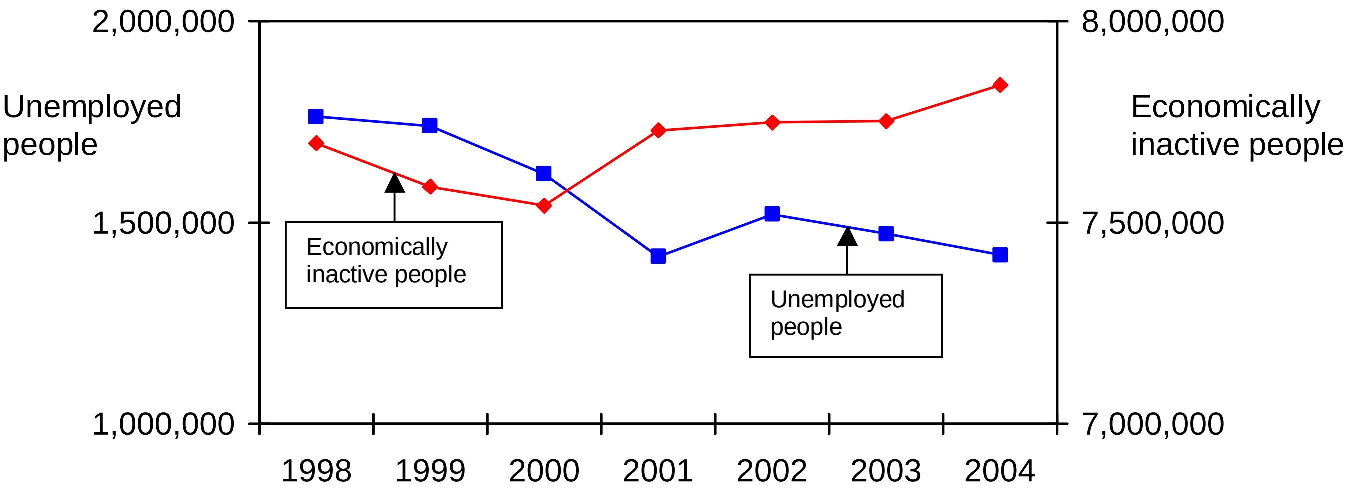
Is Britain Working?

A six-point action plan to increase employment rates

Nicholas Hillman



The author

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Introduction and Summary

Ministers regularly claim that the labour market is in the best shape for decades. For example, Alan Johnson, the Secretary of State for Work and Pensions, said in February 2005 that 'There are now more people in jobs than ever before and we have one of the strongest labour markets in the world.'[1]

In contrast, the most significant one-volume study of the labour market since 1997, which was co-edited by a member of Gordon Brown's Council of Economic Advisors, comes to a more sombre conclusion. It states that little has changed in recent years: 'The broad consensus that flows from the assessments in this volume is that many labour market issues have stabilised after the dramatic changes witnessed over the preceding two decades.'[2] In other words, the main indicators are not getting much worse, but they are not getting much better either.

Unfortunately for the millions of people who remain out of work but who would like a job, this sober academic analysis is closer to the truth than the Government's spin. It would be incorrect to suggest that there are no favourable trends within the current labour market or that all economically inactive people are in a position to work. But it is equally untrue to claim that everything is rosy.

It is possible to evaluate recent labour market performance at a micro level, for example by studying the various strengths and weaknesses of individual welfare-to-work programmes in great detail. This is a worthwhile approach that has been followed many times by both the Government and its detractors, but it is not sufficient on its own. Taking the multitude of schemes one-by-one can make it difficult to see the wood for the trees and to reach any general conclusions. In a short review such as this, it is perhaps more useful to consider what has been happening at the macro level. Such an approach suggests that:

- the main labour market trends, such as falling unemployment, have been in place since the early 1990s, but have slowed down in recent years;
- the labour market position of the groups targeted by the main welfare-to-work initiatives, such as young people, have changed less than ministers claim; and
- the labour market problems faced by particularly disadvantaged groups, such as people with disabilities, remain acute.

The first half of this pamphlet considers these issues in turn and also looks at the uneven impact of tax credits on work incentives and child poverty. The second half of the pamphlet provides a six-point action plan for the short to medium term which is aimed at improving the prospects of people who are not in work, but who could be and who would like to be.

The six policy recommendations are:

1. **greater benefit conditionality for lone parents with children of school age;**

2. **a revamped 52-week linking rule for Incapacity Benefit claimants;**

3. **more support from the Social Fund for people trying to bridge the gap between out-of-work benefits and paid employment;**

4. **robust age discrimination legislation;**

5. **more voluntary and private sector participation in welfare-to-work programmes;**

6. **better targeted in-work support.**

Such prescriptions for the future are particularly important in the context of the latest population projections from the Government Actuary's Department. These suggest the 'elderly support ratio' – that is, the number of people of working age for every person above State Pension Age[3] – will fall significantly over the coming decades. Some commentators regard even these figures as optimistic,[4] but according to the Government Actuary's Department:

- in 2003, there were 3.34 people of working age for every state pensioner;

- in 2031, there will be 2.57 people of working age for every state pensioner (despite the increase in female State Pension Age from 60 to 65 between 2010 and 2020);

- in the 2060s, there will be 2.15 people of working age for every state pensioner.[5]

It is often said that greater private saving for retirement could resolve the problems associated with a lower elderly support ratio. But, while additional saving is desirable for many other reasons, this is highly doubtful. In terms of a transfer of resources from one generation to another, it does not matter whether pensions are provided by the state on a pay as you go (PAYG) basis or through private finance. As the Pensions Commission has said:

> *In funded systems, as much as in unfunded PAYG systems, there has to be a transfer of real resources from the working generation to the retired generation. If pensioners are to consume but not to produce, there have to be workers who consume less than they produce, and who in some way transfer resources to pensioners. The difference lies therefore not in the resource transfer, but in the mechanism by which it is achieved.*[6]

Better labour market performance among people of working age could, on the other hand, go a long way towards tackling some of the wider economic and social difficulties associated with lower support ratios. As an illustration of this, if average retirement ages were to catch up by 2050 with the level they would have been at had they increased consistently in line with life expectancy since 1980, then this would fully offset the expected increase in the ratio of retirement to working life.[7] The Government is therefore right to recognise the value of greater labour market participation in the five-year plan of the Department for Work and Pensions, but existing policies need to be supplemented and, in some cases, replaced if the new 'aspiration of an employment rate of the equivalent of 80 per cent of the working-age population in work' is to be achieved.[8]

Part 1:
Is Britain Working?

