Partial Uprating:

Cost Benefit Analysis

Prepared for the Rt. Hon. Oliver Letwin MP

Minister of Government Policy

International Consortium of British Pensioners
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Executive Summary

- Partial Uprating – defined as **uprating for frozen pensions going forward from the rate currently received,** offers an affordable policy alternative and a major step towards ending a great policy injustice affecting 560,000 UK pensioners.

- It has **significant advantages** to the status quo, **benefitting all currently frozen pensioners** by ending the real terms year-on-year decline of their State Pensions, and **removes the problem completely for future retirees**.

- There are currently **560,000 British pensioners** living in countries excluded from receiving the annual uprating adjustments to their State Pension.

- The total annual cost of the current (frozen) State Pension payments made to these individuals is £1,200m. **The cost to include currently frozen pensioners in annual uprating at an average of 2.5% would therefore be £30m in year 1.** This represents only 0.03% of current pension expenditure.

- The government has previously accepted that **there is an average £4,300 (£3,800 in 2010) net saving per pensioner that moves overseas** (mainly from unused health and social care)

- It would therefore require just **6,977** more people to either retire - or remain - overseas each year to cover the cost of uprating the State Pensions for all existing frozen pensioners

- The ICBP knows from our research and membership that **the prospect of a frozen pension currently deters emigration to frozen countries.** A change of policy would remove this barrier and facilitate increased pensioner emigration.

- This is an **increasingly significant issue for some of the 2 million British Black, Asian Minority population (BAME) currently at or near retirement**, many of whom were first generation immigrants to the UK in the 1950s-70s and still have strong ties to their country of cultural origin. Our research suggests these individuals are highly likely to at least consider a move overseas in retirement.

- We know from our membership that **the financial reality of frozen pensions is a significant factor for some of the 2,500 (average) pensioners from frozen countries returning to the UK each year.** A change of policy would allow more of these individuals to remain overseas.

- **Research is needed to fully explore the potential behaviour change consequent to a change in frozen pension policy**, but the number involved is so small we consider this to be a very limited risk for the Treasury.

- There is **clear precedent for implementation and no legal risk of back payment claims** with this policy, as there is no implied recognition of historic entitlement.
- The UK is facing an ageing crisis and an NHS crisis. By 2035, the number of people at pension age is forecast to be 15 million, compared to 11.6 million today. Numerous studies have concluded that **older people consume NHS resources at an order of magnitude greater than a young person**. A pensioner in their 80's can cost the NHS 8 times the cost of a person in their 40's, depending on chronic or long term medical conditions.
- **Any policy change that facilitates pensioner emigration therefore makes sound economic sense.**

1. Background

1.1 The current situation

560,000 UK pensioners living abroad in primarily Commonwealth countries, including Australia, Canada, New Zealand and South Africa currently have their State Pension "frozen" in retirement.

For the 4% of British pensioners affected, they receive a State Pension at the same rate throughout their retirement – the rate it was when they first became entitled, or on the date they left the UK if they were already pensioners. Frozen pensioners do not receive the annual uprating awarded to British pensioners living in the UK, EU, or a range of other countries with which the UK has an historic reciprocal social security agreement to do so.

Frozen pensions are widely recognised, even by Ministers for DWP, as the product of inconsistent, unfair and anachronistic policy, however successive governments have failed to address the issue, citing the estimated cost of doing so. It is for this reason that the Coalition Government decided not to resolve the frozen pension issue within its comprehensive pension reform programme and as a result, the frozen policy will currently continue to apply when the single-tier State Pension is introduced in April 2016.

The International Consortium of British Pensioners exists to campaign for the unfreezing of State Pensions for all British pensioners regardless of where they reside and has been campaigning for an end to this injustice for over thirty years.

1.2 Impact of Frozen British Pensions

The impact of the frozen pension policy is that, in real terms, the value of the State Pension received by frozen pensioners falls throughout a recipient's life.

For many this results in an inability to live independently, serious pensioner poverty or forces individuals to move away from family abroad and back to the UK.

For others, currently living in the UK and approaching retirement, the prospect of a frozen pension is a barrier to exit, preventing individuals moving abroad to live where they want or with family overseas in their retirement. This includes an increasing number of ethnic minorities.

