



PPI Submission to the DWP's State Pension Age Review

Summary

- I. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.
- II. Most commentators agree that due to improvements in longevity, the state pension age (SPA) will need to rise in the future. However, not all commentators agree on the rate at which the SPA rises should happen. The current SPA in the UK is 60 for women and 65 for men. From 2010 to 2020 the women's SPA will rise in a series of steps so that men and women's SPA will equalise at 65 by 2020.
- III. The previous Labour Government legislated in the Pensions Act 2007 for the male and female SPA to rise further in a series of steps from 65 to 66 by 2026, from 66 to 67 by 2036 and from 67 to 68 by 2046. The current Coalition Government has indicated that it believes that the SPA may need to rise faster and further than this and is consulting on the question of when the increase in the SPA from 65 to 66 should occur. It has also announced that the default retirement age will be abolished.
- IV. This submission provides the PPI's analysis and evidence to the DWP's SPA review. This submission concludes that:-
 - The primary driver behind increasing the SPA should be to recognise recent improvements in longevity and potential future improvements in longevity. If longevity continues to improve and the SPA was left unchanged, future generations would spend a larger proportion of their working life in retirement and in receipt of state pensions compared to previous generations. This may be perceived to be unfair to today's younger generations who would have to pay for the pensions of today's people over SPA for longer.
 - In 1981, individuals received the state pension for 25% of their adult life on average. By the year 2000 this had increased to 30% of adult life and in 2010 to 33% of adult life in receipt of the state pension. If the SPA remains unchanged and longevity continues to improve then we would expect the proportion of adult life spent in receipt of the state pension to continue to increase. This will increase the cost to the Government of providing state pensions and creates intergenerational unfairness.

- A useful guiding principle may be for policymakers to aim to maintain a roughly constant proportion of individuals' total adult life in receipt of the state pension. This helps to ensure fair treatment of successive generations.
- PPI calculations suggest that if policymakers want to keep the proportion of adult life in receipt of the state pension constant at today's 2010 levels of 33% of adult life, then the SPA would need to rise to 66.5 by 2030.
- To keep the proportion of adult life in receipt of the state pension constant at the 2000 level of 30% of adult life, the SPA would need to rise to 68 by 2030.
- To keep the proportion of adult life in receipt of the state pension constant at 1981 levels of 25% of adult life in receipt of the state pension, the SPA would need to rise to 72 by 2030.
- While any move to increase the SPA is likely to generate cost savings for the exchequer, the public may be more likely to accept an argument for increasing the SPA which reflects improvements in longevity, rather than one which justifies the SPA change largely on cost saving grounds.
- There are a number of factors that should be considered when considering the timing of future increases in the SPA. Economic activity rates at older ages, employers' attitudes to employing older workers and inequalities in life expectancy/ healthy life expectancy will all play a role in determining how fast the SPA could be increased without unduly affecting certain cohorts of older people in a negative way.
- It should be recognised that individuals will need time to adjust their behaviour to any increases in SPA. Some individuals may need to delay their retirement, or save more today to be able to cope with an increased SPA.
- The evidence on male and female labour market participation rates suggests that as a minimum, men may need at least 5 years notice and ideally 10 years notice of an SPA change. Women may need more than 10 years notice if they are to have time to adjust their retirement plans in response to the policy change. This is because women tend to drop out of the labour market at a younger age than men.
- An increase in the SPA may disproportionately affect those with shorter life expectancies. A recent NAO report concluded that health inequalities in England have actually widened during the period 1995-97 to 2006-8 suggesting that this remains a real issue of concern.
- It should be recognised that policies which move the male and female SPAs further out of line may be regarded as unlawful or as gender discrimination. The PPI would suggest that the Government takes expert legal advice on this issue.

- V. This submission suggests that there are a number of safeguards that the Government could consider if it intends to go forward with its stated policy of increasing the SPA from 65 to 66 no sooner than 2016 for men and 2020 for women. These possible safeguards include:-
- The Government may need to consider what focussed policy interventions can be introduced to help improve the life expectancy and healthy life expectancies of those with the shortest life expectancies.
 - The Government could continue to pay the Guarantee Credit from Age 65, even if the SPA increases in the future - this policy would safeguard the incomes of the lowest paid older people.
 - The Government could offer an uplift in the state pension for people with short life expectancy (similar to the way that impaired life annuities work).

