Intergenerational fairness in the coronavirus economy

BRIEFING PAPER

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The coronavirus crisis has emphasised our obligations to other generations, even in the face of personal sacrifice.

This spirit must be maintained when the dust settles – with the economic costs of responding to the crisis shared fairly across the generations.

KEY POINTS

- The economic cost of tackling coronavirus will fall heavily on those of working age especially in terms of redundancies and lost income.
- Public sector net borrowing could rise above £200bn per year – higher than that seen in the financial crisis.
- This raises the prospect of "Austerity Round Two", with years of tax rises and spending cuts as we emerge from the crisis.
- Unlike "Austerity Round One", where the working age population bore the brunt of cuts in spending, especially via the welfare budget, the fiscal costs of this crisis must be fair across all age groups. The working age population face enormous financial losses in the current crisis, in a lockdown aimed at saving the lives of those at greatest risk, a group that is largely (but not exclusively) made up of older people.
- This current economic sacrifice is the right thing to do, not least given the social contract between generations: members of a good society look out for each other and are prepared to sacrifice some welfare for others. As we emerge from the crisis, older generations must uphold their part of the contract by bearing a fair proportion of future tax rises and welfare reforms.

POLICY RECOMMENDATION

- The "triple lock" ensuring substantial rises in the Basic State Pension should be replaced with a "double lock", tying increases to earnings or inflation (whichever is higher). This could contribute £20bn to deficit reduction over the next five years. Pensions would still rise, but less quickly, reducing the fiscal burden on the working-age population.

Context

With economies across the globe – including the UK – contracting sharply amid unprecedented lockdowns, the financial cost of responding to the coronavirus crisis is becoming clear. Many of us are seeing first-hand our friends and family being made redundant, furloughed or facing the permanent closure of businesses that they have spent years building up. Despite HM Treasury announcing enormous financial support packages to protect jobs and businesses during the lockdown, it is clear that a huge number of individuals are falling through the cracks. For many, help has simply not come quickly enough as businesses have ground to a halt more-or-less overnight.

Data from the US suggest millions more Americans are now out of work, while in the UK more than a million are applying for Universal Credit. In countries such as India, harsh lockdowns are leaving those already in poverty facing potential starvation.

While some have talked about a "V-shaped" economic recovery, where jobs and growth return rapidly once lockdowns are eased, there is no guarantee that this will happen. The OECD has suggested that the global economy will potentially suffer for years to come, as government debt soars and business and consumer confidence are eroded.[1] A sharp drop in property prices, while possibly good news for prospective buyers, could drag hundreds of thousands into negative equity. Savers and investors face significant losses, with potentially serious consequences for the future retirement income of workers with defined contribution schemes. Those already retired but reliant on dividend and savings income could also be badly hit by the current crisis.

Some are starting to question whether the cure for coronavirus might be worse than the disease. But this is far from a polite conversation topic. For many of us, lives must be saved even if the costs are enormous. It is deemed crass to put a price on life (or at least to talk about it – the reality is that healthcare is rationed all the time on the basis of cost and whether treatment is worth it in terms of the perceived "value" of the "quality-adjusted life years" it adds.)

Any kind of financial judgment on whether economic pain is worth it goes out the window when we start thinking about our own loved ones at particular risk from the virus – such as parents, grandparents and family members with health conditions.

Despite the economic costs, a survey by YouGov in late March showed 93% of the public supporting lockdown measures to fight coronavirus.[2] This is despite data showing that, for possibly 99% or more of the population, coronavirus is unlikely to be fatal. [i] Emerging data on fatality rates across the globe show that the elderly (those over the age of 70) are at much greater risk from the virus, while those under 50 face very little risk from it. Estimates from Imperial College London are that the death rate is almost 10 times higher than average for those over 80, and much lower for those under 40.[3]

Amid such gloomy times from an economic and public health perspective, perhaps we should take cheer in the fact that society, far from being on its last legs, seems alive and well. We have come together as a nation to protect our elderly and vulnerable, even though that means a loss of income and jobs. In a good society, people are prepared to make sacrifices to ensure the wellbeing of others.

