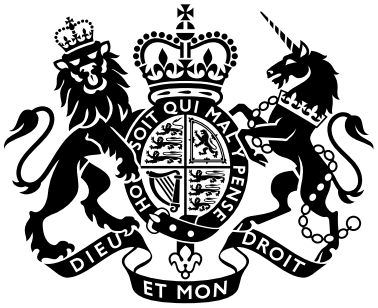
Office for
Budget Responsibility

Welfare trends report

October 2016

Cm 9341



Office for Budget Responsibility: Welfare trends report

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

October 2016

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Foreword

The Office for Budget Responsibility (OBR) was created in 2010 to provide independent and authoritative analysis of the UK's public finances. In December 2013, the then Chancellor of the Exchequer asked the OBR to take on additional responsibilities in relation to the Government's newly announced cap on a subset of welfare spending, which was then quantified in the March 2014 Budget. This request was in two parts: to assess the Government's performance against the welfare cap and, in order to facilitate open and constructive debate, to "*prepare and publish information on the trends in and drivers of welfare spending within the cap*." These requirements were formally included in the *Charter for Budget Responsibility* when it was updated in October 2015.

In our first *Welfare trends report (WTR)*, we presented a broad survey of historical trends and our latest judgements on the prospects for welfare spending delivered through the benefits system (administered by the Department for Work and Pensions) and the tax credits and child benefit systems (administered by HM Revenue and Customs). We did not consider spending on benefits in kind, for example social housing, education and health care. Our second *WTR* looked at the UK's public spending on social protection – a broader definition of welfare spending – in international context, using information compiled by the Organisation for Economic Cooperation and Development (OECD) and Eurostat.

This year's report is published against a backdrop of economic and policy uncertainty following the result of the June 2016 referendum on the UK's membership of the European Union. As well as uncertainty, that result generated new demands on the analysts in different departments whose expertise we draw upon in preparing our *WTRs*. In this context, this year's report:

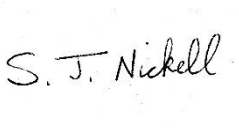
- reviews **recent developments in welfare spending** since our last report;
- explains **the path of welfare spending over the last Parliament** – defined as the change in spending between 2010-11 and 2015-16 relative to a baseline it would have reached due to population changes and uprating if the 2010-11 system had applied in each year;
- presents the same analysis for **the path of welfare spending over the current Parliament** – between 2015-16 and 2020-21 – based on our March 2016 medium-term forecast; and
- explores trends in **benefit spending in support of sick and disabled people**, an area that is undergoing significant reforms and has been the subject to large forecast errors, but is unlikely to have been affected materially by the referendum result.

As with all our flagship 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.

The analysis and projections in this report represent the collective view of the three independent members of the OBR's Budget Responsibility Committee. We take full responsibility for the judgements that underpin them and for the conclusions we have reached. We have, of course, been supported in this by the full-time staff of the OBR, to whom we are enormously grateful. We have also drawn on the help and expertise of officials across government, including the Department for Work and Pensions, HM Revenue and Customs and HM Treasury. Where resources permitted, we have been provided with all the information and analysis that we requested.

We are also grateful to the external stakeholders who gave of their time and shared their expertise in helping us to produce this third *WTR*. In particular, we would like to thank Professor Sir John Hills at the London School of Economics and Carl Emmerson at the Institute for Fiscal Studies.

We provided the Chancellor of the Exchequer with a full and final copy of the report 24 hours in advance of publication.



Robert Chote Steve Nickell Graham Parker

The Budget Responsibility Committee

Executive summary

1. This is our third *Welfare trends report* (*WTR*), in which we examine trends in public spending on different elements of the welfare system, including those subject to the Government's 'welfare cap'. Reflecting the remit that we have been given by Parliament – to focus on the sustainability of the public finances – the report does not consider the impact of the welfare system on the income distribution or measures of poverty.

2. Our first *WTR* reviewed historical trends on welfare spending in the UK. Our second considered UK welfare spending in international context. This year we focus on one overarching question: what explains the past and prospective path of welfare spending between 2010-11 and 2020-21 – a period that covers two Parliaments characterised by big spending cuts. We consider each Parliament separately, using outturn data for the last Parliament and our March 2016 forecast for the current Parliament. And we take a closer look at the trends in incapacity and disability benefits spending that have been a source of significant upward revisions to our recent forecasts.

Developments since our last report

3. In the 16 months that have passed since our last *WTR*, we have produced three new medium-term forecasts: alongside the July 2015 post-election Budget, the 2015 Spending Review and Budget 2016. These have featured a large number of policy measures and other factors affecting our welfare spending forecasts. On two occasions the Government has announced cuts to specific areas of welfare spending and then subsequently dropped them – to tax credits in July 2015 and to disability benefits in March 2016.

4. Between March 2015 and March 2016, we revised down our forecasts for welfare spending. Adjusting our March 2016 forecast for the announced disability benefits cuts that will not now go ahead, we expected welfare spending in 2019-20 to be £9.6 billion lower than we had forecast the previous year. This mainly reflects:

   - **announced welfare spending cuts**. Based on the estimates produced at the time of each forecast, these were expected to reduce spending by £12.7 billion in 2019-20. The biggest cuts reduced the generosity of universal credit, froze most working-age benefits in cash terms for four years and shifted some of the burden of paying social housing rents from housing benefit to landlords and tenants; partly offset by

   - **upward revisions to spending on incapacity and disability benefits**. Most significantly, the latest evidence suggests that the introduction of the personal independence payment (PIP) to replace disability living allowance (DLA) for working-age claims is reducing spending by far less than was originally intended.

5. In July 2015, the Government reset its welfare spending cap on a subset of benefits and tax credits at the level of our forecast at that time. Given the large cuts that were announced in that Budget, this meant setting the cap significantly lower than the level it inherited. The Government sets a 2 per cent margin above the cap that can be used to accommodate upward forecast revisions, but not to pay for policy giveaways. Thanks to the policy reversals on tax credits and disability benefits, and our revisions to incapacity and disability benefits, spending is forecast to be on average £4.1 billion a year above the cap and £1.9 billion a year above the cap-plus-margin. Hence the cap is breached.

Welfare spending in the last Parliament

6. Between 2010-11 and 2015-16, welfare spending on the definition used in this report increased by £24.4 billion to £216.6 billion, despite the substantial cuts announced by the Coalition Government in that period. While spending increased 12.7 per cent in cash terms, the increase was only 1.7 per cent in real terms (relative to CPI inflation) and represented a fall of 0.6 per cent of GDP. What explains those changes?

7. Chart 1 decomposes the change in spending over the last Parliament into five steps. The first two generate a simple baseline against which to compare actual spending. The next three break the difference between actual and baseline spending paths into the effects of policy changes and other factors. It shows that:

- **applying the default uprating policies in place in 2010-11** to future years, but holding everything else about the welfare system constant, would have added £34.6 billion to spending in 2015-16. Most benefits and tax credits were uprated using either the RPI or Rossi measures of inflation in 2010-11;

- **population growth and changes in age-structure** would have added a further £14.4 billion. Around two-thirds of this comes from general population growth and one-third from the population ageing. The overall population increased by 3.7 per cent over this period, while the population aged 65 and over increased by 13.1 per cent;

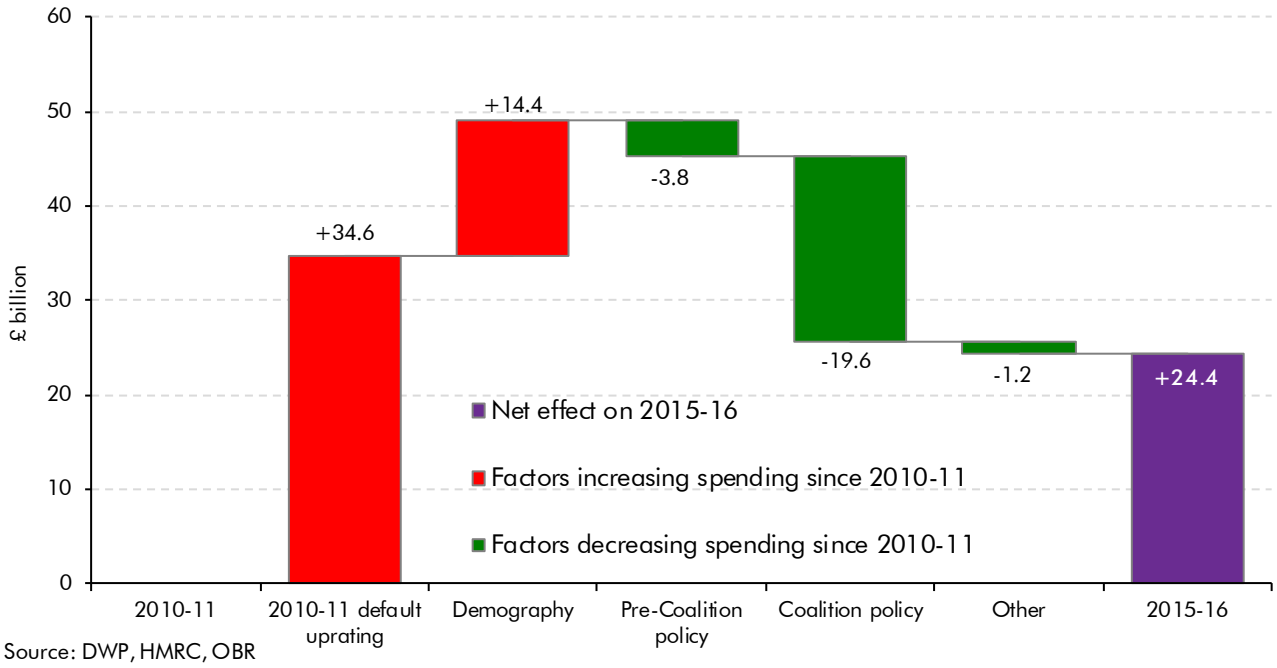
- a number of **policies announced before the 2010 General Election, but not fully implemented until after it** reduced welfare spending. The biggest effect comes from equalising the female and male state pension ages – legislated in 1995 and a little over half complete by 2015-16. This reduced spending by £5.3 billion in 2015-16, reflecting a £6.3 billion fall in pensioner benefits offset slightly by £1.1 billion higher spending on benefits where eligibility is tied to the female state pension age;

- the vast number of **policies announced by the Coalition** are estimated to have reduced spending by £19.6 billion. The biggest savings came from uprating policies that cut average awards across most working-age benefits and tax credits. In contrast, major reforms to disability benefits – replacing DLA with PIP for working-age claims – and further changes to incapacity benefits yielded far smaller savings than originally expected. Our estimate of the total savings from the Coalition's welfare spending policies is lower than you would expect from summing the initial estimates made at the

time each policy was announced. And that is despite the fact that triple lock uprating of state pensions proved cheaper than RPI uprating over the last Parliament – because all three elements of the lock were lower than RPI inflation in its first half; and

- **other non-policy factors** reduced spending further. Falling unemployment was by far the biggest contributor, cutting spending on jobseeker's allowance and the associated housing benefit for claimants who rent their accommodation. This was partly offset by upward pressures on disability benefits and carer's allowance. Higher additional state pension awards and a greater proportion of women with sufficient national insurance records to qualify for the full basic state pension pushed up the cost of the state pension. That had knock-on effects reducing means-tested pension credit spending.

Chart 1: Changes to welfare spending between 2010-11 and 2015-16



Source: DWP, HMRC, OBR

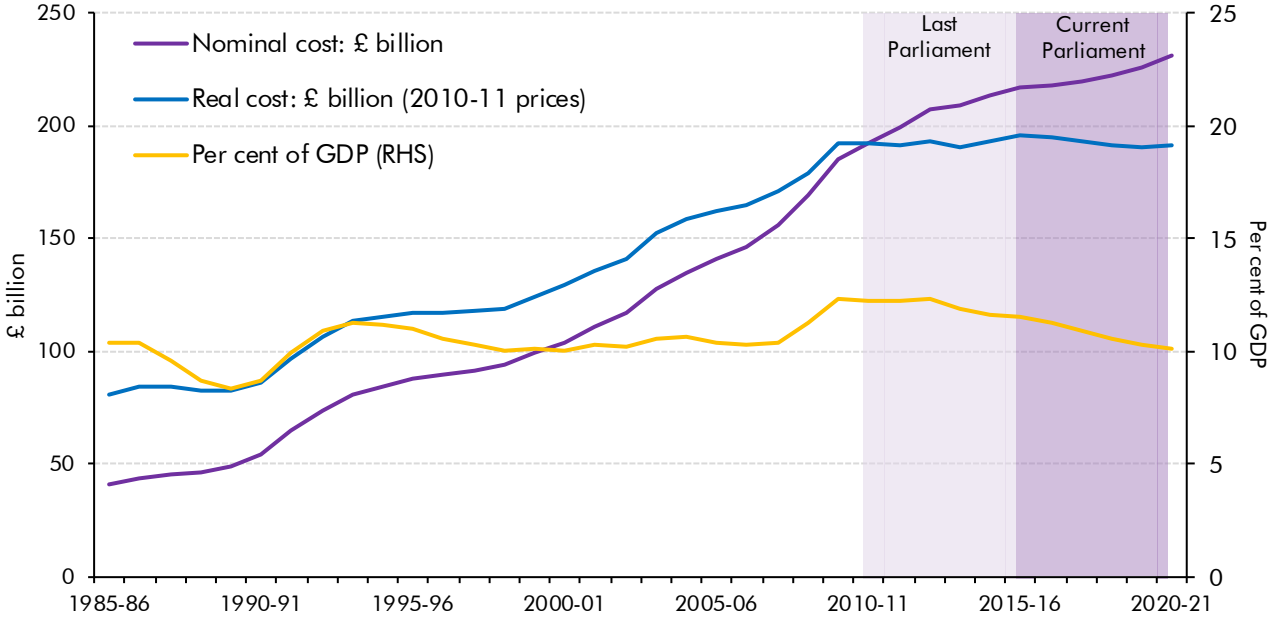
Welfare spending in the current Parliament

8. Between 2015-16 and 2020-21, our March 2016 forecast for welfare spending rises by £14.2 billion to £230.8 billion. (This figure is adjusted for the Government's announcement soon after that forecast that it would not implement the cut to disability benefits included in Budget 2016.) We expect this increase despite the ongoing effects of the Coalition's cuts and the further substantial cuts announced by the new Conservative Government since it took office. But an increase of only 6.5 per cent in cash terms means that spending is set to fall by 2.3 per cent in real terms (relative to CPI inflation) and by 1.4 per cent of GDP – a tighter picture on all three measures than we saw over the last Parliament.

9. If welfare spending follows this path, by 2020-21 it will have fallen as a share of GDP for an unprecedented eight consecutive years. The 2.1 per cent of GDP drop since 2010-11 would be the biggest on record across two consecutive Parliaments, similar in size to that

seen during the late-1980s economic boom. This would take welfare spending back to roughly its pre-crisis share of GDP. But while welfare spending in support of pensioners would also have fallen to around its pre-crisis level, spending in support of children and working-age people would be at its lowest share of GDP since 1990-91.

Chart 2: Historical trends in welfare spending



Source: DWP, ONS, OBR

10. Chart 3 presents the same decomposition of the change in spending since 2010-11 as in Chart 1, but for the end of the current Parliament. It adds an extra step for the policies announced by this Government and shows that:

- spending in the 2010-11 baseline would have continued to rise, with **default uprating policies in place in 2010-11** adding £64.1 billion and the effects of **a growing and ageing population** adding a further £33.5 billion. Demographic pressures on welfare spending are expected to be greater in this Parliament than they were in the last;

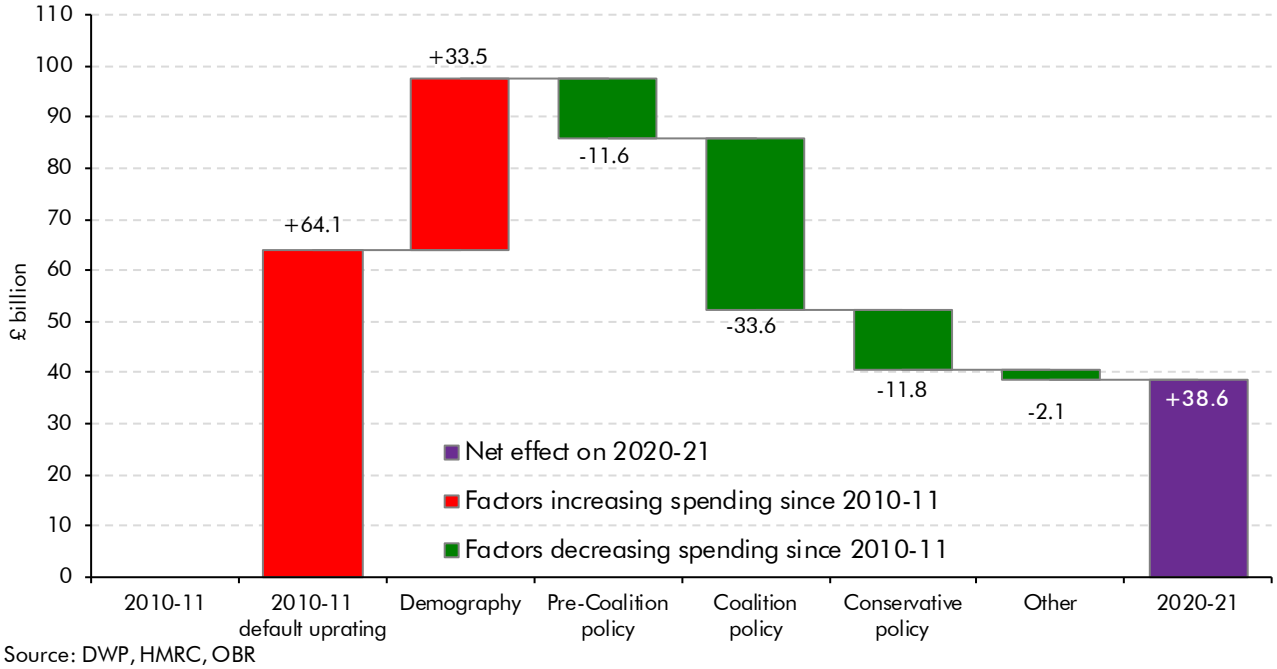
- the **pre-Coalition policy announcements** will continue to reduce spending relative to the baseline. The incremental change over this Parliament would reflect the remaining steps to equalise the female and male state pension ages – on the timetable that had been set out before the Coalition decided to accelerate it;

- many of the **Coalition Government's cuts** will also continue to reduce spending relative to the baseline. In particular, the June 2010 decision to uprate most working-age benefits and tax credits by CPI rather than RPI or Rossi inflation will typically save incrementally more each year as the CPI measure generally rises more slowly than RPI or Rossi inflation. We do not expect the transition from DLA to PIP to yield savings close to the Coalition's original goal of 20 per cent;

- the current **Conservative Government's cuts** are expected to reduce spending in 2020-21 by £11.8 billion. Two significant cuts were announced but subsequently reversed before implementation – the June 2010 cuts to elements of tax credits and the March 2016 decision to reduce the number of points awarded for some 'aids and appliances' descriptors in the PIP assessment. Most of the remaining cuts fall into three categories. First, cuts to the generosity of universal credit, relative to the current benefits and tax credits it will replace, are expected to reduce spending by £3.1 billion. These cuts were announced in July 2015, at which point their effect was roughly equal to the cuts to tax credits that were subsequently reversed in November 2015. (The fact that universal credit is now associated with significant savings relative to the current system will make our forecast more sensitive to changes in the pace with which it is rolled out. In July, the Government announced yet another delay to that schedule that will be reflected in our next forecast.) Second, further cuts to average awards across most working-age benefits and tax credits through a 4-year cash-terms freeze. And third, cuts to housing benefit spending that are largely the result of increasing burdens on social sector landlords and some of their tenants; and

- **other non-policy factors** reduce spending further. The biggest contributions come from incapacity benefits spending, as the backlog of assessment phase cases in ESA is cleared. Housing benefit also contributes to the decline. We expect the caseload to fall as a share of the population due to knock-on effects from other benefits where claimants tend to receive housing benefit too – in particular fewer lone parents on income support and a lower pension credit caseload. As in the last Parliament, other factors are expected to push up spending on state pensions (with offsetting effects on pension credit), disability benefits and carer's allowance.

Chart 3: Changes in welfare spending between 2010-11 and 2020-21



Source: DWP, HMRC, OBR

Spending in support of sick and disabled people

11. Spending on incapacity and disability benefits amounted to £31.3 billion in 2015-16. The two largest areas of spending – employment and support allowance (ESA) and its predecessor incapacity benefit (IB) and the personal independence payment (PIP) and its predecessor disability living allowance (DLA) – are the subject of ongoing reforms. The impact on spending of both sets of reforms has proved difficult to forecast, with each yielding smaller savings than were originally intended.

12. Between 2010-11 and 2015-16, spending in incapacity benefits increased by £1.7 billion in cash terms, £1.6 billion less than the 2010-11 system baseline (reflecting 2010-11 default uprating by the Rossi measure of inflation and demographic factors). By contrast, spending on disability benefits (defined here as just DLA and PIP) increased by £4.3 billion, £1.2 billion higher than the baseline (reflecting RPI inflation uprating and a bigger effect from the ageing population).

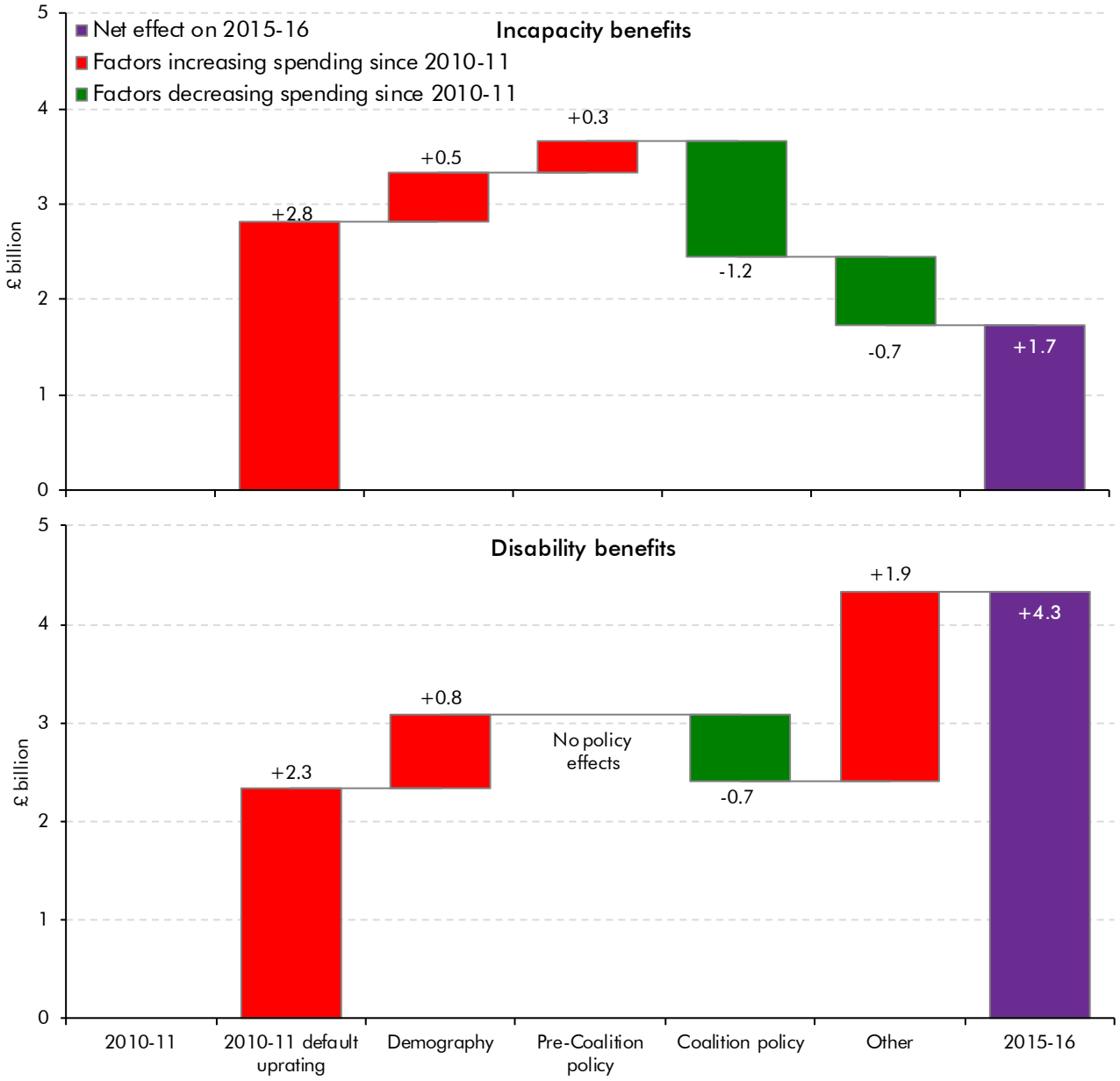
13. As Chart 4 shows, the differences relative to the baseline reflect:

- pre-Coalition policies that affected these systems after 2010-11. These led to a small increase in incapacity benefits spending, because the rising female state pension age meant more women were eligible for these benefits. This was partly offset by the impact of ESA's work capability assessments in reducing the caseload. Neither policy affected spending on disability benefits;

- Coalition policies reduced spending modestly. The biggest savings were from the June 2010 decision to switch to CPI uprating for both incapacity and disability benefits, plus the subsequent 1 per cent cap on uprating that only affected some elements of incapacity benefits. The 2010 Spending Review decision to limit awards in the contributory work-related activity group of ESA now appears to have reduced spending by a much smaller amount than initially estimated – £0.2 billion versus £2.0 billion in 2015-16 – as the affected group was much smaller than expected. The introduction of PIP is estimated to have reduced spending by just £0.1 billion in 2015-16, well short of the initial goal of cutting working-age spending by 20 per cent relative to DLA; and

- other non-policy factors pushed disability benefits spending up, but incapacity benefits spending down. For both, an upward trend in reported mental health conditions, particularly among younger people, has increased spending. This helps explain the upward trend in age-specific claim rates for both benefits at younger ages. It also explains in part the higher proportion of ESA cases being placed in the support group. Average awards have also proved higher than expected in DLA and PIP. These trends in incapacity benefits were offset by the effect of the ongoing decline in claim rates – particularly among older men – that began after the 1995 reforms that brought in ESA's predecessor benefit IB.

Chart 4: Changes in incapacity and disability benefits spending between 2010-11 and 2015-16



Source: DWP, HMRC, OBR

14. Our March 2016 forecast for the current Parliament – adjusted for the effect of the PIP 'aids and appliances' measure dropped five days after Budget 2016 – assumes that many of the trends of the last five years will continue. Spending on incapacity benefits is forecast to end the Parliament at around the same cash level it started, whereas the baseline rises by another £2.4 billion. Disability benefits spending is forecast to rise by £2.0 billion, which would be less than the £2.6 billion rise in the baseline.

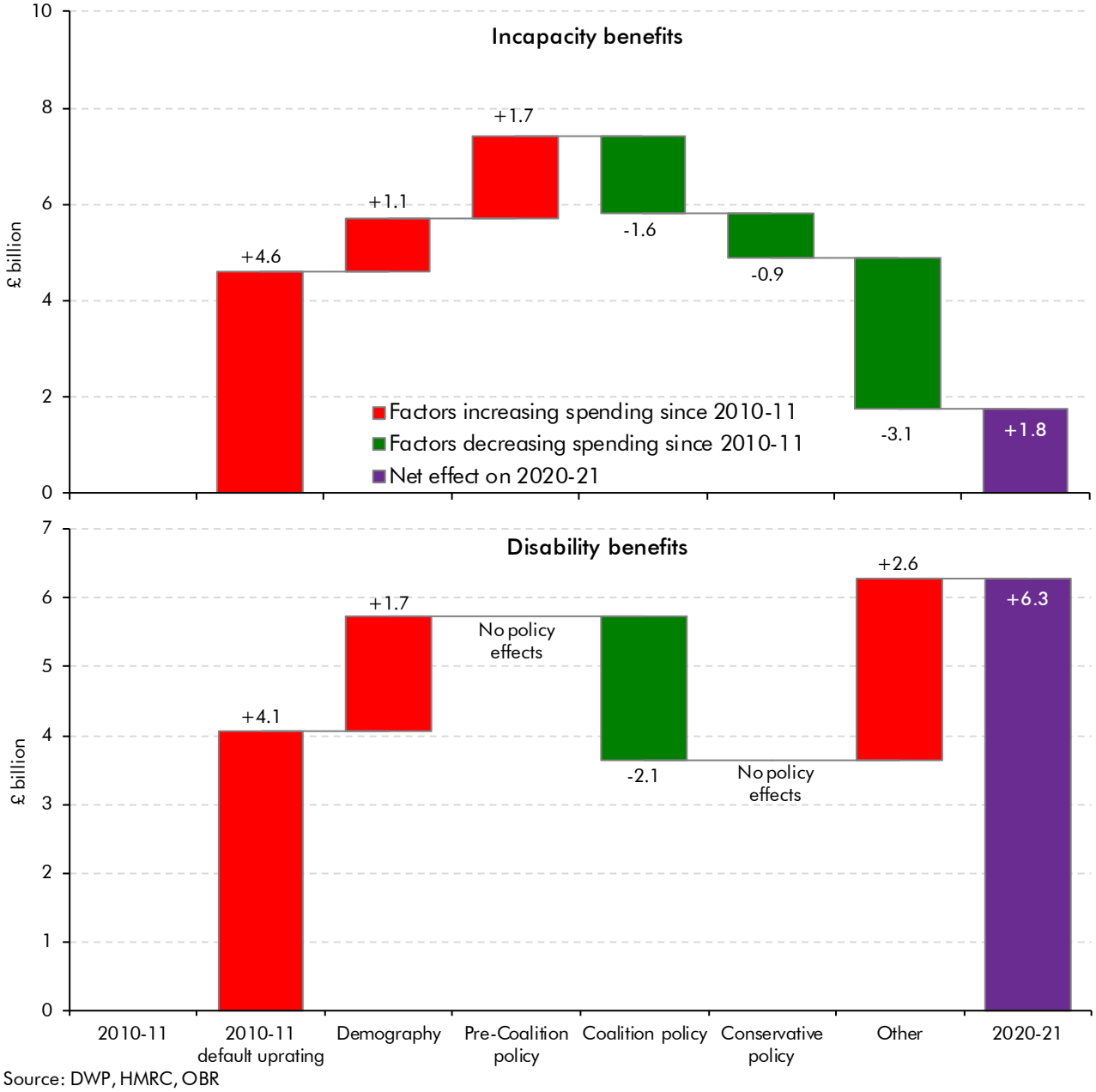
15. As Chart 5 shows, the differences relative to the baseline reflect:

- the ongoing effects of the **pre-Coalition policy** to equalise the female and male state pension ages pushing up spending on incapacity benefits;

- **Coalition policies** also continue to reduce spending relative to the baseline, with the biggest effect coming from the switch to CPI uprating that affects both benefits. The effect is proportionately greater on incapacity benefits, which were also subject to the 1 per cent cap on uprating so rise from a lower level. The transition to PIP is expected to be close to complete by 2020-21, but the associated savings are expected to reach just £0.6 billion by then. This was initially planned to reduce spending by almost £1.4 billion by the end of the *last* Parliament;

- **Conservative policies** reduce spending on incapacity benefits by £0.9 billion by 2020-21, mainly through the 4-year freeze on uprating and the decision to cut the ESA work-related activity group award by 28 per cent to align it to the jobseeker's allowance rate. After the 'aids and appliances' measure was dropped, disability benefits spending is virtually unaffected by any Conservative policies.

Chart 5: Changes in incapacity and disability benefits spending between 2010-11 and 2020-21



Source: DWP, HMRC, OBR

Conclusions

16. There are a number of conclusions that can be drawn from the analysis in this report:

- **the scale and sustained nature of the welfare spending cuts seen over the current and previous Parliaments** are in some respects unprecedented. By far the biggest effects come from simple uprating policies that reduce the generosity of awards for most claimants;

- **major structural reforms to the incapacity and disability benefits systems have proceeded more slowly than expected and have saved less than initially predicted**. Revisions to our assumptions about the timing and consequences of work-capability assessments in ESA and the reassessment process between DLA and PIP have pushed up our incapacity and disability benefits spending forecasts. The transition to ESA is almost complete, which may reduce the extent of future forecast uncertainties. The transition to PIP is still a work-in-progress, so we might expect further significant revisions in future forecasts – either up or down – as more evidence becomes available on the outcomes of reassessments and new claims;

- the **new Government's welfare spending cuts are subject to a variety of risks and uncertainties**. They can largely be grouped into three types. First, cuts to average awards for child benefit and most working-age benefits and tax credits through an uprating freeze should have a relatively certain effect on cash spending, although the amount 'saved' depends on the actual path of inflation that would have driven uprating in the counterfactual. Second, the impact of additional cuts to housing benefit, through policies that put a greater burden on social housing landlords and tenants, are subject to greater uncertainty as we cannot be sure how those affected will respond. Third, the savings from cuts to universal credit in excess of those to tax credits (which were announced but not implemented) will be sensitive to the pace at which universal credit is rolled out. This has already been pushed back again since our last forecast; and

- **the rising prevalence of mental health conditions and learning difficulties**, particularly at younger ages, has been an important driver of the rising disability benefits caseload and the rising proportion of incapacity benefits claims that are placed in the support group of ESA. This is an issue with broader implications for UK fiscal sustainability.

17. The pattern of revisions to our forecasts for incapacity and disability benefits and to the rollout of universal credit highlight how the impact of these sorts of structural reforms is particularly hard to forecast and prone to optimism bias. While there are elements of these reforms that are unique to each, there are common factors given the significant changes to rules of eligibility and the way they are administered and policed. This generates a large number of uncertainties, including:

- **how many people will be potentially eligible** under the reformed system;

- **how many of those that are eligible will try to take up their entitlement** in the face of changes to the system;

- **how the eligibility rules will be applied in practice** and how that will differ from the intentions of policy designers. And given the inevitable differences between reality and intention, how the rules or the guidelines for applying them will be changed;

- how applicants and decision-makers will behave in any **appeal processes**; and

- understanding any **issues related to contractors** that are responsible for delivering underpinning IT systems or assessment processes – are they able to recruit the necessary people, what incentives do the contracts place upon them, and so on.

1 Introduction

1.1 Around half the population receive income from at least one social security benefit at any given time, and almost everyone does so at some point in their lifetime. Furthermore, eligibility for different benefits is determined by a wide range of household or individual circumstances. The potential scope of any report on trends in welfare spending is therefore enormous. This chapter sets out the choices we have made in order to narrow that scope.

Defining welfare spending

1.2 The term 'welfare spending' means different things to different people. At its broadest, it might be considered as any spending that plays a part in the provision of the welfare state – including spending on health, long-term care, education and social housing, as well as social security benefits and tax credits for people of all ages. A narrower definition would focus just on the benefit and tax credits systems, which transfer cash from some parts of the population to others on the basis of eligibility.

