Original Article

Extending working lives

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ABSTRACT The Government has introduced several policies aimed at extending working lives. One of these policies, rises in the State Pension Age (SPA), could impact on the income of older people. This article analyses the implications of extending working lives and its impact on retirement adequacy. It finds that a rise in SPA could result in higher income in retirement for those who can work longer. However, the article also finds that while around 85 per cent of people aged between 50 and SPA could achieve a Minimum Income Standard by SPA, only around 40 per cent could reach their target replacement rate. Consequently, many people may experience a drop in their standard of living when reaching their SPA, unless they are able to work and save for longer.

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INTRODUCTION

The United Kingdom has experienced dramatic increases in life expectancy over the last three decades. For example, between 1981 and 2011, male life expectancy at age 65 rose by 7 years from age 79 to age 86.¹

Although these improvements in life expectancy could be seen as positive and will undoubtedly improve some people's lives, they are also accompanied by potential financial problems for people, employers and for the Government. This is because improvements in life expectancy have several financial implications: people might be faced with increasingly long retirements that they need to prepare for and fund; employers who

sponsor pension schemes may face increases in the length of time they have to pay pensions to their members; and the Government also faces increases in the length of time they have to pay state pensions and pension-related benefits to people.

In order to attempt to address some of the costs associated with increases in life expectancy, the Government has introduced several policies aimed at encouraging people to work for longer.

This article discusses the findings from a recent report by the Pensions Policy Institute (PPI) that explored the implications that Government policies to extend working lives have for retirement income. The report was sponsored by a consortium: The Actuarial profession, Age UK, Aviva and Partnership. The report is publicly available for download on the PPI's Website.

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HOW MANY OLDER PEOPLE ARE IN WORK NOW?

Before exploring how policy change may impact work, retirement and income among older people (people aged 50 and over), it is worth considering current patterns of working at older ages and how these have been changing over the past few decades.

Overall, the proportion of people working at ages 50 and over has been increasing over the last few decades. Between 1993 and 2011, the proportion of men in the United Kingdom aged 50–64 years, below the male State Pension Age (SPA), in work increased from 64 per cent to 70 per cent. The proportion of men working beyond the current male SPA of age 65 also increased from around 8 per cent to 11 per cent (Figure 1).²

The increase in working at older ages has been even more substantial for women. Between 1993 and 2011, the proportion of women in the United Kingdom aged between 50 and 59 (below the women's SPA) increased from around 57 per cent to around 72 per cent.

Figure 1: Employment of men at older ages has been increasing.³

Figure 2: Employment of women at older ages has been increasing.³

The proportion of women working beyond the women's SPA (age 60 until 2011 when it began to rise) increased from 23 per cent to 34 per cent (Figure 2).²

WHO IS WORKING AT OLDER AGES?

While working at older ages has been generally on the rise, not all older people are equally likely to be working. Wealthier people or people with higher skill or education levels are more likely to be working at ages 50 and above than those who are poorer or have lower skill or education levels.⁴

Men are more likely to be working at older ages than women⁴ (although women have been catching up recently) and occupation type also affects the likelihood of being in work; managerial/professional workers and the self-employed are more likely to be in work at older ages than those with lower skill or manual/routine jobs.⁵

Some people work up until or beyond their SPA because they enjoy their jobs, find their work fulfilling or see work as a way to remain socially engaged. However, many older workers remain in work out of financial necessity or because they feel that they simply cannot afford to retire.

WHO IS NOT WORKING AT OLDER AGES?

People leave work at ages below their SPA for a variety of reasons. Some of those who leave before SPA do so because they feel they have enough income to retire on, however many people are compelled to leave work before SPA due to circumstances beyond their control such as health problems, the need to provide care for a family member, or because they are made redundant and are unable to find another job. Problems can occur when people involuntarily leave work before their SPA because these people may not have had sufficient time or notice to prepare for their retirement. Therefore, they may end up with a lower income in retirement than they expected or wanted.

