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Jordan, Agulnik, Burbidge and Duffin

STUMBLING TOWARDS BASIC INCOME

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Bill Jordan, Phil Agulnik, Duncan Burbidge  
and Stuart Duffin

# STUMBLING TOWARDS BASIC INCOME

The prospects for tax-benefit integration



**STUMBLING TOWARDS  
BASIC INCOME  
the prospects for  
tax-benefit integration**

by Bill Jordan<sup>1</sup>, Phil Agulnik<sup>2</sup>, Duncan Burbidge<sup>3</sup>  
and Stuart Duffin<sup>4</sup>

April 2000

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## Foreword

I very much welcome this Report by the Citizen's Income Study Centre, with its insightful review of the prospects for tax-benefit integration and its valuable comparison of political approaches in the UK and Ireland.

The present British Government has turned its back on social insurance, which has been the centrepiece of the Beveridge welfare state. Unemployment insurance has not been re-introduced; and the basic National Insurance pension is being allowed to wither. Instead, means-tested benefits are its preferred solution, both for those out of work and for those in work. This is not a welcome development for those of us who fear that means-testing perpetuates social exclusion, that it generates poverty and savings traps, encourages people to seek their extra earnings in the informal economy, and is a source of evident unfairness.

A citizen's income, or a participation income, appears more and more attractive by the day. It is however widely regarded as utopian and not "practical politics". A very important contribution of the present Report is to show how the dynamics of tax benefit reform could lead to a basic income. Following the logic of the present Government's welfare reforms, but taking on board some of the concerns which have been expressed, the authors show how a coalition of support for basic income may be built. Stumbling may get us to a destination which route-planning has failed to reach.

*Tony Atkinson  
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## Introduction

### Background to the Project

Tax-benefit reform involves at least three elements - a *political* process, in which new ideas are brought forward and old ones challenged; a *public finance* process, in which the new principles are translated into rules and institutions within the revenue and redistribution systems; and an *implementation* process, in which these in turn are translated into practices by those officials who deal directly with the public with important consequences for social relations. This report is divided into three sections which correspond with these three aspects of tax-benefit reform.

The work on which the report is based was set in hand by the Joseph Rowntree Charitable Trust, in response to the measures announced and hinted at by the New Labour government in 1998. Since 1990, the JRCT has supported the Citizen's Income Trust (until 1993 known as the Basic Income Research Group) in its investigations into the feasibility of replacing both tax allowances and cash benefits by a universal and unconditional guaranteed income for each individual citizen. This period spanned the reforms of the benefits system undertaken by Norman Fowler in 1986, the tightening up of the conditions surrounding unemployment benefits (culminating in the creation of the Job Seekers' Allowance) under John Major's administration, and a number of changes in the rules governing income tax.

But these reforms appear fairly modest in their aims and scope when compared with those set out by the New Labour government since it took office in May 1997 - for example, to take 1/2 million people out of poverty in its first term in office (Darling, 1999), and to abolish child poverty within a generation. It therefore seems appropriate, in the light of this ambitious new programme, to reassess the prospects for tax-benefit reform along the lines of the Basic Income principle - replacing both tax allowances and most benefits by an unconditional guaranteed income for all citizens - and to review the strategy for

research and dissemination pursued by the Citizen's Income Trust.

Our reassessment and review concludes that a number of fundamental shifts have taken place across all three dimensions. First, there has been a change in *political culture* that cuts across party lines, and reflects a breakdown in the old moral and political consensus around the role of the benefits system in the economy and society. This is manifested in the government's explicit aims to usher in 'a new age of welfare', and 'break the mould of the old passive benefit system' (DSS, 1998, p.24); in the fierce debates between members of the power elite and among groups in civil society about the moral basis for these changes; and in particular struggles over tough conditionality and compulsion around welfare-to-work measures. We investigate the implications of this shift in culture through interviews with Westminster MPs and contrast our analysis of these with the tax-benefit reform process in Ireland, accomplished *within* an established political consensus. We conclude that the nature of the New Labour government's efforts to shift the culture around work and benefits (almost amounting to a crusade) will have an important influence on how the technical process of tax-benefit reform will develop in the next 15 to 20 years.

In the second chapter of our report, we turn to these aspects of *public finance* - to questions of how changes in income taxation and benefits already announced or pre-figured in policies and pronouncements will affect the likely course of developments during that period. The government is set on a course for revising these rules and institutions so as to reward low earners and ensure that 'it pays to work'. We show why gradual increases in the tax allowance are a more logical and coherent path towards these goals than widening the starting tax rate or introducing a new tax credit. Further, we also show that at a certain point in this process the value of the tax allowance (rising with earnings) will come to equal benefit rates (rising more slowly with prices). Then the value of the 'fiscal welfare' given through the tax system to individuals in work will be equivalent to the value of basic benefits paid to individuals outside the labour market.

At this point, there will be strong (we would say irresistible) political pressures towards a tax-benefit system that promotes 'full engagement'

by all citizens. Our analysis of the present (transitional) cultural climate in the UK indicates that, although government measures to widen formal economic participation enjoy wide support, there is a strong current of criticism that emphasises the value of unpaid household, family, kinship, neighbourhood, community, ecological, social and political work, and demands that the tax-benefit system should not move too far away from recognising and sustaining these. Hence a further shift towards including and rewarding activities such as caring and volunteering is likely to accompany moves towards tax-benefit integration.

We would then expect a further period of political debate, interest group bargaining and moral agonising, as it comes to be realised that the strongly conditional type of welfare system initiated by New Labour, with its strict divisions between fiscal and benefits welfare, 'deserving' and 'undeserving' citizens, and 'genuine' and 'fraudulent' claimants, is expensive and wasteful to maintain, and based on contested moral distinctions. Arguments of efficiency as well as justice will then point towards a Basic Income system where entitlement is universal and unconditional. As well as the political pressures for universality which we foresee, there is also therefore a kind of 'technical inevitability', or at least a very strong tendency, in the economic logic of these developments.

In the third chapter of our report, we turn to the wider implications for UK citizens of the range of reforms currently being undertaken by the New Labour government, and to the consequences of the future changes we envisage in chapter II. Here we deal with the broader effects on *society* of moves, first towards increased formal participation in response to tax incentives and official pressures, and then on specific groups whose roles and relationships will be affected. We argue that the government's central values, and many of the other policies within its broader programme, will eventually be compromised by the overriding priority given to paid work, and the attempt to restrict benefits to those in 'genuine need'. Hence the 'new contract' for welfare will have to be renegotiated.

Tax-benefit reforms should never be seen in isolation; they require accompanying changes in economic and social management to

'embed' them in their public policy context. Tensions already appearing in the social fabric through New Labour measures are likely to increase in the medium term, and will probably form part of the political pressures to move future governments through the stages we foresee. At the same time, issues of *implementation* (both those associated with the strong conditionality of present policies, and those that unconditional benefits will entail) require analysis in their own right. These will be the topics of chapter III of our report. They are intended to lead into a dissemination process, by which an accessible version of our ideas will be debated in a series of meetings all over the UK.

If the arguments we use in our report are coherent and convincing, they have important implications for the Citizen's Income Trust, and the wider Basic Income movement in the UK. BIRG and Citizen's Income have focused on presenting detailed costings of how the current tax-benefit regime could be converted into one incorporating the principles of individualisation, universality and unconditionality through a series of steps (transitional or partial basic incomes), ending in a scheme that retained some features of income-testing and bureaucratic control, mainly in housing allowances (for the fullest examples see Parker, 1989). Our approach, although following this logic of gradual stages over a period of time, makes more specific assumptions about the political forces driving the changes on the way. Instead of asking how a UK government would act if it were 'converted' Damascus-style to the principle of Basic Incomes, and what the costs would be of each step down this path, we instead follow the logic of New Labour's present tax-benefit reform programme, and show that - without any intention on its part, and in spite of such apparently inimical features as strong conditionality and compulsion - this leads towards a Basic Income outcome. Just to give one example, although the Working Families Tax Credit is intended to reinforce measures to guide or drive claimants off benefits and hence is entirely consistent with New Labour's philosophy of labour-market 'activation', it has the effect of creating something like a Basic Income (and a rather generous one) for people working at the national minimum wage, or just over it, for 16 hours a week or slightly longer. This might be seen as a step towards a Citizen's Income, or as an unnecessarily complex way of mitigating barriers and disincentives

to participation, which a Citizen's Income could tackle more effectively.

For the Citizen's Income Trust, such developments pose a dilemma. Should it continue to criticise the strong presumption in favour of labour market activity that is integral to New Labour's approach, or should it encourage the (largely covert and presumably unintended) steps towards Basic Income which such tax-benefit reforms can embody? Should it constantly point out, as this report occasionally does, that one logical option would be to move straight from the point where tax allowances are equal (or nearly equal) to basic benefit rates to a Basic Income system, or does it instead join in the widespread pressure for something like a 'participation income' for a much broader span of people doing unpaid work in caring, conservation, social service and civic governance? We do not attempt to answer these questions, but we hope that our report will stimulate a debate about them.

Moreover, such dilemmas will not be confined to supporters and advocates of the Basic Income principle. As we will show in chapter III of our report, they will become a feature of the work of pressure groups, voluntary associations, support organisations, community groups and political activists of all kinds. As New Labour's programme transforms political culture and society itself in the direction of higher rates of formal labour-market participation, supported by strong official pressures and considerable sums of public money, issues about how and to what extent to join in 'zones' or 'initiatives' or 'actions' will present themselves frequently. Furthermore, such organisations will be required to decide when to participate in programmes by dressing up caring, community, environmental, social and political work as 'entrepreneurship', 'economic regeneration', 'community business', etc., and to emphasise the extent that it will take people out of the benefits sector and thus save public money (even if it actually costs more); or alternatively to campaign for the greater recognition of the roles and tasks of the household, voluntary and community sectors as worth supporting and sustaining for their own sakes. Again, our aim is to contribute to the debates that will take place in organisations for women, people with disabilities, older people, ethnic minorities, local authorities and the whole voluntary sector.

Throughout the report, we confine ourselves to developments in the UK and (to a lesser extent) in Ireland. This means that we exclude the very important European dimension from our analysis. The reason for doing so is the great uncertainty about the extent to which the UK economy, and hence its fiscal and social policies, will be integrated with those of the other EU member states during the period under review. During the year in which we were conducting the research, both economic and political events seem to have made full integration a remoter prospect, because of the lack of convergence between the economic cycles of the UK and the euro area countries, and the popular preference for retaining the pound. This makes any attempt to predict the influence of membership of the common currency extremely hazardous.

Furthermore, it is much harder to read the likely direction of change in the tax-benefit systems of most of the other EU member states than it is in the UK. Taking Germany as a comparison, the UK (like Australia and New Zealand) embraced tax-benefit reform earlier, more enthusiastically and more radically, partly because of more serious worries about economic performance and competitiveness under global conditions (Scharpf, 1999; Jordan, 2000). Germany confronted many of these issues only in the mid-1990s, and then with great reluctance; Chancellor Schröder's attempts at modest reforms have been largely defeated by the combined resistance of employers, trade unions, social insurance funds and the employment services (Streeck, 1999). It remains to be seen how much longer reform can be postponed.

Second, the central issues to be tackled are rather different in Germany from those in the UK and Ireland. In the face of the fiscal pressures of the 1980s, and especially of reunification in the early 1990s, the German government opted to increase social insurance contributions rather than personal or corporate taxes. Hence the 'insider - outsider' problem that blocks the expansion of service employment in Germany is focused more on social insurance issues than on income tax or social assistance benefits, while in-work benefits and tax credits do not exist. Social insurance reform must lead fiscal reform, so the path of change will be different.

However, a number of countries occupy a position somewhere between

Germany and the UK. For example, Denmark and the Netherlands have opted for labour-market activation and attempts to improve opportunities and incentives (Cox, 1999). The Netherland, like Ireland, has relied heavily on pay restraint for competitive advantage. Tax reforms might bring them even closer to the Irish approach, and hence towards Basic Income, which both rejected in the mid-1990s. The Southern European countries are adopting more extensive social assistance programmes, thus aligning more closely with the UK (Barara, 1998). Meanwhile, the European Commission itself has been unable to reach a settled position on the direction of the reform process. While pledged to uphold the 'European model' of social policy (i.e. something like German social insurance), it also periodically indicates a need for change that will promote flexibility in employment. Its most recent *Communication or a Concerted Strategy for Modernising Social Protection* (October, 1999) listed as its first objective 'to make work pay and to provide secure income' (p.1). Yet in the absence of a clear programme towards this goal, we have not found it useful to speculate on how EC policy might influence the trajectory of reform in the UK.

Finally, a note on terminology. We have chosen to use the term 'Basic Income', in chapters I and II because this is still the one used in the debate in Ireland. In chapter III we revert to 'Citizen's Income', to indicate the term favoured by the main organisation promoting the principle in the UK. There are still some differences in the connotations of the two terms. Basic Income (BI) is the one used in the European debate on tax-benefit integration, and also in the international philosophical literature on the ethical basis for distributive justice (see for instance Van Parijs, 1995). It therefore seems more appropriate to use it in the comparative and technical parts of the report. Citizen's Income (CI) is the term that reflects the UK debate, in which members of the Citizen's Income Trust have worked hard in arguing for a social right that is the counterpart to civil and political rights. Since part of our analysis in chapter 3 is concerned with the New Labour government's attempt to redefine the rights and responsibilities of citizenship, this seems particularly appropriate for that chapter.

## **The Research: Aims and Methods**

The authors of this report undertook the independent investigation described in the previous section on behalf of the Citizen's Income Trust, through a grant from the Joseph Rowntree Charitable Trust. The stated aims of the first part of this research programme were:

- (i) to investigate how the New Labour landslide in the UK, and the subsequent high-profile welfare reform programme, have influenced the political culture on tax-benefit issues;
- (ii) to investigate how successful the New Labour leadership has been in shifting the terms of debate on welfare reform, and commanding support for its new policy measures;
- (iii) to explore the extent and nature of support for a Basic Income alternative to the present approach, and enter into a dialogue with MPs from all parties about such alternatives;
- (iv) to compare accounts of issues, values and programmes by parliamentarians in the UK and Ireland, with a view to analysing differences in political culture and policy context, and comparing support for the Basic Income proposal;
- (v) to investigate the strategies of the CORI: Justice Commission to learn whether the Citizen's Income Trust might better promote the Basic Income proposal by adopting some or all of these - specifically in relation to the work done through *Pathways to Basic Income* (Clark and Healy, 1997);
- (vi) to review the present political context for the debate on the feasibility of Basic Income in UK and Ireland.

The *method* chosen (given the short time span of the project) was interviews with MPs in the UK, and TDs and prominent members of the Social Partnership and National Economic Council in Ireland. Twelve interviews were conducted in the UK, with MPs from all parties, trying to get a balance of new and experienced, expert and lay, men and women, urban and rural, etc. In Ireland, 10 TDs and 4 policy-makers were interviewed on a short visit - here again, they were selected to give a balance of the same kind. The interviews

were tape-recorded; in the UK they were semi-structured, followed a list of topics, and lasted an average half an hour. In Ireland they were unstructured, and lasted an average of almost an hour (four were conducted by telephone).

# Chapter 1

## Political Culture and Tax-Benefit Reform

### 1.1 Tax-Benefit Reform in the UK under New Labour

During the election campaign of 1997, and when it first took office, the New Labour government gave prominence to welfare reform as an important element in its economic and social policies. In this it signalled a shift away from traditional Labour approaches to the management of employment levels, towards a supply-side focus on ‘employability’, supported by a far more ambitious and expensive programme of employment training (especially for young claimants). It also gave more emphasis to ‘activation’, through the stricter enforcement of tougher tests of eligibility. This welfare-to-work approach aimed to improve economic efficiency by increasing labour-market participation, as well as broadening the tax base and reducing expenditure on benefits.

At the same time, the New Labour leadership made it plain that it sought a shift in political culture around work and welfare, not just a ‘technical fix’ of the benefits system. While re-emphasising social justice as the basis for its policy programme, ministers insisted that this consisted in combating social exclusion, especially by expanding employment. Gordon Brown’s economic strategy aimed at ‘equality of opportunity’ in the world of work, not ‘equality of outcome’ through redistribution; he argued that increased benefits trapped citizens in dependant roles, leading to exclusion (Brown, 1997). The Prime Minister often emphasised that ‘rights imply responsibilities’ (Blair, 1998a) and that the four principles that constituted his ‘Third Way’ in politics were ‘equal worth, opportunity for all, responsibility and community’ (Blair 1998b, p.3). He presented the need to change the culture of his party and the country in terms of a need for ‘national renewal’, in which welfare reform played a central role: ‘Reform is a vital part of rediscovering a true national purpose’ (Blair, 1998c, p.iii). This was to be based on ‘a new contract between the citizen and the state, where we keep a welfare state from which we all benefit, but on

terms that are fair and clear’ (Blair, 1998c, p.v).

The emphasis on cultural change was maintained in the Green Paper *A New Contract for Welfare* (DSS, 1998), in which the Prime Minister set the tone by announcing ‘We want to rebuild the system around work and security. Work for those who can; security for those who cannot’ (p.iii). The central thrust was activation of claimants through the New Deals, seeking ‘a change of culture among benefit claimants, employers and public servants, with rights and responsibilities on all sides ... to break the mould of the old, passive benefit system’ (p.24). It heralded a new ‘fourth age of welfare’ - to succeed the Poor Law, the early and the mature welfare states - with a list of new duties to be placed on the state and the individual (p.80). ‘The development of a new contract will lead to greater trust, transparency, responsiveness, responsibility and empowerment’ (p.81).

On the technical side, the Green Paper addressed the problem of almost one in five households headed by a person of working age with no member in employment (p.10). In addition to the five New Deals (measures to improve the employability and participation rates of young people, long-term claimants, lone parents, people with disabilities and the partners of people who are unemployed), which were administered by a ‘flexible, personalised service to help people into work’, the reforms sought to lower barriers to work and make work pay (p.23). For families with children, the new Working Families Tax Credit would replace family credit. This aimed:

- (i) to improve incentives by lowering the effective marginal tax rate for low-paid workers;
- (ii) to develop a new Childcare Tax Credit aimed at covering 70 per cent of average child care costs;
- (iii) to provide through this a maximum of £105 per week for a family with two or more children (p.58). Since then, the introduction of a new 10 per cent starting tax rate and a national minimum wage of £3.60 an hour (£3.00 for those under 21) have also been aimed at making work pay for lower earners.

However, the government also stressed the aim of focusing benefits

on those in ‘genuine need’ and reducing fraud. The latter aim was to be pursued through improved intelligence, liaison and detection services, and increased penalties, as well as the stricter enforcement of benefits conditions. The former involved increased means-testing - most notably of incapacity benefit - which was defended by the Prime Minister as a way of focusing on those in greatest need. ‘Change is necessary to safeguard [the welfare state’s] future, but it must be reform that’s fair and based on principle’ (*The Observer*, 23<sup>rd</sup> May, 1999, p.30). But two backbench revolts indicated that this approach is still questioned in his own party.

For the future, the government aims to continue to expand employment (at 27,286,000 in December 1998; the highest on record) and reduce the number of claimants of all benefits for working-age people outside the labour market. The Chancellor has announced that he intends to extend tax credits to include all workers - ‘in principle, there is a very strong case for this. I want to give people a decent income from work’ (interview, *The Guardian*, 24<sup>th</sup> April, 1999). He added that child benefit will have doubled for most families by 2001, and that the government’s programme will continue to focus on employability and ‘equipping people for change’.

## 1.2 Tax-Benefit Reform in Ireland

So far, the New Labour programme in the UK has proved both popular and effective. Although there were fears that increasing unemployment among prime-age male industrial workers might more than compensate gains in jobs for young people and women during a time of world recession, the ‘soft landing’ achieved by the Chancellor has dispelled most of these. New programmes (such as Employment Zones and the Single Gateway) which extend the government’s activation approach are now coming on stream, together with the Working Families Tax Credit. However, the UK government’s success is not unique, and its methods (with their emphasis on culture shift, morality, and tightening conditions around benefits) are not the only ones available. We chose to compare the UK with Ireland, because of that country’s somewhat similar institutions and benefits structures, its recent record of economic growth (the fastest in the world), and the apparent progress made by Basic Income as a serious contribution to the debate on tax-

benefit reform.

In Ireland, there has been no recent change in what is a long-term commitment to reform the tax and benefits systems, following an economic and fiscal crisis at the end of the 1970s. The essential lines for reform were set down then, and the strategy has been pursued under a series of coalition governments ever since. At that time, the Irish adopted a Social Partnership approach to economic management. During the past 10 years, there have been four national Partnership Agreements, under which the Employer’s Federation, the Irish Trades Unions Congress, farming organisations and (since 1996) the community and voluntary sector reached compromises with governments over employment and earnings levels while pursuing a programme for rationalising the structures of taxation and social welfare expenditure. The first of these focused on levelling Ireland’s unemployment rate, which at 15 per cent in the early 1980s had been one of the highest in Europe. The second turned to issues of taxation and the incomes of those on low pay, while the third focused more on competitiveness. The present agreement, Partnership 2000, has seen the successful fruition of this approach, with record rates of growth combined with low inflation, and pay restraint in exchange for tax reforms, which have benefited a large proportion of the population.

A former Irish trade union leader explained that in the partnership process,

‘the tax thing became more pronounced each time, and finally the government have delivered on their tax commitments. Tax amendments can be seen as improving living standards over 3 years, altogether by 14 per cent ... with Europe’s lowest inflation rate at 1.7 per cent.’

Tax and benefits reforms are seen as part of the same long-term modernisation process.

The proportional representation system has required coalition governments in the 1990s, with compromise and negotiation between parties with different values and commitments. Together with social partnership, this has contributed to a long-term perspective - for instance, the continuous commitment to tax credits as an element in

tax reform since the early 1980s. A top civil servant commented:

'now tax reform has become the stock in trade for politicians of all kinds, with consensus around what needs to be reformed ... Holding deeply ideological views is not a recipe for survival in Irish politics.'

These tendencies in the political culture have been reinforced by institutions for economic management that favour a rational-technical approach to institutional reform (the National Economic and Social Council and the National Economic and Social Forum), and through joint working groups with expert members. In particular, groups studying tax-benefit integration (1993-6) and the feasibility of a Basic Income (1996 onwards) have crossed departmental as well as industrial and political boundaries. Tax policy has become social policy. A former Inland Revenue Officer, now a private-sector tax expert, commented that the whole political class in Ireland,

'has now got a strategic view of tax policy - how to make changes that are important, medium-term and irreversible ... It opened up chances in ways that were unthinkable. There is a real dialogue about budgetary policy.'

We will argue that the political settlement reached in Ireland during the early 1980s has proved more enduring than that achieved by Margaret Thatcher, as well as more successful in terms of economic outcomes (growth rates, inflation rates, reduction in unemployment). Hence there is continuity in a long-term process of welfare reform, in which moral and cultural issues are not to the fore, because there is still a viable political consensus for the modernisation of public policy. By contrast, in the UK, although Margaret Thatcher was successful in re-articulating a politics of economic individualism and social order, Tony Blair now seeks to introduce some new egalitarian elements (social inclusion, equal opportunity and responsible community) into a new settlement, and the welfare reform debate in the UK is therefore much more concerned with the politics of cultural change.

### 1.3 Political Culture - UK Interviews

UK MPs were far more likely to mention issues of morality and political justice when discussing welfare reform than Irish TDs. This occurred either in their accounts of the need for reform, or in their criticisms of the New Labour leadership's programme, and among members of all parties, ages and lengths of parliamentary experience. Where they differed from each other was *in their assessments of the moral basis of the reform legislation* (strong criticisms from the standpoint of individual liberty and egalitarian equity), and its *likely moral consequences* (pessimism from those most concerned with family and neighbourhood bonds). Those generally in favour of the reforms were ambitious, younger males from the three leading parties, with a technocratic approach to welfare issues, and a bias towards social discipline.

One younger woman, a newly-elected Conservative MP from an urban constituency saw the whole welfare reform process as addressing a moral crisis.

'... there is definitely moral breakdown, and I think that what's really worrying me is that even the instinctive moral bonds between a mother and a child, you know, most obviously between a man and a woman, have become weakened; I mean the young males don't feel any responsibility really, lots of them, for the children they give rise to ... they just don't see it as something they have produced. And the young women I see ... they are unhappy because ... fathers don't want to pay up, and they don't want them anyway, they say that when they were at home they used to beat the baby up ... More worrying is what I'm seeing ... the maternal bond, I see that as going as well, I've had a number of cases of effectively grandparents picking up the tab for their grandchildren, in dispute with their own children who have lost interest in the child ....'

When asked later why this happened, she replied that people had lost the sense of interdependence and responsibility for each other, or even how to live together. Homogeneous middle class communities were very individualistic, and in her constituency the residents hardly knew the people who lived on the nearby council estate.

'The fundamental misassumption by Margaret Thatcher, I don't think she wanted to create a polarised society, in fact she coined the phrase that the wealth would trickle down, but it totally underestimated human greed ... because the well-off could turn round and say, "Well, the state can pick up the tab". [The government's] rhetoric is right, in that it is trying to remoralise society, and we tried with "back to basics" ... governments have got to try, the levels of moral breakdown and family breakdown are so high, and such a relatively recent phenomenon (I'm talking about 20 years) that government definitely has got a role to play.'

