Briefing

Briefing: Strengthen social security for a stronger economy

The £20 lifeline supports a just recovery

The UK is currently in a deep recession, with further restrictions and lockdowns likely to increase in the near future because of coronavirus. This briefing outlines why it is so important for the Government to stimulate the economy, and which policy tools are most effective. It makes the case that social security should be considered as one of these effective tools.

Social security is a vital lifeline that keeps us afloat when we need support, but it can also boost consumer spending in a more targeted way than other policies. The Government chose to use it in this way at the start of the crisis with a welcome, but temporary, uplift of £20 a week to Universal Credit (UC) and Working Tax Credit.

This lifeline should not be cut while the economy is still grappling with a recession. Not only will it cause an immediate and devastating loss of income for millions of families, it will also take money out of a weak economy. We recommend the Government keeps the lifeline by making the temporary £20 a week uplift permanent, and extending this uplift to people on legacy benefits.

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Recommendation

- The Government must keep the social security lifeline to support the economic recovery by making the £20 uplift to the standard allowance of Universal Credit and Working Tax Credit permanent, and extending it to legacy benefits.

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Introduction

The UK is in a deep recession. We have now had two consecutive quarters of negative GDP growth and GDP is still 9.2% lower in August than it was at its February peak. As such, the Government has rightly been looking at ways to stimulate demand in the economy to mitigate negative financial impacts on households and businesses.

Two tools are consistently present when discussing what kind of spending the Government should use to stimulate the economy: capital spending and tax cuts. However, this conversation has been missing a key focus – the role that social security can play as a stimulus.

This note fills that gap. It outlines why it is important to stimulate demand right now, the different ways in which government spending can do this, and which are most effective. It makes the case that social security should be considered as one of these tools. Not only is it a vital lifeline that keeps us afloat when we need support it also has the potential to be used as an effective stimulus.

Investing in social security can increase consumer spending in a more targeted way than other forms of spending because it is quick to administer and targets money towards those at the bottom end of the income and wealth distribution. Families on low incomes, who find themselves struggling to make ends meet, need to allocate more of their budgets to bills and essentials, so they spend a higher share of any additional income than those earning more, who can afford to save a greater proportion.

We have seen the Government choosing to use this tool in response to the crisis. The Government's welcome uplift of £20 a week to Universal Credit and Working Tax Credit in April 2020 went some way to offsetting the impact of cuts to social security over the last decade, such as the recent benefit freeze. This increase is currently only temporary, and is due to be cut in April 2021, when the downturn will be far from over. For the very reasons that social security can play a key role in stimulating further spending in the economy, taking it away could have significant negative effects on economic activity. Furthermore, evidence shows that temporary boosts to income are less likely to have impacts on spending than permanent increases in income that households can depend on. This is particularly important given the likely scale and length of this recession.

As such, we recommend that the Government keep and make permanent the lifeline that they rightly extended to millions of households earlier this year. Cutting the lifeline in April would not only have significant impacts for the economy, but would mean around 16 million people will experience an immediate and devastating loss of income, almost 60% of whom are in the bottom three income deciles. We also urge the Government to continue to consider increases in social security spending as an important tool to aid a just economic recovery.

The severity of the current economic crisis highlights the need for economic stimulus

The current economic crisis is still unfolding, and we are yet to fully understand the impact of the coronavirus and associated Government decisions.

What is clear is that the UK economy remains in a significant recession. We have now had two consecutive quarters of negative economic growth and despite recent optimism, GDP is still 9.2% lower in August than it was at its February peak (ONS, 2020). While activity picked up in July and August, current and further restrictions are likely to hinder this progress as local lockdowns increase, along with virus case numbers. The OBR's July scenarios forecast that output (economic activity) would not return to pre-virus levels until the end of 2022, with the downside scenario not estimating a return to pre-virus output levels until the third quarter of 2024 (OBR, 2020).

As support for existing jobs is wound down during the Autumn, firms will be facing tough decisions about whether they can keep workers on. The wave of unemployment that is anticipated will likely hit people already struggling to stay afloat, pulling more people into poverty or deeper hardship. The only uncertainty is how many people will lose their jobs.

