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Economic Bulletin

DID CLEGG CREATE CONDITIONS FOR CORBYN?

How the triple lock has hamstrung the Government since 2010

- **Since 2010, pensioners have become, on average, richer than the working age population. Welfare spending on pensioners is up by 10% in real terms, but down by around 5% for people of working age and children.**

- **The triple lock on state pensions has been costly. Had the state pension been uprated in line with CPI inflation the Treasury would now be £8.6bn a year better off.**

- **The opportunity cost is large. This sum could have paid for a cut of 2 percentage points in the basic rate of income tax or increased spending in areas of greater need.**

- **The Liberal Democrats insisted on implementing the policy, which is partly responsible for the rise in support for Labour from those in their 30s & 40s.**

- **Conservatives have now dropped their commitment to move to a double lock, which is a missed opportunity to promote intergenerational fairness.**

- **At the very minimum, the 2.5% guarantee in the triple lock should fall to 1.5% to protect the Treasury from an environment where inflation and earnings hover around 2%.**

1. OVERVIEW

***"We will restore the contract between the generations, providing older people with security against ill health while ensuring we maintain the promise of opportunity and prosperity for younger generations"* – Conservative Party Manifesto 2017**

Since 2010 the average pensioner has enjoyed a higher median income than the average working age person after housing costs, according to analysis conducted by the Resolution Foundation. Moreover, wealth disparities between the generations have grown markedly. From 2010-2012 to 2012-2014, the top decile's wealth has increased by over £870,000, which compares to negligible amounts for the bottom three deciles[1]. This has disproportionately benefited the older generations, with 80% of financial assets being held by those over 45[2].

The discrepancy between the working age and pensioner population is set to grow under current policies, and represents a dramatic change from the past. In 2002, for example, the average working age person had around £3,500 more in median income compared to pensioners, compared to the average pensioner being £1,000 better off than the working age population currently. This economic bulletin seeks to examine how the triple lock on pensions has contributed to the growing disparity between the generations, and how it may continue to do so in the future.