Introduction

1. The Pensions Policy Institute (PPI) promotes the study of pensions and other provision for retirement and old age. The PPI is unique in the study of pensions, as it is independent (no political bias or vested interest); focused and expert in the field; and takes a long-term perspective across all elements of the pension system. The PPI exists to contribute facts, analysis and commentary to help all commentators and decision-makers to take informed policy decisions on pensions and retirement provision.
2. This response focuses on the evidence that the PPI considers is relevant to the Government's decision making in relation to when to increase the State Pension Age (SPA).

Does SPA need to rise beyond age 65 in the future?

3. Most commentators agree that due to improvements in longevity, the State Pension Age (SPA) will need to rise in the future. However, not all commentators agree on the rate at which the SPA rises should happen. The current SPA in the UK is 60 for women and 65 for men. From 2010 to 2020 the women's SPA will rise in a series of steps so that men and women's SPA will equalise at 65 by 2020.
4. The previous Labour Government legislated in the Pensions Act 2007 for the male and female SPA to rise further in a series of steps: from 65 to 66 by 2026, from 66 to 67 by 2036 and from 67 to 68 by 2046. The current Coalition Government has indicated that it believes that the SPA may need to rise faster and further than this and is consulting on the question of when the increase in the SPA from 65 to 66 should occur. It has also announced that the default retirement age will be abolished.

What factors should be considered in setting an appropriate SPA?

5. When State Pension Age was introduced in 1948 the life expectancy of a man aged 65 was 12 years and the life expectancy of a woman aged 65 was 15 years¹. The current life expectancy of a man aged 65 is 21 years and is expected to rise to 22 years by 2020 and 25 years by 2050. Similarly, the life expectancy of a woman aged 65 is currently 23 years and is expected to rise to 25 years by 2020 and 27 years by 2050. State pensions are paid from SPA until death, so, with increases in life expectancy since the introduction of SPA and further expected increases in life expectancy, the cost to the Government of providing state pensions is likely to rise in the future.
6. If the SPA is left unchanged it would also mean that in the future people would spend a greater proportion of their total working life in

¹ <http://www.ohe.org/lib/liDownload/603/Sixty%20years%20of%20the%20NHS%20-%>

retirement. This may not be good for economic growth, nor is it necessarily fair to subsequent generations as they will end up bearing the cost of paying out state pensions for longer.

Q1. What evidence concerning changes in life expectancy and the changed economic context should be taken into account when bringing forward the increase in SPA to 66?

7. The primary evidence that the Government should consider in relation to setting the State Pension Age is the evidence on recent and potential future improvements in life expectancy and healthy/disability free life expectancy. However, in addition to considering improvements in average life expectancy it is also important to consider the potential impact of any proposed policy change on those people with shortest life expectancies – often those in lower socioeconomic groups/ manual occupations.
8. One implication of increasing the SPA earlier is that the Government expenditure on the state pension will be reduced. However, if the public is to accept the case for an earlier increase in the SPA then the policy should primarily be framed in relation to recent and potential future improvements in life expectancy, rather than in relation to cost cutting and the current economic context.

Improving Government finances

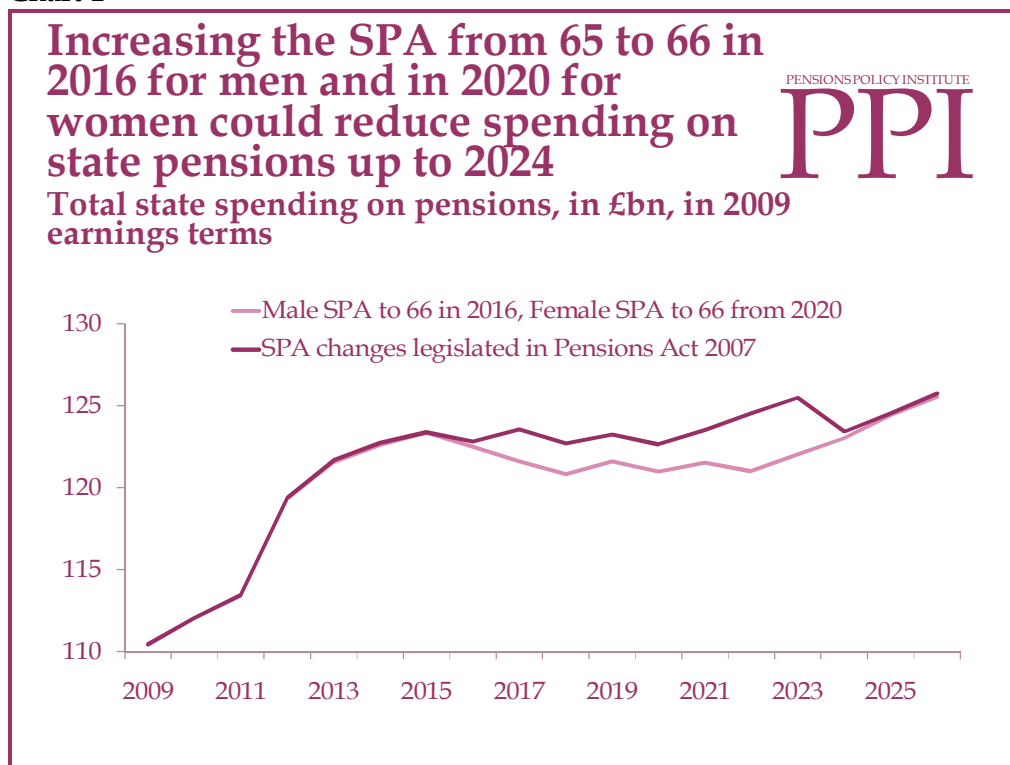
9. Bringing forward the SPA increase to 66 for men no sooner than 2016 and the SPA increase to 66 for women no sooner than 2020 would provide two major revenue benefits to the Government. Firstly, spending on state pension benefits would be reduced because fewer people would be entitled to receive state pension. Secondly, extra revenue would be generated through income tax and other taxes from those that carry on working until age 66. However, the value of this is uncertain and there are many complexities. Not all individuals affected will have the option to work, and there may be reduced job opportunities for younger workers. Therefore, there will be some offsetting expenditure increase on unemployment and welfare benefits for those below SPA.

