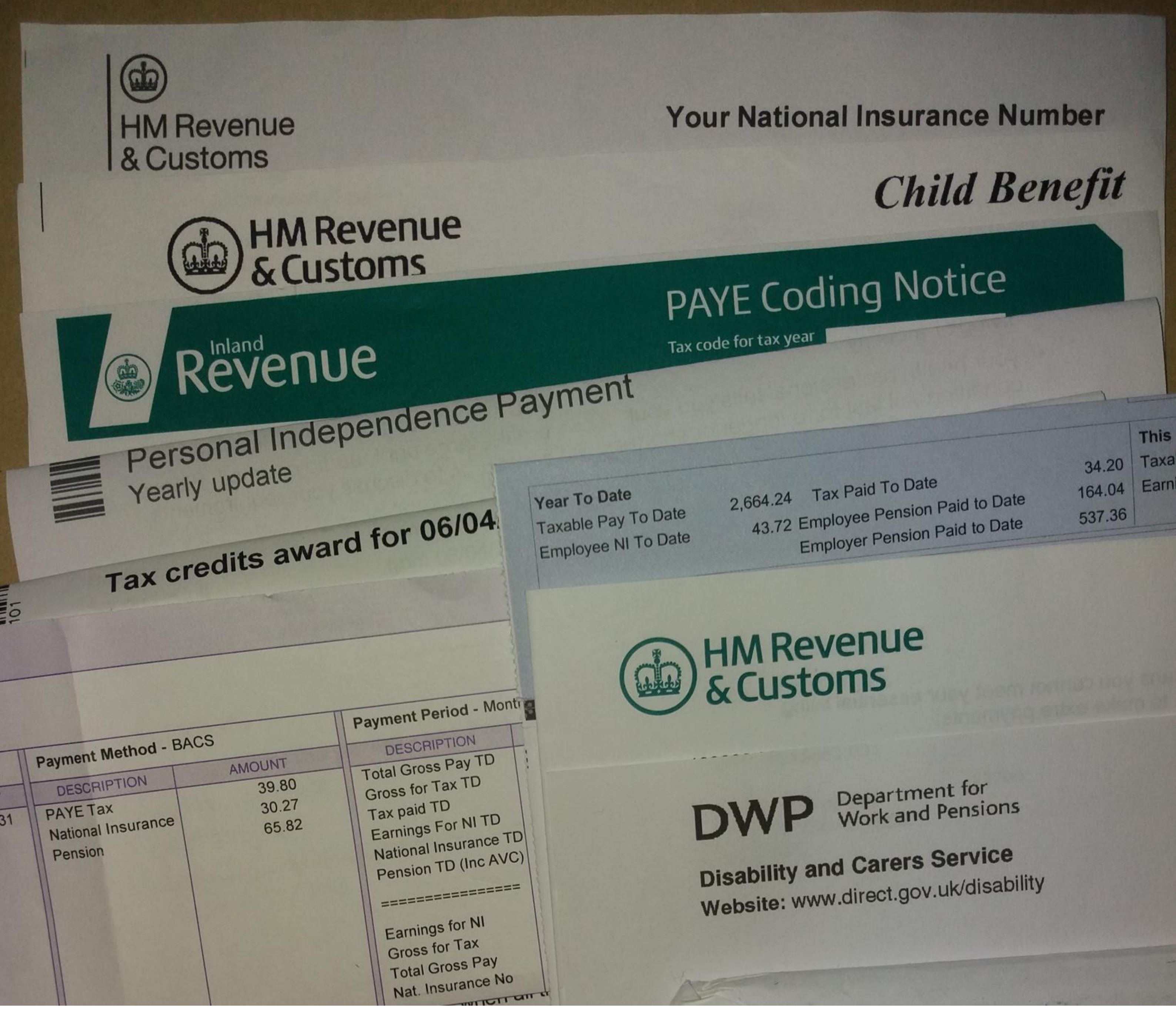

Discussion Brief 2023#5

The Future of the Welfare State

CPF Discussion Briefs exist to stimulate debate. They do not necessarily represent the views of the Conservative Party.

