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**Welfare Reform Committee**

# **The Impact of Welfare Reform on the Scottish Labour Market. An Exploratory Analysis.**



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## Welfare Reform Committee

The Impact of Welfare Reform on the Scottish Labour Market. An Exploratory Analysis.  
4th Report, 2015 (Session 4)

# Welfare Reform Committee

To monitor the implementation of the UK Welfare Reform Act 2012 and other social security legislation as it affects provision in Scotland and to consider relevant Scottish legislation and other consequential arrangements.



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# Introduction

1. This report was commissioned by the Welfare Reform Committee. It was produced by Christina Beatty and Steve Fothergill of the Centre for Regional Economic and Social Research at Sheffield Hallam University alongside Donald Houston of the Department of Urban Studies at the University of Glasgow.
2. The report was co-financed between the Scottish Parliament and Sheffield Hallam University.
3. The views expressed are those of the authors.

## Executive Summary

4. This report examines the impact of welfare reform on the Scottish labour market in order to explore whether there is any merit in the claim that welfare reform increases overall levels of employment and reduces unemployment. This is one of the key arguments used to justify welfare reform.
5. Previously published estimates show that when the pre-2015 welfare reforms have come to full fruition they will take £1.5bn a year out of claimants' pockets in Scotland, equivalent to £440 a year for every adult of working age.
6. The report explores the labour market impact of the reforms primarily by taking account of the big variation in the financial losses from place to place across Scotland. If the reforms are having an important impact on the labour market, it should be possible to observe a much greater impact in the places where the reforms have hit hardest.
7. Across Scotland, the places where the financial losses from welfare reform have been greatest have experienced the largest reductions in unemployment (JSA) claimant rates.
8. There is however no evidence across Scotland of an impact on incapacity (ESA) claimant rates, or that welfare reform has resulted in higher levels of employment or higher levels of labour market engagement.
9. On closer investigation it is also apparent that the larger than average reductions in unemployment in the places hit hardest by welfare reform also happened in previous economic upturns. This makes it impossible to attribute recent trends to welfare reform.
10. The recent upturn in the UK economy nevertheless differs from its predecessors in creating higher employment in relation to the modest growth in output. This could mean welfare reform is encouraging low-wage employment but this interpretation is not consistent with the local data.
11. On balance, the evidence in the report provides little support for the view that welfare reform is having important and positive impacts on the labour market in Scotland.



## Scope and purpose of the report

12. Welfare reform has been a defining feature of Westminster government policy since 2010. The reforms apply to Scotland as much as to any other part of the United Kingdom, even though Scotland has found ways to avert the full impact of some of the changes.<sup>1</sup>
13. The Westminster government has justified the welfare reforms on two grounds. First, the reforms reduce public spending and therefore contribute to deficit reduction. Second, the reforms are intended to encourage claimants to find work, or to increase their hours of work, rather than rely on benefits. This second argument – that welfare reform should increase labour market participation and raise employment levels – is the focus of the present study. Are more people now in work in Scotland as a result of welfare reform? Or has welfare reform made little difference to labour market outcomes?
14. The present report builds directly on the shoulders of three previous reports for the Scottish Parliament. These looked at: the financial losses arising from welfare reform to Scotland as a whole and in each of its 32 local authorities<sup>2</sup>, at the financial losses at ward level<sup>3</sup>; and at the cumulative financial losses to different types of households<sup>4</sup>. All these reports in turn drew on a wider body of pioneering research and data at Sheffield Hallam University covering welfare reform across the whole of the UK<sup>5</sup>.
15. The previous reports held all other factors constant. In other words, there was no assumption that any loss of benefit income led to compensating adjustments in the labour market in the form of extra employment or additional working hours. The present report breaks new ground by exploring whether these adjustments have indeed taken place and, therefore, whether the loss of benefit income has been offset in whole or in part by extra income from employment.
16. A number of studies undertaken or commissioned by the Department for Work and Pensions have considered whether specific elements of the welfare reform agenda are having a labour market impact<sup>6</sup>. The present report is however the first attempt, as far as the authors are aware, to examine the cumulative impact of the reforms on the labour market. This is important because a number of reforms are happening simultaneously and many individuals and households are affected by several aspects of the package. It is the cumulative impact of these simultaneous reforms that is most likely to have a labour market impact.
17. Furthermore, the present report focuses on the impact on the labour market as a whole rather than on the changes in individuals' labour market behaviour. This is important because the decisions and behaviour of individuals are likely to interact. An unemployed person who finds work may do so at the expense of another, who remains unemployed instead. Likewise, an existing employee who is successful in increasing their hours may do so at the expense of another member of staff.

18. What matters most in understanding the labour market impact of welfare reform is not whether individuals' behaviour has changed but whether the labour market as a whole shows improvement. Has welfare reform reduced unemployment? Are more men and women engaged with the labour market because of the reforms? And most crucially of all, is the overall level of employment as a result any higher? These are the key yardsticks by which the impact of welfare reform on the labour market needs to be judged. They are the indicators that tell us whether there is any substance to the Westminster government's claim that welfare reform moves people into work.
19. This is nevertheless an exploratory exercise. A full assessment of the impact of welfare reform on the labour market would require a more comprehensive investigation deploying a wider range of methods and data than has been possible here.

## The welfare reforms

20. The present report covers the labour market impact of the welfare reforms underway between 2010 and 2015. These are:

### **Housing Benefit – Local Housing Allowance**

21. Changes to the rules governing assistance with the cost of housing for low-income households in the private rented sector. The new rules apply to rent levels, 'excess' payments, property size, age limits for sole occupancy, and indexation for inflation.

### **Non-dependant deductions**

22. Increases in the deductions from Housing Benefit, Council Tax Benefit and other income-based benefits to reflect the contribution that non-dependant household members are expected to make towards the household's housing costs

### **Household benefit cap**

23. New ceiling on total payments per household, applying to the sum of a wide range of benefits for out-of-work claimants

### **Disability Living Allowance**

24. Replacement of DLA by Personal Independence Payments (PIP), including more stringent and frequent medical tests, as the basis for financial support to help offset the additional costs faced by individuals with disabilities

### **Incapacity benefits**

25. Replacement of Incapacity Benefit and related benefits by Employment and Support Allowance (ESA), with more stringent medical tests, greater conditionality

and time-limiting of non-means tested entitlement for all but the most severely ill or disabled

### **Child Benefit**

26. Three-year freeze, and withdrawal of benefit from households including a higher earner

### **Tax Credits**

27. Reductions in payment rates and eligibility for Child Tax Credit and Working Tax Credit, paid to lower and middle income households

### **1 per cent up-rating**

28. Reduction in annual up-rating of value of most working-age benefits, which would normally have been increased with inflation
29. A fuller description of each of these reforms, including the timing of implementation, is contained in the appendices of two previous reports for the Scottish Parliament<sup>7</sup>.
30. The vast majority of these welfare reforms were initiated by the Coalition government in Westminster, notably but not exclusively through the Welfare Reform Act 2012. Some of the incapacity benefit reforms, however, are Labour measures that pre-dated the 2010 general election but only took full effect after the election. They are included here to provide a comprehensive view of the impact of the reforms that have been underway over the last few years.
31. In the Scottish context, two important omissions from the list are worth noting:
  - Council Tax Benefit. In collaboration with Scottish local authorities, the Scottish Government has chosen not to pass on to claimants the Westminster Government's 10 per cent cut in the value of Council Tax Benefit payments.
  - Housing Benefit: under-occupation in the social rented sector. This reform, better known as the 'Bedroom Tax', is effectively not being implemented in Scotland from 2014-15 as a result of the Scottish Government's decision to make available sufficient funding for Discretionary Housing Payments to fully offset the reduction in Housing Benefit.
32. Three further omissions are worth noting:
  - Universal Credit. This is scheduled to replace just about all means-tested working age benefits but unlike the other reforms it is not expected to lead directly to a reduction in welfare spending. Universal Credit is better understood as a repackaging of existing benefits that for the first time introduces a consistent benefit withdrawal rate. There are still major delays in the full implementation of Universal Credit.

