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**Redesigning social security,
for the 2020s**

BY **Andrew Harrop**

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By Andrew Harrop

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SUMMARY

This report is about reforming social security for children and working-age adults, in the 2020s. For six years of the Cameron government ‘austerity’ dominated all discussion of benefit policies. Now it is time to turn a page and start to consider the long-term future of social security, as part of a strategic agenda for raising British living standards following the UK’s decision to leave the EU. Politicians need to find the confidence to argue that generous, well-designed benefits for non-pensioners are essential for a fairer, more prosperous future. Social security for pensioners is now on a strong and sustainable footing. But the system for non-pensioners will be worse in 2020 than it was in 2010 – and will carry on getting worse, unless policy changes. We can allow this to happen – or we can turn social security around, by applying the same strategic approach to policy making as the Turner Commission on pensions did in the 2000s.

As with pensions, social security for non-pensioners can be ‘for us all’. To achieve this, the UK needs to initiate a process which leads to a new plan, with ambition and coherence. The aim of this report is to lay the ground for such a process. Part One sets out why the outlook for social security in the 2020s is currently so bleak. Part Two examines four possible directions for a reformed system – more means-testing, more contributory benefits, more private

protection, and more universalism – and how they might be blended together.

Doing nothing in the 2020s will cause huge harm and should be rejected as an option. Politicians should instead begin to weigh up two broad alternative paths for reform. The first is to breathe new life into Brownite ‘progressive universalism’ by improving the mainly means-tested system we have today. The second is to create something closer to our Beveridgean pensions system, by striking a more even balance between means-tested, universal, contributory and private support, while also starting to integrate the tax and benefit system. The first path is easier in the short term – and would help millions of people – but the second path would bring a broader range of benefits to a wider range of citizens.

Under either option, means-tested support will continue to be essential to support people with low incomes and high living costs. This applies to housing costs in particular, and the UK’s approach to benefits directly relating to housing should not undergo radical reform. Major improvements to housing affordability will depend on action to increase overall incomes and address the cost of housing, not on housing benefit reform.

Part 1: The inheritance

1. Aims

The report starts by examining the UK’s £200bn-plus system of social security, and particularly the half of it dedicated to children and working-age adults. The possible aims for social security fall into four categories: (1) tackling poverty and inequality; (2) distributing resources between people and across life; (3) creating incentives for beneficial behaviour; and (4) achieving fair conditions and public acceptability. These aims should be used to assess

today's system and make judgements about possible reforms. There are trade-offs between them, but packages of policies can advance many aims together.

2. 2010 to 2020

The social security system for children and working-age adults does worse than the system for pensioners – and is getting worse over time – with respect to almost all possible policy aims. The two systems have been diverging for years but reforms during the 2010–2020 period are exacerbating the divide. During this decade there will be a huge shift in the composition of social security spending as a result of spending cuts, contrasting policies for uprating payments and changing patterns of demand. For families with children, a largely means-tested system which was once quite generous is turning into an inadequate safety-net. Universal credit will make social security better in some respects and worse in others, but will not fundamentally change the principles or outcomes of the system.

Between 2010 and 2020, the real disposable income of families dependent on out-of-work benefits will fall by around 10 to 20 per cent. Most low income working households will also be worse off, as benefit cuts will more than offset higher pay and tax allowances. The Institute for Fiscal Studies forecasts a steep rise in child poverty by 2020. After housing costs, the outlook for people with low incomes is even worse. Housing benefit is being cut across all tenures, but especially for private tenants. The value of local housing allowance has been frozen until 2020 so any rent inflation over the next four years will leave private tenants with less disposable income or worse housing choices.

3. Social security and its alternatives

The future of social security cannot be considered in iso-

lation from other forms of support for living standards, including public services, privately organised social spending, public loans, market interventions or the 'shadow welfare' of tax reliefs. The UK actually spends far less on social security than on these alternatives – for example, more than £200bn of annual tax relief has some sort of social purpose. When you look at social security and the 'shadow welfare' of tax reliefs together, the government provides the same amount of cash support to high and low income households (around £10,000 each, on average). This is a flat-rate system of 'hidden universalism'.

The Cameron government said it wanted a 'higher wage, lower tax, lower welfare' society. It increased tax-free allowances and introduced the 'national living wage', alongside its cuts to working-age social security. This rebalancing will benefit high and middle income households at the expense of those with low incomes. By 2020, typical high income households can expect to receive more 'cash' support than typical low income households, as the value of tax allowances will rise by 80 per cent during the decade, while benefits will stagnate. By then, the basic tax-free allowance for an employee will be worth almost as much as the basic benefit for a jobseeker. Privileging tax allowances over benefit spending is also shifting government support from families with children to childless adults.

4. The 2020s with unchanged policy

After 2020, non-pension benefits are scheduled to be increased in line with CPI inflation. This means that, unless policy changes, poorer households will see their real incomes stagnate over the next 15 years, regardless of whether the long term economic impact of Brexit is good or bad. As long as there is growth in real GDP and earnings over the period, income inequality will increase and there

will be a sharp rise in child poverty. By contrast, in the 15 years before the financial crisis, incomes for rich and poor grew at the same pace.

If long-term trends are still a guide after Brexit, the cost of housing is likely to rise faster in the 2020s than the disposable income of low and middle income families. This could be the single greatest social challenge of the decade. It will mean that fewer people will be able to afford to buy a home and more people will rent. If rents rise faster than CPI inflation, a large shortfall will open between local housing allowance and the cost of a cheap home in each local housing market. Under these circumstances the numbers of homeless families would be expected to rise significantly.

Meanwhile, under current policy, social security spending as a percentage of national income will fall significantly in the 2020s, unless Brexit leads to a stagnation in real earnings and productivity. Based on the OBR's pre-Brexit assumptions for the economy, spending on children and working-age adults could fall from over 6 per cent of GDP in the early 2010s towards 3 per cent by 2030. On paper, it is hard to see how these social security policies for the 2020s can be sustained (unless real earnings growth is close to zero). Current plans for housing benefit are a case in point. But change needs to be argued for and won. A more generous approach to children and working-age adults will only come with new ideas and concerted political pressure.

Part 2: Options for reform

5: The context for reform

Any new plan for social security must be grounded in the economic and social conditions of the 2020s. Reforms need to take account of: the likelihood of rising housing costs, uncertainty regarding levels of employment and low pay,

longer working lives, more flexibility and insecurity in the workplace, more diverse family lives and increased caring responsibilities, changing patterns of disability, and the probability of high migration. They also need to reflect changing public attitudes.

In a new plan, benefits should be seen as just one tool among many for improving living standards. Building on the new 'national living wage', policy makers should consider further steps to tackle low pay. But they also need to develop strategies to raise employment levels, provide more free and heavily subsidised childcare, and stabilise housing costs. These policies are complements not substitutes for social security, however. So politicians must place a redesigned benefit system at the heart of these plans for raising living standards – and have the confidence to explain why. For example, social housebuilding should be expanded and this will pay for itself over decades through benefit savings, but even very high levels of new supply will not reduce the need for more housing benefit spending in the 2020s.

Most recent proposals for reform of working-age social security have focused on the short term and therefore assumed that little or no new money will be available. But if there is reasonable economic growth over 15 years, it will be possible to spend tens of billions of pounds more than current plans without raising taxes. Rather than allowing spending as a percentage of GDP to fall, policy makers should aim for it to remain constant during the 2020s, or rise back towards 2015 levels. The 'welfare cap' should therefore be replaced by a guideline for social security expenditure as a percentage of GDP.

Scotland has recently acquired significant new powers for tax and social security, but cannot implement major structural reforms alone. Making a new UK plan for social security will therefore need to involve the Scottish government and parliament. But the plan will also need to take

a view on the future path of social security devolution. Proposals for further piecemeal devolution, especially within England, should be resisted, when authorities lack significant fiscal and economic powers. Any future localisation should only give authorities the power to vary national schemes, as the alternative is complexity and fragmentation.

6: Option one: more means-testing

Debates on reform should start by considering the case for and against retaining a mainly means-tested system, but making it more generous. Means-testing has many disadvantages but it is the established model of UK social security for non-pensioners and provides support to most people at some point in their lives. There is a good case for stability rather than more upheaval. With reasonable economic growth, during the 2020s it would be possible to spend tens of billions of pounds extra on universal credit, if politicians decided to keep expenditure on working-age benefits roughly constant as a share of GDP. There are two options for increasing spending:

Indexation: Uprate the main universal credit elements in line with average or median earnings; and the housing allowance in line with rents.

Structural reform: Revise universal credit so that it (1) better supports living costs associated with housing, children and being disabled without work for a long time; (2) makes work pay by allowing people to earn more before the benefit starts to be withdrawn, and by merging council tax support into universal credit; (3) provides guaranteed, compulsory jobs to long-term jobseekers, and compulsory training or work for young people; (4) relies less on conditions and sanctions.

Modelling carried out by the Fabian Society and Landman Economics in 2014/15 examined the impact of

some of these reforms. It showed that improved indexation and structural reform could each significantly increase low and middle incomes. A well-funded combination of both would have been sufficient to achieve the current statutory target for child poverty by 2030.

Means-tested support remains essential for supporting poorer households to meet housing costs. Reforming the structure and indexation of the housing element of universal credit will go a long way towards providing low income households with adequate support for rental costs. Policy makers should also consider piloting tenure-neutral housing payments so that universal credit also supports mortgage interest costs for low earners.

7: Option two: more contributory benefits

Contributory benefits are popular and provide support to everyone, when their earnings are interrupted, so there is a good case for significantly extending them. The aim should be to create a united contributory system, where working-age support and the state pension are viewed as equivalent entitlements. But better working-age contributory benefits can never be an alternative to means-testing, since they cannot support persistent low incomes or high living costs, so means-tested and contributory benefits need to be designed to work side-by-side. Any significant extension of contributory entitlements will be much more credible and sustainable if it is accompanied by stronger visibility and independence for the National Insurance Fund and possibly the full hypothecation of national insurance.

Insurance against loss of work: Present spending on contributory entitlements accounts for a small share of overall benefit expenditure, which means a large percentage increase is possible. Proposals for reform include: (1) raising the value of contributory benefits for maternity, unemployment and illness to match the state pension; (2)

a modest increase in the duration of eligibility; (3) simplification of the national insurance contribution system to widen eligibility; (4) extended employment-based benefits, including partial funding of longer sick pay and new categories of funded statutory pay for carers and paternal infant care.

Caring: Politicians should consider a radical extension of the national insurance system to reflect future patterns of employment, caring and learning. People with a good contribution record could be allowed to postpone their state pension age in order to 'buy' the equivalent time immediately, to stop working (usually for family reasons), and receive a weekly payment of the same value as the state pension. This system of 'time-credits' would be for people not eligible for carer's allowance, which should continue and become more generous.

Post-19 education: This idea of providing non-pensioners support that matches the value as the state pension could also be applied to the funding of post-19 education, to greatly reduce the need for today's expensive and flawed system of student loans. In this way NI would become a system for investment not just protection. The government would create 'national insurance education accounts', with each young person assigned the annual value of the state pension for three years to meet the costs of tuition fees. The accounts could be flexible and cover all forms of post-19 education. The standard pension age would be predicated on three years of post-19 education – ie an education account of around £25,000. The payment would begin as a loan, but each year a slice would be written off on the basis of national insurance contributions or credits. The cost to the public sector would therefore only accrue gradually and, as the current student finance system is already very expensive in the long run, this proposal might not add greatly to future government spending.

8. Option three: more private protection

Employer-organised support: Social support organised by employers is an important civic responsibility and helps people stay in work. Statutory minimum requirements should be reviewed, including rationalising statutory redundancy pay and extending the duration of statutory sick pay. New ways to incentivise employers to go beyond the minimum should also be explored.

Personal accounts: The case for replacing major areas of the welfare state with personal accounts is weak. But accounts should be used to provide support where there is current unmet need, in particular to resolve existing gaps in saving and income protection. However, new schemes and any associated public subsidies need to be designed to ensure they do not widen inequalities. Following the successful introduction of opt-out workplace pensions, the auto-enrolment and/or match funding principle should be used to develop two new forms of personal account:

- **An opt-out saving scheme** mainly for low and middle income households, who typically have very low savings. For example, a scheme where 1 per cent is deducted from earnings and from benefit payments, with targeted match-funding, would enable low and mid income families to automatically save £300–500 per year. Savings up to £1,000 could be used for any purpose while higher amounts would only receive match funding if set aside for specific contingencies or placed in children’s accounts.
- **An income protection scheme for middle/high income workers** designed to provide people with a fixed percentage of their former earnings if they became unable to work or were unemployed. The

scheme should be based on insurance, not savings or borrowing. There are a lot of potential permutations, so the first step should be to pilot a range of options.

9. Option four: more universalism

'Traditional' universal benefits have been used to support particular living costs and provide an income replacement when people are out of work. These remain important functions: there is a strong case for more generous non means-tested payments for carers and disabled people unable to work for a long time; as well as an increase in the value of child benefit.

However, the established debate on universalism does not reflect the reality that the UK already has a quasi-universal system, once tax relief is taken into account. Universal credit and tax-free allowances could be presented alongside each other in a single statement of entitlements, to demonstrate that the systems combined provide financial support for us all. This might shift attitudes to social security and create a stronger sense of social solidarity. Alternatively, policy makers could seek to *actually* integrate tax and benefits, by creating flat-rate credits.

At this time there is not a good case for integrating universal credit, tax allowances and child benefit into a single flat-rate payment for each individual (ie a 'basic income'). There is growing interest in the idea, which has the merit of reducing the employment disincentives, complexity and intrusion associated with means-testing. But a basic income has significant disadvantages – any revenue neutral reform would create many losers and would not reduce poverty or improve the incomes of those with least today. Reform would be very unlikely to eliminate the need for means-tested and condition-dependent benefits, especially with respect to housing.

Instead, the tax-free allowances and child benefit should be converted into an 'individual credit' for all adults and a 'child credit' paid to the main carer. Unlike a basic income, this payment would sit alongside universal credit and as a result would significantly reduce poverty and increase low and middle incomes. The credits would be paid on a flat-rate basis either through PAYE or in cash. These new credits would take the strain off universal credit by providing another mechanism for supporting the incomes of poorer households. To avoid creating cash 'losers' the credits would need to be phased in, over a number of years, by gradually lowering the tax-free allowances and introducing a cash credit of the same value. Eligibility for the adult credit should depend on paying direct taxes or on productive participation in society – and new migrants would only gradually gain access to the credit, after paying taxes.

Blending all four approaches

There are three directions that the UK should not pursue in the 2020s. We should not transform existing social security protection into private accounts; we should not adopt a fully-fledged basic income; and we should not do nothing, as this would lead to stagnating living standards and rising poverty.

That leaves two paths for reform. We can re-create a generous means-tested system, which brings the spirit of 'progressive universalism' to universal credit. It is an imperfect answer, but it would significantly improve living standards for millions of people. Or we can start to integrate taxes and benefits and build a tiered system blending universal, contributory and means-tested entitlements, as well as private action. We can found a reformed system of social protection, insurance and investment, that works for us all and itself sits in the broader context of activist government, economic intervention and strong public services.

The endpoint of reform could be a blended system with four tiers:

- **Universal:** An ‘individual credit’ for adults and a ‘child credit’ for children
- **Contributory:** National insurance and employment-based benefits that match the generosity of the state pension, a new system of post-19 education funding and the option of ‘time-credits’
- **Private provision:** Opt-out, match-funded savings accounts for all, and the piloting of income protection insurance
- **Means-tested:** Universal credit to become a generous household-based means-tested top-up to the other individual-based tiers of support.

There will always be a place for means-testing. William Beveridge could not find a solution to what he called ‘the problem of rent’ without income-related benefits – and that reality is the same today. Housing costs are both too large and too variable to be supported in a way that does not take detailed account of individual household circumstances. It is therefore essential to have a generous means-tested system, which better reflects housing need: a major shift away from mean-testing to other forms of social security is not a viable answer. But unaffordable housing costs cannot just be resolved by direct subsidies through means-testing – housing market interventions and improvements to general incomes are essential. This illustrates how a broader, more varied approach to supporting living standards is needed.

Alone, ‘more means-testing’ would not be a disaster. But a blended social security system, alongside other

forms of government action, could be much better for everyone. The next stage is to establish the institutional arrangements to develop a plan for the 2020s, and lead the technical appraisal and public debate needed, to reach a point where such wholesale reforms become conceivable. Our political leaders can grasp the nettle and create a social security system for the next decade, designed for us all.

PART 1: THE INHERITANCE

1 | AIMS OF SOCIAL SECURITY

This report is about the choices the UK will face after 2020 with respect to social security for children and working-age adults. It argues that we can either allow a system that will already be failing at that time to become even worse by 2030. Or we can make a plan to breathe new life into social security. It is a report with two parts. Part One explains what is going wrong during this decade and why the outlook for social security in the 2020s is currently so bleak. Part Two is a search for solutions – to redesign social security for us all.

Our focus is on cash transfers from government for children and working-age adults. This is the slice of the UK welfare state which is today under greatest pressure and where there is the least long-term strategic direction. But no area of public policy is a world unto itself. The report touches on social security for pensioners, in particular to make positive comparisons with the failing system for children and non-pensioner adults. It also examines the alternatives to social security, because social and economic challenges can usually be addressed by either cash payments or other interventions, such as public services, tax reliefs, private provision or market regulation. But first, in this chapter, the report starts by examining how social security works and what it aims to achieve.

UK social security: An introduction

The government currently spends £211bn on social security in Great Britain (around 11 per cent of UK GDP), with 56 per cent of this going to pensioners and 44 per cent to children and working-age adults. Three different forms of cash transfers are used:

- **Income-related:** Where entitlement is based on means-tests (which actually take account of savings as well as income). Examples include housing benefit, universal credit and pension credit.
- **Contribution-based:** Where entitlement is triggered by sufficient national insurance (NI) contributions, credits or duration of employment. NI benefits include the state pension, maternity allowance and the contribution-based versions of jobseeker's allowance (JSA) and employment and support allowance (ESA); while statutory maternity pay is an employer-based entitlement (mainly) funded by government.
- **Universal:** Where support is available to everyone with certain characteristics. Examples include child benefit, disability benefits and winter fuel payment (note that, confusingly, universal credit is not a universal benefit).

Eligibility for particular benefits is also based on: age (eg children, pensioners); circumstances (eg disability, maternity, employment status, housing tenure); and compliance with conditions (eg work-related activities). Income-related and universal benefits are funded by

general taxation, while contributory benefits are almost entirely funded by national insurance contributions.*

Payments may be 'flat rate', with the same amount paid to all eligible claimants, or they may vary on the basis of: age (eg reduced rates for under-25s); circumstances (eg increments for family size and disability); means (eg size of payments reduced as income/assets rise); or contributions (eg size of payments increase in line with past contributions). The UK is gradually phasing out earnings-related pensions (and does not have earnings-related entitlements for working-age payments).** This makes its system unusual within Western Europe. However, receipt of a full state pension will continue to depend on sufficient duration of contributions.

The systems for children and working-age adults and for pensioners blend contributory, means-tested and universal elements. However, they strike a very different balance in the way they do this. The pension system is predominantly contribution-based, reflecting the original vision of William Beveridge's 1942 report, while the non-pensioner system is mainly income-related and funded from general taxes. Figure 1 illustrates this divide: for children and working-age adults, almost two thirds of payments are means-tested and 92 per cent are funded from tax. For pensioners, three quarters are contribution-based and therefore funded via the National Insurance Fund.

* National insurance raised £105bn in 2014/15 of which £84bn was allocated to the National Insurance Fund to pay for contributory benefits (the remaining £21bn went to the NHS). It is a tri-partite system, with contributions from employees and employers, with Treasury top-ups if necessary.

** With one small exception – the first six weeks of statutory maternity pay.

Figure 1: Spending on social security in Great Britain, 2015/16

	Income related	Contributory	Universal
Children and working age	£61bn (64%)	£8bn (8%)	£26bn (27%)
Pensioners	£13bn (11%)	£89bn (77%)	£14bn (12%)

Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP

Aims for social security

The most commonly recognised aims of social security are to prevent hardship, equalise living standards, distribute resources over our lives and insure against risk. But in all, more than 20 policy aims are associated with the social security system, grouped under four headings: (1) tackling poverty and inequality; (2) distributing resources between people and across life; (3) creating incentives for beneficial behaviour; and (4) achieving fair conditions and public acceptability.

The appendices examine possible policy aims for social security in detail – and also assess the current system and proposals for reform against these policy aims (appendix 1, 2 and 3). The 21 policy aims identified are listed in Figure 2:

Figure 2: Possible aims for social security

Poverty and inequality

1. Prevent destitution and provide a safety-net for all
2. Protect people who can't be expected to work
3. Tackle poverty (ie insufficient resources to participate in society)
4. Reduce income inequality

5. Reduce wealth inequality and help everyone build assets
6. Improve life chances and equality of opportunity, especially for children and young people
7. Ensure low and middle income households share in rising prosperity

Distribution between people and across life

1. Support economic stability, by smoothing livings standards and demand over the business cycle
2. Transfer resources across individuals' lives
3. Reflect variations in family size and living costs and invest in the next generation
4. Transfer resources between income groups / geographic areas / age cohorts / men and women
5. Insure against unpredictable risks

Incentivise beneficial behaviour

1. Make work pay and maximise employment and earnings
2. Reward and support valuable non-market contributions
3. Support additional private provision and other choices with long-term benefits
4. Increase personal power, control and responsibility

Fair conditions and public acceptability

1. Provide a system the nation can afford and is prepared to pay for
2. Require past or future contributions in exchange for support
3. Require people to meet conditions in exchange for support
4. Maintain entitlements as a right for all, that bind people together
5. Achieve simplicity, transparency and minimal interference

The report deliberately uses the term 'social security' not 'welfare' to reflect the breadth of these aims. 'Welfare' has come to mean financial assistance for people facing hardship, borrowing from American usage (as a consequence it has stigmatising connotations, which have not traditionally been associated with the British term 'the welfare state'). But this is just one of many possible aims for cash transfers – we say 'social security' to avoid implying that social assistance is the only or predominate purpose of the system.

In assessing the system as it is today and in thinking about future reform, the starting point should be a close engagement with these possible goals (see appendix 2 and 3). Politicians and commentators need to clarify which of the aims they wish the system to advance, and which they reject or see as less important. For many on the left, these aims may feel like a single list of desirable characteristics, most (if not all) of which deserve support. Those on the right of politics may reject some of them, at least when it comes to non-pensioners. A key fault-line is between politicians who (in their words or actions) support a residualised safety-net and those who believe that social security should be for us all, distributing resources over our lives and helping everyone to share in society's rising prosperity.

There are choices and trade-offs when considering how to balance these possible policy aims. Should a marginal pound of extra spending go to preventing destitution, insuring middle earners from unforeseen disability, or supporting working households who have low earnings and high housing costs? And should the system place more emphasis on 'need', 'contribution', 'conditions' or 'citizenship' when determining who should be entitled? But it is a mistake to treat this as a zero-sum conflict of irreconcilable goals. Social security works when it achieves many aims at once. The goal is to create a system which simultaneously

pools the risks that arise in contemporary Britain, smoothes out lifetime living standards and also distributes between rich and poor, between those without and with children, and between men and women. The trick is to try to advance many objectives with a single set of policies, while generating as few undesirable consequences as possible.

In particular, social security should seek to advance policy goals linked both to distribution between people (ie distribution from 'us to them') and to prudential, lifecycle distribution and insurance (ie from 'us to us'). On the face of it these appear to be quite different functions (and people would normally associate the term 'welfare' with the former only). But the reality is that social security can do both at the same time, as Sir John Hills describes in his book *Good Times, Bad Times: The welfare myth of 'them' and 'us'*.¹

Social security is 'for us all'. Recent IFS research reveals that 55–65 per cent of spending that is 'inter-personal' distribution within a single year is 'inter-temporal' distribution over our lifetime.² This is true even though, as things stand, the non-pension system is largely means-tested, because most of us are eligible for income-related benefits at one point or another: even people in the richest tenth of the lifetime income distribution spend on average one fifth of adult life entitled to a means-tested benefit. Conversely people in the poorest tenth are employed for two-thirds of working-life, on average.

So how is social security doing in achieving these multiple, over-lapping goals? Chapter 2 shows that the answer to that question is a tale of two systems.

2 | SOCIAL SECURITY 2010 TO 2020

When William Beveridge conceived of British post-war social security, he had in mind a single system, with consistent principles, providing protection from cradle to grave. But roll forward 75 years and we now have two systems: one for pensioners, and one for everyone else. They are increasingly divergent and when it comes to achieving policy goals, broadly speaking, the former is doing well and the latter is not.

In part, the reason for this divergence is just because social security for pensioners is more generous. But it is also because of the contrasting design principles of the two systems. The pensioner system works in a way that Beveridge would recognise, with contribution-based entitlements to the fore, and universal and means-tested elements playing only a supporting role. And reforms introduced in the last decade are making the pension system both more successful (with respect to our possible policy goals) and more ‘Beveridgean’.

Compared to 15 years ago, the state pension today is more effective at distributing both across our lifetimes and between rich and poor – and in the decades ahead it can be expected to deliver acceptable retirement incomes at a sustainable cost. It embodies the original Beveridge vision because it is earned by long-term contribution; it is mainly funded through national insurance; it provides adequate support,

largely without means tests or earnings enhancements; and it works as a platform for additional private provision.

