**The Double Crisis of the Welfare State**

**and**

**What We Can Do About It**

**Chapter 1: The Double Crisis of the Welfare State**

The welfare state, the idea that a successful, competitive, capitalist market economy can be combined with effective services to reduce poverty and meet the needs people experience in their everyday lives, was the great gift of Europe to the world. Now it is under attack and it is a war on two fronts. The conflict is experienced with especial severity in the UK. The response to the 2007-8 banking crisis, repeated recessions and economic stagnation in this country has been to balance budgets by cutting government spending rather than increasing taxes. The harshest cuts are in social provision, with the poorest groups bearing the brunt.

Standing behind the immediate attack on the welfare state is a second crisis, which now attracts rather less attention in policy debate. Projections of the numbers likely to use the main welfare state services (health and social care, education and pensions), of future wage levels and of other factors indicate that the costs of maintaining, let alone improving provision will rise steadily during the next half-century. Taxpayers will have to pay more or accept lower standards.

This book addresses the double crisis of the welfare state with a particular focus on the UK. It shows how the immediate and longer-run pressures interact. The second, slow-burn crisis sets the mass of the population against more vulnerable minorities. The high-spending expensive services, health, education and pensions, are top priorities for most people. Spending on the less popular benefits and services that redistribute to the poor is steadily eroded. The government’s response to the immediate economic crisis builds on this division, cutting the redistributive benefits to maintain the big-spending mass services. The fact that this is happening in a context of growing inequalities and social divisions makes the task of developing a humane and generous, effective and politically feasible response to the double crisis that much harder.

In this chapter we examine the twin crises in more detail. Chapter two considers how they interact and analyses their impact on the politics of state welfare. Chapter three examines the problems faced in making a case to sustain and improve provision in the current context, focusing on redistributive welfare for the poor. Chapter four extends the discussion of feasible, effective and humane policies to health and social care, pensions and education. Chapter five brings these arguments together, evaluates the opportunities for more generous and inclusive directions in policy and identifies the political forces that might be harnessed to drive them forward.

**The immediate crisis: recession, cuts and restructuring**

Britain’s welfare state is unusual in a European context in being financed mainly through taxation rather than social insurance payments from employers, workers and government. Tax finance presents the question of who pays in and who gets the benefits more directly and raises immediate issues of stigma and desert. The system includes high-quality and relatively cheap mass health care, pensions at modest levels, an average education system that achieves good results for those at the top but not for others, relatively extensive (but costly) social housing, and weak provision for those on low incomes, with limited skills or who are vulnerable for other reasons. The main division lies between the universal services that meet the shared needs of the mass of the population (health care, education and old age pensions) and those directed at poor minorities (unemployed, sick and disabled people, lone parents, those who can’t afford rents and families in low-waged work). It is here that questions of desert arise and that entitlement tends to be policed through means-testing and stringent work-tests.

Britain’s response to the economic crisis is also unusual.

***Fig 1.1 about here***

The 2008-9 recession was the deepest since at least the great crash in the 1929-31 and has already lasted longer than any previous recession for at least a century. Figure 1.1 above shows the pattern of economic growth across the two major comparable European economies, France and Germany, the EU as a whole, the US and the G7 group since the start of the first recession in 2007. G7 includes the largest established capitalist economies: the US, Canada and Japan as well as the UK and France, Germany and Italy and offers a global comparison. The graph plots the decline in GDP and shows how long it took to return to the pre-recession level. The collapse in 2009 was of between three and a half and five per cent of GDP. All of the countries and groups of countries had recovered to their 2007 level of output or surpassed it by 2011, apart from the UK. Germany, the US and the G7 then continue to grow, while France and the EU as a whole stay at about 2007 levels. At the time of writing, some 60 months after the onset of recession, the UK is still struggling to return to its previous position. It is not expected to do so for at least another year.

The UK has, effectively, lost the resources that would have been produced over the period since 2007 if output had simply stood still. One outcome has been a real fall in living standards for most people as wages fail to keep pace with price rises, about seven per cent between 2009 and 2013 for those on median incomes (Joyce 2012, 15). So far as the welfare state goes, the response of the incoming coalition government in 2010 was to cut state spending radically, although as Figure 1.2 shows, spending in the UK (the dotted line) was already at the average of the G7 and much lower than in the other major European countries or the EU average in the better times of the early 2000s. The graph shows how spending has already fallen sharply. On current plans it will continue to decline even when the economy recovers. This pattern differs from those elsewhere. Most countries tend to stabilise state spending close to or slightly above pre-recession levels when resources return. In the UK spending will sink further below European spending levels to fall beneath those in the G7 by 2014-15 and in the US by about 2016/17. This marks a decisive shift in the level of government involvement in society and in the economy. The UK has not spent a smaller proportion of national resources on public services than the traditionally market-centred US during the period of more than a century for which good records are conveniently available.

The cutbacks are combined with an equally profound programme of structural change. We consider the two aspects of reform, cuts and restructuring, separately.

***Fig 1.2 about here***

**The cuts**

The 2010 government set itself the objective of eliminating the budget deficit by 2014-5, revised to 2017-18 in 2012 as economic growth failed to return (HM Treasury 2010, 2012b). The programme set out in the 2010 Spending Review envisaged massive and rapid cuts in public spending, about £100 billion in all, including about one-fifth of the £166 billion budgeted for housing and community, environmental protection, law and order, defence, economic affairs and other public services in 2010, and about 18 per cent of the £105 billion budgeted for welfare for the poor, housing benefit, unemployment and family benefits and for disabled people (HM Treasury 2010).The target for benefit cuts was raised to 22 per cent in 2012.By contrast, the government chose to protect the mass welfare state services (health, education and pensions) which account for about 60 per cent of state spending. These experienced relatively minor cutbacks in current spending, although capital spending plunged headlong, by three-fifths for education and one-fifth for health services (IFS 2011, 138; Chowdry and Sibieta 2011, 4). The decision to ring-fence current spending on the more popular services resulted in much greater damage to benefits for low income people and to less popular areas of state provision.