1.3 For the purposes of our *Welfare trends reports (WTRs)*, we typically use this narrower definition, focusing on all spending on benefits and tax credits as they appear in our medium-term forecasts. This is restricted to those elements that are financed by central government under what the Treasury's spending control framework calls annually managed expenditure (AME). AME spending is not subject to strict limits, instead responding to fluctuations in demand. It contrasts with welfare spending that is paid out of departments' day-to-day ('current') running costs – for example discretionary housing payments. Departments have greater choice over such spending, which is financed from within multi-year limits set by the Treasury and known as 'Resource Departmental Expenditure Limits'.

1.4 Most social security and tax credit spending is administered by three institutions:[1]

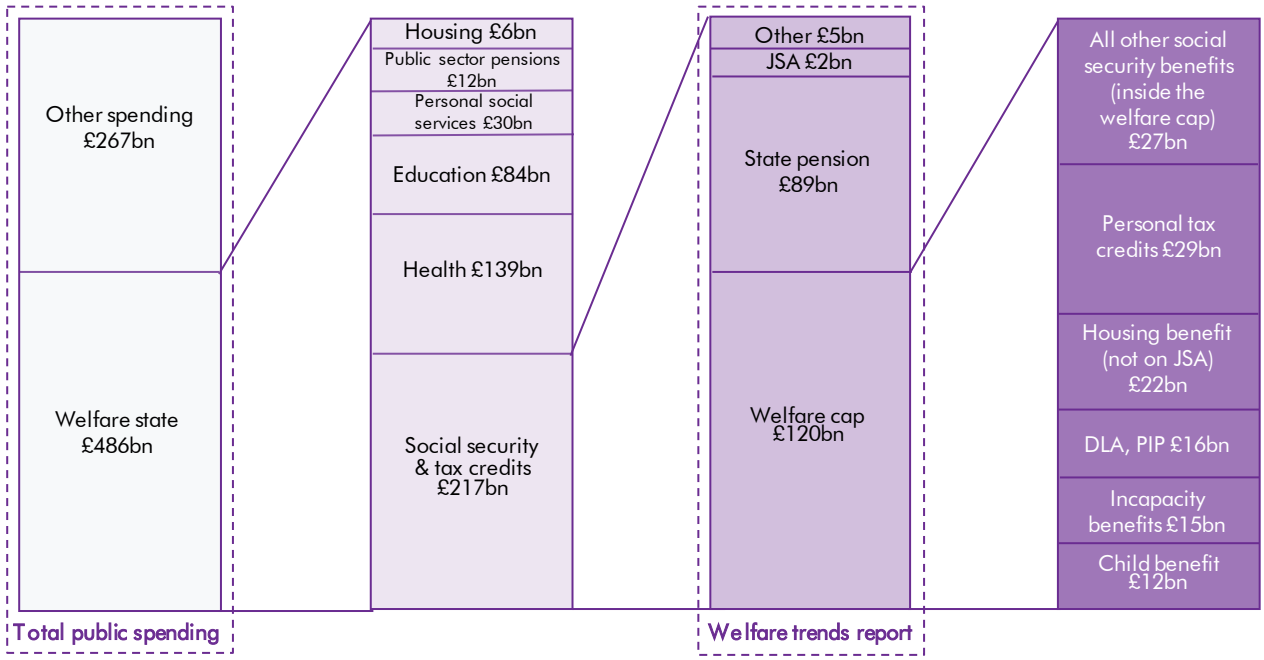
- the **Department for Work and Pensions** (DWP), which administers most benefits in Great Britain;
- **HM Revenue and Customs** (HMRC), which administers the personal tax credits and child benefit systems across the United Kingdom; and
- the **Northern Ireland Social Security Agency**, which administers most benefits in Northern Ireland.

[1] Some smaller benefits are administered by other departments – for example, paternity pay is administered by the Department for Business, Energy and Industrial Strategy.

1.5 Due to the administrative separation of the benefits system between Great Britain and Northern Ireland, this report focuses largely on trends in spending in Great Britain. The exceptions are the items administered by HMRC, for which the historical data and our forecasts are produced on a UK-wide basis.

1.6 Figure 1.1 shows how the definition of welfare spending used in this report relates to total public spending and to some other possible definitions of welfare spending. It shows that the social security and tax credits AME spending in our forecasts made up 29 per cent of the £753 billion of total public spending in 2015-16 and 45 per cent of a broader definition of spending on the 'welfare state'.

Figure 1.1: Welfare spending in the UK 2015-16



Source: HMT, OBR

Choosing appropriate spending metrics

1.7 Having established the types of spending to analyse, the next choice is which metrics to focus on. Different metrics are appropriate when answering different questions. The three most common measures of *aggregate* spending used are:

- **cash or nominal spending:** this is simply the cash amount spent in a given period. It is the metric most relevant to the Government's welfare cap, which is set in cash terms. But without putting the cash amount into context – by asking what the 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, to give 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; and

- **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 most relevant metric when considering the sustainability of the public finances.

1.8 There are other possible metrics that might be considered, including:

- **as a share of total public spending** – which would illustrate the trade-offs between welfare and other priorities within a given spending envelope;
- **relative to revenues** – a more direct measure of spending relative to the resources available to finance it; or
- **in per capita terms** – either cash or real – which could be related more directly to individual incomes or living standards.

1.9 In this report we focus on the three main aggregate measures – cash terms, real terms and as a share of GDP. When we refer to spending in real terms we use CPI inflation.

1.10 As noted above, the majority of welfare spending in the UK is administered at the Great Britain level by DWP, with benefits in Northern Ireland administered separately. For simplicity, we use UK GDP as the denominator in all the analysis in this report. This is also consistent with our focus on comparing spending to the full UK national income that can be taxed to finance it.

Our approach to analysing trends in welfare spending

1.11 When analysing trends in welfare spending there are a number of different drivers that need to be taken into account. The approach we take in is to split the drivers into:

- those that affect the number of recipients of a benefit – **the caseload**; and
- those that affect the amount paid to each recipient – **the average award**.

1.12 Total spending on each benefit and the average caseload through each year are derived from administrative data, with the average award calculated from the relationship between the two. The average award is not the same as the statutory rate or rates for a given benefit. In some cases, an average annual award is a meaningful concept – for example, those receiving the basic state pension will do so throughout each year once they have started to claim. In other cases, it is less meaningful – for example, currently around 70 per cent of those claiming jobseeker's allowance have been doing so for less than 12 months.[2]

[2] ONS (August 2016) *Jobseeker's allowance by age and duration*.

1.13 Changes in caseload can be affected by:

- **changes in the population potentially eligible for a benefit**, due to demographic or economic factors – such as growth in the number of people aged above the state pension age or changes in the number of people that are unemployed;
- **the proportion of those that are eligible who choose to take up their entitlement** – this could be affected by knowledge of the entitlement or any onerous conditions or perceived stigma associated with making a claim; and
- **policy changes that alter eligibility criteria** – such as raising the state pension age or altering the parameters that guide assessment decisions for new or existing claims.

1.14 Changes in the implied average award can be affected by:

- **statutory (or default) uprating of benefits and the economic factors that affect the measures by which benefits are uprated** each year. For example, the default setting for most benefits until 2010-11 was the retail prices index (RPI). In June 2010, the Coalition Government changed uprating to reflect the historically lower rate of consumer price (CPI) inflation each year;
- **policy choices to uprate benefits by a discretionary amount instead of the default setting**. For example, the four-year cash freeze on most working-age benefits and tax credits imposed by the new Government in its July 2015 Budget; and
- **changes in the composition of the caseload**, which can change the average award even when the overall caseload is stable if different groups receive different amounts – for example in housing benefit, where the amount paid to each recipient varies considerably across the country and between the social- and private-rented sectors. In Chapter 5 we describe how such changes have been an important factor in explaining trends in spending on benefits that support sick and disabled people.

1.15 When considering trends in spending as a share of GDP, we also need to consider how all the factors affecting cash spending relate to GDP growth. In order to assess the relative importance of changes in caseload and average award drivers for the ratio of spending to GDP, we have to decompose GDP growth itself into relevant components. We do that by considering changes in caseloads relative to the population – specifically the adult population aged 16 and over – and changes in average awards relative to GDP per person – specifically GDP per adult. GDP per adult can be thought of as a proxy for average incomes, so the ratio of the average award to GDP per adult is a measure of the 'generosity' of a given benefit.

1.16 This approach allows us to analyse whether a rise (fall) in spending on any benefit is explained by a rise (fall) in the proportion of the adult population claiming or because the average award has risen faster (slower) than average incomes. Where sufficient data are available, we can further decompose these explanations into the factors identified above.

For example, we can calculate the extent to which spending on state pensions is changing as a share of GDP due to the ageing of the population, changes in the state pension age, the effects of the triple lock on uprating and changes in the composition of the caseload.

Structure of this report

1.17 This year's report is published against a backdrop of economic and policy uncertainty following the result of the June 2016 referendum on the UK's membership of the European Union. As well as uncertainty, that result has generated new demands on the analysts in different departments whose expertise we draw upon in preparing our *WTRs*. In this context, this year's report is structured as follows:

- Chapter 2 reviews **recent developments in welfare spending**, focusing on the changes since our last report – a period that has included the July 2015 Budget, November 2015 Spending Review and Autumn Statement and March 2016 Budget, all of which involved significant changes to welfare spending policy;

- Chapter 3 explains **the path of welfare spending over the last Parliament** – defined as the change in spending between 2010-11 and 2015-16 – relative to a baseline of the level it would have reached due to population changes and inflation if the 2010-11 system had applied in each year;

- Chapter 4 presents the same analysis for **the path of welfare spending over the current Parliament** – defined as the change between 2015-16 and 2020-21 – based on our March 2016 medium-term forecast; and

- Chapter 5 explores trends in **benefit spending in support of sick and disabled people**, an area that is undergoing significant reforms and has been the subject to large forecast errors, but which is unlikely to have been affected materially by the referendum result.

2 Developments since our last report

Introduction

2.1 This is our third *Welfare trends report (WTR)*. In the 16 months that have passed since our last report, we have produced three new forecasts alongside the July 2015 post-election Budget, the 2015 Spending Review and Budget 2016. These have featured a large number of policy measures and other factors affecting our welfare spending forecasts.

2.2 In this chapter:

- we **look at how spending in 2015-16 performed** relative to the March 2015 forecast that formed the basis of our last *WTR*;
- **summarise the March 2016 forecast** that underpins this report – including the effect of the Government's decision not to implement one of the policies that it announced in Budget 2016;
- **describe the policy and other factors that explain the change in our forecast** for welfare spending relative to last year's report; and
- **discuss implications for the Government's 'welfare cap'** that applies to a subset of all welfare spending.

Preliminary estimate of spending outturns in 2015-16

2.3 Table 2.1 sets out our latest estimate of welfare spending in 2015-16 from our March 2016 *Economic and fiscal outlook (EFO)* and compares it with the forecast for that year used in last year's *WTR*, which was drawn from our March 2015 *EFO*. Total welfare spending was close to forecast, with the latest estimate £0.3 billion (0.1 per cent) lower than forecast in March 2015. That relatively small overall forecast error reflected a number of offsetting differences in spending on particular benefits.

2.4 The items on which spending was higher than expected include:

- **disability benefits** spending (including disability living allowance (DLA) and personal independence payment (PIP), but not attendance allowance) was £0.9 billion (5.9 per cent) higher than expected. This is explained by higher caseloads (as success rates have been higher than assumed) and higher average awards (as a greater proportion of claimants have been eligible for the higher 'enhanced' daily-living component of PIP). These developments are discussed in more detail in Chapter 5; and

- **incapacity benefits** spending was £0.4 billion (2.7 per cent) higher than expected, reflecting both higher caseloads (particularly in the 'support group') and higher average awards (due in large part to the composition of the caseload, with support group cases receiving higher average awards than the 'work-related activity group'). These developments are discussed further in Chapter 5.

2.5 The items on which spending was lower than expected include:

- **tax credits** spending was £0.8 billion (2.7 per cent) lower than expected. This partly reflects caseloads being lower than expected. (This is an important forecast issue as we look ahead to our November forecast. We are continuing to work with HMRC forecasters to better understand the latest trends in spending and what they imply for spending over the forecast period);

- **state pensions** spending – the largest element of welfare spending in our forecasts – was £0.5 billion (0.6 per cent) lower than forecast. This reflects a higher number of deaths than was assumed in the ONS population projections that underpin our forecast, resulting in a lower caseload than expected; and

- **housing benefit** (inside the cap, which excludes claims that are linked to jobseeker's allowance claimants) was £0.3 billion (1.4 per cent) lower than expected. This reflects slower-than-expected growth in the caseload of in-work claimants, reversing the trend of upward revisions to our forecasts in previous years (described in our 2014 *WTR*).

2.6 The table shows spending on 'other benefits' to have been lower than expected inside the welfare cap and higher than expected outside the cap. This relates to universal credit and is largely an artefact of the difference between reporting of outturn data and our forecast. Outturns are presented on a gross basis, with all universal credit spending included in 'other benefits', mostly outside the cap because the majority of cases are broadly equivalent to individuals on jobseeker's allowance in the current system. In our forecasts, only the marginal costs of universal credit relative to the current system are included – in 'other benefits' outside the cap.

Table 2.1: Welfare spending in 2015-16: changes since the 2015 *WTR*

	£ billion					
	2015 WTR estimate	2016 WTR estimate	Difference	*of which due to:* Caseloads	Average awards	Not allocated
Welfare cap						
DWP social security	75.7	76.5	0.8	-0.1	1.0	-0.1
of which:						
Housing benefit (not on JSA)	22.2	21.9	-0.3	-0.5	0.2	0.0
DLA and PIP	15.3	16.2	0.9	0.4	0.5	0.0
Incapacity benefits	14.7	15.1	0.4	0.0	0.4	0.0
Pension credit	6.2	6.1	-0.1	-0.1	0.0	0.0
Attendance allowance	5.5	5.5	0.0	0.0	0.0	0.0
Statutory maternity pay	2.3	2.3	0.0	0.0	0.0	0.0
Personal tax credits	29.5	28.7	-0.8			-0.8
Child benefit	11.7	11.7	0.0			0.0
NI social security in welfare cap	3.4	3.4	0.0			0.0
Other benefits	9.8	9.5	-0.3			-0.3
Total welfare cap	120.6	120.4	-0.2	-0.1	1.0	-1.1
Welfare spending outside the welfare cap						
DWP social security	93.9	93.9	0.0	-0.3	-0.3	0.6
of which:						
State pension	89.8	89.3	-0.5	-0.4	-0.1	0.0
Jobseeker's allowance	2.4	2.3	-0.1	0.1	-0.2	0.0
Housing benefit (on JSA)	1.8	1.8	0.0	0.0	0.0	0.0
NI social security outside welfare cap	2.4	2.4	0.0			0.0
Other benefits	-0.1	0.4	0.5			0.5
Total welfare outside the welfare cap	96.3	96.2	-0.1	-0.3	-0.3	0.5
Total welfare	216.9	216.6	-0.3	-0.4	0.7	-0.6

March 2016 medium-term forecast

Detailed forecast

2.7 Our latest medium-term forecast was published in March. It contained the effect of a policy measure that was expected to reduce disability benefits spending by £1.3 billion in 2019-20 and 2020-21, but which was subsequently dropped by the Government. We have therefore restated our March 2016 numbers for the purposes of the analysis in this report. Table 2.2 presents our adjusted forecast.

Table 2.2: Adjusted March 2016 post-measures welfare spending forecast

	£ billion						
			Welfare cap period				
	Outturn	Estimate	Forecast				
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare cap							
DWP social security	74.5	76.5	76.1	74.9	74.1	74.1	75.3
of which:							
Housing benefit (not on JSA)[1]	21.4	21.9	21.7	21.0	20.8	20.5	20.9
Disability living allowance and personal independence payments[2]	15.4	16.2	16.4	16.7	17.1	17.7	18.2
Incapacity benefits[3]	14.2	15.1	14.9	14.7	14.6	14.8	15.1
Pension credit	5.4	5.5	5.5	5.6	5.8	6.0	6.4
Attendance allowance	6.6	6.1	5.8	5.5	5.3	5.3	5.3
Carer's allowance	2.3	2.6	2.7	2.9	3.1	3.3	3.5
Statutory maternity pay	2.3	2.3	2.4	2.4	2.5	2.6	2.7
Income support (non-incapacity)	2.5	2.4	2.4	2.1	2.0	2.0	2.1
Winter fuel payments	2.1	2.1	2.1	2.0	2.0	2.0	2.0
Universal credit[4]	0.0	0.0	-0.1	-0.5	-1.5	-2.6	-3.1
Other DWP in welfare cap	2.3	2.3	2.4	2.4	2.4	2.4	2.4
Personal tax credits	29.7	28.7	28.5	28.1	27.9	27.5	27.9
Child benefit	11.6	11.7	11.7	11.6	11.6	11.6	11.8
Tax free childcare	0.0	0.0	0.0	0.4	0.5	0.6	0.7
NI social security in welfare cap	3.4	3.4	3.5	3.5	3.4	3.5	3.6
Paternity pay	0.1	0.1	0.1	0.1	0.1	0.2	0.2
Total welfare cap[6]	**119.2**	**120.4**	**119.9**	**118.6**	**117.6**	**117.5**	**119.4**
Welfare spending outside the welfare cap							
DWP social security	92.0	93.9	96.0	98.7	102.2	105.3	108.5
of which:							
State pension	86.5	89.3	91.7	94.1	97.2	100.3	103.4
Jobseeker's allowance	3.1	2.3	2.5	2.7	2.8	2.9	3.0
Housing benefit (on JSA)	2.4	1.8	1.8	2.0	2.1	2.2	2.2
Universal credit[4]	0.1	0.4					
NI social security outside welfare cap	2.2	2.4	2.4	2.5	2.6	2.7	2.8
War pensions[5]	0.8						
Total welfare outside the welfare cap[6]	**95.0**	**96.2**	**98.4**	**101.2**	**104.8**	**108.1**	**111.4**
Total welfare[6]	**213.9**	**216.6**	**218.3**	**219.8**	**222.4**	**225.5**	**230.8**
Memo: welfare cap as proportion of total welfare	*55.7*	*55.6*	*54.9*	*53.9*	*52.9*	*52.1*	*51.7*

[1] Housing benefit (not on jobseeker's allowance) is made up of a number of claimant groups. The main claimant groups are pensioners, those on incapacity benefits, lone parents, and housing benefit only claimants.

[2] March 2016 forecast with the impact of the 'PIP aids and appliance' measure removed.

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

[4] Universal credit actual spending for 2014-15 and 2015-16. Spending from 2016-17 onwards represents universal credit additional costs not already included against other benefits (i.e. UC payments that do not exist under current benefit structure).

[5] Transferred to departmental expenditure limits.

[6] Total welfare outturn inside and outside of the welfare cap in 2014-15 is sourced from OSCAR, consistent with PESA 2015. For 2014-15 only, the components reflect departments' own outturns, which may not be on a consistent basis to OSCAR. For this year the components may not sum to the total for this reason.

The path of welfare spending over the next five years

2.8 Welfare spending is forecast to rise by 6.5 per cent between 2015-16 and 2020-21. That rise is significantly slower than our March forecast for growth in nominal GDP over the same period, so welfare spending falls by 1.4 per cent of GDP to reach 10.1 per cent in 2020-21 (Table 2.3). The drop is concentrated on spending inside the welfare cap, which falls by 1.2 per cent of GDP. Spending outside the cap – the majority of which is on the state pension – falls by a much smaller 0.2 per cent of GDP.

Table 2.3: Summary of the medium-term welfare spending forecast

	Outturn	Forecast					
	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
£ billion							
Total welfare spending	213.9	216.6	218.3	219.8	222.4	225.5	230.8
of which:							
Welfare spending subject to the welfare cap	119.2	120.4	119.9	118.6	117.6	117.5	119.4
Welfare spending outside the welfare cap	95.0	96.2	98.4	101.2	104.8	108.1	111.4
Per cent of GDP							
Total welfare spending	11.7	11.6	11.2	10.9	10.6	10.3	10.1
of which:							
Welfare spending subject to the welfare cap	6.5	6.4	6.2	5.9	5.6	5.4	5.2
Welfare spending outside the welfare cap	5.2	5.1	5.1	5.0	5.0	4.9	4.9

Drivers of the change in spending over the next five years

2.9 In Chapter 1 we described how changes in spending as a share of GDP can be decomposed into contributions from how caseloads evolve relative to the population and how average awards move relative to GDP per person. Chart 2.1 presents that decomposition – allocated across the different benefits inside and outside the welfare cap – to explain the 1.4 per cent of GDP fall in welfare spending expected between 2015-16 and 2020-21. Around three-tenths of the change relates to lines of the forecast for which a decomposition has not been possible, with a further three-tenths explained by changes in caseloads and four-tenths by changes in average awards.

2.10 For spending that will be subject to the welfare cap, the expected fall of 1.2 per cent of GDP over the next five years is driven by:

- a fall in spending on **tax credits** (0.3 per cent of GDP). In particular, a freeze on uprating between 2016-17 and 2019-20 means that average awards fall significantly relative to average earnings, reducing spending on tax credits as a share of GDP;

- a fall in spending on **housing benefit** (0.3 per cent of GDP). This is driven by a reduction in average awards relative to average earnings, which reflects policies to freeze benefit uprating and to force social housing landlords to reduce rents by 1 per cent a year over four years;

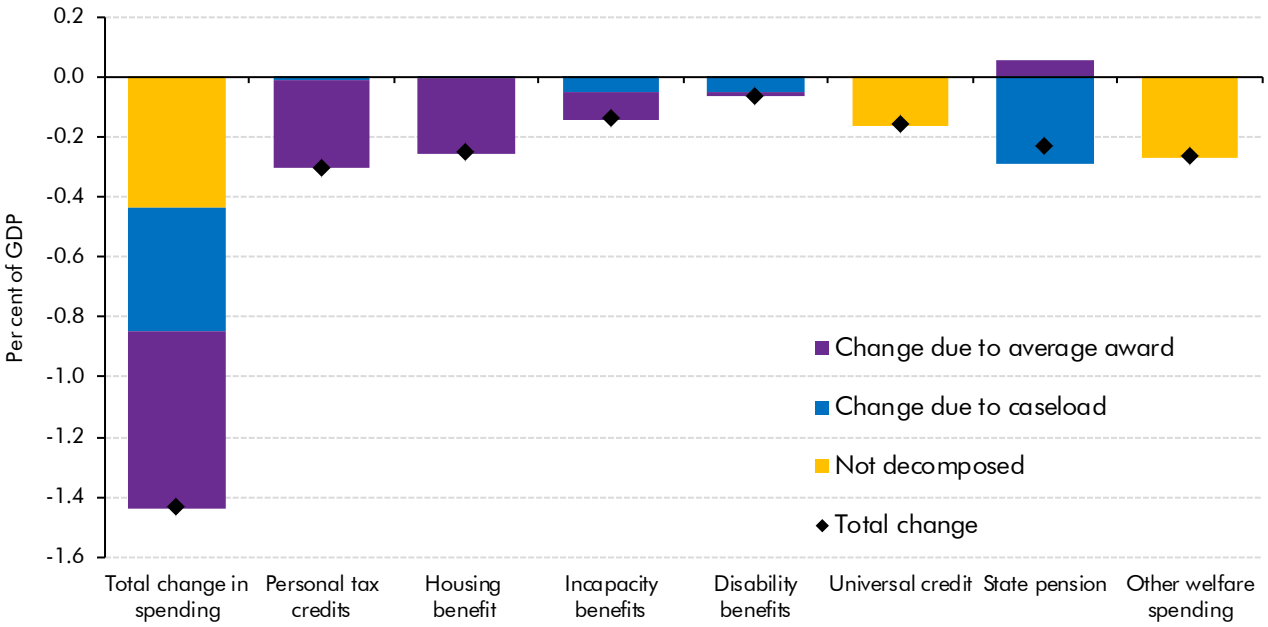
- lower spending on **disability benefits** (0.1 per cent of GDP), due largely to an assumed fall in the caseload, and on **incapacity benefits** (0.1 per cent of GDP), largely as average awards rise more slowly than average earnings. Awards outside the ESA 'support group' have been frozen for four years, like most working-age benefits; and

- a further fall associated with the transition to **universal credit** (0.2 per cent of GDP). As universal credit is now less generous on average than the tax credits and benefits systems that it replaces, the rollout of universal credit is expected to reduce spending.

2.11 Spending outside the welfare cap is expected to fall more slowly than spending subject to the cap, and by 0.2 per cent of GDP in total. This reflects a 0.2 per cent of GDP fall in spending on the **state pension**. This is driven entirely by the caseload rising more slowly than the total population as the state pension age rises. In contrast to working-age benefits, the basic state pension award is expected to rise mainly in line with earnings due to the triple lock on uprating, so average awards have little effect on state pension spending as a share of GDP. Indeed, with awards rising by 2.5 per cent in 2017-18 – higher than CPI inflation or average earnings – average awards push spending *up* slightly as a share of GDP.

2.12 In Chapter 4 we present an alternative way of breaking down the changes over this period, which will represent the second Parliament in which the Government has announced policy measures that aim to deliver significant cuts to welfare spending.

Chart 2.1: Changes to welfare spending (2015-16 to 2020-21)



Source: OBR

Changes in the outlook for welfare spending since last year

2.13 Since our March 2015 forecast was published, we have made a series of large revisions to our welfare spending forecasts. Most of these have related to policies announced – and in some cases then dropped – by the new Government that took office in May 2015. Table 2.4 presents the net effect of all these changes. These have reduced our forecast for welfare spending, but by significantly less than the estimated net effect of all the welfare policies that have been announced. As in the previous section, the breakdown of changes shown here are relative to our March 2016 forecast adjusted for the Government's decision not to implement the cuts to disability benefits that it announced in Budget 2016.

2.14 Based on the estimates that were made in each forecast, Government policy measures reduced our welfare spending forecast by increasing amounts across the forecast period, reaching £12.7 billion in 2019-20. That is higher than the updated estimates that we present in Chapter 4. The biggest cuts were associated with a 4-year freeze on uprating of most working-age benefits and a number of changes affecting universal credit and housing benefit. The cuts were overwhelmingly focused on recipients of working-age benefits and tax credits, with child benefit also subject to the 4-year cash freeze.

2.15 Other factors that have affected our welfare spending forecasts since March 2015 include:

- large **upward revisions to disability benefits spending** due to updated modelling assumptions. The transition of claimants from DLA to PIP includes a reassessment of circumstances that had been assumed – based on the results of DWP analysis of 900 existing DLA cases – to reduce the caseload by around a quarter. March 2016 was the first time we were able to base our forecast on initial evidence of actual reassessments.[1] It showed a smaller-than-expected reduction in the caseload as fewer claims were rejected. In addition, it pointed to a significantly higher proportion of claims being awarded the enhanced daily living and mobility payments, leading to higher average awards. Our March 2016 revision came on top of smaller upward revisions in the previous two forecasts. Overall, disability benefits spending was revised up by 20.7 per cent in 2019-20, the final year of the March 2015 forecast period;

- smaller **upward revisions to incapacity benefits spending**, also due to updated modelling assumptions. As in a number of previous forecasts, the proportion of the employment and support allowance (ESA) caseload placed in the 'support group' was higher than expected. That fed through to a higher assumption through the forecast period. As claimants in the support group receive higher average awards than those in the 'work-related activity group', that pushed up spending;

- a **higher claimant count forecast** increased spending on jobseeker's allowance and associated housing benefit. That reflected relatively small changes to our forecast for unemployment on the broader Labour Force Survey (LFS) measure, but an upward revision in the claimant count relative to that broader measure. Up to mid-2015, the

[1] These assumptions were discussed in more detail in paragraphs 4.114 and 4.115 of our March 2016 *Economic and fiscal outlook*.

claimant count had been falling proportionately faster than the LFS measure, but the ratio of the two measures has since stabilised;

- **lower CPI inflation** reduced spending via uprating of those elements of spending not subject to the 4-year freeze or the triple lock – mainly disability benefits and the ESA support group; and

- **updated ONS population projections** led to small changes to spending. Other factors, including subsequent evidence of higher mortality rates than were factored into those population projections, reduced spending.

Table 2.4: Changes to welfare spending since our 2015 *WTR*

	£ billion				
	2015-16	2016-17	2017-18	2018-19	2019-20
March 2015 forecast	216.9	219.5	223.6	229.3	235.1
Adjusted March 2016 forecast[1]	216.6	218.3	219.8	222.4	225.5
Change	-0.3	-1.2	-3.8	-6.8	-9.6
Policy changes (as costed in each forecast)	**-0.3**	**-2.6**	**-5.1**	**-9.1**	**-12.7**
Forecasting and other changes	**0.0**	**1.4**	**1.3**	**2.3**	**3.2**
of which:					
Disability benefits modelling changes	0.9	1.5	2.4	2.8	3.1
Incapacity benefits modelling changes	0.4	0.2	0.4	0.7	0.9
Claimant count unemployment[2]	0.1	0.1	0.4	0.7	0.8
CPI inflation	0.0	-0.2	-0.6	-0.8	-0.8
Population projections	-0.1	-0.1	-0.1	-0.1	-0.1
Other factors	-1.2	-0.1	-1.2	-1.0	-0.7

[1] March 2016 forecast with the impact of the 'PIP aids and appliance' measure removed.
[2] Including the direct effect of lower claimant count on jobseeker's allowance and the associated indirect effect on passported housing benefit spending.

Implications for the welfare cap

2.16 In the 2013 Autumn Statement, the Coalition announced that it would introduce a cap on certain items of welfare spending, excluding state pensions – which it argued are *"better planned and controlled over a longer time period"* – and jobseeker's allowance and associated housing benefit payments – which it identified as *"the most cyclical elements of welfare" in order "to allow the automatic stabilisers to operate"*.[2] The cap was formally defined and initially set in Budget 2014.

2.17 In its July 2015 Budget, the new Government reset the level of the welfare cap significantly lower than the cap it had inherited. It retained the policy of setting a forecast margin above the cap of 2 per cent in each year. The margin can be used to accommodate upward forecast revisions, but not to pay for policy giveaways. We formally assess whether or not the cap will be met at each Autumn Statement and provide an update in other forecasts. We

[2] HM Treasury (2013) paragraphs 1.100 to 1.102.

have therefore issued one formal assessment and one update since the cap was set in July 2015:

- **alongside the November 2015 Spending Review and Autumn Statement, we concluded that the welfare cap was set to be breached**. The sources of that breach were spending forecast to be higher than the cap-plus-margin in 2016-17 and 2017-18. It was also forecast to be higher than the cap, though not the forecast margin, in 2018-19, but with part of the extra spending reflecting the policy giveaway to reverse elements of the tax credit cuts announced in July 2015; and

- **alongside Budget 2016 our updated forecast showed the welfare cap being breached in every year**. The upward revisions to disability and incapacity benefits spending described above were sufficient to push spending above the cap-plus-margin in every year of the forecast. Adding on the effect of not going ahead with the PIP 'aids and appliances' measure that was announced in that Budget pushes spending up further, leaving it on average £4.1 billion a year above the cap and £1.9 billion a year above the cap-plus-margin.

2.18 In previous *EFOs* and *WTRs* we highlighted a number of potential sources of risk to the welfare cap, most notably upside inflation surprises since the cap was set in cash terms. Given the pattern of upward revisions to the lines of our forecast that are affected by ongoing reforms to the welfare system – notably incapacity and disability benefits – we also noted that as a potential source of risk.

2.19 In the event, inflation has fallen below our July 2015 forecast, although its effect on spending has been muted because of the uprating freeze that applies to most working-age benefits. But we did find it necessary to revise up spending on incapacity and disability benefits again. One source of risk that we had not highlighted was the risk that the Government would choose not to implement policy measures that had been factored into our forecasts and – in the case of the July 2015 tax credits cuts – that it had locked into the level of the welfare cap.

Table 2.5: Adjusted forecast for spending subject to the welfare cap

	£ billion				
	Welfare cap period				
	2016-17	2017-18	2018-19	2019-20	2020-21
Welfare cap (July 2015)	115.2	114.6	114.0	113.5	114.9
2 per cent forecast margin	2.3	2.3	2.3	2.3	2.3
March 2016 forecast	119.8	118.0	116.4	116.2	118.1
Difference from welfare cap	4.6	3.4	2.5	2.7	3.2
Difference from welfare cap + forecast margin	2.3	1.1	0.2	0.4	0.9
Adjusted March 2016 forecast	119.9	118.6	117.6	117.5	119.4
Difference from welfare cap	4.6	3.9	3.7	4.0	4.5
Difference from welfare cap + forecast margin	2.3	1.7	1.4	1.7	2.2

3 Welfare spending in the last Parliament

Introduction

3.1 The 2010 to 2015 Parliament saw considerable change in the welfare system, which took place in the context of a sustained period of fiscal consolidation. In 2010-11, welfare spending on the definition used in this report stood at 12.2 per cent of GDP, just down from the peak reached at the depth of the recession the year before. In launching its deficit reduction plan in the June 2010 Budget, the Coalition Government announced that it would cut welfare spending by £11 billion by 2014-15. Over the full Parliament, it announced around 150 separate measures affecting welfare spending, with the resulting cut in spending estimated at the time to be around £21 billion[1] by 2015-16, and the scale of the cuts building over time. Yet, as Chart 3.1 shows, welfare spending ended up increasing in cash terms (by 13 per cent or £24 billion). In real terms relative to CPI inflation it fell by £3 billion in 2010-11 prices. And it fell by 0.6 per cent of GDP.

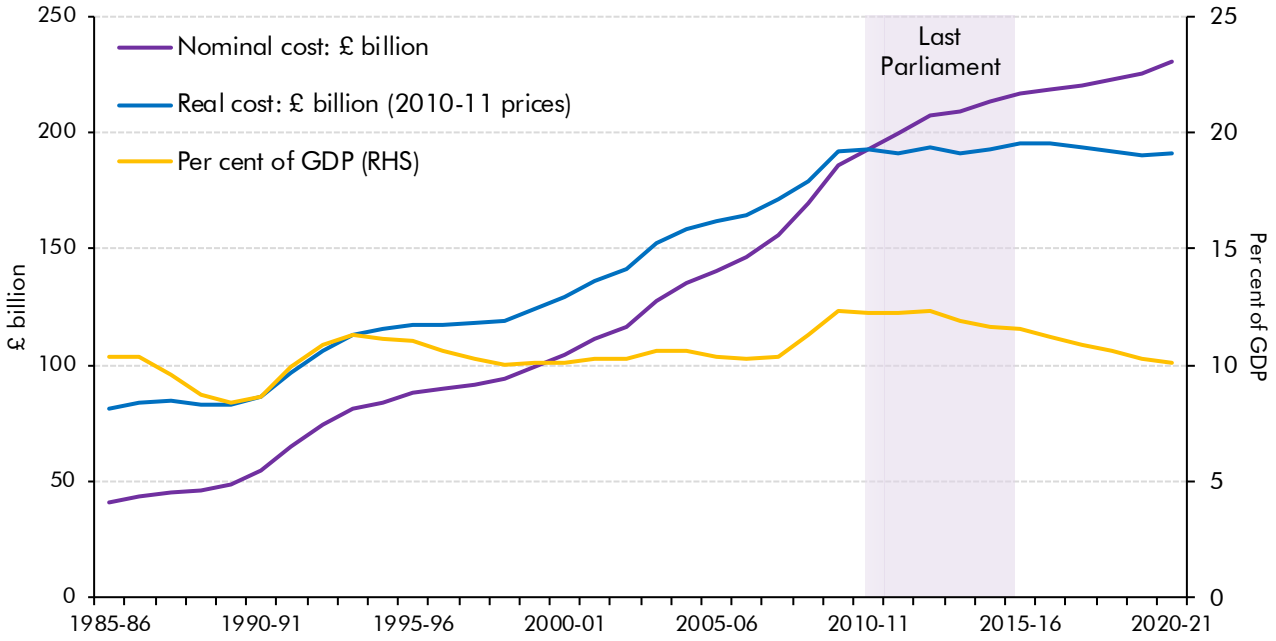
3.2 In this chapter, in order to explain that path of welfare spending, we:

- set out the **methodology** that we use to decompose the change in spending between 2010-11 and 2015-16;
- generate a simple **2010-11 baseline** by applying uprating in line with the 2010-11 welfare system and adding in the effects of changes in the size and age-structure of the population. We compare the change in that 2010-11 baseline over the five years to 2015-16 with the actual change in spending;
- **estimate the role played by policy changes in explaining the difference** from our simple baseline – both policies announced prior to the Coalition taking office and the Coalition's decisions;
- explain **how other non-policy factors influenced spending**; and
- draw some **conclusions**.

