The Pensions Review

Heidi Karjalainen

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State pension: A new way forward

IFS Institute for Fiscal Studies

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The new state pension

- Many aspects of the new state pension commendable

- Some key features should be retained:
  - Flat-rate – no means-testing or earnings-related part
  - Accessible from a single universal state pension age

- But, given the challenges, we need a **new way forward**
  - Build on the strengths of the current system
  - Provide a sustainable long-term future for the state pension

A new way forward

- We introduce a suggested new **four-point pension guarantee**
- Consider different aspects of the system together:
  - Level of the new state pension
  - Indexation
  - State pension age

- These policy suggestions are based on
  - New findings in this report
  - Evidence from specially conducted polling and focus groups
  - Discussions with expert stakeholders

Four-point pension guarantee

1. There should be a government **target level for the new state pension**, expressed as a share of median full-time earnings.

A target level for the state pension

- We need a long-term strategy for the level of the state pension
- As with the minimum wage, politicians should state what the new state pension should be as share of average earnings
- Then legislate a pathway to hit that target with a specific timetable

Four-point pension guarantee

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Four-point pension guarantee

2. Both before and after the target level is reached, the state pension will continue to increase **at least in line with inflation** every year.

Four-point pension guarantee

3. The state pension **will not be means-tested**.

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4. The **state pension age will only rise as longevity at older ages increases**, and never by the full amount of that longevity increase.

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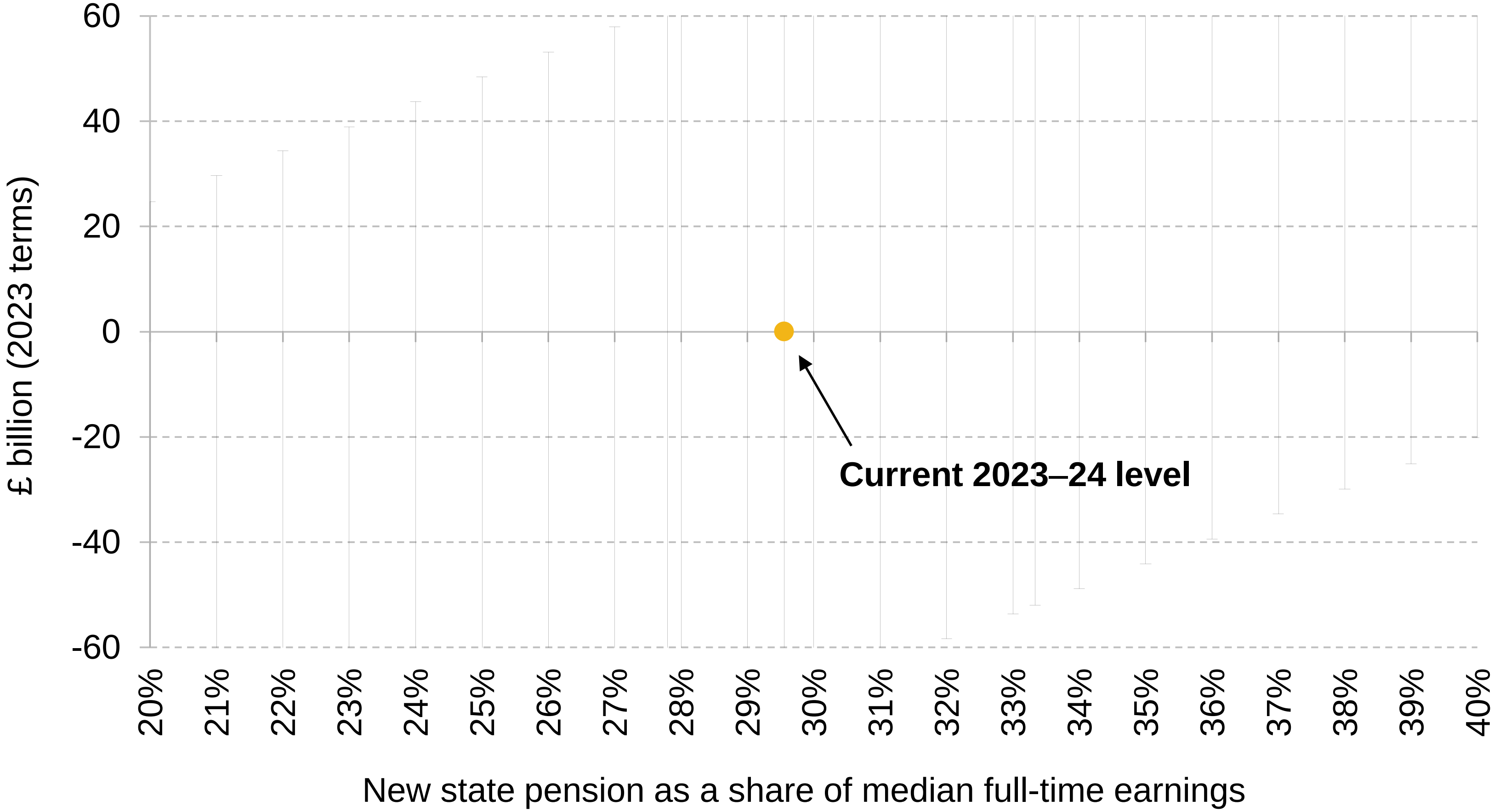
Setting the level – key trade-off