1.3 Partial Uprating: Significant Advantages to changing the Status Quo

In addition to affordability, there are many advantages to an approach of partial indexing:

1. Partial uprating is a positive step forward in redressing a long standing policy anomaly and the discriminatory treatment of British pensioners according to which country they choose to live in.

2. Partial uprating immediately stops any further decline in the purchasing value of all currently frozen pensions. All currently frozen pensioners benefit.

3. Partial uprating would end the frozen pension problem for all future generations of pensioners.

4. There is a clear precedent for partial indexing. This approach is identical to that used when reciprocal agreements were signed with countries such as the US, and most recently Barbados, through which overseas pensions have been unfrozen. In these cases, no retroactive adjustments were given to the pre-existing frozen pensioners in those countries.

5. Partial unfreezing would be very easy to implement. When the annual uprating is voted on by Parliament each year, it is awarded to all pensioners. Subsequently Regulation 3 and Regulation 5 are invoked, to remove the increase from frozen countries. All that would be needed to implement partial indexing is simply to not execute, or to modify, the Regulations in question.

6. For the 6+ million Black, Asian and Minority Ethnic (BAME) population group in the UK, it sends a very positive message of addressing a long standing discriminatory policy that inhibits freedom of movement.

2. Financial Calculations

The ICBP believe that Partial Uprating would be cost neutral for HM Treasury through consequential savings, and that the policy has potential to generate net savings.

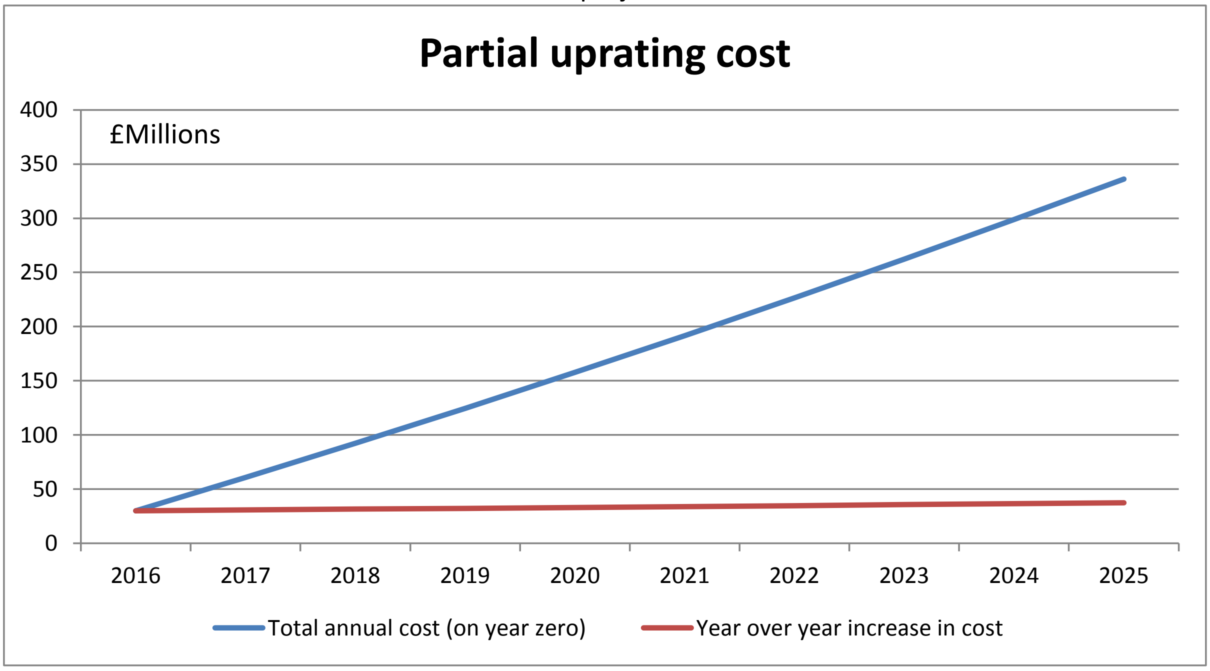
2.1 Cost Calculation

The estimated cost to partially uprate frozen pensions is shown below:

