

**REPORT BY THE GOVERNMENT ACTUARY ON THE
DRAFTS OF THE SOCIAL SECURITY BENEFITS UP-RATING
ORDER 2002 AND THE SOCIAL SECURITY
(CONTRIBUTIONS) (RE-RATING AND NATIONAL
INSURANCE FUNDS PAYMENTS) ORDER 2002**

*Presented to Parliament by the Secretary of State for Work and Pensions and the Paymaster General
by Command of Her Majesty
February 2002*

Cm

To: The Right Hon. Alistair Darling MP, Secretary of State for Work and Pensions
Ms Dawn Primarolo MP, Paymaster General

REPORT BY THE GOVERNMENT ACTUARY ON THE DRAFTS OF THE SOCIAL SECURITY BENEFITS UP-RATING ORDER 2002 AND THE SOCIAL SECURITY (CONTRIBUTIONS) (RE-RATING AND NATIONAL INSURANCE FUNDS PAYMENTS) ORDER 2002

Sir and Madam,

I attach a report on the likely effects on the National Insurance Fund of the *Social Security Benefits Up-rating Order 2002* and the *Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2002*. This report is made in accordance with sections 142(1), 147(2) and 150(8) of the *Social Security Administration Act 1992*, as amended by the *Social Security Contributions (Transfer of Functions, etc.) Act 1999*.

The report estimates the receipts of and payments from the National Insurance Fund for the years 2001-02 and 2002-03 and the balance in the fund at the start and end of each year. The economic assumptions used correspond with those prepared by Her Majesty's Treasury at the time of the Pre-Budget Report in November 2001.

On the basis of the estimates in the report, the level of the National Insurance Fund at 31st March 2003 will be greater than one-sixth of benefit payments in 2002-03. Thus it exceeds the minimum level that I recommend to ensure that a reasonable working balance is maintained. It will not therefore be necessary for any Treasury grant to be made to the National Insurance Fund in 2002-03.

Christopher Daykin
Government Actuary
February 2002

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Summary

1. This report is on the likely effects on the Great Britain National Insurance Fund of:
 - (i) the *Social Security Benefits Up-rating Order 2002* (the Up-rating Order). Section 150(8) of the Social Security Administration Act 1992 requires the Secretary of State for Work and Pensions to lay a report by the Government Actuary before Parliament with drafts of any orders which alter the rates of benefits made under that section of the Act, and
 - (ii) the *Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2002* (the Re-rating Order). Sections 142(1), and 147(2) of the Social Security Administration Act, as amended by the Social Security Contributions (Transfer of Functions, etc.) Act 1999, require the Treasury to lay a report by the Government Actuary before Parliament with drafts of any orders which alter the rates of contributions made under those sections of that Act.

The report also sets out the effects on the National Insurance Fund of changes which will be made by the *Social Security (Contributions) (Amendment) Regulations 2002*. This report does not consider the separate Northern Ireland National Insurance Fund, nor the effects of the orders on that Fund.

2. The report shows estimates of the receipts of and payments from the National Insurance Fund for 2001-02 and 2002-03. The receipts from contributions and the payments on benefits in these years will depend, among other things, upon the levels of unemployment and employment, and the rate of increase in earnings. The estimates have been made using assumptions about the levels of unemployment, employment and earnings increases which correspond with those prepared by Her Majesty's Treasury at the time of the Pre-Budget Report in November 2001 (see paragraph 16 and Appendix 3, paragraph 24).

3. The orders and regulations covered and the financial effects are as follows:
- the proposed Up-rating Order, which increases from April 2002 the rates at which many benefits are paid, and which is estimated to result in extra benefit payments in 2002-03 of £1,730 million;
 - the proposed Re-rating Order, which alters the rates of Class 1 secondary and Class 3 contributions, alters the small earnings exception for Class 2, adjusts the bands of earnings on which Class 4 contributions are paid and will reduce receipts to the National Insurance Fund by an amount which is estimated to be £317 million in 2002-03;
 - the proposed *Social Security (Contributions) (Amendment) Regulations 2002*, which increase the lower and upper earnings limits and the primary and secondary thresholds for Class 1 National Insurance contributions. It is estimated that these changes will reduce receipts to the National Insurance Fund in 2002-03 by £242 million.

4. On the basis of the estimates in this report, no Treasury grant is required in 2002-03, as the balance in the fund at 31st March 2003 is estimated to be £27,577 million (52.0% of estimated benefit payments), and so significantly exceeds one-sixth of estimated benefit payments in 2002-03.

Description of the changes to benefits and contributions

5. The Up-rating Order increases the rates of social security benefits paid from the National Insurance Fund, from the week beginning 8th April 2002 by the increase in the retail prices index in the year to September 2001 (1.7%), except for retirement pension and bereavement benefit which are increased by £3 a week (4.1%) and maternity allowance and statutory maternity pay which are increased by £12.80 (20.6%) to the level of the earnings threshold. Table 1 shows the changes to the major benefit rates. A more complete summary of the principal rates of benefit before and after the proposed changes is given in Appendix 1.

Table 1 – Changes to the major benefits rates

	Weekly rate in 2001-02	Proposed increase in weekly rate	Weekly rate proposed from 8th April 2002
Retirement pension single person standard rate	£72.50	£3.00	£75.50
Retirement pension married couple standard rate	£115.90	£4.80	£120.70
Contribution-based jobseeker's allowance single person over 25	£53.05	£0.90	£53.95
Incapacity benefit long-term main rate	£69.75	£1.20	£70.95

6. Earnings-related additional pensions of retirement pensioners and bereavement benefit beneficiaries who qualified for these pensions before 6th April 2002 will be increased by 1.7%. There is no increase in additional pension for those on incapacity benefit below state pension age. The increase applies to additional pensions before abatement for any guaranteed minimum pensions paid from occupational pension schemes where the pensioner has been contracted-out before 6th April 1997. However, where a guaranteed minimum pension in payment includes an amount arising from earnings between 6th April 1988 and 5th April 1997, such amount is also required to be increased by 1.7% by the occupational scheme, and the increase in additional pension is correspondingly reduced.

