

Executive summary

Background

This review was commissioned by the Secretary of State for Work and Pensions in December 2006. Its terms of reference have been:

“To review progress on the Welfare to Work programme since 1997, taking account of evidence from the UK and international experience, and make policy recommendations on how the Government can build on its success in using policies such as the New Deal to continue to reduce inactivity and in-work poverty, and meet the Government’s 80% employment aspiration.”

The review concludes that the Government has made strong progress in its Welfare to Work agenda, but that further evolution is necessary. Welfare to Work and the New Deals have been a success as has been the creation of the Government’s main delivery arm, Jobcentre Plus. The Government now needs to build on these successes, ensuring that resources are targeted in the most effective manner and on those who need them most, and that the expertise that exists across the public, private, voluntary and community sectors is fully utilised in tackling the challenge of extending employment opportunity to all.

The Government’s aspiration to achieve an employment rate of 80% is extremely challenging. Its achievement would establish the UK as a world leader in employment. It would also produce many other substantial benefits in helping to deliver other social goals, including, most importantly, that of reducing child poverty.

In this report I recommend that UK welfare policy applies its resources further towards helping and encouraging the least advantaged into work. The Department should develop a funding approach which will allow it to direct spending towards such groups, who have complex and demanding problems, in a more individualised way. Such programmes should be outsourced into the private and voluntary sector, giving them the incentive to improve performance. Jobcentre Plus, the Department’s one-stop shop benefit and job broking arm, should concentrate on those closer to the labour market, for which its standardised programmes have proved appropriate and successful. With the least advantaged in receipt of more individualised support, the rights and responsibilities of all benefit recipients should be brought more closely into line.

These proposals should be thoroughly tested and piloted before implementation, to establish that the long-term relationship proposed between provider and client produces enhanced outcomes and better cost-effectiveness.

Background

The foundations of today's welfare state were laid in the first half of the last century. It was after the 1942 Beveridge report that the UK made the first serious attempt to develop a comprehensive system of social insurance combined with help finding work. Where he refers to the need for the State to encourage people to find work, Beveridge's arguments still resonate today. As he put it:

"Most men who have once gained the habit of work would rather work – in ways to which they are used – than be idle ... But getting work ... may involve a change of habits, doing something that is unfamiliar or leaving one's friends or making a painful effort of some other kind."

And for those unemployed for a certain period, they:

"should be required, as a condition of continued benefit to attend a work or training centre, such attendance being designed as a means of preventing habituation to idleness and as a means of improving capacity for earnings."

So, even in 1942, it was understood that it was not enough just to provide a safety net – the welfare state also had to support people back into work in an active labour market policy. The balance between active and passive policies has ebbed and flowed over the intervening sixty years.

The welfare state ten years on

The Government has made strong, and in some respects remarkable, progress over the last ten years. Employment is up by 2.5 million; claimant unemployment is down by 670,000; ILO unemployment down by 350,000 to near its lowest rate since the 1970s; and those on the main out of work benefits are down by 900,000 to 4.4 million. The New Deals have been enormously successful - helping over 1.7 million people into work since 1998. The creation of Jobcentre Plus in 2002 extended the rights and responsibilities regime for people on all benefits (including those on lone parent and sickness benefits) and is widely seen as having been a model for effective public service delivery.

As a result the employment rate for "working age" adults (defined as those aged from 16 to 59 for women and 16 to 64 for men) is close to its highest ever level at 74.5%, an increase of 1.8 percentage points since 1997. The alternative measure, taking account of **everyone** in work (i.e. including those above state pension age) demonstrates still stronger recent performance.

This is a genuinely impressive record. And underneath these headlines the biggest improvements have been for areas and groups that were previously furthest behind. Nearly every disadvantaged group that the Government has targeted (e.g. lone parents, older workers, ethnic minorities and disabled people) has seen its 'employment gap' reduced (the only exception being the lowest skilled). Over the same period, long-term unemployment has halved on the international definition and is down nearly three quarters in terms of the claimant count.

