STATES OF JERSEY

OLD AGE PENSION: METHOD FOR INCREASE (P.164/2011) – COMMENTS

Presented to the States on 15th March 2012
by the Minister for Social Security

STATES GREFFE

COMMENTS

Summary

States Members are strongly urged to reject this proposition.

We should all be proud of the stability of our pension scheme and the firm basis on which it is funded. Successive Social Security Presidents and Ministers have made long-term decisions to protect the sustainability and long-term future of the Social Security Fund. These decisions have helped to ensure that a fair pension is available to all contributors in their old age.

- The proposal to move to a more generous uprating formula for pensions creates a significant additional cost to workers over the next few decades, at a time when contribution rates will need to rise just to maintain the current value of the pension.

- The cost of the proposal will increase cumulatively over time, reaching an annual additional sum estimated to be around £30 million by 2069 (and possibly up to £82 million). This cost will need to be borne by our children and grandchildren, during their working lives.

- The cost of the proposal completely reverses the savings and improved sustainability of the Fund recently achieved through the agreement to increase the pension age.

- The proposal is poorly targeted. The increased value of the pension will be enjoyed by both high income and low income pensioners, by both pensioners living in Jersey and the substantial proportion of pensioners who live overseas.

- If this proposal is accepted by the States Assembly, serious consideration will be given to bringing forward an increase in contribution rates to preserve the sustainability of the Fund and to ensure that current workers closer to pension age start to contribute towards the cost of such an improvement in their pension terms.

1. Background Information

1.1 Pension level and uprating

Pensions are uprated once a year in Jersey at the beginning of October. The method used to increase pensions is enshrined in primary legislation. A standard percentage uplift is applied to all pensions in payment. The value of an individual’s pension will depend upon the number of years they have made contributions. Since 2001, the increase in the annual earnings index has been used to uprate both the ceiling for contributions and the value of benefits paid.

Linking both contribution ceilings and benefits to the earnings index ensures that –

- The contributions of workers increase as their earnings increase;
- The benefits paid to workers and pensioners also increase in line with earnings, ensuring that pensioners share in any growth in the economy.

This creates a balance between contributions and benefits.

The most recent uprating in October 2011 applied the rise in the 2011 earnings index of 2.5% to the previous maximum pension of £179.97, to give the current figure of £184.45 per week.

For the last 10 years, the Jersey old age pension has been uprated annually in line with the increase in annual earnings. Before then, the increase was linked to the halfway point between the rise in the cost of living and the rise in wages/earnings.

Historically, the long-term growth of earnings in Jersey has been greater than that of prices. Since 1990, the Jersey RPI has increased by 128% (i.e. prices have more than doubled), whilst earnings have increased by 167%. Prices have increased in Jersey at a faster rate than earnings in 6 out of the last 20 years.

Appendix 1 provides details of the various retail price and earning indices used in Jersey.

1.2 Pension recipients

The Jersey pension is paid to anyone who has made sufficient contributions during their working life. It is paid anywhere in the world and it is not subject to any means test. Low income pensioners living in Jersey receive additional support through Income Support.

The total of 27,100 current Jersey pensions in payment (at 1st March 2012) is split as follows –

Country of residence	*Number of pensions in payment**	*% of pensioners*
Jersey	16,300	60%
UK	5,300	20%
Other countries	5,500	20%

*Includes some pensions paid to individuals aged between 60 and 65

From year to year, the money used to pay these pensioners comes from contributions made by current Jersey residents.

The majority of non-resident pensioners live in countries covered by reciprocal agreements which protect the pension and benefit rights of citizens of both jurisdictions. It would be very difficult to change the basis on which pensions are paid to residents in these countries, without a significant negative impact on local people working abroad.

Pensioners living in Jersey have a wide range of incomes. It is estimated that just over half of local pensioner households pay income tax.

