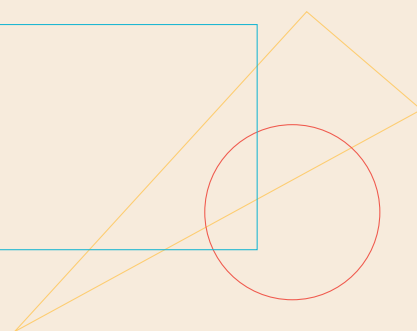


Report by the Government Actuary
on the drafts of the Social Security
Benefits Up-rating Order 2004 and
the Social Security (Contributions)
(Re-rating and National Insurance
Funds Payments) Order 2004



GAD

Government Actuary's Department
www.gad.gov.uk



**Report by the Government
Actuary on the drafts of the Social
Security Benefits Up-rating Order
2004 and the Social Security
(Contributions) (Re-rating and
National Insurance Funds
Payments) Order 2004**

*Presented to Parliament by the Secretary of State for Work and Pensions
and the Paymaster General by Command of Her Majesty
February 2004*

© Crown Copyright 2004

The text in this document (excluding the Royal Arms and departmental logos) may be reproduced free of charge in any format or medium providing that it is reproduced accurately and not used in a misleading context. The material must be acknowledged as Crown copyright and the title of the document specified.

Any enquiries relating to the copyright in this document should be addressed to The Licensing Division, HMSO, St Clements House, 2-16 Colegate, Norwich, NR3 1BQ. Fax: 01603 723000 or e-mail: licensing@cabinet-office.x.gsi.gov.uk

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

The Right Hon. Dawn Primarolo MP, Paymaster General

REPORT BY THE GOVERNMENT ACTUARY ON THE DRAFTS OF THE SOCIAL SECURITY BENEFITS UP-RATING ORDER 2004 AND THE SOCIAL SECURITY (CONTRIBUTIONS) (RE-RATING AND NATIONAL INSURANCE FUNDS PAYMENTS) ORDER 2004

Sir and Madam,

I attach a report on the likely effects on the National Insurance Fund of the *Social Security Benefits Up-rating Order 2004* and the *Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2004*. 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 2003-04 and 2004-05. The economic assumptions used correspond with those prepared by Her Majesty's Treasury at the time of the Pre-Budget Report in December 2003.

On the basis of the estimates in the report, the level of the National Insurance Fund at 31st March 2005 will be greater than one-sixth of benefit payments in 2004-05. 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 2004-05.

Christopher Daykin
Government Actuary
February 2004

Contents

	Paragraphs
Summary	1-4
Description of the changes to benefits and contributions	5-10
Methods and assumptions used to project receipts and payments	11-12
Estimates of receipts and payments and balance in the fund	13-18
Composition of benefit payments and contribution receipts	19-20
Effect of different assumptions about employment, unemployment, earnings and contracting out	21-24
Conclusion	25-27

Appendices

	Appendix
Main rates of benefit	1
Main features of the contribution system	2
Detailed methods and assumptions used	3
Estimated payments from the National Insurance Fund for benefits, and effect of benefit up-rating on payments in 2004-05	4
Analysis of the changes in contribution receipts for 2004-05 as a result of the contribution re-rating order and other measures	5
Analysis of contribution receipts by fund and class of contributor, and 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	6
Comparison of estimates for 2003-04 made now and in Cm 5746 (February 2003)	7

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 2004* (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 2004* (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 2004*. 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 2003-04 and 2004-05. 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 December 2003 (see paragraph 12 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 2004 the rates at which many benefits are paid, and which is estimated to result in extra benefit payments in 2004-05 of £1,536 million;
 - the proposed Re-rating Order, which alters the rate of Class 2 and Class 3 contributions, alters the small earnings exception for Class 2 and adjusts the band of earnings on which Class 4 contributions are paid. It is estimated that these changes will increase receipts to the National Insurance Fund in 2004-05 by £4 million;
 - the proposed *Social Security (Contributions) (Amendment) Regulations 2004*, 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 decrease receipts to the National Insurance Fund in 2004-05 by £212 million.