CPF
Conservative Policy Forum

Contents

Dear Colleagues,

2023#5 The Future of the Welfare State

Thank you to everybody who submitted a response to our consultation on the future of transportation. This briefing paper is the third in our series of consultations looking beyond the short-term political horizon to the future.

Make sure that your Conservative Association or Federation has a date in the diary to be a part of this forward-looking agenda—and, as usual, be sure to invite as many members and supporters as possible. Please send your responses to the questions in this briefing paper to CPF.Papers@conservatives.com, using the associated response form published alongside the paper on the CPF website. The deadline for submitting your response is 14th January 2024. We aim to publish our next discussion paper on 15th January, in which we anticipate looking ahead to the general election.

We look forward to hearing your views,

The CPF Management Team

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The challenge ahead

"Lloyd George and the Liberals introduced the old age pension. Attlee and Labour brought in comprehensive National Insurance. Margaret Thatcher's government introduced Family Credit. So it would be wrong to see there being a single moment in history, under a single party, when the current welfare system sparked into being – and of course there will never be a point in the future when the job is done and no further reform is needed." (From welfare state to welfare system, 16 November 2016)[1]

"Changes in the way we think about the welfare state have eroded our understanding of its mutuality – our understanding of it as a shared insurance pool to which we all contribute through our taxes and contributions and which we can all draw from when we are old or face the additional costs of children."
(David Willetts, 1 July 2016)[2]

"There remain over 2.5 million people who are inactive because of long-term sickness and disability. ... the proportion of people going through a work capability assessment who are being given the highest level of award and deemed to have no work-related requirements at all has risen from 21% in 2011 to 65% last year."
(Mel Stride, Work and Pensions Secretary, 5 September 2023)[3]

N.B. Significant aspects of social security policy are reserved in Great Britain. Largely equivalent welfare provision is available in Northern Ireland, whereas the devolution of some social security powers to Scotland since 2016 has substantially altered the structure of welfare provision in the UK. For details, see the Commons Library report "An introduction to social security in the UK".[4]

Just over half (51%) of families in the UK received a type of state support in the three years to March 2021.[5] Nearly half of all state welfare spending is on people of pension age (47.8% in 2021/22), most of this being accounted for by state pensions. The next largest proportion is spent on working-age benefits such as Universal Credit (30.9%). In July 2023, the number of people claiming Universal Credit stood at a record 6.1 million, including 2.1 million with 'no work requirements'.[6] Disability benefits and Child Benefit account for 10.7% and 4.7% of state welfare spending, respectively.[7] (See Charts 1 and 2).

Several factors mean that the number of pensioners is expected to continue increasing relative to the number of people in work. These include people living to older ages, women having fewer children, young people staying in education for longer and increasing numbers of 50-64 year-olds deciding to retire early.

- The number of people aged 65 years and over increased from 9.2 million in 2011 to over 11 million in 2021. The proportion aged 65 years and over rose from 16.4% to 18.6%.[8]
- By 2042, a quarter (24%) of people in the UK are expected to be aged 65 or older.[9]
- One-in-forty (2.5%) older people were living in care homes in 2021. In addition, there were almost 1.2 million unpaid carers aged 65 years and over in England and Wales, just over 1 in 10 of the older population.[8]
- The average fertility rate has been below 2.0 children per woman since 1973. In 2021, the average number of children per woman stood at 1.61.[10] (See Charts 3 and 4).

The current UK state pension age of 66 for both men and women is higher than the average for developed economies.[11] It is legislated to rise to 67 between 2026 and 2028 and to 68 between 2044 and 2046.[12] Despite this, as the House of Lords Economic Affairs Committee has observed, "The UK stands out among developed economies in having a growing inactivity rate and not reverting to its pre-pandemic trend" and "The biggest contributor to this change has been an increase in early retirement." As the Lords' report cautions, this all "damages growth in the near term" and "reduces the revenues available to finance public services while demand for those services will grow."[13] (See Charts 5 and 6. Also see the Appendix for a reminder about the differences between public and private sector pensions, discussed by CPF Groups in summer 2022.)