Impact on state pension spending in 2050 (relative to earnings indexation from 2023 onwards)



Source: Figure ES1 from Cribb et al. 2023.

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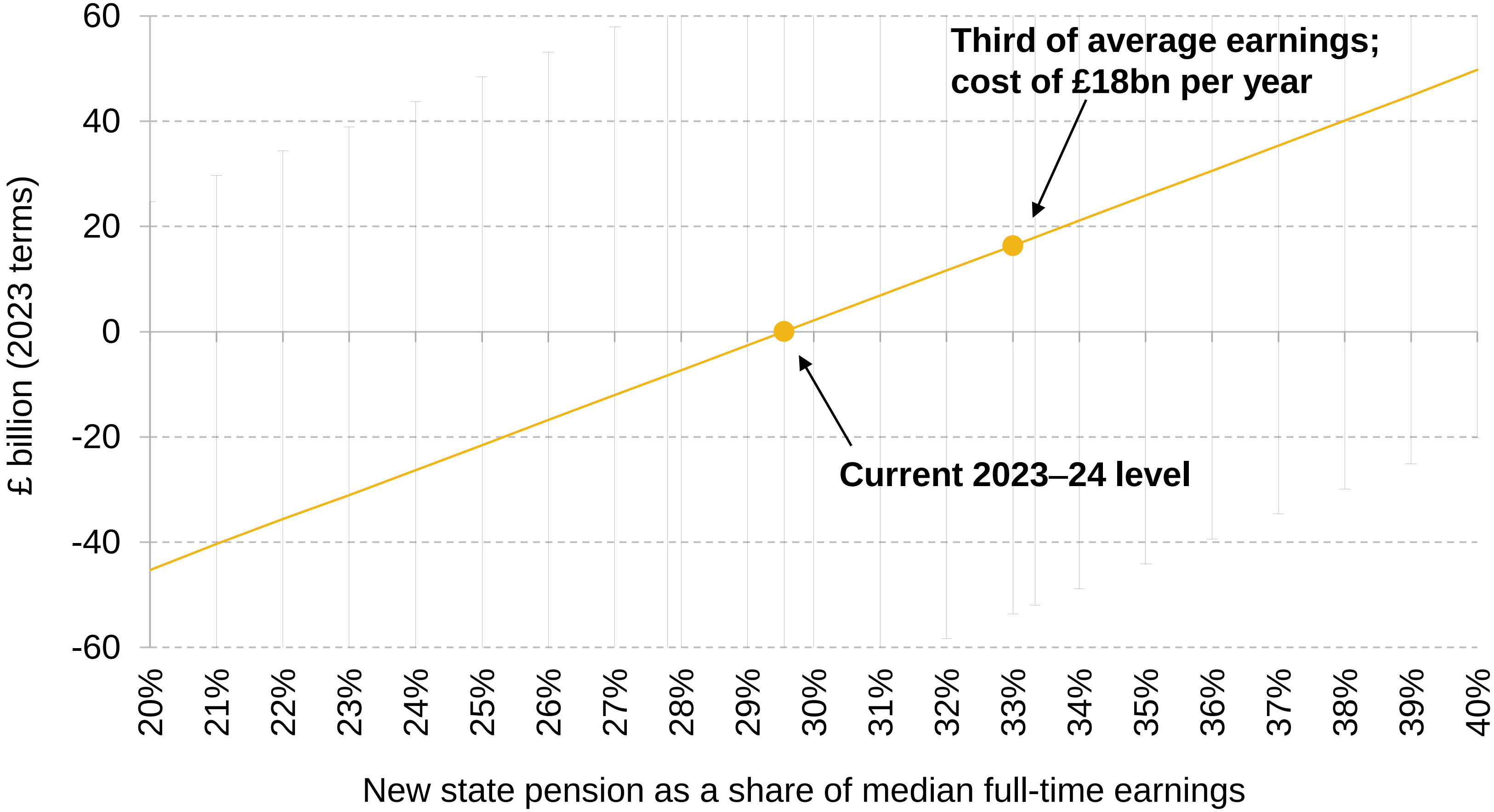

