Statutory Sick Pay: modelling costs and reforms

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About this report

This WPI Economics report, provides an overview of modelling and analysis for a report commissioned by Unum and published separately. It builds on previous work undertaken by the author for Scope and the Social Market Foundation. It contributes to understanding of the business costs of the Statutory Sick Pay system in the UK, and how changes to the system could feed through into business and government costs. It also assesses the potential economic and Exchequer benefits of an improved system of support for people needing to take sickness absence.

The author would particularly like to thank James Taylor at Scope for allowing us to update and replicate previous WPI Economics work on SSP reform, commissioned by Scope. We would also like to thank the stakeholders and experts who have engaged with this work. All views and opinions remain the authors'.

About WPI Economics

WPI Economics is a consultancy that provides economics that people understand, policy consulting and data insight. We work with a range of organisations – from FTSE 100 companies, to SMEs and charities and Central and Local Government – to help them influence and deliver better outcomes through improved public policy design and delivery. Our focus is on important social and economic policy debates, such as net zero, levelling up and poverty, productivity and mental health. We are driven by a desire to make a difference, both through the work we undertake and by taking our responsibilities as a business seriously. We are an accredited Living Wage employer.

About the author

Matthew Oakley, Director – WPI Economics

Matthew founded WPI Economics in 2015. He is a respected economist and policy analyst, having spent well over a decade working in and around policy making in Westminster. He has previously been Chief Economist at Which?, and Head of Economics and Social Policy at Policy Exchange. He began his career as an Economic Advisor at the Treasury, predominantly working on microeconomic, analysis and modelling issues around tax and welfare reform. He holds an MSc in Economics from UCL.

1. SSP - Who gets it and what does it cost?

Statutory Sick Pay in the UK

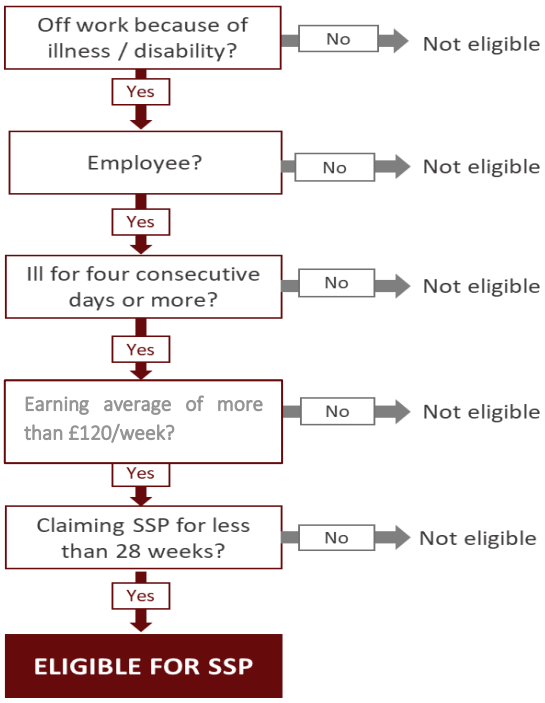
The introduction of Statutory Sick Pay in the early 1980s[i] was a landmark reform – for the first time making all employers directly responsible for the financial security of employees off sick from work, and replacing a complex and costly system of state sickness benefit that took thousands of civil servants to administer.[ii] The consequences of this change were far-reaching: almost 40 years later, Statutory Sick Pay remains one of the main ways by which the relationship between an employer and a sick or disabled employee is currently regulated, while state benefits have come and gone.

Eligibility

Even in the scheme of UK benefits, SSP is relatively complex. Eligibility is based around following criteria (shown in figure 1):[iii]

1. ***Sickness absence:*** The individual has to be off work, on a day that they would normally be working, because of an illness (or disability).
2. ***Employees:*** It is available to staff who are classed as employees.
3. ***Waiting period:*** Employees need to be ill for three consecutive days before becoming eligible for SSP. These may be working or non-working days. They can be paid SSP on days where they are off work sick after these three days.
4. ***Earnings threshold:*** Employees have to earn an average of more than £120 a week to be eligible.
5. ***Time-limit:*** It is paid for up to 28 weeks. When calculating this, periods of sickness absence that last for four more days each and are eight weeks or less apart are classed as one (linked) period.

