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How do income-support systems in the UK affect labour force participation?

Mike Brewer

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Postal address: P.O. Box 513, 751 20 Uppsala

Visiting address: Kyrkogårdsgatan 6, Uppsala

Phone: +46 18 471 70 70

Fax: +46 18 471 70 71

ifau@ifau.uu.se

www.ifau.se

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How do income-support systems in the UK affect labour force participation?*

by

Mike Brewer[#]

December 2009

Abstract

This paper reviews how income-support systems affect labour force participation in the UK. The UK's approach to social insurance is "basic security", with modest, typically flat-rate, benefits; insurance-based benefits are relatively unimportant. Compared with the EU, the UK has high employment rates, but a high proportion of non-workers say that they are not working through disability. In general, the low generosity of out-of-work benefits means that positive incentives to work exist for almost all benefit recipients, but weak work incentives exist for those receive *Housing Benefit*, and for primary earners in couples who have low earnings. Recent reforms to strengthen work incentives have altered the in-work tax credits, rather than the benefit system, and recent reforms to the out-of-work benefits have involved toughening and extending job-search requirements. The two main political parties seem to agree that future reforms will involve more conditionality, a greater use of the private sector, and a unification of the different labour market programmes.

Keywords: Institutions, incentives, reforms, labour supply, disability
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[#] Institute for Fiscal Studies, e-mail: mike_b@ifs.org.uk

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1 Introduction

When designing income-support systems (or social security benefits), there is invariably a trade-off between providing sufficient support to those with no other sources of income, minimising the cost to the taxpayer, and providing incentives for recipients to increase their earnings. In addition, certain income-support systems may be associated with active labour market programmes, or conditionality of some form, which may improve recipients' chances of finding a job, or provide them with an incentive (either a "carrot" or a "stick") to do so. The purpose of this chapter is to describe how income-support systems in the UK affect labour force participation.

The paper is organised as follows. As the paper was commissioned as one of 6 about different EU countries, Section 2 provides background on key employment trends in the UK, and on the design of the social security system. Section 3 describes recent changes to social security benefits, and to tax credits, which, by affecting in-work incomes, are important in determining the financial incentive to work for recipients of social security benefits. It will be seen that these reforms divide neatly into two: reforms which increase the requirements placed upon recipients of out-of-work benefits, and reforms to in-work benefits or credits in order to improve financial incentive to be in work. Section 4 presents evidence, where available, from evaluations of the net impact of these reforms. Section 5 concludes, discussing what reforms are likely in the UK over the next five years regardless of which party might be in government following the expected spring 2010 election, and what other countries might be able to learn.

To try to avoid confusion, the full names of benefits are given in *italics* with capital letters, or as abbreviations. For example, there is a specific social security benefit in the UK called *Income Support*. The phrase "income support systems" without capitals should be understood to refer to all social security benefits in general in the UK.

2 Background

2.1 Basic facts on employment

Analysis of data from the European LFS compiled for this project by Applica/Alphametrics shows that the UK has:

- higher employment rates for men and women, with correspondingly lower inactivity, than the EU average;
- seen a decline in the employment rate of men since 1990 (compared with no change in the EU, on average), and seen a smaller rise in the employment rate of women than the EU average, but from a higher base.
- an unemployed population which is more skewed towards the young, and to men, than the EU average (the inactive population has a similar age and sex distribution to the EU average), although this partly reflects the population structure of the UK;
- seen, over time, an increasing fraction of the unemployed and inactive composed of young men, and a corresponding shift away from prime-aged women (especially amongst the inactive), reflecting the rise in employment amongst mothers;
- like the EU average, the most recent trend (as the recession hit in 2008) is for an increasing share of the unemployed to be men; younger and older women are also increasing their share of the inactive population;
- non-employment rates in the UK are substantially below the EU average at all ages. Since 1990, non-employment rates have fallen for older working age individuals for men and women; in the EU, they have fallen mostly for women. In the current recession, the non-employment rates for older men have risen, but have continued to fall for older women;
- amongst the working-age population, the unemployed and, to a lesser extent, the inactive, are more likely than the employed to be born outside the EU, but not by as dramatic an extent as in some EU countries. But, as with other EU countries, the differences are more pronounced amongst the 25-49 group: for this group, men born outside the EU have a slightly lower employment rate than UK-born, but women born outside the EU have a much lower employment rate (and much higher inactivity rate) than UK-born women (although not shown in this data, this is particularly the case among women, usually Muslim, living in couples who are Pakistani or Bangladeshi: see, for example, Clark and Drinkwater (2007)). Trends over time look similar to the EU average;

- the reasons men give for not working are much more likely to be for illness or disability, retirement (or “other”) and much less likely to be because of education or training, than the EU average. The reasons women give for not working are much more likely to be for retirement (or “other”) and much less likely to be because for family reasons, or for education or training, than the EU average. Amongst those aged 25-49, men and women were more likely to say that they were not working because of illness or disability than the EU average. A very high proportion of older women (55 to 64) say that they are not working because of retirement, no doubt because the retirement age for women is currently 60;¹
- the proportion of GDP spent on “employment-sensitive functions” in the UK is very close to the EU average, with more spent on housing and disability, but less spent on unemployment: this presumably reflects the very large caseload receiving *Employment and Support Allowance* and *Incapacity Benefit* compared with *Jobseekers Allowance*, and the importance of *Housing Benefit* and *Council Tax Benefit*, discussed further in Section 2.2.

2.2 “Income support systems” in the UK

2.2.1 Overview

The UK’s approach to social insurance as typically characterised as “basic security”, with relatively modest benefits, typically flat-rate (unrelated to previous earnings) or earnings-related but with low income/earnings ceilings. This approach can largely be traced back to a period of retrenchment in the 1980s, which cut back earnings-related social insurance benefits, up-rated social insurance benefits more slowly (in line with a price index rather than the greater of growth in prices or earnings), and taxed some insurance-based benefits. Social partners play very little role in the design or administration of social insurance, social assistance or labour market programmes for the unemployed. Within Great Britain, the national government is responsible for the design of

¹ It is rising from 60 to 65 between 2010 and 2020. The Government plans to increase retirement ages for men and women to 66 between 2024 and 2026, and the main opposition party has proposed bringing forward the start of this rise to 2016 for men and 2020 for women.

all income support programmes; *Housing Benefit* and *Council Tax Benefit* are administered by local government, but they have almost no discretion over the rules, and most of the funding for the benefits comes from central government. Social security benefits are a devolved matter in Northern Ireland.

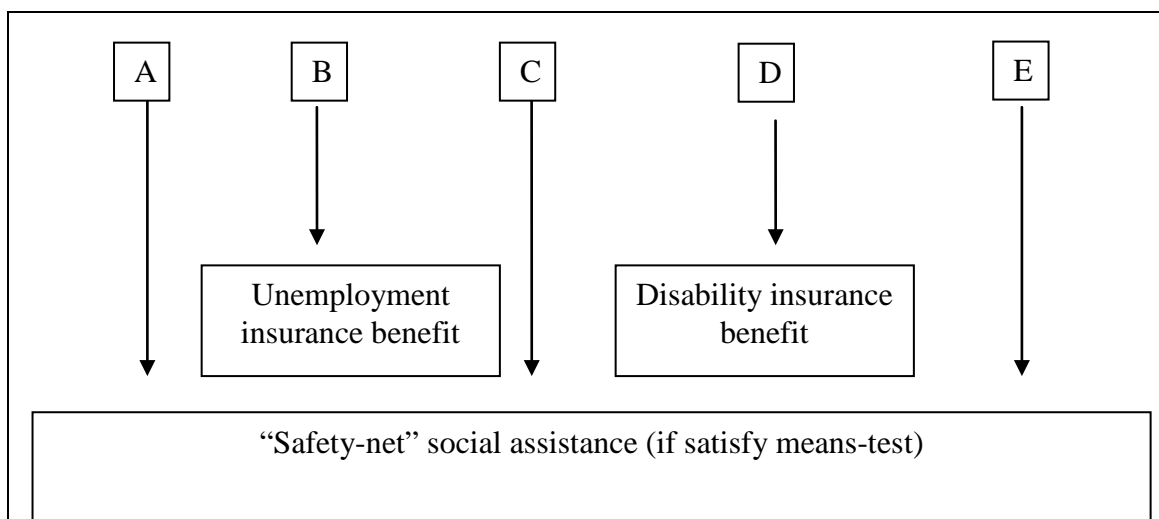
A common distinction to make is between income-replacement benefits, and extra-cost benefits. The income-replacement benefits, which are the main focus of this paper, are those which are intended to provide an income to people who cannot, or who are not expected to, work. Extra-cost benefits are paid to people who are considered to have higher needs.

2.2.2 Detail

A traditional way to think about income support systems is first to consider what coverage is provided by the social insurance benefits, and then, for those not covered by such benefits, to consider what coverage is provided by social assistance benefits (this views the social assistance benefits as “safety net” benefits) (see *Figure 2.1*). Sometimes, these social assistance benefits are administered and funded by local or municipal governments.

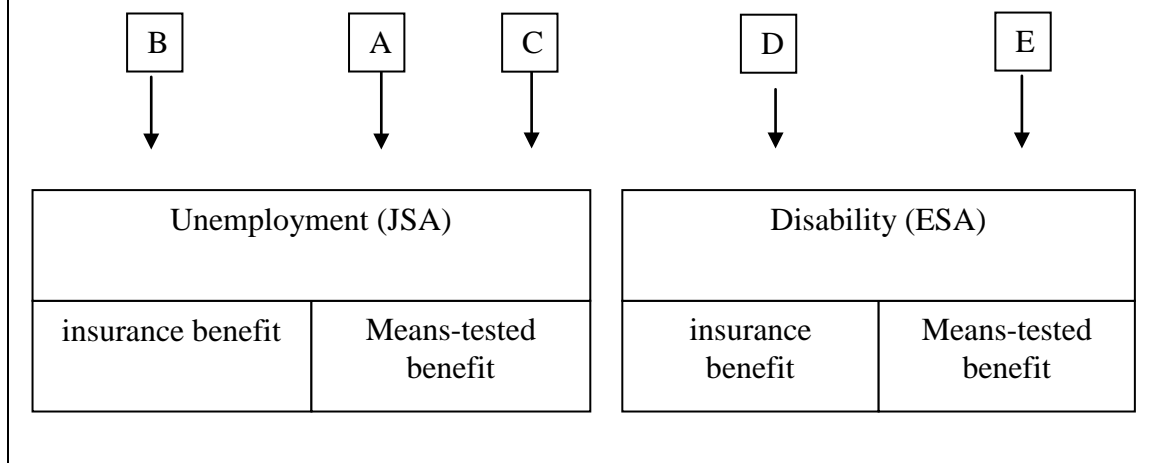
This approach is not particularly helpful for the current set of benefits in the UK. Instead, one can think of the UK benefit system as categorising claimants according to the reason they are in such a position: this determines which benefit (from a list of four, discussed below) an individual might be entitled to. Having established this, one calculates the level of entitlement to this benefit; this will depend, in general, upon any or all of the following: work history, the level of past National Insurance contributions, and the circumstances of the claimant and his or her partner (see *Figure 2.2*). Furthermore, as already mentioned, there is no real split between national and local government because the design and funding of all income support programmes is a matter for the national UK government.

Figure 2.1 Stylized picture of an income support system for those who are unemployed or unable to work through sickness or disability with insurance benefits backed up by social assistance.



In both Figures, persons A, B and C are unemployed, and persons D and E have a work-limiting illness or disability. Persons B and D can qualify for insurance benefits, but persons A, C and E have to claim social assistance benefits

Figure 2.2 Stylized picture of the UK income support systems for those who are unemployed or unable to work through sickness or disability



Of course, the actual situation is more complicated than in *Figure 2.1* and *2.2*, which only considered disability and unemployment as reasons for having no or a low income; the other main reason for claiming an income support benefit in the UK is because one

is caring, either for an adult with disabilities, or a dependent child.² A fuller list of the income-replacement benefits available to working-age adults with no or low income in the UK is (in order of number of recipients):³

- *Employment and Support Allowance* (ESA) and its predecessor, *Incapacity Benefit* (IB), for those who are unable to work through sickness or disability;⁴
- *Jobseekers Allowance* (JSA), for those who are out of work but required to seek work actively as a condition of receiving support;
- *Income Support* (IS), for those who are not sick or disabled but are not required to seek work actively (mostly full-time carers of children or disabled adults). Those aged 60 or over (or with a partner aged 60 or over) may be able to claim *Pension Credit*, which is a more generous form of IS;
- *Carers' Allowance* (CA), for those who are full-time carers of disabled children or adults.

Table 2.1 gives detail on the number of claimants. In general, ESA is the more generous benefit. A given individual's entitlement to IS and the means-tested JSA (see below) should generally be identical, and so, as JSA recipients have to be actively seeking work, and can lose their entitlement if they do not satisfy various conditions, recipients with a choice between IS and JSA should prefer to claim IS. Recipients of ESA, IS and CA do not have to look for work as a condition of receiving benefit and can, in principle, receive the benefit indefinitely, although recipients of ESA who are deemed not to be so disabled that they will never work do have to take steps to manage their health condition and attend a series of work focussed interviews.⁵

² In the UK benefit system, children are those aged under 16 or aged 19 or under and in full-time education.

³ See Annex 2 for some detail on the individual benefits/programmes, and Annex 1 for information on spending and recipients (which will help the reader assess the relative importance of the different programmes).

⁴ Hereafter we use ESA to refer to ESA and IB, unless stated otherwise.

⁵ The Government has proposed abolishing income support and requiring its recipients to claim JSA instead, but without imposing job search requirements on these new claimants. As an exercise in reducing the number of distinct benefits, this would be a good move, but it would mean that a substantial proportion of recipients of *Jobseekers Allowance* were not jobseekers. A more radical reform would combine these four income-replacement benefits (and perhaps others) into one.

Table 2.1 Working-age claimants of main income-replacement benefits, by statistical group.

	February 2009	February 2008
Benefits intended for claimants who are not in work		
Job seekers, of which	1,421,600	806,700
<i>Contributory (ie insurance-based)</i>	20%	18%
<i>Means-tested</i>	80%	82%
ESA and incapacity benefits	2,693,540	2,617,880
<i>Contributory(ie insurance-based)</i>	54%	55%
<i>Means-tested</i>	46%	45%
Lone parent	736,040	741,710
Carer	400,120	384,490
Other income related	181,880	169,950
Benefits which may be paid to workers and non-workers		
Disabled	363,820	349,380
Bereaved	95,490	104,780

Note: figures are for Great Britain. The row variables refer to statistical groups created by the DWP, rather than the names of benefits. Where a person fits in more than one category, they are assigned to the first in the table, and so the totals may be added up without double counting. "Jobseekers" means person receiving JSA, perhaps with other benefits. "ESA and incapacity benefits" means a person receiving ESA, IB, IS on disability grounds, or Severe Disability Allowance, perhaps with other benefits. "Lone parent" means a person receiving income support as a lone parent, perhaps with CA. "Carer" means a person receiving Carer's Allowance, perhaps with IS. "Disabled" means a person receiving *Disability Living Allowance* only. "Bereaved" means someone receiving bereavement benefits. Split between contributory and non-contributory for February 2009 is based on August 2008 data.

Source: all derived from tables produced using the Department for Work and Pensions' on-line tabulation tool. Full details available from author on request.

The basic entitlement to all of these benefits is unrelated to an individual's past earnings. The only advantage to an individual of having made past *National Insurance* contributions is that the amount of JSA or ESA which is paid is not means-tested against other income of that individual nor their partner.

As suggested by *Figure 2.2*, ESA and JSA are both insurance-based and means-tested benefits: adults can become entitled to them either by having made sufficient past *National Insurance* contributions, or if they (and their partner) satisfy the family-level

means-test. The majority (80% in August 2008) of JSA claimants are receiving the means-tested variant, but most (55% in August 2008) recipients of ESA and its predecessor are receiving the insurance-based benefit. In general, the rules surrounding what claimants must do to maintain entitlement to the benefit are identical for the contributions-based and the means-tested benefits, but the amount payable and the duration of payment can be different between the two (and it is possible to receive contribution-based ESA or JSA with an means-tested top-up). Carers Allowance doesn't follow this pattern: it is neither an insurance benefit nor a means-tested benefit (see Annex B for more details on who is entitled). The number of people claiming the pure social assistance benefit (*Income Support*), and who are not also claiming IB (note that this group will not exist when existing IB recipients are moved to ESA) is quite low, and is limited to those people who are not sick or disabled, and who are not required to work: mostly lone parents with young children and those who care for another adult on a full-time basis.⁶

The benefits that have been described above are sometimes known as “income-replacement benefits”, because they provide an income to people whose circumstances mean that they cannot, or should not be expected to, work. Another set of benefits are sometimes known as “extra cost benefits”, which provide additional income to households who are thought to have higher needs. The main benefits are *Child Tax Credit*, *Disability Living Allowance*, *Housing Benefit* and *Council Tax Benefit*: they are discussed in Annex B, although the way they affect incentives to work is discussed in the next section.

2.2.3 Impact on work incentives

When thinking about work incentives, a key feature of the four income-replacement benefits is that they all place restrictions on the amount of work that can be done by their recipients:

⁶ At the time of writing, the rules on who could claim IS (and therefore did not need to claim JSA) were changing for lone parents: in 2007/8, lone parents could claim IS if they had a child under 16; by 2011, lone parents will be able to claim IS only if they have a child under 7; there is currently a phase-in period where the age limit is falling in steps from 16 to 7. See section 3.1.3.

- ESA recipients are, in general, not allowed to work at all (although earnings of £20 a week can be ignored), as the benefit is supposed to be paid only to those incapable of working through illness or disability;
- JSA and IS recipients may only work up to 15 hours a week, and IS and means-tested JSA have a 100% withdrawal rate above a very small earnings disregard;
- Recipients of CA, who are supposed to be caring for a sick or disabled person full-time, may not earn more than £87 a week (which is effectively a “16 hour rule” for minimum wage workers), although there is no withdrawal of the benefit for lower levels of earnings.

