PENSIONS POLICY INSTITUTE

PPI

PRESS RELEASE

EMBARGOED UNTIL 00.01 Wednesday 21st March

"There needs to be greater clarity about the role of the State Pension" says Pensions Policy Institute

The Pensions Policy Institute (PPI) is today publishing *How would removal of the State Pension triple lock affect adequacy?* sponsored by the Centre for Ageing Better, Age UK and the Trades Union Congress (TUC).

Triple lock indexation uprates the new State Pension (nSP) and the basic State Pension (bSP) every year by the greater of the rise in earnings, the rise in the Consumer Price Index (CPI) or 2.5%.

Daniela Silcock, Head of Policy Research, PPI said "the State Pension triple lock will increase the value of pensioners' basic incomes today and for future pensioners. The triple lock will make it easier for pensioners to achieve adequate retirement incomes by reducing the amount people will need to save into private pensions."

"However, maintaining the triple lock will cost more than other indexation scenarios. Indexing the State Pension to the greater of earnings or prices, the double lock, would cost 0.2% less of GDP per year than a triple lock by 2050, and indexing the State Pension to earnings would cost 0.5% of GDP per year less." However the State Pension would still cost 5.4% of GDP

"Removing the triple lock would particularly impact those on low incomes, who would lose a greater proportion from a change in indexation than those on higher incomes. Pensioner poverty would also be higher under other indexation scenarios than it would be under the triple lock."

"State Pension aims have migrated from providing a basic level of income, to maintaining living standards, and then back again. The Government intends for the nSP to provide a minimum base of income for people to top up with private pension income, and to reduce means-testing. However, it is not clear whether this minimum base is intended to prevent poverty, allow people to achieve a minimum acceptable standard of living, or contribute some income to an earnings-related top up. In order for the implications of potential indexation changes to be properly assessed, there needs to be greater clarity about the role of the State Pension."

"Under all of the scenarios, some pensioners still experience poverty in retirement and many will need to save significant amounts into private pensions, or other saving vehicles, in order to achieve adequate retirement incomes."

Claire Turner, Director of Evidence, Centre for Ageing Better said: "financial security is incredibly important for a good later life. If you rely only on the State Pension any reduction in your weekly income is going to hit hard.

"This report shows the importance of uprating pensions to ensure fewer people will live their lives in poverty now and in the future. It also serves as a wake-up call for anyone assuming the State Pension will provide a comfortable income in retirement. Such people will find themselves much less well off than anticipated."

Frances O'Grady, General Secretary, TUC said "the UK already has the least generous State Pension in the developed world. Getting rid of the triple lock would increase pensioner poverty and hit the poorest hardest.

"Today's report shows that scrapping the lock will hurt young and old alike. A race to the bottom on pensions helps no-one."

Caroline Abrahams, Charity Director, Age UK said "this very thorough analysis from the PPI shows just how important the triple lock will be in reducing pensioner poverty in the future, enabling low income workers to save enough for a decent retirement income whilst helping to protect the income of those already retired.

"Many people are surprised to learn that the average State Pension is only just over £7,000 per year – less than half the annual salary of a full time working adult on the minimum wage of £7.50 an hour. Yet millions of older people are heavily reliant on this relatively modest sum, a situation that is set to continue for the foreseeable future.

"Considering the UK's high poverty levels, the triple lock looks to be an increasingly important mechanism to provide a degree of financial security for current and future generations of older people."

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How would removal of the State Pension triple lock affect adequacy? is sponsored by the Centre for Ageing Better, Age UK, and the Trades Union Congress (TUC).

Notes for editors

1. The Pensions Policy Institute (PPI) is an educational research charity, which provides non-political, independent comment and analysis on policy on pensions and retirement income provision in the UK. Its aim is to improve the information and understanding about pensions policy and retirement income provision through research and analysis, discussion and publication. Further information on the PPI is available on our website www.pensionspolicyinstitute.org.uk.

2. *How would removal of the State Pension triple lock affect adequacy?* is sponsored by the Centre for Ageing Better, Age UK, and the Trades Union Congress (TUC).

