# something for something restoring a contributory principle to the welfare state

Duncan O'Leary

June 2013

DEMOS

# SOMETHING FOR SOMETHING

## RESTORING A CONTRIBUTORY PRINCIPLE TO THE WELFARE STATE

Duncan O'Leary

June 2013

DEMOS

Published by Demos


Third Floor
Magdalen House
136 Tooley Street
London SE1 2TU

T 0845 458 5949
F 020 7367 4201

hello@demos.co.uk
www.demos.co.uk

## Introduction

There is growing interest in the contributory principle in welfare. Liam Byrne, the shadow welfare spokesman, has said that, if elected in 2015, Labour would 'strengthen the old principle of contribution'[i]. This echoes Ed Miliband's promise that 'Labour will be a party that rewards contribution, not worklessness'.[ii] Others, on the Centre-Right, are also pursing the idea of a more contributory system. The Conservative MP Chris Skidmore argues that the contributory principle could be revived through a system of loans to welfare claimants, which would be paid back through future contributions[iii].

This paper explores a new idea for contributory welfare. It proposes changes which would achieve three things:

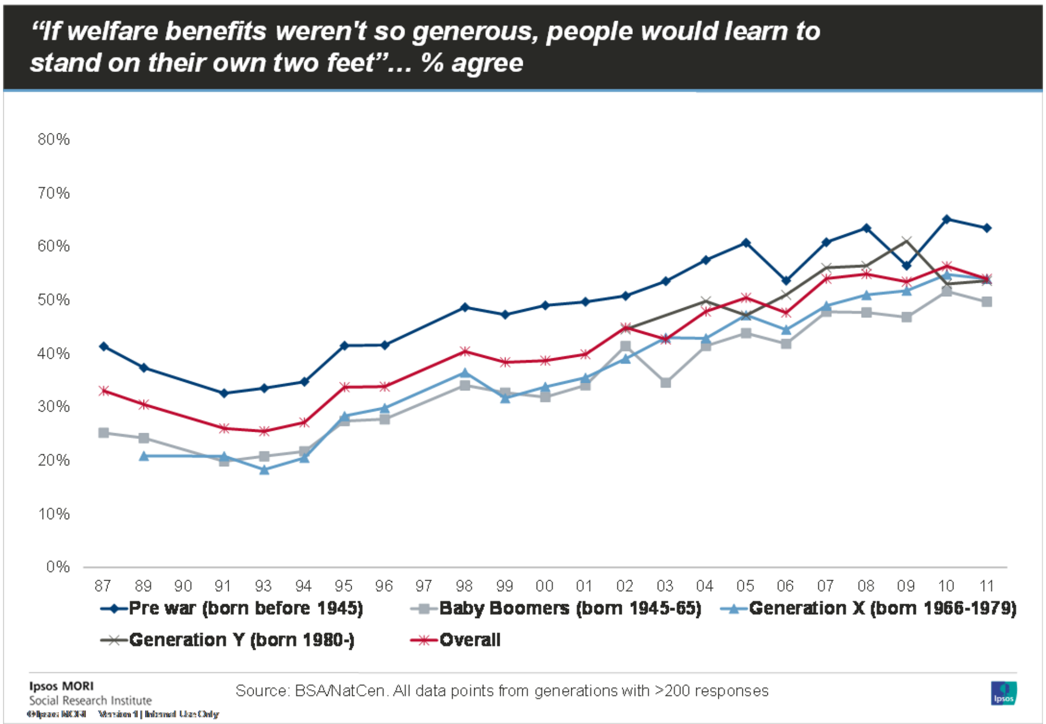
1. Creating a two-tier system for Job Seekers Allowance, in which those who have strong contribution records would be entitled to more during periods of unemployment (£94.74 per week compared to £71.70 for non-contributors). This would reward work and encourage a greater sense of reciprocity in the welfare system.
2. Equalising out-of-work benefits for disabled and non disabled people. This would reduce the incentive for people to claim disability benefits, which are currently at a higher rate than Job Seekers Allowance, and tackle stigma around disability benefits in the process.
3. Increasing the Personal Independence Payment (PIP), the benefit replacing the Disability Living Allowance ,which helps disabled people meet the extra costs of living that they face by virtue of being disabled, regardless of whether they are in work or not.

