



## State Pension uprating – 2010 onwards

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The State Pension has different elements. The basic State Pension (BSP) is based on a person's National Insurance Contribution (NIC) record. Entitlement to the additional State Pension (ASP) (State Second Pension/SERPS) is accrued on the basis of earnings between specified limits in each year of working life from 1978 (unless the person has contracted-out into an occupational or personal pension). People who defer claiming the State Pension beyond State Pension age may receive an enhanced pension in the form of "deferred retirement increments".

The legislation currently in force requires these different elements of the State Pension to be uprated each tax year in line with inflation. However, the Labour Government applied more generous arrangements to uprating the BSP. From 2002, it was uprated each year in line with inflation or 2.5%, whichever was higher. This commitment did not apply to the ASP, which continued to be uprated strictly in line with prices.

Because RPI-inflation was negative in September 2009, RPI-linked benefits (such as the ASP) were frozen in cash terms in April 2010. The BSP increased by 2.5%, in line with the commitment to increase it by at least this amount. Inflation-linked benefits are expected to rise again in April 2011, reflecting the fact that inflation is expected to be positive this year.

The legislation does not specify what measure of prices should be used – just that it should be the "general level of prices obtaining in Great Britain, estimated in such manner as the Secretary of State thinks fit." In practice, since the power was introduced, the benchmark for the review of prices has been the Retail Prices Index (RPI) and, since 1988, the September RPI. However, the Conservative-Liberal Democrat Coalition Government has announced that it will use the Consumer Prices Index (CPI) for the price indexation of benefits and tax credits, from April 2011. The BSP will be uprated by a "triple guarantee" of earnings, prices or 2.5 per cent, whichever is highest, from April 2011."

This note provides a brief overview of policy on State Pension uprating, with the emphasis on 2010 onwards. The background is covered in more detail in Library Standard Note SN/BT 2117 [Pension Uprating – background](#).

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# 1 Legislative framework

## 1.1 Primary legislation

An individual's State Pension may be made up of different elements:

- The basic State Pension (BSP), to which people build entitlement on the basis of their National Insurance record. The amount of a person's BSP entitlement depends on the number of "qualifying years" they have built up;
- The second is the additional State Pension (ASP), which is earnings-related. This can be made up of the State Earnings Related Pension Scheme (to which people could accrue entitlement between 1978 and 2002) and the State Second Pension (which replaced SERPS from 2002 onwards). Before 1978, the earnings-related part of the State Pension was provided through the Graduated Retirement Benefit; and
- Deferred retirement increments, to which people may be eligible if they have deferred claiming their State Pension after they reach State Pension age.<sup>1</sup>

At present, the legislation providing for the uprating of the State Pension is in section 150 of the *Social Security Administration Act 1992*. In a nutshell, this requires the different parts of the state pension to be increased each April at least in line with price increases over the previous review period. It says:

### 150 Annual up-rating of benefits

- (1) The Secretary of State shall in each tax year review the sums—
  - (a) specified in the following provisions of the Contributions and Benefits Act— (...)
    - (ii) section 44(4) [*the basic state pension*] ...
    - (c) which are the additional pensions in long-term benefits [*additional or earnings related pension, SERPS or S2P*] (...)
    - (d) which are the increases in the rates of retirement pensions under Schedule 5 to the Contributions and Benefits Act [*deferred retirement increments*] (...)
  - [(l) specified in regulations under section 2 or 3 of the State Pension Credit Act 2002 [*Pension Credit*]

in order to determine whether they have retained their value in relation to the general level of prices obtaining in Great Britain estimated in such manner as the Secretary of State thinks fit.
- (2) Where it appears to the Secretary of State that the general level of prices is greater at the end of the period under review than it was at the beginning of that period, he shall lay before Parliament the draft of an up-rating order—
  - (a) which increases each of the sums to which subsection (3) below applies by a percentage not less than the percentage by which the general level of prices is greater at the end of the period than it was at the beginning; and

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<sup>1</sup> For more detail, see Library Standard SN/BT 2868 [Deferred Retirement Increments](#)

(b) if he considers it appropriate, having regard to the national economic situation and any other matters which he considers relevant, which also increases by such a percentage or percentages as he thinks fit any of the sums mentioned in subsection (1) above but to which subsection (3) below does not apply; and

(c) stating the amount of any sums which are mentioned in subsection (1) above but which the order does not increase.