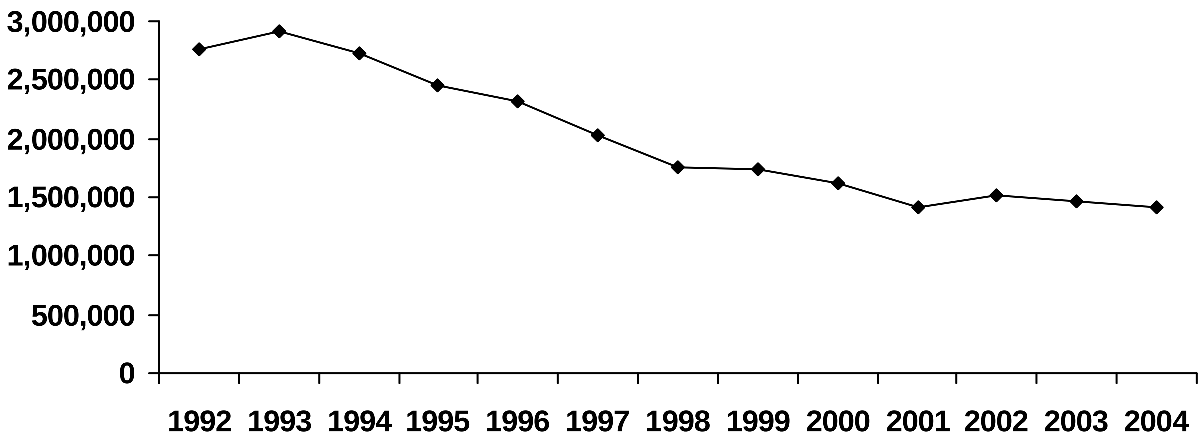
Recent labour market trends

In the period since spring 1992, when the Conservatives won the General Election, unemployment has halved. Back in 1992, the number of unemployed people on the International Labour Organization measure (ILO) was just under 2.8 million.[9] At the end of 2004, the equivalent figure was fewer than 1.4 million people.[10] Taken on its own, this is undoubtedly an impressive record. But the fall has not been at a consistent pace: it has slowed down significantly over the years.

During the six year period between spring 1992 and spring 1998, when the flagship New Deal for Young People scheme went nationwide, the headline unemployment figure fell by 1.0 million people – or around 170,000 people on average each year. In contrast, over the following six years between spring 1998 and spring 2004, the total fall in unemployment was around 340,000, or fewer than 60,000 people on average a year.

In other words, the total number of unemployed people fell three times faster in the six years before 1998, when the biggest of all the welfare-to-work schemes began, than in the six years afterwards.[11] This is reflected in the graph below.

ILO unemployment among working age people, spring quarters, 1992 to 2004



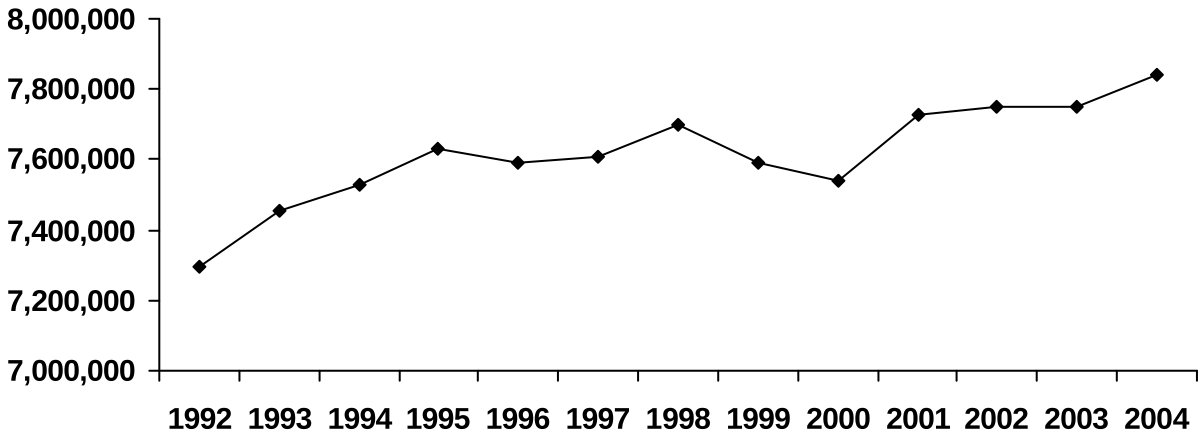
Labour Force Survey, seasonally adjusted

These unemployment figures are essential for a good understanding of recent labour market trends. But they only give half the picture. We also need to consider what has been happening to economic inactivity. If the number of people who are economically inactive – that is, who are neither in employment nor officially unemployed – has fallen alongside the reduction in unemployment, then we would be right to describe recent performance as a real achievement.

If, on the other hand, the fall in unemployment has occurred alongside an increase in the number of people who are neither in work nor officially unemployed, then we have less to celebrate. Unfortunately, this is exactly what has occurred.

Since 1992, the number of people of working age who are economically inactive has grown by over half a million, from just under 7.3 million to nearly 7.9 million.[12] Many of these people are in no position to work, but it is distinctly odd that the figure should have grown, rather than fallen, over a period when the labour market is generally regarded as having become a lot tighter.

Economically inactive people of working age, spring quarters, 1992 to 2004



Labour Force Survey, seasonally adjusted

It has become traditional for ministers to herald each new set of monthly labour market figures as a great success on the grounds that the number of people in work is higher than it used to be and to ignore, or else to spin disingenuously, the less impressive record on economic inactivity. For example, when the January 2005 figures were announced, Jane Kennedy, the Minister for Work, said:

> *Today's figures show there are even more people in work, more than ever before. … This month's figures are continuing evidence of the success of the Government's economic and welfare to work policies. Getting more people into the labour market, alongside low unemployment, is a further step towards our aim of extending employment opportunity to all.*[13]

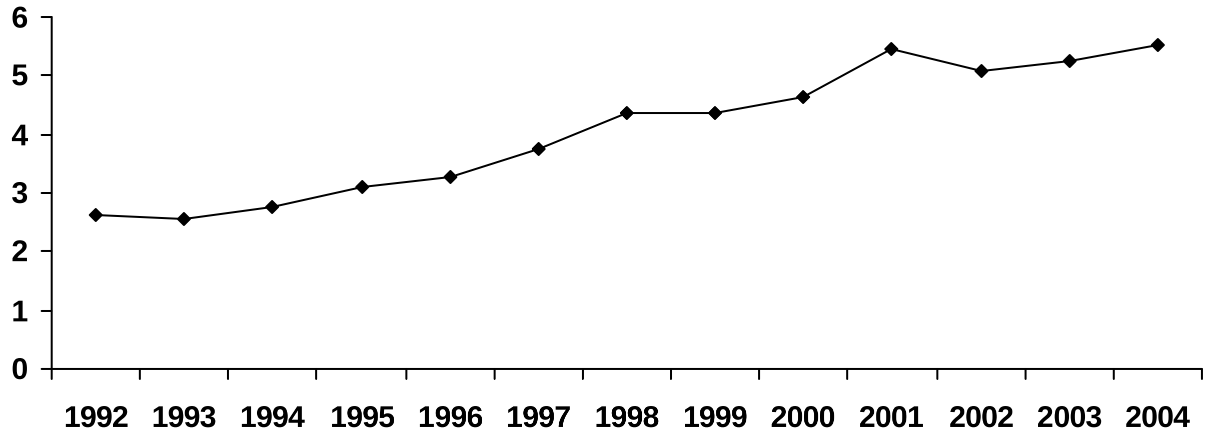
In fact, the figures did not show such a clear picture. The number of unemployed people (on the ILO measure) was slightly up on the previous quarter, but down on the year as a whole. The number of inactive people was down on the previous quarter, but up on the year. In other words, the overall picture was as clear as mud – unemployment and inactivity were either up or down, but it was not clear which. Using one month's snapshot figures to come to firm conclusions about the labour market is not usually possible.