3.3 In the next chapter we carry out a similar exercise to explain the changes in welfare spending that our March 2016 forecast set out for the current Parliament.

[1] Summing the original scorecard estimates made at the time of each announcement would give a simple estimate of £21 billion.

Chart 3.1: Historical trends in welfare spending



Source: DWP, ONS, OBR

Methodology

3.4 There are many ways that the change in spending over the Parliament could be broken down. The methodology we use in this chapter tells the story in three steps:

- **how spending would have evolved on the basis of the 2010-11 welfare system** and the default uprating assumptions that were in place before the Coalition Government took office. We do that by assuming that the age-specific likelihoods of claiming each type of welfare payment remain at their 2010-11 levels, but allowing the number of claimants to rise to reflect changes in the size and age-structure of the population. The average awards received are assumed to rise in line with the relevant measure that applied to uprating for each element of the 2010-11 welfare system – typically a measure of inflation, although some benefits were uprated by earnings or not at all;

- estimate the effects on spending of **policy decisions that altered the systems relative to the 2010-11 baseline**. Those changes are split into policies that were announced before the Coalition took office and those announced by the Coalition. We have used a variety of different approaches to update the material costings, including drawing on new estimates produced for us by departments or that we have prepared ourselves, as well as the most recent estimates from those that are routinely published in Budgets for policies that have been announced but not yet implemented; and

- explore the **other non-policy-related factors** that have affected the path of spending. These include effects that work in both directions, for example the fall in unemployment that has reduced the caseload claiming jobseeker's allowance or the

rise in the proportion of households living in private-rented accommodation that has increased the caseload claiming housing benefit.

3.5 Before turning to the analysis, it is worth highlighting some caveats:

- this is **not a forecast** of spending at each stage of the decomposition. Each step is conditioned on a number of simplifying assumptions, providing indicative results – rather than precise estimates – that allow us to look at the broad size and direction of contributions to the overall change. None of these steps represents a counterfactual of what would have happened in the absence of subsequent policy changes;

- **estimating the effect of policy changes on spending is subject to significant uncertainty**. That is particularly true for more complicated reforms, but is also for policies whose effect depends, for example, on developments at specific points in the earnings distribution (as with some changes to tax credits) or local housing market developments (as with some housing benefit changes). For universal credit, which has been subject to many changes to parameters and its delivery timetable since it was first announced, we have simply treated our final forecast of the Parliament as the estimated effect of its introduction;

- **ordering matters**. Considering the sources of change in a different order would result in more or less of the overall change being assigned to different categories. This should be less of an issue for the estimated policy effects, although as noted they are subject to considerable uncertainty on their own;

- we have considered each element of the analysis sequentially, so **have not been able to consider interactions** between the various effects. This will over- and under-state individual results; and

- we are using **a relatively narrow definition of welfare spending**, as outlined in Chapter 1, which aligns with our current forecasts. Given changes in how the Treasury manages public spending over the past six years, this definition excludes some important policy changes. Most notable is the abolition of council tax benefit paid by DWP (at a cost of £4.8 billion in 2012-13) and its replacement with locally financed council tax relief from April 2013. Spending on war pensions was also moved out of the annually managed welfare budget (where it cost £0.8 billion in 2014-15) into the Ministry of Defence's departmental budget, so does not feature in our analysis. But unlike council tax support, the war pensions system was not changed in the process of switching it between elements of the Treasury's spending control process.

3.6 These issues mean that the analysis presented here is not a full evaluation of the contribution of policy changes to the path of welfare spending over the last Parliament. But it should provide a better assessment of the relative roles of policy and other factors than would be gained from simply adding up the original estimates published at the time each policy was announced. These estimates necessarily rely on information available at the time, including our forecasts for parameters affecting welfare spending.

The 2010-11 baseline

The effect of pre-Coalition default uprating assumptions

3.7 Most elements of the social security and tax credits systems involve an annual uprating of statutory rates, with the most common approach being to uprate by a measure of inflation to maintain the purchasing power of the award. In the 2010-11 benefits system, most welfare payments were, by default, uprated by RPI inflation. The main differences were pension credit, which was uprated by earnings, and incapacity benefits, income support and jobseeker's allowance, which were uprated by the Rossi inflation measure that excludes housing costs.[2] Uprating would usually take place in April based on the rate of inflation in the previous September and earnings in the previous July.

3.8 Over the period from 2010-11 to 2015-16, the RPI rose by around 20 per cent while the Rossi index increased by 21 per cent. Average earnings increased by just 8 per cent over that period. If we assume the caseload in each of the benefits systems was unchanged from its 2010-11 level, but increase the average awards in line with the default uprating measure, spending by 2015-16 would have been £34.6 billion higher than in 2010-11. That would have been a £12.4 billion real terms increase (in 2010-11 prices) and would have pushed spending up by 0.5 per cent of GDP. (RPI and Rossi inflation were higher than growth in nominal GDP-per-head over this period.)

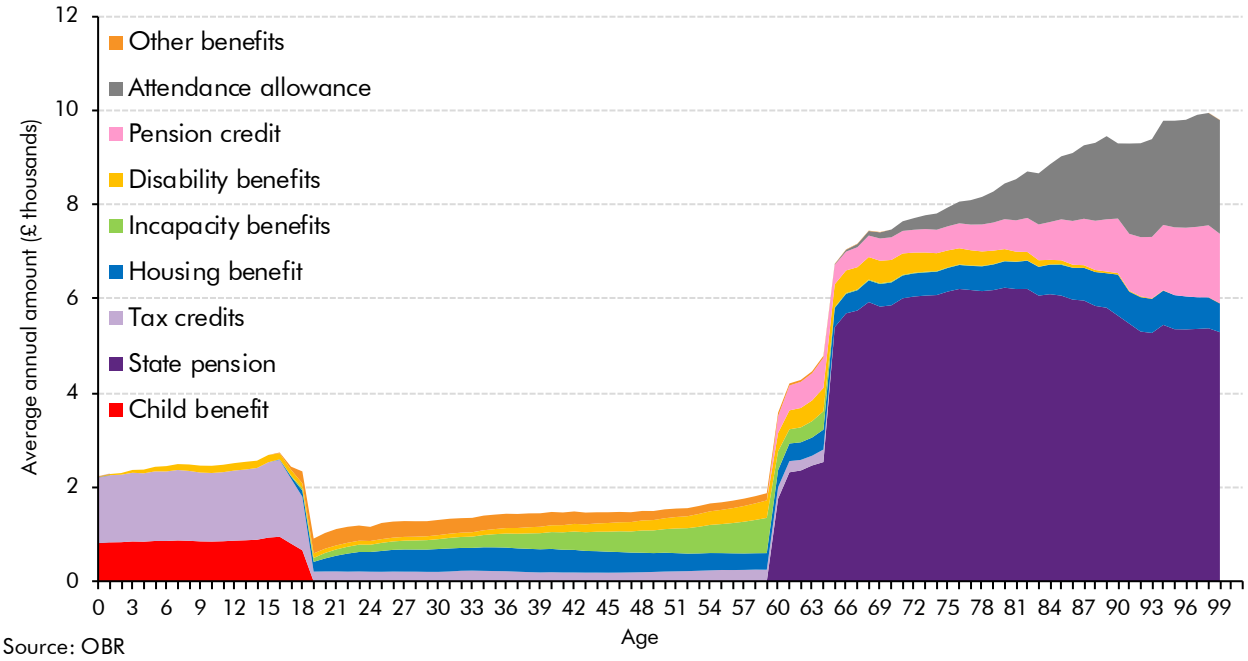
The effects of demographic changes

3.9 As well as uprating policy, spending will also change in cash and real terms because of changes in the size and age-structure of the population. The population increased by 3.7 per cent between mid-2010 and mid-2015. If the rate of growth was the same at all ages and the age-specific likelihood of receiving one or more benefit remained constant, then population growth alone would have added £8.4 billion to welfare spending over the last Parliament. All elements of spending would have risen by the same proportion, so the largest items – notably the state pension – would contribute most to the overall change.

3.10 As Chart 3.2 shows, welfare spending per person is higher at younger and (particularly) older ages.[3] The incidence of receipt of attendance allowance and pension credit rises rapidly with age. That means that ageing of the population is also an important driver of spending. Ageing continued over the last Parliament – the proportion of the population aged 65 and over increased from 16.4 per cent in mid-2010 to 17.8 per cent in mid-2015. Holding age-specific caseload rates constant, the older age-structure of the population would have added a further £6.0 billion to welfare spending. State pensions spending would have contributed £5.8 billion of that rise, with spending on working-age welfare payments slightly offsetting this due to slower population growth in those age groups.

[2] The Rossi index is based on the Retail Prices Index (RPI) less housing costs (e.g. rents, mortgage interest payments, council tax).
[3] Eligibility for tax credits is based on family rather than individual circumstances, so is difficult to allocate to a single person's age. We have split it as follows: spending on child tax credits has been allocated proportionally in line with child benefit spending while spending on working tax credits has been allocated equally across the 19 to 64 age range.

Chart 3.2: Average spending on benefits and tax credits at different ages in 2010-11



Source: OBR

Spending in 2015-16 on our 2010-11 baseline

3.11 Taken together, the uprating and population change effects set out above generate a baseline spending path. Relative to 2010-11, that baseline would be higher by £49.0 billion in cash terms, by £25.4 billion in real terms (relative to CPI inflation and in 2010-11 prices) and by 1.20 per cent of GDP.

What actually happened and why?

3.12 Table 3.1 sets out the actual path of welfare spending over the last Parliament. Relative to the simple 2010-11 baseline, it shows that spending increased by less than half as much.

Table 3.1: Welfare spending – actual vs 2010-11 baseline

	£ billion					
	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Actual spending	192.2	199.3	207.2	209.0	213.4	216.6
Change on 2010-11	0.0	7.1	15.0	16.8	21.2	24.4
2010-11 baseline spending	192.2	202.4	215.8	223.9	233.6	241.3
Change on 2010-11	0.0	10.2	23.6	31.7	41.4	49.0
Difference	0.0	3.1	8.6	14.9	20.2	24.7

3.13 In accounting terms, the difference can be split into two parts:

- **caseload** – the proportion of the population in receipt of different benefits changed between 2010-11 and 2015-16 by more or less than would be implied by changes in the age-structure of the population; and

- **average awards** – actual awards increased at a different rate than would be the case if all had moved in line with the 2010-11 default uprating index.

3.14 As we explain in the rest of this chapter, much of the difference relative to the baseline is due to the effects of policy decisions. Trends in the housing market and wider economy, and the health status of the population, have also played a part.

3.15 Some of the bigger examples of the caseload part of the explanation – both policy and non-policy driven – include:

- **jobseeker's allowance**, where the caseload fell sharply as a share of the population due to falling unemployment;

- **state pensions**, where despite an ageing population the caseload actually fell from 25.0 per cent of all adults to 24.8 per cent due to rises in the women's state pension age;

- **disability benefits**, where age-specific claim rates have been rising at most ages; and

- **incapacity benefits**, where the proportion of older men claiming these benefits has been on a declining trend since the mid-1990s.

3.16 Uprating policy was subject to a number of significant changes relative to the policy that applied in 2010-11. Chart 3.3 plots the actual path of selected statutory rates across the welfare system relative to the counterfactual path for RPI and Rossi inflation uprating (reflecting the monthly rate in the preceding September). It shows that:

- **state pensions** (represented by the main basic state pension statutory rate) – the largest single item of welfare spending – increased by 18.7 per cent, considerably more than earnings growth or CPI inflation, thanks to the triple lock on uprating. But it did not rise as fast as RPI inflation, since all three elements of the triple lock were lower than RPI inflation in the first half of the Parliament;

- **disability benefits** (represented by the middle care rate in DLA – equivalent to the standard daily living rate in PIP) increased by 15.3 per cent – in line with CPI inflation;

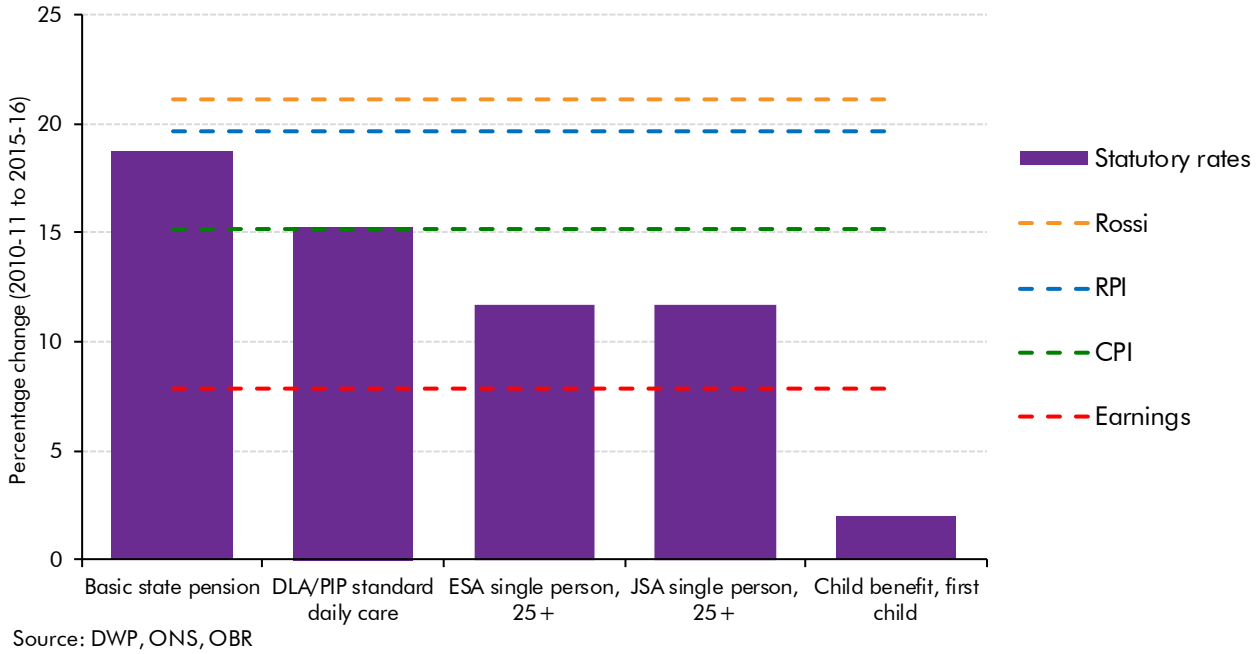
- **other working-age benefits** (represented by the main over-25s statutory rate in ESA) – including most elements of tax credits, incapacity benefits and housing benefit – increased by 11.7 per cent, thereby falling 3.5 per cent relative to CPI inflation;

- **jobseeker's allowance** (represented by the main over-25s statutory rate) also increased by 11.7 per cent and thereby fell 3.5 per cent relative to CPI inflation; and

- **child benefit** (represented by the first child amount) increased by only 2.0 per cent, down 13.2 per cent relative to CPI inflation. (Child benefit awards were reduced

further – in some cases to zero – for families containing at least one higher-earner thanks to the introduction of the 'high-income child benefit charge'.)

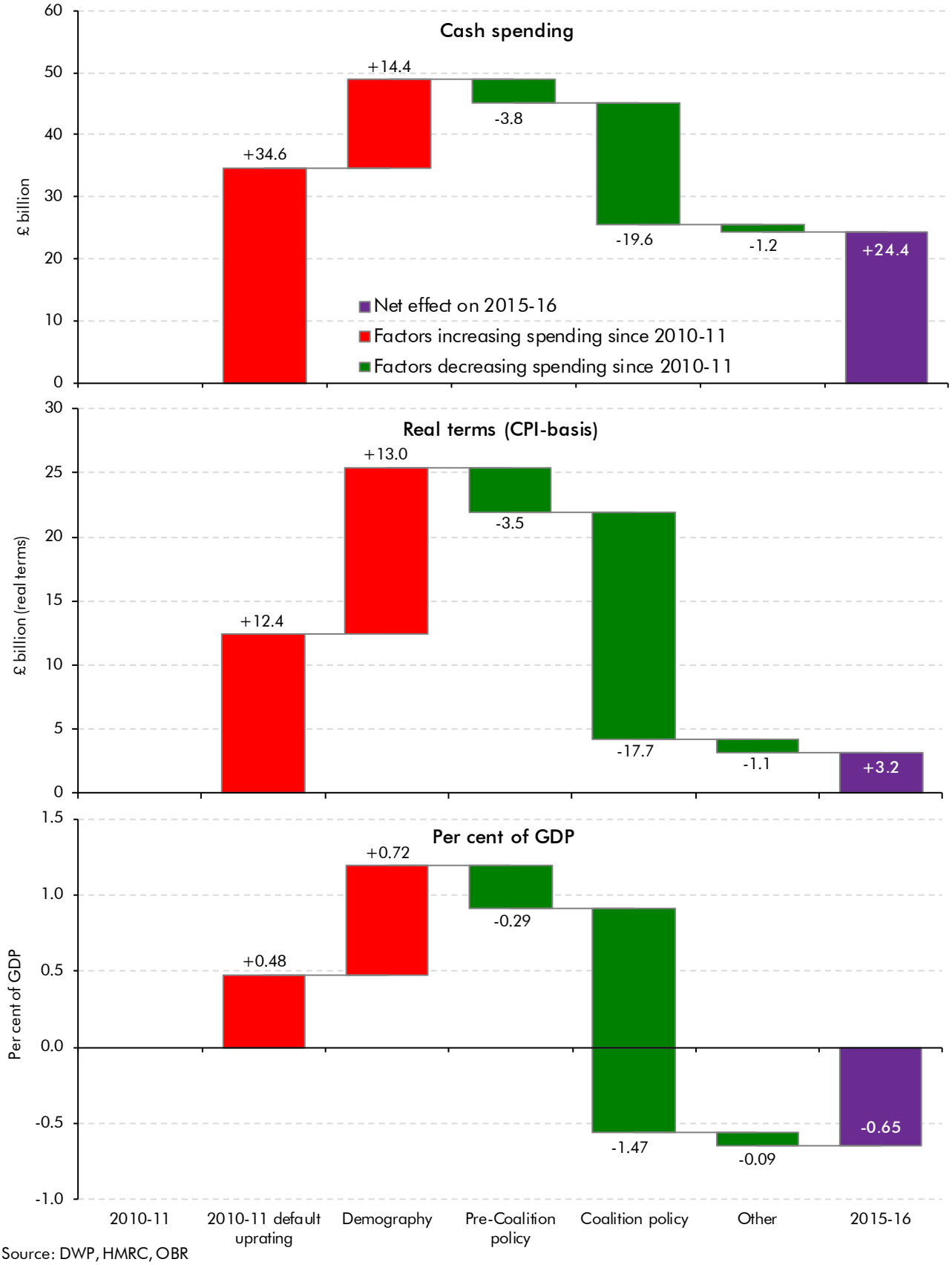
Chart 3.3: Standard rates vs pre-Coalition default uprating in the last Parliament



Source: DWP, ONS, OBR

3.17 What explains these changes relative to the 2010-11 baseline? Chart 3.4 decomposes the change in spending over the last Parliament into the steps up that were used to calculate the baseline, the effect of pre-Coalition policies implemented after 2010-11, the effect of Coalition policies and the remaining change due to non-policy factors. As the final step is calculated by residual, it will also contain the effect of any errors in the estimates underpinning the preceding steps. The following sections explore these changes in more depth – and highlight where the estimates are subject to greater uncertainty.

Chart 3.4: Changes to welfare spending between 2010-11 and 2015-16



Source: DWP, HMRC, OBR

Policy changes

3.18 This section estimates the effect of policy measures that led to differences from the 2010-11 system that underpins the baseline counterfactual. That includes policies announced before 2010, but where implementation was completed after, as well as the large number of welfare spending policies announced by the Coalition.

Pre-Coalition policy decisions

3.19 We have factored in the effects of four significant pre-Coalition policy decisions whose implementation affected the welfare system after 2010-11:

- the **equalisation of the female and male state pension age** (SPA) – legislated in 1995;
- the **replacement of 'incapacity benefit' with 'employment and support allowance'** – originally announced in the 2008 Budget;
- the **expiry of temporary uplifts in the child element of child tax credits** from 2011-12; and
- the **expiry of temporary uplifts in winter fuel payments** from 2011-12.

Equalisation of the male and female state pension ages

3.20 The 1995 Pensions Act established a timetable for equalising the male and female state pension ages (SPA), with the female SPA rising by one month every two months from the start of 2010-11. By 2015-16, that process was a little over half complete, with the female SPA having risen to 63 by the end of that year. During the last Parliament this reduced welfare spending overall via the effect on pensioner benefits, but added slightly to spending on those working-age benefits where eligibility extends to the SPA.

3.21 Between 2010-11 and 2015-16, the proportion of 60 to 64 year olds claiming the state pension fell from 13.6 to 5.8 per cent. That will have reflected the SPA changes reducing eligibility for women and other factors.

3.22 The drop in the state pension caseload due to these SPA changes would reduce spending by £4.9 billion in 2015-16. Overall, taking into account other elements of pensioner benefits affected by the change, the gross amount saved due to a higher SPA for women was £6.3 billion. The partly offsetting effect on working-age benefits, notably incapacity benefits (where the proportion of people claiming rises with age), was £1.1 billion, giving a net downward effect on spending in 2015-16 of £5.3 billion.

Introduction of employment and support allowance

3.23 In 2006, the Labour Government announced reforms to incapacity benefits that led in time to the introduction of ESA to replace incapacity benefit (IB). It would involve a new medical test and a new requirement for all but the most severely ill or disabled claimants to engage

in work-related activity. In Budget 2008, the Government announced that ESA would replace IB from October 2008, with a number of changes announced then and other policy parameters to be set at a later date. The main change would be the work capability assessment (WCA) with more stringent qualifying criteria. It would apply to new claims first, then from 2011 to the stock of IB cases. Further changes followed as a result of annual reviews of how WCAs were working and the effects they had on assessors' decision-making.

3.24 The shift from IB to ESA will have affected spending via its effects on both the caseload and on average awards. In terms of the caseload, the most obvious effect would come when an existing IB case was reassessed and the individual found fit for work. To the extent that the flow of successful new claims to ESA was lower than it would have been to IB, that would also reduce the caseload. In terms of average awards, some elements of ESA will have delivered clear savings – for example, age additions are not payable. But the rollout of ESA has been associated with a much higher-than-expected proportion of assessments resulting in the higher support group awards, pushing awards up relative to most IB outcomes.

3.25 There is no single official estimate of the effect of ESA's introduction on spending. Some elements were subject to impact assessments – for example, the 2008 announcement that WCAs would apply to the IB stock was expected to generate a relatively small saving of around £0.4 billion by 2012-13 (with a partly offsetting effect on jobseeker's allowance spending). But any effects factored into forecasts reflected assumptions about how many WCAs would take place and their outcomes, rather than incorporating an official costing. As detailed in our 2014 and 2015 *WTRs*, we have had to make substantial upward revisions to our forecasts as these assumptions have evolved.

3.26 Unpicking the extent to which higher-than-expected spending should be assigned to the effect of the policy to introduce ESA or other factors that would have pushed up spending on IB too would be resource-intensive and would still yield highly uncertain results. For the purposes of this analysis, we have assumed that ESA reduced welfare spending by £0.4 billion in 2015-16. That is based on a simple top-down calculation of the extent to which the working-age incapacity benefits caseload fell faster, relative to the working-age population, after ESA's introduction in 2008-09 than it had in the preceding five years. We have made further simple adjustments to account for the effect of the SPA rises described above and the fact that some of the individuals moving off incapacity benefits will have moved onto jobseeker's allowance.

3.27 To learn further lessons, it would be useful if a proper evaluation of the effect of introducing ESA could be undertaken. If resources permit, this is something we would like to return to.

The child element of child tax credits

3.28 The previous Labour Government announced a series of above-indexation upratings in the value of the child element of tax credits from 2008-09 to 2010-11: in 2008-09 it was uprated by earnings plus £175; in 2009-10 by earnings plus £75; and in 2010-11 by earnings plus £20. In 2011-12, uprating was planned to revert to uprating by the RPI index. RPI inflation was above earnings growth in 2011-12, which would have increased spending

relative to the 2010-11 baseline by £0.7 billion. RPI inflation continued to exceed earnings growth throughout the last Parliament meaning that, by 2015-16, spending would have been £2.5 billion higher than the 2010-11 baseline.

Winter fuel payments

3.29 In each Budget from 2008 to 2010, the Labour Government announced temporary uplifts in the value of winter fuel payments from 2008-09 to 2010-11. These were worth £50 for those aged 60 to 79 and £100 for those aged 80 and above. They were removed in 2011-12, which reduced spending on winter fuel payments by around £0.6 billion in that year. By 2015-16, thanks to growth in the number of people that would have been eligible for these payments, it reduces spending relative to the 2010-11 baseline by £0.7 billion.

Summary

3.30 Policy decisions taken before 2010, but whose implementation affected the welfare system after 2010-11, are therefore estimated to have reduced spending by £3.8 billion in 2015-16. That would be £3.5 billion in real terms or 0.29 per cent of GDP.

Coalition policy changes

3.31 During the last Parliament, the Coalition announced around 150 policies at Budgets, Autumn Statements and Spending Reviews that affected welfare spending.[4] Simply summing the original estimates of their effect on spending in 2015-16 – including the June 2010 Budget where the Treasury's scorecard only extended to 2014-15 but the forecast ran to 2015-16 – would suggest that they reduced it at the end of the Parliament by £21 billion.

3.32 In this section we use various approaches to present a more up-to-date estimate. These include new estimates for some of the bigger measures, based on outturns for the main parameters that affect spending. We have used simpler updates for some of the more complex measures (where producing a full update would be particularly resource-intensive) or official re-costings presented in subsequent Budgets where available. Like the original estimates, these updated figures are subject to significant uncertainty. But they suggest the overall saving was somewhat smaller at £19.6 billion with large changes in both directions.

Uprating measures

3.33 Some of the biggest welfare spending cuts implemented by the Coalition were the result of cutting awards across all recipients via uprating policy. The effect of these measures reflects the difference between two measures of inflation and the number of recipients' awards that were affected. Both of these will have changed relative to the original estimates. For example, higher oil prices contributed to inflation between 2011 and 2013 being significantly higher than we forecast in June 2010, while the opposite was true of more recent forecasts, with CPI inflation falling to around zero in 2015.

[4] This count is based on policies that were shown on the Treasury's 'scorecard' of policy measures in each Budget, Autumn Statement and Spending Review. It does not include any policies announced outside these fiscal events, which may nevertheless have indirectly affected welfare spending.

3.34 We have factored in updated estimates for:

- the June 2010 Budget decision to **switch uprating of most working-age benefits from RPI or Rossi inflation to CPI inflation**, which is typically lower. By 2015-16, that reduced affected rates by 4.4 per cent where they were previously linked to RPI and 5.9 per cent where they were linked to Rossi. This was originally estimated to cut spending by £6.3 billion. Our updated estimate puts the cut at £5.2 billion, of which uprating the second state pension by CPI instead of RPI contributes £1.0 billion. (As shown in Chapter 4, the extent to which this uprating switch reduces spending continues to rise every year that CPI inflation is lower than the RPI and Rossi measures of inflation);

- at the same time, **child benefit payments were frozen for three years from 2011-12**. That reduced awards by a further 11.1 per cent by 2014-15 relative to CPI uprating. It cut spending by a further £1.4 billion by 2015-16. That is higher than the original estimate of £1.0 billion because the freeze is compared against the higher-than-expected path of CPI inflation over the period;

- the **introduction of the triple-lock on the uprating of the state pension** – raising awards by the higher of earnings growth, CPI inflation and 2½ per cent – was originally estimated to cost £0.5 billion by 2015-16, reflecting our forecast at the time that earnings growth would outstrip RPI inflation in later years. In the event, even though the triple lock has pushed up state pension awards relative to both CPI inflation and average earnings, it did not quite match RPI inflation across the full period due to high RPI inflation in the early years of the Parliament (see Chart 3.3). As a result it actually reduced spending in 2015-16 by £0.6 billion relative to uprating by RPI inflation;[5]

- the **three-year freeze in the basic and 30-hour elements of the working tax credit** (WTC) from 2011-12 announced in the 2010 Spending Review – cutting awards across the board for those benefiting from WTC. This was originally estimated to save £0.7 billion. The latest estimate is higher at £1.0 billion due to higher-than-expected CPI inflation raising the counterfactual against which its effect is estimated;

- the 2012 Autumn Statement decision to **impose a 1 per cent cap on the uprating of most working-age benefits for three years from 2013-14**. The cap did not apply to the premiums in these benefits relating to disability, pensioners and caring responsibilities, the support group component of ESA or the disability elements in tax credits. Relative to the CPI uprating then in place, latest estimates suggest that this reduced spending by £1.6 billion. This is down on the equivalent original estimate of £2.0 billion.[6] CPI inflation was close to our December 2012 forecast for 2013-14 and 2014-15, but much lower in 2015-16, reducing the estimated saving in that year;

[5] We have included the full effect of the triple lock relative to RPI uprating with Coalition policies. Prior to the Coalition taking office, the Labour Government had stated its intention to move from RPI to earnings uprating, but it did not settle on a specific timetable for its implementation. It was not presented as a Budget policy until June 2010.
[6] This estimate is slightly lower than that presented in Autumn Statement 2012 because that included the impact on universal credit. We have separated out the marginal cost of universal credit in this analysis.

- at the same Autumn Statement, the Government announced **two years of 1 per cent uprating of child benefit payments, the local housing allowance (LHA) in housing benefit** from 2014-15. Relative to CPI uprating, this cut spending by a further £0.4 billion. This fell short of the original estimate of £0.6 billion because of much lower-than-expected CPI inflation meaning that the cap was closer to the counterfactual of CPI-uprating 2015-16; and

- a number of **smaller uprating measures** that together reduced spending by around £1.1 billion. This includes one measure that did not appear as a Budget or Autumn Statement policy measure – the announcement of a 10-year rents policy for social-sector rents that affected housing benefit spending.

3.35 The approach we have taken to estimating the effect of introducing universal credit (UC) – taking our March 2015 forecast of its overall marginal impact – means that all parameter changes are captured in that single line. They include applying the 1 per cent uprating measure, which is estimated to have reduced spending on universal credit by £0.6 billion in 2015-16, and the 1 per cent uprating of the income disregard, saving a further £0.1 billion.

3.36 On the basis of the adjustments described above, we estimate that non-UC uprating policies reduced welfare spending in 2015-16 by £11.2 billion versus £11.0 billion shown in original estimates. Excluding the effect of the triple lock, those figures would be £10.7 billion versus £11.5 billion. The main sources of difference relative to the original estimates are the higher-than-expected inflation in the first half of the Parliament (raising estimated savings) and the lower-than-expected inflation at its end (lowering them).

Major reforms to the welfare system

3.37 As well as continuing to implement the previous Government's reform of the incapacity benefits system, the Coalition launched two major reforms of its own that would affect spending during the Parliament: the replacement of disability living allowance (DLA) with the new personal independence payment (PIP) and the replacement of six working-age benefits with a new single universal credit (UC). Of these, the reform to disability benefits was intended to generate significant direct savings by reducing the number of people able to claim those benefits. The direct effect of UC on spending was expected to be relatively small. The Government also announced a major reform of the pension system with the introduction of a new single-tier pension. As that only applied to new claims from 2016-17 onwards, it is discussed in Chapter 4.

3.38 Of those that affected spending in the last Parliament:

- the **reform of disability benefits** was originally announced in the June 2010 Budget as a decision to introduce "*an objective medical assessment*" from 2013-14 onwards to reduce spending on disability benefits. That high-level announcement subsequently became the introduction of PIP to replace DLA for working-age claims. As we described in our March 2016 *EFO*, the original costing assumed the policy would reduce spending by 20 per cent, but with little detail underpinning that. To meet that

figure would have required all DLA cases to have been assessed by that time and for the assessments to result in 20 per cent less spending. In fact, 75 per cent of the working-age caseload remained on DLA by 2015-16. And the evidence on which we based our March forecast suggested the effect among those cases that have moved to PIP was much smaller at around 5 per cent. We therefore estimate that the introduction of PIP reduced spending by just £0.1 billion in 2015-16 rather than the £1.4 billion saving implied by the original goal of cutting spending by 20 per cent; and

- the **introduction of universal credit** was announced soon after the Coalition took office. We first factored in an estimate of its effect on welfare spending across the forecast period in December 2012. Since then, UC has been subject to a number of changes to the parameters of the policy and to its delivery timetable, which was repeatedly pushed back. By the end of 2015-16, around 200,000 cases were receiving UC, which given the small difference in UC awards relative to the legacy benefits is likely to have had only a small effect on total welfare spending.

3.39 The Coalition also announced a significant change to the incapacity benefits reforms. In the 2010 Spending Review, it decided to limit to one year the period over which claimants of contributory ESA in the work-related activity group (WRAG) could receive the benefit. This was originally estimated to save £2.0 billion in 2015-16, which depended on assumptions about the number of contributory WRAG cases whose claim would be curtailed at one year and about what would happen to those affected – for example, whether they would move onto the income-based version of the benefit that was not being time-limited.

3.40 By Budget 2012, the official estimate had been halved in its first two years, although it was still expected to rise to £1.5 billion by 2015-16. At that time, the contributory WRAG caseload was expected to be 384,000 in 2015-16 (18 per cent of all ESA cases). In the event, it was only 16,000 (just 1 per cent of the total). The Budget 2012 estimate also assumed that the proportion of WRAG cases that would income-based would fall slightly to 36 per cent by 2015-16. In fact it increased to 96 per cent. Given the smaller contribution-based caseload and the likelihood that a higher-than-expected proportion of those affect moved onto the income-based benefit, we estimate that the policy reduced spending by just £0.2 billion in 2015-16.

Other material Coalition policy announcements

3.41 We have factored in estimates of a number of other policy changes that were originally expected to have a material effect on spending in 2015-16. Where we have updated estimates, the approach taken has in most cases been relatively simple so the degree of uncertainty around them could be large.

