An Roinn Gnóthaí Fostaíochta
agus Coimirce Sóisialaí
Department of Employment Affairs
and Social Protection

TSG 20/04

Tax Strategy Group – 20/04

Pay Related Social Insurance for Self-Employed Workers

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TSG 20/04

Pay Related Social Insurance – Budget 2021

The Social Insurance System

1. The social insurance system is central to the provision of social security in Ireland. It plays a major role in Irish life both in terms of the number of people who depend on it and also the financial and economic scale of the system.

2. The basic principle underlying the social insurance system is that people, while they are economically active, make social insurance contributions in accordance with their earnings level or income from self-employment. It is an important vehicle of income redistribution, social cohesion and solidarity between generations, including those in work and those who are not. Contributions made today finance pension payments to an earlier generation of contributors and also pay for benefits to people who are temporarily economically inactive through, for example, illness or unemployment. In return, contributors build up entitlement to receive benefits on foot of their contributions, which will be paid to them provided they satisfy any non-contribution based eligibility criteria for the particular scheme, without having to undergo a means test. These benefits will be paid when contributors experience a specified contingency such as disability or unemployment or when they reach pension age.

3. This paper reviews the financial position of the Social Insurance Fund at the end of 2019 and the likely impact of the Covid-19 pandemic on the balance of the Fund at the end of 2020.

4. The paper sets out recent developments in the expansion of access to the range of social insurance benefits to self-employed social insurance contributors.

5. It also summarises the findings of a number of recent studies on the social protection of self-employed workers and the lessons arising for policy makers. In light of the insights provided from the various studies, the paper concludes by setting out a proposal to adjust the current rate of Class S PRSI in order to better align contributions made by self-employed contributors with the range of benefits now being accessed by them.

Social Insurance Fund: Financial Position to 2019

6. The Social Insurance Fund (SIF) operates on a pay-as-you-go basis, with the Exchequer acting as the residual financier of the Fund, where there is a shortfall between social insurance income into the Fund and the cost of social insurance benefits paid out of it.

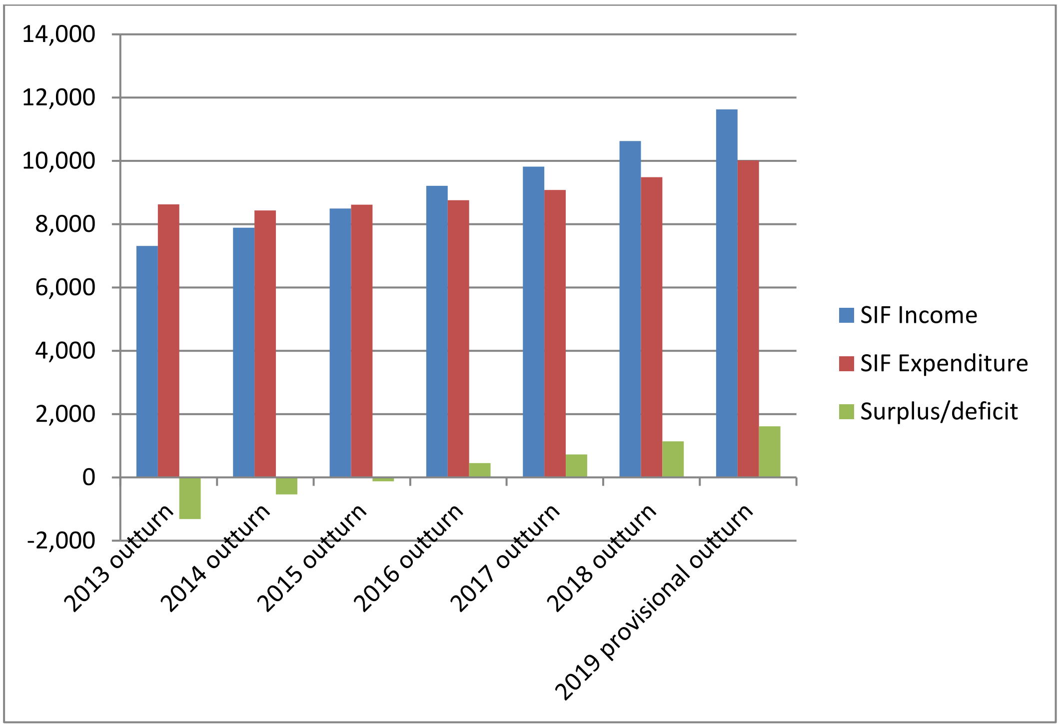
7. The SIF was established in the early 1950s and annual Exchequer contributions were the norm for over 40 years. However, no Exchequer contribution was required over the period 1997 to 2007 inclusive, as social insurance income exceeded expenditure. At the end of 2007, an accumulated surplus of €3.6 billion had built up.

