Citizen's Income *newsletter*

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Editorial

A number of previously unpublished pieces have recently come to light. In this issue we publish Christopher Downs's paper on pensions, written four years ago but as relevant now as then, and perhaps more so, as the current debate on pensions takes a new turn now that companies close final salary pension schemes.

Also in this issue is the usual mixture of news and reviews; and a 'Contribution to debate' by Anthony Sperryn on 'citizenship', a subject which we shall pursue at greater length in our next issue.

This is the first of our web-based newsletters, accessible from the website as well as via an email link. For anyone who still needs a hard copy there is one available on request.

Main article

Pay As You Go funding for pensions: panacea or pariah?

By Christopher J Downs, Open University

"If Crusoe were alone, he would obviously die at the beginning of his retirement." (Paul Samuelson, 1958, p.468).

Daniel Defoe's Robinson Crusoe is of course the world's most famous ship-wreck victim. The reason for this dire prognosis for his old age is that Samuelson assumed it was not possible to preserve consumption goods, to save them for future consumption - consumption goods cannot be transported through time because they are perishable. This assumption is still generally valid. Samuelson's 1958 paper provoked a concurring reply from his fellow economist Abba Lerner, in which Lerner stated:

"...the fable of the time-travel of consumption is accepted with implicit faith by the accountants, as guardians of the private point of view of savers who are putting money aside for their old age. It is the duty of economists, as guardians of the social point of view, to explode this fairy tale." (Abba Lerner, 1959, p.517).

The task of this paper is to explode the myth that somehow the 'burden' of an ageing population is heavier if the attempt is made to support it by a pay-as-you-go pension scheme, and that this ageing will inevitably render such PAYG schemes unsustainable and condemn any such attempt to failure.

Why is it important to dispel this myth? Well, let us be clear at the outset. A citizen's pension (CP) - a flat rate pension payable to all citizens unconditionally - would, *de facto*, be financed on a PAYG basis. In the present climate, that is almost certain to be seen as an obstacle to its adoption.

In its green paper *Partnership in Pensions*, the UK government has stressed that "Those who can save for retirement have a responsibility to do so" (DSS, 1998, chapter 9). There is no mention in the document of the responsibility on which a citizen's pension would be based; that is the responsibility of those who can afford it to bear an appropriate share of the tax burden required to finance a decent level of pension income for all pensioners. The green paper explicitly states that it is an objective of the government to reduce the proportion of the pensioner population's income that is provided via the state, and increase the proportion provided through the private sector. The basic state pension is to continue to be indexed only to prices rather than average earnings. SERPS is to be replaced by a flat rate State Second Pension and still more people will be encouraged to opt out of this and take up a private pre-funded pension instead. A new pension product is to be introduced to achieve this - the Stakeholder Pension.

Additionally, and quite inexplicably, the green paper offers the claim that "state pensions cannot be supplemented with voluntary provision" as a justification for reducing the role of state pensions. In fact, people in the UK have been using private pensions to supplement their state pension entitlement for decades. The bias against PAYG would appear to be clear and the government seems to subscribe to the same fable as Lerner believed accountants did.

If a citizen's pension is to be taken seriously as a policy option, PAYG must be rehabilitated. The present paper seeks to address the myth of the burden of PAYG pensions but also seeks to widen the debate. For once it is accepted that the 'burden' of an elderly population of given size is the same, whether that population's income is provided on a PAYG or pre-funded basis, then there are other issues which may lead us to prefer one financing method over the other. Thus, the argument that PAYG financing is not the pariah it is sometimes made to seem is developed along three dimensions:

- Economic considerations
- Risk-handling capabilities
- Equity.

In section A Samuelson's Robinson Crusoe example is adapted to dispel the instinctive mistrust of the PAYG concept. It is pointed out that the current method of raising the funds for the UK's state PAYG pension system is inefficient but that this should not be taken as an argument for scrapping the PAYG scheme. There are superior potential alternative taxes which should be used to finance state pensions. Additionally, the widely held view that PAYG pensions depress the level of private savings in the economy with detrimental effects on economic performance is based on a rather one-sided view of the economic arguments. There are persuasive counter-arguments and there is no strong empirical evidence to support claims that PAYG is damaging to the health of an economy.

In section B it is argued that PAYG has the advantage over private pre-funded pensions in dealing with certain risks, including inflation risk and risks such as unemployment. Fear of the frequently cited threat to PAYG schemes, political risk, is discussed and shown to be based on a self-fulfilling circular argument.

Section C considers two equity issues. First, it is taken as fact that some redistribution towards the less well off in retirement is desired. In this case a PAYG system is not only desirable but essential. Secondly, it is argued that the issue of what is termed inter-generational equity, which has been presented as a threat to PAYG systems, is of little practical relevance.

The economics of PAYG

Much popular debate about pensions appears to start from the position that pay-as-you-go financing of pensions is at best unsustainable and at worst fraudulent. An ageing population will render PAYG schemes insolvent (whatever that might mean) and to reinforce the point, attention is focused on alleged damaging macroeconomic effects. In the UK, as elsewhere, state PAYG pension payments constitute a part of public expenditure, and since the 1970s concern about the macroeconomic impact of public spending has turned into virtual hostility. The tide may be turning, with the election of a Labour government in 1997, but concern about public expenditure, and especially welfare spending, remains strong, as evidenced by the Chancellor's initial commitment to the previous administration's spending plans. In any event, for those waverers who might like the idea of a state pension, there is always the fear of spiralling taxes and the consequent cost to themselves. The overall result is that in TV documentaries we observe doleful members of the public opining along the lines of: "well, I'd like to rely on the state, but I just don't feel I can any more." (For example, see the *Panorama* documentary 'From the Cradle to the Grave,' 1998.)

More sophisticated debate bemoans the level of payroll taxes that will be required to finance PAYG pensions for a future larger retired population, and the effect of the private saving displaced by a PAYG scheme. The concern though is the same: the impact on inflation, unemployment and growth, the three key data items on which most popular judgements about the performance of the macroeconomy are based.

Before discussing the more sophisticated arguments, let us revisit a much earlier debate so that the popular 'bar-room' argument against PAYG can be put aside.

This instinctive scepticism about PAYG schemes is not new and nor is it a peculiarly British phenomenon. Abba Lerner, a prominent American economist, writing in 1959, noted that there was a "belief that a social security program cannot operate honestly unless it has acquired a fund actuarially corresponding to the savings of all those members who have paid in their contributions in the past and who will be taking them out as benefits in the future." He went on to say emphatically:

> "...the fact is that such a fund is completely unnecessary. It is called for only because accountants look on the social security program as old age insurance provided by an enterprise that must accumulate assets to match its contingent liabilities. Such accounting practices are completely justified for a private insurance company, which must be prepared for the eventuality of failing to enrol any new customers and still having to pay the covenanted benefits to its old customers. But from the social point of view, *the pensions of the old can only come out of the current output of consumption goods*. The pensions may therefore be paid out of current contributions, and the only fund necessary is a reserve to cover expected temporary excesses of outlays in pensions over collections in

> contributions."[1] (Lerner, 1959, p.516, emphasis added.)

Hence, Lerner's memorable point about the role of economists, quoted at the head of this paper. And nothing has changed. The time-travel of consumption remains a fable, despite technological developments, such as irradiation, allowing the longer storage of foodstuffs. Economists remain concerned with the stewardship of society's productive resources and the distribution of its output. So the OECD was able to publish a report in 1992 in which it was restated that:

> "Only reducing the consumption of the aged... reduces their cost to society. The means of financing, advance funding or pay-as-you-go, does not change these costs" (Duskin, 1992).

Since time-travel of consumption goods is impossible, if Crusoe is not to starve in his retirement, he must find someone else (either younger or willing to retire later in life) to produce the things he needs to stay alive. The assumption then is that some deal must be struck. Crusoe must offer the younger islander something in return for his sustenance in retirement. What can Crusoe offer? He can only offer some of his own output while working. His younger compatriot will thus enjoy a more extravagant lifestyle during the earlier part of his life but will then have to support Crusoe and simultaneously seek urgently to find, and strike a similar deal with, a third younger individual. If the need to strike such deals could be avoided, by somehow binding in the unborn generation to a PAYG system, then Crusoe and his successors would all be better off, since none would have to pay the succeeding generation in advance of receiving support in old age. This is the essential insight of Samuelson's 1958 paper and is what John Hills of the London School of Economics has likened to passing boxes of chocolates along a line of people (Hills, 1992).