4. On the basis of the estimates in this report, no Treasury grant is required in 2004-05, as the balance in the fund at 31st March 2005 is estimated to be £29,633 million (51.9% of estimated benefit payments), and so significantly exceeds one-sixth of estimated benefit payments in 2004-05.

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 12th April 2004, by the increase in the retail prices index in the year to September 2003 (2.8%), except for contribution-based jobseeker's allowance which is increased by 1.8%. 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 2003-04	Proposed increase in weekly rate	Weekly rate proposed from 12th April 2004
Retirement pension - person claiming on their own NI contributions - standard rate	£77.45	£2.15	£79.60
Retirement pension – person claiming on their spouse's NI contributions - standard rate	£46.35	£1.30	£47.65
Contribution-based jobseeker's allowance single person over 25	£54.65	£1.00	£55.65
Incapacity benefit long-term main rate	£72.15	£2.00	£74.15

6. Earnings-related additional pensions of retirement pensioners and bereavement benefit beneficiaries who qualified for these pensions before 6th April 2004 will be increased by 2.8%. 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 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 deemed to be increased by 2.8% by the contracted-out pension scheme, and the increase in additional pension is correspondingly reduced.

7. The Re-rating Order will increase the Class 3 weekly contribution rate from £6.95 to £7.15. It will also increase the Class 2 rate payable by the self employed from £2.00 to £2.05 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 £4,095 to £4,215 a year. 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 and

the upper profit limits will be altered to maintain their alignment with the income tax personal allowance and the upper earnings limit for Class 1 contributions respectively.

8. The proposed *Social Security (Contributions) (Amendment) Regulations 2004* will increase the lower and upper earnings limits for Class 1 contributions to £79 (from £77) a week and £610 (from £595) a week respectively. The increase to the LEL is in line with the increase to the basic retirement pension while the increase to the UEL is in line with the increase in the retail prices index to September 2003. The regulations continue to align the primary and secondary thresholds 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 2003. This will increase the thresholds to £91 (from £89) a week for weekly-paid employees and £395 (from £385) a month for other employees.

9. The changes described in paragraphs 7 and 8 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.

10. The proposed *Social Security Pensions (Low Earnings Threshold) Order 2004* will increase the Low Earnings Threshold from £11,200 to £11,600 in 2004-05. 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 £26,600 in 2004-05, compared with £25,600 in 2003-04. The effects of this proposed Order have been allowed for in this report.

Methods and assumptions used to project receipts and payments

11. 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 2002-03. Redundancy receipts are not shown as a separate item, but redundancy payments are shown net of receipts.

12. The main economic assumptions which have been used are based on those which were, in part, set out in Annexes A and 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 and excluding the self-employed, is assumed to be 26.2 million in 2003-04 and 26.3 million in 2004-05, the increase in average earnings is assumed to be 3.6% over the year to 2003-04 and 4.6% over the year to 2004-05, and the numbers unemployed and claiming benefit in GB are assumed to be 0.90 million on average in 2003-04 and 0.91 million in 2004-05. 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

13. The estimates of receipts and payments for 2004-05 (with the estimates for 2003-04 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	2003-04	2004-05
Receipts		
Contributions (as given in App 6)	60,154	63,547
Less recoveries of SSP	72	74
Less recoveries of SMP, SPP and SAP (and abatements)	1,103	1,233
Net contribution receipts	58,979	62,239
Treasury grant	0	0
Compensation from Consolidated Fund for SSP		
And SMP recoveries	1,154	1,284
Income from investments	1,312	1,388
State scheme premiums	145	149
Other receipts (4)	69	68
Total receipts	<u>61,658</u>	<u>65,128</u>
Payments		
Benefits At present rates (as given in App 4)	54,698	55,290
Increase due to proposed changes		1,536
Personal and stakeholder pensions contracted-out rebates (as given in App 6)	3,653	3,793
Age-related rebates for contracted-out money purchase schemes (as given in App 6)	303	295
Administration costs (4)	1,754	1,321
Redundancy fund payments (net) (4)	235	248
Transfer to Northern Ireland	260	255
Other payments	20	20
Total payments	<u>60,924</u>	<u>62,759</u>
Statement of balances		
Balance at beginning of year	(1) 26,530	27,264
Excess of receipts over Payments	735	2,369
Balance at end of year	27,264	29,633
Balance at end of year as percentage of benefit payments (2)	49.6	51.9

(1) The balance in the National Insurance Fund at 31st March 2003 has been taken from audited accounts of the fund for the year 2002-03.