Questions for discussion

1. How might we adjust the balance between supporting vulnerable individuals and families and encouraging personal responsibility—encouraging people to work and to save for their own financial wellbeing, while still helping households with children and providing a safety net for those in genuine need?
2. What measures could be taken to streamline and simplify the welfare system, reducing bureaucracy and administrative costs while ensuring those in genuine need receive timely support?
3. In the context of an aging population and decreasing fertility rates, how might government address the sustainability of pension and elderly care provisions within the welfare system, ensuring they remain affordable and efficient?
4. What more can we do to help those who are economically inactive return to the workplace? How could we further incentivise work and entrepreneurship among welfare recipients and early retirees to support job creation and economic growth in the UK?
5. Is there any other observation you would like to make?

Key dates in the development of Britain's state welfare system

1909: Child Tax Allowance introduced for taxpayers earning under £500 a year; and Old Age Pensions introduced for British subjects of a "good character", aged at least 70, and with an annual income no greater than £31 10s.

1911: The National Insurance Act introduced two independent contributory schemes of health and unemployment insurance.

1925: The Contributory Pensions Act set up a contributory state scheme for manual workers and others earning up to £250 a year.

1945: The Family Allowances Act created a child benefit.

1946: The National Insurance Act introduced a contributory state pension for all.

1948: National Assistance formally replaced the Poor Law system, originally established in the 1500s.

1966: Supplementary Benefit replaced National Assistance.

1977: Child Benefit replaced the Family Allowance and the Child Tax Allowance.

1978: State Earnings Related Pension Supplement (SERPS) introduced.

1980: The Social Security Act broke the link between state pension increases and average earnings.

1992: Disability Living Allowance introduced.

2002: SERPS switched to the State Second Pension scheme.

2010: 'Triple lock' announced, meaning that the basic state pension would be uprated by either wages, prices or 2.5per cent; whichever is higher.

2012: Automatic enrolment into workplace pensions introduced.

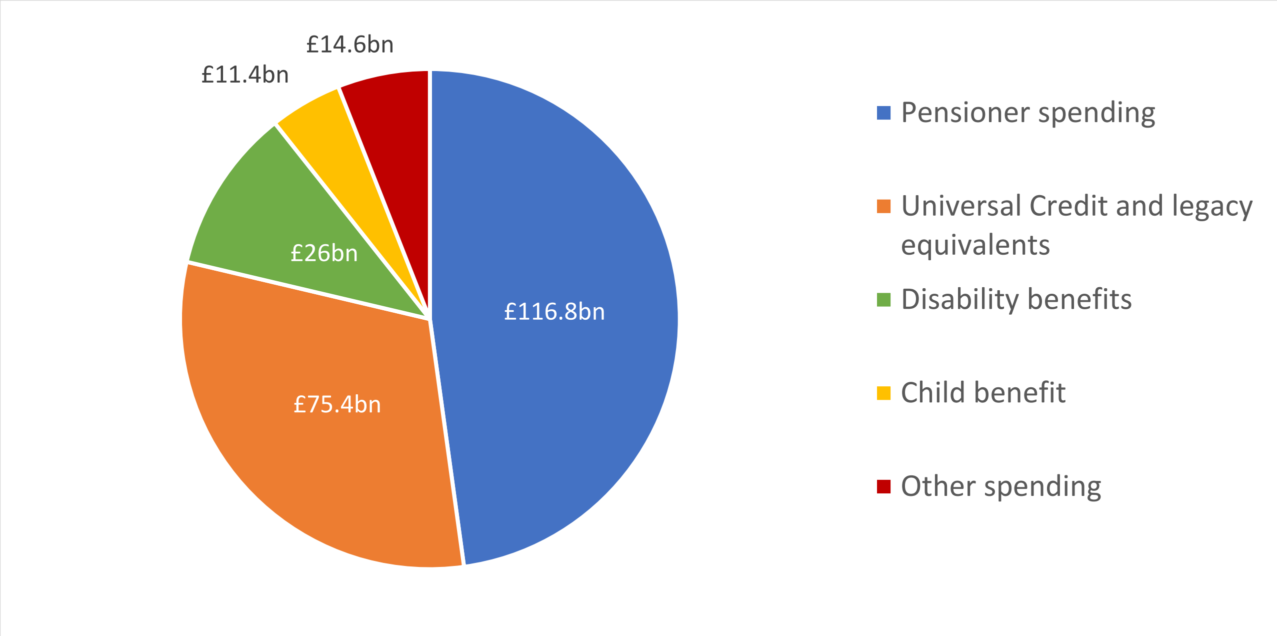
2013: Universal Credit and Personal Independence Payment started.

