Making Contributions Count

Reforms to create a social security system for the 21st Century

Steve Hughes

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Published by

Policy Exchange, Clutha House, 10 Storey's Gate, London SW1P 3AY

www.policyexchange.org.uk

ISBN: 978-1-907689-86-4

Printed by Heron, Dawson and Sawyer

Designed by Soapbox, www.soapbox.co.uk

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Acknowledgements

The author would like to thank the Hadley Trust for their continued support of this programme of work. Thanks also go to Matthew Oakley and Cameron Scott for research and ideas that inspired and supported this report.

About this Report

The UK's social security system was founded in its present form over 70 years ago. In doing so, Beveridge was clear of his intent:

> '…*first and foremost, a plan of insurance – of giving in return for contributions benefits up to subsistence level, as a right and without means test, so that individuals may build freely upon it*'.[1]

This ambition of co-provision between the state and the individual has never been achieved. We are left with a social security system that barely recognises contribution and provides inadequate support in the modern labour market. Individuals are passive recipients of state support in times of need and rarely make provision for their own support. This report recommends a new system that will simultaneously bring the social security system back to its founding roots and ensure it is fit for the 21st Century.

1 William Beveridge (1942), Social insurance and allied services. Paragraph 10.

Executive Summary

The UK's social security system is not fit for the 21st Century labour market. It does not reflect the contributions that people make. Its current structure does not reflect the changing nature of the labour market. The support it provides does not meet the variety of needs that individuals have. A prime example is that, while 15% of the labour market is now self-employed, this group is not entitled to contributory Jobseeker's Allowance (JSA(c)) and a range of contributory benefits. Even those who are entitled get a raw deal, with rates of benefits not reflecting the contributions they have made and the needs they have.

The approach to trying to improve the system over the last 20 years has failed. By trying to design and run a welfare system from the centre of government and view benefit claimants as passive recipients of support, it has created a culture of benefit dependency and a system that does little to provide the support that people actually need. As a result, public support for the welfare state, particularly as it applies to jobseekers, has been irrecoverably undermined.

The Coalition Government's reforms since 2010 have made some important progress in improving the system and bolstering public support. Cuts to benefits have proven to be popular with the public and Universal Credit will be a more efficient and effective benefits system. However, far more fundamental changes are needed in the next Parliament to ensure the social security system, and broader welfare, provide people with the support they need and are supported across society.

What is needed is a new approach. This must be built around the principles of contribution; self-reliance; sustainable costs; flexible support; and public trust. A new scheme *MyFund*, running alongside Universal Credit would deliver against each of these principles.

It is a radical reform that, without affecting long-term government finances, would reward work and put money back in the hands of working families, allowing them to support themselves flexibly in times of need. It is a scheme that, if developed fully, could significantly reduce the costs of social security and welfare more generally.

The *MyFund* scheme would:

- Introduce a hybrid system of collective insurance and welfare accounts, paid for through contributions from all employees and the self-employed, ensuring that all workers have a stake in the scheme. Costs to individuals would be offset with reductions in National Insurance contributions. As well as unemployment insurance, each working individual would receive at least £250 a year into their *MyFund* account. This would be their money;
- Pay unemployment benefits for the first three months an individual was unemployed. Half of these costs would be met from the insurance element

and half from the personal pot of *MyFund*. This means that individuals are no-longer passive recipients of state support – they clearly contributing to the costs of their benefits while they are unemployed;
- Continue to pay unemployment benefits for those contribution-based claimants who, under the current system, would be cut off from financial support after six months;
- Give individuals with sufficient contributions the option to top up their benefits by up to £100 a week;
- Allow individuals to tailor each element of the scheme. They could choose to increase the insurance element to provide a higher or longer pay-out or to cover the costs of rehabilitation from illness or injury. Individuals could also contribute more to their personal fund;
- Provide a route through which individuals could support themselves to invest in employment or skills support, to retrain to start a new career or to meet emergency costs;
- Make a significant contribution to retirement incomes, as any money left in the *MyFund* account at retirement would be taken as part of the individual's pension package. For someone with a full working life and relatively few spells of unemployment, this could be well in excess of £10,000; and
- Provide the foundations of future reforms of the broader welfare state. In future, other benefits (including Statutory Maternity Pay and Maternity Allowance and Support for Mortgage Interest) should be included and the scheme could also be used to provide for social care needs.

MyFund would not be delivered by Government. It would be delivered through a small number of partnerships between Trade Unions, business representative bodies and financial institutions. Administrators of *MyFund* schemes would be paid a fee and all profits from management of the fund would be distributed between *MyFund* accounts. In a similar fashion to Pool Re and Flood Re, the Government would act as 'lender-of-last-resort' to ensure the viability of the scheme.

This approach takes the best of systems already in place in other countries, such as Singapore and the so-called Ghent schemes in Nordic countries, to create a modern, flexible, affordable and supportive new system of social security. It would help create support for the welfare state by giving all individuals and families a stake in it and using the expertise of Trade Unions and the financial sector to run the scheme.

If introduced, the system would radically confront the culture of benefit reliance that has developed in the UK. It would:

- Better recognise the contributions of workers and strengthen incentives to work;
- Put the primary responsibility on individuals to support themselves, while still protecting the principle that the state bears ultimate responsibility for supporting those who cannot;
- Reduce government's welfare bill by around £2.5 billion a year and cut National Insurance for employees;

- Bring the self-employed fully within the social security system for the first time; and
- Provide individuals the flexibility to use funds in their personal accounts to provide for themselves in times of need.

Ultimately, individuals would be provided greater protection with more flexibility and pay less tax than they do currently. Most importantly, this would provide a base from which a new approach for the future of welfare can be built: a new means through which individuals and the state can work together to provide for uncertainty and difficult times. A new compact and a welfare state fit for the 21st Century.

Introduction

This report is the latest in a series of Policy Exchange reports that have considered the future of the UK's welfare system as it applies to jobseekers. The first of those reports outlined the principle that the welfare state should be underpinned by a mutual obligation between the state and the individual. On the part of the claimant, action should be taken to ensure that they move as quickly as possible into employment, while the state commits to supporting the claimant financially and in terms of employment support as they seek work. However, the report argued that this relationship had broken down over recent times and outlined areas where reform was needed to ensure that the system was improved.

Other Policy Exchange reports put more detail on these proposals. They have highlighted both where the state should be asking more of individuals in return for the benefits that they receive and how penalties for those who do not make that effort could be made more effective. Other proposals examined how support for those struggling to find work could be dramatically improved by providing personalised and timely help.

On the whole, each of these reports has taken the system of benefits itself as given. However, it is clear that the system of benefits, or social security, plays a vital role in ensuring that the welfare state fulfils its original purpose effectively and efficiently. In this respect, despite the much needed reforms introduced in this Parliament, it is apparent that while the labour market, expectations and risks have changed dramatically in the last 70 years, this has not been accompanied by similar changes in the social security system. To address this situation, this report builds on the introduction of Universal Credit to propose a blueprint for how the next government should develop a benefits system that better reflects the reality of modern society.

1
Reforms in this Parliament

Several of the reports in this series have already documented the rise of the costs of the welfare state over decades and the fact that, despite significant reforms by the previous government, there were deep structural failings in the UK labour market when the Coalition came to power in 2010.[2]

During this Parliament, the Coalition Government has taken significant steps to tackle these issues. Reforms have increased the requirements placed on benefit claimants in return for their benefits, changed how Jobcentres and independent providers give support to jobseekers and strengthened the system of sanctions for those claimants deemed not to be fulfilling their responsibilities. The importance of these reforms should not be underestimated, but their significance has been overshadowed (at least in public discourse) by the Coalition's major reforms of the system of benefits itself.

These have been wide-ranging, controversial and, arguably, some of the most important reforms of the benefits system since its modern-day conception. There are two areas of reforms.

First is the introduction of Universal Credit. This has not been about cost saving, but about ensuring that the benefit system works better, helps more people to move into work and to earn more and is more efficiently administered. Universal Credit will combine the main income-based benefits for jobseekers and those in work: ensuring that movements into work, between jobs and up the earnings ladder are smoother and more transparent.

The second area of reform has seen a series of changes that have looked to reduce the costs of the welfare state. That these have been among the most controversial is unsurprising as they have marked a turning point in the development of the welfare state that had, for some time, been growing in size and nature. Largely fuelled by an attempt to reduce child poverty, between 1997/8 and 2010/11 the overall costs of working age benefits and tax credits increased from £62 billion to £100 billion in real terms. This amounts to a real terms increase of 62%.[3] Nearly two thirds of this increase was driven by tax credits and, when the Coalition came to power, some 6.3 million families, with 10.2 million children between them were being supported by tax credits. Over 670,000 families were receiving benefits and tax credits amounting to over £15,600 a year.

Some of the biggest reforms since 2010 have included:

- Capping the total amount of benefits, and Housing Benefit, workless families can receive;
- Strengthening the means test in tax credits and introducing one for chid benefit;

2 Oakley, M., & Saunders, P., (2011) *No rights without responsibility.* Policy Exchange; Oakley, M., (2012), *Welfare reform 2.0: Long-term solutions not short term savings.* Policy Exchange.

3 Browne, J., Hood, A., & Johnson, P., (2013). 'Options for cutting spending on social security". Chapter 6 in Emmerson, C., Johnson, P., & Miller, H., (2013). *IFS Green Budget: February 2013.* Institute for Fiscal Studies, London.

- Announcing an overall cap to the non-cyclical elements of social security expenditure; and
- Limiting year-on-year increases in benefit levels in the short-term and permanently changing how benefits are uprated on an on-going basis.

Together, these reforms and others announced since May 2010 are forecast to reduce welfare expenditure by over £20 billion by 2015/16. They have formed a key element of the Coalition's approach to cutting the deficit and have served to protect departmental expenditure on areas such as health and schools. However, even without the financial crisis, these reforms would have been needed. As already highlighted, expenditure on working age welfare was increasing dramatically even through the boom years and, despite this massive increase in expenditure, the goals of the reforms remained largely unfulfilled: the measured rate of child poverty and worklessness remained stubbornly high and the numbers of people living in households where no-one had ever worked had doubled over 15 years.[4]

Overall, the introduction of Universal Credit and the wider reforms that have taken place over the course of this Parliament will mean that, as the economy continues to recover and unemployment falls, the welfare state will be considerably smaller both in terms of cost and coverage than it would have been without any action.

However, while these reforms are essential, as *Welfare Reform* 2.0 outlined, more reforms will be required over the course of the next Parliament. These will be needed both to tackle the ongoing costs of the welfare state (the Coalition has also outlined that it proposes to make further cuts to the benefits bill amounting to some £12 billion in the years to come) and to ensure that the structural issues of low productivity, low skills, low pay and regional differences in the UK labour market are effectively tackled.[5]

To be effective, future reforms will need to recognise that, while recent reforms have been ground-breaking, they have essentially left unchanged the existing model of state support implemented since the Beveridge Report over 70 years ago. This approach has not worked. So tackling the costs, inefficiencies and ineffectiveness of the welfare state will need a fundamentally different approach to the social security system in terms of both support for periods of unemployment and for incomes in retirement. A new approach is also needed to ensure that the wavering support for the welfare state is rebuilt and the future of social security ensured.

This report outlines the reasons for this before outlining a blueprint for a new system.

