
Breakthrough Britain

Dynamic Benefits

Towards welfare that works

BREAKING THE DEPENDENCY SPIRAL: PREFACE TO THE *DYNAMIC BENEFITS* REPORT



BY THE RT HON IAIN DUNCAN SMITH MP

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The report **Dynamic Benefits: Towards welfare that works** is published by the Centre for Social Justice in association with Oliver Wyman. For further information or to download the full report please visit www.centreforsocialjustice.org.uk

The Centre for Social Justice (CSJ) was established to find and promote solutions to deep-rooted poverty in Britain. As leader of the Conservative Party I frequently encountered significant social breakdown and dysfunctionality across the country. I met people trapped by dependency and left behind by society.

This emerging underclass lives in communities consistently defined by five characteristics, which become the pathways to poverty: family breakdown; educational failure; drug and alcohol addiction; severe personal indebtedness; and economic dependency – caused by intergenerational worklessness.

The CSJ has published more than 350 policy solutions to reverse this breakdown – breakdown which costs society more than £100 billion a year – and move people out of poverty. At the heart of these solutions is recognition that the nature of the life you lead and the choices you make have a significant bearing on whether you live in poverty. Policy-makers regularly fail to understand this, instead viewing poverty through a financial lens only.

Benefit Reform

I asked Dr Stephen Brien to conduct this work when it became obvious during our review of intergenerational worklessness in *Breakthrough Britain* that although we had produced some excellent recommendations to make the process of returning to work easier and more sustainable (many now adopted by Government and Opposition alike), the biggest barrier to those entering work for the first time was the benefit system itself. Dr Brien and his team, fully supported by us at the CSJ, then undertook this root and branch review of the benefits system. All engaged on this report were seized with the importance of finding a better system which would support social reform and have committed themselves to this project for over two years.

More of the Same, Not an Option

Routinely, incoming Governments commit to reducing the cost of welfare at the start of their administrations, by creating new rules to govern access to existing benefits, and by creating new benefits. All this is accompanied by claims that they will improve the system's efficiency. Yet, too often their grand claims that savings will be made turn out to be wildly optimistic. A simple look back over the last thirty years will show that the cost of welfare has risen above the rate of inflation. This is particularly true of the last ten years where the Government has had an almost uninterrupted period of economic growth. Despite such benign conditions, prior to the present recession, the number of people of working age on out-of-work benefits remained stubbornly high at approximately 5.4 million.

Cutting the bill of social failure, in particular welfare expenditure for those of working age is a laudable aim. Indeed, the present Government set it as one of its highest priorities on coming to office in 1997. It didn't take us at the CSJ to highlight that now in 2009, by its own rhetorical measure the Government has failed to achieve what was hoped for. After all, recent statements by a succession of Secretaries of State for Work and Pensions have made that judgement very public indeed. For at the heart of this analysis are some simple facts.

The cost of welfare has increased inexorably. By way of illustration, more than £74 billion was paid directly to working-age adults and children last year (amounting to 40% of the social security budget). Such expenditure has risen above inflation every year since 1997, when the cost was approximately £57 billion (at today's prices).

Our pre-recession youth unemployment rate, despite the huge investment of £2 billion from the New Deal for Young People, has remained pretty well static, despite a period of unprecedented economic growth. Even worse are the figures for the percentage of young people aged 16-18 years old, not in employment, education or training (NEET): this has actually increased since 1997.

Furthermore, the number of lone parents claiming Income Support (IS) – to which £9.2 billion was allocated last year – remains high at 736,000 (over a third of total IS claimants). As well as being a notable investment area for the Government through tailored programmes such as the £225 million

New Deal for Lone Parents (NDLP), lone parents also receive a significant proportion of the £21 billion spent on tax credits, and automatically qualify for Housing Benefit through IS.

Yet this targeted investment has failed to meet the challenge of employment sustainability. Present figures for the NDLP demonstrate that a very high proportion of lone parents who move into work actually enters what is classified as ‘unsustainable or unknown’ employment – approximately 52% in 2008. As one would expect during the first few years of the scheme, the proportion in sustainable work was higher (as the parents who were easiest to place found employment), but it then plateaued for several years prior to falling back significantly, even before the latest recession. (We note with interest that the series recording NDLP exit rates has recently been withdrawn).

