

A MILLION OFF INCAPACITY BENEFIT

How achievable is the Government's target?

An assessment commissioned by SCOPE

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Summary

This report assesses the extent to which the government's aspiration to reduce the number of incapacity claimants by one million within ten years is deliverable. The assessment is based on a 'model' of flows on and off incapacity benefits (IB) and how they impact on the stock of claimants in each region. The key points to emerge are as follows:

- The headline number of IB claimants will show no tendency to fall away as a cohort of former industrial workers currently on IB finally reaches pension age*
- Rolling out the Pathways to Work initiative at its current effectiveness could be expected to reduce the IB total by approaching half a million in ten years*
- Reaching the government's target of one million off IB would require the proposed reforms to have an overall impact equivalent to double the current impact of Pathways to Work rolled out across the whole country*
- There are enough 'hidden unemployed' on incapacity benefits to allow a reduction in IB numbers of one million, but only if the reduction is heavily skewed to the North, Scotland and Wales*
- Employment growth in the North, Scotland and Wales would need to accelerate sharply, or other sources of new labour supply would need to dry up, if big reductions in IB numbers are to be absorbed*
- In the North, Scotland and Wales the required reduction in IB numbers substantially exceeds the reduction in claimant unemployment since 1997*

The report concludes that in view of the likely difficulty in attaining the target reductions in IB numbers in some parts of the country it would be appropriate to limit the proposed new requirement to engage in 'return to work' activity by exempting older workers and establishing time limits on compulsion.

Purpose of this report

In February 2006 the government published its Green Paper on welfare reform¹. Central to the proposals is the aspiration to reduce the numbers claiming Incapacity Benefit (IB) by one million within ten years. This would mean reducing the current headline total of around 2.7m to 1.7m by 2016.

The aim of the present report is to assess the extent to which this ambitious target is deliverable. This is a data-intensive exercise, drawing principally on the Department for Work and Pensions' (DWP) statistics on incapacity numbers and trends, and on the performance to date of the Pathways to Work scheme aimed at moving IB claimants into work. Crucially, the analysis is carried out at the regional scale as well as for Britain as a whole. This is vital because IB claimants are unevenly distributed around the country, with exceptional concentrations in some older industrial areas in particular.

The first stage involves projecting forward current trends. This establishes a 'baseline' scenario, excluding the impact of the policy changes in the Green Paper. This is especially useful because there is a view that because so many IB claimants are approaching pension age the headline numbers will anyway fall away over the next few years. We assess whether this is actually likely to happen.

The second stage involves introducing assumptions about new trends in the wake of the government's proposed reforms. Here we draw on the performance of the Pathways to Work pilots but we also consider the scale of the changes that would be necessary to deliver a reduction of one million within ten years.

The third part of the analysis considers whether the one million target is plausible. This principally involves comparisons with estimates of the stock of 'hidden unemployed' among IB claimants, and with trends in employment and unemployment since Labour came to power in 1997.

The final part of the report considers the implications for the government's current proposals. Modifications in a number of important directions are suggested.

¹ Department for Work and Pensions *A New Deal for Welfare: empowering people to work*, DWP, London

Current IB claimant numbers

By way of background, Table 1 shows the numbers claiming incapacity benefits in each GB region in November 2005. These are the most up-to-date figures presently available. They cover the total number of men and women in receipt of Incapacity Benefit itself (about 1.4m), 'NI credits only' for incapacity (1.0m) and Severe Disablement Allowance (0.3m). The 'NI credits only' cases are claimants who have insufficient National Insurance credits to be entitled to Incapacity Benefit itself, and most receive Income Support with a disability premium. Severe Disablement Allowance is paid to pre-2001 claimants with a high level of disability and few National Insurance contributions. Together these three groups make up the headline total of 2.7m incapacity claimants that is widely quoted in public debate. For convenience, we refer to the whole of this group simply as 'IB claimants'.

None of this group are presently in employment but none will be recorded as claimant unemployed – it is not possible for the jobless to claim incapacity and unemployment benefits at the same time. A small proportion will still have a former employer to whom they could theoretically return but the figures exclude anyone who is 'off sick' and in receipt of Statutory Sickness Pay from their employer. The figures also exclude those who are in work but in receipt of Disability Living Allowance (around 0.3m). Excepting a very small number (9,000 men and 36,000 women) all the claimants are of working age - ie 16-59/64.

