Social Protection in Scotland

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Summary

- Scotland spends slightly more than the UK as a whole on social protection (expressed as a share of GDP). This puts it around the middle of the European league in terms of the resources devoted to social protection.
- Other than health, the Scottish Government's control over the social protection budget is limited. The Department for Work and Pensions controls the largest part.
- Higher state benefit spending in Scotland is largely driven by having a higher share of pensioners and disabled people in the population. Nevertheless, the gap in benefit spending between Scotland and RUK has narrowed in recent years
- There is no conclusive evidence that non take-up rates differ between Scotland and the rest of the UK
- Increases in spending on state benefits in recent years have largely been driven by non means-tested benefits – principally state retirement pensions
- The importance of welfare benefits varies dramatically by household type in Scotland. Their contribution to the household income of an average working age couple is relatively small. In contrast, older people, particularly those that are single, are heavily dependent on welfare benefits and state pensions.
- Given the extent to which it is weighted towards older people, the costs of benefits and state pensions in the future are likely to increase due to population ageing. In addition, state pensions will be relatively more generous due to the "triple-lock" which now governs their evolution. This may be manageable if the retirement age is increased gradually, but a further key condition is that the economy returns to historic growth rates of around 2.2 per cent.
- Localisation of the benefits system would offer some potential advantages, but also some disadvantages. In its favour, real benefit levels could be adjusted to more closely align with local labour market conditions, inefficiencies in the interaction between DWP and Scottish Government responsibilities could be eliminated and the system could be designed to reflect the views of the Scottish electorate, rather than the UK electorate. Against would be the loss of risk-pooling with the test of the UK, the costs of setting up an independent benefits system and potential "benefit migration".
- The existing proposals for change Devo-Max, Devo-Plus, Devo-More and full independence do not offer as yet a clear view of how a Scottish benefits system might be restructured under full independence or enhanced devolution. In particular, they do not estimate the

costs of a new Scottish welfare system.

Introduction

This paper examines the structure and costs of social protection in Scotland in the context of constitutional change. Social protection expenditure can take a number of forms – cash benefits, direct provision of services and state-funded public service provision. Under the current division of governmental responsibilities, the welfare benefits and state pensions component of the social protection budget is largely controlled by the Department for Work and Pensions (DWP), which implements UK policy on these matters. In contrast, health and social care spending, which are also components of social protection, are controlled by the Scottish Government (SG) though health and social care services are purchased or supplied by fourteen health boards and thirty two local authorities.

Some of the proposed alternatives to full independence, Devo+ and Devo-Max, involve the transfer of full or partial control over welfare spending to SG. This would imply that the system of welfare benefits would no longer be uniform across the UK. This would add to the complexity of the welfare system, particularly for those who spend time in both Scotland and the Rest of the UK (RUK), but on the other hand, might make it more responsive to local needs.

This paper addresses these issues. It begins by calibrating the budget for social protection in Scotland. It then shows how social protection spending in Scotland compares with other European nations. It then examines proposals for full or partial transfer of welfare and state pensions from DWP to the Scottish Government. A more prospective approach is taken in the following section. It considers challenges to social protection in Scotland based on a variety of economic and demographic scenarios. Population ageing and/or weaker than expected economic growth may lead to increased welfare spending expressed as a share of output or of tax revenues. This would pose a significant challenge to any Scottish Government hoping to maintain or extend the range of benefits available to its citizens, irrespective of the constitutional settlement. The final section concludes.

Social protection in Scotland

One understanding of "social protection" is that it is state-provided insurance against a set of risks for which the private market does provide full cover. The state collects taxes to compensate citizens who suffer an adverse event associated with these risks. It also puts in place regulations to identify those that are, or are not, affected by the adverse events.

In principle, the choice of the set of risks that are covered by such insurance is a reflection of the preferences of the current generation of voters as expressed through the medium of the democratic process. However, given that losses tend to carry more weight with the electorate than gains, the benefits available may also reflect historic preferences. The loss of an existing benefit is likely to carry a higher electoral penalty than does the failure to introduce a new benefit. This is an example of status-quo bias. Perhaps due to such bias, the current UK social protection system is a somewhat eclectic collection of historic benefits with no clear underlying principles. For example, while all health care may be free, some aspects of social care are not subsidized at all, although the private insurance market for such care is non-existent. Nevertheless, even though the logic underlying its structure may be weak, obstacles to significant change in the social protection system in the UK as a whole and in Scotland are formidable, irrespective of the outcome of the constitutional change process.

Insurance is inevitably associated with problems of moral hazard and adverse selection. The notion of moral hazard is that individuals may seek to be identified as having suffered the adverse event when this is not true. Alternatively, those who do not believe that they will suffer an adverse outcome may move to a jurisdiction with more limited social protection and consequently lower taxes. Conversely, those who believe they suffer an adversely outcome may move to jurisdictions that have greater social protection. Such responses are forms of adverse selection.

Another possible reaction is that those who do not expect to suffer adverse outcomes attempt to influence the political process against the provision of state-supported insurance cover. Those who might potentially gain from social protection will be principal supporters of the policy, while those who feel that they have little to gain from the cover will oppose it.

States may also use debt rather than taxation to finance higher social protection. This implies that social protection may not come at the cost of immediate tax increases. However, some taxpayers will anticipate the future tax rises that may follow from the use of debt finance, and may take actions to reduce their future liability.

The Scottish and UK Governments spend a significant amount in providing social protection. The most recent Government Expenditure and Revenue in Scotland (GERS) data showed that total public spending in Scotland (actual and imputed) was £63.8bn. This amounted to 53.6 per cent of GDP (excluding oil) and 42.8 per cent of GDP (including oil).