8. In 2008, the operating balance of the SIF moved into deficit and the annual deficit accelerated rapidly in 2009 (€2.5 billion) and 2010 (€2.75 billion) as the recession took hold. This meant that the accumulated surplus built up over 11 years was exhausted in less than 3 years and the SIF incurred annual deficits totaling about €9 billion over the period 2008 – 2015. These deficits were funded by transfers from the Exchequer.

9. The annual deficit has declined significantly since 2013 with surpluses recorded since 2016 as set out in the graph below.

10. At the end of 2019 the SIF had an accumulated surplus of €3.89 billion. The 2020 Estimate published at the end of December 2019 projected that PRSI income would exceed expenditure by €1.86 billion, which would have brought the accumulated SIF surplus by end 2020 to €5.75 billion.

SIF income and expenditure 2013 to 2019 (€ Millions)



Social Insurance Fund: Impact of Covid-19 Pandemic

11. As a result of the economic impact of the Covid-19 pandemic and the production of the Revised Estimates, the Department is estimating expenditure of €11.6 billion from the SIF in 2020 which is over €1.3 billion above that estimated at the beginning of the year. In addition, the Department estimates income of €9.7 billion to the SIF in 2020 which is a reduction of €2.5 billion from that projected at the beginning of the year. Accordingly, the SIF will, at a minimum, experience a €3.8 billion reduction over that projected at the beginning of the year and if realised, would result in a reduced SIF accumulated surplus of €1.9 billion at the end of the year.

12. The decrease in income arises from the significant reduction in the yield value of employer

and employee PRSI contributions from the decline or cessation of economic activity and the growth in expenditure is due to increased Jobseeker's and Illness Benefit payments. Expenditure on Jobseeker's Benefit is expected to further increase as recipients with an entitlement to that benefit transition from the Covid-19 Pandemic Unemployment Payment scheme or from the Covid-19 Temporary Wage Subsidy/Employment Wage Subsidy schemes should they be laid off work.

13. As part of the July Jobs Stimulus 2020, the Pandemic Unemployment Payment has been extended until 1 April 2021. By the end of July, expenditure on the scheme was approximately €3 billion. The cost of the Pandemic Unemployment Payment in the period August to December 2020 will depend on the ongoing suppression of the Covid-19 virus and on progress in reopening the economy and society. The Social Welfare (Covid-19)(Amendment) Act 2020 formally categorised the Pandemic Unemployment Payment as a social insurance benefit and consequently expenditure on the scheme will come from the SIF. The Act also provides that expenditure incurred on the scheme prior to it being established as a social insurance benefit may also come from the SIF. This may arise, for example, where social insurance contributors claiming the Pandemic Unemployment Payment had an underlying entitlement to a jobseeker's scheme, such as Jobseeker's Benefit, which is financed from the SIF. Accordingly, given this change, it is now clear that the potential SIF accumulated surplus suggested at paragraph 11 is unlikely to be realised and that the SIF will likely be in deficit by the end of 2020.

14. The 2020 SIF estimates are informed by the forecast of an average unemployment rate of 13.9% for 2020, as set out in Ireland's Stability Programme April 2020 Update.[1] In that respect they are subject to change as labour market and payment trends develop.

15. The performance of the labour market in the weeks and months ahead, including the capacity of employers to respond to the phased return to work and the level of any resulting residual unemployment, remains uncertain.

