

Government spending on benefits and state pensions in Scotland: current patterns and future issues

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Executive Summary

Benefit spending in Scotland

- Benefit spending (including spending on tax credits and the state pension) in Scotland amounted to £17.2 billion in 2011–12, the last year for which full figures are available. This is around 30% of all government spending in Scotland and 11.4% of GDP (including a geographical share of North Sea output).
- The three largest benefits in Scotland by expenditure are the state pension (£6.3 billion), child and working tax credits (£2.2 billion) and disability living allowance / attendance allowance (£1.9 billion). For Great Britain as a whole, the third most expensive benefit is housing benefit, not DLA / AA.
- Benefit spending per person in Scotland in 2011–12 was £3,238 per year, 2% higher than the average for Great Britain (£3,176). However, the gap between benefit spending in Scotland and the average for Great Britain has been shrinking in recent years: in 2005–06, benefit spending per person in Scotland was 7% higher than the average for Great Britain.
- Expenditure on disability benefits per person in the population was 22% higher in Scotland (£593) than in Great Britain as a whole (£485). Spending per person was also a little (4%) higher on old-age benefits such as the state pension. On the other hand, spending per person on housing benefit was around 12% lower, and spending on child benefits and tax credits 9% lower, than the average for Great Britain as a whole.

Explaining the differences and similarities with the rest of Great Britain

- In part, these differences in benefit expenditure reflect the different age profile of Scotland: a slightly larger fraction of the population are of pensionable age and a smaller fraction are children than in Great Britain as a whole. Spending on child benefits and tax credits per child and spending on old-age benefits per person aged 60 or over were very close to the average for Great Britain (100% and 101% of the Great British average, respectively).
- However, differences in the age structure of the population cannot explain the greater amounts spent on disability benefits: the proportion of the population claiming, and thus the average amount spent, are higher in Scotland at all working-age ages than in Great Britain as a whole. This reflects, at least in part, the fact that the proportion of Scots claiming that they have a health problem that limits their daily activity, or a disability that

restricts their ability to work, is generally higher for each group than the proportion of all people in Great Britain.

- Spending on housing benefit is lower in Scotland largely because rents are lower; the proportion of the population receiving housing benefit is fairly similar to the average for Great Britain. This reflects both lower private and social sector rents, and a larger fraction of people on housing benefit living in social housing (where rents are lower than in the private sector). However, significant spending by the Scottish government on social housing and other housing initiatives means *total* spending on housing in 2011–12 was higher in Scotland (£597 per person) than in England (£493) or Wales (£471).
- The employment rate among working-age adults in Scotland in 2012 was 72.2%, very similar to the 72.4% employment rate recorded for Great Britain as a whole. Average (mean) earnings in 2012 were around 5% lower in Scotland (at £438 per week) than in Great Britain as a whole (£460); however, the fraction of workers with low earnings, on whom most in-work means-tested benefits are concentrated, was similar in Scotland to that in Great Britain as a whole. Together, these similarities in employment and numbers of low-paid workers help to explain why – unlike in Wales – the smaller amount spent on means-tested benefits due to lower rents and a lower proportion of children is not offset by higher underlying entitlement to means-tested support.

The impact of tax and benefit reform on Scottish incomes

- Households across the UK are being affected by a substantial number of changes to the benefit system. Overall, benefit reforms between 2010 and 2015 are estimated to reduce household incomes in Scotland by 1.6% of net income, on average, a little less than in the UK as a whole (1.7%).
- This reflects the facts that lower rents mean Scottish households are less affected by cuts to housing benefit; the smaller proportion of children in the population means cuts to child benefits and tax credits hit Scottish households less hard, on average; and there is a slightly higher proportion of pensioners – who are largely insulated from benefit cuts – in the Scottish population. However, because Scottish households are more likely to claim disability benefits, they are hit harder, on average, by the tightening of the eligibility criteria for such benefits.
- There have also been substantial changes to the tax system since 2010. Adding in changes to the tax system takes the average loss for Scottish households from reforms between 2010 and 2015 to 2.8% of net income,

compared with 3.3% across the UK as a whole. Differences between the income distributions in Scotland and in the UK as a whole – Scotland has a lower proportion of people in the population with high incomes and a higher proportion of people on middle incomes – are the key reason why Scotland is estimated to have been hit less hard by tax changes in recent years.

An opportunity for reform?

- The Scottish government has said that, upon independence, it would immediately undo the recently enacted cuts in housing benefit for those living in social housing who are deemed to have ‘spare’ bedrooms. This would provide a relatively sizeable gain to the 80,000 households in Scotland estimated to have been affected by the reforms, benefiting each by about £12 per week – a total cost of £50 million per year. However, this would return Scotland to the situation where social housing tenants are treated more generously than private sector tenants (who can claim an amount based on how many bedrooms they are deemed to need).
- The Scottish government has also said that it would keep the ‘triple lock’ – whereby pensions are uprated each year in line with the maximum of CPI inflation, the change in average earnings and 2.5% – after the introduction of the flat-rate state pension. It is unclear what a UK government would do. This policy would, though, lead to the state pension rising by *more* than average earnings over the long term. In its 2013 Fiscal Sustainability Report, the Office for Budget Responsibility projected that the ‘triple lock’ would increase spending on the state pension by 0.9% of national income per year (which, in 2013–14, is equivalent to about £14 billion a year) for the UK as a whole by the 2060s, compared with uprating the state pension in line with earnings. Thus, keeping this policy commitment would become costly in the long term. It is also not a sensible way of raising pensions faster than earnings because it implies that the level of the state pension in the long term depends not only on long-term inflation and increases in average earnings, but also on the *volatility* of earnings growth and inflation.
- If Scotland becomes independent, or if benefits policy is devolved to Scotland within the United Kingdom, there would also be an opportunity for its government to reconsider a number of recent poorly-designed reforms. These include the ‘benefits cap’; the capping of increases in local housing allowance rates at the rate of CPI inflation; the decision that support for low-income families in paying their council tax is to be kept separate from universal credit; and the way in which child benefit is withdrawn from families containing someone with a high income. In each instance, it seems

likely that a better-designed policy affecting a similar group of people could save a similar amount of money.

- Independence would also give the opportunity for more radical reform, so that the system better reflects the views of the Scottish people or provides greater work incentives, for instance. However, major reforms to the benefit system – such as making benefit entitlements more closely related to the amount of National Insurance contributions paid – would likely either create large numbers of losers, many of whom are likely to have low incomes, or else involve a substantial increase in overall benefit spending.

The long-term demographic challenge and fiscal outlook

- Independence in 2016 would take place in the context of a Scottish population that is projected to age more rapidly than that of Great Britain as a whole. All else equal, this will increase benefit spending in Scotland relative to Great Britain. Together with higher spending on health and social care, this suggests demographic change will place a greater burden on Scotland's public finances than it will on Great Britain as a whole. However, it is important to note that demographic projections, and thus projections for spending on benefits, are sensitive to assumptions about fertility rates and the level and composition of net immigration in the future.

1. Introduction

There has been a growing debate about how the benefits system (that is, the system of state benefits, pensions and tax credits) may be affected if Scotland becomes independent. This debate takes place at a time when the benefits system that Scotland currently shares with the rest of the UK is going through some major changes – such as the replacement of most means-tested benefits for working-age recipients by the new universal credit – and facing substantial cuts as part of the fiscal consolidation. The Scottish government has said it plans to reverse at least some of the cuts if Scotland were to become independent.² It also plans to consult upon the principles and policies an independent Scotland should follow, which may result in broader changes to the benefits system. There are certainly some features of the current system that look ripe for reform.

But, with Scotland facing a fiscal outlook at least as challenging as that facing the UK as a whole,³ reversing the benefit cuts even partially would entail larger cuts to other spending, increases in taxes or a slower path of deficit reduction. Major reforms to the system would likely either cost substantial sums of money or create large numbers of losers, many of whom are likely to have low incomes. In the longer term, Scotland's projected more rapid ageing is likely to push up benefit spending more quickly than in the rest of the UK, putting Scotland's public finances under substantial pressure. As with much else, independence offers Scotland an opportunity to set its own course on benefits policy, but also the risk that its ambitions cannot be fulfilled as demographic pressures bite.

This briefing note aims to describe the patterns of benefit expenditure in Scotland and set out a number of issues for the future. In particular, it:

- sets out the key facts on benefit spending in Scotland, and how these compare with those in England and Wales (Section 2);
- explains the differences and similarities in spending patterns in the context of demographics, ill health and disability, housing policy, and employment and earnings patterns (Section 3);

² Most significantly, the Scottish government has said it would abandon the policy of reducing housing benefit for those living in social housing deemed to have spare bedrooms (the 'bedroom tax'). See <http://www.scotland.gov.uk/News/Releases/2013/06/welfare18062013>.

³ P. Johnson and D. Phillips, 'Scottish independence: the fiscal context', IFS Briefing Note 135, 2012, available at <http://www.ifs.org.uk/publications/6444>.

- quantifies the impact of changes to taxes and benefits in Scotland since 2010, and since 1997, to assess whether Scotland has been affected by tax and benefit reforms differently from the UK as a whole (Section 4);
- discusses a number of options for reform – both relatively small changes and more radical changes to the structure and aims of the system, pointing out the difficulties in both instances (Section 5);
- considers the impact that demographic change may have on benefit spending in Scotland in the coming decades (Section 6).

Readers should note that most of the analysis in this briefing note compares Scotland with England, Wales and Great Britain as a whole (Section 4 is the main exception; it compares Scotland with the United Kingdom as a whole). This is because comparable detailed administrative data on benefit expenditure are readily available for Great Britain only.

2. Benefit spending in Scotland (compared with England, Wales and Great Britain as a whole)

Under current constitutional arrangements, benefits policy is a ‘reserved matter’, meaning that the rules for state pensions, benefits and tax credits are set by the UK rather than the Scottish government. This means the benefits system is essentially the same in Scotland as in the rest of Great Britain.⁴ However, differences in the socio-economic and demographic characteristics of Scotland compared with the rest of Great Britain, and potentially differences in the way in which certain parts of the benefits system are administered, mean that the levels and patterns of benefits spending may still differ. These differences may also have implications for how an independent Scotland may wish to structure its benefits system, and the challenges it may face in the future.

Benefits expenditure is managed largely by the Department for Work and Pensions (DWP) and Her Majesty’s Revenue and Customs (HMRC), which are part of the UK government. Spending (payments of state pensions, benefits and tax credits) on families living in Scotland totalled around £17.2 billion in 2011–12, around 30% of overall government spending and 11.4% of Scottish GDP (using a geographical share of North Sea output).⁵ Indeed, the amount spent on benefits is just shy of the total the Scottish government and local governments

⁴ Benefits are devolved to the Northern Irish Executive but, in practice, Northern Ireland has chosen to implement a system very largely similar to that in Great Britain.

⁵ The last figure is 13.5% of GDP using a population-based share of North Sea output.

spent on the day-to-day operations of the education and health systems combined (estimated at £17.3 billion in 2011–12).⁶

Table 1 shows that benefit spending in Great Britain as a whole totalled around £195 billion in 2011–12, with spending in England of £167.3 billion and spending in Wales of £10.8 billion. Scotland therefore accounted for 8.8% of all benefit spending in Great Britain, against a population share of 8.6%. The table also shows that the four biggest benefits in Scotland were the state pension (£6.3 billion), child and working tax credits (£2.2 billion), disability living allowance / attendance allowance (£1.9 billion) and housing benefit (£1.7 billion). This pattern is the same as that in Wales, but differs from that in England – and therefore Great Britain as a whole – where more is spent on housing benefit than on DLA/AA.

Table 1. Benefit spending in Scotland, England, Wales and Great Britain as a whole, 2011–12

	<i>Scotland</i>	<i>England</i>	<i>Wales</i>	<i>Great Britain</i>
<i>Total benefit spending</i>				
£ billion	17.2	167.3	10.8	195.3
% of Great Britain total	8.8	85.7	5.6	100
State pension (£ billion)	6.3	60.9	3.9	71.0
Tax credits (£ billion)	2.2	24.4	1.5	28.1
DLA/AA (£ billion)	1.9	14.7	1.4	17.9
Housing benefit (£ billion)	1.7	20.1	1.0	22.8

Note: Expenditure figures for child benefit and tax credits are calculated using claimant numbers and average entitlements as reported by HMRC rather than actual expenditure out-turns. Figures for tax credits include both ‘payments of entitlement’, which count as government spending in the National Accounts, and ‘negative income tax’, which is counted not as part of government spending but as a deduction from income tax paid. This differs from the definition of spending used in Government Expenditure and Revenue Scotland (GERS), which includes only ‘payments of entitlement’. Note that spending breakdowns are not available for some DWP benefits (totalling around £0.85 billion): this expenditure is allocated in proportion to the expenditure for which breakdowns are available.

Source: Author’s calculations based on DWP regional expenditure statistics (available at <https://www.gov.uk/government/publications/benefit-expenditure-by-local-authority>) and HMRC regional tax credits statistics (available at <http://www.hmrc.gov.uk/statistics/fin-geog-stats.htm>) and child benefit statistics (available at <http://www.hmrc.gov.uk/statistics/child-geog-stats.htm>).

⁶ There was an additional £1.3 billion of investment spending in education and health. This and the figures in this paragraph are taken from Government Expenditure and Revenue Scotland, 2013.

In order to make a better comparison between parts of Great Britain with very different-sized populations, in the rest of this briefing note we focus on amounts spent *per person*.⁷ Table 2 shows that benefit spending per person in 2011–12 was £3,238 in Scotland, 102% of the amount for Great Britain as a whole. Spending per person was £3,150 in England (99% of the Great British average) and £3,540 in Wales (111% of the Great British average).

Table 2. Benefit spending per person in Scotland, England, Wales and Great Britain as a whole, 2011–12

	<i>Scotland</i>	<i>England</i>	<i>Wales</i>	<i>Great Britain</i>
<i>Total benefit spending</i>				
£ per person	3,238	3,150	3,540	3,176
% of Great British average	102%	99%	111%	100%
<i>By benefit type (£ per person)</i>				
Old-age benefits	1,380	1,318	1,465	1,331
Disability benefits	593	461	723	485
Tax credits and child benefits	628	697	720	692
Housing benefits	326	379	312	371
Other means-tested benefits	286	272	295	274
Other benefits	26	23	26	23
Means-tested	1,169	1,245	1,264	1,239
Non-means-tested	2,069	1,904	2,276	1,937

Note: See note to Table 1. ‘Old-age benefits’ are the state pension, pension credit, concessionary TV licences and winter fuel payments. ‘Disability benefits’ are attendance allowance, carer’s allowance, disability living allowance, employment and support allowance, incapacity benefit, industrial injuries benefit and severe disablement allowance. ‘Tax credits and child benefits’ are the child and working tax credits, child benefit, maternity allowance and statutory maternity pay. ‘Housing benefits’ are housing benefit. ‘Other means-tested benefits’ are income support, jobseeker’s allowance and council tax benefit. ‘Other benefits’ are the remaining benefits, including the small number not broken down by nation (allocated in the same proportion to those benefits for which expenditures are broken down by nation). Employment and support allowance is counted as non-means-tested, and jobseeker’s allowance as means-tested, whereas in practice both contain means-tested and non-means-tested elements. Source: See source to Table 1.

⁷ Population figures for England and Wales used in Tables 2 and 3 and Figure 1 and Census 2011-based mid-year estimates for 2005 to 2011, available at <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-280885> and <http://www.ons.gov.uk/ons/publications/re-reference-tables.html?edition=tcm%3A77-262039>. At the time of writing, Census 2011-based mid-year estimates have not yet been published for Scotland. Instead, for 2011, a population of 5,300,000 has been assumed (representing growth of 4,600 from the Census 2011 estimate of 5,295,400). Interpolation has been used to adjust Census 2001-based mid-year estimates between 2005 and 2010 for the higher-than-expected population found in Census 2011.