Spending on State Pensions would fall

10. Basic State Pension (BSP) and S2P/SERPS are paid from SPA until death and currently are increased in line with price inflation. However, the Coalition Government has committed to increase BSP in line with the greater of earnings, prices (CPI) or 2.5% from 2011. Therefore, state spending on pensions is expected to increase sharply between 2009 and 2015, and increase further in the future.

11. Bringing forward the planned increase in SPA to 66 for men to 2016 and for women to 2020 would result in lower spending on state pensions by the Government. This is because BSP, SERPS and S2P would be paid to fewer people and for less time on average. Most of the saving would be from less spending on the BSP though there are also savings on SERPS/S2P and Pension Credit. However, the spending on pensions would still be at a higher level than it is currently (Chart 1).

Chart 1²



12. Chart 1 shows that the reduction in total state spending on pensions from increasing SPA to 66 for men in 2016 and for women in 2020 could be £2bn per year in 2017 rising to £3.5bn per year in 2022³. After 2024, when the SPA for both men and women is at the Pensions Act 2007 reform levels, the reduction in spending on state pensions is minimal.

² PPI Calculations. See PPI Briefing Note 53 - Could increases in State Pension Age be brought forward? For further details.

³ All figures in 2009 earnings terms

Raising SPA could increase tax revenue

13. Bringing forward the planned increase in SPA will also impact expenditure on those below SPA. The policy may mean:
 - More income tax revenue from more people working
 - More VAT revenue from increased consumer spending from people having a higher disposable income from working longer
14. However, there could be higher Government spending on:
 - Unemployment benefits (including some on younger workers)
 - Disability benefits
15. Therefore, the overall impact on Government expenditure is uncertain. Research institute NIESR estimates that a 1 year increase in SPA, could improve government finances by £13bn on the assumption that this leads to an increase in the effective working age of 0.6 years.
16. Almost half of the £13bn estimate by NIESR comes from higher direct tax and lower interest payments, a third from higher indirect taxes and a quarter, or approximately £3.5bn⁴, from lower pensions and transfers.
17. The NIESR estimate is based on an increase in the working lives for men and women so the full impact would not be fully felt until both SPAs are increased in 2022.
18. The PPI estimate of the reduction in Government expenditure from increasing SPA to 66 for men in 2016 and for women in 2020 of £3.5bn in 2022 is similar to the reduction in Government expenditure on pensions estimated by NIESR.

Independent assessments of longevity/Future SPA changes

19. Given the public expenditure implications of any changes to the SPA as outlined above and the Government's inevitable interest in any SPA policy change, the public may be more willing to accept an SPA policy change if it is based on an independent assessment of the trends in longevity.
20. One principle that the Government or an independent body could consider in helping to decide an appropriate trajectory for the SPA is to aim to maintain roughly the same proportion of the adult population's lifespan to be spent in receipt of the state pension. The argument for such an approach is that it is fair to current and future

⁴ <http://justageing.equalityhumanrights.com/wp-content/>

generations and avoids younger generations being overburdened by the need to support older generations' longer retirements.

