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**DISABILITY BENEFIT REFORM:
RATIONALISATION OR
SUBSIDISATION?**

GERARD HUGHES

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ABBREVIATIONS

CIE	Coras Iompair Eireann
CIF	Construction Industry Federation
CII	Confederation of Irish Industry
DB	Disability Benefit
DEPD	Dail Eireann, Parliamentary Debates
DHSS	Department of Health and Social Security
FUE	Federated Union of Employers
IP	Invalidity Pension
NESC	National Economic and Social Council
OSP	Occupational Sick Pay
PRSI	Pay Related Social Insurance
RR	Replacement Ratio
SSP	Statutory Sick Pay
TFA	Tax Free Allowance

GENERAL SUMMARY

Proposed New State Sick Pay Scheme

The Minister for Social Welfare announced in a Press Release in July 1987 that the Government has decided to introduce a new sick pay scheme which will transfer responsibility for the payment of sickness benefit to employers for the first 13 weeks of illness. The new scheme is to be introduced as soon as practicable. It will be referred to in this paper as the Statutory Sick Pay scheme.

At present both the state and many employers provide income maintenance for employees who are absent from work due to illness. The state sick pay benefits are provided through the Disability Benefit scheme administered by the Department of Social Welfare and the employer sick pay benefits are provided through occupational sick pay schemes.

The broad outline of the new scheme indicates that employers will be required by statute to maintain the earnings of employees through a company sick pay scheme as close as possible to normal earnings. In return for taking over this responsibility from the state employers will be compensated for sickness payments made to employees. The precise amount and method of compensation are to be worked out in discussion with employers.

Smaller employers will be exempt from the new scheme because of the difficulties which it would be likely to impose on them. Their employees will continue to be covered by the Disability Benefit scheme. The Government intends that all employers will eventually participate in the new scheme. Responsibility for sickness payments to those whose illness lasts more than 13 weeks will continue to be exercised by the Department of Social Welfare.

At present these are the only details which the Government has made public about the new scheme and it appears that it does not expect to make any further information available before final details of the scheme are announced. However, it seems from the broad outline of the new scheme that it is modelled on the British Statutory Sick Pay scheme which was introduced by the Conservative Government in 1983.

It transferred responsibility for sick pay for the first 8 weeks illness from the state to employers. The British scheme has been in existence for nearly 5 years and some assessments of its effectiveness have now been made. They suggest that it has not resulted in the reductions in Government expenditure and public service staff numbers which the

British Government hoped for. They also suggest that the scheme may have resulted in additional costs to the Exchequer through subsidisation of some employers' sick pay costs.

There is no indication in the broad outline of the Irish Statutory Sick Pay scheme that its design has been influenced by these findings. It would be a pity if we simply took the British scheme as a model without making use of their experience to modify our Statutory Sick Pay scheme in ways which will avoid the problems to which the British scheme is prone.

Possible Objectives of Reform

The Government has not issued any policy papers to explain what the objectives of the new scheme are, how it resolved the policy questions which must have arisen in connection with the proposal, and what gains and losses it expects to accrue to the various parties likely to be affected by the new arrangements. There is a danger that the adoption of an inappropriate method of compensating employers for administering the new scheme combined with the absence of clear objectives for the scheme may result in a lost opportunity to reduce sickness absence and to cut public expenditure on sickness benefit.

Since the Government has not explained in detail what its intentions are this paper reviews the background and development of the proposal for a Statutory Sick Pay scheme to see if objectives can be identified from the public discussion which has taken place about the need to reform the Disability Benefit scheme. It appears from this discussion that the main objectives which underlie the proposal to introduce Statutory Sick Pay are:

- (i) to reduce public expenditure on sickness benefit by lowering the sickness absence rate;
- (ii) to cut down on abuse of the DB scheme by claimants who are not genuinely ill;
- (iii) to eliminate duplication in the administration of sick pay whereby both the state and the employer make sickness benefit payments;
- (iv) to enable Disability Benefit to be taxed in order to reduce excessive replacement ratios.

Assessment of Arguments for Reform

As no evidence has been presented by the Government on the significance of these objectives the evidence which is available in various sources relating to the performance of the Disability Benefit scheme is

reviewed to see if it supports the case for reform. Examination of the performance of the Disability Benefit scheme from the early 1950s to the middle of the 1980s shows that the annual number of claims per 1,000 persons at risk has been noticeably reduced by the Department of Social Welfare in the last 8 years by a variety of methods designed to improve the efficiency of the procedures for identifying unjustified claims. However, the number of days for which each claim is paid per person at risk and the national sickness absence rate have not been reduced and the national sickness absence rate has increased from 10 per cent of the insured labour force in 1978 to over 11 per cent now. The evidence also shows that the cost of the DB scheme has more than tripled from less than £100 million in 1978 to over £330 million in 1986. This represents an increase of very nearly 50 per cent in real terms.

Comparisons of sickness absence data with countries which appear to have similar arrangements for income maintenance during illness as Ireland does show that the duration of illness per worker was considerably higher in Ireland than in other countries in the OECD. Thus, in 1981 there were 34 days of sickness absence per worker in Ireland, versus 23 in Sweden, 20 in the United Kingdom, 17 in Italy, and 14 in France. The international data also show that Ireland's expenditure on sickness benefit as a percentage of GDP is high relative to other countries but that when expenditure on invalidity benefits is included its ranking is not exceptional. Although international comparisons are difficult because of differences in coverage and administration of sickness benefit schemes, the international data suggest that Ireland's sickness absence problem is among the worst in the OECD.

The evidence relating to the cost and use of the Disability Benefit scheme indicates that the objectives of reducing sickness absence and of cutting public expenditure on sickness benefits are important and that a Statutory Sick Pay scheme could provide a means of giving employers an incentive to reduce short-term sickness absence.

The argument for reforming the DB scheme because of the high level of abuse which is thought to exist does not receive much support from the outcome of the referral of DB claims for a second medical opinion under the medical referee scheme. The changes made in this scheme since the early 1980s have resulted in an improvement in the detection of unjustified claims from an average of 9 per cent in the years up to 1978 to about 14 per cent over the period 1980-86. While this figure is rather high it does not show that there is massive fraud in the DB scheme. It indicates that the medical referee scheme can be quite effective

in identifying unjustified claims if it receives the resources which it needs to do its job properly.

The argument that there is duplication in the existing arrangements whereby both the state and the employer pay sickness benefit is supported for larger firms by the results of a national survey of occupational sick pay schemes undertaken in 1985 for the Department of Social Welfare. The survey showed that nearly three-fifths of the non-agricultural labour force are covered by an occupational scheme. The coverage rate was relatively high in larger firms and quite low in small firms. These differences in coverage rates may explain the Government's decision to exempt small firms from the Statutory Sick Pay scheme.

The argument that the DB scheme itself and the exemption of DB from taxation provide a disincentive to work has been frequently made but very little evidence has been produced to support the case. There is an association between increases in sickness benefit payments and sickness absence rates but this does not mean that increases in these payments act as a disincentive to work. They may simply permit workers to take the time off work which they need in order to return to full health. This, after all, is one of the primary objectives of income continuance plans whether publicly or privately provided.

The possible disincentive effect of DB payments has not, however, been overlooked by the authorities as they have reduced pay-related benefit three times in the last five years. The effect of these changes on the proportion of income from work replaced by transfer payments from the state while out sick can be shown by calculating replacement ratios for male employees in receipt of different incomes who are eligible for pay-related benefit. These calculations show that replacement ratios in excess of 100 per cent have now been eliminated for male employees with the exception of those who are at the bottom of the income scale. Hence, the argument for introducing Statutory Sick Pay in order to reduce excessive replacement ratios does not appear to be as strong as it was some years ago. However, the argument that it is necessary to tax Disability Benefit for reasons of tax equity remains strong.

Recent developments in connection with the taxation of short-term social insurance benefits in the United Kingdom, however, suggest that it may not be necessary to introduce a Statutory Sick Pay scheme to achieve this objective. The British Government has been able to modify the PAYE system in a way which allows the local social security office to act as an "employer" for tax purposes and it is possible that a similar method could be used to tax DB in Ireland.

The main conclusion which the review of the evidence relating to the performance of the DB scheme leads is that the major objectives of reform should be to reduce sickness absence and to cut public expenditure on sickness benefit. A Statutory Sick Pay scheme could make a contribution to the achievement of these objectives by giving employers an incentive to control short-term sickness absence. Unfortunately, the method of compensation which the Government appears to favour in its Statutory Sick Pay scheme will not provide such an incentive. The reason is that employers are to be directly compensated in respect of payments for illness made to employees, probably by deduction of the relevant amount from their monthly PRSI payment to the Revenue Commissioners. This is the method of compensation used in the British Statutory Sick Pay scheme.

Experience with SSP in the UK

Studies of the operation of the British Statutory Sick Pay scheme have shown that compensating employers by allowing them to deduct the full cost of the statutory sickness benefit from their income tax and National Insurance remittances to the Inland Revenue has led to the subsidisation of sick pay costs for employers who had an occupational sick pay scheme before the introduction of the statutory scheme. It has also led to the elimination of financial benefits which were expected to accrue to the British Exchequer, and to a smaller reduction in staff than was expected to take place in the Department of Health and Social Security.

Conclusions

The British experience with Statutory Sick Pay strongly suggests that if the Irish Government wishes to reap the advantages of a Statutory Sick Pay scheme it should stick to the original proposal to compensate employers for administering the scheme by a cut in the employer PRSI contribution rate. If this is not done and a method of compensation adopted which is similar to that used in the British scheme the Irish Government could lose a lot of control over public expenditure on sickness benefit. Furthermore, there is a danger that this method of compensation could lead to the subsidisation of employers who already have occupational sick pay schemes.

If employers maintain their opposition to compensation by a cut in their PRSI contribution rate it would be better for the Government not to introduce the kind of Statutory Sick Pay scheme outlined by the Minister for Social Welfare in July 1987 because of the danger that the

scheme will subsidise rather than rationalise arrangements for income maintenance during illness.

There are other options available to the Government. It could reduce the period for which it wishes to make employers liable for Statutory Sick Pay from 13 weeks to 3 and compensate them with an appropriate reduction in the employer PRSI contribution rate. This would give most of the advantages which are expected to follow from making employers responsible for short-term claims. If there is abuse of sickness benefit it would allow employers to deal with the problem where it may be most acute as it is generally agreed that the shorter the duration of a spell of sickness absence the smaller is the medical component.

Another option would be to leave the existing Disability Benefit scheme as it is and consider (a) new measures which it might be possible to take to reduce the number and duration of both short- and long-term claims, and (b) the possibility of using the method of taxing payments to the unemployed in Britain to modify the Disability Benefit scheme in conjunction with the Revenue Commissioners to permit the taxation of this benefit within the existing PAYE system.

If the Government proceeds with its intention to introduce a Statutory Sick Pay scheme it might wish to reconsider its decision not to issue a discussion paper on Statutory Sick Pay. There has been very little public debate about the policy issues which are posed by the Government's recognition of the interplay between state and private action in relation to social protection against illness. It might also wish to consider what arrangements need to be made to publicise the new Statutory Sick Pay scheme to ensure that there is a smooth transition from the old to the new arrangements.

Chapter 1

INTRODUCTION

The Minister for Social Welfare announced in a Press Release in July 1987 that the Government had decided to introduce a new short-term sick pay scheme which would transfer to employers its responsibility for the payment of sickness benefit to insured employees during short-term sickness absence. Although no date was given for the introduction of the new scheme it was reported in the *Irish Press* on August 11, 1987 that it would come into operation in April 1988. The new scheme has not yet been given a name but I will refer to it in this paper as the Statutory Sick Pay (SSP) scheme.

The Minister noted in his Press Release (reproduced in the Appendix) that at present both the state and many employers provide income maintenance for employees who are absent from work due to illness. The state sick pay benefits are provided through the Disability Benefit scheme administered by the Department of Social Welfare and the employer sick pay benefits are provided through occupational sick pay schemes. He said that the Government had considered the question of streamlining these arrangements and had agreed to transfer responsibility to employers for sick pay for an initial period of 13 weeks.

The broad outline of the new scheme given in the Minister's Press Release indicates that during this period employers will be required by statute to maintain the earnings of employees through a company sick pay scheme as close as possible to normal earnings. In return for taking over this responsibility from the state employers will be compensated for sickness payments made to employees. The precise amount and method of compensation is to be worked out in discussion with employers.

Smaller employers will be exempt from the new scheme because of the difficulties which it would be likely to impose on them. Their employees will continue to be covered by the Disability Benefit scheme. The Government intends that all employers will eventually participate in the new scheme. Responsibility for sickness payments to those whose illness lasts more than 13 weeks will continue to be exercised by the Department of Social Welfare.

At present these are the only details which the Government has made

public about the new scheme and it appears from a reply by the Minister for Social Welfare to a Parliamentary Question in the Dail in November 1987 (DEPD, Vol. 375, No.4, Col. 714) that it does not expect to make any further information available before final details of the scheme are announced. This may be quite soon as the Minister for Social Welfare indicated in a "Summary of Main Developments in 1987" in his Department at the end of December 1987 that "detailed working arrangements are currently being formulated by an inter-Departmental working group and will be put forward to the Minister in the first week in January." The Minister for Finance, Mr. MacSharry, announced during his Budget speech in the Dail on January 27, 1988 that this report is currently under consideration and that "the Government are committed to the introduction of a scheme as soon as practicable."

Although final details of the new scheme have yet to be announced it seems from the broad outline which the Government has so far provided that the new scheme is modelled on the British Statutory Sick Pay scheme which was introduced by the Conservative Government in 1983. It transferred responsibility for sick pay for the first eight weeks illness from the state to employers. The British scheme has been in existence for nearly five years and some assessments of its effectiveness have now been made. They suggest that it has not resulted in the reductions in Government expenditure and public service staff numbers which the British Government hoped for. They also suggest that the scheme may have resulted in additional costs to the Exchequer through subsidisation of employers' sick pay costs.

There is no indication in the broad outline of the Irish Statutory Sick Pay scheme that its design has been influenced by these findings. It would be a pity if we simply took the British scheme as a model without making use of their experience to modify our Statutory Sick Pay scheme in ways which will avoid the problems to which the British scheme is prone.

The Government's decision to introduce a new sick pay scheme is an important development and its success or failure may influence the administration of other social insurance benefits in the future as has happened in the United Kingdom e.g., maternity benefit, industrial injury benefit. It is important, therefore, to ask what are the arguments for reforming the Disability Benefit scheme by introducing a Statutory Sick Pay scheme, what are the objectives of the new scheme, and does the evidence relating to the performance of the Disability Benefit scheme support these arguments and objectives? In view of opposition from employers to some features of the new scheme it is also important to

consider if there are other means of achieving the main objectives of the new scheme.

Unfortunately the Government has not issued either a Green or White Paper in which these and other questions are considered. The new scheme may, therefore, be introduced with very little public discussion of the policy issues which the Government's decision raises. It is also possible that the solution which is being proposed to the problems which are associated with the Disability Benefit scheme may create problems of its own which have not been taken into account in the broad outline of the new scheme.

The main objectives of this paper are to discuss some of the issues which arise in connection with the Government's decision to reform the Disability Benefit scheme by introducing a Statutory Sick Pay scheme and to use the results of the evaluations which have been made of the British Statutory Sick Pay scheme to show how we might avoid the kind of problems which it has created.

Chapter 2

THE DISABILITY BENEFIT SCHEME, CRITICISMS AND RATIONALISATION PROPOSALS

2.1 The Disability Benefit and Invalidity Pension Schemes

The state first took responsibility for maintaining the income of insured workers during sickness in 1911 when the National Insurance Act covering insured workers in Britain and Ireland against loss of income due to unemployment and ill-health was passed by the House of Commons. The demand for sickness benefit in the years immediately after the Act was passed was considerably greater than had been anticipated. Following the report of an interdepartmental committee which was set up in 1913 to investigate the problem of excessive claims a Medical Referee Scheme was introduced in 1916.

This scheme did not come into operation in Ireland because of its exclusion from the 1911 Act's medical care provisions "largely because of the opposition of the medical profession" in Ireland as Lyons (1973, p.668) notes. Following Independence, however, and acting on a recommendation in the interim report of the Committee of Inquiry into National Insurance and Public Health (Ireland, 1925) the Irish Government introduced its own Medical Referee Scheme in 1925.

From 1911 to 1933 sickness benefit payments in Ireland were made by a variety of approved organisations, e.g., Trade Unions, Friendly Societies, Industrial Insurance Companies, under the supervision of the Irish Insurance Commissioners. The payment of benefits higher than the statutory rates by the stronger approved organisations combined with high administration costs due to the duplication of services by different organisations in the same area led to the transfer of the powers and functions of the Irish Commissioners to the Minister for Local Government and Public Health in 1933 and to the amalgamation of all approved organisations into the National Health Insurance Society. When the Department of Social Welfare was established in 1947 responsibility for supervising National Health Insurance was transferred to the Minister for Social Welfare. The National Health Insurance Society was dissolved in 1950 and the Department of Social Welfare assumed

responsibility for the administration of sickness insurance (see Farley, 1964).

