

Office for
**Budget
Responsibility**

Welfare trends report

March 2021



Office for Budget Responsibility: Welfare trends report

Presented to Parliament by
the Exchequer Secretary to the Treasury by
Command of Her Majesty

March 2021



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Foreword

The Office for Budget Responsibility (OBR) was created in 2010 to provide independent and authoritative analysis of the UK's public finances. In December 2013, the Government asked the OBR to take on additional responsibilities in relation to its newly announced cap on a subset of welfare spending. This request was in two parts: to assess the Government's performance against the welfare cap and to "prepare and publish information on the trends in and drivers of welfare spending within the cap", so as to facilitate open and constructive debate. Parliament formally included these requirements in the October 2015 edition of the *Charter for Budget Responsibility*.

We have explored several issues in our successive *Welfare trends reports (WTR)*, ranging from a broad historical sweep of trends in UK welfare spending and international comparisons of welfare spending in our first two reports, to deeper analyses of universal credit, disability benefits, and the Summer Budget 2015 welfare spending cuts in our subsequent three reports. The demands created by the coronavirus pandemic mean that this year has been unusual in terms of our other forecasting and analytical work. We have therefore prepared a shorter than usual *WTR* that focuses on two ways that the pandemic has affected our welfare spending forecast: first, the nature of the sharp rise in spending on universal credit this year; and second, our assumptions about the medium-term implications of the pandemic for working-age welfare spending (and universal credit in particular).

The analysis in this report represents the collective view of the OBR's Budget Responsibility Committee. We take full responsibility for the judgements that underpin it and for the conclusions we have reached. We have, of course, been supported in this by the full-time staff of the OBR, to whom we are enormously grateful. We are also grateful to officials in the Department for Work and Pensions and HM Revenue and Customs that have provided their help and expertise.

As with all our reports, the *WTR* remains a work-in-progress. We have refined and modified our other reports in response to feedback from users and we would be very keen to hear suggestions on the scope and format of this report.


We provided the Chancellor with a final copy of the report 24 hours ahead of publication.



Richard Hughes



Sir Charles Bean



Andy King

The Budget Responsibility Committee

1 Introduction

Context

- 1.1 This year's *Welfare trends report (WTR)* comes at the end of an extraordinary year: a global pandemic has taken 2.7 million lives worldwide¹ and 126,000 in the UK;² six of the past 12 months in England have been spent in three separate lockdowns, with public health restrictions of varying stringency in place for the remainder; the UK experienced the sharpest annual drop in GDP since the Great Frost of 1709; and the Government has run up the highest peacetime budget deficit in UK history. This deficit has been driven by historically large temporary increases in virus-related spending on public services, and on support for households and businesses, which our *March Economic and fiscal outlook (EFO)* estimated to have reached £250 billion in 2020-21. In this *WTR* we look at the part that welfare spending has played in the rise in the deficit this year and the pace at which it then falls.
- 1.2 'Welfare spending' means different things to different people. At its broadest, it could cover any public spending that plays a part in the provision of the welfare state – including health, social care, education and social housing, as well as social security benefits and tax credits for people of all ages. One might also consider the Coronavirus Job Retention Scheme (CJRS) and the Self-Employed Income Support Scheme (SEISS) that were introduced last year to be welfare spending, although they are classified as subsidies in the official statistics (and therefore also in our forecasts). Our *WTRs* focus on benefits and tax credits, which transfer cash from some parts of the population to others who are eligible, so therefore does not cover the cost of the CJRS and SEISS over the past year. We looked at how use of the CJRS had evolved since its launch in Box 3.4 of our March 2021 *EFO*.

Definitions

- 1.3 Our *WTRs* focus on those elements of benefit and tax credit spending that are financed by central government as part of what the Treasury calls 'annually managed expenditure' (AME). (As noted, this does not include the large virus-related subsidies via the CJRS and SEISS over the past year.) Most are administered by three central government organisations:
- the **Department for Work and Pensions (DWP)** for most benefits in Great Britain;
 - **HM Revenue and Customs (HMRC)** for the personal tax credits, child benefit and tax-free childcare systems across the United Kingdom; and

¹ *Coronavirus (COVID-19) Deaths, Coronavirus Pandemic (COVID-19)*, Roser *et al* (2020), published online at 'our world in data', retrieved on 17 March 2021.

² *Deaths within 28 days of positive test by date of death*, GOV.UK Coronavirus (COVID-19) in the UK, retrieved on 17 March 2021.

- the **Department for Communities** for most benefits in Northern Ireland.

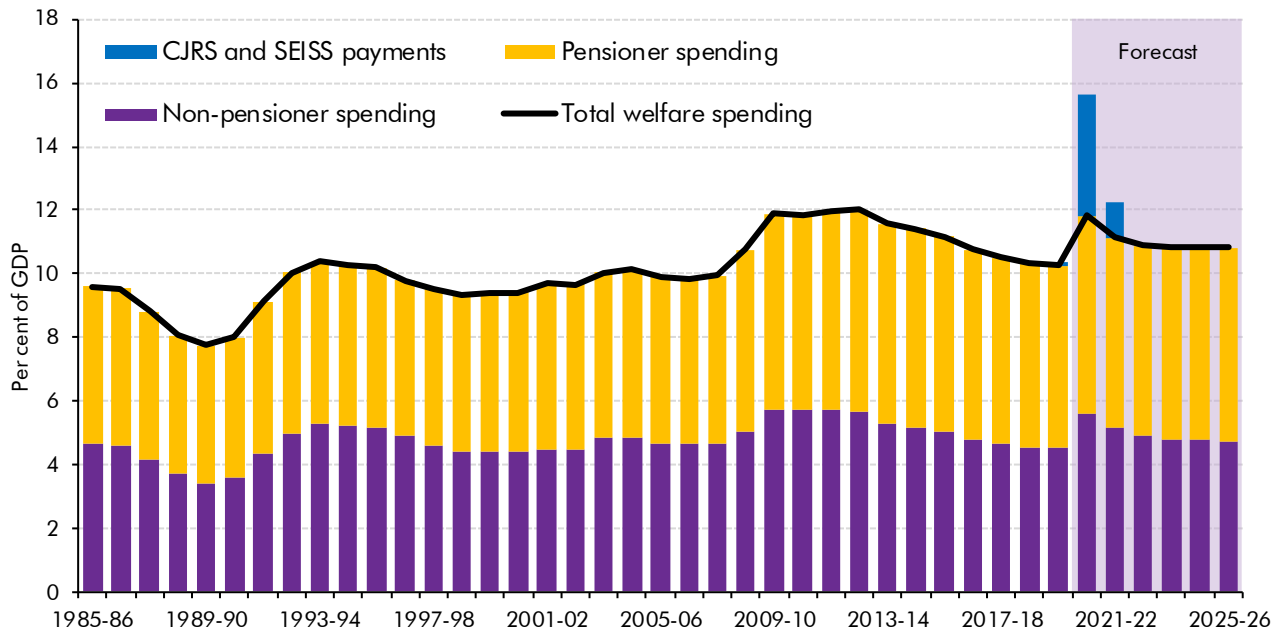
- 1.4 In addition, under the terms of the fiscal framework agreed between the UK and Scottish Governments, responsibility for some benefits paid to people resident in Scotland is being transferred to the Scottish Government. Carer's allowance and several disability benefits have been transferred as of the 2020-21 fiscal year. In our *EFOs*, Scottish Government spending on these benefits is captured separately from our welfare spending forecast.³ For the purposes of this *WTR*, we have added Scottish spending in these areas to our latest *EFO* forecast so that total welfare spending is presented on a more historically comparable basis.
- 1.5 Housing benefit and local council tax support are administered by local authorities. Most of the cost of housing benefit in Great Britain is met by DWP.
- 1.6 Due to the administrative separation of the benefits system between Great Britain and Northern Ireland, we tend to focus on Great Britain for DWP-administered spending, while HMRC-administered spending is considered on a UK-wide basis.

Recent developments and prospects in historical context

- 1.7 Our March 2021 *EFO* showed welfare spending rising by 8.8 per cent in cash terms in 2020-21, the largest increase since 2009-10. In cash terms, spending rises by £20.1 billion and, when combined with the sharp drop in nominal GDP caused by the pandemic, leaves spending up 1.6 per cent of GDP in just one year – the largest single-year jump in four decades. Even so, at 11.8 per cent of GDP in 2020-21, welfare spending falls short of the levels it reached between 2009-10 and 2012-13 as a result of the financial crisis. In part that is because the consequences of the pandemic for employment and incomes – and therefore for means-tested benefits – have been limited by the extraordinary degree of fiscal support provided through other channels. The CJRS and SEISS alone cost £79.7 billion in 2020-21 – equivalent to an additional 3.8 per cent of GDP of welfare-like spending. Adding that spending to the conventional definition of welfare spending in the UK would take the total to well above anything previously seen in the post-war period (Chart 1.1).
- 1.8 The sharp rise in welfare spending relative to GDP this year reverses relatively quickly as GDP recovers and some temporary policy costs end (primarily the UC £20-a-week uplift). This means that around two-fifths of the rise is expected to unwind next year and three-fifths by 2022-23, at which point it returns to historically more typical levels. As one would expect given its role as an automatic stabiliser, the rise and fall is overwhelmingly explained by fluctuations in spending on universal credit (and to a lesser extent some of its predecessor benefits in the legacy welfare system). This means non-pensioner welfare spending jumps £17.3 billion and 1.1 per cent of GDP in 2020-21, to its highest level since 2009-10, before falling back sharply over the subsequent two years.

³ This is captured in the Scottish welfare block grant adjustment (BGA). BGAs are applied to the Barnett-determined block grant, resulting in a net block grant, which determines the funding transferred from the UK to the Scottish Government.

Chart 1.1: Welfare spending as a share of GDP



Note: Scottish welfare BGA has been added in forecast years to show on an equivalent basis with outturn years.

Source: DWP, OBR

Our latest medium-term forecast

- 1.9 Table 1.1 sets out our March 2021 welfare spending forecast, including the amounts spent by the Scottish Government on benefits that have been devolved. As well as the rise and fall in spending described above, it shows that spending at the forecast horizon in 2025-26 is expected to be 25.7 per cent higher in cash terms than it was pre-pandemic in 2019-20. That represents a 13.7 per cent rise in real terms (relative to CPI) and leaves spending up 0.6 per cent of GDP. The latter contrasts with our pre-pandemic forecasts, where welfare spending was expected to be broadly stable as a share of GDP over the medium term.

