

**REPORT BY THE GOVERNMENT ACTUARY ON THE  
DRAFTS OF THE SOCIAL SECURITY BENEFITS UP-RATING  
ORDER 2003 AND THE SOCIAL SECURITY  
(CONTRIBUTIONS) (RE-RATING AND NATIONAL  
INSURANCE FUNDS PAYMENTS) ORDER 2003**

*Presented to Parliament by the Secretary of State for Work and Pensions and the Paymaster General  
by Command of Her Majesty  
February 2003*

Cm

To: The Right Hon. Andrew Smith 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 2003 AND THE SOCIAL SECURITY (CONTRIBUTIONS) (RE-RATING AND NATIONAL INSURANCE FUNDS PAYMENTS) ORDER 2003

Sir and Madam,

I attach a report on the likely effects on the National Insurance Fund of the *Social Security Benefits Up-rating Order 2003* and the *Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2003*. 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 2002-03 and 2003-04 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 2002.

On the basis of the estimates in the report, the level of the National Insurance Fund at 31st March 2004 will be greater than one-sixth of benefit payments in 2003-04. 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 2003-04.

Christopher Daykin  
Government Actuary  
February 2003

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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 2003* (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 2003* (the Re-rating Order). Sections 142(1), and 147(2) of the Social Security Administration Act 1992, 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 2003* and those which were made by the National Insurance Contributions Act 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 2002-03 and 2003-04. 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 2002 (see paragraph 14 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 2003 the rates at which many benefits are paid, and which is estimated to result in extra benefit payments in 2003-04 of £1,279 million;
  - the proposed Re-rating Order, which alters the rate of Class 3 contributions and alters the small earnings exception for Class 2 and will have little effect on receipts to the National Insurance Fund in 2003-04;
  - the proposed *Social Security (Contributions) (Amendment) Regulations 2003*, which increase the lower and upper earnings limits for Class 1 National Insurance contributions. It is estimated that these changes will increase receipts to the National Insurance Fund in 2003-04 by £160 million.

The *National Insurance Contributions Act 2002* increased the upper profits limit for

Class 4 National Insurance contributions, increased the rate of Class 1 and Class 4 contributions and increased the NHS allocation from these contributions. It is estimated that these changes will reduce receipts to the National Insurance Fund by £889 million in 2003-04.

4. On the basis of the estimates in this report, no Treasury grant is required in 2003-04, as the balance in the fund at 31<sup>st</sup> March 2004 is estimated to be £29,345 million (53.2% of estimated benefit payments), and so significantly exceeds one-sixth of estimated benefit payments in 2003-04.

### **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 7<sup>th</sup> April 2003, by the increase in the retail prices index in the year to September 2002 (1.7%), except for retirement pension (and benefits linked to it) which is increased by £1.95 a week (2.6%), basic retirement pension increments which are increased by 6.6%, contribution-based jobseeker's allowance which is increased by 1.3%, and maternity allowance and statutory maternity pay which are increased by £25 (33.3%). 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**

	<b>Weekly rate in 2002-03</b>	<b>Proposed increase in weekly rate</b>	<b>Weekly rate proposed from 7<sup>th</sup> April 2003</b>
Retirement pension single person standard rate	£75.50	£1.95	£77.45
Retirement pension married couple standard rate	£120.70	£3.10	£123.80
Contribution-based jobseeker's allowance single person over 25	£53.95	£0.70	£54.65
Incapacity benefit long-term main rate	£70.95	£1.20	£72.15

6. Earnings-related additional pensions of retirement pensioners and bereavement benefit beneficiaries who qualified for these pensions before 6<sup>th</sup> April 2003 will be increased by 1.7%. There is no increase in additional pension for those on incapacity benefit. The increase applies to additional pensions before abatement for any guaranteed minimum pensions where the pensioner has been contracted-out before 6<sup>th</sup> April 1997. However, where a guaranteed minimum pension in payment includes an amount arising from earnings between 6<sup>th</sup> April 1988 and 5<sup>th</sup> April 1997, such amount is deemed to be increased by 1.7% by the contracted-out pension scheme, and the increase in additional pension is

correspondingly reduced.

