

Could increases in State Pension Age be brought forward?

PPI Briefing Note Number 53

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Introduction

In October 2009 the Conservative Party announced that, if elected in 2010, it would set up a commission to investigate the possibility of bringing forward planned increases in State Pension Age (SPA).

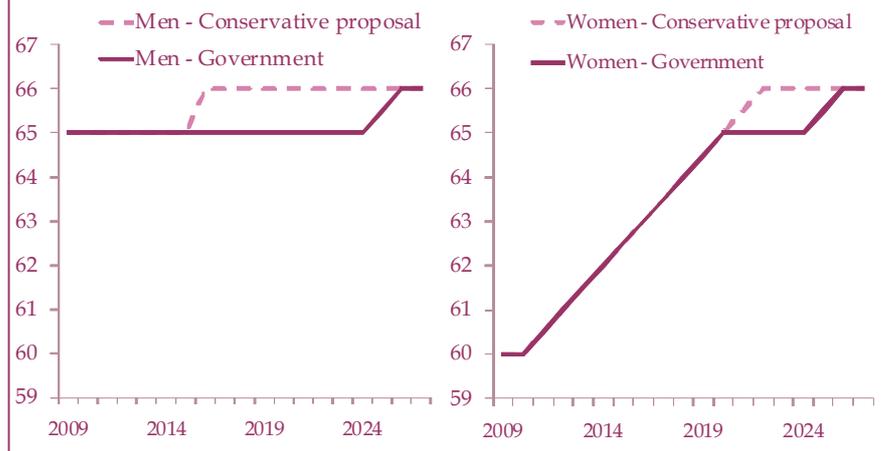
This Briefing Note looks at the effects of introducing the Conservative Party proposal on individuals who would be affected, on state spending on pensions, and the wider implications on government finances.

The current SPA is age 60 for women and age 65 for men. Under the Government reforms, the SPA is already due to increase for women from 60 in 2010, reaching 65 by 2020. The Government introduced further increases in SPA for both men and women. The increases will happen in phases, the first phase being an increase in SPA from 65 to 66 between 2024 and 2026, the second increase from 66 to 67 between 2034 and 2036 and the last increase from 67 to 68 between 2044 and 2046.

The Conservative Party proposal could mean increasing SPA for men from 65 to 66 from 2016 at the earliest and the increase for women from 65 to 66 after 2020. The aim of this policy would be to offset the cost of an ageing population and a more generous Basic State Pension (BSP) in the future.

Chart 1 shows what the new SPA could be like under the Conservative Party proposal. Between 2010

Chart 1: The Conservative Party proposal could bring forward the increases in SPA to 2016 for men and 2020 for women at the earliest



and 2020 the SPA for women will increase from the current level of 60 to 65. If the increase in women's SPA extends to age 66, the SPA for men and women will equalise in 2022.

Why increase SPA?

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 Govern-

ment of providing state pensions is likely to rise in the future. Increasing SPA would reduce the cost of state pensions in the future.

Who will be affected by the proposed increases in SPA?

Bringing forward the increase in SPA will affect individuals differently. Those affected by the reforms will need to change their work and savings patterns to adjust to the change in SPA. The cohort of people who will be most affected by the proposed increase in SPA are those who are currently aged 50-59.

Chart 2 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

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make an increase in SPA effective, attitudes towards working longer would need to change.

However, there has been a trend of people working longer 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 2020².

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.

Chart 2 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. A larger proportion, 28%, of women aged 50-59 were registered as economically inactive³.

Many members of this cohort may already be retired, be unemployed or be inactive due to sickness or disability. For these people 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

Chart 2: As people near SPA there is a large transition away from full-time employment

Economic activity of men by age, in 2008



lead-in times. With this proposal the 6 years notice may not be enough time for people to be able to change their working patterns.

Improving Government finances

Bringing forward the SPA increase to 66 for men by up to 10 years and the SPA increase to 66 for women by up to 4 years 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 in-

crease on unemployment and welfare benefits for those below SPA.

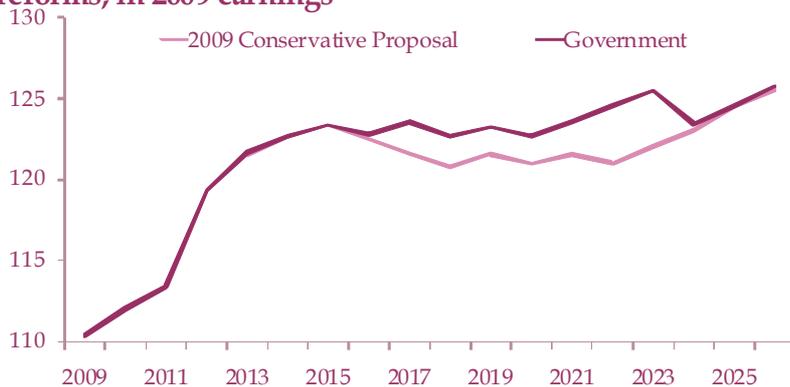
Spending on State Pensions would fall

Basic State Pension (BSP) and S2P/SERPS are paid from SPA until death and currently are increased in line with price inflation. However, the Government and the Conservative Party has committed to increase BSP in line with earnings by the end of the next parliament. Therefore, state spending on pensions is expected to increase sharply between 2009 and 2015, and increase further in the future (Chart 3).

