Report by the Government Actuary on the draft Social Security Benefits Up-rating Order 2012 and the draft Social Security (Contributions) (Re-rating) Order 2012

GOVERNMENT **ACTUARY'S** DEPARTMENT

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Presented to Parliament pursuant to 142(1), 150(8) and 150A(5) of the Social Security Administration Act 1992 as amended by the Social Security Contributions (Transfer of Functions, etc) Act 1999

January 2012 London: The Stationery Office £16.00

Any enquiries regarding this publication should be sent to us at enquiries@gad.gov.uk.

This publication is available for download at www.official-documents.gov.uk

This document is also available from our website at www.gad.gov.uk.

ISBN: 9780108511349

Printed in the UK by The Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office

ID 2474874 02/12

Printed on paper containing 75% recycled fibre content minimum.

To: The Right Hon. Iain Duncan Smith MP, Secretary of State for Work and Pensions

David Gauke MP, Exchequer Secretary to the Treasury

I am pleased to present my report on the potential effects on the National Insurance Fund of the draft Social Security Benefits Up-rating Order 2012 and the draft Social Security (Contributions) (Re-rating) Order 2012.

This report is made in accordance with sections 142(1), 150(8) and 150A(5) of the Social Security Administration Act 1992, as amended by the Social Security Contributions (Transfer of Functions, etc.) Act 1999.

This report also includes the potential effect on the National Insurance Fund of the proposed changes in the draft Social Security (Contributions) (Limits and Thresholds) (Amendment) Regulations 2012.

The report contains estimates for the National Insurance Fund of receipts and payments for the years 2011-12 to 2016-17. The estimates are based on a number of assumptions which are described in the report.

On the basis of my estimates, the balance in the National Insurance Fund at 31 March 2013 is expected to be greater than 1/6th of the amount of benefit payments in 2012-13. This exceeds the minimum level that has been recommended to ensure that a reasonable working balance is maintained. In my view it should not therefore be necessary for any Treasury grant to be made to the National Insurance Fund in 2012-13.

Trevor Llanwarne
Government Actuary
January 2012

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1 Executive summary

1.1 This report has been prepared under sections 142(1), 150(8) and 150A(5) of the Social Security Administration Act 1992 (SSAA 92). It considers the potential effect on the National Insurance Fund (the Fund) of

> the draft Social Security Benefits Up-rating Order 2012 (the Up-rating Order)

> the draft Social Security (Contributions) (Re-rating) Order 2012 (the Re-rating Order).

1.2 This report also includes the potential effect on the Fund of:

> the proposed changes in the draft Social Security (Contributions) (Limits and Thresholds) (Amendment) Regulations 2012 (the Limits and Thresholds Regulations);

> the changes to women's state pension age included in the Pensions Act 2011 as this affects the final year of the projection period covered in Section 6 of this report; and

> the abolition of contracting-out on a defined contribution basis from April 2012.

1.3 Estimates of the Fund income and outgo have been made for 2011-12 to 2016-17. Detailed figures are given for 2012-13, along with updated figures for 2011-12.

1.4 The updated estimates of benefit payments and contribution receipts in 2011-12 are £81.9 billion and £81.9 billion, respectively compared to last year's estimates of £78.0 billion and £77.6 billion.

1.5 The financial effects of the draft Orders on projected benefit payments and contribution receipts for 2012-13 (compared to the projected situation had there been no changes in benefit rates and contribution rates and limits for that year) are estimated as follows:

> The draft Up-rating Order would increase the rates at which some benefits are paid from April 2012. The full basic State Pension would increase by 5.2%, from £102.15 a week to £107.45 a week. Estimated benefit payments excluding redundancy payments in 2012-13 would increase by £4.3 billion from £82.0 billion to £86.3 billion as a result of the Order.

> The draft Re-rating Order would alter the rates of Class 2 and Class 3 contributions, the small earnings exception level for Class 2 and the band of earnings on which Class 4 contributions are paid. Together these changes would increase estimated contribution receipts to the National Insurance Fund in 2012-13 by £9 million.

> The draft Social Security (Contributions) (Limits and Thresholds) (Amendment) Regulations 2012 would:

> > increase the lower earnings limit from £102 to £107 a week;

> > increase the primary threshold from £139 to £146 a week;

> > increase the secondary threshold from £136 to £144 a week.

It is estimated that these changes would decrease net contribution receipts to the Fund in 2012-13 by £1.5 billion.

1.6 The balance in the Fund at 31 March 2013 is estimated at £32.3 billion, or 37% of the estimated benefit payments (including redundancy payments) of £86.7 billion in the year 2012-13.

1.7 The balance in the Fund at 31 March 2013 is expected to be above the recommended level of 1/6th of annual benefit expenditure. Therefore no Treasury grant is expected to be needed during the year 2012-13.

1.8 In 2012-13, payments out of the Fund are estimated to exceed receipts by £6.5 billion as a result of the measures contained in the draft Orders and the other legislative changes described in sections 1.1 and 1.2 above. As the estimated payments and receipts are two large numbers, even relatively small changes in either or both of these numbers could produce a proportionally large change in the difference between them. Therefore the size of the Fund and the Fund as a percentage of benefit payments are particularly sensitive to even small changes in assumptions and experience.

1.9 The assumptions used in my principal projections are, where appropriate, consistent with the central assumptions used by the OBR in its Economic and fiscal outlook (EFO) report published on 29 November 2011.