16. The table below shows the income and expenditure position of the SIF over recent years and the revised estimate for 2020.

SIF income and expenditure 2013 to 2019 and revised estimate for 2020

	2013 outturn	**2014 outturn**	**2015 outturn**	**2016 outturn**	**2017 outturn**	**2018 outturn**	**2019 provisional outturn**	**2020 REV Estimate**
	€ Millions	*€ Millions*	*€ Millions*	*€ Millions*	*€ Millions*	*€ Millions*	*€ Millions*	*€ Millions*
SIF Income	7,318	7,891	8,498	9,217	9,816	10,625	11,632	9,697
SIF Expenditure	8,632	8,431	8,617	8,764	9,086	9,491	10,016	11,646
Surplus/deficit	**-1,314**	**-540**	**-119**	**453**	**730**	**1,135**	**1,616**	**-1,949**

[1] https://www.gov.ie/en/publication/43a6dd-stability-programme-update-2020/

Programme for Government Commitments

17. The Programme for Government includes a number of commitments, as follows, that are likely to impact on the income and expenditure of the SIF.

- Consideration will be given to increasing all classes of PRSI over time to replenish the Social Insurance Fund to help pay for measures and changes to be agreed including, inter alia, to the state pension system, improvements in short-term sick pay benefits, parental leave benefits, pay-related jobseekers benefit and treatment benefits (medical, dental, optical, hearing).

- Establish a Commission on Pensions to examine sustainability and eligibility issues with state pensions and the Social Insurance Fund. The Commission will outline options for Government to address issues including qualifying age, contribution rates, total contributions and eligibility requirements.

- Pending the report of the Commission on Pensions and any subsequent Government decisions on its recommendations, the State Pension age will remain at 66 years and the increase to 67 years will be deferred.

18. The most recent Actuarial Review of the Social Insurance Fund projected that in the medium to long term, pension related expenditure will continue to be the predominant component of SIF expenditure, rising from 70% in 2016 to circa 80% in 2071. This projection was premised on the pension age rising to 67 from January 2021 and to 68 from January 2028.

Social Insurance Contribution Rates and Benefits: Self-Employed Workers

19. To put the PRSI rate paid by self-employed contributors into context, a comparison with the rate applying to employed contributors is illustrative. A combined PRSI rate of 15.05% is paid in respect of most (PRSI Class A) employees. This includes a 1% contribution to the National Training Fund.[2] The employee PRSI charge comprises 4% payable by employees and 11.05% by their employer (there is an 8.8% employer PRSI rate, inclusive of the National Training Fund contribution, where weekly earnings do not exceed €395).[3] Employees who pay PRSI at Class A are covered for all benefits and pensions.

20. Self-employed workers who earn €5,000 or more in a contribution year are liable for PRSI at the Class S rate of 4%, subject to a minimum payment of €500.[4]

21. Self-employed workers who are Class S contributors are now covered for a range of benefits such as: the State Pension (Contributory), Widow's, Widower's or Surviving Civil Partner's Pension (Contributory), Guardian’s Payment (Contributory), Maternity and

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[2] The National Training Fund is administered by the Department of Education and Skills. The contribution was increased from 0.9% to 1% in Budget 2020

[3] The threshold at which the higher employer PRSI rate is charged was increased to €395 per week from 1 February 2020 to cater for the 2020 increase in the national minimum wage which took effect from that date

[4] The 4% Class S PRSI rate is unchanged since January 2011 and the minimum charge of €500 is unchanged since January 2013

Adoptive Benefits, Paternity Benefit (from September 2016), Treatment Benefits (from March 2017) and Invalidity Pension (from December 2017) which also qualifies them for Partial Capacity Benefit. Class S contributors are also eligible for the Jobseeker's Benefit (Self-Employed) and Parents' Benefit schemes, which were introduced in November 2019. In addition, they may qualify for the Covid-19 Pandemic Unemployment Payment introduced in March 2020. Appendix 1 sets out the range of benefits accessible by PRSI Class A and Class S contributors.

