Notes and Brief Reports

Proposals for Social Security Reform in the United Kingdom*

In June 1985, the Conservative government of the United Kingdom presented to Parliament a Green Paper, "Reform of Social Security," intended to serve as the basis for discussion of the government's proposed revamping of the social security system. The most significant aspect of the reform proposals is the elimination of the State Earnings Related Pension Scheme (SERPS), the second layer of the state pension scheme based on covered earnings, in favor of mandatory private pension plans with defined contributions instead of defined benefits. The government cites in its Green Paper the increasing costs to the state of current benefits and of future pensions given the demographic shift toward an aging population with fewer workers to support the payment of pension benefits. It also recognizes that the current system of social assistance benefits has grown confusing and too complex to be easily understood and that it does not provide adequately for the truly needy.

Social security in the United Kingdom encompasses not only social insurance programs but also a wide range of health, social assistance, and housing benefits. Over the past 18 months, the government has conducted a series of public inquiries into the future of the British welfare state. The reform proposals contained in the Green Paper reflect the conclusions of these inquiries and therefore represent a major statement by the government regarding the proposed reorientation of the social security system. The proposed reforms affect four major programs:

- **State Earnings Related Pension Scheme (SERPS):** This second tier of the state pension scheme is based on covered earnings and supplements a basic pension provided by the state to all workers upon retirement at age 60 for women and age 65 for men. The government proposes to retain the basic pension but to gradually eliminate the earnings-related layer and substitute occupational or personal pensions with defined contributions and annuities based on accumulated pension fund reserves.
- **Supplementary Benefit:** This is the group of social assistance benefits provided to needy individuals with little savings and income to assist with normal, day-to-day living expenses. Recipients generally are not working or are in limited employment. The government proposes to introduce an income support benefit that would simplify the payment of assistance benefits and eliminate the wide array of benefit rates presently existing under the Supplementary Benefit scheme. And, for those with exceptional needs, the government proposes a social fund to provide assistance in such areas as day care or funeral expenses.
- **Housing Benefit:** Separate payments given to those who qualify for the Supplementary Benefit to help with the costs of rent and local government taxes. The government wants to make these benefits easier to understand and administer and more equitable by using the same income test used under the proposed income support scheme.
- **Family Income Supplement:** Supplements paid to low-income working families with children to help them meet some of the additional expenses incurred in raising children. The government would like to substitute a family income credit that would ensure that families have more income from work than from welfare.

Background to the Reform

The reviews of and the proposed changes to the social security system have been perceived in the United Kingdom as perhaps the most extensive to be put forward by a government since the Beveridge Report in 1942. In his now-famous report, Lord Beveridge recommended a comprehensive social insurance system to replace a patchwork of state and private provisions, characterized by widely varying qualifying conditions, that had evolved in the United Kingdom up to the outbreak of World War II. The National Insurance Act of 1946 adopted the principles of the Beveridge proposals and instituted a social insurance system in which flat-rate contributions guaranteed minimum pensions, albeit at subsistence levels, for the working population. It also encouraged workers to make additional pension arrangements through collective bargaining agreements.

Since that time, the British social security system has increased the number of different benefits paid and has required an ever-increasing share of the national budget each year. National Insurance (NI) social security spending has increased five times as fast as the cost of living since the system's inception in 1948. The total cost of the social security system today is more than £40,000 million (US $51 billion), which is almost one-third of all public spending for the year. For the period from 1978–79 to 1982–83, total expenditures on benefits

* By Daniel Wartonick, International Policy Staff, Office of Research, Statistics, and International Policy, Office of Policy, Social Security Administration. The author wishes to acknowledge the assistance of Mercedes E. Bern, who provided background information for this note.

Program Profile

General. Social security in the United Kingdom consists of: (1) old-age, survivor, and disability insurance; (2) health, cash sickness, and maternity programs; (3) unemployment insurance; (4) work injury, known as "industrial disablement;" and (5) family allowances, known as the "child benefit."