People who are less wealthy on average are more likely to have to leave work early due to health problems, while women and people from

some ethnic minority groups are more likely to need to provide care at older ages. In 2008/2009, around 15 per cent of women in England aged 50–64 reported providing care in the last week.⁶

HOW COULD CURRENT POLICIES AIMED AT EXTENDING WORKING LIVES IMPACT OLDER PEOPLE?

In order to ensure that the public and private pension systems are able to continue supporting people through retirement, the Government has introduced several policies aimed at extending working lives.

There are three main strands to the Government's extending working-lives policy agenda. The first strand is welfare-based and involves attempts to move people of all working ages (both under and over 50) off of state benefits and into paid work through tougher benefit eligibility tests and intensive, targeted support for job-seekers who are vulnerable.

The second strand involves raising the ages at which people can claim their state pension and age-related means-tested benefits.

The third strand involves attempting to remove barriers to working longer by removing compulsory retirement and tackling age discrimination.

Although all of these policies will encourage and enable some people to work longer and take their state and private pension later and could increase their income in retirement, there may be negative financial implications for those who cannot work longer because of health problems or other factors. For those who are unable to work longer, rises to the SPA and changes to the benefit system may result in lower incomes in retirement.

A RISE IN SPA COULD RESULT IN HIGHER INCOMES FOR THOSE WHO ARE ABLE TO ADJUST THEIR WORK AND SAVING BEHAVIOUR

For those people who are able to adjust their working and saving behaviour, a rise in SPA

could actually result in an increase in income both before and after SPA.

This can be illustrated using the example of a hypothetical woman, aged 49 in 2012 (who earns at median levels during working life) and works full-time (with a few breaks to care for her children) up until age 64. At age 64, she takes her private pension and then works part-time for 2 years before retiring at her SPA of age 66 and taking her state pension.

Under the current state pension system, and assuming that she contributes to a DC pension at the average level of 9 per cent of gross earnings (employee and employer contributions) while in work, her weekly income at her SPA (under previous legislation) of age 66 is around £225pw.⁷

However, if her SPA is age 67 as under current legislation and she adjusts by leaving full-time work a year later at age 65, takes her private pension and works part-time for 2 years, then she would have an income at her SPA of around £230pw.

Under the higher SPA scenario, the hypothetical woman works for a year more than under the lower SPA scenario. Working for 1 year longer has the effect increasing her income during the extra year she works before reaching her SPA at age 67 and increasing her income in retirement; she receives around £5pw more from her private pension throughout her retirement as a result of working and saving for 1 year longer (Figure 3).

Figure 3: A rise in SPA could result in higher income in retirement for those who can work longer.⁸

A RISE IN SPA COULD RESULT IN LOWER INCOMES FOR THOSE WHO CANNOT ADJUST THEIR WORK AND SAVING BEHAVIOUR

Rises in SPA in particular have the potential to impact the incomes of older people both before and after SPA. People who are unable to adjust their work and saving behaviour as a result of rises in SPA might experience a reduction in income before and after their SPA as a result. However, those who can work longer in response to a rise in SPA could increase their income in retirement.

This can be illustrated using the example of a hypothetical man aged 49 in 2012 (who earns at low levels during working life) who has to retire from work at age 60 due to a health problem. At age 60, this man purchases an annuity with his private pension savings and lives off of the income he receives from his annuity and income he receives from the state through means-tested benefits. Under the current state pension system, and assuming that he contributes to a DC pension at the average level of 9 per cent of gross earnings (employee and employer contributions) throughout his working life,⁹ his total gross income at age 60 is around £120pw in real terms.

If the man's SPA was age 66, as under previous legislation (in the Pensions Act 2007), then his weekly income at his SPA would be around £190pw.

However, if the man's SPA is age 67 as under current legislation and he is unable to adjust his work and saving behaviour to the higher SPA because his illness has meant that he needs to leave work at age 60 then the higher SPA results in his receiving around £120pw from his annuity and state benefits, between the age of 66 and 67, which is £70pw lower than he would have received if his SPA had remained at age 66. This is because he has to wait an extra year before receiving his state pension. Once he starts to receive his state pension at age 67, his income rises to around £190pw in real terms (Figure 4).