(3) This subsection applies to sums—

(a) specified in Part I, [paragraphs 1 to 6 of Part III], Part IV or Part V of Schedule 4 to the Contributions and Benefits Act;

(b) mentioned in subsection (1)(a)(ii) or (iii), [(aa),] (b), (c), (d), [(dza),] (e) or (g) above. [*Includes state basic, additional and deferred pensions*]

(...)

(7) If the Secretary of State considers it appropriate to do so, he may include in the draft of an up-rating order, in addition to any other provisions, provisions increasing any of the sums for the time being specified in regulations under ... the State Pension Credit Act 2002 or which are additions to income support under regulations made under section 89 of the 1986 Act.

(8) The Secretary of State shall lay with any draft order under this section a copy of a report by the Government Actuary or the Deputy Government Actuary giving that Actuary's opinion on the likely effect on the National Insurance Fund of such parts of the order as relate to sums payable out of that Fund.

(9) If a draft order laid before Parliament in pursuance of this section is approved by a resolution of each House, the Secretary of State shall make the order in the form of the draft.

(10) An order under this section—

(a) shall be framed so as to bring the alterations to which it relates into force—

(i) in the week beginning with the first Monday in the tax year; or

(ii) on such earlier date in April as may be specified in the order;

(...)

(11) So long as sections 36 and 37 of the National Insurance Act 1965 (*graduated retirement benefit*) continue in force by virtue of regulations made under Schedule 3 to the Social Security (Consequential Provisions) Act 1975 or under Schedule 3 to the Consequential Provisions Act, regulations may make provision for applying the provisions of this section

[(a) to the amount of graduated retirement benefit payable for each unit of graduated contributions,

(b) to increases of such benefit under any provisions made by virtue of section 24(1)(b) of the Social Security Pensions Act 1975 or section 62(1)(a) of the Contributions and Benefits Act, and

to any addition under section 37(1) of the National Insurance Act 1965 (addition to weekly rate of retirement pension for widows and widowers) to the amount of such benefit.]<sup>2</sup>

The *Pensions Act 2007* provides for the link between increases in the basic State Pension and earnings to be restored by 2015 at the latest. Section 5 of the Act inserts a new section 150A into the *Social Security Administration Act 1992* which requires the Secretary of State to uprate the amount of the basic State Pension (and the standard Minimum Guarantee in Pension Credit) in line with any increase in the general level of earnings.

## 1.2 Annual uprating orders

The annual increases in benefits and tax credits are legislated for in a statutory instrument – a Social Security Uprating Order. This is subject to the affirmative parliamentary procedure. Most SIs subject to the affirmative procedure are laid in the form of a draft Order, which is later printed and added to the numerical run of SIs when it has been approved by both Houses. Such orders cannot be made unless the draft order is approved by Parliament. To do this, a motion approving it has to be passed by both Houses (or by the Commons alone if deals with financial matters). The responsibility lies with the minister, having laid the Instrument, to move the motion for approval.<sup>3</sup>

A draft Social Security Uprating Order is usually published in November or December, following the announcement of the benefit rates for the following year. Increases take effect in the week beginning with the first Monday in the tax year, or on such earlier date in April as may be specified in the order.<sup>4</sup> The benefit rates for 2010/11, for example, were announced on 10 December 2009.<sup>5</sup> The debate on the *draft Social Security Benefits Up-rating Order 2010* in the House of Commons was on [1 March 2010](#).<sup>6</sup> The SI was approved on a deferred division in the Commons on [4 March 2010](#). The State Pension increases took effect from 12 April 2010.<sup>7</sup>

## 2 Policy of the Labour Government

### 2.1 Basic State Pension

#### *Above inflation increases*

The legislation requires the State Pension to be uprated *at least* in line with prices. It can be increased by more than this if the Secretary of State so chooses.<sup>8</sup> The Labour Government did so on a number of occasions.

Price inflation in the year to September 1999 was only 1.1% so the April 2000 pension increase came out at only 75p for a single pensioner. This notoriously small increase<sup>9</sup> persuaded the then Chancellor, Gordon Brown, to announce a minimum increase in pensions. In his Pre-Budget Statement on 8 November 2000, the Chancellor announced that:

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<sup>2</sup> Section 150 was temporarily modified by section 23 of the [Welfare Reform Act 2009](#) in to allow the basic State Pension to be uprated in April 2010 even though the September RPI did not increase.

<sup>3</sup> House of Commons Information Office Factsheet L7, [Statutory instruments](#) (May 2008), page 5

<sup>4</sup> *Social Security Administration Act 1992*, section 150 (10)

<sup>5</sup> HC Deb, 10 December 2009, c518-26

<sup>6</sup> [HC Deb, 1 March 2010, c750-768](#)

<sup>7</sup> [Social Security Benefit \(Uprating\) Order 2010, \(SI 2010/793\)](#)

<sup>8</sup> See, for example, HC Deb, 30 November 1993, c925. This is discussed in more detail in Library Standard Note SN/BT 2117 [Pension Uprating - background](#).