7. The Social Security Act 1986 provided for new awards of additional pensions to widows and widowers to fall from 100% of their deceased spouse's additional pension to 50% from 6th April 2000. However, the Child Support, Pensions and Social Security Act 2000 specified that this reduction would be delayed until October 2002 and The Social

Security (Inherited SERPS) Regulations 2001 further amended the provisions for cases where the spouse dies after October 2002. The surviving spouse of anyone over pension age at October 2002 will continue to inherit 100% of the deceased spouse's additional pension. The surviving spouse of anyone within eight years of pension age at October 2002 will inherit between 60% and 90% of the deceased spouse's additional pension.

8. Maternity allowance and statutory maternity pay are being amended in April 2002. In April 2002 the amount of the weekly flat-rate benefit will increase to £75 rather than to the £63.25 which would have been expected on the general increase of 1.7%. In addition, the threshold for Small Employer Relief will double to £40,000.

9. The new accrual regime for the State Second Pension, which was introduced by the Child Support, Pensions and Social Security Act 2000, will come into force in April 2002. Earnings-related pension will accrue at 40% of earnings factors between the lower earnings limit and the low earnings threshold, 10% of earnings factors between the low earnings threshold and earnings equal to three times the low earnings threshold minus two times the lower earnings limit and from there to the upper earnings limit it will accrue at 20%. Employees with earnings between the lower earnings limit and the low earnings threshold will accrue State Second Pension at the level of the low earnings threshold, as will certain groups of people entitled to credited earnings. *The Social Security (Low Earnings Threshold) Order 2002* sets the low earnings threshold at £10,800 for the year 2002-03.

10. From April 2002 appropriate personal pension rebates and stakeholder pension rebates will be based on the State Second Pension accrual rates, although the rebates for contracted-out salary related schemes and contracted-out money purchase schemes remain unchanged. Rebate rates will change from the same date following the latest of the five-yearly reviews of contracting out rebates. Appendix 7 shows the effect of the new contribution regime and the new rebate rates using the new limits and contribution rates in the regulation stated in paragraph 1. These changes have been taken into account in the figures shown in Table 2 and Appendices 5 and 6.

11. The Re-rating Order will decrease the Class 1 secondary rate from 11.9% to 11.8% as announced in the March 2000 budget. It will also increase the Class 3 weekly contribution rate broadly in line with the increase in the retail prices index. The Class 2 rate will remain at £2 per week. This will be paid by self-employed people with earnings above the small earnings exception, which will be increased from £3,955 to £4,025 a year. For Class 4, the lower profits limit and the upper profits limit will be altered to maintain their alignment with the income tax personal allowance and the upper earnings limit for Class 1 contributions respectively.

12. The proposed *Social Security (Contributions) (Amendment) Regulations 2002* will increase the lower and upper earnings limits for Class 1 contributions to £75 (from £72) a week and £585 (from £575) a week respectively. The increase to the LEL is in line with the increase to the basic state retirement pension while the increase to the UEL is broadly in line with the increase in the retail prices index.

13. The proposed *Social Security (Contributions) (Amendment) Regulations 2002* will continue to align both the primary and the secondary thresholds for Class 1 contributions with the income tax personal allowance, which has been increased in line with the increase in the retail prices index in the year to September 2001. This will increase the thresholds to £89 a week for weekly-paid employees and £385 a month for other employees. The primary and secondary thresholds have been increased from £87 a week in 2001-02. All the changes introduced by this order and by the Re-rating Order are shown in Appendix 2. The financial effects of all these changes are shown in Appendix 5. The effects of the orders on the Northern Ireland National Insurance Fund have not been included in this report.

14. The first contracting out via stakeholder pensions occurred in 2001-02 but the first rebates for stakeholder pensions will not be paid until 2002-03. This has been taken into account in the report. No data is yet available on which to base projections of numbers so we have continued to use the assumptions adopted for the report by the Government Actuary on the Financial Effects on the National Insurance Fund of the Child Support, Pensions and Social Security Bill 1999 (Cm 4573).

Methods and assumptions used to project receipts and payments

15. Each significant item of receipts and payments of the National Insurance Fund is estimated separately. The results are laid out in a format similar to the accounts for the National Insurance Fund for the year 2000-2001. Redundancy receipts are not shown as a separate item, but redundancy payments are shown net of receipts.

16. The main economic assumptions which have been used are based on those which were, in part, set out in Annex B of the Chancellor of the Exchequer's Pre-budget Report. The important assumptions are that the number of jobs in the UK, including the armed forces, is assumed to be 25.9 million in 2001-02 and 25.9 million in 2002-03, the increase in average earnings is assumed to be 4.5% over the year to 2001-02 and 4.4% over the year to 2002-03, and the numbers unemployed and claiming benefit in GB are assumed to be 0.93 million on average in 2001-02 and 1.02 million in 2002-03. Details of the methods used to estimate contribution income and benefit expenditure are given in Appendix 3.

Estimates of receipts and payments and balance in the fund

17. The estimates of receipts and payments for 2002-03 (with the estimates for 2001-02 shown for comparison) are given in Table 2.