Some of these concerns were echoed by a young Liberal Democrat MP, an expert on social security, in the context of a critical appraisal of the details of the government's programme, from a more egalitarian perspective. Although uneasy about the compulsory elements in the New Deal for Young People, he 'wouldn't mind a "heavier hand" with unemployed people or lone parents with older children'. Later he commented that many of the issues of social exclusion were about,

'... a breakdown in society. ... I see a lot of what is wrong is hopelessness. You get 400-odd teenagers driving cars at high speed ... where is the meaning in their lives?'

Another young Liberal Democrat, a new member from a mainly rural constituency, echoed this support for welfare-to-work, and thought that it was important in tackling a culture of benefits dependency.

'They were right to make this an important issue, because there is no doubt that there was a culture of being on benefits, and not being able to get out of benefits.'

It was therefore among younger and newer MPs that the issues for welfare reform were most likely to be seen as moral ones. Conversely, among older and more experienced MP's, the government's programme was most likely to be criticised for its suspect moral basis, especially from the standpoint of egalitarian ethics and distributive justice. This included two 'Old Labour' MPs from industrial constituencies. One said that the new emphasis on responsibilities and obligations is,

'... a means of putting the poor in their place, as idle, feckless, failures, to fulfil their responsibilities ... The approach in the '70s was always to attack scroungers, as really not deserving, not wanting jobs, just wanting to lay about; now the same tack has become a moral issue, if they don't fulfil their responsibilities we're quite justified in starving them to death.'

Another said that important values were at stake.

'The Secretary of State and the cabinet are well aware [of the vulnerability of the groups whose benefits are being cut]. I think it's a cost-cutting exercise really. They know who are ... the people least likely to know their way round the system, they're the people at the bottom of the pile, who have the least money, or, in my case, a lot of people who don't speak very much English.'

An experienced Liberal Democrat MP thought that financial disciplines had switched off many radical and progressive ideas.

'It's ... tied up with taxation, and people's attitudes to taxation in Britain, which have changed very fundamentally, ... as long as we have a selfish sort of philosophy, promoted by television adverts, etc., it will be very difficult.'

Another senior Liberal Democrat spokesperson was very forthright in condemning erosion of the political and social rights of poor people as citizens.

'I don't think many people who end up having recourse to the state for most of their income are scroungers, and they shouldn't be labelled as such. They're belonging to society, paying their taxes and insurance ... therefore when you have illness, unemployment or old age you shouldn't feel that there is stigma attached to claiming, so I feel very strongly that it is a citizenship issue. ... It's populist to crack down on scroungers and cheats and the workshy and the lazy and the wicked, and you can write a *Sun* or *Mail* headline, and the government could sell a package on the basis that that is what

it was going to achieve, and appeal to lots of people, so there are political dangers in opposing this.'

Finally, an experienced Plaid Cymru MP argued that the reform programme was unfair on poor people.

'Our fear is that the politics of the '80s and '90s has been the politics of the middle class, and middle class values, at the expense of the less well off in society, that's always concerned us. Because nobody seems to be speaking for the underprivileged, and those who have to survive on very low incomes. The drive towards greater wealth, cutting welfare, cutting taxes, is just the only solution on offer.'

It is worth noting that all these critics of the government programme, from the moral stance of egalitarianism and distributive justice, were supporters of the Basic Income principle - but as a means of *preserving* the old values of the welfare state not as a radical innovation. Also, all felt very far from a position of influence on policy on this, either in their parties or in the legislature.

The experienced Conservative critic of the reform programme was, like his colleague previously mentioned, in favour of giving more support and better incentives for two-parent families and good parenting, but more fatalistic in his assessment of the morally reformative consequences of new measures (Working Families Tax Credits would be, 'like a cross between the poll tax and the Child Support Agency'), especially in relation to attempts to include members of deprived communities.

'I would say you've lost it ... 25 years ago, Bermondsey ... had got the self-help mentality of the friendly society and all of that. And I fear we've lost that, and to restart it is extremely difficult. Nice patter about credit unions and that is just drawing-room window-dressing again.'

However, the MPs who were policy 'insiders' in the two main parties were the most positive about the potential for technical adjustments to the tax-benefits system, through increased selectivity and tax credits, but the two Conservatives among these were also the most hostile to

Basic Income, while the New Labour loyalist strongly supported present government reforms, but thought there might be a long-term possibility of Basic Income via this route.

## 1.4 Political Culture - Irish Interviews

What was strikingly different about the Irish interviews was the extent to which the reform process carried consensual support, from politicians of all parties and all age groups. Criticisms were made about details and priorities from within this consensus, but it was apparent that the long-term strategies pursued by both coalitions under partnership agreements reflect an enduring political settlement about economic management and the modernisation of the welfare system. There was only one partial exception to this rule - an experienced radical independent (socialist) TD, and even he was forced to concede that policies to fight unemployment had been so successful that a UK-style welfare-to-work approach was unnecessary, and that the most recent budget had demonstrated the potential for raising the incomes of those in greatest need through tax reform and the introduction of tax credits. Yet he maintained that 'governments here have never had the objective of narrowing the gap between rich and poor,' and that 'Ireland has become a conservative society.'

This consensus was all the more impressive, because the interviewees spoke from a variety of moral and political perspectives, yet all found something to approve as well as something to criticise in what had been achieved. Among them, there was one fatalist (an experienced Fianna Fail backbench TD); two feminist TDs (one from Fine Gael, one from Labour); a Green-egalitarian TD; two new Fianna Fail TDs from urban constituencies, who seemed to come from the heart of the consensus; a Progressive Democrat Senator with an individualist perspective; a leading economic spokesman for Fine Gael with a strong commitment to tax reform, and a tax expert, formerly from the Inland Revenue, now in the private sector; a former Democratic Left minister and his former adviser with characteristically hierarchical-egalitarian standpoints; and a former trade union leader for a low-paid public sector occupation, also broadly egalitarian.

Despite the fact that the Irish interviews were on average twice as

long as the UK ones, there were far fewer mentions of moral issues made, and only one TD (the fatalist back bencher from Fianna Fail) considered that moral issues were at the heart of the welfare reform process. While acknowledging the achievements of the tax reform programme he alone claimed that low earners resented paying for those on welfare, especially those working in the black economy. He took a line that would have been orthodox in the UK, but felt it necessary to apologise for this, in a self-deprecatory way.

'The welfare state should really be for the elderly. Governments should be encouraging the rest to work ... the problem is too many people get up at noon, the kids don't get to school. We must encourage them to get up and go out to work. No, I'm joking, I don't mean that at all.'

Several TDs mentioned the fact that lone parents - who can currently earn £115 per week without losing any of their benefits - now have much better labour-market incentives than married women. However, they saw it as an issue to be tackled by improving incentives for the latter, not reducing the advantages of the former. The Fine Gael spokesman commented on an unsuccessful attempt to make political capital out of the situation by the Progressive Democrat leader, which had been punished by the electorate.

'People didn't like the idea of being hard on young single parents ... (now) everyone is afraid to mention the subject. ... It's a pressing issue that is put to politicians by people in public housing schemes ... In the private housing estates that would not be a strong issue ... We're in a kind of post-Christian period here in terms of religious practice. But the whole Christian ethic is stronger than it ever was, and people would argue that it was a nasty campaign to try to deprive women with babies of the few pounds they have, and sure they need it, and they'll all go back to work in a few years anyway. People just didn't like it.'

A new Fianna Fail TD in an urban constituency commented that in his area,

'the vast majority of people now who are beneficiaries of the social welfare system *need* to be beneficiaries of it ... I think most people acknowledge that. We have a high concentration, for example, of travellers in our community, and it's recognised that they can contribute to the social economy, they also have very serious economic needs, and the state has to be there to support them. We have quite a high concentration of lone parents, young lone parents, and the supports also have to be there for those. There is a recognition ... working class communities like ours come to terms with these things quicker than middle class ones.'

The Progressive Democrat Senator, though market-minded in his policy orientation, said he thought 'people in Ireland are closer to deprivation, going back to history' - to famine, the experience of British rule, poverty and unemployment.

Above all, however, the consensus has revolved around the possibility of combining successful management of the economy with step-by-step reform of tax and benefits systems, through trading off wage restraint, first with reduction in unemployment, then with increased tax allowances, and now with tax credits. This in turn has allowed a reform of the benefits system that *improves incentives*, and *does not rely on negative sanctions or pressures*. 'Activation' is low-key and voluntary; the detection of 'fraud' is seen as an administrative issue, not one of macho enforcement. Thus, although there are political disagreements about the reform process, there is no perception of a need to redefine the terms or terrain of the political settlement, or to remould citizens' characters, or change the culture of welfare provision. With a likely minimum wage of £4.60 this year, lone parents on a 50 per cent taper from £115 to £230 a week, and the long-term unemployed retaining their benefit for the first year of re-employment, and then losing only 25 per cent of it for each of the next 3 years, positive labour-market incentives are self-evident.

One irony of all this is that those closest to the reform process - the senior party members, the top civil servant, and the tax expert - were most open-minded about Basic Income as the possible final shape of the tax-benefit system. Four very senior and influential interviewees

favoured reforms which moved from the recent change (of tax credits replacing tax allowances) through refundable tax credits, integrated with benefits in a step-by-step way, and ending with BI.

'I recently spent two hours with the Finance Minister ... I said we should start moving towards [tax-benefit] integration - through the Family Income Supplement, towards a Basic Income ... It would be silly not to move FIS on to credits as the first level of Basic Income ... not a taxable income, a cheque in the post to bring up the family wage. Then also systematically move to ... other tax-credit graft-ons.'

(Senior Fine Gael Spokesman)

'The objective would be to give the disadvantaged protection. The vehicle is less important than the objective - I have no ideological perspective, provided that we can eliminate those able to fend for themselves.'

(Progressive Democrat Senator)

'A refundable tax credit would now be technically much easier to administer ... [On Basic Income] a technical, incremental stumbling backwards into it is more likely than a full-blown conversion.'

(Top Civil Servant)

Enthusiastic supporters of BI see the partnership-based reform process as a slow way to achieve it, but this has the virtue of preserving the consensus.

'The partnership approach, which we're now working on again with the Partnership 2000 proposals, that has resulted alright in a fair amount of consensus among the social partners and government in how the economy is to go, but within that partnership there is, I feel, a considerably conservative point of view. Generally, because there is a consensus being looked for, and very often that consensus is the lowest common denominator, it doesn't incorporate anything too radical other than an agreement to keep the peace ... At times you can see

a glazed look come on the faces of established politicians when you mention a guaranteed Basic Income ... But it's important to see reforms of the tax system as going hand in hand with steps towards the guaranteed Basic Income.'

(Green Party Spokesman, TD)

A Fine Gael TD who had supported BI over a number of years because of its emancipatory potential for women felt that the time was now ripe for its adoption, due to the healthy state of the Irish economy, and the young, well-educated population. There was an enormous potential for development and change, partly because of the lack of the entrenched work roles for men and women that went with industrialisation in other European countries. Ireland could create a new model, because of the lack of these shackles of fear and insecurity from the past. Hence she thought that the reform process should move more decisively and quickly to BI, to take best advantage of the climate of excitement, success and innovation.

A Labour Party TD feared that Ireland's new-found prosperity had held to less concern about social justice, less sympathy for the poor, more competition and 'less consciousness of the need for egalitarian measures'. She thought the economy was less controlled than in the early 1990s, when there was a 'greater sense of society', and that recently 'there has been a view propagated by government that the state has no business interfering in people's lives.' However, she thought that the UK government had 'gone the wrong way ... the driving force is welfare to work for lone parents.' BI would be attractive partly for 'bringing everyone into the tax net: there are lots of categories of income outside it.'

A further irony in Ireland is that the former Democratic Left, which was originally the prime sponsor of the BI principle, now expresses some scepticism about it. This is because, as part of the coalition government of 1995-7, it found alternative approaches to welfare reform more attractive. The minister in that government said that BI was 'not a panacea', and that under partnership agreements there were 'no dramatic shifts, more continuity of policy, which is no bad thing, and helps to establish a base for investment.' His former adviser in government added that reductions in poverty and inequality were

possible in other ways, and that other instruments were more effective in the short term. ‘While not departing from the ideals and objectives, I think that BI is not the only, or even the best way, because of its inflexibility and tying the tax rates closely to the level of income.’

## 1.5 Political Culture - Conclusions

It has *not* been argued that the welfare reform process in Ireland is less concerned with the moral character and behaviour of citizens than that in the UK or that TDs are less concerned with social justice than UK MPs. Rather the analysis has tried to show that the interviews reveal a reform process carried out within the political settlement of the early 1980s, and embracing all the main moral standpoints and political values in mainstream European political culture. Hence there is no need for the government to construct a new cultural basis for welfare reform, and institutional change can be negotiated within coalition politics and social partnership. Above all, because the same consensual methods have achieved such success in economic management, there is no need to justify new principles of conditionality or new methods of compulsion. As the former trade union leader commented, it is easy for workers to be convinced of the advantages of tax and benefits reform when they are seeing such growth in their incomes, and it is this buoyancy of earnings and employment that has drawn so many back into the labour market.

By contrast, in the UK welfare reform is closely linked with the New Labour project to construct a new political settlement - the Third Way. The rhetoric of reform is very much couched in terms of a culture shift - ‘a new age of welfare’, ‘breaking the mould of the old passive benefits system’, etc. (DSS, 1998). The research interviews cast doubt on the success (up to now) of this project. While some MPs saw the reform process as a response to a ‘moral breakdown’ among claimants, they were unsure or sceptical about its outcomes; and a far larger number were deeply critical of the moral basis for new powers and restrictions. It was among tax-benefit experts, and for technical rather than moral reasons, that the reforms commanded most support.

In the longer term, there are other issues for both countries’ reform processes. In Ireland, it will be necessary - if present phenomenal

rates of economic growth are to be sustained - to continue to draw married women into the labour market. Hence the debates between the traditional view of the home-based wife and mother, and the continued demand for women workers in the economy, are likely to intensify. Some authors have argued that the decline in housewife roles (and rise in female employment) are the keys to future jobs growth, since each 100 new employments for married women creates a further 15 in paid child care and domestic work to sustain them (Esping-Andersen, 1999). Hence a culture shift in Catholic societies like Ireland becomes a necessary condition for the widening tax base and steady incomes growth that can support the rest of Ireland’s tax-benefit reform programme.

In the UK, by contrast, female participation is already high by European standards, so the scope for further jobs growth through this route is limited. Instead, there is likely to be a point at which some resistance to the commercialisation of household, kinship, neighbourhood, social and community mutuality starts to manifest itself, especially in the form of protests from some organisations and groups representing women, family values, children’s needs, support for people with disabilities, religious bodies (including non-Christian faiths), the voluntary sector and political parties. As formal labour-market participation rates rise, and informal household, kinship, social and community activities become residualised, voices will be raised to slow down the cultural shift that New Labour has initiated. In particular, the costs to family, neighbourhood and civic life, and threats to the long-term stock of social capital generated through informal activities, will come under scrutiny.

Thus there will be two respects in which the change in political culture that accompanies New Labour’s attempt to improve labour-market incentives raises doubts about values central to the British liberal democratic tradition. First, strong conditionality and compulsion of poor people into employment cannot be easily squared with the principle that minorities should not be coerced for the good of the majority, or individuals for the public good, except in real emergencies like wars. Second, the tax-benefit advantages given to formal work breach the principle that the law should always be neutral in relation to citizens’ different conceptions of the good life - it should uphold

those rules that are just and right for all, not favour one particular version of the good over others (Barry, 1993). By insisting on such employment as a duty of citizenship, and treating paid work better than traditional unpaid, informal ways of getting the tasks of social reproduction done, the government may risk offending more electorally significant sensibilities among the middle classes. Tax-benefit reforms that offer strong incentives to women's labour-market participation at the expense of roles in unpaid child care, kinship networks or voluntary social service may be open to just such objections.

## 1.6 Implications for the Long-Term Tax-Benefit Reform Process and Prospects for BI

The comparison with Ireland has been addressed in detail because the time perspective of the reform process is far longer there. The secret of Ireland's recent economic and employment success lies in wage and salary restraint, sustained (through partnership agreements) over a 20-year period, and based on interest-group bargaining, social planning, and tax-benefit reform. Understandably, the New Labour government in the UK has focused on the first stage in its process of reform, since this has involved very important changes in tax and benefit rules, institutions and cultural practices. It has not yet looked beyond these to a process of change lasting over three or four parliaments, which is what the Irish reforms have already entailed.

In this section we will try to draw together the evidence from our UK research on what political support there is likely to be for further changes, and in particular how the Basic Income proposal can contribute to the unfolding story of tax-benefit restructuring. In the last section we saw that some MPs in all parties were already doubtful about the long-term destination of change, and the viability of the New Labour project. However, technical experts in all parties endorsed New Labour's attempts to approach the tasks ahead through improving incentives, and reinforcing these by strong conditions on benefits eligibility, and measures against fraud. This group were all convinced that BI had little to offer in the short run, though one (from the government's party) thought it might in the much longer term be relevant.

The last point is the most important one for the research project, because the group of MPs most hostile to BI was the one which is the most influential within the policy-development process in the main UK parties. It was ambitious, knowledgeable, younger male MPs who rejected the BI proposal outright. In Ireland their equivalents (in fact, even more senior and influential members of the policy community) saw BI as a logical, and almost inevitable, development out of the long-term process of tax-benefit reform.

It is therefore worth looking first in more detail at the reasons given by this group for rejecting the BI approach.

### *Opponents of Basic Income*

Two Conservative MPs both said that they had studied the BI proposal in detail and done research, and both claimed initially to have been attracted or neutral. One argued that the diversity of claimant situations makes the attempt at a single uniform system hopeless. Since the basis of moral claims on the community is so different, the coercive and high tax regime is not viable. Furthermore, the attractiveness of BI's simplicity is disingenuous, because any residual means-testing destroys most of this, and because it ignores the complexity of real life and of the situations and moral claims of claimants. A big welfare state may be sustainable in a small homogeneous population like Sweden, but not in a big multicultural one.

The other claimed that his own research revealed that BI was unsustainable (too high tax rates) and redistributed to the wrong people (middle incomes). There are better ways to improve incentives and help the poor, involving *child benefit* and *housing subsidies*.

The Liberal Democrat expert argued that pragmatic opposition to the details of New Labour reform measures is better than an idealistic fantasy of a BI without pain, especially since his party can't get publicity for new ideas. On the one hand, he said that Labour has captured and shaped the popular political culture with its ideas for reform. On the other, he thought that those who supported BI were muddled about the feasibility of a simple 'Big Bang' transformation, and unaware of the messiness of gradualism and compromise.

The New Labour expert, while not directly opposing BI, said that present New Labour policies are a more promising route towards reform goals, and implied that it is better not to declare BI as the destination. Through the Single Work-Focused Gateway to claims, different rates and structures of benefits would come under question, and all claimants would be treated the same way (the opposite viewpoint from the first Conservative interviewee). Also tax credits - WFTC and CTC plus Employment Credit for workers over 50 - would give a new impetus to the tax-benefits integration process, and hence bring forward the goals of BI advocates, without overt commitment to this principle. His view was therefore somewhat closer to those of the Irish interviewees who were involved in policy development.

It is important that these opponents of BI tend to be *political insiders*, who are going places in their parties, and linked into important policy networks and communities. This means that they are in strong positions to discredit the BI approach, and keep it off the policy agenda, using their acknowledged expertise and insider status. Others defer to them; MPs who support BI see themselves as (and are) *outsiders* in the policy process. This implies that - if the CIT is to argue for the step-by-step reform process - the first steps must be consistent with the technical means and policy goals supported by this group.

### ***Supporters of BI***

Of the twelve MPs interviewed, half were broadly in favour of BI, or found several attractions in it, mainly because the principle was in line with their political values, and they saw that there is no future for the tax-and-spend approach to welfare that sustained these values up to now. But they saw themselves and other supporters as relatively powerless in the face of technocratic and political opposition to the proposal.

Supporters in the different parties were supporters for different reasons, which reflect their parties' traditional values and concerns.

Both Liberal Democrat supporters interviewed have remained faithful to their party's 1990 commitment to BI. One saw it as the only approach to welfare reform consistent with liberal democracy, and is horrified by the loss of political rights and liberal values under New

Labour's new authoritarianism. The other (a Welsh MP) saw it as consistent with the survival of Old Labour values such as solidarity, security social investment, quality of life and distributive justice, and reckoned there are votes to be won for Liberal Democrats in Wales from Old Labour supporters.

Of the two 'Old Labour' MPs who expressed support, one was a longstanding convert, and the other converted by the research process. Both saw the New Labour leadership's commitment to reform as cynical, picking on easy victims, and a reflection of populist pandering to middle-income voters. Both saw BI as the only way to be true to the values of social justice, and to help the most vulnerable. One put forward sophisticated political and economic arguments for BI; the other's case was based on an in-depth understanding of the problems of long-term claimants and the economic problems of deprived ethnic-minority communities.

The Plaid Cymru MP saw BI as the only path to reform that combines realism over tax-and-spend restrictions and traditional values over redistribution, security and the protection of vulnerable groups, especially in depressed rural regions.

Finally, one more senior Conservative MP was 'persuaded' of the possible advantages of BI during the interview. His responses to the questions conveyed the depth of Tory despair and rage over the failures of the recent Conservative government, and the policy vacuum in the party over welfare issues. His main criticisms of New Labour were that reforms are not radical or practical enough, and too like failed Tory ones. BI was attractive because it was new, radical, clear and potentially marketable as pro-family.

### ***Agnostics on BI***

Perhaps of most interest were the two new MPs (one Liberal Democrat and one Conservative) who were more or less neutral, though on balance anti. They were both young and knowledgeable in a *practical way about benefits, but unfamiliar with the technical and political arguments over reform options*. They probably represent a goodly proportion of younger, newer members, and hence a 'world to be won' for BI advocates.

The Liberal Democrat MP followed his party leadership in criticising WFTC and the New Deals, but was in line with New Labour in broadly accepting welfare-to-work and compulsory approaches. He favoured a broader notion of how claimants could fulfil their obligations to society, which included informal community and voluntary work and caring. Hence he was a potential supporter of some kind of 'participation income' option (see chapter 3).

The Conservative member showed the disillusion with previous Tory policies and lack of any coherent alternative described above. She was very knowledgeable about practical issues and problems with welfare-to-work initiatives, she took a familialist, communitarian-moral stance, and was perhaps open to persuasion on issues around parenthood, caring, community and voluntary work.

Here there is common ground between the second group (BI supporters) and these agnostic younger MPs. Although the New Deals are generally seen as having advantages, and tax-benefit reforms that improve incentives are clearly seen as most desirable, there is widespread concern in both these groups over a possible imbalance in favour of formal employment, and a wish to see informal work roles recognised and valued.

Where the New Labour 'culture shift' has clearly been most successful is:

- (i) ruling out any tax-and-spend options, yet disguising the high costs of the New Deals and WFTC, or making them more politically acceptable than benefits-enhancement alternatives. Only despairing Conservative critics (who could not offer an alternative) saw the welfare-to-work approach as fundamentally flawed, and likely to be a disaster;
- (ii) portraying the problem as excessive economic individualism and selfish pursuit of short-term interest, yet blaming the institutions and attitudes of the welfare state rather than middle-class choices and strategies that have evolved under Thatcherism. For instance, social polarisation, the 'learned dependency' culture and undeclared cash economy were seen as products of failures of benefits reforms, rather than

consequences of middle class families' strategies, and governments' pandering to middle class interests. Supporters of BI were the exceptions to this.

For these two reasons, it seems that the 'philosophical' case for a move straight to BI, in terms of political rights and social needs, is likely to fall on stony ground. The main constituencies for this approach - older Liberal Democrats who have never given up BI, and Old Labour supporters who have jumped straight from Beveridge to Basic Income - are already convinced by these kinds of arguments, and don't need any more of the same. They may be slightly put off by alternative ways of framing the arguments, and by the gradualism of a move through a 'participation income' stage, but not enough to matter.

This suggests that there is a substantial sector of the political elite who have not uncritically accepted New Labour rhetoric as a basis for welfare reform. While they are willing to give priority to arguments for targeting, improving work incentives and changing the 'benefits culture', they have their eyes on longer-term issues over the effects on wider social relations of the changes initiated by New Labour. In particular, they are likely to look in future parliaments for evidence of a better balance between support for employment and support for unpaid activity of all kinds. Hence they might well be convinced by a strategy for long-term tax-benefit reform that could show:

- (i) that BI can deliver better-targeted and better-incentivised benefits for people in work;
- (ii) that in the transitional form of a Participation Income, it can recognise voluntary and unpaid care work, and promote family values in ways that are consistent with economic efficiency. A strong community sector and a community development approach to economic regeneration are essential elements in such a policy mix, while compulsion and coercion are not;
- (iii) It is a necessary precondition for *both* enterprise and security;
- (iv) In the long run, it is inevitable that the reform process will lead in this direction.

be put off by the argument that it redistributes towards home-based better-off women – especially the Conservatives among them. This approach would build on the New Labour culture shift, by extending its concepts of work, participation, responsibility and inclusion, rather than trying to overthrow them. It would also adopt those parts of the Irish long-term reform strategy which suit the UK’s political culture and institutional setting.

## Chapter 2

### The Dynamics of Tax-Benefit Reform

This chapter examines two issues common to all forms of minimum income provision. The first is what combination of tax and benefit policies will *deliver* such an income in the most efficient and economic way. The second is how to *justify* the resulting tax-benefit system in political and moral terms. The first of these is strictly a question of public finance and administration; the second is a political question.