The 1952 Social Welfare Act combined the social insurance schemes for unemployment, sickness, old age, and other contingencies into a single unified scheme under the administration of the Department of Social Welfare. This Act substituted a single benefit, Disability Benefit, for the sickness and disablement benefits payable under the former National Health Insurance schemes.

Although Disability Benefit was payable for an indefinite period the Government introduced a new benefit, Invalidity Pension (IP), in 1970 which would be payable to those who are permanently incapable of work and who satisfy the social insurance contribution conditions. In order to qualify for this benefit an insured person would normally have to be in receipt of Disability Benefit for at least 12 months before transferring onto Invalidity Pension. However, not everyone who has been in receipt of Disability Benefit for a year or more transfers to the Invalidity Pension scheme. At the end of December 1986, for example, 44,840 or very nearly 57 per cent of all Disability Benefit recipients had been claiming Disability Benefit for a year or more.

There are at least two reasons why these Disability Benefit claimants may not have transferred to the IP scheme. First, a special medical examination may be necessary to prove permanent incapacity for work. Since the Invalidity Pension is payable indefinitely the medical examination may be more rigorous than would normally be the case for claimants under the Disability Benefit scheme whose incapacity would not be expected to be permanent. Second, Invalidity Pension is part of taxable income whereas Disability Benefit is not. There may be an incentive for recipients of Disability Benefit who have another source of income, or whose spouse has an income, to remain on this benefit rather than transferring to the Invalidity Pension scheme.

There appears to have been very little criticism of the Disability Benefit scheme until 1974 when the introduction of a pay-related supplement to the flat rate benefit reduced the cost to employees of going sick. This accentuated a number of features of the scheme which were criticised at sporadic intervals during the late 1970s and early 1980s.

2.2 Criticisms of the Disability Benefit Scheme

(a) Use and Cost

In 1986 the Taoiseach, Dr. FitzGerald, drew attention on a number of occasions to the effect which he thought high absenteeism rates were

having on employment and foreign investment. The *Irish Times* reported on October 4, 1986 that he had told students and staff at the Carlow Regional Technical College that "industrialists did not want to locate factories in circumstances where 'absenteeism rates in Ireland are deplorably high, far higher than in most other countries'". During his address to the Fine Gael Ard-Fheis, reported in the *Irish Times*, October 20, 1986, the Taoiseach argued that the problem of absenteeism is:

a deterrent to new investment in job-creating industries. We all know that this is a major problem. The figures show that there is an average loss of three to four weeks' work per person each year. Of course, some of this must be due to genuine illness, as in every country. But who believes that the average worker in Ireland is ill for three or four weeks every year?

Although the Taoiseach did not refer to specific examples of high absenteeism numerous reports of the problem had appeared in the press during the 1980s. Some examples are given in Table 2.1.

This table shows that there was considerable variation in the absenteeism experienced by different companies with very low rates in financial and electronics companies and very high rates in manufacturing companies. Absenteeism rates were particularly high for married women probably because they are left with the main responsibility for coping with family problems. A number of the companies mentioned in the table have unfortunately gone out of business. High absenteeism was alleged in some cases to be a factor which contributed to the financial difficulties which forced them to close down. Although some companies have taken steps to bring their absenteeism problem under control, e.g., Waterford Glass, absenteeism continues to be a serious problem for many companies particularly in the industrial sector.

The high cost of the Disability Benefit scheme has come in for some criticism in recent years as Government and opposition parties have grappled with the question of where cuts in public expenditure can be made. The *Irish Press* reported on 10 December, 1986 that the Minister for Finance, Mr. Bruton, had proposed to his Cabinet colleagues that the pay-related element in Disability Benefit should be phased out as a way of saving money and cutting down on abuse but this was not acceptable to the Labour Ministers.

No evidence was cited by either the Taoiseach or the Minister for Finance to support their arguments that absenteeism in Ireland is excessive relative to other countries and that the cost of sickness absence needed to be reduced. Data relating to the use of the Disability Benefit

Table 2.1. *Absence rates in some companies reported in the press since 1980*

<i>Publication and date</i>	<i>Company</i>	<i>No of employees</i>	<i>Year</i>	<i>Absence rate(%)</i>
<i>Business and Finance</i> 3 April, 1980	Dublin manufacturer	1,000	1979	18
	CIE Dublin busworkers	5,000	1979	13
	Motor assembly plant	300	1979	
	— office workers			3
	— assembly workers			15
	Publicly quoted company	1,000	1979	
	— urban workers			10
	— all workers			6
	Established manufacturer Dublin	1,400	1979	
	— married women			21
— single women			12	
— men			11.5	
	AIB and Bank of Ireland	15,000	1979	3.5
<i>European Industrial Relations Review</i> April 1980	Waterford Glass	1,300	1978	
	— manual workers			14
<i>Irish Independent</i> 4 December, 1980	Rowntree-Mackintosh (Ireland) Ltd	400	1979	14
<i>Business and Finance</i> 4 December, 1980	Pfizer	700	1980	8.5
	P.J. Carroll & Co.	N.S.	1979	
	— men			10.8
	— women			13.3
<i>Irish Times</i> 17 December, 1980	Verolme Cork Dockyard	1,170	1980	14
<i>Irish Times</i> 4 January, 1983	Weatherglaze	300	1982	
	— Dublin			20
	— Cahir			3
<i>Irish Independent</i> 5 March, 1983	Multi-national food company	N.S.	1982	
	— Irish plant			14
	— British plant			5
<i>Irish Times</i> 3 January, 1985	CIE Dublin busworkers	N.S.	1984	
	— drivers			11.5
	— conductors			13
<i>Irish Times</i> 6 October, 1986	New electronic and information technology companies in the Mid-West region	N.S.	1985	2

N.S. not specified.

scheme and the cost of the scheme are published by the Department of Social Welfare and there are some international data available from Eurostat and OECD sources on absenteeism. This information will be discussed in the next chapter where I will consider if there is any factual

basis for the concerns which have been expressed in connection with the high level of absenteeism in Ireland and the cost of public expenditure on sickness benefit.

(b) Tax Exemption of Disability Benefit

Disability Benefit, like all other social insurance benefits, was a flat-rate benefit until the introduction of a pay-related supplement in 1974. The combination of this supplement with the flat-rate payment, the tax exemption of Disability Benefit, the availability of tax refunds and dependants allowances for Disability Benefit claimants made it possible for some workers to have a higher income when they were out of work through illness than when they were at work.

The Federated Union of Employers quickly drew attention to this anomaly in the social welfare code (see FUE, 1973). After the pay-related benefit scheme came into operation in 1974 it argued that replacement ratios in excess of 100 per cent were providing a disincentive to work which was particularly strong in the last quarter of the income tax year. It urged the Government to find some means of bringing short-term social welfare benefits, i.e., for unemployment and sickness, into the tax net.

Since the late 1970s a number of Governments have looked for ways of responding to the demand for the taxation of short-term social insurance benefits. The first indication that short-term benefits would be taxed was given in 1978 in a Green Paper, *Development for Full Employment*, when it was noted that incomes for some workers could be higher during illness than during work. The Government announced that it was giving consideration to "treating income from short-term social welfare benefits as taxable income in order to reduce the possibility of this happening" (Ireland, 1978, par. 7.21).

In a White Paper in the following year the Government stated that short-term social welfare benefits "should be taken into account from the earliest practicable date in assessing tax liability" (Ireland, 1979, par. 6.23). Provision was then made in the Finance Act 1979 to tax short-term social welfare benefits from April 1980. It was estimated that this would bring in an extra £13 million in the tax year 1980/81 (DEPD, 23 May, 1979, col. 1306) However, the Minister for Finance announced during his 1980 Budget speech that the Government had reconsidered the matter and had decided that the proposal to tax these benefits should not be implemented. The reasons given were that the introduction of tax exemption limits in the Budget for low income persons would have

reduced the tax yield and that the widening of the tax bands had provided a greater incentive to insured workers to remain at work.

Although the Minister did not say so another reason for rescinding the decision to tax short-term social welfare benefits could have been the administrative difficulty of taxing these benefits under our cumulative PAYE tax system. While recommending that if an efficient method of taxing short-term benefits could be found it should be adopted, I estimated in an earlier paper on absence from work (Hughes, 1982A, p.64) that if short-term social welfare benefits were to be taxed on a cumulative basis by the Department of Social Welfare under the existing PAYE system it might be necessary to increase the Department's staff by 20 per cent, or 650 employees, to do so.

I noted that one way in which sickness benefits could be brought within the tax net without having to change the tax system would be to make the employer responsible for paying sickness benefit for a specified period as the British Government had proposed in a Green Paper (DHSS, 1980) in 1980 and I suggested that this possibility was worth further investigation as it might also enable the Government to reduce public expenditure on sickness benefit.

Despite the advantages which it appeared the transfer of responsibility for short-term sick pay to employers could have the Government continued to search for a solution to the problem of taxing Disability Benefit within the existing administrative arrangements. The Minister for Finance announced during his speech on the Coalition Government's 1982 Budget that it had been decided to make short-term benefits liable to tax from April 1982 onwards. Because of administrative problems, however, he said that these benefits could not be taxed in the same way as other income and he announced that:

for convenience of administration, there will be an initial 20 per cent tax on the pay-related element of these benefits, withheld at the point of payment. Subsequently, the correct liability will be determined by the Revenue Commissioners and refunds made where appropriate. This arrangement will yield £10.5 million in 1982.

It is clear from this statement that the administrative problems involved in taxing short-term benefits in the same way as other income had not been overcome and that special measures were needed which would reduce the pay-related supplement by 20 per cent for all eligible claimants irrespective of their tax liability. Thus, it seems to have been accepted that the problems posed in taxing short-term benefits under a cumulative PAYE system could only be solved by breaching the cumulative principle.

Although it appeared from the Minister's speech that overpayment of tax would be automatically refunded by the Revenue Commissioner's at the end of the tax year it was made clear in the *Principal Features of the Budget* that refunds would only be made on application to the Revenue Commissioners. The Coalition Government's proposal to tax short-term social insurance benefits lapsed when the first 1982 Budget was defeated in the Dail.

(c) Abuse of the Disability Benefit Scheme and the Effect of the Scheme on the Incentive to Work

A number of employers, trade unionists, politicians, and doctors have alleged that the Disability Benefit scheme is subject to widespread abuse and that it also provides a disincentive to work which is particularly strong at the end of the tax year. These allegations have received considerable press coverage in recent years. The impression has been created that up to half of those receiving Disability Benefit are abusing the system and that medical certificates can be secured on demand irrespective of the applicant's state of health. Some examples of the statements which have been made in the press in recent years about abuse of the Disability Benefit scheme are given in Table 2.2.

Table 2.2. *Allegations in the press of abuse of the Disability Benefit and medical referee schemes since 1980*

<i>Publication and date</i>	<i>Speaker</i>	<i>Statement</i>
<i>Irish Medical Times</i> 4 January, 1980	Dr. A. Rynne	Medical examination not carried out by doctors issuing medical certs.
<i>Irish Independent</i> 20 June, 1980	Prof. C. O'hEocha President, UCG	Graduating doctors warned not to succumb to pressure for dubious certificates of illness.
<i>Evening Press</i> 16 October, 1981	Dr. C. MacNamara Vice President, Medical Union	There was "a good deal of abuse" in the sick certificate area.
<i>Irish Independent</i> 8 March, 1982	Irish Medical Association Central Council	Doctors are being used by malingerers who demand short-term certs to stay off work.
<i>Sunday Independent</i> 28 March, 1982	FUE	Operation of the social welfare system is attracting a growing number of abusers.
<i>Sunday Independent</i> 28 March, 1982	Mr. C. Power, CH	Absenteeism reaches 20% in some instances in the 4 to 6 week period before the end of the tax year due to exemption of Disability Benefit from tax.

Table 2.2. *continued*

<i>Publication and date</i>	<i>Speaker</i>	<i>Statement</i>
<i>Sunday Independent</i> 4 April, 1982	Dr. A. Rynne	"25 per cent of those drawing medical certificates are perfectly healthy".
<i>Irish Times</i> May, 1982	Representatives of FUE and CIF	Social welfare system should be reformed to eliminate abuses.
<i>Evening Herald</i> 18 May, 1982	Sample of 300 electors in Dublin West constituency	Two out of three respondents felt that sick certificates are too easy to get.
<i>CII Newsletter</i> 27 July, 1982	CII	"The current income tax treatment of short-term sickness benefits is an incentive for individuals to abuse the system"
<i>Irish Times</i> 6 July, 1982	Galway Chamber of Commerce	"Absence from work paid better than attendance, and there was a growth in absenteeism as a result"
<i>FUE Bulletin</i> Aug/Sept. 1982	Mr. M. Cox, Gen. Sec., Nat. Ass. Transport Employees	Abuse of the social welfare system is rampant
<i>Business and Finance</i> , 28 October, 1982	Mr. O. Kealy, M. D., Waterford Glass	The absenteeism problem is a manifestation of the social welfare benefits now available
<i>Irish Times</i> 29 October, 1982	Mr. M. McGlynn, Director, Abbou Ireland Ltd.	Up to half of the claims for sick pay benefit are spurious
<i>Irish Independent</i> 15 November, 1982	Dr. G. FitzGerald	"There is clear evidence to indicate that a great deal of abuse of the disability benefit scheme is taking place"
<i>Irish Independent</i> 5 March, 1983	CII	"The ease with which medical certificates can be obtained at present is almost intolerable"
<i>Irish Independent</i> 6 March, 1985	FUE	Doctors' receptionists are issuing medical certificates to workers without an examination by the doctor.
<i>Irish Times</i> 27 April, 1985	CIE	"Declined to comment on a report that some of the company's managers had been instructed not to accept medical certificates from eight named doctors in the Dublin area."
<i>Irish Times</i> 21 November, 1986	Mr. D. Foley, T.D., Chairman, Dail Committee of Public Accounts	Outcome of referrals under medical referee scheme indicate massive fraud
<i>Irish Press</i> 15 December, 1987	Department of Social Welfare	Court proceedings have begun against a large number of workers at the Arigna collieries in Co. Roscommon for abuses of the Disability Benefit scheme.

It will be seen from Table 2.2 that the strongest allegations of abuse of the Disability Benefit scheme have come from business and employer organisations. These allegations are made in very general terms and they usually tend to exaggerate the seriousness of the problem. If specific cases of abuse are reported to the Department of Social Welfare they are investigated. It is frequently found that allegations of abuse have no substance to them. The Minister for Social Welfare, Dr. Woods, for example, indicated in a report in the Irish Independent on August 5, 1982 that up to two-thirds of complaints investigated by his department's Special Investigation Unit cannot be substantiated.

A solution to the alleged problem of abuse of the Disability Benefit scheme was proposed by FitzGerald (1983, p.76) when she noted that the scheme "has been the subject of the most vociferous complaints by employers about abuse". She argued that "at this stage of trade unionisation and with the spread of occupational sick pay schemes,... the state should not be too deeply involved in paying income maintenance for casual sick absences." Hence, she proposed that "if the employers who complain so much about absenteeism had to pay for the first two or three weeks of any sick absence, they could be in a better position to decide whether claims were genuine or not." If the first two weeks of all sick pay claims was paid by the employers she estimated that total spending on Disability Benefit would be reduced by 16 per cent and she argued that the Government could make indirect savings of over £6 million per year if employers were able to reduce claims lasting two weeks or more by 5 per cent. The administrative saving to the Department of Social Welfare from handling 100,000 fewer claims each year was estimated to be around £1 million per year. However, she noted that the proposal to make employers responsible for short-term sick pay posed practical problems which would need further exploration. The main problems which she expected to arise were that:

1. Employers might look for a reduction in their PRSI contributions which could mean that there would be no direct savings to the Exchequer.
2. Small employers might face problems unless they could pool risks in a group scheme with an insurance company.

2.3 Proposals for Rationalising the Disability Benefit Scheme

A number of suggestions for rationalising the Disability Benefit scheme have been made which have wider objectives than simply bringing this benefit into the tax net. As we have seen the main reason for

FitzGerald's suggestion that employers should take responsibility for sick pay for the first few weeks illness was that it would give them the opportunity to take action on alleged abuse of the scheme about which employers had complained so much. My suggestion that the possibility of making employers responsible for short-term sick pay should be investigated was made because it appeared to provide a way in which sickness benefit could be taxed and also because it might lead to some reduction in public expenditure on this benefit. Some further advantages which the suggested changeover to employer responsibility for short-term sick pay could have were outlined in a paper which I gave to an IMI conference on absenteeism in November 1982 (Hughes, 1982B, p.36). I argued that the proposal to transfer responsibility for short-term sickness payments to employers might be advantageous as it could:

- (a) eliminate duplication in existing arrangements and hence lead to a reduction in public expenditure on sickness benefit;
- (b) localise the problem within each firm and encourage employers and workers to take responsibility for dealing with it;
- (c) give employers an incentive to cut down sickness absence rates by, for example, providing better screening procedures and health and safety measures.

