible to take a lump-sum payment rather than weekly increments to the state pension, provided the individual defers claiming their pension for at least 12 months. The lump sum is calculated as though the pension forgone by deferring is saved each week in an interest-earning savings account, with compound interest applied monthly. The interest rate used is set by the government and will be at least 2 percentage points above the Bank of England base rate. If an individual does not choose to take their increase as weekly increments within three months of starting to claim the pension, then the individual will automatically be given the lump sum.

Individuals are not entitled to any extra pension rights for periods during which they are deferring their state pension and claiming any of the following: carer's allowance, employment support allowance, any state pension, severe disablement allowance, unemployment supplement, widow's pension or widowed mother's allowance. However, extra pension rights are not affected by claiming attendance allowance, disability living allowance or benefits for a child. If an individual defers their state pension and claims pension credit during this period, their PC award will be calculated as if they were in fact receiving the state pension to which they are entitled.

Once an individual starts receiving their higher weekly state pension income, this additional income will be treated like any other income when working out entitlement to pension credit, housing benefit, council tax benefit and tax credits. However, if they choose instead to receive a lump-sum payment, this will not be taken into account when assessing entitlement for PC. See Sections 6.4.2 and 6.4.3.

If an individual has already started to claim their pension, then they can still elect to give up their pension for a period. This can only be done once.

3.5.2 Earnings rule

From 1948 to 1 October 1989, if an individual wanted to claim their state pension within the first five years after reaching SPA, they had to have

[30] In other words, these deferral figures add – rather than compound – over time (52×0.2% = 10.4%).

retired from regular employment. An individual working more than 12 hours per week was not deemed to have retired – in other words, they were not paid any state pension income. If an individual did count as having retired (i.e. was working for no more than 12 hours a week) but had earnings above a certain limit (known as the earnings limit), then their BSP (including any increases for dependants) was reduced.

From 1948 to 1958, the pension was reduced by 1 shilling for each 1 shilling earned above the pension flat rate; in other words, the taper rate was effectively 100%. After 1958, the pension was reduced by 50% (5p for every 10p of earnings) if the individual was earning more than the earnings limit (a flat rate) and by 100% (one for one) above the top earnings limit. These retirement and earnings rules were aimed at reducing the pensions bill for the government, on the basis that those working and with reasonable incomes did not need to claim the pension yet. Clearly, this was very detrimental to the work incentives of individuals aged over the SPA, and many simply left employment in order to claim their pension. It also contributed to pensioner poverty by limiting the income of pensioners who may have been prepared to do paid work to increase their incomes.

These earnings rules were subsequently abolished in the 1989 Budget (effective from 1 October 1989) for the basic pension, but dependants' additions are still subject to some conditions on the partner's earnings (described in Section 3.4.1).

4. Earnings-related benefits

An element of earnings-related state pension income was introduced in 1961 and a system of earnings-related benefits under the state pension system has existed almost continually ever since.

4.1 Graduated retirement benefit (1961 to 1975)

Graduated retirement benefit was introduced by the National Insurance Act of 1959 and operated from 1961–62 until 1974–75. Between 1961 and 6 April 1975, those paying flat-rate class 1 NI contributions also paid graduated contributions. For every £7.50 contributed by a man (or £9 contributed by a woman), the individual became entitled to a unit of graduated pension. The value of these units in terms of pension income is determined each year.[31] The larger contribution required for women for each unit reflected higher life expectancy as well as the fact that women's SPA is five years earlier than men's. For those retiring from 2010–11, the unit of conversion will be equalised at £7.50. However, as the women potentially affected by this change will have been (at most) 25 years old when GRB was abolished in 1975, few individuals will be affected by this change and the sums of money involved will be very small.

The amount of pension earned depends on the number of units of graduated contributions the insured person paid between April 1961 and April 1975 (excluding the contributions paid by employers) and the value of a unit at the time the insured individual comes to claim their pension. The value of a unit is set annually by the Social Security Benefits Up-Rating Orders.

As the scheme was only relatively short-lived, the maximum number of units an individual can have accumulated is small. This is shown in Table 4.1 (contracting out is discussed in more detail in Section 4.6).

Table 4.1. Maximum number of GRB units an individual can have accumulated

	Not contracted-out	*Contracted-out*
Men	86	48
Women	72	40

[31] Total amount of contribution in pounds is divided by either 7.5 or 9 and any half-unit is rounded up. In 1961, it was thought that the units should be increased with contribution increases, but they were never changed.

In 2010–11, each unit of GRB accumulated entitles an individual to an additional pension of 11.53p per week. This means that the maximum income a man can be receiving from GRB is £9.92 per week[32] (86 units at 11.53p each), which is just over 10% of the amount of BSP paid to an individual with full BSP entitlement in 2009–10.

4.2 State Earnings-Related Pension Scheme (1978 to 2002)

In the 1970s, there was considerable growth in occupational pension schemes. This created a division between those who had access to an occupational scheme and those who had to rely on the state pension. The State Earnings-Related Pension Scheme (SERPS) was introduced by the Social Security Pensions Act 1975 and came into force in April 1978. It was introduced with the aim of providing everyone with an inflation-proof earnings-related pension, either through the additional state scheme or through a private occupational scheme (members of which could contract out of SERPS – see Section 4.6 for a discussion of contracting out).

The additional pension is paid to those who are eligible in addition to the BSP, but an individual does not have to be eligible for the BSP to claim an additional pension. To qualify for the additional pension, an individual must have paid class 1 NI contributions on earnings greater than the annual lower earnings limit (LEL) in at least one tax year since 1978–79. Reduced-rate contributions paid by married women or widows do not count towards entitlement to the additional pension. The self-employed do not pay earnings-related class 1 contributions and so, unless they have spent at least one year since 1978 working as an employee, they will not have any entitlement to an additional pension.

Originally, an individual had to be both over the SPA and retired from regular employment in order to claim the additional pension (see Section 3.5.2 for a definition of 'retired'). However, the requirement to be retired from regular employment was removed from 1 October 1989.

The amount of additional pension payable is based on an individual's 'surplus' earnings between the LEL and the upper earnings limit (UEL) in tax years since 1978–79, from the tax year in which the individual reached age 16 up to the tax year prior to the one in which the individual reaches the SPA. The amount of additional annual pension payable was originally calculated as follows:

$$(4.1) \quad AP = \frac{1}{20} \times \left(\sum_{best20years} \left[(E_t \times \rho_{tT}) - LEL_{T-1} \right] \times 0.25 \right)$$

[32] This excludes any increments for delayed commencement.

where E_t is earnings up to the UEL in year t; ρ_{tT} is the revaluation factor, which is equal to the average earnings growth between the year in which the income is earned (t) and the year in which the individual reaches the SPA (T);[33] and LEL_{T-1} is the annual LEL in the tax year before the individual reaches SPA.

Under this original formula, to receive the full amount of additional pension, 20 years of entitlement were required. If an individual had contributed for more than 20 years, the best 20 years of earnings were used to calculate the additional pension. The accumulation rate was 25%, so that in effect the full additional pension entitlement would have been roughly 25% of an index-linked average of earnings between the LEL and the UEL, using an individual's 20 best years of earnings during their life. When combined with a BSP worth slightly more than the LEL, this meant that the total state pension an individual with full SERPS entitlement could expect would be greater than a quarter of their average earnings up to the UEL.

The government had wanted to phase out the additional pension from 1987 but this met with considerable opposition. Instead, the Social Security Act 1986 modified it, with the proviso that no one retiring before April 1999 would be affected. The additional pension an individual is entitled to therefore depends on when the individual reaches SPA.

For those reaching SPA in or prior to the 1998–99 tax year, the entitlements to the additional pension are calculated according to equation 4.1.

For those reaching SPA from 1999–2000 onwards, two major changes were introduced. First, the additional pension is based on earnings in all the years of *working life* since 1978–79 (including zero for the years in which the individual had no earnings above the LEL). Second, earnings from 1988–89 are treated with an accrual rate that depends on when the individual reached SPA. This accrual rate was gradually reduced from 25% (for those reaching SPA in 1999–2000) to 20% (for those reaching SPA in or after 2009–10). The precise accrual rates that apply to different cohorts of individuals are shown in Table 4.2. Existing rights to the additional pension were protected, so that surplus earnings for the years 1978–79 to 1987–88 continue to be treated with an accrual rate of 25%.

[33] The revaluation factor is set by Social Security Revaluation of Earnings Factors Orders in the year that an individual reaches the SPA.

Table 4.2. Accrual rates for those retiring from 1999–2000 onwards

Tax year SPA reached	*% of surplus earnings on which additional pension based for tax years from 1988–89*
1999–2000	25.0
2000–01	24.5
2001–02	24.0
2002–03	23.5
2003–04	23.0
2004–05	22.5
2005–06	22.0
2006–07	21.5
2007–08	21.0
2008–09	20.5
2009–10 or later	20.0

The additional pension for those reaching SPA in 1999–2000 is therefore calculated as shown in equation 4.2. Further policy changes announced in 1995 (discussed below) mean that equation 4.2 only applies to those reaching SPA in 1999–2000 – later cohorts are treated slightly differently.

$$(4.2) \quad AP = \frac{1}{N} \times \left(\sum_{16}^{1987-88} \left[(E_t \times \rho_{tT}) - LEL_{T-1} \right] \times 0.25 + \sum_{1988-89}^{SPA-1} \left[(E_t \times \rho_{tT}) - LEL_{T-1} \right] \times AR \right)$$

where N is the number of years in an individual's *working life* since 1978–79 and the accrual rate (AR) depends on the year in which the SPA is reached, as shown in Table 4.2.

A tax year since 1978–79 will be disregarded from a person's *working life* if the individual was credited with contributions, or if the individual was precluded from regular employment due to responsibilities in the home (looking after a child under 16 or a handicapped or elderly person). However, the number of years of *working life* cannot be reduced below 20.

The Pensions Act 1995 increased the SPA for women reaching SPA in or after 2010–11 (which had knock-on effects on the length of *working life* and thus SERPS entitlements). This will tend to decrease the generosity of SERPS, because increasing the length of *working life* reduces the period during which individuals can receive income from SERPS and also tends to reduce average earnings over the lifetime as individuals may wind down employment in later years despite not being able to claim the state pension as early as previously.

