Comment

We need to reconsider the triple lock

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When the state pension "triple lock" target was first announced in 2010 by the UK's coalition government, it seemed like an easy win.

Access

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The government promise to increase the basic state pension each year by the highest of either 2.5 per cent, inflation or average earnings growth was regarded as both politically popular and relatively low cost. The Treasury forecast at the time that it would not cost much more than lifting the state pension in line with only average earnings growth, which the previous Labour government had promised in 2006.

As it turns out, however, the triple lock has neither been low cost nor a win for government.

Macroeconomic volatility since the early 2010s has raised the cost of pensions by far more than expected. Payouts have jumped because they are designed to go up in line with whichever benchmark is growing fastest. When prices and earnings are volatile, the state pension does not only keep up with earnings growth in the economy, it exceeds it. With each shock — Brexit, the pandemic, the recent energy price rise — the triple lock ratchets up the value of the state pension relative to average earnings.

The Office for Budget Responsibility now estimates the state pension will cost around £15.5bn more per year by the end of this parliament than if it had been linked to average earnings since the early 2010s.

Admittedly, no one in 2010 could have foreseen all of the global shocks that would come over the next 15 years. But the coalition government introduced a method of increasing the state pension which has cost more than anticipated and which creates future uncertainty by design.

Every government since then has maintained the triple lock. It has proven popular with the public, politicians are nervous about making changes that affect pensioners. This adds pressure on already fragile public finances. Growing demand for health and social care from an ageing population, a ri Nato defence spending target and elevated debt interest spending are all major fiscal challenges fac by the country.

Moving away from the state pension triple lock would not address those challenges. But a continued commitment to the pension triple lock means there is significant pressure on adjusting other parts of state spending in order to meet them — through rising taxes or scaling back of other priorities.

A better approach is needed for the future. One more sustainable and predictable option for state pension uprating would be a "smoothed earnings link" similar to that used in Australia.

Under this approach, the government would set a target level for the "new state pension" as a share of average earnings. Currently a full new state pension is worth about 30 per cent of median full-time earnings. The government could keep that as the target, or it could choose a different one.

In most years, when the state pension is at the target level and real earnings are growing, the state pension would rise in line with average earnings growth. But in years when earnings grow slower than prices, the state pension would instead rise with inflation, temporarily reaching a higher share of average earnings. It would continue to rise with inflation as earnings recover, until it returned to its target share of average earnings.

These features of the "smoothed earnings link" would mean that the state pension keeps up with living standards in the long run while protecting against inflation in economic downturns. It would do so without ratcheting up the value of the state pension over time compared with earnings.

This would in turn provide greater predictability for policymakers. The fiscal cost would depend on what the government sets as the target level. But crucially, periods of macroeconomic volatility would not add further upward pressure on state pension spending.

The Labour party manifesto in 2024 declared that it would keep the state pension triple lock and the government has recommitted to it for this parliament.

But that does not mean it has to — or should — stay forever. A sensible approach would be to announce in this parliament a move away from the triple lock after the next election. This could be way for the government to signal its commitment to sustainable public finances by showing a willingness to take tough decisions for the long-term at the Budget.

The longer we delay taking action, the more we bake in future cost pressures that will be harder to unwind. We've done enough of that already.

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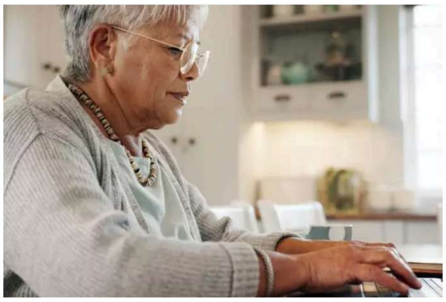

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