Another example of the Government's approach came back in February 2004. Des Browne, the previous Minister for Work, welcomed that month's figures by claiming 'The success of the government's economic and labour market policies can be seen month after month. The UK has the strongest labour market for a generation.'[14]

But, while the figures in that month had shown a reduction of 21,000 in the number of unemployed people over the previous quarter, they had also showed an increase in economic inactivity among working-age people that was nearly four times as large.[15] This explains why the Financial Times article reporting the fall in unemployment was greeted by a letter to the paper asking 'Where are they all working?'[16]

One instructive way of looking at the relationship between economic inactivity and unemployment is to consider the ratio between the number of economically inactive people and the number of unemployed people. In spring 1992, there were 2.6 economically inactive people of working age for every one unemployed person. Between October and December 2004, the comparable figure was 5.6 economically inactive people for every one unemployed person.[17]

The ratio of economically inactive people of working age to unemployed people of working age, spring quarters, 1992 to 2004



Labour Force Survey, seasonally adjusted

This represents an enormous challenge because someone who counts as unemployed on the ILO measure is by definition looking for work and therefore in one sense within the labour market, even though they are not actually in paid employment.[18] People classified as economically inactive are, in contrast, not generally looking for work and are subject to much less official pressure to find a job. It is often a significant step for an unemployed person to move into work, but for many economically inactive people the gap between work and welfare remains a chasm.

Young people and lone parents

The Government's flagship employment programmes, which generally come under the New Deal banner, target specific groups that are considered to face disadvantages within the labour market. The two most noteworthy of these schemes are the New Deal for Young People and the New Deal for Lone Parents.

Both of these programmes have been extensively evaluated and the Government claims the research shows them to have been a great success. Independent outsiders are more circumspect, however, not least because ministers have a tendency to ignore the fact that many scheme participants would have found work even if the programmes had not existed (the so-called 'deadweight').

For example, a recent analysis of the New Deal for Young People by three experts from the Institute for Fiscal Studies and one from the London School of Economics claims 'there is little obvious sign of a large impact, even when focusing on the groups of individuals (young, less skilled men) who are most likely to benefit.'[19]

It is instructive to look at the current headline labour market figures for the two groups targeted by the New Deal for Young People and the New Deal for Lone Parents and then to consider these statistics in the context of the last decade or so, rather than only the past few years.

Between October and December 2004, the number of unemployed people aged between 16 and 24 stood at around 596,000 people. A further 682,000 people in the same age group were economically inactive but not in full-time education. In total therefore, nearly 1.3 million, or 19 per cent, of the 6.8 million people aged between 16 and 24 are either unemployed or economically inactive and not in full-time education.[20] This has rightly been described in a new assessment of Labour's period in office as 'a huge and dismaying waste of potential.'[21]

It is enlightening to compare these figures for late 2004 to the situation in spring 1998, when the New Deal for Young People went nationwide, and to 1992, when the last term of Conservative Government began (and also, conveniently, when the relevant statistical series begins).

Labour market status of people aged 16 to 24, 1993 to 2003 [thousands (%)]

	Total	**Employed**	**Econ. inactive in full-time education**	**Unemployed**	**Econ. inactive not in full-time education**
Spring 1992	7,175 (100)	4,490 (62.6)	1,078 (15.0)	862 (12.0)	745 (10.4)
Spring 1998	6,256 (100)	3,893 (62.2)	1,188 (19.0)	596 (9.5)	578 (9.2)
Oct-Dec 2004	6,804 (100)	4,123 (60.6)	1,403 (20.6)	596 (8.8)	682 (10.2)

Labour Force Survey, seasonally adjusted (totals may not sum due to rounding)

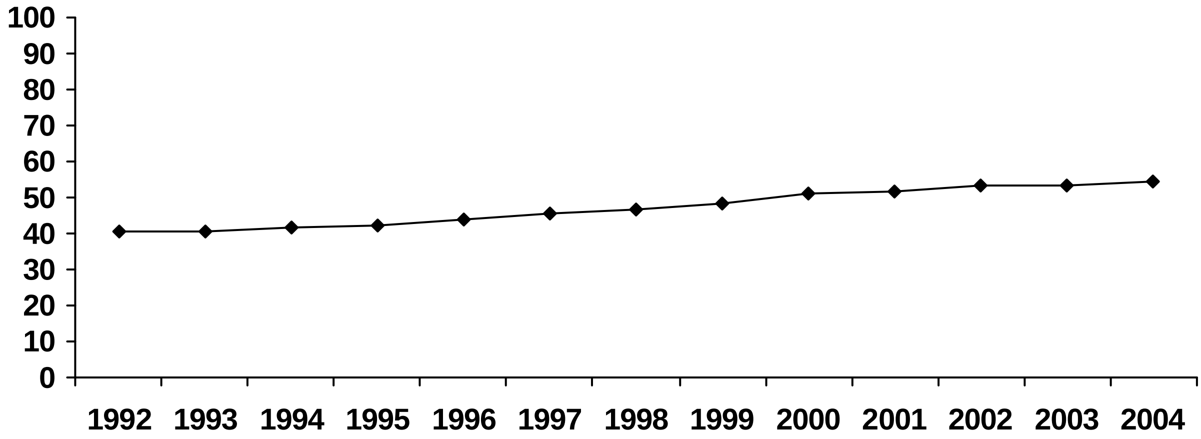
The figures in the table above confirm that the true picture is a very different one to that which ministers would have us believe. In practice, there appears to have been a slight fall in the proportion of young people in employment over the past twelve years and the fall was larger in the six years after 1998 than in the six years before. The proportion of young people who are unemployed has fallen over the same period, but again the record is worse for the period since 1998 than in the years before – the total number of unemployed young people was the same at the end of 2004 than in the spring of 1998. The total number of economically inactive young people not in full-time education has grown in recent years, as has the proportion of young people in this category, thereby reversing most of the improvement that occurred between 1992 and 1998.

One other important change implied by these figures is that the New Deal has encouraged young people to stay in education and training. Depending on the quality of the education, that may be desirable, but the scheme was designed to increase employment rates among young people, which it has failed to do.

The pattern among lone parents is somewhat different to the one for young people. Here the news is undoubtedly more positive. The proportion of lone parents in employment has risen from 46.6 per cent in spring 1998, when the voluntary New Deal for Lone Parents went nationwide, to 54.3 per cent six years later.[22] This works out as an average rise of around 1.3 per cent each year. Even though the employment rate among lone parents remains lower than in many comparable countries, it would be churlish to pretend that this increase is anything other than an achievement.

But the figures also provide real doubt as to whether the improvement has anything to do with the Government's welfare-to-work schemes – the average annual increase in the employment rate among lone parents in the previous six years, from 1992 to 1998, was not dramatically different, standing at 1.0 per cent.[23] Moreover, the decline in lone parents on Income Support is slower than it was a few years ago and the caseload currently stands at 804,000.[24]

The proportion of lone parents in employment, spring quarters, 1992 to 2004



Household Labour Force Survey (not seasonally adjusted)

In the context of so many other changes – including shifts in the characteristics of lone parents so that they are more likely to have greater experience of work, to be older and to have more educational qualifications, as well as to have different attitudes and aspirations, than their counterparts in earlier years[25] – it is difficult to find a clear positive impact for either the New Deal for Lone Parents or the compulsory Work-Focused Interviews, which were rolled out nationally for lone parents on Income Support from 2001.