Figure 1: Eligibility flow chart for SSP



Source: Adapted from WPI Economics & Scope

How much is paid?

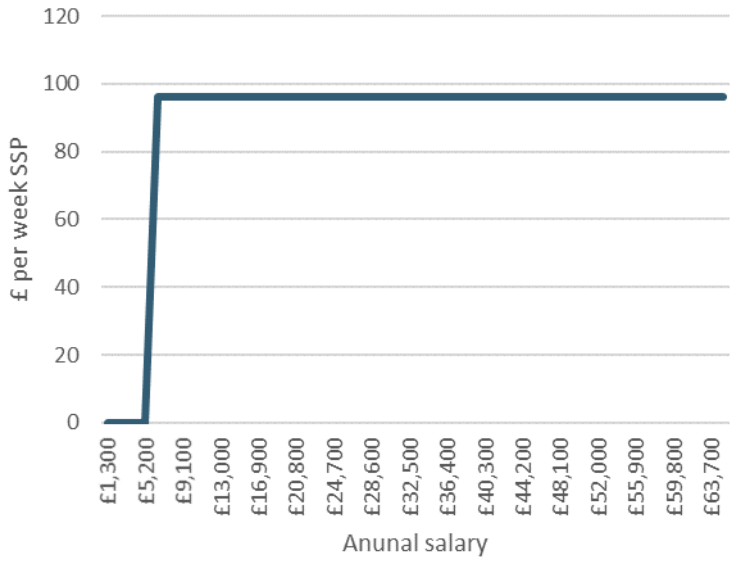
Businesses are legally required to pay SSP to eligible individuals based on the broad steps below:

1. ***Weekly rate:*** It is paid at a weekly rate. For those who are claiming for less than five days ill in a week, the payment is pro-rated by calculating a daily rate from the weekly rate which applies to each of the days the person is off ill. For example, if the person is eligible for one day of SSP payment they would receive one fifth of the weekly rate.
2. ***Pro-rated:*** The weekly rate is based on a five-day working week. For those due to work less than five days a week, the amount is pro-rated. For example, if they were due to work three days in the week, the pro-rated rate of one day off SSP would three fifths of the daily rate.

3. ***Full working days:*** It is only paid for normal working days that an employee misses in full – so working a half day would end the current claim, and no SSP would be due on that day either.

In practice, this means that notional eligibility for SSP is low. It also means that those who are eligible get a very low rate of pay compared both to what they would typically take home and to what others covered by occupational sick pay (OSP) schemes might receive. This is demonstrated in figure 2.

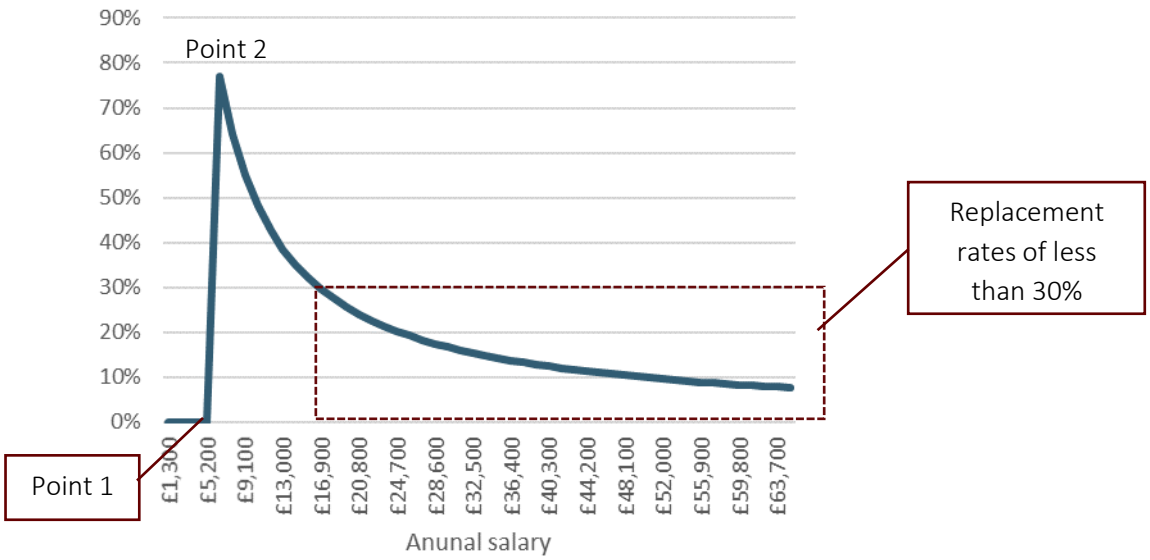
Figure 2: Level of Statutory Sick Pay paid and annual salary



