Centre for Market and Public Organisation
Bristol Institute of Public Affairs
University of Bristol
2 Priory Road
Bristol BS8 1TX
http://www.bris.ac.uk/Depts/CMPO/

Tel: (0117) 33 10799
Fax: (0117) 33 10705
E-mail: cmpo-office@bristol.ac.uk

UK Welfare Reform 1996 to 2008 and beyond: A personalised and responsive welfare system?

Paul Gregg

April 2008

Working Paper No. 08/196

ISSN 1473-625X

CMPO Working Paper Series No. 08/196

UK Welfare Reform 1996 to 2008 and beyond: A personalised and responsive welfare system?

Paul Gregg

CMPO and Department of Economics, University of Bristol

April 2008

Abstract
The UK welfare system has undergone three very profound periods of reform of the post-war model laid down by Beveridge. The first was a move in the direction of (but never fully converged with) the Bismarkian model of a contributory social insurance model with time limited earnings related benefits with a low value means tested social assistance safety net. This occurred slowly through the 1960s and up to the mid-1970s. The second phase started in 1979 and involved a dramatic move to curtail the social insurance entitlements and end all earnings related benefits. The result was a residualist low value means tested social assistance model, which ended both the Beveridge model and completely reversed the drift toward a European Bismarkian approach. Finally from 1996 a new model has emerged based on an activational welfare model with greater emphasis on incentives, support services and conditionality. As a direction of travel from the previous regime(s) this represents an increase in the engagement and support functions, increases in the (disciplinary) required activity functions combined with increased financial support for children and pensioners and personalised support services. The emerging model is far from completion and the final make up of the system remains uncertain. However, it bears strong similarities with developments in New Zealand and to a degree Australia and Canada. Within Europe the model most closely resembles a less generous version of the welfare systems in Denmark or Holland, which are sometimes referred to as embodying Flex-security. This evolutionary process of reform had some antecedents prior to 1996 but has really come to the fore since that date. This paper discusses reform in depth from 1996 and looks at its current direction of evolutionary change.

Keywords: welfare reform, tax credits, lone parents, disabled adults.

JEL Classification: H21, J22, J13, I38

Electronic version: http://www.bris.ac.uk/Depts/CMPO/workingpapers/wp196.pdf

Acknowledgements
This report has been prepared for the Friederick Eberts Foundation. Thanks go to Carol Propper and Sarah Smith for the help with the preparation of this paper.

Address for Correspondence
CMPO, Bristol Institute of Public Affairs
University of Bristol
2 Priory Road
Bristol
BS8 1TX
p.gregg@bristol.ac.uk
www.bris.ac.uk/Depts/CMPO/

CMPO is jointly funded by the Leverhulme Trust and the ESRC

UK Welfare Reform 1996 to 2007 and beyond:

A personalised and responsive welfare system?

Introduction

The UK welfare system has undergone three very profound periods of reform of the post-war model laid down by Beveridge. The first was a move in the direction of the Bismarkian model of a contributory social insurance model with time-limited earnings-related benefits with a low value means tested social assistance safety net. This occurred slowly through the 1960s and up to the mid-1970s. The second phase started in 1979 and involved a dramatic move to curtail the social insurance entitlements and end all earnings-related benefits. The result was a residualist low value means tested social assistance model, which ended both the Beveridge model and completely reversed the drift toward Europe's Bismarkian approach. Finally, from 1996 a new model has emerged based on an activational welfare model with greater emphasis on incentives, support services and conditionality. As a direction of travel from the previous regime(s) this represents an increase in the engagement and support functions, increases in the (disciplinary) required activity functions combined with increased financial support for children and pensioners and personalised support services. The emerging model is far from completion and the final make up of the system remains uncertain. However, it bears strong similarities with developments in New Zealand and to a degree Australia and Canada. Within Europe the model most closely resembles a less generous version of the welfare systems in Denmark or Holland, which are sometimes referred to as embodying Flex-security. This evolutionary process of reform had some antecedents prior to 1996, but has really come to the fore since that date. As a result, this paper discusses reform in depth from 1996 and looks at its current direction of change with a rather more cursory discussion of the demise of contributory social insurance model.

1. The Post-war UK Welfare System

1.1 The Beveridge Plan 1942

Although the origins of the British welfare started prior to the Second World War, it was with the Beveridge plan of 1942 that the modern welfare state came into being. Already a century ago all political parties agreed that the state would have to play a bigger role in providing pensions and welfare for the poor. Among the key measures introduced were old age pensions, a system of health insurance, and labour exchanges to help tackle unemployment. However, the Edwardian welfare state was incomplete. It was limited to the working class, its funding basis was insecure, and little progress was made in tackling poverty among people of working age. The end of the WWI also brought a slump, particularly in northern industrial towns, that deepened into the Great Depression by the l930s.

By the time Britain entered the Second World War, the pressures for social reform were mounting. In 1942 the Beveridge Report laid out a comprehensive programme of social reform "from the cradle to the grave". His report called for a universal flat-rate low value benefit payable to all, on the basis of fixed national insurance contributions. Beveridge wanted to tackle what he called the "five giants" - want, disease, squalor, ignorance, and idleness - through a universal welfare state which would also provide a comprehensive health service, vastly expanded public housing, and free and universal secondary education. Welfare benefits were to cover old age, unemployment, and sickness, as well as benefits for the poor and family allowances. The new Labour government, which took power in 1945, was keen to implement the Beveridge report in full as soon as possible. But, in the severe conditions of post-war Britain, it did not have the money to pay an adequate level of flat-rate benefits that would keep people out of poverty. So from early on, the residual National Assistance (later Supplementary Benefit and now Income Support) played a bigger role in alleviating poverty than Beveridge had planned. Family allowances were also never implemented in the generous way Beveridge had proposed, but they did become more generous in the 1970s as Child Benefit. The idea of basing entitlement on contributions meant that many people, especially women, were excluded from the system. The male bread-winner nuclear family and full employment - and the relative prosperity that went with it - were key to Beveridge's plan.

By the mid-1970s the post-war model had evolved from the Beveridge plan into a system closer to a Bismarkian European model with earnings-related payments for unemployment, sickness and pensions, but with time limits on payments for unemployment. However, the gender bias in support through contributions which excluded part-time jobs with shorter hours, as well as those looking after the family, lead to the pressures to widen the net to marginal groups, thus weakening the insurance principle.

The long period of Conservative government (1979-1997) saw a steady erosion of the Social Insurance model, with all earnings-related links removed, except for second stage pensions. Yet even here people were given incentive to opt out of the state second stage pension into private pension saving instead. The exemption from means testing for unemployment benefits was also reduced to 6 months. The benefit system thus became a residualised flat-rate system with large reliance on means-tested social assurance benefits (Income Support). The levels of these benefits were fixed in real terms so that their value relative to earnings progressively fell and Child Benefits were often not even uprated with prices.

1.2 The Role of Government, Business and Trade Unions

The Beveridge Report, after some resistance from the Conservative party, was implemented by the incoming 1945 Labour government and formed a broad political consensus. The National Insurance system was operated fully by the government as another form of revenue raising and expenditure counterpart. It was never created as a fund separated from government revenues and hence had no overseeing body representing the social partners. In addition to no direct role for employers and trades unions, the system was operated entirely by central government with no role for local or regional government. However, there were tripartite bodies setting minimum wages at the industry level (Wages Councils, see Dickens et al. 1993) and through the 1960s and 70s a number of tripartite bodies grew up discussing economic performance, wage setting, etc. This era was characterised as that of “beer and sandwiches”, as union leaders were regularly meeting government ministers over threatened strikes and many other issues. Trades unions often campaigned successfully for a number of extensions to working rights, including reductions in working hours, redundancy payments and even limited worker representation. However, in the Conservative era all tripartite bodies were abolished, including the setting of minimum pay levels (in 1993) and restrictions placed on the ability of trade unions to hold strike action and support other workers involved in disputes. Trade union membership and influenced plummeted after 1979.

1.3 Welfare Dependency and Social Expenditure

In 1979 around 2 million working age adults were claiming major welfare benefits (unemployment, long-term sickness/disability and lone parenthood). Social expenditures covering these benefits, universal child assistance (Child Benefit) and pensions ran to around 7% of GDP. However, from 1979 the value of the benefits received remained broadly frozen in real terms, and so relative poverty rose steadily among those without work. Yet total expenditures rose as a proportion of GDP to around 13.5% in 1994 (see Figure 1 for breakdown of expenditures). This mainly occurred because of the dramatic rise in welfare dependency associated with the growing number of jobless households (Gregg and Wadsworth, 1999). This rose so dramatically that by 1994 the numbers of working age welfare claimants had reached 6 million, before falling back to 5.5 million by 1997 (see Figure 2). The largest increase was for claims of sickness and disability benefits, with a rise of nearly 2 million. Not only had dependency risen dramatically, but the poverty gap among those on welfare (and in work) had risen dramatically. The proportions of working age adults and children living on incomes below 60% of the median (BHC) more than doubled between 1979 and 1996. But rises in the proportion below 50%, 40% and even 30% grew even faster. People were falling much deeper into poverty before the safety net held them.

