

A Fair Income

Tax-benefit reform in an era of personalisation

Simon Duffy

Editors: Simon Duffy, Jon Glasby and Catherine Needham

POLICY PAPER 01.12.2011





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About this series

Joint policy document series

In the summer of 2010 The University of Birmingham's Health Service Management Centre hosted a two day think-tank to explore whether recent innovations in health and social care might be the key to a more radical redesign of the whole welfare state.

As part of the think tank papers were produced which proposed significant policy developments. These papers were then subject to debate and criticism. The papers were then further developed for publication.

Each paper in the series has been produced by a leading practitioner and social innovator. The papers combine evidence and ideas for policy reform which are rooted in the real experience of bringing about change from the 'bottom-up'.

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Preface

In the early twenty-first century, elements of the welfare state are in the middle of a ‘transformation’ process based on the concepts of personalisation and self-directed support. Beginning in adult social care, these approaches seek to recast users of state welfare away from being passive recipients of pre-purchased services towards a situation where they are active citizens with a right to control and shape their own support. Various described as a form of ‘co-production’ or in terms of individuals becoming the ‘micro-commissioners’ of their own support, this has been seen as a shift away from a ‘professional gift model’ towards a citizenship-based approach, arguably more in keeping with other aspects of our lives (Figure 1).

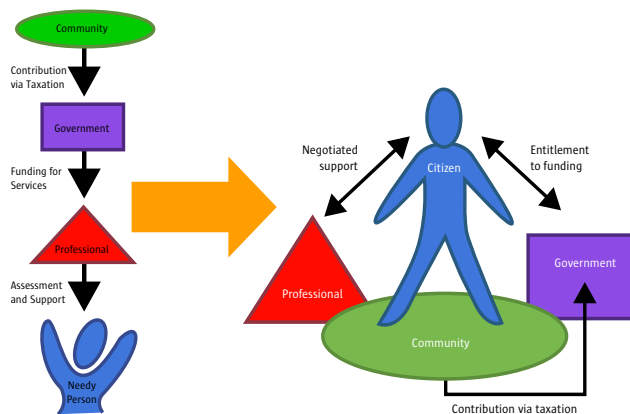


Figure 1. From Professional Gift to Citizenship Model

Central to this agenda to date has been the concept of direct payments (pioneered by disabled people's organisations and developing in the UK from the mid-1980s onwards) and individual budgets (developed from 2003 onwards by In Control). Beginning with 60 people in six local authority pilots in late 2003, there are now possibly 100,000 people receiving an individual budget and the government has stated that all adult social care will be delivered by this mechanism in future.

Although starting in adult social care, this approach is now being piloted in children's services and in healthcare, with several leading think tanks and commentators interested in its possible extension to other areas of state welfare (such as the tax and benefits system, housing, education, rehabilitation for ex-offenders, substance misuse services and support for young people not in education, employment or training). If privatisation was the key focus of the 1980s, it has been claimed, then personalisation could be the key focus of the early twenty-first century. Unsurprisingly, such issues have acquired even greater relevance in the current financial and political context, with debates about reduced state expenditure and potential government shrinkage.

Despite recent progress, much more remains to be done, including:

- Fully embedding personalisation in the training of social workers and other public service practitioners and managers.
- Exploring the implications of self-directed support for broader areas of state welfare.
- Understanding key levers for embedding change in policy and practice.
- Understanding more fully the implications for cost-effective use of scarce resources in a challenging economic climate.
- Developing more explicit theoretical and conceptual frameworks around citizenship, ethics and social justice.

Against this background, this series of papers was first presented and discussed at a national ‘think tank’ funded by the University of Birmingham’s Advanced Social Sciences Collaborative (ASSC).

We invited real experts to explore the changes they think could bring about positive change in:

- Local government and civil society
- Services for children and families
- Our health and social care systems
- The criminal justice system
- The tax-benefit system

In turn these ideas were challenged and reviewed by an audience of leading policy makers, managers, practitioners, policy analysts and researchers. We are publishing these papers in their revised form.

Underpinning many current policy debates is a sense that the ethos, law and structures that underpin the current welfare state is dominated by 1940s thinking and assumptions – and that some of the concepts inherent in debates about personalisation and self-directed support could help to shape future welfare reform. The Beveridge Report is widely credited with establishing the thinking behind the post-war welfare state. It is time to engage in the same depth of thinking about the relationship between the state and the individual in the twenty-first century. We hope that these papers contribute some fresh thinking.

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Summary: A Fair Income

Summary

The current government has committed itself to the first radical redesign of the tax-benefit systems since World War II. Unfortunately, while some of their analysis of the failings of the current system is fair, their proposed solution will fail. They may succeed in pushing through many of their proposals; but they will fail to redesign the system in a way that is fair and they will fail to make the UK a better place to live.

This paper offers another way forward; it does not fall back on the old system with its undue complexities and many weaknesses, but it avoids the increased poverty, stigmatisation and dependency. The paper proposes the creation of a system of Fair Income Security, a system that would have the following seven features:

1. integration of the current tax and benefits into one coherent system
2. A consistent approach for benefits and taxation, more supportive of families, in all their forms
3. The simplification of tax-benefit calculations into one set of questions
4. A minimum income for all, delivered through a universal, non-means-tested, benefit
5. Fair rates of taxation that remove the extreme disincentives for the poorest
6. A constitutional right to a minimum guaranteed income and to fair taxes
7. A public committee to shape the core entitlements, open to submission and scrutiny

The main arguments presented for making this fundamental change to the system are:

Argument from fairness - The principal unfairness of the current system is that it enmeshes millions of people in a dependency relationship with the state in which people find that their income security depends upon not earning, not saving, not building their family and not making the best use of their talents.

Summary: A Fair Income

Argument from rationality - The current system is unduly complex and opaque, this serves not only to erode transparency and a reasonable sense of entitlement, it also make it difficult to test out whether, and to what degree, incentives can be reshaped.

Argument from economics - By locking millions into benefit dependency the current system is inherently inefficient. It reduces the level of labour, skill and energy available to the whole economy and creates a disincentive to productive effort for the poorest and the richest. It is also a highly wasteful and inefficient system.

Argument from society - Systems of social welfare need to adapt to changing social circumstances. The structures upon which the post-war welfare settlement were based have been eroded, partly by factors driven by the welfare state itself and partly by external factors. The modern welfare state needs to be redesigned to reflect the risks and opportunities of a new social context.

In addition, I argue that the growing complexity and incoherence of the current system are linked to the weaknesses in the relationship of modern democracies to welfare provision. This analysis also suggests that normal party politics, on its own, is unlikely to achieve a coherent redesign of the welfare state. It is likely that a very different strategy will be necessary.

Introduction

For many observers the debate about public services has been an argument between those seeking more public spending and those seeking reductions in public spending. But in the last few years there has been a growing awareness of the sterility of this ‘more or less’ debate and a renewed focus on deeper questions of the design of the welfare state - the principles that should frame it and the structures by which those principles are realised.

One of the most important efforts to redesign the welfare state has become known as personalisation and many of the leading advocates of this approach have focused their efforts on shifting power and control over public funds into the hands of disabled people and their families. Although the policy and practice in this area continues to be highly contested, much of the best practice has been motivated by the plausible hypothesis that better quality decisions can be made by those who directly benefit from support and funding than when these decisions are removed to bureaucratic or professional systems.

One important element of this new approach is called the individual budget (Duffy, 2005). An individual budget can hold social care funding, healthcare funding or education funding or other funding streams (Cowen, 2010). How it is used is determined by the person who is entitled to the budget, although this use may be subject to some conditionality and require some additional support (Duffy et al. 2010). In this way the individual budget becomes a tool for individualising and personalising public services, while ensuring some scrutiny by public agencies of how the budget is used. This is welfare expenditure, but it is expenditure controlled by people themselves, and this seems to be much fairer and more effective on many levels.

What is much less well understood is how individual budgets work in practice and why they seem, in the right conditions, to be so effective at improving outcomes and increasing efficiency in public services. The element that attracts the most attention is the ability that the individual budget gives for people to purchase support that makes more sense to the detail of their lives. But this rather consumerist focus tends to miss some of the other important factors that have made individual budgets successful.

Some of these include:

- **Incentives** - Individual budgets can provide people with a more robust entitlement that is not subject to some of the vicious poverty traps that operate in the old social care system. For example, once an individual budget is set there is less disincentive from using that funding to strengthen family life, spend time with friends or get involved in local communities. The old system penalised people who had ‘natural support’ - this new system has been less damaging.
- **Transparency** - Individual budgets, because they are defined in advance of any detailed planning, have enabled people to plan in ways that are more effective and creative. In this way the budget can be treated as just one element to be used in developing a whole life solution. Individuals can use the budget to increase value by pulling other resources (not just money) into their lives (Hagel & Seely Brown, 2005).
- **Control** - Individual Budgets give people control, and this control not only serves to ensure that better decisions are made, or poor decisions responded to more quickly, it also serves to reinforce the responsibilities and rights of the citizen. Individual budgets reinforce the citizenship of those using them (Duffy, 2003).

However individual budgets, even on the most optimistic analysis, are not a panacea for the reform of the welfare state. On the one hand there are some public services (e.g. emergency

services, acute healthcare and social work) that are not well suited to being managed through an individual budget. It makes much more sense to organise these on a national or a local basis. On the other hand individual budgets can be cumbersome and inefficient. It is more empowering to ensure that people have adequate incomes using the tax-benefit system. It is even arguable that many people with individual budgets would be better off if that budget was simply part of their direct income. For it should not be assumed that the initial success of individual budgets in transforming block funding for services into more individualised funding for individual budgets is the end of the possible path of reform. There is a strong case for going further and turning individual budgets into genuine entitlements that are part of the tax-benefit system.

