

Employing BELIEF:

Applying behavioural economics
to welfare to work

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Foreword

Professor Ian McDonald, University of Melbourne

We often chastise ourselves for our own poor decision-making. I must go on a diet, study for my exams, keep my desk tidy and I will begin tomorrow. But when tomorrow comes, the task is put off to the next day. And so on. The emerging area of 'behavioural economics', by drawing on psychology and sociology, goes deeper than simply pointing out this tendency by decomposing it into underlying behavioural weaknesses. These weaknesses identified by behavioural economics are regular and predictable traits in human behaviour, albeit violations of the neo-classical model of the rational human being, that is of *homo economicus*.

This report, *Employing BELIEF*, opens up a new area by applying six of the principles from behavioural economics to the process of moving from welfare to work. The report shows how these six principles, that is myopia, information confusion, loss aversion, over-optimism, copying others and sticking with the status quo, promise to improve our understanding of the causes of failures to make the transition from welfare to work and of how these failures can be turned into successes. The report shows that by recognising these principles, social policy and practice can improve the well-being of many socially excluded people, and help to bring them to inclusion.

Behavioural economics is a new area. Its application to policy issues is in its infancy. The authors of this report recognise this. Even so, they make a convincing case for the value of applying the principles of behavioural economics to the important issue of the transition from welfare to work. The applications shown in this report, and their future development, will lead to great gains for people hit by bad labour market outcomes.

Professor Ian McDonald

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Word from the sponsor



esg has been delivering welfare to work services since the beginning of the New Deal era.

Despite over a decade of initiatives such as Pathways, Employment Zone and the Flexible New Deal, the UK still has approximately five million people on out-of-work benefits. Whilst some programmes have been more effective than others, the reality is that not enough long-term unemployed people have been moved from unemployment into sustainable work. However, statistics do not tell the whole story. As an experienced provider **esg** believes that employment services can fulfill their true potential if policy creates the right environment to change participant behaviour *and* the welfare to work industry innovates its delivery to service users.

The welfare to work industry is undergoing huge change. The creation of new measures for sustainability and the cash-flow implications for outcome-based funding has created a new top tier of potential contractors for the Department for Work and Pensions. Whilst this rationalisation and risk transfer creates welcomed efficiency; **esg** believes that at the provision level, the impact of long-term Incapacity Benefit claimants entering 'the market' for the first time will require prime contractors to deliver a very different service from the predominate Jobseeker's Allowance led provision of the past. Innovation will be fundamental if we are to move this cohort towards the labour market and sustained work.

The recommendations of this research can be transformational if they are adopted and applied imaginatively by the welfare to work industry and translated into original service lines and interventions. **esg** believes that new ways of working will be one of the keys to breaking the cycle of benefit dependency especially for our hardest to help customers.

Steve Moore, Business Development Director, esg

esg.

SKILLS FOR WORKING
SKILLS FOR LIVING

Executive summary

Traditional neo-classical economics and rational choice theory both suggest that people act rationally in ways that maximise their economic wellbeing. But, in reality, this is not always the case; individuals often consciously act in ways that are not in their best interests and this creates a significant dilemma for policy-makers.¹

Behavioural economics provides a way of understanding behavioural responses. It recognises that people do not always make decisions rationally and that a multitude of other factors can affect their choices and influence their actions. Drawing from psychology and sociology, behavioural economics presents policy-makers with a set of tools that allow them to encourage 'beneficial' behaviour more effectively at relatively little financial cost.

So far, very little work has been undertaken in the UK to apply the principles of behavioural economics to reducing worklessness. That said, a behavioural insight team was established by David Cameron in July 2010 to examine how behavioural economics could be applied to various policy challenges and, given the government's commitment to reducing the welfare budget, it would seem prudent to examine how behavioural economics could be applied to welfare to work policy.

This paper identifies a set of principles using the acronym BELIEF, which draws upon lessons from behavioural economics. For policy-makers and practitioners involved in designing and delivering welfare to work policy and programmes, this set of principles provides a valuable starting point from which to consider how influencing behaviour can improve people's chances of moving from benefits and into work:

- **B**enefits in the short term are preferred to gains in the medium to long term, even if later gains are relatively greater.
- **E**ffective communication is crucial: how information is conveyed and by whom affects how well it is received.
- **L**oss aversion is common: people dislike losses more than they like gains of an equivalent amount.

¹ Prendergrast, J., Foley, B., Menne, V. and Isaac, A.K. (2010) *Creatures of Habit? The Art of Behavioural Change*, Social Market Foundation, p.6 www.smf.co.uk/creatures-of-habit.html

- **I**nherent over-optimism: people have a tendency to be over confident and over optimistic about their own abilities.
- **E**xistence of social norms: people are strongly influenced by what others around them do.
- **F**low with the status quo: when faced with a complex decision, people go with the flow.

Building on these principles, we make a number of recommendations for how behavioural economics can be embedded into welfare to work policy and delivery.

- We recommend that providers undertake a three-stage process with new referrals: [stage 1] a comprehensive assessment of clients' needs should be undertaken and used to [stage 2] triage claimants towards the most appropriate support and identify immediate goals that should be achievable on a weekly basis. There should be short-term rewards for short-term goals.
- We recommend the [stage 3] introduction of a reward card which allows claimants to build up a balance of points. Along the lines of the retail loyalty card, claimants would accrue points for achieving short-term goals, the value of which would be set by their personal adviser. On sustaining employment for an agreed time period an individual would be able to withdraw reward payments based on the value of the points they have accrued on the reward card.
- We recommend that a professionalisation framework for personal advisers is developed. This should include a core set of competencies, qualifications and agreed standards that are endorsed by the relevant professional bodies and implemented across the industry. The understanding and application of the BELIEF system would be an integral competency.
- We recommend that providers consider the 'match' between advisers and claimants. Where possible, client caseloads should be profiled to reflect commonalities between advisers and the claimants they work with. Providers should monitor the influence this has on the quality of relationships and the likelihood of job entry.
- We recommend that the sanctions regime is simplified, making it easier for advisers to explain and for claimants to understand. We believe the regime is currently too complex and, despite people's tendency towards loss aversion, the lack of clarity around sanctions can make them ineffective. Complexity prevents

claimants from fully appreciating the financial losses they face if they do not comply with the conditions of their benefit.

- We recommend that better off calculations should frame the difference in income between benefits and work as a **per annum loss** if a person stays on benefits. This per annum loss should be used as an 'anchor' for claimants, thereby using the tendency towards loss aversion to incentivise work-related activity.
- We recommend that advisers calculate a 'reservation wage' for each claimant following the completion of the comprehensive assessment of their aspirations and support needs. This should be based on an analysis of the individual claimant employability profile and the local labour market.
- We recommend that providers identify suitable individuals who have moved into work to become 'community employment champions' to act as mentors to those coming onto the Work Programme. Not only would this approach help to promote employment as the norm but it would also enable Work Programme providers to maintain relationships with those who have moved into work until they reach the point where they are defined as having sustained employment.
- We recommend that community employment champions are rewarded for helping people find work through a system of credits. Champions should be able to redeem rewards for the credits they accrue from the provider, which could be, for example, cash payments, contributions towards training courses, new tools, or equipment.
- The creation of individual welfare accounts is not an option that is being considered by the coalition government in its plans for benefits reform. However, we would suggest this is an opportune time for the government to examine the benefits of this approach as part of its deliberations on the composition of a 21st century welfare system.

1 Introduction

Whether stopping behaviour that is harmful or encouraging behaviour that is constructive, developing policies that improve individuals' or societal wellbeing is at the heart of the policy-making process. However, this aim is often thwarted; even where the desired behaviour is beneficial to individuals, people often act in ways that are not in their best interests. In overcoming this resistance, policy-makers create legal obligations, introduce fines and impose sanctions. These coercive attempts to alter behaviour can be effective and sometimes necessary but they are not always successful or appropriate – and they should only ever be used as a last resort. Behavioural economics recognises the value of these traditional policy levers but has demonstrated that, without an understanding of the, often irrational, ways in which people make decisions, policies relying on a 'stick' can fail to meet their objectives fully.

Neo-classical economics and rational choice theory both suggest that people act rationally in ways that maximise their economic wellbeing. According to these theorists, people are rational beings with clear objectives and a full appreciation of how best to go about achieving those objectives. However, the reality is very different. People do not always act rationally and, in fact, often consciously act in ways that are suboptimal to their economic wellbeing.² For example, people are heavily influenced by their peers, even if this encourages economically irrational behaviour that reduces their earning potential. Furthermore, people often do not have clear objectives and, even if they do, they may be unsure how to achieve them or may be exposed to so much information that they feel they are ill-equipped to make a sensible decision, and therefore do nothing.

Behavioural economics provides a way of understanding the factors that influence the ways people act. It recognises that people do not always make decisions rationally, but that a multitude of other factors affect their decisions and their actions. By pulling together techniques from psychology and sociology, behavioural economics helps refine neo-classical economic models and provide better, and empirically proven, ways of understanding the 'choice architecture' (that is, the way in which decisions are influenced by how the choices are presented) that shapes people's actions.³

² Prendergrast, J., Foley, B., Menne, V. and Isaac, A.K. (2010) *Creatures of Habit? The Art of Behavioural Change*, Social Market Foundation, p.6

³ Ibid.

By understanding how people make decisions and how they are likely to react to the different ways choices are presented to them, policy-makers are able to minimise the unintended consequences that some policies might encourage, and create the circumstances in which people are most likely to act in a way that supports the policy intent. As a result, irrational behaviour does not have to be an unsurpassable barrier to achieving policy goals.

In one sense this is nothing new. It is perfectly intuitive and unremarkable to note that people do not always act rationally, and that the choices people make can be influenced by the way choices are presented to them. Adam Smith noted in 1759 the conflict between the rational and calculating side of man and the 'fury of his desires'.⁴ But it is also arguably the case that policy-makers have for too long relied on tools that have not sufficiently taken into account the way in which people make decisions, and have relied too heavily on the rational levers of economic incentives (for example, tax credits) and disincentives (taxes and fines), and often unwieldy legislation. These financial and legislative levers are likely to be more effective when, for example, regulating businesses than when encouraging citizens to take more exercise, to smoke less or to find employment.

The benefits of more nuanced policy approaches that encourage behavioural change were explored in January 2010 in the Cabinet Office and Institute for Government's report *MINDSPACE*, which examined how the principles of behavioural economics could be applied to policy-making. The coalition government has maintained this momentum and a behavioural insight team was established by David Cameron in July 2010.

