Resolution Foundation
BRIEFING

The Covid state

Analysis of the economy and public finances ahead of the 2020 Spending Review

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Summary

The economic and health response to Covid-19 has affected us all, and the Chancellor is no exception. In March – just as the realities of the pandemic were becoming clearer – the Chancellor set out his plans for steadily growing public spending to the middle of the 2020s against a relatively benign economic forecast. Now he faces the largest annual fall in economic activity in 300 years, leading to falling tax revenues and surging spending.

The health crisis is the underlying driver of the economic crisis that we are facing. As the spread of the virus has developed, so too have the interventions required to keep infection levels contained, which in turn alter the outlook for the economy. The Office for Budget Responsibility (OBR) last produced an official forecast for the economy four months ago, in July. Normally, the economic outlook would be largely unchanged in a such a short period of time, but the progression of the virus and the changes to the economic policies required to cushion the worst effects of the crisis together leave scope for the OBR to update its view substantially.

The prospects for economic activity will have been buoyed by the upside surprise in GDP growth in the third quarter of 2020: the level of GDP was 7 per cent higher than the OBR had expected in July. But with the accelerating spread of the coronavirus leading to additional social distancing restrictions through the winter, the economy is set to be 11 per cent smaller this year than pre-crisis, the largest annual contraction in GDP in 300 years.

The longer-term outlook is more positive, with encouraging early vaccine trial results. But that news may have relatively little effect on the OBR's published forecast, as economic forecasters had largely expected that social distancing restrictions would be able to be withdrawn throughout 2021.

Although the prospects for economic activity have changed by less than might be expected, with the good and bad news since July partially offsetting each other, the OBR's labour market forecasts will be much more materially — and positively — updated. Unemployment in 2020 Q3 was less than half of the level in the OBR's central scenario published in July. This is in part due to the Chancellor extending the option of full furlough under the Job Retention Scheme first through November and then until the end of this financial year: this policy change will limit flows from employment to unemployment. The extension of the scheme will mean fewer people working, leading to lower economic activity, but its efficacy in slowing unemployment

rises means that fewer people will become unemployed over the next six months, and so the peak in unemployment will be later than the OBR expected in July.

The fall in economic activity this year, and the need to spend money to tackle the virus directly, has required unprecedented increases in government borrowing. But what ultimately matters for fiscal sustainability is the amount of medium-term scarring that the crisis inflicts on the economy. The OBR is likely to forecast that the economy will be 3 per cent smaller in 2024-25 relative to its pre-crisis forecast; this is equivalent to a loss in GDP per household of £2,500 per year in today's terms. But this would be a lower level of scarring than has typically been seen in previous recessions. In order to achieve this low level of scarring, Government policy will need to encourage a swift recovery in business investment.

The fact that the economy is substantially weaker than had been expected back at the Budget in March has affected the public finances in a variety of ways. The mixture of lower taxation revenues and extra spending on automatic stabilisers combine to add £87 billion to borrowing in 2020-21, an amount which falls sharply to £43 billion in 2021-22 but remains elevated throughout the forecast period because the economy remains scarred by the crisis. Together with an estimated cost of close to £275 billion in government policy responses in 2020-21, borrowing is on course to reach over £400 billion this year, significantly more than the £322 billion forecast back in July, and a peacetime record of 21 per cent of GDP. Some of this spending – particularly that relating to health and public services – is likely to continue into the next fiscal year, but most policy costs will not persist in the medium term. This means that the fact that borrowing is forecast to be £50 billion above the levels forecast in the March Budget by 2024-25 is entirely due to the economic scarring leading to a persistently smaller economy producing lower tax revenues.

The OBR will also play a starring role in confirming just how big the state has become. Most of the additional spending in 2020-21 has already been announced at one of the various updates delivered by the Chancellor this year, including, for example, almost £50 billion of increases in health spending to tackle the virus. We expect that the Chancellor will announce significant further in-year spending commitments covering a range of departmental budgets to the end of March, possibly amounting to a further £40 billion. In all, this implies Resource Departmental Expenditure Limits could increase by almost 50 per cent between 2019-20 and 2020-21. Overall, Total Managed Expenditure could well reach levels only ever previously observed in wartime. We expect the OBR to show total government spending has climbed to somewhere in the region of 60 per cent of GDP in 2020-21. The only time public spending has ever previously been above 60 per cent of GDP was in 1943 and 1944.

This economic and fiscal backdrop leaves the Chancellor with some big questions to answer. First, what is the UK's fiscal framework? This may sound technical, but the decision on a framework matters both for the bigger picture direction of spending and tax, but also for spending control and value for money in the here and now. Implementing a flexible framework that is able to incorporate the need for significant public spending support as this crisis continues to unfold, but also recognises the need to protect the long-run health of the public finances, is vital.

Second, and relatedly, what will be the path of public spending and taxation out to the middle of the decade? The tension between a reluctance to increase taxes, the commitments made on spending increases (e.g. on schools, the NHS and defence), and the desire to keep a lid on the rise in public debt cannot be avoided forever. For now, the Government is taking the easy path of announcing the spending increases but without grappling with the trade-offs that this entails.

Third, how much of this year's exceptional Covid-related spending will roll forward into 2020-21? Significantly less will be required, but the Government's response to the pandemic will not fall to zero in 2021-22. A large amount of additional support will be needed for a range of public services, from hiring extra staff to work in Job Centres to support the unemployed, to continuing with extra public transport spending. And there will be a mixture of old and new health priorities, from test and trace to the roll-out of vaccines across the country.

The practical implementation of these spending decisions at a time of very high uncertainty means that it would be worthwhile for the Chancellor to announce a 'Covid reserve' for additional time-limited Covid spending. No-one knows how spending needs will evolve next year. Rather than have to repeatedly announce short-term funding allocations to departments, a better approach would be to use a reserve from which funds could be allocated where required. This would follow the approach last used to fund the wars in Iraq and Afghanistan. If a Covid reserve is to be implemented then it should be alongside a commitment from the Government to make any necessary funding available to departments where required– the fund should ease allocation of necessary expenditure, not hinder it.

The Chancellor faces similar challenges concerning capital spending, following the announcement of ambitious investment plans in the March Budget. Although, unlike resource spending, 'key programmes' will be allocated multi-year spending plans at the Spending Review, there remains a lack of clarity over how much of the capital envelope this will apply to. This is crucial given the ability to plan based on concrete spending settlements is essential for effective investment and the realisation of longer-term environmental and 'levelling-up' objectives. And avoiding the difficult decisions over how to maintain high levels of capital spending despite a persistently smaller economy - by announcing capital spending plans without a medium-term fiscal anchor - could place the Chancellor in a difficult position in the coming years if high investment proves inconsistent with the fiscal framework eventually adopted.

Although this fiscal event is being called a Spending Review, it would be a mistake for the Chancellor to consider only departmental spending budgets and ignore other important policy areas with significant economic and real-life consequences. Nowhere is this more pertinent than the need to commit to keeping the £20 per week boost to Universal Credit and Working Tax Credit through 2021-22. Half (54 per cent) of adults from families in the lowest income quintile have borrowed in recent months to cover everyday costs such as housing and food, and almost one-in-three (29 per cent) adults that has had a persistently low income through the pandemic say they cannot afford basic items such as fresh fruit and vegetables every day, or to turn on the heating when required. Universal Credit is providing the key safety net benefit for those unable to benefit from the JRS or the Self-Employment Income Support Scheme. Taking £1,000 off the annual income of over 6 million low-income households next April would cause a living standards crisis, and implementing a fiscal contraction at that time risks derailing any hope of an economic recovery. It makes no sense, politically or economically.

The economic backdrop to the Spending Review is an historic weakness in economic activity

The OBR last published its analysis of the state of the economy, alongside its economic and fiscal forecasts, back in July. The message in the new forecast will be much the same: 2020 will be the worst year for economic growth in at least 100 years, and total lost economic output over the next five years will be almost £700 billion in real terms relative to expectations in March 2020, around 6 per cent of total output over this period. Even by the end of the five-year forecast, the OBR is likely to conclude the economy will be 3 per cent smaller, equating to more than £2,500 per household and £1,000 per capita less in economic output per year in real terms. This is the huge economic challenge facing the Chancellor at this Spending Review.

Although the key messages from the OBR economic forecasts will be unchanged, there have been three key developments since the July forecast which will be important for their new analysis.[1] First, the Office for National Statistics (ONS) has published new GDP figures through to Q3 of 2020; second, all parts of the UK have seen the re-imposition of severe restrictions on economic activity; and third, preliminary results from phase three

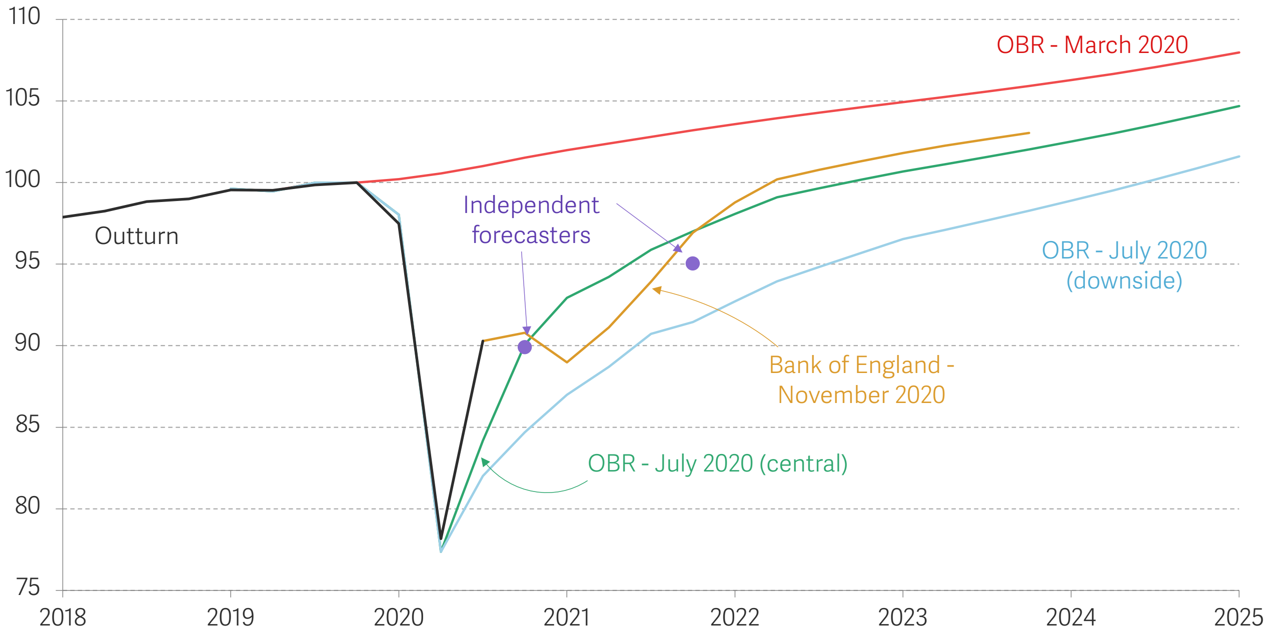
1 The OBR's most recent forecasts are set out in OBR, Fiscal sustainability report - July 2020.

vaccine trials have been published. The obvious question is what will be the impact of these developments on the OBR's outlook for the economy. We look at the impact of each in turn below, but overall we expect the OBR to reshape their predicted path of GDP, with a weaker final quarter of the year and then a moderately faster recovery.

Turning first to the impact of new GDP data, the third quarter of 2020 showed a more rapid recovery in GDP from Q2 than the OBR forecasts had anticipated. The economy was 7 per cent larger than had been assumed in the OBR's central scenario from July, as shown in Figure 1. This is positive news for the resilience of the economy, but digging into the underlying data shows that a number of sectors failed to make significant headway back towards pre-crisis output levels, despite the relative lack of social distancing restrictions throughout the third quarter of 2020. In particular, the hospitality, recreation and "other" service sectors were all more than 20 per cent smaller than their output levels in February.

FIGURE 1: **Developments since July have both raised and lowered GDP relative to OBR expectations**

Select forecasts and outturn of the level of real GDP, index: 2019 Q4 = 100



SOURCE: ONS; OBR; Bank of England; HM Treasury.

