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Article (Accepted version) (Refereed)

Original citation:
Hills, John (2011) *The changing architecture of the UK welfare state.* Oxford Review of Economic Policy, 27 (4). pp. 589-607. ISSN 0266-903X

DOI: 10.1093/oxrep/grr032

The changing architecture of the UK welfare state

John Hills*

Abstract This article looks at the way in which the role of the state has evolved within different aspects of welfare activity (broadly defined) in the United Kingdom since 1979 and forward to the possible impacts of the plans of the Coalition government that took office in 2010 for changing that role through reform and fiscal retrenchment. Even as governments restrained the growth of public social spending, total public and private activity grew by more than 150 per cent in real terms between 1979–80 and 2007–8, and from 34 to 42 per cent of GDP. If state services have not grown rapidly enough, some have paid more privately for the services they want, and in other cases governments have ended up financing activity through indirect routes. There has always been a 'mixed economy' of welfare in terms of the balance between public and private provision, finance, and control. Changes in this balance have been slow, with the largest growth being in the 'pure private sector' (with private provision, finance, and control), but with some growth in publicly financed services that are contracted out to the private sector. The experience suggests that the Coalition government's initial ambitions for radically transforming the overall structure of public–private boundaries may be hard to realize.

Keywords: welfare state, public sector, private provision, health, education, social security, housing
JEL classification: H55

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The author is grateful to the Economic and Social Research Council for supporting the work reported here under his Professorial Fellowship (ref. RES-051-27-2034), to Dan Edmiston for producing the figures for public and private welfare activity in 2007–8 reported in section II, and to Chris Allsopp, Howard Glennerster, Dieter Helm, Ruth Lupton, Ken Mayhew, David Piachaud, and Jane Waldfogel for helpful comments on an earlier draft.

I. Introduction

Given the increasingly dominant role of social policies and social spending within domestic politics and in public spending, it is inevitable that how the boundaries of the 'welfare state' are set is one of the central questions within any consideration of the economic boundaries of the state as a whole. This article looks back over how the role of the state has evolved within different aspects of all welfare activity in the UK since the 1997 change of government, and forward to the possible impacts of the Coalition government's plans for changing that role through both reform and fiscal retrenchment.

The areas covered here are those traditionally seen as covered by the welfare state's activities—education, health care, income maintenance, housing, and personal care. It is immediately apparent that the relative importance of the state within each of these areas in the UK is very different, ranging from an increasingly minor and residualized housing role to a dominant one within health care. These variations and their differences from other countries partly reflect historical accidents of the ways in which structures evolved here and elsewhere, and the difficulties faced by those trying even with great determination to change systems to which people and their expectations have adjusted, particularly where transfers across the life course are concerned. But they also reflect a varying balance that has been seen by policy-makers and the public as appropriate within each of these spheres.

To rehearse the relevant arguments briefly,[1] the core criteria involved in striking this balance can be summarized as follows.

- Vertical equity—more favourable treatment of those with lower incomes than those with higher ones in order to avoid or reduce the depth of poverty or reduce inequalities in resources more generally.
- Horizontal equity—compensatory treatment of those with similar incomes but greater needs of one kind or another (such as larger families or needs related to disability status).
- Life-cycle redistribution—allowing for cash and in-kind provision at times in people's lives, particularly childhood and old age, when incomes from market activities are low, with net contributions made when market resources are higher.
- Insurance—protection against loss of income in events such as unemployment, ill health, or greater than average life expectancy, and provision of services if needs for health or other care occur.
- Efficiency—both minimizing costs of provision and financing, but also allowing consumption to relate to individual preferences, and minimizing the side-effects of systems (such as labour market or savings disincentives from high effective marginal tax rates from means-testing and taxation).
- Externalities—encouraging activities that have positive effects on others and discouraging those with negative effects.

Three things are immediately apparent from this list. First, the way they play out will vary between areas. Private charity would leave inequalities or poverty at levels most would see as undesirable, so an important role of the social security system is vertical and horizontal redistribution. But much of social security is concerned with life-cycle redistribution, with the majority of spending going on pensions and other benefits for the elderly. While some of this can be achieved through private savings or pension systems, the state remains dominant, reflecting both high costs of private retirement provision for those on low incomes, and the complexity and incentive problems created by attempts to limit its role through means-testing. Private insurance

[1] For a more detailed discussion, see Burchardt *et al*. (1999).

market failures, that can justify a strong role for the state on efficiency grounds, are more important in some areas than others—particularly future health or social care needs affected by long-term uncertainties that are hard to quantify, such as the likelihood and cost of someone's care needs for dementia 30 years after the point in their lives when earnings are highest, for instance. The strength of arguments for external benefits from individual consumption are stronger in some areas than others—those from a better-educated population, for instance—as opposed to increased housing consumption once basic standards are met. We would not, therefore, expect the boundaries of state involvement to look the same in different parts of the welfare state.

Second, the importance of the different aims and constraints will vary over time. In particular, as life-cycle patterns change and lengths of lives expand, we would expect to see income maintenance and health and personal care in old age grow in scale, while the proportion of the population in the education system might fall (although offset by upward pressures from economic change). Equally, as incomes rise, one would expect to see a general move towards services with the characteristics of 'luxuries': health care and education, in particular, are services that appear to be more important in more affluent societies.

Third, some of the considerations suggest that the state should be paying for particular activities, but not necessarily providing it or taking the decision about who should do so. Using public financing to meet a need for distributional reasons does not necessarily imply that state agencies should be the provider. Similarly, ensuring that children's needs are met after divorce, for example, can be met through a public decision to enforce a private transfer, without there being any necessary state provision or finance. Public involvement in even the traditional core of the welfare state has never, therefore, been simply a matter of services that are publicly provided, publicly financed, and the result of public decisions, but has varied along each of these three dimensions.

Section II of this article traces how the boundaries in each welfare sector have changed over the last 30 years since Margaret Thatcher's government came to power in 1979, looking particularly at the effects of the changes under the Labour government up to 2007–8, immediately before the financial crisis. Section III looks at the implications of the policies announced by the Coalition government after it came into office, particularly the Spending Review published in October 2010 and associated reforms across these areas, but taking account of what actually happened through the 2007–8 to 2011–11 period, and how the outcomes compared with the plans announced in the previous spending review in 2007. It looks at some of the new government's early reforms that are intended to shift the balance of who provides the publicly financed services that remain. The final section concludes, drawing lessons from the last 30 years for how successful that attempt is likely to be.

II. The boundaries of the welfare state

The most obvious measure of the scale of state involvement in welfare provision is given by the conventional total of public social spending as a share of national income. This rose continuously for 30 years from the end of the Second World War, reaching around a quarter of national income by the mid-1970s. In the following 20 years the share fluctuated around this level. By the last year of the Conservative governments in 1996–7, it had reached 25.1 per cent of GDP, a little above the level they had inherited in 1979–80. The intentions of the Thatcher governments in the 1980s to 'roll back the state' collided with—and were cancelled out by—upward pressures on welfare spending from an ageing population and the tastes of a more affluent society for items such as health care and education where the state has a major role. But total public spending was kept under constraint—with defence spending squeezed, in particular—so the share of social spending rose from just over 50 per cent of all public spending in 1978–9 to 60 per cent in 1996–7.[2] Within this total housing spending fell—including housing-related benefits it had been over 4 per cent of GDP in 1974, but was half this by 1995 (Glennerster, 1998, p. 316). Over the same period, to 1995, public spending on the NHS rose from 3.8 to 5.7 per cent of GDP, and social security spending, dominated by state pensions, from 8.2 to 11.4 per cent of GDP.