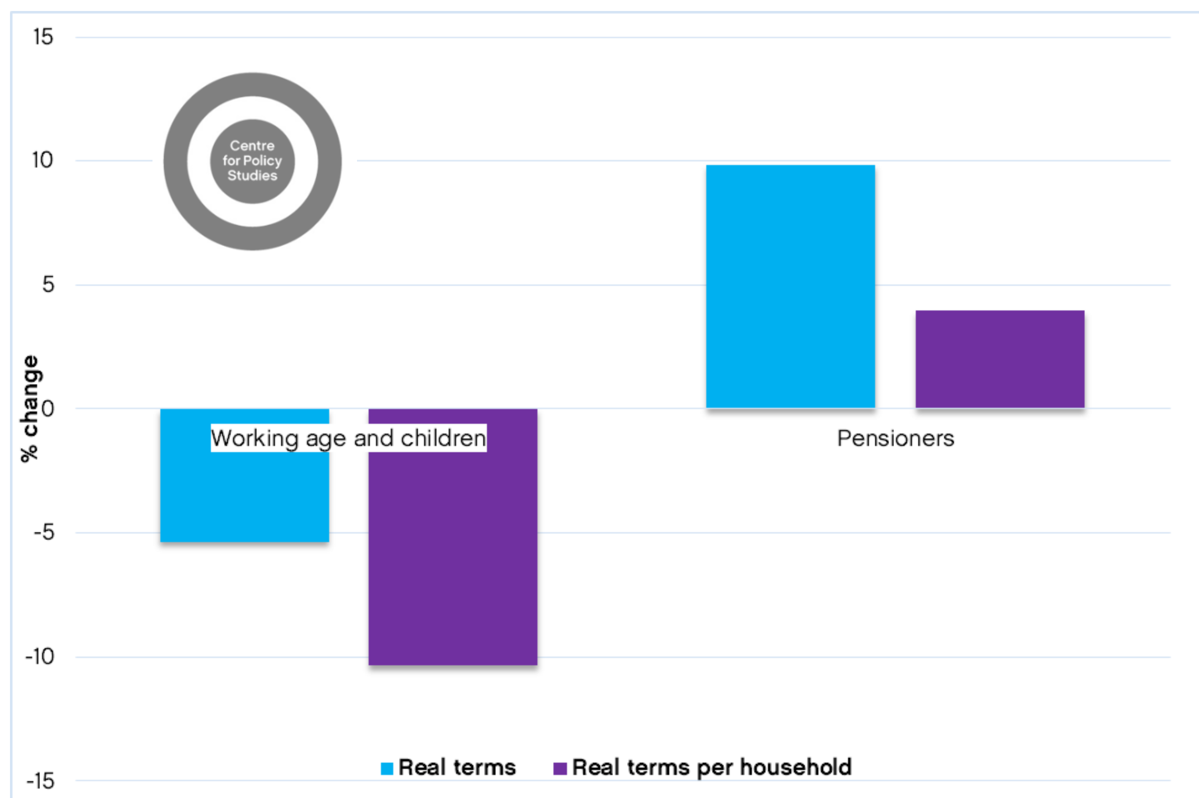
2. WELFARE REFORM: PENSIONERS GAIN, WORKERS LOSE

The changing fortune of these two demographic groups has largely arisen from the unbalanced way that welfare reform has been pursued. From 2010-11 to 2016-17, total welfare expenditure on the working age and child population has fallen by over 5% in real terms whereas welfare expenditure on pensioners has increased by nearly 10% in real terms (see Figure 1). The per capita figures are even more pronounced in relation to working age people. On a per household basis, real terms welfare expenditure is down by 10% for the working age and child population.

[1] Data comes from the Office for National Statistics' Wealth and Assets Survey.

[2] Baroness Altmann speech to Economic Research Council.

Figure 1: Change in Real Terms Welfare Expenditure (2010/11 to 2016/17)



Source: DWP

Note: Figures for 2016/17 were forecasts. Figures relate to Great Britain.

3. FISCAL PROBLEMS OF THE TRIPLE-LOCK

The number of eligible pensioners has grown by around 400,000 over this period, representing an increase of just over 3%.[3] This does not fully account for the nearly 10% real terms increase in pensioner welfare expenditure. Pensioners are also seeing a growth in welfare payments, which have risen by nearly 4% in real terms per household since 2010 (see Figure 1).

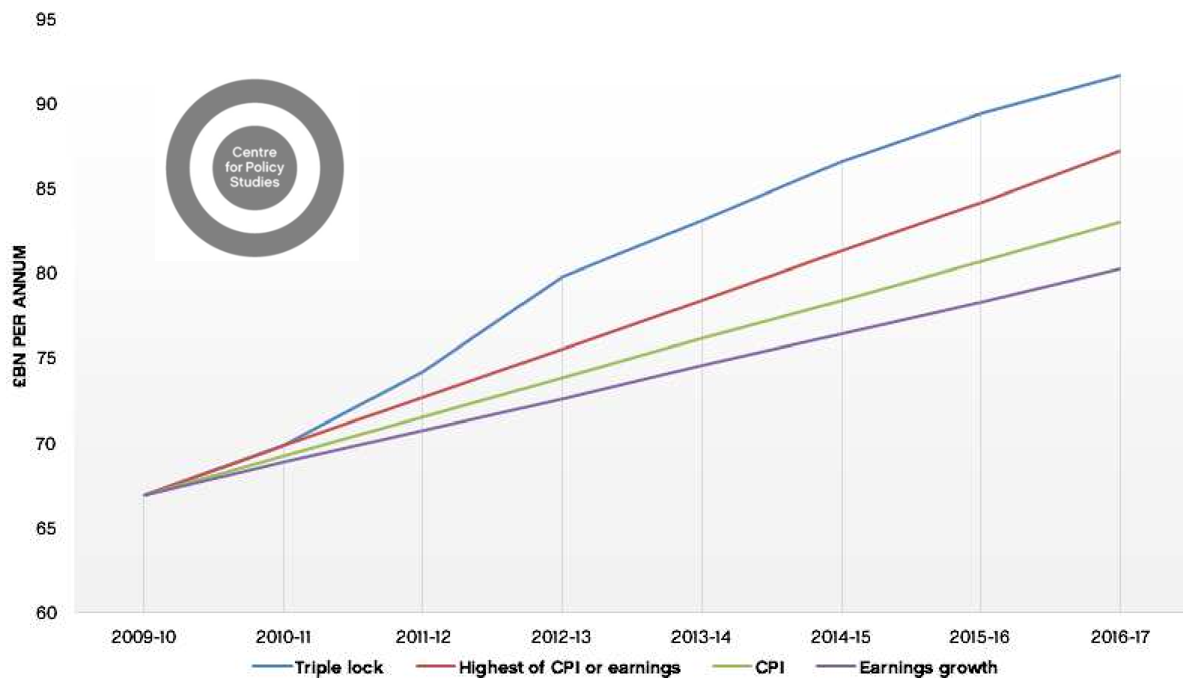
The growing pressure on budgets is not simply arising from an ageing population. Growing state pension costs since 2010 have also come about from the policy of uprating the state pension by the triple lock – the highest of earnings, prices or 2.5%. This policy has led to a dramatic increase in the cost of the state pension from £66.9bn in 2009-10 to £91.6bn in 2016-17, according to the Office for Budget Responsibility. This is in stark contrast to measures targeted at working age