Spending per head in Scotland exceeds the Great British average for old-age benefits (such as the state pension and pension credit),⁸ disability benefits, and means-tested benefits other than tax credits and housing benefit ('other means-tested benefits'). In particular, spending on disability benefits is 22% above the average for Great Britain, at £593 per person per year. In contrast, spending on tax credits, child benefits and housing benefit is substantially below the average for Great Britain. Overall spending on means-tested benefits in Scotland was £1,169 per person in 2011–12, compared with an average of £1,239 across Great Britain as a whole: lower spending on housing benefit and tax credits was only partially offset by higher spending on pension credit and other means-tested benefits (such as income support). On the other hand, in Wales, where spending on housing benefit per person is even lower than in Scotland, overall means-tested spending is *above* the average for Great Britain due to substantially higher spending per person on tax credits, pension credit and other means-tested benefits. Spending on non-means-tested benefits in Scotland exceeds the average for Great Britain, largely driven by higher spending per person on disability benefits and the state pension (although, again, the amount spent is less than in Wales). As we examine later, these differences reflect both the demographics of Scotland and its levels of employment and earnings.

Table 3 shows that there are greater differences in benefit spending per person between the regions of England than there are between England and Scotland. For instance, in the North East of England – the region with the highest level of benefit spending per person – spending in 2011–12 was 112% of the average for Great Britain, whilst in the South East of England it was 89% of the average. The difference in spending between these two regions was £725 per person per year, nearly 12 times larger than the £62 per person difference between Scotland and the average for Great Britain as a whole.

As is also shown by Table 3, the pattern and level of benefit spending per person in Scotland are fairly close to the average for the north and midlands of England. This area also has spending on disability benefits substantially above the average for Great Britain as a whole, and spending on housing benefit substantially below the average. The main difference is that less is spent on tax credits and child benefits in Scotland than in the north and midlands of England.

⁸ The note to Table 2 gives a full definition of 'old-age benefits' and each of the categories in the text and table.

Table 3. Benefit spending per person in the regions of England, 2011–12

	£ per person						£ per person		Total benefit spending	
	<i>Old-age benefits</i>	<i>Disability benefits</i>	<i>Tax credits and child benefits</i>	<i>Housing benefits</i>	<i>Other means-tested benefits</i>	<i>Other benefits</i>	<i>Means-tested</i>	<i>Non-means-tested</i>	<i>£ per person</i>	<i>% of GB average</i>
North East	1,423	650	733	382	352	26	1,404	2,161	3,566	112%
North West	1,372	624	760	360	324	25	1,365	2,100	3,465	109%
Yorkshire and Humberside	1,329	507	753	304	289	23	1,247	1,959	3,206	101%
East Midlands	1,384	484	701	263	247	23	1,108	1,994	3,102	98%
West Midlands	1,381	514	761	330	298	24	1,301	2,006	3,308	104%
<i>North and midlands</i>	<i>1,372</i>	<i>552</i>	<i>745</i>	<i>326</i>	<i>299</i>	<i>24</i>	<i>1,283</i>	<i>2,036</i>	<i>3,320</i>	<i>105%</i>
East of England	1,410	390	630	297	218	22	1,026	1,942	2,968	93%
South East	1,361	356	595	312	196	22	964	1,877	2,841	89%
South West	1,530	444	632	306	218	23	1,058	2,094	3,152	99%
<i>South (excluding London)</i>	<i>1,421</i>	<i>389</i>	<i>615</i>	<i>306</i>	<i>208</i>	<i>22</i>	<i>1,008</i>	<i>1,954</i>	<i>2,962</i>	<i>93%</i>
<i>London</i>	<i>907</i>	<i>355</i>	<i>745</i>	<i>717</i>	<i>338</i>	<i>20</i>	<i>1,701</i>	<i>1,381</i>	<i>3,082</i>	<i>97%</i>
England	1,318	461	697	379	272	23	1,245	1,904	3,150	99%

Note: See note to Table 2.

Source: See source to Table 1.

Compared with all 11 regions of Great Britain (the 9 English regions, plus Scotland and Wales):

- Scotland was ranked 7th out of 11 for spending per person on old-age benefits, meaning that spending is higher than in Scotland in more regions than it is lower than in Scotland. The reason that, despite this, spending on old-age benefits per person in Scotland is above the average for Great Britain is that spending on these benefits is especially low in London, reflecting the UK capital's young population.
- Scotland was ranked 4th out of 11 for spending per person on disability benefits, below only Wales and the North East and North West of England.
- Scotland was ranked 10th out of 11 for spending on tax credits and child benefits, with spending per person lower only in the South East of England.
- Scotland was ranked 5th out of 11 regions for spending per person on housing benefits, meaning that spending is higher in Scotland than in 6 out of the 10 other regions of Great Britain. The reason that, despite this, spending on housing benefit per person in Scotland is below the average for Great Britain is that spending per person on housing benefit in London is over £700 per year, which pushes up the average for the whole of Great Britain.
- Scotland was ranked 5th highest of the 11 regions of Great Britain for overall benefit spending per person, with spending higher in Wales and the North East, North West and English West Midlands, and lower elsewhere.

Spending per person on means-tested benefits in Scotland was lower than that in London and most of the north and midlands of England (the exception is the East Midlands), but was higher than that in the south of England. Spending per person on non-means-tested benefits was higher in Scotland than in all of England's regions bar the North East, North West (where spending on disability benefits was high) and South West (where spending on old-age benefits was the highest of any part of Great Britain).

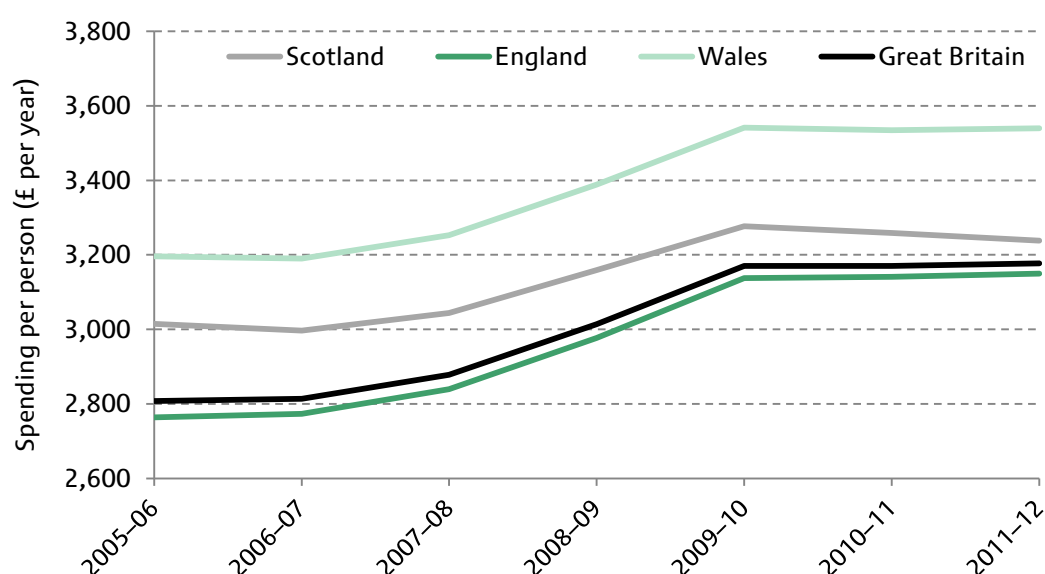
Administrative data can also be used to examine how benefit spending has changed in recent years. Benefit spending per person has grown less quickly in Scotland in recent years than in England and Wales, as shown in Figure 1. Benefit spending per person in 2011–12 in Scotland had increased by 7% in real terms (£223) from its 2005–06 level (£3,015).⁹ However, benefit spending per person

⁹ Real-terms spending per person is expressed in 2011–12 prices and is adjusted for inflation using the GDP deflator, which is a measure of whole-economy inflation.

in Great Britain as a whole grew by 13% (£369) during the same period, driven by a 14% increase in spending per person in England. This means that benefit spending per person in Scotland has fallen from just over 107% of the Great British average to 102% of the Great British average.

Real-terms spending per person in Scotland increased by less than the average for Great Britain for each category of benefit, with the biggest differences being for housing benefit payments (up 17% as opposed to 34%), tax credits and child benefits (up 12% as opposed to 21%), and other means-tested benefits (*down* 17% as opposed to 10%). Spending on old-age-related benefits grew by a fairly similar rate to that in Great Britain as a whole (12% in Scotland versus 13% in Great Britain). We offer a number of potential explanations for these trends in Section 3.5.

Figure 1. Benefit spending per person in Scotland, England, Wales and Great Britain as a whole, 2005–06 to 2011–12 (2011–12 prices)



Note: Spending per person adjusted using the GDP deflator so that it is expressed in 2011–12 prices.

Also see note to Table 1.

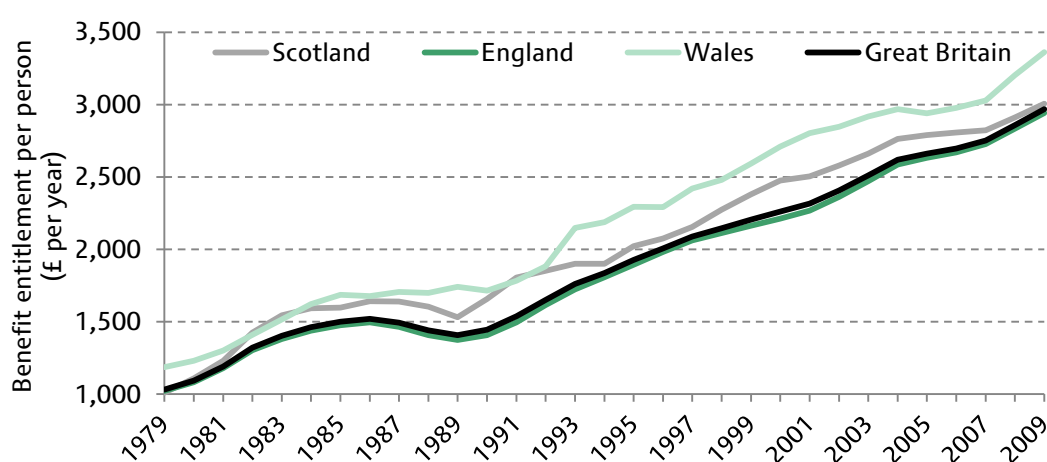
Source: See source to Table 1.

Administrative data on spending by country do not exist on a comparable basis before 2005–06. However, it is possible to use IFS's tax and benefit model, TAXBEN, to estimate how entitlements to benefits have changed in Scotland and the rest of Great Britain back to the late 1970s.¹⁰ Figure 2 shows benefit

¹⁰ Entitlement estimates using TAXBEN are based on households in the Family Expenditure Survey and Family Resources Survey. Expenditures do not exactly match administrative records, for three reasons. First, TAXBEN models benefit entitlements: in practice, some people do not claim benefits to which they are entitled, and others claim benefits to which

entitlements per person since then, adjusting for inflation (amounts are expressed in 2011–12 prices again). This shows two things clearly. First, benefit entitlement per person has increased dramatically over the last 30 years right across Great Britain, with particularly strong growth in the recessions of the early 1980s, early 1990s and late 2000s. There was also strong growth in the early 2000s, a period during which reforms substantially increased the generosity of means-tested benefits targeted at lower-income families with children and lower-income pensioners.

Figure 2. Estimated benefit entitlement per person in Scotland, England, Wales and Great Britain as a whole, 1978 to 1980 until 2008–09 to 2010–11 (2011–12 prices)



Note: Figures are averaged over three years to reduce volatility due to sampling error. Years prior to 1995 refer to calendar years. Years thereafter refer to financial years. Coverage of benefits differs slightly from administrative records. Entitlement per person adjusted using the GDP deflator so that it is expressed in 2011–12 prices.

Source: Author's calculations using TAXBEN and the Family Expenditure Survey and Family Resources Survey.

Second, Figure 2 shows that benefit entitlement per person in Scotland exceeded the average for Great Britain during nearly all of the last 30 years. In particular, benefit entitlements rose by more than the average for Great Britain as a whole in the early 1980s and again at the start of the 1990s, in the former case likely reflecting the greater impact of the recession of the early 1980s on Scotland's levels of employment.¹¹ In the three years 1990 to 1992, benefit entitlements per

they are not properly entitled. Second, as TAXBEN uses survey samples rather than the whole population, there is the potential for sampling error. Third, households may not accurately report their incomes and characteristics, which are then used in TAXBEN to estimate their benefit entitlements.

¹¹ The employment rate in Scotland in 1984 was 64%, compared with about 69% for the UK as a whole. However, in the late 1970s, employment rates were similar, at 73% in Scotland and

person are estimated to have been 17% higher in Scotland (£1,805) than in Great Britain as a whole (£1,538). The gap then shrank considerably during the first half of the 1990s (to just 3% in 1996–97 to 1998–99) before widening again around the turn of the century, a period during which the Scottish economy performed less well than the UK economy.¹² Since peaking in 1999–00 to 2001–02 at 9% above the average for Great Britain as a whole, benefit entitlements per person have grown less quickly than the average for Great Britain as a whole. As with administrative expenditure records, this reflects slower growth in housing benefit entitlements, child benefits and tax credits, and other means-tested benefits.

3. Explaining the differences and similarities with the rest of Great Britain

The previous section showed that whilst overall spending per person on benefits in 2011–12 was similar in Scotland to the average for Great Britain as a whole, there were some more sizeable differences for individual categories of benefits:

- Spending on old-age benefits was around 4% higher than the average for Great Britain.
- Spending on child benefits and tax credits was around 9% lower than the average for Great Britain.
- Spending on disability benefits was around 22% higher than the average for Great Britain.
- Spending on housing benefit was around 12% lower than the average for Great Britain.

In this section, we examine the factors that explain these differences, but also explore why, unlike in Wales (which shares *some* of these features with Scotland), overall benefit spending is not much higher than the Great British average.

The first thing to note is that the average amount received in benefits varies by age: benefit spending is concentrated upon families with children (through child benefits and tax credits) and especially pensioners (through the state pension, winter fuel payments, etc.). Therefore, in the first instance, differences in benefit

74% for the UK as a whole. See <http://www.dwp.gov.uk/docs/scotland-employment-and-prosperity.pdf>.

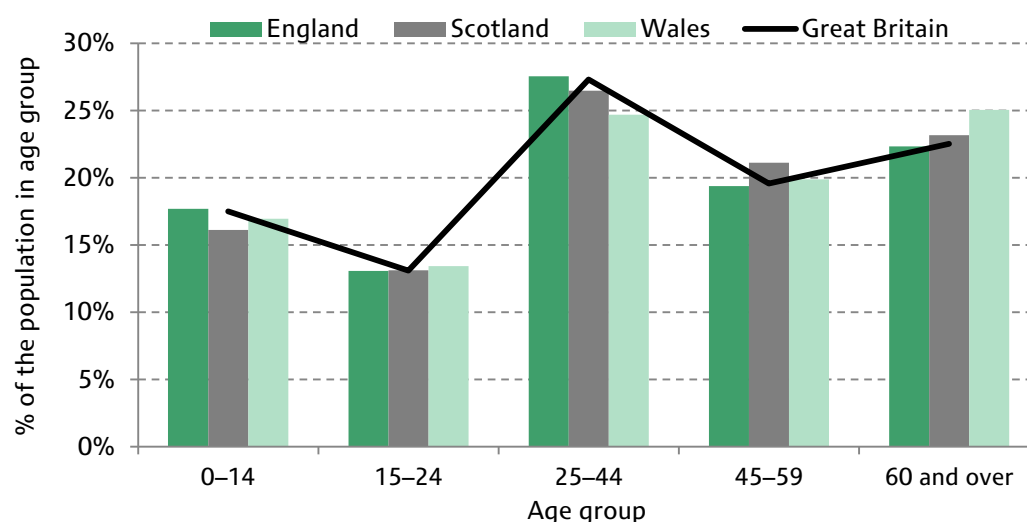
¹² See P. Johnson and D. Phillips, ‘Scottish independence: the fiscal context’, IFS Briefing Note 135, 2012, available at <http://www.ifs.org.uk/publications/6444>.

spending per person between Scotland and Great Britain as a whole can be broken down into two parts: (a) differences in the amount spent on people of given ages and (b) differences in the age structure of the Scottish and British populations.