By contrast, social security for children and non-pensioner adults is some distance from Beveridge's original vision: it is mainly available on the basis of need and subject to conditions, with only limited contribution-based and universal elements; it is almost entirely funded from tax not national insurance; it provides an inadequate level of support for many people and often fails to make work pay; and it does not promote extra voluntary protection.

At best, non-pensioner social security is mediocre in terms of advancing the possible aims one might set for it. Clearly, it is better to have today's support than none at all, so we cannot say it is an outright failure. But when thinking about almost every possible policy goal, the system for children and working-age adults is doing worse than the pensioner system, and, as we shall see, it is also getting worse over time (see appendix 2).

In Part Two, the report examines how a future government might set about reviving social security for children and adults below pension age, calling for a new plan for these age-groups. But first, this chapter describes the recent and ongoing evolution of social security.

1997 to 2010

Today's tale of two systems is, in part, down to the choices made by the New Labour government, which returned the pension system to its Beveridgean origins but retained the principle of means-testing at the core of non-pensioner social security. Entitlements for current and future pensioners became much more generous – for a time through the extended use of means testing, but then by redesigning the state and private pension system, following the recommendations of the 2003–2005 Pension Commission, chaired by Adair Turner. The state pension was indexed

to earnings, rather than prices; earnings-related top-ups were reformed to become widely available, flat-rate entitlements; and a new system of auto-enrolment workplace pensions was invented to stand alongside state-funded support. By 2010 the foundations for a decent and affordable pension system were in place.

Meanwhile the system for children and working-age adults remained largely means-tested throughout the 1997–2010 period. During this time it was successfully reformed to promote employment, through the introduction of increased incentives, support and conditions. The minimum wage and higher in-work payments made work pay. And jobseekers, lone parents and disabled people all had to do more to prepare for, and seek, work and were provided with services to help. In parallel, Labour made a huge commitment to reducing child poverty and greatly increased the value of means-tested payments for children, creating a tax credit system stretching from families without work to middle earners.

There were restrictions too. Housing benefit for private tenants was replaced by local housing allowance (LHA), a system where payments are linked to local area rents, not a specific property (meaning that in many cases they do not cover all housing costs). Incapacity benefit was also replaced by employment and support allowance (ESA), which disability campaigners argue has a tougher eligibility assessment. Above all, the level of most benefits for working-age adults were frozen in real terms (unlike those for children and pensioners), so that the value of entitlements – whether means-tested, universal or contribution-based – failed to keep up with rising living standards.

As a result, by the end of the Labour government, the pension system was on course to becoming more contribution-based and more generous; the system for families with children seemed to have reached a steady state, of generous means-testing accompanied by a limited universal offer

(so-called ‘progressive universalism’); and entitlements for adults without children were increasingly residual.

2010 to 2020

Between 2010 and 2020 the pace of reform will have been even greater than under Labour. Policy decisions during David Cameron’s time as prime minister will further increase the differences between the two systems, as a result of contrasting choices with respect to budget cuts and indexation policies. They will also make the differences plainer to see, because the principal pensioner and working-age entitlements are being relaunched to be purer embodiments of the rival principles upon which they are based. There will be a single flat-rate, contribution-based pension; and a single means-tested, condition-based credit. Appendix 4 summarise the main post-2010 reforms and illustrates how they are accelerating the divergence between the two social security systems.

For pensioners, a generous approach to the uprating of the state pension and pension credit have made entitlements more generous, albeit at a later pension age. And the pace at which the state pension is transitioning into a flat-rate payment has been sped up, with the introduction of a new state pension this year. After 15 years of reforms we have a system that prevents poverty and provides a strong platform for saving.

Looking forward, the long-term prospects for the UK pension system are now strong, not least because the system is governed by coherent, explicitly agreed and widely supported principles, originally developed by the Turner Commission. Further changes will be needed in this parliament and in the 2020s, but they can and should build on the foundations now in place. It is a question of evolution, not revolution.

Meanwhile, for children and working-age adults, most

of the means-tested payments are being combined into universal credit, with the aim of creating a simpler system. The availability of universal and contributory benefits has also been reduced. And the generosity of entitlements is declining, through uprating decisions, specific cuts and caps on payments. These iterative reforms have had the over-riding purpose of constraining cost (a criterion not applied to the pension system or to tax allowances). But the government has also stressed the goal of making work pay and argued that its reforms apply common-sense notions of fairness.

The overall result of the Cameron-era reforms is that a largely means-tested system which was once quite generous for families is turning into an inadequate safety-net, which will be increasingly ineffective at reflecting variations in living costs or protecting children from poverty. The system is becoming less successful when measured against almost all our possible policy goals including: preventing poverty; distributing across the lifecycle; making work pay; insuring against unpredictable risk; and reflecting variations in family sizes and living costs.

It was not meant to be like this. The Conservatives' flagship social security policy, universal credit, was conceived not to save money but to increase employment and make work pay. It is a huge (and possibly unworkable) administrative reform, which takes Gordon Brown's system of benefits and tax credits and simplifies it – making it better in some respects and worse in others average (see appendix 5). Universal credit is a rationalisation, not a revolution, for all the pain it has created. Originally the new benefit was intended to be slightly more generous than its predecessors – now, following cut after cut, it will leave people worse off on average.

We need a new approach. As the country prepares for its post-Brexit future and looks to the 2020s, now is the time to take a lesson from the pension world and examine

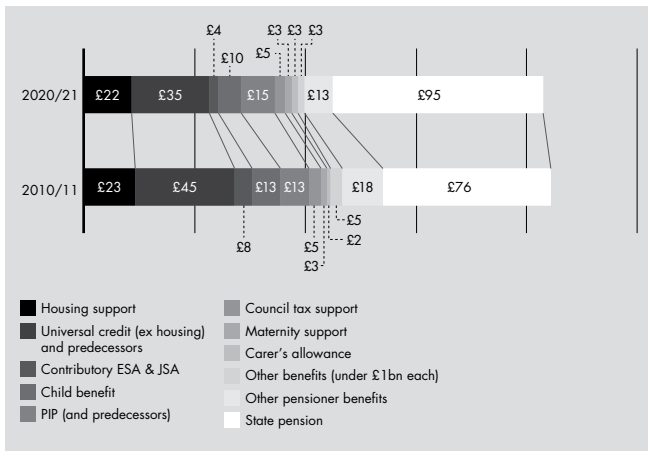
the basis of the whole system. The Turner Report was a huge achievement, but it was only a new Beveridge plan with respect to pensioners. It is time for an equivalent plan for non-pensioners too. The design of social security for children and working-age adults should not be identical to that for older people. But the same methodical approach to policy making should be embraced, so that the system for non-pensioners is also derived from clear goals and principles; based on good evidence; and focused on the long-term.

Impacts on living standards in 2020

Since 2010, Britain has grown used to almost constant reports of ‘welfare cuts’. But the true story is not one of cuts overall, but of a rapid shift in the composition of social security spending. During the decade, total real spending on social security is forecast to remain almost constant, falling from £211bn to £207bn between 2010 and 2020 (2015 prices).³ But within that sum, spending on the state pension will increase from £76bn to £95bn, even though the pension age for women has been rising during the decade (it will reach 66 for men and women by 2020).*

* This increasing spending is driven by the ageing of the population (with the baby boom generation reaching pension age), by more people being eligible for higher pension payments, and by the government’s generous policy for annual uprating (the ‘triple lock’, which guarantees that the basic state pension will rise annually by the higher of earnings, CPI inflation or 2.5 per cent).

Figure 3: the changing composition of social security spending in Great Britain (£ billion)



Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016

Policy changes have also reduced real spending on most non-pension benefits (see appendix 4). Cuts announced during the 2010–2015 parliament amounted to £25bn per year by 2015, mainly targeting children and working age adults. They included:⁴

- £6.8bn: tax credit reforms (eg reducing availability for mid income households)
- £6bn: indexation policies (uprating benefits by CPI and then by 1 per cent for three years)
- £3.5bn: child benefit reforms (freezing rate and excluding high-earner families)
- £2.5bn: housing benefit reforms (including reform of local housing allowance and the 'bedroom tax')

- £1.6bn: employment and support allowance reforms (time-limit for contributory ESA)*

Further cuts announced since the 2015 election are expected to lead to savings in 2020/21 of:⁵

- £5.3bn: cuts to universal credit and tax credits (including reduced work incentives and a restriction on payments for more than two children)
- £4bn: 4 year freeze to most benefits, tax credits and local housing allowance
- £2.2bn: savings to housing benefit (but most of these are from reducing social rents)
- £640 million: ESA reduced to same level as JSA, except for severely disabled

All these policy changes are having significant impacts on the living standards of middle and low income households. Looking at households without work, the IFS has modelled the effects of policies introduced in the last parliament, and found they reduced the real disposable incomes of poorer non-working households by around 7 per cent.⁶ Figure 4 presents the picture for the whole 2010 to 2020 period, using Joseph Rowntree Foundation calculations of the real disposable income of different types of non-working family. This shows that the basic 'safety net' will fall by between 9 and 22 per cent for working-age families (by contrast a pensioner couple with no private pension will see their income rise by 12 per cent).⁷

* Expected savings from other disability benefit reforms have been far lower than originally expected.

Fig 4: Joseph Rowntree Foundation calculations of disposable weekly income for non-working households, after benefits, direct taxes, rent, council tax (2015 prices)

	2010	2015	2020	Change 2010–2020
Couple + 3 children	£326	£331	£253	-22%
Lone parent + 1 child	£157	£156	£138	-12%
Single non-pensioner	£73	£72	£64	-11%
Couple +2 children	£264	£264	£240	-9%
Pensioner couple	£232	£235	£259	+12%

Source: Hirsch, D, Will the 2015 summer budget improve living standards in 2020?, Joseph Rowntree Foundation, 2015

The picture is a bit more mixed for low earning households. There has been plenty of bad news. Many working families saw their real incomes decrease between 2010 and 2015, due to falls in both benefits and pay. According to the IFS, just tax and benefit decisions reduced real disposable incomes for poorer working families by over 3 per cent on average.⁸ From 2015 onwards, benefits for most working families will fall again, with in-work support being cut by more than the out-of-work safety net. But there is some good news too. Some people are gaining a little from increases to the income tax personal allowance, if they have sufficient earnings. And some will also gain from the new minimum wage for over-25s (the ‘national living wage’). Meanwhile, assuming the economy grows during the rest of the decade despite the uncertainty of Brexit, everyone in work else can expect to see their real earnings increase gradually. Low paid single adults and two-earner couples are particularly likely to benefit from pay rises, because earnings make up a fairly high share of their income; lone parents in low paid jobs are in the opposite position and will be a lot worse off, compared to 2010.

Policy changes which result in declining living standards

also lead to rising poverty. The IFS forecasts that child poverty will rise steeply over the next four years, from 18 per cent of children in poverty in 2015/16 to 26 per cent in 2020/21.* This will undo all the progress made since Tony Blair promised to end child poverty in 1999. This rapid deterioration contrasts to the 2010–2015 period in which child poverty was stable (first, because middle incomes fell alongside low incomes; and then because employment among low-income families increased). Around two fifths of the projected increase in child poverty is due to specific cuts announced since the 2015 election, with the remainder due to the prevailing policy of uprating benefits in line with prices not earnings.⁹

These projections do not take account of behavioural responses to policy, and in theory they could be offset by increases in employment, hours or hourly wages. Many individuals may well respond, but the overall degree of change required to compensate for the projected losses is completely implausible, not least because so many of the households affected already have someone in work and their financial incentives to earn more are weak. Following the UK's success in reducing the number of children living in non-working households (64 per cent of children in poverty now live with an adult who works), this will be a crisis of in-work poverty.¹⁰

A decade of decline

The outlook in 2020 for social security for children and working-age adults is not good. At the start of the chapter we saw how it was already doing less well than the

* Poverty measured as the percentage of children living in a household below 60 per cent of median income, before housing costs, after adjusting for size of family. Forecast based on pre-Brexit earnings projections.

pensioner system, with respect to almost any goal you could set for it. We now have a picture of a system that, over the course of a decade, is going from mediocre to something worse.

Against almost every one of our possible aims, a decade of austerity is sending social security backwards (appendix 2). Frozen safety-net payments and harsher sanctions mean the system is failing to prevent destitution. Limits on contributory benefits are making it less effective as insurance. Poverty and income inequality is expected to rise over the next five years. Support for children has been particularly hit, with lasting implications for life chances – and both this, and cuts to housing benefit, means the system is worse at reflecting living costs.

So social security for non-pensioners is now markedly less effective at transferring resources between groups and across our lives, at protecting people who cannot work and at supporting working families. Chapter 4 shows how the situation could grow still worse in the 2020s. But before that the next chapter examines how benefits fit into the wider context of social spending and government intervention.

IN FOCUS

Housing costs and support

The statistics and projections for poverty cited in this chapter do not take account of housing. When changes in housing-related costs and spending are factored in, the situation for low income families could be even worse. In recent years the main pressure on after-housing income for poorer households has been declining housing support not rising costs. Indeed between 2010 and 2015, average private rents in England increased by less than CPI inflation.* The outlook for the rest of the decade will be determined by both social security cuts and changes in rents.¹¹

Social security

During this decade overall spending on housing benefit will fall slightly, partly because of cuts and partly due to changing patterns of eligibility (driven by stagnant earnings, declining numbers of households without work, and the rising pension age). This means that, as with social security overall, the composition of spending on housing benefit is shifting significantly between 2010 and 2020. Figure 5 shows that the type of households receiving the benefit will change markedly. The number of pensioner households and households with an out-of-work benefit who receive housing benefit are both projected to decline by 300,000. But the number of people in work receiving the benefit is expected to rise by 550,000 (this group is reported as 'other' in figure 5). So, by 2020, there will be many more working households who cannot afford rent without support, offset by fewer workless households and poor pensioners.

* Rent inflation was higher in some housing markets, rising on average 3 per cent per year in London; and in social housing, where most rents were pegged at RPI plus 0.5 per cent.

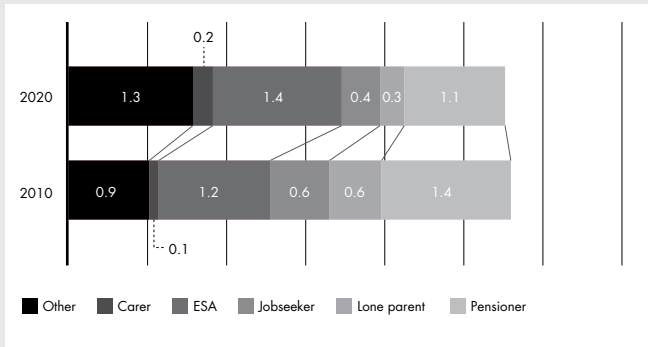
Public support for housing costs

Ever since the Beveridge report, the UK has had a separate system of means-tested social security to support low income families meet their housing costs. Even Beveridge, the architect of 'social insurance', was unable to find an affordable way for contributory or universal payments to cope with what he called 'the problem of rent'. So the UK provides means-tested support for the costs of rent separately to general income maintenance, both because only tenants are liable for rent and because rents vary greatly between areas and types of property.

Today, the cost of rent is supported by housing benefit, which is in the process of being merged into universal credit and pension credit. Housing benefit normally pays the full cost of social rents (although restrictions have been introduced, coming into force in 2013 and 2018). Most private tenants are paid local housing allowance (LHA), which is intended to cover the costs of a cheap rent in each local property market, rather than the full cost of a specific tenancy. In addition homeowners claiming out of work benefits are entitled to payments in some circumstances to meet the costs of mortgage interest, although support for mortgage interest will be converted from a benefit into a loan in 2018.

Traditionally, social housing has been an important complement to housing benefit. There are around 5 million households in the UK social rented sector, paying rents up to 50 per cent less than the local market rate.¹² In 2010/11 spending on housing benefit was £2,500 less per household for council housing than LHA recipients (2015/16 prices). At that time Shelter calculated that new-build social housing could pay for itself over 30 years, just as a result in the benefit savings from people paying social instead of private rents.¹³ But in the five years from 2010/11 the stock of homes for social rent in England grew by less than 50,000 homes.¹⁴

Figure 5: The changing composition of housing benefit recipients (millions of households)



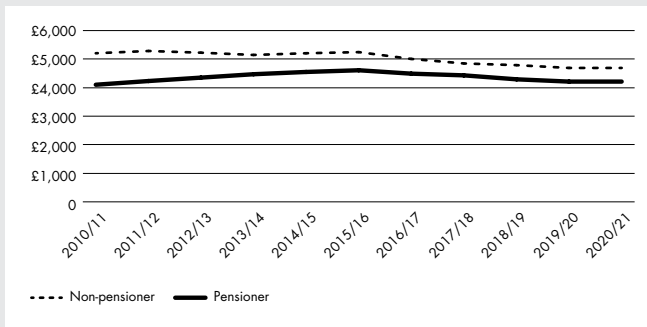
Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016

Spending per eligible household is also projected to fall during the period. This is partly because of the changing composition of claimants but mainly because the generosity of housing benefit is being significantly curtailed. This of course comes on top of other cuts affecting the same households, and also the ‘benefit cap’, which places an upper limit on the total benefits a household can receive and usually only applies to people receiving housing benefit.

- **Social housing tenants**, saw the ‘bedroom tax’ introduced in 2013. This means that tenants with one or more additional bedroom no longer receive sufficient housing benefit to cover the full costs of their rent, even if they have no income apart from benefits. New local ceilings on housing benefit for social tenants are also expected to be introduced, to match the rate of the local housing allowance. This will create a shortfall between benefits and rents for some tenants, especially for people living in supported accommodation.

- **Homeowners in receipt of an out-of-work benefits**, will see support for mortgage interest end in 2018. The benefit, which prevents people losing their home when they become unemployed, will be converted into a repayable loan.
- **Private sector tenants** are the group being most affected by reductions in support. Initially, local housing allowance was made less generous: LHA rates were set to cover the cost of renting only cheap properties in each housing market (up to the 30th percentile of local rents); claimants can no longer keep any difference between their actual rent and their LHA; a national cap on LHA has been introduced, affecting people in expensive areas like central London; LHA for 5-bedroom homes has been abolished; and single people without children aged under 35 are only entitled to support for shared accommodation. Then, in 2013, the link between LHA and local rents was broken, with annual increases in LHA linked first to CPI (as a new default), then uprated by only 1 per cent, and now frozen for four years.

Figure 6: Housing benefit spending per recipient household (2015 prices)



Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016

The introduction of universal credit will offer households who are renting and working some compensation for these losses. The maximum level of housing support, paid to non-working households, will be unaffected by the transition, but under universal credit, when people start to earn, payments will be withdrawn less quickly than with housing benefit. IFS modelling suggests that, on average, working renters will be £430 per year better off under the new system, compared to what will be in place in 2020. Take-up of housing support can also be expected to rise, as only 56 per cent of households with work who are eligible for housing benefit currently claim, compared to 91 per cent of households eligible for working and child tax credit.¹⁵ This is one positive aspect of the last decade of welfare reform, although it is striking that it is happening in parallel to significant cuts in housing benefit for people without work, who need even more help to meet their housing needs.

Housing costs

For private tenants receiving housing benefit, the outlook for the rest of the decade is uncertain because we do not know what will happen to rents. By freezing LHA, the government has transferred all the risk of rent inflation onto low income tenants, so the question of how fast rents will rise has become critical to their household finances. The pressures are likely to be significant in the short term because rents are currently rising by around 2.5 per cent per year.

The future course of private rent inflation is however hard to predict. So far, we have no idea whether the shock of Brexit will affect typical rents. But even ignoring that uncertainty, the statistical time series on rent inflation barely predates the financial crisis and so offers no evidence for 'normal' economic times. To the extent that it is any guide, the evidence from the last decade suggests that rent inflation follows earnings more

than consumer prices or house prices. If rents rise at the same rate as the OBR's pre-Brexit earnings projections, then benefit recipients will face significant shortfalls between LHA and local market rents.

In 2015/16, the median shortfall between the maximum LHA available and the 30th percentile rent for a local market was £3 per week; and the shortfall exceeded £9 per week in just one in ten local markets.* But if rents rise in line with the OBR's pre-Brexit earnings projections, by 2019/20 these figures could rise to £19 and £43 per week respectively. Families would often need to make up shortfalls from the rest of their household budget, and for many people without work this would have a very severe impact on living standards. For example, a single 30 year old living in a room in a shared house might need to make up a shortfall of £10 to £16 from a disposable income of around £70 per week; and a lone parent with one child, renting a two bedroom flat, might need to make up a shortfall of £19 to £36 from a disposable income of around £150 per week.**

If rents do increase at this pace, it is hard to see how poor households will be able to cope with such large reductions in after-rent income. Moving into work is often touted as a solution by ministers, but it would not always be a viable answer, because the LHA would start to be withdrawn as income increased, while the same underlying rent would remain. And, with significant shortfalls across many local housing markets, moving to another area might not offer a solution. Instead, the system could push people towards very cheap accommodation which may be unfit or overcrowded,

* There are very high shortfalls in the most expensive markets, but these are caused by the LHA cap, not the indexation policy.

** These are the median and 90th percentile shortfalls we project for a room in a shared house, and for a two-bedroom home.

and to avoid homelessness and destitution, more and more tenants would need to turn to charitable handouts or black market jobs. Unless the Brexit vote leads to rent inflation that is much lower than these projections, the viability of this policy must be in doubt.

3 | SOCIAL SECURITY AND ITS ALTERNATIVES

Chapter 2 described how the social security system for children and working-age adults is facing huge pressure this decade, with sweeping cost-cutting reforms. But, in parallel, ministers have maintained and even increased other ways in which they support household living standards – through public services, market regulation, private schemes and tax reliefs. This chapter examines that context, by assessing the alternatives to social security.

The strategy of the Cameron government was summed up by George Osborne when he stated in summer 2015 that his goal was to move “from a low wage, high tax, high welfare economy, to a higher wage, lower tax, lower welfare society”.¹⁶ That statement came in a budget speech in which he cut billions of pounds from social security spending, but sought to offset the change through a higher minimum wage and an increase in tax-free allowances. As a strategy it sounds attractive but, as we shall see, it turns out to have very negative distributional consequences. In particular, raising tax allowances favours high income households, because any adult whose income is below the current threshold does not benefit from each successive

increase. So what appears to be a flat-rate policy for all, is actually pro-rich – it is ‘regressive universalism’.

Since 2010 ministers have devoted a huge amount of money to providing more support to households through the ‘shadow welfare’ of tax reliefs and allowances. During the last parliament, the government raised the income tax personal allowance by much more than inflation, and in the process cut revenues by around £8bn per year (just as benefit spending cuts worth £25bn were underway).¹⁷ The plans for this parliament are similar and will entail receipts falling by another £6bn per year by 2020.¹⁸ Alongside this, ministers are maintaining existing pension tax reliefs, which amount to more than £30bn per year in foregone receipts, and therefore comprise a significant slice of the financial support that the government provides to households.¹⁹

We are not used to discussing social security alongside these other policy areas – nor in choosing between them neutrally, on the basis of evidence and clear criteria. But governments can have similar impacts on a household’s living standards through cash transfers, tax allowances, public services, or market interventions that cut living costs, raise earnings or increase private saving. We need to stop thinking in ‘silos’ about these different options. For example, it makes little sense to have a strict ‘welfare cap’ on most non-pension social security, while also having complete flexibility to provide equivalent support to households through tax reliefs or public services.

Fortunately, there is international assistance on hand. The OECD has developed a taxonomy for identifying and evaluating all forms of ‘social expenditure’. This treats spending for ‘social purposes’ as equivalent whether it takes the form of social security, public services, tax reliefs or private scheme like workplace pensions. Appendix 6 describes how the UK’s social expenditure compares to other countries, using the OECD framework.

Learning to analyse the different policy options affecting living standards together is particularly important because their distributional consequences often vary hugely. In particular, raising tax reliefs is likely to benefit higher income groups, while spending on benefits and public services disproportionately benefits poorer families. These are important considerations when thinking about whether to support families through cash or services, and whether to create integrated or parallel systems of support through the tax and social security systems.

The UK spends far less on social security than on its alternatives

Figure 7 provides a detailed breakdown of the forms of support available through UK social security and its alternatives. The three rows on social security are familiar, but it is unusual to present them alongside a breakdown of public loans to households, private social spending, tax expenditures and reliefs, public service provision and market interventions – each of which can play a similar role to social security.