21. The Pensions Commission produced some analysis of the proportion of adult life spent in retirement in their 2005 report.⁵ In 1950, men on average spent 18% of their adult life in retirement and women spent 26%. By 2005, men were on average spending 31% of their adult lives in retirement and women 36%. This has been driven by a trend during this period of both men and women exiting the workforce at an earlier age (men down from exiting the workforce at age 67 in 1950, to at age 64 by 2005) and due to very substantial increases in longevity during this fifty-year period. Male life expectancy at the age of exit from the workforce increased from 11 years on average in 1950, to 20 years by 2005. (Table 1)

Table 1: Percentage of Adult Life Spent in Retirement

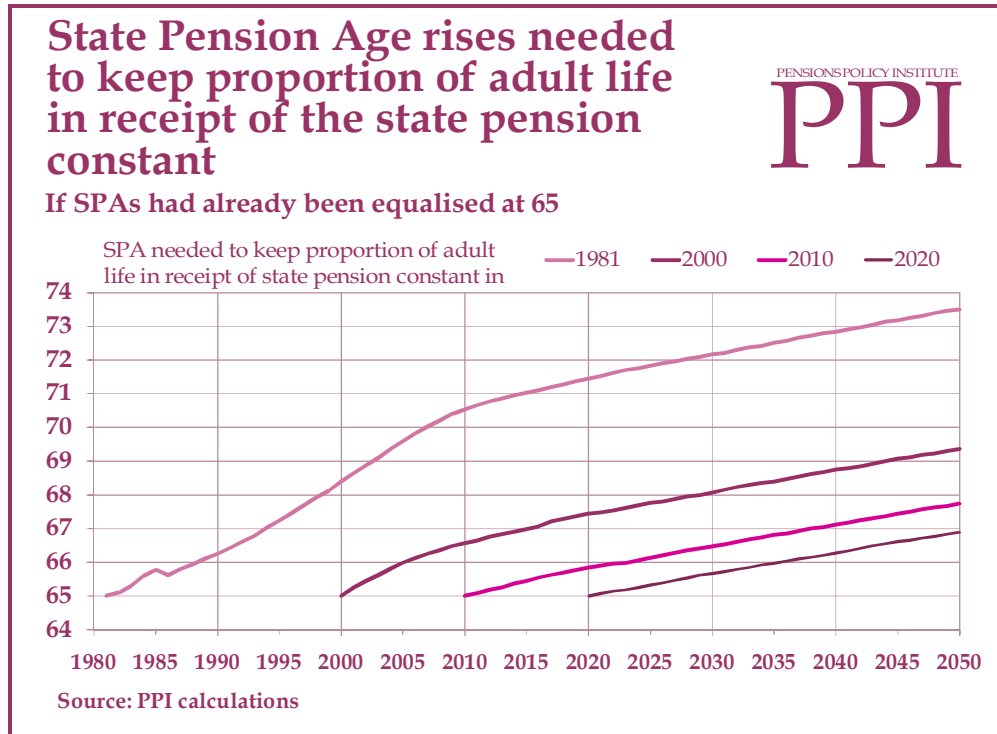
		Average Age of Exit from the workforce	Life expectancy at age of exit	% of adult life spent in retirement
1950	Men	67.2	10.8	18.0%
1980	Men	64.6	14.3	23.5%
2005	Men	64.0	20.4	30.7%
1950	Women	63.9	16.2	26.1%
1980	Women	62.0	20.6	31.9%
2005	Women	61.9	25.1	36.4%

22. The Pensions Commission also calculated what SPA would be required to maintain a constant proportion of adult life in receipt of the state pension at 1980 levels, 2005 and 2020 levels.⁶ The Pensions Commission's analysis was based on GAD historical life expectancy data 1980-2003 with the Commission's own projections thereafter.
23. The PPI has used the latest ONS 2008-based data on life expectancy and a similar methodology to that used by the Pensions Commission to calculate what SPAs would be required to keep constant the proportion of adult life spent in receipt of a state pension at 1981, 2000, 2010 and 2020 levels. (Chart 2)

⁵ Pensions Commission (2005) A New Pension Settlement for the Twenty-First Century (Second Report), figure 1.44 p.97. Pensions Commission (1990 onwards) and Blondal and Scarpetta (1999)

⁶ Pensions Commission (2005) A New Pension Settlement for the Twenty-First Century (Second Report) chart 5.14 p177

