REFORMING CONTRIBUTORY BENEFITS

Roundtable Report

5th July 2016

CSJ The Centre for Social Justice

Attendees

- Baroness Philippa Stroud (Chair)
- Stephen Brien
- Deven Ghelani
- John Godfrey
- David Hagarty
- Ted Hart
- Matthew Oakley
- David Rutley MP
- Pete Searle
- Ryan Shorthouse

Introduction

> "We have already come a long way in the last 5 years. In the last Parliament we created Universal Credit so that work would always pay. We capped benefits so we struck the right balance between incentivising work and supporting the most vulnerable. And we set up the largest programme to get people into work since the 1930s with over a million people coming off the main out of work benefits and over 2 million getting into work. But when it comes to reforming, we still have further to go …"
>
> David Cameron, June 2015[1]

> "The mission to make Britain a country that works for everyone means more than fighting these injustices. If you're from an ordinary working class family, life is much harder than many people in Westminster realise"
>
> Prime Minister Theresa May, July 2016[2]

William Beveridge's original blueprint for a welfare state had personal contributions at its core. Indeed, there is widespread consensus that the contributory principle inculcates a degree of responsibility and ownership in a system that has been criticised for breeding dependency.

However, contributory benefits have increasingly been rendered redundant for a variety of reasons: firstly, as a result of their decreasing

1 Speech by Prime Minister David Cameron MP, *Life Chances Agenda*, 22 June 2015

2 Speech by Prime Minister Theresa May MP on steps of Downing Street after becoming PM, 13 July 2016.

value; secondly, due to the fact that there is little relationship between the amount claimants receive and the amount they contribute; and thirdly, as a result of rules around claimants' 'capital limit'[3] within the Universal Credit provisions. The contributory elements of JSA and ESA that exist within the Universal Credit system complicate a system that was designed to be simple and ultimately increase administrative costs. Simply put, contributory benefits are due for reform.

One of the reasons why this has not happened so far has been the commitment to EU rules on maintaining a benefit programme that is exportable. The British Government succeeded in establishing that Universal Credit would not be exportable as long as contributory benefits were. Had contributory benefits been abolished whilst UK social security was bound by EU law, this would have exposed Universal Credit (the significantly larger budget) to exportability. In light of the British vote to leave the EU, however, there is now the possibility of reforming contributory benefits without breaching EU law.

There is a widespread consensus within the policy world that there should exist both a social assistance programme (non-contributory welfare) and a social insurance programme (a contributory system). The state should enable a state assistance programme and facilitate a state insurance programme, but should not determine premiums and should not act as an actuary. This is conceptually similar to the pension system, where Governments have created a universal basic pension that can be accessed by all, with additional products available as an add-on.

3 Also known as a 'savings limit', under Universal Credit, if you have savings or capital between £6,000 and £16,000, this is assumed to give you an income. This is called tariff income. For every £250 of savings or capital you have over £6,000, it's assumed this gives you an income of £1 a week

Context

At the heart of the previous Government's welfare reforms was a belief in simplifying the welfare system and promoting social norms such as saving, home ownership, and work. Following the financial crisis of 2008, welfare reforms were introduced during a time of economic uncertainty and fiscal austerity, meaning that changes were introduced at a time of increased political and economic scrutiny.

Now that Universal Credit has begun to be rolled out, contributory benefits have become increasingly redundant in several ways. JSA and ESA contributory benefits have nothing to do with their original contributory purpose – instead, they increase the complexity for claimants looking to claim either Universal Credit or their JSA/ESA allowance. The new JSA and Universal credit rules also limit benefit eligibility for households with savings of £16,000 or less. This means that households with above £16,000 in savings face an income shortfall and can only claim JSA or ESA contributory benefits on a time-limited basis until their savings fall below the £16,000 threshold. Finally, JSA and ESA contributory benefits pay out at the same rate as Universal Credit, reducing any incentive to save and contribute into the system.