1.10 Varying these assumptions would change the estimates for benefit payments and contribution receipts, and in turn the estimated balance of the Fund. Section 5 below shows the impact of using different assumptions. However, only fairly significant changes in the assumptions would affect the conclusion that the fund balance at the end of 2012-13 will be above 1/6th of benefit expenditure in the year.

1.11 Estimates for the period up to 2016-17, based on the principal assumptions suggest that the Fund will start to grow again from 2016-17, reaching around 30% of estimated annual benefit payments paid during 2016-17, with no Treasury grant required during this period.

1.12 This report is required to be laid by the Secretary of State for Work and Pensions before Parliament under sections 150(8) and 150A(5) of SSAA 92 in respect of the Up-rating Order, and by HM Treasury under section 142(1) of SSAA 92 in respect of the Re-rating Order.

1.13 This report is confined to the National Insurance Fund in Great Britain. It does not consider the separate Northern Ireland National Insurance Fund.

2 Proposed changes to benefits and contributions

Up-rating Order 2012

2.1 The draft Up-rating Order proposes increasing the rates of some social security benefits paid from the Fund, from the week beginning 9 April 2012. The following table shows the changes in the major benefit rates. Details of changes in other benefit rates are shown in Appendix 1.

Table 1 – Changes to the major benefits rates

	Weekly rate in 2011-12	**Proposed increase in weekly rate**	**Weekly rate proposed from 9 April 2012**
Basic State Pension – person claiming on their own or their deceased spouse's NI contributions – standard rate	£102.15	£5.30	£107.45
Basic State Pension – person claiming on their spouse's NI contributions – standard rate	£61.20	£3.20	£64.40
Contribution-based jobseeker's allowance single person 25 and over(1)	£67.50	£3.50	£71.00
Incapacity benefit long-term main rate	£94.25	£4.90	£99.15
Employment and support allowance personal allowance age 25 or over including work-related activity component(1)	£94.25	£4.90	£99.15

(1) Contribution-based jobseeker's allowance and employment and support allowance

2.2 The most significant benefit paid from the National Insurance Fund, in terms of benefit expenditure, is retirement pensions. The Welfare Reform Bill currently going through Parliament is expected to reduce the amount of incapacity benefit and contribution-based employment and support allowance paid from the Fund. Contribution-based jobseeker's allowance is already comparatively small. We have allowed for these changes in our projections.

2.3 The basic state pension is up-rated by the highest of growth in average earnings, prices (CPI) or 2.5%, the so-called 'triple lock'. The level of CPI in September 2011 was 5.2% and as this was higher than the rate of average earnings growth, 5.2% has been used to calculate the proposed increase in the basic state pension. Most other state benefits will be up-rated in line with increases in CPI.

2.4 The draft Up-rating Order proposes increasing earnings-related additional pensions (under the state earnings-related pension scheme (SERPS), state second pension (S2P) and graduated retirement benefit) by 5.2%, in line with the increase in the CPI.

2.5 The financial effects of the benefit up-ratings are shown in section 4 below.

Re-rating Order 2012 and Limits and Thresholds (Amendment) Regulations 2012

2.6 The draft Re-rating Order proposes increasing some of the contribution rates payable to the Fund and the profits limits between and above which contributions are payable. The draft Limits and Thresholds Regulations propose increasing some of the earnings limits between and in some cases above which contributions are paid. The following table shows the changes in the major contribution rates and limits. Details of changes in other contribution rates and limits are shown in Appendix 2.

Table 2 – Changes to the main limits, thresholds and contribution rates

Item	2011-12	2012-13
	Per week	
Lower Earnings Limit for Class 1 NICs(1)	£102	£107
Upper Earnings Limit for Employees' (Primary) Class 1 NICs(2)	£817	£817
Upper Accrual Point(3)	£770	£770
Primary Threshold	£139	£146
Secondary Threshold	£136	£144
Rate of Class 2 NICs for Self- employed	£2.50	£2.65
	Per annum	
Small Earnings Exception Level for Class 2 NICs	£5,315	£5,595
	Per week	
Rate of (Voluntary) Class 3 NICs	£12.60	£13.25
	Per annum	
Class 4 NICs – Upper Profits Limit(2)	£42,475	£42,475
Class 4 NICs - Lower Profits Limit	£7,225	£7,605

(1) National Insurance contributions
(2) The UEL and UPL will not increase in 2012.
(3) The UAP was introduced from April 2009 by the National Insurance Contributions Act 2008, and remains fixed in cash terms at the level of the UEL in 2008-09 (£770 a week or £40,040 a year).

2.7 The financial effects of the changes in rates and limits proposed in the draft Re-rating Order and the draft Limits and Thresholds Regulations are shown in section 4 below.

3 Assumptions and methods used to project receipts and payments

3.1 The key assumptions underlying the estimates for benefit payments and contribution receipts are those for employment and unemployment levels, and the rate of increase in earnings and CPI. In considering what principal assumptions to use, I have, where appropriate, used the same assumptions as the central assumptions used by the Office for Budget Responsibility for its Economic and fiscal outlook, published on 29 November 2011.

3.2 The table below provides details of the key assumptions underlying the estimates.

Table 3 - Key assumptions[(1)]

	Current year	Following year	< -------------- Future projection -------------- >			
	2011-12	**2012-13**	**2013-14**	**2014-15**	**2015-16**	**2016-17**
Number of jobs, excluding self-employed (millions)[(2)]	26.7	26.7	26.9	27.1	27.4	27.7
Number of unemployed and claiming benefit (millions)	1.6	1.78	1.75	1.63	1.39	1.19
Earnings increase[(3)]	1.7%	2.1%	3.5%	4.4%	4.5%	4.5%
CPI increase	5.2%	2.5%	2.1%	2.0%	2.0%	2.0%

(1) These assumptions are consistent with those used by the OBR in its Economic and fiscal outlook published on 29 November 2011.
(2) Number of jobs is based on the workforce jobs definition.
(3) These figures are taken from Table 4.3 of the OBR's Economic and fiscal outlook November 2011. In projecting National Insurance contributions we use separate earnings increases for employees for Class 1 contributions and for self-employed for Classes 2 and 4 contributions.

