STATES OF JERSEY

SOCIAL SECURITY FUND: A NEW METHOD OF FUNDING

Lodged au Greffe on 20th October 2010
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 that –

(i) the earnings limit for employer and employee contributions to the Social Security Fund should be removed with effect from 1st July 2011,

(ii) the reduction in allowances under "20% means 20%" provisions of the Income Tax law shall be removed for the year of assessment 2011 and subsequent years;

(iii) the overall social security contribution rate from 1st January 2012 should be increased by 0.5% annually, made up of a 0.25% increase in the employer contribution and a 0.25% increase in the employee contribution, or part thereof, until the requirement for supplementation is eliminated;

(b) to request the Minister for Treasury and Resources and the Minister for Social Security 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 £65 million annually) from general tax revenues to the contributions raised from employers and employees on salaries greater than the current earnings limit (part (a)(i)), and eventually in part to all contributors (part (a)(iii)). In this way the fund will effectively become self-sustaining.

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 £65 million hole in tax revenues, has been "the elephant in the room", that is, largely ignored. In response to OECD pressure, the move to zero/ten with the consequent loss of £100 million in tax revenues from business (made up of some £70 million from finance and £30 million from the non-finance sector) has resulted in fresh taxes in the form of GST and "20 means 20" being transferred to personal taxation, along with pressure on public spending. Now the impact of the recession threatens a further £60 million (or more) "black hole" in revenues.

Throughout all this the issue of supplementation has remained untouched. Back in 2003 when I first raised this issue, 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. We have now seen the results of the subsequent Actuarial Review, and still we have no action to reduce and control increases in supplementation.

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 £5.8m for 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"***

Nothing happened.

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**…"*

Nothing happened again.

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 (which has risen by £15 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. Furthermore I have acted on my belief in bringing P.153/2009 (below) to the States. This was accepted by members by 36 votes to nil on 18th November 2009.

PROPOSITION (P.153/2009)

SOCIAL SECURITY FUND: RESEARCH INTO ALTERNATIVE FUNDING MECHANISMS

"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****."*

The mechanisms referred to in the annex above are those contained in this proposition.

Members will note the timescale set on this proposition, along with the lack of action on the part of the Minister for Social Security, although some explanation for the lack of action was given on the 12th October –

WRITTEN QUESTION TO THE MINISTER FOR SOCIAL SECURITY
BY DEPUTY G.P. SOUTHERN OF ST. HELIER
ANSWER TO BE TABLED ON TUESDAY 12th OCTOBER 2010

"Question

Given that P.153/2009, approved by the Assembly on 18th November 2009, requested the Minister to report back as a matter of urgency, and in any case no later than September 2010, with the results of the research and recommendations relating to the future funding of Social Security supplementation, will the Minister inform members why his report is late and state when it will be delivered?

Answer

As I stated in the States Assembly during the last sitting, the future funding of supplementation is linked to the Fiscal Strategy Review. My department is working closely with Treasury and Resources and is fully involved in the budget proposals which will be lodged by 26th October 2010. In addition, I will be publishing shortly thereafter, a separate report setting out the challenges facing Social Security funding over the next few years. This report will include a response to P.153/2009."

Raising more tax

So what we have instead of prompt action by the Minister for Social Security is action on the part of the Minister for Treasury and Resources, who has included Social Security contributions in his Fiscal Strategy Review as one of the 4 main options to raise an additional £30 million in States revenues.

The four possible options involve increases to –

- **Goods and Services Tax**
- **Social Security contributions**
- **Domestic property rates**
- **Income Tax**

Of these options, 1 and 3 are politically unacceptable (to me) because they are intensely regressive. They will hurt the least well off disproportionately, and must therefore fail the test of fairness. Both will require some degree of compensation for those with low incomes. In the case of domestic rates, it will be extremely difficult for those who are asset-rich yet income poor, as many pensioners are. Of course, compensation once offered, can always be withdrawn later. We have seen one attempt to do so already with the recent attempt to remove the GST bonus after only 3 years.

In addition we must bear in mind the impact of the cuts to public services, often referred to as the social wage. Given the scale of the cuts in public services we have already seen and are likely to see, which have the greatest impact on the lowest earners, further damage in my opinion must be ruled out.

In principle, the way forward ought to be the only truly progressive measure of the four options, that of introducing a higher rate of tax for higher earners. However, at the time of writing, this option has not been clearly set out, certainly in terms of

raising the £30 million target revenue. If applied to household income, it may reach the target, but only at the price of discriminating against married couples. This would require a major change in the income tax law to rectify. If applied to individual incomes, there is some doubt that it will raise anything like £30 million.

Perhaps the only viable option, and one that I raised back in 2003, is to restructure social security contributions.

Social Security Contributions

Funding of the Island's Social Security provision has traditionally been on a 'one-third' principle; that is, one third from employers' contributions (5.3%), one third from employees' contributions (5.2%) and one third supplementation from States' taxation revenue.

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.