4 Oakley, M., (2012). *Welfare reform 2.0:long-term solutions not short-term savings.* Policy Exchange, London.

5 www.telegraph.co.uk/news/politics/georgeosborne/10553228/George-Osborne-warns-of-12bn-cuts-in-Government-welfare-spending-after-next-general-election.html

2

Long-term Problems for the System of Social Security

While the reforms in this Parliament are important in many respects and those yet to come will provide vital breathing space to reduce the deficit and support expenditure in other more productive parts of government, this report outlines that they will be insufficient in the longer-term. Tackling the issues outlined will require a significant reshaping of the social security system.

Costs

Costs have risen and are likely to rise in the future

Over the last 50 years, the welfare state has been built around the principle that the state will provide for people in times of need. The level of that provision has often been set with reference to living standards across the rest of society. Thus, to ensure that the unemployed and those on low incomes can fully engage in society, they have their incomes raised through benefits and tax credits and receive wider support for housing, prescriptions and a range of other in-kind services. As incomes, wealth and expectations over living standards have risen, so too have the costs of providing this security.

Continuing with this approach into the future would inevitably lead to further upwards pressure on the costs of social security. With living standards increasing, there will be renewed pressure for out of work benefits levels to keep pace with rising incomes, further increasing the costs of welfare for any given level of unemployment. The same is also likely to be true for in-work financial support. As already highlighted, the last 20 years have witnessed the rapid extension of in-work financial support and, with an ongoing commitment to a relative measure of poverty, these costs could continue to rise into the future. Of course, wider pressures from an ageing population, with greater needs for higher-quality social care, mean that there are also newer areas of cost to consider.

A new approach will be need if long-term costs are to be managed

In the context of the accepted need to control government expenditure in the future, it is clear that, because of the costs involved, the approach developed over the last 50 years is unsustainable. This system has also been ineffective in achieving many of its aims. As a vocal lobby group of anti-poverty campaigners demonstrate, it is clear that the pre-financial crisis attempt to ensure that the social security system kept pace with growing wealth and incomes failed. Rates

of poverty and inequality have been left relatively untouched, despite huge sums being spent on the system.

Reforms since 2010 have accepted that the experiment of the last 20 years largely failed and looked to tackle some of these associated costs. However, because of the political difficulties associated with cutting benefits or entitlements for retirees, the vast majority of savings from the social security budget since 2010 have come from working age benefits. Future savings are also expected to come from this area.[6] However, as the Figure 1 demonstrates, some 46% of the costs of the social security system come from non-working age benefits.

The state pension alone accounts for some 42% of the total social security budget and, as a proportion of GDP, is projected to increase by 1.8 percentage points by 2053/54.[7] In today's terms, that amounts to an increase in spending of some £30 billion a year.[8] Adding projected long-term social care costs takes the total to close to £40 billion a year.[9]

This means that, if the overall costs of social security are to be controlled, much larger cuts than those already pencilled in to working age benefits will be needed. However, it seems unlikely that cuts of the scale needed can be delivered out of a budget already squeezed by over £20 billion since 2010. It seems clear that cuts of the scale required would fundamentally undermine the protection that the social security system provides and, with very few incentives within the system for individuals to insure themselves to provide this security, it is unclear where the needed security will come from in the future.[10]

That is why this report recommends a radically new approach.

Nothing for something

What is needed is a way of both keeping costs under control and providing the kind of assistance to those in need that reflects the modern working environment.

However, as a recent report from the Trades Union Congress outlines, despite close to £100 billion of annual expenditure, for many individuals and families, the current system provides "nothing for something".[11]

Decline of the contributory principle

In part, this is due to the decline of contributory principle. The first report in this series, outlined this decline, arguing that over time, the notion of contribution has become near to irrelevant within the UK's system of social security.[12] This is clearly demonstrated in Figure 2 below, which shows that from a situation where contributory benefits accounted for 41% of the working age welfare bill in the late 1970s, just 10% of the working age welfare bill is now spent on contributory benefits.

However, despite this fall in the prominence of contributory benefits, the principle is still one that people support. Previous Policy Exchange polling showed that over half of people believe that no benefits should be paid at all unless the person has "previously contributed in tax and national insurance contributions". However, this is almost the opposite of what happens currently. For example (see Figure 3) the proportion of claimants entitled to JSA(c) has fallen over recent years and now stands at just 9% of total JSA claimants.

6 Although a small portion of pensioner benefits have been included within the remit of the overall Annually Managed Expenditure cap.

7 OBR, (2014). *Fiscal sustainability report.* Office for Budget Responsibility, London.

8 Authors own calculations using: OBR, (2014). *Fiscal sustainability report.* Office for Budget Responsibility, London.

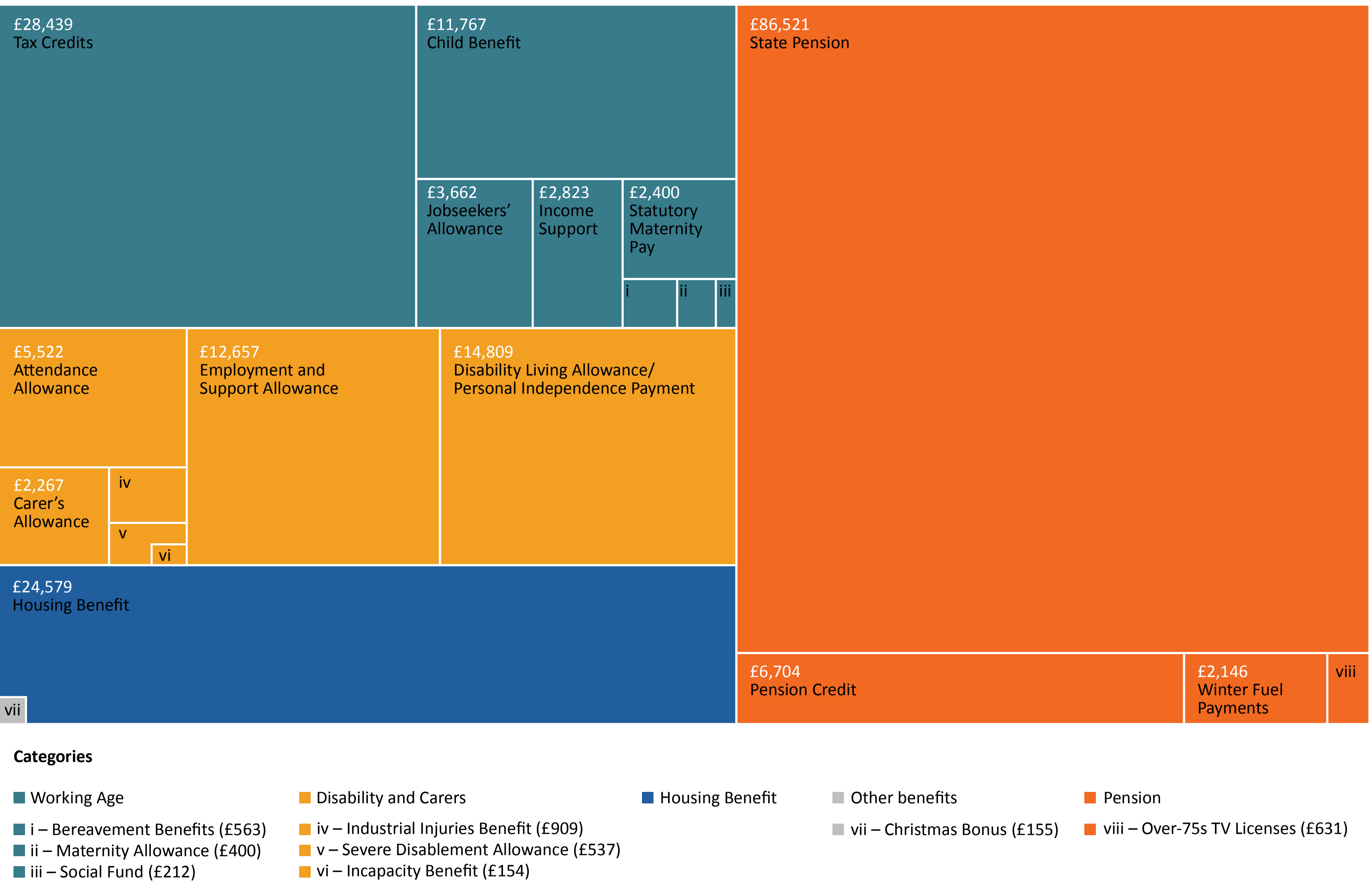
9 Ibid.

10 In fact, by having a savings cap of £16,000 on eligibility for benefits, individuals actually face a disincentive to save for themselves.

11 Bell, K., & Gaffney, D., (2012). 'Making a contribution: social security for the future'. *Touchstone Pamphlet no.12.* TUC. London.

12 Oakley, M., & Saunders, P., (2011). *No rights without responsibility: rebalancing the welfare state.* Policy Exchange, London.

Figure 1: Breakdown of Social Security Expenditure (forecast expenditure, 2014/15 prices, £m)



Source: Benefit expenditure and caseload tables, Budget 2014, DWP

Figure 2: Expenditure on working age welfare

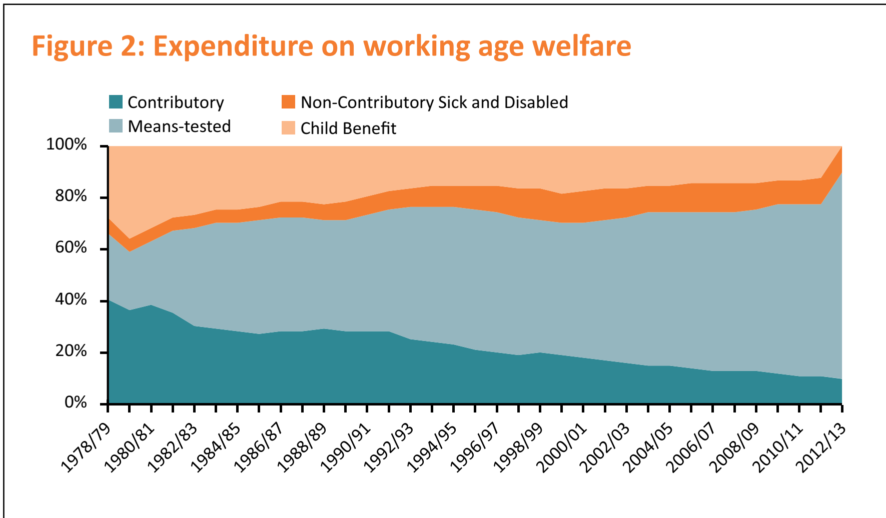
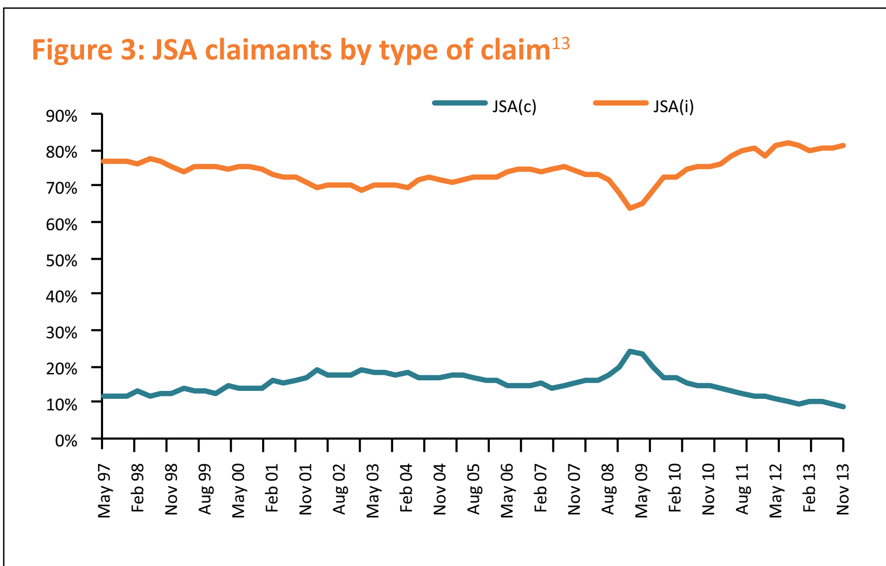


Figure 3: JSA claimants by type of claim[13]



Other qualitative surveying undertaken by Policy Exchange also highlighted peoples' frustrations with the lack of reward for contributions within the current system. Some individuals believed that they would get a higher level of benefits because of their contributions, only to realise when they became unemployed that the rates of benefit are identical. Others highlighted the perceived unfairness that claimants on income-based JSA (JSA(i)) continue to be eligible for payments indefinitely, whereas those on JSA(c) face a means test after six-months. For example, one unemployed participant whose husband was in full time work highlighted that:

> *"…despite working full-time and paying contribution [sic] for the last ten years, I'm now in a situation where I get no money whatsoever…"*

She went on to question "…why are people like me being penalised, when I've paid into the system for years?".

