# How to fix the pensions triple lock but still protect pensioners from high inflation

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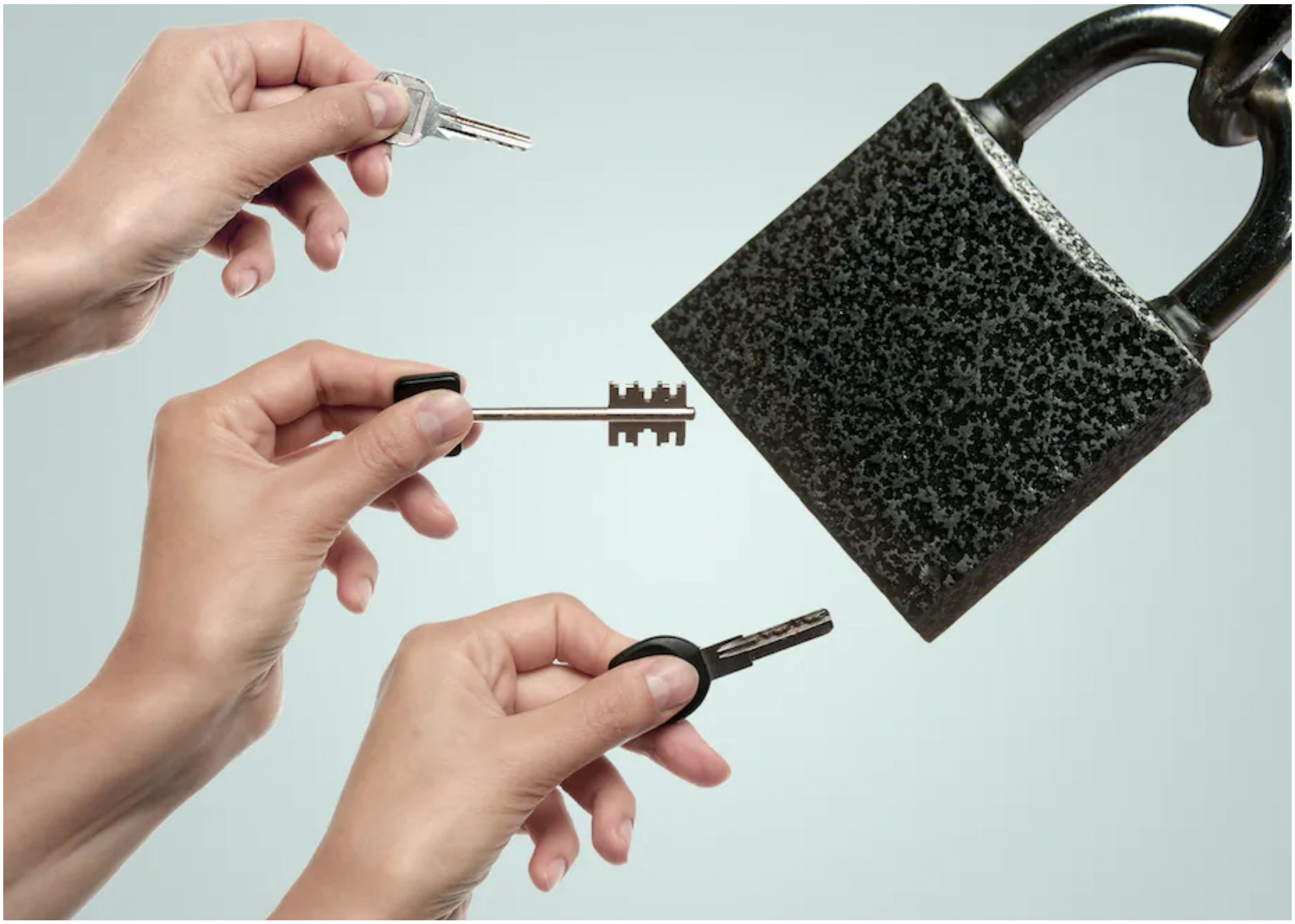

The triple lock increases some benefits payments by inflation, earnings or 2.5%, whichever is highest. Max_Z / Shutterstock

Plans to increase state pension payments in line with inflation have been reinstated by the UK government and are supported by both of the contenders for the Conservative party leadership. But even if inflation was not always at the 40-year high we are currently seeing, a more sustainable way of calculating pensioners' state income is needed.

The pensions triple lock was first introduced in the June 2010 budget. It means annual increases in payments are made in line with the highest out of earnings growth (6.2% as of May 2022), price inflation (currently 9.4%) or 2.5%.

