



Report by the Government Actuary  
on the drafts of the Social Security  
Benefits Up-rating Order 2008 and  
the Social Security (Contributions)  
(Re-rating) Order 2008



GOVERNMENT **ACTUARY'S** DEPARTMENT



**Report by the Government Actuary on the drafts of the Social Security Benefits Up-rating Order 2008 and the Social Security (Contributions) (Re-rating) Order 2008**

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Report by the Government Actuary on drafts of the Social Security Benefits Up-rating Order 2008 and the Social Security (Contributions) (Re-rating) Order 2008

To: The Right Hon. Peter Hain MP, Secretary of State for Work and Pensions

The Right Hon. Jane Kennedy MP, Financial Secretary to the Treasury

I am pleased to present my report on the likely effects on the National Insurance Fund of the proposed *Social Security Benefits Up-rating Order 2008* and the *Social Security (Contributions) (Re-rating) Order 2008*.

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 contains estimates for the National Insurance Fund of receipts and payments for the years 2007-08 to 2012-13. The estimates are based on a number of assumptions which are described in the report. The principal economic assumptions used correspond with those adopted by Her Majesty's Treasury for the Pre-Budget Report in October 2007.

On the basis of my estimates, the balance in the National Insurance Fund at 31 March 2009 is expected to be greater than one-sixth of the amount of benefit payments in 2008-09. This exceeds the minimum level recommended by my predecessor to ensure that a reasonable working balance is maintained. In my view it should not therefore be necessary for any Treasury grant to be made to the National Insurance Fund in 2008-09.

Andrew Johnston  
Acting Government Actuary  
January 2008

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## 1 Introduction

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- 1.1 This report has been prepared under the Social Security Administration Act 1992. It considers the expected effects on the National Insurance Fund of:
- > the draft *Social Security Benefits Up-rating Order 2008* (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
  - > the draft *Social Security (Contributions) (Re-rating) Order 2008* (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.
- 1.2 The report includes the effects on the National Insurance Fund of changes which would be made by the draft *Social Security (Contributions) (Amendment) Regulations 2008* and the draft *Social Security Pensions (Low Earnings Threshold) Order 2008*.
- 1.3 This report is confined to the National Insurance Fund in Great Britain. It does not consider the separate Northern Ireland National Insurance Fund, nor the effects of the corresponding orders on that Fund.

## 2 Summary

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- 2.1 Estimates have been made of the income and outgo of the National Insurance Fund for 2007-08 to 2012-13. Detailed figures have been prepared for the first two years.
- 2.2 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 used by Her Majesty's Treasury for the Pre-Budget Report on 9 October 2007 (see paragraph 4.1 and Appendix 3, paragraph 26).
- 2.3 The financial effects of the proposals are estimated as follows:
- > The proposed Up-rating Order would increase from April 2008 the rates at which many benefits are paid, and would increase estimated benefit payments in 2008-09 by £2,663 million;
  - > The proposed Re-rating Order would alter the rates of Class 2 and 3 contributions, the small earnings exception for Class 2 and the band of earnings on which Class 4 contributions are paid. Together these changes would increase estimated receipts to the National Insurance Fund by £16 million in 2008-09;
  - > The proposed *Social Security (Contributions) (Amendment) Regulations 2008* would 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 would increase receipts to the National Insurance Fund in 2008-09 by

£105 million. This includes the effects of the *Social Security Pensions (Low Earnings Threshold) Order 2008* on contracted-out rebates.

- 2.4 The balance in the fund at 31 March 2009 is estimated to be £56,947 million (81.5% of estimated benefit payments). My predecessor recommended that the minimum balance should be one-sixth (16.7%) of estimated annual benefit expenditure. On the basis of the estimates in this report, no Treasury grant should be required in 2008-09.
- 2.5 Estimates for the period up to 2012-13 suggest that the National Insurance Fund will continue to grow, reaching over 130% of estimated benefit payments by 31 March 2013.