3. Sponsorship has been given to help fund the research, and does not necessarily imply agreement with, or support for, the analysis or findings from the project.

Executive Summary

Triple lock indexation (which uprates the new State Pension (nSP) and the basic State Pension (bSP) every year by the greater of the rise in earnings, the rise in the Consumer Price Index (CPI) or 2.5%) has been in place since 2011. The triple lock has increased the value of the State Pension and will continue to increase the value for future pensioners if it remains in place. However, there are concerns about the sustainability of the triple lock. Removal of the triple lock would decrease the cost of providing State Pensions, however it would also have implications for pensioner poverty and the amount spent on other means-tested benefits such as Housing Benefit, caring credits and disability premiums.

The Government is legally required to maintain at least an earnings link for the bSP and the nSP, and therefore, if the triple lock is removed, an earnings link will be one of the potential indexation arrangements. The Conservative Party also mentioned in its most recent election manifesto the possibility of introducing a "double lock", increasing the State Pension by the higher of earnings inflation or prices.[1] The Government has committed to retaining the triple lock for the current Parliament, but bSP and nSP could potentially be linked to earnings or the double lock from 2022.

The role of the State Pension is not clearly defined

In order for the implications of potential changes to State Pension indexation to be properly assessed, there needs to be greater clarity about the role of the State Pension.

What is the aim of the State Pension?

The aim of the State Pension has migrated from providing a basic level of income, to maintaining living standards, and then back again. The Government intends for the nSP to provide a minimum base of income for people to top up with private pension income, assisted by automatic enrolment, and to reduce means-testing. However, it is not clear whether this minimum base is intended to prevent poverty, allow people to achieve a minimum acceptable standard of living, or contribute some income to an earnings top up.

How much working life income should the State Pension replace?

The full value of the nSP, £159.55 (2017/18), is worth 24% of National Average[2] Earnings,[3] and is set just above the Pension Credit level, £159.35 in 2017/18.[4] Under current arrangements, the State Pension will:

- Reduce means-testing among pensioners,

[1] The Conservative and Unionist Party Manifesto 2017; *Forward, Together; Our Plan for a Stronger Britain and a Prosperous Future*
[2] Averages are means unless otherwise specified
[3] Based on Weekly pay - Gross (£) - For full-time employee jobs: United Kingdom, 2017, ONS, Annual Survey of Hours and Earnings
[4] Full Guarantee Credit level

- Assist in preventing poverty but not fully eradicate it; and will not enable people to achieve a minimum acceptable standard of living from the State Pension alone,
- Require some people to save a significant amount of income into a private pension or other savings vehicle in order to achieve adequacy targets in retirement.

In order to determine what proportion of average earnings the State Pension should replace, it is necessary first to determine the ultimate aim of the State Pension.

How much should people be expected to save privately?

If the State Pension is intended to provide a platform for saving, there needs to be clarity regarding how much people are expected to save privately. The amount that people need to save in order to meet adequacy targets will vary depending on the level of income they receive from the State Pension. If the level of State Pension income is too low, then the amount some people would need to save privately could be unaffordable. Some assessment is necessary as to how much people from different income groups can afford to save including those not eligible for an employer contribution, such as the self-employed.

Automatic enrolment will enable many more people to save in private pensions and will help more people to meet adequacy targets, though eligibility is not universal and not all those saving through automatic enrolment will make sufficient contributions to meet targets. Changes to automatic enrolment policy which extend eligibility and raise minimum contribution levels could help more people to meet adequacy targets. However, increasing minimum contribution levels or bringing in more people with low incomes could lead to higher opt-out rates or financial hardship for those who struggle to afford contributions.

In order to make an informed decision regarding which indexation arrangement is the most appropriate, the above questions will need to be addressed.

The triple lock is the most effective indexation link for providing a basic level of income and maintaining living standards, but also costs the State more in the long-term

Triple lock indexation provides the most adequate basic level of income, when compared to other indexation scenarios. Assuming that the poverty line grows with earnings, by 2050 the proportion of pensioners in poverty (under 60% of median UK income) under a double lock could be around 1% higher (around 200,000 pensioners more) and under an earnings link could be around 4% higher (around 700,000 pensioners more) when compared to the triple lock.