Chart 2⁷



24. Chart 2 shows that if policymakers want to keep the proportion of adult life spent receiving the state pension constant at today's 2010 levels of 33% of adult life then given current expectations of future life expectancy, the SPA would need to rise to 66.5 by 2030.
25. If policymakers wanted to keep the proportion of adult life spent in receipt of a state pension constant at the 2000 level of 30% of adult life, then the SPA would need to rise to 68 by 2030.
26. If policymakers wanted to keep the proportion of adult life spent in receipt of a state pension constant at the 1981 level of 25% of adult life, then, given current expectations of future life expectancy, the SPA would need to rise to 72 by 2030. This would represent a very substantial increase in the SPA over a relatively short time frame.
27. The implication is that if policymakers do not increase the SPA beyond 65 then given current and future expectations of life, we could expect the proportion of adult life spent in receipt of the state pension to rise, with a corresponding increase in Government expenditure on the state pension.

⁷ The required SPA is calculated as the age at which remaining life expectancy as a proportion of total adult life is maintained at a constant level. PPI calculations based on ONS life expectancy calculations using historical mortality rates from 1981 to 2008 and assumed calendar year mortality rates from the 2008-based principal projections thereafter. Adult life is assumed to begin at age 18.

Q2. What evidence should the Government consider in deciding the notice period for individuals affected by a change to the timing of the state pension age increase to 66?

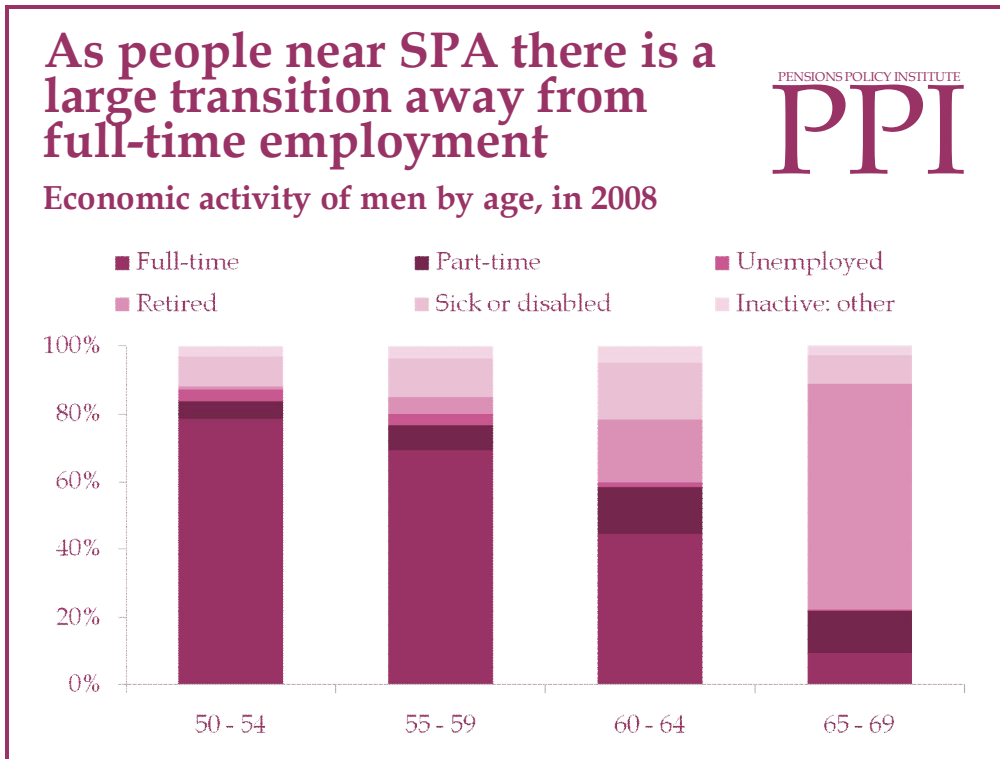
28. There has been a trend of people working beyond SPA in the past 15 years. The economic activity rate for people at or over SPA fluctuated between 7.7% and 9.1% between 1994 and 2003. This rose to over 10% in 2008 and one estimate is that this figure could rise to 13% by 2020⁸.
29. Working longer may also be an inevitable consequence of less generous private pensions in the future. The normal pension age in many occupational pension schemes may increase for younger workers, given the future cost pressures of the schemes. However, as many schemes have a normal retirement age of 60 or 65, any increase is likely to be a catch-up to SPA rather than an extension beyond it.

Who will be affected by the proposed increases in SPA?

