John Hills

The distribution of welfare

Book section (Accepted version)

Original citation: Originally published in: Alcock, Pete, Haux, Tina, May, Margaret and Wright, Sharon, (eds.) The Student's Companion to Social Policy, Chichester, UK : Wiley-Blackwell, 2016, pp. 212-217

Chapter 30

The Distribution of Welfare

John Hills

Overview

- The distribution of resources is central to the provision of welfare, and distribution and redistribution take place through both state, and private and voluntary transfers.
- There is a range of different rationales underpinning the redistribution of resources to promote welfare.
- There are different ways of measuring distribution and its benefits. How it is paid for – and who pays – is very important in this.
- Much of the redistributive effect of welfare is as a sort of 'savings bank' transferring resources between different stages of people's own lives.
- However redistribution also plays a significant 'Robin Hood' role benefiting poorer sections of society most, particularly once one allows for how it is paid for.

Distribution and Redistribution

Distribution is a central issue in the appraisal of social policies; for some, it is *the* central issue. Much of the justification advanced for social policy is about distribution: 'without a National Health Service providing free medical care, the poor could not afford treatment'; or 'the primary aim of social security is preventing poverty'.

Most of this chapter is about the distributional effects of government spending on welfare services. However, redistribution - and its measurement - are not only issues for government. For instance, governments, including in the UK, have attempted (not always very successfully) to enforce payments by absent parents (generally fathers) to parents 'with care' (usually mothers). Similarly, since 2012 employers (starting with the largest) have had to make a minimum contribution towards their employees' pensions, if the employee does not opt out of the pension scheme. Such payments made under state regulation can be important in distributional terms, but are outside the 'welfare state'.

Whether redistribution is occurring can depend on when you look at it. Under private insurance for, say, burglaries, a large number of people make annual payments (insurance premiums) to an insurance company, but only a small number receive payouts. After the event (*ex post*) there is redistribution from the (fortunate) many to the (unfortunate) few. But, looking at the position in advance (*ex ante*), not knowing who will be burgled, all pay in a premium equalling their risk of being burgled, multiplied by the size of the payout if this happens (plus the insurance company's costs and profits). In 'actuarial' terms there is no redistribution - people have arranged a certain small loss (the premium) rather than the risk of a much larger loss (being burgled without insurance).

Similarly, if you look at pension schemes over a single year, some people pay in contributions, while others receive pensions. On this ‘snapshot’, there is apparently redistribution from the former to the latter. But over a longer horizon, today’s pensioners may simply get back what they paid in earlier. Redistribution is across their own life cycles, rather than between different people.

Assessing redistribution depends on the aims against which you measure services, and the picture obtained depends on decisions like the time period used. The next section discusses the first of these issues, the aims of welfare services. The subsequent sections discuss the conceptual issues raised in trying to measure distributional effects, and illustrate some of the empirical findings on different bases.

Aims of Welfare Services

There is little consensus on the aims of social policy or of government intervention to provide or finance welfare services. For some, the primary aim of welfare services is redistribution from rich to poor. Whether the welfare state is successful therefore depends on which income groups benefit: do the rich use the NHS more than the poor, and are social security benefits ‘targeted’ on those with the lowest incomes? For others, this is only a part of the welfare state’s rationale. Depending on political perspective, other aims will be more important (see Box 30.1); and the relative importance given to each aim affects not only the interpretation placed on particular findings, but also the appropriate kind of analysis.

Box 30.1 Potential aims of social policy and ‘redistribution’

- *Vertical redistribution*. If the aim is redistribution from rich to poor, the crucial question is which income groups benefit. Since welfare services do not come from thin air, the important question may be which are the *net gainers* and *net losers*, after allowing for who pays the taxes that finance welfare provision. Allowing for both benefits and taxes in understanding distribution has become even more important since the UK Government started using ‘tax credits’ (which can count as reduced tax liabilities) instead of some cash benefits.
- *Horizontal redistribution on the basis of needs*. For many, relative incomes are not the only reason for receiving services. The NHS is there for people with particular medical needs: it should achieve ‘horizontal redistribution’ between people with similar incomes, but different medical needs.
- *Redistribution between different groups*. An aim might be redistribution between social groups defined other than by income; for instance, favouring particular groups to offset disadvantages elsewhere in the economy. Or the system might be intended to be non-discriminatory between groups. Either way, we may need to analyse distribution by dimensions such as social class, gender, ethnicity, age or age cohort (generation), or kind of area, rather than just income.

