Ageing will be fast despite the slowdown in longevity gains

Population is ageing fast in the United Kingdom, but shifts in the demographic structure will be slower than in many other OECD countries. The number of people aged 65 and over for every 100 people of working age will rise from about 32 today to 47 in 2050, posing economic and social challenges. This compares to 30 and 53 on average in the OECD.

Pensions at a Glance shows that, even before COVID-19, there has been a slowdown in old-age life expectancy gains in many countries from about 2010. This is particularly the case in the United Kingdom where the pace of longevity gains has been halved after the strong improvements during the first decade of the century. In addition, excess mortality due to COVID-19 decreased life expectancy at birth in 2020 by one year.

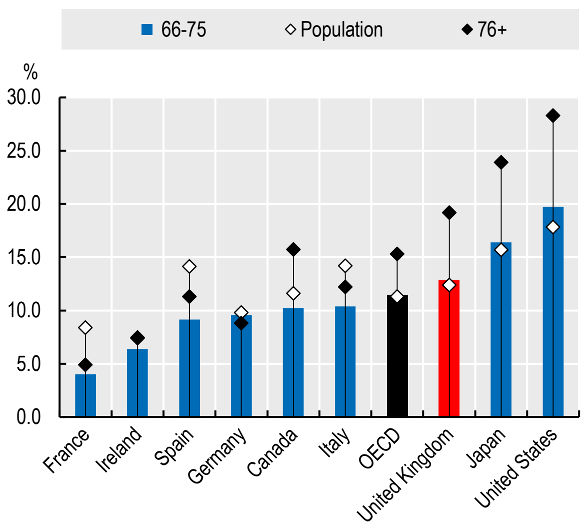
Progress made, but old-age poverty is still high

During COVID-19, pensioners' incomes have been protected; with the triple lock, payments have been increased by 2.5% given negative wage growth and low inflation. Future entitlements to the state pension kept accruing through the coronavirus job retention scheme. Given the most recent bounce in wages, the government has proposed to suspend the earnings element of the triple lock for 2022-23.

Before COVID-19, those aged over 65 had an average income around 81% of that of the total population, compared with 88% in the OECD on average. Those who had sufficient income during their working lives saved, often bought their own home and contributed to private pensions, but those less fortunate are left with few resources, primarily the state pension. Income inequality is high among the over 65s, with a Gini coefficient of 0.33 against 0.31 on average in the OECD. Whilst pensions in payment are protected due to the triple-lock, the level of the state pension benefit alone provides only a low income.

Old-age poverty is high especially after age 75

Relative poverty rates by age group, latest available



Source: Table 7.2

The current relative old-age poverty rate is high: among those aged 75 and over, 19.2% have incomes below half of median household disposable income, the majority of them being women. Women have had shorter employment records and so are less likely to have pension entitlements in their own right, thereby either relying on credits based on their partner's contributions or on survivor benefits.

The old-age relative poverty rate has declined in recent years, from 22.7% among the 66+ in 2000 to 15.5% in 2018, whilst the poverty rate among the working-age population increased slightly. Old-age poverty rates should continue to decline given the gradual increase in the state pension, to 130% of the old state pension by 2051 for those contributing for 35 years in the new system, while the effectiveness of auto-enrolment into private pensions might also help reduce poverty rates.

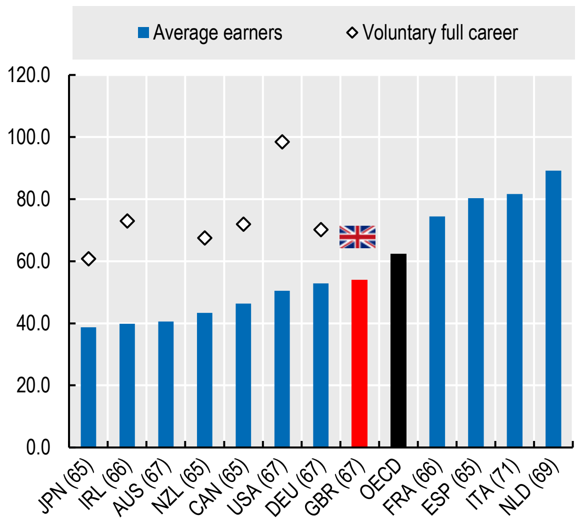
Auto-enrolment raises pension prospects significantly

The number of people with workplace pensions gradually fell until 2012, auto-enrolment has more than doubled the coverage rate, from 40% in 2012 to 88% in 2019 among eligible employees, though those earning below GBP 10,000 per year and the self-employed are not auto-enrolled. Minimum contribution rates have also increased from 3% in 2012 to 8% in 2019, of which employers pay a 3% rate.

Average-wage workers contributing for their entire career can expect a future pension equivalent to 54% of their previous take-home pay, slightly below the OECD average of 62%. Relying on the basic pension alone will only generate a net replacement rate of 28%. For low earners, the future net replacement rate is equal to 72%, assuming they contribute fully.