Recent studies of the employment schemes aimed at lone parents are somewhat inconclusive, even though, in the words of the Institute for Public Policy Research (IPPR), 'all these evaluations have taken place against a backdrop of rising employment and a benign macroeconomic climate, and the controls for such macroeconomic factors in these evaluations tend to be weak.'[26] One commentator, who is broadly supportive of the New Deal for Lone Parents, has written:

> *The decline in benefit receipt in fact started before the New Deal was introduced and, although the programme has had a positive outcome in terms of additional employment, the aggregate impact on lone [parent] employment cannot be very substantial because participation rates have not been high. Thus, the impact of the programme cannot, by itself, account for the emerging trends. And, although just over half of all those who leave the New Deal programme do so because they enter work, we do not have any robust measures of how far this represents additional employment.*[27]

Similarly, a recent evaluation of Work-Focused Interviews found: 'The introduction of Lone Parent Work Focused Interviews brought about no detectable change in exit rates from IS [Income Support] for eligible new or repeat claimants, for the groups analysed.'[28]

Whatever the success or otherwise of the Government's welfare-to-work schemes, more lone parents are in work than they used to be and this is welcome. But it is nonetheless very difficult to see how ministers can reach their target of having 70 per cent of lone parents in employment by 2010.[29] If the current trend of rising employment continues uninterrupted into the future, which is an optimistic assumption, then it will take until around 2015 to reach the target.

Older people and people with disabilities

Economic inactivity is also common among people aged between 50 and State Pension Age and among people with disabilities. These two, often overlapping, groups are each currently served by their own New Deal programme – the New Deal 50plus and the New Deal for Disabled People. But these are small scale and relatively cheap initiatives that have reached only a modest number of benefit claimants. One evaluation concluded, for example, that while 'Some policy changes have been introduced' aimed at helping economically inactive people on disability benefits, 'they have yet to have much impact.'[30]

The number of economically inactive people aged between 50 and State Pension Age has not altered much in recent years. In 1997, it was just over 2.5 million and, at the end of 2004, it was just under 2.5 million.[31] Because the total number of people in this age group has grown, this stable figure represents a slightly lower proportion of the whole age group than in the past; the proportion of people aged between 50 and State Pension Age who are economically inactive has fallen from 31.5 per cent in spring 1997 to 27.5 per cent in late 2004.[32]

At the same time, the employment rate has grown from 64.5 per cent to 70.4 per cent.[33] This growth in employment is a welcome and long-standing trend, which began before 1997, and it is likely to be based on various factors. For example, recent econometric analysis suggests that: 'The increase in the employment rate appears to be to some extent driven by an increasing participation of ethnic minorities in this age group.'[34]

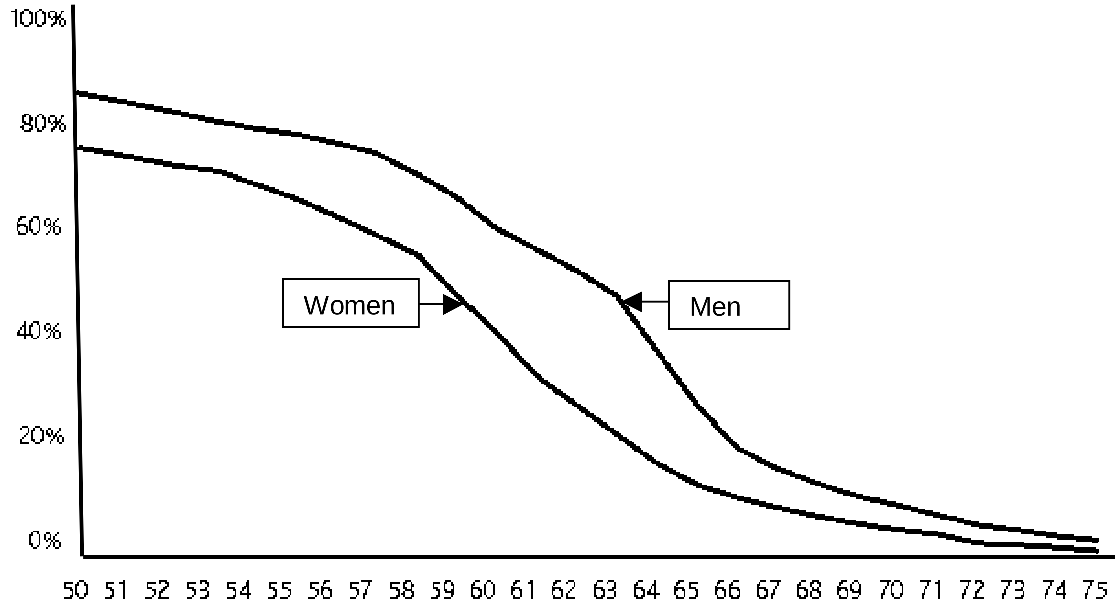
Despite this, there continues to be a serious problem of economic inactivity among older people, with more than 1 in 4 of those aged between 50 and State Pension Age neither in work nor officially unemployed.

As the graph overleaf shows, the likelihood of being economically inactive grows with age and most people retire before reaching State Pension Age. While nearly nine out of ten men aged 50 are in work, only around six out of ten men aged 60 are. Although some people have retired voluntarily, 60 per cent of people aged between 50 and State Pension Age who are not in employment have been shown to be 'involuntarily out of work'.[35]

This is very different to the situation in the past. The average age of exit from the workforce used to be higher than the State Pension Age; in 1950, the 'average age of transition to inactivity among older workers' was 67.2 years for men and 63.9 years for women.[36]

Moreover, while the State Pension Age for women is due to increase from 60 to 65 between 2010 and 2020 (back to where it was between 1928 and 1940), evidence suggests that this is not well-understood and thus may have less impact than expected.[37] If things do not improve significantly, any talk of saving money on state benefits by increasing the State Pension Age beyond 65 for both men and women (from 2010 onwards) is fairly academic.

Economic activity rates of men and women aged 50 to 75



Source: Labour Force Survey, spring 2004, as used in The Pensions Commission, Pensions: Challenges and Choices: The First Report of the Pensions Commission, 12th October 2004, Figure 2.29

There are, however, some factors which are likely to encourage greater labour market participation by older people over the next few years. These include the decline of defined benefit pension schemes, where the employer promises a certain level of pension and is generally expected to fill in any gaps in funding, and the rise in their place of defined contribution schemes, which employers tend to fund less generously.[38]

Changes to public sector pension schemes, such as increases to the minimum working life necessary to receive a full pension, could also have an impact, as could the improvement to the rules for deferring the state pension.

Such forces are unlikely, though, to be sufficient on their own to bring the rate of employment among older people much closer to that of people in their thirties and forties. Age discrimination legislation could have a role to play here, but the Government recently decided not to ban fixed retirement ages until 2011 at the earliest and to introduce a ‘Right to Request working longer’ instead. This weaker policy is likely to mean a lower proportion of older people in work than would have been the case under clearer and firmer legislation.

Around half (50.1 per cent) of the 7.2 million working age people classified as disabled are in employment and the vast majority of the rest are economically inactive. The proportion of disabled people in employment has grown slightly over the past few years, by around 0.7 per cent each year on average,[39] but the number of Incapacity Benefit claimants has grown as well.

