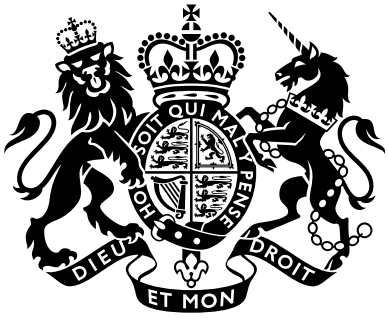
Office for
Budget
Responsibility

Welfare trends report

May 2022

CP 685



Office for Budget Responsibility: Welfare trends report

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

May 2022

CP 685

This publication is available at www.gov.uk/official-documents

Any enquiries regarding this publication should be sent to us at obr.enquiries@obr.uk

ISBN 978-1-5286-3366-6

E02748611 05/22

Printed on paper containing 40% recycled fibre content minimum

Printed in the UK by HH Associates Ltd. on behalf of the Controller of Her Majesty's Stationery Office.

Contents

Charts and tables data are available on our website.

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*. The January 2022 update to the *Charter* reduced the frequency with which our *Welfare trends report* (*WTR*) must be published from once a year to once every two years.

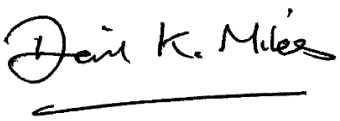
We have explored several issues in our successive *WTR*s ranging from a broad historical sweep of trends in UK welfare spending and international comparisons of welfare spending in our first two reports; to analyses of universal credit, disability benefits, the Summer Budget 2015 welfare spending cuts and the early implications of the pandemic for working-age spending across our subsequent five reports. With the UK emerging from a recession that has had sizable impacts on welfare spending over the past couple of years and continues to do so across our forecasts, this year's *WTR* focuses on changes in non-pensioner welfare spending during and after recessions, comparing the pandemic to the previous three UK recessions over the past four decades.

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, as we are to officials in the Department for Work and Pensions and HM Revenue and Customs that have provided their help and expertise. We are also grateful to external stakeholders who gave their time and shared their expertise. In particular, we would like to thank Mike Brewer at the Resolution Foundation, Carl Emmerson at the Institute for Fiscal Studies, Kayley Hignell at Citizens Advice and Jonathan Portes at King's College, London.

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



Professor David Miles CBE

Andy King

The Budget Responsibility Committee

Executive summary

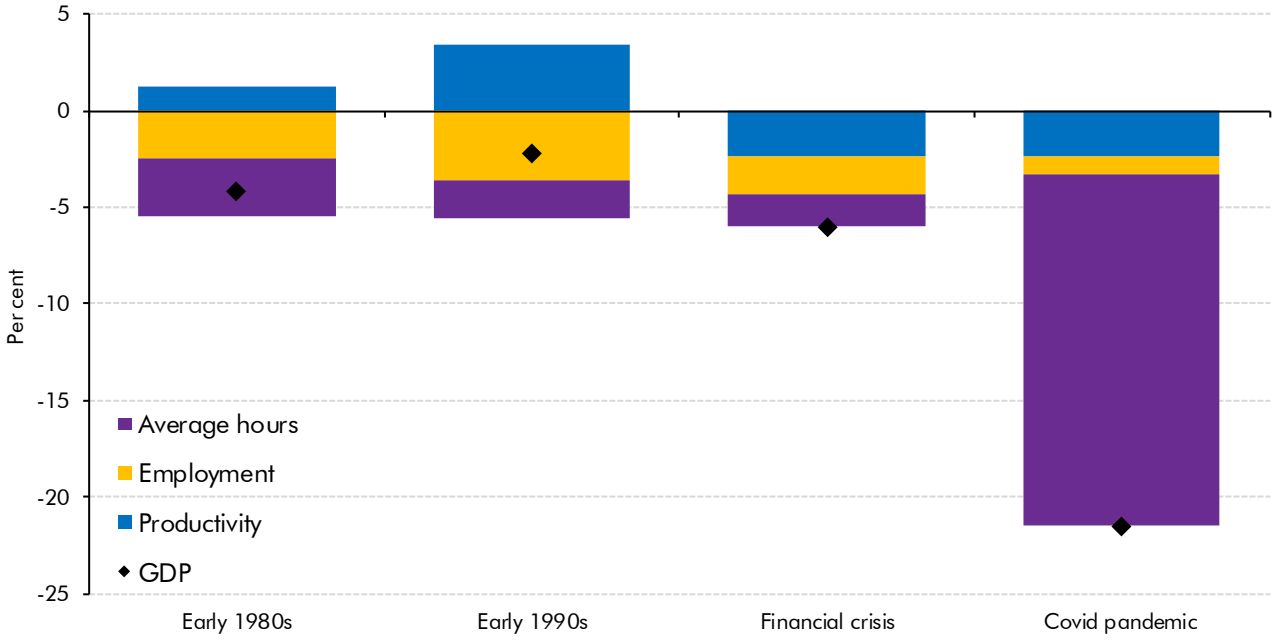
1 The pandemic caused the deepest recession in the UK in living memory, prompted the largest fiscal policy response outside the World Wars, and has, so far, been followed by an unusually rapid economic recovery. This pandemic-induced recession has also reshaped welfare spending over the past couple of years and can be expected to continue to do so over the next few. To explore both its immediate impact and longer-term legacy for welfare spending, this year's *Welfare trends report* (*WTR*) puts changes in non-pensioner welfare spending since the pandemic hit – including the novel schemes introduced to cushion the blow to people's incomes from public health restrictions – in the context of changes during and after the previous three UK recessions of the past 40 years.

UK recessions compared

2 Recessions and their aftermaths have been major drivers of the level and composition of welfare spending because they are associated with rises in unemployment, shortfalls in household income growth, business failures, and often disruptions in housing and other markets. The pandemic stands out from the three recessions preceding it – those in the early 1980s and early 1990s, and the one that followed the financial crisis in the late 2000s – in both the speed and depth of the hit to real GDP and the speed of the rebound in activity to date. The fall in output was 3.6 times larger than that in the financial crisis (the second-most severe), while real GDP recovered its pre-recession peak as quickly as it did in the early-1990s recession (the fastest recovery of the preceding three) despite far more ground to make up. This reflects the fact that the Covid shock originated outside the economy, rather than being associated with the build-up of macroeconomic imbalances that entailed a longer adjustment process. The rapid recovery is also attributable to the unprecedented level of government support to protect viable jobs and businesses through the severe, but ultimately temporary, disruption wrought by Covid.

3 From a welfare spending perspective, just as important as their size and speed is the way recessions manifest themselves in the labour market, with job losses typically more fiscally costly than more widespread declines in working hours or productivity (and therefore pay). The pandemic stands out in this respect too – the furlough and self-employment support schemes meant that the peak-to-trough fall in GDP was largely made up of lower average hours worked rather than falling employment or lower productivity (Chart 1). The unemployment rate peaked around 3 percentage points lower in 2020 than it did in the financial crisis, and has already returned to around its pre-recession level, rather than remaining elevated into the medium term as it did in the preceding three recessions. But in our latest forecast this is somewhat offset by our expectation of an 0.5 percentage point medium-term rise in the working-age inactivity rate relative to before the pandemic, reflecting scarring to participation from the rise in those unable to work due to ill-health.

Chart 1: Peak-to-trough real GDP change in recessions by labour market component



Source: ONS, OBR

4 Rising prices during or after recessions can hamper the pace of economic recovery by weighing on disposable incomes and consumption, and therefore matter indirectly for welfare spending. But they also affect spending directly because inflation rates are used to uprate benefits each year, albeit with a lag of up to 18 months. While inflation was higher at the outset of all three previous recessions, and especially so in the early 1980s, the pandemic period stands out for seeing inflation rise very sharply in the *post*-recession years, from 0.6 per cent in the first quarter of 2021 to around 9 per cent in the fourth quarter of 2022 in our latest forecast (with expectations of the peak higher still in more recent external forecasts). The lag in this rise being reflected in welfare spending means that non-pensioner benefit rates are forecast to be 6 to 7 per cent lower in real terms in 2022-23 than they were in 2019-20, a deeper trough in the real value of welfare benefits than in the wake of any of the preceding three recessions, before largely recovering the pre-pandemic real value in 2023-24. And although its effects are therefore temporary, the 4.5 per cent year-on-year decline in the real value of unemployment-related benefits this year (even excluding the effects of the removal of the temporary £20-a-week uplift mid-way through last year) represents the largest fall since annual uprating began half a century ago.

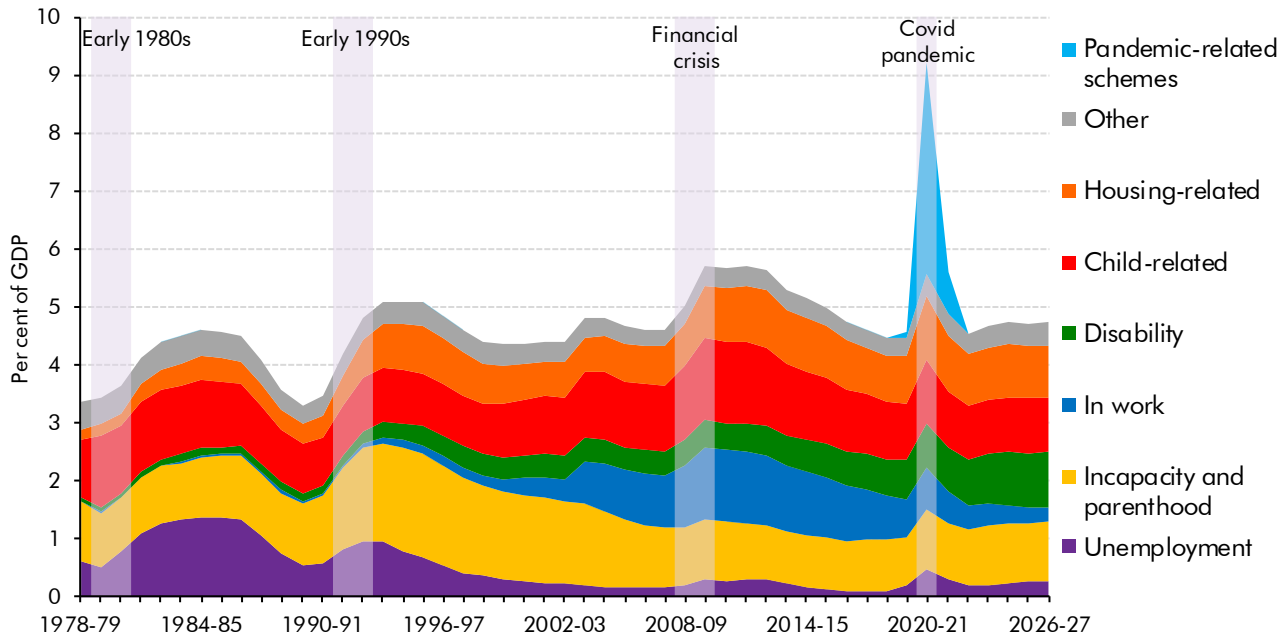
Trends in welfare spending

5 To navigate the frequent and often significant changes to the welfare system over the past half-century – including the rollout of universal credit (UC) and the creation of temporary pandemic-related schemes in recent years – we split non-pensioner spending into eight broadly consistent categories that look through various reforms and are based on the purpose of that spending. Three of these capture the main eligibility and conditionality groupings for adults in UC and the pre-UC 'legacy' benefit systems: unemployment benefits, incapacity and parenthood benefits, and in-work benefits; four capture the

particular circumstances or costs faced by different households (some of which are delivered by UC today): disability benefits, child-related benefits, housing-related benefits, and 'other' benefits; and the eighth comprises the temporary pandemic-related schemes that supported incomes through the worst of the pandemic but have now been withdrawn: the coronavirus job retention scheme (CJRS) and self-employment income support scheme (SEISS).

6 Total spending across these categories increased as a share of national income following each of the past four recessions (Chart 2), with successively higher peaks, reaching 4½, 5, and 5½ per cent of GDP, but these are dwarfed by the 9 per cent of GDP peak reached in the pandemic as a result of the unprecedented cost of the CJRS in particular. Relative to previous recessions, the pandemic is also notable for the speed of both the rise and subsequent fall in welfare spending, reflecting the rapid introduction and then withdrawal of the pandemic-related schemes and other temporary welfare measures. Based on our most recent forecast and government policies as they stood at the time of the March 2022 Spring Statement, the pandemic-induced recession has had the smallest impact on the medium-term level of welfare spending of any of the past four recessions.

Chart 2: Non-pensioner welfare spending by category



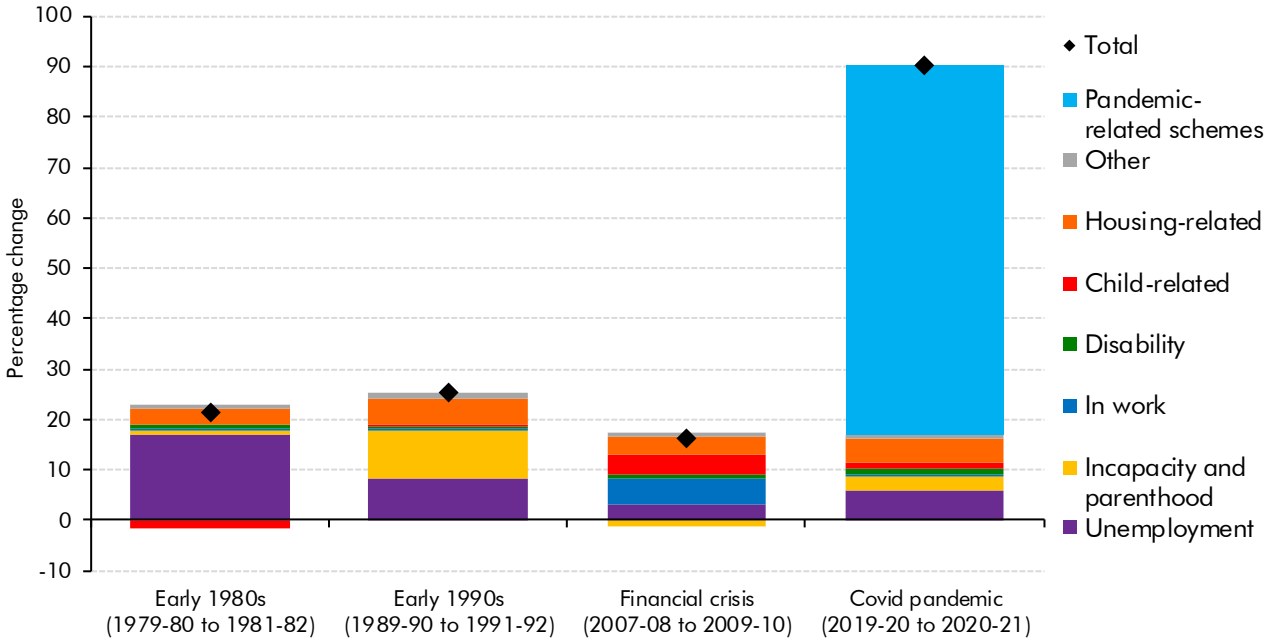
Source: DWP, HMRC, OBR

Welfare spending in recessions

7 Including the cost of the CJRS and SEISS, welfare spending in the pandemic rose by 90 per cent in CPI-adjusted real terms in one year (2020-21) (Chart 3), five times the rise excluding them and far larger than any of the initial increases in previous recessions (which we measure over the *two* years from the fiscal year before the recession's onset rather than one, reflecting the less abrupt nature of those economic shocks compared to the pandemic). These temporary interventions therefore represent the largest difference between the pandemic and preceding recessions. This reflects both their scale – they cost £78.2 billion in

2020-21 (and £97.4 billion overall) and supported the incomes of 11.5 million people at their peak – and the fact that they greatly reduced the initial impact of the pandemic on conventional welfare spending by preventing job losses and sharper falls in earnings.

Chart 3: Initial change in real non-pensioner welfare spending in recessions



Source: DWP, HMRC, OBR

8 The extent to which the CJRS and SEISS cushioned the pandemic-induced blow to conventional welfare spending is illustrated by the fact that despite a much deeper recession and the multi-billion pound cost of the temporary boost to UC and other measures, the rise in (non-CJRS, non-SEISS) welfare spending in 2020-21 was of a similar magnitude to that in previous recessions. Indeed, the 17 per cent real-terms rise in conventional non-pensioner welfare spending in 2020-21 was less than the rises of 21 per cent in the first two years of the early-1980s recession and 25 per cent in the early 1990s, and only slightly more than the 16 per cent in the first two years of the financial crisis.

9 Turning to each category of non-pensioner welfare spending:

- **Unemployment benefits** spending made a larger *contribution to the overall rise in welfare spending* in the early-1980s and early-1990s recessions than in the pandemic (shown in Chart 3). But the real-terms (CPI-adjusted) *percentage increase* in this category of spending of almost 160 per cent in 2020-21 was larger than in the first two years of any of the preceding recessions, reflecting the fact that unemployment benefits have declined as a share of spending over time. The real percentage increase in the preceding three recessions was mainly driven by rising unemployment pushing up caseloads. But the rise in the first year of the pandemic largely reflected: first, an increase in the caseload over and above the rise in unemployment (over half of the total increase), as heightened uncertainty led to a spike in claims and various easements to claims processes and conditionality effectively increased eligibility; and

second, higher average awards (around 25 per cent of the increase) largely reflecting the £20-a-week rise in the standard allowance in UC.

- **Incapacity and parenthood benefits** spending rose by around 15 per cent in real terms in 2020-21, around half the initial rise in the early-1990s recession. In both cases these increases were driven by a combination of rising working-age inactivity, an increase in the caseload over and above this (particularly in the early 1990s when changes to the operation of benefits saw flows from unemployment benefit onto incapacity benefit) and higher average awards (again reflecting the £20-a-week uplift in the case of the pandemic). Incapacity and parenthood spending actually fell in the financial crisis, due to a fall in the caseload relative to broader measures of inactivity as the introduction of employment and support allowance (ESA) tightened eligibility.

- Real-terms spending on **in-work benefits** rose by just 1 per cent in 2020-21, tempered by the much larger amounts of support provided by the CJRS and SEISS. That compares to a rise of 24 per cent in the financial crisis, driven by the in-work benefit system's automatic stabiliser effect in a recession in which real pay fell, and by discretionary increases to tax credit rates announced in successive Budgets.

- **Disability benefits** spending rose by 8 per cent in real terms in 2020-21, similar to the initial rise in the financial crisis but less than half that in the early 1980s and early 1990s. The larger percentage increases in the first two recessions reflect larger rises in caseloads, and the fact that disability benefits spending made up a much smaller proportion of overall non-pensioner welfare spending at the time.

- Real spending on **child-related benefits** rose by 6 per cent in 2020-21, much less than the 18 per cent initial increase in the financial crisis. This reflected the decision to increase child tax credit rates during the financial crisis, on top of the effects of a rising child benefit caseload in a period when births were rising.

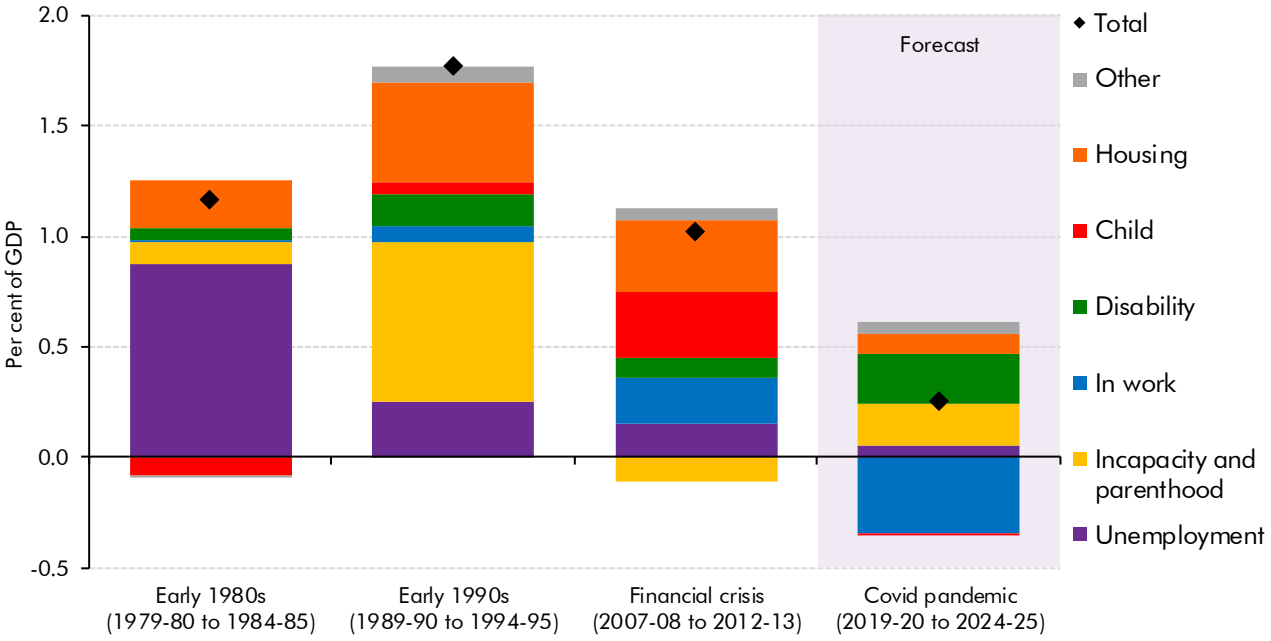
- Real spending on **housing-related benefits** rose by 27 per cent in 2020-21, reflecting a 23 per cent increase in the caseload thanks to the spike in UC claims and higher awards as a result of a policy choice to raise local housing allowance. This was similar to the unemployment-driven spending increase in the financial crisis but is only half the size of the rise in either of the preceding two recessions. These earlier rises reflected sharper increases in unemployment pushing up caseloads in the early 1980s and a rise in average awards associated with the deregulation of the private-rented sector and reductions in subsidies for social housing raising rents in the early 1990s.

Welfare spending in recoveries

10 While the immediate impact of recessions on welfare spending can be material, what matters most from a fiscal sustainability perspective is any medium-term changes in their aftermath. Based on our latest forecast, non-pensioner welfare spending is expected to rise by 0.3 per cent of GDP in the five years from the onset of the pandemic, which if it comes to pass would be less than one-third of the rise that followed any of the other recessions we

consider (Chart 4). Of course, there is considerable uncertainty around our forecast, so comparing it to outturns from previous post-recession periods should not be considered a like-for-like comparison. It shows how our latest judgements compare with the experience of history, but clearly there is scope for changes to underlying economic developments or policy settings to mean reality will differ from the picture painted by our latest forecast.

Chart 4: Medium-term change in non-pensioner welfare spending after recessions



Source: DWP, HMRC, OBR

11 Bearing these caveats in mind, looking at the medium-term changes in each category of non-pensioner welfare spending following recessions shows that:

- Spending on **unemployment benefits** is expected to rise by 0.1 per cent of GDP in 2024-25 relative to its pre-recession level. That would be much smaller than the five-year rises of 0.9 per cent of GDP, 0.3 per cent of GDP and 0.2 per cent of GDP following the early-1980s recession, early-1990s recession and financial crisis respectively. The majority of the rise in each of these three earlier recessions was explained by the impact of persistently higher unemployment on caseloads. The very small rise after the pandemic is more than explained by a higher medium-term caseload relative to unemployment in the economy, which largely reflects the wider scope of the 'intensive work search' conditionality group within UC.

- Spending on **incapacity and parenthood** benefits is expected to be 0.2 per cent of GDP higher in 2024-25 than its pre-pandemic level, driven by a modest rise in working-age inactivity and a shift in its composition towards health-related reasons (which are more likely to correspond with benefit eligibility) increasing the caseload-to-inactivity ratio. These pandemic-induced health and inactivity changes come on top of a continuation of the longer-term rise in the prevalence of (particularly mental) health issues within the working-age population. The increase we forecast following the pandemic would

be similar to the medium-term rise in the early 1980s, but is less than one-third of that in the early 1990s. The 1990s rise reflected a growing share of (mainly older) working-age men moving onto incapacity benefits as the unemployment benefits regime was tightened relative to incapacity benefits. Incapacity and parenthood benefits spending five years on from the financial crisis fell by 0.1 per cent of GDP relative to its pre-crisis level, largely reflecting the introduction of ESA and the gradual restriction of income support to parents of younger children from 2008.

- Spending on **in-work benefits** is forecast to *fall* by 0.3 per cent of GDP from 2019-20 to 2024-25, despite the boost from the higher UC work allowances and lower taper rate that were announced in the October 2021 Budget. This is in contrast to a 0.2 per cent of GDP rise in the five years following the onset of the financial crisis. The fall in our forecast reflects a 32 per cent fall in the caseload and is driven by a number of factors, including: a classification issue relating to the treatment of couples in UC in which one person is working and the other is not, relative to the legacy system, which could explain up to one-third of the fall; 'fiscal drag' – nominal earnings rising modestly faster than CPI-linked benefit rates in our forecast – taking some people out of eligibility; UC being less generous than tax credits for the self-employed; and savings associated with the gradual rollout of the two-child limit from 2017 onwards.

- Spending on **disability benefits** is expected to rise by 0.2 per cent of GDP in the five years from the onset of the pandemic. This would be the *largest* increase of any of the recessions covered in this report (and more than twice the size of the medium-term increase following the early-1980s recession and the financial crisis). This reflects rising caseloads, driven by a continuation of the longer-term rise in disability prevalence, and our judgements in respect of the long-term impacts of Covid and the pandemic's indirect implications for the health system and mental health prevalence.

- Spending on **child-related benefits** is forecast to fall slightly (by less than 0.1 per cent of GDP) in the five years from the onset of the pandemic, reflecting continued declines in the caseload due to the increasing reach of the high-income child benefit charge, amplified somewhat by a reduction in new claims to child benefit during lockdowns that does not fully unwind over our forecast for the affected cohorts of new-borns. There was also a caseload-driven decline following the early-1980s recession reflecting falling births, whereas in the five years following the financial crisis spending rose by 0.3 per cent of GDP. This was the result of both rising child benefit caseloads (thanks to rising births) and policy changes in the aftermath of the crisis that increased the generosity of child tax credits.

- **Housing-related benefits** spending is expected to rise by just 0.1 per cent of GDP in the five years from the onset of the pandemic, mirrored in a rise in housing-related benefit caseloads. This is the *smallest* increase in any of the four recessions, reflecting our assumptions of no unemployment scarring and no material changes to housing tenure or rents over the forecast period. Spending grew by much more following the three preceding recessions due to: the large increase in unemployment in the 1980s; rising rents in the 1990s raising awards, as a result of the deregulation of the private-rented

sector and falling subsidies for social housing; and in the 2000s, both rising rents and a falling share of social renters within the caseload, mirroring the rise in private renting in the overall population.

Risks and uncertainties

12 This comparison of our forecast for welfare spending changes in the wake of the pandemic to those seen in outturn after previous recessions points to some key risks and uncertainties:

- One category of risks relates to the **outlook for the economy**, and particularly the labour market. Our expectation that unemployment will remain broadly flat is reflected in a much smaller rise in unemployment and housing-related benefits spending in our forecast than in past recessions; whereas rising economic inactivity due to ill-health has the opposite effect, raising spending on both incapacity and parenthood benefits, and disability benefits, relative to historical experience. A 1 percentage point higher unemployment rate in 2024-25 would increase non-pensioner welfare spending by £2.1 billion, while doubling the 210,000 rise in inactivity assumed in our central forecast could add £2.7 billion. Lower unemployment or less severe scarring would have the opposite effects. More broadly, more or less severe pandemic-related economic scarring than our assumption of a 2 per cent reduction in potential output would have wide-ranging implications for welfare spending via productivity, migration, and the sustainability of any given amount of cash spending.

- A second category of risks relates to **policy choices and the operation of the welfare system**. These include lags in benefit uprating in the face of rapidly rising inflation, causing the real value of benefits to fall by historically unprecedented amounts this year, temporarily reducing the real value of benefits (including those for pensioners) by £12 billion before they largely catch up with inflation again next year. The associated squeeze on real incomes also creates a risk of increased take-up of various benefits relative to the assumptions in our forecast, as households seek to protect incomes. Each 1 per cent rise in non-pensioner welfare spending is worth £1.3 billion. And there are risks around the reduction in the cost of fraud and error in UC assumed in our forecast from the very high levels seen in 2020-21, including the savings associated with new policies aimed at reducing fraud and error.

13 Finally, a weaker near-term growth outlook due to persistently higher energy prices caused by the Russian invasion of Ukraine has heightened the risk of another recession this year. As this report demonstrates, the initial and lasting consequences of recessions for welfare spending differ greatly depending on how they manifest themselves economically, and how policy responds. But in all cases welfare spending rises sharply in the near term and in most cases recessions leave spending higher in the medium term. Recessions can also shape future welfare policy as governments seek to respond to subsequent developments.