<sup>9</sup> See, eg, “Paltry 75p a week rise is an insult to all pensioners”, *Sunday Express*, 23 April 2000, and “Pensions war hots up over 75p a week rise”, *Sunday Mirror*, 9 April 2000

Over the next two years, pensioner incomes should rise faster than inflation – indeed, faster than earnings – so from April next year we propose that, for a single pensioner, there should be a cash increase of £5 a week; and for a married couple, a rise of £8 a week. I can tell the House that in the following year we can also guarantee the pension will rise above prices – a cash increase of £3 for single pensioners and £4.80 for married couples. Over two years, therefore, there will be a cash rise of £8 for single pensioners and £12.80 for couples – for pensions, £2.6 billion more: more than the link with earnings would give.<sup>10</sup>

Then, with effect from 2002, the Labour Government committed itself to uprating the basic State Pension by the higher of 2.5 per cent and inflation.<sup>11</sup> In January 2009, it made an additional one off payment of £60 to pensioners and other groups eligible for the Christmas bonus. The intention was to help people “in vulnerable and on fixed incomes” in difficult economic circumstances following the financial crisis. The payment was described as the “equivalent to an amount which covers bringing forward uprating of a full basic State Pension from April to January.”<sup>12</sup>

### **Restoring the earnings link**

A statutory duty to increase state pensions in line with prices was first introduced by section 39 of the *Social Security Act 1973* (although the first uprating on a statutory duty did not take effect until April 1975. However, the Labour Government elected in February 1974 introduced legislation to require long-term benefits in line with earnings or prices, whichever was higher.<sup>13</sup> The Conservative Government elected in 1979 pronounced this “unsustainable” in the light of experience. The then Secretary of State for Social Services, Patrick Jenkin, argued that the guarantee that really mattered was “the guarantee against rising prices.”<sup>14</sup> Section one of the *Social Security Act 1980* amended the *Social Security Act 1975* to link long-term benefit increases to prices, not earnings.

The Labour Government elected in 1997 resisted calls to restore the earnings link for some years, arguing that it did nothing to help the poorest pensioners, on whom they wanted to concentrate resources:

**Mr. Wray:** To ask the Secretary of State for Work and Pensions what plans he has to increase the basic state pension; and if he will re-introduce the link to earnings. [106092]

**Mr. McCartney:** We have already announced that from April 2003, the basic state pension will increase to £77.45 for single pensioners and to £123.80 for married couples. Additionally, the minimum income guarantee will increase to £102.10 for single pensioners and £155.80 for couples. Restoring the earnings link does nothing to help poorer pensioners. We will be spending around £7.5 billion extra on pensioners in 2003–04 as a result of measures introduced since 1997. This includes around £3.5 billion that is being spent on the poorest third of pensioners—almost six times as much as an earnings link in the basic state pension since 1998 would have given them. Increases in the basic state pension over the last three years have given single

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<sup>10</sup> HC Deb 8 November 2000, c 326

<sup>11</sup> HC Deb, 27 November 2001, cc83607; HC Deb, 15 June 2005, 473W; *Pre Budget Report 2009*, para 5.43

<sup>12</sup> *Explanatory Memorandum to the Christmas Bonus (Specified Sum) Order 2008 (SI 2008 No 3255)*; See also, Library Standard Note SN/SP/632, “The Christmas Bonus and the associated £60 one-off payment for 2008/09”

<sup>13</sup> *National Insurance Act 1974*, section 5; *Social Security Act 1975*, section 125

<sup>14</sup> HC Deb 13 June 1979, c 439

pensioners £1.10 a week more than an earnings link would have given them and £1.75 a week more for couples.<sup>15</sup>

In 2005, the Pensions Commission<sup>16</sup> recommended that the Government should restore the link with earnings and make this affordable by increasing the State Pension age:

Index the [basic State Pension] to average earnings growth over the long-term: ideally starting in 2010 or 2011 as the public expenditure benefit of the rise in women's [State Pension age] begins to flow through ... making this indexation affordable long-term by raising the SPA gradually, broadly in proportion to the increase in life expectancy, for instance to 66 by 2030, 67 by 2040 and 68 by 2050<sup>17, 18</sup>

In a May 2006 White Paper, the Labour Government announced that it would restore the earnings link, probably from 2012:

3.24 During the next Parliament, therefore, we will re-link the uprating of the basic State Pension to average earnings. Our objective, subject to affordability and the fiscal position, is to do this in 2012 but in any event at the latest by the end of the next Parliament. We will make a statement on the precise date at the beginning of the next Parliament.<sup>19</sup>

Increases in the State Pension age (to 68, in stages, by 2046) would reduce the costs of the proposed reforms to the state pension system, enabling the Government to “tackle pensioner poverty, be able to sustain the generosity per pensioner of the State Pension, and sustain the balance between work and retirement.”<sup>20</sup>

The *Pensions Act 2007* included provision to restore the earnings link. Section 5 provided for an announcement to be made on the date the link would be restored by 1 April 2011 and for the link itself to be restored by the end of the current Parliament.

In its 2010 election manifesto, the Labour Party committed itself to restoring the earnings link from 2012.<sup>21</sup>

## 2.2 State Second Pension

The commitment to uprate the basic State Pension by the higher of 2.5% or inflation (see section 2.1 above) did not apply to the State Second Pension (S2P), which continued to be increased strictly in line with inflation. In 2000, the then Parliamentary Under Secretary of State, Baroness Hollis, said the Government had “no plans to alter that arrangement.”<sup>22</sup>

The different approaches to uprating the basic and additional State Pensions was raised as an issue during debate on the *Pensions Bill 2006/07* (the legislation which restored the link between increases in the basic State Pension and average earnings). Labour MP Sally Keeble commented that failure to also uprate the ASP in line with earnings could lead to its

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<sup>15</sup> HC Deb 1 April 2003 c677W

<sup>16</sup> Set up in 2002 to ‘advise on whether the existing system of voluntary private pensions would deliver adequate results’. For further details, see the archived [Pensions Commission](#) website.

<sup>17</sup> Pensions Commission, *A New Pension Settlement for the Twenty-First Century, Second Report*, November 2005, pix

<sup>18</sup> Ibid, p 21

<sup>19</sup> DWP, *Security in retirement: towards a new pensions system*, Cm 6841, May 2006

<sup>20</sup> Ibid, p 3.35

<sup>21</sup> [Labour Party Manifesto 2010, A future fair for all](#); 6.2

<sup>22</sup> HL Deb, 18 December 2000, c523W

value being eroded and was concerned about the impact on women's retirement incomes.<sup>23</sup> The then Shadow Work and Pensions Minister, Nigel Waterson, said there was a "double whammy" because the Labour Government was also introducing measures to reduce the earnings-related element of the ASP, so that it would become flat-rate more quickly than under the existing legislation. He said this would "particularly affect medium and higher earnings."<sup>24</sup> The then Pensions Reform Minister, James Purnell, argued that uprating the ASP in line with earnings would be expensive and was in any case not the right thing to do:

It would add a further £14 billion to the annual pensions bill by 2050, which is 0.4 per cent of GDP, but even setting aside the cost, neither we nor the Pensions Commission think that it would be the right thing to do....The Pensions Commission said that pensions in accrual should track earnings and that in retirement, pensions should maintain pensioners' purchasing power, but not necessarily rise beyond that. The commission also made it clear that in retirement it is appropriate to maintain overall pensioner incomes, which includes the state second pension, somewhere between earnings and prices. The Government agree with this view because, when one looks at the spending pattern of pensioners, one finds it is reflected exactly by what they do.<sup>25</sup>

In addition, there would be complex implications for contracted-out schemes:

We would, in effect, require defined benefit schemes to provide earnings indexation for that part of the occupational pension derived from the state second pension, and the rest of the pension would be indexed in line with inflation. No private scheme could face the burden of such commitment and it is clear that additional funding would be required through the national insurance rebate to provide for future pensioners.<sup>26</sup>

In September 2009, the RPI was negative (minus 1.4%). Predicting this in advance, the Labour Government explained that it would maintain the cash value of RPI-indexed social security benefits (such as the additional State Pension) in 2010-11. In 2011-12, when the RPI was projected to be positive, the same benefits would be increased from their 2010-11 levels in line with standard indexation:

#### **Box 5.1 The effect of negative RPI inflation on the value of tax and benefits**

The Government's economic projections show RPI inflation as negative in September 2009. This means general prices using this measure of inflation are expected to fall. RPI inflation for that month is used to index income tax, tax credits and national insurance allowances, thresholds and limits for 2010-11. September measures of inflation are also used to index social security benefits.