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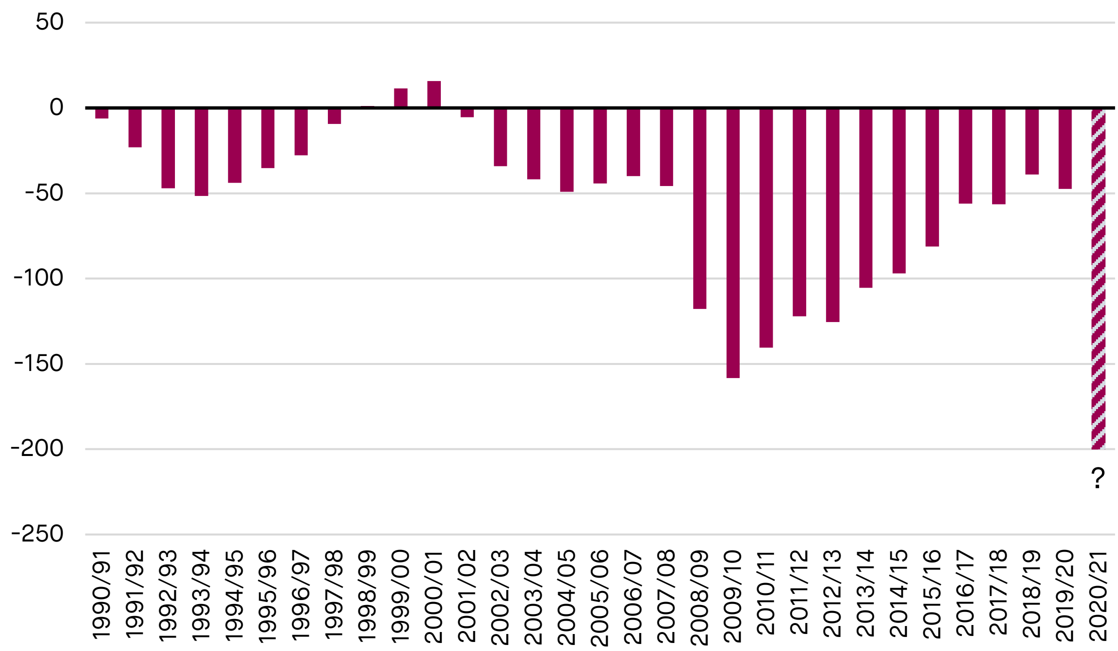
[i] At present, estimates of the mortality rate from coronavirus are imprecise. This reflects, in part, the fact that we are not testing all people for the virus (such as those self-isolating and not going into hospitals).

How can that principle of social cohesion be observed in the post-crisis recovery, when the economic cost of the lockdown must be met? How can the support that working-age Britons have offered to older compatriots be reciprocated in fiscal and other policies?

Austerity Round Two

Once we emerge from this crisis, government debt and the deficit will both stand at substantially higher levels. The deficit, as a share of GDP, is likely to surpass levels seen during the financial crisis. This raises the prospect of Austerity Round Two as governments try to get a grip on the public finances once again. The Institute for Fiscal Studies recently suggested that a government deficit of over £200 billion is well within the realms of possibility.[4]

Figure 1: Public sector net borrowing, £ billion



Source: ONS, SMF analysis

Governments should stay well away from aggressive austerity as we emerge from this crisis; the UK's recovery from the global financial crisis was slowed by George Osborne cutting public investment too much, too soon, and we should not repeat this mistake.

But once the recovery gains momentum, tax rises and welfare restrictions will be on the cards. The Chancellor Rishi Sunak hinted at new tax rises for the self-employed when announcing a support package for them in response to the crisis. His implied argument was that having benefited from crisis mitigation measures, the self-employed should prepare to reciprocate through higher taxes in future. That principle of reciprocity is important.

