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Association of Independent Advice Centres (NI)

Social Policy Briefing

Spring 2003

Increased National Insurance Contributions

The Contributory Principle:

'On the Agenda' or 'In the Firing-line' ?

Introduction

In his Budget speech in April 2002, the Chancellor Gordon Brown announced that National Insurance contributions for employees, employers and the self employed would increase by 1% from April 2003. We have now seen:

- The employee National Insurance contribution increase from 10% to 11%;
- The employer contribution rise from 11.8% to 12.8%;
- The self employed rate of contribution also rise from 7% to 8%;

Many people imagine that their National Insurance contributions are payments which enable an individual to quality for certain types of social security benefits, for example Retirement Pension, contribution-based Job Seekers Allowance and Incapacity Benefit. The principle of contribution is viewed as paying your way, and if/when the time comes to access contribution-based social security benefits in times of unemployment or sickness, it is expected that these benefits will be paid.

This view is reinforced by popular definitions of National Insurance contributions, for example:

"National Insurance Contributions (NICs) are payments that enable an individual to qualify for certain types of social security benefit. All employees and self-employed workers over 16 and under retirement age with earnings above a set lower limit must make contributions, which are related to the level of income they earn and the benefits in kind they receive including cars and fuel.

Without a full contribution record, individuals might not qualify for the full basic state retirement pension or for any state pension at all if their payments have been erratic. Maternity benefits, sickness benefits and the job seeker's allowance are also dependent on the level of contributions. In the past NICs were treated as an independent pot of government money used specifically to fund social security benefits - which is why they are termed a contribution rather than a tax."

http://www.bbc.co.uk/business/info/basics/

Therefore from this position, one would imagine that increased contributions would mean an increased pool of money available for spending on contributory benefits. You would even be forgiven for thinking that perhaps this is the government's answer to the oft talked about demographic timebomb and the solution to the pensions crisis.

Unfortunately this does not appear to be the case. This increase in National Insurance contributions is not for contribution based social security benefits, but to help meet the cost of Government spending as outlined in the Budget 2002.

Therefore we can see that the national insurance pool is being used for purposes other than contribution based benefits. We also see the qualifying criteria for contributory benefits are tightening with a view to restricting expenditure. And we see the national insurance pool itself moving towards convergence with income tax, with a break in the direct link between contributions paid and accessibility to contributory benefits.

Evidence of the Contributory Principle 'In the Firing-line'

(1) Alignment with Income Tax

The transfer of the Contributions Agency from the Department of Social Security to the Inland Revenue (took place in April 1999);

The income tax system moved, in 1992, from a joint system of assessment (where a married woman's income was treated as her husband's income for tax purposes) to an individual system, where both partners pay tax separately. Similar to the National Insurance contribution system;

The levels of weekly earnings at which employees and employers start paying National Insurance contributions have been aligned with the weekly level of the income tax personal allowance (in 1999 for employers contributions and 2001 for employee contributions);

From 1999, National Insurance contributions are payable only on earnings above the lower earnings threshold, which is equivalent to the treatment of earnings by the income tax system. Previous to this National Insurance contributions were payable on the whole of weekly earnings once earnings rose above the lower earnings threshold;

Income tax rates and National Insurance contribution rates have moved closer together. The basic rate of income tax has decreased from 33% in 1979 to 22% in 2002-2003. The rate of employee National Insurance contributions has risen from 6.5% in 1979 to 11% in 2003;

The treatment of those with higher incomes has also become similar. The 1% increase in employee National Insurance contributions apply to earnings above the upper earnings threshold, and a single 40% higher rate applies to income tax;

The replacement of Family Credit by the Working Families Tax Credit in October 1999 saw a shift in payment from Social Security to the Inland Revenue;

The further reform of benefit payments through the income tax system including the Child Tax Credit which is a single credit aimed at families with children and will replace the following premiums from Income Support, Jobseekers Allowance (Income Based) and Minimum Income Guarantee assessments: *Dependant child allowance; Family premium; Family premium/lone parent; Disabled child premium and Enhanced disabled child premium;*

(2) The qualifying criteria for contributory benefits are tightening / Decline of the contributory principle

The change from Sickness Benefit and Invalidity Benefit to the less generous Incapacity Benefit in 1995 has seen expenditure on Incapacity Benefit decrease. (The earnings-related element of the benefit was scrapped, and the more generous age related allowances were cut for most claimants);

The introduction of the All Work Test for Incapacity Benefit in 1995 was driven by a desire to tighten the qualifying conditions for the benefit;

The change from the All Work Test to the Personal Capability Assessment in April 2000, with a view to focussing on the qualifying conditions for benefit;

The impact of Welfare Reform legislation, whereby entitlement to Incapacity Benefit has been withdrawn from new claimants who have been unable to make National Insurance contributions in recent years; and means testing whereby most claimants with a personal or occupational pension of over £85 per week, would see their Incapacity Benefit reduced by £0.50 for every £1 the pension is over £85. (If you are entitled to the highest rate of Disability Living Allowance – care component, all such pensions are ignored and do not affect entitlement to Incapacity Benefit.)

