

The end of entitlement

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Executive summary

Responsibility has drained away from the British welfare state, leaving a poisonous blend of entitlement and apathy. Middle and high earners, who could and should be independent of public welfare, instead use their political weight to extract “their fair share” from government, through universal benefits and near-free higher education. The underprivileged engage with agencies that do not deal with the basic causes of unemployment. Even if people wanted to find new ways to save on their behalf, the insurance industry offers products that are too inflexible for the way we live now. The landscape is dominated by government’s central grip on benefit rates and savings rules and regulations, based on a faith in bureaucracy and uniformity undimmed by the 67 years that have passed since the Beveridge report.

The cost of middle class welfare amounts to around £31 billion per year. The most generous benefits to the entitled classes include the Child Benefit, Child and Working Tax Credits, Retirement Pension and Winter Fuel Allowance and Statutory Maternity Pay. Faced with the alternative of even more significant tax rises, middle class welfare must be cut back to help restore the public finances and put welfare on a more sustainable footing.

Welfare reform is stuck in a rut. Social enterprises and for-profit companies are improving services for unemployed people. But their impact is limited because they do not have control of the full range of benefits and programmes for the unemployed. Savings products are bedevilled with complexity and regulation.

There is a political consensus for some limited aspects of welfare reform. Yet to deliver real benefits the UK needs a radical reform plan that immediately constrains public spending and then, through reform, moves towards a smaller, more effective welfare system. The only alternative is to continue to increase the burden on current taxpayers, which will harm prospects for economic growth and postpone difficult decisions on expenditure. Key recommendations include:

- > **Abolish middle class welfare and benefit gimmicks**, with immediate cuts that would save £14 billion. Further savings, including from migrating individuals from the state pension onto personal protection accounts, should be made as part of a medium term plan to restore the public finances.
- > **Hand benefit rules and operation to social enterprises and companies**, funded through employee national insurance contributions.
- > **Develop flexible Personal Protection Accounts**, building on the success of ISAs and the introduction of auto enrolment and personal accounts for retirement savings in 2015.
- > **Where possible, replace social security benefits with private provision**, with private insurance being a potentially useful but largely underutilised tool, particularly for disability but also in other areas.

1

Entitlement UK

The welfare budget must be at the heart of the debate on how to restore the public finances. The British Government spends more on welfare than anything else. In 2009 the bill for “social protection” was around £199 billion, almost doubling in real terms over the last twenty years from £104 billion in 1989.¹ Social protection represents 32.5 per cent of all government expenditure, or 14.2 per cent of GDP.²

Spending more in good times and in bad

Some welfare spending varies with economic conditions, with increasing unemployment, for example, leading to greater expenditure on assistance to support people back to work. Yet since 2000 this spending has increased even when the economy was growing.

Table 1: Expenditure on Social Protection (£ billions, real)

Source: HM Treasury (2009), *Public Expenditure Statistical Analyses*.

1988	108.0
1989	104.0
1990	105.0
1991	108.0
1992	120.0
1993	132.0
1994	139.0
1995	145.0
1996	145.0
1997	147.0
1998	145.0
1999	143.0
2000	150.0
2001	154.0
2002	162.0
2003	165.0
2004	172.0
2005	177.0
2006	181.0
2007	182.0
2008	188.0
2009	199.0

¹ HM Treasury (2009), *Public Expenditure Statistical Analyses*.

² Ibid.

Rather than reforming welfare to support enterprise and mobility during this period of growth, entitlements were expanded to groups not in need. Failure to undertake reform while the economy was growing was a wasted opportunity and means that welfare spending now needs to be curbed in the face of deteriorating public finances and economic conditions. With the economic downturn leading to greater unemployment the costs of the UK's unreformed welfare system will increase with more people becoming dependent on government support.

Getting the public finances off welfare

The defining political issue of the moment is rescuing the public finances. In his pre-Budget Report the Chancellor is widely expected to announce that the budget deficit for 2009-10 is even higher than the £175 billion predicted in the 2009 Budget.³ The 2009 Budget foresaw UK national debt rising to 75.6 per cent of GDP in 2015, perilously close to the 80 per cent level at which the UK would be likely to lose its AAA credit rating.

The political debate has rightly turned towards the necessity of cuts and options to reduce government spending. While politicians were initially hesitant, opinion polls have revealed that the vast majority of the public now support shrinking the size of the state to reduce the deficit.⁴

All three main political parties are now in favour of spending reductions, and it is expected that Alistair Darling will announce major spending cuts in the upcoming pre-Budget Report.⁵ Meanwhile, the Conservative Party has proposed a number of cuts including a public sector pay freeze, while Vince Cable recently suggested a package of spending reductions in a *Reform* pamphlet.⁶

The welfare budget must be at the heart of these discussions. Making savings in the welfare budget will help secure the basic credibility of the UK public finances.

Poor value for money

Although the UK government spends a relatively high amount on welfare, this spending performs poorly. As previous *Reform* research has demonstrated, the UK is spending at European levels for poor American results.⁷ Attempts to use an extensive system of benefits to improve social outcomes have proved ineffective. Poor quality spending, not a lack of spending is now the major social policy problem.

In 2005 spending on family benefits as a proportion of GDP was the third highest in the OECD – only below that of France and Luxembourg.⁸ At 3.6 per cent of GDP, expenditure in the United Kingdom was 56 per cent above the average of the 26 OECD countries of 2.3 per cent.⁹ More recent OECD research has illustrated that the UK spends more than £90,000 per child from birth to the age of 18, more than the OECD average of £80,000.¹⁰

Yet by international standards the outcomes for children are poor. The UK is worse than average for overall child well-being, with high rates of risky behaviours, high levels of under-age drinking, high teenage pregnancy rates and more than 10 per cent of 15 to 19-year-olds not being in school, training or work and education.¹¹ Indeed, as the OECD recently noted, the rates of drunkenness are the highest in the OECD, with one in three 13 to 15 year olds having been drunk at least twice, and the teen pregnancy rate being fourth highest in the OECD.¹²

UNICEF research of 21 industrialised nations ranks the UK last for child wellbeing.¹³ Further, while average family income is higher and child poverty is lower than OECD averages, a recent Treasury review of child poverty found that there were 1.4 million children in workless families below the poverty threshold in the UK.¹⁴ Of these, 500,000 children were in workless couples and 900,000 children were in lone parent families.¹⁵

3 *The Guardian* (2009), "Public finances much worse than feared", 20 August; HM Treasury (2009), *Budget 2009: Building Britain's Future*.

4 *The Sunday Times* (2009), "Cut public spending, say voters", 13 September.

5 *Financial Times* (2009), "Darling set to reveal autumn spending cuts", 4 October.

6 *The Independent* (2009), "Osborne bets the election on public sector pay", 7 October; Cable, V. (2009), *Tackling the fiscal crisis: a recovery plan for the UK, Reform*.

7 Boys Smith, N. (2006), *Reforming welfare, Reform*.

8 The OECD defines public spending on family benefits as financial support that is exclusively for families and children.

9 OECD (2008), *PF1: Public Spending on Family Benefits*, OECD, Paris.

10 OECD (2009), *Doing Better for Children*, OECD, Paris.

11 Centre for Social Justice (2006), *Breakdown Britain*.

12 OECD (2009), *Doing Better for Children*, OECD, Paris.

13 UNICEF (2007), *An overview of child well-being in rich countries*.

14 HM Treasury (2008), *Ending child poverty: everybody's business*, London.

15 The trend is for poverty to be higher among families with children. Among families with children low incomes also tend to be correlated with larger family size, younger children, sole parenthood and receipt of a main welfare benefit.

Where welfare went wrong

Since the end of the Second World War society has got richer, with wage growth and greater independent wealth, meaning fewer people continue to need comprehensive state support. However, rather than reforming the system to reflect new conditions, successive governments have failed to remove universal benefits and move people out of the welfare net. Welfare has become more politicised with a benefit system increasingly responsive to the “grey vote” and middle class voters. While the Conservative government between 1979 and 1997 was able to reduce costs through increasing conditionality and letting the value of benefits fall, many middle class entitlements remained.¹⁶

New Labour began their period in power with the intention to reverse the expanding costs of welfare. In his speech to the Labour Party Conference in 1996 Tony Blair vowed to reduce welfare spending, arguing this was his “covenant with the British people. Judge me upon it. The buck stops with me.”¹⁷ Yet while welfare spending between 1980 and 2000 largely reflected economic conditions, since 2000 this spending has increased even when the economy was growing. On coming to power the Government introduced 13 new benefits.¹⁸ Many of these benefits have lacked any real rationale (beyond simply attracting voters).

The reason that welfare spending has increased during times of growth is the expanding scale of welfare payments. In 2008, 60 per cent of households were in receipt of at least one benefit; that figure rises to 93 per cent for households with children.¹⁹ The safety net that was designed to ensure a “basic minimum” has become an expensive money-go-round.

Why has middle class welfare grown?

Public choice theory illustrates the relationship between the people who directly benefit from spending decisions and incentives for the growth of government. It applies rational choice behavioural assumptions to voters, interest groups and politicians.²⁰ Voters are seen to support welfare programmes if they directly benefit from them. For instance, as Boston and St John have argued:

“People are often more willing to pay taxes to fund programmes that benefit them personally than those that assist only the poor. Politically, it is much more difficult to reduce expenditure on social programmes that benefit a large proportion of the population, particularly if the beneficiaries are well equipped to defend their interests.”²¹

Politicians’ desire to appeal to this self interest of voters has created an entitlement culture and goes a long way towards explaining the expansion of welfare over the last decade.

