

Social Insecurity

Assessing trends in social security to prepare for the decade of change ahead

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The Economy 2030 Inquiry

The Economy 2030 Inquiry is a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics, funded by the Nuffield Foundation. The Inquiry's subject matter is the nature, scale, and context for the economic change facing the UK during the 2020s. Its goal is not just to describe the change that Covid-19, Brexit, the Net Zero transition and technology will bring, but to help the country and its policy makers better understand and navigate it against a backdrop of low productivity and high inequality. To achieve these aims the Inquiry is leading a two-year national conversation on the future of the UK economy, bridging rigorous research, public involvement and concrete proposals. The work of the Inquiry will be brought together in a final report in 2023 that will set out a renewed economic strategy for the UK to enable the country to successfully navigate the decade ahead, with proposals to drive strong, sustainable and equitable growth, and significant improvements to people's living standards and well-being.

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Executive summary

The UK is facing a decade of unprecedented economic change as we adjust to a post-Covid-19 economy, a new economic context outside the European Union (EU), and the decarbonisation of the economy. And the social security system has a key role to play in the years ahead: it is part of the policy toolkit for helping individuals and the economy as a whole deal with a period of enhanced labour market change, but it also needs to address the legacy problems of slow growth in living standards and high inequality.

This report considers how well the UK's social security system for working-age households is equipped to meet these challenges, and, in particular, how well aligned it is with the country's likely future economic and social challenges. We begin by identifying the defining features of the UK's social security system for working-age individuals and considering the historical policy choices and economic and social trends that have shaped it. We then assess how well it is achieving its core objectives of providing income insurance and ensuring adequate living standards. We look back to consider historical episodes during which the social security system changed to fit a new economic agenda, and then assess how well suited our current social security system is for the challenges of 2020s.

This work forms part of The Economy 2030 Inquiry. Later this year we will publish an interim report that will assess and integrate all the evidence gathered on the performance of the UK's economic

strategy in the face of the key challenges posed by the 2020s. As part of this, it will consider the key interdependencies between the UK's social security system, labour market policy and our approach to human capital formation, skills and retraining.

The UK's social security system has low, flat-rate basic levels of benefit, with additions for those with extra needs

As a proportion of GDP, spending on non-pensioner welfare benefits has risen from 1.7 per cent in 1948-49, peaking at 5.7 per cent following the financial crisis, and is forecast to be 4.5 per cent of GDP in 2026-27. This long-run expansion of the welfare state is, however, not matched by a rise in the generosity of the basic level of benefits: unemployment benefit in 2022-23 will be at its lowest level in real-terms since 1990-91, at just £77.29, and is only slightly above an estimated destitution income level of £70 per week. As a proportion of average earnings, it now stands below 14 per cent, half the level it was in the 1970s.

Low levels of basic benefit generosity should be seen in the context of a change in the composition of spending: income-related benefits now make up almost two-thirds (65 per cent) of working-age welfare spending, while contributory benefits – dependent on past payments – make up just 8 per cent. Partly in response to low levels of basic benefits, the UK system has instead evolved to focus social security spending on those with extra, unavoidable costs such as parents, those facing high housing costs and those who are long-term sick or have disabilities. As a result, the amount of benefits paid to low-income families per child was at most 41 per cent of the basic amount of unemployment benefit paid to an adult in 1977-78; by 2010, the system paid 14 per cent more for the first child than an adult, although it has fallen back slightly since then. Spending on Housing Benefit and its predecessor benefits has risen from 0.2 per cent of GDP in 1980-81 to 1.0 per cent in 2012-13 (since when the phase-in of Universal Credit makes comparisons difficult), and spending on disability benefits rose from 0.1 per cent of GDP in 1980-81 to 0.7 per cent of GDP in 2020-21.

This approach marks the UK out from many other developed countries. We spend only 0.1 per cent of GDP on unemployment benefits, lower than nearly all other OECD countries. But the

UK spends 1.3 per cent of GDP on housing benefits-in-kind, the highest rate in the OECD, and 2.1 per cent of GDP on family cash benefits, the second highest rate in OECD.

The current system owes much to past decisions to break any link between benefits and earnings

The current social security system is often traced back to the one introduced just after the Second World War in the wake of the Beveridge report. But our current system is almost unrecognisable to that created in the mid-20th century, and now owes very little to the principles that shaped Beveridge's plans. A culmination of policy choices during several periods of significant economic and social change, as well as differing ideologies or priorities, has reshaped the social security system to meet a changing set of needs.

Three key policy choices have notably shaped the working-age social security system. First, the erosion of the contributory principle. Second, decisions to uprate working-age benefits in line with consumer prices (at best), which means benefit rates are usually falling behind average incomes. And third, targeting support for extra costs towards lower-income families.

These decisions together have created a system that provides very low amounts of basic income support, and instead provides support covering extra costs for housing, children and ill-health, favouring lower-income families with children over single adults without extra costs and higher earners. This contrasts with a more 'Bismarckian' northern European model of generous earnings-related benefits favouring workers, with a less-generous means-tested safety net underneath for those who lack contributions. Policy for working-age benefits also stands in contrast to current policy for pensioners: the desire to reduce pensioner poverty and to avoid undermining saving incentives through generous means-tested benefits have combined to mean that the system is dominated by an increasingly universal State Pension that is uprated by earnings or more.

With basic benefit levels kept low, 'extra-cost' benefits have had to deliver targeted support to deal with inequality

The economic and social context has been transformed over the past 50 years. Three trends are particularly important for the development of social security policy in the UK. The first is the growth in inequalities in earnings at the family level. In the 1980s, this was driven by increased wage and earnings inequality. But many measures of wage or earnings inequality between *workers* peaked in the early 1990s and have fallen since. However, inequality in the total earnings of the *family* continued rising to about 2016. Indeed, the 90:10 ratios for hourly wages and weekly earnings in 2019 were almost identical to their levels in 1968. But the 90:10 ratio for family earnings has more than doubled in that 50-year period.

This trend has been driven by changes in family structures, and in labour market behaviour within households and between genders. In particular, there has been an increase in the proportion of couples who have two earners (and a corresponding decline in the proportion who have no earners). There has also been a decline in the fraction of single-adult families who are in work, or who are working full time. In the 1980s and 1990s, this was due to a rising number of single parent families; more recently, it has been due to falling employment among single men (in 2019, three-in-ten working-age single men without children were not in employment). This has put considerable pressure on the social security system to make up the difference if income inequality is not to rise further. This is one of the structural reasons why benefit spending is increasingly directed at working families, where it plays a vital role in mitigating widening inequality.

The second trend has been the high and growing cost of housing for low-income households. Additional programmes to help with rental costs have existed for many decades, but the surge in housing costs in the late 1980s and early 1990s, and a more recent shift in tenure patterns that means fewer low-income households are owner-occupiers, have resulted in considerably higher spending on these programmes – rising from 0.2 per cent of GDP in 1980-81 to 1.0 per cent in 2012-13.

A third trend has been the rising number of people in receipt of a disability benefit – growing from 1.2 million in 1997 to 2.5 million in 2021-22. Moreover, in recent decades an increasing proportion of those in receipt of a disability benefit have mental health, rather

than physical health, problems. Mental health conditions now account for over a quarter (27 per cent) of all inactive people with a health condition, up from 16 per cent in 2003.

Workers have low levels of income protection meaning other policies must work harder in a downturn

A direct consequence of the UK's low, flat-rate basic level of benefits is that the amount of income insurance provided by the social security system in the event of unemployment can be very low for earners who are not deemed to have additional needs. For example, the median replacement rate for a single adult with no children is 31 per cent, and just under one-third of single people get just over 20 per cent of their in-work income if they lose their job. By contrast, the fact that that a great deal of spending in the UK goes on the means-tested extra-cost benefits means that the median replacement rate for a single parent is 69 per cent.

International comparisons show that the UK stands out in this regard. For a single person with no children on the average wage, the UK has one of the lowest income replacement rates in the OECD: 40 per cent compared to an average of 59 per cent. But for those family types likely to be eligible for our extra costs benefits, the picture is different, with the UK having a much higher replacement rate of 67 per cent for a single person with two children on two-thirds of the average wage, compared to the 77 per cent OECD average.

A consequence of this meagre income insurance is that the system provides relatively low levels of macroeconomic support in the face of aggregate shocks – the so-called automatic stabilisers. Social security spending can play a key role in supporting the economy in a downturn, but the responsiveness of UK social security spending to the economic cycle is one of the lowest among rich countries.

The issues of weak and variable income insurance, and inadequate incomes for low-income households highlighted are not just theoretical issues – they have had very real impacts during the pandemic. The creation of the Job Retention Scheme and grants for the self-employed revealed the limitations of the UK's existing social security system: we had to invent national wage insurance

scheme in real-time in the eye of the storm. The pandemic also highlighted that our existing Statutory Sick Pay system gives workers little protection against being ill, and so puts more of us at risk from an infectious disease (as well as excluding self-employed workers entirely).

The UK social security system struggles to ensure adequate living standards at the bottom

Alongside providing protection against shocks, the other core task for the social security system is to ensure adequate incomes for out-of-work or low-income families. Here, it is clear that the UK's system is not succeeding.

The UK's record on living standards for those at the bottom has been terrible since around 2003-04. Income has risen just 7 per cent (measured after housing costs) for a household at the 10th percentile since then, compared to 15 per cent for someone in the middle of the income spectrum. As a result, measures of poverty that use a fixed real poverty line have seen hardly any decline since 2001-02, with absolute poverty among working-age adults barely falling (from 21 per cent in 2001-02 to 17 per cent in 2019-20). This is an exceptionally poor performance: it is normally taken for granted that a modern economy can provide increases in real-terms living standards in the medium-term. In the decade before 2001, for example, the proportion of working-age adults below that same line fell by just under 10 percentage points. The level of income for households towards the bottom is not just failing to grow with the economy, but is also inadequate. Just over 7 per cent of adults, and over 12 per cent of children lived in a food-insecure household before the pandemic, and food bank use increased by 135 per cent between 2016 and the midst of the Covid-19 crisis in 2020. The £20 uplift in Universal Credit during the pandemic was in part a recognition that benefit levels had fallen too far.

A better long-run measure is the relative poverty rate, which has risen from 8 per cent in 1961 for working-age adults to 20 per cent in 2019-20. This is broadly the level it reached in the early 1990s. Pre-crisis data shows that, across comparable countries, the UK has high rates of relative poverty for both children and working-age adults. However, poverty rates among pensioners fell from 34 per cent in 1991 to a low of 13 per cent in 2012-13.

The low-level of core social security benefits, affected by the various real-terms cuts to benefit levels in the 2010s, is clearly a major determinant of these outcomes. But this has been exacerbated in the past decade by policy changes that undermined the idea that those with extra needs should be supported. These include the benefit cap, which now affects 165,000 families; and the two-child limit, which now affects 1.25 million children and is expected to affect 3 million when fully rolled-out by 2035. As a result, relative poverty among children has risen by 3 percentage points since 2012-13, driven entirely by rising poverty among families with three or more children.

Choices over social security reform have often been aligned with the economic strategy of the day

To help us think about the role that the social security system needs to play to help households adjust to some of the challenges of the 2020s, and how social security should fit within a wider economic strategy that addresses new realities, it is useful to learn from previous experiences. Over four broad eras of social security system policy – the original Beveridge settlement, Wilson-era expansionism, the Thatcher counter-revolution and then the Blair agenda – it is possible to identify a degree of ‘strategic fit’, or coherence, between developments in social security and wider economic and public policy objectives.

Beveridge’s social insurance plan, for example, was integrated with a commitment to achieving full employment which not only became a central plank of post-war economic policy but was also a fundamental pre-requisite for Beveridge’s agenda of guaranteeing a ‘national minimum’ for all citizens. In the mid-1960s, Harold Wilson was committed to achieving faster economic growth which, in his view, relied on the reallocation of skilled labour towards rising industries. Large-scale labour reallocation, it was thought, would be facilitated by a ‘social infrastructure’ that would help smooth the path. This included the shift towards earnings-related unemployment benefit and sick pay as well as redundancy pay, Industrial Training Boards, the pioneering of the polytechnic system, the post-Robbins expansion of universities and the launch of the Open University.

There was also a clear line of sight between economic and

social security policy running through the Thatcher era, though this took a very different form. As well as the goal of reducing public spending, there was a wider objective of creating a more flexible and lightly-regulated labour market both to help reduce unemployment and create the conditions for a more dynamic economy. Like Wilson, Thatcher aimed to encourage labour shifting towards the expanding parts of the service sector but took the opposite view of how that was best achieved: benefit levels were allowed to fall relative to average wages at the same time as the labour market was deregulated and wage dispersion grew.

More recently, the Tony Blair and Gordon Brown Governments sought to align economic and social policy objectives through a drive for full employment which in turn would support their goal of cutting child poverty. Employment was promoted via a range of active labour market programmes, a work-first approach towards social security and a suite of measures to help working parents. Work was made more (financially) rewarding not least via the introduction of the first ever minimum wage. And low-to-middle income families received substantial support via a new system of tax credits. In all eras there were failures and oversights, but there were also attempts to think coherently across economic and social objectives.

Our existing social security system is not well-placed to meet the scale and nature of challenges ahead

It is uncertain what the UK's economic strategy will be, and so we cannot tell what will be asked of our social security system in the decade ahead. But the nature of the economic context of the 2020s combined with the findings in this report mean that some areas of concern are already clear: we identify three.

The primary challenge facing the UK economy is that the pace of economic change is likely to increase in the decade ahead as the UK adjusts to a new context post-Covid-19, outside the EU, and as we decarbonise the economy. That is likely to involve elevated levels of job change – something that our labour market has not experienced for decades – which could increase the risk of unemployment for many, highlighting the low levels of income protection provided by the UK's social security system. Moreover, the increased structural change might place pressure on the

‘work first’ approach that underpins social security and welfare and skills policy in the UK. The UK certainly spends much less on active labour market programmes for the unemployed than our competitors: we spend 0.2 per cent of GDP on active labour market programmes; the OECD average is 0.5 per cent of GDP, and almost all comparable European economies spend more than that.

Second, at the aggregate level, in an era when the role of monetary policy is limited by low interest rates, fiscal policy is likely to play a more active role in stabilising the economy during future downturns. A question for policy makers is whether the experience of the pandemic – and particularly the effectiveness of more generous income support during a recession – has significant lessons for how we should do that in future recessions.

And third, it is increasingly clear that our current approach to working-age social security system is not going to deliver reductions in poverty and inequality. The long-held cross-party consensus to keep core benefit entitlement for adults at low levels means that too much of the work in supporting incomes is done by the extra cost benefits. That strategy in itself has been undermined by recent cuts to the way that support is provided to those with children and to renters. But it is also unsustainable to let benefits for groups who do not qualify for the top-ups fall to near-destitution levels. If tackling the UK’s legacy of high inequality and poverty is remotely part of new economic strategy for 2020s, then policy makers will need to reconsider this approach.

Section 1

Introduction

The Economy 2030 Inquiry, to which this report contributes, is motivated by the fact that the UK is facing a decade of unprecedented economic change, as we adjust to a post-Covid economy (of whatever form that will take), respond to the opportunities and constraints of being outside the European Union, and decarbonise the economy. And the social security system has a key role to play in the years ahead: it is part of the policy toolkit for helping individuals and the economy as a whole deal with a period of enhanced labour market change, but it also needs to address the legacy problems of slow growth in living standards, and high inequality. This report considers how well the UK's social security system is aligned with the country's likely future economic and social challenges.

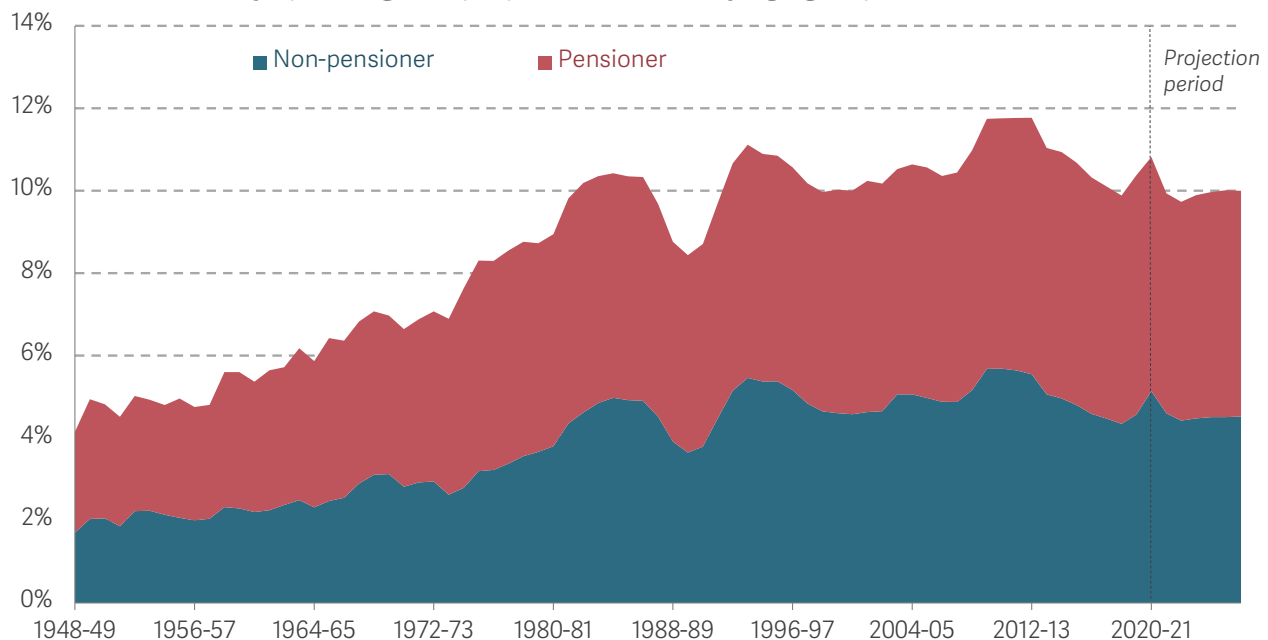
The UK's social security system is substantial, accounting for around 10 per cent of national income, and touches the lives of many: parents of 90 per cent of children are eligible for Child Benefit, 7 million working age families are currently in receipt of an income-related benefit, and almost all pensioners get the State Pension.¹ It is also necessarily complex. It provides support for families with children, lower earners, the unemployed, those with ill health, and the very old. It does this through means-tested or income-related benefits and tax credits, National Insurance-based contributory benefits, and extra-cost benefits for certain groups (conditional on status – such as a disability). Almost all of us will benefit directly from the system at some point, and even when we do not, we benefit indirectly from the role it plays in supporting the overall economy during downturns, as well as the knowledge of the safety net being there. And alongside other parts of the welfare state – such as the health and education systems – it has a core role to play in eliminating poverty and ensuring adequate incomes, providing income insurance against labour market shocks, and helping to stabilise the economy in the face of downturns.

¹ K Handscomb & L Try, Age-old or new-age? The changing incidence of social security benefits by age, Resolution Foundation, August 2021.

The focus of this report is on social security spending on benefits for working-age adults and children.² As Figure 1 shows, total social security spending represents 10 per cent of GDP, more than twice the level in 1948-49, but down from the peak just after the financial crisis. Within this total, though, spending on pensioner benefits represents 55 per cent of this, with this fraction having risen from 51 per cent in 1994-95.³ We do not consider other aspects of the welfare state, although future reports will consider the interface between social security policy, labour market policies, and approach to training and human capital accumulation.

FIGURE 1: Total social security spending is around 10 per cent of GDP, but only 40 per cent of this goes to those below the state pension age

Social security spending as a proportion of GDP, by age group: GB



SOURCE: Analysis of DWP, Benefit Expenditure Tables; BoE, a millennium of macroeconomic data for the UK, 2020; OBR, Economic and Fiscal Outlook.

The remainder of this report is structured as follows:⁴

- Section 2 sets out the key features of today's social security system for working-age households, showing that the rise in spending has not been caused by a rise in generosity of core parts of the system, but by the additional elements paid towards those with children, housing costs, or with disabilities or health issues.

² Other recent work in this area includes: L Gardiner, *The shifting shape of social security: Charting the changing size and shape of the British welfare system*, Resolution Foundation, November 2019; and K Cooper & J Hills, *The Conservative Governments' Record on Social Security: Policies, Spending and Outcomes*, May 2015 to pre-COVID 2020, CASE, February 2021.

³ A forthcoming Economy 2030 Inquiry report will discuss spending on benefits for pensioners in more detail in the context of future fiscal pressures.

⁴ We touch on, but do not consider in detail, welfare-to-work or activation policies, or broader labour market or welfare state policies. We also do not consider public attitudes towards benefits; for recent work on that, see: A Harrop & J Abey, *Going with the grain: How to increase social security with public support*, Fabian Society, May 2021, and: R de Vries et al., *Solidarity in a crisis: Trends in attitudes to benefits during Covid-19*, Welfare at a Social Distance, September 2021.

- Section 3 identifies some of the pivotal policy changes, and the economic and social context for those changes, that have led the system to evolve into the one we have today.
- Section 4 shows the implications of the way we have approached the social security system for working-age adults by assessing it against two key objectives: providing effective earnings insurance, and supporting living standards for low-income households. In both, we find it wanting, with the pandemic providing a very clear example of the deficiencies of our pre-crisis system.
- Given that we are facing a decade of enhanced economic change, Section 5 considers previous experience of aligning social security policy with wider economic policy objectives during periods of economic change, showing that, at various points in the post-Second World War period, it has been possible to identify a degree of coherence between developments in social security and wider economic and public policy objectives.
- Section 6 concludes by arguing that, given what we know about the likely economic context of the decade ahead, there are risks in maintaining the current social security system.
- A technical annex gives further detail of the modelling in Section 4.

Later this year, in the Interim Report of the Economy 2030 Inquiry, we shall return to these issues by bringing together the lessons from this report with our assessment of other key drivers of economic change, what that means for UK living standards and how we should think about the design of the social security system.⁵

⁵ All reports in this project can be found at: <https://economy2030.resolutionfoundation.org/reports/>.

Section 2

What does the UK's current social security system look like for working-age adults?

As a fraction of GDP, spending on non-pensioner welfare benefits has risen from 1.7 per cent in 1948-49, peaking at 5.7 per cent following the financial crisis, and is forecast to be 4.5 per cent of GDP in 2026-27. This long-run expansion of the welfare state is, however, not matched by a rise in the generosity of the basic level of benefits: unemployment benefit in 2022-23 will be at its lowest level since 1990-91, and is only slightly above an estimated destitution level of £70 per week. Low levels of basic benefit generosity should be seen in the context of a change in the composition of spending: benefits for which the rate depends on other income now make up almost two-thirds of spending working-age welfare; with benefits for which the rate is dependent on past contributions making up just 8 per cent. Partly in response to low levels of basic benefits, the UK system has instead evolved to focus social security spending on those with extra, unavoidable costs, such as parents, those facing high housing costs, and those who are long-term sick or have disabilities.

Other countries take different approaches. Our spending on unemployment benefits, for example, is one of the lowest in the OECD. Despite this, spending on family and housing is one of the highest, meaning overall spending on working-age welfare support as a share of GDP is slightly more (1 percentage point) than the OECD average.

This section analyses key historical trends in social security spending, looking into how spending priorities have changed between different types of benefits; and comparing the UK's spending priorities to those of other countries. Here a fundamental role of the social security system is that it supports working-age adults in adverse circumstances:

by topping up the earnings of low-paid workers; providing an income to the unemployed, or unable to work; and to certain groups including parents and people with disabilities. Spending on these benefits has increased since the post-war welfare state was set up with child benefit now a key part of the system; spending on housing and disability has increased; and UC has become a source of support for many.

Spending on non-pensioner has increased since the inception of the welfare state

As Figure 2 shows, non-pensioner benefits spending rose from 1.7 per cent of GDP in 1948-49 to a forecast 4.5 per cent of GDP in 2026-27. Over that period, spending as a fraction of GDP has been counter-cyclical, with peaks shortly after the recessions of the early 1980s, the early 1990s and the financial crisis, as well as during 2020 and 2021. On top of this cyclical pattern, spending as a share of GDP had been on a rising trend until about 2010 – and it peaked at 5.7 per cent in 2010-11, and has fallen somewhat since. In particular, the period 2012-13 to 2019-20 saw a fall in the share of GDP spent on non-pensioner benefits of 1.0 percentage point. Although this is a smaller fall than seen in the late 1980s (where it fell from 5.0 per cent in 1984-85 to 3.6 per cent in 1989-90), that fall was driven by very fast growth in GDP; the fall in the 2010s was driven instead by falling real-terms spending.