Some of these arguments were also made by the Department of Social Welfare in documents outlining the thinking behind a proposal which the Government made for an employer sick pay scheme when the Taoiseach, Dr. G. FitzGerald, announced in the Dail on 23 October, 1985 that he had requested a meeting with the National Economic and Social Council (NESC) to discuss some proposals with the members. One of these proposals was "to overhaul the Disability Benefit Scheme with a view to reducing the costs of absenteeism" (NESC, 1986, p.1). The Taoiseach indicated during his address to the NESC that a memorandum outlining the thinking behind the proposal would be submitted by the Department of Social Welfare.

The Department's memorandum has not been published but the NESC summarised some of its salient points in its published response to the Government's proposals (op. cit.) The proposal which the members of the NESC were asked to consider was that "responsibility for the first ten weeks of sickness payments be transferred to employers with an accompanying reduction of one percentage point in the rate of employers' PRSI and the creation of employers' obligations under labour law." (op. cit., p.2)

The principal result of this change was expected to be a more efficient

allocation of resources arising from the clearer delineation of responsibility for sickness payments between the state scheme and employers' occupational sick pay schemes. Reductions in absenteeism were expected to occur because:

- (a) employers would have a very strong incentive to keep their expenditure on sick pay below the 1 per cent reduction in their PRSI payments which the Government was offering to compensate them for the extra costs which the new arrangements would impose on them;
- (b) the taxation of sick pay and the elimination of tax rebates would reduce the incentive for employees to take advantage of the Disability Benefit scheme;
- (c) the change from central to local control by individual enterprises would give greater responsibility to both employers and employees for attendance at work.

The Department noted in its memorandum that there were differences in the coverage of occupational sick pay schemes with the services sector having better coverage than manufacturing. It also noted that there is a strong positive correlation between coverage and firm size. It indicated that it had commissioned a national survey of occupational sick pay schemes and that it expected the results of this survey to be available shortly. The sectors where the incidence of sickness absence were highest were mining and turf and building and construction. The incidence was lowest in insurance and banking. The Department estimated that up to £2 million could be saved on administration costs by transferring responsibility for the first eight weeks' sick pay from the state to the private sector but it did not give any estimate of the reduction in public expenditure which might be expected to result from this transfer.

2.4 Trade Union and Employer Responses

In its response to the Government's proposal the consensus view of the NESC Council members (op. cit., p.3) was that the Disability Benefit scheme was in need of reform for several reasons including in particular "the possibility that the operation of the scheme may be contributing to the existing level of absenteeism". The Council saw merit in the Government's proposal to allocate public resources more efficiently and to include short-term sickness benefit in taxable income. It argued, however, that there could be major problems in implementing the Government's proposal because of the difficulty of getting small firms to comply with the requirement for a statutory sick pay scheme and also

because the proposal would cause the costs of certain firms to rise relative to those of other firms, e.g., the cost of occupational sick pay schemes were thought to be proportionately higher for small firms than for large and small firms which do not have an occupational sick pay scheme would face an increase in their costs relative to firms which have such schemes.

The Council made two suggestions which it thought might help to get around these difficulties. The first was that small firms might be exempted from any statutory requirement to provide a sick pay scheme. The second was that the administrative savings which the state hoped to make from implementing its proposal might be shared with employers. It noted, however, that the Department of Social Welfare did not favour the exclusion of small firms because firms employing less than 10 people accounted for over three-quarters of all firms in the country and the operation of a cutoff point for such firms would increase administrative costs¹. The Council also noted that the Department felt that it would be difficult to find a mechanism for sharing the expected administrative savings of £1 to £2 million amongst employers. It observed that some firms were opposed to the provision of statutory sick pay because they favoured an unregulated environment in this regard. It commented that this attitude would create particular difficulties for the trade unions as they believed that any changes to the existing arrangements would have to incorporate a statutory obligation on employers to provide specified levels of sickness benefit. The Council concluded that the Government's proposal merited further investigation but it pointed out that:

much more information is required, both on the operation of the existing scheme (including the interaction of the Disability Benefit scheme and occupational sick pay schemes) and the likely impact of the proposed new arrangements, before the Council could commit itself to supporting it (op. cit., p.5).

The kind of information which the Council said it required included the results of the national survey of occupational sick pay schemes being undertaken at the time by the Department of Social Welfare and the results of an examination, which was also being undertaken at the time, by the FUE of the interaction of the proposed changes with existing occupational sick pay schemes. It indicated that it would be glad to review the matter when this information became available.

1. The percentage of total employment accounted for by such firms would, of course, be considerably less than 75 per cent. Firms employing less than 10 people in manufacturing industry in 1981, for example, amounted to 37 per cent of the total but they accounted for less than 5 per cent of total employment in manufacturing (see Ireland, 1986B, Table 105).

The response by the FUE to the Government's proposal was given in its *Bulletin* in April, 1986. The National Executive Council said that on the basis of the conclusions reached by a working party it had decided that "the proposal was unacceptable in its present form." It said that the FUE was concerned about the following points:

- (i) the effect the proposal could have on costs;
- (ii) the administrative and legal difficulties which it could create for employers;
- (iii) the complexities which it could introduce into the relations between employers and employees.

Despite its reservations about the Government's proposed Statutory Sick Pay scheme the FUE said that it was prepared to continue to look for a solution to the absenteeism problems which it believes are caused by the existing state sick pay scheme and the failure to integrate Disability Benefit with the tax system. It indicated its hope that the Commission on Social Welfare, which was then reviewing the operation of the Social Welfare system, would deal with the question of the taxation of short-term social welfare benefits.

The Commission on Social Welfare, however, did not make any positive proposals for the taxation of short-term social insurance benefits. In its report which was issued in July 1986 (Ireland, 1986A) it said that it was in favour of the Government's proposal in principle. It endorsed the comments which had already been made about the advantages and disadvantages of the Government's proposal and it added to them the fact that the number of new claims would be reduced from 4,500 per week to less than 1,000 according to the Department of Social Welfare. It also noted the improvement which could take place in the level of sick pay for single persons.

2.5. *Reasons for Reform of the Disability Benefit Scheme*

This review of the criticisms of the Disability Benefit scheme and the background to the Government's decision to reform it by introducing a Statutory Sick Pay scheme suggests that the main reasons why it has been decided to reform the Disability Benefit scheme are:

- (i) the Disability Benefit scheme may be contributing to a high level of sickness absence and to increasing Government expenditure on sickness benefit;
- (ii) there is thought to be widespread abuse of the Disability Benefit scheme;

- (iii) there is duplication in the arrangements for payment of sickness benefit because of the growth of occupational sick pay schemes;
- (iv) short-term social insurance benefits need to be brought into the tax net to reduce excessive replacement ratios and thereby improve the incentive to work.

One of the problems with these arguments for reform of the Disability Benefit scheme is that the Government has not brought together the kind of evidence which is needed to evaluate them. Some of the information which is needed to do so is available and the next chapter will bring it together to see if it supports the arguments which have been made for reform of the Disability Benefit scheme.

Chapter 3

ASSESSMENT OF ARGUMENTS FOR REFORM

3.1 Use and Cost of Incapacity Schemes

(a) Use of Incapacity Schemes

The introduction of the Invalidity Pension scheme in 1970 led to the removal from the Disability Benefit statistics of a significant number of long-term claimants. The omission of claimants transferring from the Disability Benefit scheme to the Invalidity Pension scheme could give a misleading impression of sickness absence trends. In order to avoid this problem in another paper (Hughes, 1982A, Appendix 1) I combined the data for the disability and invalidity schemes to give series on incapacity for the period 1954-78. These series have been updated to 1986 in the tables which follow².

Table 3.1 and Figures 3.1, 3.2, and 3.3 present data on the number of recipients of incapacity benefits, the number of incapacity payments, and the number of weeks illness for which these benefits were paid during the year for the period 1954-86. The number of recipients of incapacity benefit at the end of each year increased by two and a half times from 42,000 in 1954 to 105,000 in 1986; the number of claims paid also increased by about two-and-a-half times from 116,000 per year in 1954 to over 300,000 now with a peak in the number of claims paid in 1978 of nearly 356,000; the number of weeks for which incapacity benefit was paid in each year increased by nearly two-and-three-quarter times from 2.1 million weeks in 1954 to 5.6 million weeks in 1986.

2. The series for the period 1954-78 also included data on a number of persons who were transferred from the Invalidity Pension scheme to the Retirement Pension scheme in 1973. There may be differences between some of the time series presented in this and in my earlier paper because the calendar year data from 1974 to 1978 in that paper were adjusted to ensure comparability with the data for the period 1954-73 which generally referred to the fiscal year. This adjustment has not been made to the incapacity series in this paper. Where it is relevant the incapacity data in the tables in this chapter refer to the calendar year for 1974 and subsequent years. The headings used in the tables will indicate the series which are affected by the change from a fiscal to a calendar year basis.

Table 3.1. *Recipients of incapacity benefit, number of payments made, number of weeks for which benefit was paid, and number insured for all benefits, 1954-86.*

Year	Incapacity benefit recipients on 31 Dec	Number of incapacity payments in year ended 31 Mar or 31 Dec	Number of weeks incapacity benefit was paid in year ended 31 Mar or 31 Dec	Number insured for all benefits on 31 Mar
1954	41,892	116,250	2,070,000	638,733
1955	41,101	116,610	2,184,220	639,184
1956	43,065	113,750	2,182,000	647,177
1957	44,989	112,220	2,217,285	638,349
1958	43,233	122,820	2,346,600	623,288
1959	42,604	115,080	2,310,500	619,008
1960	45,307	111,260	2,032,000	624,784
1961	46,019	128,900	2,115,220	629,316
1962	46,091	126,700	2,173,600	633,699
1963	50,104	123,600	2,380,000	640,689
1964	51,058	123,200	2,470,000	655,977
1965	52,595	132,400	2,523,500	671,233
1966	54,691	150,480	2,907,000	688,410
1967	56,789	144,320	2,820,197	710,699
1968	60,174	147,400	2,788,796	714,536
1969	64,783	166,848	2,997,091	727,756
1970	65,834	201,454	3,114,325	729,731
1971	67,436	189,331	3,718,224	732,943
1972	70,501	189,573	3,370,652	739,590
1973	68,284	200,206	3,270,829	742,879
1974	74,913	208,298	3,402,761	716,787
1975	77,808	245,108	3,887,839	832,042
1976	81,035	317,040	4,061,838	825,973
1977	81,426	320,110	4,318,589	821,645
1978	81,944	355,977	4,568,503	820,136
1979	83,787	319,921	4,614,753	820,000
1980	83,194	326,231	4,589,573	864,000
1981	91,094	316,337	4,738,210	944,000
1982	88,208	301,597	4,837,165	955,000
1983	90,328	290,549	4,806,754	963,000
1984	96,531	296,744	5,093,778	951,000
1985	101,991	304,464	5,424,320	949,000
1986	105,225	305,055	5,633,860	952,000

Sources: *Report of the Department of Social Welfare, 1954-58 to 1981-82*; Department of Social Welfare, *Statistical Information on Social Welfare Services, 1983 to 1986*; *Statistical Abstract, 1956 to 1977*.

Note: The year ended on the 31st March up to 1974 and on 31st December thereafter.

Figure 3.1: Number of recipients of DB and DB plus IP on 31st December, 1954-86

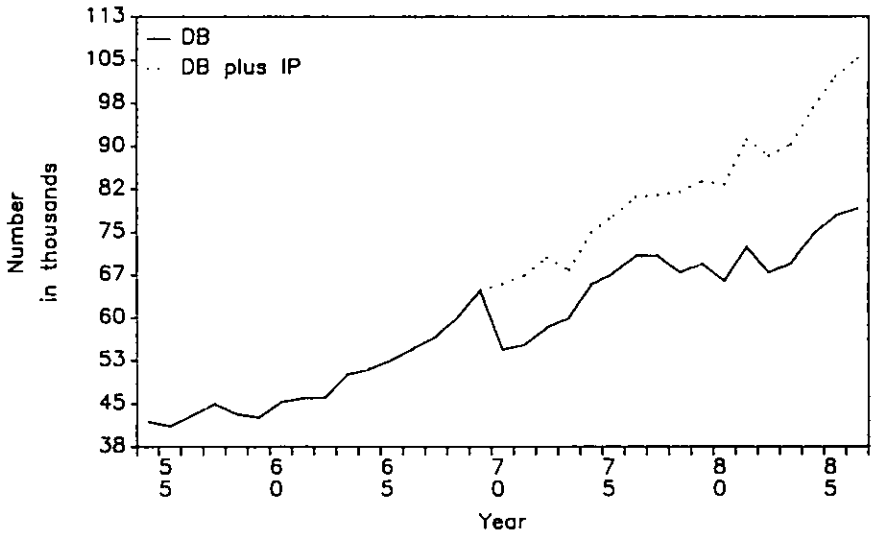


Figure 3.2: Number of DB, and DB plus IP payments in year ended 31 March or 31 December, 1954-86

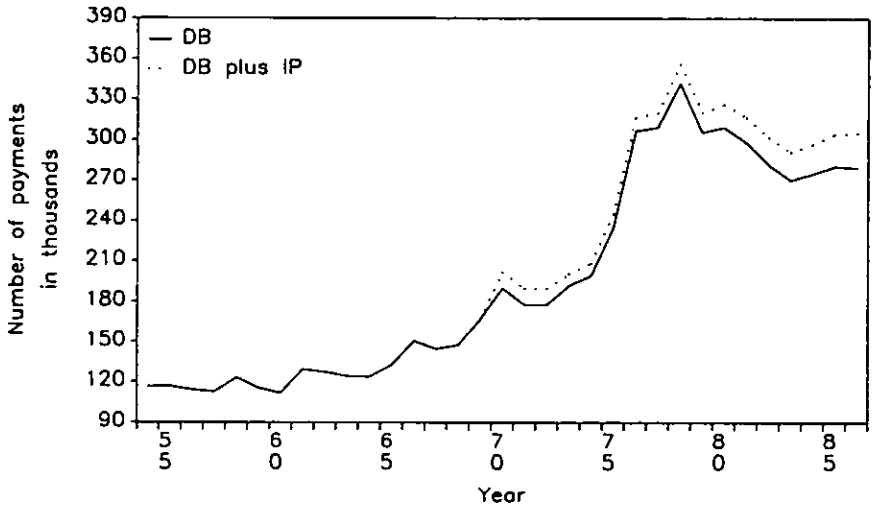
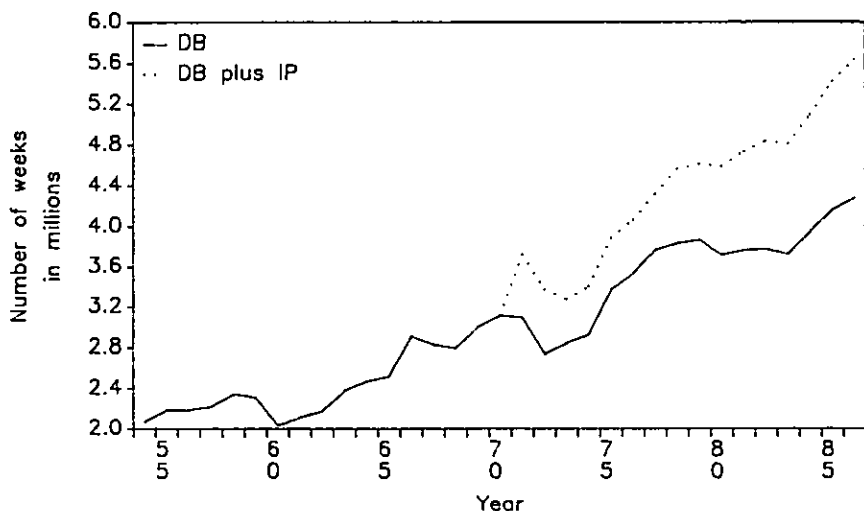


Figure 3.3: Number of weeks illness for which DB, and DB plus IP were paid in year ended 31 March or 31 Dec., 1954-86



Some of these increases in the measures of use of the incapacity schemes are due to increases in the number of employees who are insured against income loss due to disability or invalidity. Since 1954, as Table 3.1 shows, the number of insured workers has increased by about 50 per cent from 639,000 to 952,000 in 1986.

Table 3.2 and Figures 3.4, 3.5, and 3.6 present measures of use of the incapacity schemes which take account of the increase in the number of employees covered for sickness benefits. Figure 3.4 shows that the number of spells of incapacity per worker increased from 182 per 1,000 in 1954 to a peak of 434 per 1,000 in 1978, declined to 302 per 1,000 in 1983 and then increased to its present level of 320 per 1,000. Figure 3.5 shows that the number of days for which each incapacity claim was paid per person at risk was less than 20 in 1954, over 33 days in 1978 and very nearly 36 days in 1986. Figure 3.6 gives the time series data on the national incapacity rate. At the beginning of the period the incapacity rate was about 6½ per cent of the insured labour force. It increased over the following 20 years to reach a peak of 10½ per cent in 1974 dropped back to around 9½ per cent in the following year and remained stable at about this level until 1983. Since 1984 the sickness absence rate has increased by around a half a percentage point each year and this brought the rate up to over 11 per cent of the insured labour force in 1986.

