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Why has the UK's social security system become so means-tested?

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Why has the UK's social security system become so means-tested?

Nicholas Timmins (The Institute for Government and The King's Fund)[1]

Introduction

Why indeed has the UK's social security system become so means-tested? After all, it was not designed to operate that way.

In answering this question, it is worth dividing the system into three broad sectors: benefits for adults of working age, for children, and for those receiving the state pension. Their histories have differed. And, in answering the question, it is necessary to go back to the founding document of Britain's modern welfare state, the Beveridge report of 1942.

Beveridge had a visceral dislike of means-tests, and he was far from alone. He and many in Britain remembered only too well the punitive household means-tests of the early 1930s where a grandparent in the same household qualifying for a pension, or child taking a paper round, could see benefit abolished or reduced.

These means-tests were seen to be demeaning. They penalised savings, and discouraged any step back into work short of a job sufficiently well paid to lift the entire household off 'the dole', as unemployment assistance was popularly known. The means-tests almost actively encouraged small-scale fraud – why declare a tiny amount of income when benefit could be reduced? – and it led to neighbours snitching on each other, bringing the 'means-test men' round if an unexpected new coat or pair of shoes appeared (Fraser, 1973, p. 180).

In his report, Beveridge says that the means-test is offered 'only on terms which make men unwilling to have recourse to it', and they 'penalise what people have come to regard as the duty and pleasure of thrift, of putting pennies away for a rainy day'.

Throughout the report, he is clear that the minimum benefits he proposes 'should be given as of right and without means-test, so that individuals may build freely upon it', and that 'no means-test of any kind can be applied to the benefits of the scheme'.

So what was the scheme?

A system of national insurance was the answer – one into which employers, employees and the state would all pay, the so-called tripartite system. Compared with what went before, Beveridge's 'cradle to grave' plan[2] was revolutionary in its scope. Even so, it essentially built on what had gone before, with the far from comprehensive schemes of health and unemployment insurance that existed before World War II. As he put it himself, '[t]he scheme proposed here is in some ways a revolution, but in more important ways it is a natural development from the past. It is a British revolution.'

Britain's initial forays into social insurance in the early part of the 20th century had been inspired by the schemes introduced in Germany by Otto von Bismarck in the late 19th century. But it is important to grasp that Beveridge's approach was very different to Bismarck's model – the one

1 Much thanks are due to Neil Couling at the Department for Work and Pensions and to the IFS panel for review.
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2 There was both a maternity grant and a funeral grant.

adopted not just in Germany but in other European countries as they too built their more modern welfare states.

The Bismarckian models were – and are – earnings-related. They typically involve earnings-related contributions (higher contributions from the better paid) in return for earnings-related benefits. Because the benefits are earnings-related, they do more, at least for a time, to preserve a claimant's income and thus, in a sense, their economic place in society, than the approach that Beveridge adopted. He went instead for flat-rate contributions in return for flat-rate benefits. Not only were those benefits not related to earnings, they were there to provide a minimum income, or, as he put it, a 'subsistence income' – even if that needed to be sufficiently large to be 'adequate to all normal needs, in duration and amount'.

He went for this for a variety of reasons.

He believed that what the British people wanted was a 'something for something' deal – that is, benefits in return for contributions rather than benefits funded out of general taxation – and that was, anyway, the history of the British approach to both unemployment and to the health insurance scheme that pre-dated the National Health Service (NHS). 'Benefits in return for contributions, rather than free allowances from the State, is what the people of Britain desire.'

But he also worried about work incentives, and the need for people to take responsibility for their own lives. 'The state in organising security should not stifle incentive, opportunity, responsibility; in establishing a national minimum, it should leave room and encouragement for voluntary action by each individual to provide more than the minimum for himself and his family.' He added that 'to give by compulsory insurance more than is needed for subsistence is an unnecessary interference with individual responsibilities' and that 'the gap between income during earning and during interruption of earning should be as large as possible for every man'. Hence, he took a minimalist rather than earnings-related approach. But implicit in this was that there should be no saving or asset rules in these contributory benefits. Saving should be encouraged.

Beveridge did acknowledge that this scheme was built for 'normal' cases (i.e. for those who had paid enough national insurance contributions). There would be 'abnormal' cases (i.e. those who had not paid enough contributions) for whom means-tested help – in the shape of what became national assistance – would still be needed. National assistance over the years turned into supplementary benefit, income support and what is now the lower end of universal credit. The numbers on this means-tested support (i.e. the number of abnormal cases) were intended to be – and, in the design, seemed likely to be – small. They would be small because, as a condition of making his scheme work, Beveridge assumed that governments would use the power of the state to pursue a policy of full employment. And indeed, for more than 20 years, with the odd short-term fluctuation, Britain did more or less enjoy full employment.[3]

So what Beveridge essentially built was a platform on which everybody could stand, with a safety net below it in the form of national assistance for those with insufficient contributions to qualify. But, unlike earnings-related systems, it was a platform down to which everyone, including the better off, would fall if they became unemployed or disabled.

Future critics were to see in this (i.e. the decision to adopt a minimum income, rather than an earnings-related one) a flaw in the design, perhaps the 'original sin' – the original reason, though many others were to follow, as to why the UK's system has become so means-tested.