30. Bringing forward the increase in SPA will affect individuals differently. Those affected by the reforms may need to change their work and savings patterns to adjust to the change in SPA. The cohort of people who could be most affected by the proposed increase in male SPA to 66 no sooner than 2016, are those men who are currently aged 50-59.
31. Chart 3 shows a snapshot of the male workforce aged 50-69 in 2008. It shows that there is a significant transition from full-time or part-time employment into 'inactivity' past age 59. Approximately 80% of men aged 55-59 are in employment, falling to 60% aged 60-64, and only 20% aged 65-69. In order to make an increase in SPA effective, both individuals and employers' attitudes towards working longer would need to change.
32. The evidence on participation rates at older ages would suggest that policymakers would be unwise to give anything less than 5 years notice of the male SPA changes. Within 5 years of the current SPA of 65, only 60% of the male workforce are still economically active. It would be desirable to give 10 years notice, because within 10 years of the current SPA of 65, around 80% of men are still economically active and could therefore respond to the policy change by delaying their retirement if they need to. Once individuals have left the labour market at these ages it is likely to be very difficult for them to re-enter the labour market at a later date.

⁸ Future Foundation for Saga, September 2003

Chart 3⁹

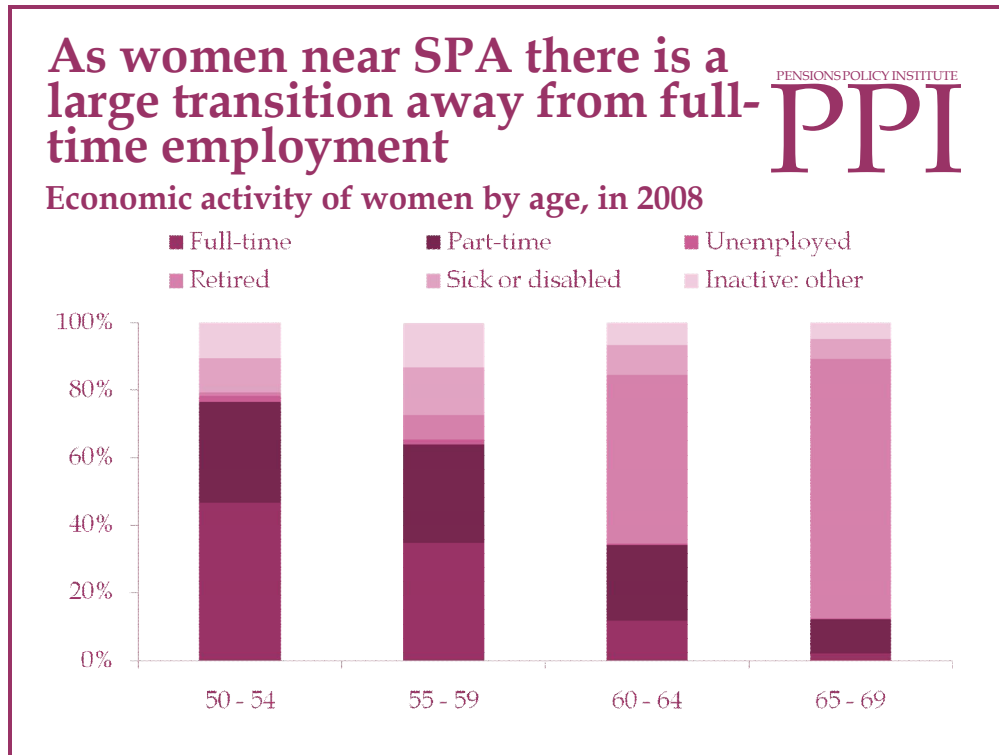


33. Chart 3 also highlights an issue with those who are already economically inactive. 16% of men aged 50-59 were registered as economically inactive i.e. are either retired, sick or disabled, or otherwise inactive.
34. A larger proportion, 28% of women aged 50-59 were registered as economically inactive¹⁰. This may suggest that there is a need to give women more notice of any proposed SPA change than men. (Chart 4)

⁹ ONS, Pension Trends, Chapter 4 (2009)

¹⁰ Pension Trends, Chapter 4 (2009)

Chart 4¹¹



35. For people who are already economically inactive when any policy change is announced it may be very difficult to adjust to an increase in SPA, especially if they have problems re-joining the workforce. SPA changes in the past have aimed to avoid this issue by using long lead-in times. Women were given at least 15 years' notice in relation to the equalisation of the male and female SPAs. The legislation was introduced in 1995 but the actual changes did not start to be implemented until 2010 to 2020.

The possible impact of the recession on older workers

36. The labour market participation rates above are based on data from 2008. Since then the UK economy has fallen into recession. The Government should monitor whether older workers are becoming economically inactive at older ages at a faster rate than these figures suggest due to the recent recession. If the latest figures suggest this is the case, then there may be a need to give slightly longer notice periods of any proposed SPA changes to reflect this evidence.