Table 2 – Estimated receipts and payments and statement of balances of the National Insurance Fund

Great Britain, £ million	2001-02	2002-03
Receipts		
Contributions (as given in Appendix 6)	57,865	59,375
Less recoveries of SSP	30	31
Less recoveries of SMP and SMP abatement	637	692
Net contribution receipts	57,198	58,653
Treasury grant	0	0
Compensation from Consolidated Fund for SSP and SMP recoveries	686	736
Income from investments	1,270	1,508
State scheme premiums	131	137
Other receipts (4)	61	95
Total receipts	<u>59,345</u>	<u>61,129</u>
Payments		
Benefits At present rates (as given in App 4)	50,469	51,104
Increase due to proposed changes		1,730
Personal pensions contracted-out rebates (as given in App 6)	2,770	2,930
Stakeholder pensions contracted-out rebates (as given in App 6)	0	370
Age-related rebates for contracted-out money purchase schemes (as given in App 6)	118	121
Administration costs (4)	869	906
Redundancy fund payments (net) (4)	196	214
Transfer to Northern Ireland	110	350
Other payments	20	20
Total payments	<u>54,552</u>	<u>57,744</u>
Statement of balances		
Balance at beginning of year	(1) 19,399	24,192
Excess of receipts over Payments	4,793	3,385
Balance at end of year	24,192	27,577
Balance in fund as percentage of benefit payments (2)	47.7	52.0

(1) The balance in the National Insurance Fund at 31st March 2001 has been taken from unaudited accounts of the fund for the year 2000-01.

(2) Percentages of benefit payments including net redundancy payments.

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

(4) These are provisional figures for 2001-02.

Estimates for 2001-02

18. The estimates shown above for 2001-02 may be compared with the estimates made a little over one year ago, and published in the report by the Government Actuary in November 2000 (Cm 4933). The estimated surplus of £4,793 million for 2001-02 shown above differs from the surplus of £2,384 million estimated in that report. The main reason for the increase is that contribution income is significantly higher although the investment income is also greater due to a higher than expected balance in the Fund. The contribution income has been higher because of more favourable economic conditions but the increased compliance of Class 2 contributors has also had an effect.

Estimates for 2002-03

19. The extra benefit payments in 2002-03 as a result of the proposed increases in benefit rates from April 2002 are estimated to be £1,730 million. Particulars of the extra cost and of the payments for individual benefits are given in Appendix 4.

20. The financial effects on contribution receipts and contracted-out rebates of the proposed changes set out in paragraphs 11 to 13 are given in Appendix 5. The total effect of the changes is estimated to be a loss in revenue to the National Insurance Fund of £559 million. Other changes in contribution receipts from 2001-02 to 2002-03 arise largely as a result of forecast increases in earnings between the two years. Appendix 7 shows that the effect of the Child Support, Pensions and Social Security Act 2000 and of changes in rebate rates will be a reduction of £690 million to the National Insurance Fund. These figures are calculated assuming the new limits and rates to be introduced by the Social Security (Contributions) (Re-Rating and National Insurance Funds Payments) Order 2002 and the Social Security (Contributions) (Amendment) Regulations 2002.

21. Table 2 shows that the amount of Treasury grant estimated to be needed in 2002-03 is again nil. At this stage, the estimate of the balance in the National Insurance Fund at 31st March 2003 substantially exceeds one-sixth of estimated benefit payments in 2002-03. My recommendation is that the level of one-sixth of benefit payments is the minimum level needed to ensure the maintenance of a reasonable working balance in the fund.

Analysis of benefit payments and contribution receipts

22. Appendix 4 shows that retirement pension accounts for the major part of benefit payments. Short-term projections indicate that the costs of retirement pension (including additional pension) as a proportion of benefit payments will increase slightly since the amount of additional pension is still growing rapidly, although it only accounts for about 13% of total retirement pension payments.

23. Appendix 6 shows an analysis of the contribution receipts to the National Insurance Fund. The changes to National Insurance contributions described in paragraph 11 to 14 above do not greatly affect the overall expected pattern of contribution receipts.

Effect of different assumptions about employment, unemployment, earnings and contracting out

24. Different assumptions about unemployment would affect the estimates of benefit payments. Different assumed levels of employment would change the estimates of contributions. The estimates of contributions are also critically dependent on assumptions about the level of earnings increases. Thus it is appropriate to consider the effect on National Insurance Fund receipts and payments of different values for these economic assumptions. It is also appropriate to consider the effects of different assumptions for the numbers contracted out by different methods after April 2002 in view of the uncertainty regarding the current number of people who are contracted-out (see paragraph 27).

25. The effect of different assumed numbers of employees does not depend greatly on the assumptions used for earnings increases, nor does the effect of different earnings increase assumptions depend greatly on the number of employees assumed. Hence these factors have been considered separately, and the two effects can be treated as additive. The results of varying the economic assumptions are given in Table 3 below.

Table 3 – Effect on receipts and payments of the National Insurance Fund in 2002-03 of variations in economic assumptions

Great Britain, £ million		
Variation compared to assumptions given in Appendix 3 paragraph 24	Effect on receipts in 2002-03	Effect on payments in 2002-03
GB number of employees-in-employment lower by 200,000 in 2002-03	-400	
GB number of employees-in-employment higher by 200,000 in 2002-03	+400	
Earnings increases 1% lower over the year to 2001-02 and 2% lower over the year to 2002-03	-1,800	
Earnings increases 1% higher over the year to 2001-02 and 2% higher over the year to 2002-03	+1,810	
GB unemployment higher by 200,000 in 2002-03		+100
GB unemployment lower by 200,000 in 2002-03		-100

26. Using the figures in Table 3 it is possible to estimate the likely contribution receipts, benefit payments and, most importantly, fund balance, under different sets of assumptions. For example, if earnings increases were 1% lower over the year to 2001-02 and 2% lower

over the year to 2002-03 and the number of employees were 200,000 lower and the number unemployed 200,000 higher, then the total effect on the receipts net of payments of the National Insurance Fund in 2002-03 would be a loss of around £2.3 billion, which would still not necessitate a Treasury grant in 2002-03.

