BRIEFING NOTE

A SPENDING REVIEW FOR A GREEN AND CARE-LED RECOVERY

OCTOBER 2021

The case for a fiscal stimulus

The UK economy has seen a spurt of rapid growth since the principal reopening of the economy in April, but this has been faltering in the last few weeks due to labour shortages and other supply chain issues. With inflation also higher, there is now considerable uncertainty in the business community about future demand, which will inevitably have an impact on business investment.[1]

Unemployment has not risen to the post-pandemic levels forecast last year, but the latest figures show that over the summer months it was 4.5% of the labour force, or more than one and a half million people.[2] Around a million people were estimated to be still on the furlough scheme when it ended on September 30th.[3] Vacancies are at an all-time high, but mismatches between the supply and demand for labour – both in skills and geographic location – mean that unemployment will not necessarily fall as rapidly as hoped. In addition the pandemic has seen a withdrawal of workers from the labour market: 8.7 million people are now classified as 'economically inactive'.[4]

Investment in the UK economy is lower (as a proportion of GDP) than in most other advanced economies, and has been for two decades. Investment is the engine of output growth and is vital to build productive capacity, which is the principal way that inflationary forces can be held in check. The UK's public investment is currently at around 2.2% of GDP, compared to an OECD average of 3.3%.[5] Total investment is around 17%, compared to a high income country average of 23%.[6]

After a decade of austerity and the impact of the pandemic, the UK needs a higher level of both public and private investment. There is a very strong case for this to be targeted at the three major challenges now faced by our society and economy. These have already been identified and prioritised by the government: addressing the climate and nature crises; developing a proper care system; and 'levelling up' and the reduction of inequalities.

To continue to stimulate the economy, the overall fiscal stimulus in this Spending Review period should be of the order of £70-90bn a year.

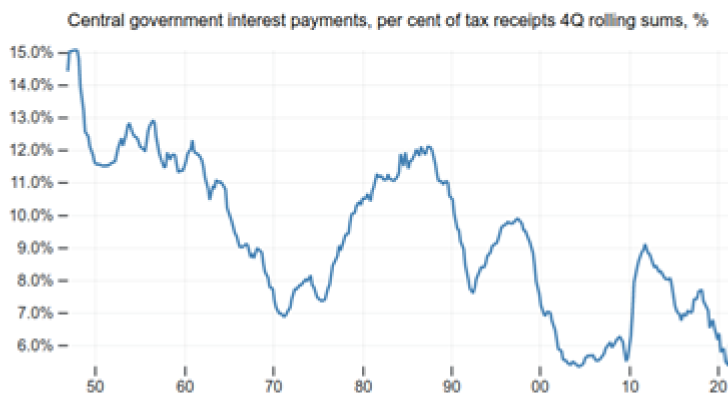
This range comes from two kinds of economic analysis.[7] In its latest forecast for the UK, the IMF calculates that the economy is about 5% below its pre-pandemic growth path.[8] It is likely that around about half of this is due to reallocation factors and the global supply chain squeeze. But it is reasonable to assume that around half is due to lack of demand and investment certainty and can be unlocked through fiscal stimulus.

If a very conservative fiscal multiplier of 0.6 is used (the IMF's own estimates are up to four times this)[9], this yields a required investment stimulus, to bring the economy up to it pre-pandemic growth path, of an additional £91 billion pa. At the same time, we can calculate the stimulus that would stabilise the UK's public debt to GDP ratio over the rest of this parliament. Again using a 0.6 fiscal multiplier, and assuming interest rates around 3% below growth rates, this yields an annual stimulus of £73bn.

£70-90bn corresponds to 3-4% of UK GDP. By comparison the Biden Administration's $1.9 trillion stimulus plan passed earlier this year is around 9% of US GDP, and another $3.5 trillion in long term spending is planned.[10] Biden's stimulus plans have brought a rapid recovery in the US economy.[11]

The UK economy still has room for further borrowing. Although public debt is now at around 100% of GDP, this figure is not of itself economically significant. It is the cost of borrowing, and the value of the spending it finances, which matter. Today the government's debt interest payments are running at under 6% of tax receipts, the consequence of near-zero interest rates (see Figure 1 below).[12] This is the second lowest figure since the second world war. Interest rates may rise over the coming months if the Bank of England believes that inflation is likely to persistently exceed its target. But they will remain by historic standards very low. So debt interest payments will remain low. Moreover just under 40% of government debt is now owned by the Bank of England,[13] which pays the Treasury back any profit on the interest it receives. So further borrowing for investment in the UK economy is affordable.[14] By generating higher national income, such investment will lead to higher tax receipts, and in this way will ultimately bring down the debt. We know from the experience of austerity that trying to reduce debt by cutting public spending not only does huge damage to public services and increases inequality, but is self-defeating.[15]

Figure 1: Government debt interest payments as a % of tax receipts



Source: Macroflow

It is for this reason that the Chancellor's rhetoric of 'fixing the public finances' is misleading, and returning to tight public spending to achieve it would be a grave

economic mistake. Following a decade of austerity and the pandemic the economy needs investment, and it can well afford to borrow for it.

