

General Election 2017

State Pension age rises

PPI Briefing Note Number 97

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Introduction

Ahead of the June 2017 general election, the PPI is issuing a series of Briefing Notes summarising some of the key issues surrounding pension policy that are relevant during this election period. The Conservative party have pledged to increase State Pension age (SPa) to reflect increases in life expectancy. The Labour party have pledged to keep SPa at age 66 from 2020 subject to further review; with SNP and Plaid Cymru pledging to oppose increases to SPa beyond 66. UKIP have said they will introduce a flexible State Pension window for retirement.

This Briefing Note explores the dynamics of SPa rises including:

- Affordability of the State Pension,
- History of the State Pension,
- Current SPa policy,
- Increasing old age dependency ratio,
- Disproportionately affected groups,
- Extending working lives.

State Pension costs are projected to continue rising despite increases to SPa

The cost of the State Pension is projected to rise over the next 30 years, though actual future cost will depend on unknown factors such as changes in life expectancy, demographics and State Pension policy.

The proportion of people over SPa is growing relative to the

Figure 1. SPa rises decrease the costs of State Pension, but the overall costs are projected to continue rising

Cost of State Pension as a percentage of GDP under SPa rises based on 2010, 2012, and 2014-based projections of life expectancy (assuming triple lock)



Source: PPI Aggregate Model

proportion of those of working age due to a combination of increases in how long people are living (longevity), decreases in child births (fertility) and the large number of people born following World War II (cohort effect) reaching SPa.

The Government expects the cost of the State Pension to increase from 5.5% of GDP in 2014/2015 to around 7.3% of GDP in 2065/2066. For every year of SPa rises, yearly costs are reduced by 0.1% to 0.3% of GDP.¹

The State Pension is funded through current revenue so any increase in proportion of GDP spent on the State Pension leads to decreases to budgets elsewhere. Contributions from working life are not saved and invested for each cohort's retirement. Instead current National Insurance (NI) contributions are used to pay for

people currently in receipt of the State Pension. The increasing cost of State Pension is mostly due to an increase in the proportion of people in retirement compared to those who are working and contributing towards the State Pension through NI contributions.

State Pension is currently uprated in line with the "triple lock": the higher of increases in earnings, the Consumer Prices Index (CPI) or 2.5%. The triple-lock increases the cost of the State Pension more quickly than an earnings index. The Government Actuary has warned that the triple-lock may become unsustainable by the late 2020s. The triple lock could help the State Pension to regain some of the relative value that it lost when it was de-linked from earnings in 1979 when State Pension was worth 26% of National Average Earnings (NAE). The full new State Pension is worth 24% of NAE

PPI Briefing Notes clarify topical issues in pensions policy.

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meaning that people may need to top up from private pension incomes to replicate their working life living standards.²

An independent report into SPa² recommended that the triple lock be withdrawn by 2020 in order to reduce State Pension spending to 5.9% of GDP by 2066/67. It stated that if the triple were to be maintained then SPa rises would need to occur more quickly in order for State Pension to remain sustainable.³ Despite SPa rises decreasing the overall costs of the State Pension, overall costs are projected to continue to rise by 1.9% of GDP between 2030 and 2055 (Figure 1).

History of the State Pension

The first SPa was introduced in 1908 alongside the Old Age Pension,⁴ (Figure 2). It was non-contributory, means-tested and available to people over the age of 70.⁵ It went through several changes before settling at age 60 for women and age 65 for men in 1940 and remaining at these ages for 70 years. In 2010, in response to longevity increases, the SPa began changing in stages, and is currently scheduled to reach age 67 for both men and women by 2028.

SPa changes between 1995 and 2016

- In 1995, it was legislated that women's SPa would rise to age 65 by 2020;
- In 2007, further SPa increases for both men and women to ages 66, 67 and 68 were legislated for;

Figure 2. UK State Pension ages for men and women by year



In 1908 when the first State Pension was introduced

- Life expectancy at birth was 40 years for men and 43 years for women.
- 24% of people reached SPa (of age 70).
- Life expectancy at SPa was 9 years (averaged between men and women).

