

The Conservative/Lib Dem coalition has put welfare reform at the centre of its programme for government. What are its proposals, and what do they mean for the welfare to work industry?

Why is welfare reform important?

The new coalition government emphasised welfare reform in its first outline agreement on 12 May and filled out some of the details in the longer and fuller document released on May 20. A Welfare Reform Bill was then announced in the Queen's Speech on May 21, and the new Secretary of State, Iain Duncan Smith, spoke about the proposals in a keynote speech on May 23.

It is clear from all these announcements that welfare will be at the centre of the new government's policies for a range of reasons - political, social and economic.

The political motivation became obvious during the election campaign, when all the main party leaders made clear their intention to ensure that all those on benefits and able to work, would be expected to work. While none were specific about how they would achieve this, the political message that there would be stick as well as carrot, i.e. more "conditionality" in the benefit system, was plain.

But the social and economic drivers of continuing welfare reform are much more important. On the social side, the reduction of unemployment and provision of support to those seeking work is now an objective of all parties and an area of policy consensus within the UK and beyond. The outgoing Labour government deserves credit for helping create that consensus, with long-standing policies designed to help people find work and specific policies and programmes through the recession designed to avoid a "lost generation" of unemployed young people. It seems unlikely that we will ever again hear a UK politician from a mainstream party say that unemployment is "a price worth paying" as Norman Lamont did during the early 1990s recession.

The economic and financial drivers are equally powerful. Every person on Jobseekers' Allowance (JSA) or on so-called "inactive" benefits (especially Incapacity Benefit) is of course no longer paying taxes and is receiving financial support from the public purse. So every person who can be found work creates a win-win for the government. While economic growth is of course key to this (because there have to be jobs for people to do) any government has an in-built incentive to continue welfare to work programmes which help move people into work.

And there is an added incentive because, as we have explained before (<http://www.a4ei.com/blog/wp-content/uploads/2009/08/The-public-spending-outlook.pdf>), all programmes which take people out of benefit reduce annually managed expenditure (AME) - the part of government spending which is regarded as uncontrolled. This is important because AME is generally excluded from all those calculations one sees in the media of the scale of cuts needed to achieve deficit reduction plans. So when you hear talk of Departments needing to reduce spending by 25%, that figure should be lower, and therefore more achievable and less painful, if benefits spending is cut.

All of which means that the new coalition would naturally want to expand welfare to work programmes, especially if the costs of those programmes can be covered by the benefit savings achieved. So it is perhaps not surprising that this is exactly what the new government plans to do.



A single welfare to work programme

As we commented in our briefing on the parties' manifestos (<http://www.i-a4e.com/blog/wp-content/uploads/2010/04/2010-Manifesto-briefing.pdf>), the Conservatives had a clear and well-worked out set of proposals on welfare reform, while the Lib Dems said next to nothing on the subject. Not surprisingly, therefore, the coalition government's policy is very much the one proposed by the Conservatives.

In essence, what we have is The Work Programme, a package of welfare reform proposals originally set out last year, in a Conservative policy paper called "Get Britain Working"

These proposals envisage the ending of all current welfare to work programmes in order to introduce the new programme. However it is very important to understand that this does not mean that spending on welfare to work programmes with private and third sector providers will fall – indeed the likelihood is that spending will rise. It is also important to understand that there is more continuity between current Labour, and planned coalition programmes than may at first appear to be the case. This is largely because both programmes stem from the same source, and are the result of work to review the system undertaken by Sir David (now Lord) Freud.

How we got here - the Freud Review

To understand the rationale and objectives of the new programme a brief history lesson is required. Between 1997 and 2007 the Labour government introduced a range of programmes designed to use a mixture of stick but mainly carrot to address and hopefully reduce worklessness. Most of these programmes were badged as one of a number of New Deals aimed at various types of claimant or, in welfare to work jargon, cohorts. Other programmes

included Pathways to Work, aimed specifically at disabled people in receipt of Incapacity Benefit.

However these programmes started to come in for criticism, not least from the major third and private sector providers, including A4e, who were involved in their implementation. In response the DWP asked Sir David Freud (an investment banker with no previous involvement in welfare to work) to review the system and make recommendations for change.

