



Institute for Fiscal Studies Briefing

The IFS Green Budget

October 2020

Edited by
Carl Emmerson
Christine Farquharson
Paul Johnson

In association with Citi and funded by the Nuffield Foundation



Welcome

Welcome to the IFS 2020 Green Budget.

For the second year running, this is a Green Budget without an Autumn Budget to follow it. Even so, this year's Green Budget is more important than ever.

The Chancellor has already announced £200 billion of support since the March Budget; there is a good chance that more will follow. The end of the Brexit transition period will bring another set of economic disruptions. Careful analysis of the scale and the shape of the challenges facing the UK is a crucial part of designing effective policies to address them.

The response to the COVID-19 pandemic has had an unprecedented impact on the UK's public finances. For the next year at least, the focus needs to be on what further support policymakers can give to the economy. But after that, the debate will need to turn to putting the public finances on a sounder path.

This conversation will be complicated by the pressures on public spending, not least on account of the government's focus on 'levelling up' the country and the highest-ever level of spending on working-age social security. We address all of these issues in depth in this year's Green Budget.

As with all IFS publications, the views expressed are those of the named chapter authors and not of the institute – which has no corporate views – or of the funders of the research.



A handwritten signature in black ink that reads "P. Johnson".

Paul Johnson
Director, Institute for Fiscal Studies

Follow Paul on Twitter [@PJTheEconomist](https://twitter.com/PJTheEconomist)

1. Global economic outlook: lessons from the pandemic



Christian Schulz (Citi)

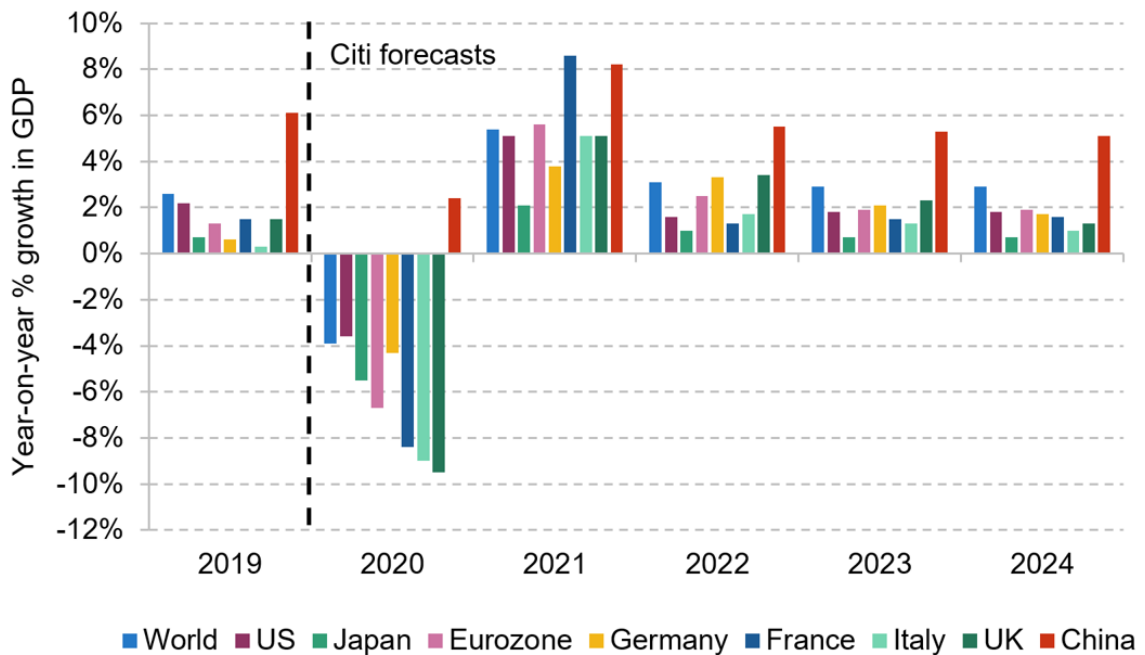
The COVID-19 outbreak and the policy response to it have not just dominated the economic and fiscal developments in 2020 so far; they also set the starting point for the rest of the year and 2021. As long as the virus remains a significant health threat – with no vaccine and no highly effective treatment – the situation remains too volatile to provide a definitive assessment of the global economic impact.

What is clear is that countries around the world have seen historic hits to their economies in the first half of 2020; GDP fell by 10% in the US, 14% in the EU and 22% in the UK. While the lockdown measures implemented in the spring and early summer were unprecedented in most countries, some countries have succeeded

in getting the virus under control (and are now reaping economic and political benefits).

Over the third quarter of 2020, most countries have started to see a sharp but incomplete economic recovery. But recovery faces risks from cautious consumers, high rates of unemployment, low investment during the first half of 2020, the rise of private sector debt, and disruptions to international trade. Citi forecasts that GDP will reach pre-crisis levels mostly in 2021 or 2022. Even so, we expect all economies to remain smaller than either our pre-COVID forecast or a simple extrapolation of pre-COVID trends would imply.

Year-on-year % growth in GDP across countries, actual and Citi forecast



Source: Figure 1.14 in Chapter 1.

Key findings

- The fiscal and monetary response has been even swifter and more comprehensive than after the 2008–09 crisis. Governments initially responded with a ‘first wave’ of measures aimed at protecting household and business incomes. This was followed over the summer by a ‘second-wave’ response targeted at boosting demand as lockdowns eased. Finally, some countries – most notably in the EU – have started to introduce ‘third-wave’ packages to help support the transition to a new normal. *Timely, well-targeted and generous support should significantly improve the chances that scarring will be minimised and a more complete economic recovery achieved.*
 - The ‘first-wave’ fiscal response saw considerable support for the labour market, which helped to keep workers attached to their jobs. In Germany, the UK, France and Italy, traditional measures of unemployment remained in single digits over the summer, but *rates of furloughing pushed total unemployment rates to nearly 25% in the latter three countries.*
 - In virtually every economy, the collapse of economic output in the first half of 2020 was historic. GDP fell by 10.2% in the US, 11.5% in Germany and 14.3% in the EU as a whole. Other countries suffered much worse economic shocks; GDP fell by 17.6% in Italy and 18.9% in France. *Of 28 major economies, Spain and the UK had the worst falls in GDP (of 22.7% and 22.1% respectively).*
- Only China continued to grow in the first half of 2020, but growth of 0.4% is a far cry from its usual growth rates.
- After an economically disastrous first half of the year, most countries experienced a sharp – but generally incomplete – recovery. *We expect that, even avoiding another round of major lockdowns, most economies will not return to pre-pandemic levels of output until 2021 or 2022.*
 - Even when the pandemic itself is over (with the development and roll-out of a vaccine or effective medication), there will be lingering economic effects. Supply will feel the impact of depressed investment in 2020, as well as ongoing hygiene measures. Demand will be affected by ongoing caution, shifts in behaviour and unemployment. *We therefore expect all economies to remain smaller than either our pre-COVID forecast or a simple extrapolation of pre-COVID trends would imply.*
 - *Citi forecasts big GDP declines and sharp recoveries almost everywhere, with GDP reaching pre-crisis levels mostly in 2021 or 2022. On current forecasts, China and the US look set to outperform European economies. Inflation and interest rates should stay low. There is a significant risk of divergence between the best- and worst-performing economies in this crisis; going into the final quarter of 2020, the UK has one of the worst starting points among major economies.*



