

Debunking the myth that keeps coming back: Excessive spending on labour market policies and benefit fraud in the UK

Tim Vlandas of Reading University shows why recent UK labour market reforms rest on false assumptions and will do little to cure unemployment

Consistent with previous trends in reforms of labour market policies, the UK government has announced yet another **restriction** on unemployment benefit claimants: they will now be asked to take certain steps – such as preparing a CV – prior to their interview with Job Centre Plus. While other similarly regressive reforms are being implemented in other policy domains such as **restricting housing benefits to those older than 25 years**, the obsession with reducing and restricting unemployment benefits is particularly surprising.

The striking thing about these reforms is not that they are unlikely to be effective, nor that even if they were effective they probably wouldn't make much of a difference in reducing the unemployment rate. Instead, the main issue is that they completely misrepresent the nature and extent of the problem.

Two sets of claims generally serve to justify the introduction of these reforms. The first is that unemployment benefit recipients fraud and that one must therefore restrict their access to prevent them from doing so or punish them **more harshly** for cheating. As **official statistics (table 2.1 on page 13)** themselves reveal, the amount of fraud was in fact very low in 2011/2012: fraud costs only about 2.6% of expenditure on income support and 2.9% of spending on Job seeker allowance (see table 1 below).

Table 1: Estimated overpayments in 2011/2012

Table 2.1: Estimated overpayments in 2011/12

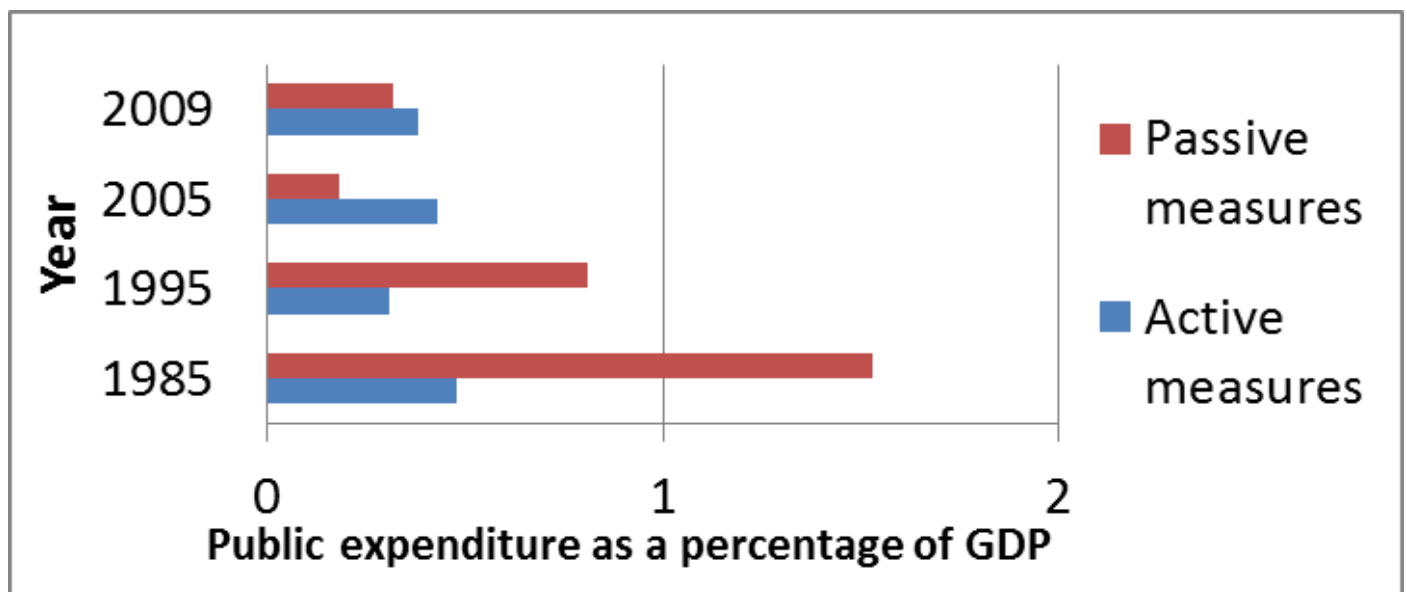
Benefit	Expenditure	Fraud & Error		Fraud		Claimant Error		Official Error		Last Measured
Continuously reviewed										
Income Support	£7.2bn	4.4%	£310m	2.6%	£180m	1.2%	£80m	0.7%	£50m	Apr 11 - Mar 12
Jobseeker's Allowance	£5.0bn	4.6%	£230m	2.9%	£150m	0.6%	£30m	1.1%	£50m	Apr 11 - Mar 12
Pension Credit	£8.2bn	5.7%	£460m	1.7%	£140m	1.8%	£150m	2.1%	£170m	Apr 11 - Mar 12
Housing Benefit	£22.8bn	4.9%	£1,130m	1.5%	£350m	2.8%	£650m	0.6%	£130m	Apr 11 - Mar 12
Occasionally reviewed										
Incapacity Benefit	£5.0bn	2.4%	£120m	0.3%	£10m	0.9%	£40m	1.2%	£60m	Oct 09 - Sep 10
Disability Living Allowance ¹	£12.6bn	1.9%	£240m	0.5%	£60m	0.6%	£80m	0.8%	£100m	Apr 04 - Mar 05
State Pension ²	£74.2bn	0.2%	£120m	0.0%	£0m	0.1%	£60m	0.1%	£60m	Apr 05 - Mar 06
Carer's Allowance	£1.8bn	5.5%	£100m	3.9%	£70m	1.0%	£20m	0.6%	£10m	Apr 96 - Mar 97
Interdependencies ³		£50m		£10m		£20m		£20m		Apr 11 - Mar 12
Unreviewed										
Unreviewed (excl CTB) ⁴	£17.6bn	2.2%	£390m	0.8%	£150m	0.7%	£120m	0.7%	£120m	
Council Tax Benefit	£4.9bn	4.4%	£220m	1.4%	£70m	2.5%	£120m	0.6%	£30m	
Total ⁵	£159.2bn	2.1%	£3.4bn	0.7%	£1.2bn	0.9%	£1.4bn	0.5%	£0.8bn	
Range ⁶		(1.8,2.5) (2.9,3.9)		(0.6,1.0)(1.0,1.6)		(0.7,1.1) (1.1,1.7)		(0.4,0.7) (0.6,1.1)		