These restrictions on the amount of work that can be done lead to substantial “cliff-edges” in the budget constraint and so, considering these benefits alone, there would be very weak incentives (or large dis-incentives) for recipients of these benefits to move into paid work, particularly at low hours or low wages. However, the main in-work tax credit in the UK, the *Working Tax Credit*, can in principle offset some or all of the removal of the income-replacement benefits as hours of work increases. The WTC is available to:

- those with children or disabilities who work 16 or more hours a week;
- to non-sick or disabled working-age adults aged 25 or over without children who work 30 or more hours a week;
- those aged 50 or over, who are returning to work and work at least 16 hours a week

There are therefore gaps in the coverage of WTC: adults under 25 who are not parents and not sick or disabled are never entitled to WTC, and WTC is not available to those who are aged 25 or more and working part-time (under 30 hours) unless they are parents, or sick or disabled (or aged 50 or over and returning to work). Past work has shown that the age cut-off at 25 is vital in containing the cost of WTC, as those under 25 are particularly likely to have earnings low enough to be entitled to the WTC, but the Government has argued that redistribution to this group is not a priority. Annex C illustrates the combined impact of the income-replacement benefits and WTC on incentives to work (but note that under 25s are not considered).

Finally, there are two other important means-tested benefits in the UK: the *Child Tax Credit* (CTC), and *Housing Benefit and Council Tax Benefit* (considered together as HB/CTB).⁷ Neither has any form of “hours rules” (whether maximum or minimum hours that must/can be worked), and so do not lead to cliff-edges, but both weaken work incentives through their withdrawal, like all traditional means-tested benefits. Child Tax Credit begins to be withdrawn only at moderate incomes (£16,000 in 2009-10) at a rate of 39%; HB/CTB are withdrawn from much lower incomes but at a rate which varies across families, and Brewer, Saez and Shephard (forthcoming) identified HB/CTB as one of the main contributors to weak work incentives in the UK because of its high withdrawal rate, and its poor administration, which can lead to a reluctance amongst HB/CTB recipients to enter work.

2.3 The financial incentive to work for non-workers in the UK

Work incentives in the UK were analysed thoroughly as part of the Mirrlees review of the tax system, and some results can be found in Brewer, Saez and Shephard (forthcoming), Adam and Browne (2009) and Adam et al (2006a).

Annex C updates Brewer et al by showing budget constraints for the primary earner in some hypothetical workless families, and those for lone parents are included below.⁸

⁷ *Housing Benefit* is a rental subsidy programme which can potentially cover the full cost of renting (subject to locally-determined rent ceilings), but where actual entitlement depends upon family income and household composition. *Council tax benefit* is a very similarly structured programme that provides a (potentially 100%) rebate on local tax payments (called *Council Tax*). HB is withdrawn at 65% but against income measured after income tax, national insurance contributions and tax credits; CTB is separately withdrawn at 20% in the same way. These withdrawal rates are cumulative, but they apply to net income, not gross income, and so the 20%/65%/85% withdrawal rate of CTB/HB/both combined is not added to the combined income tax-NI-tax credit METR, but instead applied to whatever earnings are left. For example, someone facing a combined income tax-employee NICs-tax credit METR of 70% and on the taper of both HB and CTB would lose 85% of the remaining 30%, giving a total MTR of 95.5% (plus 12.8% on the employer side, or 96% overall). Someone with a combined income tax-employee NICs METR of 31% and on the taper of CTB would lose 20% of the remaining 69%, giving a total MTR of 44.8% (51% with employer NI).

⁸ For simplicity, all of the analysis is for the primary earner in a workless family (in other words, any partners are assumed not to work) and concentrates on low earnings (£20,000 is below median male full-time earnings in the UK). Furthermore, the analysis has assumed all families either rent or have no housing costs (there is means-tested state support for those who claim income-based JSA or IS and have a mortgage, and it can lead to a substantial disincentive to work, but it is rarely claimed). Brewer et al (forthcoming) analysed the 2008/9 tax and benefit system and included the impact of employer's NI contributions; Annex 3 is of the 2009/10 tax and benefit system, but ignores the impact of employer's NI contributions.

Figure 2.3 Budget constraints for lone parent without HB, 2009-2010 tax and benefit system, £6/hour, 2 children, no childcare.

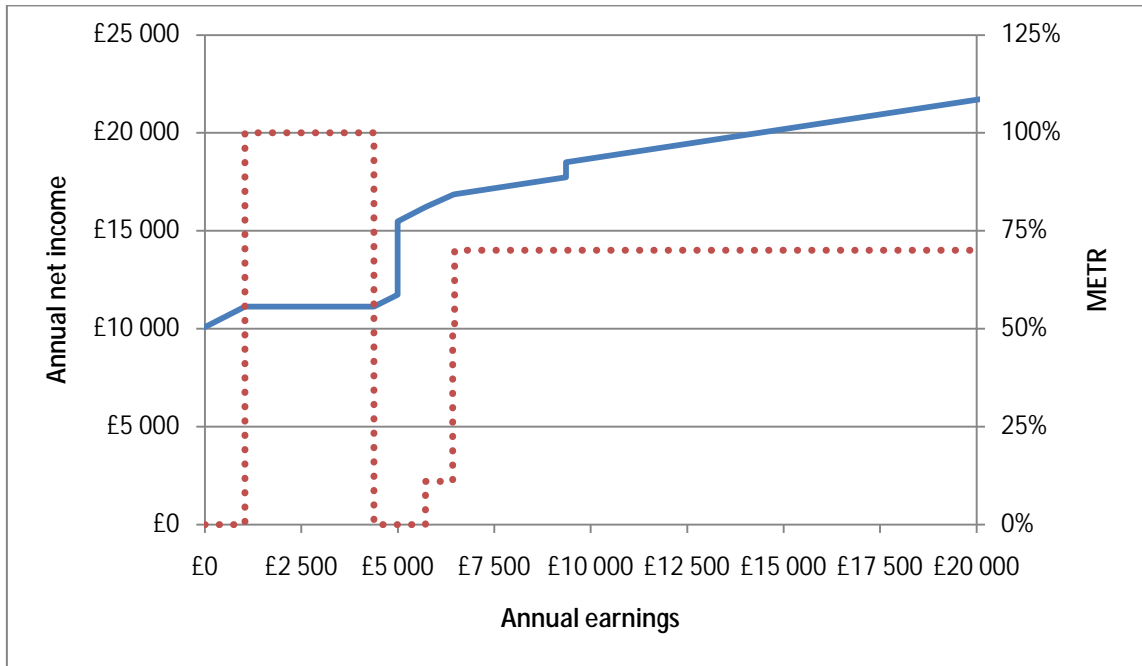
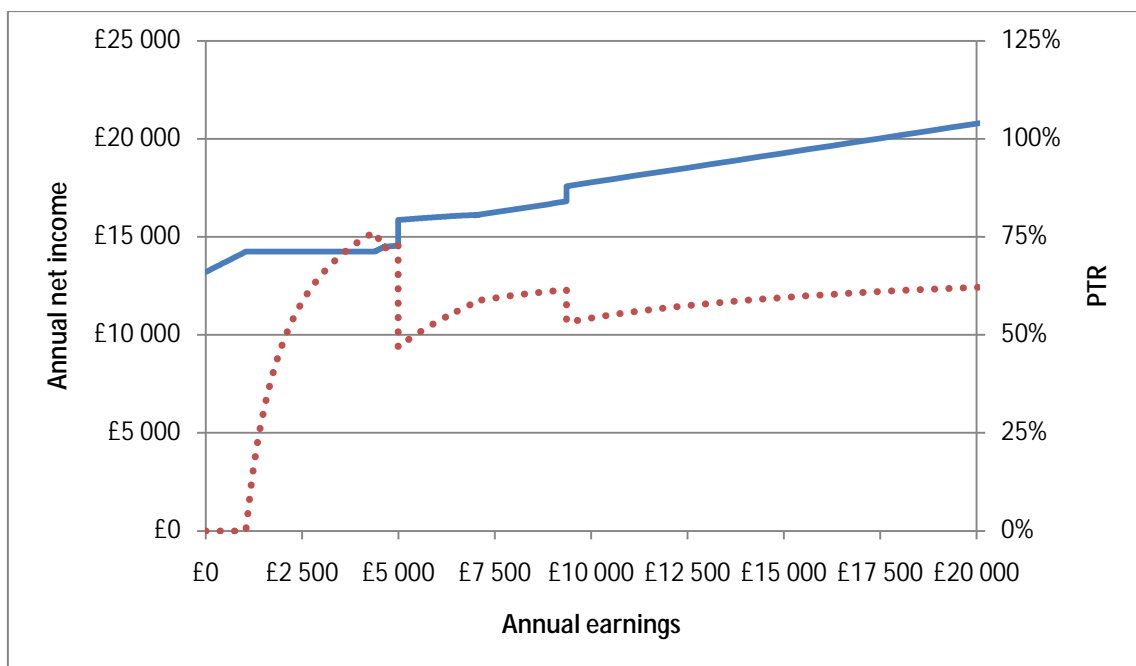
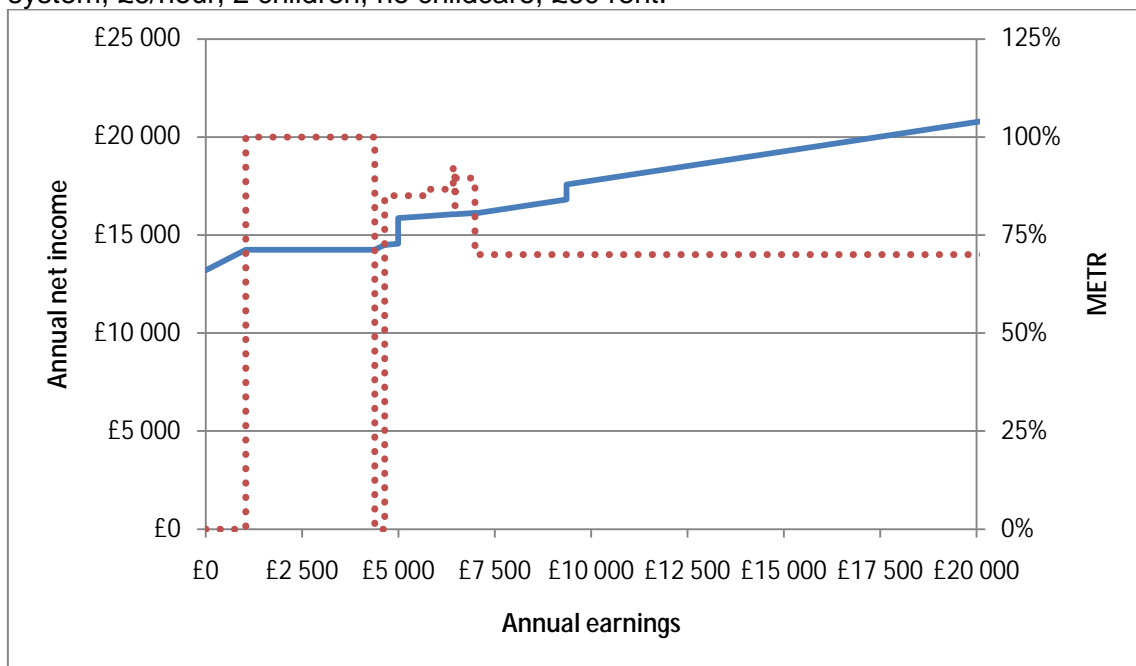


Figure 2.4 Budget constraints for lone parent with HB/CTB, 2009-2010 tax and benefit system, £6/hour, 2 children, no childcare, £60 rent.



Because the budget constraint is substantially different for those with entitlement to HB/CTB, analysis has been done with and without entitlement to HB/CTB.⁹ The main drawbacks to such analyses are that the figures can be very sensitive to the assumptions made, and this type of analysis alone does not show how prevalent or representative are the cases which are illustrated. However, they reveal that:¹⁰

- The participation tax rate (PTR)¹¹ is 0% for very low earnings and then increases rapidly. This reflects the structure of the main means-tested benefits for families with no earnings and who work no more than 15 hours a week (JSA or IS). For families on JSA/IS, a 100% withdrawal applies after a small earnings disregard: families therefore face no direct financial incentive to increase their earnings above the very low disregard unless they earn enough to exhaust fully entitlement to IS/JSA, or they work sufficiently high number of hours to qualify for WTC.
- Hours rules are an extremely important part of the benefit system in the UK. These hours rules lead to a striking discontinuity in the PTR schedule at 16 hours work a week (for those with children), and at 30 hours a week when an additional credit in the WTC is payable, or when initial eligibility occurs for those who are childless.
- The shape of the budget constraint for low to middle earners, and therefore the incentive to do any work, varies considerably by whether a family is entitled to HB/CTB).

The Figures are also informative about METRs for low earners, but these are not discussed here.

Annex D draws on Adam and Browne (2009), and presents analysis of the empirical distribution of PTRs and RRs. *Table D.1*, which is new analysis of the same underlying

⁹ HB in principle covers the full rent of a property, subject to local ceilings (calculated in relatively small areas, leading to high rent ceilings in urban areas), and CTB covers the full liability to CT. So an increase in the rent level or CT liability increases the amount of benefit for those with no income, and has no effect on those too rich to receive HB/CTB, worsening work incentives. This means that the budget constraint depends on the level of rent and of council tax; the figures have assumed a relatively low rent.

¹⁰ The rest of this sub-section draws heavily on Brewer, Saez and Shephard (forthcoming).

¹¹ This measures the extent to which the tax and benefit system erodes the gain to work. It is defined as 1 minus the increase in net income when moving into work divided by gross earnings.

data, estimates the distribution of PTRs amongst non-workers, characterising workers by their family-type, and their receipt of out-of-work benefits.¹² Like equivalent analysis in Brewer, Saez and Shephard (forthcoming), it shows that:

- PTRs are generally higher (weaker incentives to enter work) for families with children than those without with identical incomes;
- PTRs are generally lower for adults whose partner is in work than for the sole earner in a couple;
- PTRs are higher for those entitled to some form of out-of-work support than for those who are not;
- The highest PTRs occur amongst lone parents, and amongst adults in couples with children where neither are in work.

Box 2.1. Work incentives implied by the UK tax and benefit system

In a contribution to the Mirrlees review of the tax system, Brewer, Saez and Shephard (forthcoming) identified the following as the main defects in the UK tax and benefit system, having reviewed the structure of work incentives implied by the UK tax and benefit system, and having reviewed what is known about labour supply elasticities:

- “Participation tax rates for low levels of earnings are high: for most groups, they are close to 100% before individuals are entitled to the working tax credit, and they remain high even with the working tax credit. These PTRs appear much too high in a context where optimal tax theory suggests that the participation tax rate should be low, possibly even negative, at low levels of earnings, so as to encourage people to move into work. And PTRs for families potentially entitled to HB/CTB remain extremely high (over 70%) even at medium and high incomes.
- The phasing-out of the working and child tax credit, which operates on top of income tax and NICs, generates METRs of 73.4% including employer NICs (higher if also entitled to HB/CTB) for a large number of low to moderate

¹² The PTRs include the impact of employer NI and consumption taxes, which may help explain why they appear rather high.

earners; such a high METR is highly likely to be above the optimum rate even with modest behavioural responses.

- The main means-tested programme to help with housing (housing benefit) has an extremely high withdrawal rate, administrative difficulties and problems of mis-perception which deter low-income working families from claiming it (Turley and Thomas, 2006), and, by its design, predominately affects a minority group in society - tenants of social housing - who we might expect to have low earnings capabilities, a weak labour market attachment, and therefore relatively high labour supply elasticities.
- While the system for administering income tax and NICs in the UK is simple and efficient, the systems for administering child and working tax credits, and those for housing benefit and council tax benefit, are administratively burdensome for claimants, relatively expensive for the government, and prone to large amounts of fraud and error: all mean that neither is as well-targeted on the economic situation of beneficiaries as they could be.”

Where incentives to work are weak, it is generally due to one of the following:

- the so-called “hours rules” that exist in most benefits payable to those who are out-of-work: these remove entitlement to benefits altogether once a person is working more than a given number of hours a week (usually 16): these will clearly provide a substantial disincentive to work if their impact is not offset by the *Working Tax Credit (WTC)*.
- *Housing Benefit* and *Council Tax Benefit* have a very steep withdrawal rate, and relatively poor administration.
- The withdrawal of WTC and CTC, which particularly affects incentives to work for (potential) second earners in couples with children.

However, the relatively low levels of benefits paid to those who are out of work means that, in general, RRs and PTRs for non-workers are, therefore, lower than in

some EU countries.¹³ (Box 4.1 summarises the conclusions from a recent analysis of work incentives in the UK).

3 Recent reforms in the UK

In this section, we present an overview of reforms to income support programmes since 1997.¹⁴ We present them in two sections:

Section 3.1 discusses reforms which increase the requirements placed upon recipients of out-of-work benefits (i.e. reforms which require more job search or more activities preparing for work, or reforms designed to divert people from the out-of-work benefits with few requirements to the out-of-work benefits with rather more requirements). The intention was to increase off-flow rates from benefits). The reforms are:

- The *New Deal* programme (1997 onwards);
- *Flexible New Deal*, a reform to *Jobseekers Allowance* (phased in from October 2009);
- Reforms to disability benefits (the *Pathways to Work* pilot, and the replacement of IB with ESA in 2008);
- Change affecting lone parents (Work Focused Interviews for lone parents receiving *Income Support* (phased in from 2001), and the removal of entitlement to *Income Support* for lone parents with children aged 7 or over (phased in between 2008-2011).

Section 3.2 discusses the main reforms which have attempted to strengthen the financial incentive for those receiving out-of-work benefits to move into work. Note that the more important of these do NOT involve reforms to the income support programmes: instead, they involve reforms to the in-work tax credits, or similar programmes. These are

- Replacing *Family Credit* with the *Working Families' Tax Credit* (phased in between 1999 and 2000)

¹³ OECD (2009) shows that the total tax wedge on a single adult at average earnings is below the OECD average, but that for a sole earner in a married couple with two children it is above the OECD average.

¹⁴ This choice of date makes political sense, as it was, at the time of writing (2009) the last time there was a change in government in the UK.

- Introduction of the *Working Tax Credit* for those without children (2003)
- Higher earnings disregards in HB/CTB for families with children (2008)
- Various targeted and time-limited in-work incentive programmes (the Return to Work Credit for older workers, In Work Credit for lone parents (2004 onwards), and another Return to Work Credit piloted as part of Pathways to Work (since 2003, and nationwide from 2008).