The triple lock was suspended for one year in April 2022 as the end of the COVID-19 furlough scheme inflated average earnings growth. The government is now bringing it back in time for the annual update in pension and other state payments, which will come into effect in April 2023. The annual increase will be set by the government in the autumn. With inflation high and rising (the Bank of England expects it to reach 13% by October), it will be the measure used for the increase.

Inflation of more than 10% will see the value of a full basic state pension climb past £155 a week, while that of the new state pension – available to those reaching the state pension age since April 2016 – will increase to more than £200 a week. Since earnings are currently growing less quickly than inflation, a rise in pension income will be greater than any increase in average earnings. In other words, people receiving state pension payments will typically see stronger income growth than those relying on earned income.

As a result, the current period of higher growth in prices than in earnings has brought the triple lock into question. This is because it protects the value of state pensions when earnings growth is weak (as it is now) but will also continue to increase with any subsequent recovery in earnings.

A recent report from the Office for Budget Responsibility (OBR) shows why this approach is unsustainable. While inflation is spiking at the moment, the OBR believes it will average 2% over the long term and that average earnings growth will be around 3.8%. But it also thinks the triple lock will imply an average annual increase of 4.3% for pensions. This is because of volatility in the two sets of figures: while often earnings will grow faster than prices, on occasion that is not the case.

## Unexpected expense

As such, maintaining the triple lock would see the value of the basic state pension and new state pension continue to grow faster than average earnings, pushing up government spending on state pensions. Overall, the OBR report projects that state pension spending will increase from 4.8% of national income in 2021–2022 to 8.1% in 50 years time, an increase of 3.2% of national income, which is equivalent to more than £80 billion a year in today's terms. This is despite further rises in the state pension age. And the use of the triple lock will be a key driver of this increase, not average earnings growth.

When the triple lock was first introduced in the June 2010 Budget it was not expected to be this expensive. If the triple lock had been used over the 19 years prior to its launch, from 1991 to 2009, it would only have been more generous than increases in line with average earnings growth on three occasions. And so, overall, it would have caused state pension increases averaging just 0.1% a year more than if it was calculated using average earnings indexation.

In contrast, over the 12 years from 2010 to 2021, since the policy was first implemented, triple lock indexation would have been more generous than average earnings indexation on eight occasions, according to my calculations based on ONS figures. This would have caused state pension increases averaging 1% a year faster than average earnings indexation.

As such, the triple lock has already been significantly more expensive than expected. It was initially estimated to have cost £450 million in 2014–15, but subsequent OBR analysis suggests that it actually cost six times more – or £2.9 billion. This is clearly not sustainable, particularly amid the current economic downturn.

There are more sustainable ways to calculate state pension payments in the current economic environment. astarot / Shutterstock

## Finding more sustainable solutions

One solution put forward in the Conservatives' 2017 general election manifesto was to move to a double lock, where the pension would increase by the greater of growth in prices or earnings. So the 2.5% underpin would no longer exist. In recent years inflation has been greater than earnings or 2.5%, and sometimes both earnings and inflation have been below 2.5%. So the triple lock has been more generous than earnings indexation, and a double lock would also have been more generous than earnings indexation (but not as generous as a triple lock).

But over the period from 2010 to 2021, a double lock still would still have seen the state pension increase by an average of 0.7% a year more than average earnings growth, according to my calculations. So while it would not be as expensive as the triple lock, it's still not fiscally sustainable over the longer term.

Another option is to move to directly link pensions to average earnings. This was legislated by the Labour government in 2007 following the recommendations of the Pensions Commission. Such a policy could be fiscally sustainable over the long term, if implemented alongside state pension age increases due to rising longevity. But it would mean that in periods where earnings growth was running below inflation (such as now) there would be a real squeeze on pensioners' incomes.

There is an alternative that would both be as generous as (but not more generous than) earnings indexation over the long term, but that would also preserve the real (inflation-adjusted) value of state pensions in years in which earnings were not keeping pace with prices. Instead of a triple lock, the government could set a target level for the state pension relative to average earnings – let's say that pensions should be worth 25% of average earnings every year. If this target was 10% more than current pension payments, for example, the government could set a longer-term strategy for meeting that target by increasing payments in smaller annual increments. If prices grow faster than earnings one year, the government could make pension payments price-indexed and then adjust in subsequent years to remain on track for the target, if needed.

This would preserve the real value of state pensions without locking in unsustainable increases at times when earnings are growing faster than prices (as happens under a triple or double lock). It would protect pensioners from inflation while following a target. For whoever ends up being chancellor in the autumn, this could be a way to help improve long-term public finances.