A new social contract for the UK post-COVID-19

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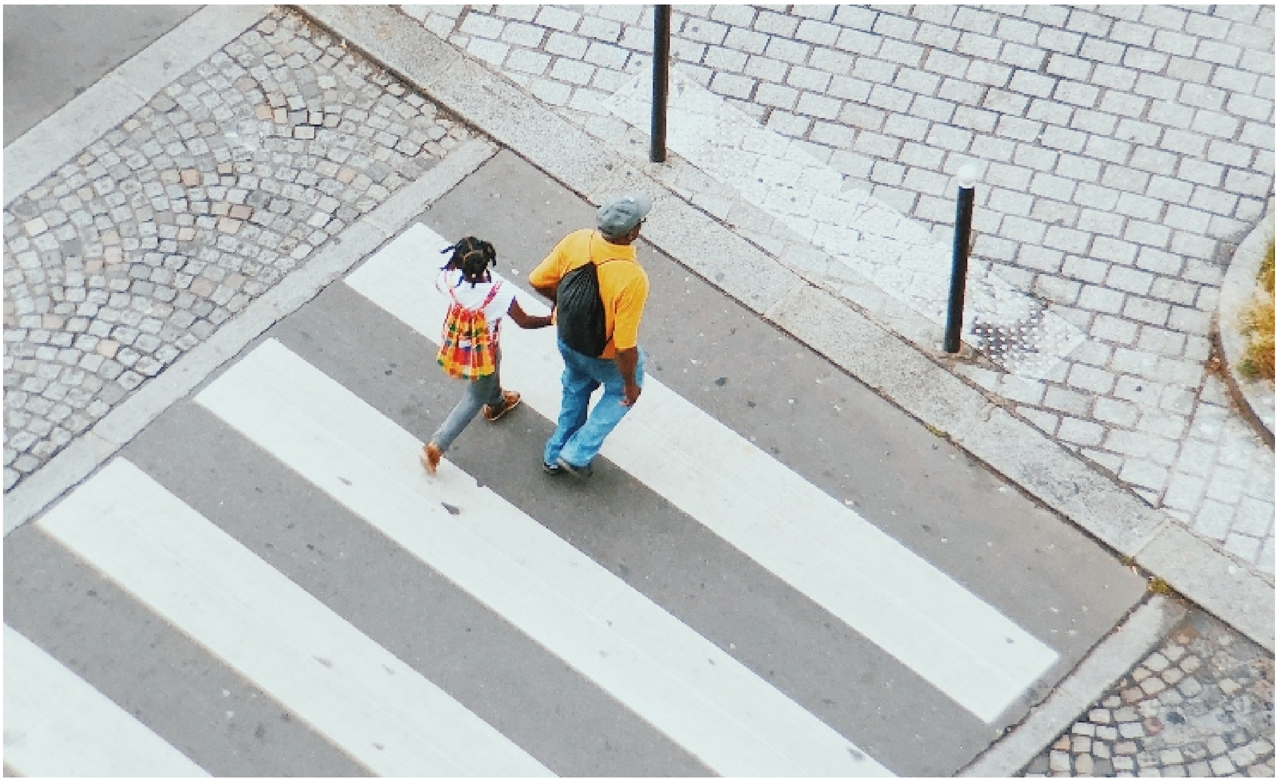

Inequalities in the UK have vast social and economic consequences, but society has clear policy tools to deal with them. Public investment and progressive taxation are key components of any plan to address the problem. ***Özlem Onaran, Cem Oyvat,*** *and* ***Eurydice Fotopoulou*** *analyse the effects of a policy mix and provide a road map to a better, greener, and more equitable UK.*

The COVID-19 crisis has laid bare that inequalities in the UK are both economically and socially destabilizing. Our research suggests that inequalities in income, wealth, gender, and race, plus weak public social infrastructure and low productivity are inter-linked. In order to address these multiple crises, public investment in social and physical infrastructure is crucial, and progressive taxation of income and wealth to fund this investment offers a fiscally viable policy package.

