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Not if but when: The demographic and fiscal case for increases to State Pension Age

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What happens next

The 2021 State Pension Age review: Terms of reference

- In December 2021, the Government announced the latest review of State Pension Age (SPA), currently 66 with two further increases set out in legislation:
  - A gradual rise to 67 for those born on or after April 1960 and a gradual rise to 68 between 2044 and 2046 for those born on or after April 1977
  - The first review, undertaken in 2017, concluded that the next review should consider whether the increase to age 68 should be brought forward to 2037-39
- The terms of reference of the 2021 review state that it should include an examination of the implications of the latest life expectancy data and provide a balanced assessment of the costs of an ageing population and future state pension expenditure.

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Key questions addressed in ILC's analysis

- Is the State Pension Age correct?

- Is the present timetable too fast/slow?

- Is it fair generationally speaking?

- Is it fair to everybody?

- How do we calculate it?

- How much will it cost?

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Context

- The UK population is living longer and the number of older people is being swelled by baby boomers.

- The SPA is currently 66 for both men and women. Legislation provides for an increase to 67 by 2026 and to 68 between 2044 and 2046.

- The 2017 review of SPA proposed a faster timetable increasing SPA from 67 to 68 between 2037 and 2039.

- Much will depend on the latest population projections, what principles to apply to the calculation of SPA and the total costs.

Four ways to determine SPA

- This analysis considers the effects of applying four different methods of determining the SPA based on the latest demographic estimates:
    1. **Equivalence rule:** Constant expectation of life on reaching SPA
    2. **Fiscal rule:** Constant relationship between the size of the population above and below SPA
    3. **One-third rule:** Constant proportion of adult life spent in retirement
    4. **Fairness rule:** Constant proportion of the population surviving to SPA

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1) The equivalence rule

- SPA adjusts such that the expectation of life at SPA is unchanged using 2022 as the base year.

- The data show that a person born in 1956 reaching SPA in 2022 of 66 will live another 22.5 years.

- However, a person born in 1966 reaching 66 in 2032 will live another 23.5 years.

- We solve for SPA such that the expectation of life going forward is always 22.5 years – i.e. the same as in 2022.

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# SPA by calendar year based on equivalised life expectancy
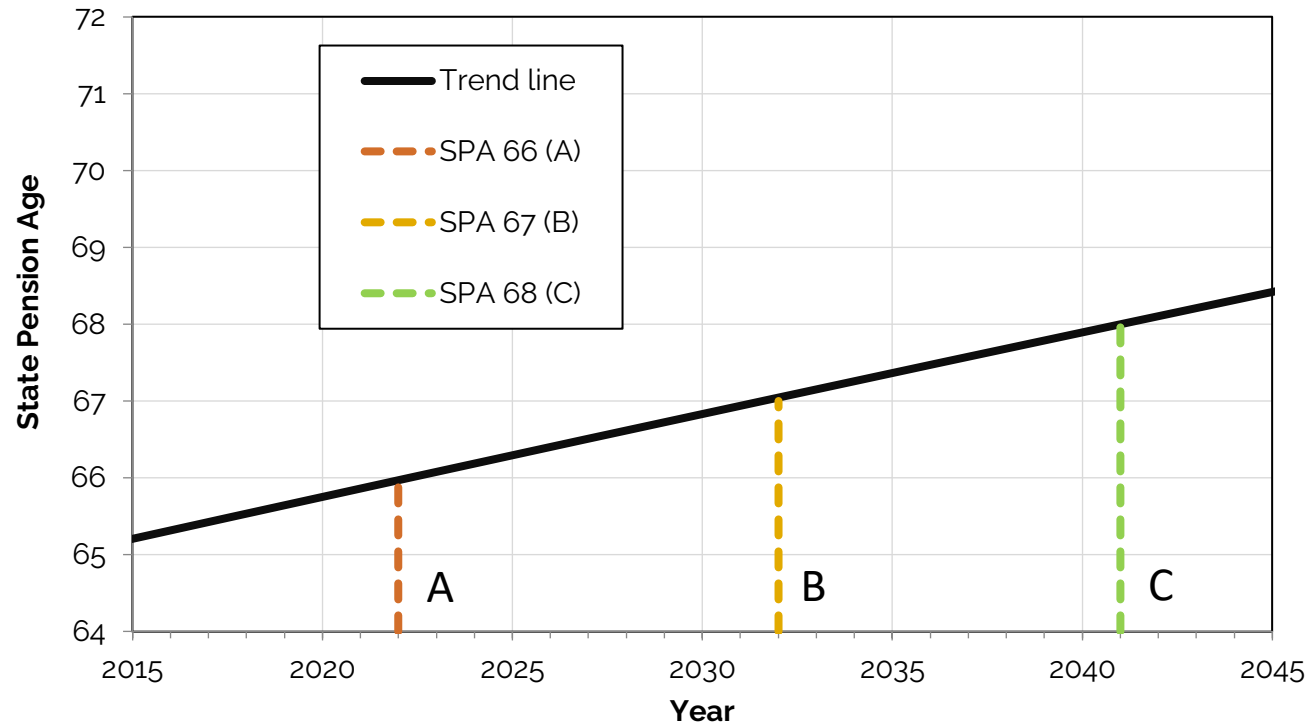
- SPA for a person born in 1956 is 66 years and is paid from 2022 (A).