3.1 The age structure of the population and benefit spending by age

Looking first at the latter issue, Figure 3 shows the age structure of Scotland compared with England, Wales and Great Britain as a whole at the time of the 2011 census. Scotland has a somewhat older age profile than Great Britain as a whole. In particular, children make up a somewhat smaller fraction of the overall population, and older working-age adults and pensioners make up a somewhat larger fraction of the overall population. For instance, those aged 14 or under made up 16.1% of the Scottish population in 2011–12, compared with 17.5% for Great Britain as a whole, whilst those aged 60 or over made up 23.2% of the population, compared with 22.5% for Great Britain as a whole.

Figure 3. The age structure of Scotland, England, Wales and Great Britain



Source: Census 2011 statistics.

All else equal, this would tend to lead to more being spent per person on old-age benefits in Scotland than in Great Britain as a whole, and less being spent on tax credits and child-related benefits: this is exactly what the expenditure figures show.

Once one adjusts for these differences in demographics, spending on child benefits and tax credits *per child* is very nearly equal in Scotland to that in Great

Britain as a whole.¹³ Thus, lower spending on child benefits and tax credits reflects the fact that a lower proportion of the population are children in Scotland rather than less being spent per child. Similarly, higher spending on old-age benefits reflects the fact that a higher proportion are old people: spending per person aged 60 or over on old-age benefits is also very similar to the Great British average (it is around 1% higher in Scotland, with somewhat higher spending on pension credit partially offset by slightly lower spending on the state pension).

This contrasts with the case in Wales. Spending on child benefits and tax credits *per child* in 2011–12 was higher in Wales than in Scotland and Great Britain as a whole (about 6% in both cases), due to higher spending on tax credits (11% higher than the average for Great Britain). Wales has an even higher proportion of elderly people than Scotland (25.1% of the population were aged over 60 in the 2011 census) and spending per person on old-age benefits was therefore, unsurprisingly, higher than in both Scotland and Great Britain. But although spending per person aged over 60 on the pension credit was higher in Wales (£625) than in Scotland (£613) and Great Britain as a whole (£583), overall spending on old-age benefits per person aged 60 or over was lower in Wales (£5,848) than in Scotland (£5,961) and Great Britain as a whole (£5,917). Scotland therefore looks much more similar to Great Britain as a whole than does Wales.

As discussed above, benefit spending is by far the highest for pensioners, followed by working-age families with children and then working-age families without children. This is shown clearly in Figure 4, which presents estimates of benefit entitlement per person in Scotland, England, Wales and Great Britain as a whole, separately for these different groups.¹⁴ The average annual entitlement in Scotland for a pensioner family in 2011–12 is estimated at £7,255 per person, compared with £1,948 per person for a working-age family with children and £1,625 per person for a working-age family without children. Thus, because benefit spending is concentrated upon pensioners and families with children, the fact that Scotland has a lower proportion of children would tend to *reduce* overall

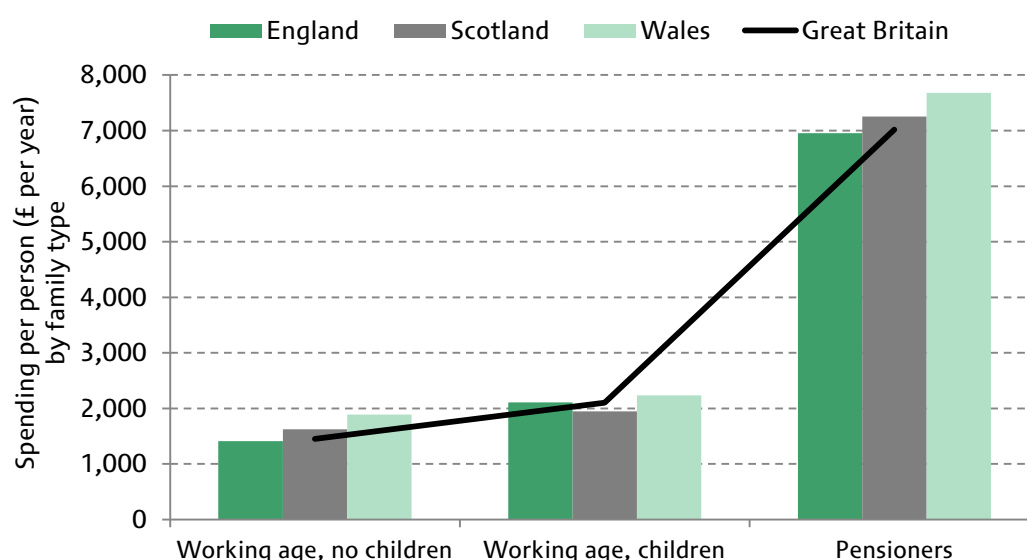
¹³ According to TAXBEN, entitlement to child benefits and tax credits per child was around 0.3% lower in Scotland than in Great Britain as a whole in 2011–12. Using the number of child benefit recipients as an indicator number of children, spending on child benefits and tax credits per child was around 0.5% higher in Scotland than in Great Britain as a whole in 2011–12. It is not possible to replicate this analysis using the census data available at the time of writing.

¹⁴ Pensioner families are defined as families where at least one adult is aged 60 or over.

benefit spending per person, whilst having a higher proportion of older people would tend to *increase* overall benefit spending per person.

However, there remain differences in the amount spent per person conditional upon these broad demographic groups. Overall benefit entitlement per person in Scotland is estimated to be a little higher than the average for Great Britain for pensioner families (3% higher), with the biggest contributor to this being greater reported receipt of disability benefits.¹⁵ Benefit entitlement per person is also estimated to be above the average for Great Britain among working-age families without children (12% higher), again driven very much by higher reported receipt of disability benefits. On the other hand, benefit entitlement per person is below the average for Great Britain for working-age families with children (7% lower), with the biggest contributor to this difference being lower entitlements to housing benefit.

Figure 4. Estimated benefit entitlement per person by family type in Scotland, England, Wales and Great Britain



Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

These estimates also allow us to assess how overall benefit spending is distributed across different family types. About 55% of benefit spending in Scotland in 2011–12 went to pensioner families, compared with 54% for Great Britain as a whole. With a lower proportion of children, and lower benefit entitlements per person among working-age families with children, the fraction of overall benefit spending going to such families is smaller in Scotland (26%)

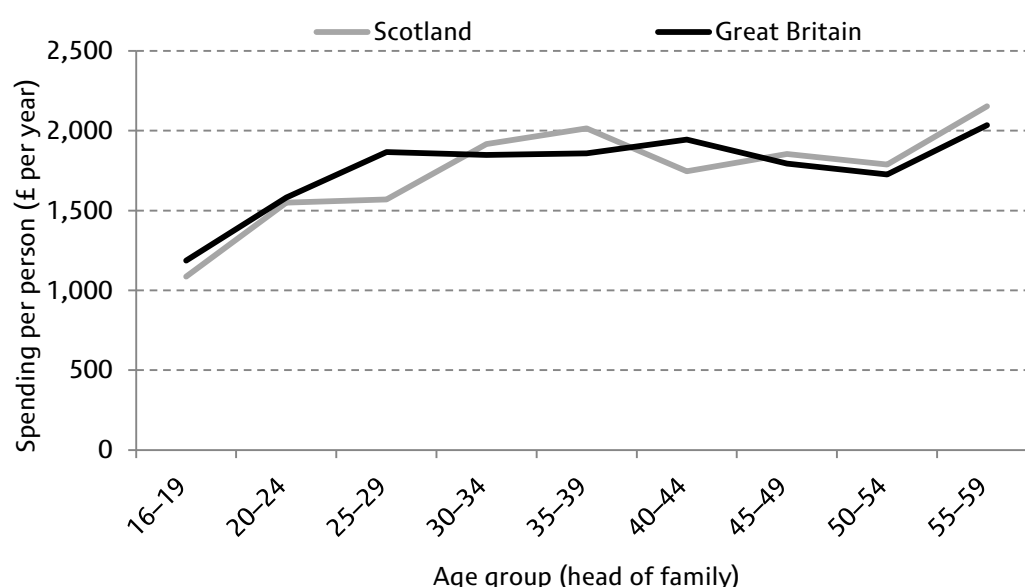
¹⁵ TAXBEN estimates disability benefit 'entitlement' based on whether someone reports receiving a disability benefit.

than in Great Britain as a whole (30%). Conversely, the larger proportion of working-age families without children, and higher entitlements per person for such families, result in a greater fraction of overall benefit spending going to working-age people without children in Scotland (19%) than in Great Britain as a whole (16%).

It is also interesting to examine how benefit spending per person varies by age. Figure 5 examines how benefit entitlements per person vary by the age of the *head of the family* in Scotland and Great Britain as a whole. Figure 5a shows overall entitlements, while Figures 5b and 5c show entitlements separately by the category of benefit for Scotland and Great Britain as a whole, respectively. The figures focus on those families whose head is a working-age individual.¹⁶

The basic patterns are similar in Scotland and Great Britain as a whole. Benefit entitlements per person are lowest for families headed by people aged 16–19, and then increase with the age of the family head due to increases in the amount of child benefits and tax credits entitlements (as the average number of children per family increases). Average benefit entitlements per person then fall a little as entitlement to child benefits and tax credits falls, before rising among those families headed by someone aged 55–59, driven by rising disability benefit entitlements.

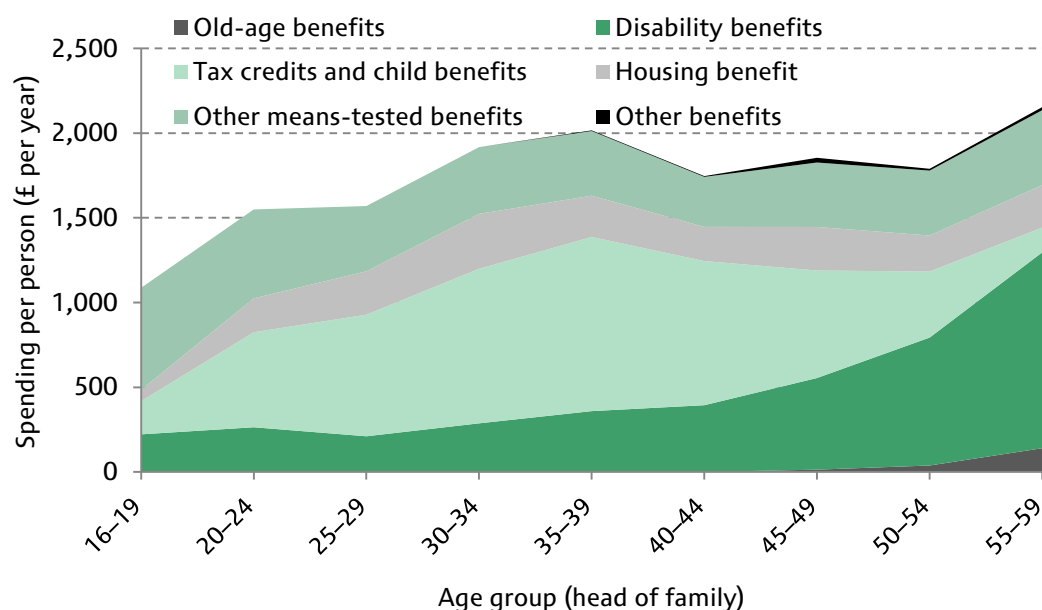
Figure 5a. Estimated benefit entitlements per person by age of family head in Scotland and Great Britain, 2011–12



Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

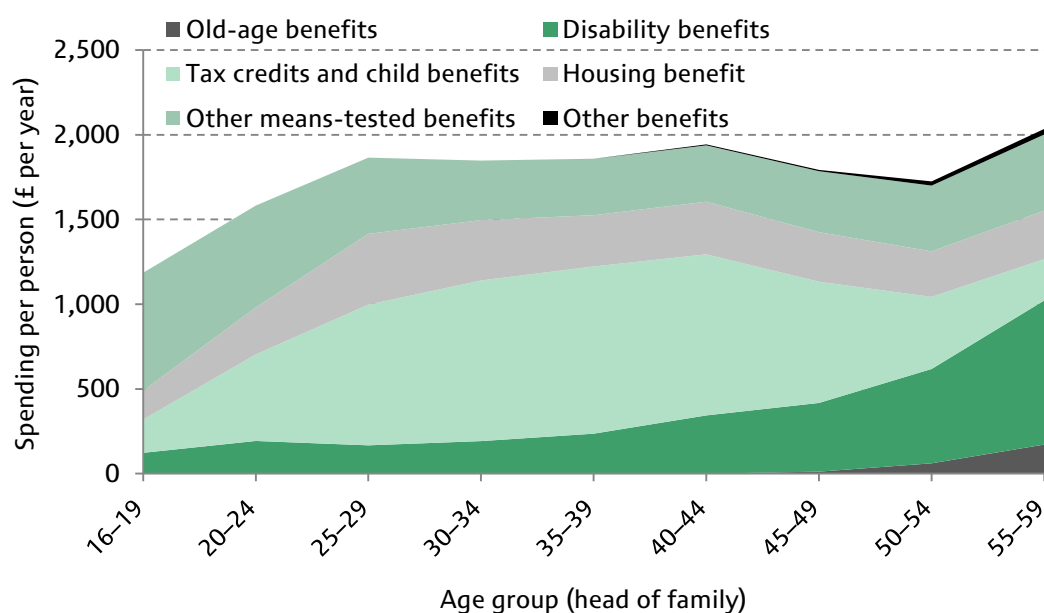
¹⁶ Including those aged 60 or over, for whom benefit spending is very much higher, would make seeing the differences among working-age adults of different ages much more difficult.

Figure 5b. Estimated benefit entitlements per person by age of family head in Scotland, 2011–12



Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

Figure 5c. Estimated benefit entitlements per person by age of family head in Great Britain, 2011–12



Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

However, there are some notable differences between Scotland and Great Britain as a whole. In particular:

- Overall, benefit entitlements per person in Scotland are estimated to be lower than the average for Great Britain for families headed by someone aged under 30, but generally a little above the average for Great Britain among families headed by someone aged 30 or over.
- Entitlements to disability benefits per person are higher in Scotland than the average for Great Britain for nearly all age groups. For instance, entitlements per person are around 50% above the average for Great Britain among families headed by someone in their 30s, and 35% above the average for Great Britain among families headed by someone in their 50s. Excluding disability benefits, average benefit spending per person is estimated to be *lower* in Scotland than for Great Britain as a whole for families headed by someone aged 16–34 or 40–59.
- In part, this reflects the fact that entitlements to housing benefit per person are lower in Scotland than in Great Britain as a whole among all working-age age groups. The difference is especially large for those families headed by someone under 30 or aged 40–44.
- Entitlements to child benefits and tax credits per person are also below the Great British average for families headed by people aged 25–34 or in their 40s or 50s, reflecting the lower proportion of children in the population.

