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NATIONAL SALARY INSURANCE

BRIEFING

REFORMING THE WELFARE STATE TO PROVIDE REAL PROTECTION

Institute for Public Policy Research

ABOUT THE AUTHOR

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IDEAS to
CHANGE LIVES

ERRATUM

Page 2, para 3: '£7.50' corrected to '£71.50'
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EXECUTIVE SUMMARY

Over the last few decades, support for the welfare state has been undermined by a pincer movement of attacks. It has come to be seen both to reward people who do the wrong thing and to let down those who do the right thing. In short, it is thought to be not *demanding* enough of people who don't work and not *protective* enough of those who do.

In response, successive governments have increased conditionality for those on benefits. This has strengthened the idea of mutual obligation, while also increasing people's engagement with the world of work (improving their chances of finding a job). But these reforms have done nothing to address the concern that the welfare state does not provide real protection, when it is needed most, for people who have contributed into the system.

The sharp rise in unemployment following the financial crisis of 2008–09 brought this weakness sharply into focus. People losing their jobs – and facing a rapid and drastic drop in their incomes – found themselves entitled to just £71.50 a week in benefits from a welfare state they had been paying into, often for many years. The fact that people who had not worked for some time were entitled to the same level of support only exacerbated the sense of frustration.

For much of the 20th century the situation was different: unemployment benefit was paid at reasonable levels of generosity to people who had lost their job after having paid into the system. Over the last three decades, however, this system has broken down. The contributory principle has been eroded (with means testing becomingly increasingly dominant), while the real value of the jobseeker's allowance (JSA) has declined significantly relative to average earnings.

So, while the system has become stricter for those on benefits, it has also become less advantageous for people who have worked but need support in times of difficulty. However, significantly increasing the value of benefits for people who have contributed into the system would be either prohibitively expensive (at a time of severe fiscal constraint and high unemployment) or badly targeted (switching resources away from the poorest households).

To address this set of problems, the government should establish **National Salary Insurance**, which would provide people with much higher levels of support if they lose their job but require this support to be repaid when they return to employment. National salary insurance (NSI) would offer much greater security to people when it is really needed, without imposing significant new net costs on the state. It would achieve this by reinvigorating the contributory principle, as well as harnessing the attractive features of the income-contingent loans system used to provide support to students.

NSI would offer working people who become unemployed up to 70 per cent of their previous earnings in non-means tested support for up to six months, capped at a maximum of £200 a week. This would incorporate their existing entitlement to £67.50 a week of contributory JSA, trebling the amount of support available to people when they lose their job. This *extra* amount – up to £132.50 a week – would be repaid once people are back in work and can afford to do so, charged at a zero real rate of interest. There would be a cap on the amount that people could borrow at any one time equivalent to the maximum support for the full six months, or £3,445.

Based on recent JSA flows – and the best approximation possible of the share of new claims currently made through the contributory route – this scheme could be available to between 700,000 and one million people a year. Estimating the annual cash outlay and the net costs to the exchequer of NSI is very difficult, given the lack of publically available data on the average claim duration and future earnings of people receiving contributory

JSA. However, around 60 per cent of all people who claim JSA leave the benefit within three months, rising to 80 per cent within six months. Given their recent work record, it is highly likely that these rates are even higher for those claiming contributory JSA.

As a rough guide, if everyone claiming contributory JSA opted in to the scheme, with half receiving the maximum amount for 13 weeks and half the maximum amount for 26 weeks, the annual cash outlay would be between £1.8 billion and £2.6 billion (based on entitlement of 700,000 to one million claimants). This is highly likely to be an overestimate, as some people will either not claim at all or be entitled to less than the maximum amount, while many will return to work more quickly.

Once people return to employment they would become liable to repay the extra support they received. This would occur through additional national insurance contributions (NICs), and could be collected either by raising an individual's rate of employee NICs or by levying an extra flat-rate cash amount per week. Someone who had borrowed the maximum amount possible – £3,445 – and subsequently repaid £20 a week would clear their debt in a little over three years. At £30 a week, repayment of the full amount would take just over two years.

The policy is designed so that the government recovers the total cash cost of higher benefit payments. However, the net expenditure risks to the exchequer lie in the costs of subsidising the loan and the potential for non-repayment.

Based on the estimates associated with the student loans system, the net costs of NSI to the government could be somewhere between £180 million and £520 million a year. However, there are good reasons for thinking that the net costs of this reform would be far lower. The maximum amount loaned to an individual would be three or four times less than is the case for student loans; repayments would start as soon as people were back in work for a month and earning above the primary threshold for NICs (£139 a week); and the likelihood of people entering (or, rather, re-entering) work quickly would be higher, given the conditionality of the benefit.