2014: The Pensions Act legislated for a new flat rate State Pension.

2016: New State Pension launched.

Charts

Chart 1: Government welfare spending, 2021-22[7]



Notes:
- Pensioner spending includes pensioner housing benefit, pension credit, and state pension expenditure.
- Universal Credit and legacy equivalents includes personal tax credits, housing benefit (excluding pensioner part), incapacity benefits, contributory ESA, income support and income-based and contributory jobseeker's allowance. It also includes industrial injuries benefit – the Scottish element of which is devolved to Scotland.
- Disability benefits includes disability living allowance, personal independence payment, and attendance allowance. It also includes the Scottish element of which is devolved to Scotland.
- Other spending includes Northern Ireland social security expenditure.

Chart 2: People on Universal Credit by conditionality regime, Great Britain, July 2018 to July 2023[6]

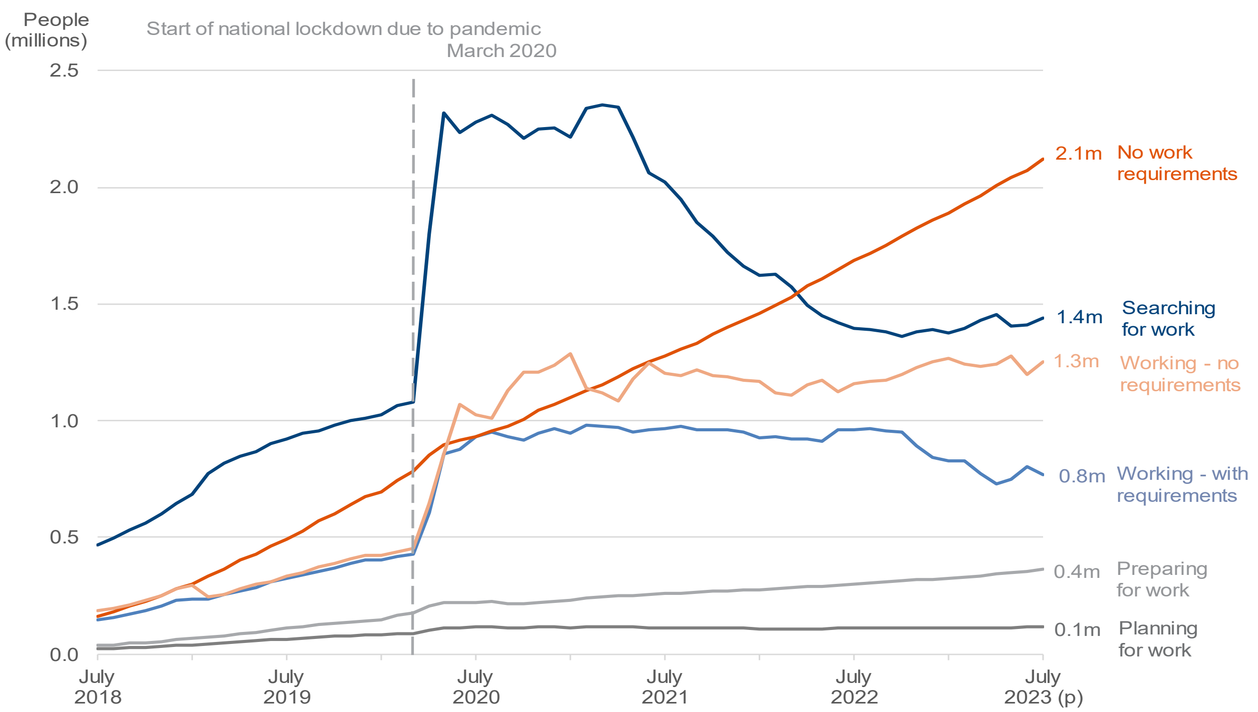
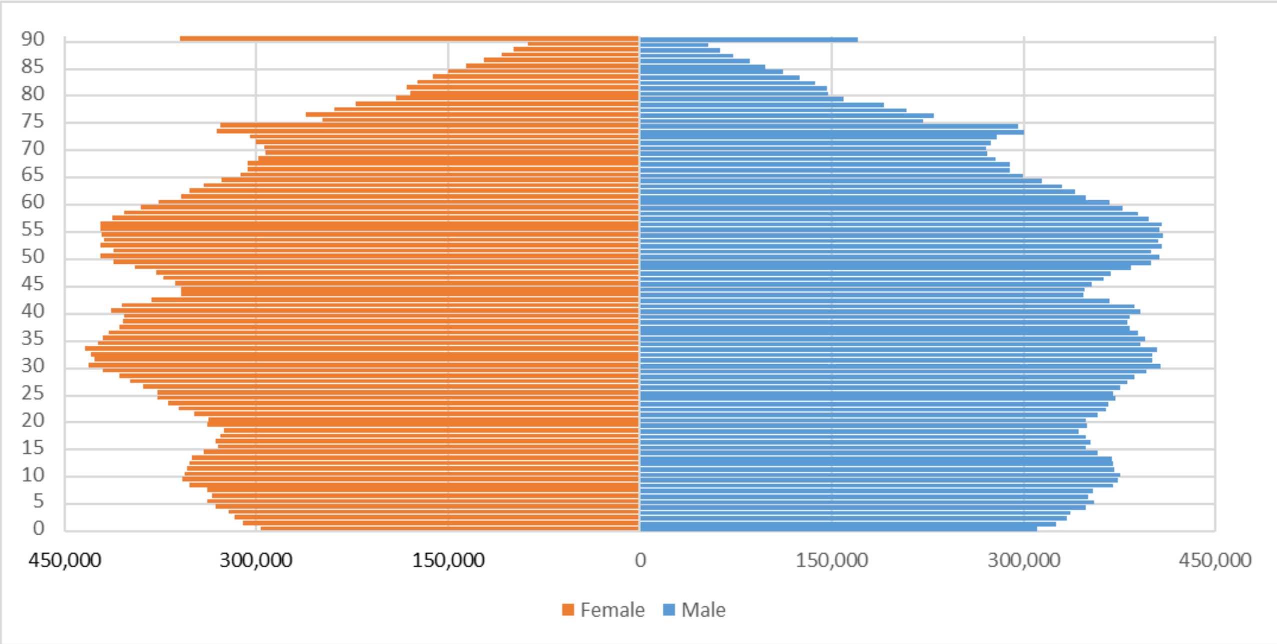