Table 1.1: March 2021 welfare spending forecast

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Pensioner benefits	111.6	114.0	118.4	124.8	130.8	136.4	142.6
State pension	98.8	101.2	105.3	111.7	117.7	123.1	129.1
Pensioner housing benefit	5.8	5.8	6.1	6.1	6.2	6.4	6.5
Pension credit	5.1	5.1	5.0	5.0	4.9	4.8	4.8
Winter fuel payments	2.0	2.0	2.0	2.0	2.1	2.1	2.1
UC and its legacy benefit predecessors¹	64.3	79.5	77.6	74.5	74.3	75.1	76.6
Universal credit	18.2	37.7	41.3	42.2	46.0	52.2	61.5
Personal tax credits	18.0	15.1	11.0	8.4	6.4	4.3	2.0
Incapacity benefits ^{1,2}	14.0	13.5	13.5	13.2	12.8	11.2	8.2
Working-age housing benefit	12.1	11.1	10.4	9.6	8.5	6.9	4.7
Income support (non-incapacity)	1.4	1.1	0.8	0.6	0.5	0.3	0.1
Jobseeker's allowance	0.7	1.0	0.6	0.4	0.2	0.2	0.2
Disability benefits²	26.1	27.5	28.6	30.5	32.2	33.8	35.8
Personal independence payment	13.0	15.1	16.5	18.3	19.8	21.4	23.4
Disability living allowance	7.2	6.5	6.2	6.1	6.0	5.7	5.4
Attendance allowance	5.9	5.9	5.9	6.1	6.4	6.7	7.0
Child benefit	11.5	11.6	11.6	11.8	11.9	11.9	11.9
Other welfare spending	14.4	15.4	16.2	16.9	17.7	18.6	19.6
Northern Ireland social security	6.4	7.1	7.5	7.8	8.3	8.7	9.0
Carer's allowance ²	3.2	3.3	3.5	3.8	4.0	4.3	4.7
Maternity and paternity pay	2.5	2.6	2.6	2.7	2.8	2.8	2.9
Industrial injuries benefits ²	0.8	0.8	0.8	0.8	0.7	0.7	0.7
Bereavement benefits	0.4	0.4	0.4	0.4	0.3	0.3	0.3
Tax-free childcare	0.2	0.2	0.4	0.5	0.6	0.7	0.9
Other items	0.9	0.9	1.0	1.0	1.0	1.0	1.1
Total welfare²	228.0	248.0	252.4	258.4	267.0	275.8	286.5

¹ Incapacity benefits includes incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).

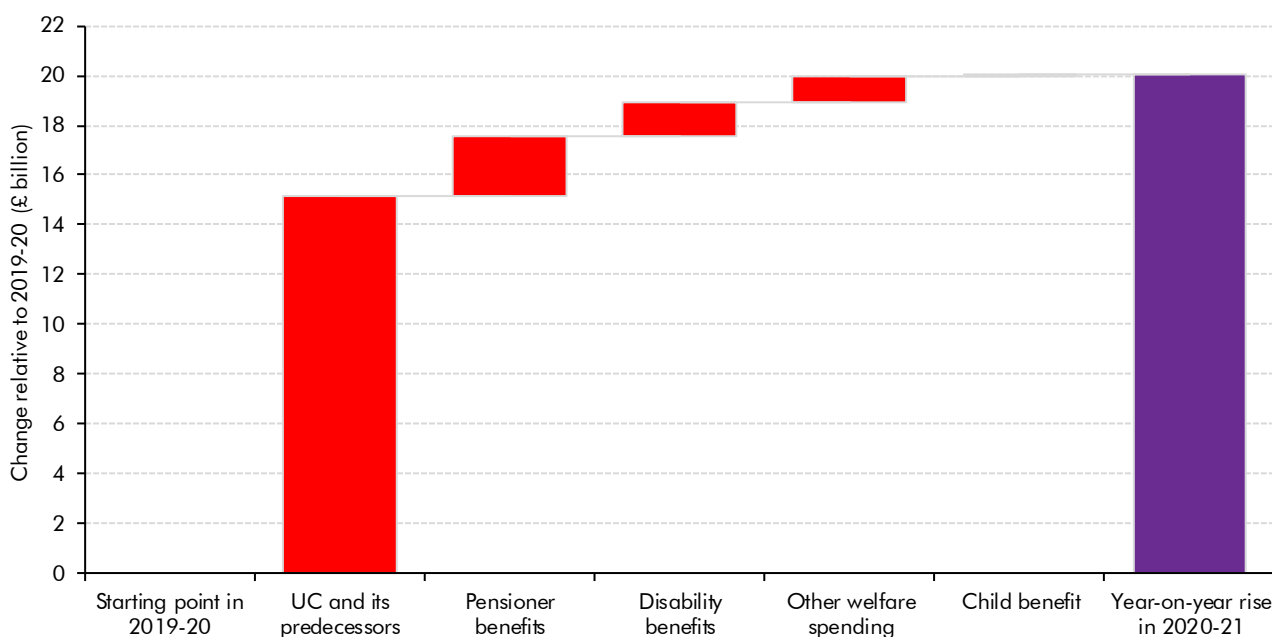
² Scottish welfare BGA has been added in forecast years to show on an equivalent basis with outturn years.

1.10 Chart 1.2 shows how each category of spending contributes to the £20.1 billion cash terms rise in spending in 2020-21:

- Spending on **universal credit and its predecessors** is up £15.1 billion (23.5 per cent). This large rise is more than explained by the £19.5 billion rise in spending on universal credit, which in turn is driven by the effects of the pandemic on the caseload overlaid by the cost of temporary policy measures. We explore this in Chapter 2.
- **Pensioner benefits** spending is up £2.4 billion (2.2 per cent). State pension awards were uprated by 4.0 per cent via the triple lock, but pandemic-related excess deaths have materially reduced the number of people in receipt of these benefits. (Our March 2021 forecast assumes that there will have been 100,000 excess pensioner deaths in 2020-21, reducing spending by £0.6 billion in that year.)

- **Disability benefits** spending is up £1.4 billion (5.4 per cent). This continues the relatively strong growth in spending seen in recent years as prevalence of disability benefit receipt continues to rise (as described in our January 2019 WTR).
- **Other welfare spending** is up £1.0 billion (7.0 per cent), largely due to growth in spending in Northern Ireland, which is up £0.8 billion (12.3 per cent). This reflects similar drivers to the rise in UC spending in Great Britain.
- **Child benefit** spending is up just £0.1 billion (0.8 per cent). This small rise reflects a year-on-year fall in the caseload that partly offsets the effect of CPI uprating on average amounts received per child. This in turn could reflect the pandemic-related reduction in birth rates that has become evident in recent weeks, as well as virus-related falls in take-up among those eligible and unexpectedly strong growth in the number of claimants affected by the high income child benefit charge.

Chart 1.2: Sources of the year-on-year rise in cash spending in 2020-21



Note: Scottish welfare BGA has been added in forecast years to show on an equivalent basis with outturn years.

Source: DWP, OBR

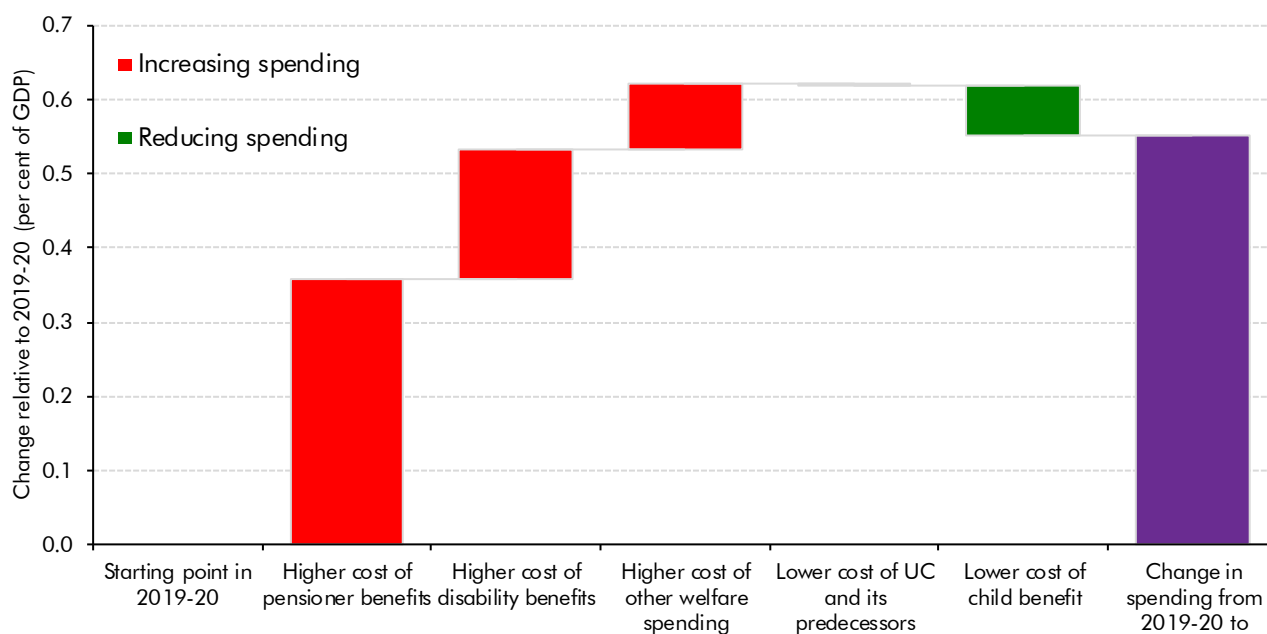
1.11 Chart 1.3 shows how each category of spending contributes to the 0.6 per cent of GDP rise in welfare spending between 2019-20 and 2025-26:

- Spending on **pensioner benefits** is up 0.4 per cent of GDP, driven by the upward pressures from the pre-pandemic trends of an ageing population and the ratchet effect of triple-lock uprating. Our forecast assumes that around two-thirds of excess pensioner deaths in the near term are brought forward from within the forecast period, so pandemic-related mortality has little impact on the change in spending between 2019-20 and 2025-26. We have not made any further assumptions about the impact of coronavirus on trends in longevity over the medium term. In this period there is little offsetting downward pressure from raising the state pension age, with the rise to 66

years having taken place between 2018 and 2020 while the rise to 67 years does not take place until between 2026 and 2028. The medium-term rise in spending as a share of GDP is greater than in our pre-virus forecast. This reflects little change in cash spending growth but a weaker path for nominal GDP.

