

Re-Engineering the Tax and Welfare Processes

by

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Introduction

*'The composition of this book has been for the author a long struggle of escape, and so must the reading of it be for most readers if the author's assault upon them is to be successful, - **a struggle of escape from habitual modes of thought and expression**. The ideas which are here expressed so laboriously are extremely simple and should be obvious. **The difficulty lies, not in the new ideas, but in escaping from the old ones**, which ramify . . . into every corner of our minds.'*

J.M.Keynes

There is a general consensus at present that 'radical things must be done' with the tax and welfare processes, but great controversy as to what those 'radical things' could or should be. Unfortunately, because of limited public attention spans when compared to the perceived complexity of the issues, propositions are typically presented using the current hotchpotch of administrative processes as the frame of reference, and it is often difficult to distinguish form from substance through the fog of terminology and inter-dependencies. How many people really understand the relationship between Income Tax and National Insurance Contributions, or the relationship between tax-allowances, tax credits and benefits, or the relationship between all the different taxes, or the relationship between all the different benefits, or the relationship between taxation and the means-testing of benefits? Indeed, how many welfare professionals, financial-services professionals and regulators could genuinely claim to be able to articulate their understanding of these relationships to the general public, or even to understand these relationships in the first place?

However, the **underlying concepts** themselves are **not** complex. The perception that they **are** complex arises mainly from the perverse and spurious complexity of many of the current administrative processes which most people, by default, use as the frame of reference for their understanding. Too many people are suffering from 'bureaucratic alienation', give up trying to understand, and simply 'go with the flow'. They have to presume that the 'experts' know what they are doing, and have the community's best interests at heart, when all the evidence suggests that most 'experts' are renown (and remunerated) not so much for their **fundamental insights and goodwill**, but for their expertise in the use (and/or abuse) of the **current administrative processes**. At best, the 'experts' have a conflict of interest in commenting on radical analysis and propositions for reform.

This review presents the case for radical re-engineering of the tax and welfare processes. Process re-engineering differs from conventional systems-development:

1. Conventional systems-development reviews what is currently being **done** and seeks a better way of doing it.
2. Process re-engineering seeks a deeper understanding of the nature of the issues under consideration, and what is to be **achieved**, and then seeks a better way of achieving it.

By addressing and resolving issues more directly 'at source' rather than having a sequence of processes accommodate incoherent inter-dependencies, successful process re-engineering leads not only to a more rational, accurate, flexible and sophisticated resolution of the fundamental issues and requirements, but also to much simpler and more transparent processes.

The requirement for simple transparent processes in a liberal democracy should not be underestimated. If liberal democracy is to survive and prosper, and if we citizens are to

prosper in liberal democratic regimes, it is essential that social justice is not only done, but is seen and **understood** to have been done. Without a solid base of coherent insight and understanding amongst the general population, the policy debate in a democracy will always be limited to what a politician can get into a sound-bite. With coherently re-engineered processes, we can hope to dispel 'bureaucratic alienation', raise the integrity of propositions and debate, and build the sense of one-nation community essential to the success of democracy.

The ultimate objective of process re-engineering is of course to define propositions for implementation to improve transparency and administrative efficiency. However, the more immediate objective is simply to define a clearer frame of reference from which economists and politicians can develop and argue their policies. By working from radical analysis through to definition of administrative processes more closely aligned to the fundamentals, process re-engineering techniques can introduce new insights into the economic and political debates, and thereby facilitate an escape from the policy and process inheritance and from 'habitual modes of thought and expression'.

With regard to tax and welfare processes, there are two critical issues to be addressed:

1. The first critical issue relates to the spurious complexity of the overall provisions related to **income**.
 - a. The complexity of the administration of tax (including Income Tax and National Insurance Contributions) arises from the desire to project an impression of 'progressive' marginal rates, particularly for low/no income citizens (with propositions such as 'take some low earners out of the tax net altogether').
 - b. The complexity of the administration of benefits (including National Insurance Benefits, Tax Credits, Housing Benefit, and Council Tax Benefit) arises from the need to means-test them against income (at a dis-jointed aggregate rate of up to approximately 90%).

In practice, the latter neutralises and reverses the effect of the former. Thus, it does not make sense for the Inland Revenue (for Income Tax) and the Contributions Agency (for National Insurance Contributions) to devise independently their own rather complex regimes for progressive marginal rates, and for employers to administer those rather complex regimes for progressive marginal rates, when the Inland Revenue (for Tax Credits), the Benefits Agency (for National Insurance Benefits) and local government (for Housing Benefit and Council Tax Benefit) **must** neutralise and reverse the effect of those progressive marginal rates for all the people to whom they were directed with such good intentions (i.e. for those with no/low income).

2. The second critical issue relates to the spurious complexity of the overall provisions related to **wealth**. All civilised societies provide some form of minimum-income safety-net (for periods including, but not limited to, old-age). Unfortunately, there is a 'moral hazard' inherent in any safety-net, whereby 'marginal' citizens are induced to 'sag' into that safety-net. We must seek to moderate that 'moral hazard' without blighting the lives of those with genuine need.

This paper argues that if reform is to have any meaningful chance of progress on these issues:

1. The means-testing of benefits against **income** must be merged into re-engineered ‘tax’ processes:
 - a. In order to improve the fluency of means-testing against income, that means-testing must be executed **reactively, rapidly and automatically** (i.e. in the light of **de-facto income on a rolling basis**, rather than during the assessment process based on ‘best guesses’).
 - b. In order to provide the data to facilitate such reactive, rapid and automatic means-testing against income, all sources of income must report that income to the state systems **rapidly and by recipient**. In particular, employers must report **earned** income to the state systems **rapidly and by recipient**.
 - c. In order to moderate the administrative burden of reporting earned income to the state systems **rapidly and by recipient**, the administration of employment must be simplified radically. This report suggests that employers should be obliged simply to ‘withhold’ from all of that income at the mid-income marginal rate of Income Tax and Contracted-Out National Insurance Contributions, without allowances or graduation.
 - d. All state systems must execute all payments to/from citizens by automated transfer to/from a ‘bank current account’.

Then, and only then, the state systems would be in a position to generate automated transfers to achieve the desired post-state income as a function of pre-state income on a rolling basis:

2. The means-testing of benefits against **wealth** must be merged into re-engineered ‘pension’ processes:
 - a. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate net-wealth.
 - b. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking asset transfers from the state. The pressing short-term cash-flow aspect of means-tested benefits should be de-coupled from the process of writing-off that cash-flow as non-recoverable. Means-tested benefits should be offered much more fluently, but initially as loans. Such loans should then be reviewed for write-off or recovery (from other net-wealth and/or anticipated income); with a rolling accounting time-base of perhaps three to five years, and with a final review on death with a claim against the estate.

With these two sets of re-engineering propositions implemented:

1. The administration of employment (and of all other sources of income) would be simplified radically.
2. The administration of means-testing of benefits against income would be would be simplified radically:
 - a. All ‘second guessing’ of means-testing against income could be eliminated from all benefit-application processes.
 - b. All means-testing of benefits against income would be administered automatically and reactively in line with de-facto income.
 - c. All discontinuities in the mean-testing of benefits against income would be eliminated, replaced by a single flat rate encompassing all benefits.
3. The administration of means-testing of benefits against wealth would be would be simplified radically.
4. The administration of ‘pensions’ would be simplified radically.
5. The ‘moral hazard’ of a minimum-income safety-net would be moderated.

As a final note, this paper does not extend specifically to discussion about the terminology and political packaging undoubtedly required to secure the consensus for implementation in a liberal democracy. The requirement for such terminology and political packaging would have to be decided in the light of the prevailing political climate.