22. Following these changes, self-employed contributors are now covered for most of the benefits available under the social insurance scheme which represents approximately 93% of the value of all benefits paid by the SIF. In effect, self-employed contributors, in return for a contribution of 11 percentage points lower than that made in respect of employed contributors, have access to benefits which comprise over 90% of the value of all benefits available to employed contributors. Class S contributors are currently not covered for Illness Benefit, Carer's Benefit, Health and Safety Benefit and Occupational Injuries Benefits.[5]

Recent Studies on the Social Protection of Self-Employed Workers

23. This section briefly discusses findings on social insurance protection and coverage for self-employed workers from a selection of work undertaken in recent years.

Third Report of the Advisory Group on Tax and Social Welfare[6]

24. In September 2013, the third report of the Advisory Group on Tax and Social Welfare on Extending Social Insurance Coverage for the Self-Employed was published. The Group:

- was not convinced that there was a need for the extension of social insurance in respect of Jobseeker's Benefit;
- found that extending social insurance for self-employed workers was warranted in cases related to long term sickness or injuries and recommended that the rate of contribution for Class S should be increased by at least 1.5 percentage points; and
- concluded that: "*extension on a voluntary basis, through either an "opt in" or "opt out" basis, could lead to the selection of bad risks and would undermine the social solidarity and contributory principles that underline the social insurance system*.".

Survey of Self-Employed Class S Contributors[7]

25. In August 2016, a survey of self-employed Class S contributors was conducted to understand how the PRSI system is perceived by self-employed workers. The main findings of the survey were:

[5] Self-employed workers may qualify for the Enhanced Illness Benefit for Covid-19 absences from work

[6] https://www.gov.ie/pdf/?file=https://assets.gov.ie/77994/ace7d54b-9e62-4bd8-82be-08f8340d8685.pdf

[7] https://www.gov.ie/pdf/?file=https://assets.gov.ie/77995/f6414964-6283-4c6f-bba9-6ba6caa7d84a.pdf

- Respondents rated cover for long-term illness, short-term illness and unemployment as the most important extra benefits to them. 82% ranked long-term illness in their top three of preferred additional benefits.
- The current headline rate of PRSI for self-employed workers is 4%. A large majority of respondents (88%) said they would be willing to pay a higher rate of PRSI in return for at least one additional social insurance benefit.
- A smaller majority (74%) would welcome an option to keep paying the current PRSI rate but also pay additional voluntary contributions in return for extra benefit coverage.
- Respondents reported low levels of coverage from private insurance with just 28% being covered for long-term illness and only 2% for unemployment.
- Respondents were dissatisfied with the range of social insurance benefits available to them. Over 80% of respondents rated both the range of benefits and the value for money as ‘poor’ or ‘very poor’.

26. It should be noted that the survey pre-dated the significant expansion of benefit coverage to self-employed workers in the years 2016 to date as set out in paragraph 21.

<u>Actuarial Review of the Social Insurance Fund</u>[8]

27. The most recent Actuarial Review, published in 2017, examined the additional PRSI expenditure that would be incurred from the extension of invalidity pension and illness, jobseeker’s and carer’s benefits to Class S self-employed workers and the PRSI contribution rates required to provide these benefits on a revenue neutral basis.
    - The review estimates the combined cost of introducing these four benefits for PRSI Class S contributions to be €118 million in 2018, rising steadily to €223 million in 2020. By 2025 the projected cost is €413 million and, over the period of the review, the cost would rise to €1.3 billion in 2071.
    - Where the level of increased expenditure in respect of these benefits is examined over a 20 year period, the income from Class S PRSI would need to be 78% higher than the current rate of 4% and when considered over the 55 year projection, this would require an increase in PRSI contribution of 94% - almost double the current contribution rate.
    - This increased contribution rate is attributable to the costs of extending only these four additional benefits to PRSI Class S contributors. It does not take account of the value to PRSI Class S contributors of access to the range of existing benefits, and in particular the State Pension (Contributory). The actuaries estimated that the typical cost of the State Pension (Contributory) on its own is of the order of 15.5% of national average earnings at the time of the Review.
    - Adding in the other four benefits referenced above, the total Class S rate of contribution to ensure revenue neutrality of just these five benefits is estimated to be of the order of 20% per annum. When taking account of the other benefits

[8] https://www.gov.ie/pdf/?file=https://assets.gov.ie/37220/99a896910d574b7daa0b65fbb00900e5.pdf

to which Class S contributors have access to, the overall percentage rate of contribution required would be in the early to mid twenties.