They noted that whilst the roots of the Social Security Fund are to be found in the Insular Insurance Scheme of 1950, which was promoted as a form of insurance on the user-pays principle, i.e. your contributions paid for your own pension/benefits. However, since 1974 the Fund has been financed on the pay-as-you-go principle. This means that expenditure on benefits and administration are met broadly from income from contributions and the States supplement in the same year. The distinction between the old insurance basis and the taxation basis since 1974 is not merely a philosophical matter, but is essential to the proposed change in funding.

Health Insurance Fund

Since the position of the Health Insurance Fund is reported to be healthy (R.C.27/2002), I have assumed that no changes in Health Insurance contributions are necessary. This proposition therefore leaves these contributions unaffected and the figures quoted are based only on the Social Security contributions from employer and employee which total 10.5%. It should be noted however the Treasury green paper includes raising the limit on the 2% Health Insurance Fund also. So far no justification has been given for this in the consultation process. I believe that any changes to Health Insurance contributions require separate consideration.

The growth in the Fund over recent years is illustrated by the Table 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	65,000	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	324,400	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

Earnings limit

The earnings limit is another remnant of the days of the old Insular Insurance Scheme. It represents the salary on which contributions must be paid in order to secure the level of pension on offer. Today it is the amount of earnings (currently £43,752 p.a.) above which an insured person's earnings shall be disregarded when calculating the contribution payable. Equally, the employer contribution is also fixed at this level and does not increase as salary increases.

Currently this means that an employee earning £43,752 a year will pay £189.59 per month, or 5.2% of salary, in contributions (employer £193.24). At the same time, an employee earning, say £243,752 will also pay £189.59 per month (employer £193.24), which equates to 0.93% of the employee's salary. This is clearly a regressive form of taxation.

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 (this can be seen in the Table). From 2002, the earnings limit has reverted to increases in line with earnings.

The result of these changes to funding is that the value of the Social Security Reserve Fund as a multiple of annual expenditure has increased from 2.8 in 1996/7 to around 5 today.

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.

The adoption of this proposal will not solve all the problems of funding our social security system. The changing demographic (the ageing society) will need to be addressed but not here. 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.

States supplementation

Every employee earning below the threshold of £43,752 will pay their contribution of 5.2% of their earnings. A person on the average wage of £32,760, for example, will pay £141.96 per month in contributions. This is less than the nominal £189.59 required by the earnings limit. The difference, in this case £47.63, is made up by a contribution from the States. That is supplementation.

A further, more graphic, illustration is provided by examining the situation of minimum wage workers. On a 40-hour week a minimum wage a worker will earn £248, on which he will pay £12.90 a week to Social Security, or £55.90 a month. His employer will pay £13.14 in employer contributions, or £56.94 a month. Supplementation payments from the taxpayer will contribute the largest proportion

with £17.71 each week, (£76.74per month). Every minimum wage worker is costing the States over £900 per year to make up the gap in funding of social security contributions.

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 almost doubled since 2000 to stand at £65 million annually.

The consultation paper (R.82/2010) published by the Minister for Treasury and Resources approaches this option as follows –

> **"Social Security**
> **Current situation:** Social Security contributions are paid on wages and not on any other kind of income. Islanders who earn up to £43,752 (the ceiling) pay 6% of their wages and their employer pays another 6.5%, making a total contribution of 12.5%. They do not pay Social Security on anything above £43,752, which means that as income rises above this ceiling the proportion of income paid in contributions falls.
>
> Most of this contribution (10.5%) pays for pensions and benefits, with the remaining 2% going into a Health Insurance Fund to subsidise doctors' fees and provide free prescriptions. Increasing the 2% contribution to the Health Insurance Fund is one option being considered to meet the costs of future investment in our health service.
>
> **Option:** To raise the employee and employer social security ceilings to £115,000 (Guernsey is moving towards this in steps). This would raise about £30 million a year for the Social Security Fund. (A further £6 million would be raised for the Health Insurance Fund if the ceiling is applied to those contributions)."

The attitude of the Minister for Treasury and Resources to this particular can be judged by the content of the consultation paper, which concentrates on negative aspects of the proposal, and in his reply to a question back in July –

WRITTEN QUESTION TO THE MINISTER FOR TREASURY AND RESOURCES
BY DEPUTY G.P. SOUTHERN OF ST. HELIER
ANSWER TO BE TABLED ON TUESDAY 6th JULY 2010

> *"Will the Minister state why he has chosen to consult on a cap of Social Security contributions at £115,000? Is it simply to be competitive with Guernsey's £117,468? What would the effect be of removing the ceiling altogether?"*
>
> ***Answer***
>
> *Social security ceilings*
> The option in the personal tax review that looks at raising the social security ceiling to £115,000 has been chosen because it would raise £30 million extra in social security contributions and would not put us out of line with the position in Guernsey. Completely removing the ceiling would raise about £45

> million in social security contributions but would also further increase the cost of employing highly skilled people who earn above £115,000. Raising the ceiling would potentially make it less attractive for highly skilled, high earning people to work in Jersey and increase the cost of employing them, putting jobs and tax revenue at risk."

