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A Welfare State or an Insurance State?

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INTRODUCTION

The changing relationship between the Welfare State and the insurance industry has become a topical issue over the past few years. It is seen by the insurance industry as presenting scope for a huge amount of additional business. It is seen by some in Government as an opportunity for making the Welfare State more efficient and cutting public expenditure, and it is seen by some commentators as being disastrous for the poor and the needy.

This paper provides an overview of this crucial issue. It begins with a brief theoretical analysis and description of the current position, comments on why the issue has become important, suggests some new principles for the future of the Welfare State, analyses what role the insurance industry can play in a reformed Welfare State, considers the key issue of compulsion and then examines the major product areas of pensions and long-term care.

THE THEORY

There are lengthy philosophical tracts on the role of the State. This paper attempts to do no more than summarise generally agreed principles. The State has a role in protecting the country as a whole against outside attack and internally in maintaining law and order. The State has a role in providing what economists call public goods, that is products which by their very nature are best provided by a single supplier and which cannot easily be charged for on an individual basis, such as road systems and basic public health and education services. Finally, the State has a role in helping the most needy, which it achieves by redistributing income and wealth from the rich to the poor.

The Welfare State has been constructed in response to the last two points. That is, there is seen to be a benefit to the community as a whole if the costs of say healthcare and state pensions are borne not by those who cause the cost

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but rather by the community at large through taxation. Also, the poor are simply in no position to provide adequately for themselves. In deciding the boundaries of the Welfare State it is necessary to keep these two issues of public goods and income redistribution firmly in mind.

THE CURRENT POSITION

Today's Welfare State goes well beyond redistributing income from the rich to the poor and providing public goods. For example, child benefit is paid to all families with children regardless of their income, and everyone with the appropriate qualifying payment record qualifies for the full State pension, regardless of whether they are millionaires or penniless. Indeed, the State goes beyond providing a minimum income for everyone in retirement, and through the State Earnings Related Pension Scheme (SERPS) or the option of contracting out seeks to provide for each person an element of pension income that is related not to needs or wants but rather to earnings.

It is true that the Welfare State does redistribute income and wealth from the rich to the poor, but for the most part it simply takes from people and gives back to them. Some 75 per cent of National Insurance contributions are merely recycled to the same people with just 25 per cent redistributing income.

No one would claim that the Welfare State is perfect, and if we were starting again today we would not construct what we now have. The Welfare State has not developed in response to any great master plan or vision. Indeed, the only time there has really been a vision was in 1944 when the Beveridge Report was published. This was a response to a clear public demand that there should be no return to the social conditions of the 1930s. But the Welfare State that developed subsequently bears little relation to what Beveridge had envisaged. Rather, it has developed in response to particular circumstances which were felt by politicians, often responding to the media and public opinion, to be in urgent need of addressing. Occasionally it has been modified by the whims of politicians themselves, and also by changing circumstances, for example, through more people recognising that they have a right to a benefit and applying for it, therefore increasing the cost to the public purse.

However, the fact that the Welfare State is not perfect does not mean that we should destroy it and start again. No one who lives and works in London would argue that the transport system is efficient; surely it would be ideal if the M1 could be joined to the M23 and the M4 to the M11, but no one seriously suggests that we should go through the pain and trauma that this would entail. Similarly, radically altering the Welfare State would involve pain and trauma. While some may be willing to go through with this, not least those who will not suffer the pain and trauma, every attempt to alter the Welfare State by even a tiny amount is controversial. If change is pursued too far or too fast, it can lead to a political and public reaction that will actually make it more difficult to achieve change in the future. There needs to be an overwhelming case for change, and where change takes place it has to be carefully planned and prepared, with the media and the public being educated or softened up for the changes. Here, in passing, one cannot but admire the way Peter Lilley, Secretary of State for Social Security, has moved the boundaries of the Welfare

State over the last few years with scarcely any debate or opposition. Perhaps this is because the changes are mostly for the long-term and generally have not had an immediate impact. A change to SERPS entitlement in 20 years' time attracts little interest, even if of significant effect, whereas immediate changes to the benefit rules for asylum seekers cause an outcry. To a large extent it is the boundaries of the future Welfare State which have been moved.