- **Disability benefits** spending is up 0.2 per cent of GDP, reflecting higher caseload prevalence in the population. This rise is also a little greater than assumed in our March 2020 forecast reflecting the assumptions we have made about lasting consequences of the pandemic for caseloads in health-related benefits.
- **Other welfare spending** is up 0.1 per cent of GDP, reflecting higher spending in Northern Ireland. Again, this rise is greater than our March 2020 forecast assumed.
- Spending on **universal credit and its predecessors** is almost flat. While caseload prevalence is up slightly in 2025-26 relative to 2019-20, lower average awards offset that upward pressure as CPI uprating reduces awards relative to earnings and GDP per adult. This medium-term path contrasts with our pre-pandemic forecast, in which caseload prevalence also fell steadily, which meant that spending fell sufficiently relative to GDP to offset the rising cost of pensioner and disability benefits on overall welfare spending. The pandemic-related forecast assumptions about unemployment and inactivity that drive this change are explained in Chapter 3.
- **Child benefit** spending is down 0.1 per cent of GDP as CPI uprating lowers average awards relative to earnings. This medium-term fall is unchanged from our March 2020 forecast. We have not made any assumptions about pandemic-related effects on fertility rates over the medium term, so the forecast continues to be based on pre-pandemic ONS projections for the number of births in the UK.

Chart 1.3: Sources of change in welfare spending as a share of GDP in 2025-26 relative to 2019-20



Note: Scottish welfare BGA has been added in forecast years to show on an equivalent basis with outturn years.
Source: DWP, OBR

Structure of the report

1.12 As set out in the Foreword to this document, we have prepared a shorter *WTR* this year that focuses on two ways that the pandemic has affected our welfare spending forecast:

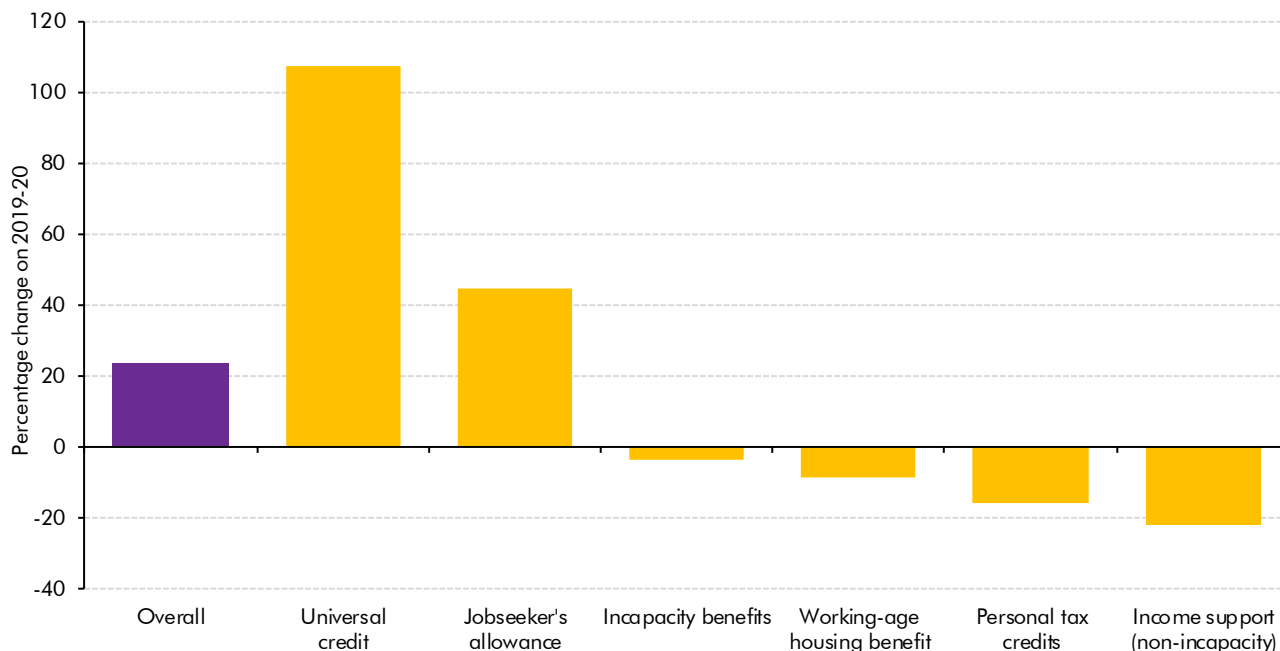
- **Chapter 2** explores the drivers of the sharp rise in the cost of universal credit this year; and
- **Chapter 3** discusses our key assumptions about the medium-term implications of the pandemic for working-age welfare spending, and for universal credit in particular.

2 Recent developments

Introduction

2.1 In Chapter 1 we showed that spending on universal credit (UC) and the predecessor benefits it replaces explains £15.1 billion of the £20.1 billion overall rise in welfare spending in 2020-21. Within that total, UC itself more than explains the rise, with spending more than doubling between 2019-20 and 2020-21 (rising from £18.2 billion to £37.7 billion). Among the legacy benefits, the cost of jobseeker's allowance rises thanks to new claims for the 'new-style' contributions-based benefit that continues to operate, while spending on tax credits, housing benefit and employment and support allowance (ESA) all fall to varying degrees (Chart 2.1). These falls reflect both the continuing rollout of UC (since all means-tested legacy systems now closed to virtually all new claims), plus pandemic-induced changes in claimants' circumstances that prompt them to migrate from the legacy system to UC.

Chart 2.1: Growth in cash spending on UC and its predecessors in 2020-21



2.2 Given the extent to which the jump in spending on means-tested working-age benefits in 2020-21 is dominated by spending on UC, the rest of this chapter focuses exclusively on what explains the £19.5 billion rise in UC spending this year. The chapter works through the steps that contribute to that overall rise. It:

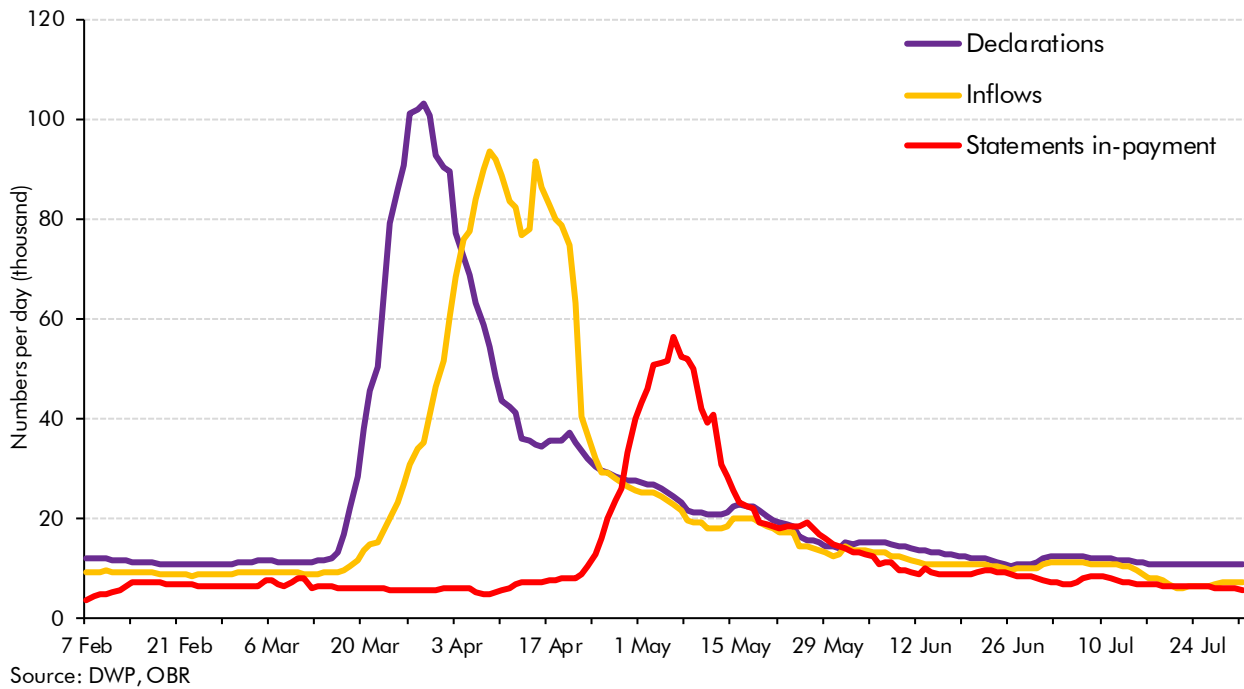
- describes how the **UC caseload** increased sharply at the onset of the pandemic;

- looks at how the **composition of those new cases** differs from the pre-virus caseload;
- considers what that means for **average awards** on UC before policy measures;
- reviews the cost of **virus-related policy measures**; and
- brings these together to summarise the drivers of the **growth in spending this year**.

The size of the UC caseload

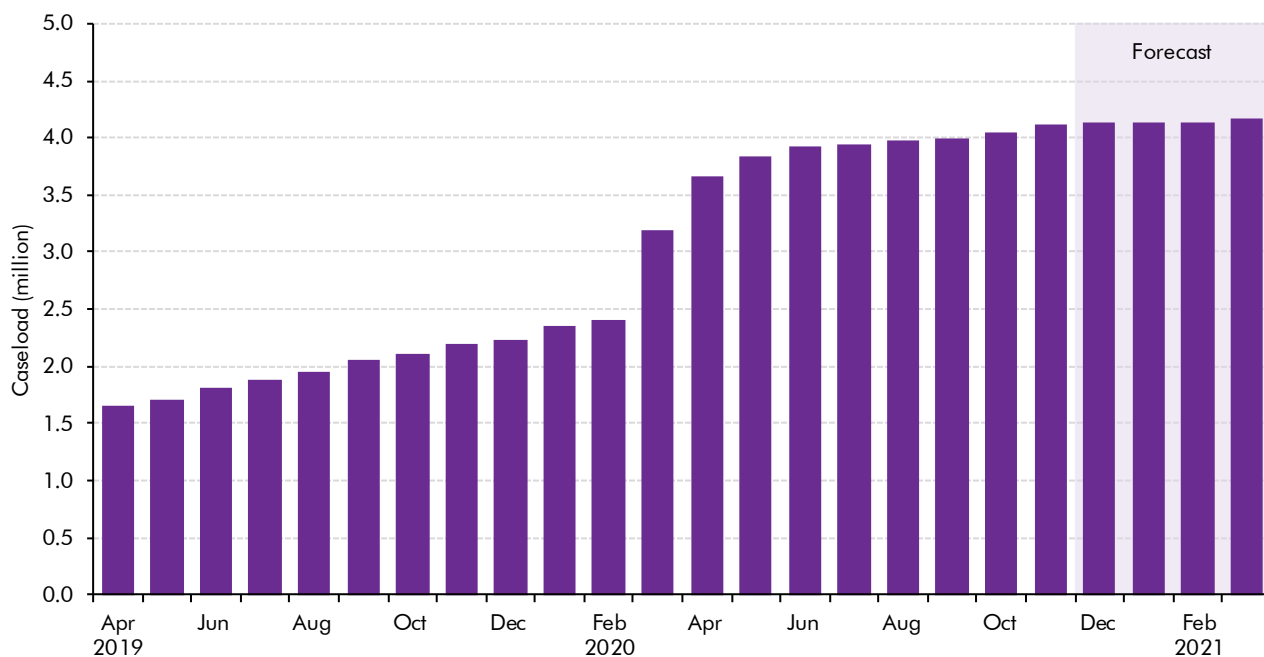
- 2.3 Our pre-virus March 2020 forecast assumed that the UC caseload would rise steadily through 2020-21 as the movement of cases from the legacy system to UC continued. This process involves some individual cases moving from receipt of one or more legacy benefits to UC as a result of a change in their circumstances, but also the natural churn of the caseload with some people leaving the legacy system and others making new claims to UC.
- 2.4 In the event, the initial weeks of the pandemic saw a very sharp rise in new claims for UC. As Chart 2.2 shows, there were 3 million UC declarations between 16 March and 31 May, with around 60 per cent of those taking place by 12 April and the numbers briefly topping 100,000 a day in late March. These declarations happen when an individual or a household provides information on their personal circumstances to begin a UC claim. As the chart shows, not all declarations flow onto UC and not all of those go on to receive a payment. For declarations between March and May, only around two-thirds were subsequently in payment in June. This reflects the fact that some people choose not to pursue their claim, while some that do find that they are not eligible for a payment.
- 2.5 One striking feature of the flows depicted in Chart 2.2 is just how rapidly people turned to UC as the pandemic hit. Unemployment increased only very slowly during this period, but there was huge uncertainty over how the initial lockdown would affect people's jobs and incomes. The Government announced the furlough scheme on 20 March, but full details about how it would work were not nailed down immediately. The system first opened for claims on 20 April. Meanwhile, the Government's daily coronavirus press conferences frequently pointed people towards UC as a key source of financial support for those whose jobs and incomes had been adversely affected. These factors may all have contributed to some precautionary UC declarations being made in the initial weeks of the pandemic.