Figure 1 continues this story through the life of the 'New Labour' governments of Tony Blair and Gordon Brown up to 2010–11. Looking at the period up to 2007–8, just before the financial crisis and subsequent deep recession, the pattern is of considerable consistency with the preceding 20 years. Total social spending as a share of national income did grow continuously after 1999–2000 and the end of the initial period of public-sector austerity following the incoming Labour government's pledge to stick to its predecessor's spending plans. However, the 26.8 per cent of GDP reached by 2007–8 was little higher than it had been in the early 1990s (although this was at the end of an economic boom, rather than in a recession). About a third of the increase from 1997–8 could be seen as responding to the pressures from ageing over the decade, albeit more mild than the ones we now face.[3] Beyond that, the preferences of the Labour government—and the public that voted for it in 1997—for *some* increase in public spending did not extend to a *large* increase in the role of the state or a willingness to increase the tax ratio by very much (Sefton, 2009). Indeed, most of the increase in social spending was accommodated by the fall in gross debt interest from 3.5 to 2.2 per cent of GDP. Social spending's share of total public spending continued its rise from what is now estimated at 63 per cent in 1996–7 to over 65 per cent in 2007–8.[4] As the figure shows, health, education, and—at a smaller scale—personal social services (PSS) were the gainers from this. Non-pension social security ('other transfers')—even including the new tax credits—fell significantly as a share of GDP.

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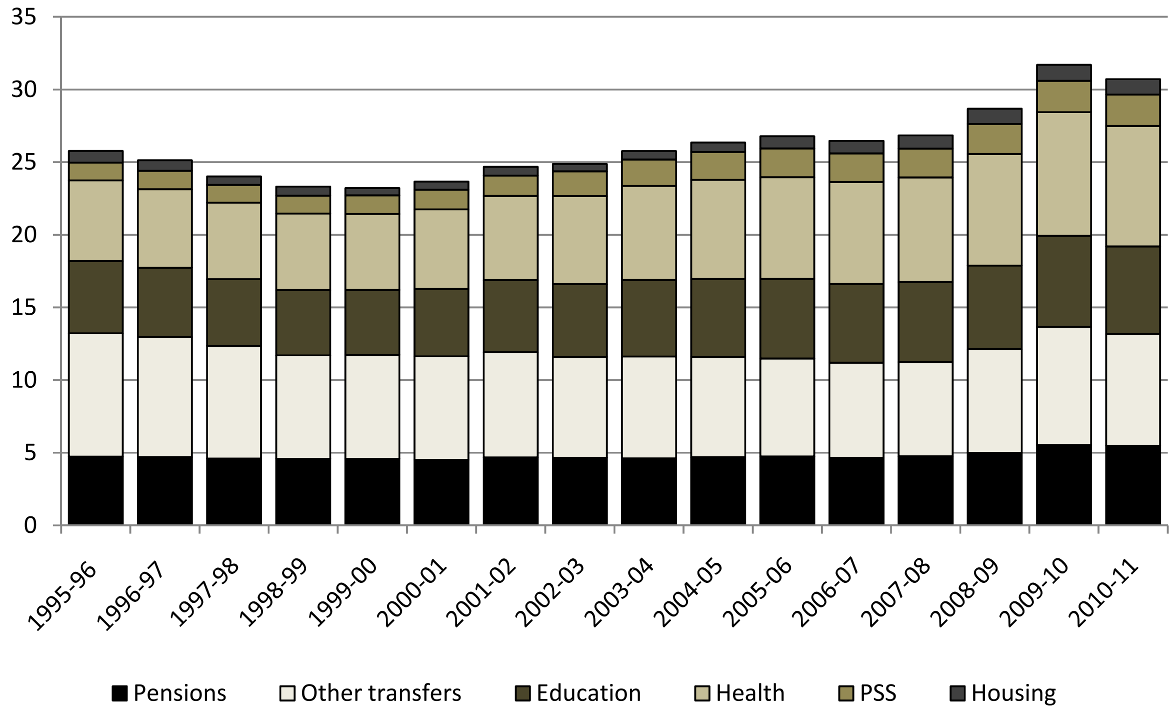
[2] Hills (2004, Table 6.1), based on HM Treasury's *Public Expenditure Statistical Analysis* (PESA) papers published up to 2003. Figures are for Total Managed Expenditure (TME), including gross debt interest.
[3] Hills (2004, Table 10.2), suggests that starting from age-related social spending patterns as they were in 2001, changing age structure would increase the cost of services with constant relative generosity by 0.6 per cent of GDP in the decade starting then, rising to 1.2 and 1.5 per cent in the following two decades.
[4] As in Figure 1, based on updated estimates in HM Treasury (2010*a*, Table 4.4).

Figure 1: Social spending in the UK, 1995–6 to 2010–11 (% GDP)



Source: HM Treasury (2010*a*) to 2009–10, extended to 2010–11 from OBR (2010*a*,*b*).

Looking purely at public spending then, there were important continuities in the first decade of New Labour taken as a whole with trends under its predecessors. Notably social spending remained relatively close to a quarter of national income, with most of its growth offset by falls in other kinds of public spending. Within social spending, health was the winner, as before, but so was education, in contrast to the preceding period. After 2007–8, of course, this pattern changed dramatically as the economy went into sharp recession, but spending continued to increase. This period is examined in more detail in section III below.

As the Introduction suggests, public spending measures only one aspect of the welfare state, however. It does not even capture the whole extent of public *financing* of activity, which is often supported by tax concessions of one kind or another—the descendants of what Richard Titmuss (1958) labelled the 'fiscal welfare state'. Nor does it indicate the changing importance of the state within total private and public activity. Table 1 presents an attempt to do this, for the five areas distinguishing between the scale of activity within eight combinations of public and private sectors in terms of:

- *provision:* is the provider of the service a public- or private-sector body?
- *finance:* does the public sector pay for the service directly through tax-financed public spending or indirectly through tax reliefs?
- *decision:* can individuals choose for themselves the amount of service used or whether the provider is public or private, or is this decided for them by the state?

Thus the left-hand column shows the scale of activity within the ‘pure public’ sector, publicly provided, financed, and decided upon (such as state schools), while the eighth column shows the ‘pure private’ sector, privately provided, financed, and decided upon (such as private rents where the tenant does not receive Housing Benefit).

In all there are eight possible combinations. For instance, the fifth column—public finance and decision but private provision—includes both services traditionally provided by private organizations (such as GPs or university places funded from public subsidies) and those that have been more recently contracted out. Similarly, the sixth column represents services that are privately financed and decided upon, but publicly financed—such as the value of private-sector occupational pension contributions that is effectively covered by tax reliefs.[5] The table shows the position in three years: 1979–80, 1995–6, and 2007–8 (all measured at 2008–9 prices). The differences between the first two panels show the impact of the changes across nearly all of the Conservative period, while the difference between the second and third is largely the result of what happened in the first decade of New Labour, just before the crisis.