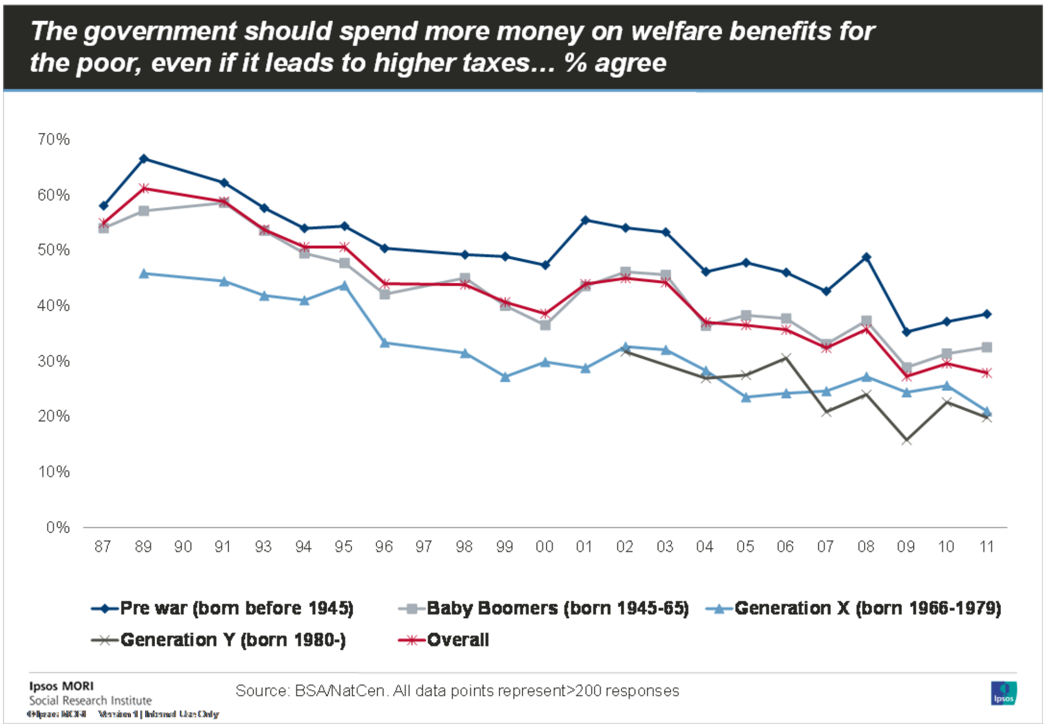
The ideas presented in this paper would neither reduce nor increase the benefits bill for government. Their purpose is to reinforce a sense of reciprocity, which is the basis for public support for the welfare system.

## Public attitudes

The last twenty years have seen a sharp decline in public support for important aspects of the welfare state. For example, the percentage of the population agreeing with the statement, "the government should spend more money on welfare benefits for the poor, even if it leads to higher taxes," peaked in 1989 and has been on a broad, downward trajectory ever since. More people disagreed than agreed with the statement for the first time in 2007. Similarly, the proportion of people who agree with the statement that “if welfare benefits were not so generous people would learn to stand on their own two feet’ has increased from around” from around one third of the population in 1987 to more than half in 2010.

Research by Demos[iv] and Ipsos MORI[v] for the Joseph Rowntree Foundation has shown that there is also a generational aspect to this. Younger generations, for example, are less likely than older generations to consider the welfare state ‘one of Britain’s proudest achievements’ or to believe that the present government should engage in more tax funded redistribution. Whilst the public still support the welfare state in general, this support is on the wane.