The Freud Review, as it is widely known, made radical proposals for change designed to address a number of weaknesses in the system (though Freud also acknowledged the progress that had been made since 1997) and meet the concerns of welfare to work providers. Among his most important findings were that:

- the various New Deals and other programmes were for the most part too inflexible, imposing a "one-size-fits-all" approach that was not sufficiently tailored to the needs of individual job seekers
- these programmes were also delivered by a very large number of providers (more than 900), working generally to short contracts and being paid according to how well they followed a prescribed process, rather than how many people were found and kept in work. Programmes also had different objectives, targets and duration; and
- there was confusion and overlap between the roles of Jobcentre Plus (JCP) and of external providers (the private and third sectors) which was failing to make best use of the strengths of all parties – in particular JCP's strength in dealing with a high volume of people who move off benefit relatively quickly; and the private and third sector's ability to deal with more complex and difficult cases.

The changes Freud recommended to the system are summarised in Figure 1 below. Essentially, he proposed that JCP would have initial responsibility for all claimants. Then responsibility for those whom it could not find work, would be transferred to external providers at clearly defined points. These providers would operate within much larger, longer contracts covering defined regions and using a prime contract model. Under this model, large prime contractors would be supported by a supply chain of smaller and specialist-sub-contractors providing specific interventions and support to those seeking work. Between them, the primes and their subcontractors would be able to work with those with multiple barriers to work over a longer period and design much more tailored programmes of support for them.

Freud also proposed radical change to the payment mechanism for such contracts, arguing that the savings which would accrue from finding and keeping people in work could be used to pay for the support they received from welfare to work providers and indeed could enable a significant expansion of welfare to work programmes. This approach has become known as the DEL - AME switch because it involves initial investment from the DWP's Departmental Expenditure Limit (DEL) in order to make eventual savings in Annual Managed Expenditure (AME).

From flexible New Deal to the Work Programme – the evolution of Freud's vision

Those who are in or close to the welfare to work industry will know what happened next. After some initial resistance to Freud's proposals (both Peter Hain when Secretary of State and one Gordon Brown as Chancellor were rumoured to be less than keen) new Secretary of State James Purnell pushed for the partial implementation of Freud's recommendations in what became the flexible New Deal (fND). The first phase of fND, fND1, is now in place across more than half of the UK while tenders for fND2 were being evaluated when the general election was called.

fND implemented key elements of Freud including the clear separation of JCP's initial role from private and third sector contracts, with jobseekers transferring after six months or one year; the use of much larger, long-term prime contracts; and a much greater element of payment related to the outcomes achieved, with more than half the payment deferred until the jobseeker has been in work for 13 or 26 weeks.

However key elements of Freud's vision did not get implemented. In particular:

- fND applies only to those in receipt of JSA, and some lone parents. Those receiving Incapacity Benefit and its replacement, the

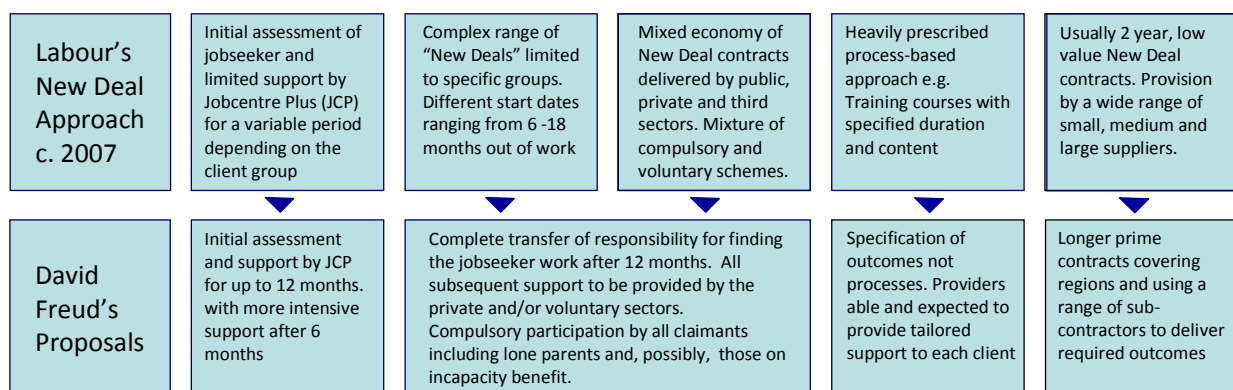


Figure 1 - How Freud modified welfare to work

Employment Support Allowance, were not included; and

■ while payments under fND became more outcome based, there was no explicit acceptance of the DEL - AME switch within the programme. By the time it lost office, the Labour government had only got as far as commissioning some pilot programmes to test whether DEL - AME would work.