Because these benefits were a minimum, they came to be pitched at a level little higher than the national assistance rates. And the national assistance rates could not be much lower or they would provide too little to live on: they would fail to 'abolish Want' (i.e. poverty) – with the abolition of Want being a primary goal of Beveridge's report. As a result, there was little in financial terms to make national insurance benefits more attractive. Their attraction lay in their being paid as of right, without a means-test.

[3] There never has been an official – a government – definition of 'full employment'. The Labour Chancellor of the Exchequer in 1951 told a United Nations' conference that Labour's definition was 3% unemployment at the seasonal peak. In practice, the odd bad winter aside, between 1945 and 1970 it averaged 1.8%.

As a result, and again in contrast to earnings-related systems, they seemed, at least psychologically, to offer less to the better off – who tended to be at lower risk of unemployment – than they did to people in lower-paid occupations who tended to be at higher risk of job loss, but for whom the gap between earnings and unemployment benefit would be smaller.

The better off – who might not unfairly be dubbed 'the middle classes' – were to see enormous gains from other parts of the modern welfare state introduced by the 1945 Labour government. They received free health care rather than doctor's bills, free secondary education for their children rather than school fees and, in time, tuition fees and maintenance grants for their children to go to university – and it was mainly their children who did.

Their stake in the social security system – which on its introduction, among other benefits, included a basic state pension, a universal maternity grant and a £20 universal grant that covered the cost of a minimal funeral[4] – was a lesser one than the stake held by the working class, who tended to be at greater risk of job loss. Overall, public support for social security – certainly as tracked by the British Social Attitudes Survey since 1983 – has never been as strong as it has for health and education.

It is worth mentioning that there were also a number of issues with which Beveridge struggled. The most significant was what he dubbed 'the problem of rent'. In the 1940s, just 26% of households were owner-occupiers. The mighty council house building programmes of the later 1940s and on into the 1960s were still to come – just 13% of households were council tenants. The remaining 60% or so were private renters. Surveys showed ten-fold differences in the rent for housing of the same size and quality. Should rent be paid in full for those on unemployment benefit? Or only for those in the means-tested safety net? What effect would that have on work incentives? And what to do about rent for pensioners? There were plenty of other issues in deciding how support for housing should be provided. Beveridge devotes nine pages to the problem before conceding he couldn't really solve it. He settled for a flat rate allowance within unemployment benefit, rather than one in any way related to the rent actually being paid. An attempt, as he put it, 'to make the best of a difficult situation'. The 'problem of rent' was to remain a problem for the entire history to date of the UK's social security system.

It is also worth noting that there was one great exception to the contribution-based model that Beveridge adopted – that is, family allowances.

Family allowances were one of Beveridge's three big assumptions that he said were needed to make his social security system work – the others being the policy of full employment and an NHS free at the point of use. To combat poverty ('Want') and at the same time provide work incentives, it was essential that children's benefits be paid at the same rate whether the parent was in or out of work. If only means-tested help was given for children, then the low-paid with large families would be better off out of work than working – unless benefit rates were to be set dangerously low. Equally, family allowances would help prevent poverty among the low paid. But while family allowances were paid – and paid out of general taxation – tax reliefs for those with children continued to exist alongside them; although, in the 1940s, a much smaller proportion of the working population paid income tax.[5]

So this, in essence, was the design of the UK's social security system – and this, in concept, is what was implemented, first by the wartime coalition (which introduced family allowances) and then, for most of the rest, by the Labour government of 1945.[6]

Two more points are worth making by way of introduction.

First, Beveridge's 'something for something' approach struck a chord so deep that one can still see its influence today. It has, as we shall see, long been in retreat in the social security system.

4 Both the maternity grant and the funeral grant became means-tested.

5 In 1949, for example, a married man with two children had to earn three-quarters of average earnings to pay any income tax.

6 There were other departures from Beveridge's plan not mentioned here, but this would be too much detail for this commentary.

But its echo plays on in the way politicians have notionally tied increases in national insurance to promised improvements in the NHS (Labour in the 2000s) and, currently, under the Conservatives, to planned changes in the funding of social care. Something may go up – national insurance contributions – but something will be received in return: improved care.

Against the 'something for something' approach, however, another sentiment has also run deep in British attitudes to social security – namely, the 19th century Poor Law's distinction between the 'deserving' and the 'underserving' poor. This is a distinction that can arguably be traced all the way back to the 1388 Statute of Cambridge, which drew a distinction between 'sturdy' beggars who would be expected to work and the 'impotent' infirm who were too old or who were otherwise incapable of being employed, and who would be supported. Today, the language tends to be less brutal, but politicians frequently make a distinction between 'hard-working families' and ill-defined others, in terms of who is deserving of support. Implicit in that is a worry about fraud – people claiming when they are not entitled – but also a fear that some who do not 'need' support are in fact able to claim it. These attitudes undoubtedly push the system towards conditionality – for example, that individuals should be actively seeking work in order to be able to claim – but they also provide a pressure towards means-testing. That is, the taxpayer, or the state, should only be supporting those who, for whatever reason, lack the means to support themselves.

The second introductory point in part reflects what has just been said. Namely that a reading of the Beveridge report is capable of persuading you that there is almost nothing new under the sun, as he sought to balance poverty prevention against individual responsibility, work incentives against decency, thrift (the incentive to save) against means-testing, and so on – almost all the arguments that have raged ever since. In other words, there are, and there always will be, inevitable trade-offs in any system of social security.

So what happened?

At this point, it makes sense to split the story between pensioner benefits and those for working-age adults and children.