More important than the higher GDP outturn in Q3 is the pick-up in coronavirus cases in the UK since the summer leading to the re-imposition of a lockdown in England, a "firebreak" lockdown in Wales, a slightly lighter lockdown in Northern Ireland, and lockdown-equivalent restrictions in large parts of Scotland. Most of these restrictions were announced in time to be reflected in the Bank of England's most recent economic forecast (shown in Figure 1), in which the Bank expected little growth over the final quarter with the economy shrinking again at the start of 2021.[2]

We can cross-check forecaster expectations of the current level of economic activity with data from Google on the mobility of people, as tracked by the location of phones. This data is some of the timeliest available and has so far correlated well with economic output during this crisis. This data, shown in Figure 2, reveals a notable drift downwards in visits to retail, transport and workplace locations since the Government introduced the three-level tier system in England, and a further fall since the second lockdown in England was announced (although it appears that there was a brief uptick in activity in preparation for the start of restrictions). So far, the falls in mobility in November seem to be substantially smaller than during the first lockdown, suggesting that, in line with forecaster expectations, economic activity will not fall anything like as far as in April. A simple mapping of the mobility indexes to GDP during the first lockdown suggests that the economy could shrink during this lockdown by a further 4 per cent.[3] In practice, the economic hit should be smaller than this, as firms and households have had more time to prepare this time round to enable economic activity to continue while restrictions are in place.[4]

The final development which could materially shape the OBR's forecasts is the news that early results from phase three trials showing that multiple vaccines are safe, effective at preventing the spread of the coronavirus, and could start to be rolled out in the coming months.[5] Given the number of vaccines in development, and the results from phase two trials suggesting that candidate vaccines provoked an immune response, it is not unexpected that some vaccines could start to be distributed imminently. But the news does have two important effects. First, the downside risk that a successful vaccine would not be found has fallen (in effect, this means the OBR's 'downside' scenario from July is no longer realistic). Second, the level of efficacy of the early vaccines appears to be greater than expected, meaning social distancing restrictions may be able to be withdrawn faster during the vaccine roll-out stage.

2 The Bank of England expects the economy to grow in the final quarter of 2020 on average, partially as a result of expected stronger growth in October before the onset of additional restrictions.

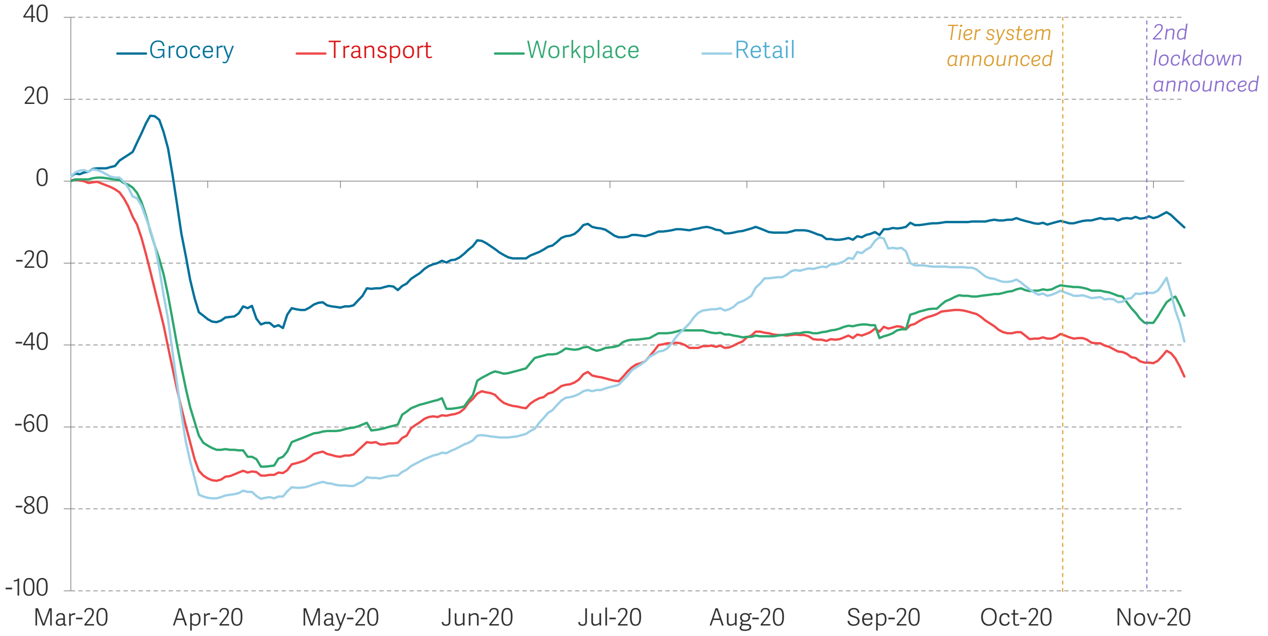
3 The relationship between mobility data and economic output is not one-for-one; this indicative calculation uses the 'exchange rate' between mobility and GDP observed between May and June (in order to abstract from the particularly large economic effects in the immediate period of the first lockdown) and applies this to the change in mobility seen so far between October and November.

4 The relationship between mobility and economic activity is likely to change over time and depend on the nature of social distancing restrictions. For example, more firms will have set up operations such that they can continue to trade online and with schools open parents should be more able to work than was the case during the first lockdown.

5 See Pfizer and BioNTech, Pfizer and BioNTech conclude phase 3 study of COVID-19 vaccine candidate, meeting all primary efficacy endpoints, November 2020, and Moderna, Moderna's COVID-19 Vaccine Candidate Meets its Primary Efficacy Endpoint in the First Interim Analysis of the Phase 3 COVE Study, November 2020.

FIGURE 2: **So far, the second lockdown appears to be reducing activity less than the first lockdown**

Index of mobility in various settings: UK



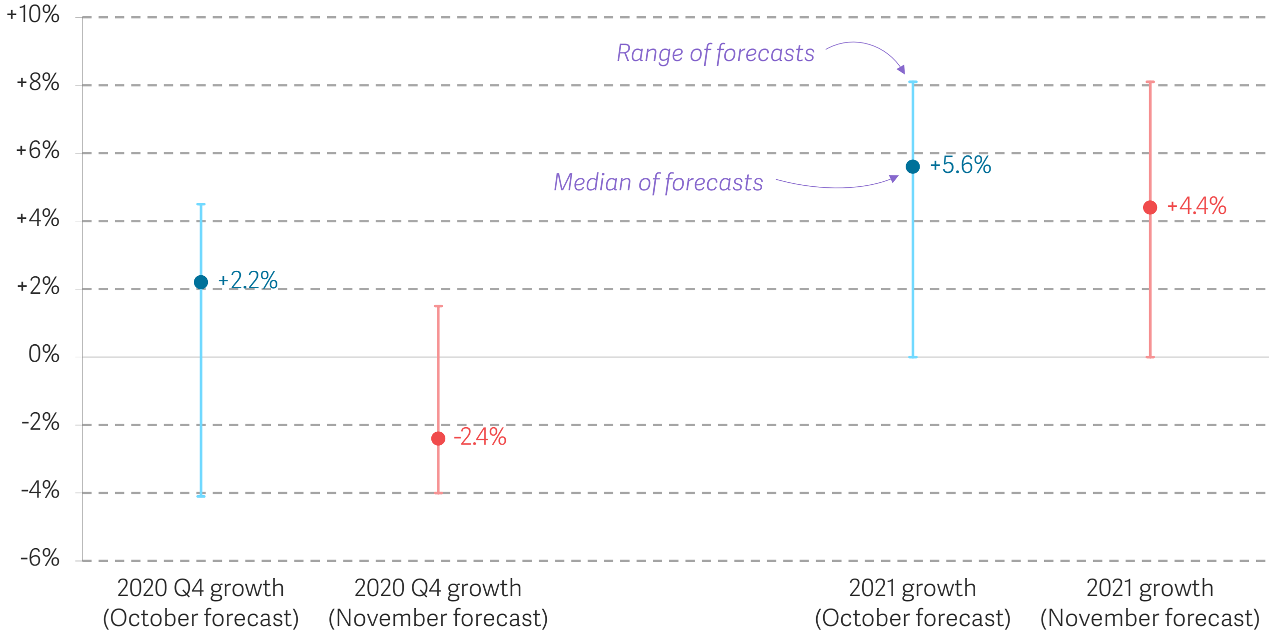
NOTES: Data is smoothed using a seven-day rolling average and therefore underrepresents some of the most recent falls in mobility.
SOURCE: RF analysis of Google.

Interestingly, when we compare external forecasts made in October to those made in November - shown in Figure 3 - there is a clear deterioration in 2020 GDP as a result of the second lockdown in England, but no change in the outlook for 2021. This suggests that the vaccine news may not affect the OBR's outlook significantly.

So, taking this evidence together the OBR is likely to downgrade its outlook for GDP in the final quarter of this year before, potentially, expecting a slightly faster recovery in 2021 than it thought back in July.

FIGURE 3: **Expectations for growth this year have fallen in the past month, but expectations for 2021 are broadly unchanged**

Non-official sector forecasts for GDP growth, by date of forecast publication: UK



NOTES: October forecast sample includes: JP Morgan, Morgan Stanley, Natwest, Pantheon, Schroders, Société Générale, UBS, Economic perspectives, and EIU. And November forecast sample includes: BAML, Barclays, Bloomberg, Capital Economics, Citi, Commerzbank, Goldman Sachs, HSBC, Beacon, Experian, Heteronomics, ITEM club, NIESR, Oxford Economics, and European Commission. Not all forecasts in the November sample would have been made after the news that the Pfizer vaccine had high efficacy in preliminary phase three results.
SOURCE: RF analysis of HM Treasury, Forecasts for the UK economy: a comparison of independent forecasts.

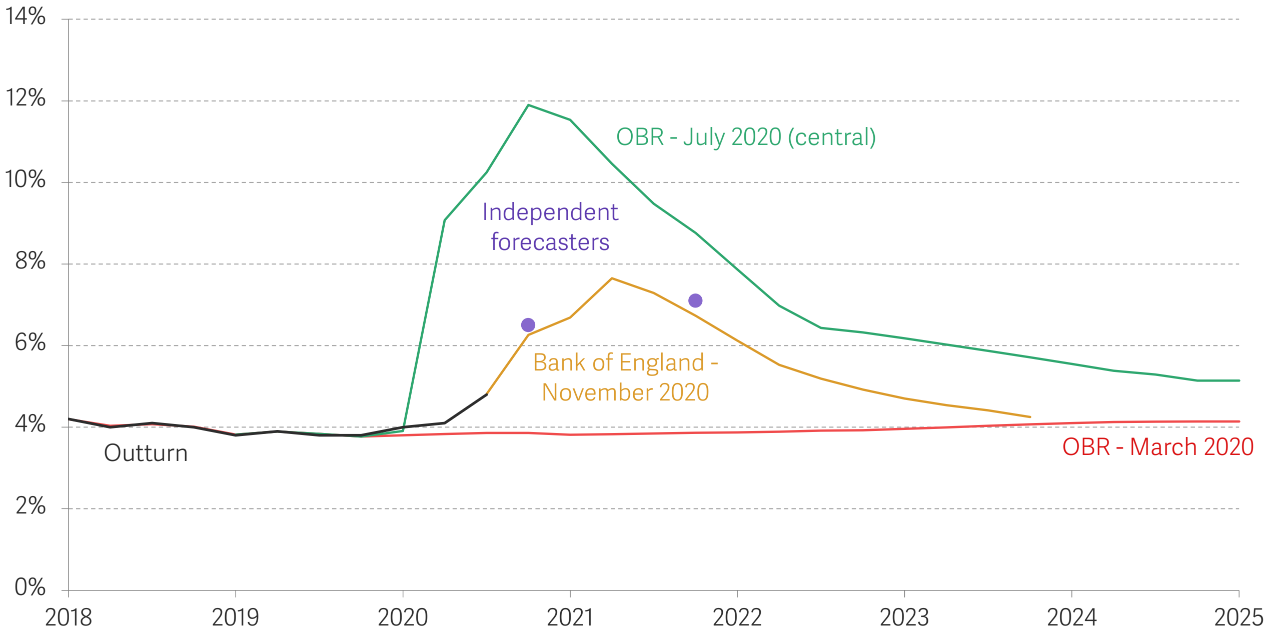
The forecast for unemployment will show a big rise, but its peak will be lower and later than in previous forecasts

The OBR forecast in July expected a sizeable rise in unemployment in 2020, persisting into 2021, before falling relatively quickly. Since that forecast, unemployment has risen only slightly, as shown in Figure 4: unemployment in 2020 Q3 was 4.8 per cent, less than half that expected in the OBR's central scenario. This is because unemployment has been held down more successfully by the furlough scheme than had been expected, particularly in the period when the generosity of the scheme has been tapered down.