These factors mean that the loan subsidy and the risk of non-payment would be lower in the case of NSI. However, should the government wish to reduce the net liability further, it could charge a real interest rate on the loan or require more rapid repayment rates. Limiting eligibility to those who have previously worked, maintaining strict conditionality and placing a six-month limit on the higher generosity provided by NSI would remove disincentives to work.

Beyond these costs, the impact of NSI would be a major reduction in the risk of families falling into poverty when someone loses a job. This would help to prevent the crisis of unemployment becoming a wider catastrophe, for them and the state, through losing a home, suffering relationship breakdown or racking up unaffordable personal debt.

Complementing the universal credit, this proposal would significantly enhance the protection that people who have contributed into the system can receive in times of need. It would mean the welfare state offered real income security in a more risky world, while reinforcing the principle that people are rewarded for working and contributing to the system.

The idea for NSI begins the task of rethinking the centre-left's approach to welfare in a post-crash era. Alongside continuing efforts to ensure people on benefits fulfil their obligations to look for work in return for the support they receive, this reform can help to make the welfare state popular again – by showing that it demands more and protects better.

1. THE CASE FOR REVIVING THE NATIONAL INSURANCE IDEAL

Headline figures for net changes in unemployment and the claimant count always mask vastly greater flows into and out of work. Each month, over 300,000 people make a new claim for JSA and a similar number leave the benefit (ONS 2011). This pattern is more dramatic during downturns – with more exits from employment and more entries to benefits – but it continues throughout the economic cycle.

While average job tenure has changed little over the last 25 years, there has been a significant fall in the 'long-term job' share among men, who face reduced job security (with contrasting fortunes for women)(Faggio et al 2011).

Thankfully, the vast majority of workers do not experience unemployment. Even at the height of the recession, 96 per cent of those in work stayed in employment throughout 2008/09. However, in a workforce of some 30 million, that still leaves more than a million people that year facing the trauma of losing a job, with all that that entails. Becoming unemployed self-evidently entails a loss of income, with direct impacts on people's standard of living and their ability to afford basic items, like mortgage repayments or rent, utility bills and food. A European Union study confirms that unemployment also has a significantly negative impact on people's health and wellbeing (Ahn et al 2004).

One major study of poverty dynamics found that one-third of households face poverty at some point over a four-year period (compared to about one-quarter at any point in time) and that nearly half (44 per cent) of all entries into poverty are caused by a change in the labour earnings of household members (Jenkins et al 2001). Job loss can also trigger a wider set of problems, increasing the risk of families losing their home, racking up unaffordable debt or experiencing greater strain on relationships. Recent IPPR research has shown the real hardships and heartaches often faced by those facing a sudden income shock caused by unemployment (Ben-Galim and Lanning 2010).

The crisis of unemployment can snowball into a catastrophe for families, with huge social and economic costs both for the individuals concerned and for wider society. Some people are lucky enough to have income from other sources to cushion the blow, such as a partner's earnings or income from family savings. But many are not so lucky and require support from the welfare state, which was invented to protect people when unemployment hits them. However, it has been doing an increasingly inadequate job.

At the start of the 1980s, unemployment benefit (now JSA) was worth 20 per cent of average earnings (Sutherland et al 2008). By 2004, this had declined to just 11 per cent, as out-of-work benefits rose in line with prices, falling behind wages. Analysis by the Joseph Rowntree Foundation projects that this decline in the value of income protection will continue: on current trends, JSA is set to rise by 14 per cent less than average earnings in the years up to 2017/18 and by 39 per cent less in the period up to 2031/32 (ibid).

Moreover, these calculations were made before the government's decision to up-rate benefits by the (usually lower) CPI rather than the (usually higher) ROSSI measure of inflation. This policy change will save the government money but will exacerbate the declining value of unemployment support still further.

Protection for workers losing their jobs in Britain is much weaker than for their counterparts in most developed countries. This is analysed by looking at 'replacement rates': the proportion of previous earnings available to people facing unemployment from the welfare state. Comparing replacement rates across countries is not straightforward, with many different systems in operation, but the table below shows the OECD's best and most recent approximation. The figures for net replacement rates are based on a set of averages of different household types and various levels of previous earnings.

Table 1
Comparison of net replacement rates and unemployment benefit durations for 26 OECD countries[1]

Country	Net replacement rate (as proportion of net earnings in work)	Duration of unemployment benefit (months, pre-means test)	Employment rate (as proportion of working age population)
1 Portugal	83	24	66.3
2 Switzerland	77	24	79.2
=3 Sweden	75	28	72.2
=3 France	75	23	64.1
5 Netherlands	74	24	75.8
=6 Denmark	70	48	75.7
=6 Finland	70	23	68.4
8 Germany	69	12	70.4
9 Norway	68	36	76.5
10 Spain	67	21	60.6
=11 Austria	63	9	71.6
=11 Canada	63	9	71.5
13 Japan	62	8	70.0
14 Belgium	61	No limit	61.6
15 Poland	59	12	59.3
=16 Slovak Republic	56	8	60.2
=16 Czech Republic	56	5	65.4
=16 New Zealand	56	0	72.9
19 Greece	55	12	61.2
=20 United States	54	6	67.6
=20 Italy	54	6	57.5
=20 Great Britain	**54**	**6**	**70.6**
=23 Ireland	49	15	62.5
=23 Hungary	49	9	55.4
25 South Korea	47	7	62.9
26 Australia	45	0	72.0