Table 1. 5 year projection

	Year 1	Year 2	Year 3	Year 4	Year 5
Cost of State Pensions in Frozen Countries (carried from previous year)	£1,200m	£1,230m	£1,260m	£1,292m	£1,324m
Year over year cost of annual uprating (2.5%)	**£30m**	**£30.8m**	**£31.5m**	**£32.3m**	**£33.1m**
Total annual pension cost	£1,230m	£1,260m	£1,292m	£1,324m	£1,357m
Additional annual Government Spend	**£30m**	**£60.8m**	**£92.3m**	**£124.6m**	**£157.7m**

Chart 1 10 Year projection



The charts above are based on DWP figures, provided to us through a Freedom of Information request.

The DWP makes the following assumptions:

1. Figures shown are annual partial uprating costs, expressed in nominal terms.

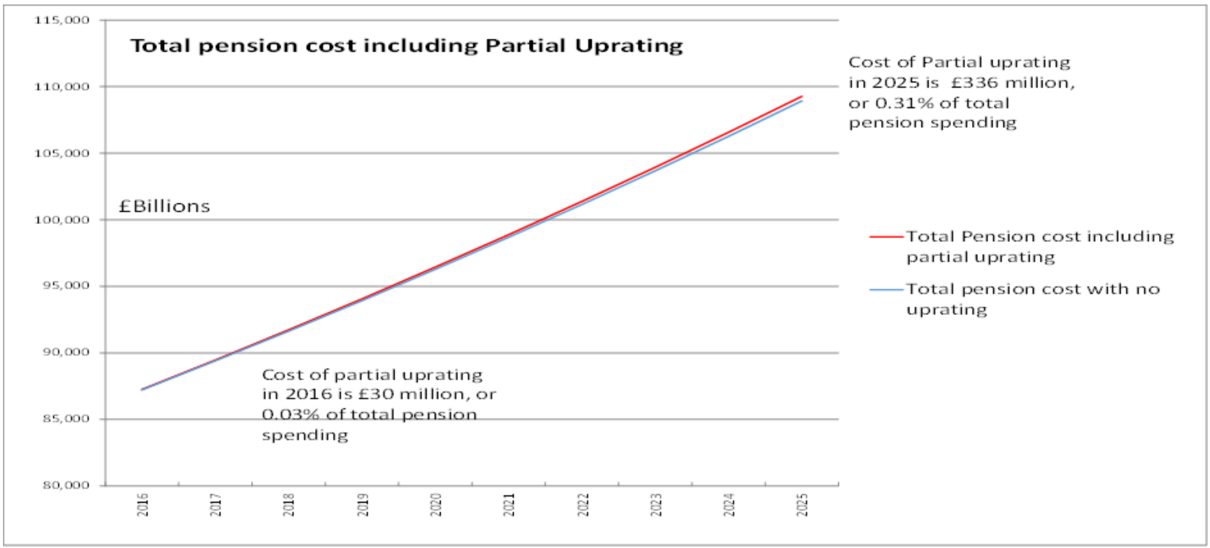
2. There will be a steady caseload of pensioners living in currently frozen countries: i.e. no increase or decrease in the total number of pensioners. (i.e that for every current pensioner that dies, there would have to be a new pensioner just retiring to replace them.)

3. There will be an annual average pension uprating of 2.5% over the period.

The annual additional cost of partial uprating is simply 2.5% of the total current cost of the State Pensions paid to currently frozen pensioners.

This cost obviously compounds over time if taking year zero as a measuring point, with the total cost of the frozen pension policy increasing each year in the same way the cost of uprating any benefit would when measured in this way.

Chart 2 10 year projection



To place the costs in context, the chart above shows the cost of partial uprating compared to the cost of all pension expenditure. As a percentage of the total pension cost in year 1, partial uprating is negligible at 0.03%. Even after 10 years, the cost is still only 0.31%

The ICBP would suggest that £30million per year is a small price to pay for a policy with such significant advantages and that ends a long standing injustice.

For comparison purposes, Mr. Robert Devereux said on 14 September 2015, at a meeting of the House of Commons Public Accounts Committee, that he considered a State Pension error and fraud rate of 0.2% (approximately £170m) to be tiny.[1] The initial cost of partial uprating is six times smaller than that.