- Income Support for lone parents. The qualifying age of the youngest child has been reduced from under 7 to under 5. The effect is to transfer the lone parent from Income Support to Jobseeker's Allowance at the same payment rate but with a new requirement to look for work.
  - RPI to CPI for benefits uprating. This was introduced from 2011-12 but is really part of a much wider accounting reform, including for example all public service pensions.
33. When fully implemented, the welfare reforms covered in this report, including those that no longer apply to Scotland, are expected to save the UK Treasury around £18bn a year.
34. In its July 2015 Budget, the Westminster government announced a further round of welfare cuts intended to save the Exchequer a further £12bn a year. The implementation of these cuts still lies ahead and therefore their impact on the labour market cannot be monitored here but the final section of the report considers the possible effects in the light of the evidence on the labour market impact of the pre-2015 reforms.

## The financial losses in Scotland

35. Table 1 shows the estimated financial losses across Scotland as a whole arising from the pre-2015 welfare reforms. These figures are taken from the third of the earlier reports for the Scottish Parliament<sup>8</sup> and are revised and updated versions of the figures presented in the two previous reports, which include full details of data sources and methods. In brief, the estimates involve taking the Treasury's expected financial savings arising from each reform and allocating the financial losses to Scotland and local areas on the basis of claimant data from DWP and HMRC. Data from the Westminster government's Impact Assessments and in some cases from pilot schemes also plays a part.
36. Table 1 shows that when the reforms have come into full effect they can be expected to take around £1.5bn a year out of the Scottish economy, or an average of £440 a year for every adult of working age – that is, an average of £440 for every person in Scotland aged between 16 and 64, whether or not they claim welfare benefits<sup>9</sup>.

Table 1: Overall financial loss arising from pre-2015 welfare reforms in Scotland

	Estimated loss £m p.a.	Loss per working age adult £ p.a.
Tax Credits	350	100
Disability Living Allowance	320	90
Incapacity benefits	280	80
Child Benefit	240	70
1 per cent uprating	230	65
Housing Benefit: LHA	80	25
Non-dependant deductions	20	5
Household benefit cap	4	<5
<b>Total</b>	<b>1,520</b>	<b>440</b>

Source: Sheffield Hallam estimates based on official data

38. In Scotland, and indeed in the rest of the UK, the biggest financial impact of the pre-2015 welfare reforms comes from the changes to Tax Credits – an estimated loss in Scotland of £350m a year. The changeover from DLA to PIP and the reforms to incapacity benefits also account for substantial sums - £320m and £280m a year respectively. Changes to Child Benefit (£240m a year) and the below-inflation uprating of most working-age benefits from April 2013 (£230m a year) also account for substantial sums.
39. The overall scale of the financial loss in Scotland (£440 a year per adult of working age) is just below the GB average (£450). Scotland is hit substantially harder than South East England (£370) but less than Wales (£520), London (£490), North West England (£530) or North East England (£530)<sup>10</sup>.
40. It should not escape note, however, that the impact in Scotland would have been around £35 a year higher (i.e. around £475 per adult of working age) if the Scottish Government had not struck a deal with local authorities to avoid passing on the cut in Council Tax Benefit or put in place arrangements to defray the impact of the 'Bedroom Tax' using Discretionary Housing Payments. The financial burden of these welfare reforms is being borne by public sector budgets in Scotland rather than by benefit claimants.
41. Table 2 shows the estimated financial loss arising from the reforms in each of Scotland's 32 local authority districts. These figures are again taken from the third of the previous reports for the Scottish Parliament<sup>11</sup> and are revised and updated from those first published.

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Table 2: Overall financial loss arising from pre-2015 welfare reforms, by local authority

	Estimated loss £m p.a.	Loss per working age adult £ p.a.
Glasgow	239	580
Inverclyde	30	570
West Dunbartonshire	33	550
Dundee	52	540
North Ayrshire	47	540
North Lanarkshire	113	510
East Ayrshire	40	500
Clackmannanshire	17	500
Renfrewshire	55	480
South Lanarkshire	96	470
South Ayrshire	32	470
West Lothian	53	460
Dumfries and Galloway	42	450
Midlothian	24	450
Fife	103	440
Falkirk	44	430
Argyll and Bute	22	410
East Lothian	25	400
Angus	28	390
Highland	56	380
Scottish Borders	27	380
Edinburgh	124	370
Perth and Kinross	34	360
Eilean Siar	6	350
Stirling	21	350
East Renfrewshire	19	340
Moray	20	340
Orkney Islands	5	340
East Dunbartonshire	21	320
Aberdeen	46	300
Aberdeenshire	47	290
Shetland Islands	4	270
<b>Scotland</b>	<b>1,520</b>	<b>440</b>

Source: Sheffield Hallam estimates based on official data

42. The biggest impact, in absolute terms and on a per capita basis, falls on Glasgow where the welfare reforms are now estimated to result in a loss of £239m a year, equivalent to £580 a year for every adult of working age in the city. On per capita basis a number of other older industrial areas are also hit hard. These include

Inverclyde, Dundee, West Dunbartonshire, North Lanarkshire, Clackmannanshire and North and East Ayrshire.

43. By contrast, the financial loss in Edinburgh – an estimated £124m a year, or £370 per adult of working age – is significantly smaller. The places least affected by the reforms are in North East Scotland, Orkney and Shetland, and two relatively affluent districts (East Renfrewshire and East Dunbartonshire) in the central belt. However, it is worth noting that even in some of these local authorities the absolute losses remain large. Aberdeen, for example, can still expect to lose £46m a year.
44. As the earlier reports explained, there are no surprises in this geography. It is to be expected that welfare reforms hit hardest in the places where welfare claimants are concentrated, which tend to be in the poorest areas with the highest rates of worklessness. There is a strong correlation between the financial loss per adult of working age arising from welfare reform and the Scottish Indices of Deprivation. The correlation applies at the level of local authority districts and at the level of electoral wards.