At the end of October, it was announced that the option for employers to put employees on full furlough in the JRS would be extended, and it is now set to close at the end of March 2021. This will substantially limit the immediate rise in unemployment, as many workers who would otherwise have been made unemployed can now be furloughed, or remain on furlough. The OBR forecast will therefore need to reflect that policy has pushed back the unemployment peak. But, importantly, the delay in announcing an extension of the furlough scheme means that substantial numbers of workers will have been made unemployed.

FIGURE 4: **The OBR had expected unemployment to be significantly higher than current official measures**

Selected unemployment forecasts: UK



SOURCE: ONS; OBR; Bank of England; HM Treasury.

Figure 5 shows that the rate of redundancies picked up dramatically in the three months to September, to a little below the financial crisis peak. This means that unemployment will likely rise materially in October, before the new furlough scheme limits additional outflows from employment. More generally, the continued low flows out of unemployment into work will also add to the unemployment total.[6]

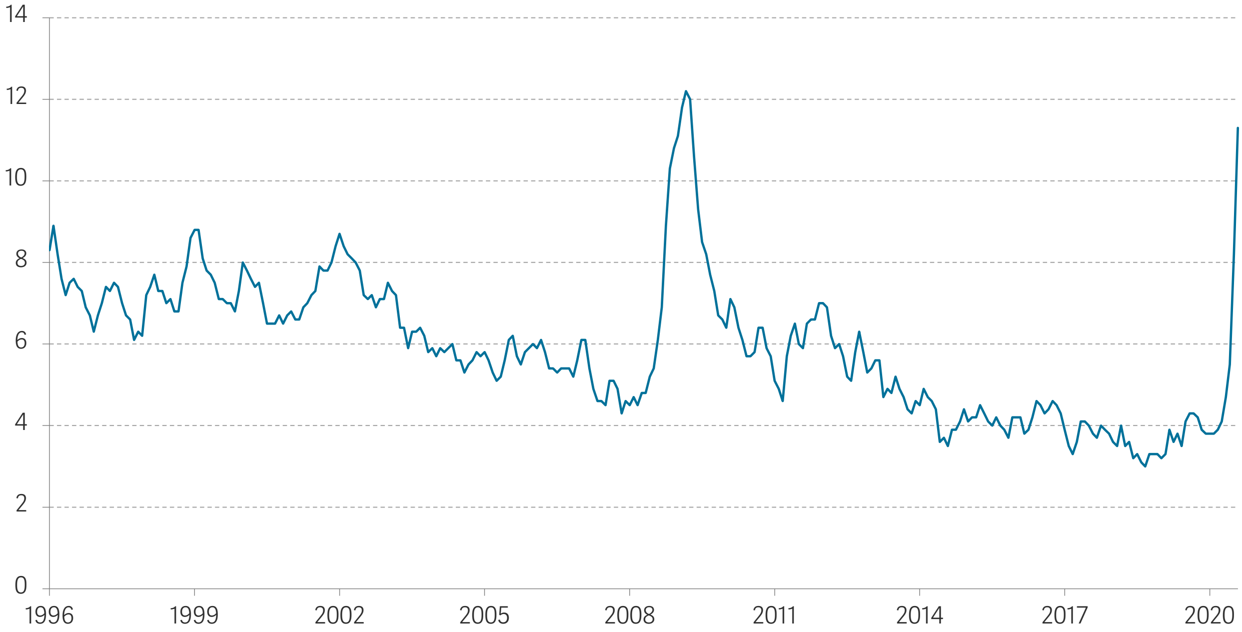
More broadly, the fact that the rise in redundancies only started after the original furlough scheme had started being phased out is evidence that the furlough scheme is delaying rises in unemployment, some of which will unfortunately be unavoidable in the long-term even if the economy has improved before it is withdrawn.[7] The OBR's forecast for unemployment will therefore still show a peak but it is likely to be later and lower than it was in July.

6 For a more in-depth discussion of the state of the labour market see: M Brewer, N Cominetti, K Henehan, C McCurdy, R Sehmi & H Slaughter, Jobs, jobs, jobs: Evaluating the effects of the current economic crisis on the UK labour market, Resolution Foundation, October 2020

7 For example, some of the redundancies that would have been made over this period, even if the coronavirus had not appeared, will have been prevented while the scheme is in place. Conversely. the scheme will prevent redundancies that won't need to be made once the health crisis is over.

FIGURE 5: **Phase out of the first furlough scheme was leading to rising redundancies**

Redundancies per 1000 employees



SOURCE: ONS, Labour Force Survey.

Importantly for the context of the Spending Review, the likely change in the OBR macroeconomic forecasts will have a material effect on the fiscal outlook. In particular, the materially-lower unemployment will reduce welfare spending requirements and raise tax revenue forecasts. This reduces the expectations for borrowing this year (and we discuss the fiscal impact of changes in the economic outlook in more detail later).

The amount of medium-term scarring on the economy is more important for fiscal sustainability than the immediate cost of dealing with the pandemic

Although the massive fall in GDP this year has pushed up government borrowing (as we show later), the more important factor for long-term fiscal sustainability is the medium-term hit to economic activity.[8] The OBR's central scenario in July had assumed that the structural hit to the economy would be 3 per cent by 2024-25. Because such a hit to the economy tends to reduce tax receipts and increase spending (for example, on higher benefit payments), it maps more-or-less one-for-one into borrowing. In the July central scenario, then, borrowing was nearly £60 billion higher than expected pre-pandemic in 2024-25, almost 3 per cent of GDP.[9] There is little reason for the OBR to update their

8 G Bangham, A Corlett, J Leslie, C Pacitti & J Smith, Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020

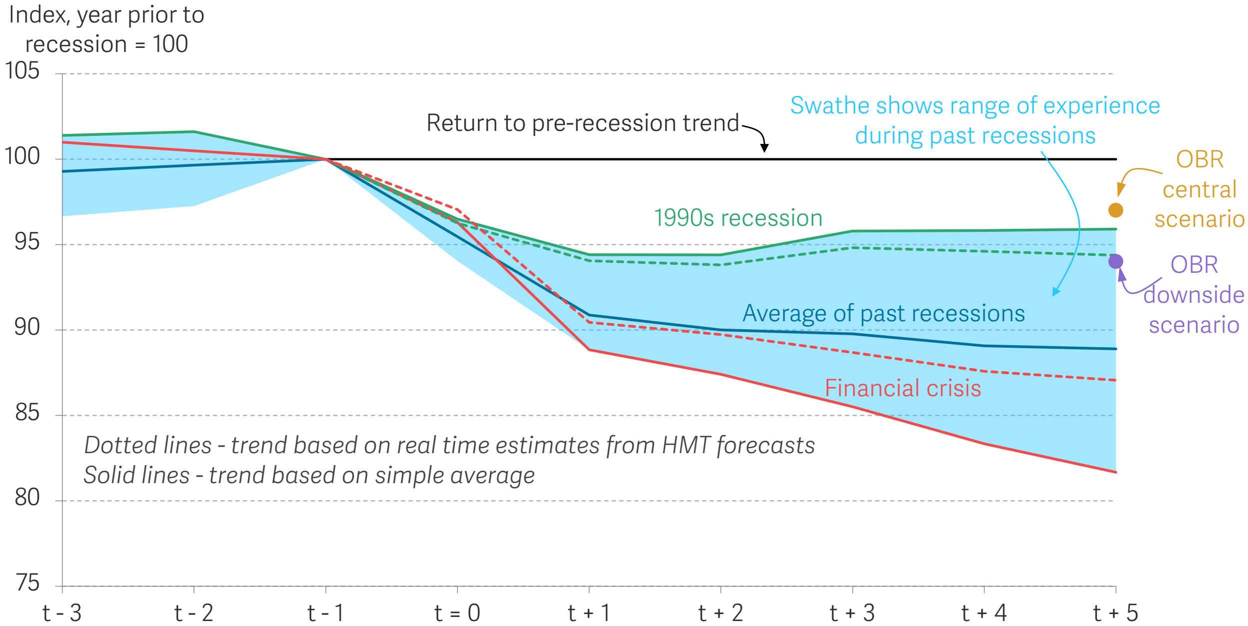
9 The economic forecast we use in the following fiscal section is based on the Bank of England's most recent forecast – adjusted for differences in the level of economic scarring. Our results point to an estimated increase in borrowing in 2024-25 of £50 billion, the difference is driven by the improvement in the expected labour market forecasts.

estimate of the amount of economic scarring in their new forecasts: the renewed tightening of restrictions on economic activity this autumn and winter may have acted to worsen their estimate of the hit, but the positive vaccine news, indicating a return to normality during 2021, will have acted in the opposite direction.

In this context, it is striking that history suggests that scarring after previous downturns has been larger - sometimes by a significant amount – than the 3 per cent assumed in the central scenario. As shown in Figure 6, during post-war recessions, GDP has fallen persistently relative to the path that the economy was on prior to the recession. On average, GDP was around 11 per cent below its pre-recession 'trend' after five years.[10] But there are good reasons that scarring this time may be lower than historical examples: first, with good prospects for an effective vaccine, the economic recovery could be swift; and second, the pre-crisis growth had already been slow, so disappointing growth over the next five years would represent, in relative terms, less of a loss in GDP than had trend growth rates matched those in the lead up to previous recessions.

FIGURE 6: **The OBR's assumed economic scarring looks optimistic based on past recessions**

The level of real GDP relative to pre-recession trend following during past recessions (year prior to recession = 100)



NOTES: t = 0 is the year of the recession (first year that GDP growth is negative); swathe includes 1970s, 1980s, 1990s and financial crisis recessions. In the solid line (and in the swathe), the trend is estimated to be the average growth rate over five years, measured five years before the start of the recession. The dotted lines show deviation from pre-recession, real-time HM Treasury forecasts included in the OBR's historical forecast database.
SOURCES: RF analysis of ONS; OBR, Historical Forecast Database.

10 Both simple averages and real-time estimates of trend provide similar results here.

In order to achieve this relatively benign level of scarring, policy makers will need to focus on ensuring a strong post-crisis recovery. Scarring can materialise from the labour market (through falling participation, skills mismatches, etc), from a loss of capital from business insolvencies and loss of job-specific skills, from weak business investment, or from slowing technological growth. Analysis of the experience of previous recessions has shown that falling capital stocks and productivity seem to be the biggest drivers of scarring, with a more than 10 per cent average post-recession fall in the capital stock in the UK. Falling business investment is a major driver of this; annual business investment has fallen by more than a quarter during this crisis (and had already barely grown since the 2016 EU referendum), so improving this will need to be a major goal for the Government if they want to minimise long-term economic scarring.

A weak economy combined with significant policy support has resulted in record government borrowing

The most eye-catching number in the Spending Review will be a new estimate of just how much borrowing is set to take place this year. It is likely that the OBR's revised estimates of the impact of coronavirus on the economy will lead to a lower impact on borrowing in this year than was originally set out in the OBR's central scenario published in July. This is largely as a result of more optimistic labour market outturn data than forecast back in July (as set out in Figure 4).[11] This is also in line with the most recent public finance published by the Office for National Statistics, which suggest that borrowing has so far been around £36.6 billion lower than forecast (excluding the impact of loan scheme write-offs that elevate forecasted figures), from a combination of lower-than-expected central government spending, and stronger income tax, NICs and VAT revenues.[12] But the overall picture for public finances is still one of record peacetime levels of borrowing.