Behavioural economics, therefore, presents policy-makers with a set of tools that allows them more effectively to encourage 'beneficial' behaviour, and in so doing, save money at a time when the government is in the process of significant belt tightening. Restructuring people's 'choice architecture' could be a cost-effective way of altering behaviour, as small changes in the way policies are framed could lead to significantly improved results.

In the current economic climate, policies that do more with less are of significant value. The June 2010 emergency budget set out to make savings of £86 billion per year by 2014–15 in order to eliminate the UK's structural deficit. The budget

⁴ McAuley, I. (2007), *Behavioural Economics and Public Policy: Some insights*, [Online], Available www.home.netspeed.com.au/mcau/academic/bepubpol.pdf [15 Oct 2010], p.1.

proposed that 80 per cent of savings should come from spending cuts, and £11 billion of welfare cuts were announced.⁵

In October this year, the Treasury's Spending Review 2010 included a further £7 billion of cuts to the welfare budget. The Chancellor of the Exchequer confirmed that, over the next two parliaments, the current system of means-tested working age benefits and tax credits would gradually be replaced with a 'universal credit', an integrated payment which is intended to ensure that work always pays and should reduce the scope for fraud and error. The spending review also heralded major changes to the eligibility criteria and levels of entitlement in the benefits system, and all of these changes are likely to have an impact upon the behaviour of jobseekers, the likely extent of which is explored further in chapter three.

So far very little work has been done in the UK to apply the principles of behavioural economics to reducing worklessness. The behavioural insight team is working across different policy areas and, given the government's commitment to reducing the welfare budget, it would seem prudent for it to examine how behavioural economics can be applied to welfare to work policy.

This is a critical time for welfare reform. The new government is introducing significant changes to the benefits system and to welfare reform, which are outlined in detail in chapter three. Together, these reforms represent the most radical changes to the welfare to work landscape in many years, and present real opportunities for new ideas and practices to be implemented. This paper provides a framework for how the insights of behavioural economists can be applied to welfare, in the hope that the most can be made of these opportunities. We identify six tenets we call the 'BELIEF' principles, which policy-makers should bear in mind and welfare to work practitioners can apply in delivery. The BELIEF principles are drawn from evidence from behavioural economics, and provide a starting point for developing new approaches to welfare to work that encourage positive behavioural changes and should improve employment probabilities.

The remainder of this paper falls into four main sections:

- a more detailed discussion of the six BELIEF principles that we have identified as relevant to this field
- an overview of the direction of travel for welfare reform

⁵ Chote, R., *Post Budget Presentations: Opening Remarks*, Institute of Fiscal Studies, www.ifs.org.uk/budgets/budgetjune2010/chote.pdf [15 Oct 2010], and Brewer, M. (2010), *Welfare Savings*, Institute of Fiscal Studies, www.ifs.org.uk/budgets/budgetjune2010/brewer.pdf [15 Oct 2010]

- a discussion of how our six principles are relevant to the challenges and opportunities in the welfare field
- a framework for how the lessons learnt from behavioural economics could be applied.

2 The six BELIEF principles

Herbert Simon challenged rational choice theory when he argued that people are not always fully rational and, in fact, that decisions are very often controlled by 'bounded rationality'.⁶ Behavioural economists have identified a wide range of traits that have an impact upon behavioural responses and often negatively affect the rationality of choices made.

This section examines six of these traits, which we argue can be applied to welfare to work. These traits suggest that:

- **B**enefits in the short term are preferred to gains in the medium to long term, even if later gains are relatively greater.
- **E**ffective communication is crucial: how information is conveyed and by whom affects how well it is received.
- **L**oss aversion is common: people dislike losses more than they like gains of an equivalent amount.
- **I**nherent over-optimism: people have a tendency to be over confident and over optimistic about their own abilities.
- **E**xistence of social norms: people are strongly influenced by what others around them do.
- **F**low with the status quo: people sometimes prefer what they have to making changes, even if those changes may be beneficial.

2.1 Benefits in the short term are preferred to gains in the medium to long term, even if later gains are relatively greater

From an economic perspective, if someone is faced with the choice of receiving £100 today and £105 in a year, where there is a five per cent interest rate their only choice is *when* they gain liquidity, as the two sums of money are economically equivalent. Individuals demonstrate a strong tendency to value things of equivalent

⁶ Simon, H. (1957) *Models of Man, Social and Rational: Mathematical Essays on Rational Human Behavior in a Social Setting*, New York: Wiley

value more if they receive them now rather than in the future – most people would choose £100 today over £105 next year, although they are in effect the same amount of money. More interestingly, people often prefer a *lower* payment in the short term than a higher one further in the future – it may be that an individual would prefer £80 now compared to £105 in a year. This would suggest that people have a very high ‘discount rate’ for now to later.

Moreover, people become more impatient the more imminent the payoff is, that is, they apply a higher discount rate the sooner the payoff.⁷ For example, given the choice of £105 in two years or £80 in one year, people are more likely to choose the £105 than if the timescale was a year further forward. These phenomena are known as ‘hyperbolic discounting,’ and have been found to apply to other areas (for example health and environmental gains), as well as to money.⁸ Hyperbolic discounting can cause us to make decisions that are not ‘rational’ from an economic perspective.

Moreover, George Loewenstein has shown that immediate ‘visceral influences,’ such as moods, emotions, pain, hunger and sexual desire, when strongly felt, can ‘crowd out’ virtually all goals other than that of mitigating the visceral factor.⁹ When these visceral influences are felt, hyperbolic discounting will be more pronounced. An addict craving a drug, for example, would certainly choose £80 now rather than £105 in a year, as having the money now would let them mitigate their cravings in the short term.

The fact that people are thus ‘present biased’ presents challenges for policy-makers. For example, it is in the interests of people to save money in a pension for their retirement, but they often prefer to spend the money in the short term rather than saving to benefit themselves in the long term. This may mean that people may not start or pay enough into a pension, and therefore be less well off in their retirement than they would have wanted.¹⁰

⁷ Dasgupta, P., and Maskin, E., (2004), *Uncertainty and Hyperbolic Discounting*, www.sss.ias.edu/files/papers/econpaper23.pdf [15 Oct 2010]

⁸ Hardisty, D.J. and Weber, E.U. (2009), ‘Discounting Future Green: Money Vs. The Environment’, *Journal of Experimental Psychology*, vol. 138, no. 3, pp. 329-340

⁹ Loewenstein, G. (1996) ‘Out of control: visceral influences on behaviour’, *Organizational behaviour and human decision processes*, vol. 65, no.3

¹⁰ van de Coevering, C., Foster, D., Haunit, P., Kennedy, C., Meagher, S. and van den Berg, J. (2006) *Estimating economic and social welfare impacts of pension reform*, Department for Work and Pensions p.45

Policy-makers need to be aware of hyperbolic discounting when incentive schemes are being designed, as it will influence the timing and level of payments.¹¹ For example, hyperbolic discounting suggests that smaller but more regular incentive payments throughout a process may be worth more than one larger payment at end of it.

2.2 Effective communication: how information is conveyed, and by whom, affects how well it is received

People may act in a manner that does not best serve their interests if they do not have all the information they require to make an informed decision. However, if one wants to allow people to make more informed decisions it is not enough simply to provide all the information people require. Given that people are faced in their everyday lives with an unremitting flow of information, and therefore tend to filter out much of it, information has to be conveyed in a way and by messengers that the target audience is most likely to be receptive towards.¹²

First, information that is meaningful and accessible is more likely to be acted upon. Most obviously, the information must stand out and be memorable, so that people do not filter it out. Furthermore, it is important to ensure that information is presented in a way that people can easily understand and encode. This is often achieved if information is conveyed in ways which relate to our personal experiences, rather than as impersonal theory.¹³

In addition, people sometimes 'anchor' or over rely on certain pieces of information or subjects when understanding a broader subject, and this can bias their understanding of the whole subject. For example, one study has shown that having a minimum payment specified on credit card bills reduces the amount people are likely to pay back. This is because specifying a minimum payment draws people's attention to making lower level payments. In an experiment, when given a £435 credit card bill, those whose bill included a two per cent minimum charge paid back on average £99 but those whose bills did not include a minimum payment on average paid back £175, over 70% more.¹⁴

¹¹ Cabinet Office and Institute of Government (2010), *MINDSPACE: Influencing behaviour through public policy*, p. 21

¹² Ibid, p. 23

¹³ Ibid.

¹⁴ Stewart, N. (2009) *The cost of anchoring on credit card minimum repayments*, www.psychologicalscience.org/journals/ps/20_1_inpress/Stewart.pdf [15 Oct 2010]

Moreover, evidence suggests that people react differently to information depending on who tells it to them. First, and most intuitively, people are more likely to act on information if it is delivered by someone who they perceive to be an expert than someone who is not.¹⁵ More interestingly, people can be more likely to act on information if it is delivered by someone who has a similar demographic profile, or who behaves in a similar way. Building on this, information received from peers who act as mentors is often better received, as people feel that the information is most relevant to their situation.¹⁶

Policy-makers therefore need to ensure that information is conveyed simply but strongly, and that those conveying information are recognised as having authority. They may also want to ensure that those conveying information are from diverse backgrounds to reflect the backgrounds of those they work with, and it may be worth considering ways in which the most important information can be 'anchored'.

2.3 Loss aversion is common: people dislike losses more than they like gains of an equivalent amount

On the whole, people tend to value something they own more than they would if they had to buy that same thing – the fact of owning something in itself can increase its value. This is called the 'endowment effect'.¹⁷ For example, people who are assigned an everyday object, such as a cup or a pen, value it at about twice the level than if they were not given it but were given the option to buy it.¹⁸ Closely linked to this, people also tend to value losses more highly than they value gains at the same level – 'loss aversion'.

The most obvious policy implication arising from loss aversion is that if policy-makers can clearly convey the losses that certain behaviour will incur, it may encourage people not to do it. For example, explaining that the annual cost of smoking 20 cigarettes a day is about £2,500 is likely to make people feel the loss of income much more than if they were to simply buy a pack each day without weighing up the total financial costs.