With projected negative RPI inflation, the Government would maintain the cash value of tax allowances and thresholds, and the RPI-indexed social security benefits, consistent with statute. Holding these constant with lower prices means that in 2010-11, their real terms value would rise in relation to RPI, and that people would be better off in real terms. Analysis in real terms shows the effect on tax and benefit changes in terms of people's purchasing power.

The basic State Pension is indexed by RPI inflation or 2.5 per cent, whichever is greater. This means that there will be an even larger real terms benefit for pensioners in 2010-11. Some benefits are uprated by earnings, and negative RPI inflation increases the real terms value of those increases. For 2011-12, when RPI inflation is

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<sup>23</sup> Pensions Bill Deb, 25 January 2007, c85

<sup>24</sup> Ibid, c85

<sup>25</sup> Ibid, c88

<sup>26</sup> Ibid, c89

projected to be positive, allowances, thresholds and benefit levels will be increased from their 2010-11 levels in line with standard indexation. This will maintain the real terms gain from 2010-11 for future years.

In the debate on benefit uprating on 10 December 2009, the then Pensions Minister, Angela Eagle, explained the Government's approach to the State Pension:

The basic state pension is traditionally uprated in line with the retail prices index, but as my right hon. Friend the Chancellor confirmed in yesterday's pre-Budget statement, the basic state pension will be uprated by 2.5 per cent from April 2010. That means that, from April next year, the basic state pension for a single person will rise by £2.40 to £97.65 a week, while the standard rate based on spouse's or civil partner's contribution will increase to £58.50, giving a pensioner couple a total of £156.15 a week. That above-inflation increase, which is delivered as a result of a commitment by this Government, will ensure that more than 11 million pensioners receive a real-terms increase in the value of their basic state pension.

The uprating of state additional pension feeds directly through to public service pensions and to some aspects of occupational pension schemes. As a result, we are unable to uprate those benefits without creating unintended consequences for occupational pension schemes. In the circumstances, we plan to hold state additional pension flat in cash terms this year. However, the 2.5 per cent increase in the basic state pension will mean that, on average, pensioners in Great Britain will see an overall increase of 2 per cent in their state pension.<sup>27</sup>

The then Liberal Democrat Work and Pensions spokesperson Steve Webb suggested pensioners might be surprised to find that the 2.5 per cent increase did not apply to the whole pension:

The Minister mentioned additional pension and the state earnings-related pension scheme, or SERPS. Surely the Government could have indexed SERPS if they had wanted to; pensioners who heard that they were getting 2.5 per cent would hardly have thought that the Government were picking and choosing which bits of their pension to index and which bits not to.<sup>28</sup>

### **3 Policy of the Conservative-Liberal Democrat Coalition Government**

#### **3.1 Restoring the earnings link**

As discussed in section 2 above, the Labour Government legislated in the *Pensions Act 2007* to restore the link between increases in the basic State Pension and earnings by the end of the current Parliament. The policy was supported by both opposition parties when the legislation was before Parliament. The then Shadow Secretary of State for Work and Pensions, Philip Hammond said:

The Secretary of State knows that the 2005 Conservative manifesto pledged to link the basic state pension to earnings. At the time, the Government condemned that pledge as unaffordable. We therefore welcome the conversion to a commitment to the earnings link from 2012 and the simplified contributions rules, which mean that men and women who have worked or cared for someone for 30 years will be entitled to a

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<sup>27</sup> HC Deb, 10 December 2009, c518-9; See also BBC News, 12 December 2009, '[State pension freeze saves up to £350m](#)'

<sup>28</sup> HC Deb, 10 December 2009, c533W;

full basic state pension in their own right. We also accept the increase in state pension age that will partly finance the changes.<sup>29</sup>

The then Liberal Democrat Shadow Secretary of State, David Laws, said:

The range of issues on which there is now agreement between the three political parties is far broader than anybody could have expected, even before the last general election. They agree on the earnings link, on raising the state pension age—traditionally a controversial and sensitive issue—on the issue of women’s pensions, and on a number of other key issues, including auto-enrolment...<sup>30</sup>

However, prior to the May 2010 general election, the three major parties have differed as to the date from which this can be afforded.