13 DWP tabulation tool.

Low levels of support for many people

This issue with a lack of support available after six months of unemployment is one part of a broader issue with the current system. By providing a standard level of support for everyone, there is no possibility of tailoring support to the needs of individuals. The clearest example of this is to assess how the rate of JSA compares to an individual's earnings before they became unemployed.

This is possible using the panel version of the Labour Force Survey that allows individuals and families to be tracked over time. To ensure that sample sizes were large enough, the two-quarter panel survey was used and the last three years of data were combined. The results are shown in Table 1.[14]

Table 1: Pre-unemployment earnings and JSA levels

JSA type	Previous weekly earnings	JSA level	JSA as a % of previous earnings
Contributory JSA	£385	£72.40	19%
Income-based JSA	£197	£72.40	37%

While this does not present a fully accurate picture of the pre-unemployment earnings of those claiming the different types of JSA, it is one of the best estimates possible with the available data.

It shows that while the rates of JSA(c) and JSA(i) are the same, the pre-unemployment earnings of those claiming JSA(c) are dramatically higher. This means that, as well as only being eligible for six-months of benefit, those on JSA(c) see a much larger fall in income when they become unemployed. Again, this demonstrates that contributions count for very little in terms of the support that is available, and the system has developed in such a way that there are few incentives for individuals to engage in a private market to provide extra support for themselves. In fact, given that those with savings of over £16,000 will not be eligible for support through Universal Credit and that means-testing across the whole benefit system is still high, the current system creates a disincentive for individuals to try to provide for themselves.

A lack of security in today's labour market

The current system has not changed in order to better reflect the realities of today's labour market.

The changes in the labour market should not be underestimated. The headlines are well rehearsed: in the last 70 years, the employment rate for working age males has fallen from 96% to 76%, while the employment rate of working age women has risen by over 50% to now stand at 66%. Life expectancy is also fundamentally different, having risen from 63 for males in 1940 to 78 in 2010.[15]

There are also changes in the types and structure of employment. Large numbers of people are entering employment at a later age because of the increase in participation in further and higher education. After entering the labour market, for an increasing number of people, full-time employment in a "job for life" has been replaced with an array of new ways of working and career paths that are changing rapidly. Self-employment, working in multiple

14 Authors own calculations using LFS data.

15 www.ifs.org.uk/publications/6475

jobs, shift work and zero-hours contracts are more and more prevalent in today's labour market and the experience of many individuals is one of a cycle between low pay and benefits, with little prospect of progression, training or permanent employment.

Self-employment is also becoming a more mainstream option for the unemployed, with government schemes supporting some 2,000 a month to move from unemployment to self-employment.[16] Anecdotal evidence also suggests that this is an increasingly popular route for long-term unemployed claimants on the Work Programme. It has also become a more common route for the older workforce as people look to extend their working lives. More than four in ten of all self-employed are aged over 50 and the number of self-employed aged over 65 has doubled since 2008.[17]

These trends have contributed to a fast-rising number of people in self-employment. Since 2008, the number of self-employed has increased by 650,000 to reach 4.5 million people, or nearly 15% of total employment.[18]

However, it is unclear how prepared many of these individuals are for potential income shocks or for retirement. For instance, just 30% of the self-employed currently have any kind of pension. As was recognised in the Beveridge Report, this means that:

> '…*many persons working on their own account are poorer and more in need of state insurance than employees*'.[19]

However, the self-employed are currently largely excluded from the JSA(c) system and a range of other contributory benefits, meaning that they may struggle in times of need and in later life. The increasing number of older and low-skilled workers in self-employment makes this all the more worrying. In short, this is just one group where, because the design of the current system, the social security system is largely irrelevant and unsupportive.

Excluded from Universal Credit

With this falling relevance, it is perhaps surprising that JSA(c) still exists. The introduction of Universal Credit will make the benefits system more streamlined and easier to understand by combining the major income-based benefits for those out of work or in work and on a low income. As such, this could have presented an opportunity to reform the system and introduce a strengthened system of contributory benefits within a streamlined Universal Credit. However, the decision was made to exclude JSA(c) from Universal Credit.

A number of other benefits were also excluded from Universal Credit (for example, support for council tax, Child Benefit, the replacement for the Social Fund and a range of so-called "passported" benefits); however, with each of these benefits there are arguments that a more local and tailored approach is more appropriate for some of these elements of support.

The same cannot be said of the exclusion of JSA(c). The omission will mean that eligible claimants will have to claim both Universal Credit (for instance if they are eligible for support for housing costs or have children) and JSA(c), adding complexity to the claims process and DWP's communication efforts both when new claims are made and also when individuals claiming JSA(c) have to move

16 www.gov.uk/government/news/budding-entrepreneurs-helped-off-benefits

17 www.ons.gov.uk/ons/rel/lmac/self-employed-workers-in-the-uk/2014/sty-self-employed.html

18 www.resolutionfoundation.org/publications/just-job-or-working-compromise-changing-nature-sel/

19 William Beveridge (1942), *Social insurance and allied services.* Paragraph 4.

fully onto Universal Credit after six-months of unemployment. The situation will inevitably increase administrative costs.

Low levels of public support

With rising costs and a system that neither recognises contribution nor covers the risks that the modern labour market brings, it is hardly surprising that support for the welfare state and attitudes towards the unemployed are low.

Figure 4 demonstrates that nearly six in ten people think that benefits for the unemployed are "…too high and discourage them from finding jobs". This is more than twice the proportion that thought the same thing 20 years ago.

Figure 4: Public attitudes towards the level of benefit payments for unemployed people[20]

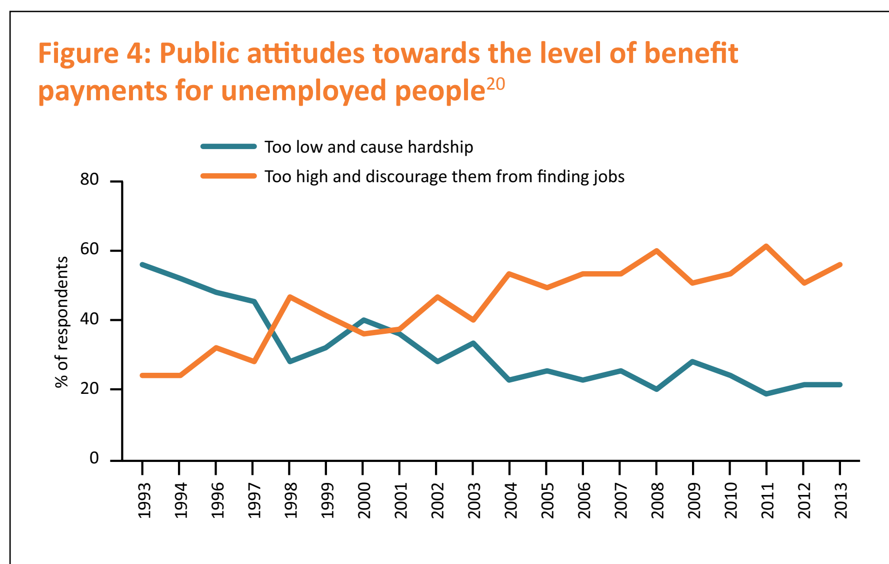


Table 2 shows that support for spending money on benefits for low-income parents and the unemployed has also fallen over the last 20 years. For the unemployed, just 15% of the public would like to see the government spend more on benefits for the unemployed, compared to near half (49%) would like to see less spending on these benefits.

Table 2: Attitudes to government spending on different benefit claimants, 1996–2013[21]

	1996	2002	2004	2006	2008	2011	2013
% would like to see more government spending on benefits for…							
…parents who work on very low incomes	68	69	62	66	67	58	59
…unemployed people	22	21	15	16	14	15	15
% would like to see less government spending on benefits for…							
…parents who work on very low incomes	3	4	4	4	4	5	5
…unemployed people	35	36	44	45	54	51	49

20 Source: *British Social Attitudes Survey, 2013*. NatCen.Note that missing data points have been interpolated.

21 Ibid.

Finally, Figure 5 demonstrates public attitudes towards benefit claimants and the unemployed. It shows that just below 80% of the public believe that a large number of claimants falsely claim benefits and that just under six in ten people believe that most unemployed people could find a job if they wanted one. Over a third of people believe that many people who get social security do not deserve help.

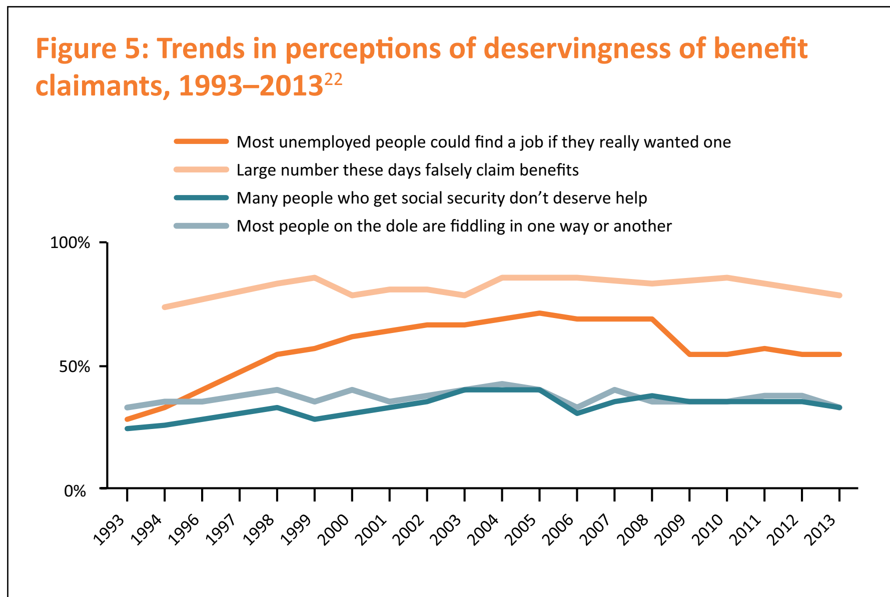


Figure 5: Trends in perceptions of deservingness of benefit claimants, 1993–2013[22]

Overall, while some have argued that these figures indicate that attitudes have softened somewhat since the height of the financial crisis and recession, there is still a significant lack of support for the welfare state. If the welfare state is to be sustainable in the long-term and fulfil its vital role in supporting vulnerable individuals and families, it clearly requires a greater level of public support. That is why there is an urgent need for further changes that make the system relevant for the modern age and help rebuild public confidence. A critical element in this process is for people to see the rewards of what they have contributed.