If everyone in the line passes their box of chocolates to the person on the left, then the person on the extreme left ends up with two boxes and the person on the right ends up with none - *unless* every person born joins the end of the line at the right with their box of chocolates. In the Crusoe case, it would be Crusoe who ended with two boxes of chocolates. Hills suggested that in the UK it was the generation who had to fight the second world war who benefited in this way from the establishment of the UK's 1948 welfare state, and so it could be argued that they were deserving of this good fortune. Once the 'game' is in progress, then no one loses out unless someone refuses to join the line and hand over their box of chocolates. As long as the 'social compact', to use Samuelson's phrase, is adhered to, all is well. In fact all is better than well, because Samuelson showed that all are better off than they would be in the non-cooperative situation wherein we rely on market transactions - having to make deals.

[1] This is, of course, exactly how the UK's national insurance scheme operates.

Hills was seeking to characterise a welfare system in its entirety and was not exclusively concerned with pensions. In fact, the analogy would be a more accurate representation of a PAYG pension scheme if we imagined that the individuals in the line pass on not the whole box of chocolates to the person on their immediate left, but rather that they pass a percentage of the chocolates their boxes contain to individuals placed beyond a certain point along the line to the left. This is a point that becomes important in the later argument in section B.

The discussion of Crusoe hints that our analysis so far is based on a rather simple economy. It has been presented, not to justify PAYG pensions in all circumstances, but to illustrate that there is nothing *inherently* wrong with financing pensions on a PAYG basis - to try to overcome the *instinctive* objection that some people seem to have to PAYG. If we have succeeded in this, then we can now proceed to consider the more subtle arguments.

Samuelson's seminal overlapping generations model allowed for no investment goods. There was no capital equipment! As soon as this assumption is relaxed, it becomes possible to see that another alternative is open to Crusoe. Upon retirement, he could have offered his successor worker his capital equipment, his fishing rods etc, in return for payment in terms of consumables during his retirement. However, Crusoe would have had to forego consumption during his working life in order to devote time and effort to the production of those capital goods. This is no different to foregoing consumption in order to pay his younger comrade in fish etc, as in the earlier case. An important difference emerges, though, if the capital equipment Crusoe produced enhances his and his successor's productivity, as would be expected. This is where much serious debate about PAYG scheme focuses: does PAYG funding 'crowd out' productive investment? For if Crusoe could establish a 'chocolate box line', *à la* Hills, then he need not make the investment in capital goods that will become his meal ticket in retirement. We take up this issue below.

In the primitive island economy inhabited by Crusoe, there was no consideration needed either of the effect of the taxes required to effect a transfer of spending power between two groups. The island was a barter economy. Taxes alter the pattern of relative prices in an economy. For instance, and most pertinently, income taxes raise the price of labour to employers and reduce the price of leisure (not working) for workers. Income taxes may therefore be expected to reduce the amount of work done[2].

It is worth pausing for a moment to clarify our terminology here. Earlier, in the quote from Duskin (1992), there was a reference to the cost of the aged to society. Duskin is talking

[2] It is well established in economics that this result is uncertain. Since taxes reduce people's income, there will be an offsetting incentive for individuals to work *more* in order to try to maintain their pre-tax level of income. The overall impact cannot be predicted from theory.

about the cost in terms of the size of the total sum expended in pensions paid to the aged. Although that is a cost to the working population, since there is an opportunity cost associated with handing over their money (they cannot spend it on other things), it is *not* a cost in the usual accounting sense of using up some resources in order to produce some desired output. In this case, the desired output is the accomplishment of a transfer of spending power from one group to another. The cost of such 'output' comprises the labour and other resources required to achieve this. Moreover, it is not hard to see why a PAYG state scheme might compare rather favourably with pre-funded private pensions in terms of this cost. There are economies of scale in administering pension schemes, and there are no costs involved in persuading citizens to sign up to become beneficiaries of a state scheme[3]. Private schemes are smaller and incur large marketing costs. (It is acknowledged that in any such comparison, the costs borne by employers in complying with the requirements of a state scheme should not be overlooked.)

The costs with which we are now concerned are different again. These are what economists would more formally call 'deadweight losses'. Such losses constitute desirable output that would have been produced in the absence of the transfer of resources (in this case from workers to the retired) but which is not now produced and for which no other output is produced to compensate. Productive investment is not undertaken because of crowding out, and labour is not applied to produce useful output because of taxes on labour; and nothing else is done with those resources that now lie idle.

These deadweight losses are what Arthur Okun had in mind when he talked of a 'leaky bucket' being used to carry resources from the better off to the less well-off. The theoretical possibility of such leaks is well established but their empirical reality and magnitude are not. Yet the question we need to answer is: how large a loss due to the leaky bucket should be tolerated before the attempt at redistribution should be abandoned? There is a cost-benefit analysis to be carried out here, which this paper does not attempt. However, further comment can be offered.

Certainly the attempt should not be abandoned or limited unless every precaution has been taken to ensure that the leak is minimised. If the case for a citizen's pension *as a benefit* is accepted, then the optimal means of financing should be sought. The current means of financing the UK's PAYG state pension payments, through 'contributions' from employers and employees which amount to a tax on employment and a tax on income from work, cannot be argued to be optimal in this sense. James Meade, Nobel Laureate in economics, has described it as the "height of folly" (Meade, 1995, p.52). In the twenty-first century, it may well be felt that an appropriate way of financing a citizen's pension would be, at least in part, through 'eco-taxes', e.g. taxes on CO_2 emissions, and this is a proposal now receiving some attention in academic circles. Whereas the contributory principle is not only used to exclude some people from benefit, but also constitutes a tax on work, taxing pollution creates a disincentive to something that most people believe should be discouraged anyway.

When a relatively simple solution such as this appears to be possible, it is perhaps not necessary to measure the 'leak' arising from the current folly all that accurately. We should, as a matter of urgency, move towards a better tax base. There is no such simple solution to the problem of crowding out and so it is important to assess as accurately as possible the extent of this phenomenon. Unfortunately that is not easy to do. There are a number of reasons why it is difficult to establish unambiguous theoretical predictions of the effect of PAYG pensions on saving and investment.

One of the justifications that has long been offered for state pension provision is myopia. Individuals are short-sighted and, left to their own devices, will make too little provision for their retirement. If that is true then it cannot be argued that the state scheme is crowding out private saving. The fact that many politicians and others involved in the policy debate over pensions in the UK and elsewhere advocate, or have introduced, compulsory purchase of private pension products for their workers suggests that there is a widespread acceptance of the notion of myopia.

It might still be argued that the economy would benefit from greater investment and so some policy to increase saving is warranted. However, this really has nothing to do with PAYG pensions; the policy need not take the form of additional pension-specific saving; and, in any event, in a world of mobile capital there would appear to be little reason to suppose that investment is constrained by low domestic saving. Too little investment is likely to reflect lack of demand for investment funds, rather than shortage of supply.

A further complication arises from the acknowledgement that ending state pension provision without retaining some vestige of state assistance for the poor elderly is not a plausible option. The UK government remains committed to state involvement in pension provision. Whilst some means-tested assistance is made available, some people will inevitably face the prospect that additional private saving will simply disqualify them from receipt of state assistance. Thus a savings trap will induce some to save less, a concern which recurs in *Pensions in Partnership.* Unfortunately, while the government has emphasised the problem, it has only been able to claim that the problem will be reduced and voluntary savings penalised less as a result of its planned pensions reforms (DSS, 1998, chapter 9). Furthermore, any proposal involving the payment of compulsory pension contributions by the state on behalf of individuals unable to pay for themselves would similarly

[3] The government has made much of this point in its green paper and claims that the distribution/recruitment costs of its proposed Stakeholder Pensions will be contained by keeping the product and its regulation simple, and by having employers promote the schemes and recruit individuals to them.

create poverty traps - if such individuals were able to find an opportunity to increase their income legitimately, they might not find it worth while to take up the opportunity because they would disqualify themselves from state assistance with their pension contributions. This was a basic flaw in Frank Field's proposals as set out in Field (1995) and would appear to afflict the green paper proposals also [4].