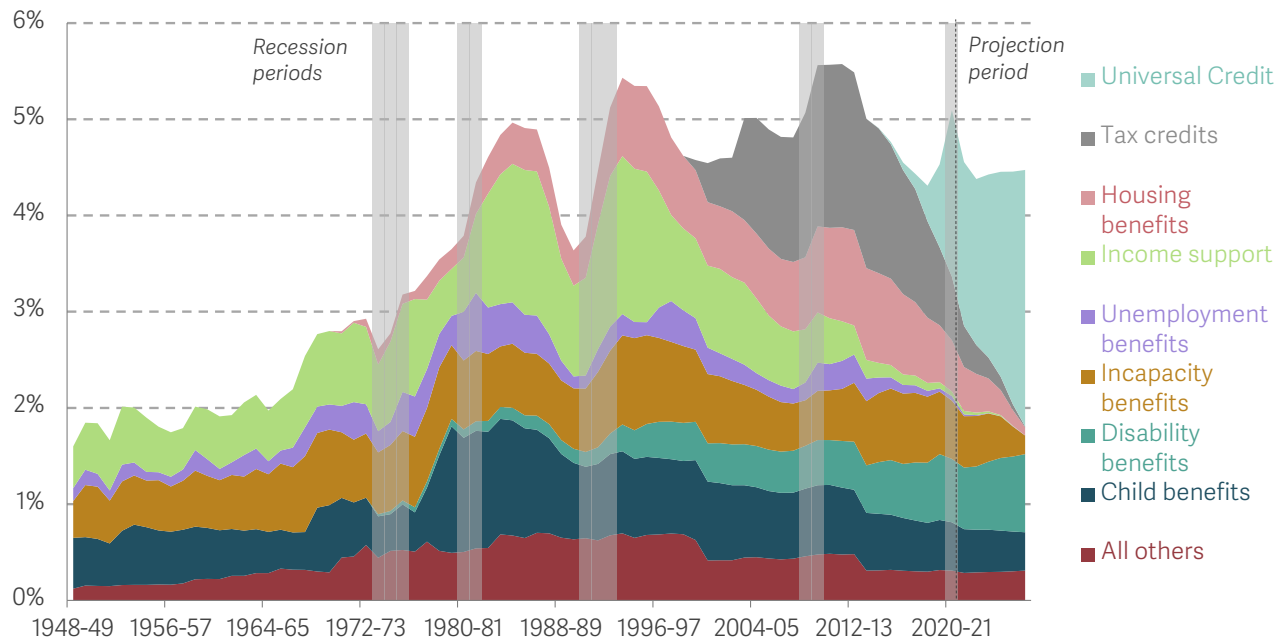
Non-pensioner benefit spending has consistently been lower than pensioner benefit spending: in 1948-49, pensioner spending was 2.4 per cent of GDP; peaked at 6.2 per cent in 2012-13; and is forecast to reach 5.5 per cent in 2026-27.⁶ The majority of this pensioner benefit spending is spent on the State Pension: in 2026-27, 4.6 per cent of GDP is forecast to be spent on the State Pension, compared to 0.9 per cent of GDP on other benefits for pensioners.⁷

⁶ DWP, [Benefit Expenditure and Caseload forecasts](#), Autumn Budget 2021.

⁷ Analysis of DWP, [Benefit Expenditure and Caseload forecasts](#), Autumn Budget 2021.

FIGURE 2: Non-pensioner welfare spending peaked in 2012-13

Non-pensioner welfare spending as a proportion of GDP: GB



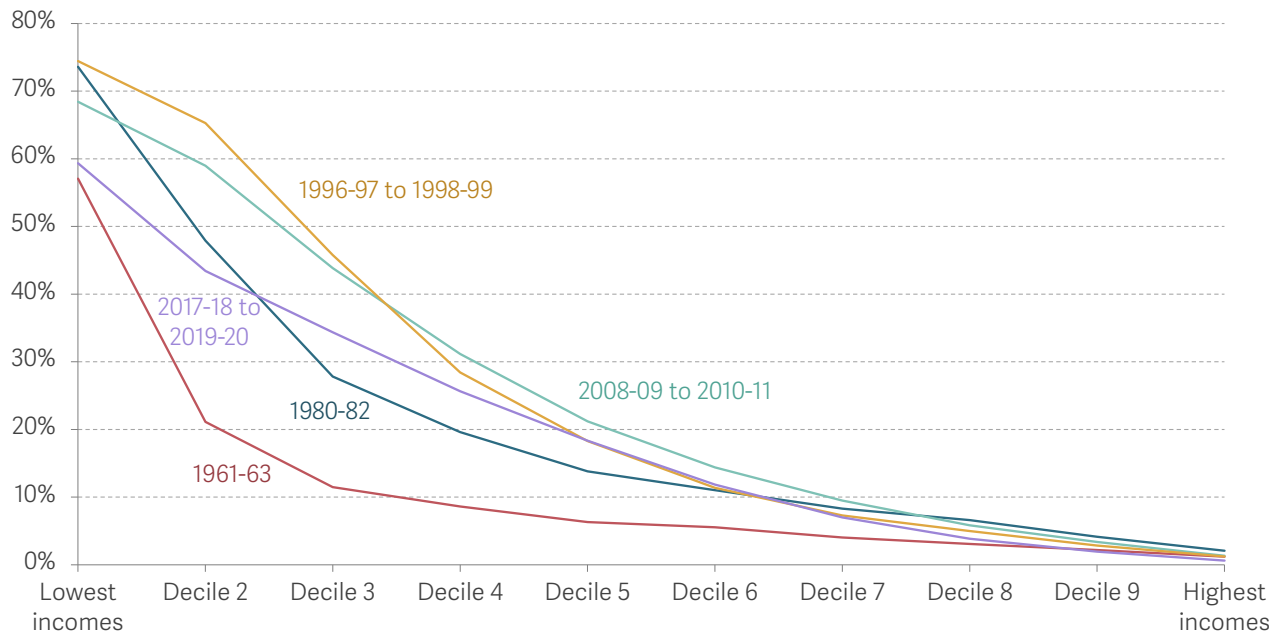
NOTES: The 'Child benefits' category includes One Parent Benefit and Guardian's Allowance as well as Child Benefit itself. 'Incapacity benefits' includes Employment and Support Allowance, Incapacity Benefit, Invalidity Benefit, Severe Disablement Allowance and Sickness Benefit. 'Unemployment benefits' includes Jobseeker's Allowance and Unemployment Benefit. 'Disability benefits' includes Armed Forces Independence Payment, Attendance Allowance, Disability Living Allowance, Mobility Allowance, Christmas Bonus, Council Tax Benefit, Family Credit, Industrial Injuries Benefits, Maternity Allowance, Social Fund (discretionary), Statutory Maternity Pay and Statutory Sick Pay. For a small number of benefits where no age split was available for earlier periods, we split benefit spending by age based on the most recent available age split data for that benefit.

SOURCE: Analysis of DWP, Benefit Expenditure Tables; Bank of England, A millennium of macroeconomic data for the UK, 2020; OBR, Economic and Fiscal Outlook.

This increase in size of social security spending is matched by its increasing importance to many working-age households across the income distribution. Figure 3 shows the proportion of households with income from benefits by income decile over time. Unsurprisingly, those on lower incomes are much more likely to rely on benefits: in 2017-18 to 2019-20 (the most recent years for which consistent data is available), income from benefits made up between 18 and 43 per cent of (before housing costs) income across low-to-middle income non-pensioner households (deciles two to five), compared to less than 3 per cent of the income for high-income households (deciles nine and 10). However, this position has changed significantly over time: in the early 1980s, benefits only provided between 10 and 15 per cent of incomes for those on middle incomes (deciles 5 and 6), compared to 12 to 18 per cent in 2017-18 to 2019-20 (and in the early 1960s it stood even lower, at just 6 per cent).

FIGURE 3: Those towards the top of the distribution are now receiving a higher proportion of their income from benefits

Benefit income as a share of income before housing costs among non-pensioner households, by income decile: GB/UK



NOTES: GB before 2002-03. We use income before housing costs in this instance as benefit income includes housing support.

SOURCE: Analysis of DWP and IFS, Households Below Average Income.

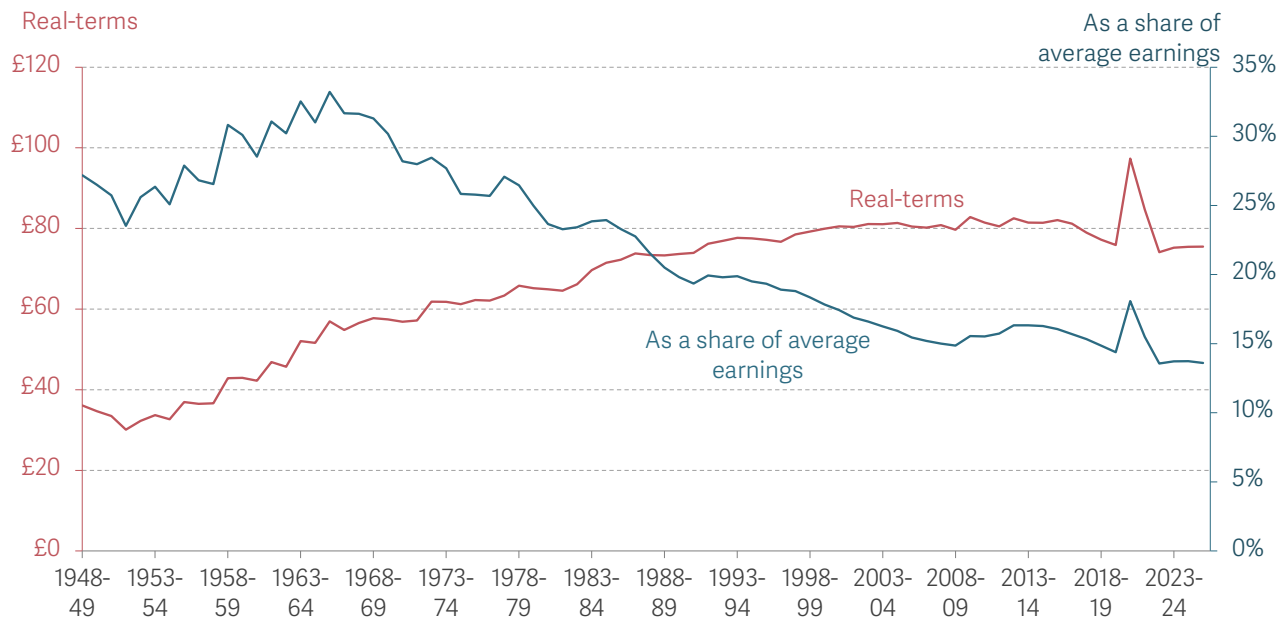
But higher spending does not reflect increased generosity for unemployment benefits

Increases in the levels of core benefits are not the key driver of higher spending. In real terms, the level of unemployment benefits in 2022-23 (which is also the payment to a single adult in Universal Credit) is forecast to be at its lowest level since 1990-91, at just £77.29⁸. As a proportion of average earnings, it is set to fall below 14 per cent by 2024-25, half the value in the early 1970s (28 per cent).

⁸ <https://www.gov.uk/government/publications/benefit-and-pension-rates-2022-to-2023/proposed-benefit-and-pension-rates-2022-to-2023>, accessed 18 January 2022.

FIGURE 4: The basic level of unemployment support has become less generous compared to average earnings

Unemployment benefits in real terms and as a share of Average Weekly Earnings: UK



SOURCE: Analysis of ONS, Average Weekly Earnings; DWP, Abstract of Benefit Statistics.

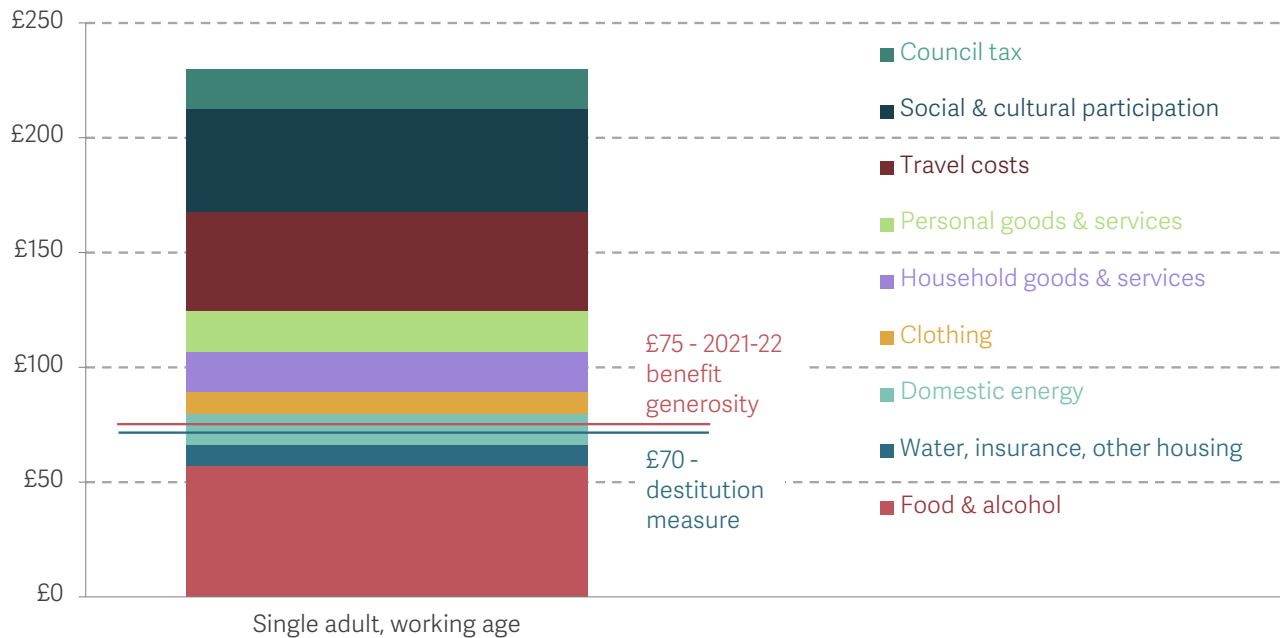
As well as being low in relation to previous rates and earnings, the UK's core level of benefit support is not enough to meet the necessary costs for an adequate standard of living. As shown in Figure 5, the current rate of UC for a single person over 25 is £75 a week. This is much closer to a destitution rate of £70 a week than it is to what is collectively seen as an acceptable standard of living, the Minimum Income Standard (MIS) rate of £230 a week.^{9,10}

⁹ S Fitzpatrick et al., *Destitution in the UK 2020*, Joseph Rowntree Foundation, December 2020.

¹⁰ A Davis et al., *A Minimum Income Standard for the United Kingdom in 2021*, Joseph Rowntree Foundation, July 2021.

FIGURE 5: UC rates just keep people out of destitution, but don't come close to meeting minimum income standards

2021 Minimum Income Standard (excluding rent); basic rate of UC; and destitution threshold, per week, for a single adult: UK



SOURCE: Analysis of JRF, A Minimum Income Standard for the UK in 2021; JRF, Destitution in the UK 2020.

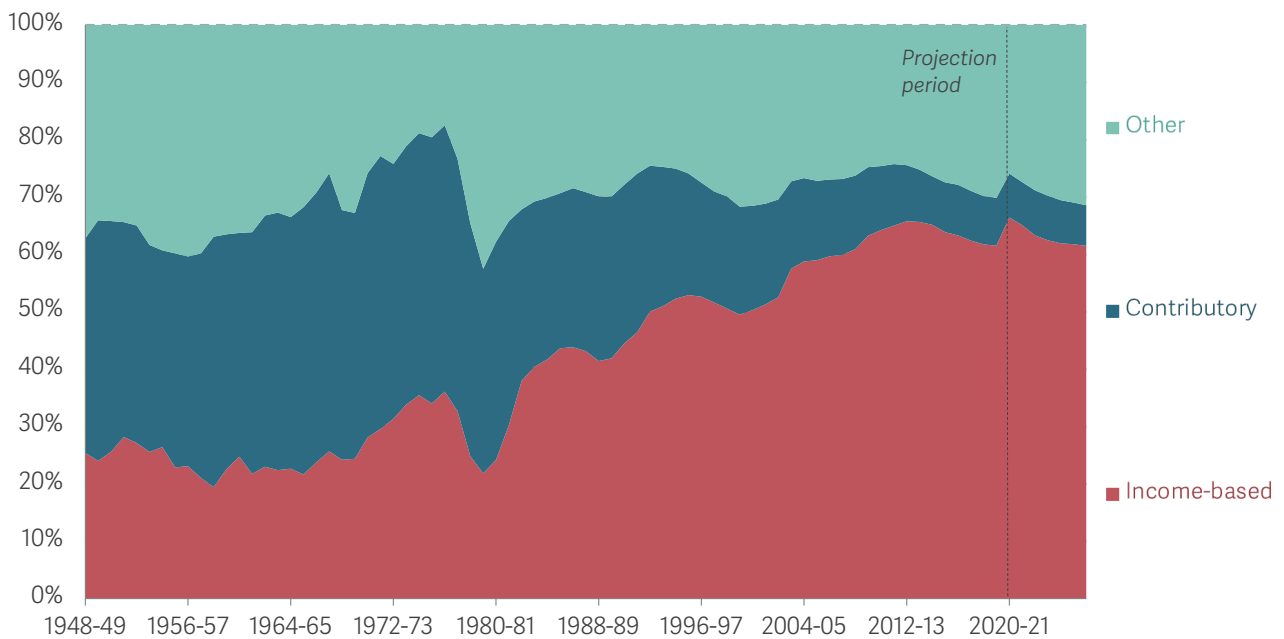
Instead, higher spending reflects a significant change in the nature of welfare spending

Figure 6 shows how spending on non-pensioner welfare is split between income-based, contributory, and other types of benefits. Since 1948 there has been a marked change in the type of benefit spending, with benefits dependent on income now accounting for almost two-thirds (65 per cent) of spending. Meanwhile, the scale of spending on contributory benefits has dwindled to just 8 per cent, having previously been higher than income-linked benefits. The remainder of spending which is neither contributory nor income-based makes up 27 per cent, including Child Benefit and disability benefits. Spending was more evenly split between the three categories in 1948-49: contributory benefits made up 37 per cent of total spend, income-based 25 per cent, and other benefits 37 per cent.¹¹

¹¹ These trends are, of course, unlike those for spending on pensioner benefits, where the contributory State Pension still makes up the bulk of benefit spending, even if the extent to which it is contributory has been falling.

FIGURE 6: Income-based benefits now make up the majority of non-pensioner welfare spending

Proportion of total welfare spending on non-pensioner groups, by benefit type: GB



SOURCE: Analysis of DWP, Benefit Expenditure Tables.

There has also been a significant rise in income-related benefits. Despite frequent changes of names or reforms to the programmes, what is clear is that during the 1980s and 1990s, spending on the means-tested programmes of supplementary benefits (pre-1988), income support (post-1988) and housing benefit grew substantially. Some of this reflected fluctuations in the size of the economy, but spending on tax credits began to grow from 1999 and became a large proportion of non-pensioner welfare spending.¹² Since its inception in 2013, spending on Universal Credit has grown rapidly, reflecting that it is replacing spending previously done through tax credits, housing benefit, income support and incapacity benefits (through the income-based part of ESA).¹³

Spending on benefits that are neither contributory nor income-related includes child benefit and spending on various disability benefits. Introduced in the late 1970s, spending on child benefit peaked at 1.3 per cent of GDP in 1979-80, and steadily declined as a fraction of GDP since 1994-95.¹⁴ Spending on non-income-related and non-contributory disability benefits rose from 0.02 per cent of GDP in 1973-74 to 0.81 per cent of GDP in 2026-27.¹⁵

¹² Tax credits spending peaked at 1.7 per cent in 2011-12, reflecting that they replaced some spending previously done through income support.

¹³ Spending on UC is projected to peak at 2.7 per cent of GDP in 2026-27. See: Office for Budget Responsibility, *Economic and Fiscal Outlook*, October 2021.

¹⁴ Child benefit replaced Family Allowances, a cash benefit; and child tax allowances, which reduced taxes.

¹⁵ Analysis of DWP, *Expenditure and Caseload Forecasts*, November 2021. Disability benefits that aren't means-tested or contributory are: Armed Forces Independence Payment, Attendance Allowance, Disability Living Allowance, Mobility Allowance, and Personal Independence Payment.

The UK has instead devoted more money to the extra costs faced by certain groups

Partly to compensate for low levels of core benefits, and to make spending more targeted (and as we explore more in Section 3), the UK has instead placed increased importance upon spending towards those with extra costs: those with children, and those facing high housing costs (through income-related benefits), as well as those who are long-term sick or have disabilities (through both income-related and other benefits). This rise is, for example, very clear when we look at Housing Benefit (and its predecessors). Here spending has risen from 0.2 per cent of GDP in 1980-81 (after being introduced in 1970-71), to 1.0 per cent in 2012-13 (after which the introduction of UC complicates comparisons).¹⁶ It is also clear for disability benefits, for which spending has increased over time from 0.1 per cent of GDP in 1980-81 to 0.7 per cent of GDP in 2020-21 as caseloads have increased.¹⁷

The tilt towards spending money on families with children can be seen in the changing levels of benefits paid in respect of adults and children. Figure 7 shows the value of selected benefits as a share of average weekly earnings – a measure of their generosity in comparison to earnings. The State Pension and unemployment benefits represent the amount of support provided to individual receiving either of these benefits as a single adult. The child-related benefits line represents the additional benefit entitlement that an out-of-work single parent of one child receives by virtue of being a parent (including Child Benefit and assuming no other benefit entitlement). Prior to 1977, benefits for one-child families remained relatively constant as a share of average benefits. When Child Benefit was introduced in 1977, benefits for families with children increased substantially.¹⁸ The end result is that by 2022-23, child-related benefits available to a single parent will be 12 per cent higher than unemployment benefits (down from 14 per cent higher in 2010-11), having risen from being just 41 per cent of unemployment benefits in 1977-78. This compares to typically decreasing generosity for unemployment benefits and the State Pension since the 1970s. In fact, a single out-of-work parent receives more support through child-related benefit additions than through the basic unemployment support.¹⁹ Therefore, the weak income replacement rates provided by the social security system's

¹⁶ The increase in housing support through the benefit system is further discussed in Section 3 of this report.

¹⁷ The increase in disability caseloads is discussed further in Section 3 of this report.

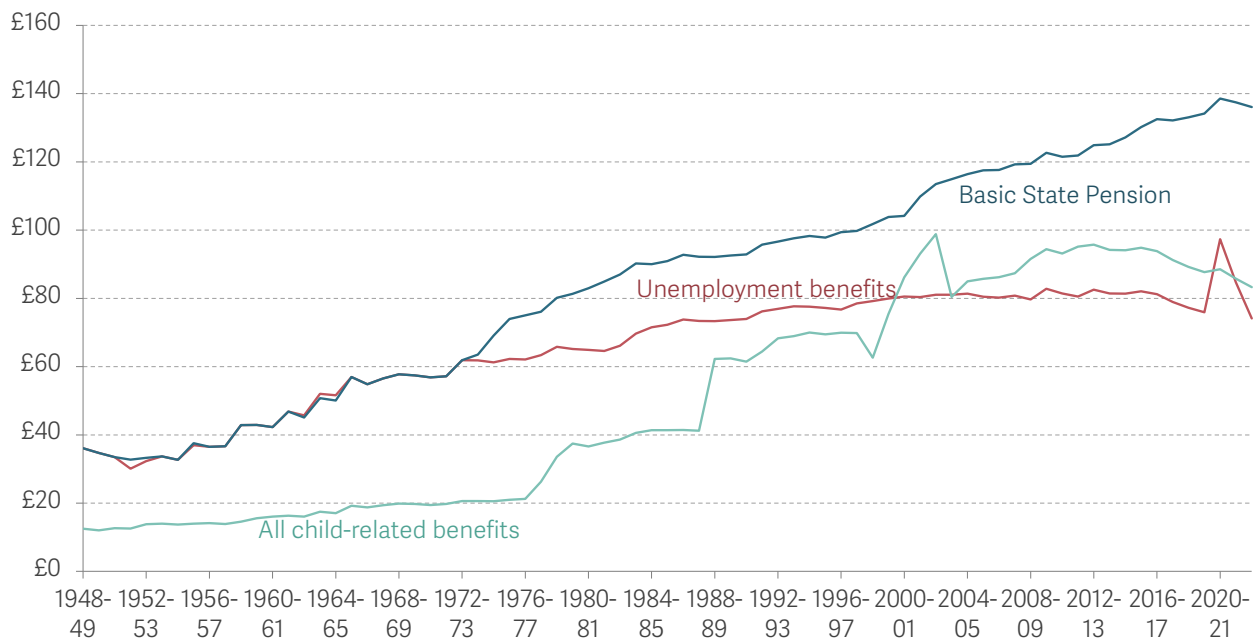
¹⁸ Family Allowance was available for the *second* child before 1977, and did increase in value. 1977 saw the introduction of Child Benefit and a substantial rise in benefits for families with children. Child Benefit replaced Family Allowance, which was paid for the first child. 1988 saw the introduction of Income Support (replacing Supplementary Benefit) which was more generous for out-of-work single parents. However, the removal of the single parent premium in 1997 (for new claims only) meant a small fall in generosity. This was compensated by an increase in the generosity of the child element in the following years. 2003 saw the integration of out-of-work income-related child benefits with in-work benefits and the introduction of Child Tax Credit – however, this meant a fall in generosity for new out-of-work claimants (part of the Government's push to get single parents into work).

