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Making a Difference

Coronavirus (COVID-19): Paying for the Pandemic

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The Problem

On April 14, the UK's Office for Budget Responsibility forecast that the public deficit could balloon by £218 billion in 2020 as result of higher spending to contain the economic and human costs of the Coronavirus (COVID-19) pandemic and lower tax revenues linked to the lockdown.

There are already concerns about how the UK government will pay for this. Concerns about affordability could lead to a premature exit from lockdown, endangering lives. Or they could limit political appetite for economic stimulus measures once the lockdown is over, endangering livelihoods.

What we discovered

Any discussion of the UK's fiscal response to the pandemic must start from an appraisal of the pre-pandemic status quo: itself a legacy of the global financial crisis, and the way in which UK policymakers chose to respond to it.

The banking bailouts of 2008 required a massive increase in public sector debt. Stimulus measures undertaken in the immediate aftermath of the crash involved both spending increases and tax cuts. The subsequent economic downturn reduced GDP and tax revenues. The net result was a spike in the budget deficit from 2007 through to 2010.

COVID-19 looks set to wreak even greater havoc on government finances and the UK economy. How, then, can the Exchequer find the additional funds that are needed?

There is little appetite or scope for further cuts to public services following a decade of austerity. Economic growth looks unlikely to come to the rescue of the public finances either – even before the pandemic, the UK's prospects looked grim, courtesy of global economic stagnation coupled with the more localised fallout from Brexit.

Borrowing is viable so long as the UK can do so cheaply. However, without rapid economic growth, debts may prove hard to shift, limiting the ability of the UK state to respond to future pressures.

That leaves taxation. But tax rises are both politically challenging, and risk stifling economic recovery. In recent years, political parties have shied away from pledging broad-based rate increases in the levies that generate the largest revenues.

However, there are alternative ways in which the government could choose to pay for the pandemic via the tax system. A one-off windfall tax on net wealth (including property net of outstanding mortgages, financial assets, businesses, savings, pensions and so forth) could raise a substantial sum of money in relatively short order.

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Wealth taxes have garnered a great deal of attention in developed democracies over recent years, in light of the widening gap between the richest and the rest, as well as the fiscal austerity that followed the global financial crisis.

However, to date the proposals of prominent commentators such as French economist Thomas Piketty have centred on a recurring annual tax on wealth, targeted at the very wealthiest individuals.

The merits and flaws of such ideas have already been extensively debated. But it is worth noting that many of the objections levelled at them (for instance, that they incentivise consumption rather than investment, or encourage wealthy individuals to migrate) are unlikely to apply, or apply as strongly, to a one-off charge.

And unlike conventional capital levies, wealthy people cannot avoid wealth taxes simply by shifting their assets abroad: they need to move their selves and their households too, making capital flight harder.

While the timing and scale of any additional tax revenues necessary remains unclear, the pandemic also creates opportunities for reform in other parts of the tax system, such as environmental tax, social insurance, corporate taxation, and the underlying fiscal framework.

Recommendations

A one-off wealth tax:

- The most recent data from the Office for National Statistics estimates the net wealth of UK households at almost £15 trillion.
- A broad-based one-off levy could thus raise a significant amount at a very low rate – over £350 billion could theoretically be generated at a tax rate of 2.5%.
- Wealth is so unevenly distributed in the UK that the poorest 50% of the households could be excluded from the scope of such a tax entirely, and the revenue yield would fall by less than 10%.
- A tax-free allowance for the wealthiest 50%, pegged to the wealth of the median individual, would cause a larger reduction in receipts, but still leave the Treasury with more or less enough to cover the fiscal costs of the crisis as currently forecast.
- In the case of illiquid or indivisible assets, the Treasury could offer taxpayers options for deferral, or government could take some form of equity stake in lieu of cash.

Other fiscal reforms

- The global slowdown, and accompanying falls in oil prices, presents an ideal opportunity for the UK government to raise fuel duty after a decade of freezes. If or when fuel prices eventually recover, attention could then turn to how best to mitigate the regressive aspects of such a tax.
- The crisis has seen a massive extension of social insurance to all parts of the working population, and arguably the greatest beneficiaries of the lockdown have been elderly people who are disproportionately vulnerable. Under the circumstances, ensuring all people contribute to public revenues on an equal footing seems appropriate, as we have all benefited (directly or indirectly) from the massive expansion of state support over recent months. Combining income tax, national insurance and capital gains into a single "income and insurance tax" payment, where all taxpayers paid similar rates, would simplify the tax system, reduce opportunities for tax planning, and improve the progressivity of the tax system.
- As in the global financial crisis before it, the pandemic has exposed how reliant many corporations are on debt, and how fragile these capital structures are during economic downturns. To encourage greater corporate resilience in future, at a minimum government should restructure the tax system to ensure that it does not actively penalise equity funding.
- The UK's fiscal framework should be reconfigured in the wake of the pandemic. The present distinction between current and capital spending may distort public expenditure in harmful ways – discouraging investment in human capital via spending on education or healthcare, for example.

Further information

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