REFORM

# How to run a country: Working age welfare

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# 1. Introduction

The welfare state plays a fundamental role in the wellbeing of the nation. It provides a safety net for individuals who fall out of work, unconditional support for those who cannot work and financial aid for those on low incomes and with significant additional costs due to disability. In doing so, it seeks to mitigate against poverty and enable all to reach a basic standard of living. However, while the welfare state has the potential to improve wellbeing, it can also limit and even damage it. A bloated welfare state in which expenditure is poorly targeted or claimants are perceived to be passively receiving 'something for nothing' can undermine its legitimacy. Governments must balance these, sometimes competing, objectives, accepting that trade-offs are inherent in the design of any social security system.

The Coalition Government inherited a welfare state suffering from a crisis in legitimacy and where the complexity of the system meant too many claimants thought they were better off on benefits than in work. Reforms which sought to make work pay, increase conditionality and reduce the total amount a household could receive in benefits have gone some way in tackling this, but more should be done.

The best way of reducing working age welfare expenditure is by reducing the demand for it. This requires a system that helps people stay in, move into and progress in work. There is also a wealth of evidence that shows that employment status has a substantial impact on individual wellbeing: for the vast majority of people, being in work is good for them and being out of work is bad for them.[1] This is because work has important physical and mental health, psycho-social and financial benefits. Moving more people into work also increases the labour supply, which contributes to economic growth. The welfare state must therefore be just as much about supporting and incentivising people, where appropriate, to move into work as redistribution. It must avoid creating a 'dependency trap' in which inactivity is (inadvertently) encouraged and self-efficacy undermined. To achieve this the Government should use both financial and non-financial levers to drive behavioural change.

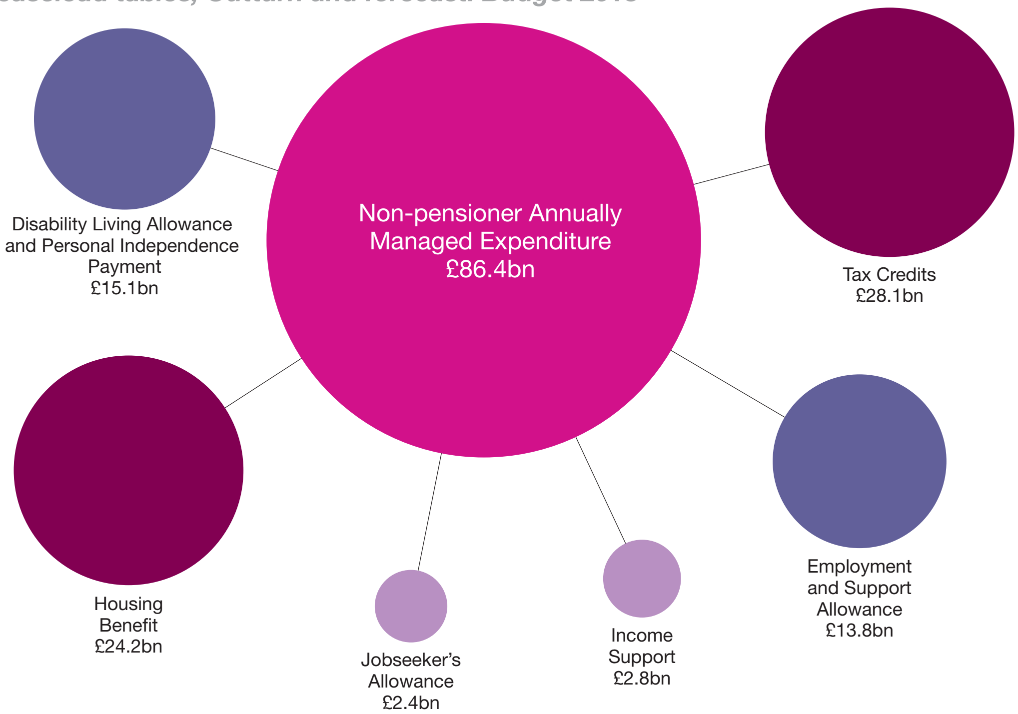
For large numbers of claimants, moving from welfare to work will require considerable personalised support. This is particularly important for claimants with multiple and complex barriers to entering the labour market. An approach which, as far as possible, designs interventions around the needs of the claimant, giving them (at least partial) choice and control, is more likely to succeed in moving them into sustained employment.

The new Government has already committed to continuing the Coalition's objective of getting people into work. Within this, it must have a particular focus on tackling the high number of people on sickness and disability benefits. This will require reform of not just the way employment support services are delivered but of the design of Employment and Support Allowance (ESA) itself. It must also seek to address the other drivers of high benefit expenditure: a shortage of social housing and the persistence of low wage, low skill jobs. Short-term cuts can only hit the standard of living of the poorest in society – a more strategic approach is needed, driven not by an arbitrary savings figure but by a core set of principles for the welfare state.

In summary, the new Government must build a welfare system in which benefit payments are targeted at those with the greatest need and one in which robust activation policies and effective employment support programmes move people into sustainable employment as quickly as possible.

1 For a summary of the evidence see Gordon Waddell and A Kim Burton, *Is Work Good for Your Health and Well-Being?*, 2006.