In its election manifesto, the Conservative Party committed itself to restoring the earnings link in the current Parliament.<sup>31</sup> The then Shadow Chancellor, George Osborne told the party conference in autumn 2009 that a review would be held to look at whether the increase to 66 in the State Pension age should be brought forward to help pay for it:

Let me affirm today that in the next Parliament we resolve to restoring the earnings link for the basic state pension. That means a more generous state pension for all. But this is another one of those trade-offs any honest government has to confront. All parties accept that to afford that with an ageing population, the state pension will have to rise. The women’s pension age is already set to start rising over the next decade to 65. And by 2026 the pension age for men and women will reach 66. That is already happening. But most experts – including Lord Turner who made this recommendation – now think that is too far off. So we will hold the review which Turner’s report itself proposed and which this government has never held. Our aim will be to bring forward the date when the pension age rises. This already is happening in Holland and in Australia. We will ensure that no increase will happen until the second half of the next decade – in the Parliament after next. For men this means the pension age will not start to rise to 66 until at least 2016. For women this means the pension age will not start to rise from 65 to 66 until at least 2020. No one who is a pensioner today, or approaching retirement soon, will be affected.<sup>32</sup>

The Liberal Democrats said they would:

Immediately restore the link between the basic state pension and earnings. We will uprate the state pension annually by whichever is the higher of growth in earnings, growth in prices or 2.5 per cent.<sup>33</sup>

On 12 May, the new Conservative-Liberal Democrat Coalition Government said the earnings link would be restored from 2011, with a “triple guarantee”, as proposed by the Liberal Democrats:

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<sup>29</sup> HC Deb, 16 January 2007, c672

<sup>30</sup> Ibid, c687

<sup>31</sup> [Conservative Party Manifesto 2010 – An invitation to join the Government of Britain](#)

<sup>32</sup> Speech to Conservative Party Conference, 6 October 2009; Conservative Party Press Release, 6 October 2009, Osborne: Specific measures to start tackling Labour’s debt crisis; See also, ‘[David Cameron: Lets win it for Britain](#),’ Speech to Conservative Party Spring Conference, 28 February 2010

<sup>33</sup> [Liberal Democrat Manifesto 2010](#)

We will restore the earnings link for the basic state pension from April 2011 with a “triple guarantee” that pensions are raised by the higher of earnings, prices or 2.5%, as proposed by the Liberal Democrats.<sup>34</sup>

As previously proposed by the Conservatives, a review would be held to “set the date at which the state pension age starts to rise to 66, although it will not be sooner than 2016 for men and 2020 for women.”<sup>35</sup> In October 2010, the Government announced its plans to speed up increase to 66. This is discussed in more detail in Library standard note SN/BT 2234 [Pension age](#).

### 3.2 The Consumer Prices Index as the measure of prices

As outlined above, section 150 of the *Social Security Administration Act 1992* currently requires the State Pension to be uprated in line with the “general level of prices obtaining in Great Britain estimated in such manner as the Secretary of State thinks fit”.<sup>36</sup> Since 1988, the measure used has been the September RPI.<sup>37</sup>

The Conservative Liberal Democrat Coalition Government announced in its June 2010 Budget that it would switch to using the CPI for the price indexation of benefits and tax credits from April 2011. The basic State Pension would be uprated according to a “triple guarantee”, i.e. it would increase by the higher of earnings, prices or 2.5%. This policy would not apply to the additional State Pension (SERPS/S2P) which would increase in line with prices.<sup>38</sup> The June 2010 Budget said:

1.106 The Government will use the CPI for the price indexation of benefits and tax credits from April 2011. The CPI provides a more appropriate measure of benefit and pension recipients’ inflation experiences than RPI, because it excludes the majority of housing costs faced by homeowners (low income households are subsidised separately through Housing Benefit, and the majority of pensioners own their home outright), and differences in calculation mean it may be considered a better representation of the way consumers change their consumption patterns in response to price changes. **This will also ensure consistency with the measure of inflation used by the Bank of England. This change will also apply to public service pensions through the statutory link to the indexation of the Second State Pension. The Government is also reviewing how the CPI can be used for the indexation of taxes and duties while protecting revenues.**

1.107 In the last Parliament, the basic State Pension was uprated by the higher of prices or 2.5 per cent. **This Government will uprate the basic State Pension by a triple guarantee of earnings, prices or 2.5 per cent, whichever is highest, from April 2011.** CPI will be used as the measure of prices in the triple guarantee, as for other benefits and tax credits. However, to ensure the value of a basic State Pension is at least as generous as under the previous uprating rules, **the Government will increase the basic State Pension in April 2011 by at least the equivalent of RPI.** To ensure the lowest income pensioners benefit from the triple guarantee, the standard minimum income guarantee in Pension Credit will increase in April 2011 by the cash rise in a full basic State Pension.<sup>39</sup>

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<sup>34</sup> [Conservative Liberal Democrat coalition negotiations Agreements reached 11 May 2010](#)