Chart 2.2: Daily UC declarations, inflows and cases in payment



2.6 Even though not all the initial UC declarations fed through to individuals and households receiving UC awards, the in-payment caseload also increased sharply, rising from 2.4 million in February 2020 to 3.2 million in March and 3.7 million in April (Chart 2.3). Since then it has edged higher to stand at 4.1 million in November 2020, the latest month for which outturn data are currently available. Our forecast assumes that the in-payment caseload will have averaged 4.0 million across 2020-21 as a whole, an 88 per cent increase on the 2.1 million average across 2019-20.

Chart 2.3: Universal credit in-payment caseload: 2019-20 and 2020-21



Source: DWP, OBR

2.7 The near doubling of the UC caseload is the largest contributor to higher UC spending in 2020-21. We consider the cost of policy measures later in the chapter, so to isolate the effect of the caseload on spending, we first look at its effects prior to the effect of those measures. The average UC payment in 2019-20 was £710 a month. If we assume that on a pre-measures basis that would have increased to £722 a month due to uprating in line with the 1.7 per cent rate of CPI inflation in September 2019, the 1.9 million rise in the average caseload in 2020-21 would have increased spending by £16.3 billion.

Composition of the caseload

2.8 In previous *Welfare trends reports* we have highlighted the importance of changes in the composition of various caseloads in determining the amount that will be spent on a given benefit. This is particularly important for UC because the overall award for each individual or household on the caseload can be the combination of several different elements, with eligibility criteria attached to each. And because UC combines several legacy benefits into a single award, differences in household circumstances that would previously have meant someone was, say, either eligible or not eligible for housing benefit, will manifest themselves as differences in average amounts received for a given caseload in UC.

2.9 Changes in the composition of the UC caseload have indeed affected average amounts received this year. Chart 2.4 compares the proportion of the caseload with and without various characteristics in February 2020, before the surge in cases, to the situation in November 2020, including those virus-related cases. It shows that:

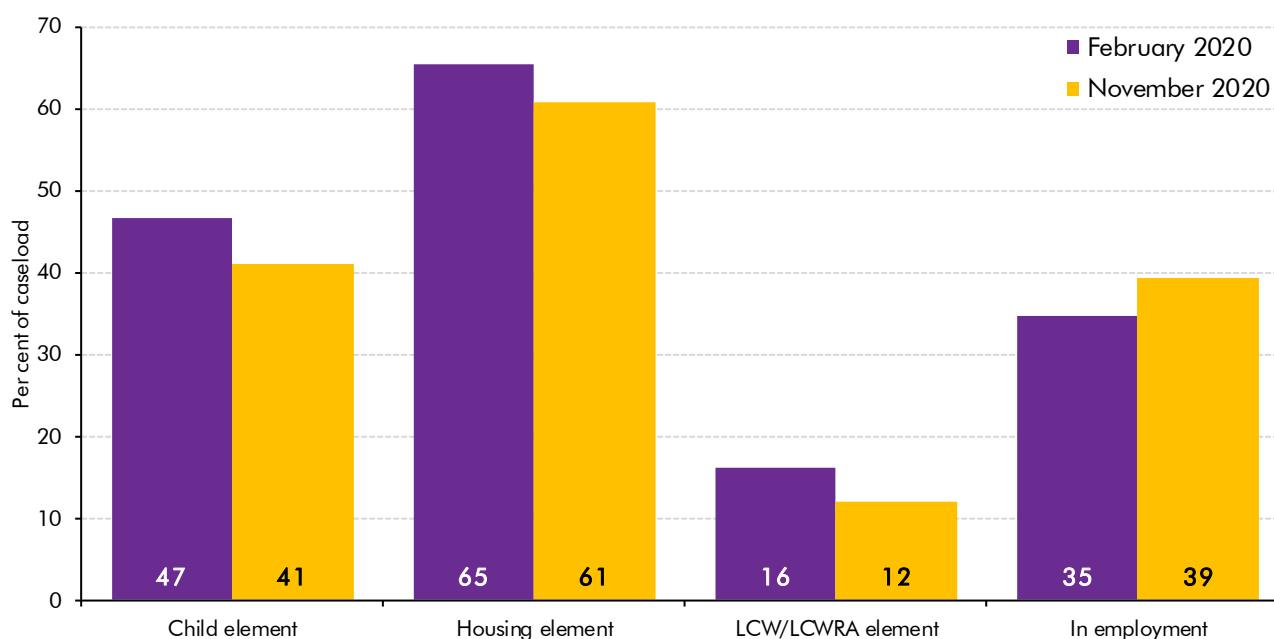
- The proportion of households in receipt of a **child element** fell from 47 per cent to 41 per cent. With the overall caseload almost doubling in that time, the 6 percentage

point fall implies that the additional cases were around a fifth less likely to receive a child element than the pre-existing caseload.

- The proportion of households in receipt of **a housing element** fell from 65 per cent to 61 per cent. That 4 percentage point fall implies that additional cases were around a tenth less likely to receive a housing element than the pre-existing caseload.
- The proportion of households in receipt of **a health-related element** (the 'limited capability to work (LCW)' or 'limited capability for work-related activity (LCWRA)' elements in UC) fell from 16 per cent to 12 per cent. That 5 percentage point fall (figures do not sum due to rounding) implies that the additional cases were almost half as likely to receive a health-related element.
- The proportion of individuals on the caseload that are **in employment** increased from 35 to 39 per cent. The 5 percentage point rise (again, not summing due to rounding) implies the additional cases were around a quarter more likely to be in employment.

2.10 Each of these differences points to a lower average award across all cases than would have been the case if the composition of the caseload had not changed.

Chart 2.4: Composition of the UC caseload: February versus November 2020



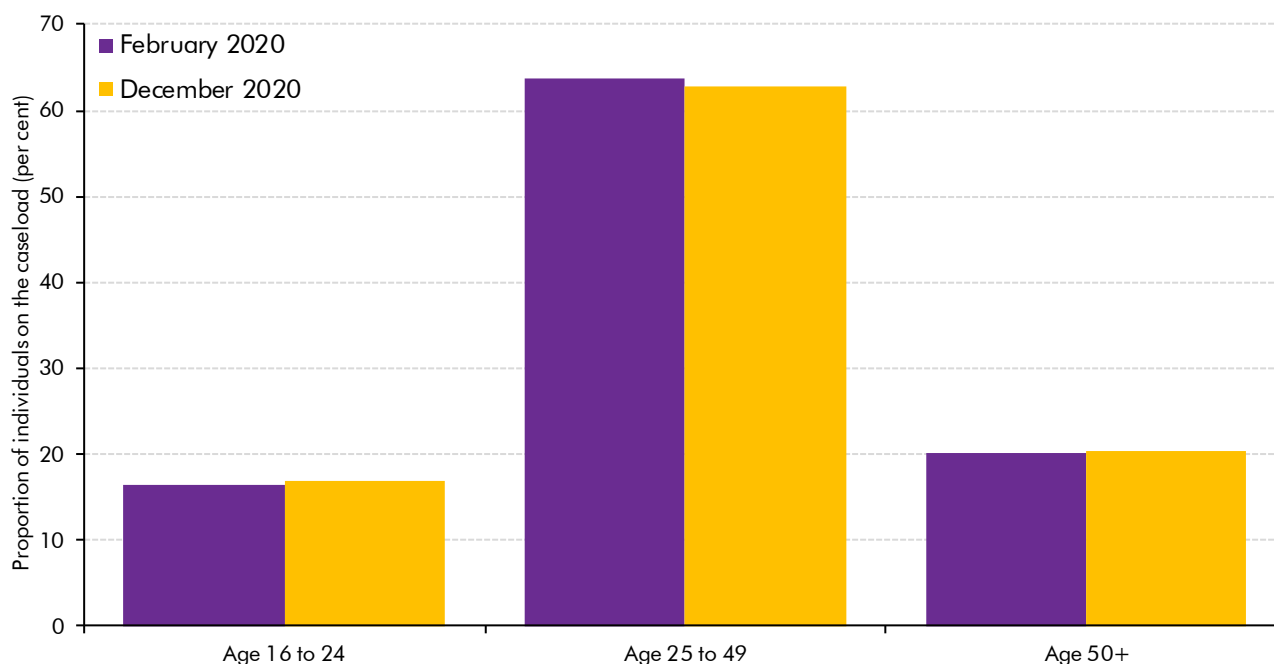
Note: In employment draws on December data.
Source: DWP, OBR

2.11 One feature of the labour market consequences of the pandemic has been how uneven its effects have been across sectors of the economy and across age groups. For example, use of the CJRS furlough scheme has been particularly concentrated in the retail sector and in arts and entertainment (as we discussed in Box 3.4 of our *March 2021 Economic and fiscal outlook*). An early snapshot of the prevalence of furloughing by age showed that 44 per cent of jobs had been furloughed among 16 to 24 year olds, whereas a much smaller 28 per

Recent developments

cent had been among 25 to 49 year olds and 27 per cent among those aged 50 and older.¹ Similarly, the Labour Force Survey measure of employment has fallen by 7.5 per cent between the first and fourth quarters of 2020 among 16 to 24 year olds, but by only 0.8 per cent among 25 to 49 year olds and by 1.6 per cent among those aged 50 and older. Given these other indicators, it is therefore surprising to find that the age composition of the UC caseload has barely changed over the past year (Chart 2.5).

