A drama in several acts: the fiscal crisis and the UK welfare state

Hills, John

A Drama in Several Acts The Fiscal Crisis and the UK Welfare State

John Hills

Dokumentiert: Am 19. November 2010 diskutierten im WZB Chiara Saraceno, John Hills, Peter A. Hall und Herman Schwartz über das Thema „Whose Crisis? The Social Policy Dimension of Financial Crisis and What it Means for Welfare State Research". Das Panel war Teil der vom Zentrum für Sozialpolitk (Universität Bremen) und dem WZB organisierten Konferenz „Never Waste a Good Crisis", gefördert von der VolkswagenStiftung im T.H. Marshall Programm. Wir dokumentieren hier pointierte Kurzfassungen der Panelbeiträge von Chiara Saraceno, Forschungsprofessorin am WZB, und John Hills, Direktor des Centre for Analysis of Social Exclusion an der London School of Economics and Political Science. Der Beitrag von Peter A. Hall, Harvard University, („The Current Economic Crisis and the Welfare State") erschien im Dezember 2010 im ZeS Report. Der Beitrag von Herman Schwartz, University of Virginia, wird in der Frühjahrsausgabe des ZeS Report veröffentlicht.

The final impact on welfare states and social policies of the financial crisis that rocked round the world in the Autumn of 2008 will not be clear for many years, but in the UK its potentially dramatic effects are already apparent, not least through the large and rapid cuts announced for public spending by the new Coalition Government in October 2010.

But to understand what might result in terms of the long run reshaping of Britain's welfare state, it should be recognized that the first Act of the drama had started a year before. The former Labour Government had adopted a system of setting public spending plans in cash terms for three years at a time. In the Autumn of 2007, it set its plans for the following three years on the assumption that there would continue to be both modest real economic growth, and low but positive inflation. Spending was then set to grow in line with the growth of nominal national income – for instance, by about 10 per cent in cash terms over the first two years.

In the event, not only did real national income fall for a period as the economy moved into recession, but inflation also fell. Crucially, the government decided to stick to its cash spending plans, so spending rose sharply as a share of national income. This fiscal stimulus by setting spending on 'cruise control' was more important than the explicit 'stimulus' measures the Government introduced later, and as important as the automatic stabiliser effects of rising benefit and tax credit payments and falling taxation. Macroeconomists will argue about the scale of the total stimulus, but the crucial feature for understanding the long run effect of the crisis on the shape of the welfare state is that this first Act involved a step change upwards in real public spending on most services, including social spending, rather than just one-off stimulus measures.

The second Act began with the election of the new Liberal-Conservative Coalition in May 2010. The new Government quickly announced that it intended to eliminate the budget deficit within four years, rather than halve it over that time as its predecessor had planned. While the roots of what was by now a fiscal crisis lay in both rising spending and falling tax revenue through the recession, it plans that nearly 80 per cent of deficit reduction should come through spending cuts and only 20 per cent through tax increases.

However, this second Act is one of 'targeted retrenchment'. Some spending programmes will be cut by a quarter or more in real terms, but health care, pensions, and school education will be to some extent protected (although without any room to accommodate pressures such as those from an ageing population). Social security for those of working age will be hit hard. Against the background of a virulent press campaign about 'welfare scroungers' and alleged cases of benefits for some living in luxury property, social assistance and housing allowances are being squeezed hardest. Over the longer term, some of the largest cuts will come through a switch in the indexation of most non-pension social security benefits to a systematically lower inflation index, so their value will fall faster behind the incomes of those in work. With large cuts in other public spending – including dramatically in support for teaching within higher education – the overall aim is a reduction in public spending of around Euro 100 billion per year by 2014.

Watching the evolution of policy, the collision of two forces within the Coalition is evident. One side clearly sees this as a crisis 'not to be wasted' and an opportunity to achieve a permanent step down in the role of the state, with a clear intention that public spending will end up as a lower share of national income than before the crisis. But another is attempting to make the cuts 'fair' or even arguing they can be 'progressive'. This is hard, to say the least, given that public transfers and services are so much larger in relation to the incomes of those in the bottom half than those of the top half of the income distribution. But across many areas the attempts to protect services (if not cash) for those at the bottom imply greater focussing of public services through sharper means-tests of one kind or another – higher social rents and so greater reliance on means-tested housing allowances, for instance, or reduced protection on those just above social assistance levels from local property taxes.

All of this threatens not just to undermine the new Government's longer term reform plans to improve work incentives and simplify the social security system, but also squeezes those with low and middle incomes hard, with of course potentially important implications for its base of political support.

But the end result of the two Acts so far will – if the plans are carried through – be a significant restructuring of Britain's welfare state. By 2013, the plans imply that social spending as a whole – social security, health care and education – will be much the same shares of national income and of public spending as when the crisis hit. But within that, the balance will shift to health care and state pensions. The previously agreed pension reforms designed to reduce the extent of means-testing in old age through improved universal pensions and a new low cost funded pension system are being carried through. By contrast, the values of different kinds of transfer and services for the working age population are being cut back sharply and subject to sharper means-tests.

The net result would be to tow the UK's system further West across the Atlantic, in the direction of something that looks more like the US social spending pattern, dominated as it is by health care and 'social security' for the older population, and residualised 'welfare' for those of working age.

However, such net results depend on current plans actually being carried through. It will be the middle of 2011 before the actual withdrawal of services required by the cuts actually hits home to many of the people who use them, and the effects of the cuts to social security benefits and tax credits on living standards will accumulate over several years. How Act Three in this drama of the welfare state plays out, and how it will differ from the parallel Acts in other countries, remains unclear.

Thus far, the recently elected government has fairly widespread acquiescence in arguing for the scale and speed of the retrenchment and its balance towards public spending bearing the brunt. This may continue, leaving the net effects to unfold as described above. But when many people are facing actual withdrawal of services which they have come to expect, and facing actual reductions in living standards from reduced transfers, the climate could change very rapidly – as it did for instance, when the regressive 'poll tax' for financing local government was introduced in the late 1980s, precipitating the end of Mrs Thatcher's premiership.

Whether the Coalition government will press ahead with its plans as their effects hit home on voters – and whether it will hold together if it does so – will doubtless be of fascination to observers from other countries. Those of us living in the UK will face all of the results of living through what will undoubtedly be 'interesting times'.