So there is no convincing theoretical argument that crowding out will be significant and the issue becomes an empirical one. Empirical studies attempting to test the hypothesis that state PAYG pensions have a deleterious effect on economic performance are frustrated by the fact that it is difficult to isolate their impact from the effect of other state transfers (to the unemployed, for example). Therefore, many studies instead address the issue of the effect of state welfare *in the aggregate* on economic performance, measured at a high level of aggregation, e.g., growth of GDP per head. Atkinson (1995) assessed nine studies all broadly concerned with this issue, though differing in detail, and found that in two of these no significant impact was detected, in four a negative effect was reported, and in three studies evidence was found of a positive influence of welfare spending on economic performance. A further recent study adopted a fairly simple econometric method to investigate the same question and found evidence of a weak negative link between state pension spending and growth of GDP per capita for the 1970s and 1980s, but not for the 1960s (Caritte & Williamson, 1995).

Atkinson criticised the empirical research he reviewed on the ground that it takes insufficient account of the "fine structure" of the welfare system. Many state benefits have complex rules governing their disbursement, and these rules influence the incentives and disincentives created by the benefits. For example, the operation of means-tested support for the elderly just mentioned might or might not take into account housing wealth. Econometric analyses that do not allow for such complication can only ever pronounce on whether welfare should be curtailed or scrapped. They cannot provide us with any help in designing reform of welfare systems.

Thus we can draw two conclusions so far.

- The current means of financing state transfers in the UK, and particularly state pensions is not optimal in the sense of minimising the 'leaks from the bucket', the deadweight losses.
- There is in fact rather little theoretical or empirical justification for such strong statements as have been made by some authors, such as Poortvliet & Laine (1994) who allege that social security programmes *are contributing* to sluggish economic growth and decreasing productivity; and there is no compelling reason to suppose that a switch from PAYG financing to advance funding would yield additional benefits that cannot be attained by adopting a more sensible tax base for the purpose of financing state PAYG pensions.

It is worth pursuing the economics of ageing and pensions a little further. Much attention tends to be focused on the so-called dependency ratio effect of ageing whereby "total output per worker has to be shared with a larger number of pensioners, leading to lower PAYG benefits [per pensioner]" (Meijdam & Verbon, 1997). Yet there is also a second and off-setting effect whereby, when the population is ageing, less saving is necessary to maintain the capital-labour ratio, and so the share of consumption in GDP can actually be increased; and some of this additional consumption can be allocated to the retired population through *higher* pension benefits per pensioner. Partly for this reason Cutler *et al* concluded in 1990 that the optimal policy response to population ageing in the US was "almost certainly a reduction rather than an increase in the national saving rate." While this may not hold for other countries, or even for the US at a different time in different circumstances, the finding is a clear demonstration that economic analysis does not lend unequivocal support to the popular idea that ageing requires more saving.

Meanwhile, population ageing itself may be expected to have economic consequences, independently of any feedback via the pension system. Cutler *et al* make another interesting observation: "any effects of demography on technical change are likely to dwarf its other consequences" (Cutler *et al,* 1990, p.55). Although Robert Solow (1957) found that technical progress was far more significant a contributor to economic growth than mere capital accumulation (the raising of the capital labour ratio, making labour more productive), much economic analysis continues to treat technology as a 'black box'. The consequences for the rate of technological progress of an ageing workforce are thus open to much speculation, even though many economists would agree with Cutler *et al* that the consequences will be highly important. It is important to keep the debate over pensions funding in perspective.

Risk

Atkinson's arguments about the 'fine structure' of welfare systems centre on their effect on incentives. Incentives are partly determined by the effect of risks faced by individuals. It is to the issue of risk that we now turn, since the way in which pensions are financed has an important impact on their characteristics as a means of dealing with risk.

There is an important risk immediately apparent in connection with pensions. The duration of retirement may be longer than anticipated and so individuals may find themselves with inadequate consumption possibilities in

[4] The proposals are quite complex on this. It seems that for a period workers earning below £9,000 per year are to be credited as if they earned £9,000 for the purposes of entitlement to SERPS, or the new State Second Pension (if the name is to be changed straight away). In the long term the State Second Pension is to provide flat-rate rather than earnings-related benefits so the amount of earnings will be of less relevance.

retirement - they may run out of money because they live longer than they expected.

Another class of risks affecting individuals' retirement provision comprises those impediments to accumulating sufficient pension rights such as, *inter alia*, periods of unemployment, illness, or caring, which interrupt work and reduce lifetime earnings. This prevents the individual accumulating the amount of pension entitlement they would have wanted prior to their retirement, and can affect both private pension arrangements and state pensions (if these are contributions-based).

There is much discussion of whether private insurance can successfully deal with these risks. Annuities insure against living 'too long' (longevity risk)[5] and permanent health insurance is available to cover the risk of loss of income due to incapacity. However, private provision for unemployment risk is not well-developed and is arguably problematical. Caring responsibilities which remove people from the labour force altogether present a very different challenge. A useful overview is provided by the Association of British Insurers (1995). Burchardt and Hills (1997) focus on three case studies (which include the risk of loss of income due to unemployment and illness, but not pensions themselves) and demonstrate that for these, social security appears to offer a better solution than private insurance.

The purpose of pensions is to allow people to carry forward consumption possibilities, even though the time travel of physical consumption goods is, by and large, impossible. Their purpose is to solve Crusoe's problem as described at the beginning of this paper. In the Samuelson-Lerner exchange, both were concerned to ensure that people are able to satisfy their preferences for consumption at different points in time. Samuelson (1958) points out that a form of social compact is needed to achieve this and that the use of money is just such a social compact. All agree to accept money in payment for goods. This means that another risk becomes of considerable importance - inflation.

In 1998 the view of the National Pensioners Convention was that "Any pension scheme worthy of the name should provide pensions of broadly predictable value" (NPC, 1998, p.12), and there is no reason to believe that its view has changed since then. What matters of course is the *real* value of the pension, and inflation makes the future real value of a pension uncertain. Only if the level of real returns on investments is independent of the rate of inflation can inflation be ignored. Whilst some assets are better hedges against inflation than others, there are times when people saving for retirement will wish to hold a substantial portion of their pension savings in cash, e.g. as they approach retirement. They are then vulnerable to inflation. Once retired, exposure to this risk is arguably even greater. Few private pension schemes offer full inflation-proofing of the annuity in payment once an individual has retired. Workers in the UK who retired in the early 1970s soon saw the purchasing power of their private pensions eroded by the inflation that followed in the rest of that decade.

In relation to this risk, a PAYG pension scheme has a clear advantage over money as a social compact. PAYG pensions can be indexed in line with inflation (or any other chosen measure, such as average earnings) and as long as the tax system is such that revenue in cash terms rises in line with inflation, this presents no economic difficulty[6]. Thus PAYG pensions can be viewed as a means of dealing with a flaw inherent in money - its inability to perform reliably its function as a store of value.

In this connection Samuelson noted that "Even after extreme inflations, social security programmes can re-create themselves anew astride the community's indestructible real tax base." (Samuelson, 1958, p.482) Whilst the notion of an indestructible tax base is meaningful - the tax base is in a sense the total formally marketed output produced by an economy - we should acknowledge that this tax base must be treated with consideration. The reader is reminded of the earlier argument about incentives and the fact that taxes can lead to reduced output. The difficulties encountered a few years ago by the Russian government in collecting sufficient taxes to cover its expenditure is also a salient example, but serves really to reinforce the point made earlier that the current system of financing state pensions in the UK by a payroll tax is folly indeed.

What this amounts to is that PAYG allows society to choose how it wishes to allocate real consumption among workers and pensioners, without the flawed mediator of money to generate interference. Thinking about it in this way casts a new light on the risk to which PAYG schemes are often alleged to be uniquely vulnerable. This is political risk - the risk that the state will not honour its pension promises. Now it is clear that what critics of PAYG must be saying is either that the government is corrupt, or that a coalition of non-retired voters is liable to vote down pension expenditures and divert the money either into projects of more direct benefit to themselves or into tax cuts. It is not the case that the state will be prevented from honouring pension promises by insuperable economic constraints.

This concern about political risk was what Samuelson was talking about when he noted that socially optimal behaviour may not be self-enforcing: "if all but one obey, the one may gain selfish advantage by disobeying - which is where the sheriff comes in: *we* politically invoke force on *ourselves*, attempting to make an unstable equilibrium a stable one"

[5] It is worth noting in the context of the earlier discussion of savings that annuities may be expected to act to *reduce* the amount of saving people would wish to undertake for retirement purposes, because the risk of running out of savings is transferred to an insurer. The insurer, with a group of insureds of whom some will die earlier than expected and some will live longer, need not keep in reserve as much money as the individuals would have needed in aggregate in the absence of insurance.