Table 1 : Incapacity claimants by region, November 2005

	Men	Women	Total no.	Total as % working age
North East	103,000	69,000	172,000	11.0
North West	246,000	173,000	419,000	10.0
Yorkshire & Humber	145,000	99,000	244,000	7.9
East Midlands	106,000	75,000	180,000	6.9
West Midlands	146,000	100,000	246,000	7.5
Eastern	101,000	75,000	176,000	5.2
London	184,000	130,000	314,000	6.3
South East	138,000	98,000	236,000	4.8
South West	114,000	78,000	192,000	6.5
Wales	120,000	87,000	206,000	10.7
Scotland	179,000	136,000	315,000	10.0
Great Britain	1,581,000	1,118,000	2,699,000	7.5

Source : DWP

The figures in Table 1 show that IB claimant numbers are substantial in all regions. However, expressed as a percentage of the working age population in each region the figures reveal large and systematic contrasts. The IB claimant rate in the North East, North West, Scotland and Wales is approaching double that in the South (London, South East, South West and Eastern England). At the extremes, one-in-nine of all adults of working age in North East England are on incapacity benefits compared to fewer than one-in-twenty in the South East.

At the local scale the differences in IB claimant rates are often acute². Two districts – Easington in Co Durham and Merthyr Tydfil in South Wales – have IB claimant rates in excess of 20 per cent of their working age population. The IB claimant rate in Glasgow is 16 per cent, in Liverpool 15 per cent, and in Manchester 13 per cent. In

² See C. Beatty and S. Fothergill (2005) *Memorandum of Evidence*, Work and Pensions Committee Inquiry into Incapacity Benefits and Pathways to Work, HC 616-iii.

some sixty districts in total, the IB claimant rate exceeds 10 per cent, but not a single one of these districts is south of a line from the Severn to the Wash. In contrast, there is a large swathe of Southern England where the IB claimant rate is typically 3-4 per cent, with Wokingham in Berkshire and Hart in Hampshire recording the very lowest rates at 2 per cent.

The point is that very high IB numbers are essentially a *regional and local* problem. By and large, it is in Britain's older industrial areas, not the more prosperous South, that the high concentrations of IB claimants are to be found.

Table 2 shows the age breakdown of IB claimants. Overall, the propensity to claim incapacity benefits rises with age. A high proportion of the stock of IB claimants are over 50 – just under 1.3m out of the 2.7m total. Within each age group the numbers of men and women are broadly similar, but overall substantially more men claim incapacity benefits because men move onto state pension at 65 rather than 60. IB claimants are skewed towards the older age groups in all the UK regions.

Table 2 : Age breakdown of incapacity claimants, November 2005

	Men	Women
Under 25	91,000	78,000
25-34	207,000	148,000
35-44	328,000	262,000
45-49	177,000	168,000
50-54	196,000	196,000
55-59	271,000	302,000*
60-64	317,000*	-
All claimants	1,581,000	1,118,000

* includes very small numbers over state pension age

Source : DWP

'Baseline' forecasts

As the first step in understanding the possible impact of the government's proposed reforms we have constructed a 'model' of incapacity claimant numbers. This is based on two elements:

- The present-day stock of IB claimants by age³, sex and region, using the published November 2005 figures from DWP
- The recent on-flows and off-flows from IB, again by age, sex and region, using data on quarterly flows specially commissioned from DWP for the present project

In essence, this is a 'cohort survival' model, similar in principle to those routinely used to forecast population totals. Combining the two elements allows a 'baseline' projection to be made. We have undertaken this exercise to project forward IB numbers for five years (to November 2010) and ten years (to November 2015). The resulting estimates represent the IB numbers we would expect in the absence of policy change.

We have used the average annual on-flows and off-flows (by age, sex and region) over the three years 2002-04. It is not possible to use more recent data because the provisional figures for 2005 and the first part of 2006 are subject to significant revision after they are first published. The average over a three-year period is used because the figures for any one quarter (or indeed year) are too erratic to be used as the basis for long-term forecasts. The figures for 2004, in isolation, show a national fall of 26,000 - the first significant reduction in the headline numbers for a generation. This is encouraging. However, it would be unwise to assume that the figures for this single year represent the beginning of a completely new trend. It would be inappropriate, therefore, to project future trends on the basis of 2004 alone.