The cuts accounted for some three-fifths of the resources required to balance the budget and tax rises (mainly a legacy from the 2005-10 government) some two-fifths. They included a rise to 50 per cent in the top rate paid by the two to three per cent of taxpayers with incomes over £150,000 (later cut to 45 per cent), a rise in National Insurance contributions for all employees of 1 per cent, and an increase in the mildly regressive VAT, plus a one-off banking levy, a rise in Capital Gains Tax (later reversed) and increases in alcohol and fuel duty.

The cut-backs coupled with immediate stimuli intended to promote a return to growth, such as the 2009-10 car scrappage subsidy, cuts in corporation taxand other taxes on business, further tightening of public spending, and £375bn of ‘quantitative easing’ (whereby the Treasury encourages private sector lending by increasing the availability of money to banks), failed to prevent a further slide into recession in 2011-12. By 2012 Office for Budgetary Responsibility projections indicated that the budget deficit would not be eliminated until after 2017-18 and that there is little hope of extra buoyancy to compensate for the lost production of the years of recession (OBR 2012a, Table 1.2). The government remains committed to further cut-backs focused again on short-term benefits and local government, in an attempt to stimulate private sector led recovery.

This programme failed to achieve its goals of reducing the deficit and stimulating growth. Further cut-backs in benefits were introduced in 2013, with £5bn diverted from public services to investment in infrastructure and corporation tax cut to 21 per cent, the lowest rate since the tax was introduced in 1965 (HM Treasury 2012b).

Cut-backs on this scale are exceptional in British policy-making and have been much discussed (for example Crouch 2011, Gamble 2011, Gough 2011a, Skidelsky 2012). Here we outline the government’s underlying assumptions, examine how the cut-backs are structured to achieve a specific impact and consider the risks run in pursuing these policies.

***Assumptions underlying the cuts:*** In recent years most governments in developed economies have pursued economic policies that balance two underlying approaches. Those inspired by Keynesian counter-cyclical theory see the problems of economic downturn in terms of the resources (factories, people, investment capital) that lie idle. They argue that government must make up for the contraction in private investment. This can be financed by borrowing which temporarily increases indebtedness but can be paid off out of the proceeds of future growth. An alternative liberal approach argues that the long-term solution must rely on competitiveness in international markets and hence on low public deficits and free markets providing good investment opportunities to attract private capital. The latter view is more appealing to those who believe that there are structural weaknesses (as they see many of the restrictions on market freedoms) in national economies that currently damage competitiveness and that may now be corrected.

Both viewpoints have influenced policy in developed countries, but the balance has shifted more in the liberal direction as stagnation has continued (Skidelsky 2012, Crouch 2011, Davies 2011). The second graph above shows that the response to the second recession of 2011-12 (the slight upswing in state spending in those years) was much weaker than that to the first recession in 2008-9. The UK is the leading exponent of liberal economic remedies, cutting spending harder and faster than any of the major developed economies, indeed than any European economy apart from those compelled to do so as a condition of IMF, ECB and EU loans.

***Structure and impact of the cuts:*** The UK cuts are indeed exceptional. Roughly two-thirds of government spending is directed at welfare state provision, in order of scale: the NHS, pensions, education, other cash benefits including housing benefit and benefits for disabled people, social care and social housing. The remainder goes on the military, police and prisons, the rest of local government (apart from education, social housing and social care), transport and environmental policies, again in order of spending. This complex interactive mechanism disposes of about a third of GDP, of everything that all economic activity in the country generates in a year. The cuts affect all areas but are not spread evenly. Non-welfare services lose roughly a fifth (IFS 2011, Figure 6.3). When it comes to the welfare state, the cuts are targeted away from the most expensive and popular areas which are used by large numbers of voters, such as the NHS, education and pensions. Instead they are concentrated on the rather lower spending but less popular benefits and services for lower income people of working age: benefits for low-paid, unemployed and disabled people, for families and children, and for housing.

The cuts will save about 27 per cent of planned spending on disabled people of working age (some £16.4bn) through reforms to employment support allowance, the replacement of disability living allowance by the less generous personal independence payments and more stringent work tests (DWP 2012a, 2012b). They will freeze child benefit until 2013 and remove it from the better off, cut working families tax credit, reduce the social housing budget by three-quarters (IFS 2011 Table 6.2) and introduce harsher entitlement rules and a series of cuts to housing benefit that will limit entitlement for single and for younger people, make it difficult to claim outside low income areas and for many kinds of housing and reduce benefit levels sharply. These cuts impact particularly severely on women, who are the main recipients of child benefit, tax credit and housing benefit, and make up some ninety per cent of single parents, and children.

