National Insurance Fund
Briefing Paper November 2017

Introduction
For a number of years, politicians of all shades have been denying the very existence of the National Insurance Fund. Some even claim it is simply an accounting tool; a notional fund that bears no relation to improving the state pension. But for millions of employers and employees who make contributions every month, this just doesn't add up.

Background
The National Insurance scheme was established on 5 July 1948 to provide unemployment benefit, sickness benefit, retirement pensions and other benefits where individuals meet the contribution and other qualifying conditions, such as the annual Christmas Bonus.

Currently, employees contribute 12% of income between £157 and £866 a week and 2% above £866 (known as the Upper Earnings Limit UEL). Employers pay 13.8% on all income above £157. Prior to April 2016, employees contracted-out of the state second pension used to receive a NI rebate of 1.6% of earnings up to the UEL, and their employers used to get 1% to 3.5% depending on their scheme.

From these contributions an allocation is made towards the NHS of 2.05% of the first slice of eligible earnings from employees and the full 2% on income above £866. Employers pay 1.9%. The remainder goes into the fund, and can only be used for the payment of benefits or the cost of administration.

In principle, the National Insurance Fund operates on a pay-as-you-go basis, the contributions received in each year being used to pay pensions and other benefits in the same year. In this respect it differs fundamentally from private pension funds, which need to build up reserves to cover their future liabilities.

The Government Actuary, who reports on the state of the Fund each year, also recommends that the Fund should also keep a balance to cover any unexpected short-fall in income of not less than two months' benefit expenditure.

The Coalition Government and the NI Fund
The NPC has long argued that the money in the NI Fund should primarily be used for its original purpose of paying pensions and benefits – but for at least a decade, successive governments have been borrowing from the surplus balance in order to spend on other items of public expenditure.

The pensions minister, Steve Webb, explains the current thinking, and in doing so, shows the weakness of the government's position. In a letter dated 9 September 2010, Mr Webb states:

“The National Insurance fund is run on a pay-as-you-go basis. This means current income, mainly from National Insurance contributions, pays for current expenditure. However, there is no ‘fund’ in the sense normally meant – that is, there is no pot of money invested in stocks and securities.”

“Under long-standing legislation, contributions paid in can only be used for contributory benefits and where any ‘surplus’ exists – it is held in a short-term investment account run by the Commissioners for the Reduction of the National Debt. This means the government will borrow less from elsewhere.”

In a few sentences Mr Webb admits there is a surplus in the fund – and that the government is borrowing from it in order to reduce borrowing from other sources. According to the Commissioners for the Reduction of the National Debt (CRND), the surplus in October 2017 was just over £24.2bn. Visit www.dmo.gov.uk, follow the link to CRND, look for Investment Accounts and then Latest Market Values. This will show the up to date surplus in the NI Fund.

Next steps

It is quite clear that millions of pensioners, workers and their employers have no idea that the money being paid in National Insurance every month is not being used to pay higher pensions and benefits – but is instead being used to balance the government’s books. As a direct result, the state pension is being kept unacceptably low and millions of older people are facing financial difficulties.

It’s time the government stopped using NI as just another form of general taxation, owned up about the way it is using the fund and started to use the surplus to raise the basic state pension and strengthen the existing NI based pension as the most effective way of tackling pensioner poverty, both now and in the future.

We propose the following key improvements to the state pension system:

- Increasing the basic state pension above the official poverty level for all existing pensioners (regardless of contributions) and setting it at 70% of the Living Wage (outside of London) currently estimated to be around £200 per week)[1]
- Indexing the basic and second state pensions annually to average earnings or prices (Retail Price Index/Consumer Price Index) or 2.5% whichever is the greater, so that its value is maintained for the future and pensioners share in the rising prosperity of the nation
- Retaining the State Second Pension (S2P) as a good earnings-related pension for all workers, maintaining the higher replacement rate for the low paid as an alternative to auto-enrolment

[1] The need for the means-tested Pension Credit would be removed, but ongoing entitlement to council tax and housing benefit would need to be considered for those currently in receipt. The state pension should also move towards becoming a Citizen’s Pension funded through National Insurance, but based on residency rather than contributions