Table 3 summarises the average annual flows incorporated into the model. The 2002-04 period was essentially one of stability in national IB numbers, though there were large flows in each direction, equivalent to about a quarter of the total stock each year. The overall stability in numbers occurred against a backdrop of a

³ The stock of IB claimants and the flows in both directions were broken down into the seven age groups shown in Table 2 earlier.

relatively strong UK labour market, with claimant unemployment also broadly stable and markedly lower than during the 1980s or 90s. At the regional scale, 2002-04 was marked by a modest reduction in IB numbers in the four GB regions with the greatest concentrations of claimants (North East, North West, Scotland and Wales) and a modest increase in the South of England, notably in London.

Table 3 : Average annual flows on and off the IB register, 2002-04

	On-flows	Off-flows	Balance
North East	47,300	50,200	-2,900
North West	108,300	110,300	-2,000
Yorkshire and Humber	68,200	68,000	200
East Midlands	47,300	48,200	-900
West Midlands	64,400	64,800	-400
Eastern	47,000	45,300	1,700
London	70,900	63,500	7,400
South East	60,200	56,800	3,400
South West	51,600	49,500	2,100
Wales	47,900	51,200	-3,300
Scotland	87,400	91,300	-3,900
Great Britain	700,400	699,100	1,300

Source : DWP

Table 4 presents our baseline projections of IB numbers. To repeat, these are the IB numbers predicted on the basis of the age composition of the current stock of claimants and the average annual flows by age, sex and region in the three years 2002-04. The projections take no account of the policy changes the government is currently proposing⁴. The figures also implicitly assume the continuation of a labour market context broadly the same as in the first part of the present decade.

⁴ The Pathways to Work pilots, which provide the template for parts of the proposed reforms, will have impacted on flows in the phase 1 pilot areas from October 2003 and in the phase 2 pilot areas from April 2004. However, because the pilots were restricted to a small number of areas they are unlikely to greatly distort the average flows for 2002-04 used in the baseline projections.

Table 4 : Projected IB numbers based on current flows

	2005 actual	2010 projected	2015 projected	Change 2005-15
North East	172,000	158,000	151,000	-21,000
North West	419,000	409,000	414,000	-5,000
Yorkshire and Humber	244,000	245,000	252,000	8,000
East Midlands	180,000	176,000	177,000	-3,000
West Midlands	246,000	243,000	246,000	0
Eastern	176,000	185,000	195,000	19,000
London	314,000	351,000	381,000	67,000
South East	236,000	252,000	265,000	29,000
South West	192,000	202,000	213,000	21,000
Wales	206,000	190,000	184,000	-22,000
Scotland	315,000	295,000	289,000	-26,000
Great Britain	2,699,000	2,705,000	2,766,000	67,000

Source : Authors estimates based on DWP data

The baseline projections suggest no overall reduction in IB numbers. Little change in the GB total is projected by 2010, and a small increase thereafter to 2015⁵.

This is a significant conclusion in its own right. There is a widely held view that IB numbers will fall away through time as a cohort of older claimants reaches state pension age. A large part of this cohort is usually understood as being made up of older men who were made redundant during the wave of job losses from industries such as coal, steel and engineering during the 1980s and 1990s. Many of these men have been IB claimants for a very long time, perhaps continuously since redundancy. It is assumed that they will gradually pass out of the IB figures as they reach state pension age, thereby reducing the headline total. What this view overlooks is the

⁵ If on-flows and off-flows during 2004 alone had been used as the basis for forecasting, the baseline projection of IB numbers would have been around 200,000 lower.

tendency for the IB stock to be renewed as new, younger claimants come onto the register and as existing claimants get older.

Our baseline projections suggest that despite this cohort of older men dropping off onto pensions, the headline national figure will show no tendency to fall over the next ten years. At the regional scale the anticipated reductions in the North East, North West, Scotland and Wales – where these former industrial workers tend to be concentrated – do nevertheless suggest that this process is at work. Indeed, the reduction in IB numbers in these regions over the last couple of years suggests that it has already started. However, in the baseline projections the reductions in these regions are offset by continuing modest growth in IB numbers in the South of England, again a feature of the last two or three years. A significant increase in IB numbers in London, in particular, is projected. The ratio between IB numbers and claimant unemployment in London is currently unusually low by national standards so an increase in IB numbers in the capital would have the effect of bringing London closer into line with the rest of the country.