16 Timmins, N. (2001), *The Five Giants: A biography of the welfare state*.

17 Blair, T. (1996), Speech to the Labour Party Conference.

18 Child Trust Fund, Child Tax Credit, Working Tax Credit, Education Maintenance Allowance, Local Housing Allowance, Sure Start Maternity Grant, Childcare Vouchers, Healthy Start, Health in Pregnancy Grant, Winter Fuel Allowance, Free TV licenses, Free Bus Passes, Employment and Support Allowance and the Job Grant.

19 Office of National Statistics (2008), *Family Resources Survey: United Kingdom 2007-08*.

20 Holcombe, R. and J. Mills (1994), “Is Revenue-Neutral Tax Reform Revenue Neutral?”, *Public Finance Quarterly*, Vol. 22, No. 1, pp. 65-85.

21 Boston, J. and S. St John (1999), “Targeting Versus Universality: Social Assistance for All or Just for the Poor?”, in Boston, Dalziel, and St John (eds.) (1999), *Redesigning the Welfare State in New Zealand: Problems, Policies, Prospects*, Oxford University Press, Auckland, p. 96.

Where welfare went right

In spite of the difficulties involved, a number of countries have achieved welfare reform. While the UK has failed to tackle the rising costs, other countries such as New Zealand and Canada made significant savings. In both of these countries recessions and high levels of government debt led governments to introduce targeted family assistance.²² More recently in Australia greater targeting of family tax benefits has been introduced, while Ireland has proposed taxing the Child Benefit, in a bid to cut welfare spending by €1.84 billion and make a “system that is fairest to all.”²³

These examples highlight that the case for reform does not need to be based on narrow self interest. Reforms may also enjoy public support for reasons other than the distribution of their financial benefits. If reform increases the real utility of a programme, possibly by increasing the extent that the direct financial benefit goes to the needy, it could also lead to sustainable expenditures, as seen with the support for assistance that supports work activity in a number of countries.²⁴

Welfare reform is essential for a low-tax economy

Increased globalisation has driven a worldwide movement towards lower taxation that effects both business and personal taxes. For business taxes there are pressures from competition, as cities around the globe are in direct competition for investment. Investment in the new service economy and in the new manufacturing industries is much more mobile than it was in the days of huge plants located in company towns. Ability is also more mobile, with locations competing for scarce resources in talent and qualified staff.²⁵

Higher public spending reduces growth in the long-term by crowding out innovation and competition. There is evidence to suggest that rising public expenditure as a share of GDP lowers the long-term growth rate.²⁶ One recent study suggests that for every one percentage point increase in the share of government consumption in GDP, there is a reduction in GDP growth of 0.2 percentage points.²⁷ The composition of government expenditure is also significant, with expenditure in the UK being relatively biased towards redistribution rather than supporting economic growth.²⁸

22 Nolan, P. (2005), “Targeting families’ assistance: Evaluating Family and Employment Tax Credits in New Zealand’s Tax-Benefit System”, Victoria University of Wellington.

23 The Irish Examiner, (2009), “Child benefit lead target of €1bn cuts in welfare budget”, 12 August.

24 Nolan, P. (2006), “Tax Relief for Breadwinners of Caregivers? The Designs of Earned and Child Tax Credits in Five Anglo-American Countries”, *Journal of Comparative Policy Analysis*, Vol. 8, No. 2.

25 Bosanquet, N. et al (2007), *UK growth and opportunity – the need for a fundamental reassessment, Reform*. “Movement of both capital and labour across borders increases competition in labour and product markets. Workers and firms are developing more effective strategies for meeting such competition. Product cycles have speeded up so that people have to take decisions and develop new responses faster. Globalisation strengthens the case for local and personal decision-making on investment by individuals and firms as against central planning by governments. At the same time, growth in the globalised economy depends on innovative products and services. These depend on private demand as the public sector mainly supports mature large firms which are able to bid for large public sector contracts. Rising taxation reduces the spending margin for new services, which is the margin left over after day to day living expenses. Thus globalisation has vital significance for the tax/spend balance. It strengthens the case for restraint in raising public expenditure and taxation.”

26 International Monetary Fund (1995), *Unproductive Public Expenditures: A Pragmatic Approach To Policy Analysis*.

27 Pak, H. (2007), “Government Expenditure and Economic Growth: The Supply and Demand Sides”, *Fiscal Studies*, Vol. 28 No. 4, pp. 497-522.

28 Bosanquet, N. et al (2009), *Road to recovery, Reform*.

2

The entitled class

In order to halt the upward trajectory of expenditure on welfare, programmes and entitlements need to be pruned across the entire department. These savings must not be arbitrary and must not penalise the poor. Instead they must take Britain along a new path where welfare provision is a safety net rather than a long term alternative to work and where individuals take greater responsibility for providing for their own future. Faced with the alternative of even more significant tax rises, middle class welfare must be cut back to help restore the public finances and put welfare on a more sustainable footing.

The cost of unnecessary entitlements

Reform's analysis of benefit expenditure reveals that, based on Office for National Statistics (ONS) data for 2007-08, around £30.9 billion is spent on providing benefits to the UK's middle classes, as shown in table 2. This represents close to a quarter of the spending on cash benefits contained in these data.²⁹ £22.1 billion of this expenditure is received by the non-retired and £8.8 billion by the retired.

Table 2: Cost of middle class welfare (2007-08, £ millions)

Source: *Reform* calculations based on Office of National Statistics (2009), *The effects of taxes and benefits on household income, 2007/08*.³⁰

Retirement pension	£12,501
Child Benefit	£4,284
Tax Credits	£2,594
Disability Living Allowance	£2,364
Housing Benefit	£1,659
Income Support and Pension Credit	£1,468
Statutory Maternity Pay/Allowance	£1,148
Incapacity Benefit	£1,138
Other benefits	£759
Student support	£428
Council Tax Benefit/rate rebates	£382
Carer's Allowance	£363
War Pension/War Widows' Pensions	£341
Industrial Injury Benefit	£242
Attendance Allowance	£227
Widows' benefits	£183
Severe Disability Allowance	£180
Jobseekers Allowance	£79
Government training schemes	£16
Percentage of total cash benefits	24%

Notes: tax credits includes tax relief at source on life assurance premiums; Winter Fuel Allowances are included in other benefits. Life assurance premiums account for less than 1.5 per cent of spending on tax credits.

29 These data are drawn from the Expenditure and Food Survey (EFS), which is known to under-report some benefits (such as tax credit payments). Given this the estimates of middle class welfare in this report should be seen as conservative lower estimates.
30 Given data constraints a number of modelling assumptions had to be made. Allocation of expenditures within income deciles to household types is based on the proportion of the population in the decile for which they account. It is also assumed that expenditures are smoothly distributed within deciles and that the decile points are the midpoints of the average total original income for the relevant decile and above.

There is no single definition of middle class and households on middling incomes are diverse and have differing income needs.^{31, 32} The estimates presented in this report are for a basic definition of middle class where every adult in the household has at least £15,000 in income and every child £5,000. Middle class welfare is welfare received by families with incomes above this level.

This basic threshold is relatively generous and likely to understate the true costs of middle class welfare. These results should be seen as conservative lower estimates. As readers may, however, wish to use different definitions of middle class welfare the results for other definitions are presented in Annex 2. These other definitions, which account for differences in the income needs of retired and non-retired households and the Joseph Rowntree Foundation minimum income levels, lead to higher costs of middle class welfare.

Expensive luxuries

Table 3 also shows *Reform's* analysis on which programmes are the most poorly targeted to people in need.³³ The table shows the proportion of the spending on each programme that goes to households that are not in need.

Table 3: The UK's worst targeted benefits

Source: *Reform* calculations based on Office of National Statistics (2009), *The effects of taxes and benefits on household income, 2007/08*.

	Percentage of spending to households above income threshold
Maternity Pay	79%
Child Benefit	42%
Winter Fuel Allowance	31%
Disability Living Allowance	31%
Retirement Pensions	23%
Child and Working Tax Credits	22%
Housing Benefit	13%

Note: Due to data constraints the percentage of spending for the Winter Fuel Allowance is measured over the entire population rather than the retired population and so is a conservative lower estimate.

The Child Benefit is not only among the most expensive forms of middle class welfare, with £4.3 billion being paid to households not in need, but is also relatively regressive (with much of the benefit going to higher earning households). Statutory maternity pay is also relatively regressive, with around 80 per cent of expenditure going to families not in need.³⁴ The Winter Fuel Allowance, Retirement Pensions, Child and Working Tax Credits and Housing Benefit are also poorly targeted.

31 Consequently two different households may have different standards of living even if their incomes are the same.

32 Recent proposals by the Conservative Party have identified households with incomes over £50,000 as high, and not middle, earning families. While Gordon Brown has pledged to defend the interests of "the squeezed middle class" and making greater demands on high-rate tax payers (currently the top tax threshold applies from £37,400).

33 These estimates are based on data provided by the ONS that separated the Child and Working Tax Credits from other tax relief and the Winter Fuel Allowances from other non-contributory benefits.

