Welfare Reform: Why Labour Must Go Further

By Daniel Herring

Summary

- Despite the Government's planned welfare reforms, the OBR is still projecting that spending on health-related benefits will increase by an average of 5.3% a year over the remainder of the 2020s – more than three times the expected GDP growth rate of 1.6%. In the long run this is utterly unsustainable and is already crowding out other vital priorities.

- Today, more than four million working age adults – over 10% of the working age population – receive a disability or incapacity benefit, up from 3.2 million (7.9%) in 2019.

- Labour have correctly acknowledged the scale of the problem and its main source: incentives in the benefits system, which push people towards inactivity and away from work.

- The Government's plans are forecast to cut health-related welfare spending by £4.1 billion by 2029/30. However, this is only a tiny dent in the projected rise. Even if the plans are successful, spending is still set to reach £97.7 billion in 2029/30, up from £66.3 billion in 2023/24.

- This would otherwise be enough to raise defence spending to 2.9% of GDP, or cut Employer's National Insurance by up to three percentage points. As things stand, the UK is forecast to spend 2.8% of GDP on health-related benefits by 2029/30 – up from 2.4% in 2023/24.

- Moreover, the Government's reforms are subject to a lot of uncertainty. Key announcements have not been costed yet, including the removal of the Work Capability Assessment (WCA) and the predicted impact of the £1 billion employment programme. And of course the Government's employment rights package, and increases in business taxation and the minimum wage, will mean it will be significantly harder for welfare claimants to move back into work.

- In particular, four big areas are neglected:

    1. The number of people receiving Personal Independence Payments (PIP) will continue to rise, with no clear plan to bring more objectivity into assessments for health conditions, especially mental health conditions (which are the largest category).

    2. Too many young people are left out of the Government's plans. Ministers are aiming to help those aged 18-21, but there are large numbers of under-30s who could also benefit.

    3. There is a rising number of children getting Disability Living Allowance for mental health conditions, flowing into PIP when they reach 18. This needs to be addressed.

    4. Reforms to the Work Capability Assessment have been cancelled. This might have saved a further £1.6 billion and led to 400,000 people moving off the health element of UC.

Overview

The Government has acknowledged that the UK has a welfare problem. More than four million working-age adults are receiving a disability or incapacity benefit, or 10% of the working age population, up from 3.2 million (7.9%) in 2019.[1] Every week, thousands of people are signing up for long-term health and disability benefits.

Before the reforms were announced, the Office for Budget Responsibility (OBR) estimated that by the end of the decade we would be spending more than £100 billion every year on health-related benefits, representing 2.8% of GDP and more than a quarter of all welfare spending.[2] This would be larger than the amounts spent on education or defence.

In her statement on March 18, the Work and Pensions Secretary correctly identified that the problem was within the welfare system, noting that 'the increase in disability benefits is double the rate of increasing prevalence of working age disability in the country'.[3] That's because of the 'perverse financial incentives… which actively encourage people into welfare dependency'.

Of course, Liz Kendall – like almost all politicians from all parties – has been rather quieter about the other component of the broader increase in welfare spending, namely the ever-higher pensions bill driven by the triple lock. However, for the purposes of this paper we will focus – as the Government is – on the incapacity and disability system.

The first thing to say is that ministers' diagnosis of the problem is the right one, and that many of the policies introduced are welcome.

In particular, reducing the difference between what someone can get on standard Universal Credit (UC) and UC with the health element will improve incentives to keep looking for work.

Furthermore, the introduction of a new contributory benefit, while having only a modest contributory element, may potentially build greater support for the welfare system: as we noted in our report 'Fair Welfare', one of the major causes of popular resentment of the welfare system in the UK is a sense that we have broken the link between claiming and contributing, in a way that has not happened in other countries.[4]

Yet despite all the promising rhetoric, the analysis accompanying the Spring Statement shows that these policies will only lower slightly the upward trajectory for benefits, rather than reversing it. We therefore believe that the current measures should only be the first step.

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[1] DWP, 'Pathways to Work: Reforming Benefits and Support to Get Britain Working Green Paper: Interim Evidence Pack' 18 March 2025. Link. See also S. Ray-Chaudhuri and T. Waters, 'Recent trends in and the outlook for health-related benefits' (31 July 2024). Link

[2] OBR, 'Table 5.10: Total welfare spending', *Economic and fiscal outlook – October 2024* (30 October 2024). Link

[3] Liz Kendall, 'Secretary of State for Work and Pensions speech to the House of Commons on Pathways to Work reform' (18 March 2025). Link

[4] J. Heywood & J. Dupont, 'Fair Welfare', Centre for Policy Studies (September 2021). Link. Note that the time-limited nature of the new contributory benefit means that the support will not last as long as current contributory Employment Support Allowance and Jobseeker's Allowance (neither of which are time-limited).