27. Different levels or patterns of contracting out could have a material effect on the cash flows of the National Insurance Fund. The introduction of NIRS2 has meant that there is a lack of data showing current numbers contracted out through different routes and consequently there is, at present, uncertainty about the numbers of people contracting-out. Information relating to individuals taking up stakeholder pensions is available but, as with the introduction of any new scheme, there is uncertainty about the future take-up. Amounts of APP rebates for 2002-03 and COMPS rebates for 2002-03 above those deducted from contributions received in 2002-03 will generally be paid by the National Insurance Contributions Office after the end of the financial year direct to personal pension providers or the pension scheme. Stakeholder pensions will be treated in the same way as personal pensions.

Table 4 – Effect on receipts and payments of the National Insurance Fund of variations in assumptions on contracting out after April 2002

Great Britain, £ million

Variation in assumptions	Effect on rebates for 2002-03	Effect on rebates paid or deducted from contributions paid in 2002-03
100,000 more members of COSRS, with same sex, age and earnings profile as assumed COSRS membership	+90	+80
100,000 more members of COMPS with same sex and earnings profile as assumed COMPS membership	+90	+40
100,000 more members of APPs with same sex, age and earnings profile as assumed APP membership	+100	0
100,000 more members of Stakeholder Pensions with same sex, age and earnings profile as assumed Stakeholder membership	+100	0

For different assumptions for changes to the numbers of people contracting-out, these amounts can be scaled pro-rata.

Conclusion

28. Table 2 of the report shows that the balance in the National Insurance Fund at 31st March 2002 is likely to be substantially above the recommended minimum level of one-sixth (16.7%) of benefit payments. The level is likely to be higher than estimated in the report on the changes in November 2000 (Cm 4933).

29. It is estimated that no Treasury grant is needed in 2002-03 for the balance in the fund at 31st March 2003 to be at least one sixth of estimated benefit payments in 2002-03. The balances in the National Insurance Fund over the period March 2001 to March 2003 are estimated to be as follows:

Table 5 – Balance in National Insurance Fund at the end of successive financial years

Balance at 31st March	2001	2002	2003
Percentage of benefit payments in previous financial year	(1) 41.2	47.7	52.0

(1) Using latest estimated figures for 2000-01.

30. If economic conditions differ from the assumptions given in paragraph 24 of Appendix 3, then the balance in the Fund at 31st March 2003 will be different from that given above. However, even quite substantial alterations in economic conditions should not cause the balance in the fund to fall significantly below its current level.

Government Actuary

CHRISTOPHER DAYKIN

Fellow of the Institute of Actuaries
February 2002

APPENDIX 1

MAIN RATES OF BENEFIT

	Weekly rate in 2001-02 £	Weekly rate proposed from 8 th April 2002 £
Retirement pension, bereavement allowance and widowed parent's allowance		
Personal benefit (basic pension)	72.50	75.50
Wife or other adult dependant	43.40	45.20
Graduated retirement benefit (unit)	0.0906	0.0921
Bereavement payment (2)	2,000	2,000
Incapacity benefit long-term rate (1)		
Personal benefit	69.75	70.95
Transitional invalidity allowance higher rate	14.65	14.90
Transitional invalidity allowance middle rate	9.30	9.50
Transitional invalidity allowance lower rate	4.65	4.75
Wife or other adult dependant	41.75	42.45
Age increase higher rate	14.65	14.90
Age increase lower rate	7.35	7.45
Incapacity benefit short-term		
Personal benefit higher rate	62.20	63.25
Personal benefit lower rate	52.60	53.50
Wife or other adult dependant	32.55	33.10
Statutory sick pay	62.20	63.25
Jobseeker's allowance (contribution-based)		
Personal benefit for those aged 18 to 24	42.00	42.70
Personal benefit for those aged 25 and over	53.05	53.95
Maternity allowance (3)	62.20	75.00
Statutory maternity pay		
Lower rate	62.20	75.00
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; guardian's allowance and child's special allowance		
First child	9.70	9.65
Other children	11.35	11.35
Christmas bonus to pensioners	10.00	10.00

(1) The threshold for Incapacity Benefit offset for occupational pensions is £85 for both years.

(2) Lump sum benefit.

(3) From August 2000 a new rate of Maternity Allowance has been payable to pregnant women earning between the maternity threshold (£30 a week) and the LEL. The rate payable is related to earnings. Self-employed women who hold a certificate of Small Earnings Exception will receive 90% of the maternity threshold.

APPENDIX 2

MAIN FEATURES OF THE CONTRIBUTION SYSTEM

	Rate in 2001-02	Rate proposed from April 2002
Class 1		
Lower earnings limit (LEL)	£72 a week	£75 a week
Upper earnings limit (UEL)	£575 a week	£585 a week
Primary threshold	£87 a week or £378 a month	£89 a week or £385 a month
Secondary threshold	£87 a week or £378 a month	£89 a week or £385 a month
Contribution rates (NI Fund and NHS combined)		
Primary		
(employee) On earnings between the primary threshold and UEL	(1) 10.0%	(1) 10.0%
Reduced rate for married women and widow optants, on earnings between the primary threshold and UEL	(2) 3.85%	(2) 3.85%
NHS allocation included in above (percentage of earnings between the primary threshold and UEL)	1.05%	1.05%
Secondary		
(employer) On all earnings above the secondary threshold	(3) 11.9%	(3) 11.8%
NHS allocation included in above (percentage of all earnings for employees earning above the secondary threshold)	0.9%	0.9%
Class 1A and Class 1B		
Contribution rate	11.9%	11.8%
NHS allocation included in above	0.9%	0.9%
Class 2		
Flat rate contribution	£2.00 a week	£2.00 a week
Small earnings exception	£3,955 a year	£4,025 a year
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
Class 3		
Flat rate contribution	£6.75 a week	£6.85 a week
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
Class 4		
Lower profits limit	£4,535 a year	£4,615 a year
Upper profits limit	£29,990 a year	£30,420 a year
Contribution rate	7.0%	7.0%
NHS allocation included in above (percentage of profits between lower and upper profits limit)	1.15%	1.15%