[3] The number of people that are of pensionable age has grown from 12.65m to 13.07m from November 2009 to November 2016 (Department for Work and Pensions – Quarterly statistical summary: May 2017).

people, which include – among other things – restraint in the uprating of various benefits. As a result, state pension costs now account for well over half of all government benefit expenditure.[4]

Figure 2 and Tables 1 and 2 outline the cost of uprating the state pension by the triple lock compared to other uprating scenarios. The annual cost to the Treasury is substantial. Had the state pension been uprated via a double lock (by the highest of CPI inflation or earnings growth), the Exchequer would now be **£4.4bn a year better off**. Government expenditure would be **£8.6bn lower per year** if it had been uprated by the CPI rate of inflation, **rising to £11.4bn a year** if it had been uprated in line with average earnings.

Figure 2: Cost of State Pension Under Various Uprating Measures



Note: Graph is based on figures in Table 2

[4] 2016/17: £91.6bn spent on state pensions. Total benefit expenditure was £172.7bn (Office for Budget Responsibility).

Table 1: Pathway of State Pension Uprating in Various Scenarios

	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	% CHANGE (09-10 TO 16-17)**
EARNINGS GROWTH (%)	1.8	2	2.8	1.6	1.2	0.6	2.9	13.6
CPI INFLATION (%)	1.1	3.1	5.2	2.2	2.7	1.2	-0.1	16.5
HIGHEST OF CPI OR EARNINGS (%)	1.8	3.1	5.2	2.2	2.7	1.2	2.9	20.7
TRIPLE LOCK (%)	2.5	4.6*	5.2	2.5	2.7	2.5	2.9	25.2

Source: UK Parliament [Note: Number SN-05649, 7th February]

Note: Uprating figures for inflation are based on the month of September in the previous year. Uprating figures for earnings are a comparison of previous AWE during the May-July period. For example, the 2016-17 uprating for earnings is the annual increase in pay across the whole economy from May-July 2014 to the same period in 2015.

**RPI rate of inflation was used in 2011-12. The uprating measure in the triple lock was subsequently changed to CPI.*

Table 2: Cost to Exchequer of Triple Lock vs Other Scenarios

Growth in state pension costs (2009-10 to 2016-17) under:	Uprating increase for individual state pension (%)***	Lower growth in uprating compared to triple lock (%)	Annual saving for the Treasury from 2016-17 onwards (£bn)****
(a) the triple-lock	25.2%	0%	£0bn
(b) the highest of CPI or earnings	20.7%	18%	£4.4bn
(c) the CPI rate of inflation	16.5%	35%	£8.6bn
(d) average earnings growth	13.6%	46%	£11.4bn

****Figures comes from Table 1*

*****Note 1: Under the triple lock policy state pension costs have risen from £66.9bn to £91.6bn from 2009-10 to 2016-17, increasing by a total of £24.7bn (Source: Office for Budget Responsibility). An 18%, a 35% and a 46% cost saving on this would lead to annual savings of £4.4bn, £8.6bn and £11.4bn respectively by 2016-17.*

*****Note 2: Under the triple lock policy state pension costs have risen by 37%. This is higher than the state pension uprating of 25.2% in Table 1. This is partly due to the number of eligible pensioners increasing over this period.*

4. THE TRIPLE LOCK WAS A LIBERAL DEMOCRAT DEMAND

The 2010 Conservative and Labour Party manifestos merely made a commitment to re-establish a link between earnings and the basic state pension. It was, in fact, the 2010 Liberal Democrat manifesto that pledged to *"uprate the state pension annually by whichever is the higher of growth in earnings, growth in prices or 2.5 per cent".* Rupert Harrison, George Osborne's former special adviser, has claimed that this policy was a Liberal Democrat demand that was accepted on the basis of being informed by the Treasury that it would only cost £50m. If true, this is no doubt one of the most costly and long-lasting decisions that was taken by the Coalition Government.

5. WHAT COULD HAVE BEEN DONE WITHOUT IT?

As shown in Figure 2 and Tables 1 and 2, the cost of implementing the triple lock from 2010-11 to 2016-17 has been enormous. The opportunity cost of the policy is therefore substantial.