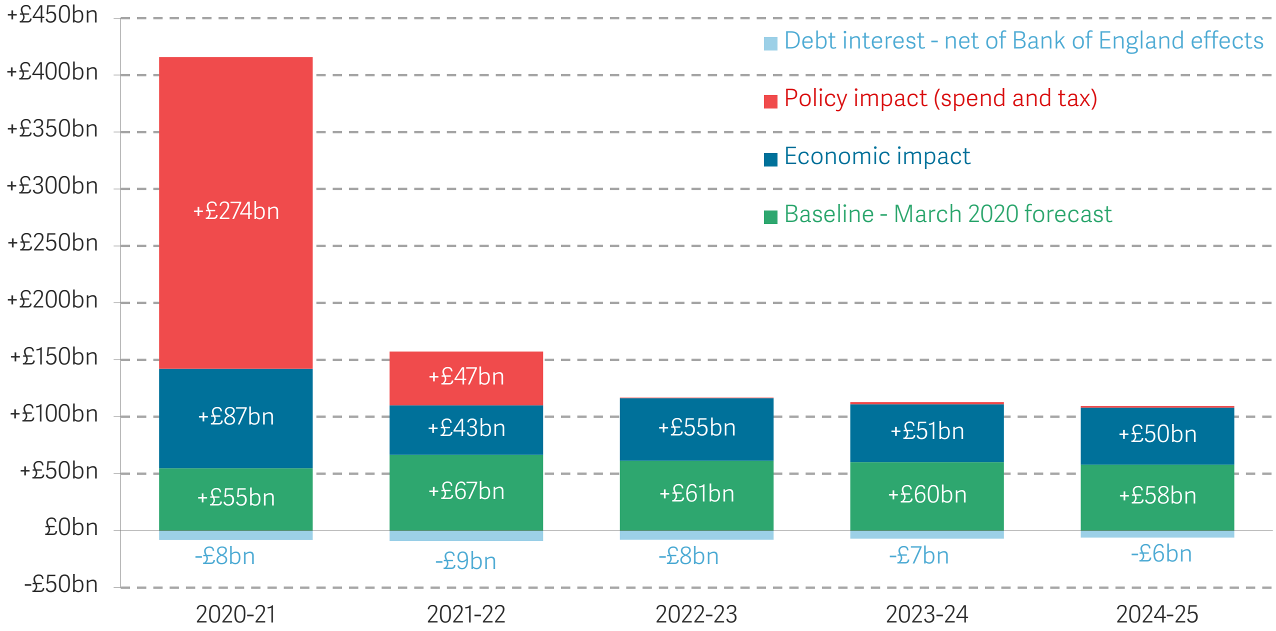
As shown in Figure 7, the impact of a smaller economy looks set to add around £87 billion to public sector borrowing this year, due to falling tax revenues and rising welfare spending, with a £50 billion persisting into 2024-25, due to the persistent impact of economic scarring on the size of the economy.

11 We calculate the economic impact on borrowing by utilising the OBR's published ready reckoners which translate changes in the economy to changes in tax revenue and spending. These estimates are conditional on an economic scenario largely based on the Bank of England's most recent forecasts in the November Monetary Policy Report. We make two adjustments to the Bank of England's forecasts: first, we expand the Bank of England forecasts to capture more variables using the typical historic relationship between economic variables; and secondly, from 2022-23, we smoothly downgrade the Bank of England forecasts for output to match the expected 3 per cent scarring to GDP (as outlined above). The fiscal hit in 2024-25 is lower than the £60 billion the OBR had expected in the July central scenario due to the expected improvement in the labour market forecasts.

12 Office for Budget Responsibility, Commentary on the Public Sector Finances: September 2020, 21 October 2020.

FIGURE 7: **Borrowing could be as high as £400 billion in 2020-21**

Public sector net borrowing: March 2020 forecast and projected economic and policy impacts of coronavirus on borrowing, £ billion



SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury, Winter Economy Plan, September 2020.

However, in the near term, both these figures are dwarfed by an estimated £274 billion worth of policy support in 2020-21 (this includes estimates of additional policy support announced since the OBR Fiscal Sustainability Report, such as the extension of support in recent months relating to the second wave of lockdown restrictions).[13] Much of this support 'drops out' of the forecast from next year onwards, with recent positive news on vaccine efficacy suggesting that lockdown restrictions and the associated policy support for individuals and businesses are unlikely to be necessary in the medium term. However, given the likelihood that the Government will still be dealing with the impact of the pandemic during at least the first portion of the next fiscal year, it is assumed that around a third of RDEL spending increases in 2020-21 are continued into 2021-22, adding around £48 billion to borrowing. In terms of health spending, these on-going costs could include the as-yet-uncertain costs of vaccine roll-out, as well as the costs of dealing with a back-log of NHS treatments de-prioritised during 2020-21. It is likely that the Government will

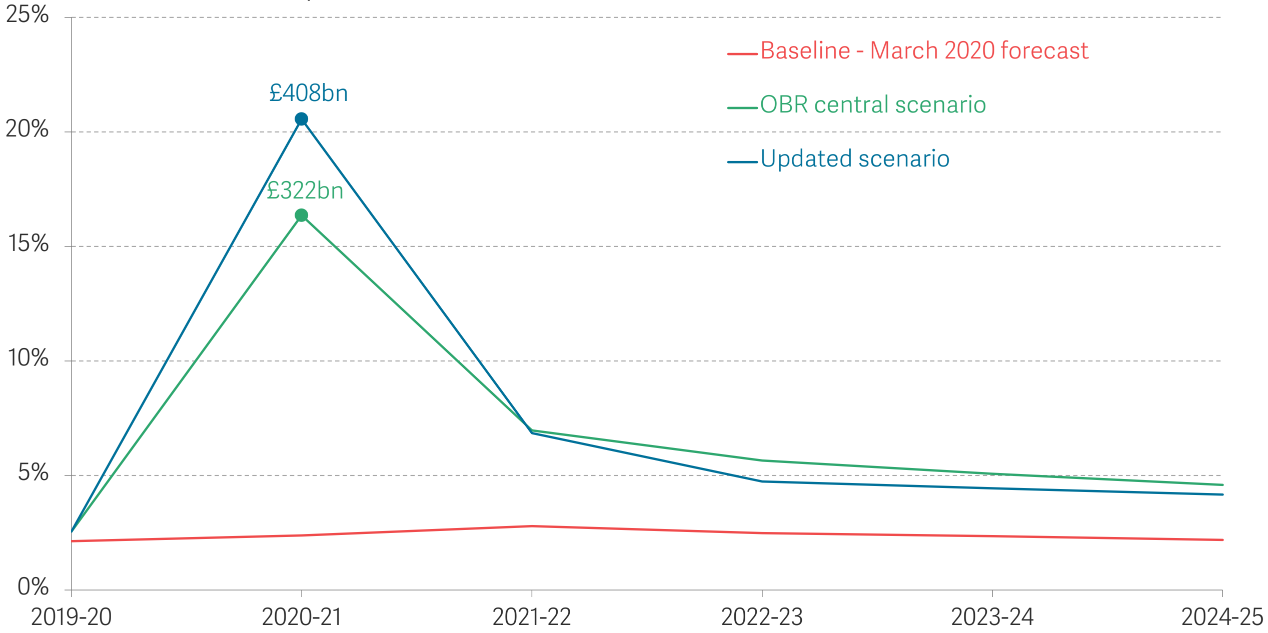
13 This includes OBR Summer Economic Update costings, HM Treasury Winter Economy Plan costings, and several policy costing assumptions relating to second wave policy. The JRS costing is constructed on the basis of HMRC's published statistics of spending on the scheme to-date, which imply that spending will be lower than forecast by the OBR in July, and assumes that JRS take-up is in line with October levels for the rest of the scheme. Costings of other second wave policy support are taken from Gov.uk, National Restrictions: Financial Support For Jobs And Businesses, 5 November 2020. SEISS replacement rates are assumed to half in the final round of the scheme (Feb – April). It is also assumed that RDEL spending on health and other public services, in addition to that announced alongside the Winter Economy Plan, has been and will be required over the rest of 2020-21. This is calculated by taking the spending announced at the Winter Economy Plan on a pro-rata basis for the second half of the year – totalling to around £38 billion in extra RDEL. Investment spending announced on 18 November is included in the scenario consistent with the OBR's 20 per cent underspend assumption, with an estimated profile evenly split over the five years of the forecast (other than the £1 billion spending on homes and public buildings included only in 2021-22).

announce these extra in-year departmental spending allocations at the Spending Review, in a similar fashion to the as has been announced in economic updates throughout this year.

Taken together, this results in an updated estimate of over £400 billion of public sector borrowing in 2020-21, around 21 per cent of GDP, and levels of borrowing unseen in Britain since the Second World War. As Figure 8 illustrates, this is significantly higher than forecasted by the OBR in its central scenario back in July. This is largely the result of the additional policy costs caused by the resurgence of the virus this autumn, such as the extension to the JRS and Self-Employment Income Support Scheme, and additional health spending for the rest of the year. Working to reduce borrowing compared to the July forecast is the more positive near-term economic outlook set out above, as well as the impact of additional quantitative easing announced since the OBR's last forecast, which has the effect of reducing debt interest payments even further. Could mention something about how much the DMO has raised?

FIGURE 8: **Borrowing is likely to peak at around 21 per cent of GDP in this financial year**

Public sector net borrowing, as a proportion of GDP: March 2020 forecast, OBR central scenario and RF updated scenario

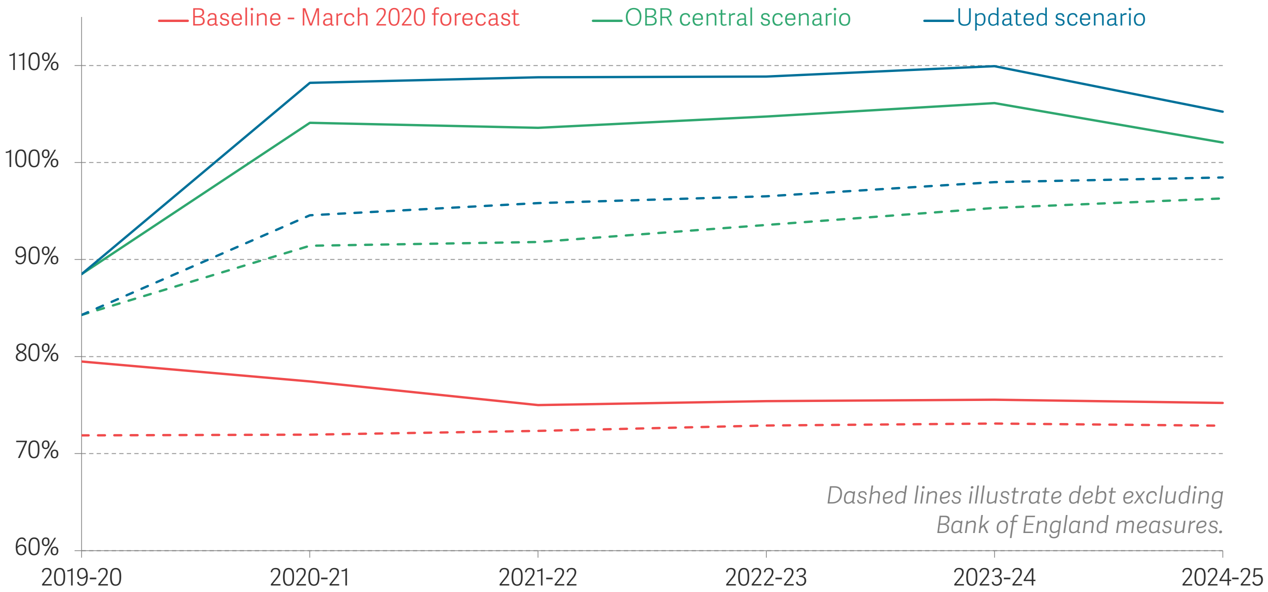


SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury, Winter Economy Plan, September 2020.

With borrowing likely to rise above £400 billion, and to stay elevated by around £50 billion by the end of the OBR forecast period, public sector debt looks set to rise to 110 per cent of GDP by 2023-24 (Figure 9), and is likely to remain on a rising trajectory by the end of the forecast (ignoring the fall in debt in the final year of the forecast that results from the Bank of England's Term Funding Scheme (TFSME) unwinding over 2023-24 to 2024-25). The announcement of a further £150 billion of quantitative easing in November is here assumed to add an additional £23 billion to public sector net debt largely as a result of valuation effects,[14] narrowing the gap between the OBR central scenario and the updated scenario when Bank of England measures are excluded (see dashed lines in Figure 9 below).

FIGURE 9: **The debt-to-GDP ratio could peak at around 110 per cent of GDP**

Public sector net debt, as a proportion of GDP: March 2020 forecast, OBR central scenario and RF updated scenario: including and excluding Bank of England measures



SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury, Winter Economy Plan, September 2020.