The impact of policy changes

The Green Paper proposes a wide range of reforms intended to reduce IB numbers. The most important are:

- Rolling out the Pathways to Work initiative to the whole country by 2008. Pathways to Work introduces a series of compulsory work-focussed interviews for most new IB claimants, routes claimants to appropriate forms of rehabilitation or training, and provides a £40 a week return-to-work premium for the first year for those entering low-paid jobs. Existing claimants can also opt in to the programme.
- Introduce a new benefit to replace IB – Employment and Support Allowance – that will introduce a new element of conditionality: all but the most sick or disabled claimants will have to undertake ‘return to work’ activity (eg training, rehabilitation, job search, voluntary work) and failure to do so will be backed up by financial sanctions.

- Place all new incapacity claimants, prior to their Personal Capability Assessment, onto the same rate of benefit that they would receive on Jobseeker's Allowance, thereby removing any financial incentive to claim one rather than the other.

In addition, the government proposes a number of other measures:

- Improvements to workplace health
- Better absence management
- Changes to the Personal Capability Assessment so that it gives greater emphasis to capability to work
- Support for GPs in helping individuals remain in work or return to work
- An end to the escalation of incapacity benefit payments at six and twelve months that is part of the present system

The government has said it intends to set the basic rate of the new Employment and Support Allowance at higher than the Incapacity Benefit level it will replace, and that it will protect the level of benefit payments for people who enter work but find that they need to return to benefits.

These are complex reforms and the government takes the view that it is not possible to model their impact because there are too many uncertainties about how they might work out in practice. However, there is one firm statistic that has been widely quoted by ministers, by the Green Paper, by DWP officials and by the Work and Pensions Select Committee⁶. This concerns the impact of the Pathways to Work pilots. In the Pathways pilot areas it has been established that the share of new claimants who leave IB within six months is eight percentage points higher than in non-Pathways areas⁷. This positive impact has been used as one of the principal justifications for rolling out the Pathways initiative to the whole country.

⁶ House of Commons Work and Pensions Committee (2006) *Incapacity Benefits and Pathways to Work*, Third report of session 2005-06, HC 616.

⁷ See in particular Figure 2.3 on page 28 of the Green Paper.

It is possible to use this key statistic to begin to assess the possible impact of the proposed reforms on the stock of IB claimants. In Table 5 we have modified our baseline projection of IB numbers by introducing the assumption that off-flows from the stock are increased by an amount equal to eight percent of the on-flow (by age, sex and region). This is in effect an attempt to model the impact of rolling out the Pathways to Work initiative across the whole country⁸.

In practice, an eight percentage point increase in off-flows within the first six months could understate the full impact of Pathways to Work:

- Pathways may also raise the off-flow after six months
- As experience of implementing Pathways grows, its effectiveness may increase

But there are also arguments that the eight percentage point figure may be too high:

- Some of the additional individuals leaving IB within six months might anyway have left IB fairly quickly thereafter
- A proportion may also return fairly quickly, especially bearing in mind their health problems and impairments
- The additional individuals returning to work within six months may displace other jobseekers, some of whom then claim IB
- As Pathways is rolled out from the high IB claimant areas where it has mostly been piloted it will often encounter a stock of claimants with more intractable obstacles to labour market engagement

On balance, and in the absence of a more reliable alternative, the eight percentage point figure nevertheless offers the best guide at present to the impact of rolling out the Pathways to Work initiative across the whole country.

⁸ The model introduces this assumption for the full 2005-15 period, whereas in fact Pathways to Work will be rolled-out progressively to the whole country by 2008.

Table 5 : Projected IB numbers based on national roll-out of current impact* of Pathways to Work

	2005 actual	2010 projected	2015 projected	Change 2005-15
North East	172,000	139,000	115,000	-57,000
North West	419,000	366,000	333,000	-86,000
Yorkshire and Humber	244,000	218,000	201,000	-43,000
East Midlands	180,000	157,000	142,000	-38,000
West Midlands	246,000	218,000	198,000	-48,000
Eastern	176,000	166,000	161,000	-15,000
London	314,000	323,000	325,000	11,000
South East	236,000	228,000	221,000	-15,000
South West	192,000	182,000	176,000	-16,000
Wales	206,000	170,000	147,000	-59,000
Scotland	315,000	260,000	222,000	-93,000
Great Britain	2,699,000	2,425,000	2,240,000	-459,000

*Off-flow increased by 8% of on-flow

Source : Authors' estimates based on DWP data

The effect of introducing this assumption into our model is shown in Table 5. This table attempts to show what will happen to IB numbers if Pathways to Work is rolled out across the whole country and its impact on off-flows is the same as in the pilot areas. Across Britain as a whole, we estimate that the effect would be to reduce IB numbers by around 460,000 by 2015. This is well short of the one million target.