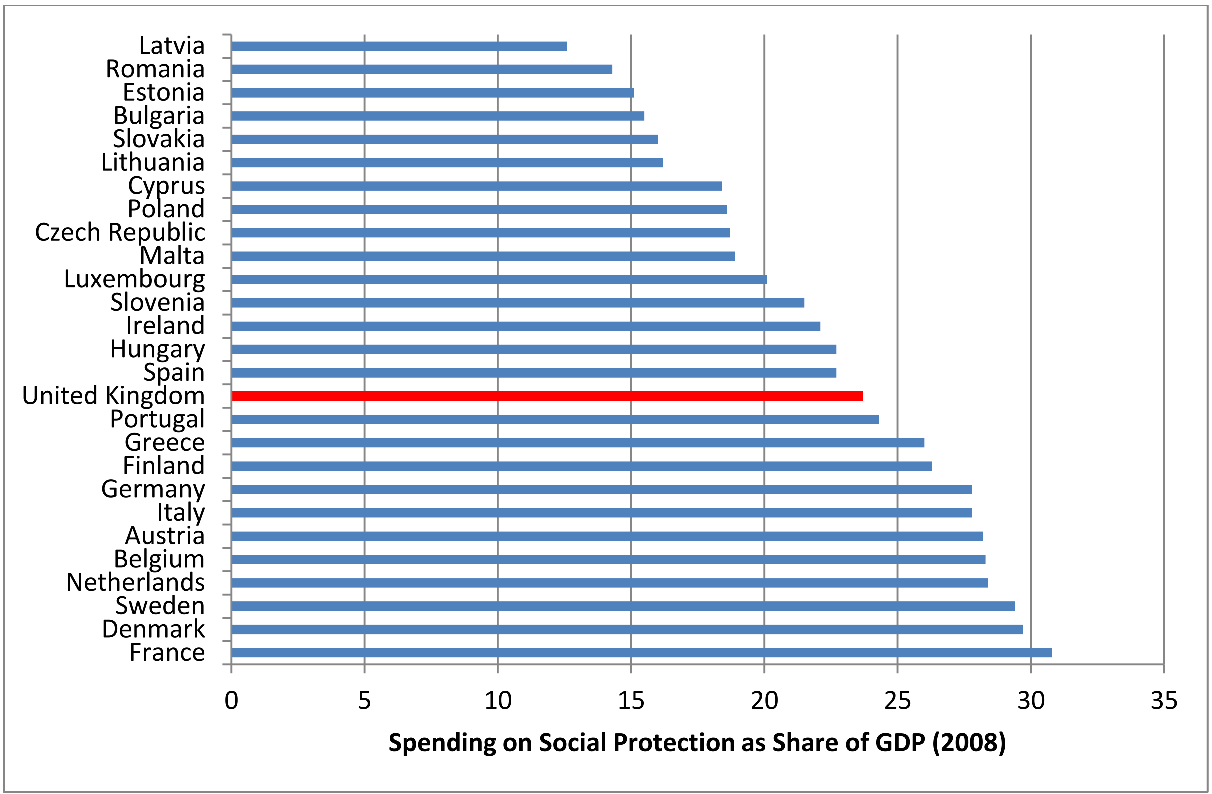
More than half of total public spending in Scotland goes on social protection. In 2010-11 DWP payments on welfare and state pensions in Scotland totaled £15.6bn. A further £10.8bn was spent by the Scottish Government on health care, while local authorities provided a further £5.2bn in support of older people, children, the homeless etc. Together these come to £31.6bn, which comprises 26.4 per cent of GDP excluding oil and gas, and 21.1 per cent including oil and gas.

The European System of integrated Social PROtection Statistics (ESSPROS) focuses on eight specific risks frequently covered by the state and uses these to construct comparable data on social protection across European countries. The risks identified by ESSPROS are disability, sickness/health care, old-age, survivors, family/children, unemployment, housing and social exclusion. Figure 1 shows how much EU countries spend on social protection as a share of GDP, using the ESSPROS definition. UK spending is below the average for the EU as a whole. In 2008, UK spending was equivalent to 23 per cent of GDP, while the average for Europe was 26 per cent. UK spending on social protection is less than the Scandinavian countries, but also less than three of Europe's major economies – Germany, France and Italy,

Most countries outside Europe devote a lower share of their output to social protection, relying more on the private market, family or charity to cushion the impact of adverse events. High state spending on social protection is frequently cited as a cause of Europe's loss of competitiveness to the rapidly growing economies of Asia. However, high spending on social protection is not necessarily a good predictor of fiscal stress: the Scandinavian countries and Germany operate tight fiscal policies, while also offering relatively generous levels of social protection compared to the UK.

An equivalent calculation for Scotland would place it slightly above the UK as a whole, but the differences in social protection spending between Scotland and RUK are relatively small. The additional spending in Scotland would not take it close to the top of the European league in social protection spending shown in Figure 1.

Figure 1: Social Protection Spending as Share of GDP, European Union 2008



Source: Eurostat

The UK follows the UN classification of the functions of government (COFOG) system to categorize social protection, but excludes spending on health care from the Public Expenditure Statistical Analysis (PESA) data on "social protection", which is therefore mainly focused on welfare benefits and state pensions. On this narrower definition, spending per head in Scotland is also above that in the UK as a whole. Thus, for example, in 2010-11 spending per head on social protection in Scotland (PESA definition) was £3972 compared with £3658 for the UK as a whole – a difference of 8.6 per cent.

There are some external indicators which might partially explain differences in per capita welfare spending between Scotland and RUK. Table 1 shows some economic and social indicators that might be expected to be good predictors of the demand for social protection. Scotland has lower income, more working age people with no skills, a higher unemployment rate, higher proportions of older people and lone parents in the population and higher levels of disability. These differences partly explain higher levels of social protection spending in Scotland, though the differences between the scores are typically less than 8.6 per cent. However, averages can be misleading.

Eligibility for state benefits is triggered by individuals being assessed as being above or below some threshold value of a particular indicator, rather than being above or below its average value. This implies that aggregate claims against the social protection budget depend both on the variance in scores as well as the average for the relevant indicators. A full explanation of the difference would require analysis of such variability.

Compensation for the costs of housing also plays an important role in social protection spending. In 2011, the average price of a house in the UK was £245,000, while the average in Scotland was £209,000, some 15 per cent less. Although house rental charges are more relevant for social protection, since those who are unable to access housing are usually offered rental accommodation, or the cash needed to rent, house prices do give some indications of rental values. Thus, one might expect that lower housing costs in Scotland to partly offset the more negative social and economic indicators from Table 1.

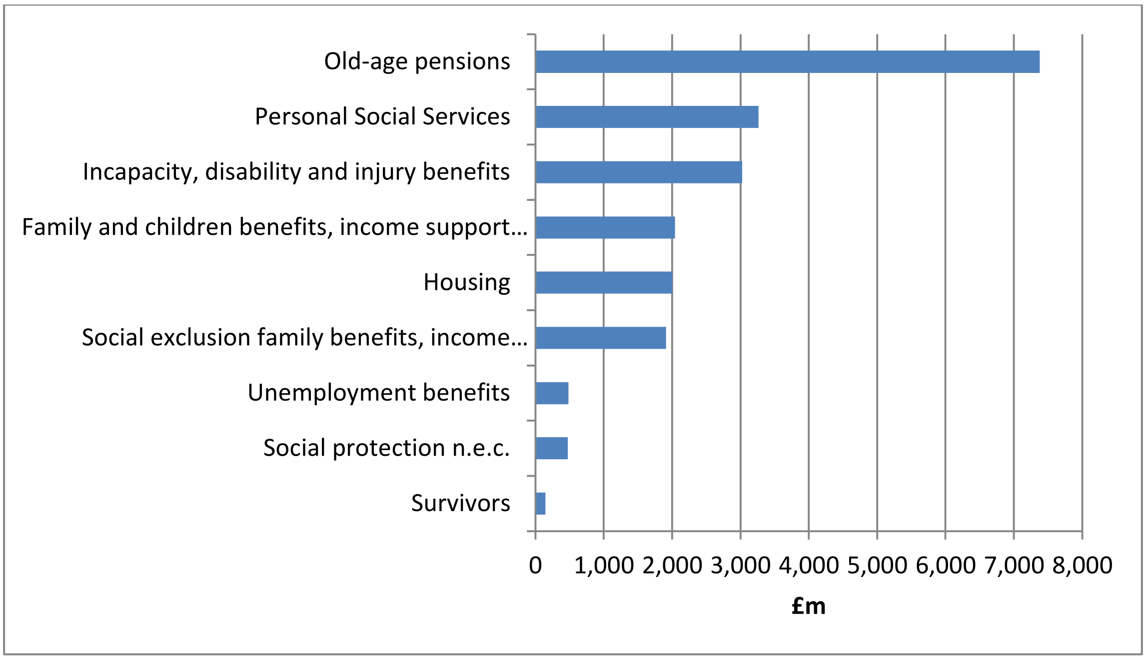
Table 1: Economic and Social Indicators: Scotland and the UK[1]

	Scotland	UK	Scotland/UK Difference
Median gross weekly earnings (£)	498	505	-1.4%
Working age population with no skills	11.6	10.9	6.4%
Unemployment rate	8.1	7.8	3.8%
Proportion of population aged over 65	17	16.6	2.4%
Proportion of lone parent households	11.1	11	0.9%
Proportion DDA-disabled and work-limiting disabled	13.4	12.1	10.7%

Under the PESA definition, social protection expenditure in Scotland in 2010-11 was £20.7bn, which comprised 39.1% of *identifiable* public spending in Scotland. The allocation of this total to the different forms of social protection is shown Figure 2, while its allocation to the Departments responsible for its allocation is shown in Figure 3.