Figure 1 Share of GDP Spent on Welfare Benefits (including Pensions) and

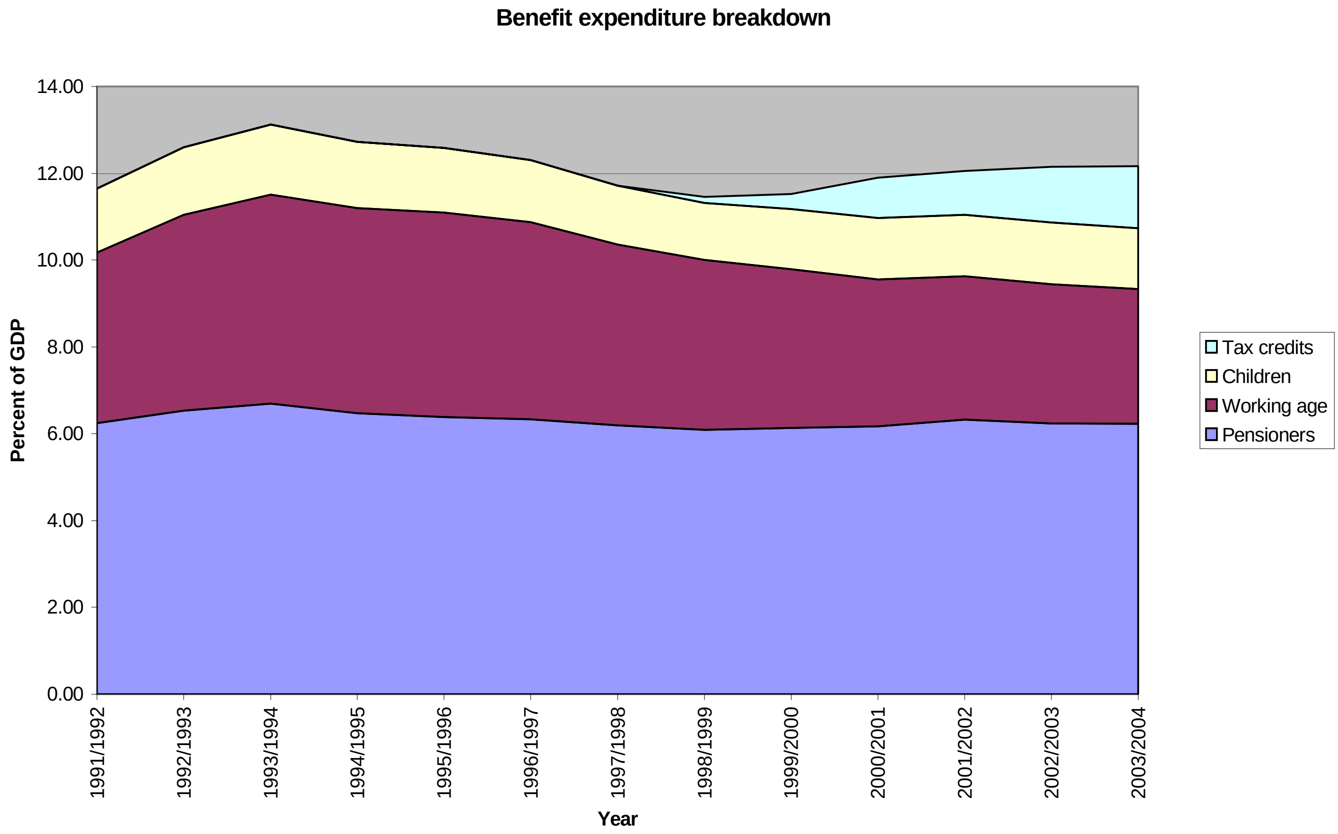
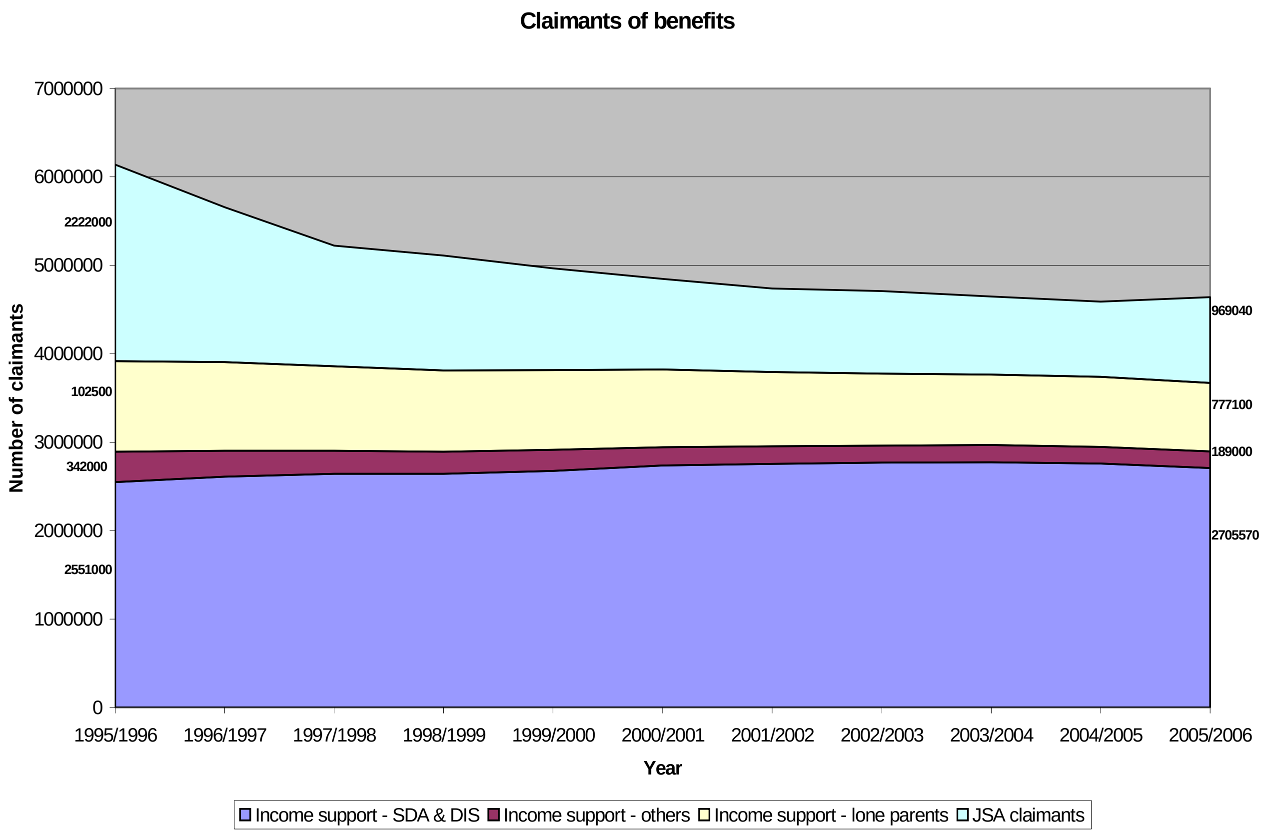


Figure 2 Numbers of Claimants of Major Groupings of Welfare Benefits Targeted on those Not in Work 1995 to 2006



Key aggregate economic figures 1960-2006

The UK was characterised as the “sick man of Europe” in the 1960s and 70s. Average economic growth and productivity was low by European standards, and hence living standards grew more slowly.

GDP and productivity

	Average GDP	Average output per worker
1960-1978	2.77	2.41
1979-1996	2.13	1.89
1997-2006	2.85	1.74

Inflation was also relatively high from the late 1960s, peaking in the mid-1970s at 25%. Unemployment was low on current ILO definitions around 4% and employment high, with 60% of the adult population in work or 75% of the working age population aged 16-64 for men and 16-59 for women). This period was also one of widespread conflict in industrial relations with a lot of strike action, which was at its most extreme in the Winter of Discontent 1978/79.

Inflation 1960 to 2006 (Retail Price Index)

Key years	Average annual inflation	Key years	Average annual inflation
1960	2%	1990	9%
1971	10%	1996	2%
1975	25%	2001	2%
1980	18%	2006	3%
1985	6%		

The 1980s saw the economy yawing from recession in 1980-82, a overheated boom 1987-89 and recession again 1990-92. Over the period as a whole unemployment was very high, as was inflation, although less than in the 1970s. Growth bottomed out at around 2%, which was no longer below that of other European nations, owing to the more rapid slowdown in continental Europe. Employment recovered to that of 1968 and 1975 by 1990, but fell away in the next recession. Employment rose amongst women who were primarily second earners within families, whilst the number of welfare dependent families continued to rise, peaking at 1 in 5 working age households 1995.

Employment and unemployment 1970 to 2006

Key years	Unemployment proportion of economic active	Employment as percentage of total population 16+	Key years	Unemployment proportion of economic active	Employment as percentage of total population 16+
1970	4%	61%	1996	8%	57%
1980	6%	60%	2001	5%	60%
1984	12%	55%	2006	5%	60%
1990	7%	60%			

2. Social Challenges and Welfare Reform from 1996

The economy in the UK has performed well since 1995, being described by the OECD as the Goldilocks economy, neither too hot nor too cold but just right. Growth has been good, averaging 2.8% pa and has had little annual variation (the range has been 1.6% to 4%). This has been the highest among the major G7 economies over this period. Inflation has been low and stable since the Bank of England set interest rates independently of the government. The Retail Price Index measure has risen at around 3%, but the CPI (which is comparable with European measures) has averaged just over 2%. This benign picture led to budget surpluses being generated in 1998-2000, but a move to increase spending on Health and Education very rapidly after the 2001 election has seen the government budget move into sustained and structural deficits. The government is now seeking to reduce these deficits with smaller increases in spending and especially with restrictions in public sector pay growth.

2.1 Fertility and the Ageing Population

Like most European countries, the UK has low fertility and an ageing population. However, the extent of these two trends is less pronounced than in many other countries.

After a period of decline in the 1980s and 1990s, birth rates in the UK are on the increase. Following the baby boom in the early 60s, declining birth rates saw the total fertility rate[1] fall from a high of 2.95 children in 1963 to below the replacement rate of 2.1 children, reaching a low of 1.63 in 2001. The five years since 2001, however, saw consecutive increases in fertility, with the latest figures showing a rate of 1.86 children in 2006, the highest level since 1980. Birth rates have increased at all ages, but particularly to women in their late 30s and early 40s, and there has also been a rise in the proportion of births to women born outside the UK, increasing from 12.8% in 1996 to 21.9% in 2006. The period of rising birth rates follows the increasing generosity of child-contingent benefits and maternity provision. Between

[1] The total fertility rate measures the average number of children that would be born to a hypothetical woman over her lifetime if she experienced the age-specific birth rates of a particular year across her own childbearing cycle.

1999 and 2003, government spending per child grew by 50 percent in real terms, a change that was unprecedented over the previous thirty-year period, while paid maternity leave increased from 14 weeks in 1994 to 39 weeks from 2007. Brewer et al. (2007) show that the advent of WFTC alone raised the birth rate of less educated mothers by 10% from 1999, which suggests that policy changes have made a sizable contribution to increasing the UK's fertility rate.

Twenty years ago, nearly 80 percent of women with children were in married couples; today the figure is only just over 50 percent. The proportion of lone mothers has risen to nearly 30 percent, reflecting both rising separation and divorce rates, as well as an increase in never-married lone mothers. Alongside this, there has been an increase in the proportion of mothers living in cohabiting couples. In 2007, the majority of babies were born outside marriage for the first time.

Rising birth rates mean that the UK population is growing as a result of natural change, as well as through net immigration. However, increasing life expectancy and the ageing of the 1960s baby-boomers will cause the population to age. The proportion aged 65+ is predicted to increase from 15.8 percent in 2000 to 25.3 percent in 2050, although this increase is smaller than that for the EU25 – from 15.8 percent to 29.5 percent. Life expectancies at birth, currently 76.9 years for men and 81.3 years for women, are above those for France, Germany, Belgium and Denmark, but below those for Ireland, Italy, Spain and Sweden.

2.2 Labour Market and Unemployment Policy

Unemployment had two marked peaks in 1986 and 1993, on both occasions this was around 12% of the economically active. Since 1993 open unemployment fell sharply until 2002, since which time it has been broadly flat at just over 5%. Employment in the UK is high at just under 75% of the working age population (age 16-59/64), a figure exceeded in Europe only in the Scandinavian countries. Even before the fall in unemployment the large numbers reliant on welfare benefits who were not looking for work (i.e., living on sickness and disability benefits and lone parents on Income Support – social assistance benefits) became a government priority after the 1997 election. With the decline in open unemployment, this hidden joblessness became a major social issue (see figure 2).

The ambition of the incoming government was to raise economic activity and reduce welfare dependency, whilst simultaneously reducing poverty. There are obvious potential conflicts in this strategy. Raising the generosity of benefits reduces the depth of poverty, but is likely to reduce incentives to work. The government's strategy to meet these twin and often contradictory goals consisted of five core elements:

- Making work pay – raising incentives to work
- Case management by a personal advisor - client engagement and activation within the welfare system undertaken by a personal advisor
- Limited conditionality – welfare payments have attached behavioural requirements, with minimum income secure for vulnerable groups, (e.g., Educational Maintenance Allowance, New Deals for the unemployed, Work Focused Interviews and Work Related Activity Premium/Job Participation Payment under pilot).
- Addressing key areas of social exclusion that damage people's future life chances (including child poverty, youth long-term unemployment, teenage pregnancy, homelessness etc.)
- Raising incentives for self-protecting savings among low income groups – savings gateway, stakeholder pensions, Children Trust Funds (saving pot schemes, which are also a form of targeted conditional financial support)