At the regional scale the projected impact is more complex. Our model anticipates that the biggest reductions would be in the North of England, Scotland and Wales. As we have previously noted, these are the regions where IB numbers are currently highest. By contrast, our model predicts only a very small reduction in three of the four regions of the South (Eastern, South East and South West) and no reduction at all in London.

This regional pattern is the result of a number of factors. One is the age profile of IB claimants in the North, Scotland and Wales, which as our baseline projection showed should lead to a modest reduction in IB numbers in these parts of Britain. A second factor is the large scale of on-flows to the IB register in the North, Scotland and Wales: as Pathways works mainly by returning a higher proportion of on-flows to the labour market, it will tend to have the greatest impact where on-flows are largest. The third factor is the recent upward trend, built in to the model via on-flows and off-flows, in IB numbers in London in particular and the rest of the South to a lesser extent.

However, the main point remains that delivering the one million target reduction within ten years does not seem possible on the basis of a national roll-out of Pathways alone. In Table 6 we have therefore incorporated the assumption that the impact of the government's proposed reforms is equivalent to *doubling* the current impact of the Pathways pilots across the whole country. In practical terms, this means raising the increase in the six-month off-flow rate from eight to sixteen percentage points. This bold assumption is not intended to imply that we expect the impact of the Pathways initiative to double, or that the combined impact of the government's reforms would in practice be the equivalent to twice the impact of Pathways. The calculation is undertaken simply for illustrative purposes.

As Table 6 shows, doubling the impact of the Pathways initiative, and rolling out this impact across the whole country, would bring the government much closer to its one million target. Our model actually suggests a reduction of just short of one million over ten years.

The model again points to a distinctive regional pattern. The biggest reductions in IB numbers would be in the North East, North West, Scotland and Wales, the four regions with the highest IB claimant rates at present. The reductions in the South of England would be smaller though there would be a fall in all regions, including London.

All models are only as good as the assumption fed into them, and a projection based on 2002-04 flows on and off IB will be influenced by the particular geography of flows during these three years. However, the regional projections in Table 6 do suggest that if the government is to achieve its ambitious target of reducing IB numbers by a

million within ten years the largest proportional falls will have to occur in Northern England, Scotland and Wales.

Table 6 : Projected IB numbers based on doubling impact* of Pathways to Work across whole country

	2005 actual	2010 projected	2015 projected	Change 2005-15	
				no.	as % working age
North East	172,000	120,000	79,000	-95,000	-6.0
North West	419,000	323,000	251,000	-168,000	-4.0
Yorkshire and Humber	244,000	190,000	151,000	-93,000	-3.0
East Midlands	180,000	138,000	107,000	-73,000	-2.8
West Midlands	246,000	192,000	150,000	-96,000	-2.9
Eastern	176,000	147,000	127,000	-49,000	-1.5
London	314,000	294,000	270,000	-44,000	-0.9
South East	236,000	204,000	177,000	-59,000	-1.2
South West	192,000	161,000	138,000	-54,000	-1.8
Wales	206,000	151,000	110,000	-96,000	-5.0
Scotland	315,000	225,000	155,000	-160,000	-5.1
Great Britain	2,699,000	2,145,000	1,715,000	-984,000	-2.7

*Off-flow increased by 16% of on-flow

Source : Authors' estimates based on DWP data

How achievable is the government's target?

What the analysis so far has established is that in order to reduce IB numbers by one million within ten years the government would have to double the current impact of Pathways to Work across the whole country. To assess whether this is feasible, we have taken the projected national and regional reductions in IB numbers from Table 6 (just under one million by 2015) and treated them as *targets*. We have then

compared these targets with data on the stock of hidden unemployed, on employment growth and on unemployment.

i) Comparison with 'hidden unemployment'

'Hidden unemployment' among IB claimants is a controversial subject and it is important to be clear about exactly what we mean. The hidden unemployed are the IB claimants who might reasonably be expected to have been in work in a genuinely fully employed economy. Their benefit claims are in no way fraudulent – indeed, they will all have been authorised at some stage by the medical profession. Nor are their health problems or impairments anything less than real. However, official statistics show that more than 3m people with long-term health problems or impairments do already hold down jobs, and many IB claimants say they would like a job. Furthermore, the fact so many IB claimants have given up looking for work, perhaps because they think there are no appropriate jobs for them, does not make them any less unemployed.