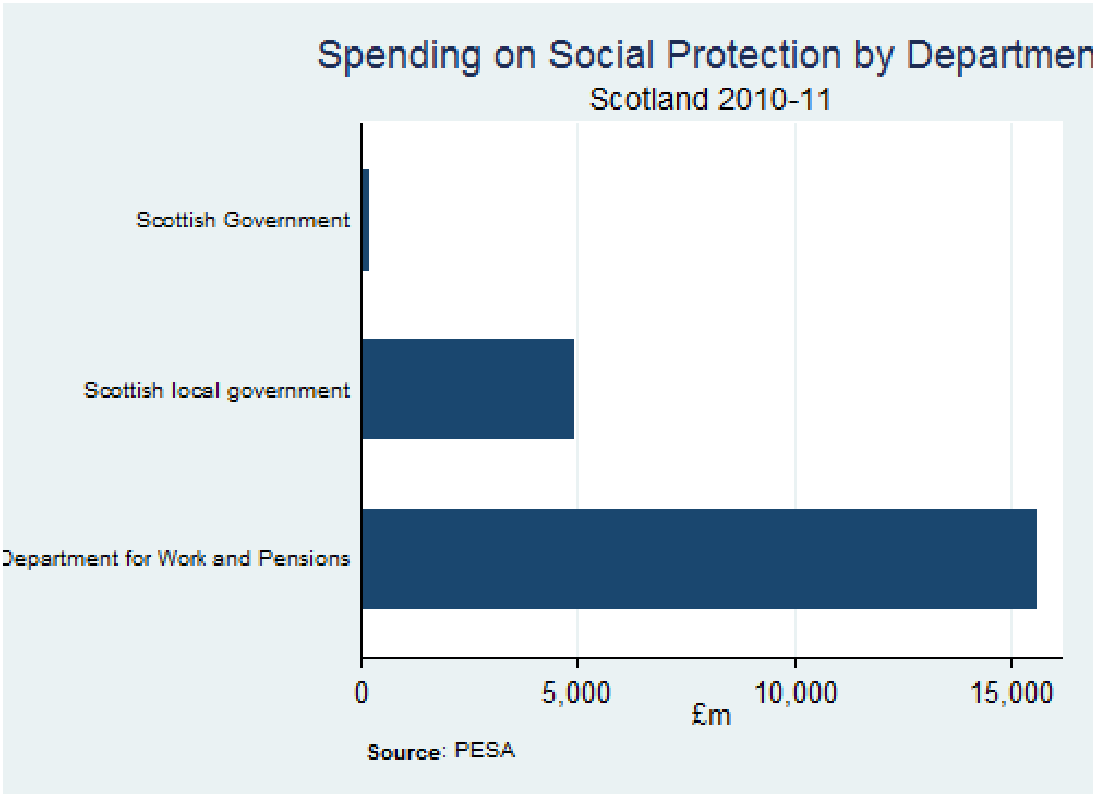
[1] ONS Regional and Country Profiles (Jan 2013) Accessed at: http://www.ons.gov.uk/ons/datasets-and-tables/index.html

Figure 2: Social Protection Expenditure by Type Scotland 2010-11



Source: PESA

Figure 3: Social Protection Expenditure Scotland 2010-11



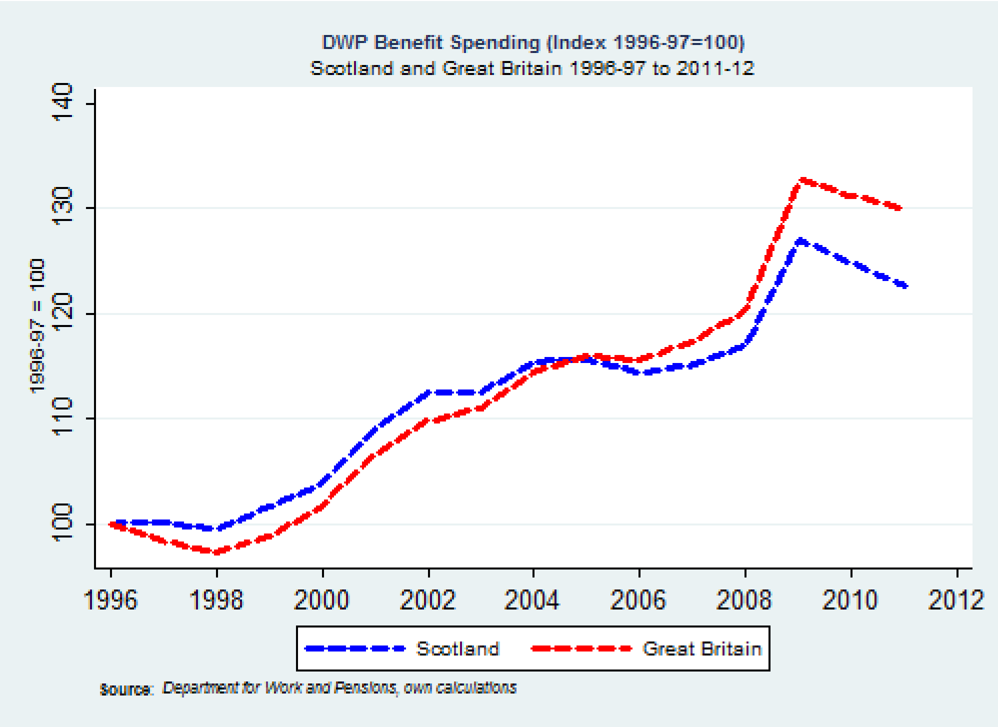
Source: PESA

It is evident from Figure 2 that much of the social protection budget is used to support older people. Spending on state pensions is more than double that of any other category. The second largest category, personal social services, captures service provision rather than cash payouts. A large proportion of these services are allocated to providing social care to older people. The third largest category is also positively correlated with age because the incidence of incapacity and disability increase with age, and will therefore also tend to disproportionately assist older people. Working age benefits account for a much smaller share of social protection spending than do those which help older people. Unemployment benefits, popularly considered to be one of the key forms of social protection, accounts for less than 5 per cent of the Scottish social protection budget.

From Figure 3, it is clear that control of social protection spending in Scotland rests largely with DWP, which allocates more than three quarters of the budget. Local government spending and service provision in support of older people, children and families and social exclusion accounts for almost all of the remainder. The SG direct contribution to social protection is small, though on the broader definition of social protection, SG also sets the health care budget of around £11bn. In addition, through its control over local authority budgets and the legislative process, the Scottish Government is able to influence local authority policy social protection policy. A notable example was the legislation passed in 2001 preventing local authorities charging older people for the costs of personal care. This legislation was the mechanism for the introduction of "free personal care".