¹⁹ This includes Child Benefit. It does not include housing support, but being responsible for children also entitles a benefit claimant to more housing support.

basic unemployment support have meant that child-related benefits are doing much of the income support for single, out-of-work parents.

FIGURE 7: Child-related benefits are increasingly compensating for low unemployment benefits

Selected benefit levels in real terms (2021-22 prices)



NOTES: All child-related benefits include additional amounts of benefit for an out-of-work single parent with one child aged 10, including: Child Benefit from 1977, National Assistance for children from 1948 to 1966, Supplementary Benefit for children from 1966 to 1987, Income Support child element and Lone Parent premium from 1987 to 2003, Child Tax Credit (family and child element) from 2003 to 2019, Universal Credit (higher child element) from 2019. Figures shown for new claimants only. 'Unemployment benefits' is the higher of contributory or income-based basic unemployment support.

SOURCE: Analysis of IFS, Fiscal Facts.

The UK's spending is skewed towards housing and children, unlike many other OECD countries

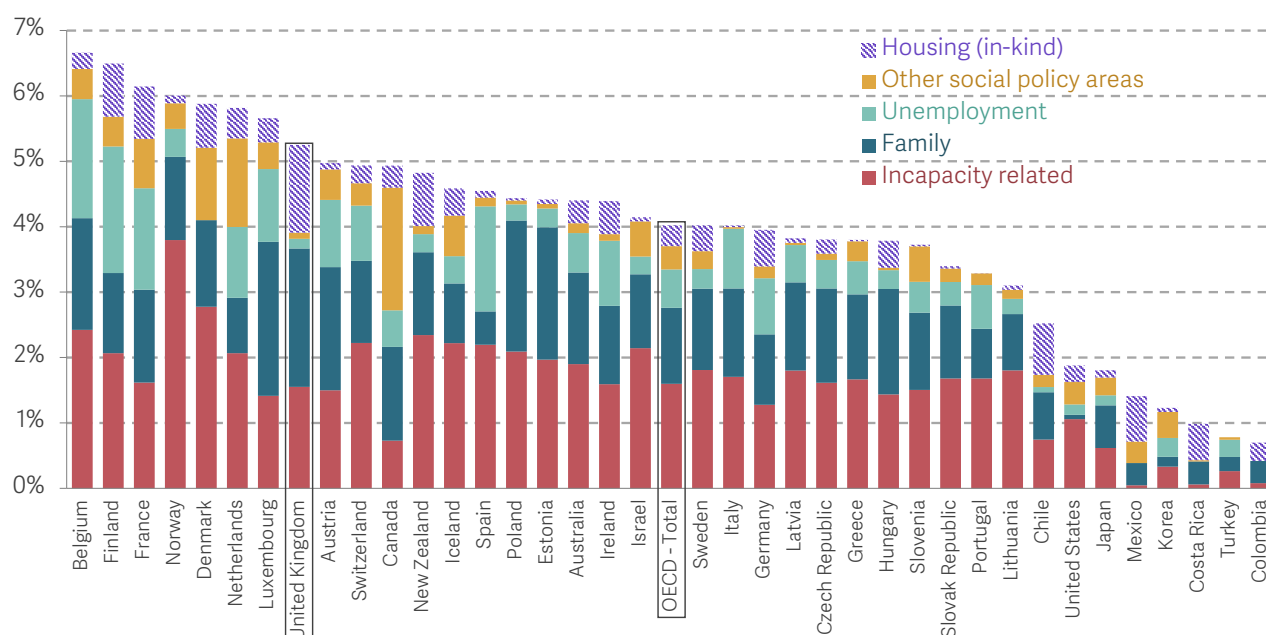
The make-up of UK benefit spending is quite different to that in other rich countries. Figure 8 shows various types of spending on cash benefits and benefits-in-kind as a proportion of GDP across the OECD. In 2017, the UK spent only 0.1 per cent of GDP on unemployment benefits, lower than nearly all other OECD countries. In part, this is due to the UK's low unemployment rate relative to other OECD countries: in September 2021, the UK had an unemployment rate of 4.2 per cent, lower than the OECD average of 5.8 per cent.²⁰ But what really stands out here is that most OECD countries have some sort of earnings-related unemployment insurance, as opposed to the flat-rate nature of UK unemployment benefits. In contrast, the UK spends 1.3 per cent of GDP on housing

²⁰ OECD, [Unemployment rates](#).

benefits-in-kind, the highest rate in the OECD; and 2.1 per cent of GDP on family cash benefits, the second-highest rate in OECD.²¹

FIGURE 8: The UK spends more on housing and family benefits than most OECD countries

Spending on cash benefits and selected benefits-in-kind as a proportion of GDP, by selected functions: OECD countries, 2017



NOTES: The housing benefits-in-kind category includes cash payments to people to help with housing costs, which we would consider to be cash benefits, but are classified as benefits-in-kind by the OECD.
SOURCE: OECD, Social Expenditure – aggregated data.

Now we have set out the basic facts of the evolution of the UK welfare state, the next section moves onto discussing the policy choices that have driven these changes. Here, our focus is on the link between the country's overall economic strategy and the design of the social security system.

²¹ For more information on the OECD Social Expenditure Database and its classifications, see: W Adema & P Fron, *The OECD SOCX Manual: A guide to the OECD Social Expenditure Database*, OECD, 2019.

Section 3

What were the forces behind the changing nature of the social security system?

As set out in the previous section, the UK's current welfare system is very different from that of the mid-20th century, and now owes little to the principles that shaped Beveridge's plans. Instead, a culmination of policy choices during a lengthy period of significant economic and social change has reshaped the social security system to meet a changing set of needs.

During this period of change, choices on three key policies have shaped the working-age social security system: the erosion of the contributory principle, decisions around uprating of benefits, and targeting support for extra costs towards lower-income families. These decisions mean that our social security system provides very low amounts of basic income support, and instead provides support covering extra costs for housing, children and ill-health. It therefore favours lower-income families with children over higher earners and single adults without extra costs. This is in contrast to a more Bismarckian northern European model of generous earnings-related benefits favouring workers, with a less-generous means-tested safety net underneath for those who lack contributions. The policy direction also stands in contrast to that taken towards social security benefits for pensioners.

Three key economic and societal changes provide important context for these decisions and other changes to the working-age system. The first is rising inequalities in earnings at the family level, caused by shifting family structures, changing labour market behaviour within households and between men and women, and trends in wage inequality. The second has been the high and growing cost of housing for low-income households, driven first by rising costs and then a tenure shift to the private rented sector. Finally, there has been a rise in the number of people in receipt of a disability benefit, driven most recently by rising mental ill health.

The previous section showed that the social security system has changed significantly since the post-Beveridge settlement of the late-1940s (Box 1 discusses this in more detail). Although some of that apparatus remains as a legacy today, today's social security system has been shaped by three main policy decisions, alongside a suite of economic and social changes over the last 70 years. We first examine the key policy points, before turning to wider economic and social changes, although in practice the two sets of changes are interlinked.

Post-Beveridge policy decisions on contributory benefits, uprating, and prioritising means-testing have changed the nature of social security

The social security system we have today for working-age households owes much to three important policy decisions: to erode the contributory principle, to reduce generosity by uprating benefits only in line with consumer prices, and to provide extra cost benefits primarily through the means-tested benefit system. These choices have meant we now provide very low levels of basic income support for working-age individuals (the implications of which are shown in Section 4).

BOX 1: The Beveridge reforms to social security put in place much of the apparatus of the late 20th century system, with some elements still present today

As we discuss in Section 5, the post-Second World War reforms to the social security system that built on the vision in the Beveridge report rationalised and universalised the complex patchwork of pre-war insurance schemes, converting them into a single, comprehensive national system. The reforms themselves were likely a product of: societal attitudes rooted in the desire for a better world following the war, the increasing numbers of workers (although not a majority) with varying degrees of private earnings insurance, the overwhelmingly disliked

and punitive household means-tests (as well as how those undermined work incentives), and a particularly stubborn and ambitious statesperson.²²

The result was a system that addressed a number of the critical issues of the day (although some only partially), but perhaps more importantly was received with overwhelming public and cross-party support. These features were:

1. A "something for something" model, where employees, employers, and the state all paid fixed amounts

²² This account of the Beveridge reforms draws on: N Timmins, *The Five Giants: A Biography of the Welfare State*, 2001.

into a National Insurance scheme that funded basic sickness and unemployment payments as well as a basic state pension to those who had contributed. These were not means-tested, and were intended to be more generous than was available through the means-tested National Assistance.

2. It was anticipated a small number of families would also need to be supported outside of this system – by means-tested National Assistance – to eliminate “want”.
3. Finally, some families would also need help with certain extra costs, specifically with housing and children. This had the consequence of meaning that for a limited number of families at the time, this extra cost support in addition to National Assistance was more generous than the national insurance-based benefits.

It’s important to note this system was fundamentally different (although

with near identical aims) from the only other major centralised social security system in place, commonly referred to as the Bismarckian system. Crucially, Beveridge’s system had a flat-rate employee contribution, and flat-rates of benefits. In Germany, the system was earnings-linked. Beveridge was not keen on such an idea, partly because he thought that individuals should retain some of the responsibility of insuring themselves against unemployment.

The Beveridge reforms had perhaps two major critiques: firstly, that in part, they were not implemented as designed;²³ and secondly, that the reforms themselves did not foresee the unpredictable societal changes in the latter half of the 20th century.²⁴ There are other issues as well, for example how generously to support housing costs through social assistance,²⁵ which Beveridge did not resolve, but was aware of, but these would start to affect the shape of the social security system by the 1950s.

Policy decisions eroded the contributory principle over time

As shown earlier in Figure 6, one major change over time in the working-age social security system has been the decline in the importance of contributory benefits. This

²³ The rate of contributory-based benefit payable to unemployed individuals was set lower than Beveridge had envisaged, and this meant there was very little difference between the contributions-based benefit and the means-tested National Assistance. Although there were other advantages to the contributions-based benefit (for example other family members’ incomes were not taken into account), this lack of a clear financial advantage makes contributory unemployment benefit less valuable to many. This precedent had important later implications.

²⁴ For example: the medical advances that enabled children with disabilities to live much longer lives, and the social changes that led to the rise in the number of single parent families.

²⁵ Not paying full housing costs to out-of-work families means that families with higher housing costs will be worse off. Paying all housing costs creates a perverse incentive to have higher housing costs. The problem is dealt with today by a complex series of caps (called Local Housing Allowance rates) by Local Authority area and based on local rents, and for a number of bedrooms depending on family size.

happened despite *increases* in National Insurance contributions paid by workers and employers, including a move from fixed to proportional-to-earnings contributions in 1975.

This has happened through a series of direct – and indirect – changes to benefit policy.²⁶ First, some contributory benefits were made more restrictive. For example: in the move from Invalidity Benefit to Incapacity Benefit the health assessment was tightened up;²⁷ and responsibility for funding Statutory Sick Pay payments has also been transferred to employers. Second, past governments have weakened the contributory principle by relaxing entitlement rules: individuals can now build entitlement to some benefits even if they are out of work by claiming National Insurance credits.²⁸ Third, contributory benefits have been made less generous through the decision in 1982 to scrap earnings-related additions to Unemployment Benefit – which were introduced in 1966 (as we discuss in Section 5) – and move to a flat-rate unemployment benefit.²⁹

In the long-run, the choice of how to uprate benefit levels has large consequences

Prior to 1975, uprating of benefits was conducted haphazardly, with benefits not uprated at all in some years, and in others they would be increased in large steps.³⁰ The net result was that income-related child additions became more important, and unemployment insurance (and contributory working-age benefits in general) relatively less so.

From 1975, the Government committed to uprate benefits annually, and, by 1982, this was done in line with the increase in consumer prices for all working-age benefits. This has had cross-party consensus since, with the only noticeable change being to switch from the RPI measure of inflation to the CPI measure (in 2011), in line with a general shift across government away from using RPI.³¹ Over time, this necessarily means that the real value of benefits fails to keep up with the usually faster growth in earnings or median income; while the freezing of some working-age benefits in nominal terms in the 2010s has exacerbated this trend.

The long-run implication of these decisions was shown in Figure 7 earlier: the basic rate of unemployment benefit rose by 19 per cent in real terms from 1975 to 2022, while average earnings more than doubled – growing by 126 per cent – in real terms.

²⁶ For a more detailed discussion of this point, see: J Hills, *Inclusion or insurance? National insurance and the future of the contributory principle*, CASE paper (68), Centre for Analysis of Social Exclusion, London School of Economics and Political Science, May 2003.

²⁷ See: J Banks, R Blundell & C Emmerson, *Disability Benefit Receipt and Reform: Reconciling Trends in the United Kingdom*, Journal of Economic Perspectives, Vol. 29 No. 2 Spring 2015.

²⁸ For example, if caring for a child, see: <https://www.gov.uk/national-insurance-credits> (accessed 14 January 2022).

²⁹ See: *The National Insurance (Graduated Contributions and Non-Participating Employments—Consequential) Regulations 1966 & The Social Security (No. 2) Act 1980 Commencement Order 1980*. Around 100,000 were receiving the earnings-related addition in 1968; see: *Unemployment Benefit (Earnings Related Supplement)*, House of Commons Debate 31, Hansard, vol 781 c21, March 1969.

³⁰ See: T Rutherford, *Historical Rates of Social Security Benefits*, House of Commons Library, November 2013.

³¹ Long-term sickness and disability benefits were uprated by the higher of price or earnings increases from 1975 to 1982.

Policy for working-age benefits also stands in contrast to current policy for pensioners, which we discuss in Box 2.

Policy makers have chosen to provide support for extra-costs through income-related benefits

The consequence of decisions on contributory benefits and on uprating is that basic benefit levels (now characterised by the UC standard allowance) have become wholly inadequate to cover all family costs; specifically: children and housing. As a result, successive governments have had to increase the amount of support provided to families with children, and have tended to do so through extra-cost additions to the income-related benefits, rather than through significant increases to universal Child Benefit.³² From 1975 to 2021 an out-of-work single parent with one child has seen the total value of their extra-cost benefit for their child quadruple in real terms (increasing by 297 per cent), a significant increase relative to average earnings. Support for housing costs (which we discuss later in this section) has always been provided through income-related programmes. As a result of these trends, by the time UC is fully rolled out (2025-26) these additional elements – for children, housing, and ill-health – are expected to account for £2 in every £3 (65 per cent) of the costs of Universal Credit according to the OBR.³³ One further consequence of providing more support for extra costs for out-of-work families was the negative effect on work incentives. Faced with this dilemma, successive governments – as we discuss in Section 5 – boosted support for extra-costs for low-income families in work.

These interacting policy decisions and directions have left the UK social security system for working-age adults looking very different to that under a Bismarckian northern European model. Those systems have a generous earnings-related system of unemployment or sickness benefits, with a lower level of means-tested benefits providing a safety net underneath for those who lack contributions. Instead, our system has a low flat-rate basic level of benefits that has ended up being supplemented, through income-related programmes, for those whose families have additional needs. The UK's system for working-age households has also evolved in a different way from the system for pensioner benefits, where we have seen a very different approach to the relative importance of contributory and income-related benefits, and to uprating policy. We discuss this in Box 2.

³² The introduction of Child Benefit coincided with a cut in tax allowances for families with children. There was also a one-off increase in the Child Benefit rate for the first child early on in the Blair government.

³³ See Chart 3.4 of: OBR, *Welfare Trends Report – March 2021*. In fact, the methodology used likely understates the proportion of UC spending directed towards extra costs as, were it not for the extra costs, families in work would not be receiving any UC (including a share of the standard allowance) at all.

BOX 2: Why have pensioner benefits been on a different path?

The Beveridge reforms set the State Pension at a similar level to Unemployment Benefit, but the former then went on to become significantly more generous (as shown in Figure 7) – reflecting the desire to keep up with a growing share of workers with much more generous occupational pensions. This was achieved first by the State Earnings Related Pension Scheme (SERPS), introduced in 1975, which aimed to pay out two-thirds of earnings in retirement, and a decision to uprate the state pension in line with earnings during the 1970s.

However, in 1982, a decision was made to uprate the Basic State Pension only in line with consumer prices, and the value of SERPS was also reduced (eventually being replaced by the even less generous for higher-earners Second State Pension, which was then replaced by the new State Pension in 2016).

As a result of the falling value of the State Pension relative to average earnings, pensioner poverty increased substantially in the late 1980s: from 14 per cent of pensioners in relative poverty (after housing costs) in 1984, to 41 per cent by 1989. This was mitigated in the 1990s by boosting the generosity of Income Support for pensioners (now

Pension Credit) – which rose by 36 per cent in real terms from 1990-91 to 1997-98.³⁴ The Blair Government then increased the generosity of income-related benefits for pensioners by 33 per cent in real terms (CPI-adjusted) in just four years from 1998 to 2002.³⁵ This allowed the additional spending to be targeted at those who needed it most. But by setting the level of the income-related benefits considerably higher than the level of the State Pension and then increasing the former at a faster rate than the latter (which was the situation in the first half of the 2000s), concerns grew that the incentive to save for retirement was being undermined.

The solution to this – as recommended by the Pensions Commission in 2005 and implemented after 2010 – was to significantly increase the basic State Pension (now the new State Pension) by merging it with the Second State Pension, to then continue to uprate the State Pension in line with earnings, to keep it non-means-tested, end contracting out, and encourage private pension saving through automatic enrolment of employees in private pensions.³⁶ Compared to working-age benefits, the pension system has returned to a near Beveridge-like

³⁴ Source: DWP, *Benefit Expenditure and Caseload Tables*, Autumn Budget 2021.

³⁵ Source: DWP, Abstract of DWP benefit rate statistics: 2020, January 2020.

³⁶ *A New Pension Settlement for the Twenty-First Century* The Second Report of the Pensions Commission, 2005.

situation: a basic State Pension that will – for home-owners at least – put people above the means-tested benefit (i.e. Pension Credit) level.³⁷

The changing economic and social context

So far, we have focused on pivotal policy choices made in the social security system. Now we turn to three major social and economic trends that have also directly led to changing levels of spending (although these trends will have weighed on policy makers' minds at the time of the policy choices discussed above).

Earnings inequality has increased significantly

The first trend has been the growth in inequalities in earnings at the family level, driven by a combination of changing family structures, changing labour market behaviour within households, and between men and women, and trends in wage inequality.

Figure 9 shows an increase in the proportion of working-age families with little or no attachment to the labour market. In 1961, 88 per cent of non-retired households had at least one person working full-time (or self-employed), this gradually fell to 70 per cent by 1992, and has remained at approximately that level since. And although the overall share of workless households has fallen slightly since the 1980s, that can be explained by a rise in families with just part-time workers.

There are two factors that explain this fall. The first is the rise in single parent families in the 1980s and 1990s: in 1961, just 2 per cent of non-pensioner households were headed by a single parent; this rose to 8 per cent by 2001-02.³⁸ Single parent households were – and still are – less likely to work, and, if they do, they are less-likely to work full-time: in 2021, 68 per cent of single parents (aged 16 to 64) were in any employment (including part-time), compared to 78 per cent of cohabiting mothers, and 93 per cent of cohabiting fathers. The second is a more recent decline in employment among, with only 72 per cent of men aged 16 to 64 without children are in employment in 2019.³⁹ These changes happened alongside an increased trend for couples to have two earners (including any part-time earners).

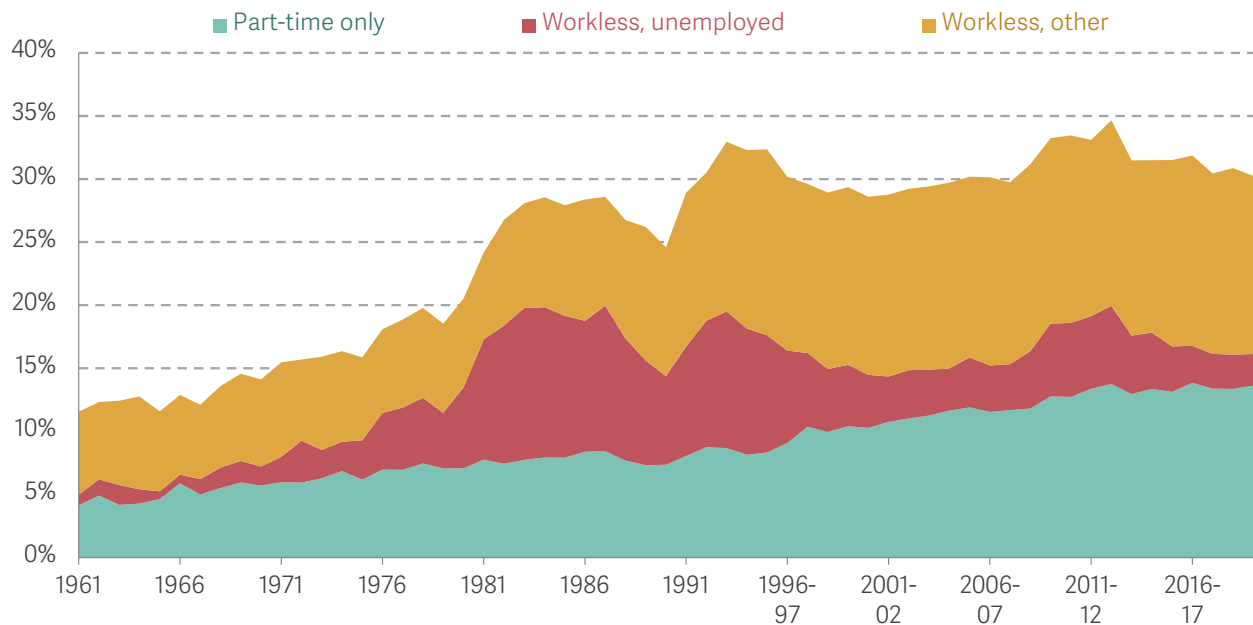
³⁷ Housing benefit presents a complication for non-homeowners. The combination of Housing Benefit and Pension Credit may leave people better off over their lifetime if they do not save for retirement.

³⁸ Analysis of: ONS, Family Expenditure Survey; DWP, Households Below Average Income.

³⁹ Source: ONS, Working and Workless Households, Employment rates of people by parental status, data for July to September 2021.

FIGURE 9: More non-retired families have become workless or work only part-time since the 1960s

Proportion of working-age families working part-time or not working, excluding retired families: GB/UK



NOTES: GB prior to 2002-03.