Source: WPI Economics

Figure 3 shows what this means in terms of replacement rates for people needing to go off work sick, at various points in the income distribution.

Figure 3: SSP replacement rate (as proportion of usual salary)

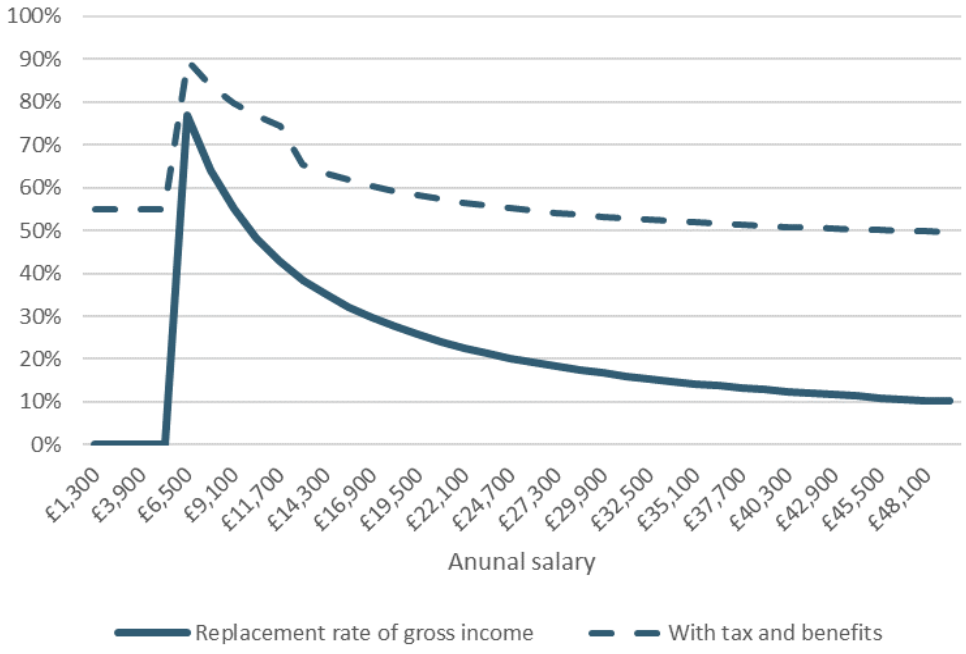


Source: WPI Economics

Whilst gross replacement rates are very low for many people needing to rely on SSP, the state actually improves this situation for those claiming benefits. This is because, falls in income are offset by an increase in benefit income. This means that net reduction rates (including an account of the change in

benefit income that is triggered as income falls from its usual level to that of SSP) are significantly higher for those who are in receipt of means-tested benefits. Figure 4 shows the effective / net replacement rates for people on SSP at various points of the income distribution. Whilst this shows a much more positive picture, there are two concerns with this. First, that the majority of people on SSP are unlikely to be claiming benefits, meaning that this higher replacement rate would not apply. Secondly, for those for whom it does apply, the costs of providing adequate sick pay are shifted from businesses onto the Exchequer. We estimate the potential costs of this below.