Now consider the evolution of the largest element of social protection spending - cash benefits paid by DWP. Though spending per head on these benefits in Scotland continues to be greater than that in the UK as a whole, its growth has been slower in Scotland. Figure 4 shows that the growth in DWP benefits spending since 1996-97 has been slower in Scotland than in the UK as a whole. This may have been a function of a gradual relative improvement in social and economic conditions in Scotland, though this perhaps predates 2005, when the relative reduction in the growth of claims appears to have begun.

Figure 4: Benefit Expenditure Scotland and Great Britain - Index 1996=100



An alternative explanation is that benefit take-up rates in RUK have grown faster than those in Scotland. DWP estimates take up rates for the different benefits it provides. The share of "entitled non-recipients" is estimated from the Family Resources Survey. Take-up rates vary across the UK, but the variations are not sufficiently large to conclude that there exist significant differences in take-up rates across the UK. Recent work on the implicit costs of means-testing by Hernandez et al[2] suggests that the implicit costs of means-testing are around £3-£4 per week for Income Support claimants. These comprise a mixture of the costs associated with the stigma of being a claimant and the transactions costs of establishing a claim. The evidence on whether take-up rates vary by whether benefits are means-tested or not is somewhat mixed. Currie (2004)[3] argues that in the USA there is as much variation in major non means-tested take up rates as there is in those that are means-tested. This would tend to favour the transactions costs, rather than the stigma explanation of non take-up.

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[2] Hernandez, M.,, Pudney, S. and Hancock, R. (2007) "The welfare costs of means-testing: pensioner participation in income support", Journal of Applied Econometrics, 22(3), pp 581–598, April/May

[3] Currie, Janet (2004) : The Take-Up of Social Benefits, IZA Discussion paper series, No. 1103,http://hdl.handle.net/10419/20338

Table 2: Spending on DWP Benefits: Scotland 2011-12

Benefit	Type	GREAT BRITAIN	SCOTLAND	SCOTTISH SHARE
		£m	£m	%
Attendance Allowance	non-contributory / non income related	5,339	483	9.1%
Bereavement Benefit/Widow's Benefit	Contributory	594	59	9.9%
Carer's Allowance	non-contributory / non income related	1,733	153	8.8%
Council Tax Benefit	income related	4,920	384	7.8%
Disability Living Allowance	non-contributory / non income related	12,566	1,373	10.9%
of which children	income related	1,259	105	8.3%
of which working age	income related	7,024	788	11.2%
of which pensioners	income related	4,283	481	11.2%
Employment And Support Allowance	contributory/income related	3,554	381	10.7%
Housing Benefit	income related	22,814	1,728	7.6%
Incapacity Benefit	Contributory	4,935	564	11.4%
Income Support	income related	6,997	670	9.6%
of which on incapacity benefits		3,918	417	10.6%
of which lone parents		2,406	191	7.9%
of which carers		354	34	9.7%
of which others		320	27	8.6%
Industrial Injuries Benefits	non-contributory / non income related	888	93	10.5%
Jobseeker's Allowance	contributory/income related	4,934	461	9.4%
Maternity Allowance	non-contributory / non income related	366	24	6.6%
Over 75 TV Licences	non-contributory / non income related	587	49	8.3%
Pension Credit	income related	8,052	751	9.3%
Severe Disablement Allowance	non-contributory / non income related	881	97	11.0%
of which working age		688	76	11.1%
of which pensioners		192	20	10.5%
State Pension	contributory non-contributory / non income related	74,151	6,325	8.5%
Total		157,702	13,979	8.9%
NHS (No user charge)	non income related	106,660	11,262	10.6%
Concessionary travel (No user charge)	non income related		249	
Free prescription (No user charge)	non income related	(450)	57	
Free personal care (No user charge)	non income related		427	
Free nursing care (No user charge)	non income related	(4180)	23	
		000s	000s	
Population		**61,371**	**5,295**	**8.62**

Aggregate DWP spending by benefit type in Scotland and Great Britain[4] in 2011-12 is shown in Table 2, which also indicates whether these benefits are contributory or non-contributory and whether the payment is related to income, implying that it is means-tested. The rightmost column shows the

[4] Figures are for Great Britain rather than the UK because Northern Ireland separately administers its own benefits system, though it pays the same rates of benefit as elsewhere in the UK.

share of spending on each benefit in Scotland as a share of the equivalent amount for Great Britain. These shares can be compared with Scotland's share of the GB population, which in 2011 was 8.62 per cent. Values greater than 8.62 per cent indicate that Scotland is receiving more than its population share, implying that spending per head is higher in Scotland, while the reverse is true for values less than 8.62 per cent.

Since much of the controversy surrounding state benefits involves the relative costs of universal and means-tested benefits, Table 2 also shows the costs of some of the better-known "universal" benefits in Scotland, which are paid for by SG rather than DWP. These also differ from DWP benefits in the sense that they stem not from cash payouts by government but rather from the government opting not to charge users. For example, SG did not make prescriptions free for individuals by giving them cash to pay for prescriptions; rather it opted to remove the charges that were previously levied on prescriptions.

Returning to Table 2, it is clear that state pensions (SP), housing benefit (HB) and disability living allowance (DLA) are the most costly benefits, both in Scotland and in Great Britain as a whole. State pensions alone account for 45 per cent of welfare spending in Scotland. Housing benefit comprises almost a further 12 per cent of the budget. As implied earlier, Scotland's share of housing benefit expenditure, unlike most other benefits, is lower than that in Great Britain as a whole, reflecting the generally weaker housing market in Scotland. The share of council tax benefit paid in Scotland is somewhat less than in Great Britain. Rather than reflecting directly on the housing market, this may be an outcome of the council tax freeze which has been in place in Scotland since 2007.

Scotland's welfare costs associated with disability are relatively high. DLA makes up a further 10 per cent of the welfare budget in Scotland and accounts for 10.9 per cent of the GB total, well in excess of Scotland's population share: the same is true of payments for incapacity benefit (IB) in Scotland which account for 11.4 per cent of GB spending. In addition, spending on Attendance Allowance (AA) in Scotland amounted to £483m in 2011-12, also accounting for more than its population share of GB spending. Three features are noteworthy about this benefit. First, it is a universal benefit, payable to all those aged 65 and over in GB that have a need for "personal care". Second, in Scotland this spending is additional to the "free personal care" funding that SG established in 2001. The two funding streams have the almost identical eligibility criteria. The criteria for eligibility for SG support are that the person is aged 65 or over and has been assessed as requiring personal care. Third, although they ostensibly address the same issue, the budget for AA in Scotland is larger than the SG budget for free personal care, a fact largely missed by the media. AA provides a weekly cash payment. In 2012, the upper rate was £77 per week, which is intended as a compensation for the additional costs incurred by those with personal care needs. The SG policy is to provide funding for care services which are supplied by a local authority, the third sector or by private enterprises. Fourth, the Scottish share of AA spending is above that in GB, even though (i) Scotland has a free personal care policy in place *and* (ii) DWP took the decision not to pay AA to those in care homes in Scotland after the introduction of free personal care. This is certainly a benefit where a lack of co-ordination between DWP and SG does lead to seemingly counter-intuitive outcomes.