Chart 3: Population of England and Wales by sex and age, at census 2021[14]



Note: All those aged 90 and above have been combined.

Chart 4: Number of children per woman, England and Wales, 1939 to 2021[10]

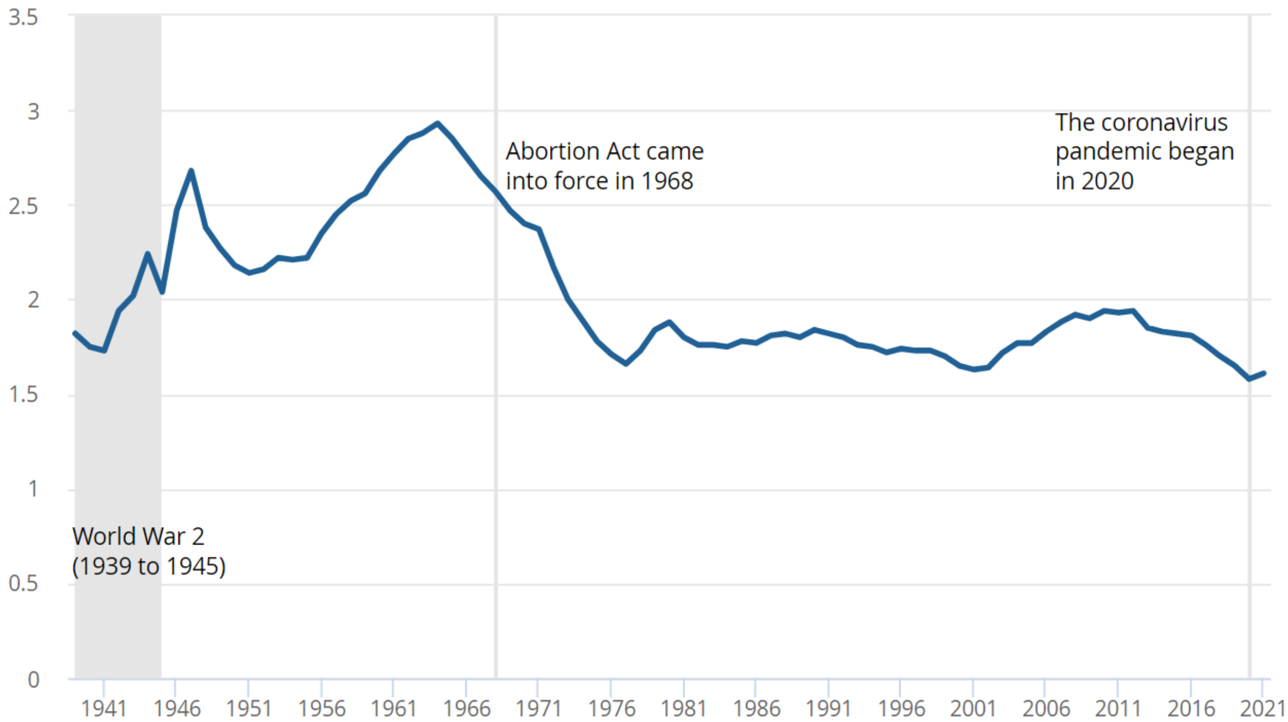
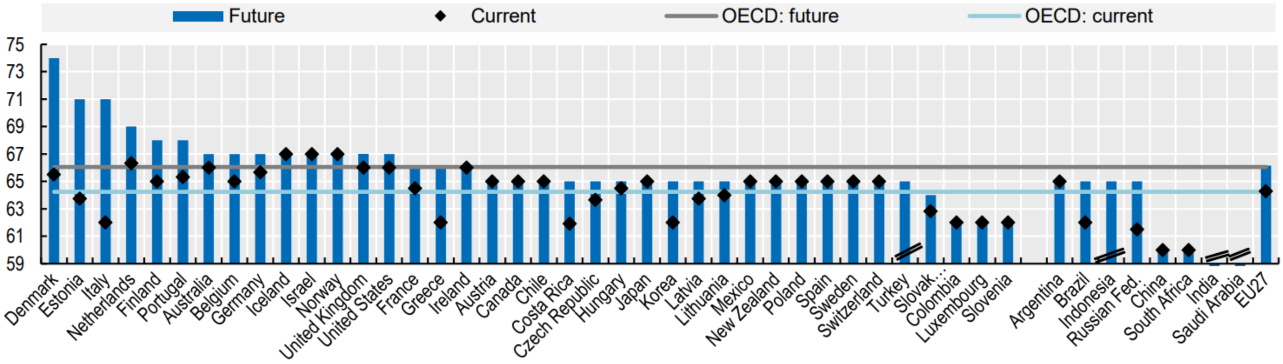