1 Introduction

1.1 '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 for people of all ages, and the novel policies introduced to cushion people's incomes from the blow of pandemic-induced lockdowns. Our *Welfare trends reports* (*WTR*s) focus on benefits and tax credits, which transfer cash from some parts of the population to others who are eligible. In this report we also include the pandemic-related income support schemes given that they played a similar role to conventional welfare spending, and on a very large scale.

1.2 This year's *WTR* focuses on the changes in non-pensioner welfare spending in the UK during and after recessions. This is motivated by the fact that the UK is emerging from the worst of the Covid pandemic that precipitated the deepest recession in around a century, the effects of which have reshaped welfare spending over the past couple of years and are likely to continue to do so across our forecasts. It may also be timely as the energy price shock emanating from Russia's invasion of Ukraine has heightened the risk that the UK economy falls into another recession this year. We set current developments in the context of changes in welfare spending around the three other UK recessions in the past 40 years: those in the early 1980s and early 1990s, and the one caused by the financial crisis in the late 2000s.

1.3 Our focus throughout is on spending related to benefits provided to people of working age and their children, meaning we exclude spending on pensioners. This is because non-pensioner welfare spending tends to be more countercyclical than spending on pensioners: caseloads typically rise when economic output weakens and unemployment rises (and vice versa), and discretionary welfare policy changes to support households and the economy in the wake of recessions also tend to be focused on this part of the welfare system. This means we do not focus on the part of the population most directly and seriously affected by the pandemic. The vast majority of the almost 180,000 Covid deaths that have been recorded in the UK were among those above pension age. And as set out in our December 2021 *Forecast evaluation report*, the cost of pensioner benefits in 2020-21 was 0.8 per cent lower than our pre-pandemic forecast, which was in line with the 100,000 excess deaths in 2020-21 among those aged 65 and over – 0.8 per cent of the population at that age.

1.4 In this chapter we introduce the metrics and methodological approach that we use to analyse the evolution of welfare spending over time. We then introduce the Covid pandemic and the other three recessions under consideration; summarise trends in non-pensioner welfare spending and caseloads over almost five decades; and explore the welfare policy interventions in each of the four recessions we analyse. Finally, we set out what the subsequent chapters of this report cover.

How we measure and analyse welfare spending

1.5 Our *WTR*s focus on those elements of benefit and tax credit spending in the UK that are financed by central government as part of what the Treasury calls 'annually managed expenditure' (AME). 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 UK; and
- the **Department for Communities** for most benefits in Northern Ireland.

1.6 In addition, under the fiscal framework between the UK and Scottish Governments, responsibility for some benefits paid to people resident in Scotland has been transferred to the Scottish Government: carer's allowance and several disability benefits were transferred in the 2018-19 and 2020-21 fiscal years respectively, while cold weather payments were transferred at the start of 2022-23. In our *Economic and fiscal outlooks* (*EFO*s), Scottish Government spending on these benefits is captured separately from our welfare spending forecast.[1] For the purposes of this *WTR*, we have added Scottish block grant spending in these areas to our latest *EFO* forecast so that total UK welfare spending is presented on a more historically comparable basis.[2]

1.7 In describing how welfare spending evolves over time, different metrics are appropriate for different purposes. The three we use most often are:

- **Spending in cash or nominal terms**. This is simply the cash amount spent in a given period. But without putting the cash amount in context – by asking what recipients could buy with it or how much national income is available to fund it – interpreting changes in cash spending is difficult, particularly over longer time periods.
- **Spending in real terms**. Trends in cash spending can be adjusted for whole-economy or consumer price inflation. This gives a sense of the volume of goods and services that could be purchased with that spending – either across the whole economy or in the hands of the recipients.
- **Spending as a share of national income**. Trends in cash spending can be related to the cash value of the economic activity that can be taxed to finance it. This is the metric that is most relevant when considering the sustainability of the public finances.

[1] Specifically, it is captured within overall Scottish Government AME spending, which we do not break down further into the various public services, social security, and other activities it comprises. Under the fiscal framework, there is a Scottish welfare block grant adjustment (BGA) associated with the transfer of responsibilities. 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. The BGA relates to the cost of the responsibilities transferred at the time of transfer, uprated in line with the UK Government's expenditure on the non-devolved benefit, and therefore does not reflect any changes the Scottish Government has made to policy settings.

[2] This is not a perfect proxy, since the Scottish Government has made several of the benefits it now sets more generous.

1.8 Other metrics include welfare spending as a share of total public spending (illustrating the trade-offs with other priorities within a given spending envelope), relative to revenues (a more direct comparison with the resources available to finance it) or in per-person terms (allowing it to be related more directly to individual incomes or living standards).

1.9 In general, our preference when looking at changes over time is to use spending as a share of national income (as we have done in past *WTR*s). But this measure can become distorted or harder to interpret when large changes in GDP occur at the same time as changes in cash spending. This is particularly the case in recessions, when (by definition) real GDP falls, while cash welfare spending often rises sharply. Given this report is focused on recessions, and that the fall in GDP at the onset of the pandemic that is our particular focus was historically very large, amplifying these distortionary effects, we instead focus on changes in CPI-adjusted real spending in the short term. For our assessment of welfare spending over medium-term recovery periods, we revert to our preferred measure of spending as a share of national income, as economic output has largely recovered by this stage.

1.10 We use the change in welfare spending over time, relative to the pre-recession level, to proxy for differences relative to pre-recession expectations. This is of course imperfect because other non-recession-related factors contribute to those changes, such as long-running structural changes in the labour and housing markets, and demographics. But it is the best approach available to us given we lack pre-recession medium-term forecasts to compare subsequent outcomes to for the earlier recessions. To help disentangle the most important of these effects, at the end of the following chapter we briefly detail those longer-term trends most relevant to changes in welfare spending over the past half-century.

Categorising non-pensioner welfare spending

1.11 There are different ways in which overall non-pensioner welfare spending can be split. For the purposes of our *EFO*s, we report spending inside and outside the welfare cap,[3] as well as looking at the breakdown by individual benefit. But the welfare system has changed frequently, and often significantly, over the past half-century – with individual benefits introduced, replaced, merged or reformed over time. It is currently in the process of changing again as universal credit (UC) is being rolled out to replace multiple working-age benefits, while pandemic-related schemes have recently been created, operated, and then withdrawn in the space of 18 months. In this *WTR* we split non-pensioner spending into eight broadly consistent categories based on the purpose of that spending.

1.12 Three of these categories capture the main eligibility and conditionality groupings for adults in the **UC and pre-UC 'legacy' benefit systems**:[4]

[3] The welfare cap requires that a subset of welfare spending (excluding the state pension and those elements of non-pensioner spending most sensitive to the economic cycle) in 2024-25 is contained within a pre-determined, inflation-adjusted cap set by the Treasury.
[4] There are six conditionality groups within UC that vary in the work-related behaviours or activities that individuals must adhere to in order to receive benefits: (1) 'intensive work search': those out of work and expected to look for work, or on very low earnings; (2) 'work preparation': those who because of health, disability or caring responsibilities have limited capability for work but are expected to take relevant steps to prepare; (3) 'work-focused interview': those with caring responsibilities for very young children, who are expected to

- **Unemployment benefits**. This initially comprises just unemployment benefit, and then its successor jobseeker's allowance, and more recently standard (adult) payments for those in the equivalent 'intensive work search' conditionality group in UC too.

- **Incapacity and parenthood benefits**. This comprises means-tested and contributory support for those whose health condition is deemed to limit their capability to work, and for parents – covering sickness benefits, incapacity benefit, employment and support allowance, income support, and out-of-work claimants in the less intensive conditionality groups in UC.

- **In-work benefits** (which we have previously described as 'low-income benefits'). These comprise successive forms of tax credits for working families, and also equivalent adult and child payments for those in the in-work conditionality groups in UC.

1.13 Four of the other categories relate to the **particular circumstances or costs faced by different households** and are consistent with approaches in previous *WTRs*: **disability benefits** that are designed to cover the extra costs associated with health issues or disabilities (mainly disability living allowance and personal independence payment); **child-related benefits** (mainly child benefit, child tax credit for out-of-work families, and child elements for those in out-of-work conditionality groups in UC); **housing-related benefits** (housing benefit and the housing element within UC) and **'other' benefits** (mainly carer's allowance, industrial injuries benefits, Northern Ireland spending, and other smaller benefits).

1.14 Finally, in addition to these conventional welfare benefits and tax credits, in this report we include an eighth category – **pandemic-related schemes** – which captures payments to individuals under the coronavirus job retention scheme (CJRS) and the self-employment income support scheme (SEISS). These schemes are not treated as welfare spending in the public finance statistics (they are instead treated as subsidies to employers). But in an economic sense they performed a similar role – in effect creating more generous, though temporary, benefit systems that supported people who were not working, or were working reduced hours, but were still connected to their employers or self-employed businesses, while public health restrictions were in place. These schemes sit somewhere between unemployment benefits and in-work benefits in the categorisation above.

1.15 Given the scale of change to the welfare system over the past five decades and particularly since the rollout of UC began in 2013, identifying consistent categories of spending in this way is difficult and imperfect. Our approach identifies equivalent spending as far as is possible on the basis of eligibility criteria for different payments, and the associated conditionality requirements, in order to make meaningful comparisons over a long period. But some inconsistencies are unavoidable. Where changes in the regime look to have created material differences (particularly in terms of the classification of 'in-work' spending in UC), we identify these and discuss their implications for our analysis.

attend periodic interviews; (4) 'no work requirements': those whose health or caring responsibilities mean they are not expected to work at present; (5) 'working – with requirements': those in work and earning below a given threshold, expected to take steps to increase their hours or earnings; and (6) 'working – no requirements': those in work and earning above a given threshold.

Decomposing changes in welfare spending

1.16 When analysing trends in welfare spending there are several different drivers to take into account. Our central approach in previous *WTR*s has been to split the drivers for individual benefits into those that affect the number of recipients of a benefit – the **caseload** (which can be further decomposed into movements in line with changes in the relevant population and those above or below that, for example due to changes in eligibility or take-up) – and those that affect the amount paid to each recipient – the **average award**. Total spending on each benefit and the average caseload in each year are derived from administrative data, with the average award calculated from the relationship between the two.[5]

1.17 We continue to use this approach in this report to understand the drivers of changes in welfare spending during and after recessions. But it is not possible to apply it to *overall* changes in non-pensioner welfare spending, or to apply it accurately to some of the spending categories described above, because the introduction of UC means we cannot identify consistent caseload numbers.[6] So we focus on decomposing spending changes in this way for the two categories of spending that support the incomes of out-of-work families – unemployment benefits and incapacity and parenthood benefits – for which we *can* identify broadly consistent caseloads over time. Fortunately, these are also the categories of most interest given our focus on recessions, and that the most recent of these was driven by a health crisis that we expect to have lasting implications for incapacity-related spending.

Welfare spending and recessions

1.18 Recessions and their aftermaths are central to understanding past and future changes in welfare spending because they are associated with rises in unemployment, shortfalls in household income growth, business failures, and are often associated with disruptions in housing and other markets. All these things – in combination with the policy choices of governments in response to them – can affect welfare spending both directly and indirectly. Here we summarise the key features of the four UK recessions that our analysis focuses on.

Four UK recessions compared

1.19 The Covid-19 pandemic has so far taken 6.3 million lives worldwide and almost 180,000 in the UK. From the first lockdown commencing in March 2020, six of the following 12 months in England were spent in three separate lockdowns, with public health restrictions of varying degrees in place in the remaining months. These lockdowns, combined with voluntary social distancing on the part of individuals, resulted in the effective closure of many sectors of the economy – albeit with the impact of later lockdowns on activity more limited, as businesses and consumers found ways to adapt to restrictions. Economic output in the UK fell by 25 per cent between January 2020 and the trough in April 2020; and in 2020-21 the Government

[5] For further details on this approach and how to interpret its results, see paragraphs 1.14 to 1.18 in our 2014 *Welfare trends report*.
[6] For example, because recipients of two different benefits are counted separately in the administrative caseload for each, and we do not know the degree of overlap, which itself will have changed over time. This is particularly the case with the rollout of UC in effect turning multiple legacy benefit recipients into single recipients of UC, even though they are in receipt of the same forms of support via UC elements instead of via two or more separate legacy benefits.

ran up the largest peacetime budget deficit in UK history. But the unemployment rate peaked at only 5.2 per cent, largely thanks to unprecedented government support for households and businesses (described below), whereas total hours worked fell by 18 per cent between the first and second quarters of 2020.

1.20 Part of the rationale for the Government delivering such unprecedented support for incomes – and the reason why it was possible for the rise in unemployment to be cushioned so successfully – was that the Covid recession was predominantly a temporary disruption to the pattern of economic activity caused by a shock that originated outside the economy. The rapid development and rollout of vaccines was the ultimate policy response to the underlying source of the economic shock, with the pandemic-related schemes essentially filling the hole that would otherwise have been left in private-sector incomes in the intervening period. This marks the pandemic out from the three recessions preceding it:[7]

- The **early-1980s recession**. A synchronised global downturn resulting from high inflation following the doubling of oil prices in 1979. Domestic policy responded by tightening fiscal and monetary policy, leading to a deep recession that had lasting consequences for output in different sectors of the economy (particularly manufacturing) and in different parts of the country. GDP fell by 4.1 per cent between the final quarter of 1979 and the first quarter of 1981, while unemployment reached a post-World War II peak of 11.9 per cent in 1984.

- The **early-1990s recession**. A domestic policy shock caused by sharply rising inflation and increases in interest rates, which hit the real economy and the housing market. Interest rates were raised in response to rising inflation following the economic boom of the late 1980s, and to maintain the required exchange rate parity in the failed attempt to maintain Britain's membership of the European exchange rate mechanism. GDP fell by 2.1 per cent between the second quarter of 1990 and the third quarter of 1991, while unemployment peaked at 10.7 per cent in 1993.

- The **financial crisis**. A shock precipitated by the US sub-prime mortgage crisis, but which revealed widespread problems in financial systems and catalysed a global financial crisis. The UK joined many advanced economies in deep recessions as confidence and credit evaporated, with housing and equity markets hit particularly hard. Domestic policy responded by providing liquidity support to the financial system, and via lower interest rates, quantitative easing and fiscal stimulus. GDP fell by 5.9 per cent between the first quarter of 2008 and the second quarter of 2009, and unemployment continued to rise until it reached a peak of 8.5 per cent in 2011.

1.21 A more detailed assessment of these four recessions is provided in Chapter 2.

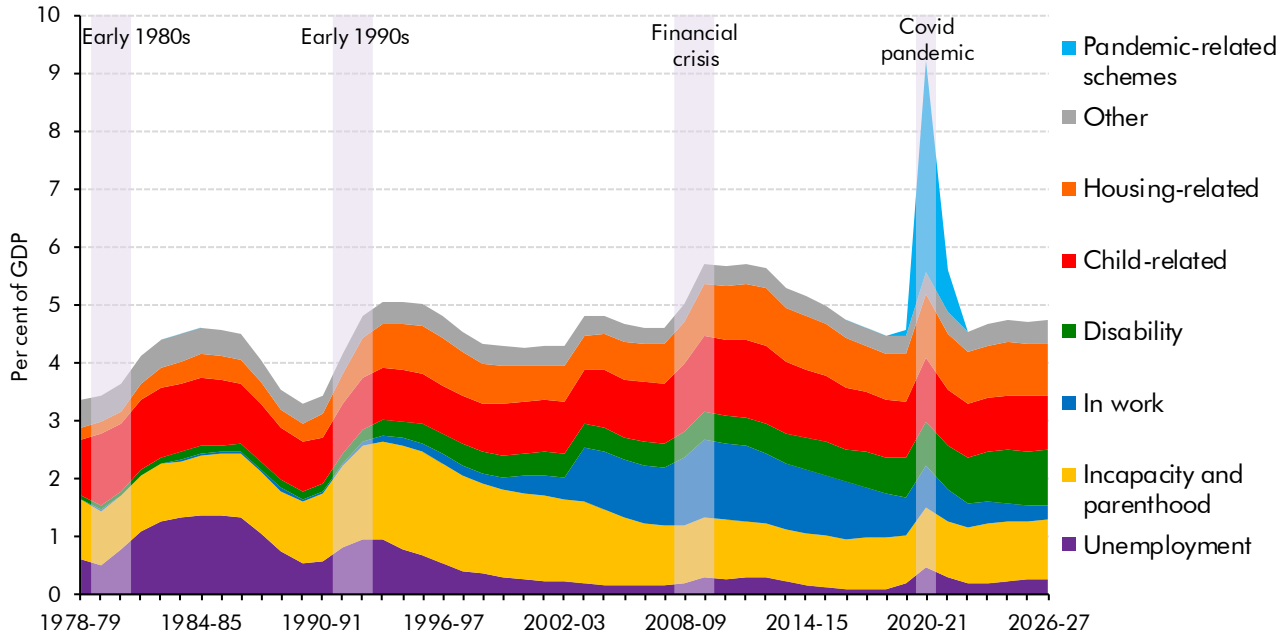
[7] For further detail, see paragraph 3.40 in our 2017 *Fiscal risks report*.

Historical trends in non-pensioner welfare spending

1.22 Welfare spending increased as a share of national income following each of the past four recessions (Chart 1.1), reaching successively higher peaks after each one. At its high point, the increase in spending around the pandemic was far larger than those around the other recessions due to the unprecedented cost of the CJRS in particular. The pandemic is also notable for the very sharp increase being followed by an equally sharp decline in spending, reflecting the withdrawal of these temporary pandemic-related schemes and other temporary increases in the generosity of conventional welfare spending too. Both the rises and falls in spending were more gradual around the three previous recessions.

1.23 The categories responsible for the increase also vary by recession. While unemployment benefits made up much of the increase in the early-1980s and early-1990s recessions, in the financial crisis child-related and in-work benefits played a bigger role (partly as a result of policy decisions, discussed below). In the pandemic, the increase in unemployment benefits spending was very much smaller than the cost of spending on pandemic-related income support schemes. These dynamics are explored in more detail in Chapter 3.

Chart 1.1: Non-pensioner welfare spending by category

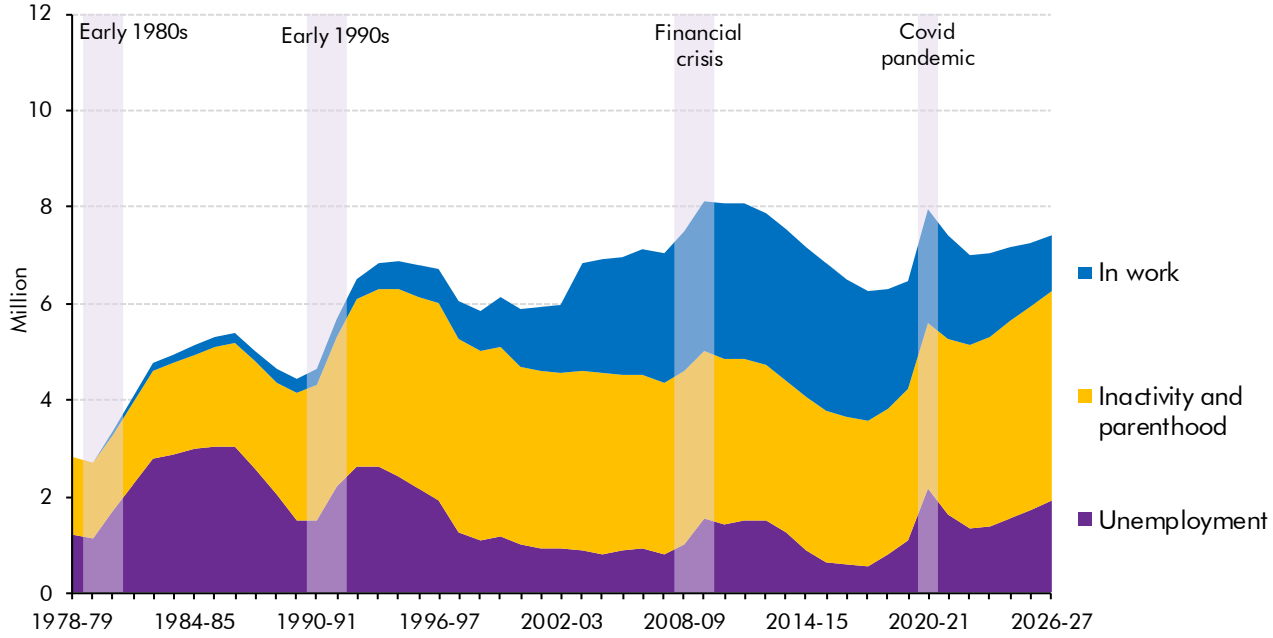


Source: DWP, HMRC, OBR

1.24 Focusing on the three categories of spending for which we can identify consistent caseloads over time, Chart 1.2 shows similar trends in non-pensioner welfare caseloads. Caseloads increased in each recession to successively higher peaks in the first three recessions, with the pandemic peak in conventional welfare caseloads similar to that in the financial crisis. The financial crisis had the smallest initial caseload *increase*, while caseloads actually fell in the medium term due to policies that served to restrict eligibility. Outside recessions, caseloads rose significantly in the early 2000s due to the expansion of in-work support via tax credits.

1.25 Of course, the pandemic peak would be significantly higher than those in the previous recessions if the millions of CJRS and SEISS beneficiaries were included, but it is very difficult to determine the overlap between these and the in-work caseload precisely. Snapshots from May and July 2020 show that just under 1 million UC and tax credits recipients were furloughed via the CJRS at those times, suggesting that around 8 million CJRS beneficiaries at that time were not part of the in-work caseload. Indeed, even if the overlap were complete and all 2.4 million in-work cases in 2020-21 were also in receipt of the CJRS or SEISS, that would still leave over 9.1 million people on pandemic-related schemes at their peak who were not also receiving in-work benefits. Adding these to the overall caseload for the three groups shown in Chart 1.2 would increase the caseload peak in 2020-21 to over twice the level reached as a result of the financial crisis.

Chart 1.2: Non-pensioner welfare caseloads for selected categories



Source: DWP, HMRC, OBR

1.26 While the immediate impact of recessions on welfare spending can be material, what matters most from a sustainability perspective is any medium-term impacts on spending in the aftermath of each recession. Table 1.1 shows that while the pandemic had the largest immediate increase in welfare spending broadly defined, we expect it to have the smallest effect five years after the onset of the recession, with the largest medium-term rise coming after the early-1990s recession. These medium-term impacts are explored in Chapter 4.

Table 1.1: Cumulative rise in non-pensioner welfare spending after recessions

Years after onset of recession	Early 1980s (from 1979-80)	Early 1990s (from 1989-90)	Financial crisis (from 2007-08)	Covid pandemic (from 2019-20)	Covid pandemic (including pandemic-related schemes)
Real-terms percentage change (CPI-adjusted)					
1	6.4	5.5	5.8	17.3	90.1
2	21.3	25.5	16.2	9.0	22.4
3	31.8	44.5	16.3	0.0	-2.1
4	41.2	57.6	15.2	4.9	2.7
5	**49.6**	**61.7**	**14.5**	**8.5**	6.2
Percentage point change as a share of GDP					
1	0.2	0.2	0.4	1.1	4.7
2	0.7	0.9	1.1	0.4	1.0
3	0.9	1.5	1.1	0.1	0.0
4	1.1	1.8	1.1	0.2	0.1
5	**1.2**	**1.8**	**1.0**	**0.3**	0.2

Note: Shading represents forecast years. There was £2.2 billion of spending on pandemic-related schemes in 2019-20, meaning that forecast years do not match up for the two Covid pandemic columns even once spending on the schemes reaches zero.

The welfare policy response to recessions

1.27 Welfare spending rises automatically in downturns – as individuals become unemployed and earnings growth slows, more people meet eligibility criteria for both out-of-work and in-work benefits. But governments often supplement these 'automatic stabiliser' effects with discretionary policy changes that provide greater support to households and thus boost welfare spending further still. This section sets out the main components of the discretionary policy responses that accompanied each of the past four UK recessions.

The welfare policy response to the pandemic

1.28 The policy response to the pandemic was in many ways unprecedented, with the greatest costs relating to the temporary income support schemes, the CJRS and SEISS:

- The Government announced **the CJRS** on 20 March 2020, four days after the initial restrictions on non-essential contact were announced and three days before the first full lockdown was imposed, with applications opening on 20 April. This paid employers a taxable grant to be passed onto employees that was worth 80 per cent of a furloughed employee's wages, up to a maximum of £2,500 a month, plus the associated employer NICs and minimum auto-enrolment employer pension contribution on the subsidised wage. Although this was initially announced as a three-month scheme, it was repeatedly extended, before finally closing in September 2021 (with the share of an employee's wage costs that were covered varying over time).

- **The SEISS** was announced on 26 March and comprised a taxable grant worth 80 per cent of average monthly profits for the self-employed over the preceding three tax years, up to a maximum of £7,500. Subsequent grants provided a reduced share of average monthly profits and introduced tighter eligibility tests, with a total of five grants covering the period until September 2021.

These two schemes had a gross cost (i.e. excluding tax paid on the associated income) of £78.2 billion in 2020-21 and £97.4 billion in total.[8]

1.29 In addition, the Government announced several policy measures designed to provide greater financial support to recipients of UC (and some legacy benefits), and to ease the administration of the benefits system, costing £8.0 billion in 2020-21. The main contributors to that cost were:

- The **temporary £20-a-week increase in the UC standard allowances**, costing £4.2 billion in 2020-21 (and a further £2.2 billion in 2021-22). The bulk of the cost of the measure came from most claimants receiving the full £20-a-week uplift. But some 'nil award' claimants no longer had their award fully tapered (so they became an in-payment case as a result of the measure expanding eligibility).

- A **temporary boost to the basic element of working tax credits** (WTCs), equivalent to the £20-a-week increase in UC, costing £1.5 billion in 2020-21. There was also an additional one-off payment of £500 to tax credits claimants in April 2021, costing £0.8 billion (although this was not classified as welfare spending). A £20 additional earnings disregard in housing benefit also ensured that the majority of WTC claimants did not lose housing benefit as a consequence of higher WTC awards.

- **Raising local housing allowance rates** for eligible private renters to the 30th percentile of local rents in 2020-21 (before freezing rates in cash terms from 2021-22 onwards). This cost £0.9 billion in 2020-21 across UC and housing benefit.

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

1.30 Several other measures relating to the operation of the welfare system during the pandemic had more modest effects on spending. For example, DWP's recovery of benefit overpayments and debts was temporarily paused, while a range of health and job-related assessments and conditions placed on claimants were temporarily relaxed. These, alongside the fact that the UC system itself successfully handled a very large volume of claims in a way that it is far from clear the legacy system would have been able to, meant that financial support via the conventional welfare system reached families swiftly.

The policy response to previous recessions

1.31 The policy response to the pandemic was on a much larger scale than in any previous recession. By way of comparison, Table 1.2 outlines the key welfare policies introduced to provide individuals and families with support during the preceding three recessions. In the earlier recessions, support was more limited: a tightening of fiscal policy partly contributed to the onset of recession in the early 1980s, limiting the scope for a welfare policy response;

[8] The total includes £2.2 billion of CJRS spending that the ONS accrued to 2019-20 in respect of employees furloughed in March 2020.

while the fiscal stimulus in response to the financial crisis included only a relatively modest welfare spending increase of up to £2 to £3 billion a year. Beyond the immediate support phase, welfare policy *following* recessions can shift to reducing any lasting welfare costs that have resulted. This was most obviously the case following the financial crisis, as detailed in our 2016 *Welfare trends report*. While the largest effects of the policies to reduce welfare spending were felt beyond the five years following the onset of the financial crisis (the time period considered in this report), these post-financial crisis cuts in welfare spending form part of the context for the large policy response in the pandemic.