3.1 Reforms to increase the requirements placed upon recipients of out-of-work benefits

3.1.1 The New Deal programme

The centrepiece of the Labour Government's welfare to work reforms in its first few years was the *New Deal*. There are a number of New Deals aimed at different groups on welfare, each with differing eligibility requirements and varying degrees of compulsion, but the New Deal generally represents a strengthening of the requirements applicable to recipients of *Jobseekers Allowance*.¹⁵

The New Deal for Young People (NDYP) was introduced across the UK in April 1998; before this time, there was no specific programme for young unemployed people, only for the long-term unemployed. Participation in NDYP is compulsory for all young people aged between 18 and 24 who have been claiming Jobseeker's Allowance (JSA) for at least six months, and involves up to four months of extensive assistance with job search from a personal advisor. If participants have not found employment by the end of this 'gateway' period, then they are offered up to four options, all of which seek to improve their employability (these are: subsidised job placement with training. Education, voluntary or environmental work). By the end of 2004, 38 per cent of participants left for sustained unsubsidised jobs, 11 per cent transferred to other benefits, 20 per cent have left for other known reasons, and the remaining 31 per cent for unknown reasons (section 4 discusses an evaluation of the impact of NDYP).

The national New Deal 25 Plus programme (ND25+) was originally launched in July 1998 and reformed in April 2001. The programme focuses upon the long-term unemployed, with mandatory participation for all individuals who have been claiming JSA

¹⁵ See, for example, DWP (2008a) for more detail.

for 18 of the last 21 months. The programme now shares common features with the NDYP, beginning with an initial ‘gateway’ period lasting for up to four months, followed by an ‘Intensive Activity Period’ typically lasting for no more than 26 weeks, which includes flexible packages of support which can combine work experience/placements, work focused training and help with motivation and soft skills.

There are also a number of voluntary New Deal programmes open to different groups of the inactive or unemployed (New Deal for Lone Parents, New Deal for Disabled People, New Deal for 50 plus and New Deal for Partners). Participants in the programme are assigned a personal advisor, who generally assists with a range of job search activities. Because the programmes are voluntary, they offer only additional support, with no threat of sanctions in the case of non-compliance.

The New Deals are in the process of being replaced with something called the flexible New Deal (FND).¹⁶ Under FND, all JSA claimants will face the same conditions, which will involve intensified job-search activity in months 6-12 of a claim of JSA, and then a referral to an external provider for specialist help and advice if a claim reaches 12 months (DWP, 2007).¹⁷ FND began in parts of Great Britain in October 2008.

3.1.2 Reforms to disability benefits

Since October 2003, the UK Government has been piloting reforms which both provide greater support (financial and non-financial) and impose greater obligations to encourage claimants of incapacity benefits to move into paid work. These were known as the ‘Pathways to Work’ reforms, and they led to the replacement of IB with ESA in 2008 (initially only for new claimants).

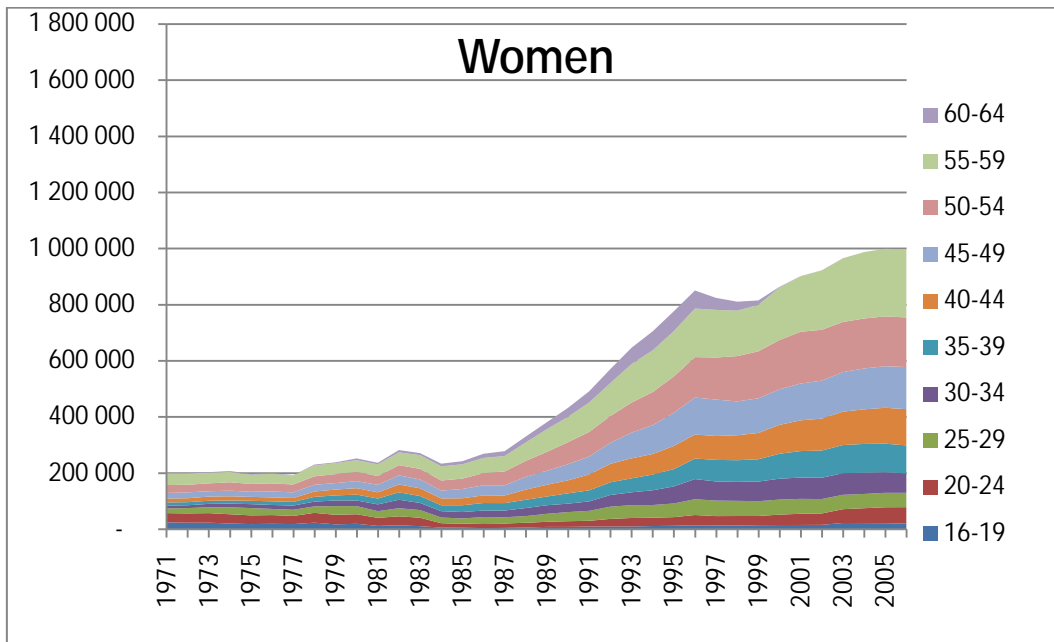
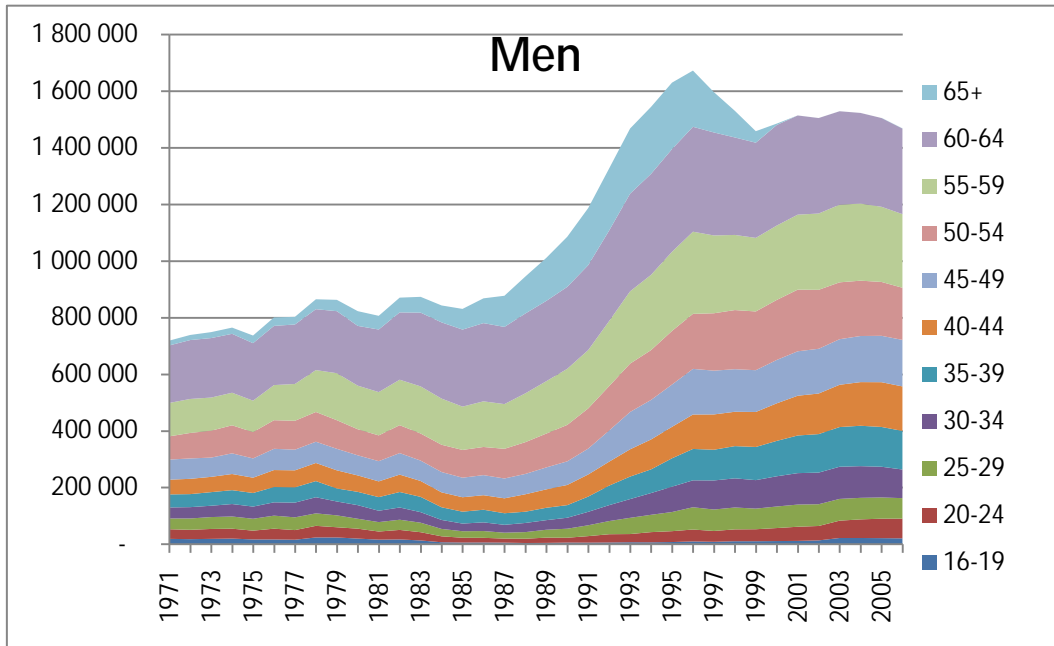
Like other OECD countries, the numbers of individuals claiming incapacity benefits have risen considerably in recent years, more than trebling in GB over the last quarter of a century. Moreover, as shown in *Figure 3.1*, despite the replacement in April 1995 of Invalidity Benefit with Incapacity Benefit – which was designed to have a more strin-

¹⁶ It started in parts of Great Britain (GB) in October 2009, and will be nationwide from October 2010.

¹⁷ The Government has also proposed testing a Community Work Programme for those who are still unemployed after the 12 months with an external provider, although this pilot is not due to start before the next general election. The Government has also proposed testing, from March 2011, a new employment programme which would include both those on unemployment (JSA) and disability (ESA) benefits (ie it would combine FND and Pathways to Work). See (DWP, 2008b) for details on both.

gent health test – the number of claimants of these benefits aged under the State Pension Age has continued to grow between 1995 and the mid-2000s, albeit at a slower rate than over the previous ten years, chiefly because of a sharp rise in female claimants.

Figure 3.1 Number of claimants of Invalidity and Incapacity Benefit aged under the State Pension Age, May 1980 to February 2005 (thousands) (men in top panel).



Source: based on data available from http://www.erini.ac.uk/dsp_sub.cfm/Page/IBGrowth/Parent/. See also Anayadike and McVicar (2008).

Many individuals receiving Incapacity Benefit do so for a long time. When introducing the pilots, the Government estimated that those claiming the benefit for more than twelve months end up claiming for eight years. The reforms piloted were motivated by concerns that the existing arrangement – which placed no requirements on recipients to look for work – did not do enough to encourage claimants back into paid work (a detailed discussion can be found in the Green Paper which proposed the pilots: DWP, 2002). The Pathways to Work package of reforms for new claimants of incapacity benefits included three aspects: mandatory monthly work-focused interviews for the first six months (those with particularly serious medical conditions are exempted), a set of health-related and labour market programmes, and increased financial support and incentives, with a new and generous Return to Work Credit paying £40 a week for the first year of paid employment after leaving incapacity benefits if gross annual earnings are below £15,000.

Pathways to Work was rolled out nationwide in 2008 (it is compulsory for new claimants and existing claimants aged under 25, optional for other existing ones). At the same time, *Incapacity Benefit* was replaced by *Employment and Support Allowance* (ESA), initially for new claimants. The key differences between ESA and IB are:

- ESA is available as a contributory or a means-tested benefit. Under the previous regime, people who had no private income because of disability or poor health were split between two benefits, claiming IB if they had made past National Insurance contributions, and IS if they had not. This change to ESA means that all adults claiming an income support programme because of disability or poor health will be receiving (when the reform is fully phased in) the same benefit (ESA), rather than split across two. This clearly makes the benefit system simpler.
- The generosity of ESA is no greater than JSA for the first 13 weeks. After, it is more generous than JSA only if a person has a serious health condition, or participates in work-related activities. IB, by contrast, placed no requirements on recipients to do anything related to work, and was always more generous than JSA.

- The medical test for ESA (called the Work Capability Test), assesses what people can do, rather than what they cannot do. The Government expected that fewer people taking the test would go on to qualify for ESA than was the case for IB.
- ESA recipients will have their health re-assessed every two years.

As discussed earlier, only new claimants are currently affected by the ESA reform, although the Government has said that it will make all existing IB recipients move to ESA between 2010 and 2013 (a process which, if carried through, will require them to participate in the new, tougher, health assessment).

3.1.3 Changes affecting lone parents

The treatment of lone parents within the UK's income support programmes deserves attention for a number of reasons. First, the UK has internationally high proportions of families with children headed by a lone parent (23% of children live in a lone parent family: see ONS (2009)). Second, lone parents tend to have relatively poor skills, and those in paid work tend to work part-time for relatively low wages, and so whether working or not, they make up a significant proportion of the group likely to be affected by welfare or tax credit reforms. Third, until recently, the UK had relatively generous rules for lone parents who claim welfare benefits: before 2008, lone parents who satisfied the mean-test were allowed to claim *Income Support*, rather than *Jobseekers Allowance*, and thereby excused from any job-search requirements until their youngest child reached 16. No doubt reflecting these points, fewer than half of lone parents were in work in 1997, and relative poverty rates for children in lone parent families were much higher than children in couple families.¹⁸

The first reforms directly affecting lone parents receiving *Income Support* were to require them to meet at least annually with a personal adviser (case worker), whose main aim was to promote the *New Deal for Lone Parents*, in what was called a Work Focused Interview.¹⁹ But a much more dramatic change is currently being phased in, whereby lone parents with no children aged under 7 with no or low private income will,

¹⁸ See Brewer, Muriel, Phillips and Sibieta (2009).

¹⁹ This requirement was fully phased in by 2006. Many of the changes to tax credits, minimum wage, and childcare policies (described in Brewer (2007)) have been of particular help to lone parents.

by 2011, not be entitled to claim IS as a lone parent, and will instead have to claim ESA (if disabled) or JSA (if not).²⁰

3.2 Reforms to strengthen the financial incentive for those receiving out-of-work benefits to move into work.

This section discusses the main reforms which have attempted to strengthen the financial incentive for those receiving out-of-work benefits to move into work. Note that the more important of these do NOT involve reforms to the income support programmes: instead, they involve reforms to the in-work tax credits, or similar programmes.

3.2.1 Replacing *Family Credit* with the *Working Families' Tax Credit*

In October 1999, an in-work benefit programme called *Family Credit* (FC) was replaced with one called *Working Families' Tax Credit*, motivated by concerns to improve the incentives for low-earning parents to be in paid work. In the jargon, WFTC was a 'refundable' tax credit, i.e. payable even if it exceeded the family's income tax liability. To be entitled, at least one adult in a family with children must work at least 16 hours a week. There is a basic credit for each family plus additions for each child, and this is withdrawn once earnings exceed a disregard. The phase-out or withdrawal rate in WFTC was 55%, but this applies to earnings after income tax and social insurance have been deducted, so the usual overall marginal deduction rate for someone receiving WFTC was 69%.²¹

In operational terms, there was little difference between WFTC and its predecessor: for example, WFTC was still subject to strict capital rules, like all welfare benefits in the UK. Some operational differences, though, were that WFTC was administered by the tax authority (not the agency responsible for social security benefits), and that, except where couples with children requested it to be paid to a non-working adult, it was paid to individuals by employers.

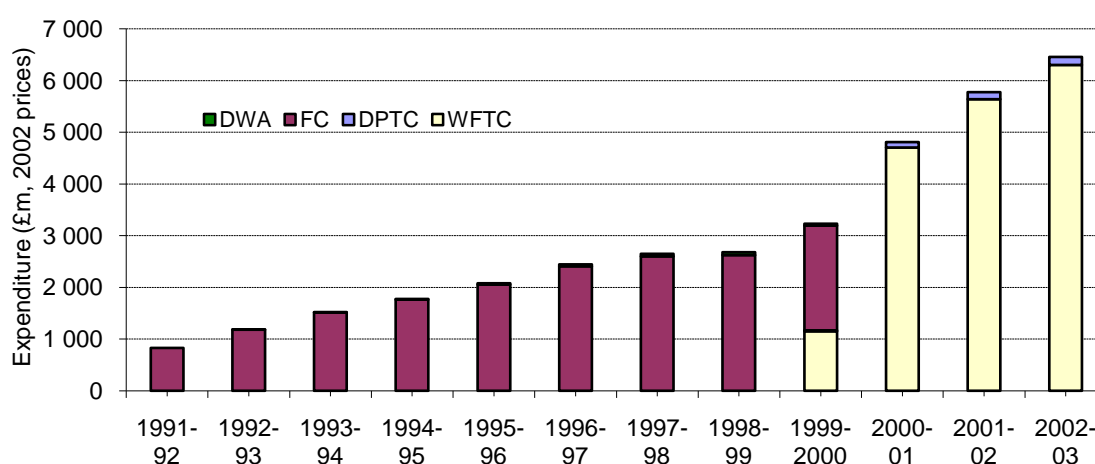
However, the more important difference with FC was that WFTC was substantially more generous, with a higher earnings disregard, a lower withdrawal rate, more gener-

²⁰ See, for example, chapter 2 of DWP (2007) for final details of the plans. Some lone parents will be entitled to claim IS even with older children if they have another reason for being entitled (such as being a carer).

²¹ The equivalent marginal deduction rate for someone receiving tax credits, paying income tax and national insurance is now 70%.

ous entitlements, and a subsidy for childcare expenditures. Overall, these changes substantially increased in-work incomes for eligible families, and the number of eligible families, and the WFTC was approximately twice as expensive as its immediate predecessor: *Figure 3.2* shows that expenditure on employment tax credits almost doubled between 1998–99 and 2000–01, going from £2.68 billion to £4.81 billion in constant 2002 prices. There was a further substantial increase by 2002, to £6.46 billion.

Figure 3.2 Expenditure in-work programmes in Great Britain, 1991/2 – 2002/3



DPTC – disabled person’s tax credit. DWA – disability working allowance.

Note: WFTC replaced FC in October 1999, so there was expenditure on both of them during the 1999–2000 tax year.

Source: taken from Brewer and Browne (2006), based on various sources.

3.2.2 Introduction of the *Working Tax Credit* for those without children

Tax credits were further reformed in 2003 with the introduction of child tax credit (CTC) and working tax credit (WTC), in what was the biggest change in support for children since the introduction of child benefit in 1977. The CTC merged together several parts of the tax and benefit system that supported families with children, and WTC extended in-work support to adults without children. This was the first time that additional support had been offered to non-disabled families without children who were in work but on a low income.

The WTC is less generous than it is for families with children: those without children have to be aged 25 or over, to work full-time (unless disabled or returning to work and aged 50 or over), and to be on very low earnings in order to qualify (a single person

without children working a standard 37.5 hour week would need an hourly wage of below £6.80 – i.e., no greater than 17% higher than the national minimum wage – to qualify in the current financial year). Around 330,000 families without children receive the working tax credit, with most beneficiaries being fairly old: 62% are aged 40 or over, and 32% are aged 50 or over.²² Take-up (programme participation), however, is extremely low by UK standards, at around 1 in 5.²³ The most common stated reason for not claiming was that potential recipients were not aware that they were eligible, perhaps because tax credits for working adults without children are still novel, and information and awareness about them still low.²⁴

3.2.3 Various targeted and time-limited in-work incentive programmes

A feature of welfare to work reforms in the UK in recent years has been the use of time-limited, targeted, back-to-work incentive payments. The key features are:

- Recipients have to be in work
- Recipients have to have previously been receiving an out-of-work benefit
- The payment is only made for a limited period of time (usually a year).

The particular schemes include:

- A 12-month supplement to the WTC for those aged 50 or over who have left an out-of-work benefit and moved into work of at least 16 hours/week. It increases WTC entitlement by up to £37 a week.
- The Return to Work credit, which is payable for up to 12 months to people who have left ESA or IB to move directly into work of at least 16 hours/week and whose earnings do not exceed £15,000 a year. It is worth £40/week.
- The In Work Credit, which is payable for up to 12 months to lone parents who have left an out-of-work benefit to move into work of at least 16 hours/week. It is worth £40/week (£60/week in London).