However it is a mistake to define personalisation as the application of individual budgets. Personalisation is actually the effort to redesign the welfare state to promote citizenship for all, and its scope is much wider than that of individual budgets (Duffy, 2010a).

In particular I will argue that there is enormous scope to rethink the current tax-benefit system in order to promote citizenship. Just as with individual budgets, we may be able to see ways to:

- Provide benefits in ways that do not damage the incentives to earn, save, strengthen the family or improve our skills.
- Simplify benefits so entitlements are clear, fair, easy to access and easy to use.
- Promote responsibility and contribution, encouraging citizens to pay taxes and support each other.

I will begin by outlining the features of a new system for tax-benefits and then I will explain why I think this model offers an attractive and feasible framework for reforming the current system.

Fair Income Security

The model for a reformed tax-benefit system which this paper outlines has seven properties:

1. The integration of the current tax and benefits into one coherent system
2. A consistent approach for benefits and taxation, more supportive of families, in all their forms
3. The simplification of tax-benefit calculations into one set of questions
4. A minimum income for all, delivered through a universal, non-means-tested, benefit
5. Fair rates of taxation that remove the extreme disincentives for the poorest
6. A constitutional right to a minimum guaranteed income and to fair taxes
7. A public committee to shape the core entitlements, open to submission and scrutiny

I will refer to this new model as Fair Income Security (represented graphically in Figure 2). This model assumes that there will still be a role for other public services, whether those are directly funded by the state (e.g. Police) or managed through individual budgets (e.g. education or long-term health and social care). How to distinguish when and where funding should be controlled by citizens and in what forms is not discussed in detail in this paper.

In this first section I will describe Fair Income Security and its central rationale. I will go on to provide more discussion of the underlying reasons for this model and the problems it is trying to overcome in the later sections of the paper.

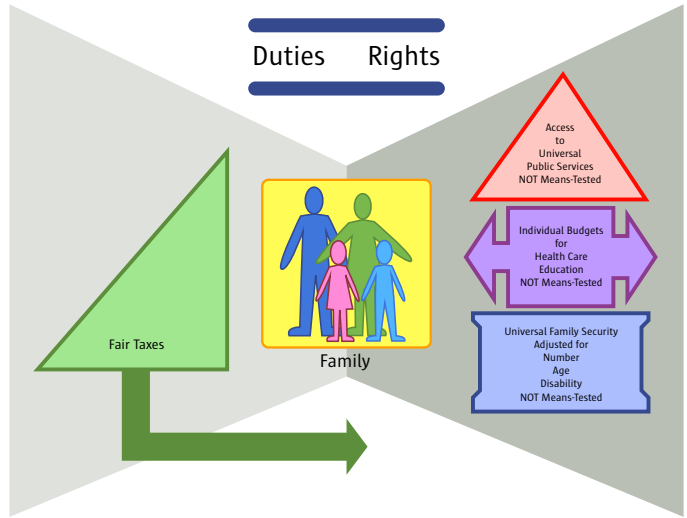


Figure 2. Fair Income Security

1. Integration of tax and benefits

Currently the major tax systems are organised and administered by the Inland Revenue, through Her Majesty's Revenue & Customs (HMRC). The main system for giving people benefits (including pensions) is the Department of Work & Pensions (DWP). There are also various other taxes and benefits scattered through the workings of other government departments and local government.

The integration of the tax and benefit systems into one coherent system would have several obvious advantages:

- The stigma of the benefit system would be eroded, all citizens would get their entitlements through one system.
- It would be clear that the wealthy were also benefiting from one universal system.

- Incoherence between the tax and benefit systems could be engineered out to create better incentives for low earners.
- It would create efficiencies in the administration of the tax-benefit system.

In the discussion that follows I will not assume that all taxes can be or should be simplified, or that all taxes will be based upon income. There are other uses for taxation beyond providing income security and other roles for taxes beyond just filling public funds. However taxes on income are a very large part of our current system and other taxes (e.g. VAT) are also significantly correlated with income.

2. Support for families

Currently the tax system pays no attention to whether you are in a family, whereas the benefit system tends to start with the assumption that families are there to provide free support. The net effect of both systems is to put families at a disadvantage. People who rely on benefits find themselves losing income when they form families. Those who are better-off are given no encouragement to spend time with their families, instead the presumption is that it is best if everyone is working as long as possible. This atomistic approach is damaging the fabric of society.

A unified system would need a unified taxonomy. There are two options, both of which would be an improvement on the current system:

1. Define entitlements for the citizen and take no account of family circumstances. This would probably have the net effect of encouraging people to build stronger families, as resources shared within families are likely to go further than resources spent by lone individuals.
2. Alternatively one could treat the household or family as the basic item of the system. This is more complex and

more dependent upon the way in which calculations of family size and any other relevant factors are weighted. It also raises questions of gender and sexual orientation. However it could be argued that the family (in all its forms) is the real social bedrock and so a system that took families seriously could also have advantages.

Whichever system was adopted such a system would need to respect and support family life and, in particular, the role of women.

A family-based system would have several advantages:

- It would enable the community to better recognise the value of the family in providing care and support to citizens in childhood, old age and in conditions of ill health or disability.
- It would provide opportunities to shift more resources into the direct control of women.
- It would create a consistent approach to agreeing how we identify and count families.

This does not mean that single people would have no obligations or rights, clearly they too must be entitled to Fair Income Security and, in such a system a person who lived alone, in a household of one, would be treated as the ‘minimal family’. However the system should start with the presumption that family life is a fundamental building block for community life, and must be particularly sensitive to ensure that no significant disincentives for family life are created.

In the following argument I will talk about family income and family need rather than citizen income or citizen need. This does not mean that the first option, the option of citizen income, is excluded as an option. However it seems more natural to consider economic questions from the perspective of the family, perhaps because the root of our word ‘economy’ is found in the Ancient Greek term ‘oikonomia’ which means household management.

3. One calculation

The tax and benefit system has evolved into a highly complex system, with 137 discrete benefits or benefit rates and at least 27 different forms of taxation. However at its heart must be some calculation of how much someone needs and how much someone owes. There is no reason why this calculation could not be done just once, focusing on: income, family size, age of family, and impairments (if any).

A system using one calculation would be:

- much simpler to calculate and deliver
- able to deliver much more focused scrutiny in determining a fair level of entitlement and contribution
- able to eradicate poverty traps that occur from linked benefits (e.g. housing)
- much more reliable and less subject to complaint

Although it is true that family circumstances will change and that this will need to be tracked, this is already a problem, and a problem made worse by the system's complexity. One of the major problems of the current system is that the poorest in society are expected to alert the DWP of minor changes in family circumstances and many other parts of the current system, e.g. tax credits, are highly vulnerable to changes that are picked up too late - thus causing delay, embarrassment or debt. It would be much better to normalise reporting of household status within one simplified system.

4. Universal entitlement

There is already a de facto commitment by the community to ensure that no one is left without income. However this commitment is not universal and it is framed in such a way that those who are seen as ‘benefit dependent’ are stigmatised and their right to income security is deemed questionable. On the other hand, poverty is also defined in a way that is relative and ineradicable. We are locked into a system that leaves far too many people far too poor, and the main solutions championed by political parties never come close to addressing this central issue.

Instead Fair Income Security means defining a level of income that no family should be without as the poverty level, and we then ensure that no family should be allowed to go below that level. This poverty level (which may vary with dimensions of family life, as set out above) becomes the basis for calculating a fundamental level of benefit income which is then defined as a universal entitlement and provided by the community to all tax payers.

This would have several advantages:

- The commitment to eradicate poverty would become feasible.
- The benefit would be universal, not targeted, so all families would see themselves as benefiting.
- The income-poverty trap would be eliminated.
- There would be a stronger sense of security which would encourage increased risk-taking and entrepreneurship at all levels.

Currently the least generous rate of income support is £2,780 per year (DWP, 2011b). If this was extended as a benefit to all 60 million people in the UK the total cost would be £169 billion, less than the current cost of all pensions and benefits in the UK (£185 billion). This would be a significant benefit to many tax payers and so it would enable rates of tax to be increased so that this extremely low minimum income could be improved to

something more reasonable. This simple example demonstrates that a universal minimum income guarantee for all is not a pipe dream, it is already within our grasp.

5. Fairer taxes

The current tax system is highly complex and purposefully obscure. Moreover many negative taxes (benefit reductions) or means-tests are hidden within the benefit system. Fair Income Security means increased transparency and flatter rates of tax. Transparency would be increased by eradicating means-testing from the calculation of the basic entitlement and fairness would be increased by moving to a flatter tax system (that is, everyone paying a similar *proportion* of their income in taxes), one that set a fair level of contribution for all. This would have several advantages:

- Everyone would understand their contribution to providing a guaranteed income for the whole community.
- The extreme marginal taxes paid by the poorest (and the subsequent poverty traps) would be eradicated.
- The wealthiest would also see themselves as part of a demonstrably fairer system and show more commitment to mutual contribution.

Some objections to flatter taxes seem to be based on a misunderstanding about the technology. Flat taxes are progressive - their flatness is a flatness in the *rate of marginal tax*. That is, the rate of tax a citizen pays is consistent, whatever their income. Flat taxes are the opposite of poll taxes (which are both regressive and highly tapered). The current system is not flat it is U-shaped. The poorest and then the wealthiest pay the highest rates of marginal tax. Moreover the poor pay the highest share of their income in tax. It is hard to imagine a more unfair tax system than the one we currently use.