Chart 2.5: Age composition of the UC caseload: February versus December 2020



Source: DWP, OBR

Average awards

2.12 Differences in the composition of the caseload lead to differences in the UC elements to which those cases are eligible. When viewed in aggregate, that has meant that the average UC award of the individuals and households that have flowed onto UC since the onset of the pandemic is lower than the average award of the pre-existing caseload.

2.13 To isolate the contribution of this compositional change from the cost of policy measures that are considered next, we first look at this on a pre-measures basis. Across the entire 4.0 million average in-payment caseload in 2020-21, we expect the average award on a pre-measures basis – excluding the £20 a week increase in the standard allowance and the boost to local housing allowance rates – to have been £681 a month.² That is 6 per cent lower than the £722 a month we estimated in paragraph 2.7 as the average amount that would have been seen if the composition of the caseload in 2020-21 had matched that in

¹ HMRC, *Coronavirus Job Retention Scheme statistics: July 2020*, 15 July 2020.

² For simplicity, these pre-measures average awards have been calculated by subtracting the cost of measures from total spending and dividing by the average caseload in 2020-21. In reality, policy measures also affect the caseload, but those effects will be very small relative to the overall differences that are described in this chapter.

2019-20. Those lower pre-measures average awards offset £2.3 billion of the £16.3 billion increase in spending that would have resulted from the higher caseload alone.

2.14 One way of illustrating the sources of lower average awards among the new cases that have flowed onto UC this year is to break down the overall average amount received by different cohorts of inflows into the average amount of each element that they receive. For simplicity, we do this on a post-measures basis rather than attempting to strip out the effect of the measures described in the next section – this means the levels in Chart 2.6 are higher than the pre-measures awards described in the preceding paragraph, but it should not materially distort the differences between the various cohorts.³ The chart shows the average award of all pre-2020 inflows in February 2020, before CPI uprating and policy measures took effect, and in November 2020, the latest available data. It then compares the average award of these earlier inflows with those of later cohorts:

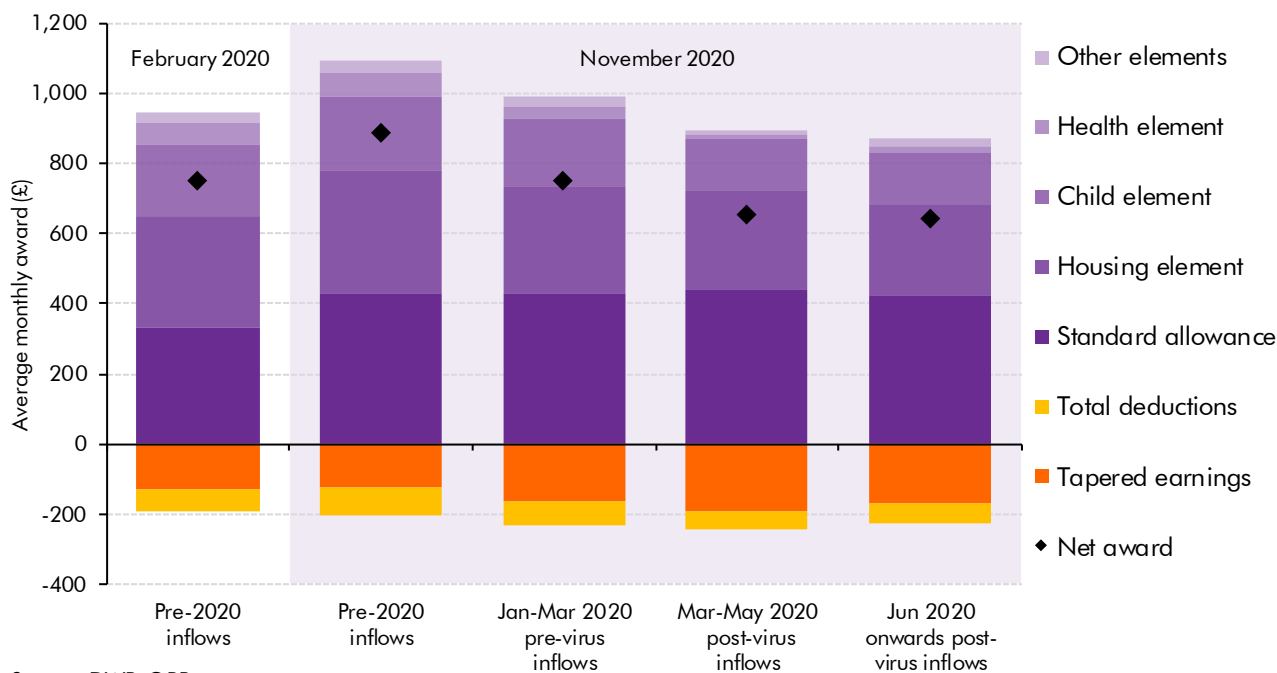
- **Inflows between January and 17 March 2020.** These are pre-pandemic inflows whose declarations took place before the sharp rise in late March, so they illustrate the difference between new and existing claims in more normal times. By November 2020, the average award of this cohort was 15 per cent lower than those of the pre-2020 caseload. Most of the difference relates to three elements: lower payments in respect of the housing and health elements and greater tapering of awards due to household earnings. Receipt of child elements was also somewhat lower.
- **Inflows between 17 March and May.** These relate to the initial surge of claims as the pandemic struck. By November 2020, average awards for this cohort were 26 per cent lower than the pre-2020 caseload and 13 per cent lower than the January-to-March cohort of claims. The differences relate to housing, health and child elements, and to the earnings taper. Relative to the pre-2020 caseload, payments in respect of the health element were 84 per cent lower, for the child element they were 31 per cent lower, and for the housing element they were 19 per cent lower. Meanwhile, the extent to which awards were tapered due to earnings was 55 per cent greater than for the pre-2020 cohort. In cash terms, these differences each explain around a quarter of the overall shortfall in average awards relative to pre-2020 cases.
- **Inflows since June 2020.** These relate to the smaller numbers of new claims that have been made since the initial surge. Their average awards in November 2020 were very similar to those of the March-to-May cohort – 28 per cent lower than the pre-2020 cohort and 15 per cent lower than the pre-pandemic January-to-March cohort. This suggests that the compositional differences seen during the initial surge in cases has largely continued in more recent months despite the number of claims each month having fallen back to more normal levels.

³ It would be reasonably straightforward to strip out the effect of raising the standard allowance by £20 a week, but the effect of raising the local housing allowance to 30 per cent of local rents would be much more challenging. The monetary value of that measure for each affected individual or household in privately rented accommodation depends on where in the country they live and how the pre-measures local housing allowance in that area differed from the 30 per cent threshold to which it has been raised.

Recent developments

2.15 These differences in average award flow from the differences in the composition of the caseload described in the previous section. In particular, the smaller proportion of cases in receipt of child, housing and health-related elements, and the greater tapering of awards due to earnings associated with a higher proportion of individuals in employment.

Chart 2.6: Average UC awards by element for different cohorts of inflows



Source: DWP, OBR

Policy measures announced since Budget 2020

2.16 The Government has announced several policy measures designed to provide greater financial support to recipients of UC (and some legacy benefits), and also to ease the administration of the benefits system, during the pandemic. Overall, our March 2021 forecast assumes that these will have cost £8.4 billion in 2020-21, of which £5.6 billion relates to UC.

2.17 The main contributors to the UC-related cost are:

- **The temporary £20-a-week increase in UC standard allowances.** This costs £4.4 billion for UC (and £5.9 billion when combined with the equivalent boost to the basic element of working tax credit). The bulk of the cost of the measure simply comes from most claimants receiving the full £20-a-week uplift. But some 'nil award' claimants will no longer have their award fully tapered (so they become an in-payment case as a result of the measure), while other claimants will have some of the additional UC tapered with income. Both sets of claimants benefit from only part of the £20 a week.
- **Raising local housing allowance rates to the 30th percentile of local rents.** This costs £0.6 billion for UC (and £0.9 billion once housing benefit is included). This raised UC

or housing benefit awards for eligible private renters to the 30th percentile of an area's market rents in 2020-21 before freezing rates in cash terms from 2021-22 onwards.

- **Relaxing the minimum income floor for UC.** This costs £0.3 billion for UC in 2020-21. It removes the assumed level of income that reduces awards for self-employed claimants earning less than that amount until the end of July 2021.

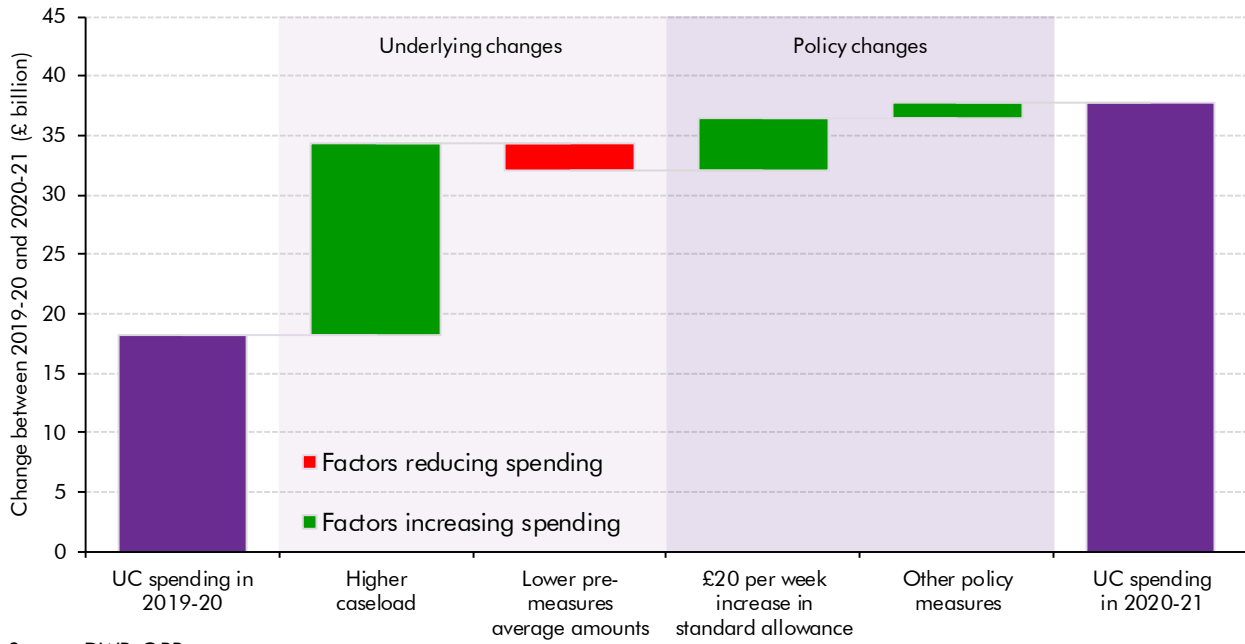
2.18 Several other measures relating to the operation of UC during the pandemic have had small effects on spending. For example, DWP's recovery of benefit overpayments and debts was temporarily paused, while a range of health and job assessments and sanctions were temporarily relaxed.