### 3 Description of the changes to benefits and contributions

- 3.1 The Up-rating Order would increase the rates of social security benefits paid from the National Insurance Fund, from the week beginning 7 April 2008, by the increase in the retail prices index in the year to September 2007 (3.9%), except for contribution-based jobseeker's allowance which is increased by the increase in the Rossi index over the same period (2.3%). 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 2007-08</b>	<b>Proposed increase in weekly rate</b>	<b>Weekly rate proposed from 9<sup>th</sup> April 2008</b>
Retirement pension - person claiming on their own or their deceased spouse's NI contributions - standard rate	£87.30	£3.40	£90.70
Retirement pension – person claiming on their spouse's NI contributions - standard rate	£52.30	£2.05	£54.35
Contribution-based jobseeker's allowance single person over 25	£59.15	£1.35	£60.50
Incapacity benefit long-term main rate	£81.35	£3.15	£84.50

- 3.2 Earnings-related additional pensions of retirement pensioners and bereavement benefit beneficiaries who qualified for these pensions before 6 April 2008 would be increased by 3.9%. Additional pension for those on incapacity benefit would not be increased. The increase would apply to additional pensions before abatement for any contracted out deduction where the pensioner has been contracted out at any time between 6 April 1978 and 5 April 1997. However, where such a contracted-out deduction includes an amount based on earnings between 6 April 1988 and 5 April 1997, this

amount would be deemed to be increased by 3.0% which would be paid by the contracted-out pension scheme of which the pensioner is a member. The increase in additional pension is correspondingly reduced.

- 3.3 The Re-rating Order would increase the Class 3 weekly contribution rate from £7.80 to £8.10. There is a liability for Class 2 contributions for self-employed people with profits or gains above the small earnings exception, which would be increased from £4,635 to £4,825 a year. The Class 2 weekly contribution rate would be increased from £2.20 to £2.30. Self-employed people with profits below the small earnings exception may still pay Class 2 contributions to protect benefit entitlement. For Class 4 contributions, the lower profits limit and the upper profits limit would continue to be aligned with the income tax personal allowance and the upper earnings limit for Class 1 contributions respectively.
- 3.4 The proposed *Social Security (Contributions) (Amendment) Regulations 2008* would increase the lower and upper earnings limits (LEL and UEL) for Class 1 contributions to £90 (from £87) a week and £770 (from £670) a week respectively. The proposed increase to the LEL is in line with the proposed increase to the basic retirement pension while it is proposed to increase the UEL by £75 a week above what would have been the UEL had it been increased in line with the increase in the retail prices index. The proposed regulations would 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 2007. The thresholds would become £105 (from £100) a week for weekly-paid employees and £453 (from £435) a month for other employees.
- 3.5 The changes described in paragraphs 3.3 and 3.4 are shown in Appendix 2. The financial effects of these changes are shown in Appendix 5.
- 3.6 The proposed *Social Security Pensions (Low Earnings Threshold) Order 2008* would increase the Low Earnings Threshold (LET) from £13,000 to £13,500 in 2008-09. The LET affects the amount of State Second Pension being accrued and, for people in appropriate personal pensions and contracted-out stakeholder pensions, the level of contracted-out rebates. Consequently, the upper limit of Band 2 accrual for the State Second Pension would be £31,100 in 2008-09, compared with £30,000 in 2007-08. The effects of this proposed Order have been allowed for in this report.

#### **4 Assumptions and methods used to project receipts and payments**

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- 4.1 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 of October 2007. 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 27.6 million in 2007-08 and 27.7 million in 2008-09
  - > the increase in average earnings is assumed to be 4.0% over the year to 2007-08 and 4.5% over the year to 2008-09; and
  - > the numbers unemployed and claiming benefit in Great Britain are assumed to be 0.84 million on average in 2007-08 and 0.87 million in 2008-09.

Details of the methods used to estimate contribution income and benefit expenditure are given in Appendix 3.