¹¹ ONS, Pension Trends, Chapter 4 (2009)

Impact of increasing the SPA on working longer

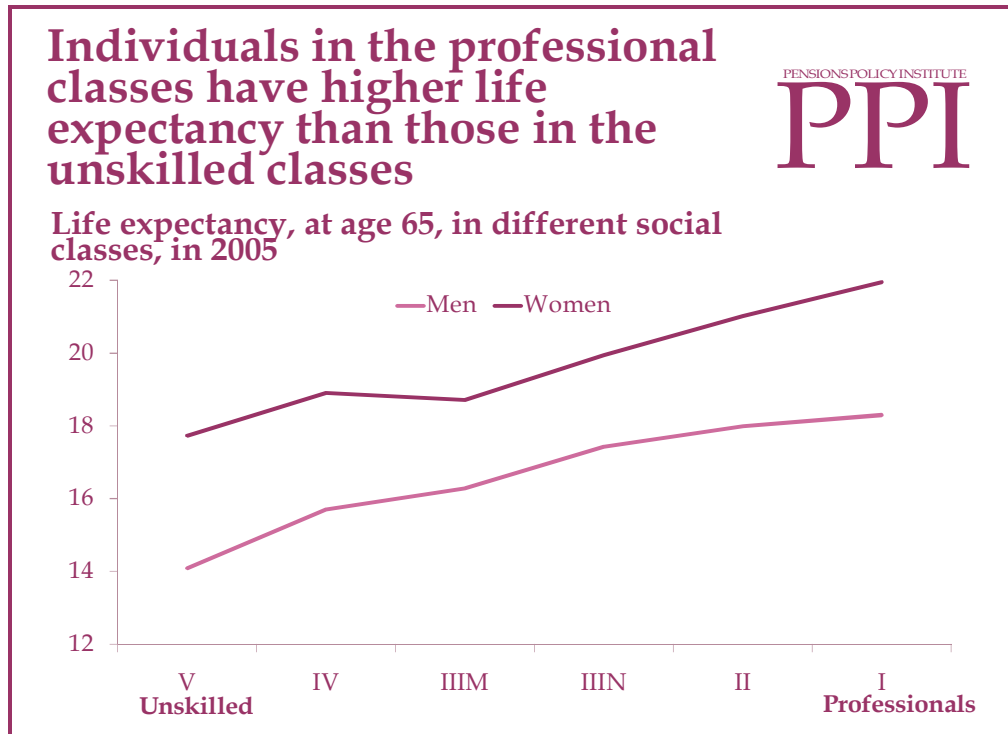
37. The Pensions Commission's original analysis showed that working longer had a far bigger impact on an individual's final level of retirement income than the proposed changes to the state or private pensions. Increasing the SPA may be one way of encouraging people to work longer.
38. However, there may be a need to educate the public about the positive impact on their level of retirement income of either deferring their state pension, or of working longer and continuing to contribute into a private pension.

Q3. What evidence should the Government consider to ensure no group is disproportionately impacted by the level of the state pension age and any change to the timing of the state pension age increase to 66?

Different Impacts for people from different social classes

39. Any review of SPA would need to consider the impact of any change in SPA on different social classes. There is a clear difference in life expectancy between individuals in different social classes. The life expectancy difference between Class I (professional) and Class V (unskilled) at age 65 is around 5 years for men and around 4 years for women (Chart 5).
40. All other things being equal, increasing SPA will reduce the number of years people can expect to receive state pension so those in Class V see a larger proportional fall in the length of time they receive a state pension than those in social class I. If SPA increases more quickly than life expectancy for each social class, then future cohorts of people could receive their state pension for a shorter time than current cohorts do.

Chart 5¹²



41. The proportion of people in Class V is now less than 5% of the population, and declining (expected to reach 3% in 2050).¹³ Therefore, differences in life expectancies between social classes should be used with caution. The majority of the population are in Class II, III or IV where differences in life expectancy are smaller. In addition, many more people are now capable of working after SPA than when the state pension system was designed.
42. However, projections of life expectancy are an average, and many people will not experience the benefits of longer living. For those people, an increase in SPA could be a big disadvantage.

Reducing Inequalities in Healthy Life Expectancy

43. From a policymaker's perspective the potential disproportionate impact of any increase in SPA on those with the shortest life expectancies suggests that there is a need for Government to have an active policy agenda to aim to improve the healthy life expectancies of those groups with the shortest life expectancies.
44. Improving life expectancy for those with the shortest lifespans is likely to be a long-term policy agenda, requiring multiple issues to be addressed including poor health and lifestyle, economic inactivity/ poor housing/ and environment.