[5] Measured by the difference between actual tax treatment of pension contributions and those that they would receive under a Comprehensive Income Tax regime. For more details of how this and the other classifications were arrived at in the earlier exercises which this extends, see Burchardt (1997) and Smithies (2004).

Table 1: Public and private welfare activity, 1979–80, 1995–6, and 2007–8, UK (£ billion, 2008–9 prices)

Provision:	Public provision				Private provision				All
Finance:	Public finance		Private finance		Public finance		Private finance		
Decision:	Public	Private	Public	Private	Public	Private	Public	Private	
(a) 1979–80									
Education[a]	21.4	–	–	–	7.7	1.0	–	2.7	32.8
Health[b]	25.1	–	0.3	0.1	6.5	–	0.5	3.1	35.6
Housing[c]	9.3	–	4.7	–	0.5	6.7	0.5	30.0	51.7
Income maintenance[d]	65.5	11.1	–	–	–	15.7	–	22.2	114.5
Personal care[e]	4.8	–	0.7	–	0.7	–	–	0.5	6.7
Total	**126.1**	**11.1**	**5.7**	**0.1**	**15.4**	**23.4**	**1.0**	**58.6**	**241.2**
(b) 1995–6									
Education	28.6	–	–	–	12.4	1.8	–	7.3	50.1
Health	43.4	–	0.3	0.3	13.6	0.4	1.2	8.7	67.9
Housing	10.4	–	4.1	–	2.8	11.2	1.8	60.8	91.1
Income maintenance	107.7	6.0	–	–	–	25.9	–	25.8	165.4
Personal care	8.7	–	0.7	–	7.0	–	1.0	3.0	20.4
Total	**198.8**	**6.0**	**5.1**	**0.3**	**35.8**	**39.3**	**4.0**	**105.6**	**394.9**
(c) 2007–8									
Education	47.4	–	–	–	14.8	5.0	–	12.4	79.6
Health	77.3	–	0.5	0.4	26.0	0.2	1.1	16.2	121.6
Housing	10.6	–	3.5	–	10.0	9.0	4.1	103.2	140.4
Income maintenance	150.1	11.5	–	–	0.3	29.3	1.0	53.2	245.4
Personal care	13.3	–	0.8	–	11.7	0.6	2.4	4.5	33.3
Total	**298.7**	**11.5**	**4.8**	**0.4**	**62.8**	**43.9**	**8.6**	**189.5**	**620.3**

Notes:
[a] Education: current expenditure only. Does not include pre-school education in 1979–80. [b] Health: some estimates necessary on contracting out, especially for 1979–80. [c] Housing: 1979–80 and 1995–6 estimates of economic rents and imputed rents based on returns on capital values. 2007–8 estimates of economic subsidies based on figures for England in 2004–5 adjusted for inflation from

Hills (2007). 2007–8 imputed rents for owner-occupiers taken from ONS's *Family Spending*. Annualized value of Right to Buy discounts based on equivalent to flow of economic subsidy owners would have received if remaining as tenants. [d] Income maintenance: figures for pensions are contributions, except for basic state pension, which is cost of pensions in payment. [e] Personal care: some expenditure split between 'own provision' and 'contracted out' on basis of volume of service rather than cost. 'Pure private' expenditure estimated for all years.

Sources: Burchardt (1997) and Burchardt *et al*. (1999) updated (for details see Edmiston (2011); figures from there adjusted to 2008–9 prices using GDP deflator).

An immediate, perhaps startling, conclusion from the table is how much overall activity increased in both periods—and by much more than would be expected from conventional measures of social spending as a share of GDP of the kind shown in Figure 1. Between 1979–80 and 1995–6, total welfare activity grew from £241 to £395 billion, that is, by 64 per cent (at 2008–9 prices). By 2007–8, it had grown by a further 57 per cent in real terms, to £620 billion. This compares with a 47 per cent increase in public social spending between 1995–6 and 2007–8[6] (and a 31 per cent increase in GDP). Total welfare activity measured in this way rose from the equivalent of 34 per cent of GDP in 1979–80 to 40 per cent in 1995–6 and had reached 42 per cent in 2007–8. While government tried to 'put the lid on' public social spending for most of those three decades, the same clearly was not true of these sectors of welfare activity taken as a whole, including that in the private sector.

A second immediate observation from the table is quite how much the balance between the eight categories of provision, finance, and control varies between the five service areas. For education, health care, and income maintenance, the 'pure public' sector still represented more than half of total activity in 2007–8, but for personal care it was two-fifths, and for housing less than a tenth. Private provision of publicly financed and publicly controlled services—'contracting out' and its equivalents—was around a fifth of total activity within education and health care, and a third for personal care, but much less important for housing, and almost absent for income maintenance. By contrast, publicly financed but privately controlled and provided services were more than a tenth of all income maintenance activity—representing the value of tax advantages of private pension contributions—but small in the other areas. The 'pure private' sector, while growing, was a fifth or less of activity in four of the areas, but was dominant—three-quarters of the total—in housing.

Figure 2 illustrates the shifts in the shares of the overall totals taken by each of the eight combinations of public and private roles between the 3 years. The circular base of each set of columns is divided into eight sectors so that those involving public finance are on the right, those involving public provision are at the top, and those where public decisions are dominant are within the inner circle. The height of each vertical column represents the share of the overall total in that year coming from that combination.

Thus one prominent feature has been the steady fall in the share of the 'pure public' sector—the white column—from 52 per cent in 1979–80, to 50 per cent in 1995–6, and again to 48 per cent in 2007–8. Meanwhile the 'pure private' sector—shown by the black column in the bottom right corner—grew from 24 to 27 per cent, and then to 31 per cent.

