Staff Paper 2015

Vote Management and the Social Insurance Fund

Irish Government Economic and Evaluation Service

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November 2015

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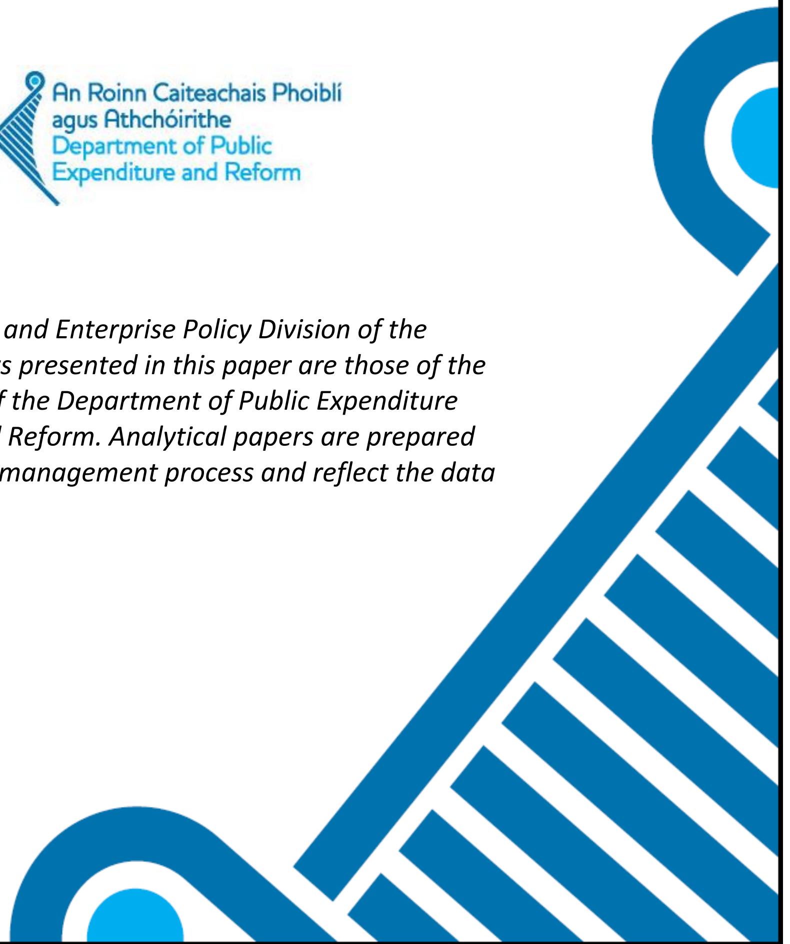

Glossary of terms

CSO	Central Statistics Office
DES	Department of Education and Skills
DOF	Department of Finance
DPER	Department of Public Expenditure and Reform
DSP	Department of Social Protection
GNP	Gross National Product
MOF	Minister for Finance
MPER	Minister for Public Expenditure and Reform
MSP	Minister for Social Protection
NTF	National Training Fund
PMG	Paymaster General
PRSI	Pay Related Social Insurance
REV	Revised Estimates Volume
SIF	Social Insurance Fund
USC	Universal Social Charge

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Executive Summary

- **Introduction:** The aim of this paper is to examine the impact of the Social Insurance Fund (SIF) on the Department of Social Protection Vote and to examine the scope for improvements from a Vote management perspective. The Social Insurance Fund was set up in 1952 to provide security to people currently in employment but who will experience periods out of employment. Most employers and employees pay 'Pay Related Social Insurance (PRSI) contributions' into the national Social Insurance Fund when in employment and for this employees receive benefits for the periods spent out of employment. SIF income policy is made by the Minister for Social Protection subject to the consent of the Minister for Finance, while SIF expenditure policy is set by the Minister for Social Protection and the Minister for Public Expenditure and Reform.

- **Appropriateness of the Current System**: There is a lack of visibility within the Dáil at year-end regarding the total spending of DSP, which has been evident in the past number of years. In certain years DSP avoided the need for a supplementary estimate despite overspending and while in other years they needed a supplementary estimate despite underspending. The paper questions the appropriateness of such a large part of the funding of DSP coming through the SIF income system, which is not subject to a Dáil vote. The SIF is projected to comprise **43% of total DSP spend in 2015**.

- **Complexity of managing SIF Income within Voted Expenditure:** Each year, Revenue undertakes a reclassification exercise following the submission of annual P35 forms. This has resulted in substantial amounts being reclassified from PRSI into Income Tax (or vice versa) in the current year in respect of a previous year. In particular, the reclassification in 2012 caused considerable disruption to the Vote position in 2012 and 2013. In addition, the SIF is particularly responsive to Labour Market fluctuations. The sharp rise in unemployment from 2008 caused the income of the SIF to fall dramatically and while also causing greater reliance on the welfare system. This all adds complexity to preparing accurate estimates of voted expenditure in the Budget for the coming year.

- **The increasing State contribution to the funding of the SIF:** In only 11 years of its existence has the SIF produced a surplus of income over expenditure. The latest actuarial review of the SIF has projected the Exchequer subvention will increase steadily over time and will exceed 50% of the total SIF funding by 2050. The likelihood that the Exchequer contribution will become a more significant part of the Fund suggests that the employee and employer SIF contributions might be better aligned with the Exchequer income. Issues of long-term reform, contribution rate levels etc., to address sustainability issues in social insurance funding are areas for separate analysis but are not the focus of this paper.

- **Reforms in other Jurisdictions:** The 1998 Taylor Report made the general case for reforming the tax system to improve the benefits of work for those on low incomes and to simplify the taxation system. The report recommended that the thresholds for National Insurance Contributions should more closely match those for Income Tax and this could be achieved through the control of operations and policy for National Insurance merging with the body that controls Income Tax operations and policy. These recommendations were subsequently introduced, with the National Insurance policy and operations moving within HM Revenue and Customs and with the thresholds of National Insurance Contributions being aligned with Income Tax. The changes in the UK illustrate the potential for significant reform of the SIF.

- **Recommendation:** This paper is recommending that the SIF income element should be separated from within the Social Protection Vote and aligned with Income Tax collections. While the payments made from the SIF should remain as part of DSP's expenditure, the operation and policy for PRSI income should be moved to the control of Revenue and the Department of Finance. This would mean that SIF income (and broadly all PRSI income) would be managed along with general receipts from taxation etc. within the Department of Finance. The Department of Social Protection expenditure allocation as voted would represent the actual expenditure of the Department and not a net figure which excludes most, if not all of, SIF expenditure.

1. Introduction

The aim of this paper is to examine the impact of the Social Insurance Fund (SIF) on the Department of Social Protection Vote and to examine if there is a better way to manage the SIF. In the last number of years, the SIF has had a big impact on the outturn of the Social Protection Vote due to a range of factors that will be discussed in this paper. The paper will address (i) the appropriateness of non-voted obligations impacting on the voted process; (ii) the complexity of managing SIF Income within Voted Expenditure and (iii) the increasing State contribution to the funding of the SIF. The paper will look at similar reforms that have been made to social security operations in other jurisdictions to see if insights can be gained for possible reforms to the Irish system, taking into account the core tenet of the original proposal for the Welfare State, the Contributory Principle.