Table 1.2: The policy response to previous recessions

Component	Policy change	Fiscal impact
	Early 1980s	
Child-related benefits	The 1980-81 Budget included a 75p a week increase to child benefit	Cost not published
Unemployment benefits	The 1982-83 Budget included over-indexation of unemployment benefit, supplementary allowances and certain other benefits to restore a 2 per cent shortfall	Cost not published - met from within contingency reserve
	Early 1990s	
Child-related benefits	The 1991-92 Budget included an increase in child benefit by £1 a week for the eldest child in each family, and 25p a week for all other children, with corresponding increases in income support, and subsequent inflation indexation of child benefit	£450 million per year (ongoing) for the £1 a week increase in child benefit
	Financial crisis	
Child-related/in-work benefits	In the November 2008 Pre-Budget Report, the Government increased child tax credits (bringing forward a commitment to increase the child element of child tax credits by £25 a year in April 2010 to April 2009, giving a total increase of £75 a year above inflation). This statement also brought forward the usual indexation of child benefit from April 2009 to January 2009	£190 million to increase child tax credits (ongoing), and £170 million to bring forward indexation of child benefit (one-off)
	The 2009 Budget then announced a further £20 increase to child tax credits in April 2010	£140 million (ongoing)
	The 2010 Budget announced further increases for the child element of child tax credits for children aged one and two	Costs increasing to £2 billion a year (ongoing)
In-work benefits	The 2009 Pre-Budget Report extended working tax credits to those aged over 65, and in the 2010 Budget the number of hours worked for those aged over 60 to be eligible was reduced from 30 to 16	£5 million cost to extend working tax credits to over 65s (ongoing)
'Other' benefits	The 2008 Pre-Budget Report also included the introduction of the £190 health in pregnancy grant, a payment available to all women after the 25th week of pregnancy	Cost not published
	The 2009 Pre-Budget Report included bringing forward indexation benefits and tax credits (with a 1.5 per cent increase to benefits in April 2010, brought forward from the usual RPI indexation in April 2011)	£700 million (one-off)

Structure and approach of this report

1.32 The remainder of this report looks at the size and incidence of the past four recessions in the UK, and then explores the associated welfare spending changes over both the short and medium term, to depict the peak cyclical impact and the lasting structural impact of each recession. To assess the short-term impacts of recessions, we look at changes from the fiscal year prior to the onset of recession to the fiscal year in which GDP troughs. For the three pre-pandemic recessions this covers two years: 1979-80 to 1981-82 for the early-1980s recession; 1989-90 to 1991-92 for the early 1990s; and 2007-08 to 2009-10 for the financial crisis. The pandemic-induced recession and rebound was more rapid so in this case we look at the change over one year: 2019-20 to 2020-21. To assess the lasting impact of recessions we look at five-year periods from the year prior to the onset of each.

1.33 The report is structured as follows:

- Chapter 2 describes **economic outcomes in the past four recessions**, including the hit to real GDP and employment, working hours, productivity, pay and inflation. It also discusses some of the longer-running structural trends that continued to evolve in the background of these cyclical consequences of the recessions themselves.
- Chapter 3 discusses **initial changes in welfare spending** in these four recessions, overall and across the different categories of spending.
- Chapter 4 discusses **medium-term changes in welfare spending** over the post-recession recovery period, overall and by category.
- Chapter 5 considers **risks and uncertainties** around our latest forecast.

2 UK recessions compared

2.1 This chapter describes how past UK recessions unfolded across the economy. It looks at the size and speed of the hit to GDP and its recovery thereafter; the impact on the labour market in terms of employment, hours and productivity; and the effects on pay and prices. We primarily focus on these areas as they are the avenues through which the economy typically drives changes in welfare spending during recessions. Finally, we discuss some of the largely non-recession-related structural trends that were evolving in the background of these recessionary impacts, and therefore also contribute to changes in non-pensioner welfare spending during, and particularly in the aftermath of, these recessions.

GDP growth

2.2 Compared to the three prior recessions in the early 1980s, early 1990s and late 2000s, Chart 2.1 shows that the Covid pandemic stands out in both the speed and depth of the hit to real GDP:[1] the decline was 3½ times larger than that in the financial crisis (the second-most severe) and the low-point was reached three quarters quicker than in the early 1980s or the financial crisis (the next-fastest recessions). This reflects the fact that previous recessions propagated across the economy, whereas the pandemic involved the swift shutdown of large sections of it to manage the rapidly unfolding health crisis.

2.3 The pandemic also stands out in terms of the speed of the rebound in activity. Real GDP recovered from its low-point to the pre-recession peak over seven quarters, roughly the same time period as in the early-1990s recession despite the initial drop in output being around 10 times greater in the pandemic. This meant the very sharp downturn lasted only eight quarters, with the worst of it concentrated in the 2020-21 fiscal year. By contrast, real GDP had only just recovered its pre-recession peak around five years on from the start of the financial crisis – by far the most sluggish recovery.

2.4 The more rapid rebound from the pandemic recession reflects several factors. Among them:

- First, the fact that **the shock originated outside of the economy**, so to a large extent the economy could reopen as before following the successful deployment of vaccines that allowed public health restrictions to be lifted and voluntary reductions in activity to ease. By contrast, previous recessions were associated with the build-up of macroeconomic imbalances that entailed longer adjustment processes to unwind.

- Second, **the unprecedented level of government support for the economy** (detailed in Chapter 1), which was put in place to avoid the loss of viable businesses and jobs

[1] Our pre-recession baseline quarter for each recession is the quarter before the initial quarter of negative growth: Q4 1979 for the early-1980s recession; Q2 1990 for the early-1990s recession; Q1 2008 for the financial crisis; and Q4 2019 for the Covid pandemic.

while the public health crisis was being tackled – and was largely successful in doing so. Fiscal support was more modest in the 1990s recession and the financial crisis, while the 1980s recession was in part precipitated by a tightening of fiscal policy.

2.5 Despite the rapid recovery in output from the depth of the pandemic, we forecast relatively muted growth thereafter compared to each of these prior recessions. This slow medium-term growth reflects three factors:

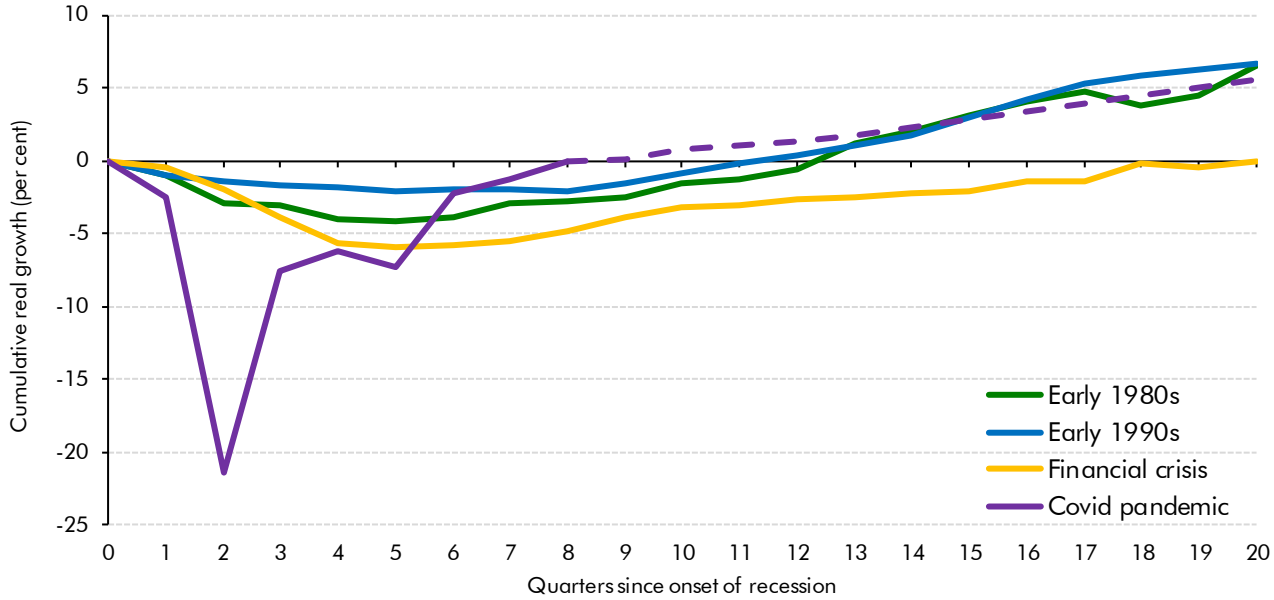
- First, the **slower growth in output and productivity in the aftermath of the financial crisis**, which has led us to downgrade our medium-term productivity assumptions. Between 2010 and 2015, growth in hourly productivity averaged just 0.6 per cent a year, having averaged 2.0 per cent a year in the pre-financial crisis decade. The largest downgrades to our underlying productivity growth assumptions were made in our March 2016 and November 2017 *Economic and fiscal outlooks*.[2]

- Second, the **impact of less trade openness as a result of Brexit**. Our forecast assumes the trade intensity of output in the UK will ultimately be 15 per cent lower than would otherwise have been the case as a result of leaving the EU and moving to trading with the EU under a free-trade agreement (a judgement that appears to be on track).[3] We assume that this will result in productivity being 4 per cent lower than would otherwise have been the case, which lowers GDP growth during the period of adjustment.[4] Finally, the post-Brexit migration regime is assumed to reduce the contribution of net inward migration to GDP growth relative to the pre-Brexit regime.[5]

- Third, it reflects **a modest degree of economic scarring from the pandemic itself**. Our latest forecast assumes potential output will be 2 per cent lower in the medium term relative to a pre-pandemic baseline, driven by: higher labour market inactivity, in particular due to a rise in the number of working-age adults unable to work due to ill-health; a smaller-than-expected population due to higher mortality and lower net inward migration; a smaller capital stock due to lower business investment; and finally, lower productivity as a consequence of disruptions to education and supply chains.[6]

[2] See also the discussion in our 2017 *Forecast evaluation report*.
[3] See Box 2.6 in our March 2022 *Economic and fiscal outlook*.
[4] See Box 2.1 in our March 2020 *Economic and fiscal outlook*.
[5] See Box 2.4 in our March 2020 *Economic and fiscal outlook*.
[6] See Annex C in our March 2022 *Economic and fiscal outlook*.

Chart 2.1: Change in real GDP by recession



Note: Solid lines show outturn data; dashed line shows forecast.
Source: ONS, OBR

The labour market

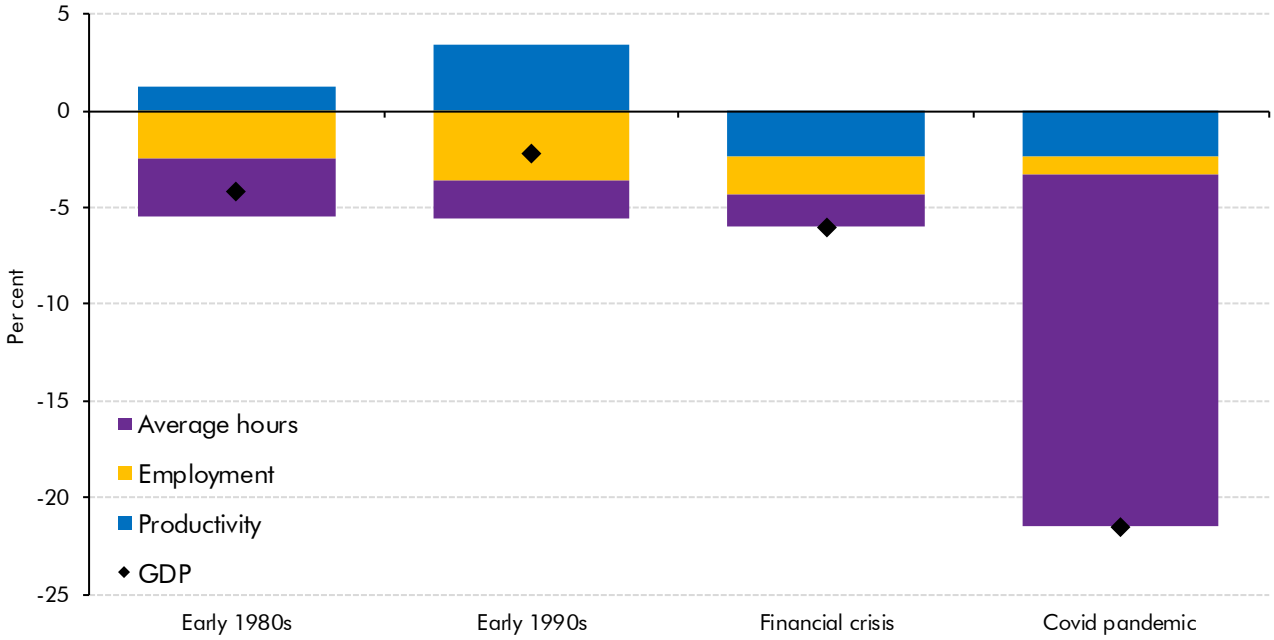
2.6 The impact of recessions on welfare spending depends not just on the scale of the shock to output, but also how it manifests itself in the labour market. For example, it is typically more fiscally costly for the shortfall in output to be concentrated in unemployment than to be spread more widely in fewer hours worked by those still in employment (although less so than in the past as unemployment-related benefits have fallen as a share of average earnings and in-work support for those on low incomes has expanded).

2.7 Chart 2.2 decomposes the peak-to-trough fall in GDP in these four recessions into contributions from employment, average hours, and productivity (output per hour worked). It shows relatively similar patterns in the early-1980s and early-1990s recessions, with both employment and average hours falling, while average productivity of those that remained in work *was higher* (especially in the early-1990s recession). By contrast, all three components contributed to the fall in output in the financial crisis, with a similar contribution from average hours as in those prior recessions, while that from employment was smaller, and productivity fell rather than rising (which was echoed in falling real pay, discussed below).

2.8 In the pandemic, the distribution of the drop in output across these three components contrasted with that in the previous three recessions. Despite a much larger hit to output, the contribution from falling employment was smaller than in any of the other three. And while productivity fell, its contribution was of a similar size to that in the financial crisis. Instead, the drop in output was almost entirely explained by declining average hours – as the furlough and self-employment support schemes subsidised the working of fewer hours than normal or no hours at all. People in this situation – notably the millions furloughed – were counted as in employment in the statistics (and were being paid) rather than as out of work.

This very different composition of the fall in output – facilitated by the exceptional fiscal support for the incomes of those working few or no hours – is key to the different way in which conventional welfare spending responded to the economic shock (Chapter 3).

Chart 2.2: Peak-to-trough real GDP fall in recessions by labour market component



Source: ONS, OBR

2.9 The lasting consequences of recessions for welfare spending depend not just on how output recovers but also any lasting effects on the labour market – in particular whether unemployment or inactivity rates remain elevated relative to pre-recession norms. Charts 2.3 and 2.4 depict these trends over the past four recessions, showing that:

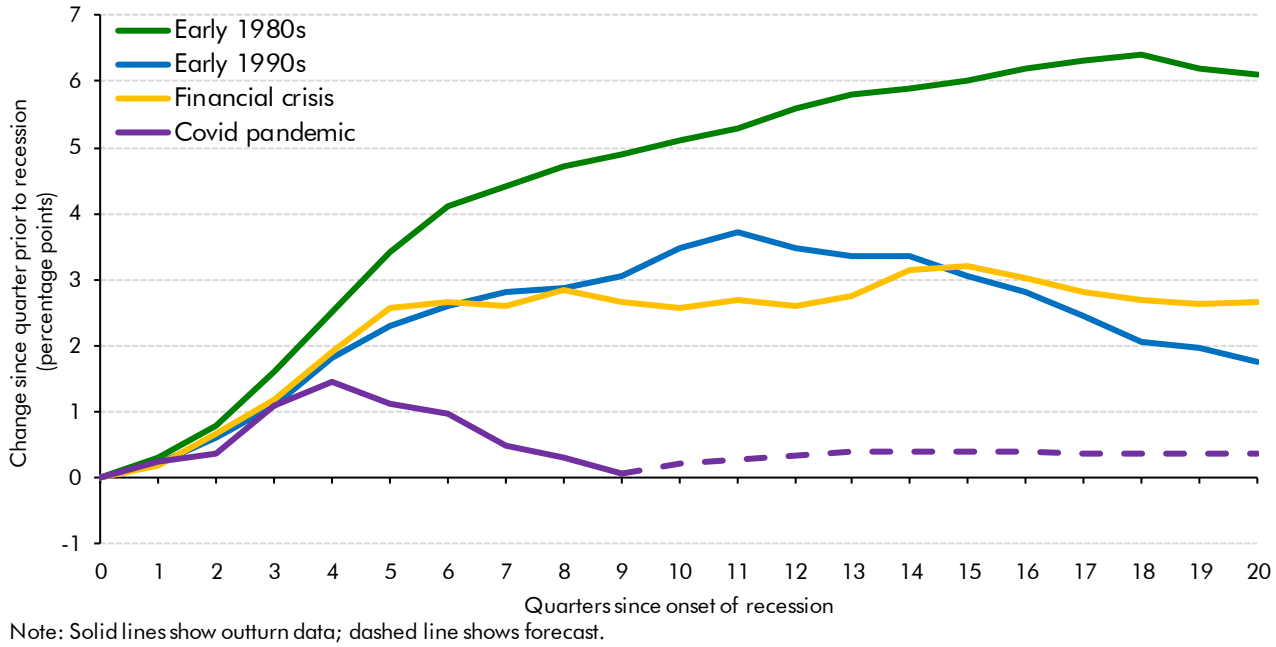
- **Unemployment** was lower going into the pandemic than in any of the preceding three recessions, at 3.8 per cent in the final quarter of 2019, compared to pre-recession rates of 5.2 per cent ahead of the financial crisis, 5.5 per cent ahead of the early-1980s recession and 6.9 per cent ahead of the early-1990s recession. Early in the pandemic, the rise in unemployment largely matched that in previous recessions, with a 1.5 percentage point increase (to 5.2 per cent) four quarters after the recession began. But the pandemic bucks the trend thereafter as unemployment has fallen back. While unemployment continued rising for 11 quarters in the early 1990s and for 18 quarters in the early 1980s (and remained elevated but largely flat following the financial crisis), it has already fallen rapidly following the initial pandemic rise and is now near its pre-recession level, where in broad terms we expect it to remain.

- **Working-age inactivity** typically rises in the aftermath of recessions,[7] albeit with more of a lag than unemployment as some people who initially become unemployed then move out of the labour force altogether. The rate started increasing sooner during the

[7] The working-age inactivity rates shown in Chart 2.4 are based on data for 16-64-year olds in the three earlier recessions, and 16-State Pension age (age 66 as of October 2020) for the pandemic.

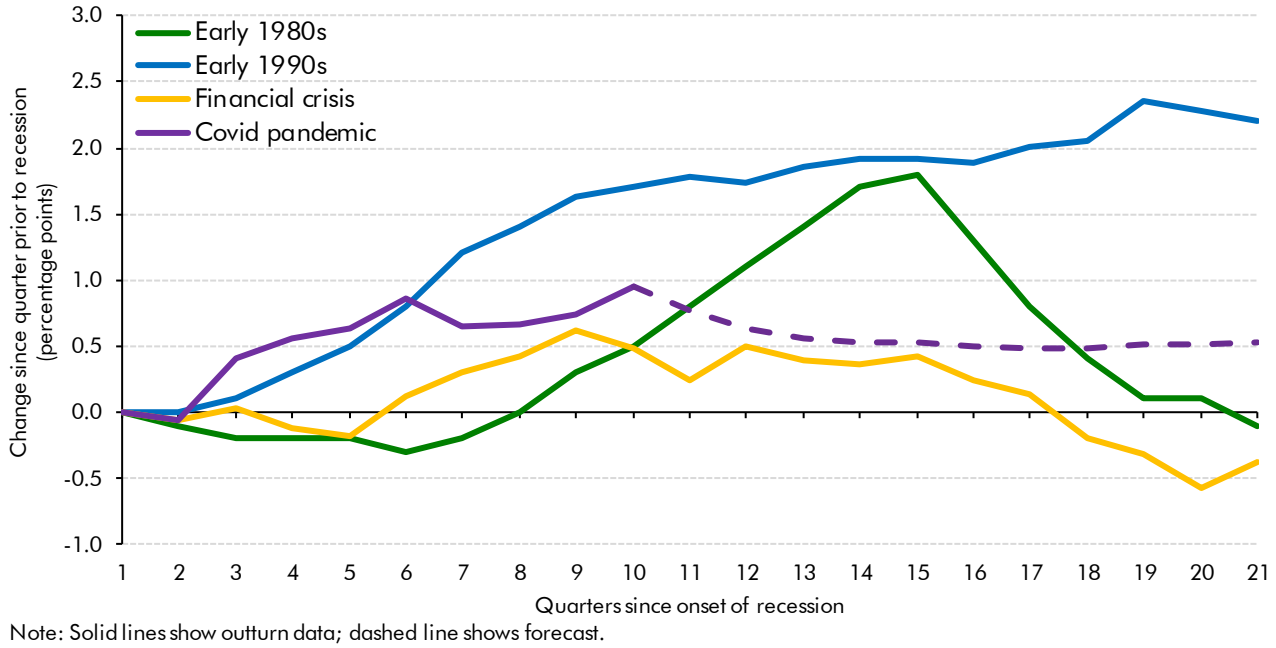
pandemic and has increased by 1.0 percentage points to date. We expect it to fall slightly but remain 0.5 percentage points above its pre-pandemic level. Only the early-1990s recession had a larger increase at this stage (a rise of 1.7 percentage points, driven by a large increase in the number of men leaving the labour market), with the rate also continuing to rise over the five years following that recession. The inactivity rate in the early 1980s peaked later and then fell back rapidly, while the financial crisis saw a relatively limited rise in working-age inactivity.

Chart 2.3: Change in unemployment rate by recession



Note: Solid lines show outturn data; dashed line shows forecast.
Source: ONS, OBR

Chart 2.4: Change in working-age inactivity rate by recession



Note: Solid lines show outturn data; dashed line shows forecast.
Source: ONS, OBR

Inflation and earnings growth

CPI inflation

2.10 CPI inflation has behaved very differently around each recession, both in terms of the immediate impact and over the medium term. Taking each recession in turn (Chart 2.5):

- As a major driver of the **early-1980s recession** (as described in Chapter 1), inflation was highest going into it, peaking at 18.3 per cent in 1980. It then began to decline rapidly as the Government's fiscal and monetary policy response sought to bring it down, settling around 4½ per cent four-to-five years after the recession began.

- Similarly, inflation was high going into the **early-1990s recession**, hovering around 7 per cent in the first couple of years before also declining as domestic policy sought to tackle it via monetary tightening (though attempting to maintain Britain's membership of the exchange rate mechanism was a more important driver of high interest rates). Inflation targeting was introduced in the UK in the aftermath of this recession, which contributed to inflation settling at 2 to 2½ per cent in the medium term.

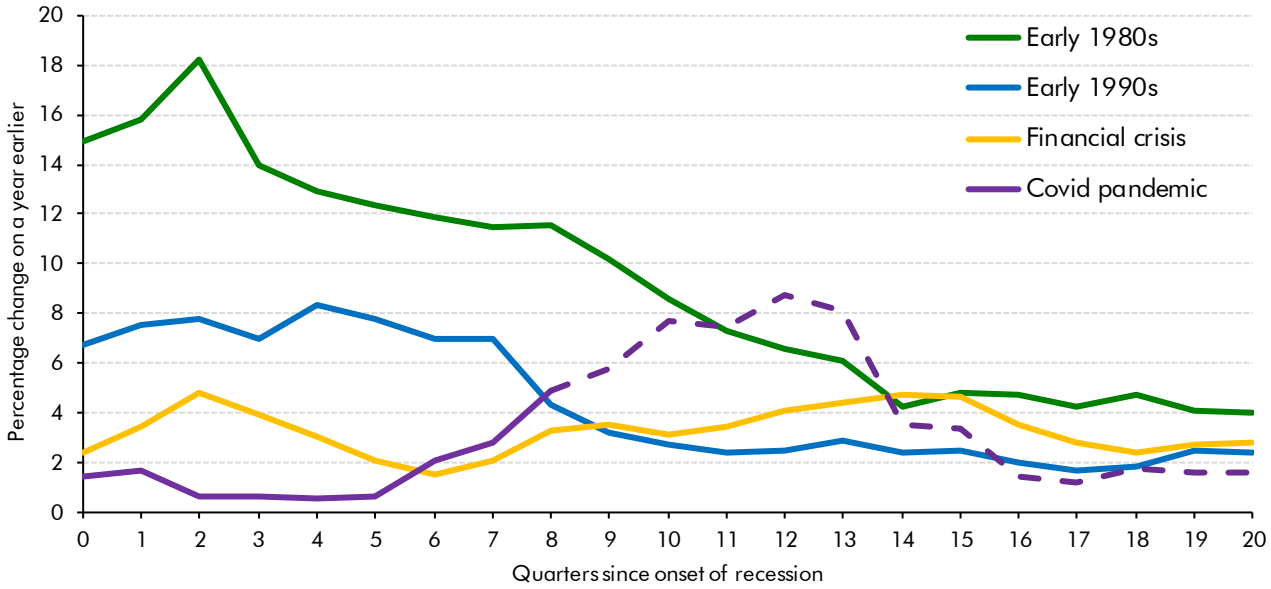
- The **financial crisis** was characterised by relatively volatile inflation reflecting various factors pushing in each direction. Domestically generated inflation was contained by weakening demand relative to supply. But imported inflation was initially pushed up by a sharp fall in sterling and rises in commodity prices (with oil peaking at $147 a barrel in mid-2008). Commodity prices then fell back sharply, pulling inflation lower. Inflation was also initially reduced by a cut in the rate of VAT at the end of 2008 and then pushed up by subsequent rises at the start of 2010 and 2011. Commodity prices also rose again in 2010 and 2011, raising household electricity and gas prices significantly.

- The **Covid pandemic** began with public health restrictions resulting in weak demand and very low levels of inflation (falling to just 0.2 per cent in August 2020). But inflationary pressures emerged in the recovery, initially driven by supply bottlenecks as global demand increased rapidly once consumers began spending again, and then by sharp rises in energy costs precipitated by Russia's invasion of Ukraine. Inflation hit a 30-year high in March 2022, with the rate last at a higher level during the early-1990s recession. Our latest forecast assumes inflation will peak at around 9 per cent in the fourth quarter of 2022 (the twelfth quarter since the onset of the recession), while the more recent Bank of England forecast from 5 May predicts a peak of around 10 per cent. In contrast, by the same stage of previous recessions inflation had already fallen substantially or, in the case of the financial crisis, was broadly flat. We expect inflation to begin declining in 2023 as energy prices are assumed to fall back.

2.11 These dynamics matter because high or rising inflation during recessions puts pressure on household budgets, and (under inflation targeting) can also put pressure on the Bank of England to raise interest rates, both of which can temper the pace of economic recovery. But inflation also matters directly for welfare spending because inflation rates are used to uprate

benefits each year. Since the mid-1980s, the default position has been that each year's uprating is based on recent, but not the very latest, inflation rates, implying a lag in terms of how quickly benefits catch up with inflation in periods when it is rising. Box 3.1 in the following chapter explores the effects of rapidly rising inflation this year for the real value of benefits, in comparison to the periods following previous recessions.

Chart 2.5: Quarterly CPI inflation by recession



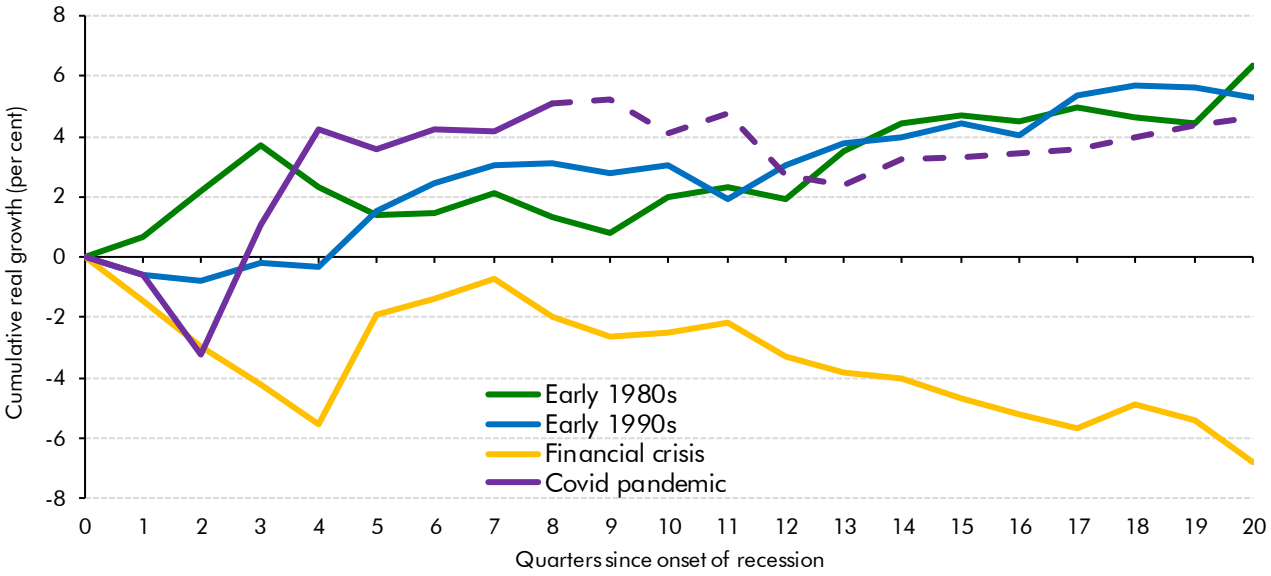
Note: Sold lines show outturn data; dashed line shows forecast.1970 to 1989 from the Bank of England's *A millennium of macroeconomic data*, outturn from 1989 onwards from the ONS.
Source: Bank of England, ONS, OBR

Earnings growth

2.12 Changes in earnings in recessions have implications for the balance of changes in welfare spending by category. For example, muted real pay growth is likely to be associated with larger increases in in-work spending relative to other factors, especially if it helps lessen the decline in employment. Real pay increased only gradually over the medium term in the 1980s and 1990s following the recessions at the start of each decade. But real pay fell consistently in the period following the financial crisis reflecting a degree of labour market slack, weak productivity growth, and increases in imported inflation.[8] Real earnings during the pandemic were initially very distorted by the coronavirus job retention scheme (CJRS). They are expected to fall this year thanks largely to imported inflation, then to recover only modestly in the subsequent years. Real average earnings are forecast to be 4.6 per cent above their pre-recession level five years on from the onset of the recession, slightly less than the increase that followed the early-1980s and early-1990s recessions. By contrast, real earnings were almost 7 per cent *below* their pre-recession level at the same point following the financial crisis.