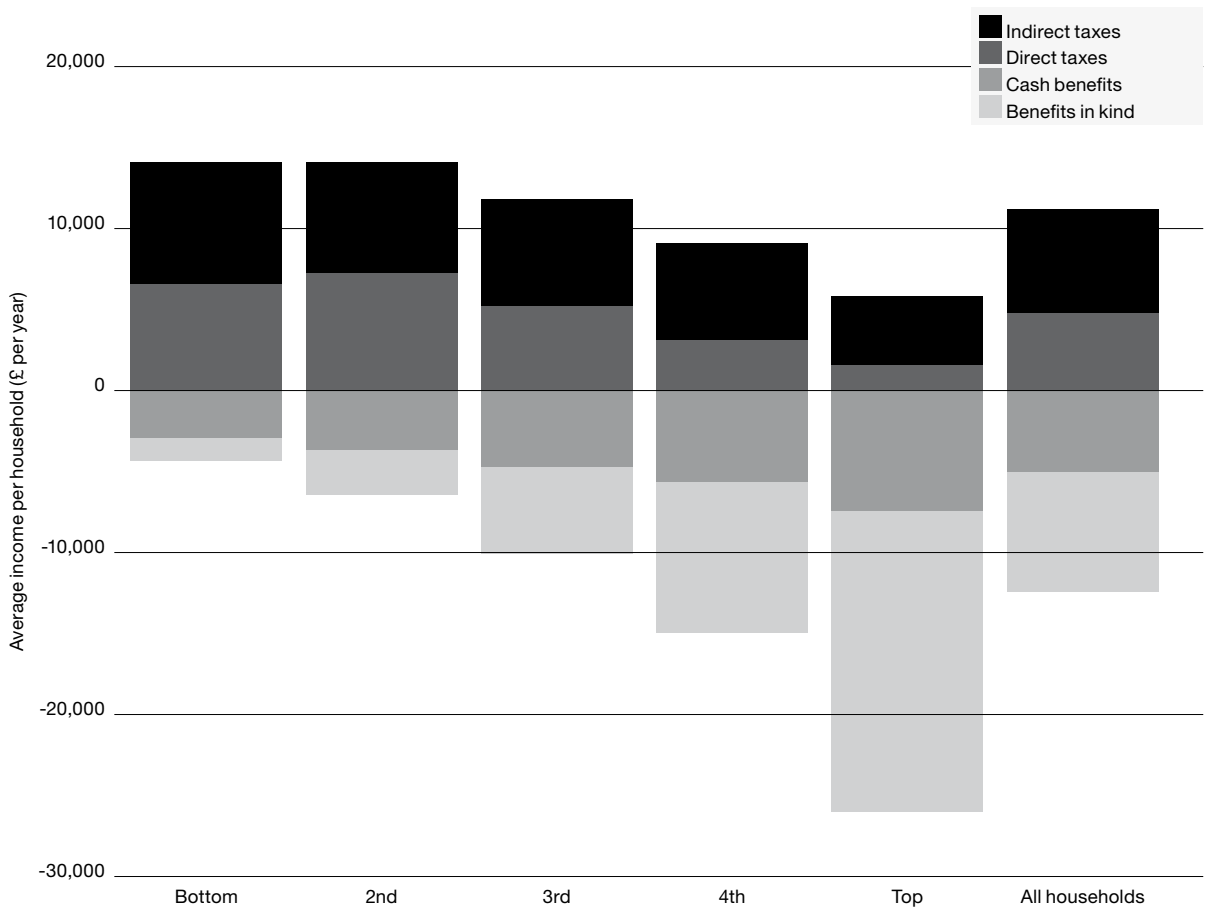
34 A recent *Reform* report proposed cost-effective reform to the current system of maternity pay and leave that would make it fairer and more flexible (Cawston, T. et al (2009), *Productive parents, Reform*).

Who benefits and who pays?

The Office for National Statistics publishes data on taxes paid and transfers received. These data show that on average the bottom 60 per cent of households receive more in cash benefits and benefits in kind than they pay in taxes and National Insurance Contributions. On average it is only the top 40 per cent of households who pay more in taxes than they benefit from in spending.

Figure 1: Effects of taxes and benefits on all households (quintiles)

Source: Office of National Statistics (2009), *The effects of taxes and benefits on household income, 2007-08*.



Note: Households are ranked throughout by their grossed equivalised disposable incomes.

Analysis by Volterra Consulting on these ONS data shows that the large majority of retired households receive more in benefits than they pay in taxes – with all but the top 10 per cent of retired households having on average original incomes greater than disposable incomes (e.g. paying more than they receive). In contrast, for households with children the top 30 to 40 per cent pay more than they receive.³⁵

These data highlight that very many households simultaneously receive government assistance from and pay substantial taxes to the Government. As Cox and Humphreys have argued this money-go-round, or churning, is undesirable because it indicates that some government expenditure is unnecessary and this unnecessary expenditure leads to taxes having to be higher than otherwise. These higher taxes come with higher administrative and economic costs.³⁶

Benefiting nobody

It is widely believed that the rise of welfare spending has been due to the unemployed and “economically inactive”. However the distribution of welfare spending (shown in Annex 1) reveals that only 12 per cent of expenditure is spent on the major out of work benefits. By contrast £80 billion, or 42 per cent, is spent on the elderly and £40 billion, or 21 per cent, is spent on working families. Twice as much is spent on Child Benefit as on Job Seekers Allowance and four times as much is spent on the Child and Working Tax Credits as on Incapacity Benefit.

Middle class welfare in the crosshairs

In the report *Back to black, Reform* laid down a first set of recommendations for reducing “middle class welfare”.³⁷ Its key recommendations were to scrap the Child Benefit and streamline the Child Tax Credit and remove pension “add ons” such as Winter Fuel Allowances and free TV licenses for the over 75s. Together, *Reform’s* proposals would save almost £11 billion from the DWP budget.

Since then many commentators have focused on “middle class welfare” as a potential source of public spending reduction without damaging the incomes of the most vulnerable.³⁸ In recent months David Blunkett, the former Home Secretary, has advocated taxing Child Benefit for high earners, while in a *Reform* pamphlet Vince Cable proposed tapering the family element of the tax credit and scrapping the Child Trust Fund.³⁹

At the 2009 Party conference the Conservative Party set out some proposals in this direction, including removing Child Tax Credit for households with incomes over £50,000 and the Child Trust Fund for all but the most disadvantaged families.⁴⁰ However, these policies would save only £0.7 billion a year, leading the BBC Economics Editor to comment that, “whoever wins the next election I’d be surprised if the next government leaves the other ‘middle class benefits’ intact”.⁴¹

35 However, as Volterra note, as the coverage of the ONS data is only partial a larger proportion of revenue has been allocated than spending and so the data will understate the transfer towards households by around £40 billion, or roughly £1,600 per household (Volterra Consulting (forthcoming), “Distribution of public finances”, report to the 2020 Public Services Trust).

36 Cox, J. (2001), *Middle class welfare*, New Zealand Business Roundtable; Humphreys, J. (2009), *Ending the Churn: A Tax/Welfare Swap*, Policy Monograph, Centre for Independent Studies.

37 Bassett, D. et al (2009), *Back to Black, Reform*.

38 Hinsliff, G. (2009), “Public Spending: Where now for middle class welfare?”, *The Guardian*.

39 *The Daily Telegraph* (2009), “Blunkett: Tax child benefit and give up nuclear arms”, 27 September; Cable, V. (2009), *Tackling the fiscal crisis: a recovery plan for the UK, Reform*.

40 Osborne, G. (2009), Speech to the Conservative Party Conference, Manchester, 6 October.

41 *The Independent* (2009), “Osborne bets the election on public sector pay”, 7 October; Flanders, S. (2009), “More on Osborne’s Plans”, *BBC Online*, 6 October.

3

Stuck in a rut

Welfare reform needs to end the entitlement culture and encourage people to make their own provision for the costs they face. As well as limiting the scope of benefits to people not in hardship, this will require moving to a mixed economy system. Demand is emerging for a greater partnership between government and social enterprises and companies. This partnership should not only involve the provision of welfare but also its financing. Much current debate on welfare is, however, stuck in a rut and fails to consider fundamental reforms to the way the welfare system operates.

The new welfare need

The vision of welfare contained in Beveridge's 1942 report reflected an economic and social environment of low and generally short-term unemployment and where couples with children and a single male breadwinner were the most common family type.⁴² These conditions no longer apply; with families being more diverse and concepts like a job for life and a complete exit from the labour market upon retirement becoming increasingly outdated. Research presented earlier this year, for example, pointed to the idea of the "death of retirement", with one in three 45-65 year-olds saying that they wanted to keep working in new jobs "on their own terms" after the official retirement age.⁴³ Welfare models need to adapt to allow a more flexible approach to life.