7. Maternity allowance and statutory maternity pay are being amended in April 2003. In April 2003 the amount of the weekly flat-rate benefit will increase to £100 rather than to that which would have been expected on the general increase of 1.7%. However, those whose earnings-related benefit is less than £100 will receive 90% of their average weekly earnings instead. In addition, the total number of weeks for which benefit is paid will increase to 26 weeks, the extra weeks being paid at the flat rate. Statutory paternity pay and statutory adoption pay are also being introduced from April 2003.

8. The Re-rating Order will increase the Class 3 weekly contribution rate from £6.85 to £6.95. The Class 2 rate payable by the self employed will remain at £2 per week. There is a liability for Class 2 contributions for self employed people with profits or gains above the small earnings exception, which will be increased from £4,025 to £4,095. Self employed people with profits below the small earnings exception may still pay Class 2 to protect benefit entitlement. For Class 4, the lower profits limit will be frozen at the same level to maintain its alignment with the income tax personal allowance and the upper profits limit will be altered in line with the upper earnings limit for Class 1 contributions. The Class 4 upper profits limit was not increased this year by the Re-rating Order but by the National Insurance Contributions Act 2002.

9. The proposed *Social Security (Contributions) (Amendment) Regulations 2003* will increase the lower and upper earnings limits for Class 1 contributions to £77 (from £75) a week and £595 (from £585) 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. No changes have been made to the primary and secondary thresholds, which remain at £89 a week for weekly-paid employees and £385 a month for other employees.

10. The *National Insurance Contributions Act 2002* increased the rates of Class 1 primary and secondary contributions, and the rate of Class 4 contributions, by 1% from April 2003. In addition, Class 1 primary contributions and Class 4 contributions will become payable on all earnings and profits above the upper earnings limit and upper profits limit respectively, at the rate of 1%. The allocation of contributions to the National Health Service was also increased. For Class 1 primary and Class 4 contributions, the extra revenue from the increase in the contribution rate will be allocated directly to the National Health Service, and there will be no effect on the National Insurance Fund. For Class 1 secondary contributions, the National Health Service allocation rate has been increased by 1%, but this is defined as a percentage of all earnings whereas Class 1 secondary contributions are payable on earnings above the secondary threshold. As a result, the NHS allocation for Class 1 secondary contributions will increase by more than the increase in total Class 1 secondary contributions, and contributions to the National Insurance Fund will reduce.

11. The changes described in paragraphs 8 to 10 are shown in Appendix 2. The financial effects of 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.

12. The proposed *Social Security Pensions (Low Earnings Threshold) Order 2003* will increase the Low Earnings Threshold from £10,800 to £11,200 in 2003-04. The Low Earnings Threshold affects the amount of State Second Pension being accrued and the level of contracted-out rebates for people in Appropriate Personal Pensions and contracted-out stakeholder pensions. Consequentially, the upper limit of Band 2 accrual for the State Second Pension will be £25,600 in 2003-04, compared with £24,600 in 2002-03. The effects of this proposed Order have been allowed for in this report.

### **Methods and assumptions used to project receipts and payments**

13. 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 2001-02. Redundancy receipts are not shown as a separate item, but redundancy payments are shown net of receipts.

14. The main economic assumptions which have been used are based on those which were, in part, set out in Annex B1 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 26.1 million in 2002-03 and 26.2 million in 2003-04, the increase in average earnings is assumed to be 4.3% over the year to 2002-03 and 4.9% over the year to 2003-04, and the numbers unemployed and claiming benefit in GB are assumed to be 0.92 million on average in 2002-03 and 0.94 million in 2003-04. 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**

