STATES OF JERSEY

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SOCIAL SECURITY FUND: REMOVAL OF EARNINGS LIMIT (P.82/2005) – COMMENTS

Presented to the States on 10th May 2005
by the Employment and Social Security Committee

STATES GREFFE

COMMENTS

The Employment and Social Security Committee cannot support this proposition and urge members to reject it on the basis of principle and detail. The Committee does not recognise a "defect" in the system and totally distances itself from the view of "haemorrhaging of general revenues into the supplementation system." The social security system in Jersey is a successful insurance system funded by employers, workers and the government where benefits are only derived from contributions paid. Supplementation or the States' Contribution to the social security system affords protection from the wider net of income tax payers to low earners to provide future pensions at a modest but adequate level. The Committee believe it unfair to place additional financial burdens on earners, who themselves may not be very well-off without protection. Deputy Southern's proposition reduces the protection to low earners and increases their financial burden beyond that of the overall Finance and Economics total fiscal package.

In considering this proposition, the Committee has looked at the principle and impact on the individual and individual businesses. Not least in this consideration is the impact on the States as an employer of considerable numbers of professional people, such as teachers, consultants, doctors and service providers who earn more than £35,000 a year (the earnings limit in 2004 was effectively £34,560 a year and in 2005 is £35,560). There is a disproportionate impact on staff costs particularly in departments with high labour costs, which may be driven not by numbers but by salaries. For example in Health and Social Services with expenditure of £132 million a year an increase in employer costs could totally wipe out a 2% growth in expenditure. In practical terms in order to make up the tax deficit, the States would have to introduce measures to raise more than has been identified under Deputy Southern's proposals to counter the increase in direct labour costs that the States would have to bear.

The Committee believes that extreme care should be exercised when dealing with the important issue of the funding of the social security pension scheme. The risk of changing the funding mechanism should be borne in mind, in that a much narrower population is being targeted in Deputy Southern's proposition; workers' earnings rather than just income. Furthermore, by raising considerable amounts from a relatively small population of people earning over £35,000 a year the scheme becomes more susceptible to significant impact caused by relatively minor changes. It is estimated that there are only approximately 8,000 to 10,000 individuals earning in excess of £35,000 a year. The number of households with income over £35,000 a year is estimated to be 12,346. When it is considered that in the future there will be less workers supporting non-workers, restricting the funding of the scheme in the manner proposed is extremely risky.

In 2004, the Employment and Social Security Committee published R.C.49/2004 which outlined the development of the social security system in Jersey and the potential for increasing contribution rates to increase the range and value of benefits. The social security pension has always been of utmost importance to the great majority of contributors and beneficiaries, any adjustments in contribution rates to protect these in future could be vulnerable, if supplementation is lost.

Supplementation

Deputy Southern's assertion is that supplementation is a "pre-existing defect in the structure" and the proposition stops "the haemorrhaging of general tax revenue" into the supplementation system. There is no clear logic behind this other than the recognition that with a £50 million transfer back to general revenues, part of the predicted tax deficit would be covered and that the deficit would lie with the social security system to be made up by increases in contribution rates across the board and removal of the ceiling. This is a back door method of introducing a payroll tax. As Deputy Southern points out in one of his principles "the fairest means of taxation is income tax" and, because of Jersey's income distribution, the unfairness of a payroll tax is amplified by the large amounts of unearned income that is taxable through income tax but not incorporated in earnings on which social security contributions are levied.

The concept of Supplementation was designed in the early 70s, incorporated into the Social Security (Jersey) Law 1974 and should not be considered as a simple grant to the Social Security Fund. It actually serves several purposes.

- Social security in Jersey, despite the view of some commentators, is an insurance system, which is defined as having a direct link between the payment of contributions and the payment of benefits, pensions and grants. The premium in this system is in reality flat-rate and is fixed by an overall percentage contribution rate set at an earnings ceiling. Those earners who earn below the ceiling cannot pay the full premium and the States makes up the difference from general revenues. For each individual earning below the ceiling this "supplement" to their premium is calculated monthly and all the supplements are added together and called "supplementation". Supplementation is a benefit to low earners that is effectively paid when a pension is claimed.

- The Social Security scheme in Jersey is comparatively small and can be influenced by small changes in economic climate. Unlike other jurisdictions, supplementation works to protect workers from economic vagaries, which may be reflected in the wage packet especially if compulsory contributions were flat rate.

