HOUSE OF COMMONS LIBRARY

BRIEFING PAPER

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The welfare cap

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Summary

The welfare cap is a limit on the amount that government can spend on certain social security benefits and tax credits. The cap aims to better control spending in an area that can be difficult for government to control.

The cap included 56% of total welfare spending in 2015/16. It excludes pensions and Jobseekers' Allowance, but includes tax credits, child benefit and disability benefit.

The cap was first introduced in Budget 2014[1] and the Office for Budget Responsibility (OBR) – the UK's fiscal watchdog – first reported on whether the cap had been met or exceeded alongside Autumn Statement 2014. The operation of welfare cap is laid out in the Charter for Budget Responsibility – the document that sets out the Government's policy and targets for the public finances.

The Government revised its approach to the welfare cap in Autumn Statement 2016. The new approach, agreed by a vote in the House of Commons, means that spending on welfare must be within the cap and a 3% margin in 2021/22. The cap will only be formally assessed at the first Budget or first fiscal update of each new Parliament. The previous approach saw the OBR make a formal assessment at each Autumn Statement, and the cap applied for each year of the OBR's forecast.

At Autumn Statement 2015 and Autumn Statement 2016 the OBR judged that the previous version of the welfare cap was being breached. A member of the Government had to come to the House of Commons on each occasion to explain why the breach of the cap was justified.

Welfare cap vs. the household benefit cap

The **welfare cap** on specified elements of social security spending is not to be confused with the **household benefit cap** – introduced in 2013 – which limits total household benefits at £500 per week for a family and £350 per week for a single person with no children (subject to certain exemptions). See our note on The Household Benefit Cap (SN06294) for more on this.

[1] HM Treasury, Budget 2014, 19 March 2014, para 1.76, p26

1. What welfare spending is included?

Welfare spending within the scope of the cap and welfare spending outside of the cap are outlined in the following table from Autumn Statement 2016.[2]

56% of welfare spending was included in the cap in 2015/16.

Table B.1: Benefits and tax credits in scope of the welfare cap

In scope	Not in scope
Attendance Allowance	Benefits paid from DEL[1]
Bereavement benefits	Jobseeker's Allowance and its passported Housing Benefit
Carer's Allowance	State Pension (basic and additional)
Child Benefit[2]	Transfers within government (e.g. Over 75s TV licences)
Christmas Bonus	Universal Credit payments to claimants subject to full conditionality and on zero income
Disability Living Allowance	
Employment and Support Allowance	
Financial Assistance Scheme	
Housing Benefit (except HB passported from JSA)	
Incapacity Benefit	
Income Support	
Industrial injuries benefits	
In Work Credit	
Maternity Allowance	
Pension Credit	
Personal Independence Payment	
Personal Tax Credits	
Return to Work Credit	
Severe Disablement Allowance	
Social Fund – Cold Weather Payments	
Statutory Adoption Pay	
Statutory Maternity Pay	
Statutory Paternity Pay	
Tax Free Childcare	
Universal Credit (except payments to jobseekers)	
Winter Fuel Payments	

[1] *These payments are subject to firm spending control through the usual DEL process.*
[2] *Includes Guardian's Allowance.*

2 HM Treasury, *Autumn Statement 2016*, Table B1, p51

2. Autumn Statement 2016: proposed revisions to the welfare cap

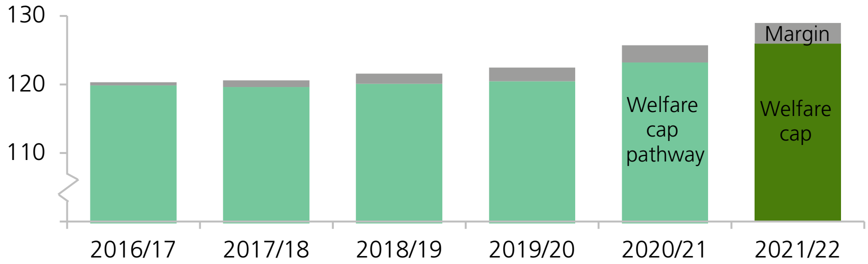
At Autumn Statement 2016 the Chancellor proposed a new target and approach to the welfare cap. The new approach came into force when the House of Commons approved a new Charter for Budget Responsibility (Charter). The Charter sets out the government's objectives and targets for the public finances including the welfare cap.

