

POLICY ANALYSIS

**Incapacity Benefit Reform:
Tackling the Rise in Labour Market Inactivity**

- There are 2.7 million people of working age in the UK who are claiming Incapacity Benefit, Severe Disability Allowance or Income Support on the grounds of incapacity. Total spending on benefits for disabled people was in excess of £19 billion in 2004.
- The inactivity rate for men – the proportion of the working age population of men over 25 who are neither in work nor looking for a job – has risen by a multiple of around four since the mid-1970s. Among prime-age men (those aged between 25 and 54), the inactivity rate is now 8.6%, a rate five times higher than it was in the mid-1970s.
- The level of inactivity among prime-age men is particularly concentrated among those who are both low skilled and suffering from a chronic health problem or disability. Over time, as inactivity has increased, this concentration has become worse. The main factors underlying these changes are the significant weakening of the labour market for low skilled workers and the operation of the invalidity benefit system.
- The inactivity rate for prime-age men in the UK is higher than the European (EU15) average. At the same time, labour market participation of older (55-64) men is higher in the UK than in continental Europe.
- There are considerable regional differences: Northern England, Wales and Scotland have higher inactivity rates than the Midlands and Southern England, and the differences are wider today than they were in the mid-1970s.
- The government's strategy to reverse the rise in inactivity and Incapacity Benefit claims includes: the New Deal for Disabled People (NDDP); the Pathways-to-Work pilots; and the recently published Green Paper on welfare reform.
- Evidence on the NDDP pilots indicates that take-up of the service has been relatively low and participation has produced modest results. By contrast, evidence on the Pathways-to-Work pilots shows that the programme *has* been successful in increasing the rate (an increase of 8%) at which new disability claimants return to work.
- The Green Paper applies and extends the successful strategy of the Pathways-to-Work programme nationwide. But the inability to deal with *existing* claimants reduces the potential impact of the proposed reforms.