What will be the impact of Labour's reforms?

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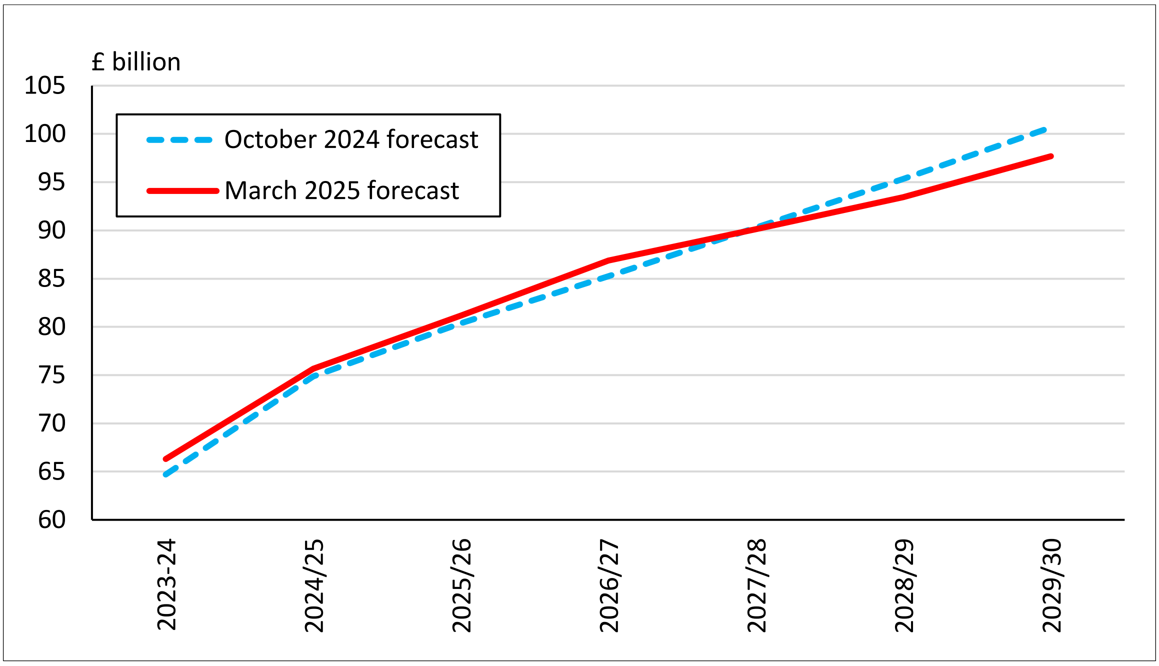
How much will the reforms save? The OBR predicts that as a result of Kendall's plans, spending on disability and incapacity benefit will be £4 billion less by 2029/30. Those savings come primarily from:

- Tightening Personal Independence Payment (PIP) criteria
- Universal Credit (UC) changes, in particular increasing the standard allowance while lowering the health element of UC, and not increasing the health element with inflation

But this £4 billion saving does not mean the welfare bill will actually be lower. The OBR predicts that, by 2029-30, spending on health-related benefits will be £97.7 billion. That is down from the £100.7 billion forecast at the October Budget. But it is still much higher than the £66.3 billion currently being spent, representing an increase from 2.4% of GDP to 2.8%. This is a huge difference – enough to raise defence spending to 2.9%, or cut Employer's National Insurance by up to three percentage points.[5]

OBR projections for spending on health-related benefits



Source: OBR

Of course, this analysis is highly uncertain. The OBR notes that many welfare reforms have saved less than intended in the past, and there are examples where reforms have actually cost the government money. That's because the impact of these reforms is highly dependent on the behavioural response of claimants and assessors – not least because many claimants will seek to find alternative ways to get alternative benefits.

[5] Approximate estimate based on HMRC 'Direct effects of illustrative tax changes bulletin (January 2025)' (28 January 2025). Link

Furthermore, many aspects of these reforms have not been costed. Most notably, officials have not yet produced numbers for the removal of the Work Capability Assessment (WCA) or the new £1 billion employment support package. The removal of WCA will be very consequential in terms of who gets PIP and the health element of UC in the future. And these reforms need to be very carefully designed – in 2017 the Conservative government tried to reform incapacity benefits to reduce their cost, and instead saw large numbers move into economic inactivity.