Figure 7: Examples of social security and its alternatives

	Children and working age	Pensioners	Housing
Social security: means-tested	Universal credit (and predecessors), council tax support	Pension credit, council tax support	Housing benefit (and successors), support for mortgage interest [until 2018]
Social security: universal	Personal Independence Payment (and predecessors), carer's allowance, bereavement benefit, [child benefit]†	Attendance Allowance, Personal Independence Payment (and predecessors), Winter Fuel Payment	

† Child benefit is now withdrawn from households with one or more high earner, but through the tax system not a social security means test

	Children and working age	Pensioners	Housing
Social security: contributory	JSA (c), ESA (c), statutory maternity pay, maternity allowance	State pension	
Public loans	Student loans	Social care deferred payment agreements	Support for Mortgage Interest [from 2018] Help to Buy equity loan
Private social spending	Help to Save [from 2018]; redundancy pay, statutory sick pay, group income protection/critical illness insurance	Workplace pensions, personal pensions, lifetime ISA [from 2017]	Help to buy ISA, lifetime ISA [from 2017]
Tax expenditures and reliefs	Income tax and NI tax-free allowances, VAT reliefs, tax-free childcare [‡]	Income tax allowance, pension tax relief, VAT reliefs, tax-free pension lump sum, NIC exemption	VAT exemption for new build construction and for rent, capital gains tax exemption for first homes
Public services	Free nursery places, public transport subsidies, free school meals, NHS	Free bus travel, social care, NHS	Social housing, 'affordable rent' housing, shared ownership leasehold
Market intervention	National Minimum Wage, price regulation of utilities	Price regulation of utilities	Planning liberalisation, public sector land disposals, starter homes

‡ The new version of 'tax-free' childcare is officially classed as public spending

In financial terms, each of the main alternatives to social security is hugely significant. While the UK currently spends around £210bn annually on social security, public and private expenditure that is equivalent or substitutable is worth even more. In particular, if we did not have the NHS, private pensions and the major tax reliefs we would need to spend several hundred billion pounds more on social security to achieve the same results. But at the same time, if we spent a little less on these alternative forms of social protection, then a lot more money might in principle be available to fund social security. The main areas of expenditure are:

- **Public services:** Huge swathes of UK public service spending can be considered to boost living standards, in that they fall under the OECD definition of social protection (not least over £130bn of NHS spending across the UK). Within this, some services are particularly close to or substitutable with social security, because they could obviously be replaced by a cash payment. The major examples identified here have a value equivalent to almost £40bn of social security spending: social housing, social care, transport subsidies, free early years education and free school meals.²⁰
- **Public loans:** Loans organised or subsidised by the public sector to meet living costs include: maintenance loans for students (worth approximately £4bn per year in England), local government deferred payment agreements, and help to buy equity loans (worth over £1bn per year in England).²¹ Support for mortgage interest will shortly become a loan scheme.
- **Private expenditure:*** Private 'social expenditure' cannot be easily estimated but must be considerably in excess of £140bn per year – just private pension payments made by insurers come to £127bn per year.²² Traditionally private social expenditure was organised by employers, on a collective basis. Increasingly it is coming to include individual provision through 'personal accounts'.
- **Tax relief and 'expenditure':** Tax relief and expenditure with a social purpose takes a number of forms, includ-

* Under the OECD taxonomy private sector 'social expenditure' includes all arrangements that are compulsory or include redistribution through either tax reliefs or risk-pooling that is not justified by actuarial evidence.

ing subsidies for the private social expenditure just discussed. The OECD only counts a narrow range of UK tax provisions in its published statistics on 'tax breaks for social purposes', but a broader range of measures are included in HMRC and NAO data on tax reliefs and expenditures.²³ In 2014/15 HMRC identified £381bn of tax expenditures and structural reliefs (not all of which affect households), compared to total tax revenue of £604bn. Our analysis identifies £218bn of tax relief/expenditure which could be said to have a social purpose – more than total expenditure on social security.*

- **Market interventions:** We do not value market interventions in the same way, as the public finances are only affected indirectly. But interventions to increase employment or earnings, or reduce living costs, can directly impact on social security spending. For example, the 'national living wage' will lead to (relatively modest) savings on in-work social security of £800 million.²⁴

When you take all these categories together, these are huge sums of money, which suggest significant future possibilities. Of course, a sudden shift in the balance of

* Tax expenditure equivalent to social security: £48bn (tax reductions linked to: pension contributions, ISAs, Save As You Earn, childcare, redundancy pay, married couples, old age, self-employed earnings, disabled motorists, living alone). Tax-free income: £121bn (income tax personal allowance, national insurance primary threshold and lower profits limit, tax waived on universal benefits – child benefit, attendance allowance, disability living allowance, war disablement benefits). Tax reductions on basic living costs: £32bn (VAT relief for food, print media, children's clothes, disability supplies, energy, rent, burial and cremation). Tax-free charges for public, welfare or utility services: £18bn (VAT relief for passenger transport, water and sewerage, prescription drugs, education, health, postal services).

spending between these activities would constitute a revolution in our political economy, which is not something policy makers would wish to contemplate during uncertain times. On the other hand, we should think hard about the future evolution of expenditure in each category because, over 10 or 15 years, marginal decisions that lead to a little more or less spending in one area or another can have a big effect. Indeed, they already are, as our analysis of the impact of the government's tax allowance policy is about to reveal.

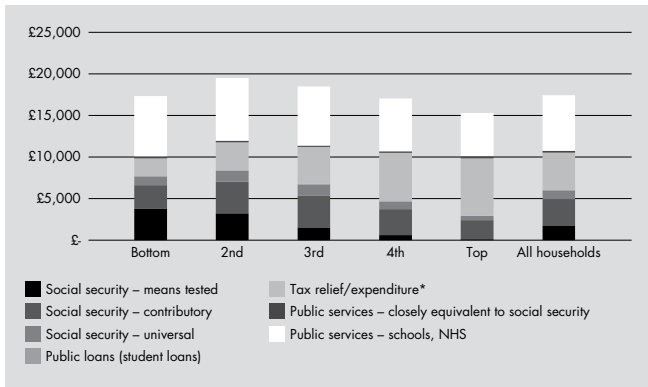
The government gives as much cash support to the rich as the poor

In 2013/14 'social expenditure' amounted to 53 per cent of pre-tax income for the average household (or £21,000), according to Fabian Society estimates based on the ONS data series *Effects of Tax and Benefits on Household Incomes*.^{*} 9 per cent (£3,600) was private pension income and 44 per cent (£17,400) was direct public support from the gov-

* The ONS publishes data on many forms of social expenditure. Household-level estimates are available for spending on the major social security benefits, student loans, major public services, and private pensions in payment (for this analysis we include all public services used by households, ignoring a distinction made by the OECD between social and economic/education expenditure). Information on tax reliefs is not included in the ONS bulletin, but it is possible to estimate their value using the published data, by comparing the amount of each tax reported as paid, compared to the amount that would be expected given reported income and earnings, if the main headline rate of tax was applied. These calculations are only approximations (especially in the case of VAT) but they are based on cautious assumptions regarding the scale of tax relief. In particular we have ignored the higher and top rate of income tax entirely, so our estimates under-estimate the tax relief for the richest income quintile.

ernment (including the ‘shadow welfare’ of tax reliefs). Figure 8 ignores private pension income and looks only at this government support.* The chart reveals that in cash terms, the value of this support is similar across the income distribution, with high and low income households receiving comparable amounts of public support (in the region of £15,000 to £20,000 per year).

Figure 8: Public support for households, 2013/14



*Tax relief/expenditure estimated by the Fabian Society, other items from official survey data
 Source: Effects of Tax and Benefits on Household Incomes 2013/14, ONS, 2015

The distinction between rich and poor is even smaller when public services are excluded, and you consider only social security, tax reliefs and public loans. These estimates suggest that in 2013/14 the average household in the top and bottom quintiles received exactly the same amount

* We do not treat any part of private pensions in payment as public support to avoid double counting, since our analysis of tax relief already encompasses pension tax relief on earnings and other income.

from government (£9,800), with middle quintiles receiving a little more. However, the composition of this support varies greatly between low and high income groups, with 80 per cent of the support for the poorest fifth of households coming through social security and 70 per cent of support for the highest fifth through tax relief. The results show that, together, social security and tax reliefs amount to a flat-rate system of support, at least when looking at averages for large groups. Spending on social security falls as incomes rise, at roughly the same pace as 'spending' on tax reliefs/expenditures increases.

This is a remarkable finding, and even more so given people's negative attitudes to social security. If there was wide public awareness that the tax relief and social security system support high and low income households to the same extent overall, this could change perceptions. The public might come to see that people without work, or with very low earnings, are not making a special claim on society, but are receiving support on similar terms to everyone else – together it is a system 'for us all'.

Admittedly, not everyone likes to think about tax reliefs in the same way as social security – as cash allowances from the state. On the face of it, there is a big difference between money you've earned, which the government chooses not to tax, and money that's already come from someone's taxes, which the government chooses to give to you. On the other hand, HMRC draws a clear distinction between headline tax rates and the plethora of reliefs, allowances and exemptions, which it does indeed value as if they were expenditure. Meanwhile, from the perspective of a family's disposable income, it makes no difference whether you receive an extra pound through a higher tax allowance or a cash payment – and from the perspective of the exchequer, policy choices which increase expenditure or forego revenue have identical fiscal effects.

The most important reason for treating tax reliefs as

'shadow welfare', however, is that it makes it possible to scrutinise and communicate the combined impacts of government policies at a time of rapid change. For when the Treasury is 'spending' billions of pounds extra on 'shadow' welfare, while cutting billions from 'real' welfare – with different effects for different types of family – it is unacceptable to not treat the two systems as equivalent.

The balance is shifting in favour of high income households

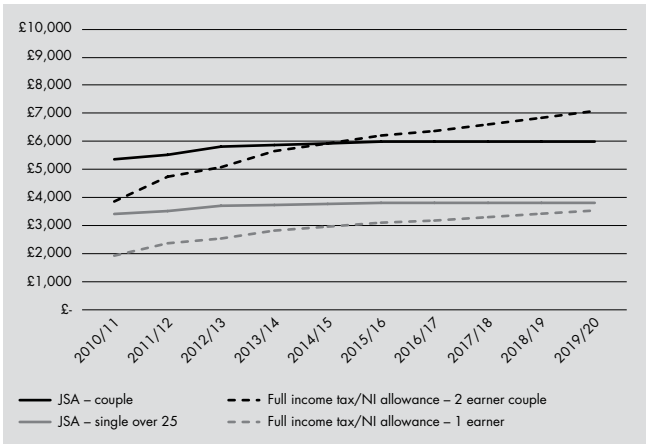
So what does our analysis of changes to tax allowances and benefits show? During the course of the 2010s the distribution of 'cash' support for working-age households will shift markedly in favour of high income groups. This is because the value of working-age social security will remain almost static, while the value of tax allowances will rise considerably (with each fresh increase only benefiting people earning above the previous allowance). Not only will this favour richer households over poorer ones, at the level of individuals, it will widen the gap in resources between men and women.

In percentage terms, the contrast is striking. The Conservatives' plans for tax-free allowances for income tax and national insurance will increase their combined cash value by over 80 per cent between 2010/11 and 2019/20. During the same period the value of the basic out-of-work benefit for an adult will rise by just 12 per cent. But even this difference tells only half the story. It is the cash values of the entitlements that really raises questions. Figure 9 shows that, while the value of benefits will hardly rise, the allowances will increase from being worth £1,920 to more than £3,500 a year.* As a result full time workers and people without a job will receive similar levels of financial support.

* This is the amount in cash taxpayers save from the existence of the allowances, compared to every pound of income being taxed.

- **Single adults:** By the time of the 2020 election the safety-net payment for a single adult without work will be £3,800 per year (excluding support for rent and council tax). That is only £300 more than the value of the tax-free allowances, even though the former is intended to meet all subsistence costs.
- **Couples:** The picture for couples is even more striking, as the point of ‘cross-over’ has already been reached. The basic tax-free allowances in 2016/17 amounts to £6,350 for a two-earner couple. For a couple who are both out of work, the safety-net entitlement is £5,970 (since, couples receive less in benefits than two single people). 2015/16 was the first year when couples started to receive more if both were working than if both were not.

Figure 9: The value of basic public support: JSA for people out of work; income tax and NI tax-free allowances for people with reasonable earnings



Source: Fabian Society calculations based on announced government policy

The story gets a little more complicated if you consider all social security and 'shadow welfare', not just these basic entitlements. Most people who are out of work and receiving benefits get more than the safety-net payment of £73 per week: they receive money to take account of children, disability, rent and council tax. Meanwhile low income working households receive a combination of social security and some tax allowances, and middle and high income households typically benefit significantly from pension tax relief, beyond the basic tax-free allowances.

Taking all these forms of support together, by 2020 it is very likely that average high income households will be receiving measurably more than low income households. We have already seen that in 2013/14 the richest and poorest quintiles were estimated to be receiving the same in cash support. And over the rest of the decade the value of social security for most non-working families will be flat or falling; low income families will lose more in benefit cuts than they gain in tax reliefs; and high income households will benefit from tax reliefs – from the rising personal allowance, but also from pension tax relief and VAT exemptions (which will each provide them more each year as saving and spending rises alongside earnings).

This shift from benefits to tax-free allowances is also a significant 'horizontal' distribution from households with children to those without, because social security distinguishes between them and tax allowances do not. Indeed, during the last parliament cuts to child benefit and the child elements of tax credits were of similar order of magnitude to the child-blind increases to tax allowances.²⁵ This meant that the combined effects of tax and benefit policies were much worse for households with children than those without, across every point of the income distribution. Middle and middle-high income households without children actually ended up better off after these 'austerity' measures.²⁶

In Part 2 of the report we will ask what might be done about this state of affairs. But just exposing it is an essential starting point. This chapter has shown why it matters to scrutinise and value social security alongside its alternatives. Examining the evolving path of benefits and ‘shadow welfare’ together helps to reveal the anti-egalitarian consequences of the government’s version of austerity. And reviewing every form of social support in parallel legitimises social security by demonstrating that it is just one of many morally and financially equivalent ways in which the government can support living standards.

IN FOCUS

Housing costs

Earlier, this chapter examined policy measures to support living standards outside the social security system. Looking only at housing related policies, the alternatives to social security comfortably exceed the value of housing benefit spending each year.

Public services: England's social housing stock saves tenants around £16bn per year in rent (based on the difference between social and private rents). This saving is the product of historic investment in social housing, and is only slightly less than the £23bn spent annually on housing benefit in Great Britain. Where social housing tenants are in receipt of housing benefit this is a direct saving to the social security budget, and in other cases it is a complimentary means of supporting low and middle income households. Beyond social housing, the public sector is providing other forms of support: affordable rent tenancies, shared ownership leaseholds and Starter Homes provide (smaller) financial benefits to residents.

Public loans: From 2018 Support for Mortgage Interest (a benefit costing £250 million per year) will become a loan. The Help to Buy equity loan scheme supports first-time buyers purchasing a home and lent £1.3bn in the year to September 2015.

Private social expenditure: New Help to Buy ISAs and Lifetime ISAs are heavily subsidised by taxpayers so constitute private social expenditure, just like private pensions. The schemes offer a 25 per cent match on saving for housing (or retirement, in the latter case) and are expected to cost around £1.5bn in 2020, which assumes private saving of £6bn.

Tax reliefs and exemptions:²⁷ The VAT exemption on domestic rents reduces housing costs by £4.6bn (and is entirely appropriate when the consumption of housing by owner occupiers is also untaxed). Other housing related tax discounts include: (1) exemption of capital gains tax for main residence (worth £18bn); (2) VAT exemption on construction costs for new homes and some conversions (worth almost £12bn and unique in the OECD);²⁸ (3) income tax reliefs for landlords. In total the value of these reliefs easily exceeds the annual cost of housing benefit and attracts no public debate. While ending each relief would not necessarily be appropriate in isolation, together they are evidence of the under-taxation of housing consumption and asset appreciation, compared to other economic goods. This issue is examined at length by the IFS in the 2011 Mirrlees Report.

4 | THE 2020s WITH UNCHANGED POLICY

The story of the 2010s is stark. By the end of the decade affluent couples will receive more than £6,000 a year in the ‘shadow welfare’ of tax allowances, but social security for low and middle income households will have gone from mediocre to something worse. This chapter shows that the outlook could be worse still in the decade that follows, because default policies will make future benefit entitlements less and less generous.

We should be debating how social security can evolve in the 2020s to respond to the economic and social change that a decade of technological transformation will bring. But with unchanged policy, we will instead need to ask whether social security can meet people’s most basic needs.

This gloomy prognosis is not driven by any particular view of our future economic path. Rather, the outlook for low and middle income households is bleak *whatever* happens to the economy over the next 15 years. But the prospects are only bad if policy does not change. After this chapter, Part Two shows that there are lots of affordable reforms that could transform prospects for living standards in the next decade.

Living standards will stagnate for low income households

We do not know the path of earnings or employment in the 2020s, especially in light of the UK's historic decision to leave the EU. But under almost any scenario for the economy, the real incomes of poorer non-pensioner households will stagnate with current policy in place. This is because working-age benefits are scheduled to rise by inflation only. Any improvements in employment levels or real rates of pay, while very desirable, will be insufficient to compensate for this. These effects will be most pronounced when it comes to the lowest income households, but they also apply to median households, because benefits are a significant portion of their income too.

Figure 10: Landman Economics 2014/15 modelling of changes to average real earnings and real household incomes between 2015 and 2030

	Average earnings	Median earnings	Median household income	Low household income (10th percentile)
Central projection	29%	26%	9%	2%
Low productivity growth	14%	11%	1%	-3%
High employment	28%	25%	14%	4%
Flat employment	31%	27%	5%	-2%
No rise in earnings inequality	30%	33%	12%	2%
'Best case'	43%	46%	26%	10%

'Best case' = high employment, productivity growth exceeding historic trends, no rise in earnings inequality

Source: Landman Economics micro-simulation model, using Family Resources Survey 2012/13

Figure 10 illustrates this point by presenting modelling results for a previous Fabian Society project carried out by

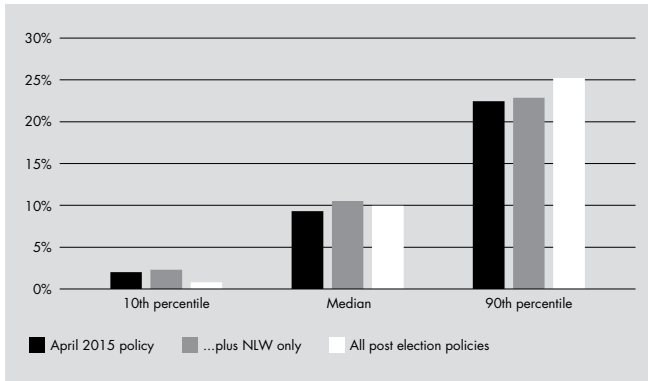
Landman Economics in 2014/15.²⁹ The model simulated the characteristics of the 2030 population and applied a range of assumptions regarding earnings, pay inequality and employment levels over the next 15 years. The central projection was based on a fairly cautious reading of historic trends (full details of each scenario can be found in a previous Fabian report *Inequality 2030*). These results are based on policy at the time of the 2015 general election, so do not reflect post-election cuts or the ‘national living wage’ (we discuss their impacts in a moment). They also reflect 2014 OBR forecasts and assumptions, which have already been revised and will be again in light of Brexit. However, while the details have changed, the broad pattern of the results are unaffected.

The key point is that under *every* economic scenario, growth in earnings is higher than growth in median household incomes, which is higher than growth in low household incomes. The sluggish outlook for median household incomes demonstrates just how important tax and benefit policies are for typical households, not just people in poverty. Meanwhile, under the central projection, real incomes for the poorest families barely change at all, even though earnings are expected to rise by more than a quarter.

Policy announcements since the election change the detail but not the basic picture. Figure 11 looks only at the Landman Economics central projection for the economy and shows the impact, first, of the advent of the national living wage, and then of the tax and social security policies announced in summer 2015 (a higher income tax allowance; cuts to universal credit and other benefits). Both before and after 2015 announcements, social security policies lead to stagnation of low incomes and slow growth in middle incomes. On its own, the national living wage brings a small but measurable boost to typical low and middle income households. But this is offset by the

accompanying benefit cuts, with typical low income households ending up worse off than they would have been under pre-election policies. Meanwhile, high income households are better off due to the higher tax relief.

Figure 11: Change in real net household income, between 2015 and 2030, using the Landman Economics central projection



Source: Landman Economics/Fabian Society 2030 micro-simulation modelling, based on Family Resources Survey 2012/13, using 2014/15 data

Figure 12 explains why the impact of the national living wage is so limited, showing that the national living wage boosts hourly and (to a lesser extent) weekly earnings for low paid workers, but does much less for household incomes. This is, first, because many of the financial gains of a higher minimum wage are lost through changes in taxes and benefits; and second, because people earning a low hourly wage are spread quite widely across the distribution of household incomes. Additionally, the poorest families gain little from the policy as they have so few hours of work. Taken together, this means that the national

living wage policy leads to a smaller increase in household incomes than in earnings, with the largest gains going to middle not low income households.

Figure 12: Landman Economics modelling of the impact of the 'national living wage' on individual earnings and household incomes in 2030

	Hourly Earnings	Weekly earnings	Weekly household income
10th percentile	20%	15%	0.3%
25th percentile	3%	9%	0.6%
Median	0%	0.5%	1.1%
75th percentile	0%	0%	0.7%
90th percentile	0%	0%	0.3%
Mean	1.6%	1.2%	0.6%

Source: Landman Economics/Fabian Society 2030 micro-simulation modelling, based on Family Resources Survey 2012/13, using 2014/15 data

All these different projections for household incomes compare very unfavourably with the outcome seen in the 15 years before the financial crisis, when the incomes of low, middle and high income families grew together. Between 1994/95 and 2009/10 the real incomes of households at the 10th, 50th and 90th percentiles of the income distribution all increased by around 27 to 28 per cent. As a result income inequality was steady over the period (except within the top 1 per cent).³⁰ By contrast, with current policies, we can expect income inequality to rise steeply between now and 2030.

Similarly, if middle incomes rise faster than low incomes over the next 15 years this will have a significant impact on poverty. The Landman Economics modelling suggests that child poverty (measured before housing costs) will rise by

9 percentage points, under the central case scenario for the economy. In other words, millions of poor children will not share in the rising prosperity of the society around them.*

These findings suggest that, unless policies change, we are heading towards a society of mass impoverishment, where a clear majority of households will see little or no improvement in their living standards for more than a decade. It is important to emphasise that these patterns are caused mainly by tax and social security policies *not* by the rising wealth of the top 'one per cent', stagnant median earnings or growing inequality in market incomes. Figure 10 presents modelling results both with and without widening earnings inequality – the 'central projection' and 'no rise in earnings inequality' – and the latter are only slightly better. So this is not the well-known American story of stagnating median pay – our gloomy projection for household incomes is caused by public policy.

We can also translate current policy into pounds and pence, and compare the outlook for pensioners and for working-age households without work. By 2030 the basic rate of universal credit for a single adult without work will be just £68 per week (2016 prices), a fall of 7 per cent over 15 years. At the same time average earnings are expected to grow (by between 14 per cent and 43 per cent in the different Landman Economics scenarios). The state pension will rise in value by at least as much, under the rules of the 'triple lock'.

* If median earnings rise less quickly as a result of either Brexit and/or weak productivity growth then poverty will not rise so much, but only because everyone's living standards will be lower.

Figure 13: value of universal credit for households without work in 2030 (2016 prices)

2015 prices	2015	2020	2030	Change 2015–2030
Single 25-SPA	£73	£69	£68	-7%
Couple 25-SPA	£115	£108	£107	-7%
Lone parent 25+, 1 child	£158	£148	£147	-7%
Lone parent 25+, 2 children	£225	£210	£210	-7%
Couple 25+, 1 child	£200	£187	£186	-7%
Couple 25+, 2 children	£267	£249	£248	-7%

Source: proposed benefit and pension rates 2016/17, DWP, 2015; announced government policy

Under the central projection (where average earnings rise by 29 per cent) the value of the state pension will be in the region of £200 per week by 2030 (2015 prices), around three times higher than the basic out-of-work support for a single non-pensioner. For couples the disparity is even greater as, by 2030, both partners in a pensioner couple will often be eligible for a full state pension. This implies a combined state income of £400, compared to £107 for a couple without work receiving universal credit. The ‘cliff-edge’ arising at the state pension age will be far greater than today, further calling into question the fairness of the two systems.*

There will also be a very significant gap between out-of-work benefits and the gross earnings of low paid workers. By 2030 the ‘national living wage’ could exceed £10 per hour (in 2015 prices) if it continues to be pegged to median wages. This would translate into full-time weekly earnings

* Particular debate may be necessary regarding those in their 60s, as people a few years below state pension age who are not working because of ill health or caring responsibilities will be treated much less generously than people who have reached pension age.

of over £350, which might lead to more people working or increasing their hours. However real freezes to in-work benefits, and their steep withdrawal as earnings rise, would offset much of the gain for many people. Nevertheless, higher pay, relative to out-of-work benefits, could in principle lead to a higher employment rate. A large increase is fairly unlikely, but even if it happened it would be insufficient to offset the damage caused by the real terms freezing of social security. To illustrate this, figure 10 presents a 'high employment' scenario, which assumes an employment rate of over 80 per cent for people aged 16 to 64, and shows that low and middle household incomes are still projected to rise far less than earnings.

Decent housing could slip beyond the means of millions

These projections for family income and poverty do not take account of housing costs, which are likely to place continuing pressure on family finances in the 2020s. The OBR's current assumption is that, after 2020, house prices will rise in line with average earnings (which, as we have just seen, will outstrip low and middle household incomes unless policies change). And this assumption could actually understate the position, since average house prices have grown annually by around 1.6 percentage points more than earnings over the last 50 years.³¹ There is no particular reason to expect a break in this longstanding trend following Brexit, as it predates the recent surge in EU migration which is sometimes blamed for driving housing demand. If house prices continue to outpace earnings as much as they have historically, then by 2030 the median price of a home would be 10.3 times the median annual earnings of a full-time worker, up from 8.1 times in 2015 (see figure 15).