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

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

(4) The figures for 2003-04 are provisional estimates supplied by other government departments on the basis of amounts received or paid so far this year.

(5) SSP, SMP, SPP and SAP stand for statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay respectively.

14. Table 2 shows that the balance in the Fund is projected to grow as a percentage of benefit payments in 2004-05. It should be emphasised that there is uncertainty around such projections as the surplus generated each year is the difference between two large numbers and so quite small percentage changes in either of them could result in a large percentage change in the surplus income, and hence in the projected fund balance. However, the general trend is upwards.

Estimates for 2003-04

15. The estimates shown above for 2003-04 may be compared with the estimates made a year ago, and published in my report in February 2003 (Cm 5746). The estimated surplus of £735 million for 2003-04 shown above differs from the surplus of £2,653 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, principally because the increase in earnings in 2003-04 has been less than expected. There has also been a large increase in the administration costs: the final costs for 2002-03 were almost 40 per cent higher than the provisional estimate given to us by Inland Revenue at this time last year and the current 2003-04 provisional estimate is 40 per cent higher than that.

Estimates for 2004-05

16. The extra benefit payments in 2004-05 as a result of the proposed increases in benefit rates from April 2004 are estimated to be £1,536 million. Particulars of the extra cost and of the payments for individual benefits are given in Appendix 4.

17. The financial effects on contribution receipts and contracted-out rebates of the proposed changes set out in paragraphs 7, 8 and 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 £209 million. Other changes in contribution receipts from 2003-04 to 2004-05 arise largely as a result of forecast increases in earnings between the two years.

18. Table 2 shows that the amount of Treasury grant estimated to be needed in 2004-05 is again nil. At this stage, the estimate of the balance in the National Insurance Fund at 31st March 2005 substantially exceeds one-sixth of estimated benefit payments in 2004-05. 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.

Composition of benefit payments and contribution receipts

19. 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.

20. Appendix 6 shows an analysis of contribution receipts. The changes to National Insurance contributions described in paragraphs 7, 8 and 10 above do not greatly affect the overall expected pattern of contribution receipts to the National Insurance Fund.

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

21. 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 2004 in view of the uncertainty regarding the current number of people who are contracted-out (see paragraph 24).

22. 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 2004-05 of variations in economic assumptions

Great Britain, £ million

Variation compared to assumptions given in Appendix 3 paragraph 24	Effect on receipts in 2004-05	Effect on payments in 2004-05
GB number of employees-in-employment lower by 200,000 in 2004-05	-420	
GB number of employees-in-employment higher by 200,000 in 2004-05	+420	
Earnings increases 1% lower over the year to 2003-04 and 2% lower over the year to 2004-05	-1,910	
Earnings increases 1% higher over the year to 2003-04 and 2% higher over the year to 2004-05	+1,930	
GB unemployment higher by 200,000 in 2004-05		+120
GB unemployment lower by 200,000 in 2004-05		-120

23. 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 2003-04 and 2% lower over the year to 2004-05 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 £2.5 billion, which would still not necessitate a Treasury grant in 2004-05.

24. 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. At the time of my last report on the up-rating (Cm 5746), I understood that such data would soon be available. The first of this data has recently been produced, giving numbers for people contracted-out through different routes up to 2000-01. However, pending the release of more detailed information on the age profile and earnings levels of those contracted-out, and data becoming available for more recent years, there is still uncertainty about the effect of contracting out on the financial position of the National Insurance Fund. Table 4 shows the effect of different assumptions on the amounts of rebates paid (or, in the case of COSRS and the flat-rate part of COMPS rebates, deducted from contributions received) in 2004-05. Amounts of APP and stakeholder pension rebates for 2004-05, and COMPS rebates for 2004-05 above those deducted from contributions received in 2004-05, 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 2004

Great Britain, £ million

Variation in assumptions	Effect on rebates for 2004-05	Effect on rebates paid or deducted from contributions paid in 2004-05
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

25. Table 2 of the report shows that the balance in the National Insurance Fund at 31st March 2004 is likely to be substantially above the recommended minimum level of one-sixth (16.7%) of benefit payments. The level is likely to be lower than estimated in the report on the changes in February 2003 (Cm 5746).