Failing to move with the times

With individuals taking a new approach to work, family and retirement, more flexible forms of support are required. But the existing welfare system is highly rigid. Pension providers have called for much greater flexibility in terms of saving into pensions and receipt of pension funds, pointing to the better example of American 401(k) retirement accounts.⁴⁴

Flexibility needs to go beyond pensions. Quietly, and rightly, the UK has begun to increase the level of welfare risk borne by the private population rather than the government. The introduction of personal pensions in 1988 was an important step in this direction, as was the introduction of student loans in 2000. In 2008, Alan Johnson's welcome decision to allow NHS patients to "top-up" their NHS-funded treatment with private contributions points the way towards a Continental model of healthcare largely funded by government and part-funded by individuals.⁴⁵ From the individual's point of view, what would be ideal would be a flexible product which enables saving towards all of these life events. The financial services industry has been slow to bring forward these products, partly due to a lack of initiative on the part of companies and partly due to an increasing weight of regulation.⁴⁶

The need for flexibility also puts into question the central role played by employers in the welfare system. The increasingly flexible world of employment is already driving employers to withdraw from defined benefit pension provision.

Trapped on welfare

The traditional welfare debate has detailed at length poverty traps and the complexity of the welfare system.⁴⁷ Previous *Reform* research has demonstrated the negative effect of social housing on social outcomes, such as poor educational attainment, worklessness and low social mobility.⁴⁸

42 Beveridge, W. (1942), *Social Insurance and Allied Service*.

43 Standard Life (2009), *The death of retirement*, Standard Life.

44 "The financial services industry needs to find a way to provide for a flexible third age. Baby boomers want to travel, work, even launch new business ventures, and as well as being personally ambitious, may also need to provide for financial dependents, whether it be their children's university fees or parents' care. These are complex financial needs that can only be met by pension products that allow flexibility in terms of investment and drawdown. We can look to the US as having started to answer this challenge already. American 401(k) plans have successfully established the link between lifelong saving and future plans by allowing far greater flexibility on drawdown. Consistent saving into a single fund brings the benefit of both securing your future but also being accessible if needed for a major purchase." Lawson, J. (2009), "The Industry Perspective", in *The death of retirement*, Standard Life.

45 Bosanquet, N. et al (2008), *Making the NHS the best insurance system in the world*, *Reform*.

46 Bosanquet, N. et al (2008), *Money's too tight to mention: will the IPOD generation ever trust financial services?*, *Reform/Chartered Insurance Institute*. "The growing regulatory burden since the 1980s has pushed up the costs of providing financial advice exponentially, and has priced the IPOD generation out of the market ... the situation has been compounded by a financial services industry geared towards older generations, using outdated models and providing complex and inflexible products not suited to IPOD's lives."

47 Martin, D. (2009), *Benefit simplification: how and why it must be done*, Centre for Policy Studies.

48 Bosanquet, N. et al (2008), *Shifting the unequal state: from public to apathy to personal capability*, *Reform*.

Recently, the Centre for Social Justice put forward recommendations to reduce poverty traps through re-engineering welfare tapering rates.⁴⁹ In an era of weak public finances the £3 billion upfront costs of these reforms makes them unworkable. Moreover, this approach of fine-tuning incentives through central planning is not the solution. More welfare needs to be taken out of the hands of bureaucrats, and put back into the hands of social enterprises and companies.

A priority for reform should be social housing and Housing Benefit. The current system has failed to encourage mobility between social and intermediate housing, or between larger and smaller homes.⁵⁰ Costs have not been controlled, with the bill for housing benefit reaching £20 billion next year. Without local initiative and innovation, the Housing Benefit will continue to be a major disincentive to employment and a block to social mobility.

Doing things by half

There is growing understanding across the political spectrum of the benefits of outsourcing the delivery of services for unemployed people to social enterprises and companies. In 2006 Nicholas Boys Smith advocated expanding the role of social enterprises and companies in the provision of welfare in the UK.⁵¹ Since then David Freud and spokespeople for both major Parties have set out similar ideas.⁵² They have rightly pointed to the advantages that such reform could bring: innovation, lower costs of delivery, competition and above all a focus on the customer.⁵³

However, such reforms only represent half of the solution. Unless social enterprises and companies delivering welfare have responsibility for the payment and the rules of benefits, they will be operating with one hand tied behind their back.

A more radical reform would be to make new providers responsible not only for the provision of services to unemployed people but also for the payment and the rules of benefits. Frank Field's previous work for *Reform* has suggested such an idea. The former Minister for Welfare Reform has suggested that benefit offices should be turned into independent, mutually owned organisations which, over time, take over the rules and payment of unemployment benefits, tax credits and child support. He concluded:

“The quality of service would rise (perhaps not an impossible task given the low level it operates at the moment) but fraud would be much more effectively countered. Similarly, these new local offices, knowing local conditions and many of their clients personally, would be far better placed to devise programmes helping claimants who have genuine difficulties in moving from benefit to work.”⁵⁴

Public use of private interest

A further dimension to reform would be to use private insurance to provide a more extensive array of welfare benefits. Protection from many social risks is now provided by private insurance, such as through life insurance and accident protection.⁵⁵ In welfare systems throughout the world new insurance products are being introduced to cover the risks that have previously been provided by the state. Very recently, the Conservative Party proposed a voluntary insurance scheme to cover the costs of long term care, while the possibility of “Livelihood Insurance” would spread the risk of economic changes beyond the state.⁵⁶

49 Centre for Social Justice (2009), *Dynamic Benefits: Towards Welfare That Works*.

50 Hills, J. (2007), *Ends and means: the future roles of social housing in England*, Centre for the Analysis of Social Exclusion.

51 Boys Smith, N. (2006), *Reforming Welfare, Reform*.

52 Freud, D. (2007), *Reducing dependency, increasing opportunity: options for the future of welfare to work*, Department for Work and Pensions; *The Sunday Times* (2009), “Tories would force jobless to work”, 4 October.

53 However, as a number of studies have shown, contracting out does not always represent good value for money: payment by results may bring significant windfall gains, with the Government paying for people entering work that would have gone into work anyway; additionally, contracts may incentivise “cream skimming” where suppliers select, or focus their efforts on, the clients who are easiest to help; and the success of payment by results may also reflect broader economic conditions, with lagging unemployment and slow job growth meaning that the UK government may have to pay over the odds for job placement. See, Lilley, P. and O. Hartwich (eds.) (2008), *Paying for success – How to make contracting out work in employment services*, Policy Exchange.

54 Field, F. and P. White (2009), *Help! Refashioning welfare reform to help fight the recession, Reform*. “Why welfare in this country was seen as a provider of work in the last resort was that policies were run locally. Strategies were set nationally but nobody in their right mind thought that policy could then be directed and operated from a central base. It was locally determined within the framework set down by legislation. As part of a radical agenda a government serious about change should begin a rolling programme of converting the local Jobcentre Plus into mutually owned businesses. The task of central government, apart from setting national objectives, would be to determine the local budgets of these newly established mutual businesses. Over time more welfare decisions would be determined in these newly created local services, allowing the local offices to run a child support service as well as determining tax credit payments. The quality of service would rise (perhaps not an impossible task given the low level it operates at the moment) but fraud would be much more effectively countered. Similarly, these new local offices, knowing local conditions and many of their clients personally, would be far better placed to devise programmes helping claimants who have genuine difficulties in moving from benefit to work. Profits from the local budget would be shared three ways: with taxpayers, with staff as bonuses, and in building up a development fund where the partners in the mutually run businesses would determine how best to spend the new capital as a means of reducing local worklessness.”

55 Beveridge, W. (1942), *Social Insurance and Allied Services*, p. 143. The Beveridge Report recognised that voluntary insurance should have a role in protecting individuals through providing supplementary support.

56 *BBC Online* (2009), “Tories unveil care home guarantee”, 3 October; Schiller, R. (2008), *The Subprime Solution*, Princeton.

Where reform has worked

Saving for retirement

A number of companies have introduced individual retirement savings accounts as a step towards more flexible welfare. Following the recommendations of the 2002 Pensions Commission personal pension accounts are set to be introduced by 2015 in the UK. It is hoped that with auto-enrolment the proposed personal pension accounts will encourage more people to prepare for the costs of their retirement.

Internationally, different funding methods have been used to encourage greater individual retirement savings. Australia converted its universal and non-contributory pension into a means-tested pension and a mandatory private wage-based savings scheme (the Australian Superannuation Guarantee). In New Zealand a scheme of subsidised individual personal retirement accounts (KiwiSaver) has been introduced. In Chile and Singapore bankrupt state financed systems have been replaced by mandated private contributory pension funds.

Saving for other social policy purposes

As well as savings for the costs of retirement, personal accounts have the potential to be used for a range of other social policy purposes. This is the approach taken in Singapore, where, alongside pension funds, individuals contribute towards personal welfare accounts that provide support for unemployment, accident or injury.⁵⁷

Personal welfare accounts have also featured extensively in academic debates on welfare reform. Martin Feldstein, Professor of Economics at Harvard University and former chief economic advisor to President Reagan, assessed the possibility of an Unemployment Insurance Saving Account earmarked to pay benefits if unemployment occurs.⁵⁸ Under this proposal all individuals would be required to have an Unemployment Insurance Account, which they would contribute towards through their income. If the individual was to become unemployed they would be able to withdraw prescribed amounts from their account, while if the account became exhausted they would be able to borrow from a government fund as the insurer of last resort.

Personal accounts directly link contributions made by individuals and their entitlement to welfare benefits. This provides incentives for individuals to both finance more of their own unemployment support and quickly locate new employment.⁵⁹ A variant of personal accounts has been in place in Brazil for several decades and has been introduced by several other Latin American countries. Uruguay has a dual public/private insurance system which covers, among others, old age and unemployment insurance.

