Pension parity: Can the UK government afford it?

15/09/2010

Foreword

The UK is currently the only country in the OECD that discriminates against its citizens on the basis of where they choose to retire by denying full pension portability rights.

British pensioners[1] who move to Australia, Canada, New Zealand, South Africa or any of 150 other countries, will have their British state pension payments frozen at the same rate as when they moved abroad with no annual increases. This leaves pensioners who have been overseas for 10 years more than 30% worse off than pensioners in the UK or those who moved to the EU, the US, and a few other countries where the government provides annual upratings to British pensioners. Having paid National Insurance contributions throughout their working lives, some British pensioners are now struggling to survive on as little as £10 per week and must rely on family or friends to survive.

The International Consortium of British Pensioners (ICBP), which represents the 543,000 British pensioners living in frozen countries, has been campaigning for justice for nearly a decade. These 543,000 pensioners represent 50% of all expatriate pensioners. Yet the British Government continues to refuse to pay our elderly citizens the pension they are due, claiming that the country cannot afford the price of justice.

This independent report, commissioned by the ICBP, exposes for the first time the huge sums that British pensioners living abroad save the government each year and reveals that providing pension parity for all could be completely self-funding on an annual basis within 15 years depending on the number of pensioners who move abroad as a result of the policy change.

The research reveals that the Government gains £2.5 billion per year in avoided health, social care and benefit costs from pensioners living in the 150 countries that are currently 'frozen', and that even if full pension parity is paid for and all British pensioners around the world receive annual upratings to their British state pension, savings to government would still be £2 billion per year and total £31billion over the next fifteen years.

To argue that this country cannot afford to provide all those who have paid into the system with their rightful pension in old age is therefore morally unacceptable. We must reverse the discriminatory policy of freezing British state pension immediately to avoid further suffering among some of our most vulnerable citizens and ensure that all British workers can enjoy the freedom to retire where they wish, without fear of becoming a financial burden on their loved ones in later life.

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International Consortium of British Pensioners

[1] Where British pensioners are referred to throughout this report we are referring to all recipients of British pensioners

matrix evidence

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1.0 Summary

Matrix Knowledge Group was commissioned by the International Consortium of British Pensioners to undertake an independent assessment of the savings related to British pensioners living abroad and the costs of uprating the British state pension to all eligible British pensioners around the world.

In November 2009 about 1.1 million[2] British state pensioners were living and receiving their pensions outside the UK. Around one third of those pensioners (370,000) live in other EEA member states and still receive some of the benefits and services enjoyed by UK-based pensioners. A total of 720,000 British pensioners live outside the EU and receive only the British state pension, and of those 543,000 live in countries where the British state pension is currently frozen.

Our analysis finds that the Government saves £3.2 billion per annum from the 720,000 British pensioners living outside the EU in avoided health care, social care and old age benefits. Currently £2.5 billion of this is gained from pensioners living in countries where pensions are frozen. With 7,000 pensioners estimated to move to frozen countries every year, annual savings would rise to £3.4 billion over the next fifteen years. The total cost saving over the next fifteen years is estimated at £33 billion.

Uprating pensions to British pensioners living in frozen countries would cost the National Insurance Fund an average of £800 per pensioner, or a total of £478 million in the first year if pensions were uprated next year. With the increasing number of pensioners moving abroad, the annual cost would rise to £748 million in 2025/26 and the total cost over this period would be £6.8 billion.

A survey carried out by the ICBP, Age UK, the National Pensioner Convention and other bodies found that 39% more pensioners would move to these countries if the policy were reversed. This would mean that over the next fifteen years, an additional 180,000 pensioners would move abroad, saving the government a further £4.8billion over that period.

The conclusion of the report is that over the next 15 years, if pensions are unfrozen, pensioners living outside Europe would still produce a cumulative net saving to the UK Government of £31 billion, £2 billion or 4% less than the saving generated if pensions were not unfrozen.

[2] The Department for Work and Pensions provides a Tab tool where the relevant numbers can be downloaded http://83.244.183.180/100pc/tabtool.html.