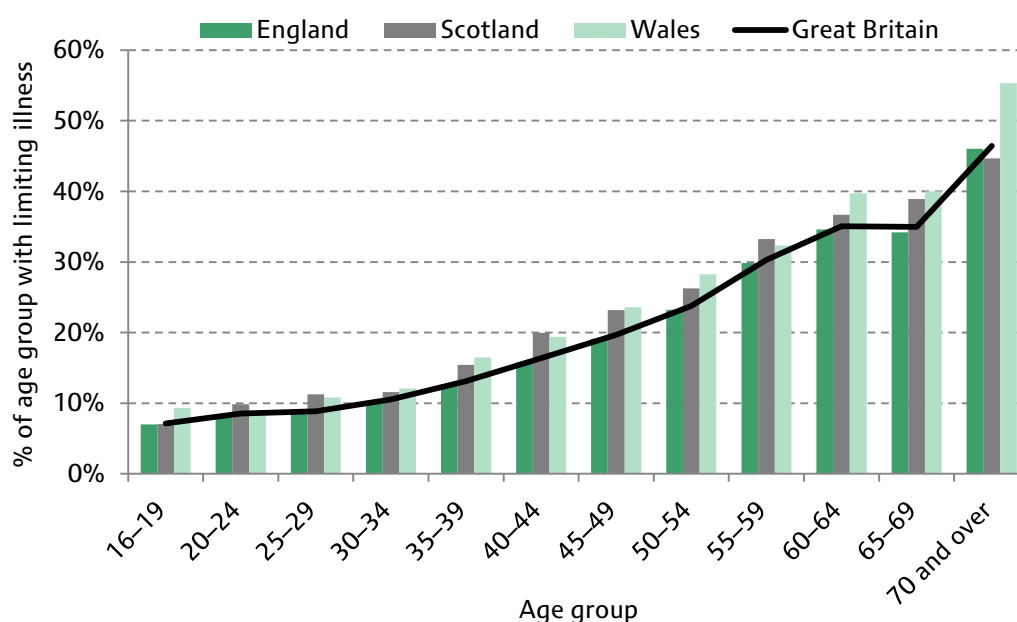
The rest of this section examines the factors underlying higher levels of disability benefit expenditure and lower levels of housing benefit entitlement and expenditure in Scotland. We then discuss employment and earnings patterns, which help explain why once one accounts for differences caused by differing demographics, health, and housing costs, benefit spending in Scotland is fairly similar to the average for Great Britain as a whole. This discussion is followed by a brief analysis of why benefit spending per person has grown less quickly in Scotland than in the UK as a whole in the last decade.

3.2 Ill health and disability

Higher levels of expenditure on disability benefits per person in Scotland reflect, at least in part, the fact that the levels of ill health and disability in Scotland appear to be greater than the average for Great Britain (although lower than in Wales, which has even higher disability benefit expenditure). Figure 6 shows that the fraction of people reporting that they have a health problem that limits their

daily activity is higher in Scotland than in Great Britain as a whole for all (adult) age groups, except for those aged 70 or over. For instance, the proportion of people with such a health problem is around 20% (or 3.5 percentage points) higher in Scotland than in Great Britain as a whole among people in their 40s and 10% (2.5 to 3.0 percentage points) higher among those in their 50s. Overall, 20.7% of working-age Scots report that they have a health problem that limits their activities, compared with 18.1% of the working-age population of Great Britain as a whole. This is a difference of around 14% (2.6 percentage points). Lower rates of health problems among the over-70s in Scotland than in Great Britain mean that the difference between the rates of ill health for the adult population as a whole is a rather smaller 9% (25.2% in Scotland compared with 23.2% for Great Britain).

Figure 6. Activity-limiting illness by age in Scotland, England, Wales and Great Britain

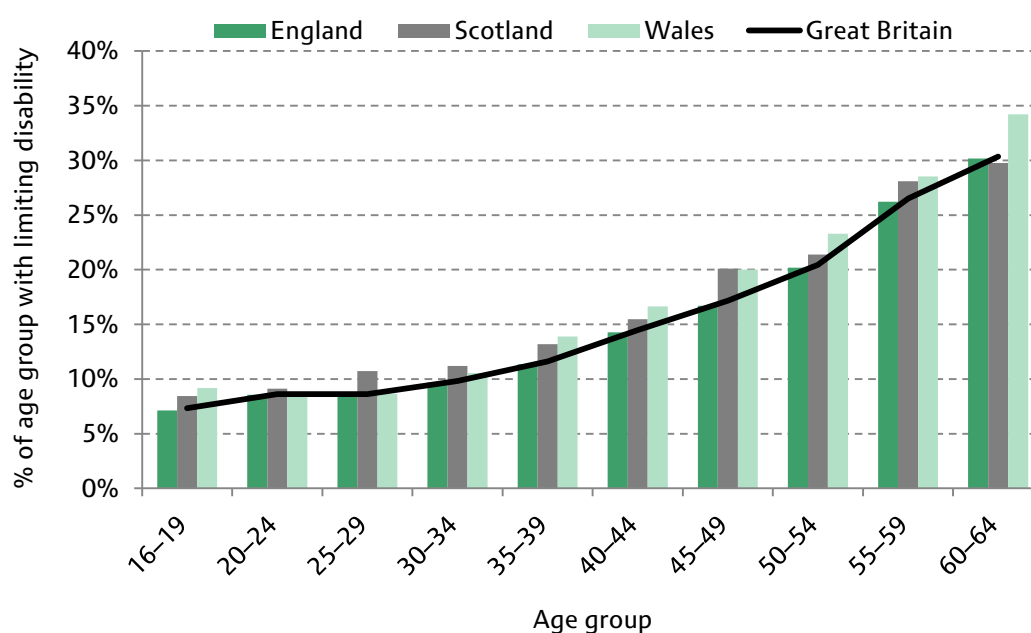


Source: Labour Force Survey, 2012.

Figure 7 shows that the proportion of people reporting that they have a disability that restricts the type or amount of work they can do is also higher in Scotland than in Great Britain as a whole among the working-age population.¹⁷ All in all, the fraction of the working-age population reporting that they have a disability that restricts how much or what kind of work they can do is 16.9% in Scotland, compared with 15.3% in Great Britain as a whole. This is a difference of 10% (1.6 percentage points).

¹⁷ This question is only asked of those aged under 65 or who are over that age and are still in work or seeking work.

Figure 7. Work-limiting disability by age in Scotland, England, Wales and Great Britain



Source: Labour Force Survey, 2012.

All else equal, having a greater proportion of the population suffering ill health and disability would be expected to lead to higher spending per person on disability benefits. However, the difference in the amount spent per person on disability benefits in Scotland compared with Great Britain is rather greater (around 22%) than one might expect given levels of work-limiting disability and activity-restricting health problems that are around 10% higher than the average for Great Britain. A number of factors could explain this. First, it may be the case that the specific health problems and disabilities from which Scots suffer make them more likely to be eligible for disability benefits. Second, it may be the case that Scots are more likely than people in the rest of Great Britain to claim the disability benefits to which they are entitled. Third, the assessments for eligibility for disability benefits for people claiming in Scotland may be less strict than those undertaken in the rest of Great Britain. Or fourth, the fraction of fraudulent or erroneous claims may be higher in Scotland. Unfortunately, with the data presently available, it is not possible to confirm which of these possible factors is at play.

However, Beatty, Fothergill and Gore (2012) have suggested that in many former industrial areas, including much of Scotland, incapacity benefits (incapacity benefit and its precursors and successors) have absorbed claimants who would

otherwise have ended up on unemployment benefits.¹⁸ Therefore, claim rates for incapacity benefits – and thus disability benefits as a whole – may be higher in Scotland in part because there is greater ‘hidden unemployment’ among incapacity benefit claimants; although, as the authors point out, this does not mean that there are more fraudulent claims for incapacity benefits in Scotland.

3.3 Housing tenure and rent levels

There are two basic reasons why expenditure on and entitlements to housing benefit could be lower in Scotland than in Great Britain as a whole:

- a smaller fraction of families being entitled to any housing benefit;
- lower cash entitlements among those entitled to some support.

Table 4. Housing benefit entitlements in Scotland, England, Wales and Great Britain, 2011–12

	<i>Scotland</i>	<i>England</i>	<i>Wales</i>	<i>Great Britain</i>
Percentage of families entitled to housing benefit	16.8%	15.9%	17.8%	16.1%
Percentage of renting families entitled to housing benefit	48.6%	46.8%	57.1%	47.4%
Average housing benefit entitlement among entitled families (£ p.a.)	2,942	4,027	3,497	3,895

Note: This table shows estimated entitlements to housing benefit *per entitled family* according to TAXBEN. Note that the estimated numbers of households entitled in Scotland and England are fairly close to estimates of the number of claimants recorded in administrative data sets (0.5% higher and 3.1% higher respectively). However, the estimated number of families entitled in Wales more substantially exceeds (by 17%) the number of claimants recorded in administrative data.

Source: Author’s calculations using TAXBEN and the Family Resources Survey, 2010–11.

It is the latter factor that drives the lower spending on housing benefit in Scotland. Indeed, as shown in Table 4, a slightly *larger* fraction of Scottish families (16.8%) are estimated to have been entitled to housing benefit in 2011–12 than the average across Great Britain as a whole (16.1%). This reflects a greater proportion of older adults being entitled to housing benefit in Scotland: for instance, 18.8% of families headed by someone aged 45 or over in Scotland, compared with 16.2% across Great Britain as a whole. On the other hand, fewer

¹⁸ C. Beatty, S. Fothergill and T. Gore, *The Real Level of Unemployment 2012*, Centre for Regional Economic and Social Research, Sheffield, 2012, <http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/real-level-of-unemployment-2012.pdf>.

young people in Scotland are entitled: for instance, 12.5% of families headed by someone aged under 35, compared with 14.2% across Great Britain as a whole.¹⁹

But conditional upon being entitled to any housing benefit at all, the *amounts* to which Scottish families were entitled were, on average, much lower – an average of £2,942 per year, 24% less than the £3,895 average across Great Britain as a whole. Perhaps more surprisingly, estimated average entitlements per entitled family were also substantially lower than in Wales.

Table 5 examines rents and housing tenure to explore why housing benefit entitlements are so much lower in Scotland than in the rest of Great Britain. It shows that average rents are clearly lower than in the rest of Great Britain – an average of £3,815 per year, 25% less than the average rent of £5,054 across Great Britain as a whole. Among households where someone is entitled to housing benefit, the gap is slightly larger: average rents are 26% below the level for Great Britain as a whole.

Table 5. Rents, housing benefit and housing tenure in Scotland, England, Wales and Great Britain, 2011–12

	<i>Scotland</i>	<i>England</i>	<i>Wales</i>	<i>Great Britain</i>
Average rent	£3,815	£5,239	£4,200	£5,054
Average rent if entitled to housing benefit	£3,679	£5,154	£4,230	£4,964
<i>If entitled to housing benefit</i>				
Average private sector rent	£5,325	£6,835	£4,792	£6,623
<i>Of which paid by housing benefit</i>	£3,917	£4,908	£3,571	£4,768
Average social sector rent	£3,202	£4,235	£3,919	£4,104
<i>Of which paid by housing benefit</i>	£2,660	£3,546	£3,455	£3,443
<i>Percentage of those entitled to housing benefit renting</i>				
From private sector	22.4%	35.3%	35.6%	34.1%
From social sector	77.6%	64.7%	64.4%	65.9%

Note: This table is at the household as opposed to family level because rents and tenure are measured at the household level.

Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

¹⁹ This low rate of entitlement to housing benefit among young Scots is likely to play some role in the especially low average *amounts* of housing benefit to which young Scots are entitled (see Figure 5 above).

This reflects two things. First, the rents paid by households entitled to housing benefit are lower in Scotland than in Great Britain as a whole whether they are renting from a private or social landlord. According to the Family Resources Survey, the average rent paid by a housing-benefit-entitled household in the private rental sector in Scotland in 2011–12 was £5,325, 20% less than the £6,623 for Great Britain as a whole. This is reflected in average housing benefit entitlements in the private rental sector being 18% below the average for Great Britain. In the social sector, the gap is slightly larger, with rents 22% below and housing benefit entitlements 23% below the average for Great Britain. Indeed, social sector rents in Scotland are substantially lower (by 18%) than in Wales, despite private sector rents being 11% *higher* in Scotland than in Wales.

Second, a larger fraction of households entitled to housing benefit are renting from the social sector in Scotland (77.6%) than in Great Britain as a whole (65.9%).²⁰ As rents are lower in the social sector than in the private sector (especially in Scotland), this compositional difference acts to lower average rents.

Lower housing benefit entitlement and expenditure per person in Scotland are therefore driven by *lower* private sector rents, *lower* social sector rents and a *larger* social rent sector, very slightly offset by a higher proportion of families entitled to some support.

However, Scotland's larger social housing sector and lower social housing rents are reflected in higher expenditure on social housing by the Scottish government. The latest data available on the amounts spent overall on housing (housing benefit plus social housing) cover 2011–12.²¹ They show that overall government spending per person on housing in Scotland in that year was £597, compared with £493 in England and £471 in Wales. Thus, overall spending on housing – that is, including both Scottish government spending on housing and UK government spending on housing benefit – is substantially higher in Scotland than in the rest of Great Britain.

There are clearly questions about whether support for housing is best delivered via greater direct investment in social housing and low social rents, or via rent

²⁰ Of all renting households, 63.1% rent from a social landlord in Scotland, compared with 50.9% in Great Britain as a whole.

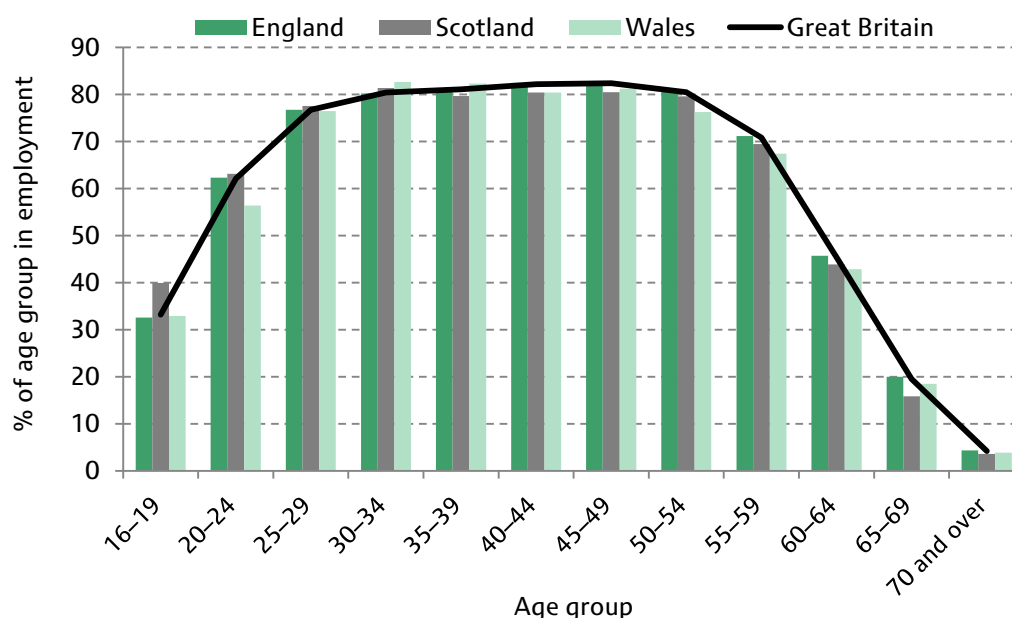
²¹ Chapter 10 of HM Treasury, *Public Expenditure Statistical Analyses 2013*, Cm 8663, 2013, available at <https://www.gov.uk/government/publications/public-expenditure-statistical-analyses-2013>.

subsidies for those with low incomes (i.e. housing benefit). But it is worth noting that under the present devolution settlement, the Scottish government is bearing the cost of greater investment in social housing and lower rents, whilst some of the benefits of that spending accrue to the UK government in the form of lower housing benefit payments.

