Is social security spending really out of control?

Acknowledgement

This report is very heavily based on a briefing the TUC commissioned from Declan Gaffney [http://lartsocial.org/], an independent researcher. We are grateful to Declan for his research; responsibility for the views expressed, however, is entirely the TUC's.

Out of control?

One of the Chancellor's favourite claims is that the coalition inherited a benefits budget that was "out of control" and that the government's cuts have successfully restrained spending. In 2010, not long after the election, he told the BBC that spending on benefits was "completely out of control".[1] In his 2012 Budget speech, he warned MPs "the welfare budget is set to rise to consume one third of all public spending. …The next Spending Review will have to confront this."[2]

When the Spending Review came, it turned out that this out of control budget was the justification for the AME Cap:[3]

"We've already capped the benefits of individuals – now we cap the system as a whole. Under that system we inherited, welfare spending was put in a category called Annually Managed Expenditure. But the problem was it wasn't managed at all. The cost of welfare went up by a staggering 50 per cent - even before the crash. Our Welfare Cap will stop that happening again."

"Out of control" social security spending is at the heart of three important government arguments. It is used:

- as evidence by the current government that the last government mismanaged its finances;
- to show that social security cuts and the Annually Managed Expenditure cap are needed;
- to suggest that the current government can bring social security under control, make difficult decisions and achieve important successes.

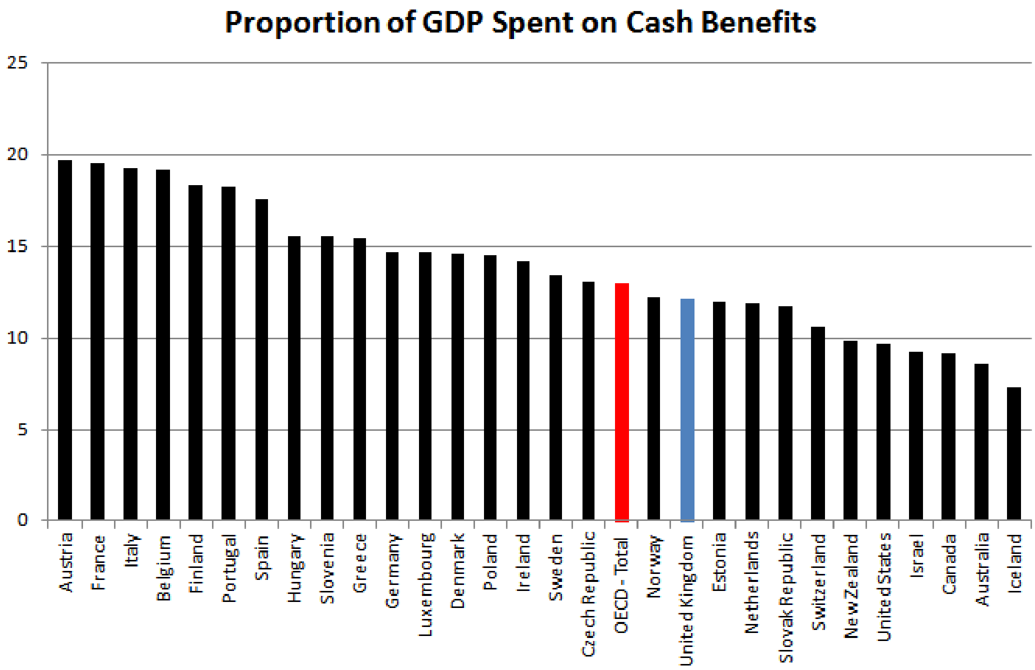
All these claims are weakened if social security spending is not, in fact, out of control.

An international comparison

If UK spending on benefits is out of control, this chart suggests that it is in good company. The data, taken from the OECD social expenditure database, is for the proportion of GDP spent on public cash benefits.[4] The UK is well below the highest-spending countries; in fact, slightly below the OECD average.

