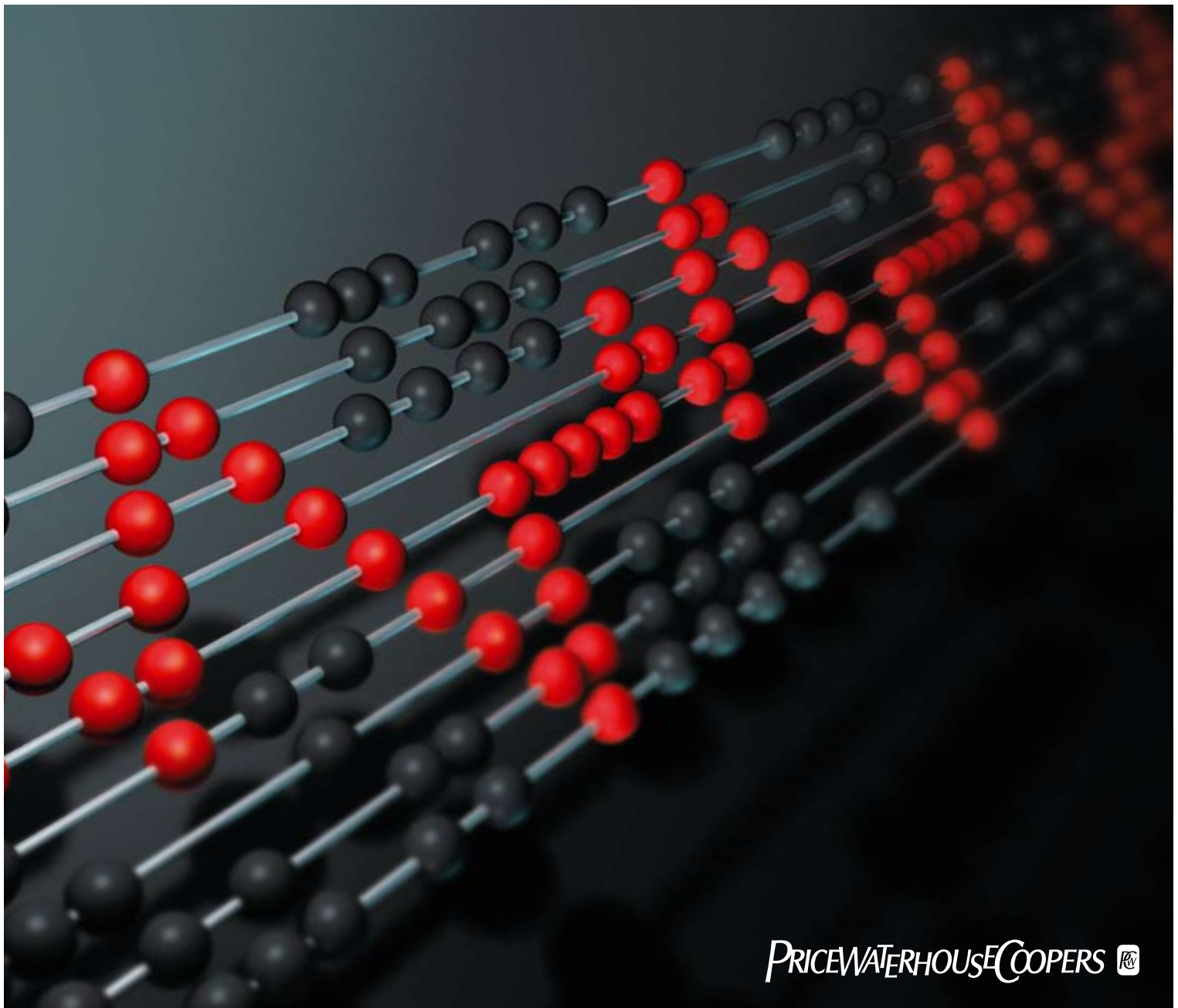


Working longer, living better: A Fiscal and Social Imperative

a PwC Public Sector Research Centre publication



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Executive Summary

This generation is enjoying longer lives and longer periods of retirement than any of its predecessors. This is a result of improved standards of living, medical advances and other factors and is clearly very good news in many ways. But these big changes also create a number of significant challenges, especially to the government's fiscal position through higher costs of state pensions, health and long-term care. This challenge is compounded in the UK (and other advanced economies) by the retirement of the baby-boom generation during the next two decades.

Given that public debt is already heading towards very high levels due to the effects of the recession, and that demographic changes are long-term in nature, the only way to deal with this challenge is through some combination of higher tax revenue and lower public spending¹. Extending working lives is potentially a very attractive way to deliver both of these: if people work for longer, then the government's coffers could benefit from more revenue and less spending on pensioner benefits.

There is little doubt that average retirement ages could be higher in the UK: they are currently below what they were three decades ago when life expectancy was significantly lower. The Pensions Commission² concluded that working longer is an essential part of the UK's response to the demographic challenge. It argued that, in combination with increased private retirement saving and a greater allocation of tax and National Insurance Contributions (NICs) to state pensions, extending working lives will be necessary to avoid pensioners becoming poorer.

A higher State Pension Age (SPA) is part of the solution and this has been accepted by the government³, which subsequently legislated to increase SPA gradually to 68 by 2046. This will directly reduce net pension spending. To the extent that a higher SPA stimulates working, it will also boost tax revenues.

The question now is whether there is a case beyond this, by raising SPA further and faster and through a wider programme of measures to support extended working lives.

As well as fiscal benefits, extending working lives may have important wider benefits for individuals and society. For example, there is evidence that work is good for people's health and if this holds among older workers, then individuals, their families and the National Health Service could benefit. Working longer provides the opportunity for people to increase their retirement income substantially, particularly if they save in increasingly prevalent defined contribution savings vehicles. Older people also represent an important talent pool for employers. Of course not everyone can work longer; some people do suffer poor health at younger ages and this is significantly more common among lower socio-economic groups. Others have caring responsibilities. However, there is good evidence that many individuals are increasingly keen to work longer.

Increasing state pension age is potentially a powerful lever to encourage people to work until they are older. However, it is just one of a range of possible interventions and there are considerable uncertainties surrounding the employment response of raising SPA. However our base case estimate is that a one year rise in SPA to 67 in 2030 (compared to 66 under current plans for that year) would have a positive net fiscal impact of around 0.35% of GDP, which is equivalent to around £5 billion at 2010/11 GDP values.

Raising the SPA to 70 by 2046 (rather than 68 as under current plans) would have a net fiscal benefit of around 0.6% of GDP on our estimates, or around £9 billion at 2010/11 GDP values. The estimated fiscal benefit for this change is less than twice the benefit from the earlier one year SPA rise because there is a smaller cohort of older people affected in 2046 than in 2030, which is just after the last of the baby boom generation reaches SPA.

¹ See 'Dealing with (even more) Debt', PricewaterhouseCoopers Public Sector Research Centre, October 2009 (available to download from www.psrc-pwc.com).

² 'A New Pension Settlement for the Twenty-First Century', the second report of the Pensions Commission, November 2005.

³ Pensions Act, HM Government – July 2007.

While this net fiscal benefit would only meet a relatively modest part of the overall fiscal cost of an ageing population, which is estimated to rise to over 5% of GDP per annum by 2060 according to HM Treasury, the impact is nonetheless material. For example, the estimated 0.35% of GDP net fiscal benefit from a one year SPA rise in 2030 is broadly equivalent to the revenue gain from a rise in 2030 of around 1p on the basic rate of income tax, or a 1 percentage point rise in the standard VAT rate.

Raising SPA on its own will, however, not be enough. A wider programme of change is needed which embraces new approaches to the delivery of health, social care and adult skills. We will also need a revolution in the attitudes of both employers and employees to accommodate working longer. In addition, there are major implications for the products provided by the financial services sector to support more flexible working arrangements.

The transition to an economy where working lives take many different shapes and forms, and are on average longer, will take time and presents challenges for:

- **Government**, which needs to:
 - implement an increase in the SPA to 70 by 2046;
 - signal a change in attitudes and behaviours among individuals and employers by abolishing the Default Retirement Age; and
 - re-shape public services and policies to promote extending working lives and to meet the needs of older workers, including policies supplementing adult skills, tackling health inequalities, providing care and creating the right incentives and safety nets with non-pensioner benefits and employment support.

- **Employers** in all sectors who need to develop solutions to overcome barriers to flexible and later working that can benefit both companies and their employees including the potential changing nature of the job role and career trends as the employee grows older.
- **Employee representative bodies**, who need to provide advice and guidance to their members on the major changes they face, whilst working with employers to shape and develop appropriate arrangements to facilitate extended working lives.
- **Financial services sector** which needs to design more flexible savings and retirement income products to support longer working. A more sophisticated decumulation approach will be required – potentially in conjunction with the employee continuing to work i.e. still accumulating. This presents a challenge to FS providers especially as retirees start to shop around even more for products or approaches, rather than taking the default position of decumulating with the existing pension provider.

We will continue the debate on this critical issue for the UK in our future research programme.

Introduction

The UK public finances have deteriorated rapidly over the past two years due to the effects of the global financial crisis in eroding tax revenues and boosting welfare spending. Coming on top of rapid growth in public spending for much of the past decade, this is set to push the budget deficit up to a post-war record of around 12% of GDP in 2009/10, with little improvement expected in 2010/11 given expected modest economic growth and a broadly neutral planned fiscal stance in that year.