Changes to the benefit uprating rules will result in further reductions in spending on benefits for people of working age that will continue to drive down costs indefinitely. Uprating for pensions will be set at the highest of the retail price index, rises in earnings or 2.5 per cent, ensuring that this group share the improvements in living standards of the mass of the population. Rises in benefits for those of working age (child benefit, housing benefit, job seeker’s allowance, income support and tax credits) will be limited to one per cent between 2013-14 and 2015-16 and then linked to the consumer price index. This index does not include mortgage interest and calculates below the arithmetic average of prices for the items included on the assumption that purchasers will continually substitute cheaper for more expensive ones. The projected outcome is to reduce the rate at which benefits rise every year by between one and two per cent indefinitely. Lower-income families of working age will experience harsh immediate cuts in living standards and a continuing downward pressure, which will exacerbate the division between better and worse-off groups. About two-thirds of the money saved will come from benefits paid to women (WBG 2012b, 3).

The division between welfare for working age poor and for pensioners will be embodied in a re-configuration of the benefit system. All benefits except child benefit and those for pensioners will be combined into a new Universal Credit from 2013. The new system will have the advantages of simplicity and transparency and will mitigate slightly the ‘poverty trap’, whereby people moving off benefit into paid work may only experience a small increase in net income because they risk losing benefits nearly pound for pound against any extra money they earn. Of the 7.1 million people likely to be claiming the benefit, some 2.9 million working-age families will experience a short-term net gain, against some 1.8 million, mainly single people, who will lose out (IFS 2012c). However the cuts in uprating and other restrictions described above will continue to drive down living standards for the poor. The pressures on benefits will be intensified by further cuts in the 2013 budget of about £1.2bn (Adam 2012). Current proposals will direct the new benefit to the chief earner in the household, typically a male partner in a couple, so that women will tend to lose control over benefit incomes (WBG 2011b). DWP modelling shows that the rates at which benefits are lost if income rises are on average higher for women, so that the incentive to work more is reduced, again leading to outcomes in which women are more dependent on men (DWP 2011a,16).

New policies cut back means-testing for pensioners just as they extend it for those of working age. A new single-tier flat-rate pension will be introduced in 2017, to replace the current National Insurance Basic, some of the means-tested Pension Credit to which those without other sources of income are entitled, and the additional State Second Pension to which those above a minimum income level contribute. The new pension has the advantage of simplicity and is set at a level slightly higher (some two pounds) than the amount all pensioners are entitled to under Pension Credit. It will benefit those on low incomes and self-employed people. It is unclear how many of those with interrupted work records (mainly women) who currently rely on pension credit will gain from the reform. A 35 year contribution record is required to receive full single-tier pension. Those with caring responsibilities will have some contributions credited but an extended work record is required to gain from the new benefit. Those who pay into an additional private or occupational pension and their employers will lose the current relief on NI contributions (DWP 2013, 9-10). The government expects more people to enrol in private top-up pensions as the size of the state pension becomes clearer. These pensions will receive less subsidy through reduced National Insurance contributions, cutting benefits.

The scale of the cutbacks for benefits for sick and disabled people of working age has attracted some surprise. This group typically attracts low levels of stigma since it is not seen as responsible for its inability to work. Policy announcements have stressed the role of work-tests in implementing these cuts. Part of the explanation for these cuts may be the sums involved: more than nine per cent of all benefit spending (Browne and Hood 2012, Table 2.1). Part may be the fact that the risk of disability is concentrated among lower social groups, attracting less sympathy from the middle mass. Those in routine and manual work report roughly twice as much limiting long-standing illness or disability as those in professional or managerial jobs (Palmer 2011, Graph 5).

Figure 1.3 shows the percentage fall in income as a result of the tax and benefit changes for different tenths of the income distribution, from poorest to richest, and for pensioners, households with children and those without. It brings home two points: in general it is a small minority of the richest who are hit hardest as a result of the tax changes, but those at the bottom who lose benefits also suffer disproportionately (HM Treasury 2012a, Chart 1b). Secondly the impact on other groups is very different according to household type. Pensioners mostly are relatively well protected. Among household with children the bottom three income groups are hit relatively hard. Among those without children the cuts for those at the bottom are very harsh indeed. This group includes people with low skills and poor work opportunities who are vulnerable to severe poverty. Poverty (understood as income below 60 per cent of the average) will continue to rise, from 19.1 to 20.8 per cent among households with children and from 15.4 to 16.8 per cent among working age adults by 2015 (Joyce 2012, Table 3). Cuts in social services provision affecting health and social care, nurseries, housing and local government services will also impact more heavily on the poor.

***Figure 1.3 about here***

The overall local government cutback is 30 per cent over five years, affecting pre-school and 16-19 college education, the careers service, local housing and transport, youth work, public health and most importantly care for frail and older people and for children, and social housing. Councils will differ in how they prioritise spending challenges. We have already noted that the main source of support for social housing, the communities’ budget, is cut by three-quarters. The changes to the formula for allocating funding from central to local government, which makes up about three quarters of local spending, more in poorer, lower community charge areas, visit cuts emphatically on these areas. Support falls by roughly three times as much in inner-city and poorer parts of England than in more affluent rural and suburban districts (IFS 2012b, ch. 6; see also HoC Library 2011, Tables 4 and 5, and PWC 2010, 2-3). These shifts have led to service cuts, mergers of provision by councils and much greater use of outsourcing to private contractors (Johnstone 2011). Whether one-off savings from such changes can be repeated in future years is unclear (Moore 2010). Similar changes have been made to the area component in NHS funding allocations (Bambra 2012).