Source: OECD Employment Outlook 2006 (see note 1)

1 These figures are slightly dated, but reflect the most recent attempt by the OECD to produce comparable numbers – and these are not figures which are subject to regular fluctuation. Data on employment rates are for 2009. www.oecd.org/dataoecd/28/9/36965805.pdf

The replacement rates shown in this table include means tested benefits, such as support with housing costs – explaining the discrepancy between the figure for Britain and the relative value of JSA on its own. Also, in recent years, the tax credit system has acted to cushion the blow of unemployment, with means tested support rising as earned income falls (although only for families with children).

However, even taking this into account, the average replacement rate in Britain is as low as or lower than in every OECD country apart from Ireland, Hungary, South Korea and Australia. It is at least 15 percentage points below major European neighbours such as Portugal, France, Sweden, Netherlands, Denmark and Germany. Interestingly, the comparative study of the impact of unemployment across the European Union cited above finds significantly lower negative affects for people in the Netherlands and Denmark, where the 'unemployment rate is lower, the spells [of unemployment] are shorter and unemployment protection (unemployment benefits and active labour market policies) is greater' (Ahn et al 2004).

A number of these countries have maintained social insurance systems that protect workers when they face unemployment, with benefits paid out in return for contributions previously paid in. In his 1942 report, William Beveridge said: 'Benefit in return for contributions, rather than free allowances from the State, is what the people of Britain desire' (Beveridge 1942). However, over recent decades, the contributory principle has gradually been superseded by means-tested and universal benefits (such as occurred in 1979 when the earnings-related additions in working age contributory benefits were abolished)(Hills 2003). This shift has often been justified in the name of advancing social justice: to target support on those who need it most (the poorest) and to reach people less likely to have a record of contribution (such as mothers, disabled people and carers).

Contribution-based support has also been directly cut back, such as when non-means tested unemployment benefit for those who had previously worked was reduced from 12 to six months when JSA has introduced in 1996. This has been part of a gradual shift towards greater prioritisation of children (and pensioners) over working age adults, a trend which was intensified under the previous Labour government to reduce poverty in a cost-efficient way. This strategy was remarkably successful, with child poverty falling by 900,000 and pensioner poverty by 600,000 between 1998/99 and 2008/. However it was less effective in addressing poverty among working age people – which rose by 700,000 over the same period – or in building majoritarian support for the welfare state among working people (DWP 2011).

This is the context in which the financial crisis hit, the moment when the lack of protection from the welfare state became a reality for many people and a mainstream political issue. While unemployment rose by far less than GDP fell during the 2008–09 recession (Gregg and Wadsworth 2011), many hundreds of thousands of people lost their jobs, many of whom had rarely, if ever, been unemployed or come into contact with the benefits system. These people found that, despite having paid their national insurance contributions, they were entitled to just £67.50 a week[2] in contributory JSA.[3] Even for people who had been on the minimum wage, this represented a low proportion of previous earnings[4] and a sharp and dramatic drop in income.

2 £53.45 for young people aged under 25.

3 With the possible addition of assistance with housing costs or extra support, through the tax credit system, if they had children.

4 Just over 30%, for someone working 35 hours a week at the national minimum wage.

In addition, other than the first six months of JSA being non-means tested, there is no difference between the level of protection provided to people who have paid into the system and that given to those who have not. The level of JSA is the same for both groups. On top of a widely held perception that welfare is not demanding enough of people receiving benefits, this has further undermined support for the welfare state. The British Social Attitudes survey finds that the proportion of the public who think that the government should spend more money on benefits has fallen from well over half (58 per cent) in 1991 to just over one-quarter (27 per cent) in 2009.[5] In response, political parties across the spectrum have sought ways to make welfare 'tougher', increasing conditions on benefits. While many of these steps have merit, they do not address the concern that the welfare state no longer provides meaningful protection in the face of job loss for those who have contributed to the system.

One way of addressing this problem would be to increase the level of JSA for people who are entitled to claim via the contributory route. However, if this was funded by switching resources within the welfare budget it would come at the expense of some of the poorest households. People who have recently worked are, relatively speaking, likely to be better off than those who have been reliant on the welfare state for their income for some time. The other alternative – funding higher contributory benefits from an overall net rise in the benefits bill – is unrealistic, given the state of the public finances. In fact, the government is already set on *reducing* welfare spending by £18 billion by 2014/15 through a range of measures.