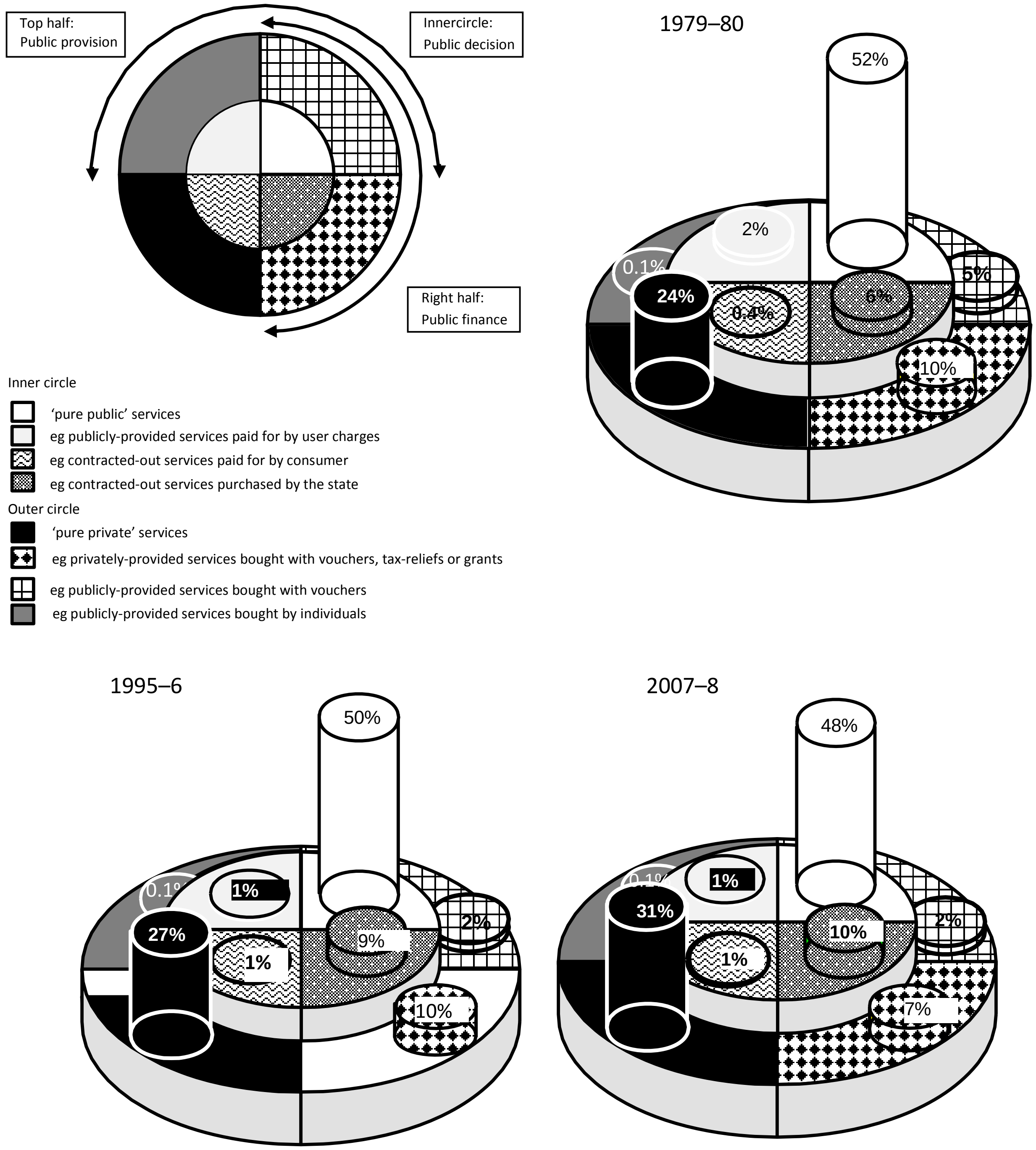
It is notable that taking all of the sectors that are publicly *financed* (the right-hand side of the diagrams), the fall was somewhat less fast than that in the sectors that are publicly *provided* (the top half): public finance fell from 73 per cent of the total at the start to 67 per cent at the end, while public provision fell from 59 to 51 per cent. But, meanwhile, the share of activity that is publicly *controlled* has hardly fallen at all, from just over to just under 61 per cent. Public finance may have become relatively less important, especially in the largely Labour years after

[6] HM Treasury (2010*a*, Table 4.3), using the same categories for social spending used in Figure 1.

1995–6, and public provision less important, especially in the Conservative years before then, but in neither period did the balance of who was setting the level of service—the main criterion for 'control' used here—change very much.

Indeed, a first glance at the figure suggests that much less has changed over the nearly three decades than might have been expected from the political dramas within them. Contrary to much received wisdom, there already was a 'mixed economy of welfare' in 1979, and its overall composition has not changed that much, even though its scale has become much larger in real terms and in relation to national income.

Figure 2: Composition of total welfare activity, 1979–80, 1995–6, and 2007–8, UK



Source: Burchardt (1997) updated (see Table 1).

However, there were shifts in its architecture reflected in the size of each sector when examined in more detail. Concentrating on the largely Labour period between 1995–6 and 2007–8, particular features explaining the overall changes presented in Table 1 and Figure 2 included the following.

- The share of the *pure public* sector (inner top right sector) fell from 50.3 to 48.2 per cent. But this was because other activity grew more quickly, as the real value of the pure public sector still grew by 50 per cent, slightly faster than public social spending growth (as items such as tax credits became more important). The importance of pure public housing declined as local authority housing was transferred to private not-for-profit housing associations. Within income maintenance, the real value of spending on the basic state pension and non-pension social security grew relatively slowly, and so fell significantly relative to GDP, but the new tax credits introduced by the Labour government offset this, reaching £27 billion by 2007–8[7] (so pure public income maintenance rose from just under to just over 10 per cent of GDP).
- The share of activity with *public finance and provision but private decision* (outer top right) rose slightly, as fewer people were 'contracted out' of the state second pension, bringing this part of pension provision back within the public sector.
- Services with *public provision and decision but private finance* (inner top left) declined, again reflecting the transfer of housing to housing associations and so less rent paid by tenants (net of Housing Benefit) to councils.
- The sector of *public provision but private finance and decision* (outer top left) remained small, with the end of 'pay beds' in NHS hospitals offset by growth in other health services provided to the private sector in 2007–8.
- The sector including contracted-out services, *public finance and decision but private provision* (inner bottom right), increased by three-quarters in real terms, rising from 9.1 to 10.1 per cent of all activity. Major contributors to this included the larger scale of housing associations (and hence the value of Housing Benefit and economic subsidies included here), payments for Private Finance Initiative hospitals, the new Child Trust Funds, and a more than doubling in public finance for private residential and non-residential personal care. Partly offsetting this, education activity in this sector grew relatively slowly, reflecting slow growth in government grants to higher education institutions as tuition fees rose.
- By contrast, *public finance for private provision and decision* (outer bottom right) declined from 10.0 to 7.1 per cent of the total. This reflected both the abolition of mortgage interest relief for owner-occupiers and the decline in the importance of 'contracting out' of the state second pension.
- The relatively small sector of *private provision and finance but public decision* (inner bottom left) grew from 1.0 to 1.4 per cent driven by increased number of tenants paying rents (net of Housing Benefit) to housing associations, growth in user charges for contracted-out personal care services, and growth in maintenance payments determined by the Child Support Agency to £1 billion.

[7] Using their gross cost.

- However, the largest change in the period was in the scale of the *pure private* sector (outer bottom left), rising from 26.7 to 30.5 per cent of the total, as its real value grew by 80 per cent from £106 to £189 billion. All five of the welfare areas contributed to this. In *education*, pure private activity grew from £7.3 to £12.4 billion, driven by higher private spending on private education in general, including pre-primary education, private schools, part of university tuition fees, and leisure courses. In *health care*, there was rapid growth in pure private activity such as private medicine (not covered by insurance) rising from £1.5 to £4.7 billion and spending on over-the-counter medicines, glasses, and dentistry from £4.7 to £8.8 billion. But by far the largest overall change overall was in *housing* from £61 to £103 billion, reflecting growth in estimates of owner-occupiers' imputed rents through the house price boom in particular. Within *income maintenance*, private pension contributions (net of tax advantages) doubled from £26 to £53 billion, particularly as employers made much larger contributions to reduce deficits in their pension schemes. Pure private *personal care* also grew, although the scale involved was much smaller.

From these details and from the figures in Table 1 it is evident that not only is the housing sector very different from the other four, but also that changes in it had an important effect on the composition of the overall total. Housing has always had an ambiguous role within the welfare state, and one of the more decisive changes over the period was the reduction of the state's role, through the outright privatization of council housing through the Right to Buy, transfers to private, although not-for-profit, housing associations, and withdrawal of the tax advantages that used to be given through mortgage interest tax relief (although owner-occupied housing remains favourably treated by taxation in other ways).

