# How could the effect of rises in State Pension age be mitigated for the most vulnerable?



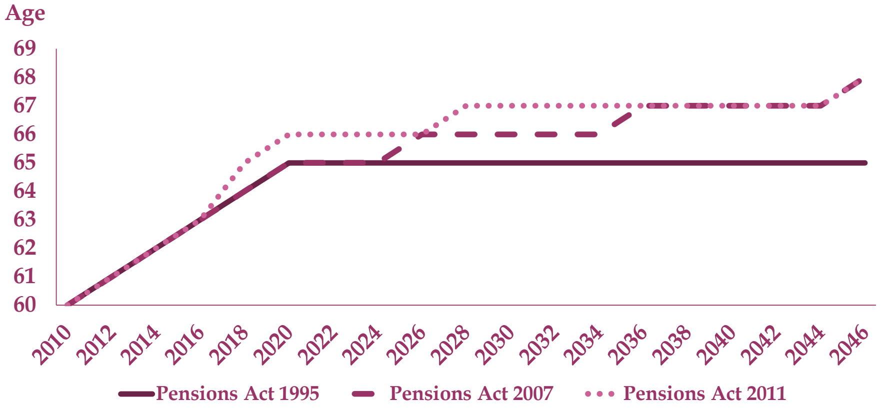
## Introduction

This note sets out the history of the State Pension age (SPa), explores current and future increases to SPa, and examines the implications of some potential policies which could mitigate the effects of SPa increases on vulnerable people. This note contains some initial, high level analysis of a range of mitigation policies, all of which would require detailed analysis before being considered further.

The aim of this note is to encourage discussion, not to make recommendations for policy reforms.

## Successive Pensions Acts have accelerated SPA rises

Chart 1: Women's State Pension Age under different Pensions Acts




## Background to the current State Pension age

The first State Pension age was introduced in 1909, when the provisions of the Old Age Pension Act 1908 came into effect, providing a non-contributory pension on a means-tested basis.

The SPa was originally set at 70 for both men and women. This was reduced to age 65 under the Widows, Orphans and Old Age Contributory Pensions Act 1925.

The women's SPa was reduced to age 60 in the Old Age and Widows Pensions Act 1940 because of the relatively high level of unemployment for women in the later part of the working life, and because wives tended to be a few years younger than their husbands, so reducing women's SPa meant that couples could draw their State Pension at around the same time.

## Increases to SPa

Equalisation of SPas, Pensions Act 1995. In the November 1993 Budget it was announced that women's SPa would rise from 60 to 65 between 2010 and 2020 (Chart 1).

The announcement of the increase in women's SPA was made for reasons of;

- a shift in working patterns that suggest that women hold their jobs for as long as men,
- increases in life expectancies, and
- the result of a European judgement on occupational pension schemes, in turn causing schemes to tend to equalise pension ages for men and women at 65.

### SPa increases to 66, 67 and 68, Pensions Act 2011

As a result of the recommendations of the Pensions Commission, the Government, in 2006, announced further SPa increases to age 66, 67 and 68 to take place. Each were scheduled to take place approximately one decade apart starting with an increase to 66 from the mid 2020s.

In 2010, the SPa rise to age 66 was brought forward to occur between 2018 and 2020 because of increases in life expectancy. This in turn required the acceleration of the women's SPa to reach age 65 in 2018. These accelerations were legislated in the Pensions Act 2011.

In 2011, the SPa increase to age 67 was also brought forward to take place between 2026 and 2028, with future SPa rises linked to increases in life expectancy. These changes were brought into legislation in the Pensions Act 2014.

The 2011 Act also introduced regular reviews of SPa which are to be informed by a report by the Government Actuary's Department and another independent review looking at wider factors. In March 2016 it was announced that John Cridland would lead the first independent review.

### Difficulties faced as a result of increases to SPa

Increases to SPa can lead to difficulties for individuals if they are unable to continue in work. For example, some manual occupations may either require a level of fitness that is difficult to maintain at older ages, or may put strain on the health of individuals such that they may not be able to continue in their role. For example, around 30% of people in Routine or Semi-Routine occupations report being in "not good" health.[1]

Other individuals may find it difficult to work because they are providing full time care. For example, around half of carers aged 16-64 providing at least 10 hours care a week are not in paid work.[2]

Improvements in longevity are not uniform to every group of people. Basing increase in SPa on the average improvements to life expectancy could be detrimental to groups of people with lower life expectancy than the national average.