Therefore, what is needed is a scheme that revives the most attractive features of the contributory principle in a way that is compatible with the reality of fiscal constraints. This would aim to 'repopularise' the welfare state – and entrench its majoritarian appeal – by enhancing the protection it offers to working people and strengthening the 'something-for-something' principle in two ways:

- By providing real protection to people in times of need, helping to prevent the crisis of unemployment turning into a wider catastrophe of home repossession, relationship breakdown or unaffordable personal debt.
- By rewarding people who have paid in to the system through employment – re-embedding the contributory principle, but without imposing significant new costs on the state or diverting resources from those in the greatest need.

But how would such a scheme work in practice?

5 http://www.natcen.ac.uk/media-centre/press-releases/2010-press-releases/bsa-27th-report

2. A PROPOSAL FOR NATIONAL SALARY INSURANCE

The starting point for reform is to remember the vital role of the welfare state in providing temporary support to people in times of need. For a minority – such as those with the most severe disabilities – the welfare state is needed to provide a semi-permanent (or permanent) source of income. But for the vast majority, a period of unemployment will be followed by a return to work.[6] For this group of people, the central problem is a short-term income shock, which they may not be able to cope with alone and which risks precipitating much bigger problems.

Therefore, for people who have contributed into the system but become unemployed, the welfare state should provide much more generous (non-means tested) benefits. This would act to smooth their income at the point of crisis and give them some breathing space to adjust their expenditure patterns.[7] However, to make this affordable, people should be required to repay the money when they are back in work. Previous employment would act as the gateway into this new system, but the principle of 'paying in' would be fulfilled after support has been 'paid out'. In other words, the national insurance principle would be reversed: the welfare state would assume the liability at the point that the need arises, with individuals paying retrospectively for benefits they have actually received.

This approach would take advantage of the state's ability to pay out money upfront and recoup over time, lending to people who are highly likely to be able to repay in the future. It would re-establish the idea that the welfare state has something to offer working people, by reinvigorating the contributory principle and providing meaningful protection from the risks of unemployment.

This could be achieved by establishing **National Salary Insurance**, with the following basic features of design and operation:

- Anyone who had made sufficient NICs to be entitled to contributory JSA would be entitled to access NSI.[8] Based on JSA inflows over recent years – and an approximation of the proportion of new claims that are contribution-based – between 700,000 and one million people could be entitled each year.[9]
- Access to NSI would entitle people to receive up to 70 per cent of their previous earnings,[10] capped at a maximum of £200 a week, for up to six months. This would significantly increase the replacement rate for the average British worker.
- This amount would incorporate the existing entitlement to contributory JSA (£67.50 a week), which would not be refundable. NSI payments would be non-means tested and subject to neither income tax nor national insurance contributions.[11] This level

6 The situation of parents with young children and carers falls somewhere in between, with employment expected in the future but perhaps not immediately.

7 Although the vast majority of people who lose their job do find work again, some return to work at a lower level than before (Gregory and Jukes 1997).

8 There are complicated rules determining eligibility for contributory JSA, which broadly require someone to have worked for one year in the two years prior to making a claim.

9 Author's analysis based on NOMIS dataset. Over the last six years, the number of new claims to JSA ranged from 2.5 million (in 2005) to 4.2 million (in 2009). Data is not available which separates new claims into contribution-based and income-based, but an approximation can be made by looking at the breakdown of claims with under 13 weeks' duration. For the period between December 2009 and November 2010, 28 per cent of such JSA claims were through the contributory route (or a combination of contribution and income-based). The estimate for the number of people expected to benefit from NSI is made by calculating 28 per cent of the total JSA inflow over the last few years.

10 Probably to be calculated on the basis of weekly pay, excluding overtime.

11 There would seem to be little justification for a lower level of entitlement for young people, given that previous employment is a gateway to access NSI support in the first place.

of entitlement would mean that anyone with previous earnings of up to £286 a week would be able to receive support at a replacement rate of 70 per cent.