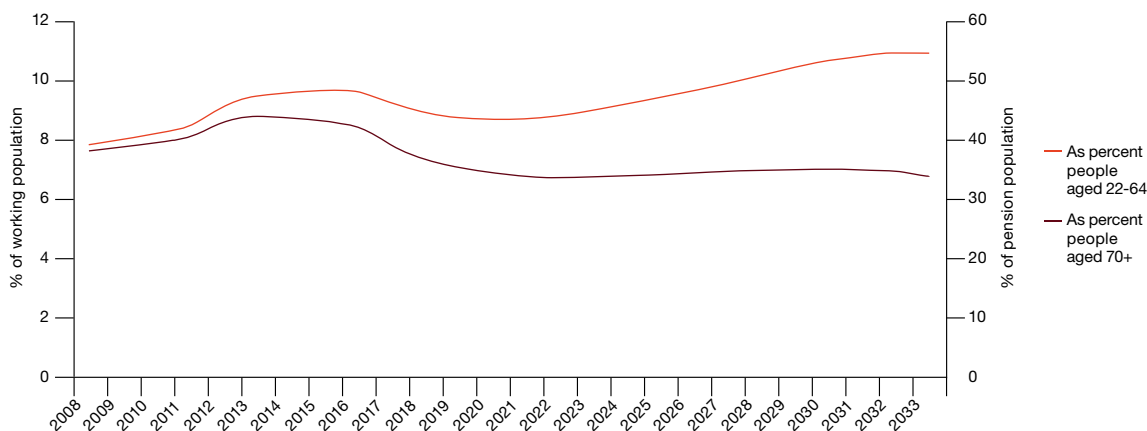
The government has already announced a programme of tax rises and spending restraint with a view to halving the deficit as a share of GDP by 2013/14 and halting the rise in the public sector net debt to GDP at a peak level of around 80% in 2014/15. Other commentators, including the IMF, OECD, Bank of England, CBI and PricewaterhouseCoopers (PwC)⁴ have argued that the fiscal tightening needs to proceed at a more rapid pace after the recession is over, although debate remains as to the optimal composition (tax rises and spending cuts) and timing of this action.

However, as discussed further below, an ageing population potentially poses an even greater challenge to fiscal sustainability (both for the UK and most other advanced economies) in the longer term. Given that public debt is already very high and that demographic changes are long-term, the only way to deal with this challenge is through some combination of higher taxes and public spending cuts. An attractive option to support both of these is raising average retirement ages, which would both reduce state pension spending and boost tax revenues as people work for longer.

The next decade will see an increase in the proportion of the population at retirement age (Figure 1). Now is the time to increase average retirement ages in order to achieve the biggest impact.

The Pensions Commission pointed out that in the face of the UK's demographic challenge the UK faces a choice: work longer; contribute more to private pensions; pay more through tax or National Insurance Contributions towards state retirement funding; or accept poorer pensioners.

Figure 1: People aged 65-69 as a proportion of the wider population



Source: PwC analysis based on 2008 population projections by the Office for National Statistics

⁴ In particular, our October 2009 report 'Dealing with (even more) debt' argued for a fiscal tightening of the order of 1.8% of GDP by 2013/14 (around £26 billion at 2009/10 GDP values) over and above plans in the Budget. We will update these estimates in our March 2010 UK Economic Outlook report.

⁵ The male state pension age is already 65 and the female state pension age will rise gradually from 60 to 65 between 2010 and 2020.

⁶ This change was announced by George Osborne at the Conservative Party conference in October 2009 and incorporated into the Conservative Party's policy statement on pensions and older people viewable here: http://www.conservatives.com/Policy/Where_we_stand/Pensions_and_Older_People.aspx (accessed 27 January 2010)

The Commission concluded that a mix of the first three options was desirable and therefore concluded that extending working lives should form part of the UK's response.

In response to the recommendations of the Pensions Commission, the government subsequently legislated for the state pension age (SPA) to rise from 65 in 2020⁵ to 66 by 2026, 67 by 2036 and 68 by 2046.

The question now is whether there is a case to go further and faster than current plans in raising SPA as part of a wider programme of measures to extend working life. The Conservative Party has suggested raising SPA from 65 to 66 somewhat earlier than current plans⁶, but this will not save money in the longer term. The Liberal Democrats may need to address the SPA issue to help pay for their other state pension proposals such as a Citizen's Pension.

Alternative pension reform proposals

Conservative proposals:

- State Pension Age (SPA) to rise by one year from 65 to 66 for men and women
- This increase is to start no earlier than 2016 for men and 2020 for women
- SPA then to increase to 68 in line with Pensions Commission recommendations
- Propose to have a second Pensions Commission to examine whether further changes to the SPA should be made, to consider both the speed and scale of increases
- Also intend to restore link to earnings at some point in the next parliament

Liberal Democrat proposals:

- Immediately restore the link between the State Pension and earnings
- Within two parliaments replace existing pension provisions with a "Citizen's Pension" to be paid to all UK citizens satisfying residency criteria

Report structure

We explore these issues further in this paper, which is structured as follows:

- **Section 2** describes the background to the study in terms of projected future demographic trends and implications for the public finances generally, and state pensions spending in particular, over the next 40-50 years;
- **Section 3** sets out some of the other opportunities and challenges presented by extending working lives;
- **Section 4** describes our approach to modelling the impacts on the public finances of a higher SPA – as one of the key options for addressing the fiscal costs of ageing – and presents the results of this modelling work, including a range of sensitivity tests for alternative assumptions; and
- **Section 5** sets out an agenda for action which we will be addressing as part of our Forward Thinking research programme.

Further details of our modelling methodology and key assumptions are contained in the Appendix.

The UK's ageing population and its implications for the public finances

Why is the UK population ageing?

The UK population is ageing for two main reasons:

- a one-off 'cohort effect' due to the retirement of the baby boomer generation born between 1945 and 1965 over the next two decades; and
- an ongoing 'longevity effect' due to people of all cohorts tending to live longer.

The baby boomer effect has boosted the UK working age population for the last three decades or so, thus boosting economic growth and making it relatively easy to pay for the smaller cohorts of pensioners from earlier generations. But this 'demographic sweet spot' is coming to an end shortly in the UK, leading to a marked fall in the projected ratio of workers to pensioners after around 2018, as shown in Figure 2.

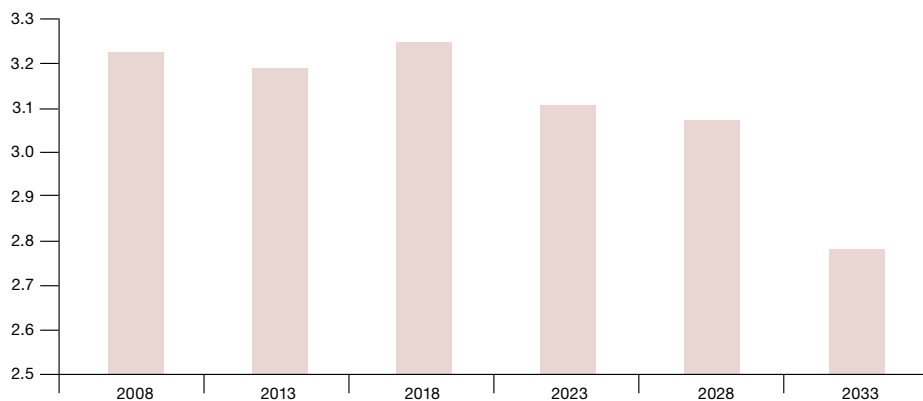
This declining 'old age support ratio' occurs despite the planned phased increase in male and female SPA to 68 by 2046. It also reflects the longevity effect as all generations tend to live longer. For example:

- between 1991 and 2008, life expectancy at age 65 increased by 5 years for men and 4.2 years for women in the UK as a whole (see Figure 3); and
- men at age 65 can now expect to live for another 21 years and women for another 23.4 years (the Government Actuary's Department central cohort projections), which poses a substantial retirement funding challenge for both state and private pensions.

Furthermore, as illustrated in Figure 4, healthy life expectancy at age 65 has also increased over time for both men and women, although more slowly than total life expectancy at that age. This indicates some ability for people to work longer, given that poor health and disability are the most significant factors pushing people in their 50s and 60s out of work.

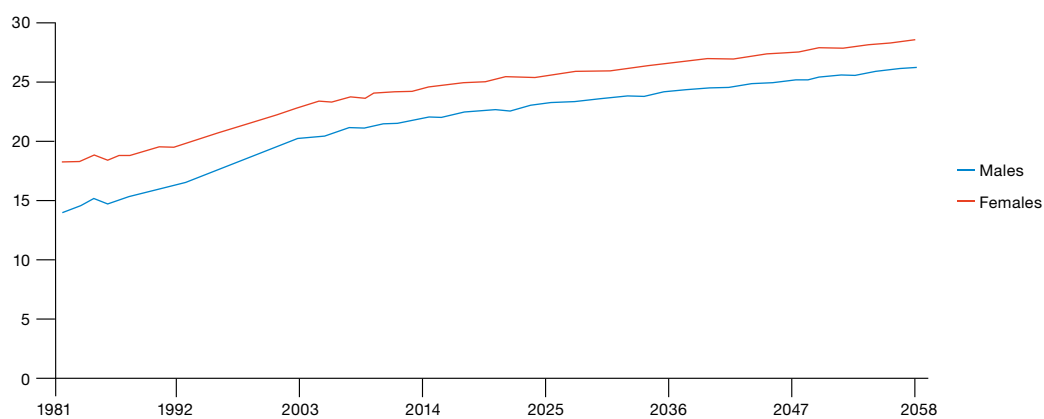
Figure 2: Trends in UK old age support ratio

Ratio of working age population to pensioners above SPA



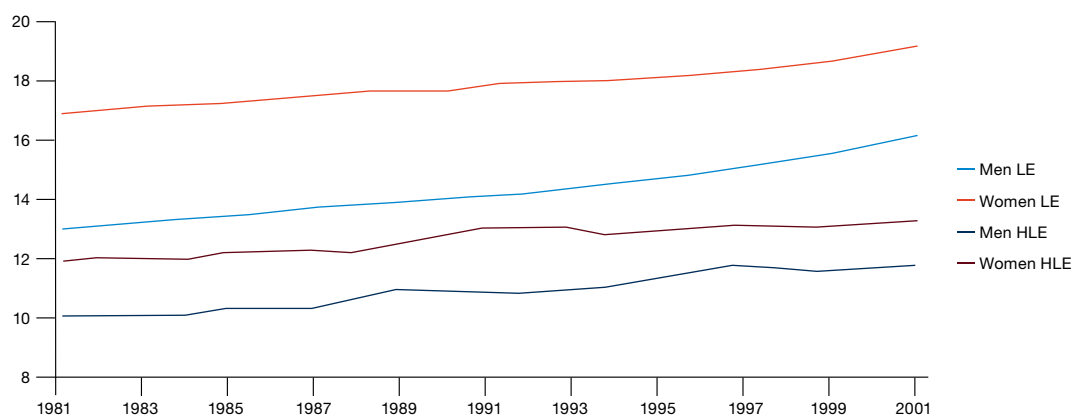
Source: ONS principal population projections for the UK (published on 21 October 2009). This projection takes into account the changes in SPA contained in the Pensions Act 2007.