It is in this context that momentum has grown for a revival of the contributory principle – a key feature of William Beveridge's vision for the welfare state which has faded away under successive governments. Key moments at which the contributory principle has been diluted include:

- 1982, when the Thatcher administration abolished the Earnings Related Supplement, which had ensured that those with strong work records received higher benefits during periods of unemployment.
- 2003, when tax credits were introduced (and subsequently expanded) as means-tested benefits for the working age population.
- 2012, when the coalition government limited contributory entitlements to Employment and Support Allowance (ESA) to 12 months. ESA is provides financial support for those who become unemployed due to illness or disability, in return for the national insurance contributions they made during their working life.

The net result of these changes and others like them is that the British system has a much weaker contributory element than many other countries, including Austria, France, Germany, the Netherlands, Denmark, Finland, Norway, Sweden, Canada and the United States.[vi] This has been characterised as a 'nothing for something' system, in which many people contribute over a number of years, only to find themselves entitled to very little when they require help. Reviving the contributory principle is increasingly seen as a way of addressing this problem. Polling evidence shows it would be a popular approach: notions of contribution are more popular with the British public than either means testing, or means-and-contribution-blind universalism in welfare.[vii]

The challenge is how to find the money to pay for enhanced entitlements for contributors in an era of constrained public spending. Only 6% of the public say they want the government to respond to the fiscal crisis by 'increasing taxes to maintain benefits at their current level'[viii], suggesting the scope for increasing public spending on welfare is extremely limited. Meanwhile, reducing entitlements for non-contributors has its own drawbacks – not least the risk of pushing more people into poverty. In addition, there is little appetite to reduce spending on pensioner entitlements to increase those for the working age population. The proposal that follows works within these parameters, finding the money from the budget already spent on the working age population.

## A contributory proposal

In order to find the money for a more contributory system we propose that the government reduces spending on the Support for Mortgage Interest (SMI) scheme[ix]. SMI goes to homeowners in receipt of income-related benefits for those out of work. SMI is normally paid direct to lenders; it covers the interest on up to £200,000 of loans or mortgages or loans taken out to finance home improvements (or £100,000 for those receiving Pension Credit). In this respect it is a needs-based benefit, driven not by what people have put into the system but what they require out of it.

We propose that in 2015 the government closes the scheme to new entrants from the working age, non-disabled population (therefore preserving the entitlements of pensioners and people with disabilities). The government expects to spend £359 million in 2013/14 on SMI[x]. The non-disabled working age population account for approximately £270 million of SMI per annum (see table appendix 1). This much could be saved within two years as the working age population is only able to claim JSA for this long, meaning the entitlements of all existing claimants would have expired during this period[xi].

The £270 million savings from this reduction could then be split between those people claiming Job Seekers' allowance who meet the criteria for contributory welfare (to reach this threshold claimants must have paid enough Class 1 National Insurance contributions in the two tax years prior to making a claim).[xii] This represents around 226,400 claimants at any one time[xiii]. This works out at £23.04 extra per claimant per week, allowing for contributory JSA (for over 25s) to be raised from £71.70 per week to approximately £95 per week. This would leave two tiers of benefits:

a. *Contributory JSA:* **£94.74**

b. *Income-based JSA:* ***£71.70***

This raises the question of what, if anything, should be done to ensure that those losing entitlements to SMI are protected from losing their homes in the event of a spell of unemployment. We make three recommendations to address this:

1. The changes to the scheme should not affect any existing claimants. Closing the scheme to new entrants would mean that only those who might have claimed in the future would lose out.
2. Mortgage providers should be obliged to provide notice to their customers that they will be auto-enrolled into *Mortgage payment protection insurance (MPPI)*, providing those customers with the chance to opt out of such insurance. This would mean that anyone who had not insured themselves against their mortgage costs in the event on unemployment would have actively made that choice. All others would be insured. One option to protect against mis-selling would be to preclude mortgage providers from selling their own MPPI products to those people they were lending to.
3. Mortgage providers would also be legally required to ask all new mortgage customers whether they would like to sign up to MPPI when taking out a mortgage.