- NSI would enable people to borrow up to a maximum of £3,445 (equivalent to £132.50 for 26 weeks). People could choose to receive *less* than the maximum weekly amount, or to not receive NSI support at all. Either way, they would continue to be entitled to (non-refundable) contributory JSA, as now.
- Conditionality would continue to apply, with anyone receiving support through NSI required to be actively seeking work and to accept reasonable job offers. If such conditions were breached, sanctions or disallowances could be enacted. As with JSA, anyone making themselves voluntarily unemployed would forfeit eligibility for NSI support.
- Access to most other benefits – including child benefit and disability living allowance (DLA) – and tax credits would not be affected by receipt of NSI support. However, there would be an argument for counting it against any assessment for the purposes of housing benefit,[12] as the NSI's higher replacement rate would help people to maintain their housing costs (rent or mortgage) during a short period of unemployment. This would prevent people becoming entangled in the housing benefit system, with its complexities and work disincentives, and would reduce administration and benefit costs to the state, although an exception would probably be needed for those with very high housing costs. Significant proportions of people losing their jobs are homeowners and so would not be entitled to housing benefit in any case.
- By definition, NSI recipients are people who have been in work recently – and the vast majority get back into employment quickly. On returning to work, people would be required to repay the amount they had borrowed, on an income-contingent basis. Repayments would begin once they had been back in work for a month and were paying national insurance again (that is, once they are earning above the primary threshold of £139 a week). The loan would be charged at a zero real rate of interest, rising only in line with inflation.
- Repayments would be administered through the national insurance system, enhanced by the government's planned 'real-time' PAYE, as this will enable taxes and benefits to be adjusted much more regularly and automatically. Repayments could be collected either by raising the individual's rate of employee NICs or by levying an extra flat-rate cash amount per week, until the loan is repaid. Someone who had borrowed the maximum amount possible – £3,445 – and repaid £20 a week would clear their debt in a little over three years. At £30 a week, repayment of the full amount would take just over two years.[13] People could opt to repay their loan more quickly, accelerating their entitlement to access NSI support were they to become unemployed again.
- If someone accessing NSI does not returned to employment within six months, their entitlement to extra support would then end. They would be entitled to claim ongoing help, if necessary, through the means tested route. In the case of repeated unemployment, people would not be able to borrow more than the maximum cap amount at any one time. Therefore, if the cap has been reached, they would not be able to access further support until they had made repayments.[14]

12 Or council tax benefit and help through the benefits system with paying for the interest on mortgage repayments.

13 Calculated using the Department for Work and Pensions tax benefit model (DWP 2010).

14 The government could consider reclaiming the remainder of the balance from the state pension or pension credit of those who reach the state retirement age with their NSI account in deficit.

More than just a 'safety net', the impact of NSI would be to stop households falling into poverty when they lost their job, by protecting them from a sharp and dramatic drop in their income. It would also shield people from having to take on unaffordable debt at high rates of interest, which can lead to a spiral of mounting problems. Poverty and debt are major causes of people losing their home and experiencing relationship breakdown. For this reason, this reform could play a major role in preventing the crisis of unemployment becoming a catastrophe that imposes huge social and economic costs on families and the state.

NSI would also act as an effective counter-cyclical stimulus measure during periods when the economy contracts and unemployment rises, enhancing the automatic stabilisers. Paying out higher benefits would get money into the pockets of people in need of cash and likely to spend it – at the point when public spending is maintaining demand in the economy. As the economy recovers and employment rises, the expenditure would be recouped – at the point when public spending needs to be controlled. Therefore, NSI is not only a measure to protect individuals who become unemployed but also an important fiscal tool to fight recession (without permanently impairing the public finances).

As a guide, Table 2 (over) provides some indication of the types of people who would be eligible for NSI. The 3.8 million new claims for JSA made in 2010 are broken down by previous occupation, with the median wage for that occupation in that year in the right-hand column. It should be remembered that 2010 saw a higher-than-usual rate of new claims to JSA. For example, there were 2.5 million, 2.6 million and 2.5 million new claims in 2005, 2006 and 2007 respectively – this rose to 3.0 million in 2008 and then peaked at 4.2 million in 2009.

This table shows that significant numbers of new JSA claims are made by people whose previous occupation had a median weekly wage well below the national average – £388 – particularly those in sales and elementary occupations. Given that the risk of unemployment is much higher for those on a low salary, it is worth noting that the weekly wage at the 25th percentile was £238.80 in 2010 (meaning that 25 per cent of everyone in employment in that year earned this amount or less). The replacement rate for those on a higher salary could be boosted beyond the maximum NSI level by other support, such as from child benefit and child tax credit if they have children and potentially by housing benefit if their housing costs were especially high.

Table 2
Previous occupations of those making new claims to JSA in 2010

Occupation	New JSA claims (2010)	Median weekly wage, excluding overtime
Sales occupations	680,400	£155.10
Elementary trades, plant and storage related occupations	617,650	£302.30
Elementary administration and service occupations	361,600	£147.40
Administrative occupations	344,015	£323.40
Skilled construction and building trades	221,740	£429.00
Transport and mobile machine drivers and operatives	197,205	£370.00
Caring personal service occupations	168,370	£236.00
Process, plant and machine operatives	143,935	£362.10
Corporate managers	137,130	£713.70
Skilled metal and electronic trades	136,235	£460.00
Customer service occupations	96,115	£278.40
Culture, media and sports occupations	86,600	£438.80
Business and public service associate professionals	80,115	£508.10
Leisure and other personal service occupations	61,330	£253.90
Secretarial and related occupations	56,675	£277.90
Textiles, printing and other skilled trades	54,540	£293.60
Science and technology professionals	53,500	£672.50
Science and technology associate professionals	52,660	£484.50
Skilled agricultural trades	49,795	£324.90
Teaching and research professionals	48,095	£625.20
Business and public service professionals	39,020	£650.60
Managers and proprietors in agriculture and services	34,045	£482.40
Health and social welfare associate professionals	30,755	£480.60
Protective service occupations	4,435	£626.30
Health professionals	2,975	£925.30
Occupation unknown	77,720	–
TOTAL	**3.8 million**	**£388.00**