THE CURRENT DEBATE

Why is the issue of the future of the Welfare State currently so topical? The facts seem very little different now than they were three or four years ago.

The ABI's initial approach to the issue was founded on the premise that in the year 1993/94 the public sector borrowing requirement (PSBR) was felt to be unreasonably high at around £50bn. Indeed, the ABI's early work to which the insurance industry generally signed up was described as 'PSBR'. There seemed to be an assumption that the PSBR was not sustainable and that the only solution was to cut back on welfare spending. This was, as is now recognised, a flawed argument. The PSBR was particularly high in 1993/94 for the same reason as it is always high at the trough of an economic cycle, and to the extent that the PSBR is a problem then it is not self evident that the solution is to cut welfare spending. Alternative solutions are to increase taxation and to cut spending in other areas which are less painful, for example, road building.

This argument is sometimes then changed to one relating to public expenditure or taxation. It is simplistically argued that the nation can no longer afford the Welfare State and that therefore the private sector must provide. This argument is not tenable. The cost of helping the poor and the needy is much the same whether it is done by the State through the tax system or by any other means. The more plausible argument is that there is concern over the high level of taxation, and that the public would rather spend its own money than have the State spend it for them. This is true at the micro level, a point that will be developed subsequently, but it is questionable whether it is true for the nation as a whole. Opinion surveys consistently show that the public would rather pay more tax in exchange, for example, for better health and education services.

This general line of argument is therefore not very valid. More validly it is linked with what is described as the 'demographic time bomb', that is that the ageing of the population will bring about intolerable pressures through the increasing cost of State pensions.

It is true that there are demographic trends which are a proper cause for concern, but use of the expression 'demographic time bomb' is to sensationalise unnecessarily. The UK, like every other country, has an ageing population. Currently, 10.3 million people are aged over 60. The number will stay at that level until around the year 2000 and will then increase fairly sharply to 11.7 million in 2010 and to 13.5 million in 2030. As a percentage of the population the increase will be from 20.8 per cent in 1990 to 29.6 per cent in 2030. Clearly this has significant implications. However, from a comparative point of view Britain is well placed. Britain currently has one of the highest proportions of the population aged over 60 but by 2030 it will have one of the lowest. Germany and Italy currently have a slightly smaller percentage of the population aged over 60, but by 2030 both will have more than 35 per cent of their population in this age category.

A recent comprehensive OECD study[1] examined this issue in some detail. It noted that in the seven major industrial countries elderly dependency ratios were projected to double by around 2030 to 2040 before stabilising or falling slightly. In Japan, France and Germany elderly dependency ratios are projected to peak at around 0.6 and in Italy at over 0.7, but in the UK, as in Canada and the USA, the peak is likely to be between 0.4 and 0.5.

Serious studies have been done on the effect of the 'demographic time bomb' purely in the UK context, and there is a reasonable line of argument that suggests that the ageing population can be accommodated by the present social security system with only a modest increase in taxation, one that the public may well be willing to bear. In his comprehensive study John Hills concluded:[2]

> There is no 'demographic' time bomb which will cause an unsustainable explosion of welfare costs.

He calculated that other things being equal, ageing by itself would imply an increase in Welfare State spending of 0.32 per cent a year for the next 50 years.

While the ageing population and, to a lesser extent, concerns about public expenditure have contributed to the debate on the future of the Welfare State there is, I believe, a third and more significant factor. The attempt to push back the boundaries of the Welfare State is closely related to the forces that have brought about privatisation in Britain and elsewhere, the end of communism in Eastern Europe and the development of new Labour in Britain and its equivalent in other countries. There has been a fundamental change in political and public opinion in the same way that there has been a change of attitude towards say smoking, drink driving and what the public wish to read and see in tabloid newspapers. That fundamental change is a recognition that however efficient the State might be, competition invariably provides a better service to the customer and that people value personal ownership and identification of their wealth in all its forms and have little time for any notion of a social wage with a right to something from the State in the future.