## **5 Estimates of receipts, payments and balance in the fund**

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- 5.1 Each significant item of the receipts and payments of the National Insurance Fund is estimated separately. The results for the year 2007-08 are laid out in a format similar to that used for the accounts of the National Insurance Fund. Redundancy payments are shown net of redundancy receipts.
- 5.2 The estimates of receipts and payments for 2008-09 (with the latest estimates for 2007-08 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	2007-08	2008-09
<b>Receipts</b>		
Contributions (as given in App 6)	76,350	82,847
Less recoveries of SSP	48	50
Less recoveries of SMP, SPP and SAP (and abatements)	1,497	1,868
Net contribution receipts	74,806	80,930
Treasury grant	0	0
Compensation from Consolidated Fund for SSP, SMP, SPP and SAP recoveries	1,539	1,910
Income from investments	1,854	2,267
State scheme premiums	74	74
Other receipts (4)	55	55
<b>Total receipts</b>	<b>78,327</b>	<b>85,236</b>
<b>Payments</b>		
Benefits At present rates (as given in App 4)	65,700	66,992
Increase due to proposed changes		2,663
Personal and stakeholder pensions contracted-out rebates (as given in App 7)	2,324	2,167
Age-related rebates for contracted-out money purchase schemes (as given in App 7)	219	212
Administration costs (4)	1,489	1,528
Redundancy fund payments (net) (4)	204	249
Transfer to Northern Ireland	452	505
Other payments	41	42
<b>Total payments</b>	<b>70,430</b>	<b>74,358</b>
<b>Statement of balances</b>		
Balance at beginning of year (1)	38,173	46,069
Excess of receipts over payments	7,896	10,878
Balance at end of year	46,069	56,947
Balance at end of year as percentage of benefit payments (2)	69.9	81.5

1. The balance in the National Insurance Fund at 31 March 2007 has been taken from draft accounts of the fund for the year 2006-07.

2. Percentages of benefit payments including net redundancy payments.
  3. Figures may not sum to totals shown due to rounding.
  4. The figures for 2007-08 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.
- 5.3 Table 2 shows that the balance in the Fund is projected to grow as a percentage of benefit payments in 2008-09. 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.

## 6 Estimates for 2007-08

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- 6.1 The estimates shown above for 2007-08 may be compared with the estimates made a year ago, and published in my predecessor's report in January 2007 (Cm 7021). The estimated surplus of £7,896 million for 2007-08 shown above differs from the surplus of £4,817 million estimated in that report. The difference is mainly due to the higher contributions paid than were projected in Cm 7021, which in turn derived from the greater use of electronic payments. The potential impact of this change was discussed in section 15 of my predecessor's report in January 2006, Cm 6732.
- 6.2 Estimates for National Insurance Fund benefits for 2007-08 are close to those made in Cm 7021. See Appendix 8 for more detail.

## 7 Estimates for 2008-09

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- 7.1 The extra benefit payments in 2007-08 as a result of the proposed increases in benefit rates from April 2008 are estimated to be £2,663 million. Particulars of the extra cost and of the payments for individual benefits are given in Appendix 4.
- 7.2 The financial effects on contribution receipts and contracted-out rebates of the proposed changes set out in paragraphs 3.3, 3.4 and 3.6 are given in Appendix 5. The combined effect of the changes is estimated to produce an increase in revenue to the National Insurance Fund of £121 million. Other changes in contribution receipts from 2007-08 to 2008-09 arise largely as a result of forecast increases in earnings between the two years. Appendix 6 shows an analysis of the contribution receipts.
- 7.3 Table 2 shows that the amount of Treasury grant estimated to be needed in 2008-09 is again nil. At this stage, the estimate of the balance in the National Insurance Fund at 31 March 2009 substantially exceeds one-sixth of estimated benefit payments in 2008-09. My predecessor recommended that one-sixth of annual benefit payments is the minimum to ensure the maintenance of a reasonable working balance in the fund.
- 7.4 Appendix 9 shows the projected development of the Fund up to 2012-13 using the assumptions in the Pre-Budget Report. The Fund (as a proportion of annual expenditure) is expected to increase over this period and so to improve its position as a buffer fund. The projected development of the Fund over the longer term is shown in

the Government Actuary's Quinquennial Review of the National Insurance Fund (Cm 6008) and the update published on the GAD website in December 2004. It should be noted that neither Cm 6008 nor the update includes the impact of the Pensions Act 2007, although this report does.

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

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- 8.1 Different assumptions about unemployment would affect the estimates of benefit payments. The estimates of contributions are critically dependent on the assumed levels of employment and assumptions about the level of earnings increases. It is appropriate to consider the effect on the income and outgo of the National Insurance Fund of different values for these assumptions.
- 8.2 The impact of contracting out is affected by changes in participation in different forms of pension provision. Changes in contracting out have been unusually large in recent years. The effects of alternative assumptions for the numbers contracted out are also examined.
- 8.3 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. 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 2008-09 of variations in economic assumptions**

