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 Finance and Economics Committee

STATES GREFFE

COMMENTS

Introduction

At present Social Security is a true social insurance scheme with the premiums, at present £4,470 a year (calculated on employee contributions of 6.0% and employer contributions of 6.5% on an earnings limit of £35,760 a year) purchasing benefits in the event of illness, accidents, widowhood, or reaching pensionable age. Where an employee's earnings are insufficient to pay the full insurance premiums, i.e. they earn less than £35,760, their contributions are topped up from States revenues. This is called supplementation. If they did not receive this top-up, they would receive a reduced pension and other benefits, and would potentially be an additional burden on States resources at that time. In effect, supplementation is a redistribution of income (currently £52.5 million p.a.) from the broad range of income tax payers to a narrower group of low earning employees.

Eradicating supplementation by raising the social security ceiling and increasing contribution rates converts social security contributions from an insurance premium to a payroll tax. The net effect of the change is simply to move the payment of supplementation from the income tax payer to the payroll tax payer.

Removing the social security ceiling would increase the tax paid by employees on their earnings in excess of £35,760 by 6.0% and the tax paid by their employers by 6.5% on those earnings. This would raise £10 million from these employees and £9 million from their employers (after allowing for the public sector which would not yield any net employer tax).

The second part of the proposition seeks to raise the balance of the cost of supplementation, i.e. the remaining £33.5 million, to yield the current supplementation figure of £52.5 million, by raising the contribution rate for all employees and employers by 0.25% a year until supplementation is eliminated. This would require a 1.5% increase in employee contribution rates and a 1.5% increase in employer contribution rates.

Accordingly, in order to raise the balance of the £52.5 million, employer and employee social security rates for earnings below £35,760 rates would have to increase by 1.5%. On earnings above £35,760 employees would have to pay a payroll tax of 7.5% and employers a payroll tax of 8%. Self-employed people would have to pay both the employee and employer payroll tax, i.e. 3.0% extra on earnings below £35,760 and 15.5% on earnings above that level.

The Finance and Economics Committee opposes this proposition on the following grounds:

It is a tax on jobs.

This proposal is predicated on employers paying approximately £25 million of the tax raised. In practice this would not happen. The employer payroll tax would increase the costs of all businesses, but particularly those which are in the high earnings/high added value sectors, which are the engine of the economy, such as finance. The significant increase in costs for these high value industries would make Jersey less competitive internationally. As a result some businesses would contract; others, including possibly some major financial institutions, could leave the Island altogether. White collar unemployment would increase, followed by job losses elsewhere as the economy shrinks. There could be a painful period of readjustment with rates of pay having to fall by an amount equivalent to the employer payroll tax in order for Jersey to restore its competitive position. By the end of the readjustment those on lower incomes are likely to have absorbed all the extra employer payroll tax, as well as the 1.5% additional deduction from their pay packets, making them 3% worse off. For higher earners the removal of the ceiling also comes into play, so they would be worse off by even more, possibly as much as 15% of all earnings above £35,760.

If any major financial institutions were to leave the Island during the readjustment period it is unlikely they would ever return. This would leave the whole Island permanently poorer.

It is for the above reasons that the independent economic advice from Oxera, which has been published, is that an employer payroll tax is by far the worst of the main tax raising options.

It would be an unfair tax, blunt in its effect, and taking no account of individuals' differing circumstances.

Unlike income tax, this payroll tax would not include any allowances to take into account individuals' varying personal financial circumstances. So, for instance, a married person earning £40,000 with a large mortgage and 2 children would pay£854 extra in payroll tax, the same as a single person earning £40,000 with no mortgage and no children.

In particular, this tax would hit married couples with a single income compared to couples with two incomes. For instance, under these proposals a married couple earning £70,000 with the wife not working, would pay an extra £3,104 in social security, an increase of 145%. However if the husband and wife were both earning £35,000 they would pay only £1,050 extra.

This proposal is most unfair, however, in that it completely excludes many better-off people living on unearned income from making any additional tax contribution at all. Lower earning working people would effectively be subsidising those living on much higher unearned income.

It would not reduce the tax burden on the less well-off compared to the Finance and Economics Committee's proposals.

As the aim of this proposition is to raise a similar amount of tax to GST, but to do it from a much narrower base, by excluding unearned income and visitor income, then it has to raise more money from people in employment on both high and low incomes, than would be the case with the Finance and Economics Committee's proposals.

Oxera estimates that the Finance and Economics Committee's package, including GST, will increase the tax contribution of lower earners by about 2.5% of their incomes. This proposal however, once the fall in wages from the increased employer contribution has fed through, will result in those on lower incomes being approximately 3.0% worse off. In addition, these proposals do not include enhanced low income support, unlike the Finance and Economics Committee package.

Summary

These proposals concentrate the burden of the additional taxation on those in employment; it is particularly burdensome on the self-employed.

The payroll tax is blunt in its effect and unfair in failing to take personal circumstances into account.

The proposals result in those on lower incomes being worse off than if they paid 3% GST.

The scale of the increase in employer payroll tax, particularly the 8% increase in the cost of employment above the ceiling, will damage the economy, make Jersey less competitive, create unemployment, and could result in the whole Island being permanently poorer.