National Institute of Economic and Social Research

Press Note

National Institute of Economic and Social Research

Budget 2021: In need of a comprehensive fiscal framework to address long-term effects of Covid-19 and Brexit

FOR IMMEDIATE RELEASE

Today the Chancellor will deliver the Budget. This Press Note highlights how and where fiscal priorities should be set.

- The duration of Covid-related support should be driven by our success in tackling the Covid-19 pandemic. Extending support until the summer is the right thing to do but policies should be flexible and not fixed to unchangeable dates.
- The extent of required deficit reduction is still uncertain but tax rises rather than spending cuts should be prioritised: in particular, rises in income taxes – especially on wealthier households – will have smaller negative economic consequences than in corporate taxes. The one-off rise in public debt should not be a cause for concern but a windfall tax on households and businesses who have benefited during the pandemic could be considered for reasons of fairness.
- After the pandemic has receded we will need government policies to limit the lasting and uneven damage from Covid-19 and Brexit. Any plan to reduce public debt should be consistent with economic and social objectives for fiscal policy.

It is essential that today's Budget lays out sufficient support for the UK economy until we are through to the other side of the Covid-19 pandemic. The Coronavirus Job Retention Scheme (CJRS) scheme has been a particular success in bridging across the collapse in economic activity; **it should be extended along with the additional Universal Credit component and other support for businesses** for as long as public health measures require. The withdrawal of fiscal support must be **contingent on progress in eliminating the health threat and aligned with the roadmap for re-opening the economy**, including allowing for subsequent changes to the current schedule.

- There are **significant risks to withdrawing fiscal support too soon based on highly uncertain economic forecasts**, as we saw when the withdrawal of the furlough scheme last October was cancelled hours before it came into effect. The Budget should give households and businesses confidence that support will be in place for as long as it is required. Policy changes should be contingent on the state of the virus, with implementation dates subject to change as the public health situation requires, but with conditions for those changes clearly laid out in advance.
- Despite vaccine roll-out, there **is significant uncertainty around the pace of the recovery over the next year associated with the path of the virus, and changes in behaviours of households and firms in the aftermath of the pandemic**. A slower than expected global recovery due to Covid-19 is also a major downside risk for the UK economy.

- If the Office for Budget Responsibility accurately forecasts a swift recovery, with GDP returning to pre-pandemic levels early in 2022, tax rises in 2022-23 would not be premature. But pre-announcing tax rises based on forecasts of swift economic recovery runs the risk of either premature fiscal consolidation or another economically damaging policy u-turn. **It would be wise not to commit too early.**

Recent NIESR research indicates that **it is preferable to increase taxes before reducing spending because of their more limited impact on the economic recovery initially**. Spending multipliers are especially larger in times of crisis when output is considerably below its potential and when interest rates are close to zero. In order to minimise the negative economic consequences of fiscal consolidation, and following a decade of spending-based consolidation, **tax rises should take the weight of any attempts to reduce the deficit** once the recovery is on a firmer footing.

- Our research also suggests that **rises in income tax rates will have a smaller economic impact than rises in sales or corporation taxes**. Multipliers on the taxation of income to wealthier households are likely to be even lower and these are the households who have amassed savings during lockdown.
- Although the one-off rise in debt poses no immediate risk to the public finances, and servicing costs will remain modest, **a windfall tax on wealthier households and/or businesses whose balance sheets have been boosted during the pandemic could be considered** for reasons of equity or to reduce the debt stock in anticipation of future economic shocks.

To limit long-term scarring in the labour market following the withdrawal of the CJRS and the Self-Employed Income Support Scheme (SEISS), **programmes to support job creation will be needed, including significant investment in education and training**.

- The twin shocks of Covid-19 and Brexit have left uneven marks on the households, firms, sectors and regions of the UK economy. Any plan to reduce public debt should be consistent with economic and social objectives for fiscal policy. To limit the lasting economic and social damage and protect the most affected**, commitment to targeted and sustained support is required**, including laying out policies to tackle regional disparities.
- **A Comprehensive Tax Review is required** considering the changing form of the economy, including trends towards automation, and the tax richness of the post-Covid economy.
- We expect the Bank of England to continue supporting the Government's fiscal response, including through its quantitative easing programme. While this has shortened the maturity of public debt, exposure to short-term interest rates will only materialise if the Bank tightens policy rates significantly in response to a faster-than-expected economic recovery, while retaining the purchased gilts, and **should be more than outweighed by the tax consequences of such a recovery**. Looking to the future, we lack a clear framework for whether and when monetary-fiscal policy coordination is appropriate, something which should be considered alongside the toolkit at the disposal of the Monetary Policy Committee.

NIESR Deputy Director, Dr Hande Kucuk, said: "*As well as short-term measures to continue support to households and businesses through the pandemic, the Budget needs to provide a comprehensive fiscal framework to build confidence in sustained recovery given the significant uncertainty regarding the long-term effects of Covid-19 and Brexit. Just as the size of the initial hit, the pace of the recovery will* *be highly uneven across households, businesses, sectors and regions, which require targeted and sustained support as well as regional planning to limit long-term economic and social damage. Withdrawing fiscal support too soon based on highly uncertain economic forecasts of swift economic recovery would put too much at stake.*"

ENDS

Notes for editors:

The latest NIESR forecasts for the UK and Global economies can be found **here**.

NIESR staff will be available to comment the Budget throughout the day. For queries and to arrange interviews, please contact the NIESR Press Office: press@niesr.ac.uk / l.pieri@niesr.ac.uk / 07930 544 631

Further details of NIESR's activities can be seen on http://www.niesr.ac.uk or by contacting enquiries@niesr.ac.uk Switchboard Telephone Number: +44 (0) 207 222 7665