Eliminating contributory benefits would produce a number of benefits, which are outlined and explained within this report. Individuals previously eligible for contributory JSA and ESA would fall into one of three categories: 'full Universal Credit entitlement', 'partial entitlement,' and, finally, 'no entitlement'. The projected annual savings from individuals who fall under 'no entitlement' and have no welfare claim would amount to £60m from JSA and £290m from ESA per

annum. Total savings over the 2015–2020 period would come to approximately £1.66bn.[4]

This is a conservative baseline estimate with different foundational assumptions. If we take into account households that would be only receive a part of their Universal Credit entitlement (because they had other earnings), the potential annual savings could rise to as much as £500m in 2016/17 (total savings of £2.7b across 2015–20).[5] This figure does not include the administrative savings from cutting contributory benefits meaning that further savings could be made on top of this estimate.

There is a strong case to be made for reforming the contributory benefits system. Firstly, following the introduction of Universal Credit (UC), contributory benefits have a seriously over-complicating impact on the delivery of UC (although it was suggested during the roundtable discussions that a time-limited exemption of the savings threshold could mitigate this). Secondly, for the majority of UC claimants, contributory benefits are unnecessary and yet at the point of claim these largely redundant benefits legally *have* to be offered and explained. Thirdly, contributory benefits are only of use to those with savings over £16,000 (and in reality these claimants could be better off with an insurance model). Finally, reform would help deliver the government's dual aim for the benefits system: to ensure the system supports those most in need and is seen as fair by the tax payer.

4 Calculations provided to the CSJ by Policy in Practice (http://policyinpractice.co.uk/)
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A potential solution

During the roundtable discussion, participants discussed a potential solution put forward by Legal & General. The suggestion was to replace the contributory benefits system with a low premium social insurance scheme delivered by employers through an auto-enrolment structure. This new social insurance scheme would take the form of a 'rainy day guarantee', where beneficiaries would make regular payments into the scheme, which would protect against the risk of future income shocks as a result of long term sickness or unemployment.

The typical recipient of contributory benefit support – and therefore the target for the new social insurance scheme – would not be part of the long term unemployed demographic, or even a regular claimant of income support. Instead, the new scheme would suit individuals from the professional and skilled class who have fewer transactional experiences with Government. They are less likely to suffer a shock to income from illness or sudden unemployment and often need support infrequently and for less than six months.

Mechanics

The infrastructure of this new social insurance scheme could replicate that of the auto-enrolment pension products that have been phased-in under the previous and current Governments. Employers could offer new employees access to a 'social insurance product' that could be administered by a private sector organisation, though partially facilitated by the Government.

The scheme would work for households with more than £16,000 in

savings who are facing a sudden income shock. It would also provide an appropriate pay-out that could sustain an individual's quality of life.

The new social insurance product would benefit from the same law of averages that allows traditional insurance markets to function. Increasing the number of people within the system allows for pooling of assets and effective risk mitigation. The larger the number of premium payers, the lower the risk profile across the total claimant population and the lower the total cost of enrolment. L&G estimate a cost of around 0.5% of payroll earnings at approximately £11 a month. Total pay-out would be £900 a month for a maximum period of one year, with a 50% replacement rate.[6]

After one year, a claimant would return to the state benefit system. A total of £10,800 could be claimed via the social insurance product. Ultimately this 'rainy day guarantee' has been designed so that a claimant would receive more than they otherwise would have on state welfare, and so that significant costs are delivered to both the taxpayer and to employers.

Advantages of reform

Reducing complexity

The new social insurance model solves many problems intrinsic in the current welfare system, not least of which is the problem of complexity. General consensus is that contributory benefits are complicated to administer and that furthermore, their relatively small size makes them insignificant to the larger goal of increasing

6 Figures provided by Legal & General, 5 July 2016

incomes and reducing poverty. The proposed insurance scheme takes administration away from the public sector, thereby reducing complexity within the bureaucracy while still maintaining the social value of the programme.

A new insurance model would also allow competition, greater diversification and, finally, the opportunity for claimants to take control over their long term financial support.

