STOP THE SQUEEZE

BUDGET BACKGROUND BRIEFING, MARCH 2023

Economic Change Unit

NEW ECONOMICS FOUNDATION

TAXJUSTICE.UK

WWW.STOPTHESQUEEZE.UK

ABOUT STOP THE SQUEEZE

Stop the Squeeze is a coalition of civil society groups who are calling on the government to tackle the cost of living crisis by guaranteeing affordable energy, boosting incomes, and raising taxes on wealth.

The full list of supporting organisations can be found at www.stopthesqueeze.uk

Supporter organisations have signed up to support the campaign launch statement and the demands of the campaign, they do not necessarily support every policy proposal that may be mentioned by the campaign.

Stop the Squeeze has been formed by a core steering group consisting of The Economic Change Unit, the New Economics Foundation, and Tax Justice UK.

This briefing document has been produced by the Stop the Squeeze steering group and is the responsibility of those organisations only.

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BACKGROUND

The cost of living crisis became sufficiently severe by Spring 2022 that the UK government was forced to intervene in the economy and provide some increased protections for households.

The crisis is still severe, with inflation remaining at a near-40 year high and wages and salary increases lagging well behind.[1]

Furthermore, food price inflation is forecast to rise into the near future, as the effects of disrupted harvests in 2022 play out[2]. The headline rate of inflation is likely to decline, but many households will still feel under severe pressure (and falling inflation only means prices are rising more slowly, on average).

Despite this context, the government is now looking to scale back support for households.

This briefing looks at existing government support for households in the cost of living crisis, and examines the prospects for extending such support into the future.

The briefing argues that:

- The government should continue to support households with the cost of living in the Budget
- That this is unlikely to increase inflation (in fact it could reduce inflation)
- That the combination of government fiscal 'headroom' and the potential to raise taxes on wealth means that this support is affordable
- And that this additional support would help support the economy overall.

1 https://www.ft.com/content/cad6f5e8-7f50-4078-8825-48e253e59167

2 https://www.theguardian.com/business/2023/jan/04/record-133-uk-food-inflation-raises-fears-of-another-difficult-year

EXISTING ENERGY PRICE SUPPORT FOR HOUSEHOLDS

The initial government responses to the energy price increases were piecemeal:

- February 2022: The "Energy Bills Discount":
  - £200 upfront discount on bills in October 2022 (paid for by customers in £40 instalments over the following five years);
  - £150 Council Tax rebate for around 80% of households in England;
  - £144m in discretionary funding for local authorities;
  - £715m additional funding for the devolved administrations.

- May 2022: The "Energy Bills Support Scheme" (EBSS):
  - Doubling of the upfront discount on bills to £400 for all households and scrapping the requirement for it to be repaid;
  - £650 one-off payment to around 8 million households on certain means-tested benefits;
  - £150 one-off disability cost of living payment for people who receive certain disability benefits;
  - £300 one-off payment for over 8 million pensioner households;
  - £500m "Household Support Fund" for local authorities to administer.

This additional support cost £15.3bn, taking the total cost of support to May 2022, including the conversion of the earlier loan into a grant, to £21.3bn.[3] Part of the financing for this spending was provided by the Energy Profits Levy (EPL), introduced as a windfall tax on energy company profits from May 2022, and expected to raise £5bn.[4]

3 House of Commons Library, https://commonslibrary.parliament.uk/research-briefings/cbp-9491/

4 HM Treasury, "Energy Profits Levy factsheet", 15 June 2022. https://www.gov.uk/government/publications/cost-of-living-support/energy-profits-levy-factsheet-26-may-2022

Rising public and political concern, including demands from the Liberal Democrats, and later, the Labour Party for a household energy bill freeze, and the threat of mass non-payment of bills in October, helped push the government to make a very significantly more comprehensive offer in September 2022.