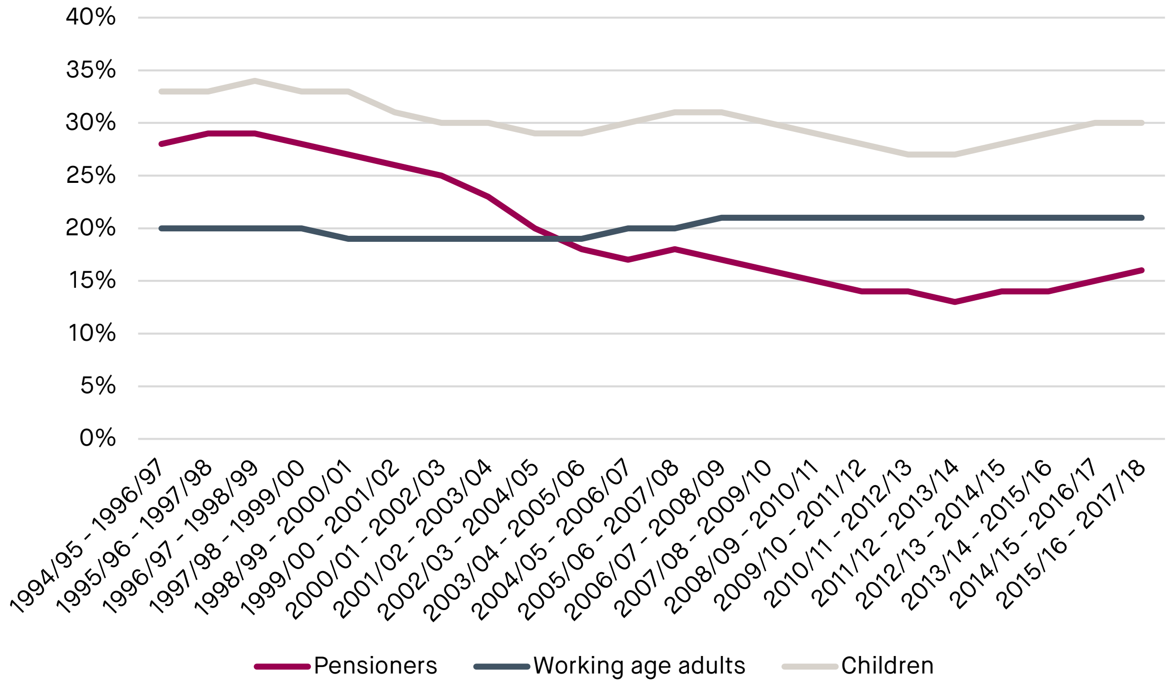
Beyond the self-employed, there are many questions to be asked about where tax rises should come from, as well as the future of the welfare state. Here, too, there are lessons to be learned from the mistakes made as we emerged from the global financial crisis (Austerity Round One).

Lopsided austerity after the financial crisis

During Austerity Round One those of working age bore the brunt of budget cuts over the past 10 years. Working age benefits were capped and frozen, producing some of the biggest Treasury savings, and biggest consequences for the lives of millions of people. Yet the State Pension was protected by a triple lock of inflation, earnings or 2.5% (whichever is higher). Universal pensioner benefits such as winter fuel payments were protected.

The impact of this lopsided austerity is clear to see (Figure 2). After housing costs, average pensioner incomes overtook those of working age households.[5] As well as welfare cuts, which fell largely on the working age population, rising housing costs also worsened their situation – a hardship arguably deepened by "nimbyism" among older generations resisting new housebuilding.