6. Constitutional right

The rights to a minimum income and to fairer taxes are fundamental and need to be protected from short-term partisan political interference. They need constitutional protections that would ensure:

- It becomes more difficult for political parties to try and give advantage to one group, to the disadvantage of another, in order to achieve electoral advantage.
- Individuals can claim protection from the courts if treated unfairly by the design of the system.
- Fundamental changes would require more than a minor shift in public support.

It is interesting to note that while the state now controls approximately 50% of GDP in the UK there are no significant constitutional guarantees for citizens about how their social rights and duties are defined and respected. Instead welfare systems have become subject to a process of political pandering to key sections of the electorate. Constitutional guarantees are an important form of self-discipline for the welfare state.

7. Independent committee

The calculation of a fair minimum income and a fair tax level would need to be adjusted in the light of changing circumstances and information about its impact on society. The decision as to the right criteria (and their weighting) will require fine judgements that can only be made by human beings deliberating together and then making a decision. Such decisions are best made by an independent committee, allowing for submissions to be made by different sectors in society and allowing for their discussions and final decision to be subject to public scrutiny.

Overall

The seven elements of the core model of Fair Income Security are interlocked, but they are still distinct. Each element could be separated and there are issues of detail which could be resolved in different ways within each part of the model. However for the purposes of this essay I am going to treat Fair Income Security as one model and to presume that it can be implemented in the full-blooded way described above.

In summary the core idea is this:

Each family will be entitled to an income that is sufficient to avoid poverty, and each will contribute to the community's capacity to provide for this income by paying a clear and fair level of taxation on any income over and above this minimum.

Although I have already provided some reasons why Fair Income Security is attractive, these reasons demand more explanation. However I think this is best done by exploring a more holistic case for reform.

I will do this by considering the question of tax-benefits from four different perspectives:

1. Fairness
2. Rationality
3. Economics
4. Society

Finally I will go on to explore some of the practical questions surrounding implementation and the politics of the welfare state.

1. The Argument from Fairness

The current system of tax and benefits is unfair because it does not help those who are poorest to make the best of their own lives. A fair society is one that never loses sight of the interests of those who are in danger of exploitation or who are suffering. This is a fact that has been known for thousands of years. For example, it is a repeated theme in the Old Testament:

Do right to the widow, judge for the fatherless, give to the poor, defend the orphan, clothe the naked, heal the broken and the weak, laugh not a lame man to scorn, defend the maimed, and let the blind man come into the sight of my clearness. Keep the old and young within they walls. Wheresoever thou findest the dead, take them and bury them, and I will give thee the first place in my resurrection.

2 Edras 2:20-23

The current welfare system fails this test of fairness. Instead of giving greatest consideration to those who are weakest it locks them into poverty and damages their ability to do the best they can for themselves. A better system would start with a broader conception of the capabilities that underpin a good life and it would be more sensitive to providing the support and incentives necessary for self-development and stronger communities.

Focusing on real wealth

The best way of understanding the injustice at the centre of the current system of income security (benefits, pensions and tax) is, paradoxically, to realise that money alone is not the key to a successful life (Sen, 2009). Money is only one means for achieving a better life, and we can identify at least five broader capabilities, each of which is essential to the creation of a good life. We might think of these five elements as ‘real wealth’, the resources necessary to construct a positive and meaningful life (Murray, 2010).

The five elements of real wealth are represented in Figure 3 and they are:

5. **Gifts** - skills, strengths, interests and even needs: Each individual has their unique gifts, and a good human life consists in the sharing and development of these gifts - whether they are great or small.
6. **People** - family, friends, peers and colleagues: Human flourishing is impossible in isolation, instead we develop through relationships with other people - especially love.
7. **Community** - associations, organisations, structures, government and civil society: Our ability to use our gifts is dependent upon our access to the opportunities available within our communities.
8. **Assets** - money, housing, time and energy: We need sufficient resources, under our own control, so that we can build a good life for ourselves (Snow, 1994).
9. **Spirit** - hopefulness, resilience or good mental health: Finally, and most fundamentally, it is our ability to shape our life, to use all the dimensions of our real wealth to develop a life worth living, that will shape the life we lead (Vidyarthi & Wilson, 2008). Hope is essential to the human spirit.



Figure 3. Five Dimensions of Real Wealth

This model reminds us that if our primary concern in building a just society is the quality of people's lives then we will only be interested in money as one aspect of real wealth. It is not just money, it is the exercise of our talents, development of relationships and engagement with community that is necessary for human development. So when examining our welfare arrangements it is not the size of public spending or even the level of minimum income, on its own, that should concern us. It is the way in which these social arrangements provide the necessary incentives and supports for personal and social development.

William Beveridge, the architect of the welfare state in the UK, recognised this clearly:

The State should offer security for service and contribution. 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 that minimum for himself and his family.

William Beveridge, *Social Insurance and Allied Services*, p.6

However, although Beveridge recognised the challenge, the way that the actual system has evolved has led to a situation where

incentives are not just weak they are often deeply perverse. Each aspect of our real wealth is put at peril when we become dependent upon the welfare system. For many people the welfare system becomes a Poverty Net - a mesh of inter-locking taxes and benefits, that locks people in poverty (Duffy, 2010b). This poverty is not just poverty of income, for many it is a poverty of relationships, capacity and community. Many people find themselves isolated, vulnerable and excluded from community life (including many people who would not consider themselves 'poor'). This broad ranging poverty is not just unfair, it can begin to damage the human spirit itself.

Just to be crystal clear, this is not the fault of welfare or of social security in itself. The welfare state is both good and necessary; we are dependent beings and we need a system of collective income security. *Welfare is not the problem; the problem is the welfare state is badly designed.*

The Poverty Net

The idea of a Poverty Net is useful because it reminds us that the better known term 'poverty trap' is too simplistic. The Poverty Net is made up of a range of different 'benefits' and 'taxes' although sometimes those benefits come as services and often those taxes are hidden within 'benefit reduction rates' or charges or other forms of 'means-testing'. The combined effect of these systems is to create a series of inter-locking poverty traps.

The most well known poverty trap is the income-poverty trap. For example, in the UK in 2011, a young woman relying on income support would be entitled to £2,780 per year. After earning £5 in a week each pound that she earns must be taken, pound for pound, from her benefits. This means she is paying a marginal tax rate of 100% (DWP, 2011b). In other words, she must pay everything she earns back to the government.

It has been observed by many critics of the current system that this extreme marginal tax rate may be creating a significant disincentive to work (Economic Dependency Working Group, 2009).

It is estimated that in total, more than 600,000 people could face a Participation Tax Rate in excess of 90 per cent – that is more than 90 per cent of their gross earnings are lost through tax and withdrawn benefits. This measure does not take account of in-work costs such as travel, which can easily wipe out a meagre financial gain.

21st Century Welfare, p.11

The DWP itself gives the following example of how increased earning hardly pays and it provides a useful graphical image that shows how as earnings increase, income hardly increases:

In this example [see Figure 4], based on current benefit and tax rates, a couple with a single earner and two children sees a Marginal Deduction Rate of 95.5 per cent on earnings between £126 and £218. This means that someone at the National Minimum Wage would be less than £7 per week better off if they worked 16 extra hours and earned an extra £92 (an effective wage rate of 44p per hour).

21st Century Welfare, p.11

Moreover, it is possible that this could be doubly damaging, not only reducing opportunities for the individual, but also reducing the individual's contribution to the whole community. In other words such systems make the poor poorer, but make all of us poorer too. But we will return to these broader economic considerations in the next section.

For many people relying on benefits total incomes are not quite as low as £2,780. Many people are entitled to some other benefits or tax credits. Benefit have different rules, different tax rates and some benefits are linked to other benefits. However the impact of these reforms has been to maintain very high tax rates and create even more complexity and confusion for citizens.

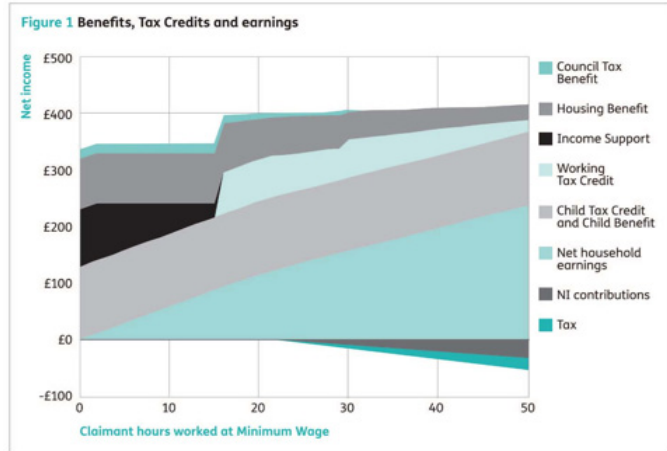


Figure 4. Extreme Taxes on Low Earners

As Table 1 shows, for the poorest 10% of households average incomes after tax are little more than £3,500 per year. This is very low indeed. Moreover, as Figure 5 show, the poorest 10% of households do not just face extreme marginal tax rates, they even pay more tax as a percentage of their income (47%) than any other group (Office of National Statistics, 2009).