But as these successes have happened, so they have brought into sharper focus the remaining challenges, including improving poor performance on low skills and tackling multiple disadvantage and benefit dependency.

Low skills

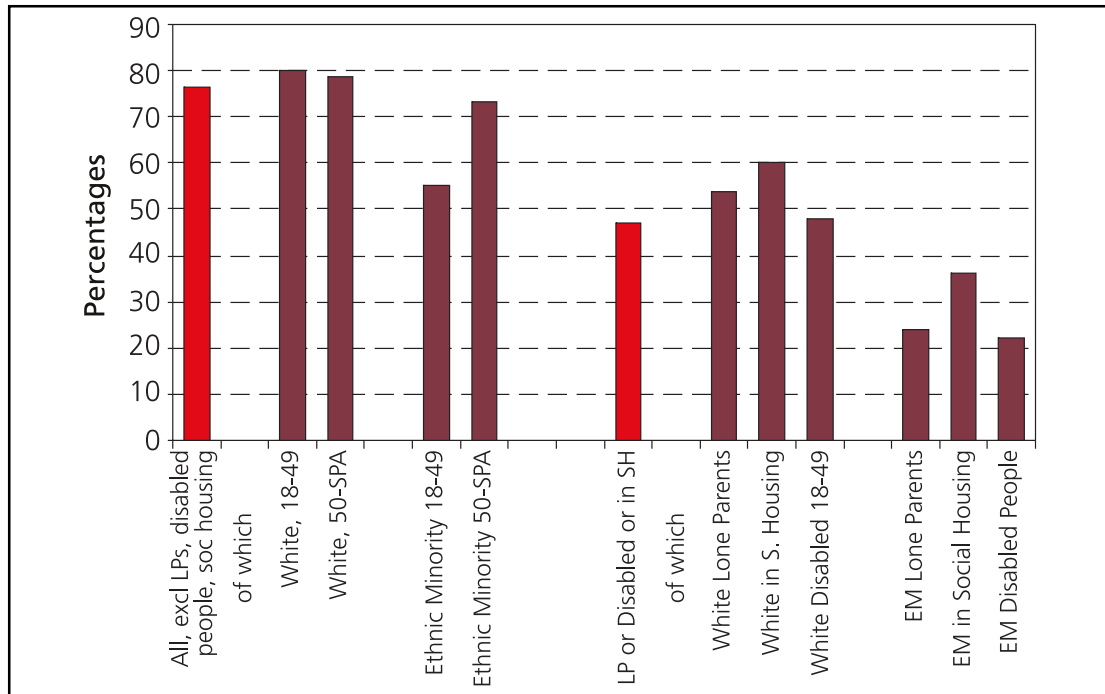
As Lord Leitch's report on skills, published late last year has demonstrated, despite recent progress the UK's skills base remains mediocre by international standards. The UK is internationally comparable in high level skills but has deficits at intermediate and low skill levels. While the number with no skills has nearly halved in the last ten years and the number of working age individuals with a Level 2 qualification is estimated to have risen by over 1 million since 2003, the figures still make sobering reading. 35% of the working age population do not have the equivalent of a good school leaving qualification, more than double the proportion in Canada, US and Germany, 4.6 million have no qualifications at all, 5 million working age people lack functional literacy and 7 million lack functional numeracy. The lowest skilled are the only client group targeted through the Department for Work and Pensions' Public Service Agreements that has seen their labour market position get worse in recent years.