We analyse the effects of a policy mix of:

i) a one percentage point increase in public social spending (as a ratio of GDP) in education, childcare, and health and social care, which we refer to as the **'purple social infrastructure'**;

ii) a one percentage point increase in public physical investment in the green economy as a ratio of GDP (e.g., in renewable energy, public transport and housing);

iii) progressive taxation, with a one percentage point increase in the tax rate on wealth, a one percentage point increase in the average tax rate on profit income, and a one percentage point decrease in the tax rate on wage income;

iv) labour market policies for an upward convergence in wages while closing the gender pay gap, via a 2% increase in women's hourly wage and a 1% increase in men's hourly wage.

As a result of this policy mix, we estimate that in the medium run, GDP in the UK increases by 10.9%, women's hours of employment increase by 9.6%, men's hours of employment increase by 5.8%, and the public debt/GDP ratio decreases by 10.3 percentage points. Private investment also increases thanks to the positive demand and productivity effects.

A one percentage point increase in public social investment alone can have a large positive impact in employment and output, which increases by 2.7% in the medium run. Despite a strong positive effect on productivity in the rest of the economy, which increases by 3.3%, employment of both women and men increase, by 3.2% and 0.4%, respectively. Concretely, this corresponds to the government increasing the budget to hire more teachers in schools and nurseries, nurses and doctors in hospitals, and social care workers, as well as paying them higher hourly wages. As women traditionally constitute a high share of these occupations, this policy has a strong positive impact in terms of closing the gender gaps in both employment and pay.

Public "purple" social infrastructure investment leads to a 3.3% increase in productivity, substantially higher than the 0.5% increase in productivity led by public physical infrastructure investment. This provides supporting evidence that public social spending serves as infrastructure investment. It has long-term benefits for society as a whole and improves gender equality by socialising the invisible unpaid domestic labour of women and unleashing women's potential to fully participate in society and the paid labour market if they choose to do so. E.g., universal free childcare for sufficiently long hours benefits mothers and fathers by giving them an equal chance to balance work and life. It also benefits society by decreasing inequality between children from different backgrounds and improving their creative capacity.

Needless to say, there will always be the need and desire for care provided by family members to children or the elderly in the domestic private sphere; regulations such as parental leave for both mothers and fathers and working time arrangements that facilitate combining care and work for both men and women should ensure that time for unpaid care can be equally shared between men and women. Finally, our results show that women spend a higher proportion of their income on things that benefit the wellbeing of their children, such as health, education, and nutrition, so, as women earn more, the positive effect on long-term productivity are further compounded.

Increasing public spending is partly self-funded because it generates higher output and tax revenues due to multiplier effects. An increase in the progressivity of taxation, with higher tax rates on capital income and wealth, can support the budget further to improve the public debt/GDP ratio. In particular, an increase in the tax rate on wealth decreases wealth concentration, and has a very strong positive impact on output, private investment, employment and the budget balance. The results indicate that taxation of wealth, e.g., an inheritance tax to fund long-term elderly care, is a particularly effective policy to fund purple and green public investment. This policy mix increases the ability of the public sector to effectively respond to the multiple crises of care and climate change with a lasting effect, as well as helping it tackle inequalities. Overall, this facilitates a move towards a needs-based approach to fiscal policy, meeting both social and ecological urgencies.

Our results also indicate that labour market policies have a positive effect on output. These policies include: an increase in the minimum wage, collective bargaining coverage, enforcing equal pay legislation, and aiming at higher rates of wage increases in occupations at the bottom end of the pay scale in both the private and the public sector, where women constitute a large share of the workforce. In that sense, output in the UK is both wage-led and gender equality-led, and hence equality-led. In the medium run, higher wages also lead to higher productivity.

A next step for equitable sustainable development involve further labour market policies such as shortening the work week, with a downward convergence in weekly working hours between men and women, and an upward convergence in hourly wages.

Finally, there is also an important complementarity between gender equality, shorter working hours and green development. A larger proportion of time spent caring for each other is also a greener alternative, whether that is paid or unpaid, as these activities have a much lower carbon footprint.

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Notes:

- *This blog post is based on the authors' presentation at the Royal Economic Society annual conference (2021) of their paper "The effects of income, gender and wealth inequality and economic policies on macroeconomic performance in the UK", Greenwich Papers in Political Economy, No71.*
- *The post expresses the views of its author(s), and do not necessarily represent those of LSE Business Review or the London School of Economics.*
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