

Tackling Economic Inactivity: The Urgent Need for Robust Benefit Reforms in a Low-Growth Economy

by Ben E. McWilliam



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Introduction

The United Kingdom's (UK) welfare system is currently contending with a pronounced economic inactivity crisis, which undermines national productivity, fiscal sustainability, and aggregate living standards within a persistently low-growth macroeconomic environment. As of October-December 2025, the economic inactivity rate among individuals aged 16-64 reached 20.8%, corresponding to 9.04 million working-age individuals — a marginal quarterly decrease of 0.1 percentage points, yet remaining above pre-pandemic levels (ONS, 2026b). The predominant factor driving this trend is long-term sickness, with 2.8 million individuals classified as economically inactive due to health-related reasons— an increase of 800,000, or 40% rise since 2019 (KBW, 2025). The resultant annual economic burden is estimated at £212 billion (approximately 7% of GDP), encompassing £45 billion in welfare benefits (projected to rise to £65 billion by 2030), leading to foregone economic output, and heightened pressures on the National Health Service (NHS) (Latimer, Ray-Chaudhuri et al., 2025).

Economic forecasts predict the economy to grow at just 1.5% on average over the medium term (OBR, 2025), these patterns worsen income stagnation. The Resolution Foundation's Living Standards Outlook 2026 projects real household disposable-income growth averaging only 0.3% annually for the rest of the decade, with poorer-half non-pensioner households seeing just 0.5% yearly gains since the mid-2000s, despite employment rises (TRF, 2026a). The Labour government's 'Get Britain Working' measures, including the April 2026 cut to the Universal Credit LCWRA element for most new claimants to £217.26 per month (from £423.27, frozen to 2029/30: protected rate rising to £429.80), seek to reduce disincentives and yield around £950 million in savings by 2030/31 (UK Gov, 2025a). Yet these steps remain too modest to halt dependency. This paper argues for bolder reforms — mandatory face-to-face assessments, time-limited benefits for treatable conditions, and strengthened work incentives with conditionality — to tackle the £212 billion ill-health burden, lift participation, relieve taxpayers, and free fiscal room for growth-orientated policies, all while safeguarding severe disabilities in a constrained 1.5% growth outlook.

Macroeconomic Forecasts & Insights

The persistent rise in health-related economic inactivity exacts a severe toll on UK economic productivity and long-term growth prospects. With 2.8 million working-age individuals inactive due to ill health — an 800,000 (40%) increase since 2019 — the Keep Britain Working Final Report estimates the annual societal cost at £212 billion, equivalent to roughly 7% of GDP. This breaks down into £132 billion in lost output, £45 billion in working-age health and disability benefits, and substantial NHS pressures, alongside £85 billion in employer costs from absence, presenteeism, and recruitment challenges (UK Gov, 2026).

NHS pressures arise primarily because prolonged ill health and economic inactivity force the system into a predominately reactive mode, treating established or worsening conditions rather than emphasising prevention and early intervention (UK Gov, 2026). The Office for Budget Responsibility (OBR) also notes that inactivity adds a measurable extra per-person burden to NHS costs, particularly amid an ageing and sicker population (OBR, 2025). Long NHS waiting lists for elective care — standing at around 7.29 million at the end of December 2025 — exacerbate this by delaying diagnosis, treatment, and recovery for conditions like musculoskeletal disorders and mental health issues, which in turn prolong symptoms, increase the risk of workforce exit, and drive higher ongoing utilisation of NHS services for unmanaged or deteriorating health problems. This feedback loop intensifies demand on emergency care, GP appointments, and overall resources, deepening system strain (NHS England, 2026).