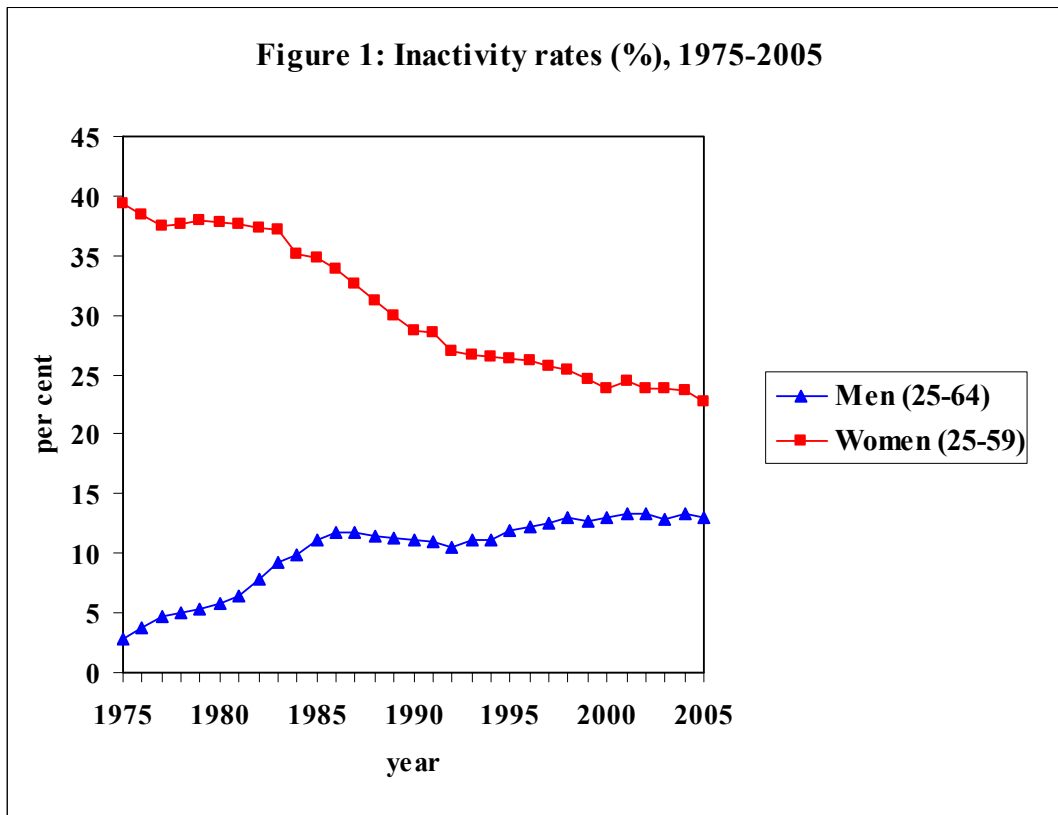
Introduction

There are 2.7 million people of working age in the UK who are claiming Incapacity Benefit, Severe Disability Allowance or Income Support on the grounds of incapacity. According to the Department for Work and Pensions (DWP), total spending on benefits for disabled people was in excess of £19 billion in 2004 (DWP, 2004a).

Inactivity rates among adult men have risen dramatically since the early 1970s whereas those for adult women have been falling.¹ While the latter is to be expected as more and more married women go to work, continuing the trend since 1950, the rise in male inactivity is more surprising.

Figure 1 shows that male inactivity not only rose during the recessions of the early 1980s and early 1990s, but it continued to rise during the booming labour market of the late 1980s and late 1990s. While male unemployment has now returned to its 1970s level, male inactivity has risen around fourfold.

This policy analysis examines what has driven the rise in labour market inactivity and Incapacity Benefit claims, and the likely impact of policies to tackle inactivity, such as those proposed in the recent Green Paper on welfare reform.



Source: Labour Force Survey: Annual (1975-1991), Spring Quarter (1992-2005)

Note: the inactive are those who are not working and not looking for a job.

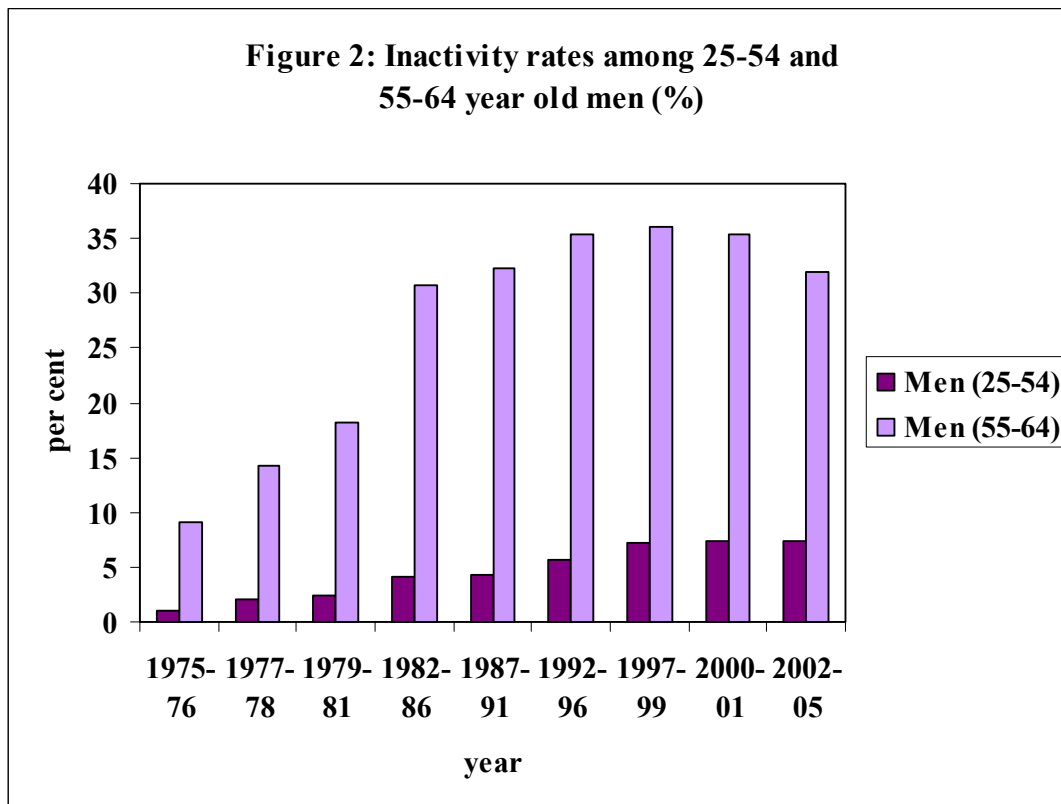
¹ See Faggio and Nickell (2003, 2005) for more details.