Source: Author's analysis of NOMIS dataset and the Annual Survey of Hours and Earnings

Impact of NSI on incentives to work

One of the traditional arguments against higher replacement rates for the unemployed is that they reduce the incentive to work. This logic underpins the Coalition government's universal credit, with its aim of reducing the 'participation tax rate' for those moving from benefits to work. It is certainly true that the design and operation of benefit regimes do affect labour market participation.

However, as Table 1 reveals, there is no simple relationship between replacement rates and employment rates across the OECD. NSI would increase the 'participation tax rate' for some workers; however, it is designed in a way that would not only mitigate against new disincentives to work but could actually *improve* positive incentives.

- Access would be limited to people who had contributed into the system through work – encouraging people to do just that to build up protection. This group has, by definition, demonstrated a strong work ethic and motivation to find employment.
- Full JSA conditionality would continue to apply to people accessing support – with people required to sign on, demonstrate steps taken to find work and accept reasonable job offers – otherwise, they face losing their benefits, including their entitlement to NSI.
- Extra help would be limited to six months – creating an incentive to find work within this period before financial support drops to the means tested level.
- Future access to NSI would be dependent on having made repayments to bring the amount borrowed under the maximum cap – providing an incentive to stay in employment to regain the right to protection in the event of future job loss.

Overall, the aim is to create a system that encourages people to work by rewarding them for doing so. However, rather than making the system increasingly *less* generous to people who haven't worked, it would achieve this by making it *more* generous for those who have. The goal would be to create a positive cycle of incentives, based on people getting generous but temporary assistance when faced with unemployment, rather than supporting a lifetime on benefits. In this it would be important to learn from other European countries – like Denmark and the Netherlands – that have combined stronger protection for unemployed workers with tough conditionality and achieved higher rates of employment and lower rates of poverty.[15]

Relationship of NSI to the universal credit

The introduction of the universal credit will create a more simple foundation onto which this reform could be grafted. The universal credit will unify the existing income replacement benefits[16] while maintaining both a contributory and a means tested gateway to support.

Once the universal credit comes into operation, a decision would have to be made about whether access to NSI would be available for people with a recent work record but not in the JSA – or 'ready for work' – conditionality stream (that is, for those who under the current system claim contributory employment and support allowance). There would be strong grounds for extending entitlement to this group: for simplicity's sake, in recognition of their previous work record and to entrench the idea that benefits (for the vast majority, including for this group) are a form of temporary assistance until people are in a position to work again.

15 These countries, characteristic of the so-called flexicurity model, also spend substantially more on active labour market programmes than the UK. For example, Denmark spends 1.4% of GDP, compared to 0.3% in the UK. See www.oecd-ilibrary.org/docserver/download/fulltext/190600091e1t002.pdf?expires=1309790669&id=id&accname=freeContent&checksum=521FF691E2A7BE9000881A5A930E4764

16 JSA, employment and support allowance and income support.

A more difficult issue is the blurring of the line between 'being on benefits' and 'being in work' that is implicit in the universal credit. At present, this distinction is marked by the point at which people work 16 hours a week or more, when entitlement to out-of-work benefits (including JSA) stops and access to the working tax credit begins (for some at least). The logic of a unified system of support, with a single withdrawal rate as earned income rises, obscures this threshold. This raises a series of issues around conditionality rules, but also makes it less clear when someone would become entitled to NSI and when they would be required to start paying it back.[17] However, this is a problem inherent in the universal credit, not particular to NSI.

Further consideration would also have to be given to the status of self-employed people, who do not currently make class 1 NICs and so are not eligible for contributory JSA. Moreover, the Chancellor's stated desire to merge the income tax and national insurance systems would clearly have implications for this policy. However, even if agreed, this change would take many years to implement, and it does not necessarily imply the contributory principle.

Costs to the state of NSI

There are two ways of thinking about the costs to the state of this reform, though neither is straightforward to calculate on the basis of publically available data.

The first is the annual cash outlay to people claiming NSI support. Estimates suggest that somewhere between 700,000 and one million people might be entitled to this extra support each year. The amount they would receive depends on their previous earnings and the duration of their benefit claim. However, neither Department for Work and Pensions administrative data nor other publically available datasets allow individuals' employment and benefit journeys to be tracked (with a decent sample size). Therefore, outside government, only approximations of likely costs can be made.