Source: DWP (2008) *100th Anniversary of the State Pension Statistics*

In 2016/2017

- Life expectancy (period) at birth was 84.1 years for men and 86.9 years for women.
- Around 85% of people reached their SPa.
- Life expectancy at SPa was an average of 24 years (men and women).

Source: ONS (2017) *Overview of the UK Population*; DWP (2008)

- In 2011, SPa rises to age 65 and that SPa should change to reflect increasing life expectancy but
- In 2011, the acceleration of the rise of women's SPa was seen as problematic and rises to SPa to age 66 were slowed down by six months in response and should not increase more than one year in any 10 year period. It also recommended that the triple lock be withdrawn in the next Parliament in order to reduce costs.
- In 2014, the increase to age 67 was brought forward, and independent reviews were legislated for. Other recommendations included extending working lives past SPa, greater support for carers, and adjusting Universal Credit to enable a smoother transition into retirement.

Rises to SPa have not been introduced without controversy. In particular, legislation accelerating rises has particularly affected women of certain ages and has led to campaigns to undo or mitigate changes by slowing the increases to women's SPa.

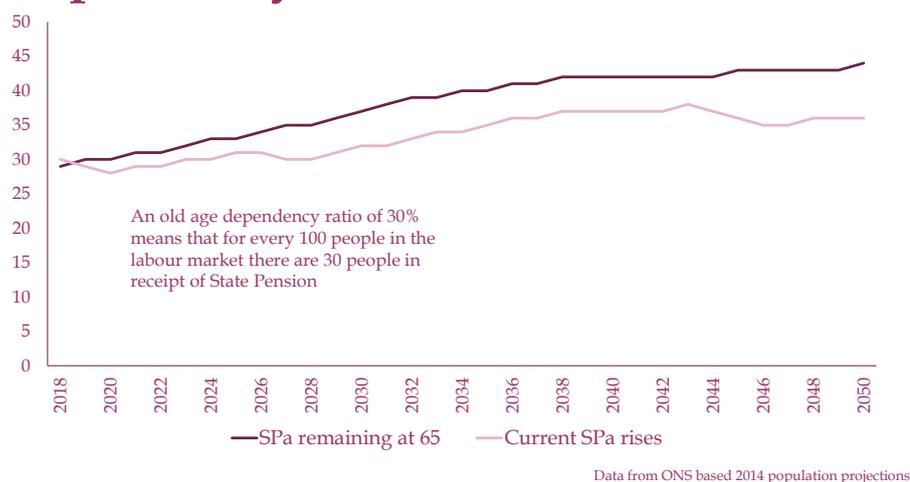
In March 2016 the Government launched an independent review into further rises to SPa.⁶ The final report (published 2017) suggested

Current SPa Policy

Current SPa is set at age 65 for men and age 64 for women. This is set to equalise in 2018 to age 65 for both men and women.

These relatively rapid increases in SPa are in order to 'catch up' with the years where it remained static, despite longevity increases.⁷

Figure 3. Increases to SPa have kept the old age dependency ratio level



of adult life in receipt of State Pension. In any given year, an increase in SPa will result in some people receiving State Pension for a third of their adult life, some receiving it for less and some receiving it for more.

Certain demographic groups and individuals are more likely to be adversely affected by rises in SPa and therefore be in receipt of State Pension for less than a third of their adult life. Factors that impact how long an individual is likely to be in receipt of State Pension include:

- Gender
- Location
- Socio economic status
- Ethnicity

It is important to recognise that these groups are not discrete and an individual can belong to one or more of these groups at any one time. Further, life expectancy varies not only between but also within groups.

Variations between groups are often estimated using 'period' life expectancy calculations. As this makes no allowance for future changes in mortality or differences between generations they are not realistic estimates of future experience.