[8] Clarke, S., and P. Gregg, *Count the pennies: Explaining a decade of lost pay growth,* October 2018.

Chart 2.6: Change in real average earnings by recession



Note: Solid lines show outturn data; dashed line shows forecast. Consistent with our forecast, this chart shows the National Accounts measure of wages and salaries per employee, deflated using the personal consumption expenditure deflator.
Source: ONS, OBR

Longer-term structural trends

2.13 The size and composition of recession-induced changes in the economy (and particularly in the labour market) drive many of the initial and medium-term changes in non-pensioner welfare spending set out in the next two chapters. But cyclical economic developments are not the only non-policy factors that determine those changes, with longer-term and largely non-recession-related structural trends also contributing, particularly over the medium term. As noted in the previous chapter, in this report we use the change in welfare spending over time, relative to the pre-recession level, to proxy for differences relative to pre-recession expectations. This is necessary given the lack of baseline medium-term forecasts to compare to for the earlier recessions, but imperfect given the structural trends also at play. To help draw out the role of these in the subsequent chapters (particularly Chapter 4, which focuses on medium-term changes), here we briefly detail those longer-term trends most relevant to changes in welfare spending over the past half-century. These include:

- **Part-time working and other labour market developments**. The proportion of those in employment working part time rose from around 23 per cent in the early 1990s to 27 per cent in 2013. While this trend is long term and runs alongside a broader rise in other forms of labour market flexibility (including rises in self-employment), most of the increase in part-time working occurred in the early and mid-1990s and after 2008, so is not entirely disconnected from the impact of recessions themselves. By contrast, rates of part-time working initially fell in the pandemic, from 26.1 per cent in mid-2019 to 24.0 per cent in early 2021, because the (limited) fall in employment was concentrated in lower-paid and shorter-hours jobs, and the move to remote working in some sectors

facilitated longer hours (particularly by those with caring responsibilities).[9] Such trends matter for welfare spending because, for example, all else equal part-time workers are more likely to be eligible for in-work welfare support, so rising part-time working would lead to rises in this category of welfare spending. But countering this – and as happened following the financial crisis[10] – the more widespread use of part-time and other flexible employment forms can help absorb shortfalls in output, and thereby limit the rise in unemployment and out-of-work spending around recessions.

- **Population and migration**. The size of the population matters for changes in welfare spending measured in real terms (as we do in Chapter 3). Within these trends, the key determinants for non-pensioner welfare spending are changes in the number of children and working-age adults. Having declined gradually since 1980, births rose in the 2000s (from 1.6 per woman in 2002 to 1.9 in 2012), but have fallen again since and are expected to continue doing so over our forecast, reflecting lower births in the latest ONS population projections. These trends help to determine child-related welfare spending. And having risen since the 1990s, net inward migration (which is mainly comprised of younger working-age adults and their children) began falling in 2016 and is expected to remain lower than in the post-financial crisis decade, thanks to the post-Brexit migration regime overlaid by an assumed migration-driven adult population shortfall of 170,000 as a result of the pandemic.[11]

- **Family structure**. Beyond the size and age composition of the population, the make-up of families and households is an important driver of welfare spending. Most important is the long-term rise (until recently) of single parenthood in the UK: the proportion of families with dependent children that were single-parent families doubled between 1971 and 1991, and then rose from 22 to 26 per cent between 1996 and 2012, after which it fell back to 23 per cent in 2021.[12] This matters because, all else equal, single-parent families are more likely to receive benefits, especially as the welfare system has adapted to support them. For example, it has been estimated that around three-quarters of working single parents are expected to receive universal credit once it is fully rolled out, compared to less than a quarter of working parents in couples.[13]

- **Health conditions and disabilities**. Chart 1.1 in the previous chapter shows that spending on disability costs and incapacity-related income support make up a large (and growing) share of non-pensioner welfare spending. This partly reflects changes in the prevalence of disabilities and health conditions within the population. Survey-based measures of disability prevalence have been increasing steadily in recent decades, with mental health problems in particular reported to affect a growing proportion of children and working-age adults (making them particularly relevant for non-pensioner

[9] Brewer, M., C. McCurdy, and H. Slaughter, *Begin again?: Assessing the permanent implications of Covid-19 for the UK's labour market*, November 2021.
[10] See Coulter, S., 'The UK labour market and the 'great recession'', in Myant, M., S. Theodoropoulou, and P. Agnieszka (eds.), *Unemployment, Internal Devaluation and Labour Market Deregulation in Europe*, 2016.
[11] See Box 2.4 in our March 2020 *Economic and fiscal outlook* and Annex C in our March 2022 *Economic and fiscal outlook*.
[12] See: Berrington, A., 'Lone parents in the UK', in Portier-Le Cocq, F. (ed), *Fertility, Health and Lone Parenting*, 2017; and ONS, *Families and households in the UK*.
[13] Gardiner, L., and D. Finch, *The long and winding road: The introduction and impact of Universal Credit in Liverpool City Region and the UK*, January 2020.

welfare spending).[14] The persistence of higher working-age inactivity over our latest forecast (Chart 2.4) is driven by our assumptions that inactivity due to long-term sickness, which has risen recently, will remain elevated relative to the pre-pandemic position.[15] This reflects a combination of the long-term direct impacts of Covid, and indirect impacts via pressures on the NHS and consequences for mental health that would be felt on top of the already rising pre-pandemic trend.

- **Housing tenure and costs**. Abstracting from cyclical factors, the growth of housing-related welfare spending (Chart 1.1) reflects developments in the housing market. The share of households in England living in the social-rented sector has been falling since 1980, while the proportion in the private-rented sector doubled from 10 per cent in 2000 to 20 per cent in 2016-17. These trends have increased housing-related welfare spending, because private-sector rents are, on average, significantly higher than social rents. In addition, the deregulation of the private-rented sector in the late 1980s and reductions in social housebuilding subsidies contributed to a sharp increase in both private and social rents, and both have risen faster than earnings during this century, pushing up the cost of the subsidy provided by housing-related benefits.[16]

Conclusion

2.14 The pandemic has been very different to any of the three recessions that preceded it. This is in part due to the unusual nature of the shock, which emerged from outside the economy and required economic activity to be stopped to address it, such that output fell further and faster than in previous recessions. But it also differed in the scale of the policy response, which helped the economy to emerge from the worst of the pandemic relatively unscathed: GDP and unemployment have already regained their pre-pandemic levels. And we expect scarring to be modest relative the huge fall in output, and far less severe than the very large shortfall in activity relative to pre-crisis expectations that followed the financial crisis.

2.15 The composition of the decline in GDP was also markedly different to previous recessions – pandemic-related support measures meant that the fall was largely felt in fewer average hours worked, with a much smaller role for falling employment. While inflation was low at the beginning of the pandemic, various factors have driven it to a 30-year high. Meanwhile, real earnings were largely protected during the initial pandemic period – helped by the CJRS – and while they are expected to fall sharply this year, they follow a similar trajectory to those in the early-1980s and early-1990s recessions in our latest forecast, which contrasts with the prolonged decline following the financial crisis. These cyclical trends combine with longer-running developments in labour market flexibility, demographics, family composition, the health of the population, and the housing market, to underpin the welfare spending changes described in the next two chapters.

[14] For example, between 1993 and 2014, the percentage of 16-to-64-year olds reporting having experienced a common mental disorder increased from 15.5 to 18.9 per cent. See paragraphs 2.10 to 2.12 in our January 2019 *Welfare trends report*.
[15] See Box 2.4 in our March 2022 *Economic and fiscal outlook*.
[16] See: Hood, A., and L. Oakley, *The social security system: long-term trends and recent changes*, November 2014; and Chapter 9 of our 2014 *Welfare trends report*.

3 Welfare spending in recessions

Introduction

3.1 This chapter looks at how non-pensioner welfare spending responded in the initial period of the four most recent recessions in the UK. For the three prior to the pandemic, this covers the two years from the fiscal year before the onset of recession, which broadly captures the period in which GDP was falling and the associated initial steep rise in welfare spending. Given the more abrupt nature of the shock and the subsequent recovery at the onset of the pandemic – when real GDP began to decline towards the very end of 2019-20, falling by over a fifth in a matter of months, but then bouncing back sharply – we instead look at the one-year change from 2019-20 to 2020-21 in this case. We explore overall rises in non-pensioner welfare spending, measured in CPI-inflation-adjusted real terms, and changes in the different categories of spending described in Chapter 1.

Changes in overall non-pensioner welfare spending

Welfare spending including the pandemic-related schemes

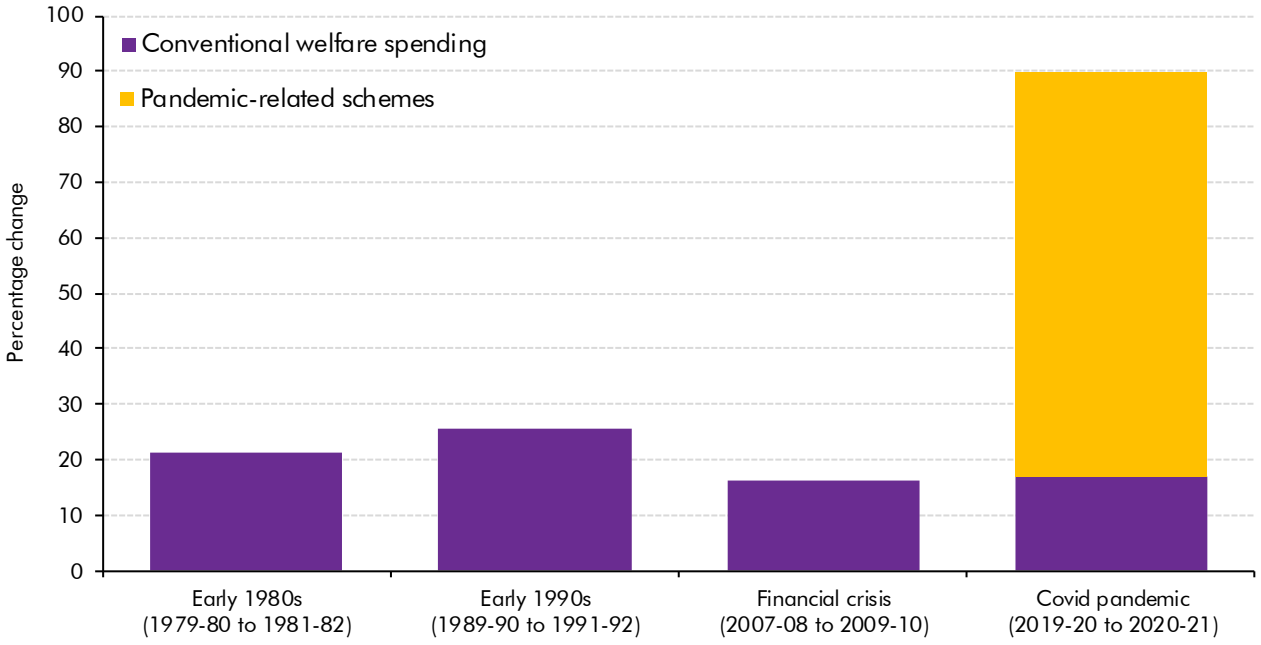
3.2 As defined in the official statistics – i.e. excluding the cost of the new mechanisms created during the pandemic to support incomes: the coronavirus job retention scheme (CJRS) and the self-employment income support scheme (SEISS) – non-pensioner welfare spending increased by 17 per cent in real terms in 2020-21. That was not out of line with the rises experienced in the previous three recessions. But with CJRS and SEISS spending included, the one-year real-terms rise in welfare-like spending in the pandemic was 90 per cent, five times greater than the rise excluding those schemes, and far larger than any of the initial increases in previous recessions (Chart 3.1). The CJRS and SEISS respectively supported the incomes of employees when not working (or when working fewer hours), and the incomes of self-employed people experiencing lost sales and profits. In doing so, they performed a similar role in an economic sense to conventional welfare spending.

3.3 In gross terms, excluding tax paid on the associated incomes, the pandemic-related schemes together cost £78.2 billion in 2020-21 alone and £97.4 billion in total by the time of their being closed mid-way through 2021-22. At their peak during the first lockdown, they together helped to support the incomes of 11.5 million employees and self-employed individuals.[1] As described in Chapter 2, they greatly reduced the impact of the pandemic on unemployment (by subsidising short-time working in the face of lower output, which would otherwise have manifested itself much more in job losses). This thereby reduced the pandemic's impact on conventional welfare spending. These discretionary policy

[1] The peak number of employees supported by the CJRS was 8.9 million on 8 May 2020, while the peak number of self-employed individuals supported by SEISS grants was the 2.6 million who received the first grant, most of which were recorded in May 2020.

interventions therefore represent the largest difference between the pandemic and the preceding three recessions. More modest differences between the scale and composition of welfare spending changes (as conventionally defined) in the pandemic versus previous recessions have so far received less attention. We explore those differences in this chapter, but first review some of the features of the pandemic-related schemes that meant they cushioned the effects of sharp falls in output on conventional welfare spending.

Chart 3.1: Initial change in real non-pensioner welfare spending in recessions: totals

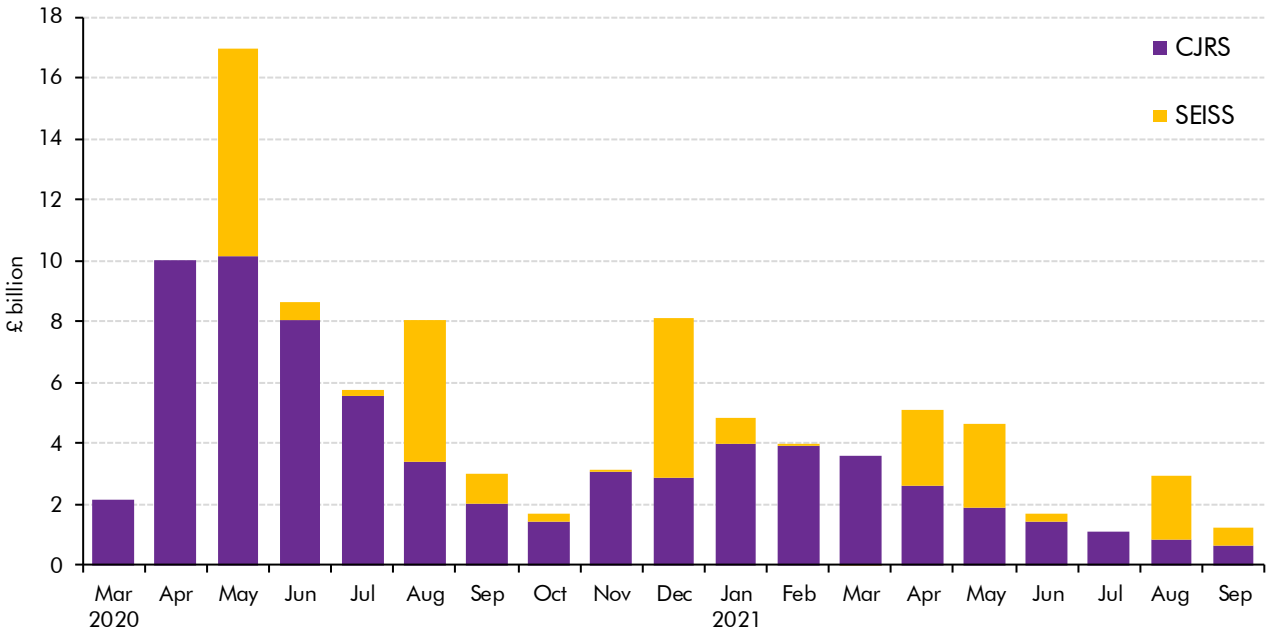


Source: DWP, HMRC, OBR

3.4 At almost £100 billion, the CJRS and SEISS were much more significant in size and generosity than any of the welfare policy interventions in previous recessions summarised in Chapter 1. Indeed, their combined cost over 18 months was similar to the entire non-pensioner welfare spending bill in 2019-20. Both schemes were designed with the intent of providing timely, accessible support, with simple application processes that reflected this intent. Chart 3.2 shows spending on the CJRS and SEISS by month. The lumpier profile of SEISS spending reflects that grants were paid in respect of several months (covering three months for all but the final grant, which covered five months). Spending peaked early in the pandemic, reaching £17 billion in the single month of May 2020, and coinciding with the tailing-off of universal credit (UC) inflows (as detailed in our 2021 *Welfare trends report* (*WTR*)). Spending increased again during the lockdown in early 2021, but to a lesser extent than in the first lockdown, as businesses and consumers had adapted to restrictions. Both schemes then continued through to September 2021, much longer than originally intended following a succession of policy extensions culminating in the end dates set at the March 2021 Budget. As we set out in our 2021 *Forecast evaluation report*, the fact that these schemes persisted through most of the period when public health restrictions remained in place and output was depressed, rather than ending much earlier as had originally been

announced, was a key factor in limiting the rise in unemployment during 2020 and 2021 (and therefore the rise in conventional welfare claims in 2020-21).[2]

Chart 3.2: Monthly CJRS and SEISS spending

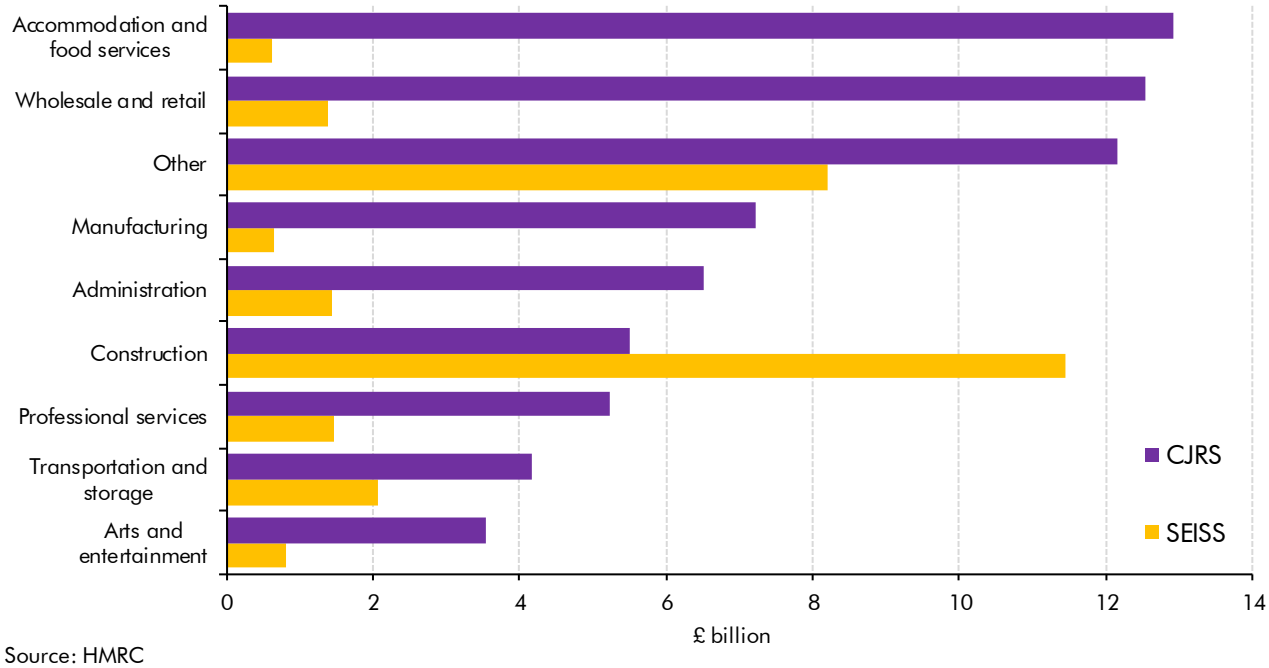


Source: ONS

3.5 The support provided by these pandemic-related schemes was highly concentrated by sector (Chart 3.3). A third of CJRS spending went to the high-contact service sectors of accommodation and food services, and wholesale and retail, which were most affected by both official public health measures and by voluntary social distancing on the part of consumers. These are also sectors with lower levels of pay than average and a higher prevalence of part-time work among employees, so those affected by furlough were more likely to be in receipt of in-work support from the welfare system than average. The cost of SEISS claims was overwhelmingly focused in the construction sector (over 40 per cent of spending went to this sector), where self-employed working arrangements are more common,[3] reflecting the fact that construction was entirely shut down in the first lockdown.

[2] For further discussion, see Tomlinson, D., *Job well done: 18 months of the Coronavirus Job Retention Scheme*, September 2021.
[3] The ONS Labour Force Survey reports that almost one-fifth of self-employed people worked in construction at the end of 2021, compared to just 5 per cent of employees.

Chart 3.3: CJRS and SEISS spending by sector

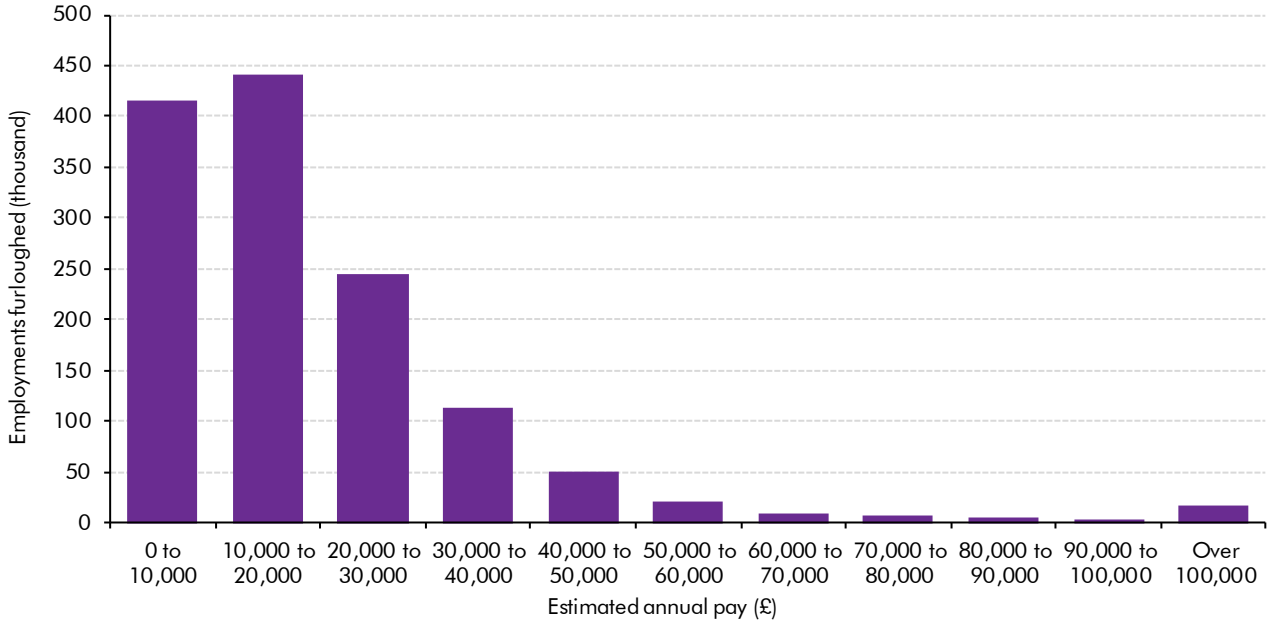


Source: HMRC

3.6 Reflecting the sectoral focus in CJRS spending, take-up of the CJRS was heavily concentrated at lower levels of annual pay (Chart 3.4). This highlights how the CJRS insulated conventional welfare spending from the costs of the pandemic, as in the absence of these schemes the affected lower-earning individuals would have been more likely to receive support from the welfare system than higher-earning ones (who would be less likely to receive in-work support if their hours were reduced, and less likely to receive out-of-work support if they lost their jobs, due to savings levels). In the same vein, the number of people receiving a SEISS grant over the scheme's lifetime (2.8 million) equates to more than half of overall self-employment in 2020-21 (4.4 million). This again demonstrates the extent of support provided to a group that would otherwise have been expected to fall back on support from the welfare system.[4] Overall then, the size, duration and focus (in respect of sector, pay and support provided to the self-employed) of these schemes that were created, operated, and withdrawn in the space of 18 months, all served to limit the potentially large increases in conventional welfare spending that would have occurred in their absence.

[4] In 2014-15, around one-fifth of families containing a self-employed individual were claiming in-work benefits or housing benefit. See Broughton, N., and B. Richards, *Tough Gig: Tackling low paid self-employment in London & the UK*, October 2016.

Chart 3.4: CJRS take-up by annual pay



Note: Employments furloughed are the average from July-September 2021. Furlough by pay is not published for earlier months.
Source: HMRC

Conventional welfare spending

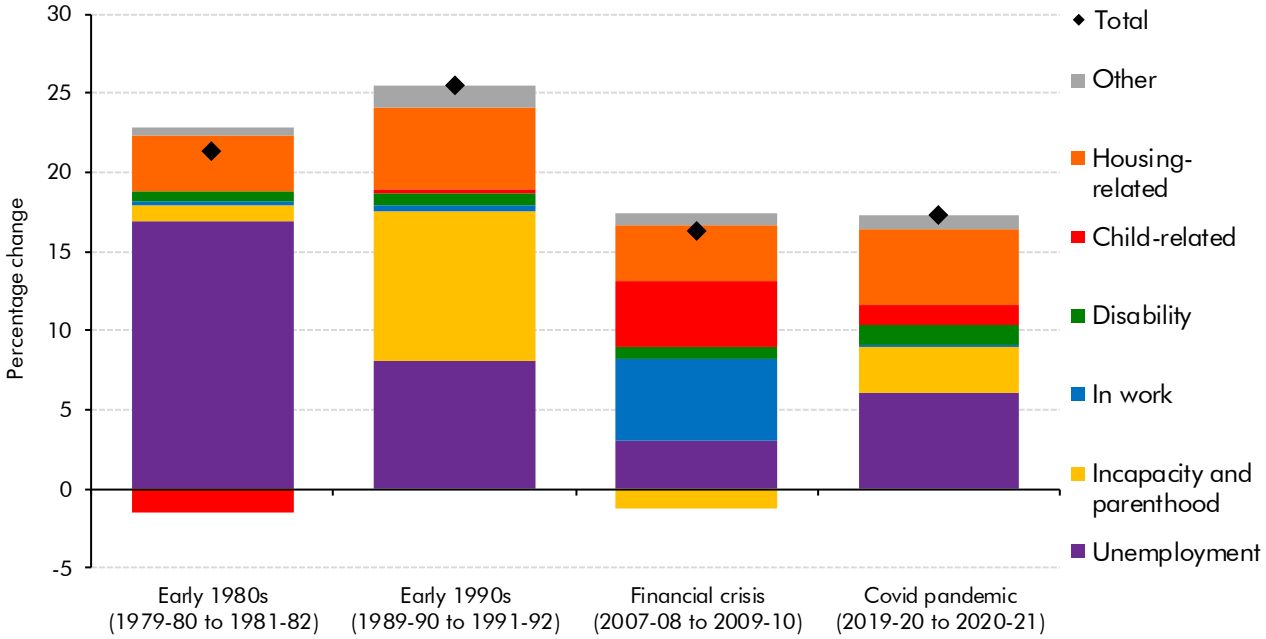
3.7 The 17 per cent real-terms rise in non-pensioner welfare spending excluding the pandemic-related schemes in 2020-21 was largely explained by unemployment and housing-related spending, which together accounted for around 60 per cent of the increase (Chart 3.5). Turning to the previous recessions that we consider:

- In the **early 1980s**, real spending rose by 21 per cent over two years, largely driven by the sharp rise in unemployment and associated increase in spending on unemployment benefits, which contributed around 80 per cent of the overall rise.