15. The estimates of receipts and payments for 2003-04 (with the estimates for 2002-03 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	2002-03	2003-04
<b>Receipts</b>		
Contributions (as given in App 6)	59,083	61,540
Less recoveries of SSP	31	31
Less recoveries of SMP and SMP abatement	725	1,066
Net contribution receipts	58,328	60,443
Treasury grant	0	0
Compensation from Consolidated Fund for SSP and SMP recoveries	736	1,162
Income from investments	1,466	1,367
State scheme premiums	150	137
Other receipts (4)	62	64
Total receipts	<u>60,742</u>	<u>63,173</u>
<b>Payments</b>		
Benefits At present rates (as given in App 4)	52,868	53,698
Increase due to proposed changes		1,279
Personal and stakeholder pensions contracted-out rebates (as given in App 6)	3,163	3,914
Age-related rebates for contracted-out money purchase schemes (as given in App 6)	133	136
Administration costs (4)	906	978
Redundancy fund payments (net) (4)	240	234
Transfer to Northern Ireland	350	260
Other payments	20	20
Total payments	<u>57,679</u>	<u>60,520</u>
<b>Statement of balances</b>		
Balance at beginning of year	(1) 23,630	26,693
Excess of receipts over Payments	3,062	2,653
Balance at end of year	26,693	29,345
Balance at end of year as percentage of benefit payments (2)	50.3	53.2

(1) The balance in the National Insurance Fund at 31<sup>st</sup> March 2002 has been taken from unaudited accounts of the fund for the year 2001-02.

(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 2002-03.

(5) These figures exclude statutory paternity pay and statutory adoption pay, which are estimated by the Department of Trade and Industry to be about £60 million and £10 million respectively in 2003-04. The inclusion of these benefits would result in a reduction in net contributions and a corresponding increase in the compensation from the Consolidated Fund. The total effect on the fund would be nil.

### **Estimates for 2002-03**

16. The estimates shown above for 2002-03 may be compared with the estimates made a year ago, and published in my report in February 2002 (Cm 5383). The estimated surplus of £3,062 million for 2002-03 shown above differs from the surplus of £3,385 million estimated in that report. The main reason for the decrease is that contribution income has been lower than expected at this time last year. This is because the buoyancy of the contributions, experienced in 2001-02 did not continue into the start of 2002-03 as had been expected.

### **Estimates for 2003-04**

17. The extra benefit payments in 2003-04 as a result of the proposed increases in benefit rates from April 2003 are estimated to be £1,279 million. Particulars of the extra cost and of the payments for individual benefits are given in Appendix 4.

18. The financial effects on contribution receipts and contracted-out rebates of the proposed changes set out in paragraphs 8 to 10 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 £730 million. Other changes in contribution receipts from 2002-03 to 2003-04 arise largely as a result of forecast increases in earnings between the two years.

19. Table 2 shows that the amount of Treasury grant estimated to be needed in 2003-04 is again nil. At this stage, the estimate of the balance in the National Insurance Fund at 31<sup>st</sup> March 2004 substantially exceeds one-sixth of estimated benefit payments in 2003-04. 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**

20. 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.

21. Appendix 6 shows an analysis of contribution receipts. The changes to National

Insurance contributions described in paragraph 8 to 10 above do not greatly affect the overall expected pattern of contribution receipts to the National Insurance Fund, although they do have a significant effect on contributions which are allocated to the National Health Service.

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

22. 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 2003 in view of the uncertainty regarding the current number of people who are contracted-out (see paragraph 25).

23. 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 2003-04 of variations in economic assumptions**

<b>Great Britain, £ million</b>		
<b>Variation compared to assumptions given in Appendix 3 paragraph 24</b>	<b>Effect on receipts in 2003-04</b>	<b>Effect on payments in 2003-04</b>
GB number of employees-in-employment lower by 200,000 in 2003-04	-410	
GB number of employees-in-employment higher by 200,000 in 2003-04	+410	
Earnings increases 1% lower over the year to 2002-03 and 2% lower over the year to 2003-04	-1,850	
Earnings increases 1% higher over the year to 2002-03 and 2% higher over the year to 2003-04	+1,870	
GB unemployment higher by 200,000 in 2003-04		+110
GB unemployment lower by 200,000 in 2003-04		-110

24. 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 2002-03 and 2% lower

over the year to 2003-04 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 2003-04 would be a loss of approximately £2.4 billion, which would still not necessitate a Treasury grant in 2003-04.

25. 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 originally led to a lack of data showing numbers contracted out through different routes. I understand that data is now becoming available, but that it is currently being analysed and validated. Consequently there is, pending the completion of this validation exercise, still 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 and stakeholder pension rebates for 2003-04, and COMPS rebates for 2003-04 above those deducted from contributions received in 2003-04, 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.

