

# WHAT SORT OF SOCIAL SECURITY SYSTEM?

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## INTRODUCTION

This brief paper begins by attempting a description of some principles for thinking about the structure and reform of social security systems from a Christian perspective. In section 2 we ask where such principles might have an impact on the practical design of social security systems, and use the current UK system as an example to describe and assess the problems faced by a real system. Section 3 attempts to identify a strategy for reforming social security. Section 4 describes and considers a range of suggestions for reform which have been proposed under the general title of 'integration of tax and social security', drawing out their distinguishing characteristics. Tentative conclusions are drawn in section 5.

## SECTION 1

We take as our starting point the eight principles outlined in Donald Hay's book *Economics Today*:

Hay's principles

1. Creation should be used to provide for our needs
2. All should exercise stewardship
3. Stewardship implies responsibility for resources
4. Work is a right and an obligation

5. Work is the means to stewardship
6. Work should be social
7. All have a right to subsistence, primarily to be achieved through productive work
8. We have a duty to provide for those who cannot provide for themselves by work<sup>1</sup>

Given these, our task is to derive from these some principles that can be applied more specifically to the problems of social security system design and reform.

Tentative principles for social security design

1. **Provision for those in need, especially those unable to work**

We must provide for those in need, especially where that need arises from the inability to work, or the lack of available work

2. **Do not discourage work**

We should aim not to discourage work, since work is a vital part of our created nature. Here we face an inevitable trade-off between provision for those in need, and concern about incentives. But as noted later, the problem of disincentives is far less well attested in careful empirical

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<sup>1</sup> It should be stressed that this summary of Hay's principles is mine, not his

work than in casual anecdote. We can perhaps be more positive, and look to the social security system, and other tools of government policy, to encourage and assist individuals into the labour market.

3. **Do not substitute social security for tackling unemployment**

Hay's principles rightly stress the importance of work for the individual. Provision of social security for the unemployed is a very poor second best to provision of work, or training or experience that can lead to work. The great majority of those dependent on social security in the UK are necessarily largely outside the labour market (the elderly, the sick, the disabled, most lone parents with very young children), but for those who are not, providing access to suitable paid work is a greater good than provision of cash benefits

4. **Run so as to minimise disaffection among non-recipients**

Social security expenditure in the UK exceeds £60 billion, more than 10 per cent of Gross Domestic Product, more than £1000 p.a. for every individual in the UK. It is the single largest element of government spending. The stewardship of so vast a resource is a heavy responsibility. If social security systems are inefficient or unfair, they will fall into disrepute

5. **Do not run so as to deny equality of recipients and non-recipients**

Part of our stewardship implies responsibility for those in need. This is not an excuse for denying our equality before God, or implying weakness or failure in those who need financial support.

## SECTION 2

Our first principle was **provision for those in need**. There are three obvious ways in which a social security system might fail to meet this objective.

First the level of benefits defined by the system may be inadequate; although benefits are paid they are not sufficiently generous to prevent real need. Here the most difficult issue is defining an acceptable level of benefit. Benefit levels in the UK permit a standard of living which is by no means luxurious, and they have fallen behind earnings in the last thirteen years. But benefits in the UK are not uniformly lower relative to earnings or the cost of living than in other OECD countries. Deciding on benefit levels is a complex task; there may well be particular benefits for particular groups in the UK which are currently set at an inadequate level, but no sweeping generalisation seems possible.

Second, there may be individuals or families who are entitled to benefits which they do not receive. This problem of non take-up is a serious one in the UK, as in some other countries<sup>2</sup> There are many potential reasons for not taking up a benefit entitlement. The clearest is simply not knowing about the existence of the benefit; but potential stigma, the hassle of claiming, or simple error on the part of the authorities can also play a part. Most cases of non take-up in the UK are of relatively small amounts of a top-up benefit for individuals already receiving another benefit. These seem to arise because of lack of awareness, partly caused by the complexity of the system, unwillingness to go through

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<sup>2</sup> See Blundell et. Al. (1988) and Fry and Stark (1991) for further discussion

complex application procedures for the sake of relatively small amounts of money, and in some cases stigma attached to means tested top-up benefits. In addition to these many cases of relatively small amounts of unclaimed benefit, there are some cases where far larger amounts are left unclaimed. This seems most frequently to occur among the working population.

Third, the system may deliberately exclude from any entitlement certain types or groups of people although we might say they were in need. In a number of European countries, most recently and notably France, central government social security simply ran out completely after one year of unemployment. This might encourage individuals to find a job, but if there are no jobs available, seems like rough justice.

