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The new government's take on state pensions
(Frank Eich)

- **New coalition government's main domestic policy challenge is to reduce the substantial deficit. It intends to achieve this mainly by reducing government spending.**
- **Government also intends to index state pension to earnings growth from 2011 onwards. This is one year earlier than planned by the previous government, which in 2006 made a 2012 implementation dependent on state of public finances.**
- **Coupled with the fact that government promises to raise NHS spending in real terms every year over this parliament (while acknowledging the implications this might have on other spending areas), this clearly demonstrates the importance of the grey vote in British politics.**

Not surprisingly the key domestic policy challenge identified by the new Conservative-Liberal coalition government is to reduce the fiscal deficit over the course of this parliament. At around 12 per cent of GDP, Britain's deficit is currently one of the largest in the developed world. The new government intends to achieve this mainly by reducing spending rather than raising taxes.

Faced with this challenge, it is perhaps a little surprising though that the new government has also announced that it would index future increases in the state pension to earnings growth rather than inflation from April 2011 onwards. When the previous Labour government launched its pension reforms in 2006 – following the 2005 recommendations of the Pensions Commission and in an economic climate dominated by eternal optimism - one of the key policy announcements was to change the indexation rule from 2012 at the earliest but in any case by the end of the next parliament. In the words of the previous government, the timing of that move would be "…*subject to affordability and the fiscal position*…"

Fast forward four years and it appears that we can afford to move to an earnings link even earlier than originally planned. Just to make sure that pensioners will definitely not fare badly over the coming years, the government even promises a "triple guarantee" that "…*pensions are raised by the higher of earnings, prices or 2½ per cent*…"

So while those in employment can expect sluggish nominal earnings growth for years to come as the economy only gradually recovers and might even face falling disposable incomes as tax and NIC increases (the latter not affecting pensioners) appear inevitable given the fiscal deficit, pensioner incomes seem relatively safe. Indeed, most pensioners will also benefit hugely from the new government's announced policy to increase the personal income tax allowance to £10,000 over time. Such a move would take most pensioners out of paying income tax altogether.

Add in the fact that the government wants to increase NHS spending in real terms in every year of the parliament – which disproportionately benefits the elderly – while fully acknowledging that this will mean even deeper cuts in other spending areas and it is clear that the grey vote clearly matters.

But it is not all good news for pensioners, in particular future pensioners: the government also announced to review the date at which the state pension age should be increased from 65 years to 66 years. As it stands this will take place between 2024 and 2026 – the new government seems keen to bring this forward. On the face of it, this appears to be a relatively easy way to save money but how much could realistically be saved given that only a minority of people actually works until the official age? Currently less than three quarters of males and females aged between 50 years and 64 years and 60 years respectively are still in employment and that rate is much lower for those at the upper end of that age group than those at the lower end. What will those without any other forms of income live off if they fail to extend their working lives?