This conclusion should not be greatly startling. There is a wealth of research to support it from all over the world. Indeed, if I can go back to a previous area in which I had a lively academic interest, there is strong empirical evidence to support the notion that poor people in third world countries who have virtually no income and no wealth are willing to save by various means (including the acquisition of cattle) if the outcome of that saving is a home of their own.

The driving force for the debate on the future of the Welfare State is not related to the need to cut public expenditure and taxation, but rather it is about the efficiency with which the State makes arrangements by which people are protected in old age specifically and in times of need generally. The State's role in this respect, as in rubbish collection and the provision of so many other services that used to be classified as public, should be that of facilitator and regulator rather than automatically as direct provider.

It may be helpful to comment here on an issue which has achieved some prominence over recent weeks, that is, the importance of funding future pension liabilities. I take a somewhat unfashionable view on this subject, drawing on my rather distant training as an economist and recalling the concept known as the fallacy of composition. Basically, this says, for example, that while any individual can, through his or her own efforts, move from being unemployed to being employed, this does not mean that every unemployed person can do so at the same time. Similarly, if an individual has a fully funded pension, then he or she is well-off compared with an individual who does not. A company which has fully-funded pension liabilities is better-off than a competing company which does not. But I do not believe the same is necessarily true for a country. Let us move ourselves forward to the year 2020 when many of us hope to be enjoying our retirement. What the British public will be able to consume in the year 2020 depends on what is produced in that year, what can be purchased with the proceeds of net overseas investments and also the proceeds from the stock of domestic capital such as roads, housing, schools, hospitals and so on. The key one of the three variables is what is being produced in the current year, and this changes over time partly in response to demographic trends. Taking a hypothetical society in which everyone is either aged over 65 or under 15, then even though there might be fully-funded pensions I doubt whether there would be a good standard of living. The pensioners' income would be heavily taxed to provide public services and the uncompetitive nature of the economy could well cause the value of pension funds to be sharply reduced anyway. Britain may have more money stashed away in funded pension schemes than all other countries in Europe put together, but this does not mean it is better placed to face the future than other European countries. What matters is the stock of fixed capital and the demographic position, and while Britain may be in a very strong position in respect of the latter, it is not so in respect of the former.

THE NEW PRINCIPLES FOR THE WELFARE STATE

Given this background, what should be the principles for the new Welfare State towards which we should be aiming, although perhaps never actually getting there?

A fundamental principle is that the State should, as far as possible, confine itself to doing what it alone can do, that is redistributing income from the rich to the poor and providing public goods. However, again the constraints on the State must be recognised. There is always pressure for the State to do more, and even to do so in an inefficient way. Taking one good example, if the State wishes to transfer income from the rich to the poor then an extremely inefficient way to do so is to exempt from Value Added Tax childrens' clothing and food, both of which have for a large part of the income range a positive income elasticity of demand, that is as income increases there is a more than proportional increase in expenditure. It would be more efficient for VAT to be levied on these goods at the full rate and for child benefit to be increased by the amount of the extra revenue raised. However, can one imagine the outcry if such a sensible policy was attempted.

A second fundamental principle is that the State has responsibility for establishing the right framework generally in which through private sector provision people take steps to provide for themselves in old age and times of need.

Thirdly, the boundary between the State and private provision needs to be clearly defined, reasonable and well understood. Here, there is an immediate problem. There are areas where this boundary already meets two of these criteria. For example, the State provides free education up to the age of 16 for every child and does not provide any rebate for those families who choose not to take advantage of this by sending their children to fee paying schools. Similarly, the State provides free medical treatment and provides no rebate for those who take out private medical insurance policies. People know precisely where they stand and there is only a tiny debate about the margins. However, in each of these two cases what we have is surely unfair. Should not those who make provision for themselves be entitled to some of their taxation back? There are other areas where people who do provide for themselves disqualify themselves from State benefit. For example, those who have made provision for their old age do not qualify for income support, those who have savings of above £15,000 do not qualify for income support and so on.