Universal credit spending in 2020-21

2.19 We can bring together the preceding analysis to show how each factor contributes to the £19.5 billion rise in spending on UC in 2020-21. As Chart 2.7 shows, it reflects:

- **A large increase in the caseload.** We expect the caseload to average 4.0 million through 2020-21 as a whole, up 88 per cent on 2019-20. All else equal (i.e. if these additional cases had received the same average awards as the pre-virus caseload), this would have increased spending by £16.3 billion.
- **A partly offsetting fall in pre-measures average awards.** Differences between the composition of those joining the caseload from March 2020 onwards and the pre-virus caseload meant that the pre-measures average award across the entire 2020-21 caseload was 6 per cent lower than if the composition had remained as it was in 2019-20. This lower average award is sufficient to lower spending by £2.3 billion.
- **The temporary £20-a-week increase in UC standard allowances.** This is estimated to have cost an additional £4.4 billion.
- **Other policy changes.** Raising local housing allowance rates and a variety of other easements cost a further £1.2 billion.

Chart 2.7: Sources of the year-on-year rise in universal credit spending in 2020-21

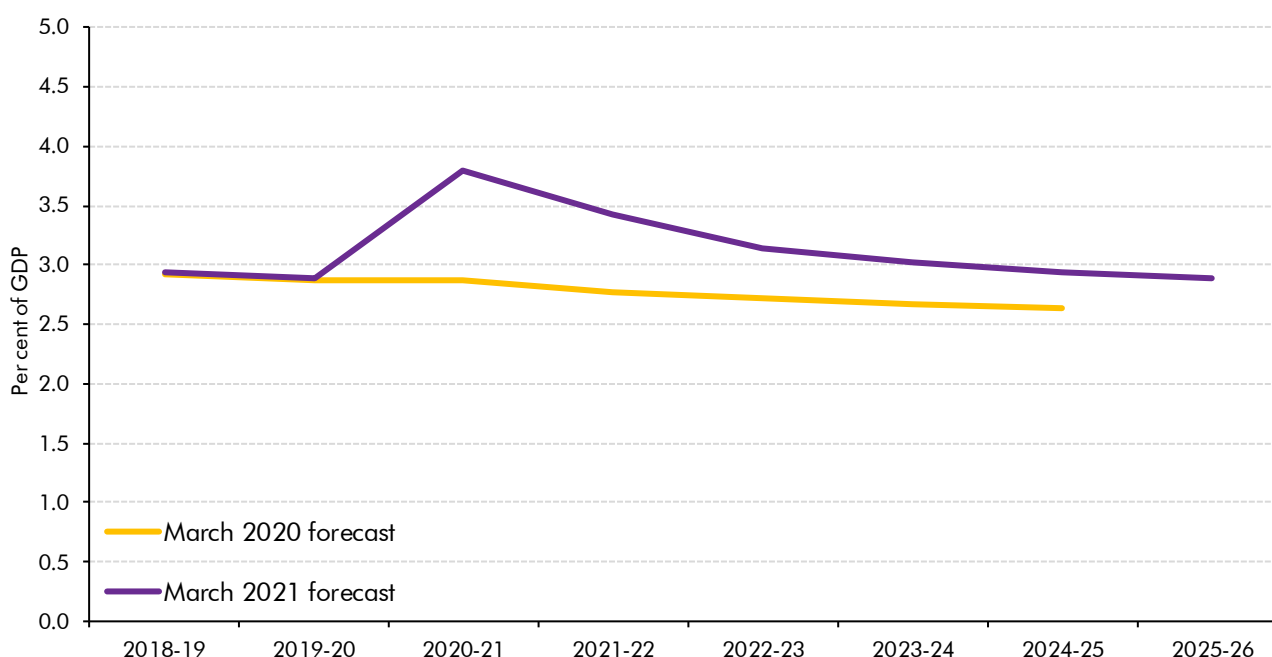


3 Medium-term outlook

Introduction

3.1 In Chapter 1 we showed that in our March 2021 forecast, overall welfare spending in 2025-26 is expected to be 0.6 per cent of GDP higher than its pre-pandemic level in 2019-20. That contrasts with our pre-virus March 2020 forecast, in which welfare spending at the forecast horizon (which was then 2024-25) was expected to be in line with the level in 2019-20. Much of the difference between those two forecasts relates to spending on universal credit (UC) and the predecessor benefits and tax credits that it replaces. In our March 2020 forecast, spending was expected to fall by 0.23 per cent of GDP between 2019-20 and 2024-25. In our latest forecast, it falls back from the pandemic-induced spike in 2020-21 to return to the same pre-pandemic level by 2025-26.

Chart 3.1: Spending on universal credit and its predecessors



Source: DWP, OBR

3.2 Our pre-virus forecasts assumed that spending on UC and its predecessors would fall gently as a share of GDP because the caseload was expected to rise broadly in line with growth in the adult population, but average awards were expected to fall relative to GDP per adult because they are uprated by CPI inflation and therefore rise more slowly than wages. Our latest forecast assumes the pandemic will have lasting effects on the prevalence of benefit receipt that results in higher caseloads and awards in the medium term. These effects are largely confined to UC and are concentrated in the health-related elements of the benefit.

3.3 This chapter therefore sets out:

- our latest medium-term forecast for **UC spending**;
- the assumptions we make about how the **UC caseload** will evolve;
- the path for **UC average awards** over the coming years; and
- the **risks and uncertainties** around these forecasts.

Our latest forecast for universal credit spending

3.4 Table 3.1 shows our latest forecast of spending on UC and its legacy benefit predecessors over the next five years. Following the sharp spike in spending in 2020-21, spending remains elevated in 2021-22 before falling back in 2022-23 and then slowly returning close to its pre-pandemic trajectory from 2023-24 onwards. As a share of GDP, by 2025-26 spending returns close to its 2019-20 level of 2.9 per cent, having fallen from the 2020-21 peak of 3.8 per cent of GDP. Within the overall total, spending on UC rises quickly in every year as new claims are made to UC (with its predecessors closed to almost all new claims), natural migration of legacy cases that experience changes in circumstances and DWP's plans for the managed migration of the remaining legacy benefit cases. Having jumped from 28 to 47 per cent of total spending on these benefits in 2020-21, the share of UC in the total rises further each year to reach 80 per cent by 2025-26.

3.5 The rise and fall in overall spending reflects several factors that are explored in more detail in the rest of the chapter. In summary, they include:

- **Labour market developments.** Our latest forecast assumes unemployment will rise from its current level of 5.1 per cent to a peak of 6.5 per cent in the fourth quarter of 2021, after the furlough scheme has closed. This pushes the UC caseload higher and changes its composition towards more expensive out-of-work cases. The steady fall in unemployment over the remainder of the forecast sees the UC caseload fall too. But we assume that there will be a modestly higher equilibrium unemployment rate as a consequence of the pandemic, so the unemployment-related caseload does not fall all the way back to its pre-pandemic level.
- **Health-related consequences of the pandemic for incapacity-related benefits.** We assume that the pandemic leads to greater levels of labour market inactivity. In part this is likely to reflect decisions to retire early, which should have little effect on means-tested working-age benefits. But in part it is likely to reflect health-related inactivity among working-age adults. We have assumed that this results in an additional 300,000 claimants across UC and working-age disability benefits.
- **Policy measures boost spending in 2020-21 and 2021-22 but have been largely withdrawn by 2022-23.** The largest effect is from the £20-a-week boost to the UC standard allowance and the basic element of working tax credit in 2020-21. This has

been extended to September 2021 for UC, while working tax credit recipients will receive a one-off payment of £500 that is treated as departmental spending. Raising the local housing allowance to the 30th percentile of local rents and then freezing it in cash terms boosts spending in 2020-21 but lowers growth in spending thereafter.

- **Average awards fall relative to GDP due to annual CPI uprating** of awards, which means that they rise more slowly than wages and nominal GDP per adult. But this underlying effect is outweighed by the rising share of the caseload made up of health-related cases due to the assumed lasting consequences of the pandemic.

Table 3.1: March 2021 forecast of spending on universal credit and its predecessors

	£ billion						
	Outturn	Forecast					
	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
UC and its legacy benefit predecessors¹	64.3	79.5	77.6	74.5	74.3	75.1	76.6
<i>of which:</i>							
Universal credit	18.2	37.7	41.3	42.2	46.0	52.2	61.5
Personal tax credits	18.0	15.1	11.0	8.4	6.4	4.3	2.0
Incapacity benefits ^{1,2}	14.0	13.5	13.5	13.2	12.8	11.2	8.2
Working-age housing benefit	12.1	11.1	10.4	9.6	8.5	6.9	4.7
Income support (non-incapacity)	1.4	1.1	0.8	0.6	0.5	0.3	0.1
Jobseeker's allowance	0.7	1.0	0.6	0.4	0.2	0.2	0.2

¹ Incapacity benefits includes incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).

² Scottish welfare BGA has been added in forecast years to show on an equivalent basis with outturn years.

Caseload forecasts

Universal credit and its predecessor benefits and tax credits

3.6 One key driver of our medium-term forecast for spending on UC and its predecessor benefits and tax credits is the rise and fall of the overall caseload as the pandemic-related surge in cases in 2020-21 and 2021-22 recedes over the remainder of the forecast. Chart 3.2 places our latest forecast in the context of recent history. It plots the number of benefit units (i.e. either individuals or households depending on the circumstance of each case) in receipt of either UC or of one or more of the legacy benefits and tax credits over time. The step changes each April are largely related to the tax credits system, hence not being a feature of the forecast period where the caseload is dominated by those in receipt of UC.