Figure 3: Trends in male and female cohort life expectancy at age 65



Source: ONS

Figure 4: Total and healthy life expectancy trends at age 65



Source: ONS

At the same time, it should also be recognised that longevity varies significantly by social class (as illustrated in [Figure 5](#)). People who are less well off, in lower socio-economic groups and living in less affluent areas have lower life expectancy on average and these differences have persisted over time. This means that lower income groups may have less ability or desire to work longer. They may also face increased financial pressures to do so if the state pension age is increased, given that lower income groups rely more heavily on state pensions than better-off groups who tend to have larger private pensions. As a result, even if raising SPA makes sense from a population-wide perspective, care needs to be taken to ensure that this does not have an undue regressive effect on the least well-off older people.

Trends in average retirement ages

Average retirement ages fell substantially for men and women from the 1950s to the mid-1990s (see [Figure 6](#)) despite increased longevity and unchanged state pension ages. Since the mid-1990s, however, this trend seems to have been reversed, at least until the current recession started (it remains to be seen whether the recession has any impact on this trend). Why this has happened is not entirely clear, although it seems plausible that:

- the earlier decline in average retirement ages was driven in part by rising defined benefit pensions for better-off workers combined with readily available incapacity benefit for lower income workers, many of whom may have lost their jobs in the recessions of the mid-1970s, early 1980s and early 1990s and then found it difficult to get back into the labour force; a preference for leisure over work as incomes rise may also have played a part in this earlier retirement trend up to the mid-1990s; and

- the more recent rise in participation rates for older workers may have reflected relatively benign economic conditions between the mid-1990s and 2007, combined with financial pressure from the closure of many defined benefit pension (DB) schemes in the private sector and disappointing returns on many defined contribution (DC) schemes due to falling annuity rates and the stock market crash of 2000-2 after the bursting of the dot.com bubble; declines in the current and expected future value of state pension benefits may also have encouraged lower income workers in particular to work for longer so long as they remained healthy and jobs remained available.

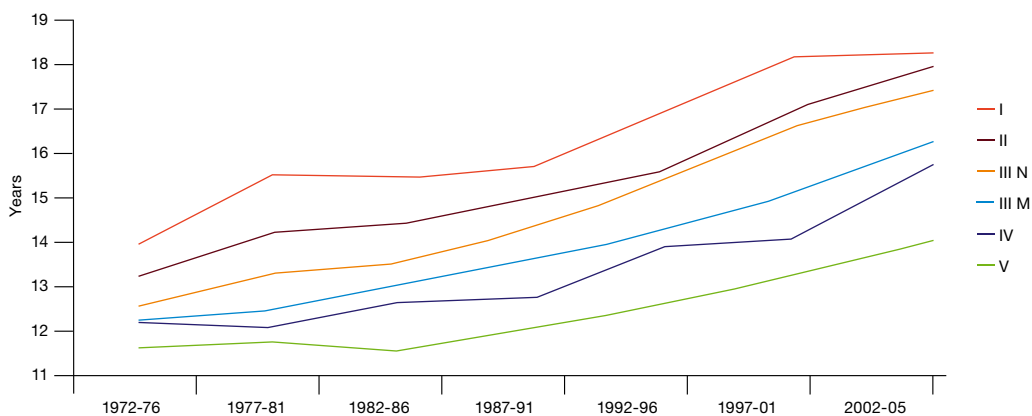
The current recession has led to some rise in unemployment rates among older workers, although it is too soon to determine if this will have significant longer-term effects in the way that past recessions did, as many older workers find it difficult to get back into the labour force once they have lost their jobs. More likely, perhaps, this will prove to be a short-term cyclical dip in the underlying upward trend in average retirement ages for both men and women (perhaps particularly the latter, given the planned rise in female SPA from 60 to 65 between 2010 and 2020).

Default Retirement Age (DRA)

The Employment Equality (Age) Regulations, which came into force in 2006, provide for a Default Retirement Age of 65 that employers can rely on if they wish. The regulations make earlier retirement ages unlawful unless employers can objectively justify them. The regulations also introduced a new statutory right for individuals to request working past their employers' retirement age – requests which the employer must consider. The Government has announced recently that it is bringing forward a planned review of DRA to this year.

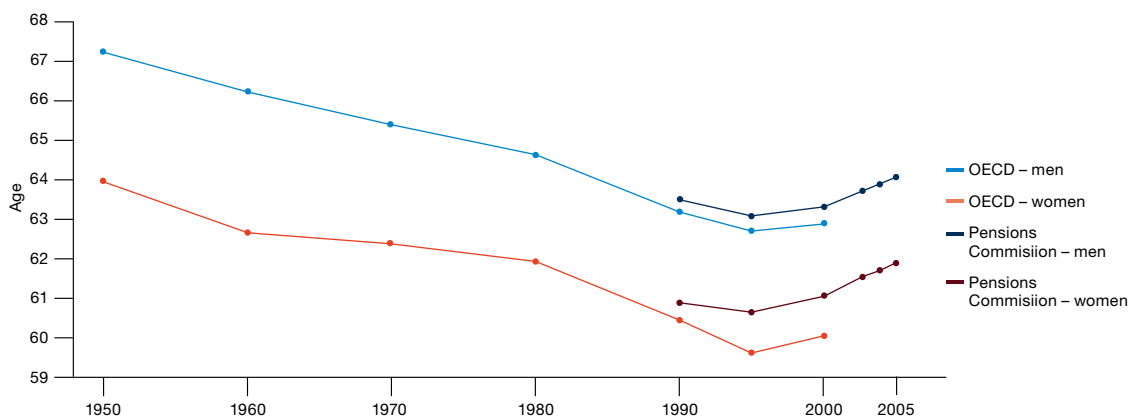
Figure 5: Variations in longevity by social class

Period life expectancy for men at 65: by Social Class group, 1972 to 2005¹
England and Wales



¹ The Longitudinal Study includes communal establishments in its sample.
Source: Longitudinal Study, Office for National Statistics

Figure 6: Trends in average retirement ages



Sources: Blondal and Scarpetta (1999), The Retirement Decision in OECD Countries.
OECD Economic Forum (2004). Working Papers No. 202.
World Economic Forum (2004), living Happily Ever After: The Economic Implications of Ageing Societies.
Pension Commission estimates.

As the population ages, so demand for health and long-term care services will tend to increase as will spending on state pensions. The latest Treasury projections⁷, as summarised in [Table 1](#), imply an increase in age-related public spending of just over 5% of GDP over the next 50 years based on current or firmly planned policies (including the rise in the SPA to 68 by 2046 and indexation of the basic state pension to earnings by the end of the next Parliament).

We can see that the largest increases relate to health spending (+2.6% of GDP), state pensions (+1.9% of GDP) and long-term care (+1% of GDP). Despite the public attention often paid to this issue, there is only a slight upward trend in projected spending on occupational public service pensions in the next decade and even a slight fall in the long term. Education spending also remains broadly constant as a share of GDP.

In fact, these Treasury estimates for upward pressures on age-related spending could even be under-estimates since they do not take account of the fact that, as people get richer and medical technology produces often expensive new treatments, demand for health care in particular may tend to grow faster than GDP even in the absence of an ageing population. In any event, however, it is clear that an ageing population does pose a fiscal challenge.

Focusing specifically on state pensions, the Department of Work and Pensions (DWP) had earlier produced more detailed projections of spending on these benefits up to around 2050, as shown in [Table 2](#). Although these are not fully consistent with the more recent Treasury projection in [Table 1](#), they do also show a clear upward trend in state pension spending over the next 40 years based on current or firmly planned policy settings.

Table 1: Age-related public spending projections as a % of GDP

	2009 – 2010	2019 – 2020	2029-2030	2039 – 2040	2049 – 2050	2059 – 2060
Health spending	8.0	8.5	9.3	10.0	10.4	10.6
Long-term care spending	1.3	1.4	1.6	1.9	2.1	2.3
PAYG public sector pension spending	1.8	1.9	1.9	1.8	1.6	1.6
State pensions	5.5	5.3	5.9	6.5	6.5	7.4
Education and skills	6.5	6.4	6.5	6.4	6.3	6.4
Total	23.1	23.5	25.2	26.6	26.9	28.3

Source: HM Treasury (December 2009) long term public finance report) and PwC analysis based on case using ONS principal population projections

⁷ These are based on data read off charts from the Treasury's December 2009 'Long-term public finance report' for the case based on the principal population projections of the ONS. Unfortunately, in contrast to previous reports in this series, the Treasury did not publish data in tabular form in this report, so the figures in Table 1 are only approximate.

