All in This Together?

Why over-65s Should Pay National Insurance

The Budget Representation from the Intergenerational Foundation (www.if.org.uk)

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Fairness for Future Generations

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The Intergenerational Foundation (www.if.org.uk) is an independent, non-party-political charity that researches the rights of younger and future generations in British policy-making.

Whilst increasing longevity is to be welcomed, our changing national demographic and expectations of entitlement are placing increasingly heavy burdens on younger and future generations. The social contract between generations is under immense strain in housing, health, education, employment, taxation, pensions and the environment. Young people who are worse-off appear to be giving more than their fair share to fund a system that benefits the older, wealthier section of society.

IF questions this status quo, calling instead for sustainable long-term policies that ensure younger and future generations are better protected by policy-makers.

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Introduction

There is currently an imbalance in the UK tax system.

As things stand, workers stop having to pay National Insurance contributions (NICs) when they reach state pension age, effectively giving workers who continue at their jobs a pay rise at the expense of the general taxpayer.

The rapid increase in the number of workers who have chosen to continue working beyond state pension age over the last decade means that the amount which is lost to the treasury because of this concession has risen significantly.

Attempts to calculate how much additional revenue levying NICs on over-65s would raise has suggested it could be around £2 billion, money which would play a useful role in alleviating the current UK debt crisis or paying for some of the costs of Britain's ageing population.

There is also some evidence that older people have been affected less severely by the impacts of the recession than other age groups, which suggests it would be fairer to impose a tax increase on them in order to show that, in David Cameron's expression "we are all in this together" when it comes to repairing Britain's public finances.

Concerns

There are currently four different classes of NICs levied on employees, all of which cease to be payable when they reach state pension age (or at the end of the following tax year in the case of Class 4 NICs for self-employed people).

There are a number of reasons why this arrangement is difficult to justify:

1. NICs aren't used to pay for pensions

Not levying NICs on people over state pension age is often justified using the following argument: NICs are based on the "contributory principle," meaning they are used to build up a worker's entitlement to a range of state benefits (most importantly, the state pension), so by the time a person reaches state pension age they have already paid for their state pension and shouldn't have to make any further contributions once they have begun claiming it.

However, this argument can be countered fairly easily. Firstly, the NICs made by employers for each employee are still levied at the same rate regardless of whether the worker is above state pension age or not, which seems inconsistent with the contributory principle. Secondly, the role which hypothecation plays in paying the state pension is relatively weak (Heald and McLeod, 2002). The state pension is unfunded (Smith, 2001): contrary to popular belief, NICs are not paid into a National Insurance Fund which invests them on behalf of members of the public; rather, it operates on a pay-as-you-go model, in which contributions are paid out again more or less immediately to fund the payments of existing benefit recipients.

A 2007 report from the Institute for Fiscal Studies spelt out how the so-called "contributory principle" functions in practice:

"Contributory benefits are notionally financed from the NI Fund, but in years where the Fund was not sufficient to finance benefits, the Fund was topped up from general taxation revenues, and in years when contributions substantially exceed outlays, the Fund builds up a surplus, largely invested in gilts: the Government is simply lending itself money. These exercises in shifting money from one arm of Government to another maintain a notionally separate Fund, but merely serve to illustrate that NI contributions and NI expenditure proceed on essentially independent paths. The Government could equally well declare that a quarter of NICs revenue goes towards financing defence spending, and no-one would notice the difference." (Adam and Loutzenhiser, 2007)

Therefore, whilst in a *notional sense* a current pensioner who has made the required number of years worth of NICs can be said to have paid for his pension, in a *practical sense* his historic contributions do not lessen the financial burden which paying his pension places on today's taxpayers.

2. Tax relief is unfair on other taxpayers

Giving tax relief to the over-65s implies that the general taxpayer will have to be taxed more heavily in order to make up the difference. This is why tax exemptions in general are unfair, as was best articulated by William Gladstone during his Budget speech of 1863:

"...it must be borne in mind that in every case exemption means a relief to A at the charge of B.... I venture, Sir, to say that this state of things is unjust. It is not fair that the taxpayers of the country, to a very large proportion of whom taxation is, and must be, a serious burden—that the fathers of families, men labouring to support their wives and children, should be taxed at an augmented rate, in order to afford the luxury of exemption [for others]." (Hansard, 1863)

There is evidence that fully three-quarters of both men and women who work beyond state pension age simply remain in the same jobs they held beforehand (Smeaton and McKay, 2003). This means that the removal of NICs functions simply as a pay rise for the vast majority of people in this position, which is delivered at the expense of other workers.