By contrast the coalition government's proposed Work Programme does incorporate both these elements, and so can be argued finally to give reality to nearly all Freud's original vision. Again, this is not surprising - since Lord Freud effectively designed the programme. After being an independent advisor to the Labour government, he became a Conservative life peer and shadow Minister under David Cameron. He is now a Welfare Minister, working alongside Chris Grayling (a former shadow Secretary of State for Work and Pensions) and with the new Secretary of State Iain Duncan-Smith.

Conditionality of benefit

The Work Programme is central to the changes which the new government is proposing but there are two other dimensions to their overall approach which are, in policy terms, just as important. The first of these is conditionality – i.e., whether and to what extent there are sanctions for those who can work but refuse to take a job when offered. In the case of Incapacity Benefit claimants, there will be interesting, emotive and highly political debates ahead about the circumstances in which people are judged able to work. But leaving that aside, the government has made clear that it will expect those who can work to do so.

What is less clear is how draconian this regime will be, or whether it will be the main lever by which the government tries to reduce unemployment. The appointment of Iain Duncan Smith as Secretary of State has been

widely seen as a signal that the government intends to take a hard line, but the true picture may be much more nuanced. The previous government was itself in the process of introducing complex proposals for personalised conditionality – i.e. linking conditions of benefit to the circumstances of the claimant in a quite specific and tailored way. Furthermore, there is clear evidence that Iain Duncan Smith favours reform to encourage people to work, rather than penalise them if they do not. Work last year by the Centre for Social Justice, the social policy think tank which Mr Duncan Smith founded after stepping down as Conservative Leader, argued strongly that reform of the benefit system to strengthen incentives to work is the right way to go. Indeed the Centre's paper¹ says that *“For many, the answer to unsustainable welfare bills is to introduce ever tighter rules for receipt of benefits, and to cut generosity for some claimants. However, this approach has never worked. It is not the particular levels and conditions that are at fault, but the structure of the system itself.”*

Reform of the benefit system

Which brings us to the third leg of the reform tripod, namely reform of the benefits system itself - i.e. who gets what, and in particular when and how benefit is withdrawn if the claimant starts work. According to the Queen's Speech, under the Welfare Reform Bill “The benefit system will be simplified and reformed, with the aim of promoting incentives for people to work”. This implies an intention to implement the proposals developed by the Centre for Social Justice already discussed above. They involve simplifying the system (replacing a total of 51 benefits with just two, one for those in work and one for those not in work) and enabling those

¹ Dynamic Benefits - Towards welfare that works
Centre for Social Justice September 2009



returning to work to keep more of their benefit, thereby reducing the financial risk to benefit claimants if they take a job, and improving their incentives to work.

We have precious little detail of these proposals to go on as yet, but if this is the government's intention the changes would be extremely radical and, crucially, might cost more money to implement unless the government is prepared to countenance losers as well as winners in a new benefit system.

However Iain Duncan Smith sees such reform as central to the whole system, observing in his speech on May 23 that *"for too many people work simply does not pay..[and].. the move from welfare into work means they face losing more than 95 pence for every additional £1 they earn"*

So what happens next?

While the commitment to reform and to a single programme is clear, the details have yet to emerge and there are many questions which still need to be addressed. Here are some of the thornier ones:

What will happen to fND1 contracts? fND1 contracts have more than four years to run. Last November, Lord Freud and the then shadow Secretary of State, Theresa May, said that they would seek to renegotiate fND1 contracts to "incorporate the principles" of The Work Programme. At the time this appeared to mean that existing programmes would be allowed to continue to their earliest contracted end date, with subsequent delivery merged into The Work Programme. However it is by no means clear that this is still the intention.

What will happen to fND2? Since fND2 is still in the tender process, it is possible to stop it and start again and/or invite those who pre-qualified to bid for fND2 to bid against a new specification for The Work Programme – provided that it is deemed legal under the European Union

procurement rules to use the same shortlist of contractors (and that those contractors are prepared to tender). Again, we await clarification. It is equally possible that the government will seek to start again with a new procurement process for the entire Work Programme, allowing fND1 to continue in the meantime but terminating that programme in due course.

How and over what timescale will Incapacity Benefit/ESA claimants become part of the programme?