(1) The contracted-out rebate for primary contributions in 2001-02 and 2002-03 is 1.6% of earnings between the LEL and UEL for all forms of contracting out – contracted-out salary-related schemes (COSRS), contracted-out money purchase schemes (COMPS), appropriate personal pensions (APPs) and stakeholder pensions.

(2) Married women opting to pay contributions at the reduced rate earn no entitlement to contributory National Insurance benefits as a result of these contributions. No women have been allowed to exercise this option since 1977.

(3) The contracted-out rebate for secondary contributions is 3.0% of earnings between the LEL and UEL for contracted-out salary-related schemes in 2001-02 and 3.5% in 2002-03. For contracted-out money purchase schemes, the employers' contracted-out rebate varies according to the age of the employee: however, only a rebate of 0.6% in 2001-02 and 1.0% in 2002-03 will be deducted from contributions at the time they are paid, the remainder should be paid by the National Insurance Contributions Office in the following financial year after the submission by employers of end-of-year returns. For appropriate personal pensions, the total rebate (primary and secondary combined) applicable to earnings is, like the rebate for COMPS, related to the age of the employee. The rebate will be paid by the National Insurance Contributions Office to the personal pension provider after the submission by employers of end-of-year returns, with the employee and employer paying the not contracted-out rate of contributions during the year. Stakeholder pensions will be treated in the same way as personal pensions.

(4) The increases in the contracted out rebate rates, which take effect in 2002-03 were introduced by the Social Security (Reduced Rates of Class 1 Contributions) (Salary Related Contracted-out Schemes) Order 2001, the Social Security (Reduced Rates of Class 1 Contributions and Rebates) (Money Purchase Contracted-out Schemes) Order 2001 and the Social Security (Minimum Contributions to Appropriate Personal Pension Schemes) Order 2001.

APPENDIX 3

DETAILED METHODS AND ASSUMPTIONS USED

Contributions

1. Contributions are estimated separately for each class. Actual known receipts in recent years are used to adjust modelled estimates for future years.

2. Estimates of Class 1 contributions are made separately for gross contributions and amounts of contracted-out rebates. Estimates of gross contributions and rebates are made using an earnings distribution based on the New Earnings Survey, projected in line with the earnings increases shown in paragraph 24 below. The gross contribution results are scaled in line with the assumed number of employees which are also given in paragraph 24. The estimates of amounts of contracted-out rebates are made in a similar way, using an assumption of the numbers contracted out which allows for the continuation of the trend in the proportions of employees contracted out into occupational schemes observed in recent years. At the moment there is more uncertainty than normal about the level of contracting out through different routes, due to a lack of recent data on the numbers contracting out. Therefore the estimates of contracted-out rebates are more uncertain than would usually be the case. The additional number assumed to be contracted out through Stakeholders Pensions are the same as those used for the report by the Government Actuary on the Financial Effects on the National Insurance Fund of the Child Support, Pensions and Social Security Bill 1999 (Cm 4573). These people are all assumed to earn above the low earnings threshold in the particular year, and are assumed to have the same earnings distribution as all employees who would be contracted-in were it not for the introduction of Stakeholder Pensions.

3. Other classes of contributions are estimated using simpler models. Class 1A contributions are estimated using data provided by the Inland Revenue and information on Class 1A contributions paid in previous years. Class 1B contributions are estimated using data provided by the Inland Revenue. Estimates of Class 2 and Class 4 contributions are estimated using data on the earnings of the self-employed received from the Inland Revenue, adjusted for earnings increases. This data is combined with information on contributions received in the past, the assumed numbers of self-employed in the future, and the rates of Class 2 and Class 4 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.

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 statutory maternity pay, the average earnings of women. 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. A lack of reliable data on actual amounts of SSP and SMP reclaimed by employers in recent years means that the estimates are more

uncertain than would usually be the case. 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.

Other receipts

5. The estimates given for receipts from state scheme premiums are based on data from the National Insurance Contributions Office on the receipts of these amounts in the recent past. The option for pension schemes to pay state scheme premiums (except for contributions equivalent premiums) was ended from April 1997, although some payments appear to have been made subsequent to this. It was assumed that the level of contributions paid since April 1998 is the ultimate level and will not change greatly in the future.

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.

7. The amount of the Treasury grant for 2002-03 is estimated as that amount needed to ensure that the estimate of the fund balance at 31st March 2003 is at least one-sixth of benefit payments (including redundancy fund payments) in 2002-03.

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 Analytical Services Division of the Department for Work and Pensions.

Benefits

9. Benefits are estimated separately for each of the contributory benefits, and separately for the basic, flat-rate elements and for additional pensions (SERPS).

10. In general, for flat-rate benefits, numbers are estimated by taking the most recent data on beneficiaries and projecting these with allowance for awards and cessations in future years based on past experience and taking into account demographic factors. The average rate of benefit is calculated, making allowance for dependency and average amounts of benefit, based on past data and observed trends.