We can all agree that we want the State to confine itself to what it is best at—redistributing income, providing public goods, providing the right framework in which people provide for themselves and having a clear boundary between the Welfare State and personal provision which recognises that people must be treated fairly and equitably. The difficulty is in putting these laudable principles into practice, especially given the starting point.

THE ROLE OF INSURANCE—PRINCIPLES AND PRACTICAL ISSUES

Having set out principles for the development of the Welfare State, one can similarly set out the principles that should govern what the insurance industry can do. Insurance provides a good long-term savings vehicle for people who can save. It also provides an efficient means by which risks can be pooled so that the fortunate many help the unfortunate few. The insurance industry cannot seek to redistribute income from the rich to the poor, nor can the insurance industry give protection against certainties. For example, it cannot give very old people private medical or critical illness insurance and it cannot insure the unemployable against becoming unemployed.

Herein lies a problem for the insurance industry. The definition of what is insurable is not cast in stone, and there is room for debate not only between the insurance industry and the rest of the world but within the insurance industry. It is also certain that the insurance industry will come in for criticism about its policies towards the less fortunate members of the community. It will come in for even more criticism when its practices are in an area where the State is seeking to redraw the boundaries of the Welfare State. This was true, for example, in the long debate about the modest cutback of income support for mortgage interest. Creditor insurers were criticised for not being willing to provide insurance to people who did not qualify for mortgages. Participants in politically controversial issues should not be surprised if they are drawn into the political debate regardless of the rights and wrongs of the issue. The insurance industry must be prepared for this.

The industry must approach this issue with logic and common sense. There is no point in the industry talking about taking the burden off the State and insurance being a necessity but behaving in a way that does not enable these to be achieved. For example, the industry cannot talk about removing the burden of the State pension yet not be willing to provide products for people who have only the State pension. If the industry really wants to assist in moving the boundaries, in many areas it needs to go further down the income and socio-economic scale than it does at present, and this means simpler and cheaper products.

It is helpful to comment here on what will be a key public policy issue for the insurance industry in the next few years—genetic testing. Genetic science is developing rapidly in a way that enables people to be tested for their susceptibility to certain illnesses and also perhaps to give more reliable indications of life expectation. The industry has already been roundly criticised by a House of Commons committee, a government minister, geneticists generally and the media for its attitude to genetics. I would be inclined to add that it has also been justifiably criticised not so much for the line that is being taken but for the slowness to realise the importance of the issue and to address very valid concerns which reasonable people have. The issue is particularly important given the stated wish of the industry to change the balance between insurance and the Welfare State. What some commentators are seeing is the industry saying this, yet at the same time saying it would like access to information which will enable it to price bad risks out of the market. This does not seem a consistent line.

I am, of course, well aware that what I have described is inaccurate and simplistic, but it is a perception and perceptions matter. The industry is perceived as having been slow to understand the importance of genetics and slow to provide the reassurance that the public and commentators want. It may well be true that genetic information is another form of medical information but this is not the way that it is perceived. The industry will finalise a code of conduct in due course. This will include restating the current policy that members will not request any individual to take genetic tests as a condition of receiving insurance and it will restate the importance of confidentiality.

The public will, I suspect, be satisfied only when insurers generally commit themselves to being willing to provide basic insurance cover in connection with a mortgage up to say £50,000 or £100,000 without wanting to know any genetic information. The industry is not united on this. Some in effect take no account of any medical information for policies up to this amount as part of an endowment mortgage package. Indeed, one insurer has already announced that it will not be seeking genetic information for life policies of up to £50,000 in connection with a mortgage loan. Others take the view that this would mean the end of the world as we know it. This is a crucial issue for life insurance companies. It is not a matter solely for underwriters or medical advisers. It is a matter that properly should command the attention of the board and the chief executive of the company who have to consider not just the underwriting issues but also the wider issues in coming to a company policy and in contributing to an industry policy.