- *Insurance*. Much of what the welfare state does is insurance against adversity. People 'pay in' through tax or national insurance contributions, but in return, if they are the ones who become ill or unemployed, the system is there to protect them. It does not make sense just to look at which individual happens to receive an expensive heart by-pass operation this year and present him or her as the main 'gainer' from the system. All benefit to the extent that they face a risk of needing such an operation. The system is best analysed in actuarial terms; that is, in terms of the extent someone would expect to benefit on average.
- *Efficiency justifications*. An extensive literature discusses how universal, compulsory and possibly state-provided systems can be cheaper or more efficient than the market left to itself for some activities, particularly core welfare services such as health care, unemployment insurance and education. Where this is the motivation for state provision one might not expect to see any redistribution between income or other groups. Services might be appraised according to the 'benefit principle' (how much do people receive in relation to what they pay?), and the absence of net redistribution would not be a sign of failure.
- *Life cycle smoothing*. Most welfare services are unevenly spread over the life cycle. Education goes disproportionately to the young; health care and pensions to the old; while the taxes that finance them come mostly from the working generation. A snapshot picture of redistribution may be misleading - it would be better to compare how much people get out of the system over their whole lives, and how much they pay in.
- *Compensating for 'family failure'*. Many parents do, of course, meet their children's needs, and many higher-earning husbands do share their cash incomes equally with their lower-earning wives. But in other families this is not so – family members may not share equally. Where policies aim to counter this kind of problem it may not be enough just to look at the distribution *between* families, we may also need to look at distribution between individuals; that is, *within* families as well.
- *External benefits*. Finally, some services may be justified by 'external' or 'spill-over' benefits beyond those to the direct beneficiary. Promoting the education of even the relatively affluent may be in society's interests, if this produces a more dynamic economy for all. Appraisal of who gains ought to take account of such benefits (although in practice this is hard).

Conceptual Issues

There is no single measure of how welfare services are distributed. It depends on precisely what is measured, and apparently technical choices can make a great difference to the findings.

The counterfactual

To answer the question, 'how are welfare services distributed?' you have to add, 'compared to what?'. What is the 'counterfactual' situation with which you are comparing reality? A particular group may receive state medical services worth £3,000 per year. In one sense, this is what how much they benefit. But if the medical services did not exist, what else would change? Government spending might be lower, and hence tax bills, including their own. The net benefit, allowing for taxes, might be much less than £3,000 per year.

Knock-on effects may go further. In an economy with lower taxes, many other things might be different. Without the NHS, people would have to make other arrangements: private medical insurance, for instance. Britain without the NHS would differ in all sorts of ways from Britain with it, and strictly it is this hypothetical alternative country we ought to compare with to measure the impact of having the NHS. In practice, this is very difficult - which limits the conclusiveness of most empirical studies.

Incidence

Closely related is the question of 'incidence': who *really* benefits from a service? Do children benefit from free education, or their parents who would otherwise have paid school fees? Are tenants of subsidized housing the true beneficiaries of the subsidies, or can employers attract labour to the area at lower wages than they would otherwise have to pay? In each case different assumptions about who really gains may be plausible and affect the findings.

Valuation

To look at the combined effects of different services, their values have to be added up in some way, most conveniently by putting a money value on them. But to do this requires a price for the services received. This is fine for cash benefits, but not for benefits which come as services 'in kind', such as the NHS or education. To know how much someone benefits from a service, you want to know how much it is worth *to them* - but you cannot usually observe this. Most studies use the *cost* to the state of providing the service. But 'value' and 'cost' are not necessarily the same. It may *cost* a great deal to provide people with a particular service, but if offered the choice they might prefer a smaller cash sum to spend how they like: the cost is higher than its value to the recipients. Conversely, collective provision may be much cheaper than private alternatives, so the value of the NHS, for instance, may be *greater* in terms of what people would otherwise have to pay privately, than its cost to the taxpayer.

Distribution between which groups?

Comparing groups arranged according to some income measure is of obvious interest, but so may be looking at distribution between social classes, age groups, men and women, or ethnic groups. A related issue is the 'unit of analysis': households, families or individuals? A larger unit makes some things easier: we do not have to worry about how income is shared within the family or household. But it may mask what we are interested in: for instance, distribution between men and women. It may also affect how we classify different beneficiaries. The official Office for National Statistics (ONS) results described below examine the distribution of welfare benefits between *households*. In this analysis a family with four children 'scores' the same as a single pensioner living alone – the situation of six people is given the same weight as that of one person. Weighting each person equally would change the picture.

Distribution of what?