3.7 From March 2020 onwards, the caseload is split between the actual caseload and a counterfactual path that we might have expected it to take absent the pandemic and that is largely consistent with our March 2020 forecast.¹ This is how we have produced our two post-pandemic forecasts for spending on UC – building a counterfactual forecast using our

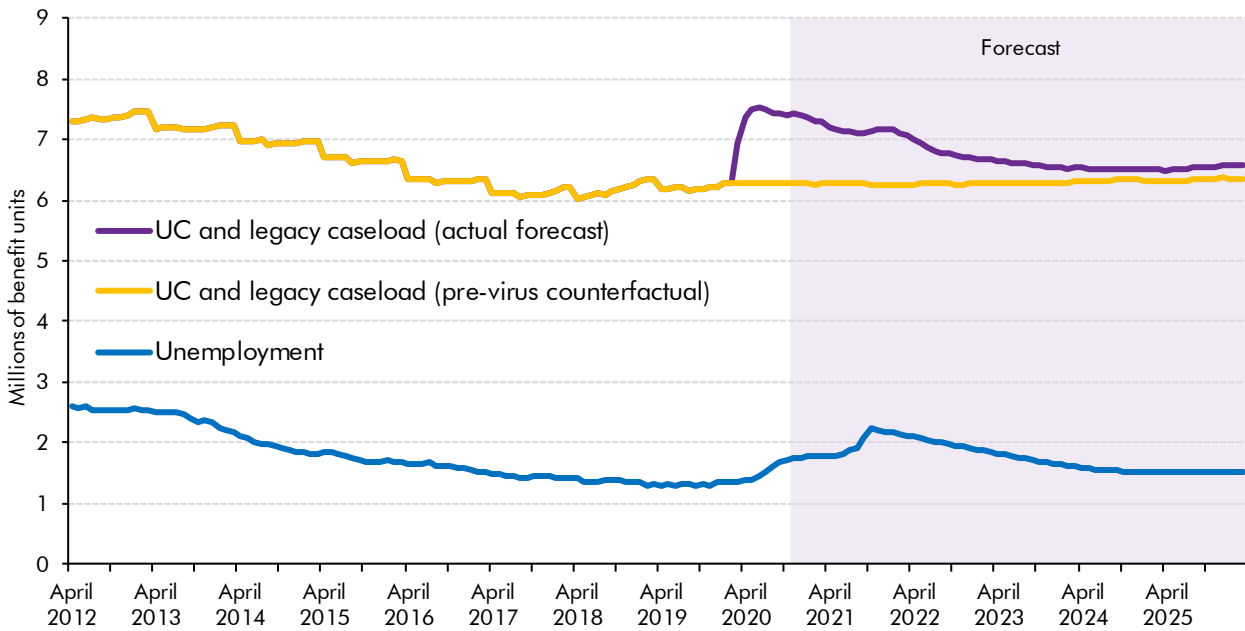
¹ It has not been possible to generate a path that is fully consistent with our March 2020 forecast because of the change in forecast methodology that we were forced to accelerate as a result of the pandemic, as described in our November 2020 EFO.

pre-existing modelling architecture and overlaying a pandemic-related hit on top. The latter includes the estimated effects of the pandemic on pre-existing cases.

3.8 Several features of this caseload forecast are worth noting:

- **The pre-virus counterfactual is relatively flat**, with the caseload rising at around 0.3 per cent a year on average – broadly in line with growth in the adult population.
- **The pandemic-related surge in cases in 2020-21 preceded any rise in unemployment.** As described in Chapter 2, there are several possible reasons why that might have happened – in particular, uncertainty over the implications of the pandemic for household incomes was very high in the early days of the pandemic.
- **The pandemic-related caseload is expected to rise again as unemployment rises later this year**, but not as sharply as unemployment itself. In part that is because caseloads typically move somewhat less than one for one with unemployment, but it is also because we assume that some of the rise in unemployment will be among people who are already part of the UC caseload and so switch from in-work status to out-of-work.
- **The pandemic-related caseload does not fall back to zero within the next five years.** This is explained by our assumptions about labour market scarring and what that will mean for unemployment- and incapacity-related benefits. In 2025-26, this translates into around 210,000 additional cases across UC and the predecessor benefits. The difference is more than explained by additional UC cases (described below), with our forecast assuming a slightly faster rundown of legacy benefit and tax credits cases, which partly offsets the effect of the higher medium-term UC caseload.

Chart 3.2: UC and predecessor benefit caseloads versus unemployment



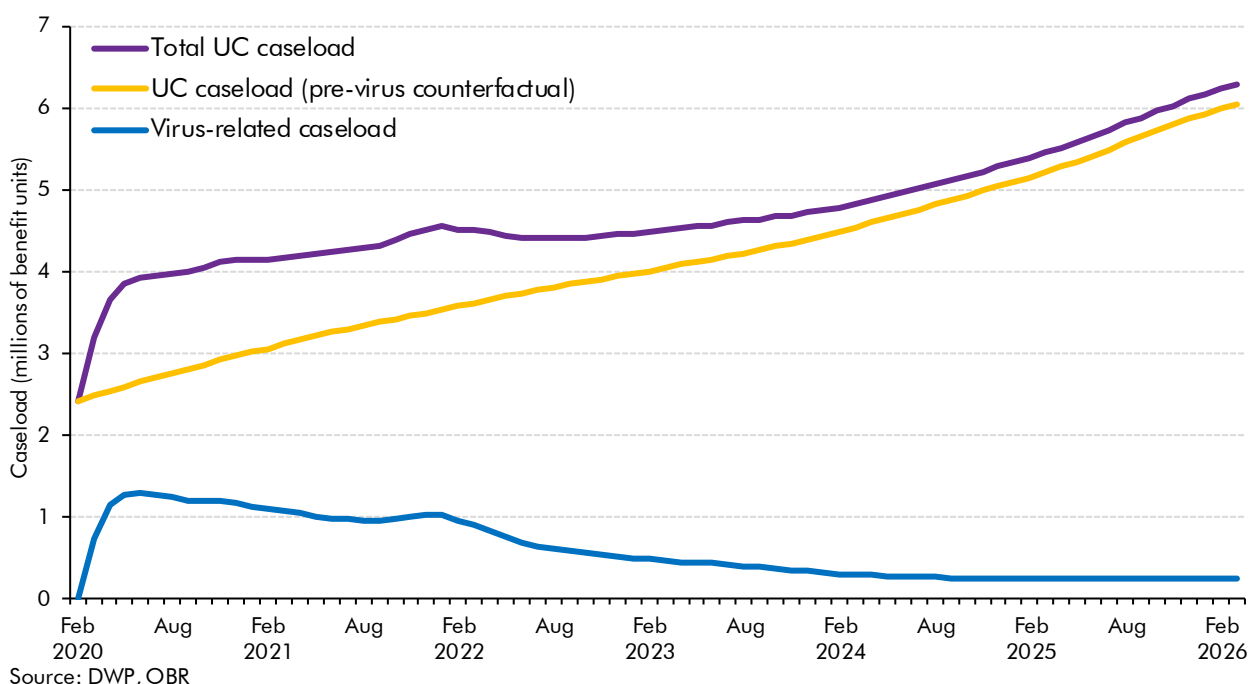
Note: monthly unemployment forecast is a simple linear interpolation of our published quarterly forecast.
Source: DWP, OBR

Universal credit in isolation

- 3.9 Chart 3.3 focuses on our forecast of the UC caseload in isolation. In the absence of the pandemic, we expected the gradual rollout of UC to put the caseload on a steady upward path from 2.5 million in March 2020 to 6.0 million in March 2026. Adding in the effect of the pandemic sees the caseload rise to 4.5 million as unemployment peaks later in 2021-22, then stay at around that level until the second half of 2023-24. Thereafter, the total caseload follows a similar path to that in the pre-virus counterfactual, but at a somewhat higher level thanks to the labour market scarring effects described above.
- 3.10 Looking purely at the path of the virus-related caseload, it peaked in June 2020 at 1.3 million. While it rises again in the second half of 2021-22 as the furlough scheme ends and unemployment peaks, this time it reaches only 1.0 million, with the underlying shift to UC also contributing to this local peak. The surge in virus-related cases in the early months of the pandemic can therefore be seen as having two effects: first, it brought forward some of the transition to UC through new claims and changes of circumstances, moving people from legacy benefits to UC; and, second, it saw the UC caseload respond much faster to the prospective labour market impact of the pandemic than has actually transpired to date (possible reasons for which were discussed in Chapter 2).
- 3.11 It is for the latter reason that the 453,000 rise in our unemployment forecast between the second and fourth quarters of 2021 translates into a rise of just 80,000 in our forecast for the virus-related UC caseload later in 2021-22. But we also assume that 200,000 UC cases will shift from in-work to out-of-work status, which is associated with average amounts received being around £200 a month higher – adding to spending but not to the caseload.

3.12 In the medium term, the virus-related caseload falls back as unemployment falls, but it stabilises at around 240,000 in 2025-26. This reflects the judgements we have made about the lasting implications of the pandemic for the labour market and for incapacity-related benefits. Our central economy forecast is predicated on higher labour market inactivity and a modestly higher equilibrium rate of unemployment in the medium term. Our UC forecast assumes that those effects translate into 240,000 more health-related cases and 55,000 more cases in the ‘intensive work search’ group. Several smaller factors partly offset these additions to the caseload, including changes in the standard allowance that reduce the number of cases with small tapered awards.

Chart 3.3: UC caseload forecast: underlying rollout versus pandemic-related cases



Average awards

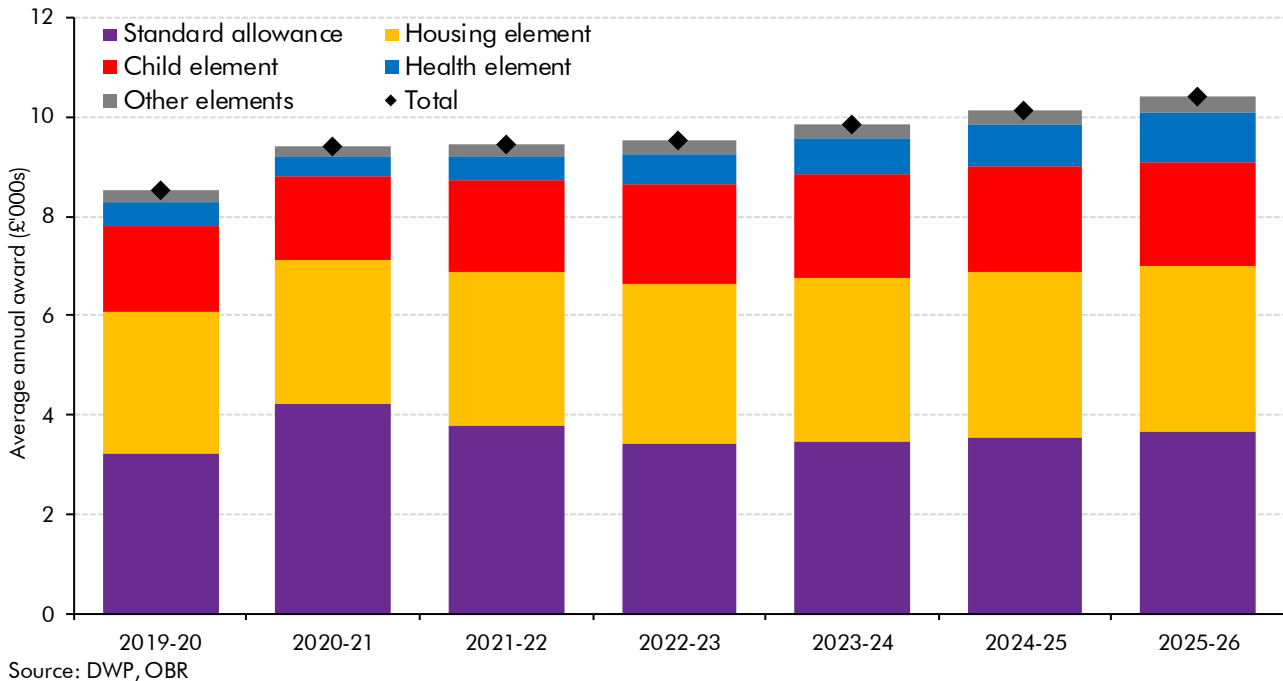
3.13 The average amount of benefit received by each household or individual on the UC caseload also contributes to the rise and fall of overall spending on UC and its predecessors over the forecast period. This reflects the combined effects of temporary policy measures that boost awards in the near term but subsequently fall away, and our assumptions about the composition of the caseload.