People who have been severely disabled from a young age – and so were never able to build up a contribution record – will now nonetheless be able to claim incapacity benefit;

Changes to the system of benefits for widows (now bereavement benefits) has sharply reduced their long-term cost (even after allowing for the cost of making men eligible for the first time), principally by paying the new bereavement allowance – the old widow’s pension – for one year only rather than until remarriage.

More recently, in Budget 2002, it was announced that child additions to contributory benefits would be abolished;

The change from Unemployment Benefit to contribution based Job Seekers Allowance in 1996, with the reduced duration of payment from 12 months to 6 months. Prior to these changes Unemployment Benefit was made taxable in 1982 and child additions were abolished in 1984.

In 1980 the decision to limit benefit increases in line with the rate of inflation rather than with the increase in average earnings affected all benefit recipients including contributory benefits.

(3) Expenditure in relation to contribution based social security benefits in comparison to the total social security benefit expenditure

In 2001/02, over £112 billion was spent on social security benefits in the UK. This represents 32.1% of total government expenditure (11.2% of Gross Domestic Product). The next largest function of government spending is on health and personal social services, at £72.2 billion (20.7% of total expenditure).

Expenditure on contributory benefits has fallen as a proportion of total government benefit (and tax credit) expenditure from a high of 76% in 1965/66 to an estimated 45% in 2003/04.

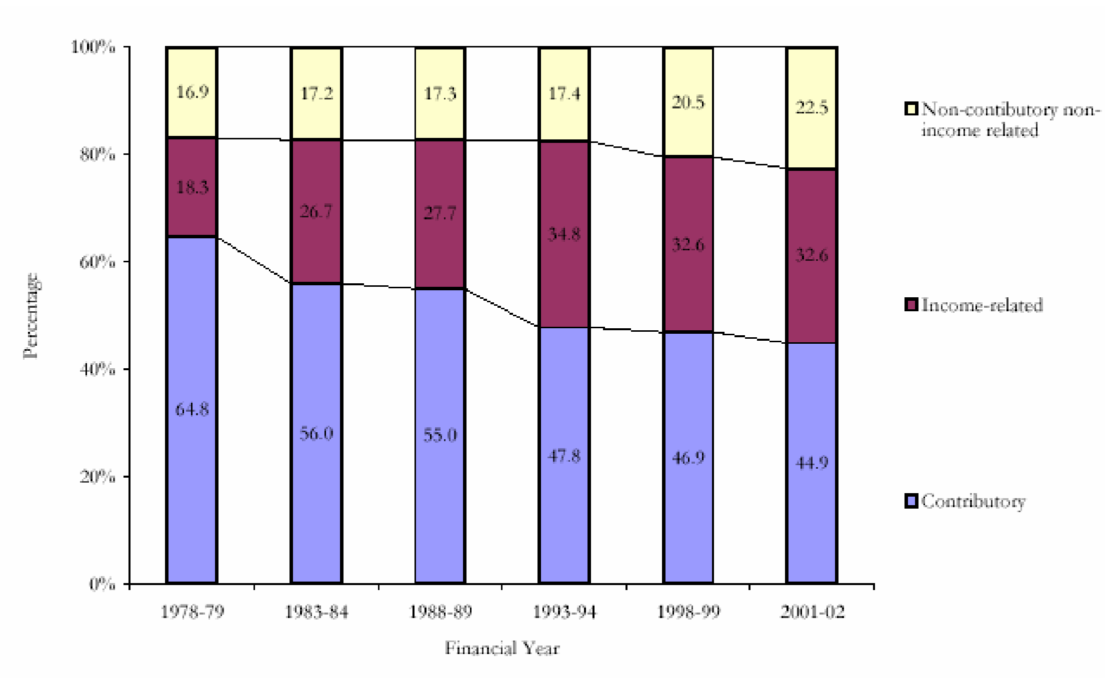
To give an example, the basic state pension (easily the biggest contributory benefit) is set to increase in line with prices (INFLATION), whereas the government's stated long-term aspiration is to increase the non-contributory minimum income guarantee (MIG) for those aged 60 or over in line with EARNINGS. That means the basic state pension is due to become less important relative to the MIG, and contributions records will gradually become less relevant in determining the amount of benefits received by those aged 60 or over.

Expenditure on social security benefits and related tax credits, 2001.02

	Expenditure (£m)	**Percentage of total**
Benefits for families with children		
Child benefit	8,825	7.9%
Guardian.s allowance	1	0.0%
Working families. tax credit	5,400	4.8%
Statutory maternity pay	641	0.6%
Maternity allowance	55	0.0%
Total benefits for families with children	*14,922*	*13.3%*
Benefits for unemployed people		
Income-based jobseeker.s allowance	2,147	1.9%
Contribution-based jobseeker.s allowance	472	0.4%
Job grant	12	0.0%
Total benefits for unemployed people	*2,631*	*2.3%*
Benefits for people on low incomes		
Income support	14,112	12.6%
Housing benefit	11,552	10.3%
Council tax benefit	2,739	2.4%
Social Fund payments	285	0.3%
New Deal employment credit	85	0.1%
Total benefits for people on low incomes	*28,773*	*25.6%*
Benefits for elderly people		
Basic retirement pension	36,487	32.5%
Earnings-related retirement pension	5,502	4.9%
Non-contributory retirement pension	29	0.0%
Retirement pension . total	*42,018*	*37.4%*
Winter fuel payments	1,702	1.5%
Concessionary television licences	370	0.3%
Total benefits for elderly people	*44,090*	*39.2%*