When the cuts in services are combined with those in benefits and with the tax changes, the full impact outcome is heaviest for poorer people of working age. The effects are particularly severe for families rather than for single people. It is difficult to cost the loss of services. Not being able to send a child to a nursery or being able to get social care provision may have a greater impact on a family’s life that is indicated by the cash value of the place. IFS have attempted to parcel out the impact of the cuts in services, assuming these are worth what it costs to provide them and not taking into account the 2013 budget cuts. The estimate shows that services cuts reduce living standards of the poorest fifth of households by a further four per cent and of the better off fifth by about two per cent (Browne 2010; O’Dea 2010).

Cuts that affect poor families have a strong impact on women, since women tend to be lower paid than men and more likely to be unwaged due to caring responsibilities. About 70 per cent of tax credits, including childcare and working tax credits and other support, is paid to mothers, as is 94 per cent of child benefit. Some 60 per cent of Housing Benefit, also due to be cut, is paid to women (Cooper 2010). The shift to Universal Credit will further deepen women’s dependence on men in families as explained above. The policy of raising income tax thresholds benefits men disproportionately since women predominate among those paid below the minimum tax level (WBG 2012b, 9). An overall analysis by the HoC Library of the combined effect of all income tax, tax credit and social security measures from June 2010 to December 2012 shows that 74 per cent of the cuts bear on women’s incomes and 26 per cent on men’s (Fawcett Society 2012).

Women are also affected differentially by other cuts across the range of government services, since they predominate among lower income state sector employees, most vulnerable to the impact of central and local government cutbacks and to cost savings in services transferred to the private sector. OBR now estimates that about 1.1 million jobs will be lost in the government sector between 2010 and 2018 (OBR 2012a). Some will be made up in newly-privatised services, mostly at lower pay and conditions. About two-thirds of the impact of the cuts to the up-rating of public sector pensions (expected to reduce benefit levels by about a fifth by 2030 and ultimately by 40 per cent) will be on women. The cuts will impact most severely on the poorest groups and on families, women and children among them (WBG 2011a).

The cuts will also impact on homelessness. The numbers of households accepted by local authorities in England as homeless and in priority need fell from about 102 thousand annually to about 42 between 1997 and 2009. It then rose to some 48 thousand (June 2012) and continues to rise (DCLG 2012, Chart 3; HoC Library 2012, Table 1). The long-term context is an established trend to an increase in demand for housing as the number of households rises, from 16.3 million in 1961 to 20.2 in 1981 to 25.3 by 2010 and is predicted to reach 27.5 million by 2033 (ONS 2012a, 1; DCLG 2010). The number of dwellings slightly exceeds that of households, but demand is concentrated, particularly in the Midlands, London and the South-East producing intense pressure on stock and higher rents and prices in these areas. The problems for low-income and vulnerable groups are exacerbated by the fact that the proportion of all housing provided by social landlords (councils and housing associations) has fallen sharply, from 31 to 20 per cent between 1977 and 2012, as a result of right to buy purchases and limited investment (HoC Library, 2012, 2). The cuts in housing benefit mentioned earlier and new rules that allow councils to rehouse vulnerable households in priority need with private landlords without taking the affordability of housing into account are likely to make the problem worse. Some authorities in areas of great housing pressure are moving homeless families outside the borough, often at a considerable distance, in order to find cheap accommodation. This may disrupt family networks, children’s schooling and work contacts.

***The risks:*** The speed and depth of the cutbacks are particularly surprising because they involve major risks in three directions: economically, politically and practically. The economic risk is simply that the assumptions about how government interventions influence the economy may prove incorrect. The decisive shift towards a liberal cut-back approach may fail to reduce the deficit or re-establish the conditions for growth. At the time of writing (December 2012) growth is stalled, the deficit expanding and the Office for Budgetary Responsibility assumes it will do so until at least 2017-18 (OBR 2012a, Table 1.2). The International Monetary Fund now argues that austerity has had a more damaging effect on economic recovery than was previously assumed and may actually cut growth (IMF 2012b, 41). The government is under pressure to regulate the financial sector more strictly and has reluctantly agreed, although serious intervention is postponed until 2019. State-led investment is now being pursued on a modest scale by underwriting bank lending to business and though transport and infrastructure undertakings. These are to be financed through further unspecified cuts to benefits and services from 2013, with the NHS and education largely protected (HM Treasury 2012b).

The political risks are especially serious for a coalition and follow from the economic problems. Continued austerity and failure to achieve key targets in growth and deficit reduction may damage prospects in the 2015 election. The coalition partners, who include some committed to a more centrist agenda, may withdraw support from for some agreed policies.

Practical risks concern the policy outcomes. In relation to the welfare state, it seems likely that the government will find it hard to protect those areas it wishes to exempt from cuts. The NHS already faces a strict programme of 4.4 per cent annual savings and is currently achieving about half that level, with much difficulty. Cost pressures are likely to lead to a deterioration in quality of service after 2013 (Appleby *et al.* 2012). IFS estimates that real increases in the cost of staff and other resources in education will raise spending by some four per cent by 2015. If extra resources are not found, the effect will be an equivalent spending cut (IFS 2011, Table 6.2). The benefit reforms have so far undershot by about one-third the targets for moving substantial numbers from disability benefits or jobseeker’s allowance into paid work (DWP 2012e). Further risks are involved in enforcing performance and quality targets on outsourced programmes. We consider why a coalition should chose to run such risks in more detail in chapter two and discuss the problems of regulating risk in chapter four.