In their recent Fiscal Sustainability Report, the Office for Budget Responsibility forecast in their central scenario that unemployment would peak at a rate of 11.9% (or 3.5 million people) at the end of 2020 (OBR, 2020). The Bank of England projected a lower unemployment rate, peaking at 7.5% at the end of 2020 (Bank of England, 2020). Only the OBR's upside scenario assumes that the unemployment rate will return to pre-virus levels by 2025, and even this assumed that 10% of those currently furloughed move into unemployment. Given that these scenarios were developed before the current rise in case numbers, local restrictions, and the announcement of the new Job Support Scheme (JSS), significant revision is expected in the next forecasting round in mid-November.

Before those forecasts are updated, the Coronavirus Job Retention Scheme will come to an end, and social distancing restrictions and local lockdowns are likely to ramp up. The Chancellor was right to extend the JSS to protect jobs in areas facing tougher restrictions, as this will provide reassurance to many workers and businesses. However, there will still be many jobs lost in the coming months, not least because the scheme is not generous enough to protect jobs in hard-hit sectors in less restricted areas. As such, thousands more households will likely be reliant on our social security system in the months ahead.

Unemployment can restrict and restrain people's prospects, harming their ability to get a good job and limiting their ability to progress out of low pay in the future. Bold economic policy that looks to increase our living standards and economic growth will be vital as we look to recover from the crisis as quickly as possible.

Why do we want to stimulate the economy in a recession?

In a recession the direct economic shock, such as the COVID-19 social distancing measures, can have knock-on consequences that can further exacerbate the situation. When people lose their jobs, they have less disposable income to spend, so they cut back on spending. This can affect other businesses who may need to lay off more people, or even shut down due to a lack of spending. This cycle can make the economic recovery slow even after the initial shock has long since passed, and it can leave scarring effects on the labour market, making unemployment persistently higher.

Without the need for any new government spending policies, social security and tax systems help to automatically stabilise incomes and consumption. As incomes fall and unemployment rises more people become eligible for support, which in turn shields them from the full force of the downturn, and counteracts swings in the economic cycle. They provide the benefits of smoothing the impact of a downturn without the delays of political decision-making. As such, having strong welfare and progressive tax systems is key to ensuring that those who lose their jobs in an economic downturn can continue to earn an income, spend, and contribute to the economy, until activity picks up again.

Economic stimulus through government spending can help to limit the negative impacts of recession for people and the economy. An economic stimulus means actively intervening to increase the level of activity in the economy. This can either be through the Government directly spending money on activities like building the rail network, employing more nurses, or by getting more money to people to boost their incomes, and therefore their spending, through tax cuts or welfare payments. This can reduce the size and length of the downturn and speed up the recovery as we emerge from recession. It can also help to avoid economic scarring in the medium- to long-term.

The unique response to the COVID-19 recession

The current economic downturn is a unique case and has required considerably bold Government intervention. Given the recent rise in COVID-19 cases, it is likely it will continue to need such interventions and flexibility in its fiscal and health-related policies.

As outlined above, automatic stabilisers can play a key role in helping to buffer the impact of a downturn. However, the UK entered the current crisis with a relatively weaker social security system than it entered the previous financial crisis, given significant real-term cuts in spending on working-age social security over the last decade (Smith et al, 2019). Furthermore, the role that the Bank of England can play using expansionary monetary policy is limited due to historically low interest rates. As such, the need for further economic stimulus spending is stronger than usual.

The Government has had a difficult job in striking a balance between boosting economic activity to stop a worsening recession and preventing the spread of the virus. Policies such as Eat Out to Help Out, and the VAT cuts for hard hit sectors to encourage spending have their limits because of the health risks involved. The Government has set new precedents in its employment support through generous furlough schemes, in part because it had to put a fairly hard stop on economic activity in early 2020 to mitigate health risks, and may need to continue to do so.

The Government also increased the generosity of Universal Credit and the Local Housing Allowance to better support millions of people already needing support, as well as those newly reliant on the social security system. While the increase of

Universal Credit and Working Tax Credits by £20 a week, and re-aligning of Local Housing Allowance to the bottom 30% of local rents in April 2020, was welcome, it was also needed to counter the social security system acting as a weaker automatic stabiliser. The decision partially offset the previous decade's cuts to social security, however the £20 uplift was also a temporary increase, and therefore does little to ensure that we have an ongoing, strong automatic stabiliser in place for any future shocks, or to bear the brunt of the current recession.