The government's SMI scheme covers interest payments on up to £200,000 of a mortgage, at a rate of 3.63%. Individuals can make a claim after 13 weeks (91 days) of unemployment and can typically claim for two years. The government has consulted on whether to return to a waiting period of 39 week (273 days) and a £100,000 limit.[xiv]

A rate of 3.63% on a mortage worth £200,000 requires people to make monthly mortgage interest payments of £605. The cost to individuals to insure themselves against this risk through MPPI, with a 90 day waiting period and the ability to claim for two years would be around **£33 per month** – less than the average monthly mobile phone bill.[xv] Those wishing to insure themselves under the same terms for one year, rather than two, would be required to pay around **£21 per month**. Coverage for one year, but with a longer waiting period of 120 days (less than half the amount of time suggested in the governent's consultation) would reduce costs to around **£10 per month**.

One argument against this kind of proposal is that the government should not be 'nudging' people to protect themselves through MPPI, given the mis-selling of Payment Protection Insurance (PPI), a similar product, in recent years. There are two responses to this objection. The first is that the market for insurance products is now more heavily regulated than was the case during the period in which wide scale mis-selling of PPI took place. The second is that the problem in this marketplace was *mis-selling*, not the fundamental principle of people insuring themselves against the risk of accident, illness or unemployment. Policymakers should concentrate on rooting out these practices, rather than writing off the product itself.

## Aligning out of work benefits for disabled and non-disabled claimants

To reinforce this contributory principle, a further reform could bring out-of-work benefits for disabled and non-disabled claimants into alignment. ESA is currently £100.15 per week once claimants over 25 have been assessed and placed in the Work Related Activity Group. (The ESA work-related activity group is for claimants who the DWP consider will be capable of work at some time in the future and who are capable of taking steps towards moving into work immediately).[xvi] This £100.15 per week compares with JSA which is currently £71.70 for both contributory and non-contributory claimants[xvii].

Under the changes proposed above, there would be two tiers of JSA:

a. *Contributory JSA:* ***£94.74***
b. *Income-based JSA:* ***£71.70***

Our proposal is that ESA would mirror this, similarly leaving two tiers:

a. *Contributory ESA:* ***£94.74***
b. *Income-based ESA:* ***£71.70***

The money saved in making this change would then be transferred to increase the Personal Independence Payment (PIP) which covers the living costs for all disabled people, whether unemployed or not. We suggest that this change should be phased in, so that it would only affect new ESA claimants rather than those already in the system. This would mean slightly reduced PIP entitlements for new claimants during the transition period, by comparison to an immediate change affecting all claimants, but the advantage of a phased approach would be to avoid a sharp drop in the living costs for those currently claiming income-based ESA. After the completion of the transition period **£1,023,456,512** per year would be reallocated from the ESA budget to the PIP budget (see Appendix 2).

Whatever the decision regarding how quickly the change should be implemented, the rationale for such a move is twofold. First, the current system conflates two things: the cost of being disabled and the cost of being unemployed. Instead of this, we propose that disabled people should be supported to meet any extra living costs by virtue of their disability, regardless of their employment status. This is the job of PIP payments. Being out of work, by contrast, should not add any *additional* expense for disabled people than it does for non-disabled people. It therefore makes sense to align out-of-work benefits for disabled and non-disabled claimants – and reallocate money 'saved' from reductions in ESA entitlements to enhance PIP payments, which cover living costs for disabled people. As such, this change would *not* represent a cut in welfare, but rather realignment from one disability benefit to another.

The second reason for making this change is that it would help reassure the public that people are not being wrongly categorised as disabled and therefore claiming more than they ought to be entitled to. There is evidence that the stigma attached to disability benefits may be on the rise. In August 2011, 47% of disabled people said that attitudes towards them had worsened over the last twelve months, while in February 2012 six disability charities warned against 'rising public resentment' of disability benefit claimants[xviii]

The changes proposed here would reduce any incentive for people out-of-work to claim disability benefits rather than Job Seekers Allowance because the entitlements for the two would be identical. With the two benefits set at the same rate(s) there would be little advantage to claiming ESA rather than JSA. As such, the task of reassuring the wider public that the system does not set the wrong kind of incentives would be much easier.

It should be noted that the number of people claiming ESA is smaller than the number of people claiming PIP. This means that savings from a smaller group would be spread over a larger group, with some individuals therefore losing out. We return to this problem at the end of the next section.