**Restructuring public services**

The UK government leads the way in liberal responses to the economic crisis. It is pursuing a major programme of cutbacks intended to last beyond the life of the current parliament and involving substantial economic, political and practical risks. The cuts have been combined with a thorough-going restructuring of almost every major area of government activity, designed to change the way in which services are delivered and ensure that cut-backs are embedded permanently in future patterns of provision. For the welfare state, the restructuring includes three main elements: the break-up of large national services so that responsibility moves away from central to local government or to non-state mainly commercial providers, The outcome will be more diverse provision between groups and areas in all services, including those that remain national, and a much greater emphasis on strengthening incentives and mobilising people into paid work. The reform programme, involving the simultaneous restructuring of the NHS (NHS and Social Care Act 2012), local government (Localism Act 2011), benefits for those of working age (Welfare Reform Act 2012), the Employment Service, higher education, social housing, pensions and public administration (*Open Government Services*, Cabinet Office 2011), stands out among the recovery packages of the larger Western democracies in scale and ambition (Hay and Wincott 2012, ch. 1; Farnsworth 2011, 258-61; Taylor-Gooby and Stoker 2011, 4).

***Fragmenting national services:*** the Prime Minister has signalled the ‘presumption’ of ‘all public services being open to outside providers’ (Cameron 2011). The Open Public Services White Paper sets out the underlying principles: greater choice, decentralisation of provision, competition and the premise that ‘wherever possible, public services should be open to a range of providers competing to offer a better service’ with fair access and accountability procedures (Cabinet Office 2011, 9). These policies massively extend the system of contracting out services that has been pursued in school and hospital cleaning, catering and ancillary services, local government and elsewhere for the past two decades. Now contracting is to ‘any willing provider’, in some cases rephrased as ‘any qualified provider’. There is a bias towards commercial providers and a relaxation of the responsibility for government to secure a particular range or standard of provision.

The 2012 NHS reforms follow this pattern. The main providers of health services will be local Clinical Commissioning Groups, GP-led and involving other health professionals, run as small businesses and managing a devolved £80bn budget within an overall regulatory framework, but with many fewer targets to direct their practice. The reforms place strong emphasis on competition, particularly on price, and ensure that the regulatory body, Monitor, has a duty to oversee the creation of a competitive market. Almost all competition within the health service was previously between NHS providers and for fixed tariff services so that different hospitals competed to provide surgery, clinical tests or routine therapies on the quality of what they could offer rather than cheapness. Experience of competition on price in the US Medicare and Medicaid schemes indicates that it is hard to resist a decline in quality (Gaynor *et al.* 2010, Gaynor and Town 2012, 76-7). The Department for Health plans to let contracts for about a quarter of its whole budget during 2012 and 2013, mainly to private for profit providers. This raises major issues in regulating standards, discussed further in chapter four.

The future shape of the service is unclear. There are currently moves by commercial providers, including the large multi-national medical insurance firms and European competitors to win contracts from GP-led commissioning panels. The process of transferring community health services mainly to profit-oriented private groups started in mid-2012. One possibility is a more variegated service with different levels and a wider range of provision and priorities for between areas. Much will depend on the decisions made by local Clinical Commissioning Groups, who hold the budgets, and the extent to which government is prepared to commit resources to meet the continuing demographic and other pressures.

In education, decentralising school reforms, initiated by the previous government, are now being expanded on a massive scale with no extra funding. The new Academies and Free Schools will be independent from local government control. Private providers are being encouraged to enter the market. Regulation of curriculum has been reduced and that over teachers’ pay, qualifications and conditions of service is being relaxed in some schools. While current account school spending has been maintained, spending on other areas of education has been cut sharply. One effect of the relaxation in regulation which allows hard-pressed councils to divert the money to other uses is that funding for the main pre-school programme, Sure Start, has fallen by about half. The national scheme of cash benefits to encourage low-income students to continue schooling and training beyond the minimum school-leaving age of 16 has been abolished and any continuation depends again on local support.

Government funding for higher education has been cut by 80 per cent with the assumption that increased fees of up to £9,000 a year will make up the difference, so that university teaching is financed almost entirely by students. Loans are available but must be repaid. Analysis of official data for the first year (2011/12) shows a 7.4 per cent fall in admissions across the UK compared with 2009/10 (admissions were distorted upwards in 2010/11 by students foregoing a gap year to avoid the higher fees). The fall was 8.8 per cent in England where fees are highest. Conversely, admission rose by 1.0 per cent in Scotland where fees were not increased and by 0.3 per cent in Wales where they were capped at £3,456. Applications fell more sharply among women and for less prestigious institutions and shifted towards directly vocational subjects such as law, medicine, business, engineering and computing (Independent Commission on Fees 2012, 5).

The restructuring of the employment service pioneers an approach to the engagement of the for-profit sector with broader implications: payment by results. Under the Work Programme, contractors, who manage unemployed claimers and provide training and work support, only receive the bulk of the money if they meet certain goals. For example, the claimer must enter and hold a job for a minimum period, three to six months. This system is also being introduced in overseas aid and in some areas of community health care, offender management and social care for young people. If successful, it will open up a new approach to public management by monitoring outcomes rather than standards of provision. How far contractual obligations will be enforceable in the event of failure is unclear. The problems of regulation and monitoring highlighted in the discussion of political risks above redouble.