2. UK economic outlook: the long road to recovery

Benjamin Nabarro (Citi)

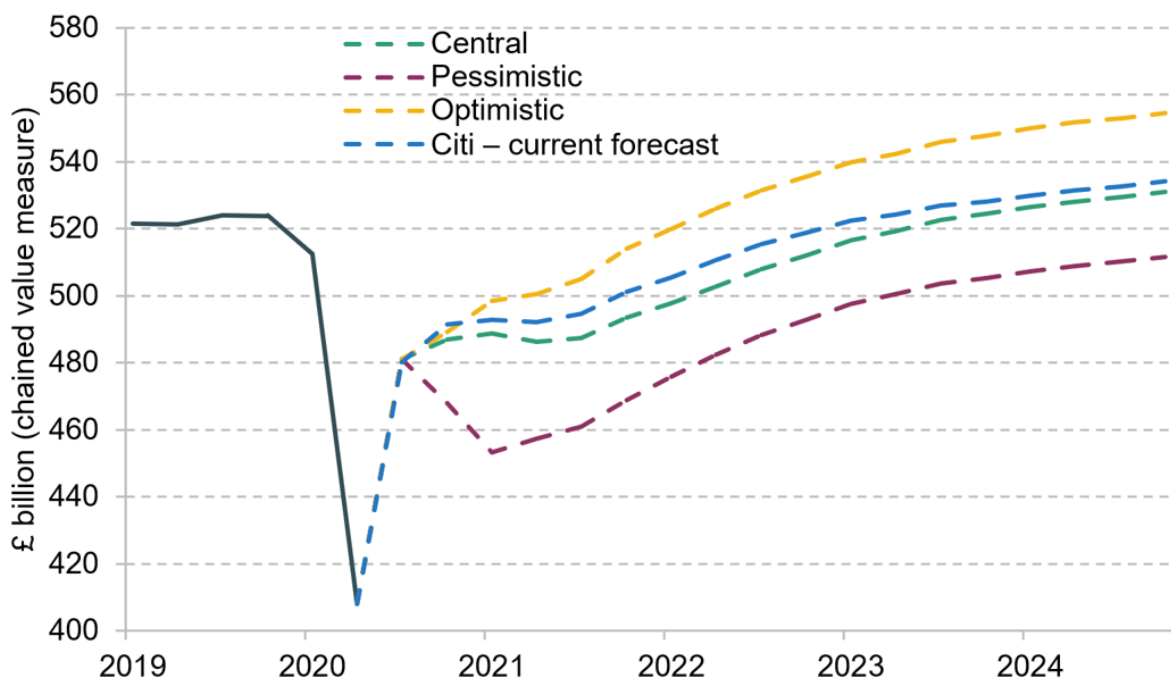
The UK faces a long road to economic recovery in the wake of the COVID-19 pandemic. In this chapter, we consider the near-term outlook in depth. Lockdown measures implemented in response to COVID-19 slashed nearly two decades of growth from the UK economy in March and April of this year. Since then, the economy has rebounded strongly on the back of the return of capacity and high levels of policy support.

However, we think this momentum is unlikely to last. Households have a key role to play in the recovery: firm balance sheets are weakened by the outbreak and the external picture remains complicated by Brexit and by other countries' experiences of the pandemic. While backing the UK consumer has historically proven a sound

bet, there are reasons why this time might be different.

Lingering virus unease and broader uncertainty seem set to weigh on demand in the second half of 2020. With these effects concentrated in labour-intensive sectors, substantial increases in unemployment risk propagating the economic downturn – especially given the dialling down of policy support. We expect output in 2020 Q4 to remain more than 6% below 2019 Q4 levels – a larger drop than the peak-to-trough fall during the financial crisis. With permanent reconfiguration within the UK economy likely over the coming years, substantial policy support is likely to remain necessary for some time to come in order to avoid an even more prolonged crisis.

Scenarios for real quarterly UK GDP



Source: Figure 2.25 in Chapter 2.

Key findings

- *Following a record 19.8% quarter-on-quarter (QQ) fall in the second quarter of 2020, we expect output to rebound by 17.5% QQ in Q3. Household consumption in particular has been recovering well, driven by the return of capacity, deferred expenditures and additional policy support.*
- *But we expect the recovery to slow sharply from here. Virus fears, and weak associated demand, are instead likely to come to the fore. In our central scenario, 2020 Q4 GDP will remain 6.2% below 2019 Q4 levels, a larger fall than the 5.9% peak-to-trough fall during the financial crisis. Even by the end of 2024, we think GDP will still be only 1.9% above 2019 Q4 (and 4.7% below its 2016–19 trend).*
- *The recovery from here hinges on households. Impaired business balance sheets and changes to trade patterns will likely weigh on investment and exports initially. By contrast, households on average saved a record 28.1% of their incomes during Q2 (compared with 6.1% between December 2016 and 2019). The question now is primarily about household confidence and whether it can drive a pick-up in spending. While possible, we are not optimistic.*
- *The COVID-19 shock is unusually concentrated in labour-intensive sectors. Payroll data to August suggest there has already been a loss of over 700,000 employee jobs, even before the end of the furlough scheme. While official unemployment figures are confused at present, the fact that the Labour Force Survey suggests 500,000 more people than in March are out of work and want a job is a cause for concern. We expect the unemployment rate to increase to around 8–8.5% (2.8 million) in the first half of 2021, feeding back into weaker sentiment.*
- *There are clearly enormous uncertainties surrounding all of these forecasts. Our outlook is conditioned on three judgements. First, we assume no effective protection against the virus is widely available before 2021 Q2; second, we expect lingering health concerns to weigh on demand until this point; and third, we anticipate that the medium-term reconfiguration (due to both COVID and Brexit) implies a larger and more persistent increase in unemployment, as well as an associated loss of capacity.*

