

Welfare trends report published today

In December 2013, the Chancellor of the Exchequer asked the OBR to take on additional responsibilities in relation to the Government's newly announced cap on a subset of welfare spending, which was then quantified in the March 2014 Budget. This request was in two parts – to assess the Government's performance against the welfare cap and, in order to facilitate open and constructive debate about welfare spending, to “*prepare and publish information on the trends in and drivers of welfare spending within the cap.*”

In our first *Welfare trends report*, the approach we have taken is to:

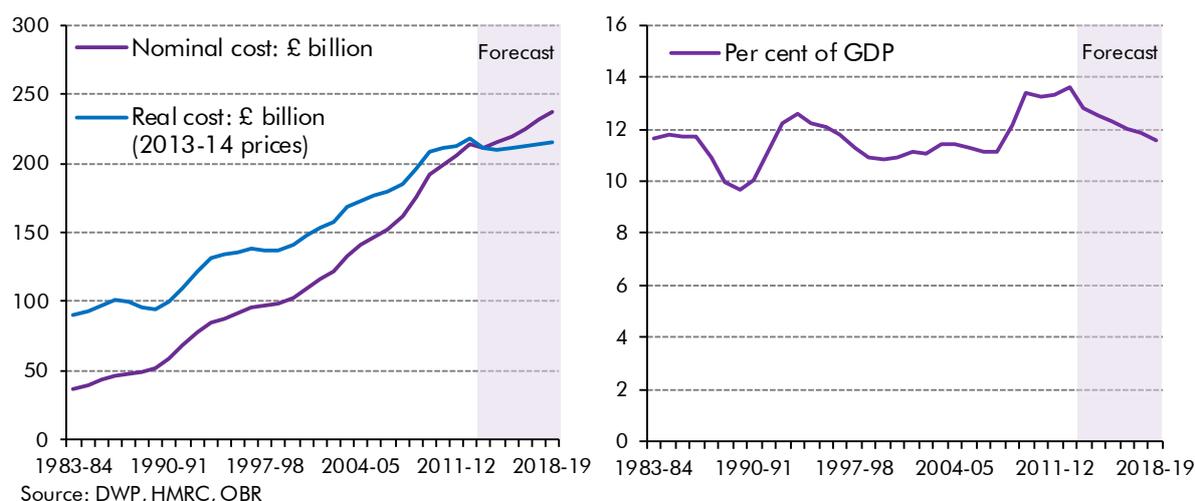
- focus on the social security and tax credits systems. We do not consider benefits-in-kind, for example social housing, education and healthcare;
- consider spending both in cash terms – as the welfare cap is a cash ceiling – and as a share of GDP – which is more relevant for the sustainability of the public finances;
- look in detail at trends over the past 30 years and in the five-year forecast period of our March 2014 *Economic and fiscal outlook*, as well as providing a summary of long-term prospects contained in our July 2014 *Fiscal sustainability report*;
- provide greater detail about the judgements and assumptions that underpin our latest medium-term forecast and the risks and uncertainties to which they are subject; and
- draw out the broad themes that help explain fluctuations in welfare spending over the past and in our medium-term forecast and long-term projections.

Over the past 30 years, welfare spending has risen steadily in cash and real terms, but on average that increase has been broadly in line with growth in the economy. So the proportion of national income devoted to welfare spending has not shown a significant upward or downward trend over time.

Welfare spending has, however, fluctuated significantly with the economic cycle. That has reflected two important features:

- the caseloads of small and highly counter-cyclical benefits (like jobseeker's allowance) rise significantly in recessions and fall significantly in recoveries; and
- second, the average awards of large and mildly counter-cyclical benefits (like state pensions or disability benefits) are more stable than GDP over the economic cycle, thereby fluctuating negatively with the cycle relative to GDP.