However, more significantly for many people, the Act also modified the way in which the additional pension was calculated for all those reaching

SPA from April 2000 onwards. For individuals reaching SPA from April 2000 to April 2003,[34] SERPS entitlement is calculated as follows:

$$(4.3)\quad AP = \frac{1}{N} \times \left(\sum_{16}^{1987-88} \left[(E_t - LEL_t) \times \rho_{tT} \right] \times 0.25 + \sum_{1988-89}^{SPA-1} \left[(E_t - LEL_t) \times \rho_{tT} \right] \times AR \right)$$

There is one (subtle but significant) difference between this and equation 4.2. As equation 4.2 shows, the previous practice had been to revalue all earnings and then calculate the yearly 'surplus' (i.e. the amount on which SERPS entitlement accrued) by subtracting the LEL of the tax year immediately preceding retirement. The change that was made by the Pensions Act 1995 (and shown in equation 4.3) is that 'surplus' income is calculated using the LEL in the year in which the income is earned, and then only the 'surplus' earnings are revalued using the revaluation factor. This change has the effect of reducing SERPS entitlements, since the LEL is increased each year in line with prices, which typically increase more slowly than earnings – to which the revaluation factor is linked.[35] Importantly, this change applied not only to the calculation of future entitlements but also to the recalculation of existing accrued entitlements.

The weekly amount of additional pension income received is fixed at 'retirement'.[36] The benefit was originally increased each year in line with earnings, but the Social Security Act 1980 changed this so that it is now only increased in line with prices by default. This percentage increase for existing pensions in payment is announced each autumn (in the Social Security Benefits Up-Rating Orders); the increase is then applied at the beginning of the next financial year.

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[34] This change also affects the SERPS entitlement of those reaching SPA after April 2003, but the final pension entitlements of these individuals are further complicated by the introduction of S2P – see Section 4.3.

[35] The reduction in annual SERPS income from one year's contributions as a result of this reform equals

$$\frac{1}{N}\left(AR \times LEL_t \times (1+i) \times e \right)$$

where i is cumulative inflation and e is cumulative real earnings growth between the year in which an individual earns (t) and the year before they reach SPA (T–1). The accrual rate, AR, is equal to 0.25 if the year (t) is before 1988–89 or as defined in Table 4.2 if the year is after 1987–88.

[36] For those reaching SPA prior to 1989, this was the date an individual actually retired rather than the date they reached the SPA. For those reaching SPA after the work test was abolished in 1989, the date of retirement is simply the date the individual reaches SPA.

4.3 State second pension

State second pension was introduced by the Child Support, Pensions and Social Security Act 2000 and came into force in April 2002, replacing SERPS as the additional pension available based on earnings received after April 2002.

The aim of S2P is to give more help to those for whom a private pension is not an option, such as those not undertaking paid work due to caring responsibilities and those on low incomes, but it is also intended to help those with moderate earnings to build up a better second pension. S2P was introduced as an earnings-related pension but it is now set, in the very long term, to become a flat-rate pension. Existing SERPS entitlements, from before the 2002–03 tax year, are protected and will become payable when the individual reaches SPA, as follows:

$$(4.4) \quad SERPS = \frac{1}{N_1} \times \left(\sum_{16}^{1987-88} \left[(E_t - LEL_t) \times \rho_{tT} \right] \times 0.25 + \sum_{1988-89}^{2001-02} \left[(E_t - LEL_t) \times \rho_{tT} \right] \times AR \right)$$

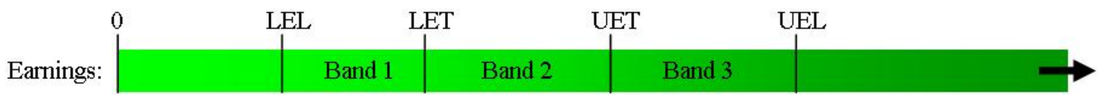
where N_1 is the number of years of *working life* between 1978–79 and 2001–02.

Similar to SERPS, an entitlement to a pension from S2P can be accrued and claimed independently of whether the individual is entitled to and/or claiming a BSP.

For the purposes of S2P, earnings between the LEL and the UEL are divided into three bands through the use of two new thresholds: the lower earnings threshold (LET) and the upper earnings threshold (UET). The LET was set equal to approximately half the national average level of earnings in 2002–03, and is increased annually in line with earnings. The UET is fixed in relation to the LEL and the LET so that the range between the LET and the UET is about twice the range between the LEL and the LET. Mathematically, $UET = 3 \times LET - 2 \times LEL$.

Annual earnings between the LEL and the LET are said to be in band 1, earnings between the LET and UET are classed as band 2, and earnings between the UET and the UEL are classed as band 3. This is represented in Figure 4.1.

Figure 4.1. Division of earnings into S2P bands



Earnings in different bands accrue entitlement to S2P at different rates. Those retiring between 2003–04 and 2008–09 have their S2P entitlement calculated as follows:[37]

$$(4.5) \quad S2P = \frac{1}{N_2} \sum_{2002-03}^{SPA-1} \left[(B1E_t \times \rho_{tT} \times AR_1) + (B2E_t \times \rho_{tT} \times AR_2) + (B3E_t \times \rho_{tT} \times AR_3) \right]$$

subject to the individual being aged 16 or over in any year since 2002–03, and where N_2 is the number of years of *working life* from 2002–03 onwards, BxE_t are earnings in band x and ρ_{tT} is a revaluation factor. The accrual rate, AR_x, for each band (x) of earnings depends on the year in which an individual reaches SPA, and is related to the accrual rate under the previous SERPS system (listed in Table 4.2) as follows:

- band 1: 2 times the accrual rate under SERPS;
- band 2: 0.5 times the accrual rate under SERPS;
- band 3: 1 times the accrual rate under SERPS.

For everyone retiring from 2009–10, the SERPS accrual rate is 20% and the calculation of S2P entitlement simplifies to:

$$(4.6) \quad S2P = \frac{1}{N_2} \sum_{2002-03}^{SPA-1} \left[(B1E_t \times \rho_{tT} \times 0.4) + (B2E_t \times \rho_{tT} \times 0.1) + (B3E_t \times \rho_{tT} \times 0.2) \right]$$

As mentioned above, one of the aims of S2P is to give more help to those not undertaking paid work due to caring responsibilities and those on low incomes. Therefore, a number of different individuals are treated, for the purpose of calculating S2P, as having annual earnings equal to the LET, even though they do not actually have earnings of this level. With respect to tax years prior to April 2010, these are individuals:

- with earnings above the LEL but less than the LET; or
- receiving invalid care allowance; or
- precluded from regular employment by responsibilities in the home (specifically, those receiving child benefit for a child under 6, or entitled to home responsibilities protection because of caring for a sick or disabled person); or

[37] Although we have separated out entitlement under the old SERPS system (equation 4.4) and entitlement under the new S2P system (equation 4.5) for clarity of exposition, in practice pensioners are paid a combined weekly income (equal to equation 4.4 plus equation 4.5).

- entitled to long-term incapacity benefit or severe disablement allowance (provided that the individual has paid class 1 NI contributions for at least a tenth of their *working life* since 1978–79 by the time they reach SPA).

With regard to tax years from 2010–11 onwards, these conditions have changed. An individual will be treated as having earnings equal to the LET if they:

- have earnings greater than the LEL but less than the LET; or
- are entitled to 52 of the weekly *earnings credits* for the year; or
- have earnings less than the LEL but would reach the LEL if their *earnings credits* for that year are also taken into account.

For tax years prior to 6 April 2010, ***earnings credits*** are awarded for each complete tax year in which an individual is aged under SPA and:

- awarded child benefit for a child under 6; or
- entitled to carer's allowance; or
- looking after an ill or disabled person and qualified for home responsibilities protection at the same time; or
- is long-term sick or disabled and qualifies (or would have qualified if they satisfied the contribution conditions) for long-term incapacity benefit or who receives severe disablement allowance, provided that they have either (i) worked and paid class 1 NI contributions for a qualifying period (usually a tenth of their *working life* since 1978 or their sixteenth birthday if this is later) before they reach SPA or (ii) been treated as having paid class 1 NI contributions for a qualifying period (usually a tenth of their *working life* since 1978) before they reach SPA. This is called the ***labour market attachment test***.[38]

[38] From October 2008, people with long-term illness or disabilities who qualify for employment and support allowance, for each complete tax year, will be awarded an *earnings credit* if they had earnings at the LET provided they have been getting either (i) the support component for at least 52 weeks or (ii) the work-related activity component for at least 52 weeks. Men born between 6 April 1944 and 5 April 1947 and women born between 6 April 1949 and 5 April 1951 who become entitled to employment and support allowance will be treated for S2P purposes as if they were getting the support component. They will also need to satisfy the *labour market attachment test*. Individuals reaching SPA from 6 April 2010 onwards will no longer need to meet the *labour market attachment test*.

For weeks from 6 April 2010 onwards, *earnings credits* will be awarded for each week in which an individual is:

- awarded child benefit for a child under 12; or
- entitled to carer's allowance; or
- a foster parent; or
- caring for someone with a qualifying disability for more than 20 hours a week; or
- entitled to severe disablement allowance or employment and support allowance (without any condition on work-life history).

As shown in equation 4.5, S2P is still (though to a lesser extent than SERPS) earnings-related. However, plans were set out in the 2007 Pensions Act to make S2P a flat-rate pension by about 2030. Though the ultimate result will be a substantially less complex system than described above, the way in which this will be implemented is somewhat complicated. We endeavour in the next few paragraphs to explain how it will be done.

For tax years from 2010–11, earnings bands 2 and 3 will be merged by effectively increasing the UET to the level of the UEL (as shown in Figure 4.2). This means that S2P entitlement for those years will be calculated as $(B1E_t \times \rho_{tT} \times 0.4)+(BzE_t \times \rho_{tT} \times 0.1)$ where $B1E_t$ are band 1 earnings (or deemed earnings) while BzE_t are earnings above the LET but below the annual UEL.

Figure 4.2. Division of earnings into S2P bands from 2010–11

At some point in the future (in the so-called 'flat-rate introduction year' – currently likely to be 2012–13), the government will introduce a new earnings limit called the *upper accrual point* (UAP). This will replace the annual UEL as the upper limit of band z earnings. The UAP will be fixed in nominal terms (most probably at the annual UEL in the flat-rate introduction year). This is shown in Figure 4.3. At this point, the UEL will become irrelevant for the calculation of S2P entitlement, although it will remain relevant for the calculation of NI contributions. The effect of fixing the UAP in nominal terms is that, for years after the flat-rate introduction year, the band of earnings on which S2P entitlement can be accrued will be smaller than it otherwise would have been.

Figure 4.3. Division of earnings into S2P bands in the flat-rate introduction year

Because the LET is indexed to earnings while the UAP will be fixed in nominal terms, the LET will converge on the UAP by about 2030. This is shown in Figure 4.4. At this point, there will only be one band of earnings on which entitlement to S2P will accrue and all individuals with earnings in this band will be deemed to have earnings equal to the LET. S2P entitlement accrued from then on will simply be a second flat-rate pension.

Figure 4.4. Division of earnings into S2P bands from approximately 2030

Under current legislation, after accrual to S2P becomes flat-rate (in approximately 2030), the LET will continue to rise with average earnings whilst the LEL and UEL will remain indexed to prices. This means that the flat-rate amount of S2P accrued each year will grow in earnings terms. Future governments could, however, choose to stop this happening by (for example) indexing the LET to prices instead of earnings from this point onwards.