2.2 Benefit Calculation

The ICBP believes that the introduction of uprating for currently frozen pensioners would generate financial benefits for HM Treasury. The financial benefit comes from two scenarios.

1. **Increased emigration from the UK,** enabled and facilitated by an unfrozen pension

   Using Government figures, we estimate a £4,300 net annual saving for every pensioner that leaves the UK.

2. **A decline in the number of pensioners returning to the UK from frozen countries**, due to their frozen pension affecting their lifestyle abroad.

[1] *Robert Devereux:* Oral Evidence to the Public Accounts Committee, Fraud and error stocktake, HC 394, Question 15 (Monday 14 September 2015), http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/public-accounts-committee/fraud-and-error-stocktake/oral/21563.html

From 2009 – 2014, 15,000 pensioners returned to the UK from frozen countries. This has come at significant cost to the UK, in terms of increase NHS usage, and consumption of other age related benefits. We believe frozen pensions were a definitive factor for some percentage of these returnees.

Net Savings for Overseas Pensioners

In 2010, an Oxford Economics study, using published Government statistics, identified that a pensioner who permanently leaves the UK saves £7,700 a year in NHS usage,[2] and other age related benefits.[3] This savings would be offset by lost income tax, indirect taxes and Council tax, estimated to be £3,900.[4] The net savings to the UK of a pensioner emigrating is therefore £7,700 - £3,900 = £3,800 per pensioner per year, as at 2010.

Assuming an inflationary adjustment of 2.5%, the net savings in 2016 would be £4,300 per person, rising each subsequent year by an ongoing inflation factor. (This is a conservative estimate, as NHS expenditure (a key component) has grown from £64.1 billion in 2003/2004 to £113.3 billion in 2014/2015 – an average annual increase of 4.7%).

When a frozen pensioner returns to the UK permanently, there is a similar net increase in cost to the UK Treasury. The increase in NHS usage costs and other age benefit costs is offset by any new income tax, indirect tax and council tax revenue, resulting in a net cost to the Treasury in 2016 of £4,300 per person, and this will increase every year. (This is also a conservative estimate as there is an additional cost for returnees. Every frozen pensioner that returns has their pension uplifted to current pension amounts. If the pensioner returns at age 65, this has no impact, but if they returned at age 75, their pension would be immediately uplifted by approximately 28%. We have not attempted to estimate this, as it depends on the age of the returning pensioner).

The ICBP thesis is that if pensions are unfrozen, the savings from both increased emigration from the UK and fewer pensioners returning to the UK means that it would take just 6977 pensioners to change their behavior regarding where to reside, to offset the cost of partial uprating.

Because savings compound in the same way costs do, the estimated savings offset the rising cost of the partial uprating policy over time. Furthermore, assuming net savings also increase by inflation, the annual number needing to change behavior will remain stable and realistic at just under 7,000.

[2] PESA 2010, Seshamani, Meena (2002) *The impact of ageing on expenditures in the NHS.* Health Economics Research Centre, University of Oxford

[3] Examples include Pension Credit, Housing and Council Tax benefit, Cold weather payments and Social care benefits

[4] ONS Barnard, Andrew, The effect of Taxes and benefits on Household income 2008/2009

Table 2 below shows the impact of the behavioural change of just under 7,000 pensioners.

Table 2

	Year 1	Year 2	Year 3	Year 4	Year 5
Year over year cost of annual uprating (inflated at an average annual2.5%)	-£30m	-£30.8m	-£31.5m	-£32.3m	-£33.1m
Additional Government Spend (on year zero)	-£30m	-£60.8m	-£92.3m	-£124.6m	-£157.7m
Estimated savings for each pensioner that adjusts behavior (inflated by 2.5% annually)	£4,300	£4,408	£4,518	£4,631	£4,746
Number of pensioners who need to change behaviour in year to balance costs	6977	6977	6977	6977	6977
New annual savings generated as a result for HM Treasury	£30m	£30.8m	£31.5m	£32.3m	£33.1m
Total saving for HM Treasury (on year zero)	**£30m**	**£60.8m**	**£92.3m**	**£124.6m**	**£157.7m**
Net impact to HM Treasury	0	0	0	0	0

2.3 Breakeven Point:

Using existing Government data, ICBP estimates that the breakeven point occurs when any combination of additional emigrants and/or fewer pensioners returning add up to a total of 7,000 people annually.