- Using cohort life tables, the equivalent SPA for a person born in 1966 would be 67 years (B, from 2032) and 68 years for a person born in 1973 (C, from 2041).

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2) The fiscal rule

- As the proportion of the population above SPA increases, the support ratio of working age adults to those above pensionable age decreases.

- Under the fiscal rule, SPA adjusts so that the size of the population below SPA divided by the size above SPA is a constant.

- It is designed to ensure the principle of all Pay as You Go (PAYG) systems is met; that outgo is balanced by contributions taking one year with another.

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SPA under the fiscal rule
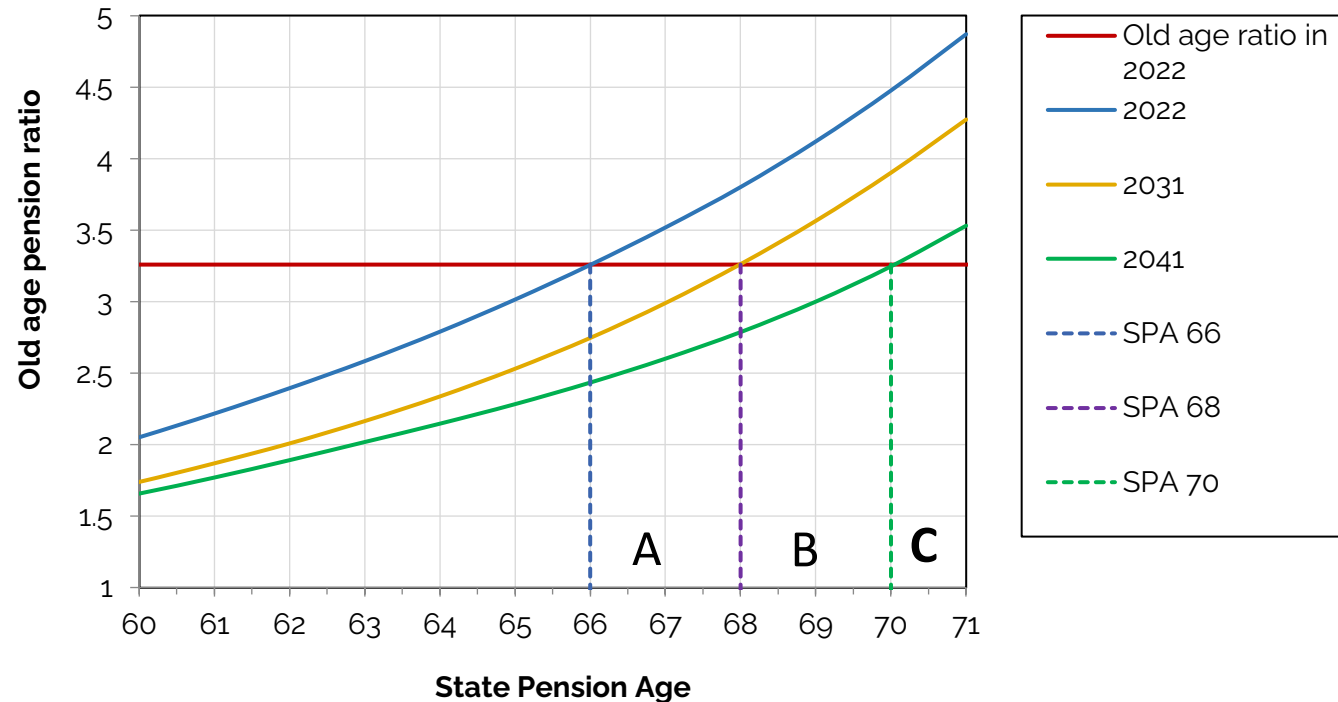
- In the fiscal rule, the ratio of the size of population below SPA to the size above SPA is a constant and equal to 3.26 in 2022 (our base year).