3.3 The estimates of future receipts and payments have used the 2010-based population projections issued by the ONS in October 2011.

3.4 Further details of the methods used to estimate benefit payments and contribution receipts are provided in Appendix 3.

3.5 Section 5 below shows the broad impact of using different assumptions from those set out above.

4 Estimates of receipts, payments and fund balance

4.1 Table 4 below provides estimates of receipts and payments of the Fund for 2012-13 along with current latest estimates for 2011-12 based on the principal assumptions.

Table 4 – Estimated receipts and payments and statement of balances of the National Insurance Fund

Great Britain, £ million	**2011-12**			**2012-13**
Receipts				
Contributions (as given in App 4)	81,586		83,653	
Less recoveries of SSP	48		51	
Less recoveries of SMP, SPP and SAP (and abatements) (1)	2,266		2,370	
Net contribution receipts		79,272		81,233
Treasury grant		0		0
Compensation from Consolidated Fund for statutory payments recoveries		2,303		2,409
Income from investments		204		128
State scheme premiums		49		49
Other receipts (2)		45		45
Total receipts (3)		81,874		83,863
Payments				
Benefits — At present rates (as given in Table 5)		81,925	81,970	
Increase due to proposed changes			4,348	
Total				86,318
Personal and stakeholder pensions contracted-out rebates		1,963		1,843
Age-related rebates for contracted-out (4) money purchase schemes		195		185
Administration costs (2)		1,147		1,171
Redundancy fund payments (net) (2)(5)		336		347
Transfer to Northern Ireland		145		335
Other payments		157		161
Total payments (3)		85,869		90,360
Statement of balances				
Balance at beginning of year (6)		42,834		38,839
Excess of receipts over payments		-3,995		-6,497
Balance at end of year		38,839		32,342
Balance at end of year as percentage of annual benefit payments (7)		47.2%		37.3%

(1) No allowance has been made for recoveries of additional statutory paternity pay (ASPP)
(2) The figures for 2011-12 are provisional estimates supplied by other government departments on the basis of amounts received or paid so far this year.
(3) Figures may not sum to totals shown due to rounding.
(4) Contracting-out on a defined-contribution basis ceases in April 2012. Receipts in 2012-13 are due to 2011-12 payments made in arrears.
(5) Redundancy payments are shown net of redundancy recoveries
(6) The balance at 31 March 2011 is taken from the accounts of the fund for the year 2010-11.
(7) Percentages of benefit payments used here include net redundancy payments.

Estimates for 2011-12

4.2 The estimates shown in Table 4 above for 2011-12 may be compared with the estimates for the same period included in my Up-rating report of February 2011. A full comparison is included in Appendix 5.

4.3 In my 2011 report I estimated that payments would exceed receipts by £3.7 billion. My updated estimate for the excess of payments over receipts is £4.0 billion as shown in Table 4 above.

4.4 The main reasons for this difference in the revised estimates are that

- Contributions are expected to be about £0.9 billion lower than previously expected partly due to higher recoveries of statutory payments, reflecting the higher number of births projected in the 2010-based population projections;
- Pension payments are expected to be about £0.3 billion lower than previously expected;
- Administration costs are estimated to be about £0.2 billion lower than previously expected.

Estimates for 2012-13

4.5 I estimate that the potential increase in benefit payments in 2012-13 as a result of the proposed measures in the Up-rating Order will be £4.3 billion, taking estimated total benefit payments from £81.9 billion to £86.3 billion. A breakdown of this is shown in Table 5.

Table 5 - Estimated payments from the National Insurance Fund for benefits, and the effect of benefit up-rating on payments in 2012-13

Great Britain, £ million (1)	Estimated total payments in 2011-12	Estimated total payments in 2012-13	Estimated extra payments in 2012-13 as a result of the draft Up-rating Order(2)
Retirement pensions – basic (3)	59,510	63,247	2,901
Retirement pensions – additional pensions	14,328	15,945	1,128
Widows'/bereavement benefits – basic	514	504	19
Widows'/bereavement benefits – additional pensions	75	67	4
Incapacity benefit – basic (4)	4,636	2,524	118
Incapacity benefit – additional pensions	122	66	-
Employment and support allowance (5)	1,486	2,524	117
Contribution-based jobseeker's allowance	770	939	44
Maternity allowance	356	371	17
Guardian's allowance	2	2	-
Christmas bonus	127	129	-
Total (6)(7)	81,925	86,318	4,348
Redundancy payments (net)	336	347	-

(1) Payments include those made to beneficiaries residing outside Great Britain.
(2) Compared to the position without any up-rating in 2012-13.
(3) Includes payments of graduated retirement benefit.
(4) The reassessment of incapacity benefit recipients and potential transition to employment and support allowance is currently ongoing.
(5) The fall in incapacity benefit is larger than the increase in employment and support allowance, reflecting that some incapacity benefit recipients will cease to receive contributory benefits as a result of the application of the work capability assessment.
(6) Figures from these lines appear in Table 4 in the main report.
(7) Figures may not sum to totals due to rounding.