Raising the ceiling would affect those earning more than £43,752, although to different degrees as Figure 4 shows –

Figure 4: Additional contributions paid with new ceiling of £115,000 and under this proposal

	Treasury (6%)	No ceiling (5.2%)
£40,000 or less	0	
£50,000	£400	£325
£60,000	£1,000	£845
£70,000	£1,600	£1,365
£80,000	£2,200	£1,885
£90,000	£2,800	£2,405
£100,000	£3,400	£2,925
£110,000	£4,000	£3,445
£115,000	£4,300	
£120,000	£4,300	£3,965
£150,000	£4,300	£5,525
£200,000	£4,300	£8,125

Figures represent the extra paid by each individual employee (the employer would pay slightly more than the employee in each case)

The consultation paper concentrates on the negative aspects of this option, when it says –

> *"However, it could also have an impact on the economy by undermining our competitive position in two ways:*
>
> 1. *Make it less attractive for highly skilled, high earning people to work in Jersey*
>
> 2. *Increase cost of employing people and of doing business in Jersey, which could put jobs at risk".*

But the argument around the additional cost of employing high earners and the risk of a mass exodus of these highly skilled employees is given the lie by the comparison with the social security rates of our closest rivals, reproduced here –

“Figure 5: A comparison of Social Security contributions

	Employee	Employer
Jersey	6% up to a ceiling of £43,752	6.5% up to a ceiling of £43,752
Guernsey	6% up to a ceiling of £79,872	6.5% up to a ceiling of £117,468
Isle of Man	11% up to a ceiling of £37,960 – 1% above that	12.8% – no ceiling
UK	11% up to a ceiling of £43,875 – 1% above that	12.8% – no ceiling”

The words of the consultation paper however admit that the rise in contributions is “not out of line” with competitor jurisdictions.

> *“Raising the ceiling on contributions would increase Social Security payments for higher earning employees, although not out of line with those of our competitors in the finance world (Figure 5). Raising the ceiling for employers would also add to the cost of employing high earning staff, although again it would not put us out of line with competitor jurisdictions.”*

Part (ii) Rescind “20% means 20%”

The first part of this proposition, the removal of the earnings ceiling altogether, will raise around £45 million in additional revenue for the States. In doing so it targets only those who are earning significantly more than the average salary of around £34,000 p.a. The total sum raised however enables one to consider the interaction of social security contributions with the rest of the tax system. With a starting point at £43,752, there is no doubt that there is an overlap with the provisions of “20% means 20%”. “20 means 20” was introduced to produce £10 million of additional revenue to recoup tax lost to zero/ten. It effectively removes tax allowances from many middle to high earners in a complex and unfair manner. It starts to have an impact for some households at around £40,000 plus. Part (ii) removes the double-whammy element of the rise in contributions. To fail to remove the “20 means 20” element which targets the same group of earners would be manifestly unfair. Whilst this would have no impact on the supplementation issue, it would reduce the overall impact on tax revenues and consequently on the fiscal deficit, only effectively contributing around £35 million, not £45 million, in additional revenue. If the Assembly were to accept this proposition, the there would have to be a consequential amendment to 2011 budget.

Part (iii) Raising employer and employee rates

The intention of this proposition is to remove the need for the expenditure of £65 million from general tax revenues. The elimination of the contributions ceiling in (a)(i) removes £45 million, leaving a £20 million shortfall, if supplementation is to be eliminated. Part (iii) suggests that this is dealt with by an overall rise in contributions to be phased in over a period of time by a rise in overall contributions by 0.5% p.a. starting in 2012. Since the contributions will be proportional to income over the whole range of salaries, this will produce an equitable increase; for example a person on the minimum wage would see an increase of 62 pence per week; a person on the average

wage would pay an extra £1.57; the high earner on £80,000 p.a. would pay an additional £3.85 weekly.

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 £65 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.

Relative numbers of beneficiaries and contributors

This proposition makes no attempt to address the longer term solutions to deal with the increased demand on the Social Security Funds caused by changing demographics. That, I hope, may be addressed by the projected review of the whole structure and funding of the benefits scheme to be conducted by the Social Security department, along with the problems caused by our relatively simplistic scheme where there are only 2 classes of contributors, so the self-employed are penalised. Before we get to the complexity of those changes, whether sort or long term, this proposition is designed simply to eliminate supplementation to help deal with the short-term revenue issues.

Financial and manpower considerations

This measure will reduce the overall demand on general taxation revenue by some £55 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 recent report on States salaries over £60,000, part (a)(i) of the proposition can be costed at £0.9 million which might lead to an estimate of around £3 million for the overall States salary bill. Each quarter per cent in (a)(iii) based on a total States salary bill of £327 million will cost a further £0.8 million. Adoption of this proposition should require no additional staffing.