Decile	Number	Income	plus Benefits	less Taxes	Net Income	Tax
1st	2,528,000	£2,043.00	£4,592.00	£3,092.00	£3,543.00	46.6%
2nd	2,528,000	£3,738.00	£7,287.00	£3,274.00	£7,751.00	29.7%
3rd	2,530,000	£7,464.00	£7,431.00	£4,642.00	£10,253.00	31.2%
4th	2,527,000	£11,387.00	£7,702.00	£6,155.00	£12,934.00	32.2%
5th	2,529,000	£18,354.00	£5,969.00	£8,656.00	£15,667.00	35.6%
6th	2,530,000	£26,523.00	£4,093.00	£10,978.00	£19,638.00	35.9%
7th	2,529,000	£33,862.00	£3,656.00	£13,379.00	£24,139.00	35.7%
8th	2,525,000	£43,552.00	£2,743.00	£16,710.00	£29,585.00	36.1%
9th	2,531,000	£56,842.00	£2,310.00	£20,833.00	£38,319.00	35.2%
10th	2,531,000	£100,138.00	£1,958.00	£35,271.00	£66,825.00	34.5%
Mean		£30,390.30	£4,774.10	£12,299.00	£22,865.40	35.3%
Sum	25,288,000					

Table 1. Household Incomes by Deciles, 2007-08

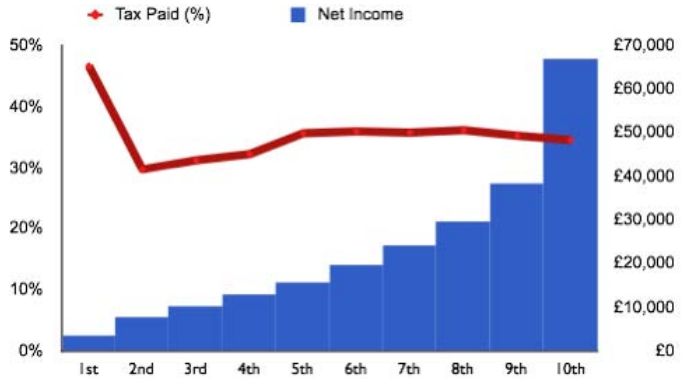


Figure 5. Average Household Income by Decile and Tax Paid as Share of Income

Moreover the income-poverty trap is only one of the many different, complex and interlocking poverty traps that make up the Poverty Net. Figure 6 provides a visual image that describes the whole Poverty Net.

First we have a wide range of different taxation systems, some general applying to all citizens, and some that are only faced by people who need extra help (Adam & Browne, 2009). The most important of these are taxes on income and taxes on sales. But there are also many other hidden taxes or taxes that are disguised as means-testing. For example, should you need extra help as you get older and frailer you will find that you will have to pay an extra tax, built into the ‘means-testing’ or charging system for adult social care. In other words there is a hidden tax that is specifically focused on people who need extra help and support. These forms of double-taxation seem particularly unjust as they target those who already need extra support. It is a super-tax on disabled people.

Second, we have a range of different benefits. There are over 100 distinct benefit rates in the Department of Work and Pensions formal system of benefits (O’Dea et al. 2009). But many other ‘benefits’ are delivered by other systems. First, there are tax credits and personal allowances, which are part of the Inland Revenue System. Second there are benefits that are delivered as services, like healthcare and education. Thirdly there are even

benefits like individual budgets in adult social care, that are intermediate between services and cash benefit and are organised as conditional resource entitlements (Duffy et al. 2009).

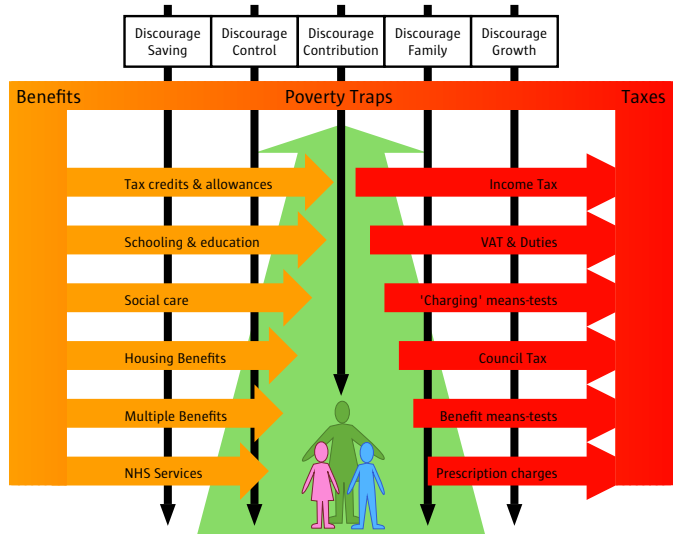


Figure 6. The Poverty Net

The complexity and perversity of this whole system is difficult to fully characterise; these are just a few of its interlocking characteristics:

- Some benefits are linked to other benefits. For example Mortgage Interest Relief is available only to people on Income Support. These conditionally linked benefits can also have the impact of dramatically increasing marginal tax rates; for people can find themselves suddenly losing their linked entitlement when they are no longer entitled to the first.
- Some benefits are means-tested, while others are not. Child Benefit and the State Pension were the most widely recognised non-means-tested benefits (paradoxically this makes the termination of Child Benefit for the rich a very worrying step away from a more universal and simpler system). But even some services that are considered to

non-means-tested often include some important elements of means-testing. For example, prescriptions for medicine are means-tested although access to healthcare is often cited as a universal and free benefit.

- Some benefits, such as tax credits, are administered through the Inland Revenue system; while others are managed by the Department of Work and Pensions or other government departments. This not only creates unnecessary complexity it has also led to many people on low incomes developing debts to the Inland Revenue (Public Accounts Committee, 2009a).
- Some taxes and benefits are locally defined, some nationally, and there is no clear logic as to which are local and which are national.

Together this complex mesh of taxes and benefits is so constructed that it creates a whole set of further poverty traps and many of those poverty traps do not only damage incentives to earn income:

1. **Gifts** - Our skills, strengths and individual capacities are often taxed. There are significant incentives to be treated as unfit for work in our current system as the benefit system tries to target additional resources at people with disabilities, health and mental health problems. Paradoxically trying to penalise those who are deemed 'fit for work' creates deeper poverty traps for those who manage to get themselves assessed as 'unfit for work'. However, with the right support, we know that many disabled people are willing and able to work. If incentives were right we would not need the undignified spectacle of the state sorting us into those who were 'fit' or 'unfit' for work.
2. **People** - More important than income to our existence and to our well-being are our relationships, particularly the relationships of love and family that create the conditions for life itself. However, two individuals over the age of 25 who were both reliant on income support, but who were

thinking of marrying (or living together as a couple), would see their joint income drop from £130.90 to £102.75 (a direct tax on marriage of 22%). They would also be likely to see a 50% cut in their housing benefits and other possible benefits - so the net taxation on family life is likely to be even greater.

3. **Community** - Many benefits are so structured that they limit the citizen's access to the wider community. For example, people needing social care may find that care is only made available in day centres or care homes that effectively segregate them from wider access to civil society. Choice of education or healthcare is limited to pre-defined options that may not suit individual needs and certainly fail to encourage social innovation. Locally defined benefits are not portable and people may feel unable to move to places they would prefer and which may offer better opportunities.
4. **Assets** - It is not just our income that is taxed, we also find that means-testing extends to our savings and to the incomes of others in our household. For example, you need to have savings of less than £14,250 in order to be fully eligible for support when you are over 65 and acquire a serious health condition or disability. This leads to many people having to spend or transfer their modest savings to family members in order to maintain or improve their entitlements to social care or an enhanced pensions.

My hypothesis is that the design of the welfare state is not only insensitive to its impact on real wealth, but that it is largely negative - dampening incentives for citizens and families to make the best of their talents, strengthen family life and increase contribution and personal control. Instead the welfare state gives benefits in a way that is demeaning, dispiriting and damaging to human development.

The impact of Fair Income Security

The challenge is to design a system that encourages, or at the very least does not discourage, personal and family growth. Fair Income Security attempts this by two very direct measures:

1. A universal, non-means-tested, benefit - calculated to be sufficient to avoid poverty for all families.
2. A fair rate of tax, payable on all earnings - that is tax is on income 'after' the universal benefit.

This means that everyone has enough income, to the extent that 'enough' is defined and revised by our community from time to time. This also means that everyone benefits from this universal benefit, removing at one stroke the stigmatising effect of the concept of 'benefit dependency'. Fair Income Security solves the problem of benefit dependency by making *everyone* eligible for this benefit. At a stroke this model removes the extreme and unfair taxes that burden the poor in the form of marginal benefit reduction rates.

In addition, this model makes very clear that it is the responsibility of every family to contribute to the maintenance of this system of income security, each according to their means. A fair tax also creates a clear, fair and progressive system of contribution and ensures that income poverty traps are either excluded, or at least are felt by all members of the community equally.

Moreover this reform may be more feasible than one may suspect. For example, in Table 2 we have set out two simplified calculations of cost. Model 1 uses the current benefit for couples relying on income support as the rate of the average benefit. In Model 2 we have doubled this rate to show the impact of a more generous approach. The cost of these two different entitlement are then expressed as a proportion of various aspects of the national economy.