## Potential impact on the labour market

45. Welfare reform can be expected to influence labour market behaviour by changing financial incentives. For an unemployed person, a reduction in the value of welfare benefits increases the financial incentive to work. For a person in work who receives benefits or tax credits – and there are a great many in-work recipients – a reduction increases the incentive to take on extra hours, or to find higher paid work, in order to maintain their income after tax and benefits.
46. Not all the pre-2015 welfare reforms work in this way or to the same extent. To illustrate this point, Table 3 summarises the likely impacts on work incentives. The majority of the reforms can be expected to have increased the financial incentive for the non-employed to find work. The notable exception is the reduction in Working Tax Credits, which for some people considering work of less than 24 hours a week may actually make taking a job financially less attractive. Similarly, the majority of the reforms increased the incentive for an existing employee to take on extra hours or seek higher paid work. The reforms to incapacity benefits and the household benefit cap only apply to out-of-work claimants.
47. The scale of the financial incentive varies a great deal. The loss of entitlement to non-means tested incapacity benefit (ESA) can be worth £5,000 a year whereas the three-year freeze in the value of Child Benefit has a far smaller impact, in some cases below £100 a year. The withdrawal of Child Benefit from higher earners can be large (over £1,000 a year) but seems unlikely to impact a great deal on the incentives of the high earner, presumably in just about all cases in full-time employment already. For all the welfare changes, of course, there will be

variation in the impact and the incentives between different individuals and households, depending on detailed circumstances.

Table 3: Possible impact of pre-2015 welfare reforms on work incentives

	<b>Increased incentive to find work?</b>	<b>Incentive to increase hours?</b>	<b>Big incentive?</b>
HB – Local Housing Allowance	Yes	Yes	Possibly fairly big
Non-dependant deductions	Yes	Yes	Modest
Household benefit cap	Yes	No	Big in some cases
Disability Living Allowance	Yes – for losers	Yes – for losers	Moderate
Incapacity benefits	Yes – for many	No	Big
Child Benefit – freeze	Yes	Yes	Small
Child Benefit – removal from high earners	No	Unlikely	Negligible
Working Tax Credit	Not consistently	Yes	Big in some cases
Child Tax Credit	Yes	Yes	Big in some cases
1 per cent uprating	Yes	Yes	Modest

Source: Authors' assessment

48. Beyond the changes in eligibility and payment rates, two other policies have reinforced the financial incentive to take up employment. One is the increase in Income Tax personal allowances. Under the Coalition government these were increased by more than the rate of inflation, raising the threshold at which Income Tax becomes payable. This has increased the financial incentive to take low-paid work, including part-time employment.
49. The other policy reinforcing the financial incentives has been increased conditionality and the wider application of benefit sanctions. These have been



applied mainly to those on Jobseeker's Allowance but also increasingly to claimants in the Work-Related Activity Group on ESA. Roughly 6 per cent of the stock of JSA claimants is now sanctioned each month, double the rate under the pre-2010 Labour government<sup>12</sup>. Life on Jobseeker's Allowance, which was never easy, has as a result become distinctly more uncomfortable since 2010, with the ever-present threat of sanctions even for those who do their best to comply with all the requirements placed upon them by Jobcentre Plus.

## Assessing the labour market impact

50. The principal complication in disentangling the impact of welfare reform is that it is only one of several things happening simultaneously. In the UK, economic growth accelerated from mid-2012 onwards after a period of stagnation in the wake of the 2008/9 recession, at much the same time as several of the welfare reforms took effect. Compared with 2012, employment is now higher and unemployment lower. However, it would be wrong to assume that these improvements can be attributed in whole or in part to welfare reform. Benefit changes may (or may not) have played a role but other factors such as a revival of consumer spending and borrowing, particularly around the housing market, have also contributed to the upturn.
51. The approach deployed here to disentangle the impact of welfare reform is based on the big variations from place to place in the scale of the financial losses. The UK benefits system operates under the same rules more or less everywhere but because the number and profile of claimants varies a great deal from place to place, the welfare reforms impact much more on some places than others.
52. Table 2, earlier, showed that within Scotland there are big differences between local authorities in the financial loss per adult of working age. At the extremes, the average financial loss in Glasgow (£580) is more than double the loss in Shetland (£270). These big differences are important because if the welfare reforms are having an important impact on labour market outcomes it should be possible to observe a much greater impact in the places where the reforms hit hardest.
53. The approach adopted here, therefore, is to look closely at the labour market changes that have been occurring in different parts of Scotland and see if they match the financial impacts of welfare reform.
54. A practical complication is that not all the pre-2015 welfare reforms have yet come to full fruition. The figures earlier, in Tables 1 and 2, showed the financial losses to claimants when the reforms have come into full effect. Some of the reforms, however, particularly those affecting incapacity and disability benefits, are being implemented in stages over a number of years. So far, for example, PIP has replaced DLA only for new claimants and the re-testing of existing DLA claimants is not scheduled to begin until October 2015 and not expected to be completed until 2018. The incapacity benefit reforms have also fallen well behind schedule

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because of the backlog in undertaking Work Capability Assessments (in part because of the loss of the original prime contractor) and in processing appeals, which in turn is delaying the implementation of means-testing for those placed in the Work-Related Activity Group.

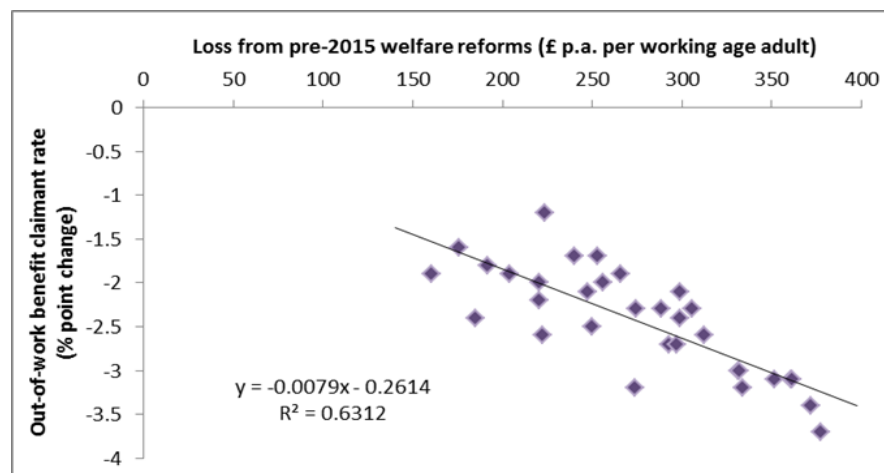
55. As noted in the February 2015 report to the Scottish Parliament<sup>13</sup>, taking the pre-2015 welfare reform package as a whole, in the spring of 2015 around 30 per cent of the overall financial loss to claimants in Scotland still lay ahead.
56. Bearing in mind that most labour market statistics do not themselves come any further forward than the end of 2014, the financial losses arising from welfare reform, shown in Tables 1 and 2 earlier, have therefore been adjusted to exclude the estimated share of the losses that at the end of 2014 still lay in the future:
  - 90 per cent of the loss arising from the changeover from DLA to PIP
  - 30 per cent of the loss arising from incapacity benefit reform
57. The financial loss arising from the withdrawal of Child Benefit from higher earners is also excluded on the basis that this has little potential relevance to work incentives.
58. The effect of these omissions is to reduce the financial losses included in the labour market impact assessment, presented below, by around one-third. This proportion varies little between Scottish local authorities so, for example, Glasgow still remains the worst-hit by welfare reform.