4.6 The key reason for the drop in the estimated size of the Fund as a percentage of benefit payments from 47% at the end of 2011-12 to 37% at the end of 2012-13 is:

> Contribution receipts are estimated to rise roughly in line with expected average earnings during 2012-13 while the basic state pension payments have been up-rated for the 2012-13 financial year by 5.2% compared to the 2011-12 financial year and the number of pensioners has increased in line with demographic projections.

4.7 I estimate that the effect of the measures proposed in the draft Re-rating Order and the draft Social Security (Contributions) (Limits and Thresholds) (Amendment) Regulations 2012 will be a reduction in contribution receipts to the Fund in 2012-13 of £1.5 billion. A breakdown of this is shown in Table 6.

Table 6 - Estimated effects of the draft Re-rating Order and Limits and the draft (Limits and Thresholds) Regulations on contribution accruals and receipts in 2012-13

Great Britain, £ million **National Insurance Fund effects**	**Contributions estimated as due for 2012-13 (i.e. accrual amounts)**		**Contributions estimated to be received in 2012-13** [(1)] **(i.e. cash paid amounts)**	
Social Security (Contributions) (Re-rating) Order 2012				
Increase in Class 2 contribution rate	+17		+14	
Increase in Class 2 small earnings exception	-6		-5	
Increase in Class 3 contribution rate	+2		+0	
Change in Class 4 lower profits limits	-42		-1	
Total		-28		+9
Social Security (Contributions) (Limits and Thresholds) (Amendment) Regulations 2012 Change in Class 1 primary and secondary thresholds and lower earnings limits				
Effect on contribution receipts from gross contributions	-1,780		-1,563	
Effect on contracted-out rebate	+75		+66	
Total		-1,705		-1,497
Net effect of all measures[(2)]		-1,734		-1,489

(1) The balance of contributions for 2012-13 will not be received until after 31 March 2013, whereas the “Contributions estimated as due” column shows all contributions based on earnings or profits in 2012-13, regardless of when they are received.

(2) Figures may not sum to totals shown due to rounding.

Fund balance

4.8 I estimate that the balance in the Fund at 31 March 2013, allowing for the measures proposed in the draft Up-rating and Re-rating Orders and the draft Limits and Thresholds Regulations will be £32.3 billion. This exceeds 1/6th of estimated benefit payments including redundancy payments (that is, 1/6th of £86.7 billion or £14.5 billion). It has been recommended that a reasonable working balance in the fund would be 1/6th of annual benefit payments. Therefore I do not expect that a Treasury grant will be needed in 2012-13.

4.9 Section 6 below shows the projected development of the Fund up to 2016-17 using my principal assumptions. The Fund (as a proportion of annual benefit expenditure) is projected to reduce between 2012-13 and 2015-16 from 37% to 28% in 2015-16 before increasing slightly to 30% in 2016-17.

4.10 It should be emphasised that there is uncertainty around such projections of the Fund balance, as this will change each year with any surplus or deficit of income over outgo. Since the surplus or deficit generated each year is the difference between two large numbers, quite small percentage changes in either of them could result in a large percentage change in the surplus or deficit.

5 Sensitivity of estimates to assumptions

5.1 To provide an indication of the broad impact of alternative assumptions, Table 7 below shows the effects of changes in the principal assumptions on contribution receipts and benefit payments for the National Insurance Fund. Contribution receipts are sensitive to assumptions for the level of earnings increases and levels of employment.

Table 7 – Effect on receipts and payments of the National Insurance Fund in 2012-13 of variations in economic assumptions

Variation compared to principal assumptions £ million	Effect on receipts in 2012-13
1% lower earnings increases over the year 2011-12 and 2012-13	-2,250
1% higher earnings increases over the year 2011-12 and 2012-13	+2,270
Lower GB number of jobs by 200,000 in 2012-13	-650
Higher GB number of jobs by 200,000 in 2012-13	+650

5.2 The assumptions for the number of jobs and earnings increases are largely independent. Therefore the effects of changes to these assumptions can be treated as additive.

5.3 The figures in Table 7 can be interpolated or extrapolated to assess the effects on contribution receipts, benefit payments and fund balance under different sets of assumptions. However, it should be noted that the emerging results become less reliable the further any extrapolation lies from the base scenario.

5.4 Receipts and payments into and out of the Fund are also sensitive to different levels or patterns of contracting-out. Rebates in respect of contracted-out salary-related schemes (COSRS) will be deducted from contributions received in 2012-13.

6 Projections beyond April 2013

6.1 Table 8 below shows projected receipts and payments for the National Insurance Fund for the years up to 2016-17 based on my principal assumptions which are, where appropriate, consistent with the central assumptions used by the Office for Budget Responsibility for its Economic and fiscal outlook, published on 29 November 2011. Increases in benefit rates, contribution rates and earnings limits and alterations to benefits paid from the National Insurance Fund after 2012-13 are estimated in line with current and draft legislation. The Fund projection assumes no further changes to benefits, contributions or contracting-out.

Table 8 - Balance in National Insurance Fund at the end of successive financial years based on the principal assumptions

Great Britain, £ million	2010-11[1]	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17
Receipts	76,581	81,874	83,863	86,964	92,124	98,148	104,754
Payments	82,379	85,869	90,360	90,665	94,023	97,935	102,054
Excess of receipts over payments	-5,798	-3,995	-6,497	-3,701	-1,899	211	2,701
Balance in fund at end of year [2]	42,834	38,839	32,342	28,641	26,742	26,953	29,653
Balance at end of year as a percentage of benefit payments [3]	55%	47%	37%	32%	29%	28%	30%

(1) From the National Insurance Fund accounts for 2010-11.