2.0 Introduction

For more than fifty years the UK government has pursued a policy of uprating pensions to British pensioners living overseas in some countries but not others. The situation discriminates between people on the basis of where they live. In 29 EEA countries and 16 other countries pensions are uprated as if the pensioner was still resident in the UK. In all other countries their pensions are frozen. This means that a pensioner living in the USA receives full annual increases whereas one in Canada does not.

There are 150 countries where pensions are frozen. Of the 543,000 pensioners living in those countries, 485,000, almost 90%, live in Australia, Canada, South Africa and New Zealand.

The aim of the study is to estimate the savings associated with pensioners living overseas in frozen countries and the potential savings of a change in pension policy which would give all eligible UK pensioners living abroad the right to receive the current rate of State Pension.

It should be noted that not all pensioners receive the full state pension, as pensions are based on the number of years of National Insurance contributions. The policy of unfreezing pensions would therefore mean that all pensioners abroad would receive the same proportional increase on their pension, but not necessarily a full pension.

This report deals with two sets of calculations:

- The cost of unfreezing pensions for all pensioners.
- The cost savings generated by pensioners living abroad.

All estimates are calculated for a potential reversal of the pension policy coming into force at the start of the year 2011/12, and the calculation is done for the 15 years until the year 2025/26. A public sector perspective is adopted, and all values are given in 2010/11 prices.

The remainder of the report is organised into the following sections:

- Section 3 describes the economic model used to undertake the analysis of average costs to the government for each person older that 64 in the UK.
- Section 4 estimates the savings to government from British pensioners living abroad.
- Section 5 considers the costs and potential savings involved if all pensions in frozen countries were uprated.
- Section 6 considers the affordability of uprating all pensions.
- Section 7 briefly considers the limitations of the analysis.

3.0 Average cost to the government for each person older than 64 in the UK

Net public funding for every person 65 and over living in the UK includes the following cost types:

- Benefits received by people 65 and over in the UK
- Health care spending on people 65 and over in the UK
- Social care spending of people 65 and over in the UK
- Taxes paid by households 65 and over in the UK

The net public funding for each person older than 65 (NF) was calculated as the sum of benefit (B) payments to people 65 and over in the UK plus health care (HC) and social care spending (SC), less tax payments (T). All components are divided by the (expected) number of people 65 and older living in the UK (N). This is summarized in equation 1:

$$NF = (B + HC + SC - T) / N \qquad (1)$$

The net public cost of each pensioner to the UK Tax payer was £4,400 in 2011/12, increasing to nearly £5,000 by 2025/26. The remainder of this section outlines the analysis undertaken to estimate each component of equation 1.

3.1 Benefits

The Department for Work and Pensions has estimated the future spending on benefits for people aged 65 or older. Table 1 summarises the Department estimates (in 2008/09 prices) for 2010/11 and for 2025/26.

Table 1: Total benefit expenditure projection (in 2008/09 prices – £ billion)[3]

	2010/11 (£bn)	**2025/26 (£bn)**
Pension Credit	8.0	6.6
Other Pension Benefits[4]	2.8	2.5
Housing-related benefits[5]	8.2	8.3
Attendance Allowance and Disability Living Allowance	9.3	12.2
Total	**28.7**	**29.6**

Using the 2008-based National Population Projections from the ONS benefits per person aged 65 or older were calculated. It was estimated that in 2011/12 the average cost per person aged 65 or older will be:

- Pension credit: £818
- Other pension benefits: £288
- Housing benefits: £850

3 Department for Work and Pensions, Numbers directly provided by the Department for Work and Pensions , Table LT3, Pensioner benefit expenditure projections, United Kingdom.

4 "Other pension benefits" comprise Winter Fuel Payments, Over 75s TV Licences and Christmas Bonus

5 "Housing-related benefits" comprise Housing Benefit, Council Tax Benefit in Great Britain, Rate Rebate in Northern Ireland, and Discretionary Housing Payments.