Table 2 explores the impact of including or excluding housing in more detail, showing the changing role of the public sector measured in four different ways within welfare activity as a whole, and then within the total excluding housing. It remains true that there was considerable growth in welfare activity even excluding housing, rising from the equivalent of 26 per cent of GDP in 1979–80 to 30 per cent in 1995–6, and to 33 per cent in 2007–8. But the decline in the role of the public sector was somewhat less marked once housing is excluded. Indeed, over the Conservative period between the first two dates, it was only in terms of its role as a provider that the public sector declined, with no fall in the share of public finance, a *rise* in the proportion under public control, and a slight rise in the share of the pure public sector. In these terms, the 'privatization' of the Conservative years can be seen as being concentrated on the state's role within housing, and on who was the provider for other services. In the second, largely Labour period, the relative importance of the public sector—within a greatly increased total—declined when measured in all four ways. However, even at the end, looking across health care, education, income maintenance, and personal care together, the public sector remained responsible for financing four-fifths, providing more than three-fifths, and controlling nearly three-quarters of the total.

Table 2: Role of the public sector in total welfare activity (%)

	Public finance	Public provision	Public decision	Pure public sector
(a) With housing				
1979–80	73.0	59.3	61.4	52.3
1995–6	70.9	53.2	61.7	50.3
2007–8	67.3	51.0	60.5	48.2
(b) Without housing				
1979–80	84.2	68.1	70.3	61.6
1995–6	84.2	64.4	73.9	62.0
2007–8	80.7	62.8	72.3	60.0

Source: Table 1.

III. Recession, spending plans, and reform

The previous section discussed changes in public social spending and the place of the public sector within the overall architecture of welfare activity up to 2007–8. This was, of course, the year in which the financial crisis began, with the collapse of Northern Rock, and the year before its full effects broke, with the collapse of Lehman Brothers a year later. After then the economy moved into deep recession and in May 2010 the government changed, with the new Coalition government announcing cuts in public spending unprecedented since the Second World War. To understand the potential impact of what is now planned on the eventual shape of the welfare state it is important two understand two things, however. The first is what had been happening before the change of government, in the last 3 years of its predecessor, when public spending was maintained in line with its previous spending plans despite—indeed, deliberately to counter—the recession. The second is that the spending cuts are selective. The combination of the *increases* in most kinds of public spending in the years up to 2010–11 followed by the selective *decreases* now planned will—if they are carried out—result in a substantial restructuring of the welfare state.

Returning to Figure 1, it can be seen that as a share of national income, public social spending rose dramatically between 2007–8 and 2009–10, and remained above 30 per cent of GDP—much higher than its share over the previous 30 years—in 2010–11. The share of national income represented by all the programmes shown increased, but the largest part came from the increase in 'other transfers' (non-pension social security and tax credits) as the economy moved into recession. This was, of course, as much a matter of GDP falling, as of spending rising. It was also not what the Labour government had intended when it drew up its plans in the Spending Review in the autumn of 2007.

Table 3 shows what had been implied by those plans for the 3 years up to 2010–11, comparing them with what actually happened. At the heart of the 2007 Spending Review was the assumption that GDP would continue its steady growth, increasing by a total of 7 per cent in real terms over the 3 years, or by 16 per cent in nominal terms. Total public spending was planned to grow slightly more slowly than this, so the share of the main elements of social spending in GDP would fall.[8] Total public spending was planned to fall from 42 to 41.6 per cent of GDP, and that on health, social security and tax credits, and education from 24.6 to 24.2 per cent. Health spending was planned to grow faster than other programmes, increasing by 11 per cent over the period, while social security (including pensions and tax credits) was to remain constant in real terms.

[8] In common with the 2010 Spending Review, the plans were presented in a way which does not allow isolation of spending on social care, and those for housing are in a form not completely comparable with the outcomes from the Treasury's PESA analysis presented in Figure 1.

Table 3: Plans in the 2007 Spending Review and actual outcomes

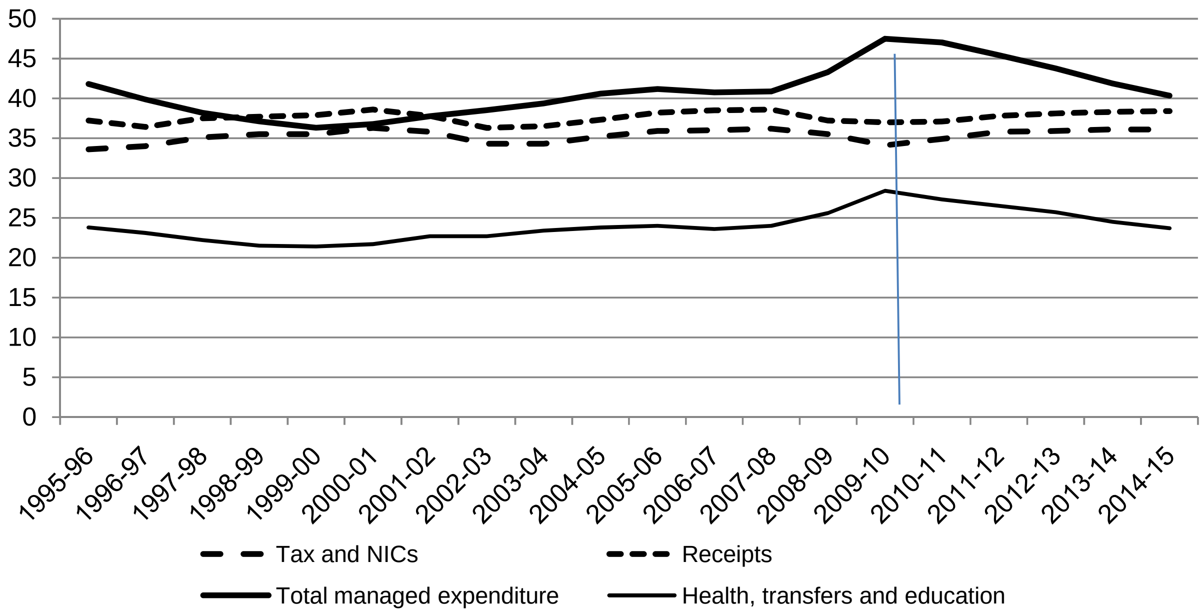
	Spending Review plans		Outcomes	
Changes, 2007–8 to 2010–11 (%)	**Nominal**	**Real**	**Nominal**	**Real**
GDP	+16	+7	+4	-3
Total managed expenditure	+15	+6	+20	+11
within which:				
Health	+21	+11	+19	+11
Education	+18	+9	+14	+6
Social security and tax credits	+8	0	+22	+13
Projected shares of GDP (%)	**2007–8**	**2010–11**	**2007–8**	**2010–11**
Total managed expenditure	42.0	41.6	41.1	47.3
Health, education, and social security	24.6	24.3	23.9	27.5

Source: HM Treasury (2007, Tables 3.2, B3, B11, D2, D6, D9, and D22) for plans. HM Treasury (2010*b*, Chart 1 and Table C13) for outcomes.