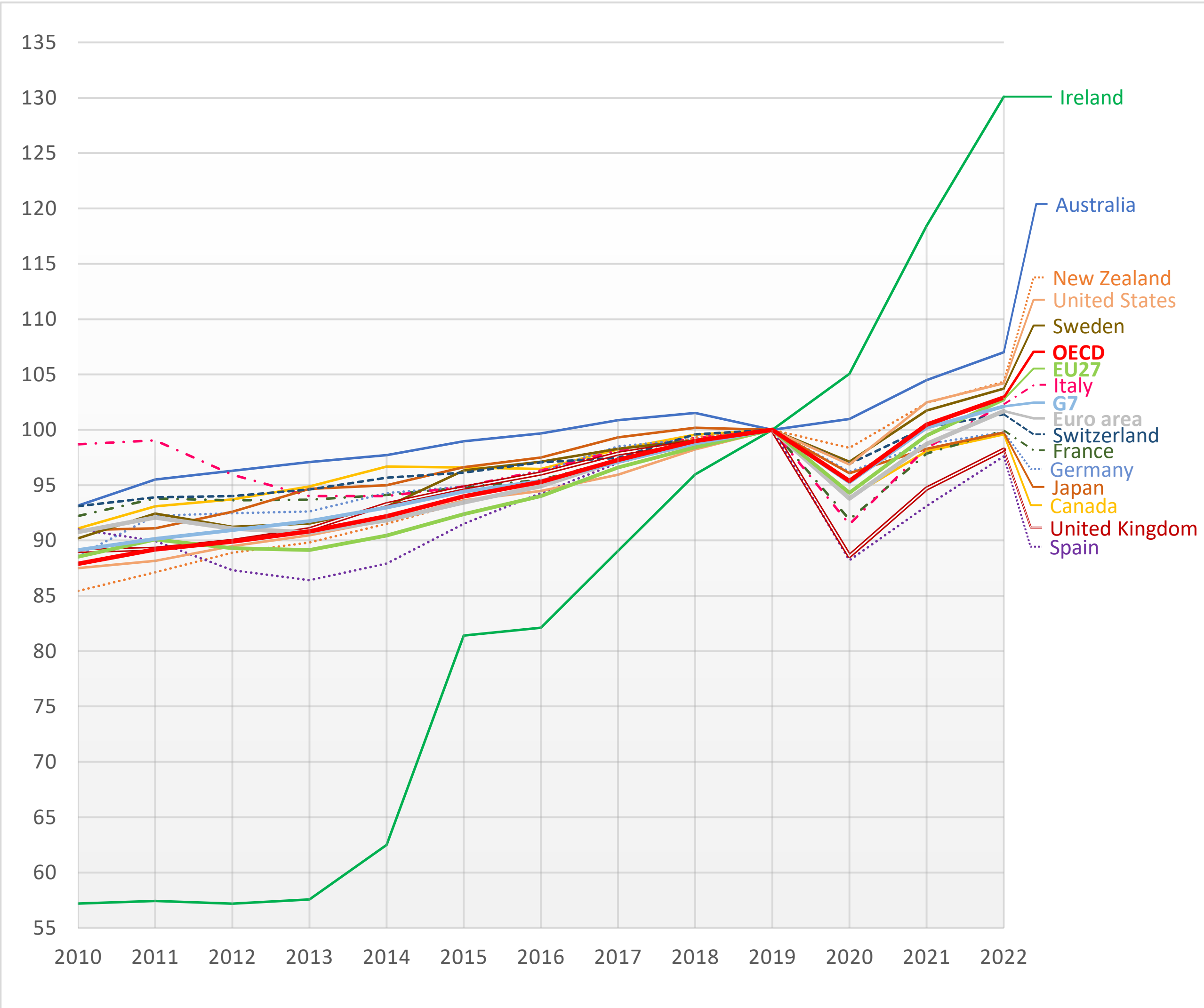
Chart 5: Current and future normal retirement ages in OECD countries[11]

Current and future refer to retiring 2020 and entering the labour market in 2020, respectively, for a man with a full career from age 22



Note: For better visibility, the scale of this chart excludes the lowest observed values of 47 for both current and future in Saudi Arabia, 52 for current in Turkey, 57 for current in Indonesia and 58 for both current and future in India. Credits for educational periods are not included.

Chart 6: Annual growth in GDP per capita, constant prices, 2010-2022, relative to 2019[15]