Spending is set to rise by a very large amount in 2020-21

A year ago, the then-Chancellor Sajid Javid set out the Government's spending plans for 2020-21. Seeking to turn the page on austerity in a pre-election Spending Round, he announced a 4.1 per cent real terms increase in day-to-day departmental spending, and a 6.4 per cent real terms increase in capital spending for 2020-21.[15] These planned increases in spending this year were the largest announced at a spending review since the early 2000s, but the pandemic has led to a rise in spending many orders of magnitude higher than these plans.

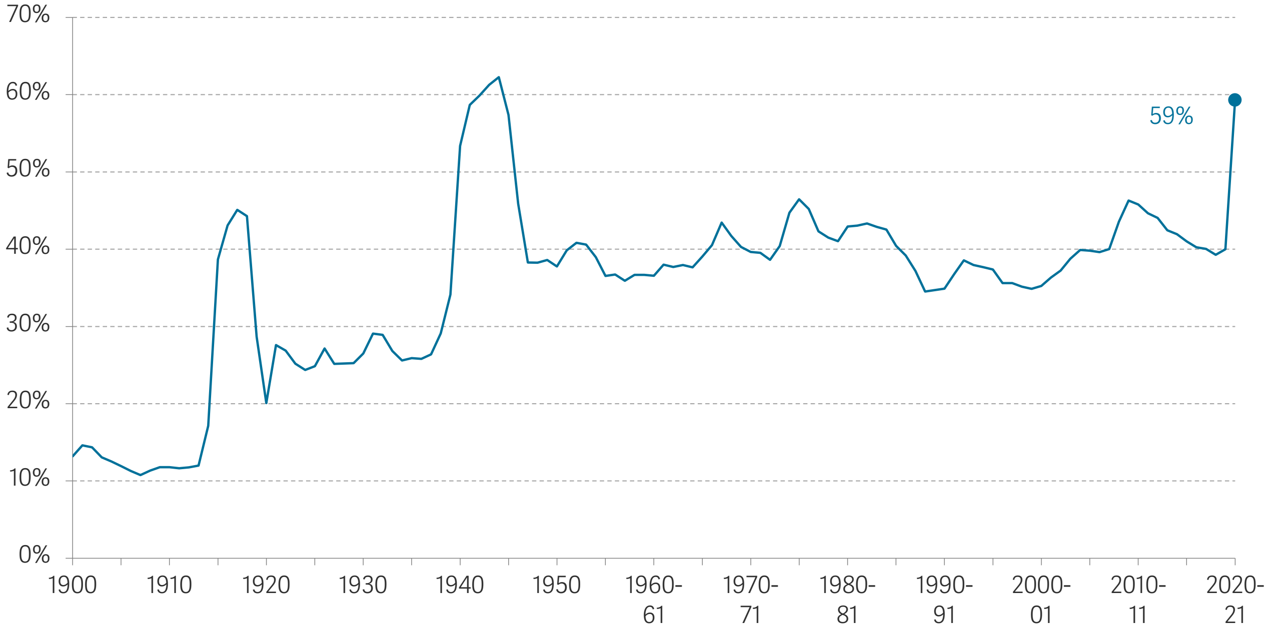
14 As set out in OBR, The direct fiscal consequences of unconventional monetary policies, March 2019, this valuation effect is the difference between the nominal value of gilts in PSND, and the (higher) market value gilts are purchased at by the Bank of England – with the £23 billion here netting off the reduction in debt interest also as a result of additional quantitative easing.

15 T Bell et al., Rounding up: Putting the 2019 Spending Round into context, Resolution Foundation, September 2020.

We estimate that in the region of £250 billion of additional Covid-related spending will take place in 2020-21. This, and the much smaller economy, combine to mean that the size of the state relative to GDP is set to sky-rocket this year, from 40 per cent of GDP to around 60 per cent of GDP (Figure 10). This unprecedented crisis will have caused the UK state to balloon to a size only ever previously observed in the UK during the Second World War.

FIGURE 10: **The size of the state has reached a peacetime record this year**

Total Managed Expenditure as a percentage of GDP



NOTES: GDP level in 2020-21 as per RF forecasts.
SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury announcements; Bank of England, A millennium of macroeconomic data.

The two main component parts of government spending that have driven this sharp increase in outlays are Annually Managed Expenditure (AME) and Resource Departmental Expenditure Limits (RDELs). AME includes spending on welfare and debt interest, and other items less suited to multi-year planning, and RDELs include the planned departmental spending on day-to-day services.

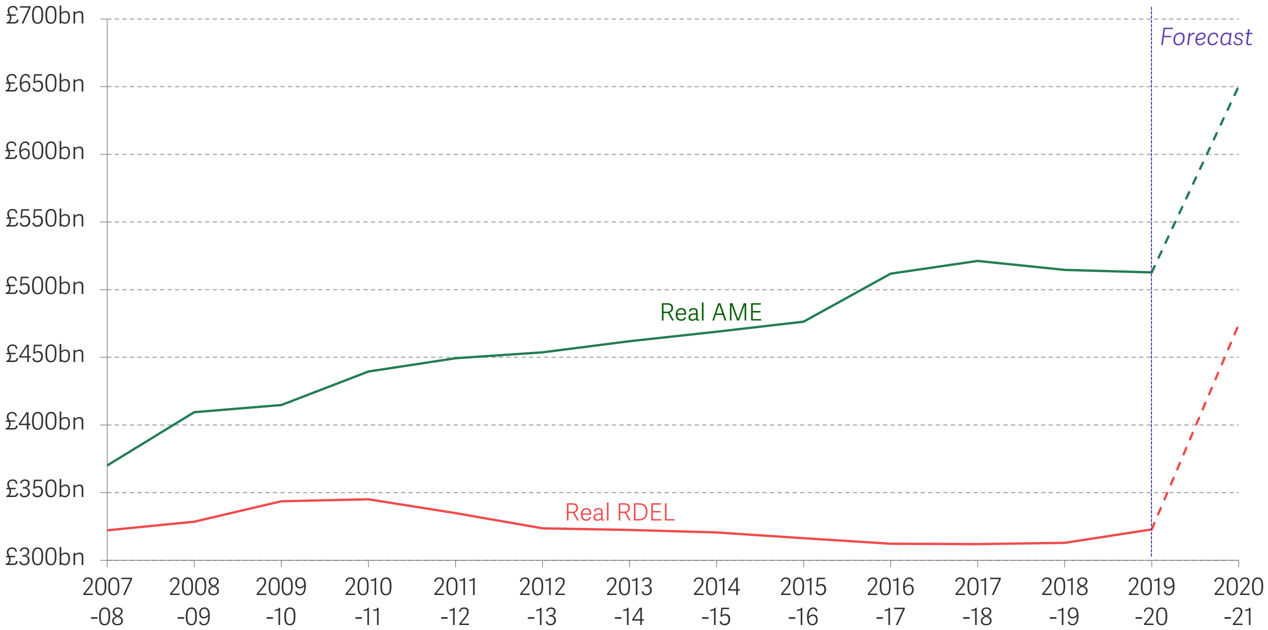
If we assume that the spending increases confirmed in the March Budget have gone ahead as planned, and then add to these the extra costs associated with Covid (both policy announcements and the impact of a higher benefits caseload from a weaker labour market), then our estimates point to a cash increase in AME of around £140 billion between 2019-20 and 2020-21, and a cash increase in RDELs in the region of £160 billion.

The largest AME components of these increases are the estimated £56 billion spent on the Job Retention Scheme (JRS) and £23 billion on the Self-Employed Income Support Scheme. The largest RDEL components are £47 billion of extra spending on the health response to the pandemic and £14 billion spent on the business grants scheme. As explained above, we have also assumed that further in-year spending allocations will be announced by the Chancellor in the Spending Review, and that these could total as much as £40 billion. On the other side of the ledger, debt interest payments (accounted for in AME spending) are estimated to be lower than forecast to the tune of £21 billion this year as a result of the fall in interest rates and the impact of Quantitative Easing, and the announced £2.9 billion reduction in Overseas Development Assistance Spending has also been accounted for.[16]

In total, and in real terms (using the OBR's GDP deflator as published alongside the July 2020 Fiscal Sustainability Report), this equates to an almost £300 billion increase in spending (combining the previously-planned non-Covid increases and the extra spending in response to the pandemic) in these two areas between 2019-20 and 2020-21. As Figure 11 shows, this is an unprecedented rise.

FIGURE 11: **Combined, day-to-day departmental spending and annually managed spending are set to be almost £300 billion higher this year than last**

Real (GDP-deflator adjusted) Annually Managed Expenditure (AME) and Resource Departmental Expenditure Limits (RDEL)



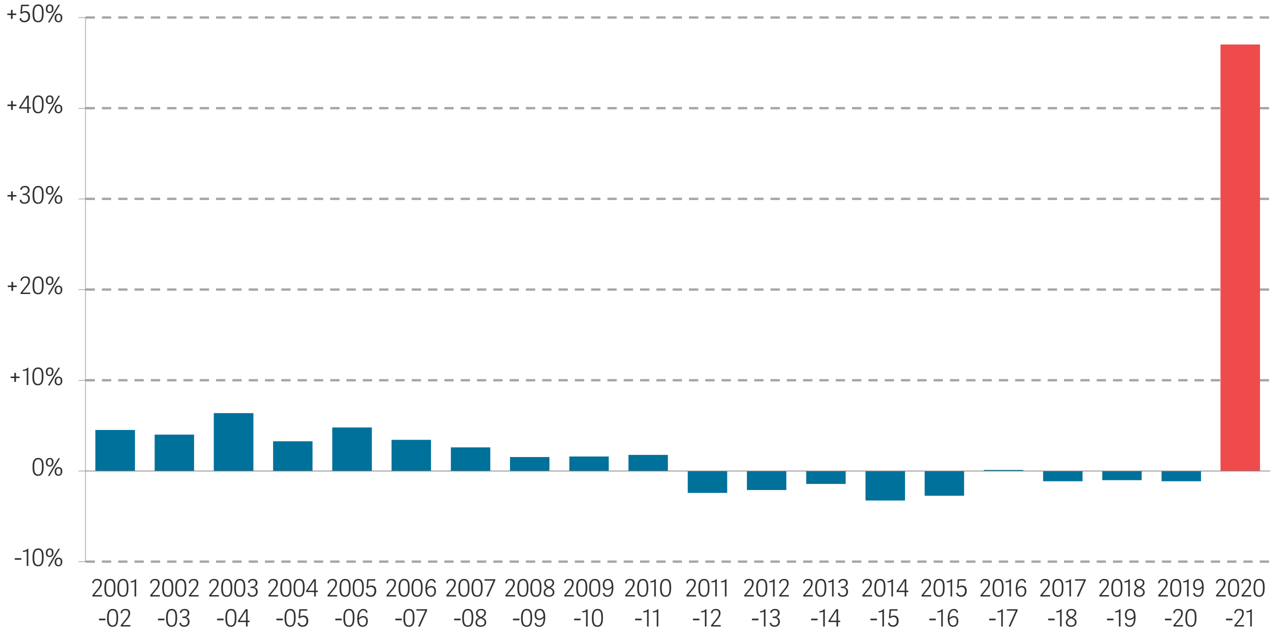
NOTES: GDP-deflator is as published in OBR, Fiscal Sustainability Report, July 2020.
SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury announcements.

16 Gov.uk, Official Development Assistance (ODA) spending for 2020: First Secretary of State's letter, 22 July 2020.

Focusing in on RDEL spending, we estimate that rather than a 4.1 per cent real terms increase as was planned, the actual increase in RDELs could be in the region of 50 per cent this year, way beyond anything experienced outside wartime. In the context of planned changes announced at Spending Rounds and Spending Reviews since 2001-02 (as shown in Figure 12) this is an astronomical rise.

FIGURE 12: **RDEL spending is set to surge in 2020-21**

Change in RDEL as announced at Spending Rounds/Reviews, and expected change in RDEL in 2020-21



SOURCE: HM Treasury, Spending Round and Spending Review documents.

Looking to the future, the Chancellor has to answer three big questions in relation to public spending – and he is avoiding answering two of them

There are three big questions about the future of spending and the public finances that the Chancellor needs to answer in the coming months, two of which he is avoiding answering at the Spending Review.