- Attendance allowance and disability living allowance: £981
- Total: £2,938

3.2 Health Care Spending

No similar projection was available for health care spending. The Department of Health[6] estimated that in 2008/09 people aged 65 and older used 45% (£32.1 billion) of all Health care spending[7] while their share of population was only 17%.

The future spending on the NHS is difficult to predict. The government has committed itself to small real term increases in funding for the NHS. An annual 2% real increase per person of 65 years and older was assumed. It was also assumed that the spending in Scotland, Wales and Northern Ireland per person is similar to that in England.

A real increase of 2% a year would mean that spending per person aged 65 and over would increase from £4,030 per person in 2008/09 to £4,276 in 2011/12. Assuming a constant rate of increase, the per head costs would rise to £5,642 in 2025/26

3.3 Social Care Spending

A similar approach was taken to estimate the publicly funded costs of social care in the UK. The NHS Information Centre has provided data[8] on historic social care spending. In 2003/04 councils in England spent overall £5.7 billion on social care, rising to £7.2 billion in 2008/09. This constitutes a real term increase of 2.7% per year. Costs per person increased by 2.3% per year as the number of people 65 and over has increased during that time. It was assumed that this real term increase per year and person will continue over the next 15 years. Again it was assumed that the spending in Scotland, Wales and Northern Ireland per person is similar to that in England. This would mean that the average spending per person would rise from £910 in 2008/09 to £975 in 2011/12 and to £1,344 in 2025/26.

3.4 Taxes

Although the majority of pensioners do not have an income above the tax threshold, the ones that do pay significant income taxes and additionally all pensioners pay indirect taxes. These tax payments have to be deducted from the sum of spending summarized above to calculate the total net funding.

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[6] Estimated PCT expenditure on HCHS, prescribing and primary care, by gender and age group.

[7] All spending for primary and secondary care which is distributed to PCTs. Public Health and other program sending is neglected.

[8] FINANCE STATISTICS OF COUNCIL SOCIAL SERVICES DEPARTMENTS: 2008 – 2009.

The ONS estimated that in 2003/4 the total tax payments of households of 65 years and older was £28.9 billion[9] rising to £33.5 billion in 2008/09. This constitutes a real increase per person of nearly 1% per year. It was assumed that this is equivalent to the total tax payment of people of 65 years and older.

Using these figures it was estimated that every person of 65 years or older in the UK pays taxes of on average £3,486 in the year 2011/12, rising to £4,332 in the year 2025/26.

4.0 Costs and savings to the government from pensioners living abroad

Pensioners who live abroad outside the European Economic Area (EEA) will on average save the UK Government £4,400 in 2011/12 compared with pensioners who live in the UK. This saving comprises lower services use, which more than offsets any reduced tax payments (see section 3.2).

In November 2009 about 1.1 million[10] British state pensioners were living and receiving their pensions outside the UK. Around one third of those pensioners (370,000) live in other EEA member states and still receive some of the benefits and services enjoyed by UK-based pensioners. The remaining 720,000 pensioners who live outside of the EEA generate the savings outlined above.

While pensioners who live abroad save the UK Government money through their reduced use of public services, they do not all receive the annual uprating of their pensions. In over 100 countries of the world British pensioners do not receive the current rate of pension but only the state pension that applied when they left the UK (or applied for the State Pension from abroad).

This practice of freezing pensions means that pensioners who live in certain parts of the world and who have received their State Pension for more than 10 years are about 30% worse off than if they had stayed in the UK, and pensioners that have received their pension for about 15 years are nearly 40% worse off.

There are currently 543,000 pensioners living abroad in countries where the British state pension is frozen, and this number continues to rise at 1.5% per annum as around 7,000 pensioners a year leave the UK to live in these countries.

Thus, pensioners living abroad in frozen countries currently save the Government more than £2.5 billion per annum. Due partly to the 7,000 pensioners that emigrate every year these savings are predicted to rise to more than £3.4 billion in 2025/26 (£2.1 billion in net present

[9] ONS: TABLE 18A (Appendix 1): Average incomes, taxes and benefits by quintile groups of RETIRED households, 2003-04.