Working-age adults

Initially, it all looked very good. Back in 1938, there had been 1.6 million claimants of means-tested benefits. The war had boosted employment and, in July 1948, when the new social security system kicked in, the figure was barely half that – 842,000 with most of those claiming small top-ups to insurance benefits.

But later analysis was to show, in the words of Brian Abel-Smith, that both the wartime coalition and the Labour government had fiddled the indices and the benefit rates actually set were nearly a third below those that Beveridge had recommended (Abel-Smith, 1992). Furthermore, as already noted – and by design – the national insurance benefits paid little more than national assistance. Unemployment benefit was paid for only a year – not indefinitely as Beveridge had recommended.[7]

Long-term unemployment was at first relatively rare, but it did see some fall back on the means-tested safety net. And the Labour government's answer to 'the problem of rent' was to pay it for those in the safety net but not for those on the contribution-based benefits. In addition, the benefits were not initially indexed to rise with inflation. They were merely subject to a review every five years.[8] This was done inconsistently, so that over the years at times the national insurance benefits were worth a little more than national assistance, at others less. When they were less, more people ended up on the means-tested benefits. The state pension (we will come to pensions) was also set low, with more people than originally assumed needing national assistance to top it up. By 1954, the National Assistance Board had 1.8 million on its books, though the majority were pensioners.

[7] While recommending that unemployment benefit should be paid indefinitely, Beveridge also recommend that after six months those receiving it should attend training centres: the concept of 'welfare-to-work' that was only introduced at real scale in the early 2000s.

[8] Annual upratings did not arrive until the 1970s.

And then society changed – changing in ways that, to be fair, Beveridge could not have entirely foreseen. With those changes came, so to speak, fresh needs. Starting slowly, but then accelerating from the early 1970s onwards, both the absolute numbers of divorces and the divorce rate rose, and, over a similar period, more women had children on their own. The result was a large rise in lone parenthood – and neither of those factors was, by definition, insurable.

In 1971, around 8% of households were headed by a lone parent, a figure that rose to 24% by 1998, since when the proportion has, broadly speaking, stabilised. Many of these households, of course, worked. But the proportion that did so was lower than in the rest of the working-age population. In the late 1970s, barely half of lone parents worked and that proportion fell to not much over 40% during much of the 1990s, before rising appreciably more recently. The result was greater reliance on the means-tested safety net.[9]

In addition, again slowly but again advancing, came the ability of medics to keep alive children who in earlier times would have died at birth or shortly afterwards. Many of these children went on to live fulfilling lives but some of them were left with ongoing disability and, for a proportion of those, their disabilities were sufficiently severe that they would not be able to work – and thus not pay national insurance contributions.

The history of disability benefits post-1948 is long and decidedly complex. For these purposes, it is sufficient to say that in 1948 there was the industrial injury scheme, and the war disability pensions, but little else. Starting mainly in the 1960s, however, the extra costs for those not covered by these schemes – people with disabilities from birth, people injured in accidents other than industrial ones, or people with conditions such as multiple sclerosis – began to be recognised, along with the costs of disability more generally. This led not only to a growth in national insurance-based contributory schemes, which paid a higher rate than unemployment benefit, and a rise in non-contributory, non-means-tested disability benefits, but also to a rise in means-tested disability benefits, either as a separate benefit, or as additions to supplementary benefit and income support. To give some idea of the scale, in constant prices, the cost of means-tested benefits for people with disabilities rose from roughly £500 million in 1974 to just over £3 billion by the end of the 1990s.

Means-testing also rose because 'the problem of rent' would not go away – and because housing policy changed. Immediately after World War II, through the 1950s, 1960s and even into the 1970s, there were large, and heavily subsidised, council house building programmes. The subsidy produced low rent for tenants – what came in time to be called 'social rents'. Step by step, however, the building subsidy was reduced – so rents went up. Councils provided rent rebates (and indeed rebates for rates, which are now the council tax). In time, these went not just to those in the safety net but to people in low-paid work – although different means-tests were applied to those in work than to those on supplementary benefit. This produced a somewhat complicated mess. It was solved in the 1980s by the introduction of housing benefit (now part of universal credit), which, in effect, completed the switch from bricks and mortar subsidies to subsidies for individual rent. And those rent subsidies in the shape of housing benefit increased the scale of means-tested benefits, paid to those in work as well as out of it.

This brings us to the increase of means-tested benefits in work. In 1965, a re-examination of the benefit and income statistics, by Brian Abel-Smith and Peter Townsend in *The Poor and the Poorest*, made it clear that, despite family allowances, there were more than a million children living in families where the family was in work but on an income lower than they would have received on benefits (Abel-Smith and Townsend, 1965). In-work poverty became a burning political issue. After much debate (the debate including whether to create what eventually became child benefit), this was initially addressed in 1971 with the creation of family income supplement (FIS), the first means-tested in-work benefit (other than rent and rate rebates) for those on low pay. It was originally introduced as a 'temporary' measure. Initially, the numbers were tiny. Some 160,000 families stood to benefit but initially under half that number did (the take-up of means-tested benefits tends always to be lower than those of contributory and non-contributory benefits, because, the critics maintain, of stigma).

[9] Employment rates amongst lone parents have since risen markedly, to 68% in 2017, compared to 85% of households of working age where someone is in work.