Figure 2: % living in relative poverty, after housing costs

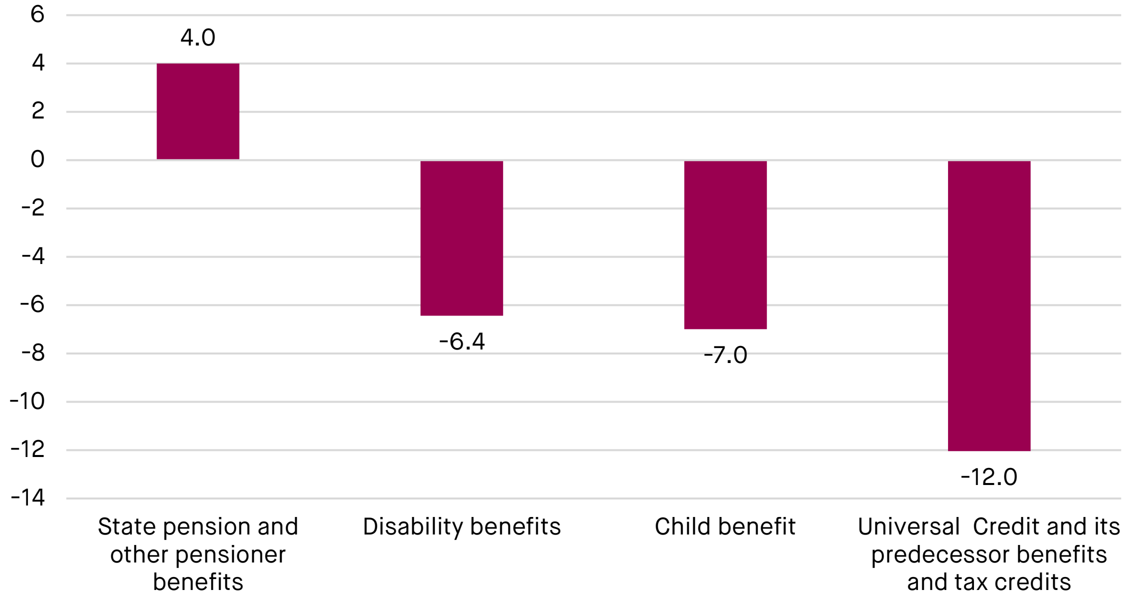


Source: House of Commons Library. Relative poverty defined as living in a household with income below 60% of the median

Figure 3 makes the distribution of austerity abundantly clear. Even as the state cut the support it offered people of working age, it became more generous to those in retirement.

£222.9 billion was spent on pensions, tax credits and working-age welfare in 2018-19, more than a quarter of all state spending. The State Pension accounted for almost £100 billion of that. Given the size of the overall welfare budget relative to other items of state spending, any future fiscal consolidation on the spending side would have to start with the welfare bill. Alternatively, taxes might need to increase significantly if there is reluctance to cut government spending.

Figure 3: Changes in welfare spending between 2014-15 and 2018-19, real terms % change



Source: OBR

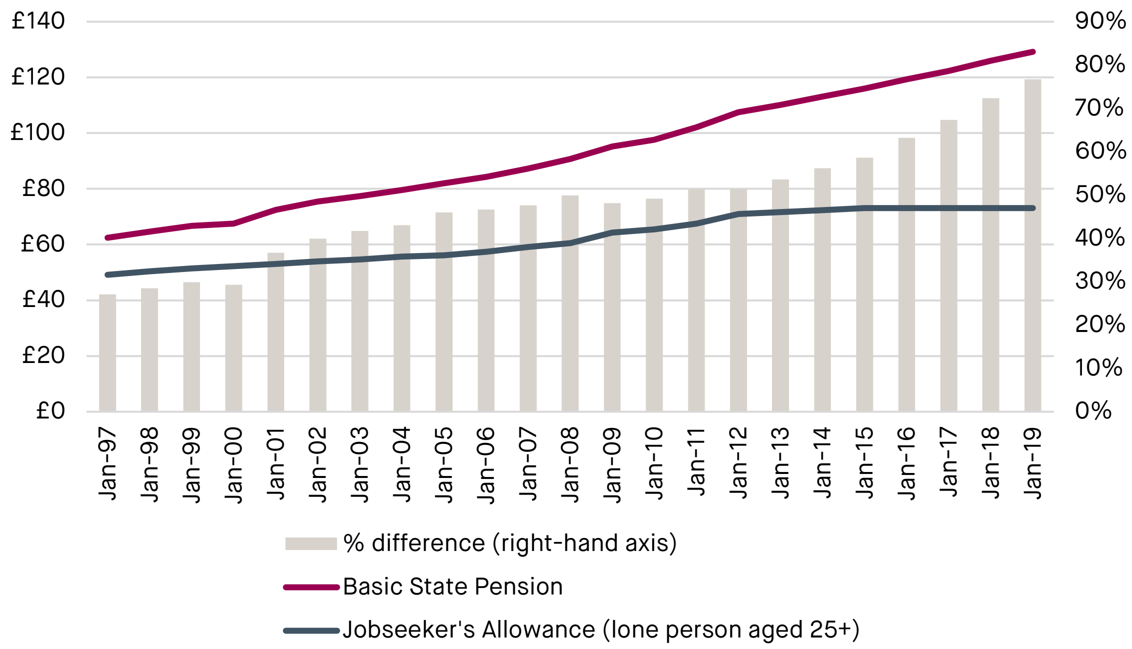
Entering the current crisis with an ill-prepared welfare state

We are entering the current economic downturn with a welfare state that is poorly equipped to help those of working age – that is to say, poorly equipped to help those bearing the brunt of job losses, pay cuts and business insolvency over the coming months.

