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Budget 2013: How Should We Deal with the Deficit in the Social Insurance Fund?

Key Point

The emerging deficit in the Social Insurance Fund does not imply that the only choice is to either increase PRSI contributions or reduce benefits. There is no reason why a contribution from general taxation should not be considered.

Context

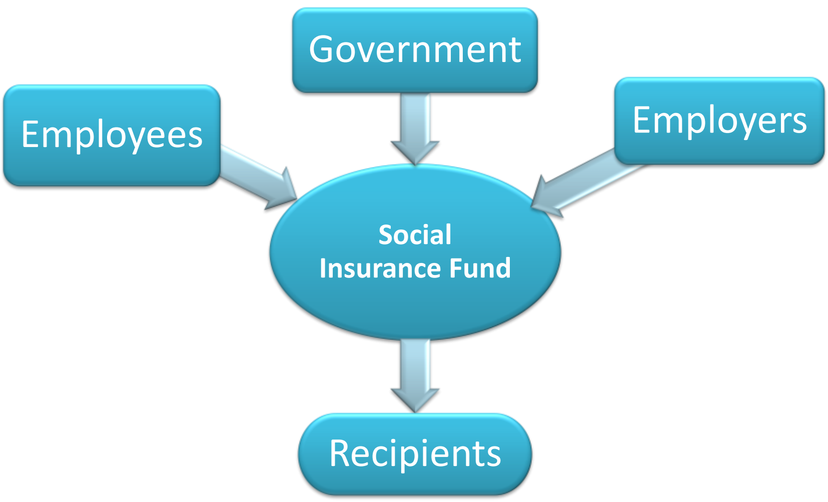
The Actuarial Review of the Social Insurance Fund 2010 carried out by KPMG shows that the Fund has a significant shortfall of €1.5 billion in 2011. Expenditure was €9 billion and income was €7.5 billion). The Fund provides for social welfare payments.

The Review projects that unless action is taken the deficit will double to €3 billion by 2019 and will increase to €25.7 billion by 2066. Expressed as a % of GNP, the shortfall is projected to increase from 1.1% of GNP in 2011 to 2 % in 2019 and 6.5 % in 2052.

Exchequer subventions will need to more than treble (from 2011 levels) by 2030 and increase by a factor of almost 8 by 2040 unless PRSI contributions are increased or benefits reduced (beyond changes already planned).

Pension expenditure is projected to rise from 57% of Fund spending in 2011 to 85% in 2066 due to population ageing.

Figure 1: Funding Sources of the Social Insurance Fund



Policy Options

Two possible responses to this deficit are either to increase PRSI contributions or to consider reducing social welfare benefits. Those opposed to increasing PRSI contributions point to the negative effect an increase would have on employment while those opposed to cutting welfare benefits argue that such a step would (among other things) hinder economic recovery by further depressing domestic demand as social welfare payments provide a vital element of support for spending.

The Beveridge Report published in November 1942, which recommended the establishment of the social insurance system in the UK, envisaged a tripartite scheme of contributions to the Fund from employers, employees and the Exchequer.

The Commission on Social Welfare (1986) found that tripartite funding is a feature of social insurance schemes in most countries and has applied in the Irish system "since its inception at the beginning of the century". The Commission did not support an adherence to any prestated shares in the financing of the Fund. Rather it considered that rates of social insurance and their impact on employment were the key factors.

The Report of the Expert Working Group "Integrating Tax and Welfare" (1996), which was chaired by Donal Nevin, former General Secretary of ICTU, considered the issue and stated

"There are no hard and fast rules concerning what proportion of the Social Insurance Fund should be financed from various sources. Legally, the Exchequer is the residual financier of the Fund, i.e. it meets the deficit between contributions received and any benefits paid out in any given year. A major reason for the decline in the Exchequer share of the Fund is that, in recent times, the social insurance system has been expanded to include additional groups such as part-time workers and the self-employed. Since these groups do not qualify for pensions, they are currently net contributors to the Fund, thus reducing the Exchequer share. As these groups qualify for more benefits, the Exchequer share of the Fund will increase, in the absence of any policy changes. Given the redistributive nature of the social insurance system we believe that the principle of an Exchequer contribution to the Fund should be maintained and reflect a commitment to social solidarity".

