Phoenix Insights

Understanding the implications of the state pension age review

April 2023

Summary

- The second independent review of the state pension age (SPA) recommends that the SPA should rise to 68 between 2041 and 2043. This is earlier than is currently legislated for, but later than the recommendation of the first independent review. The government has announced in response that a further review will be undertaken within two years of the next parliament to reconsider the rise to age 68.
- **Over 3 million people would see an increase in their SPA if the increase to 68 were to occur between 2041 and 2043** rather than between 2044 and 2046 (as is currently legislated), while nearly 7 million people would see an increase in their SPA if the increase were to occur between 2037 and 2039 (as recommended by the Cridland review).
- Those entitled to a full new State Pension would lose over £10,600 in state pension income as a result of an increase in their SPA from 67 to 68. People can respond to this change in a number of ways, including working longer, saving more, or spending less during retirement.
- Those that work for longer are likely to be better off financially as a result. This would help address the issue that **44% of defined contribution pension savers potentially affected by the increase in the SPA are not on track to be able to afford the retirement they expect**.
- There will be some people that cannot work for longer, either because they cannot find a suitable job or because they are not in sufficient health. **Around 30% of those potentially affected by the increase in the SPA are already not confident of being able to work until their planned retirement age**. Currently over one in 10 individuals aged 65 are claiming out-of-work benefits and are not seeking work due to ill-health.
- While some have private resources they can draw on to tide themselves over until they can claim their State Pension income, others do not have that option. Around 14% **of those potentially affected by the increase in the SPA are both not confident of being able to work until their planned retirement age and do not have significant sums of private wealth. Those on state benefits will suffer from the much lower generosity of working-age benefits as compared to state pension levels**.

- The government has a duty to help those worst affected by changes to the SPA. There are three areas of policy that we could recommend for the government to prioritise:
    - Supporting those wanting to work at older ages to find appropriate employment.
    - Supporting those that are entitled to benefits to take them up.
    - Reducing job search requirements for older people on state benefits.

Context

The State Pension age (SPA) is rising in response to increasing longevity. Under current legislation:

- The SPA will increase gradually from 66 to 67 between 2026 to 2028 (affecting those born 6 April 1960 onwards, with those born 6 March 1961 onwards having a SPA of 67).
- The SPA will increase gradually from 67 to 68 between 2044 and 2046 (affecting those born 6 April 1977 onwards, with those born 6 April 1978 onwards having a SPA of 68).

The law requires the government to conduct periodic reviews of the SPA to consider "whether the rules about pensionable age are appropriate, having regard to life expectancy and other factors that the Secretary of State considers relevant".[1]

The first SPA review (the 'Cridland review') recommended to bring forwards the increase to 68 to between 2037 and 2039 (affecting those born April 1970 onwards). The government accepted this recommendation, but in its final report said that it would conduct a further review before implementing the increase.

The second periodic review of the State Pension age, published in March 2023, confirmed the legislated timing of the increase to 67, but deferred further decision on the increase to 68.[2] The associated independent report, commissioned by the government and led by Baroness Neville-Rolfe, recommended that the SPA increase to 68 between 2041 and 2043 (earlier than is currently legislated for, but later than the recommendation of the first independent review).[3] The government announced in response that a further review will be undertaken within two years of the next parliament to reconsider the rise to age 68.

In this note we discuss how many people would be directly impacted by changes to the SPA, and how people in different circumstances might be affected by this change. We draw on survey data from the ONS Labour Force Survey and the Phoenix Insights Longer Lives Index, as we all ONS population estimates and administrative data on benefit claimants from the Department for Work and Pensions (DWP).

1 Pensions Act 2014 (legislation.gov.uk)

2 State Pension age review 2023

3 State Pension Age Independent Review 2022

How many people could see a change in their SPA?