As Figure 2 showed, while poverty rates are lower for pensioners than they were 20 years ago, they have changed little for those of working age. Indeed, working age households are now more likely to be in poverty than pensioners, and this could become even more pronounced over the coming months.

While in 1997 the Basic State Pension, per week, was 27% higher than the rate of Jobseeker's Allowance for a single person aged 25+ with no children, it now stands close to 80% higher – in part reflecting policy decisions during Austerity Round One.

Figure 4: Basic State Pension versus Jobseeker's Allowance (for lone person aged 25+), £ per week.



Source: SMF analysis

Recent policy has made the UK's working age benefits system even less generous than that of comparator economies than hitherto. In Germany, for example, unemployment benefits are tied to earnings and stand at 60% of an individual's net salary prior to job loss among those with no children. This rises to 67% for those with children. The maximum level of unemployment benefits is generous; up to a gross €6,700 per month in West Germany and €6,150 in East Germany.[6] Compared to those losing their jobs in the UK at present, the average German made redundant will be much better protected from the economic storm.

Economic stagnation and a fragile welfare state risk entrenching the already gloomy views of younger generations on their prospects – which arguably reflect a breakdown of a key tenet of the implied social contract that underpins open Western economies: that younger generations should expect a more prosperous future than older generations, or at least a maintenance of already good living standards.

Survey research carried out by Ipsos MORI for the Resolution Foundation in 2017 found that people were more than twice as likely to say that young people today will have a worse standard of life compared to their parents (48%) than a better standard of life (23%). There has been a sharp turnaround in views compared to 15 years ago: the proportion of people who think their children will have a better life than them has halved.[7]

The social contract between old and young

It would be a terrible mistake to repeat the unbalanced austerity seen after the financial crisis as we emerge from the coronavirus crisis, particularly as the working age are making a huge economic sacrifice to protect (largely) the nation's elderly.

James Kirkup of the SMF has argued in a recent report for a new social contract between business and wider society, once the dust settles from the current crisis.[8] Businesses are due to receive enormous financial support, and they should return the favour by acting in a decent way – training employees, paying them well, and investing in their local communities.

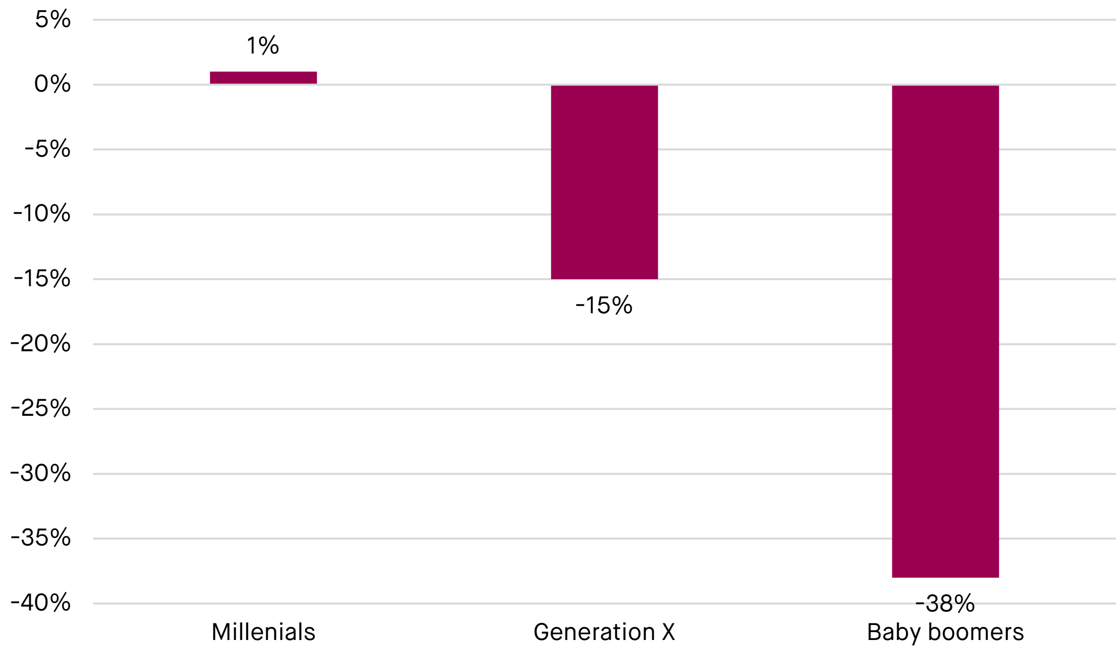
Perhaps the same can be said about the social contract between younger and older generations in the UK. This national crisis should cause us to think much more about our obligations to each other, and what that should mean for policy. As Edmund Burke noted:

> *Society "is a partnership in all science, a partnership in all art, a partnership in every virtue and in all perfection. As the ends of such a partnership cannot be obtained in many generations, it becomes a partnership not only between those who are living, but **between those who are living, those who are dead, and those who are to be born".***

That is to say, a functioning society rests on obligations between generations, including generations yet to exist.

Even before the current crisis, those in younger generations were more gloomy about the future; the Ipsos MORI survey carried out in 2017 showed slightly more millennials agreeing than disagreeing with the statement that "I would prefer to have grown up at the time when my parents were children". This contrasts sharply with gen Xers and baby boomers – with more disagreeing with this statement.

Figure 5: Net % agreeing with statement "I would prefer to have grown up at the time when my parents were children" (2017)



Source: Ipsos MORI

The risk is that the coronavirus crisis and a sluggish economic recovery combine to further undermine a sense of optimism for the future among younger generations. This could be compounded if recent policy errors are repeated.

Policy after the crisis: ensuring Austerity Round Two is fairer than Austerity Round One

Quite rightly, society is making sacrifices to protect its elderly right now. There is a clear case for intergenerational reciprocation when it comes to meeting the fiscal costs of the crisis – something that could be a feature of the policy landscape for years to come.

Politicians might be tempted for Austerity Round Two to closely resemble Austerity Round One – especially given the growing share of the electorate that is elderly and their higher propensity to vote in elections: the power of the "grey vote" largely explains the persistence of the triple lock. But for those of working age to bear such disproportionate costs again could stretch the social contract between generations to breaking point. In the long-run, that would prove a grave error.

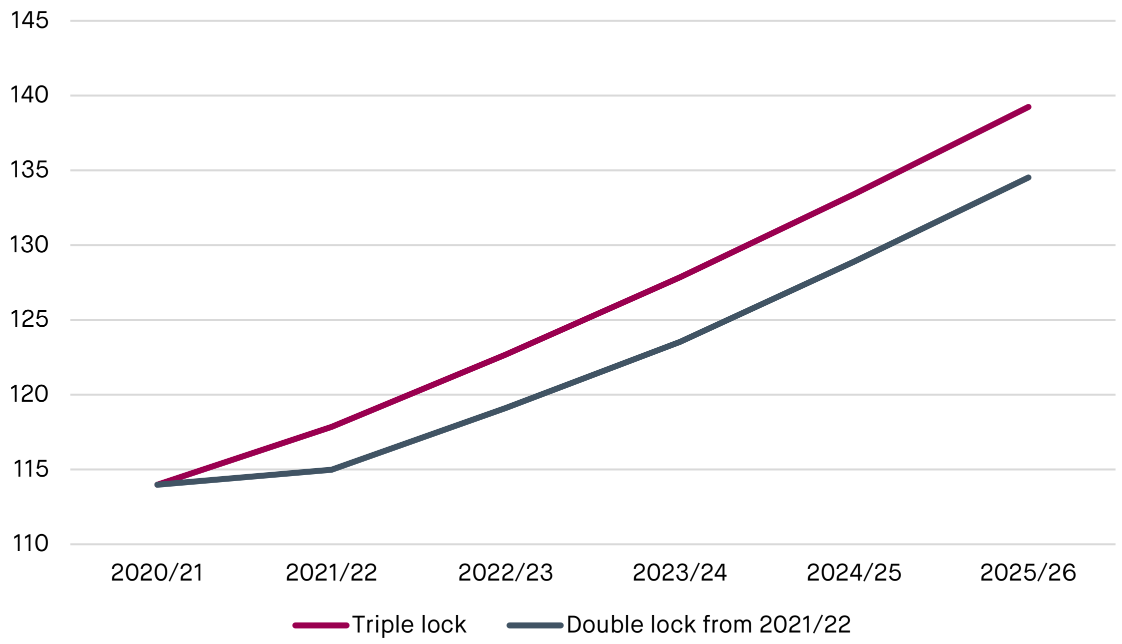
In practice, a fairly distributed programme of post-coronavirus austerity probably means looking at new taxes on wealth and property, rather than on incomes. That is, focusing relatively more tax on "old money" than "new money". Politicians might be tempted, as we emerge from the current crisis, to increase national insurance contributions (NICs) to "raise more for the NHS", but this would increase the tax burden on the working age who have borne the brunt of job and income losses. That would be a mistake.