1.1 Legislative Context for the Social Insurance Fund

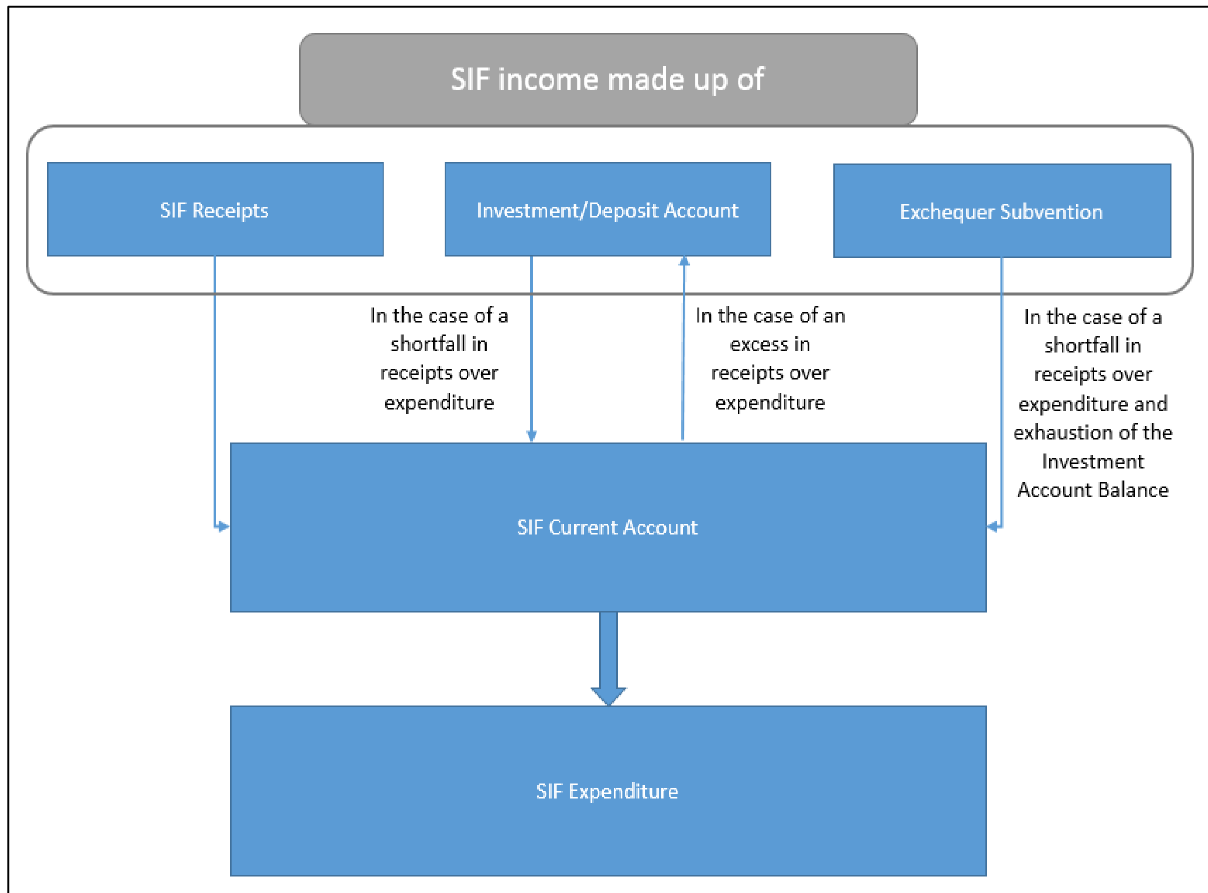
The Social Insurance Fund was set up to provide security to people currently in employment but who will experience periods out of employment. Most employers and employees pay 'Pay Related Social Insurance (PRSI) contributions' into the national Social Insurance Fund when in employment and for this employees receive benefits for the periods spent out of employment. Most notably, the SIF provides insurance to people in retirement and to those in periods of unemployment, illness leave and maternity leave. In general, the payment of social insurance is compulsory for those in the workforce. In the medium to long-term pension related expenditure is expected to become the predominant component of Fund expenditure, reflecting the ageing of the population. This issue is explored further in Chapter 2.

The Social Insurance Fund, has evolved over many years. The initial legislation for a contributory based insurance scheme in Ireland actually pre-dates the foundation of the State, with the enactment of the National Insurance Act. The Social Insurance Fund itself, as it currently stands, came into operation in 1953 following a merger of three previously established contributory funds. This section will outline the legislative basis for the current operation of the Fund, and in turn the basis of its administrative arrangements.

The Social Welfare Act 1952 created a unified fund called the Social Insurance Fund. There had previously been a number of different funds with different controlling bodies which focussed on particular cohorts within society, however the SIF brought these together. In addition, the Act provided that the Fund be administered by the Minister for Social Welfare (now the Minister for Social Protection). The Fund operates at present under the terms of the Social Welfare (Consolidation) Act 2005. Under section 9 of this Act, the Fund comprises a current account, managed by the Minister for Social Protection, and an investment account, managed by the Minister for Finance.

Sums payable out of the Fund come from the Current Account and any surplus is contained in the Investment Account. The income of the Fund is mainly made up of the Pay Related Social Insurance (PRSI) contributions of employees (including self-employed people) and employers. If there is a shortfall in these contributions which leads to a shortfall in the current account, the balance must be made up from the Investment Account in the first instance and otherwise from funds provided by the Exchequer through a subvention. Unlike the contributions of the first two parties which are fixed by law, the State's contribution is a "residual" one designed to make up whatever shortfall may arise between the Fund's income and outgoings.

Figure 1: Flow chart of SIF Income



1.2 Current operation of the Social Insurance system

Figure 2 below details the manner in which the PRSI system operates currently, and identifies five key Government bodies that interact with it. Changes to PRSI have always been seen in the context of income tax policy. While legislation regarding PRSI is the responsibility of the Minister for Social Protection, the Minister for Finance sets PRSI policy. When the Department of Finance (DOF) was split and the Department of Public Expenditure (DPER) and Reform established in 2011, the role of each Department was reflected in changes to legislation stating how regulations would be made in relation to PRSI changes. Such regulations are made by the Minister for Social Protection subject to the consent of the Minister for Finance given after consultation by the Minister for Finance with the Minister for Public Expenditure and Reform. The role for each Minister can be seen to reflect responsibility for the Fund (MSP), responsibility for the policy (MOF) and the impact of PRSI Income on voted expenditure (MPER).

In terms of the annual Budget cycle, PRSI changes are brought by the Minister for Finance to Government for decision. PRSI changes are announced by the Minister for Finance and published in the Budget book – they do not form part of the DPER Expenditure Report.

The role of collecting PRSI income lies with the Revenue Commissioners, acting as a collections agency for the Department of Social Protection (DSP), for which they receive a payment (€37.4 million in 2015).