¹⁵ Webb, T. L., and Sheeran, P. (2006), 'Does changing behavioral intentions engender behavior change? A meta-analysis of the experimental evidence', *Psychological Bulletin*, vol. 132, no 2

¹⁶ Sacerdote, B. (2001), 'Peer Effects With Random Assignment: Results For Dartmouth Roommates', *The Quarterly Journal of Economics*, vol. 116, no 2, May, pp. 681-704

¹⁷ See section 2.6

¹⁸ Johnson, E.J., Gächter, S, and Herrmann, A. (2006), *Exploring the nature of loss aversion*, CeDEx Discussion Paper No. 2006-02, www.nottingham.ac.uk/economics/cedex/papers/2006-02.pdf [15 Oct 2010]

Loss aversion also has significant implications for the ways incentives should be offered – if someone values something they have twice as much as they would if they had to buy the same thing, it suggests that simply offering incentives to encourage desired behaviour may not always be the most effective way of encouraging behaviour. Recent research has shown that this is the case; one study offering incentives to obese people to reduce their weight found that these incentives had very little effect.¹⁹ On the other hand another study got obese people to deposit money into an account. They were then told that they would receive the money back, plus some more, if they lost a set amount of weight. By framing the incentive as a loss, results showed that this group saw significant weight loss after a period of seven months.²⁰

Beyond this, loss aversion has implications for the way sanctions are implemented. If people are not clear about exactly what a sanction will cost them, they may not place a high enough value on it. This suggests that it is important for sanctions to be clearly explained, so that people have a clear understanding of the losses that they will incur if they adopt certain behaviour.

2.4 Inherent over-optimism: people have a tendency to be over confident and over optimistic about their own abilities

Research has shown that people do not assess the accuracy of their decisions, choices and characteristics correctly and, in particular, tend to be more confident than they objectively should be about decisions and answers they give.²¹ This is called an 'over-confidence bias'.

For example, there is evidence that people are often overconfident in their ability to pay off the balances of their credit cards, and that this can lead to suboptimal decision-making. It has been shown that given a choice between a credit card with a fee and low interest rates, and no fee and higher rates, many people chose to have no fee, despite this ending up being more expensive when they are unable to pay back as much per month as they expect. This is because they were over confident in

¹⁹ Paul-Ebhohimhen, V. and Avenell, A. (2008) 'Systematic review of the use of financial incentives in treatments for obesity and overweight', *Obesity Review*, vol. 9, no 4, pp.355-67

²⁰ Volpp, K. John, L., Troxel, A., Norton, L., Fassbender, J. and Loewenstein, G. (2008), 'Financial incentive-based approaches for weight loss: a randomized trial', *Journal of the American Medical Association*, vol. 300, no 22, pp.2631-7

²¹ Hoffrage, U. (2004) 'Overconfidence', in Pohl, R. *Cognitive Illusions: a handbook on fallacies and biases in thinking, judgement and memory*, Hove: Psychology Press

their ability to repay their balance and wanted to avoid a fee.²² Moreover, this over-confidence, by which people expect to get a better deal at the expense of those who fail to make payments, means that there is relatively little public pressure to regulate the market, because more people perceive the system as presenting opportunities than not.²³

This over-optimism also manifests itself when people believe they have more control over their lives than is actually the case, even when matters of pure chance are studied. This is called the 'illusion of control'. For example, a study gave two groups of people lottery tickets. Those in one group were able to choose their own tickets, and those in the other group were assigned a ticket at random. Participants were then asked whether they would like to exchange their ticket for one with higher odds of winning. Those who had picked their own ticket did not want to swap tickets, even though the new ticket would have a higher chance of winning.²⁴

Over-confidence, however, is not always uniform. People tend to be more over confident the more difficult the decision or choice is. Moreover, studies have shown under-confidence can occur when less difficult judgments are made.²⁵

2.5 Existence of social norms: most people's actions are strongly influenced by what others around them do

Most people's actions and opinions are strongly influenced by what others around them do. This is because there are social rewards from conforming and, conversely, if individuals do not conform to social norms there may be undesirable consequences. These norms may be evident throughout society, or specific to smaller communities, for example, particular age groups, people living in particular regions, or people from particular ethnic groups.

The policy-maker, therefore, needs to understand social norms and work with them, rather than creating policy that cuts across them. At its most basic, this simply

²² Warren, P.L. and Wood, D.H (2010) *Will Governments fix what markets cannot? Overconfidence and the demand for regulation*, <http://homepage.uab.edu/angner/pdf/overconfidence.pdf> [18 Oct 2010]

²³ Ibid.

²⁴ Langer, Ellen J. (1975), 'The Illusion of Control', *Journal of Personality and Social Psychology*, vol. 32, no 2: 311–328, quoted in Thompson, S.C. (1999), 'Illusions of Control: How we overestimate our personal influence,' *Current Directions in Psychological Science*, vol. 8, no 6, 187–190

²⁵ Hoffrage, U. (2004), 'Overconfidence', in Pohl, R. *Cognitive Illusions: a handbook on fallacies and biases in thinking, judgement and memory*, Hove: Psychology Press, p.242. See also Tweed, M. and Ingham, C. (2009), 'Observed consultation: confidence and accuracy of assessors', *Advances in Health Sciences Education*, vol. 15, no 1.

means that a policy-maker needs to understand the common opinions and actions that are prevalent among the people whose behaviour she is attempting to influence. Without understanding why, for example, smoking is more acceptable in one social group than another, one cannot isolate the strongest arguments against smoking for that group.²⁶

Actually creating and changing social norms is much more difficult, time-consuming and costly, and will generally require a prolonged public awareness campaign, for example, the campaign currently surrounding drink driving. Davit Knott *et al.* demonstrate the need to 'Understand where the boundaries of public acceptance for the intervention lie, and seek to win this over time through dialogue, debate and demonstrating of efficacy' and that policy-makers need to be prepared 'to seek results secured over the long term'.²⁷

Nevertheless, when policy-makers have shorter term goals and more limited resources, social norms can still be used to good effect. First, whether or not something is a social norm, the perception that it is can influence people's behaviour. To take a simple example, a tip jar in a café is more likely to fill up quickly if it already has some money in it at the start of the day than if it is empty. This is because a half-full tip jar gives the impression that tipping is expected, but if it is empty customers would not feel they are breaking a social norm by keeping their change.²⁸

Second, it is possible to encourage certain desired behaviour when people have incorrect perceptions of what the norms are. For example, students in America thought that their peers drank more alcohol than was actually the case. This misconception resulted in people drinking more in order to conform to the, incorrect, social norm. By advising students what the norm really was, that is, that people tended to drink less alcohol than they thought, there was less social pressure to drink alcohol, and therefore alcohol consumption fell.²⁹

It is important that a social-norms approach to policy is used carefully, both because it may discourage people to go 'beyond the norm' and because it may actually encourage undesirable behaviour. For example, a study found that when households

²⁶ Knott, D. with Muers S. and Aldridge, S. (2007), *Achieving Culture Change: a policy framework*, Cabinet Office, p.9

²⁷ *Ibid.*, p.88

²⁸ Griskevicius, V., Cialdini, R. B., and Goldstein, N.J. (2008) *Social norms: An underestimated and underemployed lever for managing climate change*, *International Journal for Sustainability Communication*, p.12.

²⁹ Perkins, H.W. and Craig, D. (2006), 'A Successful Social Norms Campaign to Reduce Alcohol Misuse Among College Student-Athletes', *Journal of Studies on Alcohol* <http://alcohol.hws.edu/jsa-perkins-craig-nov-06.pdf> [18 Oct 2010]

were given information about the average energy consumption in their locality, those who consumed more than the average reduced their consumption, but those who consumed less increased theirs.³⁰

2.6 Flow with the status quo: people sometimes prefer what they have to making changes, even if those changes may be beneficial

There are a number of reasons why people tend to prefer the status quo to making changes. The most obvious of these is simply inertia: people often lead busy lives and put things off that they may want to do in theory, but will not enjoy doing in practice or for which there is no significant personal gain associated with acting.

Inertia is enhanced when action requires a difficult decision. Often a decision becomes more complex when the decision-maker is confronted with large amounts of information. Whilst one might think that the more choice people have the better, people can actually feel paralyzed when they have too much choice – the so called ‘paradox of choice.’ For example, in a test two groups of people were faced with the choice of 24 and six types of jam, but those who were faced with only six choices were 10 times more likely to actually buy a jar than those with the greater choice.³¹

We have already discussed the ‘endowment effect’, by which people tend to value something they already own or have a right to at a higher level than if they had to purchase it.³² This effect can encourage people to prefer the status quo over a change, because the fear of losing what a person already has can outweigh the potential gains they might make if they alter their behaviour.

These various mechanisms by which people tend towards maintaining the status quo mean that it is important for policy-makers to ensure that any defaults created by policy are desirable. For example, countries that have an opt-in arrangement to allow organ donation have significantly lower organ donation rates than those countries that have an opt-out system.³³ Most people are happy to accept the status quo that requires them to take as little action as possible, and those who feel strongly that the status quo position is wrong for them have the freedom to change it.

³⁰ Cabinet Office and Institute of Government (2010), *MINDSPACE: Influencing behaviour through public policy*, p.22

³¹ Sheena S.I, and Lepper, M.R. (2000) *When Choice is Demotivating: Can One Desire Too Much of a Good Thing?*, www.columbia.edu/~ss957/whenchoice.html [18 Oct 2010]

³² See section 2.3.

³³ Johnson, E. and Goldstein, D. (2003) ‘Medicine. Do defaults save lives?’, *Science*, vol. 302, no. 5649

3 The direction of travel for welfare reform

The previous chapter outlines a set of principles that have been crucial to behavioural economic analysis. For policy-makers and practitioners involved in designing and delivering welfare to work policy and programmes, this set of principles provides a valuable starting point from which to consider how influencing behaviour can improve people's chances of moving from benefits and into work.

In the context of major welfare reforms, the importance not just of engaging claimants in labour market activation policies but of incentivising people to want to make purposeful steps to find and stay in work, without having to resort to coercion, cannot be overestimated. Reforms are taking place across the welfare to work landscape: at a structural level, the benefits system is changing and expected to change further still; and at an operational level the government will introduce a new single Work Programme, which will focus on personalised employment support for all those referred to it. These reforms aim to improve the efficiency of the system by improving outcomes and decreasing costs but to achieve these aims, welfare reform must encourage positive responses from jobseekers.