Depending on the question, different measures will be appropriate. We might be interested in gross public spending, or in net public spending after allowing for taxes financing services, or in gross public spending in relation to need. These can give apparently conflicting answers. NHS spending may be concentrated on the poor, but that may reflect their poor health. Allowing for differences in sickness rates, the distribution of NHS care in relation to need may not favour the poor after all.

Similarly, the gross benefits from a service may appear 'pro-rich'; that is, its absolute value to high income households exceeds that to low income households, say by 50 per cent. But if the tax which pays for the service is twice as much for rich households, the *combination* of the service and the tax may still be *redistributive*, in that the poorer households are net gainers and the richer ones net losers.

Time period

In a single week fewer people will receive a service than over a year. As services vary across the life cycle, a single year snapshot will differ from the picture across a whole lifetime. But available data relate to short time periods: there are no surveys tracking use of welfare services throughout people's whole lives. To answer questions about lifetime distribution requires hypothetical models - the results from which depend greatly on the assumptions fed into them.

Data problems

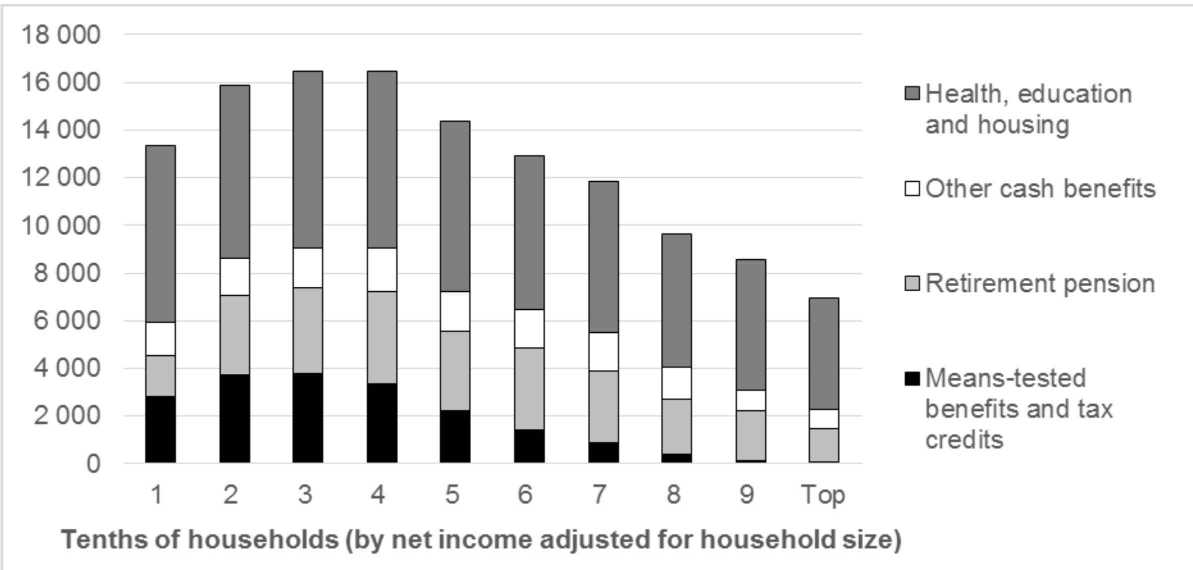
Finally, research in this area is based on sample surveys: whole-population surveys like the Census do not ask the questions about incomes and service use required. Even the sample surveys may not be very specific, asking, for instance, whether someone has visited a GP recently, but not how long the consultation lasted, whether any expensive tests were done and so on. Results assume that GP visits are worth the same to all patients. But this may gloss over the point at issue: if GPs spend longer on appointments with middle class patients - and are more likely to send them for further treatment - the distribution of medical services may be 'pro-rich', even if the number of GP consultations is constant between income groups.

Some Empirical Results

This section illustrates some of these issues by considering findings from empirical analysis, contrasting the gross distribution of welfare services with that of the taxes required to pay for them.

Figure 30.1 shows official ONS (2014) estimates of the average benefits in cash and kind from welfare services received by households in different income groups in the financial year 2012-13. Households are arranged in order of income including cash benefits but after direct taxes like income tax, and allowing for the greater needs of bigger households (technically, 'equivalent net income'). The poorest tenth is on the left, the richest on the right.