Figure 4: Notional replacement rate of SSP, and effective replacement rate after tax and benefits (%)

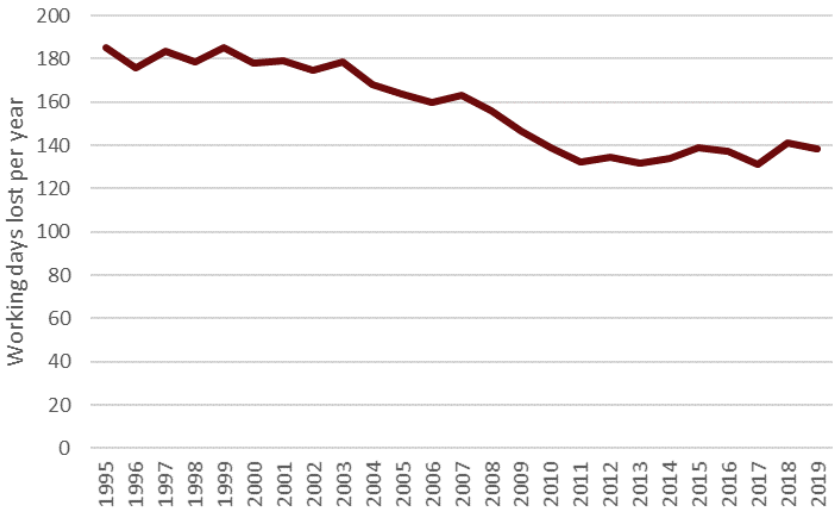


Source: WPI Economics

Who is eligible?

The actual level of eligibility for SSP is very hard to determine as firms are no longer required to monitor and report sickness absence. What we do know is that that close to 140 million sick days were taken across the UK in 2019.

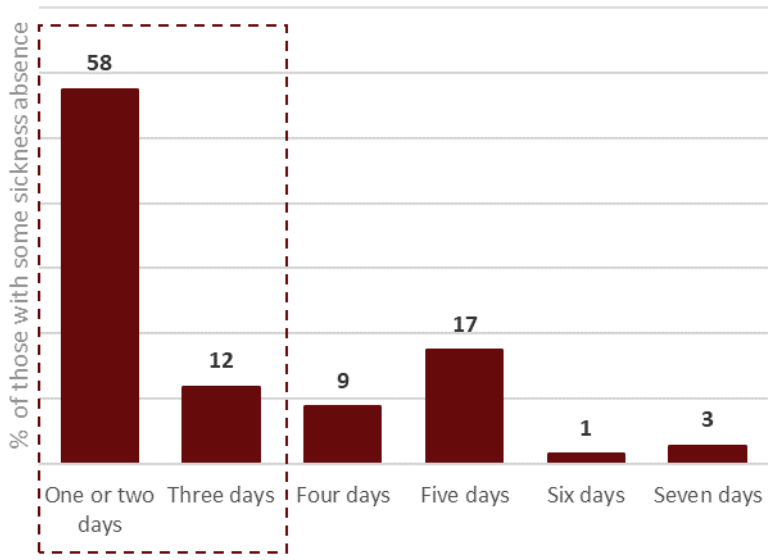
Figure 5: Number of days lost to sickness absence per year (millions)



Source: ONS

However, the vast majority of those sick days are not eligible for SSP. This is predominantly because of the waiting days eligibility criteria. Figure 6 shows that 70% of sickness absences last for three days or less, meaning that they would not be eligible for SSP.

Figure 6: Distribution of spell length of sickness absence, UK (2018)