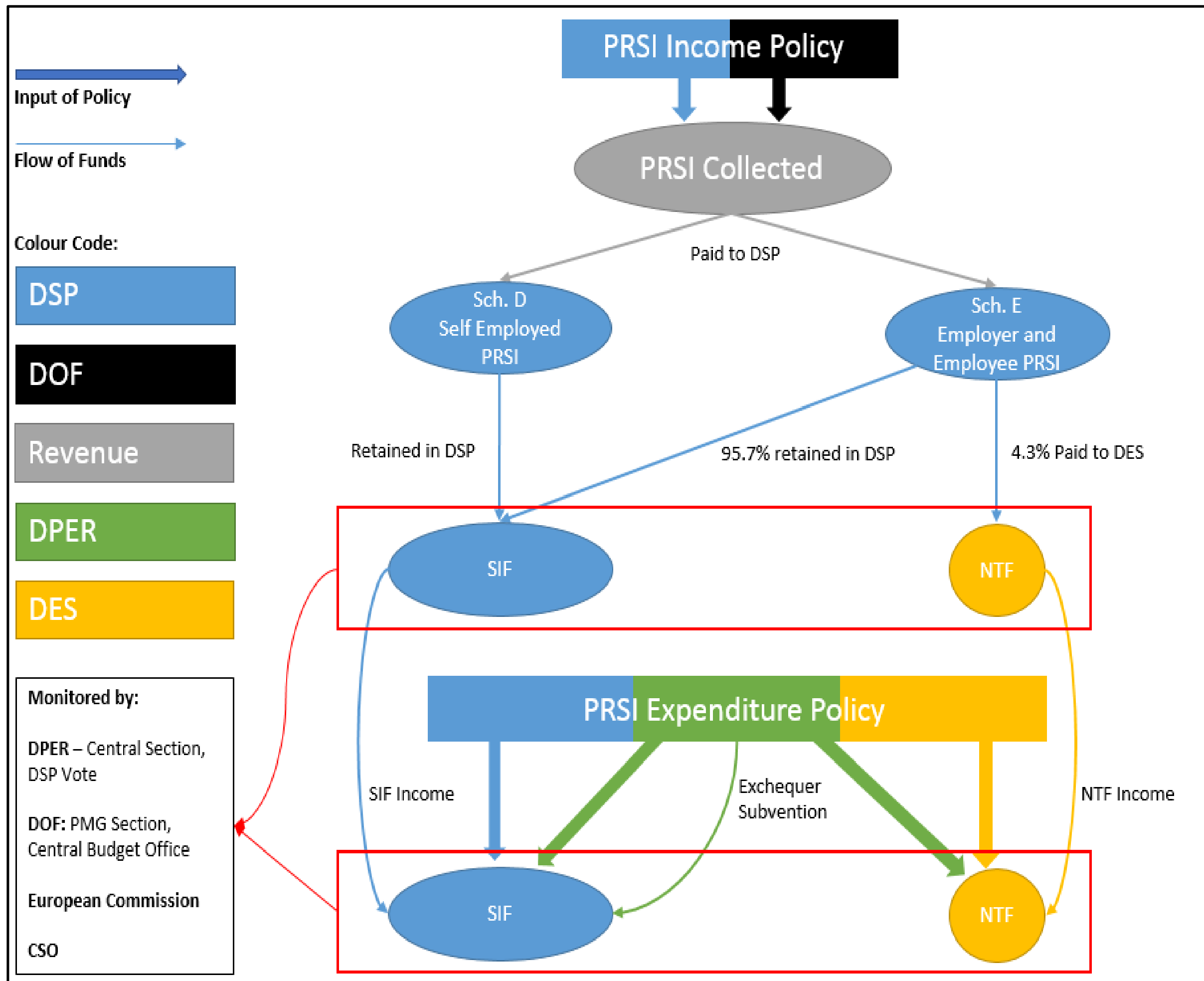
The receipts collected by Revenue are then paid over to the Department of Social Protection, who split the receipts between the Social Insurance Fund and the National Training Fund (NTF). An element of the employers PRSI receipts are paid over to the Department of Education and Skills (DES), who administer the NTF. In total, 4.3% of all Schedule E PRSI receipts[1] are paid over to the NTF with the remainder of the receipts paid to the SIF. All the Schedule D (Self-Employed) PRSI receipts go directly into the SIF also.

The expenditure policy for the Social Insurance Fund is agreed by the Departments of Social Protection and Public Expenditure & Reform as part of the annual Budget and Revised Estimates (REV) processes. A similar process is in place between DPER and DES regarding the expenditure from the NTF. In the past few years, the SIF has required additional funding by way of an Exchequer Subvention to meet funding shortfalls. This amount is typically agreed by DPER and DSP as part of the above processes and forms part of voted expenditure in the Department of Social Protection.

In addition to the policy and funding aspects of administrating the SIF and NTF, there are considerable monthly monitoring requirements throughout the annual cycle. Each month, there is a requirement to detail all PRSI income to two sections in each of DPER and DOF as shown in Figure 2 below. In addition, this data is then provided to the CSO and the European Commission to satisfy council directives.

[1] All Income Tax and PRSI receipts from employment are Schedule E receipts. For PRSI purposes, this involves receipts from employers and employees on behalf of the employees.

Figure 2: Flow chart of policy and funding of the SIF and NTF



1.3 Developments in the UK

The country with the most similar insurance fund is the UK. There have been many reports of the UK taxation system which involved looking at their National Insurance Fund. The report of most relevance to the administration of the National Insurance Fund was the Taylor Report 1998. This report looked at the how the British tax and benefit system could be modernised to improve work incentives and drew some conclusions for the administration of the National Insurance Fund.

The Taylor Report

In 1998, a task force chaired by Martin Taylor (then chief executive of Barclays Bank), published a report entitled '*The Modernisation of Britain's Tax and Benefit System*'. The task force was set up to examine the interaction of the tax and benefits systems. This group looked at how to promote work incentives, reduce poverty and welfare dependency, and strengthen community and family life. The Report made the general case for reforming the tax system to improve the benefits of work for those on low incomes. In particular, they argued for closer alignment between the taxation system and the national insurance system for the benefit of employers and employees. They recommended that the thresholds for National Insurance Contributions should more closely match those for Income Tax and this could be achieved through the control of operations and policy for National Insurance merging with the body that controls Income Tax operations and policy. Following this, the Contributions Agency, then under the direction of the Department of Social Security (now the Department of Work and Pensions), merged with the Inland Revenue (now HM Revenue & Customs) in 1999. The unit within HMRC was renamed the National Insurance Contributions Office. The office deals with all aspects of National Insurance contributions, notably keeping records of all credits.

As a result of this, there were significant changes over the next three Budgets to the National Insurance system in respect of thresholds. The Government introduced a single flat rate of Employers Contributions to replace the system of graduated rates that had been in place up to then. The lower earnings limit at which both employers and employees begin to pay contributions was aligned with the threshold at which they start paying tax. In addition, there were administrative improvements for employers through

only dealing with one body in respect of both contributions and taxation policy, namely the HMRC.