Instead, the post-crisis period might be an appropriate time to gradually merge income tax and national insurance, or to make the State Pension and private pensions subject to a tax in lieu of employee NICs (maybe called a "Health Tax", ostensibly to raise more money for healthcare). For those over State Pension Age who are in paid work, no employee NICs are made at present – meaning that such older workers face a lower marginal tax rate than younger counterparts on the same wage.

Better late than never: the overly generous State Pension triple lock should also be replaced with something more affordable as a way of reducing the deficit. The triple lock looked too expensive before the current crisis – something our Chief Economist Kathryn Petrie recently noted, and it would become even more expensive with a frail economy over the coming years.[9] In an era of low inflation and weak earnings growth, a policy ensuring a 2.5% minimum uprating will constitute considerable generosity to pensioners, at a time when working-age adults face low or no wage-growth and significant unemployment.

My calculations suggest that replacing the triple lock with a double lock of earnings or inflation (whichever is higher) over the next five years could save about £20 billion, roughly £4 billion a year. In the context of an annual deficit that could reach £200 billion as we emerge from the crisis, this is not too much to ask. It would also demonstrate reciprocity from a group whose wellbeing was, rightly, prioritised during the lockdown phase of the crisis.

Figure 6: State pension spending, £ billion



Source: SMF analysis. Assumes earnings growth of 0%, 1%, 2%, 2.5% and 2.5% for the next five years, (respectively), in the relevant months used in the State Pension uprating calculations. Also assumes inflation of 0%, 2%, 2%, 2% and 2% in the relevant months.

Conclusion: a moment to renew the contract between generations

Today's debates about the intergenerational fairness of lockdown policies are a foretaste of the questions that will face British policymakers in the recovery phase of the coronavirus crisis. This paper is intended to help frame those questions with evidence and considered argument. The aim is to help bring about policies that uphold and strengthen the sense of shared endeavour shown thus far. If the crisis is helping to bring the country together, it is because the response has demonstrated that many people are prepared to endure economic and other hardship to preserve the wellbeing of others.

The key to maintaining that feeling in the next phase of the crisis will be reciprocity, the sense that favours are returned, that support given is met with generosity in reply. An approach to future changes in welfare spending that puts more of the burden on older people than was the case in the previous consolidation is not about seeking to divide society between young and old. Quite the contrary: it is about demonstrating that in a good society, kindness is met with kindness and sacrifice with sacrifice. Following the approach outlined in this paper would help keep society together. Repeating earlier mistakes by favouring one generation group at the expense of another would be unfair and thus divisive.

ENDNOTES

[1] https://www.bbc.co.uk/news/business-52000219
[2] https://www.independent.co.uk/news/uk/politics/coronavirus-uk-lockdown-boris-johnson-poll-yougov-latest-a9420526.html
[3] https://www.bbc.co.uk/news/health-51674743
[4] https://www.ifs.org.uk/publications/14771
[5] https://www.bbc.co.uk/news/business-38957903
[6] https://ec.europa.eu/social/main.jsp?catId=1111&langId=en&intPageId=4557
[7] https://www.ipsos.com/ipsos-mori/en-uk/millennial-bug-public-attitudes-living-standards-different-generations
[8] http://www.smf.co.uk/publications/returning-favour/
[9] http://www.smf.co.uk/blog-the-triple-lock-is-a-political-tool/