Chart 1: Total welfare spending in the UK



Explaining trends in welfare spending in recent decades

We have looked at the factors that have explained the rises and falls in welfare spending as a share of GDP over the past 30 years. This report shows that:

- during the period of strong GDP growth from 1983-84 to 1989-90, spending fell by 2.0 per cent of GDP. The largest contributions to that fall were lower spending on unemployment benefits as the economy boomed and lower spending on state pensions as earnings growth outpaced uprating. The rising proportion of adults receiving incapacity benefits slightly offset those falls;
- between 1989-90 and 1993-94, a period that included the early 1990s recession, spending increased by 3.0 per cent of GDP. The largest contributions were caseload-driven increases in spending on unemployment and incapacity benefits, and average award-driven increases in spending on housing benefit, as the recession bit;
- between 1993-94 and 2007-08, a period of sustained economic growth, spending fell by 1.5 per cent of GDP. The largest contribution was the steady reduction in the unemployment rate. Spending on incapacity benefits also fell as uprating and other factors pulled average awards lower relative to earnings; and
- between 2007-08 and 2012-13, a period that spans the late 2000s recession and slow recovery that followed, spending increased by 2.5 per cent of GDP. Jobseeker's allowance made a surprisingly small contribution to the increase. The largest contribution was from uprating state pensions as inflation outstripped earnings growth. Spending on tax credits and housing benefit also increased significantly.

Future prospects for welfare spending

Our latest medium-term forecast shows welfare spending rising by 12.5 per cent in cash terms between 2013-14 and 2018-19. We expect the cash size of the economy to grow significantly more quickly, so this reduces expected welfare spending by 1.2 per cent of GDP between 2013-14 and 2018-19, from 12.8 per cent to 11.6 per cent.

Spending that will be subject to the welfare cap is expected to fall by 0.9 per cent of GDP over the next five years. Spending outside the welfare cap is expected to fall by around a third as much – 0.3 per cent of GDP – as spending subject to the cap.

Table 1: Medium-term forecast of welfare spending

	Outturn		Forecast				
	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19
£ billion							
Total welfare spending	212.9	210.1	213.9	218.8	224.5	230.6	236.3
of which:							
Welfare spending subject to the welfare cap	116.5	116.4	117.8	119.5	122.0	124.6	126.7
Welfare spending outside the welfare cap	96.4	93.8	96.1	99.3	102.5	106.0	109.6
Per cent of GDP							
Total welfare spending	13.6	12.8	12.4	12.2	12.0	11.8	11.6
of which:							
Welfare spending subject to the welfare cap	7.4	7.1	6.8	6.7	6.5	6.4	6.2
Welfare spending outside the welfare cap	6.1	5.7	5.6	5.6	5.5	5.4	5.4

Key risks

Our forecast for welfare spending is subject to a number of important risks and uncertainties. In particular, the three largest sources of uncertainty – and risks to the forecast – relate to housing benefit, incapacity benefits and disability benefits. In the case of housing benefit, this relates to underlying economic drivers. For incapacity and disability benefits, the major uncertainties are associated with the impact of ongoing policy reforms and associated reassessment of claims. In both cases there have been delays to delivery of these reforms that have affected the timing and scale of expected savings.

We have been surprised at the speed with which claimant count unemployment has fallen. It moved below 1 million in August 2014 – a level we not expect it to reach until 2017 in our latest forecast in March. Some of the fall may reflect claimants moving onto other benefits, such as employment and support allowance.

Notes

1. The Office for Budget Responsibility is the UK's independent fiscal watchdog – responsible for producing forecasts for the economy and the public finances, assessing progress against the Government's fiscal targets, and reporting on long-term fiscal sustainability and trends in welfare spending.
2. The Welfare trends report is available to download on our website at <http://budgetresponsibility.org.uk/publications/welfare-trends-report/>
3. We have also published our latest Forecast evaluation report today which is available on our website at <http://budgetresponsibility.org.uk/publications/forecast-evaluation-report/>
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