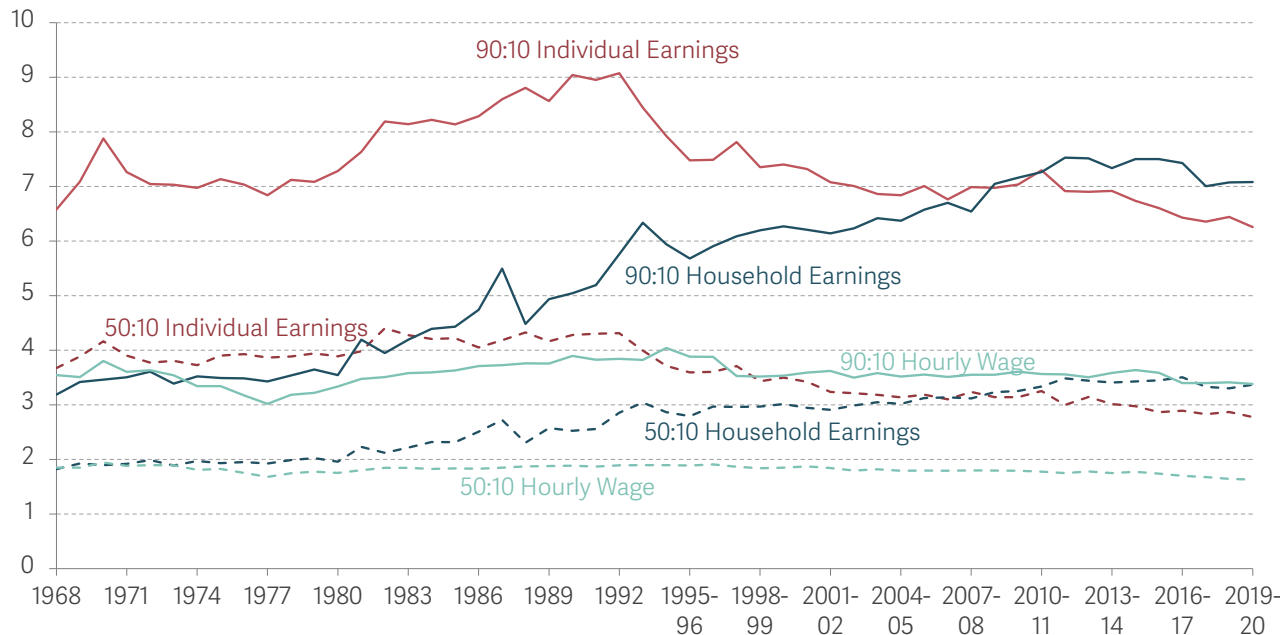
SOURCE: Analysis of DWP and IFS, Households Below Average Income.

In addition to these changes to household structures and employment patterns, earnings too have changed. Figure 10 shows hourly wage, individual and household earnings inequality.⁴⁰ A rise in inequality in hourly wages and weekly earnings was one of the defining features of the 1980s, and was the principle cause of the huge rise in household income inequality between 1978 and 1991. But individual hourly wage and weekly earnings inequality (as measured by the 90:10 ratio) both peaked in the early 1990s, and have fallen considerably since, whereas inequality in earnings at the family level continued to grow through the 1990s and 2000s – in part through the changes in family-level employment discussed above, and in part because of compositional changes in who lives in a couple and who lives as a single adult – and has peaked only very recently. Indeed, the 90:10 ratios for hourly wages and weekly earnings in 2019 were almost identical to their levels in 1968, but the 90:10 ratio for family earnings has more than doubled in fifty years.

⁴⁰ The figure is taken from a forthcoming contribution to the Deaton review of Inequality. We are grateful to the IFS for permission to use this chart in advance of the publication of the chapter.

FIGURE 10: Earnings inequality within families significantly widened in the 1980s

90:10 and 50:10 ratios of hourly wages, gross individual earnings and equivalised household earnings: GB/UK



NOTES: GB prior to 2002-03. Sample is individuals in work aged 25-74. We exclude the bottom and top 1 per cent of the gender-specific gross earnings distribution. Household earnings have been equivalised using the modified OECD equivalence scale.

SOURCE: Analysis of DWP, Family Resources Survey; ONS, Family Expenditure Survey, and taken from a forthcoming contribution to the Deaton review of inequality.

The ever-growing gap between median family earnings – increasingly reflecting a two-earner family – and those on low earnings (often based on one earner) or in families where no-one works, has put considerable pressure on the benefit system to make up the difference if income inequality is not to rise further. But, as have seen, this has not happened by increasing the generosity of the key building blocks of the social security system. Instead, it has happened by increasing the support provided to children (particularly in the 1990s and 2000s), and by extending support previously to low-income working families, and this expansion of social security system to working families – the impact of which was shown earlier in Figure 3 – has This is one of the structural reasons why benefit spending is increasingly directed at working families, where it has played a vital role in mitigating widening inequality.⁴¹

Housing costs have increased much faster than consumer prices or earnings

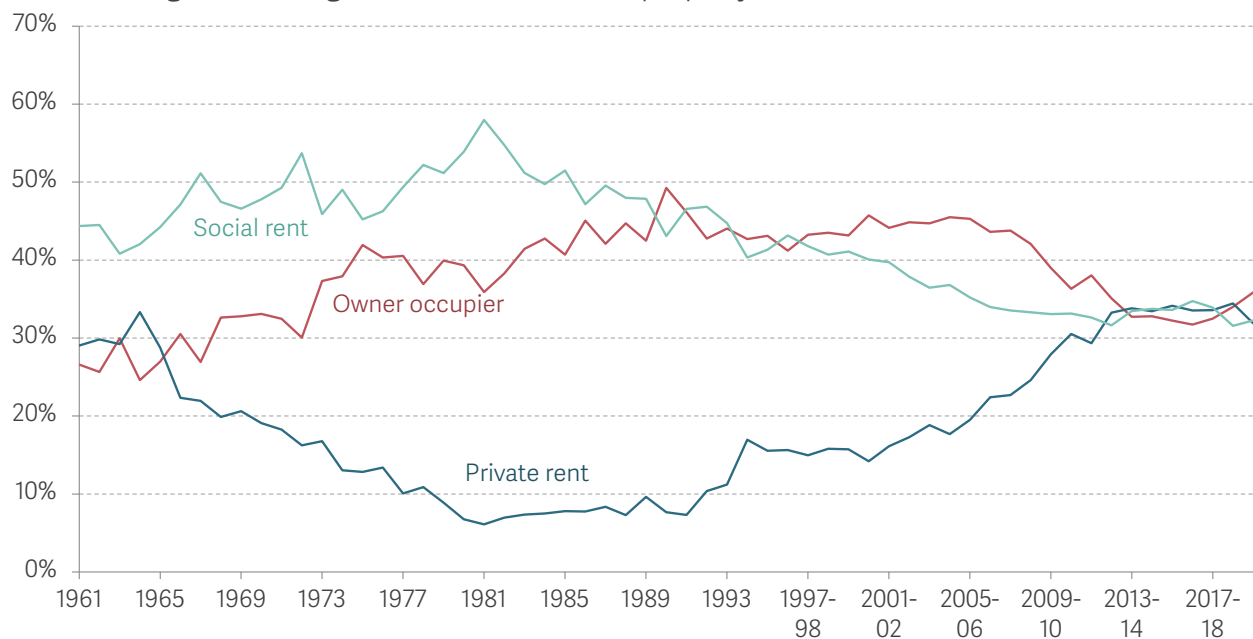
The second economic change has been the high and growing cost of housing for low-income households. The low level of basic benefits means that additional programmes to help with rental costs have existed for many decades, but there have been two important

⁴¹ See, for example, Figure 7 of C Belfield et al., Two Decades of Income Inequality in Britain: The Role of Wages, Household Earnings and Redistribution. *Economica*, 2017 (a free-to-view version is available [here](#)).

changes in the past 40 years. The first has been the surge in all housing costs in the late 1980s and early 1990s, and then in rental costs in the following decades. The second, shown in Figure 11, was a more recent shift in tenure patterns that means that fewer low-income households are now owner-occupiers.

FIGURE 11: Lower-income families have become increasingly likely to be renting privately

Proportion of non-pensioners in the bottom third of the income distribution, after housing costs, living in an owned or rented property: GB/UK



NOTES: GB prior to 2002-03. Data excludes people living rent free.

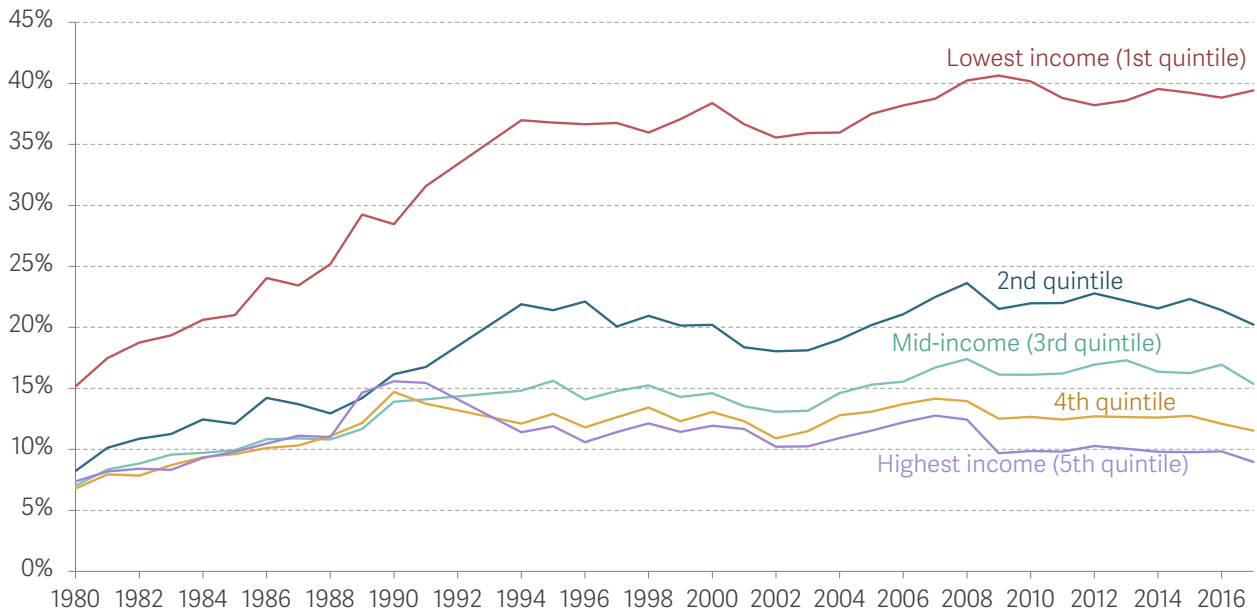
SOURCE: Analysis of DWP and IFS, Households Below Average Income.

The outcome of these two trends is made clear in Figure 12, which shows how housing costs have risen relative to incomes since 1980. Two periods stand out here. First, rising costs for all working-age families prior to the early 1990s; and second, further rises for the lowest-income families since then. The result has been that spending on Housing Benefit and its predecessors rose from 0.2 per cent of GDP (and 5.9 of all non-pensioner welfare spending) in 1980-81, to 1.0 per cent in 2012-13 (and 17.9 per cent of all non-pensioner welfare spending).⁴²

⁴² The introduction of Universal Credit complicates comparisons after 2012-13.

FIGURE 12: Housing costs have risen for all, but especially for low-income families

Average housing cost to income ratio by income quintile, working-age family units: GB/UK



NOTES: Family units are defined as any single or couple adults and their dependent children. Working-age defined as all family units in which the head of the family unit is less than 60 years old. Housing costs are calculated gross of housing benefit such that housing benefit is included in both income and housing costs. Income is net income before housing benefit is deducted. Income and housing costs assumed to be shared equally between family units within each household. There is no data for 1992 and 1993, changes between 1991 and 1994 are linearly interpolated. Data is for Great Britain only between 1994 and 2001. SOURCE: Analysis of DWP and IFS, Households Below Average Income.

Disability and ill-health caseloads have risen rapidly

A third trend has been the rising number of people in receipt of a disability or ill-health-related benefit (and, within this, the increasing fraction in recent years of those in receipt of a disability benefit who have mental health, rather than physical health, problems).

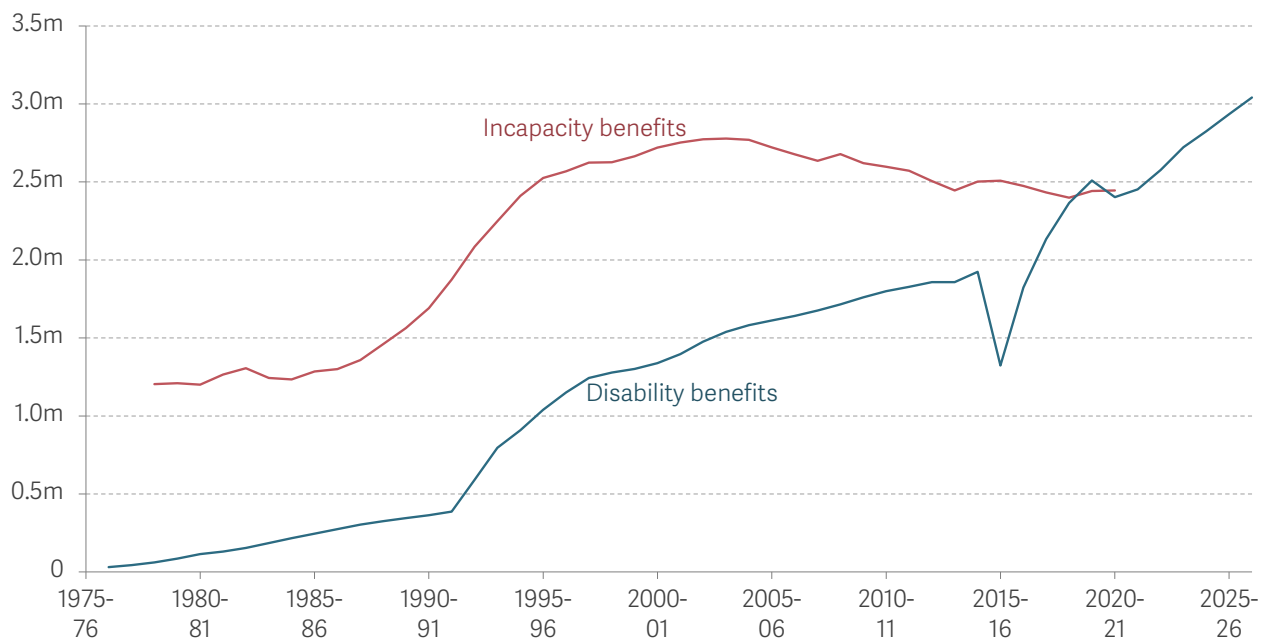
It is important to distinguish between disability and ill-health (or incapacity) benefits. Disability benefits (currently Personal Independence Payments for those below the State Pension age) are intended to meet the extra costs associated with having a disability or long-term health condition, and are available to individuals regardless of income or work status. Ill-health benefits are aimed at providing income replacement for people with a health-condition that prevents them from working, and so are normally available only for adults who are out-of-work, or working a very small number of hours. In the current social security system, there is currently a contributory ill-health benefit (Employment and Support Allowance), and an income-related benefit (UC). In addition to these benefits, there is also a disability element paid as part of 82,000 Working Tax Credit claims.⁴³

⁴³ Source: HMRC, Tax Credit Statistics, Finalised Awards 2019-20.

The number of working-age claimants of the main disability and incapacity benefits has generally risen over time.⁴⁴ As shown in Figure 13 the number of incapacity benefit claimants more than doubled from 1985 to 1995 to over 2.5 million before reducing gradually to 2.4 million in 2020-21. Disability benefit claimants have increased at a steadier rate, with fewer than half a million claimants before 1991, before rising to 1.2 million by 1997 with the introduction of Disability Living Allowance, and then rising further to 2.5 million as of 2021-22 (with a projection of 3 million by 2026-27).⁴⁵

FIGURE 13: Disability and ill-health benefit claims have been increasing over time

Number of claimants receiving any incapacity-related or disability-related benefit: GB



NOTES: Disability benefits include Mobility Allowance (pre-1992), Disability Living Allowance and Personal Independence Payment. Incapacity Benefits include Employment Support Allowance, Incapacity Benefit, Invalidity Benefit, Sickness Benefit, Severe Disablement Allowance and equivalent Universal Credit claims. Numbers of cases not available prior to 1978-79 for Incapacity Benefits. From 2015-16 we have estimated the number of UC incapacity-equivalent claims to be all claims with a Limited Capability for Work or Limited Capability for Work Related Activity entitlement, as well an estimate of those awaiting a Work Capability Assessment (calculated as the difference between the UC Searching for Work conditionality groups and the Alternate Claimant Count measure of UC cases), minus the number of UC claims that are also claiming contributory-based ESA. Note that under UC this may include claimants who are in work, and may have previously claimed Working Tax Credit with a disability element.

SOURCE: Analysis of DWP, Stat-Xplore; and DWP, Autumn Budget 2021 Expenditure and Caseload forecasts.

⁴⁴ People can – and do – claim both disability and ill-health benefits (e.g. PIP as well as ESA or UC), and neither benefit payment affects the other. In 2015, for example, 67 per cent of disability claimants and 56 per cent of incapacity claimants claimed both sets of benefit (Source: DWP, Stat-Xplore, Benefit Combinations; recent evidence on the overlap is complicated by the existence of UC). It is possible to claim contributory-based ESA at the same time as income-based UC (and around 90,000 people did so as of May 2021). Although any contributory-based ESA payment is fully deducted from the UC award, it may be advantageous to preserve entitlement to ESA. PIP awards are not contingent on a person's income.

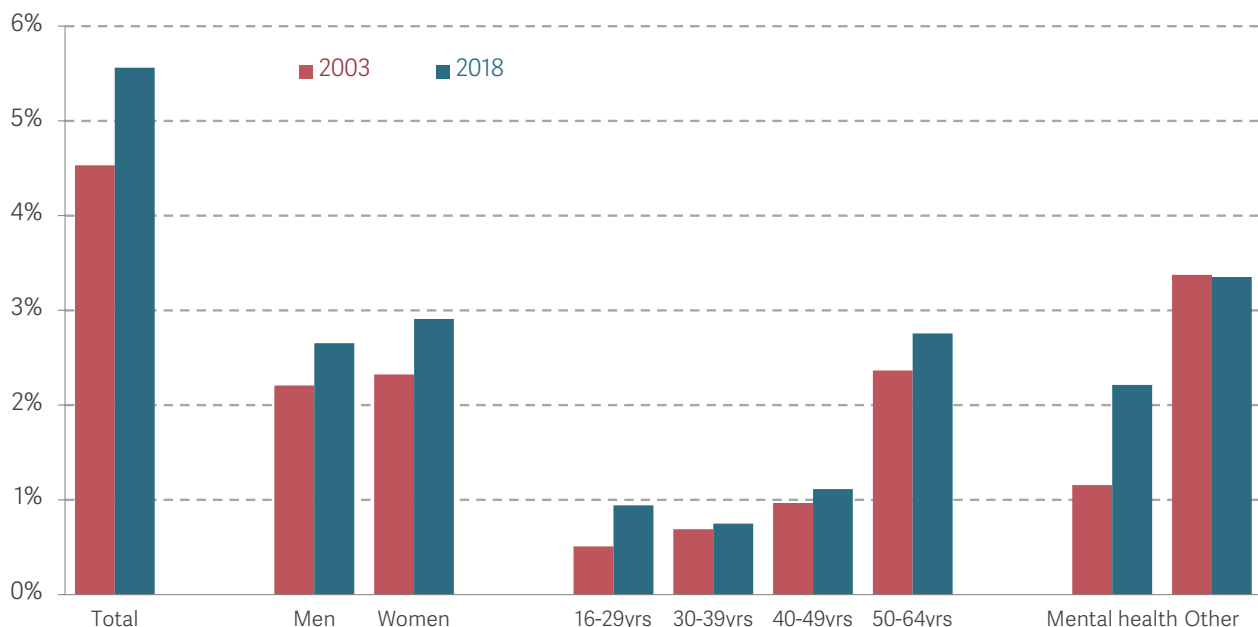
⁴⁵ The sharp dip in claimants in 2015-16 may be explained by the roll-out of Personal Independence Payment benefit.

What might be driving such changes? The rise in incapacity benefits in the 1980s followed a period of prolonged and high unemployment and, in the early 1990s, was heavily concentrated among older people.⁴⁶ Since then, however, a rise in mental health conditions (across all ages) has offset the cohort effect of older claimants ageing into retirement and off incapacity benefits.⁴⁷

We can note a similar trend with disability benefits as well. Figure 14 provides more detail on recent trends, showing how the proportion of the working-age population receiving a disability benefit changed between 2003 and 2018. Over that period, the rise in people receiving disability benefits has been disproportionately driven by increases in young people and people with mental health conditions. The proportion of 16-29-year-olds claiming disability benefit increased by 85 per cent between 2003 and 2018. While the proportion of the working-age population receiving disability benefits primarily for non-mental health related reasons remained steady at 3.4 per cent, the proportion receiving disability benefits primarily for a mental health condition almost doubled from 1.2 to 2.2 per cent.

FIGURE 14: The prevalence of people receiving benefits due to mental health conditions has increased

Proportion of working-age population receiving disability benefit by gender, age and condition: GB, 2003 and 2018



SOURCE: OBR, Welfare Trends Report – March 2019.

⁴⁶ See Figure 2 in: J Banks, R Blundell & C Emmerson, *Disability Benefit Receipt and Reform: Reconciling Trends in the United Kingdom*, Journal of Economic Perspectives, Vol. 29 No. 2 Spring 2015.

⁴⁷ See Figure 3 in: J Banks, R Blundell & C Emmerson, *Disability Benefit Receipt and Reform: Reconciling Trends in the United Kingdom*, Journal of Economic Perspectives, Vol. 29 No. 2 Spring 2015.

The rise in mental health conditions is also noticeable in its effect on the labour market. The number of working-age adults who are inactive due to ill-health has fallen slightly from 2.5 million in 2003 to 2.3 million in 2020. However, this masks a rising number of people who are inactive due to a mental health condition, which has risen by 55 per cent over the period, from 400,000 to 620,000. As a result, more than a quarter (27 per cent) of ill-health labour market inactivity is, primarily, due to poor mental health, up from 16 per cent in 2003.⁴⁸

The change in the health of the population has shaped the social security system during the past 60 years. It seems likely it will continue to play a significant role in the future – with implications for the economy and the labour market too.

This section has set out some of the key influences on today's social security system. The downplaying of the contributory principle, and decisions to uprate working-age benefits in line with consumer prices (at best) rather than average earnings, are fundamental choices that mean that we now have a low, flat-rate basic level of benefits. That basic level of benefits has ended up being supplemented by income-related programme for those with certain additional needs. These changes should be viewed in the context of economic and social changes over the past fifty years. The most important of these have been: rising inequalities in earnings at the family level; the high and growing cost of housing for low-income households; and the rise in the number of people in receipt of a disability benefit, driven most recently by rising mental ill-health. These changes have, in different ways, pushed up social security spending even while basic levels of benefits remain low. In the next section, we look at the implications of these past choices by assessing the current social security system's performance.

⁴⁸ Source: Authors' analysis of ONS, Labour Force Survey.

Section 4

How does the current social security system measure up?

Two significant drawbacks of the UK's social security system are that it provides a highly variable, and often very weak, degree of income insurance, and that it fails to deliver adequate living standards.

A direct consequence of the low, flat-rate basic level of benefits is that the UK has one of the lowest income replacement rates for single adults in the event of unemployment in the OECD. The median replacement rate for a single adult with no children is just 31 per cent, and approximately a third of single people get just over 20 per cent of their in-work income if they lose their job. The extent of insurance is, however, very varied: the fact that the UK has relatively high income-related extra-cost benefits means that households entitled to the additional elements are better protected. The median replacement rate for a single parent, for example, is 69 per cent. A direct consequence of the low levels of insurance overall is that the social security system provides relatively little protection against aggregate shocks, and the responsiveness of UK social security spending to the economic cycle appears to be among the lowest for rich countries.

Even with relatively generous extra-cost benefits, the UK struggles to ensure adequate living standards at the bottom. The low-level of core social security benefits, affected by the various real-terms cuts to benefit levels in the 2010s, is clearly a major determinant of these outcomes. But this has been exacerbated in the past decade by policy changes that undermined the idea that those with extra needs should be supported: these include the benefit cap, which now affects 165,000 families, and the two-child limit, which now affects 1.2 million children and is expected to affect 3 million when fully rolled-out by 2035. As a result, poverty among children has risen by 4 percentage points since 2011 (a period when working-age poverty has fallen slightly),

driven entirely by rising poverty among families with three or more children. More broadly, the UK's record on living standards growth for those at the bottom has been terrible since around 2003-04, with growth of just 7 per cent (measured after housing costs) for a household at the 10th percentile in the 16 years since then, compared to 15 per cent at the 50th percentile.