## Many people have more than 35 qualifying years

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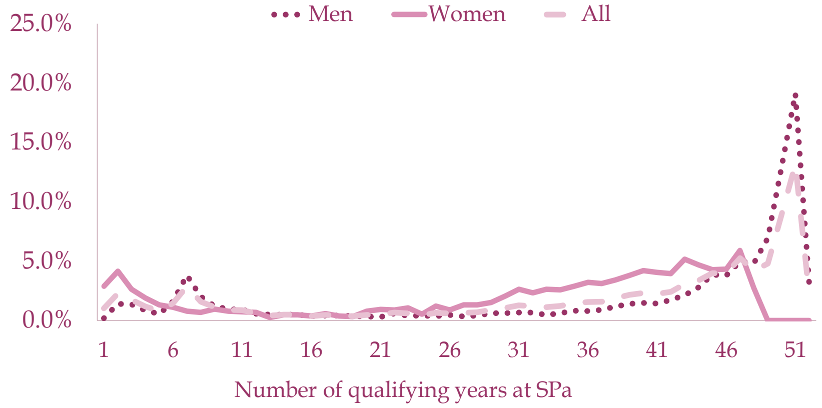
**Chart 2: Distribution of qualifying years for people who reached State Pension age in 2013**




In the 2013 Autumn Statement, the Government said that the principle to be used in reviewing the State Pension age is that "people should expect to spend, on average, up to one third of their adult life in receipt of the State Pension".[3] Groups with lower than the average life expectancies will therefore spend less than a third of their adult life receiving their State Pension.

### Mitigating the effects of SPa increases on vulnerable people

The remainder of this note examines potential reform options that may help mitigate the impact of SPa increases on vulnerable people.

### 1. Allowing people with more than 45 years of NI contributions to receive their State Pension early unreduced.

Reform—Allow people to take unreduced State Pension at the earliest of: achieving 45 contributory years, or reaching SPa. 45 years is used to illustrate the policy, however, this kind of policy could be implemented on the basis of another threshold number of qualifying years, and/or with access to the pension limited to a specific number of years before SPa.

Why—People who have been in work for a long period of time, especially in manual occupations may be more likely to have health issues that limit their ability to work up to SPa.[4]

Who—The targeted people are those who have been working for more than 45 years. This is more likely to be people who started working straight out of school, and did not go to university.

These people may be more likely to be in manual occupations, which might make then less able to continue working up to a higher SPa. This means that the reform could target people who might be less able to extend their working lives.

How many—DWP figures suggest that of the 660,000 people reaching their State Pension age in 2013 around 253,000 have more than 45 qualifying years.[5] Chart 2 shows that around 13% of people in 2013 had 50 qualifying years at SPa.

Cost - The increase in the amount of State Pension payments would depend on the number of people allowed to receive their State Pension earlier than their SPa. Assuming the distribution of qualifying years is relatively stable, the additional payments of State Pension resulting from this policy would be around £163million (in 2016 earnings terms) in 2018, increasing to around £250million in 2020[6] as the SPa increase to 66.

The net cost to the Exchequer would be affected by other factors which may offset the cost such as a reduction in working age means tested benefits, and an increase in tax revenue resulting from the State Pension payments.

These estimates are based on 45 qualifying years being required to receive a State Pension. Increasing the required number of qualifying years would reduce the cost to the Exchequer as fewer people would qualify.

## Activity rate drops sharply for people over 55

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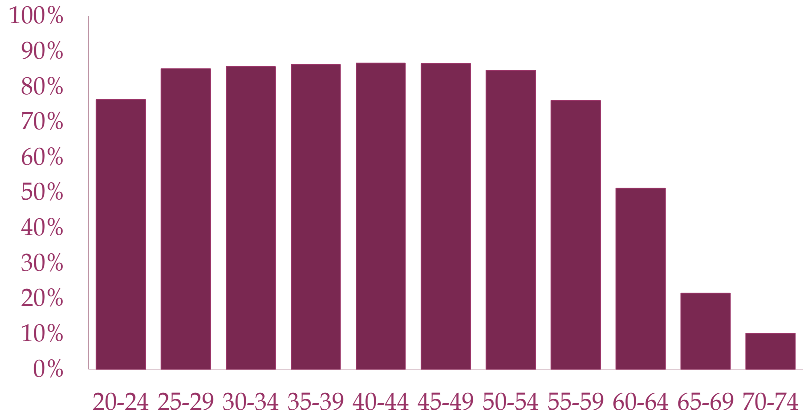
**Chart 3: Activity rate of the population of the UK by age group in 2015**




The cost to the Exchequer could be reduced by applying some early retirement reduction factors. If these were actuarially neutral then the cost may be offset.

There may be other costs of the policy. If the people who were to take early State Pension might otherwise have been able to continue working, they would have paid income tax and national insurance on those earnings. Allowing early access to State Pension may mean that some people stop working, so some tax and National Insurance Contributions are forgone, and a reduced number of people in the workforce may have an impact on economic growth.