The first of these is, quite simply, what is the UK's fiscal framework? Before too long the Chancellor will need to set out a framework which emphasises the current need for economic support while at the same time committing to long-term fiscal sustainability.[17] Such a framework would clearly have to take account of the high levels of uncertainty

17 G Bangham, A Corlett, J Leslie, C Pacitti & J Smith, Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020

about the long-term impact of this crisis on taxes and spending. But designing a flexible framework is preferable to the current situation in which fiscal decisions are being made in the absence of any constraints or any idea of the broader objectives for government borrowing or debt. This does not bode at all well either for effective spending control or ensuring value for money, vital components of good management of the public finances. Resolution Foundation analysis from 2019 provides the basis for a set of fiscal rules which could ensure long-term fiscal sustainability while facilitating the key economic reforms the Government intends to pursue, such as the levelling-up agenda.[18]

Related to the lack of framework is the second big question that will remain broadly unanswered by the Chancellor this Autumn: what will be the path of public spending and taxation out to the middle of the decade? The answer to this question matters immensely for the country, to households' own finances (to the extent that levels of tax may change) and to the support and services that the state provides. Currently, the Chancellor is studiously avoiding tackling this issue, but the tension between a reluctance to increase taxes, the commitments made on spending increases and the desire to keep a lid on the rise in public debt cannot be avoided forever.

This tension is highlighted by the fact that the Government is developing an ever-expanding list of spending priorities, with defence now added to health, education and police. By contrast, unprotected departments' budgets have fallen considerably in real-terms per capita since 2010. Increasing spending in these protected or priority areas and reversing the effects of austerity in others would lead to very large RDEL increases in the years ahead, which may ultimately be fiscally unsustainable. For now, the Government is pursuing a strategy of announcing extra spending, e.g. on carbon reduction or defence, but without conceding that it faces difficult choices and hard trade-offs over how much can be spent with a given level of tax and in the bounds of a new fiscal framework.

As Figure 13 shows, even the generous (in pre-Covid times) plans for RDEL pencilled in at the March budget left unprotected day-to-day departmental budgets set to reach the middle of the 2020s at a level, on average, 18 per cent lower than they were in 2010 (in real-terms per capita).

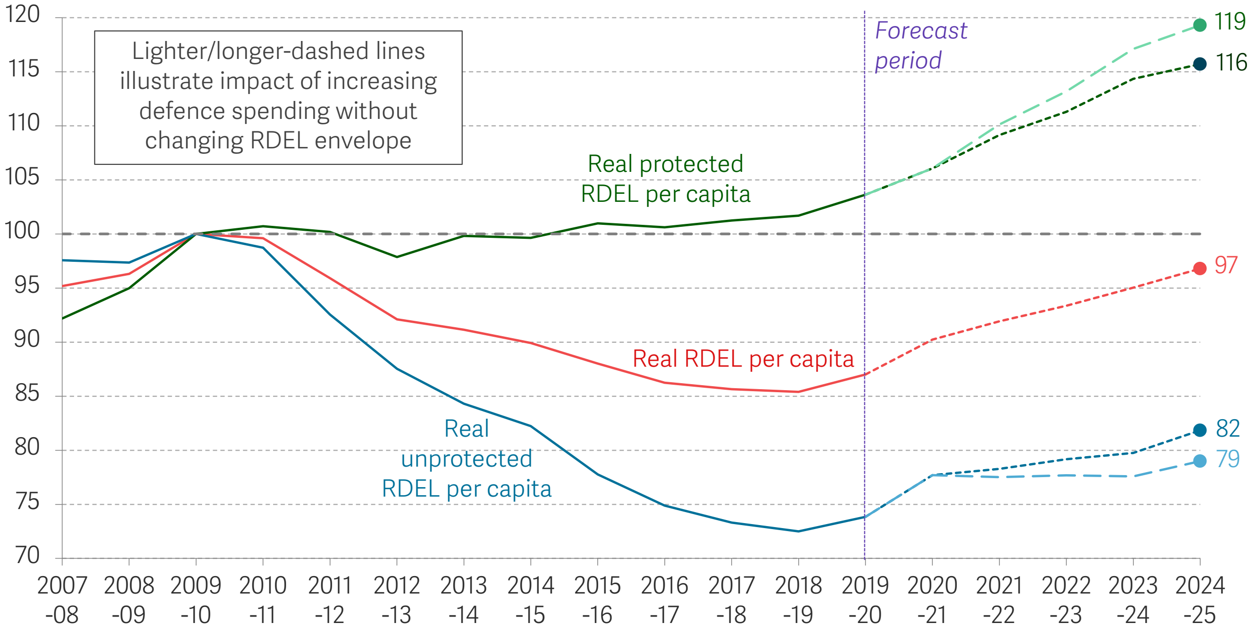
To take the recent announcement of extra defence spending as an example, the Prime Minister has pledged an additional cumulative spending increase over four years of £16.5 billion beyond the plans set out in the 2019 Conservative manifesto.[19] If this is achieved without increasing the RDEL spending envelope, and without reducing spending in protected areas (where there are pre-existing commitments), it necessarily entails a reduction in spending in unprotected areas. A steady additional increase in defence

18 R Hughes, J Leslie, C Pacitti & J Smith, Totally (net) worth it: The next generation of UK fiscal rules, Resolution Foundation, October 2019.
19 Boris Johnson, PM statement to the House on the Integrated Review, 19 November 2020.

spending over four years totalling £16.5 billion implies that by 2024-25 the annual defence budget would be £6.6 billion higher in nominal terms, and unprotected budgets lower by the same amount. Translating this to real per-capita spending implies almost no growth in unprotected budgets over the four years to 2024-25, with spending remaining greater than 20 per cent below its 2009-10 level. It's this sort of trade-off that is currently being skirted over by the Government, which is taking the more pleasant option of announcing good spending news and leaving the decisions on taxation, borrowing and spending prioritisation for another time.

FIGURE 13: **Different parts of Whitehall have fared very differently over the past decade**

Indices of real-terms (GDP-deflator adjusted) per-capita resource departmental expenditure limits (2009-10=100), all departments, 'unprotected' departments and 'protected' departments



NOTES: RDEL total adjusted for public service pension adjustment (see OBR, Economic and Fiscal Outlook, October 2018).
SOURCE: RF analysis of OBR, Economic and Fiscal Outlook, March 2020.

On capital spending, the Government is planning on setting out multi-year settlements for some key areas of investment, for example on High Speed 2, schools and hospitals. But here a similar critique applies: the Government is announcing the good spending news, without a discussion of how it fits into a broader plan for the public finances.

The Chancellor will answer the important question of just how much Covid spending he expects to roll on into 2021-22

The third big question arising from the radical change in the economic and fiscal landscape is how much of this year's exceptional Covid-related spending will continue into next year. But, far from avoiding this question, providing the answer to it is now the core purpose of this fiscal event.

The recent good news in relation to vaccines means that it is reasonable to assume that Covid-related spending will fall next year, as both the economic and health response winds down. But there will be new Covid-related spending pressures, not least those arising from the roll out of a new vaccine, and the need for additional spending in a variety of parts of the public sector - ranging from additional staff in DWP who are providing vital assistance with job search to continued subsidies to public transport – will continue. If the level of Covid-related spending next year is one-third of the expected RDEL spending on the Covid-response in 2020-21, then as much as £50 billion extra could be required. This is a very large amount: twice as much as the (pre-Covid) day-to-day budgets of the Home Office and the Ministry of Justice combined.

The extreme uncertainty over how much Covid spending will be required next year calls for a different approach to its allocation

Given the large uncertainty over the quantity of Covid spending, it would be sensible for the Chancellor to fund this separately from the usual departmental allocation process. If Covid-spending allocations were instead wrapped in with departmental spending, then there is a significant risk of some departments being awash with cash (if their need for Covid-related spending undershoots expectations) while others struggle and have to ask for repeated top-ups (if their Covid needs overshoot expectations).

To avoid these budget management issues, and to provide clarity to departments and the public as to the quantity of spending on the Covid response – and that money will be made available if needed – it would be sensible to introduce a 'Covid reserve' from which departmental Covid-related spending could be drawn during 2021-22. This would mirror the process used to fund other highly uncertain budgets, as was the case when spending was allocated to fund the wars in Iraq and Afghanistan.

There would be some technical, but important decisions, to make about which elements of ongoing Covid spend to place into this reserve, and which to allocate to departments directly. Only the temporary additional spend should be treated in this novel way: structural or ongoing commitments – such as the ongoing higher spend on PPE to build up pandemic resilience - would be most sensibly allocated directly to departments.

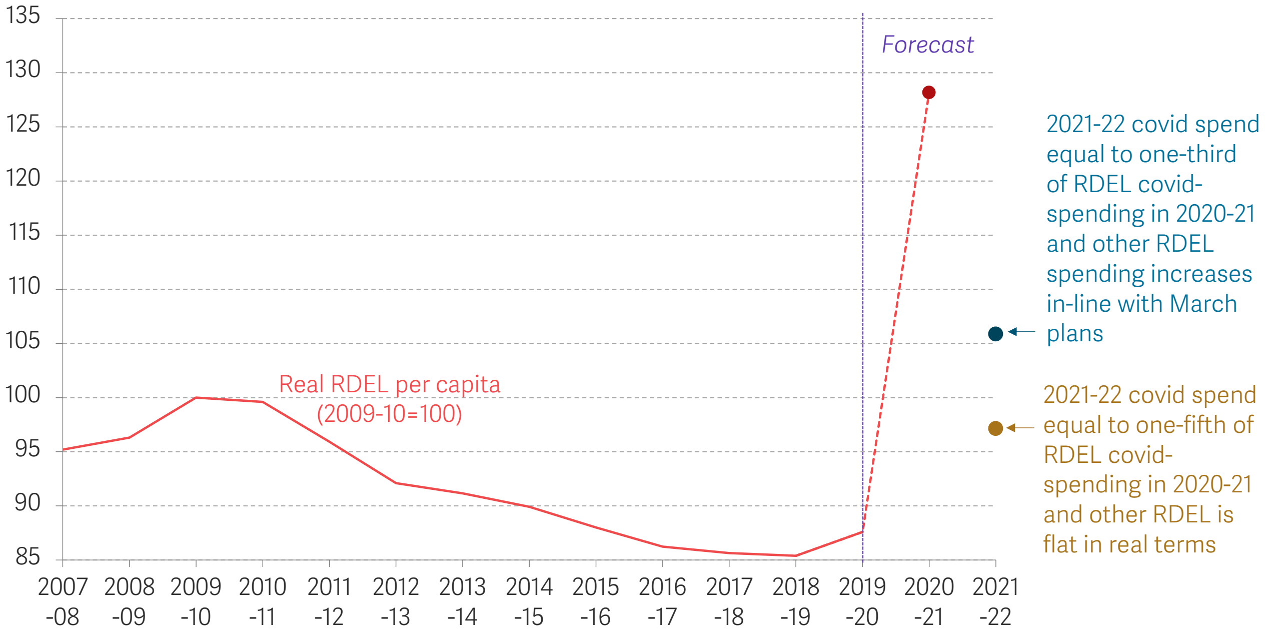
Given other commitments, day-to-day departmental spending in 2021-22 could easily be one-third higher than it was in 2019-20

The Chancellor had previously pencilled in a 4.4 per cent real terms increase in RDEL in 2021-22 – a rise that would normally be considered large - as part of the shift in political focus away from austerity towards "levelling up" and increasing spending on key public services like policing, schools and hospitals.[20]

These plans, however, have been blown out of the water by the pandemic. If Rishi Sunak decides to continue with increases to non-Covid RDELs in line with the growth rates set out in March, and the amount of Covid spending required next year is equal to one-third of the amount spent in 2020-21 (around £50 billion), then the cash increase in RDEL spending over the two years from 2019-20 to 2021-22 could be as much as £80 billion – equivalent to an increase in RDEL of 31 per cent over the two years. Covid has reshaped and expanded the state in 2020-21, and this is by no means set to end overnight. This illustrative scenario is shown by the blue dot in Figure 14 below.

FIGURE 14: **Day-to-day departmental spending will remain elevated in 2021-22**

Index of real (GDP-deflator adjusted) resource departmental expenditure limits (RDEL) per capita



NOTES: GDP-deflator is as published in OBR, Fiscal Sustainability Report, July 2020.
SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury announcements.