The Return to Work credit and In Work Credit were initially piloted in parts of the country, but all are now available nationwide.

²² HMRC (2009a),

²³ Or 1 in 4 on an expenditure basis: see HMRC (2009b).

²⁴ See McAlpine and Thomas (2008).

3.2.4 Higher earnings disregards in *Housing Benefit/Council Tax Benefit* for families with children (2008)

In 2008, a change was made to HB/CTB which effectively increased the amount of earnings that are disregarded for families with children when calculating entitlement to HB/CTB if they work 16 or more hours. This reform therefore strengthens the incentive for the primary earner in a family with children to work in jobs of 16 or more hours. The downside is that it increases the range of earnings over which a high METR applies. This is similar to a reform suggested in Bell et al (2007).

3.3 Reforms to benefits and welfare programmes to reduce the impact of the financial crisis/recession

As well as an increase in the funding available to Jobcentre Plus, there are two specific welfare-to-work measures that have been introduced as the result of the recession:

- the Future Jobs Fund
- Job guarantee for young people (“Young Person’s Guarantee”).

The Young Person’s Guarantee is that, from January 2010, all under 24s who have been unemployed for a year will have the chance of a job (possibly through the Future Jobs Fund), work-focused training or a work experience placement in something called the Community Task Force. From March 2010, this will become a condition of receipt of benefit. This is basically an acceleration of something which should happen anyway under the New Deal for Young People, but will now happen after only 12 months of unemployment.

The Future Jobs Fund aims to provide 100,000 new jobs for young people, and 50,000 in areas of high unemployment. Any employer – private, public or voluntary sector – can bid for government funds (up to £6,500 per job) to subsidise the creation of new jobs. The jobs have to pay at least national minimum wage, be full-time, last at least six months, and of benefit to the local community. Additionally, employers have to show that the jobs would not have happened without the Future Jobs Fund.

4 The effects of the reforms

4.1 New Deal for Young People (NDYP)²⁵

Three studies have looked in detail at the NDYP: Blundell et al (2004) looked at the programme in its early days, and De Giorgi (2005a,b) examined whether the early impacts were stable over later cohorts.

Blundell et al (2004) looked at the job assistance and wage subsidy element of the New Deal by examining flows off unemployment to jobs during the first four months of treatment (the “Gateway” period). They present a number of difference-in-differences (DiD) estimators making use of two sources of differential eligibility. First, they look at the first areas to pilot the NDYP, where they are able to use young adults in similar areas not operating NDYP as a control group. Second, they look at a time when the programme ran nationally, and use slightly older (and therefore ineligible) adults as a control group.

They conclude that the outflow rate to jobs has risen by about 20 per cent for young men as a result of the New Deal during its National Roll Out (i.e. five percentage points more men find jobs in the first four months of the New Deal above a pre-program level of twenty five percentage points).²⁶ The results are very similar when using older, ineligible, adults as the comparison group. This suggests that either equilibrium wage and substitution effects are not very strong or they broadly cancel each other out.

The idea of using older, ineligible, adults as a control group was exploited further in De Giorgi (2005a), who estimates a local average treatment effect (LATE) using a non-parametric regression discontinuity. De Giorgi is also able to look at outcomes after a longer period of time (i.e. up to 12 months after starting the gateway, rather than 4 months) and for a series of different cohorts. Reassuringly, the study also finds that the NDYP increases the proportion of unemployed men in work by about 6-7%, and that this impact is relatively stable over time.²⁷

²⁵ This draws on Brewer (2007).

²⁶ Women make up around 1 in 4 participants on NDYP; Blundell et al (2004) reports that the estimated impacts on women were smaller, less precisely estimated, and not robust to the choice of control group.

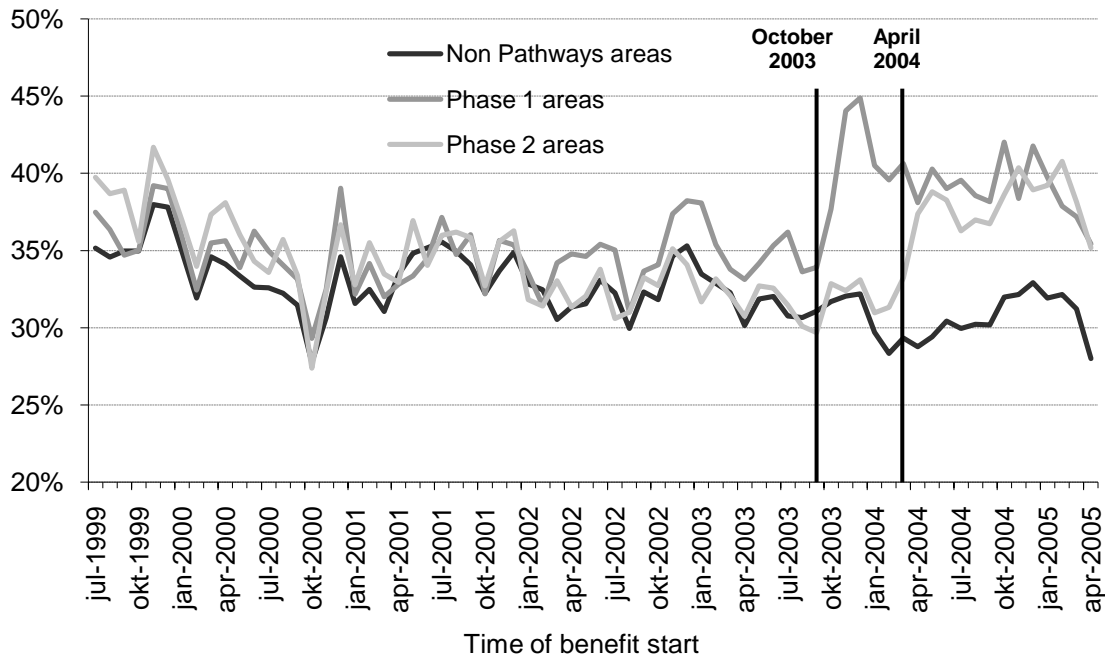
²⁷ NAO (2007) reviews the performance of the New Deals, and estimates that many run at a net cost to the Exchequer (ie the programme costs outweigh the savings from getting people into work faster), but it makes no attempt to do a social cost benefit analysis.

4.2 Pathways to work²⁸

As is common with reforms piloted by the Department for Work and Pensions, the Pathways to Work policies were first introduced in a number of areas. As with the pilots of the NDYP, this naturally suggests a DiD evaluation, using claimants of incapacity benefit in non-pilot areas as a control group.

Figure 4.1 applies this concept to administrative data, and shows that flows off incapacity benefit in the pilot areas were around 8 percentage points higher in the six months after starting a claim than in other areas, and that this effect occurred for both phases of pilots.²⁹

Figure 4.1 Six-months off-flow rate from incapacity benefits, by whether or not subject to the Pathways to Work pilots in October 2003 (Phase 1) or April 2004 (Phase 2).



Source: Blyth (2006).

In a more formal evaluation, *Table 4.1* shows DiD estimates of the outcomes of interest in the Phase 1 and Phase 2 pilots for those who made an enquiry about claiming incapacity benefits (having taking into account background characteristics, time since the enquiry and broad area of residence).

²⁸ This draws on Brewer (2007).

The first column shows the early impact of the Pathways to Work pilots on the likelihood of being in paid work in the week before to the second wave interview (which is on average around 10½ months after the individual made the initial enquiry about claiming incapacity benefits). It shows that the early impact of the Pathways to Work policy was to increase the percentage of individuals doing paid work at that time by 9.4 percentage points. To place this in context, just under one-third (31.9%) of those in the pilot areas in the period after the pilots had been implemented reported that they had been in paid work in the previous week, so the estimated impact suggests that in the absence of these pilots the employment rate in the last week would have been just 22.5% (i.e. 31.9–9.4).

Table 4.1 Difference-in-differences estimates of the early impact, all who made enquiry about claiming incapacity benefits

	Paid work last week (1)	Monthly earnings (2)	Receives incapacity benefits (3)	Reports that “health affects activities” (4)
Estimated treatment effect	9.44*** (2.26)	71.73*** (20.05)	–8.19*** (2.51)	–2.87** (1.40)
Sample size	7,861	7,861	7,861	7,861
Adjusted R ²	14.9%	13.8%	11.0%	34.2%

Note: Unweighted. Standard errors in parentheses. *** denotes that the coefficient is statistically different from zero at the 1% level; ** at the 5% level and * at the 10% level. Other variables controlled for include days since initial enquiry into claiming IB, broad area of residence, and a set of demographic variables, education level and initial health condition.

Source: Derived from tables in chapter 4 of Adam et al (2006b)

The estimates also suggest that the early effects of the pilots were to increase monthly earnings (by £71.73, or over a quarter of total earnings in the pilot areas), reduce the likelihood that an individual was claiming incapacity benefit by 8 percentage points, and reduce the percentage of respondents reporting that their health limited their daily activities. The pilots seem to have been more successful at helping older workers, and those who did not claim to have mental health problems. Subsequent evaluations continued to report positive findings, with a report on longer-term outcomes concluding that “Pathways significantly increased the probability of being employed about a year

and a half after the initial incapacity benefits enquiry by 7.4 percentage points”, and a cost-benefit analysis concluding that “Overall, the financial benefits of Pathways that we estimated significantly exceed the estimated financial costs, with net measured benefits both to Pathways participants and to the Exchequer”.³⁰

4.3 Reforms to in-work benefits and credits³¹

4.3.1 Working Families’ Tax Credit

As one of the highest-profile changes to be made early on by the present UK Government, WFTC has been evaluated in a number of studies, and these are summarised in Brewer and Browne (2006) (hereafter, BB). BB compared a number of studies that had treated the introduction of WFTC as a natural experiment, with one that used a structural model of labour supply to simulate *ex post* the impact of WFTC compared with its predecessor. In general, the results from both sets of studies are reassuringly similar (this can also be viewed as a validation of the structural model).

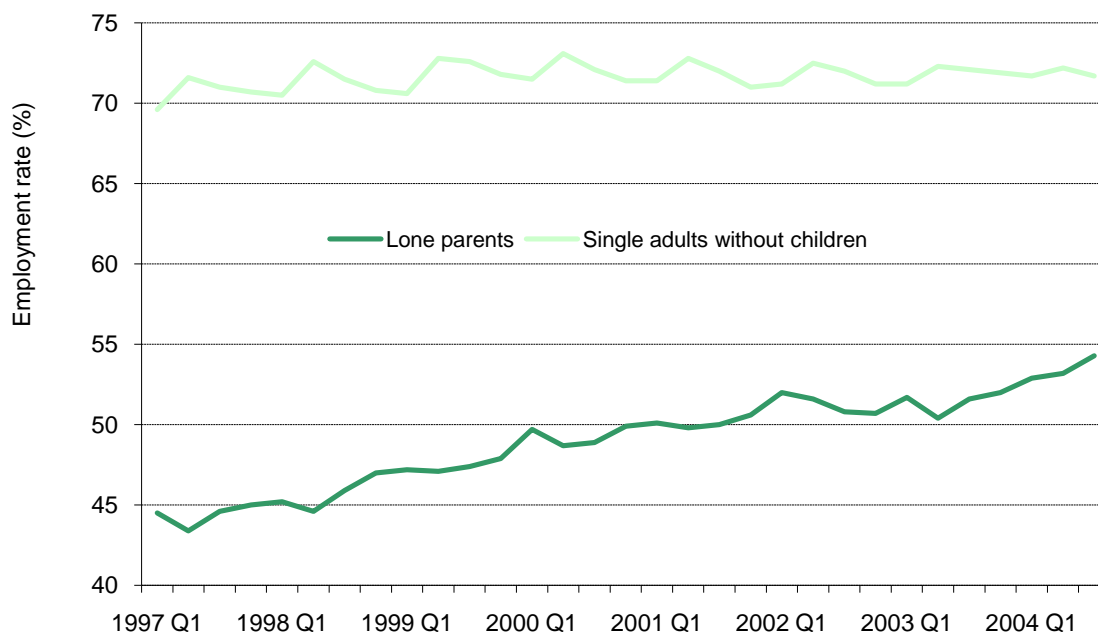
Those studies that treated the introduction of WFTC as a natural experiment used DiD to estimate the impact of WFTC on the employment of families with children, making use of families without children as a control group. The raw data underlying this is shown in *Figure 4.2*: there is a clear convergence in the employment rate of lone parents with single adults without children which would suggest a positive employment effect of WFTC.³²

³⁰ See Bewley et al (2007) and Adam et al (2008).

³¹ This draws on Brewer (2007).

³² In fact, the convergence starts some time before October 1999, and the various studies reviewed by Brewer and Browne (2006) have different ways of accounting for this.

Figure 4.2 Employment rates of single adults by parental status, 1997 – 2004.



Notes: Not seasonally adjusted. The employment rate is calculated as the percentage of the population of working age (16–59 for women and 16–64 for men) who are in employment (working at least one hour in the reference week or temporarily away from a job).

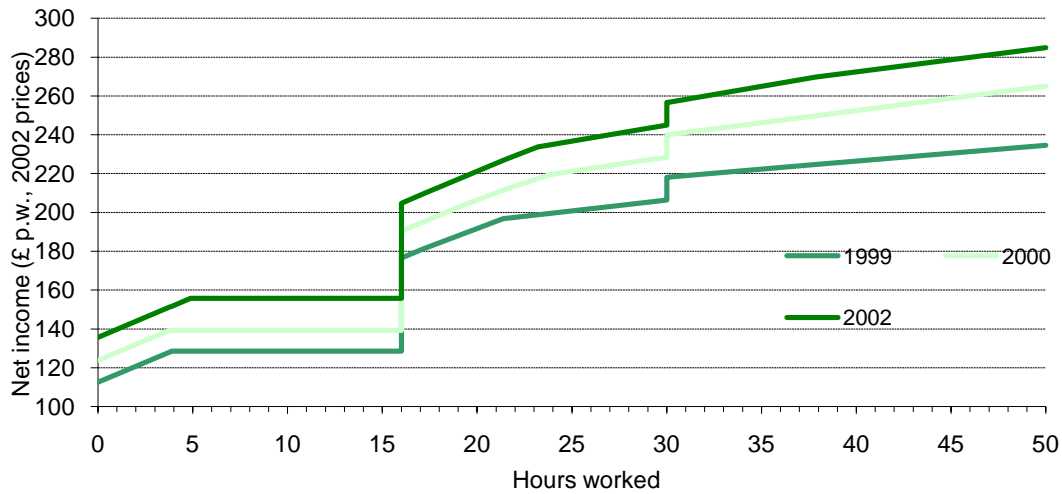
Source: Brewer and Shephard (2005), based on Labour Force Survey data, various years.

One limitation of the DiD approach is that it cannot evaluate the impact of WFTC alone on labour market behaviour of families with children, because WFTC was introduced around the same time as other tax and benefit reforms that affected families with children (see Brewer et al, 2006 or BB for details). Technically, those studies using DiD are evaluating the impact of all changes to the economic and policy environment that affected families with children differently from families without children: the most important of these other than WFTC was an increase in welfare benefits for families with children.

Figure 4.3 and *Figure 4.4* illustrate this by showing the impact of tax and benefit changes between April 1999 and April 2002 (i.e. comparing the situation just before WFTC was introduced to just before CTC and WTC replaced it) on the budget constraints faced by a lone parent and by a mother in a couple respectively, both with two children aged under 5 and earning the 2002 minimum wage. *Figure 4.3* makes clear that the income available to a lone parent who was not working increased substantially over this period, although by slightly less than the income available to a low-earning working

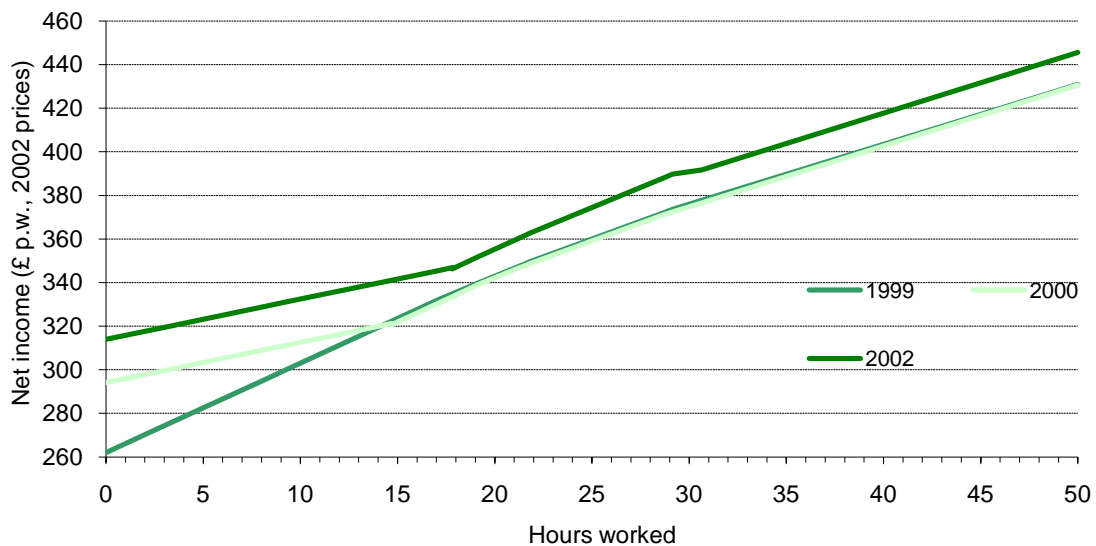
lone parent. *Figure 4.4* shows that the income available to the family when the second earner does not work increased substantially, but the income available to the family when both adults worked increased by much less, consistent with a higher PTR.

Figure 4.3 Change in the budget constraint for a lone parent with two children under 5, April 1999 to April 2002



Note: Assumes hourly wage of £4.10, no housing costs or council tax liability, no entitlement to child support and no childcare costs.