- Curves show how the old age ratio varies with pension age based on ONS population projections in 2022, 2031, and 2041.

- To find pension age, we must solve for points A, B and C.

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# Pension age by year under the fiscal rule by calendar year
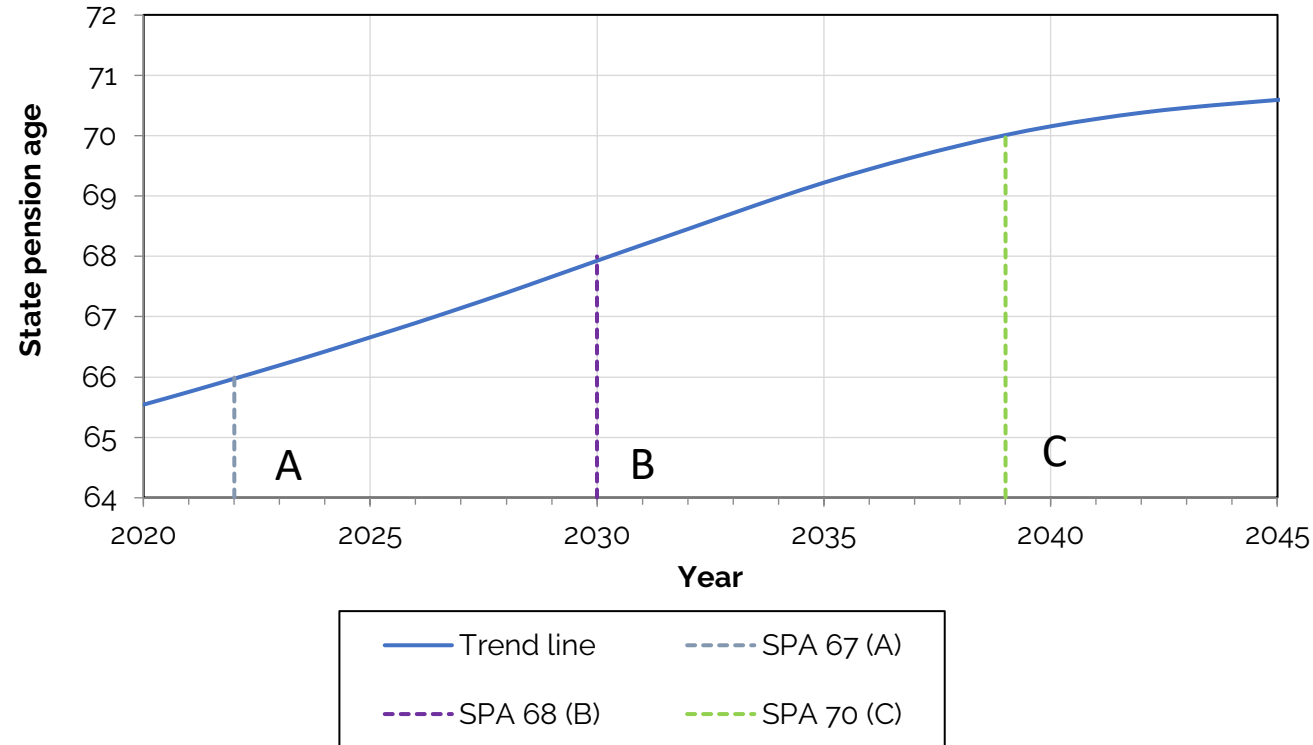
- Based on previous slide, this chart shows how SPA would increase by calendar year under the fiscal rule rising from age 66 in 2022 to age 68 by 2030 and age 70 by 2039 before levelling.