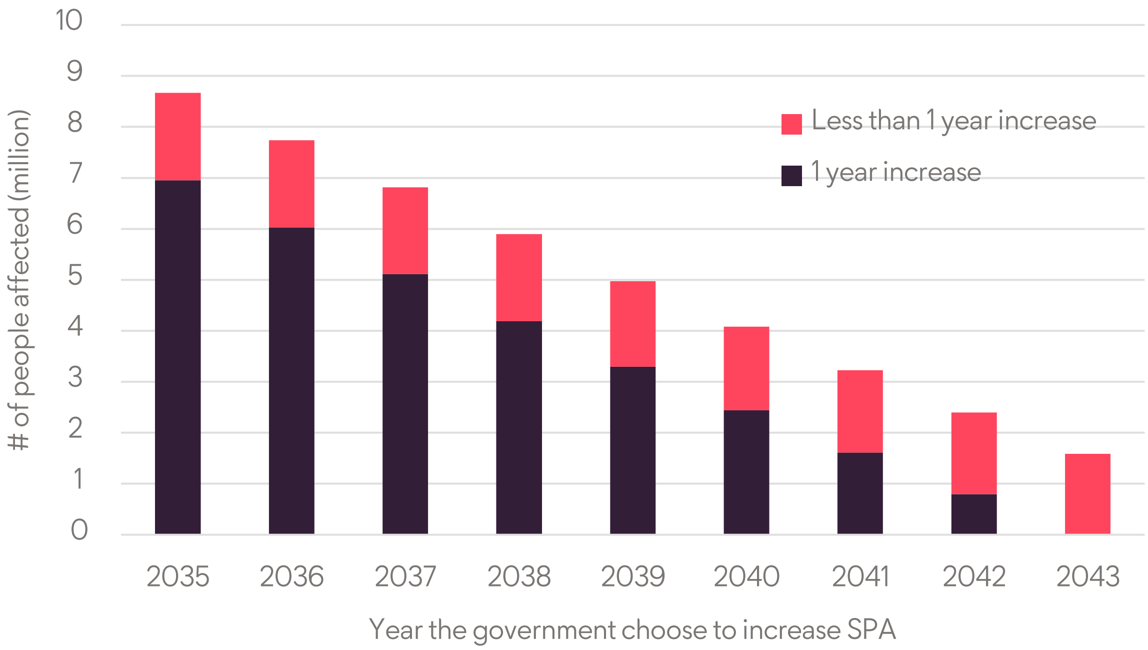
The timetable for the increase in the SPA to 68 will be reviewed within two years of the next parliament. The government has set out that all options for the rise from 67 to 68 that meet the requirement of giving those affected at least 10 years notice will be in scope at this review.

Figure 1 illustrates how many people would see their SPA increase based on various years that the government could choose to start implementing the SPA change from 67 to 68.[4]

If the government started in the increase in the SPA in 2037, as recommended by the Cridland review, this would affect individuals born between April 1970 and April 1978: nearly 7 million people would see an increase in their SPA compared to what is currently legislated (of whom over 5 million would see an increase of one year).

If the government started in the increase in the SPA in 2041, as recommended by the second independent SPA review, this would affect individuals born between April 1974 and April 1978: over 3 million people would see an increase in their SPA compared to what is currently legislated (of whom over 1½ million would see an increase of one year).

Figure 1 **Number affected by bringing forward the increase in SPA to 68, by year of implementation**



Source: Frontier Economics calculations using ONS population estimates from mid-2021

Note: We assume the increase in the SPA is implemented gradually over a 2 year period (as is the case with the currently legislated increase). This means that some people will see their SPA increase by less than a year. This will be the case for those who have an SPA of between 67 and 68 under current legislation (who will see their SPA increased to 68), and some of those who currently have an SPA of 67, who will see their SPA increase to between 67 and 68.

4 We assume that the government keeps the same profile for phasing-in the increase from 67 to 68, so that it occurs over a two year period.

How might people be affected by the changes?

The increase in the SPA has a clear direct impact on individuals: people will no longer be able to claim their state pension at age 67 and must wait until age 68. For someone who is entitled to the full new state pension amount of £203.85 per week (in 2023/24), this amount to a loss of income of £10,600.

There are also potential knock-on consequences of an increase in the SPA. Two of the main ones are:

- Many defined benefit (DB) pension schemes have a normal retirement age that is linked to the SPA. Therefore an increase in the SPA may also affect when someone can access their DB pension.
- The government intention (though this is not yet legislated) is that the normal minimum pension age (NMPA) for all private pensions should be linked to the SPA (e.g. 10 years below the SPA). The NMPA has been legislated to increase from 55 to 57 to coincide with the SPA reaching 67. If a link between the SPA and NMPA is legislated, then an increase in the SPA may also affect the age from which someone can access their defined contribution (DC) savings.

How might people respond?

There are three main mechanisms through which an increase in the SPA could affect people's behaviour:

- There is a **wealth effect**. An increase in the SPA of one year means that someone misses out on around £10,600 of State Pension income. In other words, the total resource expected over their retirement (from all sources) is reduced by that amount. (This may be compounded for people with a DB pension, who would lose additional resources if the age at which they can start receiving their DB pension increases in line with the increase in the SPA). People may respond to this reduction in their total retirement wealth by working longer or saving more, in order to increase their retirement resources again. If they do not do this, they will have to spend less over the duration of their retirement (or bequeath less to their heirs). This does not necessarily mean they have to spend less when aged 67, as they may be able to draw more on other resources (such as private pension saving) to fund spending at that age, and spend less at other ages instead. If spread over a 20 year retirement, the loss of income from the state pension imply a reduction in spending power of around £500 per year.
- People may be **credit constrained**. The delay to when people can claim their state pension may mean that some people have to stay working for longer because they do not have enough other resources or income to live on until they can claim their State Pension. If the NMPA increases with the SPA then this same mechanism may also affect people who were planning to retire on their private pension income at the NMPA.
- The SPA acts as a **signal**. For some people the SPA acts as a signal of the 'appropriate' time to retire, or a default age. The increase in the SPA may cause some people to work for longer as a result of a change in

this signal. The same may also be true of any signal associated with the NMPA, or the age at which someone can access their DB pension income.