3. The cost of adjustment: emerging challenges for the UK economy



Benjamin Nabarro (Citi)

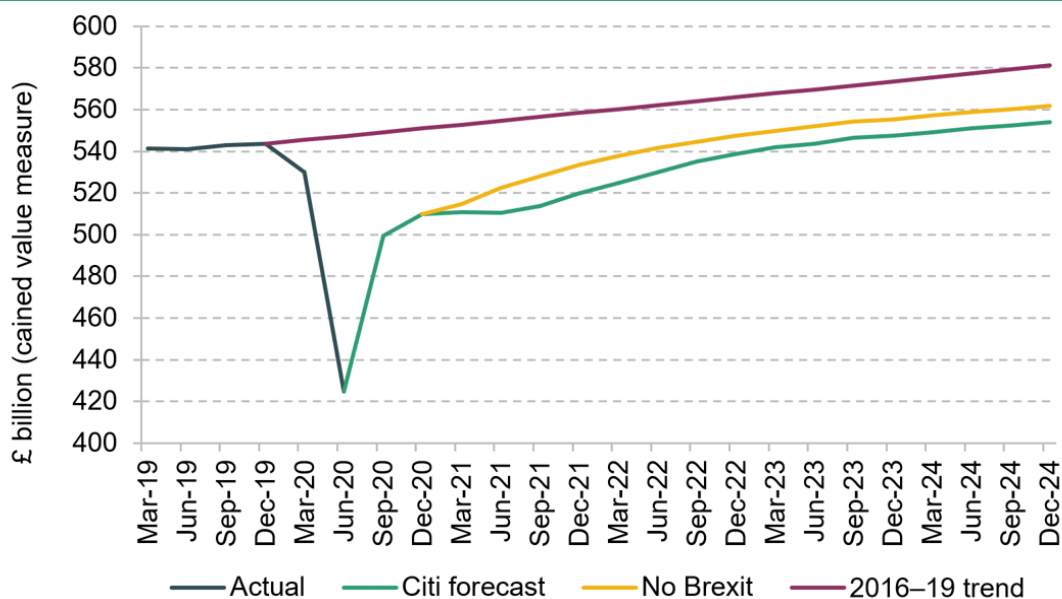
All indications point to only a thin trade deal (if any) with the European Union after the Brexit transition period ends in December. Despite over four years passing since the referendum, many of the associated economic costs still likely lie ahead. The shock from Brexit will affect different sectors from the COVID shock, meaning that Brexit is likely to cause additional economic pain even as the economy recovers from the virus-driven downturn.

In addition, we think COVID is likely to have hampered public and private preparations for the end of the Brexit transition period, compounding the near-term economic cost. We expect GDP growth in 2021 to be 2.1% lower than in the event the UK were to remain in the EU Single Market and Customs Union. In a normal year, this would be enough to push the economy into recession. Some of this growth is likely to be made up in 2022.

The UK has traditionally shown itself to be a relatively flexible economy. This reputation is likely to be tested to the extreme over the coming years. We expect substantial restructuring of the UK economy in the years ahead as it responds to the new shape of demand from UK consumers in the wake of COVID-19 and the new shape of trading relationships in the wake of Brexit. Such restructuring implies a more protracted economic recovery and a substantial loss of economic capacity as some of the expertise and capital specific to now shrinking sectors becomes surplus to requirements.

Persistent policy support will be needed to help the economy through this transition. However, fiscal policy will also have to tread a fine line between supporting growth in the near term and charting a path to fiscal sustainability in the medium term. This is a significant challenge.

UK real quarterly GDP in various policy scenarios (2016 prices)



Source: Figure 3.1 in Chapter 3.

Key findings

- Brexit remains a substantial economic challenge for the UK. The options currently on the table appear to be restricted to only a thin trade deal or a no-deal exit. *We anticipate that the former case would leave the UK economy 2.1% smaller in 2021 than in a counterfactual where the transition period continues indefinitely; a no-deal exit could see output depressed by an additional 0.5–1.0%.*
- The path that Brexit-related economic impacts take over the next 12–24 months will depend on when changes associated with the UK's exit from the Single Market and Customs Union begin to materialise, and the extent to which firms have already acted to improve their resilience. *We think the majority of Brexit-related adjustment lies ahead.* Weak sterling since 2016 has provided an incentive for many firms to maintain UK operations where they can, even if now unviable in the longer term. Low investment to date may reflect some long-term adjustment, but also reduces overseas firms' economic ties to the UK. Brexit-related adjustments could now therefore prove more front loaded.
- Both *COVID and Brexit are likely to result in medium-term economic reconfiguration, as well as near-term disruption.* The UK labour market, in particular, has shown itself better able to adjust during previous downturns than other countries. Even so, the 'double whammy' of COVID and Brexit will make adjusting to the new normal a huge challenge.
- *Adjustment to a post-COVID, post-Brexit new normal will have economic costs that last into the long term.* A rebalancing away from the consumer services sector (COVID) and some parts of manufacturing and financial/ business services (Brexit) would make much of the accumulated capital and skills in these sectors less valuable. For workers, the longer they remain unemployed, the worse their prospects in the labour market. This can have consequences that last for decades.
- The economic response to COVID-19 has seen monetary and fiscal policy complement each other, as the Bank of England and the government both seek to support the economy. However, this complementarity is less assured in the medium term: *upward pressure on inflation (and particularly inflation expectations) could lead to the Bank tightening monetary policy even if fiscal policy still needs to remain loose.* The UK's dependence on foreign credit remains a notable additional vulnerability. More fiscal support will likely be needed in the near term. But getting the public finances on a sustainable trajectory in the medium term is also now a key challenge.