Table 3.2. *Frequency, duration and rate of incapacity, 1954-86*

<i>Year</i>	<i>Spells of incapacity per 1,000 persons at risk</i>	<i>Days of incapacity per person at risk</i>	<i>Rate of incapacity on 31 Dec</i>
1954	182.0	19.4	6.6
1955	182.4	20.5	6.4
1956	175.8	20.2	6.7
1957	175.8	20.8	7.0
1958	197.1	22.6	6.9
1959	185.9	22.4	6.9
1960	178.1	19.5	7.3
1961	204.8	20.2	7.3
1962	199.9	20.6	7.3
1963	192.9	22.3	7.8
1964	187.8	22.6	7.8
1965	197.2	22.6	7.8
1966	218.6	25.3	7.9
1967	203.1	23.8	8.0
1968	206.3	23.4	8.4
1969	229.3	24.7	8.9
1970	276.1	25.6	9.1
1971	258.3	30.4	9.2
1972	256.3	27.3	9.5
1973	269.5	26.4	9.2
1974	290.6	28.5	10.5
1975	294.6	28.0	9.4
1976	383.8	29.5	9.8
1977	389.6	31.5	9.9
1978	434.0	33.4	10.0
1979	390.1	33.8	10.2
1980	377.6	31.9	9.6
1981	335.1	30.1	9.6
1982	315.8	30.4	9.2
1983	301.7	29.9	9.4
1984	312.0	32.1	10.2
1985	320.8	34.3	10.7
1986	320.4	35.5	11.1

Sources: As for Table 3.1.

Figure 3.4: DB, and DB plus IP spells per 1,000 persons at risk, 1954-86

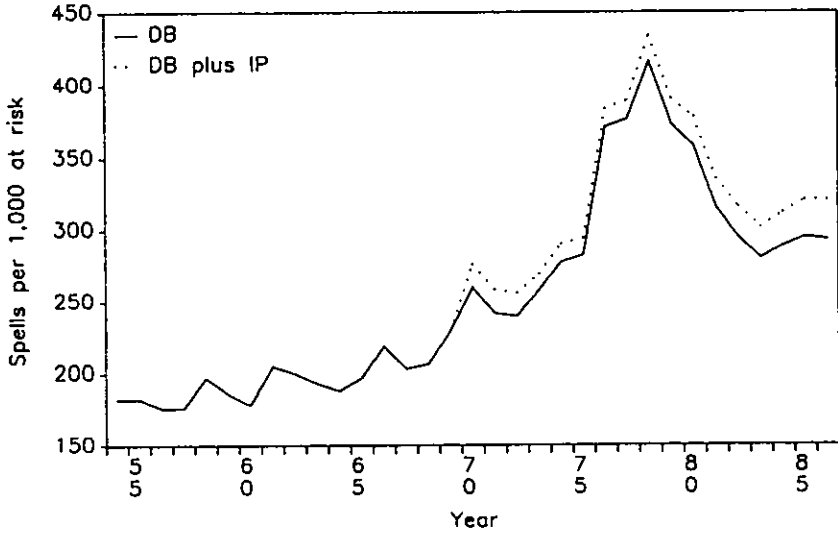


Figure 3.5: Days on DB, and DB plus IP per person at risk, 1954-86

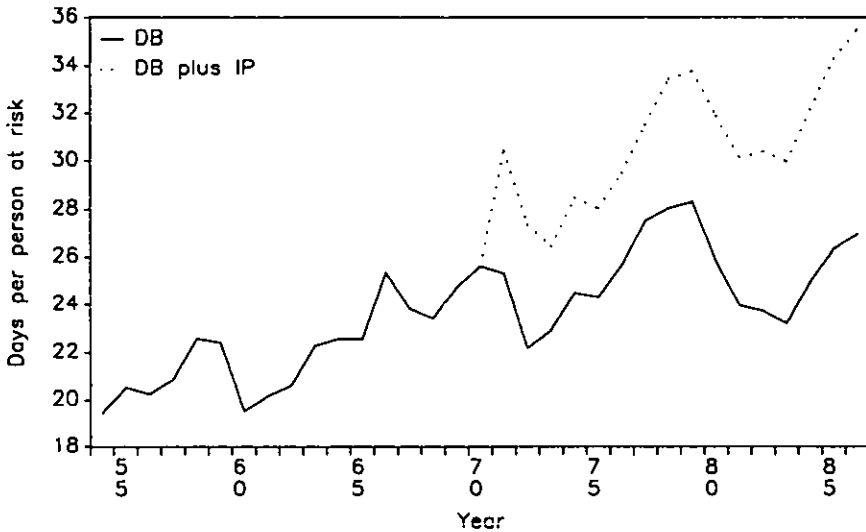
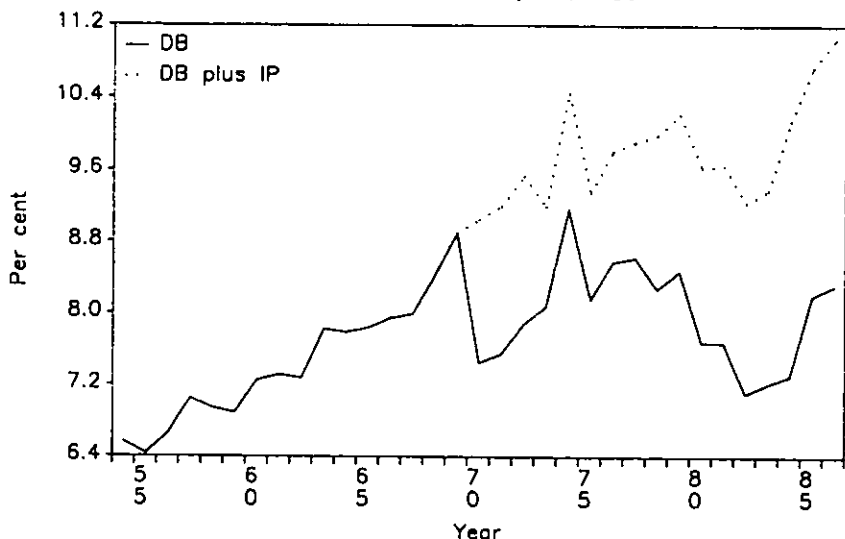


Figure 3.6: DB rate, and DB plus IP rate on 31 December, 1954-86



The time series data on the use of the incapacity schemes clearly shows that there was a strong upward trend in the number of claims per worker up to 1978 but that this trend has been reversed since then. A 30 per cent drop occurred in the number of spells of incapacity per worker from 434 per 1,000 in 1978 to 301.7 per 1,000 in 1983. This drop has been partly offset by a 6 per cent increase in the number of spells from 301.7 per 1,000 in 1983 to 320.4 per 1,000 in 1986.

The big reduction which has been achieved in the number of claims per worker followed the adoption by the Department of Social Welfare from the end of the 1970s of a series of administrative measures designed to exercise a greater degree of control on payment of short-term social insurance benefits. The measures which were adopted to control the number of claims for Disability Benefit were enumerated by the Minister for Social Welfare, Dr. Woods, in a press release on December 2, 1982. They included the appointment of additional Medical Referees and an increase in the number of control staff in the Minister's department dealing with applications for this benefit, more visits to the homes of claimants by the Department's sickness visitors, better procedures for selecting doubtful cases for referral for medical referee examination and earlier referral of such cases, greater use of penalty clauses where claimants do not attend for medical referee examination, and stricter control of late claims. In addition to these measures the computerised

system of payment for Disability Benefit which came into operation in October 1982 has been used to set a time limit on all claims after which those still in payment are automatically listed for consideration by a medical referee.

Although the efforts which have been made to control the number of claims per worker have been successful Figures 3.5 and 3.6 show that there is still a strong upward trend in the duration and rate of incapacity. This upward trend continues despite the efforts which have been made over the years to care for and improve the working population's health by considerable public expenditure on sickness benefits and health services.

Medically related factors, such as ill-health, changes in medical practice, and less toleration of relatively minor complaints, would be expected to play an important part in explaining increasing sickness absence although changes in geographical, organisational, and personal factors could also explain some of the increase as Taylor (1979) notes in his paper on aspects of sickness absence.

Very few studies have been carried out in Ireland of the factors which influence the national sickness absence rate. Enquiries which I have made to the medical faculties in some of the universities have failed to turn up any studies which can account for the increase in the national sickness absence rate in recent years on medically related grounds. O'Hare and Walsh's (1987) report for the Health Research Board on the activities of psychiatric hospitals shows that there has been a noticeable increase in admissions to such hospitals in the last decade and this suggests that there could be medical factors which are associated with the increase in the sickness absence rate.

There is also medical evidence which suggests that increases in sickness absence in Dublin in certain areas of the city in particular years could be due to ill-health. Mortality data available to doctors in St. James's Hospital suggests that in recent years air pollution in Dublin may have been responsible for an increase in illness due to respiratory problems in the Winter (see the *Irish Times*, 18 June 1985).

A study of some of the non-medical factors affecting absenteeism in Irish industry was carried out in 1971 by O Muirheartaigh (1975) but no major national study has appeared since then. Further studies of changes in the medical and non-medical factors which may account for the change in the national sickness absence rate are needed if we are to identify those factors which it might be possible to control in order to reduce our sickness absence rate.

(b) Cost of Incapacity

The growth in the cost of incapacity benefits in current and constant (1970) prices is shown in Table 3.3 and Figure 3.7. Since 1954 the nominal cost of these benefits has risen almost continuously from £2.3 million to £330 million in 1986. In constant price terms the cost has increased almost twelve fold from £4.3 million to over £50 million. Figure 3.8 shows how nominal expenditure on incapacity benefit has fared

Table 3.3. *Expenditure on incapacity benefits, GNP, expenditure as a per cent of GNP, average expenditure per claim in current and constant (1970) prices, 1953-86*

Year ended March or December	Expenditure on incapacity benefits £000s		GNP £millions	Expenditure on incapacity benefits as % of GNP	Average expenditure on incapacity per claim £	
	Current prices	Constant prices			Current prices	Constant prices
1953	2,291	4,266	524.5	0.4		
1954	2,931	5,428	527.9	0.6	25.21	46.69
1955	2,994	5,404	550.7	0.5	25.68	46.34
1956	3,034	5,323	558.8	0.5	26.67	46.80
1957	3,467	5,837	580.8	0.6	30.89	52.01
1958	4,042	6,551	600.9	0.7	32.91	53.34
1959	3,981	6,431	638.8	0.6	34.59	55.88
1960	3,975	6,360	658.1	0.6	35.73	57.16
1961	4,369	6,816	708.8	0.6	33.89	52.88
1962	4,965	7,444	765.5	0.6	39.19	58.75
1963	5,345	7,826	821.7	0.7	43.24	63.32
1964	6,776	9,269	933.0	0.7	55.00	75.24
1965	7,419	9,685	999.6	0.7	56.03	73.15
1966	8,052	10,107	1052.7	0.8	53.51	67.17
1967	9,613	11,737	1149.8	0.8	66.61	81.33
1968	10,198	11,831	1300.7	0.8	69.19	80.26
1969	11,658	12,603	1493.7	0.8	69.87	75.54
1970	14,353	14,353	1648.5	0.9	75.55	75.55
1971	17,544	16,035	1879.7	0.9	92.66	84.69
1972	20,977	17,480	2267.4	0.9	110.65	92.21
1973	22,559	16,860	2715.7	0.8	112.68	84.22
1974	35,338	22,813	3009.9	1.2	169.65	109.52
1975	52,225	27,559	3796.3	1.4	213.07	112.44
1976	67,023	29,788	4612.7	1.5	211.40	93.96
1977	79,773	31,481	5595.0	1.4	249.20	98.34
1978	94,665	34,842	6528.6	1.5	265.93	97.88
1979	110,209	35,301	7633.9	1.4	344.49	110.34
1980	138,897	37,518	9002.6	1.5	425.76	115.00
1981	171,654	38,767	10854.4	1.6	542.63	122.55
1982	221,347	43,360	12453.7	1.8	733.92	143.77
1983	240,692	43,033	13499.0	1.8	828.40	148.11
1984	266,299	43,900	14659.7	1.8	892.71	147.16
1985	303,412	47,863	15324.0	2.0	996.54	157.20
1986	330,231	50,307	16207.0	2.0	1082.53	164.91

Sources: As for Table 3.1 and *National Income and Expenditure*, 1969 to 1986.

Figure 3.7: Expenditure on DB and IP
in current and constant (1970) prices in
year ended March or December, 1953-86

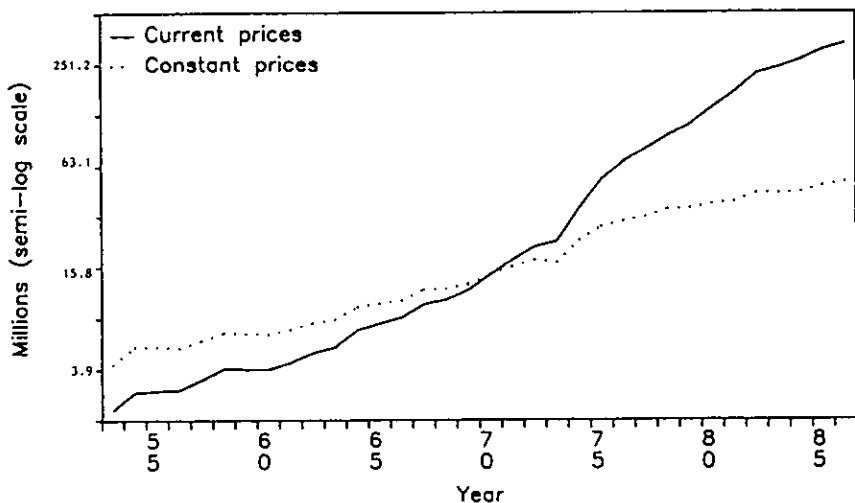
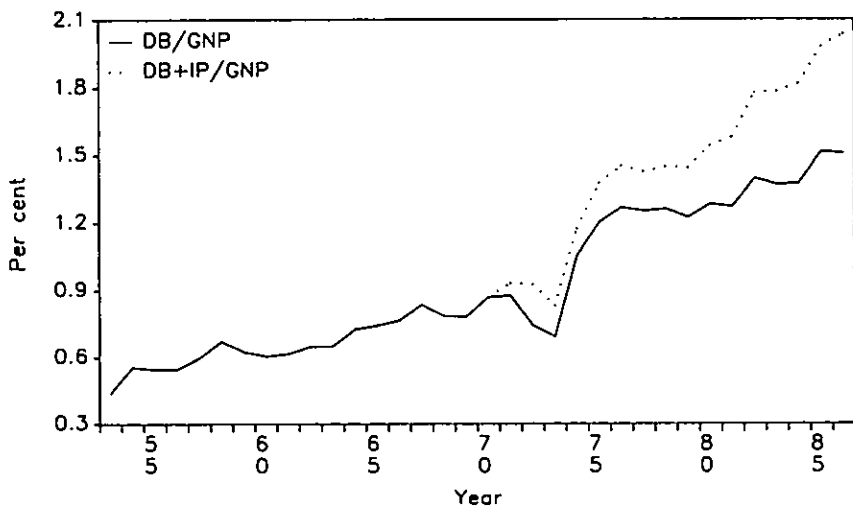


Figure 3.8: Annual expenditure on DB, and
DB plus IP as a percentage of GNP,
1953-86

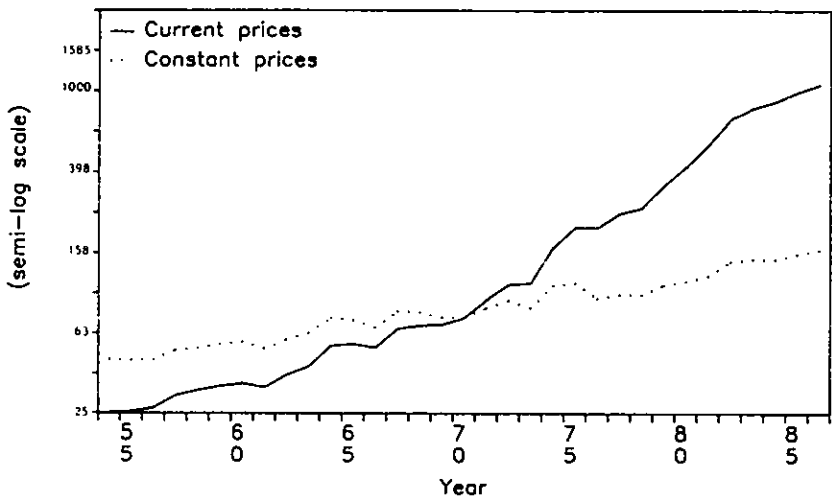


relative to GNP. In 1954 it required less than ½ per cent of GNP to pay for incapacity benefits. There was an almost continuous increase in their share of GNP up to the end of the 1960s, a slight decrease just before the introduction of the Pay-Related Benefit supplement to the flat-rate Disability Benefit in 1974 and a more rapid increase thereafter. In 1986 public expenditure on incapacity benefits amounted to 2 per cent of GNP.

Figure 3.9 shows current and constant (1970) price series for average expenditure per claim. Both series show a strong upward trend since 1954. In nominal terms each claim in 1954 cost about £25 while in 1986 the cost had risen to nearly £1,100. In constant price terms the cost of each claim has nearly tripled from £47 in 1954 to very nearly £165 in 1986. Part of the increase in the real cost of each claim is due to improvements in the value of the benefit in line with increases in wages and part is due to an increase in the period of time for which each claim lasts.