The numbers on FIS grew from 71,000 individuals to around 200,000 by the mid-1980s. Even so, in-work poverty for families remained a problem and, in 1988, FIS was re-cast into the more generous family credit with, by 1999, some 780,000 families receiving it. Three factors drove the growth: increased generosity, gradually higher take-up and a growth in the eligible population, particularly single parents (Dilnot and McCrae, 1999).

In addition, starting in the 1980s but accelerating thereafter, came the twin pressures of newer technologies – most notably, the rise in computing power – and globalisation. The two combined saw some essentially white-collar jobs (filing clerks and typists, for example) displaced by technology, while others, both blue collar and white collar and in manufacturing in particular, were displaced by newer technologies and/or exported to rising economies where labour costs were lower. The result was pressure on the amounts paid in a wide range of lower- to middle-paying occupations. And with that came a slow but progressive realisation across the political parties that rather than pay benefits to people chiefly on the condition that they did *not* work,[10] it would be better to use some of that money to support people to be *in* work – measures that went well beyond the relatively limited support from FIS and family credit, and which came with a series of 'welfare-to-work' programmes to help, encourage and, indeed, drive people into work.

The result, starting in the late 1990s but chiefly in the 2000s, was the arrival of tax credits. These in time became a child tax credit (and see the following section for more details on children) and one for adults in lower-paid work (i.e. the working tax credit). These were much more generous than family credit, so they went higher up the income scale and thus put more in-work people on means-tested benefits – and, unlike family credit, those in low-paid work without children could qualify for the working tax credit. Their numbers were relatively small in relation to the total but, by 2010, for example, those without children receiving working tax credit numbered more than 500,000, against the 780,000 receiving the in-work family credit in 1999. Around 1.4 million out-of-work families were receiving the child tax credit, but some 4.8 million families with children were receiving both child tax credit and working tax credit. They were in work but receiving means-tested benefits. And the numbers were huge compared to the 71,000 who received FIS in its first year.

In other words, in the drive to protect the living standards of those in lower-paid work, the UK social security became increasingly reliant on means-tested benefits – quite aside from any fluctuations in means-tested support as unemployment rose and fell with the economic cycle over the years. Most recently, most in-work and out-of-work means-tested support has been combined into universal credit.

Children

So far in this account, children have been both implicit and explicit. But to understand the rise in means-testing, the benefits that support them are worth describing in a little more detail. As already noted, the post-1945 welfare state introduced family allowances. These were initially highly popular, although for most of their existence they were paid only for the second and subsequent child.[11] But they were never indexed – rising automatically with inflation. This reduced public support for them, and they existed alongside tax allowances for children. The tax and family allowance rules differed, producing essentially indefensible anomalies in the support that children in different families received. So after a long battle, and between 1977 and 1979, the two were merged into child benefit. This was a non-contributory universal benefit for all children – in effect, a recognition by the state that it had a long-term interest in the support and development of all children, regardless of background or parents' income.

The real-terms value of child benefit fluctuated over the years. However, in 1999, the then Labour government wanted to put in more support for children – Tony Blair, the Prime Minister, having promised to abolish child poverty in a generation.[12] It was decided to target the money towards those children who were 'in poverty'. So, rather than a huge increase in the universal child benefit, the child tax credit, detailed above, was introduced. This was initially so generous that it went to nine out of ten families with children, although that generosity has since been substantially

[10] The condition that people *should not work* in order to be able to claim many benefits was there to prevent fraud. It was possible to earn tiny amounts, but only very tiny amounts, while claiming unemployment and disability benefits.

[11] The rules around whether or not the first child was covered fluctuated over the years.

[12] 'Our historic aim will be for ours to be the first generation to end child poverty' (Blair, 1999).

reduced.[13] Nonetheless, it contributed to making the UK's social security more means-tested, both in and out of work.

And then, in a remarkably clunky reform, and effective from 2013, child benefit became means-tested at the top end, so to speak, as part of the austerity measures in the wake of the 2008 financial crash. It was withdrawn from families where either partner has an annual income above £50,000 a year. This affected one in eight families. The £50,000 threshold has not changed since, with the effect that by 2022 more than one in five families will lose at least some of their child benefit (Emmerson, Joyce and Waters, 2019). In addition, since 2017, child tax credit is paid, with a few exceptions, only for the first two children. The exceptions include multiple births or a child that is the product of rape.

In broad summary, therefore, child support became initially less means-tested, but then more so.

Contributory, or national insurance, benefits

As noted at the outset, contributory benefits were the – somewhat soft, as it turned out – bedrock on which the UK's modern social security system was built. But, aside from the rise in means-testing for other reasons that are set out above, contributory benefits suffered a decline all of their own.

As John Hills (2003) nicely put it many years ago, '[a]sked why Denmark was so much smaller than it used to be historically, a Danish friend replied that, "you have to understand – we lost fifteen battles in a row". The story is the same for British National Insurance – except that it has lost a lot more than fifteen battles since 1948.'

The decline occurred, as Hills explains, because the two main governing parties both undermined contributory benefits – though for differing reasons. Broadly speaking, Labour wanted to make benefits more inclusive. So it boosted non-contributory benefits and tended to soften the contribution conditions for the contributory benefits. For example, one can these days be 'credited in' for the state pension – as if one had paid national insurance contributions – if one is ill, disabled, on maternity pay, or on carer's allowance.[14] This weakened the link between contributions paid and benefits received.

