PENSIONS POLICY INSTITUTE

PPI

The distributional impact of State Pension age rises

Executive summary

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State Pension age

The first State Pension age (SPa) was introduced in 1908 at age 70. SPa 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 the SPa began rising again, in stages, and is currently scheduled to reach age 68 for both men and women by 2046. In March 2016 the Government launched an independent review into options for bringing forward the rise to age 68, and investigating options for further SPa rises.

Costs

The Government expects the cost of State Pensions 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. The triple-lock increases the cost of State Pensions more quickly than an earnings index would do, though it could help the State Pension to regain some of the relative value that it lost when it was de-linked from earnings in 1980. However, the Government Actuary has warned that the triple-lock may become unsustainable by the late 2020s.

Calculating a third of adult life

The Government's formula of increasing SPa so that people will spend a third or more of adult life in receipt of their State Pension is based on a mean average, which is affected by very low and very high life expectancies. Another way to measure a third on average is by using the median, which shows when 50% of people will spend more than a third and 50% of people will spend less than a third of adult life in receipt of the State Pension.

For at least 50% of people to spend a third or more of adult life in receipt of the State Pension, SPa would need to rise to age 67 in 2034 and age 68 in 2047.

There are inherent uncertainties in life expectancy projections, and projections change over time. Projections in 2010 indicated that life expectancy was increasing more quickly than 2012 and 2014 projections indicated. If SPa rises were set on 2010 projections rather than 2014-based ones, then SPa would rise more quickly as a result, potentially resulting in fewer than a third of people receiving State Pension for a third of adult life on average (Table Ex1).

Table Ex1:[1] SPa rises in line with the three most recent mean average life expectancy projections

Life expectancy projections	SPa rise to age 68	SPa rise to age 69
2010-based	2035	2048
2012-based	2036	2049
2014-based	2042	2055

[1] PPI calculations based on ONS population projections

Impact of SPa rises

Life Expectancy (LE) varies by region, gender, ethnicity and socio-economic class. Therefore, while SPa rises are calculated to ensure that people spend the same amount of time in receipt of the State Pension on average:

- Those with lower LEs are more likely to receive their State Pension for less than a third of their adult life while,
- Those with higher LEs are more likely to receive their State Pension for more than a third of their adult life.

Variations in Disability-Free Life Expectancy (DFLE) also mean that some people will find it harder to work up until higher SPas than others, and may have to live on a lower income from working-life benefits than they would have received from the State Pension.

People with certain characteristics are more likely to have low LEs and DFLEs:

- People living in parts of the North of England, Scotland, Wales and Northern Ireland,
- People from lower socio-economic classes,
- Ethnic minorities.

Mitigating the effects

Differences in LE are not necessarily a reason not to increase SPa. However, it is clear that, in the absence of other changes, some groups will be more adversely affected by SPa rises than others.

If the Government wishes to prioritise the sustainability of the State Pension, then SPa rises are inevitable. However, there are some policy options for mitigating the effects of SPa rises on those most adversely affected. One option would be to tackle inequalities within society which lead to lower LEs and DFLEs for people from particular groups.

The PPI has also explored some State Pension policy options which have either been proposed in the UK or are used internationally:

- Allowing people with 45 years of National Insurance (NI) contributions to claim a full State Pension
- Freezing Pension Credit age or de-linking it from SPa
- Allowing early access to a reduced State Pension
- Allowing early access to an unreduced State Pension
- Allowing people with caring responsibilities to receive their State Pension early unreduced

Some of these options could reduce the level of saving from SPa rises thereby increasing the cost burden on the State, but could ensure that there is protection in the system for people with lower than average life and healthy life expectancies.

The cost of State Pensions is likely to rise in the future, however for every year of SPa rises, yearly costs are reduced by 0.1% to 0.3% of GDP. With a rise to age 69 in the late 2040s, State Pension costs are likely to reach around 7.2% of GDP by 2055.

Chart 3 assumes that the basic State Pension and the new State Pension remain Triple-Locked. As the Triple-Lock index is not legislated for, but a minimum earnings index is, the State Pension may be indexed to earnings at some point in the future. An earnings index would reduce the cost of State Pensions, but would also mean that the value of State Pension income would no longer increase above earnings over time.

In the year before the State Pension was de-linked from earnings (1979) the full-rate of basic State Pension was worth 26% of National Average Earnings (NAE). In 2016, the new State Pension is worth 24.2% of NAE. In order to reach 26% of NAE again, the new State Pension would need to remain triple-locked until around 2040.[40] However, the Government Actuary has commented that the rate of annual State Pension increases might need to be reduced from 2020 to a "small fraction below earnings" in order to maintain long-term sustainability and avoid "fund exhaustion" by 2027.[41]

While Chart 4 shows the cost of State Pensions increasing over time, the majority of the increase is due to the rising number of pensioners rather than a significant increase in the cost per pensioner. The cost of State Pensions per pensioner is projected to increase over time, due to the triple-lock, from £132 to £147 per week (2016 earnings terms) between 2030 and 2050, while the number of pensioners will increase from around 16 million to around 18 million between 2030 to 2055 (Chart 4).

[40] PPI calculations

[41] GAD (2014) para 11.9 & table 9.1, there is no ongoing National Insurance fund, the "fund" size comprises the total receipt of National Insurance contributions in any given year