Inactivity rates among prime-age and older men

For older men, the rise in inactivity was concentrated in the 1970s and 1980s (particularly following the early 1980s recession), but stopped increasing in the 1990s. By contrast, for prime-age men, inactivity rates have continued rising up to the present day, despite the relatively buoyant labour market of the last seven or eight years (see Figure 2). As a consequence, for this group, inactivity rates are now far greater than unemployment rates. This is a complete reversal of the situation in the 1970s.

Inactivity rates for prime-age men have risen significantly in most OECD countries since the 1970s. The latest figures show that inactivity rates among prime-age men in the UK (8.6%) are higher than the averages for the OECD (8%) or the EU15 (7.8%). But labour market participation of older (55-64) men is higher in the UK than in continental Europe (OECD, 2005).

There has been a fall in demand for unskilled workers since at least 1980 so we might expect bigger increases in inactivity among the unskilled. This has indeed happened. For older workers, the difference between the low skilled (bottom skill quartile) and the rest is not so great, in part because some in the higher skill groups have access to good early retirement packages. Among prime-age men, however, the low skilled are three or four times more likely to be inactive than higher skill groups.

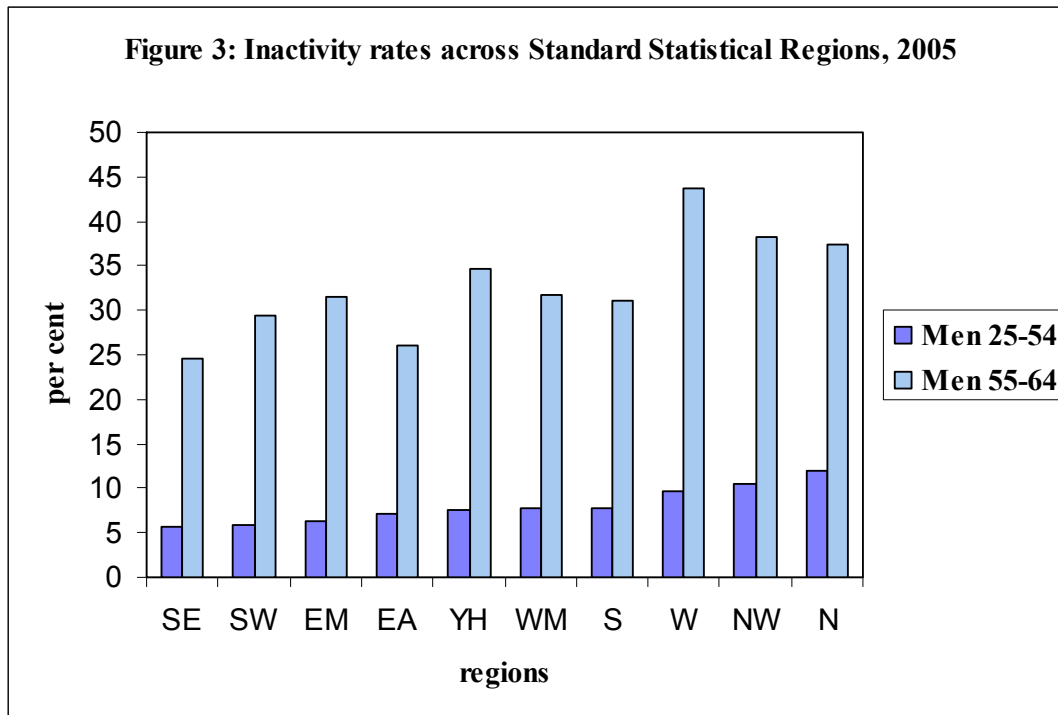


Source: Labour Force Survey, Annual (1975-1991) and Spring Quarter (1992-2005): figures are averages over the indicated periods.