26. It is estimated that no Treasury grant is needed in 2004-05 for the balance in the fund at 31st March 2005 to be at least one-sixth of estimated benefit payments in 2004-05.

27. If economic conditions differ from the assumptions given in paragraph 24 of Appendix 3, then the balance in the Fund at 31st March 2005 will be different from that given above. However, even quite substantial alterations in economic conditions in future years 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 2004

APPENDIX 1

MAIN RATES OF BENEFIT

	Weekly rate in 2003-04	Weekly rate proposed from 12th April 2004
	£	£
Retirement pension, bereavement allowance and widowed parent's allowance		
Personal benefit (basic pension)	77.45	79.60
Wife or other adult dependant (retirement pension only)	46.35	47.65
Graduated retirement benefit (unit)	0.0937	0.0963
Bereavement payment (1)	2,000	2,000
Incapacity benefit long-term rate (2)		
Personal benefit	72.15	74.15
Transitional invalidity allowance higher rate	15.15	15.55
Transitional invalidity allowance middle rate	9.70	10.00
Transitional invalidity allowance lower rate	4.85	5.00
Wife or other adult dependant	43.15	44.35
Age increase higher rate	15.15	15.55
Age increase lower rate	7.60	7.80
Incapacity benefit short-term		
Personal benefit higher rate	64.35	66.15
Personal benefit lower rate	54.40	55.90
Wife or other adult dependant	33.65	34.60
Statutory sick pay	64.35	66.15
Jobseeker's allowance (contribution-based)		
Personal benefit for those aged 18 to 24	43.25	44.05
Personal benefit for those aged 25 and over	54.65	55.65
Maternity allowance (3)	100.00	102.80
Statutory maternity pay		
Standard rate (3)	100.00	102.80
Guardian's allowance		
First child	11.55	11.85
Other children	11.55	11.85
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	9.55	9.55
Other children	11.35	11.35
Christmas bonus to pensioners	10.00	10.00

- (1) Lump sum benefit.
- (2) The threshold for Incapacity Benefit offset for occupational pensions is £85 a week for both years.
- (3) From April 2004 the weekly rate for maternity allowance and statutory maternity pay will be £102.80 or 90% of the woman's average weekly earnings if this calculation results in a figure which is less than £102.80. 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 2003-04	Rate proposed from April 2004
Class 1		
Lower earnings limit (LEL)	£77 a week	£79 a week
Upper earnings limit (UEL)	£595 a week	£610 a week
Primary threshold	£89 a week or £385 a month	£91 a week or £395 a month
Secondary threshold	£89 a week or £385 a month	£91 a week or £395 a month
Contribution rates (NI Fund and NHS combined)		
Primary		
(employee)		
On earnings between the primary threshold and UEL	(1) 11.0%	(1) 11.0%
On earnings above the UEL	1.0%	1.0%
Reduced rate on earnings between the primary threshold and UEL, for married women and widow optants	(2) 4.85%	(2) 4.85%
NHS allocation included in above		
- percentage of earnings between the primary threshold and UEL	2.05%	2.05%
- percentage of earnings above the UEL	1.0%	1.0%
Secondary		
(employer)		
On all earnings above the secondary threshold	(3) 12.8%	(3) 12.8%
NHS allocation included in above (percentage of all earnings for employees earning above the secondary threshold)	1.9%	1.9%
Class 1A and Class 1B		
Contribution rate	12.8%	12.8%
NHS allocation included in above	1.9%	1.9%
Class 2		
Flat rate contribution	£2.00 a week	£2.05 a week
Small earnings exception	£4,095 a year	£4,215 a year
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
Class 3		
Flat rate contribution	£6.95 a week	£7.15 a week
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
Class 4		
Lower profits limit (LPL)	£4,615 a year	£4,745 a year
Upper profits limit (UPL)	£30,940 a year	£31,720 a year
Contribution rate		
On profits between the LPL and UPL	8.0%	8.0%
On profits above the UPL	1.0%	1.0%
NHS allocation included in above		
Percentage of profits between the LPL and UPL	2.15%	2.15%
Percentage of profits above the UPL	1.0%	1.0%