3.1 Reforms at the structural level

3.1.1 Coalition agreement and June 2010 budget commitments

A key part of the coalition government's welfare reform strategy is structural reform of the benefits system. In its coalition agreement, the government committed to proceeding with its predecessor's plan to reassess all existing Incapacity Benefit (IB) claimants from October 2010 and to advise all new claimants with a health condition to claim Employment and Support Allowance (ESA).³⁴ The government expects to complete the reassessment process by 2014 and claimants will either be found eligible for ESA, Jobseeker's Allowance (JSA) or will leave the claimant count altogether.³⁵ In its first budget, the government announced that lone parents

³⁴ HM Government (2010) *The Coalition: our programme for Government*, p. 23

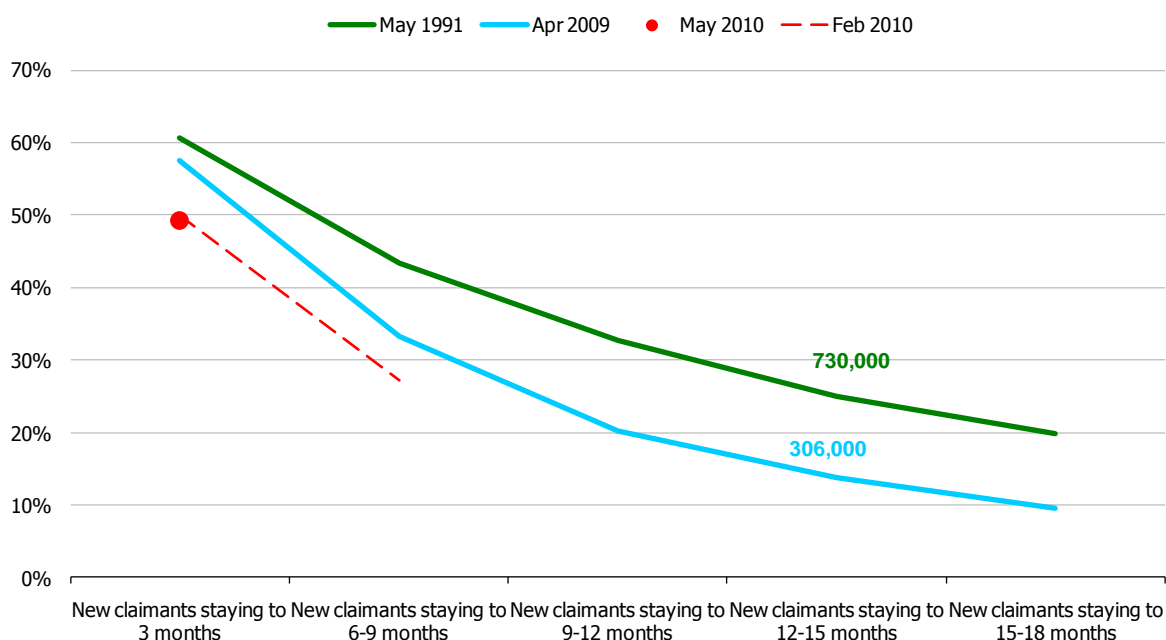
³⁵ Department for Work and Pensions (2010), *Framework for the Provision of Employment Related Support Services, Supplementary Delivery Partner Information*, www.dwp.gov.uk/docs/framework-supplimentary-info.pdf [18 Oct 2010], p.3

claiming income support will be expected to look for work when their youngest child reaches five years of age from October 2011 and will have to claim JSA.³⁶

These planned benefits reforms will significantly change the way in which many of the out of work population are defined, with large numbers of claimants who would have been classified as economically inactive and not required to look for work transferring to the unemployment count. With a change in status from 'economically inactive' to 'unemployed' comes increased conditionality, as those in the work-related activity group of ESA are expected to participate in work-related activity and those on the JSA regime must attend fortnightly interviews and actively seek work.

The purpose of conditionality is to encourage an appropriate behavioural response from the claimant. The threat of a benefit sanction should incentivise individuals to fulfil the rules of entitlement by participating in either work-related activity or active job search and there is some evidence to suggest a positive correlation between increased conditionality and the number of people leaving the claimant count. Comparing the long-term unemployment rate from the 1990s recession (before the introduction of the JSA regime) to this recession indicates that JSA claimants have moved into work quicker in this recession – preventing long-term unemployment and keeping JSA numbers down.

Figure 1: Duration of JSA claims: 1991, 2009, 2010



³⁶ HM Treasury (2010) *Budget 2010*, p. 49

However, extending conditionality to the *long-term* sick and disabled,³⁷ who have been out of work and claiming benefits for some time, is untested in the UK and we can assume that the transition from long-term benefit claim to employment is unlikely to be an easy one. Sixty-eight per cent of existing IB claimants in Great Britain have been claiming for five years or over; with no recent work experience, the prospect of employment may seem daunting and, possibly undesirable, to some in this group.

Table 1: Duration of IB claims by country (Great Britain) – February 2010

	Total	up to 3 months	3 months up to 6 months	6 months up to 1 year	1 year and up to 2 years	2 years and up to 5 years	5 years and over
Great Britain	2,166,110	7,620	8,320	17,230	172,660	492,590	1,467,700

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The data on lone parents claiming income support shows a similar picture, with almost 50 per cent of lone parents having been on the benefit for over five years.

Table 2: Duration of Income Support claims on grounds of lone parent status

	Total	up to 3 months	3 months up to 6 months	6 months up to 1 year	1 year and up to 2 years	2 years and up to 5 years	5 years and over
Great Britain	1,884,860	78,310	77,210	126,950	248,020	460,300	894,080

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Prolonged periods of unemployment or economic activity are costly to the government, to the individuals who are out of work, and to the economy as a whole. Conditionality has proved a useful tool for re-engaging 'consistent' JSA claimants in work but it is not possible to know whether it will have the same impact on long-term claimants transferring from other benefits, particularly those coming from IB.³⁸ Furthermore, conditionality and the threat of sanctions can only work if those in

³⁷ In other words, those who are long-term IB claimants

³⁸ 'Consistent' JSA claimant: i.e. those who have only claimed JSA, as opposed to those who have transferred to JSA from either IB or Income Support

receipt of a conditional benefit understand what their responsibilities are and how sanctions policies are applied. Research on lone parents by *Inclusion* and Northumbria University found that some of those who were transferred from Income Support to JSA did not realise they would be sanctioned for failing to attend work focused interviews.³⁹ Similarly, Goodwin (2008) found that few lone parents who had been sanctioned realised this was the case, and had instead assumed that their benefit entitlement had been adjusted.⁴⁰

Insights from behavioural economics show that policies designed to influence behaviour must be clear, in terms of what they are trying to achieve and how they will operate. If salient information is not simple and accessible, people will often not respond to it a way that meets the policy intent.⁴¹ The policy approach to benefits reform should consider how structural reforms can draw upon the principles of behavioural economics and 'nudge' people towards labour market participation.⁴²

3.1.2 21st Century Welfare: the Universal Credit

In summer 2010, the Department for Work and Pensions consulted on proposals to undertake further, wholesale, reform of the benefits system. The strategy paper *21st Century Welfare*, argued that the interaction between different benefits and the numerous agencies responsible for their delivery creates a complex system for claimants to navigate, and the various rules on eligibility, underlying entitlements and changing circumstances increase the risks of administrative error.⁴³

On 11 November 2011, the government published its White Paper *Universal Credit: welfare that works*, which committed to the introduction of a new benefit that will bring together out of work benefits and tax credits to create an integrated single system over the next 10 years. £2 billion was committed to achieving this aim in the Spending Review 2010.⁴⁴ Entitlement will be based on existing rules and vary depending on the nature of the individual application to reflect potential additional needs such as those of some disabled people and carers. There will be a single application and a single processing system, which will be administered using real-

³⁹ Gloster, R., Casebourne, J., Culshaw, S. Mavra, L. O'Donnell, A. and Purvis, A. (2010) *Lone Parent Obligations: early findings of implementation as well as experiences of the Income Support and Jobseeker's Allowance regimes*, Department for Work and Pensions Report 645, p. 4

⁴⁰ Goodwin, V. (2008) *The effects of benefit sanctions on lone parents' employment decisions and moves into employment*, Department for Work and Pensions Research Report 511

⁴¹ Cabinet Office and Institute of Government (2010), *MINDSPACE: Influencing behaviour through public policy*, p. 23

⁴² Thaler, R. H. and Sunstein, C. R. (2008) *Nudge: Improving decisions about health, wealth and happiness*, Penguin Books

⁴³ Department for Work and Pensions (2010), *21st Century Welfare*, cm 7913, pp. 7-16

⁴⁴ DWP (2010) *Universal Credit: welfare that works*, Cm 7957

time information on a person's income. When an individual moves into work, the Universal Credit will be withdrawn at a single rate, which will be set at a reasonable level to increase the work incentive. Earnings disregards will be variable to reflect the fact that some workers' circumstances may mean they need to retain more of their benefit than others. The government has pledged that no-one will be financially worse off if they choose to work, even if it is just for a few hours a week.

By introducing a single benefit, conditionality will no longer be linked to the benefit itself but to the reason a person claims it. This is in line with the recommendations of Professor Paul Gregg's independent review for the previous government, which concluded that conditionality should be personalised and extended to virtually everyone claiming benefits.⁴⁵

3.1.3 Spending Review 2010

On 20 October 2010, the spending review announced further reforms to the welfare system and additional cuts to the welfare budget of £7 billion, on top of the £11 billion announced in June. The Chancellor's announcements included:

- notice that household benefits payments would be capped from 2013 at around £500 per week for couple and lone parent households and around £350 per week for single adult households
- a change in the percentage of childcare costs that parents can claim through the childcare element of the Working Tax Credit, from 80 per cent to its previous 70 per cent level in April 2011
- time limiting contributory ESA for those in the work-related activity group to one year.

This paper does not set out to examine the appropriateness of these policies. However, the radical changes to benefit entitlement and eligibility criteria that were announced in the spending review will require significant behavioural change for some people. Furthermore, for families whose income will decrease significantly or who can no longer afford to live in their current accommodation, these policies' changes may lead to significant upheaval and the urgency of finding a new home in a new area may make finding employment a lower priority.

The government programme of reforms aims to radically simplify the benefits system and improve work incentives by setting marginal deduction rates at a level

⁴⁵ Gregg, P. (2008), *Realising potential: a vision for personalised conditionality and support*, Department for Work and Pensions

that ensures that financial benefits of working are explicit. By capping the amount of benefits a household can claim, this will increase the likelihood of a person being better off in work than on benefits.

However, addressing only the financial incentives, at the expense of considering the impact of other barriers to work, is unlikely to lead to significantly more people moving from benefits into employment. Research has demonstrated that the barriers to employment perceived by claimants are broad in range and extend beyond financial concerns.⁴⁶ Low confidence, housing issues, cultural worklessness and fear of the unknown have been shown to be key factors which influence a person's motivations to work.⁴⁷

Behavioural economics has come to recognise the impact that a broad range of external influences can have on individuals' choices. By applying the principles outlined in the previous chapter, the focus of structural reform can go beyond the focus on marginal income differences to ensure that barriers related to negative behavioural responses to work are addressed.

