2022-39

Policy & Resources Committee

**Response to a Question Pursuant to Rule 14**
**of The Rules of Procedure of the States of Deliberation and their Committees**

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|---|---|
| **Subject:** | **Impact of Secondary Pensions on the Long-Term Tax Deficit** |
| **States' Member:** | **Deputy S Kazantseva-Miller** |
| **Date received:** | **31st May 2022** |
| **Date acknowledged:** | **31st May 2022** |
| **Date of reply:** | **Wednesday 22nd June.** |

During the debate on secondary pensions in May 2022, I received the following response from Treasury to my question about the impact of secondary pensions on the £85 million structural long-term deficit, identified in the tax review:

*"The £85m deficit has assumed that secondary pensions will be implemented. This will have an impact on both income and expenditure. In the short to medium term, secondary pensions results in our deficit worsening as we will lose the income tax on pension contributions in the early years. This will balance out in the long term as pensions move into payment and tax is collected.*

*The scheme will take decades to come into full effect but broadly within 20 years we can expect access to pensions to remove up to 200 households from the need to claim income support and to have reduced the dependence on income support for many more. In 40 years that could increase to 300 households. At this point the increased pensioner income will have substantially replaced the income lost through the additional tax relief provided on pensions. Of our 5700 1 and 2 pensioner households approximately 630 (11%) claim income support and many more could make small claims but don't. As a rough estimate if one member of the household had been able to save an average of £100 a month between themselves and their employer through their working life more than half would not require income support today. Based on the current claim data the income support saving made if one member of each household saved (with their employer) £100 a month would be £150k to £200k a year."*

**Questions**

1. Could you provide a **breakdown of the annual projected deficit from year N to year N+40** assuming secondary pensions are introduced as per the tax review forecasts?

   *Please provide raw data per year and not graphs for questions 1-3. N is Year 1 of the first year of the tax review forecasts and N+ 40 is Year 40. Please assume that any*

*other parameters remain unchanged since the tax forecasts were presented to the Assembly in 2021.*

2. Could you provide a **breakdown of the annual projected deficit from year N to year N+40** assuming the secondary pension scheme is **NOT** introduced?

3. Could you provide the **breakdown of the annual projected deficit from year N to N+40** with the introduction of secondary pensions **delayed by 6 months** and by **12 months**?

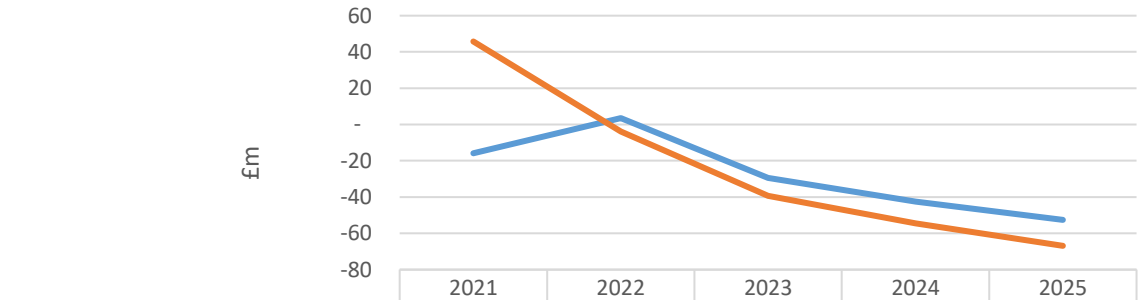
4. Could you confirm the **cost of capital** figure that the States uses for investment and financing decisions?

5. Could you confirm, if different from point 4, what the **discount rate** is that the States uses to calculate **net present values (NPV)** for investment or other financial decisions?

**Responses**

1. The graph and data below provide a forecast of the structural deficit to 2025. This is the extent to which this data has been forecast in this level of detail. These estimates include:
    - The forecast operating position of the States' General Revenue Accounts;
    - The estimated operating deficit of the Guernsey Insurance and Long-Term Care Funds;
    - Estimates of investment return on the balances held by General Revenue and Social Security Funds[1]; and
    - An assumption of 2% per annum expenditure on capital in line with the provisions of the Fiscal Policy Framework.

**Figure 1: Forecast structural deficit (in year Incl Social Security)**




| | 2021 | 2022 | 2023 | 2024 | 2025 |
|---|---|---|---|---|---|
| F&IP (mid) assuming 2% GDP capital spend | -16 | 4 | -29 | -43 | -53 |
| Less in year deficit on GIF & LTCF | 46 | -4 | -39 | -55 | -67 |

[1] Note that investment returns on States' assets were unusually high in 2021

The long-term annual funding requirement for the Guernsey Insurance Fund and Long-Term Care Fund, estimated at £34m per annum, is larger than the current combined operational deficit of these Funds (£14m) bringing the estimated long term funding requirement to between £80m and £90m.

Beyond this it is assumed that a modest rate of economic growth will contribute between £60m and £70m of additional revenue by 2040 (at an assumed real growth rate of 0.6% per annum in line with recent averages), and that this will be approximately balanced by a long-term real growth in health expenditure of £2m to £3m a year as the population ages.

2. The graph below (extracted from the initial economic assessment of secondary pensions undertaken in 2018) provides details of the marginal impact of the policy on the States' finances over time. Note that this analysis assumed a 2020 start date and the subsequent delay in initiation will also have deferred the impact.

The net impact of the secondary pensions scheme should reduce over time because, in the long term, the improvement in retirement incomes will eventually result in additional tax revenues thereon and a reduction in Income Support claims among pensioners. In the very long-term the outcome may be beneficial. The data showing the net impact on the States' position is also provided.