(2) This uses the book value of the fund as at 31 March 2011 and is in accordance both with the accounts and with past practice.

(3) This is based on benefit payments; the payments figures in the table also include personal pension and COMP rebates and administration costs.

6.2 It can be seen from the last row of the table that there is projected to be a steady reduction in the balance of the National Insurance Fund as a percentage of benefit expenditure between 2012-13 and 2015-16 and then a small increase during 2016-17.

6.3 The main reasons for the development of the balance of the fund after 2012-13 are:

- Removal of personal pension rebates which takes effect, on a cash basis, mainly from 2013-14.
- Increases in state pension age.
- Higher up-rating of basic state pension payments than increases in Class 1 contributions as CPI is assumed to be higher than average earnings increases in 2011-2012 and 2012-2013. After 2012-13 average earnings growth is assumed to be higher than CPI and, as in addition unemployment is assumed to fall, the amount of contribution receipts increases faster than benefit payments.

> The number of jobs is assumed to increase and the number of unemployed is assumed to decrease from 2013-14.
> Increasing numbers of pensioners in spite of increases in female state pension age.

Note that the Fund balance at end of year as a percentage of benefit payments is affected not just by the difference between receipts and payments in a year but also by the amount of the payments in a year. Therefore increases in the amount of payments can cause the percentage to fall even if the fund size is increasing.

6.4 In looking at the numbers in the table above, it is important to note that projections further into the future depend critically on the assumptions used, and small variations in experience from the assumptions adopted could mean that the actual outcome is very different from that shown.

6.5 The future development of the fund is particularly sensitive to:

> The relationship between CPI and increase in average earnings, due to how the 'triple lock' operates. Higher CPI than average earnings growth would tend to increase benefit payments faster than contribution receipts.
> Levels of employment, the number of jobs and unemployment. Increases in unemployment could reduce the amount of contributions received with little if any effect on retirement pension benefit payments.
> Changes in legislation, including state pension age, levels of up-rating, re-rating and changes in thresholds and limits which differ from those implicit in the assumptions I am currently making.

7 Conclusion

7.1 The balance in the National Insurance Fund at 31 March 2012, as set out in Table 4 of this report, is estimated to be £38.8 billion. This is lower than the estimate in my report in February 2011 of £40.4 billion. The difference is largely due to the opening balance at the start of 2011-12 (taken from the Fund accounts) being £1.3 billion lower than estimated in my previous report.

7.2 The balance of the Fund at 31 March 2013, allowing for the proposed increases in benefits and changes in contributions in 2012-13 that would arise from the proposed Up-rating Order, Re-rating Order and Limits and Thresholds Regulations, is estimated to be £32.3 billion.

7.3 As the estimated balance of the fund at 31 March 2013 of £32.3 billion exceeds the recommended minimum level of at least 1/6th of benefit payments during the year (equivalent to £14.5 billion), it is most unlikely that payment of a Treasury grant will be required in 2012-13. Medium-term projections suggest that a Treasury grant will not be required during the period to 31 March 2017.

7.4 If economic conditions depart from the principal assumptions used the balance of the Fund at 31 March 2013 could be different from that given above. The effect of variations in these assumptions is described in Section 5. This analysis suggests that even quite substantial alterations in economic conditions should not cause the balance of the fund at that date to fall significantly toward the level where a Treasury grant would be required for 2012-13.

7.5 Section 6 shows that the balance in the Fund at the end of each year up to 31 March 2017 is projected to be no lower than 28% of benefit payments in the year. The projections made in Section 6 include the effects of the Pensions Act 2011 in respect of accelerated increases in women's state pension age in 2016-17. Please refer to Section 6 above for a description of the main factors that can influence the future development of the Fund.

Trevor Llanwarne
Government Actuary
January 2012

Appendix 1: Main rates of benefit provided from the National Insurance Fund

All figures in £s	Weekly rate in 2011-12	Weekly rate proposed from April 2012
Basic State Pension, widow's pension and widowed parent's allowance		
Personal benefit (basic pension)	102.15	107.45
Based on spouse/civil partner's contributions (retirement pension only)	61.20	64.40
Increase for spouse or other adult dependant (retirement pension only)	58.80	61.85
Bereavement benefit	100.70	105.95
Graduated retirement benefit (unit)	0.1189	0.1251
Bereavement payment (1)	2000.00	2000.00
Incapacity benefit long-term rate (2)		
Personal benefit	94.25	99.15
Transitional invalidity allowance higher rate	13.80	11.70
Transitional invalidity allowance middle rate	7.10	5.90
Transitional invalidity allowance lower rate	5.60	5.90
Wife or other adult dependant	54.75	57.60
Age increase higher rate (3)	13.80	11.70
Age increase lower rate (3)	5.60	5.90
Incapacity benefit short-term		
Personal benefit higher rate	84.15	88.55
Personal benefit lower rate	71.10	74.80
Wife or other adult dependant	42.65	44.85
Employment and support allowance (4)		
Personal allowance (age 25 or over)	67.50	71.00
Work-related activity component	26.75	28.15
Support component	32.35	34.05
Statutory sick pay	81.60	85.85
Jobseeker's allowance (contribution-based) (5)		
Personal benefit for those aged 18 to 24	53.45	56.25
Personal benefit for those aged 25 and over	67.50	71.00
Maternity allowance (6)	128.73	135.45
Statutory maternity pay		
Standard rate (6)	128.73	135.45
Guardian's allowance		
First child	14.75	15.55
Other children	14.75	15.55
Increases for the children of widows, widowers, retirement pensioners and those on long-term rate and higher short-term rate of incapacity benefit and recipients of incapacity benefit over pension age		
First child	8.10	8.10
Other children	11.35	11.35
Christmas bonus to pensioners (1)	10.00	10.00

(1) Lump sum benefit.