- The other SPA of interest is age 67 which is triggered in 2027.

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3) The one-third rule

- SPA adjusts automatically so that one-third of adult life is spent in pensionable age.

- It assumes adult life begins at age 20 and that pensionable age is measured from SPA, currently 66 years, to death.

- Thus a person born in 1956 reaching SPA in 2022 is expected to live another 22.5 years, giving a ratio of $22.5/(66 - 20 + 22.5) = 0.33$ or ~1/3rd of adult life.

# Pension age by year under the 1/3rd rule by calendar year
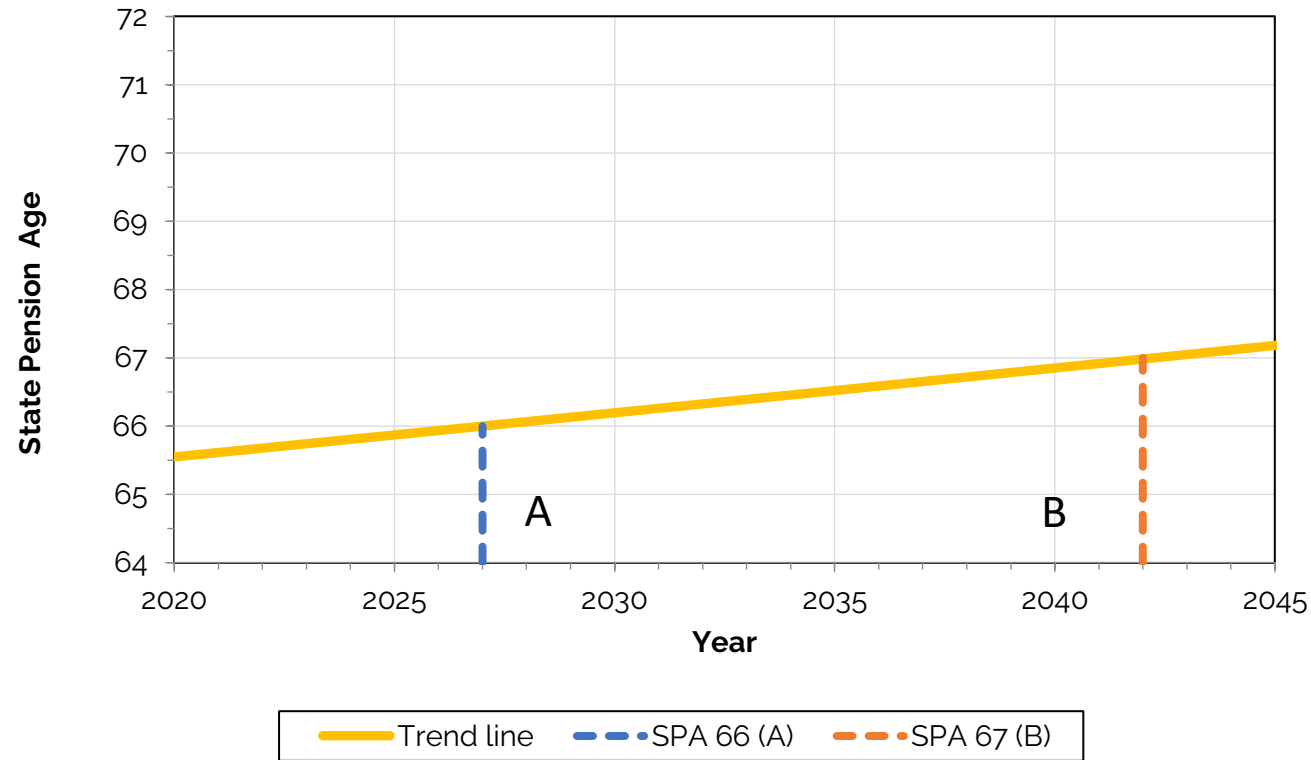
- Under this rule, 1/3rd of adult life would be spent in pensionable age based on adult life measured from age 20 to SPA and cohort life expectancy at SPA.