- Contribution rates in Jersey have been pitched relatively low by design to allow contributors the opportunity to save for the future if at all possible. Increasing contribution rates naturally affects disposable income, without any choice to the contributor, leaving less money for saving. Clearly supplementation helps to protect the contributor from this effect.

- Supplementation, as defined by the earnings ceiling and contribution rates for employer and employee, puts the social security system in Jersey on a "tri-partite funding basis; that is the scheme is equally funded by employer, employee and government in the ratio 1/3rd:1/3rd:1/3rd each.

Recent changes to contribution rates and the earnings ceiling were planned and calculated with the assistance of the Government Actuary and then fully consulted upon with contributors and beneficiaries. The well-planned changes have not been haphazard contrary to the impression given in the proposition. Changes were necessary for 2 reasons. Firstly rates were increased to cater for the demographic changes that Jersey will experience soon. At present each pensioner is supported by approximately 4.8 workers in the Jersey system but in 30 or so years' time this figure will reduce to about 2.5 workers for each pensioner. It would appear to be risky to place a further direct burden on the earnings of workers with this knowledge.

Secondly, since 1974, the principle of equally funding had been eroded by the indexation of benefits and contributions. Despite a change to the earnings index in 1991, this imbalance continued with the States contributing approximately 28% through supplementation in 1997. An additional £50 was added to the monthly earnings ceiling each year from 1998 to 2001 (4 increases) to redress the balance. Removing supplementation through changing rates and removing the ceiling turns the system into a type of payroll tax but one with no government involvement. The system becomes more of workers' mutuality where the stakeholders are beneficiaries, workers and employers. It could be argued that such an "occupational" scheme, given the size of the system, should be removed from political interference, as the government has no financial input and should be governed by its stakeholders.

Impact

One of Deputy Southern's principles is that wherever possible the least well-off should be protected. Unfortunately his proposition, which increases individual rates across the board, affords no protection to the less well-off earner. Interestingly, without acknowledging the different circumstances of households, as income tax does, the effect of his proposals on earnings above £35,000 could have substantial consequences in certain households. Even a person earning £10,000 a year will be £3 a week worse off under the Deputy's proposals if contributions are only increased by 1.5% for individuals. At the higher end of the scale a person earning £50,000 a year would be worse off by £32 a week**.** The Committee notes that the Deputy's report suggests that the transfer of the burden of supplementation will rest on "eventually all contributors" not just those on earnings higher than the earnings limit. It is difficult to see how this makes the fund self-sustaining, as is suggested in the report.

It is estimated that 22% of the value of supplementation (not the numbers receiving supplementation) supports the contributions of those under the age of 25. The Deputy is also silent on the effects his proposition will have on the self-employed, bearing in mind that in Jersey the number of small businesses is disproportionately large.

Unlike individuals, employers and the self-employed have some protection for increasing social security costs through the vehicle of tax relief. However, the cost to business and the effects on the economy are a consideration that will be answered by the Finance and Economics Committee. There is a cost nevertheless and the cost of these proposals on the Island’s largest employer, the States has not been identified. Looking at available data suggests that there are about 8,000 to 10,000 people earning in excess of £34,000 in Jersey. Estimates from the social security contribution system suggest that about 4,000 people in public administration pay contributions on earnings at or above the contributions ceiling. Departments with professional service staff, Education Sport and Culture, Health and Social Services and Home Affairs, for example, will see an increase in staff costs. Further work would have to be done on this detail but using Health and Social Services Committee as an example, a 3% increase on the amount collected through employers’ contributions would add about £2.8 million to direct labour costs (currently £93 million) which in terms of expenditure (£132 million) would more than account for a real growth of 2%. Education Sport and Culture have about 700 employees out of a total of 1,500 who earn above the earnings ceiling. To allow for this factor the States would have to collect more in contributions. In fact it can be argued that this proposition requires the States to collect more than is necessary merely to plug the tax deficit, and therefore does have a financial consideration that has not been identified by Deputy Southern.

Risk

The Social Security system in Jersey is one of insurance and as such is well-respected and it is understood that benefits can only be paid if contributions are paid. As the Deputy states, the issue is a matter of philosophy, and the Committee remains firmly behind a system of insurance as opposed to a system of tax This stance is reflective of the risk of placing the financial future of the system totally in the hands of a smaller net of income collection from a narrower band of people. The risk is increased by further focusing on a group of up to 10,000 individuals with earnings over £35,000 a year within a population of 87,000.