3.2 Reforms at the operational level

The coalition is also making significant changes at an operational level to welfare to work programme delivery. From summer 2011, all employment provision will be delivered through a single integrated Work Programme by private and voluntary sector providers. Potential contractors must first compete for entry onto a delivery framework, entrance to which will be decided based on a provider's ability and capacity to deliver employment services over the lifetime of the framework. The framework competition commenced at the end of June 2010 and selected providers will be notified in November 2010. Work Programme contracts are expected to be in place within the first half of 2011.

Providers will work with individuals for longer, be given greater freedom to design appropriate support for participants, and have stronger incentives to place the harder to help. The market will be headed by organisations capable of delivering the programme across whole regions and who can manage the financial risks of delivering large-scale contracts through an outcome-based funding model.

⁴⁶ See Dewson, S. (2005), *Evaluation of the Working Neighbourhoods Pilot Year One*, Department for Work and Pensions Research Report 297; Ritche, H., Casebourne, J. and Rick, J. (2005) *Understanding Workless People and Communities: A literature review*, Department for Work and Pensions Research Report 255; Goldstone, C. and Meager, N. (2002), *Barriers to Employment for Disabled People*, Department for Work and Pensions In House Report 95

⁴⁷ Ibid.

As emphasised above, the planned reforms of the benefits system will change the profile of the unemployed by transferring previously economically inactive IB and Income Support claimants onto the JSA regime. Along with ESA (work-related activity group), all of those transferred across will be eligible for the Work Programme. The sheer number of eligible claimants will result in the Work Programme being the largest employment programme Great Britain has ever seen.

Inclusion has estimated that, by 2014, there could be around 2.6 million participants on the Work Programme, of these, just 280,000 would be 'consistent' JSA claimants, with the rest having transferred from IB or Income Support, been found fit for work following a claim for ESA, or been placed in the ESA work-related activity group.⁴⁸

The Secretary of State for Work and Pensions, Iain Duncan Smith, has made clear that the government expects the support on offer through the Work Programme to be personalised and targeted.⁴⁹ As a concept in public-sector reform, personalisation has been supported on the grounds of its necessity in developing policies that empower service users and embed choice.⁵⁰ There has been consensus across the political divide that empowering citizens and putting the user at the centre of public services is the right approach to take.⁵¹ But personalising support and embedding choice require that those who are empowered are given clear information on which to make decisions and, crucially, that the external influences on a person's choices are understood.

*'Decision makers do not make choices in a vacuum. They make them in an environment where many features, noticed and unnoticed, can influence their decisions.'*⁵²

Thaler *et al.* highlight the important role played by 'choice architects', that is, those people responsible for creating the environment in which decisions are made.⁵³ In terms of welfare to work, choice architects are all of those involved in the design and delivery of welfare to work policy. The next chapter outlines how the six BELIEF principles identified in chapter two can be applied to policy and operations in order to improve the effectiveness of approaches to labour market activation.

⁴⁸ Centre for Economic & Social Inclusion (2010), *Intuitive transfer spreadsheet*, www.cesi.org.uk/statistics/ib_spreadsheet [18 Oct 2010]

⁴⁹ Smith, I.D., Secretary of State for Work and Pensions, *Welfare for the 21st Century*, 27 May 2010

⁵⁰ Prime Minister's Strategy Unit (2007), *Building on Progress*, Cabinet Office, p. 28

⁵¹ Prabhakar, R. (2009), 'Reforming Public Services: the views of the main parties' and Thompson, N. (2009), 'A Reply to Rajiv Prabhakar', Griffiths S. and Kevin Hickson, (eds.) *British Party Politics and Ideology after New Labour*, Palgrave

⁵² Thaler, R. H., Sunstein, C.R. and Balz, J.P. (2010) *Choice Architecture*, <http://ssrn.com/abstract=1583509> [18 Oct 2010]

⁵³ *Ibid*, p. 4

4 Applying the BELIEF principles to welfare to work

Chapter two identifies a set of principles that can be applied to welfare reform. In particular, in this paper we argue that the BELIEF principles can be embedded at an operational level in the delivery of employment support to encourage claimants to take positive and effective steps towards moving into work.

4.1 Applying principle 1

Benefits in the short term are preferred to gains in the medium to long term, even if later gains are relatively greater

The most disadvantaged tend to have the highest discount rates and demonstrate the greatest preference for shorter term rewards.

The youngest, poorest, most urban and least educated individuals are the most likely to be hyperbolic discounters.

The short-term costs of moving from the safety of benefits to an unfamiliar labour market can often outweigh the longer term gains of moving into work.

When faced with prospective choices, behavioural economists have demonstrated that people have a tendency to offset longer term benefits against short-term rewards and that discounting is steeper in the immediate future than in the more distant future, a phenomenon called 'hyperbolic discounting'.⁵⁴ Research has shown that the most disadvantaged tend to have the highest discount rates and demonstrate the greatest preference for shorter term rewards also known as 'present bias'.⁵⁵ According to Eisenhauer and Ventura (2006) the youngest, poorest, most urban and least educated individuals are the most likely to be hyperbolic discounters.⁵⁶ For jobseekers, particularly those who have been out of work for long periods of time, the short-term costs of moving from the safety of benefits to an unfamiliar labour market can often outweigh the longer term gains of moving into

⁵⁴ See Laibson, D. (1997), 'Golden Eggs and Hyperbolic Discounting', *The Quarterly Journal of Economics*, vol. 112, no 2, May, pp. 443-77

⁵⁵ Halpern, D, Bates, C. and Beales, G. (2003) *Personal Responsibility and Behaviour Change*, Prime Minister's Strategy Unit, Cabinet Office

⁵⁶ Eisenhauer, J.G. and Ventura, L. (2006) 'The prevalence of hyperbolic discounting: some European evidence', *Applied Economics*, vol. 38, no 11, p. 1223-34

work.⁵⁷ These groups are also the most likely to be receiving unemployment benefits. For example, in Great Britain in 2009 those aged 16 to 24 were 66 per cent more likely to be on JSA compared with those of working age that were 25 or older, and in England in 2009 those living in urban areas were 63 per cent more likely to be on JSA than those living in rural areas.⁵⁸ Furthermore, those with no qualifications are more than twice as likely to be unemployed than those with any qualifications.⁵⁹

4.1.1 Identifying immediate goals

Short-term rewards for short-term goals can be used to motivate claimants to continue to pursue the objectives set.

Ensure that shorter term goals are identified and pursued, as opposed to simply focusing on the longer term goal of employment.

Undertake a comprehensive assessment of client's needs.

Triage claimants towards the most appropriate support.

For those claimants who are furthest away from the labour market, the benefits of employment may seem a distant gain and this presents employment advisers with a significant challenge if they are to overcome the effects of hyperbolic discounting. One way of doing this is to ensure that shorter term goals are identified and pursued, as opposed to simply focusing on the longer term goal of employment. Goals that are suitable for each individual jobseeker should be identified as soon as jobseekers are referred to the Work Programme. By using a comprehensive assessment process that examines a jobseeker's competencies, claimants and their advisers can use this information to construct a set of goals that are short-term and realistic.

In overcoming present bias, we believe providers should undertake a three-stage process with new referrals:

1. Undertake a comprehensive assessment of client's needs. An example of such an assessment is the 'CMyPeople' tool, which was developed by Chandler Macleod and the Australian Government to profile employability and skills among welfare to work participants. This online assessment tool profiles claimants' abilities across a range of 34 competences, which are matched

⁵⁷ Ibid.

⁵⁸ JSA claimant count, Office for National Statistics; and 2009 Mid-Year Population Estimates, ONS

⁵⁹ Quarterly Labour Force Survey, ONS

against employers' requirements for over 1,000 jobs. Claimants are then provided with a detailed overview of their strengths, their job options, and their skills fit with potential jobs they are interested in. The end result is a competency profile of the jobseeker which can be used by employment advisers to build personalised actions plans with individuals.

2. Triage claimants towards the most appropriate support and identify immediate goals that should be achievable on a weekly basis.
3. Short-term rewards for short-term goals can be used to motivate claimants to continue to pursue the objectives set. In the next section, we propose the use of a reward card, on which claimants can build a balance of rewards towards an eventual bonus payment when they move into work.

4.1.2 Jobsearch

Hyperbolic discounting also has an impact upon people's approach to job search.

People view job search as an unpleasant activity with immediate costs and delayed benefits.

By monitoring the intensity of the unemployed people's job search activity, it was possible to significantly reduce the length of their benefit claim.

Hyperbolic discounting also has an impact upon people's approach to job search. Paserman (2004) found that many people view job search as an unpleasant activity with immediate costs and delayed benefits.⁶⁰ As a consequence, unemployed people had a tendency to postpone tasks that would help them find work.

Della Vigne and Paserman (2005) demonstrated that the intensity of a person's job search positively influences future employment prospects but hyperbolic discounting leads to low search intensity.⁶¹ Paserman concluded that, by monitoring the intensity of the unemployed people's job search activity, it was possible to significantly reduce the length of their benefit claim.⁶² By insisting on seeing evidence of job search during claimant-adviser meetings and encouraging claimants to be proactive in following up applications, the likelihood of a person moving into the labour market increases considerably.

⁶⁰ Paserman, M. (2004), *Job Search and Hyperbolic Discounting: Structural Estimation and Policy Evaluation*, Institute for the Study of Labor

⁶¹ Paserman, M. and Della Vigne, S. (2005), 'Job Search and Impatience', *Journal of Labor Economics*, vol. 23, July, pp. 527-588

⁶² Paserman, M. (2004) *Job Search and Hyperbolic Discounting: Structural Estimation and Policy Evaluation*, Institute for the Study of Labor p. 28

Looking for employment is a fundamental step in the process of moving back into work but for policy-makers and providers, hyperbolic discounting presents a dilemma. The jobseeker's agreement for JSA claimants sets out in writing a person's availability for work and any agreed restrictions, the type of work they are looking for, what they will do to look for work and improve their chances of finding work and what they must do to remain entitled to JSA. This agreement commits JSA claimants to undertaking job search but, as the research highlighted above demonstrates, advisers who closely monitor levels of job search and are proactive in assisting claimants with the process (from completing applications to chasing them up) are likely to achieve the best results. This is arguably nothing new; monitoring job search and proactive assistance is precisely what advisers should do now with their client caseloads. However, evidence from behavioural economics demonstrates how specific incentives can be incorporated into this process to help 'nudge' claimants more effectively towards employment.