In the UK, the first issue is dominated by the problem of incentives within a set of means-tested minimum income schemes. (In continental Europe, by contrast, it is the rather different set of problems associated with earnings-related social insurance which dominate)<sup>1</sup>. As we shall show, in purely economic terms there are compelling arguments for moving from the present tax-benefit regime towards a BI system, which would create more logical (and fairer) incentives for all. But because of New Labour’s emphasis on paid work, the second issue – the political and moral justification for income maintenance policies – has overtaken questions of delivery in the welfare reform debate.

Hence, though much of the analysis in this chapter deals with technical considerations of public finance, the structure of the argument is dictated by the logic of starting from present pro-employment tax-benefit reforms. The ‘steps’ or ‘stages’ which we describe are determined by this political starting point, and not by any technical necessity.

#### 2.1 The Reform Process

The previous chapter contrasted the highly moralised debate about welfare reform in the UK with the relatively non-ideological debate taking place in Ireland. While our UK interviewees frequently couched their arguments in terms of ‘rights and responsibilities’, the members of the Irish political elite we interviewed were more concerned with practical matters of public finance: who would gain or lose from reform

<sup>1</sup> See Introduction, p.12, for an elaboration of this point, and an explanation of why the European dimension has been omitted here.

and how labour market incentives would be affected. As we concluded earlier, the fact that a basic income is a serious policy option in Ireland – and is seen by many as the logical conclusion to tax and benefit reforms currently underway – reflects this focus. The consensus-building which goes with their successive partnership agreements favours economic analysis over moral exhortation, and, as we set out in this chapter, BI offers probably the most (economically and administratively) efficient way of redistributing and maintaining incomes. Hence, Ireland might ‘stumble backwards’ into something like a BI, with policy insiders (adopting a rational, expert-led approach) being among those pushing hardest in this direction.

The position taken by UK policy insiders, who tend to view BI as ‘social science-fiction’, is therefore paradoxical. In Ireland arguments surrounding the compatibility of social justice and labour market flexibility have led policy insiders in the direction of BI while, despite these shared concerns, UK policy insiders barely consider BI worth mentioning. Why is this?

Clearly one reason – we would argue the main reason – is the emphasis on labour-market activation as a central feature of New Labour’s attempt to change the culture of welfare and ‘break the mould of the old, passive benefits system’ (DSS, 1998a, p.23). This has led to changes in the rules for in-work and out-of-work benefits, which reflect a kind of *moral crusade* in favour of the paid work ethic. For UK policy insiders this crusade has displaced the broader social policy values of impartiality and fairness between citizens, to the point where reforms that are morally neutral (which, as we shall argue, is the case for BI) are seen as morally suspect, even when they actually improve incentives.

This preoccupation with morality, which was noticeably absent in our interviews with Irish policy insiders, presents a major obstacle to the introduction (or even consideration) of BI in the UK. The next chapter discusses further whether this focus on work and conditionality is likely to help or hinder the government’s wider policies for tackling social exclusion (Lister 1998), and its welfare reform agenda more generally. However, before these issues are addressed, we should turn to the other major reason for the opposition to BI among UK policy insiders, namely the effect of this type of reform on tax rates.

If even prominent supporters of BI (such as Parker, 1989) suggest that the tax rates it would involve are ‘too high’ (economically and politically), it is perhaps unsurprising that opponents of BI also focus on the public finance implications of such schemes. Of course, judgements about what rates of taxation are acceptable are highly normative. Economic analysis of optimal tax rate(s) relies on assumptions about the elasticity of labour supply and society’s redistributive preferences, values for both of which are difficult to determine empirically (Heady, 1996), while claims that taxes are ‘too high’ politically are inherently unprovable. Nevertheless, it is certainly the case that BI would involve higher taxes, and folk wisdom (at least in the minds of our interviewees) has it that a radical increase in tax rates would be massively unpopular, even if the majority of households in fact became better-off as a result.

Part of the job of this chapter is to calculate the public finance effects of introducing a full BI scheme (i.e. one where entitlement is unconditional and universal), and the tax rate(s) with which it might be associated. But first we aim to show that the dynamics of tax and benefit policy in the UK make the adoption of a very restrictive form of BI – which we call a ‘labour market participation income’ (LMPI)

highly likely. At root this reflects the fact that, in line with the previous administration’s policy, the government have linked the value of Income Support to prices rather than earnings (at least as far as the working age population is concerned<sup>2</sup>). This means that, relative to GDP, a basic income set at the level of Income Support is becoming steadily cheaper over time<sup>3</sup>. For the same reason, if we assume that tax allowances increase with earnings (as seems reasonable in the long run, though the failure of all recent governments to maintain the relative value of the allowance must also be acknowledged), there

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The government is committed to increasing Income Support for pensioners in line with earnings (see DSS, 1998b). Income Support claimants with children have also seen some increase in the real value of benefits, though this has come through ad-hoc rises rather than a more general change in uprating policy.

<sup>2</sup> Throughout this chapter we use the level of Income Support as the minimum income standard, and set benefit rates accordingly. Alternative approaches, such as setting the minimum standard at half average income, are not discussed; for our purposes it is useful to take the actual standard (as set by Income Support) rather than a more general measure of poverty. In other words, this study is not concerned with the level of the minimum income, only how it is delivered. We therefore make no claims as to the **adequacy** of benefit levels under the various schemes we describe.

will come a point in the not-too-distant future when the implicit value of the tax allowance will be the same as a single person's Income Support entitlement. At this juncture the switch to a LMPI would have relatively minor public finance consequences and, depending on how it was done, might not involve large administrative upheaval.

However, as this chapter sets out, we believe that a range of political and economic factors will tell against a scheme where participation is associated solely with labour market activity. Though the chief social policy concern of the 'technocratic' policy insiders we described in chapter 1 is currently worklessness, leading them to favour the LMPI approach, there are already elements in New Labour's programme which look towards a broader definition of social citizenship. In the end, we argue, the UK will arrive at something like an unconditional basic income (which for clarity we label a UBI) through gradually broadening eligibility to an intermediate 'social and economic participation income' (SEPI). The path outlined in this chapter is not the only possible one, but the requirements of the government's wider programme and support indicate that it is the most likely one. While public finance arguments will still be a factor once the LMPI stage is reached, it is the moral and political case for extending benefit eligibility which will be more important in determining the speed of transition to a UBI. Thus, although the cost of each reform is substantial relative to today's tax-benefit system, the more relevant comparison is between the three schemes, where the difference in cost is smaller. In other words, if the tax allowance was substantially increased much of the cost of introducing a basic income would be removed.

Our first task is therefore to show why an increase in the tax allowance might be desirable in any case, notwithstanding the possibilities this opens up for reform of the benefits system. To this end, the next section contrasts two ways in which the tax system might be used to help childless low earners: through widening the 10p starting rate or through raising the level of the tax (and National Insurance) allowance. In addition, it also examines the case for introducing an 'employment tax credit' targeted on low earners. (For the timebeing the position of households with children and pensioners is ignored; we discuss the former group in Section 2.6 while pensioners and pensions policy

more generally are considered in Section 2.7)<sup>4</sup>. It might be objected that this focus ignores precisely those groups which public policy is most concerned about. But since the majority of the UK's adult population live in childless non-pensioner households (DSS, 1999a, Tables B1 and B3), it makes sense to look at their position first before moving on to 'special cases'. Moreover, though under-represented relative to their weighting in the population as a whole, non-pensioner households without children account for some 35% of the bottom decile of the income distribution (after housing costs, DSS, 1999a, Table D1).

## 2.2 Helping Childless Low Earners through the Tax System

The effect of tax changes may be illustrated most easily through quantified examples. Let us suppose that, after taking account of planned increases in spending, the Chancellor calculates he has sufficient revenue to give away £2 billion a year for each of the next five years<sup>5</sup>. Further, let us assume that, in giving away this money, he is most concerned about the plight of (childless) low earners - the 'deserving poor' who are the object of New Labour's redistributive desires (Piachaud, 1999)<sup>6</sup>. What options does he have? One, clearly, would be to redistribute income through the benefits system, so that available resources are used to increase the level and/or number of recipients of state transfer payments. However, for present purposes we assume this policy option is ruled out: on the evidence of the interviews described in chapter 1, and the first 1000 days of New Labour government, we judge that UK policy makers will more readily countenance redistribution via the tax system than via the benefits system.

<sup>4</sup> It should also be noted that this chapter completely ignores the issue of housing costs – implicitly it assumes that everyone is an owner-occupier and does not qualify for any form of state support. While this is clearly very restrictive, it makes illustrations less convoluted, and simplifies the structure of the argument. However, Parker's (1989) conclusion that housing costs are the 'Achilles Heel' of basic income schemes is also relevant, and the next chapter includes a fuller discussion of housing than would be possible here.

<sup>5</sup> Such revenue buoyancy may result from higher than expected economic growth, from increases in environmental taxes (e.g. on petrol or housing), or from an over-correction for previous fiscal deficits. Depending on the outcome of the next Comprehensive Spending Review, and assuming that the economy continues to perform robustly, a give-away of £10 billion (a little over 1% of GDP) over the course of the next parliament is quite conceivable.

<sup>6</sup> For our purposes 'low earners' are people on the minimum wage. For the timebeing we ignore the position of low earners with children, where a broader range of policy instruments is available in both the tax and the benefits systems..

Accordingly, the analysis in this section is confined to the second way in which the state may directly affect incomes, namely through changes to taxation.

The most obvious way of giving money away via the tax system is through reducing the basic rate. Broadly, each penny taken off the basic rate reduces tax revenue by £2 billion; hence, over the course of a parliament, there would be sufficient revenue under our assumption to reduce the basic rate from 22% (in 2000/1) to 17%. However, assuming that the Chancellor is most concerned with how changes affect low earners, we do not think this direction for policy will be adopted. So little of low earners' income is taxed at the basic rate that they gain little from basic rate reductions<sup>7</sup>. We therefore confine our analysis to two alternative reforms – widening the 10p starting rate and raising the personal allowance – before looking at the effect of an additional policy option, recently mooted by the Chancellor, of introducing an 'employment tax credit'.

### **Graduated tax rates or higher allowances?**

Tables 1 and 2 show the effect on childless low earners, working varying number of hours, of two alternative directions for tax reform. In Table 1 we show the effect of widening the 10p starting rate so that it covers more than just the first £1500 of taxable income. In Table 2 we show the effect of an alternative policy of raising the personal tax allowance; for convenience we assume that this policy is also applied to National Insurance Contributions (NICs), so that the lower earnings limit rises in tandem with the tax allowance<sup>8</sup>. A third option of reducing the starting rate (e.g. from 10p to 5p) is not considered; while in the short-term these two policies may be distinguished, the logical conclusion to a policy of lowering the starting rate would be to reduce it to zero, and hence we will confine our analysis to increases in the tax allowance.

<sup>7</sup> For example, to take the most hard-working of the examples used below, someone on the minimum wage (£3.60 an hour) who works a 42 hour week would gain just over £100 a year from an immediate 5p reduction in the basic rate. In contrast, someone with earnings at the top of the basic rate band (on £32,000 a year) would gain £1,300. Proportionally the gains would also be skewed towards higher earners – our low earner's income increases by 1.3% in comparison with an increase of 4.1 % for the high earner.

<sup>8</sup> This will not affect benefit entitlement. As set out in the 1999 Budget, as part of the process of aligning the lower earnings limit and the tax allowance, a new 'zero rate band' for NICs has been introduced, so that everyone earning more than the 'shadow' lower earnings limit (currently £66 a week) will in the future be credited with full contributions.

**Table 1**

### **Effect on low earners of widening the 10p tax band**

		Increase in the annual income of a low earner working:			
Year	Annual tax give-away	Top of starting rate band	34 hours	38 hours	42 hours
	(£bn)	(£pa)			
0	0	5835	*	*	*
1	2	6585	64	90	90
2	4	7335	64	153	180
3	6	8085	64	153	243
4	8	8835	64	153	243
5	10	9585	64	153	243

**Table 2**

### **Effect on low earners of raising the tax and NI allowance**

		Increase in the annual income of a low earner working:			
Year	Annual tax give-away	Top of starting rate band	34 hours	38 hours	42 hours
	(£bn)	(£pa)			
0	0	4335	*	*	*
1	2	4835	100	100	100
2	4	5335	200	200	200
3	6	5835	300	300	300
4	8	6168	367	367	367
5	10	6501	406	433	433

Table 1 shows the effect of gradually widening the 10p tax band. Using the microsimulation model POLIMOD (for a description see Redmond, Sutherland and Wilson, 1996), we calculate that the cost of extending the band by £750 would be about £2 billion. Hence the point at which the

starting rate of tax ends (and the basic rate begins) could rise from its current level of £5835 (i.e. the single personal allowance of £4335 plus £1500) to £6585 in year 1, £7335 in year 2, and so on. The Table shows the effect this would have on the annual income of three illustrative low earners, all of whom earn the minimum wage but who work either 34, 38 or 42 hours a week (and hence who might all be considered ‘full-time’ workers<sup>9</sup>). Their annual earnings are therefore respectively £6365, £7115 and £7860. As can be seen, the fact that their earnings are so low means that, after year 3 of the reform programme, none of them receive any benefit from further increases in the width of the starting band. Indeed, if we look at someone working 34 hours a week (on the minimum wage) we find that widening the starting band provides little benefit even in year 1. As only £500 of their earnings is currently subject to basic rate tax, extending the starting band is of little benefit to them.

Table 2 shows the equivalent effect on low earners of raising the tax allowance (and the lower earnings limit for NICs). As can be seen, this type of reform has two clear advantages over the policy shown in Table 1. First, increasing the tax allowance has more effect on the incomes of low earners (even in year 1, when minimum wage workers on 38 and 42 hours a week receive the full benefit of widening the 10p band). Increasing the tax allowance is therefore more progressive than widening the 10p band<sup>10</sup>. Second, this policy benefits all of our low earners in every year, and in all but the final year to the same extent. The policy of raising the tax allowance might therefore also be preferred on the basis that, from the point of view of low earners, it has greater longevity than widening the starting rate band.

Against this, however, it could be argued that widening the starting band improves work incentives more than increases in allowances. At its current width the 10p band has little effect on incentives (only people earning between £4335 and £5835 a year pay tax at this rate, and there are few

<sup>9</sup> Clearly, any definition of ‘full-time’ is likely to be somewhat arbitrary. As we shall see, one of the main technical arguments for moving to a UBI is that it avoids the government having to designate the number of hours of work which it considers to be normal/acceptable.

<sup>10</sup> Assuming the width of the basic rate band is not reduced to compensate for changes in the level of the tax allowance or width of the starting band. The distributional arguments in favour of increasing the tax allowance are also recognised by the Institute for Fiscal Studies (2000, p75), who comment that this is “the most progressive means of redistribution via the tax system”.

people with annual earnings in this range), though its effect would grow as it was widened. However, as shown in Table 1, as soon as a wider starting band begins to include a significant number of people – such as full-time minimum wage workers – it would also begin to lose its effectiveness as an instrument of redistribution. Similarly, raising the tax allowance will have little effect on work incentives until it reaches the level where a significant number of people are taken out of the tax net, at which point it too will lose its redistributive efficiency. This trade-off between incentives and redistribution is shown even more clearly if we turn to the effect of introducing an ‘employment tax credit’, a form of tax assistance for low earners which the Chancellor is considering.

### *An employment tax credit?*

Just as reductions in the basic rate of tax may be objected to because high earners gain more than low earners, the changes to the tax system discussed above could be criticised on the grounds that, at best, everyone gains the same (in absolute terms). What is needed, it might be argued, are reforms which give more to low than high earners, so that resources are more tightly focussed on the target group (minimum wage workers). As shown by Tables 1 and 2, in its present guise the UK tax system is incapable of producing this outcome for childless people; hence, if use of the benefits system is ruled out, a new policy instrument must be invented to take on this task.

One potential policy innovation would be to introduce a new tax credit for low earning households without children, along the lines of the Working Families Tax Credit (WFTC). In fact, the government appears to be giving this direction for reform active consideration; in a speech last year the Chancellor stated that ‘our long term aim is an employment tax credit, paid through the wage packet, which would be available to households without children as well as households with children’<sup>11</sup>. In effect, such an employment tax credit (ETC) would extend the existing ‘earnings top-up’ (ETU) pilot scheme to the whole of the UK, and simultaneously convert the scheme into a tax credit<sup>12</sup>.

<sup>11</sup> Speech by Gordon Brown to the IFS 27.5.99. This long term aim is confirmed by the March 2000 Budget

<sup>12</sup> The ETU pilot schemes were established under the last government to test whether a benefit along the lines of Family Credit should be introduced for single people. As we discuss further below, the rationale for providing support in the form of a tax credit rather than a benefit payment is essentially political.

The rules governing the two types of ETU currently running in different parts of the country are set out in Table 3.

**Table 3**

**Earnings top-up rates**

<b>Scheme A</b>	
Credit	
Couple	49.85
Single 25 and over	30.00
Single under 25	24.40
For working 30 hrs+ pw	11.05
Applicable amount (i.e. taper threshold)	
Couple	80.65
Single 25 and over	62.45
Single under 25	51.70
<b>Scheme B</b>	
Credit	
Couple	60.15
Single 25 and over	30.00
Single under 25	24.40
For working 30 hrs+ pw	11.05
Applicable amount (i.e. taper threshold)	
Couple	80.65
Single 25 and over	80.65
Single under 25	80.65

As occurred with the conversion of Family Credit into the WFTC, we would expect the scheme to be made more generous at the same time as administration is switched to the tax system. Certainly, it seems reasonable to assume that the taper rate (the amount deducted for every £ of net earnings above an 'applicable amount' or 'threshold') will be reduced from its current rate of 70% to the WFTC's rate of 55%. However, its other parameters are more open to doubt, and this section therefore looks at three possibilities (for brevity the analysis is

restricted to the position of single people over 25).

- Design 1 (the least generous of the three schemes) provides a maximum tax credit of £30 a week, and starts to reduce support once earnings cross a threshold of £62.45 a week. This is the same as scheme A of the ETU pilots but with a 55% taper.
- Design 2 makes the scheme more generous through raising the threshold to £80.65 a week (as in scheme B of the ETU pilots), while keeping the credit constant.
- Design 3 makes the scheme more generous by increasing the credit by £10 a week while keeping the threshold constant.

Table 4 shows the effect of each design on the incomes of low earners working 34, 38 and 42 hours a week, as in Tables 1 and 2. For easier comparison with these earlier Tables, all figures are annual. Following the rules of the WFTC (and the ETU pilots), we assume a 'bonus' of £11.05 a week is paid to people working more than 30 hours (so that the relevant credit for full-time minimum wage workers in Designs 1 and 2 is £41.05, and £51.05 in Design 3). Note also that the Table assumes all the tax changes announced in the 1999 Budget have been put in place; as an individual's ETC entitlement depends on their net earnings the amount received can be affected by the shape of the tax system.

**Table 4**

**The effect of an employment tax-credit on low earners**

Design	Estimated Cost (£ bn)	Increase in the annual income of a low earner working: (figures in pounds)		
		34 hours	38 hours	42 hours
1	0.4	678	398	118
2	1.2	1466	1186	906
3	0.7	1198	918	638

It is worth commenting briefly on the cost estimates presented in the Table. These have all been calculated using POLIMOD and, as can be seen, the model suggests an ETC could be introduced relatively cheaply – even Design 2 (the most expensive variant) has an estimated cost of only £1.2 billion<sup>13</sup>. However, it should be noted that, as well as assuming incomplete take-up, POLIMOD does not take into account the possibility of behavioural change – the estimates presented are based on individuals' actual earnings in 1994/5 and 1995/6 (the Family Expenditure Survey years used for the model), rather than an estimate of what their earnings would have been under the policy reform. This means the incentive effects of reform are not included, and hence the cost estimates in the Table may be biased (because the effects of people moving off Income Support and into work, and of people already in work reducing their hours, are not included). However, estimates of how individuals are likely to respond to changes in work incentives are very contentious, and POLIMOD's assumption of no behavioural change may be the least worst option<sup>14</sup>.

This caveat aside, the introduction of an ETC appears to offer a much larger 'bang per buck' than widening the 10p tax band or raising the tax allowance. At least under Designs 2 and 3, all our low earners receive a bigger income boost than they get in year 5 of either of the tax reforms, in spite of the fact that an ETC (under any design) costs much less than the £10 billion we allocated earlier for tax cuts. Moreover, the income boost is skewed towards the poorest of the examples illustrated – the 34-hour-a-week – worker earning £6365 a year (£1500 a year less than the 42 hour-a-week worker). But herein lies the dilemma which faces all in-work benefit or tax credit schemes (and, indeed, the tax-benefit system more generally): the more tightly targeted a scheme is (in this instance,

<sup>13</sup> However, the cost of an ETC might be considerably higher if a more generous scheme were introduced. For instance, the Institute for Fiscal Studies (2000) estimate that a more generous ETC, based on the non-child elements of the WFTC, would cost £4.5 billion. In addition, the cost of an ETC will be affected by the level of the minimum wage, increases in which will reduce the cost of the scheme. The effect of an ETC on the level of the minimum wage is therefore indeterminate: the above argument suggests it will be higher, while the fact that an ETC reduces the link between earnings and income suggests a low (or no) minimum wage.

<sup>14</sup> The arguments for and against including behavioural change within microsimulation models are examined in detail by Hancock and Sutherland (1992). For an example of an attempt to include behavioural change see Gregg, Johnson and Reed (1999).

on low earners), the worse effect it will have on the incentives facing beneficiaries<sup>15</sup>. In a nutshell, in order to get claimants off benefit and into work, the scheme cannot make low earners better-off across a wide band of hours once they are in work.

One way to ameliorate this trade-off between targeting and incentives might perhaps be to introduce an ETC alongside a broader starting rate band, so that the high withdrawal rate applied to the tax credit is offset to some extent. However, while initially appealing, this argument does not bear close examination. First, the extent of the improvement in incentives is tiny: given the assumed taper on the ETC of 55% of net earnings, people paying tax at the basic rate would face a marginal deduction rate of 69% while those in the 10p band would face a withdrawal rate of 64%. Second, this policy simply amounts to combining a less redistributive reform (widening the 10p rate) with a more redistributive reform (an ETC); raising the tax allowance would be a simpler way of getting to the same distributional outcome. Last, unless the starting band is very wide, few people will actually face a tax rate lower than the basic rate, as the marginal deduction rate facing low earners (qualifying for the ETC) is determined chiefly by the taper.<sup>16</sup>

In essence, the difficulty surrounding in-work benefit or tax credit schemes is that measures which reduce the 'unemployment trap' tend to worsen the 'poverty trap' for those in work<sup>17</sup>. Redmond and Sutherland (1995, p.1) comment as follows:

'By making low paid work more attractive to the unemployed, the Earnings Top-Up will reduce incentives to become or

<sup>15</sup> The corollary to this is that incentives for beneficiaries can only be improved by reducing the degree of targeting (i.e. the taper rate). But this in turn has two knock-on effects. First, in terms of incentives, the improvement for people already benefiting from the scheme has the effect of reducing incentives for people who, as a result of its increased generosity, are made newly eligible (such as workers on slightly more than the minimum wage). Second, in terms of redistribution, the largest income gains will be felt by people some way up the earnings distribution, and the redistributive efficiency of the scheme (*its raison d'être*) will therefore be lower.

<sup>16</sup> For instance, under Design 1 (the least generous variant) entitlement to the ETC runs out at earnings of around £8,000 a year, over £2000 higher than the top of the current 10p band.

<sup>17</sup> The poverty trap refers to the lack of incentive to work more caused by high marginal deduction rates. The unemployment trap refers to the lack of incentive to enter work (i.e. leave benefit) caused by a high replacement rate between benefits and net wages.

remain higher paid. It will extend to all workers the possibility of very high marginal tax rates due to the combined effect of income tax and National Insurance Contributions and the withdrawal of benefits (the poverty trap).<sup>18</sup>

The disincentive to ‘become and remain higher paid’ can be seen most clearly if we look at the choice of number of hours to work (though incentives to train and gain promotion will also be affected). Whatever the structure of the tax system, an ETC provides a strong incentive to earn up to the threshold level, but little incentive to work beyond this (due to the high taper rate). In the case of households with children there may be arguments for this type of system; in particular, the government may wish to actively encourage parents to work less than a full working week, especially if they have sole responsibility for children (see Section 2.6). However, the arguments surrounding support for childless people (i.e. those without caring duties) are subtly different, in that ‘full-time’ work is the norm. Given the work-fetishism of New Labour’s approach to tax and benefit reform, it is difficult to see a rationale for, in effect, making benefits for childless people working 16 hours a week unconditional<sup>18</sup>. There are other disincentive effects built into the tax-credit approach which are not discussed here, for the sake of clarity of presentation. One of these is the disincentive to save, because the rules require capital assets to be taken into account. Another is *administrative complexity*, inherent in the eligibility conditions.

The main argument for an ETC, from New Labour’s perspective, therefore comes down to the fact that it is a way of increasing the incomes of low earners without adding to the benefits bill. While there is no economic difference between public and tax expenditures (such as tax credits), and international accounting standards mean much of the cost of tax credits should be ‘scored’ as public expenditure (though the Treasury has not followed this convention), income-transfer schemes based on the tax system may have political advantages. In

<sup>18</sup> While it would be possible to make ETC payments conditional on certain forms of behaviour (e.g. seeking full-time work), this would be administratively cumbersome, particularly given the Inland Revenue’s lack of experience in this area. Alternative forms of conditionality – such as varying the minimum number of hours according to household status or age - may be more practicable, but would nevertheless place a considerable administrative burden on employers.

particular, changes in the structure of a tax credit are determined directly by the Chancellor, and improvements (i.e. increasing the credit, raising the threshold or reducing the taper) may be presented as tax cuts rather than benefit increases. Hence, as part of the ‘hidden welfare state’, a tax credit scheme may be able to expand and develop in ways which would be impossible if it were designated as public expenditure, where parliamentary, Treasury and media scrutiny is more constraining (Howard 1997, Kvist and Sinfield 1996). These accounting conditions represent a barrier to rational debate about *all* approaches to tax-benefit reform.