Administration. The Department of Health and Social Security (DHSS) provides general supervision and administration of benefits for all programs except unemployment. The Department of Employment administers the unemployment program through its regional offices. The Inland Revenue Service collects contributions to the earnings-related layer of the OASDI program. DHSS collects contributions to all of the other programs.

Financing. National Insurance (NI) contributions from employees and employers of 9.0 percent and 10.45 percent of covered payroll, respectively, and government contributions from general revenues of approximately 13 percent of costs finance the administration and the basic cash benefits of the program (OASDI, sickness, maternity, industrial disablement, and unemployment). The government covers the entire cost of the child benefit and 85-90 percent of the cost of the National Health Service.

All employed persons who have met a minimum level of contributions in any one year are covered under the cash sickness, maternity, and unemployment programs, which pay modest flat-rate benefits.

almost doubled from £10,900 million to £19,000 million. Social security retirement pensions alone account for two-thirds of this spending.

A problem of particular concern is the payment of pensions in future years, when a greater proportion of workers will be receiving benefits from and a smaller proportion will be contributing to the state system. At present, there are 21.8 million contributors and 7.3 million pensioners; by 2025, the number of contributors is expected to grow marginally to 22 million while the number of pensioners will nearly double to 12.6 million. Thus, the ratio of contributors to pensioners will fall from a current ratio of 2.3:1 to 1.8:1 in the next 40 years.

The government faces not only heavy current expenditures, which are being met in part from general revenues, but an even greater burden in the coming years in funding the state pension provisions. The state pension program consists of a basic flat-rate pension, currently £35.80 (US $45.82) per week, and SERPS, the earnings-related benefit, accumulated at the rate of 1.25 percent of indexed earnings per year, starting in 1978. Legislated in 1975, SERPS was designed to supplement the basic social security pension as well as to provide a pension more closely associated to actual earnings. Workers and their employers may opt out of the earnings-related layer in favor of an occupational pension that must meet certain minimum requirements fixed by law. In return for accepting this option, a portion of the National Insurance (NI) contributions are rebated to the employer. For example, if an employer has established an approved contracted-out scheme, 6.25 percent of the employer's NI contributions will be rebated. Roughly half of all workers are covered by employer schemes. In 1998, SERPS is expected to reach actuarial maturity and will be required to pay full benefits (amounting to approximately 25 percent of indexed earnings) to those who have made contributions throughout their working lives. The scheme pays 10 percent of indexed earnings to an employee retiring now.

A "New Partnership" in the Social Security Program

In its proposals for reform of the pension program, the government proposes a "new partnership" between the state and the private sector in providing adequate retirement benefits for workers. The state would continue to provide a basic retirement income but younger workers would be required to contribute to an earnings-related pension plan, either through an employer-sponsored plan or under individual arrangements. The government's major proposals with regard to the current old-age pension program are:

- **Coverage.** The government proposes to set up two earnings-related systems beginning in 1987; one would continue SERPS coverage for older workers within 15 years of retirement who would lose the most if SERPS were phased out, and the other would insure younger workers who have time to build up credits under a new system. For those at ages between these two groups, the government would provide partial credit under SERPS to make up any benefit shortfall that would result from not being fully covered under either system. The basic flat-rate retirement benefit would be retained, however, for all groups of workers. The SERPS coverage would continue for employed men aged 50 or older and employed women aged 45 or older and would continue paying benefits to those who qualify under its provisions. For men aged 40-49 and women aged 35-44, the state would provide partial SERPS entitlement to avoid a sharp divergence in the amount of retirement benefit received by those still covered by SERPS and those workers just under the cutoff age. This partial benefit would add a maximum number of 7 1/2 years of SERPS credits for a man aged 49 and a woman aged 44 and would decrease gradually to just 1 additional year of credit for a man aged 40 and a woman aged 35. For workers younger than these ages, SERPS would be eliminated starting in 1987. This younger worker would be required to provide for a pension either by joining the occupational plan set up by the employer or by making private arrangements for a personal pension. The government envisions that these arrangements will be made for as wide a range of employed workers as possible but concedes that it would not be practical to provide coverage for casual or part-time workers. Details on what range of earnings would be covered and at which age coverage would start have yet to be worked out. However, the government believes that these aspects would not differ greatly from the present provisions under SERPS.