Auto-enrolment has increased pension prospects

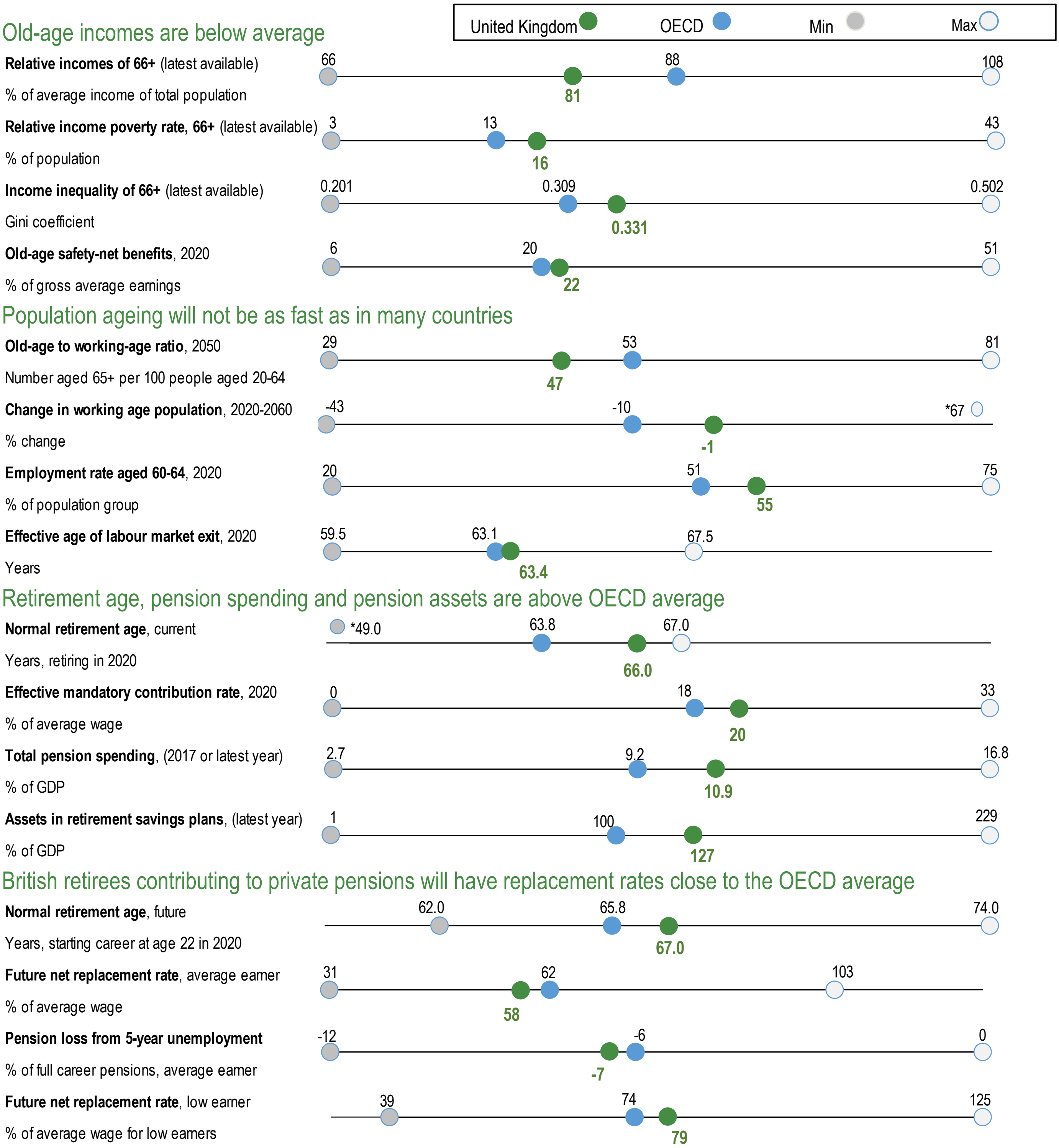
Future net pension replacement rates, %



Source: Table 4.5

However, annual contributions to private pensions will only guarantee financial security in retirement if contributions are made every year and the pension pot is fully annuitised at retirement. There is no guarantee that the level of participation in the auto-enrolment schemes will remain high in the long term. Moreover, low earners typically save less in voluntary schemes. Currently, the entire pot can be withdrawn as a lump sum from age 55, with 25% being tax-free. This withdrawal age will increase in line with legislated increases in state pension age. Early pension withdrawal generates flexibility and freedom that many people appreciate. However, enabling individuals to have such control of their assets comes with risks as people often struggle to correctly assess their future needs, especially given uncertainty about their own longevity. Moreover, the risks for low-to-medium earners might be substantial as they are more likely to be tempted to take their pension as a lump sum early if they have short-term financial difficulties.

Seven OECD countries link the statutory retirement age to life expectancy. In the United Kingdom, there is no automatic adjustment mechanism, but a review of the state pension age has to take place at least once every six years. The reviews are based around the idea that people should be able to spend a specified proportion of their adult life drawing a state pension. This proportion is set by the Secretary of State before each review. However, the reviews' recommendations are not automatically applied. Based on current legislation, the statutory retirement age will increase from 66 to 67 years, still higher than the OECD average of 63.8 and 65.8 years, respectively.



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