[6] In fact, tax systems often generate what is known as 'fiscal drag' whereby revenue actually rises *faster* than the rate of inflation. This is because the tax base is defined in nominal terms, eg the UK income tax schedule defines allowances and income bands in nominal (cash) terms, and is adjusted only annually.

(Samuelson, 1958, p480, emphasis in original). The risk is that this political attempt to provide just pensions through the mechanism of the state may fail.

But why should the political system be unable to maintain order and deal effectively with the 'free rider' problem? Are people so short-sighted and hedonistic that they genuinely do not wish to continue the 'chocolate box line' in order that they benefit in their retirement, but would rather have more chocolates - the whole box - now, in the short run? It is not clear that the evidence supports this. People are well aware, in any event, that they will need to make *some* provision for their retirement - they cannot sensibly immediately eat the extra chocolates that they have refused to pass to current pensioners.

A more likely explanation is as follows. The political risk is that voters will be frightened into thinking that political risk threatens their own pension and so rationally seek to opt out first, before *their* state pension withers away to nothing while they have borne the cost of more generous pensions paid to earlier retirees. The existence of the free rider problem creates a form of 'prisoner's dilemma'. The classic prisoner's dilemma consists of two agents with two options. If the agents cooperate, this provides a superior outcome to non-cooperation. But there is an incentive for both agents to renege on an agreement. In this context the agents will be generations (or cohorts) and the options will be to vote for a PAYG state pension scheme or to vote against it. We must also introduce the concept of time, so that voting is repeated. Consider generations A, the elder generation, and B, the younger. If both vote for, then this produces the best outcome for both (as demonstrated by Samuelson). But if the younger generation expects the generation following it, generation C, to vote against, then B must vote against[7]. It is a well known result in game theory that if it is expected that the other player will welch on an agreement in the future, then it is rational to cheat first - to get your retaliation in early. The other player will realise this, and so ultimately no agreement is possible. So, in fact, if generation A suspects that C will vote against and knows that B suspects the same thing, then it becomes rational for A to vote against. One of the arguments against PAYG pensions turns out to be circular. Perceived political risk makes PAYG pensions undesirable and so threatens their future; but political risk arises *because* the PAYG system is under threat. The problem is that the superior cooperative solution lacks credibility and this lack of credibility creates the incentive to cheat (to vote against PAYG state pensions).

The reason for this lack of credibility would seem to be the argument that PAYG pensions are unsustainable in the face of future population ageing. Yet the economics of PAYG pensions does not support this proposition. Unfortunately, bad or, at best, selective economic arguments can be just as powerful as sound economics, and if it is more easily popularised then more so. Other contributors to the pensions debate take economic 'realities' as the basis for their own argument. For example, David Shapiro's otherwise impressive paper, providing a political philosophical analysis of social insurance based pensions, accepts the possibility of crowding out as empirical fact (Shapiro, 1997). No wonder PAYG is regarded as a pariah.

It would be the nightmare of any well educated economist that fallacious or doubtful economic argument should be used as the justification for abandoning a desirable social compact (PAYG) in favour of reliance on a flawed one (money for pre-funding). Yet this appears to be the danger. It is high time that economists paid heed to Abba Lerner and exploded some fairy tales again. In the meantime, let us proceed to the third strand of this paper's argument.

Equity

The demise of overtly 'Keynesian' economic policy and the rise of the New Right, with its calls for greater self-reliance and less state welfare, more competition and less state intervention, has led to an increased emphasis on the individual and a scepticism toward any actions by the state which would alter the market-determined distribution of resources. Lawrence Mead has argued that the debate about today's social problems is not a debate about social justice. Conditions in society are more in dispute than society's values. According to Mead, the debate is moral - why do some people commit crime and not work unquestioningly within the current social order? (Mead 1997, p.226). In this author's view, this will have to be changed if a citizen's pension is to become a serious contender. However, it is not an objective of this paper to contribute directly to changing this situation. Rather, it is an assumption in what follows that, if there were a debate about social justice, then there would emerge a consensus in favour of rather more substantial redistribution than is allowed for under a minimalist system of means-tested welfare.

The justification for making this assumption is that Crusoe's predicament makes it abundantly clear that in fact we are all inter-dependent, and that there may be situations where collective action is better than relying on transactions made as individuals in the market. The public view characterised by the Panorama interviewee mentioned above would appear to reflect this tension. Some acknowledgement of our interdependence and our individual vulnerability in the face of the market seems to lead people to wish to see some notion of social justice assured; or, at least, there is a genuine sense of loss at the passing of the aspirations of the Beveridge welfare state. On the other hand, economic reality, as presented in the media and popular debate, appears to preclude the possibility of anything more than minimalist poverty alleviation.

[7] In reality the electorate may not be faced with this choice at the polls in a general election, as all major parties may present broadly similar policies on pensions. The point remains valid however, as the political parties will have devised those policies on the strength of opinion poll evidence. People's responses in opinion polls can be analysed in exactly the same way.

Evidence from the annual British Social Attitudes Survey would tend to support the idea that despite the lack of public debate there is some latent support for redistribution. Brook *et al* (1996) conclude from their analysis of responses in the thirteenth survey that:

> "There is no evidence either that richer people are less in sympathy than poorer ones with increases in public spending [on health, education and 'universal welfare benefits'] even if they are asked to pay a higher share of the tax burden to finance them. Indeed, supposedly against their interests, they appear to be more inclined to favour increases in expenditure when financed through progressive rather than regressive tax instruments."

Arguments for more substantial redistribution have a long history. John Rawls' 'maximin' principle will be one of the most familiar. In this context, Rawls requires people to imagine themselves to be in the 'original position', before any economic activity takes place and not knowing whether they will subsequently be successful in the market economy and acquire sufficient resources to ensure a comfortable retirement. Private insurance policies could be purchased to cover the risks that might prevent the individual from achieving this, but in reality insurance is not purchased in the original position. It is purchased only once the 'veil of ignorance' has been at least partially lifted and people have begun to operate in the markets and have discovered something about their life chances. This is why insurance companies charge different rates to different buyers - they are able to identify different risks and charge more to insure those in high risk occupations against illness or injury, for example. Insurance is not a substitute for state intervention in line with the maximin principle, which states that things should be ordered to maximise the welfare of the least well off. Insurance companies are in the business of *minimising* redistribution by increasing the accuracy of their pricing, subject to the constraint of the cost involved in doing so. Only the state can systematically redistribute resources in line with society's wishes.

The contention of this paper is that, if society's view of social justice requires some redistribution beyond minimalist poverty alleviation, then a universal benefit, such as CP in the case of redistribution in favour of the elderly poor, financed on a PAYG basis, is the best way to achieve that redistribution.

The tax system is no longer to be used explicitly to redistribute from rich to poor, in part at least, because of the effects of such attempts on incentives. In the limit, as suggested earlier, the abuse of the tax base may actually reduce tax revenues. This argument is famously associated with Arthur Laffer and his eponymous curve[8], reportedly introduced to government by being sketched on a paper napkin for a White House Chief of Staff in 1974. (Davidson & Davidson, 1996, p.84.)

[8] The Laffer curve plots tax revenue against the tax rate applied to a given tax base (generally personal incomes) and illustrates a situation in which revenue rises with the tax rate at first, but at some point peaks and begins to fall. Tax revenue is zero at a zero tax rate and also zero when the tax rate is 100%.

However, taxes have not contributed much to income redistribution in the UK anyway. The benefits system has long been far more significant, as shown by the Office for National Statistics' analysis of 'The Effects of Taxes and Benefits on Household Income' (Harris, 1977 and Stuttard, 1998). This analysis makes use of the Gini coefficient, a measure of inequality using a scale of 0 to 100. A higher value of the coefficient indicates a greater degree of inequality, and by examining the Gini coefficient for different measures of income the impact of taxes and benefits can be isolated. Thus the Gini coefficient for what is termed original income (household income before any benefits or taxes) was 43 in 1977 and 54 in 1993/4, indicating increasing inequality. Gross income is calculated by adding to original income all cash benefits received. The Gini coefficient for this measure of income was 29 in 1977 and 37 in 1993/4. The fact that these values are so significantly lower shows that the distribution of household income after the payment of cash benefits was considerably less unequal than prior to those payments. Deducting direct taxes from gross income produces what is known as disposable income, and Gini coefficients are published for this measure of income also. The comparable figures for 1977 and 1993/4 were respectively 27 and 34, revealing a rather modest further reduction in inequality. The same observation, that cash benefits are far more important in redistributing income than is the direct tax system, appears to be broadly valid for the period from 1961 to 1977 as well.