The time series data on the use of the incapacity schemes show that sickness absence has risen much faster than would be expected by increases in coverage of the insured labour force and the data on the cost of the two schemes show that there have been larger increases in costs than are justified by growth in GNP. These developments coupled

Figure 3.9: Average expenditure per claim on DB plus IP in current and constant (1970) prices, 1954–86



with the emergence in recent years of employees' unwillingness to pay increased PRSI contributions do support the argument which has been made that the cost of the Disability Benefit scheme needs to be contained.

They also suggest that there is a need for further research into the causes of the increase in sickness absence. One of the factors which has been shown to be positively associated with sickness absence is long-term unemployment (see Hughes, 1982A, Section 4). The age-by-duration analysis of the Live Register shows that between April 1980 and April 1986 long-term unemployment as a percentage of total unemployment increased from 35 per cent to 44 per cent of those on the Register while the number of long-term unemployed more than tripled from 32,180 to 103,661 persons. This very large increase in long-term unemployment could well account for a considerable part of the increase in incapacity.

3.2 International Data on Sickness Absence

International comparisons of sickness absence data are difficult to make due to differences in coverage of social insurance schemes and differences in the administration of sickness benefits. However, the OECD has recently assembled international data on absenteeism from work due to ill-health and some comparisons can be made with countries which appear to have similar arrangements for income maintenance during illness as we have. Data on sickness absence and sickness benefit expenditure for eleven OECD countries for 1960, 1970, and 1981 are given in a paper by Saunders and Klau (1985, p.152). Annual data since 1960 on the duration of absenteeism due to ill health are published in a recent OECD (1985, Section F) report on health care costs and performance.

The data suggest that in 1960, 1970 and 1981 the duration of sickness absence per worker was considerably higher in Ireland than in eight other OECD countries for which data were available. In 1981, for example, there were 34 days of sickness absence per worker in Ireland, 23 in Sweden, 20 in the United Kingdom, 17 in Italy, 14 in France, 12 in Luxembourg, 9 in the Netherlands, 5 in the United States and 4 in Finland. It also shows that the percentage change in days of sickness absence per worker was greater in Ireland than in any of these countries during the period 1960-81. The percentage change figures ranged from plus 73 per cent for Ireland and Sweden to minus 11 per cent for the United States.

The OECD expenditure data show that in 1981 Ireland ranked fourth

out of the nine countries in terms of its expenditure on sickness benefits as a percentage of GDP and also in terms of the rate of change in this ratio over the period 1960-81.

Social expenditure statistics published by Eurostat (1986) show that in terms of cash-benefits Ireland had the second highest expenditure on sickness benefit as a percentage of GDP of the ten European Community countries. When expenditure in cash on invalidity is included, however, Ireland's ranking for total expenditure in cash on sickness and invalidity benefits as a percentage of GDP drops to seventh place. The change in Ireland's ranking may be due to differences in the periods for which sickness and invalidity benefits are paid in different countries. Invalidity Benefit is not payable in Ireland until the claimant has been ill for at least a year whereas in the United Kingdom Invalidity Pension is payable after six months illness.

The international data for sickness absence and sickness expenditure in some of the OECD countries and in the European Community countries suggest that Ireland's sickness absence problem is among the worst in these countries and that it devotes a larger share of its national resources to public expenditure on sickness benefit than many of the other countries do although its position is not exceptional when the expenditure data on sickness and invalidity are combined. International comparisons of sickness absence data are difficult, as mentioned at the beginning of this section, and further work needs to be done in this area to ensure that the expenditure data for sickness benefit are not giving a misleading impression because of differences in coverage and duration of schemes for income maintenance during illness.

The time series data for Ireland and the international data indicate that the objectives of reducing sickness absence and of cutting public expenditure on sickness benefits are important. Giving employers an incentive to control their short-term sickness absence by making them directly responsible for the administration of Statutory Sick Pay could make a useful contribution to the achievement of these objectives. The introduction of a Statutory Sick Pay scheme, however, would mainly affect short-term claims and it may not have a major impact on measures of the cost and use of the incapacity schemes because of the greater importance of long-term claims. As Geary and Dempsey (1979, p. 169) note, "though long-term cases are far fewer than short-term they account for about half the time lost through disability". If efforts to reduce sickness absence and Government expenditure on sickness benefit are to be

successful action would also need to be taken to reduce the number of long-term claims.

3.3 *Abuse of the Disability Benefit Scheme*

Allegations by employers, politicians, and doctors of abuse of the Disability Benefit scheme have been frequently made as we saw in the last chapter and they have received considerable press coverage in recent years. The impression has been created that there is widespread abuse of the Disability Benefit scheme because medical certificates can be secured on demand from some medical practitioners.

The outcome of referrals of suspect claims for a medical examination by the Department of Social Welfare's doctors under the Medical Referee Scheme does not support these allegations. The outcome of the referral procedures is shown in Table 3.4 and Figure 3.10.

The table and chart show that there is a strong positive association between the percentage of claims which are rejected by the Department and the percentage of claimants who are summoned to see the medical referee. Since 1980 the Department has increased the intensity with which it uses the Medical Referee Scheme by very nearly doubling the proportion of Disability Benefit claimants referred for a second medical examination. This policy has resulted in the percentage of claimants not attending for examination doubling from 5.2 per cent in 1979 to 10.9 per cent in 1983. It has also resulted in a sustained increase in the percentage of claimants judged to be fit for work by the Department's medical referees. This percentage increased from 2.1 per cent of all claimants in 1979 to 5.3 per cent in 1986.

Regression of the percentage of claims rejected on the percentage of claimants summoned for a second medical examination during the periods 1955-78, 1955-86, and 1979-86 gives the results shown in Table 3.5.

The regression results show that there is a very strong positive association between the use of the Medical Referee scheme and the percentage of claims which are rejected for payment by the Department of Social Welfare. Over the whole period with which we are concerned every one percentage point increase in the proportion of claimants summoned for a medical examination resulted in a 0.42 percentage point increase in the proportion of rejected claims. The effect of the improvements which were made during the 1980s in the referral procedures can be seen by comparing the coefficients on the variable for those summoned during the periods 1955-78 and 1979-86. In the earlier period every one percentage point increase in the proportion of

Table 3.4: *Outcome of Disability Benefit claims referred for a second medical opinion, 1955-86*

<i>Year ending March or December</i>	<i>Percentage of D. B. claimants summoned</i>	<i>Percentage not attending</i>	<i>Percentage capable of work</i>	<i>Percentage of claims rejected</i>
1955	24.5	8.2	4.0	12.2
1956	25.2	7.9	3.8	11.7
1957	24.4	6.9	3.0	9.9
1958	25.5	6.9	3.7	10.6
1959	26.8	7.2	3.8	11.0
1960	28.0	7.5	3.5	11.0
1961	24.5	7.0	2.3	9.3
1962	29.5	7.8	2.3	10.1
1963	26.7	6.5	2.3	8.8
1964	28.2	6.1	3.4	9.5
1965	29.1	6.7	5.2	11.9
1966	29.3	7.4	4.5	11.9
1967	30.9	7.3	4.9	12.2
1968	31.1	7.4	4.1	11.5
1969	21.7	5.2	2.9	8.1
1970	13.2	3.9	1.6	5.5
1971	10.6	2.5	1.1	3.6
1972	18.6	4.3	1.8	6.1
1973	18.4	4.3	2.1	6.4
1974	16.1	3.6	1.8	5.4
1975	12.0	3.0	1.3	4.3
1976	15.8	4.1	2.3	6.4
1977	20.3	5.2	4.0	9.2
1978	20.7	5.8	3.9	9.7
1979	14.1	5.2	2.1	7.3
1980	25.7	8.9	4.1	13.0
1981	23.4	9.4	3.0	12.4
1982	25.5	10.9	3.5	14.4
1983	30.0	10.9	5.0	15.9
1984	28.6	9.3	4.8	14.1
1985	26.9	6.8	5.1	11.9
1986	29.5	9.3	5.3	14.6

Sources: Report of the Department of Social Welfare, 1954-58 to 1981-82 and Department of Social Welfare. Statistical Information on Social Welfare Services, 1983 to 1986

Note: 1. From 1974 onwards the data refer to the calendar year.

2. The series for percentage not attending excludes those who were medically certified as unfit to attend.

Figure 3.10: Outcome of Disability Benefit claims referred for second medical opinion, 1955-86

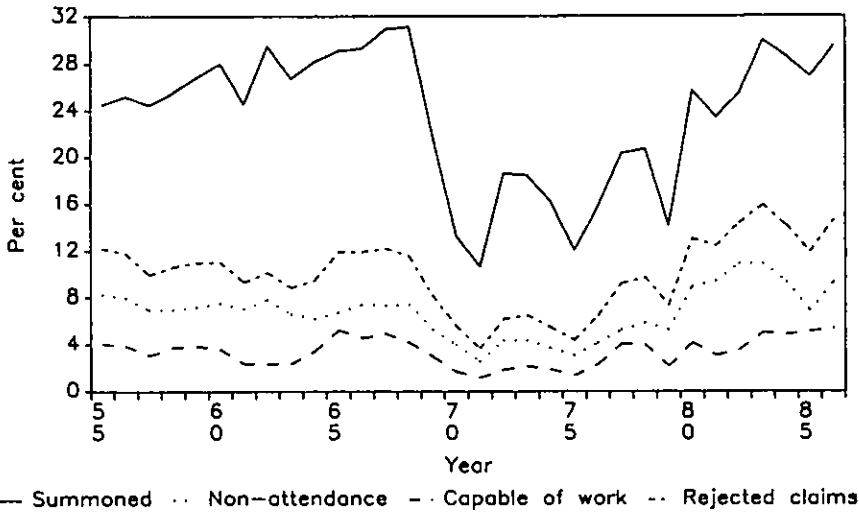


Table 3.5. Regression of the percentage of claims rejected on the percentage of claimants summoned for a second medical examination during the periods 1955-78, 1955-86 and 1979-86

Period	Variable		R-Squared	D-W	Rho	SEE
	Constant	Summoned				
1955-78	1.1248 (0.95)	0.3689 (8.99)	0.9073	1.4390	0.1410	0.7246
1955-86	0.7315 (0.56)	0.4176 (11.46)	0.9253	1.5460	0.1549	0.8252
1979-86	0.2368 (0.15)	0.4983 (8.25)	0.8983	1.4937	0.2463	0.7879

Note: t-value in parentheses

claimants summoned resulted in an increase of 0.37 percentage points in the proportion of rejected claims whereas in the later period this rose to 0.50 percentage points. The improved referral procedures have, therefore, been accompanied by greater efficiency in identifying claimants who are capable of work or who will not attend for a medical referee examination.

The elasticity of rejected claims with respect to claimants summoned is approximately 1 when the elasticity is calculated at the means of the variable for all three regression equations shown in Table 3.5.

Hence, a 1 per cent increase in summonses for a medical referee examination results in a 1 per cent increase in rejected claims. Since each referral under the Medical Referee scheme costs a great deal less than the average cost of each claim in payment, the money which is spent on the medical procedures for controlling claims is more than repaid by the savings made on claims which might otherwise have been paid. This does not mean that referrals to the medical referee should be made indiscriminately. One of the valuable features of the Medical Referee scheme is that it enables Disability Benefit to be paid to those who are entitled to it without subjecting them to the screening procedures which are necessary to identify a minority of claimants who try to abuse the Disability Benefit scheme.

Three distinct phases in the use and outcome of the referral procedures can be identified from Table 3.4. The first occurred during the years 1955-69 when 27 per cent of all claimants were summoned for a medical referee examination and about 11 per cent of all claims were rejected. The second occurred during the years 1970-79 when the percentage of all claimants summoned nearly halved to 16 per cent and rejected claims dropped to around 6½ per cent of all claims. The third phase which can be identified commenced in 1980 and it has continued up to 1986, the most recent year for which data is available. The percentage of all claimants summoned during this phase has been increased to the level it was at during the first phase, 27 per cent, and rejected claims have risen to nearly 14 per cent of all claims submitted³. Although this figure is rather high it does not show that there is massive fraud in the Disability Benefit scheme as is sometimes alleged. It suggests that a minority of claimants are prepared to take advantage of the state's arrangements for income maintenance for the sick but that the Medical Referee scheme can be very effective in identifying suspect claims and screening out those claims which should not be paid if it is given the resources which it needs to do its job properly, as it has been during the 1980s.

The results of the referral procedures do suggest that the first line of defence in screening out suspect claims, certification by the claimant's

3. The figures given for the percentage of claims which are rejected are a little too high because they do not take account of the outcome of appeals by claimants who challenge the Deciding Officer's decision in turning down their claims for Disability Benefit. Unfortunately, the Department of Social Welfare does not give any information in its statistical report on the number of appeals which are decided in favour of the claimant by the Appeals Officer. *The Report of the Commission on Social Welfare*, however, gave details of the outcome of the appeals procedure for certain social welfare schemes in 1984. It showed (Ireland 1986A, Table 21.3) that appeals were lodged in only 1215 of the 38,985 claims which were rejected in that year, i.e., just over 3 per cent of rejected claims. The number of appeals decided in the appellant's favour was 510 and this number is too small to make any appreciable difference to the outcome of the referral procedures.

own doctor, is not as effective as it should be. There is a case for an inquiry into the operation of the medical certification scheme and a need for the parties concerned to consider what action could be taken to strengthen and make more effective the medical certification scheme.

It should be noted before leaving the subject of abuse of the Disability Benefit scheme that the Department of Social Welfare recently commissioned a firm of management consultants, Craig Gardner, to look into the question of how much fraud and abuse there might be in the social welfare system. The Minister for Social Welfare, Dr. Woods, told the Dail on 15 December 1987 (DEPD, 15 December 1987, col. 2380) that their "report stresses that there is a hard core of 2 per cent fraud in disability benefit and unemployment assistance and that there is a suspect area up to 7 per cent".

3.4 Market Failure and the Growth of Occupational Sick Pay Schemes

The state became involved in the provision of social insurance against illness early in this century because private attempts, through employers, insurance companies, Friendly Societies, or trade unions, to offer insurance against this contingency only succeeded in covering a minority of the population. Buckley's (1987, p.39) data show that in 1911 when membership of Friendly Societies was at its peak in Ireland it covered only 1.68 per cent of the population. Where private arrangements did exist they encountered frequent difficulties because of the problems posed for any insurance scheme by the ability of insured persons to influence the frequency and duration of claims (moral hazard) and the difficulty of identifying the risk of illness for particular groups of employees (adverse selection).

Gradually, however, as the health of the working population improved following the public health reforms of the last century and the establishment of national health services in this century it became possible for more and more employers, who had better knowledge than insurance companies of their employees health, to supplement the state sickness benefit payments with their own occupational sick pay benefits.

If private sick pay schemes cover a large percentage of employees there may be a case for the state to divest itself of its responsibility for the administration of short-term sick pay because the market failure which originally justified state administration and provision of sickness insurance will have been largely rectified. In this section we will consider the evidence relating to the growth and present level of coverage of occupational sick pay schemes to see if they provide a justification for

the proposed Statutory Sick Pay scheme.

Unfortunately, it is not possible to document the spread of occupational sick pay schemes at national level because regular surveys of the coverage of these schemes have not been carried out. The only national survey which is available is the one which the Department of Social Welfare commissioned the Survey Unit of the ESRI to carry out in 1985. However, the Federated Union of Employers carried out a survey of occupational sick pay schemes in its member companies in 1973 and the results of that survey can be used in conjunction with the results of the Department of Social Welfare's survey for "industrial and large service firms" to draw some conclusions about trends in coverage over the period 1973-85.

The FUE carried out a survey of occupational sick pay provision by member companies in 1973. The survey report (FUE, 1973) does not indicate how the sample was selected or how many questionnaires were sent out. However, 432 questionnaires were returned of which 387 were useable. The number of employees covered by the survey was 109,000 of whom 34,000 were clerical and 75,000 were manual, 80,000 were male and 29,000 were female. The results showed that only 19 per cent of clerical employees were covered by formal sick pay schemes. Manual employees fared better as 58 per cent of them were covered by formal arrangements for sick pay. Weighting by the numbers in each group shows that only 45 per cent of employees in FUE member companies were covered by an occupational sick pay scheme in 1973.

About two-thirds of the companies provided sick pay for their employees during the first two weeks illness and of these half made flat rate payments while the other half were pay-related. The percentage of companies making payments declined with the duration of illness. Thus, only 37 per cent of companies made a payment for illnesses lasting from 11 to 13 weeks while only 8 per cent of companies made payments for illnesses lasting from 26 to 52 weeks. The average amount of occupational sickness benefit paid was £5.44 per week which was almost the same as the Disability Benefit payment, £5.55, for a single adult.

The FUE 1973 survey, therefore, showed that occupational sick pay coverage among the larger firms in the industrial sector was limited to a minority of employees, that the average level of benefit which was available was comparable to the sickness benefit provided by the state for a single adult and that most firms paid occupational sickness benefit for a period of less than 11 weeks.