Figure 14: tenure projections, based on PWC modelling for 2025 (extrapolated to 2030)

	2014	2025	[2030]
Own outright	32%	35%	37%
Own with mortgage	29%	24%	22%
Private rent	20%	24%	25%
Social rent	19%	17%	16%

Note: 2030 results are our extrapolations of the trends reported by PWC for 2014 to 2025. Source: Economic outlook, July 2015, PWC, 2015

This would inevitably lead to a rise in the number of families who rent. There are no official forecasts for housing tenure, but PWC has produced projections for 2025. Our analysis extrapolated these out to 2030 to illustrate that a quarter of households (8.1 million households) could be renting privately by the end of the 2020s. We have not seen such a high proportion of private tenant households since at least the 1960s – by 2030 they will significantly outnumber households paying a mortgage. And these projections assume that the number of social rent homes remains constant at 5 million, reflecting recent trends. However, government policy announced since the 2015 election could lead this number to a fall, if right to buy homes are not replaced on a one-for-one basis.

Figure 15: Housing projections for 2030

2015 prices	2015	2020	2030	Change 2015–2030
Households (UK) 2012-based projection	27.5m	28.8m	31.2m	+14%
House prices, based on historic trend – median (UK)	£224,000	£260,000	£384,000	+71%
Ratio: median house price to median f/t earnings (UK)	8.1	8.7	10.3	
Rent per month, if rises with OBR earnings projections – median (Eng)	£620	£670	£860	+38%

Sources: 2012-based household projections in England, Department of Communities and Local Government, 2015; Three centuries of macro-economic data, Bank of England, 2015; Economic and Fiscal Outlook, Office for Budget Responsibility, March 2016; Fiscal Sustainability report, Office for Budget Responsibility, 2015

This shift towards private rental tenure may increase overall housing costs and diminish after-housing incomes, as on average households spend more on rent than mortgages, in absolute terms and as a percentage of income.³² It is also likely to create upward pressure on rents. We do not know whether long-term rent inflation will be closer to increases in consumer prices, earnings or house prices, but there is a good chance it will rise by more than low and middle incomes. For example, rents would rise by 38 per cent in real terms over the next 15 years, if they tracked the OBR's pre-Bexit assumption for earnings growth.

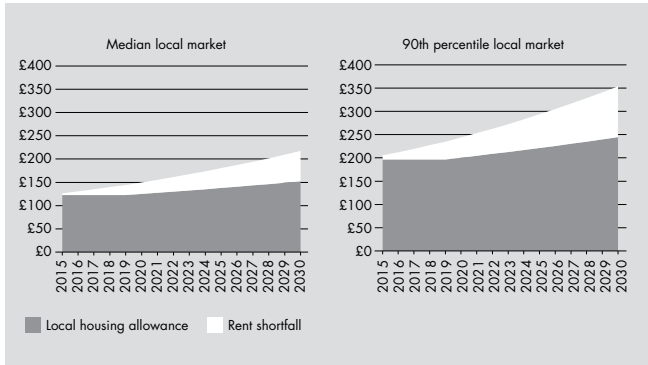
If rents do rise by more than consumer prices, the consequences for low income families will be particularly serious because of the design of housing benefit and its successors. In 2020, local housing allowance will already be insufficient to meet the costs of more than 70 per cent of local rents (following the freeze in LHA for the rest of this decade). Then, in the 2020s, on current plans LHA is to be increased only in line with CPI inflation. Should rents routinely rise by more,

then households will either need to make up the shortfall from other income or find cheaper housing.

To illustrate these pressures we can consider a scenario where rents rise in line with the OBR's expectations for earnings before the Brexit vote. In this case by 2030, in local housing markets with median prices, the gap between LHA and the 30th percentile of rents could be £65 per week for a 2-bedroom home; in an expensive housing market it might be £110 per week (figure 16). In practice this would be an impossible gap to fill for non-working households reliant on universal credit, so they would face the prospect of serious over-crowding, unacceptable housing conditions or the risk of homelessness.

The rising cost of rented housing could turn out to be the greatest social challenge of the 2020s. One in four households are likely to be private tenants and, without changes to policy, those with middle incomes can expect to see their rents rise faster than their disposable income. Meanwhile millions of poorer households, without the cushion of responsive benefits, could face acute housing crisis. If housing benefit and its successors are indexed only to inflation, the social security system will come nowhere near to meeting their mounting housing need.

Figure 16: Possible weekly shortfall between Local Housing Allowance and 30th percentile rents in a local housing market (2-bedroom home, for mid-price and expensive local housing markets)



Source: Fabian society calculations based on Local Housing Allowance rates tables 2015–2016, Valuation Office Agency; OBR pre-Brexit earnings projections and assumptions

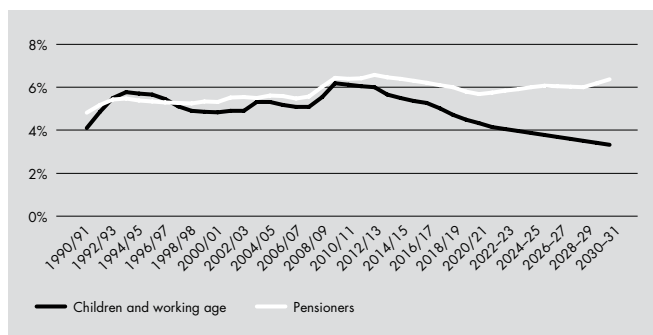
Spending on most social security is set to fall

We have seen how, under current policies, social security will fail to respond to rising housing costs or share prosperity with low and middle income families. At the same time, and not coincidentally, it is likely to become a lot cheaper. Unless Brexit leads to stagnation in real earnings and GDP, in the 2020s spending on non-pensioner social security will fall significantly, as a proportion of national income. This is because benefits will be uprated in line with consumer prices rather than earnings. By comparison spending on pensioners will be broadly flat, with the effects of population ageing and the generous ‘triple lock’ indexation policy offset by increases to the pension age.

Figure 17 shows that if policy remains unchanged and OBR pre-Brexit assumptions for real GDP turn out to be

reasonably accurate then social security spending on children and working age adults will decrease towards 3 per cent of GDP. This compares to over 6 per cent in the early 2010s.* From the perspective of the Treasury this might sound like success, but it represents a huge reduction in the extent to which the UK redistributes money to low and middle income households. It also explains why, on current policy, it is arithmetically impossible for low household incomes to rise in line with productivity growth over the next 15 years.

Figure 17: UK spending on social security as a share of GDP (outturn and projections) using pre-Brexit assumptions

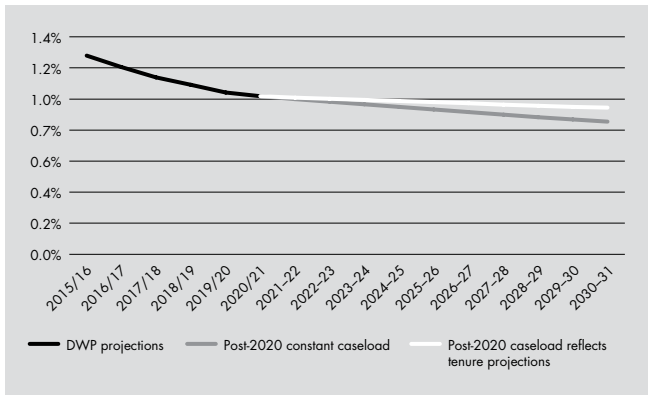


Source: Fiscal Sustainability Report, OBR, 2015; Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016

* These pre-Brexit projections need to be treated with caution, as they simply extrapolate forward long-term trends. If the economy continues to perform as poorly as it has in the 2010s, then productivity and earnings growth will not exceed inflation to the extent that the OBR assumes, which would imply a slower decline in non-cyclical social security spending. Meanwhile, a major recession might lead to a rise in cyclical spending which could last many years.

Spending on housing benefit is also likely to fall, from 1.3 per cent of GDP today, towards 0.9 per cent by 2030. As we have seen, on current policies, the exchequer is largely protected from rising housing costs *per household* to the detriment of households eligible for housing benefit. The government would be liable if more people became eligible for housing benefit, because of rising worklessness, more low earning households and (in particular) the likely increase in the number of private tenants. However, such rising demand is unlikely to offset the downward pressure of the current indexation policy. For example if the number of housing benefit recipients increased in line with the expected rise in private tenants then spending as a share of GDP would still fall to under 1 per cent in the late 2020s (figure 18). As before, these calculation are based on pre-Brexit assumptions for growth in the 2020s.

Figure 18: Projected spending on GB housing benefit, as a percentage of UK GDP (ignores transition to universal credit)



Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016; Fabian Society calculations

Another decade of decline?

Chapter 2 showed that social security for children and working-age adults will be doing less well in 2020 than 2010 with respect to most possible policy goals. The analysis in this chapter shows that, unless policy changes, it will be the same story in the 2020s. If earnings rise faster than inflation, the benefit system will fail to share rising national prosperity. This will have implications for poverty, inequality and the distribution of resources between groups and over individual lives. And if housing costs rise faster than inflation, then the system will even do worse when it comes to providing a minimal safety-net that prevents destitution. Appendix 2 presents an assessment of each policy aim.

It will only be possible to consider social security 'better' with respect to two of our possible goals. First, it will be cheaper for taxpayers (although over their lives most taxpayers also stand to lose, from social security growing worse). And second, some people will have better work incentives, because the gap between low pay and safety-net out-of-work benefits will have grown.

However, it is worth asking whether current policy can conceivably be carried forward into the 2020s? Arguably, the impacts we project for low and middle income households are just too severe for policy to be sustained; the distinction between working-age families and pensioners too striking; the implications for poverty and inequality too unsettling. Could current policy really continue unchanged? Interestingly, even the OBR assumes that policies will shift, when it makes fiscal projections for future decades. Its usual assumption is that working-age benefits will increase in line with earnings not inflation, even though this has not been official policy for a very long time.

But only economists and statisticians can 'assume' policy change. In real life reform cannot be taken for

granted just because the status quo looks unsustainable – it needs to be argued for and won, through the actions of think tanks, campaigners and political parties. A more generous approach to children and working-age adults will only come with new ideas and concerted political pressure. So in Part 2 we turn to possible alternative roadmaps for social security in the 2020s.

PART 2: OPTIONS FOR REFORM

5 | THE CONTEXT FOR REFORM

Part One demonstrated that, with current policies, social security in the 2020s will fail to meet goals such as preventing destitution, sharing society's rising prosperity, insuring risks or distributing resources over people's lives. And if policy makers take no action, there will not be stability, but decline. To stop the rot, the UK needs a new plan for the incomes of children and working-age adults, and in Part Two we start to examine the options that new plan should consider.

The model should be the Beveridge Report or the Turner Report. But the similarity should be in the process, not necessarily in the conclusions. We need the same methodical approach of those two historic inquiries, in order to design a system for non-pensioners which is derived from clear goals and principles, based on good evidence and focused on the long term. But past models should not be a shackle or constraint. Where the insights and proposals of Beveridge or Turner are relevant to the needs of working-age households in the 2020s, they should be an inspiration. Where they are not, they should be set aside.

A new process should consider the case for moving in four directions – more means-testing, more contributory support, more universalism and more private protection – assessing each on its merits, as well as how they might be combined. This should be seen as both a technical

appraisal and a public debate which draws citizens into an open dialogue about future options. But the starting point for a new plan must be the economic and social conditions of the 2020s.

New risks and opportunities

A new social security settlement for the 2020s will need to do better at responding to many old needs, where today's system is not doing well enough. But it should also reflect significant social and economic developments:

Housing: Even with Brexit, over the medium term house prices and rents are likely to continue rising, as the number of new households outstrips the supply of new homes. Fewer people are likely to become homeowners for the first time, unless they have family support. There will be many more tenant households and the rents they pay may well rise faster than low incomes (see detailed discussion in chapter 4). *Social security will need to better support people to meet housing needs, and possibly help them build assets to meet one-off housing costs (but broader policies to restrict rising housing costs are also needed).*

Employment and pay: The 'national living wage' will drive up low pay over the next decade but the prognosis for median pay is far less certain. Low productivity growth, the 'hollowing out' of the middle of the labour market due to globalisation and automation, and the decline in worker power and organisation could all mean typical wages rise slowly. Stagnant pay alongside high employment and high housing costs suggests that in-work social security will continue to play a vital role. On the other hand, it is possible that the UK's employment rate may decline, after two decades of near full employment – in the short term due to Brexit and the higher minimum wage, and after that if automation destroys more jobs than it creates. A significant structural fall in employment or worker hours would be

surprising but is not impossible. More prosaically, either in the near future or at some point during the 2020s a significant recession and a period of high cyclical unemployment is likely. *Social security must continue to make work pay and promote high employment. In-work support will need to be sustained and may need to reflect that many people could face only limited opportunities for progression in hourly pay. Policy should be adaptable so it can respond quickly in the future, should a significant decline in employment occur.*

Changing working lives: People can expect longer working lives, where they will change jobs and careers many times. They will need to acquire skills and maintain resilience across their lives to adapt to significant occupational change. The fabric of working life is also becoming less stable and standardised. People's hours are varying more frequently; they move in and out of work more; they combine several jobs; they become self-employed or start-up a business. *Social security needs to be more predictable, flexible and responsive; and better at supporting people to invest in their future and adapt to change.*

Changing family lives: Families today come in all shapes and sizes – married and unmarried; straight and gay; couples and singles; step parents, step siblings, shared parenting and more. Public policy should reflect this complex reality. The number of children in non-working families has fallen significantly. It has become typical for mothers of older children to work, at least part-time, while parents with young children make a wide variety of choices, often influenced by whether work pays after childcare costs. More fathers are aspiring to be equal carers, although policy provides limited support for this. Caring for older and disabled relatives is becoming an ever larger part of family life. *Policy should support stable families and not distort decisions about who people choose to live with. It should support both parents to be able to care for young children, but also make work pay for people with childcare needs. It should provide better support for people with*

intensive caring responsibilities, but perhaps also enable everyone to take time out of the labour market for family, at some point in our long working lives.

Changing patterns of disability: Healthy life expectancy has been rising gradually but this masks a complex picture. People with early life disabilities are living for longer, and the incidence of mental illness has risen. Increasing obesity also poses new risks. The increase in the state pension age also means there will be many more people with health problems in their 60s who will not be eligible for their pension but will have limited employment prospects. *Despite recent reforms, more could be done to help people with illnesses and disabilities stay in work and return quickly. However, a large number of disabled people will continue to face limited employment prospects for many years, and they and their families should be better supported.*

Migration: Even with Brexit, high levels of migration seem likely to continue for the foreseeable future, posing questions about the contributions and entitlements of newcomers. David Cameron's EU renegotiation on benefits was partly necessary because so few working-aged benefits are currently earned by contribution, raising public anxiety about rapid access to entitlements. *Policies should be designed so that more support is available only once people have contributed as workers and taxpayers, and established an enduring connection with the UK.*

Taken together, these trends suggest that some of our possible aims for policy will increase in importance in the 2020s. Preventing destitution and protecting people who cannot work will matter more because of rising housing costs and the likely pattern of disability. Goals linked to in-work social security will be a priority because of housing costs too, as well as continuing low pay. More complex, variable working patterns will make the insurance role of social security more important and mean that flexibility, control and simplicity will matter more. Long and

changing working lives will place a premium on supporting actions that are beneficial over the long term, including training and saving, while more family responsibilities could make it more important to support non-market contributions. And mass migration means people are likely to have a stronger preference for linking support to past or future contribution.

In addition to these social and economic trends there are more subjective, attitudinal questions, relating to the preferences of both citizens and policy makers. The public's suspicion of 'welfare' and preferences for contribution and self-help are obviously relevant considerations when thinking about the future shape of social security. People will also be more supportive of a system where they feel they have flexibility and control, and can see that entitlements correspond to their ideas of desert. However, attitudes are not necessarily immutable obstacles, since policy can shape beliefs as well as be shaped by them.

Similarly, political commitments and policy fashions may place boundaries on the feasible scope for policy, even if some technically sensible proposals lie beyond. For example, it is hard to imagine our political classes deciding to move in one go to a continental ('Bismarkian') model where contribution-based entitlements are paid as a percentage of previous earnings. Arguably, this end-point would only be achievable through staged reform over decades. Recent trends in public policy are in one respect very helpful, and in another very unhelpful, when thinking about options for social security. The 'helpful' development is that politicians and policy makers are becoming much better at recognising the wide range of alternative policies that may improve living standards. The 'unhelpful' one is that the financial crisis and austerity have led to a change in politicians' perspectives on the possible scope for spending on social security. We consider each of these in turn.

Alternatives to social security

When thinking about living standards, politicians have always focused on tax and social security. Earlier, this report showed why these twin domains of fiscal policy need to be considered side-by-side. But recently decision makers have also started to think about public services and market interventions as routes to improving living standards.

To illustrate this point, we can think back to the 2015 general election where there was a ‘bidding war’ of rival plans to extend the duration of free early years education. Then, straight after the election, the Conservatives launched the ‘national living wage’. This surprise announcement was an endorsement of micro-economic regulation as a tool for boosting living standards, an approach championed over the previous few years by Ed Miliband’s Labour party – under the ugly strapline ‘pre-distribution’.

Policy makers are also getting better at using a broader range of tools, beyond direct state provision or traditional market regulation. Behavioural ‘nudges’ and new financial incentives are being used to transform the outlook for private pensions and the success of the new workplace pensions regime suggests that the same approaches could offer solutions elsewhere. In the wake of the Turner reforms, this report dedicates a chapter to ‘private protection’ as one potential option for future social security reforms.

These developments are important, because they bring to an end the idea that social security should have to stand on its own when it comes to advancing policy goals. This compares favourably to the position in the mid-2000s, when it sometimes seemed that the government wished to end child poverty by tax credits alone. A new plan for social security is far more likely to succeed if benefits are just one tool among many, rather than being expected to do all the heavy lifting themselves.

The government is already taking action on low pay. In the 2020s further steps may be needed here, including measures to promote take-up of higher, voluntary living wages, and to support collective bargaining. But politicians must also take action to raise living standards on three other fronts:*

Housing costs: Policy should aim for housing costs to rise no faster than disposable incomes, through action to increase the supply of housing (and hence of land, finance, infrastructure and construction capacity), and perhaps to increase property taxation too. Price regulation of private rents is also touted as an answer, but comprehensive rent controls would probably have a negative impact on the quantity and quality of rented homes.³³ A better answer is to significantly increase the supply of new homes for social rent (and also for affordable ‘living’ rents). Social housebuilding pays for itself over 25 to 30 years, through a combination of extra rental revenues and savings to housing benefit, so the government and social landlords should develop a co-financing programme which ramps up towards the delivery of, say, 100,000 social homes a year.³⁴ This policy would add to national debt in the short term, but would reduce it in the long term. It is not however a quick route to reducing social security spending, as has sometimes been suggested (a ‘switch’ from ‘benefits to bricks’) but, a way of limiting the long-term upward pressure on housing benefit.

Employment levels: Previous research by the Fabian Society and Landman Economics has shown that raising the employment rate is one of the most effective ways of increasing household incomes and the government’s fiscal position. However, we already have high levels of employment, so future progress will depend on improving

* A fourth is adult social care, which we do not discuss here because the large majority of service users are over pension age.

opportunities for groups with particularly low employment rates, in particular: disabled people, mothers, young people with poor qualifications, and people from certain ethnic minority groups or economically deprived communities. The design of social security, and the conditions and support services that accompany it, play a role in boosting employment, but broader labour market and public service reforms will be essential – for example the extension of free childcare, better further education, and flexible work for parents.

Childcare: The cost of childcare is currently a huge barrier to many parents working, and its inflexibility often prevents them working in the way they want to. Policy in England currently supports childcare in three different ways. On the supply side, free early years education is available to many children (and some subsidised provision is also available out of school hours). On the demand side, there is tax-free childcare (with one version about to replace another) and childcare support through social security. This is an example of the state running two parallel and potentially divisive schemes for different income groups (and is particularly perverse because the new ‘tax-free’ system beginning in 2017 has actually been classified as a benefit not a tax relief).³⁵ In recent years the government has announced new policies to provide more support using all three approaches. Many commentators have suggested that the priority should be to make childcare a universal, free service. For example the IPPR have proposed a package that would offer year-round part-time early years provision for all 2 to 4 year-olds at a cost of around £2bn, alongside price regulation. It also suggests more generous support for remaining childcare costs, and eventually integrating the ‘tax-free’ and universal credit childcare support into a single system of childcare accounts, with subsidies provided on a sliding scale from, say, 30 per cent to 95 per cent of childcare fees.³⁶

Possibilities for spending

Recent proposals for social security reform have been focused on the short-term and have therefore assumed that little or no new money will be available to fund policy change. In the context of deficit reduction and the economic uncertainty of Brexit, this outlook is understandable. But when it comes to long-term reform, it is unhelpful and unrealistic to 'anchor' debates to an aspiration for zero real spending growth.

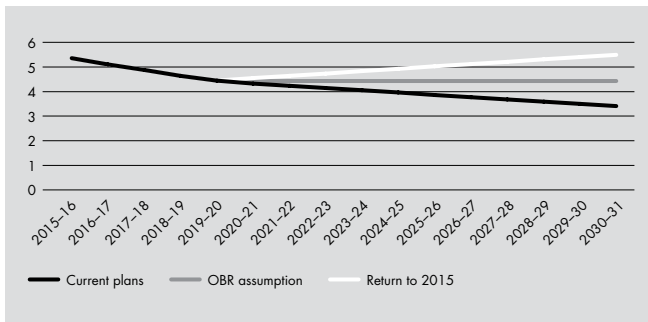
Politicians need to start thinking about the 2020s, and new spending possibilities once the public finances are in a better position. This will be difficult, given today's context. Earlier in the report, we saw how cost saving has dominated the Cameron government's agenda for social security reform. The same is likely to be true under Theresa May, with the extra fiscal pressures of Brexit. But even the thinking of opposition parties is framed by austerity. Most of the Labour party's energies have been devoted to defending current entitlements, not considering future reforms. And there is now an expectation that all manifesto policies should be fully costed, which pushes opposition parties towards promising immediate but minor revisions (which can be explicitly funded), as opposed to long-term changes which only become affordable in the context of economic growth.

The 'austerity' view of social security spending has been institutionalised by the government's introduction of the 'welfare cap'. This states that spending on social security (apart from on the state pension and support for the unemployed) should not exceed what was implied by the policy in place at the start of the parliament. This tethers all debate on the future direction of social security to a set of policies which are totally inadequate for the long term. Of course, the welfare cap has already been breached, but the alarmist tone in which this event has

been reported has reinforced the government’s preferred ‘framing’ of social security.

The long-term application of a ‘welfare cap’ would require future governments to continue with current policies, or something that cost the same. However, chapter 4 showed how this would lead the UK to spend less and less on social security as a share of national wealth, and would lead to social security getting worse at meeting policy goals. On present plans the UK’s non-pensioner social security spending will fall in real terms from £102bn today to £92bn in 2020 (and remain roughly the same in 2030). If the economy performs reasonably well in the 2020s, this modest real decline will translate into a steep fall as a share of GDP.

Figure 19: Three options for children and working-age social security as a percentage of GDP (using pre-Brexit economic assumptions)



Source: DWP projections to 2020; post-2020 projections derived from Fiscal Sustainability Report, OBR, 2015

But this also presents opportunities, because it means that a more generous system need not break the bank. In fact, if there is reasonable economic growth in the 2020s then it would be possible to spend many billions more

than current plans. For example, on current economic projections, if social security spending were kept flat *as a share of GDP* throughout the 2020s it would end the decade at £120bn (2015 prices). This is roughly the scenario the OBR assumes, when it is preparing long range fiscal forecasts. Alternatively, if there is no significant downturn during the rest of this decade, politicians could return social security back towards the share of spending seen today. Over a decade, this could be funded without tax rises, using ‘fiscal drag’ in the tax system (ie tax thresholds rising less quickly than earnings). In this case non-pensioner social security expenditure could rise to around £150bn by 2030 (2015 prices). These very large differences give a feel for how much room for manoeuvre politicians might have, assuming the economy is growing at a reasonable pace. Of course continued economic stagnation would change the picture, as there would not be such divergence between growth in prices and GDP. But there is a decent prospect that a more generous system will be affordable in the 2020s.

Looking towards the next decade, a new ‘anchor’ is needed – a default assumption that spending should rise in line with, say, GDP or earnings, rather than inflation. For example, instead of a ‘welfare cap’ expressed as money, there could be an expected threshold for spending *as a percentage of GDP*, like the ones we now have for overseas development and defence. The welfare ‘cap’ could become a ‘floor’ or ‘target’, which would create the conditions for debating first *how much* more should be spent, and then *how* it should be spent.

Judgements about how much to aim to spend over time would obviously need to be made in the context of policy decisions regarding the alternatives to social security. Market interventions, public services or new private protection schemes which reduced demand for benefit spending might justify less spending as a share of GDP. Or the savings could be ploughed back into more generous

levels of protection. And, as we shall see, there is also the option of reforming social security by using 'spending' on tax reliefs in new ways.