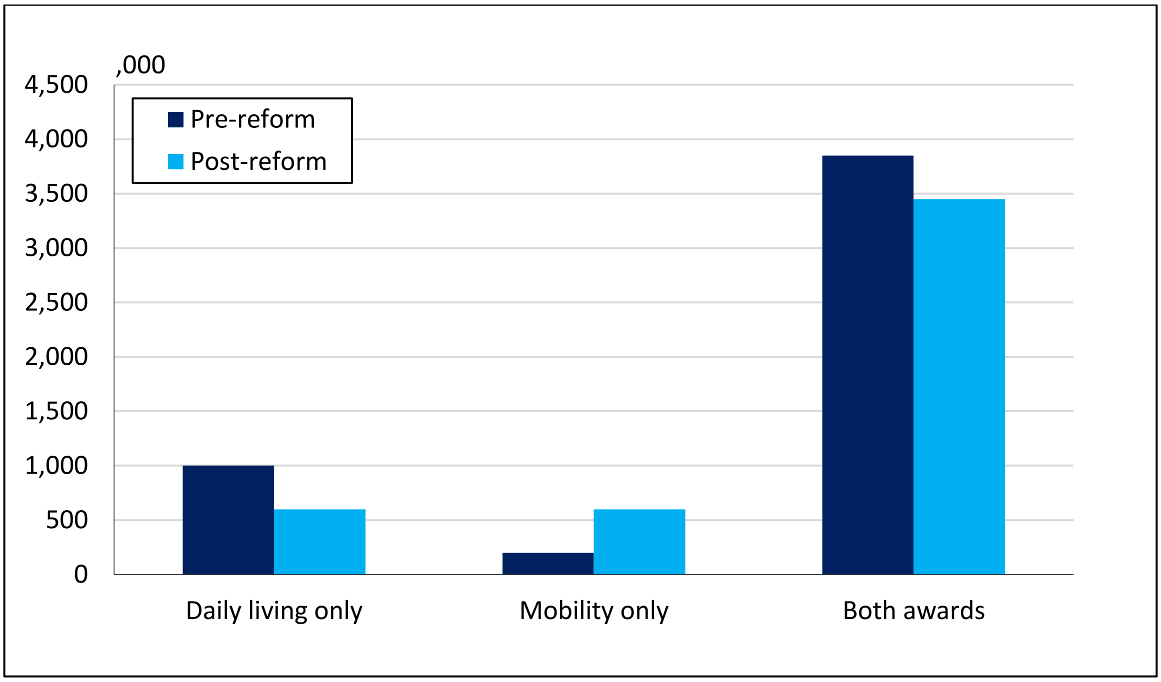
However, even in the best-case scenario, Labour's plans fall far short of reversing the trend and getting significant numbers of people back into work. We outline four areas where Labour's plans fall short.

Where the government's plans fall short

Numbers on PIP will continue to rise

Despite the reforms made, the OBR predicts a continuing rise in the number of people claiming benefits. It assumes that Kendall's plans will cut the number claiming PIP by 400,000 as of 2029/30. However, the OBR still estimates there will be 4.65 million people claiming some form of PIP by that point, up from 3.7 million in January 2025. That's because many of these reforms only tweak the existing rules, and rule out any changes to the mobility component of PIP (mobility-only claims are expected to increase, as per the chart below).

Estimated caseload impact of tightening the qualifying criteria for PIP in 2029-30



Source: OBR

This has an enormous fiscal cost – in real terms, the bill for mobility has risen from £13.2 billion to £25.9 billion in just six years (using today's prices).[6]