**Figure 1: DWP and Tax Credit expenditure (excluding pensioner only benefits), 2015-16 forecasts, real term prices 2014-15**
**Source: Department for Work and Pensions (2015), *Benefit expenditure and caseload tables, Outturn and forecast: Budget 2015***




## 2. The legacy of the Coalition

Presenting the Emergency Budget in June 2010, the Chancellor stated that the Coalition Government would "put the whole welfare system on a more sustainable and affordable footing" and that the higher the (non-pensioner) welfare savings, the lower the cuts to other departmental budgets.[2] He reiterated this in October 2010 when presenting the Spending Review settlement: "the more we could save on welfare costs - the more we could continue other, more productive areas of government spending."[3] This focus on cutting the benefit bill was combined with a narrative of building a fairer system and moving more people into work. Iain Duncan Smith in his first speech as Work and Pensions Secretary placed social justice at the heart of his reform agenda, stating: "We must be here to help people improve their lives - not just park them on long-term benefits".[4]

### 2.1 Cutting the benefit bill

The Coalition Government used a variety of mechanisms to reduce the working age benefit bill,[5] including:

- *Stopping benefits*, for example the Health in Pregnancy Grant and In Work Credit;
- *Restricting eligibility for benefits*, for example means-testing Child Benefit and lowering the income threshold for receiving Child Tax Credit;
- *Replacing benefits*, Disability Living Allowance was replaced by Personal Independent Payment for working age claimants, with a stricter health assessment;
- *Time-limiting benefits*, introduced for contributory Employment and Support Allowance for those in the Work Related Activity Group;

2 George Osborne, "Budget 2010: Full Text of George Osborne's Statement," 8 June 2010.
3 BBC News, "Spending Review: Chancellor's Speech in Full," 20 October 2010.
4 Iain Duncan Smith, "Reforms Will Tackle Poverty and Get Britain Working Again," 27 May 2010.
5 Some benefits span working age and pensioner claimants, for example Housing Benefit (in November 2014 3.6 million claimants were aged under 65, 1.3 million were over 65 (Department for Work and Pensions, *Housing Benefit Caseload Statistics Data to February 2015,* May 2013)); child related benefits are included as they are claimed by, predominantly, working age adults.

- *Changing the uprating of benefits*, for many benefits RPI was replaced by CPI as the inflation measure by which benefits were increased. Uprating of certain benefits was capped at one per cent;
- *Freezing benefits*, introduced for Child Benefit and Universal Credit work allowances; and
- *Capping benefits*, implemented for Local Housing Allowance and the total amount (with exceptions) of benefit payments a household could receive.

The Institute for Fiscal Studies (IFS) calculates that the Coalition Government's full package of welfare reforms reduced benefit expenditure by around £16.7 billion a year.[6] While this is a sizeable difference (equivalent to just over the total annual expenditure on JSA and ESA), in reality this has only stemmed the rise in spending. As a proportion of GDP, the Office for Budget Responsibility forecasts that total social security spending (ie. for all ages) will have reduced from 13.6 per cent in 2012-13 to 12.1 per cent in 2014-15, the last full year of the Coalition Government.[7] This is still significantly higher than in 2007-08, pre-recession, when the equivalent figure was 11.2 per cent.[8]

### 2.1.1 Uprating of benefits

The biggest reduction in non-pension spending over the last Parliament came from the changes to uprating, accounting for £7.6 billion of the £16.7 billion savings.[9] The switch from RPI to CPI indexation had a sound economic rationale (although recent analysis suggests that RPIJ may be a better measure of the inflation experienced by households[10]). Arbitrary caps on uprating and freezes, however, are short-term cuts. For those already on low incomes, uprating their benefits by less than prices simply erodes their standard of living. In addition, applying a below inflation increase to Working Tax Credits and freezing the Universal Credit (UC) work allowances undermined the Government's own push to make work pay.

Policy makers are nearly always faced with trade-offs, and the uprating of benefits is no exception. The methodology adopted for uprating must balance multiple objectives, including poverty alleviation, legitimacy and fairness, and incentivising work. Within this, it is important to recognise that those on very low incomes are less able to smooth their consumption and therefore periods of high inflation have a disproportionate impact on them. It may therefore be appropriate that in periods during which prices increase at a faster rate than earnings, benefits become relatively more generous – including Working Tax Credits.

However, to avoid a ratcheting effect which undermines both taxpayers faith in the welfare state and the objective of making work pay, government could offset this additional generosity by linking benefits to a specific proportion of earnings; a relative earnings link. This relative link is used for pensions in Australia, where the Government sets a floor for the state pension of 25 per cent of male total average weekly earnings. If, once earnings growth outstrips inflation again, the level of benefits has increased beyond the floor, government can in effect 'claw back' the additional generosity by not uprating benefits. Over the medium term this would ensure that the value of benefits keeps track with wages. Governments are, however, seeking to achieve different objectives via different benefits – for example, there is no need for a work incentive in pensions – and therefore careful consideration should be given to the impact of different methods of uprating on those incentives.

6 Andrew Hood and David Phillips, *Benefit Spending and Reforms: The Coalition Government's Record*, January 2015.
7 Office for Budget Responsibility, *Economic and Fiscal Outlook: March 2015*, March 2015.
8 Office for Budget Responsibility, *Welfare Trends Report*, October 2014.
9 Hood and Phillips, *Benefit Spending and Reform*.
10 John Astin and Jill Leyland, *Towards a Household Inflation Index: Compiling a Consumer Price Index with Public Credibility,* 14 May 2015.