The evidence

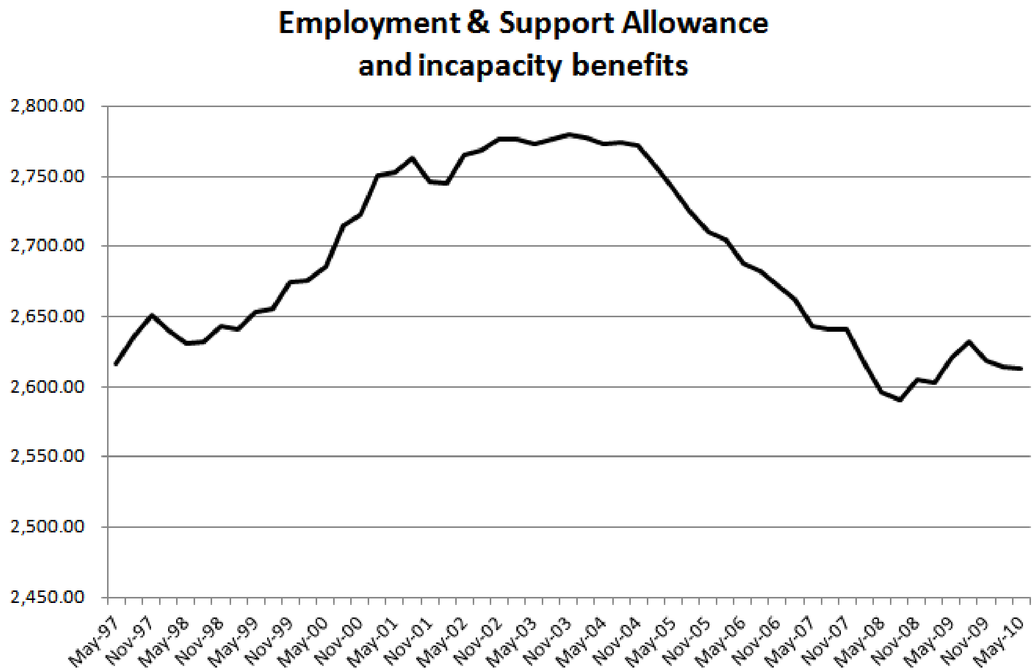
Given the fact that Ministers and newspapers talk so much about the last government's failure to control social security, one might imagine that the numbers on benefits grew substantially during this period. It is certainly true that the number of pensioners grew: the number receiving State Pension rose from 10,536,000 in 1996/7 to 12,410,000 in 2009/10.[5]



But this is not usually the focus of criticism. Critics commonly emphasise something that did not, in fact, happen: an alleged increase in the number of working age people on key benefits. As the table below shows, the number of people on all of the main working age benefits reduced between May 1997 and May 2010. Given the impacts of the recession on benefit claims from 2008, and the increase in the population over this time, this should be presented as a remarkable success:[6]