**Great Britain, £ million**

Variation compared to assumptions given in Appendix 3 paragraph 27	Effect on receipts in 2008-09	Effect on payments in 2008-09
GB number of employees-in-employment lower by 200,000 in 2007-08	-500	
GB number of employees-in-employment higher by 200,000 in 2007-08	+500	
Earnings increases 1% lower over the year to 2006-07 and 2% lower over the year to 2007-08	-2,480	
Earnings increases 1% higher over the year to 2006-07 and 2% higher over the year to 2007-08	+2,500	
GB unemployment higher by 200,000 in 2007-08		+100
GB unemployment lower by 200,000 in 2007-08		-100

- 8.4 Using the figures in Table 3 it is possible to estimate the likely contribution receipts, benefit payments and fund balance under different sets of assumptions. For example, if earnings increases were 1% lower over the year to 2007-08 and 2% lower over the year to 2008-09 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 2008-09 would be a loss of approximately £3.1 billion, which would still not necessitate a Treasury grant in 2008-09.

- 8.5 Different levels or patterns of contracting out could have a material effect on the cash flows 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 2008-09. Amounts of APP and APP stakeholder pension rebates for 2008-09, and COMPS rebates for 2008-09 above those deducted from contributions received in 2008-09, 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 from April 2008**

**Great Britain, £ million**

Variation in assumptions	Effect on rebates for 2008-09	Effect on rebates paid or deducted from contributions paid in 2008-09
100,000 more members of COSRS, with same sex, age and earnings profile as assumed COSRS membership	+120	+110
100,000 more members of COMPS with same sex and earnings profile as assumed COMPS membership	+140	+60
100,000 more members of APPs or APP stakeholder pensions with same sex, age and earnings profile as assumed APP and stakeholder pension membership	+160	0

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

- 8.6 The surplus generated in a year is the difference between two much larger numbers and comparatively small changes in these numbers will produce a large change in the surplus. This is true for the surpluses in the years 2009-10 to 2012-13 as well as for the surplus in 2008-09.

## 9 Conclusion

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- 9.1 Table 2 of the report shows that the balance in the National Insurance Fund at 31 March 2008 is likely to be substantially above the minimum level of one-sixth (16.7%) of benefit payments recommended by my predecessor. The level is likely to be higher than estimated in the report on the changes in January 2007 (Cm 7021).
- 9.2 Allowing for the proposed increases in benefits and changes in contributions for 2008-09, it is estimated on the assumptions made that the balance of the Fund at 31 March 2009 to be at least one-sixth of benefit payments during the year. Appendix 9 shows that on the assumptions made the Fund is projected to remain above this level up to 31 March 2013. The projections made in Appendix 9 include the effects of the Pensions Act 2007 and the National Insurance Contributions Bill 2007-08.
- 9.3 As the estimated balance of the Fund at 31 March 2009 exceeds the recommended minimum level payment of a Treasury grant is not expected to be required in 2008-09. Medium term projections suggest that Treasury grant will not be required during the period to 31 March 2013.
- 9.4 If economic conditions depart from the assumptions described in paragraph 4.1 then the balance of the Fund at 31 March 2009 will be different from that given above. The effect of variation in these assumptions is described in section 8. This analysis suggests that even quite substantial alterations in economic conditions should not cause the balance of the Fund at that date to fall significantly below its current level.

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Acting Government Actuary

Fellow of the Institute of Actuaries  
January 2008

## Appendix 1: Main rates of benefit

	Weekly rate in 2007-08 £	Weekly rate proposed from 7 <sup>th</sup> April 2008 £
Retirement pension, bereavement allowance, widow's pension and widowed parent's allowance		
Personal benefit (basic pension)	87.30	90.70
Wife or other adult dependant (retirement pension only)	52.30	54.35
Graduated retirement benefit (unit)	0.1057	0.1098
Bereavement payment (1)	2,000	2,000
Incapacity benefit long-term rate (2)		
Personal benefit	81.35	84.50
Transitional invalidity allowance higher rate	17.10	17.75
Transitional invalidity allowance middle rate	11.00	11.40
Transitional invalidity allowance lower rate	5.50	5.70
Wife or other adult dependant	48.65	50.55
Age increase higher rate	17.10	17.75
Age increase lower rate	8.55	8.90
Incapacity benefit short-term		
Personal benefit higher rate	72.55	75.40
Personal benefit lower rate	61.35	63.75
Wife or other adult dependant	37.90	39.40
Statutory sick pay	72.55	75.40
Jobseeker's allowance (contribution-based)		
Personal benefit for those aged 18 to 24	46.85	47.95
Personal benefit for those aged 25 and over	59.15	60.50
Maternity allowance (3)	112.75	117.18
Statutory maternity pay		
Standard rate (3)	112.75	117.18
Guardian's allowance		
First child	12.95	13.45
Other children	12.95	13.45
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	9.00	8.75
Other children	11.35	11.35
Christmas bonus to pensioners	10.00	10.00

Notes

(1) Lump sum benefit.