Figure 4.4 Change in the budget constraint for mother in couple with two children under 5, April 1999 to April 2002



Notes: Assumes hourly wage of £4.10, no housing costs or council tax liability and no childcare costs. The first earner in the couple is assumed to earn £300 per week in 2002 prices.

A structural model of labour supply tries to relate directly choices of whether and how much to work to the inherent financial incentives. WFTC was both more generous

and more slowly withdrawn than its predecessor, so economic theory predicts different impacts on different groups of parents. In particular, the increase in generosity would:

- for adults in workless families, lead to a stronger incentive to work 16 or more hours per week. We would therefore expect some currently workless families to participate as a result of this reform, and also some parents currently working less than 16 hours per week to move over the threshold.
- lead to a reduction in the number of two-worker families, when two-worker families found they needed to work a little less hard in order to achieve their pre-reform standard of living (an income effect away from work).

The lower withdrawal rate would also have different effects on adults in different families depending on their income:

- For those previously claiming FC, there would be an increase in the return to an extra hour's work as a result of the lower withdrawal rate, leading to an increase in the number of hours worked (a substitution effect towards work).
- On the other hand, those who previously earned too much to claim FC but who were now eligible for WFTC would experience a substitution effect away from work.

Table 4.2 shows the results of the simulations of WFTC alone on lone parents: employment is predicted to rise by 5.1 ppts (from 49.6 %), and mean hours worked increases amongst workers (because the lower withdrawal rate increased incomes the most where the taper previously ended, usually corresponding to full-time work). Much of this shift seems to have been into full-time work, and there also seems to have been a considerable shift among lone mothers from part-time to full-time work. However, the reforms implemented at the same time as the WFTC acted to reduce employment amongst lone parents, and a simulation of the set of changes actually introduced between 1999 and 2002 (not shown here) suggests that tax and benefit changes increased lone parent employment by 3.7 ppts.

Table 4.2 The estimated impact of WFTC on lone mothers' labour supply

		After WFTC			
		Not working	Part-time	Full-time	Total
Before WFTC	Not working	49.6	2.4	2.8	54.7
	Part-time	0.00	22.4	1.1	23.5
	Full-time	0.0	0.41	21.4	21.8
	Total	49.6	25.2	25.2	100.0
Change in employment rate					5.1 (0.68)
Average change in weekly hours (all)					1.78 (0.21)
Average change in weekly hours (workers)					0.75 (0.05)
Average hours before WFTC (all)					12.42 (0.20)
Average hours before WFTC (workers)					27.4 (0.16)

Notes: based on Table 4 in Brewer et al (2006). Estimated standard deviations given in brackets.

Estimate of the overall impact on employment are given in *Table 4.3*: although the impact of WFTC on lone parents employment is relatively high, the impact on adults in couples with children is broadly neutral, and those reforms implemented at the same time as WFTC acted to reduce labour supply. The combined effect of 22,000 workers corresponds to less than 0.1 ppt of the total workforce.

Table 4.3 The Estimated Impact of WFTC on total employment

	Lone mothers	Mothers in couples	Fathers in couples	Total
WFTC	75,000	-21,000	27,000	81,000
WFTC and contemporaneous reforms	55,000	-18,000	-15,000	22,000

Notes: based on Table 4 in Brewer et al (2006).

4.3.2 Working Tax Credit for those without children

The only evaluation of the introduction of the working tax credit for those without children was undertaken by two economists at HM Treasury, and published as HM Treasury (2008). It compares the probability of employment of low-educated 25-27 year-olds with 22-24 year olds, and how this changes when the WTC is introduced. The paper presents evidence that the probability of employment of the affected group did indeed rise shortly after the introduction of WTC relative to the younger adults, by between 2

and 3 ppts, depending on the specification. However, the number of 25-29 year olds actually in receipt of WTC in this period was extremely low, and the estimated impact of WTC implies that the majority of them would not have worked in the absence of WTC: this seems a very high responsiveness (or, equivalently, a very low deadweight) for an in-work benefit, and might suggest that the estimated impact is partly capturing contemporaneous changes in the labour market or welfare system. Furthermore, the majority of WTC recipients are aged 40 or over, and it is not clear how good a guide the estimated impacts for young adults are to the impacts for older individuals.

4.3.3 Targeted, time-limited in-work benefits and credits

Chapter 3 discussed the recent use of time-limited, targeted, back-to-work incentive payments. A key evaluation question is whether recipients discount such incentives because they are time-limited, and, if there are any impacts, to what extent they persist after the payments stop (Card and Hyslop (2005) evaluate the labour market impact of a time-limited in-work payment in Canada).

Only one of these, the In Work Credit for lone parents, has been evaluated thoroughly (Brewer et al, 2009).³³ After 12 months exposure, the proportion of lone parents who were potentially eligible for IWC (in other words, those who could have received IWC had they left benefits and started work) had risen by 1.6 ppts from a base of around 18%. Amongst IWC recipients, IWC was estimated to increase the proportion who were no longer receiving benefit by 29% averaged over the 2 years since first receiving IWC. Brewer et al (2009) argue that these impacts are much smaller than for conventional in-work credits, and at least as large as other welfare to work interventions for lone parents in the UK, but a cost-effectiveness calculation has not been carried out.

5 Summary and conclusions

- The UK's approach to social insurance can be characterised as "basic security", with relatively modest benefits which are typically flat-rate. Most claimants of the key unemployment and disability benefits are claiming a means-tested vari-

³³ The Return to Work credit has been evaluated as part of the Pathways to Work package (see Adam et al (2008)), but the evaluation could not separate out the impact of the credit from the other parts of Pathways to Work.

ant. Social partners play very little role in the design or administration of social insurance or social assistance or labour market programmes for the unemployed. Local government has almost no role in the design or funding of benefits.

- Compared with the EU average, the UK has relatively high employment rates for men and women. The employment gap between men and women, particularly mothers, continues to close. The employment rate of older workers is lower than younger workers, but rising over time, and so converging with that of younger workers. A high proportion of non-workers say that they are not working because of illness or disability. The tax wedge on those on average earnings is below the OECD average for single adults, but above it for single-earner married couples with two children.
- The UK's system of income-replacement benefits tries to categorise claimants according to the reason they are out-of-work and needing state support (sick or disabled, jobseeking, caring, other). Whether they have made contributions to social insurance in the past is not particularly relevant to their entitlement to such benefits or their generosity: the current government has continued the long-run trend to diminish the role of social insurance by reducing the value of social insurance benefits down to that of the means-tested equivalents.
- In general, the relatively low generosity of out-of-work benefits means that RRs and PTRs remain below 100% for most. However, the income-replacement benefits have a negative impact on incentives to work through maximum hours rules ("claimants may work no more than X hours/week"), only some of which are directly offset by the *Working Tax Credit*. High withdrawal rates mean that weak work incentives also exist for those who rent and are entitled to *Housing Benefit*, and for primary earners in couples who have low earnings. The fact that in-work tax credits have increased so much in generosity over the last decade means that incentives to work for potential second earners are weaker than they used to be.
- Most recent reforms to strengthen work incentives have NOT involved changing the out-of-work benefits, but instead have altered the in-work benefits or tax credits, or lowered income tax and *National Insurance* liabilities for low earners.

Such reforms are expensive compared to their impact on employment, and only make sense if the Government values their redistributive features. Most reforms to the out-of-work benefits have involved increasing the job-search or other requirements placed on claimants, and this has so far applied to the unemployed, the sick and disabled, and lone parents with children aged over 7.

- The recession has led to changes in welfare-to-work policies for the under 24s, with the government aiming to create 100,000 more jobs, and to make it compulsory for young people to undertake training or work experience in community projects after a year of unemployment.
- The precise future of welfare reform in the UK will depend on which party is in power after the election, expected in Spring 2010, but the two main political parties are broadly in agreement that the future will involve extending conditions placed to other recipients of income-replacement benefits, moving all IB claimants to ESA, a greater use of the private sector, and gradually aligning the labour market programmes for the unemployed and disabled.
- Key aspects of the UK experience which should be of interest to other EU countries are: i) the use of in-work tax credits to offset the detrimental impact on work incentives of the income-replacement benefits; ii) the way that insurance-based benefits and social assistance are treated as a single system; iii) the way that the number of income-replacement benefits is being (slowly) reduced, and the way that the welfare-to-work programmes for different types of claimants of income-replacement benefits are (gradually) being aligned. Remaining challenges for the UK, in the author's opinion, include: i) dealing with the very large stock of IB recipients, many of whom will not have worked for several years; ii) the complexity and poor administration of the in-work tax credits, which reduces transparency and thereby dulls their positive impact on work incentives; iii) the substantial disincentive to work caused by the structure of and poor administration of *Housing Benefit*.

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Annex A

This Annex is taken from <http://www.ifs.org.uk/bns/bn13.pdf>

Table A.1 GB Expenditure and claimant figures for all benefits and tax credits, 2007–08

	Expenditure (£m) ^a	% of total expenditure	Claimants ^b
Benefits for families with children			
Child benefit (including former one-parent benefit)	10,650 ^c	6.74%	7,579,700
Child Trust Fund	168 ^d	0.11%	Not available
Child tax credit	13,700 ^{c,e}	8.67%	6,131,000 ^f
Statutory maternity pay	1,469	0.93%	Not available ^g
Maternity allowance	247	0.16%	52,400
Guardian's allowance	1.9	0.00%	3,400 ^h
Education maintenance allowance	567 ⁱ	0.35%	610,000 ⁱ
Total benefits for families with children	26,796	16.96%	
Benefits for unemployed people			
Income-based jobseeker's allowance	1,816	1.15%	935,400
Contribution-based jobseeker's allowance and UB	427	0.27%	378,200
New Deal programmes (Young Persons and 25-Plus)	110	0.07%	157,990 ^c
Job grant	49	0.03%	Not available
Total benefits for unemployed people	2,402	1.52%	
Benefits for people on low incomes			
Income support	8,948	5.67%	2,045,220
Working tax credit	5,800 ^{c,e}	3.67%	2,261,000
Housing benefit	15,752	9.97%	4,403,980
Discretionary housing payments	20	0.01%	122,330 ^h
Council tax benefit	4,124	2.61%	5,428,230
Social Fund payments	419	0.27%	12,035,000 awards
Total benefits for people on low incomes	34,954	22.13%	
Benefits for elderly people			
Basic retirement pension (contributory)	47,369	29.99%	12,226,260
Basic retirement pension (non-contributory)	40	0.03%	26,300 ^o
Earnings-related retirement pension	10,184	6.45%	Not available
Pension credit	7,463	4.72%	2,723,610
<i>Retirement pension – total</i>	<i>65,056</i>	<i>41.19%</i>	
Winter fuel payments	2,071	1.31%	12,123,000
Concessionary television licences	510	0.32%	3,993,000
Total benefits for elderly people	67,637	42.82%	

	Expenditure (£m)^a	% of total expenditure	Claimants^b
Benefits for sick and disabled people			
Statutory sick pay	48	0.03%	Not available
Incapacity benefit	6,658	4.22%	2,221,890
Employment and Support Allowance	- ^p	-	87,000
Severe disablement allowance	756	0.48%	243,200
Disability living allowance	9,867	6.25%	3,043,990
Attendance allowance	4,444	2.81%	1,578,640
Carer's allowance	1,280	0.81%	502,500
Independent Living Funds	299	0.19%	21,000
Motability	12	0.01%	500,000
Industrial injuries benefits	798	0.51%	327,260 ^k
War pensions ^m	1,014 ^c	0.64%	190,745
Total benefits for sick and disabled people	25,316	16.03%	
Benefits for bereaved people			
Widows' and bereavement benefits	683	0.43%	60,720 ⁿ
Industrial death benefit	38	0.02%	9,000
Total benefits for bereaved people	721	0.46%	
Other benefits			
Christmas bonus	153	0.10%	Not available
Other small benefits	1	0.00%	Not available
Total other benefits	154	100	
TOTAL	157,987		

For notes, see next page.

Notes to Table A.1

a Figures are estimated out-turns. They may not sum exactly due to rounding.

b Details of the date on which the claimant count for each benefit was taken are given in the relevant part of Section 3 of this survey.

c UK expenditure.

d This is an estimate of UK expenditure for 2007–08 from HMRC's Revenue and Customs Account, available at <http://www.hmrc.gov.uk/about/hmrc-dep-acct0708.pdf>

e These figures are taken from HMRC's Revenue and Customs Account for 2007–08. They represent final entitlements rather than payments made, and thus do not include any impact of overpayments. Total payments made differ from final entitlement for working tax credit and child tax credit by £0.5bn, however a detailed split between working tax credit and child tax credit is not available. Note that, unlike the figures for the number of families (see note f), these figures do not include payments made to families receiving the equivalent amounts via out-of-work benefits, which are estimated to have totalled £1.7 billion in 2007–08 (see footnote 10). Such spending is included within the relevant benefits.

f Number of families, covering 10.1 million children, as at April 2009. This figure includes both in-work families receiving the child tax credit (4.7 million) and out-of-work families receiving the child tax credit or the equivalent amount via out-of-work benefits (1.4 million). Source: National Statistics, Child and Working Tax Credits Statistics: April 2009, available at <http://www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-apr09.pdf>

g Data is no longer centrally collated for Statutory Maternity Pay.

h Figure for December 2008 courtesy of HM Revenue and Customs.

i These figures are the sum of figures from England, Wales and Scotland for 2007/08 and refer to those that have received at least one payment in the year. Source: English figures from Learning and Skills Council, EMA Take Up Data July 2008, available at <http://www.lsc.gov.uk/aboutus/annualreport/annualreport0708/>. Welsh figures from the Welsh assembly government http://www.assemblywales.org/el_3__11-09__p1__fforwm_written_evidence_on_ema_-_e.pdf

Scottish figures from the Scottish Executive: <http://www.scotland.gov.uk/Topics/Statistics/Browse/Lifelong-learning/PublicationEMA2007-08>

j Figure courtesy of Department for Work and Pensions

k Includes industrial injuries disablement benefit, reduced earnings allowance and retirement allowance (see Section 3.5.8 and Appendix B). Claimant figures are as of December 2008; note that more than one assessment may be awarded to an individual. Source: Department for Work and Pensions, Industrial Injuries Disablement Benefit Quarterly Statistics: December 2008, available at <http://statistics.dwp.gov.uk/asd/iidb.asp>

Other benefits not included in this figure are the worker's compensation supplementation scheme and the pneumoconiosis, byssinosis and miscellaneous diseases benefit scheme (both payable to people who contracted certain industrial illnesses prior to 5 July 1948). Expenditure on these schemes amounts to around £1 million.

l Figures include both war disablement and war widow(er)'s pensions.

m This figure includes claimants of bereavement allowance and widowed parent's allowance; claimants of the war widow's pension are included in the war pensions statistics (see note l above).

o Figure for September 08.

p Expenditure figure for 2008/09 is £140 million (not included in total for 2007-08), forecast only.

Sources: Department for Work and Pensions, http://research.dwp.gov.uk/asd/asd4/medium_term.asp for benefit expenditure information; HMRC's Revenue and Customs Account for 2006–07, <http://www.hmrc.gov.uk/about/hmrc-dep-acct0708.pdf>; Ministry of Defence, <http://www.mod.uk/DefenceInternet/AboutDefence/CorporatePublications/AnnualReports/MODAnnualReport0809/> for war pensions expenditure information; Learning and Skills Council, <http://www.lsc.gov.uk/aboutus/annualreport/annualreport0708/> for education maintenance allowance information.

Table A.2 Benefits for Sick and Disabled People

	Benefit	T	C	M	Claimants, as at Feb. 2007 ^a	Expenditure, 2006–07 (£m) ^b
	Statutory sick pay	Û	Û	Û	Not available	85
	Incapacity benefit	Û	Û	Part	1,440,930 ^c	6,545
	Disability living allowance	Û	Û	Û	2,860,790 ^d	9,156
	Carer's allowance	Û	Û	Û	463,500 ^f	1,191
	Industrial injuries benefits	Û	Û	Û	334,240 ^g	752

T = taxable, C = contributory, M = means-tested

^a Unless otherwise specified.

^b Estimated.

^c Recipients (as at February 2007); there were 2,433,400 claimants during the same period, i.e. approximately 60 per cent of claimants received an award. Source: Department for Work and Pensions, *Incapacity Benefit tabulation tool*, available at http://83.244.183.180/100pc/ib/tabtool_ib.html

^d Source: Department for Work and Pensions, *Quarterly Statistical Summary: November 2007*, available at http://www.dwp.gov.uk/asd/asd1/stats_summary/Stats_Summary_Nov_2007.pdf

^f Source: Department for Work and Pensions, *Quarterly Statistical Summary: November 2007*, available at http://www.dwp.gov.uk/asd/asd1/stats_summary/Stats_Summary_Nov_2007.pdf

^g Includes both war disablement and war widow's pensions.

^h As at 31 March 2007. Source: Defence Analytical Services Agency, *War Pensions – Quarterly Statistics*, available at www.dasa.mod.uk/natstats/pensions/pensionstab11.html.

ⁱ Estimate of planned UK expenditure for year 2006–07. Source: Ministry of Defence, *Ministry of Defence: The Government's Expenditure Plans 2006/2007 to 2007/2008*, available at: http://www.mod.uk/NR/rdonlyres/A556F11A-E9A4-4330-A96A-898A0B760808/0/gep_0607to0708.pdf

^j Includes industrial injuries disablement benefit, reduced earnings allowance and retirement allowance (see Section 3.5.7 and Appendix B). Other benefits not included in this figure are the worker's compensation supplementation scheme and the pneumoconiosis, byssinosis and miscellaneous diseases benefit scheme (both payable to people who contracted certain industrial illnesses prior to 5 July 1948). Expenditure on these schemes amounts to around £1 million. Assessments as of March 2007; note that more than one assessment may be awarded to an individual. Source: Department for Work and Pensions, *Industrial Injuries Disablement Benefit Quarterly Statistics: March 2007*, available at http://www.dwp.gov.uk/asd/asd1/iidb/iidb_quarterly_mar07.xls

Table A.3 Benefits for Unemployed People

	Benefit	T	C	M	Claimants, as at Feb. 2007 ^a	Expenditure, 2006-07 (£m) ^b
	Income-based jobseeker's allowance	Ü	û	ü	716,900 ^c	1,962
	Contribution-based jobseeker's allowance	Ü	ü	û	161,100 ^c	478

T = taxable, C = contributory, M = means-tested

^a Unless otherwise specified.