- (1) The contracted-out rebate for primary contributions in 2003-04 and 2004-05 is 1.6% of earnings between the LEL and UEL for contracted-out salary-related schemes (COSRS) and contracted-out money purchase schemes (COMPS).
- (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 2003-04 and 2004-05 is 3.5% of earnings between the LEL and UEL for COSRS and 1% for COMPS.
- (4) Members of COMPS also receive an age-related rebate (a rebate which increases with age) which is paid by the Inland Revenue direct to the scheme on receipt of the employer's end of year return. For holders of an appropriate personal pension or a stakeholder pension, the whole of the rebate is age-related and, like that for a COMPS, is paid by the Inland Revenue direct to the scheme on receipt of the employer's end of year return. The employee's share of the rebate is 1.6%.

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 24 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 and Class 1B contributions are estimated using data provided by the Inland Revenue and information on Class 1A contributions paid in previous years. It should be noted that we have not been able to find a source of data on Class 1B contributions paid. 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, although the position is better than at this time last year. 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) is estimated in a similar way.

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 2004-05 is estimated as that amount needed to ensure that the estimate of the fund balance at 31st March 2005 is at least one-sixth of benefit payments (including redundancy fund payments) in 2004-05.
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 2001-based interim population projection as a basis for the numbers over pensionable 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 pensionable age. Allowance is also made for accruals of S2P credited earnings from 2002-03 onwards. Accrued earnings are survived to pensionable age using adjusted population mortality rates. At pensionable age the accrued survived earnings are converted to amounts of additional pension awarded, and survived using the mortality rates from 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 pensionable age at April 1975 and which would not come into payment until the widow reached pensionable 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 pensionable age. The appropriate graduated rate is applied to the survived units over pensionable 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 pensionable age, and actual additional pension in payment to those dying over pensionable 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 pensionable 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 pensionable 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 are based on recent data post 1995. 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 determined from ONS data on unemployment by age and duration.

18. The underlying Government Actuary's Department estimates of payments for all benefits are aligned to recent data on payments for 2003-04 to ensure that account is taken of more recent changes in factors affecting benefit payments than are incorporated in data on numbers of beneficiaries. 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 still some 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 for 2003-04. This estimate include several items that will not occur in future years and so administration costs for 2004-05 have been estimated as the 2002-03 costs increased in line with inflation.

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 December 2003. These are given below:

Assumptions used for estimates

	2003-04	2004-05
Number of employment jobs (UK), million (including HMF, excluding self-employed)	26.2	26.3
Increase in average earnings on one year earlier, %	3.6	4.6
Average number of unemployed (GB), million	0.90	0.91

The assumptions for 2003-04 differ from those used in making last year's report.

25. The effects of variations in these assumptions are given in paragraphs 22 and 23 of the main report.

APPENDIX 4

ESTIMATED PAYMENTS FROM THE NATIONAL INSURANCE FUND FOR BENEFITS, AND EFFECT OF BENEFIT UP-RATING ON PAYMENTS IN 2004-05

Great Britain £ million	Estimated total payments in 2003-04	Estimated total payments in 2004-05	Extra payments in 2004-05 as a result of up-rating
Retirement pensions – basic	39,474	40,800	1,046
Retirement pensions – additional pensions	6,657	7,401	294
Widows' / bereavement benefits – basic	791	737	15
Widows' / bereavement benefits – additional pensions	220	196	6
Incapacity benefit – basic	6,375	6,535	163
Incapacity benefit – additional pensions	418	361	0
Contribution-based jobseeker's allowance	519	532	9
Maternity allowance	119	139	3
Guardian's allowance and child's special allowance	2	2	0
Christmas bonus	123	124	0
Total (1)	54,698	56,827	1,536
Redundancy payments (net) (1)	235	248	0