In his report, Lord Leitch found that: *"Around 50 per cent of those with no qualifications are out of work. As the global economy changes, the employment opportunities of those lacking a platform of skills will fall still further. The millions of adults lacking functional literacy and numeracy skills risk becoming a lost generation, increasingly cut off from labour market opportunity. Equipping disadvantaged groups with a platform of skills, including literacy and numeracy, will be increasingly essential to improving their employment opportunities."*

Multiple disadvantage

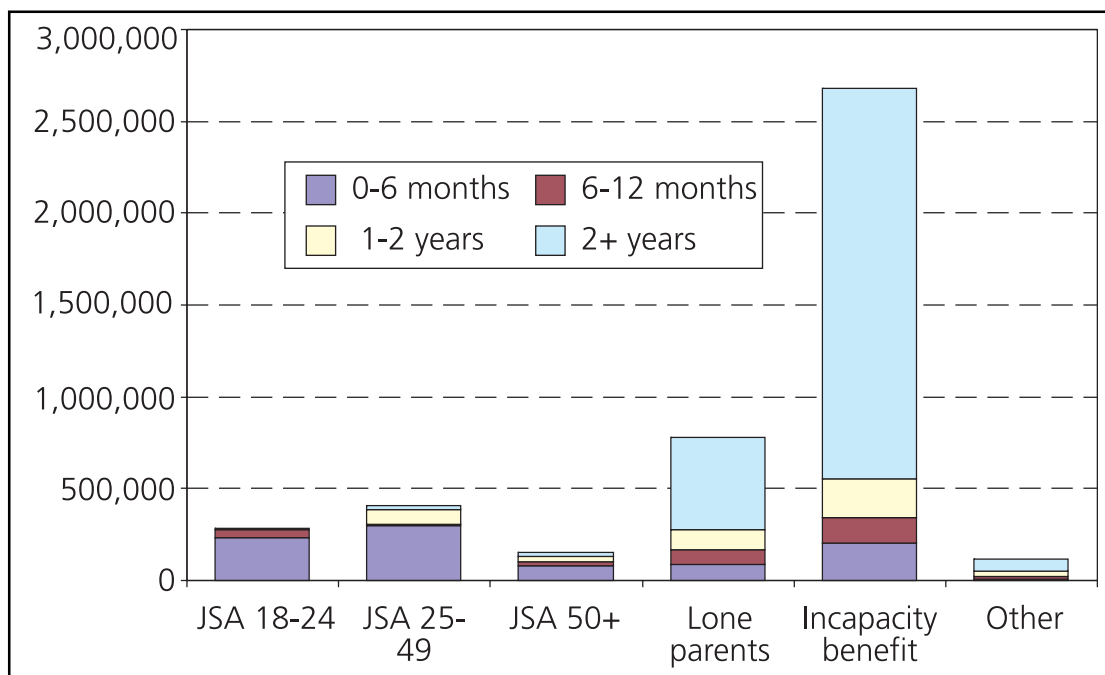
The extent to which disadvantages work together and reinforce each other is striking. Multiple disadvantage does not receive the attention it deserves because of the Government's "client group" approach. It needs more work to be understood fully. Figure 1 overleaf shows how a lack of qualifications combines with other indicators of disadvantage to depress employment rates still further. Harder to measure disadvantages, such as addiction, criminal records, and homelessness, are thought to lower employment rates even more.

Figure 1 Employment rates: 18 – State Pension age, people with no qualifications (excluding students)



The Government has tackled an inheritance of long-term dependency on unemployment benefits, but much more remains to be done on long-term dependence overall. There remain 3.1 million people who have been on benefits for over a year and over 95% of these people are on “inactive” benefits (2.3 million on incapacity benefits and 600,000 lone parents on income support). The JSA figure is 160,000. However, some 250,000 of a recent cohort of new JSA claimants have been on benefits for more than 18 months of the last 2 years.

Figure 2 Durations of claims for key benefits



So, as the Government moves beyond its traditional groups and further into the very hardest to help, the current regime will have to evolve further. It will need to move from a traditional approach based on client groups and specific symptoms to one based on individual needs.