	Model 1	Model 2
Number of Households in UK	25,400,000	25,400,000
Average Family Benefit	£5,000	£10,000
Cost of Universal Benefit	£127,000,000,000	£254,000,000,000
% of GDP (£1 Trillion)	12.70%	25.40%
% of Current Tax Bill (c. £500 Billion)	25.40%	50.80%
% of Total Benefits (c. £185 Billion)	68.65%	137.30%
Tipping Point	£39,370.08	£39,370.08

Table 2. Cost of Universal Benefit if average set at £5,000 and £10,000 pa

It is interesting to note that, on this model, as the benefit elements become more generous, and the tax rate higher, the tipping point remains the same. Households that have incomes above this point are net contributors, households below this income are net beneficiaries and the tipping point does not change with the generosity of the different systems. In fact the tipping point will always be at the mean household income. In addition it is also clear that, perhaps surprisingly, there is very little difference in the cost of this scheme compared to the cost of the current pension and benefit arrangements.

Clearly these are rough and ready calculations and it is obvious that this model also raises many other problems and uncertainties. I will address as many of these as I can manage within the constraints of this paper; and I will also try to demonstrate that even if the whole model may take time to be achieved it still provides a useful framework.

However my aim here is to demonstrate that there is a plausible alternative to the current system and that this model would be fairer for several reasons:

1. It ensures every family in the community has sufficient income to support citizenship.
2. It is a public and clear guarantee that the community can acknowledge, define and support.
3. Meeting this guarantee places reasonable demands on all citizens.

Above all else a welfare system should be fair. The current system is not fair in that it damages the lives of the poorest. This proposed alternative puts fairness at the heart of its design.

2. The Argument from Rationality

Some people will not recognise this appeal to the concept of fairness or will have a different ideas about fairness. Many people are attracted by a concept of overall utility or efficiency, others may have doubts as to the validity of my claims about the negative impact of the current system or the positive impact of such a radically universal approach. This section sets out a second and different argument for Fair Income Security; one which does not rely upon such a specific vision of social justice and may engage people with a different perspective.

The case for clarity

The current system is confusing and complicated. It has developed over time into an elaborate Byzantine structure that no one fully understands.

This is unattractive for many reasons:

- If citizens do not know what they are entitled to then they are not citizens, instead they are subjects - subject in this case to the remote and inexplicable power of a bureaucratic state.
- If citizens do not know what their responsibilities are then they are not citizens. Instead, particularly for those who are expected to contribute significantly, they will begin to see the system as a trick, a game designed to squeeze as much from them as possible, by the most obscure means.
- If the system has become too complex even for those running it to understand then we are in an even worse condition, for when the system has become too opaque to be managed effectively then even enlightened bureaucratic paternalism becomes impossible.

There is no doubt that the current system is too complex. Martin makes the point in the following way:

The DWP issues a total of 14 manuals, with a total of 8,690 pages, to its decision makers to help them to apply DWP benefits. A separate set of four volumes totalling over 1,200 pages covers Housing and Council Tax Benefits, which are primarily the responsibility of local authorities. The Tax Credits manual used by HM Revenue and Customs is a further 260 pages, even though it omits details for many relevant tax concepts which are found in other tax manuals. In addition to these encyclopaedic works is a cornucopia of circulars, news releases and guidance notes issued to professionals and claimants. The underlying legal statutes and statutory instruments make up a vast mass of further material.

David Martin, Benefit Simplification: how, and why, it must be done, 2009

This state of affairs should be repugnant to anyone who believes themselves to be a citizen, someone with a real stake in their community. Any civilised society relies upon a shared understanding of the basic economic arrangements that govern economic security and contribution. For example, at the heart of Solon's constitutional reforms in Athens, the reforms that gave birth to democracy, we see, not only a system of political organisation but also a clear and balanced system of economic security and taxation (Plutarch, 1960).

The achievement of clarity

Interestingly the problem of achieving increased clarity was faced by those of us developing systems of resource allocation to simplify and clarify someone's right to an individual budget in adult social care. In order to achieve transparency and simplicity it was necessary to examine the cost of 'care packages' in adult social care (which varied from £0 to over £60,000 per year) and to correlate these costs with critical questions, the answers to which allowed for the quantification of need (Duffy, 2005).

Today, most of the individual budgets being delivered to people in England use a resource allocation system based on these early models and typically they rely on weighting the answers to about 10 distinct questions. The process of answering the 10 questions takes less than half an hour and the resulting budget can be specified almost immediately. This system has now been extended to all of adult social care in England and will by 2013 be in place for over 1 million people and for an overall expenditure of about £20 billion (although the quality of implementation is currently very patchy).

Of course, this does not mean that there is no complexity to the question of determining a fair allocation. In one sense these new resource allocation processes simply make transparent underlying pre-existing assumptions about need; but by making such assumptions transparent it is possible to examine and test them. Furthermore the results of the actual allocations made can also be tested and the system can be further amended in the light of any emerging unfairness or inadequacy in funding.

This model, which combines clarifying underlying principles and measuring the impact of allocations is set out in Figure 7. My contention would be that if 10 questions can, in most instances, determine a fair level of funding to meet the needs covered by adult social care - which are extremely wide - then, by extension, an even greater degree of reliability could be achieved in terms of basic income security by developing a similar system to replace the current benefits and tax-credit systems.

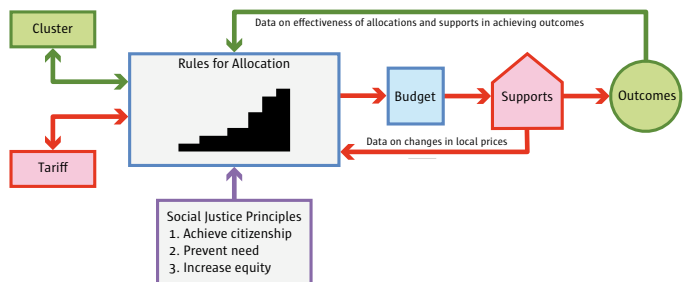


Figure 7. The Use of the Resource Allocation System in Adult Social Care

Clarity is vital to the on-going need to evaluate, understand and validate any system. When that system is an essential component of the modern democratic state then the need for clarity is a matter of the utmost significance for the well-being of society.

Making the system testable

There is one further advantage of introducing clarity into the system, which is that it would make the whole system open to empirical testing. One of the unfortunate side-effects of the current system is that it has become impossible to test and develop the system so that it can more reliably achieve desirable social outcomes.

There is certainly much that we do not know about the impact of any changes to the current system:

- We don't know to what extent high marginal tax rates on the poor stop them from earning and the degree to which lower marginal rates will increase earnings.
- We don't know whether a system of Fair Income Security would actually lead to more people withdrawing from labour markets or seeking different kinds of work.
- We don't know what the impact of flatter taxes would be on earners at different levels of income.

These and many other uncertainties will persist unless the system is changed to make it possible to test these questions. The complexity of the current system paralyses rational investigation of possible improvements.

One of the advantages of the Fair Income Security is that it creates a much clearer foundation for meaningful empirical testing:

- Poverty could be redefined and the system can be made more or less generous.
- Family dimensions could be weighted in different ways along the axes of age, size and disability.

- Marginal tax rates can also be amended and changed, even altering the flatness of the tax.
- Negative tax rates could even be used to introduce means-testing into the system at lower incomes.

This paper does not argue for these changes and the argument from social justice offers a sharper and narrower account of the system that would be demanded by a consideration of fairness alone.

Nevertheless the argument from rationality does provide further reasons to at support some elements of the proposed model of Fair Income Security:

1. The creation of a unified tax-benefit systems
2. The creation of a consistent taxonomy
3. The simplification of benefits into one calculation, with appropriate weighting
4. The clarification of a socially agreed definition of unacceptable poverty

Without these kinds of changes the tax-benefit system will continue to be immune to rational scrutiny and to meaningful public debate. In fact it should be acknowledged that the current coalition government in the UK has shown a great deal of commitment to create a reformed system that would have some of these elements. In particular, the development of Universal Credit is an attempt to move to a radically revised system which will allow for some flexibility in the design of any new system (DWP, 2011).

However, what should be of grave concern to politicians and citizens is that these structural reforms are not underpinned by any clear understanding of the basic expectations, rights and responsibilities that will make such a system explicable. There is a grave risk that the current experiments will become unstuck for lack of public support. The current reformers have accepted that the current system sends confused or damaging messages to the poor. However, unless there is an attempt to define in clear and understandable terms what the new deal is; it is likely that

bureaucratic complexity will simply be replaced with dynamic complexity (Economic Dependency Working Group, 2009).

Reforms must be based on clear and public principles that define rights and responsibilities. Continuing the complex and paternalistic micro-management of income and tax levels will further reinforce confusion and undermine citizenship.

3. The Argument from Economics

Another kind of approach to the tax-benefit system is to ask whether such a system is efficient or economically productive. For many people this is the critical question, whether reforms will lead to growth and increased economic activity. As the previous section implied, much of this is an empirical question, hard to test without real systemic change. However, there are good reasons to believe that the economic impact of Fair Income Security would be positive.

Increased activity

The primary economic attraction of the Fair Income Security is that it completely removes the income-poverty trap and gives everyone in society the same marginal tax rate and the same incentive to earn. However, in moving to this new system, the overall impact of this change would most likely be:

- to radically reduce the marginal tax rates of the poorest
- to mildly increase the marginal tax rates of middle-earners
- to slightly change the marginal tax rates for the richest (Whether this would be an increase or a decrease would depend upon how generous the guaranteed minimum would be.)

The reason why marginal tax rates are important is that they determine the financial benefit of working an extra hour. It has been plausibly argued for instance that in 1979, when marginal tax rates for high earners were slashed, the impact was not only that high earners began to earn more but also that high earners began to pay higher levels of overall tax. For example, following Thatcher tax cuts in 1979, the contribution of the top 10% of earners to the overall tax take went from 32% to 45% of total tax paid (Heathcoat-Amory, 2008).

