with the reforms, actually imply a fall in public spending on pensions as a share of GDP over the long-term.

In some ways this is an enviable situation. However, it has been achieved at two costs. The first problem is that of adequacy of social security benefits. The main way in which the cost of the UK welfare state has been kept in check in the last two decades is through the way in which most benefit levels are now linked to prices, not incomes. In effect there has been a steady fall in the relative value of benefits, which has been one of the contributors to the rapid increase in inequality and relative poverty in the UK since the 1970s. The Government's aim of linking the level of the means-tested Minimum Income Guarantee for pensioners to earnings is part of its strategy to halt this trend (although it is not being extended to other benefits). As Table 4 shows, the rates of income replacement for average earners built into the state system will be lower in 2050 than now, and much lower than those being proposed in Japan, even after cost-reducing reforms.

The second problem is that there has been a drift to greater reliance on means-tested social security benefits and away from those based on social insurance. Recent Government decisions suggest that this drift may continue. However, this development poses problems for other Government aims: the promotion of work and savings, and of partnerships with the private sector. The disincentives inherent in a wide-spread system of means-testing may be damaging to the encouragement of those currently out of work to take jobs, a central aim of current policy. The social insurance principle is being eroded and in the long-run may well not survive – but that will lose the link which it embodies between work and future protection. Greater reliance on means-testing to create a better floor to living standards in retirement may act as a disincentive to save or accumulate extra second tier pensions. If the new State Second Pension was generous enough, it could carry most people beyond means-testing; as currently proposed it will fail to do so for many low paid workers with incomplete working lives. Other elements of means-testing may discourage precisely the kind of private insurance for welfare risks (like long-term sickness or disability) which the Government has said it wishes to encourage.

The UK experience of encouraging a strong role for the private sector in providing pensions is an interesting one, although not without its problems. Around half of all employees currently contribute to an employer-provided pension and are "contracted out" of SERPS additions. Such pensions usually offer much greater benefits than the state scheme, and the system of occupational pensions is well-regarded (with the exception of some conditions which may encourage premature retirement). However, the proportion of employees covered has not risen since the mid-1960s. Pensions for the rest of the working-age population are more of a problem. The Conservative Government's attempt to widen the number of people covered by individual private pensions had some success. However, the cost of this in terms of lost social insurance contribution revenue was greater than expected. At the same time, many of the new personal pensions will actually have a very low value. Indeed, over half a million people were "mis-sold" personal pensions, when they should have stayed with the state scheme. The schemes available are not very suitable for those with low lifetime earnings. The new 'Stakeholder Pensions' are intended to get round these problems for those with low, but not very low earnings,

Table 4 UK and Japanese Pensions Systems

	UK		Japan	
	1995	2040	1995	2040
People aged 65 or more				
(% of population)[1]	16	25	14	29
Public spending on pensions				
(% GDP; OECD figures)	4.5	5	5.5	15
Contribution rate				
(% of chargeable earnings)[2]				
Current policies	18.2	15.9	17.4	34.3
(UK if earnings link restored)		(24.9)		
Japan 1999 reform proposals:				
Reform I				30
Reform II				26
Reform III				20
Income replacement				
(% average earnings on unchanged policies)				
Basic/national pension:				
Single	16	9	13	-
Couple[4]	26	14	-	-
Basic and additional pension:				
Couple	47	29	43	62
(with Japan reform proposals)	-	-	-	(37-55)

Notes:
[1] UK figures for 1994 and 2041
[2] Japan figures for 1998 and 2025 and are for Employees Pensions Insurance
[3] Japan figures for 1998 and 2025
[4] Single earner couple

Sources:
ONS (1996); OECD (1995), Figure 13; Pensions Provision Group (1998); 'Social Security in Japan' by Dr T Fukawa (NIPSSR, mimeo); *Health and Welfare Statistics in Japan 1997*, Health and Welfare Statistics Association

but it is yet to be seen whether private providers will actually be prepared to run them at reasonable cost.

More generally, the UK experience over the last twenty years offers an interesting example of the potential role of the private sector in what have traditionally been seen as parts of the "welfare state". The experience suggests that there is no simple dichotomy between "public" and "private" sectors, and that roles may vary greatly between welfare services. Under continuing pressure from a Conservative Government committed to privatisation, there was indeed a steady shift towards the use of private welfare *providers*. However, it proved much harder to shift towards private *finance* of welfare services, which is what would be needed to relieve the pressure on taxation. In certain sectors – non-pension social security – it proved very hard to increase the role of the private sector at all. Even within areas where the private sector has a major role – such as pension provision – change inevitably comes very slowly if it is not to upset the plans of those near or in retirement.

As far as long-term care for the elderly is concerned, the UK faces unresolved questions, and indeed is behind Japan in terms of developing solutions. There is a structural problem in terms of the boundary between health care (free and universally provided through the NHS) and social care (provided on a largely means-tested basis by local government). Many elderly people see the system of means-testing support for residential care as a betrayal of their expectations. Costs are likely to increase as the population ages, but there is no mechanism in place to ensure that these costs are met in a way which commands public acceptance. Private insurance is an unsuitable vehicle for meeting a risk of this kind.[46] In response, the Royal Commission has suggested expanding the coverage of free, tax-financed, nursing and personal care to include those in residential care homes who currently fail a means-test and to those still living at home. It argues that the cost would be fairly modest and proposes no special mechanism for financing it. There is no equivalent proposed of the linkage in Japan between the 'Gold Plan' for the elderly and revenue-raising measures like the increases in consumption tax. As yet there is no sign of a consensus on the way forward.

Through its political and spending priorities the Government has reaffirmed its belief in a universal, tax-funded, system of health care. It is also demolishing some of the elements of the "internal market" introduced by the Conservatives within the public system, but it is notable that other elements will be retained and expanded. Most importantly, through salaried medical staff, the UK has avoided some of the cost pressures associated with "fee for service" payment systems. The budgetary decentralisation being retained by new government reinforces the downward pressures on costs, for instance in prescribing pharmaceuticals.

Perhaps what is most striking overall in the welfare reforms so far visible is that few of them represent a dramatic break with the kind of evolution which was already occurring before the change of Government. Certain priorities – the promotion of work and a series of measures to tackle poverty and social exclusion – have been much more strongly embraced. Tax reforms have had the effect of transferring income to the bottom half of the distribution (particularly the 'working

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[46] Burchardt and Hills (1997).

poor' with children), in marked contrast to the Conservative years. However, the extent of policy change differs from sector to sector and can be seen as pragmatic rather than ideological in nature. The Government has said that it is following a "Third Way" in policy between neo-liberalism and old-style European social democracy. What this consists of is still unclear, but on the evidence of what we have seen so far, the guiding principle is that of "what works" on a sector-by-sector basis rather than all-embracing reform plans.

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