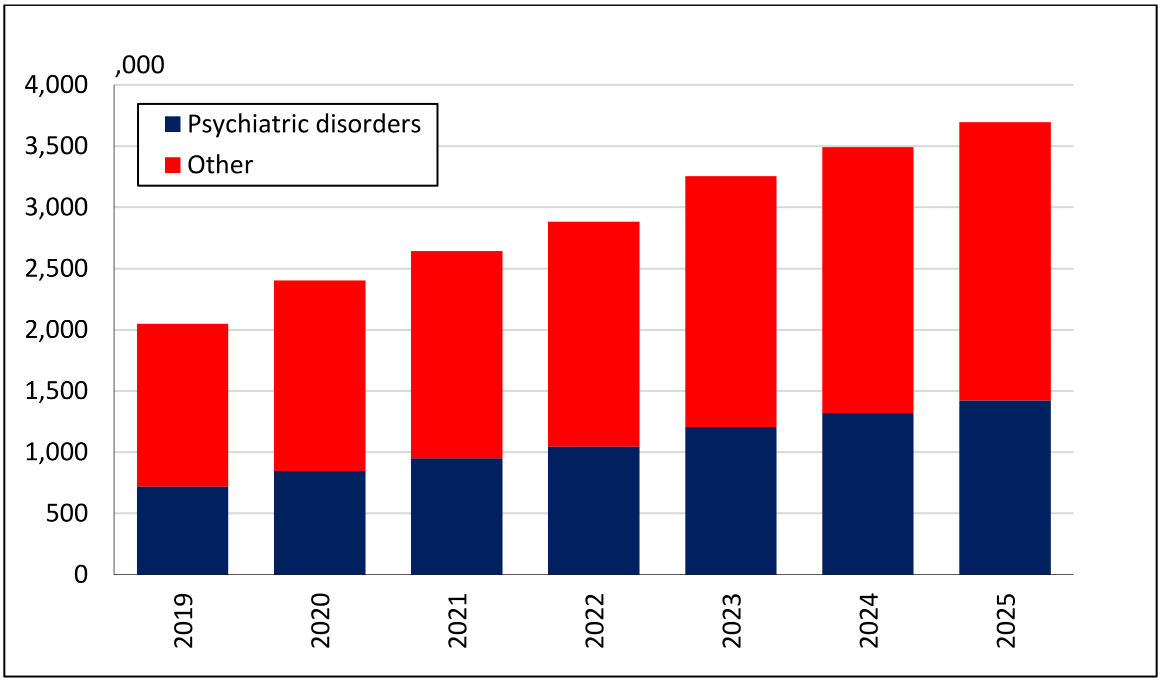
We also don't yet know the impact of the government's review of the PIP assessment, and whether this will lead to more fundamental reform of PIP. The government is reviewing the system, and rightly so. The OBR noted that a significant source of uncertainty in its analysis is the fact that PIP assessments rely heavily on an assessor's judgment of primarily self-reported conditions, rather than just on medical evidence. It cannot be the case that the rising caseload is entirely due to the rise in actual disability. The review of PIP needs to look at the increase in different types of claims.

For example, one of the major issues that needs to be tackled is the large numbers of people receiving PIP for psychiatric disorders – 1.4 million, which is almost double the number in 2019. Of these, 400,000 are getting PIP for mixed anxiety and depressive disorders. Clearly, many of these cases will be genuine. But it is hard to believe that the number of people with these conditions has multiplied quite so quickly.

Of course, PIP is not specifically linked to work. But as Fraser Nelson and others have pointed out, those on the benefit are often reluctant to go back to work for fear of losing access to their benefits. This is a tragedy, not least because, for many, not working due to mental health will only worsen their problems.

We would argue that the new PIP assessment needs be focused on diagnosable medical conditions, especially for mental health. Furthermore, future PIP changes should give funds based on the additional costs actually faced by disabled people, rather than assuming every person (or even that every category of disability) faces exactly the same costs. This is much closer to the approach in other countries.