**Table 4 – Effect on receipts and payments of the National Insurance Fund of variations in assumptions on contracting out after April 2003**

**Great Britain, £ million**

Variation in assumptions	Effect on rebates for 2003-04	Effect on rebates paid or deducted from contributions paid in 2003-04
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 or stakeholder pensions with same sex, age and earnings profile as assumed APP and stakeholder pension membership	+100	0

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

**Conclusion**

26. Table 2 of the report shows that the balance in the National Insurance Fund at 31<sup>st</sup> March 2003 is likely to be substantially above the recommended minimum level of one-sixth (16.7%) of benefit payments. The level is likely to be a little lower than estimated in the report on the changes in February 2002 (Cm 5383).

27. It is estimated that no Treasury grant is needed in 2003-04 for the balance in the

fund at 31<sup>st</sup> March 2004 to be at least one-sixth of estimated benefit payments in 2003-04. The balances in the National Insurance Fund over the period March 2002 to March 2004 are estimated to be as follows:

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

<b>Balance at 31<sup>st</sup> March</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>
Percentage of benefit payments in previous financial year	(1) 46.7	50.3	53.2

(1) Using latest estimated figures for 2001-02.

28. If economic conditions differ from the assumptions given in paragraph 24 of Appendix 3, then the balance in the Fund at 31<sup>st</sup> March 2004 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

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Fellow of the Institute of Actuaries  
February 2003

## APPENDIX 1

### MAIN RATES OF BENEFIT

	Weekly rate in 2002-03 £	Weekly rate proposed from 7 <sup>th</sup> April 2003 £
Retirement pension, bereavement allowance and widowed parent's allowance		
Personal benefit (basic pension)	75.50	77.45
Wife or other adult dependant (retirement pension only)	45.20	46.35
Graduated retirement benefit (unit)	0.0921	0.0937
Bereavement payment (2)	2,000	2,000
Incapacity benefit long-term rate (1)		
Personal benefit	70.95	72.15
Transitional invalidity allowance higher rate	14.90	15.15
Transitional invalidity allowance middle rate	9.50	9.70
Transitional invalidity allowance lower rate	4.75	4.85
Wife or other adult dependant	42.45	43.15
Age increase higher rate	14.90	15.15
Age increase lower rate	7.45	7.60
Incapacity benefit short-term		
Personal benefit higher rate	63.25	64.35
Personal benefit lower rate	53.50	54.40
Wife or other adult dependant	33.10	33.65
Statutory sick pay	63.25	64.35
Jobseeker's allowance (contribution-based)		
Personal benefit for those aged 18 to 24	42.70	43.25
Personal benefit for those aged 25 and over	53.95	54.65
Maternity allowance (3)	75.00	100.00
Statutory maternity pay		
Lower rate (3)	75.00	100.00
Guardian's allowance		
First child	9.65	11.55
Other children	11.35	11.55
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	9.65	9.55
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 April 2003 the weekly rate for maternity allowance and statutory maternity pay will be £100 or 90% of the woman's average weekly earnings if less. Self-employed women who hold a certificate of small earnings exception receive maternity allowance equal to 90% of the maternity threshold (£30 a week).