What really happened, of course, was that GDP rose by only 4 per cent in nominal terms over the 3 years, and was 3 per cent lower in real terms in 2010–11 than in 2007–8. In effect, real national income was 10 per cent lower than had been assumed in the 2007 Spending Review. However, total public spending rose by more than had been planned in nominal terms, and by 11 per cent in real terms. As the table shows, the real increase in health spending was exactly as planned and that in education slightly lower. It was the 13 per cent real increase in social security and tax credits that contributed most to the overshoot in total spending above plans. Given the fall in GDP, however, all three elements contributed to the rise in spending as a share of GDP. Whether maintaining and increasing spending levels was the correct response in macroeconomic terms is the subject of intense controversy elsewhere. What is important for the architecture of the welfare state is that much of the 'fiscal stimulus' with which the last government attempted to counter the financial crisis took the form of continuing with the previously planned real increases in public-sector spending on services, alongside the 'automatic stabilizer' effects of recession itself on social security and tax credits.

It is against this background that the Conservative–Liberal Coalition announced its aggregate fiscal plans in the July 2010 Budget and then broad outlines of spending in different areas in the October 2010 Spending Review. The overall context for social spending is given by the aggregates shown in Figure 3, all as a share of GDP, actual or now forecast. As well as spending totals, it shows public-sector receipts and tax and National Insurance Contribution revenues. Looking again at the 2007–8 to 2010–11 period, while the 2007 Spending Review had forecast real receipts growing from 39.2 to 39.9 per cent of GDP, they actually fell from 38.6 to 37.1 per cent. The gap that opened up—public borrowing—was thus greater than that accounted for just by the rise in spending. The new government's plans are now to reverse all of this by the end of the current Parliament. By 2014–15, the intention is for total spending to be a slightly smaller share of GDP than it had been in 2007–8, and receipts to be returned to their previous share. Total spending on health, transfers, and education is intended to fall back to just below its 2007–8 share of GDP. Within that, health and school education spending are intended to be protected in real terms and real spending on pensions to rise, so transfers to the working-age population and other parts of education will be squeezed harder.

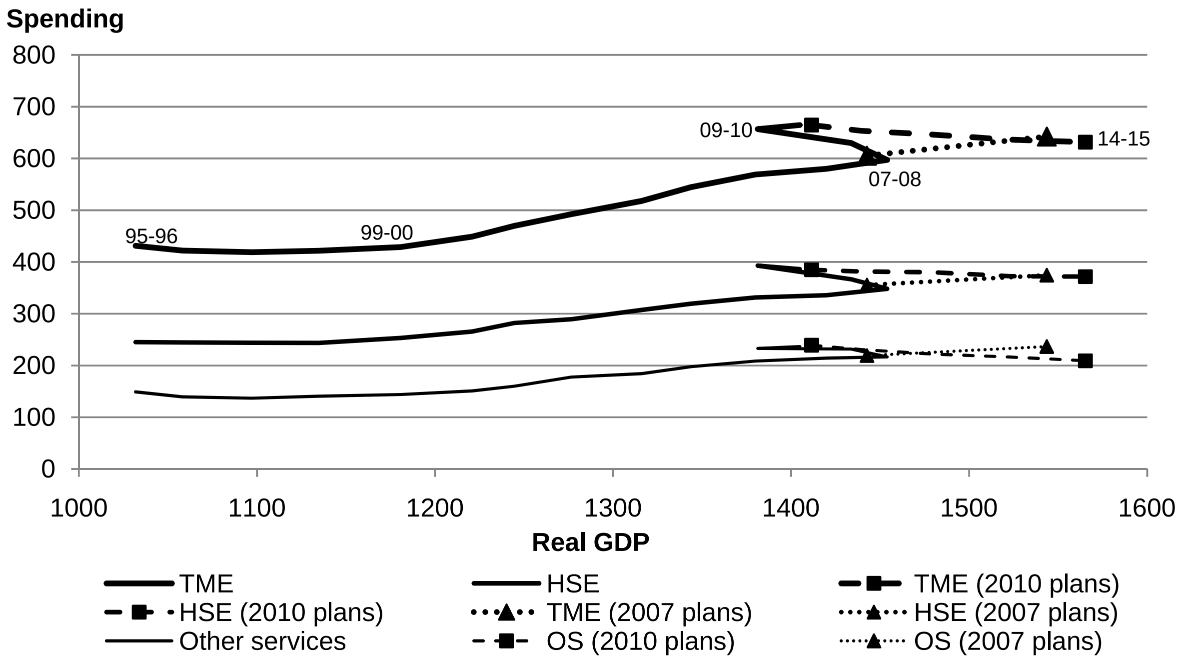
Figure 3: Public receipts and spending as % of GDP, 1995–6 to 2014–15



Sources: HM Treasury (2010*a*, 2011). Figures from 2010 are plans following 2010 Spending Review. Spending on health, transfers, and education estimated (see Table 3).

What this would mean in practice can be looked at in different ways, and the political consequences may mean that what actually occurs is somewhat different. One way of viewing the process is that it is simply about getting spending 'back on track'. This way of viewing things is illustrated by Figure 4. This relates total public spending (TME) to GDP, alongside that on health, social security and tax credits, and education (HSE), and on other public services (OS) (the rest of public spending excluding gross debt interest). The solid lines show how these evolved, mostly under Labour, between 1995–6 and 2010–11. In the early years, real spending grew little, despite the growth in GDP. This was followed by the period of faster growth in social spending than of GDP up to 2007–8 discussed in the previous section. The outcomes then show a kink, as real GDP fell but spending continued to rise to 2009–10. The dashed lines show the plans embodied in the 2010 Spending Review from 2010–11 up to 2014–15, with real spending intended to fall while GDP resumes growth.

Figure 4: GDP and spending outcomes and plans, 1995–6 to 2014–15, £ billion, 2008–9 prices



Sources: As Figure 1 for actual figures up to 2010–11; as Table 3 for 2007 and 2010 Spending Review plans.

The figure compares this potential outcome with what had been planned in the 2007 Spending Review. This had been based on real GDP reaching about £1,550 billion by 2010–11 (at 2008–9 prices). The Office for Budgetary Responsibility's (OBR) forecast published alongside the 2010 Spending Review was that GDP will not reach this level until between 2013–14 and 2014–15, effectively 3–4 years behind schedule. The 2010 Spending Review plans for total spending in 2014–15 are therefore only slightly below the trajectory planned by Labour in 2007 for this level of national income (although on a falling rather than rising trend, given the new government's ambitions for 2015–16). Those for the main elements of social spending are actually close to the trajectory set in 2007. However, spending on other public services will already be well below the equivalent trajectory planned in 2007, partly reflecting higher debt interest, following the increase in public debt.

Looked at in those terms, what is planned might at first sight seem relatively uncontroversial: we are poorer than we thought we were going to be, so we can afford less. It is unlikely that it will feel like that, however. To start with, we are not starting from levels of service as they were in 2007–8, but from where they had reached in 2010–11. If people's expectations have adjusted to that level of provision, the change will feel severe, and possibly politically undeliverable. Table 4 shows the implications of the Spending Review plans measured in three ways, differentiating between broad spending areas to the extent that the associated documents allow.