- All of the measures for self-employed workers that have been introduced in recent years were introduced without any increase in the rate of PRSI contribution paid by such contributors.
- As a consequence, self-employed workers have access to around 93%, in value terms, of the benefits paid by the SIF while making an effective contribution of 3.7% of earnings. At 3.7% the effective rate of social insurance paid in respect of self-employed workers is around 28% of that paid in respect of other workers (effective rate of 13%) and just 24% of that required to cover pension entitlements alone (15.5%).[9]

The Future of Social Protection: What Works For Non-Standard Workers? [10]

28. This OECD publication examines the impact of non-standard working patterns including self-employment on social protection systems. A number of policy insights are put forward in the work and include:

- Where possible, countries should try to harmonise social security contributions across forms of employment. Including workers that border between dependent and independent forms of work in social protection schemes not only help to close coverage gaps, but can be effective in ensuring that social protection systems cover those who are most at risk. This approach can also curb the extent of non-standard employment and limit the erosion of the contribution base of social protection systems.

- Social security contribution differentiation is a driver of non-standard work as employers seek to minimise non-wage labour costs. This can be countered by decreasing the difference in the tax/social security wedge between hiring an employee and engaging a self-employed worker.

- Voluntary schemes do not work well for non-standard workers as those who have the highest risk have the greatest incentive to join and unless a voluntary scheme achieves a very high coverage rate, this adverse selection either leads to a downward spiral of rising contributions and falling coverage or to additional costs in the system. In designing effective voluntary contribution schemes, policy makers will have to accept substantial public subsidies if they want to achieve high coverage rates and avoid adverse selection.

- Making entitlements portable supports mobility across jobs and forms of employment. Untying entitlements from specific relationships with employers, and tying them to individual contributions instead, not only makes it easier for workers to switch jobs, but also facilitates them to switch between self and dependent

[9] Table 11.10(a) of the Actuarial Review of the Social Insurance Fund: September 2017
[10] The Future of Social Protection: What Works for Non-standard Workers?: OECD Publishing 2018 https://doi.org/10.1787/9789264306943-en

employment. Furthermore, it facilitates the harmonisation of entitlements across contractual arrangements. Individualised forms of social protection can only offer coverage if sufficient contributions are paid by or on behalf of the beneficiary.

29. There is a high level of commonality on the policy principles that emerge from the foregoing studies. From a financial perspective, the link between access to benefits and the level of contributions being made to warrant the delivery of such benefits is evident. The response to the survey of self-employed contributors acknowledges the willingness of such contributors to contribute more for access to certain benefits.

30. Voluntary social protection systems are considered ineffective and, given the risks associated with them, could only operate and be sustained if supported with significant state funding.

31. There is clearly an imperative to address the actuarial fact that the contributions being made by self-employed workers are hugely disproportionate to the level of social insurance benefits that they have access to. This point is magnified by the access to further benefits that self-employed contributors have gained in recent years without any associated increase in their contribution rate.

32. The imperative to harmonise social insurance contributions across forms of employment cannot be met where a social insurance contribution differential prevails. Currently, a large difference exists between the combined contribution of employees and their employers in the case of Class A contributors and the contribution of self-employed workers making Class S payments. In addition, when considering the implications of self-employment for social insurance and tax revenues, the large differential in PRSI rates between self-employed and employed workers was found to be a major factor in incentivising the misclassification of employees as self-employed in an Irish context.[11]

33. The current situation is increasingly irrational where access to the range of social insurance benefits accruing is merging. The harmonisation of entitlement can only be achieved by ensuring that sufficient contributions are paid by or on behalf of those who ultimately benefit.