COMPULSION—ON THE INSURED AND THE INSURER

One feature of the current debate on the future of the Welfare State is the question of compulsion. The argument for can be simply stated. Taking pensions for example, if people do not save to provide for a pension in retirement then in effect the State is required to provide for them, if only to a limited extent, through taxation. This discourages people from making provision and is also unfair. The solution is to require people to provide for themselves. Frank Field MP has comprehensively and persuasively promoted this argument in his recent book.[3]

Sadly, the solution is not as easily stated as the problem. Let us take the question of pensions. Some have suggested that there should be a further compulsion on people to save for their retirement over and above what already exists through the State pension and SERPS. The most extreme argument suggests that people should be required to save 10 per cent of their income to provide a fund for their retirement. The immediate effect of this would be the same as an increase in the basic rate of income tax of 10 percentage points, not likely to be a vote winner at the next election and for this reason not featuring in any of the party manifestos. Moreover, it would take many years before the effects of such a provision could fully work through the system, and the main losers from such a change would be the poorest. If compulsion was introduced then most people would be no better off or worse off over the long term; the consumption that they would now be required to forego would be balanced by a higher income in retirement. But in the case of the poor this would not be true because they are already obtaining a State benefit in the form of income support for which they are not paying. They would in future be required to pay for this. The problem with compulsion is that it hits hardest at the poor, and to suggest that people who barely have enough income to survive as it is should be required to put aside 10 per cent of their earnings so as to reduce the need for State support for them in the long term is not an easy policy for any government to adopt.

Having said this, there will be moves towards compulsion over time, and here the industry needs to be very careful. Compulsion on people to obtain insurance cover invariably means compulsion, albeit indirectly, on the insurers to provide that cover. One need look no further than the motor market to see how this works in practice. It is a requirement on car drivers that they have Road Traffic Act insurance to protect not themselves but third parties. While there is no requirement on any individual insurance company to provide such cover, where people drive without insurance then the industry as a whole has to pick up the bill which currently is running at about £200m. a year. There is no reason to think that perceptions will be much different for those aspects of the Welfare State currently being subject to debate, although the outcome would be in the form of a pool rather than a 'Welfare State MIB'.

It is as well to look at the position in the USA as an example. The USA does not have the same public sector provision of medical services as does the UK. It is therefore not acceptable in the USA for private medical insurers to underwrite the way that they do quite legitimately in Britain.

This was usefully illustrated by Brian Atchinson, the Insurance Commissioner for the State of Maine, in a speech given to the International Association of Insurance Supervisors in October 1996. He pointed out that most states have enacted health insurance laws which include certain protections geared especially towards health insurance provided to small employers. There are restrictions on rating according to claims experience and the health status of employees. Several states now require community rating, that is a system whereby a carrier's rate does not vary according to claims experience, although in some cases variations are permitted based on age, geography and family composition. Laws also generally place restrictions on the extent to which carriers can exclude or limit coverage for particular illnesses of an individual, that is pre-existing conditions. People moving between employers governed by such laws can change coverage without facing exclusions. Several states also restrict rate variations as well as the use of pre-existing conditions in the individual health insurance market.

In the USA there are also compulsory insurance pools in many states in respect of windstorm, motor and inner city properties, areas where insurance is not compulsory but the states believe that everyone should have access to insurance while not being willing to provide it themselves.

These comments should be seen as being no more than cautionary. What the industry must never do is to urge the State to make it compulsory for people to buy products of the industry yet then deny everyone the opportunity to purchase insurance at reasonable rates. The issue needs to be handled in a sophisticated way bearing in mind that public and political opinion will invariably be against the industry, however strong the industry's case and however well it is put over, not only or primarily by the Association of British Insurers but rather by what individual companies say and, more importantly, do.

PENSIONS

Let me turn to the major issue, that is pensions. There is probably now fairly general agreement about the principles on which future pensions policy should be developed. This agreement extends across political parties, although there are differences on points of detail.