Our second principle was that **the social security system should not discourage work**. It is often asserted that the existence of a social security system does material damage to work incentives and morale. Such an assertion ignores the fact that the great bulk of participants in social security systems are excluded from the labour market by virtue of age, sickness or caring responsibilities. For the minority of recipients receiving benefits because they have no income, although they are capable of work, there is a potential problem of disincentives. By giving individuals money when they do not work, we reduce the gain to them from working rather than remaining idle. If, as economists all too often naively assume, work is a 'bad', such a distortion of the budget constraint might indeed be expected to reduce incentives to work. But the assumption that work is seen simply as a 'bad' is clearly wrong. Our

Christian perspective tells us that we are created to work, although not necessarily to be paid for it. Applied empirical economics reinforces the belief that for many individuals, the desire to work is very strong, even if there is little or no financial gain to be made from work. For prime age men, there is some consensus that increases in the level of unemployment compensation increase the duration of unemployment slightly, but the effect is small<sup>3</sup>. There are groups, in particular the mothers of young children, either living alone or married to unemployed men, for whom the disincentive effects seem quite strong, but in these cases cutting benefit levels would seem an absurd response to genuine social problems<sup>4</sup>. Although we should be aware of the possibility of damaging work incentives, this seems unlikely to be too great a problem for the bulk of unemployed individuals, and where a problem exists, disincentives are likely to be only one difficulty among many.

Our third principle was that **social security payments should not be seen as a substitute for tackling unemployment**. We should not be satisfied simply to provide income to the unemployed, but should consider training programmes, and help with job search as being vital elements in our support of this group. Difficult questions arise here as to the nature of the duties and obligations placed on the unemployed. One response has been the development, especially in the US, of 'workfare' type schemes, in which payment of benefits is contingent on participation in public work programmes. In practice, the

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<sup>3</sup> See Atkinson and Micklewright (1990) for an excellent summary of the evidence

<sup>4</sup> See Kell and Wright(1990) on women married to unemployed men, and Dilnot and Duncan(1992) on lone parents

diversity of such arrangements is enormous, making any general judgements hard. The most controversial element in such schemes is the compulsion involved, since it is clear that maintaining the habits and skills associated with working assist in returning to the active labour market.

Our fourth principle was that **the system should be run so as to minimise disaffection**. There are here two sets of problems. The first relate to disaffection amongst the group of recipients or potential recipients as a result of inefficiencies in the running of the system. These might be delays in payments, or errors in calculation, or real or apparent horizontal inequities within the structure. The second set of problems relates to potential disaffection amongst the group of non-recipients who are paying taxes to fund current payments. If this group believes that the system is unfair, or inefficient, or over generous to some groups, raising adequate funds to deal with poverty will become more difficult. Social security expenditure in the UK accounts for around 10 per cent of GDP, and around one quarter of total public spending. It is funded in part by National Insurance contributions and in part by general taxation, and is much the largest single element in public spending.

Our fifth principle was that **the system should not deny equality**. The most obvious way in which this principle can be violated is in the manner in which benefits are assessed and paid and the attitude of the population as a whole. The depressing state of many social security offices is a clear example of a problem in this area, although one which has recently received some attention and

expenditure. The attitude of DSS officials is also crucial. Perhaps the most difficult question here is the extent to which income related benefits as opposed to benefits paid to all can be made as acceptable as possible.

### SECTION 3

Given the principles we have outlined, and the clear potential for improvement, what is needed is some strategy for reform, about which three general points can be made.

First, in the real world of social security programmes, any change will be gradualist. This is **not** to say that grand schemes for reform are impossible, they are vital. But if grand reforms are to have any chance of implementation they need a well set out route from the current system to the proposed goal.

Second, many of the worst problems in the current UK system are the result of differences between the intent of the system and the outcome. These are in many ways the obvious starting point for reform. Clear examples of this problem are low rates of take up of some benefits, lack of awareness of benefits that would be available in work, delays and errors in payments, miserable DSS offices.

Third, any route to reform which ignores the problems of the current system is unlikely to be successful. Our response to income related or means-tested benefits is a good example. There is no doubt that many of the worst problems of our social security system are found in the means-tested benefit system. There can also be no doubt that it is unlikely to be possible to run a social

security system without relying on such benefits to some extent, even if we would rather not, as the proponents of universal benefits admit. Any proposal for reform which does not attempt to reduce the problems caused by such benefits fails in at least one major dimension.

## **SECTION 4**

The last decade has seen a great deal of discussion in the UK about the reform of social security, and one phrase has been much used in describing proposals for reform 'the integration of tax and social security'. This description has been used to describe so many different types of proposal that it now seems almost meaningless. In this section we describe seven distinct sorts of change that have been proposed under this general heading, and assess the impact they might have on some of the problems outlined above.

### **1. Tax integration**

Perhaps the most obvious step to take in the UK is to remove the distinction between the income tax and National Insurance contributions. Although the original Beveridge ideal retained a significant link between contributions and benefit receipt, that link is now all but dead, with National Insurance contributions now simply another income tax, albeit with a bizarre structure. By integrating the two taxes we would reduce

administrative costs, remove some structural absurdities and inequities, in particular the National Insurance ceiling, and cease to give the impression that our social security system is funded, which it is not<sup>5</sup>.