Four possible directions of travel

If politicians decide to do little or nothing in the 2020s, social security will continue to get worse with respect to almost all the possible goals you could set for it. A new plan for social security in the 2020s is needed, to ensure that social security does much better under our four broad headings: tackling poverty and inequality; distributing resources between people and across life; creating incentives for beneficial behaviour; and ensuring fair conditions and public acceptability. And that plan must work in the context of the emerging risks and opportunities described in this chapter; and be part of a wider strategy for living standards, that encompasses all the alternatives to social security.

The rest of the report considers four possible directions of travel which could form part of a new plan: more means-testing, more contributory support, more private protection, and more universalism. Each approach has its merits, and how people choose between them will come down to differing views on the balance between the various policy goals and on the implications of changing economic and social conditions.

There are a plethora of policy choices, but they boil down to two strategic options. There is the Brownite solution – to reaffirm today's mainly means-tested approach and create a more generous version of what we have. And there is a more Beveridgian solution – to blend the four approaches, and treat them as complementary, integrated tiers of support, just as we do when it comes to the pension system.

IN FOCUS

Devolution

The social security system used to be a single national regime covering Great Britain (with an almost identical system in Northern Ireland). Since 2010, that picture has been changing fast. Council tax benefit has been devolved to English local authorities and to the Welsh government. In a similar vein, the government has recently floated the idea of devolving attendance allowance for older people.³⁷ And it is commonplace for commentators to suggest devolution of housing benefit. In each of these cases the rationale for devolution is the close association between a benefit and the functions of local authorities (ie social care, housing, council tax).

In Scotland the pace of change is much greater. Following the referendum on independence, almost all social security except the state pension is being devolved. Disability and housing benefits are being passed directly to Holyrood, while the Scottish parliament will have the power to top-up most other benefits.

These are far reaching developments which have not attracted significant political debate. They change the context for future UK reform, because the Scottish government will now need to take part in any decisions on the interaction between the 'reserved' and 'devolved' parts of the system. In developing a new UK plan for social security, Scottish institutions should be involved from the outset, both to feed in their ideas on the UK system and to consider what variations might be applied in Scotland.

But a new plan for social security will also need to take a view on the future path of social security devolution. Its advantage is that it creates the opportunity to design policies

which reflect local democratic choices and patterns of need. It brings the chance to integrate social security with powers and responsibilities that have already been devolved, and it creates financial incentives for areas to reduce spending by supporting economic growth and reducing living costs. The diversity arising from devolution also means there is a possibility of natural experiments to identify and spread the best ideas.

Against this, variations between areas may not command public support, even if they arise from the choices of locally elected politicians (ie 'postcode lotteries'). Devolution makes it harder to distribute resources geographically, in response to differences in need. For example if demand for housing benefit increased in one area, this risk would rest only with the responsible authority. And the process may lead to cuts either immediately (if less than 100 per cent of spending is devolved, as was the case with council tax support) or over time, if revenues are static but need rises.

Partial devolution creates particular problems, because it fragments the system. Its advocates need to be able to explain why different groups should be treated in different ways, where localisation is to affect some people but not others. Devolution can also reduce the effectiveness of national efforts to reduce complexity and make work pay. We have already seen this with the new system of council tax support, which sits on top of universal credit. It is administered separately which has an impact on take-up and it is withdrawn simultaneously, leading many households to lose more than 80 pence of every extra pound they earn. A practical solution to this problem would be to give the national governments and/or English local authorities powers to vary GB schemes, rather than run separate benefits. In particular, it would be better for

local areas to set the maximum level of council tax support *within* universal credit – while keeping nationwide rules on withdrawal as earnings rise.

Finally, fragmentation also creates barriers to future reform. For example, under the new Scottish settlement Holyrood will not be able to implement major structural reforms alone, especially if they cover the design of tax as well as benefits. This could create a fresh source of political instability and may be a brake on future reform, both north and south of the border. Even so, Scottish devolution makes a lot more sense than the fragmentary devolution of some benefits within England, where there is no political consent to end fiscal transfers between areas, and where devolved authorities have insufficient fiscal and economic powers to be masters of their own destiny.

6 | MORE MEANS-TESTING?

Part One of the report revealed a looming living standards crisis in the 2020s, which will result from social security policies as they currently stand. Might the solution simply be ‘more of the same’: to take the current system and make it more generous? One view is that most of the problems with non-pensioner social security really boil down to the fact that it is being starved of cash: a system with the same design principles can be made to work – it will just take more money (perhaps alongside a bigger role for some alternatives to social security like public services and economic intervention).

There is one very strong argument in favour of this position: it avoids the pain of upheaval. After a decade spent implementing universal credit (assuming it is made to work) and introducing other painful reforms, a period of stability could be very desirable. If universal credit is more or less in place, as a single coherent entitlement, there is a lot to be said for revision not revolution. This project would entail going ‘back to the future’ and making the generosity of universal credit match or exceed Brown-era tax credits (which was the original intention of the policy). There would still be some non-means-tested benefits, but these would remain a minor part of the system.

There are of course plenty of arguments to challenge this view. Poverty was still high in the late-2000s and the

progress Labour made in office proved easy to unpick. The system does not help people build up financial and human capital. It is not good enough at making work pay or responding flexibly to our uncertain working lives. Household means-testing reduces women's economic independence and incentives, and also penalises people with savings or a working partner. Retaining the status quo sidesteps the question of the imbalance between benefits and tax relief, and people's concerns about stake and contribution go unresolved. Finally, entitlements that are both condition-based and means-based create division and stigma, giving the impression that they are there to distribute to underserving 'others' not from 'us to us' across our own lives.*

In later chapters we will examine proposals that may address each of these concerns – and could collectively make the system for children and working-age adults more like social security for pensioners. But for all the merit of the alternatives, the option of more means-testing – of continuing with the present UK orthodoxy – would still help advance a large number of possible policy goals for social security (see appendix 3). Given where we are today, the idea of building the generosity of means-testing should be viewed as a default or starting-point, which other options need to complement or beat.

Options for universal credit

So if ministers in the 2020s were able to make today's means-tested system more generous, what choices should they make? There are two possible, and potentially parallel, routes forward:

* Even though in reality means-testing leads to significant 'us to us' distribution – see chapter one.

Indexation: The most obvious option is to change the basis on which benefits are uprated each year. Gradually, over the medium term, this would have a significant impact on living standards:

- **Earnings indexation:** The existing policy is to index almost all working-age benefits to CPI inflation, but instead they could be linked to a measure of earnings.* There is a particularly strong case for pegging increases in UC to the rising 'national living wage'. First, it would maintain differentials between benefits and pay, meaning low incomes could be increased without affecting work incentives. Second, it is necessary to ensure that national living wage workers who receive UC gain significantly from annual increases (gains from pay rises would otherwise be clawed back by the benefit system).
- **Housing costs:** There is also a very strong case to index the housing support element of universal credit to local rent inflation, not to general consumer prices. This would ensure that the government shared the risk of rising housing costs with low income tenant households.

Structural reform: Reform to the structure of universal credit is also desirable:

- **Living costs:** (1) Housing – Improved support for housing costs is likely to be necessary, to restore some

* A number of earnings-related indexation policies are possible. The state pension is usually indexed to average earnings, the household benefit cap was originally intended to be indexed to net median weekly earnings, and the national living wage will be indexed to hourly median earnings of a worker aged 25 or over.

of the cuts to housing benefit in recent years. There is also a case for tenure-blind support for housing costs (see discussion at the end of this chapter). (2) Children – Compared to tax credits, universal credit does not do enough to support families with the costs of children. Restoring allowances after the second child is a top priority, as large families are now at acute risk of poverty. After that, extra resources should be devoted to pre-school children first, to invest in life chances and create an extra financial incentive for parents to seek work as children enter school. The allowance for parents under the age of 25 should also be increased. (3) Disability – UC should also provide more support to disabled people, to reflect the risk they face of living with a low income for a long time. For disabled people who have little chance of working, UC should ideally match the generosity of pension credit (currently £156 per week). It could be paid at this rate after one year, to people facing the most significant barriers to work (currently known as the ‘support’ group); for people assessed as being able to prepare for work, the pension credit rate could be paid after five years (with the possibility of payments increasing on a sliding scale before then).*

- **Making work pay:** Compared to the original design of universal credit (and to the think tank proposals which inspired it) the new system is failing on its own terms, because it is not very good at making work pay. This is partly because the work allowances that incentivise

* Following recent cuts to Employment and Support Allowance, people in this category (which goes by the ugly term ‘WRAG’ for ‘work related activity group’) now receive the same support as temporary jobseekers, even though they may be without work for many years.

people to move into work have either been scrapped or are lower than planned, so they should be increased. There is also a strong case for a specific allowance for the second earner in a couple, whose employment choices tend to be responsive to financial incentives.³⁸ UC is also withdrawn at a rapid rate (especially when alongside council tax support, national insurance and income tax). One good option would be to incorporate council tax support into UC, so they share a single taper for withdrawing payment. It might also be possible to reduce the taper from 65 per cent to the original proposal of 55 per cent, which would increase the reach, generosity and cost of the benefit.*

- **Savings and non-earnings income:** Unlike tax credits, UC penalises households with savings, which brings an extra layer of targeting, complexity and stigma to in-work support. Chapter 8 proposes that savings made via a new opt-out savings scheme should be exempt from this rule. Additionally, entitlement to UC is reduced on a pound-for-pound basis when households are in receipt of various forms of non-earnings income including: contributory benefits, occupational pensions, income protection insurance and child maintenance payments. People should be rewarded for providing for themselves and their children in these ways so these forms of income should be treated on the same basis as earnings.

* Even with this reduced rate, UC would still give people meagre incentives to increase their earnings, with marginal tax rates for many recipients far higher than for top-rate tax payers. More significant reductions in the UC taper would lead to eligibility extending to middle-high income households and could only be achieved by raising headline tax rates.

- **Out-of-work conditions and guarantees:** The principle of imposing out-of-work conditions to prevent long-term detachment from work is sound. However, the rules and operational practice of benefit sanctions should be reviewed, as they have been driving people to destitution, charity handouts and the black market. In place of today's emphasis on highly intrusive week-by-week policing, the government could set a clear time-limit on support for people capable of 'active job search'. After (say) 12 months, recipients should be required to accept a guaranteed job, replicating the successful future jobs fund introduced during the financial crisis.³⁹ A different approach should be considered for young people aged 18 to 21, drawing on IPPR proposals.⁴⁰ For them, receipt of UC should normally be dependent on either active job search or participation in further education or training. 18 to 21 year-olds could be required to accept a guaranteed education opportunity or job after 6 months without work.*
- **In-work conditions:** It is also important to review new 'in-work' conditions which will affect over one million working households (including some with middle earnings). They could do lasting harm to public perceptions of UC, particularly as the earning requirements to escape conditions will increase each year in line with the national living wage. The risk is that in-work conditionality leads people to believe that UC is only legitimate as a temporary safety-net when, in reality, it needs to provide long-term support to households with high living costs and low or middle incomes. One option, suggested by the Resolution Foundation, would be to reduce UC payments after (say) a

* To save money, the IPPR propose that a parental means-test should also be applied to 18–21 year-old benefit recipients.

year of working on UC, rather than impose conditions. Recipients would be paid UC as if they were earning the amount expected of them, even if their actual earnings were less.⁴¹

Modelled reforms

In 2014/15 the Fabian Society and Landman Economics modelled the impact for families in 2030 of: (1) indexing UC and other benefits in line with earnings; (2) indexing housing support in line with rents; (3) and the impact of a package of structural reforms. The particular package tested by Landman Economics increased work allowances to incentivise moves into work and increased the components in UC for children and disabled people.* The modelling was conducted in advance of the 2015 election, with results compared to the policy in place at that time. This also meant that the indexation scenarios assumed more generous uprating would have been in place for 15 not 10 years.

The modelling found that all these policies would bring a notable increase in low and middle incomes and a reduction in child poverty (figure 20). Linking benefits to earnings for 15 years was the most effective and the most expensive policy. The structural reforms were particularly beneficial to mid-income households, as they were designed to provide better support for working families. Even the housing support reform made a clear impact,

* The modelling was based on announced policy in April 2015, prior to further cuts announced after the general election. The revisions to this version of UC were: child component of UC increased by £80 per child per month; child and adult higher and lower disability additions increased by £80 per disabled person per month; UC work allowances (earnings disregards) increased by 30 percent; new earnings disregard introduced for second earners in couples, set at £70 per month. This package was originally developed for research commissioned by the TUC and CPAG.

even though it only affects a minority of households. Importantly all these reforms are potentially affordable over a 10 to 15 year time frame, as each of them resulted in social security spending ending below where it currently stands, as a percentage of GDP.

The modelling also tested the impact of combining all three of these policies, along with a fourth – a steep increase in the generosity of child benefit. We chose this particular package because we wanted to demonstrate what it would take to meet the statutory child poverty targets (ie under 10 per cent of children in poverty; under 5 per cent in poverty, using a measure ‘anchored’ to the baseline year of 2010/11). This package of policies comfortably achieved these objective, but at a cost of social security spending ending up almost 1 per cent of GDP above 2015 levels.

Figure 20: Four proposals for ‘more means-testing’ compared to policy in place at the 2015 general election

	Index all benefits to earnings from 2015 to 2030	Link UC housing support to rent inflation	Package of reforms to improve UC	All 3 combined + double value of child benefit
Change in weekly household income in 2030 (2015 prices)				
10th percentile	+£23	+£5	+£4	+£36
25th percentile	+£28	+£7	+£10	+£44
Median	+£30	+£2	+£18	+£66
75th percentile	+£10	+£~	+£6	+£51
90th percentile	+£1	£0	+£~	+£15
Mean	+£20	+£4	+£9	+£45
Child poverty	-9 ppnt	-1 ppnt	-6 ppnt	-15 ppnt
Social security spending as a share of GDP (change from 2015)	-0.7 ppnt	-1.7 ppnt	-1.3 ppnt	+0.8 ppnt

Source: Landman Economics micro-simulation model, using Family Resources Survey 2012/13

Other things being equal, it is hard to imagine this fiscal policy package being politically deliverable (chapter 5 suggested that a return to today's levels of spending, relative to GDP, might be the upper limit of plausible future expenditure). But other things might not be equal. In particular, if there was a sustained rise in employment and levels of pay the package much be much more affordable. For example, by 2030, the package would have accounted for a smaller percentage of GDP than we spend today if more than 80 per cent of 16 to 64 year-olds were to be in work. This underlines how important it is to continue to pursue high employment alongside social security reform.

We included an increase in child benefit in this package in the knowledge that, as things stand today, it is a means-tested benefit of sorts. Raising child benefit is therefore consistent with the concept of very broad means-testing, which lies behind tax credits. But this part of the reform also opens up questions regarding the role of fully universal benefits, which is explored in chapter 9.

An affordable package of reforms

The precise set of proposals modelled in 2014/15 won't ever come to pass because of the way that UC has been cut since the last election. But the exercise proves that significant reforms within the means-tested system can make a big difference. In chapter 5, we saw that, by the end of the 2020s, it might well be possible to spend in the order of £25bn or £50bn per year more than current policies imply without tax rises, as long as there is reasonable economic growth. With spending on this scale, it is plain that a social security system based on means-testing could become a lot more effective at achieving a wide range of our possible policy aims.

Gradually increasing spending would permit a future government to progressively improve the design and generosity of universal credit by pursuing many of the

options proposed in this chapter. This would help prevent destitution and protect people unable to work; reduce poverty and income inequality; better reflect differences in living costs; support young people's life chances; and help lower income groups keep up with rising prosperity. Entitlements would be higher for households without work and many more working families would receive income-related support, reflecting the original intent of Gordon Brown's tax credit system.

But these reforms would not resolve the intrinsic limitations of means-testing. Household-based targeting would continue to disadvantage many women and would provide little to those who are unable to work in homes with other sources of income; incentives to increase earnings would be weak; there would be no real support to help people build human and financial capital; little in the way of insurance based on contribution; and those with middle and middle-high incomes would receive minimal help to smooth out their income and costs over their working lives.

Overall, the gulf between the pension system and social security for children and working-age adults would be a little narrower, but not much. 'More means-testing' would be significantly better than the system we have today, or the one that will exist in the early 2020s. But a blended system – drawing on three other approaches too – might be better still.

Summary: options for 'more means-testing'

Overall generosity

1. Index UC payments and work allowances to earnings
2. Increase the generosity of UC payments for (young) children, large families and parents aged under 25

3. Increase UC to match pension credit, for people with disabilities who have limited prospects of work
4. Withdraw UC gradually from non-earnings income, on the same basis as earnings

Making work pay

5. Increase the generosity of work allowances to encourage people to work for more hours and introduce a specific allowance for the second earner in a couple
6. Merge council tax support into UC with a single taper for withdrawing payments
7. Withdraw UC more gradually, for example with a taper of 55 pence not 65 pence in the pound

Conditions and time limits

8. Police conditions for jobseekers more flexibly, but introduce a compulsory job guarantee after 12 months of being without work
9. Make UC for 18 to 21 year-olds conditional on job-search or participation in education, with one of these options compulsory after 6 months
10. Replace 'in-work' conditions with a system of 'assumed' earnings after 12 months of a household having work

Housing

11. Index UC housing payments to local rents
12. Set UC housing payments to fully cover the costs of (at least) 3 out of 10 rented homes in each area
13. Pilot a tenure-blind housing cost credit, which supports mortgage interest in the same way as rent

IN FOCUS

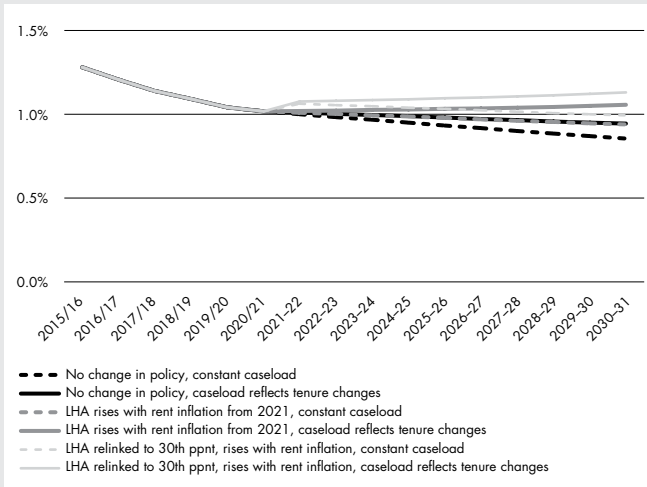
Housing support

Current plans for supporting housing costs in the 2020s will only be credible if housing costs are flat or falling. Chapter 4 showed that any real-terms increase in rents will lead to implausibly high shortfalls for tenants with low incomes. In these circumstances the government would surely have to introduce a more generous policy, sooner or later – whether in a planned, strategic fashion or as a knee-jerk response to mounting political pressure.

The Landman Economics model looked at only one option for the future of means-tested housing support (the urgent matter of re-linking housing allowance to rent increases). Another obvious reform would be to re-set levels of private sector housing support to return them to the 30th percentile of rents in each local housing market, including removing caps on support in high cost areas (it is estimated that this would cost £1–2bn if implemented in 2021). This reform should then be evaluated to see if it was sufficient for households to afford reasonable accommodation.

Figure 21 shows that if housing support were re-linked in this way, and then uprated in line with rents, spending as a share of GDP would still be lower in the 2020s than it is today. This would be true even if there was a rise in the caseload to reflect more people living in the private rented sector. We haven't analysed the effects of reversing other recent cuts to housing benefit (eg the bedroom tax and local social housing rent limits) but reversing all of them would cost a few billion pounds. In any one year this would of course be expensive, but if staged over time it could be affordable in the context of a growing economy.

Figure 21: Spending on housing benefit (GB) as a percentage of GDP (UK) under various scenarios



Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016; Fabian Society calculations

Another structural reform which merits consideration would be to create a tenure-blind housing cost credit within universal credit. This would update a proposal developed by the Fabian Society before the 2010 election, which fits well with the overall principles of UC.⁴² In place of support for mortgage interest, households with mortgages would receive a housing costs element in their universal credit award (whether in or out of work) which would be withdrawn gradually through the UC taper. To create parity with renters the payment could be set at the lower of actual mortgage interest payments or the local housing allowance rate for their area. This scheme would echo mortgage interest tax relief, which was scrapped in 1988, but it would be highly progressive form of public support for homeownership.

The advantage of this proposal is that it would help break down distinctions of tenure and remove stigma linked to housing benefit, helping build perceptions of the legitimacy and inclusivity of universal credit. It could give people more financial autonomy and flexibility by removing an artificial distortion regarding housing choices (which might be particularly helpful when choosing between renting and shared ownership). It would be a new form of government support to build assets, in keeping with other current and possible future options for 'asset-based welfare'. This proposal would also address a problem with the design of universal credit, which leaves working owner-occupiers significantly worse off than under the predecessor benefits. Given that around a fifth of households in poverty (after housing costs) are mortgage-payers, the proposal could also make an important contribution to a wider anti-poverty strategy.

The main disadvantage with the idea is its potential cost. The policy might increase the numbers eligible for housing support by around one fifth, so detailed analysis of the costs and impacts would be needed, since any new spending here might distract from more urgent housing need.⁴³ (When originally proposed, the Fabian Society authors suggested that it could be funded by reducing housing-related tax reliefs). Additionally, the policy could also distort the housing market, as another demand-side subsidy, albeit a progressive and tightly-targeted one. It would therefore be sensible to pilot the proposal initially.

7 | MORE CONTRIBUTORY BENEFITS?

Contribution-based benefits tend to be more popular than either means-tested or universal entitlements. They were the corner-stone of Beveridge's blueprint for post-war social insurance, and social security for pensioners remains largely contributory. It is therefore not surprising that politicians frequently speak about their desire for a more contributory system. Yet recent proposals for extending contributory benefits have in fact been very modest. For example, at the 2015 general election the Labour party promised extremely limited reform to contributory JSA, based on no extra spending.⁴⁴

Despite their popularity, in recent decades working-age contributory entitlements have been gradually scaled back. This chapter explores options for reversing that trend. In particular we seek opportunities to re-unite (marginalised) working-age contributory benefits with the (popular and mainstream) contributory pension – by raising the value of non-pension benefits and by making the two partially interchangeable. In this way the generous, flat-rate new state pension could turn out to be a 'Trojan horse' that ushers in more generous contributory entitlements in working life too.

Aside from national insurance benefits there is another category of contribution-related entitlement, which often gets overlooked – statutory employment-based

benefits, funded by government. These are contribution-based because they depend on an established employment contract. Their rationale is that they maintain employment relationships and therefore people's attachment to work, while also protecting employers from social risks it is not reasonable for them to carry. These days, the most important of them is statutory maternity pay, which costs taxpayers £2.3bn per year. In the 1980s the government also paid a large portion of the costs of statutory sick pay (and provided a backstop for very high sickness levels until 2014).⁴⁵

The main advantages of contributory benefits are that: they help everyone regardless of income, and therefore support people from all backgrounds smooth out lifetime living standards and insure against unpredictable risks; they are individual not household-based entitlements, so they protect against reduced income even when households have earnings or savings; and they are funded in a way that recognises a tri-partite responsibility for social protection, by individuals, employers and government. Finally, there is the advantage of public consent. In Beveridge's famous phrase: "benefit in return for contribution rather than free allowance from the state, is what the British people desire".⁴⁶

But contributory benefits have a number of disadvantages. They are exclusive, by design – people who have little or no record of contribution are likely to have zero or reduced entitlement. This means that contributory benefits are of greater value to people with middle earnings (over their working lives) than to those with persistent low incomes. Historically, this has also meant they have benefited men more than women (although contribution requirements can be designed to reduce this imbalance). They are typically designed to address short-term need (such as interrupted earnings) when much of the demand for social security in the 2020s will be for ongoing support, to support people with high living costs, low and variable earnings or those who are unable to work

on a long-term basis. Finally, as contributory payments do not vary on the basis of present income or living costs, they cannot be easily calibrated to reflect household need.

For these reasons, contributory benefits cannot guarantee a safety-net for all and are less effective than means-tested benefits at preventing destitution and poverty, or responding to extra living costs. It is therefore difficult to imagine how a contributory system could ever go very far in replacing means-testing. It would be unacceptable to remove non-contributory safety-net payments for people unable to work, or in-work support for low earning families that reflects their living costs. Long-term means-tested payments for children, low-earners and people with disabilities cannot be readily replaced by insurance-style entitlements for interrupted earnings.

So the debate on national insurance benefits is really about adding to – not replacing – the current system. If or when new resources become available in the future, should some or all of this be spent on contributory entitlements, rather than improving the generosity of the means-tested system? In other words if the overall size of the social security ‘pie’ were to grow, to reflect rising national prosperity, should contributory benefits grow too?

Addressing the risk of destitution must always be the first priority, but there is a good case for expanding contributory entitlements. It has been said that the problem with our means-tested system is not just that it offers people who have not made a contribution ‘something for nothing’, but that it also gives people who have contributed ‘nothing for something’. This is an over-statement, but it is true that today’s working-age contributory benefits only replace a small proportion of the income of people with middle or middle-high earnings. This is an uninsured risk which the government should consider addressing, as few people have equivalent private sector protection. Similarly, an expansion of contributory benefits might help

provide people with new forms of support that reflects changing family and working lives. And importantly, improving the social security ‘offer’ for typical workers might give people greater confidence in the whole system, by providing everyone more of a stake, and a sense that social security recognises and rewards contributions.