Box EX1: adequacy targets

This report compares individual outcomes to income adequacy targets in order to measure the impact of different indexation scenarios. The adequacy targets are outlined below:

- The Minimum Income Standard (MIS): allows pensioners to achieve a minimum socially acceptable standard of living – around £10,000pa for a single pensioner in 2017.[5]
- Modest target: allows pensioners to achieve a "modest" standard of living - £17,500pa.[6]
- Comfortable target: allows pensioners to achieve a "comfortable" standard of living - £25,000pa.[7]
- Target replacement rate: a level of income which allows people to replicate their working life living standards when they are in retirement - these vary between individuals.

A triple locked State Pension would make it easier for people to reach adequacy targets

Under a triple locked pension, a low earning woman (30th percentile), contributing from age 22, would need to save 1.3% (£250pa) of salary per year on average to achieve the Minimum Income Standard with £10,000pa:

- Under a double lock, she would need to contribute around 1.8% in total (£100pa extra), and
- Under an earnings link, she would need to double her rate of saving to around 2.6% in total (£270pa extra) of salary per year on average.
- In order to save enough to replicate working life living standards in retirement, she would need to save around 4.3% per year (£860pa) on average under a triple lock,
- Around 4.8% total (£110pa extra) under a double lock, and
- Around 5.6% total (£270pa extra) under an earnings link.

The proportion that those with higher incomes need to contribute is less affected by changes in indexation than it is for low earners who are more dependent on State Pensions and benefits.

Median and high earners[8] would need to contribute 6.7% and 12.2% of salary on average from age 22 in order to achieve replicate working life living standards in retirement. Under alternative indexation scenarios, they would need to contribute:

- Around 7% total (£110pa extra) and around 12.5% total (£100pa extra) respectively, to replicate living standards under a double lock, and
- Around 7.5% total (£290pa extra) and 12.8% total (£280pa extra) under an earnings link (EX1 & EX2).

[5] JRF (2017a) table 7, excluding rent and childcare
[6] PLSA (2017) p. 26
[7] PLSA (2017) p. 26
[8] Median earning males and high earning females

Chart EX1[9]

