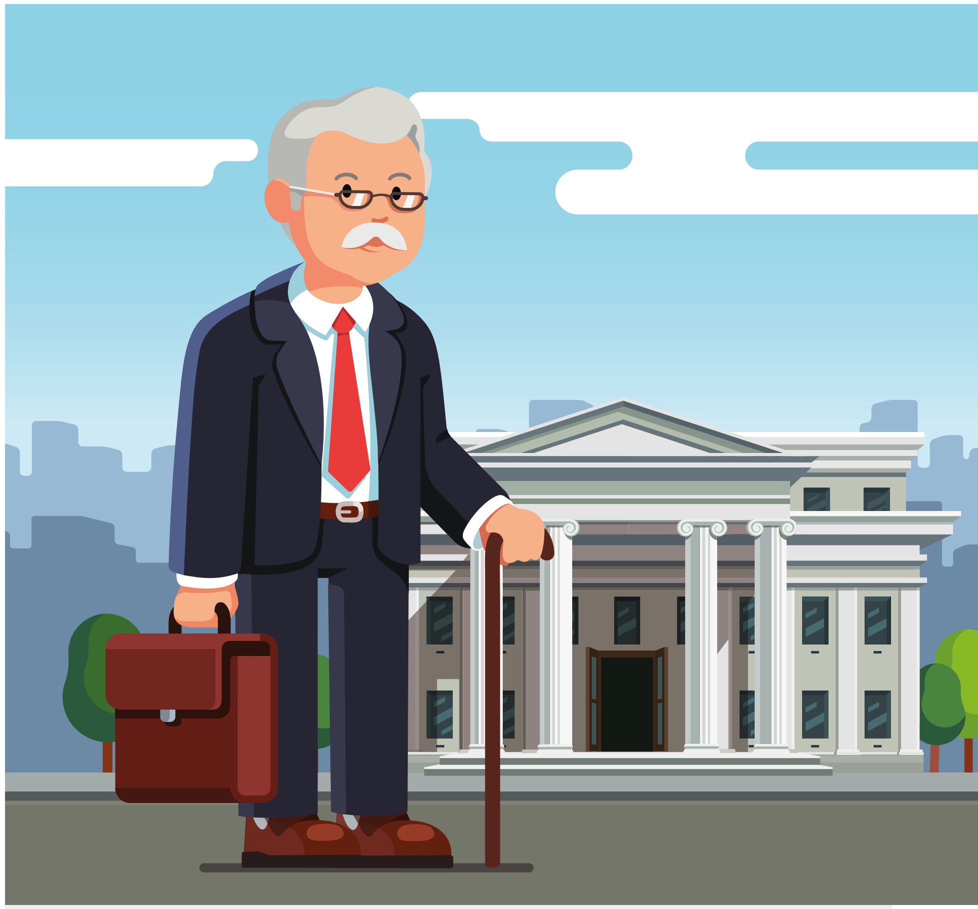
Reliance on the state

The state pension has been in the spotlight as the cost of living rises and inflation soars. Jack Gray analyses the recent developments and their potential impact on workplace savings



Summary

- Recent developments in the state pension have been hitting the headlines amid soaring inflation and a rising cost of living.
- The pausing of the triple lock has prevented a record rise this year but has increased concerns about reliance on the state pension.
- The government consultation on the state pension age closed on 25 April.
- Focus on workplace saving has intensified as people are increasingly less likely to be able to rely solely on state pension income.

Amid a backdrop of Covid-related financial pressures, adjusting to Brexit and conflict in Ukraine, economic uncertainty and rising inflation have been rearing their heads in the UK. Both at a governmental and individual level, the country has been feeling the economic squeeze.

The state pension has not been immune to these issues, with the government putting a one-year pause on the triple lock to avoid a record rise in state pension income, while the *Second State Pension Age Review* consultation has just closed as the population gets older and affordability issues persist.

It seems that people are unlikely to be able to rely on the state pension in later life, with the OECD publishing analysis showing the UK state pension provides a lower level of pension income than most other advanced economies relative to average earnings.

In the UK, this shortfall is partially made up through workplace savings, and the importance of individuals saving into a workplace pension has never been more apparent.

Making a change

"There have been both immediate and long-term changes made recently to the state pension," begins Interactive Investor head of pensions and savings, Rebecca O'Connor.