^b Estimated.

^c Source: Department for Work and Pensions, *Jobseeker's Allowance Claimants tabulation tool*, available at http://83.244.183.180/5pc/jsa_prim/tabtool_jsa_prim.html

Table A.4 Benefits for People on low incomes

	Benefit	T	C	M	Claimants, as at Feb. 2007 ^a	Expenditure, 2006-07 (£m) ^b
	Income support	û	û	ü	2,134,170 ^c	6,823
	Working tax credit	û	û	ü	1,988,000 ^d	6,200 ^e
	Housing benefit	û	û	ü	4,039,700 ^f	14,858
	Council tax benefit	û	û	ü	5,096,600 ^f	4,072

T = taxable, C = contributory, M = means-tested

^a Unless otherwise specified.

^b Estimated.

^c Source: Department for Work and Pensions, *Income Support tabulation tool*, available at http://83.244.183.180/100pc/is/tabtool_is.html

^d Number of families (including both individuals and couples, regardless of whether they have children), as at April 2007.

^e This figure is taken from HMRC's Resource Accounts and Trust Statement for 2006-07, available at <http://www.hmrc.gov.uk/about/hmrc-06-07-acc.pdf> It represents final entitlements rather than payments made, and thus does not include any impact of overpayments. Total payments made exceeded final entitlement for working tax credit and child tax credit by £0.7 billion; however, a detailed split between working tax credit and child tax credit is not available. The figure relates to UK rather than GB expenditure.

^f Source: Department for Work and Pensions, *Housing Benefit & Council Tax Benefit Quarterly Summary Statistics: February 2007*, available at http://www.dwp.gov.uk/asd/asd1/hb_ctb/hb_ctb_quarterly_feb07.asp.

Annex B. Income support systems in the UK

This Annex gives more details of the main income support systems. We follow Minas et al (2009), and characterise them into:

- Sickness, work accident and disability
- Unemployment
- benefits for full-time carers
- Social assistance
- Old-age pensions

There are no programmes for early retirement. The Annex also discusses what are known in the UK as “extra costs benefits”: child tax credit, disability living allowance and housing benefit and council tax benefit.

B.1 Sickness, work accident and disability

Statutory sick pay (SSP) is a benefit paid by employers to employees who are incapable of work. It is a legal minimum, and many employers pay more than this amount. Almost all of the cost of SSP is reclaimed from the government. SSP cannot be claimed by employees on contracts of less than three months, or if weekly earnings are less than the lower earnings limit, currently £87 per week. It is payable at a weekly rate of £72.55, and for a maximum of 28 weeks. The total cost of SSP in 2006–07 was estimated to be around £85 million, but it is not known how many people received SSP.

Adults who have no (more) entitlement to SSP and who are incapable of work through sickness or disability may be able to claim *Employment and Support Allowance* (ESA). In addition to having “limited capability for work”, adults wishing to claim ESA must:

- Have made sufficient national insurance contributions, or:
- Live in a family which satisfies the means-test, or:
- Be under 20.

ESA can therefore be claimed by adults who have no recent work history or contributions record, but only if they and their partner satisfy the means-test. The amount of ESA payable does not reflect previous earnings. The contributions-based ESA is paid at different rates to the means-tested ESA, and it is possible to receive contribution-based

ESA with an means-tested ESA top-up.. A major way in which ESA affects incentives to work is that recipients are, in general, not permitted to work while receiving ESA.

Industrial injuries disablement benefit (IIDB) is payable to individuals who have suffered injury in an industrial accident, or who have contracted an industrial disease while at work, and as a result, experience loss of faculty and are consequently considered to be at least partially disabled. But spending on ESA (and its predecessor) is an order of magnitude larger than spending on IIDB.

In addition to these, the main benefit for working-age adults who are disabled is *Disability Living Allowance (DLA)*. This is intended to cover the additional costs incurred by disabled people. It is not based on past contributions, nor is it means-tested, and so has minimal impact on incentives to work.

B.2 Unemployment

The benefit for unemployed people is known as *Jobseeker's Allowance (JSA)*. Like ESA, (and in addition to being out-of-work, being available for work, and looking for work), adults wishing to claim JSA must:

- Have made sufficient national insurance contributions, or:
- Live in a family which satisfies the means-test.

Contributions-based JSA is payable at a flat-rate (ie unrelated to past earnings), and only for 6 months. Income-related JSA is paid at an amount which depends on the claimant's family's circumstances, and can be paid indefinitely. It is possible to receive contribution-based JSA with an income-based JSA top-up. JSA can therefore be claimed by adults who have no recent work history or contributions record, but only if they and their partner satisfy the means-test.

All JSA recipients have to be “actively seeking work”, but those who have been claiming for long durations will have to enrol in a programme known as the *New Deal*, which can be thought of as an active labour market programme offering greater support but with a higher degree of compulsion. As chapter 3 describes, the Government is currently changing some of these rules as it introduces the Flexible New Deal.

JSA affects incentives to work in the following ways:

- JSA claimants cannot work 16 or more hours a week (and partners of JSA claimants who are claiming income-related JSA cannot work 24 or more hours a week)
- For work of fewer than 16 hours a week, the income-related JSA has a 100% benefit withdrawal rate after a very low disregard.

This means that JSA claimants have very little financial incentive to work in jobs of fewer than 16 hours a week, and – before considering any in-work support such as WTC – a substantial disincentive to work more than 16 hours a week. On the other hand, JSA recipients should lose their entitlement if they do not take sufficient steps to look for work, or they refuse certain job offers.

B.3 Benefits for full-time carers

Carer's allowance (CA), is payable to adults who care full-time for a person who is receiving certain kinds of disability benefit. Nearly 75 per cent of claimants are female.

CA affects incentives to work in two ways:

- recipients of CA who wish to claim a means-tested top-up may claim IS rather than JSA (and therefore are not required to look for work).
- recipients of CA may not earn more than £87 per week.

B.4 Social assistance (*Income Support*)

The main social assistance benefit for people who are not in work is *Income Support* (IS). However, as discussed above, the main unemployment and sickness benefits in the UK (*JSA* and *ESA*) are not pure insurance-based benefits, and have means-tested components to them. This means that a better way to think about social assistance in the UK is as follows:

- non-working adults who are sick or disabled and who want to claim social assistance and should claim *ESA*;
- non-working, non-disabled adults who fall into various categories (mostly full-time carers) and who want to claim social assistance may claim *IS*
- non-working, non-disabled adults who may not claim *IS* and who want to claim social assistance will have to claim *JSA*.

In general, ESA is the more generous benefit. Entitlement to IS and JSA should generally be identical: the difference is that JSA recipients have to be actively seeking work and can lose their entitlement if they do not satisfy various conditions.

IS affects incentives to work in the following ways:

- IS recipients cannot work 16 or more hours a week
- For work of fewer than 16 hours a week, IS has a 100% benefit withdrawal rate after a very low disregard.

This means that IS recipients have very little financial incentive to work in jobs of fewer than 16 hours a week, and – before considering any in-work support such as WTC – a substantial disincentive to work more than 16 hours a week.

B.5 Housing Benefit and Council Tax Benefit

Housing benefit (HB) is payable to families with low incomes who rent their homes (for families who own their own homes, mortgage interest payments may be met through means-tested JSA or IS). People on IS or the means-tested JSA are entitled to the full level of HB. For other claimants, the amount of HB payable depends upon income in much the same way as for IS or income-based JSA.

The amount of HB actually received depends on the claimant's household income and the level of rent. Council tax benefit (CTB) is payable to families with low incomes who are liable to pay council tax on a property in which they are resident. Many of the conditions for claiming are the same as those for HB. People on IS, income-based JSA or the guarantee element of the pension credit are automatically passported to maximum CTB.

B.6 The child and working tax credit

The child tax credit (CTC) is a means-tested cash payment for families with children. is made up of a number of elements: a family element, a baby element (for families with a child under the age of 1), a child element, a disabled child additional element and a severely disabled child supplement. Entitlement to CTC does not depend on employment status, but does require that the claimant be responsible for at least one child under the age of 16 (or aged 16–19 and in full-time education). Around 9 out of 10 families with children were entitled to some CTC.

Working tax credit (WTC) provides in-work support for low-paid working adults. Families with children, and workers with a disability, are eligible for WTC provided at least one adult works 16 or more hours per week. Workers with no children and no disability are only eligible if they are aged 25 or over and work at least 30 hours per week. There is a basic element, with an extra payment for couples and lone parents (i.e. for everyone except childless single people), as well as an additional payment for those working at least 30 hours per week (30 hours *in total* for couples). WTC also includes supplementary payments for disability, severe disability and those over 50 returning to work.

CTC and WTC are subject to a single means test operating at the *family* level.

B.7. Disability Living Allowance

This is a non-means-tested, non-contributory benefit available to people with long-term illnesses or disabilities. It does not depend on the work status of the claimant. DLA is paid if claimants need to be cared for, or have mobility problems.

B.8 Old-age pensions

The focus of this paper is working-age adults, so old-age pensions are not discussed in detail. The main points are that:

- The basic state pension is payable at age 65 for men, and age 60 for women (this will be equalised with men between 2010 and 2020).
- There is no earnings-test to the basic state pension, and so recipients may continue to work. This means that the only impact on incentives to work is through an “income effect”. Individuals may defer receipt, in return for a lump-sum or permanently higher state pension, but few actively do. Because people can receive the state pension and work, the decision about whether to defer is mostly an investment decision, although people may wish to consider the timing of their income.
- From age 60, both men and women are entitled to a substantially more generous form of social assistance (known as *Pension Credit*).

There is no form of early retirement pension, although individuals with private pensions can start to draw down their pension pots from aged 50 (this is due to move to 55).

Annex C. More example budget constraints

Figure C.1 Budget constraints for couple with children without HB, 2009–2010 tax and benefit system, £6/hour, 2 children, no childcare.

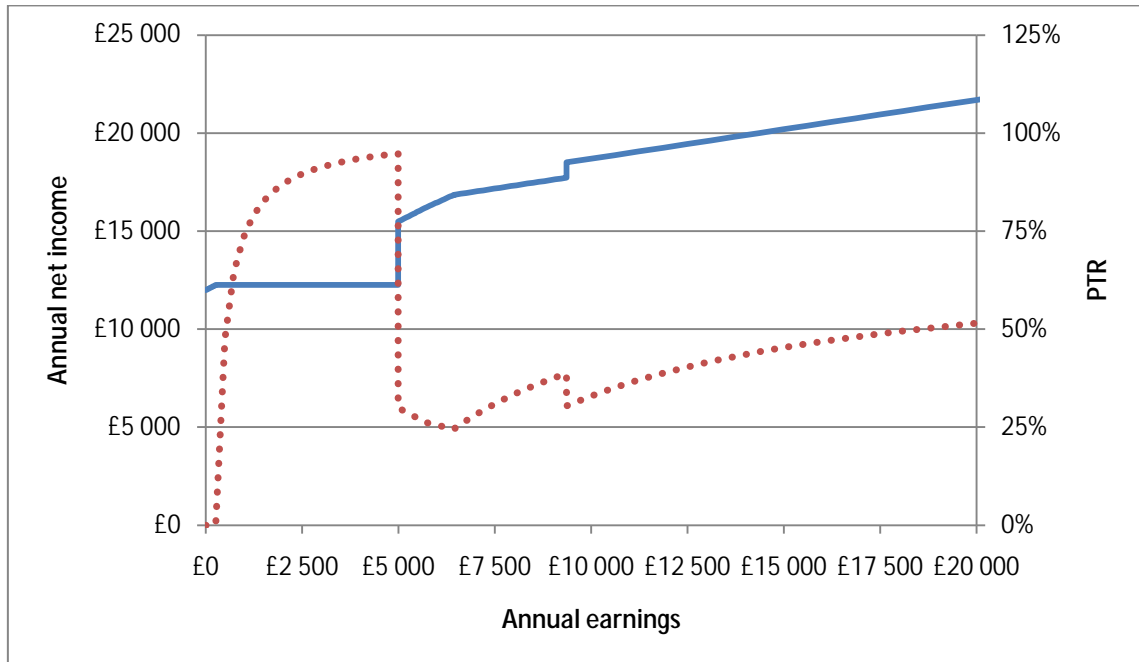
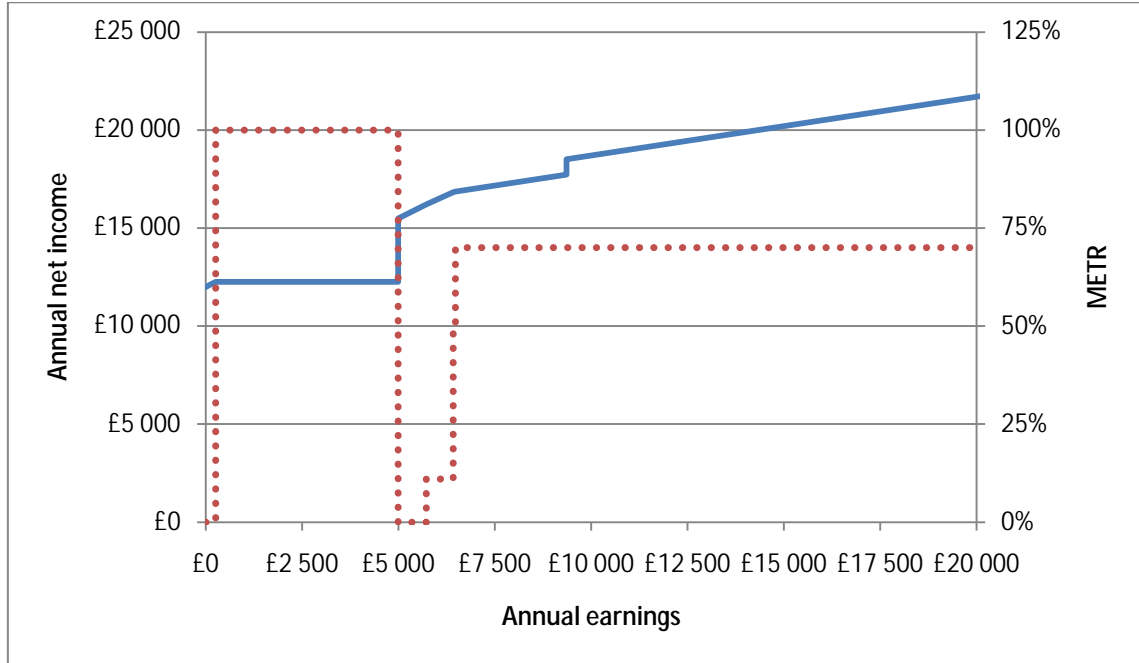


Figure C.2 Budget constraints for couple with children with HB/CTB, 2009-2010 tax and benefit system, £6/hour, 2 children, no childcare, £70/wk rent.

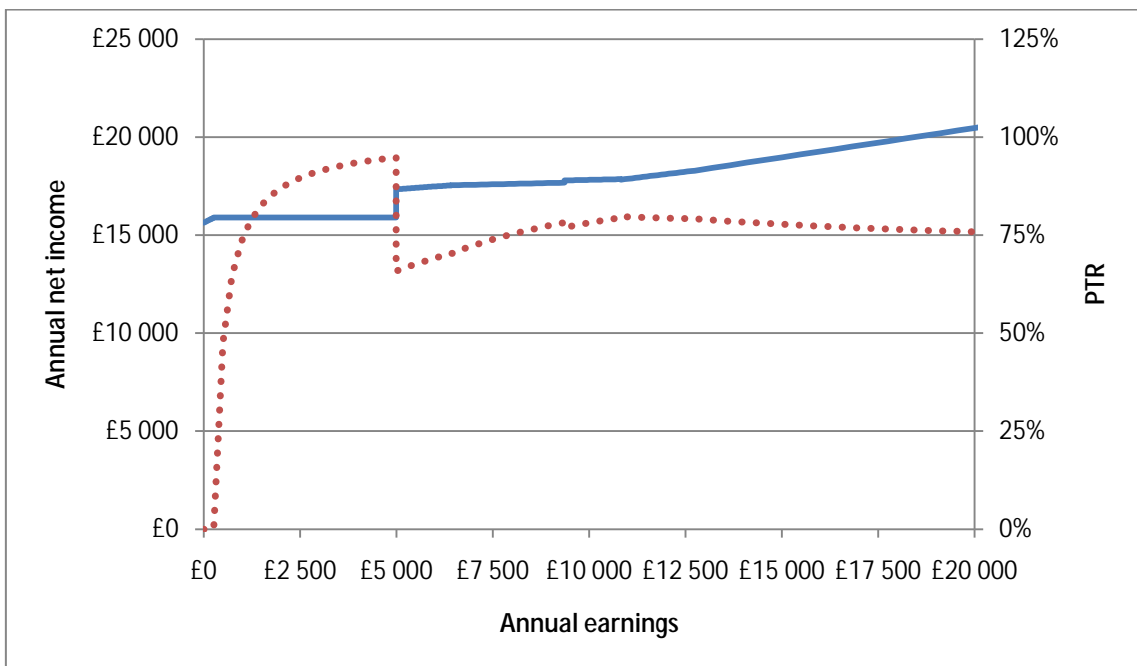
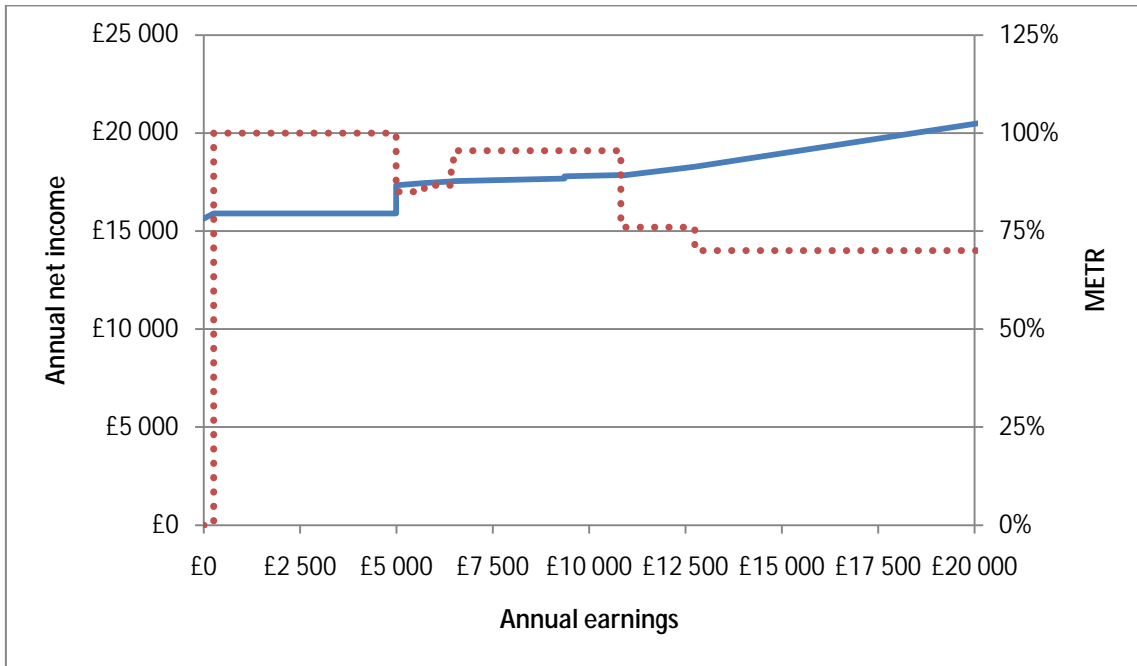


Figure C.3 Budget constraints for singles no children without HB, 2009–2010 tax and benefit system, £6/hour.