[10] The Department for Work and Pensions provides a Tab tool where the relevant numbers can be downloaded http://83.244.183.180/100pc/tabtool.html

value). Figure 1 summarises the savings generated by pensioners living abroad over the next 15 years.

Figure 1: Annual Savings due to pensioners living abroad

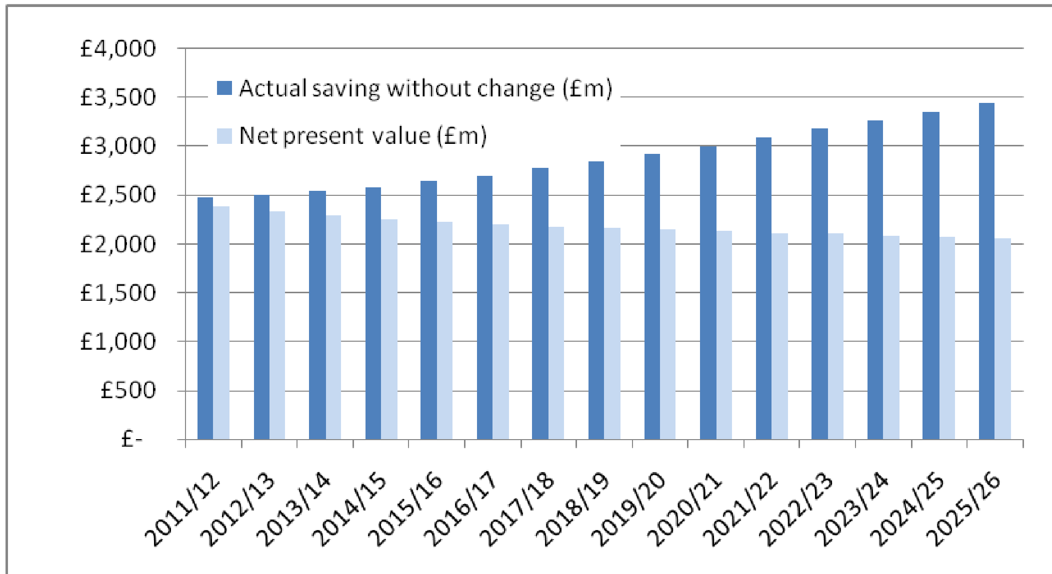
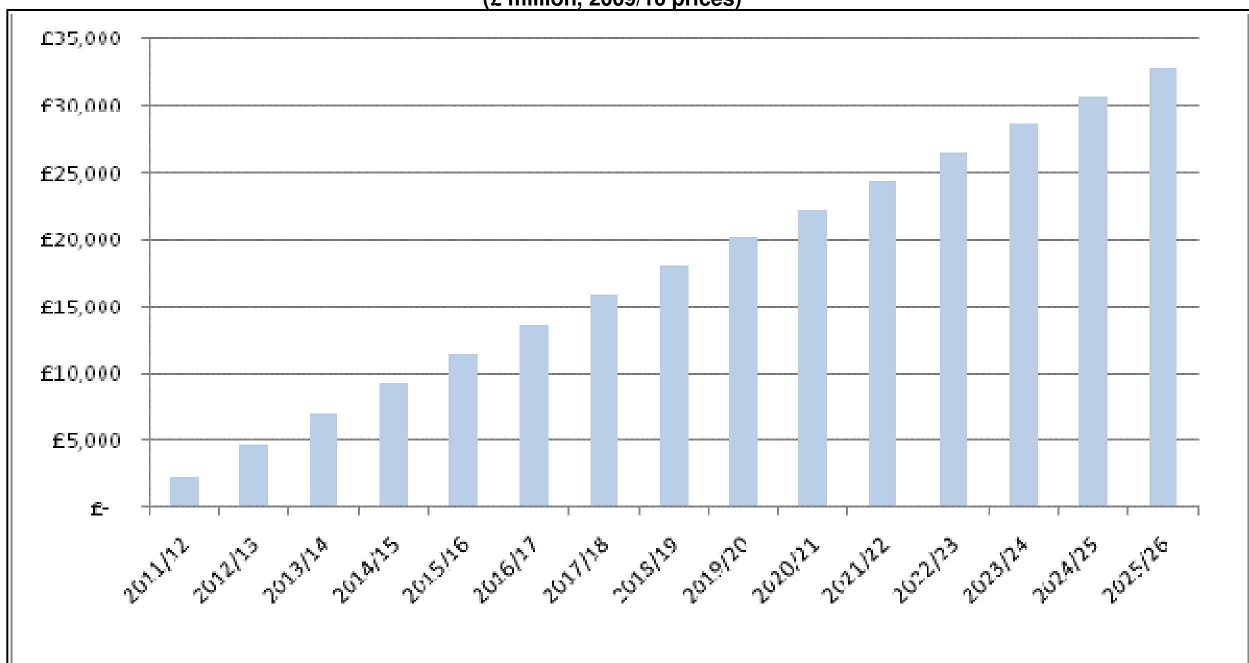