Given the overall economic conditions, and the clear need for discretionary fiscal policy to help to mitigate the impacts of the current recession, the next section outlines how fiscal policy decisions can help to stimulate demand and return the UK to an economic equilibrium of healthy employment, spending and output.

Social security is an important tool in our economic stimulus toolkit for a better recovery

The strength of the fiscal multiplier is key to whether a spending tool is an effective policy to stimulate economic activity

When considering what will be successful expansionary fiscal policy, the key factor is the impact that spending will have on further spending activity in the wider economy, leading to higher national income.

The impact of each type of government spending on economic activity is known as its **fiscal multiplier**. This is a measure of how much of any increase in spending (or tax cuts) will feed through into an increase in economic activity. For example, a multiplier of 0.8 means that for every increase in government spending equal to 1% of GDP, the expected impact is a subsequent 0.8% increase in GDP.

Policies aimed at stimulating spending are most useful in recessions because this is when they can have the greatest impact. A review by the National Institute for Economic and Social Research (NIESR) found that a number of studies have identified that the size of fiscal multipliers are dependent on how well the economy is doing, and that fiscal multipliers are larger during a recession that in normal times (Carreras et al, 2016). This highlights the importance of considering the fiscal multiplier effect on significant government spending decisions in a downturn.

Direct spending on goods and services has the highest fiscal multiplier

There are two main categories of government spending to boost the economy, which have different multipliers:

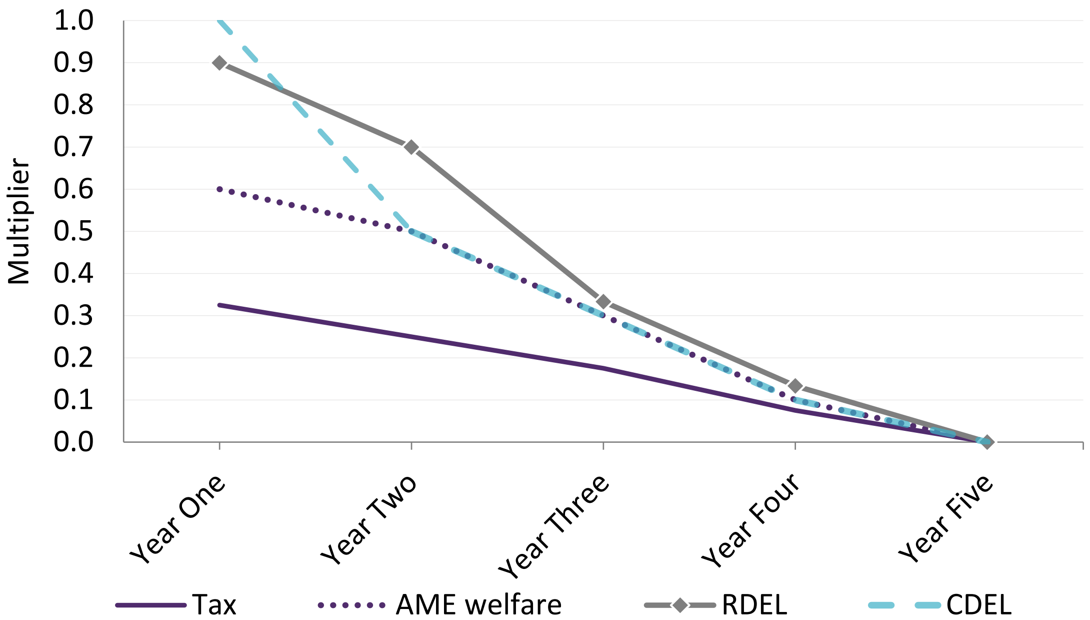
1. **Direct:** Spending can directly contribute to economic activity through the purchasing of goods and services which can contribute to job creation, such as capital investment in a new road or departmental resource spending by government departments.
2. **Indirect:** Spending, or decisions on revenue taking, that increase income for households though fiscal transfers indirectly lead to more spending in the economy. This could include an increased level of generosity of benefits under

the current social security system, new types of more universal payments to the population, or reductions in taxes or national insurance contributions.

