

Rt. Honourable Stephen Timms
Chair Work and Pensions Select Committee
Parliament

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Dear Stephen

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State Pension Age (SPA)

Thank you for asking me whether I had anything further to add to my evidence presented to the Committee on 22nd February. In my letter, I compare the costs and timing of alternative metrics that could be used as a basis for revisiting the timetable for rises in State Pension Age (SPA) and wider considerations that could affect it.

Just to say I hope you find my analysis useful and that I am content to see it published. My analysis builds on current plans as its baseline which envisages a gradual rise in SPA to 67 for those born on or after April 1960; and then a gradual rise to 68 between 2044 and 2046.

The state pension costs the Government over £100bn a year and has increased 3-fold since 2000. By 2040 there will be more than 17m people aged 65+, 4m more than today and so adjustments to keep rising costs under control seem inevitable. Increasing SPA is one way to prevent costs from inflating even further, but to varying levels depending on how it is calculated and the metric used.

The UK state pension system is usually described a Pay as you go (PAYG) – today's taxpayers pay the pensions of today's state pension recipients. Future costs are linked by the number of people of pension age and of working age, as well as wages, tax rates and the value of the pension itself. These tend to balance out, depending on fiscal considerations taking one year with another.

With government policies committed to maintaining the real value of the state pension through the triple lock, options for using levers such as raising taxes, scope for reducing pension values tend to be limited. Other options such as increasing productivity would also ease the fiscal burden but are hard to implement because they are not under the direct control of the Exchequer, whilst increasing migrant labour is another, if controversial alternative.

My research into different metrics published by the International Longevity Centre UK in 2022 is available [here](#). Using life expectancy based on year of birth and the ONS 2018 based population projections, I compared the

timetabling and costs of four different metrics for setting SPA between now and 2045.

These are defined as follows:

- **The equivalence rule:** Using this approach there is a constant expectation of life on reaching SPA such that each generation spends same number of years in receipt of the state pension as previous generations – in other words each would receive on average the same amount over their lifetime.
- **The fiscal rule:** SPA is adjusted such that ratio of adults below SPA to those above is constant. Also called the old age support or dependency ratio it seeks to maintain a balance between taxpayers and beneficiaries so that that the tax base is sustainable, and the state pension is affordable.
- **Spending a third of adult life in retirement:** In 2013 the Government stated that people should expect to spend on average up to one third of their life in retirement. The one-third rule would apply to future generations as well as the present one but is not constrained by cost, only life expectancy.
- **The fairness rule:** Currently around 85% of the population live to an age that they receive state pension. Under this rule SPA is fixed so that this percentage is always a constant, i.e. 85% will always benefit. The ratio, and therefore SPA, would shift in response to changes in mortality over the life course.

Main findings

Table 1 shows that all but one of the metrics suggests SPA may need to rise faster than planned to ensure fiscal sustainability, support intergenerational fairness and keep pace with increases in life expectancy. The one-third rule is the only metric which does not cause any increase in SPA over the period between now and 2045.

The analysis broadly agrees with current government plans in terms of direction of travel, but that SPA will need to increase faster between 2030 and 2045 in three of the four cases. How much faster depends on metric used and in particular whether cost control is a driving factor.

Year	Current plans	Equivalence rule	Fiscal rule	One-third policy	Fairness rule
2021	66	65.9	65.8	65.7	65.9
2022	66	66	66	65.7	66.1
2023	66	66.1	66.2	65.8	66.3
2024	66	66.2	66.4	65.9	66.5
2025	66	66.3	66.7	65.9	66.7
2026	66.3	66.4	66.9	66	66.9
2027	67	66.5	67.1	66.1	67.1
2028	67	66.6	67.4	66.1	67.3
2029	67	66.7	67.7	66.2	67.5
2030	67	66.8	67.9	66.3	67.7
2031	67	66.9	<u>68.2</u>	66.3	67.9
2032	67	67	68.5	66.4	<u>68.1</u>
2033	67	67.1	68.7	66.5	68.3
2034	67	67.2	69	66.6	68.5
2035	67	67.4	69.2	66.6	68.7
2036	67	67.5	69.4	66.7	68.9
2037	67	67.6	69.7	66.8	69.1
2038	67	67.7	69.8	66.8	69.3
2039	67	67.8	70	66.9	69.5
2040	67	67.9	70.2	67	69.7
2041	67	<u>68</u>	70.3	67	69.8
2042	67	68.1	70.4	67.1	70
2043	67	68.2	70.5	67.2	70.2
2044	67.3	68.3	70.5	67.2	70.4
2045	<u>68</u>	68.4	70.6	67.3	70.6

Table 1: Projected state pension age according to metric

The largest increases in SPA occur under the fiscal and fairness rules with SPA reaching age 68 in 2031 and 2032 respectively. As can also be seen, an SPA of age 70 is triggered under the fiscal rule in 2039 and in 2042 under the fairness metric and are therefore quite similar in terms of progression.

In cost terms, the different trajectories are shown in Table 2. If we set current plans to a value of 1, a value greater than 1 means that the particular metric will be more expensive to implement and if less than 1 it will be cheaper. For example the ratio for the fairness rule is 0.94 in 2030 delivering savings of 6% and 0.88 in 2040 delivering savings of 12% compared with current plans.