## Increasing support for the living costs associated with disability

Aligning the entitlements for out-of-work benefits for disabled and non-disabled claimants would open up a further opportunity. With far less riding on whether people should be claiming ESA (a disability benefit) or JSA, the government would be in a position to abolish the controversial Work Capability Assessment (WCA).

Currently, the government carries out two assessments:

1. The WCA which establishes whether people will claim ESA or JSA – and which ESA group people should fall into. This means that people are placed in one of three groups:
    i. Fit for work (32% of people[xix]) and therefore entitled only to JSA at £71.70
    ii. Work related activity (38% of people[xx]) and therefore entitled to ESA at £100.15

iii. Support group who are deemed unable to work (30% of people[xxi]) and therefore entitled to £106.50 per week.[xxii]

2. The PIP assessment, which establishes the extra living costs associated with a person's disability. This assessment seeks to establish the extra costs arising from a long term ill-health condition or disability, based on how a person's condition affects them, rather the condition they have.

Most of the controversy surrounding the WCA focuses on whether people will be deemed fit for work (and therefore eligible for JSA) or placed in the Work Related Activity group (and therefore eligible for the higher ESA). Under our proposals JSA and ESA would be at the same level, reducing the incentives for people to claim ESA rather than JSA. This would make the WCA far less important – to both claimants and the government – than is currently the case. Having two tests is also unnecessary duplication, costing the taxpayer and asking disabled people to go through more assessments than ought to be the case.

We propose that the WCA and the PIP tests be rationalised into one single assessment, with the PIP assessment responsible for (a) establishing living costs, as is already the case, and (b) establishing whether people are ever likely to be able to return to work (those who this applies already become part of the 'support group', who receive higher payments. The Work Capability Assessment costs the government **£112.4 million** each year.[xxiii] With the rationalisation of these two tests, this bulk of this money could be reallocated to increase PIP payments, making up more than two thirds of the shortfall for recent cuts in this area, which are estimated at £160 million per annum.[xxiv]

## Conclusion

How and whether to restore the contributory principle in welfare for the working age population looks set to be key battleground at the next general election. Research into public attitudes suggests that the idea could be an important one bolstering support for welfare, through re-establishing a clearer link between what people put in and what they can take out in times of need. The central question for proponents of a more contributory system is how to achieve this without asking for more money from the taxpayer. This short paper sets out one route to achieving that. The proposals set out above are to:

1. Close the Support for Mortgage Interest scheme to new entrants from the working age, non-disabled population in 2015 (therefore preserving the entitlements of pensioners and people with disabilities).
2. Require mortgage providers to provide notice to their customers that they will be auto-enrolled into *Mortgage payment protection insurance (MPPI)*, providing those customers with the chance to opt out of such insurance.
3. Create a two tier system for Job Seekers allowance, in which those who have strong contribution records would be entitled to more during periods of unemployment.
4. Align entitlements for *Employment and Support Allowance (ESA) with those of Job Seekers allowance, also resulting in* a two tier system for Job Seekers allowance, in which those who have strong contribution records would be entitled to more during periods of unemployment.
5. Allocate savings from the ESA budget made to the budget for the Personal Independence Payment (PIP), which covers additional living costs for disabled people.
6. Merge the Work Capability Assessment with the PIP assessment and allocate the savings from this to the PIP budget.

Taken together, these changes would:

- Promote personal responsibility, through homeowners insuring themselves against risk incurred by their own choices (taking out a mortgage).
- Engender reciprocity, through a system which rewards contribution,

- Address unwelcome stigma associated with disability benefits and improve incentives for honesty, through aligning ESA and JSA
- Respect the dignity of those who are disabled, through scrapping the WCA and requiring people to undergo one assessment rather than two.
- Increase support for the living costs associated with disability, by reallocating the cost of the WCA to the PIP budget.