An extension of contributory benefits could advance a number of possible policy goals that are unrelated to public attitudes – better lifetime distribution, insurance against unpredictable risk, and investment in young people (see appendix 3). It is true that spending an extra pound on contributory entitlements, not means-tested benefits, is likely to be less redistributive. However, most of the options examined here would entail relatively small amounts of spending, in the context of existing social security expenditure or the resources which might in future be available if there is reasonable economic growth. Since we spend just £8bn a year on working-age contributory entitlements at present, even doubling expenditure would be a relatively modest addition to the overall benefit budget.

Figure 22: Spending on contributory benefits

	Weekly rates 2016/17	Spending 2016/17
Employment and support allowance	£102/£109	£4.6bn
Jobseeker’s allowance	£73	£370m
Bereavement benefits	variable	£550m
Statutory maternity pay /maternity allowance	£140	£2.8bn
Total – children and working age		£8.3bn
Pensioners	£156	£92bn
Total – all age groups		£100bn

Source: Expenditure and caseload forecasts, Autumn Statement 2015, DWP, 2016; proposed benefit and pension rates 2016 to 2017, DWP, 2015

Support for loss of work

We start by considering the established contributory benefits, which typically provide support during temporary interruption of earnings linked to unemployment, sickness and maternity. The establishment of universal credit creates an opportunity to increase the visibility of these contributory benefits, since job seeker's allowance and employment and support allowance will in future be exclusively contributory entitlements. If nothing else, they need a 're-launch'. But substantive reform should also be considered. Here the main options for reform are to: increase the generosity of existing entitlements; extend the duration of entitlement; or broaden who is eligible. There is also scope to place more emphasis on employment-based benefits.

More generous payments: There is a strong case for substantially increasing the rate for contributory job-seeker's allowance, employment and support allowance and maternity payments to provide a much better income replacement for typical workers. This could be through a significant increase to flat-rate payments or the introduction of earnings-related payments.

- **Flat-rate payments:** Paying the same amount to all contributory recipients, regardless of whether they are pensioners or working-age, would start to reunite our polarised social security system and has a logic which would help to secure strong public support. Matching out-of-work contributory payments to the state pension (currently £156 per week) also has a strong practical advantage in that it provides a much better replacement income for middle earners, which will give people more of a stake. It would cost an estimated £2–3bn to increase the value of these payments to match the value of the new state pension (with ESA only paid at this rate for one year). The main uncer-

tainty regarding this estimate is the level of take-up of a more generous jobseeker's allowance. Only about one in 10 unemployed people claim contributory JSA today and part of the point of the reform would be to increase the number of claims.⁴⁷ Some of the extra spending would be offset by lower universal credit payments.*

- **Earnings-related payments:** These are the default in much of continental Europe, but would represent a significant departure from UK practice. Earnings-related payments might be an option for the long term, to follow the introduction of an improved flat-rate offer, but they would be more expensive and less progressive. A scheme could offer a time-limited payment of (say) 60 per cent of earnings, up to the national insurance upper earnings limit.** This would help people to meet a risk, which neither the state nor the market covers effectively, but it would need to be accompanied by a matching increase in NICs so might not receive public support (alternatively, the government could promote a similar scheme as a form of 'opt-out' private protection – see chapter 8).

Duration of payments: The option of extending the duration of out-of-work contributory benefits is not

* However, households with both contributory and means-tested eligibility should receive more than standard UC claimants, to make their contribution count. This can be achieved by treating contributory benefits as earned income, for the purposes of withdrawing UC.

** The maximum weekly payment would be around £550 per week. However, as low income workers are more likely to become unemployed or sick, the average payment would probably be in the region of £200 to £250 per week. The benefit could be calculated on the basis of average income over the last 1 to 2 years, to protect people whose earnings gradually decline due to illness.

particularly attractive, even though this would be the direct way of reversing cuts to entitlements since the early 1990s. A modest extension of the period of entitlement for JSA and ESA might be desirable (say to nine months and 18 month respectively). But a time limit of some sort is justified. It obviously limits costs and, as the distance from a recipient's last job increases, it makes less and less sense to treat people differently on the basis of whether they had established a record of NI contributions. This is particularly true in the case of sickness or disability, where there comes a point where a historic connection with employment and contribution is no longer sufficient justification to distinguish people with otherwise similar circumstances.* In the case of unemployment, the main reason for a time limit is to provide a clear incentive to find work, to offset the disincentive created by higher NI benefits. A generous but time-limited payment will give people with middle and high skills enough head-room to find a suitable job, rather than the first one they can get (this is important for their future productivity and earnings); but also a finite time-limit for how long this should take.

Extending eligibility: If the aim of NI benefits is to recognise contribution and adequately replace the incomes of mid and high income workers, then it makes sense for there to be a reasonably onerous threshold for triggering eligibility. However, at present the bar appears to be too high, because few people who leave work on grounds of illness or unemployment are eligible for NI benefits (because of low pay, intermittent work or having a

* There is a case for treating *all* recipients of long-term incapacity benefits more generously (not just those with a contributory entitlement), by improving either means-tested and/or universal support. But that is a separate question, considered in chapters 6 and 9.

number of 'mini-jobs').* The Office for Tax Simplification has recently proposed a significant modernisation of NICs which should have the effect of increasing eligibility for NI benefits (NICs would be calculated on the basis of annual income and the income threshold for establishing eligibility could be reached across more than one job). These proposals should be implemented and evaluated, with policy makers keeping an open mind about the possibility of relaxing contribution requirements further in the future. Eligibility for JSA should also be extended to self-employed workers, but this raises the question of the rate of self-employed NICs, which are lower than for employees for no clear reason (NI entitlements for the two groups are now identical, except for JSA). Finally, Frank Field MP has proposed that young people could be included, if parents or relatives were able to 'gift' their NI record to the young person.⁴⁸

Employment-based benefits: As with National Insurance benefits, employment-based earnings replacement entitlements should be paid at the same rate as the state pension, to provide a meaningful level of support and create a united contributory system. There are also good reasons for extending the duration of statutory pay for maternity paternity, adoption and shared parental leave. These payments should last the full duration of the matching statutory leave period, otherwise only workers with good employers or adequate savings can take advantage of their right to time off. At present this would mean an extra 1 week of paid paternity leave and three months of paid maternity (or shared parental) leave. The partners of mothers should also receive a specific (non-shared) entitlement to parental leave,

* Contribution-based JSA is currently available only to people who have paid NICs for at least 26 weeks in one of the last two tax years, and have paid contributions on annual earnings higher than 50 times the weekly lower earnings limit in both years.

given the importance of fathers establishing strong relationships with infant children and the lasting impact this may have on the couple's division of care. Consideration should also be given to creating statutory carers' leave and carers' pay, so that people can hold open a job for up to a year if they need to take time out to care for a relative. Finally, there is a case for extending the duration of statutory sick pay to a year, to extend people's relationship with their employer when they are sick. Statutory sick pay is currently funded only by employers, but the government might conclude it was reasonable to subsidise the extra costs of a longer period of entitlement. In exchange it could require employees to be referred to rehabilitation support such as the new Fit For Work service.

None of these proposals are explicitly linked to housing, but in improving the replacement income available when earnings are interrupted, they will support people with housing costs predicated on their previous wage. This might be particularly helpful for two-earner households with a mortgage, which they would struggle to pay with one partner out of work. And for lower income households, ending the practice of offsetting UC (including the housing support element) pound-for-pound against contributory benefits would provide a useful addition to household incomes.

Supporting caring and post-19 education

In the future we can expect longer working lives, more frequent occupational change, greater need for lifelong learning, more caring responsibilities and hopefully a better balance in the roles played by men and women (see chapter 5). Social security today seems ill-equipped to respond to these changes – because it looks at people's needs and circumstances over weeks and months, but does little to create opportunity and choice over years and decades.

It is time to debate a new role for the national insurance system, so that it helps people invest in their own futures and decide for themselves how to strike a balance between work, learning and care.

Caring: People with intensive caring responsibilities are entitled to carer's allowance. It is not a 'contributory' benefit but it reflects a vital social contribution. There is a strong case for raising it to the value of the state pension, alongside contributory benefits. But there are many people who are not eligible for the allowance who may still wish to take time out of work, usually for family reasons. So could the contributory benefits system be reformed to give people the choice to take a caring break, at a time of their choosing?

One option, examined by Bell and Gaffney, would be to adopt Belgium's system of 'time credits', where people build up a right to up to a year receiving benefits in order to care or train following an extended period of social insurance contributions.⁴⁹ This would be an expensive policy, however, and it is difficult to see how a period out of work that many would see as discretionary could be funded on the same basis as other NI entitlements. Most people would expect recipients to either pay in more, or receive less of something else.

An alternative option is to create time credits which people need to 'pay' back. This would be revenue neutral (or even positive) and would go with the grain of people's instincts about fairness, as well as the need for flexibility and control over long working lives. Under this proposal, people would be offered the opportunity to voluntarily receive NI benefits in exchange for delaying their date of eligibility for the state pension by the same length of time. In other words, you could 'buy' a year out of work receiving the current value of the state pension, and spend one year less receiving it in retirement. This would be a good example of the positive role of government in helping

people smooth income and consumption over their working lives, because very few people have the capacity to 'trade' income at points decades apart through their own borrowing or saving.

Post-19 education: This idea of national insurance 'years' might be a way of funding lifelong learning as well as time out for caring. Indeed it could become a major pillar for the funding of post-19 education. By absorbing much of the funding of university and lifelong learning into national insurance it would be possible to breathe new life into the whole national insurance system, re-enforcing the impression that NI is a 'something for something' deal. For the first time, NI would be a scheme for investing in young people, on the basis of their future contributions, not just providing insurance and pension income on the basis of previous contributions.

The government would create a system of 'National Insurance Education Accounts', either for England only or on a UK basis, in collaboration with the devolved governments. Every 18 year-old would be given three years of funding, with each year worth the same as the current value of the state pension (a little over £8,000 today). The payment would begin as a loan, but each year a slice of, perhaps, one thirtieth would be written off, on the basis of the recipient's NI contributions or credits. This would mean that a student starting university in 2016 could expect to graduate with £25,000 less conventional debt than today, as long as they spent most of their working life in the UK. By the early 2020s, the value of the account would be sufficient to fully cover the cost of English tuition fees (and could be a way for political parties to implement promises to 'scrap' tuition fees).

As with 'time credits', the scheme could feature a 'personalised' state pension age. The standard state pension age for each generational cohort might be predicated on people receiving three years of government support for

post-19 education. Anyone who did not make use of this allowance could receive the state pension early (which would be a helpful response to health inequalities, as on average they will have lower life expectancy too). On the other hand, additional funds for extra years of post-graduate study could be swapped for a higher pension age.

This policy is attractive because the current student finance system has huge flaws: debts are so high that three quarters of graduates are not expected to repay them in full; and the system creates very high marginal tax rates.* Under this reform typical levels of student debt would fall by more than half, so repayments would become much more affordable for graduates and much less expensive for the exchequer to subsidise. Over someone's working life, the policy might not cost hugely more than existing student funding for undergraduates. For example, the IFS calculates that if a student's total borrowing was reduced by £4,500 this would lead to a reduction in lifetime government subsidy of around £3,500.⁵⁰

Importantly, the extra public spending would only arise gradually, in annual slices as loans were written off, so this more generous approach to the funding of post-19 education would not have an immediate impact on public expenditure. Rising demand would probably be a greater long-term cost pressure, if more young people responded to the new incentives and chose to participate in post-19 higher or further education. This extra spending might pay for itself by boosting productivity, earnings and tax

* English reforms introduced in 2012 passed the full costs of most degrees to students and mean that graduates now face typical debts of £44,000 on graduation. The IFS estimates that three quarters of graduates will never repay their debt in full, despite being liable for 30 years of income-contingent repayments (which create marginal tax rates ranging from 41 pence to 56 pence in the pound).

revenues. In any case, costs could be managed gradually over time, by regularly reviewing the National Insurance taxbase and rates. One option for covering some of the extra costs would be to raise NICs on high earnings, for people eligible for the accounts, to reflect how much these proposals would improve the 'offer' for graduates with high lifetime incomes.⁵¹ If this approach was followed, the proposal would have some resemblance to a 'graduate tax'.

National insurance education accounts would allow for a much more flexible and consistent approach to student finance. The reform would remove the bias in the current system in favour of full time over part time education and higher over further education (people could spend their £25,000+ account gradually over many years); and as the payments would follow the student, the scheme would still permit student choice and a marketplace in education, overcoming one of the standard objections to replacing student loans with tax funding. Robust policing would, of course, be needed to ensure that payments were only triggered by attendance at legitimate, high quality courses.

The National Insurance Fund

Any significant expansion of national insurance entitlements during working life should be accompanied by reform of the machinery of national insurance. This is because most people do not understand the difference between national insurance and income tax, or know the entitlements which NI secures. This is partly due to the nature of the entitlements (the two most prominent contributory benefits – JSA and ESA – currently share a name and a payment value with their means-tested equivalents). But it is also due to the existing institutional arrangements, with the collection of NICs and the payment of NI benefits almost entirely integrated into the wider working of government.

Technically most NICs are paid into a separate National Insurance Fund which then pays for NI benefits. But in practice this is an accounting exercise, as there is no firm link between levels of NI contributions and benefit payments – and the government makes almost no attempt to communicate with NIC payers regarding their entitlements. Additionally, national insurance has often been increased to generate general tax revenues (the last increase in NI, after the financial crisis, was to reduce the deficit not to pay for any specific entitlements). And because NI is not independent from other government spending, successive governments have reneged on the promises their predecessors have made about the entitlements contributions would buy.

The Treasury is traditionally suspicious of earmarked taxes, but running social insurance schemes at arms-length from the rest of government is totally routine in other rich nations. It both increases public understanding and buy-in, and reduces the capacity for government to subsequently reduce entitlements or divert funds. If the UK is to attempt to revive the contributory principle – let alone to extend it to new areas like caring and education – it should also create a firmer dividing line between national insurance and general taxation.

It might be possible to achieve this mainly through a change in communication. Since the National Insurance Fund already exists, the UK could institute a new system where the chancellor is required to report to parliament in person on the fund's current and future liabilities and demonstrate it will be in balance over the medium term. The Treasury would also need to show that any increase in NICs was linked to new or increasing liabilities relating to contributory entitlements. The Government Actuary and the Office for Budget Responsibility would be required to independently audit the government's report and the fund would start to communicate directly with contributors and beneficiaries.

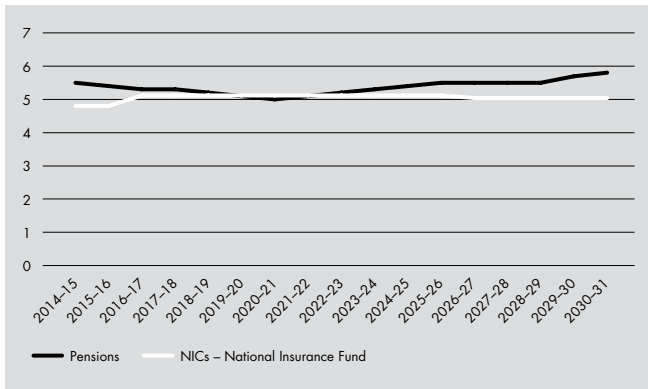
The draw-back of this approach is that it could be quickly undone by a future chancellor. So there would be advantages in creating more complete institutional independence. Decisions about entitlements and contribution rates will always be political, but the fund could be an autonomous, publicly accountable guardian of citizens' money, that might also have a role in instigating policy debate about trade-offs between payment and entitlement. For example both the IPPR and Frank Field MP have suggested that the National Insurance Fund could become a membership body, accountable to everyone contributing or in receipt of benefits, with its own independent governance.⁵² Any membership and representation arrangements should include employers, because there is currently little understanding of the role they play in funding contributory entitlements or the benefits that this brings them. The practical advantages of NI for employers should also be reinforced by transferring responsibility for funding employment-based benefits to the Fund.

In the most complete version of reform, the National Insurance Fund could be ring-fenced, so that the government would be unable to skim off funds nor provide top-ups. Since most NI liabilities are predictable and non-cyclical, the financial risk would be relatively manageable, with most of the uncertainty deriving from the variability of contributions not payments. In normal economic times, the fund could be managed to be in balance over (say) five years, although circumstances like the financial crisis would require special intervention. For the first time in many years this is a viable, revenue neutral option because the National Insurance Fund is roughly in balance.⁵³ New entitlements of the sort we have discussed would however need to be fully funded, either by increasing receipts or reducing other liabilities.

The best argument against this proposal is that the vast majority of NI entitlements today are state pensions,

so creating a formal ring-fence would mean that pensions would need to be entirely funded by workers' and employers' contributions. This could exacerbate concerns regarding intergenerational fairness, especially as state pension payments are projected to rise more quickly than NIC receipts in the 2020s (figure 23).

Figure 23: OBR projections for state pension and National Insurance Fund receipts



Source: Fiscal Sustainability Report, OBR, 2015; Fabian Society calculations.
 Note: NI Fund receipts are assumed to remain at four fifths of all NICs

But the other way of looking at this is that this ring-fencing would bring a hidden dilemma to the surface. Politicians, journalists and the public would be forced to debate trade-offs between the level of entitlements and the generosity of receipts, as well as the balance of entitlements at different points in life. With an independent fund, people of working-age would be able to have more confidence that they would receive similarly generous pension entitlements when they came to retire. But they might still conclude that regular increases in the pension age or replacing the 'triple lock' with earnings indexation were a

price worth paying, in exchange for lower contributions or additional working-age entitlements. For example, ending the triple lock in 2020 would save around £5bn by 2030 which would be sufficient to fund many of the new working-age entitlements discussed in this chapter.

A ring-fenced Fund designed to achieve fiscal sustainability for contributory entitlements would also prevent the pension system crowding out other, equally desirable, areas of spending funded from general taxation. National insurance rates might need to rise in the future to deliver sustainable entitlements, but there are other options for reforming the NI system to raise more revenue too. They include turning employer NICs into a uniform payroll tax; levying national insurance on workers aged over 65; ending salary sacrifice arrangements for pensions and other employee benefits; and harmonising NICs for employees and the self-employed.*

The rebirth of national insurance?

For many years it has seemed that national insurance has been on a path of gradual but inevitable decline – the state pension notwithstanding. This chapter has shown how NI entitlements could have an exciting future in meeting needs and creating opportunities, in a way that reflects emerging patterns of education, employment and family life. Proposals to establish the National Insurance Fund as an independent institution and to broaden the remit of NI entitlements to include voluntary career breaks and post-19 education would represent a major re-shaping of

* In any reform, for the sake of transparency, it would also be desirable to eliminate the existing national insurance payment to the NHS. This would imply a cut in employer and/or employee NICs of roughly 4p to be replaced by perhaps an equivalent rise in income tax.

the British welfare state. But the net costs of these measures over an individual's life would not be that high – with the main extra expense likely to be driven by (desirable) increases in participation in post-19 education.

Meanwhile, proposals to revive national insurance and employment-based benefits for loss of work could be relatively modest in cost. It would certainly be possible to design a significant package of reforms at a cost of between £5 to 10bn, which would be affordable over a 10 year period, especially if they were partly paid by ending the 'triple lock' on the state pension. This fairly low price-tag suggests that policy makers would not need to make a zero-sum choice between insuring people who have built up a contribution and protecting those at risk of destitution or in-work poverty. Better contribution-based, earnings replacement benefits would advance important policy aims by significantly increasing the protection typical workers have from temporary loss of income, help smooth-out lifetime incomes, and maintain high levels of employment. With or without a more radical reform of national insurance, they deserve support.

Summary: options for 'more contributory benefits'

National insurance benefits

- Raise the value of working-age contributory benefits to match the new state pension – and keep an open mind about earnings-related benefits in the long term
- Extend the duration of contributory ESA and JSA, but only modestly
- Broaden eligibility for NI benefits, for example by simplifying employee NIC rules, extending JSA to self-employed workers and enabling young people to be 'gifted' the contribution record of a relative.

Employment-based benefits

- Raise the value of employment-based benefits to match the new state pension
- Match the duration of government funded statutory maternity, paternity and adoption pay to the full duration of the associated statutory leave
- Extend the duration of statutory sick pay to 12 months – and consider whether the government should fund the second 6 months
- Introduce statutory paid leave for carers and for the partners of mothers with babies, funded by taxpayers.

Caring and post-19 education

- Introduce a ‘time credit’ for people to take time off work, in exchange for deferring their eligibility for the state pension by the same length of time
- Transform the funding of post-19 education, by creating National Insurance Education Accounts, worth the same amount as three years of the state pension, with debt gradually written-off by accumulating NI contributions and credits over people’s working lives
- Provide funding for extra years of post-19 education, by allowing people to defer access to their state pension for the same duration, and offer early access to the pension for people who do not use post-19 education.

The National Insurance Fund

- Institute an annual parliamentary statement on the National Insurance Fund and direct communication by the Fund to citizens and employers
- Transform the Fund into an organisation with independent governance, and perhaps a membership
- Fully ring-fence the Fund, with no government top-up except during economic crises

- Use NICs to fund all NI benefits and employment-based benefits (as well as the new proposals for time-credit and post-19 education entitlements) but transfer NHS funding to other taxes
- To fully meet proposed liabilities consider options for increasing the NI taxbase, raising the 2 pence NIC upper rate and scrapping the state pension 'triple lock'.

8 | MORE PRIVATE PROTECTION?

The idea of private action to meet social needs is as old as the first occupational pension or friendly society. Chapter 3 described how the OECD defines ‘social expenditure’ to include any socially-focused private spending which entails a degree of either redistribution or compulsion. Traditionally this provision was mainly collective, employer-organised protection, such as ‘defined benefit’ pensions. However, in recent decades it has shifted towards more individualised support, with people holding their own ‘personal accounts’ for various social purposes.

Here we ask whether – and how – such spending should play a larger role alongside social security? In the world of pensions, we already have a widely supported answer to this question. Discretionary employer-based pensions have always been important, but only covered a proportion of adults. Now workplace pensions are being transformed, to become ‘opt-out’ for employees and compulsory for employers when workers enrol. But what approach should be pursued with respect to children and working-age adults? Alongside the public sector welfare state, should we make more use of private ‘welfare’ during working life?

Employer-organised support

Employers pay tax and national insurance which helps to fund social security but they also support employees' social protection in two other ways. They make contributions to the personal accounts of their employees, without bearing risk or getting involved in redistribution (eg defined contribution pensions). And they organise and run provision themselves, by pooling risks amongst their employees and taking on some themselves (eg sick pay, redundancy pay). In both cases there are compulsory minimums but many employers go further in their employment contracts, on a voluntary or negotiated basis.*

While most pension provision has shifted to being only 'employer-funded', large employers still provide a good deal of 'employer-organised' collective provision *during* the employment relationship. Employer-organised protection exists because of the benefits it brings to relationships between employers, employees and the wider community – it is part of what it means to be a good employer. And there are also advantages to these schemes from a public policy perspective: they provide a different form of risk pooling, separate from the state or the insurance industry, where the employer and all the employees share risks; they help to maintain a relationship between the employer and employee at times where there is a risk of people stopping work; and they create costs for employers when business practices create 'externalities' with implications for public spending, like redundancy or stress-related illness.

* These two forms of support paid for by employers are conceptually distinct from (1) non-pay benefits with no 'social' function; and (2) employment-based benefits discussed in chapter seven, which are paid for by the government. However the water is muddied because most employers pay 8 per cent of statutory maternity, paternity and adoption pay.

The disadvantages of employer-organised schemes for employers are their overall costs, and also the uncertainty of these costs. From a government perspective, there are downsides to a two-tier system where some employees have good voluntary protection while others have little or none. State imposed minimums like statutory sick pay and redundancy pay have to be affordable for employers whatever their circumstances, so cannot be that generous – and even these do not cover self-employed workers. For these reasons employer-organised support should not become a mainstay of social protection, but there are a number of ways in which it could be improved:

Compulsory minimum responsibilities: Statutory redundancy pay should be reviewed to make it fairer between employees. The statutory scheme could require employers to take account of pay up to the NI upper earnings limit, but in exchange it might offer more consistent support to employees with similar skills and earnings, instead of payments being so dependent on length of employment. The value of statutory sick pay should also be raised, to match the state pension, and extended from six to 12 months to help people stay in work (chapter 7 suggested that this second six months of statutory sick pay might be paid for by the National Insurance Fund). As a more radical alternative, the ABI has floated the idea of making it compulsory for employers to provide full pay for one year, with employers encouraged to take out group income protection insurance to fund the scheme.⁵⁴ This is attractive in principle but it would add to employer costs (currently, group income protection policies cost roughly 1 per cent of payroll costs).

Going beyond statutory pay: Many good employers already pay more than statutory pay when employees are sick or on maternity. In future they should be encouraged to extend these contractual pay arrangements to any new forms of statutory leave which are introduced – for

example carer's leave, longer sick leave, and parenting leave for fathers. The government should work with business to agree desirable levels of protection and might consider using the tax system to reward and incentivise employers who pay more than the minimum and/or offer good occupational health services.