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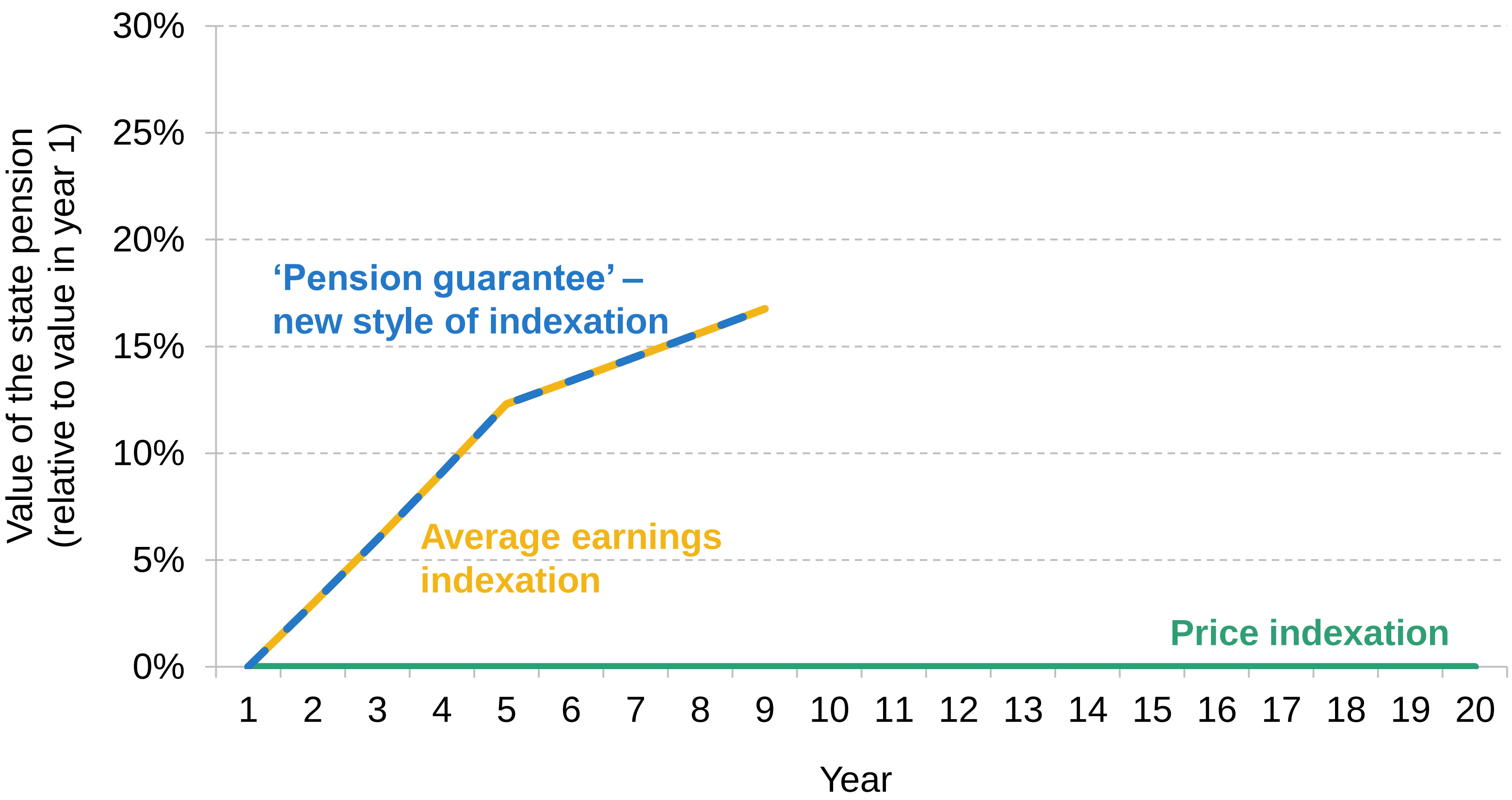
Proposed indexation