22 Source: *British Social Attitudes Survey, 2013*. NatCen. Note that missing data points have been interpolated.

3

A New Approach

Principles of reform

This report recommends that, following the 2015 election, the next government should legislate for a further set of reforms to the social security system. These will be needed to ensure that the welfare state provides real protection against the risks that individuals are facing, while being sustainable and affordable. In doing so, the reforms must also reinstate trust in, and support of, the welfare state.

The reforms will need to consider support for unemployment and those in low pay, both in terms of financial support and support to improve skills and employability; how to meet the costs of social care and pensions; and how to meet the costs of and support those with limited or no capability of work.

The reforms should be built around five principles:

- *Contribution:* individual contributions should be clearly recognised and rewarded, while still providing security for those that cannot contribute through employment. Contributions should be clearly linked to the support that individuals receive;
- *Self-reliance:* individuals should not turn immediately to the state for support when they have had chance to provide for themselves;
- *Cutting the cost of welfare:* the cost of support should not always be borne by the state and the long-term costs must be made more sustainable;
- *Flexibility and tailored support:* the base level of welfare support should be built upon by individuals and families to provide themselves with tailored and personalised support. The system should provide support for all forms of modern work; and
- *Rebuilding trust and public support:* the system of welfare support in the UK should be one that as a society, we trust and support.

Delivering a system of social security that delivers these goals will require significant reforms. This report puts forward a key part of a new approach that could provide the basis for a wide range of improvements in the future.

It recommends that JSA(c) is replaced by a hybrid scheme of unemployment insurance and a system of individual welfare accounts that are collectively funded. Unlike the existing JSA(c), this *MyFund* scheme would provide flexibility and stronger incentives, reward contribution and could be fully integrated into Universal Credit. It would also be a route through which individuals could make a significant contribution to retirement incomes and would ensure that, for the first time, the self-employed are fully brought into the system of social security.

More generally, it would also be the first step towards introducing a much more wide-ranging modern approach to welfare provision. It would provide a framework through which individuals and the state could work together to provide for a wide range of welfare and societal needs including, health, social care and education and training. The next section gives an overview of the principles underpinning *MyFund*.

A collective contribution-based welfare account and compulsory insurance

The proposals detailed in this report would replace JSA(c) with *MyFund*, a system of collective contribution-based welfare accounts and a mandatory unemployment insurance that can be fully integrated into the Universal Credit framework.

Contributing to *MyFund*

All employees would contribute a small proportion of their earnings each week to the scheme. These costs would be partly offset with a reduction in National Insurance contributions. In order to ensure that all parts of society are bought into the system and have access to the benefits that accrue from it, all employees (even those currently earning below the lower earnings limit in National Insurance) would contribute to the scheme. This would mean the lowest earning individuals contributing more to the scheme than they currently contribute in National Insurance. However, as outlined below, those working for over 20 hours would receive more than they contribute in payments into their *MyFund* account, meaning that they would be left better off. Ensuring that all those earning are contributing also ensures that everyone has a stake in the scheme; building social solidarity.

The self-employed would also be brought within the scheme. To reflect the fact that it would increase the level of support for which they are eligible and that they currently pay less in National Insurance contributions than employees, their contributions would not be offset by a cut in National Insurance rates.

This would amount to a total of around £8 billion a year being transferred into *MyFund*. The funds would finance two portions of the *MyFund* scheme:

- A compulsory collective unemployment insurance scheme that would cover part of the costs of unemployment for the first three months of any claim; and
- The majority would be allocated across a system of personal accounts under *MyFund*. To maintain the principle of collective protection and redistribution, each individual who was contributing sufficiently to the scheme would have the same amount put into their *MyFund* account.

The basic system outlined here would mean that, for each individual that contributed, *MyFund* would provide unemployment insurance and over £250 of flexible funds in their *MyFund* personal account each year:

- For low-income households with often low or no existing savings, this would represent a significant increase in saving. It would also mean that, although they are contributing to the scheme, the amount in their account would typically be higher than their level of contributions.

- Higher-income households will gain from a more flexible and supportive system. The contributions to their *MyFund* account more than offset changes to contributions and will leave them with £250 a year additional saving and security. This might seem a relatively small amount, but will build to a significant sum over time. Ultimately, they would be provided great protection with more flexibility and pay less tax to the Government than they do now.

Once in a scheme, the pot and insurance would follow individuals between jobs.

Using *MyFund*

If an individual becomes unemployed, *MyFund* will fund the initial three months of unemployment benefit from a combination of the insurance and the individual pot. This would mean that the costs of unemployment benefit to the state would fall and that individuals are using "their money" to pay for their own benefits. Payments from *MyFund* would be offset against Universal Credit. Following that initial three month period, those with funds in their *MyFund* personal account would continue to receive benefit payments from the account. This would include those in work, but still claiming Universal Credit, where payments from *MyFund* would be made where funds were available and the individual was working for less than 20 hours a week.

MyFund would also provide extra, more flexible support:

- Individuals with sufficient funds would be able to choose to take a top-up to benefits funded by drawing down their personal pot. This top up could be as high as £100 a week.
- Eligibility for benefits would also not end at six-months as it does now for JSA(c) as a draw-down from *MyFund* could be used to provide support in longer periods of unemployment.
- In the longer-term, *MyFund* could also be used to provide flexible support for a wide range of labour market and social needs. For instance, individuals could draw down funds for a range of things that might include re-training for new jobs, purchasing essential durable goods in an emergency or contributing to the costs of social care in later life.
- Administrators of the scheme would also be encouraged to provide a menu of options for individuals. This could include income protection against illness or injury and provision of rehabilitation services. It could also include access to private sector employment support services.

Structured in this way, there would be a clear link between contributions and benefits that individuals receive. Claimants would no longer be passive recipients of state support, with little ownership or clarity over where the money was coming from. They would, in part, be relying on their own money. By doing so, this would incentivise individuals to return as quickly as possible to work as the value of their personal account falls while they are unemployed. To introduce even stronger incentives, any money that is left in their fund at retirement could be taken as an addition to their retirement income.

For those with a full working life and relatively short spells of unemployment, this could provide a significant boost to pension pots. With real terms fund growth of 1%, the basic system outlined in this report would provide fund values well in excess of £10,000 even for an individual who several spells of unemployment during their working lives. This would be a significant addition to the average pension pot of just £36,800. Given that a previous Policy Exchange report highlighted contribution rates to NEST are unlikely to be sufficient, this could build on recommendations in that report to provide a further vital boost to retirement provision.[23]

For those who, either because of a poor contribution record or because they had drawn down all of their *MyFund* in previous unemployment spells, the social security system would remain as it is now. They would simply revert to the existing means tested Universal Credit system or State Pension.

Running *MyFund*

The scheme would not be administered by Government. Instead, to encourage providers to compete for customers based on their service and tailored options, and to ensure the collective funds are sufficiently large to act as effective social insurance, a small number of providers should be licensed to offer schemes to every individual.

Each scheme would be run on behalf of the scheme members, with administrators paid a fee for running the scheme. This would need to be negotiated with Government and could be based on the precedent set by NEST.[24] Any returns from fund growth would be distributed evenly between all scheme members. Established insurers and fund managers and the NEST Corporation should be encouraged to bid for the licenses and license conditions should favour consortia based on a partnership between the administrator, trade unions and business representative groups. This could work in a similar fashion to the so-called Ghent systems that are in place in the Nordic countries. Box 1 provides more detail.

Box 1: "Ghent" social security systems

The social security system in Sweden (and Nordic countries more generally) has a strong history of voluntary unemployment benefit schemes. The so-called Ghent system, relies on voluntary contributions with schemes typically run by trade unions, with an element of state subsidy. The rate of benefit differs between unions, though it is usually up to 80% of a workers annual salary for the first 200 days, with a decreased rate for the next 100 days. It is estimated that around 90% of Swedish workers are insured through the trade union voluntary schemes.[25]

To limit exposure to uninsurable risks, the government would guarantee the scheme as a kind of lender-of-last-resort in a similar way to that adopted in Pool Re to insure against losses due to terrorist action and plans for Flood Re. This would mean that, if unemployment rose beyond a certain negotiated level (for instance because of a severe recession), Government would step in to cover the extra costs.

A combination of the Government Actuary, the National Audit Office and the Financial Conduct Authority should provide regulatory oversight and scrutiny of the scheme.

23 Barty, J., (2014). *Help to save: defusing the pensions time bomb.* Policy Exchange, London.

24 www.nestpensions.org.uk/schemeweb/NestWeb/public/NESTforSavers/contents/what-does-nest-cost.html

25 www.eurofound.europa.eu/eiro/studies/tn1206018s/se1206019q.htm

What this will achieve

Introducing *MyFund* in the UK would continue with the bold reform of the benefits system that was started in this Parliament. It would meet the five principles for further reform outlined earlier in this report:

- *Contribution:* all individuals in employment or self-employment will have their contribution recognised. Each week of work will see the value of their *MyFund* increase and there will be a clear link between these contributions and the benefits claimants receive when they are unemployed and the pensions they receive in retirement.
- *Self-reliance:* With three months of unemployment benefit at least part-funded by *MyFund*, claimants will rely less immediately on the state. Those who have had chance to accumulate funds will contribute more as their length of unemployment increases and this will introduce stronger incentives for individuals to do all they can to return to work.
- *Cutting the costs of welfare:* costs of unemployment benefit and tax credit payments will be cut by £2.5 billion and those building up personal pots in *MyFund* will have less need for means-tested benefits in retirement. In the longer-term a more flexible and transparent way of individuals providing emergency cover for themselves and investing for the future could be used to cut the burden of a wider range of areas, such as social care, emergency loans and re-training.
- *Flexibility and tailored support:* individuals will be able to top-up the insurance cover they receive and contribute more to build up larger funds. These can be used flexibly in times of need and, as such, will provide a greater level of support than JSA(c) and Universal Credit. For instance, individuals with sufficient funds will be able to top up unemployment benefits when needed and continue to draw down support after the six-month period where JSA(c) currently expires. It would also extend support for the first time to the self-employed.
- *Rebuilding trust and public support for welfare:* By recognising contribution and reinstating the role of personal responsibility within a collective system, *MyFund* would help the process of re-establishing support from the public. A large majority of people will also be better off than they are under the current system, both in terms of the flexibility and level of protection that they receive and the amount of money that they can draw down. In the longer-term, by introducing a new platform through which individuals and the state can come to together to provide for the needs of families in hard times, it should mark the start of a new model of welfare provision that all parts of society can gain from.

Why this is different

By meeting each of these five principles, *MyFund* would be a stronger and more effective system of welfare compared to both the current system and other potential reforms. In fact, there have been many suggestions for how to strengthen the contributory principle in the UK's social security system. However, each has come with significant limitations.