If, however, the LET remained indexed to earnings (and the UEL remained indexed to prices), in about 2056 the LET would hit the UEL, so that in following years S2P entitlement would be earned on a larger portion of earnings than that on which the higher rate of NI contributions are paid. It seems unlikely that a future government would allow this to happen, and so it is likely that one or other of these indexation arrangements would be changed by future legislation before this point is reached.

4.4 Deferral of additional pension

An individual can increase their additional pension by not claiming it as soon as they reach SPA. The rates of deferral and conditions that apply are the same as for the BSP, described in Section 3.5.1.

4.5 Inheriting rights to additional pension

A widow, widower or surviving civil partner entitled to receive the BSP based on their deceased partner's contributions may also be entitled to some or all of their deceased partner's additional pension income.

If the spouse or civil partner died after reaching SPA, then their additional pension entitlement that is taken into consideration is whatever they became entitled to when they reached SPA. If the spouse or civil partner died before reaching SPA, the additional pension entitlement is evaluated at the tax year in which they died, and taking the length of *working life* to be the total number of years from 1978–79 to the year before they died (inclusive).

4.5.1 Inheriting graduated retirement benefit entitlement

A widow is entitled to half of the GRB to which her deceased husband was entitled as soon as she reaches 60 or from the date he dies (whichever is later). This is paid in addition to any GRB she earned through her own contributions.

A widower whose wife died on or after 6 April 1979 is entitled to half of her GRB entitlement in addition to his own, provided they were both over the SPA before she died. These rights were extended to surviving civil partners from December 2005.

Prior to October 1989, the widow(er) also had to have retired in order to claim the GRB accrued by a deceased spouse.

4.5.2 Inheriting SERPS/S2P entitlement

If the individual has their own entitlement to an additional pension from SERPS/S2P, then their own entitlement is combined with that inherited from the deceased spouse or partner (see Table 4.3 for further details on the amounts inherited), but the total amount payable is subject to a maximum limit. The maximum composite pension is the maximum pension payable to a hypothetical individual who reached SPA at the time the actual individual became widowed – in other words, the amount of pension that would have been payable to a hypothetical individual who reached SPA in the year the person was widowed and had contributed to SERPS/S2P with earnings equal to 53 times the UEL in every year of their *working life* since 1978–79.[39]

The amount of a deceased spouse or partner's SERPS that is inherited depends on when the deceased died or when the deceased would have reached SPA. For those who died prior to October 2002, their surviving widow or widower inherited the full SERPS entitlement of the deceased (subject to the limits on a maximum composite additional pension described above) plus any increases resulting from deferral.

[39] 53 times the UEL is used, as there are actually slightly more than 52 weeks in every year.

Table 4.3. Inheritance of SERPS according to the date the deceased reached or would have reached SPA

% of SERPS passing to surviving spouse/civil partner	*Date when the deceased spouse/civil partner reached or would have reached SPA*
100%	Prior to 5/10/2002
90%	6/10/2002 – 5/10/2004
80%	6/10/2004 – 5/10/2006
70%	6/10/2006 – 5/10/2008
60%	6/10/2008 – 5/10/2010
50%	After 6/10/2010

For married individuals (and those in a civil partnership) whose partner died after October 2002 (December 2005 respectively), the amount of SERPS that can be inherited depends on the tax year in which the late spouse (civil partner) reached or was due to reach SPA. This is shown in Table 4.3. Those dying after October 2002 (December 2005) but who had reached SPA before this date are able to pass on their full SERPS entitlement to a surviving partner. The reduction to the amount of SERPS that can be inherited was then phased in, until – for those who would have reached SPA from 6 October 2010 onwards – only 50% of any SERPS entitlement can be passed on to a surviving partner. This phasing-in of the reduction to the inheritance of SERPS was designed to ensure that those within 10 years of retirement had time in which to adjust their plans to take into account these changes to state pension provision.

Only 50% of any S2P entitlement can be inherited by a widow, widower or surviving civil partner, irrespective of the date the deceased would have reached SPA.

If the surviving spouse is over SPA when the partner dies, the surviving individual is entitled to the spouse's additional pension entitlement immediately. If the surviving spouse is not over SPA but is claiming one of widowed mother's allowance, widow's pension or (since 2001–02) widowed parent's allowance, they are also entitled to the inherited additional pension immediately. For other individuals, the inherited additional pension will become payable when they start to claim their own state retirement pension. These inheritance rights were extended to civil partners so that a civil partner whose partner dies after 5 December 2005 will have the same inheritance rights as a surviving spouse.

4.5.3 SERPS/S2P and divorce

Provisions were made in the Welfare Reform and Pensions Act 1999 for a claimant's additional pension from SERPS and/or S2P to be altered by divorce. This came into force from 1 December 2000. These entitlements were extended to the dissolution of civil partnerships from 5 December

2005. Sharing of SERPS/S2P entitlements on divorce or dissolution of a civil partnership is, therefore, now possible but not compulsory.

If two individuals divorce or dissolve their civil partnership, there is provision for a *state scheme credit* to be awarded to the individual with the lower SERPS/S2P entitlement and a *state scheme debit* to be taken from the individual with the higher entitlement. The amount transferred is fixed on the value of the additional pension the day before the agreement is reached, and only tax years before the year in which the agreement is reached are used when calculating entitlements.

4.6 Contracting out

Since an earnings-related element of the state pension system was first introduced in 1961, individuals have, in one form or another, been able to opt out of this if they had an alternative earnings-related pension arrangement of a sufficiently generous nature. This is known as contracting out. This section describes the conditions under which individuals can (could) contract out, what refund of contributions they receive(d) for this and what, if any, residual entitlement they continue(d) to accrue in the state scheme.

4.6.1 Contracting out of the graduated retirement benefit

If an employer provided an occupational pension that paid benefits at least as good as those payable under GRB, the employer could contract their employees out of the GRB scheme from 5 October 1966. The employee did not get any choice in the matter, but the employer had to inform the employee of their actions.

4.6.2 Contracting out of SERPS

From 1978, individuals were permitted to contract out of SERPS if their employer sponsored a contracted-out occupational pension scheme that promised to pay a guaranteed minimum pension (GMP). Such schemes were known as contracted-out salary-related (COSR) schemes. If an individual was part of a COSR scheme, then both employer and employee paid NI contributions at a lower contracted-out rate.

From 1988–89, employees could also contract out of the additional pension by joining an appropriate personal pension (APP) or a contracted-out money-purchase (COMP) scheme. The latter provides an individual with ‘protected rights’, but the level of these rights is not guaranteed.

Individuals who contracted out of SERPS in years after 1997–98 will not have any entitlement to SERPS accruing for the years in which they were contracted out.

Individuals who contracted out of SERPS between April 1978 and April 1997 are entitled to some reduced payment from SERPS for that period. The reduced SERPS payment is equal to the gross SERPS entitlement (what the individual would have been entitled to from SERPS had they not contracted out) less a 'contracted-out deduction' (COD). The COD is equal to the value of the GMP that the individual accrued during their period of contracted-out employment. If the individual was contracted out into a COMP or APP scheme, then the COD is calculated as if they had built up rights to a GMP instead. If the individual has been a member of more than one contracted-out scheme, then the COD will be the sum of the GMPs.

The GMP an individual will have accrued depends on their earnings in the contracted-out employment between 1978–79 and 1996–97. For those reaching SPA before 1998–99:

$$(4.7) \quad GMP = \sum_{t=1978-79}^{1987-88} \frac{1}{80}(REF_t) + \sum_{t=1988-89}^{SPA-1} \frac{1}{100}(REF_t)$$

where *REF* is the ***revalued earnings factor***, defined as the employee's aggregate earnings falling between the LEL and UEL, revalued by the rise in national average earnings from the year the earnings were earned to the year prior to reaching SPA.

For those reaching SPA from 1998–99 onwards:

$$(4.8) \quad GMP = \frac{1}{WL}\left(\sum_{t=16 \text{ or } 1978-79}^{1987-88} \frac{1}{4}(REF_t) + \sum_{t=1988-89}^{1996-97} \frac{1}{5}(REF_t) \right)$$

where *WL* is the number of years of *working life* since 1978–79 (inclusive).

The maximum value of the COD is the gross SERPS entitlement; in other words, if an individual has a GMP for the period in which they were contracted out that is greater than what they would have been entitled to from SERPS had they not contracted out, then they accrue no SERPS entitlement for that period.

4.6.3 Contracting out of S2P

Individuals are currently able (and have been able since 2002–03) to contract out of S2P into a COSR, COMP or APP scheme. National Insurance rebates for individuals who are contracted out into COSR or COMP schemes are, however, still related to the additional pension that would have accrued under the old SERPS system, which is different from the benefits that accrue under the S2P system. This is for two reasons: first, the accrual rates are different; and second, those with earnings between the LEL and LET are deemed to have earnings equal to the LET for the purposes of S2P entitlement, whereas their NI rebate is based on their actual earnings. Both these factors mean that contracting out of the S2P system and receiving NI rebates based on the SERPS system would, on its own, make an individual worse off than accruing an additional pension under S2P.

To compensate for different accrual rates, individuals contracted out of S2P into COSR or COMP schemes will accrue an S2P entitlement based on the difference between what their non-contracted-out entitlement would have been under SERPS and S2P. For example, an individual retiring in 2007–08 would have each year of earnings from 2003–04 accruing an entitlement under S2P according to $B1E_t \times \rho_{tT} \times 0.42 + B2E_t \times \rho_{tT} \times 0.105 + B3E_t \times \rho_{tT} \times 0.21$, whilst under the old SERPS system this would have accrued an additional entitlement according to $(E_t - LEL_t) \times \rho_{tT} \times 0.21$. The individual therefore accrues an S2P entitlement for each year contracted out based on $B1E_t \times \rho_{tT} \times 0.42 + B2E_t \times \rho_{tT} \times 0.105 + B3E_t \times \rho_{tT} \times 0.21 - (E_t - LEL_t) \times \rho_{tT} \times 0.21$.

Individuals contracted out of S2P into an APP will not receive a 'top-up' S2P entitlement to compensate for the difference between S2P and SERPS accrual rates because their NI contribution rebates already take the S2P accrual rates into account.

The Pensions Act 2007 made provision for ending the ability of individuals to contract out of S2P into COMP and APP schemes. The date on which this change will come into force has yet to be announced.

5. Non-contributory, non-means-tested benefits

The UK system currently contains a number of flat-rate benefits available to pensioners that are non-contributory and receipt of which is not means-tested.

5.1 Category C pension

The category C BSP was introduced in 1970 to provide a non-contributory benefit for individuals who had reached SPA (or whose husband had reached SPA) before July 1948 when the integrated social security system came into effect. These individuals did not have an opportunity to accrue entitlement to the contributory BSP and so alternative provision was required to help these pensioners.