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

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

## Appendix 2: Main features of the contribution system

		Rate in 2007-08	Rate proposed from April 2008
<b>Class 1</b>			
	Lower earnings limit (LEL)	£87 a week	£90 a week
	Upper earnings limit (UEL)	£670 a week	£770 a week
	Primary threshold	£100 a week or £435 a month	£105 a week or £453 a month
	Secondary threshold	£100 a week or £435 a month	£105 a week or £453 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%
<b>Class 1A and Class 1B</b>			
	Contribution rate (employer only)	12.8%	12.8%
	NHS allocation included in above	1.9%	1.9%

## Appendix 2 (cont)

	Rate in 2007-08	Rate proposed from April 2008
<b>Class 2</b>		
Flat rate contribution	£2.20 a week	£2.30 a week
Small earnings exception	£4,635 a year	£4,825 a year
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
<b>Class 3</b>		
Flat rate contribution	£7.80 a week	£8.10 a week
NHS allocation included in above (percentage of contribution)	15.5%	15.5%
<b>Class 4</b>		
Lower profits limit (LPL)	£5,225 a year	£5,435 a year
Upper profits limit (UPL)	£34,840 a year	£40,040 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 2007-08 and 2008-09 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 is 3.7% of earnings between the LEL and UEL for COSRS and 1.4% for COMPS for both years.

(4) Members of COMPS also receive an age-related rebate (a rebate which increases with age) which is paid by HM Revenue & Customs direct to the scheme on receipt of the employer's end of year return. The age-related rebate is capped at 7.4% for both years. 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 HM Revenue & Customs 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

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### *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 Annual Survey of Hours and Earnings, projected in line with the earnings increases shown in paragraph 26 below. The gross contribution results are scaled in line with the assumed number of employees which are also given in paragraph 26. The estimates of amounts of contracted-out rebates are made in a similar way, using an assumption of the numbers contracted out based on the Lifetime Labour Market Database and allowing for the continuation of the trend in the proportions of employees contracted out into occupational schemes observed in recent years.
3. Other classes of contributions are estimated using simpler models. Class 1A and Class 1B contributions are estimated using data provided by HM Revenue & Customs (HMRC) on contributions paid in previous years. Estimates of Class 2 and Class 4 contributions are estimated using data on the earnings of the self-employed received from HMRC, 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 and allowing for the extra payments made after the delayed deficiency notices were sent out. An adjustment was also made to Class 3 contributions to allow for the smaller number who will need these extra contributions to qualify for a full pension as a result of the changes to contribution conditions and credits introduced by the Pensions Act 2007.
4. Statutory sick pay (SSP) and statutory maternity pay (SMP) recovered by employers are estimated by adjusting amounts recovered in the latest year for which data are available broadly in line with changes in numbers of employees, rates of benefit, and, for earnings-related SMP, the average earnings of women. The additional amount in excess of 100% of SMP paid which can be reclaimed by small employers (SMP abatement) is estimated in a similar way. The amount of the payment from the Consolidated Fund is estimated as the amounts of SSP and SMP recovered, with adjustments in the current year arising from revisions to estimates of amounts recovered in prior years. Statutory paternity pay (SPP) and statutory adoption pay (SAP) are estimated in a similar way. There are still problems relating to the data on statutory payments but action is being taken to resolve them. In the meantime, the best estimates have been made based on the available data but it is still possible that figures for statutory payments might be amended in the future. Full allowance has been made for the recent policy changes on duration and entitlements.

### *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 2008-09 is estimated as that amount needed to ensure that the estimate of the fund balance at 31 March 2009 is at least one-sixth of benefit payments (including redundancy fund payments) in 2008-09.
8. Estimates for the item called "Other receipts" in the accounts of the National Insurance Fund (mainly recoveries of damages in tort from benefit paid) are provided by the Strategy Directorate of the Department for Work and Pensions.