1 Taxation, and Means-Testing against Income

A later section proposes that the means-testing of benefits against **wealth** should be merged into re-engineered 'pension' processes.

This section proposes that the means-testing of benefits against **income** should be merged into re-engineered tax processes.

1.1 The Inevitable Economic Characteristics of Citizens' Income

The characteristics of the current scheme in the UK for social moderation of citizen's income, and indeed the inevitable overall characteristics of **any** such scheme, are characterised in broad terms below and in the diagrams overleaf. The full range of pre-state incomes can be split roughly into three bands with the following characteristics:

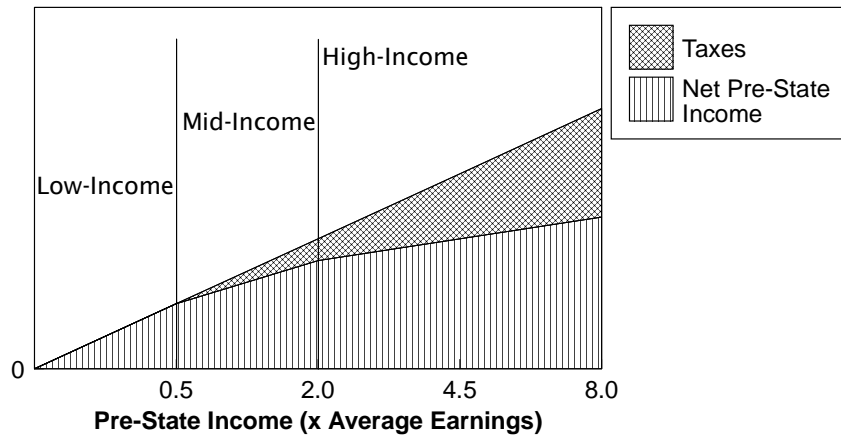
1. A no/low-income band (0.0-0.5 x average):
 - a. Citizens in this band are net cash beneficiaries from the state; in that cash benefits received are greater than taxes paid.
 - b. The income of citizens in this band is subject to a very high marginal rate of tax/means-testing (up to approximately 90%, based primarily on the means-testing of benefits).
 - c. Citizens in this band tend to have short-term cash-flow problems; to cover essentials such as housing, heating and food.
2. A mid-income band (0.5-2.0 x average):
 - a. Citizens in this band are net cash contributors to the state; in that taxes paid are greater than cash benefits received.
 - b. The income of citizens in this band is subject to a moderate marginal rate of tax.
3. A high-income band (2.0+ x average):
 - a. Citizens in this band are net cash contributors to the state; in that taxes paid are greater than cash benefits received.
 - b. The income of citizens in this band is subject to a higher marginal rate of tax.

In the UK at the turn of the millennium, these characteristics are implemented through the following two groups of administrative processes:

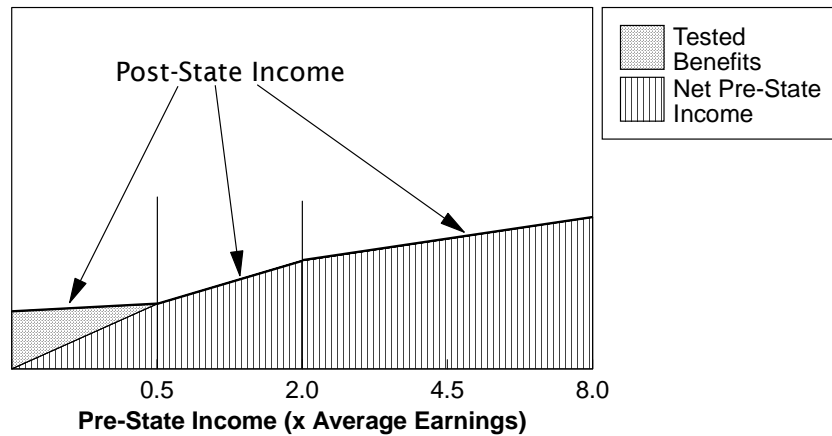
1. Taxes (i.e. Income Tax and National Insurance Contributions) are levied at increasing marginal rates from Income.
2. Means-tested benefits are distributed to boost no/low income.

The impact of this combination of processes is illustrated for earned income in the diagrams below.

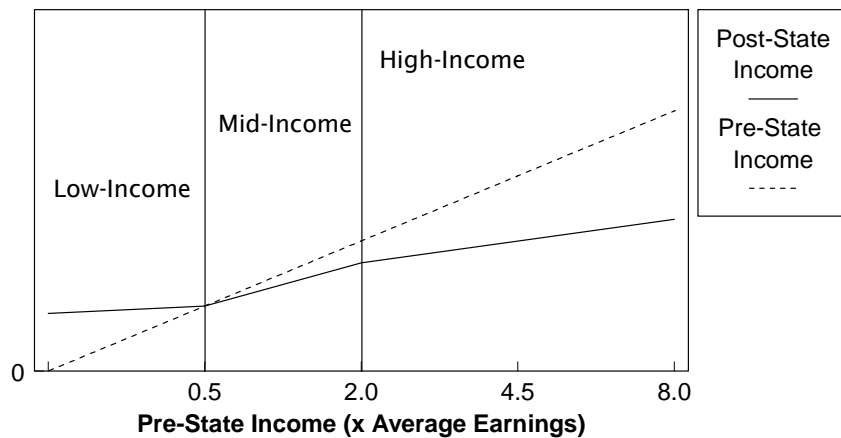
Current Administrative Processes - 1. Employment



Current Administrative Processes - 2. State Adjustment



Tax and Welfare Cashflows- The Inevitable Characteristics



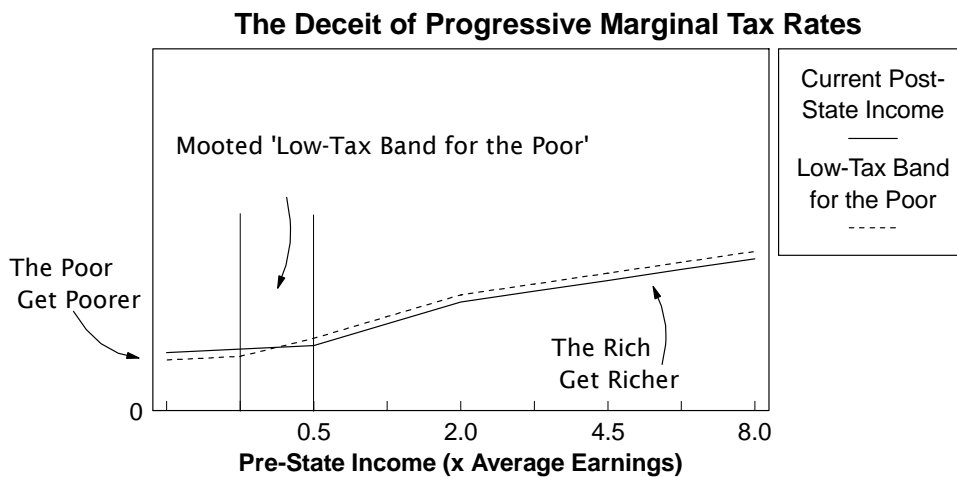
1.2 The Deceit of 'Progressive' Marginal Rates of Tax

It is an economic truism that if adequate 'social' support is to be offered to those without adequate resources of their own, then that support **must** be withdrawn at very high effective rates. It is the **avoidable** discontinuities, anomalies and wrinkles in the current administration, on top of this **unavoidably** high **average** rate, which are responsible for the worst excesses of the unemployment and poverty traps. Honest reform should aim solely to remove the avoidable discontinuities, anomalies and wrinkles; through some form of flat-rate 'Benefit Surtax' levied from those receiving means-tested benefits.