Figure 2 summarises the total savings that will be generated by this group over the next 15 years. It demonstrates that **pensioners who live abroad in frozen countries will save the UK Government £33 billion by 2025/6.**

Figure 2: Net present value of cumulative savings to the UK Government due to pensioners living abroad (£ million, 2009/10 prices)



5.0 Costs and savings to the government of unfreezing pensions

5.1 Costs of unfreezing pensions

To unfreeze pensions would cost the National Insurance Fund on average £800 per year per pensioner living abroad in a country where pensions are frozen. If pensions are unfrozen for the year 2011/12 this would cost an additional £478 million in 2011/12 which would rise to £748 million in 2025/26. Over 15 years the cost of unfreezing would total £6.8 billion.

The total costs of unfreezing pensions (TC) is calculated by multiplying the total number of pensioners with frozen pensions (N) by the difference between the average cost per pensioner without the freeze (ACnF) and the average cost per pensioner with the freeze (ACF). This calculation is summarised in equation 2.

$$TC = (ACnF - ACF) * N \qquad (2)$$

The components of equation 2 were estimated in the following way:

1. **Total number of pensioners in countries where pensions are frozen (N):** The Department for Work and Pensions[11] (DWP) provides estimates of the total number of pensioners living in countries where pensions are frozen. In November 2009 543,000 pensioners were receiving the State Pension in those countries. Since November 2002 this number has increased from 488,000 by an average of 1.5% a year. The calculation assumes that until 2025/26 the number of pensioners with frozen pensions will continue to increase by 1.5% a year.

2. **Pension cost per pensioner with the freeze (ACF):** The DWP estimated that the spending on pensions in countries where pensions are frozen was £871[12] million in 2002/03 rising to £984 million in 2008/09. Using the number of pensioners from above a cost per pensioner was calculated as £1,784 in 2002/03 and £1,849 in 2008/9 - a 0.5% per year growth rate during this period. It was assumed that this growth level would continue, meaning that the cost per pensioner without a change would rise to £2,001 in 2025/26.

3. **Cost per pensioner if unfrozen (ACnF):** If pensions are unfrozen payments for all pensioners with frozen pensions will increase. The size of the increase depends on the time since the pensions were frozen. The average age of the pensioners living abroad

[11] The Department provides a Tab tool where the relevant numbers can be downloaded http://83.244.183.180/100pc/tabtool.html .

[12] Department for Work and Pensions, Information directly provided by the Department, Title: State Pension expenditure, by country status, 1995/96 to 2008/09 (real terms)

in countries with frozen pensions was 75.65[13] in November 2009. The current pension age of 65 would therefore imply an average loss of 10.65[14] years of pension uplift. In 2010/11 a loss of 10.65 years of pension uplift would reduce the full weekly pension for a single person from £97.65 to £67.01 or by 31%. The same proportional reduction of 31% would apply to couple pensions and to levels of reduced pensions. This proportion was used to calculate the average pension payments if all pensions become unfrozen. The average pension payment to this cohort would be £2,719 in 2011/12 and would rise to £3,078 in the year 2025/26 if pensions are unfrozen.