The basic State pension will continue to underpin pension provision. However, the level of the State pension is no longer a political battleground. While increasing the basic State pension may seem to be attractive, in practice it would not help the poorest pensioners as they would lose a corresponding amount of income support. In fact, the only people who would not benefit from an increase in the basic State pension would be the poorest pensioners who claim income support. There also appears to be general acceptance that SERPS cannot be revived such that the system could provide a meaningful second pension for many people. Basic problems with SERPS are its complexity, its pay as you go nature and the lack of any sense of individual ownership.

It follows that pension provision must increasingly come through personal provision—either occupational pensions or personal pensions or a combination of the two. The responsibility of the Government is to provide a satisfactory framework in which private pensions can develop, and moreover one that recognises the inter-relationship at the margin between State and private provision. There is no point, for example, in encouraging people to make significant sacrifices to build up a very modest personal pension if they finish up in exactly the same position as those who make no effort to provide for themselves and who instead benefit from income support.

The overall aim must be to build up the resources available to people in retirement through the accumulation of wealth and the transfer of income from the time of high earnings in employment to retirement. Housing is an important component of wealth, and the growth of home ownership in Britain and in many other countries over the last 20 or so years will be of substantial benefit to old people who need to draw on their wealth to maintain their income. Safe equity release schemes should be an important part of policy on retirement. This should be a significant market for insurance companies. Other financial assets, in particular the proceeds from life insurance policies, are also important. Many pensioners have access to income from investments and many also derive some income from employment. Pension income needs to be seen in this wide context. It is a significant part of the resources available to retired people but by no means the only part.

A similar flexible approach needs to be adopted with respect to the uses to which pensions can be put. At present, in Britain, a personal pension has to be taken, other than the lump sum, in the form of an annuity which can vary in accordance with the retail prices index and which can take account of the death of the holder so as to provide an annuity to a dependant. This is unnecessarily rigid. People use their pension income to pay for a variety of goods and services including, for example, healthcare costs, long-term care costs, food and shelter. There seems no reason why pension provision should not be more flexible such that certain insurance elements, in particular in respect of long-term care, can be offered as an optional extra.

Government policy in Britain, and no doubt in many other countries, has failed to produce a satisfactory framework for retirement provision. Pensions have been regarded as a matter for the Department of Social Security, and taxation for the Treasury (and the Inland Revenue). There has been little or no attempt to link pensions policy with tax policy. The Inland Revenue has zealously sought to apply tax rules for pensions.

Many people will enjoy a satisfactory retirement income through good occupational schemes, but nearly half the population are not in occupational pension schemes, and the structure of occupational schemes is less than satisfactory given the development of the labour market. Final salary schemes in particular involve a substantial cross subsidy between the young and the old, between those who work for a relatively short time in a company and those who stay for a long time, and between those without dependants and those with dependants. These tensions are not appropriate to a flexible labour market where people may have a variety of jobs, perhaps interspersed with periods when they are not employed. Final salary schemes are also complex and costly to administer for employers.

Personal pensions are a good concept in principle, recognising the more flexible labour market and also offering the advantage of clear personal ownership of pension entitlement, without the cross-subsidies and lack of transparency inherent in occupational schemes. However, the rules governing them are complex, and, partly because of that complexity, they are expensive for consumers. The concept of personal pensions would have been greatly enhanced if, when the right to opt out of occupational pension schemes was introduced in 1988, a requirement was placed on employers to contribute an equivalent amount to personal pensions.