Over the last decade the Sheffield Hallam team has led the way in producing estimates of the extent of hidden unemployment among IB claimants at the regional and local scale⁹. The most recent estimates involve establishing a 'benchmark' for each district across Britain based on:

- The IB claimant rate in the parts of southern England that are at or close to full employment
- The underlying differences in the extent of incapacitating ill-health between each district and this fully-employed part of the South

It is not necessary to go into the detailed methods here. What is worth noting is that the preferred estimates have been cross-checked against the results of other methods and against survey data and have been shown to be robust. The estimates suggest that at the national scale around four-in-ten of the stock of IB claimants should be regarded as hidden unemployed in the sense that they could reasonably have been expected to be in work in a fully-employed economy.

⁹ See in particular C. Beatty and S. Fothergill (2005) 'The diversion from 'unemployment' to 'sickness' across British regions and districts', *Regional Studies*, vol 39, pp 837-854.

Table 7 : Comparison with estimated stock of 'hidden unemployed'

	Estimated 'hidden unemployed' 2004 (A)	Target reduction in IB numbers 2005-15* (B)	Ratio (A/B)
North East	86,000	93,000	0.92
North West	219,000	168,000	1.30
Yorkshire and Humber	97,000	93,000	1.04
East Midlands	68,000	73,000	0.93
West Midlands	103,000	96,000	1.07
Eastern	47,000	49,000	0.96
London	103,000	44,000	2.34
South East	46,000	59,000	0.78
South West	51,000	54,000	0.94
Wales	93,000	96,000	0.97
Scotland	161,000	160,000	1.01
Great Britain	1,073,000	984,000	1.09

*See Table 6

Source : Authors' estimates based on DWP and ONS data

Table 7 compares these estimates of hidden unemployment with the reductions in IB numbers necessary to hit the government's one million target. In general there is a remarkably close correspondence between the two sets of figures, nationally and regionally. This is an important observation. It indicates that if the government could get IB numbers down by one million it would do much to mop up the stock of hidden unemployed among this group. This would be exceptionally good news. What the comparison also shows is that across all the regions the size of the pool of hidden unemployed should not be a significant constraint on bringing IB numbers down. Again, this is good news.

Nevertheless, there is a critically important regional dimension to this comparison. Table 6, earlier, based on doubling the impact of Pathways to Work across the whole country, suggested that to reach the target reduction of one million the largest

proportional reductions in IB numbers would need to come in the North, Scotland and Wales. What the regional comparisons in Table 7 show is that if the target reduction in IB numbers were to be more evenly spread across the regions – say twice as large in the South East, South West and Eastern England, and only half as much in the North East, Scotland and Wales - the close match with the available stock of hidden unemployed would break down. There would not be enough in the South to shift to employment, and in the North large numbers of hidden unemployed would still be left on IB. Given the distribution across the country of the hidden unemployed, it looks difficult to bring down IB numbers by one million unless the reduction is skewed towards the North, Scotland and Wales.

ii) Comparison with employment growth

There is a view within the Treasury and DWP that ‘supply creates its own demand’ – in other words that extra labour supply, arising for example from a reduction in IB numbers, will automatically generate the extra demand to absorb that labour. This is supposed to happen through ‘market clearing mechanisms’, which put simply means that adjustments in wages (in particular) will bring the demand and supply for labour into balance. What matters in this view is that the labour market operates as flexibly as possible, with workers moving smoothly between industries, occupations and places. In this view there is no real need to worry about how the one million coming off IB will be absorbed into the labour market.

Although this view underpins substantial parts of government policy it is not one that is universally held within the economics profession, nor one that has been the dominant paradigm for very long. The alternative view is that market mechanisms do not work smoothly to bring labour supply and demand into balance, and that in the absence of extra labour demand the effect of increasing labour supply will be to increase unemployment.