Time and again our review received anecdotal evidence from lone parents about the trap of the 16 hour working week. In dramatically reducing financial incentives to work less than 16 hours (through non-qualification for the Working Tax Credit), or more than 16 hours a week (through very high benefit withdrawal rates), the Government ensures lone parents face only one sensible work option – 16 hours. Those who find themselves in circumstances where working less than 16 hours per week would be the right option, find that the financial reward is negligible; and those who want to work more find that it is not worth their extra effort to progress towards full-time work. Such an inflexible and complicated scenario creates system churn as lone parents must fit their lives around the two viable options – not working, or working 16 hours. This disrupts the lives of claimants through the loss of self-confidence and delays in receiving key entitlements such as Housing Benefit, when they change their circumstances. Crucially, it also fuels a highly influential word of mouth message that progression into work simply isn’t worth the hassle. In its recent report on child welfare, *Doing Better for Children*, the OECD also recognises this, concluding in relation to single parent benefits that “There is little or no evidence that these benefits positively influence child well-being, while they discourage single-parent employment.”

Such targeting and tweaking has created further losers, most notably couples with children who as a consequence have to work many more hours to reach the same level of income as lone parents.

Income Source v Income Level

The problem is that this piecemeal system has now become so complicated and cumbersome that it is almost impossible to predict how it will respond. Today, there are 51 separate benefits which create a myriad of tax traps and special rates for different groups. Positive life choices are penalised – such as couple formation, buying a home or saving money.

These issues are often caused by one of three problems arising from the present system:

1. It creates a series of disincentives to work;
2. It imposes penalties on constructive behaviour apart from work (such as marriage and cohabitation, saving, and home ownership);
3. It is very complex – making it costly to administer and reinforcing dependency.

It is fully accepted that being in work is good for us all, beyond the importance of the income it delivers. Government research has found income source to be more important than income level in determining levels of social exclusion. Earning money through gainful employment has many life changing advantages - people in work have better health; they develop strong social networks; and they become living proof to themselves and others around them of a link between effort and reward.

However, whilst recognising there are life changing benefits for someone who is employed, we must also recognise that few of those out of work would look upon work as a moral choice, rather a practical one. For them, employment and career progression above all has to pay and if we understand that this is part of what motivates those already in work, why do we seem to expect something altogether different of benefit claimants? Under the present system, entering work or progressing toward full-time work simply doesn't pay. In real terms it often leaves claimants no better off, or even disadvantaged, for much more effort.

Participation and Marginal Tax Rates

For claimants in part-time employment who are seeking to work more, the marginal tax rate (MTR) – a measurement of what proportion of a small rise in earnings would be lost to taxation and benefits withdrawal – can be as high as 80% or 90% for every additional pound earned. Fuelling such high MTRs are some of Europe's highest benefit withdrawal rates – up to 100% for every additional pound earned in some cases.

For out-of-work claimants we measure the participation tax rate (PTR). This identifies the relative financial incentive to commence paid employment at a given earnings level, in comparison to remaining on benefits. Too often PTRs are extremely high, meaning tangible income will hardly increase if they work, and therefore the rational option is to stay on benefits.

Why should we expect people out of work to behave differently to those in work? We know that those already employed respond to the effect taxation has on their earnings. If they perceive that working longer hours brings no tangible benefits, then they don't commit to the extra hours. Both Government and businesses set their work conditions to incentivise productive behaviour. However, when it comes to the unemployed, Government lazily assumes people will take work out of a sense of obligation - enforced or voluntary. That is why Government has, over a number of years, produced a complex system which, rather than moving people to financial independence, instead entrenches economic dependency and ensures claimants remain net receivers in society rather than contributors.

Crucially, however, the proposals contained in this review will ensure benefit claimants gain from entering work, or from working more hours. We recognise that incentives, not values alone, shape human decisions. Our reforms will remove the financial roadblocks to entering and sustaining work. They will also steadily move benefit recipients towards their full employment potential.

The review is presented in the context of other recommended support for those seeking work, or more work, as outlined in *Breakthrough Britain* – such as tailored support, training and personal mentoring.

Dynamic Modelling

Central to our vision for the benefits system is dynamic modelling – a method used extensively in the private sector. The unique Dynamic Benefits Model we have devised will bring our static and outdated welfare system into the 21st century. It will tell policy-makers how any given change to the structure of the benefits system will affect different households according to specific measures outlined in the review.