Figure 30.1 Welfare benefits and services by income group, 2012-13 (£)



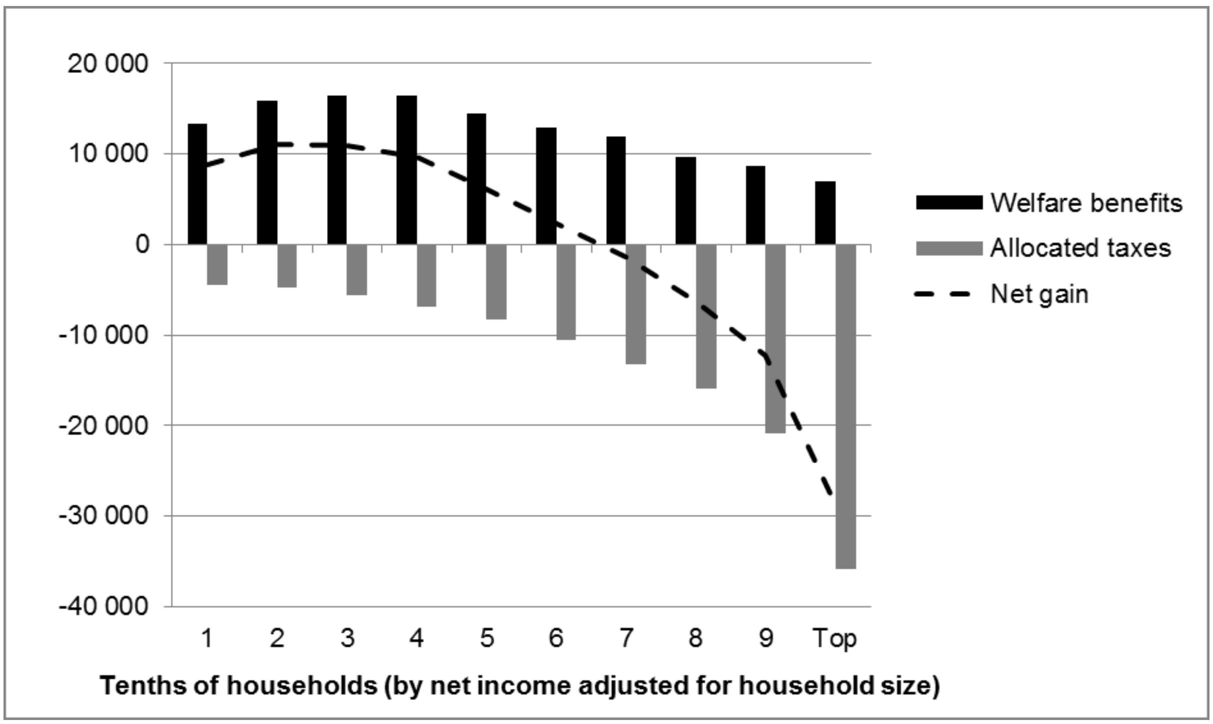
Source: based on figures from ONS (2014)

On average, households with the bottom half of incomes received 1.9 times as much from cash benefits (including tax credits) as those with the top half. Means-tested benefits such as Income Support and Housing Benefit and tax credits are most concentrated on the poorest, but even 'universal' benefits such as the retirement pension are worth more to lower than to higher income households.

The figure also shows official estimates of the combined value of benefits in kind from the NHS, state education and housing subsidies. There are different ways of doing this, and answers will vary depending on things like how the benefits of higher education for students living away from home are treated, or the way in which housing subsidies are calculated. Also, the assumption that people of the same age and gender use the health service equally is not necessarily correct: other characteristics affect service use too. However, even with adjustments for such issues, the general picture is similar: benefits in kind are less concentrated on the poor than cash benefits, but households at the bottom of the distribution receive considerably more than those at the top. On the ONS's estimates, these benefits in kind were worth an average of £7,400 for the poorest tenth of households in 2012-13 but only £4,700 for the richest tenth. On these estimates, the absolute value of welfare benefits and services is greatest for low-income households, and lower than average for high-income families. Taxation, by contrast, is greater in absolute terms for those with higher incomes (although it is not necessarily a greater proportion of income).

Most welfare spending is financed from general taxation, so it is hard to be precise about *which* taxes are paying for welfare: if state education were abolished, would it be income tax or VAT which would fall? Figure 30.2 compares the total of welfare benefits given in the previous figure with the ONS's estimates of the impact of national insurance contributions and an equal proportion (about 95 per cent in this year with a big budget deficit) of each other household tax to cover the remainder of welfare spending. For the bottom six-tenths of the distribution, benefits are higher than taxes and the figures suggest a net gain; for those in the top four groups (particularly the top two-tenths) taxes are higher, suggesting a net loss.

Figure 30.2 Benefits and allocated taxes by income group, 2012-13 (£)



Source: based on figures from ONS (2014).

These results suggest that on a cross-sectional basis, the combination of welfare services and, on plausible assumptions, their financing is significantly redistributive from high to low income groups - although they say nothing about the scale of such gains in relation to ‘need’, such as for medical care.