3.42 Ordered by the size of the original estimate of how spending would be reduced in 2015-16, these policies include:

- **the introduction of the high income child benefit charge (HICBC)** on families containing at least one high earner. This was initially announced in the 2010 Spending

Review, with high earners defined as higher-rate taxpayers. It was originally estimated to save £2.7 billion in 2015-16. In Budget 2012, the definition of a high-earner was changed to those with incomes over £50,000 and a taper was introduced for those on incomes between £50,000 and £60,000. This brought the estimated saving at the time of announcement down by £0.6 billion in 2015-16. Since then, the number of people paying the charge through the tax system has been lower than expected, which has partly reflected a higher-than-expected rate of non-registrations that reduce spending rather than generating an offsetting tax receipt. On the basis of our latest forecast, we estimate the HICBC to have reduced spending by £1.4 billion by 2015-16;

- **tax credits reforms** announced in June 2010. These cut the caseload by almost 20 per cent. First, for 2011-12 the threshold at which the family element starts to fall was lowered. The family element plateau was then removed entirely in 2012-13, to be replaced by a single taper rate. Average awards were reduced by raising the taper rate from 39 to 41 per cent and by abolishing additional payments for babies, children aged 1 and 2 and adults aged 50 and over. A range of other administrative changes cut awards further. Together these changes were originally estimated to reduce spending in 2015-16 by £3.3 billion (on top of the effect of switching to CPI uprating). Partly offsetting this, the child element of child tax credit was raised by £150 more than CPI uprating in 2011-12 and £60 more in 2012-13, at an estimated cost of £2.1 billion in 2015-16. Together, the net effect of these changes was estimated to have reduced spending by £1.2 billion in 2015-16. We have not been able to produce a full update of the effect of these measures, but the last published estimates – updated in Budget 2011 – showed a larger net cut of £1.6 billion, with the gross takeaway unchanged at £3.3 billion but the gross giveaway down to £1.7 billion;

- **further tax credits measures** announced in the 2010 Spending Review. These included a cut in the support provided for childcare costs, the working hours threshold for WTC couples rising from 16 to 24 hours, and the impact of using HMRC's 'real-time information' (RTI) in the administration of tax credits. (The 3-year freeze in some elements of the WTC described in the uprating section was part of this package.) Ignoring the uprating element, these changes were originally estimated to reduce spending by £1.1 billion. The latest official estimate suggested this had risen to £1.2 billion, with greater savings from the change in the hours requirement and cut in childcare support offsetting smaller savings from the use of RTI;

- **the cut in the local housing allowance in housing benefit to the 30th percentile** of local private sector rents, announced in the June 2010 Budget. This was originally estimated to save £0.4 billion in 2015-16. The latest estimate is that it saved £0.5 billion;

- **matching the basic state pension cash increase in 2011-12 in the pension credit minimum income guarantee**, announced in the June 2010 Budget. This was originally estimated to cost £0.7 billion in 2015-16. The latest estimate is that it cost £0.6 billion;

- **limiting working-age entitlements to reflect the size of family in the social-rented sector** from 2013-14, announced in the June 2010 Budget. This was originally estimated to save £0.5 billion in 2015-16. The latest estimate is unchanged; and

- changes to **tax credits administration and collection** announced in the 2013 Autumn Statement. This was originally estimated to save £0.5 billion in 2015-16. The latest estimate is unchanged.

Smaller measures

3.43 The updated estimates in the previous sections cover the vast majority of the original estimate of the reduction in spending by 2015-16. For the relatively large number of smaller measures announced during the last Parliament, we have used either the original costing or the last update that was presented in a Budget document. Together they are estimated to reduce spending by £2.1 billion in 2015-16 (equivalent to an average of around £70 million for each measure).

Summary

3.44 On the basis of these updated estimates, Coalition policy decisions are estimated to have reduced welfare spending by £19.6 billion in 2015-16. Within that, spending on pensioner benefits[7] accounts for just £1.5 billion, while working-age welfare spending was cut by £14.5 billion (including £7.3 billion on tax credits) and child benefit by £3.6 billion.[8] The net effect would be equivalent to £17.7 billion in real terms (in 2010-11 prices) or 1.47 per cent of GDP.

3.45 Our estimates of the savings associated with Coalition policies fall short of those that were announced at the various Budgets, Autumn Statements and Spending Reviews during the Parliament. The shortfall can largely be explained by the complex reforms of various systems have yielded much smaller savings than were originally expected:

- for **disability benefits**, it reflects the combination of a slower-than-expected rollout of PIP to replace DLA and a smaller-than-expected reduction in spending from the assessments involved in that rollout; and

- for **incapacity benefits**, unexpected changes in the composition of the ESA caseload significantly reduced the savings expected from time-limiting contribution-based ESA claims in the work-related activity group.

3.46 While universal credit was subject to repeated delays, the effect on spending was limited because at the time it was not expected to be significantly more or less generous than the benefits and tax credits it replaces.

[7] Defined as the payments that are exclusive to pensioners: attendance allowance, pension credit, state pension and winter fuel payments.
[8] The remaining £2.1 billion cannot straightforwardly be disaggregated by age.

3.47 The pattern of revisions to our forecasts for these benefits highlights how the impact of these sorts of structural reforms is particularly hard to forecast and prone to optimism bias. While there are elements of these reforms that are unique to each, there are common factors given the significant changes to rules of eligibility and the way they are administered and policed. This generates a large number of uncertainties, including:

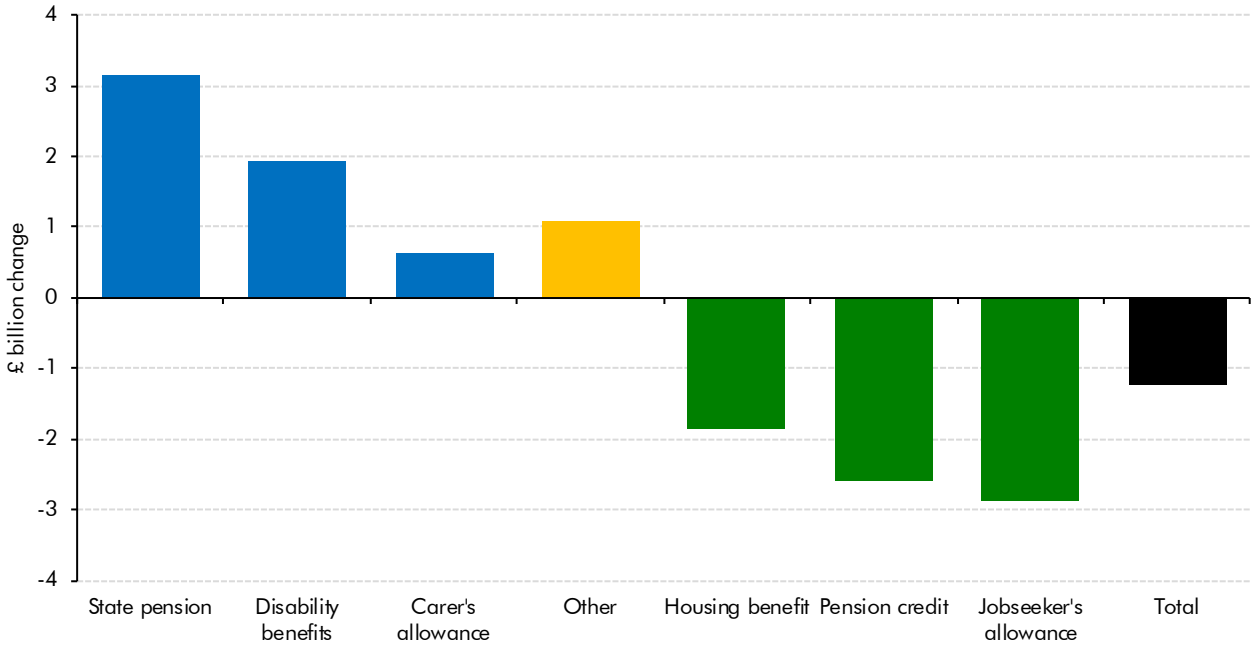
- **how many people will be potentially eligible** under the reformed system;
- **how many of those that are eligible will try to take up their entitlement** in the face of changes to the system;
- **how the eligibility rules will be applied in practice** and how that will differ from the intentions of policy designers. And given the inevitable differences between reality and intention, how the rules or the guidelines for applying them will be changed;
- how applicants and decision-makers will behave in any **appeal processes**; and
- understanding any **issues related to contractors** that are responsible for delivering underpinning IT systems or assessment processes – are they able to recruit the necessary people, what incentives do the contracts place upon them, and so on.

Other factors affecting welfare spending

3.48 As Table 3.1 reported, welfare spending in 2015-16 was £24.4 billion higher than in 2010-11. With the combined effect of pre-Coalition uprating and population changes adding £49.0 billion to welfare spending between 2010-11 and 2015-16 and the total effect of policy changes reducing it by £23.5 billion, we are left with a further £1.2 billion reduction to be explained by other factors. This reflects the partly offsetting effects of a number of different factors.

3.49 Chart 3.5 shows the contributions of different lines of welfare spending to that remaining change, including those that help to explain the fall (e.g. jobseeker's allowance and pension credit) and those where other factors pushed spending up (e.g. state pensions and disability benefits). In some cases, the drivers of these changes interact – for example, the negative contribution from pension credit is related to the positive contribution from state pensions.

Chart 3.5: Non-policy sources of growth in welfare spending



Source: OBR

3.50 As ever, the other factors driving changes in welfare spending can be thought of in terms of things affecting the caseload – which in turn can reflect drivers of eligibility or the rate at which those who are eligible take up the payments that they are entitled to – and things affecting average amounts received – such as changes in the composition of the caseload.

The main negative contributions

Jobseeker's allowance and housing benefit

3.51 Spending on jobseeker's allowance and associated housing benefit fell by £3.4 billion between 2010-11 and 2015-16. Indeed, the £1.2 billion drop in housing benefit paid to jobseeker's allowance claimants was sufficient to mean that total housing benefit spending fell as a share of GDP. These falls contrast with the rising path of spending that would be seen after adjusting our 2010-11 baseline for subsequent policy changes. The negative contribution to be explained by other factors is £4.7 billion. It is virtually all explained by the fall in unemployment – the main determinant of eligibility for jobseeker's allowance and, where they are living in rented accommodation, related housing benefit payments.

3.52 Between 2010-11 and 2015-16, the Labour Force Survey measure of unemployment fell by 30 per cent from 2.5 to 1.8 million. The jobseeker's allowance caseload fell even faster – by 48 per cent – for reasons that may be related to the tougher sanctions regime acting as a deterrent to prospective claimants.[9] The associated housing benefit caseload fell by 44 per cent. Based on the average awards in 2015-16 those falls would explain £4.1 billion of the drop relative to our simple baseline.

[9] We discussed possible reasons for the fall in the claimant count relative to the LFS measure of unemployment in Box 8.1 of our 2014 *Welfare trends report*.

The main positive contributions

Disability benefits

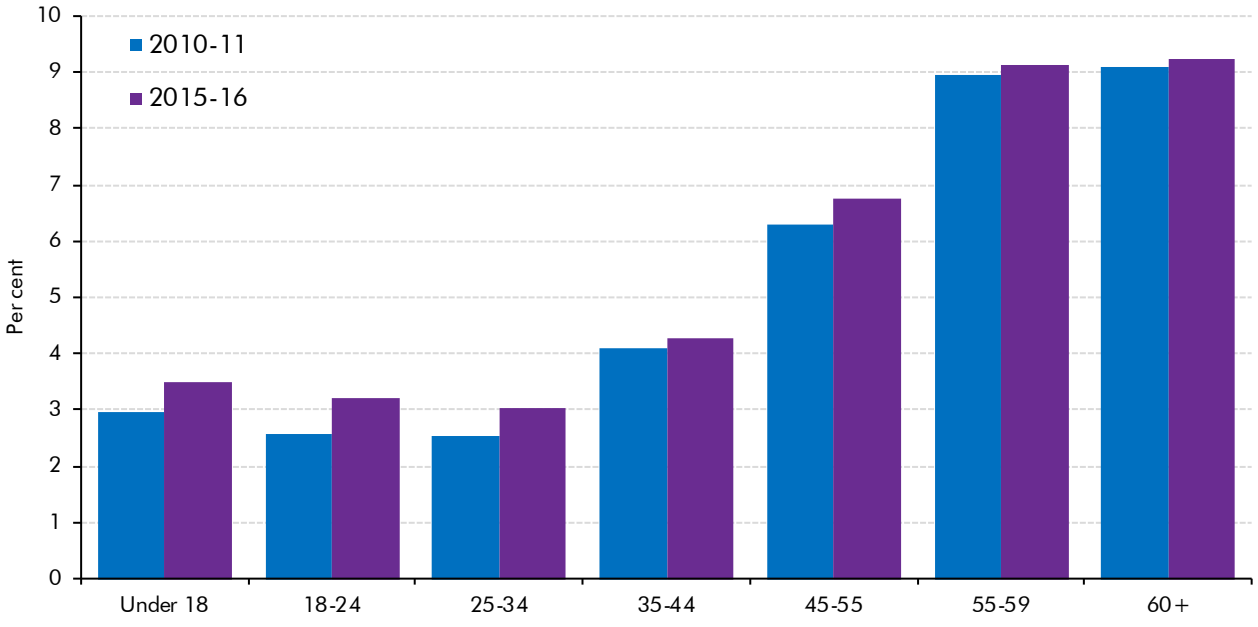
3.53 Spending on disability benefits increased by £4.3 billion between 2010-11 and 2015-16, which is £1.2 billion less than the 2010-11 baseline. We estimate that policy changes would have reduced spending by £0.7 billion, meaning a positive contribution of £1.9 billion to be explained by other factors.

3.54 As detailed in Chapter 5, upward pressures on disability benefits spending included:

- **a rising share of the population claiming disability benefits**. Despite the original expectation that the transition to PIP would reduce the caseload and spending by 20 per cent relative to DLA, the proportion of the population claiming either DLA or PIP increased from 5.2 to 5.6 per cent during the last Parliament. As Chart 3.6 shows, age-specific claim rates increased across all ages. Among younger people, the proportion of claimants who report learning difficulties as their main disabling condition increased significantly; and

- **a composition-driven increase in average awards**. The proportion of claimants receiving either the DLA 'higher care' rate or the PIP 'enhanced daily living' rate increased by 10 percentage points. At the same time, the transition to PIP reduced the share of the caseload receiving the 'lower' rate that only exists in DLA. A lower share of those in receipt of mobility payments receiving the higher awards partly offset those changes, but the overall consequence of these compositional changes was to push average awards up.

Chart 3.6: Age-specific disability benefits claim rates



Source: DWP, ONS

Carer's allowance

3.55 The 63 per cent rise in spending on carer's allowance in the five years to 2015-16 was £0.6 billion faster than can be explained by the effects of policy decisions relative to our 2010-11 baseline. The underlying driver of the caseload is the number of people receiving DLA, PIP or attendance allowance (AA) and the proportion of them being cared for by someone who claiming this support. In the five years to 2015-16, the combined DLA, PIP and AA caseload increased by 4.5 per cent, but the total carer's allowance caseload increased by 16.7 per cent and the proportion of those cases in payment increased from 55 to 65 per cent.[10] Both factors help to explain the 63 per cent growth in spending on carer's allowance.

Some big offsetting effects

State pensions and pension credit

3.56 The biggest drivers of spending on pensioner benefits – an ageing population and policy decisions on the state pension age and uprating – have been described earlier in this chapter. After accounting for these drivers, little of the change in spending over this Parliament remains to be explained. But that reflects the net effect of some larger movements. In particular, there is a £3.1 billion positive contribution from state pensions that is almost offset by a £2.6 billion negative contribution from pension credit. The driver of the former is a key explanation for the latter:

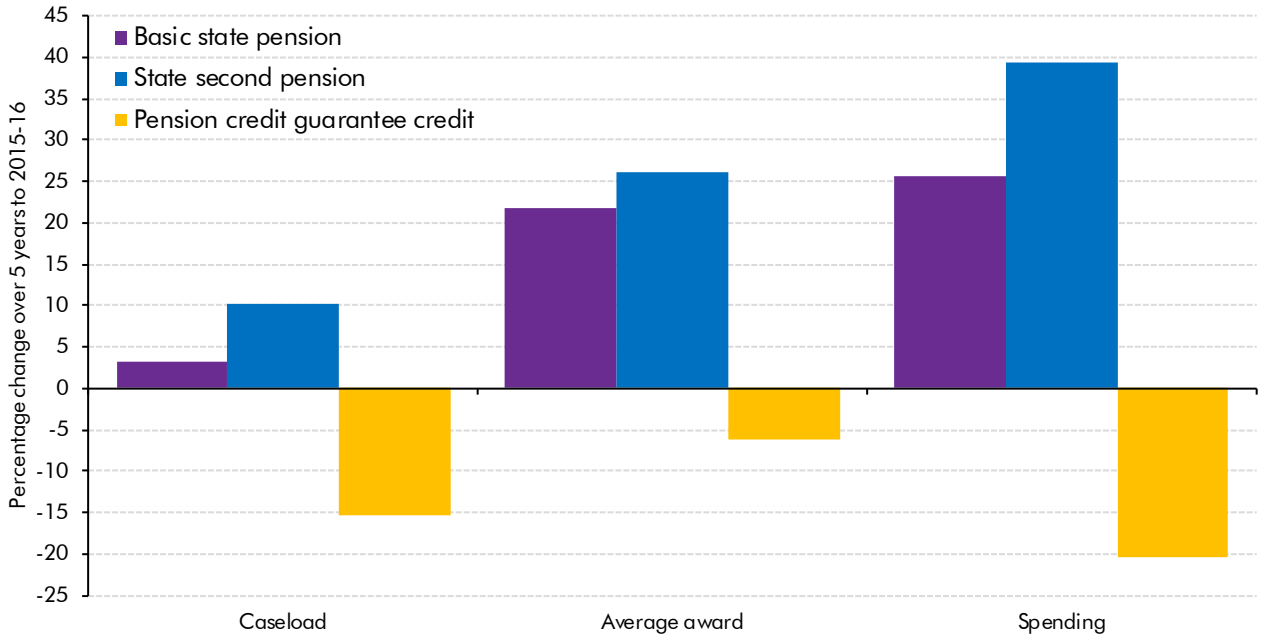
- under the **state pensions** system that was in place in the last Parliament, there were a number of potential sources of pension income, of which the basic state pension and the earnings-related state second pension were the biggest. Two factors pushed up the amount spent relative to the path it would have been expected to take based on demography and the prevailing policy settings. First, the proportion of women retiring with sufficient years of National Insurance contributions to qualify for the full basic state pension has been rising thanks to the upward trend in female employment rates in past decades. Second, recent retirees have on average been entitled to more generous second state pension payments.[11] As Chart 3.7 shows, in the five years to 2015-16, while the rising state pension age meant the basic state pension caseload increased only 3.2 per cent, for the second state pension it rose 10.3 per cent. Spending was boosted further by rising average awards – up 21.8 per cent for the basic state pension (higher than would be explained by uprating alone) and 26.2 per cent for the second state pension (reflecting the cohort effect of new pensioners having built up entitlement to higher payments than older pensioners); and

- the higher pensioner incomes associated with these trends helped to reduce **pension credit** spending. Spending on the savings credit element of pension credit was cut sharply thanks in part to the 2010 Spending Review decision to freeze the maximum award for four years from 2011-12. But even the guarantee credit element, which was

[10] Most payments fall to zero when the carer retires and starts claiming their state pension, but the underlying entitlement remains. The rising share of the caseload in payment therefore matches the rising share of the total caseload that is of working-age (up from 58 to 68 per cent between 2010-11 and 2015-16).
[11] These trends were explored in more detail in Chapter 5 of our 2014 *Welfare trends report*.

not subject to significant policy effects, fell sharply. The caseload fell more than 15 per cent and spending more than 20 per cent.

Chart 3.7: Growth in selected pensioner benefits in the last Parliament



Source: DWP, OBR

Housing benefit (excluding jobseeker's)

3.57 After taking account of the effect of falling unemployment on the 13 per cent of housing benefit spending that went to people on jobseeker's allowance during the last Parliament, there is little change relative to our baseline left to explain. But that reflects the offsetting effects of some significant changes in the remaining elements of the housing benefit caseload. This is the part of housing benefit spending that is now subject to the welfare cap.

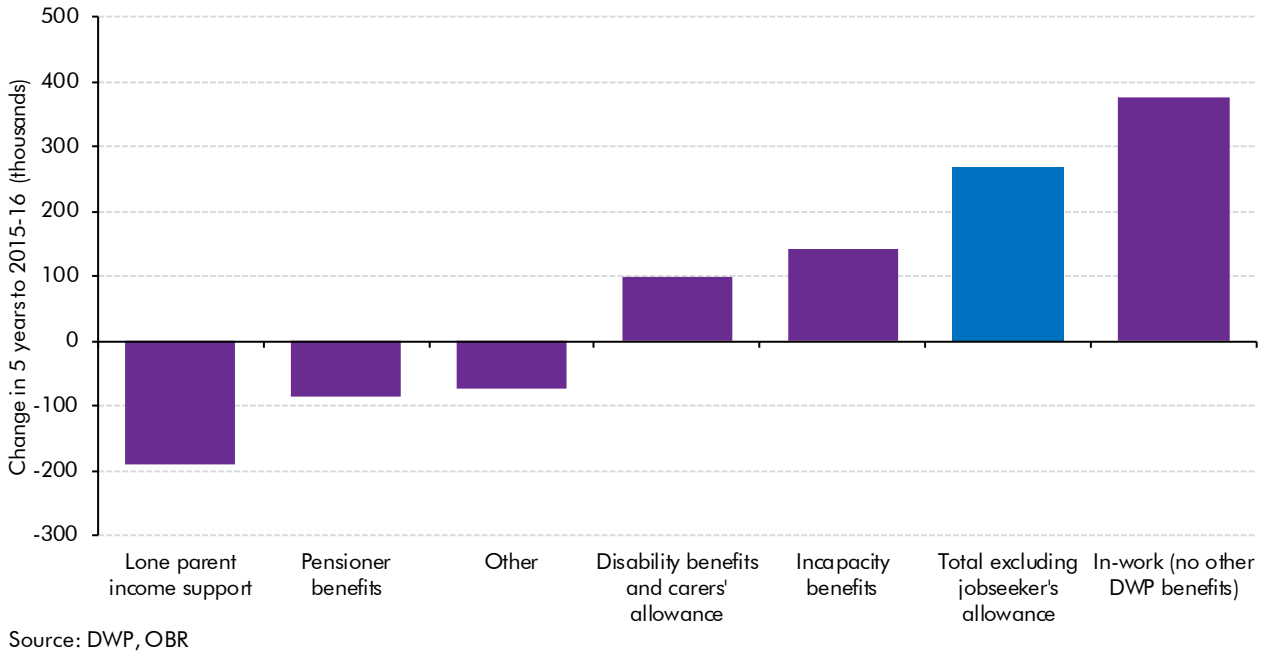
3.58 One significant change in the caseload was the sharp increase in the number of housing benefit recipients that were not in receipt of another DWP-administered benefit. That group is a proxy for the in-work caseload. It increased from 14.3 to 22.2 per cent of the overall housing benefit caseload and more than accounted for the increase in the caseload that is now subject to the welfare cap (as shown in Chart 3.8). This reflects the combined effect of rising employment, a rising share of those in employment that rent their homes and a rising share of those employed renters entitled to and claiming housing benefit. Weak productivity and earnings growth overlaid by further rises in house prices are likely to be the underlying causes of these trends.

3.59 Offsetting factors included:

- the drop in **lone parents** receiving housing benefit thanks to claiming income support (reflecting both higher employment among lone parents and some moving to jobseeker's allowance due to the lone parent obligation); and

- the drop in **pensioners** receiving it due to claiming pension credit or other income-related pensioner benefits, which reflects the rising state pension age, trends in home-ownership and the drivers of pension credit spending described above.

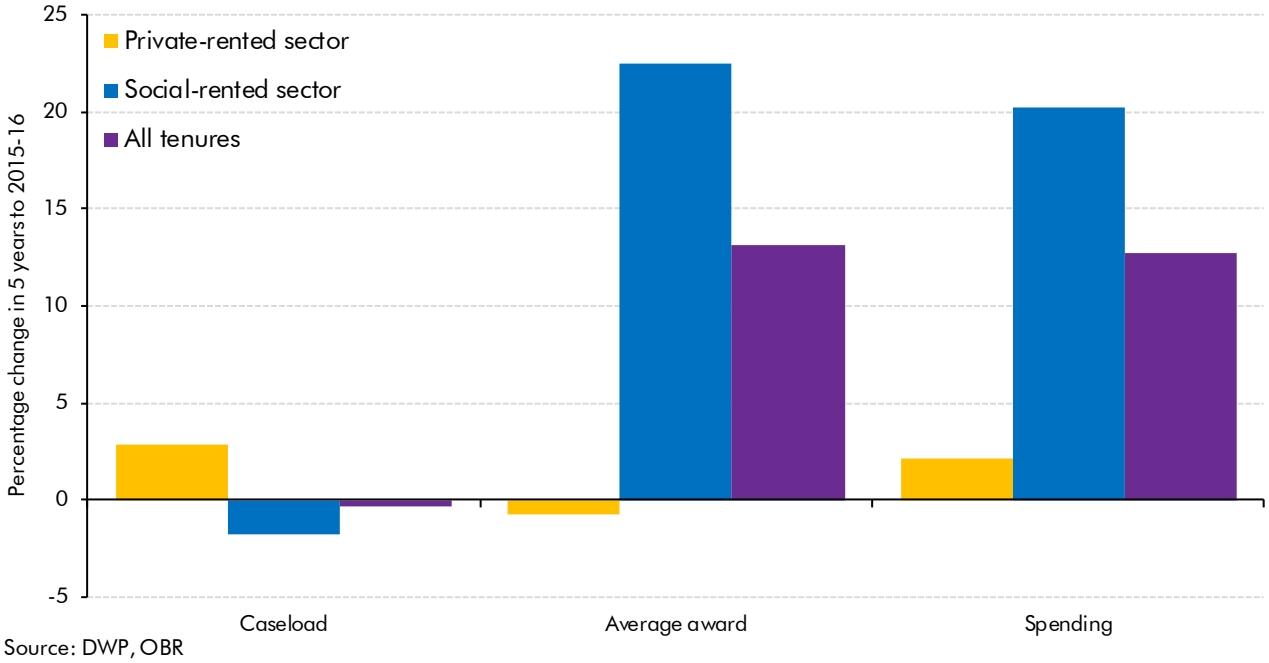
Chart 3.8: Housing benefit caseload growth in the last Parliament



Source: DWP, OBR

3.60 Another change in the composition of the housing benefit caseload was between the private- and social-rented sectors. In the five years to 2015-16, the share of housing benefit recipients in the private-rented sector increased from 31.1 to 32.1 per cent. In our 2014 *WTR* we showed how earlier rises in this share had explained some of the overall rise in housing benefit spending because of the higher rents – and therefore higher housing benefit awards – paid in the private-rented sector. Over the last Parliament, policy decisions capped the amount of housing benefit that could be put towards rents in the private sector, but allowed social-sector rents to rise considerably faster than inflation. As a result, the average award in the private-rented sector went from 32.6 per cent higher than the social-sector average in 2010-11 to a much smaller 16.3 per cent higher. That will have reduced the sensitivity of housing benefit spending to changes in the composition of the caseload.

Chart 3.9: Housing benefit by tenure type



Source: DWP, OBR

Conclusion

3.61 There are a number of conclusions that can be drawn from this analysis:

- **under default uprating policies welfare spending would have increased significantly** in the last Parliament, thanks in part to a growing and ageing population. The actual rise in cash spending was less than that this simple baseline would imply, while spending actually fell in real terms and as a share of GDP;

- **policy changes reduced spending significantly below this baseline**. The pre-Coalition decision to equalise the male and female state pension ages had a material effect on caseloads, while the Coalition's uprating cuts – making up over half of the welfare savings it announced – had an even bigger effect on average awards. But the major structural reforms to incapacity and disability benefits, and the introduction of universal credit, do not appear to have had a material effect on spending. Beyond policy changes, falling unemployment was the biggest downward pressure on spending; and

- **the savings from structural welfare reforms have proved particularly hard to forecast**. These are discussed in detail in Chapter 5. The uncertainties created by these ongoing reforms – particularly to disability benefits, which are at an earlier stage – signal the extent to which our forecasts could be subject to further change as the much bigger reforms associated with universal credit take hold.

4 Welfare spending in the current Parliament

Introduction

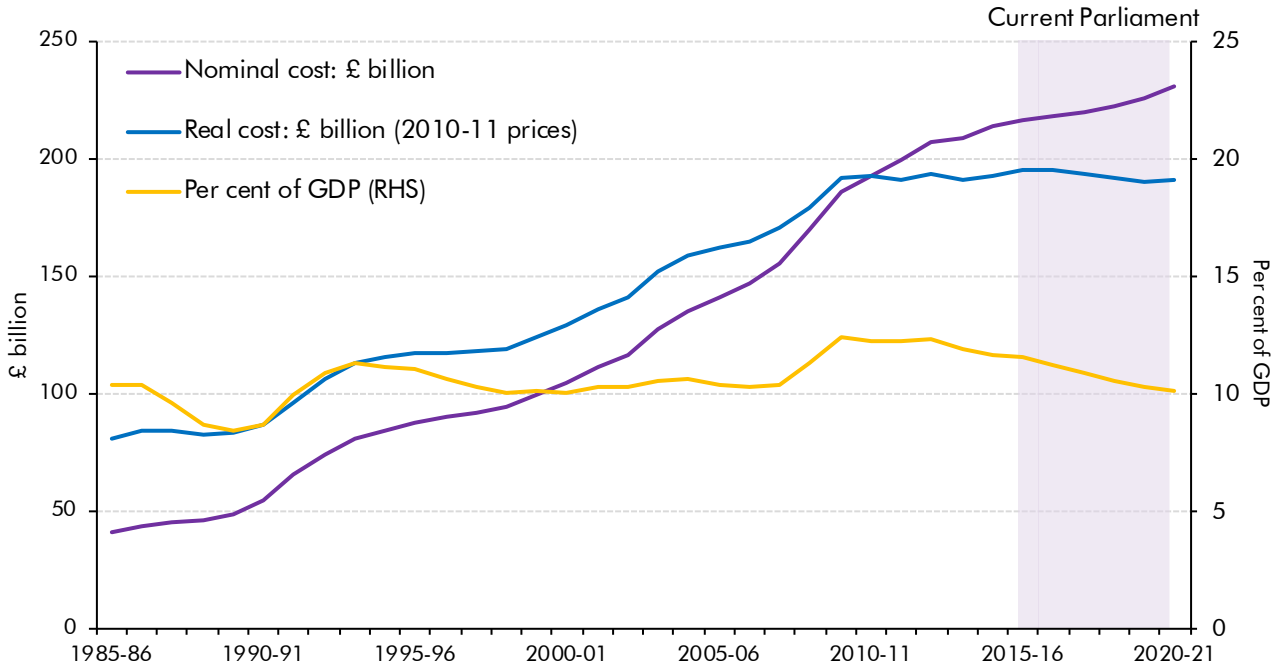
4.1 Welfare spending in the 2015 to 2020 Parliament will continue to be affected by the policies discussed in Chapter 3, as well as the policies announced over the past 15 months by the new Conservative Government. These include the policies announced in the July 2015 Budget that cut welfare spending by £12 billion in 2019-20 – an amount previously committed to, although two years later than originally pledged. Major reforms to the welfare system already in train will remain important drivers of spending, with disability benefits reform and the rollout of universal credit still work-in-progress.

4.2 As Chart 4.1 shows, on the basis of our March 2016 forecast – adjusted for one Budget 2016 policy measure that was subsequently dropped – welfare spending is forecast to rise by 6.5 per cent (or £14.2 billion) in cash terms between 2015-16 and 2020-21. That would represent a fall of 2.3 per cent in real terms relative to CPI inflation (or £4.5 billion in 2010-11 prices) and 1.4 per cent of GDP. Over the course of two Parliaments, that would mean a cumulative real terms fall of 0.7 per cent and 2.1 per cent of GDP, taking welfare spending back to broadly its pre-crisis share of GDP.

4.3 In this chapter we use the methodology set out in Chapter 3 to explain changes in welfare spending relative to a 2010-11 baseline. The chapter:

- describes how **the 2010-10 baseline** would have evolved over the current Parliament, extending the baseline used in Chapter 3 on the basis of our forecasts for the relevant uprating metrics and ONS projections for the size and age-structure of the population;
- summarises **the difference between our March 2016 forecast and that 2010-11 baseline** and how it can be broken down between policy and other factors;
- **estimate the role played by policy changes in explaining the difference** from our simple baseline. Here we distinguish the impact of policies announced prior to the Coalition taking office, under the Coalition and under the new Conservative Government;
- explain **how other non-policy factors influenced spending**; and
- draw some **conclusions**.

Chart 4.1: Historical trends in welfare spending



Source: DWP, ONS, OBR

The 2010-11 baseline

4.4 We can extend our 2010-11 baseline from 2015-16 to 2020-21 by using our March 2016 forecasts for the various inflation and earnings measures that applied to uprating policy in 2010-11 and the latest ONS population projections. The rest of the methodology is as in Chapter 3, with age-specific claim rates held constant from the outturns in 2010-11 so that the baseline spending in 2020-21 reflects changes in uprating and the size and age-structure of the population over the preceding decade.

The effect of pre-Coalition default uprating assumptions

4.5 Our March 2016 forecast was for RPI to rise by around 12 per cent in the five years to 2020-21 and the Rossi index to rise by 11 per cent. Default uprating would have added £34.6 billion to spending in the last Parliament. It would raise spending in our baseline by a further £29.5 billion by 2020-21 (£16.1 billion more than if all spending was uprated by CPI inflation). In real terms, that would be an additional £7.5 billion increase (in 2010-11 prices) relative to CPI inflation, but it would reduce spending by 0.9 per cent of GDP relative to 2010-11 due to stronger earnings growth pushing GDP up faster than uprating would have lifted benefit awards. The change expected in this Parliament would be smaller than that estimated for the last, as our March forecast did not assume a repeat of the higher rates of inflation seen early in the last Parliament.

The effects of demographic changes

4.6 The population is projected to grow by 3.5 per cent between mid-2015 and mid-2020. If the rate of population growth was the same at all ages, and the age-specific likelihood of receiving one or more benefit remained constant, then population growth alone would add £7.9 billion to annual welfare spending by the end of this Parliament.

4.7 As Chart 3.2 showed, spending per person is higher at younger and (particularly) older ages, so ageing of the population is also an important driver of spending. Ageing is expected to continue in this Parliament – the proportion of the population aged 65 and over is expected to rise from 17.8 per cent in mid-2015 to 18.8 per cent in mid-2020. Holding age-specific caseload rates constant, that would add a further £11.2 billion to welfare spending. The ageing population was a factor in pushing up spending in the last Parliament too, but its effect is expected to be greater over the next five years.

Total changes in spending on the 2010-11 baseline

4.8 Taken together with their impact in the last Parliament, the uprating and demographic effects would see spending rise in our baseline by £97.6 billion in cash terms between 2010-11 and 2020-21. That would be £47.6 billion in real terms (relative to CPI inflation in 2010-11 prices) and an increase of 0.7 per cent of GDP. Over this Parliament alone, the rise would be £48.6 billion in cash terms and £22.2 billion in 2010-11 prices. It would imply a fall of 0.47 per cent of GDP (thanks to stronger earnings growth pushing up GDP faster than uprating would lift average awards).