For example, had the state pension been uprated in line with CPI inflation – which would have maintained its purchasing power and saved £8.6bn a year for the Treasury compared to the triple lock from 2016/17 – the government could have:

- Dropped the basic rate of income tax by around 2 percentage points,[5] helping all demographic groups and the vast majority of taxpayers, while leaving the UK in the same, or possibly a better, fiscal position.

or

- Reduced the basic rate of tax by a smaller amount and allocated additional funds to areas of greater need such as the social care sector.

If the triple lock had not been implemented in 2010, the government would have more scope to introduce further tax cuts for ordinary families along with additional funds in areas of need. It is therefore very plausible that the intergenerational unfairness caused by the triple lock on pensions helped increase Jeremy Corbyn's popularity at the 2017 general election, particularly among those in their 30s and 40s.

[5] A change in the basic rate of income tax by 1p is estimated to alter Treasury revenues by £4.05bn in 2018-19 (Direct effects of illustrative changes – HM Treasury). In the case of lowering income tax rates, this is likely to be an overestimate as it does not account for the positive dynamic impact on economic activity.

6. CONSERVATIVE POLICY AT THE GENERAL ELECTION 2017

Realising the unsustainable nature of the triple lock policy, the 2017 Conservative Party manifesto pledged to change the triple lock to a double lock in 2020. This would have meant that pensions would rise in line with the highest of earnings or inflation, helping to control the ever-growing costs of state pensions in the longer term. However, following the Conservative-DUP deal, this pledge has now been dropped.

There was also a commitment to means-test the winter fuel payment, which – according to the Department for Work and Pensions – costs just over £2bn. The costs of this benefit have actually seen a significant fall over recent years due to the phasing in of a higher state pension age for women. The Conservatives have also dropped this commitment following the election – although the fiscal implications are insignificant compared to the potential long-term consequences of a U-turn on the triple lock.

7. FUTURE FISCAL IMPACT OF THE TRIPLE LOCK

It is anticipated that the CPI rate of inflation has reached its peak at around 3% and will see a steady fall down to the Bank of England's target of 2%. It is, however, expected that average earnings will begin to pick up by 2018. According to Statista, average earnings are expected to grow by 2.7% in 2018, 3% in 2019, 3.4% in 2020 and 3.6% in 2021. Should this occur, the 2.5% guarantee in the triple lock will not come into force.

However, if average earnings align more closely with the expected pathway of inflation, the 2.5% lock will come into force. For example, if inflation and earnings growth were at 2%, the triple lock would potentially lead to additional costs of nearly £1/2 a billion in any given year.[6] And, of course, if the situation was sustained the annual cost would grow. Accompanied with the already unsustainable pathway of state pension costs since 2010, this should greatly concern those that believe in fiscal responsibility.

Regardless of the immediate impact, the triple lock will no doubt add further fiscal costs in the medium to long term. The Office for Budget Responsibility's Fiscal Sustainability report suggests that the triple lock would, on average, push up the cost of the state pension by 0.34 per cent above earnings growth each year.

[6] The cost of the state pension to the public purse is approaching £100bn per annum. An uprating of 2.5% rather than 2% will lead to an additional £1/2bn cost.

8. CONCLUSION

The Liberal Democrat insistence on the triple lock on pensions has been enormously costly. The opportunity cost is immense. Had the state pension's purchasing power stayed the same since 2010, the Government could have implemented a series of growth promoting tax cuts for all demographic and income groups, as well as given additional funds to areas that require more resources – all the while being in a similar, if not better, fiscal position.

There have, of course, been broader problems with the Government's fiscal consolidation programme. Certain departmental budgets have been ring-fenced and seen astonishing growth – such as the international aid budget – while others have seen huge cuts. In the round, this has led to real terms government spending remaining broadly flat since 2010.

But it is undoubtedly the case that the triple lock policy has increased intergenerational unfairness and hampered the Government's ability to pursue a tax cutting agenda. In the longer term, the Government should be seeking to uprate the state pension in line with CPI inflation, which would maintain its purchasing power. Given pensioners are now better off on average than the working age population, it would not seem fair – nor fiscally sustainable – to continuously uprate the state pension by the triple lock. Unfortunately, the political realities mean that such an outcome is highly unlikely at the present time.

However, at the very minimum, the guarantee in the triple lock should be dropped to 1.5%. This would guard the Treasury from additional fiscal burdens arising from a situation where inflation and earnings growth are hovering around 2%. This would still technically be "a triple lock", and even if this change was to emerge, pensioners would still be getting a very good deal, leading to their living standards growing compared to the working age population.

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