By contrast, Conservative governments tended to target resources on the least well off by means-testing contributory benefits, taxing some that were initially tax-free, and by reducing their scope. It should be said that these were the parties' tendencies. In practice, each did a bit of both over the years.

So, purely by way of example, in 1966 some earnings-related additions were made to unemployment and sickness benefit (a departure from Beveridge's flat rate system) – the aim being to encourage labour mobility. However, earnings-related unemployment benefit was abolished in the 1980s, and short-term sickness benefit was returned to being not just flat rate but taxable – at a time when responsibility for it was transferred to employers. During the 1980s, other contribution conditions were tightened, and national insurance benefits tended to become less generous, with the flat rate unemployment benefit becoming taxable. In 1995, the national insurance-based invalidity benefit was replaced by incapacity benefit, which came with a tougher medical test and was made taxable. In 1996, jobseeker's allowance replaced unemployment benefit. The contributory version was paid for only six months, not the year that had applied to unemployment benefit, and tighter job search conditions were attached. As national insurance-based widow's benefit became extended to widowers, and then became the bereavement support payment, its value was cut. In the 2000s, incapacity benefit became partly means-tested and was then replaced by the current employment and support allowance, only one element of which is based on national insurance. The list could go on.

13 Currently, it is around five out of ten.

14 See the UK government's webpage on national insurance credits, https://www.gov.uk/national-insurance-credits/eligibility.

All of this downgraded the role of contributory benefits and weakened the link between contributions paid and benefits received – with the link having always been something of a myth. There is no 'national insurance fund' in the sense of an invested one into which contributions are paid and related benefits earnt are then paid out. The fund has always been a 'pay-as-you-go' system – the money raised being used to pay this year's benefits on an annualised basis – with the fund, at times, paying for other parts of public expenditure and, at other times, having to be nominally topped up from more general taxation.

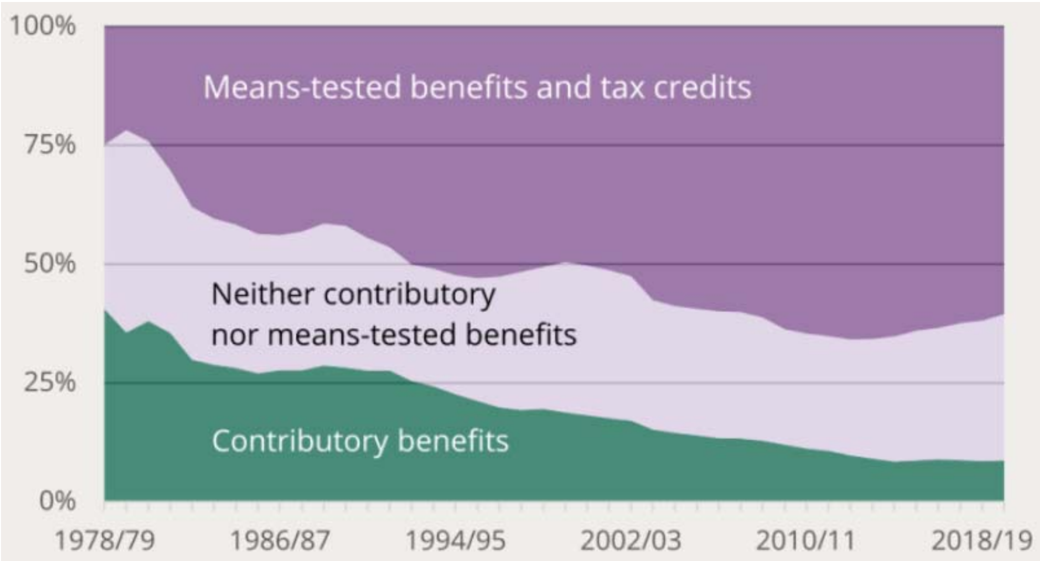
Furthermore, it is probably fair to say that the UK's huge increase in income inequality since the late 1970s has made it harder to defend, let alone extend, universal benefits on the ground that their critics always used against them – that, to put it very crudely, the rich do not need them.[15]

What has been the effect of all this?

The long-run effect (with some ups and downs on the way) has been an increasing reliance on means-tests, both in and out of work. The key factors are: a flat rate system with little difference in monetary terms between means-tested benefits and contributory unemployment benefits; societal changes that could not be addressed by insurance benefits; greater recognition of the costs of disability, not all of which could be addressed on a contributory basis; continuing problems with how to handle housing support within social security; a reluctance to maintain non-contributory children's benefits; a rise of in-work support in the face of technological and globalisation challenges; and a long-run downgrading of contributory benefits in terms both of value and the conditions attached to their receipt.

The net effect on working-age benefits is neatly illustrated by Figure 1.

Figure 1. Contributory benefits' share of non-pensioner welfare spending has fallen: benefit and tax credit expenditure directed at working-age adults and children, 1978–79 to 2019–20



Source: DWP Benefit expenditure and caseload tables 2019; figure taken from 'Contributory benefits and social insurance in the UK', House of Commons Library, https://commonslibrary.parliament.uk/contributory-benefits-and-social-insurance-in-the-uk/.

