Office for
Budget
Responsibility

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Chair, Work and Pensions Committee
House of Commons
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7 July 2021

RE: DWP 2021-22 Estimate

Dear Stephen,

Thank you for your letter dated 23 June in relation to the DWP 2021-22 Estimate and our UC forecast. We have co-ordinated a response with DWP to ensure an appropriate response on each of your questions and we have answered questions 2, 4, 5 and 6 below.

2. The OBR has assumed that unemployment will rise from 5.1% to 6.5 % in Q4 of 2021 (Welfare Trends, para 3.5). What assumptions have been made about the numbers of furloughed jobs which will be lost when the furlough scheme ends?

Our unemployment forecast reflects judgements about the pace of economic recovery and the degree to which the shortfall in output relative to its pre-pandemic trend will be reflected in unemployment versus other factors (like lower productivity or fewer average hours worked). As such, our latest forecast does not include an explicit assumption about the number of furloughed jobs that will be lost when the scheme ends. In our March 2021 *Economic and fiscal outlook* (*EFO*), we projected employment to fall by around 250,000 at the point at which the CJRS ends and that the furlough caseload would have fallen to 2.0 million by September. In our July 2020 *Fiscal sustainability report* (*FSR*), we discussed potential impacts of the ending of the furlough scheme in more detail (in paragraphs 2.42 and 2.43, which are copied below for convenience). At that time, we assumed 15 per cent of the furlough caseload would flow into unemployment as the scheme closed (at what was then a much earlier date).

"Each scenario assumes that the number of workers on the CJRS will decline broadly in line with the recovery in output until the scheme closes in October 2020. This leaves more people on the CJRS at that point in our downside scenario (5.1 million) than in the central and upside scenarios (4.6 and 4.2 million respectively). But in all three, prospects for employment and unemployment will be heavily influenced by what happens to furloughed workers once the CJRS is closed. There is limited evidence on which to draw here. A survey conducted for the Resolution Foundation found that 11 per cent of furloughed workers are confident that they will be laid off when the scheme closes and a further 14 per cent thought that was fairly likely. Some have argued that job losses could be even greater. For example, Professor Paul Gregg of the University of Bath suggests that "there will be an intensely concentrated volume of job shedding in September" (ahead of the scheme closing in October due to statutory requirements relating to large-scale redundancies).

Our scenarios invoke some broad assumptions on the proportion of those on the CJRS that move into unemployment, rising from 10 per cent in the upside scenario (roughly the minimum suggested by the Resolution Foundation survey) to 15 per cent in the central scenario and 20 per cent in the downside. So unemployment continues to rise and employment to fall beyond the second quarter, despite output recovering. In our upside scenario, the unemployment rate peaks in the third quarter at 9.7 per cent, and employment recovers relatively quickly alongside output. In our central scenario, the rate peaks in the fourth quarter– as the CJRS ends – at 11.9 per cent. And in our downside scenario, it continues to rise until the first quarter of 2021 when it peaks at 13.2 per cent."

4. How did the OBR arrive at the figure of 300,000 extra claimants of incapacity benefits (Welfare Trends, para 3.5)?

This relatively broad-brush initial judgement on the lasting impact of the pandemic on incapacity benefits is outlined in more detail on paragraph 3.97, bullet 3 of our November 2020 *EFO* (copied below). Our estimates are based on the historical experience of previous recessions. Given the unique nature of this recession and other factors, this assumption is particularly uncertain.

"We have included an explicit assumption about the lasting effect of the pandemic on ***labour market inactivity*** *and associated claims of incapacity-related benefits. This raises our forecast for UC cases with a 'limited capability for work-related activity' and for 'new style' employment and support allowance (ESA) by around 300,000. This effect builds up steadily to add £3.2 billion to UC and ESA spending in 2024-25 relative to the FSR. (This also affects disability benefits spending, as set out below.) This broad-brush assumption is very uncertain and will be refined over time. Historical experience in the aftermath of previous recessions has varied – inactivity rose by less than this in the period after the financial crisis, but by significantly more in the five years following the 1990s recession. Neither recession was precipitated by a public health crisis, which could clearly have more lasting health effects on the population."*

5. How do the OBR's forecasts take account of this increase in fraud and error?

The latest levels of fraud and error (F&E) within Universal Credit are captured in our forecasts implicitly rather than explicitly. This reflects the fact that monthly spending outturns provide the most timely data from which to start our UC spending forecast. These outturns reflect whatever rate of F&E is occurring in real time, without that F&E actually being observable in real time – instead, estimates of F&E and the amounts that would have been spent in the absence of F&E are only available with a longer lag. This means that a determinant-based forecast like ours will capture the latest F&E rates and trends implicitly, including any changes that have happened between the period covered by the most recent official estimate of F&E and the latest monthly spending outturns. We therefore only include explicit F&E judgements where we expect the rate to change in the future.