**Recommendation**

The Government should not freeze benefits. Instead, it should consider whether a more flexible approach which allows for more generous uprating at times when inflation outstrips earnings growth, but enables that additional generosity to be clawed back when this is reversed is more appropriate. This must take account of the different objectives inherent within different benefits.

## 2.2 Work as the best route out of poverty

In a speech to *Reform* in February 2015, Work and Pensions Secretary Iain Duncan Smith described the Coalition Government's welfare reforms as "restoring fiscal stability by restoring lives". This meant building a system that incentivised and supported people into work, including making work pay. Two flagship reforms, Universal Credit and the Work Programme, were at the heart of this.

### 2.2.1 Universal Credit

A core aim of UC, which combines six of the main working age benefits, is to effect behaviour change through both financial and non-financial incentives. It seeks to (a) remove the risk of income loss from moving into and out of work by using real time information to adjust the level of UC payment in line with earnings, and (b) make work pay, even for those working few hours, by introducing a single withdrawal rate.

Previous work by *Reform* has highlighted the trade-offs involved in setting taper rates. *The Money-go-round: cutting the cost of welfare* noted that in designing a welfare system government must take decisions about the relative importance of poverty alleviation, financial incentives and fiscal cost, and the trade-offs within each of these.[11]

To further support claimants to make the transition into work, the Coalition Government invested in local support services. "Universal Support", delivered by local authorities partnering with Jobcentre Plus, provides help for particularly vulnerable claimants, including help in budgeting, accessing housing and drug and alcohol treatment, and digital inclusion. This in-kind support is vital and should be a continuing priority for the new Government.

UC will also help to tackle poverty by increasing the uptake of benefits, and applying for just one benefit is more user-friendly. UC is therefore a policy with considerable advantages for claimants and wider society.[12]

Roll out of the new system has suffered from delays, largely due to the ICT challenges involved in delivering reform on such a big scale and the difficulty of transitioning from legacy systems. However the 'reset' timetable looks more promising, with the National Audit Office (NAO) stating that the changes have sought to 'de-risk' delivery.[13] Early indicators point to a successful policy: UC claimants are more likely to move into work, stay in work for longer and undertake more intensive job search.[14]

11 Thomas Cawston, Patrick Nolan and Andrew Haldenby, *The Money-Go-Round: Cutting the Cost of Welfare,* October 2010.
12 Department for Work and Pensions, *Universal Credit: Welfare the Works,* November 2010.
13 Ibid.
14 Department for Work and Pensions, *Estimating the Early Labour Market Impacts of Universal Credit*, February 2015; Department for Work and Pensions, *Universal Credit Pathfinder Evaluation*, October 2014.

### 2.2.2 The Work Programme

The Work Programme replaced several employment support programmes to create a single national outsourced programme delivered via prime contractors in 18 regional contract areas. Two or three providers were chosen for each area in an attempt to use competition to drive performance. The Coalition Government adopted a black box approach, enabling providers to use their expertise to design the service offer for participants, and a payment model that shifted risk of failure from the taxpayer to those providers. If providers failed to achieve job outcomes, they would not be paid.[15] Differential pricing was used to incentivise greater investment in participants further from the labour market and 'sustainment payments' to encourage providers to keep people in work.

Job outcome rates for all but the very hardest to help are above minimum expected levels, though sustainment levels (ie. for keeping someone in work) are lower than expected. However, as the NAO highlights, this is in part due to the Department for Work and Pensions (DWP) setting expectations too high.[16] In its most recent analysis of the Work Programme the NAO found that outcomes are in line with previous programmes (with the DWP expecting improvements for later cohorts) but have been achieved at a lower cost. Over the lifetime of the programme, £41 million will have been saved compared to previous programme costs.[17]

The key focus for this Parliament must be on ensuring the model works for those furthest from the labour market, particularly addressing the low job outcome rates for ESA claimants. Despite the differential pricing, investment in the hardest to help groups has been significantly lower than expected.[18] It is likely that greater funding is needed for these groups, however this should be explored as one of several levers to improve outcomes and the payment model should remain predominantly payment by results.

One significant barrier to better results is the lack of integration with other services, in particular skills and health. Both of these areas play a central role in enabling a participants' return to work, but to date there has been minimal alignment of objectives or integration of budgets across these services. This is despite consistent calls for this to happen, and in the case of health, considerable evidence of the positive impact of work on an individual's health.

A more integrated approach is essential to helping those with more complex needs, and particularly those with health problems and disabilities. Given the lack of evidence on what works for moving this latter group into work, the Government should focus on encouraging innovation and robustly evaluating different models.[19] This will require the allocation of appropriate levels of funding, and the three relevant departments (Work and Pensions, Health, and Business, Innovation and Skills) should all contribute. Each of these departments will accrue benefits from successfully closing the employment gap between disabled and non-disabled people.

**Recommendation**

The Government should build on the current Work Programme model, which has delivered improved value for money compared to previous programmes, but should evaluate which components have worked well and which elements require amendment. Particular attention should be paid to the differential pricing structure, which did not achieve the Coalition Government's objective of ensuring greater investment in those furthest from the labour market.

15 An attachment fee was used in the first two years to help with cash flow, from June 2014 onwards payment was 100 per cent by results.
16 Department for Work and Pensions, *The Work Programme*, December 2012.
17 Ibid.
18 Timothy Riley, Paul Bivand and Tony Wilson, *Making the Work Programme Work for ESA Claimants,* April 2014.
19 Department for Work and Pensions, *What Works for Whom in Helping Disabled People into Work?,* October 2013.

