

The balance between state and private pension provision

PPI Briefing Note Number 10

Introduction

Much of the debate on the future of pensions assumes a shift from state provision towards increasing private pension provision. This note shows that in reality this is unlikely to happen. It will continue to be the case that for most people the state will be the most important source of retirement income.

Further, state provision will increasingly be made through means-tested benefits rather than traditional state pensions—the Basic State Pension (BSP) and SERPS / State Second Pension (S2P). Means-tested benefits are more vulnerable to short-term change as they are not based on contributions built up over a working life.

Who qualifies for BSP?

BSP is a flat-rate pension. It is not universal, as not everyone qualifies for a full BSP. Qualification is closely linked to work¹.

The amount of BSP received depends on the number of years between ages 16 and state pension age that are 'qualifying years'. A year is a qualifying year if annual earnings are above the lower earnings limit².

People can also get 'credits', to replace a qualifying year for BSP in special circumstances. These

PPI Briefing Notes clarify topical issues in pensions policy.

Chart 1: Five million people are not qualifying for the Basic State Pension

Qualification for state pension in 2002/3
100% = all working age adults (35 million)

13% 5 million

Not qualifying

20%
7 million
BSP only

26%
9 million
BSP and S2P

41%
14 million
BSP and contracted-out

include receiving disability or unemployment benefits, and being in full-time education up to age 18. Men aged 60 to 64 automatically have qualifying years.

Carers (including those looking after children aged under 18) do not receive a qualifying year if they are not working, but the number of qualifying years they need to get a full BSP is reduced. This is known as Home Responsibilities Protection (HRP).

Despite the wide range of credits available and HRP, in 2002/3 up to 5 million people did not get a qualifying year; representing one-in-eight of the working age population (Chart 1)³.

These individuals may have been working but earned less than the lower earnings limit, be unemployed but not qualify for any benefits, or still be in full-time education.

As a result of missing qualifying years, many people do not qualify for a full basic state pension when they reach state pension age. The average amount of BSP received by men aged 65 in September 2003 was 97% of the full amount. For women aged 60, the average amount received was only 70% of the full amount⁴.

This picture looks better in future, but the BSP will still not be universal. By 2020 women are expected to receive 86% of the full rate on average⁵.

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Who qualifies for S2P?

Qualification for S2P is even more closely linked to employment. People with higher earnings accrue a higher benefit⁶.

Credits for S2P are not as widespread as for BSP. S2P credits for disabled people, or those caring for a child under 6 years of age cover up to 2 million people. The unemployed, and people caring for older children are not covered by S2P credits. Self-employed people do not qualify for S2P.

The result is that fewer people qualify for S2P than BSP. 12 million people (one-third of working age people) did not qualify in 2002/3 (Chart 1).

This is a snapshot, so people not qualifying in one year may qualify in other years. But the picture shows that while BSP is not universal, S2P is even less so.

Who has a private pension?

Fewer people have private pensions than have state pensions. 15 million people are currently accruing rights in a private pension, but 20 million people are not (Chart 2)⁷.

Therefore, for most people the state will continue to be the main provider of pension in-

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Chart 2: Most people are not accruing a private pension

Number of people of working age by income group with or without contributions going into a private pension in 2002/3, millions



come. People not working and lower earners are most likely not to have a private pension. These people are also those most likely to have low state pension entitlement.

State provision is changing

The value of contributory state pensions is falling. People retiring in future will get less in BSP and S2P than people retiring today⁸. This will result in many pensioners receiving very low incomes from the BSP and S2P, below poverty levels.

Private pension provision will not make up the difference for most people⁹. Only the highest earners tend to make regular private pension contributions¹⁰.

Instead, the means-tested Pension Credit (PC) will become an increasingly important part of retirement income. Most people reaching state pension age in 2028 would receive PC even if he or she had a full working life making average private pension contributions every year¹¹.

This means that the contributory system is slowly being replaced by means-testing. Despite the gaps in the contributory system, the state will continue to be the dominant provider of pensions for most people.

1 For further details see PPI (2003) *The Pensions Primer*

2 £4,108 a year from April 2004

3 PPI estimates based on data from the 2002/3 Family Resources Survey

4 Government Actuary's Department (GAD) (2003) *Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000*

5 GAD (2003) *Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2000*

6 For further details see PPI (2003) *The Pensions Primer*

7 PPI estimates based on data from the 2002/3 Family Resources Survey

8 Curry and O'Connell (2003) *The Pensions Landscape* PPI Charts 16–18

9 PPI Briefing Note Number 9 *Why is it so hard to save for retirement?*

10 Curry and O'Connell (2003) *The Pensions Landscape* PPI

11 Curry (2003) *The Under-pensioned* PPI