- This chart shows that SPA would remain at age 66 (A) until 2040 when it would turn to age 67 (B).

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4) The fairness rule

- The aim of this rule is to fix SPA so that the probability of a person born in a given year surviving to that age is the same going forward.

- Using cohort based life tables, we solve for SPA to ensure the objective is always met in future years.

- In 2022, SPA was age 66 with an 85.5% probability of reaching that age which we use as our benchmark.

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SPA by calendar year based on constant probability of survival
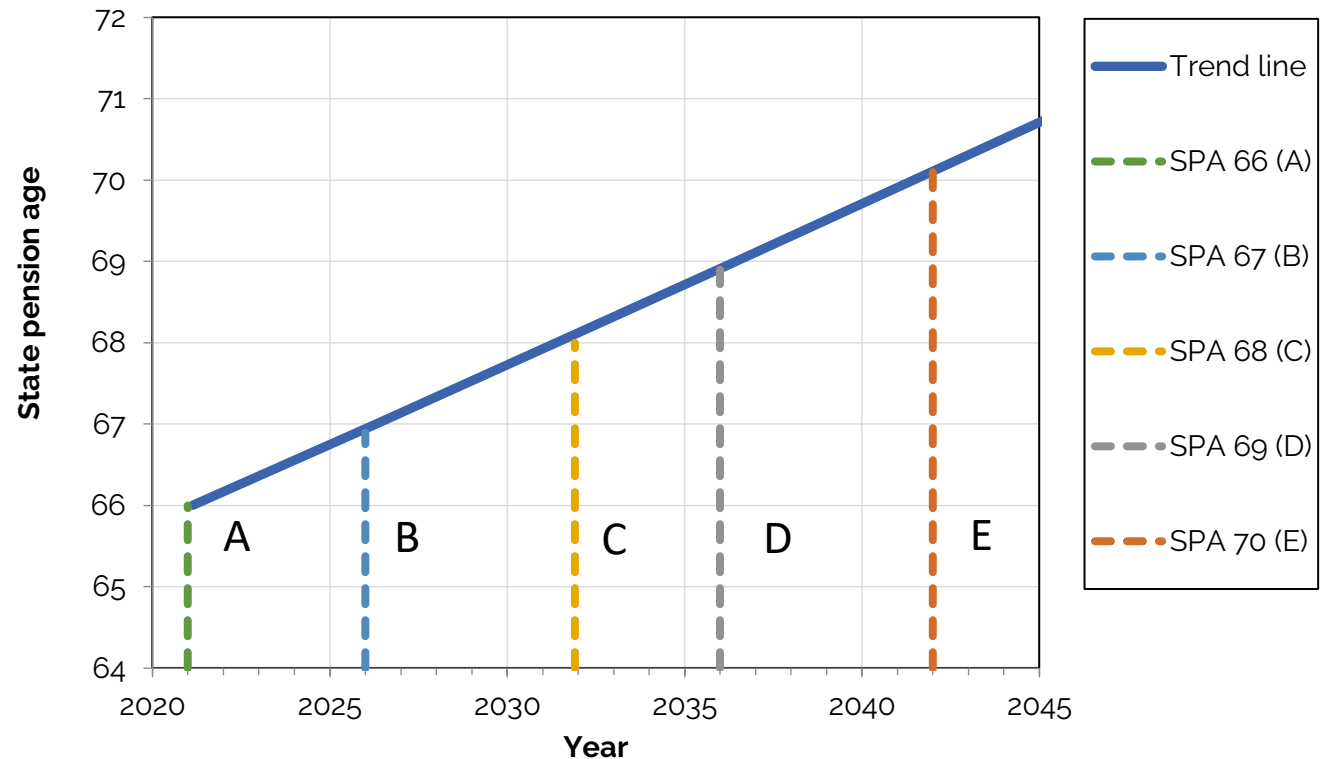
- In 2021, 85.5 % of the population born in 1956 survived to the SPA of age 66.