If society wishes to redistribute income, then it seems the way to do it, historically as well as on the basis of economic principle, is via cash benefits rather than progressive taxation. This view is in line with that expressed earlier that PAYG pensions should be financed in the way that minimises leaks from the bucket. Moreover, it is vital that the benefits used be well designed and operate efficiently, for ill-conceived benefit payments can cause leaks just as surely as can tax deductions. The universality of a benefit reduces the disincentive effects and distortions inevitably generated by any other benefit design. The distortions created by the UK tax and benefits system are comprehensively described in Parker (1995).

As argued above, a PAYG system allows society to choose how it wishes to redistribute real consumption. A self-imposed and unnecessary requirement for pre-funding transfer payments reintroduces the flawed mediator of money and can only hinder the process.

One of the critiques offered of PAYG welfare schemes is that they may lead to inter-generational redistribution. That is, a PAYG pension scheme may cause the lifetime incomes of some cohorts of people to be higher than they would otherwise have been, *at the expense of other cohorts*. This is the second equity issue to be addressed in this section.

Does such inter-generational redistribution occur and, if so, does it matter? It is worth stressing that it matters to the policy debate in that some writers, such as Shapiro (1997) assume that it does occur and argue against PAYG pensions on this ground.

In a paper addressing directly the first of these questions, Hills (1992) acknowledged that the generation in or nearing retirement when a welfare state is introduced will be net beneficiaries - they get two boxes of chocolates in Hills's analogy. The reason for this is that they will have contributed little to the scheme over their lifetime because for most of their lifetime the scheme did not exist; but if the scheme includes pensions and health care then, as older persons, they will benefit significantly in their twilight years. However, this need not be at the expense of following generations - each gives and receives a box of chocolates and so is neither a net gainer nor a net loser.

Other generations may also get out of the system more than they put in and so be net gainers in this sense, but there are two possible reasons for this. The first is that growth in GDP may swell the size of the boxes of chocolates over time, so that the box a generation receives from its successors is larger than the one it gave away to its predecessors. One can think of the gains of future economic growth being shared (redistributed) among generations, and there may be a sound argument to support this which will be outlined below.

The second reason is that there may be change in the size of the boxes of chocolates arising from things other than GDP growth (or decline). The hypothesis is that generations succeed in modifying the welfare system to their advantage over time. For example, a generation will benefit at others' expense if welfare spending is skewed towards education when that generation is in the child-rearing phase of life, but then subsequently skewed towards pension spending when that generation retires. This would be a case of one generation "gaining selfish advantage", in Samuelson's terms, by free riding.

Note that a generation may be a net loser in circumstances of falling GDP but long periods of falling GDP are rare in modern industrial capitalist societies. In any event, if one is sanguine or even positive about sharing the gains of GDP growth across generations, then one is presumably equally comfortable with sharing the pain of GDP decline. A PAYG pension scheme could ensure that a generation whose working years are blighted by depressed economic conditions is not further penalised in retirement by their failure to save sufficiently during that comparatively difficult working life.

Discussion of the inter-generational equity of PAYG schemes all too often confuses these two sources of redistribution. For example, Shapiro talks of later generations being burdened with a "low rate of return" on their pension contributions (Shapiro, 1997, p.129). By this he means that what a cohort gets out of the system is not much greater, and possibly less, than what they contributed. However, as described above, this could be due to low GDP growth, and if this is the case then it can be expected that it would also affect pre-funded pensions. If one wishes to argue that the rate of GDP growth is deleteriously affected by PAYG pensions then one has to counter the arguments outlined earlier that showed this is not easy to demonstrate, either in theory or empirically.

The sort of inter-generational redistribution that Hills was looking for was that due to changes in the size of the boxes of chocolates arising from things other than GDP growth (or decline). Hills's empirical work was on the welfare state as a whole, including education, health and social security, but it led him to conclude that the UK's welfare state had not so far led to any inter-generational redistribution of this sort. Even if Hills had found the reverse, it would be incorrect to argue for the abolition of PAYG schemes on the basis that there was this kind of inter-generational redistribution. If other characteristics of PAYG schemes are desirable, then the appropriate response would be the same as the response to criticism of the current method of financing PAYG pensions (by a payroll tax) as discussed above - to seek a solution to this *particular* problem.

Finally, consider the argument in favour of sharing the gains of future economic growth. It should be remembered that the high level of GDP per capita enjoyed by current generations is not solely the result of those generations' endeavours. They benefit from capital produced and work done by preceding generations. For instance, the UK population still enjoys the benefit of sewers and bridges built by the Victorians. The issue of the justifiability of inter-generational redistribution is thus complex. For, with hindsight, it is not clear that the Victorians would not have been justified in establishing a PAYG pension scheme whereby those generations would have shared a little of the benefits of future GDP growth to which their infrastructure construction had contributed. In this connection, it would be possible to devise an accounting system for the state's finances which justified the payment of a pension out of taxes on the younger members of society on the basis that the retired have contributed to the provision of social infrastructure - roads etc. - through their own efforts and their previous tax payments [9].

Conclusion

The case against PAYG pensions is more often than not grounded in the claim that such a system is inconsistent with the beneficial operation of the free market. Many non-economist academics, policymakers and other commentators, as well as laypersons, take this as a given fact. The discussion above has shown that in fact the economic case against PAYG pensions is far from compelling. The size of the 'burden' of the retired

[9] This may be considered a variation on the social dividend discussed by Meade (1989).

population on the working population is affected only by the number of pensioners and cannot be altered by changing the way in which their consumption is financed, whether by PAYG state pensions or pre-funded private pensions. The costs of pensions which can differ according to how those pensions are financed are lower and less visible to non-economists. They are two classes of costs: the costs of the resources used to administer the pension system; and the lost output arising from what Okun termed the leaks from the bucket used to transfer resources from one group to another - in this case to the retired. The choice of financing mechanism therefore can have divergent effects on the economy, but economic theory provides no unambiguous predictions of these.

One of the possible malign effects of PAYG schemes may be relatively easily tackled, by moving away from taxes on employees and employers in favour of less damaging taxes such as 'eco-taxes'. The effect on investment and economic growth due to the crowding out of private saving is equally theoretically uncertain, and nor does the empirical research conducted provide any conclusive evidence against PAYG.

There is a positive case to be made for PAYG on the ground that it has advantages in dealing with certain risks, and in particular inflation risk. To provide pensions which the National Pensioners Convention would regard as something worthy of the name, ie with predictability of value, PAYG is perhaps ultimately essential.

If there is a desire for some redistribution in favour of the less well off, and it seems unarguable that this is the case in relation to the retired portion of the population, then this requires state action. A CP financed on a PAYG basis is the most attractive approach to achieving this. Arguments about inter-generational redistribution arising from PAYG schemes are often confused and, when properly formulated, such redistribution does not appear to be a serious concern.

In short, any pension system appropriate for the twenty-first century requires an element of state provision financed on a PAYG basis and this provision should ideally be universal. We need a citizen's pension.

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News

Major Housing Benefit reforms announced

The Department for Work and Pensions has announced that Housing Benefit is to undergo the most radical reform since its introduction in the late 1980s. Amongst the proposals is one for a standard local housing allowance which would allow tenants who find accommodation for less than the standard amount to keep the difference. The proposal, to be trailed in ten 'pathfinder' areas, is for a flat rate allowance, based on area and family size.

Working with councils, landlords and advice agencies, the Department will evaluate the impact of the reforms and, depending on the results, may roll them out nationally.

Announcing the measures in the House of Commons, Secretary of State for Work and Pensions Andrew Smith said: "Because they're simpler, standard local allowances will speed up the claims process, reducing the uncertainties people face as their circumstances change and make trying a job a more attractive option." The Secretary of State said the measures will also help to combat fraud in the housing benefit system by freeing up resources, and by removing the practice of high rents being agreed between tenants and landlords.

The prospectus setting out the Department's proposals entitled 'Building Choice and Responsibility: a radical agenda for Housing Benefit' is available at www.dwp.gov.uk.