Year	Current plans	Equivalence rule	Fiscal rule	One-third policy	Fairness 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

Table 2: Projected costs for each metric relative to current plans (set to 1.00)

Of the four metrics the fiscal rule is cheapest to the exchequer of all and cheaper than current plans. The one-third policy the most expensive, at least until 2033 after which it re-aligns with current plans. The fairness rule is very similar to the fiscal rule in this regard, each delivering broadly similar savings relative to current plans.

The question arises whether higher mortality during the pandemic has changed the findings and if the size of the older population will be substantially less. Latest provisional 2021 based ONS projections of the older population in 2040 show very little change compared with those in 2018 suggesting that my findings will not vary significantly – although projections are due to be updated again soon.

Other observations

In other [research](#) published by City (now Bayes) Business School in 2020, I show that a lower SPA could be maintained for longer if more people were economically active up to and beyond SPA. For example, labour participation rates between 16 and 64 have been broadly steady at around 80% for many years, but if participation rates were 85% then a rise in SPA to 68 under the fiscal rule could be postponed until 2040.

Getting more people into work could slow pension age rises but poor health is a major barrier to this. Of the inactive, nearly 2.5m people aged 16 to 64 are unavailable for work due to long term sickness. The probability of being long term sick increases with age especially after 55 and in an ageing population, like the UK's, it must be considered a threat to economic prosperity.

Poor health is linked to inequalities in society, which has a strong regional component varying 17 years between the least and most healthy local authorities. I calculate that each extra year of health increases working lives by an average of 3.4 months, including wider but this conceals considerable variation between groups. For example, [never smokers](#) enjoy 6 more disability free years than current or ex-smokers and 2.5 more working years.

I conclude that whilst raising SPA age risks exacerbating hardship among the poorest and sickest, lowering SPA pension age is not the right way to address income inequality. Tackling poor health would be more effective because people would be enabled to work longer if they wanted to and so improve growth, but it would also reduce the burden on health care and the benefits system.

It is generally reckoned that the population needs ten years notice of an increase in SPA. This creates a significant window of policy opportunity for joined up policies across different sectors – most importantly pensions, welfare and health. If we take pensions, ten years notice would allow people to adjust their private pension arrangements, which they can draw on from age 55 (due to increase to 58 in 2028).

Over the past decade and more, the transition to a defined contribution pension system which is displacing final salary schemes has been strikingly successful as measured by coverage. However, getting people to save more will become more important. Inevitably, it will significantly disadvantage groups who are unable to work and do not have a pension or have saved too little.

Their needs will necessarily continue to be addressed through the UK's extensive benefits system taking cost and wider Government policy. If the success of back-to-work policies is measured by improvement in the rates of economic activity, then tackling long term sickness will be key. However, evidence of success from past policies is at best very thin.

According to DWP annual reports, the UK spends 1.6% of GDP on disability benefits today compared with 1.5% 30 years ago. At that time, 4.8% of the adult population were categorised as long-term sick; today that figure is 5.5% and still increasing it seems. The current cost of those benefits is £45bn a year – almost half the value of the state pension.

From my [research](#) there is every prospect if nothing is done the state pension age may need to increase to 69 or 70 at the next review in less than five years which might ease spiralling costs but will prove even more unpopular. To avert this possibility the solutions all broadly revolve around getting more people back to work or improving productivity which is a core focus of policy announced in the budget.

One great success has been the removal of the default retirement age of 65 which has made it easier to stay on in work. The evidence is that economic activity in the 65+ group increased since the 2011 legislation but then started to level off from 2014. One of the reasons cited are unfavourable tax rules which heavily penalises those with large pension pots.

The abolition of the Lifetime Allowance announced in the budget addresses this issue head on. However, removing the allowance altogether might have other unintended consequences for the public purse and perhaps it might have been sensible to simply raise the allowance from £1.07 million to £1.8 million as trailed in the media pre-budget.

Improvements in productivity have been relatively flat in the UK for many years. One of the problems has been the transition from a manufacturing to a service economy and another, the ageing workforce in which older workers tend to be less productive than younger workers – these two facts suggest the need for a workforce strategy to address skill shortages and career transitions for older workers, especially those in physically demanding jobs.

There are further links to other relevant policy areas worth mentioning; one in particular is migration. The argument is that higher migration increases the tax base, and so would ease the decline in the old age support ratio, which in turn help to defer further rises in the SPA. The hypothetical quantum of additional migration needed to have any material effect on the support ratio would be

very large indeed –of the order of 1 million people a year by 2030 if SPA remained at 66.

To wrap up, it seems inevitable that SPA will need to increase thanks to population ageing and that the UK needs to co-ordinate its policies in response. It is probably too late to avert an increase to 68 without reneging on policies such as the triple lock but there is time to implement policies that might slow or prevent further rises, provided they are effective. Existing Government policy to increase healthy life expectancy by five years by 2035 is a possible vehicle although it is far from clear that this is on track.

I hope this has been helpful

With kind regards

A handwritten signature in black ink, appearing to be 'Les' followed by a stylized flourish.

Professor Les Mayhew