There are strong reasons to think that people accessing NSI will return to work quickly. Around 60 per cent of people claiming JSA leave within three months and 80 per cent within six months.[18] Given their recent employment record, the return-to-work rates for those claiming through the contributory route are likely to be even higher. Assuming that everyone who was entitled to NSI claimed the maximum amount, with half accessing support for 13 weeks and half for the full 26 weeks, the annual cash outlay would be between £1.8 and £2.6 billion.[19]

This is very likely to be an overestimate. People may choose not to access NSI because they have other resources to fall back on. Some will not be entitled to the maximum amount, because their previous wage was less than £140 a week, and so would receive a weekly payment (at the 70 per cent replacement rate) somewhere below the £200 limit. And many will return to work even more quickly than the estimate allows, before the 13- or 26-week mark, sometimes significantly so.

One factor which might put upward pressure on costs is the potentially higher take-up rate of contributory JSA, if it allowed access to the extra support of NSI.[20] Even so, there are good grounds for thinking that £1.8 billion and £2.6 billion should be taken as upper estimates of the annual cash outlay.

17 This is linked to how variations in hours of work and shifts between full-time and part-time work would be handled.

18 Author's calculation based on NOMIS dataset.

19 In addition to existing expenditure on contributory JSA.

20 This would also increase administrative burdens on Jobcentre Plus, which would have to process and support more people.

The second – and more important – way of thinking about the potential costs of NSI lies in the net liability to the state. The principle behind NSI is that the full upfront cash costs to the government are recovered from people once they are back in work. Government would be using its scale and economic clout to help people smooth out income slumps and prevent them falling into unaffordable debt and a spiral of costly problems. The net liability to the exchequer would lie in the cost of subsidising the loan and the potential for non-repayment. Again, it is hard to calculate the potential value of this risk, but an insight can be gleaned from a study of the similarly structured student loan system.

Figures given in the Department for Business, Innovation and Skills (BIS) resource accounts (BIS 2010) and the Office for Budget Responsibility's recent *Fiscal Sustainability Report* (OBR 2011) suggest that the net liability of the student loans system is around 20 to 24 per cent of the total amount paid out each year. The BIS figures suggest this breaks down as 8 per cent from non-repayment and 12 per cent from loan subsidy.[21] However, there are good reasons for thinking that both elements of the net cost would be considerably lower for NSI compared to the student loans system. For example:

- The maximum amount loaned to an individual would be three or four times lower – £3,445 in total compared to £3,750 in each of up to four years
- Repayments would start as soon as people had been back in work for a month and were earning above £139 a week (the primary threshold for NICs) – rather than a £21,000 threshold for graduates
- The likelihood of people entering (or, rather, re-entering) work quickly would be higher, given the conditionality of the benefit – there are no similar employment conditions on graduates.

These factors mean that the loan subsidy and the risk of non-payment would be lower for NSI, though it is impossible to calculate without detailed modelling. However, as a guide, a range of between 10 per cent and 20 per cent would imply a net cost of somewhere between £180 million and £520 million a year. If the government wanted to minimise this liability further, it could charge a real interest rate on the loan or impose more rapid repayment rates.

Of course, NSI is not a unique solution. One alternative approach to tackling the 'protection gap' associated with low replacement rates would be to seek to strengthen the private insurance market, with incentives for individuals to purchase products that will protect their earnings if they become unemployed (Kippin 2009). There are merits to such an approach, but also real drawbacks in comparison to the reform outlined here. The most significant is that those who can afford to insure themselves are often those who need it least and those who need it most are usually those least able to insure themselves. NSI, by contrast, shares the risk, with costs to the individual only paying after the point at which the need has arisen and been met. In addition, there are issues of complexity and mis-selling which can be associated with private insurance products in markets like this.

In conclusion, NSI would substantially strengthen the protection provided by the welfare state at times of need for low- and middle-income workers, without significantly increased net costs to the government. It would provide real income security – with help for people who actually need it, when they need it – by harnessing the state's ability to lend and recoup over time and across the population.

21 The cost of the loan subsidy is calculated as the cost to the government of borrowing, assumed to be inflation (RPIX) plus 2.2 per cent.

3. A STEP TOWARDS A POPULAR, MAJORITARIAN WELFARE STATE

The proposal for a national salary insurance scheme, along the lines described here, speaks to a broader argument about the future direction of welfare policy on the centre-left. In the 1990s, the focus of centre-left thinking on welfare shifted from providing higher universal benefits to increasing conditionality and means testing. This was part of a broader repositioning, from protecting the job to protecting the worker, which was shared across social democratic parties in Europe and North America. It emerged in response to the legacy of the Thatcher/Reagan era, which produced the worst of all worlds: low benefits, weak work incentives, high unemployment, increased poverty *and* a rising benefits bill. It was also a shift aimed at dealing with the 'weak flanks' of social democracy on issues like welfare.