<sup>35</sup> Ibid

<sup>36</sup> Section 150 (1) *Social Security Administration Act 1992*

<sup>37</sup> HM Treasury, [A note on the operation of pensions increase legislation for public service pension schemes](#), 24 May 2001, Annex D, page 21

<sup>38</sup> [HC Deb, 14 June 2010, c284](#)

<sup>39</sup> HM Treasury, [Budget 2010](#), HC 61, June 2010

In response to Parliamentary Questions on 19 July 2010, Pensions Minister, Steve Webb, made two points in support of his Government's policy on pension uprating. Firstly, through an increase in the Guarantee Credit, the poorest pensioners would see the full value of the cash increase in the state pension in April 2011. Secondly, the restoration of the earnings link would add significantly to the value of the State Pension over time:

**John Robertson (Glasgow North West) (Lab):** What assessment he has made of the likely effect on pensioners of his proposed changes to the welfare system. [8928]

**The Minister of State, Department for Work and Pensions (Steve Webb):** Since the general election a number of changes have been announced to benefits and pensions. The most significant for pensioners was our decision, after 30 years of decline in the pension's real value, to restore the earnings link with the basic state pension.

**John Robertson:** I thank the Minister for his answer, but he is well aware that the earnings link will not help pensioners as of January, when they start to pay their increased VAT. That increase amounts to almost £8 billion over the life of a Parliament, so when will the hon. Gentleman stick by his party's promise during the general election campaign to fight any VAT rise? What will he do to protect those elderly people who, through no fault of their own, will be left with enormous debts, thanks to this Government?

**Steve Webb:** I am not sure whether the hon. Gentleman is aware that the Office for Budget Responsibility estimates that the country's structural deficit is now more than £12 billion larger than it was thought to be at the election. I do not know where he would have got that £12 billion from. As for pensioners, not only will we ensure that we restore the earnings link, but in April 2011 the full value of the cash increase in the state pension will go through to the poorest pensioners on pension credit.

**Ms Angela Eagle (Wallasey) (Lab):** Does the Minister agree that if the pensions in payment today had been linked to the consumer prices index rather than to the retail prices index for the past 20 years, pensions would be 14% lower than they are now? Does not the proposed shift in the definition of price indexation represent a huge raid on pension benefits, which gets worse and worse as time goes on and makes all current and future pensioners poorer?

**Steve Webb:** It pains me to suggest that the hon. Lady is being selective in her use of statistics, but if she looks at the increase in pensions as a whole—the basic state pension and additional pensions—she will see that we have linked the basic state pension to earnings, which over the course of 20 years, for a typical person retiring this year, will add £15,000 in extra state pension compared with price indexation, which was the policy of her Government.<sup>40</sup>

### ***Differences between the CPI and RPI***

As explained above, the Government says the CPI is a “more appropriate measure of benefit and pension recipients' inflation experiences than RPI”.<sup>41</sup> Some critics of the policy disagree.

By way of background, the Labour Government announced in 2003 that it was considering using the Consumer Prices Index (or Harmonised index of consumer prices HICP, as it was called then) as the indicator of inflation, in the context of the target it set for the Monetary Policy Committee:

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<sup>40</sup> [HC Deb, 19 July 2010, c3-4](#)

<sup>41</sup> HM Treasury, [Budget 2010](#), HC 61, June 2010, para 1.1106

I am required to set the inflation target in each Budget. In 1997, I spoke of the case over time for moving to a new domestic measure of inflation. The advantages of the current indicator of inflation—RPIX—is that it is known, well understood and has served us well. The advantages, however, of the internationally recognised index of consumer prices—HICP—is that it is in line with best international practice and is used by every other G7 nation but Japan, and by our neighbours in Europe. So there is a case in principle for adopting for Britain this index of consumer prices and the Treasury will continue to examine the detailed implications of such a change. Today, I am reaffirming our symmetrical inflation target based on the current RPIX measure. Our target for the financial year will be 2½ per cent.<sup>42</sup>

However, for the purpose of uprating benefits, it would continue to use the RPI on the basis that it was “representative of consumer spending patterns”:

### State Retirement Pension

**Mr. Steen:** To ask the Chancellor of the Exchequer if he will make it his policy to include average annual increase in council tax and utility bills rather than the retail prices index as a basis for assessing the annual increase in the state retirement pension; and if he will make a statement. [114858]