People could therefore respond to the increase in the SPA (and any increase in the NMPA) by saving more, working longer, changing the timing of when they draw on their private savings, or spending less over the course of their retirement.

Not everyone will have free choice over these options, in particular:

- people may be constrained in their ability to work, due to their health, employability or other commitments;
- people may not have the capacity to save more for the future given their current income levels; and
- people may not have other retirement savings (in private pensions or other savings) that allow them to adjust to the lack of state pension income by changing the profile of how they draw on other savings over their retirement.

This means that while everyone (with the same date of birth) is directly impacted by the same change in their SPA, how individuals are ultimately affected will vary dramatically depending on their circumstances.

Those that work for longer are likely to be better off financially

People that work for longer are likely to be financially better off as a result. The additional employment income likely offsets their lost State Pension income. Furthermore, they are likely to be more financially secure in retirement, as they may have delayed claiming their private pension income and they may have saved additionally for retirement while they are still working.

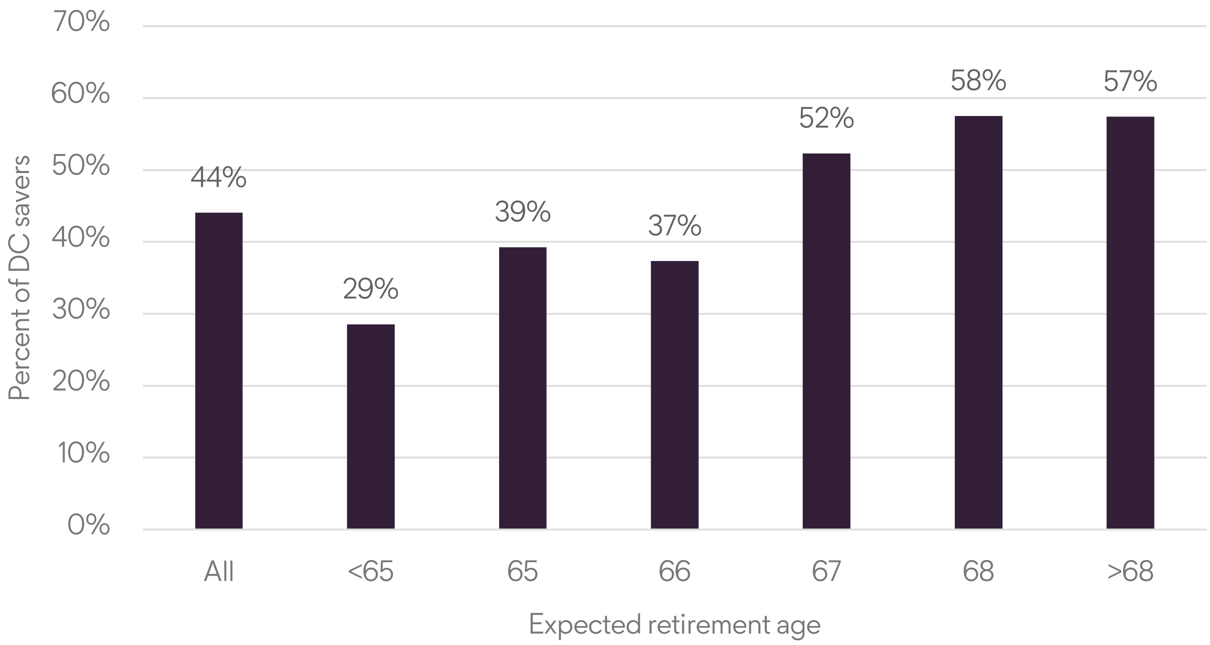
If all people were perfectly rational and made perfect choices that optimise their consumption and work over time, then they would be clearly negatively affected by the SPA change. This is because there was nothing stopping them from working to this age previously, yet they were choosing not to, so they must have valued their leisure time more than the additional income from working.

However, in reality people do not make perfect choices (for example, because they do not have enough information or they are not good at making decisions). Our previous modelling work revealed that many people are not saving enough for the retirement they think they can enjoy. In particular, nearly half (44%) of defined contribution (DC) savers[5] born between 1970 and 1978 are not 'on track' for the retirement income that they say they want, given their accumulated wealth so far and their current rate of saving. They may therefore benefit, overall, from the delay to the SPA, if it nudges them to stay in work longer and achieve retirement income closer to the level they want.

5 DC savers includes all those who are not currently saving in a DB pension (whether or not they are currently saving in a DC pension.

Figure 2 shows how the proportion of people not 'on track' for the retirement income they want varies according to people's self-reported expected age of retirement. Among those planning to retire at the current legislated age of 67, only half are on track.

Figure 2 Proportion not on track for their expected retirement income



Source: Frontier Economics calculations using Phoenix Insights Longer Lives Index data.