Economic Hypothesis

This drag directly constrains aggregate labour productivity — the core driver of long-run potential output growth, per capita income, and sustainable living standards. Reduced effective labour supply from entrenched health-related inactivity lowers the participation rate, impedes efficient sectoral and firm-level reallocation of workers, and exacerbates matching frictions (evident in slower job-to-job transitions). This stifles capital deepening (growth in the capital-labour ratio), curtails total factor productivity (TFP) gains through diminished on-the-job learning, knowledge spillovers, and hysteresis effects — whereby prolonged detachment erodes human capital, employability, and labour-market attachment. The result is a persistent negative output gap relative to natural-rate-adjustment potential, muting Okun’s law-consistent GDP expansion and constraining fiscal headroom for growth-enhancing public investment.

The Resolution Foundation underscores this in its Living Standards Outlook 2026 and New Year Outlook 2026: weak underlying labour productivity growth — aggravated by stalled labour force participation rate progress, diminished labour-market dynamism, and persistent matching frictions — remains the principal constraint on real wage growth and broad-based improvements in household living standards (TRF, 2026a; TRF, 2026b). Incomes for the poorer half of non-pensioner households (‘Unsung Britain’) have grown by only 0.5% per annum since the mid-2000s, even as employment rates in this cohort have risen substantially, illustrating a classic decoupling of employment from material living standards when productivity stagnates (TRF, 2026a). This pattern reflects limited pass-through from real GDP growth to median and lower-half household disposable income, exacerbated by compositional effects (e.g., shifts toward lower-productivity sectors) and the concentration of net job creation in activities with subdued labour productivity.

The Foundation also identifies early, tentative evidence of ‘creative destruction’ in 2025-2026 — low productivity ‘zombie’ firms exiting amid higher real interest rates, energy costs, and labour-market tightening — which could, in principle, support future productivity gains through Schumpeterian resource allocation toward higher-productivity uses. However, any such upside

remains heavily conditional on the resolution of matching frictions (skills mismatches, geographical immobility, health-related barriers to re-entry) which currently limit efficient job creation and worker reallocation. Absent stronger reallocation mechanisms, the process risks manifesting as higher structural unemployment or further inactivity rather than genuine productivity-enhancing churn. The evidence therefore reiterates that reviving trend labour productivity growth is the sine qua non for consistent real wage progression and broad-based living-standards recovery. Without it, even sustained employment gains deliver only marginal gains to median and lower incomes, perpetuating the ‘high employment, low prosperity’ equilibrium that has characterised much of the post-2008 UK economy (TRF, 2026b).

Macroeconomic Reality

Official growth projections now reveal a clear macroeconomic verdict: the UK’s welfare system is exerting a sustained, endogenous compression on the economy’s long-run supply potential. The OBR has cut its medium-term underlying labour productivity growth assumption by 0.3 percentage points to 1% per year, almost entirely the result of a downward revision in trend TFP to 0.8% (from 1.1% in March 2025), with labour supply growth (0.5%) and capital deepening (0.2%) held constant. (OBR, 2025) This adjustment trims medium-term potential output growth to 1.5%, with trend productivity now expected to edge up only gradually from 0.3% in 2024 and 0.7% in 2025 before reaching 1% by 2030 — still far below the pre-financial crisis decade average of 2.1% (OBR, 2025). Real GDP growth is accordingly anchored at around 1.5% from 2026 onwards. The National Institute of Economic and Social Research reaches a near identical conclusion, forecasting real GDP growth of 1.4% in 2026 (modestly above its 1.25% trend estimate), easing to 1.3% in 2027 and stabilising at 1.3-1.4% thereafter, which translates into real GDP-per-capita growth remaining below 1% from 2027 (NIESR, 2025). These repeated downward revisions are not random forecasting noise, they in reality reflect the cumulative impact of a welfare system that has allowed a compositional hardening of economic inactivity— dominated by long-term sickness and especially mental-health claims — to become a structural headwind against efficient labour reallocation, skill utilisation, and TFP growth.

