STATES OF JERSEY

SOCIAL SECURITY FUND: RESEARCH INTO ALTERNATIVE FUNDING MECHANISMS

Lodged au Greffe on 23rd September 2009
by Deputy G.P. Southern of St. Helier

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion −

to refer to their Act dated 10th June 2009 in which they approved the States Strategic Plan 2009 – 2014 and, in the light of Strategic Priorities 1, 4 and 6 of that Plan –

(a) to request the Chief Minister to re-prioritise the Policy budget of the Chief Minister's Department to enable funding to be made available to the Minister for Social Security to research mechanisms to eliminate the need for supplementation of social security funding from general revenues;

(b) to request the Minister for Social Security to report back to the States as a matter of urgency, and in any case no later than September 2010, with the results of the research and recommendations, including analysis of the mechanisms outlined in the Appendix to the attached report; and

(c) to request the Minister for Social Security to bring forward for approval the necessary legislation to give effect to any proposals arising from the research and recommendations to enable any amendments to the current system to be in place no later than January 2012.

DEPUTY G.P. SOUTHERN OF ST. HELIER

REPORT

Background

There can be no doubt that amidst all the recent turmoil over fiscal policies in Jersey, reform of Social Security Funding, which now imposes a £68 million hole in tax revenues, has been "the elephant in the room" and largely ignored. In response to OECD pressure, the move to zero/ten with the consequent loss of £100 million in tax revenues has resulted in fresh taxes in the form of GST and "20 means 20" along with pressure on public spending. Now the impact of the recession threatens a further £60 million "black hole" in revenues.

Throughout all this the issue of supplementation has remained untouched. When I first raised this issue in P.2/2003 Social Security Fund: New method of funding, the Finance and Economics Committee of the day stated that –

> In the light of "*consultation regarding the States Fiscal Strategy… … to debate the proposition now would be premature*".

The Social Security Committee of the day also prevaricated, thus –

> *"the current scheme is reviewed every 3 years … the next Actuarial Review is for the 3-year period ending 31st December 2003 and should be available in the middle of 2004".*

That review has been and gone and we now are awaiting the following Actuarial Review, due in September 2009, and still we have no action to reduce or control increases in supplementation. Prevarication has been the order of the day.

In the Annual Business Plan (ABP) 2008, the minister stated –

> *"There has been significant growth in the level of supplementation since 2005. In 2006 there was an increase of 11% (£5.8m)…an unfunded cost pressure of £5.8mfor 2007….expenditure expected to exceed the budget in 2008…… a review of supplementation is already underway a further review will be commissioned to examine ways of limiting exposure in future years….. **actions arising out of the review will be implemented in 2008**".*

These fine words were repeated in the ABP 2009 –

> *"The costs of supplementation are currently forecast to exceed the sum allocated…. **The department is formulating proposals to limit or reduce the costs of supplementation…**"*

And in the ABP 2010 –

> *"a revised calculation will be introduced in 2010 to **eliminate the uncertainty in the future costs of the States contribution**".*

In other words the department has admitted that it cannot limit or reduce the costs of supplementation (risen by £17 million since 2005) and has to content itself with more accurate prediction of the rising total.

I believe that the time is long overdue to tackle this problem. Table 1 clearly illustrates the size of the problem and its continuing growth over the last 12 years. We can afford to wait no longer.

The growth in the Fund over recent years is illustrated by Table 1 below.

Expansion of Social Security over last 12 years

Income £000	*1998*	*1999*	*2000*	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*	*2007*	*2008*	*2009(E)*	*2010(E)*
Contributions	63,013	73,119	81,124	92,826	103,988	108,428	110,319	115,495	123,954	133,913	144,634	146,300	151,700
States supplement	25,126	30,092	36,161	41,197	48,136	49,892	50,800	50,776	56,567	58,627	61,842	65,800	67,200
Total*	97,470	112,534	125,736	143,870	162,027	165,895	165,794	173,063	189,786	201,428	208,484	212,800	219,600