The Exchequer contribution to the Social Insurance Fund was 39.9 % in 1965 and fell gradually to 28.8 % in 1985. By 1994 it had declined to 2.4 %. The Fund went into surplus[1] in 1996 and in 2001 the Minister for Finance (Charlie McCreevy) transferred €635 million from the Fund to the Exchequer.

[1] This surplus was on a cash basis.

The Actuarial Review of the Fund makes the following projections

Social Insurance Fund				
Year	Receipts	Expenditure	Exchequer Contribution	
	€bn	€bn	€bn	%
2010	6.7	9.4	2.7	28.7
2011	7.5	9.0	1.5	16.7
2012	7.1	8.9	1.8	20.2
2013	7.2	9.2	2.0	21.7
2014	7.5	9.5	2.0	21.1
2015	7.6	9.7	2.0	20.6
2016	7.9	10.1	2.2	21.8
2017	8.1	10.6	2.4	22.6
2018	8.4	11.1	2.7	24.3
2019	8.6	11.6	3.0	25.9
2020	8.9	12.1	3.2	26.4
2030	11.8	17.3	5.6	32.4
2040	14.3	25.9	11.6	44.8
2050	16.9	36.4	19.5	53.6
2060	20.7	44.7	23.9	53.5
2066	23.5	49.3	25.7	52.1

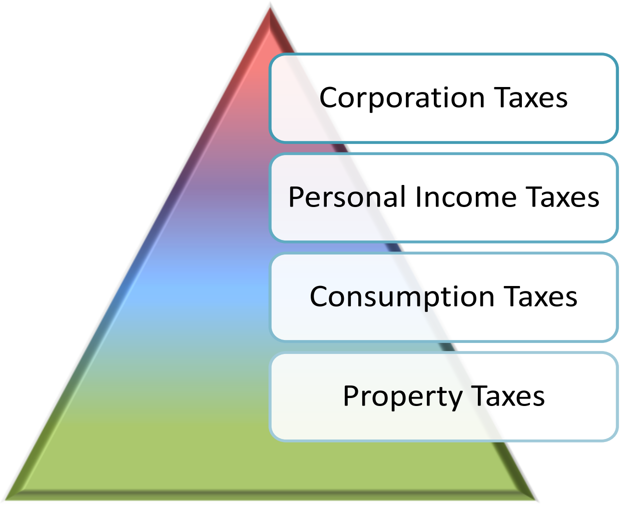
Source: Actuarial Review of Social Insurance Fund 2010 Table 1.1

Note: Figures are in 2012 prices except for 2010 and 2011 figures which are actual cash amounts

From the Table we can see that the Exchequer contribution in 2030 would still be below the 1965 level.

OECD Hierarchy of Taxes

OECD work suggests that property tax increases are less damaging in economic terms than increases in income tax and PRSI rates.



The OECD states

"Taxes on immobile bases such as property and consumption are less distortive than those on factor income (such as personal and corporate income). Income tax hikes have a bearing on growth, because they influence labour utilisation (by affecting decisions on labour force participation and hours worked) and productivity (through incentives for human capital accumulation)."

Conclusion

It is clear that the surplus which emerged in the Social Insurance Fund in the last decade was due to a significant degree to demographic factors. There is no immutable rule that current outgoings from the Fund must be met in full from social insurance contributions. There is another option which is to increase the Exchequer contribution to the Fund (financed from general taxation). Such a contribution could be raised in taxation in a manner much less inimical to employment creation than an increase in social insurance contributions.

References

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Donal de Buitleir, Director Publicpolicy.ie on 2 November, 2012