- Australian-style indexation
- In good years: value of the state pension grows **in line with average earnings** and general living standards
- In bad years when average earnings growth is **below** inflation:
  - Value of the state pension rises **in line with prices**
  - Protects the purchasing power of the state pension
- Indexation **remains in line with prices until the state pension returns to its target level**

Indexation in the long run

Illustration of how our suggested new style of indexation would operate



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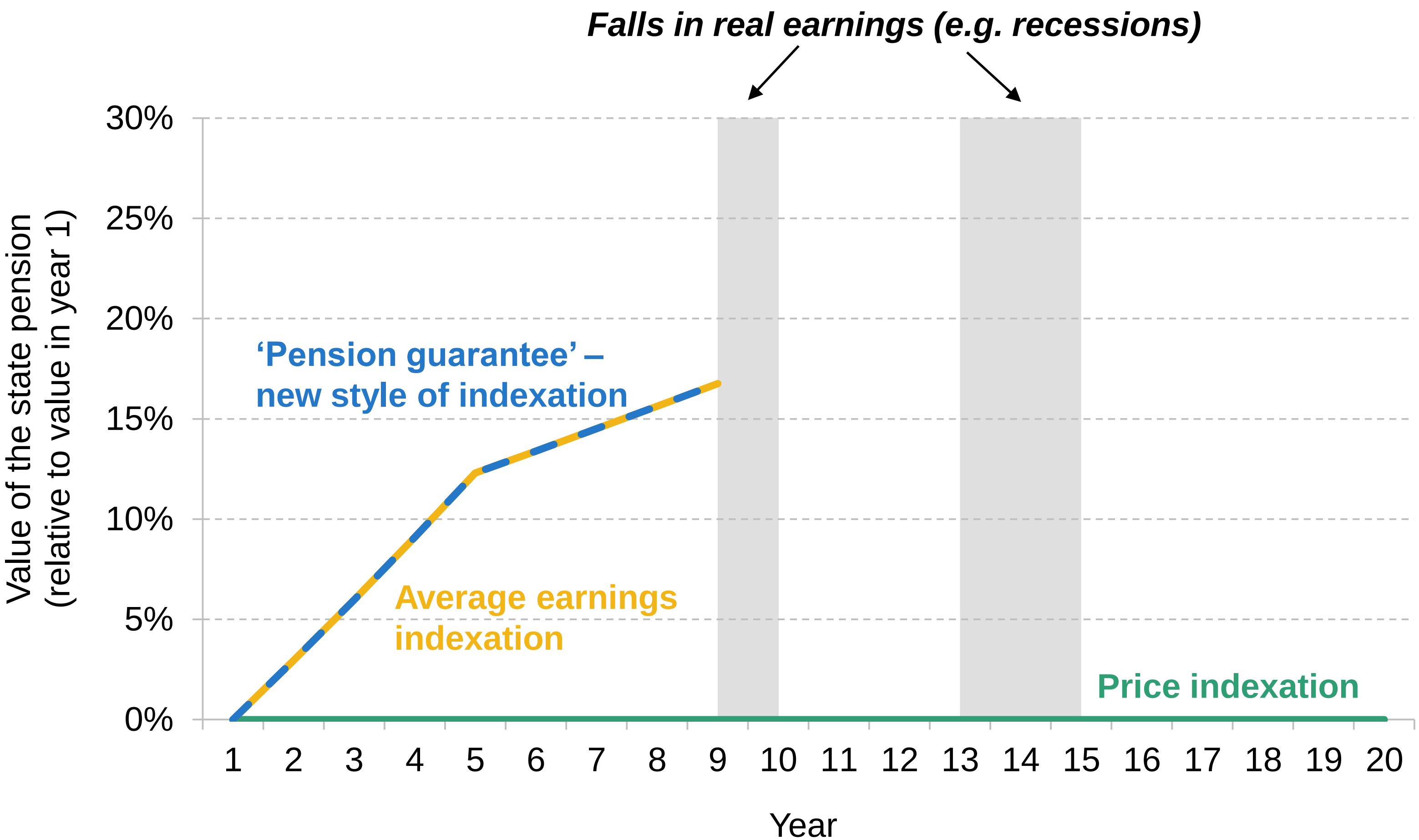