Although the headline inactivity rate — 20.8% for ages 16-64 in October-December 2025 (ONS, 2026b) — has eased modestly year-on-year and sits close to its pre-pandemic level (around 20.7% in early 2020), the underlying shift towards chronic, treatable conditions creates a qualitatively different and more enduring constraint on the production possibility frontier than earlier transitory drivers. In this environment, modest employment gains cannot translate into rising living standards or fiscal headroom; instead, they lock the economy into a low-equilibrium trajectory where weak potential output growth limits scope for pro-growth tax relief, public investment, or counter-cyclical support.

Prior Government Successes?

In contrast to the current low-growth stagnation and rising structural barriers from health-related inactivity, the period from 2010 to 2019 under successive Conservative-led governments saw a sustained improvement in labour-market participation that supported modest but consistent output gains. Economic inactivity for ages 16-64 trended downward steadily from around 23-24% in the early 2010s to historic lows of 20.5-20.7% by late 2019, driven by rising employment-to-population ratios (EPOP) that reached record highs of approximately 76.1% for working-age adults by mid-2019 (ONS, 2020). This progress was underpinned by falling long-term sickness claims in the pre-pandemic era, alongside broader increases in LFPR — particularly among older workers and women — reflecting policy measures such as state pension age rises, welfare-to-work initiatives, and a supportive macroeconomic environment of recovering demand post-austerity. Internationally, the UK also ranked consistently among the lowest inactivity rates in the G7 throughout this period (OBR, 2023), second only to Japan in late 2019, with the UK's 16-64 inactivity rate hovering below the G7 average and demonstrating relative resilience compared to peers facing similar post-crisis legacies (OBR, 2023). Real GDP-per-capita growth, while modest and hampered by fiscal consolidation and the lingering effects of the 2008 global financial crisis, remained steadier during recovery phases, averaging around 1.5-2% annually in the mid-to-late 2010s (ONS, 2026a) with cumulative gains that outpaced many European peers despite subdued productivity. This period demonstrates that, under conditions of declining inactivity and rising EPOP, the UK could achieve a virtuous cycle of higher effective labour supply, modest TFP-supported growth, and improved fiscal headroom — outcomes that stand in sharp relief to today's entrenched sickness-driven detachment.

The 'Get Britain Working' Paradox: Britain Isn't Getting More Productive

The Labour government's 'Get Britain Working' agenda, incorporated within the Pathways to Work framework and given statutory force through the Universal Credit Act 2025, constitutes the government's primary policy response to the persistent economic inactivity challenge. The agenda's core objective is to rebalance incentives within Universal Credit by narrowing the substantial gap between health-related out-of-work support and unemployment benefits, while simultaneously expanding voluntary, tailored employment assistance to facilitate gradual returns to work for those with health conditions or disabilities (UK Gov, 2025a).

The main policy response, effective from 6th April 2026, fundamentally alters the Limited Capability for Work-Related Activity (LCWRA) element of Universal Credit. For most new claimants assessed as having LCWRA from that date, the health element is reduced to £217.26 per month — approximately halved from the previous £423.27 rate in 2025/26 — and frozen in cash terms until 2029/30. A protected higher rate of £429.80 per month (uprated from £423.27 in 2025/26 to reflect the April 2026 adjustment) is retained for existing LCWRA recipients as of 5th April 2026 who maintain continuous entitlement, new claimants meeting severe conditions criteria (lifelong, severe

impairments where no meaningful work-related activity is feasible), and claimants subject to special rules for end-of-life. Transitional protections apply to certain legacy benefit recipients migrating to Universal Credit before the cut-off, ensuring they access the higher rate (Waters, 2026). To offset the reduction for the broader claimant base, the Universal Credit standard allowance receives a sustained above-inflation increase — for example, the single person 25+ rate rising by £7 per week from £91 in 2024/25 to £98 in 2026/27 — delivering a net cash boost to many households (UK Gov, 2025a).