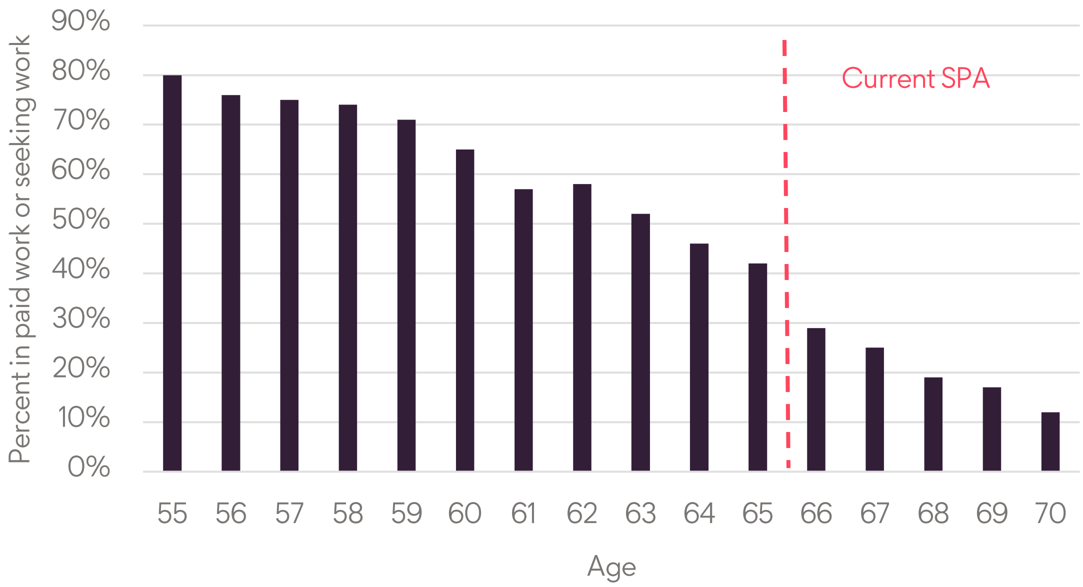
Note: Sample is people born 1970 to 1978 who are not currently saving in a defined benefit pension.

Not everyone will be both willing and able to work for longer

The increase in the SPA has to be understood in the context of current labour market engagement. It is important to remember that only a minority of people retire at the SPA; many retire before (and some retire after) the SPA.

This is illustrated in Figure 3, which shows how the proportion of people currently in or seeking paid work varies with age. The employment rate among current 66 year olds (who are all above the SPA) is 29%, compared with 42% among 65 year olds, 65% among 60 year olds and 80% among 55 year olds.

Figure 3 **Employment rate by age**

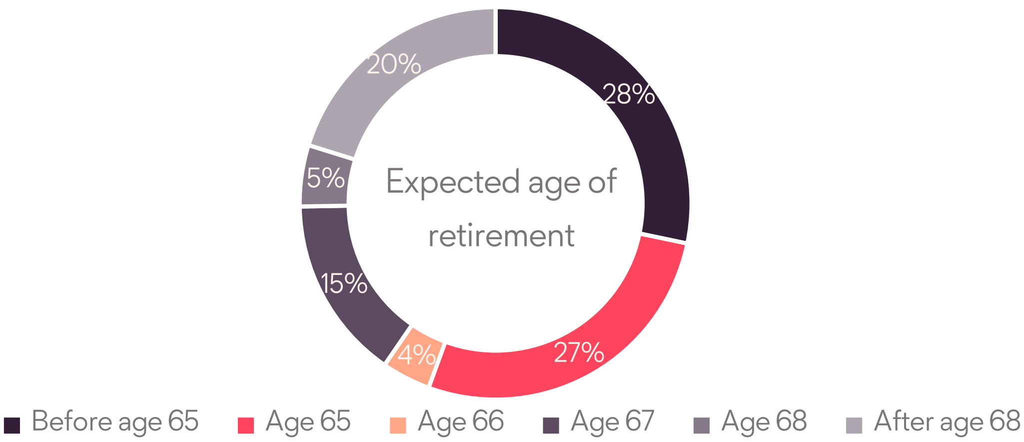


Source: ONS Labour Force Survey

Note: Paid work includes employees and self-employed.

It is striking that there is not a particularly large fall in employment at the current SPA. People's own expectations about when they will leave work also show a similarly small amount of bunching at the SPA. Among those born between 1970 and 1978, 15% expect to retire at 67 (their currently legislated SPA). Figure 4 shows that 28% expect to retire before age 65, 27% at age 65, 4% at age 66, 5% at 68 and 20% above age 68.[6]

Figure 4 **Expected retirement ages**



Source: Phoenix Insights Longer Lives Index

Note: People born 1966 to 1978 only.