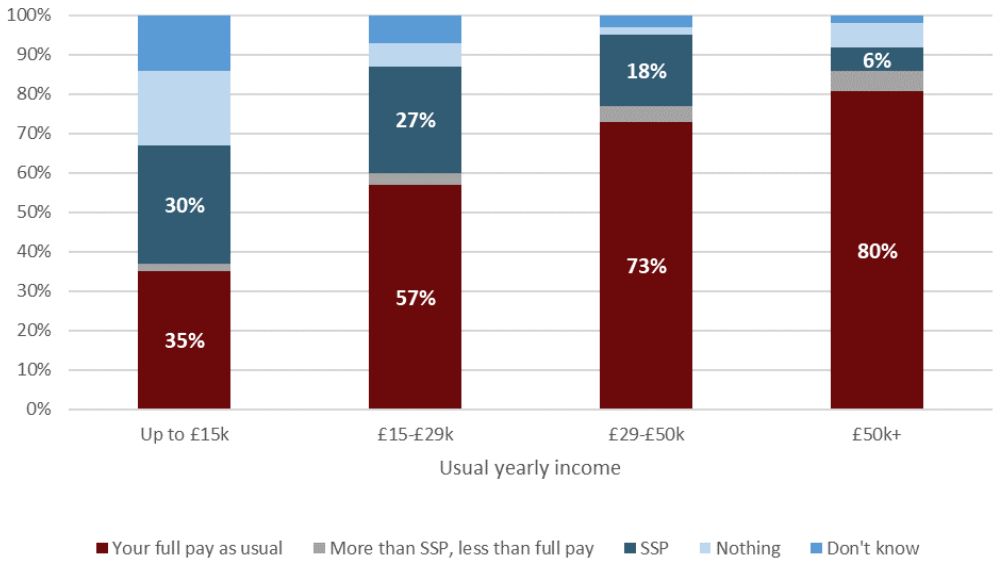
Source: WPI Economics analysis of Annual Population Survey

Eligibility is further reduced by the fact that some of those off sick for four days or more will not be classed as employees, are earning less than the earnings threshold, or become ineligible because of one of the other criteria for claiming SSP.

Modelling eligibility for and costs of SPP

To understand the potential number of people that might actually be eligible for, and then receive SSP, we used the Annual Population Survey (APS). Details on sickness absence (including length of absence, when absence began and condition that led to absence) are only available on secure access versions of the APS.[iv] To ensure adequate sample size, we used the three-year pooled APS (January 2015 – December 2017). We use this data to first estimate the number of people in any given week who might be eligible for SSP, and then used estimates of the number of people who are covered by more generous occupational schemes (provided by the TUC – see figure 7), to estimate the proportion of those who are potentially eligible who would in fact have to rely on SSP. We then estimated what this eligibility would translate to in terms of overall costs to businesses paying SSP.

Figure 7: Employees reporting different levels of sick pay when they are off sick, by yearly income



Source: TUC, Sick Pay that Works

We use a similar approach for understanding the impacts on the Exchequer. The overall logic behind the modelling is provided below, and more detail is available from the author on request.

Our modelling takes specimen households at each point of the income distribution and calculates their notional payments and replacement rates should they become eligible for SSP. To understand the potential costs on business and Government, the first step is to estimate the number of people who are likely receiving SSP at each point of the income distribution:

1. Calculate the number of people potentially eligible for SSP each year, at each point of the income distribution (using analysis of Annual Population Survey, based on reporting of sickness absence and weekly incomes).
2. Calculate the proportion of people at each point of the income distribution who are likely to be covered by a more generous occupational scheme (based on figures provided by TUC).
3. Calculate the proportion of people at each point of the income distribution who are likely to be in a family claiming state benefits (from analysis of the Family Resources Survey).

Costs on business are: sum of results across income brackets of value of SSP * 1 * (100%-2)

Costs on Government are then calculated by:

A) Estimating the notional amount of tax that each person would pay at each point of the income distribution.

B) At each point of the income distribution, calculating the difference in earnings between prior income and the amount they receive through SSP and calculate the difference in tax paid between these two states.

C) In the same way, calculate the difference in Universal Credit that would be received following a reduction in income when someone went off sick (using the standard taper in Universal Credit).