Figure 1: Direct versus indirect ways of stimulating the economy

As shown in the graph below, the multiplier estimates used by the OBR assign the highest fiscal multipliers to increases in resource, or capital spending by the Government. This is because the Government is itself directly pumping activity into the economy through these actions, for example by building a new trainline or expanding its spending on defence.

Figure 2: Fiscal multipliers used by the OBR



Source: OBR Forecast Evaluation Report December 2019, Chart 2.B 'Fiscal multipliers used by the OBR'

Note: AME welfare refers to annually managed expenditure on welfare, including pensions and other benefits. RDEL refers to government spending for resources and administration costs. CDEL refers to capital spending on investments and things that will create growth in the future.

Welfare spending and tax cuts have lower multipliers because government cannot control what proportion of the income that it injects into the economy will be spent, or what it will be spent on. In both cases it is increasing the income of a group of people in the hope that a lot of it will then be spent, increasing economic activity.

The effectiveness of these policies – as measured by their fiscal multipliers - therefore depends on how much of this additional income will be spent rather than saved. To help understand this, we can look to the marginal propensity to consume (MPC), and whether different groups of people are more likely to save or spend.

Spending that increases the incomes of low-income households has a high fiscal multiplier because it is targeted at those who have a higher likelihood of spending additional income, not saving.

The MPC is the proportion of an increase in income that someone spends on goods and services, rather than saves. It is measured as the change in consumption that is triggered as a proportion of the change in income received:

$$\textbf{MPC} = \frac{\textbf{change in consumption}}{\textbf{change in income}}$$

The MPC of a low-income person (or household) tends to be higher than a high-income person. The same is also true for those with low liquid wealth, for example, having few or no assets that can be easily turned into cash to spend in a short amount of time. This is because those on high incomes will often already spend enough to meet their everyday needs and can choose whether to spend or save the additional income they receive. Evidence suggests that because those on low incomes need to allocate more of their budgets to essentials and core bills, they will spend a higher share of any additional income than those who earn more.

There is a body of evidence to support this finding. Canbary and Grant (2019) evaluate the MPC of different socio-economic groups. They find that the MPC seems to be much higher for unemployed households and low-skilled workers, who tend to be on low incomes and have greater liquidity constraints. They provide these estimates in their analysis:

Table 1: Estimates of MPC for different groups of households

Low-skilled	Unemployed	Professional	High-skilled
0.94	0.75	0.53	0.59

Source: Canbary and Grant (2019)

Carroll et al's (2017) analysis shows that a fiscal stimulus targeted toward individuals in the bottom half of the wealth distribution, or the unemployed, would be two to three times more effective at increasing spending than the same stimulus focused on the whole population.

The response to the 2008 US stimulus payments provides another example of differing MPC's across the income distribution in practice. As part of the country's stimulus package to support the economy through the financial crisis, all households were sent a one-off payment, equal to $900 on average. Evaluations of the programme have found that those in the bottom third of the income distribution spent a greater proportion of the money than those in the top third, providing evidence of these families having a greater MPC than those on the highest incomes (Broda and Parker, 2014). For those with low liquid wealth, there was an even higher propensity to spend in the first month of receipt than for those with middling- to high-levels of liquid wealth.

While these estimates pre-date the coronavirus, during the current crisis we have seen a growing divide across the income distribution in the ability to save. Recent data from the ONS shows that household savings rates have soared on average during lockdown, but this is not true for all households (ONS, 2020). Analysis from the Resolution Foundation finds that during the lockdown, one-third of low-income households have been saving less, while one-third of high-income households have been saving more. Households with the highest incomes were more than twice as likely to be saving more than normal than those on the lowest incomes (Brewer et al, 2020).

The contrasts are striking. Our recent polling of parents on means-tested benefits found that 70% of families were cutting back on essentials like food or electricity, 60% were borrowing money, and 50% were behind on rent or other essential bills (Maddison, 2020).