## APPENDIX 2

### MAIN FEATURES OF THE CONTRIBUTION SYSTEM

	Rate in 2002-03	Rate proposed from April 2003
Class 1		
Lower earnings limit (LEL)	£75 a week	£77 a week
Upper earnings limit (UEL)	£585 a week	£595 a week
Primary threshold	£89 a week or £385 a month	£89 a week or £385 a month
Secondary threshold	£89 a week or £385 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) 11.0%
On earnings above the UEL	0%	1.0%
Reduced rate on earnings between the primary threshold and UEL, for married women and widow optants	(2) 3.85%	(2) 4.85%
NHS allocation included in above		
- percentage of earnings between the primary threshold and UEL	1.05%	2.05%
- percentage of earnings above the UEL	0%	1.0%
Secondary		
(employer) On all earnings above the secondary threshold	(3) 11.8%	(3) 12.8%
NHS allocation included in above (percentage of all earnings for employees earning above the secondary threshold)	0.9%	1.9%
Class 1A and Class 1B		
Contribution rate	11.8%	12.8%
NHS allocation included in above	0.9%	1.9%
Class 2		
Flat rate contribution	£2.00 a week	£2.00 a week
Small earnings exception	£4,025 a year	£4,095 a year
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
Class 3		
Flat rate contribution	£6.85 a week	£6.95 a week
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
Class 4		
Lower profits limit (LPL)	£4,615 a year	£4,615 a year
Upper profits limit (UPL)	£30,420 a year	£30,940 a year
Contribution rate		
On profits between the LPL and UPL	7.0%	8.0%
On profits above the UPL	0%	1.0%
NHS allocation included in above		
Percentage of profits between the LPL and UPL	1.15%	2.15%

(1) The contracted-out rebate for primary contributions in 2002-03 and 2003-04 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 in 2002-03 and 2003-04 is 3.5% of earnings between the LEL and UEL for contracted-out salary-related schemes. For contracted-out money purchase schemes, the employers' contracted-out rebate varies according to the age of the employee: however, only a rebate of 1.0% 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 and stakeholder pensions, the total rebate (primary and secondary combined) applicable to earnings is, like the rebate for COMPS, related to the age of the employee. Unlike COSRS and COMPS, the rebate reflects the three different bands of State Second Pension accrual. 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.

## 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 the reasons described in paragraph 25 of the main report. Therefore the estimates of contracted-out rebates are more uncertain than would usually be the case.

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 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. Statutory paternity pay (SPP) and statutory adoption pay (SAP) will start to be paid in 2003-04, and the employers will be reimbursed in the same way as for SMP.

## **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.
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 2003-04 is estimated as that amount needed to ensure that the estimate of the fund balance at 31<sup>st</sup> March 2004 is at least one-sixth of benefit payments (including redundancy fund payments) in 2003-04.
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 and S2P).
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 (the 2001-based interim projection) 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 (the 2001-based interim 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 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, due to the paucity of 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. 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 were 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 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 2002-03 to ensure that account is taken of more recent changes in factors affecting benefit payments than are incorporated in data on numbers of beneficiaries. Account was also taken of the under-recording of bereavement payments. Allowance is made for the estimated effects of policy changes which are not included in the underlying Government Actuary's Department estimates.

### **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.

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 2002. These are given below:

### **Assumptions used for estimates**

	<b>2002-03</b>	<b>2003-04</b>
Number of employment jobs (UK), million (including HMF, excluding self-employed)	26.1	26.2
Increase in average earnings on one year earlier, %	4.3	4.9
Average number of unemployed (GB), million	0.92	0.94

The assumptions for 2002-03 differ from those used in making last year's report.

25. The effects of variations in these assumptions are given in paragraphs 23 and 24 of the main report.

## APPENDIX 4

### ESTIMATED PAYMENTS FROM THE NATIONAL INSURANCE FUND FOR BENEFITS, AND EFFECT OF BENEFIT UP-RATING ON PAYMENTS IN 2003-04

<b>Great Britain £ million</b>	<b>Estimated total payments in 2002-03</b>	<b>Estimated total payments in 2003-04</b>	<b>Extra payments in 2003-04 as a result of up-rating</b>
Retirement pensions – basic	38,159	39,609	960
Retirement pensions – additional pensions	6,041	6,660	166
Widows' / bereavement benefits – basic	892	840	16
Widows' / bereavement benefits – additional pensions	243	218	4
Incapacity benefit – basic	6,343	6,448	100
Incapacity benefit – additional pensions	490	422	0
Contribution-based jobseeker's allowance	507	539	7
Maternity allowance	71	117	26
Guardian's allowance and child's special allowance	2	2	0
Christmas bonus	122	123	0
<b>Total (1)</b>	<b>52,868</b>	<b>54,977</b>	<b>1,279</b>
Redundancy payments (net) (1)	240	234	0

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

## APPENDIX 5

### ANALYSIS OF THE CHANGES IN CONTRIBUTION RECEIPTS FOR 2003-04 AS A RESULT OF THE CONTRIBUTION RE-RATING ORDER AND OTHER MEASURES