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

APPENDIX 5

ANALYSIS OF THE CHANGES IN CONTRIBUTION RECEIPTS FOR 2004-05 AS A RESULT OF THE CONTRIBUTION RE-RATING ORDER AND OTHER MEASURES

Great Britain, £ million

National Insurance Fund effects	Contributions for 2004-05	Contributions 2004-05 (1) received in
Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2004		
Increase in Class 2 rate	+6	+5
Increase in Class 2 small earnings exception – indexation effect	-2	-2
Increase in Class 3 rate	+2	+1
Increase in Class 4 profits limits – indexation effect (2)	+2	+0
Total	<u>+9</u>	<u>+4</u>
Proposed Social Security (Contributions) (Amendment) Regulations 2004		
Increase in Class 1 primary and secondary thresholds, and lower and upper earnings limits – indexation effect		
Effect on contribution receipts from gross contributions (3)	-197	-177
Effect on contribution receipts from contracted-out rebates (5)	-96	-35
Total	<u>-292</u>	<u>-212</u>
Total, all measures	-284	-209

- (1) The balance of contributions for 2004-05 will not be received until after 31st March 2005.
- (2) Because of self-assessment, changes in the limits in 2004-05 do not have an effect on contributions received until 2005-06.
- (3) Figures are gross of statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay.
- (4) Figures may not sum to totals shown due to rounding.
- (5) This line also includes the effects of the proposed Social Security Pensions (Low Earnings Threshold) Order 2004.

APPENDIX 6

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

Great Britain, £ million			2003-04	2004-05
National Insurance Fund				
Class 1 (1)	Primary	Gross	26,515	27,858
		Contracted-out rebate (2)	2,411	2,494
		Net	24,104	25,364
	Secondary	Gross	37,983	40,144
		Contracted-out rebate (2)	4,970	5,144
		Net	33,013	35,001
Total		Gross	64,498	68,002
		Contracted-out rebate (2)	7,381	7,638
		Net	57,117	60,364
Classes 1A and 1B			1,135	1,128
Class 2			250	251
Class 3 (3)			68	101
Class 4			1,584	1,703
Total National Insurance Fund Contributions (4)			60,154	63,547
National Health Service				
Class 1	Primary		6,321	7,034
	Secondary		8,305	9,215
		Total	14,626	16,250
Classes 1A and 1B			95	197
Class 2			46	46
Class 3 (3)			12	18
Class 4			311	904
Total National Health Service Contributions			15,090	17,415
All contributions				
Class 1 (1)	Primary	Gross	32,836	34,892
		Contracted-out rebate (2)	2,411	2,494
		Net	30,425	32,398
	Secondary	Gross	46,288	49,360
		Contracted-out rebate (2)	4,970	5,144
		Net	41,319	44,216
Total		Gross	79,124	84,252
		Contracted-out rebate (2)	7,381	7,638
		Net	71,743	76,614
Classes 1A and 1B			1,229	1,325
Class 2			296	297
Class 3 (3)			80	119
Class 4			1,895	2,607
Total contributions			75,244	80,962

- (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 include an allowance for extra payments made after the delayed deficiency notices are sent out.
- (4) These figures appear in Table 2 in the main report.
- (5) 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	2003-04	2004-05
Personal and Stakeholder pension rebates		
Primary contracted-out rebates	823	847
Secondary contracted-out rebates	2,830	2,946
Total (1)	3,653	3,793
Age-related rebates for members of contracted-out money-purchase schemes (1)	303	295
All payments in respect of personal pensions and age-related rebates to contracted-out money purchase schemes	<u>3,956</u>	<u>4,088</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 2003-04 MADE NOW AND IN Cm 5746 (FEBRUARY 2003)

Great Britain, £ million	2003-04 estimates made now	2003-04 estimates given in Cm 5746
Receipts		
Contributions	60,154	61,540
Less recoveries of SSP	72	31
Less recoveries of SMP, SPP and SAP and SMP, SPP and SAP abatement	1,103	1,066
Net contribution receipts	58,979	60,443
Treasury grant	0	0
Compensation from Consolidated Fund for SSP and SMP recoveries	1,154	1,162
Income from investments	1,312	1,367
State scheme premiums	145	137
Other receipts	69	64
Total receipts	<u>61,658</u>	<u>63,173</u>
Payments		
Benefits	54,698	54,977
Personal and stakeholder pensions contracted-out rebates	3,653	3,914
Age-related rebates for contracted-out money purchase schemes	303	136
Administration costs	1,754	978
Redundancy fund payments (net)	235	234
Transfer to Northern Ireland	260	260
Other payments	20	20
Total payments	<u>60,924</u>	<u>60,520</u>

Figures may not sum to totals due to rounding.