3.4 Employment and earnings

Table 2 showed that spending on means-tested benefits per person in Scotland was less than the average for Great Britain as a whole. In large part, this reflects the facts that rents are lower in Scotland, and therefore less is spent per person on housing benefits, and that a lower proportion of the population are children in Scotland, so that spending on tax credits (most of which goes to families with children) is also lower. However, Wales also has lower rents and a lower proportion of children than the average for Great Britain as a whole, but it has *higher* spending on means-tested benefits. This difference reflects the fact that Wales's *low* earnings and *low* employment rate increase entitlements to means-tested benefits. But earnings and employment in Scotland look much closer to the average for Great Britain.

Figure 8. Employment by age in Scotland, England, Wales and Great Britain

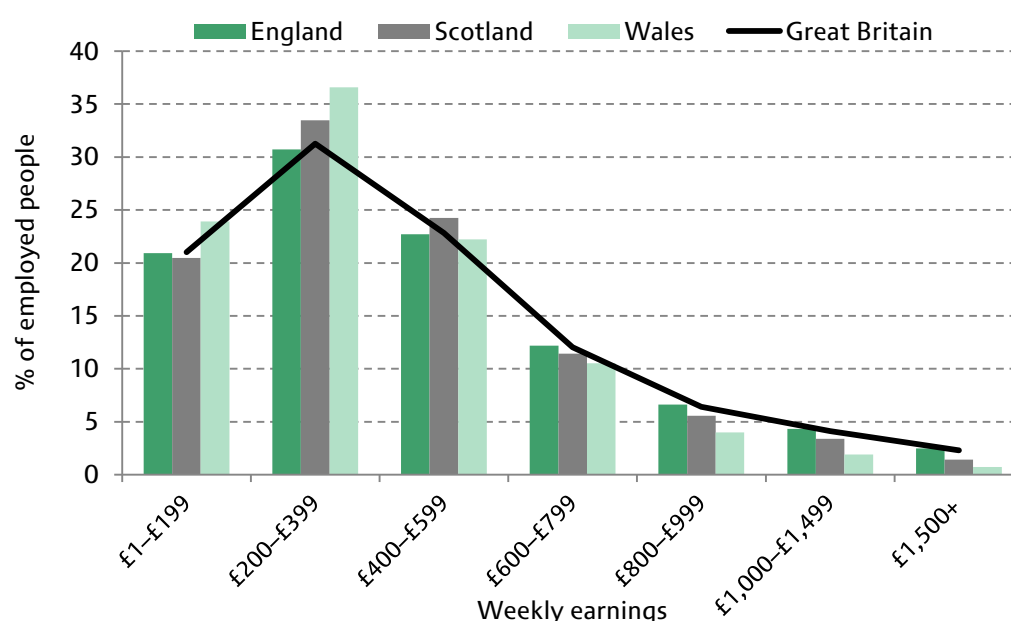


Source: Labour Force Survey, 2012.

The employment rate among working-age people in Scotland (72.2%) was very similar to that in Great Britain as a whole (72.4%) in 2012.²² As shown in Figure 8, this reflected slightly higher rates of employment among those aged under 35 (most notably for those aged 16–19) and slightly lower employment rates among those aged over 35.

Turning to earnings, average (mean) weekly earnings in Scotland (£438) were around 5% lower than the average for Great Britain as a whole (£460) in 2012.²³ However, as shown in Figure 9, this largely reflects the fact that Scotland has fewer high earners than England: the fractions of people with low earnings, on whom most means-tested in-work benefits are concentrated, are very similar in Scotland and in Great Britain as a whole. For instance, the fraction of employed Scots earning less than £200 a week was 20.5% in 2012, compared with 21.0% across Great Britain as a whole; and 37.0% earned less than £300 a week, compared with 36.4% across Great Britain as a whole. Again, Wales is rather different, with 23.9% of employees earning less than £200 a week and 43.1% earning less than £300 a week.

Figure 9. Weekly earnings in Scotland, England, Wales and Great Britain



Source: Labour Force Survey, 2012.

²² Labour Force Survey, 2012. Problems with the data prevent the employment analysis being done using 2011–12 LFS data. Working age is defined as being between 16 and 64 for men and between 16 and 61 for women.

²³ Labour Force Survey, 2012. Problems with the data prevent the earnings analysis being done using 2011–12 LFS data.

3.5 Can changes in demographic and socio-economic factors also explain the slower growth in benefit spending in Scotland in recent years?

As noted in Section 2, between 2005–06 and 2011–12, overall benefit spending per person grew just 7% in real terms in Scotland, compared with 13% for Great Britain as a whole. This smaller increase reflects the fact that all categories of benefit spending have grown less quickly in Scotland than in Great Britain since 2005–06, with the exception of spending on old-age benefits. Looking back further, estimates from TAXBEN suggest that benefit entitlements per person increased by 21% in real terms in Scotland during the period between 1999–00 to 2001–02 and 2008–09 to 2010–11, compared with 31% for Great Britain as a whole.²⁴ Can changes in demographic and socio-economic factors explain why benefit spending in Scotland has grown less quickly than across Great Britain as a whole in recent years?

The first thing to note is that between about 1999 and 2007, the employment rate among working-age people in Scotland increased relative to that of Great Britain as a whole, and of England in particular. For instance, whereas in 1999 the employment rate of 16- to 64-year-olds in Scotland (69.4%) was 3.4 percentage points lower than that in England (72.9%), in 2007 the comparable employment rate was 1.6 percentage points higher in Scotland (74.4%) than in England (72.8%).²⁵ An increase in the employment rate would tend to reduce benefit spending as people's private incomes increase. However, since 2007, the employment rate in Scotland has performed less well than that of Great Britain as a whole. For instance, in 2011, whilst the employment rate in Scotland (71.2%) remained above that in England (70.6%), the gap had shrunk to 0.6 percentage points. Thus changes in the overall employment rate would have tended to *increase* benefit spending per person in Scotland relative to England, rather than *reduce* it as has actually been the case.

On the other hand, the relative increase in the median and mean earnings of Scottish workers that has taken place over at least the last 10 years did continue during and after the recession. For instance, according to the Annual Survey of Hours and Earnings, in April 2002 the median weekly wage in Scotland (£302.00)

²⁴ Between 1990 to 1992 and 2008–09 to 2010–11, the difference was even more striking: 67% real-terms growth per person in Scotland, compared with 93% for Great Britain as a whole.

²⁵ Statistics available at <http://www.scotland.gov.uk/Topics/Statistics/Browse/Labour-Market/TrendData>.

was 92.6% of the median weekly wage in Great Britain as a whole (£326.30), whilst the mean weekly wage (£357.50) was 90.7% of the mean for Great Britain as a whole (£394.10). By April 2007, the median weekly wage in Scotland had increased to 95.3% of that of Great Britain, and the mean wage in Scotland had increased to 93.0% of the mean for Great Britain. And by April 2012, the median and mean Scottish weekly wages were 97.2% and 95.7% of the comparable Great British levels. The figures show that this increase in the relative wages of Scots occurred right across the weekly wage distribution. Such a relative increase in the weekly wages of Scots would reduce entitlements to many means-tested benefits relative to the rest of Great Britain and is therefore likely one factor underlying the slower growth in benefit spending per person in Scotland.

Demographics also look to have played a role. Child benefit statistics show that whereas the number of children for whom a claim for child benefit was made in Great Britain as a whole increased by 4.2% (536,000) between August 2003 and August 2011, in Scotland the numbers fell by 1.7% (18,000).²⁶ This reflects, at least in part, the fact that the increase in the number of children born per year since 2001 has been lower in Scotland (11.5%) than in Great Britain as a whole (20.9%). The substantial fall in the number of children in Scotland relative to Great Britain as a whole is one reason why spending on tax credits and child benefits has grown less quickly in Scotland than in Great Britain as a whole. And, as families with children tend to receive more in benefits than other working-age families, this would also help explain slower growth in overall benefit spending per person.

Figures show that disability benefit spending per person has also grown less quickly in Scotland than in Great Britain as a whole. This reflects the fact that in recent years, the proportion of people entitled to disability benefits has grown less quickly in Scotland than in Great Britain as a whole. For instance, according to the Family Resources Survey (FRS), the chance that a randomly chosen adult was entitled to a disability benefit was over 1.4 times higher than the average for Great Britain in Scotland in 2001–02, whereas by 2010–11 it was less than 1.2 times higher. At the same time, the FRS has *not* recorded a substantial change in the relative proportions of the population reporting that they have a health problem or disability that limits their daily activity: in both years, just over 22% of adult Scots reported this to be the case, compared with just under 21% of adults across Great Britain as a whole. And there has only been a slight reduction

²⁶ Statistics available at <http://www.hmrc.gov.uk/statistics/child-geog-stats.htm>.

in the relative numbers reporting a disability that restricts their ability to work (from 1.9 percentage points to 1.5 percentage points of the population difference). Rather than a broad-based improvement in the relative health of Scots, it therefore seems more likely that slower growth in disability benefit spending reflects other factors.

One key factor is likely to be the different timing of the growth in, and different patterns of receipt of, the two main disability benefits for working-age adults – incapacity benefit and disability living allowance (and their precursors and successors). The numbers of people entitled to incapacity benefits increased most during the 1980s and early 1990s, and this increase was concentrated in areas such as Scotland that were particularly hard hit by industrial restructuring and unemployment in the 1980s. As discussed in Section 3.2, there is also some evidence that in areas hit hard by the 1980s recession and economic restructuring, such as large parts of Scotland, incapacity benefits absorbed people who would otherwise have moved onto unemployment benefits.²⁷ As those affected entered retirement and, in some cases, died, this would act to reduce disability benefit spending in Scotland. Since the mid-1990s, most of the growth in disability benefit spending has been in the form of higher spending on disability living allowance, which is not as concentrated in former industrial areas, such as Scotland, as incapacity benefit expenditure.

The biggest difference between Scotland and Great Britain as a whole, however, has been the slower growth in spending on housing benefit per person in Scotland. This does not appear to have been driven by differential changes in rents, at least according to the FRS: average rents actually increased somewhat more in Scotland between 2005–06 and 2010–11, in part because the private rented sector (where rents are higher) increased slightly more as a proportion of the overall market in Scotland during this period. Instead, it appears that the main factor is that the number of households in receipt of housing benefit has increased less rapidly in Scotland than in the rest of Great Britain. For instance, according to official statistics, the number of housing benefit claimants in Scotland increased by 15.5% between November 2008 (the first month for which

²⁷ C. Beatty, S. Fothergill and T. Gore, *The Real Level of Unemployment 2012*, Centre for Regional Economic and Social Research, Sheffield, 2012, <http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/real-level-of-unemployment-2012.pdf>.

data are available) and March 2012, compared with an increase of 20.2% across Great Britain as a whole.²⁸

3.6 Summary

The differences between benefit spending and entitlement patterns in Scotland and Great Britain as a whole can be explained in large part by Scotland having:

- a somewhat older population, with a lower proportion of children and a higher proportion of pensioners;
- a population that, at any given age, are more likely to report having a health problem or work-limiting disability;
- lower rents, in part due to greater spending by the Scottish government on social housing.

These factors raise the amount spent on non-means-tested benefits, such as disability benefits and state pensions, and reduce the amount spent on major means-tested benefits, such as tax credits and housing benefit. With Scotland's earnings and employment levels close to the average for Great Britain, this is not offset by higher *underlying* entitlement for means-tested benefits, unlike in Wales.

The relatively slower growth in benefit spending in Scotland compared with Great Britain as a whole can be explained in part by somewhat stronger growth in employment (at least until 2007) and earnings, a relative fall in the proportion of people entitled to disability benefits, a fall in the number of children relative to the rest of Great Britain, and slower growth in the proportion of households in receipt of housing benefit.

4. The impact of tax and benefit reform on Scottish incomes

The UK direct tax and benefit system has seen significant reforms since 2010. In particular, on the benefits side, substantial cuts to working-age benefits and tax credits have been made as part of the fiscal consolidation efforts, whilst the roll-out of universal credit planned to begin in Autumn 2013 represents perhaps the biggest reform to the working-age benefits system since the 1940s. On the tax side, there have been substantial increases in the income tax personal allowance, raising the income level at which people start paying income tax, but higher

²⁸ DWP statistics on housing benefit claimants, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/208272/hbctb_release_may13.xls.

income tax on those with the highest earnings, an increase in National Insurance contributions for those on middle and higher earnings, and an increase in VAT.

This section examines how these changes have affected different types of household in Scotland, and how this compares with the picture for the UK as a whole. In doing this, we focus on the impact of the reforms *excluding* universal credit (which will only be fully rolled out in late 2017). IFS researchers will be publishing a detailed analysis of the impact of universal credit for the UK as a whole in Autumn 2013, and an analysis for Scotland will be available shortly afterwards. However, with the changes in benefit entitlements associated with the introduction of universal credit being broadly revenue-neutral once fully implemented (i.e. it is neither a substantial net takeaway from nor giveaway to households), the findings discussed in this section will still broadly hold even after universal credit is introduced. In particular, accounting for universal credit is not expected to substantially change the distributional impact of the reforms, nor is there any particular reason to expect its impact to differ significantly in Scotland from in the rest of the UK.

The benefit reforms since 2010 are many and include:

- the introduction of a ‘triple lock’ guaranteeing that the basic state pension will rise by at least earnings, CPI inflation or 2.5%, whichever is higher;
- uprating most benefits in line with CPI inflation, which is generally less generous than the RPI and Rossi index formerly used;
- freezing a number of benefits – such as the working tax credit and child benefit – in cash terms, and restricting the increase in most working-age benefits to 1% in cash terms in April 2013, April 2014 and April 2015;
- withdrawing child benefit from families containing someone with taxable income over £50,000 a year, and cutting the generosity of the child tax credit for middle-income families;
- various changes that reduce the generosity of housing benefit;
- tighter eligibility conditions for working-age disability benefits;
- the ‘localisation’ of council tax benefit, accompanied by a reduction in the funding for it;
- an overall cap on the amount most non-working working-age families can receive in benefits and tax credits;
- the replacement of a number of means-tested benefits and tax credits with universal credit.

The tax changes to personal direct and indirect taxation include:

- a substantial real-terms increase in the income tax personal allowance, increasing the income at which people start paying income tax;
- a substantial real-terms reduction in the income tax higher-rate threshold, bringing more people into the 40% income tax band;
- a freeze in the higher income tax personal allowances given to most people aged 65 or over;
- the introduction of an 'additional' rate of income tax on incomes over £150,000, now set at 45% (initially at 50%);
- significant reductions in the amount of tax-free pension contributions that can be made in each year and in total;
- an increase in the earnings at which employees, employers and the self-employed start paying National Insurance, and an increase in the rates of National Insurance each group faces;
- freezes in council tax in England and Scotland;
- an increase in the standard rate of VAT to 20%;
- real-terms reductions in taxes on road fuels and real-terms increases in taxes on cigarettes and alcohol.

With the exception of the cuts to council tax benefit, which the Scottish government has said it will make up using its own budget (at least in 2013–14), and freezes in council tax, which are not being implemented in Wales, the set of reforms being made in Scotland are the same as those being made in the rest of Great Britain. However, differences in the demographics and incomes of families in Scotland could mean that the reforms have a differential impact on Scottish families.

Work by researchers at Sheffield Hallam University has attempted to quantify the impact of the reforms to benefits and tax credits on the incomes of households in Scotland and the rest of Great Britain.²⁹ Beatty and Fothergill include the impact of most benefit reforms with the exception of universal credit and the switch to the CPI uprating of benefits. They estimate that the reforms they model will

²⁹ C. Beatty and S. Fothergill, *Hitting the Poorest Places Hardest: The Local and Regional Impact of Welfare Reform*, Centre for Regional Economic and Social Research, Sheffield, 2013, http://www.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/hitting-poorest-places-hardest_0.pdf.