And these are not theoretical issues – they had very real impact during the pandemic. The inadequate levels of insurance provided by the social security system was one reason why the Government had to introduce the furlough scheme and grants for the self-employed. The Covid-19 crisis also exposed the UK's wholly inadequate approach to sick pay, although this remained unreformed. And the low levels of benefits were one reason behind the £20 a week uplift to UC and tax credits.

Section 2 established that the UK's system is characterised by a low flat-rate basic level of benefits that is supplemented, through income-related programmes, for those whose family has additional needs, and Section 3 identified the key policy turning points and economic and social trends that have shaped working-age benefits since Beveridge. This section focuses on the implications of such a system, assessing it across in two key areas:

- First, we show that the UK's social security system performs poorly at providing individual earnings insurance in the event of labour market shocks such as unemployment or earnings fluctuations. The greater the degree of earnings insurance provided through the social security system, then the more individuals' own incomes are protected, and the more likely it is that we can maintain macroeconomic stability in the event of recessions.
- Second, we show that the social security system is failing to deliver adequate living standards for low-income households, something that is helping to maintain the UK's internationally and historically high levels of income inequality.

The experience of the pandemic reinforces both of these conclusions: the UK Government introduced furlough and new grants for the self-employed to compensate for the weak insurance provided by the social security system, and the low levels of benefit were one reason behind the £20 a week uplift to UC and tax credits. Statutory sick pay, although not significantly reformed during the pandemic, was also shown to be wholly inadequate.

The UK offers variable – but overall weak – income insurance in the event of labour market shocks

A core role for the social security system is to protect households from labour market shocks. This sort of earnings insurance is particularly important given the low levels of savings that UK households have. Recent research showed that over 40 per cent of workers in the bottom half of the earnings distribution would not be able to make ends meet for a month if they lost their main income source.⁴⁹ And in the run-up to the pandemic, 46 per cent of the lowest income working-age households in the UK had insufficient financial assets to cover a three-month 25 per cent reduction in gross household employment income, compared to 33 per cent in France and 36 per cent in Germany.⁵⁰ So the UK appears to have internationally-low levels of financial resilience, where many households are unable to smooth over short-term shocks using private savings.

But this is compounded by the UK's low basic rate of benefits, which leaves many workers exposed to labour market shocks (we cover health shocks and sick pay later in this section when considering the lessons from the pandemic). We can see the low replacement rates for workers in the UK in Figure 15 and Figure 16, which show income replacement rates in the event of unemployment.⁵¹ The median replacement rate across all workers is 53 per cent, which means that a worker losing their job would see their family income (counting all of their income from social security system plus the income of any partner) fall to 53 per cent of its previous level. Figure 15 shows that replacement rates vary significantly across the income distribution. For workers on the lowest incomes, the median replacement rate is 71 per cent; for the highest incomes, the median replacement rate is only 47 per cent. This is a direct implication of having flat-rate, levels of unemployment benefit that are not related to previous earnings.

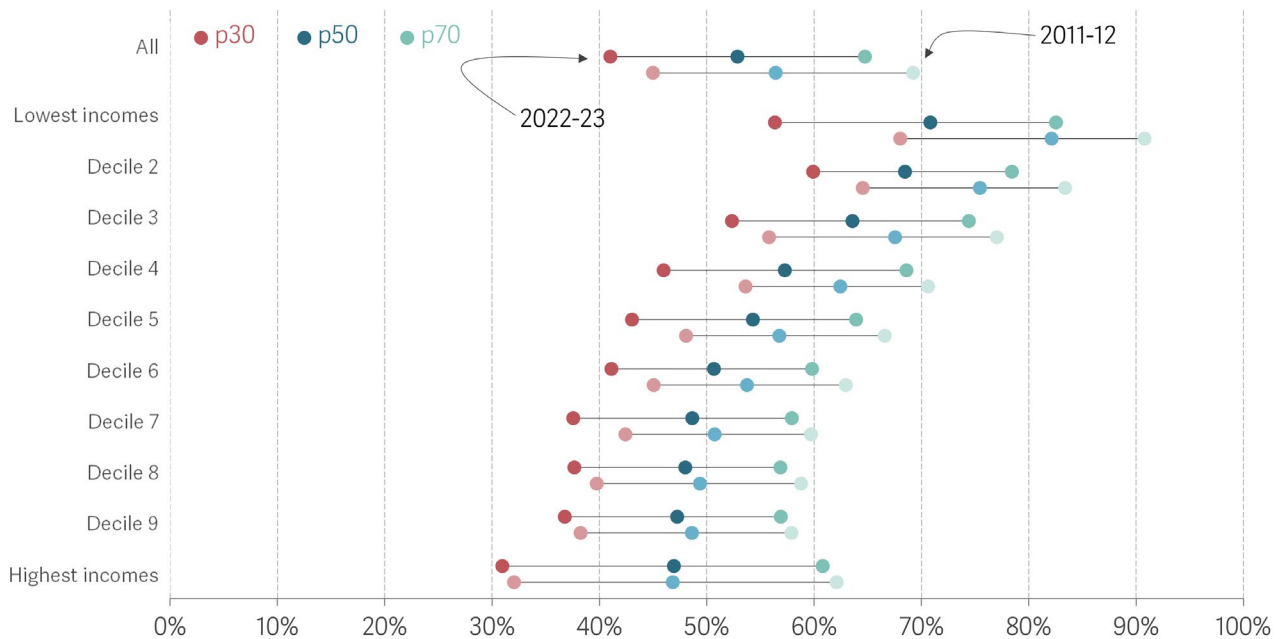
⁴⁹ See Figure 39 in: G Bangham & J Leslie, *Rainy days: An audit of household wealth and the initial effects of the coronavirus crisis on saving and spending in Great Britain*, Resolution Foundation, June 2020.

⁵⁰ M Gustafsson et al., *After Shocks: Financial resilience before and during the Covid-19 crisis*, Resolution Foundation, April 2021. When UK households do have wealth, it is much more likely in property than in other major European countries: just 12 per cent of the lowest income German households had property wealth in 2017, compared with one-third of the lowest income households in Great Britain. Average property wealth across all households was around half as large (at around €90,000) in France and Germany than in Great Britain (£182,000) in 2017.

⁵¹ This analysis includes all aspects of the personal tax and benefit system. For details of the assumptions used for the modelling shown in this chapter, see Annex 1.

FIGURE 15: Replacement rates have fallen across the income distribution since 2011-12, but especially for those on the lowest incomes

Income replacement rates in the event of unemployment for workers by income decile: UK, 2022-23 and 2011-12



NOTES: For a detailed explanation of modelling assumptions, see Annex 1.

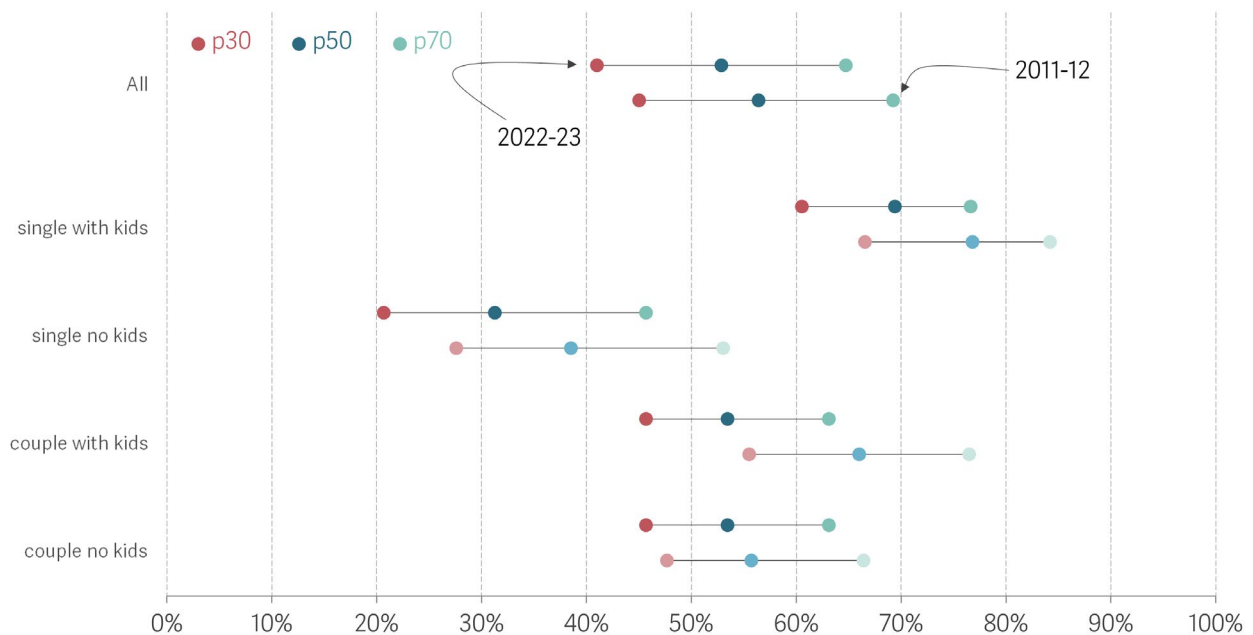
SOURCE: Analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

Benefits which support those with additional costs mean that the system is more generous for certain groups (see Figure 16). The median replacement rate for single people without children is just 31 per cent (and almost one in three single people would find that their income if unemployed was just 20 per cent of their in-work income). By contrast, single parents, who will be entitled to add-ons for children, have a median replacement rate of 69 per cent.⁵² By providing only a flat rate of benefits to people who are out of work regardless of their previous earnings, our social security system provides very low levels of income replacement for people who experience unemployment and who do not have these additional needs.

⁵² Replacement rates are generally higher for those in couples because our measure of the replacement rate includes any earnings received by the partner.

FIGURE 16: Replacement rates are much higher for single people with children than without

Income replacement rates by family type: UK, 2022-23 and 2011-12



NOTES: For a detailed explanation of modelling assumptions, see Annex 1.

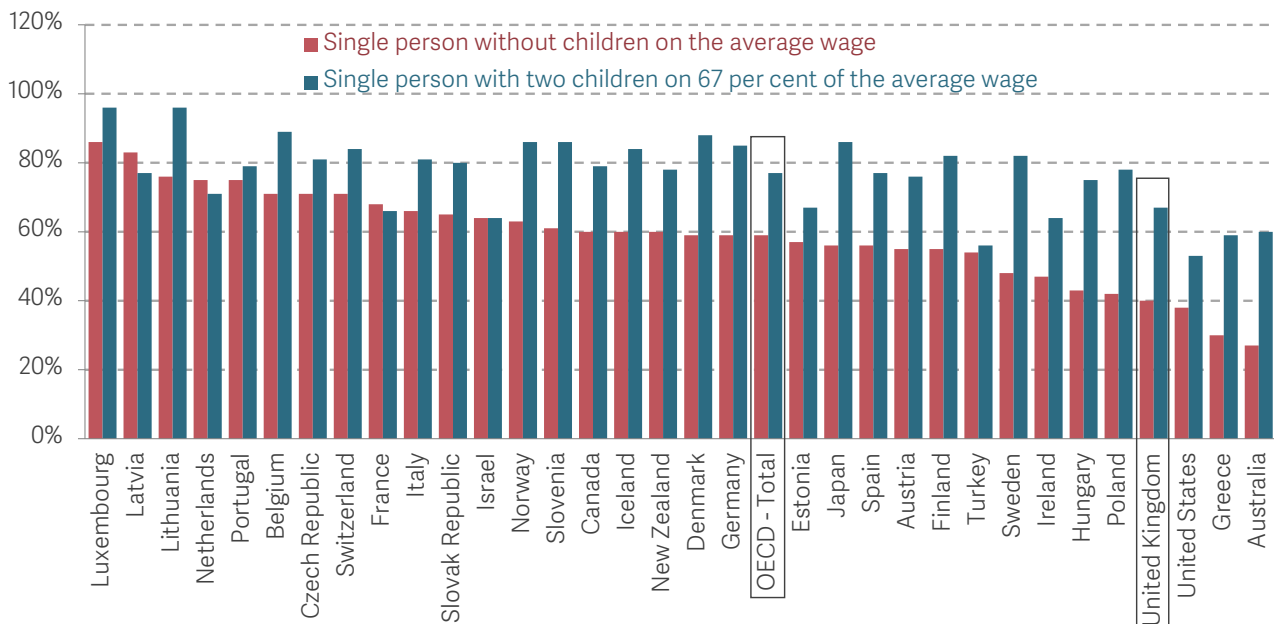
SOURCE: Analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

The ability of the social security system to replace earnings in the event of unemployment has fallen over the past 10 years, reflecting cuts to the income-related parts of the social security system since 2011-12. The median replacement rate was 56 per cent in 2011-12, rather than 53 per cent now. The difference is particularly noticeable for couples with children, whose median replacement rate has fallen from 66 per cent to 53 per cent. This shows the impact of the cuts to tax credits and other support for families with children since 2011.

The low replacement rates seen in the UK are unusual in comparison to other countries in the OECD. For someone on the average wage, the UK has one of the lowest replacement rates in the OECD for single people, at just 40 per cent. This compares to an OECD average of 59 per cent. However, the situation is a little better for people with extra costs, with the UK having a replacement rate of 67 per cent for a single parent on two-thirds of the average wage, closer to the OECD average of 77 per cent.

FIGURE 17: Replacement rates are low in the UK

Net replacement rate in the event of unemployment, OECD countries: 2020



NOTES: Replacement rates shown are for one month of unemployment and include social assistance and housing benefits.

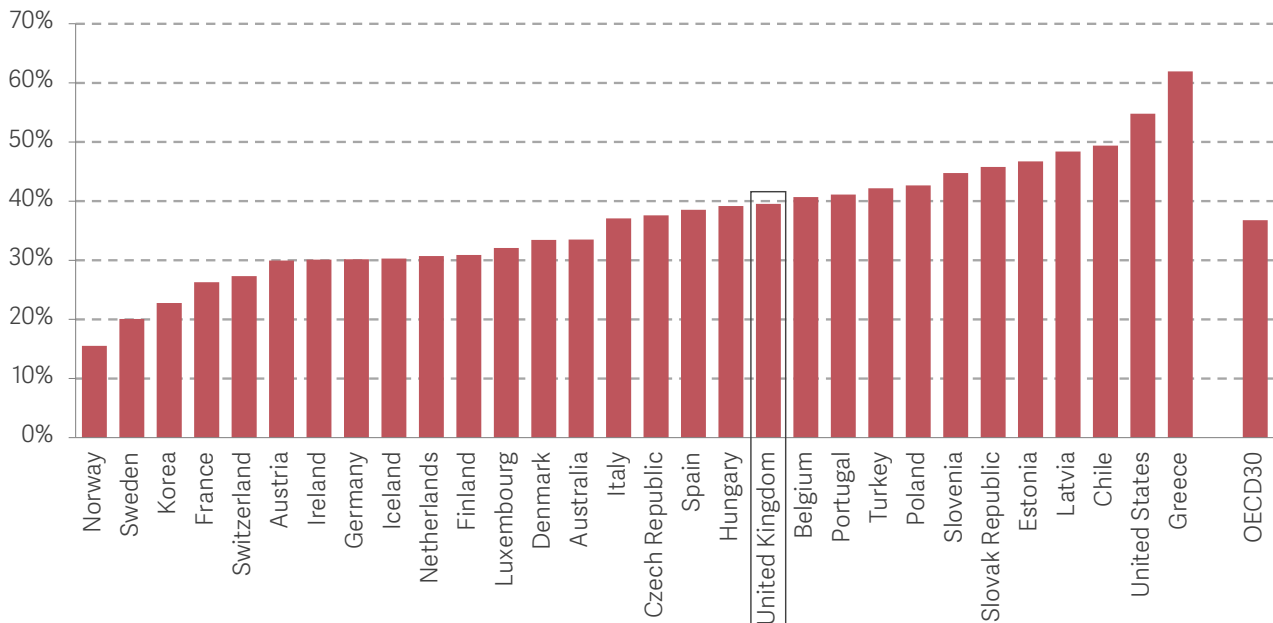
SOURCE: OECD, net replacement rate in unemployment.

The results shown so far in this section come from microsimulation modelling of hypothetical families, and cross-country evidence, but the implication of the findings can be seen in empirical data too. Data covering the period prior to the onset of Covid-19 showed that 40 per cent of workers who move out of work in the UK faced a loss in household income of at least 25 per cent, considerably above the proportion in comparable western European countries, and slightly above the OECD average of 37 per cent (Figure 18). Cross-national research during the pandemic showed that, among UK respondent households in which at least one person moved out of work over the past year, 60 per cent recorded a fall in household income, compared with 40 per cent in Germany and 37 per cent in France. Moreover, the share of respondent households that experienced a substantial fall in income (of 25 per cent or more) when one person in the household moved out of work is 41 per cent in the UK – significantly larger than in Germany (28 per cent) or France (20 per cent). This highlights the severe income shock that losing a job in the UK can bring.⁵³

⁵³ M Gustafsson et al., *After Shocks: Financial resilience before and during the Covid-19 crisis*, Resolution Foundation, April 2021.

FIGURE 18: The UK has a high proportion of people likely to face a large income loss when becoming unemployed, but a low risk of unemployment

Proportion of employed people experiencing a large income loss when becoming non-employed: OECD average, early 2010s or latest



NOTES: Large income losses are defined as 20 per cent or more income losses from one year to the next. Data for the United States refer to bi-annual transitions. Data is for the working-age population (18-65).
SOURCE: OECD, A Broken Social Elevator? How to Promote Social Mobility.

The other risk affecting households comes from fluctuations in earnings for those who are in work. Box 3 discusses this.

BOX 3: Insuring workers against earnings fluctuations

The social security system and tax system also provides protection to households from volatility in earnings. We can examine this protection by looking at “pass-through rates” of income losses – that is, how much of a fall in pre-tax earnings passes-through to a fall in family income after the effects from the tax and benefit system are taken into account. Figure 19 shows the pass-through rate from a gross income loss of 25 per cent.

Without the tax and benefit system, 100 per cent of this reduction would feed through to net income. But because individuals pay lower taxes and can receive higher benefits when their income falls, the typical pass-through rate lies somewhere between 0 and 100 per cent. The lower the pass-through rate, the more protected an individual is from changes to gross income (such as earnings). The higher the rate, the more of the gross-income fall is directly

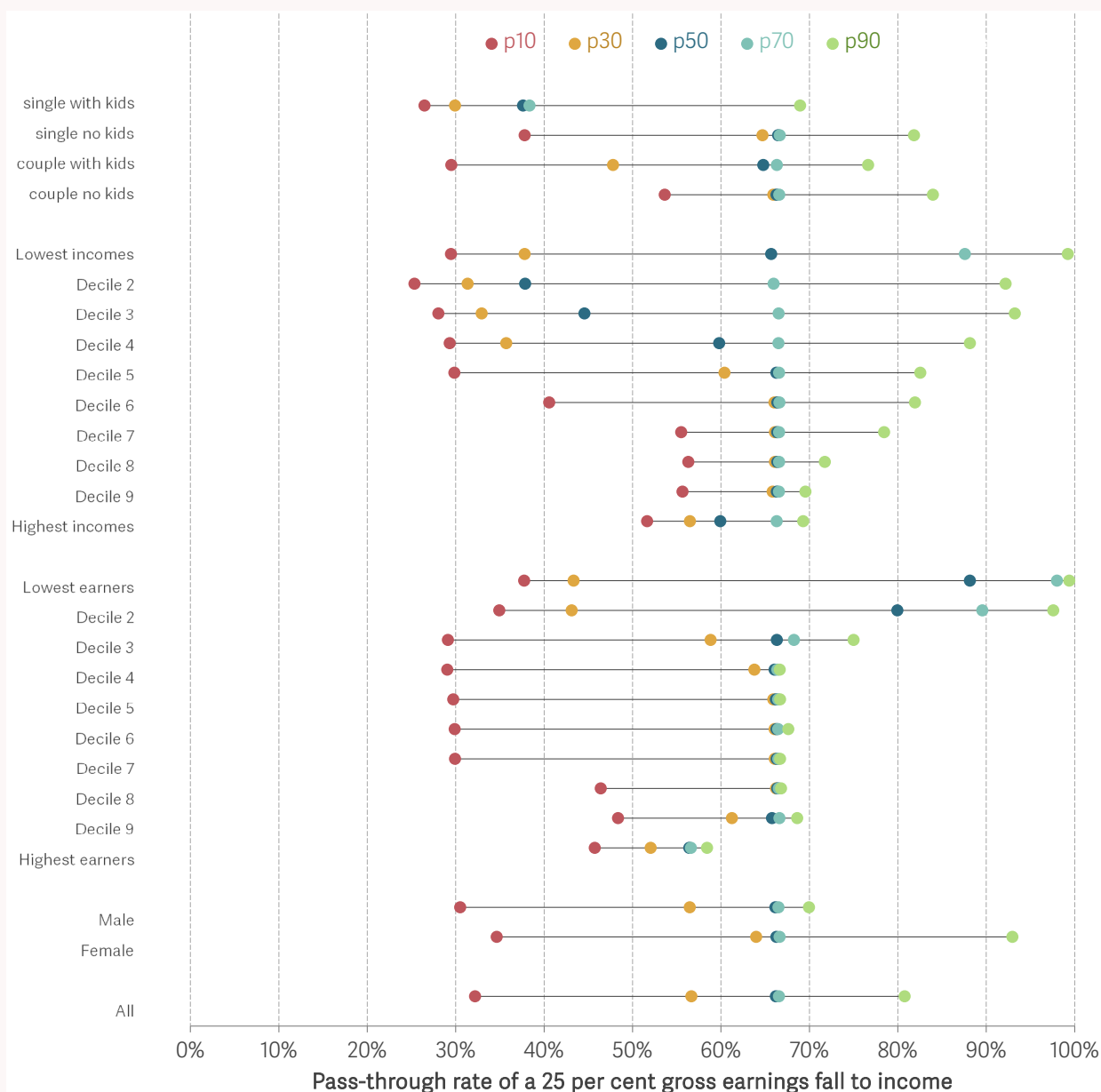
felt by the individual in changes to their income.

Pass through rates vary considerably depending on characteristics. As shown in Figure 19, the median pass-through rate is 66 per cent of the gross income loss. But this ranges from 32 per cent at the 10th percentile of all pass-through rates to 81 per cent at the 90th percentile. Similar to total income replacement rates, prior earnings (through marginal tax rates) and family circumstances (through benefit entitlement) affect the pass-through rates. The median pass-through rate for a single person with children is 38 per cent compared to 66 per cent for a person with a partner and no children, and 56 per cent for a worker with earnings in the top decile compared to 88 per cent with bottom decile earnings.

Here, the fact that the much of the support for extra costs is done through income-related benefits implies that the degree of insurance against earnings falls is, like for insurance in the event of unemployment, very variable. Helpfully, it tends to be higher for those on lower incomes, who would otherwise be more likely to find earnings volatility problematic – as they are more likely to see earnings falls offset by higher income-related support. However, some of those on the lowest earnings see almost no cushioning if they earn too little to pay tax and are not entitled to in-work support through UC. This position – of more support for low-income families with extra costs, and very low levels of support for those on low earnings – is precisely because our benefit system is focussed on providing support on extra costs (as discussed in Section 3).

FIGURE 19: Low-income families are protected from falls in earnings because of the extra-costs elements in the benefit system, otherwise low-earners get very little support in the event of an earnings fall

The distribution of pass-through rates for lower earnings to family income by selected characteristics: UK, 2022-23



NOTES: Pass-through rates calculated as the resultant change in family income as a percentage of a 25 per cent fall in individual earnings. For a detailed explanation of modelling assumptions, see Annex 1.

SOURCE: Analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

Low levels of income insurance weaken the extent to which the social security system can support the economy in a downturn

These issues of income insurance provided by the social security system matter not just for individuals, but also affects us collectively, through the system's ability to protect the economy from aggregate fluctuations.⁵⁴

The social security system stabilises the economy in the event of a downturn mostly by providing direct support to household incomes: when a recession hits, benefit payments rise in response to unemployment or falls in earnings. This partly offsets falls in incomes, and so helps to stabilise household spending. The economy also benefits from the redistribution of resources from richer to poorer families – this boosts demand, as poorer families are less likely to save – and from the very existence of the social security system, which reduces the incentives for families to retrench spending when a downturn hits.⁵⁵

Overall spending has tended to expand during recessions but part of this reflects discretionary changes in policy not just the operation of the system itself. As shown in Figure 2 earlier, welfare spending has indeed risen in the aftermath recessions. For example, in the first year of the financial crisis, nominal welfare spending increased by around £14 billion, a quarter of the overall rise in government spending. But this rise in spending conflates discretionary policy changes during a recession with the automatic response of the social security system as incomes fall.