**Figure 2: Marginal impact of secondary pensions on the overall States' finances**

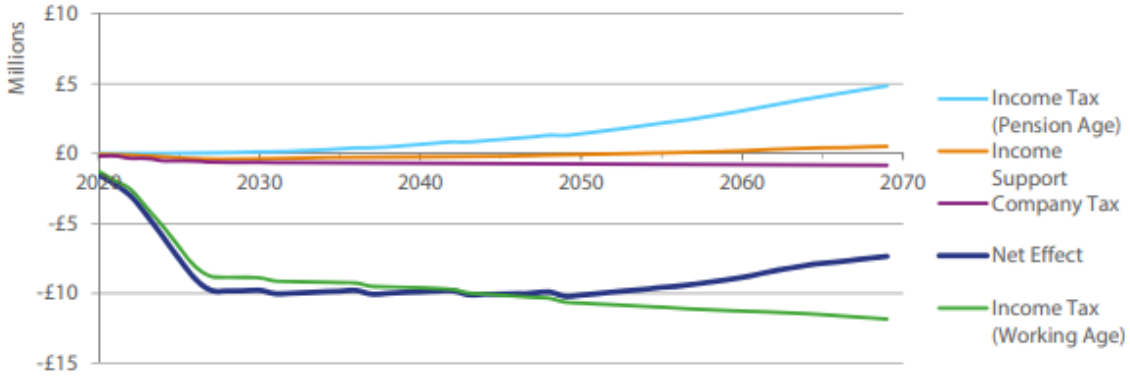


**Table 1: Overall Net Effect of secondary pensions on States finances**

| Base case | Overall Net Effect of secondary pensions on States finances £m | | | | | | |
|---|---|---|---|---|---|---|---|
| | | | | | | | |
| **Year1** | -1.6 | **Year21** | -8.5 | **Year41** | -4.9 | **Year61** | 0.3 |
| **Year2** | -2.3 | **Year22** | -8.3 | **Year42** | -4.6 | **Year62** | 0.5 |
| **Year3** | -3.1 | **Year23** | -8.2 | **Year43** | -4.2 | **Year63** | 0.6 |
| **Year4** | -4.5 | **Year24** | -8.3 | **Year44** | -3.9 | **Year64** | 0.7 |
| **Year5** | -6.0 | **Year25** | -8.2 | **Year45** | -3.5 | **Year65** | 0.8 |
| **Year6** | -7.5 | **Year26** | -8.0 | **Year46** | -3.2 | **Year66** | 0.9 |
| **Year7** | -8.8 | **Year27** | -7.9 | **Year47** | -2.9 | **Year67** | 1.0 |
| **Year8** | -9.5 | **Year28** | -7.7 | **Year48** | -2.6 | **Year68** | 1.1 |
| **Year9** | -9.5 | **Year29** | -7.5 | **Year49** | -2.2 | **Year69** | 1.1 |
| **Year10** | -9.4 | **Year30** | -7.7 | **Year50** | -1.9 | **Year70** | 1.2 |
| **Year11** | -9.3 | **Year31** | -7.5 | **Year51** | -1.7 | **Year71** | 1.3 |
| **Year12** | -9.4 | **Year32** | -7.3 | **Year52** | -1.4 | **Year72** | 1.3 |
| **Year13** | -9.3 | **Year33** | -7.1 | **Year53** | -1.2 | **Year73** | 1.4 |
| **Year14** | -9.2 | **Year34** | -6.8 | **Year54** | -1.0 | **Year74** | 1.4 |
| **Year15** | -9.0 | **Year35** | -6.6 | **Year55** | -0.7 | **Year75** | 1.4 |
| **Year16** | -8.9 | **Year36** | -6.3 | **Year56** | -0.5 | **Year76** | 1.5 |
| **Year17** | -8.8 | **Year37** | -6.1 | **Year57** | -0.3 | **Year77** | 1.5 |
| **Year18** | -8.9 | **Year38** | -5.8 | **Year58** | -0.2 | **Year78** | 1.5 |
| **Year19** | -8.8 | **Year39** | -5.5 | **Year59** | 0.0 | **Year79** | 1.5 |
| **Year20** | -8.6 | **Year40** | -5.2 | **Year60** | 0.2 | **Year80** | 1.5 |
| | | | | | | | |

Table 2 below estimates the impact of the forecast structural deficit should secondary pensions not proceed. Note that because the net impact begins to reduce from approximately 10 years after introduction, the very long-term impact of not introducing secondary pensions becomes negligible.

**Table 2: estimated impact on projected structural deficit on not proceeding with Secondary pensions**

| | In year aggregate deficit forecast assuming secondary pensions commence in 2023 (£m) | In year aggregate deficit forecast assuming secondary pensions is not introduced (£m) |
|---|---|---|
| 2022 | -4 | -4 |
| 2023 | -39 | -38 |
| 2024 | -55 | -52 |
| 2025 | -67 | -64 |
| c2040 | Approx. -85 | Approx. -76 |

3. Because of the long-term nature of this proposed policy change implication for the States' finances from a six-month delay is negligible in the medium to long term.

4. & 5. The States of Guernsey bond (issued in 2014, maturing in 2046 ) has an 'all-in' rate of 3.625%. This would typically form the basis for the cost of capital for any capital projects to be funded therefrom.

Other projects would likely be assessed on an individual basis dependent on the lifespan of the asset and the projected forward rates.

The investment portfolio has a target rate of return of UK RPI plus 4%. (Note: the discount rate prudently used in the Actuarial Valuation of the Superannuation Fund is UK RPI +2.5%).

**Deputy Peter Ferbrache**
**President**
**Policy & Resources Committee**