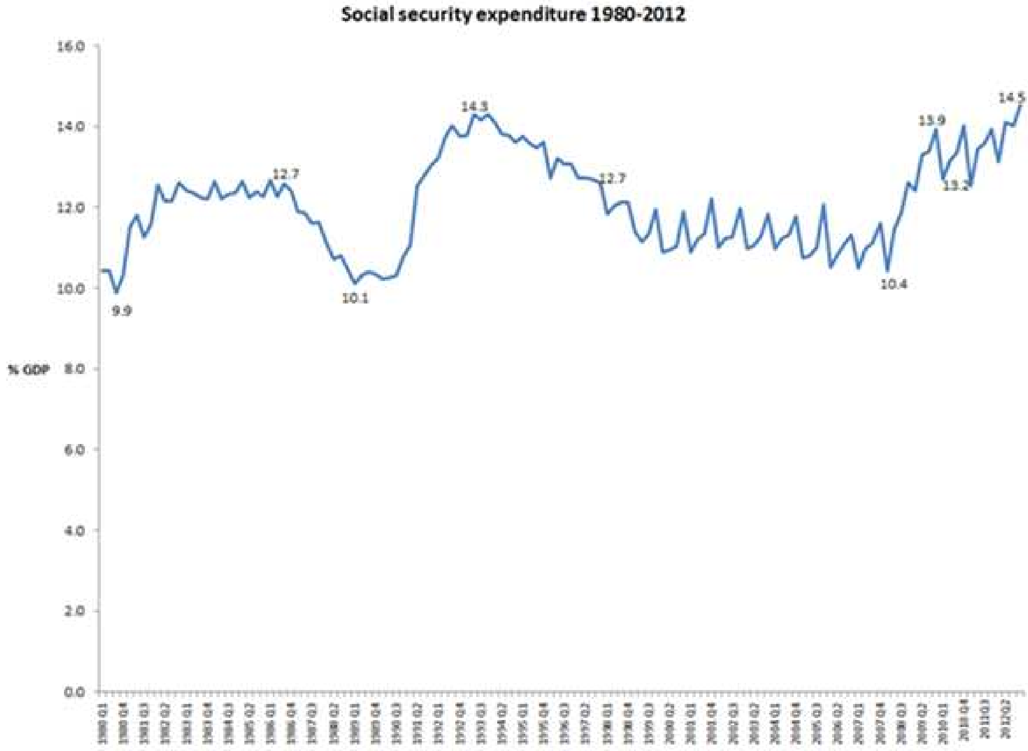
	Jobseeker's Allowance	ESA and incapacity benefits	Lone Parents on Income Support	Other
May-97	1,619.60	2,616.30	1,014.20	256.20
May-10	1,487.50	2,613.10	679.15	192.19
Change	- 132.10	- 3.20	- 335.05	- 64.01

A modified version of the "social security out of control" story is that the last government failed to control incapacity benefits for working age people, letting thousands waste their lives, instead of pressing them to get jobs. But if we look at the numbers claiming these benefits this story falls apart too:[7]



What *is* true is that the amount spent on benefits has grown over the years. In 2012-13, the UK spent £217.6 billion; even if we measure spending in 2012-13 prices, this is still a significant increase from £148 billion in 1996-97.

But this does not mean that spending is out of control: except during recessions, the economy grows, typically in this country by two to two and a half per cent a year. Social security spending will only be unaffordable – be "out of control" - if it continually grows at a faster rate than this. This did not happen for most of the last government's time in office – as the following chart shows social security expenditure fell as a proportion of GDP until the recession:[8]



In the final years of the Major government and the first few years of the Blair government, social security spending as a proportion of GDP fell. It then fell at a much slower rate until the onset of the global recession. Spending on social security rose sharply during the recession – as it is supposed to do. What is perhaps more worrying, is the fact that spending as a proportion of GDP has started to rise again during a period when a government has declared that bringing it down is one of their central objectives.

The current government's failure to control spending

In the last quarter of 2012, social security expenditure reached 14.5 per cent of GDP. This broke a record set by the Major government in the third quarter of 1993, when it reached a post-war peak of 14.3 per cent. It is possible to make too much of one quarter's data, but the government has made cutting 'welfare' a centrepiece of its programme. This increase can hardly be attributed to structural problems built up under its predecessor - as the chart shows, spending was remarkably stable over most of Labour's time in office apart from seasonal fluctuations.

In fact, social security expenditure in 2012/13 as a whole comfortably exceeded the levels set out in the 2010 spending review, and will do so again in 2013/14 and 2014/15. In 2010, the Chancellor made a great deal of the fact that welfare had been brought within the spending review process, as if this in itself ensured government control of spending.

In fact, by the end of the current spending review period in 2014/15, social security spending measured on a consistent basis will be more than £9 billion higher than set out in 2010. An unanticipated increase in CPI inflation explains only a small part of this departure from plan: other forecast errors, both for the general economy and for specific benefits, have played the major role.