The imperative to act

“There is a strong evidence base showing that work is generally good for physical and mental well-being. Worklessness is associated with poorer physical and mental health and well-being. Work can be therapeutic and can reverse the adverse health effects of unemployment. That is true for healthy people of working age, for many disabled people, for most people with common health problems and for social security beneficiaries. The provisos are that account must be taken of the nature and quality of work and its social context; jobs should be safe and accommodating. Overall, the beneficial effects of work outweigh the risks of work, and are greater than the harmful effects of long-term unemployment or prolonged sickness absence. Work is generally good for health and well-being.”¹

Governments have in the past shown a reluctance to engage with those furthest from the labour market. But the evidence is now overwhelming that employment is generally beneficial for individuals and their families. This corpus of evidence stands traditional Government policy on its head. Far from being reluctant to engage, the Government could on this evidence be accused of dereliction if it were to fail to do so.

Alongside this, greater global economic integration and unprecedented demographic change present both challenges and opportunities. The pace of change in the global economy will put pressure on existing jobs. Parts of the economy are likely to be exposed to international competition to an extent that they have not been before, and the evidence suggests that this exposure will tend to further disadvantage the lowest skilled. As the Leitch Review sets out, the UK response will need to go far wider than just helping people find a job. His report sets ambitious goals that 95% of adults should have basic skills in literacy and numeracy and 90% should be qualified to Level 2 by 2020. This will be central to extending employment opportunity to all.

To achieve its 80% aspiration, the Government will need to target its welfare strategy at tackling **all** of the inactive groups. It will require about one fifth of the “economically inactive” population to move into work. This would include 300,000 lone parents (relative to a current population of 780,000 claiming Income Support); 1 million more older people in work (relative to 20 million people aged over 50 in total) and reducing the numbers claiming incapacity benefits by 1 million (relative to 2.68 million).

¹ “Is Work Good for your Health and Well-Being”, Gordon Waddell and A Kim Burton [2006].

It also has significant implications from the perspective of the most socially disadvantaged – the 3.1 million people who have been on benefits for more than a year. To achieve the 80% figure would imply reducing that total by 1.3 million people, or 42%.

While current policies are making progress for those closer to the labour market, further reforms are needed for those further away. The welfare system will need to both widen and deepen its contact with those furthest from the labour market, and deliver innovative and flexible new ways to help people to find work.

Recommendations

Contracting support for the hardest to help

Intensive intervention at the start of a claim, focused on assisted job search, is now established as the best way to help people to move back into sustainable employment. As a one stop shop, Jobcentre Plus should therefore remain at the core of the service provided and retain ownership of claimants as they pass through the system. However the longer that someone is out of work, the more likely it is that they will stay out of work – long-term worklessness is both a cause and consequence of labour market disadvantage.

The intensive, individualised support which is effective in putting the most disadvantaged people into work is expensive. However, evidence from Employment Zones and the New Deal for Disabled People suggests that an outcome-based approach can deliver significantly improved results for the hard to help. And while there is no conclusive evidence that the private sector outperforms the public sector on current programmes, there are clear potential gains from contesting services, bringing in innovation with a different skill set, and from the potential to engage with groups who are often beyond the reach of the welfare state.

Therefore this report recommends that once claimants have been supported by Jobcentre Plus for a period of time, back-to-work support should be delivered through outcome-based, contracted support. This arrangement could in principle apply to all benefit recipients, including people on incapacity benefits, lone parents and partners of benefit claimants, but excluding carers. The private and voluntary sector would be responsible for intensive case management and for providing individual, tailored help for individuals to re-engage with the labour market. The contracting regime would set a core standard that everyone would receive, but beyond this there would be freedom between the provider and the individual to do what works for them. There may need to be enhancement of arrangements for the very hardest to help, who are the clients of multiple agencies, and supported by third sector contractors.

These contracts would roll up the existing patchwork of public, private and voluntary provision and put in its place a flexible approach that looked forward rather than back – focused on the barriers individuals face rather than the benefit that they are on or the Public Service Agreement category they are in. Payments to providers could be made over – perhaps – a three year period, from when an individual client moved into work. Periods of temporary unemployment, breaks for training and progress in career terms would all be factored into the rewards for providers. In order to ensure that everyone was supported, including those who required the most intensive help, the contracts would need to offer rewards that are proportionate to the value to society and the taxpayer of moving into work.