Even so, the administration of tax credits presents a number of practical difficulties:

- as with all means-tested forms of support, take-up is likely to be less than complete;
- employers’ administration costs may be high, particularly in low wage sectors;
- since entitlement to the credit will probably be calculated over a 5 week period and then granted for 6 months (like the WFTC), working patterns must be arranged in a rather unusual way to maximise the credit;
- taxpayers’ privacy will be invaded as, in effect, such a scheme would mark a return to joint taxation.

Ultimately we believe these practical considerations (and the incentive effects outlined above) will tell against the introduction of an ETC. Certainly, we can expect a further fundamental examination of the respective roles of the tax and benefit system prior to any such move. There is therefore a window of opportunity for advocates of a BI to make the case for an alternative course for tax-benefit reform. The remainder of this chapter sets out our view of this course, of how the UK might gradually progress towards a BI through capitalising on elements within New Labour’s programme. As such, our analysis is an explicit attempt to go with the grain of government policy - to map out a ‘path of least resistance’.

## 2.3 Making Work Pay: A Labour-Market Participation Income

A ‘participation income’, or conditional basic income, has been advocated by Atkinson (1995a, p.301):

‘the most promising route (for tax-benefit reform) is to complement Modernised Social Insurance with a scheme which preserves the principle of a basic income, of not being means tested and of being on an individual basis, but which is conditional on participation.’

We attempt in this section and the next to unpackage Atkinson’s proposal, so that we first look at a stage where means testing is abolished (in the sense that incentives are more or less equalised) but eligibility remains partly predicated on the household, before turning to a fully individualised scheme. Moreover, in this first stage we also define ‘participation’ in a rather more restrictive way than Atkinson, so that a large(r) number of activities (and people) remain outside the scope of the scheme. Accordingly, the ‘labour market participation income’ (LMPI) which this section discusses is only distantly related to Atkinson’s proposal, and a scheme which is closer in spirit to his ideas – which we call a ‘social and economic participation income’ (SEPI) – is not discussed until the next section. Even then there is a significant difference with Atkinson, in that we do not look at how such a scheme (or, indeed, any of the schemes outlined) might be complemented by social insurance. Rather, we assume that the introduction of a BI would be accompanied by the abandonment of National Insurance. This has important implications for the political strategy to be pursued by BI advocates, and needs to be addressed as a separate issue elsewhere. We refer to it again in our conclusions (p.126).

### ***Helping childless low earners through the benefits system***

The previous section looked at how the incomes of childless low earners could be boosted through the tax system via tax credits. As we saw, there were numerous problems with this direction for tax-benefit reform: it would create a new in-work poverty trap, it would (in effect) subsidise low earners who chose to work part-time, and it

would be administratively cumbersome. In spite of our UK interviewees’ prejudice against transfers labelled as public spending (rather than negative taxation), let us therefore imagine that the benefits system is now included in our armoury of policy tools. Clearly, one possible way of boosting the incomes of childless low earners (the policy goal adopted at the start of Section 2.2) would now be to extend the in-work Employment Top-Up scheme. However, this would suffer from most of the problems just outlined for an ETC. We therefore look at an alternative type of reform, namely changing the structure of Income Support so that, in place of the current £ for £ means test, entitlement is tapered-off.

At present, Income Support is essentially a replacement income for those outside the labour market for a variety of reasons (unemployment, lone parenthood etc)<sup>19</sup>. Earnings by claimants must be declared and, above a very low limit, are in effect confiscated by the authorities, as a way of making claimants seek (regular, formal) employment and come off Income Support<sup>20</sup>. But research has shown that in today’s ‘flexible’ labour market, with much of the work available in the form of short-term or variable-hours employment or self-employment, many claimants see Income Support as a kind of unofficial BI, and do not declare occasional or modest regular earnings (Evanson and Woods, 1995; Rowlingson et al, 1997; Jordan et al, 1992). What is proposed and examined here is a scheme which in a sense regularises this practice, by introducing a far gentler taper on the withdrawal of benefits with earnings.

The effect of a taper in Income Support, and its similarities to the ETC scheme looked at in the previous section, can be illustrated most

<sup>19</sup> We make no distinction between Income Support and Job Seekers’ Allowance, the means-tested benefit paid to people who are not in employment but are capable of working full-time. In part this reflects the structure of POLIMOD, which treats the means tested elements of the two benefits as being the same. However, it also reflects our belief that, though Jobseekers’ Allowance is not means tested for the first 6 months (if contributions are sufficient), and hence the issues are more complex, the same approach should apply whatever type of benefit an individual is claiming.

<sup>20</sup> It should be noted that, in addition to a test of income, entitlement to means-tested benefits also depends on a household’s assets, with capital of over £3,000 reducing the amount payable.

easily if we assume the government has already decided to increase the tax allowance (and lower earnings limit for NICs) to £6500 (as in Table 2 earlier). This level of tax allowance has a number of useful properties. First, it is the amount a minimum wage worker on 35 hours a week currently earns, and further increases in the tax allowance above this level (beyond those needed to keep pace with changes in the minimum wage) would be of no benefit to such an individual. Hence, if a 35-hour week is considered 'full-time', this level of tax allowance might in some sense be considered optimal<sup>21</sup>. Second, for a higher rate taxpayer an allowance of this level would be worth £50 a week, £1.40 a week less than the current rate of Income Support for a single person aged over 25. It therefore well illustrates the point we made in the introduction – that as benefit rates fall in relation to earnings, as they will tend to under current government policies, the value of the tax allowance will gradually come to equal Income Support. Last, this level of tax allowance has the arithmetically convenient property of being exactly half as high again as the current allowance of £4335.

Before looking at the situation under a tax allowance of £6500, it is also useful to look at the effect of introducing a taper into Income Support when the tax (and NI) allowance is increased more modestly. Suppose, for instance, that the allowance were increased by £1000 to £5335. As shown in Table 2 earlier, if increases in the tax allowance are spread out evenly over a span of five budgets, this stage might be reached in Year 2 of a reform programme<sup>22</sup>. This level of tax allowance also has an interesting property: it is twice the annual value of Income Support for a single person (over 25). The arithmetic of replacing the current means test (where entitlement is reduced £ for £) with a taper system is therefore simplified: if entitlement were reduced by 50p for every £ of income a single person would cease to be eligible once their earnings reached the level of the tax allowance. This approach –

<sup>21</sup> In order to take account of changes in earnings (and in particular the minimum wage) it might be better to express the £6500 target as a commitment to 'taking full-time low earners out of the tax net'.

<sup>22</sup> Increasing the tax and NI allowance by £1000 would cost around £4bn, assuming that the starting rate was simultaneously narrowed to £500 (prior to its abolition). It therefore costs about the same as a 2p reduction in income tax, from 22p (in 2000/1) to 20p.

setting the taper so that entitlement is exhausted at the point where the tax system starts – therefore avoids difficulties which arise when income tax and benefits overlap (at least as far as single people are concerned)<sup>23</sup>. In particular, as well as preventing needless duplication between the Inland Revenue and the DSS, it also avoids a sudden jump in marginal tax rates, such as occurs when the personal allowance is crossed and people suffer the effect of tax as well as benefit withdrawal.

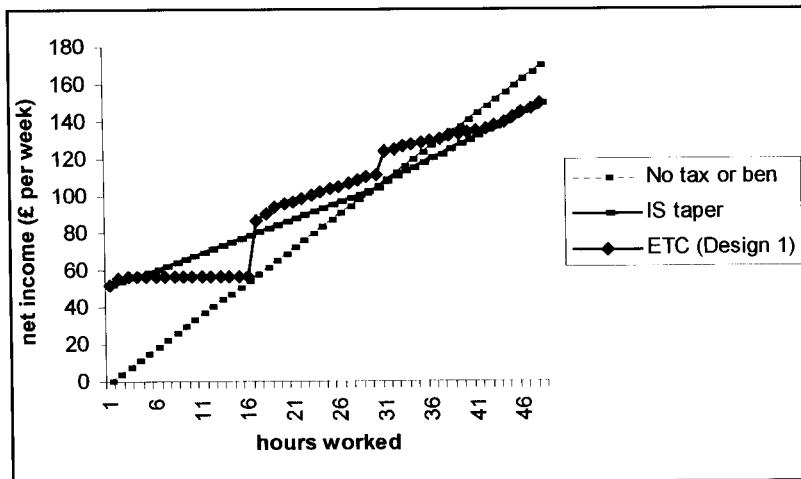
Figure 1 illustrates the effect of a 50p taper in Income Support on the income of a (single) minimum wage worker, assuming that the tax and NI allowance is increased to £5335 (and the 10p band is reduced to the first £500 of income above this level). The Figure plots the net income associated with different numbers of hours of work, from zero (when it is assumed Income Support may be claimed) to 48 hours a week. The 45 degree line plots the position in the absence of taxes or benefits, i.e. when net income is the same as gross (or original) income. For comparison, the Figure also shows the position under Design 1 of the EITC scheme described in the previous section.



<sup>23</sup> The position facing couples is more complicated. Because couples receive a higher rate of Income Support than single people (£80.65 a week rather than £1.40), their household benefit entitlement would not be extinguished when the tax allowance was reached (assuming only one of them entered work). A 'bend point' would therefore arise at the tax allowance where, for a period, couples entitled to Income Support would face a very high marginal deduction rate. This might be avoided through some form of (partial) benefit individualisation, as introduced in Australia. However, for reasons of brevity, and because of difficulties involved in estimating the cost of such a change, we do not include this as part of our analysis of an LMPI.

**Figure 1**

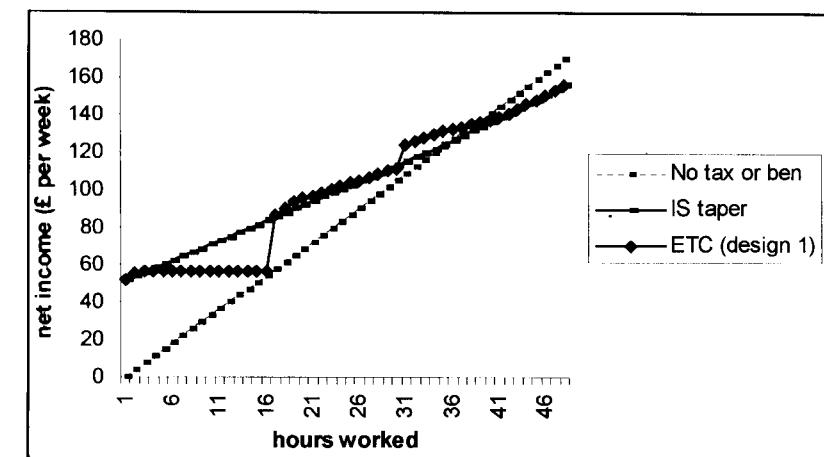
**Net Income of a (single) low earner under a 50% taper and a £5335 tax allowance**



As can be seen, the effect of a taper in Income Support is not all that different from an ETC/ETU. Below 16 hours of work a low earner would do better under the tapered Income Support system (because, by assumption, the in-work benefit or tax credit is only available to people working more than 16 hours). But above 16 hours a low earner would do better out of an ETC, at least under the assumptions used here. But if we look at the situation under a £6500 tax allowance (see Figure 2) a policy of tapering-off Income Support is unambiguously superior to an ETC, in that low earners receive broadly the same income boost above 16 hours but now face better incentives, as well as qualifying for support if they work less than 16 hours. In line with Figure 1, Figure 2 assumes that the Income Support taper is set so that (for a single person over 25) entitlement runs out at the level of the tax allowance. Given our assumed allowance of £6500 this implies a taper rate of 41%.

**Figure 2**

**Net Income of a (single) low earner under a 41% taper and a £6500 tax allowance**



The cost and distributional effects of introducing a taper into Income Support are discussed below. However, it is worth first emphasising that, in contrast to an ETC, the taper in Income Support which we propose will improve incentives both to enter work *and* to work more. As Figures 1 and 2 show, an ETC would create a number of ‘bend points’ in the relationship between hours worked and net income, and this will affect the precise number of hours individuals choose. Clearly, one bend point is at 16 hours, where workers first become eligible for the credit. However, more subtly, the scheme also creates bend points at the threshold level, where the taper first sets in, and at 30 hours of work, where people become eligible for a bonus (of £11.05 a week in the example). The incentives facing individuals are therefore to work at these bend points, and evidence suggests that this is what people actually do (Blundell, 2000). For instance, in the example scheme illustrated in the Figures (Design A), the effect of an ETC is to encourage minimum wage earners to work either 16 or 17 hours a week (below the threshold level but above 16 hours) or to work 30 hours a week; beyond these points the effect of benefit withdrawal and tax makes the net income gain from extra hours of work rather

low. As noted earlier, though there may be arguments for encouraging carers to work less than ‘full time’, it is difficult to see why the government would wish to encourage individuals without caring responsibilities to work these particular hours.

A major advantage of a taper in Income Support is therefore that it avoids the rather arbitrary effects of an ETC on the number of hours low earners choose to work; at least for single people, it creates a tax and benefit system which provides consistent (and, because of its simplicity, comprehensible) incentives to work and earn more<sup>24</sup>. Moreover, because individuals would remain part of the benefits system, a taper would allow the activity of people working less than a ‘full’ working week to be monitored, and help offered or sanctions imposed as appropriate (i.e. conditionality could easily be incorporated into the scheme). A taper system therefore genuinely encourages work, of all hours and all types, rather than selectively encouraging particular types of work – regular employment of 16 or 30 hours a week. And, as we shall see, it also opens the way to a more fundamental realignment of the tax and benefit systems, in the form of a Social and Economic Participation Income (SEPI).

### ***Cost and distributional effects of a LMPI***

However, before describing the transition from an LMPI to a SEPI, we should set out the cost and distributional effect of the changes discussed so far. As described above, an LMPI may be thought of as a combination of two policies – raising the tax (and NI) allowance and introducing a taper into Income Support. We have suggested that the end-point to these policies would come when the tax allowance reached £6500 a year, the amount earned by a minimum wage worker on 35 hours a week, allowing the Income Support taper to be set at 41%. Accordingly, the effect of an LMPI is estimated below using these parameters.

<sup>24</sup> Unless entitlement to Income Support is *individualised* in some way, this conclusion must be significantly weakened for couples, who will experience a high marginal deduction rate in the portion of earnings immediately above the tax allowance (as Income Support would still not be fully extinguished at this level of earnings).

For analytical convenience, however, we also make one further change. At present take-up of Income Support by working-age households is less than complete, at around 88%. We envisage that under a SEPI take-up would be 100%, reflecting the fact that the system would be far more universal, and the next section provides costings on this basis. But this means that gains at the bottom of the income distribution would be greatly affected by the increase in take-up, obscuring the ‘pure’ effect of the policy. We therefore assume 100% take-up rates throughout this chapter, and this increase in take-up is shown as part of the cost of an LMPI.

POLIMOD’s estimates for the cost of introducing an LMPI are shown in Table 5. As can be seen, the majority of the cost comes from the increase in the tax allowance (see Table 2 earlier), with the taper in Income Support costing less than half as much. Even so, given the similarity between the distributional effects of an ETC and a taper in Income Support, the estimated cost of £4.5 billion is surprisingly high

in section 2.2 we estimated that Design A of an ETC would cost only £400 million to introduce. The main reason is that, as modelled here, the taper in Income Support would apply to all income, not just earnings. In particular, lone parents on Income Support would benefit dramatically from the fact that, in contrast to the current system, they would receive a major slice of any child maintenance payments made. Hence much of the cost of the scheme reflects this effect which, while unintended, would also produce substantial social policy benefits.

**Table 5**

### **Cost of a LMPI**

Measure	Cost/Saving (£, bn)
Increase in tax allowance	10.3
Taper in Income Support	4.5
Increase in take-up to 100%	2.8
Total	17.6

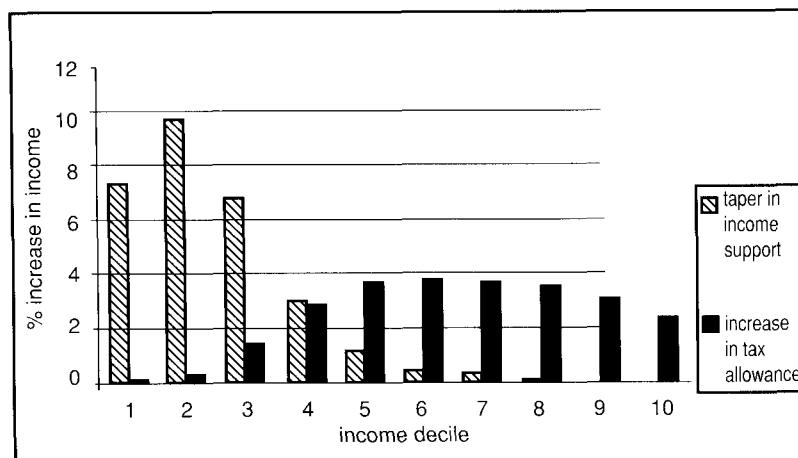
Source: POLIMOD

The distributional effect of the two components of an LMPI are shown

in Figure 3 (for easier comparison with later Figures the distributional effect of the assumed increase in take-up is ignored)<sup>25</sup>. As elsewhere in this chapter, we look only at the *gains* which households at different income levels would experience; the Figure is not on a revenue-neutral basis. This reflects the argument we made earlier - that tax and benefit reform will inevitably evolve over time, and it is the direction of reform with which advocates of a BI should be most concerned. Two points are particularly worth emphasising. First, if Income Support levels continue to fall further behind earnings the cost of the schemes we present will go down by default. Second, in common with Ireland, the UK appears to be entering an era of revenue buoyancy, and in this context debate about tax and benefit reform is likely to focus on how the fruits of economic growth should be distributed, rather than how much Peter should be robbed to pay Paul.

**Figure 3**

#### Distributional effect of a LMPI



Source: POLIMOD.

As the Figure shows, the two elements of an LMPI would have rather different distributional consequences. The introduction of a taper into

<sup>25</sup> Figures 3,4 and 5 are all based on the Households Below Average Income (HBAI) equivalence scales. Alternative equivalence scales would generate slightly different results.

Income Support is very progressive, with people in the bottom half of the income distribution enjoying practically all of the gains. In contrast, gains from the increase in the tax allowance are more spread-out, with people in the upper-middle of the income distribution doing best.

Overall the gains from an LMPI will be gently tilted in favour of the poor (due mostly to the taper in Income Support), though everyone will see some benefit<sup>26</sup>. However, perhaps more important than these static effects, the *incentive* effects of the scheme will be concentrated on people at the bottom of the income distribution, and we might therefore expect the dynamic effects of an LMPI to be even more progressive. It is this aspect of the scheme which we believe is most likely to appeal to New Labour. As shown by Figure 3, in itself an LMPI is not vastly redistributive. And, because we assume that continued economic growth allows incremental changes to be financed from revenue buoyancy, there is no redistributional effect resulting from the way the scheme is financed. At least as described above, an LMPI is best seen as a way of tackling social exclusion rather than reducing income inequality or poverty. Its real effect is to encourage greater income *mobility*, through giving benefit claimants a greater incentive to enter work and move up the earnings ladder.

#### 2.4 Rewarding Responsibility: A Social and Economic Participation Income

The reforms to the tax-benefit system undertaken by the UK government since 1997, the logic of which is followed by our analysis in the previous section, are aimed at improving incentives for low earners to participate in the formal labour market. However, it is widely anticipated (for instance, by the Welsh MPs we interviewed) that for many citizens - especially those living in deprived communities and in areas with structural economic problems – lack of labour demand will prevent these reforms from having much practical effect. Even if the UK does move towards full employment, as the Chancellor has predicted (Brown 1999), employment opportunities will not be evenly

<sup>26</sup> The distributional implications of an LMPI would, of course, be rather different if we looked at a revenue-neutral scheme. Note also that the distribution of gains would be different if we included the effect of the assumed increase in take-up.

spread, and for some the incentive to work will not be matched by an opportunity to work (at least in the formal sector).

As the government's record in creating jobs and reducing unemployment grows ever more impressive, the task it faces in relation to the remaining stock of non-employed people will therefore alter. In the future, working-age people who are not in work will increasingly either be 'hard cases' (e.g. people with poor language skills or living in depressed pockets of the country), disabled or partially-disabled (and hence to varying extents restricted in the jobs they can take), or outside the labour market altogether (for instance, because of caring responsibilities)<sup>27</sup>. The very success of the government's policies will therefore make it more difficult to depict full-time paid employment as a feasible alternative to benefits for the remaining stock of claimants. Eventually the government will have to modify the advisory, motivational and compulsory elements in its approach (as expressed through the various New Deals), so that these correspond better to the realities facing the residuum of benefit claimants<sup>28</sup>.

We therefore expect that a point will be reached - probably in the next parliament - where the current approach will have run its course, and another is needed. This would involve enabling citizens to be active in the 'social economy', as carers, members of voluntary organisations, social entrepreneurs, and so on (Ginsburg, 1999; Jordan, 1998, Ch. 5; Williams and Windebank, 1998). This would complement other efforts by government to combat social exclusion and promote the regeneration of social capital in such areas (see pp.109 -125). But these efforts are not well sustained by current structures and rules for benefit receipt, or by the New Deals, Employment Zones, etc. To maximise the benefits of such programmes, more flexible forms of activation policy must be put in place, where the object is promoting participation in *either* the

<sup>27</sup> In other words, achieving 'full employment' (however this is defined) will not mean that everyone of working age is in a full-time job.

<sup>28</sup> The interviews described in Chapter 1 also suggest there may be considerable political pressure for a broader approach, particularly as constituency-minded, newer MPs become more influential.

formal *or* the social economy. One element of such an approach – the move from a Labour Market to a Social and Economic Participation Income - is described in this section; broader questions surrounding the role of public services, community groups and voluntary organisations in the social economy are discussed in chapter 3.

Before looking at support for people outside the formal labour market, we need to consider how such a minimum income might be delivered while maintaining incentives.

### ***Full equivalence between benefits and the tax allowance***

The last section described a system where benefits remain means-tested but which, through the introduction of a taper in Income Support, provides better incentives for people to enter work and increase their earnings. As we saw, if the tax allowance were increased to £6500 an Income Support taper of around 41% could be implemented. However, if Income Support continued to be linked to prices while the tax allowance rose with earnings, or if there were further increases in the relative level of the allowance, this type of approach would rapidly become unsustainable.

For instance, consider the situation if the tax (and NI) allowance were double its current level, i.e. £8670 a year rather than £4335. At current tax and NI rates this level of allowance would be worth £2775 a year to a basic rate taxpayer, around £2 a week higher than the level of Income Support for a single person over 25. Moreover, if the level of the allowance and the taper in Income Support were linked, as suggested in the last section, then an allowance of £8670 would imply a taper rate of 31%, lower than the current tax and NI rate. We doubt whether either of these outcomes is acceptable. As the value of the tax allowance converges on Income Support, we therefore expect mounting political and technical pressure to rationalise the administration of 'fiscal welfare' (through the tax allowance) and 'public welfare' (through benefits).

Political pressure for reform would stem from the perception that it would be wrong to give people in work higher allowances than the benefits paid to those in 'genuine need'. Assuming the labour market

remains tight, and that activation policies such as the New Deals are successful, it will become increasingly hard to argue that benefit claimants are predominantly undeserving or voluntarily dependent. The moral/political case for aligning benefits and the tax allowance will therefore be strong. However, technical arguments will also be important. In particular, as the taper rate falls the tax and benefit system will increasingly come to resemble a 'negative income tax' and, if only for administrative reasons, pressure will grow to integrate the two systems<sup>29</sup>. As we saw in chapter 1, such reasons are already being recognised by tax-benefit policy 'insiders' in Ireland.

The arrangements brought in with the introduction of the WFTC provide a clue to how such an integrated system might work. Though the WFTC is described as a tax credit, and is the responsibility of the Treasury, it will in fact be possible to claim it as a benefit. With certain exceptions, people eligible for the tax credit will have the choice about whether to receive payment via a Giro or via their pay packet. Much the same type of system could apply to the tax allowance. People in full-time permanent jobs earning above the level of the tax allowance could (and probably would) continue to receive the allowance through their pay packet. But those with earnings below this level, or in casual work, or who simply preferred it, could opt to receive the allowance as a benefit, in which case they would be taxed from their first £ of earnings. In fact, as many temporary workers already know, this is how the existing 'emergency tax' arrangements work: the Inland Revenue already requires employers to ignore the allowance when calculating PAYE if an individual does not have a P45.

The effect of this merged system is therefore that, for low earners (people taking the allowance as a benefit), the task of clawing back benefit is performed by the tax system, while for those with incomes above the allowance the tax system effectively does the job of distributing benefits. Such a system would automatically assume that anyone earning more than the allowance was fully participating in society ('economic participation'). However, the activity of people with earnings lower than this level could be monitored as part of the process of benefit payment, i.e. conditionality could be implemented

<sup>29</sup> For a fuller analysis of the relative merits of negative income taxation and a basic income see Kesselman and Garfinkel (1978).

in a similar way to today. A distinction between taxpayers and benefit recipients is therefore retained, allowing people on low or no earnings to be tested for eligibility ('social participation')<sup>30</sup>.