The government has placed considerable emphasis on the role of Third Sector organisations alongside for-profit providers in engaging local communities in a ‘Big Society’: ‘a broad culture of responsibility, mutuality and obligation’ (Cameron 2009). The voluntary sector is very much smaller that the state sector, limiting its potential contribution. Activity is concentrated in particular areas, generally the richer parts of the country (Lyon and Sepulveda 2009, Mohan 2011, 7). It focuses on particular needs (chiefly health care and research, schools and youth clubs, religious groupings and overseas aid) and is not necessarily in a position to substitute for cutbacks in support for the poorest (NCVO 2010: vi, 10). In any case much depends on state support. The sector is enormously diverse. The five areas of provision closest to the state services which are now being cut back (employment and training, law and advocacy, education, housing, and social services) receive more than half their income from local government through contracts which are now also subject to cuts (NCVO 2011). The capacity of the Third Sector to substitute for government is limited, especially in the current context.

***Diversity in provision:*** the cash benefit, NHS and education reforms have passed into law and are now being implemented. Local government cuts, employment service changes and the new rules for pension uprating are established by ministerial decision. It appears certain that the moves towards decentralisation, much greater use of contracts and shifting responsibility away from Ministers for outcomes in services like the NHS will lead to greater diversity in provision. In health care, the GP-led Clinical Commissioning Groups will be able to decide on priorities and spend state resources to promote them to a much greater extent than at present. Local state schools constituted as separate semi-autonomous agencies will vary in curriculum, staffing and de facto admission policies. Local government services, especially in social care will depend very much on variations in local resources.

The combination of cut-back and restructuring will impact differently on better and worse-off, women and men and richer and poorer areas, deepening social divisions. Cash benefits targeted on lower income people of working age have been cut most sharply while those directed to pensioners have been protected. Reforms to housing benefit will concentrate poorer households in the lowest rental areas of cities. The impact of changes in local government funding is roughly three times as severe in the most deprived areas as in the least deprived. Some specific grants, such as those for the educational maintenance allowance, Sure Start day nurseries, or community charge benefit for poorer payers, have been reduced and authorities given discretion to divert money elsewhere. Local government is prevented by heavy financial penalties from making up the shortfall through higher community charges. The fact that the cuts will hit families of working age and women in those areas more severely has already been discussed.

The decentralisation of provision and outsourcing of major parts of large national services such as the NHS and education will lead to greater spatial divisions as GP-led commissioners or consortia of schools pursue their own policies and make different arrangements with suppliers. One tendency is for the linkages within national services that spread good practice and improved national standards, for example, the cancer and heart disease networks in the NHS, to be weakened to enable separate contracting and promote local responsibility. In local government the biggest cutbacks are in office services such as planning and development (43 per cent according to IFS), while social care (the biggest area of council spending) has only suffered a four per cent cut nationally. Transport has been cut by about one fifth and social housing by three-quarters with big local variations (IFS 2012b, ch. 6).

***Mobilisation into paid work:*** the reforms place great emphasis on programmes to move more claimers into paid work. The structural reforms of benefits, in particular the greater emphasis within Universal Credit on weakening the poverty trap, the redefinition of part-time work so that tax credits are no longer available to those working between 16 and 24 hours a week, the determination to shift some two-fifths of those currently claiming disability benefits into the labour market, the imperative in the ‘payment by results’ system for the Employment Service to get claimers into jobs and the restriction of support for lone parents to those whose youngest child is under five, all tighten the pressures on claimers. The raising of the pension age to 67 for both women and men by the late 2020s creates a new pool of potential workers.

Lying behind this is an ideological valuing of ‘strivers’ (Osborne 2012) and ‘hard-working families’ against the feckless and undeserving poor, presumed to enjoy idleness on benefits. This ignores the fact that most poor people earn their poverty. Fifty-nine per cent of working-age households in poverty after housing costs have at least one adult in full-time work (DWP 2012c, Table 5.4db). The welfare state for those of working age is becoming even more work-centred. This draws a sharp distinction between those within and outside the realm of employment and maps it onto a corresponding division between deserving and undeserving poor.

**The long-run crisis**

The headlong cuts and root and branch restructuring of the welfare state are the government’s response to the immediate crisis of public spending. This approach is an extreme outlier in the international context, driven by commitment to a radical liberal political economy. The current crisis is set in the context of longer-run pressures which escalate costs in the higher-spending areas of social provision and call the future stability of the state welfare system into question. The main pressures are:

* Population ageing, with increases in the numbers claiming pensions and using health services and social care, which will far outweigh a projected decline in numbers in education;
* Continuing pressures for wage rises in these services to match those in the rest of the economy although productivity does not rise at the same rate; and
* Social factors such as shifts in expectations about service standards and changes in family support which are substantial but often hard to quantify.

We will examine the three areas: population ageing, the impact of sluggish productivity in welfare services on costs and the social context.

***Population ageing and rising demand for health, social care and pensions:*** people tend to live longer lives, have fewer children and have them rather later in life. As a result the average age of UK citizens will rise as time goes on, an effect amplified by the post-war demographic bulge. The proportion of the population over 65 is expected to increase from 17 to roughly 26 per cent between 2012 and 2061 (OBR 2012c, para 22). Population structures are also affected by other factors such as the mortality of children and young people, which is gradually falling, and immigration, which has made a marked contribution in recent years, but is expected to continue at a substantial but rather lower rate. Population ageing and falling mortality apply across most European countries. The UK is expected to age rather more gradually than many, mainly because immigration will bring in extra people of working age. The projected population increase is from 62 million in 2010 to about 79 million by 2060, slightly ahead of France, rising from 65 to 74 million. Italy will grow from 60 to 65 and Spain from 46 to 52 million. On the other hand, the population of Germany, where population ageing is further advanced and expected immigration lower, will fall from about 82 to 66 million (EC 2012, 26).