Indeed, it is an economic truism that 'low-tax bands for the poor' (including earnings disregards, tax allowances and the current 10% band) can help only the rich. The following statements hold true with respect to any proposition to lower the rate in a given income band:

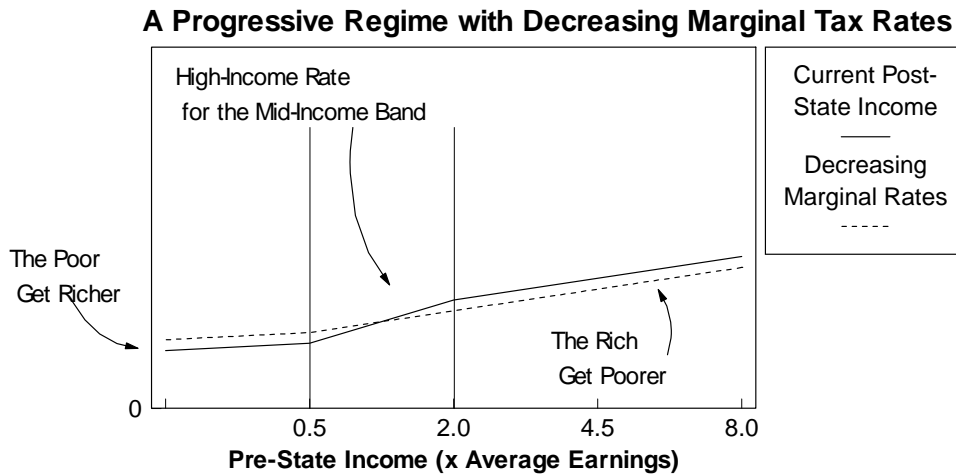
1. They provide nothing for those whose marginal income is under the lower limit of the band.
2. They provide an increasing bonus to those whose marginal income falls between the lower and upper limits of the band.
3. They provide the full bonus to all those whose marginal income is over the upper limit of the band.

In fact, in order to define a revenue-neutral proposition (a pre-condition for honest debate), the poor must be made worse off through reduced benefits in order to raise the revenue to pay the bonus for the rich! The diagram below illustrates the economic impact of a reduced tax rate for the top half of the no/low-income band (e.g. a reduction from 90% down to the mid-income marginal rate).



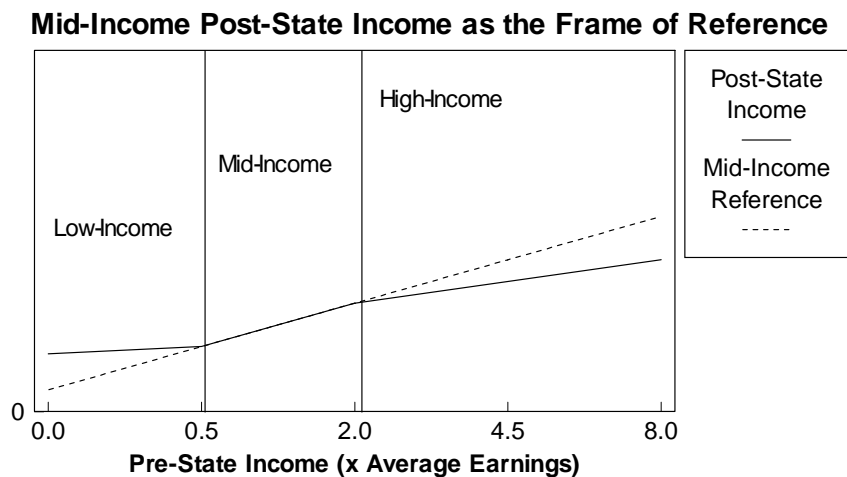
These arguments apply to all notions of 'low-tax bands for the poor' (including earnings disregards, tax allowances and the current 10% band), and also to all notions of graduation of National Insurance Contributions.

In fact, using the high-income rate as a frame of reference, even the mid-income rate can be seen in the same light. The diagram below illustrates the economic impact of increasing the tax rate for the mid-income band to that of the high-income band.



There is of course a strong emotional and intuitive appeal to propositions expounded with phrases such as 'take some low earners out of the tax net altogether', and to the possibility of extensions to the earnings disregards, tax allowances and the current 10% band 'for the poor'; with the implication that these propositions would in some way address the problems of those without adequate resources. In practice of course, all those 'out of the mid-income tax net' (at approximately 33%) are 'in the means-testing net' (at 90%), and it is dishonest to separate these issues. In fact, as described earlier, every 'low-tax band for the poor' makes the underlying problem worse. Thus, the concept of progressive marginal rates of tax on income is a deceit; and a wholly incoherent vehicle for delivery of provision for social distribution. We should be looking instead for a **progressive overall regime** based on **decreasing marginal rates**.

As illustrated in the diagram below, those in the no/low-income band are not only net beneficiaries from the state, they are beneficiaries even when compared to the equivalent of the mid-income line projected down through the no/low-income band.



Thus, it does not make sense for the Inland Revenue (for Income Tax) and the Contributions Agency (for National Insurance Contributions) to devise independently their own rather complex regimes for progressive marginal rates, and for employers to administer those rather complex regimes for progressive marginal rates, when the Inland Revenue (for Tax Credits), the Benefits Agency (for National Insurance Benefits) and local government (for Housing Benefit and Council Tax Benefit) **must** neutralise and reverse the effect of those progressive marginal rates for all the people to whom they were directed with such good intentions (i.e. for those with no/low income).

In practice, this spurious complexity is compounded by the fact that each 'scheme' appears to have been designed and developed by happenstance, in the absence of any perceived need to standardise. As a result, the current tax processes places an unacceptable administrative burden on employers; because of the need to administer an individual Tax Code for each employee, progressive marginal rates of Income Tax (on a cumulative-yearly accounting time-base) and progressive marginal rates of National Insurance Contributions (on a mixture of weekly, monthly and cumulative-yearly accounting time-bases) in the presence of a great deal of 'churn' in the employee base. Meanwhile, the Inland Revenue (for Tax Credits), the Benefits Agency (for National Insurance Benefits) and local government (for Housing Benefit and Council Tax Benefit) appear to be inflexible and inaccurate in their administration of means-testing (based on a variety of accounting time-bases).

But perhaps the most serious source of spurious complexity lies in the need to means-test benefits. Unfortunately, the processes which administer benefits do not have access to data reflecting income on a timely basis. In fact, no state system has access to data reflecting income on a timely basis. Of course, the Inland Revenue **eventually** has access to such data, but only for the previous tax year, and only when all the relevant data from that year has been submitted and collated. Thus, in current practice, all benefits are means-tested 'up front'; based on 'best guesses' as to future income, and the means-testing of each benefit has to be revised (independently, and clerically) as current and projected circumstances change (frequently, for citizens in the no/low-income band). Again, the means-testing process in each 'scheme' appears to have been designed and developed by happenstance, in the absence of any perceived need to standardise. The result is that citizens in the no/low-income band have to live through a nightmare of inter-connected economic and administrative discontinuities.

Thus, the current processes cost a great deal to administer, constrain political and economic debate and scope for change, and deliver a very poor quality of service.