As Table 3 sets out, large numbers of people are now ‘benefit dependent’ or live on incomes just above these benefit levels (DWP, 2008). Although it may be hard to prove, it seems plausible that many of the 7 million households who are benefit dependent would seek to earn extra money on top of their benefit income. Of course many of these 7 million households include people who have pensions or disabilities. However this should not lead us to underestimate the potential for increased economic activity when it begins to be worth people’s while to work.

	Benefit Dependent	Low Earners	High Earners	Total
Households	27.6%	28.3%	44.1%	25,400,000
Household No.s	7,000,000	7,200,000	11,200,000	
Women	25.4%	29.2%	45.5%	26,400,000
Men	19.7%	27.8%	52.6%	23,400,000
Children	33.1%	27.3%	39.6%	13,900,000
People	15,900,000	18,100,000	29,800,000	63,700,000
Total Percentage	25%	28%	47%	

Table 3. Household Data, UK, 2007-2008

Increased productivity

An increased supply of labour into the labour market would increase the overall volume of activity and will increase wage flexibility in that market. However the other fundamental change that Fair Income Security would introduce is modest income security for all. The sceptic will fear that this will have an opposing impact on the economy, that is many people might choose to withdraw from the labour market (at least to some degree). Ultimately this question rests on the degree to which people's earning behaviour is currently determined by fear of falling into the benefit system and whether a universal system of modest income security would then lead to a radical withdrawal of labour from the market.

Again much of this has not been tested; but at least two things are worth considering. First, if it is true that there would be such a significant reduction in economic activity by earners then this is likely to lead to a redistribution of labour towards the poorest. This is hardly an unattractive outcome in a world where millions don't work, but millions seem to work too much.

The second factor to consider is whether any change that is underpinned by increased income security would not in fact lead to increased fussiness about the nature of work that people choose. It seems plausible that the fear of the consequences of not working does not primarily drive a willingness to work. Most people who can work want to work, and not just for the economic benefits of working. However many people work in jobs that they do not value or which do not seem productive 'to them'.

It may well be that the actual economic impact of the Fair Income Security would be a shift towards economic activity which is more personally rewarding. In which case we may see more people choosing work that pays less well and fewer people doing activities that seem less enjoyable. Of course the labour market can adjust to some degree for this fact by altering relative salaries.

This is not an economic problem; instead it is an opportunity for the creation of a more genuinely productive economy, one that does not use fear of poverty to drive people into less rewarding work.

Reduced waste

Finally the economic impact of these reforms would be to radically reduce the need for administrators of the current system and to much greater reliability and consistency in tax and benefit decisions. Here are just a few examples of the current levels of waste in the tax-benefit system:

- At least £1.5 billion is over paid in tax credits each year to people on low incomes and there is no fair or effective system for reclaiming this money (Public Accounts Committee, 2009a).
- At least £1.8 billion is overpaid in benefits each year to people who are dependent upon benefits for their income and there is no reasonable way of reclaiming this money (Public Accounts Committee, 2009b).
- In any reformed system there would only need to be one IT system (there are currently 37 in the DWP alone).
- The Department for Work and Pensions and its agencies spend around £2 billion a year to administer and pay working-age benefits, Local Authorities spend a further £1 billion to administer Housing Benefit and Council Tax Benefit, and HM Revenue & Customs spends more than £500 million a year. (DWP, 2010)

The complexity and confusion of these systems leads to the situation that Teresa Perchard, Director of Social Policy at Citizen's Advice put like this in a letter to the government:

Citizens Advice acknowledges that the £1.5 billion cost of fraud in the benefit system must be recovered, but we are very concerned at the government's persistent tendency to roll fraud and error

figures together. Errors account for the remaining £3.7 billion of the £5.2 billion figure quoted In the meantime, the £5 billion cost to government through fraud and error is dwarfed by the £17 billion of benefits and tax credits that remain unclaimed every year, because people don't know they are entitled to claim, or because the system is too complicated.

Teresa Perchard, (quoted in Duffy & Hyde, 2012)

It is worthwhile looking at these figures in detail. £1.5 billion is actually less than 1% of the cost of the whole benefits system. This is actually a tiny figure and suggests that citizen-fraud is currently negligible. However, if people don't know that they can claim for £17 billion then this is about 10% of the total benefit bill. A system that has been designed so that the poor do not get what they are entitled to is a fraudulent system. It is the poor who are being defrauded, by the government, and at eleven times the rate at which citizens defraud the government.

In summary, although there are many uncertainties, if one believes that the millions of people who are currently benefit dependent are in fact people who are full of positive capacities that are just waiting to be unlocked, then the net impact of helping to release those efforts into the economy is likely to be beneficial, both to them and to the whole of society.

4. The Argument from Society

Finally I will consider one last argument for reform. This argument is based upon the social conditions that lead to reform. The welfare state was not designed in a vacuum, rather it has evolved to meet social needs and it was designed in the light of assumptions that reflected the beliefs and practices of the time.

The development of the welfare state

It is modern arrogance to believe that earlier societies made no provisions for the care of all their members. However earlier societies often built their provision around the agrarian economy. For example, Mosaic Law sets out measures for the harvesting of fields which are purposefully designed to ensure that there will be enough left for the widow without land to be able to gather food for herself (Maimonides, 2005). Similarly in the Middle Ages it was part of the role of the Church to provide charity for those in need within feudal society.

However the nature of production and distribution has changed radically. Production of the basics for life used largely to lie in the hands of those who needed them, and security came through both holding land or being a part of the social fabric around its production. The enormous advantage of technological innova-

tion has been the ability of many fewer people to produce food, clothing and all the many other goods and services we need or want. The enormous disadvantage of technology, and the capitalist society which has grown up around it, is the inherent insecurity that seems to come with industry, technology and the modern business. We have never been so wealthy, and we have never had such a weak hold upon that wealth.

In the nineteenth and twentieth-centuries this insecurity fuelled revolutions, violent social change, war, eugenics and, finally, the development of the welfare state, as an attempt to reduce this radical insecurity.

Unsurprisingly the design of the welfare state also reflected the conditions and assumptions of its time, including that:

- The state can, using macro-economic management (Keynesianism) keep most people in work.
- Taxation can be used to provide a modest benefit for those temporarily out of work.
- Family structures will exist to provide love and support for men, women and children.
- Healthcare and education are best delivered by expert professionals.
- Those who can't own their own home will be able to rent a home at an affordable rent.
- Many additional benefits (e.g. sickness and pensions) will be delivered by the firm.

Of course, it is interesting to note the many differences of detail that arise as different countries solve the problem of building the welfare state. Some societies, like Japan and the US, gave a much bigger role to business. Other countries, like France, developed national insurance systems to include payments for healthcare; while others, like Britain, focused on a state-provision model. But the similarities are even more marked, for all systems have tended to see the fundamental security as a combination of (a) protecting overall employment rates in the economy and (b) providing some limited support for those who fall out of employment and onto 'benefits'.

Some systems seem to be more ‘generous’, like the Swedish system, while others seem more austere, like the US system. But all welfare state economies have seen an enormous shift of power and resources towards the state that has no obvious precedence in recorded history. All modern states provide some broad form of insurance to protect citizens from the radical insecurities of modern economies.

Moreover the trend since the early development of the welfare state has been to increased technological efficiency, combined with increased business insecurity. Furthermore, other social structures, the family, communities and the firm, have all become weaker. This has put further pressure on the state to provide security through the welfare system and growing numbers are now reliant on benefits (Parker, 2009).

In addition we also seem to have reached a certain kind of limit to the degree to which the welfare state can grow relative to the size of the whole economy. Since the 1970s there have been on-going efforts to restrict the growth in welfare spending and to limit levels of taxation as a share of overall economic activity. Some foolishly advocate eliminating the welfare state, as if the underlying need for welfare had somehow mysteriously disappeared. Some foolishly pretend that simply increasing spending on welfare inevitably makes things better. Policy debates have often been reduced to a ridiculously simplified battle of ‘more’ or ‘less’.

The fact is that all modern societies need a system of collective economic security in order to counterbalance the kind of radical insecurity that has been created by industrialisation. This fact has not changed. The creation of the welfare state should be celebrated as a double achievement. First, it put in place new social structures that reduced the vicious impact of poverty and increased social cohesion. Without the modern welfare state we would return to the corrosive poverty and fear that characterised the early part of the twentieth-century.

Second, it tried to make the achievement of social justice an explicit part of our community life. And, at first, social justice did improve. However the welfare state has now become increasingly ineffective at promoting social justice. In the early twenty-first cen-

tury there are troubling signs that injustice is increasing and that quality of life for most people is not developing as it should.

In these circumstances it seems extraordinary that we should not be prepared to rethink the design assumptions of the welfare state. It is time to reflect upon some of the unintended consequences of its current design and to critically examine how the welfare state now fits within a world that has changed significantly since the 1940s.

The need for redesign

The reasons that the current system will continue to come under further pressure for reform are not difficult to discern, although there will be disagreement about how acute these factors are:

The erosion of social structures - The decline of important social structures (e.g. businesses, the family, the church and civil society) seems to increase the pressure on the welfare system. For example it is noticeable that in recent discussions about funding for adult social care, the fact that the vast majority of support is provided for free by families has not led to a reexamination of a system that actually undermines families by limiting their eligibility to social care. Instead the debate has focused on how to increase the taxes placed on families, thereby reducing family strength further. It is a mistake to try and solve every social problem by increasing the size of state spending. State-controlled welfare is not the only social structure we need. Some things, like love, meaning and enterprise, can only be provided in a state of freedom by the family and through civil society.