Many have tried to work within the context of the current system of national insurance and JSA(c) and, in doing so, made recommendations that would

benefit relatively few people and impact negatively on a number of others. For instance, one recent proposal suggested a top-up to JSA(c) paid for by changing entitlement conditions.[26] While this would give a small number of claimants a higher level of benefit to better reflect their contributions, it would not improve incentive effects (since there is still no clear link between the claimant's benefits and what they have paid in) and would leave claimants as passive recipients of state support, rather than actively bringing them into the system. It also would result in a potentially large number of claimants losing out as contribution requirements are significantly increased.

Other proposals have been more radical, but have still come with significant potential problems. For example, a number of reports have suggested a system of loans for unemployed people, similar to those given to university students.[27] The key problem here is that the unemployed would be saddled with debt when they move back into work and this would further exacerbate the negative impacts that debt already has on work incentives and employment outcomes.[28]

Towards the more radical end of the spectrum, other reports have made suggestions including the merger of National Insurance and income tax and the creation of a new system of welfare accounts, funded solely by individual contributions.[29] While closer to the recommendations in this report, these suggestions would undermine the principles underpinning the UK's welfare state and risk leaving significant portions of society without the protection they need. In fact, these recommendations are similar to a system already in place in Singapore, which leads to very unequal outcomes and a lack of protection for many of the most vulnerable who are in greatest need of help. Box 2 outlines the system in place in Singapore.

Box 2: Contributory principle in Singapore

The emphasis of the welfare system in Singapore is that of self-reliance and a belief that government help should only be given as a last resort:

> *…we believe incentives towards self-reliance matter that Singapore's social assistance policies require people to exhaust their own resources, those of their families, and those of the community, before turning to the Government for help.*[30]

This approach is exemplified by their approach to providing for retirement, healthcare and a range of other extra costs/insurance programmes through the Central Provident Fund (CPF). The CPF is a mandatory scheme requiring contributions to be made when an individual is in paid employment. The employer also has to pay a contribution. Contributions for employees range from 5% to 20% of monthly salary and the employer pays a further 6.5% to 16%. In practice, this means that individuals invest their own money and earn interest over their working life, so that they can pay for their own benefits when out of formal work later in life.[31]

This system clearly has strong contributory element. However, this also comes with significant limitations. The close link to contributions and lack of wider collective social security means that many low income workers have to survive on very low incomes in old age and have little chance to insure themselves against potential income shocks.[32]

26 http://labourlist.org/2014/06/miliband-to-unveil-policies-on-youth-training-contributory-welfare-and-housing-benefit/

27 Cooke, G., (2011). *National Salary Insurance: reforming welfare to provide real protection.* IPPR, London. Skidmore, C., (2013). *A new Beveridge:70 years on – refounding the 21st Century welfare state.* Free Enterprise Group.

28 www.centreforsocialjustice.org.uk/policy/pathways-to-poverty/serious-personal-debt

29 Saunders, P., (2013). *Beyond Beveridge: restoring the contributory principle to retirement pensions and welfare benefits.* Civitas, London.

30 www.cscollege.gov.sg/Knowledge/ethos/Issue%203%20Oct%202007/Pages/Security-with-Self-Reliance-The-Argument-for-the-Singapore-Model.aspx

31 www.internations.org/singapore-expats/guide/working-in-singapore-15462/health-and-social-security-in-singapore-2

32 www.socwork.net/sws/article/view/119/535, paragraph 3.

MyFund would be distinctly different to these proposals from other reports and the systems in place in other countries. By recognising that the UK's current system is not fit for purpose, the recommendations in this report would put in place a new foundation for the welfare state that draws on the best elements of a many previous recommendations and those in place in other countries. It would introduce a hybrid system that mixes the ethos of the system of self-reliance in Singapore with a British version of the collective insurance schemes that run in Nordic countries.

How much this will cost

While *MyFund* provides individuals with around £8 billion of insurance and fund contributions each year and reduces tax revenue by around £4 billion a year, overall it is estimated to be cost neutral for the government in the long-term.

Table 3 demonstrates the situation for *MyFund*, the state and individuals. It shows that, while tax revenue falls, payments from *MyFund* will completely replace JSA(c), the equivalent of the first three months of JSA(i) in Universal Credit and contribute to the costs of the equivalent of tax credits. This would lead to around £2.5 billion of benefit savings to offset the reduced NI contributions. A significant proportion of the remaining £1.5 billion would be expected to be recouped from tax paid on funds as they are drawn down in retirement, leaving the system broadly revenue neutral for Government.

To make the whole system cost neutral in the short-term, the introduction of *MyFund* could be accompanied by further reforms to cut costs. Examples include:

- *MyFund* could be tailored so that more aspects of the social security system were included immediately. For instance, together, Statutory Maternity Pay and Maternity Allowance account for over £2.5 billion a year. Using *MyFund* to fund part of the contributions towards these benefits could save significant amounts of money.
- Limiting Child Tax Credit to the first four children in a family and giving larger families the flexibility to draw down support from their *MyFund* if needed. HMRC data show that around 270,000 families claiming tax credits have four or more children. Only around half of these families have anyone in work. Limiting average entitlement to match that of families with three children would deliver savings of around £1 billion.
- Welfare time limits. A full record of individual's benefit history could be collected and used to target stronger support and conditionality at those who persistently cycle in and out of work. Using a full record of a claimants' unemployment history, individuals who had spent more than a given period (for instance, three years) unemployed in their lifetime could be automatically referred to a workfare scheme or their benefit entitlement reduced. The associated benefit savings and improved chances of moving off benefits could deliver substantial savings.
- A more stringent conditionality regime could also be introduced. Options are outlined in previous Policy Exchange reports including, *Work Fair?*, *Slow Progress*, *Welfare Reform* 2.0 and *Cultures of Dependency*.[33]

33 See www.policyexchange.org.uk/welfarereform

Table 3: Balance sheet for *MyFund*, the state and individuals (figures in in brackets reflect negative amounts)

	MyFund	To the state	To the individual
Reduction in National Insurance rate by 1% and contribute 1% of eligible earnings into *MyFund*	£4 billion	(£4 billion)	£4 billion
2% contribution to *MyFund* from all earnings below current lower earnings limit	£3.5 billion	–	(£3.5 billion)
Contributions to *MyFund* from self-employed	£500 million	–	(£500 million)
Abolishing JSA(c)	(£500 million)	£500 million	–
First three months of JSA(i)	(£1.5 billion)	£1.5 billion	–
Draw down when on in-work Universal Credit[34]	(£500 million)	£500 million	–
Flexible draw down and extra support bought with insurance	–	–	+ve
Fund growth and draw down in retirement	-ve	+ve	+ve
Overall long-term	**–**	**–**	**+ve**
Short-term without accompanying savings measures	**£1.5 billion**	**(1.5 billion)**	**+ve**
Short-term with accompanying supporting measures	**–**	**–**	**+ve**

A vision for the future – why *MyFund* should be adopted

MyFund would represent the next step in ensuring that the benefits system is fit for the 21st Century: providing the support that individuals need, while introducing a long-term way of ensuring that the welfare state is more affordable.

MyFund supports those who cannot support themselves, but it also provides the basis for a restating of the joint responsibility between the state and the individual. It would ensure that personal responsibility is at the heart of the social security system and that individuals are empowered to provide flexibly for themselves when they can.

This concept could then be developed across much wider areas of the welfare state – giving individuals a route through which they can provide for the wide range of needs and challenges that modern life can bring. For instance, it is immediately apparent that providers of the scheme could give individuals the option to take extra insurance for sickness and disability and the costs of rehabilitation or the potential costs of re-training in later life. It could also provide a vehicle through which individuals could provide for social care (either through an insurance or savings product).

34 Based on the numbers of in-work families claiming tax credits on low earnings available from www.gov.uk/government/statistics/child-and-working-tax-credits-statistics-finalised-annual-awards-2012-to-2013, and a weekly contribution from *MyFund* of £36 for three months.

35 SSAC (2014), 'Social Security

Over time, more parts of the welfare state could also be brought within the scope of *MyFund*. For instance it could be used to provide more flexible support on top of that currently available through a range of benefits including:

- Maternity and Paternity Pay;
- The support previously provided by the Social Fund; and
- Support for Mortgage Interest.

As such, *MyFund* should be seen as the first step in transforming the welfare state for the needs of the 21st Century. The remainder of this report outlines a more detailed blueprint for how *MyFund* could be structured and administered in practice.

4
A More Detailed Outline of *MyFund*

This section provides a more detailed outline of how the *MyFund* scheme could work in practice. It looks at some of the key features, explains how they could work and outlines detailed design options that could be tailored and adjusted as *MyFund* was introduced.

Replace contributory Jobseeker's Allowance

The *MyFund* scheme would replace the existing system of JSA(c) to provide an element of insurance for short-term unemployment and a vehicle through which individual contributions can help to fund both benefits when individuals are unemployed and their incomes in retirement. It would provide a more transparent link between individual contributions and the benefits and pensions entitlements people receive, making it clear that contributions while in work were helping to fund an individual's benefits.

Contributions and distribution

Collective contributions

The *MyFund* scheme would be a compulsory collective social insurance system. All those in paid employment would contribute to the scheme. This would ensure that all those in work have both access to support if they become unemployed and funds available for wider social support and retirement if they do not become unemployed. It would therefore create a system that caters for everyone and would transfer money back from the state into individuals' welfare accounts.

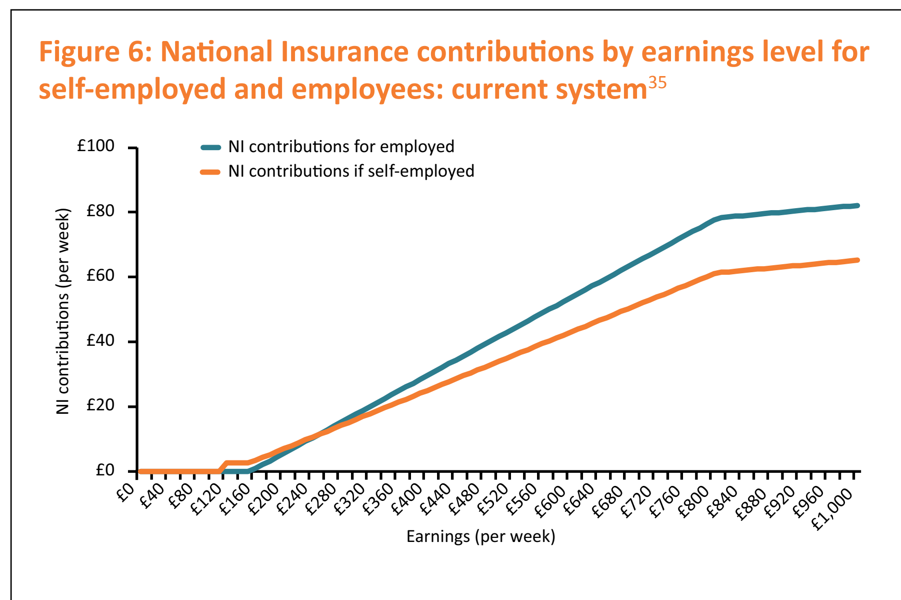
In doing this, it is important that the majority of individuals are left in a better situation than currently. As well as introducing welfare accounts, contributions should also be offset by a cut in National Insurance contributions. That would mean, all employees contributing to the scheme but paying less in National Insurance. The scheme outlined in this report cuts the headline National Insurance rate by 1% in order to introduce a 1% contribution to *MyFund*. It also introduces a 2% employee contribution below the existing lower earnings limit (LEL) in order to "buy-in" all employees. This would mean those currently earning below the LEL will pay more in contributions to *MyFund* than they currently pay in National Insurance contributions. There are two clear advantages of this. The first is that, as outlined below, low earners working for over 20 hours a week will receive more in payments to their *MyFund* account than they contribute to the scheme, ensuring

that the system remains redistributive. The second reason is that, as all of those in paid employment contribute to the scheme, it will be clear that everyone is paying in and contributing to their own security. It will ensure that everyone has a stake in the scheme and should build social solidarity.