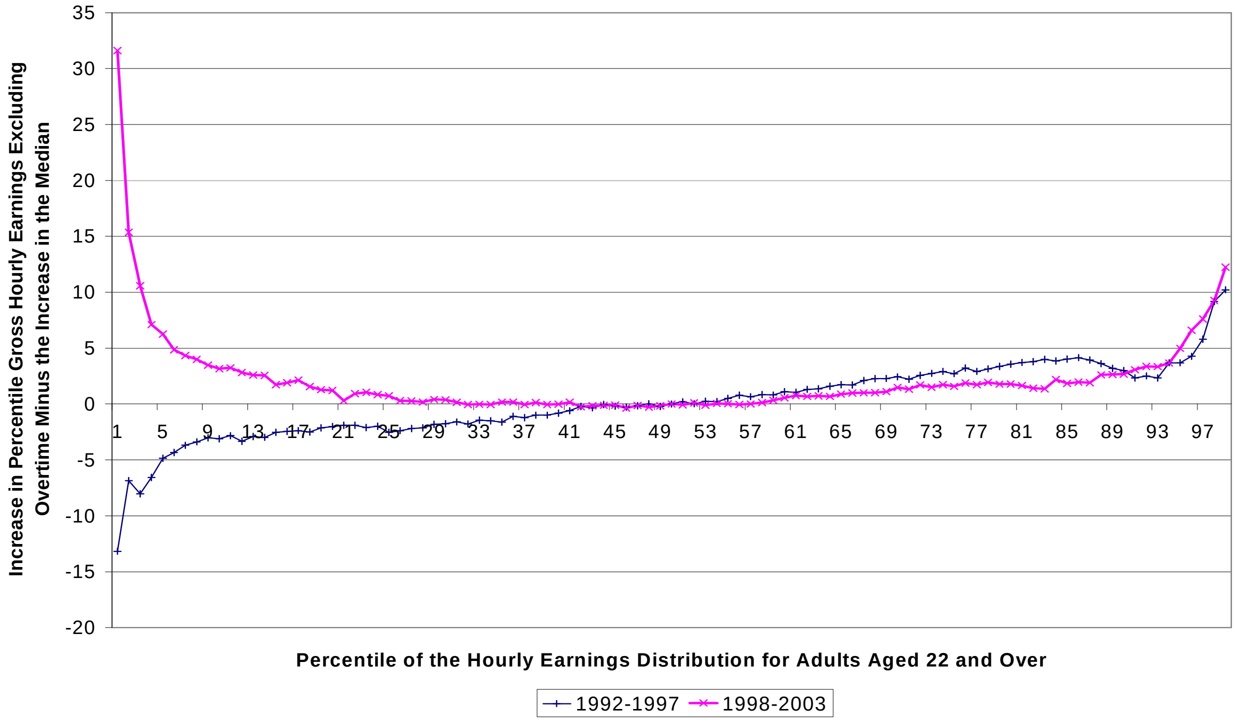
The first three elements will be discussed in this sub-section, the latter two will be discussed under section 2.6 Poverty and Social Exclusion.

Making Work Pay – National Minimum Wage

Upon its election the current government made a number of key strides to raise take-home pay for low earning jobs. The most prominent measures were the introduction of, and later increases in, the National Minimum Wage and the expansion of the Tax Credit system. The UK had had a system of industry specific minimum wages set by Wages Councils dating back to 1917. As industries changed in importance many sectors were combined, but new sectors such as security remained uncovered. After 1979 the value of minimum wages set by Wage Councils declined, and they were finally abolished in 1993. In 1998 the Low Pay Commission set a new NMW for the whole country and all sectors, but the initial coverage was low by international comparisons. Indeed, even this level was not raised much above prices until 2001, after which a sharp increase in the minimum wage occurred, but only until 2006.

The core message of the impact of the NMW is set out in Figure 3. This shows wage growth at each percentile of the wage distribution compared to that at the median (50th percentile) for two periods: 1992 to 1997, prior to the NMW's introduction; and 1997 to 2003, which covers the introduction in 1998 and substantial increases in relative value in 2002 and 2003. Prior to introduction there is pretty much a continuous upward sloping line with twists at the top and bottom reflecting far slower growth in earnings in lowest decile and faster growth in the top decile. By contrast, after introduction the pattern is U-shaped, with the most rapid growth in earnings at the lowest paid part of the distribution, with growth in earnings 20% above that at the median (growth at the median was slightly faster in the second period than the first). The upper half of the distribution has continued in a very similar fashion as before. Note that the faster growth in earnings in the second period is evident all the way up to the 40th percentile, which is unlikely to be due to the NMW and probably reflects the tighter labour market. However, the impact of the NMW on the lowest paying 8 to 10% of jobs is marked.

Figure 3 Growth in Hourly Earnings by Percentile (compared to the median) 1992–2003 Source: Annual Survey of Hours and Earnings



Making Work Pay – Tax Credits

Minimum Wages raise the pay of all low paid workers, but take no account of family structure, such as the presence of children or numbers of earners or hours worked in a family. Hence the relationship between low hourly pay and low household income even among working families is far from close. Likewise, the working poor often do not have a worker in the lowest decile or so of hourly earnings. The government made clear its concern about poor work incentives for benefit dependent families with children in a series of publications (The Modernisation of Britain's Tax and Benefit System, numbers 1 through to 5, 1997 to 1999). The response was a major expansion of the country's Tax Credit system (then called Family Credit) under the banner of the Working Family Tax Credit (WFTC) and then later split into two parts – Working Tax Credit and Child Tax Credit.

Before the 1998 Budget, support for children came from four sources: a universal per- child transfer (Child Benefit) normally paid to mothers, extra payments in means-tested benefits (Income Support) normally paid to the household head in workless families, a refundable tax credit for working families (Family Credit) paid to the mother, and one of two related non-refundable tax credits available to an earner within a couple.[2] The Government has increased the generosity of all four of these starting with the March 1998 budget, and all but Child Benefit have had some form of structural reform.

The increases in the generosity of Child Benefit in the 1998 and 1999 budgets together raised the real level of support by 27 percent for the eldest child. The increases in support for children in means-tested benefits was focused on younger children between April 1997 and 2001, such that weekly payments for children up to 4 years of age rose by £13.25 a week above inflation – a 73% real increase – whilst support for children aged 11-15 rose by just £4.25 in real terms. The result is that the level of financial support for children of all ages up to 15 have been equalized – older children had previously received more generous support. This reform partly reflects

[2] There are approximately 7 million families with children in the UK, and 13 million children.

recognition by the Government that poverty rates were higher among families with younger children, and partly it facilitates the move to an integrated child credit.

The new Children's Tax Credit was a non-refundable tax credit that replaces two mutually exclusive and equal-valued tax credits: the Married Couple's Allowance (MCA) and the Additional Person's Allowance (APA).[3] The overall impact was that married couples without children lose an extra tax allowance, and families with children, regardless of their marital status, receive around twice as much as before. Whereas the MCA and APA were available to all taxpayers, the Children's Tax Credit was withdrawn at 6.7 percent from people paying higher-rates of income tax (over £33,515 in April 2001).

The Working Families' Tax Credit (WFTC) was an evolutionary reform to the existing in-work benefit called Family Credit. It was announced in the Labour government's first full budget in spring 1998, and became available to claimants from October 1999. The WFTC was available to families where any adult member is working 16 hours a week or more. It consists of a per-family element – the same for couples and lone parents – and per-child elements. There is a flat zone where the maximum award is paid, and the credit is phased-out beyond an earnings limit of £92.90 a week at a rate of 55 percent of after-tax income. This equated to 38% of gross income for a person on the basic-rate of tax and National Insurance rates, or a total marginal deduction rate of 69%.

WFTC had 4 major differences from its predecessor. First, it was more generous, as both the family and the child elements have risen. For a family with one child, the WFTC was worth a maximum of £78.75 a week. Each subsequent child raised the maximum credit by £25.60 a week. Worth noting here is that, although the level of out-of-work support has also risen, these changes by themselves made little difference to work incentives. Second, families can earn more before support is withdrawn. The maximum weekly earnings before withdrawal starts was raised from £80 under the old Family Credit system to £92.90. Third, the phase-out rate was lowered from 70 to 55 percent of after tax income. These three changes increased

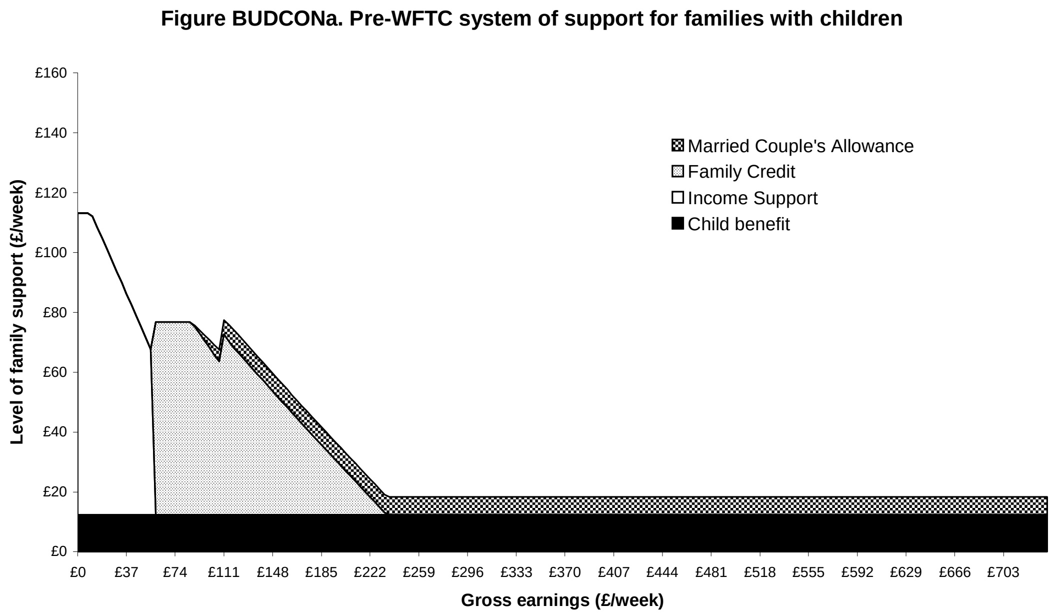
[3] The UK has an individual system of income tax. These credits and allowances appear in a person's tax code through which employers assess and then deduct income tax directly from pay checks. Allowances are typically less generous than in the US, so people start paying income tax at lower annual incomes (see Gale (1997) and Brewer (2000) for more comparisons of the US and UK tax systems).

support for those in full-time or better paid part-time work (i.e., earning more than £92.90) and extended eligibility to in-work support to a large number of families. Lastly, the WFTC can help with childcare costs though a new Childcare Tax Credit, which paid parents 70 percent of childcare costs up to a (generous) maximum of £100 a week for 1 child or £150 for more than 1 child. The Childcare Tax Credit is restricted to households where all parents are in paid work, but lone parents are the prime beneficiaries to date.

The effect of these changes are shown in Figure 4a&b, which show the 2001 and 1997 support packages for a couple with one child. The increased generosity of the WFTC over the previous in-work benefit accounts for £2.7 billion of this £7.2 billion early reform package total, with £2.5 billion going to child payments in means-tested and universal benefits, and £1.8 billion on the Children’s Tax Credit (see HMT, 2000).

Figure 4 Picture of Welfare Support available for Families with Children under the pre-1997 system (Figure a) and WFTC circa 2001 system (Figure b)

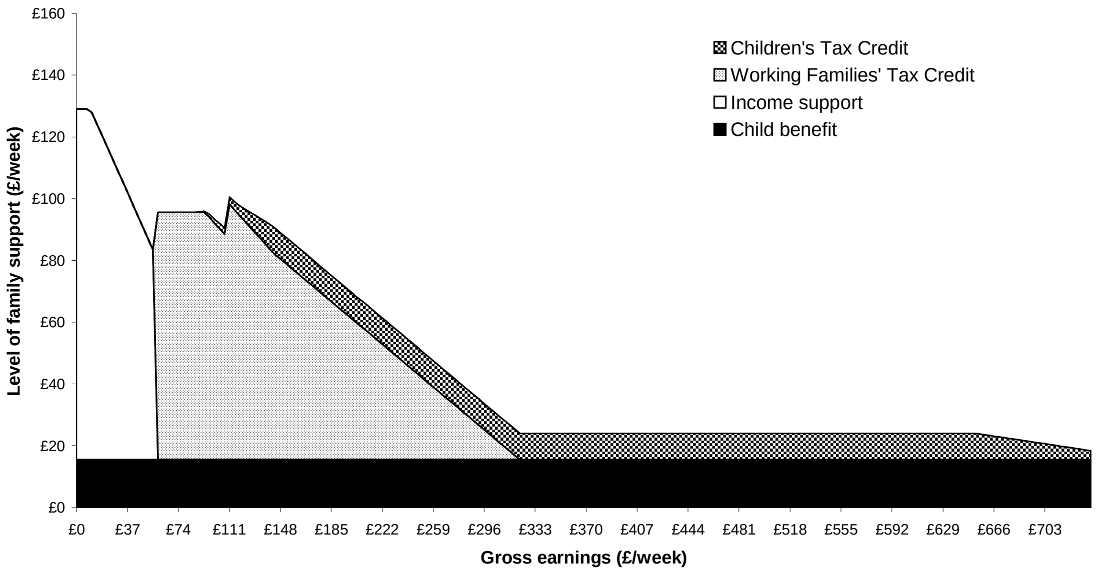
Figure a



Note: Assumes entitlement for WFTC reached at £59.20, or 16 hours work at the minimum wage. Values uprated to 2001-2 prices.