In our March forecast we were still forecasting UC in two parts, with an underlying forecast overlaid by assumptions about the pandemic-related cases (as we outlined in the *Welfare trends report*). At this stage, we have not made an explicit assumption about the relative importance of F&E versus other factors in driving the rise and subsequent fall of that pandemic-related spending. We will consider this breakdown again alongside other new information that will become available ahead of our next forecast in the autumn. If at that time it looks like an explicit F&E assumption will help us to produce a more central forecast, we will be able to add one.

6. How will OBR and DWP be monitoring and reviewing the forecasts against actual spending to identify areas where the forecasting model can be further refined and improved for the future? What role does DWP have in assisting the OBR in its preparation of forecasts involving Universal Credit caseload and expenditure?

DWP's analysts undertake much of the data monitoring and forecast modelling on our behalf (and from our perspective have performed admirably on both during the pandemic). The OBR's role is to scrutinise their work, to steer some of it towards the forecast issues that we consider most important, and ultimately to determine how the results of this work should affect our medium-term forecasts. The forecast models that underpin our UC and wider working-age welfare spending forecasts – and more importantly the data and assumptions fed into them – will inevitably be subject to greater uncertainty than usual over the coming months as the labour market adjusts to the withdrawal of the unprecedented fiscal support that has been in place since last year. In the light of this, we have placed considerable weight on continuing discussions between DWP analysts and ourselves on latest developments and how they can best be reflected in the DWP models that are used to produce our forecasts.

Yours sincerely

Richard Hughes
Chairman

Department for Work & Pensions

From the Permanent Secretary

Peter Schofield CB
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Rt Hon Stephen Timms MP
Chair, Work and Pensions Select Committee

6 July 2021

Dear Stephen

Thanks for your letter on the 23rd June regarding the DWP 2020-21 Main Estimates. In your letter you asked a number of questions; I have provided an answer to all of these apart from your questions *2, 4 and 5,* which will be answered separately by the Office for Budget Responsibility (OBR).

Question 1
What is the very latest forecast on UC spending for 2021-22 showing? How have assumptions underlying the March 2021 OBR forecast changed since the March 2021 *Welfare trends* report, and what is driving those changes?

DWP's latest medium-term UC forecast remains the one published at Spring Budget 2021 and used in the March 2021 Welfare Trends Report which forecasts £41bn expenditure on UC in 2021/22.

Although the UC caseload in the first few months of 2021 was higher than our expectations at Spring Budget 2021 (4.4 million in February compared with 4.1 million), more recent economic and financial data, including unemployment being below the OBR's forecasts, is consistent with the forecasts moving towards the assumptions in the Spring forecasts for UC. A new forecast will be available in the autumn that will capture this new data, alongside any policy changes and new economic determinants.

At the time of the Spring Budget 2021 forecasts, where UC data was available until November 2020, the OBR and DWP agreed:

- The UC caseload was expected to largely remain relatively flat over the first 6 months of 2021, rising from 4.1m households in-payment (January) to 4.2m (June).
- The UC caseload was then expected to increase, as the OBR's unemployment forecast peaked, in the last 6 months of 2021.
- UC expenditure was expected to follow a similar trend to caseload over the year

There is around a two-month lag in reports of UC monthly expenditure and data on the number of households in payment, so we have limited data to assess how UC expenditure for 2021-22 compares to our forecast but we continue to monitor closely.

Question 3
What impact will the delay to full re-opening planned for 21 June have on UC spending?

We have made no formal assessment of any impact but continue to monitor developments in the labour market; as set out in response to question 1, recent data has been broadly in line with Spring Budget 2021 expectations and unemployment is currently lower than forecast by the OBR at Spring Budget 2021.

Question 6

How will OBR and DWP be monitoring and reviewing the forecasts against actual spending to identify areas where the forecasting model can be further refined and improved for the future? What role does DWP have in assisting the OBR in its preparation of forecasts involving Universal Credit caseload and expenditure?

As set out in the Memorandum of Understanding[1], DWP provide forecasts of benefit payments to the OBR basing these on economic determinants provided by the OBR and the judgements and assumptions of the OBR's Budget Responsibility Committee[2].