Personal accounts

Personal accounts are individual forms of private protection (although they often receive funding from employers and can be established via the workplace, as in the case of workplace pensions). Personal account policies are often referred to as 'asset-based welfare' – the idea is that the state supports people to build assets to meet their future needs. But schemes can also include arrangements for insurance and borrowing (eg US health insurance and UK student loans). Examples of personal accounts in the UK include – *Assets*: defined contribution pensions; child trust fund (scrapped 2010); savings gateway (scrapped 2010); help to buy ISA; lifetime ISA (announced); help to save (announced). *Insurance*: income protection insurance, pension annuities. *Borrowing*: student loans; deferred payment agreements for residential care; help to buy equity loans; support for mortgage interest (announced).*

Though personal accounts are sometimes associated with 'privatised welfare', it is worth saying that they are not intrinsically left or right wing. Neo-liberal versions of reform can be pitched as an alternative to the welfare state, but egalitarians can embrace personal accounts as complements not substitutes to government, with the potential to close gaps in wealth and opportunity. For example in

* The new system of 'tax-free' childcare should probably also be considered as a personal account policy, rather than a traditional tax relief.

a famous 1999 book Bruce Ackerman and Anne Alstott proposed that every young American should be given an endowment of \$80,000 to equalise life chances – and the idea was brought to the UK in a subsequent Fabian pamphlet.⁵⁵ This was a radical proposal because the payment was to be universal and unrestricted, but the British state already makes large cash transfers to citizens in limited circumstances* (and the national insurance education accounts, proposed in chapter 7, can be thought of as an endowment policy).

So, personal account policies encompass many different sorts of scheme. The social spending can derive from assets, insurance or borrowing. Participation by individuals may be compulsory, opt-out, opt-in or ‘seek-out’. It may or may not be compulsory for providers to accept customers or for employers to make a contribution. The government may contribute and, even if it does not, it may regulate to create cross-subsidies within schemes. Accounts may be designed in a more or less progressive fashion – both in terms of any taxpayer contribution, and in the overall outcomes achieved. And payments may be restricted to a designated range of purposes or unrestricted.

The main advantages of personal accounts are that they offer a way to build up assets and smooth out lifetime expenses through a system of contribution that is tied to the individual and fully funded. As a result people can have more direct control of the resources, and there is less risk of changes in government policy reducing expected outcomes. Accounts are often non-compulsory, which is attractive when policy makers believe that a course of action is desirable (for some or many) but should not be

* For example student loan write-offs and Right to Buy discounts for social tenants. Additionally, over decades, high earners can expect well in excess of £100,000 of public match-funding for their private pensions.

mandated (eg saving to buy a home, or saving for retirement beyond a minimum baseline). Many personal account policies help people to acquire assets, or provide the ability to borrow, in order to invest in their own future and accumulate resources over time. In this way, the welfare state can create opportunity, human capital and future wealth, not just provide immediate protection.

However, critics of asset-based welfare say that personal accounts are not necessarily the best way to achieve an investment-oriented state. This is partly because of the 'dead-weight' costs of supporting people who will receive family help, or can save or borrow on their own. But it is also said that asset-based policies intervene too late, since the most effective investments to improve life chances are likely to be targeted early in life, on nurseries, schools and financial support for parents.⁵⁶ There are other disadvantages too. Personal accounts tend to be anti-egalitarian, unless they are very carefully designed and subsidised; they entail much less risk-pooling and distribution than traditional social security; and they may have higher transaction costs than ordinary public provision.

For these reasons, the case for personal accounts taking over major components of the welfare state is weak. Generally, tax-funded entitlements are the most effective way of matching disparities between income and need at different points in our lives; and they are essential for transferring resources between generations or different income groups. The pension system is a public-private partnership which depends on a strong state pension; the NHS is cheaper, more efficient and fairer than comparable health insurance models; and the main costs associated with working-age social security – supporting children and long-term disability; and topping-up low pay – do not lend themselves to asset, loan or insurance based schemes.

Furthermore, funding major elements of social provision through personal accounts is just very expensive. In the USA healthcare costs usually account for 10 to 20 per cent of earnings, and in Australia compulsory pension contributions are rising to 12 per cent. Schemes like these may ‘shrink the size of the state’, but they certainly do not increase households’ disposable income – indeed they may reduce it. In the UK these limitations are best demonstrated by the case of student loans (see chapter 7). Whatever you think of the principle of people paying for their own higher education, the flawed loan system shows that, in practice, it is very hard for most people to pay for a major public service through self-funded accounts.

The arguments against personal accounts are persuasive when it comes to large-scale programmes, where accounts would substitute for major elements of the welfare state. In the sphere of social security their potential is therefore limited, and this is implicitly acknowledged in many of the recent proposals advanced by think tanks and insurers. Almost all of these have focused on contributory protection for temporary interruption to earnings, which accounts for a very small part of the working-age benefit system.⁵⁷ Similarly the plan to convert support for mortgage interest into a loan applies to a tiny fraction of overall spending (and SMI is also unusual, in being directly associated with an existing asset).

But there are still good reasons to support personal accounts on a more modest scale, to build assets and provide protection against risks that are currently uninsured. The government has already decided to provide taxpayer subsidies to people wishing to save for a deposit, on a similar basis to pension tax relief. Now politicians should consider two new types of account to resolve (1) the ‘income protection gap’ for households with middle and middle-high income; and (2) the ‘savings gap’ for households with low and middle incomes. Action to address these two ‘gaps’

is at least as deserving of government support as saving to buy a home (and more deserving than pension saving for very high earners). And while saving for a deposit is a voluntary activity, in these two cases most people stand to benefit from new support, suggesting there is a case for opt-out or compulsory schemes. The answer could be two new add-ons to the auto-enrolment and match-funding system that is now in place for workplace pensions.

Saving

The new ISAs to help people save for a deposit are mainly designed to benefit middle to high earners, who are in a position to afford a mortgage. Help to save, the parallel scheme for low earners to save for any purpose, is expected to be much smaller in scale. It offers a more generous match-payment than the deposit schemes, but the Treasury believes the latter will attract much higher levels of saving and therefore public subsidy. However, inadequate saving among low income households is probably the greater social concern, since most low income families have tiny savings. 33 per cent of all adults, and 43 per cent of adults under 34 live in a household with net financial assets of under £500.⁵⁸ As a result they find it very hard to pay for 'lumpy' costs, like rent deposits, or to build a financial cushion for a rainy day. Meanwhile, the need for such saving is probably becoming greater, with increasing flexibility and insecurity in the labour market. Although saving with a low income is difficult, the damage caused by high-cost credit is a firm indication that almost everyone would be better off with modest savings.

Help to save, which participants must 'seek out', will have low take-up so will only make limited inroads into under-saving. In its place, a future government should consider creating a match-funded 'opt-out' scheme to combine the best features of workplace pensions, help to

save and child trust funds. The scheme should be open to all, and achieve high participation by making automatic deductions from monthly payroll and social security, unless people request otherwise. Government match funding should prioritise people with low incomes, and should only be available for regular deductions, to stop people investing existing assets or one-off family gifts. The scheme could serve a number of functions by enabling people to save modest amounts for any purpose, and more significant amounts for specified contingencies or for their children. It would also need to be exempt from the universal credit means-test to give people clear incentives to save, even if they have some existing assets.

Example of an opt-out savings scheme*

One version of this proposal would see a personal account opened for all universal credit recipients and NIC payers, either by individuals themselves, or automatically by the government if no action was taken. Financial institutions would offer kite-marked accounts and each adult and child would be eligible for one account. The default deduction would be 1 per cent of earnings (up to the NI upper earnings limit), and 1 per cent of universal credit payments.

These deductions would automatically rise and fall with incomes on a month-by-month basis, and people could choose to either opt-out or increase their contribution. Match-funding would be available for all, but focused on low income groups (the example here applies pound-for-pound matching to deductions from UC and provides a £100 annual bonus to top-up everyone's earnings deductions). If no one opted-out, the scheme might cost the government around £3bn per year, which could be funded by reforming pension tax relief.

* Paul Gregg proposes another interesting model in the 2010 Demos report *Liberation Welfare*.

Up to (say) £1,000 of savings could be used for any purpose (with the match provided after a year, to reward commitment). Further matched saving would need to be directed to a child's Junior ISA, or reserved for specified uses, such as maternity, leaving work, housing needs or retirement. Savings in these accounts would not be taken into account by universal credit. A parent with low or middle earnings who allocated 1 per cent of income to a child's account could expect to give well in excess of £10,000 after 18 years.

Figure 24: Savings after one year: 1 per cent deductions from earnings and universal credit

Earnings	£0	£10,000	£20,000	£30,000	£40,000
Single adult over 35, £100 weekly rent					
Net income	£173	£240	£330	£460	£590
Weekly deduction	£2	£2	£4	£6	£8
Weekly government match	£2	£2	£2	£2	£2
Savings after 1 year	£180	£250	£300	£400	£500
Lone parent over 25, 2 children, £130 rent					
Net income	£355	£430	£480	£520	£630
Weekly deduction	£3	£4	£5	£6	£8
Weekly government match	£3	£4	£3	£2	£2
Savings after 1 year	£330	£410	£420	£430	£500

Source: Fabian Society calculations

Income protection

Previous chapters have shown how the public social security system provides very limited support to people with middle or high earnings who have to stop work on grounds of illness or unemployment. Contributory JSA

and ESA provide inadequate replacement income for typical workers and they both have time-limits, after which people with savings or a working partner are eligible for little or no public support. Meanwhile private sector alternatives have gained only limited traction, with the ABI estimating that around 1 million people have access to individual income protection insurance for illness or disability.⁵⁹ Chapter 7 briefly examined the option of creating time-limited earnings-replacement insurance in the public sector, and concluded that this was unlikely to be a priority in the medium term (and even if such a scheme were to be introduced, it would leave people unprotected from the risk of long-term disability). So as things stand neither the public nor private sectors seem capable of offering protection for some very significant life events.

This means there is a case for government support for personal accounts to advance two of our policy aims – to insure against unpredictable risks and to transfer resources over individuals' lives. Ideally a solution is needed that would enable people to replace 60 to 70 per cent of their salary, which will usually be sufficient to prevent their fixed housing costs from placing acute pressure on family finances. Various think tanks and insurers have proposed alternative options, sometimes as standalone policies and sometimes as part of a broader 'lifetime account'.^{*} Some of these are proposals for saving or loan accounts, which

* For example IPPR propose a salary insurance scheme funded by a repayable loan; Policy Exchange call for a highly redistributive savings and insurance scheme that would replace the early period of a benefit claim; Legal and General have suggested a group income replacement product, with risk shared within the private sector; and SMF propose income replacement payments to top-up means-tested entitlements, based on drawing down or borrowing from a lifetime account.

have the advantage of creating a strong personal incentive to reduce the duration of a claim. However, they also have a (greater) disadvantage: for most people it takes years of saving or loan repayment to cover the costs of even a short spell without work. This means that, for anything apart from protection for a limited period between jobs, insurance is the only viable option.

But what sort of insurance? It turns out that there are a lot of moving parts to consider. New government-sanctioned products could be for temporary interrupted earnings and/or long-term disability. They could be compulsory, opt-out, opt-in and/or subsidised, depending on your view on how desirable it is for workers to be protected. Running schemes could be an employer responsibility (along the lines of group income protection) or they could be part of auto-enrolment accounts. They could be personally under-written or based on group-wide risks and therefore cross-subsidised. And to reduce costs, policies could have waiting times, limited payment periods or incentives for employers or insurers to support people back to work.

Some of these variables might be for insurers or employers to determine, but the government would need to create a regulatory framework and minimum standards. The two key questions to debate are what product features might be affordable, for a low and uniform premium of, perhaps, $\frac{1}{2}$ to 1 per cent of payroll; and should schemes be part of the 'opt-out' auto-enrolment framework or be a direct employer responsibility, on either a compulsory or incentivised basis? The review of auto-enrolment scheduled for 2017 provides an opportunity to start this debate, but a consensus is unlikely to emerge before the next election.

Underpinning these issues, there is also the question of how the state's social security offer should interact with private protection. The means-tested safety-net for low income households already exists and chapter 6 has

proposed that it should not penalise people who have income protection cover, by off-setting universal credit against it pound-for-pound. Beyond that, advocates of 'privatised welfare' on the right of politics have suggested that income protection should replace contributory JSA and ESA. But as many workers, including the self-employed, would not be covered this would create a two-tier system (which would also make it harder to attract support for improved state-backed protection for everyone).

It is better to think of future public and private schemes as two complementary tiers of contributory support. During the periods when both are in payment, private schemes could be designed as top-ups to the state offer (the proposal in chapter 7 to increase the value of contributory benefits would therefore reduce insurance premiums). Public and private provision could also be designed to be sequential, so that private protection took over in full, when public support ran out. To complicate the picture still further the ABI has suggested that there could be a public back-stop after five years of payments to limit the costs of premiums – in effect a disability pension.

This is highly complex policy terrain and none of the current policy options have been examined in detail. In particular, there is no evidence whether people consider the benefits of protection are worth the cost of the insurance. Politicians should therefore initiate debate and seek detailed evidence. The first step in this process could be to set out policy goals and a desired direction of travel, in order to secure engagement from a wide-range of stakeholders, commission analysis and engage the public in debate. A future government should consider a two-stage process of reform. Stage one could pilot an experimental system of government-sanctioned income protection policies – perhaps trialling opt-out, incentivised and compulsory variants. This would provide vital evidence on affordability, public support and social impact. Stage two could build

on this evidence to develop a permanent package, which could combine reform of both private and public systems.

Towards lifetime savings accounts?

Following the creation of these two new personal account schemes for saving and income protection, the end point could eventually be the creation of integrated personal accounts to cover post-19 education, pension saving, housing, general saving and loss of work. However, this feels a long way off at present, notwithstanding the announcement of the new lifetime ISA, as there would be significant barriers with respect to integrating both pensions and student debt. It will be important to ensure people don't sacrifice pension saving for other goals, and the different tax treatment of pension contributions stands in the way of integration. Meanwhile the sheer volume of student debt (and the likelihood that so much of it will need to be written off) is also a major obstacle, unless a scheme along the lines of the national insurance education account is introduced.

However, eventually, it might be possible to create an integrated scheme for repaying debt, building up modest working-age savings/insurance, and then saving into a pension. Even if there were different 'accounts' within an overall portfolio, there could be a single schedule for employee and employer contributions. When the account was in debit, repayments would be compulsory; when in credit, some or all would be opt-out, through auto-enrolment. Merging the existing workplace pension and student loan payment schedules would suggest personal deductions of 4 per cent on earnings from around £5,000 to £21,000 and 13 per cent on earnings over £21,000. An extra 1 to 2 per cent might be added to take account of saving or income protection.

Taken together, we can see that these ideas for personal accounts could help progress a number of possible aims for social security (see appendix 3), and need not compete

with the recommendations advanced in other chapters. Importantly they would have a fairly low cost for the exchequer, especially if implemented gradually. The costs of income protection insurance would fall largely on employers and individuals; and the costs of match-payments on savings would certainly be affordable, if viewed as a substitute for today's support for the pension contributions of high earners.

Summary: options for 'more private protection'

Saving

- Introduce an 'opt-out' savings personal account, with automatic deductions from earnings and benefit payments, and government match-funding financed from cuts to pension tax relief
- Link the new accounts to Junior ISAs to enable people of all backgrounds to save at least £10,000 for their children.

Income protection

- Use the scheduled review of pensions auto-enrolment in 2017 to initiate a public debate on government-mandated income protection accounts
- Pilot variants of income protection policies, trialling opt-out, incentivised and compulsory options
- Following pilots, introduce a permanent income protection policy, with complementary reforms to non means-tested social security.

Lifetime accounts

- Do not introduce fully integrated lifetime accounts, while concerns about the future of pension saving and student loans exist; but consider introducing a single schedule of deductions across all accounts.

IN FOCUS

Housing and asset-based welfare

Housing and 'asset-based' welfare have always been closely connected. Historically right to buy and mortgage interest tax relief were both (expensive) government policies designed to help people build housing assets. Recent government policies carry this tradition forward and include three personal account policies (the help to buy ISA, the lifetime ISA and the help to buy equity loan), plus the starter home discount and right to buy for housing association tenants. These policies only support those lucky enough to take advantage of them (who will tend to have reasonably high earnings), but in their different ways they aim to help people own a home and build assets.* The five schemes either reduce the overall costs of a home (and therefore a mortgage). Or they help people to save for a deposit – a 5 per cent deposit on a typical first home amounts to £8,000, which few young adults are able to find without family help.⁶⁰ For this reason the government has decided to subsidise saving for a housing deposit along the same lines as pension saving.

Housing wealth may also be a potential source of funds for personal account policies. Deferred payment agreements for residential care have just been introduced (with interest rates currently more than 2.5 per cent less than commercial equity release products). In future, this model might inspire other drawdown products to help people 'decumulate' housing wealth in later life, for specified social purposes (although schemes of this sort are an incomplete answer, as they do not pool the financial risks associated with longevity

* On the other hand, personal account policies can be a barrier to homeownership. Student loan repayments (and, to a lesser extent, workplace pensions) now significantly reduce the capacity of young adults to save for a deposit.

and disability). The new support for mortgage interest loan, launching in 2018, works on similar principles. It will rely on the government taking a charge on a recipient's home, to match the cost of the accumulated loan.

9 | MORE UNIVERSALISM?

The final possible path for reform is ‘more universalism’. This chapter considers whether politicians should reverse the recent retrenchment of universal entitlements, and shows that there are two ways of thinking about the issue. You can look solely at social security, and ask whether some of the extra resources which might become available in the 2020s should be spent on universal instead of means-tested benefits. Or, you can look across tax reliefs and benefits, and examine the case for combining the money in the two systems to create a single regime of fairer, simpler flat-rate transfers, which might ultimately become a ‘basic income’.

For the left, the debate on universalism has traditionally turned on questions of progressivity and targeting. Should money be targeted only at the poorest, or do most households need public support at different points in life? Are universal entitlements, funded by progressive taxation, sufficiently egalitarian and affordable for the exchequer? During austerity should payments which help higher income groups be cut first? These questions have been behind recent controversies regarding existing universal benefits like child benefit and pensioners’ winter fuel payment (although chapter 3 showed that rising tax reliefs for middle and high earners have not been subject to the same scrutiny).

Questions of incentives and attitudes are also well-established features of the debate. Within the pension system, the role of means-testing is being reduced in part to ensure that people are not dis-incentivised from saving for their retirement. There is also a widely held view that, when everyone receives an entitlement, public attitudes and electoral politics help to sustain the system. Some international academic studies have suggested that, because universalism leads to better-funded systems, it can even be more effective than means-testing in fighting poverty. This position is not supported by the latest research but the argument that universalism helps to preserve spending does seem to be supported by the UK's current experience of austerity, since the cash values of the main universal entitlements have been maintained.⁶¹

This established debate on universalism does not, however, reflect the reality revealed in this report – that we already have a quasi-universal system, when benefits and tax reliefs are examined side-by-side. Chapter 3 showed how, in 2020, the UK will have something close to a flat-rate system of cash support, at least when you look at the averages for large groups, or the basic entitlements for adults. No matter how much households earn (or don't), on average, they will receive the same income top-up from the government, when you include tax reliefs as well as benefits. This new flat-rate system of support could bring opportunities. If social security and shadow welfare could be presented as a combined entity, which provides different households with broadly similar levels of support, then it might be possible to initiate a major shift in attitudes to social security. The aim would be to persuade the public that people without work, or with very low earnings, are not making a special claim on society, but are receiving support on similar terms to everyone else.

'Traditional' universal benefits

We turn to the question of integrating tax and benefits in a moment. First, let's consider the case for extra spending on universal benefits, when the alternative might be to spend the same pound on means-tested support. Universal entitlements can hold their own in this contest, when they advance policy aims where household-based means-testing falls short. There are occasions where it seems right to provide an 'earnings replacement' to someone who isn't working, regardless of their household income or assets (as is the case with carer's allowance today). There are also 'living cost' benefits, where a universal benefit makes sense because of the costs of children or disability – and the spending is an exercise in lifetime distribution, or in 'horizontal' distribution between people with similar incomes, with and without the extra needs.

Looking at options for reform, the existing universal entitlements for children and working-age adults could be uprated in line with earnings, so that these benefits maintain their value as a share of GDP. This certainly makes sense for personal independence payment, otherwise disabled people will fall behind everyone else in their purchasing power.* Over and above indexation policies, the candidates for extra spending are:

Living costs – children: Child benefit, which helps reflect the higher costs of having children, has been falling in value for years. There is a good case for a significant

* The value of PIP and Attendance Allowance should also be evaluated periodically, to assess the range of costs associated with disability. There may also be a case for creating a special payment account for these benefits to nudge people towards spending them in full on expenditure related to disability, and to improve integration with social care personal budgets, for people eligible for both.

increase. First this would redress the balance between parents and non-parents (during austerity, families with children have seen their incomes fall by more than those without, right across the income distribution). Second, spending on child benefit is a fairly effective way of tackling child poverty, even if it is not as well targeted as the UC child element. The 2014/15 Landman Economics modelling suggested that doubling the value of child benefit by 2030 would lift half a million children out of poverty and cost in the region of £10bn. If there is to be more spending, the first priority should be to raise child benefit for pre-school children, as this is a time when future life chances can be shaped, living costs are high and earnings capacity is often reduced. But spending an extra pound on UC rather than child benefit will always help poor children more, so there is still a balance to strike. The policy becomes more attractive when the trade-off is not between spending on rich and poor, but between parents and non-parents, which suggests that child benefit should be discussed in the context of reforms to the tax system also (see below). *

Earnings replacement – carers: Carer’s allowance is not a contributory benefit but it recognises the essential social contribution made by carers, so can be thought of in similar terms. It could be raised in value to match the state pension, alongside the working-age contributory benefits. It is hard to justify paying a full-time carer only £60 per week while a pensioner receives £156. This reform would cost in the region of £3bn if implemented straight away, but would be affordable if introduced gradually over a decade.

* There is also the question of whether child benefit should return to being a truly universal benefit, by including families with a higher rate taxpayer. This would be desirable *if* it was funded by high income households, as a horizontal distribution from non-parents to parents (for example by freezing the higher rate tax threshold and recycling the savings to removing the current child benefit charge).

Earnings replacement – disability: Chapter 6 proposed that universal credit for disabled people with limited prospects of work should be increased to match pension credit. There is also a case for providing a non means-tested, non contributory income replacement for people with long-term disabilities, on the grounds that they are still deserving of public support even if they have savings or a working partner. The government has placed a one year time-limit on contributory ESA, except for people with the most significant disabilities, but simply repealing this is not the right answer because, after a certain time, it is inappropriate to differentiate between recipients on the basis of their historic employment record. One option is to introduce a universal benefit immediately after contributory ESA expires; another is a ‘back-stop’ entitlement after a long period without work (which might sit alongside private income protection schemes). Or a payment could be made at different rates according to how long people had been without work, or the extent of their disability. In the long term there is a case for supporting people with severe or long-term disabilities on a similar basis to disabled pensioners, and this would also replace the sudden cliff-edge at state pension age with a gradual transition.* These ideas could cost many billions of pounds, and they would sit alongside our proposals for raising UC for disabled people, so there would be trade-offs to make between cost, caseload and generosity.

Integrating tax and benefits

Moving beyond these ideas for universalism, should politicians also seek to merge taxes and benefits to create a

* People who become disabled over pension age are entitled to non means-tested payments of between £156 and £238 per week, depending on their degree of disability. Disabled people under pension age are entitled to between £0 and £140.

single broadly flat-rate system? The first step could be to introduce cosmetic, presentational changes. With universal credit in place, there will be a single system of payments uniting people with work and without. Alongside this the income tax and national insurance tax-free allowances might be described as 'credits' too. UC could be renamed 'household credit', the tax-free allowances would be 'individual credit', and child benefit would become 'child credit'. Operationally the three would remain distinct, but all the elements of support would be listed together, and described as cash entitlements for us all, in a single online statement.

There are other more radical possibilities. The new cash parity between out-of-work benefits and tax-free allowances could create the conditions for a genuine integration of taxes and benefits. This is an intriguing thought in the context of the growing debate about whether the UK and other advanced economies should introduce a universal basic income (also called a citizen's income). The idea is that every adult and child should receive a single flat-rate subsistence payment from the government, in place of both tax-free allowances and means-tested benefits. The payment would then be gradually offset by taxation, using a single marginal rate of withdrawal.* A basic income becomes a more practical proposition if it is conceived, not as vast new spending, but a process of integrating and rationalising existing entitlements of broadly similar

* For purists, basic income schemes entail actually handing over cash to every citizen, but the same financial effect can be achieved through the pay packet by redesigning the tax code. Money is then paid out only when people's entitlements are greater than their total income tax and NI liabilities. This is a form of 'negative income tax', a concept popular on the libertarian right. Negative income tax proposals that treat each individual separately bear a close resemblance to a basic income. Other versions, which use the household as the unit of assessment, are closer in concept to universal credit.

generosity. For people of working-age, the task would be to combine the basic tax-free allowances with universal credit and child benefit in a way that was broadly revenue neutral.

So is a fully-fledged basic income a good idea? Appendix 7 provides a detailed breakdown of the arguments advanced for and against the proposal. There are important points on both sides, but overall the case is not proven. The main reason for supporting a basic income is that it removes the need for means-testing, government intrusion and complex administration. As a universal, citizenship-based entitlement it could bind together people, who are currently divided by the gulf between benefits and tax allowances. And it might prove essential as a replacement for earnings, if the economy of the future offers far less employment than we know today.