Taken together, the data on disability-related benefits show that ill health and disability are among the principal reasons for Scotland's relatively high levels of spending on welfare benefits. For example, DLA spending in Scotland grew from £610m in 1998-99 to £1373m in 2011-12. Even after allowing for the inflation measure against which benefits have been indexed each year (RPI), there has been a growth of 56 per cent in real terms in DLA payments in Scotland, a real growth rate which exceeds the growth of the Scottish economy by 27 per cent during this period. This rate of growth would be unsustainable over the long-run. In these circumstances, were welfare benefits the responsibility of SG, one might expect to see greater policy emphasis on public health initiatives intended to mitigate growth in disability. While such initiatives do form part of the broad SG policy agenda, the pressure to ensure their success is diluted because any consequent financial benefits will be shared between SG (reduced health spending) and DWP (reduced payments on disability benefits).

Overall spending on welfare benefits and state pensions in Scotland increased by 78 per cent in nominal terms between 1998-99 and 2011-12 – a real increase of 23.2 per cent[5]. This real increase closely matched the increase in Scottish GDP over the period – implying that the share of Scottish GDP allocated to welfare spending (albeit not by the Scottish Government) has not changed significantly during this period. However, within this total, there has been considerable change.

One contrast is between those elements of welfare spending that are means tested, and those that are not. The issue of means testing has achieved some prominence in public debate in Scotland and

[5] Measured using the CPI, the real increase was 35.4 per cent. The difference between the CPI and RPI estimates of the "real" increase in benefit spending gives some indication of the impact of a change in the indexation method. This is important since the UK government has indicated that CPI will be used to index benefits (and pensions) in the future.

RUK. At a time of austerity, it is argued, means testing for the allocation of benefits and for the application of user charges promotes equity and efficiency in the use of scarce tax revenue. A subsequent paper will comment on this issue: in this paper, I restrict myself to examining some data on the size and trends in the value of means-tested/universal benefits.

Table 2 shows that, for example, the cost of free personal care in Scotland in 2011-12 was less than 7 per cent of the cost of state pensions. The extent to which this spending indicates that frail older people in Scotland receive more generous support from the state than in RUK is difficult to determine, partly because the systems of support are now radically different. The NHS provides financial support for social care provision both in Scotland and RUK. Establishing comparisons of the levels of support is now extremely difficult due to the differences in reporting systems. Those living in care homes in Scotland receive a lower level of funding to pay for nursing care than those in England. They also do not receive AA. Hence it is difficult to be categorical about the relative levels of social care support in Scotland compared with RUK. This is an exemplar of a wider problem – as reporting systems increasingly diverge, it becomes difficult to make valid comparisons of efficiency and value-for-money of public service provision north and south of the border.

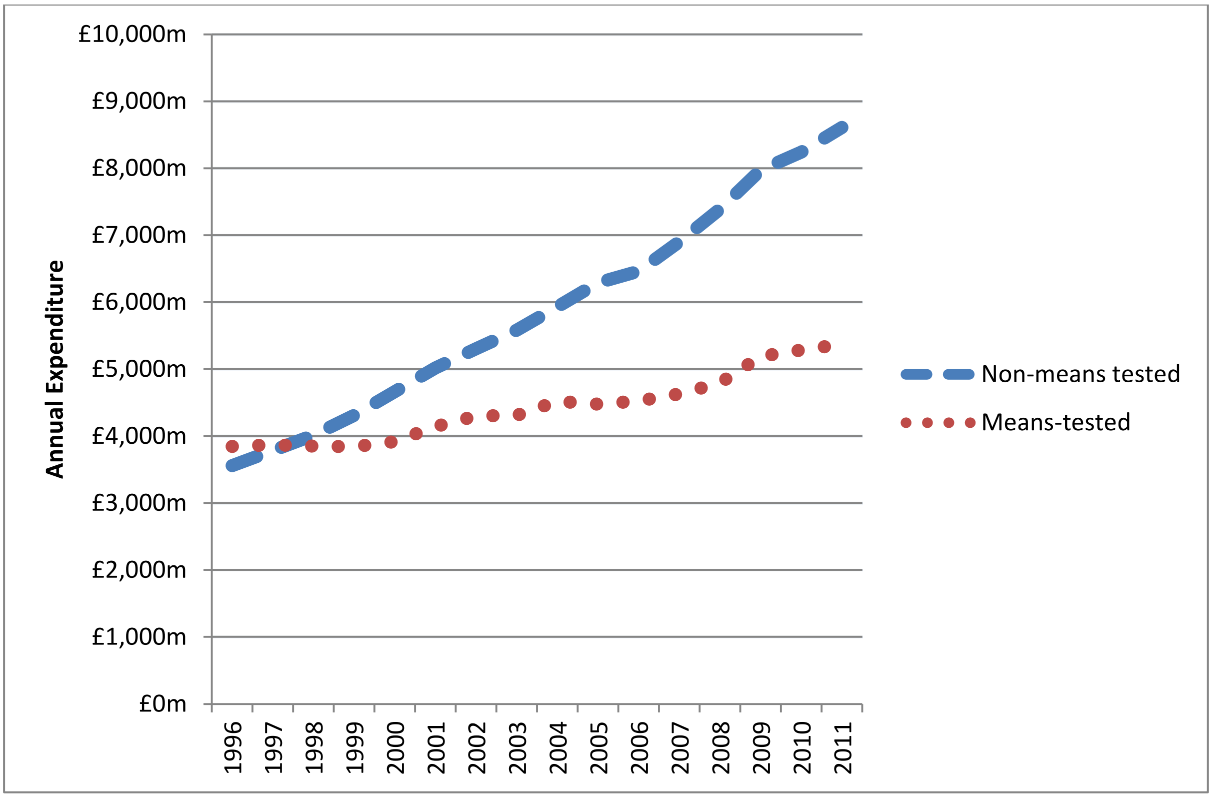
Table 2 also shows that the costs of the universal benefits provided by the NHS dwarf the costs of other social protection mechanisms. Within totaling spend of health, Scotland provides free prescriptions. England does not and is able to raise £450m from such charges, which amounts to 4.2 per cent of its total health budget. If Scotland levied the same charges it would collect around £39m. While this is a significant sum, it is small in relation to the Scottish health budget of £11,262m and also even to the total prescriptions budget, which is in excess of £1bn.

Welfare spending is controlled both by the levels of support provided and by the criteria used to control eligibility. If these are drawn tightly and the rigor with which the rules are applied is not well-understood, then what may be perceived as generous cash benefits may not constitute a great expense to the public purse. Similarly, where eligibility is very wide, the removal of user charges may cost a relatively small amount. This argument could be applied to the removal of prescription charges in Scotland.

To determine the relative costs of means tested and non means-tested benefits in Scotland, Figure 5 shows the evolution of their costs over the period 1996-97 to 2011-12. Those benefits classified as not means-tested are Attendance Allowance, Disability Living Allowance, TV Licenses for the over 75s, Winter Fuel Payment, State Pension, Industrial Injuries Benefits and Severe Disablement

Allowance. Other benefits are classified as means tested. It is clear that by far the most rapid growth has been among non means-tested benefits. There are a number of possible interpretations of this finding. First it might be the case that the process of means-testing limits the growth in spending, since it gives government an additional mechanism to limit spending. Another argument is that many of the non-means tested benefits are provided to pensioners and that successive governments have been unwilling to pay the political price of means-testing pensioner benefits. The political costs of introducing means-testing to what was previously a universal benefit are likely to be higher than those associated with introducing a more stringent means test on an existing means-tested benefit.