There are two levels of category C pension, a higher and a lower rate. Women currently over the SPA whose husband was over the SPA in 1948, and who are currently married and have been ever since they reached SPA, receive a category C pension at the lower rate. All other individuals (that is, men aged over the SPA in 1948 and women over the SPA whose husband was aged over the SPA in 1948 but are now no longer married, or who have not been married at some point since reaching the SPA) are entitled to a category C pension at the higher rate.

The higher category C rate is equal to the BSP married person's rate (i.e. 60% of the full BSP rate). The lower category C pension is approximately 60% of the higher category C pension rate. Given that men eligible for a category C pension must have been aged 65 or over in 1948, and eligible women must have been married to men aged 65 or over in 1948, very few individuals are still entitled to claim and eventually no one will be. However, there were still approximately 60 people claiming a category C pension in February 2007.

Additions can be paid on a category C pension for dependants. Additions for children are paid at the same rate as child additions to category A or B pensions (see Section 3.4.1). Additions for adult dependants are paid at the lower category C pension rate.

5.2 Category D pension

The category D pension was introduced in 1971 and offers a non-contributory pension to those aged 80 or over who do not have entitlement to a state pension or who would receive a state pension less than the category D rate. Receipt of this pension is subject to a residency condition: the claimant must be ordinarily resident in the UK and must have been living in the UK for 10 years out of the 20 years ending on their eightieth birthday. Since the Social Security Act 1985, the category D pension has been payable at the same rate as the higher category C pension. Prior to this, it was payable at a different rate to some women:

- married women (who had always been married since reaching SPA) received the lower category C rate;

- men, and women who either were not married or who had been not married at some point since reaching the SPA, received the higher category C rate.

5.3 Christmas bonus

The Christmas bonus was introduced in 1972 and is a £10 lump sum that is paid to qualifying individuals in the last week of November. A qualifying individual is a person aged over the SPA and who, during the last week of November, is ordinarily resident in the UK and is receiving (on any day of that week) any of: retirement pension, long-term incapacity benefit, widowed parent's allowance, carer's allowance, attendance allowance, disability living allowance, unemployability supplement/allowance, income support, family income supplement, disability working allowance, income-based jobseeker's allowance, severe disablement allowance, widow's pension, widowed mother's allowance and industrial death benefit.

If, in a couple, one partner is not entitled to the Christmas bonus in their own right but their partner is entitled to an increase in any of his/her other benefits for the ineligible partner, then the eligible individual can claim an extra Christmas bonus on behalf of their husband/wife/civil partner as well, provided that the ineligible partner is also over SPA by the end of the first full week in December and is ordinarily resident in the UK.

If a person is deferring their state pension, they will not qualify for a Christmas bonus unless they are receiving some other qualifying benefit.

5.4 Winter fuel payments

Winter fuel payments were introduced for pensioners in 1997, notionally to take account of the higher costs of heating experienced in the winter months. They are a flat-rate benefit not related to the actual amount of fuel expenditure. Between 1997 and 1999, payments were made to all individuals aged over the SPA. From 2000, payments have been made to all individuals aged 60 and over rather than those aged over the SPA; the previous difference in entitlements of men and women was deemed to be sex discrimination. From 2003–04, a higher payment has been made to those aged 80 and over.

A lower winter fuel payment is made if the individual lives in residential care or if the individual is living with other people who are also entitled to a winter fuel payment. If the individual lives with one other person entitled to a winter fuel payment, the payments are calculated in such a way that the total payment is equal to the highest payment either individual would be entitled to if they lived alone. If the couple is in receipt of pension credit (see Section 6.4), then the total winter fuel payment is made to the individual receiving the PC, while the other individual receives nothing. If an individual lives with more than one other person who qualifies for a winter fuel payment, then they are entitled to:

- half of the standard rate if they are aged under 80;
- half of the over-80s' allowance if they are aged 80 or over and at least one other qualifying individual is also aged 80 or over;
- half the over-80s' rate plus half the difference between the over-80s' rate and the standard rate if they are the only qualifying individual aged 80 or over.

5.5 Over-75s' TV licence

Since 2000–01, all individuals aged 75 and over have been entitled to a free television licence, even if they share their dwelling with individuals aged under 75. In some cases, retired individuals aged 60 and over living in residential care homes can also apply for a concessionary TV licence at a considerably lower rate (£7.50 in 2009, as opposed to the full licence fee of £142.50).

6. Means-tested benefits for pensioners

A fear of spiralling costs has meant that the UK state pension system has never been sufficient to ensure all pensioners avoided living in relative poverty, and the non-universality of the system was also going to leave gaps that some would fall through. Therefore, since 1948, a key role has always been played by non-contributory, means-tested benefits of one sort or another. These have attempted to target additional spending on those most in need, to ensure that no pensioners have incomes that are deemed too low to live on. Despite the extension of the BSP to near-universal coverage (from 2010–11 onwards), these benefits are and will continue to be very important to many pensioners, as the level of the BSP is not currently deemed to be sufficient for individuals to live on if they have no other retirement provision.

6.1 Means-tested pensions and National Assistance (1948 to 1966)

Men (women) over 65 (60) on 5 July 1948 who had not paid any contributions to a state insurance scheme were not brought into the main BSP scheme. In effect, they did not pay contributions and never received benefits. But they were entitled to receive benefits based on the Old Age Pensions Act 1936. These non-contributory pensions were paid to men and women over 70 who were UK subjects (for at least the preceding 10 years) and who had been resident in the UK for at least 12 years since the age of 50.[40] The amount received depended on the claimant's means: all the sources of income were added together and a weekly rate was provided that decreased as income increased. Since these pensions were only ever intended to cover those older individuals who had not built up sufficient entitlement within the new state pension scheme, no new awards were granted to individuals who reached the age of 70 after 30 September 1961.

Apart from these pensions, means-tested benefits existed in the form of National Assistance benefits distributed by the National Assistance Board. These were benefits defined by the government and distributed to those in need not covered by National Insurance. It was not a scheme specific to older individuals.

6.2 Supplementary benefits (1966 to 1988)

In 1961, the National Assistance Board was abolished and National Assistance benefits were replaced by supplementary benefits. These

[40] Naturalised British subjects were required to have been resident for at least 20 years since the age of 50.

provided an allowance to those below SPA and a supplementary pension to those above. The supplementary pension had no requirement for work.

The structure of the benefits depended on the income of the recipient and an evaluation of their need (including an assessment of housing costs, the size of the household and whether the individual had extra needs due to disability or sickness).[41]

6.3 Income support (1988 to 2003)

From 1988 to 2003, pensioners were entitled to a minimum level of income through income support (IS), which was introduced in the Social Security Act 1986 and the Income Support (General) Regulations 1987. IS was a general non-contributory cash benefit designed to ensure the income of individuals did not fall below certain levels (subject to some limits on capital assets). Pensioners were granted extra premiums which increased the minimum levels of income they were guaranteed. However, IS had to be claimed, and take-up was not 100%, meaning that pensioners who did not claim may still have had income below the minimum level that was being guaranteed by the state. There was a 100% taper on IS, meaning that IS income was withdrawn pound for pound for any non-IS income, as shown in equation 6.1.

(6.1) $\textit{Income support} = \textit{Applicable amount} - \textit{Income}$

where *Applicable amount = Personal allowance + Premiums + Housing costs*. *Income* for this purpose was defined as any income from employment, self-employment, pensions, maintenance payments and certain other forms of income. However, some elements of income were ignored for the purposes of this calculation, including: the first £5 of any income, any expenses refunded to people engaged in voluntary or charity work and all redundancy pay. The levels of the personal allowance, premiums and housing costs were usually uprated each year in line with prices.

The idea of ensuring the incomes of pensioners specifically was formalised by the government in 1999, when it introduced the idea of a 'minimum income guarantee' for pensioners. This was simply equal to the existing IS personal allowance plus the pensioner premium, but the rebranding was accompanied by an increase in the pensioner premium of three times the normal increase, which made it appear more of a distinct policy change. From 1999 to 2002, the level of the MIG was increased faster than prices each year and broadly in line with average earnings.[42] In his foreword to

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[41] The exact levels of these benefits can be found on the IFS website at http://www.ifs.org.uk/fiscalFacts/taxTables.

[42] A particularly large increase in the MIG occurred in April 2001 when, as pre-announced in the Pre-Budget Report of 2000, the lower rates of MIG were equalised

the 1998 Pensions Green Paper, the then Prime Minister, Tony Blair, set out his government's aspiration to increase the MIG in line with earnings 'over the longer term'.[43]

6.4 Pension credit (from October 2003)

The PC was introduced by the State Pension Credit Act 2002 and came into force in October 2003, replacing the MIG for pensioners. The aim of the Act was to implement a system that could enact two seemingly contradictory aims:

- to provide pensioners with a guaranteed minimum level of income through means-tested benefits; and
- to encourage workers to make provision for their own retirement.

The PC has two components – guarantee credit (PCGC) and savings credit (PCSC).

6.4.1 Guarantee credit

The guarantee credit is available to anyone aged above the female SPA. This was age 60 until April 2010 but will gradually increase to 65 over the period from 2010 to 2020, as the female SPA is gradually equalised with the male SPA, and then eventually to 68 by 2046 as the SPA of both men and women is increased further (see Section 3.1.2). The PCGC plays the role of the former MIG – ensuring all pensioners have a minimum level of income – and it is withdrawn at a rate of 100% for any non-PCGC income. Put simply:

(6.2) *Guarantee credit = Appropriate amount – Income*

The ***appropriate amount*** is the standard guarantee credit amount plus any additional amounts (for being disabled or a carer) plus any housing costs. The additional amounts broadly correspond to the premiums that had been payable under IS. The standard guarantee credit amount and the additional amounts are uprated each year in line with average earnings; the continued earnings indexation of the PCGC was legislated for in Pensions Act 2007.

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with the highest rate, which was increased by average earnings growth and also by the real increase in the BSP that occurred in that year (see HM Treasury (2000, paragraph 5.63)).

[43] Department of Social Security, 1998, page iii.

6.4.2 Savings credit

The savings credit component of the PC was designed to reduce the disincentives to save created by means-tested benefits. As mentioned above, the MIG and now PCGC have a 100% taper rate on any other income that the pensioner receives. This clearly provides a strong disincentive to have any additional income from savings for those who are eligible for the PCGC. The PCSC was therefore introduced to reduce this taper rate from 100% to 40%. This will indeed have reduced disincentives to saving for those who are eligible for PCGC. However, because this 40% taper (of course) extends further up the pensioner income distribution than the 100% taper did, some pensioners who would previously have had no interaction with means testing (i.e. would have had a 0% taper rate) will now experience a 40% taper rate. Thus, while marginal saving disincentives were reduced for one group, they were increased for another.

