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Work and Pensions Committee  
House of Commons  
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Dear Frank

### **Universal credit**

Thank you for your letter of 17 October.

We noted several areas of concern with the forecasting architecture for universal credit in our January 2018 *Welfare trends report (WTR)*. These included the need for greater use of administrative data about individuals and families that are already in the system to inform our forecast judgements, the problems that arise from the use of proxy methodologies (such as those used to estimate the cost of transitional protection) and the general complexity of the marginal cost forecasting approach.

We had very detailed and useful discussion with DWP during the preparation of the WTR, which gave us both a better understanding of the strengths and shortcomings of the architecture. We have been working closely with DWP analysts since then to ensure that the forecast can draw on a more accurate representation of the real-world operation of UC.

As regards your specific questions:

#### ***Has the Department now improved its monitoring and forecasting architecture to your satisfaction?***

As noted in our October 2018 *Economic and fiscal outlook (EFO)*, the department has made some progress in developing and using UC administrative data. Our October forecast has been informed by provisional data and analysis relating to self-employed UC cases and early estimates of fraud and error rates in UC. We were also able to draw on analysis that better identifies claimants' other characteristics and allows more meaningful comparisons with the legacy system. This represents a marked improvement on the situation prior to the statements we made in the WTR. But it is important to recognise that such analysis remains in its early stages and the department has indicated that there is much work to be done in both processing and understanding the data that are now flowing in from the UC administrative systems.

Further improvements in the real-time assessment and monitoring of the outturn data from UC management systems would further enhance our ability to forecast UC spending during the rollout, which is proving to be period of uncertainty in terms of both operational delivery and claimant behaviour. The

geographical shape of the rollout adds to the analytical and forecasting challenge, as the characteristics of claimants across the country are not uniformly distributed. This affects how we interpret emerging information and the conclusions we draw from it. It is not an issue we often face in our forecasts.

The principal challenge with the current forecasting architecture that we now need to address is maintaining the marginal cost approach to forecasting UC. This approach was detailed in the *WTR*. It requires forecasting legacy benefit spending as if UC did not exist and layering the marginal cost or saving from moving to UC on top. This provided a relatively robust basis for the forecast when the weight of the real-world caseloads and expertise lay in the legacy system, but this approach is becoming increasingly difficult to operate as legacy benefit outturn data are increasingly affected by cases having moved to UC.

Moving to a full 'gross' forecast of the UC build-up, alongside the legacy system run-down, would remove some of the problems we currently face. But it comes with its own challenges, not least that the transition between the systems is dependent on claimant characteristics that are not always observable in the data. And experience tells us that data from the early days of any new system cannot be relied upon as a good indicator of behaviours and characteristics once the new system is more fully in place. Nonetheless, we are working with DWP to ensure that we can move to such a model as soon as is feasible.

***If not, what more does it need to do?***

In the near term, we expect the department to continue to prioritise the production and analysis of UC administrative data on a continuous basis, affording timely insights for our forecasts. As UC caseloads continue to grow in size and maturity, we will need to be able to explore how individuals and families move on and off UC – and between the different UC groups and award elements – which we have so far been unable to model given the lack of data.

The average amounts of UC paid per claim, which can be a major source of error in forecasts, has tended to receive less analytical attention than the volume of claims. The composition of UC awards in terms of their different elements – the amounts payable for variable elements (such as housing costs) and the different types and amounts of income offsetting the maximum award – is critical if we are to forecast UC spending accurately. Unfortunately DWP statistical publications generally contain little information about the composition of amounts paid. Greater transparency on this front would help us to compare the assumptions on which our forecasts are based against real-world developments more effectively. Where there are gaps in the data extraction, these need to be filled as a matter of priority. We would be extremely concerned were the experience of ESA to be repeated, where it has taken ten years to obtain key information on disability premia from the front-end IT.

In the longer term, we are working with DWP analysts on moving to a full UC forecast model. We are keen for the department to make concrete steps towards this approach.

***If so, what impact does this have on forecasts of the costs and benefits of Universal Credit, compared to those set out in the Universal Credit business case?***

We assess the impact of UC spending on the public finances over a five-year forecast horizon, rather than the costs and benefits of UC in a business case. This narrower focus means that our forecast differs from many aspects of the UC business case, which attempts to assess the wider social costs and benefits of the

policy in line with the requirements of the Treasury's Green Book. When it comes to decisions on the business case, we believe that the adequacy of the forecasting architecture should be an important consideration.

Best regards,  
Robert

Robert Chote

**Chairman**