4. Outlook for the public finances

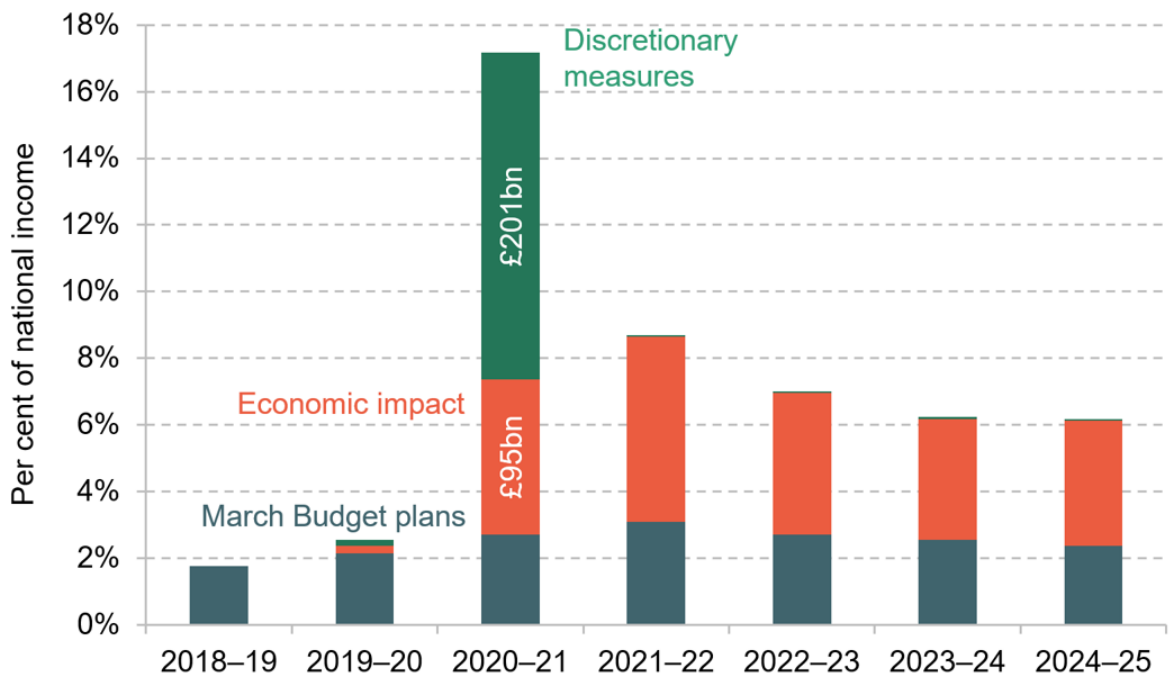
Carl Emmerson and Isabel Stockton (IFS)

The COVID-19 pandemic and the public health measures implemented to contain it will lead to a huge spike in government borrowing this year. We forecast the deficit to climb to £350 billion (17% of GDP) in 2020–21, more than six times the level forecast just seven months ago at the March Budget. Around two-thirds of this increase comes from the large packages of tax cuts and spending increases that the government has introduced in response to the pandemic. But underlying economic weakness will add close to £100 billion to the deficit this year – 1.7 times the total forecast for the deficit as of March.

matters much more for the long-run health of the public finances is how complete the economic recovery will be. With the cost of borrowing at a record low, additional spending now that helps to deliver a more complete recovery would almost certainly be worth doing. For now, the government should focus on designing and delivering such support. But, in the medium term, getting the public finances back on track will require decisive action from policymakers. The Chancellor should champion a general recognition that, once the economy has been restored to health, a fiscal tightening will follow.

This year’s deficit will reach a level never before seen in the UK, outside of the two world wars of the 20th century. But what

Drivers of the increase in borrowing in the central scenario



Source: Figure 4.5 in Chapter 4.

Key findings

- *Government borrowing this year is projected to climb to £350 billion which, at 17% of GDP, is a level never before seen in the UK, outside of the two World Wars of the 20th century. This compares with a March Budget forecast of £55 billion.*
- *What matters most for the long-run health of the public finances is how complete the economic recovery will be. Under our central scenario, and assuming none of the temporary giveaways in 2020–21 are continued, borrowing in 2024–25 is forecast to be over £150 billion as a result of lower tax revenues and higher spending through the welfare system*
- *Both COVID and Brexit are likely to result in medium-term economic reconfiguration, as well as near-term disruption. The UK labour market, in particular, has shown itself better able to adjust during previous downturns than other countries. Even so, the ‘double whammy’ of COVID and Brexit will make adjusting to the new normal a huge challenge.*
- *There will be significant pressures to increase public spending above March plans rather than eliminating all COVID-related extra spending. If a quarter of the additional public service spending announced in response to COVID-19 were made permanent, this would add £20 billion (in today’s prices) to spending by 2023–24. Depending on the size of any tax rise implemented by that point, this could add up to 1% of national income to forecast borrowing in 2023–24.*
- *Prior to the pandemic, public sector net debt was around 80% of national income. This was considerably above the 35% of national income seen in the years prior to the financial crisis. In 2024–25, we forecast public sector net debt to be just over 110% of national income in our central scenario, close to 100% of national income in our optimistic scenario and close to 130% in our pessimistic scenario. Most of this is related to lower economic activity, rather than the large increases in spending implemented this year.*
- *Once the economy has recovered, policy action will be needed to prevent debt from continuing to rise as a share of national income. Even if the government were comfortable with stabilising debt at 100% of national income – its highest level since 1960 – it would still need a fiscal tightening worth 2.1% of national income, or £43 billion in today’s terms. A rise in interest rates or future adverse economic shocks would make the task of preventing debt from rising further even more challenging.*
- *The Conservative Party manifesto commitment to reduce debt as a share of national income over this parliament will be broken, and the current fiscal targets lie in tatters. But the high degree of uncertainty means that now is not the time to be announcing new targets, or the size, timing or nature of any fiscal tightening. Even the Autumn Budget of 2021 may be too soon for this. But Mr Sunak should champion a general recognition that, once the economy has been restored to health, a fiscal tightening will follow.*

5. Managing much-elevated public debt

Carl Emmerson (IFS), David Miles (Imperial College London) and Isabel Stockton (IFS)