One important point to note here is that Basic State Pension (BSP) is the dominant element in total state pension spending given the recent policy decision to link BSP to earnings rather than prices in the long run. By contrast, means-tested pension credit is projected now to be much less significant in the long run than was apparent from projections made in the period when BSP was planned to be indexed only to prices. This helps to justify the approach we have adopted to state pensions modelling in this report, which is to focus on the effect of SPA changes on total BSP spending and then gross this up using ratios based on the data in [Table 2](#) to get estimates of changes in total state pension spending when SPA changes (see Appendix for more details).

Table 2: Pensioner benefit expenditure projections as a % of GDP

	2006 – 2007	2010 – 2011	2015- 2016	2020 – 2021	2025 – 2026	2030 – 2031	2035 – 2036	2040 – 2041	2045 – 2046	2050 – 2051
Basic State Pension	3.5	3.4	3.5	3.6	3.9	4.2	4.4	4.5	4.3	4.3
S2P/SERPS	0.7	0.8	0.9	1.0	1.0	1.1	1.2	1.3	1.4	1.5
Pension Credit	0.5	0.5	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.1
Other Pension Benefits*	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total Pensions	4.9	5.0	5.0	5.1	5.3	5.7	5.9	6.1	6.0	6.1

Source: Department of Work and Pensions (May 2008)

* Other pension benefits comprise Winter Fuel Payments, over 75s TV Licences and Christmas Bonus
Note: definitions do not exactly match those used in Table 1 for state pension spending.

How can the fiscal costs of ageing be met?

Public sector net debt is set to rise to around 80% of GDP by 2015 under current Treasury plans. Without the fiscal costs of ageing, this debt ratio would tend to decline gradually in the long run, as shown in Figure 7. But once the costs of ageing are taken into account, based on the Treasury projections of age-related spending shown in Table 1 above, then the debt ratio would remain much higher and would start to rise again in the long run.

Such a public debt ratio would leave the UK very exposed to adverse future shocks as well as leaving a permanently higher debt interest burden on future generations. To the extent that this is not considered acceptable, the solution would need to be some combination of:

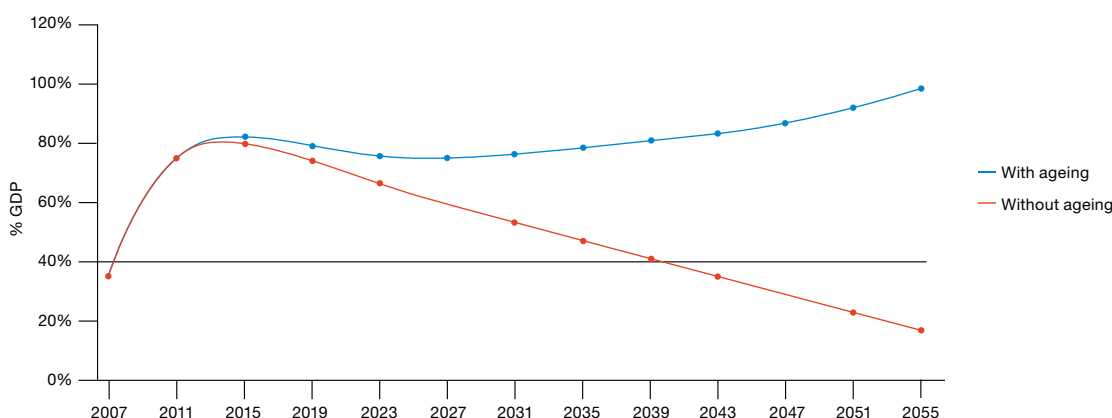
- higher taxes, either now or in the future (but with an increasing cost the longer the delay);
- lower non-age-related spending;

- reducing service levels in health and long-term care;
- reducing levels of state pensions and occupational public service pensions; and
- increasing the state pension age (over and above what is currently planned).

In practice, all of these potential solutions may be adopted to some degree, including allowing the public sector debt to GDP ratio to remain somewhat higher in the long run than the 40% of GDP target level set before the global financial crisis.

However, there appears to be a relatively strong case for including a higher than planned SPA in this package of measures given that this would both boost tax revenues as people work for longer and reduce state pension spending. It would also be consistent with the increase in healthy life expectancy shown in Figure 4, although an adequate safety net would be needed for those not able to continue to work beyond the existing SPA.

Figure 7: Alternative scenarios for public sector net debt using Treasury projections with and without costs of ageing



Source: PwC projections using Treasury data from December 2009 report

As shown in Table 3, some other OECD countries such as Germany and Norway have already raised their state pension ages to 67, while the Netherlands and the US have announced plans to do so by 2025 and 2027 respectively, rather earlier than the planned date of 2036 for the UK state pension age to rise to 67. Admittedly no other country has yet announced plans to increase its state pension age to 68, as the UK has said it will do by 2046, but it seems likely that other countries will find themselves under increasing fiscal pressure to announce such longer term rises in SPA in due course.

We have therefore focused on raising SPA in later sections of this report as one of the key policy options for addressing the fiscal costs of an ageing population and also the one that is most readily amenable to quantitative financial analysis. However, in the next section, we consider the wider implications of later working.

Table 3: State pension ages in selected OECD countries and BRICs

Country	Current state pension age – men	Current state pension age – women	Future state pension age – men	Future state pension age – women	Target year for future state pension age
Australia	65	63	65	65	2014
Brazil*	65	60	65	60	N/A
Canada	65	65	65	65	N/A
China*	60	60	60	60	N/A
France	60	60	60	60	N/A
Germany	67	67	67	67	N/A
India*	58	58	58	58	N/A
Italy	65	60	65	60	N/A
Japan	65	65	65	65	N/A
Korea	60	60	65	65	2033
Netherlands	65	65	67	67	2025
New Zealand	65	65	65	65	N/A
Norway	67	67	67	67	N/A
Russia*	60	55	60	55	N/A
United Kingdom	65	60	68	68	2046
United States	66	66	67	67	2027

Sources: OECD Pensions at a Glance 2009: Retirement-Income systems in OECD countries. Online Country profiles accessed at www.oecd.org 1 February 2010

* Where indicated, data taken from AARP Aging Everywhere interactive world map available here: www.aarpinternational.org accessed 1 February 2010

Extending working lives: opportunities and challenges

Working longer affects many aspects of people's lives, and is affected by many factors, including, but not limited to, SPA. This section starts by setting out some of the opportunities arising from extending working lives in relation to financial wealth in retirement, health, caring and employment before turning to the challenges for employees and employers.

Financial considerations

As well as providing a direct boost to income, working longer can provide the opportunity to generate a dramatic impact on future retirement income, as illustrated in [Table 4](#). This is a potentially crucial benefit of extending working lives, given well documented inadequacies in many people's retirement saving.

Most people have some assets just before SPA, and so can finance earlier retirement. However, extending working lives can have a dramatic impact on retirement income, especially for those with DC pensions for three complementary reasons:

- pension pots accrue for longer;
- longer periods for people to contribute to their pensions; and
- higher annuity rates for older retirees.

Recent evidence from the 2006 English Longitudinal Survey of Ageing (ELSA) suggests that people with DC pensions are indeed working longer.

For those with DB pensions, the effect is less dramatic but still significant, so the long-term shift from DB to DC means that more people will have a bigger financial incentive to work longer. The shift from DB to DC potentially offers more flexibility to savers, with increased portability of pensions and so more opportunity to support flexible working arrangements. However, financial services products for savings and decumulation are generally fairly standard. Historically decumulation products have tended to be of simple design, focused upon retiring on a particular date. Some allow draw-down and partial drawing of pensions but, in general, there is a need for more innovative products to support and complement extending working lives.

Working can be good for health and wellbeing

Longevity has been increasing rapidly (see [Figure 3](#)). For example from 1991-93 to 2005-07 life expectancy in the UK at 65 increased by three years for men and two years for women. Whilst average longevity varies across different socio-economic groups, average healthy life expectancy has also been rising although not as much as total life expectancy, as discussed in [Section 2](#).

Table 4: Pension pot, annuity rate and pension income at different ages (real terms)

Age	Pension Pot (£000s)	Annuity Rate	Private Pension Income (£ per year)
60	176,000	3.9%	6,900
65	221,000	4.7%	10,400
70	274,000	5.8%	15,900

Source: PwC analysis based on Pensions Commission method.


Note: Assumes pension contributions of 8% of earnings, rate of return of 2.5% real, annuity rates from Annuity Bureau on 13 January 2008 for man, single life RPI escalation extrapolated.

Inequalities in health and longevity create a substantial social policy challenge for those who want to encourage later working. Those in the lowest socio-economic groups tend, on average, to have the worst life expectancy and health life expectancy. This may act as a constraint on their ability to work longer.

However, working longer may in itself be part of the solution, since working longer may be good for their health and for inclusion. There is some good evidence that work is, at least on average, good for health and wellbeing.



Recent evidence suggests that work can be good for health, reversing the harmful effects of long-term unemployment and prolonged sickness absence. Yet much of the current approach to the treatment of people of working age, including the sickness certification process, reflects an assumption that illness is incompatible with being in work.

Dame Carol Black, National Director for Health and Work, Department of Health: 
'Working for a healthier tomorrow', 17 March 2008

But there is a lack of evidence on whether this positive relationship between health and work holds amongst older people, and we believe there is a need to investigate this area further.

There is some evidence from Scandinavia which has suggested a weaker link between work and health/wellbeing for this age group. The health effects of later retirement appear to depend on the nature of the job (e.g. does it involve physical labour, how satisfying is it for the workers, does it provide mental stimulation etc) with, on average, lower socio-economic groups potentially benefitting less from continued working than those in higher socio-economic groups.⁸

The recently released Marmot report goes further and states "With the levels of disability shown, more than three-quarters of the population do not have disability-free life expectancy as far as the age of 68. If society wishes to have a healthy population, working until 68 years, it is essential to take action to both raise the general level of health and flatten the social gradient."