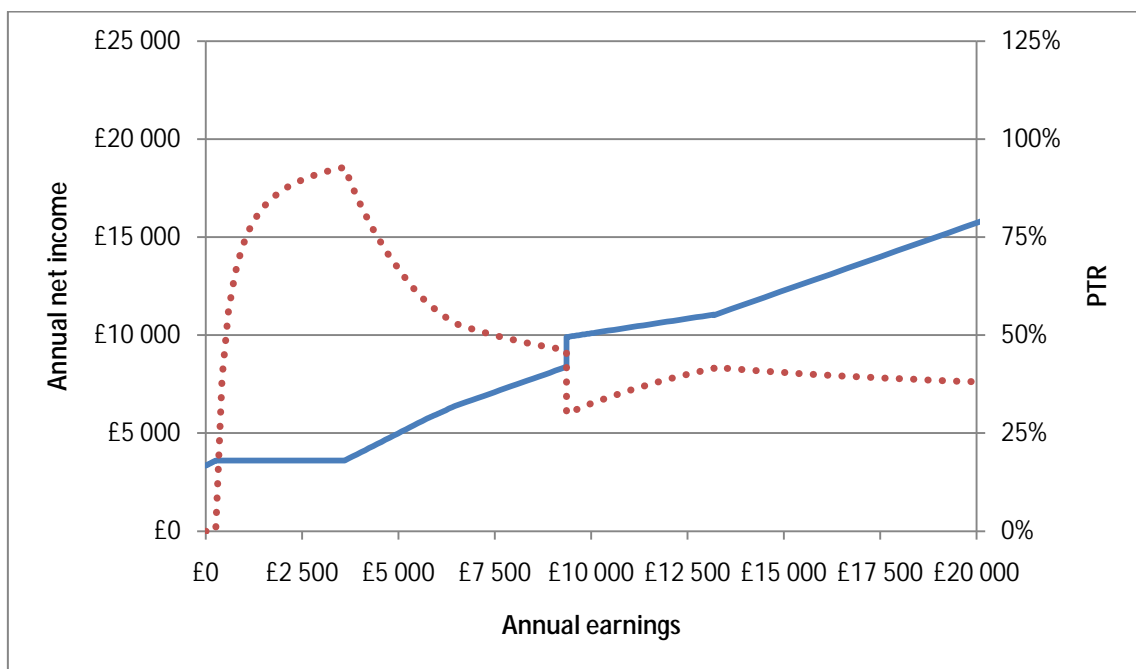
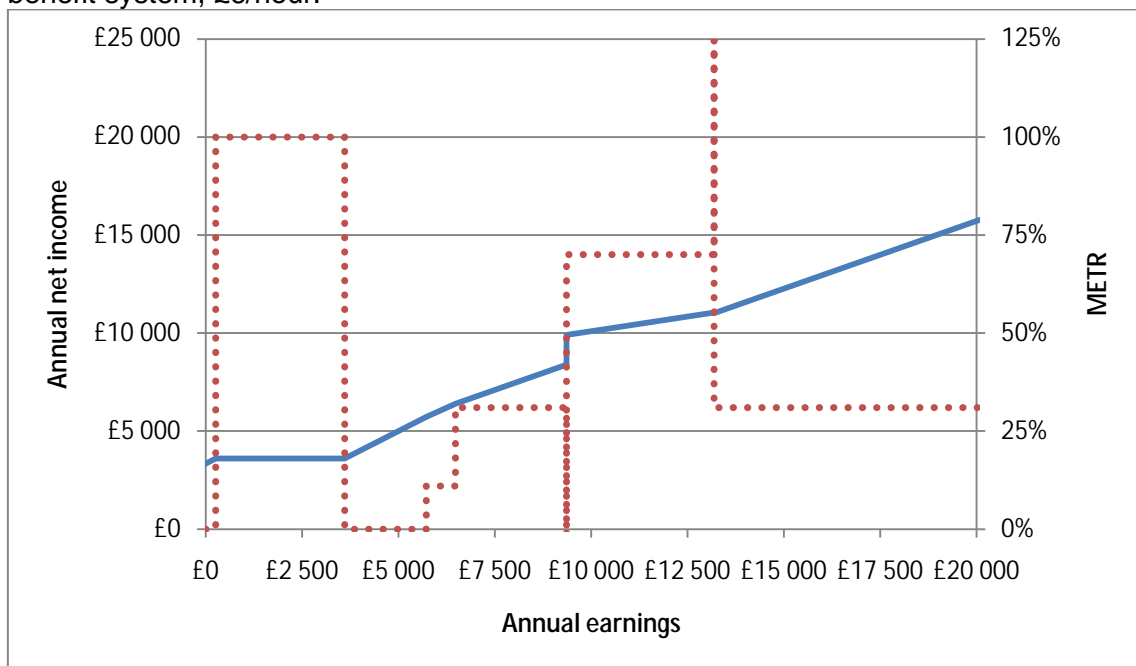


Figure C.4 Budget constraints for singles no children with HB/CTB, 2009-2010 tax and benefit system, £6/hour. Rent of £50/wk.

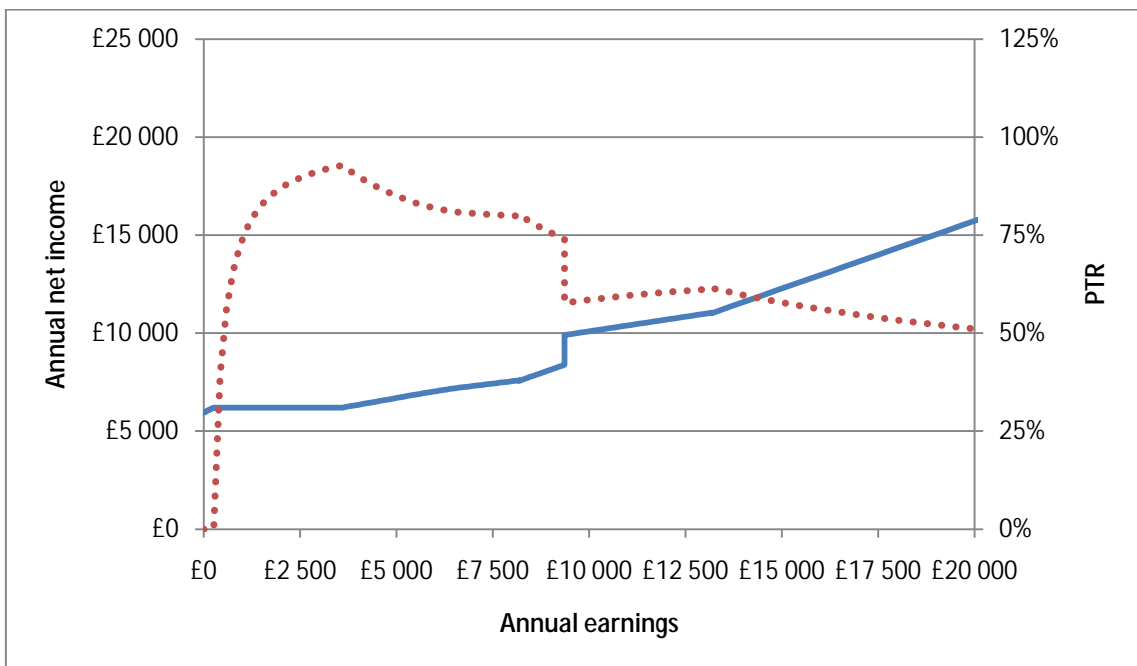
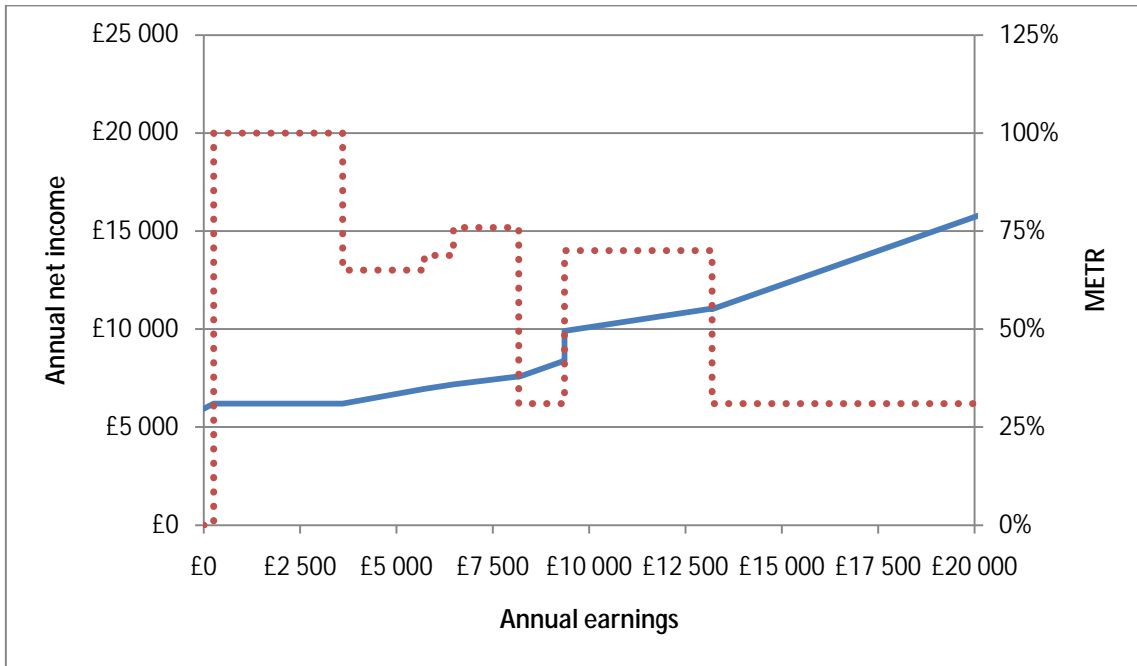


Figure C.5 Budget constraints for couple without children without HB, 2009–2010 tax and benefit system, £6/hour.

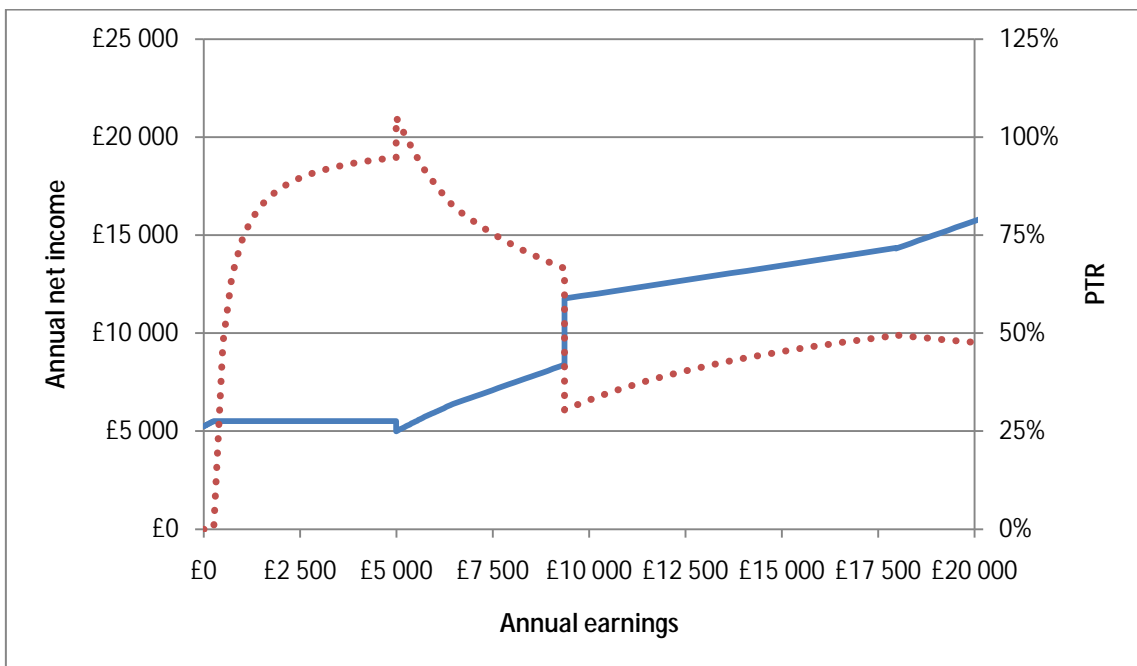
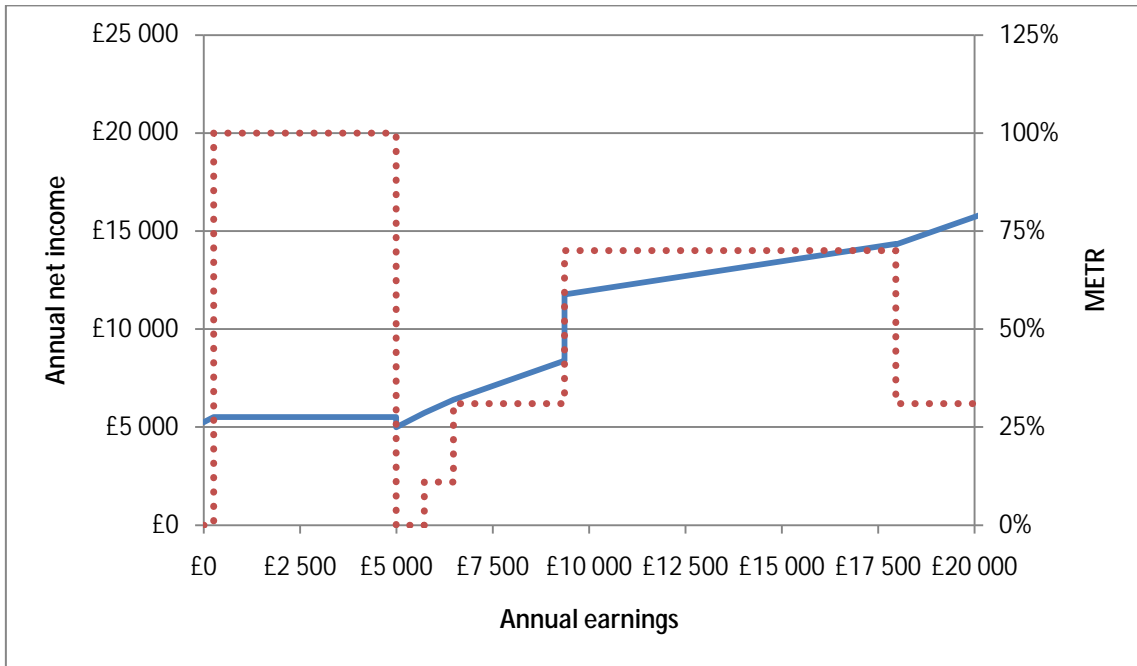


Figure C.6 Budget constraints for couple without children with HB/CTB, 2009–2010 tax and benefit system, £6/hour. Rent £60/wk.