The first three columns show the scale of the spending cuts in the way conventionally presented, measured by the difference in real spending in 2010–11 and 2014–15. Total spending is planned to be £33 billion lower, but as this includes a rise of £10 billion in debt interest, spending on services would be £43 billion lower. However, health spending would be £2 billion and state pensions £6 billion higher, so the cuts elsewhere are larger.[9] In particular, non-pensions social security and tax credits are planned to fall by £12 billion, and education by £10 billion (despite the protection of the schools part of the budget). Other services in total—including housing and personal social services—face a reduction of £30 billion. The fourth column shows this change as a percentage of 2010–11 spending. Overall spending is planned to be reduced by 5 per cent, but this translates into increases of 2 per cent in health spending and 8 per cent in pensions, while the other groups of services shown are cut by more than 10 per cent.

[9] The figures for health and education are based on plans for the relevant departments in England. Under devolution the outcome for the UK as a whole may differ from that shown—for instance, the Welsh Assembly Government has announced plans to protect higher education spending more, but health spending less than the equivalents in England.

Table 4: Three ways of looking at effects of the 2010 Spending Review

	Spending in £ billion (2008–9 prices)			Change by 2014–15 (%)		
	2010–11	**2014–15**	**Change**	**Relative to 2010–11 real spending**	**Relative to 2010–11 GDP share**	**Relative to 2007–8 GDP share**
Health	116.1	118.5	+2.4	+2	–8	+5
State pensions	77.1	83.5	+6.4	+8	–2	+11
Other transfers	107.0	95.3	–11.7	–11	–20	–6
Education	84.7	74.3	–10.4	–12	–21	–14
Health, social security, and education	**384.9**	**371.7**	**–13.2**	**–3**	**–13**	**–1**
Other public services	239.0	209.0	–30.0	–13	–21	–10
Debt interest	40.6	50.7	+10.1	+25	+13	+47
Total spending	**664.6**	**631.5**	**–33.1**	**–5**	**–14**	**–2**

Sources: Own calculations based on HM Treasury (2010*a*,*b*) and OBR (2010*a*,*b*). Pensions spending from DWP (2010). Health and education spending in 2014–15 estimated from plans for England only.

However, this is only one way of looking at the impact of the cuts. An alternative measure of their impact would be to compare the planned level of spending in each area in relation to GDP in 2014–15 with that reached in 2010–11. If expectations and demands rise with income levels (for instance in terms of objectives for income smoothing or for standards of public services) and people had already adjusted to the position reached at the point the government changed, this may give a better measure of quite how severe the adjustment will feel. On this basis, shown in the fifth column, even health faces a reduction, and for non-pension transfers, education, and other public services the reduction is huge, a fifth or more.

Even if one takes the levels of GDP as they were in 2007–8 as the base, as shown in the last column—equivalent to assuming that people's underlying expectations had not adjusted to the step rise in relative spending by 2010–11—the reduction in education and other public services is a tenth or more. Other transfers are only reduced on this basis by 6 per cent, but this, of course, is alongside a much higher level of unemployment projected for 2014–15 than it had been 7 years before.

But on top of all this, even over just the 7 years between 2007 and 2014, ageing pressures will be significant. On the OBR's long-term fiscal projections, spending pressures on health care and long-term care for the elderly from ageing are the equivalent of 0.7 per cent of GDP over the decade from 2009–10, slightly offset by reduced pressures on education and pensions over that period (OBR, 2010*a*, Table 5.1). Over a 7-year period, those pressures would be roughly equivalent to around 5 per cent of health spending and up to 10 per cent for long-term care spending: even a stand-still in terms of inputs would therefore mean a decline in service in relation to demand, other things equal. This would, for instance, be enough to account for all of the rise in health spending in relation to GDP, even starting from 2007 levels shown in the last column of Table 3. It would exacerbate the impact of the cuts measured in comparison to GDP shares in 2010–11.

The final column of Table 4 reflects the *net* effect of both the changes in the last 3 years of the Labour government and of those now planned by its successor. Health and pensions gain, but the other services lose. The consequences of this for the structure of public spending are shown in Table 5. In 2007–8 health and pensions together made up 30.7 per cent of all public spending on services (excluding debt interest); by 2014–15 the 2010 Spending Review plans suggest this will rise to 34.8 per cent of the total. By contrast, education and non-pension transfers are set to fall back to well below their shares in 2007–8, and to below their shares in 1995–6. It is hard to project what will happen to housing and personal care spending, as these will depend heavily on the decisions made by individual local authorities in the face of considerable cuts in their budgets. But even if both fall significantly (as seems highly likely for housing), social spending as a whole may well remain as high a share of total spending on services in 2014–15 as it was in the earlier years. It is the *composition* of that spending that is set to change.

Table 5: The restructuring of social spending (% of total public spending on services)

	1995–6	**2007–8**	**2010–11**	**2014–15 (planned)**
Health	14.6	18.5	18.7	20.4
State pensions	12.4	12.2	12.4	14.4
Other transfers	22.2	16.7	17.3	16.4
Education	13.0	14.2	13.6	12.8
Health, social security, and education	**62.2**	**61.6**	**62.0**	**64.0**
Other	37.8	38.4	38.0	36.0
of which:				
PSS	*3.2*	*5.1*	*4.9*	*n/a*
Housing	*2.1*	*2.3*	*2.4*	*n/a*
Social spending	**67.5**	**69.1**	**69.3**	**n/a**
Total	**100**	**100**	**100**	**100**

Sources: Own calculations based on HM Treasury (2010*a*,*b*), OBR (2010*a*,*b*). Pensions spending is from DWP (2010). Health and education spending in 2014–15 estimated from plans for England only. Spending on services excludes debt interest.

The discussion so far relates only to plans for public spending. As we saw in section II, however, these are only a partial guide to the role that the public sector plays within overall welfare activity. Looking at public finance more widely and at public decision-making it is less clear what the scale of change may be, but the direction of the Coalition government's reform policies is clear. To give just a few examples of early initiatives relating to provision:

- within school education, the government is encouraging new groups to set up 'free schools', a new kind of private not-for-profit provision, but using public finance;
- while public spending on higher education is being sharply cut back, universities will charge higher fees, funded through repayments by graduates once their incomes reach a threshold level, effectively increasing the role of private finance (although this rests, initially at least, on most of the up-front funding provided by the Student Loans Company being classed as outside public spending);[10]

[10] It is only to the extent that the fees initially paid are not expected to be repaid later that this spending becomes part of 'public spending' (Barr and Johnston, 2010).

- the health care reforms are intended to move control of much of the budget of the National Health Service to GPs, who will then contract with providers such as hospitals for their services. Crucially, as initially proposed, the terms of tendering for these services would have opened up competition to 'any willing provider', including private-sector providers, with competition on price as well as on meeting quality thresholds. In terms of the analysis of public and private roles as in Figure 2, if this is implemented, a significant part of provision could have moved from public to private hospitals. Indeed, in some ways one could argue that the end result would have been public finance of services with private provision *and* private decision (by GPs, who are not public employees). These plans caused some of the greatest controversy in the first year of the Coalition's life and were modified part of the way through the Bill's passage through Parliament. At the time of writing, it remains unclear what the end result will be: some expansion of the role of private providers seems likely, but not on the scale originally envisaged;
- within income maintenance, the government is pressing ahead with its predecessor's plans for 'automatic enrolment' of employees to make at least minimum contributions to occupational pension plans, or to a newly created low-cost pension provider, the National Employment Savings Trust. This is intended to boost—or at least stem the decline in—private pension provision; as a corollary, part of this potential expansion will be backed by public finance in the form of tax reliefs;
- more generally, the government wants to see local citizens' groups or 'mutuals' of current public-sector employees taking over running public services.