The rest of this briefing looks first at the forecasts for total spending on social security, including tax credits, in 2010 and 2013; then at errors in forecasts for some of the major benefits; and finally at the economic forecasts.

The table below[9] shows how forecast expenditure in nominal terms - without adjusting for inflation - changed between the 2010 spending review and the 2013 budget.

The picture is complicated by the fact that Council Tax Benefit was abolished this year and is being replaced by schemes provided by local authorities. This means that CTB was included in the 2010 forecasts for social security up to 2014/15 but is excluded from the 2013 forecast from this year. Forecasting a fall in spending because of this re-classification is misleading.

Excluding CTB, the government spent £6.4 bn (in nominal terms) more than planned in 2012/13 and will be spending £9.4 bn and £9.2 bn more this year and next year, if these forecasts prove more reliable than previous ones. In percentage terms, nominal spending will be 5.2% higher than planned by 2014/15.

Social security and tax credit expenditure forecasts

			£ billion	
Source		2012-13	2013-14	2014-15
OBR Dec 2010	Total	203.5	202.8	207.6
OBR Mar 2013	Total	210	207.9	212.4
Difference	Total	6.5	5.1	4.8
		2012-13	2013-14	2014-15
OBR & DWP Dec 2010	Total excl. CTB	198.68	198.47	203.19
OBR & DWP Mar 2013	Total excl. CTB	205.08	207.90	212.40
Difference	Total excl. CTB	6.39	9.43	9.21
Difference explained by	Inflation exceeding forecast	1.74	1.39	0.66
	Other	4.66	8.04	8.55
Difference	As % 20210 forecast, excl. CTB	3.7%	5.5%	5.2%

The unexpected rise in inflation from 2011 is playing a role here, but, as this briefing has shown, the difference in inflation expectations explains only part of the difference between forecasts: spending would still be £8bn higher than expected in 2013/14 had inflation been correctly forecast. Most of the difference is explained by unrealistic forecasts for the main DWP benefits and tax credits:[10]

Main social security benefits: difference between 2010 and 2013 forecasts

			£ billion
	2012-13	2013-14	2014-15
State pension and pension credit	1.2	1.3	0.4
Housing Benefit	1.8	2.4	2.5
Incapacity Benefit/Employment and Support Allowance	1.9	1.9	1.7
Jobseeker's Allowance	0.7	1.1	1.5
Income Support	0.7	-0.1	-0.2
Tax credits	1.2	1.6	2.6

Spending on state pensions (offset by changes in pension credit spending) was over a billion higher than planned in 2012/13. This appears to be due to differences in demographic modelling between the forecasts.[11] The 'triple-lock' on pensions, meaning that entitlements will rise with the highest of earnings, prices or 2.5% is thus going to cost more than expected.