C. Beatty and S. Fothergill, *The Impact of Welfare Reform on Scotland*, Report commissioned by the Scottish Parliament, 2013, http://www.scottish.parliament.uk/S4_Welfare_Reform_Committee/Reports/wrR-13-02w.pdf.

reduce total household incomes in Scotland by £1,660 million per year, equivalent to £480 per working-age adult in Scotland, compared with £18,870 million (£470 per working-age adult) per year in Great Britain as a whole. This makes Scotland harder hit than most of southern England, but less hard hit than most of northern England and Wales. Cuts to housing benefit for private sector tenants, child benefit and tax credits are modelled to have a somewhat smaller impact on household incomes in Scotland than in Great Britain as a whole, whilst cuts in disability benefits are predicted to have a greater impact. These findings reflect the pre-reform patterns of demographics and benefit entitlements in Scotland.

Using the IFS tax microsimulation model, TAXBEN, it is possible to examine the distributional impact of the benefit reforms, and add in the impact of changes to personal direct and indirect taxes.³⁰ We can include some reforms not included by Beatty and Fothergill (including the largest, the switch to CPI uprating), but are unable to include certain others (such as aspects of the tax credit reforms) due to limitations in the household data available to us. In addition, unlike Beatty and Fothergill, we do not include moving existing recipients of incapacity benefit and income support on the grounds of disability to employment and support allowance as part of the benefit reforms since 2010. This is because the roll-out of employment and support allowance began in October 2008.

Figures 10 and 12 show the percentage change in net household income for each decile group of the population³¹ resulting from the reforms implemented between January 2010 and April 2015, separately for Scotland and for the UK as a whole. Figure 10 shows the impact of the reforms to benefits and tax credits only, while Figure 12 adds in the impact of tax changes (Figure 11 shows additional analysis of the impact of the benefit reforms in Scotland).

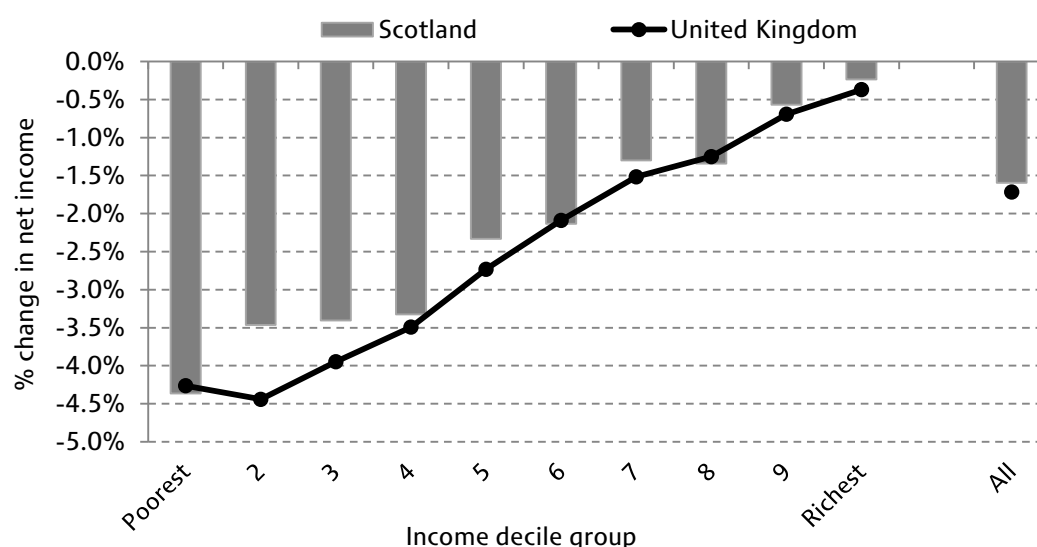
Looking first at Figure 10, it is clear that benefit reforms implemented (or due to be implemented) between January 2010 and April 2015 are a net takeaway from households. Excluding universal credit, the average loss to each household is estimated at £560 a year in 2013–14 prices across the UK as a whole, or

³⁰ Income tax, National Insurance, council tax, excise duties and VAT.

³¹ Decile groups are defined on the basis of a household's position in the UK income distribution (equivalised to account for household size using the McClements equivalence scale). This means that, for instance, the first decile group for Scotland contains those Scottish households that are among the poorest 10% of the *UK population* (and which may constitute more or less than 10% of the Scottish population).

approximately 1.7% of average household income. It is also clear that the benefit reforms are regressive, with poorer households losing more as a percentage of their income than middle- and upper-middle-income households. For instance, across the UK as a whole, the average loss for the lowest income decile group (i.e. the poorest tenth of households) is estimated to be £471 a year, or 4.3% of net income, whilst the average loss for the tenth income decile group (i.e. the richest tenth of households) is estimated to be £325 per year, or around 0.4% of net income. Note that in absolute cash terms, the largest losses are not at the very bottom of the income distribution, but in the lower-middle and middle parts of the distribution (decile groups 2 to 6).

Figure 10. Impact of benefit reforms between January 2010 and April 2015 (excluding universal credit), by income decile group in Scotland and the UK



Note: January 2010 system uprated using default indexation rules to April 2013 level. April 2015 system downrated using default indexation rules to April 2013 level. Decile groups defined on the basis of net household income in the baseline (January 2010) system, equivalised using the McClements equivalence scale.

Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

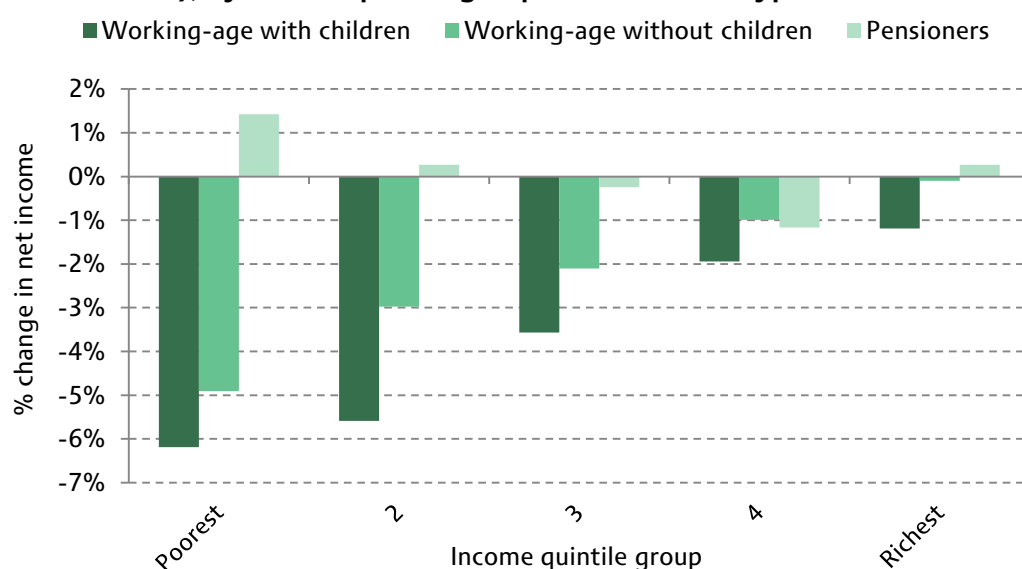
It is also clear that the average loss resulting from the benefit reforms is a little *lower* in Scotland than for the UK as a whole – £480 per year (1.6% of net income) compared with £560 (1.7% of net income).

Towards the lower-middle part of the income distribution – where most benefit spending is concentrated – the gap between Scotland and the UK as a whole is even larger. For instance, average losses for a household in the second and third deciles of the income distribution are 4.4% of income and 3.9% of income, respectively, for the UK as a whole. But in Scotland, they are estimated to be only 3.5% and 3.4%, respectively. In other words, Scottish households on low-to-

middle incomes appear to be suffering less from the benefit cuts than the average for such households in the UK.

There are a number of reasons for these smaller losses. For instance, lower rents and a smaller private rented sector mean that cuts to housing benefit are having a smaller effect on Scottish households. The smaller proportion of children in the population means cuts to tax credits and child benefit also have less of an impact on Scottish households, on average. Pensioners have been largely insulated from the benefit cuts, and the slightly higher proportion of pensioners in the Scottish population therefore acts to reduce the average impact of reforms on Scottish households. Figure 11 shows just how much the impact of the benefit cuts varies between working-age families with children, working-age families without children, and pensioners in Scotland. For instance, Scottish households with children who are among the poorest fifth of all households in the UK are estimated to lose the equivalent of just over 6% of net income following the benefit reforms. Other working-age Scottish households in the poorest fifth of all households in the UK are estimated to lose the equivalent of around 5% of net income, on average. But pensioners among the poorest fifth of all households in the UK are estimated to gain the equivalent of nearly 1½% of net income, due to above-indexation increases in the guarantee element of the pension credit. Right across the income distribution, households with children in Scotland are hit

Figure 11. Impact of benefit reforms between January 2010 and April 2015 (excluding universal credit), by income quintile group and household type in Scotland



Note: Income quintile groups are used instead of income decile groups in order to ensure sufficient sample sizes. Also see note to Figure 10.

Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

hardest by the benefit cuts, followed by other working-age households, with pensioners generally least hard hit.

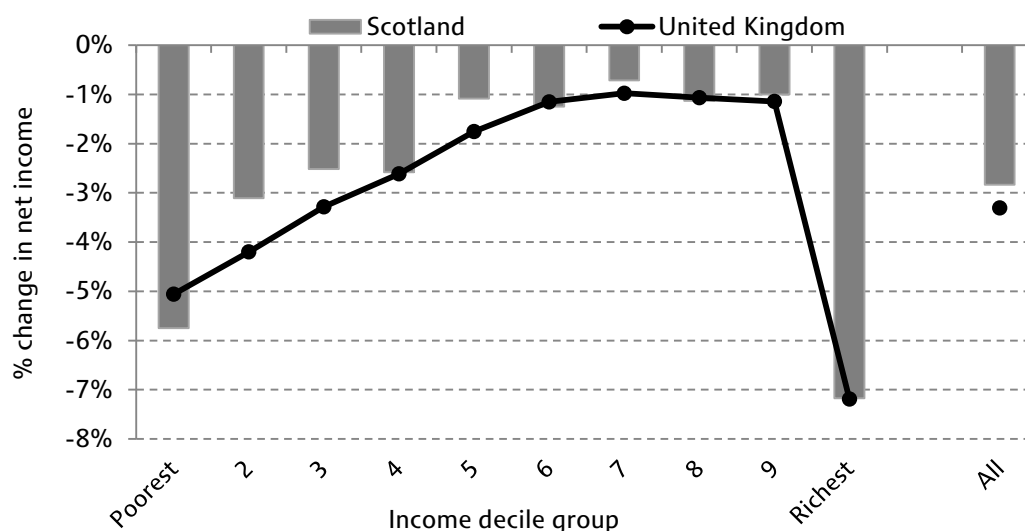
Not all benefit cuts are estimated to have hit Scotland less hard. The relatively high proportion of the Scottish population claiming disability benefits means that Scotland is hit harder by cuts to disability benefits than the UK as a whole. But this is not enough to fully offset the fact that the other cuts reduce incomes by less in Scotland, on average.

This is rather different from the results of Beatty and Fothergill, who found that the benefit reforms they modelled reduced incomes in Scotland by slightly more than the average for Great Britain. What may explain this difference?³² First, there are differences in the reforms covered. For instance, their estimates include the shift from incapacity benefit to employment and support allowance, whereas in our analysis we count that as a reform taking place *before* 2010 as implementation began in October 2008. This reform is estimated to have a greater impact on Scotland, so the fact that we are not counting it here (we instead see it as a reform taking place *before* 2010) lowers our estimate of the losses from reforms by more in Scotland than in the UK as a whole. On the other hand, we model reforms to pensioner benefits and include pensioner households, which are less adversely affected by the reforms and are slightly more numerous in Scotland, and we model the impact of the shift to the CPI uprating of benefits. Second, we use individual household data to estimate the impact of reforms in Scotland and the UK as a whole, whereas in a number of instances (for example, for the shift to uprating housing benefit rates for private sector tenants by CPI and for the removal of child benefit from high earners), Beatty and Fothergill use methods based on aggregate data that look likely to lead them to allocate larger losses to Scotland than our methods. Indeed, given just how different the methods used to estimate the impacts of the reforms are, it would be very surprising if the different estimates were very similar.

Of course, the changes to the benefits system are only part of the full set of tax and benefit reforms introduced in recent years. Figure 12 shows the estimated impact of the reforms across the income distribution once changes to direct and indirect taxes are also taken into account.

³² Because Northern Ireland's population is so small relative to that of Great Britain, the fact that Beatty and Fothergill report figures for Great Britain rather than the UK as a whole is unlikely to be an important part of the explanation.

Figure 12. Impact of benefit and tax reforms between January 2010 and April 2015 (excluding universal credit), by income decile group in Scotland and the UK



Note: See note to Figure 10.

Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

The first thing to note is that the average loss to households once one also accounts for tax changes is larger: 3.3% of net income across the UK as a whole. In other words, the changes to the tax system represent a net takeaway, on average, from households.

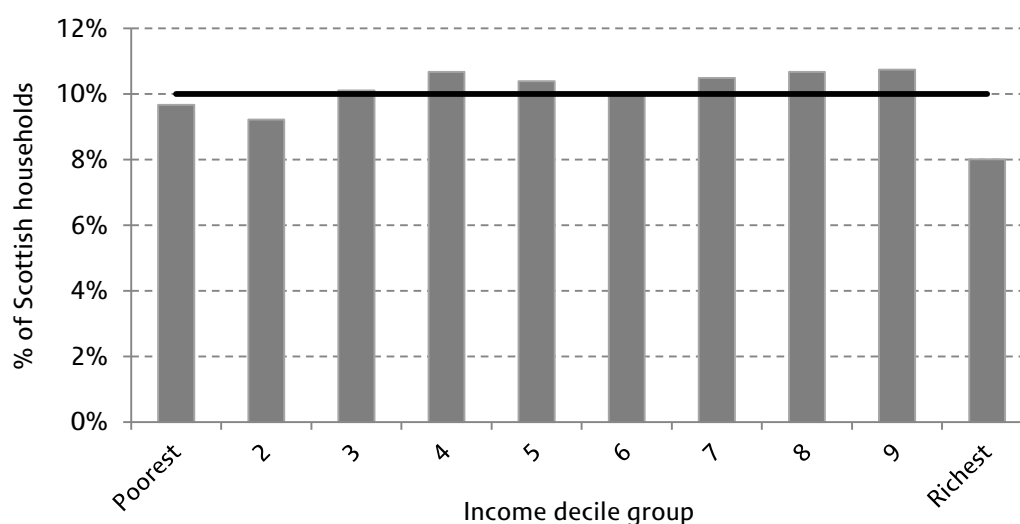
Furthermore, the reforms remain regressive over most of the income distribution once one accounts for changes in taxes as well as benefits, with poorer households losing more as a percentage of their income than middle- and upper-middle-income households. For instance, across the UK as a whole, the average loss for households in the lowest income decile group is estimated at £560 per year, or 5.1% of net income, whilst the average loss for someone in the ninth income decile group is estimated to be £530 per year, or 1.1% of net income. However, the largest losses are for the richest tenth of households, driven by income tax increases largely affecting about the top 2% of households. Across the UK as a whole, the average loss among the richest tenth of households is estimated at over £6,300 per year, or 7.2% of net income.

It is also clear that the average loss resulting from the tax and benefit reforms is lower in Scotland than for the UK as a whole, and this gap is bigger than for the benefit reforms alone. In other words, the tax changes are estimated to lead to smaller reductions (in both proportional and cash terms) in the incomes of Scottish households than in the average for the UK as a whole: Scottish households are estimated to lose £856 per year (2.8% of net income) from the

tax and benefit changes together, compared with an average loss of £1,078 (3.3% of net income) across the UK as a whole.