The PCSC is available to individuals aged 65 and over (or whose partner is aged 65 or over) and who have small amounts of *qualifying income* above what is known as the *savings credit threshold*. (For a definition of *qualifying income*, see Section 6.4.3.) The credit is payable at a rate of 60% (so a credit of 60p is payable for each £1 of income above the threshold) up to the maximum savings credit amount. Effectively this means that, rather than losing £1 of PC income for each £1 of income above the level of the BSP (which is what happens under PCGC alone), individuals instead lose just 40p (= £1 – 60p).

The maximum savings credit that can be paid is 60% of the difference between the standard *appropriate amount* and the *savings credit threshold*. If the claimant has income greater than their *appropriate amount*, then the PCSC is withdrawn at a rate of 40% (so the credit is reduced by 40p for each £1 of income above the *appropriate amount*).

An individual's PCSC entitlement is calculated using the following formulae:

If $QI \leq SCT$, then savings credit = 0

If $QI > SCT$ and $TI \leq AA$, then savings credit = a

If $QI > SCT$ and $TI > AA$, then savings credit = $a - b$

where *QI* is *qualifying income*, *SCT* is the *savings credit threshold*, *TI* is *total income*, *AA* is the *appropriate amount*, $a = \min\{0.6\times(QI - SCT), 0.6\times(AA - SCT)\}$ and $b = 0.4\times(TI - AA)$. (Definitions of *qualifying income* and *total income* are provided in Section 6.4.3.).

If the calculated savings credit is negative, then none is paid. If the savings credit to which an individual is entitled is less than 10p, then the credit will only be paid if the individual is claiming other benefits that the savings credit can be paid alongside.

At the inception of the PCSC, the ***savings credit threshold*** was set equal to the level of the BSP. However, the 2006 White Paper set out plans, allegedly aimed at ensuring that 'means-tested provision continues to be focused on those with small savings',[44] to index the *savings credit threshold* to earnings from 2008 onwards, whilst the BSP was to remain indexed to prices until at least 2012, and the maximum savings credit award will be fixed in real terms from 2015 onwards.[45] The *savings credit threshold* and the BSP therefore started to diverge in April 2008, with the *savings credit threshold* moving above the level of the BSP for the first time.

This indexation policy will have the effect of reducing the number of people who will be eligible for PCSC and will reduce the maximum amounts to which people are entitled (relative to what would have happened under the earlier indexation arrangements). However, the presentation of this policy as a way of focusing resources on those with the smallest savings is slightly disingenuous. By increasing the *savings credit threshold* faster than the level of the BSP, it reintroduces a 100% taper of means-tested benefits for those who have only a small amount of private income in addition to their BSP – in other words, those with the lowest levels of income from savings.

For further details on the PCGC and PCSC and the relevant thresholds, see Levell et al. (2009). Distributional analysis of the reforms and an assessment of their impact on incentives can be found in Brewer and Emmerson (2003).

6.4.3 Definitions of income and capital used for pension credit calculations

Total income includes earnings, pension income (BSP, GRB/SERPS/S2P, occupational/personal pensions, income from annuities), prescribed social security benefits and tax credits (but with some exceptions, outlined below), war pensions, *tariff income*, *notional income* and any income paid in lieu of the above.

Benefits and tax credits that are discounted entirely from income for the purposes of calculating PCGC are: attendance allowance, bereavement payments, child benefit, child tax credit, constant attendance allowance,

[44] Department for Work and Pensions, 2006, paragraph 3.62.

[45] Department for Work and Pensions, 2006, paragraph 3.64.

exceptionally severe disablement allowance, disability living allowance care component and mobility component, guardian's allowance, mobility supplement under the war pensions scheme, Christmas bonus, Social Fund payments, housing benefit, council tax benefit, supplementary payments to pre-1973 war widows or widowers, and increases for child dependants.[46] Furthermore, there are a number of items that can be disregarded from measured earnings and income other than earnings; these are described in Appendix C.

Tariff income is income hypothetically derived from stocks of *capital* held by the individual. For every £500 (or part thereof) of capital above £6,000 (£10,000 if the individual is living in a care home), the individual is deemed to have £1 per week of income. (Actual income derived from capital is ignored except in the case of income from annuities, life interest or life rent, rent paid by occupants of property owned by the claimant, and property held in trust. In these cases, actual income is counted rather than *tariff income*.)

Notional income is income that the claimant is deemed to have deprived themselves of in order to qualify for PCGC. This includes, for example, state pensions that the claimant is entitled to but has deferred claiming.

Capital includes all assets owned or part-owned by the individual (subject to some exceptions, outlined below). Capital in the UK is valued at current market or surrender value less 10% if there would be expenses attributed to its sale. Capital outside the UK is valued at its foreign value if it can be transferred to the UK or at the price for which it could be sold to a UK buyer if not (again less 10% if there are expenses associated with its sale). Shared capital is treated as if it is shared equally between all owners.

There are some exceptions that are not included in measures of capital for the purposes of calculating *tariff income* for PC:

- The value of the home the claimant normally lives in if they own it. This includes any garage, garden, outbuildings and land, together with any premises that the claimant does not occupy but that it would be impractical or unreasonable to sell. This includes:
  - any premises the claimant will occupy within 26 weeks, or the proceeds of the sale of the former home which will be used to purchase a dwelling that will be occupied within 26 weeks;

[46] Increases for adult dependants are only ignored if the dependant is not the claimant's partner.

  - a dwelling owned by the claimant in which any family member who is over 60 or incapacitated lives.

- The taxable lump sum paid from deferred state pension entitlement (see Section 3.5.1).

- Personal possessions (including jewellery, furniture and car).

- Sums paid to repair/replace the damage/loss of personal possessions or sums acquired to repair or improve the home are ignored for six months, or longer if reasonable.

- Business assets for a self-employed claimant.

- Value of a funeral plan.

- Arrears or concessionary payment to compensate for the non-payment of some benefits.

- The payments from some trust funds for some periods.

- The value of the right to receive income from an occupational or personal pension scheme.

Notional capital is included in measures of capital, and includes all capital an individual is deemed to have disposed of (or failed to claim where they were entitled to it) in order to qualify for PC. A claimant is not deemed to have intentionally disposed of capital if they used it to reduce or pay off debts or to make reasonable purchases.

Qualifying income for the purposes of savings credit entitlement includes all income included in *total income* except: working tax credit, incapacity benefit, contributory employment support allowance, contribution-based jobseeker's allowance, severe disablement allowance, maternity allowance, and maintenance payments for an individual or their partner from a spouse or former spouse.

6.4.4 Practicalities of pension credit payment

Pension credit is awarded for an 'assessed income period', normally five years (beginning on the day the decision is made). The specified period can be less than five years if it is considered that the particulars of the claimant's retirement provision are not likely to be typical of the provision over the next 12 months. The assessed income period will also end if the claimant changes marital status, enters a care home, reaches 65 or has a partner who reaches 65. An assessment period cannot be specified if one partner is aged under 60.

What is treated as retirement provision is fixed for that assessed income period and the claimant does not have to report any changes in their retirement provision. The amounts from each element of provision can be deemed to increase annually, and this will be taken into account when making the PC award. If a claimant thinks this automatic annual uprating is working against them, they can apply for a new decision. The aim of having an assessed income period was to make the scheme less intrusive.

6.5 Other means-tested benefits

Under the current system, individuals aged over the SPA may also be entitled to other means-tested benefits that are not specific to pensioners but that are potentially available to all low-income individuals. The most important of these are:

- housing benefit (HB), which is payable to low-income families who rent;[47]
- council tax benefit (CTB), which is payable to low-income families who are liable to pay council tax on the property in which they live.

For more detail on HB and CTB, see Levell et al. (2009).

Entitlement for these benefits is means-tested and calculated in a similar way to entitlement for PC. Pensioners who are entitled to the PCGC are automatically entitled to the maximum amount of HB and CTB. Those who are entitled to only the PCSC or to no PC may still be entitled to HB and CTB if their income is less than some 'applicable amount'. This applicable amount is higher for pensioners than for younger individuals by an amount equal to the maximum PCSC. This ensures that pensioners entitled to both the PCSC and HB/CTB receive the full benefit of any PCSC entitlement, rather than having it offset by a lower HB/CTB entitlement. However, pensioners who have capital over £16,000 (and are either entitled to the PCSC only or not entitled to any PC) are not able to claim any HB or CTB.

[47] Low-income pensioner families who have non-rent housing costs, such as paying interest on a mortgage on their home, are not eligible for HB but may instead be eligible for an additional payment through PC; see chapter 34 of Child Poverty Action Group (2009/10).

7. Overview of the post-2007 state pension system

Sections 3, 4 and 6 have described in detail the changes to state support for pensioners that were legislated in the Pensions Act 2007. However, there are many transitional issues involved in each case and examining each policy in isolation distracts from the bigger picture. Section 7.2 therefore draws together all the reforms (to the BSP, S2P and PC) to take a look at what state support for pensioners will be like once all the reforms are fully implemented. As background to this discussion of the post-2007 system, we begin in Section 7.1 with an overview of the state support provided to earlier cohorts of pensioners and what pre-2007 policy would have implied for future pensioners.

7.1 Pre-2007 policy and implications for earnings replacement

The various policies outlined in the preceding sections indicate that the state support that a pensioner receives depends not only on how many years an individual worked for, but also how much they earned and – crucially – when they earned that income. One way of summarising the compound effect of all the policies and policy changes mentioned is to look at how the level of state income in retirement compares with the earnings that an individual was used to during their working life. This is shown, for an example 'type' of person, in Figure 7.1. The vertical axis measures the replacement rate of age-50 earnings provided by state income at the SPA (that is, the ratio of annual income from the state received at SPA to annual income from earnings at age 50). This is shown for people reaching SPA in each year from 1970 to 2060, assuming that each of these people earned at the level of median male earnings for someone of their age throughout their working life. Figure 7.1 incorporates all policy announcements up to (but excluding) Pensions Act 2007.