Total costs to Government are then sum of results across income brackets of (B*1*(100%-2)) + (C*1*(100%-2)*3)

Headline findings

Bringing all of these together, we calculated that:

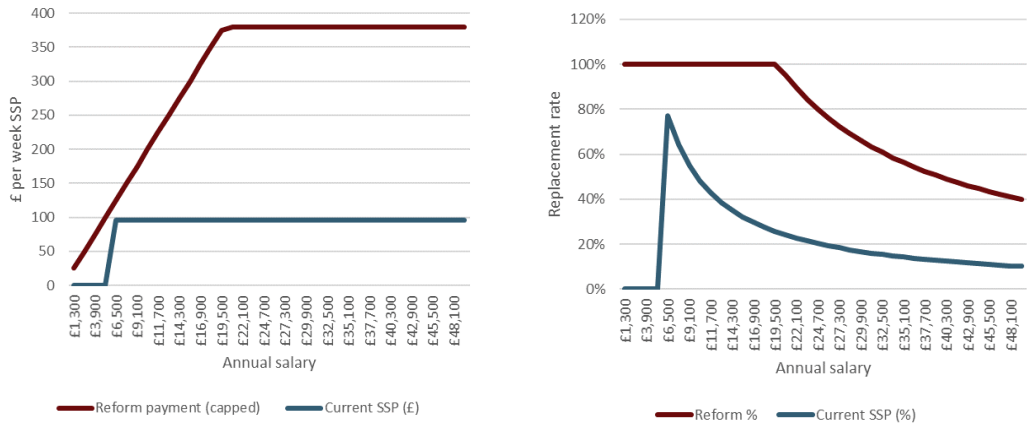
- There are around **18 million SSP-eligible days taken by around six million people each year**.
- The costs of these days for business (i.e. 'binding' days taken by employees who are receiving sick pay at the level of SSP, rather than a higher rate chosen by the firm) fall in the range of **£100 million to £250 million a year**.
- The average replacement rate of someone having to rely on SSP is around 28% of usual earnings.
- Costs of the SSP system to Government, in terms of reduced taxation and increased benefit spend (including the costs of lack of cover for those with short absences) **comes to around £850m a year.**

Modelling eligibility for and costs of reforms to SPP

We use the approach above to also undertake analysis of potential reforms to the system. Key findings include that:

A flat rate SSP system paid at the National Living Wage would lead to a payment schedule and replacement rates as below:

Figure 8: Payment schedule and replacement rates under a NLW-type scheme of SSP



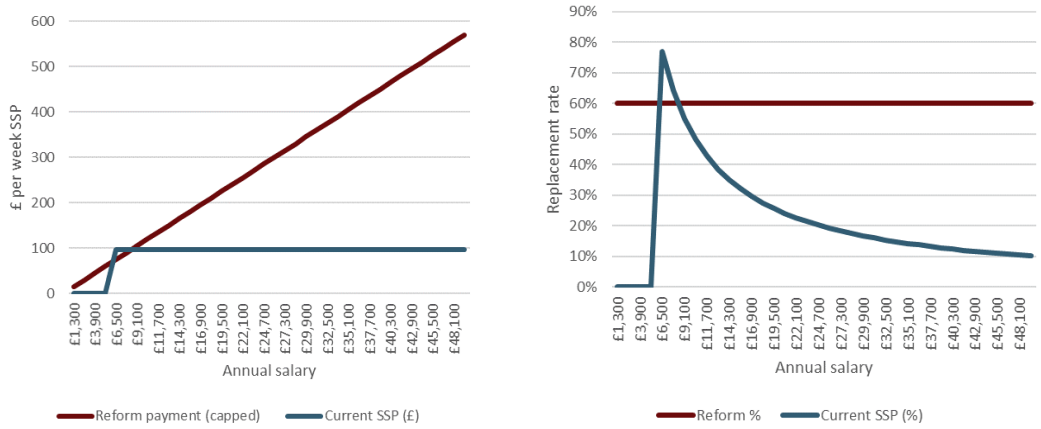
Source: WPI Economics modelling

The changes would be associated with:

- Additional costs to businesses of at least an additional £700m a year (and a total cost of around £1bn a year).
- Savings to the Exchequer of around £220m a year.
- Average replacement rates of around 86% for those having to rely on SSP.