Finally, before turning to pensions, it might just be worth turning the question round and asking why – given all these pressures – a limited range of working-age national insurance benefits have in fact survived? The answer lies in part because 'something for something' does linger on – in

[15] Even before the Beveridge report was published, the wartime Chancellor Kingsley Wood observed that '[t]he weekly progress of the millionaire to the post office for his old age pension would have an element of farce for the fact that the pension is provided in large measure by the general taxpayer'.

part (as we will come to later) because there remain advantages in them to the recipients, and in part also, perhaps, because of the European Union (EU). The issues are immensely complex. But to put it at its simplest, the EU does not seek 'harmonisation' of social security benefits – the systems of individual countries are too diverse, and too rooted in culture and national preference, for that. However, as a means of supporting free movement of labour, the EU has long implemented a degree of 'co-ordination' that has mainly covered insurance benefits as opposed to means-tested or subsistence benefits – those that are dubbed 'social assistance' in EU parlance. When universal credit was being devised in 2010, the EU was updating its regulations on insurance benefits[16] and there was a perceived risk that if contributory-based jobseeker's allowance and employment and support allowance were also rolled into universal credit (i.e. the UK more or less ceased to have working-age insurance benefits), then in time universal credit might itself become an exportable benefit – creating a high and uncertain bill for the UK.

State pensions

If that is the picture for working-age benefits, what about the state pension? The short answer is that, today, the picture is very different. But it has been a roller-coaster ride to get here when, at one point, projections suggested that 70% of the population could end up on means-tested pensions in the future.

Beveridge's original proposal was for a national insurance-funded state pension into which people would pay, phased in over 20 years in two-year instalments as individuals gradually built up their entitlement to its full value – that is, something closer to a properly funded state pension. In the aftermath of World War II, with memories of the great depression of the 1930s fresh and with survivors of World War I reaching pension age, this proved politically impossible. So the basic state pension was paid in full from the start, with national insurance contributions going into the 'pay-as-you-go' annualised scheme outlined above.

But, as with national assistance, neither the national insurance pension nor the means-tested safety-net pension were linked to annually rising prices. Both were irregularly reviewed, at times one being higher than the other and at times the other way round. The 1950s saw a huge rise in occupational pensions – pensions funded by employers, with or without employee contributions – not least because the trade unions, whose penetration of the workforce was far higher than it is now, campaigned hard for them as 'deferred pay'. From 1.8 million people being members of such schemes in 1936, the figure had risen to 8 million – a third of the workforce – by 1956, and was eventually to rise to 40% (although only 40%). This led to the charge that two nations were being created in old age: those reliant only on the basic state pension, which was set at a minimal rate, and those with an occupational pension on top, with those occupational pensions, as they developed, becoming more earnings-related.

The pressure rose for an earnings-related state pension – something very different to Beveridge's flat rate one. The history is tortuous, but it culminated with legislation in 1975 for the state earnings related pension scheme, otherwise known as SERPS. It aimed, when fully mature, to pay out two-thirds of average earnings. This was the UK's one big attempt at earnings-related benefits, aside from the relatively short-lived additions to unemployment benefit, sickness and widows benefits already referred to. Employers and their employees were allowed to contract out of paying higher national insurance contributions to fund this state scheme, as long as the employer provided a broadly equivalent pension. Its memory lingers on in the higher state pensions that those employees who did contribute now receive once they have passed state pension age.

Around the same time, the basic state pension acquired proper indexation, rising at the higher of prices or earnings. Both of these reforms proved short-lived. In 1980, the basic state pension was linked only to the rise in prices not earnings – and earnings tend to rise faster. As for SERPS (and there is an argument that its future costs were seriously underestimated at the time), its value was halved in the 1980s and halved again in the 1990s. It was replaced in the 2000s with the less

[16] See the European Commission's webpage on EU social security coordination at https://ec.europa.eu/social/main.jsp?catId=849; see also the webpage on Regulation (EC) No 883/2004 at https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX%3A32004R0883.

far-reaching, and even shorter lived, state second pension. This was more generous to the lower paid than what remained of SERPS, but much less generous to the higher paid. It encouraged them to opt out into private pensions by, somewhat ironically in this context, providing flat rate benefits in return for earnings-related contributions.

By then, the 1980 decision to link the basic state pension only to prices was coming home to roost. Its value had fallen relative to the means-tested pension, which received repeated boosts as pensioner poverty remained a continuing issue. The history is again tortuous. But, in the 2000s, the then Labour government eventually introduced the much more generous means-tested pension credit, which did much to tackle pensioner poverty. With the basic state pension still linked only to prices, however, its value was withering away compared to earnings, and thus to the living standards of the working population. It paid out less than the pension credit, with growing numbers receiving the state pension also qualifying for pension credit in order to top up their basic pension. So a fresh problem emerged. As an independent government appointed body, the Pensions Provision Group, pointed out, if these policies continued unchanged, by 2050 some 70% of pensioners would be reliant on the pension credit: producing an awesome combination of a big benefits bill but little incentive to save for old age.

So, at this point, the UK's social security system was heading towards a future in which the pension system would become even more means-tested than the working-age system has become.

To cut a long story short, this unholy mess was rescued by the Pensions Commission, which in 2005 recommended that in return for a progressively later state pension age, the basic state pension should be rebuilt, with a private earnings-related element added on by automatically enrolling employees, with an employer contribution, into low-cost private schemes.