Figure 5: Expenditure on means-tested and non means-tested benefits, Scotland 1996-97 to 2011-12



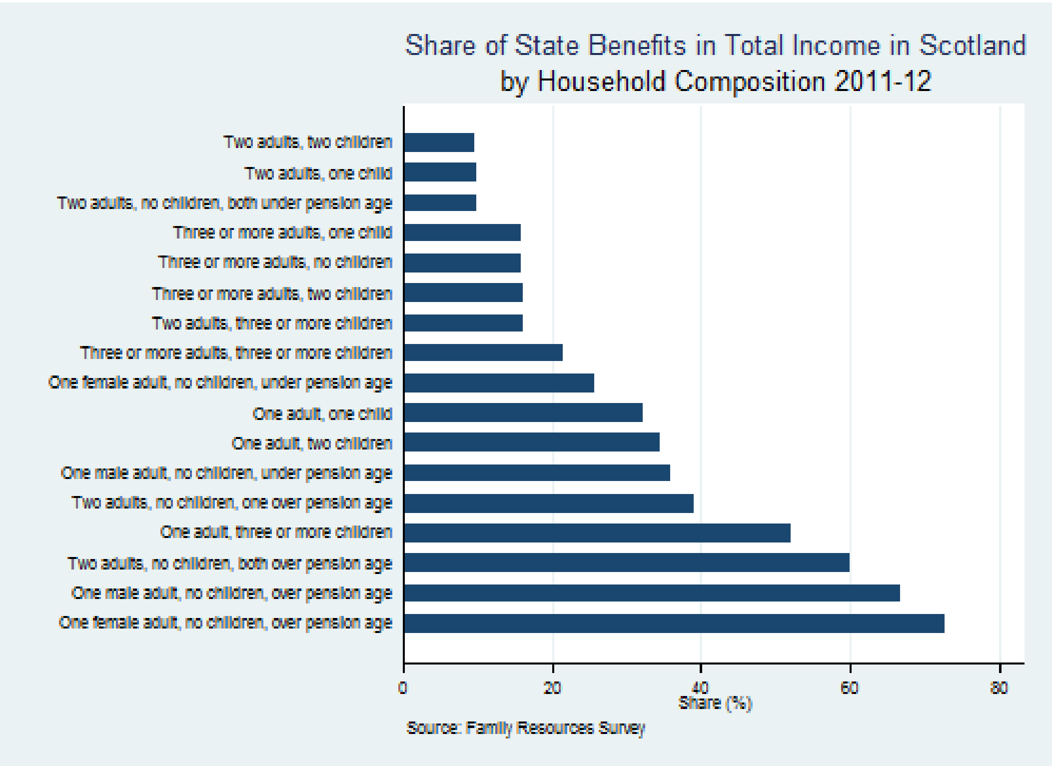
Source: DWP and own calculations

Looking to the future and assuming that the means testing regime does not change, then increased spending on welfare benefits will be driven by population ageing and the associated entitlements to state pensions and disability benefits. We return to this issue subsequently.

Survey evidence reinforces the information on benefits spending from Table 2. It clearly indicates that benefits are an important source of income for older people.

Figure 6, which is drawn from the 2010-11 Family Resources Survey, shows the importance of benefits as a share of household income for different household types in Scotland. The average family with two adults and two children receives only around 8 per cent of gross weekly income from benefits. In contrast, pensioner families, both couples and single person households, rely on state benefits for at least 60 per cent of their weekly income. For single female pensioners, the share exceeds 70 per cent. The distribution of households by composition is broadly similar in Scotland to the rest of the UK and does not therefore provide a strong argument for differentiating benefits policy in Scotland from that in the RUK.

Figure 6: Share of State Benefits in Total Income by Household Composition (Scotland 2011-12)

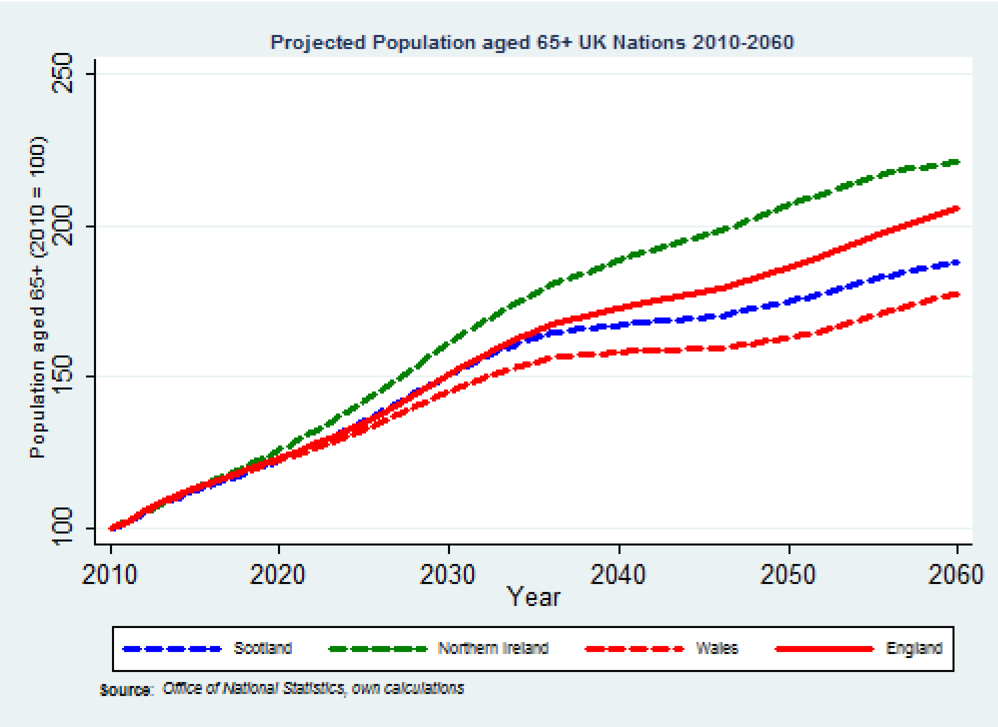


This evidence illustrates the difficulties that a Scottish Parliament with enhanced powers would have in making significant alterations to the existing structure of welfare benefits. State benefits play a vital role for in supporting the incomes of types of household which have limited alternative sources of income. In addition, for at least the next two decades, these household types will grow rapidly in number due to demographic change. In the next section, we exemplify how the costs of welfare benefits might rise by focusing on their largest element – state pensions.

Future costs

Figure 7 shows the projected numbers of pensioners in the constituent countries of the UK indexed on 2010=100 for the period 2010-2060 (Source: ONS). Growth in pensioner numbers is slower in Scotland than in England, partly reflecting an assumption that Scots will continue to have lower life expectancy. Nevertheless, the number of Scots pensioners will increase by 80 per cent between 2010 and 2060, with most of the increase concentrated in the 2010-2035 period.

Figure 7: Projected Increase in Pensioner Numbers (UK Nations 2010-60)



If Scotland acquires new fiscal responsibilities, including control over welfare benefits, there will be a need to raise revenues to meet the increased costs of state pensions. These will have to be derived from the economic activity of the working age population. Retirement ages are set to increase gradually during the next two decades. Nevertheless, meeting the costs of welfare entitlements for older people will, as we shall see, require a return to consistent patterns of economic growth if increases in the tax burden are to be avoided.