2.1 What is the target?

The target is for relevant welfare spending in 2021/22 to be within a cap and margin set by the Treasury at Autumn Statement 2016. The margin allows for pressures on, and fluctuations in, relevant welfare spending.

The Treasury has set out the level of the welfare cap in 2021/22 and what margin will be allowed on this.[3] The Treasury has also set out a specific pathway and margin for welfare spending in each year running up to 2021/22. The margin is set as a percentage of either the pathway or the cap.

Welfare cap, pathway and margin £ billion



2.2 When will we know if the cap is met?

The cap will be formally assessed by the Office for Budget Responsibility (OBR) – the UK's fiscal watchdog – at the first Budget or fiscal update of each new Parliament. The cap will only be officially breached in this formal assessment if spending in the designated year is above the level of the cap and margin.

The OBR will monitor welfare spending against the pathway in each of its biannual forecasts leading up to the formal assessment, but this will not constitute a formal assessment of the cap.

2.3 How will the cap be set in future?

The Treasury will set the level of the cap and the year to which it will apply at or before the first fiscal event of each new Parliament. At the

3 HM Treasury. *Autumn Statement 2016*, 23 November 2016, Table 1.6

same time the Treasury will specify a pathway for relevant welfare spending in each year running up to year of the welfare cap.

The Treasury shall also set the percentage margin for the cap and pathway in each year.

If the Treasury wishes to change any of its decisions about the year of the cap, level of the cap, the margin, or the items of spending included in the cap it will require the approval of the House of Commons.

2.4 What happens if the cap is exceeded?

If the OBR's formal assessment shows that the welfare cap is breached, then the Secretary of State for Work and Pensions will either:

- lay a paper before the House of Commons proposing government policy measures which will reduce welfare spending to within the level of the cap; or,
- the Secretary of State for Work and Pensions will explain to the House of Commons why a breach of the welfare cap is considered justified.

A vote will then be held in the House of Commons, normally within 28 sitting days, on the suitability of the Secretary of State's response to the breach.

Box 1: How does the proposed welfare cap compare with the previous version

Section 3 discusses the previous welfare cap. The key similarities and main differences between the current and previous approaches to the cap are summarised below:

- The same welfare spending is included in both approaches.
- The OBR assesses performance against the cap in both approaches.
- The welfare cap only applies in one year – 2021/22 – under the current approach. The welfare cap covered each year of the OBR's forecasts under the previous approach.
- The only formal assessment of the cap, in the current approach, will be made by the OBR in the first Budget or fiscal update of each new Parliament. A formal assessment was made at each Autumn Statement under the previous approach.
- The current approach allows the margin to be used for general pressures on welfare spending, as well as changes in the forecasts. The margin under the previous approach could only be used for volatility and fluctuations in the forecasts.

3. Pre-Autumn Statement 2016: the previous welfare cap

The previous version of the welfare cap was introduced in Budget 2014[4] and the Office for Budget Responsibility (OBR) first reported on whether the cap had been met or exceeded alongside Autumn Statement 2014.

3.1 Setting the previous cap

The Treasury was required to set the level of the cap at or before the first Budget of each new Parliament. At the same time the Treasury would specify a margin above the cap to allow for volatility and fluctuations in the forecast.

The cap was set for a five year period. The Treasury set a cap for an additional year each time the OBR added an additional year to its forecast, so that a five year period was always covered.

If the Treasury wanted to change the list of benefits included in the cap, approval of the House of Commons was required.

3.2 How did we know if the previous cap was met?

The cap was a limit on the amount forecast to be spent, not the actual amount spent.

At the time of each Autumn Statement, the OBR assessed whether the welfare cap was being met in each year of its forecast.

If the forecasts were higher than the cap for any of the years to which the cap applied, then the cap was judged to have been exceeded.