To assess the extent to which the changes to the social security system have affected the response of the social security system to different types of recessions, we have used microsimulation modelling to simulate two types of recession (see the Annex for full details). Firstly, a 'financial crisis-like' recession, where employment falls by 4.3 per cent, and earnings fall by 4.3 per cent. That recession was characterised by *relatively* small falls in employment compared to the overall size of the recession but sustained weakness in earnings growth. Secondly, we also simulate a 1980s recession, with a 8.6 per cent fall for employment, and no change in earnings (details can be found in Annex 1).⁵⁶ Figure 20 shows how social security spending would change as share of pre-recession GDP after these two hypothetical recessions if they hit in 2022-23, and under three different policy scenarios: current policy for 2022-23, benefits policy if austerity decisions since 2010 were reversed, and boosting the basic rate of benefits by 74 per cent (so they are at a similar level compared to average earnings as in 1983-84). The key takeaway from this exercise

⁵⁴ This role for the social security system can be seen in the broader context of overall 'automatic stabilisers' – that is, the tendency for government spending to rise during recession and for the tax take to fall. In this report we do not focus on the operation of the tax system, but it is worth keeping in mind that the tax system will also play a role in boosting the economy during a recession. Instead, in this section we look at the effectiveness of the UK social security system in providing insurance against aggregate risk.

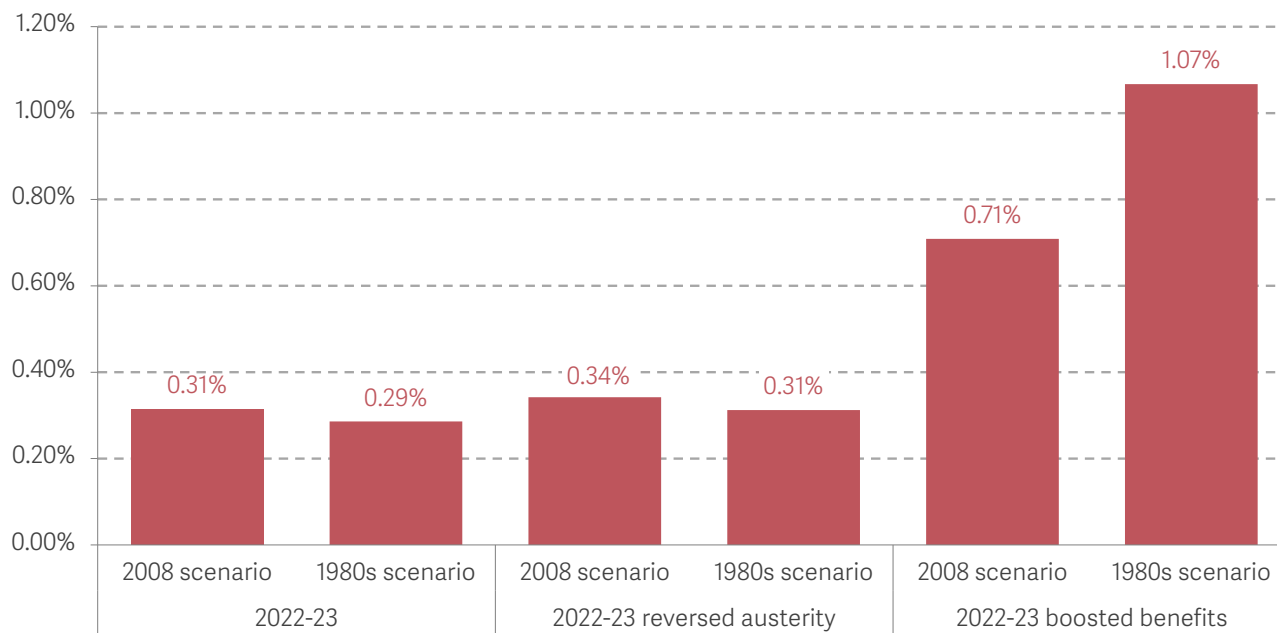
⁵⁵ See A McKay & R Reis, 'The Role of Automatic Stabilizers in the US Business Cycle', *Econometrica*, 84, pages 141-194, 2016.

⁵⁶ Our approach is similar to that in: J Cribb, A Hood & R Joyce, *Recessions, income inequality and the role of the tax and benefit system*, Institute for Fiscal Studies, November 2017.

is that the response of the system to income shocks caused by recessions is stronger when spending on benefits is higher (i.e. the response is larger if austerity cuts since 2010 were reversed, and even larger if the level of UC and JSA were boosted by the percentage change in the real value of unemployment benefits as a share of AWE between 1983-84 and 2022-23 – around 74 per cent).

FIGURE 20: If the 2008 or 1980s recessions were to happen today, benefit spending would increase

Benefit expenditure increase as a percentage of GDP in real and modelled recession scenarios: UK, 2022-23



NOTES: For a detailed explanation of modelling assumptions, see Annex 1.

SOURCE: Analysis of DWP, Family Resources Survey using the IPPR tax-benefit model; DWP, Benefit Expenditure Tables; OBR, Economic and Fiscal Outlook October 2021.

To assess the full extent to which higher social security spending translates into a boost to the economy, we need to apply a so-called ‘fiscal multiplier’. The OBR’s assumed multipliers for spending on social security benefits is 0.6 – that is, an increase in welfare spending of 1 per cent of GDP would increase output by 0.6 per cent at its peak.⁵⁷ All this means that the impact of the social security system in stabilising the economy is small when compared to the overall size of the recession. Indeed, the peak to trough fall in GDP during the financial crisis was 5.9 per cent.⁵⁸ Overall, then, the existing UK system in its current form does not contribute all that much to overall macroeconomic stabilisation.⁵⁹

⁵⁷ See Box 2.1 on page 30 of: Office for Budget Responsibility, Economic and Fiscal Outlook, November 2020.

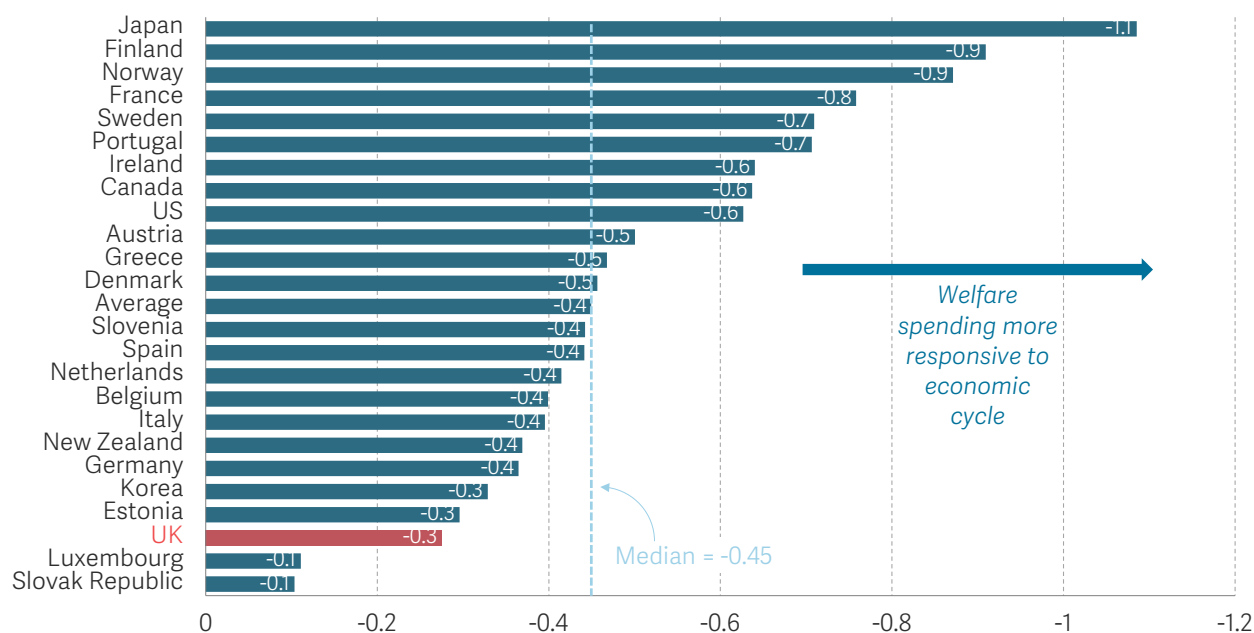
⁵⁸ Source: ONS, [Gross domestic product index: CVM: Seasonally adjusted](#).

⁵⁹ This accords with our previous work which showed that overall stabilisation was weak and had decreased since the financial crisis that used a heterogeneous-agent dynamic-stochastic general equilibrium model. See: M Graziano, G Thwaites & J Smith, [The effect of automatic stabilisers in the UK](#), unpublished manuscript, December 2018.

The degree of stabilisation performed by the UK's social security system – as measured by the strength of the relationship between social security spending and the output gap – also appears to be smaller than in almost all other developed economies (see Figure 21).⁶⁰ It is beyond the scope of this report to say precisely why this is, but it is clearly related to the low levels of income replacement in the UK (and see especially Figure 17 earlier, which showed replacement rates across OECD countries). Although we have not considered whether the fiscal multiplier might also vary across countries, this analysis supports the idea that the UK's social security system plays a relatively small role in overall macroeconomic stabilisation.

FIGURE 21: UK welfare spending appears to be less responsive to the economic cycle than other developed countries

Country-specific regression coefficient of welfare spending on the output gap: selected advanced economies, 1992-2018



NOTES: Chart reports the regression coefficient of a linear regression of the welfare spending to GDP ratio (OECD data) on the output gap (IMF data). Sample is 1992 to 2018 (except for Estonia, New Zealand, Slovenia and the Slovak Republic for which we have a shorter sample). Covers all advanced economies for which data are available over a comparable period. For the UK in this chart OECD and IMF data are used in the estimation, but repeating results using OBR data yields almost identical results (a regression coefficient of -0.3).

SOURCE: Analysis of OECD, Social Spending & IMF, World Economic Outlook database.

⁶⁰ The output gap is the difference between actual output and its assumed sustainable rate and thus provides a measure of the economic cycle. This means that the regression coefficient can be interpreted as the responsiveness of the social security system to the cycle. Note that the chart conflates discretionary changes in spending with the automatic response.

The UK's social security system also fails to ensure adequate living standards at the bottom

The second implication of the way that the UK's social security system for working-age households is designed is that it does not deliver adequate living standards for low-income households. As discussed in Section 3, there are two underlying policy choices behind that. These are:

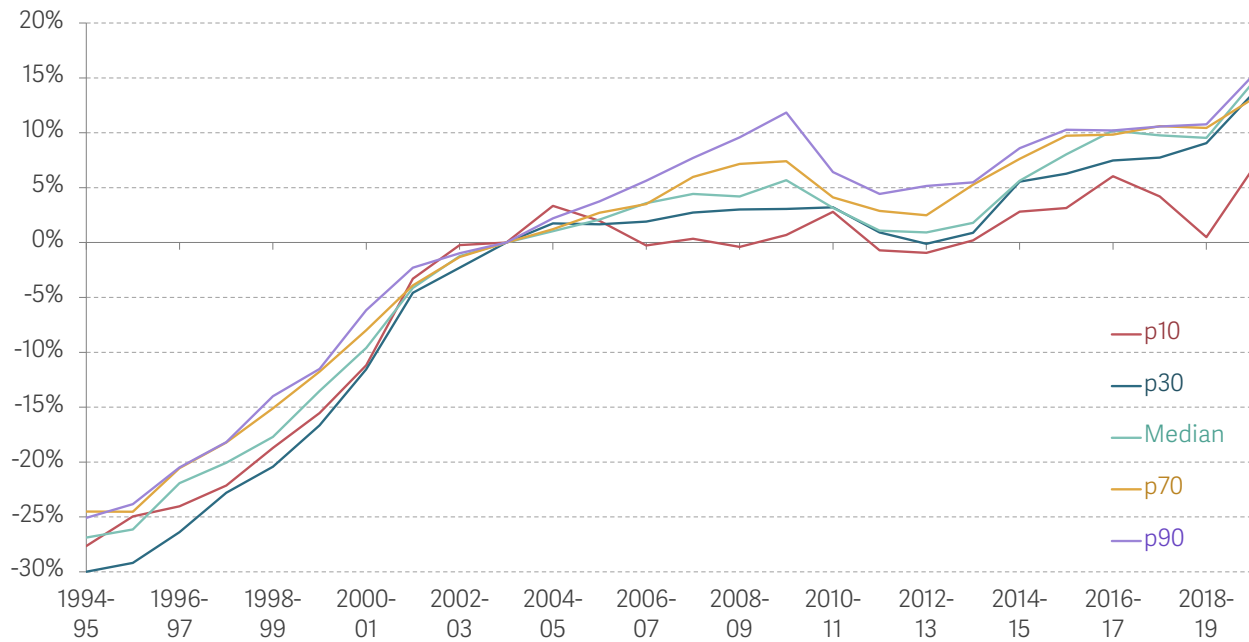
- a long-term decision to have flat rates of benefit that have been falling in value relative to earnings since the early 1980s; and,
- more recent decisions to cut back some of the support provided for those with additional needs without a full appreciation that such support is needed in part because of the very low level of basic support.

The most important, and telling, outcome is that the UK's record on living standards has been terrible since around 2003-04 (as shown in Figure 22), and, even worse for those towards the bottom, with income growth of just 7 per cent in the 16 years since then (measured after housing costs) for a household at the 10th percentile, compared to growth of 15 per cent for one in the middle of the income distribution. This failure is, of course, not solely due to the social security system, but, as Figure 3 shows, social security benefits make up a considerable proportion of the household income of those in the bottom fifth of the distribution. And the UK compares poorly to other rich countries – for example, working-age household incomes in the bottom quintile in the UK pre-crisis were, on average, 20 per cent lower than in France.⁶¹

⁶¹ M Gustafsson et al., *After Shocks: Financial resilience before and during the Covid-19 crisis*, Resolution Foundation, April 2021.

FIGURE 22: Income growth at the bottom of the distribution has been poor since the early 2000s

Cumulative real-terms change since 2003-04 at selected points of the non-pensioner household income distribution: GB/UK



NOTES: GB before 2002-03.

SOURCE: Analysis of DWP, Households Below Average Income.

As a result of this weak growth in incomes, measures of poverty that use a fixed real poverty line have seen barely any decline since 2001-02, with absolute poverty among working-age adults falling from 21 per cent to 17 per cent in 2019-20 (see Figure 23). This is an exceptionally poor performance: it should be taken for granted that a modern economy can provide increases in real-terms living standards in the medium-term. The experience since 2001-02 stands in marked contrast to that seen in the decade before, where the fraction of working-age adults below this fixed real line fell by just under 10 percentage points.

And it is clear that the level of income for households towards the bottom is not just failing to grow in line with the economy, but is also inadequate. Pre-crisis estimates were that over one million households were destitute,⁶² and that 5 million people lived in households experiencing food insecurity.⁶³ Just over 7 per cent of adults, and over 12 per cent of children live in food insecure households. Food bank use has increased by 135 per cent between 2016 and the midst of the Covid-19 crisis in 2020.⁶⁴

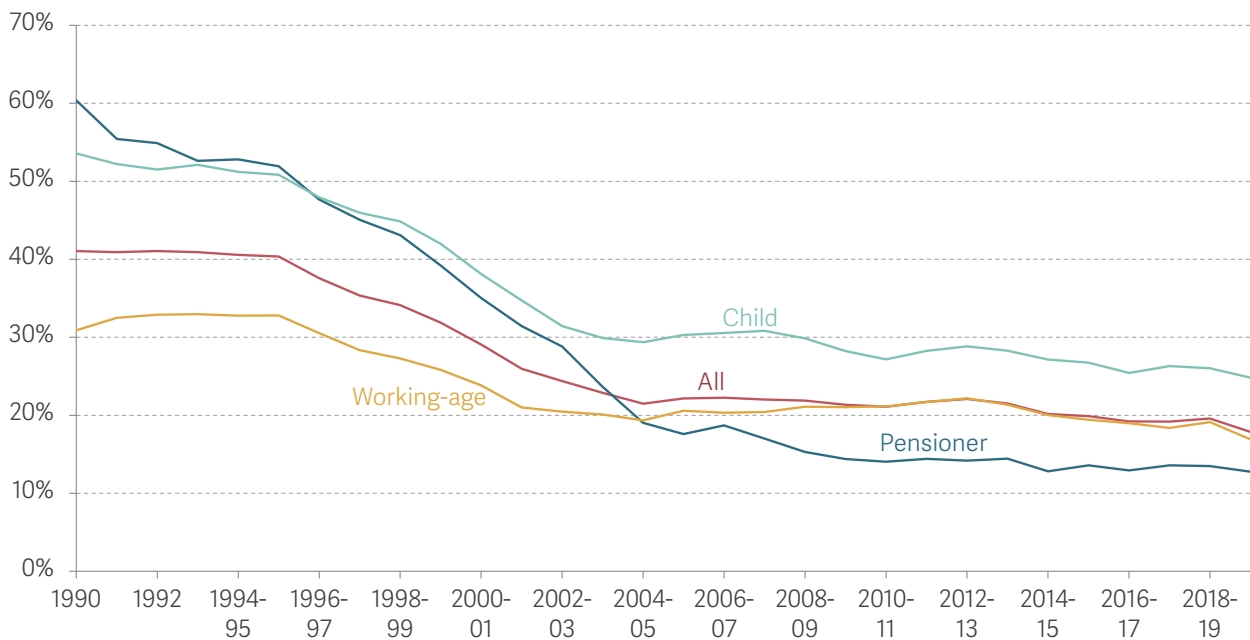
⁶² S Fitzpatrick et al., *Destitution in the UK 2020*, Joseph Rowntree Foundation, December 2020.

⁶³ DWP, *Households Below Average Income*.

⁶⁴ Analysis of The Trussell Trust, *Mid-Year Statistics*.

FIGURE 23: Declines in absolute poverty have slowed significantly since the early 2000s

Proportion of people with incomes below 60 per cent of the median income in 2010-11 after housing costs: UK



NOTES: GB before 2002-03.

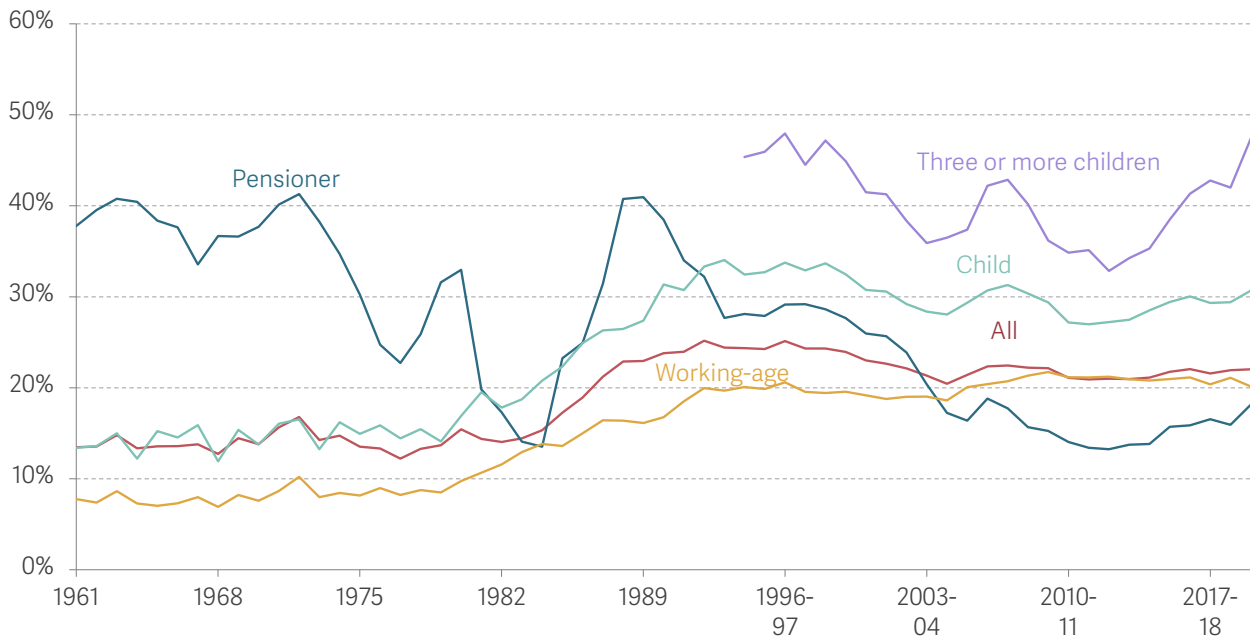
SOURCE: IFS, poverty and inequality.

Moreover, while absolute poverty measures increases in living standards over time against a fixed threshold, relative poverty – which compares living standards against contemporary median income – is a better measure of living standards. Here, the long-run impact of decisions on uprating are especially noticeable: among working-age adults, the relative poverty rate (using an after housing costs measure of income) has risen from 8 per cent in 1961 to 20 per cent in 2019-20 (the latest available consistent data). It is true that the rate of relative poverty among working-age adults has not risen appreciably since the early 1990s, but this is in contrast to the rate among pensioners, where the different policy approach we described in Section 3 and a rise in private pensions among new retirees has caused pensioner poverty to fall from 34 per cent in 1991 to a low of 13 in 2012-13. Pre-crisis data shows that, across comparable countries, the UK has high rates of relative poverty for both children and working-age adults.⁶⁵

⁶⁵ Relative poverty rates are higher in Spain, Italy and Greece, plus a number of central European or Baltic countries (depending on the measure). See: OECD (2022), Poverty rate (indicator). doi: 10.1787/0fe1315d-en (Accessed on 17 January 2022).

FIGURE 24: Relative poverty rates have remained relatively steady in recent years

Proportion of people with incomes below 60 per cent of median income after housing costs: UK



NOTES: GB before 2002-03.

SOURCE: IFS, poverty and inequality; DWP, Households Below Average Income.

With the UK social security system's focus on providing extra support for extra-costs – especially children- you would expect the UK's performance on child poverty to be better. In fact, it has risen by more than working-age poverty, from 13 per cent in 1961 to 31 per cent in 2019-20. Child poverty did fall during the late 1990s and 2000s, the period when child-related benefits became more generous (as shown in Figure 7), but relative poverty among children has risen by 4 percentage points since 2010. More concerning, this rise in poverty among children is driven entirely by families with three or more children: the risk of poverty in such families has risen from 33 per cent in 2012-13 to 47 per cent in 2019-20, a level last seen in the late 1990s.⁶⁶ This is almost certainly driven by specific policies targeted at large families: the benefit cap, which now affects 165,000 families (or 4 per cent of households on UC);⁶⁷ the two-child limit, which affected an estimated 350,000 families and 1.25 million children as of April 2021 and is set to affect 800,000 families and 3 million children when fully rolled out;⁶⁸ and, the various real-terms cuts to benefit levels implemented in the 2010s. A social security system that is focused heavily on providing support for extra costs is one where large cuts – as we have seen since 2010 – will have a big impact on those at whom the extra-costs benefits are aimed, in this case children.

⁶⁶ K Handscomb et al., *The Living Standards Audit 2021*, Resolution Foundation, July 2021.

⁶⁷ Analysis of DWP, Stat-Xplore.

⁶⁸ Taken from: Child Poverty Action Group, the Church of England and the Welfare Reform and Larger Families research project, *"It feels as though my third child doesn't matter": the impact of the two-child limit after four years*, Child Poverty Action Group, April 2021. For more in depth analysis of the rise in poverty among large families, see: K Stewart, A Reeves & R Patrick, *A time of need: Exploring the changing poverty risk facing larger families in the UK*, CASE, July 2021.