A system of SSP that provided all employees with cover at 60% of their usual earnings would lead to a payment schedule and replacement rates as below:

Figure 9: Payment schedule and replacement rates under a 60% replacement rate of SSP



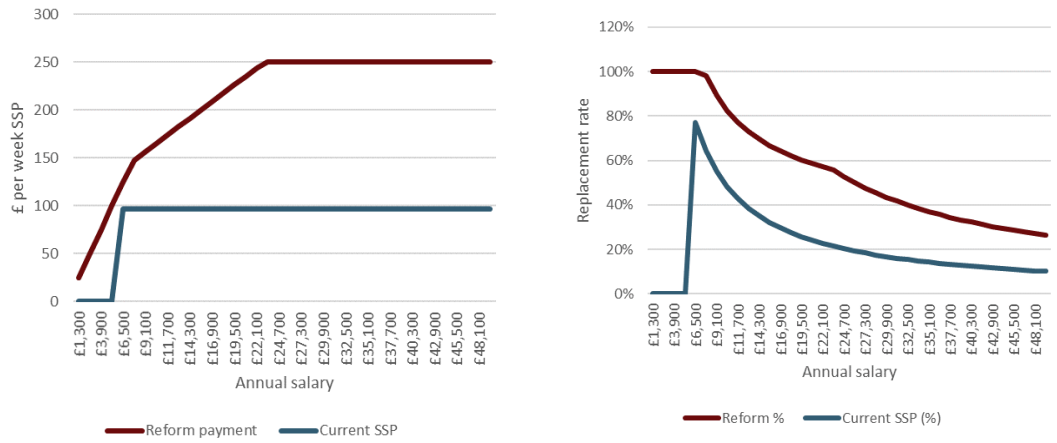
Source: WPI Economics modelling

The changes would be associated with:

- Additional costs to business of around an additional £700m a year.
- Savings to the Exchequer of around £150m a year.[1]
- Average replacement rates of 60% for those having to rely on SSP.

A system that targets higher replacement rates towards low-earnings by providing a standard allowance of 10*NLW (pro-rated) with an additional 35% of usual earnings on top (pro-rated), with a cap of £250 a week, would lead to a payment schedule and replacement rates as below:

Figure 10: Payment schedule and replacement rates under targeted SSP scheme



Source: WPI Economics modelling

The changes would be associated with:

- Additional costs to business of around an additional £400m a year.
- Savings to the Exchequer of around £120m a year.
- Average replacement rates that rise from 28% under SSP to 63% under the reformed system.

We estimate further savings of at least £500m a year for the Exchequer based on improved support for those needing to take sickness absence. The methodology for this (and economic benefits) is provided below.

[1] Note that savings are lower than for a flat rate NLW option, as eligibility for SSP is higher for those on lower incomes – and the NLW option provides more support to those on lower incomes – meaning that it also provides higher Exchequer savings.

Modelling the potential economic and Exchequer benefits of reforms to SSP

Costings of potential Exchequer and economic benefits associated with reduced sickness absence, reduced flows onto disability benefits and reduced presenteeism are from a model developed by WPI Economics. This is based on a methodology from the Department for Work and Pensions (see here: work-health-and-disability-green-paper-background-information-and-methodology.pdf (publishing.service.gov.uk)).

Results of this work are updated to the current time, and assumptions made about the proportion of the total Exchequer / economic costs that could be averted by improving the effectiveness of support for those needing to take sickness absence.

Assumptions for the effectiveness of support are derived from a range of sources. In each case we have used extremely conservative assumptions choosing;

- A level of improvement of return to work of 20% (e.g. compared to other evidence that suggests that return to work rates from long-term sickness absence could increase by 50%-90%[2]).
- Reductions in sickness absence of 10% - compared to others studies that (e.g.) suggest that return to work with better intervention could be as much as 17% quicker on average[3]).
- Less evidence exists around the potential impact on presenteeism, so we assume a very low 1% reduction in rates of presenteeism.

This ensures that we do not overstate the potential benefits. In practice, this means that the results represent a likely lower bound on the impacts of the policy.

Using this methodology suggests that reforms that improve the support for those needing to take sickness absence could lead to significant Exchequer savings and economic benefits, because return to work could increase and length of absences reduce.

[2] SMF, *Insuring a Return. (2021)*
[3] CEBR, *The benefits to business and the economy of early intervention and rehabilitation.* (2015).