THE ENERGY PRICE GUARANTEE

The Energy Price Guarantee (EPG) was announced by Prime Minister Liz Truss on 8 September 2022, effective from 1 October 2022.[5] It was intended to cap the typical household energy bill at no more than £2,500 for two years, to the end of financial year 2024. This was initially reported to cost £150bn over two years, although official costings in the Plan for Growth (the "mini-Budget") suggested it would be £31bn over a single year (plus £29bn in business support), without providing future forecast costs due to their claimed uncertainty.[6]

The EPG's support was then reduced in the Autumn Statement of November 2022 to cap typical household bills at £3,000 a year. This helped reduce the anticipated cost of the EPG to £24.78bn in 2022-23 and £12.78bn in 2023-24.[7]

Forecast typical annual household energy bill with no intervention, mini-Budget plans, and Autumn Statement revision

Scenario	2022				2023			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
No intervention	1277	1971	1971	3549	4255	3702	3158	3182
Mini Budget	1277	1971	1971	2500	2500	2500	2500	2500
Autumn Statement	1277	1971	1971	2500	2500	3000	3000	3000

5 https://www.gov.uk/government/news/government-announces-energy-price-guarantee-for-families-and-businesses-while-urgently-taking-action-to-reform-broken-energy-market

6 Table 4.1a. https://www.gov.uk/government/publications/the-growth-plan-2022-documents/the-growth-plan-2022-html#policy-decisions

7 Table 5.1. https://www.gov.uk/government/publications/autumn-statement-2022-documents/autumn-statement-2022-html#policy-decisions

Sources: Fraser of Allander Institute; OFGEM, HM Treasury, Cornwall Insight[8]

The Energy Price Guarantee is not targeted. Half of the costs of the EPG are forecast to go to the top half of the income distribution,[9] whilst even with the EPG the poorest households faced spending nearly half their income on energy bills over the winter.[10]

Furthermore, despite this support, the cost of living crisis has had a devastating toll on those most exposed to it. Research from the Joseph Rowntree Foundation (JRF) has found that 90% of those on Universal Credit are now unable to afford life's essentials[11], while the Independent Food Aid Network (IFAN) reports that food banks are overwhelmed by demand.[12]

It is still the government's plan to raise the energy price guarantee from £2500 to £3000 from April 2023. The anticipated rise in the cap will cost the typical household another £500 a year. Households with more than typical demands for energy will likely face more significant increases.

Alternative systems of support have been proposed:

- The New Economics Foundation has proposed "free basic energy" for every household, guaranteeing every household a minimum consumption standard before charging.[13]
- The National Institute of Economic and Social Research has proposed a revenue-neutral "Variable Energy Price Cap", offering targeted support at the

8 Table 1, https://fraserofallander.org/energy-price-guarantee-is-now-less-generous-but-will-play-a-role-in-fighting-inflation/

9 Institute of Fiscal Studies, 2022. "Response to the Energy Price Guarantee". https://ifs.org.uk/articles/response-energy-price-guarantee

10 Richard Partington, 22 September 2022, "Poorest risk spending half disposable incomes on energy bills, UK report says", Guardian. https://www.theguardian.com/business/2022/sep/22/poorest-risk-spending-half-disposable-incomes-on-energy-bills-uk-report-says

11 https://www.jrf.org.uk/report/guarantee-our-essentials

12 https://uploads.strikinglycdn.com/files/1eef6bda-b532-490f-8f38-2bbd495a8c4f/IFAN%20DECEMBER%20PRESS%20RELEASE_FINAL.pdf?t=1672211105?id=3972176

13 New Economics Foundation, 5 September 2022, "Warm Homes, Cool Planet". https://neweconomics.org/2022/09/warm-homes-cool-planet