11. Estimates of basic retirement pension, by far the largest benefit, use the latest population projections (mid-2000 based) as a basis for the numbers over pension age. They allow for gradual changes in the proportion of that population receiving basic retirement pension, as well as for an increasing trend in the numbers of overseas residents receiving pension. Allowance is also 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.

12. Estimates of amounts of additional pension paid with retirement pension are derived

from age-specific data on past earnings. For future years, earnings factors are derived by adjusting these for earnings increases, for the introduction of different accrual rates on different bands of earnings in the State Second Pension (S2P), and for demographic and economic activity rate changes under pension age. Allowance is also made for accruals of S2P credited earnings from 2002-03 onwards. Accrued earnings are survived to pension age using adjusted population mortality rates. At pension age the accrued survived earnings are converted to amounts of additional pension awarded, and survived using the latest population mortality rates (mid-2000 based). Paragraph 7 of the main report contains details of the assumptions which have been made regarding the amount of SERPS pensions which are inherited by widows and widowers. A similar method is used for guaranteed minimum pensions and contracted-out deductions, with adjustment to the mortality rates to allow for generally lighter mortality for those contracted-out.

13. 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 pension age at April 1975 and which would not come into payment until the widow reached pension age. The units at April 1975 are survived using population mortality rates. Allowance is made for inheritance of graduated units by widows and, from 1979, by widowers. Units in respect of people under pension age are assumed to be put into payment on reaching pension age. The appropriate graduated rate is applied to the survived units over pension age.

14. Estimates of widows' benefits and bereavement benefits are based on an awards and survivorship model. This model is split between projecting the remaining pre-1988 widows who have full transitional protection and are subject to the pre-1988 rules for widows' benefit, projecting a build-up and run-off of widows widowed between 1988 and 2001, and projecting a build up of widows and widowers post 2001 who are subject to the rules for widows' benefits and bereavement benefits introduced by the Welfare Reform and Pensions Act 1999. Allowance is made for widowers with children who were widowed before April 2001 and who have received widowed parent's allowance since April 2001. Awards are based on recent data and are projected using numbers of new widows and widowers from the latest marital condition projection (mid-1996 based adjusted); termination and transfer rates by single age and type of benefit are derived from recent data. For widowers, in the absence of any actual data, assumptions are based on those for widows, with adjustments to allow approximately for age differentials and entitlement.

15. Estimates of the amount of additional pension paid with widows' benefits and bereavement benefits are derived from the retirement pension additional pension model. Accrued additional pension to people dying under pension age, and actual additional pension in payment to those dying over pension age are converted to give amounts of widows' and widowers' additional pension using assumptions on marital status and age of surviving spouse. Paragraph 7 of the main report contains details of the assumptions which have been made regarding the amount of SERPS pensions which are inherited by widows and widowers. The amount is split by type of benefit and survived using the main basic widows' benefit model. Allowance is made for the changes which have applied since April 2001, under which additional pension will only be paid to widows and widowers under

pension age who receive widowed parents allowance. Amounts of survived additional pension are transferred back to the main retirement pension model in respect of widows and widowers who reach pension age, including amounts which are not actually paid under pension age. A similar method is used for contracted-out deductions.

16. Trends in awards and survival for incapacity benefit take account of assumptions of the effect that the personal capabilities test is expected to have both on new cases and on those awarded invalidity benefit before 1995. The estimates also take account of incapacity benefit ceasing at pension age and those on benefit converting to retirement pension at that age. Additional pension with incapacity benefit ceased for new awards from April 1995, although after 1995 cases still retain the benefit at the existing rate. The estimates also allow for the changes that have been introduced from April 2001 under the Welfare Reform and Pensions Act 1999. Data post 2001 is very limited and the effect of the changes is still largely based on estimates made previously.

17. The estimate of the cost of contribution-based jobseeker's allowance is based on the assumptions for the number of unemployed set out in paragraph 24 of this appendix. It takes account of the estimated proportion of those unemployed who are entitled to the contributory element of jobseeker's allowance. The proportion entitled is derived from recent data on contributory jobseeker's allowance analysed by duration of unemployment. The data suggests that there has been little change in the proportion entitled amongst the inflow to unemployment since the introduction of jobseeker's allowance. The model takes recent data on duration-specific proportions entitled and applies these to a durational split of the numbers unemployed based on durational profiles supplied by the Labour Market Division of the Department for Work and Pensions.

18. The underlying Government Actuary's Department estimates of payments for all benefits are aligned to recent data on payments for 2001-02 to ensure that account is taken of more recent changes in factors affecting benefit payments than are incorporated in data on numbers of beneficiaries.

Other payments

19. Redundancy payments estimates (net of redundancy receipts) are provided by the Department of Trade and Industry, and are based on the same economic assumptions as the other estimates.

20. Estimates of payments to providers of appropriate personal pensions (APPs) and stakeholder pensions are made using the method for calculating contracted-out rebates which was described in paragraph 2 of this appendix. Virtually all the rebates in respect of contributions paid in one financial year are paid in the following financial year. As noted in paragraph 2 of this appendix, there is currently a great deal of uncertainty regarding the number of people contracting-out through personal pensions and stakeholder pensions, due to a lack of recent data.

21. 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 2.66% of the combined balance in the two funds. Estimates of transfers to Northern Ireland are made on this basis.

22. The estimates for administration costs are provided by the Inland Revenue.

23. 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.

Economic assumptions

24. The estimates for contribution receipts are sensitive to the assumptions used about the numbers of employees and the numbers of self-employed workers, and to the assumptions used for earnings increases. The estimates of benefit payments depend, among other things, on assumptions about the numbers unemployed. In accordance with normal practice, working assumptions have been given by the Government in regard to these factors. The economic assumptions which have been used are those which underlie the estimates of the contributory social security benefits as given in the Pre-Budget Report in November 2001. These are given below:

Assumptions used for estimates

	2001-02	2002-03
Number of employment jobs (UK), million (including HMF, excluding self-employed)	25.9	25.9
Increase in average earnings on one year earlier, %	4.5	4.4
Average number of unemployed (GB), million	0.93	1.02

The assumptions for 2001-02 differ from those used in making last year’s report.