The evidence from the UK regions, over many years, is that labour demand and supply do not come smoothly into balance. Indeed, the persistence of serious joblessness in some regions provides clear evidence of the failure of market mechanisms. That said, there are times and places where additional labour supply can indeed be expected to generate additional labour demand. This is most likely when regional economies are operating at or close to full employment, when firms’ growth is frustrated by shortages of labour. The South East of England comes close

to fitting this model but not the rest of Britain, though outside the South East there are specific places and occupations where supply might currently be expected to generate its own demand.

The point here is that the ability of Britain's regional economies to absorb large reductions in IB numbers remains a valid question. Nor is this simply about a comparison with number of vacancies. Large numbers of jobs become vacant in all regions all the time because of labour turnover, creating opportunities for individuals coming off benefit to enter work, but what ultimately determines the scale of joblessness in a region is not the flow of vacancies but the balance between the stock of jobs and the stock of available labour. Put simply, if there aren't enough jobs in total to go around, someone is going to be out-of-work.

Table 8 compares the target reductions in IB numbers by region with the increases in employment by region between 1997 and 2005 (ie since Labour came to power). This is intended as a guide. There is no guarantee of course that the next ten years will see the same scale and regional distribution of job creation as in the recent past, and it could in fact be argued that the UK economy has just gone through an extraordinary period of growth that it will be difficult to repeat. The final column in this table shows the ratio between recent employment growth and the IB target: anything substantially less than one would represent a problem in absorbing the required reduction in IB numbers.

In fact, with the notable exception of one region (the North East) this comparison suggests that if the recent pattern of employment growth across the regions were sustained, the number of additional jobs should keep up with the reduction in IB numbers. In the South of England there would be more than enough job growth, though as we have noted, this is not where the largest concentrations of IB claimants are found nor where the greatest reductions in IB numbers are required. In the rest of the country, the balance between falling IB numbers and rising employment would be a closer run thing.

Table 8 : Comparison with employment growth

	Increase in employment 1997-2005 (A)	Target reduction in IB numbers 2005-15* (B)	Ratio (A/B)
North East	35,000	93,000	0.38
North West	163,000	168,000	0.97
Yorkshire and Humber	151,000	93,000	1.62
East Midlands	79,000	73,000	1.08
West Midlands	75,000	96,000	0.78
Eastern	183,000	49,000	3.73
London	282,000	44,000	6.41
South East	189,000	59,000	3.20
South West	156,000	54,000	2.88
Wales	88,000	96,000	0.92
Scotland	142,000	160,000	0.89
Great Britain	1,871,000	984,000	1.90

*See Table 6

Source : Labour Force Survey and authors' estimates

However, this simple comparison overlooks one key point: the creation of nearly 1.9m additional jobs between 1997 and 2005 has actually been associated with *no reduction at all* in the stock of IB claimants. In fact, IB numbers have risen a little (by around 200,000) over this period. The large increase in the number of jobs has been entirely met by other sources of labour supply – by a reduction in recorded unemployment, by rising labour force participation by other groups (especially women) and by international in-migration. What the figures in Table 8 therefore imply is that if IB numbers are to be reduced by one million without simply adding to the stock of unemployed, then either employment growth must accelerate or the growth in other sources of labour supply must slow down.

iii) Comparison with claimant unemployment

Since the recession of the early 1990s a large part of the UK economy's growing demand for labour has been met by falling claimant unemployment (ie the number out-of-work and claiming Jobseeker's Allowance (JSA)). This was to be expected. Unlike IB claimants, JSA claimants are required to look for work, they are a younger group, and they do not face the health problems and impairments of IB claimants, so they were always likely to be the first to be taken on in an up-turn. However, with claimant unemployment now down to just below one million, compared to three million at its peak, the scope for further big reductions in claimant unemployment is limited. For the first time in a generation there is the possibility that further employment growth could lead to falling numbers on IB.

Table 9 : Comparison with reduction in claimant unemployment

	Reduction in claimant unemployment 1997-2005 (A)	Target reduction in IB numbers 2005-15* (B)	Ratio (A/B)
North East	48,000	93,000	0.52
North West	92,000	168,000	0.55
Yorkshire and Humber	78,000	93,000	0.84
East Midlands	43,000	73,000	0.59
West Midlands	47,000	96,000	0.49
Eastern	47,000	49,000	0.96
London	107,000	44,000	2.43
South East	64,000	59,000	1.08
South West	63,000	54,000	1.17
Wales	39,000	96,000	0.41
Scotland	71,000	160,000	0.45
Great Britain	696,000	984,000	0.71

*See Table 6

Source : ONS and authors' estimates

Table 9 compares the target reduction in IB numbers with the fall in claimant unemployment between 1997 and 2005, again by region. This is relevant in so far as falling IB numbers might now be expected to take over from where falling JSA numbers have left off. The final column again shows the ratio between the two, with any figure substantially less than one suggesting there will be difficulty in absorbing the reduction in IB numbers.