Others may argue this simply introduces a ring-fence to National Insurance contributions however, there is a very clear and important difference. As outlined later, contributions to *MyFund* would not be made to the Government and individuals would be provided flexibility both over how the contributions are used (in terms of how they are invested and what the insurance covers) and how they draw down the money in future. It is their contribution and their money not a tax paid to the state over which they have no control.

Self-employed individuals would also be required to contribute to the scheme. Figure 6 demonstrates that, in general, under the current system of National Insurance, self-employed individuals contribute less overall than employees with equivalent earnings. They are also not eligible for a range of contributory benefits, including JSA(c). Extending *MyFund* to the self-employed, would give them the same level of security as employees. Given the blurring of lines between employment, unemployment and self-employment and the low level of pension provision and social protection for the self-employed, it is critical that this group is given equal access to this support.

Figure 6: National Insurance contributions by earnings level for self-employed and employees: current system[35]



However, given the fact that the self-employed currently pay lower National Insurance contributions in return for a lower level of support, it would not be appropriate to cut their rates of National Insurance in return for a greater level of support. This means that contributions from self-employed individuals would not be offset by an equivalent cut to National Insurance rates. This would lead to a narrowing of the gap between National Insurance contributions by the self-employed and employees.

provision and the self-employed'. *A study for the Social Security Advisory Committee, Occasional Paper No. 13.*

36 Barty, J., (2014). *Help to Save:*

MyFund could be funded by:

- Cutting employee National Insurance main rate by one percentage point.
- Introducing a 1% contribution for all earnings below the existing upper earnings limit into a collective welfare account scheme, *MyFund*.
- Extending the scheme to the self-employed and those earning below the current lower earnings limit in National Insurance, with a 2% contribution from earnings.

This would mean around £8 billion a year being contributed into *MyFund*.

Individual distribution

While *MyFund* would be funded in a similar fashion to National Insurance contributions, how the money is used would be dramatically different. A small proportion of the funds would be used to purchase a short-term unemployment insurance scheme that, as a minimum, would provide for half of the costs of unemployment benefit for three months of unemployment.

The remainder of the funds would be used to collectively fund a system of individual welfare accounts, built around the principle that "it's your money". Everything that goes into the account would be available to be used by the individual in times of need.

As now, this system would mean that those who earn more pay more. However, there are a number of options about how this money is allocated across the welfare accounts. Previous reports that have looked at individual accounts have suggested that all individual contributions should be earmarked for individual accounts, as is the case in Singapore. However, this would fundamentally undermine the principles of social security and redistribution that underpin the basis of the UK's welfare state. To maintain these principles, this report suggests an option where the total contributions (after having paid for the insurance scheme) are split equally between individual *MyFund* accounts. Adopting this approach would mean that, while those earning below the current lower earnings limit in National Insurance would contribute to the scheme, they would get more back in terms of the value of their *MyFund* than they had contributed.

Other options could include a tiered level of contributions where the system remains redistributive, but those with higher pay still get more.

Structured in this way, the system would recognise employment and contribution, with a week's work recognised in the same manner regardless of pay. It would be a system of collective protection where everyone who contributes is left better off than they are under the current system.

Of the £8 billion contributed to *MyFund* each year:

- £2 billion would be used to buy insurance scheme to cover first three months of unemployment.
- £6 billion would be put into individual accounts of those contributing and working for over 20 hours a week.

For these individuals, that amounts to at least £5 a week or £260 a year.

What happens when individuals become unemployed?

If an individual became unemployed, *MyFund* would cover the unemployment benefit costs of an initial period of unemployment for all claimants who meet a qualifying period of six months contributions in the last year. The costs would be shared equally between the insurance element and the individual's personal pot. This would provide a clear link between an individual's contributions and the benefits they receive in hard times, while still allowing the costs to be shared through an element of social insurance.

For those not also claiming Universal Credit, claiming the two elements of *MyFund* when they became unemployed would be optional. This means that they could choose to maintain the value of their *MyFund* rather than drawing it down.

For those entitled to Universal Credit, these payments will substitute rather than top-up Universal Credit and payments from *MyFund* would be mandatory. Payments from *MyFund* would be deducted pound for pound from Universal Credit eligibility. For example, if total Universal Credit entitlement would currently be £250 a week, the receipt of £72 from *MyFund* would reduce Universal Credit entitlement to £178 a week.

The pound for pound offset means that, if there are not enough funds in the *MyFund* personal pot, or where the personal pot is depleted before the end of the first three months of unemployment, Universal Credit will adjust to compensate. This would only likely be the case for claimants with a very poor contribution record as only two and a half years of contributions would be needed to fully fund a three month spell of unemployment. The insurance element of *MyFund* would continue to be paid and would offset Universal Credit.

Should the individual remain unemployed for longer than three months, the principle would be that the personal element of *MyFund* would continue to be drawn down to pay unemployment benefit, until the pot were depleted or the individual entered work. For those eligible for Universal Credit, this would mean that their *MyFund* would be drawn down by £72 a week while they were unemployed and there were sufficient funds in the account. The same would be true of in-work claimants of Universal Credit who were working for less than 20 hours a week.

For those not eligible for Universal Credit (current JSA(c) claimants with other income or substantial savings), funding for benefits would come solely from their personal pot until the pot was depleted. Were the pot to be depleted and the individual remain out of work, no further payments would be received unless they had become eligible for Universal Credit.

Throughout the whole claim, where a claimant has more than six-months of funding in their *MyFund*, they could choose to draw-down an additional benefit top up of up to £100 a week on top of their usual benefits. This amount would not be withdrawn from Universal Credit entitlement and would not contribute towards the benefit cap. In the case above, total receipt (Universal Credit, *MyFund* and top-up) would then be £350 a week.

MyFund would be used to pay unemployment benefits:
The first three months of unemployment would be covered by *MyFund* at a rate equivalent to JSA(c). This would be funded:

- Half from insurance; and
- Half from personal pot.

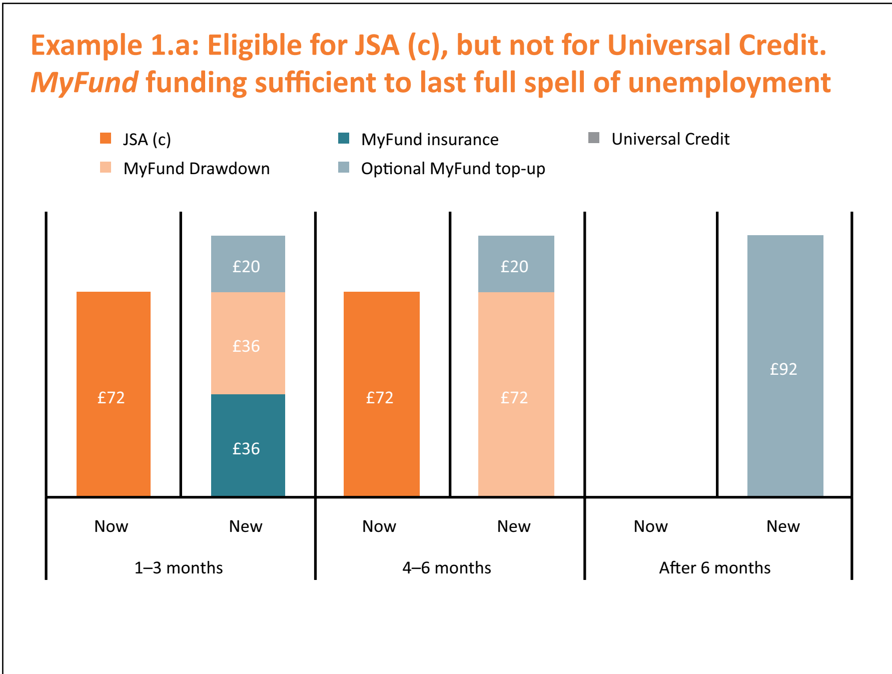
Where the individual is also entitled to Universal Credit, payments from *MyFund* would be withdrawn at a 100% rate from Universal Credit entitlement.
Following the first three months of unemployment:

- For those eligible for Universal Credit, the personal pot would continue to pay £72 a week in benefits until the pot was depleted.
- For those not eligible for Universal Credit, funding for benefits would come solely from their personal pot until the pot was depleted.

Those with over the equivalent of six months of benefit payments in their *MyFund* account could chose to take up to a £100 a week top-up to their benefits. Claimants of Universal Credit working for less than 20 hours a week would also see their *MyFund* contributing to their benefit payments.

What this means in practice: benefit examples

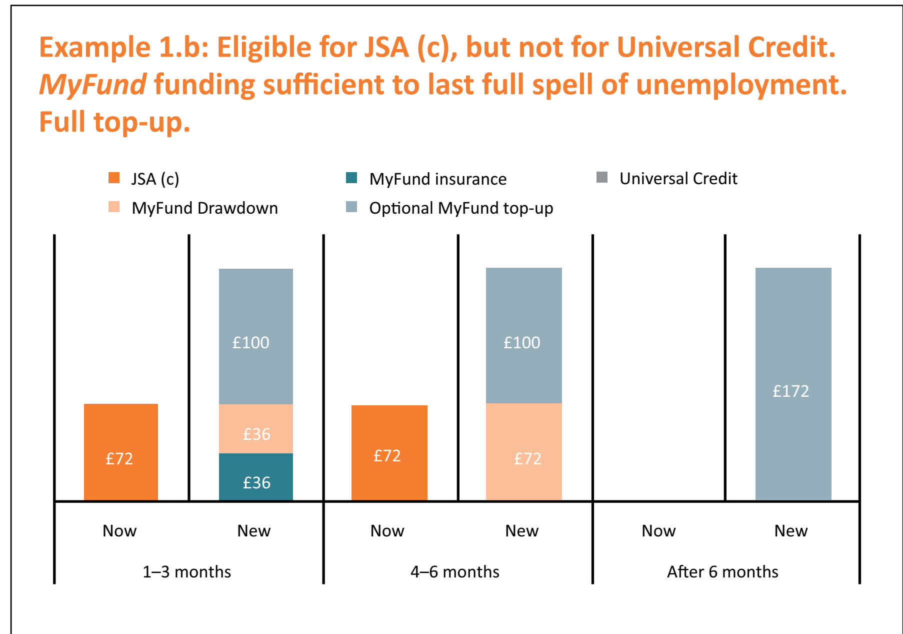
Example 1.a: Eligible for JSA (c), but not for Universal Credit. *MyFund* funding sufficient to last full spell of unemployment



Here, instead of the state paying out £72 a week in JSA(c) in the three two months of unemployment, this cost is shared between the insurance element and personal pot in *MyFund*. The individual also chooses to take a £20 top up from their personal pot, meaning that their total level of support is greater under *MyFund*.