The survey carried out for the Department of Social Welfare by the

ESRI's Survey Unit in 1985 gave estimates of coverage of occupational sick pay schemes by sector. Table 3.6 shows that 58 per cent of the non-agricultural labour force were covered by an occupational sick pay scheme in 1985⁴. When the results are classified according to employment in the non-commercial public and private sectors a significant difference between coverage in the two sectors emerges.

Table 3.6 Overall estimates of coverage by sick pay scheme

Sector	Covered		Not Covered		Total	
	000s	%	000s	%	000s	%
Industrial and large service firms (excluding Building and Construction)	277.3	66.2	141.7	33.8	419.0	100
Small service firms and non-agricultural self employed	0.0	0.0	211.0	100.0	211.0	100
Agriculture, Forestry and Fishing	0.0	0.0	182.0	100.0	182.0	100
Private Sector Building and Construction	28.0	41.8	39.0	58.2	67.0	100
Non-commercial Public Sector	231.0	100.0	0.0	0.0	231.0	100
All sectors	536.6	48.3	573.7	51.7	1,110.0	100

Source: Keogh, Williams, and Whelan (1985).

Note: Commercial public sector organisations are included with industrial and large service firms.

Very nearly 100 per cent of employees in the non-commercial public sector were covered by an occupational sick pay scheme whereas only 44 per cent of employees in the private sector had the benefit of such a scheme. The majority of employees who were covered in the private sector were employed in industrial and large service firms. Coverage in these firms accounted for 66 per cent of employees. It will be recalled that coverage in such firms in 1973 only accounted for 45 per cent of employees so considerable growth has occurred in coverage in industrial and larger firms in the period 1973-85. The 1985 survey contains

4. The survey which was carried out in 1985 by the ESRI (Keogh, Williams and Whelan, 1985) for the Department of Social Welfare was designed to determine the extent to which members of the labour force were covered by occupational sick pay schemes and to discover the characteristics of these schemes. As coverage for the "non-commercial public sector", "private sector building and construction", and the "agriculture, forestry and fishing" sectors were known, i.e., 100 per cent, 42 per cent and 0 per cent respectively, the sample was drawn from three different frames which encompassed the top 1,000 firms in the country, 6,500 industrial firms and the small firms listed in the Golden Pages Telephone Directory. This combination of sampling frames is believed to give very nearly exhaustive coverage of all the firms in the country in the sectors chosen for inclusion in the survey. The survey classified the completed questionnaires into those received from "small service firms and non-agricultural self employed" and from "industrial and large service firms". Only 2 out of 78 firms from the small services group who responded indicated that they had an occupational sick pay scheme. It was concluded, therefore, that this group could be ignored for the purpose of estimating coverage and the analysis of the characteristics of occupational sick pay schemes was confined to those provided by firms in the industrial and large service group.

information on the date of establishment of occupational sick pay schemes in large firms which confirms that growth in coverage is of relatively recent origin. Only 10 per cent of the schemes in large firms were set up before 1960, 39 per cent were introduced in the period 1961-75 and the remaining 51 per cent were established during the last decade.

The 1973 survey showed that a significantly greater percentage of manual than of non-manual employees were covered by occupational schemes. The relative advantage which manual workers had in terms of formal arrangements in 1973 changed over the next 12 years as by the time the 1985 survey was undertaken the majority of non-manual workers (78 per cent) were covered whereas there was little change in the proportion of manual workers covered (57 per cent). Most of the growth which has occurred in the last decade in the coverage of occupational sick pay schemes has taken place among non-manual employees of large industrial and service firms. There has been little, if any, change in coverage for employees of small firms.

The 1985 survey results showed that 93 per cent of those who were covered by an occupational sick pay scheme in large firms belonged to non-contributory schemes and that 86 per cent of them received pay-related sickness benefit when they were ill. Very nearly 100 per cent of pay was replaced for a fixed period which averaged 6 weeks for members of schemes for manual workers, 19 weeks for members of staff (i.e., non-manual) and manual schemes and 22 weeks for members of staff schemes. When the fixed period set for payment of full benefit was exhausted one-third of employees received no further payments and the percentage of salary payable was reduced to 63 per cent for members of manual schemes, to 57 per cent for members of staff and manual schemes, and to 54 per cent for members of staff schemes. Occupational sick pay ceased altogether for 93 per cent of scheme members within nine months of the commencement of illness. Thus, for members of manual schemes no payment was made after 18 weeks on average, while for members of staff and manual schemes the average was 29 weeks and for members of staff schemes it was 38 weeks. Non-manual employees, therefore, have far better occupational sick pay coverage than manual employees and they receive benefit for twice as long on average as manual employees.

Sickness benefit payments commenced from the first day of illness for 78 per cent of scheme members and from the third or fourth day for nearly all of the remainder. Medical certificates were required under the terms of nearly all schemes by the third day of illness and certificates

were generally required weekly thereafter.

The survey results show that the market failure argument which in the past was used to justify state administration of social insurance against illness has weakened in the last decade or so because a majority of those who work in large firms in the industrial and services sector are now covered by occupational sick pay schemes. Hence, they support the case that there is scope for streamlining the administrative arrangements for income maintenance during short-term illness for employees who are covered by an occupational scheme. This argument does not apply to the great majority of those who work for small service firms or who own their own businesses in the non-agricultural sector because they are not covered by occupational sick pay schemes.

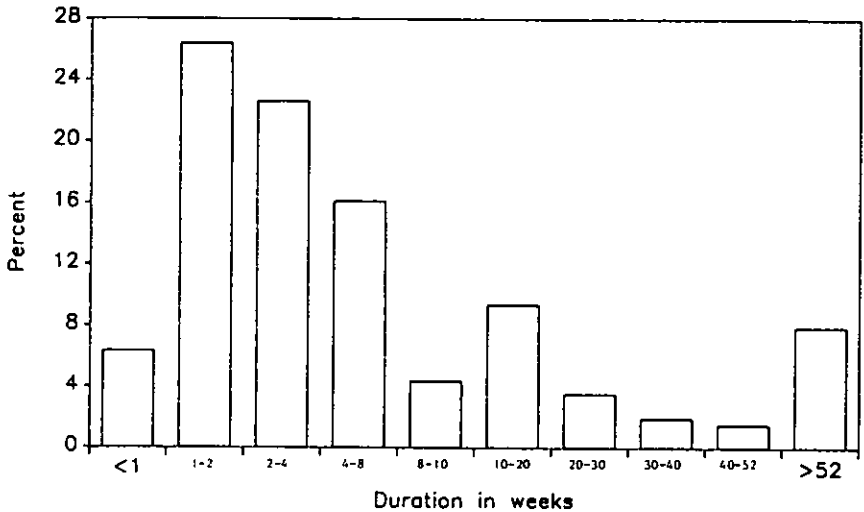
Although the existence of occupational schemes supports the case for streamlining the arrangements for income maintenance during illness it does not give conclusive support to this case because there are other factors which should be taken into account. It would be inefficient, for example, to transfer the administration of sickness benefit to private sector firms if it costs them more than it costs the state to administer this benefit. Unfortunately, it is not possible to compare the administrative costs of public and private provision of sickness benefit due to lack of data for occupational schemes. However, it is implicit in the Government's decision to transfer administration of short-term sick pay to employers that their costs are no higher than the state's cost although the Beveridge Report (HMSO, 1942, Appendix E) showed that in Britain the state's administrative costs for health insurance during the period 1914-39 were only about 3 per cent of contributions whereas administrative costs for Approved Societies and Insurance Committees were about 12 per cent of contributions.

It is not clear why 13 weeks has been chosen as the period for which employers are to be responsible for short-term sick pay. It may have been because that is the period within which 80 per cent of all claims are terminated, as Figure 3.11 shows, and it would lead to a very significant reduction in the Department of Social Welfare's work load. The survey results suggest that it might be better to choose a shorter period since occupational sick pay schemes covering manual workers generally make payments for only the first 6 weeks illness.

3.5 The Disability Benefit Scheme and the Incentive to Work

The argument which employers have pressed most strongly in their campaign, through the FUE, for the taxation of short-term social welfare

Figure 3.11: Distribution by duration of Disability Benefit spells terminated in 1986



benefits is that the combination of tax exempt social welfare benefits and refunds of tax to employees who are out of work due to unemployment or ill health can lead to high replacement ratios which are a disincentive to work. Regression analysis of the time series data relating to the Disability Benefit scheme (Hughes 1982A, Section 4) shows that there is a positive association between increases in the frequency and duration of certified incapacity for work and the percentage of pre-sickness earnings replaced by Disability Benefit. This does not prove that incapacity benefits are discouraging employees who are perfectly healthy from working because there are other explanations which could account for the observed association between certified incapacity and the replacement ratio. For example, increases in Disability Benefit may (a) have enabled more workers to comply with their doctors' instructions to take time off work when ill or (b) have caused workers to take less care of their health by lowering the cost of illness relative to the cost of preventing illness. Unfortunately, it is not possible to discriminate between different hypotheses concerning the reasons for the increase in sickness absence on the basis of the limited information which is published about the characteristics of Disability Benefit claimants.

Despite the lack of evidence about the alleged disincentive effects of the Disability Benefit scheme the Government restructured the pay-related component of both the Unemployment Benefit and Disability

Benefit schemes in 1983, 1984, and 1987 to reduce the possibility of some employees being better off out of work than in work. It did this by reducing the percentage rates of payment, increasing the waiting period to three weeks, and increasing the income "floor" which is disregarded when calculating pay-related benefit. It also decided to introduce a wage-stop from April 1983 which would limit Disability Benefit to 80 per cent of reckonable earnings where claimants are entitled to both the flat-rate and pay-related benefits. The wage-stop was reduced to 75 per cent of reckonable earnings from April 1984. The only study which has been undertaken of actual replacement ratios for Disability Benefit claimants concluded (Buckley, 1985, p.7) that:

The 1983/84 structural changes have considerably reduced the pay-related benefit component of replacement ratios. This is particularly pronounced for single persons and married persons with no family or relatively small families. In those cases typical replacement ratios were reduced by between 8 and 13 percentage points. Replacement ratios are lowest for single persons and do not vary dramatically by income level for them. They are highest for married persons with large families and highest of all for such families previously in low wage employment who in fact have little or no pay-related benefit entitlement.

This study also established that in November 1984 only about 3 per cent of Disability Benefit recipients had replacement ratios in excess of 100 per cent and it noted that this group consisted of low paid married workers with large families. These high replacement ratios arose not because of the pay-related supplement but because the flat-rate entitlement of some married persons with low earnings and large families was close to or exceeded their previous net earnings.

One factor which Buckley's study did not take into account because of lack of data was the effect of tax rebates on income while out sick. Tax rebates arise because Disability Benefit, like Unemployment Benefit, is not taxed as it is an irregular payment for most workers. It cannot, therefore, be allowed for in the PAYE tables which employers use to deduct income tax cumulatively. Cumulative withholding of tax generally ensures that tax payments are the same as tax liabilities at each pay day. Hence, at the end of the tax year the great majority of wage and salary earners will have paid exactly the amount of tax for which they are liable and there will be no need for end of year adjustments as there is where non-cumulative withholding is used as in the case of taxation of the self-employed. One of the disadvantages of cumulative withholding is that

it can lead to a refund of tax where an employee's income drops below its normal level due to unemployment or sickness. An unemployed or sick employee would be entitled to a refund of tax paid on previous earnings in the tax year whenever the weekly tax-free allowance is greater than the income for a particular week (see Hughes, 1982A, Appendix 2 for an example).

The proportion of income which will be replaced, the "replacement ratio", when the most recent changes in Disability Benefit come into effect in July 1988 are shown in Table 3.7 for male employees whose claim lasts for more than three weeks. This table shows what percentage of net take-home pay will be replaced by flat-rate and pay-related Disability Benefit and income tax rebates for single and married male employees at different income levels who experience a particular duration of sickness absence. It is important to note that claimants who might fall into these categories are not representative of all Disability Benefit claimants as very nearly half of all claims are terminated within three weeks and in recent years only a minority of claimants have been eligible for pay-related benefit. In 1986, for example, only 22 per cent of the average number of Disability Benefit recipients qualified for pay-related benefit (see Department of Social Welfare, 1987, Table 67) and this figure is representative of the percentage receiving pay-related benefit in previous years. The income position of male employees whose Disability Benefit claims last for at least three weeks has been chosen for investigation because it will show the maximum replacement ratios which can be expected to occur in the coming year in the light of the changes announced in this year's Budget in the income tax and social insurance systems.

The replacement ratio data presented in Table 3.7 are graphed in Figure 3.12. Part A shows what the replacement ratios are expected to be around the middle of this year when tax rebates are included in the calculations and part B shows what the replacement ratios would be if no tax rebates are made. Part A shows that replacement ratios in excess of 100 per cent are likely to occur only for married employees getting about half of average weekly earnings for adult males in manufacturing industries. The tax rebate is more important in leading to this result than the pay-related benefit but more important than either of these is the fact that such workers are among the lowest paid in manufacturing industry. High replacement ratios are inevitable for such workers when the main sickness benefit which they receive from the state is paid at a flat-rate according to family size. Flat-rate benefits by definition will

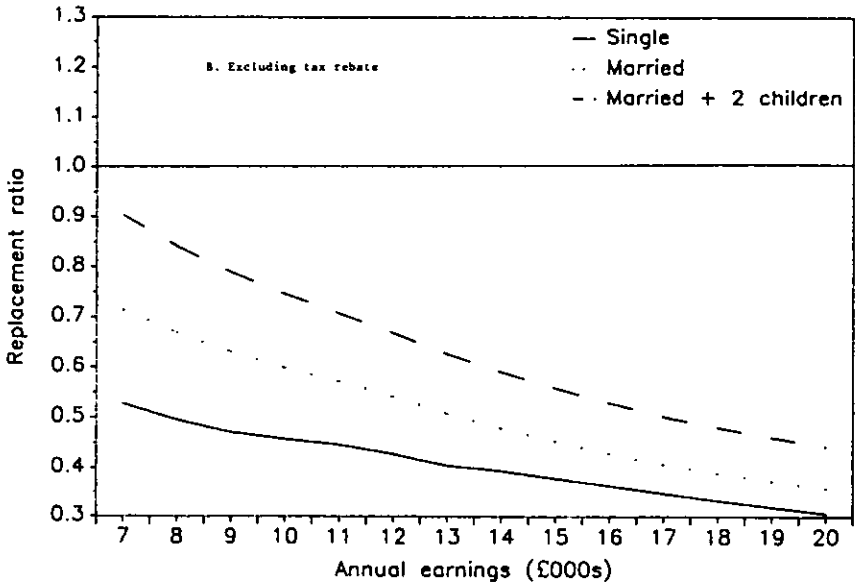
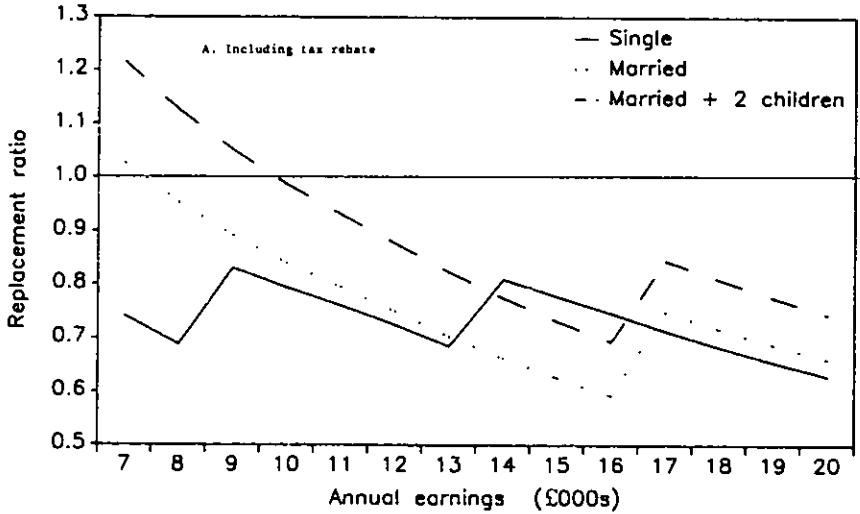
Table 3.7: *Weekly income in work and out sick for single and married men and replacement ratios after three weeks on Disability Benefit from July 1988*