If spending within the scope of the cap was forecast to be above the level of the cap but within a pre-set margin (set at 2% above the cap level), and this was due to forecast changes rather than discretionary policy action, then the cap was not deemed to be breached. The OBR assessed whether any breach was due to forecast changes or policy action.

3.3 What happened if the cap was exceeded?

If the cap was judged to have been exceeded, then the government was to:

- Propose policy measures to reduce welfare spending
- Seek approval for the cap level to be increased
- Explain why a breach of the cap is justified.

A votable motion would follow in the House of Commons within 28 sitting days seeking approval for these actions.

4 HM Treasury, Budget 2014, 19 March 2014, para 1.76, p26

4. OBR formal assessment of previous welfare cap

4.1 Autumn Statement 2014

The welfare cap was initially set in the 2014 Budget. The OBR made its first formal assessment around 9 months later at Autumn Statement 2014.

The OBR assessed that the Government were on course to meet the welfare cap. The OBR's forecast higher welfare cap spending – compared with its forecast at Budget 2014 – in 2015/16 and 2016/17. However, as this was because of forecast revisions and was within the permitted forecast margin the OBR were able to assess that the Government were on course to meet the welfare cap.[5]

4.2 Autumn Statement 2015

Alongside the Autumn Statement 2015, the OBR stated that relevant welfare spending would breach the cap in 2016/17, 2017/18 and 2018/19. The OBR found that relevant spending would observe the cap in 2019/20 and 2020/21. The OBR stated that the breaches were due to the cancellation of proposed changes to tax credits that had been proposed in the Summer Budget 2015.

Note that the welfare cap includes a 'forecast margin' which allows for breaches of 2% when changes to forecast mean relevant welfare spending exceeds the cap.

OBR assessment of welfare spending in cap at Autumn Statement/Spending Review 2015

	2016/17	2017/18	2018/19	2019/20	2020/21
Welfare cap set in Summer Budget 2015	115.2	114.6	114.0	113.5	114.9
Plus 2% forecast margin	117.5	116.9	116.3	115.8	117.2
Forecast welfare spending in cap	119.2	117.7	115.9	115.3	117.1
Cap breached or observed?	*Breached*	*Breached*	*Breached*	*Observed*	*Observed*

Source: OBR, Economic and Fiscal Outlook November 2015, Table 5.3

The 2% margin can only be used for forecast-driven changes to welfare spending

The OBR assessment of performance against the cap by year is set out below:[6]

- 2016/17: Relevant welfare spending will be £4.0 billion above the cap level and £1.7 billion above the forecast margin, so the cap is set to be **breached**.
- 2017/18: Relevant welfare spending will be £3.1 billion above the cap level and £0.8 billion above the forecast margin, so the cap is set to be **breached**.
- 2018/19: Relevant welfare spending will be £1.9 billion above the cap level but £0.4 billion below the forecast margin. However, the OBR judges that the spending above the cap is due to policy decisions and is not driven by forecast changes, and therefore, the cap is set to be **breached**.

5 OBR, *Economic and Fiscal Outlook,* December 2014, para 1.41 – 1.42
6 OBR, *Economic and Fiscal Outlook*, November 2015, pp 192,193

- 2019/20: Relevant welfare spending will be £1.8 billion above the cap but £0.5 billion below the forecast margin. The OBR judges that the cap is set to be **observed** because policy changes actually reduce relevant spending in that year. The technical breach of the cap is the result of classification changes.
- 2020/21: Relevant welfare spending will be £2.1 billion above the cap level but £0.2 billion below the forecast margin. The OBR judges that the cap will be **observed** because policy changes reduce relevant welfare spending, and technical breech is again due to classification changes.

A breach of the cap meant that the matter was debated in the House of Commons, as set out in the Charter for Budget Responsibility:[7]

> If the welfare cap is found to be breached in one or more of the years in which it applies, there will be a debate on a votable motion led by the Department for Work and Pensions, normally within 28 sitting days, giving an assessment of the reasons for the breach. The Department for Work and Pensions will:
>
> - propose government policy measures which will reduce welfare spending to within the level of the cap;
> - seek approval for the level of the welfare cap and/or margin to be increased, along with an explanation of why this is considered to be justified; or
> - explain why a breach of the welfare cap is considered justified.