Higher tax receipts over recent months have given the Chancellor some headroom for higher spending. The bulk of the investment proposed should be funded by borrowing.

Within the overall stimulus envelope of £70-90 billion a year, there are many priorities. A fair pay rise for public sector workers is one; restoring to local government a decent level of funding for local public services is another. But the government has highlighted three areas as particularly important priorities. These are: green spending, to meet the government's commitments to tackling the climate and nature crisis; spending on social care and childcare; and spending on "levelling up" and the reduction of inequalities.

Priority 1: Green spending

The UK has set itself a statutory commitment to reduce its greenhouse gas emissions to net zero by 2050; and en route to that to achieve a reduction of 78% against 1990 levels by 2035. As the government's official watchdog the Climate Change Committee has noted, the government is currently well off track to meeting this goal. To do so will require a significant increase in green investment.

Using the Committee's own figures, and separate calculations done by the Green Alliance and others, IPPR have estimated that annual green spending in this Spending Review period should be increased by around £30bn a year, broken down as in the table below. In some cases it may be difficult to spend these sums in the first year of the Spending Review, so spending might start lower than this and rise to £30bn in the third year.

Table 1: Proposed green spending package[16]

Area of spending	Additional spending	Specific measures include
Transport	£11.96 bn	· £1.55 bn on subsidies for take up purchase of e-bikes, mobility schemes and EV and spending on EV infrastructure · £1 bn on tram infrastructure · £5.52 bn on rail expansion · £0.19 bn on electrifying the bus fleet · £2.7 bn to expand rural bus networks · £1 bn on cycling and walking infrastructure
Agriculture and nature	£5.55 bn	· £2.15 billion on environmental land management schemes · £1.43 bn on nature protection, enforcement and regulation · £0.74 bn on a national nature service · £0.11 bn on marine protection · £1.12 bn on water, adaptation and flooding measures
Retrofitting homes	£7.55 bn	· £7.55 bn for VAT cut for home retrofit, subsidies and grants for energy efficiency and low carbon heat solutions
Industry (including transition fund)	£2.79 bn	· £2.79 bn on zero interest business loans, supporting the circular economy and supporting the transition
Carbon capture and storage (CCS)	£0.93 bn	· £0.93 bn on support for CCS and hydrogen clusters
Green training	£1.06 bn	· £1.06 bn to support payments for re-training for existing workers in carbon intensive industries
Institutions	£0.20 bn	· £0.20 bn to support a standing Climate and Nature Assembly, a new Nature Recovery Committee and a Net Zero and Fair Transition Delivery Body

Total	£30.04 bn	

IPPR estimate that green spending of this order would create at least 500,000 new jobs, spread right across the country.

Priority 2: Social infrastructure spending

The care system is often regarded as part of the ‘consumption’ side of the economy. But it is also a vital part of the investment side. Social care and childcare enable people – overwhelmingly women – to enter the labour force and increase their working hours. The additional earnings they receive then contribute to raising demand, which in turn generates higher tax receipts. So public spending on care makes a major productive contribution, as well as bringing significant welfare benefits, particularly to households on lower incomes. Along with healthcare and education, social care and childcare can be regarded as part of the *social infrastructure* which sustains an advanced economy.[17] Often overlooked by mainstream economics and policymakers, it is notable that spending on social infrastructure tends to generate higher employment than investment in physical infrastructure.[18]

It is now widely accepted that the social care system in England needs radical reform. Eligibility for adult care varies hugely across the country, largely according to the financial health of the local authority, with over a million people unable to access the care that they need.[19] Under current rules for private contributions, many people face ruinous costs to pay for prolonged social care. Care workers are grossly underpaid, leading to high rates of staff turnover and sometimes poor quality care. The privatisation of care homes has left many acting essentially as financial assets whose aim is profit rather than care. The integration of health and social care is patchy at best, lacking altogether at worst.

Social care needs much higher investment. With the government’s announced increase in National Insurance contributions earmarked for the NHS not social care, IPPR calculate that at least £11 billion in additional funding is needed.[20] This would deliver free personal care for the over-65s under current eligibility rules, improve access to care in people's own homes, and raise pay rise for social care workers paid below the Real Living Wage (currently £9.50/hr, and £10.85/hr in London, as calculated by the Living Wage Foundation[21]).