5.2 Savings from unfreezing pensions

Unfreezing pensions would motivate more pensioners to move abroad, resulting in further savings to the UK Government in terms of avoided health and social care services, and reduced benefits payments. A survey of pensioners undertaken by AGEUK, the National Pensioner Convention, ICBP and other bodies, found that about 39% of pensioners that would consider moving to countries where pensions are frozen reconsider when they learn that their pension would be frozen.

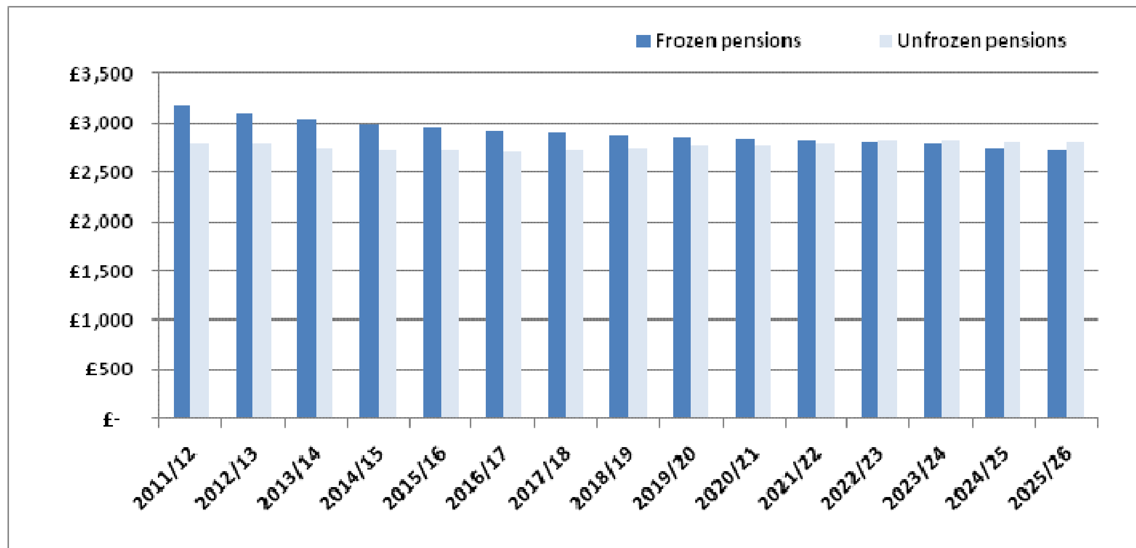
It is estimated that approximately 180,000 more pensioners would live abroad in the next 15 years if pensioners were unfrozen. This would result in £4.8 billion of further cost savings to the UK Government over this period in avoided health, social care and benefit costs.

Figure 3 shows the savings to the UK Government of pensioners living in frozen countries, with and without a policy of unfreezing pensions. It demonstrates that in the short-term unfreezing pensions would reduce the savings associated with pensioners living abroad, as the cost of uprating the pensions of those pensioners already living abroad exceeds the savings associated with reduced public sector service use of those who would move abroad as a result of the policy.

[13] Calculated on the basis of the Tabtool of the Department for Work and Pensions http://83.244.183.180/100pc/tabtool.html .