If reform is to have any meaningful chance of progress on these issues, the administration of taxation, benefits and means-testing **must** be re-engineered through a single state system as follows:

1. All sources of income must report that income rapidly to the state. In particular, employers must report earned income rapidly to the state. In order to moderate the administrative burden of doing so, the administration of employment must be simplified radically. All sources of income other than benefits must 'withhold' from all of that income at the mid-income marginal rate of Income Tax and Contracted-Out National Insurance Contributions, without allowances or graduation, and must report that income and withholding rapidly to the single state system.
2. All awarders of benefits must award on the presumption of no income; and must report those awards rapidly to the single state system.
3. The single state system would then be in a position to generate timely automated debits and credits to achieve the desired post-state income of each individual and/or

family unit on a rolling basis.

1.3 Flat-Rate Taxation, and Tax Credits

The analysis of the previous sections suggests that the 'inevitable economic characteristics' of tax and welfare should be implemented through the following set of administrative processes, to generate timely automated debits and credits to achieve the desired post-state income of each individual and/or family unit on a rolling basis.

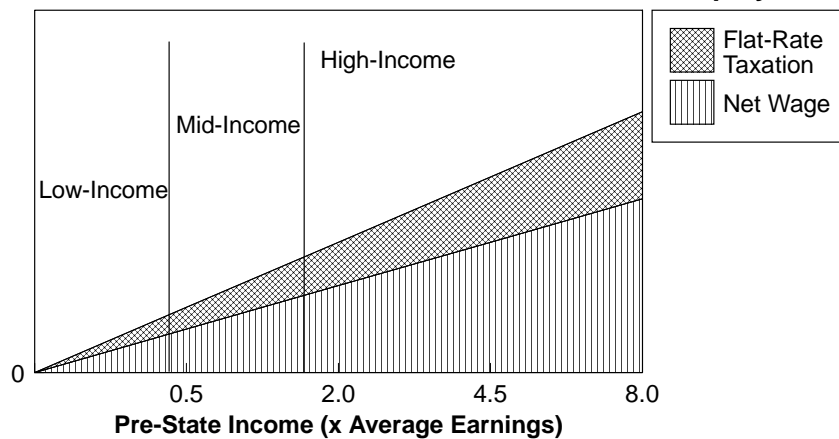
Tax and welfare agencies would co-operate to define the parameters of the required system:

1. Tax agencies would define a **Universal Income Tax** (equivalent to the current mid-income marginal rate of Income Tax plus the current mid-income marginal rate of National Insurance Contributions).
2. Tax agencies would define a **Basic Tax Credit** to restore the post-state income of those in the mid-income band. These Basic Tax Credits would encompass the current value of Child Benefits, the value of the Basic Pension, and the value to citizens in the mid-income band of Personal Allowances from Income Tax and National Insurance Contributions.
3. Tax agencies would devise a scheme of escalating high-income marginal tax rates.
4. Benefit agencies would define a minimum acceptable level of income for each family-unit, and would subtract the value of the Basic Tax Credits of all of the members of that family-unit. This would define a means-tested **Supplementary Tax Credit** for each family unit.
5. Benefit agencies would define a single aggregate means-testing rate (at approximately 90% minus the rate of the Universal Income Tax).

Then:

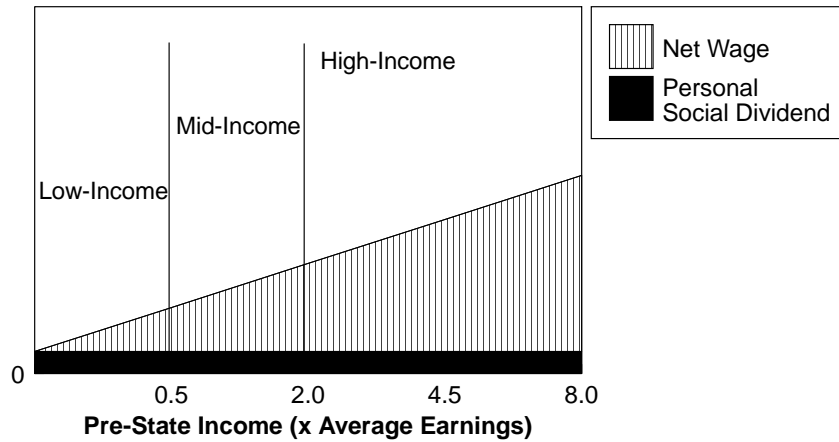
1. All sources of income other than benefits would withhold from all of that income at the mid-income marginal rate, without allowances or graduation, **and would report that income rapidly to the state system.**

Flat-Rate Taxation Administrative Processes - 1. Employment



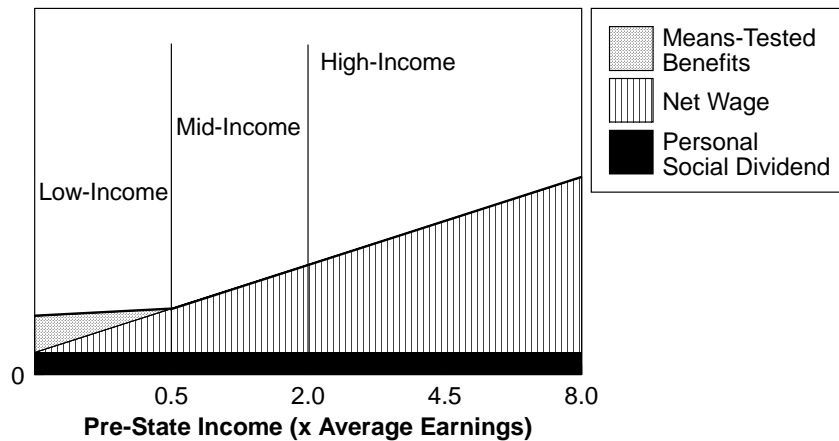
2. For each citizen, the state system would pay the Basic Tax Credit (depicted here as a Personal Social Dividend). This would restore the current post-state income of those in the mid-income band.

Flat-Rate Taxation Administrative Processes - 2. Personal Social Dividend



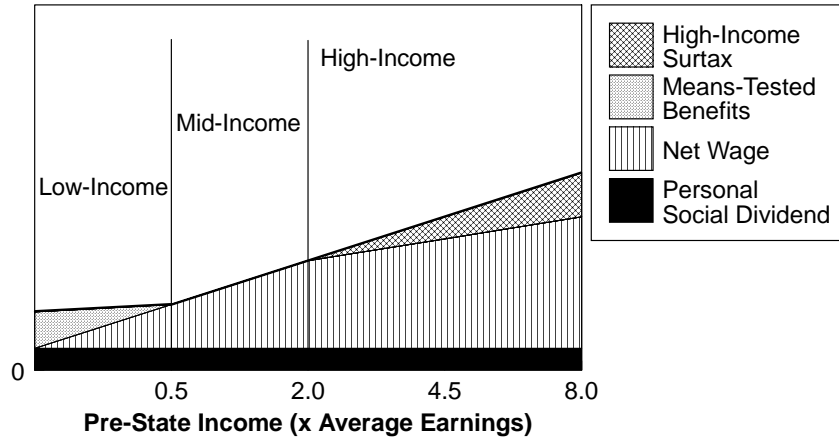
3. The state system would pay means-tested Supplementary Tax Credit to each no/low-income family-unit claiming them. **Because all sources of income would report that income rapidly to the state system**, the state would be in a position to means-test Supplementary Tax Credit automatically and reactively in line with the de-facto income of the members of that family-unit. This would restore the current post-state income of those in the no/low-income band.

Flat-Rate Taxation Administrative Processes - 3. Means-Tested Benefits



4. The state system would levy high-income Surtax. **Because all sources of income would report that income rapidly to the state system (see earlier)**, the state would be in a position to levy high-income Surtax automatically and reactively in line with all of the de-facto income of the members of each individual or family-unit, rather than just the earned-income from the primary earned-income source. . This would restore the current post-state income of those in the high-income band.