What counts as 'social participation' would rest on political decisions, and hence on the political justification for moving to a SEPI. For people in good health and without caring responsibilities, it seems probable that the system would rely on records of attendance and such like, with local bureaucrats being empowered to separate out the wheat (participants) from the chaff (non-participants). Such individual decisions would mirror (and perhaps be integrated with) the labour-intensive New Deal approaches of motivation and counselling, and would involve officials in detailed casework, and presumably also negotiation, about the level of socially relevant tasks undertaken. It is therefore likely to have high administrative costs and, as with any exercise in social engineering, will be paternalistic and frequently intrusive. Given this, we expect a number of categories of people to be automatically exempted from having to meet participation conditions: pensioners and disabled people are two obvious examples. However, this will, in turn, open the door to interest-group conflict and bargaining, as different organisations seek to ensure that a particular activity or group is automatically included in the scheme. In effect, the government's New Contract for Welfare (DSS, 1998) will have broken down, and a new moral and political basis for the tax-benefit system will be required; hence the opportunity for Basic Income to re-enter the debate (see section 2-5).

Perhaps the biggest challenge will be to arrive at a satisfactory definition of 'participation' for the over-50s. Two factors are relevant. First, labour market participation among this group is low and falling (Campbell, 1999)<sup>31</sup>; given this, it would hardly be credible to portray

<sup>30</sup> While an administrative distinction between the tax allowance and benefits could be retained, we envisage that both would become the responsibility of the Treasury, and the level of each would be set simultaneously in the Budget. The transition to a SEPI should therefore, *de facto*, result in benefit levels becoming linked to earnings.

<sup>31</sup> Uncoincidentally, 50 is also the age at which the Inland Revenue allows (tax-relieved) private pension schemes to make payments. The principle that tax-benefits may be used to support labour market withdrawal in late middle-age therefore already exists.

work as the sole badge of good citizenship. Second, and perhaps more important, a hidden knock-on effect of a SEPI would be to cut the incomes of early retirees. This reflects the fact that, unless 'participation' is rather eccentrically defined, the option of receiving benefit in the form of a tax reduction (i.e. as a tax allowance) would only be available to people with earned income<sup>32</sup>. Hence a large number of early retirees might see their net income fall dramatically upon the introduction of a SEPI, as, for non-participants, the loss of the allowance will not be compensated for by benefit payments. While there is nothing wrong with demanding that people with large pension or savings income should prove their social participation (and hence eligibility for benefit), we anticipate fierce opposition to such 'nannying'. Yet the alternative - of retaining the tax allowance for unearned income - would legitimate non-participation by the wealthy, making it harder to impose tough benefit conditionality on the non-working poor.

We are therefore pessimistic about the ability of legislators to translate the notion of 'participation' into a system which is both morally defensible and politically feasible, particularly as far as older people are concerned. However, for younger people we recognise that the move to a SEPI may be a necessary intermediate stage, falling between the labour market basis for eligibility we described in the last section (2.3, p.50) and the citizenship basis described in the next (p.73). This conclusion reflects the views expressed in the interviews carried out for chapter 1: though a few MPs believed that benefits should be given as a right of citizenship, the larger group comprised those MPs who, accepting the government's rhetoric about rights and responsibilities, felt the problem was about defining participation to include non-labour market activity. Accordingly, we expect the implementation of a SEPI to be a rather messy affair, with benefit rates and rules varying widely according to individuals' age, status and activity. Unfortunately, modelling such a variegated approach is not possible, and we look below at the cost and distributional effect of a hypothetical SEPI constructed along rather simpler lines.

<sup>32</sup> Being in receipt of unearned income says nothing about whether an individual is volunteering from dawn to dusk (participation), playing golf (non-participation), or a mixture of the two. In contrast to earned income, it cannot therefore be used as a way of automatically labelling people as participants.

### ***Cost and distributional effects of a SEPI***

The effect of a SEPI can be modelled through POLIMOD's 'conditional basic income' option, as used in Callan, O'Donoghue, Sutherland and Wilson (1999, COSW hereafter). We set our participation conditions in the same way as COSW, so that people working over 8 hours a week (including the self-employed), students, carers and existing benefit claimants (including lone parents, the unemployed and all recipients of Income Support and National Insurance benefits) automatically qualify for the SEPI. People outside these categories, principally housewives without children and early retirees, do not qualify for a payment (and lose entitlement to the tax allowance). In line with our analysis of a LMPI, the SEPI is set at Income Support levels, with the variations by age and health-status this implies<sup>33</sup>.

Using POLIMOD, we estimate that the net cost of introducing a SEPI with such characteristics would be around £28 billion, after taking account of savings on benefit payments and from the abolition of the tax allowance. Relative to an LMPI, which we believe is the more relevant comparison (as this stage is likely to precede the introduction of a SEPI), the net cost of the scheme is around £11 billion. Details are in Table 6. However, a few words of caution about the estimates in the Table are required. First, the estimated cost of SEPI benefit payments is based on data from the Family Expenditure Survey about what people are doing (e.g. working, studying) and their sources of income (particularly from benefits). We cannot tell the extent to which people who do not qualify for payments in the model will, in reality, be able to establish their status as 'participants'. Second, as discussed earlier, the effect of the move from an LMPI to a SEPI on take-up rates is effectively ignored. Last, we must again bear in mind that the Table shows the cost of implementing a SEPI *today*: over time, as Income Support rates fall in relation to earnings, the effective cost of the scheme will fall.

<sup>33</sup> A novel feature of our analysis is the incorporation of a premium for disability in all the schemes looked at. The costings presented should therefore be more representative of a 'no losers' reform than the simpler schemes looked at by, for example, Desai (1998).

**Table 6****Cost of moving from an LMPI to a SEPI**

<b>Measure</b>	<b>Cost/Saving</b> (£, bn)
SEPI benefit payments	79.7
Abolition of tax and NI allowance	-35.5
Savings on benefits <sup>34</sup>	-15.9
Total cost of SEPI	28.3
<i>Cost of LMPI (see Table 5)</i>	-17.6
<b>Net additional cost of SEPI</b>	<b>£10.7</b>

Source: POLIMOD.

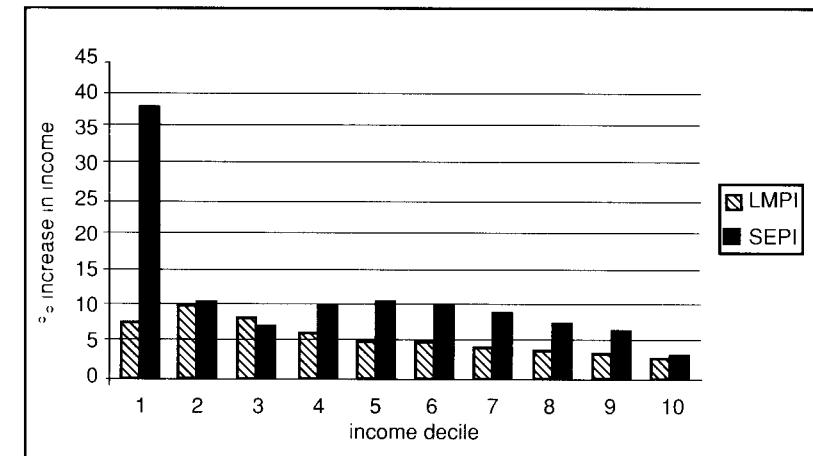
Even with these caveats, the large costs associated with a SEPI are somewhat surprising, particularly given the fact that the scheme will lead to some consequential increases in tax revenue<sup>35</sup>. But a SEPI will individualise entitlement and, as modelled here, extend eligibility somewhat. The effect of the first of these would be felt most by couples on Income Support, who would gain by £22.15 a week as a result of benefit individualisation (their joint income rising from £80.65 currently to £102.80 a week under a SEPI). This increase in the benefits provided to couples is an inevitable consequence of making payments on an individual rather than a household basis. The principal beneficiaries of the second effect - the extension of eligibility - would be full-time students (or rather, their graduate selves), as, in effect, a SEPI would mark a switch back from loans to grants. Of course, their gain (which adds nearly £2bn to the cost of a SEPI) could be clawed

<sup>34</sup> This figure is particularly uncertain, as the extent of savings on benefits is rather difficult to estimate. In particular, savings on means-tested benefits may be higher than POLIMOD estimates; we have attempted to set the structure of SEPI payments to mirror Income Support yet, as modelled, around one million households (excluding those with children and pensioners) remain eligible for benefit.

<sup>35</sup> As well as savings from not providing a tax allowance for non-participants with unearned income, there will also be savings from the fact that, as modelled here, the change to a SEPI would effectively cause the tax allowance to be standard-rated.

back through moving towards full-cost fees for tuition, but we ignore this possibility here.

The distributional effect of the scheme is shown in Figure 4. For convenience, the overall distributional effect of an LMPI - adding together the two columns in Figure 3 - is also shown. As can be seen, a SEPI is much more progressive than an LMPI. In particular, the lowest income decile do much better under a SEPI than under an LMPI, which is accounted for in large part by the gains which couples on Income Support enjoy due to benefit individualisation.

**Figure 4****The distributional effect of SEPI and LMPI compared**

Source: POLIMOD.

## 2.5 Recognising Citizenship: an unconditional basic income

The final stage in this process of tax-benefit reform we envisage would be to move from a SEPI to an unconditional basic income (UBI), where benefit is paid to all adults irrespective of their labour market status, non-labour market activity or position in a household. Though the UK policy insiders we interviewed rejected such a rights-based approach, arguing instead that benefit must be 'earned' through

individuals acting in a socially responsible way (e.g. by working), we believe that ultimately political and administrative realities will lead in the direction of a citizenship (or long-term residency) basis for eligibility. Though there will clearly still be strong (though not insuperable) moral arguments for matching the state's responsibility (to provide a minimum income) with individual responsibilities, putting this into practice will, we believe, be highly problematic.

The problems with a SEPI, and analogously the advantages of a UBI, are two-fold. First there is the issue of which groups should automatically be assumed to be participating; as discussed in Section 2.4, early retirees with large amounts of unearned income are likely to be the most difficult group. Second, are the implementation issues associated with expecting ground-level bureaucrats to deliver support to individuals while simultaneously determining their benefit status. Ultimately we believe a voluntary approach to activation, with policy focusing on supporting communities rather than on policing individual activity, offers a better way forward (see Ch.3). Experience will be the best judge of what works - whether social inclusion will be better promoted by voluntarism and macro-level reform than by the kind of detailed social engineering favoured by the government, with benefits rules and regulations encouraging very specific forms of behaviour.

### ***Cost and distributional effects of a UBI***

The cost of a UBI relative to a SEPI arises as a result of the extension of benefit support to all adults. However, as shown in Table 7, unless participation is defined more narrowly than in the analysis in the previous section, the cost of these additional benefits is relatively small. Hence, the main difference between a SEPI and a UBI is the way in which benefits are administered (i.e. with or without conditions), and the political justification for making such payments. Administratively, the move to a UBI would mean a much simpler system, as there would be no need to monitor individuals' behaviour as a condition for benefit receipt. Savings on administration for the state, businesses and individuals are therefore likely to be substantial, though we make no estimate of these here. Politically, the move to a UBI would require a shift away from the current emphasis on 'rights and responsibilities'

towards a citizenship basis for eligibility; as argued earlier, it is the broad range of political support for the former principle (and the weak position of those advocating citizenship) which is the chief obstacle to a UBI.

**Table 7**

**Cost of moving from a SEPI to a UBI**

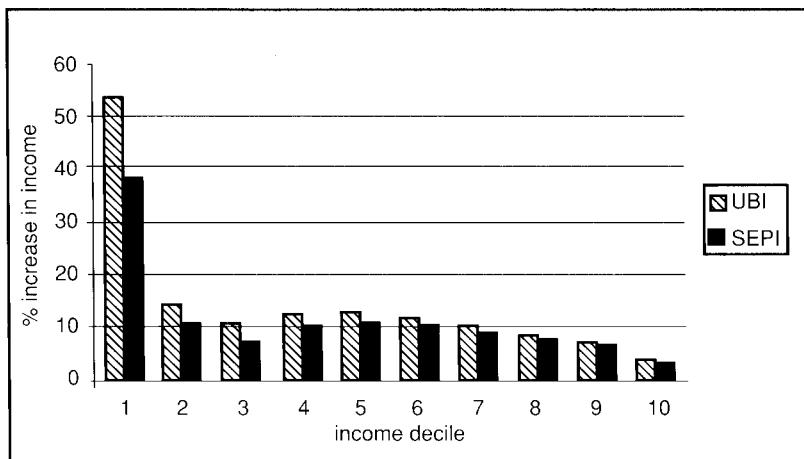
Measure	Cost/Saving (£, bn)
UBI benefit payments	87.7
Abolition of tax and NI allowance	-35.5
Savings on benefits	-19.3
Total cost of UBI	32.9
<i>Cost of SEPI (see Table 6)</i>	-28.3
<b>Net additional cost of UBI</b>	<b>£4.6</b>

Source: POLIMOD.

The distributional effect of a UBI is shown in Figure 5. As expected given the similarity between this scheme and a SEPI, it varies little from Figure 4 (p.71). However, it is worth noting that most of the additional payments under a UBI will go to the lowest income decile, so the distributional arguments in favour of moving to a citizenship basis for eligibility are strong.

**Figure 5**

**The distributional effect of a UBI and a SEPI compared**



Source: POLIMOD.

**Financing a UBI**

Before looking at the positions of households with children and pensioners, we should discuss the issue of how benefits for the working population might be financed. Unlike most analyses of a BI, we have not attempted to present our various schemes in revenue-neutral terms. Rather, we have hypothesised that revenue buoyancy, together with the fact that all our schemes are getting cheaper over time (as Income Support rates fall in relation to earnings), will allow benefit reform to take place without raising tax rates. However, tax changes would certainly hasten the process we envisage, and, equivalently, introduction of a BI would make a large range of tax reforms feasible (both technically and politically).

At the furthest extreme, a BI would make it possible to abolish income tax and rely instead on expenditure or pollution taxes<sup>36</sup>. Here we confine our attention to two ways of raising revenue that have already been widely canvassed by BI advocates - abolishing the various tax reliefs which

<sup>36</sup> More generally, ‘earmarking’ additional revenue from the introduction and extension of environmental taxes (for instance, on carbon emissions or housing) for financing benefit reform may be a politically attractive strategy.

individuals are currently entitled to, and moving to a flat rate of income tax. The first of these reforms reduces the tax rate(s) needed to finance a BI by broadening the tax base – if items of income or expenditure are exempted from tax then the rate applied to the remaining taxable items must be higher than would otherwise be the case. Consequently the provision of tax reliefs (for instance, on income which is contributed to a pension) increases tax rates in precisely the same way as public spending (Willis and Hardwick, 1978; Kvist and Sinfeld, 1996).

The current cost of these tax reliefs (or ‘tax expenditures’) is somewhere over £20 billion (a full list is provided as an annex to the Budget). However, while abolishing all tax reliefs would certainly be one way to pay for the changes outlined above, there is no necessary connection between introducing a basic income and altering the tax base. As argued by COSW, all tax systems constantly face a trade-off between tax rates and the tax base, and a move to withdraw tax concessions need not accompany changes to the benefits system. Indeed, recent attempts in some countries to broaden the tax base (most notably in New Zealand) have occurred independently of any move towards a BI. Moreover, as Atkinson (1989) points out, the revenue gain from abolishing reliefs is difficult to estimate, and many studies of the cost of a BI may have overestimated the amount of additional revenue which would in fact be raised. We therefore set this potential source of revenue to one side.

The second major tax reform issue raised by a BI relates to whether it should be implemented alongside a switch to a linear (i.e. flat) income tax structure, thereby raising revenue for BI payments if tax rates are levelled up. As Atkinson (1995b) suggests in the title of his study of the issue, a flat-tax and a BI are often thought of as two sides of the same policy proposal. In particular, economic analyses of ‘optimal taxation’ – the best trade-off between incentives (which are affected by *marginal* tax rates) and redistribution (which reflects *average* tax rates) – have tended to favour a linear tax schedule<sup>37</sup>. This, in turn,

<sup>37</sup> See Mirrlees’ (1971) for an outline of the problem with which optimal taxation theory is concerned, and some initial results. More detailed numerical estimates of a number of optimal tax schedules are in Tuomala (1990). Broadly, Mirrlees found that an optimal tax structure would be linear, while Tuomala (p14) concludes that “it is difficult (if at all possible) to find a convincing argument for a progressive marginal tax rate structure”, and hence suggests that (optimally) marginal tax rates would gently decline as income increased.

implies that an optimal tax-benefit system might do away with individual tax allowances altogether (replacing them with BI payments), thus allowing most taxes to be collected at source on a simple flat-rate basis. However, as shown by Diamond (1998), this conclusion is sensitive to the assumed distribution of skills (earning power), the responsiveness (elasticity) of labour supply to changes in taxation, and society's redistributive preferences; rather than a flat-tax being optimal, Diamond finds that under certain assumptions a U-shaped pattern for tax rates is preferable. The economic case for linear taxation, while perhaps stronger than many may have imagined, is therefore not incontrovertible. Moreover, while ultimately a flat-tax could vastly reduce collection and compliance costs, the political obstacles to moving away from graduated rates should be acknowledged.

Therefore, though it would be difficult to implement a flat-tax (collected at source) without simultaneously introducing a BI, it would be possible, and arguably preferable, to move towards a benefits system which looks more like a BI while retaining graduated tax rates. Even so, it is doubtful whether a very low 'starting rate' of tax would make either political or economic sense under a BI, and hence we confine our attention to a dual-rate structure<sup>38</sup>. The question is then what would be the rate(s) of tax needed to finance the £33 billion cost of the UBI scheme outlined above? Using POLIMOD, we calculate that a flat-tax of around 40% (the current higher rate) would be sufficient to finance the scheme, though the inclusion of additional support for pensioners and households with children (see the next two sections) would increase this somewhat<sup>39</sup>. Alternatively, under a dual-rate structure where the basic and higher rates were increased in proportion, the basic rate would need to increase by seven percentage points to

<sup>38</sup> The arguments in favour of a dual-rate income tax structure are discussed at length in Kesselman (1990).

<sup>39</sup> It is worth noting that our estimate of 40% is slightly less than the flat-tax of 42% which COSW found would be necessary, reflecting the fact that in the period since their analysis Income Support rates have fallen relative to earnings (their calculations were carried out for 1994/5). However, the exclusion of additional support for children or pensioners from our analysis, and differences in modelling techniques (in particular our inclusion of premia for people with disabilities), will also have affected this comparison.

39% (from a combined tax/NI rate in 2000/1 of 32%), while the higher rate would need to go up to 49%. In the former case this would mean that anyone earning under £13,500 a year would be better-off, the loss of income resulting from the increased tax rate being more than compensated for by the effective increase in the value of the tax allowance, while under a dual-rate structure everyone earning less than £15,000 a year (approximately median earnings) would be better-off.

## 2.6 Households with Children

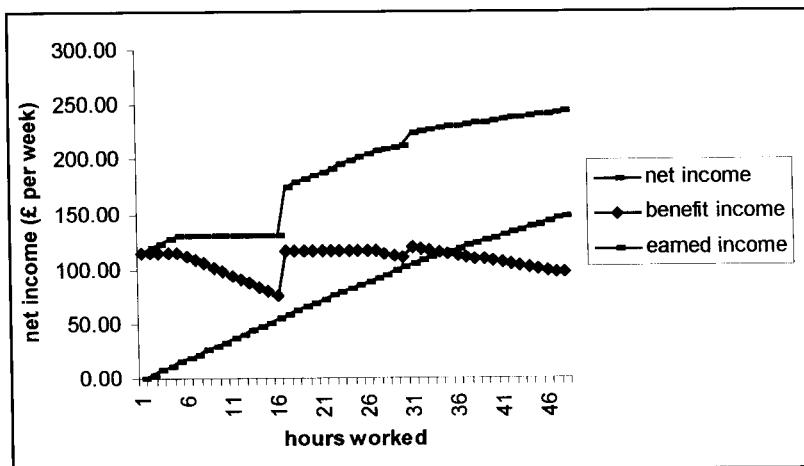
Hitherto we have set the issue of support for children to one side, and have looked at the logic of tax-benefit reform from the perspective of single people. In part this reflects the fact that the tax-benefit system for households with children is far more complex than that for other household-types, and incorporating this group in our earlier analysis would have been rather convoluted. It also reflects the fact that New Labour's agenda for tax-benefit reform is more advanced in this area than in others, and (this section argues) something like an LMPI for households with children is already in place in the form of the Working Families Tax Credit (WFTC). Indeed, in some respects the scheme has some of the properties of a SEPI, in that it reduces incentives for people with children to work very long hours. The discussion below shows why.

### *The effect of the WFTC*

The current structure of financial support for low income households with children is shown in Figure 6. In the same way as Figures 1 and 2 earlier, it shows the relationship between hours worked (on the minimum wage) and net income. Note that in this instance the illustration is for a specific household-type (a lone parent with two children under 11); benefit rates for families vary between couples and lone parents, by the number of children in the household, and by the age of each child, hence a different budget constraint is applicable in each circumstance. For simplicity the Figure ignores the Child Tax Credit, which (from 2000/1) will be payable to basic rate taxpayers with children.

**Figure 6**

**Net Income of a low earning lone parent under the WFTC**



Source: DSS (1999b).

The Figure shows that in some ways the WFTC resembles a basic income. Indeed, beyond 16 hours of work it is more generous than a BI, in that neither benefit withdrawal nor tax (below 23 hours of work) reduce gross earnings. The trade-off is that, above 30 hours, there is a very steep withdrawal rate (of 69%), shown by the rather flat end-segment of the net income line. The generosity of the scheme for parents with low earnings is therefore at the expense of incentives for those slightly higher up the earnings distribution.

In one sense, therefore, the WFTC is clearly about encouraging work – individuals are only eligible for the credit if they are working 16 hours a week. However, because of the poverty trap which it creates, the scheme simultaneously reduces incentives to work long hours. So its overall impact on labour market incentives is ambiguous, and only empirical investigation of individuals' behaviour under the new scheme will be able to determine whether the effect of the improvement in the unemployment trap will dominate the effect of the worsening poverty trap.

Existing research, such as Blundell et al (1999) and Gregg, Johnson and Reed (1999), does however shed some light on the likely direction

of labour supply changes. For couples where neither partner makes much more than the minimum wage, the evidence suggests that the WFTC will most likely reduce aggregate time spent working. The (presumably) unintended effect of the scheme will therefore be to encourage couples to spend more time with their children, as illustrated by the case study we present in the next chapter. In contrast, research suggests that lone parents will work more than they would have done in the absence of in-work support, the incentive to enter work prevailing over the incentive to work fewer hours. Lone parents will therefore on average spend less time with their children. However, this need not mean that the child will suffer; indeed, quite the reverse may be the case. First, it might be argued that working allows lone parents to provide better care due to their improved financial position. Second, in addition to these financial benefits, work may also bring with it various psycho-social rewards, which are likely to generally improve the quality of parenting. Last, the fact that a lone parent is working for some of the week creates an opportunity for directly improving the (current and future) well-being of their children, via high-quality childcare and child development work.

The arguments for the WFTC are therefore just as much social as economic. Indeed, as we pointed out at the start of this chapter, the government's emphasis on paid work is essentially driven by the moral view that work is 'good', not because what is produced through work has value (the economist's view), but because in itself the process is meritorious. From this point of view the labour market incentives created by the WFTC make more sense - in effect it acts to counter extreme work patterns, discouraging both no-earner households and two full-time earner households. The question now is whether the scheme will develop along labour-market orientated lines, or whether its social aspects will be enhanced (as under a SEPI). This latter direction for reform is discussed below, before we look at the alternative of abandoning the WFTC and instead increasing Child Benefit (an approach which would be more in line with the UBI scheme outlined in the last section).

### ***Reforming the WFTC***

As we have seen, the WFTC has both social and labour market objectives, and the future development of the scheme depends on which

of these two roles is emphasised. Clearly, in terms of labour market objectives the priority should be reducing the taper rate, so that there are better incentives to earn more through working longer hours, acquiring skills or gaining promotion. The scheme might therefore be extended by bringing people further up the income distribution into its net (this being the inevitable result of reducing the taper rate). It is apparent, however, that this policy improves incentives for people on the WFTC but worsens incentives for those who become newly eligible, creating something of a dilemma for the government<sup>40</sup>. Indeed, it was precisely this problem which led us to reject the introduction of an employment tax credit.

We therefore believe an alternative direction for reform, which has more in common with the SEPI approach, may ultimately prove more promising. Rather than worrying about incentives for parents already in work (and claiming the credit), this alternative strategy would concentrate on ensuring that as many parents as possible performed some work, even if only for part of the week. Accordingly, the entry conditions for the scheme might be made somewhat looser, through reducing the minimum hours of work for certain groups, so that in effect tax-credits were extended *downwards* to those currently without any earnings<sup>41</sup>. For instance, lone parents with children under 5 might qualify if they worked for 8 hours a week or more (this in fact being the definition of 'working' which we used in our modelling of a SEPI). By coincidence, at the current minimum wage rate (£3.60 per hour), this is also the number of hours at which prospective mothers now qualify for statutory maternity pay (prior to the 1999 Budget they had to have earnings at or above the lower earnings limit of £66 a week).

The process might go even further in the case of lone parents with very young children, where the WFTC might be more formally connected with pre-school care and child health services. As demonstrated by the

<sup>40</sup> Arguably, the reduction in taper rate from 70 to 55% which occurred when the WFTC was introduced has already moved the balance between incentives for those receiving the credit and its reach up the earnings distribution too far in favour of the former.