- In the **early 1990s**, real spending rose by 25 per cent over two years, the largest rise of the four recessions, thanks to a combination of rising spending on incapacity and parenthood benefits, unemployment benefits and housing-related benefits.

- Real spending rose by 16 per cent in the first two years of the **financial crisis**, the smallest rise among the four recessions. In contrast to the other recessions, spending on in-work benefits was the largest contributor, explaining around one-third of the rise.

Chart 3.5: Initial change in real non-pensioner welfare spending in recessions: composition by spending category



Source: DWP, HMRC, OBR

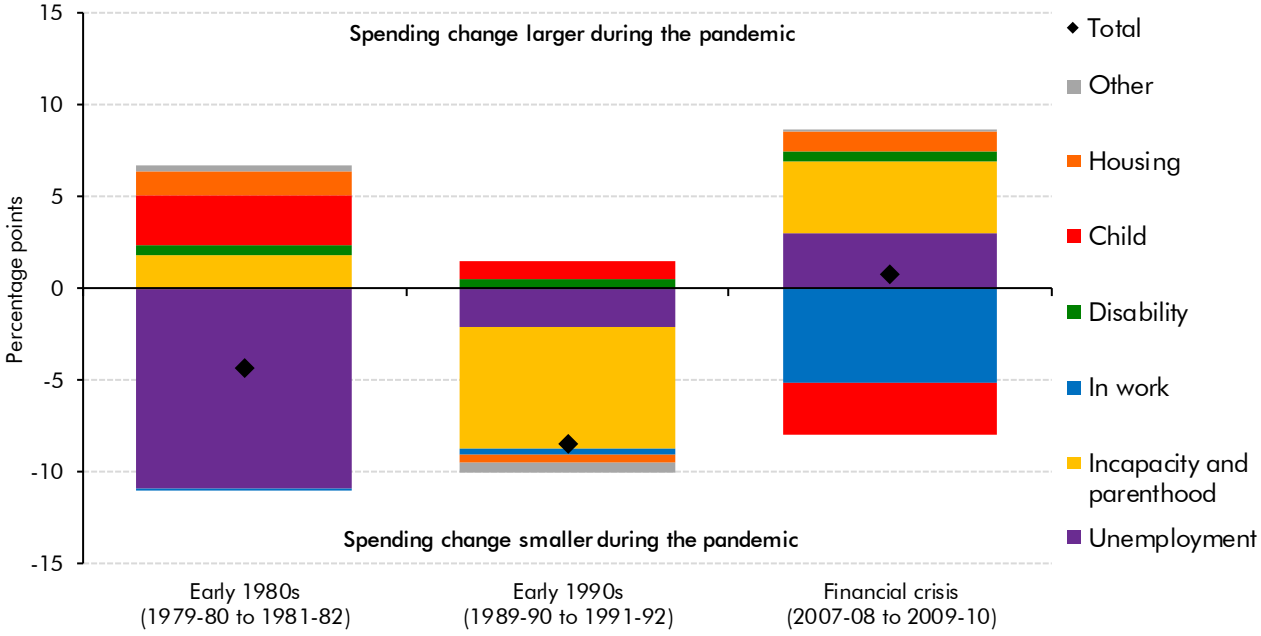
3.8 The remainder of this chapter compares these recession-induced rises in spending in the pandemic with the preceding three recessions for each category of welfare spending. These differences are summarised in Chart 3.6, which in essence shows the difference between the right-hand column in Chart 3.5 and the three columns to its left. It shows that:

- The increase in real spending during the pandemic was around 4 percentage points smaller than that in the **early-1980s** recession. The rise in unemployment spending was much lower than during the early 1980s, contributing 11 percentage points less, thanks to the CJRS and SEISS limiting the rise in unemployment due to the pandemic. Partially offsetting this, the contribution of most other categories of spending to the overall increase was slightly larger during the pandemic than in the early 1980s.

- The rise in spending during the pandemic was 9 percentage points smaller than that in the **early 1990s**. Most of this difference was due to a much lower rise in spending on incapacity and parenthood benefits during the pandemic, with the difference in unemployment spending considerably smaller than in the early 1980s.

- The rise in spending in the pandemic was similar to that during the **financial crisis**. There was a larger contribution from unemployment benefits and incapacity and parenthood benefits in the pandemic than the financial crisis, offset by a smaller contribution from in-work (excluding the CJRS and SEISS) and child-related spending.

Chart 3.6: Initial change in real non-pensioner welfare spending: the pandemic versus previous recessions



Source: DWP, HMRC, OBR

Explaining changes in individual categories of spending

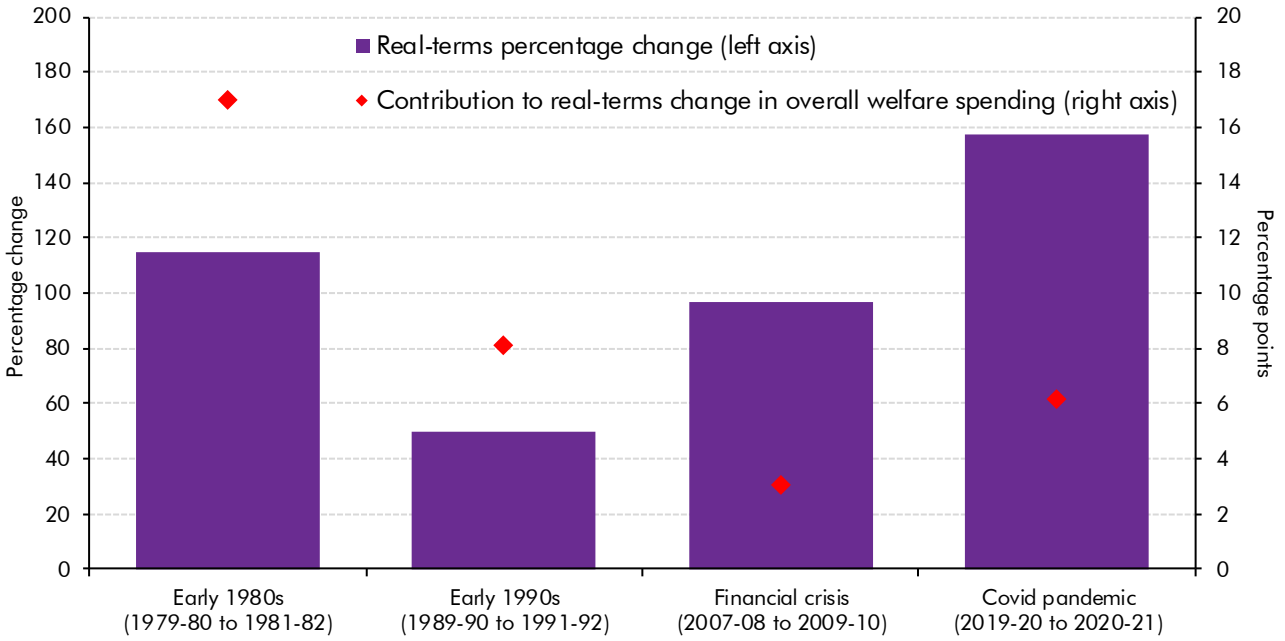
3.9 The remainder of this chapter considers each of the categories of non-pensioner spending in more detail, comparing initial changes in the pandemic to those in previous recessions. Where possible, we also explore the respective roles of caseloads and average awards in driving these initial recession-induced spending changes.

Changes in unemployment benefits spending

3.10 Real spending on unemployment benefits – jobseeker's allowance (JSA) and its predecessors plus the standard allowance for the 'intensive work search' conditionality group in UC – rose by almost 160 per cent in 2020-21 (representing an increase of 0.3 per cent of GDP). This was a larger percentage increase than in the first two years of any of the preceding recessions, and over three times the size of the increase in the early 1990s (the columns in Chart 3.7). But it made a smaller contribution to the overall rise in welfare spending than in either the 1980s or 1990s recessions (the diamonds, which is the metric shown in the summary Charts 3.5 and 3.6 above).

3.11 The difference between these two metrics reflects the fact that unemployment benefits spending has fallen by more than three-quarters as a share of overall non-pensioner welfare spending over time (from 15 per cent to 4 per cent in the four decades to 2019-20), so a larger *percentage* increase in unemployment benefits spending in the pandemic than in the early-1980s and early-1990s recessions equates to a much smaller contribution to the change in *overall* welfare spending (and also a smaller change as a share of national income: as a share of GDP, the initial increase in the pandemic was similar to that in the early 1990s and around half the size of that in the early 1980s).

Chart 3.7: Initial change in real unemployment benefits spending in recessions



Source: DWP, HMRC, OBR

3.12 Chart 3.8 breaks down the sources of the rise in real-terms spending on unemployment benefits across the four recessions into three components:

- first, due to the rise in the Labour Force Survey measure of **unemployment**;
- second, due to changes in **the benefit caseload relative to unemployment**; and
- third, due to changes in the **average amount of benefit received** by each recipient on the caseload.

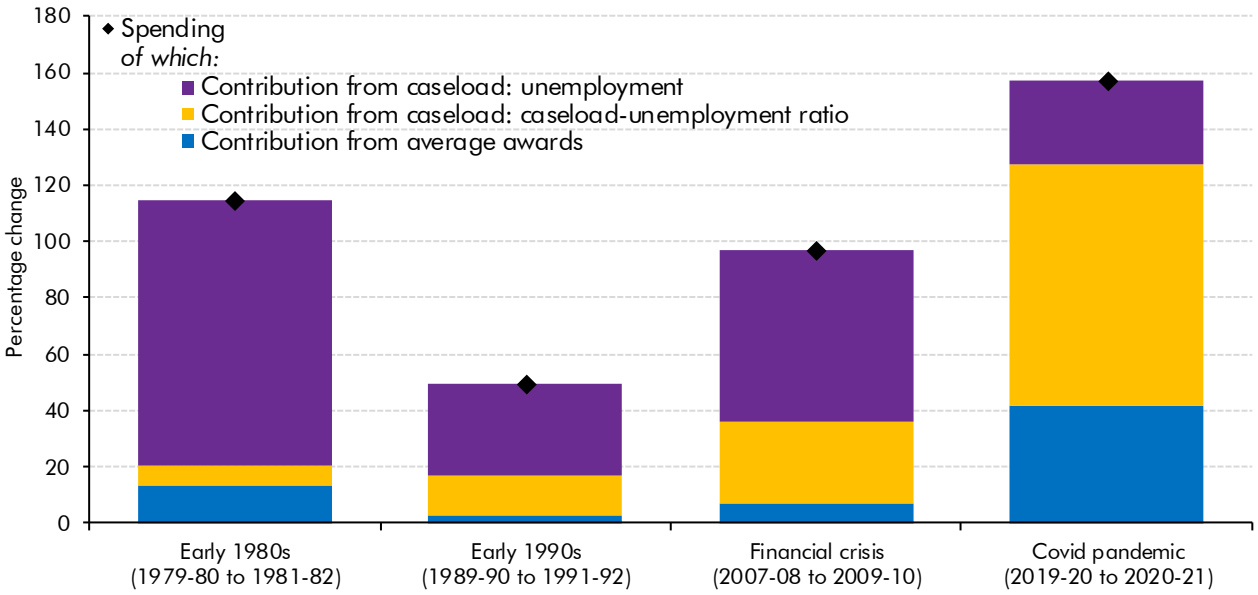
3.13 The rise during the pandemic largely reflects an increase in the caseload over and above the rise in unemployment (the yellow column, accounting for over half of the overall rise), reflecting the large spike in UC claims relative to a modest rise in the unemployment rate. The rise in unemployment itself – from 3.9 per cent on average in 2019-20 to just 4.8 per cent on average in 2020-21 (1.3 million to 1.6 million) – accounted for just 19 per cent of the overall rise (the blue column). This apparent increase in the caseload-to-unemployment ratio was driven by a number of factors, including: heightened labour market uncertainty at the beginning of the pandemic giving rise to a spike in claims; the various easements to claims processes and conditionality that effectively increased eligibility; a spike in fraud and error rates among new claims for UC (jumping from 9.4 to 14.5 per cent of spending, with new claims subject to an estimated fraud and error rate of 25.6 per cent[5]); the wider scope of the 'intensive work search' conditionality group within UC – which includes some working claimants on low earnings – compared to JSA, affecting the caseload associated with new claims for UC; and classification issues relating to the fact that rises in survey-based measures of unemployment (which is defined as looking for a job and being available to

[5] As described in Annex A of our March 2022 *Economic and fiscal outlook*.

start) may have been muted by the difficulty of searching for jobs during the initial lockdown. Higher average awards explain around 25 per cent of the overall increase, largely reflecting the £20-a-week rise in the standard allowance in UC.

3.14 By contrast, in each of the three preceding recessions, the initial increase in spending on unemployment benefits was mainly driven by rising unemployment itself pushing up caseloads. This explained over 80 per cent of the overall increase in the early-1980s recession, 66 per cent in the early-1990s recession, and 62 per cent in the financial crisis. Caseloads increased faster than survey-based measures of unemployment during each of these recessions too, as economic uncertainty and slowing household income growth prompted more unemployed people to engage with the benefits system.[6] These increases in the caseload-to-unemployment ratio explain most of the rest of the increase in spending in the early-1990s recession and the financial crisis. Average awards also play a modest role in explaining the rise in the early-1980s recession.

Chart 3.8: Drivers of the initial change in real unemployment benefits spending in recessions



Note: The caseload contribution relating to unemployment is based on changes in the level of unemployment; the contribution from average awards is based on average awards deflated by CPI.
Source: DWP, ONS, OBR

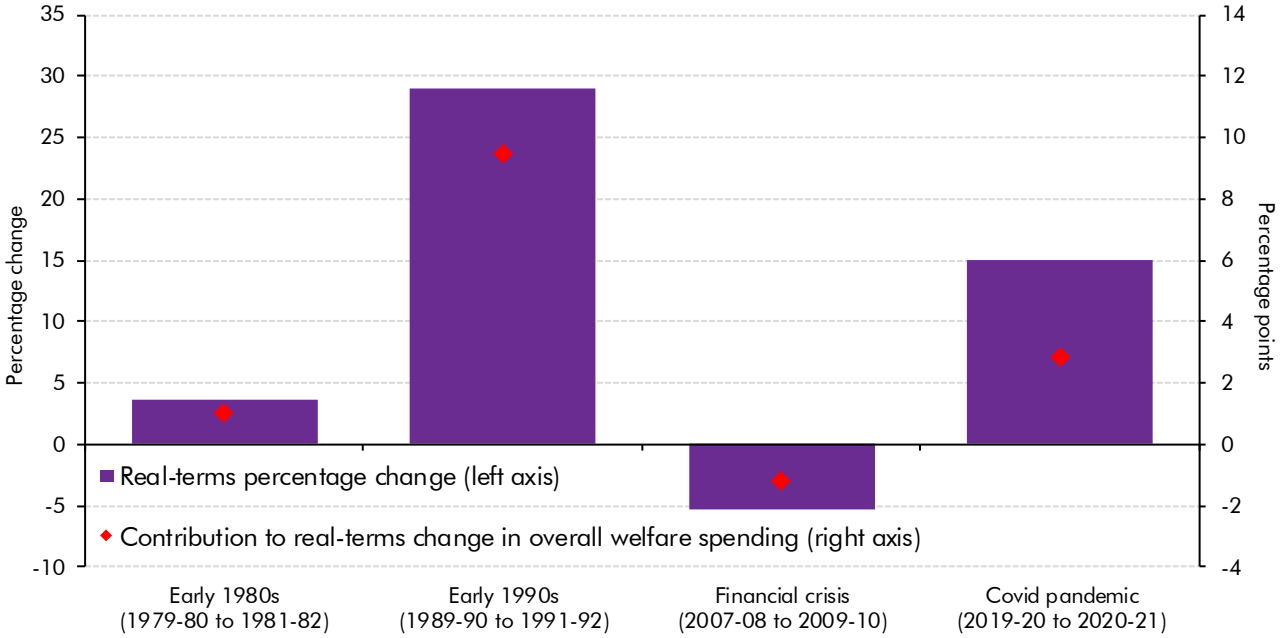
Changes in incapacity and parenthood benefits spending

3.15 Spending on incapacity and parenthood benefits – which include incapacity benefits (employment and support allowance (ESA) and predecessors), income support, and the standard allowance for the out-of-work conditionality groups with reduced requirements in UC – rose by around 15 per cent in real terms in 2020-21, representing an increase of 0.2 per cent of GDP. Chart 3.9 shows that this was a smaller increase – both in relative terms and as a share of overall welfare spending – than in the early-1990s recession, when spending rose by almost 30 per cent in real terms. But it outstripped the changes in the

[6] Phillips, T., *Falling through the cracks: The widening gap between unemployment and benefit statistics*, January 2018.

other two recessions: in the early 1980s spending rose by just 4 per cent in the initial two years, while during the financial crisis it actually fell by 5.3 per cent in real terms.

Chart 3.9: Initial change in real incapacity and parenthood benefits spending in recessions



Source: DWP, HMRC, OBR

3.16 Chart 3.10 shows the sources of changes in real-terms spending on incapacity and parenthood benefits across the four recessions into the equivalent three categories used for unemployment benefits, but based on the Labour Force Survey measure of working-age inactivity rather than unemployment. It shows that the 15 per cent rise in spending during the pandemic is explained in roughly equal parts by:

- the effect of rising **working-age economic inactivity** on caseloads (the working-age inactivity rate rose from 20.9 per cent on average in 2019-20 to 21.7 per cent in 2020-21 – rising from 8.7 million to 9.1 million);
- an increase in **the caseload over and above that rise in survey-based inactivity**; and
- an increase in **average awards** due to the £20-a-week uplift in the UC standard allowance (the smaller effect here relative to unemployment benefits spending partly reflects the fact that a greater proportion of the caseload remained on legacy benefits – ESA and income support – which did not benefit from the uplift).

3.17 Turning to the three preceding recessions:

- There was a similar contribution from caseload increases in the **early-1980s** recession as in the pandemic, although more as a result of a rising caseload-to-inactivity ratio than rising inactivity. But this was partially offset by average awards, which fell in real

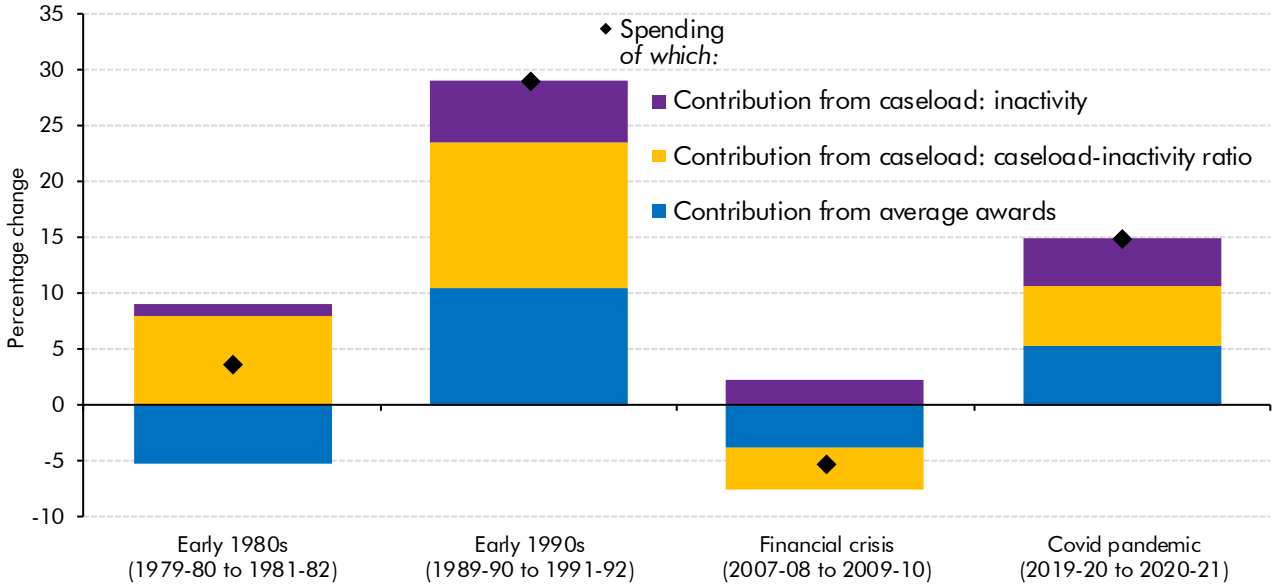
terms over these two years, partly because of a shortfall between the rates used to uprate benefits at that time and outturn inflation.[7]

- As in the pandemic, the 29 per cent increase in spending in the initial two years of the **early-1990s** recession was driven by a combination of all three factors. Rising working-age inactivity pushed up caseloads, but the contribution from the caseload rising faster than survey-based inactivity was over two times greater, in part reflecting changes to the operation of benefits over this period that saw flows from unemployment benefit onto incapacity benefit.[8] Rising average awards explain the remaining 36 per cent of the rise, reflecting: first, the RPI inflation measure used for uprating at that time being higher than the CPI-based measure of real spending we use; and second, the fact that inflation was falling at the time so the rates used to uprate benefits temporarily boosted their real values (as Box 3.1 describes).

- The fall in incapacity and parenthood spending in the initial two years of the **financial crisis** was largely due to a fall in in the caseload relative to survey-based inactivity following the introduction of ESA in October 2008, which sought to tighten eligibility in particular through the introduction of work capability assessments. To a lesser extent, it also reflected the beginning of the tightening of eligibility requirements for single parents claiming income support, based on the age of their youngest child – known as the 'lone parent obligation'. In our *2016 WTR*, we produced a top-down estimate that the ESA reforms saved £0.4 billion a year by 2015-16 against a baseline of caseloads rising largely in line with the working-age population without this policy change. A smaller proportion of awards at higher rates in ESA than incapacity benefit also drove a small negative contribution from average awards.[9]

[7] Matejic, P., *Fifty years of benefit uprating*, April 2022.
[8] See Chapter 6 of our 2014 *Welfare trends report*.
[9] See paragraph 3.26 of our 2016 *Welfare trends report*.

Chart 3.10: Drivers of the initial change in real incapacity and parenthood benefits spending in recessions



Note: The caseload contribution relating to inactivity is based on changes in the level of inactivity; the contribution from average awards is based on average awards deflated by CPI.
Source: DWP, ONS, OBR

Changes in in-work benefits spending

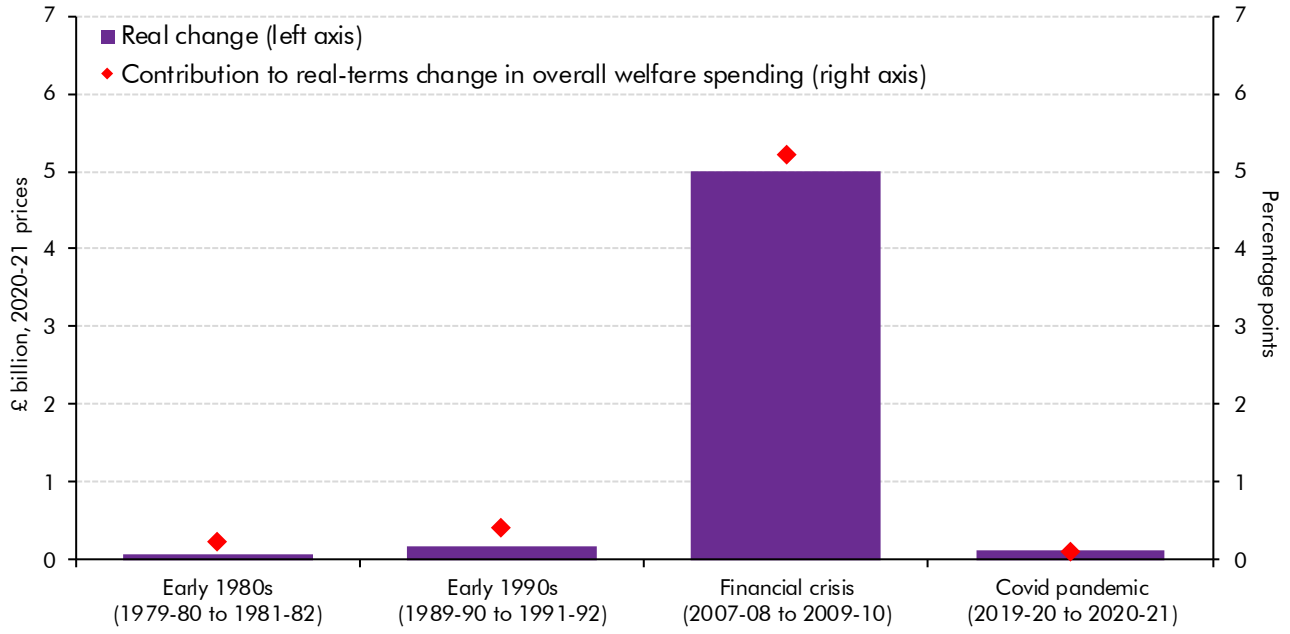
3.18 Spending on in-work benefits – which include working tax credit and its predecessors; child tax credit (CTC) for working families; and the standard allowance, child and other elements for the in-work conditionality groups in UC – rose by just £0.1 billion (1 per cent) in real terms in 2020-21 (the bars on Chart 3.11, which show real-terms changes in amounts rather than percentage changes because spending was so small prior to the early-1980s and early-1990s recessions that differences in growth rates are not meaningful). As with unemployment-related spending, this increase was tempered by CJRS and SEISS support, which played a role somewhere in between that of in-work and unemployment benefits in supporting the incomes of employees and the self-employed. Were spending on these schemes to be included as in-work spending, it would have risen by £76.2 billion (over 400 per cent) in 2020-21, dwarfing the rise seen in any other recession.

3.19 The scale of the in-work benefits system was significantly smaller prior to the introduction of tax credits in the late 1990s and their subsequent expansion in the early 2000s, so the most meaningful comparator for the pandemic is the first two years of the financial crisis. This period saw a much larger rise in in-work spending of £5.0 billion (24 per cent) in real terms. This largely reflected increases to CTC rates in successive Budgets, alongside the in-work benefit system's automatic stabiliser effect as real pay fell (see Chart 2.6 in Chapter 2). In-work benefit caseloads rose by 16 per cent over the first two years of the financial crisis,[10] compared to a 4 per cent rise in 2020-21 (excluding the pandemic-related schemes) – so

[10] The 'In-work CTC: family element or less' component of the caseload (which received very small awards) has been excluded from the caseload (but not spending) time series in order to prevent the removal of the second income threshold in the aftermath of the financial crisis from distorting our interpretation of caseload trends.

the marked rise in in-work spending in the initial phase of the financial crisis was explained by a combination of rising caseloads and higher average awards.

Chart 3.11: Initial change in real in-work benefits spending in recessions



Source: DWP, HMRC, OBR

Changes in disability benefits spending

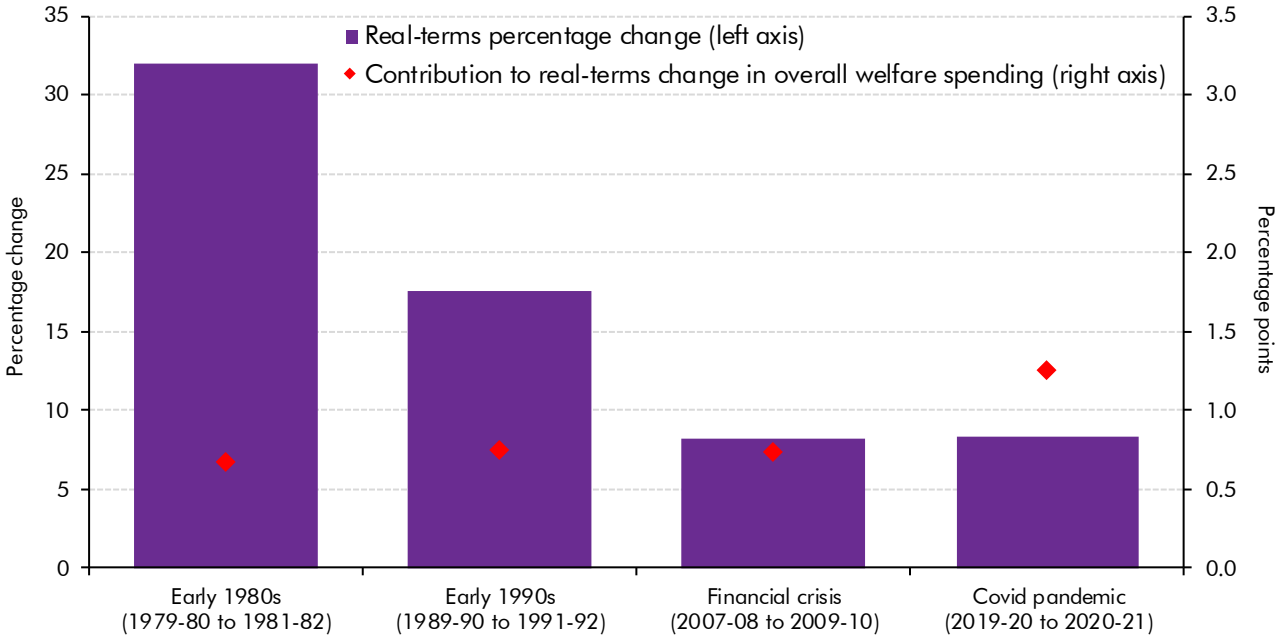
3.20 Spending on disability benefits – non-pensioner spending on personal independence payments, disability living allowance and their predecessors – rose by 8 per cent in real terms in 2020-21. Chart 3.12 shows that because disability benefits spending has risen significantly as a share of overall non-pensioner welfare spending over time (from 2 per cent to 15 per cent in the four decades to 2019-20), a smaller *percentage* increase in spending in the pandemic than in the early-1980s and early-1990s recessions equates to a much larger contribution to the change in *overall* welfare spending (and also a larger change as a share of national income: as a share of GDP, the initial increase in the pandemic was almost twice as large as those in the early 1980s and early 1990s). Comparing the pandemic to other recessions:

- The **early-1980s** recession saw the largest initial relative rise in spending of 32 per cent, almost four times the increase in 2020-21. This was from a relatively small base and was partly due to increasing take-up for mobility allowance as it came into effect in the late 1970s, reflected in rising disability benefits caseloads, which increased by 29 per cent compared to a rise of just 2 per cent in 2020-21.