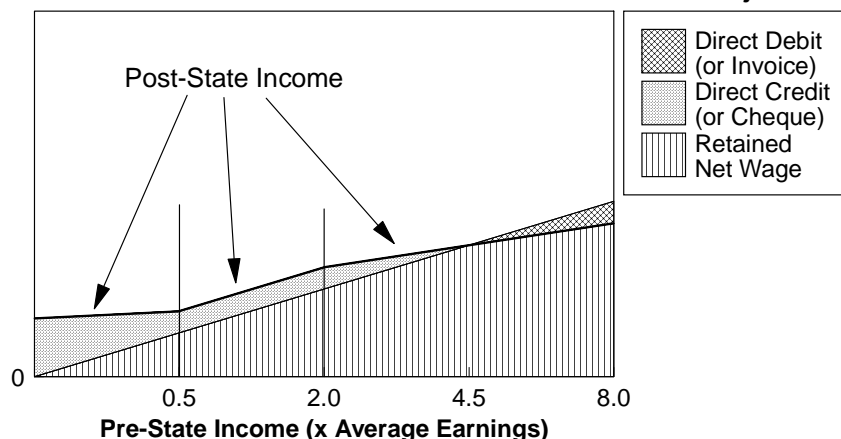
Flat-Rate Taxation Administrative Processes - 4. High-Income Surtax



In cash-flow terms, the State system would generate a regular sequence of adjustment payments/charges to the home-maker of each family-unit; to implement 'the right result' on a rolling basis; including the following elements:

1. The Basic Tax Credits of all of the members of that family-unit.
2. Supplementary Tax Credit means-tested in line with de-facto income.
3. High-income Surtax levied in line with all de-facto high income, rather than just the earned-income from the primary earned-income source.

Flat-Rate Taxation Administrative Processes - 5. Net State Adjustment



1.4 Housing Benefit and Council Tax Benefit Based Purely on ‘Need’

To the extent that benefits are extended in proportion to actual expenses, potential beneficiaries will be encouraged to ignore economic imperatives in their spending behaviour. For example:

1. With Housing Benefit based on actual rent, tenants will be encouraged to collude with landlords in committing to a housing rent beyond their means.
2. With Council Tax Benefit based on actual Council Tax, voters receiving Council Tax Benefit will vote for high spending safe in the knowledge that they will not suffer from the costs.

Thus, Housing Benefit and Council Tax Benefit should ideally be based purely on ‘need’, rather than on actual rent and council tax. In order to moderate ‘ghettoisation’, they should be based purely on family formation and post code; along the lines of the current Local Housing Allowance (LHA) initiative. The post-code variations would allow for variations in local rents and other living costs.

1.5 Tax Credits

Currently, there are a number of different benefits aimed at supplementing the income of those in the no/low-income band. There is a great deal of spurious activity devoted to ‘thrashing’ between those benefits. However, most of the differences between those benefits are based on false assumptions about entitlement and means-testing. In terms of practical effect, tax allowances and benefits could be rationalised as follows:

1. Non-means-tested **Basic Tax Credits** (based purely on age) could replace the value of the following:
 - a. Child Benefit.
 - b. The value of the current allowances against tax.
 - c. The Basic Pension.
 - d. The mid-income ‘non-means-tested’ part of the Working Tax Credit.
 - e. The mid-income ‘non-means-tested’ part of the Child Tax Credit.
2. Means-tested **Supplementary Tax Credits** (based on age, family formation and post code) could replace the value of the following:
 - a. Income Support minus by the value of the Basic Tax Credit.
 - b. Incapacity Benefit minus by the value of the Basic Tax Credit.
 - c. Job Seekers Allowance (Contribution Based) minus by the value of the Basic Tax Credit.
 - d. Job Seekers Allowance (Income Based) minus by the value of the Basic Tax Credit.
 - e. The no/low-income ‘means-tested’ part of the Working Tax Credit minus by the value of the Basic Tax Credit.
 - f. The no/low-income ‘means-tested’ part of the Child Tax Credit minus by the value of the Basic Tax Credit.
 - g. Housing Benefit (based purely on family formation and post code, rather than on actual rent).
 - h. Council Tax Benefit (based purely on family formation and post code, rather than on actual Council Tax).

These Supplementary Tax Credits could be means-tested automatically and reactively against de-facto income at a single aggregate flat rate of approximately 90% minus the rate of the Universal Income Tax which would have been levied on all income at source.

2 Pensions, and Means-Testing against Wealth

The previous section proposed that the means-testing of benefits against **income** should be merged into re-engineered tax processes.

This section proposes that the means-testing of benefits against **wealth** should be merged into re-engineered 'pension' processes.

2.1 Response to the Pensions Commission

The following comments are offered as a response to the First Report of the Pensions Commission, published in 2004:

1. The Report places major emphasis on aggregate, average and median figures. However, the sole social imperative relates to the likely incidence of poverty, and poverty is a very **personal** thing. Aggregate, average and median figures are of merely peripheral interest. One citizen with an annual income of £1 million and 99 citizens with an annual income of nothing leaves us with an average annual income of £10,000 but 99% of the population living in abject poverty. Thus, the Commission should ignore the wealthy, should ignore aggregate figures, and should focus solely on the outlook for those tracking to 'sag' into poverty. All civilised societies provide some form of minimum-income safety-net (for periods including, but not limited to, old-age). Thus, the Commission should focus **primarily** on the following:
 - a. At what level should we set the minimum-income safety-net (which ought to be the boundary of our concern); based on age, family formation and post-code ?
 - b. How many citizens are tracking to 'sag' into that minimum-income safety-net, and by how much ?
 - c. How do we moderate the 'moral hazard' inherent in any safety-net provision, whereby citizens are induced to 'sag' into that safety-net ?

2. Citizens can accumulate net-wealth without state intervention. State intervention can range through the following:
 - a. Education and exhortation.
 - b. Tax wrinkles.
 - c. Compulsion.

Of the above:

- a. Education (definitely) and exhortation (possibly) would be counter-productive in the context of ‘the pensions conundrum’, simply because they would merely highlight the self interest of the ‘moral hazard’. The state would have to lie and/or obfuscate, or advise no/low-income citizens to spend their savings and ‘sag’ into the minimum-income safety-net. In addition of course, education and exhortation is irrelevant for those who have too little to consider saving.
- b. Tax wrinkles are merely ‘giveaways’ to those who would save anyway, with bribes in proportion to net-wealth and income – the very opposite of the social imperative. The classic example is the Stakeholder Pension, the majority of which have been taken out by the non-earning partners of surtax payers.
- c. Compulsion is the only option which addresses the ‘moral hazard’.

Thus:

- a. Education and exhortation, whilst worthy objectives in their own right, should be discounted as a deceit in the context of ‘the pensions conundrum’.
- b. All tax wrinkles should be discontinued, and the currently-squandered resources should be re-directed into increased basic benefits.
- c. Accumulation of net-wealth from income should be compulsory.

3. The Report places major emphasis on ‘retirement’. However, to a very large extent:

- a. Poverty **in** old age is simply a continuation of, and a natural and inevitable consequence of, poverty **before** old age.
- b. As employment has become more disjointed, all citizens face periods without earned income (for periods including, but not limited to, old-age).
- c. With improvements in health, and the consequential increase in life expectancy, the boundary between ‘working’ age and ‘retirement’ age has become diffused.

Thus, the Commission should drop the concept of ‘retirement’ altogether. The following definition suggests itself:

- a. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate net-wealth.
- b. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking income support from the state.