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
% States	28.5	29.2	30.8	30.7	31.6	31.5	31.5	30.5	31.3	30.4	29.9	31.0	30.7
Cont. rate % **	8.5	9.0	9.5	10.0	10.5	10.5	10.5	10.5	10.5	10.5	10.5	10.5	10.5
Employee rate %	3.85	4.20	4.55	4.9	4.7	4.7	5.2	5.2	5.2	5.2	5.2	5.2	5.2
Employers rate %	4.65	4.80	4.95	5.1	5.8	5.8	5.3	5.3	5.3	5.3	5.3	5.3	5.3
Earnings limit £/year	22,704	24,768	27,264	29,352	31,728	33,048	34,608	35,760	37,656	38,904	40,728	42,480	43,752

* includes investment, bank interest and sundry income
** excludes contributions in respect of the Health Scheme

In the introduction to his departmental Business Plan 2009, the minister committed himself to a broad review of the Social Security Fund with the following words –

> Following a period of public consultation, the Department will also make recommendations for a long-term care funding scheme, and will address the actions proposed by The Health, Social Security and Housing Scrutiny Panel scrutiny report "Long Term Care of the Elderly" (S.R.12/2008).

The public consultation on long-term care will need to be co-ordinated with a broad review of the Social Security Scheme that takes account of the wider issues facing the Island, particularly as a result of the ageing demographics of the local population. Pressures on the funding of Social Security in the medium term include the increasing number of pensioners, the substantial increase in the number of people aged 85 and above, with greater care needs, and the reduction in the number of working age people providing Social Security contributions.

If the Social Security Fund is to be sustainable going forward, consideration will need to be given to changes to the current system. These are likely to include a combination of measures such as increasing the age at which a Social Security Pension is first paid, increasing the level of contributions paid, and reducing the generosity of benefits that are available.

The current system of supplementation that provides full Social Security cover for lower income wage-earners has been the subject of comment in recent years and options for the future role of supplementation also need to be considered as part of the review.

During 2009 it is planned to change the way in which the States contribution to supplementation is calculated to ensure that future budgets can be determined with more certainty. Interim measures will also be introduced in respect of changes to Incapacity benefits, to address operational issues in advance of the full Social Security review.

Furthermore, in the 2010 Business Plan, the Minister sets himself the following interlinked objectives on pages 107 to 108 –

> **"2. Supplementation**
>
> Following a review of the method of calculating the States contribution to supplementation costs, a revised calculation will be introduced in 2010 to eliminate the uncertainty in the future costs of the States contribution.
>
> **3. Social Security Review**
>
> The Department will commence work on a major review of the Social Insurance Scheme. This will include consideration of the system of funding for social insurance and a review of the assessment methods used to determine incapacity benefits.
>
> **6. Ageing Population**
>
> The ongoing consultation programme, widening the understanding of the consequences and opportunities presented by the ageing society and receiving feedback in respect of the options for addressing the issues, will form the cornerstone of further consultation and proposals in respect of pension and other income provision beyond current retirement age. To ensure the long term sustainability of the Social Security Fund, changes to pension age, the level of contributions made and the level of pensions paid will be reviewed.
>
> **7. Long-term Care Scheme**
>
> The cost of long term care is increasingly an issue for people facing the prospect of requiring such care. Those with insufficient income or assets can currently expect support from within the Income Support Scheme, yet the increasing size of such a burden upon the taxpayer, combined with an increasing demand for a mechanism by which those faced with funding their own care can make adequate provision for that care, has led to a growing momentum for a funding scheme for long-term care which shares the costs more fairly. Following a public consultation exercise, the Department will bring forward proposals for consideration by the States."

Furthermore, it is understood that the following preparations have been put in place in order to initiate a major review –

- Actuarial review to be published in September 2009.

- Additional questions asked of Actuary on restructuring of Social Security Funding, including supplementation.

- Additional staffing allocated to Social Security Policy department.

The involvement of the Chief Minister's department is to ensure that proper resource is provided to enable a co-ordinated and coherent approach to such a far-reaching review. The main areas of operation for the CMD are described on page 10 of the 2010 ABP as –

> "The Policy Unit (policy support and research for the Council of Ministers and Chief Executive; strategic and business planning)"

including –

> "2010 will see the Council of Ministers implementing the new Strategic Plan and its priorities will drive the department's policy programme. A major priority for the Chief Minister's Department will be to ensure that development and implementation plans for the new policy direction are put into place and properly co-ordinated."
>
> "The Council of Ministers will progress its population policy, including the implementation of appropriate review mechanisms, and will continue to progress policy initiatives designed to address the effects of the ageing population."

