Proposed cap on Annually Managed Expenditure: Recommendations from NCVO's Welfare Reform Group

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The National Council for Voluntary Organisations (NCVO) is the largest membership organisation for the voluntary sector in England. With over 10,000 members, NCVO represents all types of organisations, from large 'household name' charities to small voluntary and community groups involved at the local level.

NCVO has convened a group of leading national charities ('the Group') which work with and on behalf of millions of people whose lives may be affected by further changes to social security policy - including families with children, older people, people with disabilities, and those who struggle with their housing costs.

Overview

Government proposals for a cap on Annually Managed Expenditure (AME) were announced in Spending Round 2013. The cap will place fixed annual limits on social security spend for future years, and limit the scope for future discretionary increases to working age entitlements. More detail on the development of the cap is expected to follow in the Autumn Statement and first caps to be set in Budget 2014. The caps will be applied from 2015/16.

Overall, charities are concerned that the cap mechanism will not encourage a strategic approach to social security spending, but will lead to short-term cuts and have a detrimental impact on people's lives. Instead, it is essential to provide adequate support for claimants while also investing in long-term policies such as early action and preventative initiatives which address the root causes of rising costs of social security in the medium-term. This includes initiatives such as house-building projects, support for older workers and youth employment programmes. If the government does proceed with its proposal for an AME cap, it is essential that it consults on the technical design and process for review, to ensure that spending is effectively managed and the lives of claimants are safeguarded from serious unintended consequences.

The Group strongly recommends that Government should announce a consultation on the detail of its AME cap plans in the Autumn Statement. This should include consideration of impacts on the population as well as technical aspects. Government should also produce an impact assessment of the proposed cap, including impact on different sections of the population and rates of poverty.

Key issues

Scope of the cap

The Group recommends that Government holds a full consultation on the proposed scope and design of the cap.

- The Group has strong concerns that the proposed changes to social security in the form of the cap will have a detrimental impact on people's lives, including families with children, older people, people with disabilities, and those who struggle with their housing costs.
- The cap is essentially targeted at social security spending on working age claimants and non-contributory pension benefits. It will aim to exclude "automatic stabilisers" or benefit payments for which there is increased demand during economic downturns.
- The rationale for which benefits will be included within the scope of the cap remains unclear, with concerns that the government has adopted a very narrow definition of an "automatic stabiliser", which currently only includes Job Seeker's Allowance (JSA) and passported benefits.
- There is a clear need for Government to consult on this contested definition. JSA is classed as an automatic stabiliser as spending on JSA increases in recessions as more people are made unemployed and subsequently claim this support. But tax credits and housing benefit also display these characteristics, increasing as earnings decrease in downturns.
- How "automatic stabilisers" is defined within this policy is crucial so that social security spend can increase during economic downturns to provide adequate support to claimants, which in turn supports economic recovery.
- The lack of information about how Universal Credit would fit within the definition of an "automatic stabiliser", and will operate within the framework of the cap is also a concern for charities.

How the cap will be expressed

The Group is concerned that a cap expressed in nominal cash terms will lead to short-term cuts, and longer-term erosion in social spending. It is imperative that the proposed cap should have a mechanism to adjust for inflation and market conditions.

- The government plans to express the cap on welfare spending in cash terms, and set nominal targets for the first four years (2015/16-2018/19) in Budget 2014. We understand that nominal targets will not be recalculated for any circumstances that would affect conditions in the economy and forecast revisions.
- This would be a critical flaw in the cap's design as it is inflexible in accounting for inflation and unable to manage for economic shocks. It would instead increase the likelihood that the cap would be breached and necessitate further policy actions to reduce spending.
- Charities are especially worried that incorrect assumptions about inflation could lead to the erosion of social spending in real terms, and will have a detrimental impact on the overall living standards of claimants, such as disabled people, particularly in times of poor economic performance, due to irresponsive and immovable cap levels.
- If proceeding with a cap, Government should follow examples from other countries which set their targets in real terms and provide nominal figures at the beginning of each Budget

year. This will ensure that spending plans reflect market conditions and protects against overall the erosion of social security, while also meeting the government's objective to provide a greater level of certainty on welfare expenditure.
- OBR forecasts will be used in 2014 to set nominal targets for the next four years. However there is concern that targets will be "out of date" by Year 4, given the annual revision of economic forecasts. Claimants who rely on social security could be severely disadvantaged by carrying the burden of larger than expected inflation increases or poorer than expected economic performance.

How the cap level will be set

As Government is considering the appropriate level at which to set the cap, it will be essential to consult on the underlying assumptions.

- If the cap is a mechanism to aid policy debate about spending, it should be sufficiently flexible to adjust for new assumptions.
- It is understood that the OBR will combine their economic forecasts with forecasts derived through the Department for Work and Pensions' data and models, which are the basis for social security forecasts. It is unclear how the OBR will evaluate DWP assumptions on the success and longevity of certain initiatives e.g. Work Programme and Universal Credit, and there is a considerable risk that assumptions in 2013/14 will be 'baked into' the cap levels set for the next four years.
- Assumptions about market conditions and the success of government initiatives should be subject to regular review and consultation, so that social security spending targets are adjusted to prevent erroneous calculations for what constitutes as adequate provision of support to claimants.

The "buffer zone"

The Group understands that the Government is considering options for a "buffer zone" and believes that there should be consultation on options for including the buffer zone within the cap level or alternatively, setting it annually to adjust for inflation and any other factors which affect the forecasts.

- The government is considering plans to include a "buffer zone" that will be set above the nominal cap targets, to signal that temporary or relatively small increases in expenditure would not necessarily call for policy action.
- It is unclear how these buffer zones will be calculated and when they will be announced.
- There are serious concerns that political pressure to respond robustly to minor breaches will prevent Government from adopting measured approaches in dealing with small or temporary increases in spending. Building a buffer zone into the proposed cap could better enable Government to consider long-term strategic solutions.
- Another option would be for the buffer zone to be calculated at the beginning of each financial year to allow incorporation of latest economic forecasts and help to adjust for

cyclical factors and economic performance. If designed in this way, the buffer zone could act as a compensatory design feature, should the government prefer to stick to fixed nominal targets.

Process in the event of cap breaches

The Group recommends that a process is built in, to ensure that the Government consults with stakeholders in the event of a cap breach, before any policy action is confirmed.

- While the cap is considered as a mechanism to prompt the debate on annually managed expenditure, and not trigger short-term or 'automatic' decisions, it is likely that with fixed nominal targets, a range of policy actions could result in the event of a cap breach.
- Options for policy actions or the process this would follow are still unclear; however there are strong concerns that political pressure will encourage swift and short-term actions without consultation.
- It is imperative that clear processes in the event of a breach should be determined from the outset; this should include reasonable timeframes and releasing data to enable analysis of causes for breaches, communicating these factors to stakeholders and the public, and allowing for meaningful consultation with key stakeholders on policy options and actions.
- Any government announcement of a breach should be followed by a compulsory consultation period prior to any confirmed Government policy actions. It is important that Government fully considers the causes for a rise in social security spending and assesses the impacts of possible options on the lives of claimants.
- By expressing the cap in nominal terms there is a clear focus on expenditure levels, which make short-term policy options such as changes in eligibility or uprating more likely to occur in the event of a breach. However, a more effective approach to drive down expenditure would be to address long-term causes and structural drivers of increased working-age benefit entitlements, including measures such as house-building and improving employment initiatives.