Gender

The average life expectancy for both men and women aged 65 in the UK in 2017 is 87.7 years. However, men have a lower average life expectancy than women. Men aged 65 in 2017 have an average life expectancy of 86.6 years and women of 88.8 years.¹⁰

Period vs. cohort life expectancy projections

This Briefing Note uses both period and cohort life expectancy measurements:

- **Cohort life expectancy** shows the number of years a person of a specific age is expected to live, taking into account any known or projected future changes in mortality.
- **Period life expectancy** shows the average number of years a person in a specific area, or with specific characteristics, is expected to live at the time the measurement is taken. It does not allow for future changes in mortality or for differences between generations.

Increasing old age dependency ratio

Figure 3 describes how old age-dependency ratio would change if there were no SPa rises from 2018, compared to current expected changes. Increasing SPa prevents a significant increase in the old-age dependency ratio: the number of people in the labour market supporting those in receipt of State Pension through NI contributions. Despite SPa rising the gradual increase in the old-age dependency ratio is not eradicated. In 1971 old-age dependency ratio was 28/100, meaning that for every 28 people in

retirement there were 100 people in the labour market. This is expected to increase to 30 people in retirement for every 100 people in the labour market by 2028.⁸

Certain groups are more likely to be disproportionately affected by rises to SPa

The Government believes that people should spend "on average up to one third of their adult life drawing a State Pension," with adult life being assumed to begin at age 20.⁹ Variations in life expectancy mean that a SPa rise will not result in everyone in the UK spending the same proportion

Men are therefore less likely to spend a third of their life in receipt of State Pension. Although women on average live longer than men, they have a lower healthy life expectancy than men. This means they are more likely to spend proportionally more time in poor health than men, and may find it more difficult to work up to higher SPA's.

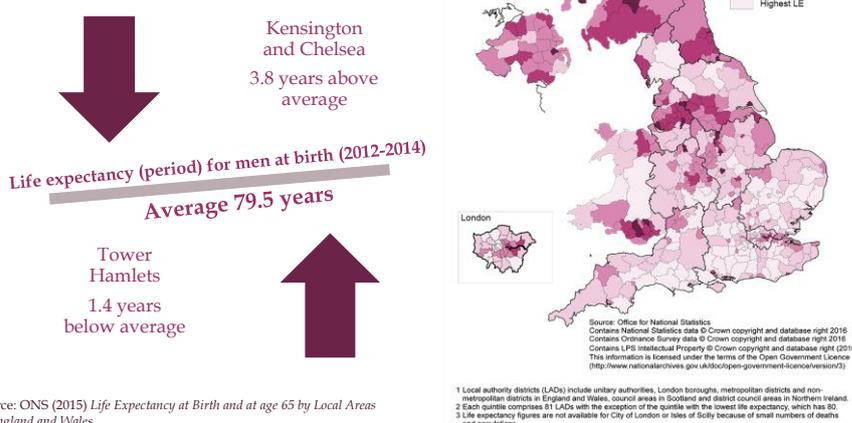
Location

Throughout the UK, life expectancy varies by region (Figure 4). Deprived areas with high unemployment, poor housing, and lifestyle factors that affect health (such as smoking) tend to have lower than average life expectancies.¹¹ The highest period life expectancy (which does not allow for future improvements in mortality)¹² in England and Wales (2012-2014) was in Kensington and Chelsea at 8.5 years more than the lowest in Blackpool.¹³ The areas with lowest life expectancy tend to congregate in the North of England, Scotland, and Northern Ireland, parts of Wales and London and Southern coastal areas. This means that people who live in these areas are less likely to be in receipt of their State Pension for a third or more of their adult life.

Socio economic status

Life expectancy varies by socio-economic status with people in the most disadvantaged class being twice as likely as those in the highest class to report that their health is "not good".¹⁴ Such people are most likely to be in the lower managerial and professional class.