## 2.3 A fairer social security system

The Coalition Government made fairness a key plank of its reforms: (a) fairness between those in work and those out of work, and (b) fairness between those on low incomes and those on higher incomes.

### 2.3.1 Capping benefits

On the first point, it sought to ensure that out of work benefit claimants could not afford a lifestyle beyond that of working people on low incomes. Measures included reducing the level of Local Housing Allowance (LHA) payable to claimants and capping the benefit payments an out of work household could receive to the income of an average working household (with some exceptions, including for disability).[20] The benefit cap is lifted when a household member moves into work, thereby incentivising positive behaviours that increase wellbeing. As of November 2014, 40 per cent of those no longer subject to the cap had moved into work (opened a Working Tax Credit claim), equating to 12,500 households who, previously workless, now have someone in employment. This is the single biggest reason for moving off the cap, the majority of the remaining 60 per cent are no longer subject to the cap due to changes in Housing Benefit or household structure.[21]

### 2.3.2 Middle-class welfare

On the second point, the Coalition Government sought to tackle 'middle-class welfare', as recommended by *Reform*, notably in *The End of Entitlement*.[22] To this end, it reduced the income threshold for Child Tax Credits and introduced a means test for Child Benefit. These two measures are projected to save £2.7 billion annually.[23] The new Government should, however, go further.

These types of reforms prioritise better targeting of expenditure over the smoothing of marginal deduction rates. This is an acceptable trade-off to ensure that social security expenditure is spent on those in need. To this end, Child Benefit should be targeted at those on the lowest incomes by moving it into UC. The IFS calculates that abolishing Child Benefit and increasing the level of UC to compensate low-income families could save £4.8 billion.[24] In addition, *Reform* has previously recommended that consideration be given to means-testing or taxing Disability Living Allowance (DLA).[25] At a minimum, the Government should tax DLA and its replacement Personal Independence Payment (PIP). This would save £0.9 billion.[26]

**Recommendation**

The Government should abolish Child Benefit and compensate low income families through Universal Credit. Disability Living Allowance and Personal Independence Payments should either be taxed or means tested.

# 3. The next phase of welfare reform

Further cuts to non-pensioner welfare are not possible on the scale of those achieved by the Coalition Government. Absent a dramatic reduction in demand for benefits relating to disability, sickness, unemployment or low income, reducing working age welfare spending in the short term simply means reducing the incomes of those in most need. Benefit levels are already low and average awards for out of work benefits have been declining in real

20 This included using the 30th percentile of local market rents in place of the median, introducing a national cap for different size properties and capping LHA at four instead of five bedrooms.
21 Department for Work and Pensions, "Benefit Cap," https://www.gov.uk/benefit-cap, accessed on 9 June 2015.
22 Thomas Cawston, Patrick Nolan and Andrew Haldenby, The End of Entitlement, October 2009.
23 HM Treasury, *Spending Review 2010*, October 2010; HM Treasury, *Budget 2010 Policy Costings*, June 2010.
24 Stuart Adam, James Browne, Carl Emmerson, Andrew Hood, Paul Johnson, Robert Joyce, Helen Miller, David Phillips, Thomas Pope and Barra Roantree *Taxes and Benefits: The Parties' Plans*, Institute for Fiscal Studies, April 2015.
25 Dale Bassett, Thomas Cawston, Andrew Haldenby, Patrick Nolan, Lucy Parsons, Nick Seddon and Kimberley Trewhitt. *Budget 2010: Taking the Tough Choices*, Reform, June 2010.
26 This would apply to pensioners in receipt on DLA as well as working age recipients of DLA and PIP (Adam et al., *Taxes and Benefits).*

terms.[27] Instead a new, strategic approach is needed which focuses on the drivers of expenditure.

## 3.1 Tackling the drivers behind welfare expenditure

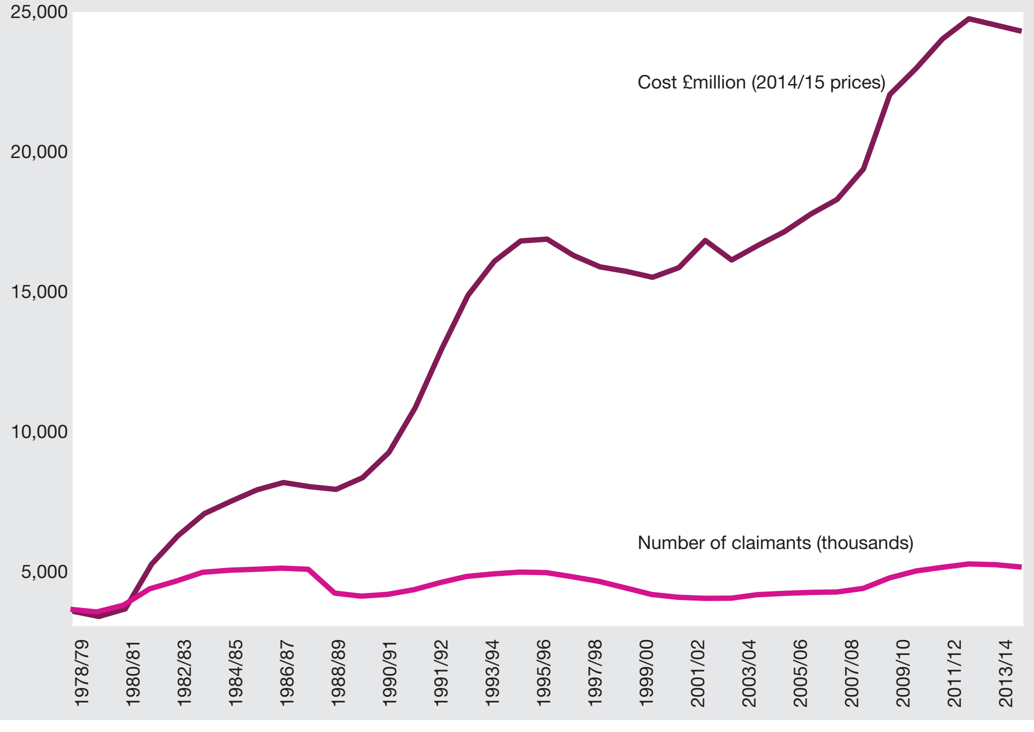
The three main drivers of working age welfare spending are Housing Benefit, Tax Credits and disability benefits. The Government should therefore focus on structural reforms to reduce costs in these areas. This will require cross-departmental working, particularly with the Department for Communities and Local Government (DCLG) to enable more house building and with the Department for Business, Innovation and Skills to support skills development and engagement with businesses on wage levels.