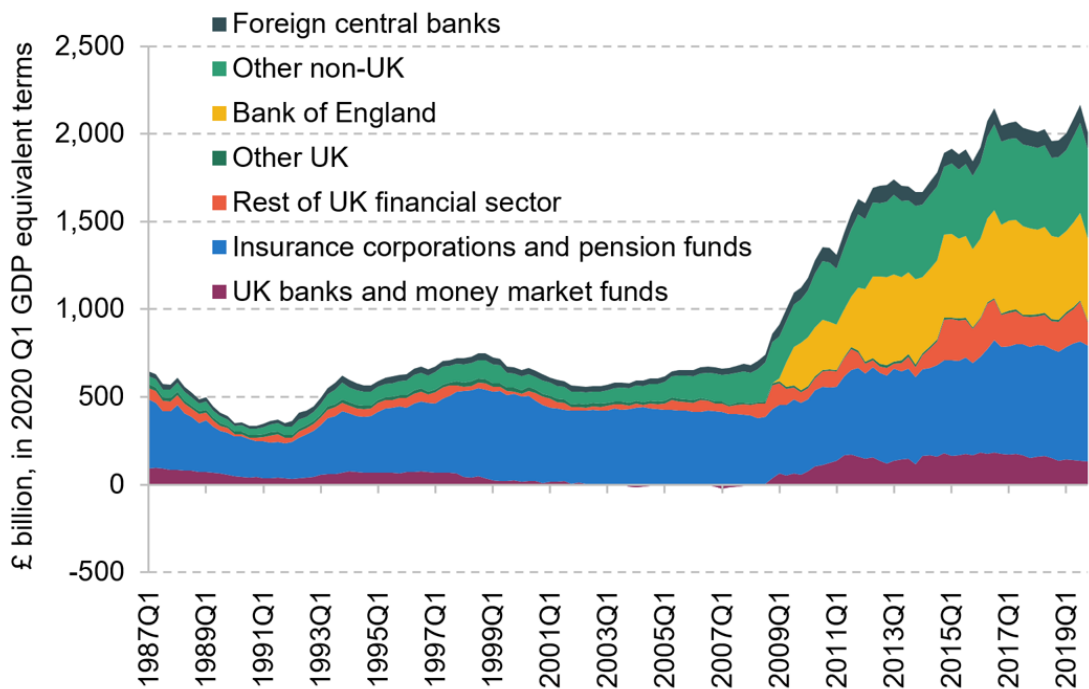
The COVID-19 crisis has pushed up government borrowing substantially, meaning that the Debt Management Office will need to sell a much larger value of gilts than normal. In our central scenario, we forecast the total amount to exceed £1.5 trillion, more than double the Budget forecast in March. While there is tremendous uncertainty around this figure, the total value will easily be the highest in recent history outside of the two world wars.

As a result, the UK’s public finances will be extremely sensitive to the effective interest rates on this debt, and to the risk that they rise. One way to address this risk is by selling more long-term, index-linked gilts while the effective interest on

them is extraordinarily – some would say unsustainably – low.

The expansion of the Bank of England programme of quantitative easing means that virtually all of this new debt has been bought by the Bank. The cost of financing this debt is the Bank Rate. While this remains historically low, it helps to hold down the government’s debt interest bill; however, debt interest spending will rise suddenly and sharply when the Bank Rate increases. Since government spending is now more closely tied to the Bank Rate, it will be even more important to ensure that the Bank of England continues to be – and be perceived as – independent and focused on its monetary policy mandate.

Holders of UK gilts (£ billion)



Note: Negative values represent repo positions.
Source: Figure 5.3 in Chapter 5.

Key findings

- The Debt Management Office will need to sell a much larger value of gilts than normal. *Our central scenario is for over £1.5 trillion to be raised through gilt issuance over the next five years, double the £760 billion forecast in the March 2020 Budget.* There is considerable uncertainty around this amount. *The enormous value of debt being issued means the costs of financing it just slightly wrong will be large.*
- Short- and long-maturity gilt yields have fallen even further from the already low rates seen prior to the pandemic. *Yields are now much closer to the very low rates that have become typical for Japan.*
- The expansion of the Bank of England's programme of quantitative easing means it has bought almost all of the extra debt issued during the pandemic. The financing cost of quantitative easing is Bank Rate, which is at record low levels, and has therefore further depressed government debt interest spending. However, *the tilt towards Bank of England held debt means that the government's debt interest bill will rise sharply if Bank Rate rises.* It will be particularly important to maintain the credible independence of the Monetary Policy Committee in setting monetary policy, since the government has a more direct stake in Bank Rate.
- Rising yields accompanied by stronger growth would be welcome. The risk to the public finances is that yields rise but growth prospects do not. *One way to address this risk is by selling more long gilts.* Long-term rates are extraordinarily – some would say unsustainably – low. Even 50-year gilts have been consistently offering just 0.5% a year (in nominal terms) since April 2020. With inflation anywhere near its 2% target, investors would see a negative return in real terms.
- *Contrary to the direction of recent policy, there could be considerable benefits from tilting the UK's debt portfolio more towards index-linked gilts.* This would have the advantage of locking in the current very low real rates for a greater share of government debt.
- The Chancellor needs to signal that he takes the long-run health of the public finances seriously, that he fully respects the Monetary Policy Committee's independence, and that he will not water down the inflation target in an attempt to help manage the public finances. *Issuing a larger share of gilts on a long-term, indexed basis could only help to signal that intent.*

6. Spending Review 2020: COVID-19, Brexit and beyond

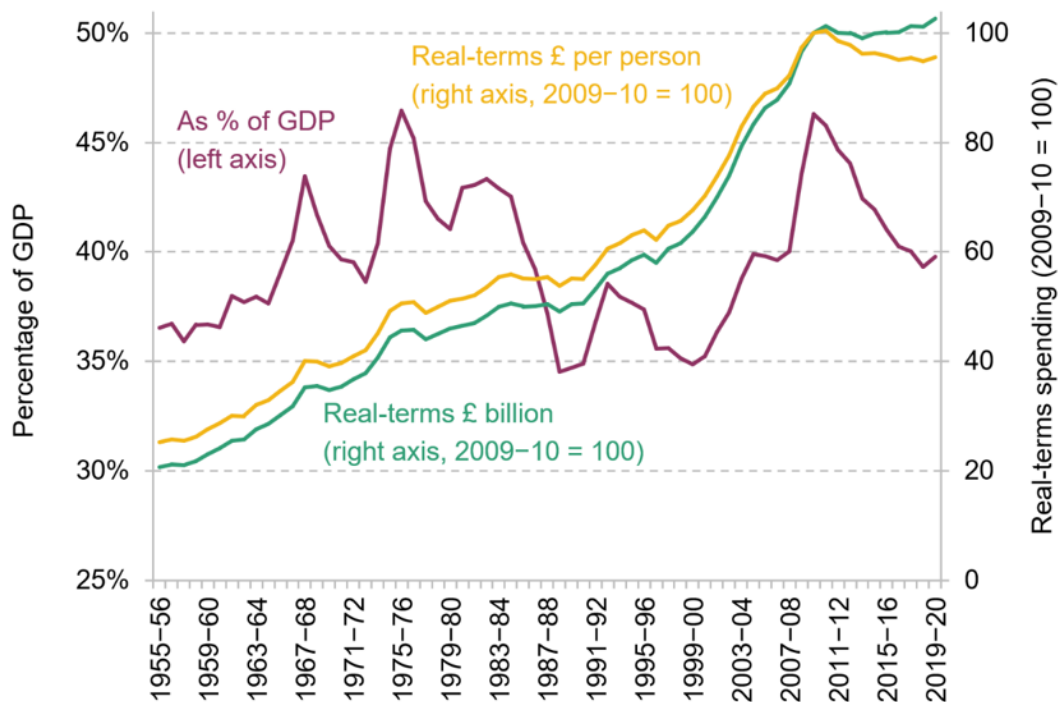
Ben Zaranko (IFS)

The Chancellor, Rishi Sunak, has announced his intention to hold a Comprehensive Spending Review this year. The immense economic uncertainty associated with the COVID-19 pandemic, and the looming end of the Brexit transition period, make this an extraordinarily difficult time to be formulating public spending plans.

