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BRIEFING PAPER 4: NATIONAL INSURANCE FUND

Funding Pension Schemes

1. There are two generally accepted ways to fund collective pension schemes:
    - Pay-As-You-Go (PAYG) Schemes, where contributions received from members accumulating benefits are used to pay the pensions of members; and
    - Funded Schemes where contributions received from members are invested and the aggregate of contributions and investment earnings are used to pay pensions.
2. British State Pension is a PAYG Scheme but a notional National Insurance Fund account is maintained to ensure that National Insurance Contributions are sufficient to meet current and future National Insurance Benefits.

National Insurance Fund

3. The British State Pension is funded as a component of National Insurance which funds health care through the NHS, social security payments (for example, unemployment benefits) and British State Pension.
4. Notional accounts are maintained to measure contributions against outgoings. The main fund is the Great Britain National Insurance Fund. There is a separate fund for Northern Ireland. The following comments relate to the main fund.
5. Annual and quinquennial actuarial fund reviews facilitate assessment the adequacy of contributions. The surplus balance on the notional account represents an interest-free loan to the government whilst a negative balance will require an increase in contribution rates or taxation to bring the account back into balance. Balance is currently defined as a surplus balance of $1/6^{th}$ of expected annual benefit expenditure (i. e. equivalent to two months' expenditure).
6. The Government Actuary reports to Parliament annually on the financial implications of changes to National Insurance contribution and benefit rates. This report includes short-term projections of the financial position of the National Insurance Fund. The most recent report is dated January 2021. It is available here. The report forecasts a surplus in 2021-2022 of £1.3 billion and deficits in the following for years of £0.5 billion (2022-2023), £1.4 billion (2023-2024), £1.5 billion (2024-2025), £2.0 billion (2025-2026). This compares to a forecast surplus balance of £40.8 billion at 5^{th} April 2022 (equivalent to 36% of the fund).
7. The Government Actuary reports to Parliament every five years on his long-term projections for the National Insurance Fund. The last such review was dated 2015 and presented in October 2017. This is available here. The report forecasts an increase in surplus in the fund until 2024-2025, followed by deficits until the fund is exhausted in 2032-2033.
8. The next Government Actuary report is underway and is expected to be presented late next year. Covid-19 may have a significant impact on the fund, with reduced benefits due to mortality amongst pensioners offset by reduced numbers of contributors and contributions.

Future Fund

9. Australia funds Age Pension from general taxation. However, it does maintain a Future Fund. The balance in the Future Fund can be used to pay for annual unfunded Commonwealth superannuation liabilities. The fund was established using budget surpluses in the benign economic conditions of the later 20th century and early 21st century together with part of the proceeds of privatisation of government-owned business.

10. The balance in the Future Fund at 31st March 2021 was A$178.6 billion. The assets of the fund are invested by an independent investment authority. The same authority also invests other government funds such as the Medical Research Future Fund, the Aboriginal and Torres Strait Islander Land and Sea Future Fund, the Future Drought Fund, the Emergency Response Fund and the DisabilityCare Australia Fund.

11. The Australian Government announced in 2017 it would not make withdrawals from the Fund in 2020 and indicated its inclination to allow the Fund to grow until at least 2026-27.

12. The UK has not established a future fund. The benefits of North Sea Oil, benign economic conditions and the proceeds from privatisations were used to fund lower taxation. Mismanagement of UK financial reserves was exacerbated by the sale of the UK's gold reserves in the period 1999 to 2002 during a bear market in gold prices.

13. In contrast, the other country to benefit from North Sea Oil used those benefits to establish a future fund. The balance on the Norwegian Sovereign Fund (Statens pensjonsfond) is available to pay for social security benefits including Norwegian Age Pension. The latest market value of the fund is NOK 11,633 billion (about A$1,800 billion). The fund is widely invested in real estate and listed shares around the world.