1.3 Existing pressure on Social Security Fund

Significant financial pressures are building up on the Social Security Fund due to the increasing number of pensioners at a time when the working age population is set to decline or, with continuing immigration of working age people, at best remain roughly constant.

Growth in number of individuals aged 65 or above living in Jersey –

	2010	*2020*	*2030*	*2040*	*2050*	*2060*
Estimate of number aged 65 or above	14,800	20,000	25,900	28,900	27,900	28,500
% of total population aged 65 or above	16%	21%	27%	30%	29%	30%

These figures are taken from the current population model (based on net inward migration of 150 heads of household per annum) and show the dramatic growth in the number and proportion of older residents in Jersey over the next 50 years.

To maintain the current value of the pension, the increase in the number of pensioners will inevitably lead to an increase in contribution rates for those of working age. The only alternative would be to reduce the value of the pension, or limit eligibility to receive the pension. In 2011, the States agreed to increase the pension age by 2 years between 2020 and 2031. This will help to limit the necessary increase in the contribution rate. However, increases in pension age alone cannot fully compensate for the increase in the number of pensioners.

Any **additional** costs to the Social Security Fund need to be justified against this background of significant increases in the cost of contributions paid by working age people and longer working lives to maintain the value of the current pension.

2. Proposal under consideration

2.1 "Triple Lock"

P.164/2011 proposes that each year the value of the pension would increase by the highest of –

- The earnings index
- RPI(OAP)
- 2.5%.

In most years, the increase in the earnings index is likely to be the highest of these 3 measures and the uprating will proceed as now. However, in a year of low economic activity, RPI (OAP) may exceed the rise in the earnings index. For example, this was the situation in June 2011 with a rise in earnings of 2.5%, compared to a headline RPI of 4.5% and an RPI (OAP) figure of 4.5%.

The fixed 2.5% ensures that pensioners always see an increase in their pension, even if earnings and price rises are both very low in a given year.

Senator Breckon's proposition is based on the triple lock mechanism recently introduced by the UK government. The basic UK pension is currently £102.15 per week, compared to £184.45 in Jersey. The main pressure behind the UK government decision was a commitment to reinstate the link between earnings increases and pensions which had been abolished in the 1980s. This is a link that Jersey has had in place for the last 10 years.

The UK government frequently makes changes to benefit rules. For example, the prices element in its triple lock is the annual rise in the Consumer Price Index (CPI), not the RPI as applied in the past – in general, inflation as measured by the CPI tends to be lower than that measured by the RPI.

Similarly, changes to the UK pension age agreed some time ago have now been amended to increase pension age more quickly, but with a subsequent minor concession in respect of a specific group that would have been badly affected by the proposed amendments.

The Jersey Social Security pension has been uprated using the same formula since 2001. Phased changes to pension age have been agreed 9 years before they will start to take effect. Pensions are paid out of a ring-fenced fund that is kept quite separate from other States finances. The stability and sustainability of the local pension scheme must be protected.

2.2 Cost of proposal

The financial implications included in the report accompanying P.164/2011 do not provide any details on the estimated cost of the proposal. The report simply states that "the costs of any increases in pensions are drawn from the Social Security Fund". This ignores the fact that the costs of the Social Security Fund are borne by contributors.

The long-term sustainability of the Social Security Fund is paramount, and any change to benefits must be considered over a period of decades. The UK Government Actuary has undertaken an analysis of the cost of this proposal and presented his results at a meeting, open to all States Members, on 7th February this year. A copy of the presentation was also distributed to all States Members after the meeting.

Appendix 2 contains copies of the slides relating to this topic. The Actuary considered 2 scenarios – RPI (OAP) exceeds the earnings index by 1% every 5 years (0.2% option) and RPI (OAP) exceeds the earnings index by 1% every other year (0.5% option).

The key points identified by the Actuary are as follows –

- The additional costs associated with the triple lock increase over time;

- The 2069 break-even contribution rates, assuming that pension age increases to 67, would be 16.9% (using the 0.2% option) compared to 15.2% without the introduction of triple lock.