In this last respect, the government's ambitions may be more radical than those of Margaret Thatcher's governments in the 1980s. As David Cameron summarized this aspect of the intended 'Big Society' in February 2011, 'We are in the process of opening up billions of pounds' worth of government contracts so charities and social enterprises can compete for the first time. The scale of this opportunity dwarfs anything they've had before.'[11] Expanding further on the theme when introducing the White Paper on 'open public services' in July 2011, he argued that the plans were about, 'ending the old big government, top-down way of running public services . . . it shouldn't matter if providers are from the state, private or voluntary sector'. The White Paper would make sure that, 'in health, social care, education, housing, there are organisations whose job is to make sure new providers come in'.[12]

[11] D. Cameron, 'Have no doubt, the big society is on its way', Comment is free, *Guardian Unlimited*, 12 February 2011.
[12] D. Cameron, Speech on open public services, 11 July 2011.

IV. Conclusion

This article has looked at the role of the public sector within the areas traditionally associated with 'the welfare state', showing how it changed first under Conservative governments up to the mid-1990s and then in more detail under Labour up to just before the economic crisis. It then looked at how public social spending evolved through the crisis up to 2010–11 and the incoming government's plans for both future spending and for reform of how services are provided.

There are three aspects of the architecture of welfare activity that this history of the last 30 years has shed light on, relating to its overall scale, its structure in terms of the roles of public and private sectors, and to the balance between different services.

First, the services covered here have consistently been ones of which we have wanted—and been prepared to pay for—more. Even as governments restrained the growth of public social spending, overall welfare activity has grown—by more than 150 per cent in real terms between 1979–80 and 2007–8, and from the equivalent of 34 per cent to 42 per cent of GDP. Even excluding housing, the rise in public and private activity combined was from just over a quarter to nearly a third of GDP. If services available through the state have not grown rapidly enough, some people have managed to pay for what they want privately. If governments have been unwilling to see public spending rise, they have often still ended up financing increased activity in other ways. This is not an accident. Health care and education have been things we want more of as real incomes have grown. Pensions, personal care, and health care have been things we need more in an ageing society. With increased inequality in market incomes over the period, increased transfers—whether described as social security or tax credits—have been needed even to slow some of its effects. There is little reason to think that any of these factors are about to go into reverse.

Note, however, that the distributional consequences of public and private finance and spending are usually very different, the former generally being redistributive and the latter not. So as pure private activity has met part of the rising demand for these activities, the growth in welfare activity has not meant an increase in services for all.

Second, faced with these pressures, governments have tried, but mostly failed, to change the structure of welfare activity. Twenty years ago, surveying the wave of 'quasi-market' reforms in health, education, and personal social services introduced by the Conservative governments in the late 1980s, Julian Le Grand (1991, p. 1257) summarized their aims as having the intention, 'for the state to stop becoming both the funder *and* the provider of services'. He suggested that, 'If these reforms are carried through to their conclusion, the welfare state in the 1990s will be a very different animal from the welfare state of the previous 45 years.' A glance at Figure 2 suggests this has not been the case. There was always a mixed economy of welfare rather than the state monopoly often described, and there has been a further shift away from the Morrisonian 'pure public' sector, but that shift has been very slow, if not glacial. Most of the more exotic combinations of public and private roles remain relatively small, with the partial exception of the limited growth from 8 to 10 per cent of the total coming from equivalents of 'contracted out' but publicly funded and controlled services. The biggest shift is one that has come partly by default—the increasingly important role of the 'pure private' sector, with no public involvement at all, as other ways of meeting rising demands have not kept pace.

Again, this is no accident. Attempts to shift the boundaries more rapidly have run into the very reasons why that state is involved in these areas outlined in the Introduction. For instance, Mrs Thatcher's governments in the 1980s recoiled from moving to a US-style private health insurance system because of the efficiency costs of doing so. Soon after it came into office in the late 1990s, the Blair government set out an ambition to shift the funding of pensions from an alleged balance of 60 per cent public and 40 per cent private to the reverse. But the private sector's role was never as large as this anyway, once one allowed for tax reliefs and public service pensions, and private provision was actually shrinking as companies realized the extent of the uncertainty around the liabilities they had taken on. Attempts to concentrate the public sector's role to pensions for those with low incomes through increased means-testing created both problems of complexity and savings disincentives. Recent pension reforms have been designed to go back in the other direction.

This kind of experience suggests that the Coalition government's initial ambitions for radically transforming the overall structure of public–private boundaries may not be realized. Its intentions to open up the National Health Service to more competition from private providers has been circumscribed by public opposition. Its reforms of higher education finance are going through, with the intention of introducing more private finance through higher fees, later repaid from graduates' incomes. But the system will involve heavily means-tested student bursaries, in an attempt to prevent the rise in fees putting off lower-income applicants. This adds another substantial layer to the means-testing already faced by many middle-income families through tax credit withdrawal. Even if this is not eventually reversed or toned down for the same reasons as were previous moves towards more means-tested pensions, there is a limit to how many other services this approach can be extended to before people realize that combined effective marginal tax rates are approaching 100 per cent. But if lower-income recipients are not protected from cuts, the result is a simple exacerbation of existing inequalities.

It is in the third aspect of the architecture of welfare activity—the balance between what remain public services—that change seems most likely. This is a result of the combination of what happened in the last years of the Labour government and the selective nature of the cuts now planned by the Coalition government. The previous government stuck to its 2007 spending plans, formulated on the assumption of steady growth, fearing that cuts in spending would exacerbate the recession. Indeed, most of its 'fiscal stimulus' came through this route, rather than through special additional measures. As GDP declined and real spending continued to rise, social spending rose to more than 30 per cent of GDP, well above the level of a quarter about which it had fluctuated for much of the previous 30 years. The Coalition government now plans to reverse that growth, with large cuts in real spending on some services, and reductions in the share of GDP for all of them compared to 2010–11 by 2014–15.

But the selective nature of the cuts combined with the differential growth of different services through the crisis will mean—if they are carried through—that the structure of public spending on the welfare state will have changed, even if its overall scale in relation to national income returns to what it had been before the crisis. Health care and pensions are becoming more important, but non-pension social security, housing, and non-school education less important.

A welfare state where provision for the older population through health care and pensions becomes more important, and that for the working-age population becomes less generous and more residualized, promises to take the UK system further in the direction of the structure in the USA, where Medicare and 'social security' (state pensions) are large, but working-age provision smaller and more stigmatized, with less overall redistributive effect, than they have been in this country.

Looking back over the last 30 years, the scale of welfare activity in the UK has greatly increased but the shape of its architecture has changed relatively little. One interpretation of this is that we have ossified systems that have proved impossible to change, despite Margaret Thatcher's attempts to 'roll back the state', or the 'scars on the back' of Tony Blair in his attempt to reform public services. But another is that what has evolved—and continues to do so, albeit slowly—is a structure of boundaries between state and private sector that effectively reflects the balances between conflicting aims for different services. Rather than in the grander debates about the overall scale of the state and of public spending, the more important issues in the way welfare activity evolves further may lie in the details of the ways in which particular services are run – whether by public or by private providers—and of who gains and who loses as the ways in which they are paid for are reformed.

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