Economic constraints - There appear to be some near absolute limits of state expenditure and when these are reached economic effectiveness is imperilled such that state spending comes under further pressure. For many observers this maximal point of state growth was reached in the 1970s and

certainly the growth in the size of the welfare state, relative to the whole economy, has stopped or slowed since that point. The political and economic crises in communist countries that led to the end of the Cold War also seem to be at least partly connected to the problem of hubristic state control - the state believing itself to be competent to control economic life far beyond its actual capacity. Today we are less confident that passing economic control to the state is always the best solution for social and economic problems.

Increased social unrest - There is concern that benefit dependency is also likely to create wider social problems. Crime, civil unrest and forms of self-harm (drugs, alcohol, poor mental health) all seem to increase in places where benefit dependency dominates. This phenomenon also leads to a culture of blame where those who suffer most from a system that they did not create are also blamed for these problems. The recent development of terms like 'underclass' or 'benefit thief' should alert us to the dangers of increased social alienation between those who have and those who have not. We have started to blame the poor for poverty - this is dangerous and stupid.

These issues should be of particular concern in the UK. According to Wilkinson and Pickett the UK is the third most unequal developed country in the world and this income inequality is causing social problems that include increased crime, mental illness, infant deaths, obesity and early deaths (Wilkinson and Pickett, 2010). In fact Wilkinson and Pickett argue that the growing size of the welfare state has reflected the failure of society to address the deeper problem of income inequality. If this is true then this underlines how important it is not to simply resort to increased welfare spending as a solution for every problem. It is also a mistake to be complacent. These social problems will get worse, will increase conflict and may lead to more draconian measures on behalf of powerful groups.

The possibility of reform

There are however some signs that positive reform may be possible and a number of relatively new trends offer some hope:

New information technologies - The internet and systems for processing and personalising complex sets of data, have led to approaches where technically complex chores are being simplified. Brokerage industries - like travel, insurance - are being simplified into systems like moneysupermarket.com or confused.com. Outside the welfare state, citizens both expect greater simplicity and greater control and they find that, when they put their minds to it, they can also create systems that make this possible.

New social movements - The failure of political parties to protect the interests of genuinely disadvantaged groups has also led to new social movements that not only advocate reform but also design and create reform. The disability movement created the possibility of reform in adult social care. *London Citizens* has had great success in improving the wages of Londoners.

An increased focus on rights - The primary political philosophy that underpinned the development of the welfare state has been utilitarianism, and this is reflected in the cost-benefit models applied by social theorists. This approach tends to be insufficiently concerned with the rights of the weakest and underestimates the value of shifting power and control to individuals. However a renewed focus on rights, including our rights to social justice, can offer a better ethical framework for promoting positive reform and a fresh focus on citizenship.

It is far too early to declare that any change to the current system is inevitable. It takes political will, courage and thoughtfulness to reform a complex system: particularly when that system involves the economic interests of millions. But there are some reasons to think such a change is possible and that, unless action is taken, further pressure for change will arise.

5. The Challenge of Implementation

Throughout this essay I have avoided discussing the biggest problem faced by any potential reform of the tax-benefit system - the challenge of implementation. Just because a system is just, rational, economic or even 'inevitable' does not make it feasible. Feasibility only arises when the will to reform is combined with a coherent and achievable plan and the ability to communicate that plan in a way most people can understand and accept.

In the UK today some of these conditions seem to exist. There is certainly some political will to bring about change and there is some understanding of the problem. What is much more uncertain is whether the proposed reforms are clear or fair. In fact it seems possible that the current wave of reforms will drive up income inequality, create increased confusion and add to the stigmatisation of the poor. They do not seem to create a genuinely universal solution that will make sense to all citizens.

The reason why positive reform is so difficult to achieve is that such reforms rely on normal political processes and these processes struggle to deliver the kind of fundamental reform required.

Again, if we return to the moment when Beveridge was trying to persuade government of the need for deep and systematic reform, we can sense his fear that his proposed solutions would be undermined:

The first principle is that any proposals for the future, while they should use to the full the experience gathered in the past, should not be restricted by consideration of sectional interests established in the obtaining of that experience. Now, when the war is abolishing landmarks of every kind, is the opportunity for using experience in a clear field. A revolutionary moment in the world's history is a time for revolutions, not for patching.

William Beveridge, Social Insurance and Allied Services, p.6

In fact, as soon as the welfare state was first designed, the patching began. The current system is very patchy indeed and, as Beveridge spotted, the reason for this is 'sectional interests' although it may be surprising to consider who these 'sectional interests' really are.

Primarily the blocks to positive reform are:

1. the politicians need to please swing voters and median income earners
2. an administrative system that oversees its own reform
3. the economic and political power of the welfare state itself

We will consider each of these blocks in turn.

Medianocracy

The biggest block to reform does not lie in the expected place. It is not the civil servants or those reliant on benefits who really block reform. The most likely block to reform are middle earners and the politicians who need to win their support. Swing voters are vital to electoral victory, and the swing voter is very likely to be the median income earner.

For example the median household income in the UK is currently about £22,000 (see Figure 8). Like most groups (except the poorest 10% who pay 46% tax) they pay about 35% of their income in tax.

However if we look at real marginal tax rates - that is the tax on the 'next pound earned' we find that the tax system may treat this group very differently:

1. This group is not in the benefit system at all, and so has escaped the extreme marginal tax rates paid by the poorest.

2. This group pays the lowest rates of income tax (whether as one earner or as a couple) and for a couple almost all income would be excluded from income tax all together.
3. This group still gets universal benefits like child benefit.

It is not an accident that this group faces the lowest marginal tax rates. If the household was much poorer then they would start to attract benefits that would increase their effective marginal tax rate (although the tax rate would be disguised as a benefit reduction rate). If the household was richer then they would attract higher marginal tax rates. It seems that the tax-benefit system is so designed that the most important group *politically* is treated better than groups that are much less important *politically* (the poor and the better off).

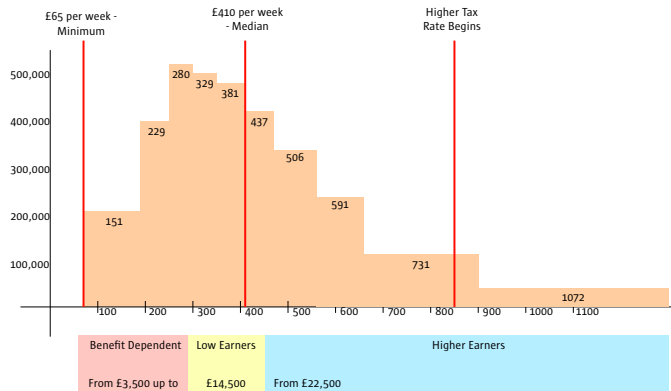


Figure 8. Distribution of Income by Deciles in 2008

It is also interesting to note that the tax system is designed so as to disguise the real marginal tax rates that people pay. This enables the state to give the appearance of taxing at modest levels (c. 20%) but spending at much higher levels (c. 50%). This sleight of hand is possible because taxes are shifted out of sight - onto sales (VAT), employers or redistributed in more opaque fashion (e.g. National Insurance) - or shifted on to the poor or wealthy.

We might describe this form of political power as a ‘medianocracy’. It is the median voter who has the most power, and principles of natural justice easily become distorted where this occurs.

Note also how much of contemporary political debate can be analysed as the efforts of political parties to get the median voter to identify themselves as their core constituency: on the Left the strategy is to encourage people to see themselves as needing more support, services or welfare. On the Right the strategy is to encourage the same group to see themselves as subject to unduly high taxes. Language such as ‘alarm clock Britain’ or the ‘squeezed middle’ tells its own story.

Both sides are then tempted to fulfil their promises by targeting programmes so that they bring extra benefits to their core voters and the swing voters they need. In this way benefits are minimised for non-target voters (the poor and the rich). These groups may be thought of as already ‘captured’ by Left or Right and so no special effort needs to be made on their behalf. In addition ‘their’ party will only be in power intermittently - whereas the median voter is always represented by the party in power.

The greatest block to positive reform is the need of politicians to pander to one economic group - middle earners.

Administrative self-protection

The second problem for reformers is that they find that the welfare state is not neutral. It begins to develop its own inherent interest and politicians find themselves not only having to deliver value to voters but also to implement that value within and through the welfare state’s own bureaucracy.

This leads to what we might call the sedimentary quality of the welfare state. Each new benefit, entitlement or reform tends to be developed as a new layer sitting on top of older systems. It has proved incredibly challenging to redesign or challenge those previous layers. Each layer has its own ‘delivery group’ (civil

servants, professionals, commercial or charitable organisations) and each layer has focuses on some group who benefits from that particular benefit.

In addition, political leaders are rarely responsible for any government department for long enough to fully understand how it works and what would be necessary for genuine reform. Similarly legislative change tends to be piecemeal and incoherent.

For example the Law Commission, in reviewing legislation for adult social care said:

Adult social care law remains a confusing patchwork of conflicting statutes enacted over a period of 60 years. Some of these statutes reflect the disparate and shifting philosophical, political and socio-economic concerns of various postwar governments. Other statutes were originally Private Members' Bills and represent an altogether different agenda of civil rights for disabled people and their carers. The law has also developed with an inconsistent regard for previous legislation: some statutes amend or repeal previous legislation; others repeat or seek to augment previous law; and others can be categorised as stand alone or parallel Acts of Parliament.