The report recommends that these contracts are outcome-based, long term, and based on the 11 regions and countries in Great Britain. They should be let to “prime contractors” who would be responsible for marshalling an appropriate blend of subcontractors to deliver the services required for the variety of claimants in that region. The prime contractors, who would compete on both price and quality for a regional contract, would need to arrange the finance to cover the upfront cost and risk of achieving adequate off flows from benefit. While it will be important to test this recommendation, I believe that on balance, each region should become the province of a sole prime contractor because of the complexity of the arrangements likely to be required with many other parties. The Government will need to balance this with the need to avoid over-dependence on single monopoly providers. The quid pro quo for local monopoly arrangements would be a totally transparent performance regime, so that innovative strategies that work could be quickly replicated in other regions. The prime contractors would also be required to work with local agencies and through any City Strategy consortia to ensure that the provision was responsive to local conditions and objectives.

Modelling outcome-based contracting for long-term worklessness

The contracting approach described above would work as a public-private partnership to deliver up-front investment in order to realise savings over the life of the contract. In order to deliver this the Department would need to develop a model that allowed it to understand the full costs and benefits of different groups of individuals moving into work. The more sophisticated this model becomes, as it develops over the years, the easier it will become to target early interventions cost-effectively.

The fiscal gain of a year-long move into employment by a claimant on one of the three main benefits is substantial. I estimate that the savings in terms of gross costs to the Department of moving an average recipient of incapacity benefits into work is £5,900, with wider exchequer gains (offsetting direct and indirect taxes paid with additional tax credits) raising this figure to £9,000. The equivalent figures for Jobseeker’s Allowance are £4,100 and £8,100 respectively. For lone parents on Income Support the Department savings are £4,400, with no further Exchequer savings because of the weight of extra tax credits balancing other tax revenues.

To the extent that the person would not have otherwise worked for many years, the saving to the State is a multiple of this figure. For example, once a person has been on incapacity benefits for a year, they are on average on benefit for eight years. So a genuine transformation into long term work for such an individual is worth a present value of around £62,000 per person to the State.

The cost of additional employment entry would reflect the terms the State could obtain in a competitive contracting process. To the extent that this cost was less than the welfare benefits that the Department would have paid over a three year period, the State would enjoy a financial gain. Outcome payments should only be made for performance which exceeds that achieved with current policy, so a benchmark could be set at the existing level of exit rates from benefit. This would be revised and updated as the involvement of the private and voluntary sectors developed over time.

Payment mechanisms would also need to create incentives to develop programmes across the spectrum of claimants and not to focus on a narrow group. This could be achieved through higher payments for the hardest to help or by providing bonus payments where certain outcome levels had been delivered for multiple client groups. It is likely that a combination of the two would be required to provide a strong incentive.

The Department would need to develop a world class contracting capability so as to ensure that the Government's complex social goals were met without compromising the robustness of the outcome focus. It would also need to develop sophisticated performance management tools and be prepared to remove contracts from providers who were not performing.

The scale of the potential market is large. It will be made up of the flow of new and existing hard to help clients from Jobcentre Plus. In the early years it would be further swollen as the existing customers on incapacity benefits were required to participate in labour market activity. Based on the analysis in this report, I have no doubt that this will be an annual multi-billion market. Such scale would attract commitment from a wide range of private service providers and voluntary groups.

The fiscal prize is considerable. Achievement of the 80% employment aspiration would boost GDP, reduce benefit spending and increase Exchequer revenues to a material extent.

Rights and responsibilities

Making a step-change is not, however, only about delivery. The Government has made a commitment to rights and responsibilities a central feature of policy. In return for more support in obtaining employment, it would seem appropriate for the state to expect more work-related activity from those on benefit. Recent evidence suggests that expecting more from those on incapacity and lone parent benefits, alongside the right support, can deliver greatly improved outcomes. It is also clear that, particularly as regards lone parents, the UK imposes much less 'conditionality' on these groups than in many other OECD countries.