A better deal for the end user

The new social insurance scheme would increase pay-outs to the claimant. Under the proposed 'rainy day guarantee' scheme, a claimant who earns £27,000 a year could receive £900 a month which is equal to 40% of their take home pay. This amounts to £10,800 annually. The same claimant under the old benefit system would receive £404 per month which is equal to 16% of take home pay.[7]

An insurance system is preferable to a savings system due to the current low interest rates and low returns that would accrue on top of an £11 monthly contribution. This benefits existing claimants, effectively reducing their monthly outgoings while also maximising the level of income support they are entitled to.

Finally, under a social insurance scheme, a payment could be treated differently from a contributory benefits payment under the welfare system. The proposal would be for an insurance pay-out to be treated as income rather than as a benefit, therefore, claiming against a social insurance scheme would have no impact on the ability to claim Universal Credit.

7 Figures provided by Legal & General, 5 July 2016

Feasibility

The success of the automatic enrolment pension products was rooted in broad consensus across the political spectrum, as well as in a strong body of evidence to support its practical application. This broad consensus appears to be replicated over the issue of reforming contributory benefits. The possibility for reforming the system is real, and the political capital is available to get it achieved.

Challenges

During the roundtable discussion, a significant question emerged over whether a new social insurance product would be compulsory or voluntary. One concern raised in discussion was that a voluntary system risks not gaining a critical mass that enables it to function, whereas a compulsory programme could undermine public confidence in the state welfare system.

One of the barriers to wide-spread acceptability of a private insurance model ahead of a state-contributory benefits model is the emotional reaction by claimants who have paid taxes but are no longer entitled to a benefit payment. Many trust the system to pay out – any alternative outcome could undermine trust in the state welfare system. Herein lies a problem: many people place a high degree of trust in the welfare system, only to be disappointed when it delivers less than they expect it to. Part of the challenge in proposing an insurance model, therefore, is to communicate the benefits compared to the state system.

Another challenge is the extent to which a new social insurance model could be extended to include both unemployment and sickness

support currently covered by ESA and JSA contributory benefits. PwC has estimated that the annual cost of sickness absence in the UK is almost £29 billion.[8] Insurance premiums are calculated on risk and probability, such that if the risk and the probability are high, the premiums will also be high. From an insurance perspective, unemployment is seen as a greater long-term risk than sickness.[9] Company efforts to mitigate the risk may thus mean premiums rise to an amount greater than the £11 previously stated.

Furthermore, employers may struggle to see the short and medium term advantages of another cost after having auto-enrolment pension reforms imposed on them in addition to the apprenticeship levy and other employment-related regulations.

8 PWC, *The Rising Cost of Absence*, London: PWC, 2013 [accessed via: http://www.pwc.co.uk/services/human-resource-services/insights/the-rising-cost-of-absence-sick-bills-cost-uk-businesses-29bn-a-year.html]

9 Legal and General, *Policy Document: Lifestyle Cover Insurance*, London: L&G, 2012 [accessed via: http://www.bestinsurance.co.uk/NL/Policy%20Documents/Policy-Wordings-L&G.pdf]

Conclusion and policy recommendations

As this report has discussed, the contributory benefits system is ripe for reform and the proposition of a social insurance model poses a potential solution. With regards to the implementation of a social insurance programme to replace contributory benefits, participants at the roundtable discussion made the following conclusions:

- Premiums should be treated as income in the Universal Credit system, promoting use of the social insurance system.
- The notion of a social insurance model must be communicated correctly; Lessons can be learned from past government announcements on, for example, privately run prisons.
- The support of business is essential, and communication must be clear as this is another product that sits alongside auto-enrolled pensions, the new lifetime ISA, and the apprenticeship levy.
- High opt-out rates risk destabilising the functionality of a voluntary model, and will therefore determine the necessity of a mandatory system or at the least an opt out model.
- Individuals who do not draw down on their insurance pot could be offered financial recourse in the form of either a savings or pensions benefit.

Overall, the opportunity to reform contributory benefits has arrived, the political and economic climate allows for it, and the presence of a strong alternative policy makes it possible and practical.

Putting social justice at the heart of British politics

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