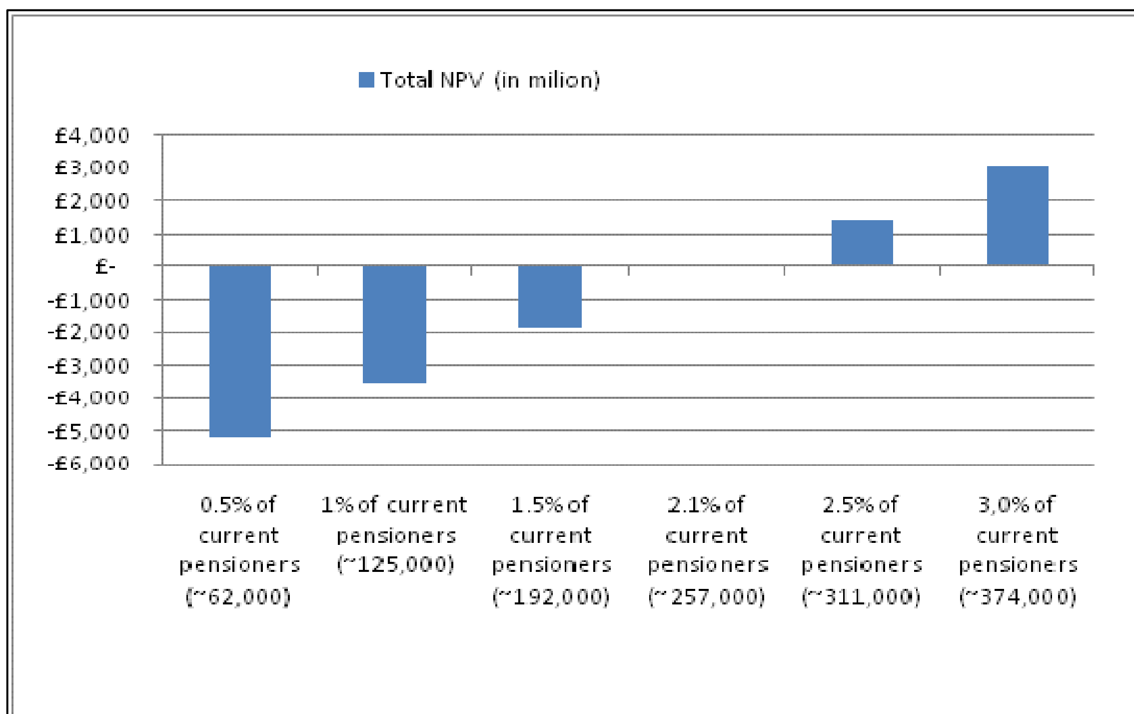
[14] Currently there are some female pensioners younger than 65 (41,000). We have not taken into account the impact of the pension age of women rising in the next decade to the men's pension age of 65 years. Due to their low average pension payments this will not change results by much.

Figure 3: Net present value of annual savings due to pensioners living abroad, with and without frozen pensions (£ million, 2009/10 prices)



The estimate of the savings generated by unfreezing pensions is strongly dependent on the estimate of the number of pensioners emigrating due to the policy change. Figure 4 shows that if more than 257,000 people of pensionable age (2.2% of current pensioners) emigrate over the next 15 years as a result of unfreezing pensions, then the policy would pay for itself over this period. If even more pensioners were to move abroad over the next 15 years, the savings to government would be greater still.

Figure 4: Net present value of unfreezing pension with different emigration assumptions



6.0 Affordability of unfreezing pensions

The costs and savings associated with pensioners living in frozen countries, estimated above, reveal that even if pensions were uprated across the board, as a whole, pensioners living in frozen countries would still save the UK Government approximately £2 billion in the first year after the implementation of the policy. Over the next 15 years, if pensions are unfrozen, pensioners living in frozen countries would still produce a cumulative net saving to the UK Government of £31 billion, £2 billion or 4% less than the saving generated if pensions were not unfrozen.

Furthermore, the cost of unfreezing pensions would not fall on HM Treasury. HM Treasury would reap all the savings from benefits and would lose the tax receipts but the costs would be borne by the National Insurance Fund, which is actually at the moment (unlike the government as a whole) in a solid surplus (£42.3 billion in July 2010 and forecast by the Government actuary to exceed £90 billion by 2015). Table 2 shows how the costs and savings are distributed between the National Insurance Fund and HM Treasury.