Getting to the bottom of this issue is crucial. If work is indeed good for the health of older workers, then extending working lives may be part of a necessary programme of changes needed to narrow health and life expectancy inequalities. If this link does not hold so thoroughly for lower socio-economic groups, then we believe more effort will need to go into addressing these inequalities partly in order to facilitate longer working.

Caring

Older people appear to be taking more responsibilities for caring, for example for grandchildren, parents, or even both. This is driven by demographic change and changing family structure and is clearly very valuable activity, both socially and economically.

There are some older workers who will not be able to work longer, because they need to care for others. However, we suspect that there are many more who could work longer if work was flexible and, for example, offered them good part time work. We would like to see more research conducted on the need for flexible working among older workers and ways to facilitate it.

We also suggest that the government and others should take full account of the potential impact on employment of older workers when considering child care and social care. If the provision of extra care would enable more older people to work longer, then there may be a significant benefit to the UK.

⁸ Fair Society, Healthy Lives', Marmot Review Final Report, February 2010

Employment concerns are misplaced

There is evidence that some older workers are concerned that by working longer, they prevent their younger counterparts from finding work.

We acknowledge that there may be certain, relatively unusual, circumstances in which this could be a concern, e.g. during the depths of a recession when the economy is severely 'demand constrained'. However, in general this view, however well intentioned, is misleading. In almost all circumstances, an increased supply of labour will lead employers to identify opportunities to use that talent and they will invest and hire new workers to take advantage of the opportunity⁹.

In summary, a growth in employment of older workers is most likely to lead to an increase in the size of the economy, not a reduction in employment of other groups. Our view is that the effect of more older people working could be significant and beneficial to the economy as a whole. This is set out in more detail in the next section, where we examine the macroeconomic impact of increasing SPA.

Employee attitudes

DWP research¹⁰ with people aged 50–69 has already highlighted that the attitudes of individuals and employers affect the extension of working life and identified some barriers to working longer.

For example, as well as the view already noted that older people who remain in work prevent younger people from getting jobs, there is evidence that suggests people tend to underestimate their longevity, which could partly explain their inadequate preparation for retirement.

In practice, it is likely that attitudes and behaviour vary substantially (Box 1). For example, evidence suggests that the least and the most well off may retire earliest, but for very different reasons. The MORI Survey¹¹ found that the 'middle classes' see more benefits to working longer than lower socio-economic groups, in terms of money, mental stimulation and use to society. The self-employed appear to work longer whilst particular occupations have different experiences e.g. the "retirement bulge" among teachers.

Box 1: The challenges facing DWP in the future: Deliberative research with the UK public

- People classed as middle aged thought that there would be inadequate funds to claim State Pension;
- Initially respondents only saw a risk to NHS from an aging population;
- 69% strongly believed that people should be allowed to work beyond SPA if they want to;
- DWP should help to facilitate this through provision of training, support, job help etc;
- Putting up SPA, or restricting entitlements was seen as the state renegeing on its promises to people, the ability to claim a pension was seen as a RIGHT; and
- There was support for the state playing a role in encouraging people to be responsible for their own provision.

Source: Ipsos MORI/DWP, 2007

⁹ For a fuller discussion of this point see J. de Koning, R. Layard, S. Nickell and N. Westergaard-Nielsen, „Policies for Full Employment”, October 2002. Available to download from <http://publishing.eur.nlr.ir/repub/asset/2004/Policies%20for%20full%20employment.pdf>

¹⁰ 'The challenges facing DWP in the future: Deliberative research with the public' Department for Work and Pensions, December 2007

¹¹ 'Three score years and ... when?' Ipsos MORI, September 2007

A key policy issue is the need for the education and training system to step in and provide opportunities for up- and re-skilling, targeted specifically at the older worker, to enable continued participation in the labour market. Otherwise, there is a risk, particularly where people have worked most of their lives in manual occupations, that this leaves them less physically able to continue with their jobs later in life, but also less flexible in switching to alternative ones.

There is increasingly evidence that individuals would like to be able to work. A recent survey published by the Equalities and Human Rights Commission suggested that the majority of workers over 50 (62% of women and 59% of men)¹² want to work beyond the state pension age. This survey also indicated that 62% of people aged between 50 and 75 feel as strong mentally and physically at work as they did when in their 20s and 30s.

A 2002 survey found that 50% of men and 40% of women who retire before State Pension age say they were 'forced' out of work. There is also evidence that people are keen on more flexible working. A 2004 survey found that half of workers aged 50 to 69 would consider working part-time or occasional jobs after they retire, but only 10% would consider full-time work¹³.

Employer views

There is a widely held perception that employers view older workers less favourably than other age groups (SEPPP, 2006):

- 49% of employers had a maximum recruitment age (in 2006);
- 8% of firms think certain ages (under 22 and over 60) count against applicants; and
- 24% of private sector firms think some jobs are more suitable for certain ages.

The views of some employers compound this perception according to comments recorded in recent DWP research, although this is not universally true as shown by the comments in [Box 2](#).

Box 2:

"We have actively targeted young people to inject new blood"

"[Young people]...have got a darn sight more drive and hunger than someone of 55"

"The only criteria we've used when interviewing is experience and knowledge"

"The ability to train [young] people to a level of experience that is equal to the older people that work in there is extremely difficult"

Source: 'Employer responses to an ageing workforce: a qualitative survey', DWP, 2007

¹² Results taken from 'Working Better: The over 50s, the new work generation' published by the Equalities and Human Rights Commission in January 2010. Available from www.equalityhumanrights.com/workingbetter

¹³ DWP 'Building a society for all ages'

In our work, we have found that businesses generally perceive two broad types of barrier to employing older workers:

- **Attitudes to older workers:** there are various (mis) perceptions about older workers including that they are less productive, less willing to change/re-skill, more prone to accidents/sickness and more likely to want part-time work (in industries where full-time employment tends to be the norm); and
- **Working practices:** the processes and systems for recruiting, developing and retaining staff can act as a barrier to older workers. For instance, recruitment practices may not be age-neutral in practice even if they appear to be so in legal

terms; jobs may be typically designed with full-time rather than part-time working in mind; and reward is often focused on the needs of younger workers (with priority given to wages rather than wider benefits, including pensions). There is also often a lack of communication, support and advice on the options for employees to work flexibly in old age.

However there are examples of employers with explicitly positive attitudes to extending the working lives of their employees and evidence that they get significant benefit and can overcome the barriers. **Box 3** sets out some examples of good practice.

Box 3: Some employer examples

1.2 South Downs NHS Health Trust

South Downs NHS Health Trust provides services to people living mainly in Brighton and Hove. It currently employs 2,061 staff ranging in age from 16 to 74. The organisation is committed to promoting equality and diversity and tackling age-related discrimination. It has introduced and promoted a range of options to attract and retain older workers, including the removal of the mandatory retirement age and the introduction of more flexible retirement options.

1.3 Co-operative Group

As well as being the UK's largest co-op food retailer, the Co-operative Group is also the UK's largest independent travel retailer, a funeral director, a pharmacist and a bank. The Co-operative Group has removed their contractual retirement age altogether. Employees who choose to continue working are able to continue in the Group's pension scheme, and it is also possible to draw a pension whilst continuing to work for the Group.

When it comes to recruitment, the Group has re-designed their job application forms so that date of birth is not visible to recruitment managers, and 'age-proofed' the way it assesses pay by focusing on the performance and contribution of staff, rather than how old they are.

1.4 Aberdeen City Council

Aberdeen Council's 'age-neutral' policy was introduced to help the organisation prepare for demographic change and meet current and future business needs. The Council removed its previous age limit on recruitment, which means that individuals aged 65 and over are eligible to apply for its vacancies. Employees approaching the usual retirement age have the option of extending their employment. This has already been taken up by a number of employees across a diverse range of occupations. The Council is also finding that their flexible approach to retirement is useful in recruiting new staff. As well as widening the pool of potential job applicants and retaining highly skilled and experienced staff, the organisation also believes that its age-neutral policy creates a positive image of the organisation.

Source: DWP (www.dwp.gov.uk/age-positive/)

There is no doubt that older workers represent a big pool of skills and experience and employers need to make changes to their working practices to take full advantage of the increasing pool of older workers, including the following areas for action:

- **Focus on age-neutral recruitment:** emphasise capability, not age, in the recruitment process by removing age-related information from job advertisements and the subsequent sifting and interviewing process and actively highlight older workers as a potentially more stable element of the workforce;
- **Test the case for flexible working:** challenge each new vacancy to test if there are feasible alternatives to full-time working e.g. flexi-time, part-time, job share and flexible rotas;
- **Identify investments to extend working lives:** where appropriate, use new equipment e.g. lifting machinery, to assist older workers to retain their jobs;
- **Maximise the value of experience:** make greater use of older workers to pass on their knowledge and experience and recognise that investments in training older workers may result in them staying with companies longer than the equivalent younger workers and so increasing rather than decreasing the return on investment;
- **Become 'age confident' in performance management:** remove compulsory retirement ages and make more effective use of performance management to exit employees when they are no longer capable of performing their job, rather than relying on an arbitrary retirement age limit; and

- **Reward beyond the 'wage packet':** consider the wider package beyond the wage packet, particularly those benefits of more interest to older workers e.g. pension, death-in-service benefit.

Of a sample of over 200 HR managers, the main solutions they saw to prolong working life were:

- flexible working hours (26%);
- different health benefits (21%); and
- change in way of working and attitude towards the old (19%)¹⁴.

Interestingly, 25% of the public saw benefits to working longer compared to 10% of HR managers, although these views may have changed by now.