The MPC also varies depending on whether the extra income generated by the policy is temporary or permanent. There's evidence to suggest a temporary boost to incomes is less effective at stimulating consumption than a permanent rise (Romer and Romer, 2016). People tend to save more of a one-off amount, whereas the certainty of a permanent increase gives them the confidence to spend more.

With the current context of the temporary uplift to Universal Credit, this is a particularly important reason to consider a permanent uplift to current social security levels. Providing that certainty as soon as possible can increase the chance that the additional income is spent, putting it back into the economy.

Given the significance of MPC on the potential fiscal multiplier of the policy, the question of targeted or broad-based policies that increase household incomes becomes significant.

Targeting an income boost through social security towards low-income households is an effective way to stimulate spending

Increasing the level of means-tested benefit payments is a far more targeted approach to spending than other types of government spending or tax cuts at getting money to those on low incomes and with low savings (low liquid wealth). For example, nearly 60% of the families who gained from the £20 uplift in April 2020 were in the bottom three income deciles (Porter, 2020).

As a result, the strength of the fiscal multiplier used by the OBR in Figure 2 above may underestimate the impact of spending on means-tested benefits for low-income households, as the 'AME welfare' category includes more universal payments such as pensions. Being a targeted payment towards a cohort with a high likelihood to put the money back into the economy in a downturn means that increased spending in social security has strong value for money for the Government's purse, as well as doing the vital job of keeping families afloat.

In comparison, while tax cuts and other universal payments (transfer payments that tend to go to the majority of the population, with limited forms of means-testing) also increase household incomes, they tend to spread the monetary gain to households more broadly. Or they are more targeted towards those with higher incomes and savings. For example, around £2 in every £3 of the funding for a National Insurance threshold increase goes to households in the richest half of the country (Adam et al, 2019). One reason for this is that those on Universal Credit lose 63% of the gains from any tax cut (Barnard, 2019).

This increases the risk that this extra government spend will result in less economic activity, as some of these households choose to save, rather than spend, the increase. This can impact the value for money that the Government can get from its spending.

Figure 3: Fiscal stimulus options that are more or less targeted to low-income households

So can social security be used as an effective tool to increase spending levels?

Increasing means-tested benefit income can be a more effective stimulus than cutting taxes

As illustrated above, increasing the generosity of means-tested benefit payments can be a key tool to provide a targeted stimulus. It can provide an income boost to those with the least, who need to use this money to cover costs and spend on essentials. It is an effective lever using current systems surrounding government spending that can effectively provide targeted increases in incomes to these households.

In addition, increasing the level of benefits is relatively quick and easy to implement and spend as it relies on existing systems. This is particularly true when compared to the large lag times that can be associated with capital spending, due to long processes regarding procurement, contracting and consultation.

As the above analysis shows, the targeted increasing of incomes for low-income households has a higher fiscal multiplier than broader policies like tax cuts or universal payments for increasing household incomes. Increasing the levels of means-tested benefit payments is relatively quick to implement, making it an effective stimulus that can be rolled out quickly in tough times.

The Chancellor's emergency £20 uplift in April provided this stimulus

When the coronavirus storm swept in, the Government recognised the urgent need for a lifeline to help families stay afloat and acted by providing the £20 uplift. These actions not only helped prevent a surge in poverty, they also provided exactly this kind of stimulus. It increased the incomes of around 5 million households in a very short space of time, meaning they could continue to buy goods and services and cover their costs, which in turn prevented a greater economic downturn.

In NIESR's analysis of the likely economic impact of the Chancellor's emergency support package, the targeting of low-income households was expected to significantly strengthen the impact of the intervention. They estimated a 2.1% increase in household consumption from the emergency package, but expected it would have been less than half this effective if it had not specifically targeted those on lower incomes (Lenoel and Young, 2020). This shows how social security can be a very effective tool to boost the economy at a time when it is essential to increase confidence and spending.

In contrast, reducing means-tested benefits takes money out of the economy

While an increase in our means-tested benefits pumps money into the economy (such as through the recent uplift in UC), a reduction does the opposite. Families who are receiving these benefits will see their monthly incomes fall, and as a result will likely need to cut back their spending or find other ways to make up the shortfall. A reduction in the generosity of social security therefore acts as a negative economic stimulus, contracting economic activity as people spend less.