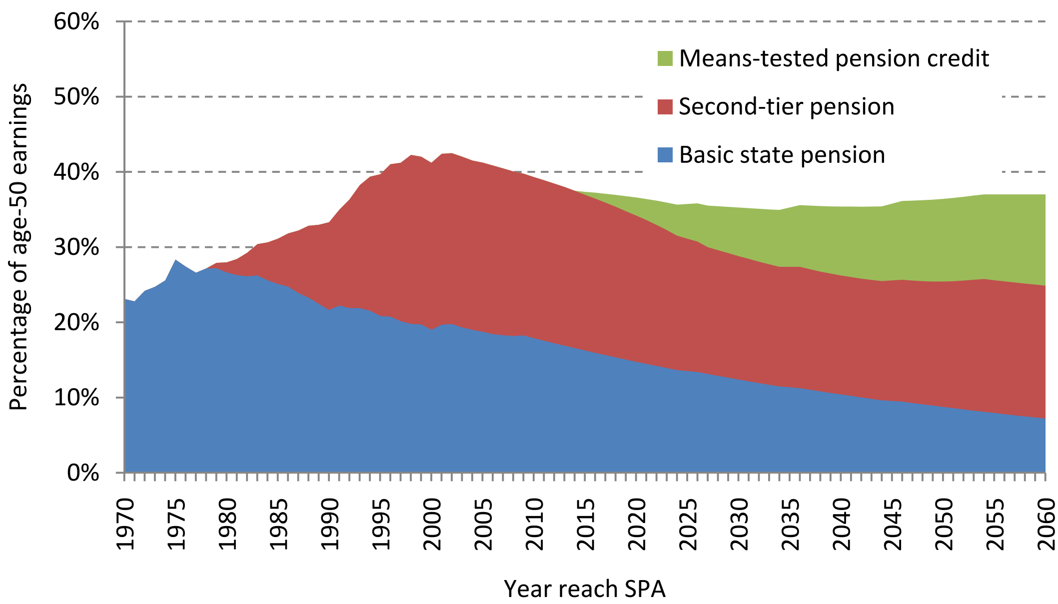
As a result of its level being indexed to average earnings from 1970 until the early 1980s, the replacement rate provided by the BSP to someone who had earned median male earnings throughout working life rose slightly. However, from 1980, the relative value of the BSP began its long decline relative to median earnings, as it was then indexed solely to prices, which grew less quickly than earnings over this period. As Figure 7.1 shows, the ratio of BSP income at SPA to age-50 median male earnings peaked at about 28% for those reaching SPA in 1975 and declined thereafter. Under the policies in place prior to Pensions Act 2007, this decline was projected to continue indefinitely.

The introduction of the second-tier pension in 1978 increased the income replacement rate of the state pensions. This was more important for those reaching the SPA later, as they had longer to build up entitlement to the additional pension. The combined replacement rate of the state pension under the current system therefore peaked for those who reached the SPA around 2000. Since then, the generosity of the state pension has started to decline again.

With the combined value of SERPS/S2P and the BSP relative to lifetime earnings declining for those reaching SPA from 2000 onwards, under pre-2007 policy, reliance on means-tested benefits was projected to increase significantly. As Figure 7.1 shows, assuming they had no private income sources, individuals retiring in 2030, who had earned each year at the male median earnings level, were projected to receive about 18% of their state retirement income in the form of means-tested benefits. However, as their replacement rate is so low (at 35%), such an individual would have had a strong incentive to save and so they would have been unlikely in reality to have had no private income sources.

A similar picture to that shown in Figure 7.1 (which is for an individual on median male earnings) would be painted for higher- (lower-) income individuals. The main differences would be that income replacement rates would be projected to level off at a lower (higher) level and lower-income individuals would also be likely to be eligible for more means-tested benefits from an earlier date.

Figure 7.1. Income replacement rates from state pensions and means-tested benefits at SPA for a median earner: before the Pensions Act 2007



Notes: Simulated age-50 earnings replacement by state pensions and means-tested benefits when reaching SPA. The calculations assume that the individual earned median male earnings in each and every year of their working life.
Source: Authors' calculations.

7.2 What will the 'new' system look like?

The Pensions Act 2007 will take decades to implement fully. In particular, the amount of S2P entitlement earned in a year will not cease to be in some way earnings-related until about 2030 (see Section 4.3). This means that the first individuals to have spent their entire working lives under a system of flat-rate S2P accrual will not reach pension age until about 2080. However, it is worth taking a broader look at what the final system will look like to get a clearer picture of what the latest state pension reforms sought to achieve.

Once the Pensions Act 2007 reforms are fully implemented, the state pension system will essentially consist of two broadly flat-rate components – the BSP and S2P – to which almost all UK pensioners will be entitled. Since the range of activities that will earn credit to the BSP and S2P (outlined in Sections 3 and 4) is so broad, most individuals who have spent most of their working life resident in the UK will reach SPA with full entitlement.

In other words, most pensioners will be provided with a minimum level of income by the BSP and S2P, which will be related to the average level of economy-wide earnings but will be unrelated to an individual's own past earnings. Those used to higher earnings during their working lives will therefore need to make greater private provision than those with previously lower earnings, in order to achieve a given level of earnings replacement from pension income.

The BSP will be paid at a single rate, with all eligible pensioners in any one financial year receiving the same amount of income. This level will be increased each year in line with average earnings.

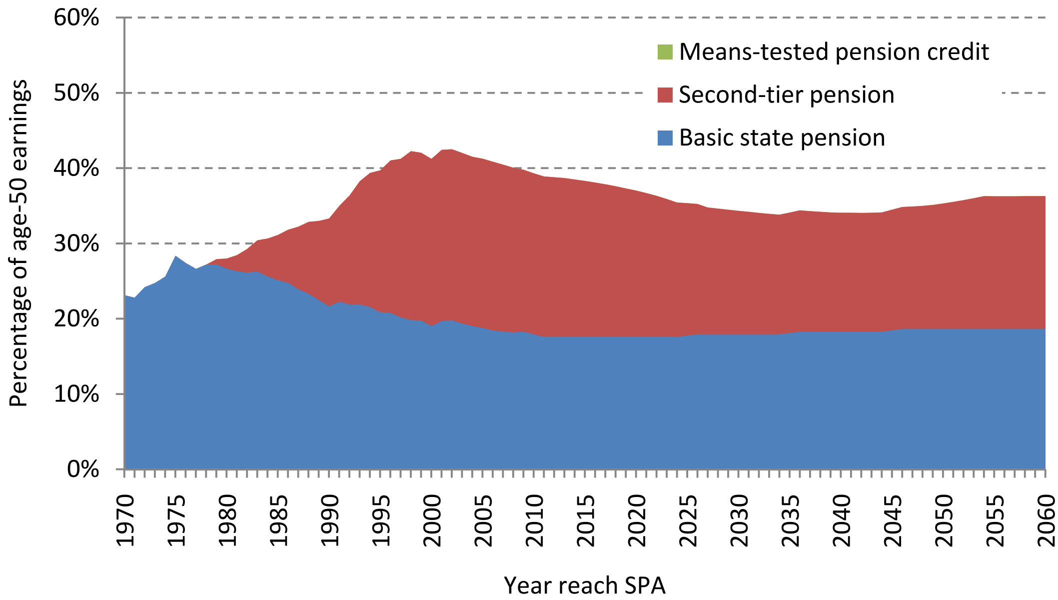
S2P income will be calculated slightly differently. Provided an individual is engaged in a 'creditable' activity in a particular year of their working life, they will earn entitlement to a given weekly pension income which will be some function of the average level of earnings in that particular financial year. What this means is that the weekly S2P income any one pensioner receives in a particular year will depend on how old they are at that time. Specifically, as long as average earnings grow in real terms over time, younger pensioners will receive more S2P than older ones. Unlike BSP income, pensioners of different ages will receive different weekly incomes, even though they may all have accrued the maximum possible entitlement to S2P. An individual's S2P income in payment will increase in line with prices each year.

The fact that, in payment, BSP income is set to be indexed to earnings while S2P income is set to be indexed to prices means that BSP income will account for an increasingly large share of a pensioner's total state pension income as they move through retirement.

7.3 Post-2007 policy and earnings replacement

As Figure 7.1 showed, in the absence of the 2007 state pension reforms, the replacement rate from non-means-tested state pensions had been forecast to continue declining and eligibility and reliance upon means-tested benefits to rise substantially. The effect of the Pensions Act 2007 policies, as shown in Figure 7.2, is broadly to halt the decline in non-means-tested state pension income as a share of earnings and thus limit the expansion of eligibility for means-tested benefits.

Figure 7.2. Income replacement rates from state pensions and means-tested benefits at SPA for a median earner: after the Pensions Act 2007



Notes and source: As Figure 7.1.

Figure 7.2 again shows the replacement rate provided by state income at SPA for someone who has earned median male earnings in each year of working life, but now incorporating the Pensions Act 2007 reforms. This figure assumes that earnings indexation of the BSP is started in 2012. Under this assumption, the value of the BSP relative to age-50 earnings for these example individuals will stabilise from 2012 at nearly 18%. On current plans for the BSP and S2P (see Sections 3.1 and 4.3), the combined replacement rate of age-50 earnings for someone with earnings equal to median male earnings throughout their working life will stabilise at around 35% for those reaching SPA from 2030 onwards.

As Figure 7.2 shows, these example individuals would not be eligible for any means-tested PC upon reaching the SPA, as entitlement to BSP and

SERPS/S2P is sufficient to raise them above the threshold.[48] Though, of course, given the indexation arrangements for BSP, SERPS/S2P and means-tested benefits, these individuals may still drift back onto means-tested benefits later in retirement.

The significant differences between Figures 7.1 and 7.2 demonstrate the potential success of the Pensions Act 2007, assuming all policies are implemented as planned, at meeting its aim of halting the constant decline in the generosity of UK state pensions relative to earnings. What these figures also highlight is the profound difference policy changes can make to the entitlement an individual can expect from the state pension system. However, as Section 8 will show, the new state pension policies (and, importantly, the rising number of pensioners in the UK) imply a significant increase in pension spending as a proportion of GDP in future years. If future governments decide to shy away from this, the pension system could face more important changes, and future entitlements could look very different. State pension entitlements are therefore still subject to a fair amount of political risk.

Only three years after Pensions Act 2007 was passed, the new Conservative/Liberal Democrat coalition government has indicated an intention to change the proposed state pension reforms. The coalition agreement commits it to increasing the level of the BSP by the highest of growth in average earnings, RPI inflation and 2.5% from April 2011 onwards.[49] This is an increase in generosity relative to previous policy on two fronts: first, because the link to average earnings growth has been brought forward by one year from the earliest date previously envisaged; and second, because the coalition government has introduced a guarantee that the BSP will not be increased by any less than RPI inflation or 2.5%. However, it has also said it will review whether the date at which the SPA starts to rise to 66 should be brought forward.

[48] It is possible, however, that individuals would still be subject to means testing if they qualified for housing benefit or council tax benefit. This would depend on their housing costs and council tax liability.