Benefits for sick and disabled people		
Incapacity benefit	6,769	6.0%
Attendance allowance	3,131	2.8%
Disability living allowance	6,592	5.9%
Disabled person.s tax credit	120	0.1%
Severe disablement allowance	1,040	0.9%
Invalid care allowance	934	0.8%
Statutory sick pay	30	0.0%
War pensions	1,199	1.1%
Industrial injuries disablement benefit	724	0.6%
Other industrial injuries benefits	2	0.0%
Independent Living Funds	150	0.1%
Motability 6 0.0%		
Total benefits for sick and disabled people	*20,697*	*18.4%*
Benefits for the bereaved		
Widows. Benefits	1,108	1.0%
Industrial death benefit	49	0.0%
Total benefits for the bereaved	*1,157*	*1.0%*
Others		
Christmas bonus	138	0.1%
Earnings top-up pilots	0	0.0%
Other small benefits	6	0.0%
Total others	*144*	*0.1%*
TOTAL	**112,414**	**100.0%**

Relative importance of spending on contributory, income-related and other benefits, 1978-79 to 2001-02



Source: DWP and the Institute for Fiscal Studies

The decline in relative importance of contributory benefits has been largely due to the growth of non-contributory benefits since the late 1970's.

This therefore points towards:

(1) Successive government's policy to construct a social security system based ever-more clearly around 'need' rather than past National Insurance contributions.

This has been taken on by the Labour Government, and to quote Alaistair Darling: "the important difference in social security is not whether [benefits] are insurance-based or means-tested, but whether or not they provide enough help to get people back to work and improve their lives", and that income-testing was essential to ensure that "state spending … be concentrated where it is needed most".

(2) An integrated National Insurance and Income Tax policy which will generate income for all government expenditure.

Returning to the beginning of this paper, if people imagine that their National Insurance contributions are something separate from Income Tax and which will ensure some degree of protection and financial security in times of sickness, unemployment or old age, then this myth needs to be exposed. The facts speak for themselves, although the perception (or perhaps this should read 'deception') has been allowed to continue.

The most important benefit increases have been to the main means-tested benefits, which depend on current financial and other circumstances, and to some extent the decline of the contributory principle is the inevitable flipside of targeting – which means, after all, that payments are directed on the basis of a family's financial or other needs.

There have been reforms to the contributory benefit system – on both the benefit and contribution side – which weaken the link between what is paid in and what is paid out. This constitutes a weakening of the contributory principle. The tendency to spend any available extra resources on benefits that relate to current circumstances rather than to past contribution records has strengthened this trend.

Although it may be politically damaging to broadcast this fundamental truth, government should make their position clear on the future of National Insurance contributions and the contributory principle. The reason that this would be damaging is that it has been demonstrated that people are strongly in favour of the contributory principle, which is seen to legitimise benefit claims and forges social solidarity.

However government will need to clarify their position in relation to the contributory principle if they wish to pursue the agenda of encouraging people to make their own provision against sickness/ill-health, unemployment, old age or any other key life event.

Acknowledgements

- ***The Social Security Select Committee, and latterly the Work and Pensions Select Committee***
  http://www.parliament.uk/parliamentary_committees/work_and_pensions_committee.cfm
- ***The Department for Work and Pensions***
  http://www.dwp.gov.uk
- ***Memorandum Submitted By The Rt Hon Frank Field MP to the Social Security Select Committee***
  http://www.parliament.the-stationery-office.co.uk/pa/cm199899/cmselect/cmsocsec/485/9110302.htm
- ***The Official Report (Hansard) of proceedings in the Chamber, in Westminster Hall and in Standing Committees***
  http://www.parliament.uk/hansard/hansard.cfm
- ***The Institute for Fiscal Studies***
  http://www.ifs.org.uk/
- ***The BBC Business and Money Website***
  http://www.bbc.co.uk/business/index.shtml

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AIAC Mission Statement

AIAC is a voluntary organisation for the independent advice sector in Northern Ireland, representing and giving voice to its members aspirations to deliver effective and holistic, community or issue-based advice through the provision of services, support and development opportunities.

Values

As a membership organisation, our values are embedded in promoting the application of creative community development approaches to advice giving, which place people and communities at the centre of the process and involves them in finding solutions and making informed choices.

AIAC believes in

Quality advice which is delivered free.

Advice services which are impartial and non-judgemental and respect the individuals dignity.

Advice which is wholly confidential, and accountable to the public.

Independent advice, which is free from statutory or private control and is both non-party political and non-sectarian in nature.

Advice services which are aimed specifically towards overcoming social exclusion.

Offering people choice through the provision of flexible, accessible advice services.

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