Other news

In *Search 37*, for Summer 2002, **the Joseph Rowntree Foundation** reports on research carried out during 2001 on the disincentives experienced by people with disabilities. The Foundation's working party examined the 'personal assistance trap': "the mechanism by which disabled people, in receipt of cash or support, find themselves deterred from seeking work because of the punitive charge which local authorities can make against them if they find themselves a job. These charges are so severe that disabled people's disposable income can often be left not much more above Income Support levels even for those earning an average of £20,000 a year." While the working party was at work, the Government announced that income from earnings would be disregarded in any financial assessment. The group went on to study remaining barriers to employment, and concluded that "financial and benefit questions are more easily answered than ones of attitude, assumption and prejudice." The report, *Not just the Job: Report of a working group on disabled people using personal assistance and work incentives*, by Marilyn Howard, is published by the Joseph Rowntree Foundation (ISBN 1 85935 072 0, price £14.95).

The 'Traps and Springboards' research project, sponsored by the European Commission and conducted by a group which includes the Centre for Research in Social Policy at Loughborough University, has reported that its main findings can be summarised as follows: "The extent of inadequate [social] protection is high (between 10% and 30%) even in countries with well established [though differing] minimum income schemes such as Belgium, Denmark and the UK. Groups over-represented among the non-covered population include the elderly, those with disabilities, single parents, students, school-leavers and non-nationals. Five main causes of inadequate protection have been examined: non-eligibility for minimum income (e.g. among foreigners, travellers, homeless people), sanctions and suspensions (particularly in unemployment insurance), non-take-up, inadequacy of benefits, and deductions made from benefits to pay arrears of utility bills etc. Only 20% to 25% of all minimum income recipients were reintegrated each year into the labour market in the period 1993-95 in Belgium, Denmark and the UK. The differences between the countries were small."

Catalyst has published a paper by Paul Spicker entitled *Poverty and the Welfare State*. He writes: "We are in danger of losing sight of what the welfare state is about. It was not intended to focus on the relief of poverty, but to be a universal service tiding us over periods of economic difficulty and preventing us from falling into deeper disadvantage as a result. … The best way to help the poor within the welfare state is not to target programmes more carefully on the poor, but the converse: to ensure that there is a general framework of resources, services and opportunities which are adequate for people's needs, and can be used by everyone. That is what the welfare state was meant to do. That is what we have forgotten." Further details about 'Catalyst' can be found at www.catalystforum.org.uk, or at Catalyst, PO Box 27477, London SW9 8WT.

Events

A hearing on 'Debt and the way out'

Kevin Donnelly writes: "The Wirral is a des-res peninsula between the Mersey and the Dee, mostly well off but with areas of acute deprivation. In the summer of 2002 I was invited to a *Debt and the Way Out* hearing in Wallasey. From the start it was clear that it was to be a hearing for voices of the debt-ridden, not an occasion for the affluent to come along and sympathise. There were speakers, some splendid mime by a theatre group, and the welcome presence of the Mayor of Wirral Borough council, who spoke warmly of the venture and stayed long enough to meet the participants. There were workshops in the afternoon. Mine was on Citizen's Income, and once again we saw how men were uneasy about getting something for nothing, as they put it, while women as usual had no difficulty in seeing the merits of CI. There were personal testimonies from veterans of the benefits obstacle race, which recalled Bill Jordan's words in 1984, that the tax and benefits system is in a mess. It still is; along with some over-all improvements, the forms are even longer, and the questions even more intrusive, all intended to push people into what Hermione Parker once called 'busy-busy make-work jobs'.

When I was last involved in CI conferences in the UK or in Europe, the old funding debate was still going in circles: who is going to pay for a Citizen's Income ? My preference would be for an optimum income, based on production rather than hours of employment. Now that French economics students have begun to protest successfully against classical economic theory there is a chance for some really new thinking about funding BI/CI. I hope so."

Contribution to Discussion

A funded state pension scheme is a practical possibility and is a crucial step towards the liberalisation and empowerment of the individual

by Anthony Sperryn

British subject or U.K. citizen? The question is still open and the evidence is ambiguous. One looks at the buzz words and slogans: taxpayers' money, prudence, rights and responsibilities, them and us, standing on our own feet, targeting those in need and so on and so on and one can well ask the questions: 'who is it all for?' and 'who owns it all?'

And then one thinks of the administration of the tax and benefits systems and the minimum income guarantee for pensioners and one is forced to the conclusion that the majority of Britons are slaves, working for that supreme slavemaster, Her Majesty's Treasury.

But it doesn't need much to visualise a change from 'British subject' to 'U.K. citizen'. The first thing to do is to abolish the use of the word 'taxpayer' as a means of differentiating between 'them' and 'us' and, by inference, as a term of abuse towards those who have the misfortune not to be in a position to pay any or much income tax. The second thing is to recognise that each U.K. citizen has, or ought to have, equal status before the law. One person, one vote. It does not require much of a stretch of the imagination then to extend that to mean that each citizen has an equal share in everything the state (collectively) owns: the public property, the things, be they roads, schools, hospitals, government buildings, museums, tanks, fighter bombers - the lot, that are in the public domain or are part of the nation's heritage.

I have recently heard a government adviser say that the government does not make a good shareholder. But the government, as representative of the people as a whole, can own things. It can manage things. It can decide, and may have to decide, when it is better to get other people to manage things for it. It can account for things. It must account for things. It can also recognise when markets fail, or are rigged, and act as a stabilising force accordingly.

For the latter task, it has an over-riding duty to step in, for the sake of the British economy as a whole. It cannot abrogate responsibility to that latter-day deity, 'the market'. Markets fail and, as anyone with any experience of the City knows, markets can be rigged.

Whatever the state owns has been built up, over the years, from investment out of taxes (and, possibly, borrowings), from assets that were acquired by conquest or by custom, and it is all capable of being valued at today's prices. Roads at current cost, with allowance for depreciation; the same for schools and hospitals and the rest. All of it is *ours*, not 'theirs'. In general, it ought not to be for sale by this generation for its own benefit. Much of it has some sort of monopoly status in the British way of life. Most, if not all, has an aspect of public service attached to it.

Very few people want to see it privatised - which is not to say that private sector management couldn't be brought in to manage it from time to time. But actual ownership is important and *that* belongs to the people as a whole, not just to that sub-class of people described as taxpayers, nor to the lucky participants in a privatisation offer for sale, nor to the winners of some (mostly bogus) process of competitive bidding or search for value for money.

Where things have gone wrong is that most of these assets have become disconnected from the people. The proprietorial link has gone. The break has come with the questioning of society as an entity. Reductions in income tax over time have been matched by reductions in the services the state provides and, especially, the run-down of the assets involved.

The National Asset Register is a place to start. Everything in it could be transferred on Day 1 into a National Pension Fund. Also, the roads, schools, hospitals and the rest. The beauty of this scheme is that these assets all keep their value in line with inflation. What is missing so far is that the nation as a whole, which owns the assets, has not been properly accounting for depreciation, nor giving the owners a return on capital, both of which need to be set aside out of the general fund of taxation. This is not hypothecation; it is simply prudent accounting.

Cash flow into the National Pension Fund would also include a part of National Insurance contributions, together with credits for individuals unable to make a contribution in any particular year and, if necessary, something more out of general taxation. Payments out would be state pensions, no longer means-tested, at the minimum income guarantee level, plus investment in infrastructure. That is investment for the future. Fresh investment might not be required if the population started shrinking. The level of pension is for political decision, but has to be adequate to live on.

The National Pension Fund would thus be comparable to a private sector pension fund. It would not, in principle, hold stock market assets, but its assets would all be inflation-linked in value and would earn an administered rate of return (something like that on index-linked government stocks, the risk-free rate of return, currently 2-2.5% plus inflation). (There is a precedent for an administered rate of return. The independence of the Bank of England is subject to the requirement to keep inflation within a specified band.)

Before New Labour came to power, it proclaimed a wish for people to have security. The setting up of a National Pension Fund is an important step in that process. A further advantage of this proposal is that, once the level of the state pension has been set, an automatic annual increase of 2-2.5% over inflation can be built in, no problem, as an equivalent to the earnings link. The disadvantage is the loss of the Chancellor's ability to decide by how much to uprate pensions.

There is a neglected, but profound, truth in economics: that one cannot save spending power. One can only use investments that promise a future call on spending power. Share of GDP is what is in question. The current balance of dividends, interest and taxation is not providing security for our pensioners. A mechanism that automatically locked in a share of GDP that produced an adequate pension for all must surely be an improvement which all would welcome.

Reviews

Sheila Shaver, 'Australian Welfare Reform: From Citizenship to Supervision', *Social Policy and Administration*, vol.36, no.4, August 2002, pp.331-345.