Figure b)

Figure BUDCONb. System of support for families with children from 2001



Note: Assumes entitlement for WFTC reached at £59.20, or 16 hours work at the minimum wage.

The impact of the increased generosity of the WFTC and the Children's Tax Credit is muted for those with medium to high rents. Low-earning renters are eligible for rent support known as Housing Benefit (owner-occupiers normally get no housing support). Housing Benefit is phased out as income rises, but at a faster rate than WFTC – 65%, and starting at a lower income level.[4] Under FC, the maximum marginal deduction rate could reach 97 percent.[5] The increased generosity of the WFTC compared to FC has meant that fewer households claiming in-work support are eligible for HB, and the reduction in the taper has eliminated the worst of the poverty traps.

The effect of the multiple phase-outs, and the effect of the increased generosity in WFTC increased the range of incomes (or rents) over which people are on both WFTC and HB phase-outs has been sharply reduced. This comes at the cost of a

[4] All low-income households (not just renters) can apply for rebates for the local taxes in the UK, which are assessed against property values. This rebate – Council Tax Benefit – is administered alongside Housing Benefit, and phased out at an additional 20 percent. So if families receive both benefits, the combined withdrawal rate on post-tax income is 85 percent.

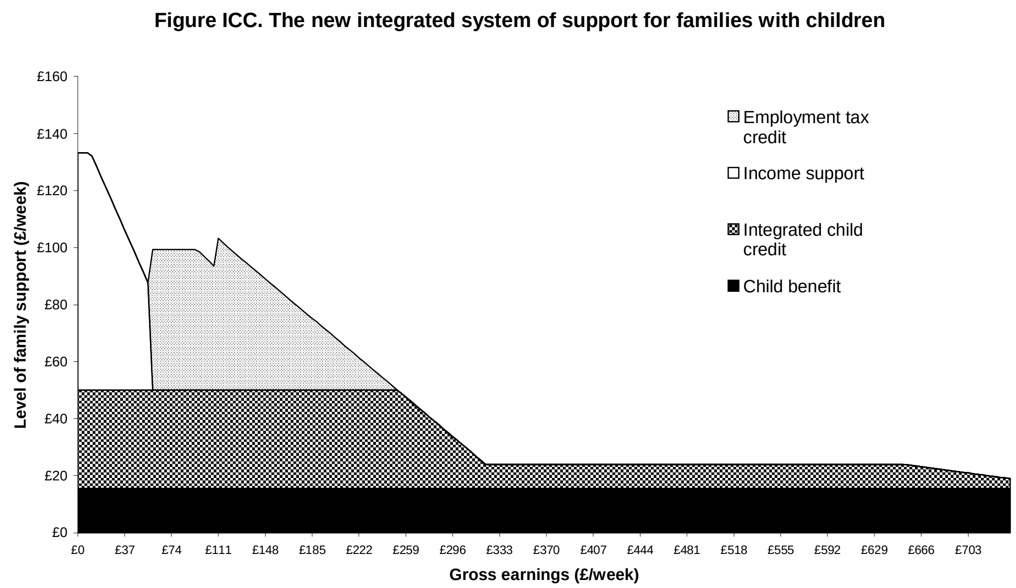
[5] Marginal deduction rate is the term used in the UK for the combined effect of taxes and benefit withdrawals (or phase-outs).

large increase in the numbers with phase-out rates at around 70% stemming from the combination of income tax, National Insurance and tax credit withdrawal.

In 2003 a second round of reform occurred and the WFTC was split into two parts: a Working Tax Credit paid to the principal earner, and a Child Tax Credit paid to the principal carer. The later now included all the child payments inside Income Support and the tax system (Childrens Tax Credit) and is paid alongside child benefit – so that all child payments were now paid to the primary carer through a single system.

The new system had a number of other changes, including being assessed over annual income and paid through the year. Last year's income is used as a prediction of this year's annual income and this is then reassessed at the end of the year, and any adjustments (through over- or under-payment) are then made. To avoid too many people repaying credits a disregard is employed, such that if income rises, but remains below this disregard, no repayment is required. This was initially quite low (around £3,000), but has since been raised to over £20,000. The second major change is that the withdrawal has been switched from an after tax net withdrawal rate of 55% to a gross (before tax) rate of 39%. The new structure is laid out in Figure 5 on the same basis as Figure 4 for a family in 2003.

Figure 5 The Post-2003 structure of Support for Families with Children



Note: Assumes entitlement for employment tax credit reached at £59.20, or 16 hours work at the minimum wage. Values deflated to 2001-2 prices.

Making Work Pay – Tax and National Insurance

The third element in making work pay entailed a significant reduction in income tax and NI contributions for lower earning individuals. This was done by extending the amount a person could earn before making NI contributions, and introducing a low starting rate of Income Tax at 10p in the pound. These early reforms have now largely been undermined since 2003, as tax- and NI-free allowances were linked to prices, not earnings, and the 10p starting rate of tax was abolished in 2007, whilst reducing the standard rate of tax to 20p from 22p.

Case management with Limited conditionality

From 1986, under the ReStart programme, the idea of job search conditions for the unemployed was enhanced and monitored with benefit sanctions if breached. This was greatly enhanced in 1996 under the move to Jobs Seeker Allowance (JSA). This renaming of unemployment benefits reflects the extra requirement to look for work actively of face sanctions. Claimants are required to keep a diary of job search activities, interviews etc. and they can be quizzed about this activity every two weeks, although in practice only those about who are thought suspicious are checked in depth. Claimants can not restrict the distance they have to travel to a job or the type of job sort after 13 weeks. This tightening of conditions has undoubtedly contributed to declining unemployment since 1986, but some of the displaced claimants have ended up on other, mostly sickness and disability, benefits.

At this time there was limited support for job search activities for the unemployed. What was available included loans for things that would help secure work and provision of short courses in preparing a CV or interview techniques, etc. However, there was nothing for all other claimant groups. The strong conditionality meant a clear line between the unemployed and other claimant groupings (the sick and disabled and lone parents).

New Deals for the Unemployed

The incoming government added a New Deal structure on top of the required activity explained above. For young people (aged 18-24) after 6 months of claiming JSA, the claimant was placed in an intensive job search regime with more monitoring and help and guidance with job search. This is called the Gateway phase. If after 10 months the claimant is still without work, then they must partake in a designated activity programme. There are four major options: subsidised work, an education or training course that lasts for 9 months to a year, placement with a charitable body or environmental project or a self-employment start up. The decision of which branch to move onto is made in discussion between an advisor and the claimant, however, the education option is restricted to those with lower skills and the subsidised jobs are often in short supply. For older claimants a similar process starts at 18 months, but the activity programme is more flexible in that people can move from one option to another, as the personal advisor deems most appropriate.

New Deals for Lone Parents and Sick and Disabled - Personalised Welfare-to-work Support

The slightly later New Deals for those on inactive benefits offered a rather different structure. Participation for these groups was voluntary and so a more flexible approach to the support on offer and engagement between the personal advisor was created. This new approach is sometimes described as Personalised Welfare-to-Work Support.

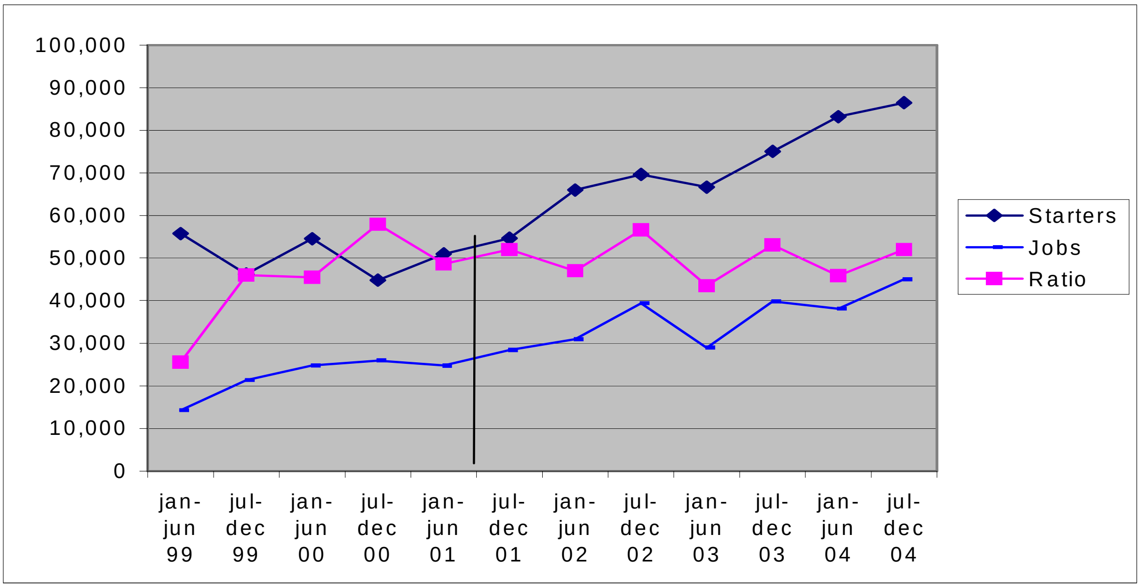
If the claimant agrees to pursue participation in the New Deal, an Action Plan is designed delivering a package of support services tailored to the individual's needs brokered by the Case Worker. The Action Plans set out an agreement between the claimant and a case worker on a return to work strategy and time scale. These contain a range of potential support services which are tailored to individual circumstances (short skills courses, confidence building, work trials, condition management, help getting child care, etc.) Evaluation suggests that the New Deal for Lone Parents raises participants' moves into work by 22 ppts (Dolton et al. 2005).

Work Focused Interviews

Upon introduction, participation rates were low in these New Deals for Lone Parents and the Disabled, but they were often successful in helping participants into work. So it was decided to introduce a Work Focused Interview (WFI) whereby Lone Parents (from 2001) had to meet their case worker on a regular basis to discuss the potential for return to work. This will include better off calculations for specimen jobs, discussions on childcare and the Action Plan based support. Attendance for Lone

Parents is required, i.e., sanctions can apply if a claimant fails to attend. They will shortly amount to 6 monthly and will be even more intensive when the child turns 14. Evaluations suggest that the WFI regime raised participation in New Deal for Lone Parents by 25% (Knight et al. 2004). There is a danger that such expansion could lead to reduced success in moving claimants into work, as the expansion includes less job ready or less willing participants. Figure 6 suggests that this was not the case with WFIs. The figure plots the numbers participating and numbers entering work after 6 months on the New Deal. They track well with a fairly constant entry rate of about 50%. Note the increase in participation after WFIs were introduced in mid-2001.

Figure 6 Numbers Participating in the New Deal for Lone Parents and Entering Work within 6 months of starting a New Deal, 1999 to 2004 – Source Department for Work and Pensions



The New Deal for Disabled People was very similar to that for lone parents, but with extra support for condition management to help people work with their conditions rather than waiting for the condition to improve. It had even lower take up than that for lone parents – but again, for those that did the outcomes were good. So following the use of WFIs for lone parents this approach was tried for the sick and disabled in pilot programmes, ones discussed in more detail below.