<sup>41</sup> The SEPI approach might also imply that this qualifying condition should be raised for couples, e.g. from the current minimum of working 16 hours a week to (say) 30 hours a week.

government's loud trumpeting of its 'Sure Start' programme, there is increasing official recognition of the importance of the first two or three years of a child's life on their subsequent development (Waldfogel, 1999 and Pally, 1997). In a similar vein, the period immediately before and after birth is also receiving more attention, with the government doubling the value of the maternity payment for mothers claiming means-tested benefits or the WFTC (the new benefit being known as the 'Sure Start Maternity Grant'). In the longer run, the 1999 Pre-Budget Report promised that 'The Government will also examine whether the Working Families' Tax Credit or other measures can give additional help to the mother who wishes to stay at home in the first months after her child is born' (HM Treasury, 1999, paragraph 5.27).

The use of the WFTC to support wider social policy goals is therefore clearly already on the government's agenda, and, if they are serious about abolishing child poverty, is likely to become more so in the near future. For parents with very young children the participation condition might be extended not just through reducing the minimum qualifying hours of work, but through conditioning receipt against other forms of behaviour. For instance, attending the New Deal for Lone Parents or certified education courses might enable lone parents with very young children to claim the WFTC. Or, for mothers with severe social problems (such as drug or alcohol addiction), the WFTC might be paid on the basis of attendance at rehabilitation courses. Notably, a step down this path has already been taken with the new Sure Start Maternity Grant, where 'the increased payments will be linked to contact with a healthcare professional to ensure expert advice on child development and services' (HM Treasury, 1999, paragraph 5.39).

### ***Households with children and a UBI***

The above showed how the WFTC might be reformed to include almost all low income households with children. However, it does this at the price of extending the world of tax credits into areas where the benefits system might be thought the more appropriate vehicle for support. Moreover, as we have discussed at length, though the WFTC provides a high level of support for families with low earnings, it does this at the expense of their incentives to earn more. Simply increasing Child Benefit may be a simpler solution than the complex schemes just discussed.

Certainly, if support for adults were made wholly unconditional, as would be the case under a UBI, the retention of a household (and means-tested) basis for eligibility to the WFTC and Child Tax Credit would look anachronistic. We therefore envisage that the final stage of the reform process we have discussed (the introduction of a UBI) would be accompanied by a substantial increase in Child Benefit and the abolition of the WFTC and the Child Tax Credit.

This creates a problem when looking at the most appropriate level for Child Benefit under a UBI. If we are concerned about not creating losers then the benefit should be set at a very high level, so that the incomes of people on maximum WFTC would be protected. But, apart from being extremely expensive, this approach violates our principle of (wherever possible) not changing the level of the safety net. We therefore use Income Support (for 11-16 year olds) as the basis for our Child Benefit rates. These are shown in Table 8, alongside the current rates of Child Benefit, the child premia in Income Support and the WFTC.

**Table 8**

**Income Support premia for children and Child Benefit rates**

<b>Proposed Child Benefit rates</b>	
- only, elder or eldest child	<b>39.80</b>
- each subsequent child	<b>25.90</b>
<b>Current Child Benefit rates</b>	
- only, elder or eldest child	<b>14.40</b>
- each subsequent child	<b>9.60</b>
<b>Income Support premia for children</b>	
- aged 0-11	<b>24.90</b>
- aged 11-16	<b>25.90</b>
- aged 16-18	<b>30.95</b>
Plus family premia (i.e. addition for the eldest child)	<b>13.90</b>
<b>WFTC premia for children</b>	
- aged 0-11	<b>19.85</b>
- aged 11-16	<b>20.90</b>
- aged 16-18	<b>25.95</b>

According to POLIMOD the gross cost of increasing Child Benefit to the rates shown in Table 8 would be around £14.5 billion. However, to arrive at a net cost we need to subtract savings from the abolition of the child premia in Income Support, the WFTC and the Child Tax Credit. POLIMOD calculates that these programmes cost £5.5, £2.1 and £1.9 billion respectively<sup>42</sup>, so the net cost of the changes we describe would be around £5.5 billion. It should be borne in mind that, if policy makers are concerned about the incentive effects created by the current system (as illustrated by Figure 6), changes to the WFTC, and associated increases in spending, are inevitable. Moreover, there will also be savings on the childcare subsidy provided by the WFTC. The long run net cost of these changes to Child Benefit is therefore likely to be substantially less than £5.5 billion.

## 2.7 Pensioners and Pension Policy

The final group we should discuss are pensioners. As set out in Sutherland (1998), there is already a prototype BI for retirees in the form of the basic state pension, which means that implementing a BI for pensioners poses fewer administrative, political and financial problems than is the case for the working-age population. In effect, therefore, we propose that a UBI should be implemented for people over retirement age as soon as possible - a staged transition, along the lines we envisage for younger people, would be unnecessary. Accordingly, this section looks at how the basic pension could be turned into a basic retirement income (or 'Citizen's Pension' as the proposal is termed by Sutherland) through changing the structure and level of the basic pension.

The structural change would be the abandonment of the social insurance basis for eligibility to the pension, in favour of a simple test based on residence (or citizenship). Under the current system men and women must have respectively 44 or 39 contribution years to be able to claim the full pension; individuals with less than the requisite number of years receive a reduced pension proportional to their years of contribution, except for those who fail to cross a threshold of 25%

<sup>42</sup> Note that this latter figure is rather larger than the government's £1.4 billion estimate for the cost of the Child Tax Credit.

who receive nothing (Rake, Falkingham and Evans, 1999). While the availability of credits to cover periods of joblessness (which has existed since the inception of the scheme) means that almost all male pensioners qualify in full, less than two-thirds of female pensioners are currently eligible for the full payment (GAD, 1995). Moreover, though the introduction in the 1970s of credits to cover periods spent caring for children ('Home Responsibilities Protection') will improve women's eligibility for the pension, the DSS (1998c) estimate that in 1995/6 around 17% of the working age population still failed to make contributions or receive a credit. Significant gaps in the coverage of the basic pension are therefore likely to remain<sup>43</sup>.

A basic retirement income would close these gaps through paying the full pension (of £66.75 a week in 1999/2000) to everyone over 65<sup>44</sup>. Its effect would be to eradicate means-testing for pensioner couples, as their joint entitlement of £133.50 (2x£66.75) would automatically be above the current rate of Income Support rate for couples (£116.60 a week at age 65). However, to eradicate means-testing among single pensioners a further change would be required, namely to increase the level of the basic pension to £75 a week, the level of Income Support for a single person aged 65-74<sup>45</sup>. At the same time, more generous age-increments would need to be introduced - while the basic pension increases by a mere 25p at age 80, older claimants of Income Support receive more substantial increases of £2.30 a week at age 75 and a further £4.95 a week when they reach 80<sup>46</sup>. In the same way as

<sup>43</sup> This conclusion contradicts Johnson and Stears (1996), who suggest that the system of credits will be so successful that, by 2020, practically all retirees will receive the full amount. It should be also be noted that the eligibility conditions for the proposed State Second Pension (see DSS 1998b), which in effect will replace the basic pension in the latter half of the next century, are considerably more restrictive than those currently in place.

<sup>44</sup> We ignore the current inequality in retirement ages by gender, as under current legislation this is set to be phased out by 2020.

<sup>45</sup> We ignore the effect of the recently created system of 'winter allowances', whereby all pensioner households receive an annual payment of £100 (in the 1999/2000 tax year) irrespective of their status in relation to the basic pension.

<sup>46</sup> It is worth noting that, partly because of the age-increments, but also because of widowhood and private pension indexation rules, the majority of pensioner Income Support claimants are over 75 (and 40% are over 80).

earlier (and as in Sutherland, 1998), we therefore increase the level of the (newly universal) basic pension to these Income Support rates. As before, we also adjust the benefit by health-status.

### ***Cost and distributional effect of a basic retirement income***

Table 9 sets out the gross and net cost of a basic retirement income, along similar lines to Tables 5, 6 and 7 earlier. However, in this case we also take into account consequential increases in tax revenue – because we leave the level of the tax allowance for pensioners unchanged, and the basic pension is taxable, some of the additional income provided by our scheme flows back to the Exchequer through higher income tax payments.

**Table 9**

#### **Cost of a basic retirement income**

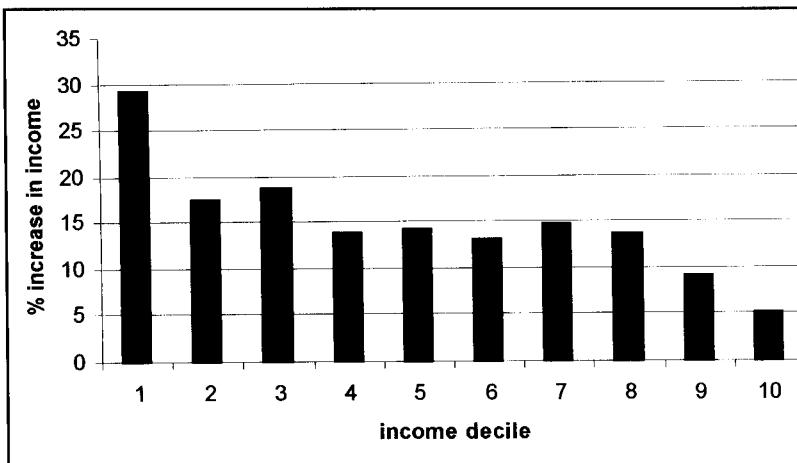
<b>Measure</b>	<b>Cost/Saving  (£, bn)</b>
Benefit payments	37.6
Savings on basic pension	-25.7
Savings on other benefits	-2.9
Additional tax revenue	-0.8
<b>Net cost of a basic retirement income</b>	<b>8.2</b>

Source: POLIMOD.

Our estimated net cost of £8.2 billion may be compared with Sutherland (1998), who finds that a similar scheme ('An Age-related Citizen's Pension') would cost £4.6 billion. The higher cost of our scheme is accounted for by two factors. First, we include disability additions, so that the structure of Income Support is replicated more precisely. Second, the relative level of Income Support is higher in 1999/2000 than 1998/99, the year for which Sutherland's analysis was carried out, due to the above-inflation (and earnings) increase implemented in April 1999. Given this, the difference between the two estimates should not be of concern.

The effect of the scheme on the pensioner income distribution is shown in Figure 7. As can be seen, the benefits of a basic retirement income would be concentrated on the bottom half of the pensioner income distribution. Note though that, in this instance, much of the gain in the bottom deciles is accounted for by the (assumed) increase in take-up to 100%.

**Figure 7**  
**Distributional effect of a basic retirement income<sup>47</sup>**



Source: POLIMOD.

It is worth briefly mentioning an alternative form of basic retirement income, where payments would vary by household status (i.e. between single pensioners and couples). In effect, this system would attempt to adjust for household economies of scale, in the same way as Income Support does now. The existence of such household economies is also recognised in other areas; for instance, single households qualify for a reduction in their Council Tax bills.

It is easiest to imagine such a scheme operating through the introduction of a new supplement for single pensioners, so that for couples the basic pension would continue to be worth £66.75 (and would be fully universal), but single pensioners would enjoy a specific

<sup>47</sup> In this figure, unlike others, the effect of take-up rising to 100 per cent is included.

addition. For instance, consider a scheme where, on top of the basic pension, all single pensioners received a supplement of £8.25 a week below age 75 (enough to bring them up to the level of Income Support), with equivalent increments at age 75 and 80. Just as with the fully-individualised scheme, this policy would effectively eradicate the need for Income Support payments to pensioners. However, because additional benefits are focussed on single people, who account for the vast majority of means-tested benefits for pensioners, it would (according to POLIMOD) cost around £5 billion, less than two-thirds the £8.2 billion we estimated earlier. Nevertheless, we assume below that a fully individualised basic retirement income scheme is introduced, and hence it is the larger figure which we need to cover through increases in tax or NI revenue.

### *Financing a basic retirement income*

The extra resources needed to pay for a (individualised) basic retirement income might come from among pensioners themselves (inter-personal redistribution within the cohort) or from the working age population (inter-generational redistribution from one cohort to another). The former route might involve reducing the level of the tax allowance to £75 a week (£3900 a year), the new level of the basic pension, and increasing the basic rate of tax paid by pensioners<sup>48</sup>. However, it should be noted that, if the social insurance basis for the pension were abandoned, we would in any case expect the tax and NI systems to be merged. The effective tax rate facing retirees would therefore rise from 22 to 32%. Using POLIMOD, we calculate that in themselves these two tax changes will produce £6 billion of additional revenue, nearly enough to pay for an individualised basic retirement income and more than enough to pay for the household-based scheme.

The alternative policy would be to seek resources not from pensioners but from pensions policy more generally. In particular, the introduction of a basic retirement income might be accompanied by the abolition of the State Earnings-Related Pension Scheme (SERPS).

<sup>48</sup> Rather than reducing the tax allowance to the level of the basic pension, an alternative policy would be to abolish the allowance altogether while making income from the basic pension non-taxable.

As well as putting a floor under pensioner incomes, the current pension system also tries to replace individuals' earnings in work. This operates through the state forcing all employees to contribute either to SERPS or to a private pension scheme (via the system of contracted-out rebates). However, the rationale for this 'second tier' of compulsory earnings-related provision is unclear; if paternalistic arguments are excluded, it is difficult to see why the state should concern itself with individuals' accustomed living standards (Jupp, 1998; Agulnik, forthcoming). We therefore assume that, in the move to a basic retirement income, this objective for policy is abandoned, so that (above the minimum) individuals are free to decide for themselves how to structure their finances over the lifecycle.

The abolition of SERPS and its related system of contracting-out would result in large savings to the Exchequer both now and in the future. The long-run savings would come in the form of reduced public expenditure on SERPS benefits, which would gradually fall to zero as accrued benefit entitlements unwind<sup>49</sup>. The more important source of saving would, though, be the immediate gain resulting from abolishing contracted-out rebates, which currently cost the government £8 billion a year in lost National Insurance revenue (see Budget 99, Table 1C.1)<sup>50</sup>. This sum is almost exactly enough to pay for the individual basic retirement income scheme described above.

However, given the ageing of the UK's population, we should adjust our analysis to take account of the growing cost of benefits for retired

<sup>49</sup> The government actuary estimates that, under existing policies, SERPS benefits will cost around £15 billion in 2050 (in 1998/99 prices). However, under the government's proposals to transform the scheme into a State Second Pension, this cost will rise to about £25 billion (written parliamentary answer 11,2,99).

<sup>50</sup> In effect, abolishing SERPS would mean that all employers and employees paid NICs at the full contracted-in rate of, respectively, 12.2 and 10%, as against the contracted-out rates of 9.2 and 8.4%.

<sup>51</sup> Assuming that the retirement age remains fixed at 65 (after gender equalisation in 2020), there will be roughly 40% more pensioners in the middle of the next century as there are today. The cost of the basic retirement income scheme will therefore be equivalently larger, at least if the level of payments keeps pace with rises in national prosperity (as we believe it should). In comparison to the current policy of price-indexation, a basic retirement income would cost £60 or £70 billion more by 2050 (in today's prices).

people in the next century<sup>51</sup>. In particular, we should use some of the money released by the abolition of SERPS to reduce the level of the national debt, so that over time the burden of interest payments falls to offset the increasing cost of state transfers (see Agulnik and Barr, forthcoming). The £8 billion yielded by abolishing SERPS might therefore be used partly to pay off the national debt and partly to implement a basic retirement income, with co-financing from the retired population as appropriate.

## 2.8 Conclusions

In this chapter we have analysed the public-finance implications of the New Labour government's attempt to 'make work pay' and increase labour-market participation among households excluded under previous rules. Accepting these goals, we have shown that the tax-credit approach adopted is inherently flawed as a long-term path to reform, but that it would be possible to achieve the government's objectives by a staged progression from this towards a Basic Income. While the government is unlikely to acknowledge that the Basic Income approach is more capable of delivering the outcomes it seeks, this is the clear implication of our overall analysis. The path described has the advantage that most of it could be followed without renegotiating the New Contract for Welfare. The stages on the way correspond to the groups of MPs identified in Ch.1; 'policy insiders' would support an LMPI, 'agnostics' a SEPI, and 'old welfare state loyalists' and long-term CI enthusiasts a UBI.

The main thrust of our argument has been to show that tax-benefit reforms need to be developed on lines other than the tax-credit principle in order to provide a consistent set of incentives, and the kinds of labour-market flexibility that the government pursues. For the sake of clarity in presentation, we have said little about the important issues of *administrative simplicity* and *incentives to save*. In both these respects, the public-finance approach adopted by the government is severely flawed. The Basic Income principle offers a coherent alternative, with more reliable linkages between the rules designed to promote efficient use of resources, optimum labour supply and responsible individual choices.

In the next chapter we will turn to the question of implementing tax-benefit reforms - not only those of administering these systems, but also those of how they interact with other parts of New Labour's reform programme, and how citizens are likely to respond to these changes, both individually and collectively.

## Chapter 3

# Implementation of Tax-Benefit Reforms

### Introduction

In this chapter, we will analyse the issues for implementing the tax-benefit reforms described in chapter 2. Obviously there are important questions about how the processes of change triggered by these reforms in the rules surrounding benefits will be managed, and how their effects on other policies domains and on economic behaviour will work themselves through. Of special interest is the compatibility between the government's goals for labour market incentives and formal participation rates, and its other policies for regionalisation, democratisation, social cohesion and empowerment. How, too, will these policies interact with those for health, education, social care and housing? Can the values espoused in policy documents for those areas be upheld within the kinds of strategies that citizens will pursue under the reformed rules?

The New Labour government is explicitly ambitious in its reform goals (DSS, 1998, p.24 and title), aiming to change the behaviour patterns of public-sector staff, service users and claimants in all the major social services, and to transform the social security system from a generalised safety net into a set of customised trampolines (launching citizens to individual independence). But - despite claims about 'joined up government' - there are serious questions about the interactions between tax-benefit reforms and other policies. On the whole, the New Labour government is not particularly interested in implementation. It places its trust in elaborate Benthamite systems of regulation, with layer upon layer of supervisory boards and authorities (see for instance DETR, 1998 and DoH, 1998), plus the very detailed intervention of quasi-social work counsellors, advisers and officials in the daily lives of claimants and service users.

Nowadays every child knows, from computer games which simulate complex interactions, that it is counterproductive to try to accomplish changes in one part of a system without making compensating changes in all the other parts. Above all, it is always a mistake to try to produce

large changes in one part of the system, because this produces unintended and largely unpredictable shifts in other parts; and an even bigger mistake to try to make large changes in all parts simultaneously (Krempel, 1999). Unfortunately, New Labour ministers have never played games like SIM City, and the civil servants who try to anticipate the effects of policy cannot avail themselves of models which are as sophisticated as today's children's games.

The plan of the chapter is as follows. **Section 3.1** introduces one of the central issues, common to all domains - the relationship between paid employment and informal economic activity of all kinds. The New Deals, the strategy of conditionality and the reforms that improve incentives to take paid work all conceal assumptions about the desirability of increasing the ratio of paid formal employment to informal activities. Yet it is by no means obvious that this always and necessarily improves economic efficiency or social justice, especially when the work in question is concerned with sustaining ordinary family and social life. The possible unintended consequences of this major shift in incentives, reinforced by strongly-enforced conditionality, will be considered here.

**Section 3.2** uses examples from a number of policy areas - illness and disability, social care and homelessness - to illustrate the possible perverse incentives of a Labour Market Participation Income, and how, far from promoting social inclusion and social justice, it could actually reinforce the exclusion of some citizens and some activities from the mainstream of public life. Barriers and inequalities of access, together with inconsistencies with stated values and goals, will be illustrated here.

**Section 3.3** considers potential paradoxes and contradictions in the implementation of tax credits and an LMPI, concerning disincentives as well as incentives to formal labour market participation. Here we look at just how complex the relationship between paid and unpaid, formal and informal activity can be, and how instruments for influencing choices or how to combine them are at best only approximate.

**Section 3.4** identifies the four major common means of implementation across the New Labour programme, and shows how strong

conditionality and work tests are constraining or distorting these measures.

**Section 3.5** looks at how these issues could trigger a political movement for a shift from an LMPI towards a Social and Economic Participation Income (SEPI), and eventually from that to a Citizen's Income (CI), which implements the Basic Income principle. We will show how a CI would offer the chance to resolve many of the problems identified in the preceding sections, and how a variety of groups might coalesce into a movement for such a shift, because they feel unjustly excluded and devalued by the strict conditionality of the LMPI approach. We argue that a CI would be the best way to achieve the social cohesion aimed at by New Labour, and to empower groups who would remain marginalised under LMPI policies.

Finally, **Section 3.6** addresses the issue of housing costs, showing that these will be a headache to policy makers under any tax-benefit regime, but that at least no extra difficulties would be introduced by the SEPI or CI approach to the reform process.

### **3.1 Formal and Informal Economic Activity**

Embedded in the whole of New Labour's package of reforms of welfare services is the assumption that paid work is the most reliable route out of poverty, the most satisfactory way for citizens to perform their obligations to society, the best way to reconcile economic efficiency with social justice, and the most direct way of accomplishing social inclusion and empowerment. For example, it is largely assumed that people with disabilities and long-term illnesses want paid employment, as the means to independence, and that it is desirable to promote this (DoH, 1998, sec. 2.18). Equally embedded, and occasionally explicit, is the notion that informal economic activity is less desirable, less efficient, and often illicit - for instance, where undeclared earnings are combined with claiming benefits (DSS, 1998, chapter 9).

Yet there are some grounds for questioning these assumptions. In part, these questions can only be answered by analysing the kind of employment that is likely to be generated by changes in policies and tax-benefit rules, and the kinds of informal opportunities available. In the UK economy, it seems indisputable that most of the new formal

work that will be created by the whole range of policies in New Labour's programme will be concerned with tasks of sustaining ordinary family and social life (social reproduction work). This can partly be deduced from long-term trends in employment patterns, both in the UK and in other advanced industrial economies (Scharpf, 1999). What is at stake here is how best to regulate and organise the systems through which people nurture, rear, socialise, sustain and service each other - work concerned with feeding, grooming, tending, correcting, caring, protecting, curing, recreating, teaching, training, cossetting and finally laying to rest. New employment in manufacturing, extracting, constructing and financing may to some extent be possible (subject to global competitive constraints), and new developments in imagining, simulating, creating and marketing will certainly bring new jobs. But the main source of increased formal work has for some time been the task of looking after people's everyday needs outside such workplaces (Esping-Andersen, 1996; Iverson and Wren, 1998).

From an economic point of view, two iron laws meet around social reproduction work, and the outcome of this clash is contested. On the one hand, Adam Smith's law of the division of labour states that prosperity is closely linked to the constant refinement and specialisation of work tasks, and that this is only achievable through labour markets, which allow productivity to be maximised (Buchanan, 1995). On the other hand, Engel's law holds that as prosperity increases, so the proportion of paid services consumed rises; but that improvements in productivity in many of these services cannot match those of manufacturing industry. In most tasks of social reproduction, productivity has hardly risen in 200 years - it takes as long to cut someone's hair or nails today as it did in 1800 (Gershuny, 1983).

Even so, wages in social reproduction service employment may rise, either because of increased demand for these services, or because under-supply of workers in particular, if the wages and profits of those involved in industry (or the incomes of those drawing dividends from investments abroad) rise fast enough, service earnings may increase despite barriers to productivity growth, because of rising demand. High quality jobs with good salaries, for example in counselling, may expand. But in fact the major growth has been (and is likely to continue to be) in the care of an increasing proportion of elderly frail and

disabled people, not in counselling or curative medicine; and there is a plentiful supply of less skilled workers for such tasks. So *either* the incomes of the growing proportion of the population employed to perform rather mundane but essential services must remain very low, relative to those working in high-tech industries and services, *or* increasing transfers must be used to subsidise people doing those kinds of paid work.

The New Labour programme addresses this issue directly; its tax-benefit reforms transfer substantial sums to subsidising paid work in social reproduction through the various tax credit schemes, and through programmes for 'modernising' local authority and commercial social services (DoH, 1998). The conscious aim of the former changes is to make it more attractive for benefits claimants to go to work in a restaurant, child care centre, leisure complex, theme park, shop or old people's home than to cook, clean, garden, decorate, shop, care or wash for their families or neighbours on an unpaid basis, at least during working hours. Where such incentives fail, persuasion or the threat of benefit disqualification increasingly come into play.

The question then arises: who is more unjustly exploited and excluded, a citizen (usually a woman) who stays at home and does these things on an unpaid basis for her family and neighbours, or at a local day centre as a volunteer; or one who goes to work and does them for very low pay, without the prospect of escaping from the poverty trap? The fact that the second alternative is not an academic one was illustrated in chapter 2 (pp. 54 - 63), where we showed the expansion of this trap across a range of earnings not previously subject to high effective marginal tax rates. Tax credits provide strong incentives for taking paid work, but not for increasing earnings. For many women, the injustice of this is increased by the fact that they then have to go home and do the unpaid tasks anyway, especially if they are lone parents.