Financial and manpower considerations

Such a research task set to a fairly tight timescale is difficult to cost without knowing the depth of preparatory work already undertaken and the scope of what was already described as a "major review" in the objectives of the Social Security Department above. I would expect external expertise to be engaged for the research, but it seems unlikely that the additional costs of including approaches to supplementation in the review would exceed the range £50,000 – £100,000. I await responses from CMD and Social Security department on potential costs before debate.

APPENDIX

P.137/2009

STATES OF JERSEY

SOCIAL SECURITY FUND: A NEW METHOD OF FUNDING

Lodged au Greffe on 7th October 2003
by Deputy G.P. Southern of St. Helier

STATES GREFFE

PROPOSITION

THE STATES are asked to decide whether they are of opinion −

(a) to agree in principle that –

  (i) the earnings limit for employer and employee contributions to the Social Security Fund should be removed with effect from 1st January 2005, and

  (ii) the overall contribution rate from 1st January 2006 should be increased by one percent annually, made up of a 0.5% increase in the employer contribution and a 0.5% increase in the employee contribution, until the requirement for supplementation is eliminated;

(b) to charge the Employment and Social Security Committee to bring forward for approval the necessary legislation to give effect to the proposals.

DEPUTY G.P. SOUTHERN OF ST. HELIER

REPORT

The overall effect of this proposition, if adopted by the States, will be to transfer the burden of supplementation (currently £50 million annually) from general tax revenues to the contributions raised on salaries greater than the current earnings limit (part (a)(i)), and eventually to all contributors (part (a)(ii)). In this way the fund will effectively become self-sustaining.

Background

Funding of the Island's Social Security provision has traditionally been on a 'one-third' principle; that is, one third from employers' contributions, one third from employees' contributions and one third supplementation from States' taxation revenue. The fund has also historically been financed on the pay-as-you-go principle. With this method of financing, expenditure on benefits is broadly met by the income from contributions and the States supplement in the same year.

The growth of the Fund, along with the associated Reserve Fund, has been marked since 1974, when it replaced the scheme contained in the Insular Insurance (Jersey) Law 1950. This growth is linked to a number of factors –

- the relative levels of benefits and earnings;
- the increase in the number of benefits;
- increase in the rates of contribution;
- increase in the earnings limit;
- the relative numbers of beneficiaries and contributors.

The growth in the Fund over recent years is illustrated by Table 1 below.

Expansion of Social Security over last 12 years

Income £000	*1990/1*	*1995/6*	*1998*	*1999*	*2000*	*2001*	*2002(E)*	*2003(E)*
Contributions	38,827	50,351	63,013	73,119	81,124	92,826	104,000	109,200
States supplement	14,244	19,970	25,126	30,092	36,161	41,197	48,130	50,132
Total*	60,855	79,113	97,470	112,534	125,736	143,870	152,130	159,332

% States	27	28	28	29	31	31	32	32
Cont. rate % **	8.0	8.0	8.5	9.0	9.5	10.0	10.5	10.5
Employee rate %	3.5	3.5	3.85	4.20	4.55	4.9	5.2	5.2
Employers rate %	4.5	4.5	4.65	4.80	4.95	5.1	5.3	5.3
Earnings limit £/year	15,816	20,400	22,704	24,768	27,264	31,728	33,048	34,608

* includes investment, bank interest and sundry income
** excludes contributions in respect of the Health Scheme

Health Insurance Fund

Since the position of the Health Insurance Fund is reported to be healthy (R.C.27/2002), it is assumed that no changes in Health Insurance contributions are necessary. This proposition therefore leaves these contributions unaffected.

Contribution rates

A contribution rate of 8% of earnings (3.5% paid by the employee and 4.5% by the employer) was set in 1975. This was intended to provide a small margin over a strict pay-as-you-go rate, and it enabled the same rate to be maintained until 1997. It was then decided to increase rates in the light of demographic trends to enable the funds to build up to compensate in a limited way for the ageing of the population over the coming 30 to 40 years. Over the years 1998 to 2002 contribution rates were increased by 0.5% per annum to 10.5%.