The changes in the UK illustrate the potential for significant reform of the SIF. The UK reforms acknowledged at a broad level the interactions between Income Tax and Social Insurance and made a case for aligning thresholds and amalgamating collection agencies. There is a case for considering treating PRSI collection more like a tax receipt for vote management purposes given its connection with Income Tax. Not only would this allow for more transparent and manageable expenditure policy system but as evidenced in Britain, it would allow income policy-makers the opportunity to consider the impacts that these at-source deductions are having on businesses, to allow them to simplify the taxation/social insurance system in Ireland.

2. Analysis

This section will present the justification for simplifying the administration of the SIF. Primarily it will focus on the issues of transparency, complexity and future funding, while also addressing the interaction with the Contributory Principle and identifying reforms from other jurisdictions which may be of relevance to Ireland.

2.1 The appropriateness of non-voted aspects impacting on the voted process

Impact of the SIF on Voted Expenditure and need for Supplementary Estimates

As mentioned in section 1.1, there is a necessity for an exchequer subvention to the SIF if the expenditure exceeds the income. The subvention is provided from the Social Protection Vote, as the Minister for Social Protection administers the Fund. In the past number of years, an estimate for the subvention to the SIF has been included in the voted allocation for the Department of Social Protection. This means that containing expenditure within the voted expenditure allocation, as set out in the REV, is highly dependent on the SIF income collected in that year. To illustrate the impact that the SIF income can have on achieving the allocation, we will look at the comparison between the Voted and Total DSP expenditure outcomes against profile over the past 11 years (See Figure 3 and Appendix 1).

The necessity for a supplementary estimate is based on the Net Vote position; if the net voted expenditure is over profile then a supplementary estimate is required by vote through the Dáil. On three occasions in the past 11 years, DSP have required a supplementary estimate, in 2008, 2010 and 2012. These years are circled in black in the figure below and the supplementary estimates[2] correspond to the years where voted expenditure (the blue columns) were above profile. On these occasions, there was a significant net overspend when compared to the profile. However, we see that the total DSP expenditure variance from profile (the orange line) has differed markedly from the vote position from 2007 onwards. There was an overspend on total DSP expenditure in

[2] The level of the supplementary estimates required were estimated around a month before the end of the year. These estimates consequently have an element of contingency built in.

five years out of the last eleven, in 2007, 2008, 2011, 2012 and 2014. Despite this, in only two of those years was a supplementary estimate required, in 2008 and 2012. In the other three years there was no need for a supplementary estimate as the vote spend was under profile due to better than expected SIF income. The figure below highlights the three years with red circles. Conversely, there was a supplementary estimate in 2010 despite the total departmental spend being under profile (as highlighted below with a blue circle), which was due to SIF income performing well below profile.

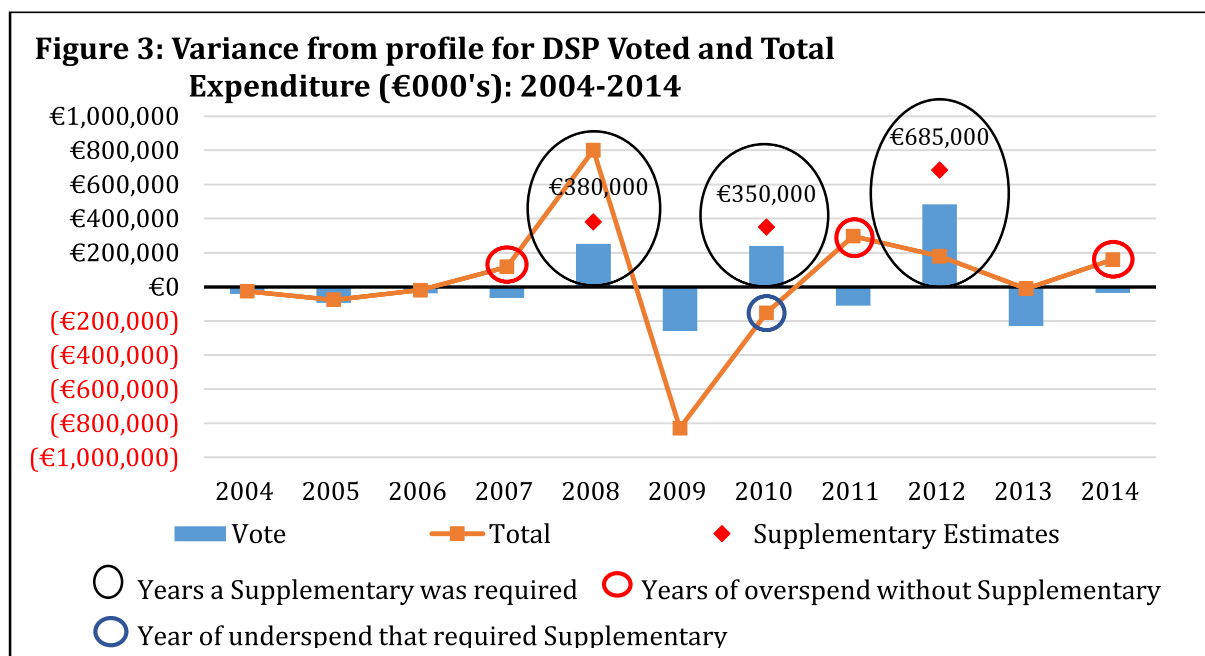


Figure 3: Variance from profile for DSP Voted and Total Expenditure (€000's): 2004-2014

Source: Appropriation Accounts 2004-2013; Provisional Outturns 2014

The large variances in performance between the total and voted position has added much complexity to the management of the Social Protection Vote. On one hand, the expenditure ceilings for each Department are set on <u>a total expenditure basis</u> and, as pointed out above, DSP have exceeded these ceilings on 5 occasions in the period shown. However, only when the voted expenditure is exceeded does the Department require the Dáil to vote on a supplementary estimate. It could be argued that this has contributed to less visibility within the Dáil around the total spending of the Department in the past 7 years and there have been cases where this could be seen as both advantageous and disadvantageous for the Department. The Department was helped in 2007, 2011 and 2014, where they avoided the need for a supplementary estimate despite overspending and they were hampered in 2010 when the Department needed a supplementary

estimate despite underspending. A situation where such a large part of the funding for Social Protection comes through the SIF income system, which is not subject to a Dáil vote, is less than optimal. The SIF is projected to compose 43% of total DSP spend in 2015.

2.2 The Complexity of managing SIF Income within Voted Expenditure

This section illustrates how the SIF interaction with voted Social Protection expenditure is a complex one.

1. The annual reclassification of tax and PRSI receipts from employers can result in artificially high or low allocations to the SIF which impact on DSP's net voted expenditure.
2. Recent Labour Market Fluctuations – here it is illustrated how DSP's voted expenditure is currently affected by labour market fluctuations which impact on both scheme expenditure and PRSI receipts i.e. have a dual impact on DSP voted expenditure management.