Differences between the income distributions in Scotland and the UK as a whole are the key reason for this. First, the smaller number of high-income individuals in Scotland means that a smaller proportion of households are affected by the substantial increases in income tax for those with the highest incomes. As an indication of this, only around 8% of Scottish households are among the richest 10% of households in the UK (see Figure 13). Conversely, the greater-than-average proportion of Scots on middle incomes means that the average gain from increases in the income tax personal allowance is greater in Scotland than across the UK as a whole.³³ A lower fraction of high earners and a larger fraction of middle earners mean that Scottish households will also have been hit less hard, on average, by the changes to National Insurance contributions in April 2011.

Figure 13. The proportion of households in Scotland in each decile group of the UK household income distribution



Note: Decile groups defined on the basis of net household income in the baseline (January 2010) system, equivalised using the McClements equivalence scale. January 2010 system uprated using default indexation rules to April 2013 level.

Source: Author's calculations using TAXBEN and the Family Resources Survey, 2010–11.

To summarise, the changes to taxes and benefits between January 2010 and April 2015 are estimated to reduce incomes by less in Scotland than across the UK as a whole. But like in the UK as a whole, the tax and benefit reforms result in larger proportional falls in the incomes of poorer Scottish households than in those

³³ The individual earnings distributions in Scotland and Great Britain (discussed in Section 3.4) also show Scotland having a lower proportion of people with very high earnings and a higher proportion towards the middle of the earnings distribution (earnings are the single largest component of income).

towards the middle and upper-middle of the household income distribution (although the richest households see the biggest falls in income in both absolute and proportional terms).

It is important to note that the reforms since 2010 follow on from a period during which reforms to the tax and benefit system were very *progressive*. In particular, between 1997 and 2010, the previous government substantially increased the generosity of benefits and tax credits for low- and middle-income families with children and pensioners. This led to substantial gains towards the bottom of the income distribution from tax and benefit reforms, on average, paid for to a significant extent by higher taxes, and therefore losses from reforms, further up the income distribution.³⁴ The reforms being implemented between 2010 and 2015 undo part but not all of the gains from tax and benefit reforms since 1997 for poorer households, on average. However, the last government's generosity to low-income families with children and pensioners did not extend to low-income working-age families *without* children. Thus, with this group *not* gaining from reforms between 1997 and 2010, but being hit fairly hard by the cuts in benefits since 2010, low-income working-age adults without children will have been adversely affected by changes in taxes and benefits between 1997 and 2015.

5. An opportunity for reform?

Under the current devolution settlement, benefits policy – i.e. the structure and generosity of pensions, benefits and tax credits and the associated rules – is mostly a reserved matter for the UK government.³⁵ At present, this means the benefits system in operation in Scotland is very largely the same as that in the rest of the UK. But, if benefits policy were devolved or Scotland were to become independent, Scotland would face the choice of whether to maintain the system it inherited and shadow the system set by Westminster (as Northern Ireland typically does at the moment) or to make changes that may ultimately lead to rather different systems north and south of the border.

³⁴ See J. Browne and D. Phillips, 'Tax and benefit reforms under Labour', IFS Election Briefing Note 1 (IFS Briefing Note 88), 2010, available at <http://www.ifs.org.uk/publications/4807>.

³⁵ The main exceptions are that, following the localisation of council tax benefit and parts of the Social Fund, policy on these is now set by the Scottish government.

5.1 Changes planned by the Scottish government in an independent Scotland

The Scottish government has announced two policies that differ from current UK government policy: first, that it would cancel the recent reductions in the amount of housing benefit provided to those renting from social landlords (such as the local council and housing associations) who are deemed to have spare bedrooms; and second, that the current policy of guaranteeing that the state pension will rise by the *maximum* of CPI inflation, average earnings and 2.5% (the ‘triple lock’) would be continued after the introduction of the new flat-rate pension in April 2016 – this is something that UK government ministers have said they might do, but they have not yet made a firm commitment.

Both policies would involve additional spending on benefits. Undoing the changes to housing benefit would cost the Scottish government approximately £50 million per year.³⁶ This is equivalent to just under 3% of the amount spent on housing benefit or 0.3% of the amount spent on benefits as a whole in Scotland in 2011–12: not insignificant, but not especially costly either. The Department for Work and Pensions estimates that around 80,000 claimants in Scotland have been affected by the cuts to housing benefit for social tenants with spare bedrooms, with an average loss of £12 a week. This is a fairly sizeable amount for a group of low-income people who, in many cases, will have been hit by other benefit cuts too. Undoing the change (and making additional cuts elsewhere or increasing taxes) would therefore represent a relatively large gain for affected families and ease the pain of austerity for them. It would also solve the problem of those required to pay some rent for the first time falling into rent arrears, which may become a costly problem for social landlords.³⁷ However, undoing the reform would also reintroduce a difference between the treatment of social sector and private sector tenants: the amount of housing benefit a private sector tenant can claim has long been dependent on how many bedrooms they are deemed to need, and the Scottish government has not announced plans to change this. It is difficult to think of a rationale for treating social housing tenants more generously than private tenants.

³⁶ Author’s calculations using Budget 2013 costing of the policy for the UK as a whole, and the DWP’s policy impact assessment (see https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/138017/social-sector-housing-under-occupation-wr2011-ia.pdf.pdf).

³⁷ Scottish councils reported a substantial increase in arrears linked to the housing benefit changes during April and May 2013. See <http://www.cosla.gov.uk/news/2013/07/100-day-survey-reveals-pressures-councils-bedroom-tax>.

Keeping the ‘triple lock’ is potentially a much more costly policy – at least in the long term. The triple lock means that when earnings are rising more quickly than the rate of inflation (or 2.5%), as is usually the case, the state pension will increase in line with earnings. However, when earnings increase by less than inflation, as has been the case for the last couple of years following the financial crisis, the state pension would increase by inflation or 2.5%, whichever is greater. This means that if wages sometimes increase less quickly than prices, the state pension would rise by *more* than earnings. In its 2013 Fiscal Sustainability Report,³⁸ the Office for Budget Responsibility (OBR) predicts that if earnings and inflation in future behave as they have done since 1993,³⁹ the state pension will increase by an average of 0.30% per year more than earnings. For the UK as a whole, the OBR estimates that this would increase spending on pensions by 0.9% of national income more than if the state pension were increased in line with earnings by 2062–63. This is in the context of a projected increase in the cost of the state pension from 5.8% of GDP in 2017–18 to 8.4% of GDP in 2062–63. Therefore, for the UK as a whole, the cost of the triple lock is over one-third of the increased cost of state pensions projected over the next 50 years. To put these figures in context, in 2011–12 – the last year for which we have data – 0.9% of national income (excluding North Sea output) would be equivalent to £1,130 million for Scotland, or 6.6% of the entire benefits budget in Scotland. And, given Scotland’s higher proportion of elderly people and more rapidly ageing population, all else equal, the cost of the triple lock to Scotland would likely be a bit higher than 0.9% of national income in 2062–63.⁴⁰

Even if the Scottish government did want to see the state pension increase by more than earnings in the long term, the ‘triple lock’ is not a sensible way of achieving this. This is because, under the triple lock, the value of the state pension in the long term depends not only on long-term inflation and increases in average wages, but also on the *volatility* of wage growth and inflation. Consider two scenarios for the level of the state pension in 49 years’ time that involve the same average growth rates in earnings and prices. In scenario 1, the annual growth rates are volatile and consist of cycles of two years of 6% growth in earnings and one year of no growth in earnings, and two years of 1.5% inflation

³⁸ See http://cdn.budgetresponsibility.independent.gov.uk/2013-FSR_OBR_web.pdf.

³⁹ This is the year following the UK’s exit from the European Exchange Rate Mechanism.

⁴⁰ Note that the relationship between inflation and earnings growth in future may differ in Scotland from that in the rest of the UK.

and one year of 3% inflation. In scenario 2, the average growth rates are the same, but are constant at just under 4% per year for earnings and 2% for prices.⁴¹

When earnings growth and inflation are stable at approximately 4% and 2% per year, respectively, the triple lock would lead to the state pension being increased by approximately 4% each year. Under this scenario, after 49 years, both the state pension and earnings would increase by a factor of about 6½ in nominal terms and 2½ in real terms. However, when earnings growth and inflation are volatile, the triple lock would lead to the state pension being increased by 6% – in line with earnings growth – for two years and by 3% for one year – in line with inflation. This is equivalent to an average annual increase of nearly 5% per year, which over time leads to a much higher state pension: over 49 years, it would increase by a factor of about 10½ in nominal terms and 4 in real terms. In other words, despite the *same* average rate of inflation and earnings growth, after about 50 years the state pension would be worth about 60% more in the scenario with volatile earnings growth and inflation than in the scenario with stable earnings growth and inflation.

There is no rationale for the state pension to increase more in the long term just because of greater year-to-year volatility in earnings growth or inflation. But this is the effect of the ‘triple lock’ (or, indeed, a ‘double lock’ that did not involve the 2.5% minimum increase). Thus, extending the triple lock indefinitely does not look sensible: it is a poorly-designed and expensive policy that both the UK government and the potential government of an independent Scotland should let lapse. If it is felt that the state pension should grow faster than average earnings in the long term, there are better ways of doing this (for instance, via simple discretionary increases in generosity).

In addition to the two policies announced already, the Scottish government set up an Expert Working Group tasked with looking at how the benefits system should be managed and delivered in the years immediately following independence, and to suggest aspects of the system the Scottish government should consider reforming. Following this group’s final report,⁴² the Scottish government is in the process of setting up a new Working Group that will

⁴¹ The exact values for the stable rates of earnings growth and inflation are 3.961031% and 1.997557%, respectively.

⁴² See Expert Working Group on Welfare, *May 2013 Report*, 2013, <http://www.scotland.gov.uk/Resource/0042/00424088.pdf>.

examine medium- to long-term options for reform of the benefits system in an independent Scotland. Whilst many of the responses to the first group's call for evidence were critical of recent changes to the benefits system made by the UK government, it is important that the new group considers the design and operation of the benefits system more widely.

Nevertheless, there are aspects of the recent benefit reforms that do not look particularly well thought out and that an independent Scotland should consider modifying in the longer term.

5.2 A chance to 'fix' the existing benefit system?

First is the 'benefits cap', whereby the maximum amount in benefits and tax credits that most working-age families can receive is limited to £350 per week for a childless single person or £500 a week for all other families.⁴³ This is anticipated to affect only about 2,500 families in Scotland, but those affected are likely to see a substantial reduction in their income (the estimate for Great Britain as a whole is £93 per week).⁴⁴ The UK government has justified this policy by arguing that it is unfair for a family on benefits to receive more than the average in-work family receives in net earnings, and has said that it hopes the reform will encourage people to seek cheaper accommodation or take up paid work. However, as detailed in analysis of the reform by IFS researchers,⁴⁵ the policy increases the incentives *not* to live with a partner (or at least declare that they do not), as the cap applies at the family level and so living apart could mean it can be avoided.

The implication behind the cap is that the UK government believes that the benefits system was too generous to some out-of-work families who were able to claim for very large amounts of support due to their high housing costs and/or

⁴³ There are exemptions for war widows and widowers, families in receipt of disability living allowance, the personal independence payment, the support component of employment and support allowance, an industrial injuries benefit or working tax credit, and those on universal credit whose family earnings exceed £430 per month. The cap will also not apply for 39 weeks after the end of an employment spell if that spell lasted for at least one year.

⁴⁴ See DWP's impact assessment, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/207954/benefit-cap-wr2011-ia.pdf.

⁴⁵ R. Joyce and D. Phillips, 'Tax and welfare reforms planned for 2013–14', in C. Emmerson, P. Johnson and H. Miller (eds), *The IFS Green Budget: February 2013*, Report R74, London, http://www.ifs.org.uk/budgets/gb2013/GB2013_Ch7.pdf.

large numbers of children. We take no stance on whether this is an appropriate judgement. However, it is important to recognise that the application of an overall cap on benefit entitlement breaks the link between circumstances and entitlements that the rules of individual benefits imply, once the cap is reached. And yet circumstances and entitlements will remain inextricably linked until benefits reach the level of the cap. The rationale for this is unclear. The government of an independent Scotland should therefore examine carefully whether there are better-targeted ways of dealing with the perceived problem of overgenerosity to certain families via changing specific benefit rates responsible for particularly high benefit entitlements (for example, the amounts that families can claim to cover their rents).

A second recent change that the government of an independent Scotland should reconsider is capping increases in local housing allowance (LHA) rates – the maximum private sector tenants can claim in housing benefit in a particular area – at the rate of CPI inflation. Given that rents are anticipated to increase by *more* than CPI inflation, LHA rates will tend to *fall* relative to local rents and fall relatively more in areas that experience faster rent growth. The government hopes that this will put downwards pressure on rents and save money.

But the details of this policy will lead to some very odd effects. In particular, the policy may lead to differences in future LHA rates in different parts of the country resulting purely from historical *volatility* in local rents. And it will mean that future geographical differences in LHA rates will depend on past differences in rents but not on current differences, so that (for example) an area where rent is higher than in another area could end up with the lower LHA rate.⁴⁶ Neither of these features seems desirable. Undoing the change would cost the government of an independent Scotland money, but it would be possible to recoup this from other more transparent cuts to housing benefit that do not have the same perverse effects.

A third policy that should be re-examined is the UK government's decision that support for low-income families in paying their council tax is to be kept separate from universal credit, which is due to replace most other means-tested benefits and tax credits for working-age families. Instead, support for council tax has been localised, with English local authorities and the devolved Scottish and Welsh

⁴⁶ See R. Joyce and D. Phillips, 'Tax and welfare reforms planned for 2013–14', in C. Emmerson, P. Johnson and H. Miller (eds), *The IFS Green Budget: February 2013*, Report R74, London, http://www.ifs.org.uk/budgets/gb2013/GB2013_Ch7.pdf.

governments designing and implementing their own schemes for support since April.

The UK government has stated that it hopes localisation will allow support to reflect local priorities and will strengthen the incentives of the local government to promote employment and growth in the local economy. However, the Scottish government has chosen to implement a national scheme rather than allow each local authority to design and implement its own policy. If Scotland were to become independent, or benefits policy were to be devolved, its government would face a choice over whether to maintain the current system or to integrate support for council tax with universal credit.

There is a clear case to do the latter. With support for council tax being decided at the national (Scottish) level rather than by each local authority, keeping it separate from universal credit creates unnecessary complication. It may mean an additional organisation to deal with (local councils currently handle claims for support with council tax and the Department for Work and Pensions handles other benefit claims) and would require an additional set of forms to be filled in by benefits claimants. On a more fundamental level, there could be difficult issues regarding how the two benefits interact (a particularly important question is whether universal credit would count as income in any means test used in assessing support for council tax), and the possibility of people being subject to overlapping means tests and hence having extremely weak work incentives. Integrating support for council tax for working-age people with universal credit would solve these problems and reduce complexity and bureaucracy.⁴⁷

A fourth recent reform that might warrant re-examination is the withdrawal of child benefit from families containing an individual with a taxable income of £50,000 a year or more. This means test based on the income of the person with the highest income contrasts with the more usual family-income means test used in the benefits system. It leads to the situation of a family where the highest-income individual has an income of £60,000 receiving no child benefit, but a family where both parents have an income of £50,000 and hence with total income of £100,000 receiving *full* child benefit. This may be seen as unfair.

In addition, the way in which it is withdrawn (1% of total child benefit for the family is withdrawn for every £100 by which taxable income exceeds £50,000) means that people with more children face higher marginal income tax rates than

⁴⁷ Support for council tax and housing costs for pensioners could be integrated with the administration of the pension credit.

those with fewer children: for instance, someone with one child facing withdrawal of child benefit currently faces a marginal income tax rate of 51% (the higher rate of 40% plus 11% as child benefit is withdrawn), whilst someone with three children would face a marginal income tax rate of around 64% (40% plus 24%). Over time, as inflation-uprating increases the amount of child benefit that is to be withdrawn, these tax rates increase: after 10 years of 2% inflation, the marginal income tax rate facing someone with three children would increase to 69% (40% plus 29%). Indeed, with many children (nine or more, currently) and/or in the long term as child benefit increases, the marginal income tax rates facing people with children will exceed 100%, meaning that cutting back their gross earnings would leave them *better off*. These are not desirable features of a means test. Therefore, if the government of an independent Scotland felt that it wanted to continue to means-test child benefit, it would be sensible to consider reforming the current means test so that it operated at the family level, and did not weaken work incentives so much more for larger families and more over time.