Relative poverty among children has risen by 3 percentage points since 2012-13, driven entirely by rising poverty among families with three or more children

The pandemic has just shown us that both of these flaws have real and serious consequences

The issues of weak and variable income insurance, and inadequate incomes for low-income households highlighted in this section are, of course, not just theoretical issues – they have had very real impacts during the pandemic.⁶⁹ While we all hope that the Covid-19 crisis was, of course, unique, the inadequate levels of insurance provided by the social security system were one reason why the Government introduced the furlough scheme and grants for the self-employed. The pandemic also exposed the UK's wholly inadequate approach to sick pay, although this remained unreformed; and highlighted the inadequacies in how the social security system treats the self-employed (which we discuss further in Box 4). Finally, the low levels of the basic rate of benefit were one reason behind the £20 a week uplift to UC and tax credits. We discuss these below.

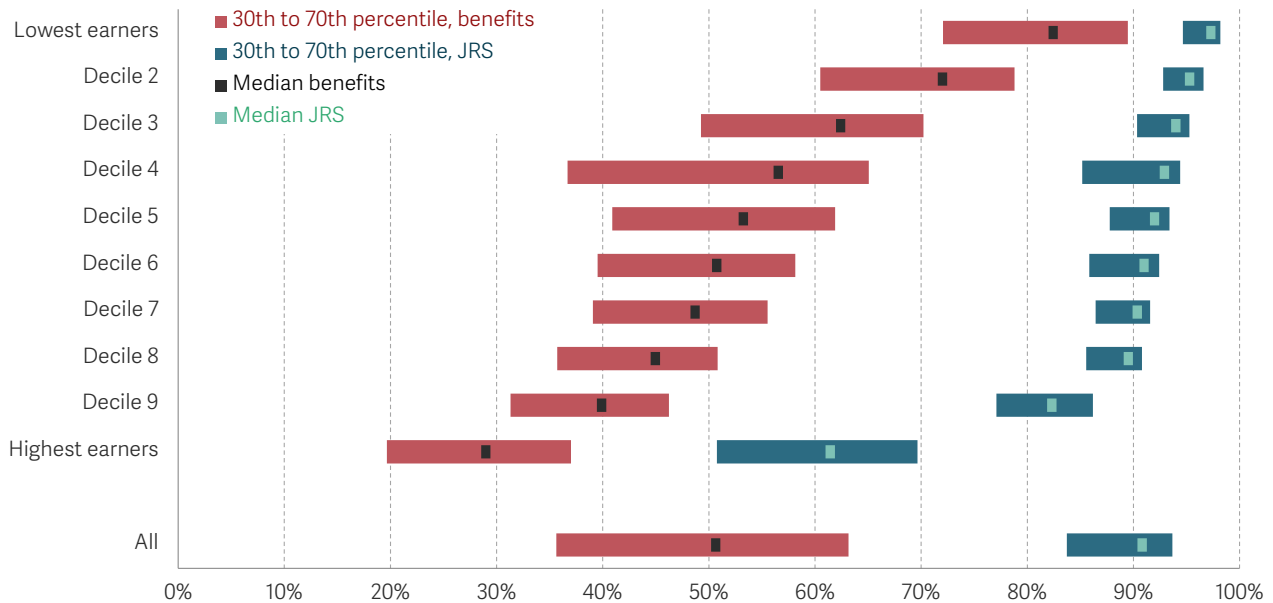
The JRS underlined that the income protection provided by the pre-pandemic system was clearly inadequate

A major part of the Government's economic policy response to the pandemic was the introduction of the Coronavirus Job Retention Scheme (JRS) and the Self-Employment Income Support Scheme (SEISS). What is common to those programmes is that they provide payments to workers that were directly related to their previous earnings. Designed in this way, they made a massive difference to the scale of income replacement provided by the social security system. For workers who could receive the JRS or SEISS, replacement rates stood at over 90 per cent, much higher than the 50 per cent replacement rate for those relying on the pre-crisis social security system (with the £20 a week uplift taking that to 53 per cent). As Figure 25 shows, the JRS and SEISS made a much greater difference to these replacement rates for higher-earning workers, reflecting that the pre-crisis social security system had flat-rate benefits and, for those who had not made sufficient NI contributions in the previous two years, was means-tested against their partner's earnings and family's savings.

⁶⁹ This subsection draws heavily on M Brewer, K Handscomb & K Shah., [In need of support? Lessons from the Covid-19 crisis for our social security system](#), Resolution Foundation, April 2021 and: M Brewer & M Gustafsson, [Time Out: Reforming Statutory Sick Pay to support the Covid-19 recovery phase](#), Resolution Foundation, December 2020.

FIGURE 25: The JRS and SEISS increased effective replacement rates for highest earners the most

Family income replacement rates when earner stops working, is furloughed or claims a self-employment grant, by earnings decile: UK, 2020-21



NOTES: Replacement rate shown for whole benefit unit income before housing costs, for adults aged 16-64 who stop working and then claim benefits as entitled. £20 per week boost to Universal Credit is not included. Full roll-out of UC and full take-up of benefits assumed.

SOURCE: Analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

The pandemic was an extreme event, but many instances of unemployment in normal times are just as random or unpredictable. And it has not been the case that every country heavily affected by Covid-19 had to respond in as dramatic a way as the UK did: some already had social security systems that could be adapted (such as Kurzarbeit in Germany), rather than implementing an entirely new system. Without the JRS and SEISS in the UK however, the GDP fall and unemployment rise during the pandemic would have been much more severe.⁷⁰

A key issue for policy makers going forward, then, is the extent to which the experience of the pandemic should change the way we think about providing earnings-replacement in the event of a significant economic downturn. Both in terms of providing greater income protection to individuals, but also as a counter to aggregate economic risks.

The pandemic also highlighted the important role of Statutory Sick Pay (SSP). SSP has played an important role during the pandemic as it allows people who are ill for a short time to stay home from work and recover, and helps prevent the spread of illnesses. But in 2020 it was clear that SSP gave workers little protection against loss in income while infected (or self-isolating). And, because sick pay affects individuals' ability to take time

⁷⁰ See: M Brewer & C McCurdy, [Post-furlough blues: What happened to furloughed workers after the end of the Job Retention Scheme?](#), Resolution Foundation, November 2021.

off work when they show symptoms or are told to self-isolate, it directly influences the rate of transmission of Covid-19.⁷¹

The core problems with SSP are that not every worker is eligible and, where they are, the rate of pay is very low. To be entitled to any SSP at all, workers have to be classified as an employee or agency worker and have to earn at least £120 per week to qualify. Strikingly, these eligibility rules mean that around 2 million low-paid employees, as well as all 5 million self-employed workers, are entitled to nothing.⁷² Those who are not eligible are typically working in low-paid jobs or working part-time (or both); this means that women, younger and older workers, and workers with atypical contracts are all more likely than the average worker to be ineligible.

The current rate is £96.35 per week,⁷³ and the flat rate of SSP means that its replacement rate falls rapidly in higher earnings deciles, so that it represents less than half of weekly earnings for all eligible workers outside the bottom earnings decile, and only a quarter of weekly earnings, on average. Although some employers offer top-ups, survey estimates (from 2014) are that a quarter (26 per cent) of those who got some sick pay rely on SSP alone when they are ill (a further 17 per cent reported that they did not know what they were entitled to).⁷⁴ Just like the levels of unemployment support in the UK, these rates of sick pay are extremely low compared to those in other countries, with OECD comparisons putting the UK at the bottom, save only for Korea and the US, which pre-Covid-19 had no mandatory sick pay.⁷⁵

In some ways, SSP typifies the worst aspects of the British system of benefits, with both a low level of payment and also a legacy eligibility-restriction from our old contributory system that means that low earners are entitled to nothing. The pandemic has shown clearly that adequate sick pay – in terms of coverage and generosity – should be seen as a collective benefit, and a crucial part of our public health policy.

⁷¹ Strikingly, during the first wave of Covid-19, the Office for National Statistics (ONS) found that care homes paying sick pay were significantly less likely to have seen Covid-19 cases among residents in the early weeks of the pandemic. See: ONS, [Impact of coronavirus in care homes in England: 26 May to 19 June 2020](#), July 2020. The level of support received has also been reported to affect compliance with Test and Trace (both in terms of coming forward for a test when symptomatic, as well as complying with self-isolation requirements). See: L E Smith et al., [Adherence to the test, trace, and isolate system in the UK: results from 37 nationally representative surveys](#), BMJ 2021; 372:n608

⁷² Resolution Foundation estimates based on pre-crisis data from ONS, Labour Force Survey. To be eligible, workers have to be classed as an employee or agency worker and earn an average of at least £120 per week (this is the Lower Earnings Limit (LEL) in the National Insurance system).

⁷³ <https://www.gov.uk/statutory-sick-pay>, accessed 12 January 2022.

⁷⁴ The original data came Health and Wellbeing at Work: A Survey of Employees, 2014, but the fact comes from M Brewer and M Gustafsson, [Time Out: Reforming Statutory Sick Pay to support the Covid-19 recovery phase](#), Resolution Foundation, December 2020.

⁷⁵ Figure 3 is OECD, [Paid sick leave to protect income, health and jobs through the COVID-19 crisis](#), July 2020.

BOX 4: The pandemic showed that we should not keep the self-employed out of the working-age social security system

As well as income-replacement for employees, the pandemic also highlighted the inadequacies in how the social security system treats the self-employed. The historical principle is that self-employed workers should be responsible for their own income protection in the event of sickness or unemployment, whether through formal or informal insurance schemes. But this principle has long ceased to have much practical relevance in our social security system. It is true that self-employed workers have for many years not been able to claim SSP (although they can claim Employment and Support Allowance (ESA) if their illness prevented them from working long-term and they had made past NI contributions), SMP, or unemployment benefits (by which we mean new-style contributory Jobseeker's Allowance, JSA). But self-employed workers have always been able to claim in-work support through tax credits, and can also claim all the non-contributory benefits that provide extra support for those with children or housing

costs.⁷⁶ So 'reduced social security entitlement' is no grounds for asking self-employed sole traders to pay lower NI contributions than employees. As the number of self-employed grows, this distinction becomes ever harder to justify. And, as there is a growth in people who are both employees and self-employed, these attempts to treat employees and self-employed differently become harder to operate in practice.

It was right to extend income-replacement schemes to the self-employed during the crisis. Policy makers now should consider how best to reform both policy and operational aspects of social security and taxation systems so as to distinguish as little as possible between different forms of employment (acknowledging that different operational rules could be warranted, given that self-employed workers do not have an employer who could verify information provided to DWP), including ending the preferential rates of NI paid by the self-employed.

Providing adequate income for low-income households

As we discussed in Section 2, the UK went into the pandemic with the core component of UC for a single adult at its lowest level since the early 1990s. This is undoubtedly why

⁷⁶ For further detail see: S Adam & H Miller, [Taxing work and investment across legal forms: pathways to well designed taxes](#), Institute for Fiscal Studies, January 2021.

the Government introduced a £20 a week uplift to UC and tax credits, and undid many of the post-2012 cuts to Local Housing Allowance.

Despite these extremely important changes, there is still overwhelming evidence that levels of deprivation or hardship, or instances of problem debt, worsened during the Covid-19 crisis. For example, a survey in January 2021 of families who newly-claimed UC in the crisis found that one-in-five were behind on essential bills, and three-in-ten were more in debt than they were in February 2020.⁷⁷ A government-run survey from November and December 2020 estimated that 9 per cent of private renters in England were in arrears, up from 3 per cent in the year before the crisis.⁷⁸ The Trussell Trust distributed 2.5 million emergency food parcels to people in crisis in 2020-21, a 33 per cent increase on the previous year.⁷⁹ This suggests that the multi-billion pound support packages were not able to offset the very uneven nature of the Covid-19 recession,⁸⁰ and did comparatively little for those not in work despite the extra costs that many families faced.⁸¹

Measures of hardship have eased as the economy opened up during 2021, but the long-run legacy is, unusually for economic downturns, an increase in wealth inequality. Although in aggregate, households increased savings and paid off debts in the pandemic. But there was a strong distributional skew to this, with low-income households more likely to see debts increase, and high-income households much more likely to benefit from enforced rise in savings driven by reduced opportunities to engage in social expenditures. Even more important is the boost to existing wealth holders that has come about through strong growth in house prices and in some other classes of assets.⁸²

This section has assessed the current UK social security system against two of its key tasks: protecting household income (and the economy as a whole) in the event of labour market shocks, and ensuring adequate living standards for all. In both areas, we see the consequence of the policy decisions to provide low, flat-rate basic level of benefits. First, this has meant that the amount of income insurance provided by the UK's social security system is very low for high earners who are not deemed to have additional needs. Second, the UK struggles to ensure adequate living standards at the bottom, even for those who qualify for the extra payments to help meet their higher costs. We have also

⁷⁷ M Brewer & K Handscomb, [The debts that divide us: Flash findings from a survey of families claiming Universal Credit](#), Resolution Foundation, February 2021.

⁷⁸ MHCLG, [English Housing Survey: Household Resilience Study, Wave 2 November-December 2020](#), MHCLG, November-December 2020.

⁷⁹ The Trussell Trust, [Trussell Trust briefing on mid-year statistics relating to use of food banks: April 2021-September 2021](#), Trussell Trust, November 2021.

⁸⁰ For a discussion of the distributional effect of the pandemic on the labour market, see: N Cominetti et al., [Long Covid in the labour market: The impact on the labour market of Covid-19 a year into the crisis, and how to secure a strong recovery](#), Resolution Foundation, February 2021.

⁸¹ See: M Brewer & R Patrick: [Pandemic Pressures: Why families on a low income are spending more during Covid-19](#), Resolution Foundation, January 2021.

⁸² J Leslie & K Shah, [\(Wealth\) gap year: The impact of the coronavirus crisis on UK household wealth](#), Resolution Foundation, July 2021.

seen the lessons from the pandemic. Changes to the social security system since the financial crisis have, if anything, reduced the extent to which it cushions the economy during a downturn, and this is one of the reasons why the Government had to introduce new schemes when the pandemic hit. The Covid-19 crisis also exposed the UK's wholly inadequate approach to sick pay, and the need to include the self-employed in the social security system. But the Covid-19 pandemic is, we hope, largely behind us. The pressing challenge is to ensure that our social security system is ready for the economic challenges of the decade ahead and we turn to that in the next section.

Section 5

How have past social security reforms been aligned to the economic strategy of their time?

Before we turn to thinking about the role that the social security system needs to play to help households adjust to some of the challenges of the 2020s, and how social security should fit within a wider economic model that addresses new realities, it is useful to have in mind previous experiences at aligning social and economic policy agendas. Over four broad eras of social security system policy – the original Beveridge settlement, Wilson era expansionism, the Thatcher counter-revolution and then the Blair agenda – it is possible to identify a degree of ‘strategic fit’, or coherence, between developments in social security and wider economic and public policy objectives. Understanding the past will help us consider how to ensure coherence between our approach to social security and the country’s economic strategy over the next decade.

To make sense of the trajectory of the UK welfare state over the past 70 years a broad lens is required. Key changes in social security in the post-Second World War era have themselves been shaped by shifts in the prevailing set of economic and social ideas and programmes that defined a given era.

Indeed, if we look across four broad eras of social security system policy over the last seventy years – the original Beveridge settlement, Wilson era expansionism, the Thatcher counter-revolution and then the Blair agenda – it is possible to identify at least a degree of ‘strategic fit’, or coherence, between developments in social security and wider economic and public policy objectives. Or, to put it another way, some of the major periods of social security upheaval and transformation over the past 70 years can be seen as resulting from a perceived lack of alignment between inherited welfare policies and

the demands of the wider economic and social agenda that the government of the day wished to pursue.

Some of these inter-dependencies are prosaic. Nearly all governments are keenly aware of the implications of social security policy for their fiscal objectives. But at different points, and in different ways, there has also been a clear line of sight between social security system reforms and a wider range of policy objectives spanning employment levels and active labour market policy, labour productivity, skills and human capital formation, industrial policy, labour mobility, entrepreneurship and wider macroeconomic stabilisation.

The claim here is not that all governments try, never mind succeed, to use the social security system as an instrument of economic policy. Connections between different areas of policy are always messy and imperfect. But it remains the case that various moments in our recent history social security and wider economic agendas have been viewed, to a degree at least, as being developed in tandem with, and as part of, a wider economic and social programme.

As we turn to thinking about the role that welfare policy needs to play to help households adjust to some of the challenges of the 2020s, and how social security should fit within a wider economic model that addresses new realities, it is useful to have in mind previous experiences at aligning social and economic policy agendas.

Beveridge's founding moment

The landmark Beveridge agenda of rationalising and universalising the complex patchwork of pre-war insurance schemes and converting them into a single, comprehensive national system defined much of the early post-war era. To this day, despite the fact that many of its central arguments have long been jettisoned, it is held up as the totemic example of far-sighted social ambition.

But from the start these social objectives relied on a wider shift in economic policy. The experience of the war-time economy, led Beveridge to become a fervent convert both to Keynesian thinking ('socialising demand') and to stringent economic planning more generally, in pursuit of the maintenance of high levels of employment. Without such maintenance, he argued, 'all else is futile', but with it 'all other problems become soluble'.⁸³

Full employment was seen as the fundamental pre-requisite for guaranteeing a 'national minimum' for all citizens – for Beveridge 'idleness' was the most fundamental of all the social evils that needed to be abolished, and this required full employment. But the relationship went the other way too. He also worried that significant unemployment

⁸³ J Harris, William Beveridge: A Biography, Oxford, Oxford University Press, 1977 (Revised 1997).

would create unsustainable financial pressure on his social insurance fund making his other social objectives unaffordable. Economic and social policy objectives had become inextricably linked in the eyes of the nation's policy establishment. Beveridge always expected the wartime government to ask him to follow up his landmark report (which he recognised could not answer the employment question) with a second, and in his view more fundamental, inquiry into maintaining full employment. It was to his great disappointment that this invitation never came.

However, the Government's commitment in its 1944 White Paper to achieving a 'high and stable level of employment' became a central plank of post-war economic policy. Proposals for realising this goal - including counter-cyclical public investment, varying employee and employer insurance contributions over the economic cycle and relaxing the stance taken on reaching a balanced budget in a given year (though not over a longer period) – may have fallen short of Beveridge's expectations but were seen as a major advance by many. Full employment was not seen as an add-on to Beveridgean social protection but rather the assumption on which it was founded. In the post-war decades, governments would be seen as responsible for the level of unemployment in the economy – which rarely surpassed 3 per cent. Rather than being viewed as an 'act of God or the market' unemployment would now be seen as a consequence of policy.⁸⁴

Wilson's pursuit of industrial dynamism

Harold Wilson came to office committed to achieving faster economic growth which, in his view, relied on the rapid expansion of rising industries and the reallocation of skilled labour towards them. This large-scale reallocation of labour would in turn require the existence of appropriate 'social infrastructure' that would help smooth the path to workers transitioning to new roles.

Seen through this lens, Beveridge's subsistence-level flat rate benefits appeared to be an impediment to workers, particularly skilled workers, embracing risk and indeed risked a counter-reaction to industrial change. The task, as Wilson saw it, was to 'ease the transition from job to job which must be made if the country is to achieve the redeployment of manpower which it so urgently needs' which meant creating the 'social conditions' which made this flux 'tolerable'.

The necessary social infrastructure included a shift towards earnings-related and time-limited unemployment benefit as well as earnings-related sick pay. This increase in benefit generosity came alongside a raft of other measures aimed in different ways at supporting labour to adjust: the Statutory Redundancy Pay Act (1966), the delivery of Industrial Training Boards, the pioneering of the polytechnic system, the post-Robbins

⁸⁴ H Glennerster, *British Social Policy Since 1945* (2000), Blackwell.

expansion of universities and the launch of the Open University. It was an era where social security, workforce development and wider industrial policy were considered, to a degree, in the round – though the same cannot be said of wider macroeconomic and exchange rate policy.

Thatcher's counter-revolution

Margaret Thatcher's first ministerial post had been as junior minister for national insurance. In some respects, she was an instinctive Beveridgean in that the reciprocity of paying in contributions to earn benefits appealed to her. Nevertheless, the goal of reducing public spending, together with sharpening incentives to work, led her to reduce the significance of national insurance in the social security system, reduce benefit generosity and increase means-testing.

Two broader goals drove social security reforms. The first and overwhelming priority was reducing public borrowing and public spending as a proportion of GDP. The value of the contributory state pension had very broadly risen with earnings, but from 1982 it was uprated by prices alone – the single biggest saving in public spending of her Government. Barbara Castle's State Earnings Related Pension Scheme was also cut back and private pension saving encouraged instead. The resulting increased dependence of pensioners on means-tested benefits led in time to anxieties about whether pension saving was being deterred.

The second broad objective was to create a more flexible labour market which was thought to be a necessary step in reducing unemployment (which peaked at almost 12 per cent in 1984) and laying the foundations for a more dynamic economy over the longer term. Indeed, in this respect (if few others) Thatcher and Wilson had something in common: they both thought that social security reform was needed to support a wider shift in employment towards growing sectors and occupations. They just had very different convictions about what this meant. For Mrs Thatcher this meant a reduction in the replacement rate of benefits for unemployed people relative to average wages. Wilson's earnings-related supplements for unemployment and sickness pay were abolished, benefits linked to prices, and unemployment benefit made taxable. These changes to social security took place alongside wider labour market reforms. Wages Councils were weakened then abolished in the early 1990s. Trade union reforms reduced the power of organised labour in a number of respects. Self-employment and entrepreneurship were promoted through, for example, the Enterprise Allowance Scheme, which paid higher benefits to unemployed people setting up a new business (which came alongside a surge into the labour market of many young adults born in the second peak of the baby boom in the early 1960s). During this era of extensive industrial

restructuring and labour market de-regulation job mobility between sectors reached very high levels (surpassing any other post-war decade). Wage differentials widened which was viewed as having the positive effect of signalling where labour should best be deployed. Overall, over the course of the 1980s, there were high levels of job market mobility and average income growth alongside fast-rising income inequality.

The wider economic context, in the form of the high levels of unemployment of the early 1980s, also shaped the nature of social security reforms. There was a decline in monitoring of job search activity, which cuts in staff numbers working in benefit offices made more acute. But as unemployment fell during the mid-1980s the Government introduced the Restart programme to enforce job search and basic job readiness training more effectively. Such stringent policies are much easier to operate when unemployment is at a more manageable level. The second surge in unemployment during the early 1990s recession undermined this initiative and left a vacuum which Labour's 'New Deals' would go on to fill.

There were tensions in this overall strategy. While reducing replacement rates was pursued ruthlessly for unemployed adults, the internal view in the Government was that there were limits to how low unemployment benefits for families with children could be cut. How then were incentives to work to be improved? Mrs Thatcher came to recognise that there should be a benefit top-up for people in low-earning working families – Family Credit was the result. Initially it had been planned to be delivered through the pay packet but after pressure from campaigners it was instead paid as a benefit to the parent with caring responsibilities which also helped address concerns of a 'Speenhamland effect' with employers cutting wages as they knew higher benefits would pick up the strain.

The big picture was that the Thatcher Government found itself significantly eroding the contributory principle and spreading means-tested benefits including to low-income working families. Above all, public spending reductions, which shaped all its social security reforms, hit childless working-age adults and pensioners particularly hard. Surprisingly, perhaps, some aspects of the Labour years were prefigured – top-ups for low paid workers with families and increased conditionality of benefits for the unemployed. But the approach to pensioner benefits has been subsequently reversed, whereas the pressures on single workless adults have further intensified.

Blair's agenda: high employment while tackling child poverty

The Blair administration aimed to use the power of government to promote employment, expand opportunity and tackle poverty and entrenched social exclusion. These goals were more a direct response to some of the problematic legacy of the 1980s and early 1990s – high rates of poverty and long-term unemployment for particular groups –

than they were a reflection of some wider economic shift in the external environment. Promoting employment for everyone able to work – which crystallised into an extremely ambitious employment target of 80 per cent – at the same time as setting a national mission to end child poverty became the dominant goals. Landmark reforms were implemented to advance these twin objectives that still shape our system today.

The goal of raising employment ran through much of welfare policy but also shaped reforms ranging from workplace regulation, to early-years support and place-based policy. The returns to work were increased through the introduction of the first ever National Minimum Wage. A major new system of tax credits was created which boosted the position of low- and middle-income working families as well as those out of work with children. The great majority of the work of lifting incomes was done via tax credits, rather than raising the real levels of out of work benefits, together with increases in the employment rate – which were particularly pronounced for some groups such as lone parents.

A whole suite of active labour market policies followed. The ‘New Deals’ targeted groups like the young, long-term unemployed and lone parents (and offered training, personal support and job subsidies for employers) and these were overlaid with a number of programmes aimed at deprived communities, some of which had a particular focus on boosting employment. Obligations on the workless to search for work were increased – for instance, lone parents were required to seek work when their children reached the age of five rather than sixteen.