Law Commission, 2008

This sense of powerlessness in the face of bewildering complexity also confronts the think-tanks and policy bodies that have developed on the edges of the welfare state to support politicians in the development of their thinking and policy proposals. There is a very real sense that radical reform is beyond the reach of the contemporary political system.

Nobody understands the whole system, but everyone within that system is acutely aware of their own place within it and the need to protect it from meddling or reform.

The welfare industry

In this essay my primary focus has been on the income adjustment side of the welfare state - the system for increasing (and reducing) income. However the welfare state is also made up of a set of services that exist to benefit everyone. In fact very little of our taxes goes on income adjustment. Most of our taxes are spent on universal services.

This can be seen clearly in Table 4, drawing upon the same data as in Table 1, which analyses the degree to which each decile has their income adjusted up or down by the combination of tax and benefits (Office for National Statistics, 2009). For example, for the poorest decile the average adjustment is an addition of £1,500 per year, whereas for the richest decile the average adjustment is a subtraction of £33, 313 per year. In fact, on this analysis, only the first four deciles receive positive income adjustments, the remaining 60% of families are net contributors.

To put this more simply, after receiving benefits and paying taxes the poorest 10% are £1,500 better off. For the poorest 10% this improvement in income costs under £4 billion. For the four poorest deciles (the poorest 40% of households) the total cost of income adjustment was £25 billion. However, when we examine the extent of the positive contribution of the tax payer we find that this amounts to approximately £215 billion. This means £190 billion goes towards universal services.

Of course the 40% poorest families also benefit from these universal services, but often they benefit to a lower degree than the better-off. For example, the poorest 10% use £1,675 per year *less* than the mean. This amount is actually higher than the amount that they receive in positive income adjustment. Perhaps, if people really understood how badly the current system treats the poorest we might be more open to consider sensible reforms. The poor are not 'scroungers' and 'benefit thieves'. In fact many of the poor hardly benefit at all from the current system.

Furthermore, one might also note that the £190 billion contribution of the tax payer to services, rather than to income

adjustment, is then spent on services that employ people. That is, tax payer income is primarily converted into salaries for doctors, nurses, teachers and civil servants. In other words, the primary beneficiaries of the welfare state are those whom it employs, directly or indirectly. For every £1 spent on reducing poverty at least £8 is spent on employing people within welfare services.

Decile	Number	Adjustment	Cost	Contribution	Services	Net Use	Balance
1st	2,528,000	£1,500	£3,792,000,000		£4,314	-£1,675	-£175
2nd	2,528,000	£4,013	£10,144,864,000		£4,854	-£1,135	£2,878
3rd	2,530,000	£2,789	£7,056,170,000		£5,503	-£486	£2,303
4th	2,527,000	£1,547	£3,909,269,000		£5,839	-£150	£1,397
5th	2,529,000	-£2,687		£6,795,423,000	£6,025	£36	-£2,651
6th	2,530,000	-£6,885		£17,419,050,000	£5,908	-£81	-£6,966
7th	2,529,000	-£9,723		£24,589,467,000	£6,281	£292	-£9,431
8th	2,525,000	-£13,967		£35,266,675,000	£6,733	£744	-£13,223
9th	2,531,000	-£18,523		£46,881,713,000	£7,473	£1,484	-£17,039
10th	2,531,000	-£33,313		£84,315,203,000	£6,958	£969	-£32,344
Mean		-£7,525			£5,989		
Sum	25,288,000		£24,902,303,000	£215,267,531,000	£151,444,774,400		
Surplus				£38,920,453,600			

Table 4. Spending on Income Adjustment vs Services

Again, it is useful to return to Beveridge, who was keen to point out that income adjustment was only one part of what a decent welfare system should do. He argued:

The second principle is that organisation of social insurance should be treated as one part only of a comprehensive policy of social progress. Social insurance fully developed may provide income security; it is an attack upon Want. But Want is one only of five giants on the road of reconstruction and in some ways the easiest to attack. The others are Disease, Ignorance, Squalor and Idleness.

William Beveridge, Social Insurance and Allied Services, p.6

However the balance has now slipped too far the other way. It seems that the political system prefers to invest in services rather than in income adjustment. This may be because welfare state workers are a better source of votes for politicians than the poor are; or it may be because there is a glamour associated with welfare services that are more 'visible' benefits of the welfare state

than income adjustment (building a new hospital than lifting the incomes of the poorest).

Whatever the reason it is important that we start to become much clearer about the need for income adjustment as a fundamental feature of the welfare state. In the past there have been proposals to hypothecate healthcare spending as a fixed element of our taxation. However, given the facts, it looks like income adjustment - not healthcare - is what needs that kind of protection and ring-fencing.

Our thinking about welfare is corrupted by a focus on particular services that have great emotional value or which have become politically powerful, like the NHS. In order to begin a process of genuine reform it is necessary to return to a focus on poverty and income equality.

The constitutional solution

One possible solution to the conundrum of building a fairer welfare system within a modern democracy is to seek some kind of constitutional solution. This means defining certain fundamental principles (e.g. the elimination of poverty, the fairness of the taxation system, the elimination of poverty traps) within a constitutional framework that is protected from short-term political interference and protected by other structures - in particular the courts. In this way political process can discipline itself from the temptation to pander to the median voter.

It is for this reason that the sixth element of Fair Income Security is a legislative framework, ideally with constitutional protections, that guarantees the basic rights to a minimum income and fair taxes.

It is important here to distinguish rights and entitlements. Rights are more fundamental and static than entitlements; ideally they would be established within constitutional arrangements that would be relatively immune to shifts of power within the

political system. Entitlements are more mobile, they are particular interpretations of a right, fixed to suit particular times, needs or circumstances. The proposal here is that a fundamental right to sufficient income to sustain citizenship would be fixed - constitutionally.

However the precise entitlement, that would achieve the fulfilment of that right, would need to be calculated empirically and this would change as society changes, and as:

- prices fluctuate
- essential goods change
- overall wealth changed
- learning increases about the impact of entitlement patterns

This means that the seventh feature of the Fair Income Security will be a mechanism for determining the size of the universal benefit whose decisions would be open to public scrutiny. This could work like the Low Pay Commission or the Bank of England committee that fixes interest rates.

Public understanding

However, even if reforms are coherent and rational, they will still need to appeal to the hearts and minds of the public, and particularly to those median voters who might focus on any increase in their marginal tax rates. It is this consideration that probably demands that the whole proposal is not treated simply as a modest technical adjustment but rather is explained as **a new deal for all citizens**.

Here are a number of arguments that could be used by policy leaders:

- This reform will finally free the poor from benefit dependency, encourage greater social contribution, greater economic activity and stronger family life.

- The guarantee of a basic household income is universal and, while it may not create an immediate net economic advantage for the median household, it will give the median household a much stronger sense of security.
- It is simply unfair not to provide a guaranteed minimum income or to ask people to contribute in ways that are obscure or punitive.
- This reform will help reduce crime, violence, mental illness and social instability

The current Welfare Reform Bill is useful in that it has created greater awareness of some of the problems that the poor face. However it is undermined by on-going stigmatisation of the poor and the failure treat the reforms as part of a universal set of entitlements. Ultimately the current reforms will leave some people in even deeper poverty and many people subject to confused and confusing regulations.

Conclusion

There will be two reactions to Fair Income Security. On the one hand there will be those who feel that my critique of the welfare state is too harsh, or even dangerous. We are still wedded to the Beveridge model of how to deliver welfare and we are understandably nervous about anyone proposing changes in the name of reform.

I understand this fear. The concept of ‘welfare reform’ has often masked further attacks on the poor or eroded standards of social justice. Yet surely Beveridge, if he were alive today, would be the first to be asking whether the systems that he helped to design were really working. He would surely notice that many of his fears have been realised and that it is the poor, above all, who are losing out.

This is why the concept of design is so important. We need to move away from simplistic thinking about the welfare state - the ‘more or less’ argument. The welfare state is good, but its design is wrong. We need the welfare state, but we need one that is designed better; and especially we need a welfare state that is more effective at supporting the poorest and disabled people.

The second reaction will be that this analysis is naive or simplistic. Things are much more complicated than I suggest. Change is much more difficult than I imagine. This reaction is also understandable. Change is difficult and there are certainly many more issues to resolve than I have been able to cover within this essay. Perhaps, as Beveridge feared, “patching” is all we will be able to manage.

Yet even if our political leaders can only manage to patch the welfare state we are surely right to try to define the principles that shape that patching. Even patching is a political process.

If you believe that poverty is not the fault of the poor then you will want to live in a society that works to improve the situation of the poor. If you believe that everyone, including the poor, has talents and the need to develop them, then you will want to live in society where everybody gets the incentive, support and encouragement necessary to use those talents. If you want to live in a society where everyone is treated as a fellow citizen then you will want there to be clear rights and responsibilities that everyone understands and acknowledges.

Fair Income Security offers a model that can be understood and communicated. It is a model that would serve the poor better, but would be feasible and attractive to many. It is a model that reasserts the importance of meaningful rights and responsibilities. Rights we can identify, define and achieve; responsibilities which are neither burdensome nor obscure.

Ultimately Fair Income Security offers a different way of understanding the problem of welfare. Welfare should not be a system for 'taking care' of the poor. Instead welfare should be our shared system for providing each other with security and support necessary for each of us to be full citizens.

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