Proposal to Adjust the Class S PRSI Rate for Self-Employed Workers

34. The Programme for Government "Our Shared Future" sets out how consideration will be given to increasing all classes of PRSI over time to replenish the SIF to help pay for measures and changes to be agreed including, inter alia, to the state pension system, improvements to short-term sick pay benefits, parental leave benefits, pay-related jobseekers benefit and treatment benefits (medical, dental, optical, hearing).

[11] The use of intermediary-type structures and self-employment arrangements: Implications for Social Insurance and Tax Revenues, Department of Finance and Department of Employment Affairs and Social Protection: 2018 https://www.gov.ie/en/publication/cf024d-report-on-the-use-of-intermediary-type-structures-and-self-employmen/

35. In line with the above analysis, the current precarious position of the SIF, the actuarial costs projections into the future, the need to bring greater coherence to the social insurance system from a contributions/benefits perspective and to bring greater balance to the level of contributions from various employment types, it is proposed that consideration be given to adjusting the level of social insurance contributions for self-employed workers (i.e. Class S PRSI) to that of the standard rate of employer PRSI (i.e. 11.05%) incrementally over four budgets. Based on current rates this could be achieved by increasing the Class S rate by 1.75% each year for three years and by 1.80% in the fourth year as follows:

- Budget 2021 – increase from 4% to 5.75%
- Budget 2022 – increase from 5.75% to 7.50%
- Budget 2023 – increase from 7.5% to 9.25%
- Budget 2024 – increase from 9.25% to 11.05%

36. Remaining social insurance benefits not currently accessible by self-employed contributors such as Illness Benefit, Health and Safety Benefit, Occupational Injuries Benefits and Carer’s Benefit to be incrementally extended to them. In light of the significant access to a range of social insurance benefits in recent years without any increase in the rate of contribution, access to the remaining benefits should be considered in the context of the Programme for Government commitment to improvements to short-term sick pay benefits.

37. The minimum annual charge of €500 for self-employed workers with incomes of €5,000 or more per annum to remain in place for the time being to avoid any adverse impact on lower earning self-employed workers in the current economic circumstances. It is expected that the number of contributors liable to pay the minimum charge will decrease as increases in the percentage rate of contribution take effect. This is because the current liability is either 4% of the annual reckonable income or €500 whichever is the greater amount.

38. Provisional estimates of the yield to the SIF from the contributions of self-employed workers following the increases in the Class S PRSI rate as set out in paragraph 35 are provided at Appendix 2.

39. The Tax Strategy Group is invited to consider this paper.

Appendix 1

Benefit Entitlements and Rate of PRSI as a Percentage of Earnings contributed in respect of Class A and Class S contributors

Benefit Entitlements	Employed PRSI as % of earnings **15.05%**	Self-Employed PRSI as % of earnings **04.00%**
	PRSI Class A	**PRSI Class S**
Adoptive Benefit	✓	✓
Guardian's Payment (Contributory)	✓	✓
Invalidity Pension	✓	✓
Jobseekers Benefit (Self-Employed)	✓	✓
Maternity Benefit	✓	✓
Parent's Benefit	✓	✓
Paternity Benefit	✓	✓
State Pension (Contributory)	✓	✓
Treatment Benefit	✓	✓
Widow's, Widower's or Surviving Civil Partner's (Contributory) Pension	✓	✓
Partial Capacity Benefit	✓	✓
Covid-19 Pandemic Unemployment Payment	✓	✓
Health and Safety Benefit	✓	
Carer's Benefit	✓	
Illness Benefit	✓	Enhanced Illness Benefit for Covid-19 absences from work
Occupational Injuries Benefits	✓	

Appendix 2

Provisional Estimated Yields from Proposed Increases in the Rate of Self-Employed Workers Class S PRSI

Rate	Full Year Yield € millions
Current Rate of 4%	550
Increase to 5.75% from January 2021	780
Increase to 7.50% from January 2022	1,000
Increase to 9.25% from January 2023	1,250
Increase to 11.05% from January 2024	1,500