Summary

Financial considerations, health and the attitudes and behaviour of both employees and employers are all important factors in determining the extent to which working lives will be extended. Clearly employers are in pole position to take the initiative and make changes to their employment practices, but further actions are also required by trade and governmental organisations. This includes raising employer awareness of the value of older workers and also raising older worker awareness of the options to work flexibly in old age, and the range of support and advice available from government, trade bodies and professional associations.

¹⁴ 'Three Score Years and ... when' Ipsos MORI Sep 2006

The fiscal impact of a higher SPA

We set out below our methodological approach and key assumptions in modelling the fiscal impact of a higher SPA and then go on to present our base case results and sensitivity analysis.

Methodology

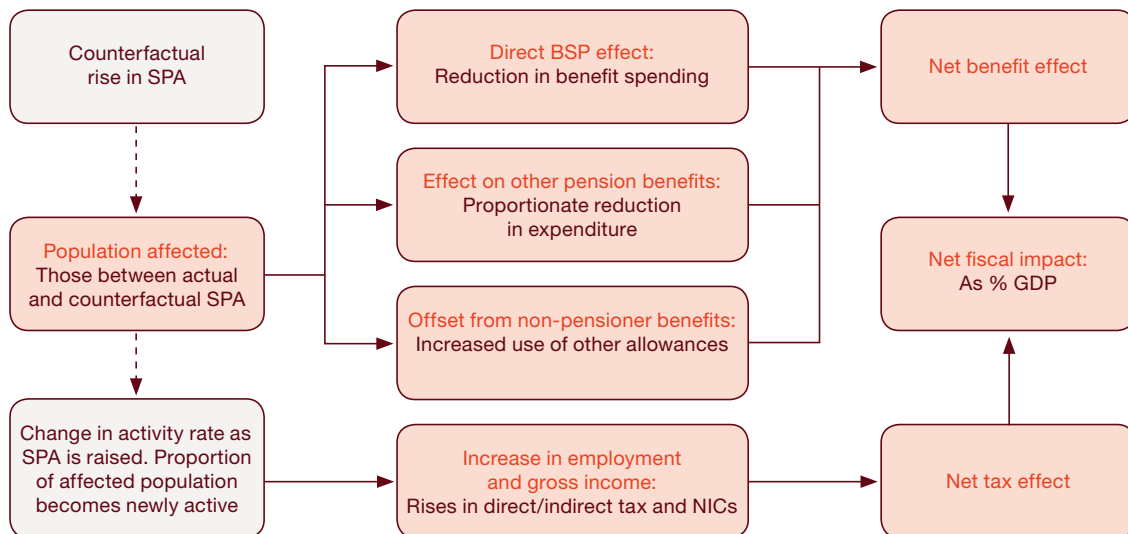
We have modelled the impact on the public finances of a rise in SPA to 67 by 2030 (rather than 66 in that year under current plans) and 70 by 2046 (rather than 68 under current plans).

The rise in SPA affects the public finances via both benefit spending and tax revenues. These effects have been calculated as a % of potential GDP in the year of the SPA change using the modelling approach set out in [Figure 8](#).

Following this rise in SPA, state pension benefits are no longer available to the cohorts affected (i.e. the 66 year olds in 2030 and 68 and 69 year olds in 2046). To an extent, this is offset by a shift on to other benefits, in particular Employment and Support Allowance.

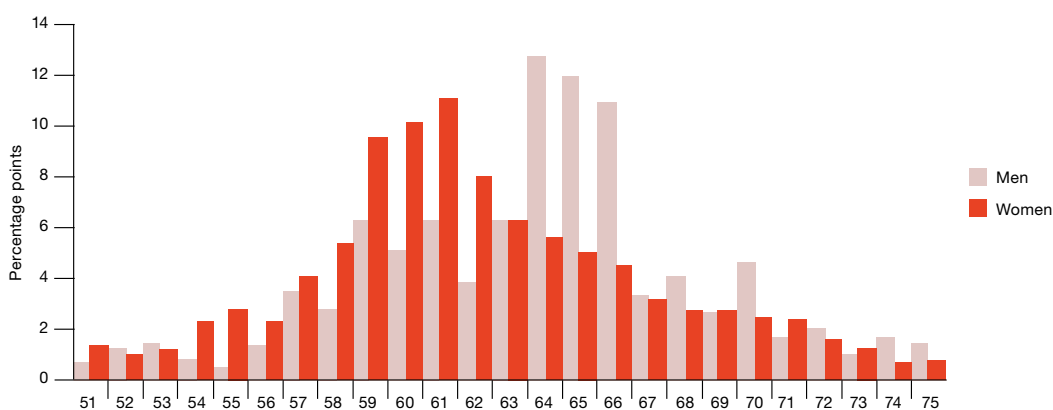
Some of the affected population will work longer and retire upon reaching SPA. The increased employment generates a tax benefit from direct taxes and National Income Contributions (NICs). More indirect tax will also be collected as gross income and spending rises.

Figure 8: Model structure: Fiscal impact following a rise in SPA



Source: PwC analysis

Figure 9: Proportion leaving the labour market, April to June 2009: by age and sex (UK)



Source: ONS Pensions Trends, Labour Force Survey and PwC analysis

Assumptions

Below we describe our key assumptions on the employment response and the effect on benefit spending. Please see the Appendix for further details on other modelling assumptions and data sources.

Employment response

A key assumption underpinning our analysis is the response of employment rates of older workers to a higher SPA. At the same time, this response is also highly uncertain given the lack of prior data on how a change in SPA would affect employment rates: we will know more after the female SPA starts to rise, although even then it will not be easy to disentangle the effects of a higher SPA from other factors including the economic cycle and expected pension payouts after retirement.

Figure 9 shows rates of exit from the labour market by gender and age. There are marked spikes in exit rates roughly around the current SPA for both men (around age 64-66) and women (around age 59-61). This suggests that SPA has an important signalling or focal point effect in influencing retirement ages.

If the retirement age were raised, some people would therefore be expected to work longer in response. We focus on the responses of the cohorts directly affected by the change i.e. those who would be eligible for retirement before the change. Currently, the full-time equivalent (FTE) employment rate in the five years prior to SPA (averaged across men and women) is around 50% and in the five years after the SPA is just 19% (see Figure 10).

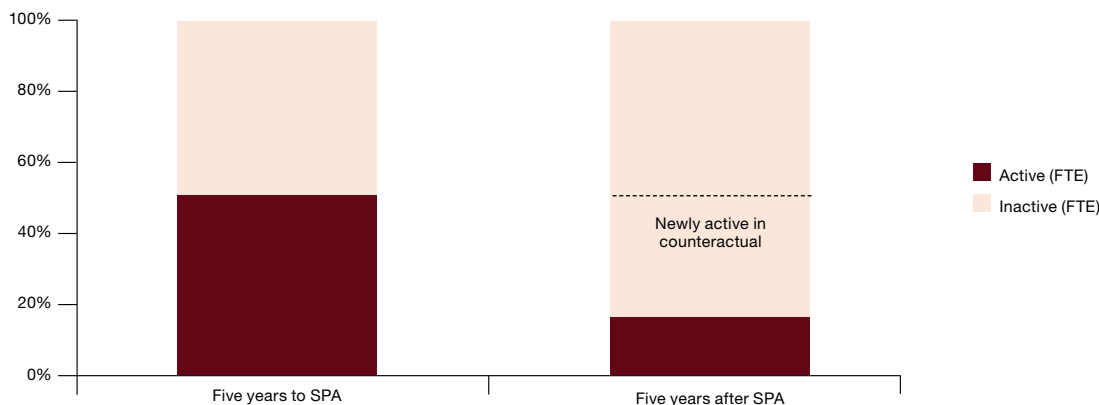
We assume in our base case that future participation rates continue to follow this pattern. Thus, affected cohorts change their behaviour to mimic that of those currently approaching retirement age, with employment rates rising from 19% to 50% – this 31% are therefore ‘newly active’ due to the rise in SPA. These precise figures are clearly subject to considerable uncertainties, however, so we have also looked at a range of alternative assumptions.

Effect on benefit spending

There is reduced spending on state pension benefits due to the higher SPA but higher reliance on non-pension benefits:

- **Basic State Pension:** we estimate the direct amount saved as SPA is raised. We have indexed the current state pension (£95.25 per week) to earnings from 2014/15 onwards. This assumes that the change in indexation (from price inflation to earnings) happens in the last full year of the next Parliament. Earnings are assumed to rise by 2% per annum in real terms in line with assumed labour productivity growth (this is also the standard Treasury assumption in their long term public finance reports);
- **Other pension benefits (S2P, pension credit, etc¹⁵):** the amount of other pension benefits saved is calculated as a proportion of BSP using projections from the Department of Work and Pensions. This is projected to be 36% of BSP spending in 2030 and 40% in 2046; and

Figure 10: Five year employment rates before and after SPA



Source: ONS Pensions Trends, Labour Force Survey and PwC analysis

¹⁵ Other benefits include Winter Fuel Payments, Over 75s TV Licences and Christmas Bonus.

- **Non-pensioner benefits:** poor health and disability are significant factors pushing people in their 60s out of work. We have therefore modelled Employment and Support Allowance as the benefit that is most likely to be taken up by the affected cohorts just below the new higher SPA who do not work. The current allowance (based on Assessment, Work-related and Support Group Phases) is estimated to be around £85 per week. We have assumed this allowance will be indexed to price inflation in line with current policy. Therefore, it is 90% of BSP in 2010 but falls to only around 48% by 2046, given that BSP is linked to earnings not prices. We have also assumed a 75% take-up rate of this benefit by those not working.

Base case results

Tables 5 and 6 summarise the base case results of the model. The population affected is over 0.8 million in 2030, as the last of the baby boomers reach SPA, and over 1.3 million in 2046. The effect on direct BSP and other pension benefits is offset by the effect on non-pensioner benefit spending. Allowing for increased tax revenues from the newly active gives the overall estimated fiscal impact in the year of change. The net fiscal gain as a result of raising SPA is 0.36% of GDP (or around £5 billion at 2010/11 GDP values) for a one year rise in 2030 and 0.59% of GDP (or around £9 billion at 2010/11 GDP values) for a two year rise in 2046 in our base case model run.

