Executive summary

The financial experience of the National Insurance Scheme is closely linked to the performance of the Barbadian economy. The ability of the various Funds to pay benefits well into the future is not only dependent on the contribution and benefit provisions, and changing demographics, but also on the labour market and general economic activity.

Recent economic and employment growth have resulted in significantly more contributors than projected in the Ninth Actuarial Review. Increased contribution income and stable investment yields have offset two adjustments to pensions in payment in 1997 and 1998. In fact, one often-used measure for the level of funding, the reserve-expenditure ratio, indicates that the National Insurance Fund was better funded at the end of 1999 (4.6 times) than at the end of 1996 (3.9 times). This increased funding level was also due to a reserve transfer from the Unemployment Fund and an increase of 1.5% in contribution rate.

The future of the National Insurance Fund (NIF) will also be heavily dependent on population changes. Continued low birth rates, net outward migration and overall population aging, may lead to shortages of skilled labour. If immigrants and older workers do not add to a shrinking labour force, low or even negative rates of economic growth may result.

Continued improvements in the National Insurance Fund’s funding levels will be short-lived unless major reforms are made to contribution and/or benefit provisions. This Review projects the reserves of the NIF up to 2060. Other than for assumed annual increases in the ceiling and pensions in payment, these long-range projections assume that present contribution and benefit provisions are maintained. The key projection results are:

(a) contribution income will be insufficient to meet total expenditure beginning 2011;

(b) benefit and administrative expenditure will exceed contribution and investment income for the first time in 2018;

(c) NIF reserves will be exhausted in 2028;

(d) once the Fund is depleted, annual contribution rates of 25%, increasing to 30%, will be required. Shortly after 2040, pay-as-you-go contribution rates will remain relatively stable at just over 30%;

(e) a level contribution rate of 21.2% would be required to meet the cost of benefits to be paid between 2000 and 2060;

(f) a gradual increase in the contribution rate from the present average of 13.9% to 21.2% in 2009, would secure a reserve of twice total expenditure in 2060;

(g) the number of NIS contributors per pensioner will fall from 3.4 in 2000 to 1.8 in 2030 and to 1.5 in 2060.

To test the sensitivity of the above results to other plausible scenarios, several additional projections have been performed. These include assumptions of higher rates of return on investments, periodic lower adjustments to pensions in payment, as well as increased GDP growth achieved through net immigration. In all cases where experience is assumed better than in the original projections, the year the Fund is exhausted is extended by only one or two years, and the projected future contribution rate is slightly lower. However, the trend in the reserve and the high cost of projected benefits remain.

These sensitivity tests indicate that future demographic changes, where the number of contributors per pensioner is projected to fall from 3.4 in 2000 to 1.5 in 2060, will place overwhelming pressure on the National Insurance Fund. These changes dictate either the ultimate depletion of the Fund or the need for much higher contribution rates.
Reform measures aimed at extending the life of the NIF are now being considered by the Government of Barbados and The National Insurance Board. The ILO compliments such a review and will be pleased to provide assistance in the costing and/or formation of reform ideas and proposals. As immediate reforms are not required, thorough planning and the establishment of goals of the reformed NIS should be made. Reform ideas should not be limited to several minor changes but should also include major reforms consistent with revised objectives. There should also be extensive consultation with stakeholders so that the need for change is well understood. Such widespread discussion will also ensure that eventual reforms are acceptable and that the confidence in the Scheme’s ability to meet its future obligations is maintained.

The Unemployment and Severance Funds do not face the same long-range challenges as the National Insurance Fund. Instead, the future of these Funds will be more closely tied to short-term economic conditions. Labour market projections discussed later in this report suggest continued reductions, and ultimate stability, in the overall unemployment rate. Should this be realized, these two funds can be expected to accrue surpluses, and even larger reserves, if the present contribution rate and benefit provisions are maintained.