20 HM Treasury, Budget 2020, March 2020.

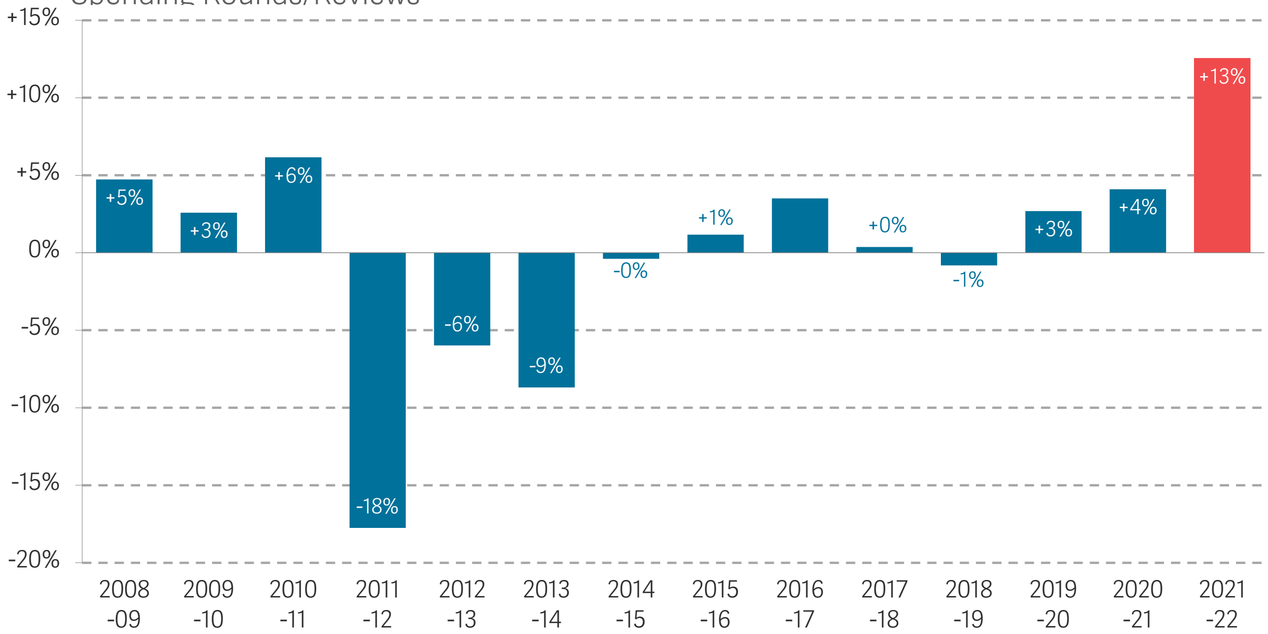
Even if a more optimistic scenario where just one-fifth of Covid-related additional spend were to carry forward to next year, and where the Chancellor exercises very tight spending restraint on the rest of day-to-day spending by keeping non-Covid RDEL flat in real terms (something we do not expect him to do), then RDEL would still increase by 20 per cent in nominal terms in just two years. There's no shying away from just how much the pandemic is changing both what and how much the Government spends.

Some capital spending plans will be set out beyond 2020-21

Turning to the other aspect of the Chancellor's spending envelope, capital spending, the centrepiece of the March 2020 Budget was a so-called 'infrastructure revolution', with an extra £100 billion of gross investment plans for the next five years. As a baseline for the capital spending in consideration at the upcoming Spending Review, these ambitious Budget spending plans included a 12.5 per cent increase in Capital Departmental Expenditure Limits (CDEL) forecast in 2021-22, illustrated in Figure 15. Although a significant increase in the overall capital 'envelope' was announced in the Budget, as discussed in previous work,[21] very little specific allocation of capital spend to projects or timescales was provided, with most capital spending recorded only as the 'capital envelope for the Comprehensive Spending Review 2020' in Budget costings.[22]

FIGURE 15: **The plans set out in March included a 13 per cent increase in CDEL in 2021-22**

Planned change in Capital Departmental Expenditure Limits (CDEL) as announced at Spending Rounds/Reviews



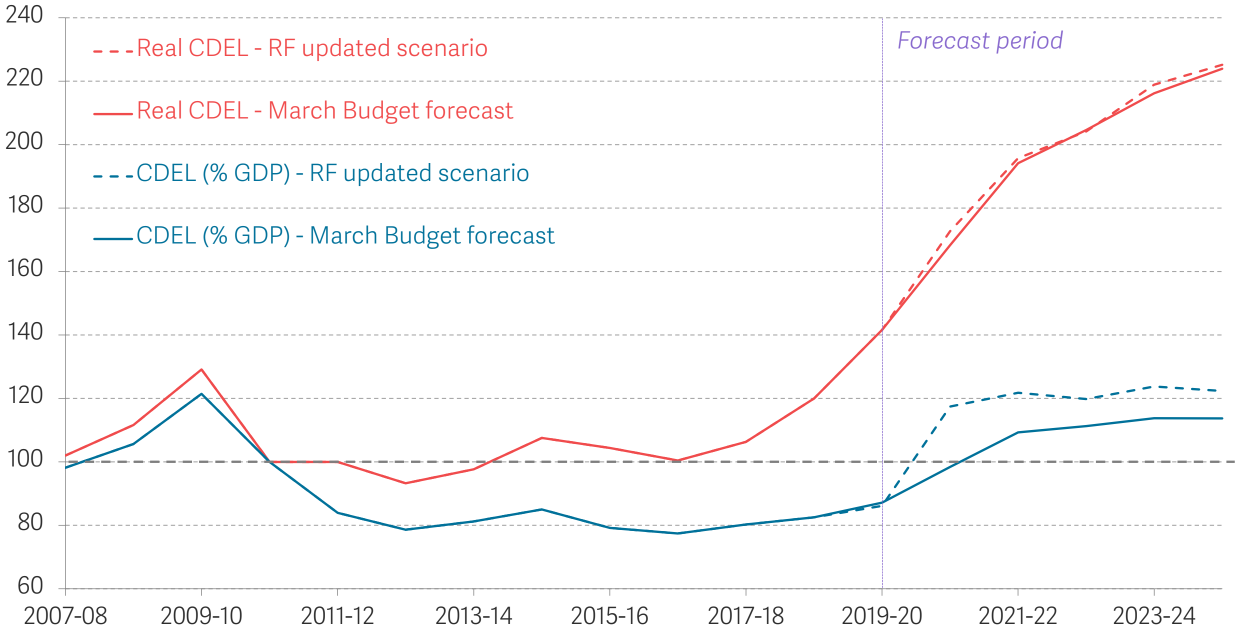
SOURCE: HM Treasury, Spending Round and Spending Review documents.

21 Resolution Foundation, Spring Budget 2020 response, March 2020.
22 HM Treasury, Budget 2020, March 2020.

In contrast to the dramatically-altered current spending forecasts as a result of the pandemic response, increases in CDEL related to the pandemic have been far smaller, albeit coming on top of a baseline that was already set to rise to historic levels. Revised estimates of policy costs since the OBR provided updates alongside its Fiscal Sustainability Report in July suggest CDEL could be elevated by around £2 billion in 2020-21. This additional capital spending includes: the Summer Economic Update investment package; small amounts of capital spending in, for example, health; and recently announced spending on green infrastructure. But this also takes into account the £5 billon of capital underspending in 2020-21 that the OBR assumed would take place due to the de-prioritisation of some projects during the pandemic. As shown in Figure 16, this means that the path of CDEL spending in real terms thus far looks relatively unchanged from pre-pandemic plans. However, it is worth noting that, given the path of GDP is likely to be far lower as a result of the economic impact of coronavirus, CDEL spending as a proportion of GDP is far more elevated over the forecast.

FIGURE 16: **CDEL is only slightly elevated above March Budget plans**

Indices of real (GDP-deflator adjusted) per-capita capital departmental expenditure limits (2009-10=100), March Budget forecast and revised RF scenario

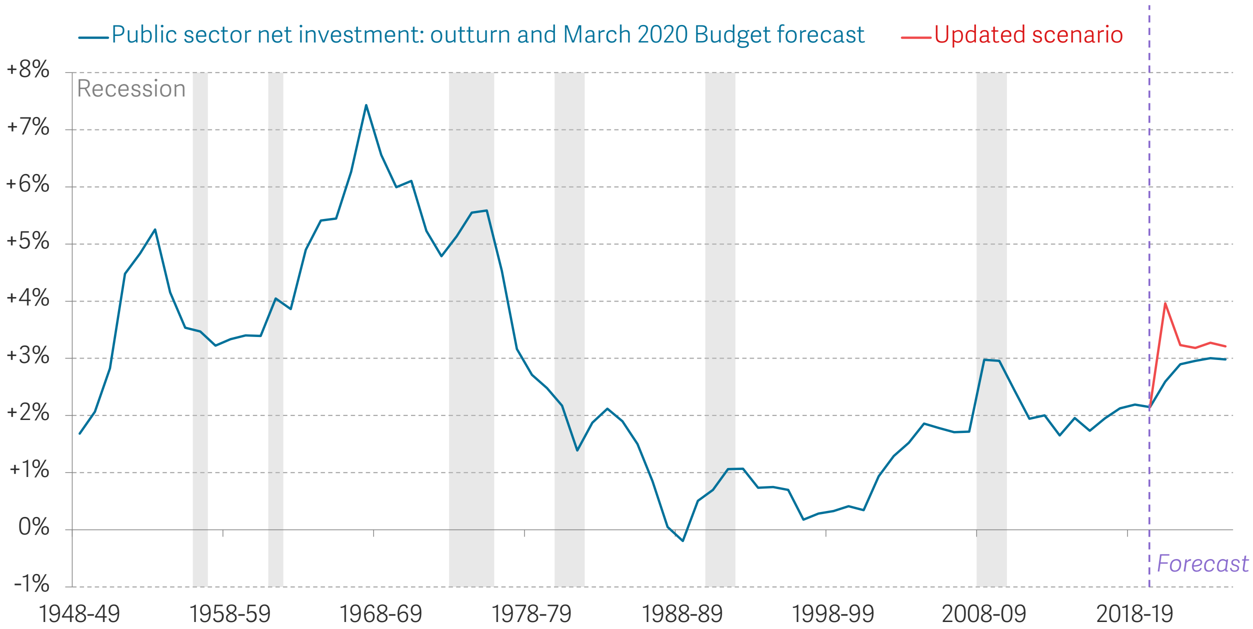


SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury announcements.

Turning to a more complete measure of Government capital spending, total public sector net investment (CDEL and Capital AME, net of depreciation), is set to peak at around 4 per cent of GDP in 2020-21, and at a significantly higher level than CDEL spending. This is as a result of around £17 billion worth of projected write-offs of government-guaranteed loans, primarily through the Bounce Back Loans Scheme, which are recorded as capital transfers in Capital AME. As shown in Figure 17, this peak in public sector net investment in 2020-21, combined with the effect of a lower path of NGDP, means that were the Chancellor to stick to the investment plans set out in the March 2020 Budget, he would break the fiscal rule set out in the Conservative Manifesto 2019, which limited investment spending to a maximum of 3 per cent of GDP.[23]

FIGURE 17: **Net investment spending tends to fall following recessions**

Public sector net investment, as a proportion of GDP: outturn and projections



SOURCE: RF analysis of OBR, Fiscal Sustainability Report, July 2020; HM Treasury announcements.

Looking ahead to the Spending Review, this leaves us with two questions surrounding the Government's capital spending plans: how much clarity will we receive over the allocation of capital spending, and will the Chancellor stick with the ambitious level of capital spending set out in the March Budget?

On the first of these questions, we will receive significantly more medium-term clarity than on resource spending. Government statements suggest that multi-year capital spending plans will be set out for 'key programmes where certainty is needed to ensure no time is lost in delivery', giving the examples of HS2 and hospital building programmes.[24] However, the extent to which other capital spending programmes fulfil this criteria is unclear, particularly those relating to more long-term stated aims of the Government, such as 'levelling up', or reaching net zero by 2050. For example, the 'Green Industrial Revolution' package set out on 18 November contained £4 billion new capital

23 The Conservative and Unionist Party, Our Plan: Conservative Manifesto 2019, December 2019.
24 HM Treasury, Spending Review to conclude late November, 21 October 2020.

spending, but provided no profile for this spending, with much of it relating to longer-term projects (currently allocated roughly equally over five years in our scenario).