In the UK this concept of individual welfare savings has been developed by the Adam Smith Institute, who called for every individual to have a “Fortune Account” where individuals would contribute into private accounts to cover the costs of retirement and purchase insurance that will cover for “shocks” in individuals’ working lives.⁶⁰

The insurance opportunity

A recent joint report by the Government and the insurance industry highlighted the growing demand for public private partnership in this area. The Insurance Industry Working Group, co-chaired by the Chancellor of the Exchequer, Alistair Darling, and Andrew Moss, Group Chief Executive of Aviva, argued that there were opportunities “for the industry to act in partnership with the Government to increase savings and protection provision, where appropriate, and help consumers manage financial distress caused by accidents, ill-health or old age.”⁶¹ Key areas where there could be greater opportunities for collaboration include disability insurance, unemployment insurance and savings (including pensions).

57 Butler, E., M. Asher and K. Borden (1996), *Singapore versus Chile: Competing models for welfare reform*, Adam Smith Institute.

58 Feldstein, M. (2005), “Rethinking Social Insurance”, *American Economic Review*, Vol. 95, No. 1, p. 14. Also see, Butler, S. and M. MacGuineas (2008), “Rethinking social insurance”, The Heritage Foundation and New American Foundation; Orszag, J. and D. Snower, (1997), “Expanding the welfare state: A proposal for Reform”, Centre for Economic Policy Research.

59 Brown, A., M. Orszag and D. Snower (2006), “Unemployment accounts and employment incentives”, Centre for Economic Policy Research. Kippin, H. (2009), *Angle-Flexicurity II: Insuring against unemployment in the UK*, Social Market Foundation.

60 Butler, E. and M. Pirie (1995), *The Fortune Account*, Adam Smith Institute.

61 Insurance Industry Working Group (2009), *Vision for the insurance industry in 2020*, HM Treasury, p. 9.

There is already a very considerable amount of practical experience in non-government insurance for welfare.⁶² There is, however, a question as to whether individuals are doing enough to protect themselves. As the Insurance Industry Working Group noted, many people are not saving enough to provide for their retirement or to deal with the risks they face in their everyday lives. Estimates are that the overall protection gap in the UK could be as high as £2.4 trillion.⁶³

The limits of insurance

Yet there are limits to the use of private insurance for social policy purposes. The Joseph Rowntree Foundation conducted an analysis that suggested that public social security offered better value for money than proposed private welfare insurance schemes.⁶⁴ Certainly, a greater role for private insurance in the welfare system implies a need for the insurance industry to provide more and better products to fill the welfare gap. Further, as Söderström and Rikner note, private insurers will not be willing to cover all income risks, or may only want to partially cover particular segments of markets, as not all risks are insurable. This may be because of moral hazard, collective risk, adverse selection and political regulation.⁶⁵

Söderström and Rikner evaluated a potential combination of public and private insurance schemes in Sweden. A public scheme would exist to cover big damages and extreme cases, and a private one for normal everyday damages, such as the loss of income for a few weeks.⁶⁶ This would encourage the supply of private insurance through ensuring that private companies do not have to worry about the long tail of the risk distribution. They argue that old age pensions (including survivor's pensions) and sickness insurance (including workers' compensation) are the main candidates for privatisation.

The case of private disability insurance

The OECD has identified private disability insurance as a potentially useful but largely underutilised tool.⁶⁷ Private disability insurance has become an important part of welfare provision in countries such as the Netherlands and Finland. In the Netherlands, for example, the introduction of experience-rated premiums for public disability insurance was a key factor in explaining the recent sharp fall in the rates of inflow onto disability benefits. The use of private insurance in Switzerland and Canada has also had similar effects on reducing the inflow and costs of disability. These positive effects reflect the financial incentives facing private providers to avoid the liability from people becoming unwell and, if they do become unwell, not recovering as quickly as possible.⁶⁸

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- 62 Indeed, in the UK current private sector alternatives to social insurance exist and include:
- > Critical illness: a policy that pays a lump sum to the insured if they are diagnosed with specific critical illnesses during the term of the policy.
 - > Income protection: income protection insurance pays an income as long as the policyholder is unable to work due to accident or sickness. The policy usually lasts until retirement.
 - > Accident and health: personal accident insurance pays either a lump sum or weekly benefits in the event of accidental death or specified injury.
 - > Payment protection insurance: covers the policyholder against inability to meet debt repayments in the event of accident, sickness or unemployment.
 - > Long term care insurance: covers the potential costs of long term care for the elderly (Insurance Industry Working Group (2009), *Vision for the insurance industry in 2020*, HM Treasury).
- 63 Insurance Industry Working Group (2009), *Vision for the insurance industry in 2020*, HM Treasury, p. 22.
- 64 Burchardt, T. and J. Hills (1997), *Private welfare insurance and social security*, Joseph Rowntree Foundation. The report also argued that many people in low income and high risk groups would see their contributions rise, while the highest earners would be net beneficiaries
- 65 Examples Söderström and Rikner cite include:
- > Moral hazard: occurs when, due to having insurance, people change their behaviour to increase risk. In the case of benefits with children, for example, private insurance would require a large co-insurance rate or high premium as the activity that triggers assistance (having children) is something that families can alter.
 - > Collective risk: occurs when the risks for different individuals are strongly positively correlated, and so insurers would face the risk of having to pay a huge amount of compensation at the same time. In the case of unemployment insurance, for example, weak labour demand (such as during a recession) would mean that the longer term costs of unemployment may be uninsurable. Options for addressing this include making insurance mandatory or segmenting private insurance for short periods (say, up to two months) from longer-term unemployment.
 - > Adverse selection: when the insurance company has less information on individuals' risks than the individuals themselves, expensive customers are most likely to take-up insurance. This can be addressed through mandating insurance (Söderström, L. and K. Rikner (2003), "Privatisation of social insurance in Sweden", in Andersen, T. and P. Molander (2003), *Alternatives for Welfare Policy*, Cambridge).
- 66 Söderström, L. and K. Rikner (2003), "Privatisation of social insurance in Sweden", in Andersen, T. and P. Molander (eds.) (2003), *Alternatives for Welfare Policy*, Cambridge.
- 67 OECD (2009), "Sickness, Disability and Work: Keeping on Track in the Economic Downturn", High-Level Forum, Stockholm, 14-15 May.
- 68 Bosanquet, N., A. Haldenby, and H. Rainbow (2009), *Fit for recovery, Reform*.

4

From entitlement to contribution

There is a political consensus for some limited aspects of welfare reform. Commentators across the political spectrum support a reduction in middle-class welfare as a means to reduce the public sector deficit without harming low income groups.

The Conservative Party has, for example, recently pledged to means-test the £250 Child Trust Fund paid to every child, saving £0.3 billion per year.⁶⁹ There is also support for greater social enterprise and company provision of specific services for unemployed people. While following Lord Turner's recommendations, the Government is set to introduce compulsory personal accounts for pensions in 2015.

But the current debate would only deliver a small part of the benefit that radical welfare reform could achieve. The true scale of middle-class welfare identified in this report by *Reform* is £30.9 billion per year; removing that cost would mean a dramatic improvement in the public finances. There is also much greater scope for using social enterprises and companies to provide individual services.

To deliver real benefits the UK needs a radical reform plan which immediately constrains public spending and then, through reform, moves towards a smaller, more effective welfare system. The only alternative is to continue to increase the burden on current taxpayers, which will harm prospects for economic growth and postpone difficult decisions on expenditure.⁷⁰ Key features of this plan for reform should include:

- > **Abolish middle class welfare and benefit gimmicks**, with immediate cuts that would save £14 billion. Further savings, including from migrating individuals from the state pension onto personal protection accounts, should be made as part of a medium term plan to restore the public finances.
- > **Hand benefit rules and operation to social enterprises and companies**, funded through employee national insurance contributions.
- > **Develop flexible Personal Protection Accounts**, building on the success of ISAs and the introduction of auto enrolment and personal accounts for retirement savings in 2015.
- > **Where possible, replace social security benefits with private provision**, with private insurance being a potentially useful but largely underutilised tool, particularly for disability but also in other areas.

Abolish middle class welfare and benefit gimmicks

The second chapter of this report showed that the cost of middle class welfare amounts to £30.9 billion per year, with unnecessary payments being made through programmes such as Child Benefit, the Child and Working Tax Credits, Statutory Maternity Pay, the Winter Fuel Allowance and concessionary bus fares. There is an immediate need to claw back these benefits to lower the overall costs of welfare, supporting the move to a lower-tax economy. These costs can be lowered without compromising other key objectives, such as achieving targets for reductions in child poverty. Immediate recommendations are given in the table below and explained in greater detail in Annex 3.

⁶⁹ The Conservative Party (2009), "Stop Child Trust Funds except for disabled children and the poorest families".

⁷⁰ With population ageing leading to growing welfare costs the need for hard decisions on reducing expenditure growth is unavoidable.