But the introduction of a basic income would bring political pain and the usual financial and operational risks of any significant administrative reform. It is hard to conclude that the effort would be worthwhile, because the end result would be a system where the overall income distribution and the incidence of poverty would be no better than today. Those in the deepest poverty – people out of work for long periods of time – would not see their incomes rise, because a full basic income would simply replace universal credit (except for housing costs). Indeed, if UC increments for incapacity and other special circumstances ended, many might end worse off. Many with low or middle earnings would also lose, if their tax liability increased by more than the value of the basic income. Recent modelling for Compass confirms these fears, and finds that the introduction of a full basic income would lead to many ‘losers’ among low income groups and a rise in child poverty.⁶²

The proponents of basic income counter that the reform would have powerful behavioural effects, by greatly

improving and simplifying the incentives to enter work and earn more. But a basic income could also lead some people to reduce the hours they work, perhaps to care for children, and it might lead to more long-term unemployment, if work-search conditions were removed from recipients without a job. The dynamic effects of a basic income on employment, earnings and therefore poverty are, of course, empirical questions, which can only be determined by experimentation. It is therefore welcome that local pilot studies are either being established or lobbied for in a range of developed countries including Finland, the Netherlands and Canada.⁶³ But the advocates of the basic income often appear ambivalent as to whether they want or expect to see people work more or less. If their answer is more (because of the superior employment incentives of a universal payment) then a basic income paid at today's benefit rates might conceivably reduce poverty. But those who wish to see us work less, or just believe this to be an economic inevitability, need to accept the limitations of a basic income. The system might be better than universal credit at dealing with 'under-employment' and in-work poverty, by topping-up limited household earnings, but it would provide no more help than UC to low income households without work.

The question of conditions for people without work is worth considering from the perspective of public attitudes too. Although we have an unconditional system for supporting children, it would be a huge leap to provide adults in non-working households with financial support without any obligations in return. Backers of basic incomes see unconditional citizenship-based entitlement as a core element of the concept, but it is hard to see how this would be acceptable to the British public and media, at least in the medium term. On the other hand, an integration of tax and benefits could be introduced which retained an obligation for non-disabled people to seek work, train, care or

(perhaps) volunteer. This is a 'participation income', a policy proposed by the leading economist Sir Tony Atkinson.⁶⁴

The other main problem with the basic income concept is that it could never truly remove the need for means-testing because it cannot affordably support housing costs. It would be implausibly expensive to provide everyone with a basic income that would cover a cheap rent in the typical housing market. And even if this did happen, anyone in more expensive areas would still be unable to meet their housing costs. In the context of the UK housing market, a complete end to means-testing is a non-starter, removing one of the main attractions of a basic income.

With these drawbacks in mind, some commentators have suggested that the basic income concept should be treated as the platonic ideal for a tax-benefit system, not a real-life plan of reform.⁶⁵ They say it should be used as a thought experiment to generate principles, which should then inform gradual improvements to our messy, path-bound reality. For now, perhaps policy makers should try and ride two horses. They should engage seriously with the idea that a basic income might be the eventual end-point after many decades of reform. That is essentially the history of state pension reform over recent times, with the pension morphing gradually into a flat-rate, near-universal payment. But in the meantime they should focus on practical, incremental policy changes which embody something of the spirit of the basic income idea, but make sense as reforms in themselves. We now turn to proposals that do just that.

From tax allowances to individual credits

This chapter has suggested that UC and tax-free allowances could be presented together, as 'household credit' and 'individual credit'. But you could go further and transform the allowances into a real cash credit, along the lines

of a modest basic income. This was a recommendation of *The Solidarity Society*, a major Fabian Society report published in 2009 (prior to the invention of universal credit, the authors called it 'universal tax credit'). The tax-free allowances would be converted into 'individual credits' for all adults of working age, in or out of work.* The credit could still be 'paid' through PAYE for employees, but it would be a cash payment for everyone else. Importantly, it would not be a conventional basic income because it would be paid on top of 'household credit' – ie means-tested universal credit. As a result it would bring a big boost in incomes to the very poorest households.

Alongside this change, the earlier proposal to significantly increase the value of child benefit should be adopted (rebranded as a 'child credit'). If this system was introduced with the credits for adults and children each set at around £40 per week, a two-parent family of four would have a stable baseline income of £160, before net earnings or means-tested additions. The value of the credits would be increased each year, in the same way as today's tax allowances and benefits, automatically benefitting high and low income families by the same amount. This would mean that the usual political pressure for a rise in the personal allowance would in future help rich and poor alike.

Reforms along these lines would be very effective at reducing poverty and inequality. In 2014–15 the Fabian Society and Landman Economics modelled the impact of one version which recycled money from the tax allowances to new individual credits, and also raised overall spending

* We have not considered options for people over pension age. A similar system of individual credits could be introduced for pensioners, or the existing system could be retained. At present pensioners do not pay national insurance and a majority do not make full use of their income tax personal allowance.

to introduce a child credit.* We found that levels of income inequality fell and poverty plummeted. The number of children projected to be in poverty in 2030 fell by two fifths (from 3.7 million to 2.2 million). The modelling did not look within households, but this reform would also lead to an equalisation of resources between men and women, with women now likely to receive their own individual credit and child credits (paid to the main carer), regardless of whether they were in work or not.

Figure 25: Impact on weekly household income in 2030 of an 'individual credit' and 'child credit' – Landman Economics modelling

	10th	25th	Median	75th	90th	Mean
Change in weekly income	£25	£27	£20	-£9	-£24	£10

Source: Landman Economics micro-simulation model, using Family Resources Survey 2012/13

These results appear too good to be true – and they are. To make the package broadly revenue neutral, this version of the reform introduces the individual credit at a lower cash value than that of the allowances it replaces (for people who currently use them in full). However, major fiscal reform, on a cash neutral basis, inevitably means that many will suffer considerable losses. This would affect middle as well as high income households. While many families with children would gain, irrespective of their income, a single

* The reform we modelled was an individual credit for all adults of £37.50 (including pensioners, who we do not consider in the rest of this chapter); and a doubling in the value of child benefit for each child. The package cost £16bn more in 2030 than current spending plans, but still results in social security spending as a share of GDP being projected to be much lower than today.

childless adult paying modest rent might become a net loser once his or her annual earnings reached £17,000. The alternative, of paying every adult £68, would seem implausibly expensive as a one-off reform (costing around £50bn).

A gradualist solution

It would therefore be both unfair and politically impossible to introduce these proposals as a one-off measure. Does this mean this initially promising model for integrating tax and benefits is simply a non-starter? As a 'big bang' reform, the answer must be yes. But as a staged process, during a period of reasonable economic growth, there is a path to reform. Each year the tax-free allowances could be reduced in value and replaced with a portion of 'individual credit' worth the same cash amount to someone in full-time work. The cost of introducing the credit would always be higher than the saving from the tax allowances (as it would be paid to more people) so the pace of reform would depend on economic conditions and political priorities.

Every year (whatever the fiscal circumstances) the personal allowance could be cut by £500 and replaced with an individual credit for all (working-age) adults of the same value (ie £100 per year). Once the personal allowance was reduced to the value of the NI tax-free allowance, they two allowances would both be reduced together.* The allowances would continue to be cut until they were trivial, to

* At this point, as the NI 'primary threshold' would start to be reduced, decisions about the future of National Insurance eligibility and contributions would need to be taken. Lowering the threshold would increase NIC receipts, while reducing the 'lower earnings limit' would increase eligibility. While employees would be unaffected, self-employed workers would be net gainers from reducing the NIC tax-free allowance, so this would also be a sensible moment to increase the self-employed rate of NICs to match the employee rate.

avoid people having to report very low earnings (eg below £2,000 per year). There would be no cash losers and the policy would be entirely self-funded, by recycling the money saved from not increasing the allowances in line with inflation. Taking this cash-neutral approach would mean the policy would take at least 20 years to implement, during which time spending on the allowances/credits would fall significantly as a share of GDP. However, when in a position to do so, chancellors would often wish to cut the allowances by much larger amounts, to accelerate the process. This would have a net cost in cash terms, but the Treasury could work on the basis of spending a constant share of GDP on the system (including the child credits). Gradually a regime of tax-free allowances and child benefit worth 5 per cent of GDP would be replaced by 'individual credits' and 'child credits' worth the same.*

This slow process of 'switching' could be a gradualist, 'Fabian' route to creating a full basic income in the distant future. It would at least put in place the machinery that would make it possible to make larger universal payments should it be required, becoming an insurance policy in the event of a structural decline in the total hours of work, or of a severe recession which required a fiscal stimulus to support household spending. But for the time being it is better to think of individual credit as 'child benefit for adults' not a step towards a basic income – ie a universal component in a hybrid system, which also includes

* The individual and child credits could also be funded by replacing existing exemptions on VAT for basic products (this would pay for a credit worth around £12 per week). We are used to thinking of these exemptions as supporting low income households, but high income families spend more, even on basics, so benefit more from VAT exemptions and reliefs. Scrapping VAT reliefs on items like food and children's clothes and recycling the savings to flat-rate payments would be a progressive reform which would increase the living standards of households with low and middle spending.

contributory and means-tested elements. In two important respects the version of gradual reform would look rather different from a basic income.

The credits would be additional to means-testing: Purist advocates of a basic income would cut UC every time they increased ‘individual credit’, to gradually replace a quasi-universal regime, which arises from the two systems together, with a real universal income. But it is hard to see why any progressive politician would want to do that, with benefit incomes so low at present. The minimum post-housing income for a working-age adult is now £73 per week, compared to £156 for a pensioner, so it would make much more sense to share the money from the tax-free allowances with everyone. Only in the distant future, when out-of-work income levels are clearly adequate, would it be possible to consider substituting means-tested benefits for universal entitlements. In the meantime, paying an ‘individual credit’ on top of current UC levels would significantly raise the income of households without work. And all the specific proposals to increase the generosity of elements of UC, set out in chapter 6, could be scaled-back in recognition of the new source of income. UC would bear less of the load of providing for decent living standards. Additionally, it might make proposals for improved contributory provision more affordable, if they only needed to top-up ‘individual credit’.

The credits would be based on participation: The ‘individual credit’ should be paid on the basis of participation not residence, to secure public consent. As a start, it should only be available to people who both have a national insurance number and are on the electoral register (or an equivalent register for people without the right to vote). This would promote political participation and reduce the risk of fraud. Except for people with significant disabilities, receipt should also be dependent on either paying a certain amount of income tax or national insurance, or on

learning, parenting, caring, job search or work preparation. The policing need not be particularly onerous, but people who refused the offer of a guaranteed job or educational place, after a significant time without working or paying direct taxes, should not continue to receive the credit. Additionally, the credits should only be available in full to people with established links to the UK. Credit could be paid in part after one year of NI contributions or credits, but only in full after four years (with different arrangements for young people). In this way, most people coming to the UK, would first need to pay significant tax and national insurance on their earnings and would only then receive a compensating individual credit to reduce their net contribution.

A universal tier

The case for replacing mean-tested support with a mainly universal system is unproven. A 'full' basic income is not the right option for the next few decades, because it would not help address poverty, destitution, inequality or young people's life chances. The possible advantages of a basic income with respect to improved work incentives or greater simplicity are not nearly good enough to compensate, while today's social security system is so threadbare. And it is not at all clear that the public would accept higher taxation or unconditional support for people not working.

But there is a much better case for a strong universal tier, as a foundation for other forms of support, created by turning the tax-free allowances into a credit for all adults. Additionally, turning child benefit into a more generous child credit would tackle poverty, equalise life chances and reduce income inequality, as well as helping people transfer resources over their lives and meet the extra costs of children. Beyond these two credits, better universal earnings-replacement benefits would have similar

advantages, as well as providing insurance and supporting vital social contributions.

None of these options directly support housing costs, however, for the simple reason that these costs are hugely variable. Support for housing does not therefore sit well with a flat-rate system. Higher general incomes are important however, because housing benefit alone cannot be expected to resolve problems of housing affordability.

As part of a tiered approach, there is reason to believe that universalism can make a comeback. This takes us to our conclusion, which considers how the different options for social security might fit together.

Summary: options for 'more universalism'

'Traditional' universal benefits

- Universal benefits should be indexed to earnings, to share rising national prosperity
- Carer's Allowance should be paid at the same rate as the state pension
- A universal earnings replacement benefit for disabled people should be introduced, after contributory ESA expires. For people out of work for many years it should match the value of the state pension
- The value of child benefit should be increased significantly over the course of a decade

Merging tax and benefits

- The main entitlements should be renamed 'individual credit' (tax-free allowances), 'child credit' (child benefit) and 'household credit' (universal credit) and presented in a single statement
- 'Individual credit' should be gradually turned into a universal entitlement for all adults, paid through PAYE or in cash. This would be achieved by reducing the value

of the personal allowance by at least £500 per year and replacing it with a matching cash sum

- 'Individual credit' should be conditional on paying sufficient income tax and national insurance, or on participating in education, parenting, caring, job search or work preparation. Recent migrants would gain gradual access to the credit, after paying taxes

10 | CONCLUSION

From the standpoint of a single financial year, decisions on social security always seem narrowly constrained – by public attitudes, by the inevitable limitations of the public finances and by the path dependency created by every decision that has gone before. Those constraints have been even tighter in the years since 2010, because of the pain of deficit reduction and the narrow and regressive way in which austerity has been pursued. But when you look a decade or more ahead, from 2020 out towards 2030, the space for significant reform starts to open up. New institutions of the welfare state can be created, and gradual acts of rebalancing – prosecuted strategically year after year – can reshape the fabric of social security and taxation.

Choosing between two paths

So thinking strategically, where should the UK be heading on social security for children and working-age adults? There are three directions that the UK should not pursue in the 2020s. First, we should not convert our existing social security into a private system of personal accounts, except in some very marginal cases. Second, for the foreseeable future we should not adopt a fully-fledged basic income, because it brings little or no benefits to low income house-

holds. Third, and perhaps most importantly, we should not do nothing, because the status quo implied by current policy will lead to mass impoverishment in the 2020s.

That leaves two pathways. One is to build a more generous version of the status quo. This would combine a better-funded, but mainly means-tested social security system (often called ‘progressive universalism’); with a system of tax-free allowances targeting higher income groups (in other words, ‘regressive universalism’). Together they add up to a quasi-universal system – an accidental Brown/Osborne synthesis. The second option is to start to integrate taxes and benefits and build a tiered system of support which blends universal, contributory and means-tested entitlements, as well as private action. This option is closer to Beveridge’s original vision of social security, and to the pension system of today.

The former path is certainly easier and would significantly improve living standards for millions of people. Appendix 3 shows that a reformed universal credit would perform better than the system which will be in place in 2020, against a wide range of policy aims. But this option would not resolve the fundamental design flaws associated with means-testing, nor the stigma and division created by two rival systems for supporting living standards.

The latter road is likely to create a better system of social protection, insurance and investment in the long run, ‘for us all’. It is an approach better suited to ensuring that social security succeeds in distributing income across all our lives and insuring against risk – and possibly for building strong public support in the future. The different elements of the package each make a distinctive contribution to meeting possible policy aims, from preventing destitution and addressing inequality to improving life chances, reflecting extra costs and insuring against unpredictable risks. But the challenge of transformation would be formidable, in

terms of political imagination and public acceptance, as well as technical implementation.

This report has assessed means-testing, contributory benefits, personal accounts and universalism one-by-one, as alternative options. But the end-point might be a single system that unites them all. This new tiered system would itself sit in a broader context of activist government, with economic intervention and public services also playing their part in securing good living standards. No one part of the system would have to do all the heavy-lifting. The four tiers of social security could be:

1. **Universal:** An 'individual credit' for adults and a 'child credit' for children, in place of tax-free allowances
2. **Contributory:** National insurance and employment-based benefits that match the generosity of the state pension, and the option of time-credits, paid for by a visible and accountable National Insurance Fund
3. **Private provision:** Opt-out, match-funded savings accounts for all, and the piloting of income protection insurance on an opt-out or employer-organised basis
4. **Means-tested:** A generous means-tested 'household credit' that tops-up the other tiers of support and is designed to be non-stigmatising, to make work pay, to support children, to protect people unable to work for a long time, and to reflect higher living costs.

This four tier schema could be the architecture for social security from a national institutional perspective, but also from a personal and household level. Everyone would be able to access a statement detailing all their existing entitlements and the protection they would be able to access if their circumstances changed. This would have an

important psychological effect in binding people together and into a system of financial support designed for us all.

In addition to this, post-19 education funding can become part of national insurance to transform social security into a system of 'investment' as well as 'protection', and to overcome the extraordinary inadequacies of the current student loans system.

The economy and the public finances

Some of the ideas in this report would cost significant amounts of money. Others are cheap, when viewed over a 10 year time-frame, or would have no net cost for the exchequer. But overall, it would be possible to create a strong multi-tiered system while spending no more than today, as a percentage of GDP. The proposals for 'individual credit' and 'child credit' would be funded by switching money from tax-free allowances – over a decade or more, around 4 per cent of GDP might shift from being tax allowances to credits. Meanwhile, more generous means-tested and contributory benefits would be possible if spending on non-pensioner social security was kept constant in terms of GDP, instead of real expenditure. And finally extra private protection might end up adding another perhaps 1 per cent of GDP to the support available, above public social security.

The big question overhanging this analysis, however, is what will happen to economic growth? We are coming towards the end of the worst decade for the British economy for at least 140 years, and the nation has just voted to leave the EU. There is a good chance of a downturn in the short term, but the outlook for the 2020s is far less clear. Will the UK enter a new era of low productivity growth for the foreseeable future, or might the economy grow in line with historic trends in the 2020s?

It is, of course, the path of GDP growth per head that is the primary driver of household living standards – everything else is a question of distribution, either through the market or the state. If there is low growth, everyone will do badly but inequalities will not rise so fast, because earnings will not pull away from benefit incomes. But there will also be less new money for the exchequer, which arises when tax revenues outstrip social security obligations. This will make major reform much harder, because implementing significant changes without creating cash ‘losers’, requires extra revenue. If there is little growth, an incremental and minimalist approach to social security reform therefore becomes more likely. On the other hand, if productivity growth returns to trend, the need for significant reform will potentially be greater, to ensure that the proceeds of growth are shared. But there will also be much more room for major changes, because the money will be there to do it.

The options examined in this report include reform proposals, small and large, to suit different economic – and political – contexts. If the economy is smaller than hoped, then policy makers will have to ‘cut their coat according to the cloth’. The same targets for spending as a share of GDP could still apply, but there would be less in terms of spare cash to pay for more generous means-tested and contributory benefits. Similarly, with slow growth, the pace of transition from tax allowances to individual credits would be slower too. And it will also be harder to increase the role of private protection, as neither individuals nor employers can be easily asked to set aside more money if earnings and profits are not rising. The outlook for the economy in the 2020s should not necessarily affect our view on the long-term direction of travel, but it is very likely to determine what pace of change is possible.

'The problem of rent'

William Beveridge could not find a solution to what he called 'the problem of rent' which did not entail means-testing and that reality is the same today. Housing costs are both too large and too variable to be supported in a way that does not take detailed account of individual household circumstances. A universal system cannot be calibrated to these differences – which means that proposals for a full basic income do not pass the 'housing test'. Meanwhile people's ability to contribute (through public or private systems) bears little relationship to their likely need for housing support. A major shift away from means-testing to other forms of social security is therefore not a viable answer for housing.

Moreover, rising housing costs are likely to be one of the most significant pressures of the 2020s, if rents increase faster than typical incomes or benefit entitlements. So any reform to social security that is designed to respond to the changing social context must include better direct support for housing costs. Indeed, current policies will be totally implausible, if rents outstrip inflation. In this sphere, there needs to be more means-testing not less – with a generous universal credit, which better reflects housing costs. In particular entitlement must grow in line with rising housing costs. There is also a case for reversing some of the recent cuts to housing benefit, and piloting an element in UC that supports mortgage interest too.

But unaffordable housing costs cannot just be resolved by means-tested benefits. Spending on housing benefit will balloon if it is the only policy tool available to plug the gap between rising rents and stagnant incomes. Action to stabilise house prices and build more homes for social rent is therefore essential, even though it lies outside the remit of this report. Similarly, action to increase general incomes is needed, so that the gap which rent subsidies have to close is

less. Higher employment and better pay can play a role, but this report has demonstrated that generous social security is also essential to boost household incomes, and it is here that universal and contributory tiers could be important.

For this reason, almost all the ideas in this report have a bearing on housing, in that they increase disposable income overall. They hold out the prospect of better incomes for households with low earnings. But they also offer much better income replacement when people are without work on a temporary basis. This would leave many families in a better position to meet their usual housing costs, without the need for a specific benefit, which would hopefully reduce the number of people with mortgages who need means-tested support in future.

Lastly proposals to help people to save automatically will make an important difference in meeting one-off housing costs in the short-term. The scheme may also enable people from all backgrounds to save enough money for their children to have a deposit to buy a home.

Next steps

This report has described the challenges facing social security in the 2020s, examined individual options for reform and set out some possible directions that bring the different approaches together. The next step is to create an institutional structure to engage with politicians and citizens, agree principles for reform, develop the overall architecture, and design the initial stages. The task is to write a plan which is capable of securing widespread support, and then selling it.

This process could be led by a non-party or cross-party commission of inquiry, like the Turner Commission on pensions, or it could be led by a political party seeking to develop its own 2020 manifesto proposals. Whatever the formal machinery, the commission will need to work on three distinct levels.

Political principles and narrative: The boundaries of possible reform are partly constrained by the way the political debate on social security is framed. The work of any commission will be to challenge and seek to replace existing political perspectives. In particular, it should: seek to promote neutral debate on the pros and cons of social security vis-à-vis its alternatives (especially tax reliefs) in order to lay the ground for politicians to accept a substitution of one for the other; encourage policy makers to think about social security in terms of share of GDP, not cash spending, so long-term decline is not seen as the default; establish the state pension as a benchmark for assessing the generosity of other benefits; promote the idea of an independent National Insurance Fund; and initiate debate on the concept of merging post-19 education and social security spending. A political dialogue would also be needed with the Scottish government and parliament, to determine the extent to which Scotland wished to develop reform options in partnership.

Public attitudes: A commission would also need to work to engage with the public and craft its narrative and proposals in light of their reactions. This would be a particular priority for any process led by or associated with the Labour party, which is seen as being unthinkingly 'pro-welfare' and only 'for' people dependent on benefits. Ideas to improve social security coming from the left would need to pass tough tests, proving they weren't about spending money for its own sake, or targeting money at people 'undeserving' of assistance. Some of the issues where detailed work on public opinion is needed include: how to present social security reforms alongside complementary action to reduce demand for spending; which ideas work best at making people feel the system is 'for us all', and built on transfers 'from us to us' over our lives; the extent to which public concerns about housing costs might lead to support for housing subsidies; which groups the public

might wish to support on the same basis as pensioners; how to present 'individual credit' as an equivalent to tax relief not as brand new spending; people's appetite for new opt-out private schemes; views on the acceptability of different revenue sources that might fund proposals.

Technical and empirical: The goal of the commission would be to set out the broad direction of travel over 10 years, with the detail depending on political and economic context as well as lessons learnt as time went by. However, the first few stages of each reform would need to be designed and costed in detail, not least so they could be included in the manifestos of political parties. More generally, the commission would also want to develop quantitative analysis and modelling of the various options to understand their potential impacts and costs, both in isolation and as a package. Some of the reforms would need particular technical work, including the design and funding of an independent National Insurance Fund and the creation of new private sector income protection products. Early work would also be needed to consider the operational implications of proposals to ensure that all changes involved the minimum of administrative burden and technology transformation.

It is time for a plan, and a new process is needed to produce one. The plan will succeed if it is big picture and looks over decades, setting aside the constraints of conventional wisdom. It must consider the case for more means-testing, more contributory support, more universalism and more private protection – assessing each on its merits, as well as how they might be combined. This should be seen as both a technical appraisal and a public debate which draws citizens into an open dialogue about future options. In that way we can have a plan that is fit for the challenges the country will face in the 2020s, and that citizens are ready to accept – and a social security system designed 'for us all'.

APPENDICES

Appendices available online at www.fabians.org.uk

1. Possible aims for social security
2. Today's social security system, assessed against possible policy aims
3. Options for reform, assessed against possible policy aims
4. Pensioners and non-pensioners: diverging policy choices between 2010 and 2020
5. Universal credit in the early 2020s
6. Social expenditure – the international context
7. Arguments for and against a universal basic income

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Politicians need to find the confidence to argue that generous, well-designed benefits for non-pensioners are essential for a fairer, more prosperous future. They should begin to weigh up two broad alternative paths for reform. The first is to breathe new life into Brownite 'progressive universalism' by improving the mainly means-tested system we have today. The second is to create something closer to our Beveridgean pensions system, by striking a more even balance between means-tested, universal, contributory and private support, while also starting to integrate the tax and benefit system. The first path is easier in the short term – and would help millions of people – but the second path would bring a broader range of benefits to a wider range of citizens.

The report examines the reason why current policies are failing and then assesses improvements to means-tested, contributory and universal benefits as well as private support, proposing that the end-point might be a tiered system with elements of them all. Our political leaders can grasp the nettle and create a social security system for the next decade, designed for us all.

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