It took more than a dozen years to implement this in full, with some additional changes being made in the 2010s, although those are still not fully completed. These effectively roll the second state pension back into a more generous, and single, basic state pension, paid at a later age – one that will not be means-tested, thus providing a platform on which additional private pension saving can again be built in the almost certain knowledge that the benefit of doing that will not be means-tested away. In a sense (though it is not fully funded), this is the one bit of the social security system that has 'gone back to Beveridge': a flat rate pension paid at a level that does provide a minimum income, off the back of which people can build private saving. It is currently being uprated by the higher of prices, earnings or 2.5%. This uprating formula will at some point have to change (at least in the view of this author), given that it guarantees, over the long term, that those reliant only on the state pension will do better in relative terms than those of working age.

It is still, nominally, a contributory benefit, but the numbers of years for which both men and women have to contribute have yo-yoed up and down over the past couple of decades. At one point, men needed to have paid national insurance contributions for 47 years to qualify in full; women slightly fewer. The rules, it should be said, are not simple. But, these days, individuals need a minimum of 10 years contributions, and 35 years for those whose contribution record started after April 2016. However, individuals can be 'credited in' (i.e. assumed to have paid in even though they have not parted with the cash) for a wide range of reasons, including being unemployed, ill, disabled, a parent or carer.[17] In future, it will not be impossible, but it will be quite hard, not to qualify. Indeed, the basic state pension is heading towards being a universal basic income for those past state pension age.

A summary of the argument so far

Pensions, at least in recent years, are the great exception to the general rule that the UK's social security system has become increasingly means-tested. Why has it become so? A whole range of factors include:

[17] See https://www.gov.uk/new-state-pension.

- its original flat rate nature, which meant that it was less valuable to 'the middle classes', and thus less valued by them, than an earnings-related system;

- the rise in divorce and in lone parenthood more generally, even if the rate of the former has declined and the latter stabilised;

- the increase (for entirely honourable reasons) in disability benefits, some of which are non-contributory and some contributory, but with others being means-tested and with greater conditionality being attached to the contributory ones;

- the relegation over time of the importance – and value – of working-age contributory benefits by governments of all colours, though from different motives;

- decisions to put more means-tested – more targeted – money into child support, rather than raising the universal child benefit, which itself has become means-tested;

- the switch to using less of the social security money to pay people on condition they do not work, and more to supporting them to be in low-paid work, with that being accompanied by more 'welfare to work' measures to get them into work.

The UK's widening income inequality has probably also made it harder to defend, let alone extend, the more universal and contributory cash benefits. Most notably, in the case of the state pension (when it was becoming increasingly means-tested), one of the past arguments against national insurance-based contributory benefits was that the 'better off' do not really need them. They can make their own private provision, either individually or with support from an employer. As income inequality widened, this argument appeared more powerful, although, as we have seen, it was defeated in the case of the state pension by the argument that over-reliance on means-tested state pensions (as was becoming the case in the early 2000s) would discourage private pension saving. It made sense to provide a platform on which people could build private saving without the risk that they would see the benefit of that saving being means-tested away (unless, of course, government policy changed yet again). However, against that, child benefit has become means-tested through the tax system for higher earnings, and while that was essentially done purely as a money-saving measure, the argument that better-off families do not 'need' child benefit played a part.

So is there a case for change?

The answer to that question goes far wider than whether there is a case for rebuilding the contributory system. It hinges in part on whether there is a decision to merge national insurance and income tax. As already noted, without disappearing entirely, the link between national contributions paid and benefit received has become progressively weaker over the years. This has led plenty of academics and think-tanks to argue that there is a case for combining and rationalising the two. There has, however, perhaps unsurprisingly, been remarkably little political support for this, given that it would expose the true degree of individual taxation. Just by way of example, someone paying standard rate income tax at 20% in fact currently pays 32% on much of their taxable income once national insurance is added in. Combining the two would be a decidedly complex operation (the thresholds for the two taxes differ and employers as well as employees pay national insurance contributions), but were this to happen, the link between employee contributions and national insurance benefits would disappear.

Equally, the case has been made that national insurance should be turned into a largely hypothecated tax for health, or for health and social care combined. Again, were that to happen, the remaining links between contributions paid and benefit received would be broken (or, as in the previous proposition, they would have to be recast in some way). Among the propositions for merging income tax and national insurance, there have been suggestions that employer contributions could be turned into a 'pay roll' tax to cover the cost of contribution-based jobseeker's allowance (JSA), employment and support allowance (ESA) and maternity pay.[18]

Assuming neither of those happens, is there a case for change? For working-age benefits, the case has been made both ways: on the one hand, for abolishing the contribution-based versions of JSA and ESA; on the other, for rebuilding the contributory system.

The case for abolition has, in the past, included the argument that unemployment benefits should be privatised, even if that has never really been a runner.[19] More recently, particularly since the arrival of universal credit, the argument has been that contributory JSA and ESA increasingly look like an anachronism, given the shift to a much more means-tested approach. They are administratively untidy. Separate machinery has to remain in place to pay them. It would be simpler, cheaper and tidier to abolish them.

Against that, others have made the case for rebuilding the contributory system, although the propositions vary in scale and scope, not least because the 'something for something' proposition is seen still to have public appeal (see Bell and Gaffney, 2012).[20]

Prior to the COVID-19 pandemic, the contributory and non-contributory versions of JSA and ESA have, for many years, been paid at the same level of benefit. The picture is very different in many other OECD countries in which the benefit system is earnings-related. On average across the OECD, the income someone will receive if made redundant is substantially higher if they have an adequate contribution history than if they do not.