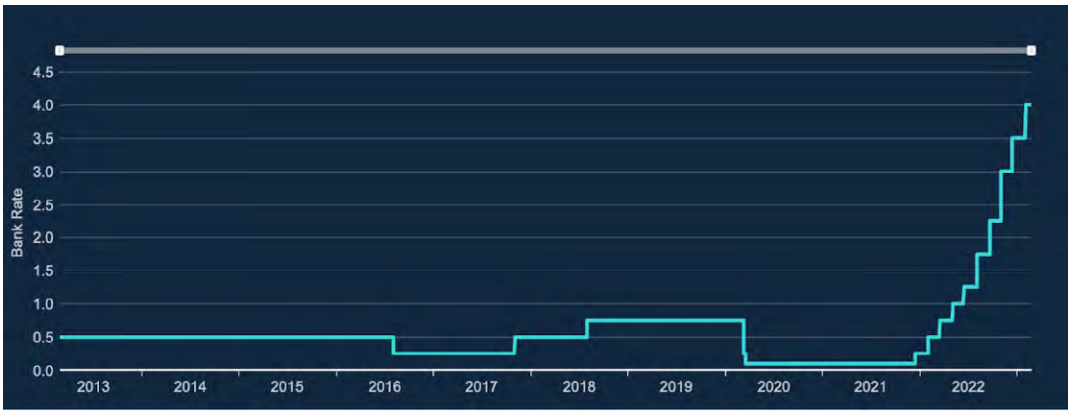
poorest financed from expenditure by the richest.[14]

- The Breugel Institute maintain a directory of household energy support schemes across Europe.

INTEREST RATES AND INFLATION

As inflation began to pick up from late 2021, the Bank of England has begun systematically increasing the interest rate it controls on deposits left at the Bank by other commercial banks.

Bank of England base rate, 2013-2023



Source: Bank of England

The actual impact of interest rates on UK inflation is presently limited, since most of the rise in inflation over the past 12-18 months has been driven by global factors outside of the UK's control, including the war in Ukraine and poor harvests. Inflation is now falling (meaning prices are rising at a slower pace) but this is largely due to energy costs internationally falling since the summer.

14 NIESR, 7 September 2022, "A 'Variable Energy Price Cap' to Help Solve the Cost-of-Living Crisis". https://www.niesr.ac.uk/publications/variable-energy-price-cap-help-solve-cost-living-crisis?-type=policy-papers

GOVERNMENT SPENDING AND INFLATION

Would extra cost of living support fuel inflation?

It is important to note that the extra funding offered for the cost of living crisis, primarily the Energy Price Guarantee, has acted to reduce the headline rate of inflation. Energy costs are an important component of overall inflation, so freezing those costs significantly reduces inflation overall.

Overall inflation would have been 2.6% higher in December 2022 without the EPG, from ONS calculations. Cornwall Insights' forecasts implied that, without the Energy Price Guarantee, bills would continue to rise steeply in 2023, adding 6.2% to inflation by January 2023.[15]

To the extent that government spending directly targets prices, and offers subsidies, it is always likely to reduce overall inflation. However, the government has recently begun to claim that higher government spending is likely to lead to higher inflation. It has proposed two mechanisms for this.

First, government sources have claimed that public sector pay must be kept below the rate of inflation. They argued that higher public sector pay will inevitably lead to demands for higher pay in the private sector, fuelling inflation.[16]

Various factors point to this assertion being incorrect:

- Public sector pay rises are unlikely to have an inflationary effect, since much of what the public sector produces (for example: NHS treatments, ed-

15 Fraser of Allender Institute, "Energy Price Guarantee is now less generous but will play a role in fighting inflation", 18 November 2022. https://fraserofallander.org/energy-price-guarantee-is-now-less-generous-but-will-play-a-role-in-fighting-inflation/

16 "..the Chancellor is adamant that pay must be kept under control and has been briefed by Treasury officials that wage awards in the public sector set a benchmark for settlements in the private sector. A Treasury memorandum seen by the Financial Times says that public sector pay rises of less than 5 per cent for 2023-24 would have a "low risk" of protracting high private sector pay growth, 6 per cent would worsen inflation, and 7 per cent would "pose a significant risk" and could trigger higher interest rates." George Parker and Robert Wright, 14 February 2023, "Rishi Sunak explores public sector pay deal that backdates wage offer", Financial Times. https://www.ft.com/content/df1ad00d-0ebc-4345-85a2-956c9e8e5457

ucation for school children) is not sold. Therefore its price will not change.