Overall, the target reduction in IB numbers of one million by 2015 exceeds the reduction of 700,000 in claimant unemployment that Labour has achieved since it came to power in 1997. Region by region, the excess of the IB target over the fall in claimant unemployment is greatest in the North East, North West, Scotland and Wales, where IB numbers would need to fall about twice as fast as claimant unemployment since 1997.

Assessment and implications

It is important not to place too much weight on the detailed output from any forecasting exercise. What matters are the directions of anticipated change and the broad orders of magnitude. Our analysis does however point strongly to a number of conclusions:

- The headline number of IB claimants will show no tendency to fall away as a cohort of former industrial workers currently on IB finally reaches pension age
- Rolling out the Pathways to Work initiative at its current effectiveness could be expected to reduce the IB total by approaching half a million in ten years
- Reaching the government's target of one million off IB would require the proposed reforms to have an overall impact equivalent to double the current impact of Pathways to Work rolled out across the whole country
- There are enough 'hidden unemployed' on incapacity benefits to allow a reduction in IB numbers of one million, but only if the reduction is heavily skewed to the North, Scotland and Wales

- Employment growth in the North, Scotland and Wales would need to accelerate sharply, or other sources of new labour supply would need to dry up, if big reductions in IB numbers are to be absorbed
- In the North, Scotland and Wales the required reduction in IB numbers substantially exceeds the reduction in claimant unemployment since 1997

Having an overall policy impact on IB numbers equivalent to double the current impact of Pathways to Work, and delivering that impact across the whole country, is a tall order. But it is the last three points, regarding the regional dimension, that really expose the weakness in the strategy to lower IB numbers. Put simply, there seems little prospect of achieving the one million target without a sustained acceleration in employment growth in the North, Scotland and Wales. In the absence of this growth, the most likely outcome in these regions is that most or all of any reduction in IB numbers will simply boost the numbers in other jobless groups, including the claimant unemployed.

We would question whether the policies are in place to deliver this acceleration in regional job growth. Nationally, the long period of economic growth driven by consumer spending and rising debt seems to be drawing to a close, and public finances preclude further big increases in public sector employment. In the North, Scotland and Wales, big reductions in EU regional aid will begin to bite from 2007 onwards. The upshot is that we think it unlikely that over the next few years the economies of the North, Scotland and Wales will be able to absorb the very big reductions in IB numbers that the government needs to hit its one million target.

If a reduction in IB numbers of one million within ten years is not in practice attainable, at least within the present economic and policy context, there are important implications for the government's proposed reforms. In particular, the government needs to recognise that it is unreasonable to apply a blanket expectation to all but the most severely ill claimants to undertake 'return to work' activity. For a great many IB claimants the prospects of a successful return to work are likely to remain slim, partly because of their health or impairments, partly because of complicating factors such as poor qualifications and skills, and partly because of the difficult labour markets they face in some parts of the country. They are unlikely to be employers' first choice.

An earlier paper on the proposed reforms¹⁰ argued for two exemptions:

- Men and women approaching state pension age should be exempt from the compulsory requirement to prepare for work. Their engagement in return-to-work activity should be entirely voluntary. (In 2004, 125,000 new claims were made by men and women over 55).
- For claimants who fail to return to work after a specified period, continuing engagement in preparation for work should also be entirely voluntary.

The analysis in the present report confirms the good sense in these exemptions. There is little point in raising false hopes among men and women who by virtue of age, skills, ill health or location are likely to find re-entry into the labour market highly problematic. Compulsion is likely to be unpopular, and it does not make sense to target time and resources at men and women who will resent the intervention. The government's aspiration to deliver a reduction of one million in IB numbers may be laudable, but until all the UK regions are capable of absorbing big numbers back into work it would be best to proceed sensitively and pragmatically.

¹⁰ S. Fothergill (2006) *Not the Green Paper!: The reform of Incapacity Benefit: alternatives to the government's proposals*, SCOPE, London.