Much of the complexity inherent in pensions derives from the requirements that have to be met to qualify for the favoured tax position, but pensions are no longer nearly as tax-favoured as they used to be. Broadly speaking, a pension scheme is a means of deferring income. Contributions to a pension scheme therefore attract tax relief but the proceeds, in the form of an annuity, are taxed. This is advantageous compared with investments, such as, say, bank or building society deposits or life insurance policies, where contributions are paid out of taxed income and the benefits are also taxed. However, the Government has introduced and extended instruments in which the proceeds are entirely tax-free. These include TESSAs, which have been rapidly transformed from being a supposedly regular savings vehicle to a method by which people can now hold £9000 forever in a tax-free account, and, more significantly, PEPs, which allow each individual to put £9000 a year into a variety of financial instruments with the whole of the income and the capital gains being tax-free for all time. A married couple who have taken full advantage of the annual PEP entitlements since the product was first introduced could now easily have a fund of between £150,000 and £250,000, building up on a tax-free basis, with the ability to take the proceeds at any time without incurring any tax liability. PEPs are as generous as pensions in terms of the tax treatment with the exception of the anomalous lump sum. PEPs are advantageous over pensions in that they are more flexible in relation to how much can be put in and how much can be taken out and when.

It is perhaps a sad commentary on the policies of the present government that the National Lottery, which transfers income from the poor to the rich, is regarded as a huge success, and that what tax breaks there are for savings go predominantly to middle and upper income people for short-term savings through PEPs and TESSAs.

PENSION REFORM

What then should be done to develop policy in relation to pensions and taxation in a way which enhances the ability of people to increase their resources in old age? The first essential is that whatever tax breaks are available should be biased towards provision for retirement. There is a variety of ways in which this could be done. For example, TESSAs could be extended such that a substantial fund could be built up with withdrawals being allowed only after the age of, say, 50 or 60. PEPs could be restructured so that investments would have to be held until a certain age or for a certain period of years before all of the tax benefit could be achieved.

A more radical, yet sensible, option would be to allow every person, regardless of their income, or lack of it, to put a minimum sum, say £6,000 a year, into a pension scheme of their choice. Such a provision would significantly simplify pensions as many of the current rules are designed to stop people contributing 'too much' to their pension. It is absurd that, say, a 30-year-old earning £30,000 a year, should be able to put no more than £5250 a year into a pension scheme but £9000 a year into a PEP. This proposal would be no more advantageous in tax terms than the present PEP arrangements.

Related to this option should be the removal of the present ban on people having both a personal pension and an occupational pension. Pensions law in this country still seems to assume that people have only one job in their lifetime. We all know that this is not the case. People move from employment where there is an occupational pension scheme, to self-employment, to being unemployed, perhaps to employment where there is a group personal pension and so on. Personal pensions are good value if they are held until retirement. They are not good value if cancelled after a few years, but many people are forced to stop paying into a personal pension because they have moved to employment where there is an occupational scheme or because they have become unemployed and are prohibited from making payments into their pension. Allowing people to have both occupational and personal pensions would simplify the pensions system and recognise current work patterns.

It is worth mentioning here that there is a more general need for simplification of pensions. The whole of the law and regulations governing pensions seems to assume that they are a bad thing and that people should be severely restricted in how much money they can have in a pension scheme with onerous rules applying to almost every aspect of the pensions business. This is all done 'to be safe'. It is worth asking the question of whether we actually needed the Pensions Act 1995. One of the most damaging features of the parliamentary process in Britain is the belief that every crisis has to be followed by legislation. Look at the Dangerous Dogs Act for an example of how not to do things.

Separately, or in conjunction with such a proposal, there is a strong case for a new form of funded second pension, a development which the Labour Party is considering. The essential features of such a new product should be personal ownership, simplicity and transferability between providers. Also, charges would have to be significantly lower than those which currently apply to many personal pensions. A government which did not want to go fully down the route suggested earlier in this section could, for example, introduce a new funded second pension which would allow every person to invest up to, say, £3000 a year in a scheme with an approved institution which might, for example, guarantee a maximum level of charges or even a minimum return. If there was clear individual ownership of such a pension and if people were free to transfer from one provider to another without penalty, then it follows that there would be little or no need to have the elaborate regulation of selling that now exists for personal pensions and which probably acts as a deterrent to some people establishing satisfactory pension arrangements.