- Pay rises have lagged well behind inflation, with private sector pay rising 7.3% in the year to December, and public sector pay 4.2%. Inflation is currently 10.1% and has been above average pay rises for 14 months. Even significant pay rises now will only act to compensate for a year of real terms' losses.
- If pay rises are tax-financed, any remaining inflationary impacts will be reduced. This is because taxes remove money from the wider economy, and so the additional money has less impact. These tax rises could be redistributive, moving money from richer people and companies to the rest.
- Even the Institute for Fiscal Studies has said that the idea that public sector pay rises will fuel inflation is "not a strong argument".[17]

Second, the Chancellor has claimed that more spending in a weak economy will fuel inflation. This is a claim about the "full employment" level of the UK economy, since a standard economic model will tell you that pumping more money into the economy when it is at its "full employment" level will produce more inflation, not more output.

Official estimates of the UK's "potential output" by the Office for Budget Responsibility, which is the gap between current and full employment output, have been reduced over the last decade. This is intended by the OBR to reflect underlying weaknesses in the economy.

However, the TUC has recently argued that these seeming weaknesses are themselves the result of low spending, creating an economic "doom loop" where low demand reduces the willingness of firms to invest, and to employ better-paid workers.[18] By contrast, Janet Yellen, US Treasury Secretary, has argued for a "high pressure" economy where higher government spending actively supports higher pay and more output.[19]

17 https://ifs.org.uk/articles/fiscal-backdrop-spring-budget-2023

18 Geoff Tily, February 2023, From the doom loop to an economy for work not wealth, Trades Union Congress. https://www.tuc.org.uk/research-analysis/reports/doom-loop-economy-work-not-wealth

19 https://www.reuters.com/article/us-usa-fed-yellen-idUSKBN12E22M

Given the uncertainties around these forecasts (for example with a £70bn "hole" becoming a £30bn "surplus" in the public finances in two months) we should not try to fix fiscal policy on them.

Instead, given that we know inflation is mostly imported, government should concentrate on supporting living standards – for example through higher pay and action on price rises.

Bloomberg reports that the fall in government borrowing costs since the "mini-Budget" was enough to finance a 10% (i.e. an inflation-matching) pay rise for the entire public sector.[20]

With the unexpectedly high tax take in January, the government could even more easily afford to meet pay demands from public sector workers. Every 1% increase in public sector pay costs approximately £2.5bn (Bloomberg estimate). A 10% pay rise is therefore about £25bn in total.

In summary, with inflation largely imported, it is unlikely that additional cost of living support would increase inflation. In fact, when cost of living support acts to reduce prices (such as the energy price guarantee) then it actively suppresses inflation. When support is paid for through tax rises elsewhere, then it is even less likely to contribute to inflation.

20 Philip Aldrick, 7 December 2022, "Sunak Has Weak Hand on Strikes and Should Settle, Economists Say", Bloomberg. https://www.bloomberg.com/news/articles/2022-12-07/sunak-has-weak-hand-on-strikes-and-should-settle-economists-say

FINANCING COST OF LIVING SUPPORT

Thus far, cost of living support from government has depended heavily on borrowing, with some additional revenues (£5bn) raised through the Energy Profits Levy (EPL). Labour have called for a significantly higher windfall tax,[21] backdating payments and removing some investment allowances, adding a further £8bn to the £5bn revenue raised.

This clearly falls well short of even the lower forecast cost of the EPG. Although UK-based fossil fuel companies (primarily Shell and BP) have made exceptionally large profits, much of this profit is generated outside of the UK (for example only 6% of BP revenue comes from the North Sea) and so is harder to tax.[22]

There have been somewhat conflicting reports on the government's financial standing in the last month:

- Within the government's own fiscal targets, the better-than-expected surplus of tax revenues over spending in January have been forecast to imply £30bn of extra "headroom" (i.e. additional spending that could take place without breaking the government's rules for spending.) This is in radical contrast to the approximately £60bn "hole" in the finances widely reported before the 2022 Autumn Statement, and reflects the uncertainties of forecasting.[23]
- However, early reports from the Office for Budget Responsibility suggest that whilst it is likely to show an improvement in the public finances in the short term, a longer-term higher estimate for inflation, and lower estimate for trend growth, will make meeting the government's fiscal rules very difficult.[24]

21 https://news.sky.com/story/labour-pledge-to-extend-windfall-tax-to-protect-families-from-soaring-energy-bills-12791263

22 City AM, "BP and Total Energies most exposed to North Sea oil and gas levy", 30 May 2022. https://www.cityam.com/bp-and-total-energies-most-exposed-to-north-sea-oil-and-gas-levy/

23 Andrew Atkinson and Philip Aldrick, "UK's surprise budget surplus gives Hunt room to manuever", Bloomberg.

24 David Smith, 26 February 2023, "Things are looking up, but the deficit's far from fixed", Sunday Times.

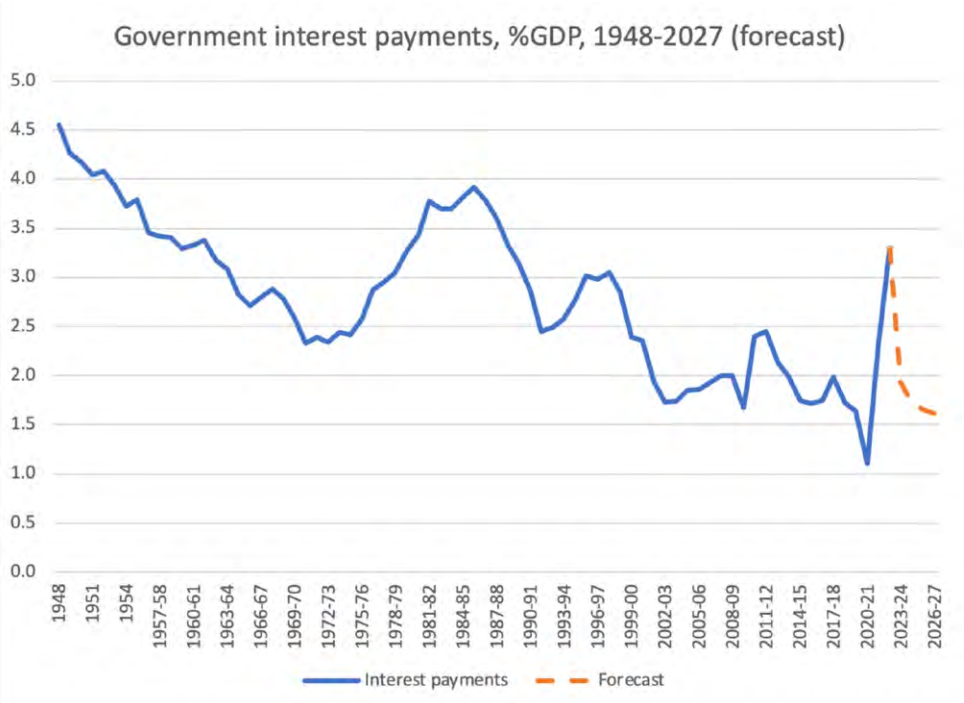
It is important to note that these rules are essentially designed and self-imposed by government, and frequently broken. There have been seven different versions of such fiscal rules since 2011. In fact, the rules were changed at the last Autumn Statement, when the deficit target was moved from three years to five years out.

However, the arbitrary nature of fiscal rules does not mean the government has no constraints on what it can do.

CAN THE GOVERNMENT BORROW MORE?

The government's own cost of borrowing has been increasing since the pandemic, in common with countries across the world. It increased very rapidly in the wake of the "mini-Budget" last autumn, but government borrowing costs have now fallen back to what they would have been without that fiscal shock.

Nonetheless, whilst interest payments for government have risen since 2021, as a share of GDP they remain well below the long-run average, as shown below, and are forecast to fall back down again over the next few years as the initial covid shock wears off.