## Recent labour market trends

### Out-of-work benefits

59. It is appropriate to begin by looking at the relationship between welfare reform and out-of-work benefit claimant rates.

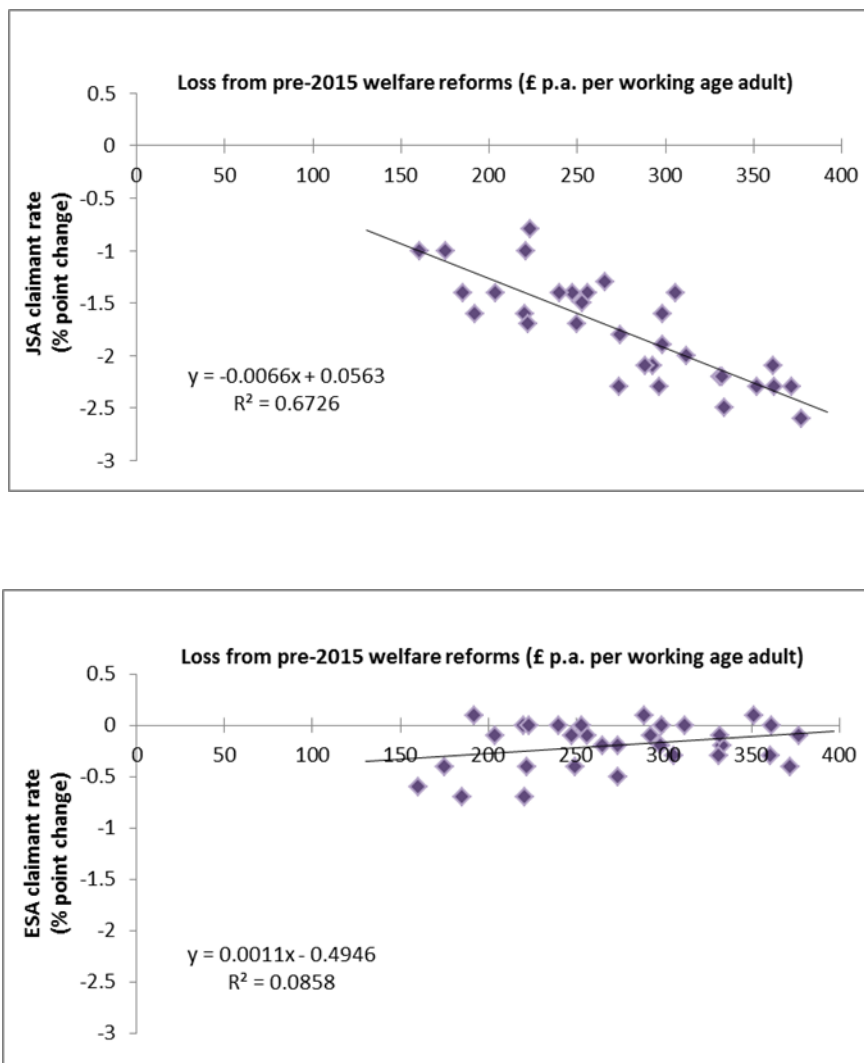
Figure 1: Out-of-work benefit claimant rate, Feb 2011- Nov 2014



Sources: DWP and Sheffield Hallam estimates

60. Figure 1 shows the relationship between the percentage point change in the out-of-work benefit claimant (on the vertical axis) and the average financial loss per adult of working age arising from welfare reform (on the horizontal axis) by local authority in Scotland between February 2011 and November 2014. This period begins just before the first of the Coalition government's reforms came into effect and finishes with the latest available benefit data. The dots on the scatter diagram are Scotland's 32 local authorities. 'Out-of-work benefits' is a standard DWP category principally comprising all those on JSA, on IB/ESA and on Income Support as a lone parent.
61. It is immediately obvious from this first chart that there is a relationship between the impact of welfare reform and the fall in the out-of-work claimant rate: the bigger the financial loss arising from welfare reform, the bigger the fall in the claimant rate<sup>14</sup>. Very broadly, in the Scottish local authorities where welfare reform has hit hardest the fall in the claimant rate has been 3-4 percentage points, compared to around 2 percentage points where welfare reform has impacted less.

62. Figure 2: JSA and ESA claimant rates, Feb 2011 – Nov 2014



Sources: DWP and Sheffield Hallam estimates

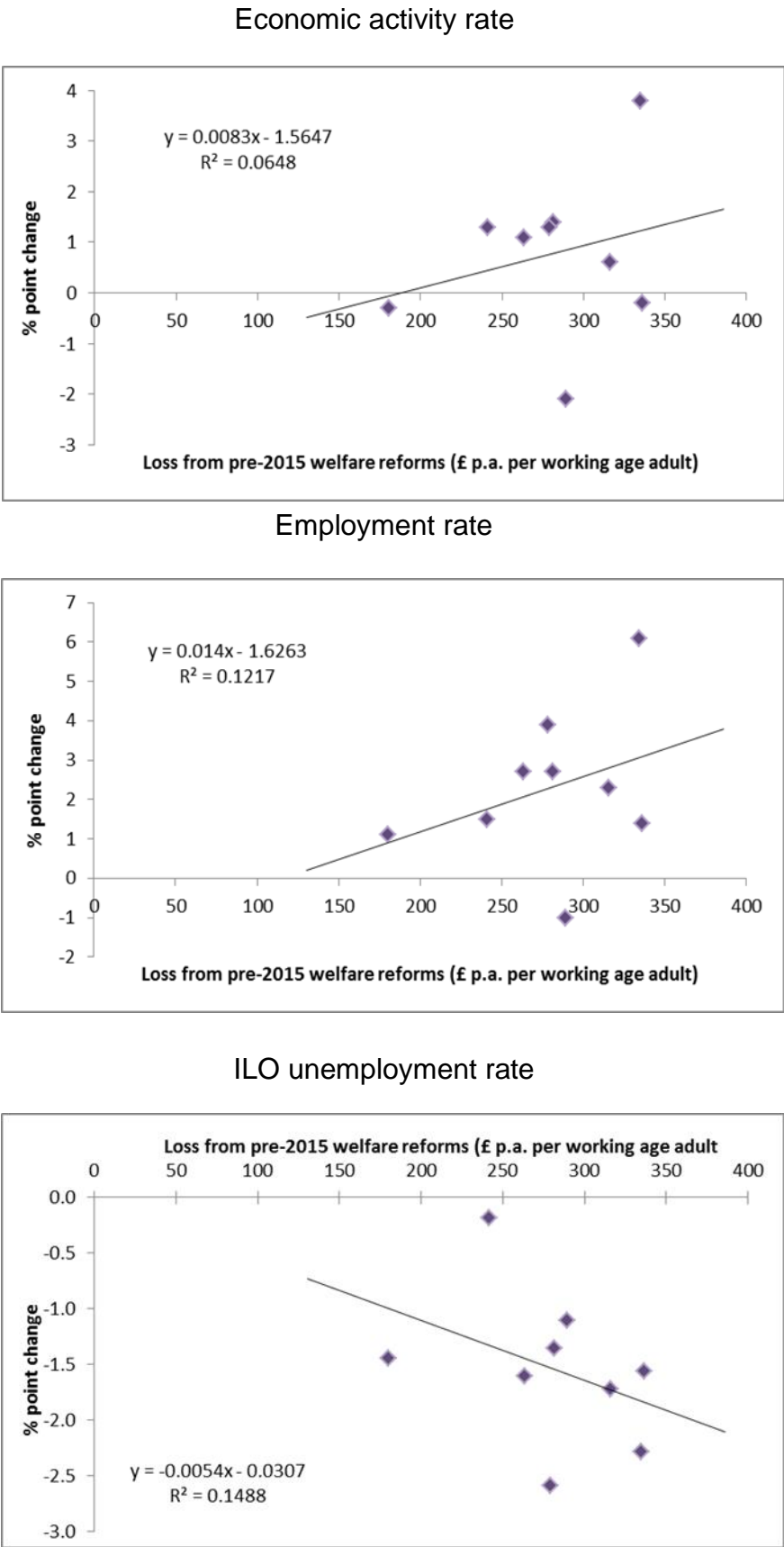
63. Figure 2 disaggregates the change in the out-of-work claimant rate into its two largest components – the change in the Jobseeker's Allowance (JSA) claimant rate and the change in the Incapacity Benefit/Employment and Support Allowance (ESA) claimant rate. This highlights an important difference: the relationship between the change in the benefit claimant rate and the impact of welfare reform applies to JSA but not to ESA. Indeed ESA claimant rates have barely fallen at all in Scotland (or indeed elsewhere in the UK) – generally by less than half a percentage point. The reductions in the ESA claimant rate have been no larger in the local authorities where welfare reforms have hit hardest.
64. That the fall has just about all been in JSA rather than ESA numbers is in some respects surprising. The welfare reforms have not in themselves removed entitlement to potential JSA claimants (though the tougher stance by Jobcentre Plus on sanctions may have had this effect) whereas the new medical test for ESA (the Work Capability Assessment) has made access to incapacity benefits more difficult for new claimants and disqualified some existing claimants. Furthermore,