Alongside investment in back-to-work support, skills and tax credits, this approach contributed to record employment rates and falling poverty up until the financial crisis. However, it did not deal with entrenched worklessness – largely because reform of incapacity benefit came too late – and it provided too little of tangible benefit to ordinary working families. For example, the mantra of 'adapt or die' – plus a policy mix of tax credits and skills – left many low- and middle-income workers unable to secure increases in living standards and exposed to the winds of change blown by globalisation. This has left the majoritarian appeal of the welfare state fragile among large sections of society.

In response, serious thinking has begun on how to ensure that our economy 'shares the proceeds of growth' with ordinary workers (Plunkett 2011). The approach described here seeks to complement that mission by setting the welfare state on a path towards providing support which is more generous, more temporary and more conditional. Such an approach would aim to provide better protection to fewer people for shorter amounts of time – as employment rates rise and access to support is rigorously controlled. This could, in time, allow for greater help to people who are semi-permanently unable to work, if there were fewer people reliant on benefits overall.[22] By demanding more and protecting better, it can also command stronger, majoritarian support.

In this spirit, NSI could be included among a wider set of welfare policy reforms that would strike out in a decisively new direction:

- Weekly 'signing on' for everyone on JSA – to increase their engagement with the labour market and improve monitoring of back-to-work activity.
- Clear action plans for all jobseekers from the six-month point of their benefit claim – with Jobcentre Plus and private and voluntary providers delivering personalised back-to-work pathways (based on the Dutch 'individual reintegration agreement' model[23]). This could be achieved through extending and reforming the work programme.
- A guaranteed job for anyone facing long-term unemployment[24] – with the third sector and local government providing jobs of social value and a requirement for jobseekers to take up work or lose their benefits.[25]
- Steps to ensure that working people take home a decent income – through pressure to expand the living wage (especially in large, high-turnover companies) and targeted wage top-ups from the state.

22 By drawing a sharper distinction between these two groups of people, with very different needs, who are currently treated the in same way.

23 Finn 2008

24 When someone is either 12 or 18 months out of work.

25 See for example this proposal for such a scheme in the United States: www.thenation.com/article/161249/job-guarantee-government-plan-full-employment

While they have strengths, the universal credit and the work programme do not respond to these demands and so provide insufficient bases for future policy. The universal credit will not improve protection for people who have paid in to the system but face temporary unemployment – in fact, it will penalise savers and reduce incentives for second earners in working couples or families. Meanwhile, the work programme will not prevent long-term unemployment, because there is no backstop in place to guarantee work or curtail unlimited benefit claims.

The principles behind the NSI proposal – upfront support recovered through income-contingent loans – could be extended to other segments of the welfare state in, for example, national mortgage insurance, national sickness insurance or national retraining insurance. This could provide a way for assisting people during 'high-cost moments of life' in a way that is affordable to the state over the medium term. The move to a single-tier state pension already planned could be combined with a reconceptualising of the existing NI system as national pensions insurance (though not on a repayable basis).

While further thought and investigation is needed, the approach outlined in this paper begins to develop a new centre-left agenda for welfare.[26] This agenda would give priority to universal services, rather than universal benefits. And it would aim to provide fewer but clearer and more substantive offers that really mean something to people – rather than lots of little things that often don't. A list of top priorities might include:

- A **job guarantee** for anyone facing long-term unemployment
- A generous system of **salary insurance** for people losing their job
- Free universal **early years services**
- **Parental leave** that enables mothers and fathers to have real choices about work and care
- A **decent pension** for those who have worked or cared.

Making this approach happen would require tough decisions on funding, including looking at whether to continue paying certain benefits – like the winter fuel allowance and free bus passes – and whether to restructure others. For instance, entitlement to child benefit for older children might be refocused to instead pay for high-quality early years care. Tax relief on pension contributions for high earners might be switched to support employers to contribute more to the pension pot of those on low wages. Savings made from tightening eligibility for disability benefits might be partly channelled towards effective schemes, like Access to Work, that enable disabled people to secure employment.

This agenda could allow the centre-left to regain the initiative on welfare, rather than always playing on the defensive. It offers a response to those on the right whose goal is to undermine the existence of a collective welfare state that embodies our responsibility to look after each other in times of need. And it challenges those on the left who simply want to defend every aspect of the current system or deny that irresponsibility in the welfare system exists.

By demanding more and protecting better, it aims to speak to the majority of British people – so often left out of the debate – who know that anyone could find themselves needing a helping hand when times are tough, but who want the welfare state to be based on fulfilling our mutual obligations to each other. That is the centre-left case for welfare.

26 For more thinking in this area see Ben-Galim et al 2011

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