Of course, not all households will respond in the same way to a permanent drop in their monthly income. Some will have enough income to not have to change their spending, and so will instead drop the amount they save. Others may find it hard to cut their spending if they are currently spending all their income on essentials like housing, heating and food, and so accumulate debt to compensate for the fall in income.

There are three key reasons why it is likely a fall in benefits income will result in a significant drop in spending.

- First, a drop in income can have a greater impact on spending than an increase in income. Georgarakos (2018) and Bunn et al (2017) find that the change in spending for households losing income is significantly higher than those experiencing a spike in income.

- Second, both these papers study temporary, unexpected changes in income. Reducing means-tested benefits would instead be a permanent, or at least a longer-term, change. This means the evidence could be underestimating the resulting impact on spending behaviour. While it may be possible for a family to borrow to maintain their spending for a short period of time, this will be less sustainable as a response to a permanent drop in income.

- Third, households on low incomes, or not in work, are more likely to be credit constrained because they have less access to borrowing than those earning more (Collard and Kempson, 2005). This means that when their income falls, they are less able to borrow to prevent a drop in their spending and may mean facing difficult trade-offs and cutting back on essentials. In contrast, a family with easy access to credit might borrow to prevent their spending on food, clothes or holidays falling as much when their income drops.

Despite this, some households may need to maintain their spending to meet a base level of essential costs. In the current crisis there is evidence that the current level of Universal Credit is not enough to prevent all households falling into debt. Low-income households have been more likely than high-income households to have taken on additional debt, even though they were less likely to pre-COVID-19 (Bangham and Leslie, 2020). Policy decisions that can push households further into debt are bad in normal times, but are particularly bad during a recession, especially when borrowing by low-income households is more likely to become problem debt.

Why we're calling for a permanently strengthened social security system

The temporary £20 a week uplift in Universal Credit and Working Tax Credit is currently intended to be cut in April 2021. This will represent a significant drop in income for families receiving these benefits.

JRF analysis (Porter, 2020) has shown that as a result of removing the £20 uplift 16 million people are in families that will experience an overnight loss of £1,040 per year and that as a result 700,000 more people are likely to be pulled into poverty. For many this will mean cutting back on essentials like food or heating or borrowing from friends and family to cover costs. This impact will disproportionately affect the poorest, with nearly 60% of those losing income being in the bottom three income deciles.

Not only does this weaken the social security lifeline, at a time it is most essential to those out of work or dealing with reduced hours and earnings, it also takes money out of the economy at a time when it is far from recovered. We know that social distancing restrictions are forecast to remain in place until at least March 2021, that unemployment is unlikely to recover in the next five years, and will peak in 2021. When the economy is this weak, we would not expect the Government to announce tax rises, or cuts to planned infrastructure projects when they need the economy to grow. So why consider a key stimulus tool like social security differently?

Its removal acts in the opposite way to the initial stimulus. Cutting social security reduces families' incomes, and as a result they will cut their consumption and take money out of the economy. At a time when the economy is weak, this will likely reduce aggregate consumption and see a rise in families facing difficult trade-offs in their spending, rather than support the economy to grow and recover.

The immediate priority must be to keep this lifeline and stop it from being whipped away overnight from around 16 million people in April, cutting many of us adrift and pushing us deeper into hardship. The Government must continue to do the right thing: strengthen our economic recovery and keep families afloat.

That is why JRF is calling on the Government to make the £20 a week uplift to the standard allowance of Universal Credit and basic element of Working Tax Credit permanent, and extend it to Employment and Support Allowance, Income Support, and Jobseeker's Allowance.

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About the Joseph Rowntree Foundation

The Joseph Rowntree Foundation is an independent social change organisation working to solve UK poverty. Through research, policy, collaboration and practical solutions, we aim to inspire action and change that will create a prosperous UK without poverty.

We are working with private, public and voluntary sectors, and people with lived experience of poverty, to build on the recommendations in our comprehensive strategy - We can solve poverty in the UK - and loosen poverty's grip on people who are struggling to get by. It contains analysis and recommendations aimed at the four UK governments.

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