What actually happened and why?

4.9 Table 4.1 sets out our adjusted March 2016 forecast for welfare spending over this Parliament and the 2010-11 baseline against which we will analyse the differences. In terms of the change over two Parliaments, we expect spending to have risen by £38.6 billion in a decade, £59.1 billion lower than the counterfactual. Of that difference, 42 per cent built up during the last Parliament, as described in Chapter 3, with the remaining 58 per cent expected by the end of this Parliament.

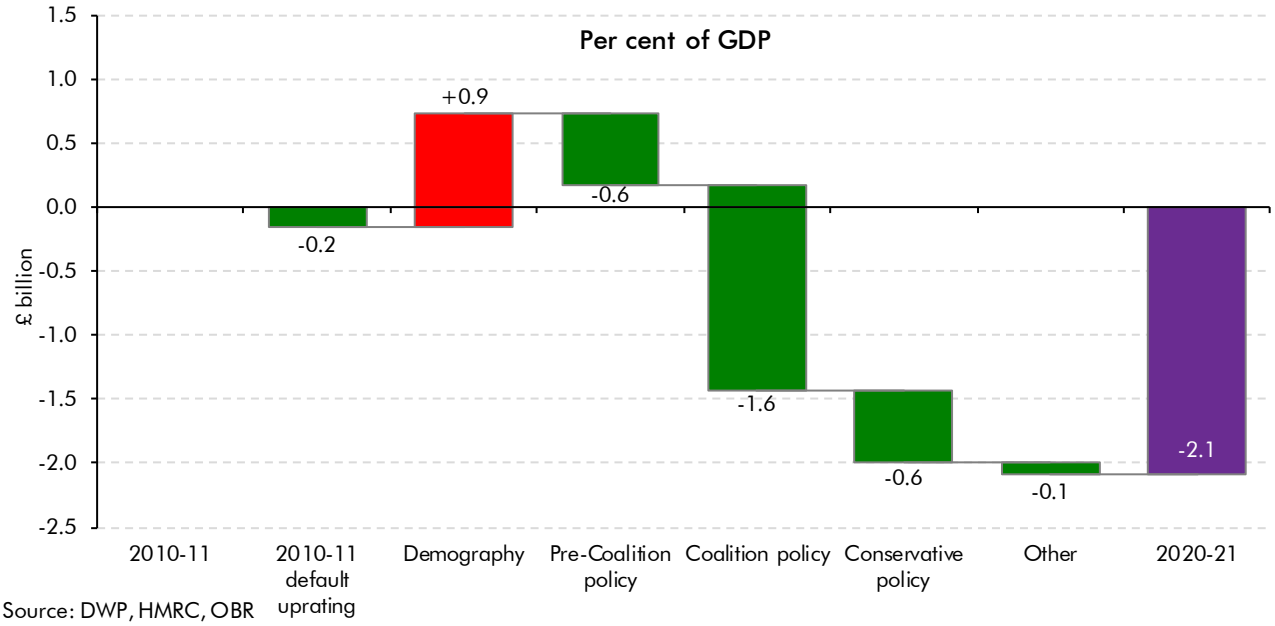
Table 4.1: Welfare spending – forecast vs 2010-11 baseline

	£ billion						
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	Incremental change since 2015-16
Forecast spending (adjusted)	216.6	218.3	219.8	222.4	225.5	230.8	
Change on 2010-11	24.4	26.0	27.6	30.2	33.3	38.6	14.2
2010-11 baseline spending	241.3	247.1	254.8	265.2	277.4	289.9	
Change on 2010-11	49.0	54.9	62.6	72.9	85.1	97.6	48.6
Difference	-24.7	-28.9	-35.0	-42.7	-51.8	-59.1	-34.4

4.10 In Chapter 2, we set out how the overall fall in welfare spending as a share of GDP can be split between changes in the proportion of the population claiming different benefits and tax credits and changes in average awards received relative to average earnings. Chart 2.1 showed that the majority of the fall was explained by lower spending on working-age benefits and tax credits, where average awards are set to rise much less than inflation or average earnings. A much smaller contribution comes from spending on pensioner benefits, where the caseload is expected to rise more slowly than the population due to further rises in the state pension age.

4.11 Chart 4.2 decomposes the change in spending that outturn data and our March forecast implied for this and the last Parliament together, following the approach set out in Chapter 3. It starts with the steps up that were used to calculate the 2010-11 baseline, then accounts for the ongoing effects of pre-Coalition policies implemented after 2010-11 and Coalition policies brought in during the last Parliament. It then adds the estimated effect of policies announced by this Government since it took office. Finally, the remaining change is assumed to be due to non-policy factors. As the final step is calculated by residual, it will also contain the effect of any errors in the preceding steps. The following sections look at these effects in more detail. We focus on the final two steps since Chapter 3 detailed the effects of earlier policy changes.

Chart 4.2: Changes to welfare spending between 2010-11 and 2020-21



Source: DWP, HMRC, OBR

Policy changes

4.12 This section estimates the effect of policy measures that lead to differences from the 2010-11 baseline. We start by summarising the effects of policies announced before 2010 but not implemented fully by then. Next we look at the bigger effects of the policies announced by the Coalition, some of which continue to build up over time. Finally, we look at the effects of the large cuts that have been announced by the new Government since it took office.

Pre-Coalition policy decisions

4.13 As described in Chapter 3, we have factored in the effects of three significant pre-Coalition policy decisions that affected the welfare system after 2010-11:

- the **equalisation of the female and male state pension age** (SPA) – legislated in 1995. The timetable set before the Coalition took office would have completed raising the female SPA to 65 by April 2020. By 2020-21, it would have reduced spending on pensioner benefits by £14.8 billion and raised it on those working-age benefits where eligibility is linked to the SPA by £2.6 billion;

- the **replacement of 'incapacity benefit' with 'employment and support allowance'** – originally announced in the 2008 Budget. There is considerable uncertainty around the true effect of this reform on the level of spending. Using a simple top-down approach, we have assumed that this change reduced spending by £0.4 billion by 2015-16, when the transition to ESA was almost complete. We have not assumed it will lead to any further reduction in spending in this Parliament, so the effect in 2020-21 is also £0.4 billion;

- the **expiry of temporary uplifts in the child element of child tax credits** from 2011-12. This increased spending relative to earnings uprating in the 2010-11 baseline by £2.5 billion in 2015-16. As earnings are forecast to rise faster than inflation in this Parliament, the addition to spending declines to £1.8 billion in 2020-21; and

- the **expiry of temporary uplifts in winter fuel payments** from 2011-12. This reduced spending by £0.6 billion in 2011-12. By 2020-21, that rises to £0.7 billion as the lower awards apply to a bigger pensioner population.

Coalition policy changes

4.14 In Chapter 3 we describe how policies announced by the Coalition in the last Parliament affected welfare spending by 2015-16. Based on updated estimates for the biggest of the measures and the original or latest published costing for the rest, we estimated that Coalition policies had reduced spending in 2015-16 by £19.6 billion. Rolling those estimates forward another five years to 2020-21 adds a further layer of uncertainty. Bearing that in mind, we estimate that Coalition policies will have cut annual welfare spending by the end of this Parliament by £33.6 billion.

4.15 The changes to uprating – including the switch to uprating by CPI inflation and the 1 per cent cap on most working-age benefits and tax credits for three years – have by far the largest effect of the Coalition policies. Based on our March 2016 inflation forecasts, we estimate that the total effect of all uprating policy changes would be to reduce spending by £21.8 billion lower in 2020-21, with £11.2 billion of that having built up during the current Parliament. Indeed, every year that CPI inflation is lower than RPI and Rossi inflation – as we

would expect it to be in most years due to the ways these measures are calculated[1] – this policy will cut average awards and spending further relative to the counterfactual.

4.16 Other significant effects include:

- the decision to **accelerate SPA equalisation and to raise the SPA for both men and women to 66** between 2018 and 2020. That is expected to reduce spending by £4.5 billion by 2020-21;

- **changes to tax credits on top of the changes to uprating**, announced in the June 2010 Budget and October 2010 Spending Review. These are estimated to reduce spending by £3.1 billion; and

- the introduction of the **high-income child benefit charge** (HICBC). With the £50,000 threshold fixed in cash terms, an increasing proportion of families will be affected as earnings rise. It is estimated to reduce spending by £2.1 billion in 2020-21.

4.17 We are only assuming small savings from the ongoing reforms to incapacity and disability benefits during this Parliament. For ESA, the changes made by the Coalition – particularly limiting contribution-based claims in the work-related activity group to one year – are expected to have a minimal effect on spending. That relates to changes in the composition of the caseload, as set out in Chapter 3. For the transition from DLA to PIP, savings are expected to rise from £0.1 billion in 2015-16 to £0.6 billion in 2020-21 as the majority of working-age DLA cases are reassessed as they migrate to PIP. That still represents a small fraction of the original goal of cutting spending by 20 per cent.

4.18 For universal credit we have used our March 2016 forecast for its marginal cost relative to the current tax credits and benefits systems that it will replace. For most other policies, we have generated an estimate of the effect on spending in 2020-21 by taking the final year of the latest costing and projecting it forwards in line with inflation and population growth. That approach is a simpler version of how the 2010-11 baseline has been generated for the rest of this analysis.

4.19 The Coalition also announced a major reform of the state pensions system. Under the Pensions Act 2014, the current two-tier system will be replaced by a single-tier pension. It has been open to newly-retired pensioners since April 2016. It combines the basic state pension and state second pensions into a flat-rate pension set above the basic level of means-tested support and is uprated in line with the triple lock. The number of qualifying years required to claim the full single-tier pension will rise to 35 years, with a minimum qualifying period of 10 years. While the effects of this policy change on spending in the current Parliament are likely to be small – we have not factored an estimate in to this analysis – the longer-term effects are more substantial. In our 2014 *Fiscal sustainability*

[1] Our most recent assumptions for the long-run wedge between RPI and CPI inflation – relating to the 'formula effect' that comes from using a different averaging approach plus differences in coverage and weights in each index – was set out in Box 3.3 of our March 2015 *Economic and fiscal outlook*. This is an assumption that we review periodically as more evidence becomes available on these effects.

report we estimated that while there would be little impact on spending until the 2040s, by 2063-64 it would deliver savings of 0.4 per cent of GDP by 2063-64.

Conservative Government policy changes

4.20 Since the new Government took office there have been two Budgets and a Spending Review, containing a number of announcements that affected welfare spending. These included two significant cuts to welfare spending where decisions were announced but then reversed before being implemented. Both had implications for spending in this Parliament beyond the direct effects of the reversal:

- **the July 2015 Budget contained a package of cuts to tax credits on top of the 4-year uprating freeze** that was partly reversed in the November Spending Review. Measures to increase the taper rate and reduce income thresholds that were estimated to reduce spending by £4.2 billion in 2016-17 were not implemented. But the measure to reduce work allowances in universal credit (equivalent to reducing tax credits income thresholds) was not reversed, meaning that as universal credit is rolled out savings will build up. By 2020-21, they will be broadly the same as the July Budget package. The result is that the transition to universal credit is now expected to reduce spending by £3.1 billion in 2020-21. Our forecasts will therefore now be more sensitive to any changes in the timetable and other assumptions about the rollout of universal credit. In July 2016, the Government announced yet another delay to the rollout that will push the associated savings back. And our March 2016 *EFO* described a number of other important uncertainties in the modelling of complex elements of the transition, including the transitional protection that will be paid to individuals that lose out when they are transferred to universal credit, but only until a change of circumstances warrants a change of award; and

- **the March 2016 Budget included a cut to disability benefits via a reduction in the entitlement points that would be awarded in PIP for cases involving the use of certain aids and appliances**. This would have cut spending by £1.3 billion in 2020-21, but shortly after the Budget the Government announced that it would not be implemented. The knock-on effect from this reversal appears to have been a reassessment of the extent to which further working-age welfare spending cuts will be considered in the rest of this Parliament. The last Secretary of State for Work and Pensions told Parliament that "*we have no further plans to make welfare savings beyond the very substantial savings legislated for by Parliament*".

4.21 Table 4.2 sets out the main policy effects that were factored into our March 2016 forecast in relation to those announced by this Government – adjusted for the PIP 'aids and appliances' measure having been dropped. Overall these policies are expected to reduce spending in 2020-21 by £11.8 billion, £1.5 billion less than the July 2015 Budget package of measures was expected to save. The biggest effects include:

- **cuts to universal credit in excess of those to tax credits**. When the Government reversed the July 2015 tax credits measures described above, it retained the cut to work

allowances in universal credit. That was by far the biggest factor explaining why our forecast for the impact of universal credit on welfare spending went from being a small marginal cost in March 2015 to showing a marginal saving of £3.1 billion by 2020-21 in our latest forecast. In July 2016, DWP announced yet another delay to the rollout of universal credit. The extent to which that reduces the marginal saving by the end of the Parliament will depend on the composition of the caseload that will migrated more slowly than assumed in March and the extent to which those cases would have been entitled to transitional protection. (The remaining costings reported below exclude any impact on universal credit captured here);

- cuts to average awards via the **4-year cash freeze on uprating of child benefit and most working-age benefits and tax credits** announced in July 2015. This is estimated to reduce spending by £3.4 billion in 2020-21, which is lower than the £3.8 billion estimated when the policy was announced. The difference reflects downward revisions to our CPI inflation forecast since then, which mean that the freeze is compared to a lower counterfactual;

- **cuts to housing benefit**. The biggest effects are related to policies that put a greater burden on social housing providers and their tenants – in particular, the July 2015 decision to force social landlords to cut rents by 1 per cent a year for four years and to charge higher rents to tenants that earn above a defined threshold. Together these reduce spending by £1.4 billion in 2020-21;

- **other changes to tax credits** announced in July 2015. The largest was the decision to limit child tax credit to the first two children for new births. Together with the removal of the family element and the cut in the income rise disregard , these changes cut tax credits spending by a further £1.7 billion in 2020-21; and

- **other policies** reduce spending by £2.3 billion. These include reducing awards in the ESA work-related activity group by around 28 per cent to align them with jobseeker's allowance and the effect of reducing the income threshold beyond which the household benefit cap applies.

Table 4.2: The effect of welfare spending policies announced in this Parliament

	£ billion					
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
4-year uprating freeze	0.0	0.0	-0.5	-1.6	-3.2	-3.4
Universal credit	0.0	0.0	-0.6	-1.7	-2.8	-3.1
HB rent cuts and pay-to-stay	0.0	-0.2	-0.4	-0.8	-1.3	-1.4
Other tax credits changes	0.0	-0.1	-0.5	-0.9	-1.3	-1.7
Other policies	-0.1	-0.3	-0.9	-1.6	-2.0	-2.3
Total	**-0.1**	**-0.7**	**-2.8**	**-6.7**	**-10.6**	**-11.8**

4.22 Another policy announced by this Government that will affect welfare spending over this Parliament is the 'National Living Wage', the objective of which is to raise the minimum wage for over-25s to 60 per cent of median hourly earnings in that age group. We expect

this to lead to a significant rise in hourly pay at this part of the earnings distribution between now and 2020 and to have a number of knock-on effects to the wider economy. Partial maintenance of pay differentials will lead to spillover effects further up the earnings distribution. The resulting increase in labour costs for firms will prompt them to respond in a variety of possible ways: raising prices if they can, reducing the hours worked by their staff (e.g. by reducing overtime or by hiring fewer staff than they otherwise would have) or by accepting lower profits. Altogether we expect it to reduce hours worked by 0.4 per cent (equivalent to around 4 million hours a week), split evenly between fewer hours for those in work and higher unemployment. The assumptions and judgements that underpin these estimates – and discussion of the uncertainties around them – were set out in detail in Annex B of our July 2015 *EFO*.

4.23 Table 4.3 sets out our July 2015 estimates of the effect of the NLW's introduction on welfare spending. They are relatively small due to a number of partly offsetting effects:

- **higher earnings** towards the bottom of the earnings distribution will reduce spending on tax credits and housing benefit, where awards are means-tested. But the effect on average earnings growth at the whole economy level will increase spending on state pensions via the triple lock on uprating;
- **higher unemployment** will increase spending on jobseeker's allowance and the associated housing benefit for those who are unemployment and living in rented accommodation; and
- **higher inflation** will increase the amount spent on the relatively small proportion of non-pensions welfare spending that is not affected by the uprating freeze.

Table 4.3: The effect of the National Living Wage on welfare spending

	£ billion				
	2016-17	2017-18	2018-19	2019-20	2020-21
Total indirect NLW effect	**-0.2**	**-0.2**	**-0.3**	**-0.4**	**-0.5**
Factors reducing spending	**-0.2**	**-0.3**	**-0.5**	**-0.7**	**-0.8**
of which:					
Earnings effect on tax credits	0.0	-0.2	-0.3	-0.4	-0.5
Earnings effect on housing benefit	-0.1	-0.2	-0.3	-0.3	-0.3
Factors increasing spending	**0.0**	**0.1**	**0.2**	**0.3**	**0.4**
of which:					
Earnings effect on triple lock uprating	0.0	0.1	0.1	0.2	0.3
Other uprating effects	0.0	0.0	0.1	0.1	0.1

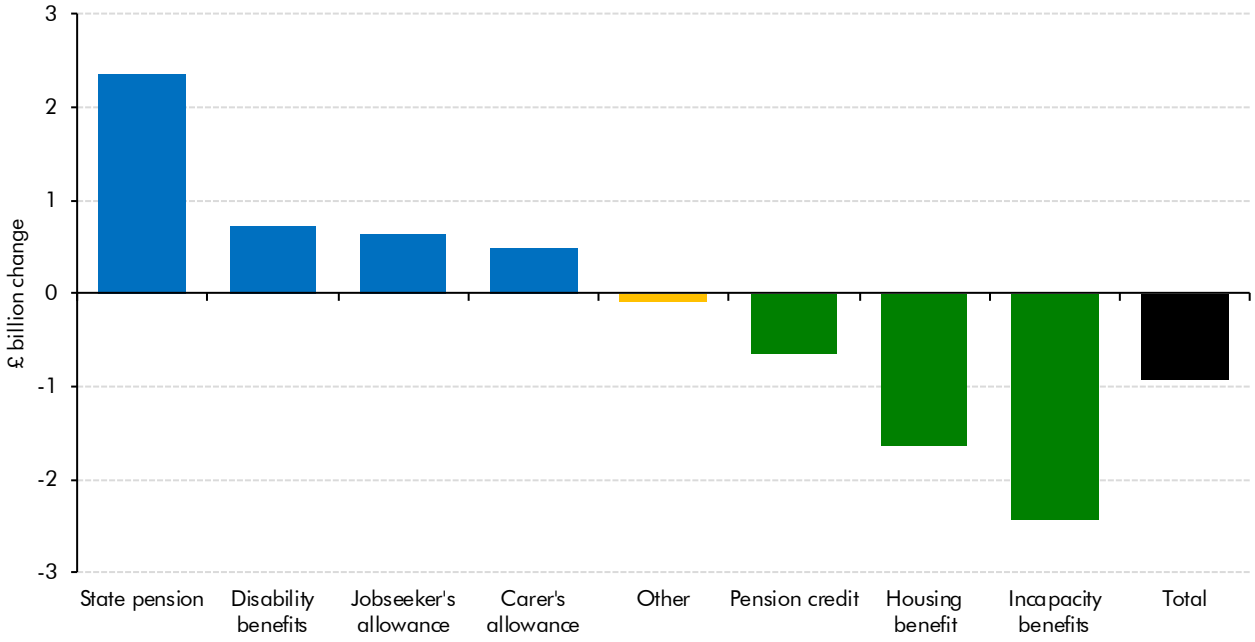
Other factors affecting welfare spending

4.24 As Table 4.1 reported, welfare spending in 2020-21 is forecast to be £38.6 billion higher than in 2010-11, with £14.2 billion of that rise coming in the current Parliament. With the 2010-11 baseline rising a further £48.6 billion between 2015-16 and 2020-21 and the total effect of policy changes expected to reduce spending by £33.6 billion, we are left with

very little (a £0.9 billion reduction) to be explained by other factors. That small figure represents largely offsetting positive and negative contributions from different factors.

4.25 Chart 4.3 shows the contributions of different lines of welfare spending to that remaining change, including those that help to explain the fall (e.g. housing benefit and incapacity benefits) and those where other factors push spending up (e.g. state pensions and disability benefits). The drivers of these changes – reflecting assumptions and judgements underpinning our March 2016 forecast – are described in the rest of this section.

Chart 4.3: Non-policy sources of growth in welfare spending



Source: OBR

The main positive contributions

State pensions – partly offset by pension credit

4.26 The biggest drivers of spending on pensioner benefits – an ageing population and policy decisions on the state pension age and uprating – have been described in the preceding sections. After accounting for these drivers, a £1.7 billion positive contribution to the change in spending over this Parliament remains to be explained. That is made up of £2.4 billion positive contribution from state pensions, partly offset by a related £0.6 billion negative contribution from pension credit.

4.27 The rise in state pensions spending continues a trend described in Chapter 3, whereby new retirees receive higher awards on average relative to existing pensioners. In the last Parliament that reflected generous additional state pension entitlements and growth in the number of women who will have accrued the minimum qualifying years for a full award. In this Parliament it reflects the fact that almost all new retirees will be receiving the new single-tier pension that replaces the old two tiers of basic state pension and additional pension. The partly offsetting effect relates to the impact of higher state pension payments on the

number of pensioners eligible for pension credit. This means that age-specific inflow rates – the proportion of people of a given age that start claiming pension credit in each year – have been on a declining trend. We assume that that trend will continue in the next five years, although at a slowing pace.

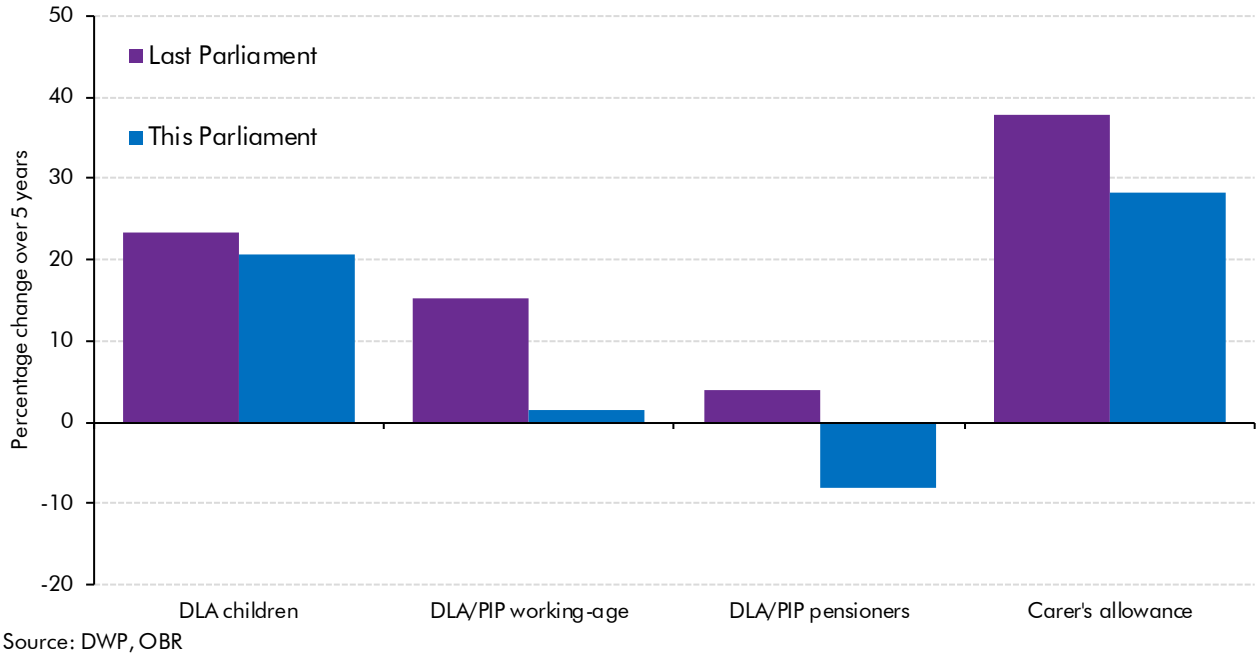
Disability benefits and carer's allowance

4.28 Two of the bigger positive contributions to explain relate to disability benefits and carer's allowance. While both relate to trends in eligibility for disability benefits, these positive contributions stem from different forecast judgements:

- for **disability benefits**, the £0.7 billion positive contribution that remains to be explained is much smaller than the equivalent contribution in the last Parliament. That reflects our assumption that the working-age caseload will not rise further relative to the population and that the composition of the caseload will remain relatively stable rather than continuing to shift towards those receiving higher awards. We continue to expect bigger increases in the number of children receiving DLA, consistent with the mental health-driven trend over the preceding five years (described in Chapter 5); and

- for **carer's allowance**, the £0.5 billion positive contribution that remains to be explained is similar to that in the last Parliament. The underlying driver of the caseload is the number of people receiving DLA, PIP or attendance allowance (AA) and the proportion of them being cared for by someone who claims carer's allowance. We expect the number of carer's allowance claims to continue rising faster than the combined growth in the DLA, PIP and AA caseloads.

Chart 4.4: Disability benefits and carer's allowance caseload growth



Source: DWP, OBR

Jobseeker's allowance

4.29 The smaller positive contribution from other factors to the change in jobseeker's allowance spending in the current Parliament is largely related to the shift of cases from income support due to the lone-parent obligation. The small rise in unemployment due to the labour cost pressures generated by the National Living Wage also raises spending.

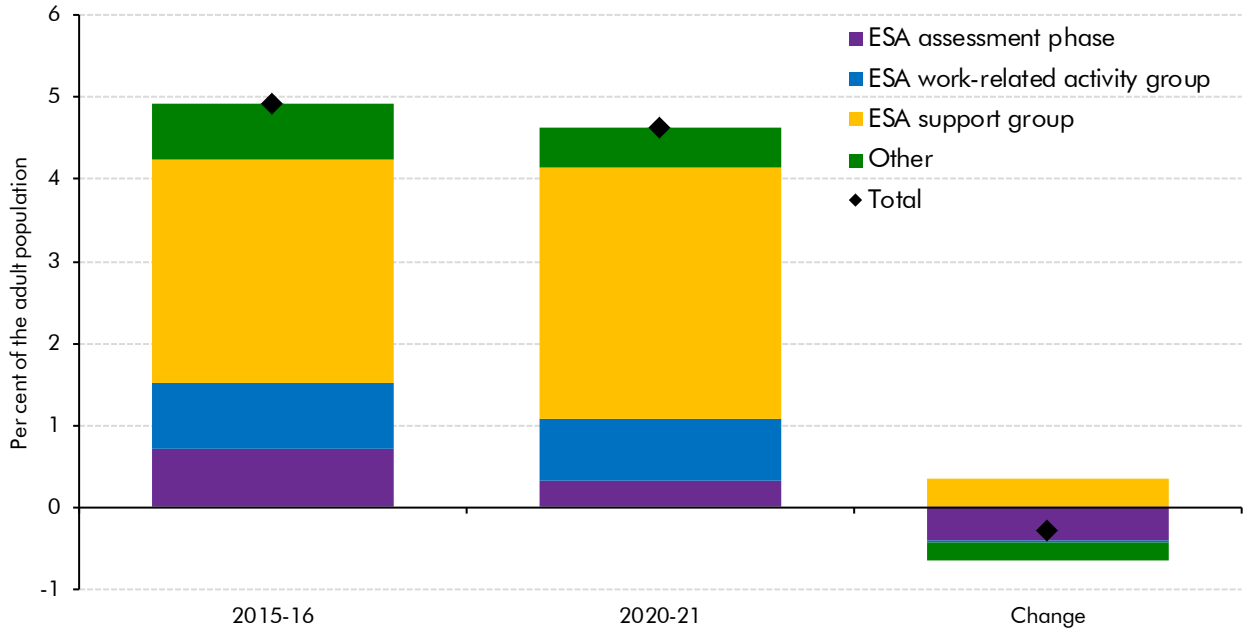
The main negative contributions

Incapacity benefits

4.30 Cash spending on incapacity benefits is forecast to be the same in 2020-21 as in 2015-16, with a small fall in the next few years followed by a small rise towards the end of the Parliament. While the policies announced by the Coalition and Conservative Governments have cut spending relative to our simple baseline, a reduction of £2.4 billon over this Parliament remains to be explained. This mainly reflects the assumptions we have made about how the different incapacity benefits caseloads will evolve relative to the demographic factors that are captured in the baseline.

4.31 As Chart 4.5 shows, in the five years to 2020-21 we expect the support group caseload in ESA to continue rising slightly faster than the adult population (up around 230,000 in absolute terms). But that is more than offset by the fall in non-ESA cases (down 100,000 as the final incapacity benefit and income support cases move to ESA or other benefits, or out of the welfare system altogether) and the fall in assessment phase cases (down 200,000 – almost entirely due to a 50 per cent fall expected in 2016-17 as the backlog of cases is cleared – an assumption that past experience suggests is subject to much uncertainty).

Chart 4.5: Incapacity benefits caseload



Source: DWP, OBR

Housing benefit

4.32 Spending on housing benefit is forecast to fall by £0.5 billion in the current Parliament rather than rising in the 2010-11 baseline. Policy measures that focus mainly on reducing average awards explain part of the difference, but £1.6 billion remains to be explained by the assumptions that underpin our forecast.

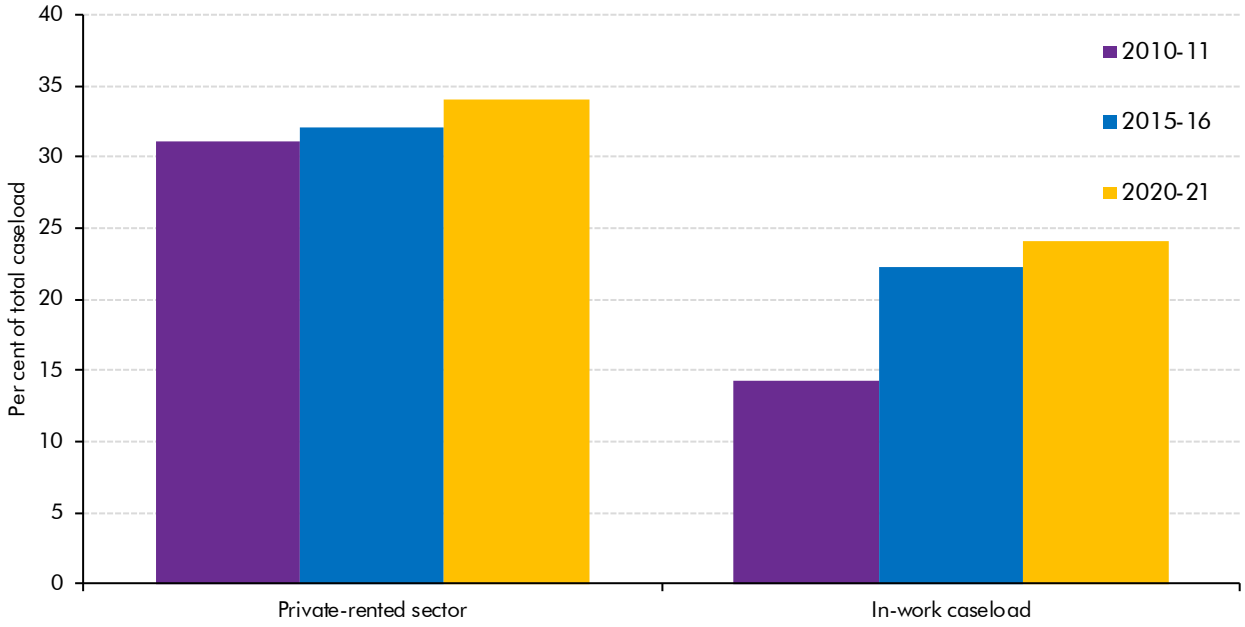
4.33 Eligibility for housing benefit is often associated with receipt of another benefit, since those living in rented accommodation whose income is derived from the welfare system are likely to meet the means-test criteria for housing benefit. Our forecast is built around this fact, with the caseload for other benefits acting as the main drivers of the housing benefit caseload. Our March forecast was for the housing benefit caseload to remain relatively flat at around 4.8 million during this Parliament. Given ongoing growth in the adult population allowed for in our simple baseline, that means the caseload as a proportion of all adults is forecast to fall by 0.3 percentage points. This relates in particular to our assumption that the lone-parents caseload will continue the downward trend seen in the last Parliament and the knock-on effect of the falling pension credit caseload described above. This would account for about half the difference to be explained. Since housing benefit awards reflect local factors, including rents that vary significantly across the country, the cumulative effect of many individually small forecast assumptions will explain the rest of the difference.

4.34 Chart 4.6 illustrates two trends that we expect to continue over the next five years:

- **the shift in the caseload from tenants in the social- to the private-rented sector**. As we set out in our 2014 *WTR*, this trend reflects both a rising share of all households living in private-rented accommodation and, since the late 2000s, a rising share of those renters that are in receipt of housing benefit. The slightly bigger rise in the private-rented share of the caseload expected this Parliament compared with the last partly reflects policies announced by the current Government that are expected to reduce the social-rented sector caseload. Average awards in the private-rented sector are typically higher than in the social-rented sector, so this trend would push up spending; and

- **the rising share of the total made up of individuals that are in work**. This is proxied via the caseload that do not receive another DWP-administered benefit. As this will mainly be renters in lower-paid employment, they will often be in receipt of HMRC-administered tax credits. After a sharp rise over the past five years reflecting the combination of strong employment growth but weak earnings growth, the small rise expected over the forecast period reflects our assumption that this caseload will grow broadly in line with employment, thereby remaining flat as a share of the population. Average awards among this group are typically lower than among those receiving other DWP-administered benefits alongside housing benefit, so this trend would tend to reduce spending on housing benefit.

Chart 4.6: Housing benefit caseload groups as a share of the total caseload



Source: DWP, OBR

Conclusion

4.35 There are a number of conclusions that can be drawn from this analysis:

- if **welfare spending as a share of GDP** continues falling in line with our March 2016 forecast, by 2020-21 it will have done so for an unprecedented eight consecutive years. The 2.1 per cent of GDP fall between the start of the last Parliament and the end of this Parliament would be the biggest on record across two consecutive Parliaments. The overall fall would be similar in size to that seen during the late-1980s economic boom. Welfare spending in support of children and working-age people would be at its lowest share of GDP since 1990-91 while spending in support of pensioners would have fallen much less significantly, returning close to the pre-crisis level recorded in 2007-08;

- as in the last Parliament, the outlook for welfare spending in the current Parliament will be sensitive to **the rollout of major reforms announced by the Coalition**. The transition to ESA is almost complete, but judgements about what it means for the size and composition of the caseload remain subject to significant uncertainty. The transition to PIP is still in progress, with reassessments for the stock of DLA claimants just getting underway. Changes to our assumptions about how that process – and the equivalent for new claims – will affect the caseload have already led to significant upward revisions to our forecasts. Those assumptions are liable to change again – in either direction – as the processes continue. The rollout of universal credit is at an earlier stage and is subject to even greater uncertainty. Finally, the transition to the single-tier pension will take decades to complete. We have not yet had reason to make

significant changes to our forecast of its effects, but that will remain a possibility as the caseload rises and more information becomes available on its effects; and

- the **new Government's welfare spending cuts are subject to a variety of risks and uncertainties**. They can largely be grouped into three types. First, cuts to average awards for child benefit and most working-age benefits and tax credits through an uprating freeze should have a relatively certain effect on cash spending, but the amount 'saved' depends on the actual path of CPI inflation that would have driven uprating in the counterfactual. Second, additional cuts to housing benefit through policies that put a greater burden on social housing providers and tenants are subject to greater uncertainty as they rely on estimates of how those affected will respond. Third, cuts to universal credit in excess of those to tax credits (which were announced but not implemented) will be sensitive to the pace at which universal credit is rolled out. This has already been pushed back again since our last forecast.