In addition, the Spending Review will come on the back of the longest sustained squeeze in public spending on record, with pressure for austerity to be brought to a decisive end. Whether Mr Sunak makes the sensible decision to set only one year of spending plans, or embarks on a 'comprehensive' multi-year review, the process will be fraught with difficulty and delicate trade-offs.

In this chapter, we outline the public spending framework and explain which components of spending are subject to the Spending Review process, and why. We then discuss four major challenges confronting the Chancellor: the economic fallout from the pandemic; uncertainty associated with Brexit; making decisions on the back of a decade of austerity; and the government's ambitious 'levelling-up' agenda. We also discuss the options facing Mr Sunak, setting out a number of scenarios to illustrate the two major choices to be made – the initial baseline of public spending and its real-terms growth rate over the next three years – and considering the implications of each. Finally, we make the case for holding a one-year Spending Review.

Total managed expenditure



Source: Figure 6.2 in Chapter 6.

Key findings

- *This year's Spending Review comes on the back of a decade of austerity. By 2019–20, total government spending was just 2.6% higher in real terms than a decade previously, and 4.4% lower in real per-person terms. Day-to-day spending on public services was down 7% in real terms (13% per person). Outside of Health, real-terms public service spending was cut by 20% (25% per person) over the decade to 2019–20. This has been the longest sustained squeeze on public spending on record. Yet despite these cuts, on the eve of the pandemic, government spending as a share of the economy (i.e. the size of the state) was the same as in the mid 2000s.*
- *Following the September 2019 Spending Round, which provided across-the-board real-terms budget increases for 2020–21, the plans published in March 2020 would have seen public service spending rising by 10.7% between 2019–20 and 2023–24. This would have reversed two-thirds of the last decade's cuts to per-person public service spending.*
- *But COVID-19 has rendered these plans obsolete. Departments have been allocated more than £70 billion this year as part of the response to the virus. A crucial question for the Spending Review is the extent to which this COVID-19 spending needs to continue into future years. If much of the spending on programmes like PPE procurement and test and trace remains, they could swallow up a huge chunk of the increase in funding pencilled in between now and 2023–24.*
- *For instance, if 25% of the spending announced in response to COVID-19 needs to be permanent, that would eat up almost half of the planned £40 billion increase in departments' non-COVID budgets between 2020–21 and 2023–24 (in today's prices). Given the government's commitments on the NHS, schools, the police and 'levelling up', that would almost certainly require another bout of austerity for some public services.*
- *It is now likely that the economy will be smaller than expected into the medium run, and there are additional pressures on public spending. As a result, even if no COVID-19 spending continues into future years, it is probable that total spending will settle at a significantly higher fraction of national income than it was pre-pandemic, and higher than the 40% it was after 10 years of Labour government in 2007–08.*
- *Given the huge amount of economic uncertainty, the Chancellor would be ill advised to embark on a multi-year Spending Review this year. Instead, he should repeat the decision he took in 2019 to hold a single-year review and postpone longer-term decisions until some of the uncertainty has dissipated.*

7. Levelling up: where and how?

Alex Davenport and Ben Zaranko (IFS)

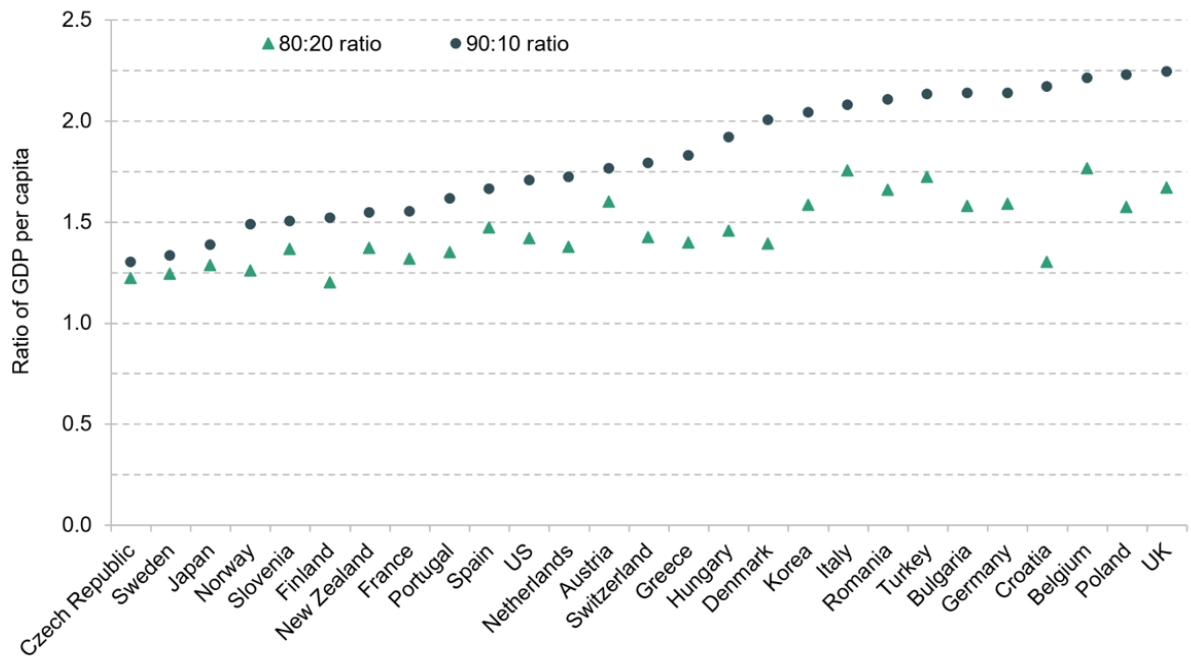
This government has pushed geographic inequalities to the top of the policy agenda. In his very first speech as Prime Minister, Boris Johnson made clear his intent to boost economic performance outside of London and the South East, to ‘level up’ across the country and to revive the fortunes of the UK’s ‘left-behind’ towns and cities. This is an ambitious agenda, and one that will not be quickly achieved with off-the-shelf policy solutions.