Reduction in flows onto disability benefits

We base estimates on the number of people that flow onto disability benefits from work per year,[4] after taking account of the proportion of these that come from directly from a period of SSP-eligible sickness absence

Results suggest:

- Initial benefits to the economy of up to **£800 million a year**; and
- Initial Exchequer benefits of up to **£300 million a year**.

These benefits will increase over time, as more people are supported to stay in work each year. This implies that after five years, the benefits each year will amount to:

- benefits to the economy in the fifth year are up to **£3.6 billion**; and
- Exchequer benefits in the fifth year of up to **£1.2 billion**.

Reduced sickness absence

This suggests:

- Benefits to the economy of up to **£300 million a year**; and
- Exchequer benefits of up to **£100 million a year**.

Reduced presenteeism

We assume that the proportion of presenteeism costs attributable to those eligible for SSP are similar to the proportion of sickness absence that is attributable to those on SSP. In these circumstances we could expect:

- Benefits to the economy of up to **£100 million a year**; and
- Exchequer benefits of up to **£50 million a year**.

[4] Evidence suggests that around one in five (22%) of new claims for disability benefits comes following a period of sickness absence (Sissons, P., & Barnes, H., (2013), 'Getting back to work? Claim trajectories and destinations of Employment and Support Allowance claimants', Journal of Poverty and Social Justice, vol. 21 (3) (2013): 233-246. Cited in Holmes, E., Pickles, C., & Titley, H., (2015), Employment and Support Allowance: the case for change. Reform, London) and there are around 1,000,000 new claims for social security benefits each year (DWP Statexplore).

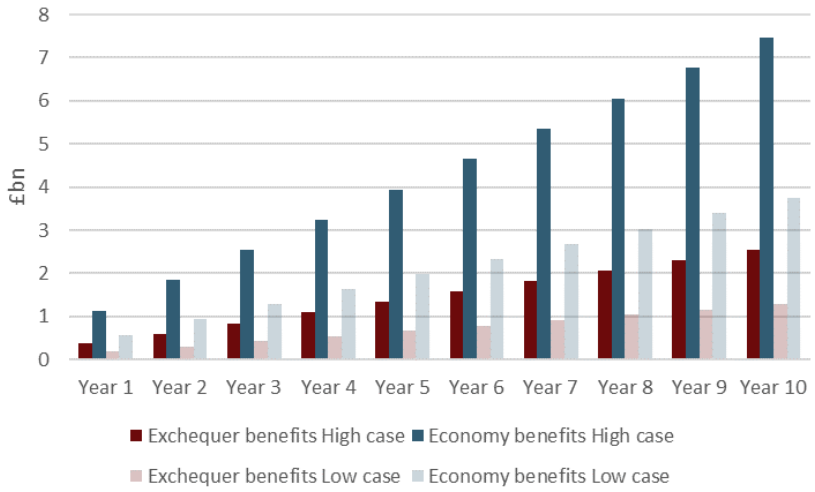
Overall benefits

Overall this suggests that reform could bring:

- Benefits to the economy of over £1bn a year.
- Exchequer savings of at least £450m in the first year, and significantly more in future years.

Figure 11 demonstrates these potential benefits over a ten-year period, also presenting a sensitivity analysis where the overall dynamic impacts of the change of the policy are assumed to be half of that of the main case. In year five, benefits to the economy could be as high as £3.9bn and savings to the Exchequer of up to £1.3bn.

Figure 11: Potential economic and Exchequer benefits from introduction of targeted SSP scheme



Source: WPI Economics modelling

[i] Social Security and Housing Benefits Act 1982

[ii] NAO, *Report by the Comptroller and Auditor General – Department of Health and Social Security: Statutory Sick Pay Scheme (HC 45 1984/85)* (London: HMSO, 1984), p. 5

[iii] See https://www.gov.uk/statutory-sick-pay/eligibility Accessed 20/12/18.

[iv] Office for National Statistics, Social Survey Division. (2018). Annual Population Survey, 2004-2017: Secure Access. [data collection]. 13th Edition. UK Data Service. SN: 6721, http://doi.org/10.5255/UKDA-SN-6721-12