the financial losses to incapacity claimants are substantial – an estimated £280m a year in Scotland when this element of the reform package has come to full fruition<sup>15</sup>.

## **Wider labour market variables**

65. The benefit numbers, deployed above, have the advantage that they are accurate and robust. Other official labour market data is based in whole or in part on sample surveys and can therefore be distinctly erratic, especially at the local scale. This applies in particular to local data from the government's Labour Force Survey, which is the up-to-date source of information on labour force participation and employment rates.
66. To help circumvent these statistical difficulties, we have grouped Scotland's 32 local authorities into nine groups. For each of the groups, the Labour Force Survey data is likely to be more reliable than for individual authorities though the effects of sampling error cannot be completely eliminated:
  - Ayrshire: East Ayrshire, North Ayrshire, South Ayrshire
  - Fife and Central: Clackmannanshire, Falkirk, Fife, Stirling
  - Greater Aberdeen: Aberdeen, Aberdeenshire
  - Greater Dundee: Dundee, Angus, Perth & Kinross
  - Greater Edinburgh: Edinburgh, East Lothian, Midlothian, West Lothian
  - Greater Glasgow: Glasgow, East Dunbartonshire, East Renfrewshire, Inverclyde, Renfrewshire, West Dunbartonshire
  - Highlands & Islands: Argyll & Bute, Eilean Siar, Highland, Moray, Orkney, Shetland
  - Lanarkshire: North Lanarkshire, South Lanarkshire
  - Southern Scotland: Borders, Dumfries & Galloway
67. This grouping has the added advantage that some of the areas are nearer to being functional labour markets whereas at the local authority scale, especially around Edinburgh

Figure 3: Wider labour market variables, 2011-2014



Sources: LFS and Sheffield Hallam estimates

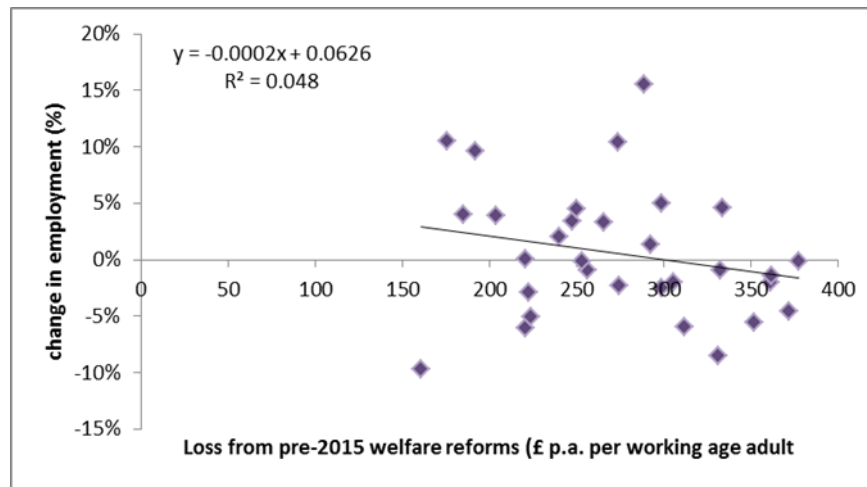
68. and Glasgow, labour market trends in one area will interact with trends in neighbouring areas.
69. Figure 3 looks at the relationships between the financial losses arising from welfare reform and three variables from the Labour Force Survey, using the nine groups of local authority areas. The diagrams look at the changes over the 2011-14 period<sup>16</sup>.
70. The first part of Figure 3 examines the economic activity rate – the share of adults of working age who are in work or seeking work. In theory, this should be one of the variables that responds most to welfare reform because a prime aim of the reforms is to raise labour market engagement. Even if welfare reform does not succeed in increasing employment, it should raise the number of people looking for work. The regression line in this diagram goes in the ‘right’ direction – the increase in the activity rate is higher where the financial losses from welfare reform are greater – but the strength of the relationship (measured by the R<sup>2</sup>) is poor so little or no weight can be placed on the trend line.
71. The second part of Figure 3 looks at the employment rate – the share of adults of working age in employment. This too shows a relationship that points in the ‘right’ direction – the increase is higher where the financial losses from welfare reform are greater – but once more the statistical association is weak and can be given little or no weight.
72. The third part of Figure 3 looks at the unemployment rate. This is measured differently here to the JSA claimant count. The Labour Force Survey uses the International Labour Organisation (ILO) definition of unemployment which counts anyone who is out-of-work, has looked for work within the last four weeks and is available to start work within two weeks, whether or not they are claiming unemployment benefits. In the UK over recent years the ILO definition has generated unemployment figures around a million higher than the JSA claimant count. The regression line again goes in the right direction – the higher the financial losses arising from welfare reform, the greater the fall in the unemployment rate – and this is consistent with the trends in benefit data (see Figure 2 earlier) but once more the statistical association is weak.
73. The Labour Force Survey data does not therefore provide convincing evidence of links between welfare reform and labour market outcomes, though some of the problem may lie with shortcomings and sampling errors in the data itself.