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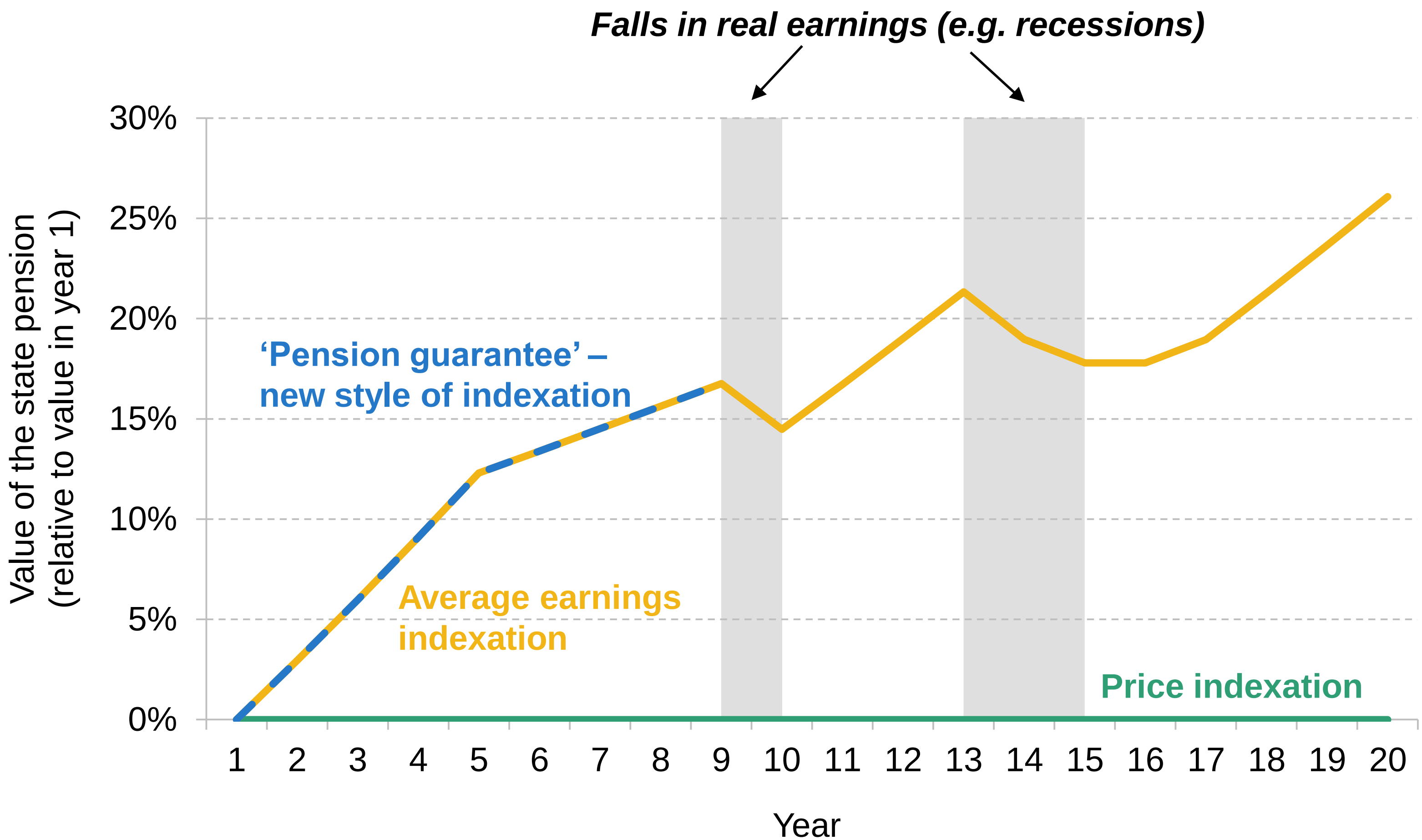