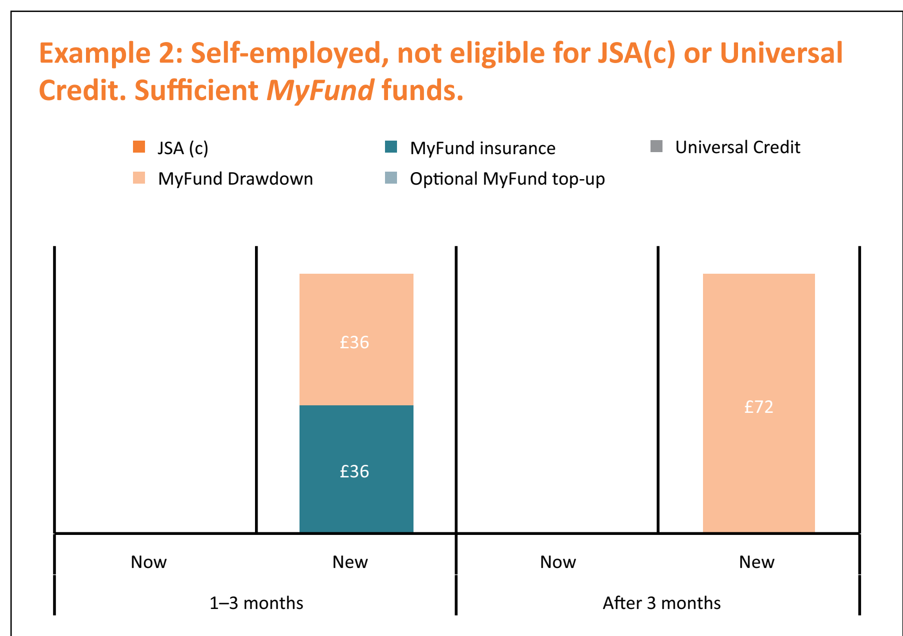
Between four and six months, all costs are covered from the individual's personal pot and again, the individual receives a higher level of support.

Under JSA(c), benefit entitlement runs out after six months. Under *MyFund*, where the individual has contributed enough to their personal pot, they can continue to draw this down to provide support for longer periods of time. Less than seven years of basic level contributions would be enough to fully fund six months of unemployment with a £20 top-up in the scheme.



Example 1.b: Eligible for JSA (c), but not for Universal Credit. *MyFund* funding sufficient to last full spell of unemployment. Full top-up.

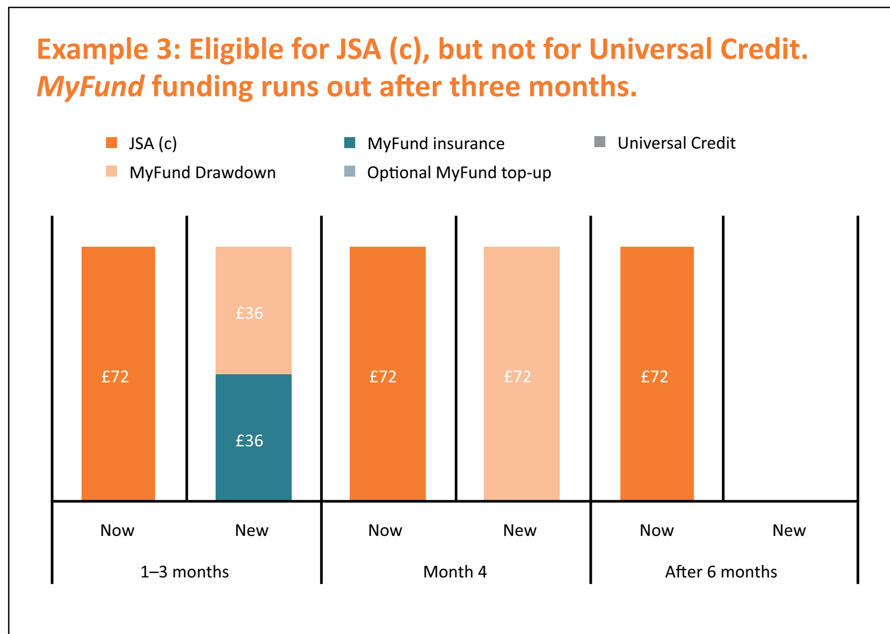
This example shows the same situation, but where the individual has sufficient funds in *MyFund* to draw down the maximum £100 top up. With just over 14 years of basic contributions, the individual could fully-fund six months of this level of support.



Example 2: Self-employed, not eligible for JSA(c) or Universal Credit. Sufficient *MyFund* funds.

In this example, since the claimant was previously self-employed, they are not currently eligible for JSA(c) and, because of other earnings or capital, are not eligible for Universal Credit. However, under *MyFund* they would be eligible for support through the insurance and personal pot and would have the option to draw down a top-up if they had sufficient funds. Given the rapid increase in the proportion of the labour market accounted for by the self-employed, this is a major advantage of *MyFund*.

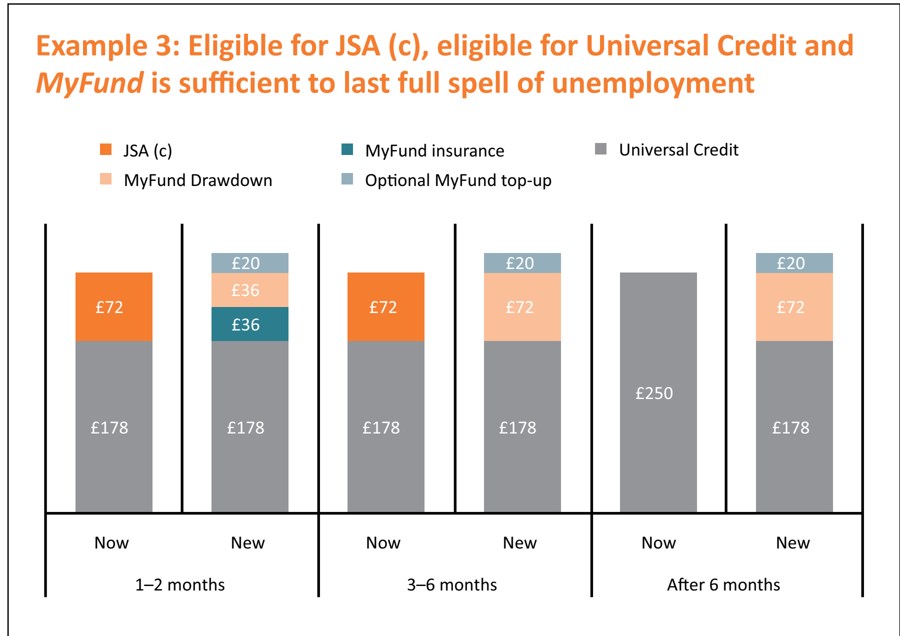
Example 3: Eligible for JSA (c), but not for Universal Credit. *MyFund* funding runs out after three months.



From this chart, it is apparent that, under *MyFund*, there could be some individuals who have lower entitlement to benefits than under the current JSA(c) system. These will be claimants with a relatively poor contribution history, whose *MyFund* runs out before the six month point of unemployment, but do not qualify for Universal Credit by virtue of the income or capital means test. Under JSA(c) they would have continued to claim benefits until the six month of their claim, but under *MyFund* they would receive nothing after two months.

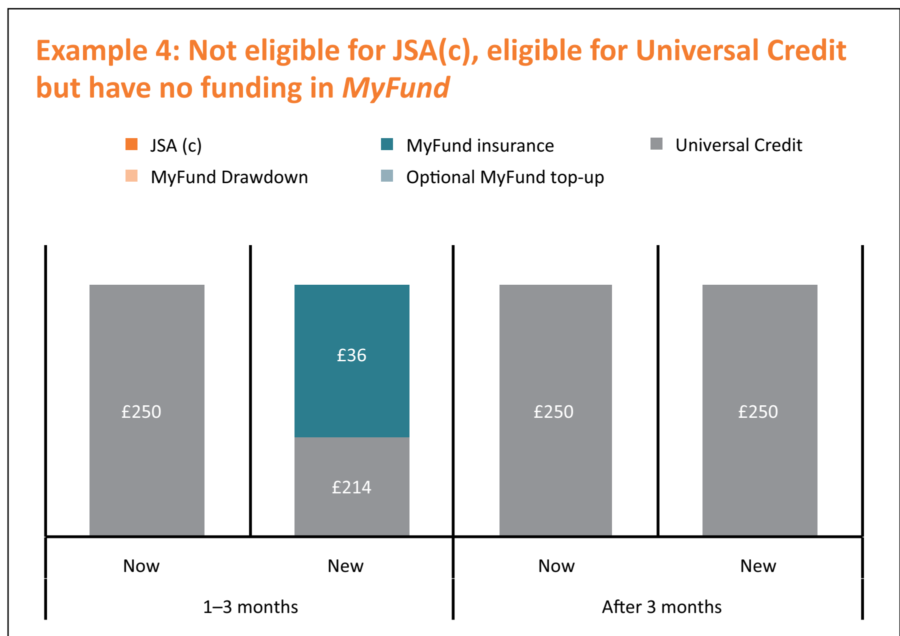
However, while this situation might occur, it is likely that it will affect very few individuals. Just 9% of JSA claimants currently have JSA(c) and the most recently available data suggest that 75% of JSA(c) claimants have duration of claim of less than three months, meaning that for the majority of individuals, less than three months of benefits will be needed in *MyFund* and this would only take just over two years of contributions to build up. A contribution history of just five years would allow full funding of six months unemployment.

For the relatively small number of people who might fall within this group of losers, by virtue of the fact that they are not eligible for Universal Credit because of a means test, they will have income from other sources, or substantial savings on which they should be able to support themselves.



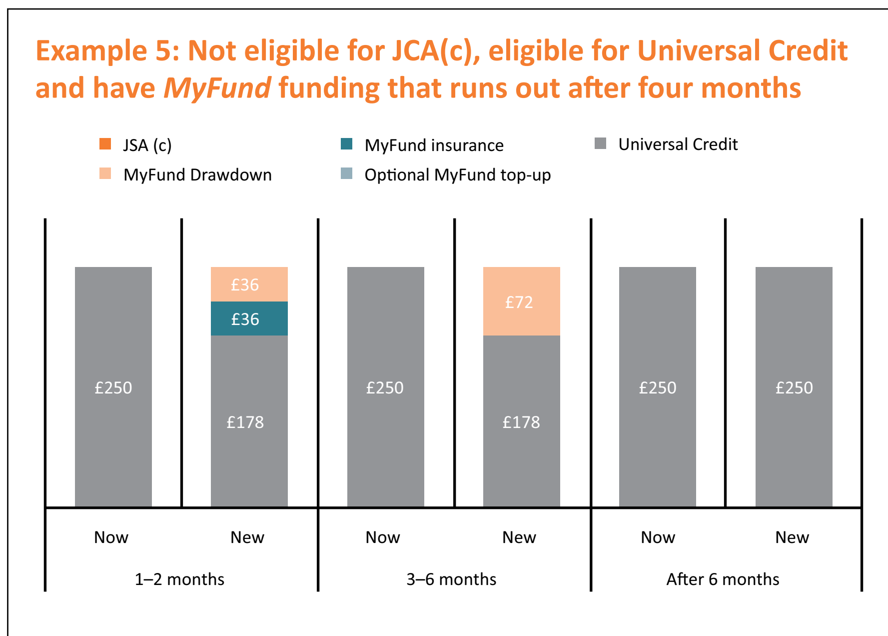
Example 3: Eligible for JSA (c), eligible for Universal Credit and *MyFund* is sufficient to last full spell of unemployment

This chart demonstrates an example where the claimant is also eligible for Universal Credit. As with Example 1, the insurance element and personal pot reduce the costs of unemployment to the government by contributing to the costs of benefits in the first three months of unemployment. After the first three months, the personal pot contributes £72 that reduces the costs of benefits to the Government and tops up eligibility by £20 to increase the level of available support.