(2) The threshold for incapacity benefit and contribution-based employment and support allowance offset for occupational and personal pensions is £85 a week for both years.

(3) The Employment and Support Allowance (Up-rating Modification) (Transitional) Regulations 2008 permit the modification to the rates of age additions, as part of the transition from incapacity benefit to employment and support allowance (ESA). The aim is that the total benefit (personal benefit plus age increase) is up-rated by no more than half the increase in CPI.

(4) Employment and support allowance replaced incapacity benefit for new claims from 27 October 2008. The benefit contains many allowances depending on the circumstances of the recipients. However, everyone who satisfies the work capability assessment will receive a personal allowance and either the work-related activity component or the support component. The process is underway to review incapacity benefit claims to assess if they can be transferred to ESA.

(5) Unemployed people who meet certain conditions, primarily relating to the payment of National Insurance contributions in the period recently before they become unemployed, can claim contribution-based jobseeker's allowance. Other unemployed people who meet the conditions for receiving any benefit receive non-contributory jobseeker's allowance.

(6) The first 6 weeks of statutory maternity pay is paid at 90% of the woman's average weekly earnings with no upper limit. Thereafter the remaining 33 weeks are paid at the standard rate or, if lower, 90% of her average weekly earnings. Maternity allowance is paid at the amount shown or 90% of the woman's average weekly earnings if this calculation results in a figure which is less. Self-employed women who hold a certificate of small earnings exception receive maternity allowance equal to 90% of the maternity allowance threshold (£30 a week).

Appendix 2: Main features of the contribution system

		Rate in 2011-12	Rate proposed from April 2012
Class 1			
Lower earnings limit (LEL)		£102 a week	£107 a week
Upper earnings limit (UEL)(1)		£817 a week	£817 a week
Upper accrual point (UAP) (2)		£770 a week	£770 a week
Primary threshold		£139 a week	£146 a week
Secondary threshold		£136 a week	£144 a week
Contribution rates (NI Fund and NHS combined)			
Primary (employee)	On earnings between the primary threshold and UEL	12.00%	12.00%
	Reduced rate on earnings between the primary threshold and UEL for married women and widow optants	5.85%	5.85%
	On earnings above the UEL	2.00%	2.00%
	NHS allocation included in above		
	– percentage of earnings between the primary threshold and UEL	2.05%	2.05%
	– percentage of earnings above the UEL	1.00%	1.00%
Secondary (employer)	On all earnings above the secondary threshold (3)	13.80%	13.80%
	NHS allocation included in above (percentage of all earnings on which contributions are paid for employees earning above the secondary threshold)	1.90%	1.90%
Class 1A and Class 1B			
Contribution rate (employer only)		13.80%	13.80%
NHS allocation included in above		1.90%	1.90%

Appendix 2 (cont)

	Rate in 2011-12	Rate proposed from April 2012
Class 2		
Flat-rate contribution	£2.50 a week	£2.65 a week
Small earnings exception	£5,315 a year	£5,595 a year
NHS allocation included in above (percentage of contribution)	15.50%	15.50%
Class 3		
Flat-rate contribution	£12.60 a week	£13.25 a week
NHS allocation included in above (percentage of contribution)	15.50%	15.50%
Class 4		
Lower profits limit (LPL)	£7,225 a year	£7,605 a year
Upper profits limit (UPL) (1)	£42,475 a year	£42,475 a year
Contribution rate		
On profits between the LPL and UPL	9.00%	9.00%
On profits above the UPL	2.00%	2.00%
NHS allocation included in above		
Percentage of profits between the LPL and UPL	2.15%	2.15%
Percentage of profits above the UPL	1.00%	1.00%

(1) The UEL and UPL will not increase in 2012.

(2) The UAP was introduced from April 2009 by the National Insurance Contributions Act 2008, and remains fixed in cash terms at the level of the UEL in 2008-09 (£770 a week or £40,040 a year).

(3) The contracted-out rebate for secondary contributions in 2011-12 and 2012-13 is 3.7% and 3.4% respectively of earnings between the LEL and UAP for COSRS and is abolished for COMPS, having been 1.4% in 2011-12.

Appendix 3: Methods

Contributions

1. Contributions are estimated separately for each class of National Insurance contribution. Actual known receipts in recent years are used to adjust modelled estimates for future years. The modelled estimates for the current year, 2011-12, are aligned with HM Revenue & Customs estimates, based on contributions received in the year to date.

2. Estimates of Class 1 contributions are made separately for gross contributions and amounts of contracted-out rebates. Estimates of gross contributions and COSR rebates are made using an earnings distribution based on the Annual Survey of Hours and Earnings (ASHE) produced by the Office for National Statistics.

3. Other classes of National Insurance contributions, which generate substantially lower revenues than Class 1, are estimated using simplified models. Class 1A and Class 1B contributions are estimated using data and projections provided by HM Revenue & Customs on contributions paid in previous years. Estimates of Class 2 and Class 4 contributions are estimated using data on the earnings of the self-employed received from HM Revenue & Customs, adjusted for earnings increases. These data are combined with information on contributions received in the past, the assumed numbers of self-employed in the future, and the Class 2 and Class 4 contribution rates in order to estimate the contributions paid. Class 3 contributions are estimated by adjusting the contributions paid in earlier years for the changes in the contribution rate. The underlying numbers of people paying Class 3 contributions are based on HM Revenue & Customs assumptions.