Shaver's paper examines the implications of welfare reform for the meaning of social citizenship in Australia. She concludes that deepening emphases on the market, the family, and individuals' moral obligation to sustain themselves are moving welfare provision from being a limited social right to being conditional support, and are moving Australia's understanding of the human person from that of a sovereign individual to that of a subject of paternalistic supervision. "Hidden in the shift from rights to conditional support, and from sovereignty to supervision, is a denial of the equality of selfhood as the price of welfare assistance" (p.342).

To generalise a point which Shaver makes, following Offe's suggestion that there has been "a loss of political support for class-based collective strategies of equality and redistribution," (p.342): individuals throughout the Western world now see themselves as over against the welfare state, evaluating it against other possibilities, rather than as members of it. In this context, as Shaver recognises, welfare states (and political parties of the left) are adapting themselves to this new situation. One consequence of this adaptation is that the fostering of equality is no longer an aim (either explicit or implicit) of social policy.

This paper is about Australia, but there are significant parallels with the ways in which welfare provision is changing in the UK and the USA. In all three, obligations balance, and sometimes outweigh, the individual's rights. Whilst these concepts cohere with the notion of liberal social citizenship, policy changes are beginning to damage the foundations of such a liberal society. "The shift from support available as of right to assistance provided on condition violates the presumption that all citizens are equal in status, dignity and worth that is necessary for full participation in democratic society. The shift from the presumption of individual sovereignty to welfare supervision entails levels of intrusion into spheres of privacy and individual volition that have been highly protected in liberal society. Much of the development of twentieth-century welfare has been concerned with the assertion of equality in precisely these respects. It is this development of equal social citizenship that contemporary liberal welfare reform is now putting in question" (p.343).

Shaver sees Tony Atkinson's concept of a 'participation income' (quoted from our *Bulletin* no.16) as part of the same process, away from a citizenship of belonging and towards a citizenship of active participation – with the corollary that anyone not participating is no longer regarded as a citizen.

But maybe the difference is one of degree rather than of kind. If the criteria for 'participation' were to be drawn sufficiently broadly then there would be few members of the population not receiving the participation income, especially if it were to be paid to those adults deemed unable to participate actively in society by virtue of illness or disability. Atkinson's own criteria are very broad, and the Citizen's Income Trust's research when he first made the proposal ten years ago suggested that only about 1% of the population would not be receiving the participation income – meaning that it would be cheaper to pay a Citizen's Income than to continue to administer a participation income which would require the policing of participation criteria.

Yes, there is a shift going on in our understanding of citizenship, and changes in welfare provision both respond to and help to drive that change. Child Benefit, by ameliorating the poverty and unemployment traps, represents a citizenship both of belonging and of participation. A Citizen's Income would do the same.

Martin Evans, Michael Noble, Gemma Wright, George Smith, Myfanwy Lloyd and Chris Dibben, *Growing together or growing apart? Geographic patterns of change of Income Support and income-based Jobseeker's Allowance claimants in England between 1995 and 2000* (The Policy Press for the Joseph Rowntree Foundation, 2002).

This report is precisely what it says it is, and the thorough nature of the research and its careful conclusions will be of considerable service to policy-makers. The researchers conclude that "there have been very different rates of change in different areas, and the areas with the highest numbers and proportions of claimants in 1995 have tended to be slower to participate in the overall national economic growth" (p.81); that some claimant groups have increased in size (for instance, people with disabilities) (p.81); and that "there has been increasing polarisation between wards with high and low claim rates from 1995 to 2000" (p.82). Generally, claimant numbers have declined between 1995 and 2000, and claimant numbers have declined in the wards with the highest claim rates even if claim rates haven't; but in 2000 there were still 3.8m claimants of Income Support, Job Seeker's Allowance and Invalidity Benefit in England, and about half of them lived in the 20% of wards with the highest claim rates.

The report suggests that future research should take the analysis further, to the level of the individual. We would encourage this. It would bring into the spotlight not only the ways in which location and personal characteristics influence the probability of leaving benefit, as the researchers suggest: it would also enable questions about disincentives to be asked. The development of a disincentive index (an important component of which would be the maximum marginal rate of benefit deduction experienced by an individual entering employment or increasing their earned income) might go a long way towards uncovering some of the reasons for the differences between claim rates in different areas and amongst different groups of people.

Robley E. George, *Socioeconomic Democracy: An advanced socioeconomic system* (Praeger, 2002).

In this book Robley George combines discussion of a Universal Guaranteed Personal Income (with its level democratically agreed) with advocacy of a Maximum Agreed Wealth (with the level again democratically agreed). The style is rather quaint (and there are too many adverbs), and the book is overlong (and could have been half its current length), but it contains a road-map which, if followed, would lead to a democratic and socialist society.

The first chapter defines 'Universal Guaranteed Personal Income' (UGI): "Society guarantees some minimum amount of purchasing power to each citizen, with citizenship the only requirement for eligibility" (p.8). As we suggested in our last edition, 'guarantee' is ambiguous as it can suggest either an automatic, universal and non-withdrawable payment or a means-tested guarantee.

Chapter 2 compares a Basic Income to a Negative Income Tax, and then relates the ideas' histories and a variety of unresolved dilemmas related to the concepts. The argument rambles and is rather colloquial, but there is useful material, especially the historical.

Chapter 3 is about the 'Maximum Allowable Personal Wealth' (MAW), and mainly about different kinds of taxation; chapter 4 is about democracy and the different ways in which the population might control the levels of the MAW and the UGI; chapter 5 is a short passage on different types of society; chapter 6 offers justifications for MAW and UGI; chapter 7 offers a history of Islam and discusses Islamic taxation and its treatment of wealth; chapter 8, in discussing economic incentives, suggests that the MAW offers an incentive to the wealthiest to increase others' wealth so that they will vote for a higher MAW; chapter 9 discusses practical approximations to a UGI (such as means-tested benefits with work tests); chapter 10 is about financial benefits and costs; chapter 11 is about realisability; and chapter 12 is on ramifications in relation to ecology, budget deficits, etc.. There is an appendix containing questions for further study or discussion – and if this were a shorter book with concluding paragraphs for each chapter then it would indeed have been suitable for sixth-form study. For instance, it would be useful for a class to discuss the feasibilities of a government-controlled Citizen's Income and of a democratically-controlled UGI, and to ask itself whether a 100% tax rate (which is what a MAW would imply for high earners) would ever be politically feasible.

Tony Atkinson is quoted in the bibliography but not the surely essential *Public Economics in Action*.

This is a useful book as it should stimulate important debate in the USA. Its importance for a European readership is that it reveals a serious gap in the market: since Tony Walter's *Basic Income* and Hermione Parker's *Instead of the Dole* are now out of print, there is no accessible book-length introduction to the Citizen's Income debate for a British or European audience.

Peter Saunders, Jonathan Bradshaw and Michael Hirst, 'Using Household Expenditure to Develop an Income Poverty Line', *Social Policy and Administration*, vol.36, no.3, June 2002, pp.217-234.

Income and expenditure measures are commonly used to establish poverty lines representing, respectively, the availability of cash resources and the standard of living approaches to measuring the extent and composition of poverty in the UK. Using UK data (and also Australian data) the researchers compare these two measures and find that while the overall poverty rates are similar whichever measure is used, the relativities they imply for different types of household differ considerably. They find that there is little overlap between income and expenditure poverty, and that very few households are both income- and expenditure-poor.

The authors define their own concept of poverty as constraint on choice or constrained expenditure, and identify its presence by discovering where there is absence of spending on durable goods and luxury items. They then derive income thresholds for observed levels of constrained expenditure for different types of household. They assume that in such households all income is spent, and they are thus able to define poverty lines below which expenditure is severely constrained. Income support rates are then compared with these poverty lines.

The article draws attention to the limitations of the Family Expenditure Survey data, identifies future research needs, shows the value of exploring the links between income and expenditure, and makes suggestions as to how new poverty measures might be calculated by employing both income and expenditure data; but its longer term importance surely lies in its definition of poverty as constrained expenditure. If this *is* to be the definition of poverty, then it will be essential to include in the definition of poverty a household's ability and opportunity to increase its income. If there are significant barriers to a household increasing its income then expenditure will be more constrained over time and poverty will be deeper, and if there are fewer barriers to a household increasing its income then expenditure will be less constrained over time and poverty will be less deep.

This necessary factor in the calculation of poverty will require such barriers to be quantified.

It is to the quantification of the barriers to a household increasing its income that the research agenda must now turn.

Paul Treloar, 'New Tax Credits', *Benefits*, number 33, volume 10, issue 1, February 2002, pages 49-52.