Figure 4. There is wide variation in life expectancy across the UK, including within cities



Only 16% of men and 8% of women are in the highest class. Women are more likely than men to be in the more disadvantaged classes.¹⁵ Those in higher managerial and professional occupations have the highest period life expectancy at birth (2007-2011), 5 years higher than those in routine occupations.¹⁶

Ethnicity

Life expectancy also varies by ethnicity.¹⁷ In 2001 White British men had an average life expectancy at 2 years greater than Bangladeshi men who have the lowest average life expectancy. There is less data available on ethnicity than on other factors such as location and gender. It is therefore important to recognise that ethnic minorities experience a great deal of variation in life expectancy both between as well as within a specific minority. Some ethnic minorities have lower life expectancy due to external factors such as class, region or immigration status.

Extending Working Lives

Although average age of exit from the workforce has remained fairly consistent between 1980 and 2005 at 63.3 years and 63.0 years respectively (for both men and women), the average life expectancy at age of exit from the workforce has increased from 17.5 years in 1980 to 22.8 in 2005.¹⁸ Numbers of older people (aged 50-64) in the workforce have also risen, from 55.4% in 1984 to 69.5% in 2015.¹⁹

Rises to SPA mean that people are expected to work longer before receiving their State Pension. Some people are unable to work for these increasingly long periods due to lower healthy life expectancies. People with low healthy life expectancies include those in manual jobs (who are disproportionately those of lower socio economic status and ethnic minorities) and the disabled. Carers may also be unable to work

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up to higher SPa's as their caring responsibilities mean they may be required to leave the labour market to care for partners or other family members.

Carers and disabled people are also more likely on average to have lower private pension provision and therefore more likely to require means-tested benefits when they are unable to work up to increasingly high SPa's. Those in receipt of carers' allowance, on average, have less than £100 in Defined Contribution pension savings (mean total of DC pension

savings of people aged 16-64 in 2010/2012).²⁰ These benefits include Housing Benefit, Local Council Tax Support, Disability-related benefits and uplifts and tax allowances (for some older pensioners). Such means tested benefits are not as high as a full State Pension and may leave some groups (including carers, the disabled, ethnic minorities and those of lower socio economic status) disproportionately worse off than others who are able to work until SPa.

Conclusion

If the Government wishes to prioritise the sustainability of the State Pension, SPa rises are inevitable. Differences in life expectancies are not necessarily a reason not to increase SPa. However, in the absence of other changes, some groups will be more adversely affected by SPa rises than others. However, there are policy options for mitigating the effects of SPa rises on those most adversely affected.

¹OBR Fiscal Sustainability Report 2017, Supplementary tables 1.1 and 1.5

² PPI Pensions Primer (2016) p.13; see PPI (2017) BN96

³ DWP (2017) *Smoothing the Transition, Independent Review of State Pension Age*; Government Actuary's Department (GAD) (2014) *Government Actuary's Quinquennial Review of the National Insurance Fund as at April 2010* GAD

⁴ The Old Age Pensions Act 1908

⁵ webarchive.nationalarchives.gov.uk/20080910140413/dwp.gov.uk/mediacentre/pensioncentenary/ (retrieved 01.04.2016)

⁶ DWP (2016) *SPA Independent Review – Terms of Reference*

⁷ PPI (2016) *The Distributional impact of State Pension age rises*

⁸ ONS, Population estimates and 2008-based principal population projections

⁹ DWP (2013) Autumn Statement announcement on a core principle underpinning future State Pension age rises: DWP background note

¹⁰ ONS 2014-based National Population Projections

¹¹ Buck and Maguire (2015)

¹² PPI (2017) BN90

¹³ ONS (2014)

¹⁴ Based on a range of possible answers: "Very Good", "Good", "Fair", "Bad" or "Very Bad". "Not Good" includes all those who

answered "Fair", "Bad" or "Very Bad".

¹⁵ ONS (2013) *Health Gaps by Socio-economic position of occupations in England, Wales, English Regions and Local Authorities*

¹⁶ ONS (2015) Table 1, Table 4

¹⁷ Lievesley, N (2010), p.28, Table 9

¹⁸ Jagger et al (2014) *Raising the Retirement Age: Implications for UK and Europe*

¹⁹ DWP (2015) p.3

²⁰ Wealth and Assets Survey Wave 3 (2010/ 2012)

For more information on this topic, please contact

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