4. The Report places major emphasis on ‘pension’ schemes. However, all ‘pension’ schemes comprise an ‘accumulation of net-wealth’ phase (i.e. through contributions) and a ‘dissipation of net-wealth’ phase (i.e. through income drawdown and/or purchase of annuities). Informed opinion has already drawn attention to the need to distinguish clearly between those two phases. Indeed, informed opinion has already emphasised that citizens should ‘shop around’ for the best ‘dissipation’ package when switching from one to the other. Thus, the Commission should drop the concept of ‘pension’ schemes altogether, and should consider independently the options for accumulation of net-wealth and the options for dissipation of net-wealth. Again, the following definition suggests itself:
 - a. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate net-wealth.
 - b. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking income support from the state.
5. The Commission should concern itself more positively with the fluency with which citizens can draw-down from their net-wealth. Citizens should be able to ‘borrow’ from the state to supplement their income whilst maintaining ownership of a ‘family’ home or business of ‘reasonable’ value. However:
 - a. Citizens should be obliged to liquidate more speculative investments before seeking to ‘borrow’ from the state in this way.
 - b. Any such ‘borrowing’ should be secured against the value of the ‘family’ home or business concerned, and should be recovered on death from the estate.
6. The Report places major emphasis on current contributions in proportion solely to income. However, the requirement must surely take account of current net-wealth and the time left for further contributions. The following extended definition suggests itself:
 - a. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate net-wealth up to an **age-related reference net-wealth**. The age-related reference net-wealth should rise with age until ‘peaking out’ during a ‘retirement age’ band at the actuarial value required to top up the Basic Pension to the minimum-income safety-net for the rest of the citizen’s life. From then on it should decline with age as life-expectancy declined.
 - b. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking income support from the state (taking their net-wealth ‘overdrawn’ if necessary by ‘borrowing’ from the state).

7. The Report places major emphasis on the breakdown of net-wealth. However, the Commission should not concern itself with the breakdown of net-wealth; only with the ‘bottom line’ of net-wealth:
 - a. There should be no distinction between assets ‘to be left to heirs’ (e.g. a family home or business) and other net-wealth. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be expected to draw down from **the whole of their net-wealth** before seeking income support from the state. If a citizen chooses to live in poverty in order to leave wealth to heirs, that should be a personal choice of that citizen. There is no social imperative to boost the wealth of heirs. If there is a social imperative to maintain continuity of ownership of a ‘family’ home or business of ‘reasonable’ value, the owners should be able to borrow against those assets (see earlier).
 - b. There should be no distinction between different asset classes:
 - i. Family home.
 - ii. Other real estate.
 - iii. The actuarial value of defined-benefit pension schemes.
 - iv. The actuarial value of SERPS and S2P pension schemes.
 - v. The actuarial value of annuity schemes.
 - vi. Stocks and shares.
 - vii. Gilts and bonds.
 - viii. Bank accounts in credit, and cash.
 - c. Negative wealth should be included in the assessment of net-wealth:
 - i. Real estate borrowing (e.g. mortgages).
 - ii. Educational borrowing (e.g. student loans, etc.).
 - iii. Consumer borrowing (e.g. hire-purchase debt, card debt, etc.).
 - iv. Bank accounts in debit (i.e. overdrafts).
 - d. There should be no distinction between different ownership packages:
 - i. Specific holdings (e.g. personally-owned real estate, shares, etc.).
 - ii. Specific collective holdings (e.g. unit trusts, investment trusts, insurance policies, defined-input pension schemes, etc.).
 - iii. ‘Slush-funded’ collective holdings (e.g. with-profits insurance schemes, SERPS, S2P, defined-output pension schemes, precipice bonds, etc.).
 - e. There should be no distinction between different tax packages (indeed, these should be part of the options for change):
 - i. Pension and insurance schemes.
 - ii. PEPs, ISAs, VCTs, etc.

8. The 2004 reports of both the Pensions Commission and the Employer Task Force on Pensions have placed a great deal of emphasis on the role of 'employer' contributions to pension schemes. However, it is important to note that 'employer' contributions to such schemes are not philanthropic or altruistic acts by the employer. They are an integral part of the employer's cost of employment and an integral part of the employee's remuneration package. Thus, the initial debate about employer pension schemes should focus not on the detail merits of those schemes, but on a question more fundamental in a liberal democratic society: does it **make sense** for employees to sub-contract administration of their welfare to their employers? Surely, it makes far more sense for employers to be free to concentrate on their 'real' business and the actual employment in question, rather than diverting their management and administrative attention to the running of patronising and amateurish welfare and asset-management services. Seen in this light, the answers must surely be guided by the principle that **employers should be obliged to pay the full remuneration package immediately, in full, and in legal tender.** The current employer plus employee contributions should be seen as a **citizen's** contribution (from the full remuneration package) to **personal** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation). Thus, the Commission should consider the proposition that all employer schemes should be re-engineered into **personal** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation).
9. Many employer pension schemes are defined-output schemes rather than defined-input schemes. Over and above the general points already made about employer contributions to such schemes, the whole concept of defined-output schemes is a deceit. Thus, the Commission should consider the proposition that all employer and defined-output schemes should be re-engineered into **personal defined-input** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation).
10. Finally, with regard to macro-economic factors:
 - a. In the first instance, increased savings would simply bid up the value of existing assets without increasing future earnings – a deceit.
 - b. If enterprises/borrowers become aware that citizens/consumers are going to decrease consumption (a pre-requisite for increased savings), they will not respond by increasing borrowing to absorb those savings 'as a patriotic duty'. They will respond by cutting back on borrowing for investment, stocks and employment. The result would be a slump, and reduced wealth for all.

Thus, **if we wish to persuade the poor to increase their saving**, without blighting the return on those savings or blighting the economy, **we must find a way to persuade the rich to reduce their savings.** We must persuade the rich to spend more of their wealth, thereby creating the infamous and elusive 'trickle-down effect'. This confirms the previously made point that all tax wrinkles (for the wealthy, in proportion to wealth) should be discontinued, and that **the resources currently squandered on 'bribing the rich to save' should be re-directed into increased basic benefits for those who actually need such social support.**

2.2 The Deceit of 'Employer' Contributions

The 2004 reports of both the Pensions Commission and the Employer Task Force on Pensions have placed a great deal of emphasis on the role of 'employer' contributions to pension schemes.

However, it is important to note that 'employer' contributions to such schemes are not philanthropic or altruistic acts by the employer. They are an integral part of the employer's cost of employment and an integral part of the employee's remuneration package. Thus, the initial debate about employer pension schemes should focus not on the detail merits of those schemes, but on a question more fundamental in a liberal democratic society:

1. Does it **make sense** for employees to sub-contract administration of their welfare to their employers ?
2. Should the state **encourage** employees to sub-contract administration of their welfare to their employers (via Income Tax and National Insurance Contribution wrinkles) ?
3. Does it **make sense** for employers to get involved in the administration of the welfare of their employees ?
4. Should the state **encourage** employers to get involved in the administration of the welfare of their employees (via Income Tax and National Insurance Contribution wrinkles) ?
5. Should the state **allow** employers to get involved in the administration of the welfare of their employees ?
6. Should the state **allow** employers to **force** employees to contract-in to employer schemes ?
7. Should the state **allow** employers to **withhold** part of the remuneration package from employees who do not contract-in to employer schemes ?

Surely, it makes far more sense for employers to be free to concentrate on their 'real' business and the actual employment in question, rather than diverting their management and administrative attention to the running of patronising and amateurish welfare and asset-management services. Seen in this light, the answers must surely be guided by the principle that **employers should be obliged to pay the full remuneration package immediately, in full, and in legal tender.** The current employer plus employee contributions should be seen as a **citizen's contribution** (from the full remuneration package) to **personal** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation).