The Department for Work & Pensions estimates these changes will yield approximately £950 million in net savings by 2030/31 (after accounting for the standard allowance uplift), with the fiscal space redirected into a multi-billion pound investment package in employment support by the end of the decade (UK Gov, 2025b). This includes over 1,000 dedicated Pathways to Work advisors embedded in Jobcentres across England, Wales, and Scotland, offering personalised, voluntary support to people on health-related benefits who previously had limited or no mandatory engagement. The package also encompasses the nationwide rollout of WorkWell, a health-and-employment integration programme providing early, joined-up interventions such as physiotherapy, counselling, workplace adjustments, and return-to-work planning for up to 250,000 additional people.

Conclusion

These reforms pushed by the Labour government are framed as a decisive reset of incentives — reducing the ‘health premium’ that can discourage transitions into employment — while prioritising dignity, prevention, and tailored support over punitive conditionality for most claimants with health conditions. However, the paradox lies in the gap between this ambitious branding and the reality of incremental change that fails to address the structural drivers of inactivity. While the LCWRA reduction for new claimants narrows the financial disincentive between sickness and unemployment benefits, it applies only prospectively, creating a two-tier system that risks entrenching dependency among existing claimants and does little to curb the inflow of new cases into long-term sickness benefits. The reforms introduce no mandatory face-to-face medical assessments for low-level or fluctuating mental-health claims, no time-limits on support for treatable conditions, and no robust work-search or skills-training requirements for those capable of gradual return — measures long advocated for greater accountability and prevention of over-diagnosis. Overall inactivity remains near pre-pandemic levels despite these initial steps, with ill-health trends largely unchecked, suggesting these changes are too timid to reverse entrenched dependency (TRF, 2026b).

Multiple papers reviewed within this article provide crucial benchmarks, estimating that bolder reforms — including mandatory face-to-face assessments, time-limited benefits for treatable conditions, integrated mandatory skills training and job-search obligations, and balanced incentives with reasonable sanctions — could deliver initial annual savings of £3-8 billion, potentially scaling to £9-18 billion at maturity through reduced benefit flows, lower NHS burdens, and higher economic output (UK Gov, 2026). Labour’s current package, by contrast, delivers only £950 million in projected savings by 2030/31 while relying on voluntary support that has historically proven insufficient to shift

large-scale participation in a low-growth economy (UK Gov, 2026). This cautious approach risks perpetuating the vicious cycle of weak labour supply, subdued TFP growth, and constrained potential output growth, rather than decisively prioritising personal responsibility, rigorous verification, and work as a pathway to dignity and contribution (Cribb, Karjalainen et al., 2025).

Policy Recommendations

- **Mandatory face-to-face medical assessments for low-level and mental-health claims.** Independent, occupational-health-trained assessors would conduct in-person (or robust video) evaluations for all new and periodic reviews of fluctuating or lower-severity conditions (e.g., anxiety, stress, mild depression). This curbs potential over-diagnosis, ensures support targets genuine incapacity, and aligns assessments with functional work capability rather than self-reported symptoms alone.
- **Time-limited benefits for treatable/recoverable conditions.** Introduce initial 6–12 month duration for LCWRA or equivalent support in cases deemed treatable or improvable, with renewal conditional on demonstrated medical progress or engagement in rehabilitation (via mandatory reassessment). Indefinite protection remains for severe, lifelong disabilities meeting strict criteria.
- **Mandatory skills training, job-search requirements, and phased return-to-work plans.** For claimants assessed as capable of gradual return (LCW or LCWRA-lite categories), enforce reasonable work-related activity: participation in approved skills/bootcamp programmes, weekly job-search evidence, and employer-linked rehabilitation plans. Pair with positive incentives (enhanced earnings disregards up to £500/month, in-work bonuses for sustained employment >6 months) and proportionate sanctions for non-compliance.
- **Balanced sanctions regime with safeguards.** Implement graduated, reasonable sanctions (e.g., 10–50% benefit reduction for repeated non-engagement) only after warnings, support offers, and appeal opportunities, with full hardship protections and ring-fenced funding for discretionary hardship payments. Reinforces mutual obligation without undue hardship, improves compliance rates, and accelerates re-entry.

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