There were also some attempts to facilitate employment for particular groups by removing barriers to work. The introduction of the right to request flexible working, improvements to parental leave, and the creation of a nationwide childcare support system all sought to improve employment prospects for parents, particularly mothers.

By the end of the Labour era the UK had developed a model characterised by relatively high employment rates – though the 80 per cent target was never realised – and a tax and benefit system that offered significant support for families with children and those with high housing costs alongside limited income replacement for other groups, like single adults, who fell out of work. A suite of major supply-side reforms – large-scale tax and benefit changes, childcare, employment advice and support – was married to the UK’s relatively lightly-regulated labour market. There was less change when it came to the regulation of employment (the first ever national minimum wage being the biggest exception). Wage councils were never replaced and trade union reforms were relatively modest. Levels of child and pensioner poverty fell sharply; but poverty levels for working-age adults rose slightly.⁸⁵ Overall income inequality was broadly flat while the gap

⁸⁵ Lupton et al, Labour’s Social Policy Record: Policy, Spending and Outcomes 1997-2010, Centre for Analysis of Social Exclusion, London School of Economics, June 2013.

between the bottom and middle fell. Households in the UK experienced comparatively high levels of income volatility.⁸⁶

In some ways this era marked a further and final departure from the original Beveridge settlement – both in terms of it placing a means-tested programme at the epicentre of the working-age welfare state, and its further erosion of contributory principle for some remaining benefits. But it also moved beyond Beveridge in its focus on the problem of working poverty (an issue that Beveridge didn't foresee) and the creation of a minimum wage (which he steered clear of). Despite all that change, the elevation of high levels of employment – both a vital economic goal itself and a key enabler of wider social ambitions – is something that the great war time reformer himself would have instantly recognised.

⁸⁶ OECD, A Broken Social Elevator? How to Promote Social Mobility, June 2018.

Section 6

How well prepared are we for the decade ahead?

Having considered the fit between social security and economic strategy at various points in our past, we conclude by considering how well our current social security system is suited for the challenges of 2020s. The primary challenge here is that the pace of economic change is likely to increase in the decade ahead, as the UK adjusts to a post-Covid economy, responds to the opportunities and constraints of being outside the EU and decarbonises the economy. That may involve elevated levels of job change – something that our labour market hasn't experienced for decades – which could widen the risk of unemployment, highlighting the low levels of income protection provided by the UK's social security system. Moreover, the increased structural change and job turnover that we expect might place pressure on the work-first approach that underpins both social security and welfare and skills policy more generally.

There are other risks that the social security system of the next decade must also be able to cope with. At the aggregate level, in an era when the role of monetary policy is limited by low interest rates, our social security system may need to play a more active role in stabilising the economy against aggregate fluctuations. And there are dangers in keeping basic benefits at such low levels: such a policy has put all the burden on extra-cost benefits that have in turn been cut back. This contributes to the high poverty and inequality that all political parties are now seeking to address, and leaves some groups with very little support from the social security system. Without addressing these risks, it is unlikely the social security system will play its full part in helping the UK to successfully navigate the challenges of the 2020s.

The Economy 2030 inquiry, to which this report contributes, is motivated by the fact that the UK is facing a decade of unprecedented economic change, as we adjust to a post-

Covid economy, respond to the opportunities and constraints of being outside the EU, and decarbonise the economy.⁸⁷ And the social security system has a key role to play in the years ahead: it is part of the policy toolkit for helping individuals and the economy as a whole deal with a period of enhanced labour market change, but it also needs to address the legacy problems of slow growth in living standards and high inequality.

Sections 2 and 3 established that a defining feature of the UK's social security system is that it has low basic benefit levels, topped up by relatively generous extra cost benefits (although these were reduced in the 2010s), and Section 4 showed the consequences of this: a lack of earnings insurance in the event of unemployment for many workers, and a very poor outcome on living standards for the poorest, with high rates of relative poverty, and very little growth in incomes for the poorest working-age households over the past 15 or so years (with rising rates of poverty among large families also showing that our system of helping those with additional needs is fraying). In Section 5, we identified four broad eras of social security system policy in which it is possible to identify a degree of 'strategic fit', or coherence, between developments in social security and wider economic and public policy objectives. To inform thinking on how social security can play a part in a renewed economic strategy for the decade ahead, this section considers how the challenges with our existing social security system interact with the new context the UK faces in the 2020s. To that end, we highlight key three risks to be considered, addressed or ameliorated.

The UK economy is likely to see a greater degree of structural change

One of the major weaknesses of our social security system is the highly variable degree of income insurance in the event of unemployment. Proponents of the system would say that this has contributed to low levels of unemployment in recent decades, and has delivered high levels of job availability (in that the labour market is flexible enough to offer employment opportunities across regions, sectors, and jobs), and relatively high job security (as shown by lengthening job duration). But contrary to the widely-held story that the UK has a dynamic labour market, the truth is that the pace of economic change was low in the two decades before the pandemic. Over the past decade, structural change in the labour market, as measured by the proportion of employment reallocated across 21 industry sectors, was about one-third as high as in the 1980s peak.⁸⁸ At the individual level, job mobility in 2019 was 25 per cent lower than in 2000, and moves between sectors were 35 per cent lower. Future work will assess how much structural change and job churn we might expect over the 2020s, but it is almost certain to be

⁸⁷ T Bell et al., *The UK's decisive decade: The launch report of The Economy 2030 Inquiry*, Resolution Foundation, May 2021.

⁸⁸ N Cominetti et al., *Changing jobs? Change in the UK labour market and the role of worker mobility*, Resolution Foundation, January 2022.

higher than we have become used to in recent years. In such an economy, we can expect more workers to experience labour market disruption. Moreover, the experience of the pandemic highlights the possibility that the impact of this may not be felt evenly across workers. This will throw into relief the very low levels of income protection that the UK's social security system provides to some workers. And, as we discuss in Box 5, our social security system may also come under pressure if future structural changes lead to greater pressures on workers from earnings instability.

BOX 5: Many workers, particularly the young, are affected by earnings and employment instability

Pay volatility is widespread in the UK. Past research shows that, on average, employees experience two months of falling pay (by more than 5 per cent) in a given year, and that, at an annual level, between 23 per cent and 28 per cent of employees (depending on the data source) experience changes in real pay from one year to the next that are greater (in absolute terms) than 20 per cent.⁸⁹ Although studies have suggested that large earnings shocks have become less likely over the past two decades, and overall levels of earnings volatility look like they have fallen slightly (job duration has also lengthened, and job mobility

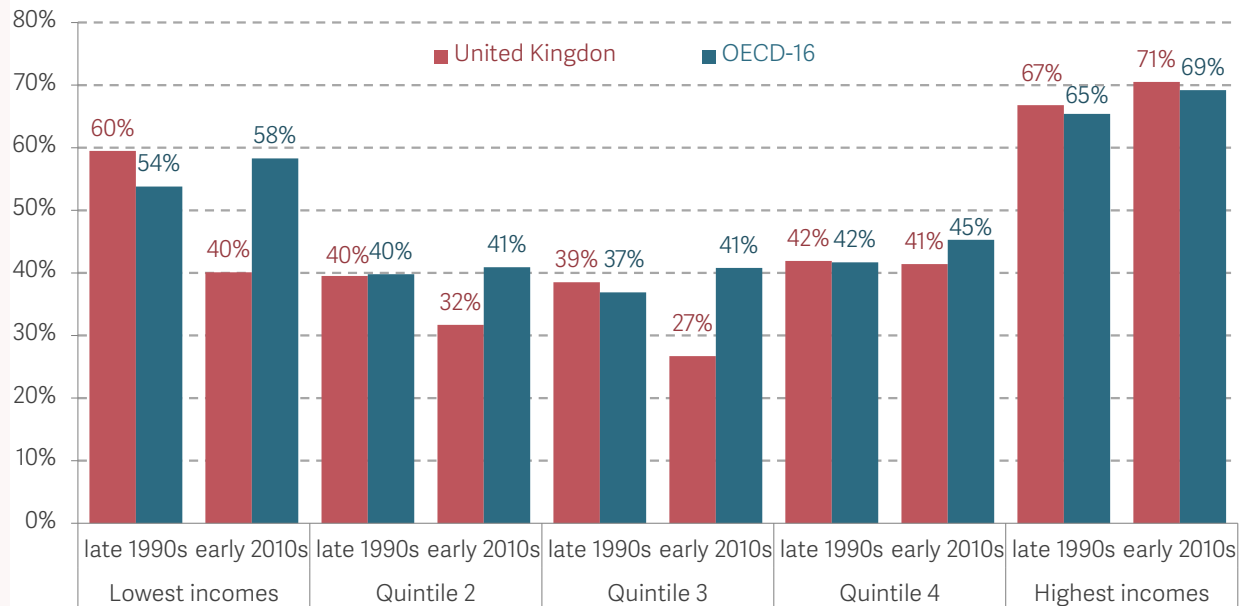
declined), there has been a growth since the financial crisis in the sort of employment – ZHCs, temporary or agency work and some forms of self-employment – that features high levels of insecurity, and this is especially notable among younger workers.⁹⁰ Furthermore, international comparisons – albeit limited, and difficult to do – suggest that the UK experiences more medium-run (i.e. over four years) income variability than comparable OECD countries: see Figure 26, which reports the fraction of people who stay in the same quintile over a four-year period.

⁸⁹ D Tomlinson, *Irregular Payments: Assessing the breadth and depth of month to month earnings volatility*, Resolution Foundation, October 2018.

⁹⁰ L Gardiner & P Gregg, *A steady job? The UK's record on labour market security and stability since the millennium*, Resolution Foundation, July 2015.

FIGURE 26: The proportion of people staying in the same income quintile has fallen in the UK, unlike other OECD countries

Share of individuals staying in the same income quintile over four years: UK and OECD-16, late 1990s and early 2010s



NOTES: Data refers to the working age population (18-65-year-olds). Data for the late 1990s refers to 1997-2000 for all countries except Korea (1998-2001). Data for the late 2010s refers to 2011-14 for all countries except Germany, the United Kingdom, Korea and Ireland (2010-2013). For the US, as data is collected on a biannual basis, the results for four-year averages are based on the averages between 3-year and 5-year panels.

SOURCE: OECD, Secretariat calculations.

We looked at the ability of the tax and benefit system to address these sorts of earnings fluctuations in Box 3:. It showed that the UK's tax and benefit system is quite well placed to deal with earnings fluctuations than it is to losing jobs altogether, thanks to the amount of income-related in-work support. Given this, and given that much of the root cause of the volatility for many

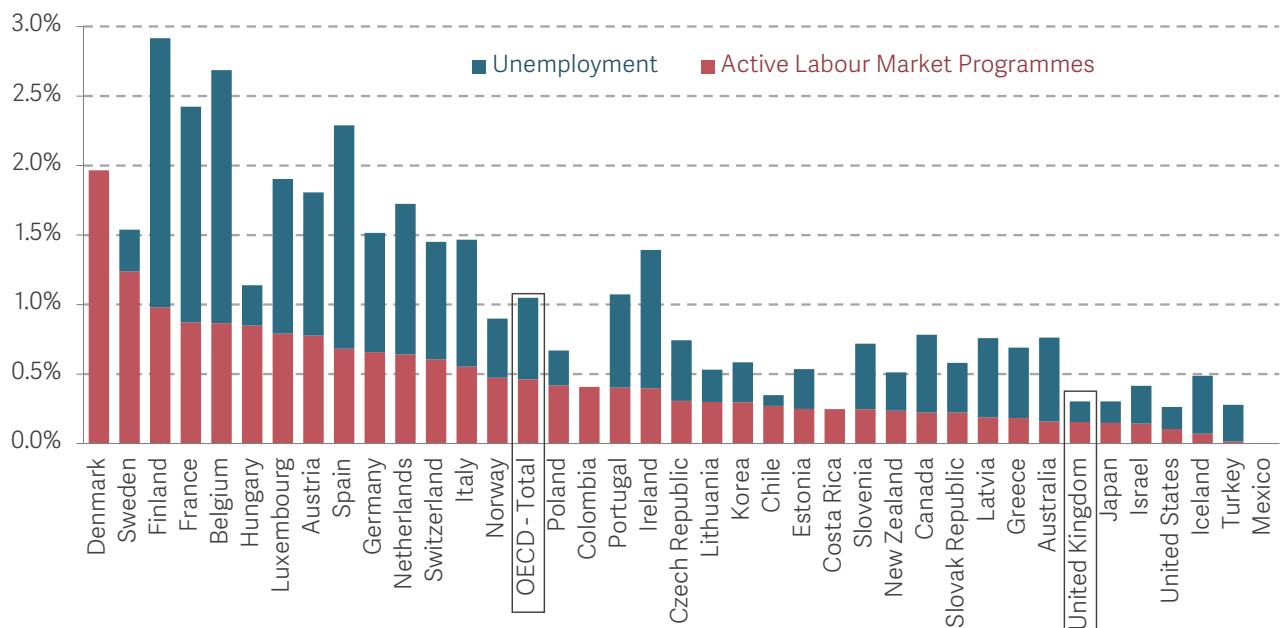
workers is likely to stem from variability in hours of work offered, solutions to this problem may come from changes to employment regulation and labour standards rather than the social security system. But it provides another example of where social security and labour market policy need to work together rather than in isolation.

Increased structural change will also put pressure on the 'work first' approach that underpins both social security, and welfare and skills policy more generally. This approach takes the form of conditions that apply to jobseekers in order to encourage them to accept job offers as soon as possible, and that assistance with training and reskilling gets relatively little weight. As shown in Figure 27, the UK spends much less on active labour

market programmes for the unemployed than our competitors: the UK spends 0.2 per cent of GDP on such programmes, whereas the OECD average is 0.5 per cent of GDP, and almost all comparable European economies spend more than that. As we discussed in Section 5, this ‘work first’ approach has also arguably underpinned social security policy since at least the early 1980s, and is part of the reason why unemployment benefits are unrelated to past earnings, and uprated only with price inflation.

FIGURE 27: The UK spends less than average on active labour market programmes

Spending on active labour market programmes and unemployment benefits as a proportion of GDP, OECD countries: 2017



NOTES: Unemployment benefits are cash benefits.

SOURCE: OECD, Social Expenditure – aggregated data.

But, as we move into a period with more extensive changes in the structure of our economy, systems that encourage the unemployed to take the first vacancy they find – or perhaps that push workers into self-employment – risk, as we discuss in Box 6, reducing the quality of matching between workers and jobs – something that is an important determinant of labour productivity and so our potential to generate lasting growth and prosperity. A related consequence of the low levels of benefits and the pressure to find any job quickly, regardless of how well it pays or how good the match is, is that it can reduce the labour market mobility of young people if one way they insure against labour market risk is by living with their parents for longer.⁹¹ The solution to these issues will involve looking both at the low level of insurance in the social security system, but also on how social security interacts with other elements of our welfare state and wider policy

⁹¹ See: M Gustafsson, *Boom(erang) Time? An analysis of younger adults living with their parents*, Resolution Foundation, June 2021.

framework to shape whether workers are able to make good job matches in a changing labour market.

BOX 6: Labour market matching and benefit generosity

A traditional view of social security design has been that higher rates of unemployment benefit reduce the financial incentive to finding a job and so lead to longer periods of individual unemployment, and so higher unemployment overall.⁹² Against this moral hazard problem has to be set the core policy objective of unemployment benefits to minimise income disruption for those who become unemployed. That is not to say that the generosity of benefits is all that matters: flows into work tend to fall during and immediately after recessions,⁹³ and there is clear evidence that work search conditions set through jobcentres also have an effect.⁹⁴

But research has also examined whether the generosity of unemployment benefits might affect the type of jobs that are taken up, and, more importantly, the quality of the match between job and worker. The potential links are two-fold. First,

higher unemployment benefits might mean that the unemployed can pursue a longer job-searching strategy: that is, declining low-wage job offers and waiting for higher-wage opportunities that better match their skills. Second, higher unemployment benefits reduce the financial risks of moving from one job to a riskier one when an employer may fail, or an employee may not pass a probationary period (we saw in Figure 15 the magnitude of the income risk).⁹⁵ On the other hand, there are risks in searching for work for too long, as long spells out of work can depreciate skills and worsen individuals' mental health.

Recent work has considered the relationship between the quality of job transitions (as measured by whether the task requirements increased or reduced, interpreting an increase as a move to a more demanding and potentially higher-paid job) and whether the transition involved any intermediate spell of unemployment

⁹² See: OECD, *Employment Outlook 1991, Chapter 7: Unemployment Benefit Rules and Labour Market Policy*, and: D Card & C Levine, *Extended benefits and the duration of UI spells: evidence from the New Jersey extended benefit program*, *Journal of Public Economics* 78 (2000) 107–138. A more recent discussion is in: OECD, *The design of unemployment benefits schedules over the unemployment spell: The case of Belgium*, January 2020.

⁹³ M Elsby et al., *The Role of Worker Flows in the Dynamics and Distribution of UK Unemployment*, *Oxford Review of Economic Policy*, 2011, 27 (2), 338–363.

⁹⁴ For example, see: Department for Work and Pensions, *Jobseeker's Allowance Signing Trials*, January 2015. More generally, the DWP and Jobcentre Plus have a long history of implementing and evaluating changes to work search conditions or support.

⁹⁵ This is a similar concern to that raised by Andrew Haldane who surmised/concluded that a reduction in worker power and structurally-higher job insecurity may be dissuading workers to move jobs. For example, see: <https://www.bankofengland.co.uk/speech/2018/andy-haldane-advisory-conciliation-and-arbitration-service-future-of-work-conference>, October 2018, accessed on 10 February 2022.

or inactivity.⁹⁶ On average, workers who do not experience any long spell out of-employment tend to have better transitions than workers who go through spells of inactivity and particularly unemployment. But it is interesting to focus on workers who left their previous job involuntarily: those who remain ‘continuously’ employed thereafter seem to experience stronger ‘occupational downgrading’ than workers who go through unemployment or inactivity. One potential explanation is that laid-off workers face a trade-off whereby avoiding unemployment (with

its associated negative income shock) comes at the cost of moving (at least temporarily) into any available job even if this implies drastic changes in the type of tasks the worker will have to perform.

Although the wider academic evidence on these points is not clear cut, it would be amiss not to consider the possibility that more generous unemployment benefits, and a longer job-searching period, may actually lead to a better worker-employer match that means a higher wage longer-term.⁹⁷

With monetary policy constrained, fiscal policy needs to do more to stabilise the economy, and it is clear that the social security system alone does not do enough

Fiscal policy is likely to be the main tool for supporting the economy during future downturns. As discussed in our previous work, this is because the secular decline in interest rates means that the scope for the Bank of England to use monetary policy to cushion the economy in the face of a significant downturn is likely to be limited, and so, to avoid unnecessary hardship, fiscal policy will need to be more active.⁹⁸ In principle, the social security system (as part of the overall automatic stabilisers which include operation of the tax system) could do the heavy lifting in providing such a cushion. But, in practice, as shown in Section 4, evidence suggests that the extent of stabilisation provided by the UK social security system is relatively weak and has actually weakened in recent years. This suggests that it may not be appropriate to rely solely on the current system to provide macroeconomic stabilisation.

This is no doubt one of the reasons why the UK – like many other countries – did not rely on its pre-existing social security system alone when the Covid-19 crisis hit. The furlough scheme provided much more generous income replacement – meaning that those losing earnings as a result of an unforeseen pandemic did not see their living standards

⁹⁶ See: Figure 31 in N Cominetti et al., [Changing jobs? Change in the UK labour market and the role of worker mobility](#), Resolution Foundation, January 2022.

⁹⁷ A Nekoei & A Weber, [Does Extending Unemployment Benefits Improve Job Quality?](#), American Economic Review, vol. 107, No. 2, February 2017.

⁹⁸ J Smith et al., [Recession ready?: Assessing the UK's macroeconomic framework](#), Resolution Foundation, September 2019.

collapse. There is a clear argument for providing such individual social insurance during a pandemic. But there is also a macroeconomic case: the furlough scheme was successful in minimising the aggregate fall in income, keeping workers attached to their jobs, and, ultimately, reducing the extent of the rise in unemployment markedly in the face of a huge fall in the size of the economy.

The next severe downturn is unlikely to be quite as bad as this one, but effective stabilisation will be required, and it very likely that fiscal policy will need to carry most of the burden in supporting the economy. A key question for policy makers is whether the experience of the pandemic – and particularly the effectiveness of more generous income support during a recession – should change our approach to stabilising the economy during others sorts of recessions. This is an issue that we will return to in future work.

Keeping core levels of benefits only just above destitution levels will not work as a strategy to boost living standards for low-income households

There is broad agreement that poverty and inequality levels in the UK are too high. But it is also increasingly clear that our current approach to the working-age social security system is not going to deliver an answer to that. As we discussed in Sections 2 and 3, the long-held cross-party consensus to keep core benefit entitlement for adults at low levels means that much of the work in supporting incomes is done by the extra cost benefits. But there are two major drawbacks to this approach. The first is that, as we discussed in Section 4, the ability of extra costs benefits to provide targeted additional support to those with additional needs has been undermined by specific policy reforms in the 2010s. These cuts leave low-income households exposed to growing housing costs, and they mean that poverty in families with three or more children has gone back up to rates seen in the 1990s.

Even if these recent cuts could be reversed, though, decades of only price-uprating most benefit entitlements has led to a situation where some groups reliant on social security benefits are left on extremely low incomes. As a proportion of average earnings, the value of Universal Credit for a single adult will fall below 14 per cent of average earnings by 2024-25, half its value in the early 1970s. In cash terms, UC (and our remaining contributory unemployment benefit, Jobseekers Allowance) provide an income to a single adult of only £5 a week above what is estimated to be needed to avoid destitution (after paying housing costs); for someone under 25, they do not even meet that basic

requirement (the rate is currently £59 a week).⁹⁹ For several reasons, this cannot be sustainable: if unemployment rates rise as the change coming in the next decade takes hold it will surely not be credible to provide such low levels of protection to a large swath of the working-age population; it raises concerns over intergenerational fairness, given the very different approach that it taken to those over the state pension age; and it is condemning too many to unacceptably low incomes. If tackling the UK's legacy of high inequality and poverty is remotely part of new economic strategy for 2020s, then policy makers will need to reconsider this approach.

⁹⁹ In addition, up to 25 per cent of the UC standard allowance can be deducted to recover various types of debt or benefit advances from a claimant. As of December 2020, over a third of UC claims had a deduction applied. See: House of Lords, [UIN HL 54](#), tabled on 11 May 2021.

Annex 1: Tax and benefit microsimulation modelling

We have used the IPPR tax-benefit model (based on the latest Family Resources Survey data from 2019-20) as part of our analysis of income replacement rate, pass-through rates and macroeconomic stabilisation properties of the social security system.

Income insurance modelling assumptions

Complete take-up and full UC roll-out were assumed for all the modelled scenarios. Simulations for 2022-23 were conducted using the 2022-23 tax and benefits system, which includes the changes to the taper rate and work allowances. Simulations for 2011-12 were conducted using the 2011-12 tax and benefits system.

Macroeconomic stability modelling assumptions

Simulations for 2022-23 were modelled as above, including for reversed austerity.

For 2022-23 'boosted benefits', the 2022-23 tax and benefits system was used, but basic elements of UC (standard allowances) and JSA (personal allowances) were boosted to raise the value of unemployment benefits as a share of average earnings back to their value in 1983-84 (an increase of 74 per cent). For 2022-23 'reversed austerity', the 2022-23 tax and benefits system was used, but the benefit cap, two-child limit, first child rate and bedroom tax were removed. In addition, the ESA work-related activity group, Child Benefit, contributory JSA, UC, and UC limited capability for work addition were increased to levels equivalent to uprating by CPI from 2010-11.

For the 2008 scenario, employment was reduced across the income distribution by the percentage change in employment for people aged 16 and over from the Labour Force Survey between March-May 2008 and July-September 2011 (4.34 per cent). Earnings were reduced by the percentage change in Average Weekly Earnings between January-March 2009 and July-September 2011 (4.28 per cent). For the 1980s scenario, employment was reduced across the income distribution by the percentage change in employment for people aged 16 and over from the Labour Force Survey between October-December 1979 and April-June 1983 (8.57 per cent).

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