However, it should also be remembered that redistribution also takes effect over the lifetime of individual citizens. Over their lives people both receive benefits and pay taxes. Those with higher lifetime incomes pay much more tax than those with low incomes. In effect, people finance some of the benefits they receive through their *own* lifetime tax payments. However, some people do not pay enough lifetime tax to pay for all of their benefits; they receive ‘net lifetime benefits’ from the system. These net lifetime benefits are paid for by others who pay more than enough tax to finance their own benefits; they pay ‘net lifetime taxes’ into the system. Evidence on this lifetime redistribution suggests that on a lifetime basis the system does still redistribute from the ‘lifetime rich’ to the ‘lifetime poor’, but as it was in the 1980s and 1990s, nearly three-quarters of what the welfare state does is like a ‘savings bank’, and only a quarter is ‘Robin Hood’ redistribution between different people (see Hills, 2015a, Ch. 3).

Emerging Issues

How welfare services are distributed has a major bearing on whether we judge them successful. The results presented above suggest that lower income households receive more from the welfare state than they pay at any one time. As a corollary, policies to reduce the government budget deficit by cutting welfare services and benefits hit those in the bottom half of the distribution harder than those at the top; doing it through tax increases takes more from those with higher incomes in absolute terms (but much the same from all groups as a share of their income). The Coalition Government elected in 2010 put most emphasis on spending cuts, with most analysis suggesting that losses through reduced benefits and services were a much greater share of income for those with lower than for most of those with higher incomes (Hills, 2015b; Reed and Portes, 2014; but see also HM Treasury, 2015).

Distribution between rich and poor is not the only issue though. As the population ages, and the retired population grows in size relative to the working age population, questions are being asked about whether the age groups are being treated fairly – and whether older ‘baby boom’ generations have done better out of the system than younger ones will do.

Guide to Further Sources

A wider discussion of the effects of the welfare state in redistributing income in a single year and across the life cycle and how to analyse them can be found in chapters 2 and 3 of J. Hills (2015a), *Good Times, Bad Times: The welfare myth of them and us*, Bristol: Policy Press.

Each year the Office for National Statistics (ONS) publishes official estimates of the distributional effect of taxation and of a large part of public spending, including social security and welfare services. The figures in this chapter come from ONS (2014), *The effects of taxes and benefits on household income, 2012/13*: (http://www.ons.gov.uk/ons/taxonomy/index.html?nscl=Effects+of+Taxes+and+Benefits+on+Households)

The Institute for Fiscal Studies (www.ifs.org.uk) publishes regular analysis of the distributional effects and other effects of changes to tax and benefit policies, for instance those of the Coalition government from 2010-2015 in its analysis published after the 2015 Budget in R. Joyce (2015), *Household incomes: trends and the impact of tax and benefit changes:* http://www.ifs.org.uk/tools_and_resources/budget/502. The Treasury also publishes distributional analysis of its policies after each Budget and Autumn Statement. See for instance, HM Treasury 2015, *Impact on households: Distributional analysis to accompany Budget 2015*, London: HM Treasury: https://www.gov.uk/government/publications/budget-2015-documents. Differences in the precise assumptions made can make important differences to the conclusions reached.

For more general discussion of reforms in that period, including their distributional impact, see J. Hills (2015b), *The Coalition's policies towards cash transfers*, Social Policy in a Cold Climate Working Paper 11, London: London School of Economics: http://sticerd.lse.ac.uk/case/_new/publications/series.asp?prog=SPCCWP.

The distributional effects of cuts in both services and benefits on different groups in the population are discussed in H. Reed and J. Portes (2014), *Cumulative Impact Assessment*, EHRC Research Report 94, London: Equality and Human Rights Commission: http://www.equalityhumanrights.com/publication/research-report-94-cumulative-impact-assessment.

Review Questions

1. Is its success in redistributing towards the poor the only, or even, the main criterion we should use in evaluating the impact of the welfare state?
2. Does it matter that some of those with middle or high incomes receive cash benefits and use services like the NHS and state education, so long as they pay in more for them through the tax system?
3. What does the distribution of who receives welfare benefits and services and who pays the taxes that pay for them tell us about how different ways of closing the public budget deficit would affect different groups?
4. If much of what the welfare state does is to act as a 'piggy bank', with people paying in at one point and benefiting later in their lives, is this a safe arrangement, if, for instance, younger generations decided that they no longer wanted to continue with as generous a system?

Essay Question

Who gains most, and who loses from the existence of the welfare state and how it is financed? How does the answer change depending on the time period looked at?