- The 18 per cent increase in the **early-1990s** recession was more than double the initial increase during the pandemic. Again this is reflected in higher caseloads, which increased by 14 per cent in the initial phase of the early-1990s recession.

- The increase in spending during the pandemic was around the same as the 8 per cent rise in the initial two years of the **financial crisis**, despite the caseload increase in the financial crisis (6 per cent) being around twice as large as that during the pandemic. This implies a more modest rise in average awards in the financial crisis than in the pandemic, which is likely to reflect differences in the composition of the caseload in these two periods.

Chart 3.12: Initial change in real disability benefits spending in recessions



Source: DWP, HMRC, OBR

Changes in child-related benefits spending

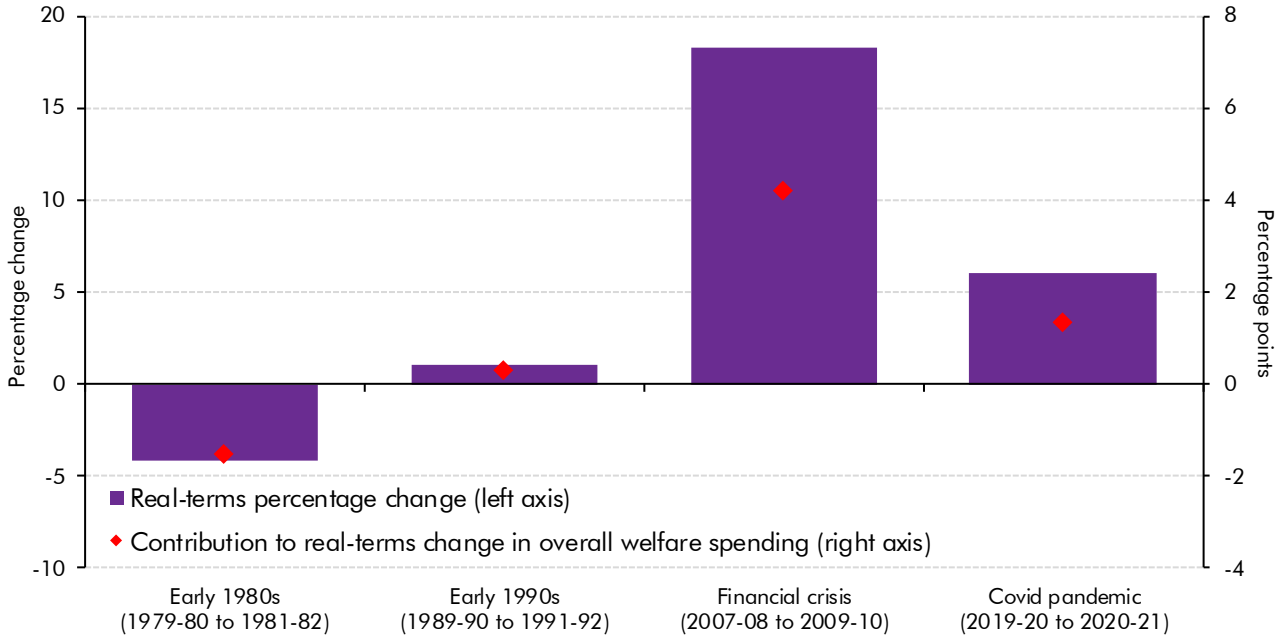
3.21 Spending on child-related benefits – which include child benefit, tax-free childcare, CTC for out-of-work families, and child elements for out-of-work conditionality groups in UC – rose by 6 per cent in real terms in 2020-21 (an increase of 0.1 per cent of GDP). Considering only child benefit, a subset of all child-related spending accounting for around half the total, caseloads actually *fell* marginally (by 1 per cent), partly due to lower births and to lockdowns hampering initial child benefit claims. We explore this in more detail in Box 4.1. Comparing the pandemic-induced increase in spending to other recessions:

- Real spending actually fell by 4 per cent in the first two years of the **early-1980s** recession, due to a 1 per cent fall in the child benefit caseload and below-inflation child benefit uprating (see Box 3.1).

- The rise in the **early-1990s** recession (1.1 per cent) was five times smaller than during the pandemic, with child benefit caseloads rising broadly in line with this spending increase (by 1.6 per cent).

- Spending rose by significantly more (18 per cent) in the first two years of the **financial crisis** than in the first year of the pandemic. This partly reflected rising CTC rates, which increased the child element by 21 per cent from £154 a month to £186 a month,[11] and rising child benefit rates as a result of earlier uprating in 2009 (see Table 1.2 in Chapter 1). This recession also saw the largest increase in the child benefit caseload (4 per cent), which was more than double the next largest increase, reflecting the rising trend in births at the time (see Chapter 2).

Chart 3.13: Initial change in real child-related benefits spending in recessions



Source: DWP, HMRC, OBR

Changes in housing-related benefits spending

3.22 Housing-related benefits – which include working-age housing benefit and UC housing elements across in-work and out-of-work groups – are heavily influenced by the economic cycle, with spending typically rising during downturns and falling during periods of strong economic growth. This reflects the fact that this spending is often 'passported', whereby those newly eligible for other benefits also become eligible for housing-related support.

3.23 Real spending on housing-related benefits rose by 27 per cent in 2020-21 (Chart 3.14). This reflected a 23 per cent caseload increase due to the spike in UC claims, and to a lesser extent higher awards as a result of the local housing allowance increase in both UC and housing benefit (see Chapter 1). Like disability benefits spending, housing-related benefits spending has risen as a share of overall non-pensioner welfare spending over time (from 5 per cent to 18 per cent between 1979-80 and 2019-20), meaning a smaller *percentage* increase in spending in the pandemic than in the early-1980s and early-1990s recessions results in a similar contribution to the change in *overall* welfare spending.

[11] Institute for Fiscal Studies, *Fiscal facts: tax and benefits*.

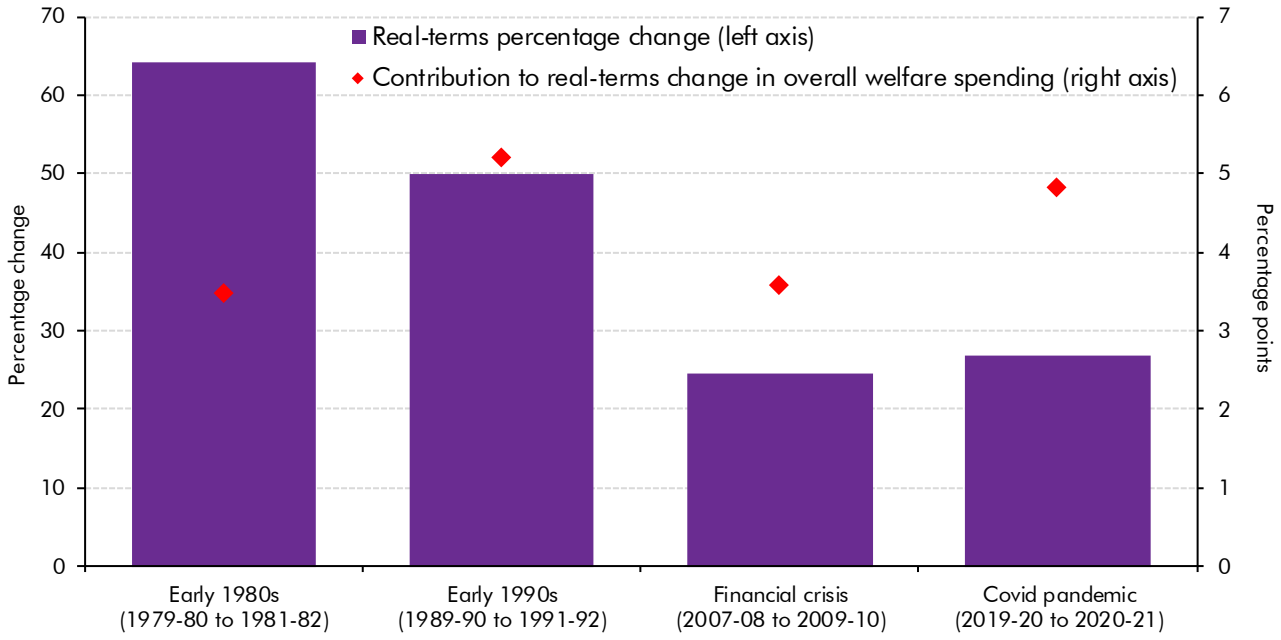
3.24 Comparing the pandemic experience to other recessions:

- Real spending increased by 64 per cent in the **early-1980s** recession, more than twice the rise during the pandemic. This is likely to reflect the impact of fast-rising unemployment on housing-related benefit caseloads (a consistent caseload series for non-pensioners is not available for the 1980s to confirm this).

- Spending also increased by almost twice as much (50 per cent) in the first two years of the **early-1990s** recession as it did in the first year of the pandemic, whereas the rise in the caseload (at 21 per cent) was similar to that in the pandemic. This reflects the rise in rents (and therefore average awards) associated with the deregulation of the private-rented sector and reduced spending on social housing (see Chapter 2).

- The real-terms rise during the initial phase of the **financial crisis** was similar to that in 2020-21 at 24 per cent. This is matched by similar rises in caseloads in both periods (the caseload increase was 18 per cent in the first two years of the financial crisis).

Chart 3.14: Initial change in real housing-related benefits spending in recessions



Source: DWP, HMRC, OBR

Box 3.1: Benefit uprating during and after recessions

One of the most important drivers of changes in welfare spending over time relates to when, and by how much, the vast array of rates and allowances in the welfare system are updated – a process known as benefit 'uprating'. Default policy settings typically see these uprated in line with a measure of inflation or earnings growth, but governments can choose to uprate most benefits by any amount, and often implement discretionary changes during and after recessions (as set out in Table 1.2 in Chapter 1). They can also choose to uprate benefits more frequently, which has been less common but happened most recently when the indexation of child benefit was brought forward from April to January 2009 during the financial crisis.[a]

Since the mid-1980s, the default for most non-pensioner benefits is that each year's uprating is based on outturn inflation rates (as opposed to forecast rates of inflation for the year in question, which were often used prior to that).[b] Most rates and allowances in the non-pensioner welfare system are currently uprated each April by outturn CPI inflation from the previous September.

This means that there is a lag of up to 18 months in terms of how quickly benefit rates reflect changes in inflation in periods when it is rising or falling. This gives rise to temporary declines or increases, respectively, in the real living standards of (mainly lower-income) families as uprating takes time to catch up with inflation developments. Chart 2.5 in the previous chapter showed that while inflation was higher at the outset of all three previous recessions, and especially so in the early 1980s, the pandemic period stands out for seeing inflation rise very sharply in the post-recession years, from 0.6 per cent in the first quarter of 2021 to an expected peak of around 9 per cent in the fourth quarter of 2022 according to our latest forecast. (And to around 10 per cent in the more recent Bank of England forecast published on 5 May.[c])

The precise timing of inflation changes this year and last is such that the lags to benefit uprating are particularly pronounced: benefits were uprated by 3.1 per cent this April – in line with last September's CPI – but inflation began rising rapidly just after that and is forecast to average 8.0 per cent across fiscal year 2022-23 as a whole, meaning the real value of benefits falls by around 5 per cent, or £12 billion in total (including pensioner spending) this year. Our forecast assumes that benefits will rise by 7.5 per cent in April 2023 (our March forecast for the CPI inflation rate in September this year), whereas CPI inflation is expected to average 2.4 per cent in 2023-24 as a whole. So the real value of benefits is expected to rise by around 5 per cent in 2023-24 (£13 billion in total), largely restoring their real value after the dip in 2022-23.

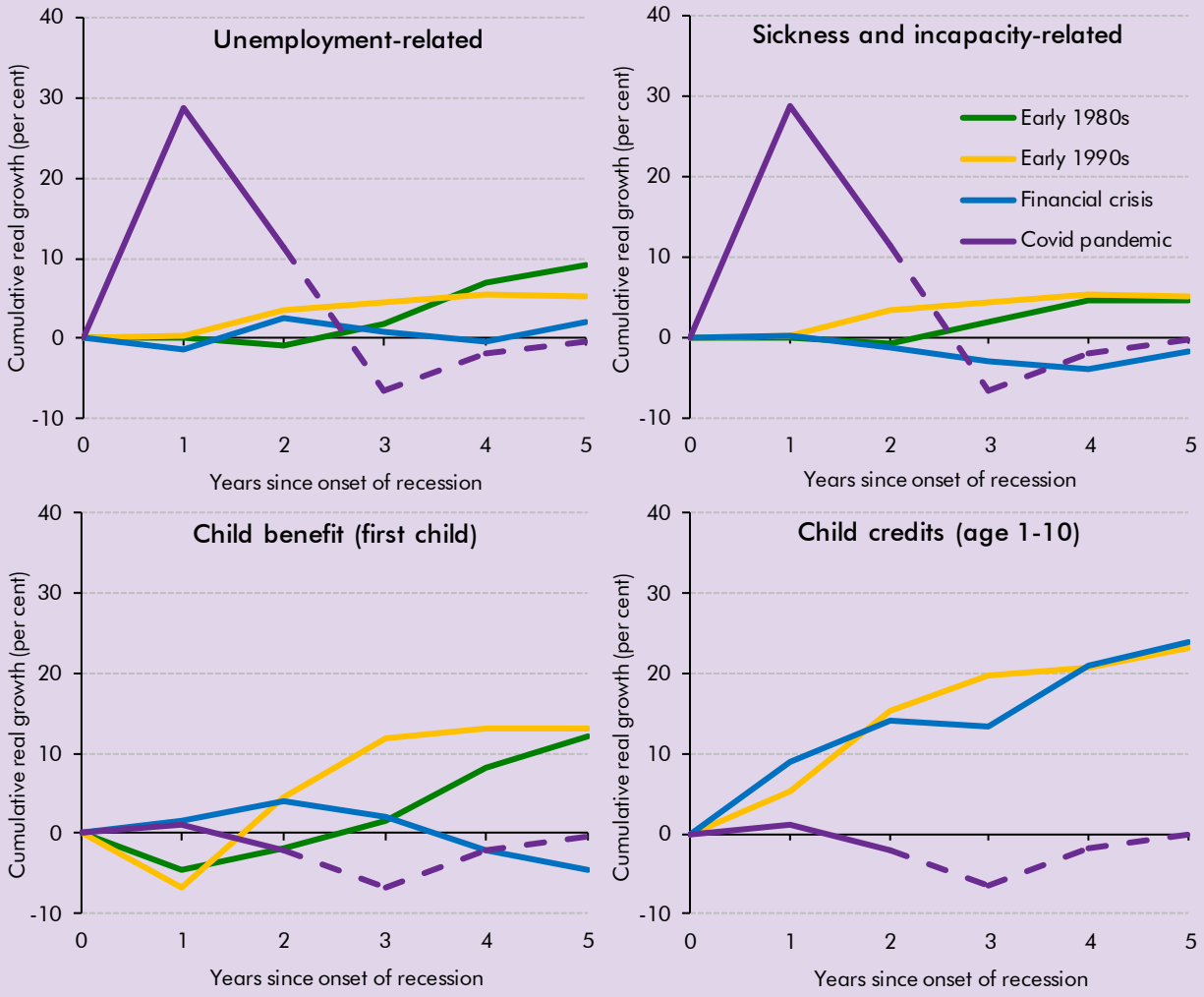
Chart A puts these post-pandemic uprating dynamics in the context of the previous three recessions, showing the real value of non-pensioner benefit rates for which we have comparable data across successive post-recession periods. For all four benefits, it shows that the forecast trough in the real value of benefits is deeper in the wake of the pandemic than for any of the previous three recessions, at 6 to 7 per cent lower in real terms by 2022-23, the third year after the start of the recession. (This trough would be around 8 per cent lower on the basis of the Bank of England's latest inflation forecast.) And while all benefit rates are forecast to have almost caught up with their pre-recession real value by the fifth year of the pandemic (2024-25), they are in all cases lower than at the equivalent point following the early-1980s and early-1990s recessions. The comparison to the financial crisis is more mixed, with child benefit higher in the pandemic, child credits much lower, and unemployment- and sickness and incapacity-related

benefits relatively similar. (The three-year 1 per cent cap on benefit uprating following the financial crisis began in 2013-14 – after the five-year period covered by our analysis – with the four-year benefit freeze that followed taking effect from 2016-17 onwards.)

Taking each benefit in Chart A in turn:

- Rates of **unemployment-related** benefits rose by almost 30 per cent in the first year of the pandemic, reflecting the £20-a-week uplift to the standard allowance in UC (which was also in place for half of the second year – 2021-22). This stands in contrast to the three prior recessions, when unemployment benefits roughly maintained their real value initially. The removal of the £20 uplift and the rise in inflation are expected to take unemployment benefits 6.6 per cent below their pre-pandemic real value in 2022-23. The drop in 2022-23 alone would represent the largest real year-on-year decline in the real value of unemployment benefits since annual uprating began fifty years ago (whether or not the removal of the £20 uplift is captured – the decline is 16.1 per cent including this and 4.5 per cent without it). Rates of unemployment-related benefits then recover their pre-recession real value over the fourth and fifth year following the pandemic, in contrast to the early 1990s and particularly the early 1980s, when the real value rose modestly (due, for example, to over-indexation in 1982 and 1983 to reverse previous declines,[d] and the fact that RPI – historically used to uprate benefits – was often higher than the CPI-based series we use to express benefit rates in real terms here).
- Trends in rates of **sickness and incapacity-related** benefits are similar to those for unemployment-related benefits, with the £20-a-week uplift for UC recipients again dominating in the early years of the pandemic before its removal and rising inflation temporarily eroding real benefit values. The slightly weaker trend for the financial crisis reflects the move from incapacity benefit to ESA over this period, in which rates were limited and aligned with those for unemployment-related benefits.[e]
- **Child benefit** rates (for the first child) fall in real terms in the third year of the pandemic (2022-23) reflecting the time-lag in relation to rising inflation described above, before recovering their real value over the following two years. This stands in contrast to the early-1980s and early-1990s recessions, when the real value of child benefit declined in the first year before rising steadily (thanks to a policy choice to raise child benefit in the early 1990s, detailed in Table 1.2 in Chapter 1), and to the financial crisis, when the real value rose initially (again driven by policy choices) before falling back to below where they are currently expected to reach five years on from the onset of the pandemic.
- Rates of **child credits** (for younger children) follow a similar decline-then-recovery pattern to that for child benefit during the pandemic. This is in marked contrast to the early 1990s and the financial crisis, when decisions to increase the generosity of these credits more rapidly raised their real value by over one-fifth in the fifth year of each recession, relative to the pre-recession value. During the financial crisis, increases in the child element of child tax credits were the key welfare policy measure to support families on lower incomes.

Chart A: Real value of selected benefit rates following recessions



Note: Solid lines show outturn data; dashed line shows forecast. Adjusted using CPI inflation. 'Unemployment-related' covers unemployment benefit, jobseeker's allowance and the UC standard allowance; 'Sickness and incapacity-related' covers sickness benefit, incapacity benefit, employment and support allowance and the UC standard allowance; 'Child credits' cover family credit, working families' tax credit and child tax credit. Unemployment-related and sickness and incapacity-related benefits are for a single person and include the temporary £20 per week uplift during the Covid pandemic that did not apply to contributory and pre-UC benefits; where relevant, sickness and incapacity-related benefits are at the short-term lower rate; child credits exclude the two-child limit.
Source: DWP, IFS, OBR

[a] HM Treasury, *Pre-Budget Report*, November 2008.
[b] Matejic, P., *Fifty years of benefit uprating*, April 2022.
[c] Bank of England, *Monetary Policy Report – May 2022*.
[d] Matejic, P., *Fifty years of benefit uprating*, April 2022.
[e] For more detail, see our October 2016 *Welfare trends report*.

4 Welfare spending in recoveries

4.1 In Chapter 3 we considered the immediate, recession-induced rises in overall non-pensioner welfare spending, and its component parts, at their respective peaks in the pandemic and the three preceding recessions. In this chapter we turn to the medium-term picture, considering lasting changes in spending five years from the onset of each recession, relative to pre-recession spending. This is an imperfect approach since it necessarily involves comparing our *forecast* for welfare spending in 2024-25 with *outturn* for how spending actually evolved following prior recessions. It is therefore not a like-for-like comparison given the considerable uncertainty surrounding our forecast, including in respect of both changes to underlying economic developments and the policy position. Rather, the analysis in this chapter shows how our latest judgements compare with the experience of history. Indeed one purpose of this comparison is to illustrate the risks and uncertainties around our latest forecast, which are discussed further in Chapter 5.

4.2 We explore both overall changes in non-pensioner welfare spending and changes in the different categories described in Chapter 1, but in this case switching from looking at spending in real terms (adjusted for CPI inflation) to looking at spending as a per cent of GDP. We use this latter measure because output has largely recovered from the temporary cyclical element of the downturn by this stage, leaving only lasting structural effects on the GDP denominator that are relevant for the sustainability of welfare spending.

Changes in overall non-pensioner welfare spending

4.3 Based on our latest forecast, non-pensioner welfare spending is expected to rise by 0.3 per cent of GDP in the five years from the onset of the pandemic, which would be a quarter of the rise that followed any of the other recessions we consider (Chart 4.1). Spending on disability benefits and incapacity and parenthood benefits are the largest drivers of this increase (accounting for 0.2 per cent of GDP each), with unemployment, child-related, housing-related and other benefits spending combined contributing a further 0.2 per cent of GDP to the rise. These are partially offset by spending on in-work benefits being forecast to fall by 0.3 per cent of GDP over this period.

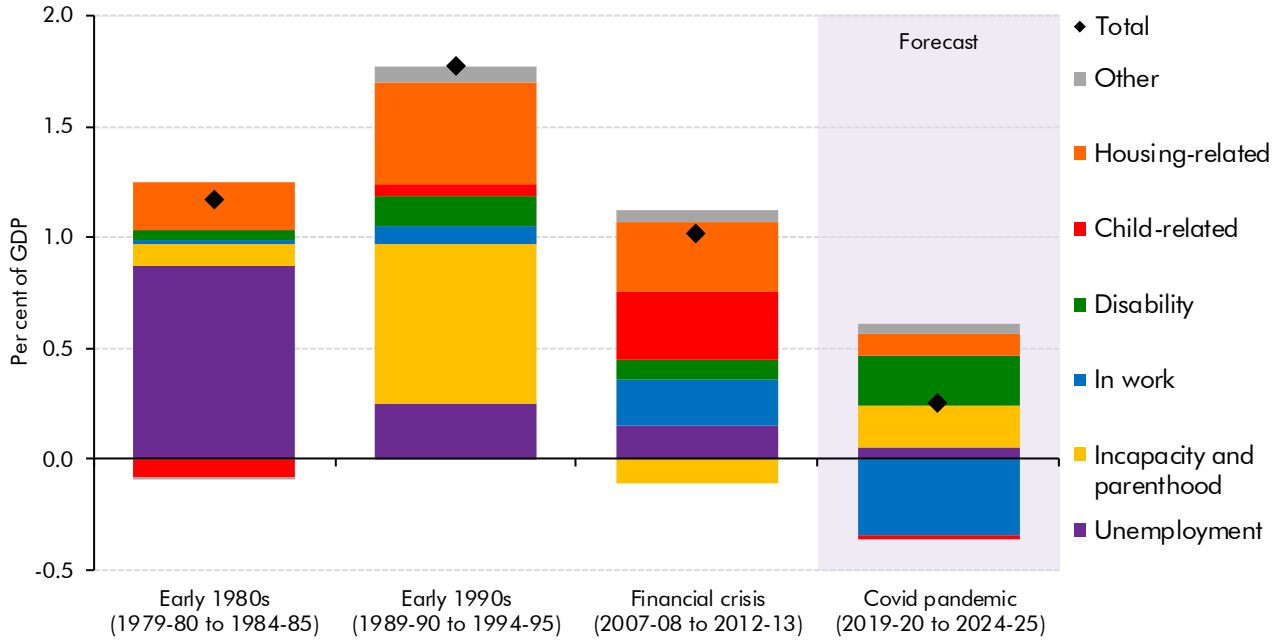
4.4 The overall rise in spending assumed in our forecast is considerably smaller than that witnessed in the aftermath of the three preceding recessions:

- Spending had increased by 1.2 per cent of GDP five years on from the onset of the **early-1980s recession**, the second largest increase among these recessions. This was largely driven by a 0.9 per cent of GDP increase in unemployment benefits spending.

- Following the **early-1990s recession**, spending was 1.8 per cent of GDP higher than its pre-recession level, the largest rise among these recessions, and over seven times the increase assumed in our latest forecast. Incapacity and parenthood benefits were the largest contributor to the increase, but all categories of spending were higher five years on from the onset of the recession than they were before it began.

- Spending rose by 1.0 per cent of GDP in the five years after the onset of the **financial crisis**, the smallest medium-term increase of the three recessions that preceded the pandemic. Housing-related and child-related benefits were the largest drivers, while incapacity and parenthood benefits fell by 0.1 per cent of GDP.

Chart 4.1: Medium-term change in non-pensioner welfare spending after recessions



Source: DWP, HMRC, OBR

4.5 The remainder of this chapter compares the medium-term spending changes by category that we have assumed in our latest forecast to those witnessed in outturn following the three previous recessions. These differences are illustrated in Chart 4.2, which essentially compares the right-hand column in Chart 4.1 with the three columns to its left. It shows that the medium-term increase in spending following the pandemic is forecast to be:

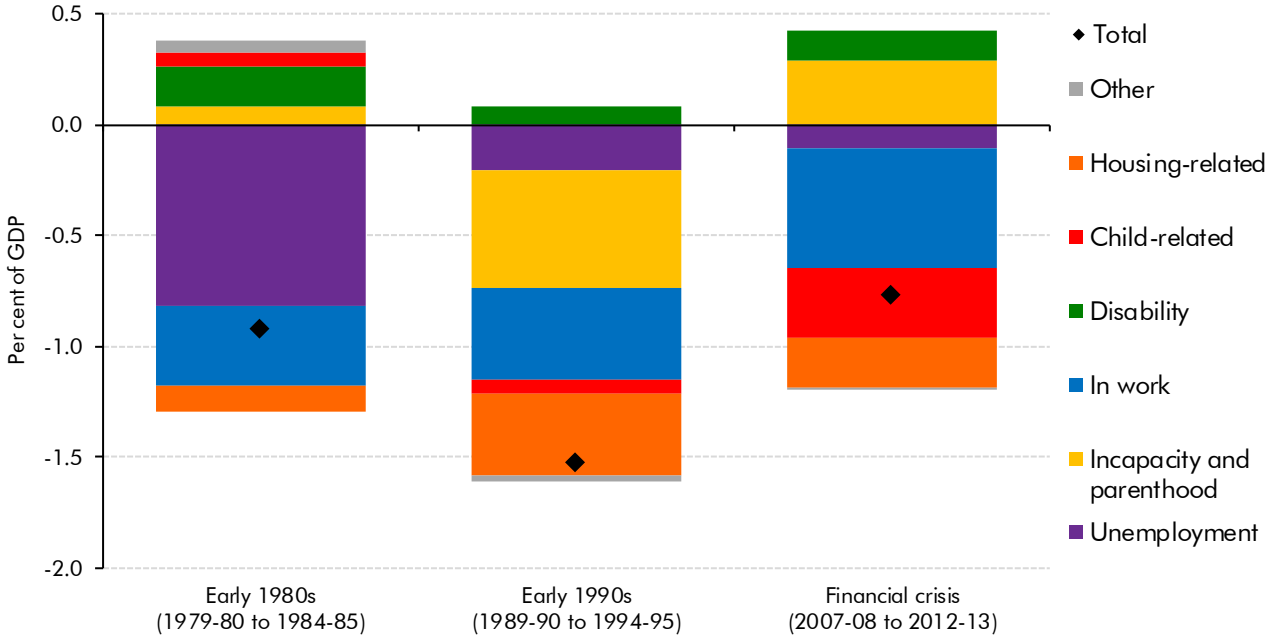
- 0.9 per cent of GDP smaller than in the **early-1980s recession**. Unemployment benefits spending explains most of this difference (0.8 per cent of GDP), partially offset by slightly larger increases in spending on disability, incapacity and parenthood, child-related and other benefits in our latest forecast.