Great Britain, £ million	Contributions for 2003-04	Contributions received in 2003-04 (1)
<b>National Insurance Fund effects</b>		
Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2003		
Increase in Class 2 small earnings exception – indexation effect	-1	-1
Increase in Class 3 rate	+1	+0
Total	<u>0</u>	<u>-1</u>
National Insurance Contributions Act 2002 (2) (3)		
Increase in Class 4 profits limits – indexation effect (4)	+2	0
Additional effect of freezing the lower profits limit (4)	+11	0
Combined increase in Class 1 secondary rate and Class 1 secondary NHS allocation (5)	-994	-889
Total	<u>-981</u>	<u>-889</u>
Proposed Social Security (Contributions) (Amendment) Regulations 2003		
Increase in Class 1 primary and secondary thresholds, and lower and upper earnings limits – indexation effect		
Effect on contribution receipts from gross contributions (6)	-43	-39
Effect on contribution receipts from contracted-out rebates	-103	-31
Additional effect of freezing the primary and secondary thresholds	+234	+210
Additional effect of raising the lower earnings limit above the rate of increase in the RPI	+44	+20
Total	<u>+133</u>	<u>+160</u>
<b>Total, all measures</b>	<u>-849</u>	<u>-730</u>

- (1) The balance of contributions for 2003-04 will not be received until after 31<sup>st</sup> March 2004.
- (2) The National Insurance Contributions Act 2002 also introduced 1% extra Class 1 primary contributions on all earnings above the primary threshold and 1% extra Class 4 contributions on all profits over the lower profits limit. However, as the NHS allocation for both these classes was increased by 1% as well, the net effect on Class 1 primary and Class 4 contribution receipts to the National Insurance Fund is zero.
- (3) The National Insurance Contributions Act 2002 and the Social Security

(Contributions) (Amendment No. 2) Order between them increase the reduced Class 1 primary rate for married women and widow optants by 1%; the NHS allocation for these contributors is also increased by 1%. The combined effect of these changes has no impact on the Class 1 primary contributions paid by these contributors to the National Insurance Fund.

- (4) Because of self-assessment, changes in the rates and limits in 2003-04 do not have an effect on contributions received until 2004-05.
- (5) The National Insurance Contributions Act 2002 increased both the Class 1 secondary rate and the Class 1 secondary NHS allocation rate by 1%. The NHS allocation is based on all earnings while the Class 1 secondary rate is only applied to earnings over the secondary threshold. The NHS allocation has therefore increased by more than the increase in total Class 1 secondary contributions and so contributions to the National Insurance Fund (being the difference between Class 1 secondary contributions and the Class 1 secondary NHS allocation) are estimated to fall by the amount shown above.
- (6) Figures are gross of statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay.
- (7) Figures may not sum to totals shown due to rounding.

Some of the measures, as mentioned above, have a large 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			2002-03	2003-04
<b>National Insurance Fund</b>				
Class 1 (1)	Primary	Gross	25,869	27,170
		Contracted-out rebate (2)	2,396	2,464
		Net	23,472	24,706
	Secondary	Gross	37,724	39,137
		Contracted-out rebate (2)	5,033	5,254
		Net	32,690	33,883
Total		Gross	63,592	66,306
		Contracted-out rebate (2)	7,430	7,717
		Net	56,163	58,589
Class 1A			1,088	1,124
Class 1B			11	11
Class 2			228	216
Class 3			50	51
Class 4			1,544	1,549
Total National Insurance Fund Contributions (3)			59,083	61,540
<b>National Health Service</b>				
Class 1	Primary		3,039	6,496
	Secondary		4,061	8,522
	Total		7,100	15,019
Class 1A			89	93
Class 1B			1	2
Class 2			42	40
Class 3			9	9
Class 4			305	305
Total National Health Service Contributions			7,546	15,467
<b>All contributions</b>				
Class 1 (1)	Primary	Gross	28,908	33,666
		Contracted-out rebate (2)	2,396	2,464
		Net	26,512	31,203
	Secondary	Gross	41,785	47,659
		Contracted-out rebate (2)	5,033	5,254
		Net	36,751	42,405
Total		Gross	70,693	81,325
		Contracted-out rebate (2)	7,430	7,717
		Net	63,263	73,608
Class 1A			1,177	1,216
Class 1B			12	13
Class 2			269	255
Class 3			59	61
Class 4			1,849	1,854
<b>Total contributions</b>			<b>66,629</b>	<b>77,007</b>