Significant capital spending projects require certainty over future funding – and, as set out in previous work, shrinking or inconsistent funding horizons have proved obstacles to effective investment in the past.[25] As such, the Chancellor should seek to provide as much clarity as possible within the capital envelope if he is serious about advancing a levelling-up and green agenda.

The second question relates to whether capital spending is likely to be continued at the ambitious level set out in the March 2020 Budget. We think it is likely that the Chancellor will avoid this question in the Spending Review.[26] But maintaining high levels of investment spending in the medium term while also running higher borrowing to fund elevated current spending as a result of a persistently weaker economy will mean debt rising significantly.

As shown in the six decades of investment spending set out in Figure 17, it is for this reason that investment spending has tended to fall in the aftermath of recessions, with capital spending seen as a politically 'easier' target than current spending budgets and so bearing the brunt of spending cuts in previous fiscal consolidations. The Chancellor should not be considering beginning a fiscal consolidation while the economic recovery is still yet to come, but pressure to cut capital budgets in the years ahead is likely to increase, so setting out a fiscal framework that delivers sustainable public finances while maintaining high levels of public investment should be a priority. This is especially crucial given the extent to which public investment has the capacity to boost employment, and stimulate the economy during the post-crisis recovery – so avoiding a consolidation that would drastically cut capital spending is highly desirable, as set out in previous work.[27]

Avoiding this dilemma, and announcing multi-year capital spending programmes without a medium-term fiscal anchor runs the risk that these spending profiles will be inconsistent with the requirements of the fiscal framework the Government chooses to adopt to bring the public finances back onto a sustainable trajectory. Large capital spending increases can certainly be accommodated within a fiscal framework (not least if net worth, and the current balance are the main targets), but the key issue right now is that a number of large multi-year capital allocations are set to be confirmed with no consideration (publicly at least) of the relationship between this spending and wider fiscal objectives.

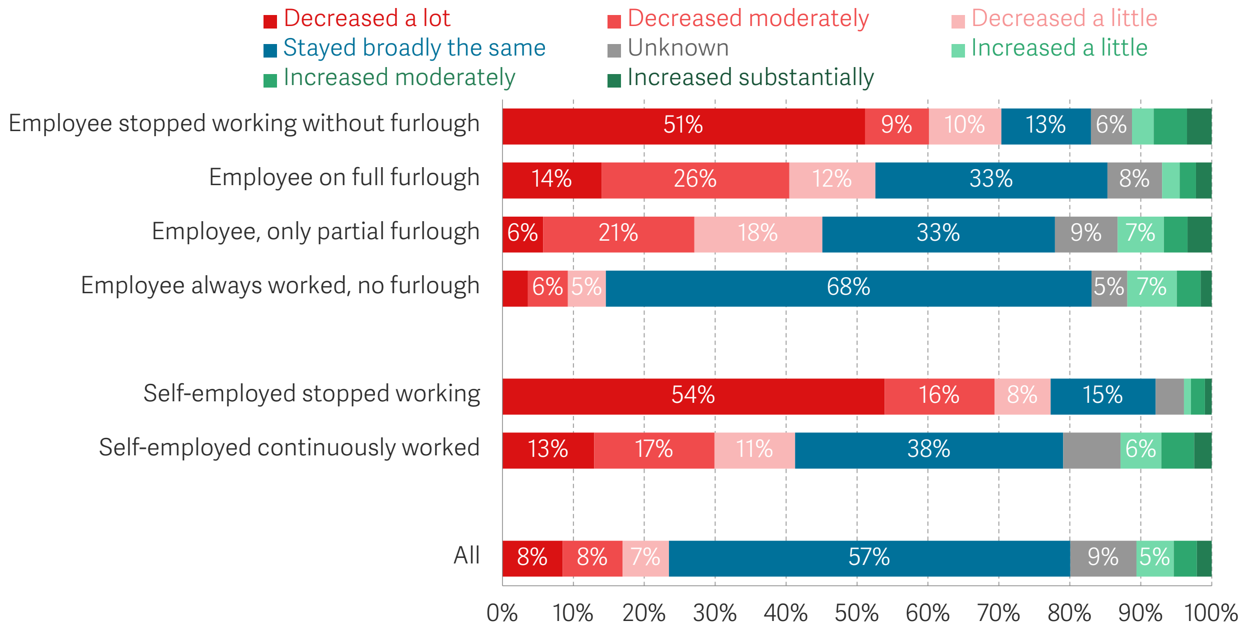
25 A Bailey, R Hughes, L Judge & C Pacitti, Euston, we have a problem: Is Britain ready for an infrastructure revolution?, Resolution Foundation, March 2020.
26 Our scenario assumes that capital spending profiles announced at March Budget 2020 will be maintained in cash terms, although it is possible that these could be reduced to reflect o GDP.
27 G Bangham, A Corlett, J Leslie, C Pacitti & J Smith, Unhealthy finances: How to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.

With the crisis far from over, keeping the £20 per week boost to Universal Credit will protect living standards and the wider economy

Amid this very uncertain economic and fiscal outlook, the Chancellor has decided to make some departmental spending decisions alongside an updated economic forecast. But it is a mistake to ignore other areas of government policy that have a major role in supporting the economic recovery.

FIGURE 18: **Those who have been able to access government schemes have seen their household incomes protected to a degree**

Change to household income during re-opening (July-September) compared to February 2020, by current working status: UK, 17-22 September 2020



NOTES: Base=6,061. Sample sizes for each group: employee stopped working, 176; employee on full furlough, 357; employee, only partial furlough, 154; employee always worked, 3,066; self-employed continuously worked, 324; self-employed stopped working, 102. Adults previously not employees or self-employed are not included except in the 'All' category. Furlough and work responses analysed for months July to September. Decreased a lot (>25%), decreased moderately (10-25%), decreased a little (<10%), unknown (did not know or refused to answer), increased a little (<10%), increased moderately (10-25%), increased substantially (>25%). Where an adult is in multiple statuses across the period then they are included in the worst outcome - stopped working, followed by full furlough, then partial furlough, then always working. These figures have been analysed independently by the Resolution Foundation.
SOURCE: RF analysis of YouGov, UK Adults Age 18 to 65 and The Coronavirus (Covid-19) – September wave.

Whatever the future brings, the evidence on what has happened to incomes so far during this crisis has been overwhelming. 1 in 6 of working-age adults have seen their household incomes fall by more than 10 per cent, with 1 in 13 seeing a fall of more than 25 per cent.

Figure 18 sets out how this has been driven mostly by the labour market effects of the crisis, most especially for those that have stopped working and were not eligible for the JRS or were self-employed.[28]

As the duration of the crisis continues, so the difficulties in making ends meet on a reduced income intensifies. Our recent work on how the crisis has affected income, spending and saving shows that 43 per cent of adults are now more concerned about their household finances than before the pandemic.[29] And there is a clear distributional skew to the impact of the pandemic: high-income adults were more likely to have seen their family budgets improve than deteriorate compared to their pre-pandemic position, with 35 per cent seeing their income rise relative to spending, and 37 per cent reporting that they are saving more than before the crisis started. But 50 per cent of those who entered the crisis with the most meagre of savings have been forced to dip into them to cover everyday costs such as housing and food, and half (54 per cent) of adults from families in the lowest income quintile have borrowed in recent months to cover everyday costs such as housing and food, and almost one-in-three (29 per cent) adults that has had a persistently low income through the pandemic say they cannot afford basic items such as fresh fruit and vegetables every day, or to turn on the heating when required. One area in particular where it is very difficult to quickly adjust spending habits is housing. Renters – unlike mortgage holders – have been unable to defer their housing costs forward, leading to 6 per cent of all renters in the private sector saying they will have to move house in the next year as their current housing is now unaffordable.[30]

Given this, reducing Universal Credit and Working Tax Credit awards by £20 per week in April makes little sense, as it will only compound this hardship for low-income households, including households that have seen their incomes fall since the start of the crisis. If the cut goes ahead, we estimate it will mean a 7 per cent fall in incomes for the lowest-income working-age households in April next year, as shown in Figure 19.[31]

28 This figure uses data from an online survey conducted by YouGov and funded by the Health Foundation. The figures presented from the online survey have been analysed independently by the Resolution Foundation and the views expressed here are not necessarily those of the Health Foundation or YouGov. For further analysis, see: K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020.

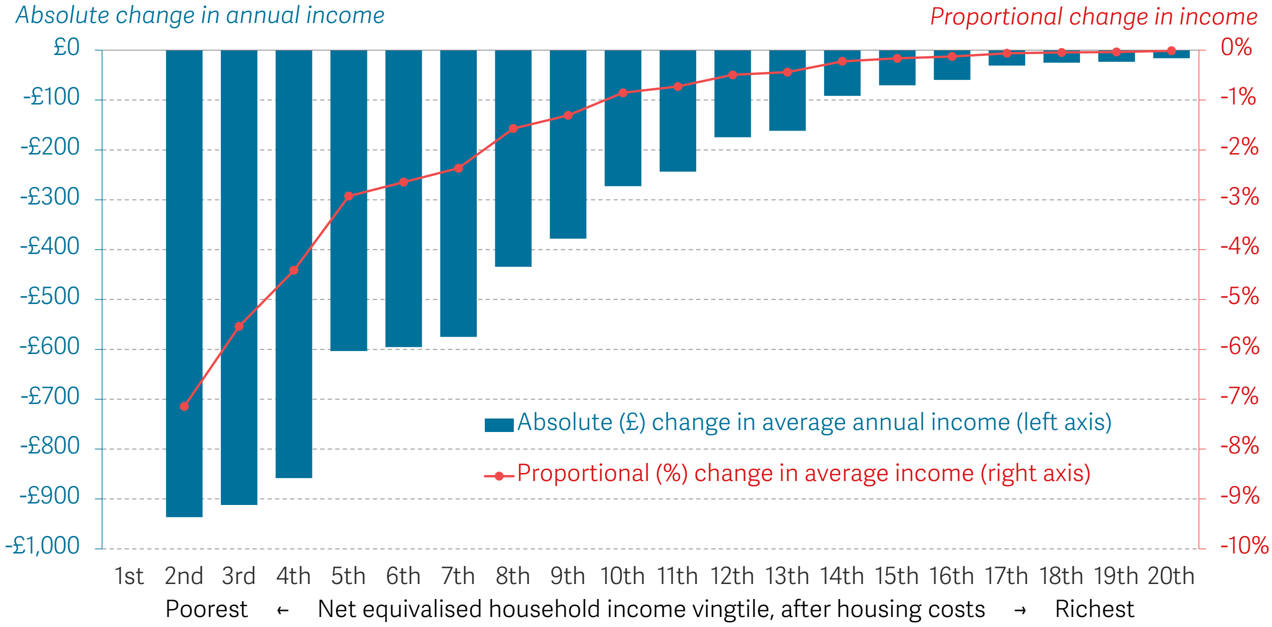
29 See: K Handscomb & L Judge, Caught in a (Covid) trap: incomes, savings and spending through the coronavirus crisis, Resolution Foundation, November 2020.

30 See: L Judge & C Pacitti, Coping with housing costs, six months on… new findings from the Resolution Foundation’s Covid-19 study - wave two, Resolution Foundation, October 2020.

31 First published in: T Bell, A Corlett & K Handscomb, Death by £1000 cuts? The history, economics and politics of cutting benefits for millions of households next April, Resolution Foundation, October 2020.

FIGURE 19: **Proceeding with the planned cut in benefits next year would see the poorest households lose 7 per cent of their income**

Impact on average household income by vigintile, of not retaining Universal Credit & tax credit boost in 2021-22



NOTES: We exclude the bottom 5 per cent, due to concerns about the reliability and volatility of data for this group.
SOURCE: RF analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model.

Making such a change to benefit generosity makes little sense on many levels, but perhaps the most striking is the economic argument. Despite vaccine hopes, the economy will be in a far from normal state in April next year. Now is not the time for consolidation, least of all for low-income families who have a higher propensity to spend any extra income in the wider economy.[32]

32 For a more detailed discussion on this see: G Bangham et al, Unhealthy finances: how to support the economy today and repair the public finances tomorrow, Resolution Foundation, November 2020.

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