The following motion was debated in the House of Commons on 16 December 2015:

> That, pursuant to the Charter for Budget Responsibility: Summer Budget 2015 update, which was approved by this House on 14 October 2015, under Section 1 of the Budget Responsibility and National Audit Act 2011, this House agrees that the breach of the Welfare cap in 2016-17, 2017-18, and 2018-19 resulting from the decision not to pursue proposed changes to tax credits, as laid out in the Autumn Statement 2015, is justified and that no further debate will be required in relation to this specific breach. [8]

4.3 Autumn Statement 2016

The OBR assessed new forecasts of spending within the previous cap alongside Autumn Statement 2016. The assessment was carried out, despite the government's proposed revised welfare cap having been announced, because this was the version of the welfare cap included in the latest Charter for Budget Responsibility to be approved by the House of Commons.

The OBR's assessment was that the cap will be breached in each year of its forecast.[9]

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7 HM Treasury, *Charter for Budget Responsibility*, December 2014, para 3.30, p10
8 HC Deb 16 December 2015 c1633
9 OBR, *Economic and fiscal outlook – November 2016*, 23 November 2016, para 5.30

OBR assessment of welfare spending in cap at Autumn Statement 2016

	2017/18	2018/19	2019/20	2020/21
Welfare cap set in Summer Budget 2015	114.6	114.0	113.5	114.9
Plus 2% forecast margin	116.9	116.3	115.8	117.2
Forecast welfare spending in cap	119.6	120.1	120.5	123.2
Cap breached or observed?	*Breached*	*Breached*	*Breached*	*Breached*

Source: OBR, Economic and Fiscal Outlook November 2016, Table 5.3

The 2% margin can only be used for forecast-driven changes to welfare spending

A breach of the cap meant that the matter was debated in the House of Commons. The following motion was debated in the House of Commons on 12 December 2016:

> That pursuant to the Charter for Budget Responsibility: Autumn 2015 update, which was approved by this House on 14 October 2015, under Section 1 of the Budget Responsibility and National Audit Act 2011, this House agrees that the breach of the Welfare Cap in 2019-20 and 2020-21, due to higher forecast inflation and spend on disability benefits, is justified and that no further debate will be required in relation to this specific breach.

5. Public finances background to the cap

Beyond the political arguments for capping spending on welfare, there are fiscal reasons as to why the Coalition Government and current Government have employed a welfare cap.

5.1 Fiscal consolidation

Both the Coalition Government and the current Government have put ensuring the sustainability of the public finances, and reducing government borrowing – often described as the deficit – at the heart of their objectives for manging the public finances.

Controlling spending across government has been a high priority and the cap on welfare spending is one measure that has been taken in order to achieve this.

5.2 Control of public spending

Government spending is classified as either Departmental Expenditure Limits (DEL) or Annually Managed Expenditure (AME):

- DEL is spending which departments have direct control over and includes most elements of predictable spending, such as teacher's salaries, or money used to fund most policy programmes.
- AME is the less predictable elements of expenditure, such as spending on debt interest and spending on social security. All of the spending within the scope of the welfare cap is classified as AME.

Historically, DEL has accounted for a greater proportion of public spending than AME. In recent years this has been reversed; in 2015/16, AME accounted for 53% of total spending. The OBR forecasts that AME may rise to 55% of total spending in 2021/22.

By setting a cap on a significant portion of AME spending it is hoped that it will be easier to control AME spending more easily in the future.

6. Will the cap make any difference?

The welfare cap is set at the level of spending on relevant benefits as forecast by the OBR. So, in order for the cap to be met, spending must simply remain at or below its expected level. This has led some commentators to argue that the cap has "no policy effect."[10]

However, the Institute for Fiscal Studies (IFS) disputes this and has stated that "the cap could reduce future downside risks to public finances."[11] The IFS state that the economic deterioration in 2011/12 increased forecast welfare spending in 2015/16 more than 2% above the level previously forecast. This suggests that another economic deterioration on the scale seen in 2011/12 could lead to the cap as it is currently designed triggering government action.