Policy Reform and Employment

Figure 2 above charted how the numbers of claimants for the major out-of-work benefits fell from over 6 million in 1995 to 4.7 million in 2006. JSA unemployment benefits fell rapidly with the economic upswing from 1996 to 1999, and this decline accounts for 1.2 million of the fall. However, this stopped and reversed a little after 2004. The contribution of the New Deal programme to this fall is minor, as the main point is to address long-term unemployment and even then the contribution of the NDs is minor (van Reenan 2000). However, the making work pay strategy has made a larger contribution to reducing joblessness, especially among families with children. The numbers of Lone Parents on Welfare have fallen from 1,025 to 777 thousand (1995 to 2006) and the employment rate of this group has risen from 44% to 57% over this period. This is an extraordinarily rapid rise. Evaluation has consistently shown that the WFTC contributed around 4 percentage points to that rise between 1999 and 2003 (around 70,000) and policy is likely to have had continued effects since the move to the new Tax Credits (see Gregg et al. 2007 for a summary).

Figure 2 above also shows that over this period there was a slight rise in the numbers claiming sick and disability benefits although this peaked in 2004 and has begun to fall. This group, along with lone parents, remain a major policy concern for the government to meet its targets on employment and poverty. Policy development for this group is discussed further below.

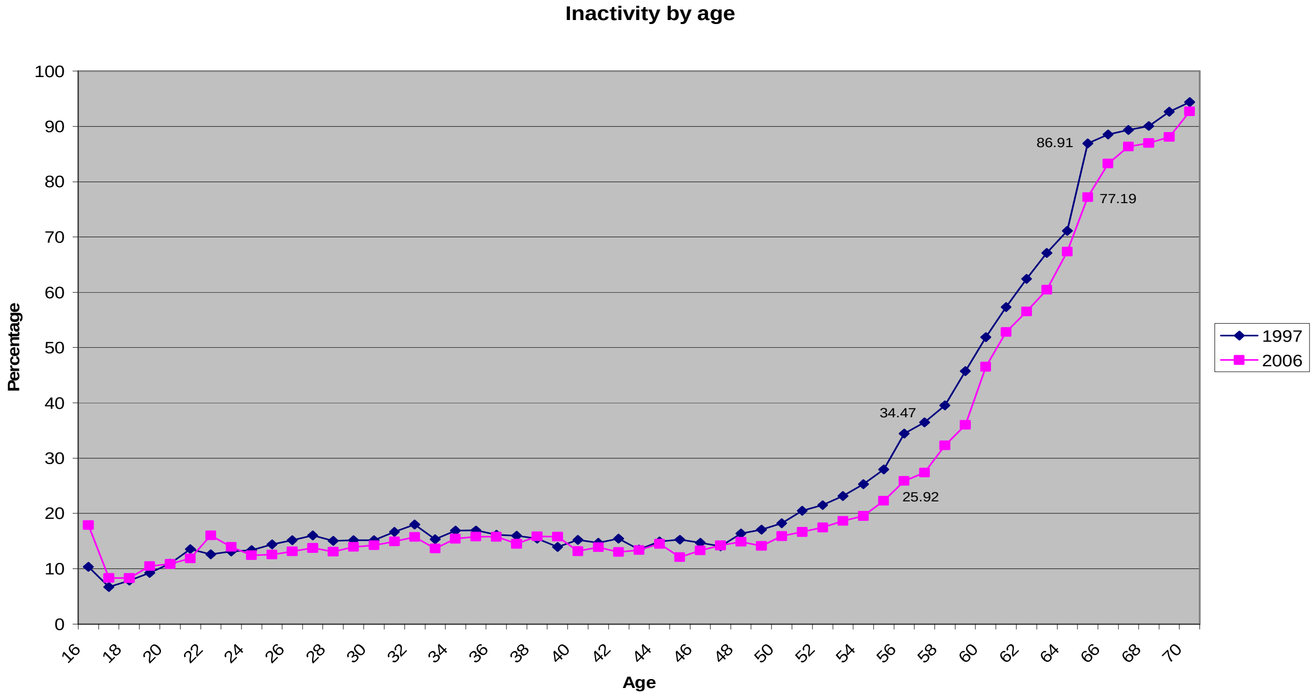
Current Policy Pilots and Reform Proposals

The process of welfare reform in the UK since 1997 has been a rolling one rather than a single big bang. Further, policy makers have regularly sought evidence of some degree of success from reforms in welfare-to-work programmes before national introduction. There has thus been a culture of piloting reforms. The analysis above highlighted some of the remaining important challenges for welfare reform in the UK, the large numbers of disability benefits, the slowing down of employment gains for lone parents, the aging population and (not mentioned in detail) the large numbers of working poor families with two or more children.

Overall economic inactivity rates have fallen only marginally to around 21%, but this broadly static picture of inactivity masks an ageing population and rising numbers in full-time education, which push inactivity up. Improvements within key groups, such as lone parents, older workers and the emerging pathways evidence for the sick and disabled, suggest there have been improvements of substantial worth. Figure 7 shows inactivity rates by age (16 to 70) for the UK in 1997 and 2006, excluding full-time students. The picture shows that there have been marked falls in inactivity amongst those aged 50+, typically of around 5 percentage points, but we see little change among younger groups (around 1ppt declines between 25 and 50). The rise in education participation among the young and the general ageing of the population (in particular, the first post-war baby boom,1947 to 1950, who are now approaching 60), mask this development in aggregate data.

Figures 1 and 7 therefore highlight the three (not mutually exclusive) target populations the government wishes to raise employment among: lone parents, the sick and disabled and those over 50. These groups must be brought back into the labour market if the government is going to meet its targets of reducing child poverty (by half the 1998 rate by 2010) and of raising the working age employment rate to 80% (no specified time). Virtually all jobless families with children are now either on lone parent or disability benefits rather than JSA for the unemployed.

Figure 7 Inactivity (excluding full-time students) by age, 1997 and 2006



Current Pilots

To address these issues the government has three major current pilot programmes in the field which are producing information for the design of possible policy reforms in 2008 and beyond.

The three pilots are:

Pathways

The Pathways programme seeks to help claimants of sickness and disability benefits (Incapacity Benefit and Income Support with Disability Premium) get back to work. It consists of six Work Focused Interviews in the first 9 months of a person's claim. At these interviews the client is encouraged to join the Choices programme (which can contain mixtures of rehabilitation and New Deal for Disabled People) and is supported by a Back-to-Work Bonus and a Job Preparation Premium. These help make sure work pays and that participants are able to meet any costs associated with the extra activity required. The Choices support package is almost always delivered by an outside contractor, rather than the government agency.

Pathways, to date, has applied only to new claimants, but an additional pilot for the 'short term stock', that is, those who have been in receipt of benefit for between nine months and 3 years, has started. The pilots or 'Pathfinder' areas have been chosen and implemented in three waves. The first covering four relatively small Job Centre Plus districts started in October 2003. The second wave started in April 2004 and a more substantive group, which brings coverage to around a third of the country, was implemented from October 2005 through to October 2006[6]. The Programme will be rolled out nationally by the end of 2008.

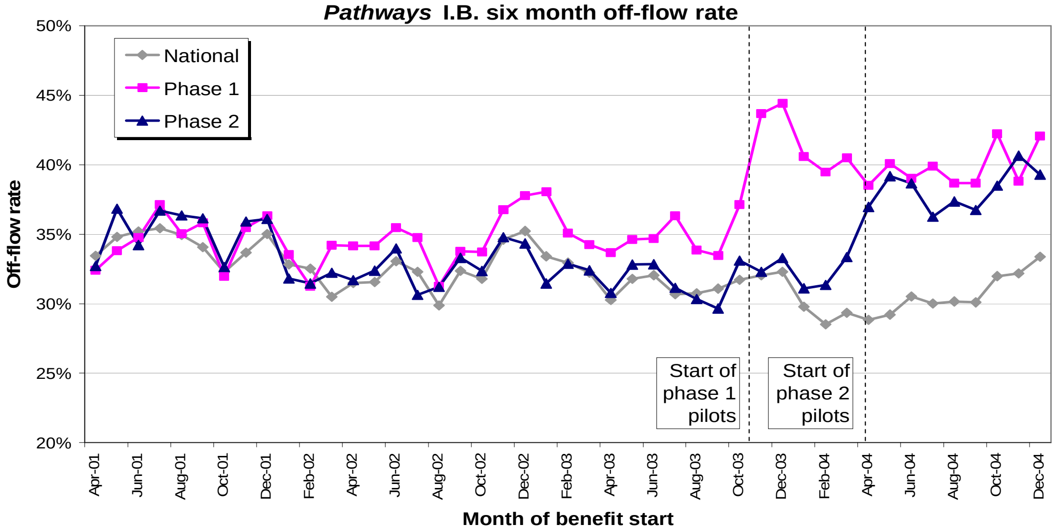
Pathways appears to be having an impact on numbers leaving incapacity benefits. Figure 8 shows the proportion of initial claimants in a month who are no longer in receipt of benefits 6 months later. Each month reported thus reflects the month of entry on to benefit. The count is of the proportion of the initial claimants who are no longer in receipt 6 months later, so any claimant who leaves but later returns to being a claimant counts as a benefit recipient. It is clear that both phases of Pathways' implementation have reduced the numbers of claimants by 7% after 6 months. There are also indications that this decrease has been associated with a reduction in the total number of benefit recipients in the pilot Districts. There is a risk, however, that it is the most job ready who move into work and hence these people would have returned to work anyway, but at a later date (see Adam et al. 2006 for evidence on Pathways to Work).

---

[6] **Current Pilot areas:** Began October 2003: Bridgend & Rhondda, Cynon, Taff, Derbyshire, Renfrewshire, Inverclyde, Argyll & Bute; Began April 2004: Lancashire East, Essex, Gateshead & South Tyneside, Somerset

PBR04 announcement: Phase 1 Jobcentre Plus Districts (October 2005): Glasgow, Cumbria, Lancashire West; Phase 2 Jobcentre Plus Districts (April 2006): County Durham, City of Sunderland, Greater Manchester Central, Liverpool & Wirral, Swansea Bay West Wales, Lanarkshire & East Dunbartonshire, Barnsley, Doncaster & Rotherham, Tees Valley; Phase 3 Jobcentre Plus Districts (October 2006) Staffordshire, Greater Mersey, Eastern Valleys

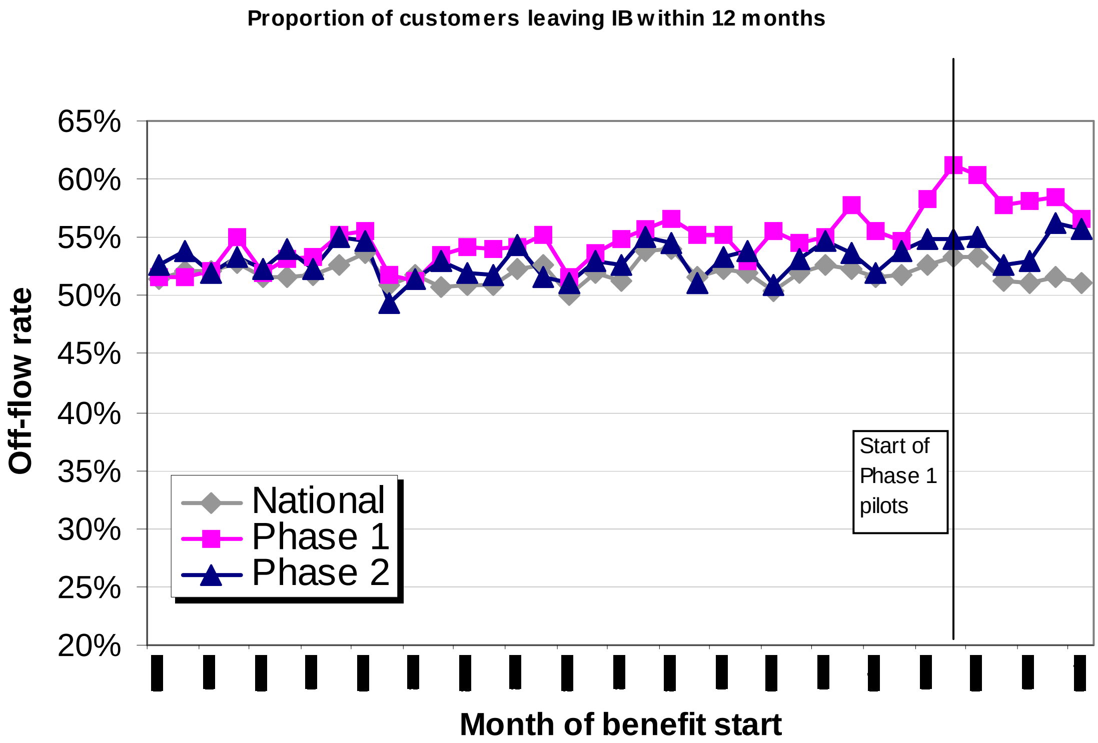
Figure 8 Percentage of Claimants Leaving Sickness and Disability Benefits after 6 months under the Pathways Programme



The off-flow rates presented are produced from the Working Age Statistical Database (WASD). WASD does not include a proportion of short-term Incapacity Benefit claims, therefore the off-flows presented will be lower than actual rates. However, trends over time will be consistent.