4. Statutory sick pay (SSP) and statutory maternity pay (SMP) recovered by employers are estimated by adjusting amounts recovered in the latest year for which data are available broadly in line with changes in numbers of employees, rates of benefit, and, for earnings-related SMP, the average earnings of women and number of births. The additional amount in excess of 100% of SMP paid which can be reclaimed by small employers (SMP abatement) is estimated in a similar way. The amount of the payment from the Consolidated Fund is estimated as the amounts of SSP and SMP recovered, with adjustments in the current year arising from revisions to estimates of amounts recovered in prior years. Statutory paternity pay (SPP) and statutory adoption pay (SAP) are estimated in a similar way. Additional statutory paternity pay (ASPP) was introduced from April 2011. No data is yet available for ASPP and our estimates do not include any allowance for ASPP recoveries. Historically there were problems with the data for statutory payments. The position has improved and work on resolving remaining issues is continuing. In the meantime, estimates have been made based on the available data but it is still possible that figures for statutory payments may be amended in the future.

Other receipts

5. The estimates given for receipts from state scheme premiums are based on receipts data from HM Revenue & Customs in the recent past and on estimated amounts of contracted-out rebates.

6. The investment return on the National Insurance Fund is estimated by applying an assumed rate of return to the average balance in the Fund during the year. The assumed rate of investment return is based on estimates of future interest rates derived from Bank of England Government Liability forward rates, given that the assets of the National Insurance Fund are deposited with the Commissioners for the Reduction of

National Debt.

7. The amount of the Treasury grant, if any, for a year is estimated as that amount needed to ensure that the estimate of the Fund balance at the end of that year is at least 1/6th of benefit payments (including redundancy fund payments) in the year.

8. Estimates for the item called “Other receipts” in the accounts of the National Insurance Fund (mainly recoveries of damages in tort from benefit paid) are provided by the Strategy Directorate of the Department for Work and Pensions.

Benefits

9. Benefits are estimated separately for each of the contributory benefits, for the basic flat-rate element of state retirement pensions and for additional earnings related pensions (SERPS and S2P).

10. The estimate of basic retirement pension, by far the largest benefit, uses the ONS’s 2010-based population projection as a basis for the numbers over state pension age. The estimates allow for different proportions of the population at different ages above state pension age receiving basic retirement pension. Allowance is made for trends in the average amounts of benefit and the changing mix in categories of retirement pension for women arising from the increasing trend for women to have entitlement on their own contributions.

11. Allowance has been made in the estimate of the basic retirement pension for the changes introduced by the Pensions Act 2007 and Pensions Act 2011 which impact expected expenditure in the years to 2016-17, namely:

    > For women born on or after 6 April 1950 the current state pension age has started increasing from 60 to 65 from April 2010. Under the Pensions Act 2011 women’s state pension age will increase more quickly to 65 between April 2016 and November 2018.

    Both these changes have only a small effect in 2011-12 and 2012-13, but an increasing effect in later years. Increasing women’s state pension age more quickly to 65 between April 2016 and November 2018 will affect the final year covered by the projections. The increase in state pension age for both women and men to age 66 by April 2020 contained in the Pensions Act 2011, does not affect the Fund during the period covered by these projections.

12. A separate model estimates the amounts of retirement pension paid to pensioners overseas (and therefore not covered by the ONS’s population projections). This model takes as a starting point the data on the amounts of pension currently paid to pensioners overseas and an estimate of the amounts of contributions paid in past years by people under state pension age who are believed to be currently overseas. These are then projected allowing for mortality, immigration and emigration, and awards of new pension for those reaching state pension age. Allowance is made for those overseas cases whose pension rate is frozen.

13. Estimates of amounts of additional pension paid with retirement pension are derived from age-specific data on past earnings from the L2 dataset. For future years, earnings factors are derived from the output of the National Insurance Class 1 contributions model, with adjustments for the difference between earnings on which contributions are paid and earnings counting for accruals of additional pension, and with allowance for different accrual rates on different bands of earnings in the State Second Pension (S2P). Allowance is also made for accruals of S2P-credited earnings from 2002-03 onwards, including the changes introduced by the Pensions Act 2007 based on

information from DWP. Accrued earnings are projected to pension age based on population mortality rates from the ONS 2010-based population projections. At state pension age the projected accrued earnings are converted to amounts of additional pension awarded, and projected using the mortality rates from the ONS's 2010-based population projection. Allowance is made for additional pension which is inherited by surviving widows and widowers after the death of a pensioner. A similar method is used for guaranteed minimum pensions and contracted-out deductions, with adjustment made to the mortality rates to allow for generally lighter mortality for those contracted out.

14. The estimates of graduated retirement pension are based on the numbers of graduated units earned between 1961 and April 1975. An estimated adjustment was made to allow for units of deceased men inherited by their widows who were under state pension age at April 1975 and which would not come into payment until the widow reached state pension age. The units accrued up to April 1975 are projected allowing using population mortality rates. Allowance is made for inheritance of graduated units by widows, widowers and bereaved civil partners. Units in respect of people under state pension age are assumed to be paid on reaching state pension age. The appropriate graduated rate is applied to the remaining units over state pension age.

15. The estimates of benefits for widows, bereavement, incapacity, employment and support, jobseekers, maternity, and Christmas bonus are derived from information provided by the Department for Work and Pensions. Estimates for guardian's allowance are derived from recent data, adjusted in line with the projected number of children in the population.