International precedents—A number of countries operate a policy to allow early retirement without penalty if individuals have achieved a given number of years contribution to their national pension scheme. For example, in Germany, individuals are able to take unreduced State Pension up to two years before their SPa if they have more than 45 years. In Greece employees can retire unreduced five years early, from age 62, after 40 years.

### 2. Delinking Pension Credit and SPa

Reform—Freeze Pension Credit age at 65 without further increase, or define Pension Credit age as 5 years before SPa.

An alternative approach would be to introduce a higher rate of Universal Credit for people within 2 or 5 years from SPa.

Why—Some people are not in a position to continue working or to find alternative work. Chart

3 shows the economic activity rate (those in work or actively seeking work) drops for people aged 60 to 65 to around 50%, compared with an activity rate of around 75% for people aged between 55 and 59.[7] The data relates to 2015 when women's SPa was around 62 and a half. This means that the average activity rate in the 60-64 age band may be higher after SPa equalisation.

The people who are inactive are likely to be partly people who are unable to work and partly those who have chosen to stop work, however a means tested benefit like Pension Credit specifically targets those who are on low incomes.

Who—the type of people who are likely to be eligible are people who are not in work as they approach their SPa. This may be because they are unable to continue doing the job they were doing, or are unable to find work. The impact of increasing SPa on these people is a reduced income that they are unable to mitigate through continued work.

How many—it is very difficult to quantify how many people might be unable to work past the current level of SPa, as it requires knowledge of how many people might be unable to continue working if the SPa is increased.

Cost—As it is difficult to know how many people would be eligible, it is difficult to quantify the cost.

This policy could be viewed as problematic if it encourages people to leave work early and claim Pension Credit. However, this could be mitigated if conditions were applied to any pre SPa receipt of Pension Credit, such as requiring eligible people to be carers, unable to work due to ill health, or actively seeking work.

### 3. Allowing early access to reduced State Pension

Reform—allow individuals to access their State Pension before their SPa, but with a reduction factor applied to allow for the fact that the pension is being paid for a longer time.

Entitlement to Pension Credit would also have to be considered, so that Pension Credit does not simply fill back in the reduction, while still providing protection for pensioners with low incomes.

Why— Those entitled to the State Pension have the opportunity to delay receipt beyond their SPa in order to enhance the pension received, but do not currently have the opportunity to take the pension earlier. Being able to take their pension early could provide a source of income for people who are happy to accept a lower State Pension in return for early payment.

Who— The option could be freely available to everyone over a given age. The number of people who would take early retirement is difficult to estimate. It depends on whether the early retirement reduction factors are set at a level which make them attractive.

PPI calculations based on 2014 based ONS mortality figures for the UK suggest that reduction factors of around 4% for each year that the pension is received before State Pension age might ensure actuarial neutrality for women.[8]

This results in a substantial reduction in the State Pension if the pension is taken a few years early. For example taking State Pension 3 years before SPa would reduce a pension of £155.65 a week by around 12% to around £137 a week.

Cost—While the early retirement factors should be cost neutral in the long term, there would be some years where the annual expenditure is lower, and some years where the annual expenditure is higher than would be the case under the current policy.

In the short term the annual expenditure is likely to increase. This is because those people who take up the option to take their pension early are an additional cost on the Exchequer, for the years before their SPa.

## Impact of allowing disabled people or carers to take State Pension early unreduced

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**Table 1: Projected impact in 2018 of allowing disabled people to access state pension 5 years early and carers to access state pension 3 years early without reduction**

| | Disabled (support group) | Disabled (WRAG group) | Carers |
|---|---|---|---|
| Number of people (thousands) | 260 | 90 | 60 |
| Cost to the Exchequer (£millions, in 2016 earnings terms) | 440 | 340 | 490 |

However the amount of their State Pension is reduced, so in the years after their SPa expenditure is lower than it would otherwise have been, resulting in a lower annual expenditure in the medium to long term.

There may be a self-selection effect, where people who feel they have less time to live may be more likely to take the early retirement reduction, in order to get at least some income from the State Pension. This would introduce a bias into the system and additional cost.

International comparison—Many countries offer early access to their national pension scheme subject to a reduction factor. The USA and Canada both allow some early access to their state pension system and in both countries there is a peak of access at the earliest age available.[9,10]

The Government may therefore be concerned that this policy could lead to a perception of a lower standard voluntary retirement age at the earliest available access date.

### 4. Allowing unreduced early access to particular individuals

Reform– allow people who have disabilities or carers to access State Pension before SPa.