Between May 1995 and February 2000, the number of Incapacity Benefit claimants fell from 2,419,700 to 2,259,500. In this period, the number of claimants fell in seventeen of the nineteen quarterly periods. Since then, the number of claimants has increased to 2,403,300 claimants and the total has increased in fourteen of the eighteen quarters.[40] The current number of claimants is fewer than 50,000 people away from the highest ever level.[41]

Ministers often boast that the rate of new claims to Incapacity Benefit has slowed down significantly in recent years. Alan Johnson, the Secretary of State for Work and Pensions, told the House of Commons in February 2005 that 'New claims are down by almost one third since 1997'.[42]

This fall is welcome but, at the same time, there has been a similar fall in the number of claims that come to an end. In 1996, just over 250,000 people left the benefit each quarter; in 2003, fewer than 175,000 did.[43] This explains why the fall in new claims is not showing up in the figures for the overall caseload. It is serious because: 'At least half of all [Incapacity Benefit] spells end within their first year. But it takes another nine years before half of the remainder have been completed.'[44]

The Government launched a pilot initiative called Pathways to Work in October 2003. This package of help, which so far has only been available in pockets around the country, incorporates employment advice, rehabilitation and a £40 a week Return to Work Credit (paid for one year).

There is not currently very much information available on the results of the pilot, but the figures that do exist suggest it is having some success in helping people leave Incapacity Benefit.[45] The Government plans to build on the pilots by extending the scheme and by replacing Incapacity Benefit with some new benefits that more closely reflect the needs of different clients.[46] These changes are welcome. They are certainly more sophisticated and more likely to work than some of the Prime Minister's past threats to out-of-work disabled people.

But there are two major problems. First, the new system is not going to be in place until 2008. Assuming the current rate continues, there will be over two million (around 700,000 a year) new claims of Incapacity Benefit between 2005 and 2008. Secondly, just like the existing pilot, the latest reforms will be aimed at new claimants.[47] This means that, while they might reduce the flow onto out-of-work disability benefits, they are unlikely to do much for the millions of people whose claims began before 2008.[48]

The Labour Force Survey suggests there is enormous scope for doing more to improve the rate of employment among people with disabilities. The proportion of economically inactive people with disabilities who want a job is substantially higher than the equivalent figure for economically inactive people who are not disabled.[49]

Tax credits and the labour market

No assessment of the current state of the labour market is complete without some recognition of the role played by tax credits.

Governments of both colours have attempted to bolster the income of parents in low-paid work: the Family Income Supplement was introduced in 1971 when Edward

Heath was Prime Minister; Family Credit was introduced in 1988 under Margaret Thatcher; and Tony Blair's first administration introduced the Working Families Tax Credit (WFTC) in 1999.

The Child Tax Credit and the Working Tax Credit, introduced in 2003, are on a larger scale to these earlier measures, however, and their potential impact is consequently greater; expenditure on these measures in 2003/04 was £13.5 billion.[50]

The way the new tax credits were introduced caused huge problems for disadvantaged families and has been roundly condemned. One Parent Families found that 28 per cent of lone parents had an overpayment in the first year, with more than 80 per cent of them saying the overpayment was due to Inland Revenue mistakes.[51] One of the many problems was that Jobcentre Plus staff were unable to provide decent information about the new system to their clients:

> *Jobcentre Plus staff did not feel completely prepared to deal with NTC [New Tax Credit] applications made by customers. This was partly due to feelings of inadequate training and partly due to initial problems with the IT systems. … the Inland Revenue (IR) Helpline could not always sufficiently answer their enquiries. … The consequence of these training and IT issues was that Jobcentre Plus staff did not always feel confident to deliver NTCs to customers.*[52]

There are two issues of particular importance associated with the new tax credits: first, the extent to which they keep families with children out of poverty; and secondly, whether having such an extensive system of in-work support artificially holds down wages.

The Government's commitment to eradicating child poverty by the end of the next decade is very challenging. This is true even though the Government's new definition of relative child poverty ignores housing costs; as a result, around one million children have been lifted out of poverty via the stroke of a pen.[53]

On the definition of child poverty that has generally been used in the past (60 per cent of median income *after* housing costs), 3.6 million children lived in poverty in 2002/03. Under half, 45 per cent (1.6 million), of these children were in households headed by a lone parent and the rest (2.0 million) were in households headed by a couple.[54]

There is a striking difference between the poor children living in households headed by a couple and the poor children living in households headed by a lone parent. Nearly all the poor children in lone parent households (1.3 million out of 1.6 million) are in homes where the adult is not in paid work. In the short-term at least, their hopes of becoming less poor are likely to depend above all on the lone parent finding paid work, on an increase in out-of-work benefits or in improvements at the Child Support Agency.

In contrast to poor children in lone parent households, the vast majority of poor children in households headed by a couple (1.4 million out of 2.0 million) already have at least one resident adult in work and their household is therefore already potentially entitled to both the Child Tax Credit and the Working Tax Credit. But the existing system is not well suited to help them. This is because of the existence of what is sometimes termed the 'invisible second adult' principle, whereby a three-person household receives the same as a two-person household with no allowance being made for the second adult.

In other words, the Government's 'Weekly minimum income guarantee' for families with children is the same for one parent families and couples.[55] Or, in the words of the Institute for Fiscal Studies (IFS), the Working Tax Credit implies 'a higher level of child-contingent support for lone parents than for couples: single people without children receive a lower rate than lone parents or couples (with or without children), so single people who have a child receive a rise in their working tax credit award that couples do not get.'[56]

Because the out-of-work benefits Income Support and Jobseeker's Allowance take account of all the people in a household, whereas the tax credits do not, there are some odd effects on the net return from moving into work. A lone parent working part-time for £165 a week with one child under 11 and living in local authority accommodation has a net income after housing costs that is £60.11 higher than if they were on Income Support (£176.98, rather than £116.87). A couple in otherwise similar circumstances is only £29.88 a week better off (£178.40, rather than £148.52) after moving into work. Indeed, the couple would need to have gross earnings of over £280 a week to be at least £60 a week better off in work than on out-of-work benefits.[57]

This helps to explain why new figures from the IFS show that the package of tax and benefit reforms introduced since 1997 have made lone parents in work £36.67 a week better off on average, whereas one-earner couples with children are only £8.42 a week better off on average (and two-earner couples with children are £13.56 worse off).[58] Other IFS research has shown that 'Labour's changes to personal taxes and benefits have had a mixed impact on financial work incentives for parents. For lone parents, the story is relatively positive … Among couples with children, the impression is much less positive.'[59]

In its early days, the Government was accused of unjustifiably reducing the incomes of one parent families when it abolished (for new claimants) the higher rate of Child Benefit, Income Support and income-based Jobseeker's Allowance paid to lone parents. This accusation no longer sticks because of the additional help that has been directed to these families since then. Now, a major problem seems to be that the latest tax credit system is not particularly effective at tackling child poverty among working two-parent households.

Reforms to tackle this particular anomaly should be urgently considered, but there is a powerful argument against wholesale restructuring of the tax credit system at the current time: there is not, as yet, very much information available about the system's full impact and all its advantages and disadvantages. One particularly noticeable void is the lack of good quality information on the impact of in-work tax credits on gross pay.