### 3.1.1 Housing Benefit

Providing housing for those who cannot afford it is a key plank of the welfare state and is crucial to ensuring a basic standard of living for all. The cost of this welfare state commitment has, however, increased by almost a half in real terms over the last decade. The Housing Benefit bill in 2014-15 was £24.4 billion compared to £16.6 billion in 2004-05.[28] Equivalent to 1.1 per cent of GDP in 2004-05, Housing Benefit now stands at 1.4 per cent GDP.[29] This increase in spending is largely a result of the change in the way successive governments have chosen to support low-income households, not an increase in generosity (see Figure 2).[30] Instead of providing (social) housing, governments have chosen to pay for housing via the private rental market. Social housing supply has halved over the last ten years from 21,670 in 2004-05 to 10,840 in 2013-14[31] and there are 1.8 million households on waiting lists for council housing.[32]

**Figure 2: Housing Benefit caseload and expenditure**

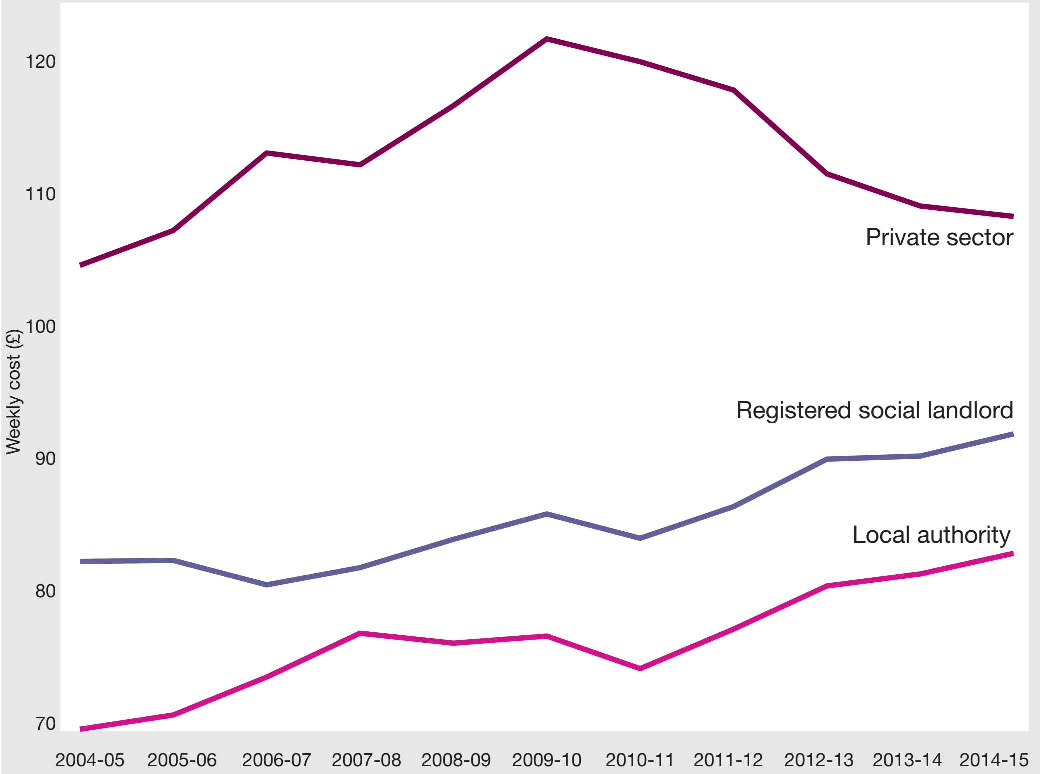
**Source: Department for Work and Pensions (2015), *Outturn and forecast: Budget 2015***




27 Office for Budget Responsibility, *Welfare Trends Report*.
28 Department for Work and Pensions, *Benefit expenditure and caseload tables, Outturn and forecast: Budget 2015*, March 2015.
29 Office for Budget Responsibility, *Welfare Trends Report*.
30 Andrew Hood and Laura Oakley, *The social security system: long-term trends and recent changes*, Institute for Fiscal Studies, November 2014.
31 Includes both local authority and housing association housing; Department for Communities and Local Government, *Affordable Housing Supply: April 2013 to March 2014 England*, October 2014.
32 Department for Communities and Local Government, "2010 to 2015 Government Policy: Rented Housing Sector," 7 May 2015.