"The triple lock was scrapped for a year this year, controversially. This was because wage growth after lockdowns meant it would have gone up by an unusually high amount had the triple lock remained. Instead, it went up with inflation, which at the time was 3.1 per cent."

Since the pause, the government has confirmed that the triple lock will be reinstated from next April. Although the announcement to reinstate the measure has been praised, O'Connor warns that the government's ability to quickly remove the triple lock creates uncertainty on whether pensioners can count on a rise in line with inflation or earnings.

AJ Bell head of retirement policy, Tom Selby, agrees, adding: "Clearly the choices facing a government which has spent hundreds of billions of pounds paying people to not work during a pandemic are difficult, but that is likely to be of little comfort to pensioners feeling the squeeze.

"And while the government has said it will reinstate the triple lock from next year, this is a reminder that relying on the state pension leaves you as a hostage to the policies of current and future policymakers."

Two increases to the state pension age are currently 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 *Second State Pension Age Review* sought evidence on whether the increase to 68 should be brought forward to 2037-39.

"A rise to 68 is now considered potentially controversial because longevity is no longer rising," O'Connor says. "It is also very unequal between different parts of the country.

"The state pension has already risen quite dramatically in recent years and one of the main justifications for doing so has been rises in living standards contributing to greater longevity. That trend appears to have paused, but pressure on the government to fund the state pension grows with the population of older people."

Selby adds: "While the triple lock has dominated debate around the state pension recently, the state pension age is likely to be a key battleground as we head towards the next general election.

"Given the latest data suggests life expectancy improvements have slowed – and even gone backwards in certain parts of the UK – any decision to move the goalposts further away will inevitably cause uproar.

"However, the Treasury has been forced to borrow over £400 billion during the pandemic and will be scouring for revenue raising measures."

The Investing and Saving Alliance head of retirement, Renny Biggins, states that the increasing costs due to an aging population raises questions about how the state pension will be funded in the medium to long term.

"There will have to be a trade-off between other areas of government spending, or the government will need to introduce higher or new taxes, which highlights how sensitive the state pension is to political intervention," he comments.

"All future retirees with eligibility to a state pension entitlement will potentially be impacted. How they will be impacted will be dependent on the outcome of the review."

Growing importance

With people potentially being less able to rely on the state pension in later life, the spotlight has inevitably intensified on the importance of workplace pension saving.

"It's actually very hard to replace state pension income through workplace pensions and takes quite a high level of contributions throughout working life," says O'Connor.

"The need to increase contributions will have to be communicated to workers. Or else done for them. There is a strong argument for higher employer contributions, too."

Selby adds: "As the state recedes from providing pension incomes, a greater onus will be placed on individuals building up their own retirement pots.

"However, millions of people – including the self-employed – do not benefit from workplace pensions, while many of those saving at the minimum of 8 per cent of band earnings will not be putting enough to one side to fund the retirement they are hoping for."

With the rising cost of living, many employees are being forced to decide whether to extend their working lives or accept a lower standard of living and retire at their chosen age, notes Biggins.

"We should also be mindful of the trends occurring in the private sector over recent decades, including the sharp decline in DB provision," he continues.

"We should ensure that all reviews and changes to the state pension take in to account the overall retirement income targets that are deemed appropriate and the impact this has on auto-enrolment's ability to deliver on the income level that will be required from a private pension."

Affordability issues

Questions over the affordability of the state pension triple lock have been widely debated over the past year as the pandemic brought to light a statistical anomaly in the formula used to calculate the annual increase, explains Aegon pensions director, Steven Cameron.

"During the pandemic, the earnings growth measure of the triple lock was distorted by people having been on furlough the year before and this would have granted pensioners an unrealistic increase of over 8 per cent in April 2022.

"Although the government has already committed to reinstating the triple lock for next year, the funding challenge they now face is that inflation is sitting at a 30-year high of 7 per cent and set to rise to the end of 2022.

"With the inflation measure of the triple lock based on September's CPI figure, this could mean that pensioners receive a bumper increase of around 8 per cent in April 2023. And with pensioners losing out on recent inflationary rises in the April 2022 uprating, it would be far harder to justify cutting this back in any way next year.

"The government's commitment to reinstating the earnings figure means the triple lock looks to have survived at least another year, but it's still to be seen if the commitment will survive in future years. Every 1 per cent rise in the state pension costs the government around £0.9 billion, so during a period of significant volatility where earnings are rising and inflation is increasing at unprecedented pace, the affordability of the triple lock may come under further questioning."

Written by Jack Gray