- This chart shows what SPA would need to be assuming the same rate of survival in future years based on cohort life tables by year of birth.

- SPA would be age 67 in 2026, age 68 in 2032, age 69 in 2036 and age 70 in 2042.

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Implied State Pension Age by calendar year and policy option

- The equivalised rule tracks current SPA rises to 2041 before turning 68.

- The 1/3rd policy delivers slower increases in SPA only reaching 67 years in 2040.

- Fiscal equivalence and the proportionate policy deliver faster rises with SPA turning 68 years in 2031/32.

- Notes: Calculated using ONS 2018 based population projections and ONS cohort life tables and rounded.

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Year	Current plans	Equivalised life expectancy	Fiscal equivalence	One third policy	Proportionate rule
2021	66.0	65.9	65.8	65.7	65.9
2022	66.0	66.0	66.0	65.7	66.1
2023	66.0	66.1	66.2	65.8	66.3
2024	66.0	66.2	66.4	65.9	66.5
2025	66.0	66.3	66.7	65.9	66.7
2026	66.3	66.4	66.9	66.0	66.9
2027	67.0	66.5	67.1	66.1	67.1
2028	67.0	66.6	67.4	66.1	67.3
2029	67.0	66.7	67.7	66.2	67.5
2030	67.0	66.8	67.9	66.3	67.7
2031	67.0	66.9	68.2	66.3	67.9
2032	67.0	67.0	68.5	66.4	68.1
2033	67.0	67.1	68.7	66.5	68.3
2034	67.0	67.2	69.0	66.6	68.5
2035	67.0	67.4	69.2	66.6	68.7
2036	67.0	67.5	69.4	66.7	68.9
2037	67.0	67.6	69.7	66.8	69.1
2038	67.0	67.7	69.8	66.8	69.3
2039	67.0	67.8	70.0	66.9	69.5
2040	67.0	67.9	70.2	67.0	69.7
2041	67.0	68.0	70.3	67.0	69.8
2042	67.0	68.1	70.4	67.1	70.0
2043	67.0	68.2	70.5	67.2	70.2
2044	67.3	68.3	70.5	67.2	70.4
2045	68.0	68.4	70.6	67.3	70.6

Comparative cost of each option against current plans

- Equivalising life expectancy tracks current plans until 2037.

- Fiscal equivalence preserves the PAYG principle.

- Alongside the proportionate policy it is the cheapest.

- The 1/3rd rule is the most expensive.

- Notes: Relative cost of the state pension compared with already planned rises in the SPA.