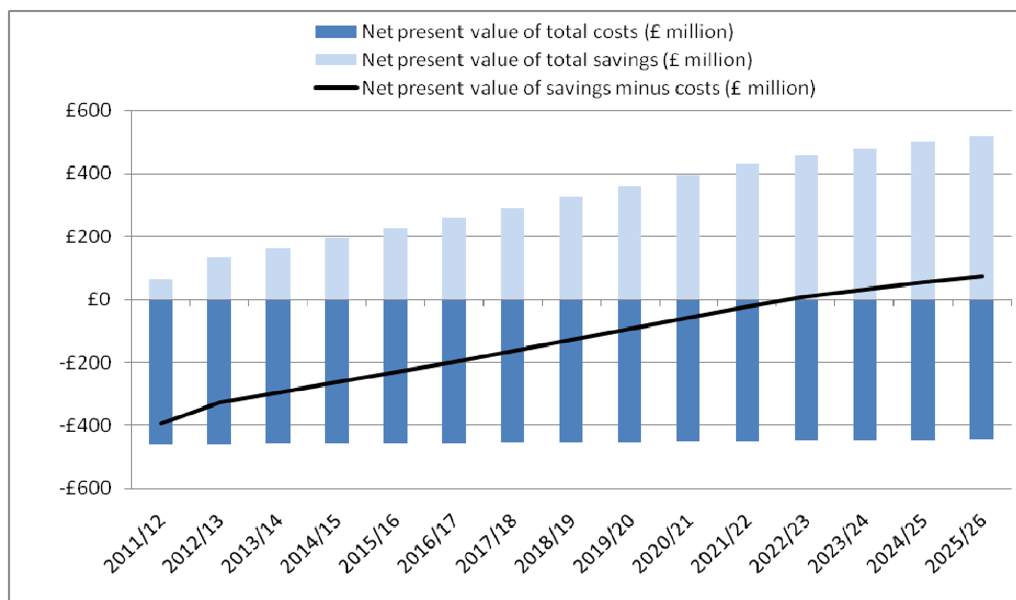
Table 2: Costs for the National Insurance Fund and for HM Treasury of unfreezing pensions

	Total	2011/12
Net present value - National Insurance Fund	-£6.8 billion	-£441 million
Net present value – HM Treasury	£4.8 billion	£66 million

Figure 3 above also demonstrates that the policy of unfreezing pensions eventually becomes self-funding on a year by year basis, and may prove entirely self funding if a long enough perspective is adopted. As more people move abroad due to the policy over time, the savings generated by these movers offsets more of the cost of uplifting the pensions of those pensioners already living in countries where pensions have been frozen.

Figure 5 shows that from 2022/23 onwards the annual savings generated solely by new pensioners moving abroad as a result of a change in the frozen pension policy would exceed the extra cost of the pension uplift.

Figure 5: Annual costs and cost savings of unfreezing pensions



7.0 Discussion

This paper has explored the savings associated with British pensioners living overseas in countries where British state pensions are frozen, and the cost implications of unfreezing those pensions. It is estimated that savings to the government from pensioners living and moving overseas in countries where pensions are currently frozen amount to £2.5billion annually. If the policy were changed and pensions were uprated across the board, savings in the first year would still amount to £2 billion and a total of £31 billion over the next fifteen years.

As with any economic modelling exercise, however, this estimate is subject to some uncertainties. Overall savings will depend heavily on the number of additional pensioners moving abroad each year as a result of any change in policy. Other, though perhaps less significant, uncertainties relate to the public sector costs incurred due to pensioners staying in the UK as a result of pensions being frozen in certain countries. For instance, for some countries it is likely that pensioners return home for health treatment. Thus, healthcare cost savings may be overestimated. However, cost savings as a whole may be underestimated as they do not take into account all services used by pensioners, such as criminal justice services. Additionally some pensioners living abroad still pay some taxes in the UK which would mean that the savings per emigrating pensioners is underestimated.

The analysis presented above adopts a public sector perspective, evaluating the freezing of pensions from the perspective of the exchequer. It, therefore, does not consider the effect of unfreezing pensions on the well being of pensioners. A full assessment of the value for money

of unfreezing pensions should incorporate these well being impacts. It is also worth noting that the induced additional emigration would free up much needed affordable housing and ease the pressures on the housing market.