The break-even contribution rate is the rate needed to cover the cost of benefits and pensions in a given year. The Actuary is forecasting an increase from the current contribution rate[1] of 10.5% to a break-even rate of 15.2% by 2069. This rise of just under half (45%) reflects the growth in the number of pensioners in the population.

Introducing a triple lock mechanism would mean that the break-even contribution rate would be even higher, at 16.9%, by 2069 (using the 0.2% option). This is an increase of around three-fifths over the current level.

The break-even rates under the 0.5% option are considerably higher. The increase in rates builds up gradually over the next few decades and Appendix 2 gives further details.

A telling comparison is to consider the savings generated by the recent decision to increase the pension age by 2 years. The improvement in contribution rates achieved by the increase in the pension age would be completely reversed by the introduction of triple lock (0.2% option).

2.3 Contribution increases

Last year the States approved the introduction of a long-term care benefit, to be funded by contributions from working aged people and higher income pensioners. This scheme will provide a significant benefit to pensioners facing long-term care costs, but it will need to be paid for by contributions from people of all ages. Inevitably, the majority of the costs of this scheme will be borne by those of working age, while those who will receive the most benefit from the scheme are those requiring care in the next few years, who will have contributed the least towards it.

Although the details have not yet been finalised, it is inevitable that we will also need to pay more to cover the increasing costs of healthcare in the coming years. The additional costs are mainly driven by the increasing number of older people in our population but, as with long-term care costs, the extra cost of healthcare will need to be borne principally by working age people.

In addition, as noted above, contributions into the Social Security Fund will need to increase just to maintain the value of the existing pension.

If this proposition is approved, with the pressures on future funding that this will bring, serious consideration will be given to bringing forward proposals for an immediate increase in contribution rates to seek to mitigate the long-term impact of the additional costs associated with triple lock uprating.

[1] The current contribution rate is slightly higher than the current break-even rate following a decision taken in the late 1990s to build up a financial buffer for use in future years as the number of pensioners increases.

2.4 Impact on workers in a year in which RPI exceeds increase in earnings

The major review of benefits undertaken by the then Social Security Committee in 1995, "Continuity and Change" commented on the link between earnings and benefits as follows –

> *"Now that an earnings index... is published any betterment by salary increases greater than the cost of living could be reflected by similar increases in benefit rates, obviously only in arrears. The beneficiaries in Jersey would share in the Island's success as reflected by increases in earnings in excess of inflation. Conversely, when the island's labour force takes a salary cut in real terms, beneficiaries would suffer equally. … Failure to take full account of the Island's economic situation will hardly promote social cohesion in Jersey."*

At that time, it was clearly accepted that in a year of poor economic activity, those in receipt of pensions and benefits should not be protected at the expense of local workers.

The impact of any increase in the value of the pension is borne by the working age population at that time. Consider a year in which prices rise faster than earnings.

Under the current system, the impact of increased prices is spread throughout the population – people of working age experience a drop in the real value of their wages, and pensioners receive an uplift below the rise in price inflation.

Under the proposal, the pensioner population would be fully protected as they would receive an increase in line with inflation. This protection would be paid for by the working age population who would, at the same time, be bearing the impact of a decrease in the real value of their wages.

As the pension uplift each year is based on the value of the pension in the previous year, these additional increases for pensioners will, over a number of years, lead to increases in the value of the pension in excess of the growth experienced in the economy as a whole.

In summary, the triple lock proposal protects pensioners during poor economic times over and above the protection available to workers and regardless of need. This protection is achieved at the expense of workers who will be hit by a "double whammy" – seeing their own wages fall relative to prices, and paying more to support pensioners.

2.5 Low income pensioners

The report accompanying P.164/2011 suggests that "some pension increases are being offset by reductions in income support for pensioners". The report does not include any evidence to explain this statement.