There are differences across regions. Inactivity rates among both older and prime-age men are higher in low employment regions (Wales, Scotland and Northern England) than in high employment regions (East Anglia, the Southern regions and the Midlands).

These regional differences have increased over time. In the mid-1970s, the differential in inactivity

rates among prime-age men between the South East and Wales was about 1 percentage point; in 2005, the differential was 4 percentage points (see Figure 3).



Source: Labour Force Survey (2004): standard statistical regions are East Anglia (EA), South East (SE), South West (SW), East Midlands (EM), West Midlands (WM), Scotland (S), Yorkshire and Humberside (YH), North West (NW), Wales (W) and the North (N).

Inactivity and disability

Inactive men over the age of 25 report themselves as being in one of four categories: full-time student; looking after family; early retired; or sick or disabled. In the prime-age group, around 70% of the inactive report themselves as being sick or disabled. In the older age group, the equivalent figure is over 50% with another third being early retired. Disability is, therefore, a key factor in understanding the rise in male inactivity.

Among prime-age men, the majority of those with a limiting illness or disability are economically active. But whereas in the 1970s, a mere 10% of this group were inactive, by the late 1990s, this number had risen to around 40%.

Prime-age men in the bottom skill quartile are now around three or four times more likely to be inactive than the rest of the prime-age male population. This difference is explained by two facts:

- First, the least skilled are more likely to report a limiting illness or disability.
- Second, among the men who do report a limiting illness or disability, those who are least skilled are more likely to be inactive.

Why have so many men become inactive?

One fundamental change causing rising inactivity is the dramatic weakening of demand for unskilled

labour since at least the mid-1970s. This is mainly due to technological change, which has favoured the more educated (for example, computer use) and, to a lesser extent, globalisation (exports from countries with many unskilled workers). At the same time, there has been a general increase in the supply of skills, but it has not been rapid enough in the UK to keep up with demand.²

Employment rates of low skilled workers have fallen because of this, but why has this rise in non-employment been so heavily focused on inactivity as opposed to unemployment? There are both 'push' and 'pull' factors.

The main 'push' reason is that as the low skilled labour market weakens, the group who are most at risk are those who have additional disadvantages, such as people with a disability that limits the sort of work they can do. As soon as the low skilled labour market started to weaken, those unskilled men with a chronic illness or disability were particularly badly hit.

Because the low skill group found it much harder to find work, the social security system found it much easier to shift them onto invalidity benefit (now Incapacity Benefit). Thus, some individuals who were hard to place in work were advised by the Employment Service to claim invalidity benefits.

Furthermore, doctors, whose certification was required for invalidity benefit entitlement, were influenced by their assessment of the probability of patients finding a job.³

The main 'pull' factor for the rise in inactivity is that invalidity benefits were considerably more generous than unemployment benefits. Furthermore, this gap increased from the mid-1980s to the mid-1990s before falling back in the later 1990s. This occurred because of the operation of the Additional State Pension system, an earnings-related supplement to invalidity benefit.

Also on the 'pull' side is the fact that once a person was in the invalidity benefit system, the pressure to take up work was minimal.

Current policies to tackle inactivity

The government's current strategy to try and reverse the rise in activity and Incapacity Benefit claims is three-pronged. The overarching aims of these policies are to make work relatively more rewarding and to help people obtain work that is tailored to their individual needs:

- First, there is the New Deal for Disabled People (NDDP).
- Second, there is the Pathways-to-Work programme and, more generally, the Jobcentre Plus system.
- Third, there is the recently published Green Paper on welfare reform (DWP, 2006).

The NDDP began in September 1998. A 'personal adviser' aims to assist disabled people to work, to help those already in work to remain in employment and to extend the range of services available to them. The scheme is entirely voluntary.