¹² ONS(2006) Trends in life expectancy by social class 1972 – 2006

¹³ ONS(2006) Trends in life expectancy by social class 1972 – 2006

45. In November 2008, Professor Sir Michael Marmot was asked by the then Secretary of State for Health to chair an independent review to propose the most effective evidence-based strategies for reducing health inequalities in England from 2010. The review reported in February 2010.¹⁴
46. A recent NAO report¹⁵ concluded that health inequalities in England have actually widened during the period 1995-97 to 2006-8. Life expectancy has improved year on year in the areas with most severe health problems since 1995-97 and stood at 75.8 years for males and 80.4 years for females in 2006-08. However, life expectancy in the areas with the most severe health problems has not improved as fast as the whole population and the gap in life expectancy between the two has widened since 1995-97, by 7 per cent for males and 14 per cent for females.
47. It is unlikely that in the short-term the Government could help to improve the life expectancies of those with the shortest life expectancies, so the Government may need to consider whether there are short-term safeguards that it could put into place alongside any prospective increase in SPA to reduce the potential negative impact on those who may be disproportionately affected.

Safeguards for those on low incomes

48. One possible safeguard that the Government could consider is to continue to pay the Guarantee Credit (GC) from age 65, even if the SPA rises. Guarantee Credit replaced the Minimum Income Guarantee (MIG) in October 2003. Guarantee Credit is the name used for income support for people over the age of 60. It is currently payable from age 60 as a tax-free means-tested benefit – it is only paid to those with low incomes and with low savings.¹⁶
49. Its effect is redistributive – the benefit is paid for from taxes that are related to income and only paid to those on low income. In 2010/11 it will 'guarantee' single pensioners a minimum income of £132.60 per week and couples a minimum income of £202.40 per week.

¹⁴ <http://www.marmotreview.org/>

¹⁵ NAO, Tackling inequalities in life expectancy in areas with the worst health deprivation, June 2010

¹⁶ Savings consist of liquid assets, such as cash, building society and bank accounts, national savings, unit trusts and shares. It does not include the value of the home.

50. An individual or couple¹⁷ is eligible for GC if they:
 - are aged 60 or over (either person in the case of a couple)
 - on a low income, and
 - working less than 16 hours a week (and any partner working less than 24 hours a week).
51. GC can be higher where an individual or an individual within a couple is a carer getting Carer's Allowance, or where there are housing costs not fully covered by Housing Benefit.
52. Lower levels of benefit are paid if pensioners have savings of more than £10,000.¹⁸ GC is currently reduced by £1.00 per week for each £500 (or part thereof) in excess of £10,000.¹⁹
53. If the Government were to continue to pay the Guarantee Credit from age 65, even as the SPA rises, then the Guarantee Credit would act as a safety net for people on low incomes who may be affected by any such policy change.

More radical options

54. Perhaps more radically, the Government could consider whether those people with the shortest life expectancies should receive an uplift in the value of their state pension, in recognition that they are unlikely to receive it for as long as those people with higher life expectancies. In the private sector, insurance companies offer impaired life annuities to those with poorer than average health.

Gender discrimination

55. If the Government proposes to increase the male SPA before 2020 when the male and female SPA equalise at 65, then the Government will have to consider whether there are any legal impediments to doing so. Some commentators have suggested that this may run contrary to gender discrimination legislation.

Need for public education

56. More generally, whatever trajectory of increasing the SPA is followed, the Government will need to think carefully about how to communicate any such SPA changes.

¹⁷ Married, Civil Partners, or living together as husband and wife or as civil partners

¹⁸ The amount of savings pensioners could have before their GC entitlement was reduced was £6,000 until November 2009 when it was raised to £10,000 See Budget 2009 speech, www.hm-treasury.gov.uk/bud_bud09_speech.htm

¹⁹ Under the previous legislation the MIG was reduced by £1.00 per week for each £250 in excess of £6,000.

57. A recent survey carried out by the DWP²⁰ suggests that around 75% of people don't know what their SPA is, with almost all of these thinking they will reach it sooner than they actually will. This highlights that many people have given very little thought to retirement planning. Any SPA changes will need to be communicated clearly in advance to affected people, and with enough notice for them to be able to change their retirement plans if they need to.

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6 August 2010**

²⁰ <http://research.dwp.gov.uk/asd/asd5/WP72.pdf>