## 2. Unit of assessment

At present the unit of assessment for income tax is the individual, whereas the unit of assessment for most social security benefits is the family.

Until 1990 the unit of assessment for income tax was also the family.

Moving to individual assessment for benefits would reduce confusion, and would make the system more neutral with respect to marriage, but would be very costly. Many individuals, mainly mothers, do not work, and therefore do not have any income of their own, despite having an adequate standard of living because of their partner's earnings. To pay benefits to all individuals on the basis of their own income would ignore all income sharing within families. It seems unlikely that an entirely individual based system is feasible, although some moves in this direction might be possible. It is worth noting that an individual basis of assessment for benefits would help with problems of disincentives for individuals with unemployed partners.

## 3. Assessment period

At present the assessment period for income tax is the tax year, whereas the assessment period for benefits is the current period, either weekly or fortnightly or monthly. There are some apparent attractions in extending

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<sup>5</sup> In fact, more people believe that the NI contribution pays for the NHS, which it largely does not, than that it pays for retirement pensions, which is its main function.

the assessment period for benefits, since this might be a way of recouping benefit expenditure from those who suffer a brief period of unemployment, but are soon back in the labour force with an adequate income. Any such move would increase administrative costs, but faces a much more serious problem, which relates to incentives. If an individual knows that when she returns to work she will have to repay the benefit she has received, she is much less likely to return to work at all, and will certainly require a higher wage before it seems worthwhile. One response to this would be to make the assessment period one year, but if at this point all debts were written off we would expect all unemployed individuals to have an incentive to remain unemployed for one year, and if the debt was not written off the problem would remain. These difficulties seem insoluble.

#### 4. Aligning and unifying benefits

At present in the UK we still have a wide range of separate benefits: Unemployment Benefit (UB), Income Support (IS), Family Credit (FC), Housing Benefit (HB), Retirement Pension (RP), Invalidity Benefit (IB), Child Benefit (CB) are some of the most important. The reforms introduced in 1988 went some way towards aligning the levels of these benefits, but they are still separately administered. Two sorts of problems might be reduced if the benefits were unified into a single structure and administration. First, potential recipients and policy makers would find the system easier to understand. This would reduce confusion amongst recipients and claimants, and facilitate flexible policy making for

government. Perhaps more important than this, uncertainty arising from changes of state would be reduced. At present, if a lone parent ceases to be unemployed, and moves into a low paid job, she will move from being entitled to IS, CB and HB, to being entitled to FC, CB, and HB. Her total net income including benefit entitlement in work should be higher than out of work, even if the job is very badly paid. But many lone parents are unaware of FC, or worried that it will take some weeks from the time they lose IS to the time FC starts to be paid. Unfortunately, they are right to be worried, and this sort of delay at changeover is a serious problem. Were the benefits unified, no delay or uncertainty need occur.

5. Unifying payment mechanisms

The greatest problems of non take-up of benefits affect those in work entitled to FC. This has led to calls for use of the income tax payment mechanism, which works very well, to be used to deliver FC like benefits. The attraction of such an idea is that it ought to deal with the problem of non take-up. Such a scheme would save on DSS administration costs, but would increase employer costs. By making the in-work benefit system more effective, such a scheme would encourage individuals to work rather than not work, but would mean an increase in the number in work facing high marginal tax rates. Difficult questions arise over which parent should receive benefits in the case of a two parent family.

6. Changing the rate structure

Proposals are often made to change the pattern of marginal tax rates

produced by the current system, typically because of concern at high marginal tax rates affecting those with low incomes. There is an unavoidable problem here. If we wish to provide a decent income to families with low earnings we must pay benefits to them. We cannot pay benefits at this level to all, indeed money must be found to pay even for these benefits. This means that the level of benefit must be reduced as income rises. If the rate of reduction is slow, larger numbers become entitled, the cost of the scheme increases, and the level of benefit for each low paid individual must fall, reducing the incentive to work rather than remain unemployed. There are no easy solutions to these issues.

7. Changing the eligibility/work test

Some proposals have been made which suggest removing the requirement that individuals be prepared to take a job if offered one before they become entitled to benefit. Indeed, this is the main distinguishing characteristic of 'Basic Income Guarantees'. Such schemes will have ambiguous effects on work incentives.

## SECTION 5

The problems of low take-up of benefit, complexity, and confusion and delay in benefit payments when shifting in and out of the work force are serious and should be tackled. We should be moving towards more integrated benefit structures and more effective administration, and should be considering alternative methods of delivery.

The disincentive effects of social security are easily exaggerated. Where problems of this type do exist, the solution is rarely to reduce benefit levels, and far more likely to involve better training, assistance in job search, or improved childcare provision.

It seems to me that the work test should remain, but that this implies a great responsibility for the state in organising training and work experience programmes for the unemployed. I see little scope for moving to an individual based benefit system for those of working age.

All these conclusions must be seen to be provisional, and are certainly not universally accepted, but if some agreement can be reached on the issues we must discuss, a little progress will have been made.

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