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Year	Current plans	Equivalised life expectancy	Fiscal equivalence	One third policy	Proportionate rule
2021	1.00	0.94	0.94	0.94	0.94
2022	1.00	1.00	1.00	1.00	1.00
2023	1.00	1.00	1.00	1.00	1.00
2024	1.00	1.00	1.00	1.00	1.00
2025	1.00	1.00	0.94	1.00	0.94
2026	1.00	1.00	0.94	1.00	0.94
2027	1.00	1.00	1.00	1.07	1.00
2028	1.00	1.00	1.00	1.07	1.00
2029	1.00	1.00	0.94	1.07	1.00
2030	1.00	1.00	0.94	1.07	0.94
2031	1.00	1.00	0.94	1.07	0.94
2032	1.00	1.00	0.94	1.06	0.94
2033	1.00	1.00	0.88	1.06	0.94
2034	1.00	1.00	0.88	1.00	0.94
2035	1.00	1.00	0.88	1.00	0.88
2036	1.00	1.00	0.88	1.00	0.88
2037	1.00	0.94	0.83	1.00	0.89
2038	1.00	0.94	0.83	1.00	0.89
2039	1.00	0.95	0.84	1.00	0.89
2040	1.00	0.95	0.84	1.00	0.84
2041	1.00	0.95	0.85	1.00	0.85
2042	1.00	0.95	0.85	1.00	0.85
2043	1.00	0.95	0.86	1.00	0.86
2044	1.00	0.95	0.81	1.00	0.86
2045	1.00	1.00	0.86	1.05	0.86

Conclusions

- The analysis generally agrees with current government plans but that SPA will probably need to increase faster between 2030 and 2045.

- The size of this increase depends on the latest data used to determine SPA and in particular whether cost control is a driving factor.

- The smallest increase in SPA by far is based on the one-third option but it would also be the most expensive to implement and higher than current policy in later years.

- The largest increases in SPA occur under the survival and fiscal rules with SPA reaching age 70 by the end of the period.

- Only the fiscal rule is consistent with the PAYG principle and is the cheapest of all the methods to implement, with savings of 15% to 17% compared with existing plans.

- Other methods break the PAYG principle and so adjustments may be needed to contribution rates and/or benefits in payment to keep costs down.

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Fiscal issues arising

- Preceding results are based on pre-COVID data and should be revised if more recent data are available; however, the basic conclusions would not change.

- From a fiscal viewpoint, a lower SPA could be maintained for longer if:
  - More people were economically active up to and beyond state pension age
  - More were enabled to work through health improvement and worked longer hours
  - The triple lock, which maintains and increases the real value of the state pensions, was relaxed

- In view of its importance, consideration should be given to keeping SPA under constant review and for GAD to advise Government accordingly; changes to which would alter the generational balance between pension benefits and taxes.

- Among the technical questions to consider are whether SPA should be flexible or always be integer numbers; if kept at integer numbers, cost pressures would build faster between SPA revisions.

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Further work envisaged: Can rises in the SPA be postponed?

- We believe that rises in SPA could be postponed if more people worked for longer and productivity improved

- Priority areas for additional research include:

  - Supporting and incentivising people to work up to and beyond state pension
  - Investigating barriers to work for longer and inequalities between areas and sub-groups
  - Help for people to transition into new careers especially in late middle age including better access to education
  - Spotlighting poor health as one of the barriers to working longer and the role of prevention
  - Working with employers to promote later life career planning and promotion of health in the workplace

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"Deciding state pension age is not a trivial matter. The decisions made in the latest review will impact on the incomes of everybody, whether that be via pension benefits or taxes.

Frankly, we're probably going to have to increase SPA further between 2030 and 2045 for it to be intergenerationally fair and fiscally sustainable. It's not a question of 'if' but 'when' and 'by how much'. The impact of COVID on life expectancy needs to be considered in this data, but the trends are fairly well set in stone.

However, the Government will need to assure that any plans for increases do not unduly exacerbate existing income inequalities without some form of remediation. Those who are unable to work for health reasons may well need additional help."

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