So the crucial question is: how long can these reductions in caseload persist? Figure 9 shows the same information as Figure 8, but 1 year after claims have started, rather than after 6 months. The first monthly cohort of Phase 1 pilots to reach a year from the pilot start are shown by the vertical line and are still showing a 5% reduced caseload on welfare. So, whilst there had been some decay, there was still a marked lowering of caseload after a year. The Phase 2 pilots had not been running for a full year for this data period, but the pre-effect is apparent in the two months prior to start up. Early evidence suggests that the policy is not helping those with mental health problems (e.g., depression and anxiety), nor those with physical conditions.

Figure 9 Percentage of Claimants Leaving Sickness and Disability Benefits after 12 months under the Pathways Programme



The off-flow rates presented are produced from the Working Age Statistical Database (WASD). WASD does not include a proportion of short-term Incapacity Benefit claims, therefore the off-flows presented will be lower than actual rates. However, trends over time will be consistent.

The effects of Pathways and the increasing focus on disability within JC+ is for the first time leading to a pronounced decline in the numbers of claimants. Numbers on both disability benefits had previously risen continuously, from around 700,000 in 1979 to a little over 2.77 million in November 2003, but they are now 100,000 below this peak. This represents healthy progress in tackling the problem.

New Deal plus for Lone Parents

The pilots addressing potential further support mechanisms for lone parents include an in-work credit of £40 on entry into work paid for one year and, in a reduced number of areas, a Work Search Premium designed to generate greater participation in NDLP and other programmes. More recently a full package of potential support including the in-work credits and an activational payment (entitled Work Related Activity Payment – WRAP) has started, labelled the ND+LP pilot programme. Early evaluation of this new package suggest that it has raised lone parent employment in targeted areas by 1.2 ppts, but it had a more marked impact in raising employment among those with over 12 months of claiming benefits previously (where the change was 7ppts after 2 years of the scheme).

Employment Retention and Advancement Pilot

The Employment Retention and Advancement pilot (ERA) is aimed at understanding better what policy mix can support retention of re-entrants in the labour market after leaving welfare benefits. This focuses on time-limited financial support and follow up contact between the case manager, the worker (former claimant) and their employer. In addition, this pilot programme is trying to engage with non-claimant/non-working partners of those in-work, but at risk of in-work poverty. The first evaluation evidence is now available and a few pointers are clear. Engaging non-working partners proved very difficult. The ambition to improve job retention has seen reductions in repeat benefit claims for both New Deal groups (NDLP and ND 25+) of 4-5 percentage points. Earnings advancement has a 29% increase in earnings for NDLP group (mainly by raising working hours rather than hourly wages with a 7pp increase in likelihood of working full-time), but much smaller effects on earnings for WTC/ND25+ groups. Skill development has also proved somewhat difficult, but an increase in likelihood of combining training/education with employment of 14 percentage points for lone parents on WTC, but much smaller for other groups. Compared to US evidence for such programmes, this does appear encouraging.[7]

Looking Forward

New Disability Benefit

A Welfare Reform Bill currently in parliament suggests a new test for disability benefit claimants. The two different disability benefits (one contributory and one means-tested social assistance) are to be merged into one. Those making claims will be split into two groups: the most disabled will receive the full benefit without conditions, whilst those with less severe conditions (based on functional capabilities) will only receive the full benefit if they engage in the action plan process described earlier under Pathways. If they fail to meet the agreed activity requirements, they will lose part of their benefit (perhaps £30, which would take them done to the same rates as JSA).

---

[7] DWP briefing, sourced from Dorsett et al (2007) Implementation and first-year impacts of the UK ERA demonstration, DWP research report 412.

Further Lone Parent Reforms

A proposed further reform for lone parent benefits is to transfer lone parents on to JSA unemployment benefits when the youngest child reaches 12 and in due course to age 7 (rather than 16 at present). They will then be treated as a special category of the JSA unemployed, with extra support services to help the transition back to work. Therefore, this will be rather like the New Deals for the Unemployed, but the details are not yet clear.

These developments would move the UK much further toward a mixed approach of support services and sanctions, whereas to date conditionality has been used rather lightly.

2.3 Old-age Pensions

The population's ageing is putting increased strain on the UK pension system. Unlike many other OECD countries, there is not the prospect of rapidly growing state spending on pensions, but the pension system is not without its problems.

The first tier of the UK pension system is the Basic State Pension, a flat-rate, fairly minimal pension paid to men from age 65 and women from age 60, rising to 65 from 2020. Receipt of the full Basic State Pension depends on contributions and there are big gaps in coverage for those with caring responsibilities, with more than two-thirds of women retiring today failing to qualify for a full pension.

Since the early 1980s, the Basic State Pension has been up-rated annually in line with inflation (rather than wage growth) and its value has fallen relative to earnings. On top of the Basic State Pension sits a second tier of compulsory pension provision. The default is membership of the state scheme (formerly the state earnings-related pension scheme SERPS, now the state second pension S2P), but individuals can choose to opt out into a private pension. When it was introduced, SERPS was intended to pay a pension worth one-quarter of an individual's best twenty years' earnings (up to a specified upper earnings limit), but its value has gradually been reduced and in the medium term, S2P will become a flat-rate top-up to the basic state pension. Even at its most generous for individuals retiring at the turn of the century, however, the combined pension from BSP and SERPS yielded a replacement rate of around 40 percent for someone on median earnings. This is relatively low by European standards.

Rather than increasing the value of contributory pensions, the Labour government chose to target financial support at the poorest pensioners by raising the value of means-tested benefits through the introduction in 1999 of the Minimum Income Guarantee, changed to Pension Credit in 2003. These reforms were relatively successful in reducing pensioner poverty and raising replacement rates at the bottom of the income distribution, although take-up rates of Pension Credit are still quite low – estimated at around 60 percent of caseload. Since their introduction, the value of means-tested benefits for pensioners has been annually up-rated in line with earnings and, as their reach has crept up the income distribution, there has been growing concern about the potential disincentive effects on saving that such extensive means-testing might have. This was identified as a key issue by the independent Pensions Commission reporting on the state of the UK pension system in 2005. One of its central recommendations was to restore the earnings link in the Basic State Pension in order to reduce dependency on means-testing, and this is due to be implemented in 2012. There will also be more generous credits for those with caring responsibilities.

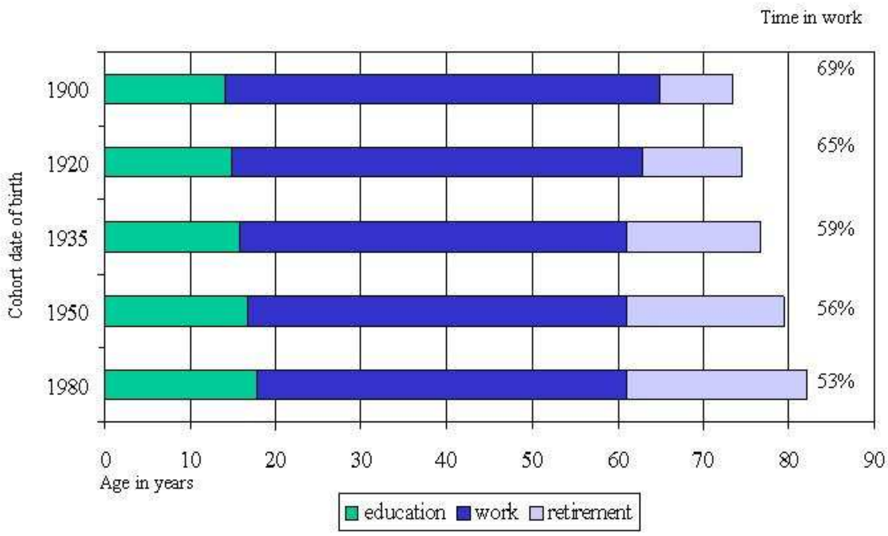
Compared to many other European countries, the UK has a relatively high level of private pension provision. Between 1978 and 1988 individuals could opt out of the state second tier into a defined benefit (final salary) scheme. From 1988 onwards individuals could additionally opt out into a defined contribution (money purchase) pension scheme. The option to opt-out of the state system helped to preserve occupational DB pensions and encouraged take-up of individual DC schemes. Nearly half of people now entering retirement receive more money from one of these private (occupational or individual) schemes than they do from the state.

However, the relatively low – and falling – generosity of the state schemes means that the overall system is very reliant on private schemes to deliver reasonable replacement rates to the middle and top of the income distribution. Moreover, there is concern about growing gaps in coverage of private schemes that will leave people with relatively low levels of income in retirement.

Cost pressures from increasing longevity, as well as from a growing burden of regulation, have caused many DB occupational schemes to close to both new and (albeit less frequently) existing members. Take-up of individual DC schemes has failed to fill the gap and, if anything, has also been in decline. The government introduced stakeholder pensions from 2001 to provide a regulated, but privately-provided individual DC scheme suitable for low- to middle-earners, but their introduction has had almost no effect on overall take-up rates. The government's policy towards private provision was initially one of "informed choice", underpinned by a belief that if "given the right opportunities, people will plan ahead sensibly". In other words, the government would provide information and make suitable products available, but leave individuals to make savings decisions themselves. However, there is a growing body of evidence from new behavioural economics that letting people make their own decisions does not necessarily yield optimal outcomes; that default options, for example, can have a huge effect on whether or not people belong to a pension, how much they save and where they choose to invest. The conclusion drawn from this literature is that the government can – and indeed should – encourage saving by framing individuals' pension choices. The result has been a move to introduce a new National Pension Savings Scheme which will automatically enrol all eligible employees into a low-cost individual pension account, albeit with the option to opt out. Individuals in the scheme will be required to contribute a minimum of 4% earnings, with employers contributing a further 3%, and the government, 1%. The introduction of automatic enrolment through this scheme, recommended by the independent Pensions Commission, and taken up by the Government in its recent White Paper, is intended to boost take-up of private pension saving.

The third main proposal from the Pensions Commission which has been adopted by the government concerns gradually raising the state pension age for men and women from 65 in 2020 to 68 by 2050. This follows a period of over twenty years from the 1970s to the mid 1990s during which retirement ages have fallen, in practice to well below the current state pension ages. Together with rising life expectancy, this has meant that people now spend a longer proportion of their lives retired (see figure).