The Social Security Department protects low income pensioner households through Income Support. The Income Support scheme is carefully targeted to ensure that taxpayers' money is used to support local pensioners with the greatest need. This is in contrast to the Social Security pension, which is available to all contributors whatever their income from other sources, including those who no longer live in Jersey.

2.6 Other pensioner benefits

Cold Weather Bonus: Additional support with heating costs has recently been extended to other 65+ households through the cold weather bonus. The new bonus will be paid twice a year at the same total value as the Income Support cold weather payments and will be available to 65+ households that do not pay income tax. The value of the new bonus is estimated at £200 – £250 a year. These payments are automatically uprated each year in line with fuel prices.

In addition, pensioners who do not pay income tax can apply for the **Food Costs Bonus** (£193 in 2011) and they are covered by the **65+ Health Scheme** which provides assistance with dental, optical and chiropody costs (up to £414 a year). Pensioners over 75 who do not pay tax are eligible for a **free TV Licence** (£145.50) and all local pensioners aged 65 or above also receive an annual **Christmas Bonus** (£80 in 2012).

2.7 Other vulnerable groups

P.164/2011 seeks to enhance the uprating mechanism for pensions, but it will not affect the uprating applied to other benefits paid from the Social Security Fund. In particular, no reference is made to providing additional support for working age individuals with severe disabilities who rely on Long Term Incapacity Allowance for some or all of their income.

2.8 The link to 2.5%

It is impossible to predict future economic conditions and a link to a fixed percentage increase, which may seem reasonable at present, could create significant difficulties for the Fund in the future. The impact of a link to a fixed percentage would be that in a year in which earnings and prices remain more or less constant, or even fall, pensioners would still be guaranteed an increase of 2.5%. This would represent a real increase in the value of the pension, measured against **both** earnings in the economy and the cost of buying goods.

2.9 Use of RPI (OAP)

In the UK, the "prices" element of the triple lock is linked to the CPI index, rather than the RPI. Differences in the way that the 2 indices are calculated means that, generally, the rise in the CPI index will be approximately 1% point below that of the RPI index. CPI also excludes housing costs.

Senator Breckon's proposition specifies using the RPI pensioner index. RPI (OAP) includes the effect of GST. The high value of RPI (OAP) experienced temporarily in 2008 and 2011 was directly linked to the introduction and then increase in the rate of GST.

If the value of the Jersey old-age pension is adjusted to compensate fully for any future change in GST, then working age people will bear both the cost of GST changes on their own purchases and the cost of GST rises on the purchases of pensioners.

As pensions are paid throughout the world, a link to the Jersey RPI (OAP) will give pensioners living abroad the benefit of a pension increase although they may not be subject to any increase in their local prices.

3. Conclusion

The (mean) average full-time wage in June 2011 was £650 per week. This table shows the increasing cost of Social Security contributions, using a wage of £650 per week and the forecasts prepared by the Government Actuary in respect of the impact of the Triple Lock.

	Social Security contributions, without triple lock		*Social Security contributions, triple lock (0.2% pa)*		*Social Security contributions, triple lock (0.5% pa)*	
Date	*% rate*	*cost per week*	*% rate*	*cost per week*	*% rate*	*cost per week*
Today	10.5	£68.25	10.5	£68.25	10.5	£68.25
2029	12.4	£80.60	12.8	£83.20	13.4	£87.10
2049	14.3	£92.95	15.3	£99.45	17.0	£110.50
2069	15.2	£98.80	16.9	£109.85	19.8	£128.70

In addition to social security contributions, contributions towards long-term care and health care need to be considered.

In terms of annual pension costs paid out, these could be up to 35% higher by 2069 if a triple lock is introduced –

Date	*Pension cost, without triple lock*	*Pension cost, with triple lock (0.2%)*	*Pension cost, with triple lock (0.5%)*
Today	£126M	£126M	£126M
2029	£190M	£198M	£210M
2049	£225M	£243M	£274M
2069	£233M	£263M	£315M

In summary, there are substantial extra costs to be borne over the next few decades to maintain the value of our existing pension and to ensure that we can afford to pay for increasing care costs and health costs.

