

# Response to DWP 21<sup>st</sup> Century Welfare

**John Van Reenen, Professor of Economics, LSE and Director of  
the ESRC Centre for Economic Performance**

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## **I. Introduction and Summary**

This is written in response to the DWP consultation on 21st Century Welfare (<http://www.dwp.gov.uk/consultations/2010/21st-century-welfare/>). I write in a personal capacity. CEP has no institutional views.

## **II. General Points**

Better integration of the tax and benefit system to reduce high marginal rates and reduce complexity is to be welcomed. I think all governments have aimed for this, but it has proven difficult to accomplish for several reasons. First, there are transitional costs. Second, there will inevitably be losers. But, third and perhaps most importantly, there are also some inescapable trade-offs that are brushed under the carpet in the Consultation Paper.

## **III. Insurance vs. incentives**

The welfare system is essentially one of insurance against bad luck in the lottery of life, whether this is a bad draw in one's working life (like losing a job or falling ill) or simply getting the wrong social background or genes. Now, although background isn't a choice, choosing to work is (to some degree) so inevitably, the more generous is insurance, the worse will be the incentives to work.

Recognising these disincentive effects, modern reformists have tried two complementary strategies. First, enforcing the conditionality of receiving welfare payments: broadly enforcing the work search criterion that has always been part of the welfare state. The right to benefit entails the responsibility to look for work as emphasised by Beveridge and many before him. The second strategy is to reduce the "sharp cliffs" of rapid loss of income when people move between work and non-work ("making work pay").

These are laudable aims and the Labour government made good progress on these. But they blunt the trade-off they do not abolish them.

### *Work Incentives*

Reducing high effective marginal rates is easier said than done. Smoothing the tapering does indeed reduce these effective marginal rates, but it brings more people into the tax credit system. Although the paper seems to believe that there is something intrinsically wrong with this (perhaps under the belief that it will foster "dependency") I can see no logic in this at all. People have to pay taxes so the state is always involved with their income in one way or another.

The objections are ones of cost – the smaller the withdrawal rate, the further this reaches up the system - and complexity (multiple agencies, confusion). These seem inevitable.

### *Conditionality*

We have learned a lot about the importance of conditionality. Much evidence does show that enforcing work search can reduce numbers claiming JSA or its earlier equivalents (e.g. the randomized control trials on RESTART). Sending letters, looking for evidence of search or sanctions do have some major effects.

But the question is whether those who are pushed off benefits find work. If they remain unemployed, non-active or worse, go into crime (Machin and Marie, 2004) then the conditionality is self-defeating. The introduction of JSA, for example, reduced claimants but had much more muted effects on the job-finding rate (see Petrongolo, 2009, and Manning, 2009).

On the other hand, when conditionality is combined with active assistance in finding help through personal advisors, this has a much stronger effect on job finding rates. The success of the New Deal for Young People (NDYP) is a good example of this. High quality evaluations by the Directors of IFS (Blundell) and CEP (Van Reenen) found that the NDYP increased the job finding rate by around 20% (see Blundell et al, 2004, Van Reenen, 2004). These jobs also seem to last (e.g. Di Giorgi, 2005). The combination in NDYP of “carrot and stick” was very effective. What is needed is tougher implementation of these policies – combining strong conditionality with help in job search to activate the unemployed.

## **IV. Evaluation**

The most important thing to know is that governments (and academics) generally do not know. So rigorous evaluations of policy proposals are really what we need. The DWP has a lot of evaluations but these tend to be low quality, highly selective surveys and qualitative case studies. What is needed is gold standard quantitative evidence based on randomised control trials.

Policies should be piloted when introduced and these pilots should be done in a way that we can learn what the effects will be. So it is much better to have randomisation than “matched” areas and to use administrative data with histories of outcomes rather than bespoke (and often unrepeatable) surveys.

These things take political courage, but in an era of constrained resources finding out what actually works is critical before making large and unknown changes.

This might be important for issues around complexity (question 3) of the tax and benefit regime. It seems intuitive that complexity creates waste, but I (and in my view no one else) really has much idea how much (and therefore what the cost-benefit ratio is). This is an area

where some experimentation and evaluation could be implemented to see how big a deal it really is.

#### **V. In-work benefits**

The consultation seems to suggest that in-work benefits have been unsuccessful. But the evidence from all the serious analyses I have seen suggests that Working Family Tax Credits and its successors have had large and important effects on increasing the employment rates of lone parents (e.g. Banks et al, 2005). This has to be a major success to build on as the rate of lone parenthood is very high in the UK compared to other European countries.

The big concerns with the expansion of in-work benefits was first, that there would be incentives for other groups (like married women) to reduce their labour supply. This has happened only to a very minor degree. Second, there was a concern that employers would respond by cutting wages. Again, these “equilibrium effects” seem to be small or non-existent possibly because the national minimum wage is an effective way of counterbalancing this incentive.

#### **VI. Fraud**

Question 4 focuses on this. Large numbers are bandied about, but OECD evidence suggests that the UK has one of the developed world’s toughest regimes. I have yet to see evidence that the costs outweigh the benefits on this.

#### **VII. Conclusions**

In answer to question 1, the best way to reduce welfare dependency is to use the New Deal type approach of combining carrot and sticks. In answer to question 2, the “widely held view” is like many of these, not true. In answer to question 5, the government is largely following the same (broadly correct) approach of the previous government.

The consultation seeks to gloss over many of the inevitable trade-offs. Unfortunately they will not disappear by political dictat.

#### **References**

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1. What steps should the Government consider to reduce the cost of the welfare system and reduce welfare dependency and poverty?
2. Which aspects of the current benefits and Tax Credits system in particular lead to the widely held view that work does not pay for benefit recipients?
3. To what extent is the complexity of the system deterring some people from moving into work?
4. To what extent is structural reform needed to deliver customer service improvements, drive down administration costs and cut the levels of error, overpayments and fraud?
5. Has the Government identified the right set of principles to use to guide reform?
6. Would an approach along the lines of the models set out in chapter 3 improve work incentives and hence help the Government to reduce costs and tackle welfare dependency and poverty? Which elements would be most successful? What other approaches should the Government consider?
7. Do you think we should increase the obligations on benefit claimants who can work to take the steps necessary to seek and enter work?
8. Do you think that we should have a system of conditionality which aims to maximise the amount of work a person does, consistent with their personal circumstances?<sup>21st Century Welfare</sup>

9. If you agree that there should be greater localism what local flexibility would be required to deliver this?
10. The Government is committed to delivering more affordable homes. How could reform best be implemented to ensure providers can continue to deliver the new homes we need and maintain the existing affordable homes?
11. What would be the best way to organise delivery of a reformed system to achieve improvements in outcomes, customer service and efficiency?
12. Is there anything else you would like to tell us about the proposals in this document?

[benefit.reform@dwp.gsi.gov.uk](mailto:benefit.reform@dwp.gsi.gov.uk)