PIP caseload by year



Source: DWP StatXplore

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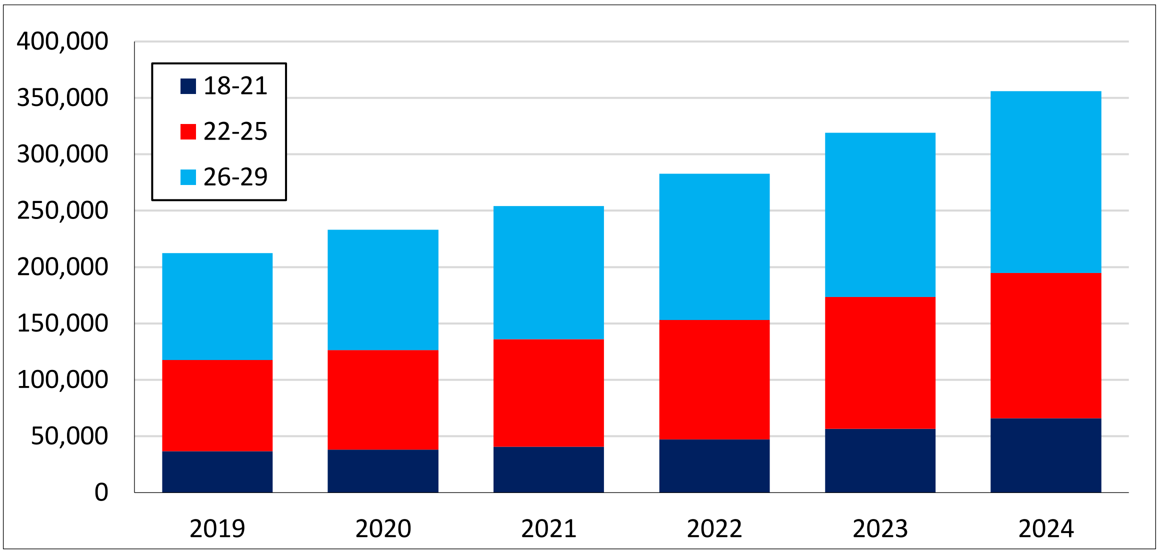
6 DWP, 'Benefit expenditure and caseload tables 2024' (7 March 2025). Link. PIP caseload data for the start of each year.

Too many young people are left out of the Government's reforms

The Government has announced that it is restricting access to the health element of UC to people under the age of 22. This is sensible – the number of young people on the UC health element (and its predecessor, the Employment Support Allowance) has more than trebled since the onset of the Covid pandemic, to the point that there are now almost 65,000 people aged 18-21 on this benefit.

It is important to note that this would not be as punitive as it might appear. The quid pro quo of this policy – the Youth Guarantee – is supposed to mean that every young person can access help to find work and mental health support.

Young people in UC Health and Employment Support Allowance support group, by age[7]



Source: DWP StatXplore

The Government should consider extending this policy to everyone under 25 or even under 30. There are 128,000 people aged 22-25 and 161,000 aged 26-29 that are on the health element of UC. We estimate that returning to the 2019 level of such claims could save the government up to £2 billion.[8] A promising way to do that would be to extend the Youth Guarantee and withdraw the health element from this group also. There is a case for focusing reform and support on younger people as they have a whole working life ahead of them, and intervention now would yield the largest gains – both to individuals and their prospects, and in terms of savings to welfare spending.

A more radical alternative would be to abolish the UC health element altogether, on the basis that an extra costs disability benefit ought to be sufficient in itself. Under current proposals for the abolition of WCA, PIP will become the gateway to UC health, and so we will have people getting two sets of benefits via that single assessment, one means tested and one non-means tested. Abolishing or consolidating the

[7] This is the UC LCWRA and ESA Support Group. Numbers are taken at August each year.

[8] This assumes that person is receiving UC standard allowance (we assumed half were over 25 and half under, so received £393.45 and £311.68 per month respectively), UC health element (£416), and a housing allowance (we chose a value of £403, based on the median value of the housing allowance for a single person). We assume they return to work and stop drawing UC altogether.

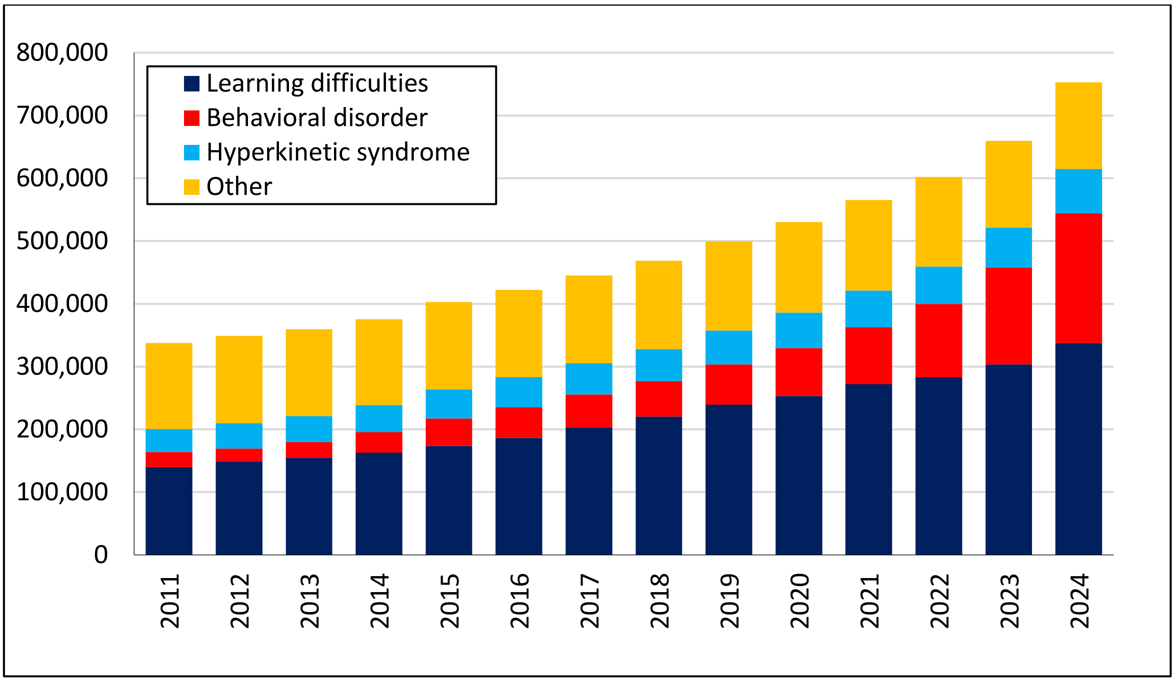
health element of UC would make the welfare system more logical and easier to administer, peeling back some of the complexity that can arise through piecemeal reform.