The pragmatic answer to the question is that it depends whether the job which is taken by someone previously outside the labour market is a dead end, or the first step on a ladder to higher-paid employment, via better training and qualifications and wider employment options. Optimists hold that this is the likely outcome for most new entrants,

at least in the long run. However, the logic of Engel's law suggests otherwise. If an increasing proportion of employment is in low-paid social reproduction services (because of technological improvements in other branches and international competition), it follows that more and more jobs must be dead ends, since productivity cannot be improved in these. Otherwise why has it been necessary to introduce in-work benefits, and why has the volume and coverage of such benefits had to be increased so rapidly since their inception in the late 1960s? Engel's law would predict that the net of in-work benefits must necessarily go on widening as employment in low-paid social reproduction job grows, so that people who receive the same (poverty) levels of income no matter how hard they work will constitute a larger and larger proportion of employees. This has been happening now for 30 years, in the USA as well as the UK (Iverson and Wren, 1998). Against this, the Scandinavian model of improved wages and conditions in an expanding public service sector was sustained for two decades – but that model depended on a very particular set of political and institutional conditions that is unlikely to be reproduced elsewhere.

On the other side of the argument, it is frequently claimed that the informal economy, and especially the domestic economy, turns its participants (particularly women) into oppressed and exploited serfs, who are ruled by duty and altruism, and denied access to the wider world. The case stated above can all too easily become a justification for trapping women in particular, and oppressed minorities more generally, in situations of exploitation and exclusion, based on patriarchal or racist relations. Above all, such roles deny informal participants opportunities and choices. New Labour policies are founded on repeated assertions that claimants *want to work* (focus groups must have echoed to such pleas). By what paternalist edicts should they be denied that chance?

Again pragmatically, those who argue the opposite case maintain that *real* choice lies in the opportunity to choose between formal and informal work, and to combine them in ways that suit the citizen, not the system. Although certain groups are always at greater risk of exclusion than others, and women are especially vulnerable to patriarchal forms of domination, these groups will only begin to be

free to assert their claims against such oppression when they enjoy the same choices as mainstream citizens, who can and do balance the demands of earning and caring. Research suggests that most mainstream women do not choose to pursue male-style careers, with promotion, pensions and perks, but compensate for this by interesting combinations of paid and unpaid activities, while being 'supportive' of (i.e. investing in) their partners' conventional (and often boring) career pathways (Jordan, Redley and James, 1994, chapters. 2 and 5). The demand for Social and Economic Participation Income, rather than a Labour Market Participation Income, implies a 'full engagement society', rather than a 'full employment society' (Williams and Windebank, 1999) and suggests that such choices should be extended to all citizens, including those with low earning power, who take employment in social reproduction work.

All New Labour's policies raise these issues, because they both direct public funds towards the in-kind services, such as social care (DoH, 1998), and subsidise social reproduction employment of this sort through the tax-benefit system. Hence the dilemma - or 'trilemma', as Iverson and Wren (1998) call trade offs between wage equality, service employment and budgetary restraint - arises in every policy area, as we shall show.

### **3.2 The Unintended Consequences of a Labour-Market Participation Approach**

In this section, we will show how particular instances of the 'trilemma' work themselves out. First, we identify a number of common aims of New Labour's programme, and the declared values that are claimed to be promoted by these policies. Then we go on to show how difficult it is to achieve these goals, or stay true to these values, within the constraints of strong conditionality, on the road to a Labour Market Participation Income. In section 3.4 we will show how a Social and Economic Participation Income resolves some of these problems, and how a Citizen's Income would provide consistency across the whole field of social policies.

The *values* upheld by the programme are:

- Equal worth
- Opportunity for all
- Responsibility
- Community

The *common goals* of all the elements in the programme are:

- Equality of opportunity
- A balance of rights and responsibilities
- Promoting independence through work
- Lifelong learning
- Empowerment and capacity-building
- Provision for genuine need

The *means* by which goals and values are implemented include:

- Breaking down barriers to access and inclusion
- Making governance work (harmonised and coherent policy across the various areas)
- Public-private partnerships
- Standards, indicators and targets

Throughout this report, we have accepted the *values* and *goals* of New Labour's social policy programme, but tried to explore the implications of the *means* by which they are being implemented. In what follows, we will show that the strong conditionality and means-testing in the tax-benefit reforms are already making it difficult to reconcile the various goals of the programme within a number of policy domains (secs. 3.2.1 - 3.2.3). Then we will look at the fundamental ambiguity in these reforms over labour-market incentives and work effort. We will argue that there are apparently unintended incentives for those claiming tax credits to work *fewer*, rather than *more* hours -

but that this may promote New Labour's values and goals, rather than hinder their implementation. However, the full potential of this liberating and empowering aspect of the programme cannot be realised unless something like a SEPI is adopted (sec. 3.3). Next, we show which of the four means identified have been shaped by the tax-benefit reforms (and how they are in danger of being distorted by them), and which have little to do with New Labour's main values and goals, and may even undermine them (sec. 3.4). Then we look at how a Citizen's Income approach would be the best way to reconcile all the values and goals, and how the political processes of implementation launched through New Labour's reforms may mobilise a movement for such a change in policy orientation (sec. 3.5). Finally we will turn to the vexed question of housing costs (sec. 3.6).

It is important to emphasise here what has been implicit throughout the report so far. New Labour inherited from John Major's government all the unintended consequences of Margaret Thatcher's reforms - to the tax-benefit system, labour-market regulation, the public services and everything else. The most pernicious of these was the variant of the insider-outsider problem created by the shift to selective, means-tested benefits. A very large proportion of the potential workforce were excluded (or excluded themselves) from the labour market: some 5 million households of working age had no one in employment. Because of unemployment traps built into these benefits, incentives for employment were minimal or absent for these citizens. Over the years, many of them had evolved strategies for compensating themselves for exclusion and disadvantage, involving undeclared work for cash (Jordan, James, Kay and Redley, 1992; Evasion and Woods, 1995; Rowlingson *et al.*, 1997), petty crime, drug dealing, prostitution and hustling (Jordan and Travers, 1998). Statistics showed far lower declines in expenditure by the poor than falls in income (Goodman and Webb, 1994), perhaps partly because of these factors. In other words, many of the most disadvantaged and excluded had no interest in tax-benefit reforms, because they were already using (and felt justified in using) income support and incapacity benefits as a kind of basic income, and making undeclared extra income through informal activity to protect their living standards.

Despite denials by the poverty lobby and most of the social policy academic community, all this was well known, and widely publicised

in the popular press. Mainstream voters were aware of these strategies, and hence resisted increases in taxation and in redistribution through the benefits system. Margaret Thatcher's winning electoral coalition mobilised these sentiments but - as Conservative MPs now acknowledge (see pp.20-25) - Conservative governments were unable to break out of the political deadlock this caused. Mainstream voters would not contribute more while poor people stuck to their resistance strategy; poor people would not give this up until they were offered better incentives.

It was therefore left for Tony Blair's New Labour government to break out of this deadlock through the 'moral crusade' on rights and responsibilities, and the duty on citizens to take paid work in exchange for benefits. Only by such measures as the minimum wage and tax credits could the unemployment trap be sprung. However, the coercive elements in the New Deals, Employment Zones, etc., betray the fact that incentives were not sufficient to attract all claimants back into employment. Although respect for the law and the rights of others is a necessary condition for social justice, compulsion to contribute to the common good is in great tension with the principles of liberal democracy, including New Labour's values (Jordan, 1998, chapters 2 and 3).

As we showed in chapter 1, New Labour is in some danger of becoming trapped in its own moral rhetoric on conditionality and the work ethic, and also of provoking a reaction within its own ranks among those who still support the redistributive ideals of the post-war welfare state. To resolve these dilemmas the government should recognise this stage - of conditionality and increased means-testing, which actually extends the poverty trap to spring the unemployment trap - as a regrettable and temporary necessity, forced on it by the legacy of Thatcherism, rather than a desirable direction for policy development. As we showed in that chapter, Ireland has reached much the same stage in the process of increasing labour-market participation and combating exclusion without such a moral crusade, or such fierce enforcement of work tests. If this stage is acknowledged as a *transitional* one, towards a '*full engagement*', rather than a '*full employment*' society, then the dangers of becoming trapped by its own moral rhetoric - of law-and-order, work enforcement and punishment and the unintended

consequences identified in this chapter - will be greatly reduced.

Considerations of space do not allow us to demonstrate all the perverse incentives and moral hazards introduced by the tax-benefit reform process. We have selected the following three for illustrative purposes, to show how New Labour's values and goals are made harder to put into operational terms by some of these.

### **3.2.1 People with Disabilities and Incapacities**

This has been a troubled policy area for the New Labour government, which suffered bad publicity around the beginning of the welfare reform process, and two embarrassing backbench revolts during the Welfare Reform Bill's passage through parliament. The Green Paper reflected a considerable redraft of its original plans, putting a positive spin on such contentious issues as the means-testing of incapacity and disability benefits. Even so, there are unresolved problems over the implementation of its goals.

In this domain, there is a distinction between (i) disability benefits designed to replace income and (ii) disability benefits designed to compensate for the extra costs incurred through being disabled. Benefits in the first category include Incapacity Benefit, which is for people with sufficient National Insurance contributions, and its non-contributory equivalent, Severe Disablement Allowance. Also in the first category are general means-tested benefits like Income Support, and specific means-tested benefits like Disability Working Allowance (the in-work benefit now replaced with a tax credit). Benefits in the second category include Disability Living Allowance and Attendance Allowance, which are paid to all qualifying disabled people regardless of income or work status. They are exactly similar in structure and purpose to Child Benefit, and to a Citizen's Income.

The Welfare Reform Bill instituted three major changes:

- (i) Incapacity Benefit will be means-tested against occupational pension income.
- (ii) It will no longer be possible to move from unemployment onto Incapacity Benefit (IB) if you have been unemployed for three years or more. Until now, National Insurance credits accrued

- while unemployed counted towards IB entitlement, but they will no longer do so.
- (iii) Severe Disablement Allowance (SDA) will be abolished. Instead, those disabled in childhood will go straight on to IB on becoming an adult. This leaves a gap for those who become disabled later in life but who do not have sufficient NICs to get IB (traditionally, 'housewives'). Previously they would have got SDA, now they will either get nothing or Income Support.

The Green Paper acknowledges that many people with a disability are simply not in a position to undertake work (DSS, 1998, p.51), but even so sets its goals in terms of removing barriers to work, as well as recognising the extra costs of care. Declaring its commitment to wider *social* participation, equal opportunity and more effective civil rights, the government promises £195 million to put an extra one million disabled people back into the employment market. It relies for this (typically) on personal advisers to co-ordinate individual help, plan action and prepare placements, with the usual pilot schemes set up immediately.

In pursuit of removing barriers to work, the Disabled People's Tax Credit (DPTC) replaces Disability Working Allowance, and is an in-work benefit. To encourage people to leave income support in favour of this, the IB linking rules are changed to encourage a trial period of 'therapeutic' work, so that people can undertake a trial period of work of up to one year (previously 8 weeks) before losing other benefit rights. This is clearly an important concession to the disability lobby, since it allows far more flexibility over return to work.

In justifying restrictions of Incapacity Benefit, the Green Paper argues that, as in many other countries, it was expanded in the 1980s to accommodate people who were more accurately classified as unemployed, at a cost by then of £7.8 billion, as a 'more generous' (i.e., less conditional) form of unemployment benefit. By 1997 there were 1.75 million claimants of IB. The 'All Work Test', introduced by the Conservative government to start cutting back these numbers, is acknowledged as an imperfect instrument. It does, the Green Paper acknowledges, 'write off some people', because it is an 'all or nothing test', categorising claimants as either fit or unfit for work. The

government says it is 'examining the scope for a more effective test in future', which would establish a 'scale of employability' that would be 'a continuum' (p.54). So far, nothing has emerged.

The truth is that the attempt to introduce *increased* conditionality (through tougher tests of eligibility) into incapacity and disability benefits is in enormous tension with the goals of empowerment, equal opportunity and access to full rights of citizenship. The All Work Test has notoriously disqualified many claimants with progressive illnesses who have been in receipt of benefits for years, as well as others with quite severe disabilities. It is difficult to see how a new test could actually produce fair outcomes, which give positive incentives without penalising people who have no real prospect of employment by taking away their security of entitlement.

One possible interim solution would be to stipulate quite different numbers of hours per week as the requirement for tax credits, according to levels of incapacity or disability. This would mean that more incapacitated people might be able to get access to substantial extra income for very few hours worked; but it would not improve incentives for spouses, since their income would also be taken into account in assessing eligibility for the tax credit.

The biggest problem concerns those deemed unfit for any formal work. They are by definition ineligible for the considerable incentives offered through tax credits, and must therefore subsist entirely on benefits. By way of compensation, the Green Paper offers to allow Disability Living Allowance and Attendance Allowance (whose claimants may be in work) to remain as universal, non-means tested benefits (p.55), but warns that it will continue to prune the number of recipients (by up to two thirds), through some improved version of the Benefits Integrity project (simultaneously raising take-up by the 40 - 60 per cent eligible who do not claim). The approach we adopt in chapter 2 assumes that all people with disabilities qualify for a UBI (or Citizen's Income), and this means many are gainers under the proposed final stage of our three-stage tax-benefit integration process.

Meanwhile, local authority social services departments will be reminded of their duties to participate in the New Deal for Disabled People (DoH, 1998, sec. 2.18), but also given extended powers and

resources to make direct payments to people with disabilities for their care needs - a kind of extra compensation to people most of whom are deemed unfit for work. This is supposed to give them 'new freedom and independence in running their own lives' (sec. 2.15). However, in effect it means that these claimants, who are denied access to any paid work by the terms of their benefits, are in a better position to employ others to care for them. While this is a good principle, it has implications for social care in general, which are analysed in the next section.

### **3.2.2. Social Care**

In marked contrast with the overall strategy of promoting paid employment for all claimant groups (thus reducing numbers on benefits as well as nationally widening the tax base), the New Labour government clearly relies on *unpaid carers* for a large part of its programme for improving social services for those who need care. The White Paper deals only very briefly with these issues, announcing (yet another) National Carers Strategy, which restates the goals of previous such documents - recognising and supporting unpaid carers with drop-in facilities, information and respite services, consulting about appropriate support, and so on. Essentially nothing is changed; unpaid care by partners (almost half of whom are men, and mostly retired) and offspring (overwhelmingly women) will continue to be the main source of social care, and no changes in the tax-benefits system will improve the situation of such carers in the immediate future.

This illustrates the 'trilemma'; budgetary constraints forbid proper benefits for such caring, and - despite its rhetoric of empowerment and access to full participation in the public sphere - the government continues to exploit bonds of family commitment to provide front-line services. Notoriously, carers act from motives of love, altruism and duty, to the detriment of their health, and at enormous cost to their incomes and access to wider society (Finch and Groves, 1984; Finch, 1989). It is well known that paid care services do not mesh well with such informal systems of affection, loyalty and trust, yet this problem is not even acknowledged. Carers are a natural constituency for a campaign for a Social and Economic Participation

Income, because present policies do not achieve New Labour's values and goals in relation to their inclusion and empowerment.

On the other hand, the government acknowledges that there are important issues over standards of paid care, the protection of service users, and effectiveness in practice. It announces elaborate regulatory mechanisms and institutions (DoH, 1998, chapters 2, 3, 4 and 5), and an entirely new system of registration, standard setting and training. The goal of the latter is to improve the competence and qualifications of the *one million* people now working in social care employment - two thirds in the independent (commercial) sector, mainly in residential homes (sec. 5.1). The goal is 'to give those working in social care a new status which fits the work they do' (sec. 5.6).

In practice, of course, the government is simply reacting to developments of the past 20 years; commercial social care provision expanded exponentially in the 1980s, because the Thatcher government provided an open purse from social security funds (DSS, 1990). The vast majority of the new employees in social care are women and are employed part-time. The effect of the Working Families Tax Credit will be further to promote such employment by tax subsidisation. Whether such policies for reducing costs to employers are compatible with raising professional standards, qualifications and effectiveness in practice remains to be seen, but the two goals are clearly in tension with each other. History does not suggest that employers who receive tax subsidies for their part-time employees are keen to collaborate with efforts to raise standards of professionalism or qualifications.

### **3.2.3 Homeless People**

Homelessness is the focus of several government initiatives, notably by the Social Exclusion Unit (whose report on rough sleeping aims to cut the number of people sleeping rough by two thirds by 2002), the Department of the Environment, Transport and the Regions and the Department of Health (DoH, 1998, sec. 6.24 - box). Plans are announced for better partnerships between agencies, especially over appropriate housing for homeless people.

The government is clearly moved by concern over clearing the streets of people who offend taxpayers' susceptibilities, and who are seen by

some to pose a threat to public order. Its solution is to subject homeless people to rigorous assessments of their individual circumstances and, subject to the availability of any additional resources deemed to be required for their support to maintain themselves adequately, to offer them such accommodation as the assessor considers suitable. Social housing for homeless people is a scarce resource, which is financed by a mix of public sector and private money. As a condition of funding, the state generally requires the social landlord to set further conditions on the allocation of such accommodation, which require it to be shared out on the basis of need rather than choice. Homeless people are expected to reveal all manner of intimate details to assessors and providers. The more desperate the applicant's circumstances, the more likely they are to score points based on need. The more compliant they are, the more likely they are to score points based on predicted positive outcome.

Such practices are difficult to reconcile with the goals and values proclaimed in New Labour's policy documents. They do not readily give homeless people 'equal value' with other citizens, develop their potential, promote their independence, or empower them. Instead they often demean them. Many homeless people are simply unwilling to subject themselves to these processes. Others try them, but find their needs are not met. Since the state has a monopoly of access to such social housing, there is normally no way to circumvent the system.

One voluntary organisation, the Emmaus Community, has set up an alternative to state social housing. This takes applicants on a 'first come, first served basis', and allows them to stay as long as they like, and return as often as they like, without questions about their circumstances or personal lives. The conditions for (lifelong) membership are arduous, and include sobriety and consideration for other members, as well as work for the Community (paid outside work, or outside income of any kind that is not shared with others, is regarded as a 'crime against the Community'). Thus informal economic activity (often recycling schemes), and responsibility to the Community (not the 'community', i.e. the government) is seen as the appropriate expression of equal value, autonomy, empowerment, and the realisation of potentialities.

The Emmaus Community directly challenges New Labour's programme for implementing its values and goals, especially in giving priority to informal work and responsibility to immediate companions, not the state's definition of civic obligations, or the state's definition of needs. It is difficult to see why Emmaus' principles are less socially just than the government's, or why homeless people should not at least have a choice between the two alternative approaches to citizenship and social inclusion.

### 3.3 Paradoxes of Tax Credits and Negative Income Tax

In this section, we consider the 'moral hazard' that is built into tax credits (and would also be present in negative income tax schemes). These issues link directly with the questions of allocation of paid and unpaid work, formal and informal activity, but they do so in a rather different way from the ones illustrated in the previous section. However, we suggest that in a paradoxical way this could enhance the long-term progress to New Labour's goals of social cohesion and empowerment.

It seems obvious at first sight that the incentives of the Working Families Tax Credit and the other tax credits, both those already in place and those promised, should encourage greater labour supply. In one sense they do - more people have reasons to participate in paid work, and more do so. But this does not necessarily mean that these individuals work harder, for longer hours, or have incentives to improve their skills. Indeed, as we argued in chapter 2, pp. 44 - 50, *recipients of WFTC and other tax credits may have incentives to work less, not more*. Consider the following case study.

#### *Case Study 1: Jim and Brenda Shaw*

Jim and Brenda Shaw, both in their early 30's, are both model New Labour citizens (and voters). They have two sons, aged 7 and 3, and live in a house that they are buying on a mortgage. Jim works nights in a food-processing factory, earning around £200 a week, Brenda does three day jobs, at a supermarket checkout, as a cleaner, and at a child care centre. Together they work about 70 hours per week, with Jim looking after the children when Brenda is working.

The couple have never previously claimed (or been eligible for) in-work benefits, but with the advent of WFTC, the high-profile publicity on TV drew their attention to this possibility. On further investigation, they discovered (to their surprise) that they were eligible for a small amount, given the fact that for the next 5 weeks Jim will be working slightly short-time in the factory, because of slack demand at this time of year.

On further reflection, they found that the benefit opened up new options for them. With the prospect of the two boys being at school, Brenda is considering doing an education or training course, perhaps in book-keeping. Jim is fed up with his routine, and would like to reduce his working time. They calculate that they will be only between £10 and £20 a week worse off if they reduce their joint working time to 16 hours per week (i.e. by about 54 hours). Either Jim could go part-time, or Brenda could give up her jobs to study; or both.

### ***Implications***

Usually when a new benefit is introduced, it takes some time for claimants to work out strategies for maximising claims. No system is strategy-proof, but the moral hazard (in terms of the work ethic) of WFTC is particularly transparent. Despite their lack of previous claiming experience, Jim and Brenda have already seen the opportunities for reducing their labour supply which it offers. The authors know of other couples who have spotted the same openings.

WFTC functions as a kind of Basic Income for households with children, where one parent has the chance to do 16 hours a week of paid work; after that, they are free to combine paid and unpaid work as they wish. In Jim and Brenda's case, this means they can (at last) spend more time with each other, and with their sons. It is a liberating opportunity for them, and also (of course) a good chance for lone parents to gain access to labour markets. But we doubt whether a reduction in work effort of this order was quite what our legislators intended.

To counter this, as we suggested in chapter 2 (pp. 51 - 60), the government might vary the stipulated hours for various categories of claimants, or categories of tax credits, leading eventually to

differentiated conditions for a negative income tax. But it is doubtful whether moral hazards of all kinds could be eliminated altogether. The trouble is that a form of tax transfer that favours paid over unpaid work is vulnerable to another strategy, when the tasks involved are identical, and can be done by either work process. Child care, washing, gardening and home improvements are all obvious examples. Under tax credit and negative income tax systems with work tests, it always pays for claimants to do these tasks for each other (on some kind of exchange basis) for cash, rather than doing them informally for themselves. It is hard to avoid the conclusion that lone parents (for instance) will pay each other to look after each other's children, or pay others in their district to do their gardens, in return for being paid for some reciprocal service. This will, unlike the case study, certainly promote the paid work ethic, but not economic efficiency.

We have argued that this problem stems from New Labour's determination, under the New Contract for Welfare, to 'make work pay' (i.e. reward paid employment). The aim in the long term should be to have a tax-benefit system that is *neutral* between paid and unpaid work; perverse incentives arise only when rules try to change behaviour rather than to give fair choices to citizens. On pp.119-123 below, we argue that a Citizen's Income approach would supply such neutrality and choice.

### **3.4 New Labour's Means of Implementing Welfare Reforms**

This section is concerned with the four main common *means* for implementing the values and goals of the broader reform programme identified in section 3.2. We will argue that three of these are strongly influenced by the measures for tax-benefit reform adopted and anticipated, and that an SEPI (or, better still, a CI) would make it far easier for the values and goals of the whole programme to be implemented through these means. For the other two means, we suggest that other agendas have mainly informed the choice of these, and that an SEPI or CI approach to tax-benefit reforms would allow methods more consistent with New Labour's values and goals to be adopted.

## **Dismantling Barriers to Participation and Inclusion**

The main barriers to participation are both economic and social; of these two, the latter are more difficult to remove. Social barriers may affect an individual (e.g. poor education), or an entire disadvantaged community.

The relevant policy initiatives in which these measures are deployed are:

- New Deals providing training and education for employment;
- Lifelong learning, with emphasis on self-improvement and employability;
- Employment Zones, concentrating special attention on the long-term unemployed in disadvantaged areas;
- Better health, arising to narrow the disparity in standards between rich and poor; and
- Drugs policy, affecting the young and disadvantaged.

In all of these, activity in the informal economy is both a potential barrier and a potential contribution to breaking down barriers. For example, drug dealing is a kind of economic activity which flourishes where markets of all kinds have failed, and which develops various entrepreneurial skills and attitudes - but it also develops criminal links and cultures. Drug-taking can also be a severe barrier to learning and working.

Ideally, implementation programmes and projects build on the positive experiences from informal activity, to overcome the negative ones. Health is certainly enhanced by many kinds of voluntary and unpaid work, though it is undermined by activities such as drinking and smoking, which often accompany certain kinds of informal activity.

At present, many of these initiatives are moulded by tax-benefit rules, which themselves constitute barriers to the implementation goals of the people who operate them. As a case study of this, we will describe the experiences of one pilot Employment Zone.

## **Case Study : Employment Zones**

One of the cornerstones of New Labour's case for The Third Way is its commitment to 'joined up solutions'. Given the proliferation of measures for social and economic regeneration in deprived districts (New Deal for Communities, Social Exclusion Unit and Single Regeneration Grants) one test is: how do the many different zones, schemes and programmes break down barriers by joining up top-down policy with bottom-up initiatives? The Employment Zone (EZ) is a government measure initially piloted in three areas of the country and subsequently extended to a further twelve zones, allocated to urban areas with high concentrations of long-term unemployed people. EZ is designed to address the individual needs of 48,000 unemployed people over the age of 25. The key new elements of EZ are:

- The introduction of a Personal Job Account (PJA), rolling up all existing benefits into a flexible fund to be jointly spent by the participant (zoner) and the personal adviser (EZ operator/employee) on whatever measures they agree are appropriate;
- Each EZ will be subject to tender: bidders may be private, public or voluntary organisations; and
- Payment to the EZ operator will be by results: the scheme pays the EZ operator a small initial per capita fee, the PJA (most of which must be paid to the zoner but which may be match-funded) and a premium of £3,000 for each successful 'zoners into jobs' output (a higher rate premium is paid for the very long-term unemployed). All zoners will be required to participate in the scheme for a period of 26 weeks on pain of sanctions.

The 15 zones were to be spread across the whole of the country and range in size from relatively small zones which projected only 900 zoners over the two-year period of the scheme to very large schemes which would aim for a throughput of over 10,000 zoners. The Smortham zone (pseudonym) anticipated 2,000 long-term unemployed people becoming zoners during the two years of the contract.