The implication is that, whilst government borrowing costs have risen, they remain well inside sustainable levels since the expected expenditure (as a share of GDP) is set to fall. If the government needed to borrow to finance cost of living support, then this would be possible without risking unsustainable levels of debt.

CAN THE GOVERNMENT RAISE MORE IN TAXES?

It has become popular to claim that taxes have risen "to their highest level since the 1960s". But this ignores the distribution of taxation and the fact that the overall level of taxation in the UK is below the OECD average.[25] In particular, Britain taxes wealth very unevenly,[26] allowing extremely wealthy people and businesses to pay minimal tax[27] – as reports of BP and Shell super-profits, but minimal taxes, have exposed.

Support for higher taxes on wealth is growing, and, since wealth is chronically undertaxed, it also presents a low-hanging fruit for a government searching for additional revenues.

The LSE/Warwick University estimate that

- Equalising Capital Gains Tax rates to income tax rates would target overwhelmingly the richest and raise £15.6bn.
- Abolishing non-dom status would raise £3.6bn
- Extending National Insurance to investment income (eg property rental income) would raise £9.6bn.[28]

25 https://data.oecd.org/tax/tax-revenue.htm

26 Arun Advani, Emma Chamberlain, Andy Summers (2021), A Wealth Tax for the UK, LSE: Wealth Tax Commission.

27 Arun Advani, Andy Summers (June 2020), "How much tax do the rich really pay? New evidence from tax microdata in the UK", CAGE policy brief 27. https://warwick.ac.uk/fac/soc/economics/research/centres/cage/manage/publications/bn27.2020.pdf

28 https://arunadvani.com/taxreform.html

Furthermore, the government could also introduce a tax on net wealth above a certain level, as has been implemented in other countries in an attempt to tax the very richest. It is estimated that a 1% tax on wealth above £10m would raise £11.1bn in revenue.[29]

Tax rises such as those above could pay for significant additional cost of living support, for example pay rises for public sector workers, higher universal credit payments or further extending the energy price guarantee. These tax rises would also help to offset any potential inflationary effect of cost of living support.

AVOIDING RECESSION

The economic news is currently conflicted, with earlier, very negative reports and forecasts by the IMF and others for 2023 giving way to more optimistic expectations on the basis of recent reports of job and pay growth, falling energy prices, and lower expected future interest rates. The Bank of England continues to expect Britain to have a shallow, but prolonged, recession[30] and developed economies look set for a number of years of depressed economic growth.

Under these circumstances, the case for government spending and support for households is reinforced. If demand is weak, for example due to households spending so much on essentials like energy and food costs, there is a very solid case for the government to step in and spend, to boost demand. This happened during the covid-19 crisis and set a floor to the economic collapse. Support now, even if at a lower level than that provided during the pandemic, could be expected to have a similar, positive impact.

29 https://arunadvani.com/taxreform.html

30 https://www.bbc.co.uk/news/business-64487179

The effects of squeezed household incomes, due to the cost of living crisis, are already apparent, for example in lower retail spending[31] and record numbers of pub and bar closures.[32] If households had more disposable income (either by earning more, or having more protection from rising prices of essentials) they would spend more, staving off a recession. The government could intervene and help boost household disposable income by raising public sector wages and subsidising energy and other rising costs of essentials.

In the longer term, investment in renewable energy, public transport and most likely food systems will all be necessary. The government could provide the necessary finance and direction immediately, as, for example, the US Inflation Reduction Act does for renewable energy investment.

In conclusion, additional cost of living support would not only help to protect households, it would help to support the economy through the downturn, boosting spending power and enabling the economy to bounce back faster.

31 Investment Week, 20 January 2023, "UK retail sales fall by 1% in December: decline more than expected". Note that there has been some rebound in January, with sales picking up on the back of lower fuel costs.

32 Oliver Barnes, 13 February 2023, "UK pub closures in 2022 near to highest level in a decade", Financial Times. https://www.ft.com/content/08bd9a70-63f9-49a4-8cc5-fa071d3d229a