A two-year evaluation of the pilot service indicates that take-up of the service was relatively low.⁴ At the end of June 2000, 22% of those who joined the programme had found employment though results were less encouraging for job retention. The NDDP was implemented nationwide on 2 July 2001 and

² See Nickell and Layard (1999), Machin et al (1999).

³ See National Audit Office (1989), Ritchie et al (1993).

⁴ DWP (2001).

has been extended to run until March 2006. There were 88,870 participants by December 2004.⁵

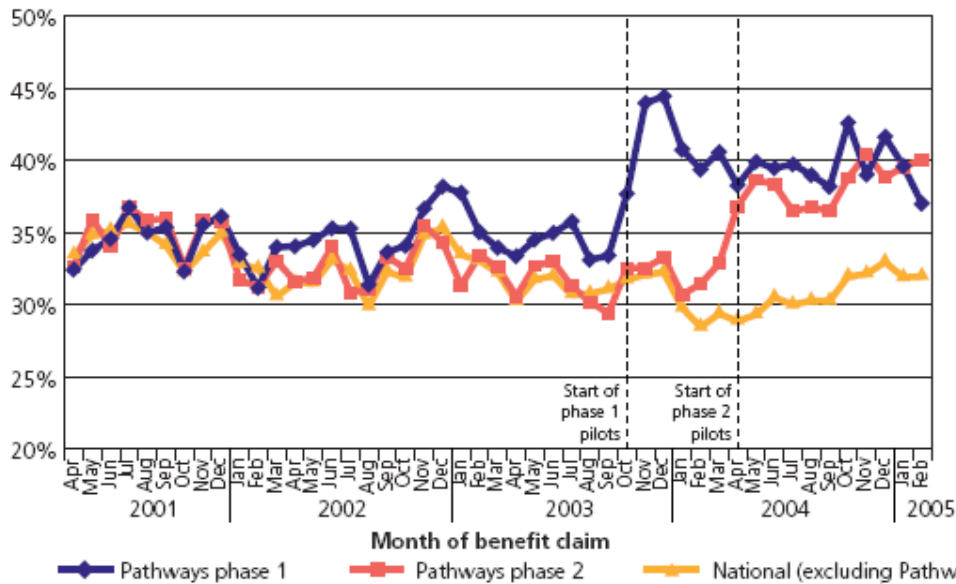
Three Pathways-to-Work pilots were introduced in October 2003 (in Renfrewshire, Derby and Bridgend) with a further four launched in April 2004 (in Essex, Gateshead and South Tyneside, Somerset and East Lancashire). The Pathways-to-Work programmes introduce a mandatory element: participants must see a personal adviser regularly.

Under the Pathways-to-Work pilots, Jobcentre Plus and the NHS work together to refocus people on their ability and aspirations for a return to work. The pilots offer to all claimants: a personal adviser; NHS rehabilitation support; local partnership with the NDDP; a £40 a week return to work credit for one year; and GPs and employers' involvement to prevent discouragement from working.

The Pathways-to-Work pilots have targeted new claimants and existing claimants who volunteer.⁶ Successful findings for the first and second waves of pilots were published in the 2005 Budget and in the welfare reform Green Paper (DWP, 2006). Outflow rates from Incapacity Benefit in the pilot areas have increased on average by 8% relative to the national average (see Figure 4).

On 2 December 2004, the government announced an ambitious reform programme to expand Pathways-to-Work pilots to cover the Jobcentre Plus districts with the greatest proportions of the working age population on Incapacity Benefit. The target was to get 900,000 claimants back to work by October 2008.

Figure 4: Proportion of claimants leaving Incapacity Benefit within six months of their claim start



Source: *Incapacity Benefit reforms Pathways-to-Work pilots, performance and analysis*, DWP Working paper No. 26; *A new deal for welfare: Empowering people to work*, DWP, 2006.

Note: The data presented are produced from the National Benefits database and do not include a proportion of short-term Incapacity Benefit claims. Therefore the percentages shown are lower than the actual rates. But trends over time will be consistent.

⁵ This total contains both Job Broker and NDDP Jobcentre Plus jobs. The number of NDDP participants relates to registrations with NDDP Job Brokers only (DWP, 2004b).