**Maria Eagle:** I have been asked to reply The Retail Prices Index (RPI) is representative of consumer spending patterns. The items in the RPI are kept under review and already include average council tax bills for households in Great Britain and average rates bills in Northern Ireland. Also included are amounts for utilities including water, sewerage and environmental charges, telephone charges, electricity, gas, coal and solid fuels and oil and other fuels. The full list of items can be found on the National Statistics website: [www.statistics.gov.uk](http://www.statistics.gov.uk). However, we increased the basic state pension by more than RPI in the last three years.<sup>43</sup>

The CPI and RPI are both consumer price indices and the calculation of each uses much of the same basic price data. There are, however, some major differences:

- The CPI excludes some goods and services included in the RPI. Some housing costs, including mortgage interest payments and council tax but not utility bills and rents, are excluded from the CPI and account for much of the difference between the indices.
- The CPI includes some costs that are not in the RPI, such as charges for financial services and university accommodation fees.
- The CPI covers a broader population than the RPI, which excludes high-income households and low-income pensioners.
- The mathematical formulae used to calculate the indices differ. For a given set of data, the method used for the CPI (geometric means) will show smaller changes than that used for the RPI (arithmetic means).

The Institute for Fiscal Studies explains that changes in the CPI tend to be lower than the RPI both because it excludes most housing costs and because it is calculated differently.<sup>44</sup> Library Standard Note SN/EP 2792 [Economic Indicators update: Inflation](#) looks at trends in

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<sup>42</sup> HC Deb 9 April 2003, c 273

<sup>43</sup> HC Deb 21 May 2003, c 844W: The debate that took place on this issue at the time is covered in Library Standard Note SN/BT 2168 [Pension increases: the index used \(June 2003\)](#).

<sup>44</sup> IFS presentation following June 2010 Budget

the RPI and CPI in recent years. The Treasury forecasts of the CPI and RPI increases for the next 5 years were published in the [June 2010 Budget](#) Red book (Table C2 and C5).

The Royal Statistical Society recently called for a “comprehensive review of issues relating to the measurement of inflation”.<sup>45</sup> A letter to the UK Statistics Authority expressed its main concerns. One of these was that the CPI had become the “headline index” even though it was “not necessarily the best index for all purposes”:

As we all know, the CPI was originally the Harmonised Index for Consumer Prices (HICP) constructed in order to compare price movements between EU countries; its methodology and coverage are on agreed EU definitions. Lack of agreement over the treatment of owner occupier housing costs, of particular importance for the UK, means that these are still excluded; it is debatable whether its exclusion of items such as council tax, vehicle excise duty, trade union subscriptions and television licenses, and its inclusion of spending in the UK by foreign residents, are appropriate for all purposes. Its methodology, specifically the comprehensive use of the geometric mean at the lowest level of aggregation, has many supporters. It is approved by some other international bodies as well as the EU. However, some would argue that it is not the best approach for products where consumers are typically slow to substitute newly cheaper outlets, brands or varieties for existing more expensive ones.<sup>46</sup>

A further concern was that the rates of inflation shown by the CPI and RPI could at times differ widely, due to the “formula effect”:

But the RPI inflation rate has also been consistently higher than the CPI rate due to the “formula effect” whereby the RPI uses an arithmetic mean at the lowest level of aggregation while the CPI uses a geometric mean. Over the last five years, according to the ONS press notice, the difference in the annual inflation rate due to the formula effect has never been less than 0.43 percentage points and has been as high (recently) as 0.86 percentage points.<sup>47</sup>

The RSS considered it “highly unsatisfactory that a difference in statistical treatment should generate such a substantial difference in the two indices”.<sup>48</sup>

The UK Statistics Authority responded on 6 October as follows:

We continue to regard both the Consumer Prices Index (CPI) and Retail Prices Index (RPI) as important measures of consumer price inflation. We believe the CPI should become the primary measure of consumer price inflation but only when the inclusion in the index of owner occupiers' housing costs has been achieved. We note that the ONS has an active research and development programme for the CPI and the RPI, and are preparing for wider user engagement on a forward work programme, starting this autumn.<sup>49</sup>

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<sup>45</sup> RSS press release, 31 August 2010, '[RSS calls for comprehensive review of inflation measures](#)'

<sup>46</sup> [Letter from the Royal Statistical Society to the UK Statistics Authority, 25 August 2010](#)

<sup>47</sup> RSS press release, 31 August 2010, '[RSS calls for comprehensive review of inflation measures](#)'

<sup>48</sup> Ibid

<sup>49</sup> Letter from Chair of UK Statistics Authority to President of Royal Statistical Society, 6 October 2010; <http://www.statisticsauthority.gov.uk/reports---correspondence/correspondence/letter-from-sir-michael-scholar-to-professor-david-hand---6-october-2010.pdf>