25. The effects of variations in these assumptions are given in paragraphs 25 and 26 of the main report.

APPENDIX 4

ESTIMATED PAYMENTS FROM THE NATIONAL INSURANCE FUND FOR BENEFITS, AND EFFECT OF BENEFIT UP-RATING ON PAYMENTS IN 2002-03

Great Britain £ million	Estimated total payments in 2001-02	Estimated total payments in 2002-03	Extra payments in 2002-03 as a result of up-rating
Retirement pensions – basic	36,412	38,062	1,427
Retirement pensions – additional pensions	5,494	6,057	152
Widows' / bereavement benefit – basic	889	900	28
Widows' / bereavement benefit – additional pensions	274	251	5
Incapacity benefit – basic	6,189	6,344	100
Incapacity benefit – additional pensions	574	498	0
Contribution-based jobseeker's allowance	459	534	9
Maternity allowance	56	66	9
Guardian's allowance and child's special allowance	1	2	0
Christmas bonus	121	122	0
Total (1)	50,469	52,834	1,730
Redundancy payments (net) (1)	196	214	0

(1) Figures from these lines appear in Table 2 in the text.

APPENDIX 5

ANALYSIS OF THE CHANGES IN CONTRIBUTION RECEIPTS FOR 2002-03 AS A RESULT OF THE CONTRIBUTION RE-RATING ORDER AND OTHER MEASURES

Great Britain, £ million	Contributions for 2002-03	Contributions received in 2002-03 (1)
National Insurance Fund effects		
Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2002		
Decrease in secondary Class 1 contribution rate	-363	-317
Increase in Class 2 small earnings exception – indexation effect	-1	-1
Increase in Class 3 rate	+1	+0
Increase in Class 4 profit limits – indexation effect (2)	+3	0
Total	<u>-361</u>	<u>-317</u>
Proposed Social Security (Contributions) (Amendment) Regulations 2002		
Increase in Class 1 primary and secondary thresholds and lower and upper earnings limits – indexation effect		
Effect on contribution receipts from gross contributions (3)	-281	-252
Effect on contribution receipts from contracted-out rebates	-152	-31
Additional effect of raising the LEL above the rate of increase in the RPI	+97	+42
Total	<u>-336</u>	<u>-242</u>
Total, all measures	<u>-698</u>	<u>-559</u>

- (1) The balance of contributions for 2002-03 will not be received until after 31st March 2003.
- (2) Because of self-assessment, changes in the rates and limits in 2002-03 do not have an effect on contributions received until 2003-04.
- (3) Figures are net of contracted-out rebates but gross of statutory sick pay and statutory maternity pay.
- (4) Figures may not sum to totals shown due to rounding.

The measures given above also have a small effect on contributions allocated to the National Health Service.

APPENDIX 6

ANALYSIS OF CONTRIBUTION RECEIPTS BY FUND AND CLASS OF CONTRIBUTOR, AND ANALYSIS OF OCCUPATIONAL PENSION SCHEME CONTRACTED-OUT REBATES

Great Britain, £ million			2001-02	2002-03
National Insurance Fund				
Class 1 (1)	Primary	Gross	25,274	26,305
		Contracted-out rebate (2)	2,394	2,475
		Net	22,881	23,830
	Secondary	Gross	36,554	38,033
		Contracted-out rebate (2)	4,369	5,207
		Net	32,185	32,827
Total		Gross	61,829	64,339
		Contracted-out rebate (2)	6,763	7,682
		Net	55,066	56,657
Class 1A			987	885
Class 1B			11	11
Class 2			271	241
Class 3			49	50
Class 4			1,481	1,532
Total National Insurance Fund Contributions (3)			57,865	59,375
National Health Service				
Class 1	Primary		2,970	3,090
	Secondary		3,909	4,090
	Total		6,879	7,180
Class 1A			79	72
Class 1B			1	1
Class 2			50	44
Class 3			9	9
Class 4			287	300
Total National Health Service Contributions			7,304	7,607
All contributions				
Class 1 (1)	Primary	Gross	28,244	29,396
		Contracted-out rebate (2)	2,394	2,475
		Net	25,851	26,920
	Secondary	Gross	40,463	42,123
		Contracted-out rebate (2)	4,369	5,207
		Net	36,094	36,917
Total		Gross	68,707	71,519
		Contracted-out rebate (2)	6,763	7,682
		Net	61,945	63,837
Class 1A			1,065	957
Class 1B			12	12
Class 2			321	285
Class 3			59	59
Class 4			1,768	1,832
Total contributions			65,169	66,982

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- (1) All figures are gross of recoveries by employers of statutory sick pay and statutory maternity pay.
 - (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 text.
 - (4) Figures may not sum to totals shown due to rounding.

APPENDIX 6 (cont)

ANALYSIS OF PAYMENTS IN RESPECT OF APPROPRIATE PERSONAL PENSIONS AND AGE-RELATED REBATES IN RESPECT OF CONTRACTED-OUT MONEY PURCHASE SCHEMES MADE BY THE INLAND REVENUE

Great Britain, £ million	2001-02	2002-03
Personal pension rebates		
Primary contracted-out rebates	804	847
Secondary contracted-out rebates	1,966	2,082
Total (1)	2,770	2,930
Age-related rebates for members of contracted-out money-purchase schemes (1)	118	121
Stakeholder pension rebates		
Primary contracted-out rebates	0	121
Secondary contracted-out rebates	0	249
Total (1)	0	370
All payments in respect of personal pensions and age-related rebates to contracted-out money purchase schemes	<u>2,888</u>	<u>3,420</u>

(1) The figures from these lines appear in Table 2 in the text.