*Duncan O'Leary is Deputy Director of Demos think tank.*

## Appendix 1: Moving resources from SMI to contributory JSA

- SMI is projected to cost £356 million per in 2013.14[xxv].
- 230,000 people claim it at any one time[xxvi].
- 38% of that group are over 65 = 87,400 people. That leaves 139,500 working age claimants. That leaves 142,600 working age claimants.
- 32% of the working age population are in receipt of DLA = 45,632 people. That leaves 96,698 non-disabled, working age claimants of SMI.
- The average claim per person, per year, is estimated at £2,805.06 (see table below). This means that the 96,698 non-disabled, working age claimants claim a total of **£271,243,691.88** per year.
- There are approximately 226,400 contributory JSA claimants at any one time.
- £271,243,691.88 divided between 226,400 people = £1,198.07 extra per person per year
- This works out at £23.04 extra per claimant, raising contributory JSA from £71.70 per week to £94.74.

| Age | % non disabled working age SMI claimants | Total non-disabled working age SMI claimants | Average £ per week | Average claim per year | Total |
|---|---|---|---|---|---|
| 25-29 | 2% | 1,897 | £94 | £4,888 | £9,272,536 |
| 30-34 | 6% | 5,692 | £83 | £4,316 | £24,566,672 |
| 35-39 | 12% | 11,383 | £70 | £3,640 | £41,434,120 |
| 40-45 | 17% | 18,061 | £61 | £3,172 | £57,289,492 |

| | | | | | |
|---|---|---|---|---|---|
| 45-49 | 20% | 18,972 | £52 | £2,652 | £50,313,744 |
| 50-54 | 21% | 19,920 | £45 | £2,340 | £46,612,800 |
| 55-59 | 21% | 19,920 | £38 | £1,976 | £39,361,920 |
| 60-64 | 0% | 0 | £0 | £0 | £0 |
| **Total** | | 95,845 | | | **£268,851,284** |

*Table: Support for Mortgage interest claims – 2010 figures*[xxvii]

£271,243,691.88 divided between 95,845 people = an average SMI claim of **£2,805.06** per year.

## Appendix 2: Equalising ESA and JSA, whilst shifting resources from ESA to PIP

- ESA is currently £71.70 for 13 weeks (for over 25s) until people are assessed. It is then £100.15 per week for those in the Work Related Activity Group.
- Under the new system there would be two tiers, as with JSA:
  - Contributory JSA: **£94.74**
  - Income-based JSA would be **£71.70**
- Approximately 2.5 million people claim ESA every month.
- Of those approximately 32% are in the Work Related Activity Group (WRAG) after assessment, translating into 800,000 people in the WRAG at any one time[xxviii].

- They each claim £100.15 per week, working out at £80,120,000 total claimed by WRAG claimants every week.
- Assuming a contribution rate for ESA that is proportional to JSA (16.7%)[1] that leaves 133,600 WRAG claimants claiming contributory JSA and 666,400 claiming income-based ESA.
- Under the new rates that leaves the spend at:
    - 133,600 people x £94.74 = £ 12,657,264
    - 666,400 people x £71.70 = £47,780,880

  The difference between the old system and the new system is £80,120,000 – £60,438,144
  = £19,681,856 per week, or **£1,023,456,512 per year** reallocated from ESA to the PIP.

The Work Capability Assessment costs the government **£112,400,000** each year. This money would also be added to the PIP, leaving a total budget of £112,400,000 + **19,681,856** = **£1,135,856,512 per year** added to the PIP.

In practice, PIP payments would not increase by the same amount for every claimant, because PIP payments are made according to individuals different needs and circumstances. However, the average gain per claimant would be **£8.09 per week** per person. This is £1,135,856,512 per year divided between 2.7 million PIP claimants = £420.69 extra per claimant, per year – or £8.09 per week per person.

On average, this would mean that:

- Those claiming contributory ESA would see their ESA drop from to (£100.15 - £94.74) = £5.41, but their payment PIP increase by £8.09 per week. This would mean a **weekly gain of £2.68** during a period of unemployment.
- Those claiming income-based ESA would see their ESA drop from to (£100.15 - £71.70) = £28.45, but their payment PIP increase by £8.09 per week. This would mean a **weekly loss of £20.36**

However, looking at the situation as a snapshot does not give the full picture, as losses to ESA would be time-limited (assuming people in the Work Related Activity Group return to work and therefore move off ESA), whereas increases in PIP would be permanent – continuing when people return to work. All PIP claimants who had previously claimed ESA would therefore begin to benefit from the new system, on a week-by-week basis, upon returning to work.