Other payments

16. The administration costs for 2011-12 are based on estimates provided by HM Revenue & Customs. Future costs have been estimated as the 2011-12 costs increased in line with average earnings growth.

17. Redundancy payments estimates (net of redundancy receipts) are provided by the Department for Business, Innovation and Skills, and are based on the same economic assumptions as the other estimates.

18. Transfers from the Great Britain National Insurance Fund to the Northern Ireland National Insurance Fund are made in order to keep the balance in the Northern Ireland National Insurance Fund at 2.84% of the combined balance in the two funds. Estimates of transfers to or from Northern Ireland are made on this basis.

19. The figures for "Other payments" are based on an extrapolation of amounts shown in the accounts of the National Insurance Fund for this item in previous years.

Appendix 4: Analysis of contribution receipts by fund and contributor class

Great Britain, £ million			2011-12		2012-13	
National Insurance Fund						
Class 1 (1)	Primary	Gross	36,170		36,544	
	Contracted-out rebate (2)		2,212		1,827	
		Net		33,958		34,717
	Secondary	Gross	49,711		50,248	
	Contracted-out rebate (2)		4,972		4,389	
		Net		44,739		45,858
	Total	Gross	85,881		86,792	
	Contracted-out rebate (2)		7,184		6,217	
		Net		78,697		80,576
Classes 1A and 1B				1,009		1,091
Class 2				282		291
Class 3				64		60
Class 4				1,534		1,635
Total National Insurance Fund contributions(3)				**81,586**		**83,653**
National Health Service						
Class 1	Primary		8,135		8,139	
	Secondary		11,031		11,231	
	Total			19,166		19,369
Classes 1A and 1B				173		174
Class 2				52		53
Class 3				12		11
Class 4				651		618
Total National Health Service contributions(4)				**20,054**		**20,226**

Appendix 4 (cont)

Great Britain, £ million		2011-12		2012-13	
All contributions					
Class 1 [1]	Primary Gross	44,305		44,683	
	Contracted-out rebate [2]	2,212		1,827	
	Net		42,093		42,856
	Secondary Gross	60,742		61,478	
	Contracted-out rebate [2]	4,972		4,389	
	Net		55,770		57,089
	Total Gross	105,047		106,162	
	Contracted-out rebate [2]	7,184		6,217	
			97,863		99,945
Classes 1A and 1B			1,182		1,266
Class 2			334		345
Class 3			76		70
Class 4			2,186		2,253
Total contributions [4]			**101,640**		**103,879**

[1] All figures are gross of recoveries by employers of statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay. No allowance has been made for recoveries relating to ASPP.

[2] Contracted-out rebates in respect of contracted-out occupational pension schemes deducted from contributions paid in year only.

[3] These figures appear in Table 2 in the main report.

[4] Figures may not sum to totals shown due to rounding.

Appendix 5: 2011-12 estimates – current and February 2011 estimates

See section 4.2 for reasons for the difference shown in the following table.

Great Britain, £ million		2011-12 current estimates, on the current principal assumptions		2011-12 estimates in the February 2011 Up-rating Report
Receipts				
Contributions [(1)]	81,586		82,311	
Less recoveries of SSP [(2)]	48		50	
Less recoveries of SMP, SPP and SAP, and SMP, SPP and SAP abatement [(2)]	2,266		2,066	
Net contribution receipts [(3)]		79,272		80,195
Treasury grant		0		0
Compensation from Consolidated Fund for SSP and SMP recoveries		2,303		2,106
Income from investments		204		358
State scheme premiums		49		77
Other receipts		45		49
Total receipts [(3)]		**81,874**		**82,784**
Payments				
Benefits [(4)]		81,925		82,295
Personal and stakeholder pensions contracted-out rebates		1,963		2,011
Age-related rebates for contracted-out money-purchase schemes		195		195
Administration costs [(5)]		1,147		1,377
Redundancy fund payments (net)		336		308
Transfer to Northern Ireland		145		157
Other payments		157		137
Total payments [(3)]		**85,869**		**86,480**

(1) The estimates of contributions are lower than last year. In particular, in-year experience data for Class 1 contributions indicates that contributions receipts have been lower than expected in the year to date. Receipts of classes of contributions other than Class 1 are historically volatile.

(2) Estimates of SSP, SMP, SPP and SAP are about 10% higher than estimates made last year partly due to higher projected numbers of births. There are still some unresolved questions in relation to the data and therefore there is the possibility of revisions to these estimates in the future when these problems are resolved. However, the position concerning data has improved considerably in recent years.

(3) Figures may not sum to totals due to rounding.

(4) The estimate of total benefit payments for 2011-12 is lower than that shown in last year's report. The main reason for this is the lower cost of jobseekers allowance being paid from the National Insurance Fund, reflecting fewer claimants than expected satisfying the contributions requirement. Estimates of basic state pension expenditure in 2011-12 are also lower due to lower in-year inflows than previously forecast.

(5) Estimates of the administration costs are lower than estimated due to faster greater cost reduction than expected.

The principal assumptions underlying the two sets of estimates are set out in the table below.

	2011-12 estimates on the current principal assumptions	2011-12 estimates in the February 2011 Up-rating Report
Number of employees in employment (UK, including HM Forces, excluding self-employed) (millions)	26.7	26.6
Increase in average earnings on one year earlier (%)	1.7%	2.1%
Average number of unemployed (GB) (millions)	1.60	1.49

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ISBN 978-0-10-851134-9