5 Welfare spending support for sick and disabled people

Introduction

5.1 Support for people who are sick and/or disabled has been a longstanding feature of the UK's welfare system. Benefits for those who suffer industrial accidents have one of the longest histories, with workmen's compensation schemes introduced in the nineteenth century. War disability pensions were introduced relatively soon after that, in the aftermath of the First World War. Welfare benefits were initially compensatory (recognising service and/or injury during employment), but then supplemented by earnings-replacement benefits (providing income for those unable to work due to sickness or disability) and extra-costs benefits (providing help towards additional costs incurred as a result of disability).[1]

5.2 Our medium-term forecasts contain a number of lines that are relatively directly linked to support for sick and disabled people:

- **incapacity benefits**, which cost £15.0 billion in 2015-16. These are income-replacement benefits available to people who are unable to work as a result of sickness or disability. They include employment and support allowance (ESA) – the replacement for incapacity benefit – and severe disablement allowance (SDA). Claimants may also have been eligible for the incapacity element of income support (IS). ESA was introduced in October 2008 for new claims, followed by a staged migration of existing claims from incapacity benefit, income support and severe disablement allowance. By 2015-16, 93 per cent of the incapacity benefits caseload[2] was made up of ESA claimants. Working-age claimants on SDA and IS (incapacity) are expected to fall to zero by 2017-18. By 2020-21 the majority of claimants are expected to be claiming universal credit (UC) instead;

- **disability benefits**,[3] which cost £16.2 billion in 2015-16. These provide help towards the additional costs incurred as a result of having a disability, payable irrespective of an individual's employment status or income. Support for children and working-age people currently consists of disability living allowance (DLA) and personal independence payment (PIP) – the replacement for DLA – which is being rolled out gradually over the next few years. By 2015-16, 16 per cent of people claiming disability benefits were receiving PIP. By 2020-21, we expect this to rise to just over 70 per cent. Pensioners are not able to make new claims for DLA, but approximately 1

[1] See Burchardt (1999) for a fuller explanation.
[2] Total incapacity caseload includes ESA, IB and SDA, but excludes IS (incapacity) since most claimants also receive one of ESA, IB and SDA. ESA, IB and SDA account for 95 per cent of spending.
[3] We define disability benefits as spending on disability living allowance and its replacement the personal independence payment.

million pensioners continue to claim DLA because it was awarded before they reached the age of 65;

- **attendance allowance** (AA), which cost £5.5 billion in 2015-16. This is designed to help pensioners pay the costs of personal care. It is payable at two rates, depending on the level of help required. Individuals in receipt of AA may also be eligible for additional pension credit, housing benefit or council tax support;

- **carers' allowance** (CA), which cost £2.6 billion in 2015-16. This provides support to those that provide at least 35 hours a week of unpaid care for disabled people. It is currently paid at a rate of £62.10 a week;

- **industrial injuries benefits**, which cost £0.9 billion in 2015-16. These benefits – the largest of which is the industrial injuries disablement benefit – are payable to individuals who are ill or disabled as a result of an accident or disease caused by work. The amount paid varies according to the condition suffered; and

- **spending on these benefits in Northern Ireland**, which cost around £2.3 billion in 2015-16. Our forecast splits spending between Great Britain and Northern Ireland to reflect the way in which it is administered (by DWP and the Northern Ireland by the Social Security Agency respectively), which in turn determines how the data on which we base our forecasts are collected.

5.3 Our forecasts for incapacity and disability benefits have been revised significantly in recent years as we have learnt more about the effect of ongoing reforms to both systems. Our forecasts for AA and CA have been much more stable, while spending on industrial injuries benefit is very small. Spending in Northern Ireland has been subject to some of the same trends, but also some specific to its population, timescales for reform and other factors.

5.4 Given these recent trends, in this chapter we focus on explaining recent developments and prospects for spending on incapacity and disability benefits. The chapter:

- describes the main components of **the incapacity and disability benefits systems**;

- sets the scene by rehearsing the **analysis of historical trends** that was presented in our first *Welfare trends report (WTR)*;

- uses the same approach as in Chapter 3 to analyse **trends in spending over the last Parliament**;

- uses the same approach as in Chapter 4 to **decompose the further changes expected over this Parliament**, as set out in our March forecast;

- highlights some **issues that we expect to factor in our next forecast**; and

- draws some **conclusions**.

How incapacity and disability benefits work

5.5 There are both similarities and differences in the processes by which individuals claim incapacity and disability benefits. Both systems are being reformed, with new benefits being rolled out to replace their predecessors. The descriptions that follow refer mainly to the new benefits in each area.

Incapacity benefits: employment and support allowance

5.6 ESA is available in two forms: contributory and income-related. Contribution-based ESA is paid to those with sufficient national insurance contributions and income-based ESA is paid to those on low incomes.

5.7 On making an application for ESA, claimants are initially placed into an 'assessment group'. During that time they receive a basic rate of ESA (£73.10 a week in 2016-17)[4] and must attend a work capability assessment (WCA). At the WCA, the assessor awards the claimant points against a set of criteria (known as 'descriptors') that are intended to reflect factors that determine the claimant's ability to work. DWP decides between three possible outcomes from this assessment:

- the claimant is deemed **fit for work**, in which case the claim is rejected and the claimant will cease to be eligible for ESA;

- the claimant is deemed to have "*a limited capability for work*", in which case the claimant will be placed in the **work-related activity group**. Claimants in this group receive £102.15 a week in 2016-17. It is paid for up to one year in the case of contributory ESA, while there is no time limit for those on income-based ESA. Those moving off contributory ESA after a year may be eligible to move onto income-based ESA at that point. The Government has announced that from 2017-18 the work-related activity group award for new claims will be cut by around 28 per cent to align it with the jobseeker's allowance rate. Claimants in the work-related activity group are expected to attend regular meetings with advisors to prepare them for entering work; or

- the claimant is deemed to have "*a limited capability for work-related activity*" and is placed in the **support group**. Claimants in this group currently receive £109.30 a week. If the claimant is placed in the support group and is on income-related ESA, they will also be entitled to the enhanced disability premium at £15.75 a week and may also qualify for the severe disability premium at £61.85 per week. Individuals in the support group are not required to attend meetings with advisors.

5.8 Some claimants may be eligible for ESA without attending a face-to-face WCA, for example if they are terminally ill or if a support group recommendation can be justified on the basis of the paperwork provided by new claimants. This can include a risk to physical or mental

[4] £73.10 per week for those aged 25 and over. For those aged under 25, the rate is £57.90.

health that justifies the claimant being placed in the support group. The latter is covered by 'Regulation 35', unexpectedly frequent use of which helps to explain upward revisions to our recent forecasts.

5.9 These processes are subject to a number of reviews, appeals and reassessments at various stages, each potentially resulting in decisions being overturned.

Disability benefits: personal independence payment

5.10 As with ESA, individuals wishing to claim disability benefits are initially assessed against a number of criteria before an award is made. This is designed to test an individual's ability to 'participate fully in society' and the extent to which individuals have difficulties with 'daily living' and 'mobility'. This is common to both PIP and its predecessor DLA.

5.11 Reflecting these two elements of the assessment, disability benefits are made up of two components: the care/daily living component and the mobility component. Both have standard rates for claimants assessed to have lower needs (£55.10 a week for daily living and £21.80 for mobility) or enhanced rates for those assessed to have greater needs (£82.30 and £57.45 a week respectively).[5] At the PIP assessment, successful claimants are awarded a fixed term payment for between one and ten years. Claimants will be assessed automatically at the end of that term. They will also be assessed during that term if their circumstances change.

5.12 A small proportion of claimants are able to receive disability benefits without attending an assessment if they are terminally ill. This is known as the 'special rules' process.

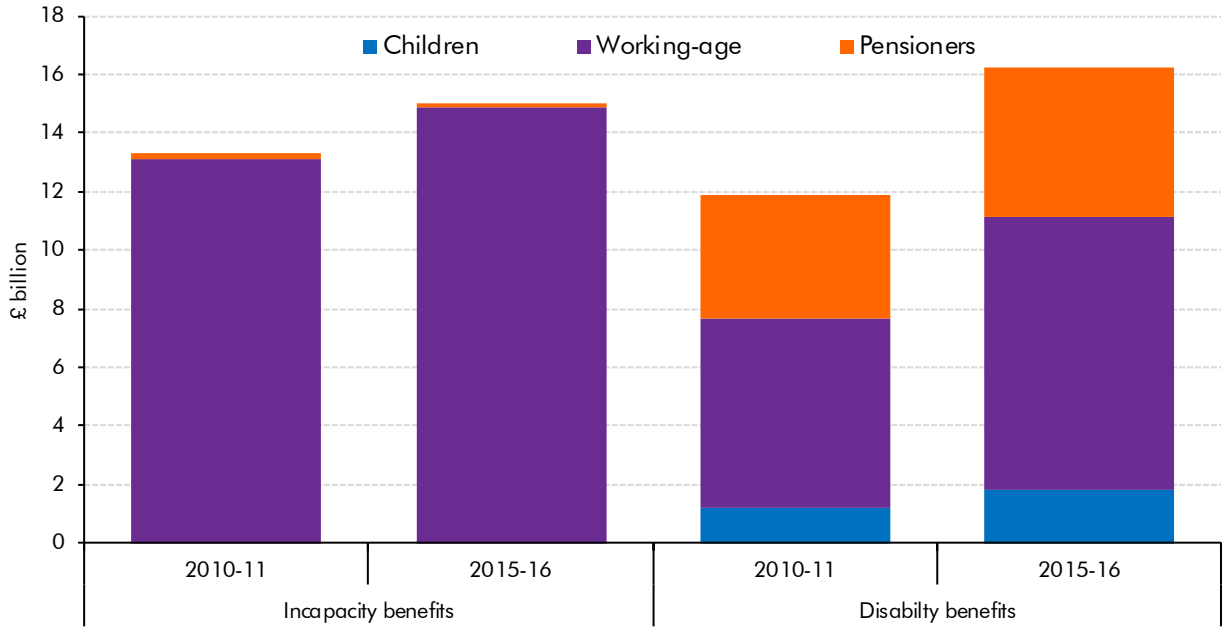
5.13 As with incapacity benefits, these processes are subject to a number of reviews, appeals and reassessments at various stages, each potentially resulting in decisions being overturned.

Spending in 2015-16

5.14 Spending on incapacity and disability benefits together totalled £31.3 billion in 2015-16. As Chart 5.1 shows, most – around 79 per cent – went to working-age adults. They receive virtually all the spending on incapacity benefits.[6] Working-age recipients also receive the majority of spending on disability benefits, but significant amounts are also paid to pensioners (31 per cent) and in relation to children (11 per cent). Of those benefits that we are not covering in detail in this chapter, all spending on attendance allowance goes to pensioners, virtually all spending on carer's allowance goes to working-age individuals and just over half the amount spent on industrial injuries benefits goes to pensioners.

[5] There is also a 'lowest' rate for claimants on DLA receiving the care component (£21.80 per week in 2016-17).
[6] Some pensioners receive the severe disablement allowance (around 28,000 in 2015-16).

Chart 5.1: Spending on incapacity and disability benefits in 2015-16



Source: DWP, OBR

5.15 Chart 5.1 is based on the amount spent on each benefit. The caseloads underpinning these figures will be higher than the number of individuals in receipt of these benefits because some people will be eligible for more than one. Table 5.1 presents an April 2016 snapshot of these overlaps for incapacity and disability benefits. It shows that around 3.5 million individuals were in receipt of one or both benefits, with similar numbers receiving incapacity benefits only, disability benefits only and both. As such, just over half of each benefit's caseload overlaps with the other.

Table 5.1: Claimants of incapacity and disability benefits (April 2016)

	Incapacity benefits		Disability benefits	
	Caseload (millions)	Per cent	Caseload (millions)	Per cent
Total	**2.5**		**2.3**	
of which:				
Incapacity benefits only	1.2	48	-	-
Disability benefits only	-	-	1.0	43
Both incapacity and disability benefits	1.3	52	1.3	57

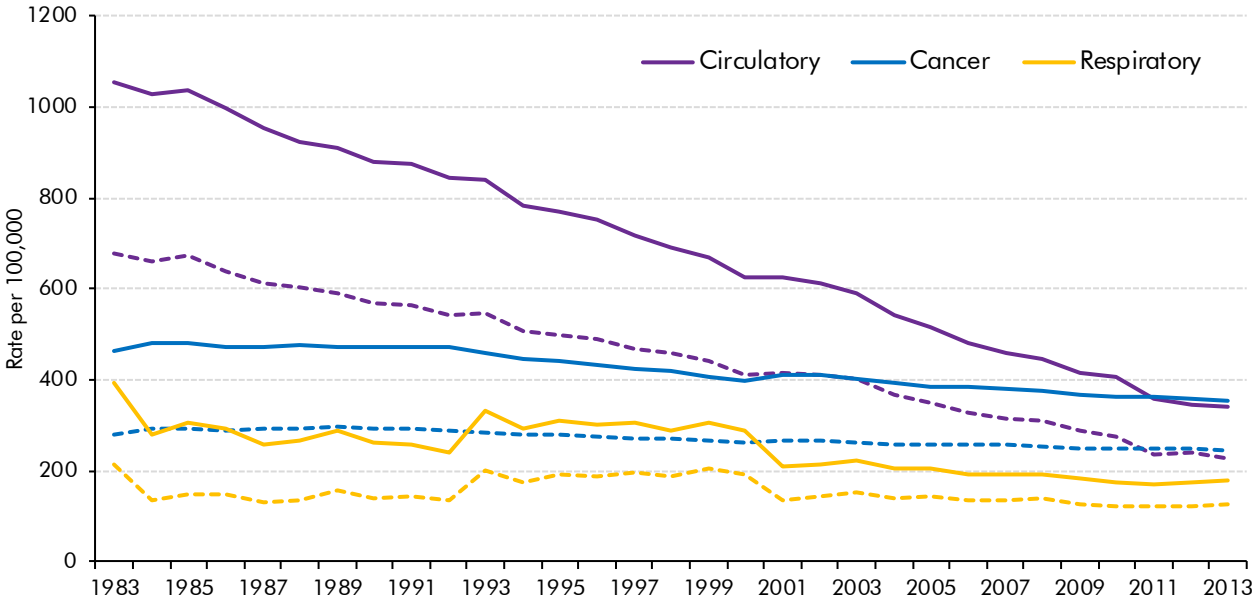
Historical drivers of and trends in spending

5.16 The elements of welfare spending covered in this chapter are ultimately related to the health status of the population and the extent to which governments choose to provide support for those that have a health condition of one sort or another. Before looking at trends in spending, it is therefore useful to view this in the context of trends in health over time.

5.17 Chart 5.2 shows that over the past 30 years there have been steady declines in mortality rates for three significant causes of death in the UK. The reasons for this include

improvements in the treatment and diagnosis of these diseases, and the introduction of preventative programmes, such as NHS breast screening which was introduced in 1988.[7]

Chart 5.2: Historical trends in mortality rates

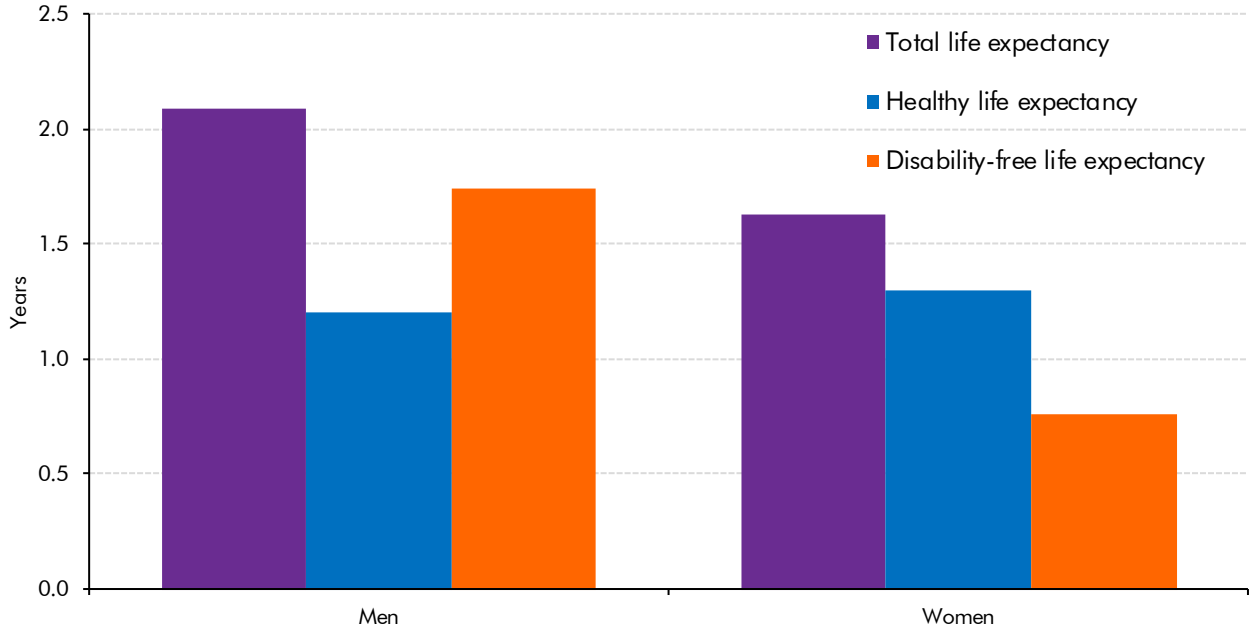


Note: solid lines denote men, dashed lines denote women.
Source: ONS

5.18 The implications of these mortality rates for spending on incapacity and disability benefits depend on whether increased years of life are more likely to be spent in good- or ill-health. Chart 5.3 shows that both healthy life expectancy and disability-free life expectancy improved in the 2000s, but that neither did so by as much as overall life expectancy, indicating some increase in the amount of time spent in ill-health too.

[7] ONS, *Mortality in the United Kingdom: 1983-2013*, December 2014.

Chart 5.3: Change in total, healthy and disability-free life expectancy at 65 between 2000-2002 and 2009-2011



Source: ONS

5.19 In our 2014 *WTR* we looked at historical trends in welfare spending over the past 30 years and at the prospects set out in our latest forecast and long-term projections. To set the scene for the analysis that follows, in this section we update that analysis with the latest data and our March 2016 forecasts. (We have made one adjustment to our March forecast to reflect a cut to disability benefits that was announced in Budget 2016, but subsequently dropped.)

Incapacity benefits

5.20 Chart 5.4 shows trends in spending on incapacity benefits between 1985-86 and the end of our March 2016 forecast period in 2020-21. It shows that spending increased significantly in the decade to 1995-96, since when the rate of increase has slowed substantially while spending has fallen in real terms and as a share of GDP. By 2010-11, the share of GDP spent on incapacity benefits had returned close to its level of 25 years before. It has fallen slightly further in recent years and is expected to continue falling – at a somewhat faster pace – over the forecast period.

5.21 In considering the drivers of these trends, we can split the full period into four sub-periods:

- **the sharp rise in spending from the mid-1980s to the mid-1990s**. This was largely the legacy of high unemployment and the effects of industrial restructuring through the 1980s and early 1990s. Higher spending on unemployment benefits prompted the Government to tighten conditionality and make them less generous relative to incapacity benefits, although there were no significant reforms to the system itself during this period. Making the unemployment benefit system relatively less attractive duly encouraged out-of-work people to move to incapacity benefits;

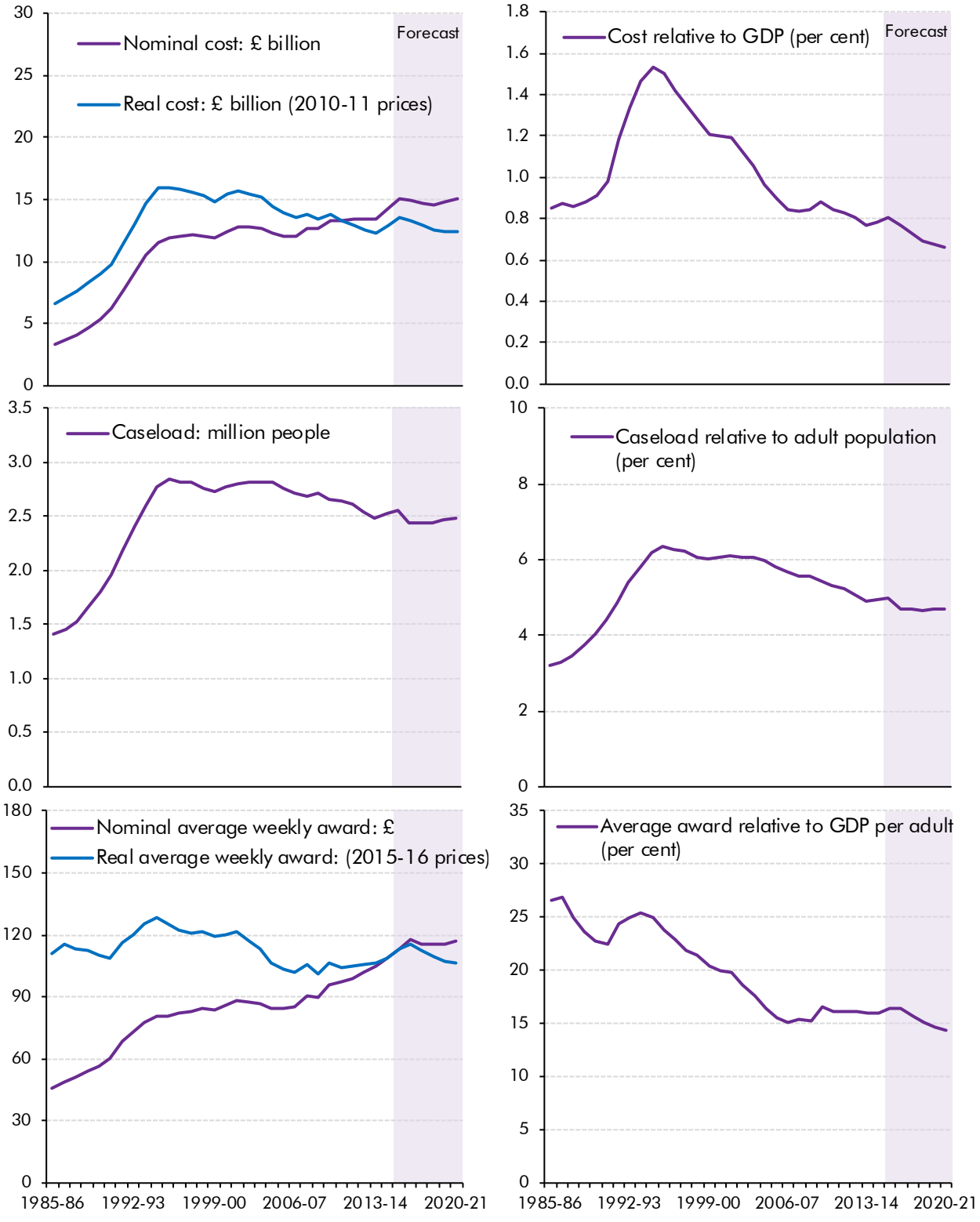
- **the fall in spending between 1995-96 and 2007-08**. This followed wide-ranging incapacity benefit reforms in 1995 in response to the preceding large rise in spending. These included cutting their generosity, with the introduction of three different rates[8] and the abolition of the additional pension for new claimants. The fall in spending as a share of GDP also reflected the strength of GDP growth;

- **a period of relative stability in spending from 2007-08 to 2015-16**, which includes the introduction of ESA. The caseload fell slightly during this period, but average awards continued to rise. More importantly, due to the sustained weakness in real earnings growth, the inflation-linked uprating of awards pushed spending up as a share of GDP; and

- **a steady decline in spending between 2015-16 and the end of our latest forecast period in 2020-21**. The majority of this fall takes place during the current Parliament and reflects assumptions about the effect of work capability assessments, the abolition of the work-related activity component and the effect of the 4-year freeze from 2016-17. All are expected to contribute to the fall in spending as a share of GDP. It is worth noting that our forecasts are constructed on the basis of the legacy benefits system continuing, with the transition to universal credit factored in as an overall adjustment at the end of the process. In reality, ESA cases will transfer to universal credit progressively over the forecast period (and beyond). So actual spending on the incapacity benefits discussed in this chapter will fall considerably further, with a broadly offsetting rise in spending on universal credit in their place.

[8] The rates were (i) a short-term lower rate for incapacity benefit replacing sickness benefit for people not eligible for statutory sick pay; (ii) a short-term higher rate payable from week 29 to week 52, which was less generous than the invalidity benefit rate; and (iii) a long-term incapacity benefit rate that was as generous as invalidity benefit and only payable from 52 weeks onwards.

Chart 5.4: Incapacity benefits spending since 1985-86



Source: DWP, ONS, OBR

Disability benefits

5.22 Chart 5.5 shows trends in spending on disability benefits between 1985-86 and the end of our March 2016 forecast period in 2020-21. (We have adjusted our March forecast to remove the effect of the Budget 2016 cut in PIP that was subsequently dropped.) In contrast to the rise and fall of spending on incapacity benefits, the chart shows that spending on disability benefits has been on an upward trend since the early 1990s when DLA was introduced. That is true whether spending is measured in cash or real terms or as a share of GDP. Spending has continued to rise in recent years, but the rate of increase is expected to slow sufficiently in cash and real terms for it to fall slightly as a share of GDP over the forecast period.

Historical context

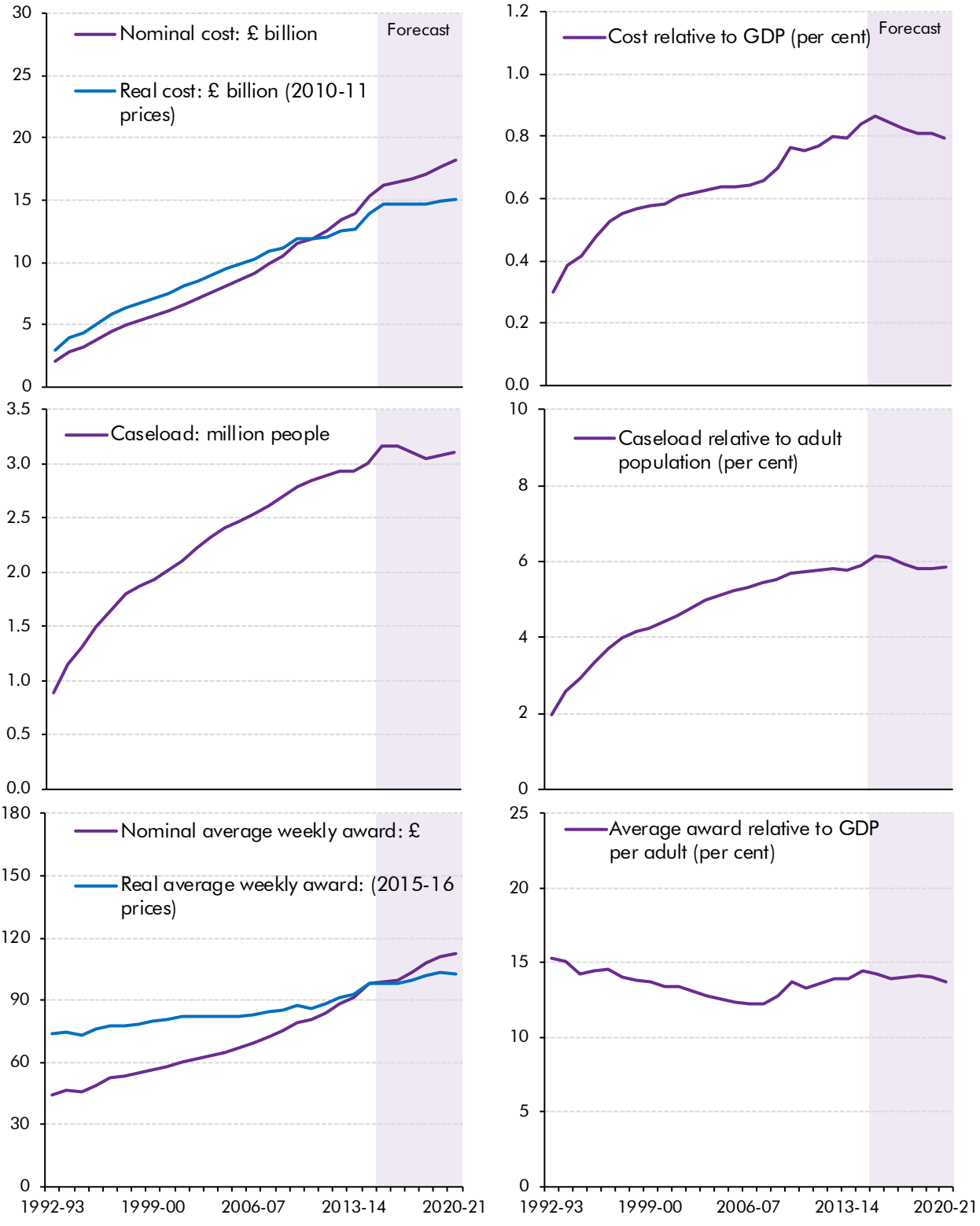
5.23 These historical trends provide context for what happened to spending over the last Parliament and how it is expected to evolve of this Parliament. They shows that:

- spending on **incapacity benefits** has been on a relatively steady downward path relative to GDP since its peak in the mid-1990s. That decline stalled during the last Parliament, but is expected to resume in the current Parliament. This would take spending on incapacity benefits to the lowest share of GDP since the late 1960s;[9] and

- spending on **disability benefits,** by contrast, has been on a steady upward path since DLA was introduced in 1992. That upward path continued through the last Parliament, but is expected to peak and reverse during the current Parliament.

[9] Banks, James, Richard Blundell and Carl Emmerson. 2015. *Disability Benefit Receipt and Reform: Reconciling Trends in the United Kingdom*, Journal of Economic Perspectives, 29(2): 173-90.

Chart 5.5: Disability benefits spending since 1985-86



Source: DWP, ONS, OBR

How spending evolved over the last Parliament

5.24 There are many ways to explain the change in spending over a chosen time period. Following the approach set out in Chapter 3, this section tells the story for the last Parliament – from 2010-11 to 2015-16 – in three steps:

- a **simple 2010-11 baseline** reflecting incapacity and disability benefits systems as they stood at the time and the default uprating assumptions in place before the Coalition Government took office. For the purposes of this baseline, we assume that the age-specific likelihoods of claiming each type of benefit remains at their 2010-11 levels, but that the number of claimants rises to reflect changes in the size and age-structure of the population. Average awards are assumed to rise with outturns for the relevant metric that applied in 2010-11;

- the effects on spending of **policy decisions that altered the systems relative to the 2010-11 baseline**. We distinguish between the policies announced before the Coalition took office and those announced by the Coalition; and

- the impact of **other non-policy-related factors**.

The 2010-11 baseline

The effect of pre-Coalition default uprating assumptions

5.25 Statutory rates for most elements of the social security system are uprated annually, with the most common default being to uprate by a measure of inflation to maintain the purchasing power of the award. In the 2010-11 system, disability benefits were uprated by RPI inflation and incapacity benefits by Rossi inflation (i.e. RPI minus housing costs and local taxes). Uprating would take place in April based on inflation in the previous September.

5.26 If we assume that the caseload for each of the benefits was unchanged from its 2010-11 level, but increase the average awards in line with the default uprating measure, spending by 2015-16 would have been:

- £2.8 billion higher for **incapacity benefits**, reflecting the 22.4 per cent rise in the Rossi index over that period. That would have been a £1.2 billion real terms increase relative to CPI inflation and would have pushed spending up by 0.04 per cent of GDP because Rossi inflation was higher than growth in GDP-per-head; and

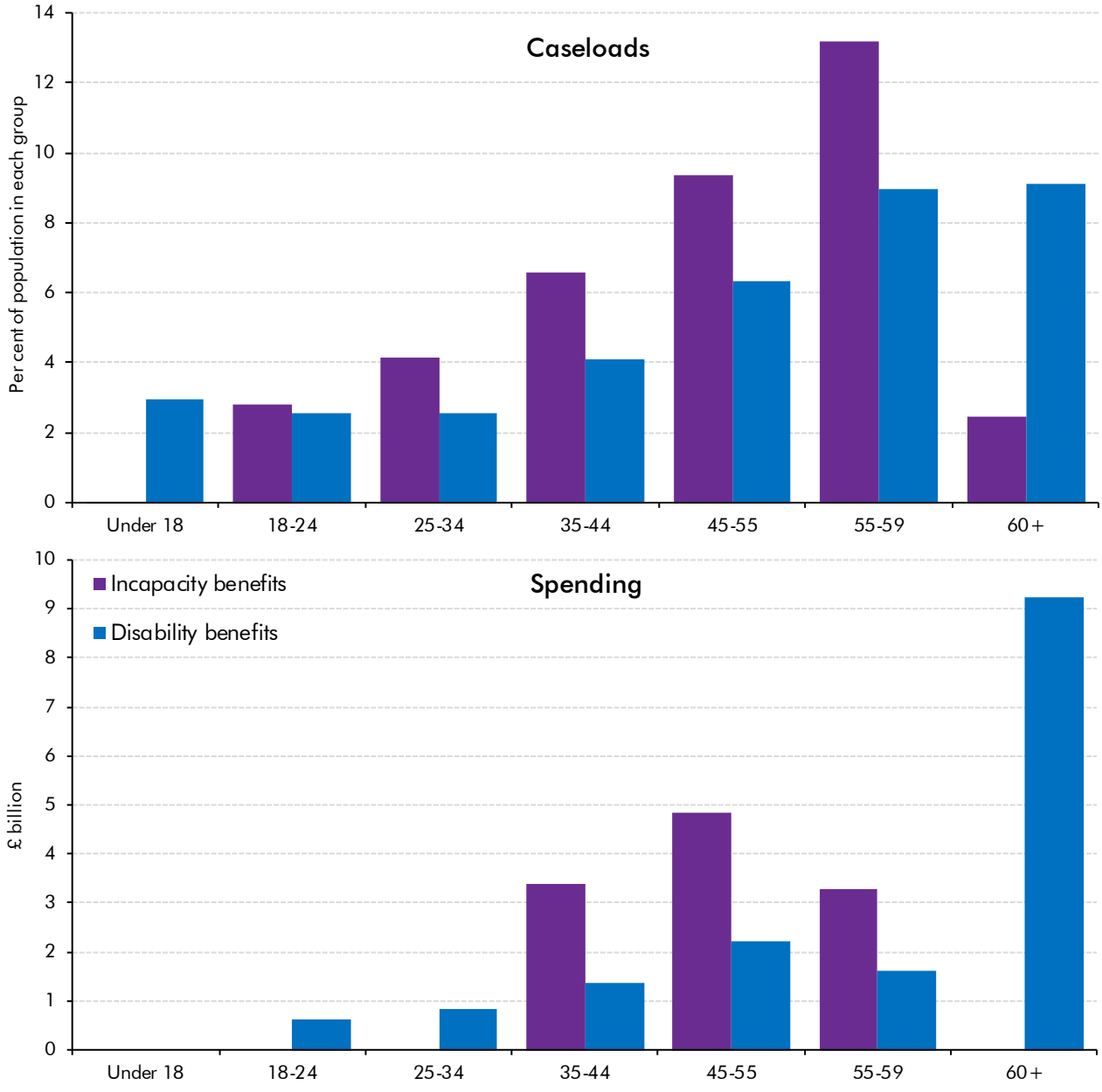
- £2.3 billion higher for **disability benefits**, reflecting the 19.6 per cent rise in the RPI over that period. This is equivalent to a £0.9 billion real terms increase relative to CPI inflation. It would have pushed spending up by 0.03 per cent of GDP because RPI inflation was also higher than growth in GDP-per-head.