Figure 4: A rise in SPA could reduce income for those who cannot work longer.⁸

HOW COULD WORKING AND SAVING PATTERNS IMPACT THE FUTURE INCOMES OF OLDER PEOPLE, BASED ON TODAY'S EXPERIENCE?

The PPI research also explored the likelihood that today's older workers might meet different measures of income adequacy by their SPA.

The PPI analysed people aged 50 and over in England (but below SPA) who were still in work and made an assumption that they remain working and saving at their current levels. The analysis also assumed that if people were not saving into a pension, and if they were eligible, they were automatically enrolled into saving in a pension scheme, in line with Government legislation.

In reality, many people over age 50 and currently in work may be unable to continue working and saving until SPA (or beyond) because of health problems, the need to provide care or redundancy.

In order to measure adequacy, the research used two different levels. The first measure is the Minimum Income Standard, a basic income measure that should allow individuals to achieve a minimum acceptable standard of living.¹⁰ The Minimum Income Standard for a single pensioner in 2011 is just under £11 000pa (£211pw).

The second measure used is a target replacement rate, which measures how much individual pensioners may need in order to replicate working-life living standards in retirement, based on their income during working life. People can generally achieve a similar standard of living in retirement to the one

that they had in working life with an income in the range of 50 per cent–80 per cent of their gross working-life income.¹¹ As an example, a man retiring in 2011 on median income of around £500pw may need an income in retirement of around 67 per cent (£335pw) to recreate working-life living standards.

PPI modelling suggests that the majority, around 85 per cent, of people aged 50 and over should be able to achieve a minimum acceptable standard of living (using state and private pension income) by their SPA, assuming they continue to work and save at their current levels. This result is not too surprising when you consider that people should be able to achieve the Minimum Income Standard in retirement through receipt of means-tested benefits (including Pension Credit, Housing Benefit, Council Tax Benefit and Winter Fuel Payments.) Those who were unable to achieve a minimum acceptable standard of living by SPA tended to have savings above the level of eligibility for means-tested benefits or a partner below eligibility age (both of which make them ineligible) and around 10 per cent of those who could not meet it by SPA would be able to do so within the next 5 years after SPA (Figure 5).

However, the Minimum Income Standard level will not necessarily be high enough to provide the minimum acceptable standard of living to everyone. For those who have lived on a higher income during working life, the minimum acceptable standard of living is unlikely to feel acceptable as it will represent a drop in living standards.

Some people who have lived on lower incomes during working life may also find it

difficult to meet all of their needs from an income at the minimum standard level if, for example, they have health problems or live in rural areas (so are unable to access public transportation and large discount shops).

Therefore, it is useful to explore whether or not people can meet their target replacement rate of working life income by SPA, in order to determine whether or not people are likely to be able to achieve a standard of living that they will find acceptable.

The research indicated that it would be a lot harder for people to meet their target replacement rates by their SPA than it would be for them to meet the Minimum Income Standard. The research found that only around 40 per cent of people aged 50 and over have a good chance of meeting their target replacement rate by SPA, even assuming that they continue working and saving at their current (or auto-enrolled) levels up until SPA.

The research found that a further 10 per cent might be able to meet their target replacement rate if they continue working and saving for up to 5 years beyond their SPA. The research also indicates that around 50 per cent of people currently aged 50 and over may need to continue working and saving for 6 or more years after their SPA in order to meet their target replacement rate (from state and private pension income), and that of these, the majority would need to continue working and saving for 11 years or more (Figure 6). Some people may be able to meet their replacement rate using income from other savings and assets.

Figure 5: Around 85 per cent of people aged between 50 and SPA could meet the Minimum Income Standard by their SPA.¹²

Figure 6: Around 40 per cent of people aged between 50 and SPA could meet a target replacement rate by SPA.¹²

For many people, working beyond (and, in some cases, up until) their SPA may not be a possibility if, for example, they have health problems that prevent them, they need to provide care or they are made redundant before SPA.