Table 4: Immediate measures for reform

Recommendation	Saving (£ billion)
Means test Child Benefit	7.0
Scrap unnecessary benefits for families: > the Child Trust Fund > Employer-supported Childcare Schemes > Health in Pregnancy Grants > the Healthy Start Scheme > the Sure Start Maternity Grant	1.3
Abolish universal pensioner gimmicks: > the Winter Fuel Allowance > free TV licenses for the over 75s	3.2
Start raising the qualification age for the state pension to 68 from 2010-11	0.2
Concessionary bus fares	1.0
Charge student loan borrowers at the market rate	1.2
Abolish the Educational Maintenance Allowance	0.5
Total	14.4

The remaining costs of middle class welfare should be addressed as part of a medium term strategy to tackle the public finances. A major source of these costs is the state pension. However, as people have prepared for retirement on the basis that this assistance would be there it would be unfair to remove this in the short-term. In the longer term these costs should be addressed through migrating individuals onto personal pension plans.

Hand benefit rules and operation to social enterprises and companies organisations

Previous *Reform* research, the Freud review and current Government and Opposition proposals have called for contracting out employment services. Social enterprises and companies have already succeeded in delivering more innovative active labour market policies. There is now a vibrant market of specialised companies, charities and housing associations that hold the promise to cutting long-term unemployment.⁷¹ However, current proposals still have yet to bring the full effect of private enterprise and competition led innovation to the delivery of welfare services.

As well as active labour market policies, benefit provision should be outsourced, including unemployment benefits and Housing Benefit. This would bring a more consumer orientated approach to moving the unemployed back into work. With the proper contractual incentives, private organisations would provide greater assistance and do much more to keep individuals engaged with the job market. New approaches, such as contracting providers to manage welfare spending in local areas for ten year periods, could encourage greater innovation and real support for the most disadvantaged sections of society.⁷²

The profound benefit of this change would be to shift from welfare as a national bureaucratic service to one focused on the needs of individuals. Providers would work much more closely with individuals to find new and innovative ways to reduce the dependence of claimants. Closer supervision would include much more frequent personal contact, to maintain the habits of working life, and direct communication of advice and job opportunities, for example via text messages.

⁷¹ Given the high degree of worklessness among social tenants, housing associations may be well placed to provide a wider range of welfare services in partnership with other social enterprises and companies. Recognising the value of bringing more residents into employment pioneering housing associations have already begun to deliver employment services. Between 2003 and 2008, £209.5 million was invested by housing associations in over 900 projects addressing unemployment. However, it is widely recognised that the benefit systems, and particularly the steep withdrawal rate of Housing Benefit, act as a strong disincentive and a major block for more individuals entering employment. Currently, as John Hills noted in his report on the future of social housing, "there is no sign of a positive impact on employment of the kind that the better incentives that sub-market rents might be expected to give." Hills, J. (2007), *Ends and Means: The Future Roles of Social Housing in England*, Centre for the Analysis of Social Exclusion; Housing Corporation (2007), *Housing associations tackling worklessness*.

⁷² There is a strong case for focusing welfare solutions on local delivery. See, Direct Democracy (2007), *The localist papers, No. 5 Local Welfare*, Centre for Policy Studies; Local Government Association (2007), *Welfare reform: the case for devolution*.

Develop flexible Personal Protection Accounts

The introduction of personal pension accounts in 2015 is the opportunity to introduce broader personal welfare accounts, where individuals can save for and protect themselves against life “shocks” such as unemployment, disability, parenthood and retirement. These accounts would allow individuals to take control over their finances and their future. When individuals reach working age, they would be free to choose a welfare insurance provider to open their personal welfare account. If no provider is chosen, then they would be allocated one. As well as making minimum contributions into their welfare account, individuals would also be free to top up their coverage through insurance products. Supplementary insurance could cover a range of life events through products already available such as income protection and life insurance.

Where possible, replace social security benefits with private provision

The greater use of private insurance has the potential to fundamentally improve the welfare system. Key areas where there could be greater opportunities for collaboration include disability insurance, unemployment insurance and savings (including pensions). Private insurance schemes potentially have three key benefits:

- > Private schemes contain strong incentives to identify and intervene early to stop cases from deteriorating into long-term benefit claimants.
- > The operation of private schemes can provide lessons for public ones on how efficiency and effectiveness may be improved.
- > By diversifying and expanding the funding base, privately-managed schemes (funded by combinations of employer and worker contributions) could be used to cut public expenditure.

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Annex one: Expenditure and claimants of welfare programmes

Table 5: Expenditure and claimants of welfare programmes

Sources: Department of Work Pensions (2009), *Benefit Expenditure Tables*; Department of Work and Pensions (2009), *Tabulation Tool*, February 2009 data; HM Treasury (2009), *HMRC Supply Estimates 2009-10*; Office of National Statistics (2009), *Housing Benefit and Council Tax Benefit National Statistics*, August; Office of National Statistics (2009) *DWP Quarterly Statistical Summary*, August.

	Expenditure 2009-10, millions	Number of claimants
Benefits for families with children:		
Child Tax Credit	£16,200 ⁷³	4,258,000
Child Benefit	£11,770	7,530,000 ⁷⁴
Child Trust Fund	£500	796,000 ⁷⁵
Statutory Maternity Pay	£1,824	330,150 ⁷⁶
Maternity Allowance	£352	704,000
Education Maintenance Allowance ⁷⁷	£532	553,000
Maternity/Childcare Benefits	£239	N/A
Student loans	£1,200 ⁷⁸	N/A
Benefits for unemployed people:		
Jobseekers Allowance	£5,858	1,602,189
New Deal Programmes	£90	178,800 ⁷⁹
Job grant	£51	N/A
Benefits for people on low incomes:		
Income Support	£7,856	2,045,220
Employment and Support Allowance	£2,043	175,810
Working Tax Credit	£7,500 ⁸⁰	2,259,000
Housing Benefit	£19,632	4,403,980
Discretionary Housing Payments	£20	N/A
Council Tax Benefit	£4,778	5,428,230
Social Fund payments	£489	N/A

73 Figure is from 2008-09. HM Revenue and Customs (2009), *HM Revenue and Customs 2008-09 Accounts*.

74 Figure is latest available. HM Revenue and Customs (2007), *Child Benefit quarterly statistics*, August.

75 Figure is from 2008. HM Revenue and Customs (2009), *Child Trust Fund Statistics*, September.

76 Estimate based on Equality and Human Rights Commission (2009), *Working better: Meeting the changing needs of families, workers and employers in the 21st century*.

77 Learning and Skills Council (2009), *Annual Report and Accounts for 2008-09*.

78 The Times Higher Education (2008), "Top earners gain from student loan 'subsidy' as low-paid struggle", 27 March. Currently interest is charged at the rate of inflation only, hence student loans are interest free in real terms. The £1.2 billion saving is estimated by Nicholas Barr, Professor of Public Economics at the *London School of Economics*.

79 Figure includes New Deal for Young People, New Deal 25+, New Deal 50+ and New Deal for Partners only, figures for New Deal for Lone Parents and New Deal for Disabled People are not available.

80 Figure is from 2008-09. HM Revenue and Customs (2009), *HM Revenue and Customs 2008-09 Accounts*.

	Expenditure 2009-10, millions	Number of claimants
Benefits for elderly people:		
Basic State Pension	£53,953	12,226,260
SERPS and SSP	£13,301	N/A
Pension Credit (savings)	£1,380	3,330,090
Pension Credit (guarantee)	£6,820	
Winter Fuel Allowance	£2,731	12,583,000
Free TV license	£545	4,087,000
Free bus pass	£1,029 ⁸¹	N/A
Benefits for sick and disabled people:		
Statutory Sick Pay	£51	N/A
Incapacity Benefit	£5,912	2,221,890
Severe Disablement Allowance	£888	246,730
Disability Living Allowance	£11,394	3,043,990
Attendance Allowance	£5,093	1,578,640
Carer's Allowance	£1,499	502,500
Independent living funds	£334	21,000
Motability	£16	N/A
Industrial injuries benefits	£806	327,000
War Pensions	£1,024 ⁸²	187,475 ⁸³
Benefits for bereaved people:		
Widow's and bereavement benefits	£634	95,490
Industrial Death Benefit	£36	N/A
Total benefit expenditure	£188,380	

81 Department for Transport (2008), *Annual Report 2008*.82 Ministry of Defence (2009), *Annual Report and Accounts 2008-09*.83 Office of National Statistics (2009), *War Pension quarterly statistics*, June.

Annex two: Range of estimates of the cost of middle class welfare

There is no single definition of middle class and the group of households on middling incomes is incredibly diverse. Given this a range of income thresholds for middle income welfare were modelled for this report. The results of this modelling are shown in table 6. This table shows the results of the modelling at three different income thresholds.

The first threshold is the basic one presented earlier in this report (where every adult requires £15,000 and every child £5,000).

As this threshold does not account for the finding that retired households tend to have lower income needs than non-retired households, the second threshold modelled was the same as above except non-retired adults were assumed to require only £10,000 per person per year.

Finally a threshold based on Joseph Rowntree Foundation minimum income levels was modelled. This threshold provides an indication of the extent that assistance goes to the non-poor (which indicates targeting efficiency, or the degree to which welfare spending is wasted on those people not in need).^{84, 85}

Table 6: Cost of middle class welfare at different income thresholds (2007-08)

Source: *Reform* calculations based on Office of National Statistics (2009), *The effects of taxes and benefits on household income, 2007/08*.