6 This varies somewhat with current age: older people on average expect to retire at slightly later ages.

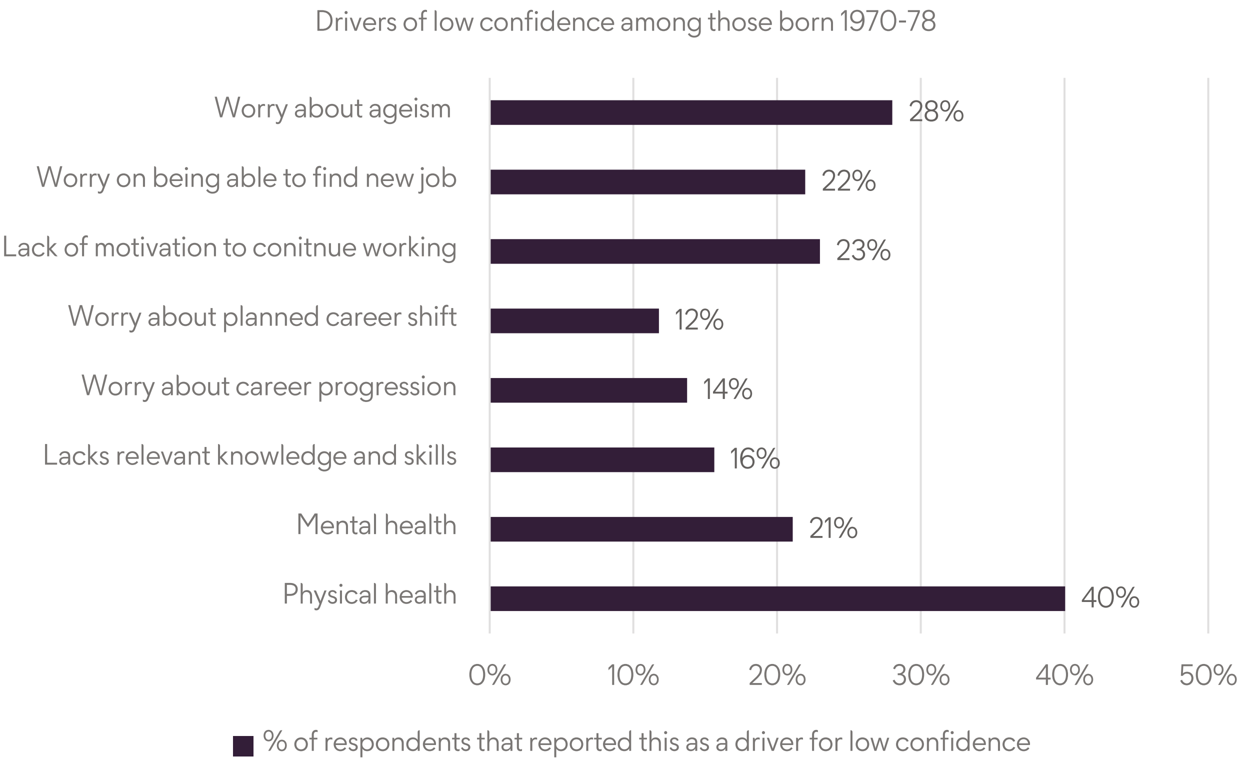
This suggests that two of the mechanisms highlighted above through which an increase in the SPA may affect people's behaviour do not seem that likely: the signal of the SPA and credit constraints are not currently nudging or constraining many people to retire at the SPA. Many people evidently want or need to retire before the SPA, and this may limit the extent to which they are able or willing to work longer in response to an increase in the SPA.

Many are unable to work for longer

While retiring before the SPA will be the preferred option for some people, others leave the labour market because they are not healthy enough to work or because they are unable to find a suitable job.

Such "push reasons" are clearly a concern among people. Among those born 1970 to 1978 29% are not confident about staying in paid work until their planned retirement age.[7] Figure 5 summarises their reasons for not being confident. Concerns about physical health are highest, but concerns about ageism, being able to find a new job, mental health, motivation and having relevant skills are also common.

Figure 5 Drivers of being not confident about staying in work



Source: Phoenix Insights Longer Lives data

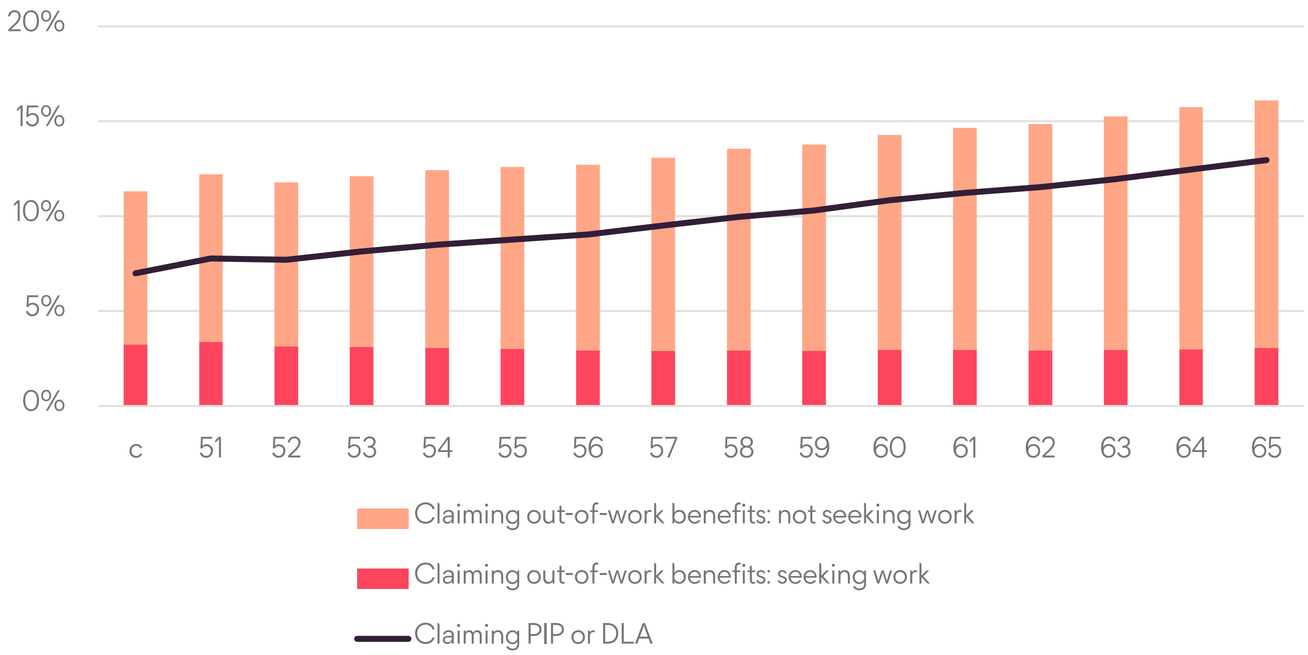
Note: Sample is those born 1970-78 who are not confident about being able to stay in work until their planned retirement age.