The effects of demographic changes

5.27 As well as uprating policy, spending will also tend to rise in cash and real terms because of population growth. In 2010-11, 4.3 per cent of the population were in receipt of incapacity benefits and 5.2 per cent in receipt of disability benefits (with some overlap where people receive both). With the population increasing by 3.7 per cent between mid-2010 and mid-2015, holding those proportions constant but applying them to the bigger population would have meant £0.5 billion higher spending on incapacity benefits and £0.8 billion on disability benefits.

5.28 Population growth is not the only demographic factor that affects spending – the age-structure of the population is important too. Chart 5.6 shows the proportion of different age groups in receipt of incapacity or disability benefits in 2010-11. It shows that a higher share of the population at older ages are in receipt of both benefits. The population continued to age over the last Parliament, with the proportion of the population aged 65 and over – an important driver of disability benefits spending – increasing from 16.4 per cent in mid-2010 to 17.8 per cent in mid-2015. By contrast, the population aged 55 to 64 – more important for incapacity benefits spending – fell from 11.8 to 11.5 per cent as the large post-war baby boom cohort shifted into the 65+ age bracket. That means that holding the age-specific caseload rates shown in Chart 5.6 constant, changes in the age-structure of the population would have pushed disability benefits spending up a further £0.2 billion, but reduced spending on incapacity benefits by £0.1 billion.

Chart 5.6: Spending and caseloads in different age groups in 2010-11



Source: DWP, OBR

What actually happened and how can we explain the differences?

5.29 Table 5.2 sets out the actual path of spending on incapacity and disability benefits over the last Parliament. Relative to the baseline counterfactual described in the previous section, it shows that incapacity benefits spending increased by less (£1.7 versus £3.3 billion), while disability benefits spending increased by more (£4.3 versus £3.1 billion).

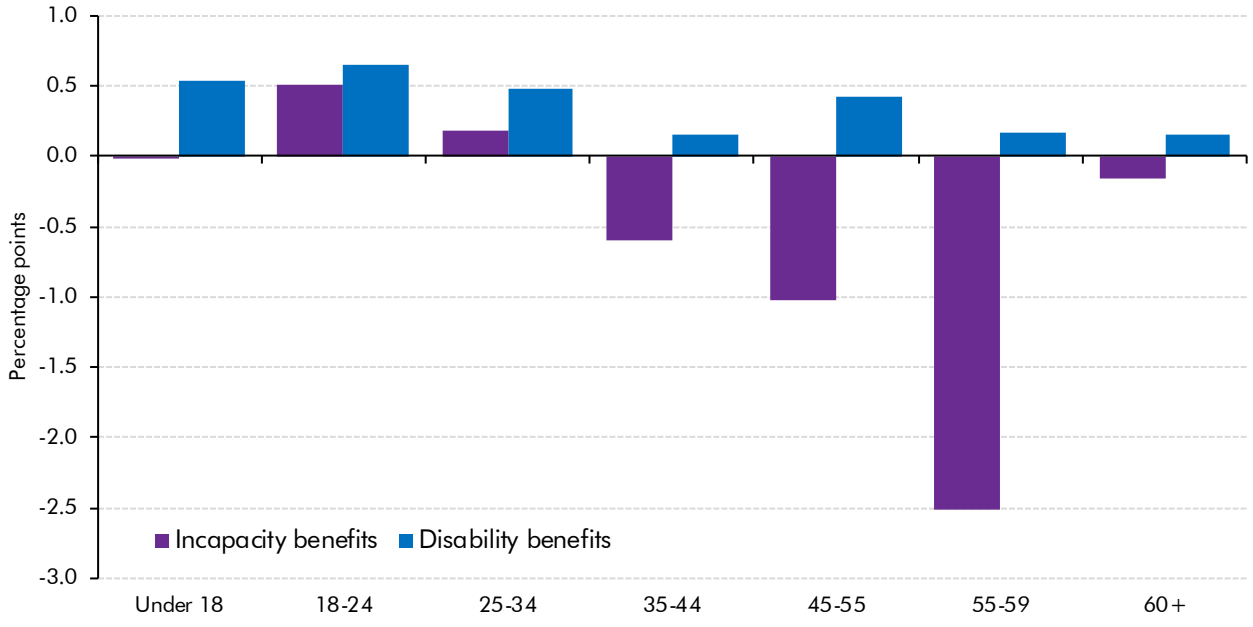
Table 5.2: Incapacity and disability benefits spending – actual versus baseline

	£ billion					
	2010-11	2011-12	2011-13	2013-14	2014-15	2015-16
Incapacity benefits						
Actual spending	13.3	13.5	13.5	13.5	14.3	15.0
Change on 2010-11	0.0	0.1	0.1	0.2	1.0	1.7
2010-11 baseline spending	13.3	14.1	15.1	15.6	16.2	16.6
Change on 2010-11	0.0	0.8	1.8	2.3	2.9	3.3
Difference	0.0	-0.6	-1.6	-2.1	-1.9	-1.6
Disability benefits						
Actual spending	11.9	12.6	13.4	13.9	15.4	16.2
Change on 2010-11	0.0	0.7	1.6	2.0	3.5	4.3
2010-11 baseline spending	11.9	12.6	13.4	13.9	14.5	15.0
Change on 2010-11	0.0	0.7	1.5	2.0	2.6	3.1
Difference	0.0	0.0	0.0	0.0	0.9	1.2

5.30 In accounting terms, the difference between actual spending and the counterfactual can be split into two parts: the caseload part – age-specific claim rates changed between 2010-11 and 2015-16 – and the average award part – actual awards increased at a different rate than would be the case if all had moved in line with the default uprating index.

5.31 Chart 5.7 shows how age-specific claim rates in 2015-16 differed from the 2010-11 rates that were used to generate the spending counterfactual (shown in Chart 5.6 above). It shows that lower spending on incapacity benefits is related to lower claim rates among older working-age people in particular, while higher claim rates for disability benefits was more evenly spread across the age distribution.

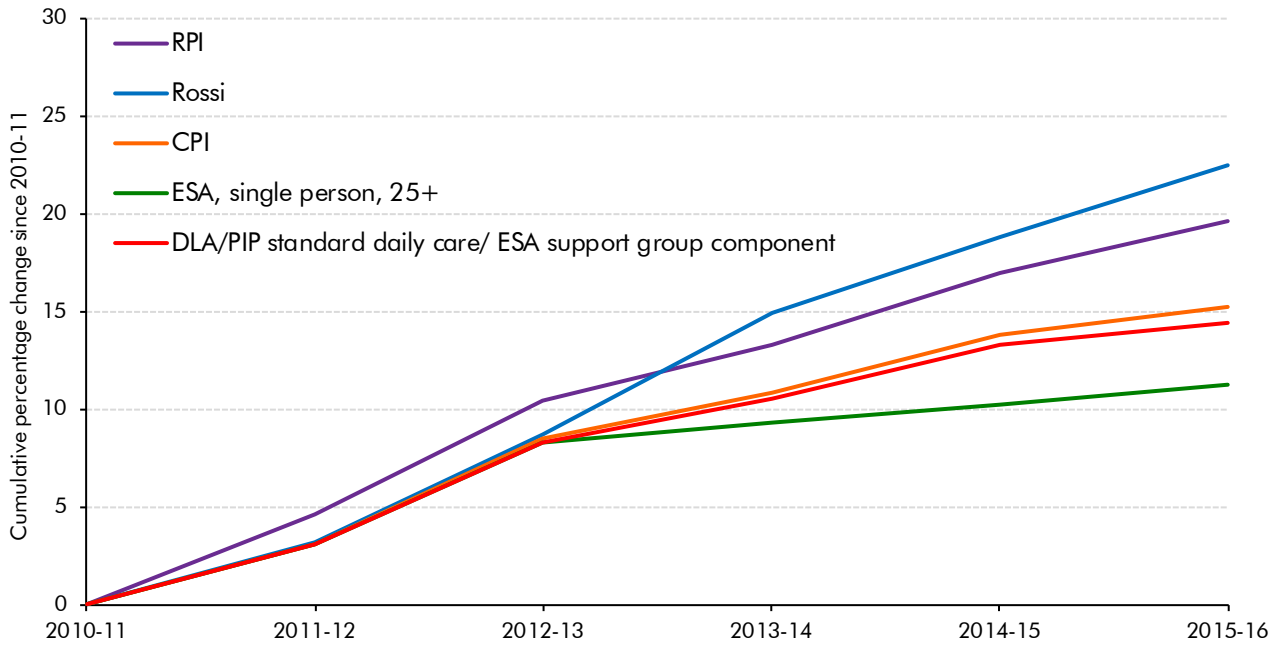
Chart 5.7: Changes in age-specific claim rates between 2010-11 and 2015-16



Source: DWP, ONS, OBR

5.32 Chart 5.8 plots the actual path of selected statutory rates for each benefit relative to the counterfactual path for Rossi and RPI inflation uprating (reflecting the monthly rate in the preceding September). It shows that the award rate received by those on incapacity benefits has increased by less than both RPI and ROSSI due to the decisions to uprate it by CPI inflation and then to impose a 1 per cent limit on top of that for three years (see paragraph 5.44). Disability benefit rates, including the support group component in incapacity benefits, were not subject to the 1 per cent cap, so have risen in line with CPI since 2012-13.

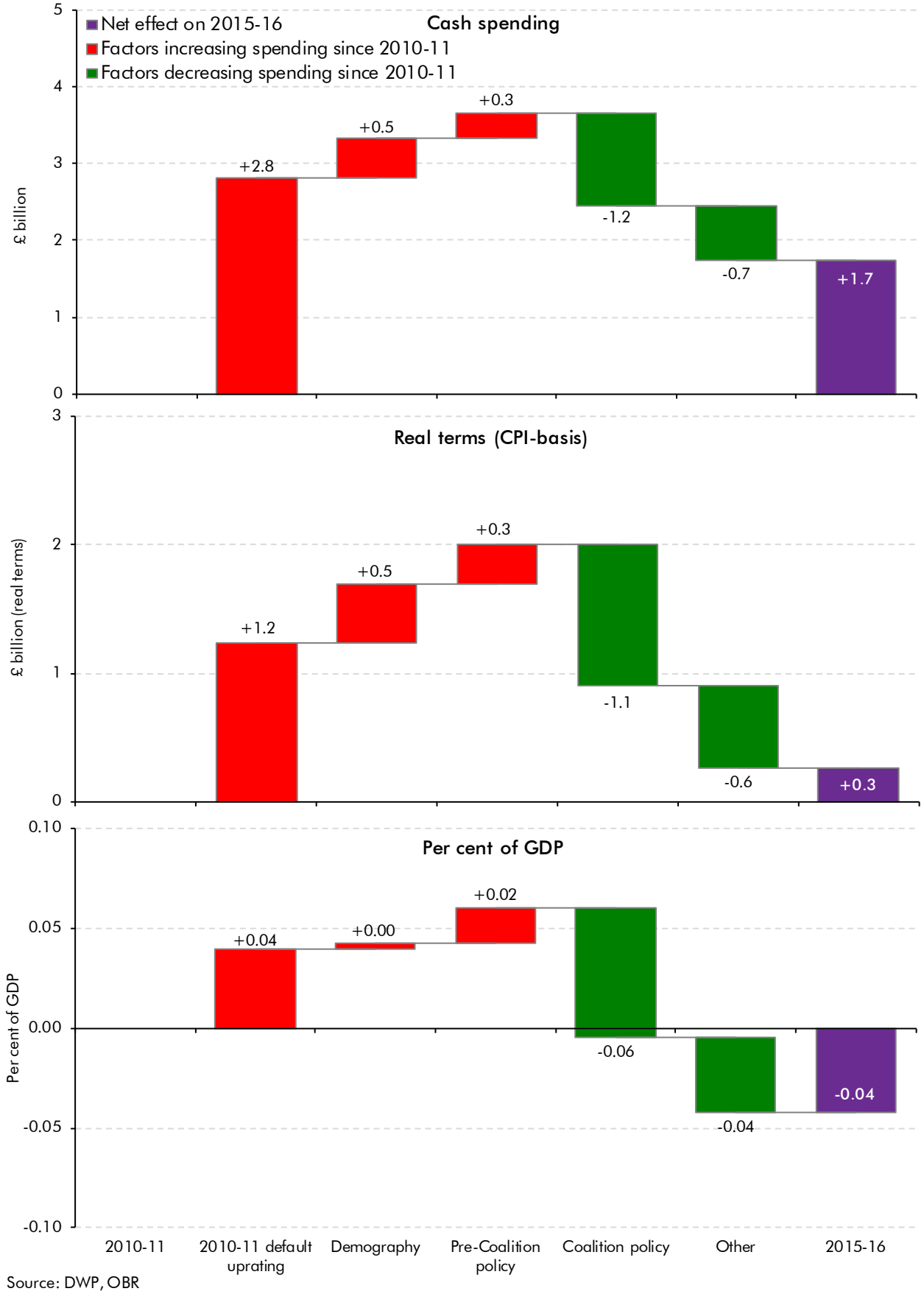
Chart 5.8: Statutory rates versus pre-Coalition default uprating



Source: DWP, OBR

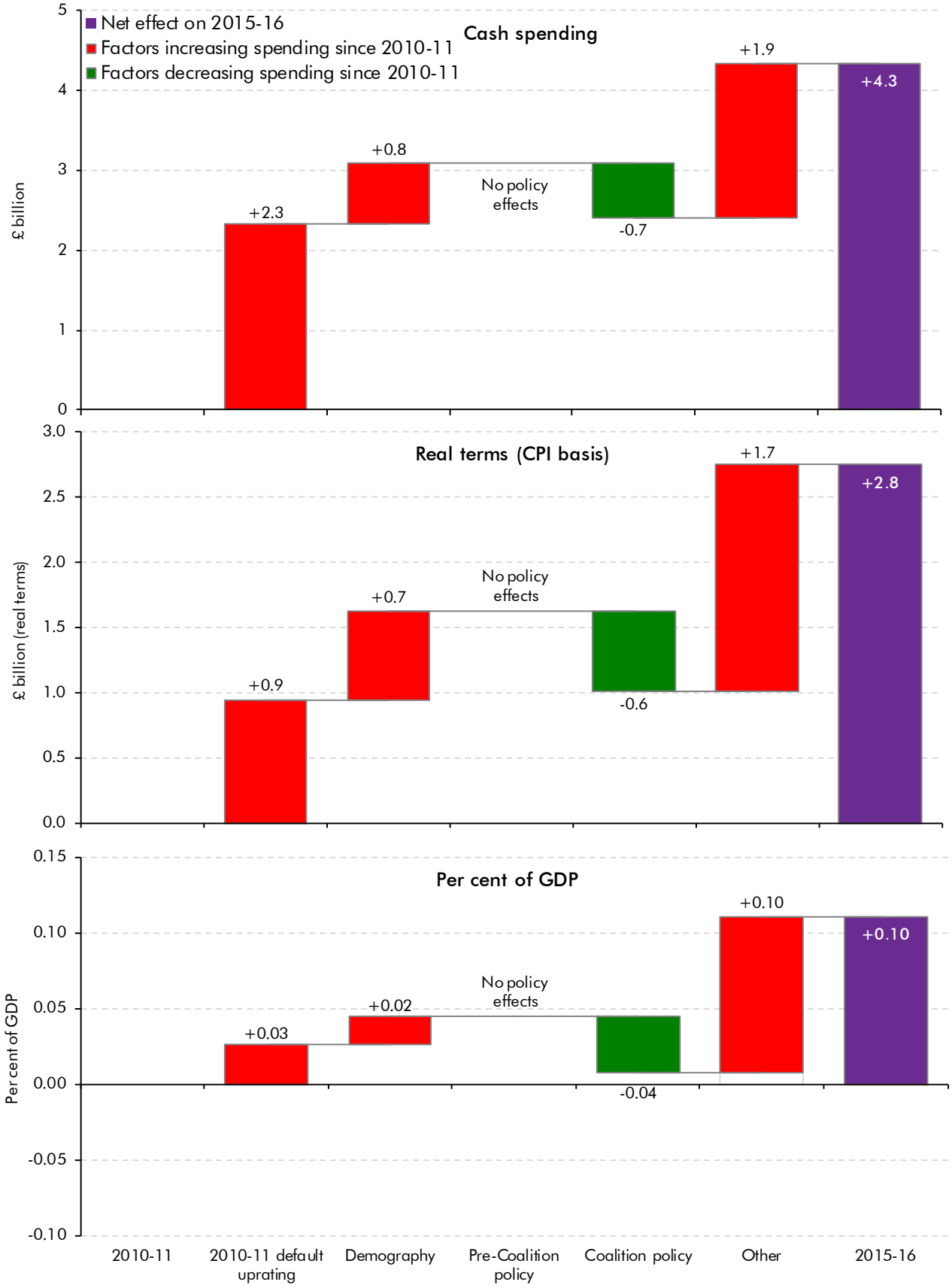
5.33 What explains these changes relative to the 2010-11 system counterfactual? Charts 5.9 and 5.10 decompose the change in spending over the last Parliament into the steps up that were used to calculate the counterfactual (the first two columns), the effect of pre-Coalition policies not fully implemented until after 2010-11, the effect of Coalition policies and the remaining change that reflects non-policy factors. As the final step is calculated by residual, it will also contain the effect of any errors in the estimates underpinning the preceding steps. The rest of this section explores these changes in more depth – and highlights where the estimates are subject to greater uncertainty.

Chart 5.9: Changes to incapacity benefits spending between 2010-11 and 2015-16



Source: DWP, OBR

Chart 5.10: Changes to disability benefits spending between 2010-11 and 2015-16



Source: DWP, OBR

Policy changes

Pre-Coalition policy decisions

5.34 We have factored in the effects of two significant pre-Coalition policy decisions whose implementation affected spending on incapacity benefits after 2010-11. Neither affected spending on disability benefits:

- the **equalisation of the female and male state pension age (SPA)** – legislated in 1995; and
- the **replacement of 'incapacity benefit' with 'employment and support allowance'** – originally announced in the 2008 Budget.

5.35 The 1995 Pensions Act established a timetable for **equalising the male and female state pension ages** (SPA), with the female SPA rising by one month every two months from the start of 2010-11. By 2015-16, that process was a little over half complete, with the female SPA having risen to 63 by the end of the year. As set out in Chapter 3, the implementation of that policy decision during the last Parliament reduced welfare spending overall, but it added to incapacity benefits spending where eligibility extends to the SPA. It did not affect spending on DLA, where both men and women could claim up to the age of 65.

5.36 Between 2010-11 and 2015-16, the proportion of 60 to 64 year olds claiming incapacity benefits increased from 9.1 to 9.9 per cent. That will have reflected both the SPA changes increasing eligibility for women and other factors. DWP has provided us with an estimate of the effect of the SPA change in isolation of around 145,000 additional incapacity benefit claimants. That would represent 4.3 per cent of 60 to 64 year olds in mid-2015. If those additional claims received the same age-specific average award as the rest of the caseload, they would add around £0.6 billion to incapacity benefits spending.

5.37 In 2006, the Labour Government announced reforms to incapacity benefits that led in time to the **introduction of ESA** to replace incapacity benefit (IB). It would involve a new medical test and a new requirement for all but the most severely ill or disabled claimants to engage in work-related activity. In Budget 2008, the Government announced that ESA would replace IB from October 2008, with a number of changes announced then and other policy parameters to be set at a later date. The main change would be the work capability assessment (WCA) with more stringent qualifying criteria. It would apply first to new claims, then from 2011 to the stock of IB cases. Further changes followed as a result of annual reviews of how WCAs were working and the effects they had on assessors' decision-making.

5.38 The shift from IB to ESA will have affected spending via both its effects on the caseload and on average awards. In terms of the caseload, the most obvious effect would come where an existing IB case was reassessed and the individual found to be fit for work. To the extent that the flow of successful new claims to ESA was lower than it would have been to IB, that would also reduce the caseload. In terms of average awards, some elements of ESA will have delivered clear savings – for example, age additions are not payable in ESA. But the rollout

of ESA has been associated with a much higher-than-expected proportion of assessments resulting in the higher support group awards, which would push awards up relative to most IB outcomes.

5.39 There is no single official estimate of the effect of ESA's introduction on spending. Some elements were subject to impact assessments – for example, the 2008 announcement that WCAs would apply to the IB stock was expected to generate a relatively small saving of around £0.4 billion by 2012-13 (with a partly offsetting effect on jobseeker's allowance spending). But any effects factored into forecasts reflected assumptions about how many WCAs would take place and their outcomes, rather than incorporating an official costing. As detailed in our 2014 and 2015 *WTRs*, we have had to make substantial upward revisions to our forecasts as these assumptions have evolved.

5.40 Unpicking the extent to which higher-than-expected spending should be assigned to the effect of the policy to introduce ESA or other factors that would have pushed up spending on IB too would be a resource-intensive process. Even then it would still yield highly uncertain results. For the purposes of this analysis, we have assumed that ESA reduced incapacity benefits spending by £0.7 billion in 2015-16. That is based on a simple top-down calculation of the extent to which the working-age incapacity benefits caseload fell faster relative to the working-age population after ESA's introduction in 2008-09 than it had in the preceding five years. (As set out in Chapter 3, the effect on welfare spending as a whole will have been lower, because some of the individuals moving off incapacity benefits will have moved onto jobseeker's allowance or into employment supported by tax credits.)

5.41 To learn further lessons, it would be useful if a proper evaluation of the effect of introducing ESA could be undertaken. If resources permit, this is something we would like to return to.

5.42 The implementation of the state pension age equalisation policy and the introduction of ESA is estimated to have added £0.3 billion to spending on incapacity benefits in 2015-16. That would be £0.3 billion in real terms or 0.02 per cent of GDP.

Coalition policy changes

5.43 We have factored in the effects of Coalition policy decisions that affected spending on incapacity and disability benefits. One affected both incapacity and disability benefits:

- the June 2010 decision to **switch uprating of most working-age benefits from RPI or Rossi inflation to CPI inflation**, which is typically lower. That affected all components of the incapacity and disability benefit systems. Since we now know the path of the relevant inflation measures over the last Parliament, we have been able to reflect the actual amount by which spending was cut as a result of this change – £0.7 billion from incapacity benefits (slightly higher than originally expected) and £0.6 billion from disability benefits (slightly lower than expected). The differences relative to the original costings reflect changes in the respective paths of CPI, RPI and Rossi inflation (which determine the percentage saving) and the overall level of spending (the amount to which that percentage is applied).

5.44 Three policies affected only incapacity benefits:

- the biggest expected saving was associated with the 2010 Spending Review decision to **limit to one year the period over which claimants of contributory ESA in the work-related activity group (WRAG) could receive the benefit**. This was originally estimated to save £2.0 billion in 2015-16, which depended on assumptions about the number of contributory WRAG cases whose claim would be curtailed at one year and about what would happen to those affected – for example, whether they would move onto the income-based version of the benefit that was not being time-limited. By Budget 2012, the last time an official re-estimate was published, the expected saving had been halved in its first two years, although it was still expected to rise to £1.5 billion by 2015-16. At that time, the contributory WRAG caseload was expected to be 384,000 in 2015-16 (18 per cent of all ESA cases). In the event, it was only 16,000 (just 1 per cent of the total). The Budget 2012 estimate also assumed that the proportion of WRAG cases that were income-based would fall slightly to 36 per cent by 2015-16. In fact it increased to 96 per cent. Given the smaller contribution-based caseload and the likelihood that a higher-than-expected proportion of those affect moved onto the income-based benefit, we estimate that the policy reduced spending by just £0.2 billion in 2015-16;

- the 2012 Autumn Statement decision to **impose a 1 per cent cap on the uprating of most working-age benefits from 2013-14 to 2015-16**. No elements of disability benefits, nor the support group component of ESA, were subject to this cap. As with the switch to CPI uprating, we have been able to update the costing of this measure to reflect the actual difference between uprating by CPI inflation each year (the baseline against which this was costed) and uprating by 1 per cent; and

- the 2014 Budget decision to **introduce a 7-day waiting period before payments would be made to new ESA claims**. That was expected to cut spending by around £10 million a year. We have not adjusted that costing, since any change would be immaterial relative to the other policies.

5.45 One policy affected only disability benefits:[10]

- the June 2010 Budget decision to **introduce "*an objective medical assessment*" from 2013-14 onwards to reduce spending on disability benefits**. That high-level announcement subsequently became the introduction of PIP to replace DLA for working-age claims. As we described in our March 2016 *EFO*, the original costing assumed the policy would reduce spending by 20 per cent, but with little detail underpinning that. To meet that figure would have required all DLA cases to have been assessed by that time and for the assessments to result in 20 per cent less spending. In fact, 75 per cent of the working-age caseload remained on DLA by 2015-16. And the evidence on which we based our March forecast suggested the

[10] The 2010 Spending Review also announced the removal of eligibility for mobility payments from recipients living in residential care, which was estimated to reduce spending by £0.2 billion in 2015-16. In Budget 2011, the removal of eligibility was pushed back from 2012-13 to start from 2013-14. Then in Budget 2013, it was dropped altogether, so has no effect on our analysis.

effect among those cases that have moved to PIP was much smaller at around 5 per cent. We therefore estimate that the introduction of PIP reduced spending by £0.1 billion in 2015-16.

5.46 On the basis of the adjustments described above, we estimate that these policies have the combined effect of cutting spending in 2015-16 on incapacity benefits by £1.2 billion and on disability benefits by £0.7 billion. In real terms (deflated by CPI inflation in 2010-11 prices), those figures would be £1.1 and £0.6 billion respectively. Their respective contributions to the change in spending as a share of GDP would be 0.06 and 0.04 percentage points.

5.47 For both incapacity and disability benefits, our current estimates of the savings associated with Coalition policies fall well short of the original estimates that were announced at the various Budgets, Autumn Statements and Spending Reviews during the Parliament. The shortfalls largely reflect the complex reforms of both systems having yielded much smaller savings than were originally expected. In the case of disability benefits, we estimate the shortfall relative to the £1.4 billion by 2015-16 factored into our June 2010 forecast was £1.3 billion. In the case of incapacity benefits, the biggest shortfall was relative to the savings expected from time-limiting contribution-based ESA claims in the work-related activity group. We estimate the shortfall relative to the original estimate of £2.0 billion by 2015-16 was £1.8 billion.

Other factors affecting incapacity benefits

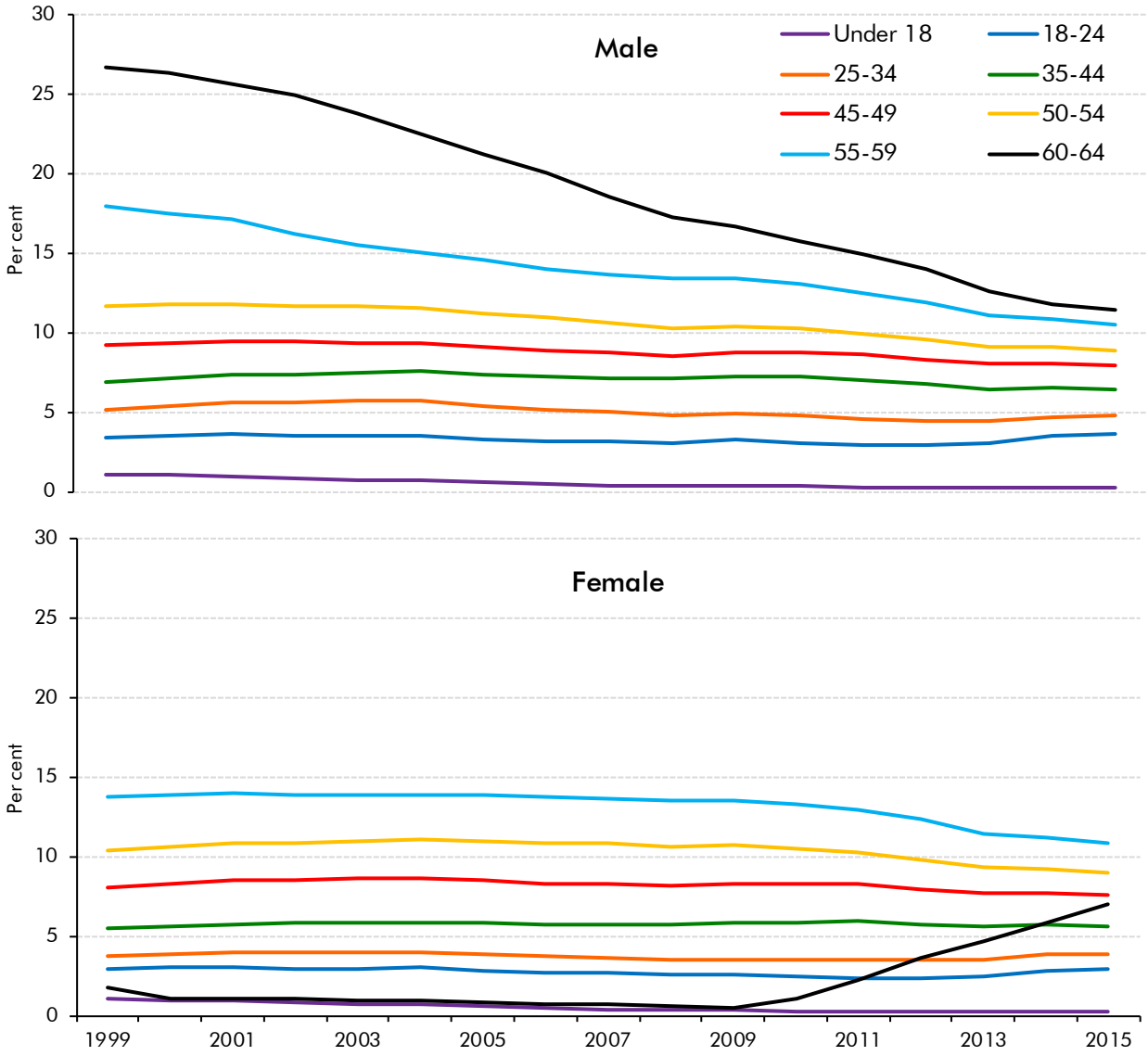
5.48 With the combined effect of pre-Coalition uprating and population changes adding £3.3 billion to incapacity benefits spending between 2010-11 and 2015-16 and the total effect of policy changes reducing it by £0.9 billion, we are left with a further £0.7 billion reduction to be explained by other factors.

5.49 As ever, these other factors can be thought of in terms of factors affecting the caseload – which in turn can reflect drivers of eligibility or the rate at which those who are eligible take up the payments to which they are entitled – and factors affecting the average amounts received – such as changes in the composition of the caseload. The overall effect is likely to reflect partly offsetting contributions from different trends.

5.50 Looking first at factors that could have affected the **caseload**, the policy changes described in the previous section would in most cases be expected to have only small effects on the proportion of the population claiming incapacity benefits. One exception is the equalisation of the male and female SPAs, which pushed up the caseload among women aged 60 to 62. The introduction of ESA could also have affected the caseload, but we have not factored in any change to spending as a result of that measure. That could be interpreted as it not changing the caseload either, or that it had offsetting effects on the caseload and average award. It therefore seems likely that other factors must explain the majority of the fall in age-specific claim rates across most of the age distribution (as was shown in Chart 5.7).

5.51 Excluding the SPA-affected rise in the proportion of 60 to 64 years olds receiving incapacity benefits, and assuming the same average award across all remaining age groups, the net effect of changes in age-group claim rates between 2010-11 and 2015-16 would reduce spending by £1.1 billion. The majority of that effect comes from the significant falls in the proportion of older working-age people claiming these benefits (down from 13.2 to 10.6 per cent among 55 to 59 year olds), which in large part is likely to reflect the continuation of the longer-term trends shown in Chart 5.11.

Chart 5.11: Proportion of men and women claiming incapacity benefit by age group



Source: DWP, OBR

5.52 In contrast to trends at older ages, the proportion of 16 to 24 year olds in receipt of incapacity benefits increased from 2.8 to 3.3 per cent. This may relate to the rising prevalence of mental health conditions in that age group.[11] Between 2010-11 and 2015-

[11] See Chapter 3 of the *Fifth independent review of the WCA* (2014).

16, the proportion of working-age people claiming incapacity benefits whose primary condition was mental-health related increased by almost a tenth to 3.2 per cent. Among those aged 25 or less, the proportion increased by around a fifth to 2.0 per cent.

5.53 Turning to factors that could have affected **average awards**, most of the policies described in the previous section would have reduced awards – most directly those affecting uprating. Despite that, average awards increased by 16.5 per cent between 2010-11 and 2015-16, 1.3 percentage points faster than headline uprating policy would have implied.