Since modern in-work benefits were first devised, people as diverse as Enoch Powell and Polly Toynbee have argued that extensive in-work support encourages employers to pay lower wages than they otherwise would,[60] as supposedly occurred under the Speenhamland system of the late eighteenth and early nineteenth centuries. The Earnings Top-up pilots that occurred between 1996 and 1999 offer some support for this view.[61]

The extension of in-work support to a new group (people aged over 25 without children) through the Working Tax Credit has arguably made this sort of wage effect more likely, as a greater proportion of the workforce is covered. On the other hand, there is still a large group of people in low-paid work (those aged under 25 without children) who are generally not entitled to any tax credits and this could mitigate any wage effects.[62]

Moreover, the Government has recently performed a u-turn on paying tax credits through the wage packet and, in future, they will always be paid directly to claimants, in the same manner as the old Family Credit.[63] As a result, employers will tend to know less about their employees' personal financial arrangements so may be less well-placed to calculate their total net household income. Either way, it is surprising – and disappointing – that the same Government which introduced the minimum wage to protect people against derisory pay and which is so supportive of 'evidence-based policy' has displayed so little interest in the potential impact of tax credits on wages.

Part 2:
A six-point action plan

A six-point action plan to increase employment rates

The evidence put forward so far suggests that, while unemployment is historically low, there are a number of problems within the labour market. In particular, economic inactivity among young people, lone parents, older people and people with disabilities is higher than is desirable, despite numerous welfare-to-work initiatives. In addition, two of the main policy instruments designed to tackle child poverty and low pay, the Child Tax Credit and the Working Tax Credit, are not as efficient as the Government hoped. It is therefore unlikely that existing policies will be sufficient to meet the Government's employment targets.

If the immediate challenge is to help some of the 7.9 million inactive people of working age find work, then we need to consider new ways to do this which go with the grain of existing policies and which are capable of being implemented over the short to medium term. Six policies that could have a significant impact on the people who remain outside of the labour market and which could be implemented relatively easily are:

1. greater benefit conditionality for lone parents with children of school age;

2. a revamped 52-week linking rule for Incapacity Benefit claimants;

3. more support from the Social Fund for people trying to bridge the gap between out-of-work benefits and paid employment;

4. robust age discrimination legislation;

5. more voluntary and private sector participation in welfare-to-work programmes; and

6. better targeted in-work support.

1. Greater benefit conditionality for lone parents with children of school age

When Jobseeker's Allowance (JSA) was introduced in 1996, the effect on eligible claimants was dramatic:

> *Research examining the effect of JSA found that the new benefit has had a significant impact upon unemployed people. Unemployed people are now looking for, and finding, work much more than they were before the introduction of JSA, and are now much clearer about their responsibilities – probably as a result of the extra advice and assistance they receive from Jobcentre staff. Attitudes have changed too: clients increasingly feel that their entitlement to benefit should be conditional upon proving that they are looking for work.*[64]

This is powerful evidence of how attaching clear conditions to the receipt of benefits can have a positive impact and it provides one possible model for improving work rates among certain, clearly-defined, groups of economically inactive people. In particular, if the Government's target of having 70 per cent of lone parents in employment by 2010 is to be achieved, there is a strong argument in favour of extending the benefit conditions for non-working lone parents whose youngest child has started school.

Many people would accept the right of lone parents with very young children to refuse paid work in order to stay at home and look after their children; in a recent poll, only 14.3 per cent of people said they thought single mothers with pre-school age children have a ‘duty to work’.[65]

There is less support and less justification, however, for exempting lone parents with children at school from an expectation to look for work. It would make sense to consider applying the same rules faced by Jobseeker’s Allowance claimants to lone parents with children of school age, so long as it is done in a sensitive way and so long as recognition is made of the additional obstacles to work faced by many lone parents.

A detailed study of benefit conditionality published recently by the IPPR noted that ‘The UK is unusual amongst EU countries in not requiring lone parents to fulfil work conditions once their children reach a certain age (usually around four or five years)’ and that ‘stringent work conditions are applied in the US.’[66] In general, the report was positive about the potential advantages of introducing greater benefit conditionality for lone parents on the grounds that it ‘is compatible with social democracy’, ‘is reasonably likely to reduce the numbers of workless households and thereby reduce child poverty’ and ‘can play a role in changing behaviour and enhancing outcomes.’[67]

Despite the strong evidence put forward, the IPPR surprisingly concluded that ‘it would not be advisable to prioritise the extension of conditions on Income Support for lone parents.’[68] This looks even more surprising when subsequent research conducted for the same think-tank is taken into account, as this shows that 79 per cent of people believe lone parents should face benefit sanctions if they do not visit a job centre to talk about ways of finding work when asked to do so.

When these views are investigated further, ‘the most telling comparison is that between the single mother with a child under school age and the single mother with a child over school age.’[69] Eleven times as many people (45.3 per cent) believe single mothers with school age children have a ‘duty to work’ as think they have a ‘duty to stay at home’ (4.0 per cent).[70] In other words, there is a general expectation that lone parents’ benefits should come with certain conditions related to work once the youngest child is at school.

Work-Focused Interviews for lone parents on Income Support have been running for a number of years and so the resources necessary for checking that lone parents are seeking work are already in place. Indeed, it is possible that extending the ‘actively seeking work’ rules to lone parents whose youngest child is at school could be the key to making these interviews a success, for their current record is unimpressive.

Extending conditions only for those lone parents with children at secondary school would be an alternative improvement to the status quo, but it would be likely to have only a limited impact. This is because, among lone parents whose youngest child is at secondary school, the proportion of workless households has already fallen to 29 per cent. In contrast, among lone parents whose youngest child is aged 5 to 10 the workless household rate is 41 per cent.[71]

The state currently spends nearly £5 billion a year on Income Support payments to lone parents and over two-thirds of all the dependants of lone parents on Income Support are aged over 5.[72] The approach outlined here could lead to substantial savings, especially once reductions in Housing Benefit and Council Tax Benefit are also taken into account, and even after paying for new employment-related support, including childcare. It might be possible to spend some of the savings on additional payments to lone parents with younger children, who would still not be expected to look for work in return for benefit, or on more financial support for pregnant women.

2. A revamped 52-week linking rule for Incapacity Benefit claimants

Additional conditionality is likely to be less appropriate for people with disabilities who are out of work because, as the name suggests, one of the criteria for claiming Incapacity Benefit is an inability to hold down a job. There is a broad consensus, however, that many out-of-work benefit claimants with disabilities could work and would like to work.

A recent Joseph Rowntree Foundation report, which sought to provide 'A shared road map' for tackling poverty and disadvantage, highlighted the need to 'Prioritise help for disabled people who want work but have no job.'[73] The Government's Pathways to Work initiative is an interesting, if somewhat long-term, attempt to put such ideas into practice, particularly for new claimants, and it has been widely welcomed.

There remains a real need, however, for more immediate policies that could help people already claiming Incapacity Benefit. Because it is a long-term benefit which increases in value after the first 52 weeks of a claim and because people on the benefit since before 6 April 2001 are not subject to the means-testing rules, there is a financial disincentive for claimants to accept a job unless they are absolutely certain that it will last and that they will not need to make a new claim in due course.

The Government introduced a 52-week linking rule to tackle this issue in October 1998. In theory, this new measure provided additional security for Incapacity Benefit claimants by enabling them to return to the same level of benefit if they are unable (for whatever reason) to hold down a job for more than twelve months. The regulation making the change is laid out in the box below.