Therefore, the research does not necessarily imply that these people will be working up until and beyond their SPA. Rather, it implies that many people may find that they have an income in retirement that is below their target replacement rate, and therefore they may experience a drop in their standard of living.

Not all older people have an equal chance of missing (or meeting) their target replacement rate in retirement. The likelihood of being in a position where someone will be able to meet their target replacement rate varies by characteristics.

PEOPLE ON LOWER INCOME MAY BE MORE ABLE TO MEET A TARGET REPLACEMENT RATE OF WORKING-LIFE INCOME BY SPA

Although it may appear to be counter-intuitive, people on lower incomes are actually more likely to meet a target replacement rate than those on higher incomes. That is because an individual's target replacement rate is a function of their working-life income, and those whose incomes were low in working life will have a lower (absolute) income value to meet as their replacement rate, even though the actual percentage of working-life income that they need to achieve may be the same or higher than the percentage required by someone at a higher income level.

Those who have a lower absolute level of target replacement rate income will be much more likely to be able to meet some or all of this income from state pensions and means-tested benefits and/or a small amount of private pension savings. Whereas those with higher incomes during working life might need to save quite a lot in private pensions (or other private savings vehicles) in order to top up their state pension income to the level of their target replacement rate.

Figure 7: Around 70 per cent of people from the poorest-income quartile could meet their target replacement rate by SPA.¹²

The research showed that around 70 per cent of the poorest 25 per cent of people (aged between 50 and SPA) could meet their target replacement rate if they continued to work and save up until their SPA. However, only 30 per cent of those from the richest 25 per cent were able to meet a target replacement rate by SPA (Figure 7).

HOUSEHOLD MAKEUP AND TYPE OF PENSION SAVING ALSO IMPACT THE LIKELIHOOD OF MEETING A TARGET REPLACEMENT RATE

As well as income level having an impact, the household makeup of individuals also impacts the likelihood of people meeting their target replacement rates by SPA. For example, people in couples and single women are more likely to meet their target replacement rates than men living alone. This is because women are more likely to be on a low income during working life, and people in couples are more likely to be able to supplement their pension income with income from the earnings, savings or pensions of their partner.

The type of pension saving people have during working life is also correlated with their likelihood of reaching a target replacement rate by SPA. The research found that around 50 per cent of people aged 50 and over with Defined Benefit pension savings could meet a target replacement rate by SPA, whereas around 30 per cent of those with Defined Contribution (but no Defined Benefit) savings

and 25 per cent of those who were assumed to be auto-enrolled into Defined Contribution saving were able to meet a target replacement rate by SPA.

CONCLUSIONS

The Government has introduced several policies aimed at extending working lives. One of these policies, rises to SPA, have particular potential to impact the incomes of older people both before and after SPA.

However, there are many reasons why people stop working. Some people who leave employment before SPA do so because they feel they have enough income to retire on. Others are compelled to leave work before SPA due to circumstances beyond their control such as health problems, the need to provide care for a family member or because they are made redundant. When people involuntarily leave work before their SPA, they may end up with a lower income in retirement than they expected or wanted.

A rise in SPA could result in higher incomes for those who are able to adjust their work and saving behaviour; however, people who are unable to adjust their work and saving behaviour might experience a reduction in income before and after their SPA as a result.

Recent research by the PPI explored the likelihood that today's older workers might meet different measures of income adequacy by their SPA.

The research indicated that the majority, around 85 per cent, of people aged 50 and over should be able to achieve a minimum acceptable standard of living (using state and private pension income) by their SPA, assuming they continue to work and save at their current levels. However, the research found that only around 40 per cent

of people aged 50 and over have a good chance of meeting a level of income that will allow them to replicate working-life living standards by their SPA.

Consequently, many people may find that they have a potential income at SPA that is far below their working-life income, and therefore they may experience a drop in their standard of living, unless they are able to work and save for longer.

However, for some people, working beyond (and, in some cases, up until) their SPA may not be a possibility if, for example, they have health problems that prevent them, they need to provide care or they are made redundant before SPA.

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