## **Employment**

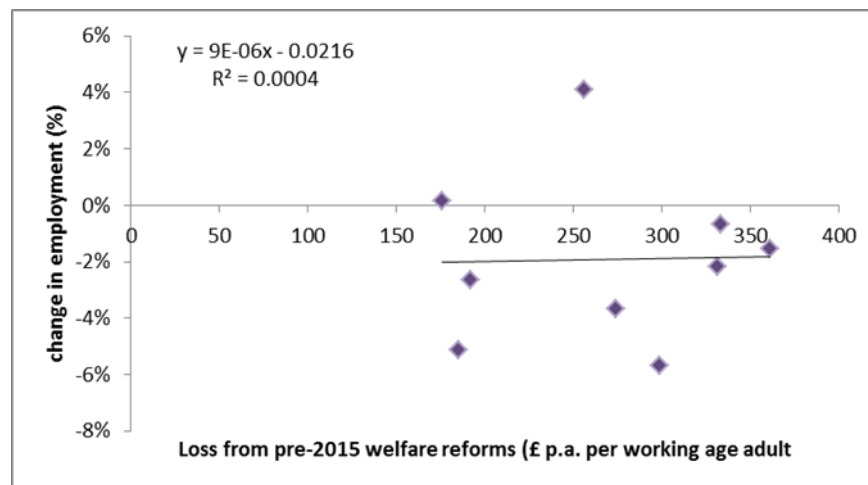
74. The best official statistics on employment in each local authority, from the Business Register and Employment Survey (BRES) are something of a halfway house, in terms of reliability, between the benefit claimant numbers and the Labour Force Survey: they are tolerably reliable but still affected by errors and discontinuities which can distort the measurement of change through time.

Figure 4: Employment, late 2010 – late 2013

(1) Local authorities



(2) Groups of local authorities



Sources: BRES and Sheffield Hallam estimates

75. Figure 4 therefore presents two views of the relationship between changes in employment and the financial losses arising from welfare reform, one for all 32 Scottish local authorities and the other for the nine groups of authorities. The employment data is the number of employee jobs located in each area. The time period covered in 2010 to 2013, which given the timing of the annual BRES survey in practice means late 2010 to late 2013. BRES data for 2014 will not be available until later in 2015. The period of fastest post-recession growth in the UK (during 2014) is unfortunately therefore missing from these statistics.
76. Figure 4 provides no evidence that there is a relationship between employment growth, by authority or by wider area group, and the financial loss arising from welfare reform. In both cases, the scatter of observations is considerable.

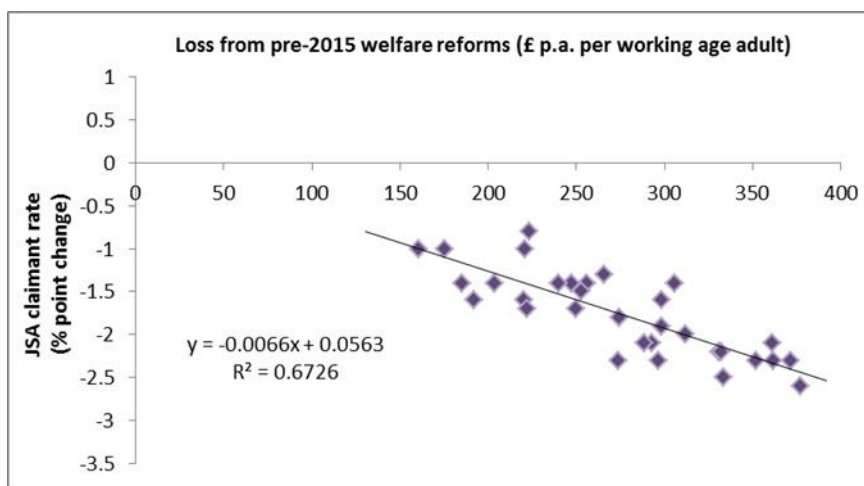


## Comparisons with other upturns

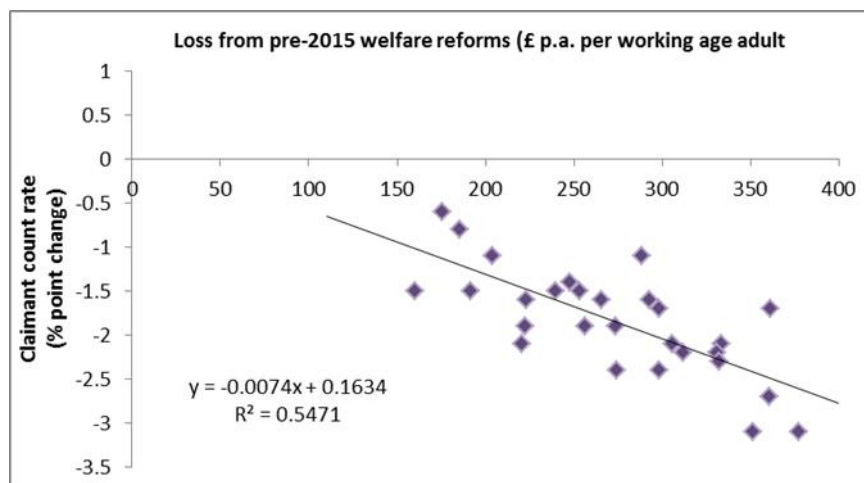
77. Recent labour market trends across Scotland therefore provide only limited evidence that welfare reform is an important causal factor. The important exception concerns the trend in JSA claimant numbers, which in turn underpins the trend in overall out-of-work claimant numbers. The reduction in JSA numbers is higher in the places where the financial loss from welfare reform is larger. This could be interpreted as evidence that, for JSA claimants at least, welfare reform is working.
78. The problem with this interpretation is that when unemployment falls during an economic upturn it generally does so more in some places than others, irrespective of welfare reform. In particular, it is always likely that in an upturn the reduction in unemployment will be greater in the places with initially high unemployment than in more prosperous, low unemployment areas. This is partly because the high unemployment areas are by definition where most of the unemployed live, and partly because of arithmetic. A reduction of, say, four percentage points in the unemployment rate is possible where the unemployment rate starts at eight per cent, but not where the rate starts at just three or four per cent. Bear in mind here that unemployment rates never fall to zero – there is always some frictional unemployment, as people change jobs, even in the most prosperous areas.
79. The point here is that economic upturns are normally associated with convergence in unemployment rates, and the high unemployment areas are the ones most affected by welfare reform. The more rapid fall in JSA numbers that can be observed in the areas hit hardest by welfare reform may in practice have little to do with welfare reform.
80. Two upturns are never exactly the same so finding the perfect match for the recent post-recession period is impossible. Figure 5 therefore compares the reduction in the JSA claimant rate between February 2011 and November 2014 (taken from Figure 2 earlier) with two other periods when there was a similar percentage point fall in claimant count unemployment<sup>17</sup> in Scotland:
- February 1998 to November 2004. This is a longer period than Feb 2011 to Nov 2014 but one in which claimant unemployment fell from broadly similar levels and by similar amounts, though unemployment was already well down on peak levels in the early 1990s<sup>18</sup>.
  - August 1993 to August 1996. This is a more comparable period in the economic cycle, covering the immediate recovery from recession, but one in which claimant unemployment was falling from a far higher starting point. Unemployment Benefit had also not yet been replaced by Jobseeker's Allowance, with its significantly more restrictive entitlement for claimants of more than six months.