7 Not confident is defined as answering 1-4 on a scale of 1 to 10, where 1 is "Not confident at all" and 10 is "Very confident".

The impact of ill-health on people's ability to remain in work as they age can be seen in claimant rates for state benefits.[8] Figure 6 shows how the receipt of various benefits varies with age. A steady minority of people, around 3% at each age, are out of work but searching for work. But there is an increasing proportion of people claiming out-of-work benefits and who are not expected to be seeking work due to ill-health (either claiming Universal Credit and in the 'no work requirements' category or claiming Employment Support Allowance). Around 13% of 65 year olds are in this situation, compared to 8% of 50 year olds. The increase in the proportion claiming Personal Independence Payments or Disability Living Allowance shows that long-term disability or ill-health are increasingly common with age.[9] Around 13% of 65 year olds are claiming one of these benefits, compared to 7% of 50 year olds.

Improvements in health over time may mean that work-limiting health conditions are less common among those who are 65 in the 2030s than among those who are 65 today. However, the trends in Figure 6 also suggest that ill-health will be more common among those aged 66 than among those aged 65. It is therefore clear that even if there are some improvements in population health, there will be a significant minority of people who will be unable to work until 68 due to ill-health.

Figure 6 Receipt of government benefits, by age



Source: Department for Work and Pensions Stat-Xplore

Note: Great Britain, August 2022. "Claiming out-of-work benefits: not seeking work" is those on some combination of Employment Support Allowance, Incapacity Benefit, Severe Disablement Allowance or Income Support on the basis of incapacity, or on Universal Credit in the No Work Requirements category. "Claiming out-of-work benefits: seeking work" is those on Job Seekers' Allowance or Universal Credit in the Out-of-work category. "Claiming PIP or DLA" is those claiming Personal Independence Payments or Disability Living Allowance.

8 Claimant statistics will understate how many people are unable to work due to ill-health or their ability to find a suitable job as not everyone in that situation will claim benefits.

9 These benefits aim to help with some of the extra costs caused by long-term disability, ill-health or terminal ill-health. They are grouped together since the underlying situation for the individual making the claim is similar; which benefit is claimed depends on when the claim was made and the age of the individual.

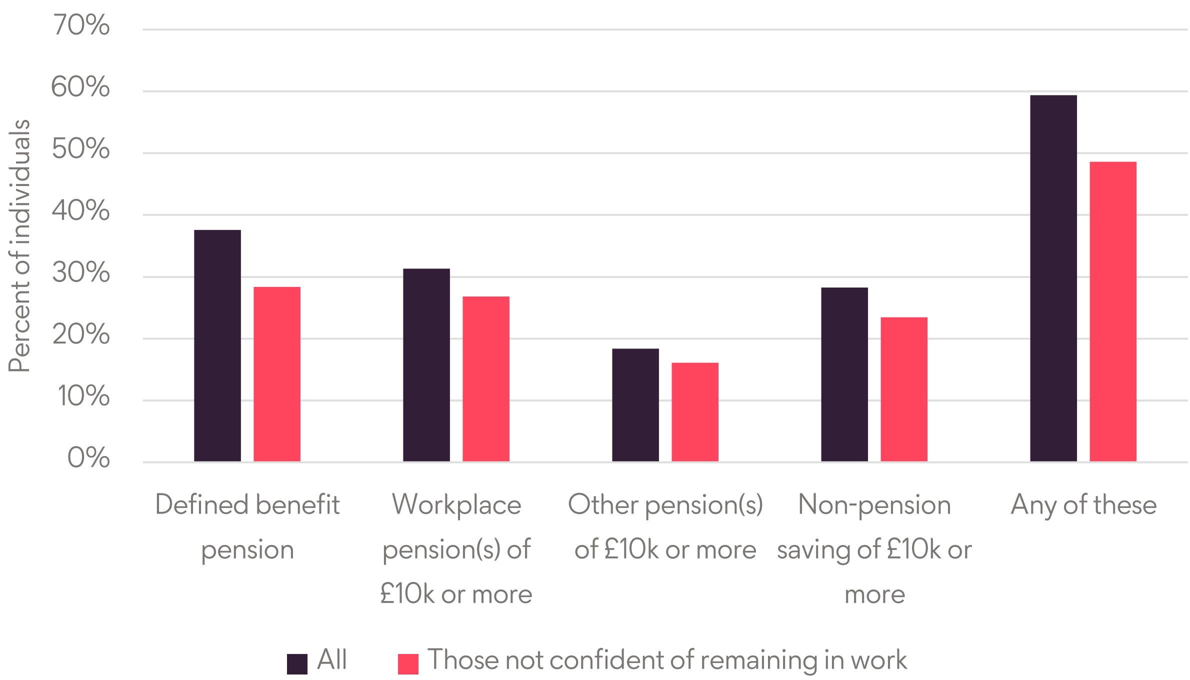
Finances for those unable to work for longer will be very stretched