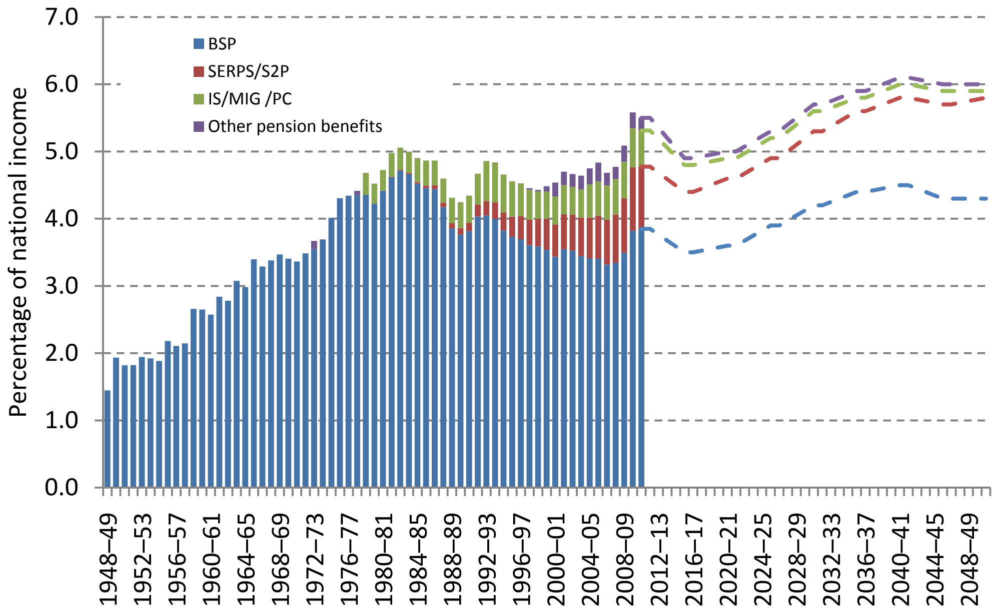
[49] HM Government, 2010.

8. Total government spending on pensioners: history and projections

8.1 Total spending on pensioners

It is clear from the preceding sections that state support for pensioners has varied over time. This can be seen in Figure 8.1, which shows UK government spending on pensioner benefits, as a percentage of national income (GDP), since 1948. The policy changes described in earlier sections have led to changes in the level of state spending on pensioners over time.

Figure 8.1. UK state pension expenditure as a share of national income



Note: These figures do not include spending on housing-related benefits (i.e. HB and CTB) or disability-related benefits paid to pensioners.
Source: Benefit expenditure from Department for Work and Pensions, Benefit Expenditure Tables, medium-term forecasts (June 2009) and long-term projections (May 2008), http://research.dwp.gov.uk/asd/asd4/expenditure.asp.

In Figure 8.1, total expenditure is divided between the main components of the system: BSP (all categories), additional pension (SERPS/S2P), means-tested benefits (MIG/PC) and other benefits (which comprise the Christmas bonus, winter fuel payments and the over-75s' TV licence).

From the introduction of the integrated social security system in 1948 until the 1980s, expenditure on the BSP rose rapidly – from 1.5% of national income in 1948–49 to over 4.5% by 1981–82. As the system matured, increasing numbers of pensioners reached SPA with NI contribution records that entitled them to a BSP. Furthermore, whilst it was only increased on an ad hoc basis until 1975 (when the increases were formally linked to the higher of average earnings growth or price inflation), the discretionary increases were on average more than sufficient to keep pace with increases in average earnings until the 1970s (this was shown in Figure 3.1). From the early 1980s, expenditure on the BSP as a share of national income fell fairly dramatically, primarily as a result of the switch to price indexation. However, total spending on pensioner benefits remained fairly constant because the expenditure on SERPS increased, as individuals built up entitlement, and a fairly constant amount was spent on IS/MIG/PC.

In the last decade, there has been an increase in total pension expenditure. This has been contributed to by the continuing gradual increase in entitlements accrued in the earnings-related schemes (the peak of generosity of these schemes was for those reaching SPA in 2000) and by the introduction of the other non-means-tested flat-rate pension benefits (discussed in Section 5). However, per-pensioner expenditure on these benefits has been fairly constant since they were introduced because they are small-value benefits that have not been significantly altered since their introduction. Therefore, any expenditure increase shown in Figure 8.1 is caused primarily by the increase in the number of claimants.

The Department for Work and Pensions also produces forecasts for state spending on pensioners from 2010–11 to 2050–51 at five-year intervals; these figures assume that the existing uprating policy continues forevermore.[50] The projections show a rapid increase in expenditure on the BSP, a slight increase in expenditure on the additional pension, and a slight fall in expenditure on means-tested benefits. Part of the increase shown will be due to growth in the size of the retired population (discussed in Section 8.2). The other important factors affecting the increase in BSP spending are the increase in the ease with which individuals will acquire full entitlement (through reducing the *requisite number* of *qualifying years* of contributions required for the full BSP, as discussed in Section 3.2) and the planned increase in the generosity of the pension (through the future return to earnings indexation). Expenditure on SERPS/S2P is projected to rise, because in future years more individuals will be retiring with greater entitlements to them. Expenditure on means-tested benefits is projected to fall as more individuals have sufficient income from their state (and private) pension entitlements and other savings to avoid being eligible for means-tested benefits.[51]

[50] In the case of the BSP, the forecasts for spending assume that the level of the BSP is increased by the greater of RPI inflation and 2.5% each year to 2011–12 and by earnings growth thereafter.

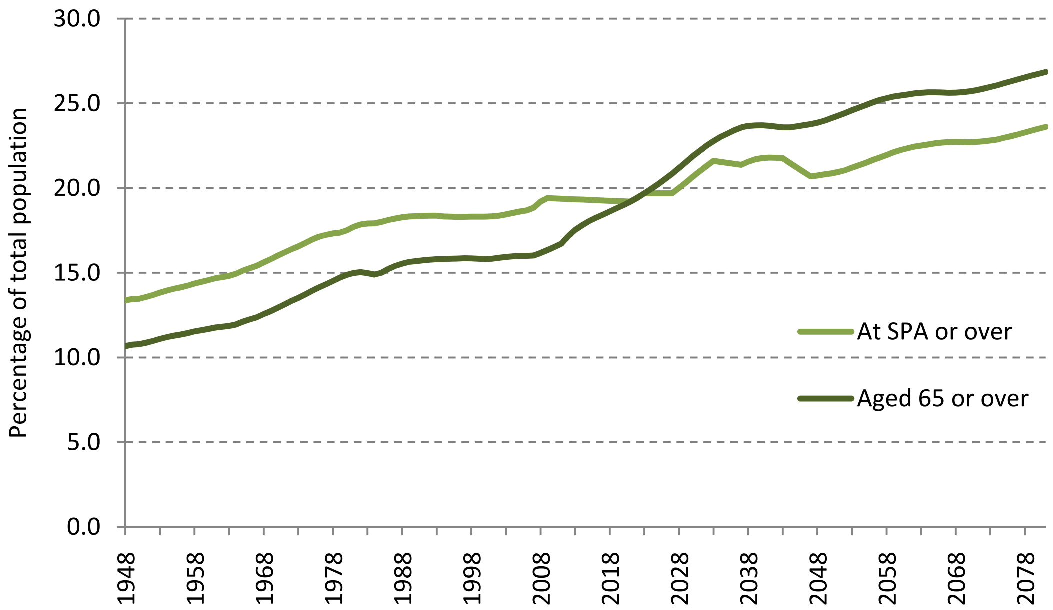
[51] This was an explicit aim of the pension reforms legislated in the 2007 and 2008 Pensions Acts – i.e. that higher BSP entitlement, coupled with S2P and greater private provision, should mean fewer pensioners will be eligible for means-tested benefits in future.

Expenditure on the other flat-rate benefits is predicted to stay roughly constant as a proportion of GDP. The value of these small benefits is not significantly increased each year and so the increase in the number of claimants, which would tend to increase spending, will likely be offset by real growth in the economy, leaving expenditure as a proportion of national income unchanged.

8.2 Growth in the number of pensioners

Aside from policy changes, the other factor driving the patterns of spending shown in Figure 8.1 is changes in the demographic composition of the UK population over time. Figure 8.2 shows that the fraction of the population at SPA or over (in other words, the fraction of the population who were pensioners) increased from just over 13% in 1948 to just over 19% in 2010.

Figure 8.2. Percentage of the UK population aged 65 or over and at SPA or over



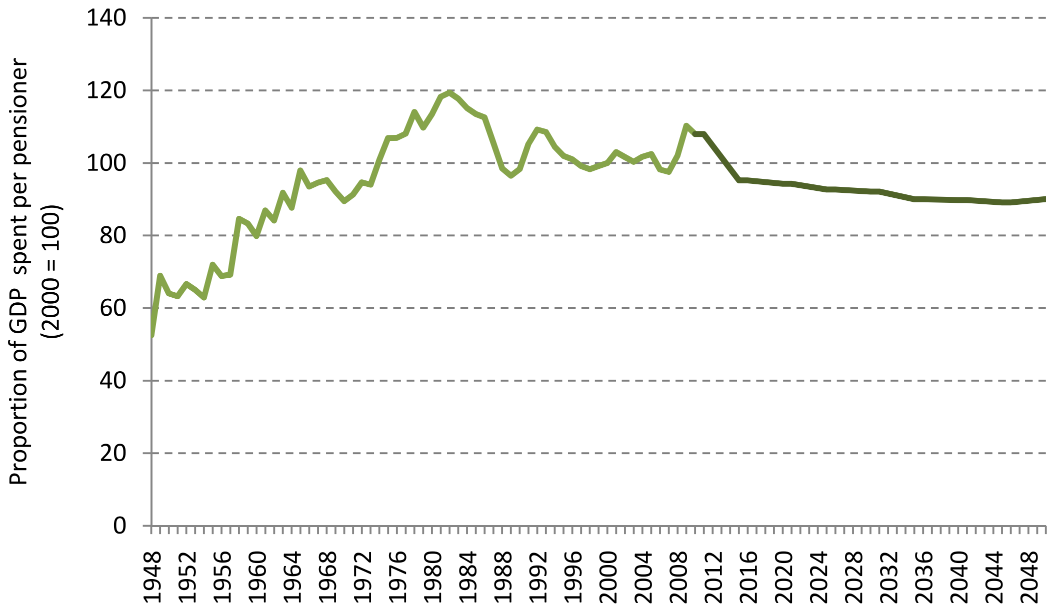
Note: Population data refer to calendar years rather than financial years.
Source: Data 1948–2007 are from the Human Mortality Database (http://www.mortality.org/). Projections 2008 onwards are from Office for National Statistics, Population Estimates (http://www.statistics.gov.uk/hub/population/index.html).

Looking forwards, the proportion of the population at SPA or over is forecast to continue growing over the next few decades, reaching almost 21% by 2050. However, this growth in the size of the pensioner population is lower than it might have been, because the SPA is due to increase over this period, as discussed in Section 3.1.2. As Figure 8.2 shows, the population aged 65 or over is projected to grow more quickly than the population at SPA or over.

8.3 Spending per pensioner

Taking together the figures for total spending as a share of national income and the figures for the size of the pensioner population, we can produce figures for state spending per pensioner, presented in Figure 8.3. This shows that the increase in total spending between 1948 and the early 1980s was also reflected in an increase in spending per pensioner, as more and more people reached SPA with substantial entitlement to state pensions. The proportion of national income spent per pensioner roughly doubled between 1948 and the late 1970s.