In this chapter, we consider the evidence on UK regional inequalities and place them in international context. We then assess which areas might be classified as ‘left behind’ and in need of ‘levelling up’, and how this might

be affected by the economic fallout from COVID-19 and Brexit. We consider the regional inequalities in four of the factors that are often cited in the context of levelling up: spending on investment, transport and R&D as well as in where civil servants are located.

Finally, we examine some of the existing programmes aimed at targeting resources to left-behind places and discuss some of the issues and risks that the Chancellor should keep in mind ahead of this year’s Spending Review, which will be a chance to provide a road map for where, and how, this government plans to take its ‘levelling-up’ agenda forward.

Measures of inequality in regional GDP per capita, by country



Note: Figures denote the ratio between GDP per capita in the 80th percentile ranked region and the 20th percentile ranked region (80:20), and the ratio between GDP per capita in the 90th percentile ranked region and the 10th percentile ranked region (90:10). Region defined as OECD ‘small’ (TL3) regions.

Source: Figure 7.1 in Chapter 7.

Key findings

- *The UK is one of the most geographically unequal countries in the developed world; compared with 26 other developed countries, it ranks near the top of the league table on most measures of regional economic inequality.*
- *Neither the focus on nor the rhetoric around 'levelling up' is new, but reducing these spatial disparities is a stated priority of this government. The UK's regional inequalities are deep-rooted and complex: even well-designed policies could take years or even decades to have meaningful effects.*
- *There is no single set of factors that characterise a 'left-behind' place, and the government cannot be all things to all places. We combine measures of pay, employment, formal education and incapacity benefits to identify which areas might be considered 'left behind' and in need of 'levelling up'. These areas can be found across the country, but left-behind places are particularly concentrated in large towns and cities outside of London and the South East, in former industrial regions, and in coastal and isolated rural areas.*
- *We find that the traditionally 'left-behind' areas are not those most exposed to the short-term economic impact of COVID-19. This complicates the picture with regard to 'levelling up', since it introduces another dimension of geographic inequality. There are, however, important exceptions: a number of hospitality- and tourism-dependent coastal communities and the centres of some Northern and Scottish cities (such as Liverpool, Glasgow and Dundee), face the 'double whammy' of being both 'left behind' and vulnerable to the immediate economic fallout from the pandemic.*
- *Brexit could make 'levelling up' more difficult. While the economic impact of Brexit remains highly uncertain, the options on the table are likely to impose a particularly high economic cost on some groups, such as less-educated male workers in blue-collar jobs. Many of these are concentrated in traditionally 'left-behind' areas in the North of England, South Wales and the West Midlands.*
- *Currently, some sorts of public spending – transport and R&D, for example – are heavily concentrated in London and the South East. Increasing spending on these in other parts of the country might help with levelling up. But we should not forget that 'current' spending – especially on things such as schools and further education – may be as, if not more, effective.*
- *There are at least eight existing place-based spending programmes relevant to the 'levelling-up' agenda. These include the EU's Regional Development Fund, which provides funding only until the end of this year. Rather than reinventing the wheel, the government could seek to build on these schemes, and develop a broader strategy around how they fit together. The Chancellor should also pay particular attention to the important role that local governments will play in 'levelling up'.*

8. The temporary benefit increases beyond 2020–21

Pascale Bourquin and Tom Waters (IFS)

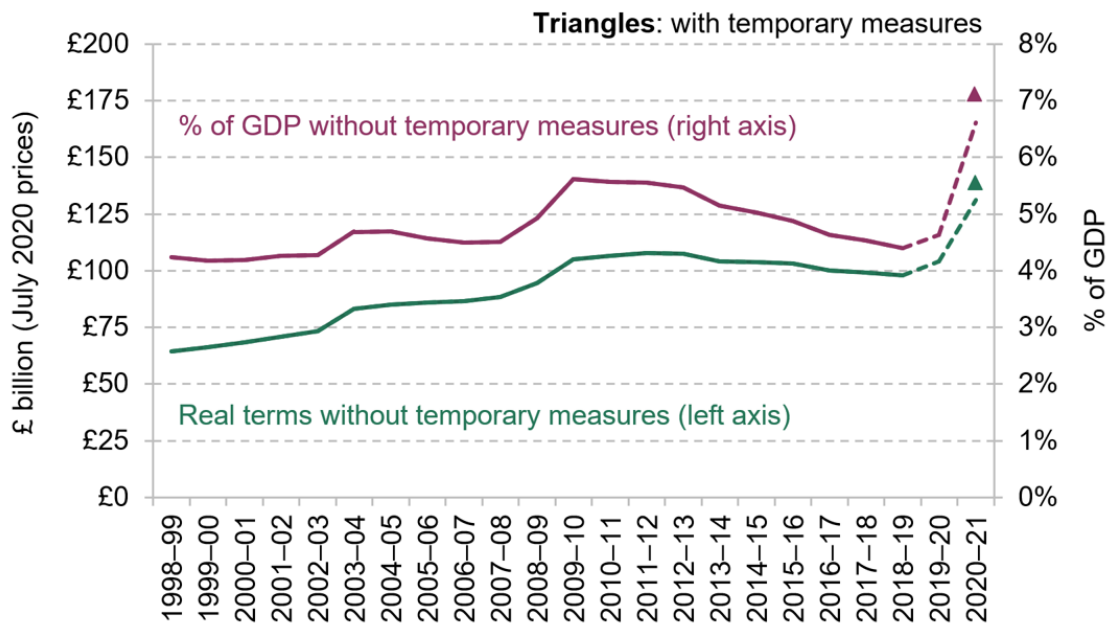
The COVID-19 crisis has led to a profound shock to the labour market, one consequence of which is a rising number of claimants of means-tested benefits and higher entitlements among existing claimants. Under its central scenario, the Office for Budget Responsibility forecasts that these effects will raise benefit spending by £25 billion in 2020–21; even its optimistic scenario puts the figure at £17 billion.