Listening to the current government, one would be forgiven for thinking that benefit overpayment has been skyrocketing in recent years. Readily available official estimates debunk this claim: as Government figures (follow the link below) show there is no statistically significant difference between overpayment in 2005/6 and 2012/13 (Figure 5.5 page 45).

The second claim is that these policies simply cost too much and that the system is too generous in the UK. For instance Ian Duncan Smith recently **declared** that the conservatives “inherited an out-of-control welfare system: under Labour, spending on benefits rocketed to an unsustainable level”. To assess this claim in the case of labour market policies I plot spending on **active labour market policies** (training schemes, employment incentives, rehabilitation programs, etc) and passive labour market policies (mainly composed of traditional unemployment benefits). Figure 1 below shows that the UK government spends much less on unemployment benefits than in both the 1980s and 1990s and that spending on active measures has not increased since 2005.

Figure 1: Evolution of spending on active and passive labour market policies in the UK



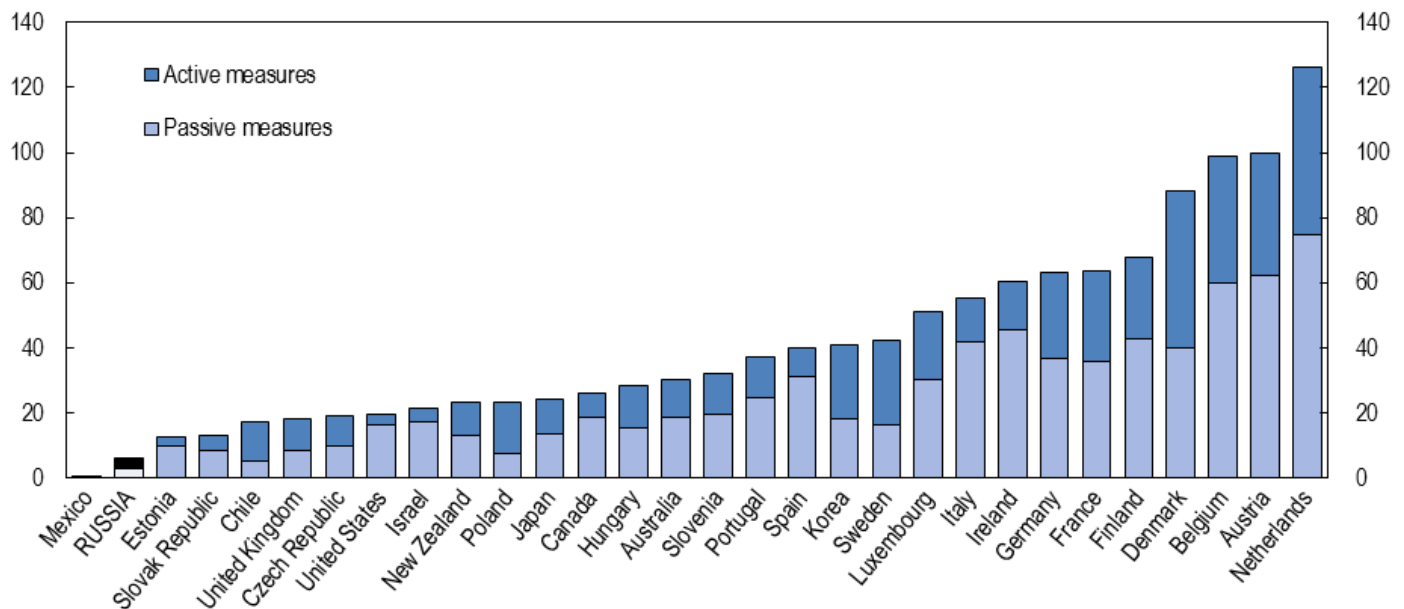
To put the amount that the UK government spends in perspective it is useful to look at other developed economies. I have **shown elsewhere** that the replacement rate (ratio of unemployment benefits a worker receives relative to the worker's last gross earning) is certainly lower in the UK than in most other developed countries. Indeed the UK has the 46th highest replacement rate. That UK spending is not excessive by international standards is also apparent when comparing public expenditures on labour market policies per unemployed (% of GDP per capita) across OECD countries. For the latest comparable data available, the UK spends the 25th highest amount on labour market policies (Figure 2).

In other words the vast majority of other OECD countries spend more than the UK. The same picture remains when one distinguishes between different types of labour market policies. Besides passive labour market policies that are mainly composed of traditional unemployment benefits, there are also **active labour market policies** that aim to promote unemployed workers return to work and include training schemes, employment incentives, rehabilitation programs, etc. Considering only active labour market policies that are presumably consistent with the proclaimed aim to reduce unemployment, the picture in the UK becomes even worse: the UK only spends more in proportion of their GDP per unemployed than Russia, Chile, and Mexico.