The reason why the marginal income tax rates facing people affected by the withdrawal of child benefit are set to increase over time is that the thresholds between which child benefit is withdrawn (£50,000 and £60,000) are frozen in cash terms by default, whilst child benefit rates increase in line with CPI inflation by default. This is one example of a more widespread issue – certain elements of the benefits system are fixed in cash terms and do not increase automatically in line with inflation as most other parts of the system do. It is hard to think of a justification for such default cash-terms freezes: benefit rates that are frozen tend to steadily lose value over time – more quickly when inflation is higher – and require periodic ad-hoc adjustments to bring them back into line with the rest of the system. Getting rid of such default cash-terms freezes would therefore be a sensible thing to do.⁴⁸

Another systemic problem with the current benefits system that a Scottish government may want to consider is the treatment of financial capital. Most working-age means-tested benefits (but not tax credits), including the new universal credit, ignore any financial capital up to £6,000 when determining the entitlement amount. Above that, entitlements are reduced by £1 per week (or £52 per year) for every additional £250 of financial capital held. And people with

⁴⁸ Although cash freezes may still be a policy to be considered when *discretionary* benefit cuts are needed or wanted, as in recent years.

£16,000 or more of financial capital are not entitled to means-tested benefits at all.⁴⁹ This leads to an odd relationship between the amount of financial capital held and the benefit entitlement, providing very strong incentives for people to keep their savings below £16,000 (because of the ‘cliff edge’, with entitlement falling to zero at this point). Furthermore, the implied interest rate on financial capital between £6,000 and £16,000 of over 20% is far higher than can realistically be obtained for the foreseeable future, and means much *more* is being withdrawn in benefits than is seen in additional interest income. Again, this provides particularly strong disincentives to save.

Because of these issues, it would be worthwhile considering moves to treat capital income similarly to the way in which the child and working tax credits treat it – that is, , with entitlements being reduced by an amount that is based on the actual interest and dividends received. Entitlement could be reduced by the same amount per £1 of capital income as per £1 of earnings, or by a higher or lower amount, depending on government priorities and finances.

5.3 What about more radical reform?

However, independence would give Scotland the opportunity to consider much more radical reforms than ‘fixing’ parts of the current system that look ill-conceived. The new Working Group being set up by the Scottish government has been tasked with examining, amongst other things, the ‘principles’ that should guide Scottish benefits policy if Scotland were to become independent.

One principle that might be considered is the extent to which benefit entitlement should depend upon contributions to the system (for instance, via National Insurance). At present, the UK benefits system differs from those in operation in many western European countries and the United States in that the link between contributions and entitlements is particularly weak. For instance, whereas in countries such as France, Germany, the Netherlands and the US the amount to which one is entitled when unemployed depends upon earnings (and therefore contributions) prior to becoming unemployed – at least for a period of time – in the UK, jobseeker’s allowance is a flat-rate (and fairly low) amount. In principle, an independent Scotland could choose to move towards a more contributory system with higher pensions, disability benefits and unemployment benefits for those earning and contributing more. Such a link between benefits and

⁴⁹ For pensioners, the disregard is £10,000; £1 is withdrawn for every additional £500 of capital; and there is no upper limit above which entitlement ceases.

contributions might improve work incentives, as people would see the additional social security contributions they pay when working more, not as a tax, but as a contribution to an insurance fund from which they will later benefit in terms of higher benefits and pensions. It could also increase the amount of insurance against illness and unemployment provided by the system for people with higher earnings (at the moment, flat-rate benefits mean higher earners face a much larger drop in income when they become unemployed unless they have taken out private insurance, which can be expensive). However, higher entitlements for higher earners might blunt the incentives they face to return to work.

But perhaps the biggest challenge is that – like all major reforms – increasing the link between entitlements and contributions would either involve a substantial increase in benefits spending or else involve creating significant numbers of losers, who in this case would likely be those with the lowest current incomes. This is because linking entitlement amounts to contributions without creating losers would require setting the existing flat-rate entitlements as the *minimum entitlements*, with people with higher earnings/contributions receiving more than these minima. Keeping existing entitlements for some and increasing entitlements for others would clearly increase the overall costs of the system. If one wished to curtail the costs whilst maintaining the link between contributions and entitlements, the minimum would have to be set *below* existing benefit rates. This would mean losses for people entitled to the minimum – those with the lowest earnings and shortest work spells – and a reduction in the extent to which the system redistributes from higher-income to lower-income families.

The difficult trade-off between cost and the creation of substantial numbers of losers when making major reforms is also illustrated by the introduction of universal credit. This represents one of the most substantial changes to the UK working-age benefits system since the 1940s. One of the major aims is to increase work incentives for people who have weak ones under the existing system. This is to be done by increasing the amount of earnings one can have before entitlements start being reduced for some groups of the population, and reducing the maximum rate at which benefits are withdrawn as earnings increase. If one did not want to make anyone worse off relative to the existing system, this would cost money. However, the UK government has chosen parameters for the system that lead to total entitlements under universal credit being roughly equal to entitlements under the existing system. This means that whilst about 1.9 million families are expected to gain by at least £100 per month,

about 1.3 million are expected to lose by at least £100 per month.⁵⁰ Both the gainers and losers are concentrated towards the bottom of the income distribution.

Thus, whilst independence would give Scotland the potential to make radical reforms to its benefits system, such reforms would require difficult decisions about how to trade off cost, generosity, work incentives, redistribution and the extent to which the system should be based on the contributory principle. This means that if the Scottish government's new Working Group wants to consider or advocate radical reforms to the benefits system, it needs to be clear just how it proposes these trade-offs will be made. And it must do this in the context of demographic trends and a long-term fiscal outlook that look, if anything, even more challenging for Scotland than for the UK as a whole.

6. The long-term demographic challenge and fiscal outlook

Section 2 showed how recent years have seen benefit spending per person grow less quickly in Scotland than in Great Britain as a whole. In particular, the bill for housing benefit, child benefit and tax credits has grown less quickly than in the rest of the country, whilst spending on old-age benefits has grown at a fairly similar pace.

Similar growth in spending on old-age benefits per person has taken place despite the fact that the proportion of the population aged 60 or over has grown at a somewhat quicker pace in Scotland than in Great Britain as a whole in recent years. Figure 14 shows that between the 2001 and 2011 censuses, the proportion aged over 60 increased from 21.1% to 23.2% for Scotland, compared with from 20.9% to 22.5% for Great Britain as a whole – an increase of around 10% in Scotland compared with just under 8% in Great Britain as a whole.

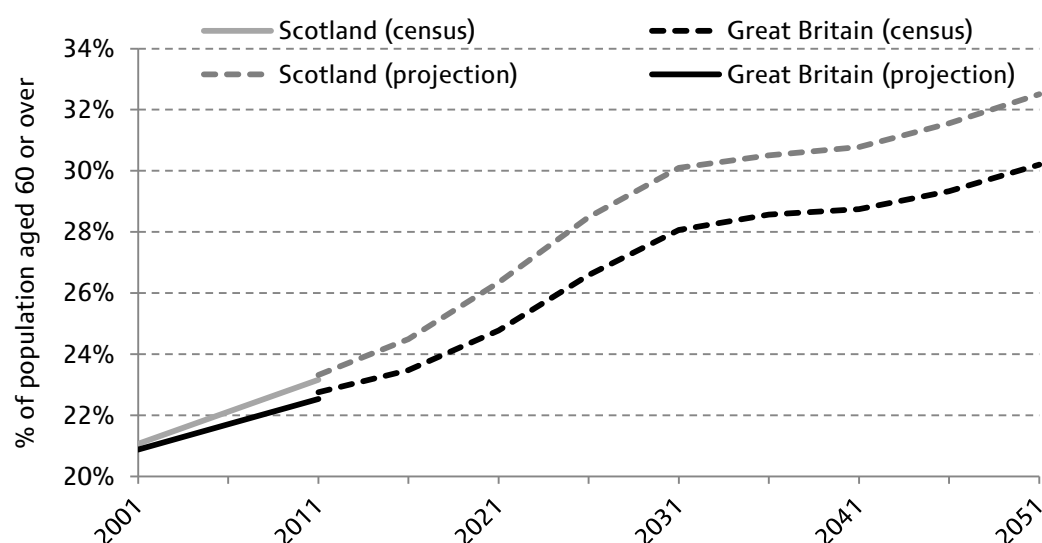
This more pronounced ageing in Scotland is expected to continue in the coming decades. For instance, 2010-based projections (also shown in Figure 14)⁵¹ show the percentage of the population aged 60 or over in Scotland increasing from 23.3% in 2011 to 26.4% in 2021, 30.1% in 2031 and 32.5% in 2051. For Great Britain as a whole, the proportion of the population aged 60 or over was

⁵⁰ See DWP's impact assessment, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/220177/universal-credit-wr2011-ia.pdf.

⁵¹ Note that these projections slightly overestimated the share of the population that was aged 60 or over in 2011 in both Scotland and Great Britain as a whole.

projected to increase from 22.8% in 2011 to 24.8% in 2021, 28.1% in 2031 and 30.2% in 2051. In other words, demographic change, which will put upwards pressure on benefit spending across Great Britain (and, indeed, all developed nations) due to the greater average spending per person among older people, looks set to be even more challenging for Scotland, especially in the next 20 years or so.

Figure 14. Proportions of the population aged 60 or over in Scotland and Great Britain, 2001, 2011, and 2010-based projections



Source: Census 2001 and 2011 statistics and 2010-based population projections.

In response to increasing longevity and the associated ageing of the population, the age at which people are able to claim old-age benefits is being increased. The age from which women can claim the state pension (and everyone can claim pension credit and the winter fuel payment) is in the process of being increased from 60 to 65 by 2018 to align it with the state pension age for men. Under current law, the state pension age is then increasing to 66 between 2018 and 2020, 67 between 2034 and 2036, and 68 between 2044 and 2046.⁵² These increases in the state pension age slow the growth in the pensioner population, especially between now and 2020. However, during the 2020s, there is still expected to be a substantial increase, especially in Scotland. The central projection is for the fraction of the population aged over the state pension age in Scotland to increase from 19.8% in 2011 to 19.9% in 2021, 22.4% in 2031 and

⁵² Note that the government plans to bring forward the date at which the pension age increases from 66 to 67 to 2026–2028, but this has yet to be made law and is not reflected in the 2010-based population projections.

22.6% in 2051. In Great Britain as a whole, the projection is for the proportion of pensioners to *fall* from 19.5% in 2011 to 19.1% in 2021, before rising to 20.9% in 2031 and 21.0% in 2051.⁵³

Later this year, IFS will be publishing an analysis of how this demographic change may affect public spending and the public finances in Scotland. This will include projections of the amount spent on benefits both for people aged over the state pension age and overall. However, the more rapid growth in the elderly population in Scotland, combined with the greater amounts spent on benefits for older people (largely in the form of state pensions, but also disability benefits) can clearly be expected to lead to more rapid growth in benefit spending in Scotland than in Great Britain as a whole, all else equal.

To get a feel of the potential magnitude of this change, let us assume that, apart from the increase in the proportion of people aged over the state pension age, all else remains equal. In particular, the relative amounts spent on pensioner versus non-pensioner families in Scotland and Great Britain as a whole remain constant. Note that, if anything, this is likely to *understate* the differential impact of population ageing on benefit spending in Scotland compared with Great Britain as a whole. This is because Scotland is expected to see a more rapid increase in the proportion of older adults below the state pension age (for example, aged 55 to 65), who receive more benefits per person than the average for working-age households due to higher rates of disability. Furthermore, as discussed in the previous section, the OBR expects the ‘triple lock’ to mean that the state pension will increase more rapidly than other state benefits; this would push up benefit spending in Scotland relative to Great Britain as a whole because of Scotland’s older and more rapidly ageing population.

However, the assumption does not lead to a *lower bound forecast* for benefit spending in Scotland relative to the rest of Great Britain, as many other things apart from demographics may change in future – including rents, average incomes and employment rates – and these may act to reduce benefit spending in Scotland relative to the rest of Great Britain. And, of course, the demographic projections on which our analysis is based are sensitive to assumptions about fertility, migration and life expectancy: it is possible that an independent Scotland might see higher (lower) fertility and net migration than presently

⁵³ 2010-based population projections available at <http://www.ons.gov.uk/ons/rel/npp/national-population-projections/2010-based-projections/index.html>.

projected, reducing (increasing) the extent to which its population will age.⁵⁴ Instead, using the above assumption allows us to conduct an indicative exercise to illustrate the kind of impact demographic change may have.

Under this scenario, estimated benefit spending in Scotland per person would be about 3% higher than the average for Great Britain as a whole in 2021–22, 4% higher in 2031–32 and 4% higher in 2051–52. This compares with benefit spending per person being 2% higher in 2011–12.

This means that even on relatively conservative assumptions, ageing looks set to add a bit more to the costs of Scotland's benefits bill than it does to that of Great Britain as a whole. This means that funding the benefits system in the decades ahead may prove somewhat more burdensome for an independent Scotland. It will also make undertaking major reforms of the benefits system perhaps even more difficult for Scotland than for the UK as a whole, as such reforms are either costly or create many losers. Like the UK, one option to ease the fiscal burden of the ageing population would be to make further *cuts* to benefits. Thus, whilst the government of an independent Scotland might undo some of the benefits cuts implemented by the current UK government (as Scottish government ministers have said they would do), it seems likely that this slightly more generous system could not be sustained in the long term without discretionary tax rises or further cuts to spending on public services.

7. Conclusions

In recent years, the amount spent on benefits per person has increased less quickly in Scotland than in Great Britain as a whole: spending per person has fallen from around 107% of the Great British average in 2005–06 to 102% in 2011–12, the last year for which data are available. A slightly older population, suffering greater levels of disability and ill health and paying lower housing costs, means that this average masks some more significant differences in spending on different types of benefits. Less is spent on housing benefits, child benefits and tax credits, and more on disability and old-age benefits, per person.

⁵⁴ The OBR's 2013 Fiscal Sustainability Report shows that assumptions about future levels of migration and the age structure of the population have a significant impact on the projected level of government spending and tax revenues, and thus the sustainability of the public finances in the long term, for the UK as a whole. Part of that impact will reflect differences in spending on benefits under different assumptions. See http://cdn.budgetresponsibility.independent.gov.uk/2013-FSR_OBR_web.pdf.

These differences are likely to become more pronounced in future, as Scotland is projected to age more rapidly than the rest of Great Britain. Given the concentration of benefit spending on the elderly, this relatively rapid ageing means, all else equal, that spending on benefits would rise more quickly in the coming years in Scotland than in Great Britain as a whole. This means that funding the benefits system in the decades ahead may prove somewhat more burdensome for an independent Scotland.

However, independence – or the devolution of benefits policy – would also provide Scotland with an opportunity to redesign its benefits system to reflect the priorities of the Scottish people, and to reassess some aspects of current UK policy that make little economic sense. But any major redesign of the system would either require Scotland to spend rather more on benefits than is spent now or else create large numbers of losers, who will typically have fairly low incomes. The difficult trade-offs between cost, generosity, work incentives and redistribution, and the rather difficult long-term fiscal outlook, mean that the Scottish government's new Working Group on welfare will face a challenging task when examining the potential medium- and long-term reforms to the benefits system of an independent Scotland.