The benefits of an insurance philosophy are also demonstrated in compliance terms where employed earners’ misdemeanours are few. However in terms of the self-employed the assessment of earnings is difficult and compliance is not so easily obtained. This is more prevalent where individual business income can be presented in a variety of ways to minimise declared income. Moving the system to a payroll tax base could cause more forensic accounting methods to be employed to guarantee that the calculation of earnings are fair and reasonable and does not disadvantage the general body of contributors and beneficiaries. There is likely to be additional administration costs.

Deputy Southern suggests that removing the ceiling would not be too much of a risk for the tourism and agricultural industries because their relatively low wages would protect them from increased costs. The other side of the argument to this is that supplementation is providing protection now to these sectors. These sectors are not alone however. In 2002 some work was undertaken on supplementation in sectors and whilst hospitality had the most contributions supplemented (5,274) in the analysis, public administration had 5,241, retail 4,496, construction 4,630 and banking 4,048. Agriculture being a smaller sector had 1,914. The point to be made is that supplementation is an important feature throughout all sectors of industry.

Comparisons

The Deputy makes reference to the recent report “Social Protection in Jersey – a Comparative Study” and the Committee would draw the Deputy’s attention and that of Members to the reply given to the Deputy to a question put by him on 15th March 2005. As with any comparison it is important to compare like with like and drawing comparisons on “social protection” in a proposition on social security funding might be termed unfortunate. Social protection by definition includes health care for example which is dealt with differently in mainland Europe than the U.K. and Jersey and in a small jurisdiction may skew the comparison. European figures also include occupational pensions schemes funded not by the States but by employer and employee contributions This is clearly stated in the report in the paragraph underneath it, which the Deputy does not appear to take into consideration when making his assumptions. The breakdown of expenditure is different compared to Europe and the government contribution in Jersey is also sourced differently. The General Revenues of the States, which are derived from tax, have a comparatively large component drawn from business and employers. This information was published by the Finance and Economics Committee in the fiscal review consultation.

The question has been asked as to the level and type of Government contributions in other countries. This varies between countries; some make grants, others fund specific programmes (for example unemployment), or the government guarantees the difference between what is collected and what is actually paid out. Andorra for example has no government contribution whilst Austria, in general, picks up deficits in the different programmes, e.g. pensions and unemployment. The U.K. Government gives a grant of 17% of benefit expenditure of contributory programmes as well as 92% of maternity schemes whereas Guernsey give a grant of 50% of total contribution receipts. France has a system of variable subsidies but earmarks certain taxes on alcohol, tobacco and car insurance to fund sickness and maternity insurance. In short there is no clear pattern. It is quite clear that most Governments in developed countries see it as their role to support the most vulnerable in the community by funding social security programmes in one way or another.

Timescale

Taking just a cursory look at the work that would be required to implement the proposals it is quite evident that the timescale is impossible if all legislative changes; payroll systems and computer system amendments are to be in place by 1st January 2006. What is being proposed would require a legislative change, which is ultimately a change in the primary Law and will take longer to amend than a simple Order or Regulation.

It would also be prudent to ask the advice of the Government Actuary and other experts before embarking on a fundamental change to the system of funding States age pensions.

Changes in computer systems affect businesses as much as government departments and enhancements to payroll packages would need to be made and would have to dovetail with any changes being promoted through the ITIS tax collection system.

Finally introducing an additional labour cost for 2006 does not allow sufficient warning for some businesses to reflect price changes in services and goods they provide for the year 2006. Changes to the rates of contributions in 1998 were only achieved after giving over a year’s notice.

Summary

The Committee urges members that this proposition must be rejected as the risks to existing and future beneficiaries are too great and it would place the Social Security Fund in a vulnerable position. Social Security contributions should be used to fund social protection and, with the requirement in the future to consider ensuring that existing benefits are protected and the possibility of extending the scheme to enhance pensions, establish a contributory jobseeker’s allowance and importantly an elderly care programme, it is vitally important to retain the existing valued partnership that exists with employees, employers and government. If this proposition was approved and contributions were raised now it would make it more difficult in the future to introduce any of the new social and health protection programmes.