Example 4: Not eligible for JSA(c), eligible for Universal Credit but have no funding in *MyFund*

Here, even where personal contributions to *MyFund* have run out, the costs to the state are reduced in the first three months of unemployment as the *MyFund* insurance element contributes half of the equivalent costs of JSA(c). There is no impact on the financial support that the individual receives.



This example shows an individual who has sufficient funds in their *MyFund* to contribute further to reducing the costs to the state after the first three months. After the fourth month, *MyFund* funding runs out and they are fully supported by Universal Credit.

Using *MyFund* for pensions

Most spells of unemployment are relatively short and the majority of individuals do not experience significant periods of unemployment. Even where individuals become unemployed, where they are not claiming Universal Credit, they can choose not to drawn down the support offered by *MyFund*. This means that, for the vast majority of individuals, *MyFund* will accumulate over time and will leave them with a potentially sizeable fund at retirement.

Where this is the case, once the individual reaches retirement age, the fund would be made available for the individual as part of their pension package. It would have the same tax treatment as other parts of their pension arrangements.

For an individual entering the labour market at, say 20, who does not experience any periods of unemployment and retires at the state retirement age, even with a modest real return of 1%, the fund would be worth £15,500. If fund values were to grow by 2% in real terms, the value would be £20,500.

The average pension pot is estimated to be just £36,800 and a previous Policy Exchange report, *Help to Save*, highlighted that contribution rates to NEST are likely to be insufficient to fund adequate retirement incomes for many individuals. This means that, alongside recommendations in *Help to Save*, this could provide a much needed boost to retirement provision.[36]

Even those experiencing significant levels of unemployment can still see large *MyFund* funds accumulate by the time of retirement. Exact amounts will, of course, depend on the length of unemployment and the timing of that unemployment over their working life. Those with fewer years of contributions would also see lower fund values. Table 4 provides some scenarios to give a sense of the potential individual funds available on retirement.

diffusing the pensions time bomb. Policy Exchange, London.

37 William Beveridge (1942),

It shows that, for instance, if, over their working life, the same individual experienced two six month spells of unemployment (at age 25 and 35) and drew down their *MyFund* during those two spells, the value of *MyFund* would be £11,500 at retirement with 1% real growth in fund values. The same person experiencing two spells of six months of unemployment (age 40 and 45) and two year-long spells (30 and 60) would see a *MyFund* value of £4,500 at retirement.

Table 4: Indicative scenarios of how the value of *MyFund* at retirement could vary based on contribution and unemployment history and fund growth.

Years in labour market	Unemployment history	Indicative fund value at retirement	
		1% real growth	2% real growth
48	None	£15,500	£20,500
	Two six month spells at ages 25 and 35	£11,500	£14,000
	Two six month spells at ages 40 and 50	£12,000	£16,000
	Two six month spells at ages 40 and 45 Two 12 month spells at ages 30 and 60	£4,500	£5,500
35	None	£11,500	£14,500
	Two six month spells at ages 25 and 30	£8,000	£10,000
	Two six month spells at ages 40 and 50	£7,500	£9,500
	Two six month spells at ages 40 and 45 Two 12 month spells at ages 30 and 60	£2,000	£2,000

The value of the *MyFund* fund left at retirement would form part of the individual's pension package and would be taxable under normal pension rules.

Individual flexibility to tailor *MyFund* support

The original intention of the Beverage plan, was clear:

> '...*first and foremost, a plan of insurance – of giving in return for contributions benefits up to subsistence level, as a right and without means test, so that individuals may build freely upon it*'.[37]

In the same way, the outline of *MyFund* described so far should be seen as the base upon which individuals and families should build a package of support and insurance to meet their own needs. With a renewed focus on personal contribution and the promise that it is "your money", the ambition should be that many individuals choose to engage actively with the *MyFund* system. In this way, *MyFund* would allow individuals to contribute more to:

- Purchase a level of insurance above that provided as the minimum. For instance, by extending the cover beyond three months of unemployment, increasing the rate at which it is paid or covering wider circumstances such as illness or disability; and/or

Social insurance and allied services. Paragraph 10. *Our underlining.*

38 See www.poolre.co.uk/

- Increase the value of the *MyFund* personal fund. This could be attractive to individuals who wanted to use *MyFund* as a savings vehicle for retirement or for those who wanted to build up larger reserves to fund higher pay-outs during unemployment or longer coverage periods when not eligible for Universal Credit.

> Scheme providers would be encouraged to provide a range of flexible scheme options to allow individuals to tailor both the insurance and savings accumulation parts of their account.

What else can the pot be used for?

Alongside flexibility for individuals to contribute more to their *MyFund* fund in order to provide for additional insurance or increased fund value, *MyFund* could also be used to provide additional support for a wider range of individual needs.

For instance, while ensuring that at least six month's benefit payments were maintained in the *MyFund* fund, individuals could draw down the funds to contribute to:

- Investments in employment, skills or training support;
- Emergency expenditure needs alongside the localised support available through the successor to the Social Fund; and/or
- The costs of social care in retirement.

This level of additional flexibility is one of the key advantages of the scheme. It has individual benefits in terms of giving people control of the support the can receive in times of need and allowing them to adapt to the changing needs of the modern labour market. It will also be a better way for the state to manage the costs of provision going forward as it makes it clear that there is a joint responsibility between the state and individual and gives people a vehicle through which they can make provision for themselves.

> As the government develops its plans for the future welfare to work and skills provision, emergency financial support and funding of social care, it should consider how the principle of *MyFund* could be extended to help individuals contribute to and manage these costs.

Who will deliver *MyFund*

Delivering *MyFund* will be a significant undertaking. With upwards of £8 billion of funds coming into the fund each year and a significant proportion flowing out in benefits and pensions payments, choosing the administrator and designing the delivery system will be hugely important. Given the commercial and technical detail involved in this task, it is beyond the scope of this paper. However, some general principles are outlined below.

- *Not Government:* Given the sums of money involved, there could be arguments that the *MyFund* should be administered by the Government. However, given

that the intention is to ensure that individuals regard contributions to *MyFund* as "their money" rather than a tax, this would be inappropriate. It would also miss the opportunity to leverage wider expertise and resources across the private and third sectors.

- *A financial institution:* The essential task of the delivery body would be to manage a large fund, ensuring that sufficient monies were available to meet yearly outgoings. That makes the established finance industry in the UK, a prime candidate for running the scheme. Large insurers would be the obvious first choice because of their experience in administrating and managing large funds.
- *But with Government backing:* the delivery body should be expected to manage the fund such that a reasonable level of payment fluctuations could be managed – for instance, if unemployment rose temporarily. However, as has been seen through the recent financial crisis, large fluctuations from macroeconomic shocks can lead to significant increases in benefit payments and would be both unreasonable and inefficient to require the body to cover all of these costs. For instance, doing so would require the body to retain an extremely high level of reserves and these funds could not be used to invest and grow the fund. With this in mind, the government should provide a 'lender-of-last-resort' type guarantee to cover costs once a given level of unemployment had been breached. This model could function in a similar fashion to Pool Re that, with government backing, provides insurance for otherwise uninsurable risks associated with terrorism.[38] A similar approach is also soon to be adopted for insurance to cover flooding.[39] As with these schemes, the relevant breach-point where would need to be negotiated between the government and scheme provider.
- *Run for the scheme members:* One principle that should be laid down is that the scheme is run for the benefit of the scheme members. That means that, aside from an administration fee paid to the scheme administrator, any income or capital gains that accrue from the managing the fund should not be retained by the fund manager. Instead, any returns from income and capital growth should be split between individual *MyFund* funds.
- *With collaboration from voluntary sector and trade unions:* While large institutions in the finance industry would be the obvious scheme administrators, the tendering process should encourage partnership with the voluntary sector and Trade Unions. This "Ghent" model has worked in other countries, such as Denmark and Sweden, where trade unions run insurance and benefit schemes for employees. In the UK case, partnerships could be established between fund managers, Trade Unions and business representatives (for instance, the CBI) who could jointly manage and administer *MyFund*.
- *Encouraging competition:* The *MyFund* system should not rely on a single monopoly provider. Instead, a number of licenced providers should administer *MyFund* schemes to encourage them to offer better service and value for money to the scheme members. However, there cannot be unlimited numbers of potential competitors. *MyFund* funds need to be of sufficient size to manage the risks of adverse selection and the organisations running the system need to be carefully vetted and regulated to manage the risk of failure. The intention should be that a small number of licenses are granted to run *MyFund* schemes. The NEST Corporation should be encouraged to apply to be one of these providers.

for details of Pool Re.

39 See www.abi.org.uk/Insurance-and-savings/Topics-and-issues/Flooding/Government-and-insurance-industry-flood-agreement/The-future-of-flood-insurance for plans for Flood Re.

- *Personal choice:* Individuals would be free to choose their *MyFund* provider, which would apply to all of their sources of earnings and would follow them when they move jobs. If no choice were made, a random allocation would be undertaken. Movements in and out of different scheme providers should be allowed and not chargeable. This could be facilitated by asking members to make a choice at the start of each tax year.
- *Oversight:* While it would seem appropriate for an experienced business to run the administration of the scheme, it is also important that risks are carefully managed and that they operate within a framework set down by Government. That means that Government should legislate to give the body a clear mandate, outlining its responsibilities and the Government Actuary and National Audit Office should regularly audit the scheme and its administration. It should also fall under the regulatory mandate of the Financial Conduct Authority (FCA).

When should this be introduced?

The introduction of *MyFund* would fundamentally change the shape of the benefits system. It would replace unemployment benefit for all claimants for the first three months of unemployment and mean that some people would not claim unemployment benefit or Universal Credit at all if they became unemployed. It would require providers to be contracted to run the administration of the scheme and for them to develop the appropriate infrastructure. The changes would also need to be communicated to the public and properly understood.

It is also essential that *MyFund* works effectively alongside Universal Credit, which is due to be fully rolled-out in the early years of the next Parliament.

As with Universal Credit, the roll out should be phased in over a number of years. For this reason, following the 2015 General Election, the new Government should build detailed plans for this system and legislate for it to be in place by 2020.

What if Universal Credit is delayed?

By removing the outdated and ineffective JSA(c), *MyFund* would support and work best alongside Universal Credit. Its structure is designed to build upon the ambition to increase work incentives in the benefit system and to help individuals move more quickly into higher-paying, longer-term employment. However, should Universal Credit be further delayed, *MyFund* would also work well in conjunction with income-based JSA.

The UK's social security system was founded in its present form over 70 years ago. In doing so, Beveridge was clear of his intent:

> *'…first and foremost, a plan of insurance – of giving in return for contributions benefits up to subsistence level, as a right and without means test, so that individuals may build freely upon it'.*

This ambition of co-provision between the state and the individual has never been achieved. We are left with a social security system that barely recognises contribution and provides inadequate support in the modern labour market. Individuals are passive recipients of state support in times of need and rarely make provision for their own support. This report recommends a new system that will simultaneously bring the social security system back to its founding roots and ensure it is fit for the 21st Century.

£10.00
ISBN: 978-1-907689-86-4

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