Any number beyond that produces net financial benefits to HM Treasury.

In making a policy decision to unfreeze pensions, the Government would be incurring a certain initial cost of £30 million, which will increase every year by the uprating factor.

Any benefits that accrue from uprating have a risk attached, in that they might not materialize. We understand that. Our research into the probability factor has led us to conclude that these risks are so small as to be almost nonexistent.

To put this annual number of 7,000 pensioners who need to change behavior as a result of partial uprating in perspective:

- 7,000 represents 0.06% of the current UK resident pensioner population of 11.6 million.
- 7,000 represents just a 2.2% increase on the 323,000 who emigrated from the UK last year.
- 7,000 is a tiny number in the context of annual fluctuations in emigration. Over the last 10 years annual emigration from the UK has varied by as much as 110,000, with a high in 2008 and low in 2013.
- 7,000 represents 0.3% of the 2 million strong BAME population over 55. A demographic group whose choices are disproportionately affected by the prospect of frozen pensions and who we believe are more likely to consider a move overseas in retirement.

- Based on the midpoint of two separate survey results, 7,000 represents 2.1% of a population of 325,000 pensioners **who have already indicated a strong desire to emigrate, providing their pension would not be frozen.**

We believe that in this context this breakeven number is so small that the predicted behavior change carries very little risk.

3. Examining the predicted behavior change factor

3.1 Increased Emigration

It is very difficult to prove absolutely that there will be increased emigration if the UK were to unfreeze pensions going forward. This is often the case when Government is planning a change of policy. There are, however, already strong indicators that we believe will be supported through government research if commissioned.

Two different opinion polls have been carried out, in 2011 and 2014 by separate professional polling companies.

Opinium Poll – February 2011

A random survey of over 1,000 soon to be retired individuals in the UK, aged between 45 and 64, was conducted to determine how many current and future pensioners would be dissuaded from moving abroad if it meant that their pension payments would be frozen as a result. Using standard statistical analysis, a random survey of this sample size results in a 99% confidence level, with a +/-4% error factor.

Among other questions, survey respondents were asked:

- "Would you consider moving abroad when you retire?"
- "What country would you be most likely consider moving to?"
- "How likely is it that you would change your mind about retiring abroad if you knew that your pension would be frozen?"

Of all survey respondents, a subset indicated a willingness to move abroad (56% for soon-to-be retired individuals, 30% for already retired individuals). Of that number, another subset indicated a desire to move to frozen-rate countries specifically (30% for soon-to-be retired individuals, 19% for already retired individuals). Of that number, some indicated an extreme likelihood of changing their mind about moving if it would result in receiving a frozen-rate pension (27% for soon-to-be retired individuals, 39% for already retired individuals), while others indicated a lower likelihood of changing their mind.

To produce a figure representing the propensity of pensioners to move abroad depending on pension uprating policy, the percentage related to the first subset is multiplied by the percentage relating to the second subset. The resulting percentage is then multiplied by a weighted average of percentages that corresponded to respondents' stated likelihood of changing their mind if moving would result in receiving frozen-rate pensions. The net result is a probability representing pensioners' propensity to move abroad depending on pension uprating policy. This procedure was conducted twice – once for currently retired individuals and once for soon-to-be retired individuals – providing propensities to move of 7.6% for soon-to-be retired individuals and 3.4% for already retired individuals.

Using the calculated propensities to move, it is then possible to estimate the number of additional pensioners who could be induced to move abroad if pensions were unfrozen.

According to DWP Caseload tables, in 2015 there are 12,880,000 State Pensioners, of which 1,211,000 are currently living abroad. That leaves 11,669,000 pensioners resident in the UK.

Using the survey calculated figure of 3.4% of already retired individuals with a propensity to move abroad if pensions were unfrozen, produces an estimated 397,000 potential new emigrants. This figure does not include pre retirees from the survey, who indicated an even higher propensity to move.