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

APPENDIX 7

ANALYSIS OF THE CHANGES IN CONTRIBUTION RECEIPTS FOR 2002-03 AS A RESULT OF THE CHILD SUPPORT, PENSIONS AND SOCIAL SECURITY ACT 2000 AND OTHER MEASURES

Great Britain, £ million	Contributions for 2002-03	Contributions received in 2002-03 (1)
National Insurance Fund effects		
Child Support, Pensions and Social Security Act 2000		
Effect on contribution receipts from the introduction of the new accrual regime for the State Second Pension	-357	0
Social Security (Reduced Rates of Class 1 Contributions) (Salary Related Contracted-out Schemes) Order 2001		
Changes in contracted-out rebates for COSRS	-750	-670
Social Security (Reduced Rates of Class 1 Contributions and Rebates) (Money Purchase Contracted-out Schemes) Order 2001		
Changes in contracted-out rebates for COMPS	-32	-
		20
Social Security (Minimum Contributions to Appropriate Personal Pension Schemes) Order 2001		
Changes in contracted-out rebates for Personal Pensions (2)	-199	0
Changes in contracted-out rebates for Stakeholder Pensions	-32	0
Total effect on National Insurance Fund receipts	-1,013	-690
Total, all measures	-1,370	-690

- (1) The balance of contributions for 2002-03 will not be received until after 31st March 2003.
- (2) Including rebates in respect of people who are currently contracted out through an APP but who may switch to being contracted out through a Stakeholder pension.
- (3) Figures may not sum to totals shown due to rounding.

APPENDIX 8

COMPARISON OF ESTIMATES FOR 2001-02 MADE NOW AND IN Cm4933 (NOVEMBER 2000)

Great Britain, £ million	2001-02 estimates made now	2001-02 estimates given in Cm 4933
Receipts		
Contributions	57,865	55,492
Less recoveries of SSP	30	30
Less recoveries of SMP and SMP abatement	637	657
Net contribution receipts	57,198	54,805
Treasury grant	0	0
Compensation from Consolidated Fund for SSP and SMP recoveries	686	683
Income from investments	1,270	1,112
State scheme premiums	131	137
Other receipts	61	205
Total receipts	59,345	56,942
Payments		
Benefits	50,469	50,504
Personal pensions contracted- out rebates	2,770	2,518
Age-related rebates for contracted-out money purchase schemes	118	115
Administration costs	869	1,136
Redundancy fund payments (net)	196	156
Transfer to Northern Ireland	110	110
Other payments	20	20
Total payments	54,552	54,558

Figures may not sum to totals due to rounding.

REASONS FOR CHANGES IN ESTIMATES

1. The estimates of Class 1 contributions are significantly higher than last year for both primary and secondary contributions. This is largely because of greater than expected receipts during 2000-01. This higher level (which is mainly due to more employment jobs than was expected) has continued into 2001-02 and is forecast to continue for the rest of the year.
2. Receipts of Class 2 contributions are now estimated to be higher than was estimated last year. This is also due to greater than expected receipts in 2000-01, something which has also continued into 2001-02. This is believed to be due to efforts by Inland Revenue to improve compliance.
3. Estimates of Class 1A contributions are higher than last year. This is because of changes in estimates received from Inland Revenue showing the taxable value of benefits in kind. Estimates of Class 1B, Class 3 and Class 4 contributions are little changed since last year.
4. Estimates of SSP are little changed since last year. SMP estimates are lower than was estimated last year largely because of a lower projected number of births from the latest population projections. Estimates of both SSP and SMP have suffered greatly from a lack of reliable data since the transfer from the NIRS to the NIRS2 computer system. It has been some years since the data on SSP and SMP has been free of problems and there may be substantial revisions to estimates of these amounts once sufficient reliable data on amounts of SSP and SMP recovered by employers in recent years is available.
5. Income from investments is estimated to be higher than was estimated at this time last year. This is largely to due to the higher balance in the fund at the end of 2000-01 than was estimated last year.
6. The estimate of total benefit payments for 2001-2002 is very similar to the estimate shown in last year's report.
7. Payments of minimum contributions to appropriate personal pension providers are now estimated to be higher than was estimated last year. This is largely due to data showing significantly higher than expected payments of PP rebates in 2000-01. While recent data shows payments of appropriate personal pension rebates in 2001-02 being slightly lower than in 2000-01 they are still higher than was estimated last year. It should be noted however that there are still data issues related to information on these payments since the introduction of NIRS2. The new recording system lead to delays in payments and the full effect that this has had on the series of rebates since then is not yet clear. Information on the numbers (and age/sex profile) of those contracting out in this way is some years out of date and has lead to further uncertainty in these forecasts.
8. Estimates of the administration costs that will be charged to the National Insurance

Fund have been supplied by the Inland Revenue. The estimates are lower than those given last year. Estimates for “other receipts” (mainly recoveries of compensation in tort) are also lower than the estimates made last year.

9. The assumptions used in making the two sets of estimates are compared in the table below.

	2001-2002 estimates made now	2001-2002 estimates given in Cm 4933
Number of employees in employment (UK), million (including HMF, excluding self-employed) (1)	25.9	24.7
Increase in average earnings on one year earlier, %	4.50	4.50
Average number of unemployed (GB), million	0.93	1.01

(1) The estimated number of jobs in 2001-2002 is now significantly higher than last year. However, this is due to a rebasing of this particular series and so these particular assumptions are not directly comparable.