81. Figure 5: Comparison between upturns

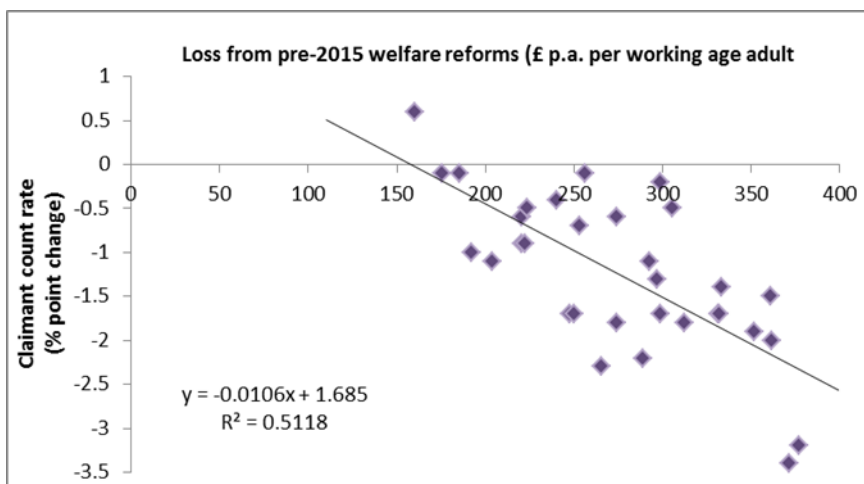
Feb 2011 – Nov 2014



Feb 1998 – Nov 2004



Aug 1993 – Aug 1996



Sources: DWP and Sheffield Hallam estimates

82. To maintain comparability, the horizontal axis on all three diagrams – the financial loss arising from the pre-2015 welfare reforms – is held constant. Left to right, each Scottish local authority is therefore at the same place on the scale in each diagram. The point here is not to suggest that these particular welfare reforms had any impact on earlier events. Rather, the point is simply to examine whether the pattern of change by local authority that can be observed in the 2011-14 period is similar to that in previous upturns.
83. As will be immediately apparent, there is very strong similarity between the geography of the reduction in unemployment in all three periods. The places that have experienced the biggest percentage point reduction in JSA unemployment during the recent upturn, which were also the places hit hardest by welfare reform, are the same places that experienced the biggest reduction in claimant unemployment during previous upturns.
84. In the present context this is key observation. What it suggests is that the big reductions in JSA unemployment in a number of Scottish local authorities cannot be attributed to welfare reform. Rather, these big reductions in areas of high unemployment are a normal feature of economic upturns.

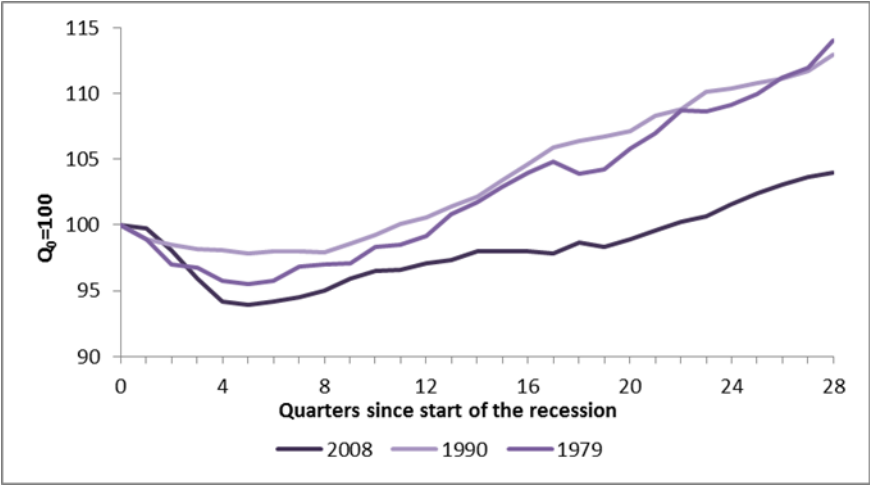
## Employment, output and productivity

85. The recovery from the 2008/9 recession does however differ from other economic upturns in one important respect: it has been far more labour-intensive.
86. This point is illustrated by Figure 6. The first part shows the trend in UK economic output (GDP) from the start of the recent recession and compares this with the trends during and after the recessions at the start of the 1980s and 1990s. During the recent, 2008/9 recession output fell further and has subsequently recovered more slowly than in the previous two recessions. The second part of Figure 6 shows the trends in UK employment over the same periods. This shows that employment did not fall as steeply during the recent recession and has then risen relatively strongly. The third part compares the employment trends in Scotland and the UK since 2008 and shows that they have been broadly similar.
87. These trends are well known and have been the subject of much discussion. In effect, the recent resurgence in employment, in the context of modest increases in output, indicates that labour productivity in the UK has risen little if at all since the 2008/9 recession.
88. The relevance of these aggregate trends is that they are at the very least consistent with welfare reform. If welfare reform has made staying out-of-work on benefit less attractive, and if as a result more men and women have been willing to take low-wage employment, or indeed any work at all, the effect may have been to encourage employers to take on additional labour rather than invest in machinery and new working methods that deliver higher productivity. Aggregate

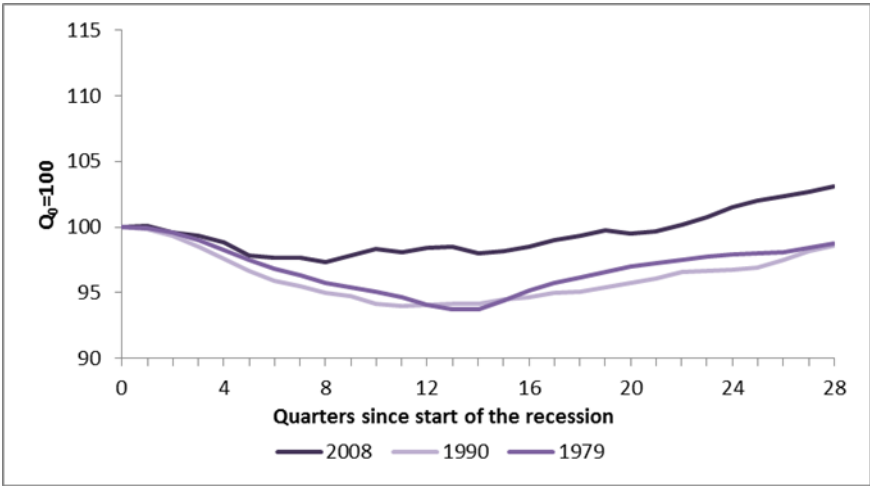
economic trends may therefore after all point towards labour market impacts arising from welfare reform. And welfare reform may, after all, explain why the recent upturn has been different from its predecessors.