LONG-TERM CARE

Currently, the major Welfare State policy issue is long-term care. It is interesting to consider briefly why this has become an issue. It has always been the case that many people require fairly intensive care during the last few months or years of their lives. This care has largely been provided within families. State assistance has been available for poorer families. In practice, however, some people needing long-term care were, in effect, catered for within the National Health Service. Hospitals have been seeking to use their facilities more efficiently and this has led to a reduction in the proportion of people needing long-term care being catered for within the hospital system.

The issue has also generated some political heat. This is because a relatively small number of people are affected, but the amounts of money are large. There have been some well documented cases of people having to sell their homes to pay for long-term care. Some have argued, albeit without much evidence, that it was always their understanding that the State would provide. Others are resentful because those who have not made provision for themselves get similar care funded by the State.

The Prime Minister has taken a personal interest in this particular subject which is as well given that no fewer than seven government departments are involved. He specifically mentioned long-term care in his manifesto for the Conservative Party leadership contest and in his party conference speech in 1995. The Chancellor announced some relatively minor measures in his 1995 budget, broadly speaking increasing the assets below which people are eligible for help from government for care in residential and nursing homes. At the same time, a consultation process began on a range of proposals to encourage people to make provision for long-term care.

The consultation exercise has been in two stages. Firstly, a team of civil servants has had detailed discussions with interested parties, including insurance companies, about their perception of the market and the products which can be offered. Secondly, following these consultations, a formal consultative document was published at the beginning of May. Significantly, the foreword to the document was by the Prime Minister.

The Secretary of State for Health, Stephen Dorrell, said that there were two objectives of the Government's proposals: to continue to offer targeted support to elderly people who are not able to meet the full cost of their care and to recognise the contribution made by those who plan for the future and reward them for thrift and responsibility.

The Government is seeking views on the possibility that final salary pension schemes could offer variable pensions which involve a smaller initial payment in return for a larger payment later on.

The main proposal is to establish a partnership scheme for people using an insurance policy or annuity to meet some of their long-term care costs. People who had financed some of their care costs through insurance or an annuity would receive extra protection for their assets in the means test for residential care applied by local authorities. The two main partnership options proposed are

(a) a partnership scheme which would disregard an extra £1.50 of capital for every £1 of insurance benefit paid out;

(b) a partnership scheme which would disregard an extra £1 of capital for every £1 of insurance benefit paid out, and an extra £15,000 of capital once the individual had funded his own residential care, with the help of insurance, for four years.

The Government's green paper marks a very welcome step forward, not only for long-term care but also for the debate on the Welfare State generally. The Government has consulted widely in producing the consultative paper and now we are in a process of open consultation. If, after all this exhaustive work, something cannot be produced which works, then this will be a sad reflection, not only on the government but also on the other interested parties, including the insurance companies.

It was widely expected that the Government would announce its proposals for long-term care in September. In the event, it has decided not to bring forward legislation in the present session of Parliament, perhaps because it feels that the legislation would not emerge in the way the Government wanted it. This is unfortunate but not a disaster. More time is available to get what is being proposed absolutely right, and I would hope that a draft bill will be at a stage such that the incoming government will be able to put it to Parliament.

CONCLUSION

The boundary between the Welfare State and the Insurance State is certainly shifting not, it has to be said, in response to anything that the insurance industry has said or has done, but rather in response primarily to changing political and public attitudes towards the role of the State. This is giving the insurance industry a great opportunity to expand the services that it offers to the British public, but with all opportunities come threats, problems, challenges and difficulties. The opportunity will not be realisable unless the problems are first overcome. The industry must anticipate the problems that will inevitably arise from seeking to take on responsibilities that currently are within the province of the state. Products must be attractive to people at the lower end of the income scale who are not usually sophisticated in terms of their ability to deal with complex financial products. The issue of genetics needs to be professionally addressed in a way that satisfies not just the insurance industry but outside commentators as well.

The prize at the end of the day may be very great for the insurance industry and, more importantly, to the British public, but it is a prize that has to be earned rather than one that is naturally going to fall into the laps of the insurance industry.

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