4.1.3 Bonus payments

Delays in payments may limit the incentives from a re-employment bonus because individuals must sustain work for a significant period, sometimes up to two years, before they are eligible for the financial reward.

In improving the value of the reward payment it is critical that the claimants are able to see the effects of behaviour in the short term on the worth of the longer term gain.

There is mixed evidence on the success of bonus payments as a possible means of overcoming hyperbolic discounting by increasing the longer term reward on offer and improving its attractiveness vis à vis immediate gains. Paserman (2004) argued that re-employment bonuses set at a reasonable level (equivalent of 10 weeks of unemployment benefit) were able to counteract the effects of hyperbolic discounting.⁶³ However, research from the Netherlands by van de Klaauw and van Ours (2010) demonstrated that the design of a bonus payment system can compromise its success unless it is guided by the behavioural trait of hyperbolic discounting.⁶⁴ They argued that delays in payments may limit the incentives from a re-employment bonus because individuals must sustain work for a significant period, sometimes up to two years, before they are eligible for the financial reward.⁶⁵ They

⁶³ Paserman, M. (2004), *Job Search and Hyperbolic Discounting: Structural Estimation and Policy Evaluation*, Institute for the Study of Labor, p. 27 and p. 29

⁶⁴ Van de Klaauw, B. and van Ours, J. C. (2010), *Carrot and Stick: How Reemployment Bonuses and Benefit Sanctions affect Job Finding Rates*, Tinbergen Institute Discussion Paper

⁶⁵ Ibid, p. 24

also found that take up rates were low; recent Department for Work and Pensions research indicates that low take-up of back to work bonuses is also an issue in the UK.⁶⁶

The time lag between the demonstration of positive behaviour and receipt of the reward is often too much and therefore weakens the incentive the re-employment bonus serves to create. In improving the value of the reward payment it is critical that the claimants are able to see the effects of behaviour in the short term on the worth of the longer term gain. The introduction of a reward card, which allows claimants to build up a balance of points, against which they can claim a final reward payment would improve the incentives in the shorter-term. Along the lines of the retail loyalty card, claimants would accrue points for achieving short-term goals, the value of which would be set by their personal adviser. On sustaining employment for an agreed time period, an individual would be able to draw out reward payment based on the value of the points they have accrued on the reward card.

In designing an incentive structure that takes account of hyperbolic discounting tendency:

We recommend that providers undertake a three-stage process with new referrals: [stage 1] a comprehensive assessment of clients' needs should be undertaken and used to [stage 2] triage claimants towards the most appropriate support and to identify immediate goals that should be achievable on a weekly basis. There should be short-term rewards for short-term goals.

We recommend the [stage 3] introduction of a reward card which allows claimants to build up a balance of points. Along the lines of the retail loyalty card, claimants would accrue points for achieving short-term goals, the value of which would be set by their personal adviser. On sustaining employment for an agreed time period, an individual would be able to withdraw reward payments based on the value of the points they have accrued on the reward card.

⁶⁶ See Dorsett, R., Metcalf, H. and Rolfe, H., with Bewley, H., Dhudwar, A., George, A. and Hopkin, R. (2010), *The Better-off in Work Credit: Incentives and experiences*, Department for Work and Pensions Research Report 637; and Sims, L., Casebourne, J., Bell, L. and Davies, M. (2010) *Supporting lone parents' journey off benefits and into work: a qualitative evaluation of the role of In Work Credit*, Department for Work and Pensions Research Report

4.2 Applying principle 2

Effective communication is crucial: how information is conveyed and by whom affects how well it is received

The use of open-ended questions and tailoring information to suit the individual claimant (as opposed to adopting a standardised approach) is a successful way of communicating with JSA claimants.

Taking a directive and challenging approach to communicating with claimants is effective.

Framing the relationship between advisers and jobseekers in a way that encourages claimants to take ownership of their job search and actively seek work is important.

Communication strategies are more effective if: they are delivered by an expert, similarities exist in social and educational background, information is communicated by peers and information is meaningful and accessible.

Evidence from behavioural economics tells us that our response to news is influenced by its bearer. The MINDSPACE report by the Cabinet Office (2010) and the Institute of Government found that effective communication relies heavily on messenger characteristics.⁶⁷

The issue of how to design communication strategies that work has been explored by the Department for Work and Pensions. Recent research has examined how advisers interact with claimants in work focused interviews.⁶⁸ The use of open ended questions and tailoring information to suit the individual claimant (as opposed to adopting a standardised approach) were found to be valuable ways of communicating with JSA claimants.⁶⁹ For IB claimants in particular, the research evidence illustrates the benefits of clear and salient information. For example, the Department for Work and Pensions' research showed that IB claimants often demonstrated less awareness of the expectations of work focused interviews, and advisers frequently failed to fully explain their purpose and had a tendency to focus on information gathering instead of offering advice about work opportunities.⁷⁰ For

⁶⁷ Cabinet Office and Institute of Government (2010) *MINDSPACE: Influencing behaviour through public policy*, Institute of Government, p. 19

⁶⁸ Drew, P., Toerien, M., Irvine, A. and Sainsbury, R. (2010), *A study of language and communication between advisers and claimants in Work Focused Interviews*, Department for Work and Pensions Research Report 633

⁶⁹ Ibid.

⁷⁰ Ibid.

lone parents, framing information about 'better off calculations' in terms of how they might help claimants, as opposed to focusing on the practice being something that had to be completed, elicited positive responses.⁷¹

Taking a directive and challenging approach to communicating with claimants is effective. A focus on supporting people to take a positive approach to job search activities and labour market entry benefits the jobseeker. Framing the relationship between advisers and jobseekers in a way that encourages claimants to take ownership of their job search and actively seek work is important and has been shown to increase the likelihood of claimants moving into employment.⁷²

Employment advisers should look to develop communication strategies that engage clients and encourage positive responses:

- **Collaborative:** claimants should be encouraged to take a partnership role in interviews.
- **Directive:** that said, advisers should set the agenda for discussions during interviews and provide clear instructions, including what conditions claimants are expected to meet and direction on practical matters such as CV construction and how to fill in application forms.
- **Proactive:** advisers should look to identify claimants' perceived barriers during initial meetings and actively try to address them during each interview.
- **Positive:** offering encouragement and focusing on claimants' positive attributes increases the likelihood of their positive engagement.
- **Challenging:** whilst remaining positive, advisers should challenge claimants about disinclinations to consider certain types of work and about their job search techniques.

For employment advisers delivering support on the front line, developing good relationships with clients on a programme is crucial in helping advisers to identify support needs and agree what practical help individuals require to find employment. Research has shown that communication strategies are more effective if:

- They are delivered by an expert. People are more likely to act positively on information if they feel the person delivering this is someone with specialist

⁷¹ Ibid.

⁷² Behncke, S., Frölich, M., Lechner, M. (2007), *Unemployed and Their Caseworkers: Should They Be Friends or Foes?*, Institute for the Study of Labor

knowledge.⁷³ *Inclusion* has argued for the establishment of a framework for the professionalisation of personal advisers in the welfare to work industry. In our recently published report, *Professionalising the welfare to work industry* we set out to benchmark the current skills, qualifications and backgrounds of personal advisers and argue for the creation of a framework for accreditation.⁷⁴

We recommend that a professionalisation framework for personal advisers is developed. This should include a core set of competencies, qualifications and agreed standards that are endorsed by the relevant professional bodies and implemented across the industry. The understanding and application of the BELIEF system would be an integral competency.

■ **Similarities exist in social and educational background** between the deliverer and the recipient of information. This can improve the effectiveness of communication.⁷⁵ On some programmes, both Jobcentre Plus and providers already do this and it has been found to be effective. For example, research on the 'Action Teams for Jobs' programme reported that recruiting advisers from targeted local areas helped to attract clients to the programme.⁷⁶

We recommend that providers consider the 'match' between advisers and claimants. Where possible, client caseloads should be profiled to reflect commonalities between advisers and the claimants they work with. Providers should monitor the influence this has on the quality of relationships and the likelihood of job entry.

■ **Information is communicated by peers.** This approach is often better received than information delivered by a stranger. Studies in psychology have shown that the presence of peers influences effort.⁷⁷ In line with the concept of the Big Society, providers should identify potential 'community employment champions', local people who have successfully moved from benefits and into work. This approach is discussed in more detail later in the chapter.

⁷³ Webb, T. and Sheeran, P. (2006) 'Does changing behavioral intentions engender behavior change? A meta-analysis of the experimental evidence.' *Psychological Bulletin* 13: 249 - 268

⁷⁴ Crawford, E. and Parry F. (2010) *Professionalising the welfare to work industry: Developing a framework for action*, Centre for Economic & Social Inclusion

⁷⁵ Cabinet Office and Institute of Government (2010) *MINDSPACE: Influencing behaviour through public policy*, p. 19

⁷⁶ Casebourne, J. Davis, S. and Page, R. (2006) *Review of Action Teams for Jobs*, DWP Research Report 328, p. 20

⁷⁷ Sacerdote, B. (2001), 'Peer Effects With Random Assignment: Results For Dartmouth Roommates,' *The Quarterly Journal of Economics*, vol. 116, no 2, May, pp. 681-704 (restricted)

- **Information is meaningful and accessible.** Clear and salient information is better received and is more likely to be acted upon.⁷⁸ Clarity about what is expected at claimants and every meeting and what the consequences will be if they fail to comply is critical.

4.3 Applying principle 3

Loss aversion is common: people dislike losses more than they like gains of an equivalent amount

When inertia sets in, it becomes difficult to convince jobseekers of the benefits of work because the advantages are irrationally outweighed by the prospect of failing to secure employment.

Unless the sanctions process is clear and transparent, it is unreasonable to expect claimants to understand fully or appreciate the potential financial losses they face if they do not fulfil the conditions of their benefit.

Making explicit exactly how sanctions will affect a person's benefit is important.

People sometimes 'anchor' certain facts which they over-rely on when thinking about a subject.