The bid guidance states clearly, 'We are interested in seeing innovative and varied approaches to the Personal Job Account. We hope that

bids will reflect flexibility and choice in the approach to the Personal Job Account itself as the level of detail or choice which suits one participant may not suit others. We expect a commitment to provide information, including financial information, to participants in order to help them choose the right course of action to meet their goals. This should be linked to real opportunities in the labour market.' If flexibility is the name of game so far as the Personal Job Account is concerned, it is certainly not the case as far as the Rules of the scheme are concerned. They are extremely tightly drawn, in such a way as to ensure that the Treasury's desired outcome of moving people off benefit, and into paid employment is achieved.

Compare this objective with the concerns expressed at a meeting to promote social entrepreneurs in the most deprived area of Smortham, a city in Southern England. While the government were drafting the bid guidance for the Employment Zones, a group of services managers from the public sector and street-level workers from voluntary and community organisations were meeting to discuss ways of improving local networks and their ability to promote social entrepreneurialism. All were agreed from their various perspectives that the benefits trap excluded a large number of people from the process of developing a strong and healthy voluntary and community sector, especially in the most excluded neighbourhoods and communities. Some of those present were community workers concerned with the recruitment of community leaders and activists to take responsibility for organising community groups. Some were managers attempting to recruit people to become involved in 'community governance'. Some were social entrepreneurs looking for people to join them in trying out innovative ideas for social change. All recognised the major stumbling block of the benefits trap.

The idea that emerged from this group was a 'Passport to Participation'. This was the name given to an alternative benefit payment, which would entitle claimants to sign off the normal qualification requirements for their benefit. It would pay them a weekly amount, not less than what they were currently receiving, and enable them to participate in a range of socially beneficial activities, from which they would personally benefit, without any additional conditions. Participation would, of course, be voluntary.

For several weeks this idea continued to reverberate around discussions in the voluntary and public sectors concerned with community development and social enterprise. Murmuring were heard that the government was considering including relevant legislative changes in a forthcoming Bill. When the bid guidance on EZ was published, it became apparent that enabling legislation would be required to remove the normal conditions applying to Job Seeker's Allowance and income support for the unemployed. Could this offer a glimmer of hope for those people who were advocating a 'Passport to Participation'? Was it possible that there would be scope for at least some of these 2,000 zoners to be allowed to use EZ as a form of 'Passport to Participation'?

A flurry of activity on the part of all those involved in the proposal immediately ensued. Contacts were made with people operating in other EZ pilot areas to find out what ideas they were pursuing. Consultation with other local interested parties took place. The views of national experts and think tanks specialising in economic strategies and employment initiatives were sought. Local politicians and trade unionists were lobbied. An attempt was made to prepare a series of questions to put to the Minister responsible.

The result of the local consultations revealed some interesting information. Firstly, amongst those people who worked with the long-term unemployed there was virtually universal cynicism about the likely outcome of the Employment Zone in Smortham. It was clear from the statistical data that the highest concentrations of long-term unemployed people lived in high-rent private sector accommodation in the town centre. They would require relatively well-paid employment to continue to live in their present accommodations and would be likely to resist attempts to push them into low paid menial work in fast food joints and supermarkets. The cynicism deepened when it became apparent that included in both consortium bids for the Smortham EZ were private sector employment agencies. Without a clear lead from government indicating that it wished to see the voluntary sector actively included in the provision of unconditional placements, the expectation was that there would be insufficient benefit to private sector zone operators to include this option amongst the range offered to zoners.

The reaction from local Labour politicians was also rather pessimistic. All were cautious about the possibility of influencing the government as to how the Employment Zone might be adapted to local circumstances. Privately they all welcomed any initiative which genuinely increased the flexibility and choices available to people who were long-term unemployed, but considered that it would be most unlikely that the government would concede even 10% of the EZ places to a 'Passport to Participation' option.

Consultation with people planning Employment Zones in other areas of the country were equally gloomy. The comment from the Liverpool prototype EZ was that the government had invited feedback and suggestions from all three prototype EZs; each had made representations requesting that the EZ should be made longer than 26 weeks and that there should be greater flexibility for participants to be involved in 'intermediate labour markets', which had been the inspiration for the EZ scheme. But the government had rejected outright any attempts to modify the re-drawn scheme, which was considerably more restrictive and inflexible than the prototype EZs had been.

Only one experience offered any hope and this came, surprisingly, from a regeneration project without any aspirations to operate an Employment Zone. Canning Town Community Links had embarked on a course of declaring their own zone irrespective of how this met any government-defined zones in Newham. They called their zone a 'Social Enterprise Zone' and made it the basis of a Single Regeneration Budget Round 5 bid for a ten-year development programme. Their bid was based on the notion that public sector spending in Newham accounted for approximately 70% of the local GDP for the borough. Of this 98% was spent on mainstream public services, benefits, etc. Their aim was to use the 2% of regeneration money to free up as much of the mainstream public sector spend as possible to create real opportunities for local citizens. Benefits were a significant target. They had engaged in considerable consultation with local trade unionists, politicians, civil servants and Ministers to create a programme of consultations involving local people aimed at achieving a relaxation of the benefits rules within their Social Enterprise Zone. The success of their application gave them encouragement to believe

that their proposals met with approval, if only from the London Regional Development Agency. It was however recognised by the advocates of the 'Passport to Participation' in Smortham that this model, which had been designed over a considerable period, could not be adapted to fit the bid timetable for EZ. It was therefore decided that there was no point in trying to influence Ministers, and the objective of the group shifted to looking for find a sympathetic EZ bidder.

With help from the Centre for Social Inclusion a draft plan was drawn up for how the scheme might be operated by a local voluntary organisation. It quickly became apparent that the cash flow and general financial risks were too great for any voluntary organisation to take on its own. An organisation with the potential to attempt the bid came forward but decided that it needed a commercial partner. Approaches were made to one of the major bidders but were flatly rejected after one initial meeting. Given the way that the rules of the Zone were structured, from the point of view of an investor in a profit-making enterprise, it is entirely understandable that no commercial enterprise would want to handicap itself by entering into a partnership with a voluntary organisation with a broader agenda.

### ***Discussion***

Recent research has shown that self-help and self-provision are extensive in poor areas of the UK, and would be even greater if residents had the materials, skills, physical energies and networks to do more tasks in this way. Most self-help and self-provisioning, including paid informal work, is done *by choice*, partly because the process and product are preferred to formal exchange, partly to strengthen community or kinship ties (Williams and Windebank, 1999). Research also shows that poor districts have extensive community groups, supportive groups and voluntary agencies, all of which reach residents far better than official social services (especially where minority ethnic communities are concerned). Volunteers are particularly important in linking isolated individuals with local support systems (Ginsburg, 1999). In other words, grass roots local groups and volunteers - the informal community sector - constitute significant social capital in such districts, and require conservation, funding and support.

Instead, these groups and networks are threatened by approaches to economic regeneration (like the Employment Zones) that rely on crude incentives or compulsion to take paid employment, often outside the district, or to pursue an activity which makes no use of the human capital accumulated in informal work. This threatens to weaken networks and destroy social capital, increasing the need for official services, which cannot be as efficient.

Agencies which know the districts chosen as Employment Zones, and which would want to involve residents in collective projects to improve their quality of life, or help them as individuals to build on their existing skills and networks, both social and economic, are frustrated by the rules of benefits generally, and the structures and incentives of Employment Zones in particular. But hitherto efforts to persuade the government to relax these rules or vary these incentives have fallen on deaf ears.

There are many voluntary and community sector organisations, and some staff in social services departments, who would support the movement to shift from a LMPI to a SEPI. Those that rely heavily on volunteers will be especially frustrated by pressures on some participants to enter unsuitable employment. Arguments will focus on the need to conserve and build on social capital, which is essential for the regeneration of these neighbourhoods, rather than waste it.

The strategy of using the informal sector as a bridge between poor and excluded people and the formal economy has been successful in other countries, notably South Africa (Mazibuko, 1997). It should at least be tried, by allowing pilot Employment Zones to experiment with this approach, using the community sector as lead agencies. There is little point in setting up a number of pilot projects, all doing almost exactly the same thing, as the government has done with Employment Zones. This typifies its blind spot over implementation - New Labour has clear, *a priori* models of how to put its programmes into practice, all top-down in structure, and is never ready to learn from local employed practitioners, and seldom from local voluntary activists. Both these groups would form potential constituencies for a campaign for an SEPI.

A Citizen's Income would be compatible with the values and goals of

these initiatives, and would have the advantage that recipients would face no barriers to participation and inclusion.

### ***Making Governance Work***

New Labour's efforts to harmonise policy are seen in the details of their indicators, which make frequent reference to linked objectives ('joined-up' thinking), and in the growth of one-stop shops where members of the public attend a single point of access to a variety of services. The EZ case study illustrates some of the problems with these approaches also.

The initiatives which demonstrate this are:

- Gateway to Work, which combines the Benefits agency, Employment Service, Child Support Agency and the local authorities;
- Employment Zones, where claimants have a personal adviser who works with their job account to get the best from the range of benefits, incentives and penalties on offer; and
- *Indicators of Success*, which list interrelated targets.

A genuinely linked set of policies saves time for the citizen, and is able to ensure that they are receiving appropriate services; but those who become excluded from one benefit are now more likely to be excluded from them all. Hence the phenomenon of 'disappearing citizens', who no longer figure as claimants, taxpayers, voters or anything else, and perhaps also the rising prison statistics. The linkage of benefits and services is more likely to result in an 'in or out' scenario, with new kinds of social exclusion that are more extreme than hitherto.

A Citizen's Income would not take the place of a well co-ordinated information and assistance system, but would ensure that failure to comply was not too costly. Freedom to use the system as individuals consider appropriate would replace the more prescriptive linkages and gateways that many claimants and service users find off-putting.

### ***Public-Private Partnerships***

The explicit involvement of the private sector and voluntary

organisations is intended to give national policy flexibility and capacity to adapt to local issues. The initiatives that demonstrate this are:

- Lifelong learning, where the University of Industry will have:
  - Courses run by private institutions;
  - A mandatory £25 contribution from individuals to their £150 learning account; and
  - Contributions from employers to top up the accounts of their employees.
- Employment Zones, which will look to the local private and voluntary sectors for innovations; and
- New Deal, which provides subsidies to the private sector in return for training or work placements.

Involvement of local companies makes these initiatives more flexible and responsive to local needs. However, these companies are motivated by profit, which dictates that money is taken out of these systems according to commercial logic, not the public good. In some cases efficiency will be improved, but some gains will be offset by the costs of monitoring service quality and contract compliance.

More generally, tax credits and negative income tax subsidise low-paying employers, and therefore favour some companies over others, introducing distortions into labour markets, and encouraging the inefficient use of labour power. In-work benefits tend to be self-aggrandising, in that more firms make more jobs part-time or short-term, and the total volume of such employment qualifying for subsidies grows. All this contributes to the casualisation of employment, and drives wages downwards at the bottom of the labour market.

Citizen's Income does not do this, because it gives an equal 'subsidy' on *all* wages, since all citizens qualify. Furthermore, the removal of work tests and other forms of conditionality means that citizens are under no pressure to accept low-paid work, or to labour under poor or dangerous conditions. Hence there are more incentives for employers to use labour efficiently.

### **Indicators and Targets**

New Labour has an approach to public administration that is top-down and prescriptive, but tries to make itself accountable through publishing the results of its policy initiatives. It believes in a 'contract' with citizens, presumably to legitimise revenue-raising (see p.99). Most policy initiatives come with appended and often quite specific targets. They were brought together with the publication of *Opportunity for All: Tackling Poverty and Social Exclusion: Indicators of Success, Definitions, Data and Baseline Information* (DSS, 1999).

This reflects a belief that the outcomes of policy change can be predetermined. In chapter 2 and at the start of the previous section, we suggested that no such accuracy of forecasting is realistic for many of the reforms undertaken (e.g., over individual or household labour supply). Better governance may require citizens to be left to determine outcomes by their own choices, especially if formal and informal activities are to be combined in new ways. The LMPI approach fits New Labour's present methods, the SEPI and CI ones do not.

Targets are often short-term and treat the issue in isolation, not taking account of compensatory changes in other areas (such as increases in imprisonment when claimants' benefits are disallowed).

Citizen's Income is not target-driven, but rests on the assumption that once improved choice, access and opportunity are established, tangible economic benefits will follow. Making it easier for individuals to create social and economic capital by facilitating the endeavours they themselves select ensures that change is not artificially engineered, and is therefore likely to be more durable, and to reflect genuine progress.

### **3.5 The Justification for a Citizen's Income**

In this chapter, we have indicated some of the internal tensions and contradictions in implementing the tax credit, LMPI and negative income tax approaches to tax-benefit reform. We have also shown how these could give rise to movements for an SEPI and a CI. But it might be argued that we have not yet shown how these could be reconciled with one of New Labour's goals - that rights and

responsibilities should be balanced. There may be some weaknesses in the New Labour programme, but its insistence on this balance has been crucial in correcting the residual impasse of the economic individualism of the Thatcher-Major reforms - the insider-outsider problem identified on pp.99 - 102. By instigating a transparent 'Contract for Welfare', New Labour has convinced mainstream citizens that money allocated to welfare is well spent, and it has required claimants to give up their (illegal) self-compensatory strategies of informal earnings.

However, we will argue here that this solution is at best a temporary one. The problem is that 'reciprocity' (something for something) and 'responsibility' cannot be imposed from above, as civic obligations, except as an interim part of a crash programme of reform. This is because - at least in liberal democracies - work must be motivated by some gains, if not material then psychological. Employment taken under the threat of loss of benefits must yield other advantages, or it will not be efficiently done, or perhaps not done at all. This is where the impact of Engel's law on work in social reproduction is crucial. If such employment turns out to be a 'dead end' in income terms, and larger and larger proportions of employees find themselves in poverty traps, then it will only be a matter of time before this is reflected in work effort reduction, falling productivity, absenteeism, and all the other typical symptoms of forced labour systems.

An SEPI approach, leading to a full CI scheme, would increase incentives for citizens to participate in paid labour-market activities. The kinds of people excluded under LMPI and negative income tax regimes (see Secs. 3.2.1 - 3.2.3) would have inducements to take such work and - above all - those in poverty traps under such regimes (Sec. 3.3) would have incentives to work longer hours and earn more. The net benefit of participation in paid work would be higher for low earners. Hence New Labour's value of responsibility and its goals of empowerment and inclusion would be better served.

We have argued that the aim of tax-benefit rules should be *neutrality* between paid and unpaid work, and that some tasks are more efficiently done through informal activity. This implies that individuals have choice, and that there will be wide variations between them over how

they combine paid with unpaid work. However, from society's point of view, there must be an optimum level of CI, that attracts the most efficient *overall supplies* of formal and informal labour. Too high a CI would discourage workers from paid employment, too low would encourage employers to use labour power inefficiently. In principle, no level can *both* offer too good and too bad incentives.

But if CI is wholly unconditional, how can it provide any elements of reciprocity or responsibility? Here it is important to distinguish between top-down versions of accountability, and bottom-up communal ones. New Labour relies on obligations imposed by officials, albeit often individual personal advisers. These are conceived in terms of responsibility to the state, not to fellow-citizens. We have shown, in previous sections of this chapter, how these can be difficult or even counterproductive to implement. However, the alternative is to draw on, support and strengthen the obligations that citizens actually feel to fellow-members of kinship and friendship groups, associations, clubs, community groups, organisations and communities. Such activities and movements rely on reciprocity and responsibility, because it is the very stuff of co-operation and collectivity (Jordan, 1998, Chs. 2 and 3). Thus it is in informal activities that individuals actually *experience* the requirement to reciprocate and take responsibility, not in relation to officials. This increases *engagement* in society and *social cohesion*.

There is beginning to be some recognition of this in New Labour policy, especially in Scotland. The Scottish Parliament's document *Working in Partnership* (1999 p.2) acknowledges three main agendas for social justice - child poverty, poverty in old age and the knowledge economy. But the new model outlined for tackling these, the Social Inclusion Partnership Projects, emphasises *full engagement*, through attracting funding from a variety of sources for a variety of activities. This opens up a vision of a programme for *economic justice*, discussed further in our conclusions (pages 126 - 128).

For these reasons, it makes sense for policy to move in the direction of an SEPI and CI. The organisations and groups that can move their members towards *voluntary participation* and *willing contribution* are small-scale, face-to-face ones, doing *informal* work that improves the

quality of life and replenishes the social and physical capital of their communities. We have seen, in the case studies in this chapter, and in the work of Williams and Windebank (1999) and Ginsburg *et al* (1999) already quoted, that self-help, mutual assistance, volunteering and community work are already strong, though largely invisible, aspects of deprived areas. We also know that informal economic activity flourishes, and that many skills have been developed in this, and might be harnessed to more orthodox purposes. The goal of policy should be to build bridges between the formal and informal economies, by gradually linking the community sector of social support networks and the informal sector of undocumented production and exchange with the formal systems of social care and the economy. *Social enterprise* may be promoted through credit unions and LETS schemes, with participants moving on to set up small businesses. It is a cultural shift that is already under way, especially in Scotland and Northern Ireland, and could be accelerated by CI.

Political theorists and researchers have in recent years explored the relevance of informally-generated reciprocity, trust, co-operation and the conservation of common resources, for prosperity and good governance. Writers like Taylor (1987) have shown that voluntary co-operation is possible in face-to-face relationships, building trust through mutual adjustments in shared tasks. Ostrom (1992) has shown that democratic processes of management evolve for groups of stakeholders to conserve and improve common property cooperatively, and Dryzek (1994) has given up-to-date examples of these forms of 'discursive democracy' in solving disputes and conflicts of interest over resources in developed economies. Finally Putnam (1993) has drawn attention to the correlations between associational experience that builds reciprocity, trust and social capital, and both economic growth and efficient democratic institutions. All these point in the direction of local, spontaneously evolving and informal groupings, responding to their shared conditions and issues, as far more reliable sources of responsibility and community than state-led, imposed obligations.

Under a Citizen's Income system, there would of course be some individuals who reneged on their responsibilities to others, as there are under any system. But research suggests that policies for promoting

and supporting local activism in all spheres, through democratic and self-governing groups, would be more likely to succeed than top-down, official measures. Furthermore, by breaking the impasse of the Thatcher-Major era, and giving far more citizens the experience of economic participation (while denying them illegal alternatives) New Labour will have created a better platform for this approach. For all these reasons, a CI would be a suitable instrument for the implementation of the final stage of the reform programme, because it allows all citizens to participate through chosen combinations of paid and unpaid work, under divisions of labour and shares of the burdens and benefits of co-operation that are negotiated between them - in groups, associations and households.

To summarise, a movement for a Citizen's Income is likely to be generated by criticisms of the LMPI approach, and would have as its natural constituents carers, volunteers, the community sector, and many others who recognise the shortcomings of the Third Way's version of distributive justice. It would emphasise that a CI would be a more effective means of combating remaining elements of:

- social exclusion - new kinds of 'outsiders';
- inequality of opportunity - of chance, access and share;
- disempowerment - including educational, health and cultural factors.

At the same time, it would be a more effective means for promoting the growth of:

- social capital - responsibility through trust and co-operation;
- democratic voice - self-governing associations and groups;
- lifelong learning - flexibility that allows time for study and training;
- social cohesion - links between all members of society.

### **3.6 Housing Costs**

Housing costs have been the bane of the income maintenance system since Beveridge (Hills, 1999). It is not within the province of this report to address these in any depth. At the time of writing, the government is mired in an analysis that looks unlikely to yield any radical conclusions. Perhaps the most probable outcome is that the three main sectors - social housing, private renting and owner occupation - will be treated quite separately, under different rules. Housing benefit seems likely to continue, with reforms focused on its administration.

If this is the case, CI would assist the process, because its simplicity and transparency would greatly aid the administrative mechanics of determining housing benefit claims. Conversely, however, the latter would muddy the simplicity and transparency of tax-benefit integration through the CI principle.

This is exactly the same problem as the one faced by the government in trying to improve incentives for low earners. The figures used in chapter 2 are based on owner-occupier households, and therefore exclude housing benefit calculations. But the combined impact of tax credit and housing benefit tapers intensifies the main problem identified in that chapter – the extension of the poverty trap under tax credits and an LMPI. The withdrawal of housing benefit with each pound of additional earnings gives an even lower return on extra hours worked above the thresholds, and on increments for additional skills and responsibilities.

The problem for policy makers is to sustain housing supply while improving affordability, but not to provide an open purse for unscrupulous landlords. This means trying to ensure a supply of dwellings in high-price locations, while maintaining a ceiling on rental subsidies. One pre-requisite is a variety of providers capable of responding to a range of low-income households' needs, and a civic response to market failure that keeps pace with demographic change.

Various options explored in other countries offer both advantages and disadvantages. In Ireland, local authority housing provision was in such a mess it was virtually given away to tenants - but this has left

a terrible legacy of maintenance neglect and decay. In New Zealand in the 1950s, citizens were given a demigrant at the age of 18, for an individual stakeholder's housing account, as a loan against child benefit. This, like most of the rest of the New Zealand welfare state (including child benefit itself) is now history.

Housing tax credits would have the same strengths and weakness of the tax-credit approach already identified above. It would also be difficult to take account of regional price differences through this approach. But the essential point is that none of these issues specifically concerns CI. The value of CI is that it would mitigate some of the difficulties in any of these approaches and it would not add any new ones.

Housing costs provide a clear example of the issues of implementation that can complicate the process of tax-benefit reform. Although equality, inclusion, opportunity and social cohesion (the government's values) are fundamental to its programme, all of these can jeopardised by a problem which has traditionally been seen as 'belonging' in another policy area. This is why issues of implementation must always be considered as important in their own right, and tax-benefit reform must be part of a simultaneous adaptation of all other social and economic programmes

## Conclusion

### The Path of Tax-Benefit Reform

In this report we have explicitly adopted a ‘path of least resistance’ over tax-benefit reform. Instead of investigating how Citizen’s Income might be phased in, assuming that the government had committed itself to adopting this principle for tax-benefit integration, we have followed the internal logic of the reform path chosen by the New Labour government.

We have argued that this leads towards a Participation Income, and set out the possible sequence of adaptations that could lead (circuitously) to a Citizen’s Income. This could come about through a combination of the public-finance requirements of the government’s attempts to ‘make work pay’, and the political consequences of favouring formal over informal work. We drew on the interviews with Westminster MPs in identifying the political forces driving the sequence of stages in this process.

Of course there are other paths that tax-benefit reform might take, some of which lead towards Citizen’s Income. For instance, if the government chooses to introduce an Employment Credit scheme for all citizens of working age, it might – for some of the same reasons as we identified in chapters 2 and 3 – gradually reduce the number of hours of paid work required to become eligible for this credit. If these fell to 10 or even 8 hours per week, large numbers of carers, volunteers, students and people with disabilities might then be included in the scheme. The result would then be similar to the Social and Economic Participation Income discussed in chapter 2.

For the government, this path would have the advantage of making all these inclusions conditional on employment. This would be in line with public opinion’s continued willingness to accept ‘selective universalism’ – higher taxation and increased redistribution, but not improved rates of benefits for people who can work yet are unemployed (Hills and Lelkes, 1999). But it would also make transparent the perverse incentives for lower-paid workers to seek very small numbers of hours of employment, and for employers to fragment paid work

into very small part-time jobs. Hence it is unlikely that the government could avoid the political instability that we anticipated in chapter 2, as the New Contract for Welfare would then have to be renegotiated, to rectify or take account of such anomalies.

Our report should not be read as a *recommendation* of the path it traces for tax-benefit reform. Our analysis shows that the CI principle has fundamental advantages over the approaches favoured by the government. In relation to its values and goals – of equality, inclusion, opportunity and social cohesion – CI offers a more direct route. In other words, CI can be justified on its own merits in relation to *today’s* situation, and as indicating a path for tax-benefit that can be sustained without the changes of direction required by an LMPI-SEPI-UBI path.

Finally, there are several issues that considerations of space have not allowed us to discuss in any detail, but require further research. The first of these is the future of the National Insurance system. For reasons of simplification and clarity, we have assumed that this gradually phased out, as LMPI and SEPI are adopted as the basis for income protection. This needs to be investigated more fully, both for its political implications, and as part of a detailed public-finance analysis of the reform process.

The second issue is the link between income protection through the tax benefit system, and employment security, employment democracy and economic justice. We have acknowledged that the process of labour-market transition (from a predominantly industrial employment structure to one in which most jobs are in social reproduction work) involves increased employment insecurity (Standing, 1999). This transition therefore involves a likely growth in the proportion of labour-market ‘outsiders’, whose final incomes are determined by tax-benefit provision rather than their productivity and demand for their skills, and decline in that of labour-market ‘insiders’, who enjoy the advantages of job security, efficiency wages, promotion prospects and employment-related pensions, perks and welfare benefits. It also implies a continued decline in membership of trade unions and professional associations, which predominantly represent ‘insiders’, and not ‘outsiders’.

We have not attempted to discuss all the implications of such changes,

or how, the tax-benefit reforms we discuss are likely to affect them. It seems likely that tax credits will accelerate the fragmentation of 'insider' jobs into part-time 'outsider' posts, and shift more employment costs onto taxpayers. Nor have we analysed the consequences of these changes for economic democracy and justice; part-time, short-term, low-paid workers are less likely to have any voice in company decisions or agency strategies. These issues, too, deserve a full and detailed investigation elsewhere.

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