As private rents are significantly more expensive than social rents (see Figure 3), this shift in policy has led to higher spending for little additional benefit, an inefficient way to help low income families meet their housing needs.

**Figure 3: Housing Benefit: average weekly rent**
**Source: Department for Work and Pensions (2015), *Outturn and forecast: Budget 2015*.**




The Government has committed to extending the Right to Buy scheme to Housing Association tenants. This policy risks depleting the stock of social housing further and therefore increasing the Housing Benefit bill in the longer term. From 1980 when then Prime Minister Margaret Thatcher introduced Right to Buy through to the end of 1990 just shy of a million houses were sold. Fewer than half that number were built. Since then, a further 915,000 houses have been sold through the Coalition Government's Right to Buy programme, with just 545,000 local authority and housing association houses built.[33] The Government has pledged a one-for-one replacement of the houses sold through the extension of the programme, but if taxpayers are to get better value for money for the billions they spend on Housing Benefit significantly more social housing is needed. Careful consideration needs to be given to the longer term implications of this policy.

Any substantial increase in house building will require sustained focus by the Government on ensuring the conditions for it: cheap land, flexibility in planning and investment.

**Recommendation**

The Government should reverse the shift towards private rental accommodation by investing in new social housing. This would require substantial capital investment, but over time would reduce the Housing Benefit bill and ensure that taxpayer money is being spent more efficiently.

33 Department for Communities and Local Government, "Social Housing Builds Statistical Data Set, Table 213"; Department for Communities and Local Government, "Social Housing Sales Statistical Data Set, Table 678."

### 3.1.2 Tax Credits

Tax Credits were introduced in 2003 to help tackle poverty and make work pay for low earners. These objectives are in line with a policy approach that seeks to increase wellbeing.

In the last decade, the Tax Credits bill has increased by a fifth in real terms, from £23.6 billion in 2004-05 to £28.8 billion in 2014-15.[34] If the polarisation of the labour market continues, the increasing number of low skill, low pay jobs means the Tax Credits bill is likely to keep rising.

The inadequacy of the National Minimum Wage has led to increasing calls for the introduction of a Living Wage, with many employers voluntarily paying it.[35] This, however, is easier for sectors that do not have high levels of low skill jobs. 58 per cent of people earning below the Living Wage work in Hotel and Restaurants, Wholesale and Retail, and Admin and Support Services.[36] Any drive by government to increase wages must therefore consider the potential employment impact by sector, and in particular the likelihood that job losses will have the biggest impact on the least skilled.[37] A better understanding is therefore needed of the trade-off between a loss of jobs and higher wages and this should take into account the wellbeing value of work for those with very low or no skills.

The Social Mobility and Child Poverty Commission has recommended that the Low Pay Commission "calculate non-binding sectoral and regional floors on pay so that employers, workers and trade unions have a credible reference point from which to make progress towards higher pay".[38] This is a sensible approach and the Government should press ahead with this.

**Recommendation**

The Government should have as an objective a reduction in the number of people on low pay. This should include encouraging employers to pay higher wages for those at the bottom of the earnings scale, and applying ministerial pressure where appropriate.

In addition, the Government should look at how people in low paid jobs can be supported to progress in work. Evidence of what works in this area is limited and therefore the Government should invest in testing different models. A social investment model similar to the Department for Work and Pensions Innovation Fund could be used.

### 3.1.3 Out of work sickness and disability benefits

Expenditure on out of work incapacity-related benefits has remained stubbornly high over the past decade despite significant reform. In 2004-05 the benefits collectively cost £15.4 billion; in 2014-15 the figure was £14 billion. The forecast for 2019-20 is £13.7 billion, nearly all of which is ESA.[39]

Unconditional support for those who are deemed, due to incapacity, unable to work or carry out any work related activity is a key principle of the welfare state. However, for many of those claiming sickness and disability benefits, the system is doing more harm than good. Given the well evidenced benefits of work, including for many sick and disabled people, and that labour market detachment increases over time,[40] the high number of people on these benefits coupled with the very low off-flow rates is devastating.

34 Department for Work and Pensions, *Benefit expenditure and caseload tables, Outturn and forecast: Budget 2015*, March 2015.
35 Social Mobility and Child Poverty Commission, *State of the Nation 2014: Social Mobility and Child Poverty in Great Britain*, October 2014.
36 Ibid.
37 David Neumark and William Wascher, *Minimum wages and employment: A review of evidence from the new minimum wage research*, November 2006.
38 Social Mobility and Child Poverty Commission, *State of the Nation 2014*.
39 Department for Work and Pensions, *Benefit expenditure and caseload tables, Outturn and forecast: Budget 2015*.
40 Carol Black and David Frost, *Health at work: An Independent Review of Sickness Absence*, November 2011.

