How did increasing the state pension age from 65 to 66 affect household incomes?

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Report

With rising life expectancy and an ageing population, there are pressures on the financial sustainability of providing state pensions in the UK: the number of people of pensionable age is projected to reach over 15.2 million by 2045, a 28% increase on the level in 2020 (Office for National Statistics, 2022). One response to this challenge by the UK government has been to increase the earliest age at which people can claim a state pension ('the state pension age', SPA). The female state pension age began rising from age 60 in April 2010, achieving parity with the male state pension age of 65 in late 2018. The state pension age for both men and women then increased from 65 to 66 between December 2018 and October 2020. It is this latter reform that we examine in this report. Further increases in the state pension age are already legislated, starting with an increase to age 67 between 2026 and 2028.

Although such increases to the state pension age are a coherent government response in the face of rising life expectancy at older ages, they can have a substantial effect on household finances. In the current year (2022–23), a full new state pension is worth £185.15 a week. This is a significant amount for many: state support (the most important source of which is the state pension) makes up just over half of income for middle-income pensioners, and more than 80% of income for the poorest fifth of pensioners (Department for Work and Pensions, 2022).

In response to a higher state pension age, some people might change their retirement and financial plans. The full effect of a rise in the state pension age

on household incomes will depend on these responses and is therefore unclear a priori. In this report, we quantify the impact of increasing the state pension age from 65 to 66 (which occurred between 2018 and 2020) on household incomes, poverty and public finances, after – in particular – taking into account that some will remain in paid work at age 65 as a result of the reform. Not only is this analysis important for evaluating this previous increase in the state pension age, but it is also useful for assessing the potential effects of future increases.

Key findings

1. The biggest impact on incomes of the increase in the state pension age from 65 to 66 is simply that 65-year-olds lost – on average – state pension income worth around £142 per week in 2020–21. This reduction in state pension income was much larger than the overall increase in earnings arising from around 9% of 65-year-olds delaying their retirement until they reached the new state pension age.

2. Accounting for all forms of income, including state pensions, earnings, other benefits, private pensions and investment incomes, the increase in the state pension age pushed down the net income of 65-year-olds by an average of £108 per week. This is an average, and many will have seen bigger reductions in their incomes, while those who remained in full-time work as a result of the reform actually received a higher total income than if the state pension age had remained at 65.

3. The reduced payments of state pensions – and the higher direct tax payments resulting from the increase in the state pension age – boosted the public finances by around £4.9 billion per year. This is the counterpart to the reductions in household incomes caused by the reform. This exchequer gain is equivalent to around ¼% of national income and almost 5% of public spending on state pensions.

4. The reductions in household incomes have had a particularly important effect on lower-income households: they have caused significant increases in income poverty rates among 65-year-olds. The reform caused absolute income poverty rates (after accounting for housing costs) among 65-year-olds to climb to 24%, some 14 percentage points higher than – or more than double – the 10% that we estimate it would have been had the state pension age remained at 65.

5. For some groups, the increase in the state pension age from 65 to 66 caused absolute income poverty rates among 65-year-olds to rise by much more. These include single people (rising to 38%, 22 percentage points higher than the 16% it would have been without the reform), those with at most GCSE-level education (to 35%, 21 percentage points higher than the 14% it would have been) and renters (to 46%, 24 percentage points higher than the 22% it would have been). This is because many in these groups were close to the poverty line prior to the latest increase in the state pension age.

6. This latest increase in the state pension age led to a larger increase in income poverty than that seen following earlier increases in the female state pension age. This is for two reasons. First, the gap between state support for those just above and just below state pension age has increased, as both means-tested support for pensioners and state pensions paid to new pensioners have risen while working-age benefits have not. Second, fewer people are in work at older ages, meaning people were much more reliant on the state pension at age 65 than at age 60.

7. Most of the increase in absolute income poverty for 65-year-olds as a result of the reform has been among people not in paid work. The fraction of 65-year-olds who were in poverty and not in employment rose by 10 percentage points from a pre-reform baseline of 9%. However,

there was also an increase in in-work poverty, with the share of 65-year-olds in work and in poverty rising by 3½ percentage points from a pre-reform baseline of only 1% of the 65-year-old population being in in-work poverty.