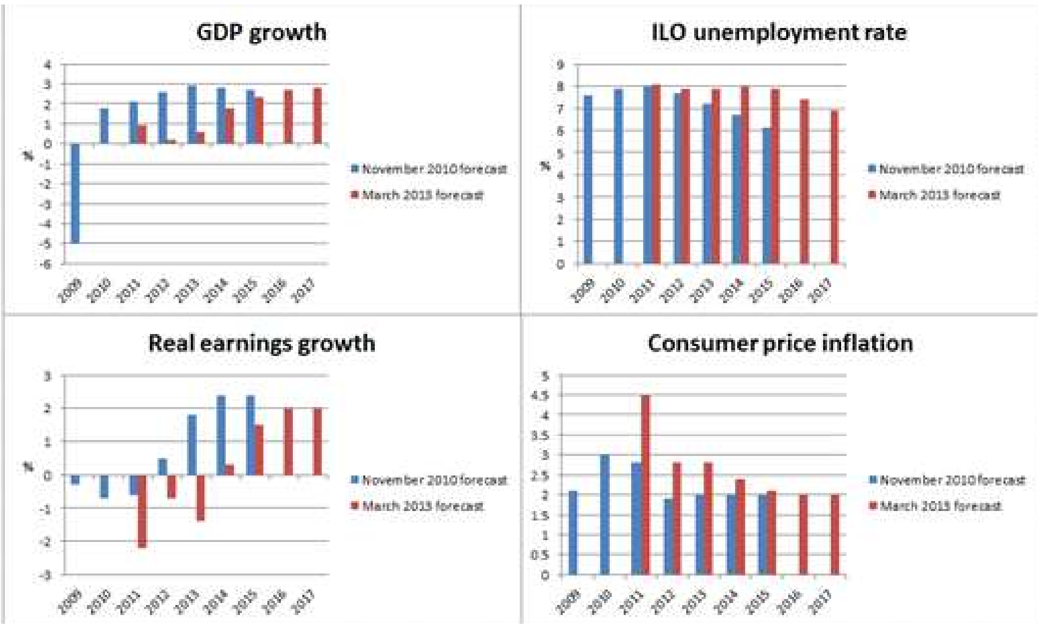
Over-optimistic expectations on employment in 2010 largely explain why JSA spending was £700m higher than planned in 2012/13 and is set to rise to £1.5bn above plan by 2014/15.

More strikingly, two of the benefits the coalition singled out as exemplifying undisciplined spending under Labour are spectacularly above planned spending levels. Housing benefit cost £1.7 bn more than planned in 2012/13, and the departure from planned spending levels will increase this year and next year: by the end of the current spending review period, spending will be £2.5bn higher than planned. Falling real wages are the main explanation, as most of the increase in the housing benefit caseload since 2010 comes from working families. And Incapacity Benefit and its successor Employment Support Allowance were £1.9bn over target in 2012/13. This seems to be due to DWP over-estimating the proportion of claimants who would be found 'fit for work' and thus denied these benefits.[12]

Looking at the economic expectations on which the 2010 plans were partly based, those who said at the time that the coalitions – and the OBR - were being excessively optimistic have been proved right. By 2012, on the 2010 forecasts, we should have been seeing rising real wages and GDP growth of 2.6%. Instead, we saw wages continuing to fall and growth of next to zero.

On the revised expectations in the 2013 forecasts, the drivers of working age benefit expenditure will not be going away. Earnings are forecast to fall by a further 1.4% in 2013, and unemployment is set to stagnate to 2015.

Spending review 2010 and Budget 2013 economic forecasts compared[13]

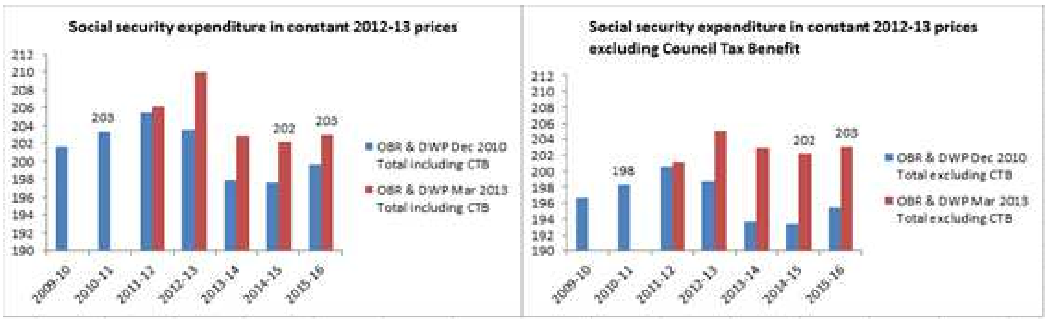


The departures from planned expenditure levels are mainly explained by two different types of forecast error. On the one hand, economic forecasts proved to be wildly out, with the result that cyclical factors (notably falling real wages) pushed back against the expenditure-reducing measures adopted in 2010 and later budgets: hence higher spending on JSA, housing benefit and tax credits. This illustrates the lack of realism in assuming that benefits which are contingent on earned income and employment status can be ‘planned’ in times of economic uncertainty.