Within DWP, we regularly monitor our expenditure and caseload forecasts using the latest information, and inform the OBR of any deviations. We work closely at a working-level, having regular discussions on priorities, latest data/trends, and supporting additional asks to ensure the OBR have the right information to assist their judgement. In addition, DWP, HMRC, HMT and OBR regularly hold meetings to discuss and agree:

- Latest trends, information, and analysis of Universal Credit
- Model development and prioritisation plans
- Areas of interest or emerging risks

Question 7

For each legacy benefit (including tax credits), please specify the volume of claims that have transferred to UC in 2020/21 and are forecast to transfer in 2021/22 through natural migration prompted by a change of circumstances related to the pandemic. Please also specify the impact of these additional volumes on forecast UC spending in 2021/22.

As we explained to the previous Work and Pension Select Committee's enquiry into Natural Migration we are not able to estimate the underlying causes of natural migrations, including how many were caused by the pandemic itself. Our modelling infrastructure for Universal Credit is integrated between legacy benefits (including Tax Credits) and UC forecasts, this ensures that reductions in the number of legacy cases from natural migrations lead to an increase in the number of UC cases.

Yours sincerely

Peter Schofield CB

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[1] https://obr.uk/docs/dlm_uploads/obr_memorandum040411.pdf

[2] https://obr.uk/docs/dlm_uploads/In-year_fiscal_forecasting_and_monitoring_2.pdf

Work and Pensions Committee

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From the Chair

Peter Schofield,
Permanent Secretary,
Department for Work and Pensions

Richard Hughes,
Chairman,
Office for Budge Responsibility

23 June 2021

Dear Peter and Richard,

DWP 2021-22 Estimate

The Committee has recently considered the DWP's latest Estimate memorandum, which accompanied the publication on 13 May of the DWP's 2021-22 Main Estimate.

In particular, we noted the increase of 9.5% in the Universal Credit (UC) spending forecast, taking spending from £37.7 billion in 2020-21 to an expected £41.2 billion in 2021-22, as set out in Table 9 of the memorandum. We note that this mirrors the forecast by the Office for Budget Responsibility in its March 2021 *Welfare Trends* report (Chapter 3, Table 3.1).

The Committee has a number of questions for both DWP and the OBR about the forecasts for Universal Credit spending which have been made for 2021-22 and beyond. We would be grateful if you could co-ordinate a response to us to the following questions:

1. What is the very latest forecast on UC spending for 2021-22 showing? How have assumptions underlying the March 2021 OBR forecast changed since the March 2021 *Welfare trends* report, and what is driving those changes?

2. The OBR has assumed that unemployment will rise from 5.1% to 6.5 % in Q4 of 2021 (Welfare Trends, para 3.5). What assumptions have been made about the numbers of furloughed jobs which will be lost when the furlough scheme ends?

3. What impact will the delay to full re-opening planned for 21 June have on UC spending?

4. How did the OBR arrive at the figure of 300,000 extra claimants of incapacity benefits (Welfare Trends, para 3.5)?

Levels of fraud and error within Universal Credit are estimated to have risen by more than 50% in the last year to 14.5% of UC spending.

5. How do the OBR's forecasts take account of this increase in fraud and error?

The OBR highlights risks and uncertainties inherent in its forecasts in the Welfare trends report (paras 3.18 to 3.22). Some of these are a consequence of the unprecedented circumstances of the pandemic, and a lack of a past track record of patterns of spending for Universal Credit.

6. How will OBR and DWP be monitoring and reviewing the forecasts against actual spending to identify areas where the forecasting model can be further refined and improved for the future? What role does DWP have in assisting the OBR in its preparation of forecasts involving Universal Credit caseload and expenditure?

The OBR's March 2021 analysis also says that the early stages of the pandemic led to an increase in the number of 'natural migrations' to UC from legacy benefits and that this has reduced anticipated 'managed migration' volumes by 50,000. I presume that these additional natural migrations have been taken into account in DWP's spending estimates for UC for 2021/22.

7. For each legacy benefit (including tax credits), please specify the volume of claims that have transferred to UC in 2020/21 and are forecast to transfer in 2021/22 through natural migration prompted by a change of circumstances related to the pandemic. Please also specify the impact of these additional volumes on forecast UC spending in 2021/22.

I look forward to hearing from you.

Yours sincerely,

Stephen Timms

Rt Hon Stephen Timms MP
Chair, Work and Pensions Committee