<i>Single person</i>					
	7000.00	9000.00	11000.00	14000.00	17000.00
Annual earnings	7000.00	9000.00	11000.00	14000.00	17000.00
Gross weekly earnings	134.62	173.08	211.54	269.23	326.92
Basic TFA	60.30*	90.00†	90.00	113.40§	113.40
Taxable income	74.32	83.08	121.54	155.83	213.52
Tax due	26.01	39.88	58.34	90.38	123.84
PRSI deductions	10.43	13.41	16.39	20.87	23.98
Total deductions	36.44	53.29	74.73	111.25	147.82
Net take-home pay	98.17	119.79	136.81	157.98	179.10
DB: Flat-rate	43.60	43.60	43.60	43.60	43.60
Pay-related	8.08	12.65	17.22	18.50	18.50
Tax Rebate	21.11	43.20	43.20	65.77	65.77
Take-home pay including tax rebate	72.78	99.45	104.02	127.87	127.87
RR incld. tax rebate	0.74	0.83	0.76	0.81	0.71
Take-home pay excluding tax rebate	51.68	56.25	60.82	62.10	62.10
RR exclud. tax rebate	0.53	0.47	0.44	0.39	0.35
<i>Married person</i>					
	7000.00	9000.00	11000.00	14000.00	17000.00
Annual earnings	7000.00	9000.00	11000.00	14000.00	17000.00
Gross weekly earnings	134.62	173.08	211.54	269.23	326.92
Basic TFA	99.73*	99.73	99.73	99.73	159.11†
Taxable income	34.89	73.35	111.81	169.50	167.81
Tax due	12.21	25.67	39.13	59.33	80.55
PRSI deductions	10.43	13.41	16.39	20.87	23.98
Total deductions	22.64	39.08	55.53	80.19	104.53
Net take-home pay	111.97	133.99	156.01	189.04	222.39
DB: Flat-rate	71.80	71.80	71.80	71.80	71.80
Pay-related	8.08	12.65	17.22	18.50	18.50
Tax Rebate	34.91	34.91	34.91	34.91	76.37
Take-home pay including tax rebate	114.79	119.36	123.93	125.21	166.67
RR incld. tax rebate	1.03	0.89	0.79	0.66	0.75
Take-home pay excluding tax rebate	79.88	84.45	89.02	90.30	90.30
RR exclud. tax rebate	0.71	0.63	0.57	0.48	0.41
<i>Married + 2 Children</i>					
	7000.00	9000.00	11000.00	14000.00	17000.00
Annual earnings	7000.00	9000.00	11000.00	14000.00	17000.00
Gross weekly earnings	134.62	173.08	211.54	269.23	326.92
Basic TFA	99.73*	99.73	99.73	99.73	159.11†
Taxable income	34.89	73.35	111.81	169.50	167.81
Tax due	12.21	25.67	39.13	59.33	80.55
PRSI deductions	10.43	13.41	16.39	20.87	23.98
Total deductions	22.64	39.08	55.53	80.19	104.53
Net take-home pay	111.97	133.99	156.01	189.04	222.39
DB: Flat-rate	93.00	93.00	93.00	93.00	93.00
Pay-related	8.08	12.65	17.22	18.50	18.50
Tax Rebate	34.91	34.91	34.91	34.91	76.37
Take-home pay including tax rebate	135.99	140.56	145.13	146.41	187.87
RR incld. tax rebate	1.21	1.05	0.93	0.77	0.84
Take-home pay excluding tax rebate	101.08	105.65	110.22	111.50	111.50
RR exclud. tax rebate	0.90	0.79	0.71	0.59	0.50

* Tax at 35% Table A and R † Tax at 48% Table B and S allowances

§ Tax at 58% Table C and T allowances

Fig. 3.12: Replacement ratios by income group for single and married men after three weeks on DB from July 1988



replace a smaller percentage of income as income increases. This feature of flat-rate benefits is brought out clearly in Figure 3.12 which shows that in general the replacement ratio declines steadily as income increases. The replacement ratios for single people are an exception to this general tendency because the use of tax tables to spread tax deductions evenly over the year leads to upward steps occurring in the replacement ratio at the points where the tax tables come into effect by increasing the value of the income tax rebate at these points in the income range. For example, the replacement ratio for a single person increases from 0.68 to 0.81 between incomes of £13,000 and £14,000 because the value of the income tax rebate increases from £43.20 per week to £65.77 per week.

The restructuring of pay-related benefit in 1983, 1984 and 1987 has resulted in the elimination of excessive replacement ratios over all but the lowest part of the income range. Bearing in mind Buckley's (1985) finding that less than about 3 per cent of Disability Benefit claimants had replacement ratios in excess of 100 per cent current replacement ratios suggest that the argument for introducing a Statutory Sick Pay scheme in order to make sickness benefit taxable and thus reduce replacement ratios below 100 per cent is no longer as strong as it was some years ago.

The argument for taxing short-term sickness benefit can still be made on equity grounds. Parts A and B of Figure 3.12 show that the exemption of Disability Benefit from tax means that some recipients of this benefit are treated more favourably by the tax system than employees receiving the same income from work. Some years ago it appeared that the only way in which tax equity could be given to those in receipt of similar incomes in and out of work was by making employers responsible for the payment of short-term sickness benefit. This was one of the main arguments supporting the introduction of a Statutory Sick Pay scheme. Recent developments in relation to the taxation of short-term social welfare benefits in the United Kingdom, however, indicate that there may be another way of ensuring equity in the tax treatment of income from work and transfers from the state.

The problem of taxing short-term social insurance benefits under a cumulative PAYE system was tackled by the British Government in the early 1980s by making the local benefit offices responsible for the taxation of certain benefit payments to the unemployed and transferring responsibility for short-term sickness benefit to employers. The aim of this approach is to ensure that cumulative taxation of income under PAYE is maintained. It is not possible to achieve this aim in all cases

and Prest and Barr (1985, p.166) argue that it would be much easier to tax short-term national insurance benefits under a system of self-assessment.

Unemployment Benefit and Supplementary Allowance payments to the unemployed in the United Kingdom were brought into the tax net by the 1981 Finance Act and Income Tax regulations made in 1982. Benefits to the unemployed are taxed by the local social security office which acts as an "employer" for tax purposes. A modified form of PAYE is operated so that PAYE calculations are made only at the end of each claim or tax year rather than each time a payment is made as is the case with normal employers. The method of taxing benefit payments to the unemployed rests on five main principles:

1. tax is not deducted from benefit payments
2. child additions to benefit, or payments for housing costs or additional requirements are not generally taxed
3. refunds of income tax are not made to unemployment benefit claimants except at the end of each claim or tax year, whichever is earlier
4. any tax due on benefit payments is generally met either by reducing the amount of any tax refund due at the end of each claim or tax year, or by adding the taxable benefit to subsequent pay and thus reducing the amount of tax free pay allowed on return to work
5. underpayments of tax are recovered by tax coding adjustments on return to work.

The way in which benefit payments to the unemployed are taxed is as follows. The unemployed person gives the local DHSS office form P45 parts 2 and 3 when a claim for benefit is submitted. The DHSS office sends part 3 to the Inland Revenue and uses part 2 to set up a tax record for the employee which shows running totals of earnings from employment and unemployment benefit payments. It does not deduct tax from the benefit payments. When the employee has found another job the DHSS office calculates tax liability on total income received during periods of employment and unemployment. If an overpayment of tax has been made, as would generally be the case, the refund is made by the local office. If there has been an underpayment of tax the local DHSS office notifies the Inland Revenue which then issues an adjusted certificate of tax free allowances to the employee. The adjusted certificate will permit the amount of tax due to be paid over the time remaining in the current tax year or in the following tax year. At the end of each period of

unemployment the DHSS office issues a new P45 certificate of income and tax paid for presentation to the next employer.

These arrangements appear to be working satisfactorily in Britain and Northern Ireland⁵. It has not been possible to establish if they necessitated a significant increase in DHSS staff to implement them as the Inland Revenue thought would be the case in 1979 (see Hughes, 1982A, p.64). However, the fact that it is possible for the DHSS to modify the PAYE system in a way which ultimately allows the taxation of Unemployment Benefit in the United Kingdom suggests that it might be possible for the Revenue Commissioners and the Department of Social Welfare to devise a similar method for the taxation of disability and unemployment benefits in Ireland as our taxation and social welfare systems are very like those in the United Kingdom.

If it were possible to bring short-term social welfare benefits into the tax net by a modification of PAYE one of the main reasons which have been given for the introduction of Statutory Sick Pay would be redundant and the Government would not be justified in reckoning receipts from the taxation of short-term sickness benefits through the Statutory Sick Pay scheme as additional tax revenue. The relevance of this point will become clearer when we come to consider the gains and losses from Statutory Sick Pay in the United Kingdom in the next chapter.

3.6 Conclusion

The last chapter identified the main arguments which have been made for reforming the Disability Benefit scheme by introducing a Statutory Sick Pay scheme and the evidence relating to those arguments has been reviewed in this chapter. In general the evidence does support the case that action needs to be taken to try and reduce our sickness absence rate and public expenditure on sickness benefits and that there is duplication in the arrangements which the state and large firms in the private sector have made for the maintenance of income during illness. It does not support some of the specific arguments which have been made for reforming the Disability Benefit scheme. Thus, the argument that the scheme is subject to widespread abuse is not supported by the outcome of referrals under the Medical Referee scheme and the argument that excessive replacement ratios arise because Disability Benefit is exempt from tax is not supported by the evidence relating to current replacement ratios.

5. I am indebted for the information on the taxation of unemployment benefits to the Department of Health and Social Services, Unemployment Branch, Northern Ireland.

A Statutory Sick Pay scheme could make a useful contribution to reducing short-term sickness absence and public expenditure on sickness benefit. If it is to do so it should contain incentives which encourage employers to regard it as part of their task to develop positive absenteeism control programmes in consultation with their employees. A positive approach to the control of absenteeism through administrative procedures is used in the Civil Service. This approach might repay study by private sector firms who are anxious to reduce their absenteeism rate because the sickness absence rate in the Civil Service is very much lower than the national sickness absence rate to which the private sector makes the largest contribution (see Blennerhassett, 1987, p.22).

The method by which employers will be compensated for taking responsibility for Statutory Sick Pay will be crucial in determining whether they have an incentive to invest the time and effort needed to implement positive absenteeism control programmes in consultation with their employees. Unfortunately, the method of compensation which the Government appears to favour in its Statutory Sick Pay scheme may not provide such an incentive as employers are to be directly compensated in respect of payments for illness made to employees. This will probably be by deduction of the relevant amount from their monthly PRSI payment to the Revenue Commissioners.

This would be similar to the method of compensation which is used to compensate employers for Statutory Sick Pay in the United Kingdom. Evaluations by independent researchers of the gains and losses to the British Government from its Statutory Sick Pay scheme suggest that it has gained very little, if anything, from the scheme because of the concessions which it has made to employers to secure their participation in the scheme. These concessions include refunds in full of all Statutory Sick Pay payments by deduction from the employer's payment of tax and National Insurance contributions and waiving of the employers' National Insurance contribution for recipients of Statutory Sick Pay.

There is a danger that if the Irish Statutory Sick Pay scheme simply copies the compensation arrangements used in the British Statutory Sick Pay scheme the opportunity to reduce sickness absence rates may be lost through the adoption of an incentive structure which encourages some employers to utilise the scheme for their own financial advantage at the expense of the Irish Exchequer. Thus, one of the problems with the Disability Benefit scheme which has received most attention, employee moral hazard, would be replaced by another, employer moral

hazard, to which Statutory Sick Pay schemes are prone. The British experience with Statutory Sick Pay which shows that employer moral hazard is more than a theoretical possibility will be discussed in the next chapter.

Chapter 4

EXPERIENCE WITH STATUTORY SICK PAY IN THE UNITED KINGDOM

4.1 Introduction

The Statutory Sick Pay scheme which the Irish Government wishes to introduce is very similar to the Statutory Sick Pay scheme which was introduced in the United Kingdom in 1983. Some studies of the effects of the British scheme argue that the arrangements which were made to compensate employers for taking on responsibility for short-term sick pay have negated the expected financial gains to the British Exchequer to such an extent that it is now a net loser under the scheme because it is subsidising employers in a way which was never intended.

The compensation arrangements which the Irish Government appeared to favour when it announced its decision to introduce a Statutory Sick Pay scheme last July are somewhat similar to the compensation arrangements incorporated in the British scheme. There is a danger, therefore, that the proposed rationalisation of short-term sick pay could result in the Irish Exchequer providing a subsidy to employers rather than reducing public expenditure on sick pay. It is important, therefore, to review the British experience with Statutory Sick Pay and to consider the evidence which shows that the method which they have chosen to compensate employers for administering Statutory Sick Pay is a net drain on, rather than a net benefit to, the Exchequer.

4.2 The Case for Statutory Sick Pay in the United Kingdom

Shortly after the British Conservative Party was returned to Power in 1979 it presented its case for privatising the administration of short-term sick pay in a Green Paper entitled *Income During Initial Sickness: A New Strategy* (HMSO, 1980). The main arguments which it presented in favour of privatisation were as follows:

1. The growth of occupational sick pay schemes since the introduction of the 1946 National Insurance Act had extended private insurance against income loss during short-term illness from a relatively small number of mainly public sector white collar workers to about 80 per cent of full-time employees. This had

led to unnecessary duplication as employers and the Department of Health and Social Security (DHSS) both have to be supplied with evidence of incapacity for work and both of them have to make arrangements for the calculation and payment of income during sickness.

2. The difficulty of taxing the state sickness benefit under the PAYE system of taxation had led to the exclusion of this benefit from taxable income almost since its inception. One consequence of this was that the income which some employees received during sickness from their occupational sick pay scheme and untaxed state sickness benefit could exceed their income from work. This outcome was never intended and it was regarded as indefensible by successive Governments. The Conservative Government had stated its firm intention in its 1979 Election Manifesto to tax short-term benefits and its proposal to privatise short-term sick pay would meet this objective and reduce administrative costs.
3. The Government believed "that the State should, wherever possible, disengage itself from activities which firms and individuals can perform perfectly well for themselves" (HMSO, 1980, p2.).

The scheme which the Green Paper proposed was that:

- (a) employers would be responsible for the first eight weeks sick-pay for insured employees on their payroll;
- (b) the level of payment would be similar to the state sickness benefit and it would be subject to national insurance and income tax deductions through the PAYE system;
- (c) the employer national insurance contribution would be reduced by about one-half of a percentage point to compensate them for the increase in their costs which the new arrangements would impose.

The advantages which the new scheme was expected to have were clarified in a consultative document issued by the DHSS (1981) in the following year when the scheme's objectives were quantified. In addition to the objectives of bringing 90 per cent of sickness payments into the tax net and eliminating duplication between the public and private sectors it was stated that the scheme would "remove the need for some 5,000 civil service posts" and "reduce public expenditure by over £400 million" (DHSS, 1981, p.1). The latter figure refers to the gross saving on sickness benefit expenditure. Neither the Green Paper or the consultative document gave an estimate of net savings to the Exchequer arising from

benefit savings, income tax receipts, national insurance contributions, and savings in manpower and administrative costs.

The Government's proposal was opposed by organisations representing big and small business and the poor. Both of the business organisations were opposed because the compensation terms offered were insufficient, in their view, to cover the additional costs which employers would incur and the small business organisations were opposed to the general principle of such a scheme. The organisations representing the poor were also opposed to the scheme in principle because it entailed dismantling a component of the Welfare State and they thought that some employees would be worse off under the Government's proposal. It was suggested to the Government that compensation to the employer should take the form of 100 per cent self deduction from national insurance contributions but the DHSS argued strongly against this in its consultative document. It noted (DHSS, 1981, p. 6) that:

With 50 per cent self deduction, employers would have a direct financial interest in controlling absenteeism and ensuring that they had properly applied the rules of the statutory scheme; 100 per cent self deduction would not have this built in control.

and it concluded that:

... a 100 per cent self deduction scheme could end up with the honest, efficient employer subsidising the dishonest, inefficient one. For these reasons the Government remain strongly opposed to this approach.

Despite its strong opposition in the consultative document to 100 per cent self deduction the Government adopted precisely this method of compensation in the final scheme which it enacted in the Social Security and Housing Benefits Act 1982. The final scheme differed significantly from that originally proposed. In addition to the Government's surrender to the employers on the compensation terms the main changes which were made were:

1. Three levels of benefit were provided, for instead of the one originally proposed.
2. The estimate of Civil Service manpower savings was reduced to 3,000 from the original figure of 5,000.
3. The net benefit to the Exchequer was estimated to be no more than £90 million.

4.3 Evaluations of Statutory Sick Pay in the United Kingdom

The disadvantages of the changes which the British Government made in its original Statutory Sick Pay proposal in response to protests by

employers were pointed out by Prest (1983, pp.50-51) before the scheme came into operation. He acknowledged that a few of the changes which had been made were desirable but he argued that "some of the changes which were made do detract very considerably from the potential benefits of the changeover". One of the changes which he thought was for the worse was "that the system of 100 per cent self-deduction is grossly inferior to the original proposal of a more or less uniform cut in the rate of employer National Insurance Contributions" because it did nothing to improve the competitive environment in which business should operate and it "opens up many opportunities for abuse, thereby requiring more public surveillance". One of the lessons which he drew from the British Government's attempt to reform the sickness benefit scheme was that:

when it comes to the point, support for market principles on the part of organised business disappears as rapidly as melting snow if the complaints of the losers weigh much more heavily than the gratitude of the gainers (Prest, 1983, p.53).

Prest's fears about the adverse effect on the Governments's account of the new arrangements for paying short-term sickness benefit have been confirmed by evaluations of the scheme by the National Audit Office (HMSO, 1984), Klein (1984), Disney (1987A and 1987B), and Creedy and Disney (1987).