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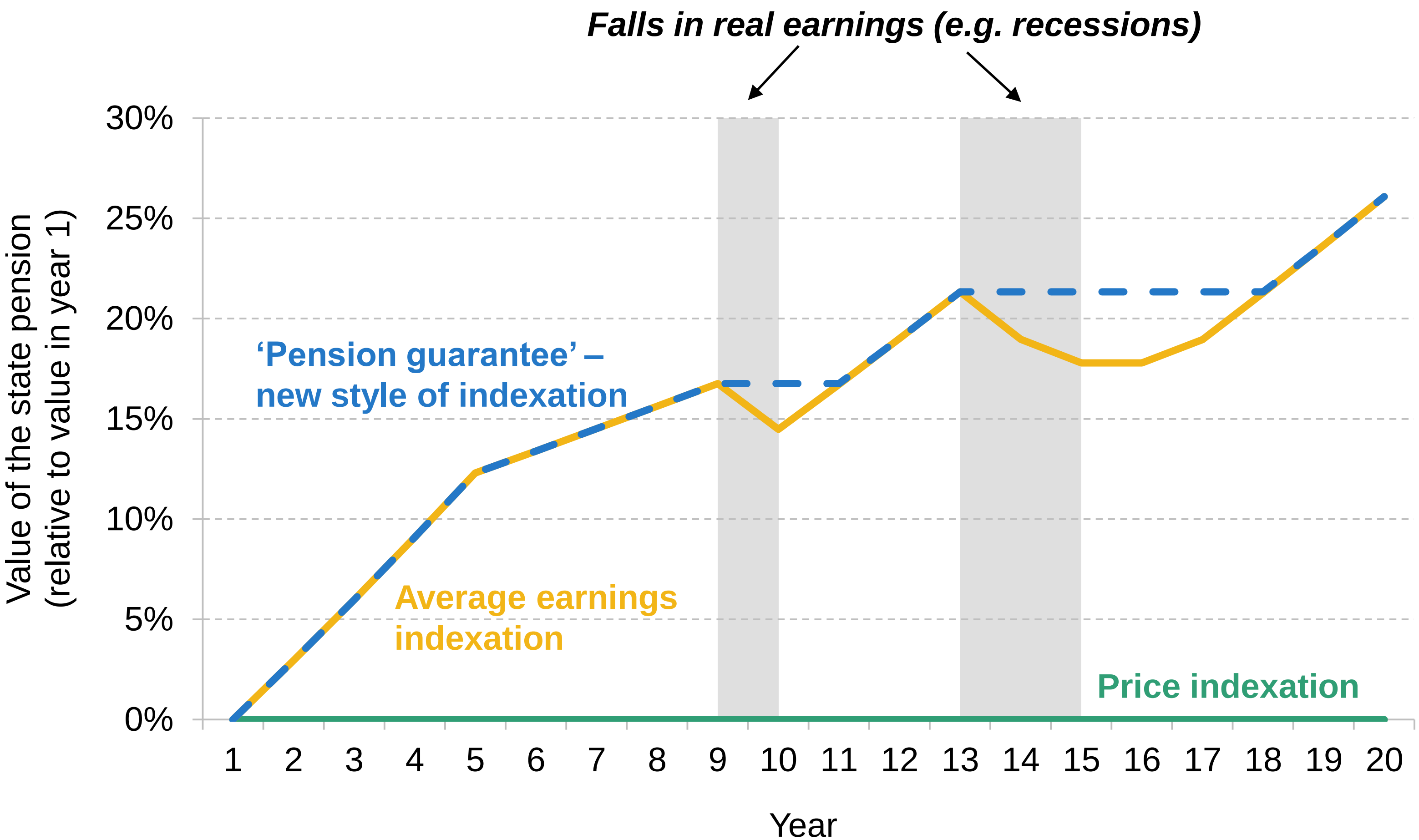

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Summary

- Our four-point pension guarantee is carefully designed to provide a new way forwards for the state pension

Four-point pension guarantee

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1	2	3	4
Long-term commitment to keep the state pension at a **set level relative to average earnings**	State pension will **always** be **protected against inflation**	State pension will **never** be **means-tested**	**State pension age** will only go up **when life expectancy increases**

Summary

- Our four-point pension guarantee is carefully designed to provide a way forwards for the state pension

- It would:
  - Build on the strengths of the current state pension system
  - Address some of the key challenges we have identified
  - Help ensure people can have confidence and certainty over the state pension as a future source of income
  - Protect from old-age poverty and provide a bedrock on top of which people can build private pension saving

The Institute for Fiscal Studies
7 Ridgmount Street
London
WC1E 7AE

www.ifs.org.uk