Changes in population structure affect public spending. Pensions, of course, apply to older people. The distribution of health care spending by age peaks for those over 65, at about £15 thousand a year on average, and for those aged five or younger, at about five thousand a year. Spending on those in between is on average lower. Social care spending hits a peak in advanced old age (six thousand a year for those aged 85 or over) and education among the young, averaging £12 thousand a year at age 12. Aggregate social spending is relatively high for young people, averaging about £18 thousand a year for those aged 10 to 12, lower at about eight thousand a year in middle age, then rises steadily from aged 65 to plateau at age 85 at about £27 thousand a year. The distribution of tax payments is much flatter, with a peak at about age 45 (OBR 2012c, 65). Population ageing increases demand but doesn’t increase revenue.

As the population ages, spending will increase, from 36 per cent of GDP in 2016-17 to 41 per cent by 2061-2, according to the OBR projections. Rising health spending is the main factor, followed by pension and social care costs. The estimates refer to an extended time period and do not allow for any changes in unemployment or the possibility that productivity will fall as population ageing slows enterprise and innovation (estimated by the EC to cut EU growth rates from 1.6 to 1.3 per cent annually after 2030: EC 2012, 32). They are highly sensitive to fluctuations, for example in the cost of health care or in immigration rates. However, projections by the EC point to broadly similar increases and show that the UK is slightly below the European average and clearly below Germany, Spain and Italy in the impact of ageing on public finances. The precise impact of the changes is uncertain but likely to be significant and expansionary. It will be very much greater if the kinds of efficiency gains in welfare state services discussed below cannot be achieved.

***Productivity and staff costs:*** the main welfare state services, health and social care and education, employ large and increasing numbers of people. Numbers employed in education rose from 1.4 to 1.6 million and in the NHS from 1.2 to 1.6 million between 1999 and 2011 (ONS 2012b). Pay constitutes the major part of the costs of running these services. Under normal conditions, the economy grows and produces more each year. Part of the extra product is allocated in pay increases for workers. Staff in the welfare state sector will expect pay rises at roughly the same rate, although their contribution to the economy is indirect in enabling the private sector to generate a greater surplus.

Productivity in welfare state services is typically understood as the relationship between the output of the service (such factors as numbers of patients treated or students taught) and the input (the money and other resources spent), taking account of any changes in quality (measured by factors such as patient satisfaction, waiting times or examination passes). In education and health care the main input is staff pay. Workers in these sectors are likely to demand the same wage increases as elsewhere in the economy, where rises reflect greater productivity and economic growth. The problem is that it is very difficult to achieve real increases in the output of these services year by year comparable to those in the economy as a whole. In many areas real gains can be achieved by automation, use of ICT and new management techniques. The human services are intricate operations and often it is the time spent in contact with skilled (and expensive) professionals that people value most highly and that seems to produce the results. It is difficult, for example, for every teacher to teach larger classes year on year or for a surgeon to do more hip replacements.

Enormous efforts have been spent on trying to achieve real improvements in welfare state productivity in recent years. These have included: introducing competition between the various clinics, schools and other agencies within state services or between state and non-state, commercial on not-for-profit providers in education and NHS front-line services from the early 1990s onwards; a number of experiments with ICT, including the ambitious attempt to establish a national system of access to patients records between 2005 and 2011, only partially successful; ‘efficiency saving’ cost-paring measures from the mid-1980s onwards; a target-centred management system through Public Service Agreements developed from the 1998 Comprehensive Spending Review onwards, radically scaled back in 2010; the ‘Nicholson Challenge’ from 2009, intended to produce four per cent savings annually in the NHS from 2009 onwards, succeeding at less than half that rate; pay freezes, which damage recruitment if maintained; and now payment by results.

It is difficult to estimate productivity for services like the NHS and education because the quality of provision is often a matter of judgement. The most recent ONS estimates take into account measures of output (patients treated, students in schools) and also of quality (waiting times, patient satisfaction survey results, the success of treatment, exam pass rates, test results, school satisfaction and similar factors). They conclude that overall output in health and social care kept pace with inputs between 1995 and 2001. Resources for health care increased sharply after 2001 but had little immediate effect on output, so productivity actually fell between 2001 and 2004. From 2005 to 2009 productivity has been largely unchanged. The net effect over the whole 14 years is a slight average annual fall (-0.2 per cent: Hardie *et al.* 2011). For education, productivity grew in the early period as the school age population expanded, fell in the middle period as this was outstripped by extra funding, then increased after 2004 as funding increments tailed off and quality measured by exam results rose. Overall, productivity declined, but at an even slower rate than in the case of health (Baird *et al.* 2010).

Attempts to examine a longer period run into further data problems. Research by the University of York shows a broadly similar pattern, while work that attempts to look back to 1979-80 suggests a gradual productivity improvement under more stable financing (Oliver 2005). Le Grand’s summary of recent evidence implies that some, at least, of the quality improvement is due to greater competition between health service providers (2007). It is unclear whether productivity in the private sector is greater or lower than in the public sector (Jurd 2011), and how far gains from privatisation result from changes such as a shift to non-unionised labour that cannot be repeated over time.