Figure 6: Comparison of recessions and recoveries

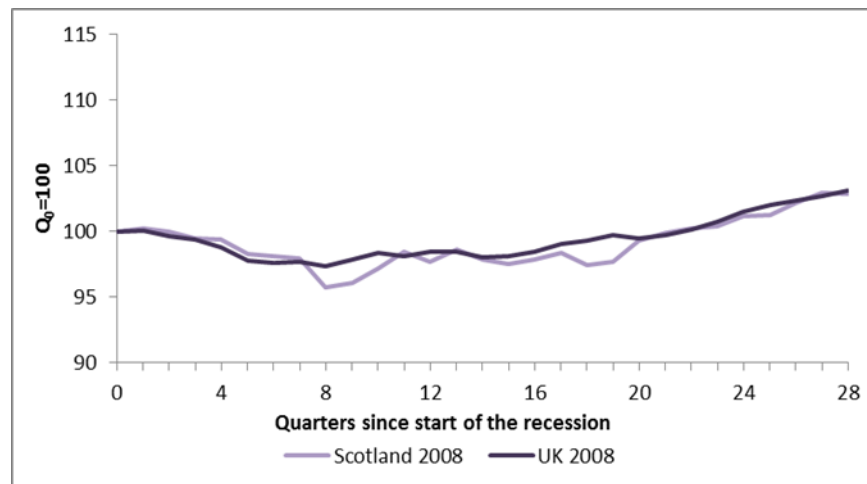
UK GDP at constant prices



UK employment



### UK and Scottish employment since start of 2008 recession



Sources: ONS, LFS

89. It is equally possible, however, that the aggregate economic trends have nothing to do with welfare reform. The slow growth in labour productivity in the recent upturn may instead reflect the particular structure of the upturn, driven by yet more consumer spending on low-productivity services (retailing, leisure etc.) rather than by a revival in manufacturing or exports, and by expansion in part-time working and zero-hours contracts. The ready availability of migrant workers may also have helped fuel a labour-intensive upturn.
90. The timing of the divergence in employment trends between the recent and previous recessions is difficult to reconcile with explanations based on welfare reform. The first of the Coalition government's reforms only began to take effect in the spring of 2011, some three years after the start of the 2008 recession, and measures such as the 'bedroom tax' and household benefit cap came into effect two full years later in the spring of 2013. By this time employment levels had already diverged from what might have been expected on the basis of trends in earlier recessions. In the period up to spring 2011, only the new Work Capability Assessment for new incapacity claimants – a Labour initiative – was fully underway. Although this is a significant part of the overall welfare reform package, its impact on claimant numbers is far too small to explain the resilience in overall employment levels during and immediately after the recession.
91. Furthermore, interpreting aggregate labour market trends in the upturn as being the result of welfare reform remains inconsistent with the finer-grain data for local areas. If welfare reform really was the driving force in generating higher employment and lower unemployment, it would have been reasonable to expect greater impacts in the places in Scotland where welfare reform has hit hardest. As the evidence presented earlier showed, this is not the case.
92. That across the UK economy as a whole employment has risen faster than might have been expected, given the growth in output, can therefore be no more than a footnote. It does not provide convincing evidence of impacts from welfare reform.

## Conclusions

93. On balance, the evidence in this report provides little support for the view that welfare reform is having important and positive impacts on the labour market in Scotland.
94. The out-of-work benefit claimant rate, and more particularly the JSA claimant rate, has fallen faster in the parts of Scotland where the welfare reforms have resulted in the largest financial losses. Superficially, this might be interpreted as evidence that welfare reform is working in the way the Westminster government intended. Closer examination, however, shows that similar falls in unemployment in these places have been a feature of previous upturns. Recent trends cannot therefore be attributed simply to welfare reform.
95. Looking ahead, the Conservative government in Westminster has announced a further £12bn a year of welfare cuts to be implemented over the next few years. These include reductions in tax credits, a lower household benefit cap, lower ESA payment rates and a four-year freeze in the value of most working-age benefits, including Housing Benefit in the private-rented sector. In the light of the evidence on the impact of the pre-2015 welfare reforms it is hard to see this new round of reductions having any greater labour market impact. Indeed, given that reductions to tax credits account for around half the additional planned saving, and that a large proportion of these cuts falls on in-work claimants, a reduction in the numbers on out-of-work benefits seems even less likely as a result of the new round of welfare reforms.
96. The analysis presented here remains exploratory. A final word on the labour market impact of welfare reform would require a substantially larger and more wide-ranging exercise, beyond the scope of the present project. Nevertheless, there is sufficient evidence in the present report to cast doubt on one of the central claims used to justify welfare reform. Welfare reform does reduce public expenditure and thereby the budget deficit but it does not, it would seem, lead to higher employment or lower unemployment.

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<sup>1</sup> Council Tax Benefit and the 'Bedroom Tax'

<sup>2</sup> C Beatty and S Fothergill (2013) The Impact of Welfare Reform on Scotland, Scottish Parliament,

<sup>2</sup> C Beatty and S Fothergill (2013) The Impact of Welfare Reform on Scotland, Scottish Parliament, Edinburgh.

<sup>3</sup> C Beatty and S Fothergill (2014) The Local Impact of Welfare Reform, Scottish Parliament, Edinburgh.

<sup>4</sup> C Beatty and S Fothergill (2015) The Cumulative Impact of Welfare Reform on Households in Scotland, Scottish Parliament, Edinburgh.

<sup>5</sup> See in particular C Beatty and S Fothergill (2013) Hitting the Poorest Places Hardest: the local and regional impact of welfare reform, CRESR, Sheffield Hallam University.

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<sup>6</sup> See for example Department for Work and Pensions (2014) Post-Implementation Effects of the Benefit Cap, DWP, London; Department for Work and Pensions (2014) Universal Credit Pathfinder Evaluation, DWP, London; R Sainsbury and A Corden (2014) Early Process Evaluation of New Claims for Personal Independence Payment, DWP, London.

<sup>7</sup> C Beatty and S Fothergill (2013) and (2014) op.cit.

<sup>8</sup> C Beatty and S Fothergill (2015) op.cit.

<sup>9</sup> The financial loss per adult of working age is a good yardstick because nearly all the impact of the reforms falls on working-age claimants.

<sup>10</sup> All these figures for other parts of GB have been fully revised and updated and are therefore comparable with the revised figures for Scotland.

<sup>11</sup> C Beatty and S Fothergill (2015) op.cit.

<sup>12</sup> See in particular the regular briefings on benefit sanctions, using DWP statistics, produced by David Webster of Glasgow University.

<sup>13</sup> C Beatty and S Fothergill (2015) op.cit.

<sup>14</sup> NB. The financial loss arising from welfare reform is calculated independently of outturn changes in out-of-work claimant numbers.

<sup>15</sup> See Table 1 earlier.

<sup>16</sup> The LFS statistics at each point cover a full year (i.e. January to December 2011 and January to December 2014).

<sup>17</sup> 'JSA unemployment' and 'claimant count unemployment' differ marginally in coverage but are sufficiently similar to be compared.

<sup>18</sup> Three outliers have been excluded from the figures shown for 1998-2004. These are Eilean Siar, Highland and Inverclyde.







*The impact of welfare reform on the Scottish labour market. An exploratory analysis*

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