- **Contributions.** For those employees continuing under SERPS, the NI combined employer/employee contribution rate for all social security programs would remain roughly the same at 19.45 percent of covered earnings or could increase by at least 1 percentage point. Under the new earnings-related pension arrangements, the total NI contribution rate paid by both employer and employee for all NI social security programs would be approximately 16.5 percent of covered earnings. In addition, a minimum contribution amount for the new pension system, to be phased in over a 3-year transitional period, would start with a combined 2 percent for both employee and employer in the 1987–88 tax year, rise to 3 percent in the second year, and to 4 percent in the third year and thereafter. Employees would have the option of contributing an additional amount if they desire. If an employer sets up an occupational pension plan, the current contracted-out contribution rate rebate to the employer of 6.25 percent would be gradually phased out. The effect would be to increase employer costs for pensions.
- **Benefits.** Credit for benefits under SERPS would continue to accrue at the same rate as at present. The contributions paid into each employee's occupational pension or personal pension fund under the new system would be invested to build up retirement reserves, which would be used to purchase a retirement annuity when the employee chooses to retire. This differs from the current practice in occupational pension plans, which provide a defined benefit as a proportion of earnings. Under the new arrangement, the employee would be able to identify total pension savings at any time. Under the new system, employers would be required to certify that the amount in an employee's pension fund is on average no less than the required minimum contribution. The size of the benefits would not be regulated by the government but would depend on the performance of the investment. In the event that an employee changes jobs, the accumulated reserves would be transferred to a personal pension set up for this purpose. This would provide the portability that has been lacking in the existing contracted-out system of occupational pensions.
- **Retirement age.** The government is proposing a greater degree of flexibility in retirement age than presently exists and finds particularly attractive the idea of a "retirement decade." A retirement decade would allow individuals to retire on their occupational or personal pensions at any age between 60 and 70 and provide actuarially reduced or increased benefits for retirements initiated before or after a common age of 65 for both men and women. The government suggests that either a reduction or increase of 8 percent per year would be appropriate, depending on whether the employee opted for retirement before age 65 or continued working. The government does not propose, however, eliminating the current retirement age difference for the basic pension available at age 60 for women and age 65 for men. Left open for debate is the question of whether the worker will be allowed to continue in full-time employment and receive the basic, flat-rate pension or whether an earnings test should be applied before age 65. The government makes clear, however, that it is committed to eventually eliminating this earnings test for those who continue working after age 65.

Reform of Social Assistance Benefits

In the Green Paper, the government also proposes an overhaul of the three major social assistance programs: Supplementary Benefit (SB), Housing Benefit, and Family Income Supplement (FIS). Determination of eligibility for these benefits is currently based on need. In general, families out of work or only in part-time employment may qualify for SB based on income and capital assets. If they qualify for SB, they automatically qualify for the housing benefit. Full-time, working married couples and single parents with children are entitled to FIS for 1 year based on income and hours worked either as wage earners or in self-employment. Following are the major changes proposed for these benefits:

- **Supplementary Benefit.** The government proposes to replace this benefit with two separate systems referred to as an income support system and a social fund. It envisions that these programs would be easier to administer and understand and would better address the needs of the claimants than the present SB system. Under income support, benefits would continue to be subject to both an income test and a limit on capital assets, but a more liberal disregard of both would be used. Beneficiaries would be classified, on the basis of their various needs, into such client groups as the unemployed, pensioners, single parents, and the sick and disabled. Benefits would vary according to each client groups' needs as defined by the government. For example, an unemployed single worker under age 60 would have different needs and responsibilities and hence receive a different benefit than an unemployed worker over age 60 with family responsibilities. In addition to income support benefits, a social fund would be established to assist claimants with exceptional needs such as day care, funeral expenses, and other emergency expenses. Eligibility for assistance from this fund would be determined on a discretionary basis with a greater degree of flexibility than now exists under the current system of SB. Both schemes would be administered by local Department of Health and Human Services (DHSS) offices.