The establishment and utilisation of this Model is foundational to delivering the other essential, and costed, recommendations the review makes. These include more generous earnings disregards (the amount of income kept before beginning benefit withdrawal) for household categories; streamlined benefits to simplify the system; and a move away from penalising positive behaviour such as couple formation, saving money and home ownership.

These landmark reforms emerge after two years of challenging and complex endeavour. Throughout, the Working Group consulted with a number of expert academics and professionals who helped to shape its methodology. Here I am particularly grateful to Mike Brewer, Director of the Direct Tax and Welfare programme at the Institute for Fiscal Studies, for his valuable contribution as an adviser to the group, and for reviewing and helping us refine the methodology used to create the Dynamic Benefits Model. The team also engaged several focus groups of benefit claimants to test the logic and practicality of the recommendations – my thanks to these groups.

My thanks also go to Working Group members, supported by researchers at the CSJ; Nicholas Boys Smith, of Lloyds Banking Group; David Godfrey, Chief of Staff to Greg Clark MP; James Greenbury, who has 20 years experience running private equity-backed businesses; Nick Hillman, Chief of Staff to David Willetts MP; Sara McKee, of the Anchor Trust; Dr Peter King, of De Montfort University; Lee Rowley, Westminster City Cabinet Member of Customer Services and Communities; Debbie Scott, Chief Executive of Tomorrow's People; and Corin Taylor, Senior Policy Adviser at the Institute of Directors and formerly with the TaxPayers' Alliance.

My particular thanks and gratitude is reserved for the review's Chairman Dr Stephen Brien, who with great dedication has brought his insight to bear on this complex problem. The excellence and simplicity of these proposals are

down in large part to Stephen's dedication and innovation. My thanks also to Oliver Wyman for supporting this work.

Conclusion

This review marks a watershed for Britain's benefits system. Although quite technical, the recommendations hold to the simple principle that work is the most sustainable route out of poverty. We believe the group's success in devising a system which smoothes out the participation and marginal tax rates so that there is no financial disincentive to work, should be taken seriously by members of every political party.

I hope these recommendations are accepted by politicians and civil servants alike. There are those who say this is not a priority because we are mired in a recession and the jobs aren't there. We disagree, for unless we put the system right now, we run the risk of increasing the number of residually unemployed, only this time it will manifest itself as large numbers of younger people permanently excluded from gainful employment. That is why we simply cannot go on talking about the importance of getting people into work while we persist in creating disincentives for the very people we say should be in work. Our existing complex and inefficient benefits system should finally be laid to rest; otherwise all the talk about improving the number of people going back to work will be just another form of empty rhetoric.

About the Centre for Social Justice

The Centre for Social Justice aims to put social justice at the heart of British politics.

Our policy development is rooted in the wisdom of those working to tackle Britain's deepest social problems and the experience of those whose lives are affected. Our working groups are non-partisan, comprising prominent academics, practitioners and policy makers who have expertise in the relevant fields. We consult nationally and internationally, especially with charities and social enterprises who are the champions of the welfare society.

We are not a typical Westminster 'think-tank'. In addition to policy development, we foster an alliance of poverty fighting organisations that reverse social breakdown and transform communities.

We believe that the surest way the Government can reverse social breakdown and poverty is to enable individuals, communities and voluntary groups to help themselves.

The CSJ was founded by the Rt Hon Iain Duncan Smith in 2004, as the fulfilment of a pledge he made to Janice Dobbie, a mother whose son had recently died from a drug overdose after he was released from prison.

Chairman: Rt Hon Iain Duncan Smith MP

Executive Director: Philippa Stroud



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With more than 2,900 professionals in over 40 cities around the globe, Oliver Wyman is an international management consulting firm that combines deep industry knowledge with specialised expertise in strategy, operations, and business transformation. Oliver Wyman routinely uses approaches such as dynamic modelling when helping clients improve their business performance, and is delighted that the Centre for Social Justice has been innovative in deploying similar methods. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC].

For more information, email stephen.brien@oliverwyman.com or visit www.oliverwyman.com



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IAIN DUNCAN SMITH MP, *Dynamic Benefits*

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