Why—some groups of people may be unable to work longer because of their life circumstances. This policy would allow such people to access their State Pension early without a reduction for early access.

Who—the people targeted are those with disabilities, and/or people with caring responsibilities.

### 4a. Allowing disabled people to receive their State Pension early unreduced

Who—People with disabilities may be less likely to be able to continue in work, or work at all, as they approach retirement; around a half of disabled people are unemployed.[11] An increase in the SPa may therefore have a significantly detrimental impact on disabled people.

Cost—Allowing people who are in receipt of Employment Support Allowance (ESA) in the Support Group and within 5 years of retirement to access their State Pension early could impact around 260,000 people in 2018. The support group contains people who are considered unable to work, with little chance of being able to work in the future.[12]

The annual cost of paying an unreduced new State Pension to these people to replace their ESA in 2018 could be around £440 million more than the cost of their ESA, in 2016 earnings terms.[13] Some of the cost could be offset by increased tax revenue, and reduction in means tested benefits (Table 1).

To an individual on the average amount of ESA in the support group the impact could be an increase in income of around £33 a week in 2016 earnings terms.[14]

If the policy were extended to allow people who are in receipt of Employment Support Allowance in the Work-Related Activity Group (WRAG) and within 5 years of retirement, it could impact around a further 90,000 people in 2018.[15] The WRAG group contains people who are considered unable to work, with a chance of being able to improve their ability to work in the future.

The annual cost of paying an unreduced new State Pension to these people in the WRAG group, to replace their ESA in 2018 could be around £340 million more than the cost of their ESA, in 2016 earnings terms.[16] Some of the cost could be offset by increased tax revenue, and reduction in means tested benefits.

Individuals in the WRAG group receive a lower average level of ESA than those in the Support group, so the net amount per individual is higher. To an individual on the average amount of ESA in the WRAG group the difference could be around £74 a week in 2016 earnings terms (Table 1).[17]

### 4b. Allowing people with caring responsibilities to receive their State Pension early unreduced

Who—Carers may also be limited in the extent that they can work up to a delayed SPa, as a result of their responsibilities. Around a half of carers are unemployed.[18]

How many— Allowing people who are within three years of their SPa and entitled to Carer's Allowance (whether or not they are in receipt of it), could impact around 60,000 people in 2018.

Cost—The annual cost to the exchequer of paying an unreduced new State Pension to these people could be around £490 million in 2016 earnings terms (Table 1).[19]

### Conclusion

State Pension increases can have an impact on people who are unable to work longer for reasons such as caring responsibilities or disability, especially when they have had time on low earnings or out of the labour market and are more dependent on State Pension income in retirement. This note explores the impact and potential cost to the state of introducing policies which mitigate the impact of SPa rises on vulnerable people.

1. Office for National Statistics (ONS) (2013) *Health Gaps by Socioeconomic Position of Occupations in England, Wales, English Regions and Local Authorities*, 2011
2. PPI (2016) *The under-pensioned 2016*
3. HM Treasury (2013) *Autumn Statement 2013*
4. Phillipson C, Smith A (2005) *Extending working life: a review of the research literature* DWP Research Report 229
5. DWP response to FOI request made by PPI. Note that the 660 thousand people who reached SPa in 2013 contains only women who were born in a six month period. This suggests that there would be around a further 200,000 people reaching SPa each year following SPa equalisation
6. PPI calculations includes only cost of full new State Pension being paid before SPa. Based on DWP response to FoI request on distribution of qualifying years and ONS 2015 *2014-based National Population Projections*
7. PPI (2016) *PPI Response to early drawing of state pension Committee inquiry*
8. Eurostat (2016) *Activity rates by sex, age and citizenship*
9. US Government Accountability Office (2014) *Challenges for Those Claiming Social Security Benefits Early and New Health Coverage Options*
10. Canada's Office of the Superintendent of Financial Institutions (2013) *Actuarial Report (26th) on the Canada Pension Plan*
11. PPI (2016) *The under-pensioned 2016*
12. PPI analysis of DWP (2016) Tabtool and ONS (2015) *2014-based National Population Projections*
13. PPI analysis of DWP (2016) Tabtool and ONS (2015) *2014-based National Population Projections*
14. PPI analysis of DWP (2016) Tabtool
15. PPI analysis of DWP (2016) Tabtool and ONS (2015) *2014-based National Population Projections*
16. PPI analysis of DWP (2016) Tabtool and ONS (2015) *2014-based National Population Projections*
17. PPI analysis of DWP (2016) Tabtool
18. PPI (2016) *The under-pensioned 2016*
19. PPI analysis of DWP (2016) Tabtool and ONS (2015) *2014-based National Population Projections*

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