### *Benefits*

9. Benefits are estimated separately for each of the contributory benefits, and separately for the basic, flat-rate elements of state pensions and for additional pensions (SERPS and S2P).
10. In general, for flat-rate benefits, numbers of beneficiaries 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 2006-based 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 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. A review of the assumptions used in the model has been carried out incorporating data from the Lifetime Labour Market Database to provide an indication of future entitlements to basic retirement pension. Allowance has been made for the changes in contribution conditions in the Pensions Act 2007.
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, including the changes introduced by the Pensions Act 2007. 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 2006-based 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, widowers and bereaved civil partners. 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 the remaining widows widowed between 1988 and 2001, and projecting a build up of widows, widowers and bereaved civil partners 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, widowers and bereaved civil partners from the latest marital condition projection (mid-2003 based adjusted); termination and transfer rates by single age and type of benefit are derived from recent data. A full review of all the assumptions used in the model has been made incorporating data post 2001. This has enabled appropriate assumptions to be made for widowers based on actual data.
  15. There has been no firm data on the number of lump sum widows payment / bereavement payment since 1996-97. Estimates for this are derived from numbers of awards of bereavement benefit, combined with assumptions on those cases who are not awarded bereavement benefit based on the old data. The awards of bereavement allowance have been unusually low in recent statistics. There are no external factors that would explain a drop of the size that has been observed and so the probability that the data is incorrect is significant. In the absence of any other information, this data has been used but it has led to a drop in the estimates previously made.
  16. 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', widowers' and bereaved civil partners additional pension, using assumptions on marital and civil partnership status and age of surviving spouse and civil partner. The amount is split by type of benefit and survived using the main basic bereavement benefit model. Allowance is made for the changes which have applied since April 2001, under which additional pension will only be paid to widows, widowers and civil partners 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, widowers and bereaved civil partners who reach pensionable age, including amounts which are not actually paid under pension age. A similar method is used for contracted-out deductions.
  17. Trends in awards and survival for incapacity benefit are based on recent data. 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 do not include the effects of the Welfare Reform Act 2007. This only affects new awards of benefit and so will not have a significant effect for several years.
  18. 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 26 of this appendix.

These estimates were provided by the Strategy Directorate of DWP. The estimates were adjusted to convert them from an accruals (resource) to a cost (encashment) basis.

19. Estimates for maternity allowance are based on recent data on awards and benefits in receipt varied in line with numbers of births from the latest population projection. Full allowance has been made for the recent policy changes on duration and entitlements. Estimates for guardian's allowance are derived from recent data, varied in line with numbers of children in the population and with an allowance for recent trends. Estimates for the lump sum Christmas bonus are derived from numbers assumed to be entitled to the qualifying benefits (retirement pension, widow's pension, widowed parent's allowance and long-term incapacity benefit) with allowance for those cases not entitled to the Christmas bonus.
20. The underlying estimates of payments for all benefits are aligned to recent data on payments for 2007-08 to ensure that account is taken of more recent changes in factors affecting benefit payments than are incorporated in data on numbers of beneficiaries.

#### *Other payments*

21. 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.
22. Redundancy payments estimates (net of redundancy receipts) are provided by the Department for Business Enterprise and Regulatory Reform, and are based on the same economic assumptions as the other estimates.
23. Transfers from the Great Britain National Insurance Fund to the Northern Ireland National Insurance Fund are made in order to keep the balance in the Northern Ireland National Insurance Fund at 2.84% of the combined balance in the two funds. Estimates of transfers to Northern Ireland are made on this basis.
24. The administration costs have been estimated as the 2006-07 costs increased in line with inflation.
25. 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*

26. 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 assumed number of JSA claimants is based on an NAO – audited assumption, derived from an average of independent forecasts. 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 October 2007. These are given below:

<b>Assumptions used for estimates</b>	<b>2007-08</b>	<b>2008-09</b>
Number of employment jobs (UK), million (including HM Forces, excluding self-employed)	27.6	27.7
Increase in average earnings on one year earlier, %	4.0	4.5
Average number of unemployed (GB), million	0.84	0.87

The assumptions for 2007-08 differ from those used in making last year's report.