Another point to note is that the cap increases scrutiny of the relevant parts of the welfare budget, meaning that there is more of an incentive for governments to seek to control these budgets.

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[10] G Cooke, "The coalition's welfare cap puts politics before policy", *New Statesman* [online], 19 March 2014

[11] G Tatlow, "Economy bouncing back more strongly but policy choices have increased long-run risks to the public finances", presentation at IFS Budget 2014 briefing, 20 March 2014

7. Detailed OBR forecast of welfare spending (at Autumn Statement 2016)

Table 4.24: Welfare spending

	£ billion						
	Outturn	Forecast					
			Welfare cap period				
	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Welfare cap							
DWP social security	76.3	76.4	74.9	74.3	75.2	76.8	78.3
of which:							
Housing benefit (not on JSA)[1]	21.8	21.4	21.0	20.8	20.7	21.1	21.5
Disability living allowance and personal independence payments	16.2	16.6	16.7	16.9	17.7	18.3	19.0
Incapacity benefits[2]	15.1	15.0	15.1	15.2	15.5	15.9	16.3
Attendance allowance	5.5	5.5	5.5	5.6	5.9	6.1	6.3
Pension credit	6.0	5.7	5.4	5.1	5.1	5.1	5.1
Carer's allowance	2.6	2.7	2.9	3.0	3.2	3.3	3.5
Statutory maternity pay	2.3	2.3	2.4	2.5	2.5	2.6	2.7
Income support (non-incapacity)	2.4	2.3	2.1	2.0	2.0	2.1	2.2
Winter fuel payments	2.1	2.1	2.0	2.0	2.0	2.0	2.0
Universal credit[3]	0.0	0.6	-0.5	-1.2	-1.7	-2.1	-2.7
Other DWP in welfare cap	2.3	2.4	2.3	2.3	2.3	2.3	2.3
Personal tax credits	28.5	28.0	27.9	27.7	27.3	27.9	28.4
Child benefit	11.7	11.6	11.6	11.5	11.5	11.7	12.0
Tax free childcare	0.0	0.0	0.6	0.8	0.9	0.9	1.0
NI social security in welfare cap	3.4	3.5	3.5	3.5	3.6	3.8	3.9
Paternity pay	0.1	0.1	0.1	0.1	0.2	0.2	0.2
Autumn statement measures	0.0	0.1	1.0	2.2	1.8	1.9	2.4
Indirect effects of Government decisions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare cap[4]	**120.0**	**119.8**	**119.6**	**120.1**	**120.5**	**123.2**	**126.0**
Welfare spending outside the welfare cap							
DWP social security	94.0	96.1	99.2	102.0	104.4	107.3	113.0
of which:							
State pension	89.4	91.5	94.1	96.7	99.1	101.9	107.5
Jobseeker's allowance	2.3	1.9	2.8	2.9	2.9	2.9	3.0
Housing benefit (on JSA)	1.9	1.6	2.2	2.4	2.4	2.4	2.5
Universal credit[3]	0.5	1.0					
NI social security outside welfare cap	2.3	2.4	2.5	2.6	2.6	2.7	2.9
Autumn statement measures	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Indirect effects of Government decisions	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total welfare outside the welfare cap[4]	**96.2**	**98.5**	**101.6**	**104.6**	**107.0**	**110.0**	**115.9**
Total welfare[4]	**216.1**	**218.4**	**221.2**	**224.6**	**227.5**	**233.2**	**241.8**
Memo: welfare cap as proportion of total welfare	*55.5*	*54.9*	*54.1*	*53.5*	*53.0*	*52.8*	*52.1*

[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] Incapacity benefit, employment and support allowance, severe disablement allowance and income support (incapacity part).
[3] Universal credit actual spending for 2015-16 and 2016-17. Spending from 2017-18 onwards represents universal credit additional costs not already included against other benefits (i.e. UC payments that do not exist under current benefit structure).
[4] Total welfare outturn inside and outside of the welfare cap in 2015-16 is sourced from OSCAR, consistent with PESA 2016. For 2015-16 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.

Source: OBR, *Economic and fiscal outlook*, November 2016, Table 4.24

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