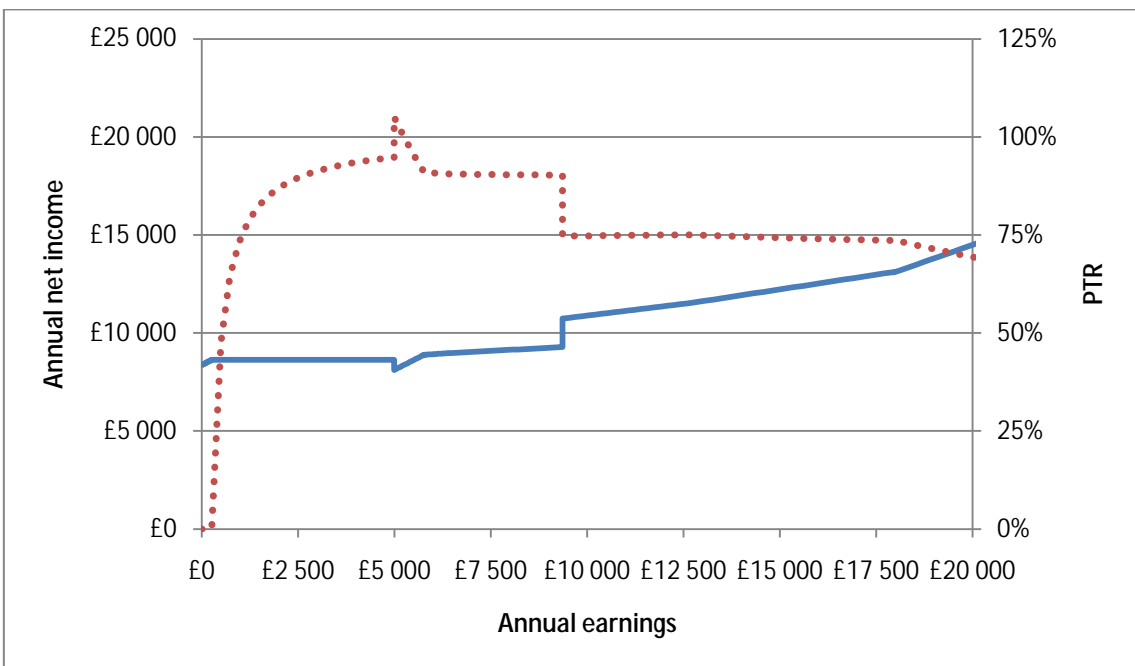
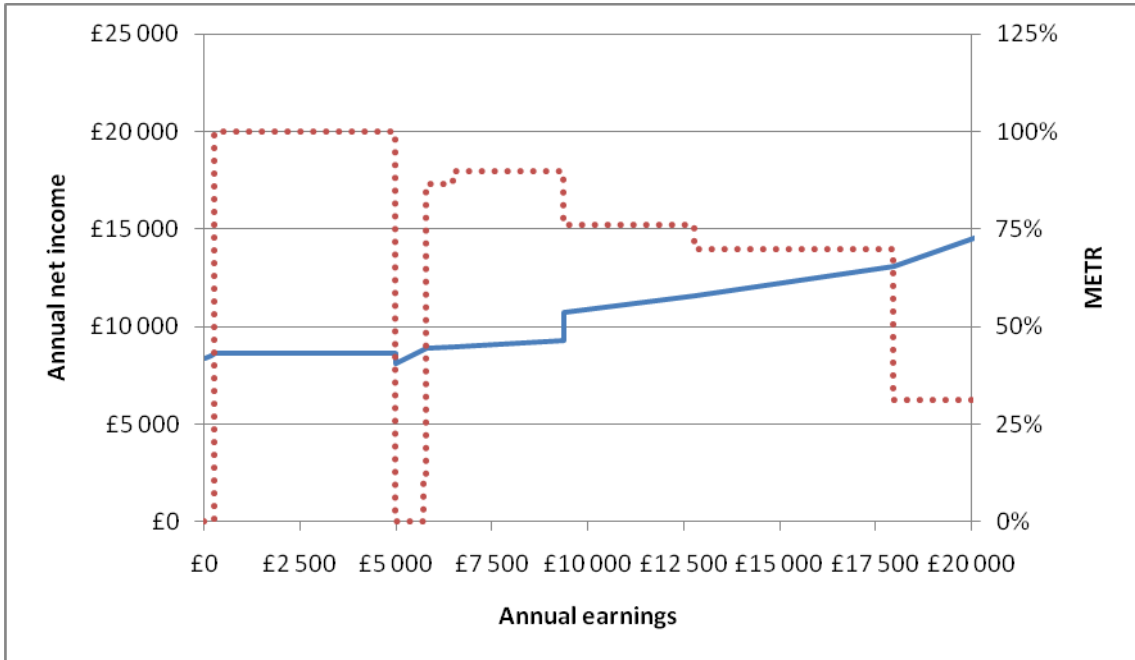


Table C.1 Replacement Ratios at various levels of gross earnings; 2008/9 tax and benefit system, low rent levels

Family Type	Gross weekly earnings (minimum wage was £5.52 and £5.73 over this period)										
	£100	£125	£150	£175	£200	£225	£250	£275	£300	£325	£350
Single person (aged 25+)											
	85.6	81.9	77.5	68.3	57.1	49.1	43.1	38.4	34.6	31.5	28.9
Lone parent with no childcare costs											
1 child	73.4	71.1	69.6	66.9	64.5	62.2	60.1	58.1	56.3	54.6	52.9
2 children	82.4	81.2	80.3	79.4	77.2	74.9	72.8	70.8	68.9	67.1	65.4
Lone parent with child care costs £100 pw											
1 child	75.3	74.0	73.6	73.1	72.2	71.2	69.7	67.1	64.6	62.3	60.2
2 children	84.0	82.9	82.5	82.1	81.7	81.2	80.3	79.4	77.3	75.0	72.9
Married couple with no children											
	95.0	88.4	86.4	84.4	82.5	79.8	70.1	62.2	55.9	50.7	46.5
Married couple without WTC 30 hour credit											
1 child	84.7	83.4	83.0	82.5	82.1	80.2	77.7	75.1	72.6	70.3	68.2
2 children	90.7	89.6	89.2	88.8	88.4	88.0	87.2	85.2	83.3	81.3	79.2
3 children	93.3	92.4	92.0	91.7	91.4	91.0	90.3	88.6	86.9	85.2	83.3
Married couple with WTC 30 hour credit and children											
1 child	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	80.5	78.0	75.4	72.9	70.6	68.4	66.4	64.5
2 children	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	88.1	87.4	85.4	83.5	81.6	79.4	77.4	75.5
3 children	<i>n/a</i>	<i>n/a</i>	<i>n/a</i>	91.1	90.5	88.8	87.1	85.4	83.5	81.7	80.0

Source: Table 2.3a of "Tax Benefit Model Tables: April 2008", <http://research.dwp.gov.uk/asd/tbmt.asp>

Notes: based on net income after paying rent and council tax. Assumes social housing tenant in receipt of Jobseeker's Allowance when out of work. *n/a* means weekly earnings imply sub-minimum wage work at 30 hours a week.

Table C.2 Replacement Ratios at various levels of gross earnings; 2008/9 tax and benefit system, high rent levels

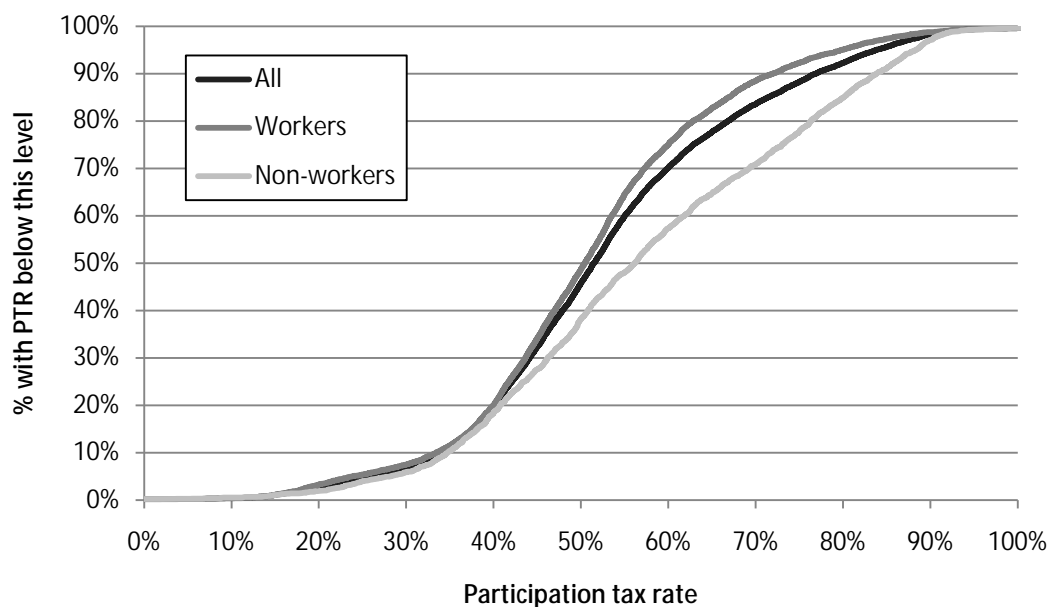
Family Type	Gross weekly earnings (minimum wage was £5.52 and £5.73 over this period)										
	£100	£125	£150	£175	£200	£225	£250	£275	£300	£325	£350
Single person (aged 25+)											
	85.6	81.9	77.5	71.9	67.1	62.9	59.2	55.9	52.9	48.3	42.5
Lone parent with no childcare costs											
1 child	73.4	71.1	70.2	69.9	68.3	67.4	66.5	65.6	64.8	63.9	63.1
2 children	82.4	81.2	80.3	79.4	78.5	77.7	76.9	76.1	75.3	74.5	73.8
Lone parent with child care costs £100 pw											
1 child	75.3	74.0	73.6	73.1	72.2	71.2	70.2	69.2	68.3	67.4	66.5
2 children	84.0	82.9	82.5	82.1	81.7	81.2	80.3	79.4	78.6	77.8	76.9
Married couple with no children											
	95.0	88.4	86.4	84.4	82.5	80.7	77.3	73.7	70.4	67.4	64.6
Married couple without WTC 30 hour credit											
1 child	84.7	83.4	83.0	82.5	82.1	81.6	80.9	79.8	78.9	77.9	77.0
2 children	90.7	89.6	89.2	88.8	88.4	88.0	87.7	87.3	86.9	86.3	85.4
3 children	93.3	92.4	92.0	91.7	91.4	91.0	90.7	90.4	90.1	89.5	88.8
Married couple with WTC 30 hour credit and children											
1 child	n/a	n/a	n/a	81.7	81.0	80.0	79.0	78.0	77.1	76.1	75.2
2 children	n/a	n/a	n/a	88.1	87.7	87.3	86.9	86.4	85.5	84.7	83.9
3 children	n/a	n/a	n/a	91.1	90.7	90.4	90.1	89.6	88.9	88.1	87.4

Source: Table 2.3b of "Tax Benefit Model Tables: April 2008", <http://research.dwp.gov.uk/asd/tbmt.asp>

Notes: based on net income after paying rent and council tax. Assumes social housing tenant in receipt of Jobseeker's Allowance when out of work. n/a means weekly earnings imply sub-minimum wage work at 30 hours a week.

Annex D. The distribution of participation tax rates in the UK

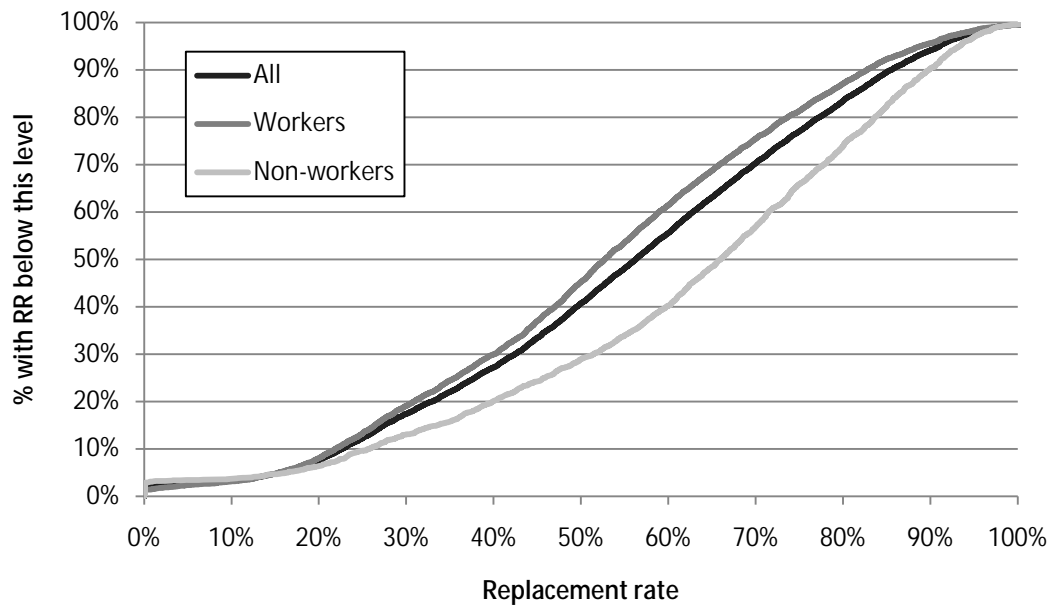
Figure D.1 Cumulative distribution of participation tax rates in the UK in 2009–10



Notes: Calculations for personal direct and indirect taxes only; excludes most 'business taxes' (notably corporation tax and business rates but not employer NI), and capital taxes (notably inheritance tax, stamp duties and capital gains tax). Non-workers are imputed a wage. Excludes those over the state pension age.

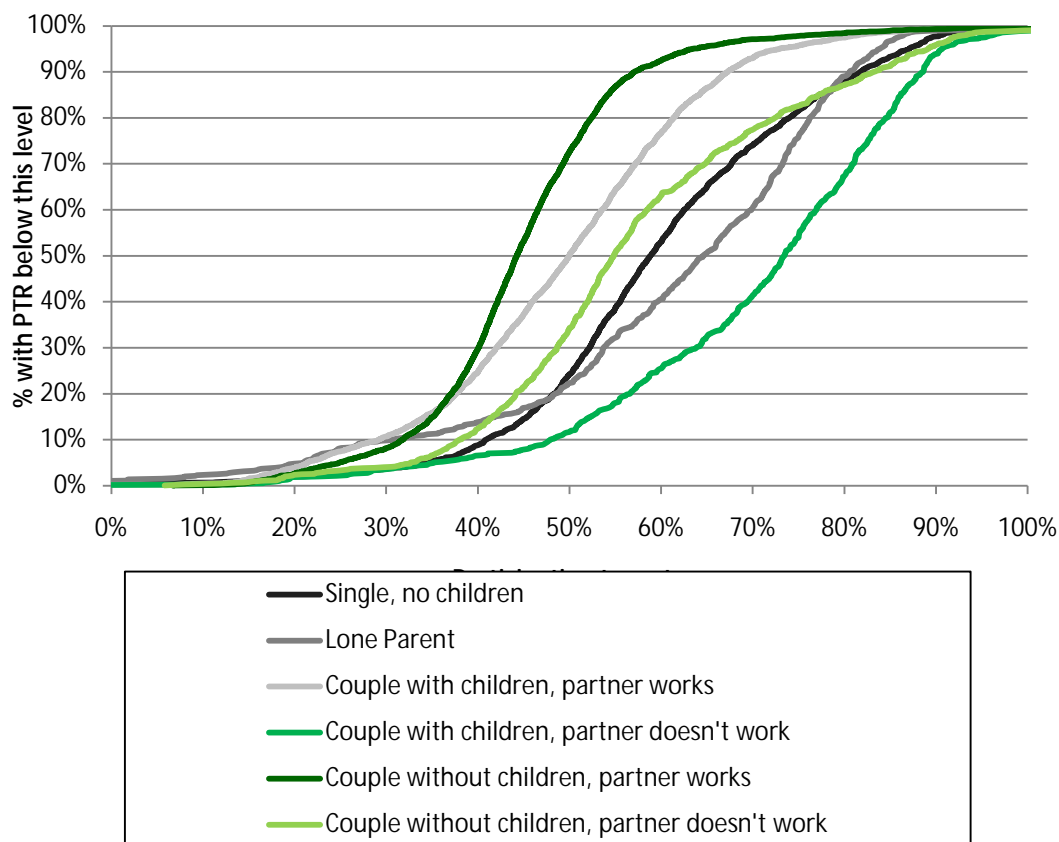
Source: Adam and Browne (2009), based on TAXBEN run on updated data from the 2005–06 EFS.

Figure D.2 Cumulative distribution of replacement rates in the UK in 2009–10



Notes: See figure D.1
Source: See figure D.1

Figure D.3 Cumulative distribution of participation tax rates by family type³⁴



Notes: See figure D.1. Of the 34.8 million adults in the UK who are below the state pension age, 8.6 million are single without children, 2 million are lone parents, 9.5 million are members of couples with children whose partner works, 2.3 million are members of couples with children whose partner does not work, 10.3 million are members of couples without children whose partner works, and 3.8 million are members of couples without children whose partner does not work.

Source: As figure D.1

³⁴ See Adam and Browne (2009) for the equivalent analysis for RRs.

Table D.1 Participation tax rates of non-workers

		10 th centile	30 th centile	50 th centile	70 th centile	90 th centile	Number of people	% within person-type	% within benefit recipients
Single adult	Disabled	53	63	73	80	87	787,257	35%	27%
	Carer	52	57	66	74	78	56,669	2%	7%
	Contributory JSA	49	58	67	76	89	94,779	4%	35%
	JSA/IS	46	51	61	75	88	698,740	31%	32%
	NOTA	28	38	44	51	65	640,517	28%	16%
Lone parent	Disabled	62	70	74	80	87	94,624	9%	3%
	Carer	49	55	74	81	85	55,320	5%	7%
	Contributory JSA	44	66	71	74	82	20,869	2%	8%
	JSA/IS	49	64	72	77	83	736,779	71%	33%
	NOTA	18	23	33	50	63	123,404	12%	3%
Couple with children, partner works	Disabled	43	57	64	71	86	186,841	9%	6%
	Carer	50	53	58	62	71	64,018	3%	8%
	Contributory JSA	46	48	57	65	88	33,684	2%	12%
	JSA/IS	46	47	50	52	57	149,789	7%	7%
	NOTA	29	39	46	57	67	1,676,018	79%	41%
Couple with children, partner does not works	Disabled	70	75	81	88	90	185,348	24%	6%
	Carer	71	75	87	89	93	50,248	7%	6%
	Contributory JSA	78	83	85	87	93	42,351	6%	16%
	JSA/IS	51	71	78	83	89	432,188	57%	20%
	NOTA	19	28	38	50	60	51,284	7%	1%
Couple without children, partner works	Disabled	40	53	58	63	80	389,253	21%	14%
	Carer	39	46	50	51	59	45,617	2%	6%
	Contributory JSA	32	32	54	54	54	9,358	1%	3%
	JSA/IS	47	51	53	56	73	145,593	8%	7%
	NOTA	30	38	42	47	57	1,238,921	68%	31%
Couple without children, partner does not works	Disabled	53	65	73	84	91	510,169	31%	18%
	Carer	51	59	66	73	85	71,161	4%	9%
	Contributory JSA	15	52	53	72	85	49,838	3%	18%
	JSA/IS	47	62	69	82	91	331,693	20%	15%
	NOTA	35	42	46	51	63	674,911	41%	17%
All						9,647,241			

Notes: Calculations for personal direct and indirect taxes only: excludes most 'business taxes' (notably corporation tax and business rates but not employer NI), and capital taxes (notably inheritance tax, stamp duties and capital gains tax). In-work incomes for non-workers calculated as described in section 2.4. Excludes those over the state pension age.

Source: Authors' calculations using TAXBEN run on updated data from the 2005–06 EFS. Uses same data as Adam and Browne (2009).

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