The overall picture is inconclusive but carries a strong suggestion that productivity improvements in the main welfare state services are much harder to achieve than in the private non-welfare sector, where annual productivity rises are normal and average just over two per cent a year for the whole period between 1990 and 2011, including the first recession (OECD 2012a). This matters: if the state sector does not make productivity gains at the same rate as the private sector but wants similar pay rises it must find ways to reduce costs or spend more money each year. By way of illustration, the Office for Budgetary Responsibility in its projections estimates the impact on health care costs of differences in productivity. If productivity in health care matches that in the rest of the economy, overall costs will grow steadily from about six per cent of GDP in 2016-17 to about nine per cent by 2061-2, mainly as a result of demographic shifts. This is a real but manageable pressure. If productivity fails to improve, costs inch up to 10 per cent of GDP by 20131-2, nearly 15 per cent by 2041-2 and to 24 per cent by the end of the period (OBR 2012c, Chart b5). To shift from six per cent of GDP to nearly 25 per cent on health care would have major consequences for the rest of social spending and for the economy as a whole. However, experience indicates that the most stringent efforts can do little more than hold productivity constant.

***Social changes: family structure, standards and expectations:*** some of the other factors likely to influence public spending are also difficult to quantify. These include: changes in family structure, which will probably increase the proportion of people in paid work, but also affect demand for accommodation and reduce the amount of informal family care available; and the demands that people make for higher standards in public services as they become increasingly aware of what is technically available or is provided elsewhere.

***Family structure:*** the rising pressure on housing as the number of households increases has already been discussed.At the same time gender roles are changing. The numbers of women in work and the numbers who combine work with childcare have risen steadily. The proportion of men in paid work fell from 95 to 83 per cent between 1971 and 2011, while that of women rose from 56 to 70 per cent. Seventy-one per cent of mothers with dependent children were in paid work by 2011, up from 66 per cent in 1996, against 90 per cent of fathers in both years (ONS 2012c). Current benefit reforms will withdraw benefits from mothers of school age children, increasing work incentives for this group at the same time as cuts to childcare support and other services make it more difficult for mothers to pursue employment.

***Standards in public services*** raise complex issues. Society has become more individualistic, people are typically better educated, feel that a greater range of opportunities should be open to them and are generally less deferential and more confident in their own judgements (Giddens 1995, ch.4). One result is a much greater awareness of attainable standards in such services as health care and education and a willingness to demand better provision. Two outcomes can be identified. First people experience treatment as consumers rather than clients in the private sector and increasingly expect the same when they use state services (Glennerster 2010). One result has been a move towards user choice in health and social care services and towards much greater personalisation in provision (see chapter four). This has encouraged the development of personal budgeting where health and social care services may make available (within constraints) the relevant budget to individual users, who then decides how to spend the money to best meet their own needs (Glendinning *et al.* 2009). If resources are constrained users may end up supplementing payments from their own purse.

Another development is much greater willingness for service users to pursue litigation to demand higher quality treatment or to protest against apparent shortfalls. The total cost of NHS compensation claims has risen from £550 million in 2001-2 to £1,329 million in 2011-12. (NHS Litigation Authority 2012). A series of demands from suppliers and patients for new and expensive treatments to be funded by the NHS exerts significant pressures on the drugs bill.

All these changes alter the environment in which the welfare state operates and increase pressure for radical changes, in most cases increasing the cost of maintaining provision. The profound and immediate cuts and restructuring currently underway are set in the context of a longer-run crisis resulting from established trends towards rising real costs for the most expensive areas of social provision, an increase in the proportion of older people in the population and social and attitudinal changes that are likely to escalate demands. These demands bear mainly but not exclusively on the mass services that make up the bulk of current spending. It is because the cutbacks are set in this context that the pressures on public provision are so intense and bear so heavily on the least popular area of provision, for the poorest groups.

**Conclusion**

This chapter makes three points:

* The UK welfare state faces an immediate crisis as resources are cut back precipitately and services are restructured, fragmented and privatised. These policies carry real political, economic and practical risks. They may damage support as voters lose valued services, they may fail to restore growth, as investment is reduced, and they may fail to deliver services of acceptable standard. For political reasons the cuts are imposed most stringently on welfare for lower-income minorities of working age, impacting most severely on women and children among them. Health care, pensions and education, the welfare state services most valued by the mass of the population, escape the harshest cuts, but still face real pressures. The current government is addressing the immediate crisis in a way that deepens divisions between the mass and the more vulnerable poorer minorities.
* These changes are taking place in the context of long-run pressures from population ageing, continuing wage escalation and other factors, which bear mainly on the popular services, predominantly on health and social care and pensions. More resources are required over time simply to maintain standards. Demands for extra spending here intensify the squeeze on benefits for the poor of working age since the mass services are more highly valued by most voters. The long-run crisis becomes a continuing war of attrition to slow the rise in costs for these services.
* These issues are important across almost all developed countries. They are particularly intransigent in the UK, because government has decided to respond to the immediate crisis through cut-backs rather than investment, because it imposes the cuts most stringently on vulnerable lower-income groups, because a liberal ideology intensifies the ideological divisions between deserving and undeserving groups and because the impact of global trends to greater inequality and social division is particularly marked in this country.

The next chapter steps back from cut-backs and restructuring and analyses the broader social and political context in which these changes are taking place. It considers why government chooses to respond to the immediate crisis in the way that it has despite the economic, political and practical risks outlined above, and shows that an underlying project to entrench a radical, competitive and individualistic liberalism permanently in the UK political economy is at least part of the explanation.

**Figure 1.1: GDP change as percentage of 2007 GDP 2007-13**

Source: author’s calculations from IMF (2012), projected from 2012.

**Figure 1.2: State spending, major economies, per cent GDP, 2005-17**

Source: IMF

Source: IMF (2012), projected from 2012.

**Figure 1.3: the impact of tax and benefit cuts on incomes for different household and income groups 2010 to 2015 (%)**

Source: calculated from Adam (2012)

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