

Austerity: where next?

By Gemma Tetlow

Just as the UK was emerging from a decade of austerity following the global financial crisis, it was hit by a health crisis that became an economic one. The coronavirus pandemic has required unprecedented government intervention to shut down normal life and prop up businesses and households while the disease is brought under control. For 10 years public services have been told to cut the fat and achieve more with less to bring public borrowing down from a post-war high. But almost overnight fiscal caution was – justifiably – thrown to the wind, as Chancellor Rishi Sunak put together a support package that would keep UK businesses and workers going while the economy was temporarily mothballed to curb the spread of Covid-19. ►

Exactly how and when the UK will emerge from the shadow of coronavirus is still unclear. But it already seems likely that, on the other side, there will be questions about the future size and scope of government and how it is to be paid for.

Public borrowing in 2020–21 is very likely to exceed the peacetime record of 10.2% of GDP reached in 2009–10.

Much of that borrowing a decade ago was judged to be permanent, rather than merely temporary, leading – as Nick Crafts describes – to a longer and deeper period of austerity for public services than witnessed in either the 1930s or the 1980s. Benefits for those of working age were also cut sharply, while those for pensioners were protected. Public spending has borne the brunt of the fiscal tightening over the past 10 years because that is the choice governments – supported by the electorate – made, rather than opting for larger tax rises. But the Covid-19 crisis is likely to reopen this settlement.

Coronavirus will increase borrowing

The best-case scenario for the government is that the UK economy can emerge from the Covid-19 crisis without permanent scarring. That has been the core focus of the Treasury's wide-ranging economic support measures. If that can be achieved, the high level of public borrowing expected in the short-term will be purely temporary – a one-off increase in the stock of debt but not a permanent increase in its rate of growth.

If instead the current crisis causes the sort of permanent damage to the UK's economic potential that the financial crisis did, annual public borrowing would be left at an elevated level indefinitely.

In the best-case scenario, the government would face a choice between allowing debt to remain elevated (giving the government less flexibility in the face of future increases in borrowing costs or future economic downturns), or raising taxes or cutting spending further to bring it down. If instead there is permanent damage to the economy and public finances, the need for tax rises or further spending cuts is likely to be unavoidable.

Growing appetite for more – not less – public spending

If a fiscal reckoning is coming, it seems unlikely that public spending will bear the brunt in the way it has for the past ten years. At the 2019 general election, it was already clear

that the public were growing tired of austerity. The ruling Conservative party promised austerity was at an end and ultimately were elected on promises of more money for the NHS, the police and schools.

The response to coronavirus has further expanded the role of the state. It is too early to know yet whether the crisis has shifted public opinion sufficiently that the British

public would like to see these changes made permanent, but it might. Some of the measures – such as the unconditional payments to the self-employed – cannot be maintained in their current form. But others, such as the increase in entitlements for those on Universal Credit and the Local Housing Allowance, will be very hard to reverse, since that would entail cutting cash payments to low income households. These are

also areas in which there have been long-standing calls for the government to reverse earlier cuts (including for the reasons set out by Fetzer).

The crisis has also highlighted the important role played by the NHS and those who work in social care. The debate on how to fund these essential services is likely to gain even more prominence than before.

Had public services been cut too far?

The crisis has raised questions about whether some public services had been cut back too far during the period of austerity, leaving them unable to cope with such a shock. For example, controversy around the lack of personal protective equipment for health workers highlighted decisions, made by the Department of Health in 2017, not to stockpile visors or safety glasses because this was deemed too expensive – even though the medical advice suggested these would be needed in the event of a flu pandemic (Davies, 2020).

The focus over the past decade has been on ensuring public services are run as efficiently as possible. The main means for achieving this has been through imposing tight spending settlements. For services that are partially funded and delivered locally, the cuts to central government spending resulted in unequal cuts to services across different parts of the country. As Draca and Langella demonstrate, police officer numbers were cut more sharply in areas with initially high levels of crime. Local authority spending has also been cut more sharply in

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more deprived areas than less deprived ones (Harris et al. 2019).

But the experience of Covid-19 may alter perceptions among those in government and among the public about the need for building into services resilience to low probability but high impact events. But such resilience would come at a cost.

Who will pay?

If debt or borrowing are to be reduced, or if the size of the state is to be expanded, the country will face a question that has not yet reared its head – who should pay?

The answer may depend on who is seen to have benefitted from the state's largesse. For example, Sunak hinted that his emergency support for the self-employed would be followed by changes to their tax treatment, which is more generous than that faced by employees (Marshall, 2020). There has also been much public debate already about the trade-off between limiting the number of deaths from coronavirus (which predominantly affect the old) and the economic costs (which impact the young more heavily).

Alternatively, the public might expect those with the broadest shoulders to bear the lion's share of the cost. Advani and Summers' evidence on capital gains (which are excluded from official income and inequality measures) received by those at the very top are likely to add fuel to such arguments. There has long been a disconnect between a public perception that the incomes of the very richest have pulled away from everyone else's over the past decade and the hard statistics. The official statistics show that the vast majority have fared poorly but they show that the rich have too. Advani and Summers' new work suggests the reality may be closer to the public's perception than the official statistics suggest.

Whether or not the UK state takes on a permanently larger role after the coronavirus pandemic has passed will depend in no small part on the UK public's willingness to pay more for it. That willingness will depend in turn on who is asked to pay. As my own work has highlighted (Tetlow et al., 2020), previous governments have usually struggled to impose higher taxes on anyone. But the experience of Covid-19 – which, after 10 years of public spending austerity, has highlighted the unique power of the state in such a situation, as well as the lack of safety nets in some areas and the importance of resilience in public services – could provide the conditions needed for a reassessment of the shape and size of government and who should pay for it.

The future of UK government

The UK state has temporarily taken on wide-ranging responsibility for paying employees and the self-employed, guaranteeing loans to businesses, providing generous

support to some of the worst affected industries and offering health and social care services whatever they need. In the coming months, the government will face difficult decisions about how and when to withdraw those extraordinary measures. But we may well not return to exactly where we started from: government in the UK may be reshaped forever – both what it does and how it does it. ◀

About the author

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Further reading

Davies, H., (27 March 2020) 'Advice on protective gear for NHS staff was rejected owing to cost', *The Guardian*.

Harris, T., Hodge, L., Phillips, D., (2019) *English local government funding: trends and challenges in 2019 and beyond*, Institute for Fiscal Studies

Marshall, J., (31 March 2020) 'The coronavirus crisis could open the window for long overdue tax reform', blogpost, Institute for Government.

Tetlow, G., Marshall, J., Pope, T., Rutter, J., Sodhi, S., (2020), *Overcoming the barriers to tax reform*, Institute for Government