REASONS FOR CHANGES IN ESTIMATES

1. The estimates of Class 1 contributions are lower than last year for both primary and secondary contributions. This is largely because earnings growth has been less than was expected at this time last year.
2. Receipts of Class 2 contributions are now estimated to be higher than was estimated last year. This is due to revisions on the amounts outstanding in respect of previous years.
3. Estimates of Class 3 contributions are higher than last year and are based on more recent data on the contributions in this class. Note that the number contributing in this class is small and is subject to fluctuations.
4. Estimates of Classes 1A and 1B and Class 4 contributions are little changed since last year.
5. Estimates of SSP and SMP are higher than was estimated last year because we have taken account of the latest data on these benefits. Estimates of both 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. We are now receiving some data that we consider reliable and have adjusted our estimates accordingly. However, there are still some question marks over this data and therefore there is the possibility of further revisions in the future when these problems are resolved.
6. Income from investments is estimated to be lower than was estimated at this time last year. This is largely due to the lower balance in the fund at the end of 2002-03 than was estimated last year.
7. The estimate of total benefit payments for 2003-04 is £279 million less than the estimate shown in last year's report. The main reason for this difference is the linking of our estimates to IMBE (in-year monitoring of benefit expenditure). It should be noted that the difference between the cash IMBE and the accruals IMBE is larger than has previously been the case.
8. 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 in line with more recent data on the amounts that have been paid.
9. Estimates of the administration costs that will be charged to the National Insurance Fund have been supplied by the Inland Revenue. These estimates are higher than those given last year for two reasons. An extra payment was made to the Department of Work and Pension to compensate for an underpayment in 2001-02 and a one-off payment was made to the Welfare Modernisation Fund.

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

	2003-2004 estimates made now	2003-2004 estimates given in Cm 5746
Number of employees in employment (UK), million (including HMF, excluding self-employed)	26.2	26.3
Increase in average earnings on one year earlier, %	3.6	4.6
Average number of unemployed (GB), million	0.90	0.91

Published by TSO (The Stationery Office) and available from:

Online

www.tso.co.uk/bookshop

Mail, Telephone, Fax & E-mail

TSO

PO Box 29, Norwich NR3 1GN

Telephone orders/General enquiries: 0870 600 5522

Order through the Parliamentary Hotline Lo-call 0845 7 023474

Fax orders: 0870 600 5533

E-mail: book.orders@tso.co.uk

Textphone 0870 240 3701

TSO Shops

123 Kingsway, London WC2B 6PQ

020 7242 6393 Fax 020 7242 6394

68-69 Bull Street, Birmingham B4 6AD

0121 236 9696 Fax 0121 236 9699

9-21 Princess Street, Manchester M60 8AS

0161 834 7201 Fax 0161 833 0634

16 Arthur Street, Belfast BT1 4GD

028 9023 8451 Fax 028 9023 5401

18-19 High Street, Cardiff CF10 1PT

029 2039 5548 Fax 029 2038 4347

71 Lothian Road, Edinburgh EH3 9AZ

0870 606 5566 Fax 0870 606 5588

TSO Accredited Agents

(see Yellow Pages)

and through good booksellers



www.gad.gov.uk

GOVERNMENT ACTUARY'S DEPARTMENT

Finlaison House 15-17 Furnival Street London EC4A 1AB

Fax (GTN): 020 7211 2630/2640

Switchboard: +44 (0)20 7211 2600/2601

Direct (GTN): 020 7211 plus extension number

E mail enquiries: enquiries@gad.gov.uk

E mail: firstname.secondname@gad.gov.uk

ISBN 0-10-161172-2



9 780101 611725



INVESTOR IN PEOPLE