The replacement of Incapacity Benefit (IB) with ESA was designed to help address the high numbers of people 'parked' on out of work sickness benefits. Announcing the reform, then Secretary of State John Hutton said "Nine out of ten people who come on to incapacity benefit expect to get back into work, yet if you have been on incapacity benefit for more than two years, you are more likely to retire or die than ever get another job. That cannot be right."[41]

In its 2006 Green Paper *A New Deal for Welfare* the then Government stated their aim to "reduce by 1 million the number on incapacity benefits".[42] Eligibility for ESA is determined by a Work Capability Assessment (WCA), which assesses an individual's capacity for work. Claimants can either be found 'Fit for Work' and moved on to Jobseeker's Allowance (JSA) or be found eligible for one of two groups within ESA – the Work Related Activity Group (WRAG) or the Support Group. Claimants in these groups are given a 'prognosis' which determines when they will be required to attend a reassessment WCA.

These reforms have had limited success. As of August 2014 there were almost 2.4 million people on incapacity benefits (ESA and IB), essentially the same number as in August 2008, shortly before ESA was introduced for new claims.[43] However within this, over half a million people were in the 'assessment phase', meaning they had not yet had their WCA to determine whether they were indeed eligible for the benefit. Nonetheless, of those who do undertake the WCA a high proportion then move fully onto ESA either in the WRAG (meaning they are able to undertake activity designed to help them move towards work) or the Support Group (meaning they are not required to participate in this type of activity). 70 per cent of claimants whose assessment was completed between July and September 2014 moved into one of these groups; 30 per cent were found Fit for Work.[44] A significant proportion of people who are found Fit for Work appeal and then move into the WRAG or Support Group: to date 39 per cent of all Fit for Work decisions have been appealed against and 51 per cent of those had their decision overturned.[45]

Despite a clear objective of ensuring fewer people languished on incapacity benefits, 51 per cent of those in the WRAG and 43 per cent of those in the Support Group have already been on ESA for more than two years.[46] Indeed the latest data on reassessment after a claimant's prognosis period shows 85 per cent remaining on ESA. Too many people for whom a move (back) into work could improve their health and wellbeing are instead, once again, becoming trapped on benefits.

**Reforming ESA**

In short, ESA is replicating the problems of IB. Part of this is the failure to reduce the attractiveness of the benefit. As the Organisation for Economic Co-operation and Development (OECD) pointed out in its 2010 cross-country review:

> *"Much of the widespread and increased use of disability benefit systems over the past two decades is related to the large and, in many cases, increasing difference between disability benefits and other working-age benefits; in particular differences in benefit generosity, participation and job-search requirements and the way in which beneficiaries are reactivated and supported into work."*[47]

The introduction of UC provides an opportunity to address this.

41 BBC News, "Hutton Unveils Benefits Shake-up," 24 January 2006.
42 David Freud, *Reducing Dependency, Increasing Opportunity: Options for the Future of Welfare to Work,* 2007.
43 ESA was introduced in October 2008 for new claims and IB claimants were migrated across to ESA over the last Parliament. In August 2008 there were 2,379,460 IB claimants, in August 2014 there were 2,367,017 ESA and IB claimants, just 12,290 fewer (Department for Work and Pensions, *Tabulation Tool*, http://tabulation-tool.dwp.gov.uk/100pc/tabtool.html, accessed 5 June 2015).
44 Department for Work and Pensions, "Employment and Support Allowance (ESA)," 16 April 2015.
45 Ibid.
46 Department for Work and Pensions, *Tabulation Tool*.
47 OECD, *Sickness, Disability and Work*, November 2010.

**The rate**

The weekly ESA WRAG and Support Group rates are respectively 40 and 50 per cent higher than that of JSA.[48] Whilst, as already highlighted, both financial and non-financial elements contribute to claimant behaviours, the monetary incentive for claimants to 'fail' the WCA and move onto ESA is significant.

Lowering the rate of ESA WRAG to that of JSA would re-balance the incentives and further contribute to making work pay. Contributions towards additional costs associated with a disability would continue to be paid via PIP, unrelated to a claimant's work status. This, however, would increase the incentive for people to be placed in the Support Group.[49] It may therefore be worth exploring the viability of introducing a single rate for out of work benefits. In doing so policy makers would need to consider the different purpose of the ESA Support Group, which currently has no work related conditionality due to the assumption that claimants' disability or health condition means they are unlikely to ever work – an assumption which in itself may be problematic. For those who are unable to increase their income through work, a higher payment may be appropriate to ensure a standard of living above the basic level provided through JSA.

**The gateway**

The WCA was introduced to provide a tougher gateway than had been in place for IB, ensuring eligibility for ESA was kept to those without immediate capacity for work. Since its introduction in 2008 the WCA has received heavy criticism. Multiple independent reviews have led to some reform, but it remains a discredited model. In a mid-2014 report, the Work and Pensions Select Committee stated:

> *"The WCA itself is flawed in that it frequently fails to provide an accurate assessment of the impact of the claimant's condition on their fitness for work or work-related activity."*[50]

Quite clearly, the assessment is not fit for purpose. The very low off-flow rate has already been mentioned. The composition of those on the benefit is also of concern: 48 per cent of people on ESA post-assessment have "Mental and Behavioural Disorders".[51] Whilst this is a broad category, a significant proportion are likely to be suffering from 'mild/moderate' problems.[52] In their independent review of sickness absence, Dame Carol Black and David Frost highlight that "[m]uch absence and inactivity is due to comparatively mild illness which is compatible with work" and that "[m]any people with long-standing health conditions are in work".[53] Indeed the OECD highlights that "Mental health tends to deteriorate significantly when people leave employment and improve again when people move back into employment."[54] Dr Litchfield in his fifth independent review of the WCA raised as a particular area of concern the number of young people assigned to the Support Group for mental health problems.[55]