This report has looked at a range of best practices from the UK and abroad:

- The Jobseeker's Allowance intervention regime is the most important reason why as many as nine out of ten people who claim the benefit leave within a year. A "work first" approach, alongside the New Deal for those with longer durations, has worked for the mainstream unemployed.
- For people with health conditions and disabilities, the Pathways to Work programme is now breaking new ground and delivering an increase in employment outcomes of 9 percentage points.
- By contrast, although eight out of ten lone parents want to work, the UK is some way behind international best practice. The lone parent employment rate in Great Britain stands at 56.5%, compared to 80% in Denmark, one of the best-performing comparators. Practices round the world vary. What is increasingly common, however, is an expectation that once children reach school age then receipt of benefits should be conditional on looking for a job.

The report therefore recommends maintaining the current regime for the unemployed, introducing stronger conditionality in line with Jobseeker's Allowance for lone parents with progressively younger children, and moving to deliver conditionality for other groups (including people already on incapacity benefits) along the lines of Pathways to Work and the Employment and Support Allowance. These changes should be phased in over the next decade, to take account of the rollout of Pathways to Work, the new Employment and Support Allowance, and the Government's childcare strategy.

Benefit reform – a single system

There is a strong case for moving towards a single system of working age benefits, ideally a single benefit, in order to better support the Government's ambition of work for those who can and support for those who cannot. A range of international evidence suggests that complexity in the benefit system acts as a disincentive to entering work, and that badly designed systems create unemployment and/ or poverty traps. The UK has made progress on both (and virtually eliminated the unemployment trap) but it can go further still. It should also do more to change the perception, where it exists, that moving into work does not pay; a perception which can be a function of fragmented delivery by the central benefit system, local authorities and tax authorities.

The report has considered a number of options for fundamental reform of benefits but none is straightforward and all would create winners and losers. Debate on further reform should be informed by detailed modelling on the impacts on work incentives, costs and benefits (for individuals, the Exchequer and society) and take into account the interactions between all out-of-work and in-work support. This should call on existing expertise in academia, think-tanks and the private and public sectors.

Streamlined, mass market provision based on Jobcentre Plus

With support for the hardest to help being delivered through the private and voluntary sector, the focus in Jobcentre Plus should increasingly be on providing a professional, high-quality, work-focused service for all claimants in the first year of their claim.

In the longer-term Jobcentre Plus should aim to provide a one-stop front-end for all benefits. Such a move would not necessarily mean changes in responsibilities for the benefits themselves, but it would mean linking the benefit system to improve the service that the Government gives to the 5 million claimants on out of work benefits and to support them in taking the first steps back into work. Such a programme would build on the progress made in recent years, in particular on the links with Housing Benefit and on the successful DWP/HMRC trials in North Tyneside which have shown that it is possible to significantly reduce processing times for benefits and tax credits while greatly improving customer service.

Implementation

These recommendations would involve substantial change for the Government, external providers and claimants and would take an extended period to test and implement. I anticipate that it would take at least six years to roll out a full system of provider contracts; at least eight years to introduce a new benefit system. Lone parents whose youngest child is aged 12 could be moved over to Jobseeker's Allowance as soon as is practicable, with further reductions in the age of the youngest child to follow.

This report has been commissioned by the Department for Work and Pensions and has naturally concentrated on its programmes and strategy. As the Department and the Government considers its response to these proposals I recommend that it develops its programme together with the other major Departments of State involved in social policy: the Departments of Health; Education and Skills; Communities and Local Government; Trade and Industry; the Home Office; and the Treasury.

The programme recommended here represents a major step forward in welfare reform, with the ambitious objective of reducing by two fifths those trapped at the bottom of society. To succeed fully, it will need sustained support from policy-makers, local organisations and employers. It represents an opportunity that I hope all these groups will seize with enthusiasm.