Behavioural economists tell us that, on balance, people prefer to avoid losses more than they want to acquire gains of an equivalent amount.⁷⁹ Tversky and Kahneman's seminal research into this area (1971) demonstrated that individuals predictably undervalued rewards and overvalued potential losses because of *loss aversion*.⁸⁰

Research has shown that the fear of rejection is a form of loss aversion and can lead to inertia. When inertia sets in, it becomes difficult to convince jobseekers of the benefits of work because those advantages are irrationally outweighed by the prospect of failing to secure employment.⁸¹ The tendency towards loss aversion may have negative implications for the Secretary of State's proposal to encourage jobseekers to move to areas where there are greater numbers of employment

⁷⁸ Kling, J. (2009) *Helping more unemployed workers find jobs and build skills*, the Brookings Institution

⁷⁹ Chetty, R. (2003), *Consumption Commitments, Unemployment Durations, and Local Risk Aversion*, UC-Berkeley and NBER www.economics.harvard.edu/faculty/chetty/files/commitments.pdf [18 Oct 2010]

⁸⁰ Tversky, A. and Kahneman, D. (1971), 'Belief in the law of small numbers' *Psychology Bulletin*, vol. 76, no 2, Aug, pp. 105–110

⁸¹ Le, A.T. and Miller, P.W. (2000), 'An Evaluation of Inertia Models of Unemployment' *The Australian Economic Review*, vol. 33, no 3, September

opportunities because loss aversion makes people less inclined to take risks and more reluctant to consider relocation.⁸²

Sanctions

A wealth of Department for Work and Pensions research has examined the use of sanctions and their efficacy. Some advisers have criticised the sanctions regime for ESA work focused interviews, which is applied to additional premiums payments for attendance, as opposed to basic benefit payments. Consistent with the theory of hyperbolic discounting, advisers argued that this approach lessened the potential effect of the sanction, as the result of the sanction was that they would forgo an additional premium for attendance, rather than losing existing payments.⁸³

Given that, for most people, losses are more important than comparable gains, it is important that potential losses are defined and made explicit to jobseekers. In his review of conditionality for the Labour government, Professor Paul Gregg argued that the visibility and effectiveness of the sanctions regime should be improved.⁸⁴ Unless the sanctions process is clear and transparent, it is unreasonable to expect claimants to understand fully or appreciate the potential financial losses they face if they do not fulfil the conditions of their benefit. On JSA alone, there are eight different reasons a person can be referred for sanction and, in April 2010, over 900,000 people were referred for sanction.⁸⁵

Anchoring

Making explicit exactly how sanctions will affect a person's benefit is important. Equally important in addressing the tendency to be loss averse is for providers to frame the losses a claimant will make if they remain on benefits for long periods as opposed to working.

People sometimes 'anchor' certain facts which they over-rely on when thinking about a subject. It is important when helping people with their job search that they anchor the benefits they will accrue if they gain employment, rather than focusing too much

⁸² Sunday Telegraph, 'Coalition to tell unemployed to "get on your bike"', 26 Jun 2010, www.telegraph.co.uk/news/newstoppers/politics/conservative/7856349/Coalition-to-tell-unemployed-to-get-on-your-bike.html [18 Oct 2010]

⁸³ Barnes, H., Sissons, P., Aston, J., Dewson, S., Stevens, H., Williams, C. and Francis, R. (2010), *Employment and Support Allowance: Early implementation experiences of customers and staff*, Department for Work and Pensions Research Report 631, p. 38

⁸⁴ Gregg, P. (2008), *Realising Potential: A vision for Personalised Conditionality and Support*, Department for Work and Pensions, p. 45

⁸⁵ Department for Work and Pensions tabulation tool
http://83.244.183.180/sanction/sanction/LIVE/dec_fix_dec/q_2gp/jcreg/a_stock_r_q_2gp_c_jcreg_apr10.html

on how difficult it will be to gain work. Anchoring the benefits of gaining employment, rather than the challenges of job search is an important way of engaging claimants in the positive steps towards finding employment.

It is important that claimants are given the opportunity to articulate the motivations that will anchor their job search. Advisers can calculate the annual additional income an individual would be likely to gain if they found employment. By presenting the additional income as an annual figure it will appear more substantial than if it were presented by a weekly or monthly figure, and by relating that annual sum to the goods or services that the customer most wants, the benefits will be personalised.

Incorporating this approach into the development of action plans by explaining the potential financial losses of not working that are accumulated over a period of time would highlight the risks of financial loss if unemployment spells persists for long periods. However, an individual's perception of loss may not be best articulated in financial terms. It is important that advisers identify early on what a person values most about the prospect of work and ensure that all subsequent job search and work-related activity are anchored to these values.

In addressing loss aversion the following actions should be considered.

We recommend that the sanctions regime is simplified, making it easier for advisers to explain and for claimants to understand. We believe the regime is currently too complex and, despite people's tendency towards loss aversion, the lack of clarity around sanctions can make them ineffective. Complexity prevents claimants from fully appreciating the financial losses they face if they do not comply with the conditions of their benefit.

We recommend that better off calculations should frame the difference in income between benefits and work as a *per annum loss* if a person stays on benefits. This per annum loss should be used as an 'anchor' for claimants, thereby using the tendency towards loss aversion to incentivise work-related activity.

4.4 Applying principle 4

Inherent over-optimism: people have a tendency to be over confident and over optimistic about their own abilities

Job search behaviour is influenced by the over confidence bias; unemployed people often engage in too little job search because they overestimate the ease with which they will find a job.

The *over confidence bias* refers to the tendency for individuals to be more confident in their own abilities and probabilities of success than they realistically should be.⁸⁶ Job search behaviour is influenced by the over confidence bias; unemployed people often engage in too little job search because they overestimate the ease with which they will find a job.⁸⁷

Over-optimism about wage expectations can also be a major barrier to some people considering moving into work. The 'reservation wage', i.e. the lowest wage at which a person is prepared to work, has been the topic of much labour market research.⁸⁸ From a theoretical perspective, higher reservation wages are associated with reduced likelihood of securing future employment.⁸⁹ Having people question their own judgement by explicitly considering counterarguments to their own thinking has been found to be effective in addressing unrealistic wage expectations.⁹⁰

It is important that advisers are able to *de-bias* jobseeker's wage expectations as soon as possible.⁹¹ Employment advisers should be upfront with claimants during their very first interview about:

- what wages they can expect
- where vacancies are
- how their experience, skills and aspirations match with the opportunities available.

We recommend that advisers calculate a 'reservation wage' for each claimant following the completion of the comprehensive assessment of claimants' aspirations and support needs. This should be based on an analysis of the individual claimant employability profile and the local labour market.

⁸⁶ Kahneman, D. and Tversky, A. (1984) 'Choices, Values and Frames' *American Psychologist*, vol. 39, no 4, pp.341–350

⁸⁷ Spinnewijn, J. (2008), *Unemployed but Optimistic; Optimal Insurance Design with Biased Beliefs*, London School of Economics

⁸⁸ See, for example, Mortensen, D. T. (1986), 'Job Search and Labor Market Analysis', in Ashenfelter, O. and Layard, R. (eds.) *Handbook of Labor Economics, Volume 2*, North-Holland, and Pissarides, C. A. (2000) *Equilibrium Unemployment Theory*, Second Edition, MIT Press, Cambridge, MA

⁸⁹ Ibid.

⁹⁰ Ibid.

⁹¹ Kling, J. (2009) *Helping more unemployed workers find jobs and build skills*, the Brookings Institution, p. 3

4.5 Applying principle 5

Existence of social norms: people are strongly influenced by what others around them do

The higher the unemployment rate among an individual's reference group, the less likely it has been found that the individual would be unhappy about their employment status.

It is unrealistic to expect that changes to the social norm can occur quickly.

Social norms are a powerful influencing factor on people's behaviour and research has identified a 'social norm effect' in unemployment.⁹²

The higher the unemployment rate among an individual's reference group, the less likely it has been found that the individual would be unhappy about their employment status.⁹³ Furthermore, there is a gender bias to these effects, with men more likely to be influenced by the social norm than women.⁹⁴ Finally, those who are less concerned about being unemployed have been found to be more likely to be out of work in the future than those where the social norm was to be in employment.⁹⁵

Conversely, in areas where employment is the norm, jobseekers tend to move off the claimant count and into work more quickly.⁹⁶ Social norm effects are often weaker in larger, and probably more anonymous communities, and for unemployed people for whom the local language is not their mother tongue.⁹⁷

Research has found that living in an area where there are other workless people can damage life chances.⁹⁸ Once people live in an area with many people out of work, their chances of finding work can be reduced simply because of where they live. This happens because of the characteristics of a place (lack of jobs, poor transport etc.) and the effect of living with other workless people (limiting the chances of finding work through friends; Social Exclusion Unit, 2004a).

⁹² Clark, A., Knabe, A. and Ratzel, S. (2008) *Unemployment as a social norm in Germany*, Working Paper No 2008 – 45, Paris School of Economics

⁹³ Clark, A. (2003), 'Unemployment as a Social Norm: Psychological Evidence from Panel Data', *Journal of Labor Economics*, vol. 21, no 2, pp. 289-322

⁹⁴ Ibid.

⁹⁵ Ibid.

⁹⁶ Lalive, R. and Stutzer, A. (2004), 'The role of social work norms in job searching and subjective well-being', *Journal of the European Economic Association*, vol. 2, no 4, 696–719

⁹⁷ Ibid.

⁹⁸ Ritchie, H., Casebourne, J., and Rick, J. (2005) *Understanding workless people and communities: A literature review*, Department for Work and Pensions Research Report 255, p. 50

Initiatives that tackle worklessness in areas where unemployment is the social norm have included area-based investments, such as the Working Neighbourhoods Fund. The Working Neighbourhoods Fund was established in 2007 by Communities and Local Government and the Department for Work and Pensions to provide local authorities with a resource to tackle worklessness in the most deprived areas.⁹⁹ Since 2008, £1.5 billion of funding has been distributed or allocated to councils to tackle worklessness in their areas but funding is due to end in March 2011. Under the Work Programme, providers delivering in areas with persistently high unemployment may need to change the perceptions of those who live in areas or within households where working is not considered the norm. This is made all the more challenging in areas where the claimant count is high but the vacancies in the local area are low. For example, in Bootle (Merseyside) there are currently 28 claimants to every job, compared with a national average of five to one.¹⁰⁰

It is unrealistic to expect that changes to the social norm can occur quickly. It is therefore more important that providers are able to identify what the social norm is, and whether this is likely to have a negative impact on a person's attitude to returning to work. Where unemployment is perceived as the standard, advisers should be equipped to challenge this view.

Developing effective communication strategies to provide claimants with information that refutes this assumption will be highly valuable. Acknowledging that information is often better received when it is communicated by peers, providers could approach individuals that have already been supported into work about sharing their experiences with those still looking for employment and assisting them in their job search. The Work Programme model is set up to support this, as providers will be working with claimants for a significant period after they move in to work.