- 1.5 per cent of GDP smaller than in the **early-1990s recession**. This is driven by spending on incapacity and parenthood benefits (which explains 0.5 per cent of GDP of the difference), in-work benefits (explaining 0.4 per cent of GDP) and housing-related benefits (explaining 0.4 per cent of GDP). All categories apart from disability

benefits spending are expected to rise by less (or to fall in the case of in-work spending) five years on from the pandemic than was experienced in the early 1990s.

- 0.8 per cent of GDP smaller than the change in spending that followed the **financial crisis**. This is largely driven by in-work spending (which explains 0.5 per cent of GDP of the difference), alongside spending on child- and housing-related benefits (respectively explaining 0.3 and 0.2 per cent of GDP of the difference). Faster increases in incapacity and parenthood benefits and disability benefits spending following the pandemic compared to the financial crisis partially offset these categories.

Chart 4.2: Medium-term change in non-pensioner welfare spending: the pandemic versus previous recessions



Source: DWP, HMRC, OBR

Explaining changes in individual categories of spending

4.6 The remainder of this chapter considers each of the categories of non-pensioner spending in more detail, comparing the change five years after the onset of the pandemic to changes over the same period following previous recessions. Where possible, we also explore the respective roles of caseloads and average awards in driving these spending changes.

Changes in unemployment benefits spending

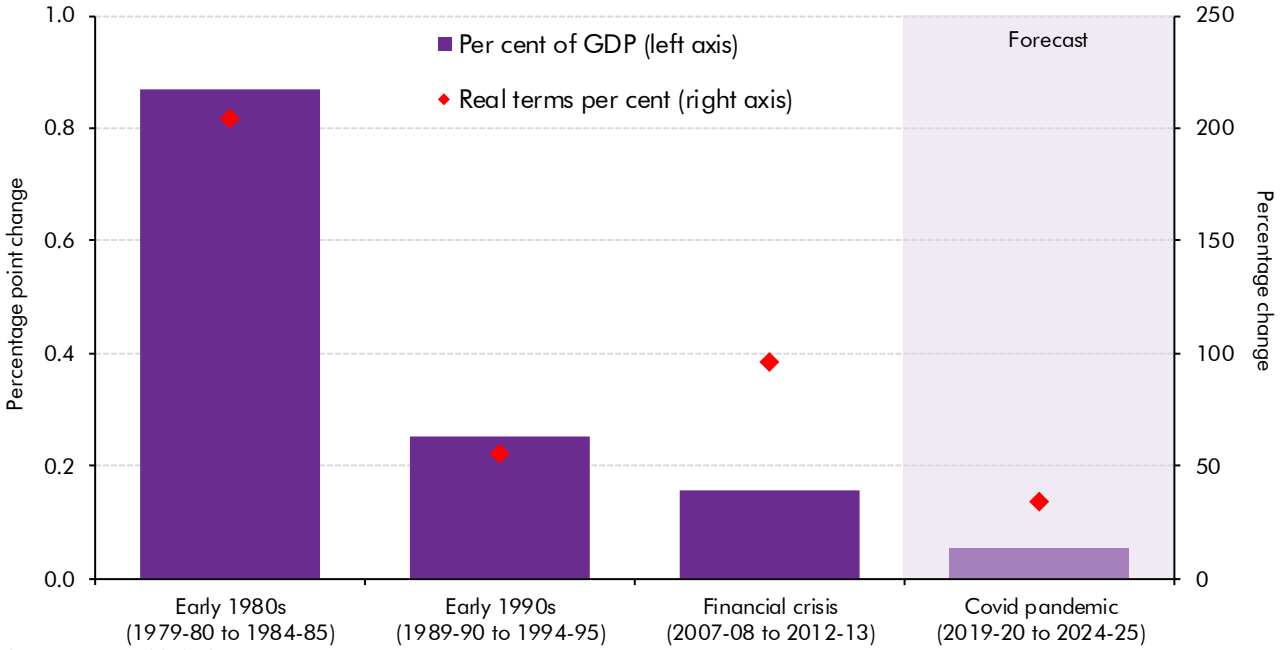
4.7 Spending on unemployment benefits is expected to be 0.1 per cent of GDP higher in 2024-25 than its pre-recession level (a rise of almost 35 per cent in real terms, though this represents a significant fall from the 2020-21 peak). Chart 4.3 shows that this is also a smaller medium-term increase than after any of the preceding three recessions (whether measured in real terms or as a share of national income):

- Five years on from the **early-1980s recession**, spending on unemployment benefits had more than tripled in real terms and had increased by 0.9 per cent of GDP, more than 16 times greater than the medium-term increase as a share of GDP we have assumed will follow the pandemic and the largest rise of all the recessions we consider.

- The medium-term increase in unemployment benefits spending following the **early-1990s recession** was 55 per cent in real terms and 0.3 per cent of GDP. This is almost five times the size of the increase as a share of GDP we expect to follow the pandemic.

- Unemployment benefits spending roughly doubled in real terms in the five years from the onset of the **financial crisis**, and rose by 0.2 per cent of GDP, almost three times larger than the assumed medium-term pandemic increase as a share of GDP.

Chart 4.3: Medium-term change in unemployment benefits spending after recessions



Source: DWP, ONS, OBR

4.8 The remarkably modest medium-term increase in unemployment benefits spending we expect to follow the pandemic is even more striking when we consider the drivers of the rise. These are depicted in Chart 4.4, which splits the rise in unemployment benefits spending as a share of GDP into components related to the Labour Force Survey measure of unemployment, the administrative caseload relative to that survey-based measure of unemployment, and the average amount of benefit received per recipient on the caseload.

4.9 The very small rise after the pandemic is more than explained by a higher medium-term caseload relative to unemployment in the economy, which reflects the wider scope of the 'intensive work search' conditionality group within universal credit (UC) – which includes some working claimants on low earnings – compared to jobseeker's allowance. In that sense it is a consequence of the rollout of UC to replace the legacy benefit system rather

than being a consequence of the pandemic-induced recession. The lack of any contribution from unemployment reflects the fact that our most recent forecast assumes no medium-term unemployment scarring from the pandemic,[1] which in turn reflects the success of the furlough scheme and other interventions in cushioning the labour market from the consequences that would otherwise have been felt when output dropped sharply.

4.10 By contrast to this sanguine outlook over the next few years, in each of the preceding recessions the medium-term increase in unemployment benefits spending was mainly driven by persistently higher unemployment maintaining upward pressure on caseloads:

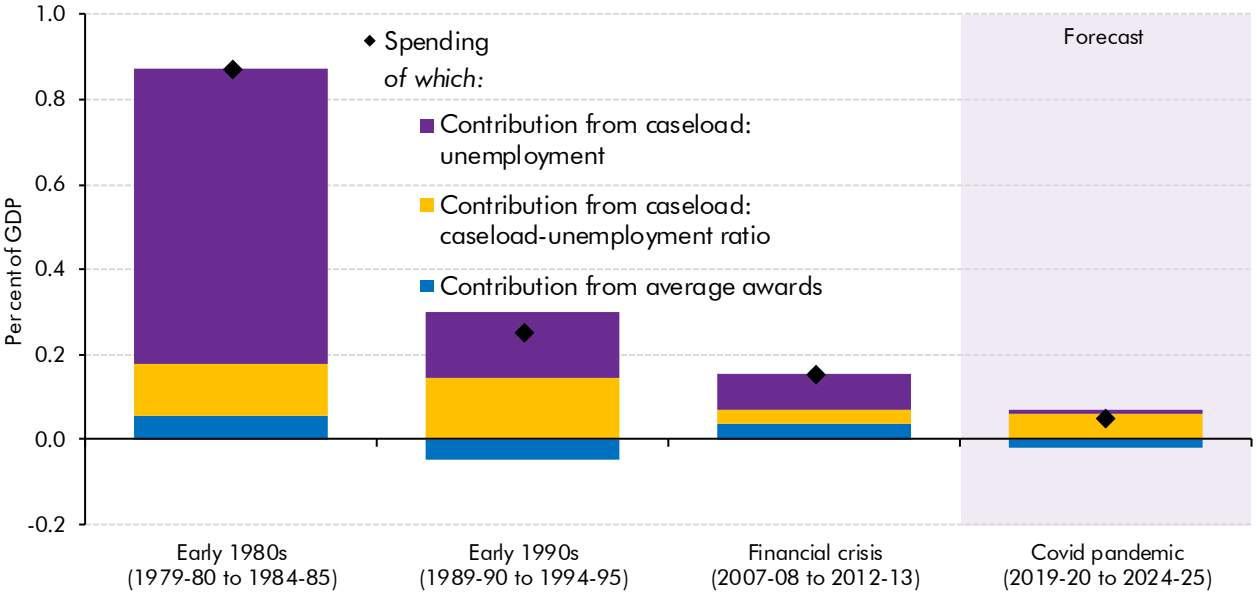
- Four-fifths of the increase in unemployment benefits spending following the **early-1980s recession** was owing to the effects of higher unemployment on caseloads, reflecting the fact that the unemployment rate in 1984-85 (11.7 per cent) was more than double the 1979-80 pre-recession rate (5.5 per cent). A higher caseload-to-unemployment ratio and higher average awards each contributed smaller amounts.

- Over three-fifths of the medium-term rise in spending after the **early-1990s recession** was driven by the impact of higher unemployment (with the unemployment rate having risen from 7.1 per cent pre-recession in 1989-90 to 9.2 per cent five years later in 1994-95). In this case, a higher caseload-to-unemployment ratio contributed a similar amount to the rise in spending, but this was partially offset by the effects of lower average awards (relative to national income per working-age adult). This higher caseload-to-unemployment ratio comes despite the tightening of the unemployment benefit regime from the mid-1980s (described below).

- Three-fifths of the medium-term increase in unemployment benefits spending following the **financial crisis** was driven by the impact of higher unemployment on caseloads: unemployment remained elevated in 2012-13 at 7.9 per cent – the same level it reached in 2009-10 when output reached its low point, and well above the pre-crisis level of 5.2 per cent in 2007-08.

[1] For further detail, see Annex C of our March 2022 *Economic and fiscal outlook*.

Chart 4.4: Drivers of the medium-term change in unemployment benefits spending after recessions

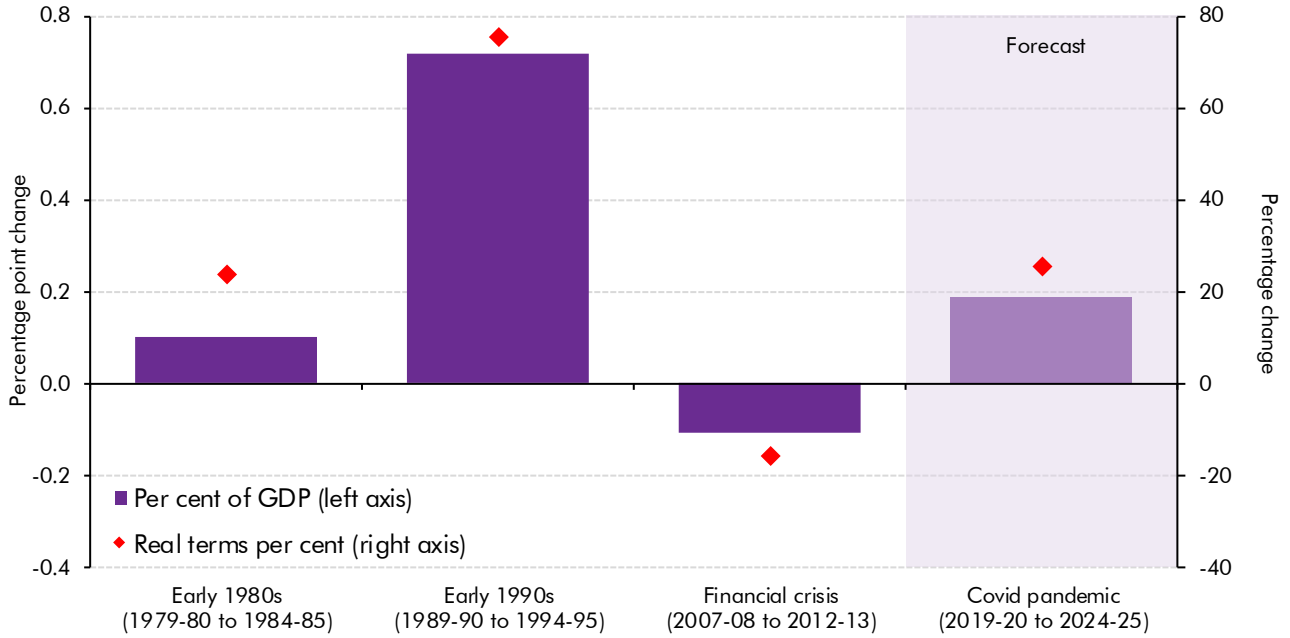


Note: The caseload contribution relating to unemployment is based on changes in unemployment as a proportion of the working-age population; the contribution from average awards is based on average awards relative to GDP per working-age adult.
Source: DWP, ONS, OBR

Changes in incapacity and parenthood benefits spending

4.11 Spending on incapacity and parenthood benefits is expected to be 0.2 per cent of GDP higher in 2024-25 than its pre-pandemic level (a 25 per cent real-terms increase). This is double the medium-term rise as a share of GDP in the early 1980s, but only around one-quarter of the 0.7 per cent of GDP rise in the early 1990s. Only the financial crisis bucks this trend, with spending five years on from the onset of the crisis actually falling by 0.1 per cent of GDP relative to its pre-crisis level (Chart 4.5).

Chart 4.5: Medium-term change in incapacity and parenthood benefits spending after recessions



Source: DWP, ONS, OBR

4.12 Chart 4.6 shows the sources of medium-term changes in real-terms spending on incapacity and parenthood benefits across the four recessions. The increase following the **Covid pandemic** is more than explained by a higher caseload-to-inactivity ratio. This largely reflects a change in the composition of working-age economic inactivity towards groups more likely to be eligible for support from the welfare system, specifically a pandemic-driven shift from those looking after families towards the long-term sick (reflecting a combination of the long-term impacts of Covid and the effects of the pandemic on NHS pressures and mental health incidence).[2] A higher working-age inactivity rate makes up almost one-fifth of the overall rise, reflecting the role of lower participation in our judgement about medium-term economic scarring relative to pre-pandemic trends, which accounts for a 210,000 medium-term increase in working-age inactivity relative to our pre-pandemic March 2020 forecast. As discussed in Chapter 2, these pandemic-induced health changes come on top of the long-term rise in survey-based measures of the incidence of (particularly mental) health issues in the working-age population.

4.13 Turning to the three preceding recessions:

- Both the scale and composition of the medium-term rise in spending in the **early-1980s recession** were similar to changes expected following the pandemic, with the increase more than explained by a higher caseload-to-inactivity ratio, which in turn partly reflects rising prevalence of single parenthood (Chapter 2).

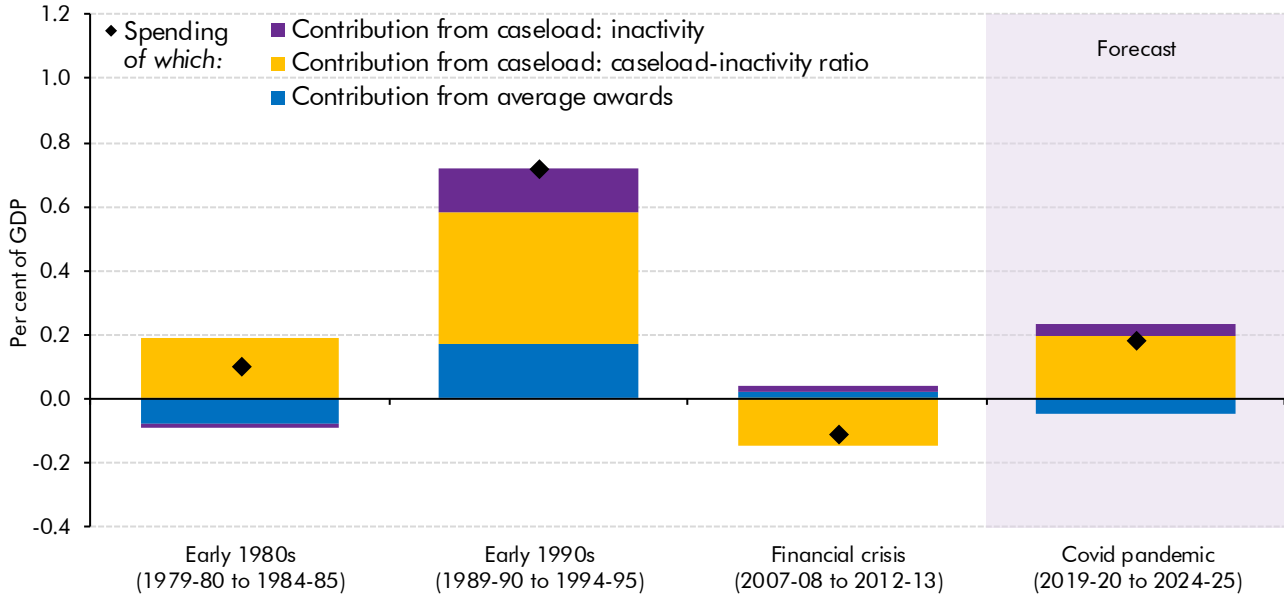
[2] For more information on this change in composition, see Box 2.4 of our March 2022 *Economic and fiscal outlook*.

- Similarly, almost three-fifths of the medium-term rise in spending following the **early-1990s recession** was driven by a higher caseload-to-inactivity ratio. As well as a continuation of the long-term (and non-recession-related) rise in single parenthood, this reflected a growing share of (mainly older) working-age men moving onto incapacity benefits, often after spells on unemployment benefits. This was driven by various policy changes over this period, as the unemployment benefit regime was tightened from the mid-1980s, while the incapacity system had relatively limited conditionality and incapacity benefits were more generous than unemployment benefits.[3] Contributions from higher inactivity and higher average awards made up the final third of the overall increase, in roughly equal measure. The aftermath of the early-1990s recession saw incapacity and parenthood benefits spending reach a high of 1.8 per cent of GDP in 1995-96.

- The medium-term fall in spending following the **financial crisis** was largely driven by a lower caseload-to-inactivity ratio as eligibility was restricted with the introduction of employment and support allowance (ESA) and income support was progressively restricted to parents of younger children only from 2008 onwards. This was partially offset by the contribution from higher average awards, as a rising share of ESA cases were eligible for the more generous 'support' group (with mental health conditions being significant drivers of this growth – reflecting their steady long-term rise described in Chapter 2 – and particularly driven by a very high volume of successful appeals against initial work capability assessments).[4] These policy changes mark the aftermath of the financial crisis out from the other three recessions, including the pandemic where (as required by legislation) our forecast is conditioned on current policy and therefore assumes no changes that would either restrict or increase spending.

[3] See: Banks, J., et al., *Disability, health and retirement in the United Kingdom*, IFS Working Papers No. W11/12, 2011; and Chapter 6 of our 2014 *Welfare trends report*.
[4] See our 2016 *Welfare trends report*.

Chart 4.6: Drivers of the medium-term change in incapacity and parenthood benefits spending after recessions



Note: The caseload contribution relating to inactivity is based on changes in inactivity as a proportion of the working-age population; the contribution from average awards is based on average awards relative to GDP per working-age adult.
Source: DWP, ONS, OBR

Changes in in-work benefits spending

4.14 Spending on in-work benefits is forecast to fall by 0.3 per cent of GDP from 2019-20 to 2024-25 (Chart 4.7), despite in-work UC spending being lifted by the higher work allowances and lower taper rate that were announced in the October 2021 Budget (at an annual cost of £2.2 billion by 2024-25). This fall is in large part driven by a 32 per cent fall in in-work benefit caseloads over the same period. It reflects several factors, including:

- **Classification differences.** Our categorisation of spending relies on UC conditionality groups, which do not line up perfectly with different benefits in the legacy system. This inflates out-of-work caseloads and reduces the in-work caseload relative to a true like-for-like comparison with historical spending. In particular, all spending under UC in respect of a couple in which each partner faces a different conditionality regime is assigned to one group. This means that spending on some couples with one partner in work, who would previously have been in receipt of working tax credits, can be assigned to one of the out-of-work conditionality groups in UC. For example, our forecast assumes the number of families counted in one of the mainly out-of-work conditionality groups in UC, but containing someone who is in work, will increase by 240,000 (42 per cent) between 2020-21 and 2024-25,[5] the period during which most remaining tax credit claimants are expected to move over to UC. This figure is equivalent to just under one-third of the fall in the in-work caseload over that period, suggesting that somewhere up to this proportion of the fall in in-work spending following the pandemic is a statistical phenomenon as a result of this classification

[5] We do not have access to the data necessary to calculate this relative to a 2019-20 base year.

difference rather than a real-world outcome. Further classification issues relate to how spending is 'tapered' in UC as earnings rise: in the legacy system in-work tax credits spending was effectively withdrawn after housing benefit, whereas all UC elements are tapered simultaneously.

- **'Fiscal drag'.** Our expectation that earnings will grow somewhat faster than relevant rates and allowances in UC and tax credits (which are uprated with CPI inflation) in the coming years takes some people out of eligibility for in-work benefits over the forecast period: nominal earnings are forecast to grow by 20 per cent between 2019-20 and 2024-25, while rates and allowances are expected to rise by 17 per cent.

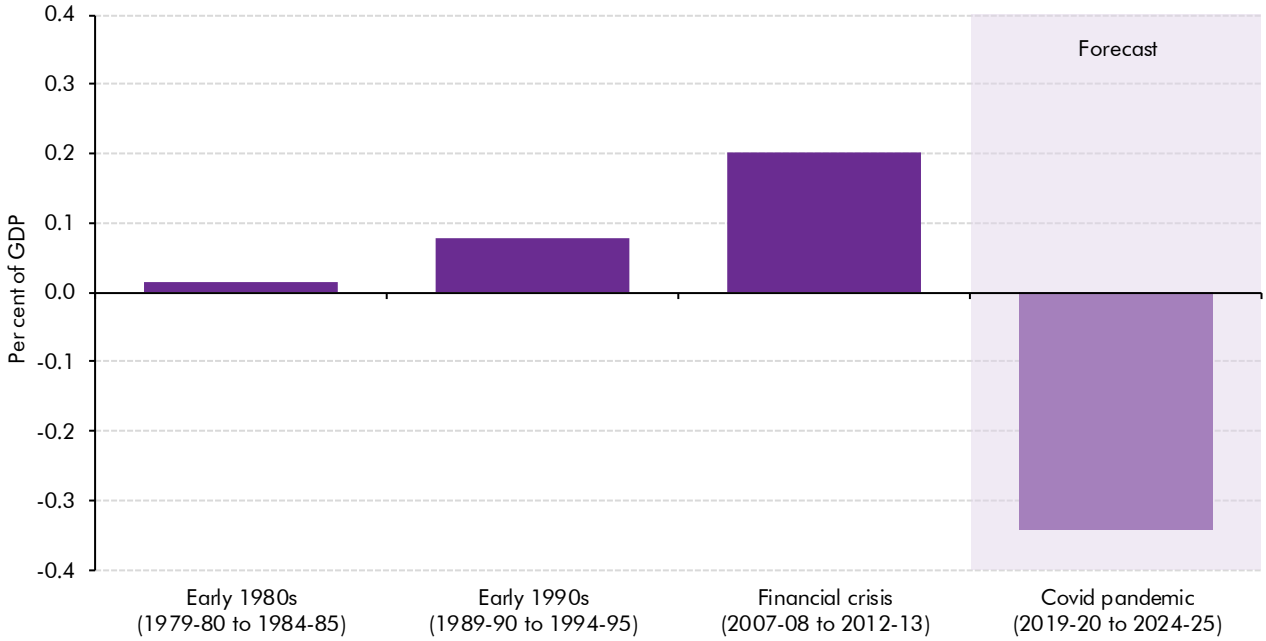
- **UC being less generous for the self-employed than the legacy system.** The self-employed receive less support on average in UC than in the legacy benefits system thanks to the minimum income floor mechanism, which in general means single claimants earning less than £1,350 a month are treated as though they earn this amount, and therefore often receive less support than they would have in the tax credits system.[6] The continued rollout of UC over our forecast therefore reduces spending on some self-employed people relative to what they would have received in the tax credits system.

- **The gradual rollout of the two-child limit** (and the smaller impact of the gradual removal of the 'family element'). These policies, announced in the 2015 Summer Budget, reduce means-tested support for in-work (and out-of-work) families with children born after 6 April 2017. This means they take effect gradually and will not be fully rolled out until the mid-2030s when all children will have been born after that date. These savings are split across in-work and child-related spending in our classification. As of April 2021, over 300,000 families claiming UC or child tax credits (CTC) were affected by the two-child limit.[7]

4.15 With a much more limited in-work benefits system in the early 1980s or early 1990s, the most relevant historical comparison to our latest forecast is the financial crisis, when in-work spending rose by 0.2 per cent of GDP in the five years to 2012-13. This reflected a 17 per cent increase in the caseload, as well as rising awards thanks to policies that increased the generosity of tax credits in the recession's aftermath.[8] Both caseloads and awards will also have been affected by the weakness of productivity growth and real pay growth in the sluggish recovery that followed the financial crisis, alongside the longer-term rise in part-time working (and other more flexible employment forms including self-employment), which accelerated following the financial crisis until around 2013.

[6] The minimum income floor is not a uniform amount across all claimants. The £1,350 figure would apply to a claimant that was expected to work 35 hours a week at the equivalent of the National Living Wage.
[7] Department for Work and Pensions and HM Revenue and Customs, *Universal Credit and Child Tax Credit claimants: statistics related to the policy to provide support for a maximum of 2 children, April 2021*.
[8] The 'In-work CTC: family element or less' component of the caseload has been excluded from the caseload (but not spending) time series in order to prevent the removal of the second income threshold in the aftermath of the financial crisis from distorting our interpretation of the caseload trends. Between 2010-11 and 2012-13, 1.6 million families (that had been in receipt of very small awards) were removed from the caseload as the 'family element or less' component became redundant as a result of the policy change.

Chart 4.7: Medium-term change in in-work benefits spending after recessions



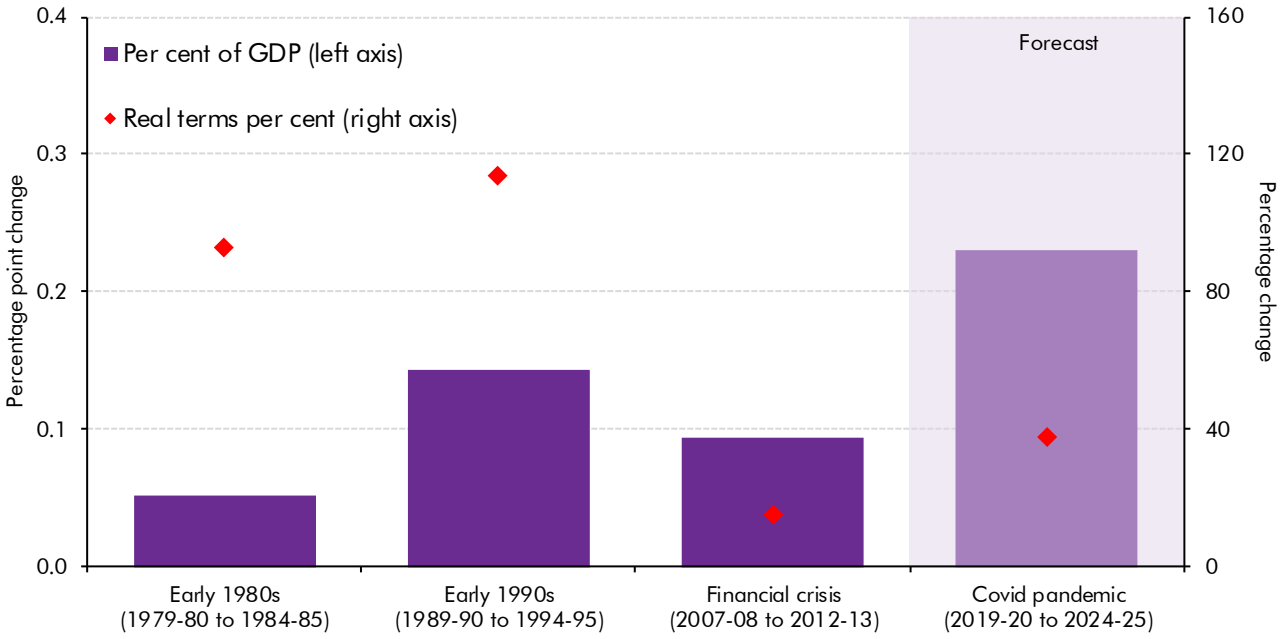
Source: DWP, HMRC, ONS, OBR

Changes in disability benefits spending

4.16 Spending on disability benefits is expected to rise by 0.2 per cent of GDP (and almost 40 per cent in real terms) in the five years from the onset of the pandemic. This would be the largest increase as a share of national income of any of the past four recessions (and more than twice the size of the medium-term increase following the early-1980s recession and the financial crisis). This largely reflects our forecast judgements in respect of some of the same pandemic-induced health-related drivers as the rise in inactivity and parenthood benefits spending, discussed above. These increases come on top of our pre-pandemic expectation that disability benefits spending would continue to rise modestly as a share of GDP as a result of rising prevalence of benefit receipt in the population – partly reflecting longer-term trends in the prevalence of mental health conditions (see Chapter 2).[9] Even so, the rise expected in our forecast is a smaller *real-terms* increase than the early-1980s and early-1990s recessions, reflecting the fact that spending on disability benefits is equivalent to a much larger share of GDP now than it was in the 1980s and 1990s.

