Conservative proposals for the future of the basic state pension

By Robert Chote and Carl Emmerson

(Reprinted from IFS Bulletin 81, December 2003)

In the great state pension debate, the main political parties have switched sides from where they stood six years ago. In opposition Labour argued that pensioners should no longer be subjected to means-testing, but in government they have extended it. Now it is the Conservatives in opposition who say means-testing should go, despite raising means-tested benefits more than universal support when they were in office.

The state helps pensioners financially in two main ways. First, through the Basic State Pension, with entitlement fixed regardless of other income. And second, through the new means-tested Pension Credit, where someone’s entitlement is lower the more income they have from savings and other sources. (The Pension Credit is introduced on Monday, when it will replace the less generous Minimum Income Guarantee.)

The Conservatives and Labour now have very different visions for the mix of universal and means-tested support. Labour aspires to raise the Basic State Pension in line with prices, while increasing the maximum amount that pensioners can receive (with the means-tested top-up included) in line with average earnings. In contrast, the Conservatives aspire to raise the Basic State Pension in line with earnings, but to increase the total entitlement to help for poorer pensioners only in line with prices.

The Conservatives say “no pensioners will lose from our package”. This is only true if by the time the Conservatives came to office Labour had abandoned its aspiration to continue raising the Pension Credit in line with earnings. But what if Labour was sticking to its guns? Assume prices rise by 2.5% a year and average earnings by 4.5% a year.

After four years, the Basic State Pension for a single person would have risen from £77.45 now to £85.55 under Labour’s plans and to £92.40 under the Conservatives. But taking the Pension Credit into account as well, total entitlement for the poorest single pensioners would rise from £102.10 now to £121.75 under Labour but to only £112.70 under the Conservatives.
Under the Conservative proposals, for anyone who had rights to a full Basic State Pension, the Pension Credit would be squeezed out of existence in 14 years. At that point the government would have to decide whether to continue to raise the Basic State Pension in line with earnings, to link it to prices, or use some other figure.

But the Conservatives rightly argue that not all pensioners take up the means-tested benefits they are entitled to, whereas almost all take up their Basic State Pension rights. Even if the current government were to hit its own target for take-up, as few as 73% of households entitled to the Pension Credit would actually receive it in 2006. People are less likely to claim benefits if their entitlement is relatively small, but even some of the poorest slip through the net. Pensioners who receive no income other than the Basic State Pension - because they are failing to receive the means-tested benefits to which they are entitled - would be better off under the Conservative proposals.

So where is the money coming from?

Labour’s existing spending projections explicitly assume that for the remainder of this Parliament the Pension Credit rises in line with earnings and that the Basic State Pension rises in line with prices (and by no less than 2.5% a year). Thereafter whether the aspiration continues to be met will depend on Budget plans each year.

Under the Conservatives the Basic State Pension would cost more than under Labour – and this difference would mount over time. The extra spending necessary would be partially offset because entitlements to means-tested benefits would be lower and because some pensioners would be paying income tax on the extra pension they received. The Conservatives also propose to find money by scrapping Labour’s New Deal packages to help younger people and lone parents into work, which they do not believe are cost effective. They also plan to make benefit rules for lone parents with older children more restrictive. Both would leave some people worse off.

The Conservatives’ own figures suggest that this policy package would roughly break even over the first four years. But they also concede that the net cost per year would have reached more than £500m in year four and would continue to rise thereafter if the aspiration to raise the Basic State Pension in line with earnings was maintained. As we noted earlier, the Conservatives assume that by the time they came to power Labour would have abandoned its goal to increase the Pension Credit in line with earnings. If Labour did maintain the link with earnings, the net cost of the Conservative package would actually be lower, but would still rise steadily over time.

Beyond the next parliament, question marks can be raised over the long-term aspirations of both parties. Is it realistic to assume that the number of pensioners facing means-testing can continue relentlessly to increase, as Labour’s aspirations imply? Or alternatively that the maximum financial help available to poorer pensioners will fall relative to average living standards, as the Conservatives’ imply? Who knows which party will be supporting what policy in another six years’ time?

ENDS
Figure 1.a Basic State Pension and Pension Credit Guarantee under Labour and Conservative aspirations in nominal terms

Note: Assumes inflation of 2½% a year and real earnings growth of 2% a year. No account is made for each year’s rounding of pension benefits. Normally benefits would be rounded to the nearest 5 pence per week.

Figure 1.a Basic State Pension and Pension Credit Guarantee under Labour and Conservative aspirations in real terms (2003–04 prices)

Note: Assumes real earnings growth of 2% a year. No account is made for each year’s rounding of pension benefits. Normally benefits would be rounded to the nearest 5 pence per week.