Given that there will be a group of people who are unable to work for longer in response to an increase in the SPA – either because they are in ill-health or otherwise unable to find a suitable job - the question then is how they cope with the lack of state pension income at age 67.

Some will have other resources they can draw on. Over 70% of those born between 1966 and 1978 have a partner, who may be working or be able to claim the state pension and therefore whose income might help bridge the gap until the state pension can be claimed.[10]

Figure 7 describes how common other financial resources are, for all those born between 1970 and 1978 and for the subset of those birth cohorts who report not being confident about being able to remain in work until their planned retirement age. It is striking that only 59% of those born between 1970 and 1978 have either a defined benefit pension or more than £10,000 in at least one of workplace pensions, non-workplace pensions or non-pension saving. Among those who are not confident about staying in work, only 49% have such other resources. In other words, 14% of all those born between 1970 and 1978 are both not confident about staying in work until their planned retirement age and do not have significant sums of private wealth.

Figure 7 **Private wealth holdings**



Source: Phoenix Insights Longer Lives data

Note: Sample is those born 1970-78

10 Calculated using the ONS Labour Force Survey.

This is the group who are of most concern – they may be unable to remain in work (for a variety of reasons) and may not have sufficient private resources to replace the state pension income they may no longer be entitled to at 67. As a consequence, they could suffer acutely from the loss of pension income.

Working-age benefits for low income households are substantially less generous than the benefits available to those above the SPA. Figure 8 illustrates this. For example, a single healthy low-income pensioner could get a maximum weekly income from pension credit of around £183. In contrast the equivalent individual aged below the SPA would be required to seek work, and would only be entitled to job-seeker's allowance (JSA) or universal credit of around £77 per week.[11] In other words, those in good health but unable to find work at 67 would get much lower income from state benefits than would have been the case without the SPA rise.

A similar picture is also true for those who are out of work and in ill-health. Those who are in ill-health but are seeking work and claiming Job Seekers' Allowance (JSA) may get a disability premium, but this would increase their benefit entitlement to around £113 per week. Even those in such ill-health that they are placed in the support group of Employment Support Allowance (ESA), and no longer required to seek work on the grounds of ill-health, may only get total ESA and enhanced disability premium of around £135 per week – still significantly less than is available to an equivalent individual aged above the SPA.

This difference in benefit generosity has been highlighted as a significant driver of the increase in poverty among those aged 65 that has arisen as a result of the increase in the SPA from 65 to 66. Cribb and O'Brien (2022) found that being under rather than over the SPA at age 65 increased the probability of being in absolute poverty by 14 percentage points – more than doubling the poverty rate from the pre-reform baseline of 10% to 24%.[12] Of this increase, 10 percentage points was from an increase in the share of people who were in poverty and not in paid work at age 65. The rise in the SPA to 66 increased the poverty rate among this group from 9 to 19%.