Table 5: Base Case Results: Raising SPA from 66 to 67 by 2030

	% GDP 2030	£ billion at 2010/11 GDP values
BSP	0.23	3.4
Other pensions	0.08	1.2
Non-pension	-0.06	-0.9
Net benefit effect	0.26	3.8
Income tax	0.03	0.4
NICs	0.04	0.6
Indirect tax	0.03	0.4
Net tax effect	0.10	1.5
Total fiscal impact	0.36	5.2

Source: PwC analysis (based on projected GDP of £1472bn in 2010/11)

Table 6: Base Case Results: Raising SPA from 68 to 70 by 2046

	% GDP 2046	£ billion at 2010/11 GDP values
BSP	0.36	5.2
Other pensions	0.14	2.1
Non-pension	-0.06	-0.9
Net benefit effect	0.44	6.4
Income tax	0.05	0.8
NICs	0.06	0.9
Indirect tax	0.04	0.6
Net tax effect	0.16	2.3
Total fiscal impact	0.59	8.7

Source: PwC analysis (based on projected GDP of £1472bn in 2010/11)

Our base case estimate of 0.36% of GDP (or £5 billion at today's GDP values) for a one year rise in SPA in 2030 falls between earlier estimates of the fiscal impact of a one year rise in SPA published previously by:

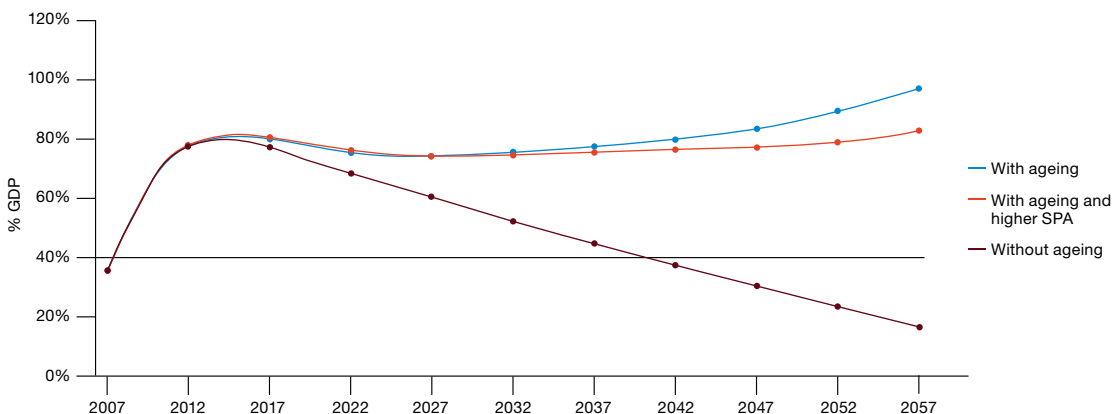
- **the IFS¹⁶**: around 0.15% of GDP (£2.2 billion at 2010/11 GDP values) assuming no employment response but using a sophisticated micro-economic model of taxes and benefits based on current data; and
- **NIESR¹⁷**: around 0.67% of GDP (around £10 billion at 2010/11 GDP values) for a change in the early 2020s assuming a very strong employment response where everyone works for an extra year and using a general equilibrium macroeconomic model, NIGEM.

Our estimate therefore appears to be of a plausible order of magnitude, but is subject to various uncertainties as described below.

Focusing on our base case estimate of a net fiscal benefit of around 0.6% of GDP from raising SPA to 70 rather than 68 by 2046, we can see that this would meet only part of the extra cost of an ageing population up to that date as illustrated in [Figure 11](#).

But it would moderate the long-term rise in the public debt to GDP ratio in the case with the costs of ageing included in the analysis. Raising the SPA to 70 by 2046 would also cover a large part of the projected rise in state pension costs up to that date of around 1% of GDP, as shown in [Table 2](#). Other measures would, however, be needed to address other upward pressures in areas like health and long-term care.

Figure 11: Alternative scenarios for public sector net debt using Treasury projections with and without costs of ageing



Source: PwC projections using Treasury data from December 2009 report

¹⁶ Institute for Fiscal Studies, Green Budget 2010. We are grateful to Carl Emmerson and Gemma Tetlow of the IFS for taking time to discuss their estimates with us and for providing some useful background data for this paper. Their estimate relates to a change in SPA now and would be greater if this change was made at a later date due to larger cohort sizes of older workers and fuller entitlements to state pensions for women in particular.

¹⁷ R. Barrell, I. Hurst and S. Kirby, 'How to pay for the crisis: macroeconomics implications of pension reform', NIESR Discussion Paper no. 333, 2009.

Nonetheless, a higher SPA would avoid the need for other measures to meet the fiscal costs of ageing, such as higher taxes. For example, other ways for the government to raise around 0.35% of GDP in 2030 rather than a one year rise in the planned SPA by that date might include a 1p increase in the basic rate of income tax, or a 1 percentage point rise in the standard rate of VAT. So the potential fiscal benefits of a higher SPA would be quite material when seen from this perspective.

Key uncertainties

There are two particularly important uncertainties in our analysis: the employment response and the effects on non-pensioner benefits.

Employment response

As discussed previously, we assume in our base case a change in the employment rate just prior to SPA based on current data for this age group. However, there are two areas of uncertainty surrounding this assumption. First, the response is unlikely to completely mimic the current participation rate, as other extending working lives and age-related policies may change in the future. This may change incentives to work longer. Therefore, participation rates may be higher (or lower) than those we have modelled.

Furthermore, as is evident by the labour force exit data in [Figure 9](#), SPA affects retirement ages but these effects are somewhat spread out across ages. This has implications for which cohorts are affected by a higher SPA. We have assumed a behavioural change only for those age groups directly affected by the change but, in reality, the effects are likely to go wider than this. Upon announcement of the policy, younger workers will adjust their expectations and participation rates could rise from a younger age.

This will result in a stronger overall employment response. Alternatively, if other benefits and policies change to accommodate the rise in SPA, it is possible that there is no employment response at all. For instance, if the affected cohort is given access to more generous non-pensioner benefits than currently available, this could offset the rise in SPA altogether.

Non-pensioner benefits

We have assumed that non-pensioner benefits will comprise primarily of Employment and Support Allowance (ESA). We also assume that this is indexed to price inflation (in line with current policy) and hence does not grow as rapidly as pension benefits. The amount spent on non-pensioner benefits would be significantly larger if this was indexed to earnings, but on the other hand take-up rates for ESA could well be below the assumed 75% rate and some people without health problems who choose not to work could be moved on to less generous benefits.

Sensitivity test results

In Table 7 we outline the sensitivities of our base case results to changes in some of the key assumptions discussed above.

The most important variable is the employment response. If other policies were to change substantially, it would change incentives and perhaps the age-structure of the labour market in ways not captured in this analysis. If employment response was 10 percentage points stronger than our assumption (so that 10% more of the affected cohort are newly active and 10% less are on non-pensioner benefits), the net fiscal impact would increase by 0.05% in 2030 and 0.06% in 2046. However, net fiscal impact does not increase to the level indicated by NIESR even in this case since their implied employment response appears to be even greater than this (although the difference may also reflect their different modelling approach based on a general equilibrium approach but with less detail on individual tax and benefit effects).

An extreme case is where employment does not respond at all. Participation rates remain exactly the same and raising SPA does not succeed in extending working lives. The resulting net fiscal impact would decrease by 0.13% in 2030 and 0.20% in 2046. This scenario brings us close to the results of the IFS for a similar assumption on employment response (i.e. a net fiscal gain of around 0.2% of GDP for a one year rise in SPA although our estimate is still slightly higher due perhaps to being for 2030 rather than the current year as well as detailed methodological differences).

We also look at reducing the assumed take-up rate of Employment and Support Allowance from 75% to 50%, as more of the affected group of people may rely on savings and private pensions instead of claiming benefits. With a lower take-up rate of these alternative benefits, the net fiscal impact would increase by 0.02% in both 2030 and 2046. Further such effects could arise if we allowed for some affected people to go onto benefits less generous than ESA such as Job Seekers Allowance.

Table 7: Sensitivity analysis

Net fiscal impact (%GDP)	If raise SPA to 67 by 2030	If raise SPA to 70 by 2030
Base case	0.36	0.59
Additional employment rate: from 31% in base case to 41%	0.41	0.65
No employment response: additional employment rate of 0% and 81% remain inactive	0.23	0.39
Take-up rate: from 75% in base case to 50%	0.38	0.61
Second order indirect tax effects	0.33	0.53

Source: PwC analysis

Another uncertainty relates to possible second-round effects on taxation from changes in benefit spending. There could, for example, be some indirect tax foregone from reduced BSP and other pension benefits spending, although against this there could also be an increase in indirect tax collected from the additional non-pension benefit spending. Factoring this effect in decreases the estimated net fiscal impact by 0.03% in 2030 and 0.06% in 2046. But whether it is appropriate to include such second-order effects is debatable given that, if taxpayers money is not spent on these benefits, then it may be spent elsewhere, generating similar second-order effects on tax revenues. Since it is impossible to model all such second-order (and higher order) effects using our approach, we have chosen not to include any such effects in our base case estimates.

Non-material variables

Population projection variants (varying life expectancy, fertility and migration assumptions) and earnings/labour productivity growth assumptions were also considered but were not found to have a material impact on the estimated overall net fiscal effect of raising SPA.