To illustrate this, Figure 8 shows a projection of the costs of older people's benefits in Scotland measured as a share of GDP over the period 2010 to 2060. This is based on the OBR forecast of the future costs of older people's benefits6 in the UK as a whole. The projection for Scotland is based on the assumption that costs will largely be determined by Scotland's share of UK pensioners. If economic performance in Scotland follows that assumed by the OBR for the UK as a whole, and, in particular, worker productivity grows at 2.2 per cent per annum for the period to 2060, then the share of older people's benefits in GDP would be broadly as shown in Figure 8.

The projection shows pensioner benefits falling as a share of GDP until 2020 and then rising. The reason for the dip during this decade is mainly due to the increase in retirement ages, particularly for women. Thereafter costs trend upward with increasing numbers of pensioners, though they dip after 2040 due to a further projected increase in the retirement age. Another key assumption that affects disability benefits (and also health spending though this is not included in these projections) is that of healthy life expectancy (expected years of disability free life). The OBR assumption is that healthy life expectancy will grow in line with life expectancy at age 65. This assumption is therefore implicit in the projections for Scotland, although, given the earlier discussion of its higher incidence of disability, significant improvement in healthy life expectancy poses a particular challenge for Scotland.

While state pensions dominate benefit payments for older people, other benefits such as AA, DLA and WFP also contribute to the total cost. Their relative contribution is expected to decline over time due to their value being uprated in line with CPI, rather than with the "triple-guarantee[7]" which will apply to state pensions.

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[6] These benefits and the assumptions underlying their evolution are: State Pension Age equalised at 65 by November 2018, with the Pension Credit and Winter Fuel Payment qualifying ages rising in line. State Pension Age reaches 66 by October 2020, and rises further to 67 between 2026 and 2028, and 68 between 2044 and 2046; qualifying ages for Pension Credit, winter fuel payments, Disability Living Allowance and Attendance Allowance rise in line. Basic State Pension uprated using the 'triple guarantee' mechanism which is assumed to cause it to grow by earnings growth plus 0.26 percentage points a year. State Second Pensions in payment uprated in line with CPI.

[7] The "triple guarantee" means that state pensions will rise by the greatest of: (1) the rise in average UK earnings, (2) the rise in inflation (as measured by the Consumer Price Index) and (3) 2.5 per cent

Figure 8: Projected Costs of Older People's Benefits as a Share of GDP Scotland: 2010-2060

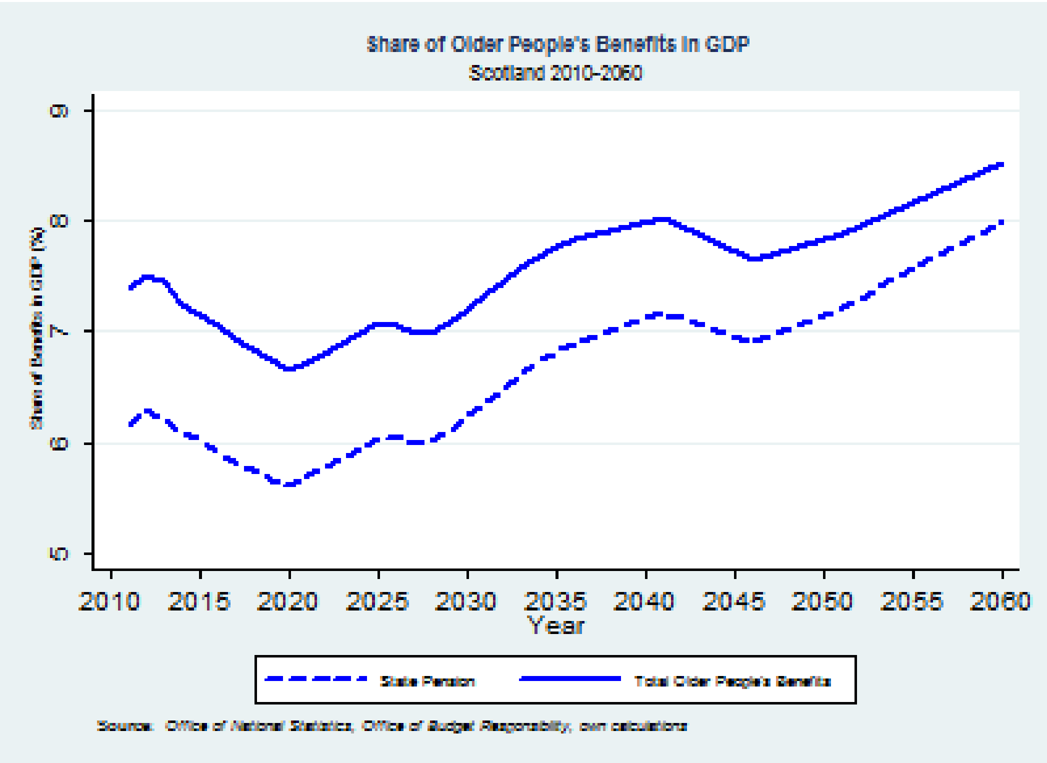
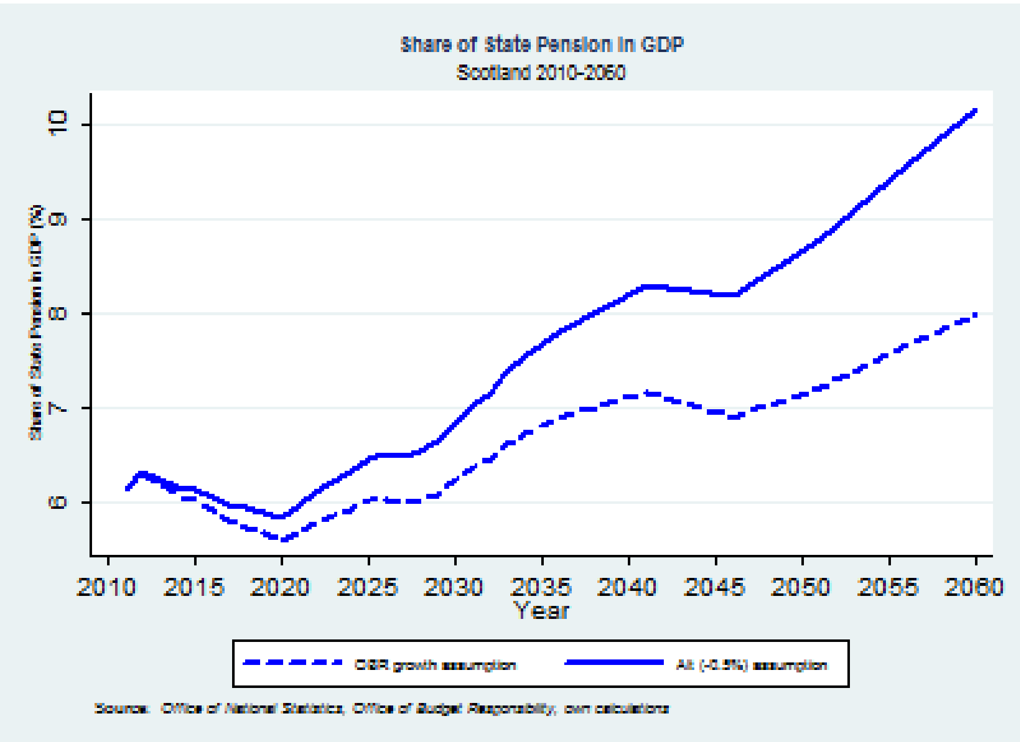


Figure 9: Share of Old Age Pensions in GDP if Annual Productivity Growth Reduced by 0.5 per cent



Another critical assumption on the OBR projection is that of consistent productivity growth of 2.2 per cent per annum. A fall in this growth rate would place increased pressure on the public finances. For example, a reduction of 0.5 per cent per annum substantially increases the share of GDP devoted to older people's benefits (see Figure 9). The lower (dashed) line replicates the central OBR assumption of 2.2 per cent productivity growth, while the upper (continuous) line assumes 1.7 per cent growth. This increases the share of GDP going to older people's benefits by almost 1 per cent by 2035.