Annual Reclassification of receipts

In February of each year, Revenue undertake a reclassification exercise once the annual P35 forms (employer returns) are submitted. This exercise ascertains whether the correct amounts were allocated to Income Tax/USC and PRSI from the tax returns in the previous year. This can result in a substantial amount being reclassified from PRSI into Income Tax (or vice versa) in the current year in respect of a previous year. In the past couple of years PRSI receipts have benefitted in the region of €60 to €80 million in February, however there is still confusion as to whether these are PRSI receipts being reclassified from Income Tax/USC into PRSI in 2014 and 2015. However, it is noticeable in February each year that there is this large variance of receipts against profile which can have significant impact on the annual PRSI income. In addition, once-off issues can arise when P35 forms are examined as happened in 2012 when it came to light that significant policy changes made in the early years of this decade caused a significant disruption to the level of PRSI receipts.

In 2010, a significant reform of the Irish taxation system was announced with the introduction of the Universal Social Charge (USC) with effect from 2011. This charge differed in rate, threshold and composition from the existing charges in place at that time. The USC replaced the long standing Health Levy and the recently introduced Income Levy. The Health Levy income went directly to the Department of Health and was collected as part of the 'Pay Related Social Insurance' (PRSI) income, while the Income Levy was introduced in 2009 as an addition to the Income Tax system. Subsequently, in 2011, more PRSI income was collected than was expected.

This was largely explained in early 2012 when Revenue identified the need to reclassify an amount of €300m previously classified as PRSI in 2011 as income tax/USC in 2012 (i.e. €300 million of the 2012 PRSI Income was reallocated as Income Tax to offset the over-payment to PRSI in 2011). This was attributed to employer confusion around the classification of USC as either part of income tax or PRSI, which is understandable given that the USC was made up of former income tax and PRSI elements. This had considerable implications for the Social Protection Vote in 2011 and 2012, with the large overspend in 2011 being completely offset by the artificially high PRSI income in that year, while 2012 voted expenditure was overstated due to the higher subvention required to offset the artificially low PRSI income in that year.

Recent Labour Market Fluctuations

In 2008, the Irish economy underwent a massive shock following the global financial crash. The labour market was impacted almost immediately due to the collapse of the construction sector. At its peak of employment in Q2 2007, the construction sector had employed almost 274,000, while the numbers employed in this sector dropped by 178,000 to 96,000 by early 2013. The numbers employed in other areas of the economy also reduced dramatically over these years.

The economic crisis and the consequent sharp rise in unemployment had a hugely negative impact on the direct and indirect tax take between 2008 and 2013. On the expenditure side, the increase in unemployment caused greater reliance on the welfare system through expenditures on Jobseekers schemes in particular. Between 2008 and 2010, expenditure on Jobseekers doubled from €2 billion to €4 billion, while PRSI income

decreased by around €1.5 billion. As mentioned in section 2.2, the fall in employment also had a huge impact on the SIF income and by association the position of the Social Protection Vote. For those years between 2008 and 2012 in particular, the falls in employment and the increases in unemployment were extremely difficult to forecast considering the scale of the collapse in 2008 and 2009, and the uncertainty around whether or when the situation would improve. This had a dual impact on the Social Protection Vote given the likelihood of both reduced income to the SIF and increased expenditure on Jobseekers schemes in these years. This makes the wide variations between Total and Voted expenditure as shown in Figure 3 above easier to comprehend. The position of the labour market has stabilised now and this makes it easier to project both SIF income and Jobseekers expenditure. Nevertheless, the potential for a double impact on the Social Protection Vote, in the case of a labour market shock, remains and this is a source of concern.

2.3 The increasing State contribution to the funding of the SIF

The State contribution, or the subvention to the SIF, has varied considerably over time. In the initial years of the SIF, the State contributions formed a significant part of total expenditure. In the first full year of the SIF between April 1953 and March 1954, the subvention amounted to 41% of total SIF expenditure (State subvention of €4.5 million out of the total SIF spend of €10.8 million). The subvention percentage remained around the high 30's for much of the 1950s and 1960s. The subvention to the SIF decreased significantly through the next couple of decades, primarily due to increasing the PRSI contribution rate for employees and employers.

By the 1990s, the subvention to the SIF was consistently below 10% of total SIF expenditure. For the first time since its establishment, the fund ran a surplus of income over expenditure in 1997, which continued until 2007. A significant balance had built up in that 11 year period, reaching around €3.6 billion by the end of 2007. The balance would have been higher, at around €4.2 billion, except that €635 million was taken out of the fund in 2002 and given to the Exchequer. This was in response to the global downturn in 2001/2002.

The main drivers of this surplus were the strong underlying labour market conditions prevailing at the time, with employment growing significantly from the lows of the 1980s and early 1990s, and the addition of certain groups in the mid-1990s into the Social Insurance system (such as the Self-Employed in 1994 and greater contributions from Public Servants since 1995[3]). Since 2008, the Fund has been in deficit with Exchequer subventions required in every year since 2010. The most recent subvention in 2014 amounted to 6.5% of total SIF expenditure (Table 1 below contains details of the SIF position from 2004 to 2014).

Table 1: SIF Surplus/Deficit and Exchequer Subventions 2004-2014

Year	Income	Expenditure	SIF Surplus/ Shortfall	Taken from Balance in SIF Investment Account	Subvention drawn from Exchequer	% of Spend from Exchequer funding
	€000	€000	€000	€000	€000	%
2004	5,649,219	5,272,854	376,365			
2005	6,158,629	5,663,436	495,193			
2006	6,974,325	6,325,554	648,771			
2007	7,833,069	7,251,438	581,631			
2008	8,144,410	8,399,745	(255,335)	255,335		
2009	7,304,096	9,746,838	(2,442,742)	2,442,742		
2010	6,717,773	9,462,751	(2,744,978)	890,345	1,854,633	**19.6%**
2011	7,543,883	9,004,245	(1,460,362)		1,460,362	**16.2%**
2012	6,785,558	8,869,567	(2,084,009)		2,084,009	**23.5%**
2013	7,309,275	8,619,830	(1,310,555)		1,310,555	**15.2%**
2014	7,872,271	8,417,833	(545,562)		545,562	**6.5%**