Amendment of the Social Security (Incapacity Benefit) Regulations 1994
2. After regulation 5 of the Social Security (Incapacity Benefit) Regulations 1994 (night workers) there shall be inserted–
"Calculating periods of incapacity for work for welfare to work beneficiaries
5A. For the purpose of incapacity benefit, in the case of a person who has been determined in accordance with regulation 13A of the Social Security (Incapacity for Work) (General) Regulations 1995 as a welfare to work beneficiary, section 30C(1)(c) of the Contributions and Benefits Act (any two periods of incapacity for work not separated by a period of more than 8 weeks shall be treated as one period of incapacity for work) shall have effect as if for the reference to 8 weeks there were substituted a reference to 52 weeks."
HMSO, The Social Security (Welfare to Work) Regulations 1998

Unfortunately, the impenetrable wording is not just typical legal opacity. The rules really are as complicated as they sound. A benefits guide explains the procedure as follows:

> *To qualify for 'welfare to work' you have to have been receiving a benefit (or premium) for 196 days on the basis of being incapable of work. You have to start employment within a week of stopping receiving the benefit. You have to tell the DWP [Department for Work and Pensions] within a month of starting work that you have done so. You have to tell them* after *you've started work, telling them before won't count. (It is advisable to inform the DWP in writing and to keep a copy). You should then get a letter from the DWP confirming that you are now protected by the 'welfare to work' rules and telling you the date on which your protection will end. If you don't receive this letter within 14 days, contact your local office.*[74]

Many long-term benefit claimants with disabilities who enter work would not be in a position to negotiate such legal niceties even if they could trust the Government's bureaucracy to maintain their records accurately; research among New Deal for Disabled People participants has uncovered 'a relatively low level of awareness or understanding of, or confidence in, the 52-week benefit linking rule.'[75] Other research has found:

> *several cases where someone has taken up the 52-week linking rule only to suffer when they have sought to return to IB [Incapacity Benefit] … A service user with severe learning difficulties tried employment under the 52-week linking rule. The job collapsed within 52 weeks yet, due to administration problems, he had to wait nearly three months before returning to benefits.*[76]

It would be an inordinately useful, and simple, change to introduce a new linking rule which did not put so much onus on Incapacity Benefit claimants themselves. In particular, there should be no need to register interest in the linking rules in advance. If a job does not work out within the first year, then all Incapacity Benefit claimants should automatically be able to reclaim the benefit at the same rate at which they received it previously. This would be well-targeted on the existing stock of claimants and in tune with the Pathways to Work initiative and it could be implemented swiftly.

Most importantly of all, it would be likely to be taken up by large numbers of existing claimants. In a research project, people with disabilities who were not in work (or who were working fewer than eight hours a week and who wanted to work for more) were asked about a range of things that might enable them to work: 'The factor that respondents were most likely to identify with as a bridge to work was if they knew they could return to their original benefit if they needed to (71 per cent).'[77]

3. More support from the Social Fund for people trying to bridge the gap between out-of-work benefits and paid employment

For many people of all ages, the financial gap between the last out-of-work benefit payment and the first wage packet can seem like an unbreachable chasm. They often have to cope with having no income at all for a limited period and this occurs just as new work-related expenses arise, such as travel costs, work clothes and childcare.[78] Indeed, research shows that 31 per cent of lone parents who move into work of 16 hours or more a week fall into arrears with their financial commitments.[79]

The logical way to help bridge the gap for people in this position is through the Social Fund, which makes interest-free loans to benefit claimants, yet currently most Social Fund help is not available to people who have found paid employment (or who are regularly cycling in and out of employment).

Research shows that among 'less well off' and 'worse off' households where someone moves into work, there is 'a significant gap where Social Fund loans had once existed. These households often needed loans to provide extra income to make ends meet, not just in the transition period but throughout their working lives. What they lacked most was the access to low cost credit.'[80] Improvements to the administration of Housing Benefit would also help such families,[81] although this raises many wider issues that are not covered in this report.

Although the Government has made some welcome small-scale changes to the Social Fund (and plans further relatively minor improvements[82]), there are still serious problems with the way it works. For example, much of the Crisis Loans budget is used to cover the cost of alignment payments, which are paid to people who have applied for benefits and tax credits, but who are waiting for the authorities to process their applications.[83] This is not what the system was designed for and it diverts money from other important areas of need.

The most important short-coming, however, is the lack of resources. The result is that many people are forced into commercial loans at very high interest rates (1,834 per cent APR in one case[84]) from buyback stores, home credit, mail order catalogues and unauthorised money lenders.[85] In addition to the obvious and serious problems that this causes, it can also serve as a barrier to work.[86]

Nonetheless, the principles behind the Social Fund are sound ones. The evidence suggests that, while the scheme is far from perfect, it is highly valued by users who like the fact that loans are recovered directly from their benefits,[87] and it is the cheapest form of credit available. It also makes sense from the perspective of Government.

Nicholas Timmins, the Public Policy Editor of the Financial Times, has written: 'By operating on a closed budget and offering much of its help in loan form, it put an end to what had been a running sore for governments of all colours for 30 years – the seemingly inexorable growth in various forms of extra payments made through what was then called supplementary benefit.'[88]

Now that the Social Fund is over 15 years old, it is time for a full-scale review of the scheme. This should focus on three particular questions.

- What additional support could be offered through the Social Fund, in particular to people who are trying to move from welfare and into work?

- How could the Social Fund be utilised to offer an alternative to the extortionate interest rates offered by loan sharks to people on low incomes?

- How can the Social Fund be modified to resemble more closely – and act as a gateway to – mainstream private sector financial services?

This is not a particularly original recommendation. A report commissioned by the Treasury, which was published in 1999, called for large-scale reform of the Social Fund to be in place by 2003 and the old Social Security Select Committee also called for a similar programme in 2001.[89] Voluntary organisations, including Citizens Advice, One Parent Families and the Child Poverty Action Group, have also called for large-scale improvements.[90] The problem is that, although ministers committed themselves to 'immediate action'[91] on the issue six years ago, not much of significance has occurred since. It would be a good issue for the new Financial Inclusion Taskforce to consider.[92]

It is important to remember that any changes to the Social Fund to encourage more people into work are likely to have a very modest cost. This is because most additional payments arising from an extension to the scheme could be in the form of loans and so would eventually be paid back to the Government, or to the private sector if banks provided capital.[93]

4. Robust age discrimination legislation

The OECD has noted that the UK has a lower proportion of older people in work than many comparable countries, such as Japan, New Zealand and the United States, and has warned that 'unless there is a substantial increase in labour force participation, especially among older people', then there is a real danger of 'rising labour shortages and a pronounced slowdown in economic growth.' Their concerns have led them to call upon the Government 'to move forward with anti-age discrimination legislation, including the abolition of mandatory retirement ages unless objectively justified.'[94]

In its early days, the Government rejected this sort of legislation, but they were forced to consider the issue again because the European Union issued an Employment Directive aimed at tackling discrimination in the workplace. The Department for Trade and Industry paper Age Matters, which was published in July 2003, proposed implementing the age aspects of the Employment Directive by making compulsory retirement ages illegal, except where 'exceptionally' they could be justified by employers, and by setting a 'default' retirement age of 70 after which employers would be able to force their employees to retire without justifying their decision.[95]

These recommendations were a compromise between those who favoured tough new rules and those who wanted the Directive interpreted in a more flexible way. If they had been implemented, they would have been in line with the Pensions Commission's recommendation that 'there should either be no "default" retirement age beyond which these workers' rights do not apply, or that if one is allowed, it should be different from and significantly higher than the current SPA [State Pension Age], for instance 70.'[96]

More recently, the Government announced, however, that the Directive would be implemented though a new national default retirement age of 65 and by providing workers with a right to request working beyond 65, which employers must consider.[97] Although the default retirement age will be reviewed in 2011, this package is less anti-discriminatory than many people hoped. It is not, for example, as straightforward as the OECD's recommendation of an end to 'mandatory retirement ages unless objectively justified' or the Institute of Directors' demand of an end to 'forced retirement on age grounds'.[98]

The new rules will mean that people who wish to go on working after 65 will be able to doff their cap and ask ‘please sir, may I work some more’, but (as now) their employers will not be under any obligation to comply with the request. Indeed, the only people who will not be protected from having their job taken away on grounds of age are those over 65, the very group that many people would expect to be most protected by age discrimination legislation. In the US, age discrimination legislation protects people aged *over* 40; in the UK, it will protect people *under* 65.