Thus, all employer and defined-output schemes should be re-engineered into **personal** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation). This should be done as follows:

1. The state should create and manage a **Social Reserve Account** for each citizen.
2. The state should assign unequivocally to each individual citizen the actuarial value of rights already-established through historic employer and employee contributions to state pension schemes such as SERPS and S2P. This should be done in the form of once-off contributions to **personal** schemes of the citizen concerned, with that citizen's Social Reserve Account as the default. Note that this is merely a book-keeping exercise to recognise in the national debt a liability which has been kept 'off the balance-sheet' for far too long.
3. The state should oblige employers to assign unequivocally to each individual citizen the actuarial value of rights already-established through historic employer and employee contributions to employer schemes. This should be done in the form of once-off contributions to **personal** schemes of the citizen concerned, with that citizen's Social Reserve Account as the default.
4. The state should oblige employers to incorporate the actuarial value of ongoing employer contributions into a higher level of nominal wages.
5. All employer contributions should be discontinued.
6. By default, all employee contributions should be re-set to generate from the increased nominal wages the same total contributions as the existing employer-plus-employee contributions generate from current nominal wages. This should be done in the form of contributions to **personal** schemes of the citizen concerned.

Then:

1. The State should define a **minimum-income safety-net**; based on age, family formation and post-code.
2. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate net-wealth up to an **age-related reference net-wealth**. The age-related reference net-wealth should rise with age until 'peaking out' during a 'retirement age' band at the actuarial value required to top up the Basic Pension to the minimum-income safety-net for the rest of the citizen's life. From then on it should decline with age as life-expectancy declined. This should be done in the form of contributions to **personal** schemes of the citizen concerned, with contributions to that citizen's Social Reserve Account as the default.
3. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking income support from the state. This should be done in the form of withdrawals from **personal** schemes of the citizen concerned, with withdrawals from that citizen's Social Reserve Account as the default (taking the balance 'overdrawn' if necessary).

This combination of measures would diffuse the urgency of the need to means-test benefits against wealth during the application processes, and would moderate the 'moral hazard' inherent in any safety-net provision for poverty and old age.

2.3 The Deceit of Defined-Benefit Schemes

Many employer pension schemes are defined-output schemes rather than defined-input schemes. Over and above the general points already made about employer contributions to such schemes, the whole concept of defined-output schemes is a deceit:

1. They form an inappropriate base for those who do not follow the 'old' employment pattern of 'a single employer for life'. The modern trend is towards a more fragmented employment history, and the need for continuity of welfare processes is most needed at times of discontinuity in employment history.
2. Because of the focus on final-salary times years of service, early leavers subsidise the long stayers. It should be illegal for an employer to do so with 'employee assets'.
3. Because of the input-focus on employee status (i.e. with a single rate of 'input' regardless of family formation), and the benefit-focus on provisions for a family unit (i.e. with ongoing benefits for surviving spouse and offspring), single/childless employees in effect cross-subsidise those with dependants. Whilst such cross-subsidy may well be appropriate for services funded by the state from taxes and subject to democratic audit, it should be illegal for an employer to do so with 'employee assets'.
4. Because the ownership of the assets of the scheme is usually diffused in trust-fund status ('morally' owned by the employees and pensioners but legally owned by the employer, and administered and controlled by a trust which is usually controlled in turn by the employer), over-funding can become a focus of acrimony when for instance an employer uses 'surplus' assets to take an input holiday, make a withdrawal, or fund redundancy payments.
5. Because even the 'moral' ownership of the assets of the scheme is usually diffused in trust-fund status, the rights of the dependants of employees and pensioners are usually subject to rather arbitrary variation. In the event of divorce, for example, a spouse and children can lose all rights to a share.
6. They contradict insurance principles, in that if an employee's career flattens out or goes downhill, then so does the pension.
7. They contradict insurance principles, in that employees' current pay and subsequent pension are both exposed to the solvency and integrity of their employer.
8. They promote ageism, in that promotions and/or wage rises to older employees are disproportionately expensive, because of the requirement for higher outputs without a corresponding input history.
9. They are open to abuse by senior management voting big wage rises for themselves in their last few years, to secure high but low-visibility outputs without a corresponding input history.
10. They are open to abuse by senior management voting big but low-visibility outputs for themselves without any corresponding input history.

In addition, the theoretical 'insurance' or 'smoothing' aspect of a typical employer's final-salary pension scheme is a deceit. In theory, the employee is protected from adverse movements in investment values by reserves within the scheme and/or top-ups from the employer. However:

1. The only way the trust-fund of such a scheme can accumulate such reserves is to withhold allocation to the employees of some of the accumulated inputs, income and capital gains in that trust-fund.
2. The only way an employer can accumulate such reserves is to withhold distribution of the full remuneration package during employment.

In both cases, the theoretical 'insurance' is provided by the employees' and pensioners' own assets! It would surely be more honest and transparent if such reserves were allocated fully to the employees during the period of employment (or better still, distributed fully to the employees as part of the full remuneration package; for the employee to make **personal** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation). The possibility that the employer and/or the trust might turn out to have dissipated such reserves by the time they are needed reinforces this point.

In addition of course, it is impossible to insure against **systemic** losses. The principle underpinning insurance is shared exposure to specific risks. For example, if approximately 1% of the population breaks a leg each year, then £1 annual premiums can fund £100 claims by the 1% who are unfortunate each year. However, if the value of financial assets fall in aggregate, the value of everyone's financial assets fall simultaneously. There simply isn't enough wealth to go round!

Surely, it makes far more sense for employers to be free to concentrate on their 'real' business and the actual employment in question, rather than diverting their management, administrative and financial attention to the running of asset-value insurance services.

Thus, all defined-output schemes should be re-engineered into **defined-input** schemes. As an extension of the re-engineering proposition outlined in the previous section, all employer and defined-output schemes should be re-engineered into **personal defined-input** schemes (i.e. independent from employment status, and subject solely to **state** direction and regulation).

1. The state should create and manage a **Social Reserve Account** for each citizen.
2. The state should assign unequivocally to each individual citizen the actuarial value of rights already-established through historic employer and employee contributions to state pension schemes such as SERPS and S2P. This should be done in the form of once-off contributions to **personal defined-input** schemes of the citizen concerned, with that citizen's Social Reserve Account as the default. Note that this is merely a book-keeping exercise to recognise in the national debt a liability which has been kept 'off the balance-sheet' for far too long.
3. The state should oblige employers to assign unequivocally to each individual citizen the actuarial value of rights already-established through historic employer and employee contributions to employer schemes. This should be done in the form of once-off contributions to **personal defined-input** schemes of the citizen concerned, with that citizen's Social Reserve Account as the default.
4. The state should oblige employers to incorporate the actuarial value of ongoing employer contributions into a higher level of nominal wages.
5. All employer contributions should be discontinued.
6. By default, all employee contributions should be re-set to generate from the increased nominal wages the same total contributions as the existing employer-plus-employee contributions generate from current nominal wages. This should be done in the form of contributions to the **personal defined-input** schemes of the citizen concerned.

Then:

1. The State should define a **minimum-income safety-net**; based on age, family formation and post-code.
2. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate net-wealth up to an **age-related reference net-wealth**. The age-related reference net-wealth should rise with age until 'peaking out' during a 'retirement age' band at the actuarial value required to top up the Basic Pension to the minimum-income safety-net for the rest of the citizen's life. From then on it should decline with age as life-expectancy declined. This should be done in the form of contributions to **personal defined-input** schemes of the citizen concerned, with contributions to that citizen's Social Reserve Account as the default.
3. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking income support from the state. This should be done in the form of withdrawals from **personal defined-input** schemes of the citizen concerned, with withdrawals from that citizen's Social Reserve Account as the default (taking the balance 'overdrawn' if necessary).