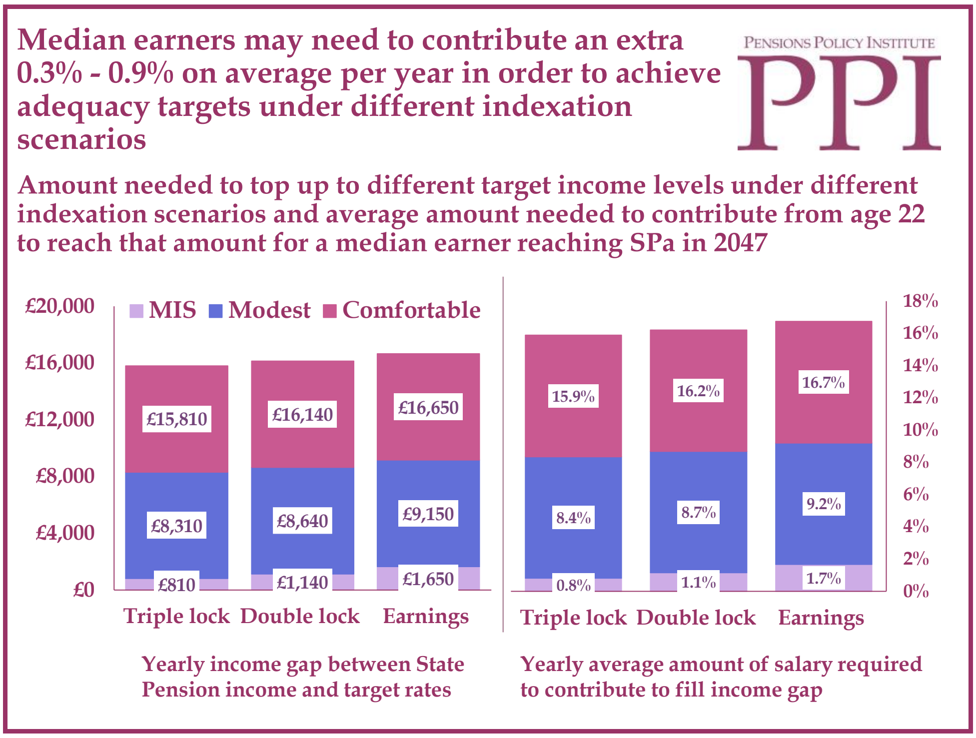
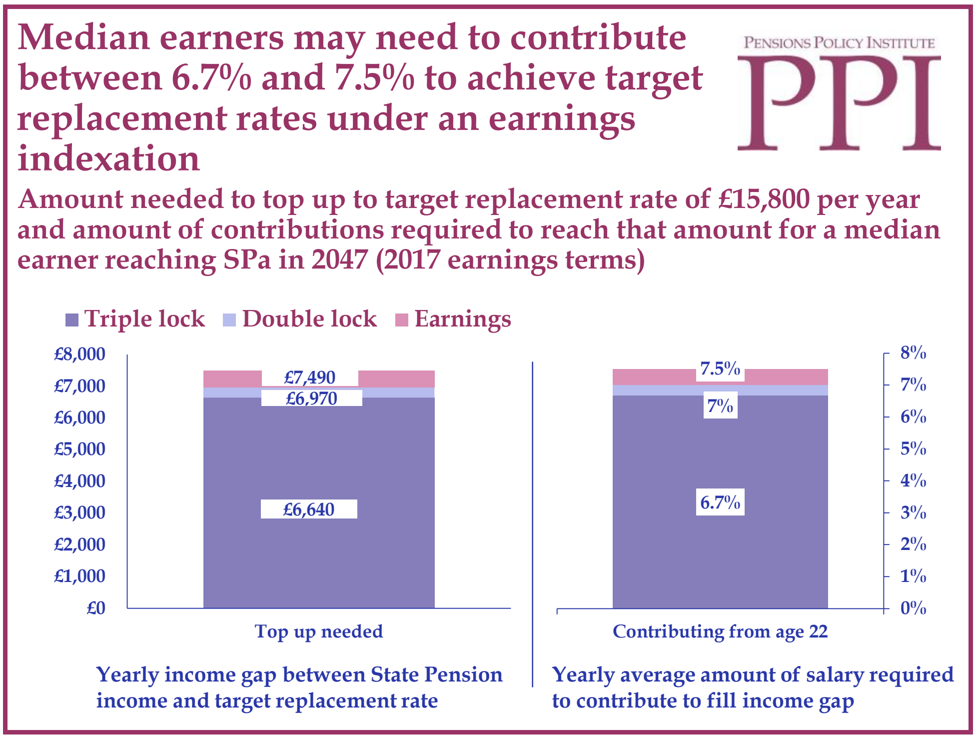


Chart EX2[10]



[9] PPI Individual Model
[10] PPI Individual Model

It cannot be assumed that the majority of people will save consistently into a pension from age 22. People are likely to start and stop saving as their income and employment status fluctuates, especially those who take career breaks due to caring or health problems, and those trying to meet competing spending priorities on a limited income. Therefore, required levels of contributions will vary between people, and for some, the contribution amount required to meet adequacy targets could be unaffordable.

A triple locked State Pension would improve adequacy for future as well as current pensioners

Younger people will benefit most from triple lock indexation, which gradually increases the value of the State Pension relative to earnings:

- A median earning male aged 30 in 2017 would receive around £216,000 total from the triple locked State Pension during his lifetime, compared to
- £190,000 total for a median earning male aged 50 in 2017 (2017 earnings terms).

An increase in the value of State Pension income would reduce the proportion of salary that future workers need to save into private pensions in order to meet adequacy targets.