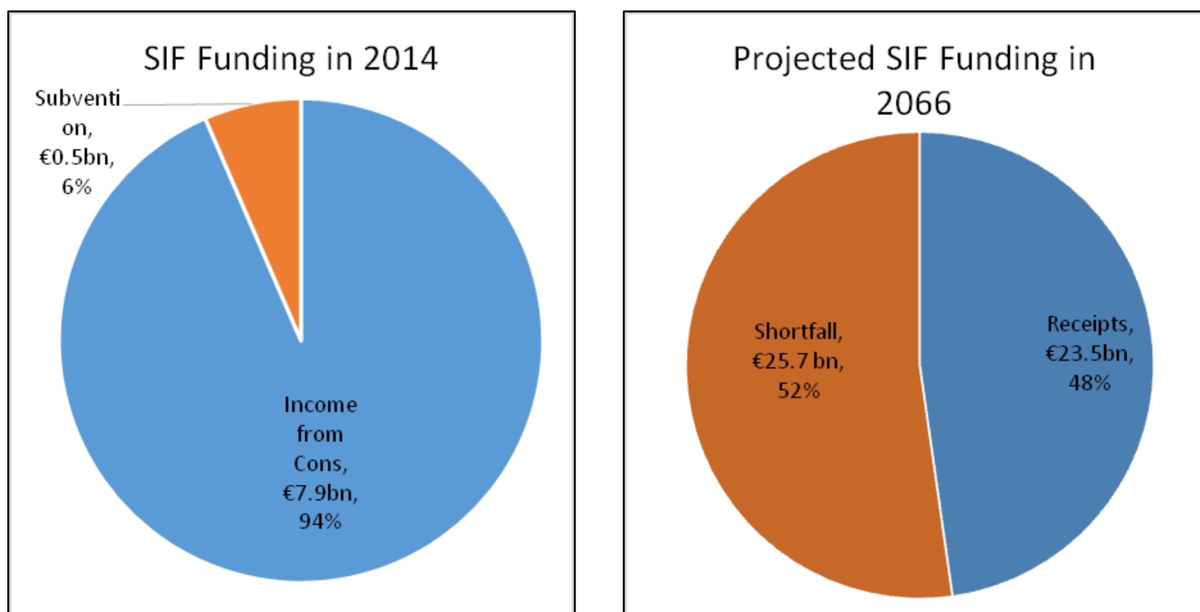
Source: Appropriation Accounts 2004-2013; Provisional Outturns 2014

[3] New contribution arrangements were set up for employees entering the Public Service after April 6th, 1995. The new Public Servants would pay Class A contributions at 4% of their weekly earnings, the same as private sector employees, and for this they would receive the majority of insurance benefits available within the SIF, most notably the State Pension (Contributory) payment. Public Servants hired before April 6th, 1995 would remain paying Class B contributions of 0.9% of their weekly earnings and would only be able to avail of limited insurance benefits, not including the State Pension (Contributory) payment. See Appendix 2 for the range of PRSI classes.

Findings from the Actuarial Review of the Social Insurance Fund 2010

An actuarial review of the Social Insurance Fund was undertaken in 2012. Under the Social Welfare Consolidation Act, 2005, these reviews must take place every five years and they are intended to look at the long-term funding of the SIF. The most recent review looked at the funding projections out to 2066. The review indicates that in the absence of any action to tackle the shortfall, the excess of expenditure over income of the Fund will increase significantly over the medium to long term. In summary, the 2011 deficit of €1.5bn is projected to double to €3.0bn by 2019 and to have increased to €25.7bn by 2066. The figure below show the expected change between the current subvention and the projected subvention as detailed in the Actuarial Review, with the subvention increasing from 6% of all SIF funding in 2014 to 52% in 2066.

Figure 4: Share of funding required for the Social Insurance Fund 2014 and 2066



Source: The Department of Social Protection and KPMG Actuarial Review of the SIF

Expressed as a % of GNP, the shortfall is projected to increase from 1.1% of GNP in 2011 to 2.0% in 2019 and further increase to 6.4% in 2052 before gradually reducing to 5.7% by 2066. The report found that in the medium to long term, pension related expenditure is projected to become the predominant component of Fund expenditure, rising from 57% in 2011 to 85% in 2066. The significant increase in pension-related expenditure is attributable to Ireland's rapidly altering population structure and in particular the large

rise in the over 65 population which is projected to increase from 11% of the total population in 2010 to 15% in 2020 and further to 24% in 2060[4].

One of the benefits of the Social Insurance Fund at present is the idea of intergenerational solidarity in the manner in which the fund operates. Those of working age pay into the fund now to cover the pension provisions of those who paid into the fund in the past. Similarly, those of working age who pay into the fund now can rely on the next generation to cover their pension provisions. However, as the actuarial review points out, by 2050 the working age contribution will cover less than 50% of the total cost of the SIF, which will be made up of mainly State Pensions payments by then. It can be argued that there will still be an element of intergenerational solidarity in place as the working age population will be covering the costs of the pension aged population, but mainly through the taxation system rather than the social insurance system.

2.4 Erosion of the Contributory Principle

The UK Beveridge Report, *Social Insurance and Allied Services*, published in 1942, gives a clear description of the contributory principle. The Report's plan for social security is detailed as first and foremost a plan of insurance, whereby the insured would "give contributions in return for benefits up to subsistence levels, as of right and without means test, so that individuals may build freely upon it" (Beveridge, 1942: para 10).

The plan for funding is similar to that put in place for the SIF, in that the Report argued that general taxation should meet part of the cost of any such insurance scheme, along with contributions from the individuals and employers. The Report summarised the case for funding from individual contributions as being that "the insured persons themselves can pay and like to pay, and would rather pay than not do so. It is felt and rightly felt that contribution irrespective of means is the strongest ground for repudiating a means test" (Beveridge, 1942: para 274 (i)). On the next part of the funding, the Report argued for levying contributions on employers as well as on employees and taxpayers as an

[4] The core results in this review are calculated on the basis of the EUROPOP 2010 population projections (with an adjustment for mortality rates, reflecting greater anticipated increases in life expectancy) and overlaid with the population data from Census 2011.

employer's contribution should be "regarded as a proper part of the cost of production, maintaining the labour force that is necessary both when it is actually working and when it is standing by" (Beveridge, 1942: para 276). Thirdly, it was suggested that taxation should contribute as the wealthier should pay more for the general purposes of the community and this would provide an element of redistribution.

There is much evidence to suggest that the Contributory Principle has been significantly weakened in Ireland since the SIF was set up. There has been significant growth in the use of means-tested schemes since the post-World War II period, which means less of the social security expenditure goes to schemes based on contributions. In Ireland, only 40% of welfare expenditure went to contributory based schemes in 2014, a majority of which was due to the State Pension (Contributory) scheme. In recent years, Ireland has weakened the relationship between contributions and benefits through the following measures:

1. Reduction of the duration on Jobseekers Benefit from 15 months to 9 months.
2. Reduction of duration on Illness Benefit to 2 years.
3. The change in payments of State Pension (Contributory) based on average contributions.
4. The removal of the last earnings related payment in the Maternity Benefit scheme.
5. Reductions and abolitions of treatment benefits and elements of the Household Benefits Package.

This all signifies the weakening relationship between the contributions that are paid in and the benefits that come out of the Social Welfare system as a whole. This issue was also highlighted by the OECD in their Review of the Pensions System in Ireland (http://www.welfare.ie/en/downlods/OECD-Review-of-the-Irish-Pensions-System.pdf)

There is still merit in retaining a contributory element within the Irish social welfare system, especially for pensions, but it is not necessary to keep all the contributions and related benefits within a separate fund. The total Department of Social Protection spend should be acknowledged as part of voted expenditure while retaining the contributory element for certain benefits (as currently covered by the SIF) within that voted

expenditure. The income raised from PRSI could then be used to supplement income from other forms of taxation and form part of the Exchequer funding.

3. Conclusion and Recommendation

Section 2 points out the considerable impact the SIF has on the management of expenditure of the Social Protection Vote. Firstly, it has a big impact on Social Protection voted expenditure and has caused the vote and total expenditure outturns to vary considerably in the last 6 years. In fact, there were five occasions where the Department overspent in gross terms but only required a supplementary estimate for two of these occasions. The opposite was true on one occasion, where the Department actually underspent in gross terms but required a supplementary estimate as SIF income had been under profile. This leads us to question the appropriateness of including a non-voted fund as part of the voted process, given that the Fund forms 43% of all DSP expenditure in 2015.