There has been a dramatic rise in child disability allowance payments

The government is raising the age for transitioning from the Disability Living Allowance (DLA), which is a child benefit, to PIP, from 16 to 18. This is a welcome move. But there is another trend related to the mental health crisis: about half of the successful transitions (where an award is kept the same or increased) are for learning disabilities, which have increased dramatically since 2018. The source of these are higher child DLA claims: indeed, learning difficulties and behavioural disorders are responsible for the entirety of the increase in the caseload.

The Department for Work and Pensions expects that over one million children will be receiving DLA by 2029/30, with the OBR expecting the costs to increase from £3.7 billion to £7.0 billion. This is a higher rate of increase than either working age or pensioner benefits.

Caseload of children on Disability Living Allowance[9]



Source: DWP StatXplore

Not reforming Work Capability Assessment (WCA)

The Government has pledged to abolish the WCA and to determine eligibility for the health element of UC through the PIP assessment. But this will not happen for three years. In the interim, ministers have chosen to cancel the previous Government's proposals to reform the WCA. The OBR and DWP say these reforms could have saved £1.6 billion and led to 400,000 people fewer on the health element of UC.[10]

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[9] DLA caseload data is for August of each year.
[10] DWP, 'Spring Statement 2025 health and disability benefit reforms – Impacts' (28 March 2025). Link

Labour's cancellation of the plans they inherited would be justified if they were planning to get rid of the WCA within the year. But waiting three years means that sensible, pragmatic reforms proposed by the Conservatives will not be implemented.

One of these reforms involved changes to the 'Substantial Risk Criteria', which were designed to be used when not being awarded UC or the health element would lead to a substantial risk of mental or physical harm.[11] These criteria were intended to be used for a small set of sensitive cases. But claimants rapidly grew wise to their existence. In 2023, the previous Government noted that 15% of all UC health claims were under the substantial risk criteria.

The Tories' proposal was to put such people on a less generous benefit, but with enhanced employment support (this category is called 'limited capability to work'). Another big part of the proposed reforms was changing or removing the 'mobilising' activity part of the WCA, so that people with mobility issues could be supported into working from home.

We think these reforms were and are sensible and worthwhile, especially in the interim period before WCA is abolished. They would save the taxpayer money while also helping people back into work.

Conclusion

We welcome the Government's measures to tackle the welfare bill. But they will only have a limited impact on the upward trajectory of welfare spending – and the extent of that impact may be even less than hoped. There is therefore a strong case for bolder action, especially given the myriad economic challenges we face.

Ultimately, a radical rethink of the fundamentals of the modern welfare state is needed, based on the principles of personal responsibility and fairness. People should be rewarded for working, contributing and saving for their own needs, while receiving appropriate support from the state when work becomes genuinely impossible.

The rising welfare bill represents a massive opportunity cost for individuals and for the Government. An additional £30 billion in annual spending could cut taxes, pay off debt, or boost defence spending – all of which contribute to national prosperity. For individuals, the massive welfare bill represents a mountain of wasted potential. If the UK is to have a safe, prosperous and secure future, we must help and incentivise more of these people back into employment.

[11] DWP, 'Work Capability Assessment: activities and descriptors' (22 November 2023). Link