27. The effects of variations in these assumptions are given in paragraphs 7.3 and 7.4 of the main report.

**Appendix 4: Estimated payments from the National Insurance Fund for benefits, and effect of benefit up-rating on payments in 2008-09**

<b>Great Britain £ million</b>	<b>Estimated total payments in 2007-08</b>	<b>Estimated total payments in 2008-09</b>	<b>Extra payments in 2008-09 as a result of the up-rating</b>
Retirement pensions – basic	47,274	50,057	1,777
Retirement pensions – additional pensions	10,265	11,489	620
Widows' / bereavement benefits – basic	599	557	16
Widows' / bereavement benefits – additional pensions	139	121	5
Incapacity benefit – basic	6,436	6,410	226
Incapacity benefit – additional pensions	246	210	0
Contribution-based jobseeker's allowance	416	411	9
Maternity allowance	195	267	10
Guardian's allowance	2	2	0
Christmas bonus	129	130	0
<b>Total (1)</b>	<b>65,700</b>	<b>69,654</b>	<b>2,663</b>
Redundancy payments (net) (1)	204	249	0

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

## Appendix 5: Analysis of the changes in contribution receipts for 2008-09 as a result of the contribution re-rating order and other measures

Great Britain, £ million	Contributions for 2008-09	Contributions received in 2008-09 (1)
<b>National Insurance Fund effects</b>		
Social Security (Contributions) (Re-rating and National Insurance Funds Payments) Order 2007		
Increase in Class 2 rate	+15	+11
Increase in Class 2 small earnings exception – indexation effect	-4	-3
Increase in Class 3 rate	+4	+1
Increase in Class 4 profits limits – indexation effect	+88	+8
<b>Total</b>	<b>+103</b>	<b>+16</b>
Proposed Social Security (Contributions) (Amendment) Regulations 2008		
Increase in Class 1 primary and secondary thresholds, and lower and upper earnings limits – indexation effect		
Effect on contribution receipts from gross contributions (2)	+561	+493
Effect on contribution receipts from contracted-out rebates (4)	-543	-389
<b>Total</b>	<b>+19</b>	<b>+105</b>
<b>Total, all measures</b>	<b>+122</b>	<b>+121</b>

(1) The balance of contributions for 2008-09 will not be received until after 31 March 2009.

(2) Figures are gross of statutory sick pay, statutory maternity pay, statutory paternity pay and statutory adoption pay.

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

(4) This line also includes the effects of the proposed Social Security Pensions (Low Earnings Threshold) Order 2008.

**Appendix 6: Analysis of contribution receipts by fund and class of contributor, and analysis of occupational pension scheme contracted out rebates**

Great Britain, £ million			2007-08	2008-09
<b>National Insurance Fund</b>				
Class 1 (1)	Primary	Gross	31,562	34,988
		Contracted-out rebate (2)	2,443	2,672
		Net	29,119	32,317
	Secondary	Gross	49,632	53,385
		Contracted-out rebate (2)	5,429	5,998
		Net	44,203	47,386
Total		Gross	81,194	88,373
		Contracted-out rebate (2)	7,872	8,670
		Net	73,322	79,703
Classes 1A and 1B			924	931
Class 2			323	338
Class 3 (3)			109	104
Class 4			1,672	1,771
Total National Insurance Fund Contributions (4)			76,350	82,847
<b>National Health Service</b>				
Class 1	Primary		8,394	9,145
	Secondary		11,202	12,051
	Total		19,596	21,196
Classes 1A and 1B			161	162
Class 2			59	62
Class 3 (3)			20	19
Class 4			785	824
Total National Health Service Contributions			20,621	22,263

## Appendix 6 (cont)

Great Britain, £ million			2007-08	2008-09
<b>All contributions</b>				
Class 1 (1)	Primary	Gross	39,956	44,133
		Contracted-out rebate (2)	2,443	2,672
		Net	37,513	41,461
	Secondary	Gross	60,834	65,436
		Contracted-out rebate (2)	5,429	5,998
		Net	55,405	59,437
Total		Gross	100,790	109,569
		Contracted-out rebate (2)	7,872	8,670
		Net	92,918	100,899
Classes 1A and 1B			1,085	1,093
Class 2			383	400
Class 3 (3)			129	123
Class 4			2,457	2,595
<b>Total contributions</b>			<b>96,972</b>	<b>105,110</b>

(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 7: Analysis of payments in respect of appropriate personal pensions and age-related rebates in respect of contracted out money purchase schemes made by HM Revenue and Customs**