# NOTES

[i] http://www.bbc.co.uk/news/uk-politics-22056212
[ii] http://www.politics.co.uk/comment-analysis/2011/06/13/ed-miliband-responsibility-speech-in-full
[iii] http://chrisskidmoremp.files.wordpress.com/2012/11/beveridge2.pdf
[iv] http://www.demos.co.uk/projects/talkingaboutourgeneration
[v] http://www.ipsos-mori-generations.com/welfare
[vi] http://www.tuc.org.uk/social/tuc-20994-f0.pdf
[vii] http://www.policy-network.net/publications/4320/European-Welfare-States-after-the-Crisis-Changing-public-attitudes
[viii] http://www.policy-network.net/publications/4320/European-Welfare-States-after-the-Crisis-Changing-public-attitudes
[ix] https://www.gov.uk/support-for-mortgage-interest/overview
[x] https://www.gov.uk/government/news/support-for-mortgage-interest-must-be-fair-and-affordable
[xi] http://www.parliament.uk/briefing-papers/SN06618
[xii] https://www.gov.uk/jobseekers-allowance/what-youll-get
[xiii] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/182926/foi-45-2011-jsa-conts.pdf.pdf
[xiv] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/176907/support-for-mortgage-interest-call-for-evidence.pdf.pdf
[xv] The average annual phone bill is £495, working out at around £36.50 per month. http://www.telegraph.co.uk/technology/mobile-phones/8441980/Britons-could-save-195-each-per-year-on-mobile-phone-bills.html
[xvi] http://www.benefitsandwork.co.uk/employment-and-support-allowance/esa-glossary/1345-work-related-activity-group
[xvii] Contributory JSA claimants can claim for 6 months. This would not change under our proposals.
[xviii] http://www.turn2us.org.uk/PDF/Benefits%20stigma%20Draft%20report%20v9.pdf
[xix] http://statistics.dwp.gov.uk/asd/workingage/esa_ibr/esa_ibr_jan13.pdf
[xx] http://statistics.dwp.gov.uk/asd/workingage/esa_ibr/esa_ibr_jan13.pdf
[xxi] http://statistics.dwp.gov.uk/asd/workingage/esa_ibr/esa_ibr_jan13.pdf
[xxii] https://www.gov.uk/employment-support-allowance/what-youll-get
[xxiii] http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/744/744.pdf
[xxiv] http://www.publications.parliament.uk/pa/cm201012/cmselect/cmworpen/1493/1493we04.htm
[xxv] http://www.parliament.uk/briefing-papers/SN06618
[xxvi] http://www.parliament.uk/briefing-papers/SN06618
[xxvii] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/175060/support-for-mortgage-interest.pdf.pdf
[xxviii] http://statistics.dwp.gov.uk/asd/workingage/esa_ibr/esa_ibr_jan13.pdf

Recent years have seen a growing interest in the contributory principle in welfare. Social attitude surveys have seem to indicate a sea change in public attitudes, with many disillusioned by the current system, feeling it promotes a 'nothing for something' culture.

Politicians from across the political spectrum have begun to respond to this dissatisfaction. Conservative MP Chris Skidmore proposed a system of loans to welfare claimants, which would be paid back through future contributions. Meanwhile, Liam Byrne, the shadow welfare spokesman, has said that, if elected in 2015, Labour would 'strengthen the old principle of contribution'. This echoes Ed Miliband's promise that 'Labour will be a party that rewards contribution, not worklessness'.

This short paper sets out  a new idea to reintroduce the contributory principle into the welfare system. It proposes a cost-neutral alternative, creating a two-tier system to reward work and encourage a greater sense of reciprocity within benefits. It suggests that failing to do so threatens the very basis of public support for the welfare system.

Duncan O'Leary is Deputy Director of Demos.

£10