The National Audit Office (HMSO, 1984, p.5) noted in its report that "the Government hoped that DHSS would be able to save 5,000 staff" following the introduction of Statutory Sick Pay but it stated that "because of the change eventually conceded by the Government in the method of compensating employers it became necessary for DHSS to allocate more staff to the examination of employers' records" and that "in December 1983 the Department stated that they had achieved staff savings of 3,342".

Klein argues that the financial concessions which the British Government were forced to make have turned the gains to the Exchequer which could have been made under the original proposal into losses under the final scheme. Thus, he states (Klein, 1984, pp.22-23) that:

The current position [in 1983/84] is that the government has reduced its spending by £435 million a year — mainly in benefits saved, partly in administrative costs — but has paid out £615 million in compensatory tax cuts to employers. The government still claims the exercise as a success story, since it adds into the equation the income from tax on sick pay and extra contributions (both of which could, of course, have been raised under the old system), and thus

manages to show a notional net gain of £90 million. But, financial cosmetics apart the exercise is in fact a warning against equating cuts in public expenditure with effective action for relieving fiscal stress. Self-evidently, a public expenditure cut is neutral – however dramatic – in its effects on the public sector borrowing requirement if it has to be balanced by an equivalent concession on the revenue side.

In his appraisal of the Statutory Sick Pay scheme Disney (1987B) presents accounts for Government, employers and employees which show what their gains or losses from Statutory Sick Pay in 1986/87 were. These include the effects of the extension of Statutory Sick Pay in April 1986 to cover spells lasting up to 28 weeks. They are based on the United Kingdom Government's own accounting format as used by the DHSS when it presented figures to the National Audit Office and to the Public Accounts Committee. The adoption of this format means that the extra income tax and National Insurance receipts which were pivotal to Klein's argument that the Government was a net loser from the Statutory Sick Pay scheme are included on the credit side of the Government account.

The Government's account is shown in Table 4.1.

Table 4.1. *Impact of SSP on Public Funds, 1986/87 (when extended to 28 weeks) (DHSS accounting format)*

		<i>£million</i>	
<i>Losses</i>		<i>Gains</i>	
SSP refunds to employers	820	National Insurance benefit saved	550
Extra expenditure on supplementary benefit and reduced housing benefits	(10)	Savings on DHSS administration costs	35
		Extra income tax collected on SSP	175
		Extra National Insurance contributions on:	
		– employees	37
		– women paying the lower rate	60
Total	830	Total	857
		Net gain	27

Disney's (1987B, p.64) overall conclusion from this table is that: ... using the DHSS accounting format, the gain to the Government is small, and, within the bounds of error, not significantly different from zero. This contradicts the DHSS submission to the National Audit Office that the Government would be a systematic net gainer.

There is a further issue here, concerning whether the DHSS accounting format is the correct one. For example, the Government now taxes all short-term insurance benefits, and it might be argued that the gain of income tax revenue should not be included on the credit side of SSP. The Government would then be a significant net loser.

The gains or losses to employers are harder to quantify than those to the Government because the final incidence of employer tax and benefit changes is uncertain as it may be passed on to consumers, employees, or shareholders. Unfortunately, the DHSS ceased to publish any information on short-term sickness spells when the SSP scheme was introduced in 1983 and this made it difficult to draw up a balance sheet for gains and losses to employers in 1986/87. An estimate can be made using the account for the Government and estimates made in 1982 by the DHSS (1982A) of the expected distribution of the benefits of the Statutory Sick Pay scheme among employers by type of Occupational Sick Pay (OSP) scheme.

The account for employers is presented in Table 4.2.

Table 4.2. *Impact of SSP on Employers, 1986/87 (when extended to 28 weeks) (DHSS accounting format)*

<i>£million</i>			
<i>Losses</i>	<i>Gains</i>		
Extra OSP for employees	640	SSP refunds from Government	820
Total	640	Total	820
		Net gain to employers	180

This table shows that employers are clear net gainers from Statutory Sick Pay contrary to the Confederation of British Industry's submission to the Government in response to the Green Paper (HMSO, 1980) that employers would be net losers.

While employers as a group are net gainers from Statutory Sick Pay not all employers have gained from the scheme. Table 4.3 is an abbreviated version of Disney's (1987B, p.67) table showing the distribution of the gains from Statutory Sick Pay among employers by type of Occupational Sick Pay scheme.

Disney calculates that employers providing occupational sick pay schemes which gave full pay with no deduction for the state sickness

Table 4.3. *Impact of SSP on Employers' Direct Costs (at 1983/84 rates)*
(DHSS accounting format)

<i>£ million</i>			
<i>Type of OSP scheme</i>	<i>Total amount of extra OSP</i>	<i>SSP refunds</i>	<i>Excess of SSP refunds over OSP</i>
(a) Full pay; no deduction for NI benefit	0	60	60
(b) Full pay; with deduction for NI benefit			
– males	100	135	35
– females	60	100	40
(c) Other schemes	270	270	0
Total	430	565	135

benefit gained £60 million from the Statutory Sick Pay scheme in 1983/84, that employers providing schemes which gave full pay from which the state sickness benefit was deducted gained £75 million while employers who did not provide an occupational sick pay scheme had no net gain from the scheme. He concludes from these figures "that the notional gain to employers is wholly directed to those who have experience of operating OSPs and thus incur at most minor extra administrative costs from the transition to SSP."

The net gain or loss to employees depends on the balances on the accounts for the Government and the employers. Using Tables 4.1 and 4.2 and abstracting from administrative costs he estimates that the Government is a marginal net loser of £8 million and employers are net gainers of £180 million. "So... employees will be net losers by an amount equal to the difference between the financial losses of the Government and gains of employers" (Disney, 1987B, p. 68). The account for employees is shown in Table 4.4.

Table 4.4. *Impact of SSP on Employees, 1986/87 (when extended to 28 weeks)*
(DHSS accounting format)

<i>£million</i>			
<i>Losses</i>	<i>Gains</i>		
National Insurance benefits saved	550	SSP refunds to employees	820
Reductions in OSP	180	Extra expenditure on supplementary and related housing benefits	(10)
Extra income tax collected on SSP	175		
Extra National Insurance contributions	97		
Total	1,002		830
Net loss to employees	172		

Disney's calculations show that there was a net loss to employees of £172 million in 1986/87. This loss was sustained mainly by employees who were previously receiving full pay with no deduction for state sickness benefit or who were receiving this benefit without it being taxed.

4.4 *Employer Moral Hazard*

The method of compensating employers in the United Kingdom for Statutory Sick Pay carries with it the possibility of deliberate overpayment as the British Comptroller and Auditor General noted in his report on Statutory Sick Pay (HMSO, 1984, par 4.1):

Because they can readily recover SSP from National Insurance contributions employers have little incentive to ensure that all the SSP payments they make are strictly in accordance with the Act and the statutory regulations.

The waiving of the employers' National Insurance contribution for sickness benefit in conjunction with the extension of Statutory Sick Pay to 28 weeks in April 1986 removes the remaining cost to the employer in allowing a Statutory Sick Pay claim. This means that the sickness benefit scheme's problem of employee moral hazard has been tackled by introducing a Statutory Sick Pay scheme which is prone to the problem of employer moral hazard.

Disney (1987B, p.72) argues that the employer moral hazard aspect of Statutory Sick Pay can take two forms:

The first is that employers might be tempted to substitute SSP for OSP by, for example, using a more relaxed definition of qualifying days than the SSP regulations, or perhaps paying SSP to employees who are not eligible (above pension age, under the Lower Earnings Limit, and so on). Secondly, and more generally, it must be tempting in a period of recession for an employer facing increasing unsold stocks of finished output to use the SSP scheme as a form of unofficial short-time working compensation scheme.

Some employers have already succumbed to the first temptation by counting any day an employee was off sick as a qualifying day. As a report in Industrial Relations Service (IRS, 1985, p.14) notes:

This enables employers with their own sick pay schemes to recover the maximum possible rebate on SSP. But the DHSS viewed this as an abuse of the system, and new regulations have now outlawed such "maximising" or "optimising".

Although the DHSS has procedures for monitoring the payment of Statutory Sick Pay by employers they are likely to be successful only

in picking up errors in payments to individual employees. Disney (1987B, p.73) argues that:

... there is no apparent procedure that is able to pick up any tendency on the part of particular employers to overpay SSP to employees as a whole...since there is no point in the procedure at which year-by-year checks of sickness records, or comparisons between different employers (in the same industry or region, for example) are made.

He notes that one way in which this problem could be handled would be to institute random checks of sickness records but that this has not been done in the United Kingdom because extra civil servants would be required to do it and this would offset to some extent the savings in manpower which was one of the attractions of Statutory Sick Pay for the Conservative Government.

Chapter 5

CONCLUSIONS

The use and cost of incapacity benefits have risen almost continuously over the last thirty years. These increases are due in large part to the removal of obstacles which used to stand in the way of taking adequate sick leave. The removal of these obstacles has been made possible by economic growth which has been accompanied by substantial improvements in the real value of sickness benefits during the 1960s and early 1970s. Other countries such as Britain, France, Germany, and Norway have had similar experience with sickness absence during this period (see International Social Security Association, 1981). However, the trend towards higher rates of sickness absence levelled off in these countries in the latter half of the 1970s whereas sickness absence in Ireland continued to rise. The existence in the early 1980s of high absenteeism levels in sections of Irish industry combined with allegations that there was widespread abuse of the Disability Benefit scheme, worries about the possible disincentive effect of the scheme, and concern over the increasing cost of the scheme led to proposals in the mid-1980s for reform of the scheme.

The reform proposed is to transfer the administration of short-term sickness benefit to the employer for a period of 13 weeks under a Statutory Sick Pay scheme. Specific details of the method by which the Government proposes to compensate employers for taking on this responsibility have not yet been announced but the broad outline of the scheme which the Minister for Social Welfare gave at the end of July 1987 suggests that it may be similar to the method which is used in the British Government's Statutory Sick Pay scheme.

Studies of the operation of the British Statutory Sick Pay scheme have shown that compensating employers by allowing them to deduct the full cost of the statutory sickness benefit from their income tax and National Insurance remittances to the Inland Revenue has led to the subsidisation of sick pay costs for employers who had an occupational sick pay scheme before the introduction of the statutory scheme, to the elimination of financial benefits which were expected to accrue to the British Exchequer, and to a smaller reduction in the staff of the Department of Health and

Social Security than was expected.

The British experience with Statutory Sick Pay strongly suggests that if Ireland wishes to reap the advantages of a Statutory Sick Pay scheme the state should not compensate employers for administering the scheme by full reimbursement of any statutory sickness benefit payments which they make but that it should compensate them by a reduction in the employer social insurance contribution.

This is the method of compensation which was originally suggested in the Statutory Sick Pay proposal made by the Government in 1985. It was objected to by the employers, through the FUE, on the grounds that it would lead to an increase in the costs of small firms. This argument appears to have persuaded the authorities to change from an indirect to a direct method of compensation even though the FUE's own survey report on company sick pay arrangements in 1980 shows that "companies with less than 50 employees show a markedly lower average overall absence rate than any of the larger size categories" (FUE, 1980, p.27). The inverse relationship between firm size and absence rates is a general finding in the absenteeism literature (see O Muirheartaigh, 1975, p. 32) and Immergut (1986, p.83) reports that in Germany where sickness absence is also generally below average in small firms "a government study concluded that *Lohnfortzahlung* [the Statutory Sick Pay scheme which was introduced in 1969] was no more burdensome for small employers than for any other employers".

There is a very strong case, therefore, for the Irish Government to stick to the original proposal to compensate employers for administering Statutory Sick Pay by a cut in the employer PRSI contribution rate. If this is not done and a method of compensation adopted which is similar to that used in the British scheme the Irish Government could lose a lot of control over public expenditure on sickness benefit and there is a danger that this method of compensation could lead to the subsidisation of employers who already have occupational sick pay schemes.

If employers maintain their opposition to compensation by a cut in their PRSI contribution rate it would be better for the Government not to introduce the kind of Statutory Sick Pay scheme outlined by the Minister for Social Welfare in July 1987 because of the danger that the scheme will subsidise rather than rationalise arrangements for income maintenance during illness.

There are other options available to the Government. It could reduce the period for which it wishes to make employers liable for Statutory Sick Pay from 13 weeks to 3 and compensate them with an appropriate

reduction in the employer PRSI contribution rate. This would give most of the advantages which are expected to follow from making employers responsible for short-term claims. If there is abuse of sickness benefit it would allow employers to deal with the problem where it may be most acute because, as the Office of Health Economics (1971, p.7) notes, "it is widely accepted that the shorter the duration of the spell the smaller is the medical component".

Another option would be to leave the existing Disability Benefit scheme as it is and develop new measures to reduce the number and duration of both short- and long-term claims and modify the scheme in conjunction with the Revenue Commissioners to permit the Department of Social Welfare to act as an "employer" in order to bring the benefit into the tax net.

The Government has said that it is committed to the introduction of a Statutory Sick Pay scheme as soon as practicable. Before it introduces the new scheme it might wish to reconsider its decision not to issue a discussion paper on Statutory Sick Pay because there has been very little public debate about the policy issues which are posed by the Government's recognition of the interplay between state and private action in relation to social protection against illness. If it did so it could publish the background documents which have influenced its thinking on Statutory Sick Pay, present its case for the new scheme, explain how the main policy questions which arise in connection with Statutory Sick Pay were resolved, set out its objectives for the scheme and establish criteria by which the success or failure of the new arrangements are to be judged in the future.

Some of the questions which the new scheme poses which it would be helpful to have discussed in such a policy paper are as follows:

1. Why does the Government believe it would be more efficient to make the private sector responsible for the administration of short-term sick pay ?
2. Is any other method of taxing short-term sickness benefit available in Irish circumstances and if there is why has it not been adopted?
3. What does the Government believe is the right balance between public and private provision of welfare benefits ?
4. What reductions in public expenditure and in Civil Service numbers are expected under Statutory Sick Pay and how will these outweigh the losses which the new arrangements may impose on some employers and employees?

5. How does the Government propose to monitor and control the problem of employer moral hazard which may arise under the new arrangements?
6. Why was it decided that the period for which employers should be responsible for short-term sick pay is 13 weeks rather than a shorter period?
7. What other possibilities are there for the provision of sickness benefit and why is a Statutory Sick Pay scheme preferred to them?

Finally, the Government might wish to consider what preparations may be needed to ensure a smooth transition from the old to the new arrangements if it proceeds with its plan for Statutory Sick Pay. The British Government, through the Department of Health and Social Security (DHSS), prepared for the transition to the new scheme in the year preceding the introduction of Statutory Sick Pay by (a) issuing an Employer's Guide to Statutory Sick Pay (DHSS, 1986) and a brief for seminars (DHSS, 1986), (b) conducting an extensive public relations campaign, and (c) undertaking personal visits by DHSS staff to a very large number of firms to explain the new arrangements.

The employers' guide provided a detailed outline of the Statutory Sick Pay scheme, explained what employees would need to know before anyone falls sick, told employers how to decide when Statutory Sick Pay is due and how to pay it, gave detailed guidance to employers on when their liability to pay Statutory Sick Pay would end, informed them on how to recover from the Inland Revenue any payments which would be made under the scheme, listed the records which would have to be kept and the procedures to be followed to correct errors in the administration of the scheme, and directed them on how the transition was to be made from the old to the new arrangements.

If the Government's commitment to introduce a Statutory Sick Pay scheme as soon as practicable included the undertaking of a publicity campaign to familiarise employers and employees with the new arrangements and the issue of booklets and leaflets which answer questions about the new scheme it would contribute to a smooth transition of administrative responsibility for short-term sick pay from the state to the employer.

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APPENDIX

Minister for Social Welfare's Announcement on 29 July, 1987 of Government's Decision to Transfer Responsibility for Short-term Sickness Benefit to Employers

The Minister for Social Welfare has today announced that the Government has decided to transfer responsibility for the payment of sickness benefit to employers for the first 13 weeks of illness.

At present the state, through the Disability Benefit scheme administered by the Department of Social Welfare, provides income maintenance for people when they are absent from work due to illness. The cost of this scheme is borne by employers and employees through their PRSI contributions and by the Exchequer which makes up the shortfall between expenditure and income in the Social Insurance Fund. In addition many employers have occupational sick pay arrangements whereby the amount of disability benefit that a person gets can be topped up.

The Government has considered the question of streamlining these arrangements and has agreed to transfer responsibility to employers for sick pay for an initial period of 13 weeks. The following is a broad outline of the new scheme which will be the subject of discussions with the various interested parties.

1. Employers will be required to pay employees for the first 13 weeks of absence from work due to illness.
2. During this period employers would be required by statute to maintain the earnings of employees through a company sick pay scheme. The aim will be to require employers to provide as close as possible to normal earnings.
3. Employers will be compensated in respect of payments for illness made to employees. The detailed arrangements concerning the amount and method of compensation will be worked out in discussion with employers.

4. Arrangements will be made to exempt smaller employers from the scheme because of the difficulties that the scheme would be likely to impose on them. Their employees will continue to be entitled to claim under the state Disability Benefit scheme. It would be the intention that all employers would eventually be brought into the scheme and the exemption would give smaller employers the opportunity to make the necessary arrangements.
5. The Department of Social Welfare would take over responsibility for those whose illness extends beyond 13 weeks.