Strengthen social security for a stronger economy

The £20 lifeline supports a just recovery

The UK economy 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. Attention has rightly turned to how best to stimulate the economy to limit the downturn and speed up recovery.

Social security should be recognised as an effective tool to stimulate the economy. Discussions of stimulus policies focus on infrastructure, tax cuts and spending by government departments. While social security is known to play a key role in automatically stabilising incomes in a downturn, it can also be used as an effective, discrete, stimulus tool to achieve a fast increase in consumer spending.

An effective stimulus has a high fiscal multiplier: a large proportion of the spend on the policy feeds through into an increase in economic activity. The highest multipliers are assigned to policies that **directly** increase economic activity, for example building a new trainline or spending more on defence. The multipliers for **indirect** stimuli, for example a tax cut or increase in social security, tend to be lower because the government cannot ensure all the money it injects will be spent and therefore boost economic activity. However, they often have the advantage of speed, for example a rise in benefit income can be implemented faster than building a new hospital.

Of these indirect stimuli, policies that raise the incomes of low-income, low-savings households have higher fiscal multipliers because they are targeted at those most likely to spend extra income. That's because the marginal propensity to consume (MPC) – the share of an increase in income that someone spends on goods and services, rather than saves – is higher for those with lower incomes and less liquid wealth (Carreras, 2016). Those on low incomes need to allocate more of their budgets to essentials and core bills and so will spend a higher share of any additional money. A stimulus targeted at those 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 (Carroll et al, 2017).

Increasing the level of means-tested benefit payments is a more effective way to stimulate spending than other indirect methods, such as tax cuts, because it is so well targeted at those on low incomes. Tax cuts instead tend to benefit a broader set of households or target those with higher incomes. For example, nearly 60% of families who gain from the £20 uplift in Universal Credit and Working Tax Credits in April are in the bottom three income deciles (Porter, 2020), but around £2 in every £3 gained through a National Insurance threshold increase goes to the richest half of households (Adam et al, 2019). This is illustrated by the fiscal multiplier estimates used by the OBR: 0.6 for welfare spend and 0.3 for tax (OBR, 2020).

Cutting social security takes money out of the economy by reducing consumer spending. While an increase in our means-tested benefits pumps money into the economy, a reduction does the opposite. Families receiving these benefits will see their monthly incomes fall, and so will likely need to cut back their spending. Not only will this mean families going without essentials or getting behind on bills, a reduction in the generosity of social security acts as a negative economic stimulus, contracting economic activity. Evidence suggests a drop in income can have a greater impact on spending than an increase (Georgarakos, 2018), especially for low-income households who tend to be more credit constrained.

The Chancellor's emergency £20 a week uplift in Universal Credit and basic element of Working Tax Credit provided an effective stimulus to our economy at the start of this crisis. By targeting low-income households, this policy significantly strengthened the expected economic impact of the Chancellor's emergency support package. Modelling by NIESR estimated that only half the increase in household consumption would be achieved if the policy had not been targeted in this way (Lenoel and Young, 2020). The uplift also allowed social security to act as a strong automatic stabiliser during this economic downturn as it partially offset the previous decade's cuts which had weakened its ability to play this role.

But this temporary uplift is currently intended to be cut in April 2021. Its removal will act in the opposite way to the initial stimulus. Not only will this weaken the social security lifeline when it is needed most, it also takes money out of the economy at a time when it is far from recovered. While the economy remains so weak, we would not expect the Government to announce tax rises or cut planned infrastructure projects. For the same reason, it does not make economic sense to cut social security.

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.

At a time when we need certainty and stability in the face of a wave of unemployment, restrictions, and hardship, this will keep the lifeline for millions of families as the coronavirus storm rages on. It will strengthen social security's crucial role as an automatic stabiliser, keep families' heads above water, and support the economy through this downturn.

For more details and references see the full briefing – https://www.jrf.org.uk/report/strengthen-social-security-stronger-economy

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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.

All research published by JRF, including publications in the references, is available to download from www.jrf.org.uk

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