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<b>Great Britain, £ million</b>	<b>2007-08</b>	<b>2008-09</b>
Personal and Stakeholder pension rebates		
Primary contracted-out rebates	527	429
Secondary contracted-out rebates	1,797	1,738
 Total (1)	 2,324	 2,167
 Age-related rebates for members of contracted-out money-purchase schemes (1)	 219	 212
 All payments in respect of personal pensions and age-related rebates to contracted-out money purchase schemes	 2,543	 2,379

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(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 8: Comparison of estimates for 2007-08 made now and in Cm 7021 (January 2007)

Great Britain, £ million	2007-08 estimates made now	2007-08 estimates given in Cm 7021
<b>Receipts</b>		
Contributions	76,350	73,152
Less recoveries of SSP	48	49
Less recoveries of SMP, SPP and SAP and SMP, SPP and SAP abatement	1,497	1,356
Net contribution receipts	74,806	71,747
Treasury grant	0	0
Compensation from Consolidated Fund for SSP and SMP recoveries	1,539	1,397
Income from investments	1,854	1,799
State scheme premiums	74	118
Other receipts	55	69
<b>Total receipts</b>	<b>78,327</b>	<b>75,130</b>
<b>Payments</b>		
Benefits	65,700	65,744
Personal and stakeholder pensions contracted-out rebates	2,324	2,156
Age-related rebates for contracted-out money purchase schemes	219	205
Administration costs	1,489	1,470
Redundancy fund payments (net)	204	251
Transfer to Northern Ireland	452	452
Other payments	41	33
<b>Total payments</b>	<b>70,430</b>	<b>70,313</b>

> Figures may not sum to totals due to rounding.

*Reasons for changes in estimates*

1. The estimates of Class 1 contributions are higher than last year. This is due to the volatility in the receipt of contributions by the National Insurance Fund caused by electronic payments.
2. Receipts of Class 2 and Class 3 contributions are historically volatile and the differences between these estimates and those in Cm 7021 are not unusual. Receipts of other classes are little changed from last year.
3. Estimates of SSP, SMP, SPP and SAP are higher than last year, mainly because of changes in the lag pattern (i.e. the difference between when the liability occurs and when it is recovered). There are still some unresolved questions in relation to this data and therefore there is the possibility of revisions in the future when these problems are resolved. However, the position has improved considerably in the past two years.
4. The estimate of total benefit payments for 2007-08 is very similar to that shown in last year's report.
5. Payments of minimum contributions to appropriate personal pension (APP) providers (including APP stakeholder pensions) are now estimated to be higher than was estimated last year. This is in line with more recent data on the amounts that have been paid.
6. Estimates of the administration costs are little changed from those in Cm 7021.
7. The assumptions used in making the two sets of estimates are compared in the table below.

	<b>2007-08 estimates made now</b>	<b>2007-08 estimates given in Cm 7021</b>
Number of employees in employment (UK), million (including HM Forces, excluding self-employed)	27.6	27.4
Increase in average earnings on one year earlier, %	4.0	4.5
Average number of unemployed (GB), million	0.84	0.98

## Appendix 9: Projected receipts, payments and fund balances for the National Insurance Fund up to 2012-13

### Balance in National Insurance Fund at the end of successive financial years

Great Britain, £ million	2006-07 (1)	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
Receipts	71,296	78,327	85,236	88,499	94,317	100,326	106,535
Payments	67,382	70,430	74,358	77,748	80,987	84,351	88,822
Excess of receipts over payments	3,914	7,896	10,878	10,751	13,330	15,975	17,713
Balance in Fund at end of year	(2) 38,173	46,069	56,947	67,698	81,028	97,003	114,716
Balance at end of year as a percentage of benefit payments (6)	61.3	69.9	81.5	92.4	106.0	121.6	136.3

(1) From the draft accounts for 2006-07.

(2) This uses the book value of the fund as at 31 March 2006 and is in accordance both with the accounts and with past practice. However, it is not consistent with the fund projections made in my predecessor's latest Quinquennial Review of the National Insurance Fund, which used market values.

(3) Projections for 2009-10 and later years are based on the economic assumptions used for the Pre-Budget Report in October 2007.

(4) The excess of income over expenditure 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. This, in turn, could have a significant effect on the fund balances.

(5) Increases in benefit rates, contribution rates and earnings limits after 2008-09 are estimated in accordance with the legislation.

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



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