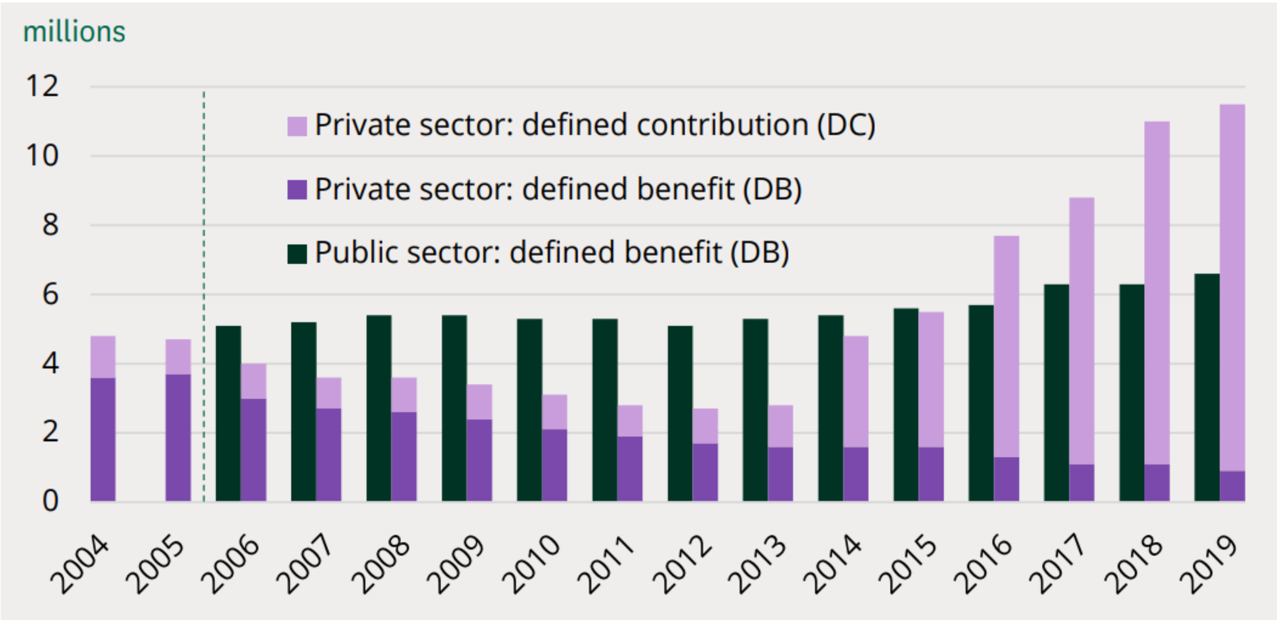
Note: As of 2023 Q2, GDP per capita is now estimated to be 0.1% above the level seen at the end of 2019, [16] *and GDP is estimated to be 1.8% higher.*[17]

Appendix: Reminder of material from 2022#3 Jobs & Pensions consultation

The two main types of occupational schemes are Defined Contribution (DC), in which contributions are made to a fund that is invested and used to provide an income in retirement, and Defined Benefit (DB), in which pension benefits are based on salary and length of service. The rollout of automatic enrolment (AE) from 2012 onwards led to a tenfold increase in total membership of DC schemes, from 2.1 million in 2011 to 21 million in 2019. Employers contribute a minimum 3% and employees 5%, part of which includes tax relief.[18]

For employees with a workplace pension, the average value was £10,300 in the private sector compared with £65,400 in the public sector.[19] Employer contributions across the four main public service pension schemes increased to 24.3% in 2019-20.[21] The annual cost to the taxpayer of public-sector pensionable payroll totals is about £95 billion.[20]

As of 2019, public sector employees accounted for 6.3 million out of 7.6 million (87%) of all those actively contributing to a DB pension scheme. 82% of employees in the public sector contributed to DB pensions, compared with just 7% of employees in the private sector. 39% of employees in the private sector contributed to DC pensions.[21]



Note: Changes to methodology from 2006 onwards mean comparisons with prior periods should be treated with caution. (a) The 2005 survey did not cover the public sector.

The six largest public service pension schemes in the UK are statutory defined benefit (DB) pension schemes: those for the NHS, Teachers, the Civil Service, Armed Forces, Police and Firefighters (which operate on a pay-as-you-go basis) and the Local Government Pension Scheme (which is funded).

Pension liabilities of central and local government in 2018 comprised:

- £4.8 trillion of state pension entitlements (224% of 2018 gross domestic product (GDP))
- unfunded defined benefit workplace pension entitlements for public sector employees estimated at £1.2 trillion (55% of GDP)
- funded defined benefit workplace pension entitlements for public sector employees worth £413 billion (19% of GDP)

Non-government pension liabilities for private sector employees in 2018 comprised:

- £2.2 trillion of defined benefit and hybrid workplace pension entitlements (103% of GDP)
- £347 billion of defined contribution workplace pension entitlements (16% of GDP)[22]

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