Even though the unemployment rate has declined from its high in 1992, unemployment benefit expenditure has increased in each of the past four years. In 1999, benefit expenditure almost equalled contribution income, which was based on a rate of 1.5% of insurable earnings for the first full year, having been decreased from 3% in 1998. However, even with the $109 million transfer of reserves to the NIF in 1997, the Unemployment Fund remains very well funded. In fact, a recommendation is now being made for additional funds to be transferred out of the Unemployment Fund and into the National Insurance Fund.

The Severance Payment Scheme, meantime, has experienced relatively stable expenditure patterns. The Severance Fund has continued to grow and stood at over seven times annual expenditure at the end of 1999. In addition to a recommendation to transfer reserves from this Fund to the NIF, it is also being recommended that the contribution rate of 1% be reduced to 0.5% of insurable earnings. At this level, the Fund will be able to support expenditure patterns similar to those seen in the early 1990s.

The NIB has initiated a review of The National Insurance and Social Security legislation. Once again, such a review has the support of the ILO. Items included in the review are the amount of the Funeral and Maternity Grants, which have not been increased since 1986 and 1989, respectively. Given the effect of inflation, the grants now paid do not nearly meet their desired objective when the amounts were last adjusted.

The ILO also recommends that a review be made of the ceiling on insurable earnings that has remained unchanged at $715 per week since 1991. Each year wage increases have made NIS benefits less relevant to more workers. (During 1999, approximately 18% of workers contributed at the ceiling.) The Board is encouraged to review its policy on ceiling increases so that they are more frequent and predictable. One such method would be to adjust the ceiling every three years in line with actual increases in an established and reliable wage index.

A review of the policy on increases to pensions in payment should also be made. Even though benefit increases made between 1997 and 1999 exceeded accumulated inflation, these increases were not equitable. While those awarded pensions just before the adjustment date received the same percentage increase as those whose pension was constant for many years, these adjustments favoured lower income pensioners. In one instance only the minimum pension was increased while in the other, the more highly paid pensioners received no increase at all. Once again, regular pension adjustments to all pensioners would ensure that they are able to maintain the standard of living that they enjoyed when they first received their pension.
Other recommendations made throughout this report are:

1. transfer $60 million of reserves from the Unemployment Fund to the National Insurance Fund;
2. transfer $40 million of reserves from the Severance Fund to the National Insurance Fund;
3. reduce the contribution rate for Severance by 0.5%. At the same time, the contribution rate for all contributors to the NIF should be increased by 0.5%. These changes would only affect those who presently are not covered for Severance payments;
4. develop a policy for the timing and magnitude of increases in the ceiling and pensions in payment;
5. adopt an explicit funding policy that will set out the desired long-range funding level for the NIF and define when and by how much contribution rates will be increased. Such a policy may suggest that the long-range goal is to have a reserve in 2060 of twice total expenditure and that the contribution rate will be increased when specific reserve-expenditure ratios are reached;
6. increase the amount of Funeral and Maternity grants to amounts consistent with the objectives of the grant. These grants have not been increased since 1989 and 1986 respectively;
7. monitor closely Sickness benefit and Invalidity benefit claims, ensuring that payments are made only to eligible insured persons for the correct duration;
8. review the asset mix of the National Insurance Fund investment portfolio, along with investment procedures and strategies, with a goal of earning higher rates of return without introducing significant amounts of additional risk;
9. consider separating the funding and accounting of the main benefit types now paid from the NIF by creating three benefit branches. Each branch would have different funding objectives and would have its own allocated share of contribution income, investment income and administrative expenditure;
10. improve the capabilities of in-house data management systems so that accurate, timely and relevant data are readily available.

The projected evolution of National Insurance Fund income, expenditure and reserves is not unlike that of similarly designed social security schemes. As the National Insurance Scheme approaches maturity further increases in the contribution rate and/or benefit reforms are inevitable. The financial rewards, however, of sustained economic and productivity growth, coupled with well-designed contribution and benefit reforms, will serve to enhance the ability of the National Insurance Fund to meet its obligations to future generations.