To build an adult social care system with wider eligibility, free at the point of use, both for those aged 18-64 and the over 65s, with a pay rise and better working conditions for all social care workers, the Women’s Budget Group (WBG) estimate that £29bn a year is required, over and above the £20bn currently spent by local authorities.[22] This figure assumes take-up rates based on the experience of free social care in Scotland. WBG estimates that an additional £29bn spending package would create

around 466,000 new full-time equivalent (FTE) jobs, spread right across the country, with approximately 333,000 in social care itself and 133,000 in other sectors.[23]

The system of childcare in England is even more haphazard than adult social care. Current spending on free childcare hours and tax credits totals around £5.1bn. WBG calculates that to provide 30 hours of free childcare for all children aged 6 months to 4.5 years, with level 3 staff paid at the Real Living Wage and 45% graduate recruitment, would require additional spending of £10.4bn a year.[24] This assumes current statutory child/staff rations, and take-up of 50% from 6 months to 2 years, 75% of 2 year olds and 90% of 3-4 year olds. Allowance has been made for childcare centre overheads, annualised rent or mortgage repayments, and additional training costs.

WBG estimates that this package would create approximately 310,000 new FTE jobs, including 207,000 in childcare and 103,000 in other sectors, spread right across the country. It would increase revenue from income tax, indirect taxes and reduced spending on social security which would make the additional spending requirement fall from £10.4bn to £3bn. This means that about 70% of the gross annual spending would be recouped simply from increased employment and tax revenue.

Priority 3: Levelling up / Reducing inequalities

The Government has expressed its commitment to “levelling up” geographic and other inequalities. The package of spending we propose would make a significant contribution to this: each of the priority areas would see jobs being created right across the country, including areas experiencing acute economic disadvantage. There is demand for making homes more energy efficient, and providing social care and childcare, in every community.

But if the Government’s commitment to levelling up is to be made real, and made assessable, there should be a specific bias in public spending towards areas of economic disadvantage. This could done, for example, by setting a target of 50% of all additional public spending which is geographically identifiable to be spent in the poorest third of local authorities according to the Index of Multiple Deprivation.

Unfortunately at present the government does not produce statistics for geographically identifiable public spending by local authority area. There is a very strong case for it to do so. Without this it will not be possible to see how its commitment to levelling up is actually manifested in public spending.

But the government should go further than this. Under the Equality Act 2010 Public Sector Equality Duty (PSED), all public bodies, including HM Treasury, are obliged to have ‘due regard’ to the impact of their policies on people with protected characteristics. One of the main ways in which public bodies do this is through Equality

Impact Assessments. EIAs can be an important way to analyse the ways in which policy impacts differently on different groups as a result of structural inequalities.

However, Treasury practice has been poor when it comes to Equality Impact Assessments. The 2020 Spending Review contains just three pages containing ‘illustrative examples’ where spending allocations will have a positive impact on people with protected characteristics, but no meaningful analysis of the impact of the spending review as a whole. The Treasury has repeatedly failed to publish Equality Impact Assessments for successive Budgets, despite requests from both the Treasury Select Committee[25] and Women and Equalities Select Committee.[26] HMRC publish some assessments of tax changes, but these are limited in scope and demonstrate poor understanding of equality impact.[27]

To ensure that the distributional impacts of the Spending Review and Budget are transparent and clear, the Treasury should commit to publishing a comprehensive Equality Impact Assessment (EIA) of both the Budget, each year, and the Spending Review to accompany their publication. This should assess the impact of all their policies on people with protected characteristics under the Equality Act 2010, along with socio-economic status (which was originally included in the PSED but not enacted). It should consider the cumulative impact, the intersectional impact, the impact on individuals as well as households, impact over a lifetime, and the impact on unpaid care. EIAs should be based on evidence and consultation with those most likely to be affected by policy.

It is important that the Treasury carry out its own EIAs, to embed ‘levelling up’ commitments in that institution. But given its repeated failure to meet its obligations under the PSED so far, there is also a strong case for the Office for Budget Responsibility to be given the responsibility of carrying out comprehensive Equality Impact Assessments for the Budget and Spending Review, and for future ones, in the years after they have been published. This will ensure that the Government’s expected outcomes can be assessed against actual outcomes.

Towards a fairer taxation system

The bulk of the investment proposed should be funded by borrowing. But there is also a very strong case for making the tax system fairer.

A clear priority for this is to bring the tax rates on income from wealth into line with those on income from work.[28] The present system of reduced tax rates on capital gains and dividends is unfair to those who do not have financial wealth (overwhelmingly those on lower incomes), benefits the predominantly already wealthy, and gives them an incentive to convert income into wealth as a form of tax avoidance.

In the longer term, the tax treatment of land and property needs particular attention to make it fairer. Despite a huge growth in wealth over the past two decades, and its

extremely uneven distribution, wealth and property are significantly undertaxed in the UK.[29]

To raise additional finance there is also a clear opportunity in the present moment to levy a windfall tax on the significant additional profits made by some companies during the pandemic, particularly those benefiting from digital activity and sales.[30]

Briefing Note prepared by the Economic Change Unit

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Notes

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