Freud has always believed that this is crucial, but such claimants are not only a different cohort, with different challenges; they have always been part of different and in some ways more specialised programmes, delivered sometimes by the same providers but sometimes by different ones. So the integration of such programmes raises questions over and above contractual issues. In his recent speech, Iain Duncan Smith chose his words with care, saying that *"We will create a Work Programme which will move toward a single scheme!"*

How and when will it be possible to use the DEL - AME switch?

The DEL - AME switch is a good idea but not one which is easy to put into practice, as the previous government's prevarication tends to indicate. A separate paper we produced last year (<http://www.a4ei.com/blog/wp-content/uploads/2010/01/VF-Invest-to-Save-1.pdf>) explains in more detail why this is so. The biggest problem is ensuring that there is no "deadweight" in the system, and that payments are made only when the claimant would not have found work without help. Lord Freud has said previously that this will mean using the DEL - AME approach only for defined cohorts where there is strong evidence that their chances of finding work without help would be very low. These include incapacity benefit claimants assessed as able to work (the new programme envisages all claimants being reassessed) and so called "cyclers" – chronic repeat claimants of

both JSA and Incapacity Benefit. One option which the new government may consider is extending the scope and scale of the existing pilot programmes.

What will/should be the role of JCP in the new programme? The programme appears to envisage reducing the time claimants spend with JCP before being referred to external providers, with claimants facing “the most significant barriers to work” being referred immediately and all claimants under 25 being referred after a maximum of six months. However DWP will be concerned that this risks making it too easy for providers to find work from some who would have found work on their own – increasing “deadweight” in the process. Against that providers will have to keep people in work for much longer – perhaps up to two years – before they get paid. So there is an equal risk on the other side – that it will be too hard to find and keep people in work – which may discourage some providers from even taking part in the work programme at all.

What are the implications for the welfare to work industry?

With there still being much uncertainty around the detail of The Work Programme, the wider changes that might be made to the benefits system and the transition from existing contracts, it is not easy to identify what the precise implications will be for welfare to work providers. But here are a few predictions.

- Overall, gross spending on welfare to work programmes is likely to increase. Given their social, economic and financial benefits, the new coalition government will be most reluctant to cut back such programmes. In addition, the plans envisage earlier and greater involvement by external providers, compared to fND.

- But net spending may fall. Provided that Treasury objections can be overcome, net

spending is likely to be lower, with a much bigger element of the programmes being funded by the DEL - AME switch.

- Larger providers will benefit. This in turn will benefit larger providers, who will have the capacity and cash flow (or access to capital) to bear the risk of programmes where a much higher proportion of payment is deferred and/or linked to job outcomes, including outcomes which are much more challenging (in terms of time in work) than those which apply now. Lord Freud has said in the past that he expects the industry to consolidate around three or four very large prime contractors. While he was later contradicted by his colleagues (who are obviously keen to encourage wider competition in the industry) there is no doubt that some of the smaller and medium-sized providers will find it more difficult to compete as prime contractors under the new programme.

- There will also be opportunities for specialist providers. The Work Programme will extend and reinforce the notion of tailored support to the needs of individuals. As explained above this is a key feature of fND but it will gain further emphasis because of the inclusion in The Work Programme of Incapacity Benefit claimants, and the structure of a programme which will give providers more reward in return for more intensive work with individuals over a longer period. There will thus be even more of an opportunity to provide specialist interventions to tackle long term barriers to work, in the knowledge that the rewards will justify the time and effort.

Overall there are some challenges for the industry, but the opportunities are considerable. The transition to fND has already required suppliers to up their game, and they have responded well. If they can do it again, they could not only grow their own businesses but also make a real difference to the wider social and economic well-being of the nation.



A4e Insight is the Research and Consultancy arm of A4e, a market leader in global public service reform and in the design, development and delivery of front-line public services that benefit individuals, organisations and communities.

We are specialists in public sector markets with more than ten years experience of providing strategic business and market advice to the public service industry and investors in the sector

The services we provide include business strategy, commercial due diligence and business development support across public sector markets and sectors including central and local government, health, social care, housing, criminal justice, welfare/employability, education, skills, facilities management, IT and business services.

If you would like to know more about the issues in this article or about the work of A4e Insight please contact Neil Stanworth on 075890 4414594 e-mail neil@i-A4e.com.

A4e Insight

53-55 Holmes Road

London NW5 3AN

Tel: 0207 482 9161 Email contact@i-A4e.com