This combination of measures would diffuse the urgency of the need to means-test benefits against wealth during the application processes, and would moderate the 'moral hazard'

inherent in any safety-net provision for poverty and old age.

2.4 Means-Testing against Wealth

The pressing short-term cash-flow aspect of means-testing benefits against income should be de-coupled from the process of writing-off that cash-flow as non-recoverable. The means-tested Supplementary Tax Credits defined earlier should be replaced by **Supplementary Cash-Flows**; offered initially as automatic withdrawals from Social Reserve Accounts (taking the balances overdrawn if necessary).

2.5 The Propositions for Reform

The tax and welfare processes should be re-engineered as follows:

1. The state should create and manage a **Social Reserve Account** for each citizen:
 - a. Negative balances should attract interest at base rate.
 - b. Positive balances should attract interest at base rate, and/or should be invested in a range of low-cost tracker funds. These would be low-cost because of size, and because there would be no 'marketing', 'promotion' or intermediary costs.
2. The state should assign unequivocally to each individual citizen the actuarial value of rights already-established through historic employer and employee contributions to state pension schemes such as SERPS and S2P. This should be done in the form of once-off contributions to personal defined-input schemes of the citizen concerned, with that citizen's Social Reserve Account as the default. Note that this is merely a book-keeping exercise to recognise in the national debt a liability which has been kept 'off the balance-sheet' for far too long.
3. The state should oblige employers to assign unequivocally to each individual citizen the actuarial value of rights already-established through historic employer and employee contributions to employer schemes. This should be done in the form of once-off contributions to personal defined-input schemes of the citizen concerned, with that citizen's Social Reserve Account as the default.
4. The state should oblige employers to incorporate the actuarial value of ongoing employer contributions into a higher level of nominal wages.
5. All employer contributions should be discontinued.
6. By default, all employee contributions should be re-set to generate from the increased nominal wages the same total contributions as the existing employer-plus-employee contributions generate from current nominal wages. This should be done in the form of contributions to the personal defined-input schemes of the citizen concerned.

Then, each citizen should manage their own ‘pension’ affairs (i.e. independent from employment status, and subject solely to **state** direction and regulation). This should be done as follows:

1. The State should define a **minimum-income safety-net**; based on age, family formation and post-code.
2. During periods with income above the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to accumulate **registered net-wealth** up to an **age-related reference net-wealth**
 - a. The Social Reserve Account of each citizen would be the prime element of the **registered net-wealth** of each citizen. Each citizen should be able to register other assets such as a home, other real estate, pension schemes, annuity schemes, insurance schemes, saving schemes, stocks, shares, gilts, bonds, collectables, etc.. The state would have a ‘lien’ on each such registered asset (i.e. as if that asset were mortgaged to the state). Citizens should be obliged to register all debts secured against registered assets (such as a mortgage on a registered home or on other real estate), and only the **net** value would count for the above comparison with the age-related reference net-wealth.
 - b. The age-related reference net-wealth should rise with age until ‘peaking out’ during a ‘retirement age’ band at the actuarial value required to top up the Basic Pension to the minimum-income safety-net for the rest of the citizen’s life. From then on it should decline with age as life-expectancy declined.
 - c. The compulsory accumulation should be done in the form of contributions to **personal defined-input** schemes of the citizen concerned, with contributions to that citizen’s Social Reserve Account as the default.
 - d. The compulsory minimum rate of accumulation should be proportional to the shortfall of actual net-wealth when compared to the age-related reference net-wealth.
3. During periods with income below the minimum-income safety-net (including, but not limited to, old age), citizens should be obliged to draw-down from their net-wealth before seeking income support from the state. This should be done in the form of withdrawals from **personal defined-input** schemes of the citizen concerned, with withdrawals from that citizen’s Social Reserve Account as the default (taking the balance ‘overdrawn’ if necessary).
4. Citizens should be able to ‘borrow’ from the state to supplement their income whilst maintaining ownership of a ‘family’ home or business of ‘reasonable’ value. However:
 - a. Citizens should be obliged to liquidate more speculative investments before seeking to ‘borrow’ from the state in this way.
 - b. Any such ‘borrowing’ should be done in the form of withdrawals from **personal defined-input** schemes of the citizen concerned, with withdrawals from that citizen’s Social Reserve Account as the default (taking the balance ‘overdrawn’ if necessary).
 - c. Any such ‘borrowing’ should be secured against the value of the ‘family’ home or business concerned, and should be recovered on death from the estate.

5. Citizens should be able to ‘borrow’ from the state to fund ‘productive education or training. However:
 - a. Citizens should be obliged to liquidate more speculative investments before seeking to ‘borrow’ from the state in this way.
 - b. Any such ‘borrowing’ should be done in the form of withdrawals from **personal defined-input** schemes of the citizen concerned, with withdrawals from that citizen’s Social Reserve Account as the default (taking the balance ‘overdrawn’ if necessary).
6. All negative balances in Social Reserve Accounts should be reviewed for write-off or recovery (from other net-wealth and/or anticipated income); with **a rolling accounting time-base of perhaps three to five years**, and with **a final review on death with a claim against registered assets**.

3 The Benefits of the Propositions for Reform

The Propositions for reform would have the following benefits:

1. They would eliminate the incoherent **economic** discontinuities in the levying of IT/NICS, and in the delivery of benefits (i.e. the rather arbitrary 'step changes' in the level of benefits typically required to simplify administration in non-reactive processes).
2. They would eliminate the incoherent **cash-flow** discontinuities in the delivery of benefits (i.e. the rather arbitrary delays in changing the level of benefits in non-reactive processes when circumstances change).
3. They would eliminate the psychological and administrative nightmare of abandoning the reliable cash-flow safety net of no-income benefits in order to take up part-time and/or insecure employment and/or training; with the risk of further discontinuities in cash-flows each time circumstances changed.
4. They would tend to direct the reliable cash-flow safety net of benefits to the housekeeper/purse rather than to the breadwinner/wallet; with only the incremental earned income directed to the breadwinner/wallet.
5. They would minimise the exposure of the most vulnerable to the integrity and competence of employers.
6. They would simplify the administration of employment.
7. They would simplify the administration of all other sources of income.
8. They would simplify the administration of Benefit. The level of benefits would be assessed to reflect **need** without regard to potential income, and would need to be re-assessed only when that **need** changed. The total of benefits would be means-tested automatically and reactively on a rolling basis in line with reported income.
9. They would improve take-up rates for no/low-income benefits, in that they would be delivered automatically by default.

In addition:

1. They would mitigate the current 'two-nation' perception of 'on the dole' benefit recipients as a 'feckless underclass'. All citizens, from cradle to grave, poverty-stricken through to wealthy, would receive their Basic Tax Credit as a right of citizenship. Those on low incomes would receive means-tested Supplementary Tax Credit, but that would be a matter of degree rather than distinction.
2. They would clarify the spurious nature of the current debate about effective tax rates for those on low incomes. The current effective tax rate 'for the poor' is around 90% not 0%, and we should be discussing realistic propositions to reduce that 90% rate rather than spurious propositions related to the mirages of 'taking some low-earners out of the tax net altogether' and 'extending low tax rates for the poor'.
3. They would clarify the spurious nature of the current debate about minimum wage legislation. If the true position was more transparent, employers would not be able to attract employees with a very low gross wage; simply because potential employees would not work for less than 10% of a very low wage!