Figure 8.3. Proportion of national income spent per pensioner in the UK (2000 = 100)



Notes and source: As Figures 8.1 and 8.2.

Since the early 1980s, spending per pensioner has been broadly flat or declining. (It is of interest to note that spending per pensioner, as a share of national income, tends to increase during recessions and fall during booms – see, for example, the early 1990s and 2008/2009.) The forecast is for spending per pensioner to decline slightly over the next few decades.

9. Conclusions

To understand the state pension incomes received by pensioners today, one has to look back at 60 years of policymaking that has trivially tweaked and majorly reformed a system that Beveridge originally envisaged, in 1942, as 'for all citizens adequate pensions without means test'.[52] This Briefing Note is not a history of pension policy as it might be understood by historians or political scientists. Its main objective is to provide practical information on pension rules over the last 60 years to allow researchers, and especially economists, to compute pension rights, measure incentives and assess the impact of pension provision on individual behaviour.

This document has provided both a short history of the evolution of the state pension system and, for the interested analyst, a detailed description of pension income entitlements for pensioners over the last 60 years. Our aim was, as comprehensively as possible, to collect in one place all the rules and regulations relating to state pensions that have prevailed over the last 60 years. There is not, to our knowledge, any other work that has done this. In this endeavour, we have drawn particularly heavily on various editions of the extremely comprehensive Tolley's and CPAG (Child Poverty Action Group) handbooks on state benefits.

Apart from producing complex and abstruse rules, the historical dimension of pension provisions has another, more important, consequence: any future pension reform is bound to depend on past choices. Much more than for any other types of public policy, pension provision cannot escape the promises made in the past. This makes it all the more important to have a clear overview of the long-term history of pension provision in the UK since the major contribution of the Beveridge Report.

Many commentators have criticised the Beveridge Report for its failure to choose between non-contributory pension provision and the social insurance framework. In the words of Dilnot, Kay and Morris (1984), 'the Beveridge concept of social insurance has proved inadequate as a basis for the British social security system and … has in fact been substantially abandoned'. As we have shown, the UK state pension system that exists today is a complicated one that is the product of decades of policy changes. There are four main components: the basic state pension, earnings-related benefits, flat-rate non-contributory benefits and means-tested benefits. Each of these has been tinkered with or reformed over time and, as new systems and rules have been introduced, entitlements under previous

[52] Beveridge, 1942, page 8.

systems have often been preserved. This means that individuals retiring today can still be affected by pension systems and rules that existed over 40 years ago. In other words, the pension benefits available to a given individual depend not just on their National Insurance contributions history but also, crucially, on the dates they made these contributions and the date at which they reach state pension age.

The UK state pension history is best described as the result of a dilemma amongst policymakers as to whether to choose comprehensive social insurance or merely the provision of subsistence income. Earnings-related social insurance schemes are costly for the public finances and do not have redistribution at their heart. They address concerns of market failure and rest somehow on the paternalistic view that individuals would not, on their own, save sufficiently for their old age. Non-contributory, means-tested pensions address, at a lower cost, redistributive motives. However, such means-tested benefits have unattractive disincentive features. Trading off the concerns of cost minimisation and poverty avoidance without destroying retirement saving incentives has been the story of pension reform in the UK ever since Beveridge. The state pension system has been a mainly flat-rate, largely non-contributory system, periodically tempted by the higher replacement rate of social insurance schemes, but always eventually frightened by their cost. The latest reforms (in the Pensions Act 2007) are no different; this Act legislated for more generous flat-rate benefits, for which more people would be eligible, but any significant element of earnings replacement has been left to private provision (albeit with greater state encouragement and support for such private saving). However, forecasts for spending on pensioners under the new policies suggest that this spending will increase quite considerably as a share of national income over the next few decades. Will future governments be prepared to bear this cost or will they too become frightened, as their predecessors have?

Appendix A. State pension ages

An individual's SPA depends on their sex and birth date:

- SPA for men born before 06/04/1959 is 65.
- SPA for women born before 06/04/1959 is given in Table A.1.
- SPA for all individuals born after 05/04/1959 is given in Table A.2.

Table A.1. SPA for women born before 06/04/1959

Date of birth (DOB)	*Date SPA reached*
Before 06/04/1950	DOB + 60 years
06/04/1950 – 05/05/1950	06/05/2010
06/05/1950 – 05/06/1950	06/07/2010
⋮	⋮
06/02/1955 – 05/03/1955	06/01/2020
06/03/1955 – 05/04/1955	06/03/2020
06/04/1955 – 05/04/1959	DOB + 65 years

Table A.2. SPA for men and women born after 05/04/1959

Date of birth (DOB)	*Date SPA reached*
06/04/1955 – 05/04/1959	DOB + 65 years
06/04/1959 – 05/05/1959	06/05/2024
06/05/1959 – 05/06/1959	06/07/2024
⋮	⋮
06/02/1960 – 05/03/1960	06/01/2026
06/03/1960 – 05/04/1960	06/03/2026
06/04/1960 – 05/04/1968	DOB + 66 years
06/04/1968 – 05/05/1968	06/05/2034
06/05/1968 – 05/06/1968	06/07/2034
⋮	⋮
06/02/1969 – 05/03/1969	06/01/2036
06/03/1969 – 05/04/1969	06/03/2036
06/04/1969 – 05/04/1977	DOB + 67 years
06/04/1977 – 05/05/1977	06/05/2044
06/05/1977 – 05/06/1977	06/07/2044
⋮	⋮
06/02/1978 – 05/03/1978	06/01/2046
06/03/1978 – 05/04/1978	06/03/2046
06/04/1978 onwards	DOB + 68 years

Appendix B. Earnings credits

An individual can be credited with earnings on their National Insurance contribution records for a number of reasons.

- *Credits for unemployment or incapacity for work (class 1 credits)*
    - each week receiving contributory jobseeker's allowance
    - each week claiming credits and seeking work and not in work or education
    - each week claiming incapacity benefit
    - each week claiming severe disablement allowance
    - each week claiming disability or severe disability element of the working tax credit
    - each week entitled to statutory sick pay
    - each week spent sick or unemployed with income support
- *Credits for caring for a disabled person (class 1 credits)*
    - each week receiving carer's allowance
- *Credits for the maternity pay and adoption pay period (class 1 credits)*
    - each complete week receiving statutory maternity pay, maternity allowance or statutory adoption pay
- *Credits for jury service (class 1 credits)*
    - each week spent on jury service (after 6 April 1988)
- *Credits following bereavement (class 1 credits)*
    - each year since end of bereavement benefit until the second condition for contribution-based jobseeker's allowance or incapacity benefit is satisfied
- *Credits for tax credits (class 1 credits)*
    - each week receiving working tax credit – but only to one person in a couple; same provision previously with working families' tax credit and disabled person's tax credit – abolished in April 2003 – as well as family credit and disability allowance

- *Credits for quashed conviction (class 1 credits)*
    - each complete week imprisoned or detained if conviction has been subsequently quashed by the court
- *Credits for official error (class 1 credits)*
    - credits if they were wrongly awarded
- *Starting credits – aged 16–18 (class 3 credits)*
    - each week after 16 and the following two years if insufficient other contributions to achieve full BSP entitlement (but this does not apply to years prior to 6 April 1975)
    - prior to 1975, contributions could be credited to any person who had not attained the age of 18 for any week of education, apprenticeship or training provided there was no liability to pay a contribution; the class of credit depended on their circumstances, but for someone who had not regularly worked, it was a credit as a non-employed person (similar to the present class 3)
- *Credits for education and training (class 1 credits)*
    - for weeks when in full-time education if:
– training is full-time
– course lasts less than one year
– training is not part of job
– they are 18 or over at start of tax year in which relevant week falls
- *Credits for people aged 60 and over (class 1 credits)*
    - for tax year in which they turn 60 and for following four years (autocredits), unless they are due to pay class 2 contributions or are abroad for more than 182 days; these applied to men from the 1983–84 tax year onwards

      These will be phased out from April 2010 in line with the increase in women's SPA. Men born after 5 October 1954 will not get these credits. Men born earlier will get between one and five full years of automatic credits depending on their date of birth.

Appendix C. Disregards for the purposes of pension credit

There are a number of items that can be partially disregarded from income for the purposes of calculating PC. These are described in the State Pension Credit Regulations 2002, Schedule VI. A number of the main disregards are listed below.

Sums disregarded from earnings are:

- Payments in kind (e.g. petrol)
- An advance on earnings or a loan (which are instead treated as capital)
- The value of free accommodation provided by the employer
- Payments towards expenses that are 'wholly, exclusively and necessarily' incurred during the course of work
- £20 if:
  - claimant is a lone parent
  - claimant or partner is receiving long-term incapacity benefit, severe disablement allowance, disability living allowance or mobility supplement or is registered blind
  - claimant or partner qualifies for a carer premium
  - claimant or partner is a part-time fireman, auxiliary coastguard, part-time member of a lifeboat crew or a member of the Territorial Army

  Note that a maximum of £20 can be disregarded for any one of the above reasons, even if both partners were to satisfy the relevant condition.
- If none of the above, the first £5 per week of a single claimant's earnings, or the first £10 per week of a coupled claimant's earnings, is disregarded.

Sums disregarded from non-earned income are:

- £10
  - from any war disablement pension, war widow(er)'s pension, widowed mother's allowance and widowed parent's allowance

- from any guaranteed income payment and survivor's guaranteed income payment under the Armed Forces and Reserve Forces Compensation Scheme
- from any pension paid by Germany or Austria to the victims of Nazi persecution

- If a claimant provides board and lodging accommodation in their home, 100% of payments for such accommodation less than £20, or £20 + 50% of payments in excess of £20. However, if the boarder is a 'close relative' or not staying on a commercial basis, this disregard does not apply.

- If a claimant rents out part of their home but does not provide board, 100% of the weekly rent up to £20 maximum is ignored.

- The interest on a loan used to purchase an annuity secured on their home (subject to some conditions)

- Up to £20 from payments from trusts for some purposes

- Income that cannot be transferred to the UK

- Charges from converting foreign income to Sterling

- Payments for injury/accident/disease

Appendix D. Abbreviations

APP	appropriate personal pension
BSP	basic state pension
COD	contracted-out deduction
COMP	contracted-out money-purchase
COSR	contracted-out salary-related
CTB	council tax benefit
GDP	gross domestic product
GMP	guaranteed minimum pension
GRB	graduated retirement benefit
HB	housing benefit
HRP	home responsibilities protection
IS	income support
LEL	lower earnings limit
LET	lower earnings threshold
MIG	minimum income guarantee
NI	National Insurance
PC	pension credit
PCGC	pension credit guarantee credit
PCSC	pension credit savings credit
RPI	retail price index
S2P	state second pension
SERPS	State Earnings-Related Pension Scheme
SPA	state pension age
UAP	upper accrual point
UEL	upper earnings limit
UET	upper earnings threshold

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