Household Income at the 'Middle'	Overall Cost of Middle Class Welfare	Middle Class Welfare Received by Non-Retired	Middle Class Welfare Received by Retired
Every adult requires £15,000 and every child £5,000	£30.9 billion (24 per cent of all spending on cash benefits)	£22.1 billion (33 per cent of spending on cash benefits to non-retired)	£8.8 billion (14 per cent of spending on cash benefits to retired)
Non-retired adults require £15,000, children £5,000, and retired people £10,000	£35.4 billion (28 per cent of all spending on cash benefits)	£22.1 billion (33 per cent of spending on cash benefits to non-retired)	£13.3 billion (22 per cent of spending on cash benefits to retired)
Joseph Rowntree Minimum Income Levels	£44 billion (35 per cent of all spending on cash benefits)	£31 billion (46 per cent of spending on cash benefits to non-retired)	£13 billion (22 per cent of spending on cash benefits to retired)

84 Targeting efficiency is the extent that expenditure goes to the poor (Creedy, J. (1998), "Taxation, Redistribution and Progressivity: An Introduction", *The Australian Economic Review*, Vol. 32, No. 4, pp. 410-422).

85 Hirsch, D, A. Davis, and N. Smith (2009), *A minimum income standard for Britain in 2009*, Joseph Rowntree Foundation. This research estimated that a single pensioner needs £202.35 per week, a pensioner couple £287.86 per week, a single adult £265.35, a couple £415.76, a lone parent with one child £250.27 and a couple with two children £609.21.

Annex three: Detailed recommendations

Recommendation one: Scrap the Child Benefit and streamline the Child Tax Credit

The Child Benefit is currently worth £20.00 per week for the first child and £13.20 for every subsequent child, it is universal, untaxed and costs the State nearly £12 billion a year. *Reform* has argued that the Child Benefit should be means tested and rolled into the Family Element and Child Tax Credit.⁸⁶ The Child Tax Credit is already widely received among those families in most need of assistance. Removing the universal Child Benefit would save £10.8 billion (prior to the cost of increasing the Family Element and Child Tax Credit, which could cost in the order of £4-5 billion).⁸⁷

In addition the Institute for Fiscal Studies estimated that tapering the family element of the tax credit would save approximately £1.35 billion.⁸⁸ With the saved expenditure on the universal Child Benefit, total savings would be in the order of £12.15 billion (or £7.15 billion after allowing for a £5 billion increase in the Family Element and Child Tax Credit to address child poverty concerns).

Rationale

Gordon Brown has argued that the Child Benefit is “society’s support for, and investment in, the upbringing of children.”⁸⁹ Yet it is not possible to argue that the universal Child Benefit may be justified by concerns with child poverty when much of this assistance goes to well-off families and when other policy tools, such as the Child Tax Credit, are available and widely received among families in need of assistance. Take up of the Child Tax Credit is already high among lower income groups.^{90, 91}

Further, while it may be argued that the universal Child Benefit avoids some of the problems of targeted assistance (such as poverty traps created by the withdrawal of assistance), this is only one side of the equation. Unless spending elsewhere is reduced, the money spent on the Child Benefit must come from taxpayers or from extra government debt. These funds are not free and incur administrative and economic costs, which themselves create disincentives to work and save.

Finally, research by the IFS has shown that it is largely parents and not children who benefit from the Child Benefit, which is invariably spent by the parents on “adult-assignable goods” and not on “child assignable goods”.⁹² The need to redistribute income to all families with children can also be questioned as children provide families with benefits as well as costs.^{93, 94}

86 Bassett, D. et al (2009), *Back to black, Reform*.

87 A selection of options for increasing the Family Element and Child Tax Credit were modelled in Brewer, M. et al. (2008), “Options for Tax Credit Reform”, Institute for Fiscal Studies.

88 Ibid.

89 Hansard (1998), Col.1107, 17 March.

90 In 2004-05 among low income working families with children the estimated (central estimate) caseload take up rate of the Child Tax Credit was 90 per cent and the expenditure take-up rate was 95 per cent (HMRC (2007), *Child Tax Credit and Working Tax Credit take up rates: 2004-05*, London).

91 There may be some concern with overpayment and underpayment of the Child Tax Credit but these problems have been adequately addressed in a number of other countries and any failure in the UK reflects the administration of means-testing, which should be improved through addressing systemic weaknesses in Whitehall. Not all mean-tested systems exhibit rates of overpayment and underpayment as high as those in the UK (Nolan, P. (2005), “Targeting families’ Assistance: Evaluating Family and Employment Tax Credits in New Zealand’s Tax-Benefit System”, Victoria University of Wellington).

92 Blow, L. et al (2005), *Who Benefits from Child Benefit?*, Institute for Fiscal Studies, 28 February.

93 Thus, for instance, “if a family chooses to have three children... when it could have two ... then a revealed preference argument implies that the family prefers the alternative it chose. Whilst children may be costly, that parents (often) choose them must imply that they bring offsetting benefits” (Bradbury, B. (2003), “The Welfare Interpretation of Consumer Equivalence Scales”, *International Journal of Social Economics*, Vol. 30, No. 7, pp. 770-787).

94 A further set of arguments relates to the fact that a universal Child Benefit smoothes incomes over the lifecycle (people pay tax revenues in anticipation of when they have children), but not all families, however, will have children. And similar arguments could also be made regarding fiscal deficits. Deficits increase the requirement to raise the taxes facing future generations of workers (or reduce the entitlements they will eventually receive), and represent transfers of wealth from the future to the present. Providing assistance to the well-off through increasing burdens on future taxpayers is hardly consistent with a concern for intergenerational welfare.

Why taxing the Child Benefit would not work

Taxing the Child Benefit as a way of clawing back expenditure was suggested in 1998 by the then Chancellor, Gordon Brown.⁹⁵ More recently, David Blunkett, the former Home Secretary has advocated taxing Child Benefit for the highest earners.⁹⁶ This approach of taxing the Child Benefit has also been proposed for the Irish welfare system.⁹⁷

However the savings from taxing the Child Benefit would only be in the order of £0.11 billion.⁹⁸ Such an approach would also add to the already excessive complexity of the welfare system. For example, if this programme was taxed in the hands of the mother (to whom the benefit is paid) then little revenue would be clawed back. If this programme was taxed on a household basis extra complexity would be created for married couples (as a decision would need to be made on whose income the payment would be taxed). Given that the Child Tax Credit is already in operation and widely received among those families with children in need, taxing the Child Benefit would, while recognising the need for means-testing, simply be an ineffective half measure.

Recommendation two: Scrap the Child Trust Fund, Employer Supported Childcare Schemes, Health in Pregnancy Grants, the Healthy Start Scheme and the Sure Start Maternity Grant

Recommendation two is to scrap unnecessary and poorly targeted transfers to families. In the case of the Child Trust Fund the Government should cease making any additional contributions (existing accounts would not be nationalised). The costs and features of these programmes are:

The Child Trust Fund: gives every child born after September 2002 £250 (a further £250 for low income parents) and an additional £250 at the age of 7 (a further £250 for low income parents). This costs taxpayers £0.5 billion a year.⁹⁹

Employer Supported Childcare Schemes: this allows employers to provide employees £243 of their gross monthly salary as tax free vouchers for childcare (free from both tax and National Insurance Contributions). This costs taxpayers £500 million in 2008-09 and tended to favour higher income workers and workers who benefit from workplace schemes.¹⁰⁰

Health in Pregnancy Grants: one-off payments of £190 go toward the costs of healthy lifestyles in the later stages of pregnancy. The scheme is expected to cost £145 million in 2010.

The Healthy Start Scheme: provides £3.00 vouchers to mothers that they can spend on milk, fresh fruit and vegetables, or infant formula at a cost to taxpayers of £94 million.

The Sure Start Maternity Grant: provides additional support for parents who are on tax-credits at a cost to taxpayers of £112 million.

Rationale

The Child Trust Fund aims to encourage saving by ensuring that every child has a financial asset, but so far the scheme has failed to encourage independent contributions beyond the minimum, especially among the target low-income group.¹⁰¹ As well as failing on this “microeconomic level”, the scheme has also failed on a “macroeconomic” one, with there being no evidence that the scheme has increased national savings (which include the costs of taxpayer funds and switching from other forms of savings). If the policy goal is to improve the longer-term position of lower income families, more direct measures that would improve the life chances for their children (such as reducing classes in infant schools) would be more effective than expensive gimmicks in the form of poorly designed subsidies.¹⁰²

95 Hansard (1998), Col.1108, 17 March. Also see, Greener, K. and R. Cracknell (1998), “Child Benefit”, House of Commons Library.

96 *The Daily Telegraph* (2009), “David Blunkett: tax child benefit and give up nuclear arms”, 28 September.

97 *The Irish Times* (2009), “Report suggests tax on child benefit”, 7 September.

98 The IFS has estimated that the savings from subjecting the Child Benefit to the top personal tax rate in 1999 would be in the order of £70 million (Clark, T and J. McCrae, *Taxing Child Benefit*, Institute for Fiscal Studies, 1998). To give a figure for 2009 this figure has been increased based on the growth in expenditure on this benefit between 1999 and 2009.

99 Emmerson, C. (2009), “Should the child trust fund be abolished?”, Institute for Fiscal Studies.

100 The Government has recently proposed abolishing this scheme and using the funds saved to provide direct funding to childcare providers (Brown, G. (2009). Speech to the 2009 Labour Party Conference); this approach was also proposed in Cawston, T. et al (2009), *Productive parents, Reform*.