Figure 2. Public expenditures on labour market policies per unemployed (% of GDP per capita) in 2010

Source: OECD public expenditure and participant stocks on LMP database, OECD Economic Outlook database and OECD Annual national accounts database.





We are also often told that citizens from other European countries **come to the UK to claim benefits**. The implicit claim in this argument is that the UK unemployment benefit system is more generous than in other European countries. I already showed above that this was not the case for other OECD countries. Since so much of the current discourse is about benefit tourism from eastern European countries, I also compare UK labour market policies to these countries using Eurostat data. As a percentage of GDP (column 1), the UK government only spends more than Malta, Bulgaria and Romania. Note however that unemployed workers have a **higher unemployment benefits replacement rates** in Bulgaria and Romania. When taking into account the higher unemployment rates of some of these countries (column 3), the UK ranks better, but still not particularly high in the ranking (column 4).

The fact that benefits in other European countries are if anything more generous is consistent with the observation that immigrants predominantly do not come to the UK to take advantage of benefits. **We know** that immigrants are on average younger and better educated than people born in the UK. They are therefore not surprisingly **less likely to receive transfers and state benefits** and have higher employment rates than natives.

Table 2. Expenditure on labour market policies in UK and Eastern Europe compared

Columns	(1)	(2)	(3)	(4)
	Public expenditure on lab mkt policies	Unemployment rate		Spending per unemployed
Country			Country	
Romania	0.452	6.9	Romania	0.065507
Malta	0.497	6.9	Lithuania	0.06587
Bulgaria	0.651	6.8	Malta	0.072029
UK	0.703	7.6	Slovakia	0.076529
Czech Rep	0.709	6.7	Latvia	0.0768
Lithuania	0.909	5.4	UK	0.0925
Slovakia	0.926	13.8	Bulgaria	0.095735