⁶ Since February 2005, Pathways to Work pilots have been set up for existing claimants with a disability record between nine months and three years. They offer participants all the services of the scheme plus an extra £20 weekly Job Preparation Premium (DWP, 2005).

The Green Paper on welfare reform

On 24 January 2006, the government published its Green Paper on welfare reform, which includes detailed proposals to help the disabled, lone parents and older workers back into work.

Focusing on people who are sick or disabled, the Green Paper plans to replace Incapacity Benefit with a new Employment and Support Allowance for new claimants by 2008. The paper also proposes introducing a two-tier system that distinguishes between people who are severely disabled and people who are temporarily unfit to work.

Those who cannot engage in any activity because of the severity of their condition will receive an enhanced *support* component. The remainder will receive an enhanced *employment* support component on condition that they undertake mandatory work-focused interviews and later work-related activities. Benefit sanctions will be imposed on those who do not comply. Sanctions will reduce an individual's benefits in 'slices' to the level of Jobseeker's Allowance.

The proposals include plans to revise the medical assessment process focusing on ability and support needs rather than incapacity. Employment advisers will also be placed in GPs' surgeries.

The government plans to address the flow of people from Statutory Sick Pay to Incapacity Benefit by encouraging the development of healthy workplaces and by simplifying Statutory Sick Pay in order to enable employers to manage workers' sickness and absenteeism better.

Given the success of the Pathways-to-Work programme, the government has outlined a further extension of the programme to cover the country by 2008. In doing so, it plans to create financial incentives for local authorities to engage with the private and voluntary sectors in order to establish local back-to-work schemes. Private and voluntary players will be chosen by outcome-driven bids only.

Unfortunately, reform of Incapacity Benefit will affect new claimants only. Existing claimants will continue under the old regime but will face a tougher Personal Capability Assessment in order to verify whether their condition has changed or improved. They will be involved in Pathways-to-Work schemes only if they volunteer. A strategy specifically aimed at the barriers faced by existing claimants was not discussed in the Green Paper.

Apart from simplifying Statutory Sick Pay, the Green Paper fails to encourage employers to retain employees with a disability or to create incentives for firms to recruit disabled people. It does, however, create incentives to encourage employers to reduce risk in the workplace.

One potential problem is that there is not adequate disability training for Jobcentre Plus staff although the Green Paper now requires them to make judgements about whether or not someone is able to attend work-focused interviews or take part in work preparatory activities. With sanctions based on their judgements, how can the government achieve its goals? (Disability Benefits Consortium, 2006).

The Green Paper assumes that many GPs underestimate the detrimental effects of a life spent in inactivity and benefit dependency. A full range of initiatives are planned to improve the training of doctors and health professionals to bring about a cultural change in the way work is viewed by families and individuals. But is the application of these initiatives fully justified?

The ambitious target of reducing 900,000 Incapacity Benefit claimants by October 2008 was modified in the Green Paper. The new target is to reduce by one million the number on Incapacity Benefit 'over the course of a decade' (DWP, 2006). It is not clear, though, whether the government expects to reach the target by 2016 or 2018.

Conclusions

As unemployment has fallen, male inactivity rates have escalated dramatically. Among prime-age men, 13% are inactive whereas less than 5% are unemployed. Inactivity rates are now about four times higher than they were in the mid-1970s.

The rise in male inactivity has been mainly caused by a fall in demand for less skilled workers, which has been exacerbated by the benefit system – when unemployment started to take off in the 1980s, people who lost their jobs shifted onto invalidity benefit.

The government's current policies have been to make access to Incapacity Benefit stricter, which should help stem the flow of new entrants. The NDDP offers job search assistance and training that should help the stock of motivated claimants. But it is unlikely that an entirely voluntary scheme will reach the large numbers of inactive people outside of the labour market.

The extension of the Pathways-to-Work pilots, which has a mandatory element, seems more likely to produce successful results.

The Green Paper applies and extends the successful strategy of the Pathways-to-Work programme nationwide by 2008. But the inability to deal with existing claimants reduces the potential impact of the reforms.

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