On top of that, the government has announced several temporary expansions to the welfare system, including increasing the universal credit (UC) standard allowance by around £1,000 per year, suspending the ‘minimum income floor’ (and so boosting benefit entitlements among low-income self-employed claimants) and raising the maximum amount of housing support for private

renters. Together, the temporary giveaways (including related changes to the legacy benefits system) cost an additional £9 billion. Between the boost to spending from underlying economic weakness and the government’s temporary giveaways, this year will see working-age benefit spending rise to 7% of national income – easily the highest level on record.

The government will soon have to decide on the future of these temporary giveaways. In some cases, they relate to areas of the benefit system that were already ripe for reform prior to the onset of the crisis. Now is therefore a natural time to think about the design of these parts of the system. In this chapter, we discuss the options that the government faces in unwinding, adjusting or making permanent these temporary expansions.

Spending on working-age benefits



Source: Figure 8.1 in Chapter 8.

Key findings

- *The number of families claiming universal credit (UC) has increased from 2.6 million in February 2020 to 4.2 million in May. Claimants are receiving higher entitlements than they were before – due to both the changes in their circumstances and the temporary increase in generosity of working-age benefits. Consequently, spending on working-age benefits is now forecast to be 7% of national income in 2020–21. This is 2% of national income higher than it was last year and the highest it has been since records began in 1978–79.*
- *Choosing to make permanent the £1,000-a-year increase in the standard allowance for UC would, in the long run, cost the government £6.6 billion per year (in today's prices), adding roughly 10% to the annual cost of UC, though undoing only a fraction of the cuts to benefits implemented since 2010. This would represent a bigger increase to the entitlements of out-of-work claimants without children than has been seen over the whole of the past 45 years.*
- *The minimum income floor (MIF) in the UC system caps entitlements among the low-income self-employed at the same level as for full-time minimum-wage employees. It affects around 450,000 self-employed households, mostly on low incomes, who lose an average £3,200 per year. The MIF has sensible aims but there is scope to reform it by adopting a cap based on a 12-month rolling average of earnings (rather than monthly earnings).*
- *Prior to the pandemic, the link between local rents and the amount of housing support for low-income private renters had broken down; bizarrely, maximum support related to local rents in 2011. This meant that – rather arbitrarily – families in some high-rent areas were eligible for less support than those in low-rent ones. The government has temporarily re-established the link, by setting the maximum housing support level so it covers the rent of 30% of local rental properties in the private sector. A link to contemporaneous local rents is clearly more sensible than the pre-COVID system, and the government should not return to the latter.*
- *Making the increase to housing support permanent would cost about £1 billion per year, with renters in London gaining the most. Alternatively, the government could set the maximum support level so that it covers 20% (rather than 30%) of local rented properties. That would cost about the same as the pre-COVID system, but be fairer and less arbitrary.*

Support IFS

For any questions about the IFS membership scheme, please contact us at members@ifs.org.uk

Our goal at the Institute for Fiscal Studies is to promote effective economic and social policies by better understanding how policies affect individuals, families, businesses and the government's finances.

Almost all of the Institute's income is raised through traditional research funding, a reflection of the very high quality of our work.

However, this doesn't cover everything we'd like to do, particularly when it comes to providing quick responses to policy announcements.

Support from the general public allows us to be flexible, commenting on policy as it happens, and to continue to provide everything we do free of charge to everyone on our website.

To support the work of the Institute for Fiscal Studies through a regular donation and to join as an individual member, please visit our website:

www.ifs.org.uk/about/membership



Individual membership

We're grateful for any donations you are able to spare, but everyone who chooses to donate at least *£5 per month* will join as individual members and receive the following additional benefits as a thank you:

- An invitation to our annual members' event with presentations from IFS researchers and a drinks reception.
- Advance ticket booking for events that are likely to sell out, such as our Budget briefings.
- Regular e-newsletters outlining our recent work and other key highlights, as well as printed updates, such as InBrief magazine.
- The right to take part in elections for members' representatives on the IFS Council.

Corporate membership

Annual membership fee: £5,000 (+ VAT)

Insight into public policy issues

- Five free places at all charged IFS events, including a delegate place at our prestigious residential conference
- Reduced member rate attendance for all other staff of the company
- One free copy of all our printed publications and substantial discounts on all additional copies
- Corporate members' electronic updates

Access to the policy debate

- Invitation to private presentations by IFS staff each year, on topics such as our annual Green Budget report or our Budget analysis
- Invitation to private dinner/breakfast events with high-profile guest speakers

Profile as an organisation with input into the policy debate

- Your organisation listed as a corporate member on the IFS website
- Demonstration of your organisation's commitment to corporate social responsibility through supporting IFS as a registered charity

Gold corporate members

Annual membership fee: £10,000 (+ VAT)

All the benefits of Corporate Membership, plus bespoke options, such as:

- Additional free places at all IFS charged events, including the prestigious IFS residential conference
- A private individual briefing once a year with the IFS Director or Deputy Director at the member's office with local staff on topics of member's choice
- The opportunity for the Director or Deputy Director to participate as a guest speaker at an event organised by the company
- An invitation to join senior IFS staff and a high-profile speaker at a private dinner following the IFS Annual Lecture; our most recent speaker was Gus O'Donnell.

Since 1982, the Institute for Fiscal Studies' annual Green Budget has examined the challenges and choices confronting the Chancellor of the Exchequer in the run-up to the keynote statement on fiscal policy and the economy. The COVID-19 crisis has fundamentally reshaped the UK's public finances and has already seen the Chancellor announce £200 billion of fiscal support. This year's Green Budget sets out the economic landscape facing the UK for the next six months ahead of the Spring 2021 Budget, with analysis of:

- The impact of COVID on advanced economies and the UK
- Brexit and longer-term challenges to the UK economy
- The challenges facing the public finances
- Managing a much higher level of government debt
- The Spending Review and challenges facing public spending
- The 'levelling-up' agenda
- Temporary changes to the benefits system

'The respected and independent institute...has become notable for its careful analysis of the parties' tax and spending plans'

Chris Giles, The Financial Times

'When it comes to understanding the UK's public finances, there is no substitute'

Ben Chu, BBC

'The Institute for Fiscal Studies, the ultimate arbiter of what is and what isn't doable in the budget'

Larry Elliott, The Guardian

For more information about the Institute for Fiscal Studies, including details of our latest research and analysis, please visit www.ifs.org.uk

Follow us on:

twitter.com/TheIFS

facebook.com/InstituteforFiscalStudies/

7 Ridgmount Street
London WC1E 7AE
+44 (0) 20 7291 4800
mailbox@ifs.org.uk

ISBN: 978-1-80103-006-9

© Institute for Fiscal Studies

Not to be reproduced without permission