Secondly, the cyclical nature of SIF income means that the Social Protection Vote is doubly impacted by periods of cyclical unemployment. This adds complexity in estimating the levels of SIF receipts and Jobseekers expenditure during periods of labour market instability and can lead to large variations between estimated expenditure and the outturns of the voted and total spend. In addition to this, the reclassification of funds each February makes it more complex to accurately estimate SIF receipts and a big variance from expectations has a knock-on impact on the Social Protection Vote.

Finally, it must be noted that the SIF has been in deficit for most of its existence since 1953, with a small 11-year window where it was in surplus. The review of the SIF indicates that, long-term, the subvention to the SIF from the Exchequer will increase substantially as a result of the growing numbers of people who will become reliant on the State Pension (Contributory) scheme. The merit in sustaining the structure of a distinct fund where the majority contributor is the Exchequer is questionable.

What has been quite notable in drafting this paper is that while the UK has been very active in considering taxation and national insurance reform, Ireland has produced very few papers looking at similar reforms. Serious consideration should be given to setting up a review group for the Social Insurance Fund. The membership of such a group should contain experts from all the relevant government departments with a vested interest in

social insurance, external experts from organisations such as the OECD and experts from academia.

For the purposes of this paper and from considering the UK recommendations and subsequent reforms in section 2.5, there is merit to looking at how the Social Insurance Fund operates currently and its interaction with the taxation system.

This paper recommends that the SIF income element should be separated from within the Social Protection Vote and aligned with Income Tax collections. This paper has made the case that PRSI income is closely aligned in terms of collection to Income Tax and the USC as things stand, in that all are collected by Revenue and taken directly from source; and, as experienced in 2012, the correct split of collections between the three may not be fully clear until February the following year.

While the payments made from the SIF should remain as part of DSP's expenditure, the operation and policy for PRSI income should be moved to the control of Revenue and the Department of Finance. This would mean that SIF income (and broadly all PRSI income) would be managed as part of general taxation receipts within the Department of Finance. The Department of Social Protection expenditure allocation as voted would represent the actual expenditure of the Department and not a net figure which excludes most, if not all, SIF expenditure. Figure 6 below updates Figure 3 but shows the supplementary estimates that would have been required if the SIF income element had not been part of the Social Protection Vote. The indicative values are noticeably different from the actual Supplementary values that were voted on at the time.

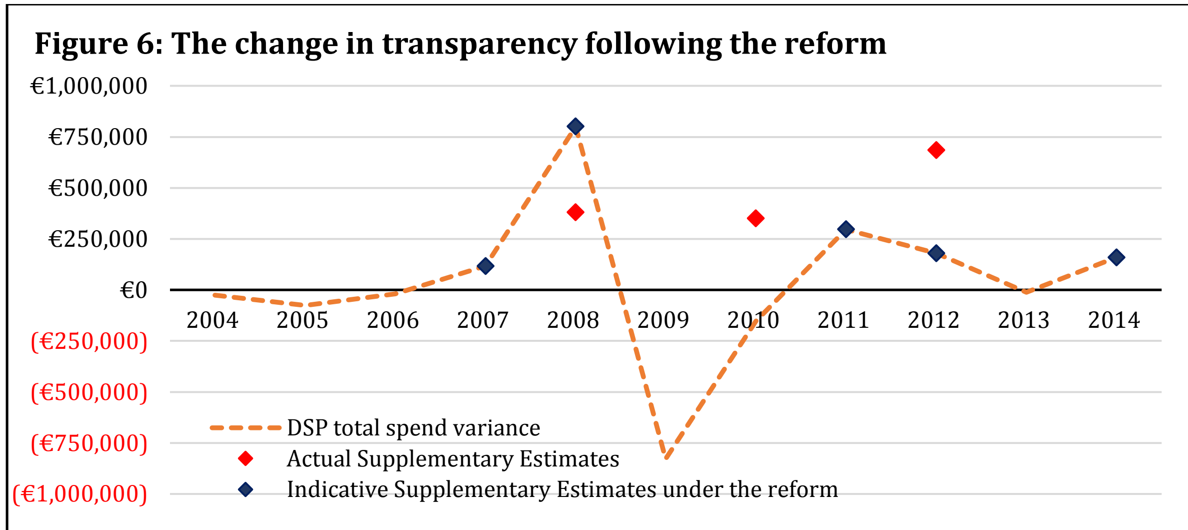
Therefore, the **advantages of this reform** would be that:

i) It would simplify the management of expenditure on the SIF and Social Protection Vote;

ii) It would remove the double impact of cyclical variations on the Social Protection Vote;

iii) It would allow for clearer management of income and expenditure given that a significant element of Government income would now be included with other sources of income rather than an offset in expenditure; and

iv) It would bring together PRSI and Tax policy and support the process of simplifying the system as a whole.



Issues to acknowledge when considering such a reform

There are a number of issues arising from this proposal which would require further consideration. However, the proposal articulated here provides a basis for advancing a discussion on reform aimed at addressing the identified flaws in the current system. It would be envisaged that this would be among the options for discussion by a review group of the Social Insurance Fund, for example.

1. The main potential concern associated with this proposal is the undermining of the contributory principle, with the income from contributions being separated from the expenditure linked to those contributions. However, it is possible to retain the contribution record without necessarily housing the income and expenditure in one fund. For example, it should be feasible for the income to remain with Department of Finance and administrative arrangements put in place to communicate contribution record information to DSP for benefit entitlement/payment purposes.

2. There would have to be similar operational changes to the National Training Fund (NTF) which is also funded from PRSI receipts. This is a smaller fund under the operation of the Department of Education and Skills (DES) which provides training opportunities to the unemployed and is funded by Employer PRSI receipts. This proposal would obviously have to be considered by the DES.

3. There would be considerable legislative change needed to bring about this reform. As discussed in Section 1, the Social Welfare (Consolidation) Act 2005 provides the current legislative basis for the SIF but legislation would have to be enacted to move control of all PRSI income to the Minister for Finance.

4. Considerable engagement with all stakeholders would be required, including not only the relevant Government Departments, but also, for example, the CSO (regarding possible impacts on the National Accounts) and the European Commission (due to data requirements and how this change would affect the Stability and Growth Pact).