At the same time, pensions and IB/ESA proved more costly than expected because of faults in the modelling. In the case of IB/ESA, it seems that the DWP extrapolated from early results for the new assessment process. These quickly proved to be an unreliable guide to future caseloads as a large percentage of decisions were overturned on appeal - a case of modelling based on inadequate data.

For pensions, there seem to have been problems with the demographic modelling.

So attempts to plan welfare spending are vulnerable to economic developments but also to data and modelling limitations that will be a risk whatever is going on in the economy.[14]



Is benefit spending out of control? Given it fell as a proportion of GDP is hard to maintain the claim that the last UK government was particularly bad at managing benefit spending.

And with regard to the cyclical component of spending, rises in spending over levels the current government planned are almost inevitable as real incomes decline, even given over deeper cuts in entitlements. The cost is hardly excessive given the economic circumstances, but it does raise the question of whether some of this additional expenditure could have been put to better use in employment-creating programmes has the economy been better managed.

There has been a real issue about the current government's forecasts of social security spending. But, rather than saying welfare is out of control, it seems more appropriate to say that the macro economy and labour market have slipped out of the government's control - and that working age social security spending has risen as a result.

As for the modelling errors that affected non-cyclical spending, these are a risk for any attempt to plan demand-led expenditure and are hardly of a scale to justify big words.

However, expenditure is arguably out of control in the government's own terms. In his spending review statement in 2010, the Chancellor said:

"We will ... be seeking substantial savings from the rest of the £200 billion benefit bill.... As I said in June, the more we could save on welfare costs, the more we can continue other, more productive areas of government spending."

We have seen that it is only because of the exclusion of Council Tax Benefit from the social security figures from 2013/14 – a development in the reporting of the statistics which only happened at the end of 2012 – that the government can claim to have reduced welfare spending in real terms over its time in office. Apart from this classification change, total social security expenditure is forecast to be £4bn higher in 2015/16 when the coalition leaves office than in 2010/11 when it arrived.

The government has certainly cut social security. It has not reduced social security expenditure.

Notes

[1] "Welfare spending to be cut by £4 bn, says George Osborne", BBC news website, 9-9-10, http://www.bbc.co.uk/news/uk-politics-11250639

[2] http://www.guardian.co.uk/uk/2012/mar/21/budget-speech-2012-full-text

[3] https://www.gov.uk/government/speeches/spending-round-2013-speech

[4] http://stats.oecd.org/Index.aspx?datasetcode=SOCX_AGG# We could instead have used the figures for public and mandatory private cash benefits, but the most recent figure for the UK is for 2009; the relative position of the UK is not significantly altered.

[5] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/222845/expenditure_tables_Budget_2013.xls

[6] Figures taken from http://83.244.183.180/100pc/wa/oowb/oow_Nov12.xls JSA figures are claimant count, UK, seasonally adjusted, "Others" are Pension Credit and Income Support claimants not included in the other columns.

[7] Source: as for previous table.

[8] Public sector finances supplementary tables, ONS, series ANLY

[9] OBR *Economic and fiscal outlook* and DWP *Benefit expenditure tables,* December 2010 and March 2013 editions

[10] OBR Economic and fiscal outlook and DWP Benefit expenditure tables, December 2010 and March 2013 editions. Tax credits exclude company tax credits included in OBR data from 2011-12.

[11] OBR 2013

[12] OBR 2010, 2011

[13] OBR Economic and Fiscal Outlook December 2010, March 2013

[14] OBR Economic and fiscal outlook and DWP Benefit expenditure tables, December 2010 and March 2013 editions.