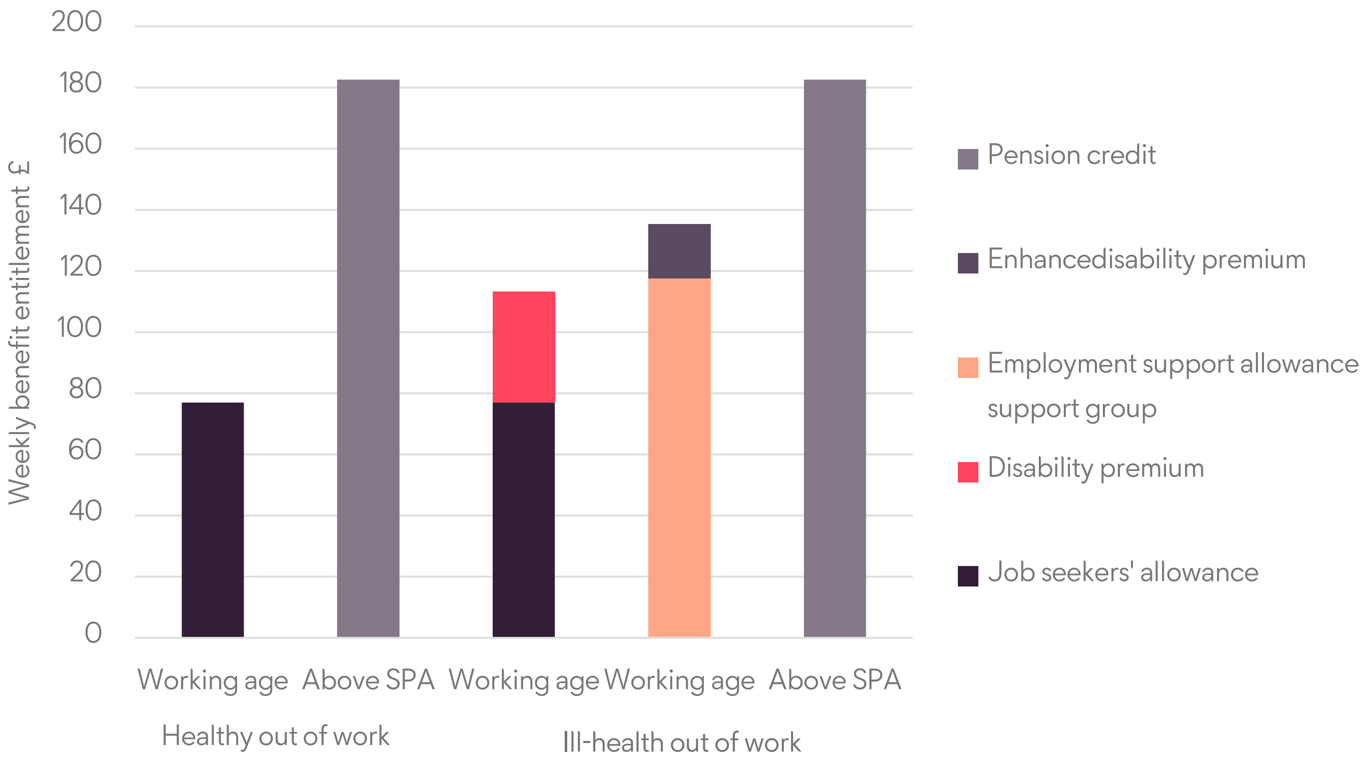
There is reason to be concerned that increases in poverty for future SPA rises could be even greater. There are likely to be more people who are unable to work at 67 or 66 than is the case at 65, and the gap between working age benefits and pension generosity will likely widen over time without a change in policy direction.[13]

11 Calculated using the ONS Labour Force Survey.

12 Cribb and O'Brien (2022) How did increasing the state pension age from 65 to 66 affect household incomes?

13 The triple-lock of the state pension means that the value of the state pension will continue to rise relative to working-age benefits.

Figure 8 **Benefit rates for those above and below the SPA**



Source: Department for Work and Pensions Benefit and Pension Rates 2022 to 2023

Policy implications

There is a sound case for increasing the SPA as longevity increases. The latest forecast from the Office for Budget Responsibility was that spending on the state pension (and related benefits) would increase from around 4.9% of national income in 2031-32 (similar to the 4.8% of national income in 2021-22) to around 6.2% of national income in 2051-52, and that is after factoring in an increase in the SPA from 67 to 68 between 2037 and 2039.[14] Without the increase in the SPA, spending on the state pension would increase even faster, requiring greater tax rises or spending cuts elsewhere to finance it.

A one year increase in the SPA reduces the amount of income received from the state pension by around £10,600 for most people. Many will be able to adjust relatively easily to this change: either working longer, or saving more while working, or spreading this income loss over their whole retirement so that the cut required to their annual spending power is small.

However, the analysis above has highlighted that there will be a small minority of people who could be badly affected. Those unable to continue in work, and who have little other resources to draw on while they wait for their

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state pension, will acutely suffer that loss of state pension income. They will find themselves at the mercy of a benefit system that is significantly less generous to working age people than it is to those above the SPA.

The government has a duty to help those worst affected by changes to the SPA. Three areas of policy that could recommend that the government should prioritise are:

- Supporting those that are able and willing to work at older ages to find appropriate employment. This will not only help the individuals concerned (both financially and socially), but also benefit the public finances through increased tax revenues and lower benefit spending.
- Supporting those that are entitled to benefits to take them up. There is currently believed to be a significant amount of non-take up of benefits by eligible individuals, which means some people's financial situation is worse than it needs to be.[15]
- Reducing job search requirements for older people on state benefits. As recommended by the Cridland review, there should be adjusted conditionality requirements for those approaching the SPA. For example, those on out of work benefits and deemed able to work could only be required to find part-time work, and those on means-tested benefits and working part-time could cease to be required to be taking steps to increase their hours.

15 Age UK, Benefit take-up and older people