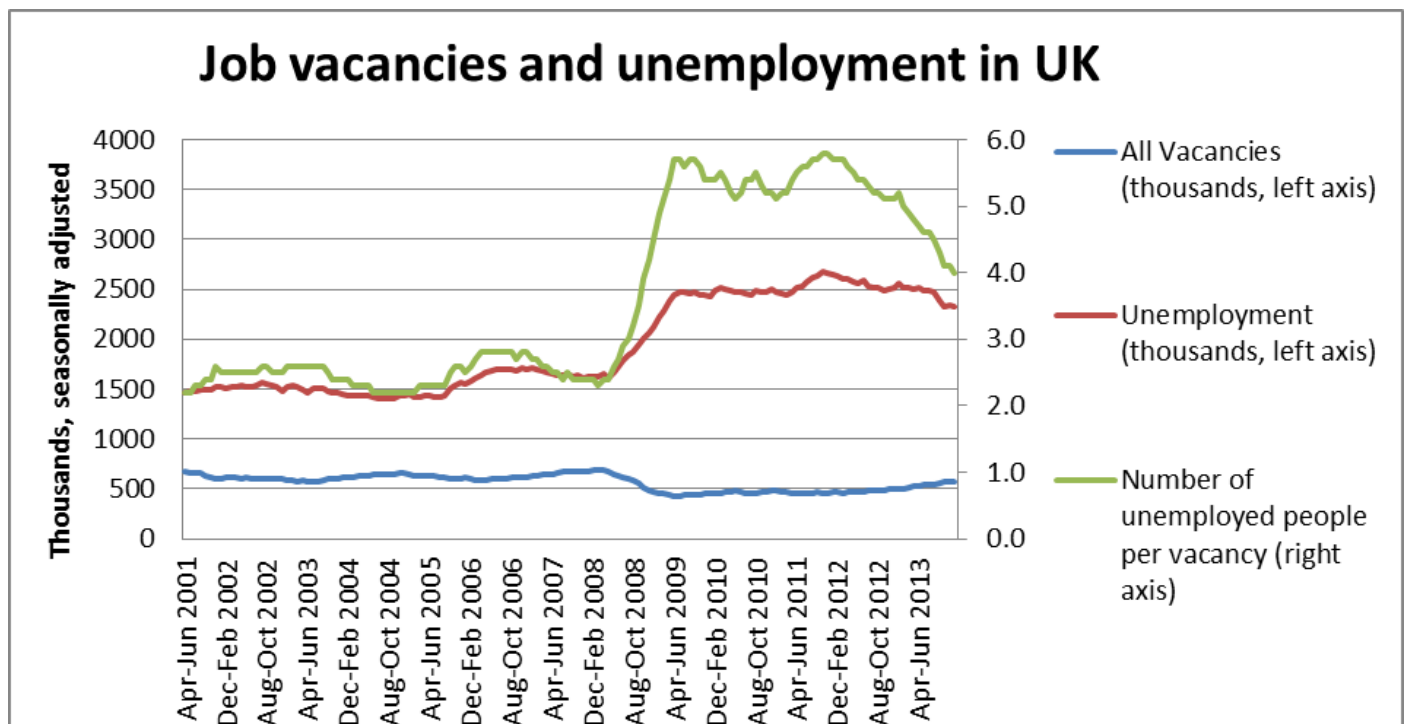
Poland	0.961	9.5	Czech Rep	0.105821
Slovenia	0.962	12.1	Hungary	0.117
Hungary	1.17	8.1	Poland	0.118642
Latvia	1.344	5.9	Estonia	0.118741
Estonia	1.603	10	Slovenia	0.163051

Of course there is significant evidence that the design of unemployment benefits (and other social policies) has important effects on recipients' incentives to return to work. But the paradox is that as one reduces the amount that unemployed workers can claim, their incentive to actively seek work to avoid losing benefits actually falls (i.e. the cost of non-compliance with benefit schemes' requirements decreases as the amount of the benefit is reduced).

In addition, for unemployment benefit reforms to be effective, active labour market programs need to be well-funded. Indeed, improving incentives can only achieve so much if unemployed are not properly trained and there are no funds to promote their mobility. The number of unemployed per vacancy also remains particularly high (see figure 3 below).

Given that the level of fraud is low, that spending on labour market policies is comparatively small, and that the relative availability of jobs remains limited, it makes no sense for the government to try to further restrict eligibility and add sanctions (not least on a benefit system that has already been significantly 'activated'). Instead, there is a need to increase spending on training schemes to improve the match between unemployed and available jobs, and to support aggregate demand (instead of tightening budgets) to increase the number of vacancies.

Figure 3. Job vacancies and unemployment in UK (2001-2013)



Data source: ONS Vacancy Survey/ Labour Force Survey.

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