It is against this background of projected increases in the costs of some of the more important forms of state benefits that any discussion of increased devolution of welfare benefits to Scotland should be viewed. In the next section, we discuss some of the proposals.

Alternative Proposals for Welfare Payments and State Pensions in Scotland

Proposed alternatives to the existing system of the UK-wide regulations and rates of benefit have tended to argue for the principal of devolving the responsibility for benefits rather than in discussing the details of how this might operate in practice. There is certainly a case for devolution, or at a minimum, greater coordination between the DWP and SG, of aspects of the benefits system. There are three arguments in favour of devolving responsibility over some or all of the benefits budget:

1. One could take the view, on the grounds of equity, that benefit recipients should receive the same real level of support, irrespective of their location. Real and nominal support levels will coincide if prices are equal at all locations. This is clearly not the case within the UK at present because, for example, the costs of housing vary substantially. While central government could try to fine tune benefits to equalise real incomes and so achieve equity, an alternative approach would be to allocate block grants based on price differences to better informed lower levels of government and allow these to determine benefit levels.

2. There are clearly areas where powers of devolved governments interact with the social welfare system. An example already quoted relates to SG provision of social care and the cash benefits provided by DWP to compensate for the need for care. Another key area of interaction is around the labour market. Skills development is a function of SG. Yet this has strong interdependencies with active labour market policies (ALMPs) designed by DWP around the benefits system. More effective use of public funds might be achieved if there were greater cooperation between central and devolved governments in all stages of policy

development or if there SG was given more policy control in this area.

3. There may be differences between central and devolved governments in support for welfare benefits in general and/or particular types of benefit in particular, as expressed through their respective democratic processes. This may be dealt with by allowing some local variation in benefit levels, where the costs are met from local resources (either higher taxes or reduced spending on other government programs). Any such initiative would also have to be consistent with the fiscal stance of the devolved parliament, which might specify, for example, that taxes did not exceed a threshold value in relation to GDP.

Amongst the arguments against are:

1. The possibility that differences in benefits levels cause inefficient movements of population between jurisdictions. This argument was first made by Stigler (1956) in relation to differences in benefits between US states. Gramlich (1987) argued that "states can free ride on the benefit payments of other states by the simple expedient of paying lower benefits so that recipients will move across the border to get higher benefits. Competing state governments could then engage in a competitive benefit cutting process, driving benefits levels in both states, far below the levels desired in either state in the absence of migration." Evidence on this proposition is mixed, most authors concluding that if there is any such effect, it is small. Brueckner (2000)8 argues that policymakers may nevertheless believe that such effects exist and set benefit levels close to those in nearby states to reduce the incentive for such migration. Given the flexibility of the UK labour market, Scottish politicians might also be influenced by this perception, which would imply that any increased autonomy of the benefits system would be based on perception rather than reality.

2. Balkanization of the benefits system reduces the opportunity for welfare-enhancing risk pooling. Thus, for example, under current arrangements other parts of the UK support parts of the territory that have been adversely affected by some event, such as a large plant closure. With the risk spread over a large number of taxpayers, the tax cost to the individual is likely to be small. If the risk pool is reduced, say by Scotland having an independent benefits system, then any costs of an adverse event would fall only on Scottish taxpayers rather than those of

[8] Brueckner, J. (2000) "Welfare Reform and the Race to the Bottom: Theory and Evidence." Southern Economic Journal, 66 (3), 505-525

the UK as a whole.

3. Economies of scale in the operation of the benefits systems reduces costs and directs a greater share of the benefits to clients. The UK social security is administratively efficient. Setting up a new agency to carry out the same functions would incur costs that would fall on Scottish taxpayers.

The alternative proposals for additional powers over state benefits are, do not really address these arguments. Full independence would obviously imply full control over all forms of social protection, including welfare benefits. The Devo-max proposal is that Scotland should have the full range of fiscal powers, including control over the welfare system. Each year the Scottish Government would make balancing payments to the UK government for the services that it provides, such as defence. The net effects on the welfare of the Scottish population would partly depend on the balance of the arguments listed above.

Devo+ proposes that some additional powers be granted to Scotland and that SG and local government are able to supplement DWP benefits as they see fit. Finally, the “Devo More” proposals make the important point that failing to devolve at least some powers over welfare spending implicitly locks Scotland into the “English model of the welfare state”. What exactly these additional powers comprise and how they would be implemented is less fully specified.

What is absent from the debate thus far is a fully-costed alternative vision of how a “Scottish model of the welfare state” might differ from the English model. One could envisage a more Scandinavian style of welfare system, with a greater proportion of GDP allocated to state benefits. Only the Devo-max or full independence solutions would make this possible. The medium-term constraints on its implementation would be likely to be (1) Scotland’s fiscal position, (2) the effects of demographic change on welfare costs and (3) potential spillover effects of running a different welfare system from that of a large near neighbour.

Conclusions

This paper has examined the structure of social protection in Scotland. It has argued that Scotland, like the UK as a whole, is around the middle of the European pack in the proportion of its GDP that it devotes to social protection. Scottish spending is somewhat above that in the UK as a whole, partly driven by relatively high levels of disability. The largest component of the social protection budget in

Scotland is controlled by the Department for Work and Pensions. Its policies reflect the views of the UK government and may not coincide with those of the Scottish Government.

Though the level of benefits spending per head is significantly higher in Scotland, its growth has been less rapid than that in the UK as a whole since 2005. In Scotland and the UK as a whole, benefits spending has been increasingly dominated by payments made to older people. There is no strong evidence of difference in take-up levels of welfare benefits between Scotland and the UK as a whole, but there has been a marked shift in spending towards non-means tested forms of benefits.

There are areas where Scottish government and DWP policy clearly conflict. A notable example concerns free personal care, where there the role of different funding streams to support frail older people lacks clarity. Similar arguments might be made in relation to skills and employment policy.

The future costs of state benefits will be largely driven by demographic change, independent of the constitutional arrangements. For Scotland, if it were to take on greater responsibility for welfare spending, key issues would be (1) the growth rate of productivity in Scotland and (2) changes in healthy life expectancy.

While supporters of increases in the powers of the Scottish government, including full independence, have indicated a desire to take greater control over the welfare budget, what has been lacking is a clear, costed vision of what that “Scottish welfare system” might comprise. There are opportunities to improve the operation of the welfare system, but there are also constraints which few of the advocates of increased powers seem willing to acknowledge.