[9] As discussed in our January 2019 *Welfare trends report*, which was dedicated to trends in disability benefits spending.

Chart 4.8: Medium-term change in disability benefits spending after recessions



Source: DWP, ONS, OBR

4.17 Chart 4.9 shows that this pattern of changes as a share of national income is mirrored in medium-term changes in caseload prevalence as a share of the working-age population (and similarly, the pattern of changes in real-terms spending is mirrored in medium-term *percentage* changes in the caseload). The 1.7 percentage point medium-term rise in caseload prevalence following the pandemic is the largest of all recessions, exceeding the 1.2 percentage point rise seen in the early 1990s and much larger than that in the other two recessions. The early-1980s rise partly reflected the accelerated rollout of (working-age) attendance allowance[10] and mobility allowance after their introduction in the 1970s, while the early-1990s rise partly reflects the introduction of disability living allowance in 1992.

[10] This currently pensioner-only benefit previously supported people of working age and children too prior to the introduction of disability living allowance.

Chart 4.9: Medium-term change in disability benefit caseloads after recessions

Source: DWP, ONS, OBR

Changes in child-related benefits spending

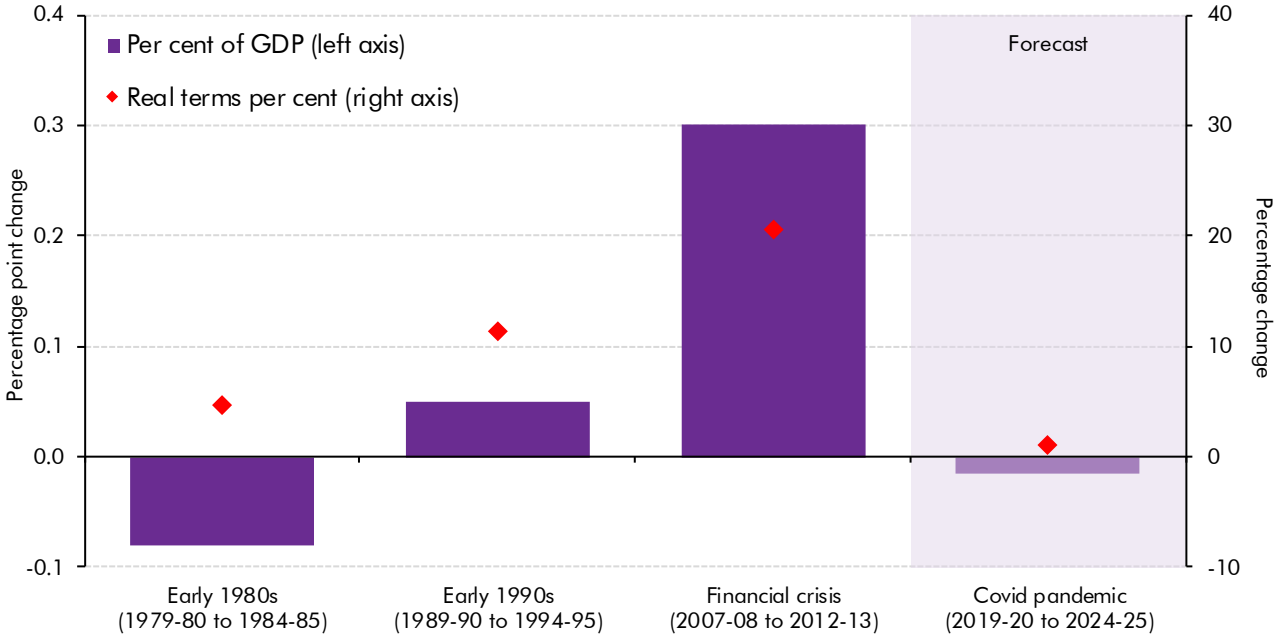
4.18 Spending on child-related benefits is forecast to fall slightly as a share of GDP in the five years from the onset of the pandemic, and is expected to be only 1 per cent higher than its pre-pandemic level in real terms (Chart 4.10). In part this reflects the downward trend in the child benefit caseload described below. The gradual implementation of the two-child limit and removal of the family element (discussed above) also reduce spending on UC and CTC for out-of-work families over this period. Relative to other recessions:

- The **early-1980s** recession saw the largest medium-term fall in child-related benefits spending (0.1 per cent of GDP), accompanied by a 4 per cent decline in child benefit caseloads over this period reflecting the structural decline in births reducing the child population (Chart 4.11).

- Spending marginally increased as a share of GDP in the five years from the onset of the **early-1990s** recession, while the child benefit caseload grew by 2 per cent reflecting higher take-up.

- Spending increased by 0.3 per cent of GDP following the **financial crisis**, the largest rise as a share of national income across the four recessions. This partly reflected a higher child benefit caseload, which grew by 6 per cent over this five-year period, reflecting higher take-up and the rise in births in the first decade of the 21st century. In addition, policy changes in the immediate aftermath of the financial crisis increased the generosity of CTC for out-of-work families (see Table 1.2 in Chapter 1).

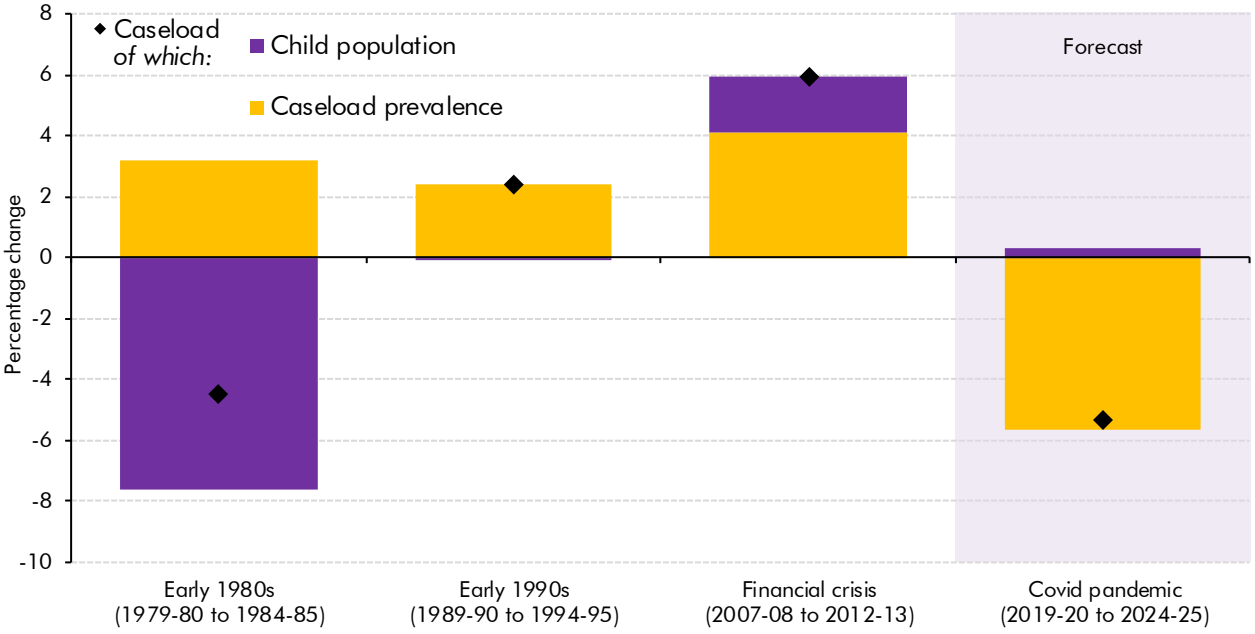
Chart 4.10: Medium-term change in child-related benefits spending after recessions



Source: DWP, HMRC, ONS, OBR

4.19 In line with the change in spending, the child benefit caseload, a subset of the total child-related caseload, is expected to fall by around 5 per cent in the medium term following the pandemic, the largest fall of any of the four recessions. Chart 4.11 shows that this is driven by a fall in caseload prevalence (the proportion of children for which child benefit is paid). This largely reflects the increasing reach of the high-income child benefit charge, which tapers away child benefit for families where at least one adult has an income between £50,000 and £60,000. To a lesser extent, it also reflects the drop in new claims during the pandemic, which does not fully unwind over our forecast (Box 4.1). The lack of growth in the child population in the five years following the pandemic in Chart 4.11 reflects the continuation of the longer-term trend of lower births since 2012, which has accelerated in the latest ONS population projections (see Chapter 2).

Chart 4.11: Medium-term change in child benefit caseloads after recessions



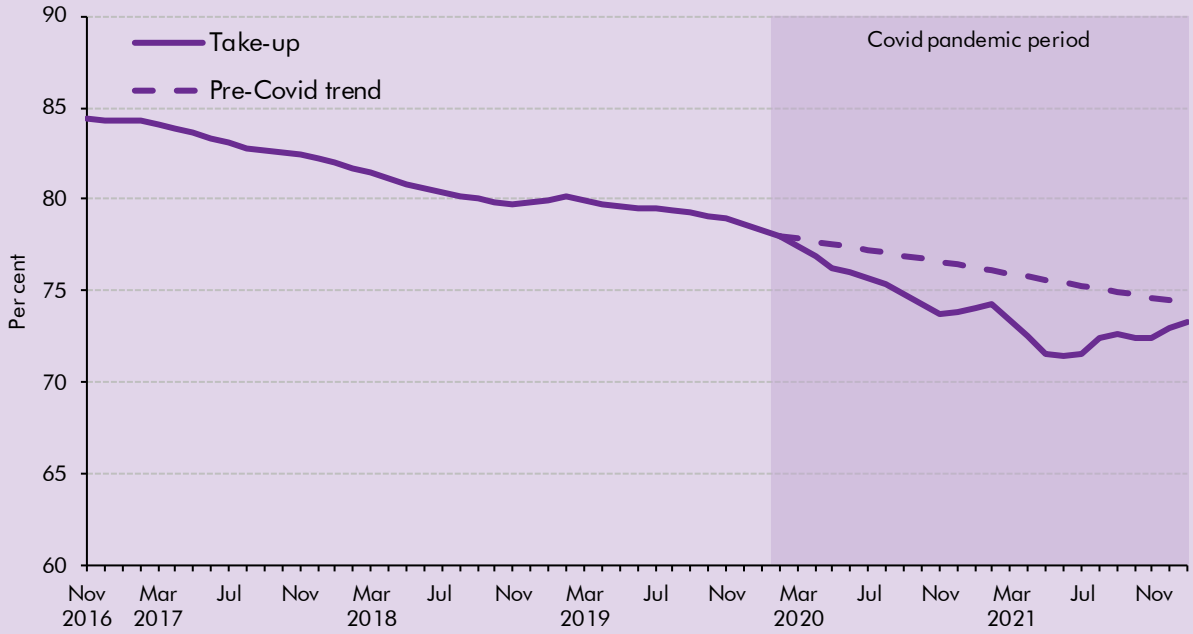
Source: DWP, HMRC, ONS, OBR

Box 4.1: The impact of the pandemic on child benefit take-up

There are two main drivers of the child benefit caseload:[a] new claims, which are mainly driven by births, and the high-income child benefit charge (HICBC), which effectively tapers away child benefit for individuals with income between £50,000 and £60,000, thresholds that have been held flat in cash terms since the HICBC's introduction in 2012-13. Before the pandemic, the child benefit caseload had been falling steadily as a result of both drivers: take-up had been falling since the introduction of HICBC as income growth meant more individuals faced the charge, while the eligible population was also falling due to fewer births (see Chapter 2). The child benefit caseload fell from over 7.9 million in 2012-13 to below 7.3 million in 2019-20.

The pandemic resulted in a further fall in the number of new child benefit claims (measured by the number of 0-year-olds for which child benefit is paid each month). They fell by 13 per cent between February 2020 and June 2021 (including backdated claims) – a fall of around 70,000 in the new-claims caseload. While this was partly due to a 4 per cent drop in the number of births in 2020, the majority was due to the take-up rate for 0-year-olds falling from 78 per cent in February 2020 to a low of 71 per cent in June 2021, before recovering back towards the pre-pandemic downward trend (Chart A).

Chart A: Child benefit take-up rates for 0-year-olds



Source: HMRC, OBR

There are two main (and many smaller) ways that the pandemic may have affected take-up:

- **Parents were unable to register new births due to lockdown.** In normal circumstances, a birth certificate is required for a new child benefit claim, and while a temporary easement was put in place allowing parents to claim child benefit without one, it seems likely that not all new parents were aware of this.
- The **'Bounty' packs** that are distributed in hospitals to new parents, which contain child benefit application forms, were not distributed as widely as they would be in normal times. This is likely to have reduced awareness of child benefit among new parents.
- **Other smaller factors** include a reduction in word-of-mouth information about child benefit between parents during lockdown, and a lack of contact with services that might trigger a claim such as post-natal groups or health visitors.

The medium-term implications of lower take-up during the pandemic depend on the extent to which these 'missing' claims are recovered in the future. Our forecast assumes that only half of the 0-year-olds who were not registered for child benefit in 2020-21 and 2021-22 will be registered by 2026-27. As a result, we expect the child benefit caseload to be 29,000 lower in 2022-23 and 17,000 lower in 2026-27 than it would have been without the pandemic (holding all other drivers of the caseload constant). This amounts to a modest reduction in spending of £33 million in 2022-23, falling back to £22 million in 2026-27.

[a] The child benefit caseload, new claims and take-up in this box all refer only to claims in payment and exclude opt-out claims, as only the former affect child benefit spending. HMRC includes opt-out claims in their published child benefit caseload and take-up statistics.

Changes in housing-related benefits spending

4.20 Housing-related benefits spending is expected to rise by 0.1 per cent of GDP (14 per cent in real terms) in the five years from the onset of the pandemic (Chart 4.12), while the housing-related benefit caseload as a share of the working-age population is expected to increase by 2.3 percentage points (Chart 4.13). On either measure of the rise, this is a smaller increase than in any of the previous three recessions:

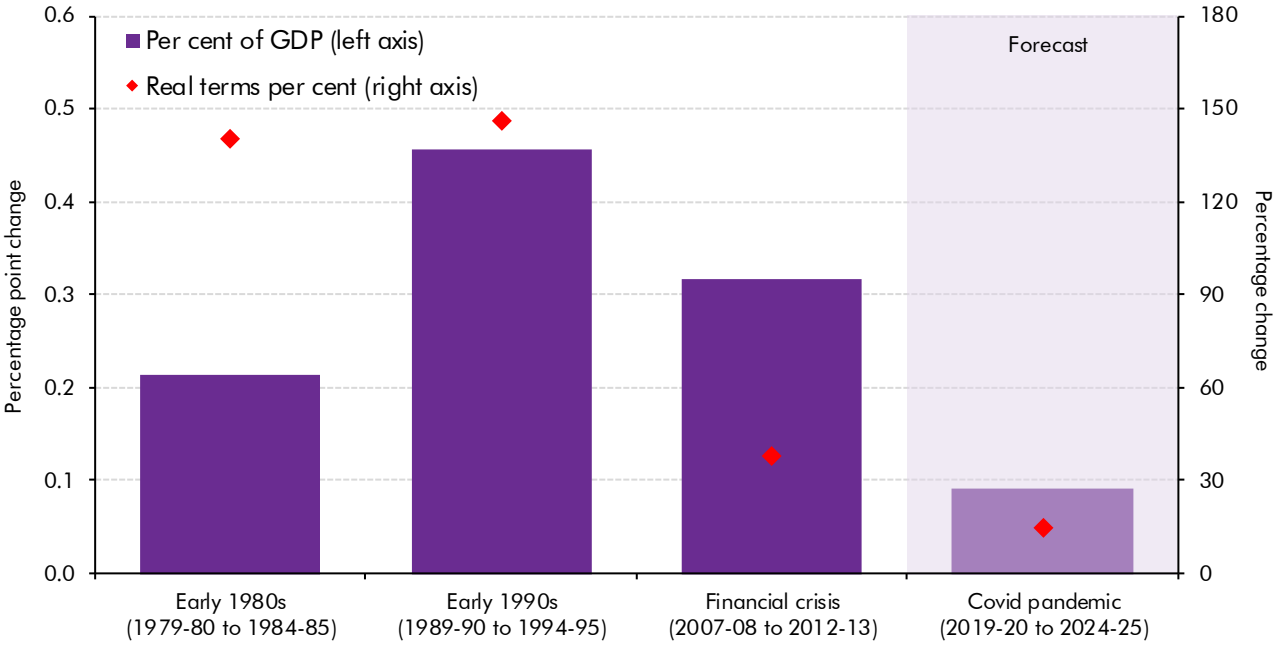
- Spending rose by 0.2 per cent of GDP in the five years from the onset of the **early-1980s recession** (and by 140 per cent in real terms). While a consistent caseload series for non-pensioner households is not available for the 1980s, this is likely to reflect the large increase in unemployment described above (since those newly eligible for unemployment benefits often also become eligible for housing-related support).

- The medium-term increase following the **early-1990s recession** was five times greater than the rise we assume in the wake of the pandemic at 0.5 per cent of GDP, and ten times greater in real terms, but the increase in the caseload as a share of the working-age population was only slightly larger (Chart 4.13). As discussed in Chapter 2, this difference reflects the rise in rents associated with the deregulation of the private-rented sector, rising social rents, and a falling share of social renters within the caseload in the 1990s, all of which increased average awards.[11]

- Spending following the **financial crisis** rose by 0.3 per cent of GDP, and by almost 40 per cent in real terms, over three times greater than the pandemic rise as a share of GDP and around 2½ times larger in real terms. But the increase in the caseload as a share of the working-age population was very similar to that we expect to follow the pandemic, at 2.2 percentage points. As in the early-1990s recession, this reflected rising rents (particularly in the social-rented sector) and a falling share of social renters within the caseload mirroring the rise in private renting in the overall population.[12] By contrast, our forecast assumes that the proportion of households in different tenures will remain broadly flat and that rents will grow broadly in line with earnings.

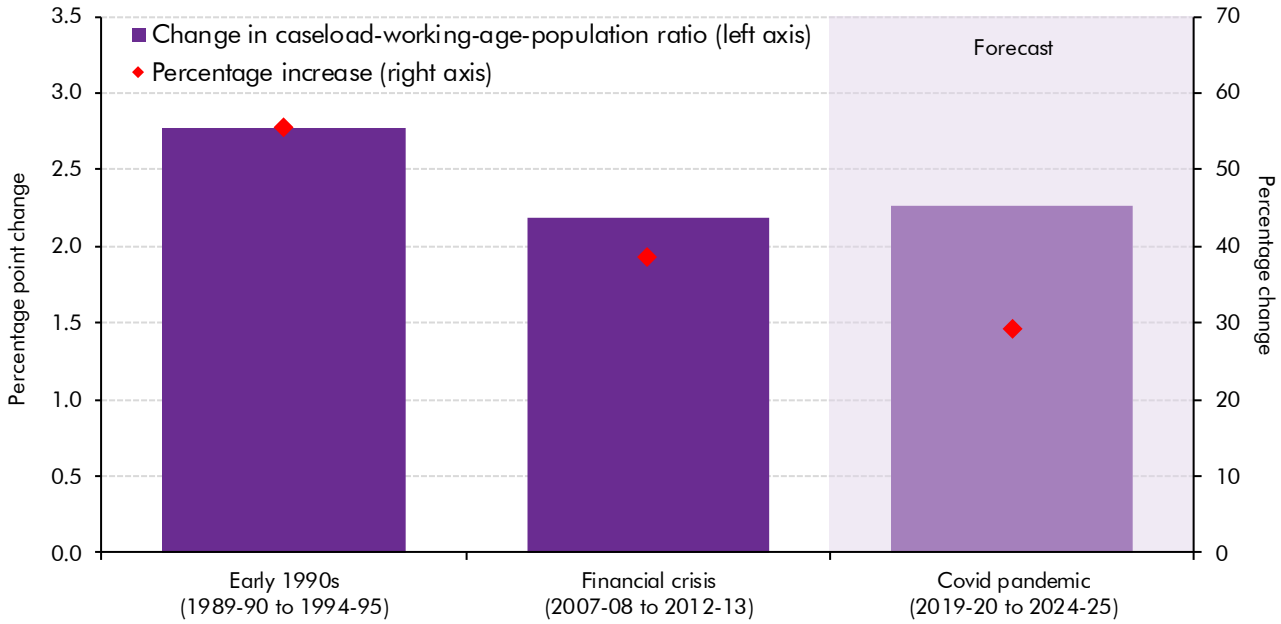
[11] See Chapter 9 of our 2014 *Welfare trends report*.
[12] See: Chapter 9 of our 2014 *Welfare trends report*; and Hood, A., and L. Oakley, *The social security system: long-term trends and recent changes*, November 2014.

Chart 4.12: Medium-term change in housing-related benefits spending after recessions



Source: DWP, ONS, OBR

Chart 4.13: Medium-term change in housing-related benefit caseloads after recessions



Note: A consistent non-pensioner caseload series is not available for the early-1980s recession.
Source: DWP, OBR

5 Risks and uncertainties

5.1 Our forecasts are always subject to a range of risks and uncertainties, which we try to highlight in our *Economic and fiscal outlooks* (*EFO*s). In comparing the evolution of welfare spending across past recessions and recoveries – including our expectations for the coming years – this report illustrates several of the risks and uncertainties surrounding our most recent welfare spending forecast, both to the upside and the downside. A general finding from our successive *Fiscal risks reports* has been that recessions are an ever-present risk – the chance of one happening in any five-year period is around one-in-two – but they are rarely predicted since they typically follow an unanticipated shock. Moreover, as documented in successive *Forecast evaluation reports*, it has also proved challenging to forecast the strength and composition of recoveries from economic shocks, as illustrated by repeated downward revisions to prospects for productivity growth in the wake of the financial crisis and more recently by the faster-than-expected economic rebound from the worst of the pandemic. In this chapter we conclude by briefly setting out some of key risks and uncertainties for welfare spending that emerge from the preceding chapters.

5.2 One category of risks relates to the outlook for the economy, and particularly the labour market, which is a key driver of the number of people eligible for non-pensioner benefits:

- Our expectation that **unemployment** will remain broadly flat at its current rate of around 4 per cent in the coming years – with no medium-term scarring from the pandemic (a key policy success) – is reflected in a much smaller rise in unemployment and housing-related benefits spending than in any of the three preceding recessions. These two categories of welfare spending cost 1.1 per cent of GDP in 2024-25 in our latest forecast. All else equal, if unemployment were 1 percentage point higher at that point, non-pensioner welfare spending would be £2.1 billion (1.6 per cent) higher. Conversely, if unemployment were to continue on its current downward path and settle at an equilibrium rate that was 1 percentage point lower, spending would be lower by the same margin. The overall effect on welfare spending would depend on whether those moving into or out of these out-of-work benefits would have received in-work benefits in the counterfactual, while broader fiscal consequences would also depend on any additional amounts they paid in tax.

- Our forecast assumes **greater economic inactivity** due to ill-health, which is reflected in our forecast via increased spending on both incapacity and parenthood benefits, and disability benefits, relative to historical experience. These two categories of spending are expected to cost 1.9 per cent of GDP in 2024-25. Our forecast judgements here are particularly uncertain given the fact that they relate to a combination of the long-term direct impacts of Covid, which are still emerging, and indirect impacts via pressures on the NHS and consequences for mental health that would be felt on top of

the already rising trend in prevalence prior to the pandemic.[1] Our latest economy forecast assumes that working-age inactivity will be 210,000 higher in the medium term as a result of the pandemic. If this scarring were twice as large at 420,000, working-age inactivity would be 2 per cent higher than forecast. And if all these extra inactive people received incapacity benefits, non-pensioner welfare spending would be £2.7 billion (2.1 per cent) higher in 2024-25.

- More broadly, our central forecast assumes 2 per cent **scarring** to potential output in the medium term, relative to a pre-pandemic baseline. Less severe scarring would have wide-ranging implications for welfare spending. Higher productivity and thus higher average incomes would be expected to reduce spending on in-work benefits, whereas higher migration tends to increase the cash amount of welfare spending as some migrants would be eligible to claim benefits. Both would lift GDP and therefore reduce the share of national income a given cash amount of spending represents. The opposite would be true of more severe scarring than assumed in our central forecast.

5.3 A second category of risks relates to policy choices and the operation of the welfare system:

- The lag in **benefit uprating** in the context of rapidly rising inflation means that non-pensioner benefit rates are forecast to be 6 to 7 per cent lower in real terms this year than they were in 2019-20. This would be a deeper trough than in the wake of any of the preceding three recessions (see Box 3.1 in Chapter 3) – and the drop would be even greater on the basis of the Bank of England's latest forecast (at around 8 per cent). As set out in Box 3.1, the 5 per cent real-terms fall in 2022-23 assumed in our forecast reduces the real value of benefits (including those for pensioners) by £12 billion this year. The April 2023 uprating then raises their real value by £13 billion, thereby largely confining the real-terms fall to a one-off effect in 2022-23.

- Even in the absence of policy decisions, the pressure on household budgets this year will create a risk of **increased take-up** of various benefits relative to our forecast assumptions, as people seek alternative ways to cover higher costs of energy and other essential items. Given the unprecedented nature of the shock to living costs, and the implications of universal credit (UC) – which is still in the process of being rolled out – for benefit take-up, there is limited information on which to make judgements on the scale of such take-up effects. One simple way to illustrate this risk is the cost of a 1 per cent rise in caseloads across non-pensioner welfare spending, which would be £1.3 billion in 2024-25 if the new claims attracted the same average awards as existing ones. To the extent that those not currently claiming benefits to which they are eligible would attract lower average awards – i.e. those with least to lose are currently not claiming – the risk to spending from higher take-up would be smaller than this figure.

- We discussed in our March 2022 *EFO* the forecast judgements we had taken regarding **fraud and error** in UC, which jumped from 9.4 per cent to 14.5 per cent of

[1] On NHS pressures, see Box 3.4 in our March 2022 *Economic and fiscal outlook*; on mental health prevalence and disability benefits, see our January 2019 *Welfare trends report*.

spending between 2019-20 and 2020-21 (with new claims made during 2020-21 subject to an estimated fraud and error rate of 25.6 per cent). We assumed that fraud and error would subside from the very high levels seen in 2020-21, resulting in a reduction in spending of around £0.6 billion a year relative to a situation in which rates remained elevated. Our forecast also includes the impact of several policies aimed at reducing fraud and error in UC, which are expected to save around £0.6 billion a year. These figures suggest that plausible fraud-related risks to our forecast could run into the hundreds of millions of pounds.

5.4 Finally, the weaker near-term growth outlook that has resulted from the Russian invasion of Ukraine and its effects on energy and other prices has heightened the risk of the economy falling into **recession** again this year. As the analysis in Chapters 3 and 4 illustrates, the initial and lasting consequences of recessions for welfare spending differ greatly depending on how they manifest themselves economically, and how policy responds. But in all cases welfare spending rises sharply in the near term and in most cases recessions leave spending higher in the medium term, which in some cases shapes subsequent welfare policy as governments have tried to reduce those medium-term costs.

Index of charts and tables

E02748611

ISBN 978-1-5286-3366-6