5. The feasibility of using any SIF surpluses for investment purposes could be examined in this context.

6. Resource and cost implications, including from an administrative perspective would need to be fully explored.

Appendix 1: Net and Gross DSP expenditure 2004 – 2014

Table 2: Net DSP Expenditure vs. Estimate

	REV	Outturn	Over/Underspend	Supplementary Estimates
2004	€5,999,368	€5,959,200	**(€40,168)**	
2005	€6,533,952	€6,441,123	**(€92,829)**	
2006	€7,215,246	€7,177,180	**(€38,066)**	
2007	€8,245,135	€8,181,274	**(€63,861)**	
2008	€9,075,847	€9,328,040	**€252,193**	**€380,000**
2009	€10,917,009	€10,658,512	**(€258,497)**	
2010	€12,920,168	€13,159,326	**€239,158**	**€350,000**
2011	€13,427,412	€13,317,604	**(€109,808)**	
2012*	€13,397,935	€13,881,765	**€483,830**	**€685,000**
2013	€13,085,237	€12,855,614	**(€229,623)**	
2014	€11,856,900	€11,820,920	**(€35,980)**	

Table 3: Gross DSP Expenditure vs. Estimate

	REV	Outturn	Over/Underspend	Supplementary Estimates
2004	€11,275,508	€11,249,405	**(€26,103)**	
2005	€12,198,806	€12,122,583	**(€76,223)**	
2006	€13,540,293	€13,521,451	**(€18,842)**	
2007	€15,334,728	€15,451,435	**€116,707**	
2008	€16,951,529	€17,752,541	**€801,012**	**€380,000**
2009	€21,271,322	€20,443,390	**(€827,932)**	
2010	€20,959,799	€20,807,376	**(€152,423)**	**€350,000**
2011	€20,620,205	€20,917,160	**€296,955**	
2012	€20,546,724	€20,726,652	**€179,928**	**€685,000**
2013	€20,243,447	€20,232,621	**(€10,826)**	
2014	€19,603,500	€19,763,038	**€159,538**	

Appendix 2: List of PRSI Classes and Benefits

Class A	Employees in industrial commercial and service –type employment with gross earnings of €38 or more a week, civil and public servants recruited from 6 April 1995 and Community Employment workers from 6 April 1996.
Class B	Permanent and pensionable civil servants, doctors and dentists employed in the civil service and Gardaí, recruited before 6 April 1995.
Class C	Commissioned Army Officers and members of the Army Nursing Service recruited before 6 April 1995.
Class D	Permanent and pensionable employees in the public service, other than those mentioned in Classes B and C, recruited before 6 April 1995.
Class E	Ministers of religion employed by the Church of Ireland Representative Body.
Class H	Non-Commissioned Officers and enlisted personnel of the Defence Forces.
Class J	Employees in industrial, commercial and service-type employment with gross earnings of less than €38 a week.
Class K	People who pay only the Health Contribution on their income such as occupational pensions, income from employment of certain office holders (for example judges and State solicitors) and income of people aged 66 to 70 previously liable for Class S.
Class M	People who do not pay PRSI, for example, employees under age 16 and people within Class K who do not pay PRSI (medical card holders, widows and widowers, people aged 70 or over).
Class P	Self-employed people whose main income comes from share fishing.
Class S	Self-employed people such as farmers, certain company directors, sole traders and people with income from investments, rents and maintenance where the income is €3,174 or more a year from all sources.

Benefit	Class A	Class B	Class C	Class D	Class E	Class H	Class J	Class P	Class S
Adoptive Benefit	✓				✓	✓			✓
Carer’s Benefit	✓	✓	✓	✓	✓	✓			
Guardian's Payment Contributory	✓	✓	✓	✓	✓	✓			✓
Health and Safety Benefit	✓				✓	✓			
Illness Benefit	✓				✓	✓		✓	
Invalidity Pension	✓				✓	✓			
Jobseekers Benefit	✓					✓		✓	
Maternity Benefit	✓				✓	✓			✓
Occupational Injuries Benefit	✓	✓		✓			✓		
Retirement Pension	✓				✓	✓			
State Pension Contributory	✓				✓	✓			✓
Treatment Benefit	✓				✓	✓		✓	
Widow/er’s and Surviving Civil Partners Pension Contributory	✓	✓	✓	✓	✓	✓			✓

Appendix 3: The Evolution of the Irish Social Insurance system

Pre – 1921: Prior to the foundation of the State, the British social welfare system in general applied in Ireland. The concept of Social Insurance in Ireland was initiated with the National Insurance Act, 1911. This Act set up the key components of what was to become the Social Insurance Fund. Part I of the Act focussed on the introduction of health related benefits such as sickness benefit, disablement benefit, maternity benefit and treatment benefit, while Part II introduced unemployment benefit. These benefits were paid for by contributions from employees, employers and state subvention. The rationale for introducing sickness benefits and unemployment benefits concurrently was that these schemes covered both those who were 'capable of work' and 'incapable for work'. There were concerns about "strong temptation for unjustified claims" if one of these benefits were given priority over the other[5].

1922 – 1944: During this period, significant work was done in identifying the cohorts in society where social supports were still weak. The main report in this time was the Report of the Poor Law Commission, which was published in 1927. This report recommended the introduction of 'Mothers' Pensions' payable by the State. In 1935, a social insurance widow's and orphan's pension scheme was introduced to cover those families impacted by a father's death. The intention was primarily to set up an insurance scheme. However, due to the limited proportion of the male population of insurable age actually covered by social insurance, the scheme also provided a means-tested pension.

1945 – 1960: The UK Beveridge Report, *Social Insurance and Allied Services*, which was published in 1942, led to much debate here around its recommendations and their relevance to Ireland. Subsequent to this, in 1947 the Department of Social Welfare was established with the aim of improving the efficiency of the social welfare schemes already in operation. During this period, the biggest reform was provided for in the Social Welfare Act, 1952. This legislation established the Social Insurance Fund, into which all contributions were paid and out of which all insurance payments would be made. This replaced the three main schemes then in existence (up to that point there had been

[5] Clarke, Omre; *The National Insurance Act, 1911*; London, 1912.

separate schemes covering unemployment benefits, health benefits and the widow's and orphan's pensions).

1960 – 1979: This represented a period of expansion of the coverage provided by the social insurance system. The Contributory Old Age Pension was introduced in 1961 which meant people could gain a State Pension at age 70 based on contributions alone without the need for a means test. It is interesting to note that the comparable scheme had been introduced in the UK in 1925. In 1967, a compulsory occupational injuries scheme was introduced, which insured against injuries or illnesses suffered while at work. This was followed by the introduction of the retirement pension in 1970 whereby those insured could receive payment at age 65. The Invalidity Pension was introduced in 1970 for those in need of long-term illness related income supports. Finally, the Deserted Wife's Benefit was introduced in 1973 for women who had been deserted by their husbands. In addition to the setting up of new schemes, there were significant policy changes impacting on the Fund in this period. In 1974, social insurance was extended to cover all private sector employees and the eligibility age for the State Pension was reduced from 70 to 66 years between 1973 and 1977.

1980 – Present: A new pay-related Maternity Allowance scheme was introduced in 1981. In terms of policy changes the social insurance system was extended to the self-employed in 1988 and to part-time workers in 1991. In addition, the social welfare code was amended in this period to take account of an EU Directive on equal treatment for men and women in matters of social security. This led to the Widow's Contributory Pension being broadened to include widowers in 1994. In 2011, the welfare system was reformed to ensure that those in civil partnerships were treated equally to married people. In terms of development of social insurance, the main focus has been on rationalising existing schemes in the most recent period. Appendix 1 contains the list of PRSI classes currently in operation in Ireland, with the description of the cohorts they cover.

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