Summary

Raising SPA will directly reduce net benefit spending but will also boost tax revenues to the extent that it increases employment among affected age groups. There are considerable uncertainties surrounding this employment response and some other relevant variables, but our base case estimate is that a one year rise in SPA to 67 in 2030 (compared to 66 under current plans for that year) would have a positive net fiscal impact of around 0.35% of GDP, which is within the range of previous estimates by the IFS (c.0.15% of GDP assuming no employment response) and NIESR (c.0.67% of GDP assuming a very strong employment response and using a general equilibrium approach). Raising the SPA to 70 by 2046 rather than 68 as under current plans would have a net fiscal benefit of around 0.6% of GDP on our estimates.

While such net fiscal benefits would only go a relatively small part of the way to meeting the overall fiscal cost of an ageing population, which is estimated to rise to over 5% of GDP per annum by 2060 according to HM Treasury projections, they are material. For example, the 0.35% of GDP estimated fiscal benefit from a SPA rise to 67 by 2030 rather than 66 is broadly equivalent to the revenue gain from a rise in 2030 of around 1p on the basic rate of income tax, or a 1 percentage point rise in the standard VAT rate. At today's GDP values, all of these three options would improve the public finances by around £5 billion per annum.

An agenda for action

Government cannot worry only about today's problems – it must also concern itself with longer-term challenges, including those created by our ageing society. Even whilst addressing the very real issues of dealing with today's debt, government needs to look to the future and take early action to ameliorate the fiscal costs of an ageing population.

Much attention in recent years has focused on the issue of pension reform, but less on the related issues of extending and re-shaping working lives and the associated fiscal impact of ageing on future debt. There are many related issues around, for example, State Pension Age, changing employer and employee attitudes and behaviour and ensuring inter-generational fairness. We believe that this presents an agenda for action for government in particular, but also for employers, employee representatives and the financial services industry.

The agenda for government

As we have argued in this paper, we believe that government will need to move faster and more boldly to address this agenda, which has real merit in combating increasing pension and benefit costs whilst also adding to the productive potential of the economy (and so also boosting the tax take). With the impending retirement of the baby boomer generation, there will be a critical need to re-shape public services to meet their needs (be it supplementing adult skills or providing appropriate health care, social care and benefits).

We believe that encouraging people to work longer should be a key objective for government in future for both fiscal and social policy reasons. As in other parts of the labour market, there is a range of activity that government can undertake to ensure people make effective decisions, increase the willingness of older people to work (supply), increase the desire of employers to recruit and retain them (demand) and help match people to jobs that suit them (market clearing).

A higher State Pension Age would be part of this, with our estimates suggesting that raising SPA to 70 by 2046, rather than 68 as currently planned, could have a net fiscal benefit of around 0.6% of GDP.

But in order to deliver the full benefit of extending working life, government will need to drive behaviour change with a number of complementary policies and address some major challenges including:

- Ensuring messaging and signalling supports later working. Whilst retirement is spread over a wide range of ages there is a big spike of people retiring at the SPA. This social, cultural and signalling effect of SPA implies that the 'framing' and presentation of retirement in communications to people about state and private pensions is an important driver of behaviour. Increasing SPA will in itself be useful, but to have maximal impact, the communications around it need to focus on promoting later working. In addition, there is an opportunity to align and promote related age-related areas of policy, for example around private pensions and annuities;
- abolishing the Default Retirement Age, which we support as part of effecting a change in attitudes and behaviours among individuals and employers;
- keeping an older workforce (including lower socio-economic groups) healthy enough to keep working later into life including addressing health inequalities;
- developing an adult skills strategy to support older workers, for example by helping older workers to reskill;
- ensuring that employment policies promote extending working lives, for example by removing Default Retirement Age, supporting flexible working for older workers, consider more actively promoting self employment later in life, and making sure older workers receive the practical back to work help they need;

- ensuring social care and family support enable, and are not compromised by, an extension to working lives;
- maintaining a pensions and benefits system which is sustainable and provides a level of income which keeps particularly poorer older workers out of poverty, whilst providing the right incentives; and
- making sure individuals and others understand the benefits of working longer.

Whilst there is a good evidence base for policy-making around extending working lives, there are some important gaps and uncertainties. We suggest the following as particular priorities for future research:

- establishing firmly the relationship between work and health for older workers, and in particular, whether work is good for the health of this group specifically; and
- better understanding individuals' attitudes to working longer, and what the barriers and interventions are.

The agenda for employers

Extending working lives represents both a major opportunity, and a challenge for many employers. Older workers are a vast potential talent pool on which to draw, and successfully recruiting and retaining such workers could provide a genuine competitive advantage. On the other hand, we recognise that many employers will need to make changes to their approaches to employment to take advantage.

There is a need to instigate a wider behavioural change programme amongst employers and employees and engage with employers and trade unions in developing solutions that can benefit both companies and their employees. Employers need to change their views on the value added of older workers and the willingness to change ways of working to accommodate them.

Examples of actions employers may want to consider to recruit and retain older talent include:

- increasing the awareness amongst employees of the benefits of working longer and the associated impacts;
- understanding employee motivations, needs and intentions with respect to extending their working lives;
- developing new and innovative ways of enabling flexible working patterns later in life;
- exploring alternative employment vehicles;
- developing career paths and performance management systems to accommodate those later in life with experience to offer;
- making sure pension and benefit arrangements create the right incentives to work longer;
- creating enabling employment processes and removing any barriers in HR policies and procedures, e.g. default retirement ages; and
- making sure people development and training is well suited to older workers and avoids focussing on younger people.

We note that government employs a large part of the UK workforce, and that it has a further important role to play in promoting extending working life in its role as employer. We believe that government's actions to promote EWL in this context will be both critical, and challenging, given the fiscal context. It will be very important for government to promote later working at the same time as it seeks to cut costs.

The agenda for employee representatives

Employee representative bodies, including trades unions, have traditionally and quite rightly sought to protect the retirement benefits of their members, particularly ensuring that their members' pensions are protected and well funded. Changes to employment patterns present employee representatives with a new challenge: to provide advocacy on behalf of their members who will be working longer than ever before.

Employee representative bodies will therefore need to provide clear advice and guidance to their members on the major changes they face in working longer and more flexibly, whilst at the same time working with employers to shape and develop appropriate arrangements to facilitate extended working lives.

The agenda for financial services providers

The financial services sector will have a key role to play in facilitating later working, in particular through its provision of saving and 'decumulation' products that people use to fund their retirement. Key challenges for financial services organisations include:

- develop awareness raising and education campaigns to alert people to their future needs; and

- deliver both savings and decumulation products which are flexible enough for people to plan their later lives, for example without fixed retirement dates in mind and accommodating part-time or other forms of more flexible work. A more sophisticated decumulation approach – potentially in conjunction with the employee continuing to work i.e. still accumulating – will therefore be required. This presents a challenge to FS providers especially as retirees start to shop around even more for products or approaches, rather than taking the default position of decumulating with the existing pension provider.

This is an important agenda for action, to which we will be contributing through a future programme of research which aims to put forward a range of options for re-shaping and re-designing the policies and services offered across the generations (e.g. health, benefits, adult skills, social care, family support) in order to generate a debate on the long term solutions to the pressing issue of the fiscal consequences of our ageing society.

In summary, extending working lives is a social and fiscal imperative. It is essential that government, employers, financial services providers – and citizens – work together to make it a reality.

Appendix: Other assumptions

Population affected

Based on the latest 2008-based ONS principal population projections, we assume that there were 836,045 people between 66-67 years in 2030 and 1,318,193 between 68-70 years in 2046.

Earnings assumptions

We assume earnings grow at 2% per annum in real terms in line with assumed labour productivity growth. We have taken current earnings for the 60+ age group as £308 per week (based on ONS ASHE data). Earnings for 60+ year olds at constant 2010/11 prices is projected to average £457 per week in 2030 and £628 per week in 2046 based on 2% real earnings growth.

GDP assumptions

Our GDP growth assumption is broadly in line with the latest HM Treasury long term public finance report assumptions with labour productivity growth of 2% per annum and employment growth of 0.50% p.a. until 2020 and 0.25% p.a. thereafter. There are also cyclical effects of 0.75% p.a. until 2014 as the current output gap is closed. Real GDP therefore grows at an average of 3.25% p.a. from 2011 until 2014, 2.5% p.a. from 2015 until 2020 and 2.25% p.a. thereafter.

Tax assumptions

We assume the basic tax rate remains at 20%, and that NICs remain at 26% (combined rate for employer and employee). We assume that indirect taxes paid are 12% of gross income. Personal allowances have been taken as general rather than age-related, of £6,475 p.a. in 2010 and indexed to earnings growth of 2% p.a. from 2014/15. The resulting personal allowances are £8,889 p.a. and £12,202 p.a. in 2030 and 2046.

Sources

Population affected:

2008-based National Population Projections, Office of National Statistics http://www.statistics.gov.uk/downloads/theme_population/NPP2008/NatPopProj2008.pdf.

Employment Response:

Labour Force Survey 2009 http://www.statistics.gov.uk/downloads/theme_compendia/pensiontrends/Pension_Trends_ch04.pdf

Basic State Pension:

Department of Work and Pensions http://www.direct.gov.uk/en/Pensionsandretirementplanning/StatePension/Basicstatepension/DG_10014671

Other pension benefits:

Department of Work and Pensions http://research.dwp.gov.uk/asd/asd4/explanatory_notes_long_term.asp

Non-pensioner benefits:

Department of Work and Pensions <http://www.dwp.gov.uk/employment-and-support/>
http://www.jobcentreplus.gov.uk/jcp/Customers/WorkingAgeBenefits/Dev_015412.xml.html

Earnings:

ASHE, Office of National Statistics http://www.statistics.gov.uk/downloads/theme_labour/ASHE-2009/2009_age.pdf

Tax:

National Accounts, 2009, Office of National Statistics
HM Revenue and Customs <http://www.hmrc.gov.uk/rates/it.htm>

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