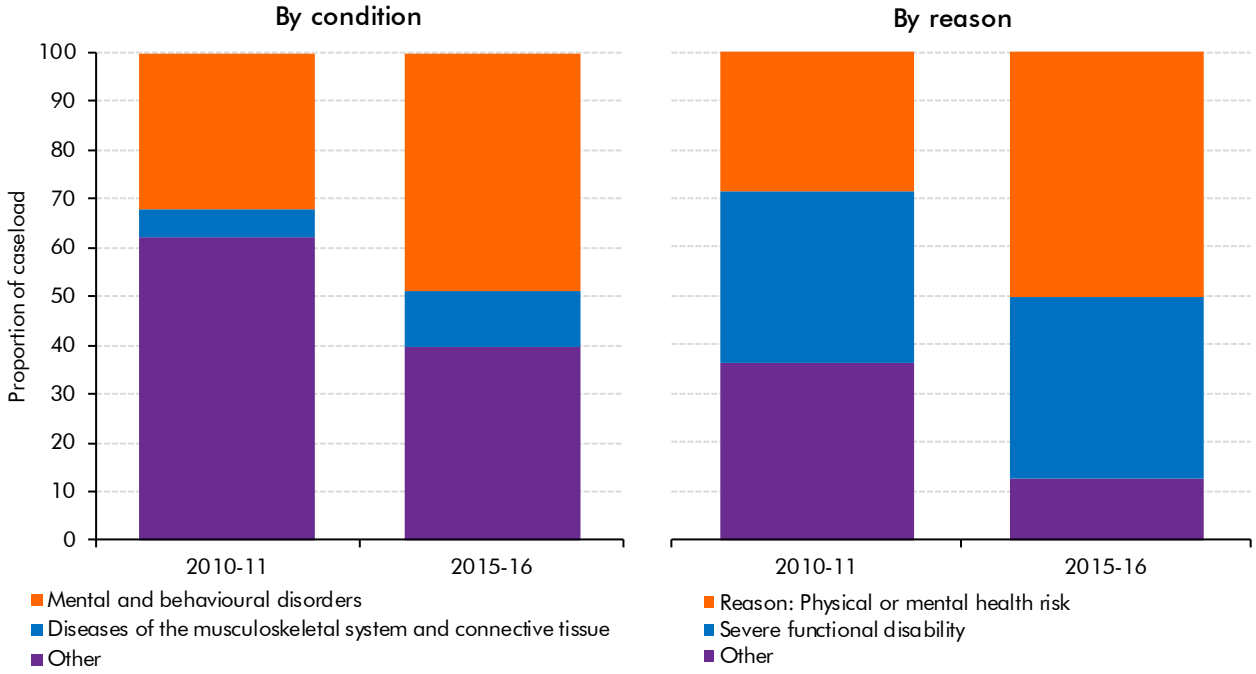
5.54 The most significant change over the last Parliament was the rising proportion of ESA claims that received the higher support group award. In 2015-16, the support group contained just over 1.4 million cases, representing 64 per cent of all ESA claims. As a share of the caseload, the support group almost doubled in just three years and it was almost twice the share we had assumed in our March 2013 forecast. This was the last forecast in which we assumed the roll-out of ESA work capability assessments would generate significant savings.

5.55 Chart 5.12 illustrates two ways in which mental health conditions appear to have been significant drivers of the rise in support growth cases. It shows that:

- in terms of **the primary condition reported** by claimants in the support group, mental and behavioural disorders increased from around a third of the total to almost half. That rise more than explained the increase in the proportion of the total incapacity benefits caseload accounted for by mental and behavioural conditions from 42.7 to 47.9 per cent; and

- in terms of **the reason given by assessors** for placing cases in the support group, the proportion referred directly into the support group via the use of regulation 35(2)(b), where decision-makers have deemed there to be a risk to physical or mental health, increased from just over a quarter to around half.

Chart 5.12: ESA support group caseloads (new claims)



Source: DWP, OBR

5.56 With average awards in the support group 37 per cent higher than across other groups, if the share of the caseload in the support group had been half the outturn in 2015-16, spending would have been £1.4 billion lower. Given the approach we have taken to adjusting the estimated effect on spending from introducing ESA, this figure is presented as an illustrative sensitivity rather than being factored into the decompositions directly.

Other factors affecting disability benefits

5.57 With the combined effect of pre-Coalition uprating and population changes adding £3.1 billion to disability benefits spending between 2010-11 and 2015-16 and the total effect of policy changes reducing it by £0.7 billion, we are left with £1.9 billion of additional spending to be explained by other factors. As in the previous section, we consider these in terms of factors that would affect the caseload and those that would affect average awards.

5.58 Looking first at factors that would affect the **caseload**, the policy changes described in the previous section include the introduction of PIP, which was originally intended to reduce the caseload sufficiently to reduce spending by 20 per cent. The evidence that informed our March 2016 forecast implies that the effect on the caseload in 2015-16 would have been minimal. Indeed, rather than falling, the share of the population claiming disability benefits increased from 5.2 per cent in 2010-11 to 5.6 per cent in 2015-16.

5.59 Claim rates increased across most of the age distribution (as was shown in Chart 5.7), but the rises were bigger among children (who are not affected by the introduction of PIP) and young adults (who are). Assuming the same average award across all age groups in 2015-16, the net effect of changes in age-group claim rates between 2010-11 and 2015-16 would increase spending by £1.2 billion. Almost two-thirds of that increase would be

accounted for by those under the age of 35, despite them accounting for only a quarter of the total disability benefits caseload.

5.60 The proportion of the disability benefits caseload who report learning difficulties as their main disabling condition has increased from 12.0 per cent in 2011-12 to 14.9 per cent in 2015-16. This rise is more pronounced among younger people, with the proportion of the caseload under 25 in this category increasing by 4.5 percentage points over the period.

5.61 **Average awards** increased by 22.9 per cent between 2010-11 and 2015-16, 7.6 percentage points faster than headline uprating policy would have delivered. That would add £1.0 billion to spending in 2015-16. It reflects compositional changes in the caseload.

5.62 Both DLA and PIP incorporate different rates that depend on the severity of the disability that led to the award. For the care component of DLA, there are three rates – lower, middle and higher – while for the equivalent PIP daily living component there are two – standard and enhanced, but no equivalent to 'lower'. For the mobility component of both systems there are two rates – lower/higher for DLA and standard/enhanced for PIP.

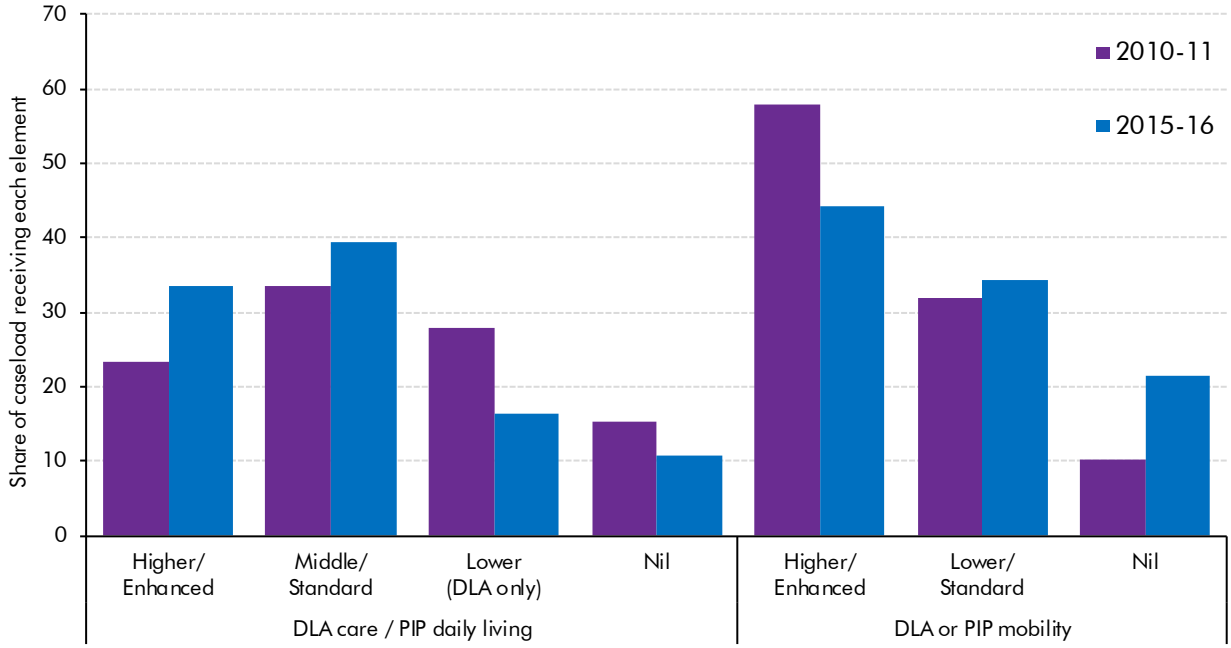
5.63 The composition of the caseload changed significantly between 2010-11 and 2015-16. As Chart 5.13 shows:

- in the **DLA care/PIP daily living component**, the share of the caseload receiving the highest award increased by 10.0 percentage points. The 2010-11 caseload was entirely made up of DLA cases, so the increase over the period reflects both a small rise in the share of DLA cases receiving the higher rate and, more significantly, the transition to PIP, where a much higher share of cases receive the enhanced rate. As there is no equivalent of the lower rate in PIP, the share of the total caseload receiving the lower rate fell by 11.4 percentage points; and

- in the **mobility component**, the pattern was the opposite. The share of the caseload receiving the highest award fell by 13.7 percentage points. Again, that reflected a small reduction in the share of DLA cases receiving the higher rate and, more significantly, the transition to PIP, where the share of cases awarded the nil rate is much higher.

5.64 The effect of these compositional changes on spending in 2015-16 would have been to increase it by £0.4 billion, with the care/daily living changes adding £2.2 billion and the mobility changes subtracting £1.8 billion.

Chart 5.13: Disability benefits caseload split by award rates

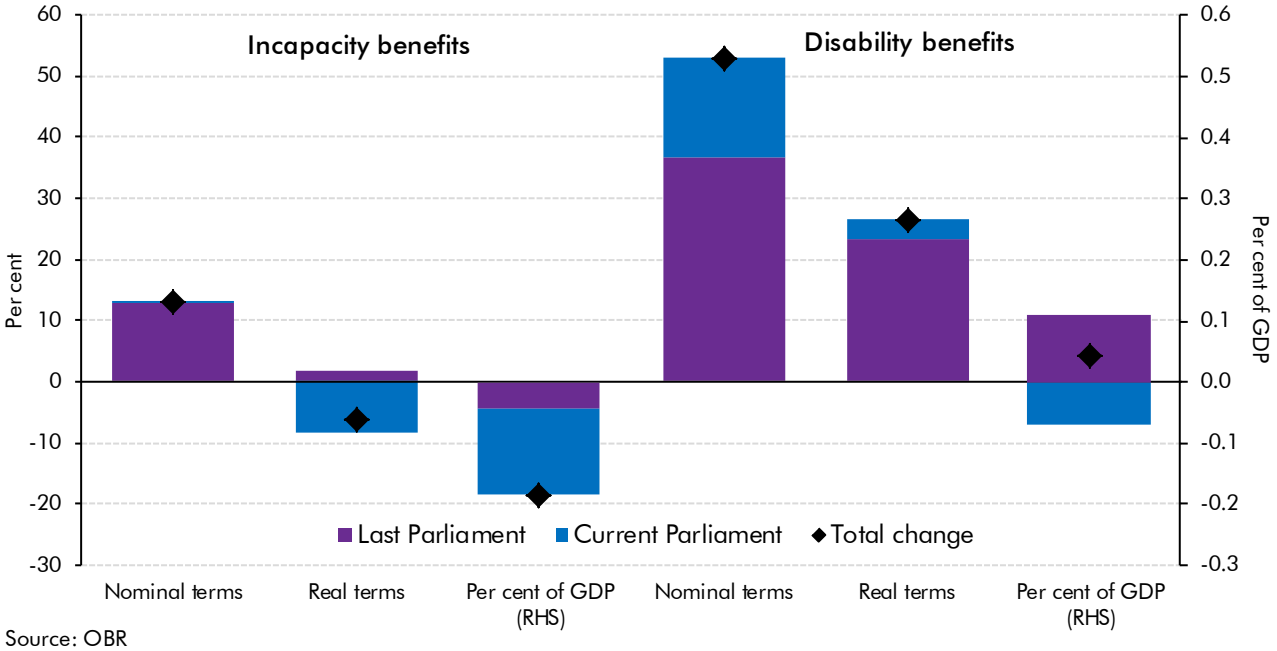


Source: DWP, OBR

How spending is forecast to evolve over this Parliament

5.65 We now consider the second half of the ten year period from 2010-11, which encompasses the current Parliament. Over that full period, Chart 5.14 shows that spending on incapacity benefits is expected to rise by 13 per cent in cash terms and to fall by 6 per cent in real terms and by 0.18 per cent of GDP. Spending on disability benefits is expected to rise by 53 per cent in cash terms, by 27 per cent in real terms and by 0.04 per cent of GDP. Across all the measures and both systems, it shows that spending is set to rise less (or to fall by more) in the current Parliament than it did in the last.

Chart 5.14: Incapacity and disability benefits spending: 2020-21 versus 2010-11



Source: OBR

5.66 Building on the approach set out in the previous section, we can decompose that change into the parts explained by uprating and population changes under the 2010-11 system, the continuing effects of pre-Coalition and Coalition policies, plus new policies announced by the Conservative Government, and other factors that will again reflect both non-policy drivers of spending and any errors in estimating the preceding elements.

5.67 The analysis that follows is based on our March 2016 forecast, adjusted to remove the effect on disability benefits spending from the PIP 'aids and appliances' measure that was announced in Budget 2016 but then dropped five days later. We highlight some of the specific issues that we foresee being relevant to our next incapacity and disability benefits forecasts in the subsequent section.

The 2010-11 baseline

The effect of pre-Coalition default uprating

5.68 If the pre-2010 policy setting of uprating incapacity benefits by Rossi inflation and disability benefits by RPI inflation had applied through the current Parliament too, by 2020-21:

- cash spending on **incapacity benefits** would be £4.6 billion higher than in 2010-11 and £1.8 billion higher than in 2015-16. (That would leave it £2.9 billion higher than our March forecast for 2020-21.) The increment over the current Parliament is smaller than over than the last because our March forecast for inflation on all measures – which predates any effects on import prices from the fall in sterling since the referendum result – is lower on average over the forecast period than in recent years. That would push spending up further in real terms (deflated by CPI inflation) because of the wedge between Rossi inflation and the CPI due to measurement differences. But

it would see spending fall back as a share of GDP, due to our assumption that productivity growth will pick up such that GDP-per-head rises faster than CPI; and

- cash spending on **disability benefits** would be £4.1 billion higher than in 2010-11 and £1.7 billion higher than in 2015-16. (That would leave it £2.2 billion lower than our March forecast for 2020-21.) As with incapacity benefits, that would be a smaller increment than in the last Parliament – although slightly less so because our March forecast assumed that housing costs would push RPI inflation up more than Rossi inflation – and would imply spending rising further in real terms but falling as a share of GDP.

The effects of demographic changes

5.69 The effect of growth and ageing of the population will continue to exert upward pressure on spending. Using the same approach as for the previous Parliament, with 2010-11 age-specific claim rates held constant, by 2020-21:

- cash spending on **incapacity benefits** would be £1.1 billion higher than in 2010-11 and £0.6 billion higher than in 2015-16. (Taken together with the effects of the default updating, spending would be £4.0 billion higher than our March forecast for 2020-21.) As in the last Parliament, population growth explains the majority of that increase, with ageing adding further to spending because of higher age-specific claim rates at older ages. These effects would also push spending up in real terms and (marginally) as a share of GDP; and

- cash spending on **disability benefits** would be £1.7 billion higher than in 2010-11 and £0.9 billion higher than in 2015-16, reflecting the same factors as for incapacity benefits and with the same implications for spending in real terms and as a share of GDP. (Taken together with the effects of the default updating, spending would be £0.5 billion lower than our March forecast for 2020-21.)

What is forecast to happen and how can we explain the difference?

5.70 Table 5.3 extends the comparison shown in Table 5.2 for the current Parliament. It compares our forecast for the path of spending on incapacity and disability benefits over the current Parliament with the simple 2010-11 counterfactual described in the previous section. By 2020-21, incapacity benefits spending is expected to be well below that counterfactual (having risen by £1.8 billion over 10 years versus £5.7 billion in the counterfactual). By contrast, disability benefits spending is expected to be higher than the counterfactual (up £6.3 versus £4.3 billion).

Table 5.3: Incapacity and disability benefits spending – forecast versus baseline

	£ billion						
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	Incremental change since 2015-16
Incapacity benefits							
Forecast spending	15.0	14.9	14.7	14.6	14.8	15.1	
Change on 2010-11	1.7	1.6	1.4	1.3	1.5	1.8	0.0
2010-11 baseline spending	16.6	16.8	17.2	17.8	18.4	19.0	
Change on 2010-11	3.3	3.5	3.9	4.4	5.1	5.7	2.4
Difference	-1.6	-2.0	-2.5	-3.2	-3.6	-4.0	-2.4
Disability benefits							
Forecast spending	16.2	16.4	16.7	17.1	17.7	18.2	
Change on 2010-11	4.3	4.5	4.8	5.2	5.8	6.3	2.0
2010-11 baseline spending	15.0	15.2	15.7	16.2	16.9	17.6	
Change on 2010-11	1.7	1.9	2.4	2.9	3.6	4.3	2.6
Difference	2.7	2.6	2.4	2.3	2.2	2.0	-0.7

5.71 What explains these changes relative to the 2010-11 system counterfactual? Charts 5.15 and 5.16 repeats for the current Parliament the decompositions shown in Charts 5.9 and 5.10 for the last. Added to the breakdown are the effects of policies announced by the new Conservative Government since it took office in May 2015. Again, it is important to note that the final step is calculated by residual, so it will also contain the effect of any errors in the estimates underpinning the preceding steps. The rest of this section explores these changes in more depth.

Chart 5.15: Changes in incapacity benefit spending between 2010-11 and 2020-21

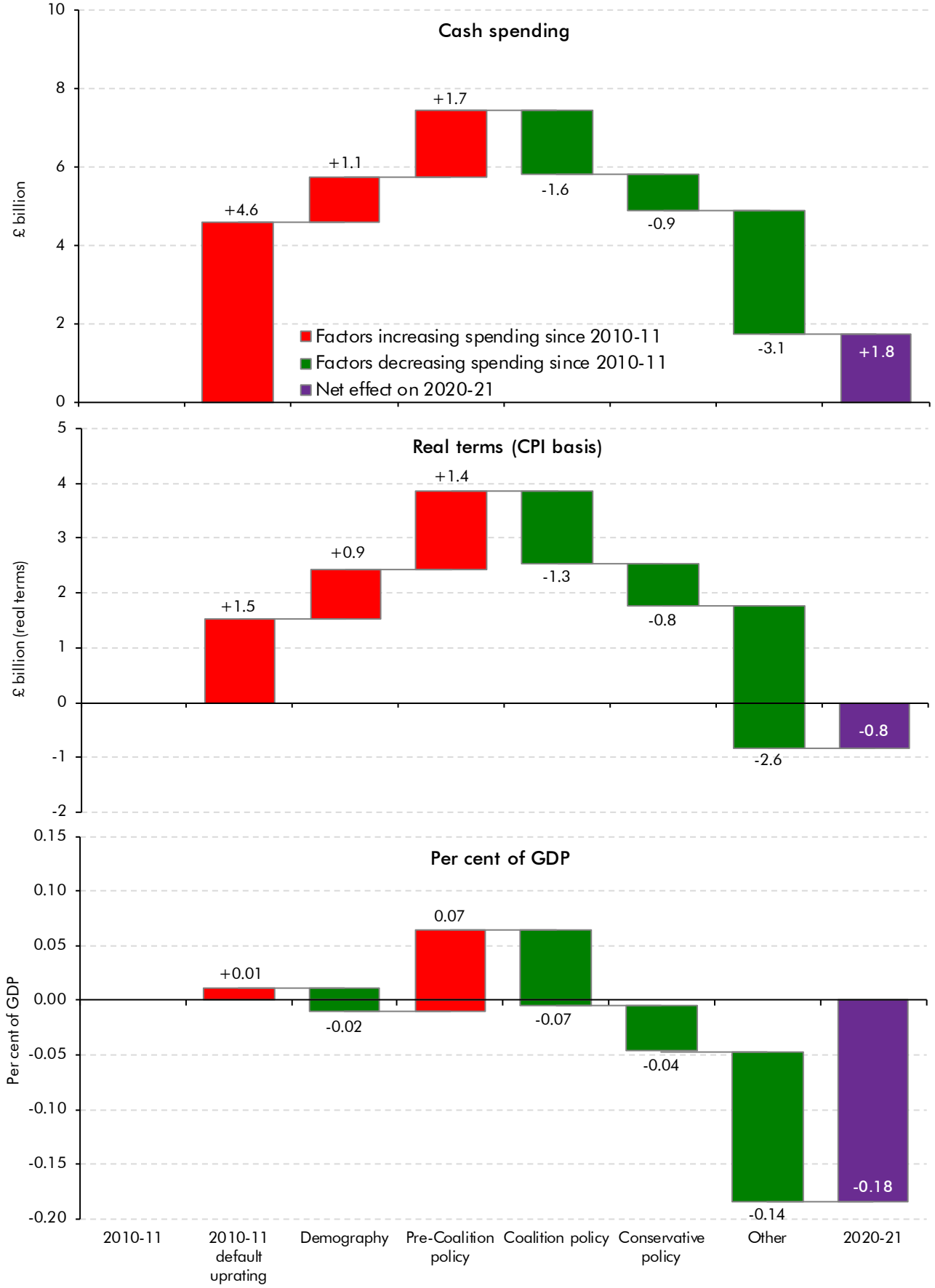
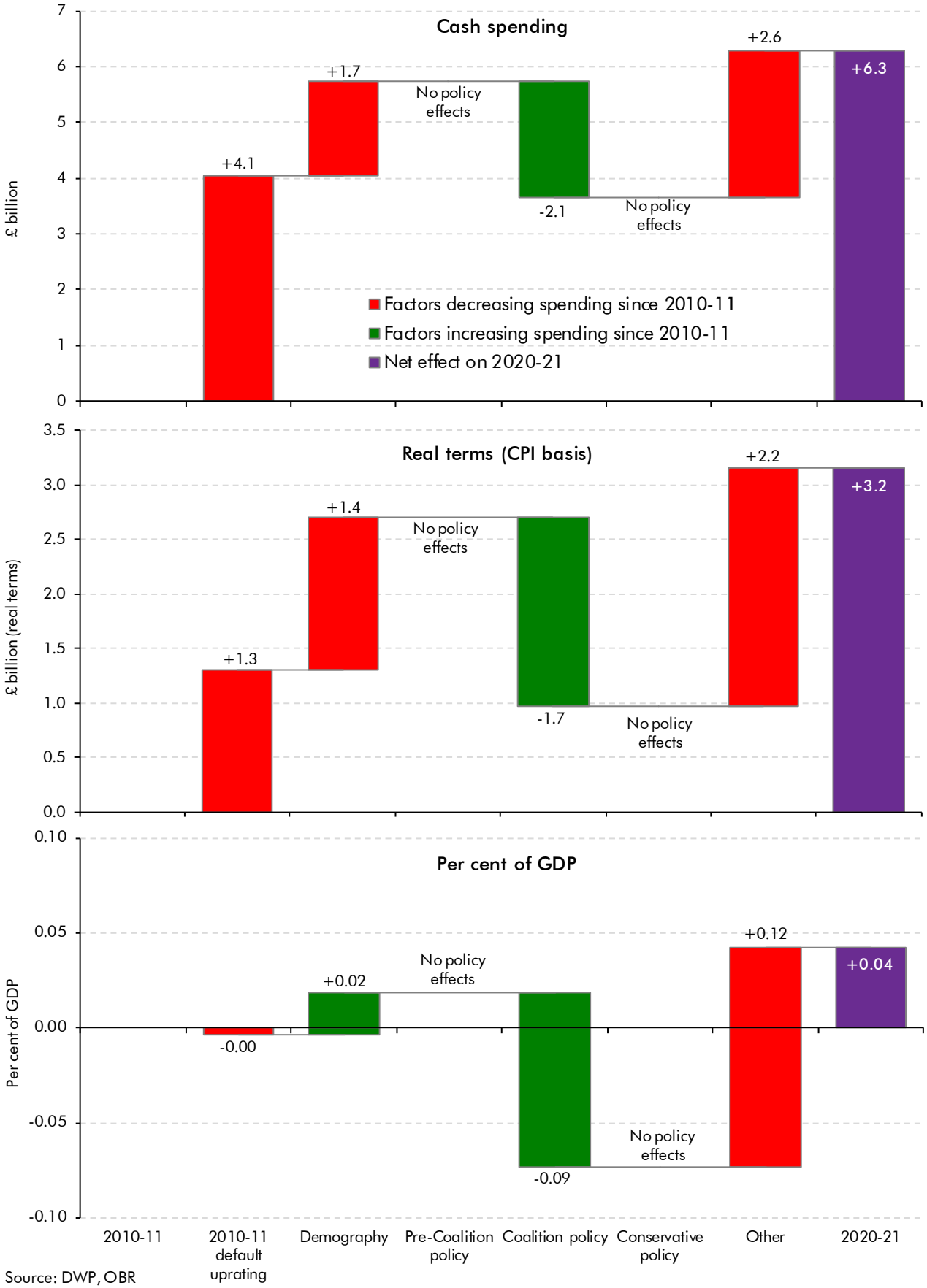


Chart 5.16: Changes in disability benefits spending between 2010-11 and 2020-21



Source: DWP, OBR

Pre-Coalition policy decisions

5.72 There are two pre-2010 policy decisions that are relevant to our decomposition of how incapacity benefits spending has changed since 2010-11: the equalisation of the male and female SPAs and the introduction of ESA. Neither affects disability benefits spending.

5.73 The timetable for SPA equalisation that was set out in the 1995 Pensions Act would have seen the female SPA reach 65 by the end of 2019-20, so would have continued to expand the population eligible for working-age incapacity benefits during the current Parliament. Relative to the 2010-11 counterfactual, that would have added £2.4 billion to incapacity benefits spending by 2020-21 (an additional £1.4 billion relative to the effect in 2015-16).

5.74 As set out from paragraph 5.37, we have produced a simple top-down estimate of the effect of ESA's introduction on spending by the end of the last Parliament of £0.7 billion. With the transition from incapacity benefit to ESA nearly completed by 2015-16, we have assumed that there will be no incremental effect on spending in this Parliament, so that the effect on spending in 2020-21 is also £0.7 billion.

5.75 Overall, we estimate that the ongoing effects of policies announced before the Coalition took office will increase incapacity benefits spending in 2020-21 by £1.7 billion. In real terms, deflated by CPI inflation, this would be an increase of £1.4 billion or 0.07 per cent of GDP.

Coalition policy changes

5.76 The Coalition policy decisions that affected incapacity and disability benefits spending in the last Parliament will continue to affect the path of spending in the current Parliament. A number of assumptions must be made to generate estimates of their effects in 2020-21, which are therefore subject to considerable uncertainty. We have assumed that:

- **the acceleration of state pension age equalisation and the raising of the state pension age to 66** for both men and women, announced in the 2011 Pensions Act, adds £0.8 billion to spending on incapacity benefits. The acceleration of state pension age equalisation has no impact on disability benefits spending as the age limit is already set at 65, but the subsequent rise to 66 will lead to a small increase in spending. As with the steps towards equalisation that took place in the last Parliament, this policy reduces state pensions spending by far more than it raises spending on working-age benefits like ESA;

- the **effect of switching uprating for RPI or Rossi to CPI gets bigger each year**, with the incremental effect based on our March 2016 forecasts for each measure of inflation. This decision – which affects both incapacity and disability benefits – accounts for the majority of the incremental effect on spending from Coalition policies during the current Parliament;

- the **effect of the 1 per cent uprating cap** on incapacity benefits also gets bigger in the current Parliament because it lowered the starting point for spending from where –

absent further policy changes announced in this Parliament – it would have been uprated by CPI inflation each year;

- the **effect of the introduction of PIP** continues to be considerably less than originally estimated. We assume that the savings relative to DLA are around 5 per cent, substantially smaller than the 20 per cent that was originally targeted;

- the **effect of introducing a one year time-limit for claimants on contributory-ESA in the work-related activity group** changes in proportion with the latest forecast on the number of claimants in the work-related activity group; and

- the **effects of all other policy decisions** are assumed to rise from 2015-16 or the last year of the forecast period when it was announced in line with the effects of inflation and population growth. That is broadly consistent with the approach we have used to generate the simple 2010-11 baseline.

5.77 Overall, we estimate that the ongoing effects of policies announced by the Coalition will reduce spending in 2020-21 by £1.6 billion for incapacity benefits and £2.1 billion for disability benefits. In real terms, deflated by CPI inflation, those figures would be £1.3 and £1.7 billion respectively. This represents falls of 0.07 and 0.09 percent of GDP respectively.

Conservative policy changes

5.78 As described in Chapter 2, there have been three 'fiscal events' – containing a large number of welfare spending policies – since the new Government took office in May 2015. Over that time, the decision that had the biggest effect on our forecast for spending on support for sick and disabled people was announced in Budget 2016 – the decision to reduce the number of points awarded for some 'aids and appliances' descriptors in the personal independence payment assessment. It was expected to cut spending on disability benefits by £1.3 billion by 2020-21, but the Government announced five days after the Budget that the measure would not go ahead.

5.79 Most other policies announced by the present Government that affect our forecast for incapacity and disability benefits spending are relatively small. In order of size, they are:

- for new claimants from 2017-18 onwards, the **work-related activity group award will be cut by around 28 per cent to align it with the jobseeker's allowance rate**. That is expected to reduce incapacity benefits spending in 2020-21 by £0.5 billion;

- the **4-year freeze on uprating most working-age benefits** does not apply to those in the support group and those on disability benefits, but does apply to the main incapacity benefit awards. It is expected to reduce spending in 2020-21 by £0.5 billion; and

- **other policies with smaller effects** include changes related to support for mortgage interest, the lone-parent obligation and the recruitment of presenting officers to

support DWP in ESA/PIP tribunals. The net effect of these decisions reduces spending in 2020-21 by less than £0.1 billion.

5.80 Overall, we estimate that policies announced by the new Government will reduce incapacity benefits spending in 2020-21 by £0.9 billion (£0.8 billion in 2010-11 prices and 0.04 per cent of GDP), but have virtually no effect on disability benefits spending.

Other factors affecting incapacity benefits

5.81 With the combined effect of pre-Coalition uprating and population changes adding £5.7 billion to incapacity benefits spending between 2010-11 and 2020-21 and the total effect of policy changes reducing it by £0.8 billion, we are left with a further £3.1 billion reduction to be explained by other factors. The incremental reduction over this Parliament would therefore be £2.4 billion.

5.82 This reduction in spending beyond what can be explained by population changes and planned uprating and other policies reflects the assumptions we have made about how the different incapacity benefits caseloads will evolve relative to the demographic factors that are captured in the baseline. In the five years to 2020-21 we expect the support group caseload in ESA to continue rising slightly faster than the adult population (up around 230,000 in absolute terms). But that rise is more than offset by the fall in non-ESA cases (down 150,000 as the final incapacity benefit and income support cases move to other benefits or out of the welfare system altogether) and the fall in assessment phase cases (down 200,000 – almost all of which reflects a 50 per cent fall expected in 2016-17 as the backlog of cases is cleared).

5.83 As with all aspects of welfare spending in our forecast, these figures are compiled on the basis of the incapacity benefits system continuing in its legacy form with the effect of the transition to universal credit (UC) added at the end of the process. In reality, the number of cases in the legacy system will fall as they move to UC. Our March forecast for the net saving from UC assumed that 89 per cent of income-related ESA cases would have moved into UC by 2020-21.[12] As UC is now set to be less generous than the legacy benefits system, that shift was associated with a reduction in welfare spending. Our forecast will therefore be more sensitive to any changes in the timetable and other assumptions about the rollout of UC. In July 2016, the Government announced yet another delay to the rollout that will push the associated savings back. And our March 2016 *EFO* described a number of other important uncertainties in the modelling of complex elements of the transition, including the transitional protection that will be paid to individuals that lose out when they are transferred to universal credit, but only until a change of circumstances warrants a change of award.

[12] OBR (July 2016) Supplementary forecast information release, *Universal credit (UC) caseload forecasts*.

Other factors affecting disability benefits

5.84 With the combined effect of pre-Coalition uprating and population changes adding £5.7 billion to disability benefits spending between 2010-11 and 2020-21 and the total effect of policy changes reducing it by £2.1 billion, we are left with £2.6 billion of additional spending to be explained by other factors. The incremental addition in this Parliament would therefore be £0.7 billion – considerably smaller than seen in the last Parliament.

5.85 This increase in spending beyond what can be explained by population changes and planned uprating and other policies reflects our assumption that the working-age caseload will not rise further relative to the population and that the composition of the caseload will remain relatively stable rather than continuing to shift towards those receiving higher awards. We continue to expect bigger increases in the number of children receiving DLA, consistent with the trend over the preceding five years.

Issues for our November 2016 forecast

5.86 Our next forecast will need to include judgements about the effects on the economy and public finances that flow from the vote to leave the EU in June's referendum. With the Government's policy response to the referendum still unfolding, there will be greater-than-usual uncertainty around the economic assumptions that we feed into our forecasts for incapacity and disability spending. This could include any changes in the size or age-structure of the population due to changes in migration flows or the effect of changes in inflation via uprating policy. And any changes in prospects for economic growth could affect spending as a share of GDP.

5.87 There are also a number of issues specific to incapacity and disability benefits that we will be considering as we prepare our November forecast:

- the effect of **dropping the Budget 2016 decision to reduce the number of points awarded in PIP for certain aids and appliances** will increase spending by amounts increasing to £1.3 billion in 2019-20 and 2020-21;

- the Government's July 2016 announcement of yet another **delay to the rollout of universal credit** will mean a larger share of the caseload receiving the equivalent of incapacity benefits will remain on ESA. As our forecast is currently constructed by assuming the legacy benefit system continues, with the effect of universal credit on spending then subtracted, that will affect our forecast for the marginal saving from universal credit rather than incapacity benefits themselves;

- we will review the **latest evidence on success rates and average awards associated with PIP new claims and reassessments**. As explained in Chapter 2, the initial results that we were able to use in our March 2016 forecast implied a higher share of reassessed cases being awarded PIP and that more of them would receive the higher rates; and

- we will also review the **latest evidence on the pace at which ESA work capability assessments are being carried out and the proportion of cases ending up in the different groups**. The proportion of claimants in the assessment phase has risen in recent months as the resumption of repeat assessments has resulted in an increase in the backlog of claims.

Conclusions

5.88 There are a number of conclusions that can be drawn from this analysis. These relate to the many factors that influence the path of spending on incapacity and disability benefits:

- **the ageing of the population** will continue to affect spending, given differences in health status and claim rates across the age distribution. The ongoing rise in the state pension age will also put upward pressure on incapacity benefits spending, where eligibility extends to that age;

- **the rising prevalence of mental health conditions and learning difficulties**, particularly at younger ages, has been an important driver of the rising disability benefits caseload and the rising proportion of incapacity benefits claims that are placed in the support group of ESA. As we noted in our recent *Fiscal sustainability analytical paper* on long-term trends in health care spending, this is an issue with broader implications for fiscal sustainability in the UK;

- **uprating policy has been more generous for disability benefits than incapacity benefits.** Both the Coalition and the Conservative Governments chose not to include disability benefits in their decisions to freeze or cap uprating, although the Coalition did include disability benefits in the June 2010 decision that switched uprating of most benefits and tax credits to the CPI measure of inflation. The result of these decisions is that most disability benefit rates have risen by around 3.6 per cent more than the main incapacity benefit rates. This helps to explain why spending on incapacity benefits is expected to have fallen from 6.9 per cent of welfare spending in 2010-11 to 6.5 per cent by 2020-21, whereas spending on disability benefits will rise from 6.2 to 7.9 per cent over the same period; and

- **major reforms to both systems have proceeded more slowly than expected and with different outcomes to those initially predicted**. Revisions to our assumptions about the timing and consequences of work-capability assessments in ESA and the reassessment process between DLA and PIP have been the primary factor explaining upward revisions to our incapacity and disability benefits forecasts. The transition to ESA in incapacity benefits is almost complete, which may reduce the future forecast uncertainties. The transition to PIP in disability benefits is still a work-in-progress, so we might expect further significant revisions – up or down – in the future as more evidence becomes available on the outcomes of reassessments and new claims.

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