3. 1.4 million people now work beyond state pension age

Exemption from NICs for people above state pension age would have been somewhat easier to justify when the number of workers in this category was still relatively small. However, the number of people who continue to work past state pension age nearly doubled between 1993 and 2011.

Figures from the ONS show that there were 1.4 million people above state pension age who were still active members of the labour force in 2011, compared with 753,000 in 1993 (ONS, 2012a). This means the amount of revenue lost to the Treasury in missing NICs will have risen accordingly.

4. Pensioners have been less affected by the recession than other age groups

According to figures from the ONS, mean gross pensioner incomes grew by an estimated 50% in real terms between 1994/95 and 2010/11 (ONS, 2012b). These figures chafe against the popular misconception that the majority of older people are poor. Whilst statistics from the Department for Work and Pensions (DWP) show that 17% of over-65s (which amounts to 2 million people) live in households which are beneath the government's official poverty threshold the same set of figures also reveals that this is a smaller amount (as both a proportion and an absolute number) than among children, 18% of whom live in households which are below the government poverty threshold (equal to 2.3 million people). At the same time, 5.5 million working-age adults live in households which are officially impoverished (DWP, 2012).

Whilst not all pensioners who live above the poverty threshold are spectacularly well-off, figures released by Intergenerational Foundation in October 2012 demonstrate that there are two million people aged over-60 who live in households which have an asset wealth greater than £1 million (IF, 2012). Recent economic developments appear to have sharpened the impacts of these long-term trends. Paul Johnson, the director of the Institute for Fiscal Studies, argued earlier this year that the young have been hit harder than older people by the current recession:

"What our research shows is that pensioners have done relatively better than working-age people over the last 13 years. But other work done by the Institute has shown that in terms of employment, income and consumption it is the under-30s who have really borne the brunt of the recession." (Wright and Cooper, 2012)

In this context, requiring people who are over retirement age to pay NICs would only constitute a small sacrifice in the interests of repairing Britain's damaged public finances, while it would be another chance to show that "we are all in this together" when it comes to pursuing this goal.

5. The extra revenue could help pay for social care

Whilst the weak relationship between specific forms of taxation and expenditure in Britain means that the additional revenue raised from charging NICs on people above state pension age would not necessarily have to be assigned to any particular purpose, it would be especially fitting if was used to pay for some of the costs associated with the UK's ageing population.

One good example of such a use would be if the revenues were used to pay for the increasing bill for adult social care. The government has recently announced a set of reforms to the adult social care system that would create a cap on personal liabilities of £75,000, which the Department of Health estimates will cost the exchequer £1 billion a year by the end of the next parliament (Department of Health, 2012). Given that it has been estimated that imposing NICs on people working above state pension age could raise up to £2 billion per year (see below), it could be argued that paying for adult social care would be an appropriate use for some of this money. This would create a mechanism whereby members of the older generation were doing more to pay for the costs of the older generation, reducing the need for further financial transfers from young to old.

Aims/Proposals

The major proposal of this budget representation is that people who remain in the workforce beyond state pension age should become liable to pay all four classes of NICs at the same rates as younger workers, rather than being excused from paying them as happens at present.

As explained earlier the number of people choosing to work beyond state pension age is increasing and had reached 1.4 million in 2011. A report by the Free Enterprise Group of Conservative Party MPs, published in July 2012, quoted figures which suggest that levying NICs on earned income for people above state pension age would raise £2 billion per year, based on Treasury PAYE figures (Baldwin et al. 2012). This would be additional revenue for the Treasury, as there would be no direct financial costs to the government associated with this policy (apart from possible indirect impacts such as slightly reduced VAT revenues if it meant older workers did less spending, but these would be very indirect and difficult to quantify). The fact that this estimate was prepared using PAYE data suggests that many of these people would already be within the PAYE system, meaning the compliance costs of paying this additional tax should be relatively low.

Conclusion

This budget submission has argued that exempting people who work beyond state pension age from paying NICs creates an intergenerational unfairness. The government has said that "we are all in this together" when it comes to rescuing Britain's public finances, but there is significant evidence that older citizens have largely been spared the harsher impacts of austerity. Levying NICs on people who continue working beyond retirement age would be a small but significant change which could contribute up to £2 billion in additional revenue, sending a clear signal to hard-working youngsters that the politicians are asking older people to contribute equally.

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