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

Chart 3: The Conservative SPA proposal would reduce spending on state pensions up to 2024

Total state spending on pensions, in £bn, under the Conservative SPA proposal and the Government reforms, in 2009 earnings



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 3).

Chart 3 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 2022⁴. 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.

Raising SPA could increase tax revenue

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

However, there could be higher Government spending on:

- Unemployment benefits (including some on younger workers)
- Disability benefits

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 £13bn⁵ on the assumption that this leads to an increase in the effective working age of 0.6 years.

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 £3.5bn⁶, from lower pensions and transfers.

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.

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.

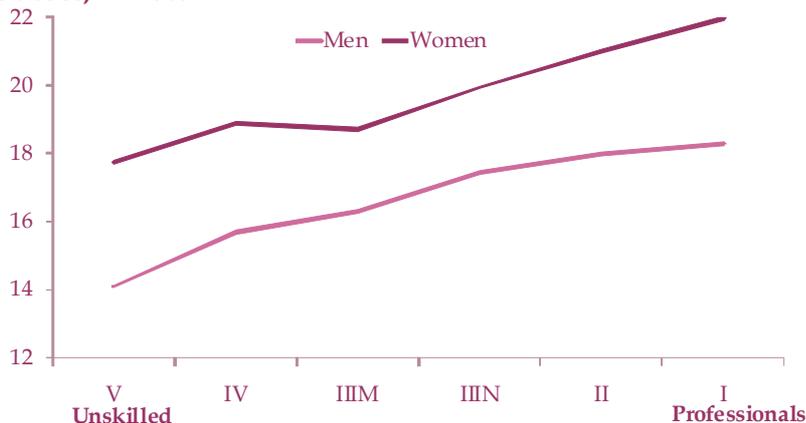
Increasing SPA could lead to some people working longer

There is uncertainty as to whether a 1 year increase in SPA would increase the effective working ages of people over a relatively short period of time. The reaction to an increase in SPA may depend on the lead-in time and how long people are given to adjust and change their working patterns. Currently approximately 80% of men aged 55-59 are in employment, falling to 60% aged 60-64, and only 20% aged 65-69. This shows that there is a large gap between the age at which people currently retire, and the retirement age implied by the proposals.

A recent survey carried out by DWP suggests that around 75% of people don't know what their SPA is⁷, with almost all of these thinking that they will reach it sooner than they actually will. This highlights that many people have given very little thought to their re-

Chart 4: Individuals in the professional classes have higher life expectancy than those in the unskilled classes

Life expectancy, at age 65, in different social classes, in 2005



tiement and suggests that an increase in the SPA could have little effect on the behaviour of many people.

Does increasing SPA discriminate against different social classes?

Any review of SPA would need to consider the impact 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 4)⁸. 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 pensions 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.

The proportion of people in Class V is now less than 5% of the population, and declining (expected to reach 3% in 2050⁸). 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 work-

ing after SPA than when the state pension system was designed.

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.

Conclusion

Increasing life expectancies and a more generous state pension will cause the cost of state pensions to increase rapidly in the future. One way to reduce the cost of state pensions is to increase the State Pension Age.

In October 2009 the Conservative Party announced that it would set up a commission to investigate the possibility of bringing forward planned increases in SPA. The effect of increasing SPA to 66 for men in 2016 and for women in 2020 would be to reduce spending on state pensions in the short term. The reduction in total state spending on pensions could be £2bn in 2017 and £3.5bn in 2022.

Any commission would need to balance the cost savings to the Government against the impact on people in the most affected groups who may not be able to adjust their working patterns to an increase in SPA at short notice.

¹<http://www.ohe.org/lib/liDownload/603/Sixty%20years%20of%20the%20NHS%20-%20Demographics.pdf?CFID=1573171&CFTOKEN=30270288>

²Future Foundation for Saga, September 2003

³Pension Trends, Chapter 4 (2009)

⁴All figures in 2009 earnings terms

⁵<http://www.niesr.ac.uk/pdf/EWLfin.pdf>

⁶<http://justageing.equalityhumanrights.com/wp-content/uploads/2009/10/dwpew10new-shrt.pps#1>

⁷<http://research.dwp.gov.uk/asd/asd5/WP72.pdf>

⁸ONS(2006) Trends in life expectancy by social class 1972 – 2006

⁹DWP (2006) *Security in Retirement: towards a new pension system*

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