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- (1) All figures are gross of recoveries by employers of statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption 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 main report.
  - (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**

<b>Great Britain, £ million</b>	<b>2002-03</b>	<b>2003-04</b>
Personal and Stakeholder pension rebates		
Primary contracted-out rebates	914	888
Secondary contracted-out rebates	2,250	3,026
Total (1)	3,163	3,914
Age-related rebates for members of contracted-out money-purchase schemes (1)	133	136
All payments in respect of personal pensions and age-related rebates to contracted-out money purchase schemes	<u>3,296</u>	<u>4,050</u>

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

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

## APPENDIX 7

### COMPARISON OF ESTIMATES FOR 2002-03 MADE NOW AND IN Cm5383 (FEBRUARY 2002)

Great Britain, £ million	2002-03 estimates made now	2002-03 estimates given in Cm 5383
<b>Receipts</b>		
Contributions	59,083	59,375
Less recoveries of SSP	31	31
Less recoveries of SMP and SMP abatement	725	692
Net contribution receipts	58,328	58,653
Treasury grant	0	0
Compensation from Consolidated Fund for SSP and SMP recoveries	736	736
Income from investments	1,466	1,508
State scheme premiums	150	137
Other receipts	62	95
Total receipts	<u>60,742</u>	<u>61,129</u>
<b>Payments</b>		
Benefits	52,868	52,834
Personal and stakeholder pensions contracted-out rebates	3,163	3,300
Age-related rebates for contracted-out money purchase schemes	133	121
Administration costs	906	906
Redundancy fund payments (net)	240	214
Transfer to Northern Ireland	350	350
Other payments	20	20
Total payments	<u>57,679</u>	<u>57,744</u>

Figures may not sum to totals due to rounding.

## REASONS FOR CHANGES IN ESTIMATES

1. The estimates of Class 1 contributions are slightly lower than last year for both primary and secondary contributions. This is largely because the buoyant contributions in 2001-02 did not continue into the first part of 2002-03 as expected.
2. Receipts of Class 2 contributions are now estimated to be lower than was estimated last year. This is due to a revision in the amounts estimated to be outstanding in respect of previous years.
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 higher than was estimated last year, as a result of the changes in the number of women of child bearing age estimated to be working, following the publication of the 2001 census. Estimates of both SSP and SMP have suffered greatly from a lack of reliable data following early problems with the transfer to the NIRS2 computer system and subsequent difficulties in analysing and validating the data. As a result, there may be substantial revisions to estimates of these amounts once sufficient validated data on amounts of SSP and SMP recovered by employers in recent years becomes available.
5. Income from investments is estimated to be lower than was estimated at this time last year. This is largely to due to the lower balance in the fund at the end of 2001-02 than was estimated last year.
6. The estimate of total benefit payments for 2002-03 is very similar to the estimate shown in last year's report.
7. Payments of minimum contributions to appropriate personal pension (APP) providers (including stakeholder pensions) are now estimated to be lower than was estimated last year. This is the result of two factors. The number of people contracting out has been revised down, but this has been partially offset by an upward revision in the estimates for total rebates. This revision has been made as a result of more reliable data on the incidence of payment of the rebates. The age-related rebates paid in respect of contracted-out money purchase schemes are higher than was estimated last year as a result of an upward revision similar to that for APP rebates.
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 the same as those given last year.
9. The assumptions used in making the two sets of estimates are compared in the table

below.

	<b>2002-2003 estimates made now</b>	<b>2002-2003 estimates given in Cm 5383</b>
Number of employees in employment (UK), million (including HMF, excluding self-employed)	26.1	25.9
Increase in average earnings on one year earlier, %	4.3	4.4
Average number of unemployed (GB), million	0.92	1.02