- **Housing Benefit.** Claimants for the new housing benefit would qualify automatically if they were receiving the new income support benefit, which is the case currently under the SB and housing benefit regulations. Claimants would be eligible for a reimbursement of 100 percent of their costs for rent and 80 percent of their local taxes, if they qualify for full income support. Those with incomes above the income support threshold would face a reduction in the housing benefit according to the increase in their incomes or, as the government refers to it, an "income-related taper." In light of the possibility that landlords or tenants might take advantage of these rebates, the government proposes that local authorities bear a greater responsibility for ensuring that the housing is not extravagant or unnecessarily expensive. The government proposes to set the direct subsidy to local authorities at less than 100 percent of costs. The government believes that local authorities would have a greater incentive for cost containment and improved efficiency to make up the difference in funding, since local authorities administer the present scheme and would continue to provide the administration under the reform proposals.
- **Family Income Supplement.** The FIS scheme would be abolished under the government's proposals and be replaced by a family credit system. The allowance would be included in net earnings as an offset to taxes and NI contributions and would be paid through the employer, in principle, similar to the negative income tax. A similar income test as that used under the proposed income support scheme based on net earnings would be used to assess entitlement for the family credit system. The thrust of the new family credits is to better ensure that working families with children will not fall into the poverty trap of being better off out of work than in work. The government is placing the emphasis on providing adequate resources for families to decide on how best to meet their needs, rather than deciding on their behalf through the provision of social services and a complicated array of other means-tested benefits. Officials of DHSS will make the determination of eligibility for the new family credit scheme.

Additional Proposed Reforms

In addition to the proposed changes in the assistance programs noted above, the government is suggesting changes to three other benefits. First, the government proposes to replace the current maternity grant of £25 (US $32), available to all families, with an increased benefit payable only to families who qualify for benefits under the proposed income support scheme. Second, the government would like to eliminate the universal death grant paid at varying rates to families of deceased persons in favor of providing for funeral expenses from the proposed social fund to families who truly need assistance. Finally, the government proposes to replace the current widow's allowance, which is a short-term transitional benefit, with a single lump-sum payment of £1,000 (US $1,280). The government proposes greater flexibility in the payment of a widowed mother's allowance for the widow with children, beginning payment from the time of death instead of after the current 6-month waiting period. Both of these reforms, it is believed, would assist with the immediate financial problems that a widow faces after the death of a spouse.

With regard to administration of the social security program, the government suggests that the streamlining of the social security system proposed in the Green Paper would help implement a proposed, long-term computerization of the system. Currently, approximately 81,000 employees of the Department of Health and Social Security administer the social security program. They pay benefits to approximately 9.3 million NI retirement pensioners, among others. To administer the full range of income security and social assistance benefits more efficiently, the government is proposing to embark on a wide-ranging computer modernization program, which they believe would give them the most up-to-date data-processing systems in the country by the mid-1990's. In making reference to the present "state of the art" in British administrative techniques at local social security offices, the government declares: "As for administration, much of the social security system is run from local offices which largely lack the kind of aids which modern computer science can provide. The result is that the service for the public too often fails as the staff hunt for files in a Dickensian paper-chase."

Comment

Since the release of the Green Paper, some critics have pointed out that the proposed reforms may not save money and may, in fact, be more expensive than anticipated. However, given the fact that no cost analysis of the reforms has been presented in this paper, this point is not yet clear. Other critics have decried the proposals for dismantling elements of the British welfare system by shifting the burden of old-age protection away from the state to the employer and employee and eliminating certain universal benefits in favor of benefits for more needy categories of the population. Others, however, support certain aspects of the reform such as the creation of a "retirement decade," which they believe could provide greater flexibility in retirement decisions and also help to promote equal treatment of both men and women under the pension system.

Because these proposals have been presented in the form of a discussion document, the debate as well as the formulation of alternative proposals will continue. In all probability, the government will introduce preliminary legislative proposals at the beginning of the next Parliamentary session in the fall of 1985. Final legislation is not expected to be in place before the middle of next year.