Figure 10 Years spent in education, work and retirement, by date of birth cohort



Note to figure: Retirement age for 1950 and 1980 cohorts is assumed to be unchanged from 1935 cohort. Age when leaving school and retirement age based on Family Expenditure Survey. Data on life expectancy from ONS Population Trends (2004).

In raising the state pension age, the government wants to “signal the need for a behavioural change”, for if we are living longer, we may need to work for longer. The UK already has a lower inactivity rate among older workers (aged 55-64) than much of continental Europe and the rate has fallen by 5 percentage points since 1997 to around 30%. In practice, what the government does to the state pension age is likely to have only a limited direct effect on employment among this group, since retirement decisions are likely to be more affected by incentives in private pensions than what is happening to the state pension. However, much of the evidence points to people working into older ages in the future.

Until recently, many DB schemes encouraged early retirement, but now, faced with growing deficits, they are reducing provision for early retirement and raising normal retirement ages. So, retirement ages among people with occupational pensions will undoubtedly rise in the future. For people with individual schemes, the age at which they retire will depend on the size of funds that they have been able to build up and their investment strategies (and asset returns) in the run-up to retirement. Preliminary evidence shows that people with individual DC schemes have typically built up far less pension wealth than those in DB schemes, again pointing to later retirement.

Among those with no private pension, it is income support and, more commonly, disability benefits that have provided an alternative route into early retirement before the state pension age. Nearly half the total 2.3 million incapacity benefit recipients are aged 50+. From 2008, the introduction of the Employment and Support Allowance will aim to encourage people off disability benefits and into work. However, since the reforms are primarily targeted at the flow of new claimants, rather than the existing stock of recipients, it may take a while to have a big impact.

In many European countries, the challenge of reducing projected spending on pensions without imposing big cuts in pensioners' real incomes has often resulted in political gridlock in pension reform. As noted by Disney et al (2007), the UK stands in stark contrast for the frequency with which reforms have been implemented in recent years – a series of major reforms have come into effect in 1999, 2001, 2002 and 2006 (see Disney et al. 2007). The nature of the UK's "pensions crisis" is quite different to that in many European countries – the problem is not one of spiralling costs, but that past reforms which have brought down the costs (indexing the Basic State Pension to prices and scaling back on the generosity of the state second pension) have led to growing gaps in provision, exposed further by the likely decline in employer pensions. These past reforms also created a system of almost unparalleled complexity, which perhaps inevitably has led to further tinkering with individual elements of the system in order to achieve a better whole. Many of the changes, such as the expansion of means-tested benefit, have focused on short-term problems (poverty among current pensioners), but have carried the seed of longer-term problems (disincentives for saving) which require further reforms to be solved. The appointment of the independent Pensions Commission in 2005 to make an assessment of the current state of pension provision and recommendations for reform was not motivated by the need to overcome political stalemate, but rather a recognition of the need for a longer-lasting set of reforms. Whether it will achieve this or not remains to be seen.

2.4 Health

The period since 1997 has seen unprecedented growth in the resources devoted to the NHS in the UK. The long-run trend in annual increases in NHS expenditure since 1948 is around 3%. Real growth during the Blair era exceeded this and in the second Blair administration was around 8% per annum, meaning that the UK spent just under 9% of its GDP on health care in 2006. This increase in real resources was accompanied by the greater use of targets. There were targets set for inputs – staffing numbers, aspects of care, most notably waiting lists, and towards the end of the period for health outputs.

The record on growth in inputs was impressive. In 2006 compared to 1997 there were 26% more nurses, 56% more consultants, 20% more GPs (FTEs). This growth in numbers was accompanied by large increases in pay, ranging from 30% for GPs to 10% for nurses. Levels of staffing are now in the middle of the international league and the pay of salaried physicians is near the top of the league.

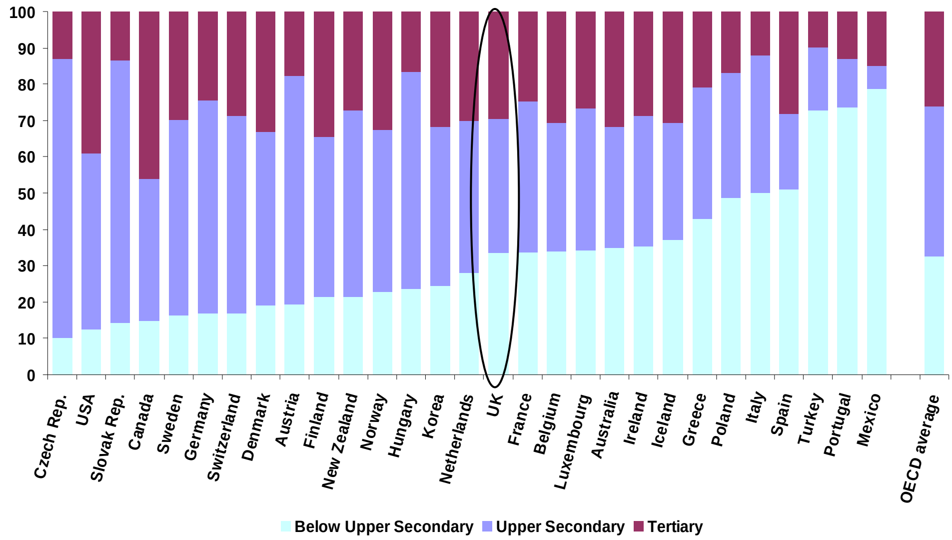
The impact on waiting lists has also been large. In 1997 the maximum allowed waiting times for non-emergency hospital inpatient treatment was 18 months. By 2005 this was brought down to six months. The average wait was considerably lower and had also fallen over the period. Performance on other non-targetted aspects of treatment was less satisfactory. Productivity increases were small. The volume of activity showed few change electives between 1998-2001, with some increase thereafter, though much of the growth was in emergency care. The growth in real inputs was quite similar, meaning that at aggregate level there was no general increase in productivity. In other areas, there was poor performance, for example, slow uptake of new cancer drugs relative to other countries.

The impact on health outcomes is less clear. Satisfaction levels have risen and there were some improvements in the health of the nation, as measured for example by falls in mortality from heart disease and cancer, but much of this fall appears to be a continuation of previous trends. In terms of levels of health, the UK remains in the middle of the international pack. Indeed, for some diseases (like cancer) survival levels are below those of other high income OECD countries. Obesity, which is even less susceptible to health service intervention, has been rising steadily and the UK is near the top of the international league for both adults and children.

2.5 Education Development

Education, like Health, has seen a large increase of government spending since 2000. The long-run share of GDP spent on education is around 5%, but when the New Labour government was elected spending was below this average and fell to 4.5%, with tight spending plans in the first two years inherited from the previous regime and stuck to by the incoming one. Since then, spending has increased to 5.75% of GDP in a little under a decade (HMT 2006). This puts the UK firmly in the upper half of spending in developed countries (OECD 2002).

Figure 10 Educational Participation of School Leavers in OECD Countries



Source OCED, Education at a glance, 2007

The increases in spending have been primarily directed at three areas. First, capital spending on new schools and buildings has been implemented after what was seen as long-term under-investment. Second, there has been an increase in spending aimed at raising participation in schooling in the Upper Secondary and Tertiary areas. Thirdly, and perhaps most strikingly, is the pre-school period. This has involved a guaranteed free ½ nursery places for 4 year-olds from 1999 and to 3 year olds from 2003. Much of this was provided on school sites. In addition, there has been increased funding for nursery provision in deprived areas where supply was seen as weak. Moreover, the Sure Start programme for the under 4s has also been targeted at deprived areas. This package is now being co-ordinated by Children's Centres in each neighbourhood to ensure delivery of Sure Start, nursery places, some health visiting services and after-school clubs and holiday schemes.

This programme of spending has been focused at addressing what the government has seen as key weaknesses in the UK education system. First, as shown in Figure 10 below, is the large proportion of school leavers not going onto Upper Secondary Education. Despite sizable improvements in this area, the UK is still lagging behind many countries.

Further, the emerging evidence of a long tail of low achieving children in the UK from studies such as PISA (OECD, 2007) and the large educational gradient in attainment by social background of children on entry into the school system have led to the strong focus on pre-school years (see Feinstein, 2003). Hence the strong focus on spending on pre-school services with extra funding in the most deprived wards. However, it is also true that on entry to school these social gradients continue to widen, and this raises concerns both about differential access to the best schools and the level of support for schools serving deprived communities.

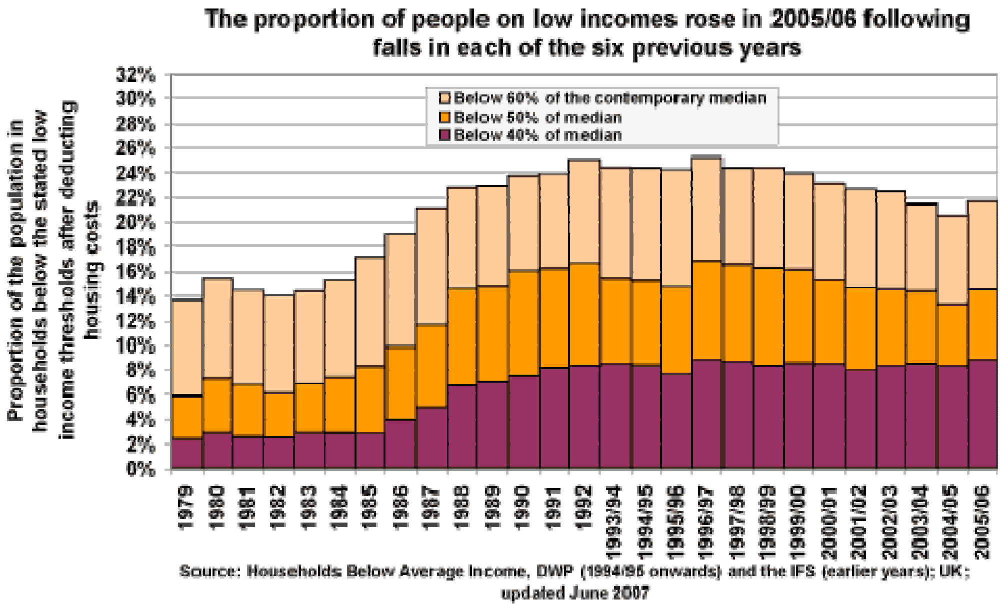
2.6 Poverty and social exclusion

Figure 1 showed how the fall in numbers of claimants has covered the increase in spending on children and pensioners where welfare payments have seen increased generosity and the cost of the WFTC. The tax credit system and tax allowances for children that existed prior to WFTC is not shown (owing to difficulty in finding data), but they accounted for 1/3 to 1/2% of GDP. Hence total welfare spending, including pensions and tax credits, has fallen by around 1.8% of GDP despite the expansion of tax credits, increased generosity of support for children in low-income households and low-income pensioners and an ageing population. In large part this has come from rising employment (and falling welfare rolls), but it also reflects a squeeze on the generosity of payments for jobless working age adults and pensioners who have private incomes where support has remained linked only to prices. Again, with slower progress in reduction in welfare rolls and resources continuing to be put in to reduce child poverty, this decline in total spend halted from around 2003.