If it was really necessary to pull back from the recommendations made in July 2003, which is doubtful, it is a pity that the Government has not made an explicit commitment to outlaw fixed retirement ages by 2011, rather than simply promising to review the new default retirement age then. It is not too late for another change of heart.

5. More voluntary and private sector participation in welfare-to-work programmes

The most noteworthy shortcoming that afflicts all the various New Deal schemes is their lack of focus on those most in need. Resources are spent on people who then manage to find work through their own effort – one evaluation of the New Deal for Lone Parents suggests the proportion of people who find work through the scheme but who would have done so anyway without the additional help could be as high as 80 per cent.[99]

Moreover, the schemes are not responsive to the obstacles to work faced by individual jobseekers – for example, those participants who do not find employment soon after joining the New Deal 50plus tend to remain out of work.[100]

The most wasteful area of all is probably the Options within the New Deal for Young People and that is one reason why the Conservative Party is committed to using the money that is spent on this programme and on the New Deal for Lone Parents and the New Deal 25plus for boosting the basic state pension instead.[101]

Despite the shortcomings of the current employment schemes, some unemployed people and even more economically inactive people are unlikely to find work through their own resources and will continue to need support. It would make sense to use whatever money that is available from existing Government-run employment projects and from the rather inefficient Work-Focused Interview regime in a more targeted way than at present.

This approach could be implemented through a fund-holder model which allows employment service staff – and their colleagues in the private and voluntary sectors – to be far more responsive to the needs of those individual jobseekers who face particularly high barriers to work. In practice, this means allowing Jobcentre Plus staff to make professional judgements about where their resources can be used most effectively, rather than placing someone on a specific course that might be unsuitable just because they fall into a particular category of benefit recipient.

This has already been tried on a modest scale in the Employment Zones, which are delivered by non-governmental organisations and which are characterised by having far fewer constraints on how available funds can be used than in the New Deal programmes. The record shows that Employment Zones ‘were substantially more effective in helping participants into work than we estimate would have occurred if the programme operating had been New Deal 25 Plus. This appears to have been due to a different funding regime which emphasised job entry and which rewarded jobs that were sustained for 13 weeks.'[102]

It is important to understand how a fund-holder reform might work in practice. Research shows that 'more than half' of those who claimed the Employment Credit within the New Deal 50plus say they would have taken their new job even if the credit had not existed.[103] Under the fund-holder system, much of this money could be saved and used instead to help other people who need more intensive support.

6. Better targeted in-work support

A report on child poverty by the Department for Work and Pensions published in 2003 claims it is a 'common-sense notion that a family of several people needs a higher income than a single person in order for both households to enjoy a comparable standard of living.'[104] That is why the Government's poverty statistics are produced on an equivalised basis, which means they are adjusted to take account of family size and shape.

But this equivalisation process was ignored by the Treasury officials who designed the tax credits, as they decided to pay couples at the same rate as lone parents in similar circumstances. In short, the Government has a child poverty target based on equivalised incomes, but their main policy instruments for reducing child poverty are calculated on a different basis.

The charity CARE has considered this issue in detail and concluded that, 'the problem the Government faces in reducing the number of children living in poor two parent families is that, even when the parent works, many of these families are still in poverty even at relatively high pre-tax incomes. For them tax credits do not deliver enough income to raise their equivalised income above the 60% median. On the other hand, this does mean that, if it wished, the Government could take these families out of poverty by appropriate changes to the tax credit regime.'[105]

Despite the nightmare end of year reconciliation arrangements, which have been rightly criticised by Citizens Advice, the Child Poverty Action Group and One Parent Families among others,[106] it may be unwise to overhaul the whole tax credit system before it has bedded down. A Government that is serious about tackling child poverty should, however, at least consider cost-effective ways of making the tax credit system, or else the tax system in general, more responsive to the needs of poor households headed by couples.

In addition, there is an urgent need for robust research into the impact of the current tax credit system on wages to see whether it is, in practice, pulling gross wages down. It should be possible, for example, to compare what is happening to the pay of people aged under 25 in low-paid work, who are not entitled to the Working Tax Credit, to the situation among their older counterparts, who are having their wages supplemented by the state. Until this sort of information is available, ministerial claims about the potential of their tax credit system to relieve in-work poverty should be treated with caution.

Conclusion

Over the past decade, some of the main trends within the labour market have moved in the right direction. In particular, the halving of unemployment since 1992 is a real achievement. But some other statistics have gone the wrong way, most notably the figures on economic inactivity among people of working age.

The groups targeted by the main welfare-to-work initiatives, such as the New Deal for Young People and the New Deal for Lone Parents, and others who face disadvantage within the labour market, such as older people and people with disabilities, have not found it much easier than before to secure paid work.

In addition, the full effect on the labour market of the expansion of tax credits is unclear. In particular, we do not know the extent to which they are encouraging employers to pay less than they otherwise would to people in low-paid jobs and urgent research is needed in this area. We do know, however, that the ability of the tax credit system to eradicate child poverty will be limited so long as poor households headed by couples receive the same as smaller households in otherwise similar circumstances.

Tackling these problems presents a real challenge. But there are cost-effective ways to improve the support provided by the state to unemployed and economically inactive people. For example:

- extending the conditions for the receipt of benefits for out-of-work lone parents with children of school age would be in the interests of all concerned;

- a revamped 52-week linking rule for Incapacity Benefit claimants would tackle the disincentives to work faced by long-term benefit claimants with disabilities;

- reform of the Social Fund could be an effective, popular and cheap way to improve work incentives, especially for people who fear the short-term financial trap of moving off out-of-work benefits and into paid employment;

- robust age discrimination legislation could help to ensure that people are able to work for as long as they wish and have higher incomes when they do choose to retire;

- moving from the existing inflexible welfare-to-work schemes towards a more responsive model with greater voluntary and private sector involvement would be cheaper and more successful than the current approach;

- a better targeted tax credit system could help to improve work incentives and reduce child poverty.

These reforms will not solve all the challenges within today's labour market, such as the need to make it easier for people in low-paid jobs to stay in work and to move up the jobs ladder, nor will they provide a complete answer to the problems of poverty and disadvantage. But they do have the capacity to make it far easier for people who are shut out from the labour market to find work and to tackle the challenges posed by the declining support ratio. Without these sorts of policies, it is difficult to see how the Government can achieve its new 'aspiration of an employment rate of the equivalent of 80 per cent of the working-age population in work'.

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