As a basic principle, eligibility for benefits should be separated from assessment of employment support needs. An application for UC should involve the online collection of data pertinent to someone's distance from the labour market, akin to Australia's Job

48 The ESA WRAG weekly rate is £102.15, for the ESA Support Group it is £109.30. This compares to £73.10 for JSA.
49 For example in his fifth independent review of the WCA, Litchfield stated: "Time limiting applies only to those placed in the WRAG and therefore increases the existing financial incentive for individuals to be placed in the Support Group, if they need to remain on the benefit beyond 12 months", (Paul Litchfield, *An Independent Review of the Work Capability Assessment: Year Five,* November 2014).
50 House of Commons Work and Pensions Select Committee, *Employment and Support Allowance and Work Capability Assessments, First Report of Session 2014-15*, July 2014.
51 Department for Work and Pensions, *Tabulation Tool*, August 2014 data.
52 "common health problems…account for two-thirds of sickness absence and long-term incapacity (ie. mild/moderate mental health, musculoskeletal and cardio-respiratory conditions)." (Waddell and Burton, *Is Work Good for your Health and Wellbeing?*)
53 Black and Frost, *Health at work*.
54 OECD, *Sickness, Disability and Work*.
55 Litchfield, *An Independent Review of the Work Capability Assessment*.

Seeker Classification Instrument.[56] For example their age and employment history over, say, the past five years (using DWP and HM Revenue and Customs data); where they live; any diagnosed health conditions (with an option to provide health practitioner details and permission to contact them); and a psycho-social test. For those flagged as having a significant health-related barrier to work, a comprehensive ‘biopsychosocial’ assessment – ie. one which considers biological, psychological and social barriers to work – should be undertaken separately to produce a rehabilitation plan for claimants.

**Conditionality**

Given that people with common health problems should be “encouraged and supported to…(re-)enter work as soon as possible” due to the physical, mental and social benefits, the low levels of conditionality within ESA are potentially harmful.[57] Work Programme job outcome rates are instructive. Provider payment rates are higher for those in the JSA ex-IB group (ie. for claimants who moved from IB onto JSA) than for participants in the ‘new ESA’ payment group because they are judged harder to get into work. Yet the job outcome rates for the harder to help JSA ex-IB cohort are 18 per cent higher than those for the short prognosis new ESA claimants.[58] DWP should look into what is driving this, paying particular attention to the effect of the differing levels of conditionality for JSA and ESA.

In February 2015 the Prime Minister announced that he had asked Dame Carol Black to undertake a review into how people with treatable conditions can be best supported, including “consider[ing] whether people should face the threat of a reduction in benefits if they refuse to engage with a recommended treatment plan.”[59]

**Recommendation**

The Government should, as a priority, review the principles upon which out of work support for those with a disability or health condition is built. In doing so it should:

- pay particular attention to ensuring that the benefit encourages and supports claimants to move into work as quickly as possible;
- reduce the Work Related Activity Group rate to that of the Jobseeker’s Allowance;
- explore the advantages and disadvantages of a single rate out of work benefit;
- overhaul the gateway and assessment process to ensure that recipients receive personalised, rehabilitative employment support as quickly as possible;
- consider the scope for mandating claimants to follow a rehabilitation plan and engage fully in back-to-work programmes.

56 The Job Seeker Classification Instrument assesses a job seeker’s relative difficulty in getting into and staying in work. It helps to determine the level of support a job seeker will need to help them find work. Job seekers are assessed when they register for employment assistance and if they experience a significant change in their circumstances. They are allocated to one of the three levels of employment assistance – Streams 1, for work ready job seekers, 2, or 3, as appropriate to their needs. Job seekers who have complex or multiple barriers to employment may be allocated to Stream 4 services or referred to other services such as Disability Employment Services. The Classification Instrument uses a range of factors to determine a person’s distance from the labour market, including; employment history, geographical location, ethnicity, medical history and living circumstances. For the full list of factors assessed, visit http://employment.gov.au/job-seeker-classification-instrument.

57 Waddell and Burton, *Is Work Good for Your Health and Well-Being?*

58 19.3 per cent of JSA ex-IB claimants referred to the Work Programme in December 2012 achieved a job outcome by December 2014 compared to 15.8 per cent of the equivalent New ESA (excluding 12 month prognosis) claimants (Department for Work and Pensions, *Tabulation Tool*, http://tabulation-tool.dwp.gov.uk/100pc/tabtool.html, accessed 5 June 2015).

59 Rowena Mason, “David Cameron calls on obese to accept help or risk losing benefits,” *The Guardian*, 14 February 2015.

## 4. Conclusion

The welfare state is central to the wellbeing of the nation. Multiple objectives, however, require trade-offs to be made and government must balance the interests of claimants and taxpayers. The legitimacy of the welfare system relies in large part on perceptions of fairness, a theme that the Coalition Government adopted and one that the new Government looks set to continue. However, where the Coalition was able to make significant cuts to expenditure, the current Government faces a harder task. The Government must avoid making short-term cuts that will erode the wellbeing of those on very low incomes and instead focus on the drivers of demand. As such, the Government should prioritise moving people into and keeping them in work. It should also focus on addressing the structural drivers of the three biggest benefit budgets: Tax Credits, Housing Benefit and sickness and disability benefits.