Table 1. Replacement rates for different family types for workers on average earnings, 2018

	UK	OECD average	
		Without contributory benefits	With contributory benefits
Single, no children	0.13	0.20	0.55
Single, two children	0.35	0.40	0.66
Couple, no children	0.20	0.31	0.57
Couple, two children	0.41	0.47	0.66

Note: Based on a family with one worker paid average earnings. 'With contributory benefits' shows what replacement rates would be for a worker receiving unemployment benefit who is aged 40 and has worked uninterrupted since age 19. All figures relate to the second month of unemployment. Ignores housing benefits. Children are 4 and 6 years old. The OECD average is measured across 36 OECD countries (Turkey is excluded because of lack of data availability). The replacement rate measures out-of-work income as a share of in-work income.

Source: Table taken from Bourquin and Waters (2020). Their calculations using OECD.Stat.

[18] See, for example, Martin (2010).

[19] See, for example, the article by N. Timmins, 'Contract with Britain?: Rolling back the state: the how, where and why', *The Independent*, 17 July 1996, https://www.independent.co.uk/news/contract-with-britain-rolling-back-the-state-the-how-where-and-why-1329187.html; the transcript of the RAB Butler memorial lecture on the Welfare State given by the Rt Hon Peter Lilley MP, https://www.theguardian.com/politics/1999/apr/20/conservatives; and Yarrow (2002).

[20] See also the Women's Budget Group submission to the Labour National Policy Forum: Rebuilding a just social security system, 2019, https://wbg.org.uk/wp-content/uploads/2019/08/Social-security-WBG-submission-to-Labour-NPF-June-2019.pdf.

Table 1 shows, for example, that a lone parent with two children on average earnings and a couple with two children receive for a time 66% of their previous wage, on average, in OECD countries, compared to 35% and 41%, respectively, in the UK. Even for those without a contribution record, the OECD average is more generous. Furthermore, there is also an argument that these lower levels of benefit leave the UK with greater long-term 'scarring' effects from recessions (OECD, 2014).

For 18 months during the pandemic, an extra £20 per week or £1,040 per year was put into universal credit as an emergency uplift, but this increase was not applied to contributory JSA and ESA, a relative disadvantage for those who paid their national insurance contributions. The temporary £20 per week uplift has since been removed, with about a third of what it was costing being retained by reducing the rate at which the benefit is withdrawn as earnings rise.

Even so, the contributory versions of JSA and ESA still offer advantages to those able to claim them. In universal credit, household – not individual – savings of more than £16,000 debar a claim; even below that, benefit is reduced to allow for savings until it is only paid in full once they have fallen to £6,000. Contributory JSA and the work-related portion of contributory ESA are individual, not household, benefits, and savings are not taken into account. Thus, they allow a working partner to carry on earning without the household's income becoming subject to a means test. As a result, they provide a better cushion against job loss for the individual, and for the family if they have one. It is also argued that, in turn, this is likely to be good for the economy as people may well reduce short-term expenditure by less than would be the case if they relied purely on means-tested benefits.

It would be expensive to create a much more generous earnings-related benefit system on the lines typical in many other European countries. It would require either appreciably higher national insurance contributions or higher general taxation.[21] There will be differing political views on how desirable this would be, and on the public's appetite for it. But it is worth noting that since at least the 1970s, the main political parties have rarely offered significant tax increases in their general election manifestos and have failed to form a government when they have done so.[22]

There is, however, a good case for making the out-of-work benefit system more generous overall, and for preserving what remains of the contributory system. Prior to the pandemic, many benefit rates had fallen in relation to average earnings, and in the near decade of austerity that followed the financial crash some had reached historic lows in real terms. Here is not the place to discuss detailed benefit rates. But, as one element of the means-tested benefit system, it is worth noting that, while relatively few individuals have significant savings, the £16,000 savings limit that debars claims for universal credit has not been increased since 2006 and would be approaching £25,000 by now if it had matched the rise in prices.

For the reasons advanced above – that is, enhanced protection for individuals and families from the financial effects of job loss, and a reduced impact on spending in the economy generally – there is also a case for preserving and at least modestly enhancing what remains of the contributory benefit system. In the past, means-tested benefits tended to be paid at higher rates for those out of work longest, on the grounds that while people can get by for a time without new shoes or a new coat or replacement white goods, those costs mount over time. To some extent, this has been addressed for those who qualify for the 'support' group in ESA – in other words, those whose level of disability means that it is deemed unreasonable to apply any requirement for them to seek or take work. The 'support' group in ESA is paid at a higher rate, is not time limited, and does not have work-search conditions attached to it.

The proposition would be that contributory JSA should not be paid at a lower rate than its means-tested equivalent in universal credit, as happened during the pandemic. It should revert to being paid for a year, not for just for six months, which would bring it into line with the work-related activity group in ESA. Ideally, it should be paid at a higher rate so that individuals receive a higher return for the contributions they have paid.

[21] Earnings-related benefit expenditure and higher health spending are two of the key reasons why many European countries have higher levels of public expenditure than the UK.

[22] Although there will, of course, be many other reasons why general elections are won or lost.

These are very modest proposals. The drift towards greater means-testing would also be slowed if, as with the universal credit savings rule, a number of similar thresholds – for example, the household benefit cap, the child benefit withdrawal point, local housing allowances and, indeed, the means-test for social care (where there are propositions for reform) – were to be brought up to date (i.e. to allow for past inflation) and were to be indexed thereafter. The repeated failure to do that gradually pulls more people into means-testing.

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