3.14 To illustrate the drivers of the path of average awards over the forecast period, we split expenditure by element of UC and divide it by the overall caseload. In practice, UC is received as a single payment rather than by element, with that single payment tapered where recipients have sufficient earnings and/or subject to other deductions. So, we generate this split by assuming that the share of each award accounted for by each element is equal to the share of entitlement before earnings or deductions. In effect, this means that all elements including the standard allowance are assumed to taper proportionately. This is a simplifying assumption that proves useful in describing the shape of the forecast.

3.15 It is also worth noting that we are considering the contribution of each element to the overall average UC award, not to the UC awards of cases in receipt of a particular element. As such, movements in the average amounts associated with each element reflect both changes in the value of the element (e.g. due to CPI uprating) and to changes in the proportion of the overall caseload in receipt of that element. As we discuss below, compositional changes are a key driver of average amounts over the forecast period.

3.16 Average UC awards rise sharply in 2020-21 thanks to the £20 a week boost to the standard allowance (Chart 3.4). Awards are then relatively flat in cash terms in 2021-22 and 2022-23 as the standard allowance measure continues in the first half of 2021-22 before being withdrawn. Awards thereby fall relative to CPI inflation in the next two years. They return to a rising trend again from 2023-24 onwards, with the growth rate somewhat faster than CPI inflation thanks to changes in the composition of the caseload.

Chart 3.4: UC average awards by element

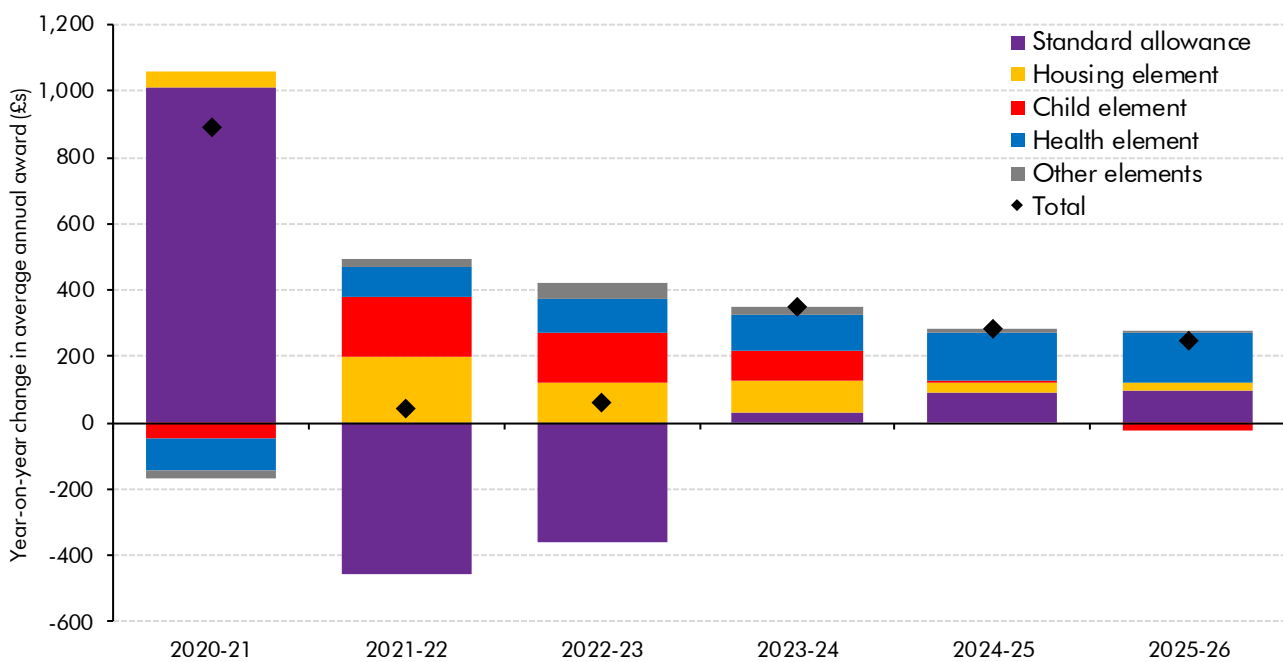


3.17 The contribution of different factors to the path of average awards is clearer when viewed in terms of year-on-year changes (Chart 3.5). On this basis, we can see that:

- The average **standard allowance** is a little over £1,000 a year higher in 2020-21 than in 2019-20 thanks to the £20-a-week boost. It then falls by £450 in cash terms in 2021-22 and £360 in 2022-23 as the boost is withdrawn halfway through 2021-22. CPI uprating and the effect of tapering and deductions means that the average standard allowance does not fall by the full £1,000 over those two years. From 2023-24 onwards, CPI uprating means the standard allowance makes a modest positive contribution to the year-on-year growth in average UC awards.

- The **housing element** makes a surprisingly small positive contribution to growth in 2020-21 given the £0.6 billion cost of raising local housing allowances to the 30th percentile of local rents. The effect of the measure is largely offset by the lower share of the caseload in 2020-21 that is entitled to the housing element. Our forecast assumes that this dip in entitlement will prove temporary, so the average amount of housing element received across the caseload rises substantially over the coming three years before rising more slowly in the final two years of the forecast.
- The contributions of the **child element** are driven by changes in the composition of the caseload, with the proportion of cases that are entitled to it having fallen in 2020-21 (as described in Chapter 2) and the forecast assuming that this will unwind over the next couple of years. The average value of the child element across all UC cases therefore falls in 2020-21, but then recovers between 2021-22 and 2023-24.
- The **health elements** (i.e. the limited capability for work and for work-related activity elements) contribute negatively in 2020-21 due to the drop in the proportion of the caseload that is eligible (see Chapter 2). As with housing and child elements, we assume that this is a temporary effect that will unwind. But in addition, we assume that the pandemic will result in a higher health-related caseload. Health elements are therefore the largest driver of growth in average awards from 2023-24 onwards, rising from £489 in 2019-20 to £991 in 2025-26 on average across the whole caseload (driven largely by a greater share of the caseload receiving them). As health-related cases are the most expensive UC cases, this explains why average awards across the whole caseload rise faster than CPI inflation in the medium term.

Chart 3.5: Year-on-year change in UC average awards by element



Source: DWP, OBR

Risks and uncertainties

Underlying forecast risks

- 3.18 Our forecasts are always subject to a variety of risks and uncertainties. In our March 2021 *Economic and fiscal outlook (EFO)*, we highlighted the unusual degree of uncertainty around assumptions about how the pandemic will evolve. In Box 2.1 of that *EFO* we considered the uncertainties around key epidemiological assumptions and the risks they pose – ranging from an optimistic outcome in which the virus impinges little on daily lives (perhaps thanks to very effective therapeutics and vaccines) to a pessimistic outcome in which the Government needs to reimpose restrictions in the face of future waves of infection (perhaps as a result of threatening new variants). The upside and downside risks to economic activity associated with these possible scenarios would also represent risks to welfare spending via their effects on employment, earnings and the health status of the population.
- 3.19 Among the many novel aspects of this economic and fiscal shock is that this is the first one the UK has experienced since UC became the main source of means-tested welfare support for working-age adults. We are therefore learning in real time how UC responds in the face of such a shock. As described in Chapter 2, one of the striking features of the past year was that the UC caseload soared within weeks of the pandemic breaking, despite the initial impact on the labour market being cushioned by Government support programmes. Our forecast assumes that when unemployment rises later this year, the effect of that on the size of the UC caseload will be limited, with the main consequence being that some previously in-work UC claimants become out-of-work claimants. There is no historical precedent on which to base this assumption, so there are clearly risks around it – even if we are right about the extent to which unemployment will rise this year, we could have over or underestimated how much that will affect the UC caseload and spending.
- 3.20 Similarly, we know little at this stage about how the composition of the UC caseload will respond to a further rise in unemployment and to the furlough scheme being wound down. History already tells us that no two recessions are the same in terms of their consequences for welfare spending (as detailed in our 2014 *Welfare trends report (WTR)*). For example, the early 1980s and early 1990s recessions were associated with much larger rises in unemployment benefit caseloads than occurred in the financial crisis and recession of the late 2000s. The early 1990s recession was also associated with a big rise in incapacity benefits spending, while the financial crisis saw the cost of tax credits rise sharply as the shock was felt more in lower hours worked and lower incomes for those in work. Our forecast assumes some shift in the composition of UC from in-work to out-of-work cases as unemployment rises, and a persistent pandemic-related impact on incapacity cases over the medium term. These assumptions are also subject to considerable uncertainty.

Policy risks

- 3.21 In last year's *WTR*, we looked back at how the large cuts to welfare spending announced in Summer Budget 2015 had fared in practice. One of the key conclusions of that report was that the measures that were subsequently dropped, reversed or watered down were typically

those that generated cash losers from one year to the next. This prompted us to flag the risks posed by ending the one-year £20-a-week boost to the UC standard allowance. As many expected, that measure was extended into 2021-22 at the March 2021 Budget, but it has only been extended for half a year. This means the point at which millions of families will face cash losses has now moved to October of this year. In our central forecast, this coincides with the point at which unemployment rises most sharply as other support measures are withdrawn. The risk of further extensions to the £20 uplift therefore remains.

- 3.22 By contrast, the boost to housing support by raising the local housing allowance to the 30th percentile of local rents in 2020-21 is being withdrawn progressively over several years by freezing rates in cash terms from 2021-22 until 2025-26. Our review of the Summer Budget 2015 measures showed that real-terms cuts of this sort that do not generate cash losers from one period to the next were much more likely to be implemented as announced. This points to the greater political salience of families experiencing actual cash losses as opposed to seeing their spending power squeezed by real-terms cuts.

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