Poverty

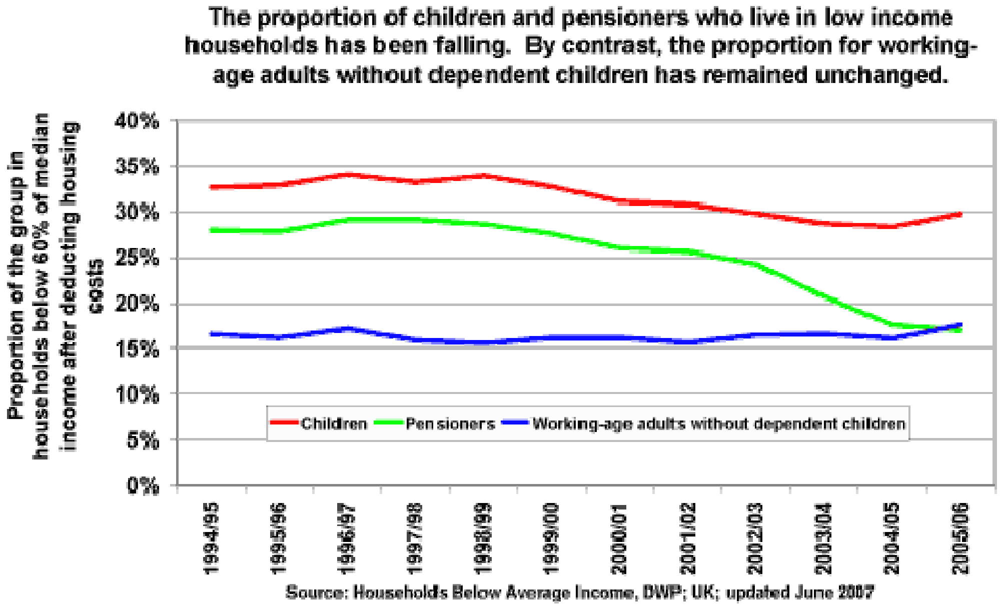
Poverty measured as persons in households below 60% of median income (the UK uses two measures before and after housing costs) rose steadily from low levels in late 1970s to a peak in the early 1990s. Measured after housing costs are deducted, this peak showed around one in four people to be in poverty. For a decade poverty levels have fallen, except in the last year. But the improvement is moderate rather than dramatic.

Figure 11 Proportion of People Living in Poor Households 1979 to 2006



To a degree this masks two groups with marked decreases in poverty, children and especially pensioners with modest increases among childless working age people (see Figure 12). The decline in poverty among families with children has come about partly through increased employment and partly through the increased generosity of benefits. However, much of the increased generosity compensates for rising earnings, as the standard benchmark in the UK is for benefits to rise only with prices. The sharp fall in pensioner poverty reflects the increasing incidence among newly retired groups to have occupational pensions or the second stage earnings related state pension. The Minimum Income Guarantee has also played a substantial contribution. Although poverty has fallen in the UK, Britain remains a high poverty country within Europe and child poverty is especially high.

Figure 12 Proportion of People in Poverty by population group 1995-2006



A key supporting role has been attempted by reducing the incidence of longer-term damage that certain conditions, often described as social exclusion, can cause. This damage (described as “scarring”) derives from evidence that falling into certain states reduces people’s employment or earnings opportunities in the future, and often other dimensions of future opportunities, as well. These states include child poverty, long-term unemployment (especially for youth), teenage pregnancy, homelessness, and of course low educational achievement. Some of these states are directly targeted through welfare reform (poverty and long-term joblessness), but others were the target of other policy reforms delivered by other departments of government. The Educational Maintenance Allowance (which is paid to 16 and 17 year-olds from poor families at a rate of £30 a week to stay in full-time education) or the Sure Start programme (to boost early child development in deprived areas) are clear examples (see Dearden et al. 2005 for an assessment of EMA and National Evaluation of Sure Start, 2008).

Raising incentives for self-protecting savings

Most countries give tax breaks for certain forms of saving. This is close to universal for pension saving, such that contributions to pensions are not taxed. But this is often extended to interest received in certain other savings products, such as the Individual Savings Account (ISA) in the UK. Such tax breaks are paid at the marginal rate of tax, and hence non-tax payers do not receive them and they are worth more to those on higher rates of tax. The government has introduced a number of savings products which are worth more to low earners and non-taxpayers. These include the Savings Gateway, Stakeholder Pensions and Children Trust Funds. These are saving schemes where, rather than tax relief, there are matched payments from the state, which are thus also a form of conditional financial support. The aim is to support self-protection against income loss through unemployment, illness or retirement among lower income groups. This approach still remains in its infancy, however.

3. Europe and the UK Welfare State

The UK came closest to the European Social Model in the 1970s when there was a concerted effort to bring trade unions into a more co-ordinated dialogue with business and government, with the Social Insurance Model still central to the workings of the Welfare State. Widespread industrial unrest, culminating in the Winter of Discontent (1978/79) undermined this approach and was followed by a clean break with the election of Mrs. Thatcher's government. Mrs Thatcher steered the UK rapidly away from the Social Model concepts of social solidarity, collective responsibility and social justice, toward a firm focus on individual freedom and responsibility and entrepreneurial incentives (low marginal tax rates for the wealthy). The shift in the welfare system was toward a residualised low value means tested safety net and personal saving, and away from a social insurance model. The relationship with the EU over this period was always arms length and often hostile, especially in the areas of labour market regulation.

The New Labour government from the outset made it clear that it was not going to return to tripartite institutions and widespread regulation of markets, but it did place a clear emphasis on social justice (reducing poverty and social exclusion). Hence the UK has developed a model that has a rather distinctive flavour compared to most European countries, with some aspects of models used in the US and the

Scandinavian countries. The UK model however, is perhaps closer to that of Canada, Australia and New Zealand than most European countries.

Denmark and Sweden have long had models encapsulating high benefits with strong activational support systems and required activities after certain durations. Richard Layard, an early advocate of the New Deal programme in the UK, was influenced more by Sweden than the US in his thinking (See Layard et al. 1991). Swedish and Danish childcare and maternity leave laws have also heavily influenced UK policy developments over the last few years. However, the strong history of experimentation and evaluation in the US has been very influential too, although it has not always led to similar policy outcomes. The Minnesota Family Income Program, the Canadian Self-sufficiency Programme, and the Californian GAIN Program were influential on the development of UK welfare-to-work programmes such as the NDLP. The Earned Income Tax Credit was the inspiration behind WFTC and Early Head Start evidence drove the development of Sure Start in the UK.

Within Europe, the UK model most closely resembles a less generous version of the welfare systems in Denmark or Holland, which are sometimes referred to as embodying Flex-security. This evolutionary process of New Labour’s reforms had some antecedents prior to 1996, but has really come to the fore since that date. The UK has for some years seen itself as setting the pace on aspects of welfare reform within Europe. In areas such as job protection and labour market regulation it has long resisted European harmonisation or extensions of policy. More recently it has been engaged in advocating aspects of its model to the rest of Europe, most particularly tax credits and activation in welfare. It has thus wanted to be seen positively in cross-country reports or reports from international bodies such as the OECD and IMF. Whilst this view has some merit when comparisons are made with the other major EU countries (France, Germany, Italy and Spain), it rather ignores similar but earlier developments, along with evidence of success being made in smaller countries such as Denmark and Holland.

In other areas the UK debate views itself to be lagging behind other countries and is thus more prone to learning from other European countries. Childcare and maternity leave is one area that has been mentioned earlier, but the biggest debate in the UK is probably around school attainment differences between low and high ability children, which are much bigger in the UK than most other countries. Another related issue is that of school attainment gaps between poor and affluent children. Other areas include children looked after by the state, mental health, obesity, and teenage pregnancy.

In this way commentary acts as an open method of co-ordination, and the UK has wanted to prove itself fully informed of international best practice and to be one of pace setters. There remains at best a lukewarm attitude to the EU within the UK government, with strong concerns of expansion of EU competencies into areas of national sovereignty. Additionally, the position of the UK outside the Euro area means that the Growth and Stability Pact has little traction, with more focus on the government meeting its own “Golden Rule” of borrowing only to invest over the economic cycle. Despite this rule, the government appears to be running large structural deficits derived from strong spending on health and education rather than weak revenues.

Conclusion

In the UK, welfare has undergone two very profound periods of reform since 1979. The first was a move away from a contributory social insurance model to a low value social assistance model, this lasted up to 1996. The second phase started in 1996 and involves a move to an activational welfare model with greater emphasis on incentives, support services and conditionality.

The emerging UK model has a rather distinctive flavour, compared to most European countries, with some aspects of US thinking and some aspects drawn from Scandinavian examples. The UK model however, is perhaps closer to that of Canada, Australia and New Zealand than most European countries. Within Europe the model most closely resembles a less generous version of the welfare systems in Denmark or Holland, which are sometimes referred to as embodying Flex-security.

As a direction of travel from the previous regime(s), this represents an increase in engagement and support functions, increases in the (disciplinary) required activities, combined with increased financial support and personalised support services.

However, in areas of social inclusion the UK has been much more open to ideas and current programmes used in different EU countries and the process of open method of co-ordination, and in particular the spread of best practice through evidence and research is widely supported in government and the wider academic and campaigning sectors.

As a move away from the ethos and regime established in the Conservative years, this represents a degree of modest convergence between the UK and continental Europe. However, this is not convergence driven mainly by the EU, for the spread of ideas and best practice, the concept at the heart of Open Method Co-ordination is an imprecise reality for UK policy making. There has been a strong emphasis on evaluation, piloting and knowledge transfer emanating from the government in these areas.

References

Adam, S. Emmerson, C. Frayne, C. And Goodman, A. (2006) Early Quatative Evidence of the Pathways to Work Pilots, Department for Work and Pensions Research Report 354

Brewer, M. (2000) Comparing in-work benefits and financial work incentives for low-income families in the US and the UK, A*ug 2000, IFS Working Papers*, *W00/16*

Brewer, M. Ratcliffe, A. and Smith, S. (2007) Does Welfare Reform Affect Fertility? Evidence from the UK, CMPO Working Paper No. 07/177

Dearden, L. Emmerson, K. Frayne, C and Meghir, C. (2005) Education Subsidies and School Drop Out Rates IFS Working Paper 05/11 available at http://www.ifs.org.uk/publications.php?publication_id=3376

Dorsett, R., Campbell-Barr, V., Hamilton, G., Hoggart, L., Marsh, A., Miller, C., Phillips, J., Ray, K., Riccio, J., Rich, S. and Vegeris, S. (2007) Implementation and first year impacts of the UK Employment Retention and Advancement (ERA) demonstration, DWP Research Report 412.

Dickens, R., Gregg, P., Machin, S., Manning, A. and Wadsworth, J. (1993), 'Wages Councils: Was there a case for abolition?' *British Journal of Industrial Relations*, vol. 31, no.4.

Disney, R., Emmerson, C. and Wakefield, M. (2007) *Pension provision and retirement saving: Lessons from the United Kingdom*, SEDAP research paper no. 176

Gale (1997) What America Can Learn from the British Tax System, *Fiscal Studies* 18(4)

Gregg, P.A. and Wadsworth, J. (1996) It Takes Two: Employment Polarisation in the OECD CEP discussion paper no. 304, commissioned by OECD

HM Treasury (1997-2000) *The Modernisation of Britrains Tax and Benefit System No.s 1-5*, London, HMT

HM Treasury (2006) *Public Expenditure Statistical Analysis*, London, HMT

Knight, G.; Speckesser, S.; Smith, J.; Dolton, P.; de Azevedo, J.P.; (2006) 'Lone Parents Work Focused Interviews/New Deal for Lone Parents: combined evaluation and further net impacts', Department for Work and Pensions Research report no.368.

Layard, R. Nickell, S. and Jackman, R. (1991) *Unemployment: Macroeconomic Performance and the Labour Market*, Oxford University Press, Oxford

National Evaluation of Sure Start (2008) The Impact of Sure Start Local Programmes on Three Year Olds and there Families, Report 027, HMSO, March

OECD (2005) *Education at a Glance*, Paris

OECD (2007) *Education at a Glance*, Paris

OECD (2007) *PISA 2006* Volume 2:Data

Van Reenan, J. (2004) “Active Labor Market Policies and the British New Deal for the Young Unemployed in Context”, in Card, David, Richard Blundell, and Richard B. Freeman, editors Seeking a Premier Economy: The Economic Effects of British Economic Reforms, 1980-2000, University of Chicago Press.