The current generation of pensioners will benefit from the introduction of the “triple lock”, although they will not have made any contribution towards its cost.

The proposal set out in P.164/2011 does not provide any clear justification for these additional costs. It creates a further burden on local workers and is poorly targeted, with the benefit being provided to the 40% of pensioners who do not live in Jersey and to the 52% of pension households living in Jersey with household incomes sufficient to pay tax.

If additional support for pensioners is needed, it should be based on targeted support to local residents.

Members are strongly urged to reject this proposition.

APPENDIX 1

INDICES PUBLISHED IN JERSEY

There are a number of **RPI** (Retail Prices Index) measures produced in Jersey. At June 2011 these stood at –

	12 month increase to June 2011	*Note*
RPI	4.5%	"Headline" RPI
RPI (X)	4.4%	Excluding mortgage interest payments
RPI (OAP)	4.5%	Based on basket of goods for a pensioner
RPI (Low income)	4.4%	Based on basket of goods for low income household
RPI (Y)	3.0%	Underlying inflation, excluding mortgage interest payments, GST and other indirect taxes

The RPI figures are produced and published each quarter.

The **Index of Average Earnings** measures changes in average earnings (gross wages and salaries) that have occurred, and been paid, to workers in Jersey. It includes overtime payments, but excludes bonuses, employers' insurance contributions, holiday pay and benefits in kind (e.g. free accommodation or meals). The 2011 Index measures changes in average earnings received between the last weeks of June 2010 and June 2011. In June 2011, the average weekly earnings of workers in Jersey was 2.5% higher than in June 2010.

APPENDIX 2

GAD SLIDES

Analysis undertaken by the UK Government Actuary's Department identifies the substantial cost of the proposal put forward by Senator Breckon.

Extract from presentation provided to States Members – 7th February 2012.

Actuarial Review of the Jersey Social Security Fund 2009

Additional advice - Introduction of "Triple Lock"

- Uprating of pension to be based on highest of average earnings increases, cost of living increases (RPI) and 2.5%.
- To allow for variability in which of these three factors is highest in different years we modelled:
  - a) a margin above average earnings increases of 0.2% per annum
  - b) a margin above average earnings increases of 0.5% per annum
  - c) earnings growth plus 1% in every 5th year and earnings growth alone in all other years.

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Actuarial Review of the Jersey Social Security Fund 2009

Additional advice - Introduction of "Triple Lock"

- The larger the margin above earnings increases the larger the break-even contribution rates required.
- The additional cost associated with the Triple Lock increases over time.
- The 2069 break-even contribution rates assuming that pension age increases to 67 on options a) and c) would be 16.9% compared to 15.2% without the introduction of Triple Lock.

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Additional advice - Introduction of "Triple Lock"

Year	Transition to pension age 67			
	Average earnings	Average earnings + 0.2% pa	Average earnings + 0.5% pa	Average earnings + 1% every 5 years
Break-even contribution rate (%)				
2009	8.7	8.7	8.7	8.7
2014	9.8	9.8	9.9	9.8
2029	12.4	12.8	13.4	12.8
2049	14.3	15.3	17	15.3
2069	15.2	16.9	19.8	16.9
Expenditure on old age pensions in constant 2009 earnings terms (£m)				
2009	126	126	126	126
2014	142	144	146	144
2029	190	198	210	198
2049	225	243	274	243
2069	233	263	315	263
Fund balance at year end (£m)				
2009	782	782	782	782
2014	982	978	971	981
2029	1,133	1,047	913	1,064
2049	0	0	0	0
2069	0	0	0	0
Year in which combined Fund balance is extinguished				
	2049	2045	2040	2045

Constant participation
150 HoH migration projection

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