This is a useful discussion of the nature and likely effects of the new Child Tax Credit announced in the 2000 budget. For the government's proposals see *Opportunity for All: Making Progress*, published by the Department for Work and Pensions in September 2001, Cm 5260, £22: "From 2003 we will introduce an integrated child credit, which will bring together all existing income-related benefits and tax credit support for children into a single source of income, providing financial support to families both in and out of work. This will build on the foundation of the universal Child Benefit, along with extra help for families on low incomes." A description of the move to tax credits and of the international context is followed by a discussion of the contradiction between our individual-based income tax system and the family-based Working Tax Credit (which will soon replace the Working Families Tax Credit and the Disabled Person's Tax Credit) and CTC (Child Tax Credit: the new name for the integrated child credit). A welcome proposal is that no upper capital limit will apply to receipt of CTC: instead, actual investment income will be taken into account. This will make tax credits more like the rest of the income tax system. Similarly, there will be no work test for CTC, with assessment being made purely on the basis of family income.

Like Child Benefit, CTC will be paid in full to recipients of Income Support or income-based Job Seeker's Allowance; and because it will be received by low earners it will provide a new level of income security during employment-pattern transitions. This is one of CTC's most attractive features.

The article bemoans a continuing lack of detail relating to tapers and levels of CTC, pointing out that it is the detail which will determine whether CTC will reduce poverty and make work pay.

Benefits, number 34, volume 10, issue 2, June 2002, *Work after Welfare*

This edition of *Benefits* suggests that the agenda has moved on – or rather, that it ought to do so. As Robert Walker writes in his editorial, "getting people from welfare to work is last year's problem, and a comparatively easy one at that, certainly when compared to the task of keeping job entrants in employment … Sustaining people in rewarding employment is a much greater challenge" (p.83).

Richard Dickens, in his article 'Is welfare to work sustainable?', discusses the increases in both relative and absolute poverty which have taken place between 1979 and today, commends the government for taking a variety of steps to remedy the problem, suggests that the current work-based policy is not enough because it "may shift individuals into long-term in-work benefit dependency and possibly in-work poverty" (p.88), and concludes that those who move in and out of low-paying jobs will remain in poverty because job retention is low and there is little progression into higher-paid jobs. "Perhaps another strategy that the government should take more seriously is to tackle the primary earnings distribution" (p.89).

In response to the problem which Dickens discusses, there are new policy initiatives here and in other countries aimed at supporting people in employment through a case-work approach. Karen Kellard's article, 'Job retention and advancement in the UK: a developing agenda', examines new policy in the UK, and in 'The road to sustained employment: lessons from a US job retention intiative', Anu Rangarajan discusses new developments in the USA. Both articles conclude that flexible schemes tailored to individuals' needs are what is required.

A rather different approach is 'Workfare': compulsion to accept employment (State-provided if necessary), the refusal of which results in loss of benefit. In 'Rhetoric and retrenchment: 'common sense' welfare reform in Ontario', Dean Herd finds that, far from being the success it is claimed to be, a Canadian workfare scheme has removed large numbers of people from benefits by "reducing welfare services and tightening eligibility requirements" (p.105).

When read together these well-researched articles argue for an entirely 'carrot' approach: that is, if work doesn't *pay* (literally), then 'making work pay' won't work as a means of 'welfare to work'. An important means of making work pay must surely be to reduce the marginal tax rates which people suffer. Tax credits have reduced these to between 60% and 70% for most low-earners. This is not low enough. The problem is, of course, that if, under the present structure, they are reduced further, then disincentives are moved further up the earnings scale. The only answer to this particular part of the problem is to replace tax allowances and tax credits with an unconditional cash payment and then to tax all or most earned income at rates lower at the bottom of the earnings scale than at the top.

Tania Burchardt and Julian Le Grand, *Constraint and Opportunity: Identifying Voluntary Non-Employment* (CASEpaper 55, Centre for Analysis of Social Exclusion, London School of Economics, 2002). A summary appears as CASEbrief 22.

This paper attempts to assess the extent to which the behaviour of an individual in the workforce is the result of the constraints which they face or of the exercise of preferences. Four 'layers' are used to measure the extent of opportunity for employment: 1. those factors over which an individual has no control (such as age); 2. those factors over which someone has no control at present (such as educational achievements); 3. those factors which someone can change in the near future but where high costs of various kinds might be experienced (such as place of residence); and 4. those factors which someone could change easily (such as starting voluntary work).

The researchers start from the position that all non-employment is voluntary and then introduce into their analysis the constraints in layers. If the model predicts that someone has a high probability of being in work, and he or she is not in work, then they are regarded as voluntarily out of work.

The researchers conclude that if the only factors regarded as beyond someone's control are age, gender, ethnicity, and parental social class, then British Household Panel Study data show that 35% of all men and half of all women not in work are out of work through choice; if health, labour market experience and education are also regarded as beyond an individual's control, then 20% of men and 31% of women not in work are voluntarily so; and if place of residence and family responsibilities are also regarded as beyond someone's control, then again 20% of men are not in work voluntarily, but the proportion of women not in work by choice falls to 25%.

The authors recognise that there might be 'unobserved constraints'. One important constraint is the high marginal tax rate suffered by many people who enter the employment market, and another (less quantifiable) constraint is the uncertainty people experience about the level of change in net income. It is one thing to know that net income will rise very little if you enter employment; it is another not to know how much income will rise or fall, whether free school meals will still be available, or how long it will take to recalculate housing benefit if employment proves to be short-term.

The research reported in these papers is a valuable start. It is to be hoped that the research will continue, and particularly that it will research the effect of these additional two constraints on whether or not individuals enter the labour market, and that it will go on to quantify the effects of the reduction of such constraints which would occur if either Child Benefit were increased, or proportions of tax allowances, tax credits and means-tested benefits were to be paid as nonwithdrawable cash benefits.

John Hills, Julian Le Grand and David Piachaud (eds.), *Understanding Social Exclusion* (Oxford University Press, 2002), £50, hb, 274+xiv pp.

The replacement of 'poverty' with 'social exclusion' in political debate is not merely a change of terminology designed to include in the debate those who think that there is no such thing as poverty (though it is that), for 'social exclusion' encompasses a field of interest broader than that encompassed by 'poverty'. For one thing, the new terminology draws attention to someone's exclusion from active participation on family, community, national, and global levels, and it invites a dynamic analysis rather than snapshots of people's resources at a particular time.

The first and second chapters explore the meaning of 'social exclusion' by relating social inclusion to social justice and social solidarity in such a way as to suggest that an increase in inequality translates into an increase in social exclusion. Chapter 3 seeks measurable definitions of participation in order to measure social exclusion (though because consumption, production, political engagement and social interaction relate to outcomes rather than restraints, measurable definitions of disincentives to participation are not sought – and surely disincentives to participation are an important part of the definition of social exclusion). Chapter 4 studies poverty dynamics, i.e. the ways in which people move in and out of poverty, and concludes that there is a group of people who experience poverty more often than most. Chapter 5 is on social exclusion across the generations; chapter 6 shows how family resources affect people's experience of social exclusion; and chapter 7 shows how Housing Benefit, Council Tax Benefit and the Working Families Tax Credit reduce incentives to employment and thus increase social exclusion. (This is particularly important because poverty in low-wage families affects children and increases the likelihood of their social exclusion). Chapter 8 is on the effect of concentrations of disadvantaged people in particular neighbourhoods; chapter 9, on child poverty, suggests that an adequate minimum income is necessary for those out of work to prevent their children from experiencing poverty; and chapter 10 shows that some social policies aimed at preventing social exclusion can simply move the problem elsewhere (for instance, policy aimed at keeping the unemployment count low can increase the number of people claiming sickness benefit) and that policies which respond to existing social exclusion are needed to prevent existing social exclusion from causing more social exclusion in the future. Chapter 11 is on education's role in preventing social exclusion; chapter 12 is on the relationships between social infrastructure, community participation and social inclusion; and in chapter 13 John Hills asks whether a focus on social exclusion changes the policy response and concludes that a dynamic analysis is needed: for instance, it is important to help families to reduce from two earners to one earner rather than from two earners to no earners so that it can then more easily return to being a two-earner family. In this connection universal benefits are recommended, not because they redistribute income differently at a particular time (which they don't necessarily) but because they contribute to social solidarity and thus decrease social exclusion.

This book is a fund of useful research data and results, and the concluding sections of each chapter provide important indications as to where social policy should be going if we want to reduce social exclusion in our society. Thoroughly recommended.