OnePoll – October 2014

The 2011 Census in the UK states that there are 6,000,000 people in the UK that identify as being of African, Asian, South East Asian or West Indian (BAME) ethnicity. Of that 6 million, 2 million are aged 55 and older. The majority of those people came to the UK in the 1960s, 1970s and 1980s to seek work, and are now reaching retirement age.

There are no immigration barriers to this group of people returning to their country of birth. The median retired household income in the UK is £15,000 a year. [5] This income, including an indexed State Pension, would place them in the top 10% of income of the population in countries such as India and Pakistan. In addition, countries like India have excellent health care for people who can afford it. There is also a push from the Indian government for expats to return home to India.

ICBP commissioned a poll in October 2014, carried out by OnePoll, a reputable and well known polling company. 600 people of African, Asian South East Asian and West Indian ethnicity were sampled. Given this sample size, and a population of 6,000,000, the survey has a 95% confidence level, with a 4% plus or minus error factor.

The results were revealing.

1. 61% of respondents did not know that their pensions would be frozen if they went back to their country of origin.
2. 51% of respondents indicated that they were likely, or very likely, to return to their country of origin on reaching retirement age.

[4] ONS Barnard, Andrew, The effect of Taxes and benefits on Household income 2008/2009

3. 40% indicated that knowing their pension would be frozen would possibly affect their decision to leave, while 25% said it would definitely affect their decision.

Given the population size of 2,000,000 over the age of 55, the number of people who indicated they were likely or very likely to leave the UK to return to their homeland within 10 years, and who would not go based on their pension being frozen, can be calculated using the formula.

2,000,000 x 51% (likely to leave) x 25% (definitely would remain if pensions were frozen) = 255,500

Conclusions:

No poll is definitive, especially regarding important life decisions such as emigration. However, two professionally conducted polls, done by two different polling organisations, of two different groups of respondents, with statistically valid sample sizes, both produced numbers of between 255,500 and 400,000 pensioners who would most likely emigrate, but only if their pension was not frozen. The 255,500 figure was from a targeted survey of BAME's, and the 400,000 from the entire population of pensioners.

Using the midpoint of the two polls of 325,000, spread over the 10 year period, this equals an average of 32,500 potential new emigrants per year, if pensions were unfrozen.

If the business case for unfreezing pensions assumed that the majority of those pensioners would in fact emigrate, it would be risky. However, the business case only requires 7,000 additional pensioners to emigrate annually for partial uprating to be cost neutral to the UK. Taking the midpoint average of the two survey results of 32,500 per year, the 7,000 number is only 21.5% of those pensioners **who have already indicated a strong desire to emigrate**, **if their pension was unfrozen.** Even if the surveys accuracy were off by 78%, it would still be profitable for the UK to unfreeze pensions going forward.

Putting this in context of the pensioner population as a whole, the breakeven of 70,000 new emigrants over 10 years represents only:

- 3.5% of the 2 million BME's currently at retirement age.
- 0.6% of the entire current UK resident pensioner population.
- 1.16% of the full 6 million (and growing) BME population
- 0.5% of the expected 13.2 million pensioners in 2025.

These numbers are so small as to be very low risk to the Treasury.

3.2 Fewer frozen pensioners returning

In addition to more pensioners emigrating if pensions were unfrozen, fewer pensioners would return to the UK from frozen countries. Since 2009, 15,000 pensioners have returned to the UK from frozen countries, and are now receiving their fully uprated pension.[6] It is not known exactly why they all

[6] State Retirement Pensions: British Nationals Returning From Abroad - Craig Mackinlay MP - Nov 15

returned, but it is a reasonable assumption that frozen pensions were a factor in some of the cases. Each pensioner who returns to the UK costs the treasury an additional net £4,300 per year in NHS usage and other age benefits. They also may consume council housing stock.

Using the figure of £4,300 per year net savings for every pensioner who leaves the UK and for every pensioner who does not return to the UK (and assuming a future annual average cost increase of 2.5%) it is possible to calculate the annual savings over a 10 year period. The chart below shows the cost of partial uprating and the savings from any combination of increased emigration and fewer returnees that add up to 7,000 annually.

Chart 3 10 year breakeven projection