We recommend that providers identify suitable individuals who have moved into work to become 'community employment champions' and act as mentors to those coming onto the Work Programme. Not only would this approach help to promote employment as the norm but it would also enable Work Programme providers to maintain relationships with those who have moved into work until they reach the point where they are defined as having sustained employment.

Developing a system which harnesses reciprocity, in line with the government's 'Big Society' concept, will require incentives to encourage those who have found work to help others to do the same. A system of credits which rewards community

⁹⁹ Department for Work and Pensions and Communities and Local Government (2007), *The Working Neighbourhood Fund*, www.communities.gov.uk/documents/communities/pdf/566881.pdf

¹⁰⁰ Nomis, Official labour market statistics, August 2010

employment champions who have found work and then go on to support others to do the same is one way this could be done. This approach could adopt similar principles to the successful Japanese programme, *Fureai Kippu*. This is a community currency, whereby electronic credits are paid in a computerised savings account to individuals who help elderly or disabled people with any aspects of their care that the Japanese national healthcare system does not cover. The unit of account of the Fureai Kippu is the hour of service and different rates apply depending on the different services provided.¹⁰¹ Individuals can use the credits they accumulate to 'pay' for care services for themselves or family members in the future.

We recommend that community employment champions are rewarded for helping people find work through a system of credits. Champions should be able to redeem rewards for the credits they accrue from the provider which could be, for example, cash payments, contributions towards training courses, new tools, or equipment.

4.6 Applying principle 6

Flow with the status quo: people sometimes prefer what they have to making changes, even if those changes may be beneficial.

When faced with a difficult decision or one involving too much choice, people may choose not to change their behaviour at all, or to choose the easiest option. As already shown in this paper, a cornerstone principle of behavioural economics, is loss aversion. Related to loss aversion is the tendency for people to favour the status quo if they are faced with a decision that entails potential losses compared with comparable potential gains, owing to an irrationally strong aversion to losses.

It is no surprise that, unless the incentives are compelling, people tend not to change their behaviour. Public policy reforms have already recognised this common behavioural response; pension reforms in particular have been designed to capitalise on individuals' preference for the status quo and the fact that they have a tendency to choose the default option.¹⁰²

The Pensions Act 2008 contains a number of measures that are aimed at encouraging greater savings in retirement by requiring employers to automatically enrol all eligible employees into a qualifying pension scheme.¹⁰³ By auto-enrolling scheme members, employees have to decisively opt out and the expectation is that

¹⁰¹ Lietaer, B. (2006), 'Complementary Currencies in Japan Today: History, Originality and Relevance' *International Journal of Community Currency Research*. vol.8, pp.1–23

¹⁰² Department for Work and Pensions (2009), *Automatic Saving: Changing workplace pensions*

¹⁰³ Pensions Act 2008. (c. 30), London: HMSO

status quo bias will lead most people to remain in the scheme and continue to save for their retirement.

Status quo bias can result in resistance to change and, for people who have been out of work for a long time, the prospect of work can be daunting. Fear of financial gaps that occur when making the transition into work and fear of losing the security of the benefits system can lead to a preference for the status quo, despite the positive impact employment would almost certainly have on a person's life.¹⁰⁴

Overcoming a status quo bias requires employment advisers to draw upon the lessons of all five principles set out above: appreciating the tendency towards short-term benefits of larger longer term gains, developing effective communication strategies, and having an awareness of people's propensity for over-optimism and loss aversion.

What is more difficult to do is to create a status quo which always encourages people to work without compelling any significant changes in behaviour. Research has been undertaken to explore how the benefits system itself could be designed to create a system which embeds a default option that links individual national insurance contributions directly to social security payments.¹⁰⁵

Proponents of this sort of system argue that individual welfare savings accounts could provide income security and facilitate redistribution over the life course, whilst also encouraging individuals to stay on benefits for as short a time as possible.

- Using the same principles behind auto-enrolment in pension schemes; employees would be expected to save a small proportion of their monthly income into savings accounts, from which a weekly sum could be withdrawn in periods of unemployment. Those who accrued savings over their working life would be able to draw down this amount in retirement, as either a lump sum payment or as a top up to their state pension. Where people had a negative balance, they would be eligible to collect the standard rate of state pension.¹⁰⁶

The creation of individual welfare accounts is not an option that is being considered by the coalition government in its plans for benefits reform. However, we would suggest this is an opportune time to examine the benefits of this approach as part of its deliberations on the composition of a 21st century welfare system.

¹⁰⁴ D'Souza, J., Conolly, A. and Purdon, S. (2008) *Analysis of the choices and constraints questions on the Families and Children Study*, Department for Work and Pensions Research Report 481

¹⁰⁵ See Sørensen, P. B. and Bovenberg, A. L. (2007) *Working to Account? Social Security Without Dependency*, Politea and van Huizen *Unemployment insurance savings schemes: insights from behavioural economics*

¹⁰⁶ Ibid.

5 Conclusion: a framework for application

The table below provides a framework for application as a quick reference for those delivering employment programmes. It sets out the basic six BELIEF principles, what they mean and ways in which they can be applied to assist in the development of strategies which encourage positive behavioural responses from claimants:

Principle	Basic tenants of the principle	Conclusions and recommendations
<p>Benefits in the short term are preferred to gains in the medium to long term, even if later gains are relatively greater.</p>	<p>We live for today at the expense of tomorrow – even if the pay-off is smaller.</p> <p>Hyperbolic discounting leads people to discount the future heavily when sacrifices are required in the present.</p>	<ul style="list-style-type: none"> ■ We recommend that providers undertake a three-stage process with new referrals: [stage 1] a comprehensive assessment of client’s needs should be undertaken and used to [stage 2] triage claimants towards the most appropriate support and to identify immediate goals that should be achievable on a weekly basis. There should be short-term rewards for short-term goals. ■ We recommend the [stage 3] introduction of a reward card which allows claimants to build up a balance of points. Along the lines of the retail loyalty card, claimants would accrue points for achieving short-term goals, the value of which would be set by their personal adviser. On sustaining employment for an agreed time period an individual would be able to withdraw reward payments based on the value of the points they have accrued on the reward card.

<p>Effective communication is crucial: how information is conveyed and by whom affects how well it is received.</p>	<p>Encouraging behavioural change relies upon people understanding and appreciating what changes are desired and why. Ensuring this is the case requires effective communication strategies that acknowledge that:</p> <ul style="list-style-type: none">■ People are more likely to act on information if an expert delivers it.■ Demographic and behavioural similarities between expert and recipient can improve the effectiveness of the intervention.■ If the message is delivered by a peer, it is likely to be more effective.■ Liking the messenger helps. That said, a directive approach can be more effective than a conciliatory approach.■ Consistency of message, across occasions is important.	<ul style="list-style-type: none">■ We recommend that a professionalisation framework for personal advisers is developed. This should include a core set of competencies, qualifications and agreed standards that are endorsed by the relevant professional bodies and implemented across the industry. The understanding and application of the BELIEF system would be an integral competency.■ We recommend that providers consider the 'match' between advisers and claimants. Where possible, client case-loads should be profiled to reflect commonalities between advisers and the claimants they work with. Providers should monitor the influence this has on the quality of relationships and the likelihood of job entry. <p style="text-align: right;">Continued>></p>
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<p>Loss aversion is common: people dislike losses more than they like gains of an equivalent amount.</p>	<p>The fear of not getting a job is a form of loss aversion and can lead to inertia.</p> <p>Given that, for most people, losses are more important than comparable gains, it is important that potential losses are defined and made explicit to jobseekers (e.g. the sanctions regime).</p>	<ul style="list-style-type: none"> ■ We recommend that the sanctions regime is simplified, making it easier for advisers to explain and for claimants to understand. We believe the regime is currently too complex and, despite people’s tendency towards loss aversion, the lack of clarity around the sanctions regime can make it ineffective. Complexity prevents claimants from fully appreciating the financial losses they face if they do not comply with the conditions of their benefit. ■ We recommend that better off calculations should frame the difference in income between benefits and work as a <i>per annum loss</i> if a person stays on benefits. This per annum loss should be used as an ‘anchor’ for claimants, thereby using the tendency towards loss aversion to incentivise work-related activity.
<p>Inherent over-optimism: people have a tendency to be over confident and over optimistic about their own abilities.</p>	<p>Jobseekers are over optimistic about chances of finding work but are pessimistic about the returns on the search efforts.</p>	<ul style="list-style-type: none"> ■ Employment advisers should be upfront with claimants during their very first interview about: <ul style="list-style-type: none"> <input type="checkbox"/> what wages they can expect <input type="checkbox"/> where vacancies are <input type="checkbox"/> how their experience, skills and aspirations match with the opportunities available. ■ We recommend advisers calculate a ‘reservation wage’ for each claimant following the completion of the comprehensive assessment of claimants’ aspirations and support needs. This should be based on an analysis of the individual claimant employability profile and the local labour market.

<p>Existence of social norms: people are strongly influenced by what others around them do.</p>	<p>Social norms have a powerful automatic effect on behaviour. Research has shown that this norm has important economic effects - the stronger the norm, the more quickly unemployed people find a new job. In areas where the norm is weak, greater effort needs to be made to promote this.</p>	<ul style="list-style-type: none"> ■ We recommend that providers identify suitable individuals who have moved into work to become 'community employment champions' and act as mentors to those coming on to the Work Programme. Not only would this approach help to promote employment as the norm but it would also enable Work Programme providers to maintain relationships with those who have moved into work until they reach the point where they are defined as having sustained employment. ■ We recommend that community employment champions are rewarded for helping people find work through a system of credits. Champions should be able to redeem rewards for the credits they accrue from the provider, which could be, for example, cash payments, contributions towards training courses, new tools, or equipment.
<p>Flow with the status quo: people sometimes prefer what they have to making changes, even if those changes may be beneficial.</p>	<p>Unless the incentives are compelling, people tend not to change their behaviour.</p> <p>Status quo bias can result in resistance to change and, for people who have been out of work for a long time the prospect of work can be daunting.</p>	<ul style="list-style-type: none"> ■ Challenging the status quo bias requires employment advisers to draw upon the lessons of all five principles set out above. ■ The creation of individual welfare accounts is not an option that is being considered by the coalition government in its plans for benefits reform. However, we would suggest this is an opportune time to examine the benefits of this approach as part of its deliberations on the composition of a 21st century welfare system.

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