101 Cable, V. (2009), *Tackling the fiscal crisis: A recovery plan for the UK, Reform*.

102 Ibid.

Recommendation three: Reform statutory maternity pay and leave

Recommendation three is to reform statutory maternity pay and leave. In *Productive parents*, Reform recommended a new approach that rebalances maternity pay towards low income families, makes it available to fathers and gives freedom over parental leave. These changes could be undertaken with reduced expenditure and lower levels of bureaucracy.¹⁰³

Rationale

Reform's research has shown that Statutory Maternity Pay is among the most regressive of the benefits the government currently provides.¹⁰⁴ While professionals and managers get gold plated maternity benefits and can afford time off, those in casual and low skilled jobs receive the least pay and take the least maternity leave. The lion's share of the £1.8 billion spent on maternity pay goes to high earners.

Fathers are also largely excluded from leave arrangements, with Britain having one of the most old fashioned systems in the developed world. This antiquated system not only creates significant costs for businesses, in red tape and uncertainty, but creates an either/or choice on whether to work or stay at home. Parents on leave are prevented from staying in touch with the workplace or doing occasional shifts and casual work – with the exception of a small number of prescribed “keep in touch” days. This damages mothers' career prospects and reinforces a gender pay gap.

Recommendation four: Scrap the Winter Fuel Allowance and other pensions gimmicks

Recommendation four is to scrap the Winter Fuel Allowance and other pensioner gimmicks. The costs and features of these programmes are:

The Winter Fuel Allowance is received by 12.3 million claimants and has a cost of £2.7 billion. The value of the payment was £100 in 1998. In 2006 the value was increased to £200 for people between 60 and 79 and £300 for people aged over 80 (half of the payment is made to each spouse in couples). The costs of the scheme rose by £623 million in 2008 when the Government increased the payments from £200 to £250 for over 60s and £300 to £400 for over 80s.

Concessionary bus fares are provided by local authorities but this is reimbursed by the Treasury at a cost of £817 million in 2008. Additional funding of £212 million was provided in 2009 and a further £217 million in 2010. Total funding for concessionary fares is now some £1 billion a year.¹⁰⁵ Concessionary fares currently total 29 per cent of all government expenditure on buses.¹⁰⁶

Free TV licenses are claimed by over 4 million pensioners and will cost the Treasury £545 million in 2010.

Rationale

It is particularly important to find savings in the area of expenditure provided to the elderly. Over 40 per cent of the welfare budget is spent providing support for pensioners. With population ageing these costs will increase, and proposals for restoring the link between the core state pension and wages, which have been advocated by all the main political parties would add £700 million in the first year, £1.34 billion in the second and rising thereafter.¹⁰⁷ The Department for Work and Pensions has estimated that by 2050–51 the cost of indexing pension to wages will be 1.7 per cent of national income (£21.1 billion).¹⁰⁸

In this context it is useful to note that pensioner households are less likely to be in poverty than other households and have relatively high rates of asset ownership. Many people in their 60s, 70s and even 80s are interested in working full time, part time or flexibly.¹⁰⁹ Yet current government policy is predicated on the idea that the majority of people around retirement age are poor and are unable or unwilling to work.

103 Cawston, T. et al (2009). *Productive parents*, Reform.

104 Ibid.

105 Department for Transport (2008), *Annual Report 2008*.

106 Local Government Association (2009), *Securing best value and outcomes for taxpayer subsidy of bus services*.

107 Financial Times (2009), “Cameron vows to restore pension-earnings link”, 22 September.

108 Emmerson, C. et al (2006), *An initial response to the Pensions White Paper*, Institute for Fiscal Studies.

109 Standard Life (2009). *The Death of Retirement*, Standard Life.

As well as the universal state pension, nearly £5 billion is spent on various “pension add-ons” which have little social value. Politicians with an eye for the “grey vote” have increased the number of add-ons and benefits to the basic package.¹¹⁰ This has been at a growing cost to the exchequer and it has become politically difficult to reduce this support.

As the Environment, Food and Rural Affairs Select Committee illustrated, only 12 per cent of claimants for the Winter Fuel Allowance are in fuel poverty.¹¹¹ This poor targeting efficiency means that fewer funds can be provided to families actually in need without costs being prohibitively high. The increase in the value of the programme also bears little relationship to changes in heating costs, with a 150 per cent increase in the payment since 1999 comparing to an increase in electricity bills of 15 per cent.¹¹²

Free bus passes were introduced for the over 65s in 1998 and have recently been extended to over 60s and persons who are disabled. In 2009 the Local Government Association released a report criticising the scheme as “inefficient and high cost”, with “many people benefiting who do not need to”.¹¹³ There is evidence that, for example, “new pass holders are younger, better off and more likely to be car owners.”

The preface to this report, however, asserted without evidence that means testing “concessionary fares is not the solution. Take up of the scheme would fall drastically, the benefits it delivers greatly reduced and administrative burdens significantly increased.” This argument is very weak as means-testing a benefit-in-kind of a service of this nature could be administered very simply and at low cost (all that would be required would be the issuing of bus passes to, say, recipients of the Pension Credit).

Recommendation five: Scrap the mandatory retirement age and raise the qualification age for the basic state pension

Recommendation five is to scrap the mandatory retirement age and raise the qualification age for the basic state pension.

Rationale

The mandatory retirement age should be abolished and the flexibility for hiring and firing older people should be increased. The World Bank ease of doing business survey highlighted that in the UK working hours regulations are particularly inflexible when it comes to firing costs (especially for redundancy dismissal after 20 years of continuous employment).¹¹⁴ While this may increase the tenure and wages of incumbent workers, this is likely to lead to fewer jobs being created and people approaching retirement age being discouraged from investing in new skills. Abolishing mandatory retirement means that some of those claiming state benefits would delay their take up of this assistance as well as bringing extra wealth and talent to the economy.

Current plans to increase the qualification age for the state pension need to be speeded up. Current plans are for the retirement ages of 65 for men and 60 for women to rise to 68 between 2024 and 2046 to reflect the life expectancy of the new generation of pensioners. This report proposes shifting this increase forward to begin from 2010-11.

It is proposed that the retirement age for females will increase at the rate of 12 months for every calendar year and males by 6 months for every calendar year. At this rate the retirement age for males will reach 68 at 2015-16 and the retirement age for females will reach 68 at 2017-18. This age would apply to the basic state pension and associated add-ons (including the Second State Pension).

Based on a range of assumptions regarding the average level of the basic state pension, this change would save around £95 million in the 2010-11 year, increasing to around £190 million in 2011-12. These estimates are conservative as they do not include savings from reduced payments of associated programmes, such as the Second State Pension, or any increase in tax revenue from increased labour participation.

110 The proportion of the voting aged population that is aged 60 or above illustrates the growing voting power of the elderly population. In 1951 around 16 per cent of the 20+ population were aged 60 or above. By 2001 this had increased to 21 per cent, and is forecast to grow to 30 per cent by 2031.

111 House of Commons (2009), *Environment, Food and Rural Affairs Select Committee: Energy efficiency and fuel poverty*.

112 Figure for the period from 1998 and 2008. Bolton, P. (2009), “Energy Prices”, House of Commons Library.

113 Local Government Association (2009), *Securing best value and outcomes for taxpayer subsidy of bus services*, p.14.

114 World Bank (2009), *Doing Business 2009*.

Recommendation six: Charge student loan borrowers market interest rates and scrap the educational maintenance allowance

Recommendation six is to charge student loan borrowers market interest rates to scrap the educational maintenance allowance. The student loans subsidy currently costs the Government £1.2 billion every year. The cost of the educational maintenance allowance, which provides weekly payments of £10, £20 or £30 to over 500,000 students, was £532 million in 2009.¹¹⁵

Rationale

Subsidised loans were deemed necessary to reduce the barriers facing students from low-income backgrounds to participate in higher education. However in 2009 the richest 24 per cent of the population represented 55 per cent of the students at the UK's best universities.¹¹⁶ Student loans are income-contingent in Australia, Sweden and the Netherlands, without any regressive impact on participation.

A positive step to balance the budget and pave the way for fee and admissions reform would be to offer student loans at market interest rates. This measure would save around £1.2 billion a year.¹¹⁷ The obligation to start paying back the loan only once reaching a threshold of £15,000 earnings per annum would be maintained.

The educational maintenance allowance was introduced to encourage more people from low income backgrounds into further education. However the merit and value of this scheme is questionable. More young people than ever are already undertaking post-16 education, suggesting that the windfall gains (people being paid to do things they would have done otherwise) are significant. Research from the Joseph Rowntree Foundation has also shown that there is no evidence to suggest that EMAs have improved educational attainment.¹¹⁸

115 Learning and Skills Council (2009), *Annual Report and Accounts for 2008-09*.

116 *The Guardian* (2009), "Universities don't like common people, do they?", 3 February.

117 *The Times Higher Education* (2008), "Top earners gain from student loan 'subsidy' as low-paid struggle", 27 March. Currently, interest is charged at the rate of inflation only, hence student loans are interest free in real terms. The £1.2 billion saving is estimated by Nicholas Barr, Professor of Public Economics at the London School of Economics.

118 Carlo, R. et al (2007), *Education and poverty: A critical review of theory, policy and practice*, Joseph Rowntree Foundation.

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