Earnings limit

Another variable that can be used to raise income to the funds is that of the level of the earnings limit. This is the amount of earnings above which an insured person's earnings shall be disregarded when calculating the contribution payable. During the period 1998 to 2002 the earnings limit was increased each year by £50 per month in addition to increases in line with earnings. From 2002, the earnings limit has reverted to increases in line with earnings.

By these mechanisms the value of the Social Security Funds as a multiple of annual expenditure should increase from 2.8 in 1996/7 to around 5 by 2010.

The increases between 1998 and 2002 have produced a growth in income of some 31%. Despite this, if the 10.5% rate is maintained, it is estimated that the Reserve funds will be extinguished at some time between the years 2035 and 2042 depending on immigration rates. Alternatively, in order to break even on a pay-as-you-go basis, contribution rates of between 15 and 17.8% are envisaged by the year 2040.

States supplementation

The actions taken over the period 1998 – 2002 in raising both contribution rates and earnings limit have had the predictable effect of increasing the size of the contribution required from States revenue to keep the fund functional. Supplementation has grown by a factor of 2.5 over the period to stand at £50 million annually.

Relative numbers of beneficiaries and contributors

The relative numbers of beneficiaries in the scheme is due to rise inexorably as the population ages. Old age pensions, accounting for 67% of the Fund's expenditure in 2000, are expected to rise steadily to around 80% of expenditure by the 2030s. The number of residents over pensionable age will double from just under 12,500 in 2000 to 24,500 by 2035. Already we can see the start of this rise in the number of elderly, with a 15% growth in the number of pensions between 1997 and 2001, whilst the number of contributors has remained relatively static.

There are those who believe that the solution to the problem is to increase the number of contributors by immigration. Without wishing to debate the issue here, even 200 a year net immigration, which might raise the number of contributors in the short term, will only extend the life of the current system by a mere 7 years, or cut the maximum contribution rate required from 17.8% to 15%.

The only other way we might reduce the burden of supplementation would appear to be to cut back on either the number or the level of benefits available, or to reduce the numbers who are eligible to receive benefits. I cannot believe that this is a route that members would willingly take and I am certain that it would not be welcomed by voters. After all what is at stake here is the basic ‘safety net’ that underpins the fabric of our society.

Whilst the large increases in supplementation that have been seen over the past 5 years (due to the combination of above inflation increases in the earnings limit and increases in the contribution rates) will not be repeated in the immediate future, the current sum of some £50 million annually will continue to grow in line with the rise in earnings.

Many believe that given our current tax and spending deficits in the short-to-medium term, we can no longer afford the current and projected levels of supplementation. To put at its simplest, without the siphoning off of £50 million each year, we would not have a funding deficit. In order to carry on meeting our social security needs, I believe we need a fundamental rethink of the funding mechanism. This proposal contains such a fundamental, but structurally simple change.

Contributions as tax not insurance

The principal advisors to the previous Finance and Economics Committee, OXERA, discussed changes to social security contributions as a mechanism for increasing States’ income in their paper of May 2002 (sections 7.2.2 and 7.4.6). It is interesting to note that, in their discussion, the authors consistently refer to the contributions, whether from employers or employees, as a form of tax. The roots of the Social Security Fund are to be found in the Insular Insurance Scheme of 1950. As with many such schemes, this was promoted as a form of insurance on the user-pays principle, i.e. your contributions paid for your own pension/benefits. Since 1974, the Fund has been financed on the pay-as-you-go principle. That is, expenditure on benefits and administration are met broadly from income from contributions and the States supplement in the same year. The distinction between taxation and insurance is not merely a philosophical matter, but is essential to the proposed change in funding.

In section 7.4.6 of the OXERA paper, the authors point out that employees’ contributions have the economic effect of a type of income tax because the underlying tax base is the employees’ earned income from employment. The distributional differences between this tax and income tax are as follows –

- social security contributions start at a much lower income level;
- the amount paid by the employee does not take into account personal circumstances (number of children etc.) or income from other sources;
- the total contribution per employee is capped at the earnings ceiling. Earnings above this are not subject to tax;

- the tax is hypothecated to pay for a specific set of benefits. The value of these benefits depends upon the contributions record. This, in turn, relates to the contributions paid by the employer and the top-up provided by the States from other revenue.