However, triple locking the State Pension will cost more than other indexation scenarios

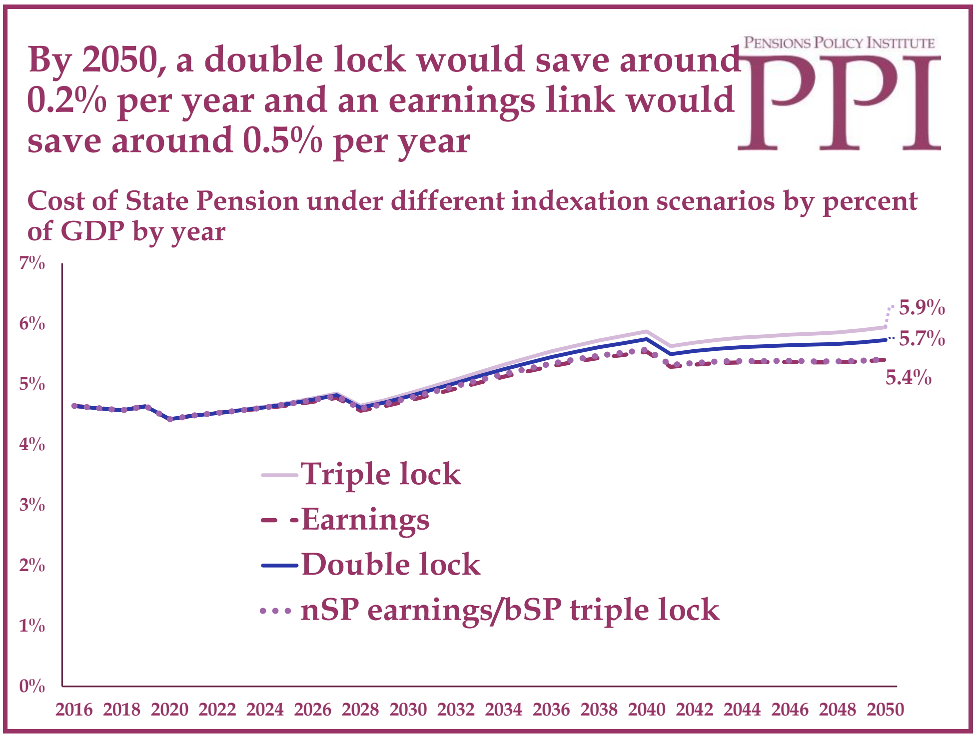
Compared to the baseline of the bSP and nSP being triple locked, by 2050:

- An earnings link would save 0.5% per year,
- A double lock would save 0.2% per year,
- A bSP triple lock/nSP earnings link would save 0.5% per year.

An earnings link would cost less than the other three options, though it would increase the gap between State Pension income and adequacy targets.

While linking nSP to earnings and bSP to the triple lock would originally cost more than an earnings link for both pensions, of around 0.04% of GDP per year, by 2050 it would begin to cost within 0.01% of an earnings link as the proportion of pensioners still in receipt of the bSP would be very low by then (Chart EX3).

Chart EX3[11]



Some of the savings arising from changing the indexation arrangement are reduced by extra expenditure on means-tested benefits. The savings under an earnings indexation compared to the triple lock are reduced by 0.04% when means-tested benefits are taken into account.

One way of compromising between costs and adequacy would be to index the State Pension to a less generous measure than triple lock, but a more generous measure than an earnings indexation. This could be achieved through a double lock, saving 0.2% of GDP per year by 2050 or linking bSP to the triple lock *and* nSP to earnings, saving 0.5% of GDP per year by 2050.

A double lock in particular would have less of a negative impact on those with lower incomes when compared to an earnings indexation. For example, a pensioner with income at the 10th percentile would experience a 3% (£300pa less) drop in income under the double lock when compared to the triple lock, and a 7% (£700pa less) drop in income under an earnings link, by 2050.

Under none of the indexation scenarios, does the State Pension provide full protection from poverty, or sufficient support to maintain living standards

Under all of the scenarios, some pensioners still experience poverty in retirement and many will need to save significant amounts into private pensions, or other saving vehicles, in order to achieve adequate retirement incomes.

[11] PPI Aggregate Model, cost of State Pension and Pension Credit