The paper points out that, as currently structured, the contributions produce a gradually increasing effective tax rate up to the earnings ceiling and, as a tax, it is therefore progressive. Above the ceiling, however, the total tax paid remains the same no matter what level income rises to. Over this part of the income range, the tax is therefore regressive in that the effective rate of tax decreases as earned income increases.

The net effect of the removal of the earnings ceiling on employees' contributions would, according to OXERA, raise an additional £25 million in contributions. The distribution of this additional income is as follows –

- those earning below the current ceiling would not be affected;

- those earning above the current ceiling would pay an additional tax of £5.2 for every £100 earned above the ceiling. By way of illustration, at an income of £40,000, this would be approximately £280 more; at £50,000, £800 more; and at £100,000, approximately £3,400 more.

The corollary to removing the ceiling on employees' contributions is to do the same for employers. This will raise a further £25 million of income annually. OXERA point out that this means of increasing tax on business has a different distribution than the two other methods of increasing income previously exploited from 1998 to 2002. By increasing the contribution rate, all businesses would see their contributions increase by the same proportion (around 50% to raise £25 million). If the ceiling is removed, businesses with higher paid employees would see their contributions increase proportionally more than those with lower paid employees. Thus, the agricultural and tourism industries, with their relatively low wage structures, would be (relatively) protected from increased costs.

Since I first started to work on this proposition, the OXERA estimate of a total of £50 million, originally published in July 2002, and based on figures collected earlier, has come under scrutiny and has been called into question. The question concerns where the balance lies between the proportions of earned and unearned income of those above the earnings limit. The current thinking of the Economic Advisor now matches the thoughts of the Social Security officers in that the OXERA figures may need revising downwards. The Social Security department now consider that the additional income that might result from the removal of the earnings limit on both employee's and employer's contributions might be as low as £22 million. The Economic Advisor's office believes that the figure lies somewhere in between the 2 extremes. We should have a clearer idea of the real figure when we see the results of the income distribution survey, which is due to be published by autumn 2003.

My intention is to eliminate the need for supplementation from the system. Given the uncertainty surrounding the estimates, the need for the second half of the proposition becomes clear. Removal of the ceiling on earnings in 2005 may produce the £50 million required to eliminate supplementation at a stroke. On the other hand, it may still leave a gap in funding of up to £28 million. This proposal therefore permits the raising of the contribution rates to eliminate this shortfall from 2006. With the ceiling removed, my calculations show that each percentage point rise in the combined employee and employer rate will produce an increase in income of approximately £14 million. Thus even with the worst-case estimate the funding gap should be closed by 2009 by increasing employee and employer contributions by 1% each.

Self-employed

In discussing this proposition with interested parties, it has been brought to my attention that these proposals will disproportionately affect the self-employed, in that under the current system, they are liable to pay both the employee and employer contributions. With around 10% of the workforce, this group deserves some consideration. At the time of writing, it is thought that the majority of the self-employed are below the earnings ceiling and will not be affected by the first element of the proposition, but will suffer the increase outlined in (a)(ii). Further information on the precise proportion is being sought. Whatever the position, should this proposition be adopted, then it may prove an opportune moment for the Finance and Economics and Employment and Social Security Committees to review the position of the self-employed within the Social Security scheme.

The adoption of this proposal will not solve all the problems of funding our social security system. The relative balance between costs and benefits associated with this fundamental support system for the poor, the disadvantaged and the sick will continue to test our ingenuity for decades to come. What this proposition does do is to stop, once and for all, the haemorrhaging of general tax revenue into the supplementation system. This we can no longer afford. Further, this proposal progressively re-directs funding from those sectors that can most afford to those of greatest need.

Financial and manpower considerations

This measure will reduce the demand on general taxation revenue by some £50 million annually. However, since the States employs significant numbers of civil and public servants at salaries above the earnings ceiling, there will be a cost to the States as an employer. Based on the 2002 figure for States salaries of £207.7 million, I estimate that this will amount to some £2.4 million from part (a) and £2 million from part (b) of the proposition. Adoption of this proposition should require no additional staffing.

Re-issue Note

This projet is re-issued because part of the Report and the Appendix was omitted.