Tough economic decisions will litter the road ahead once Covid-19 crisis is over

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The government's huge fiscal response to the present crisis is designed to protect jobs, firms and incomes. The better they are protected, the quicker we can all get back to something like normal when restrictions are lifted.

The new normal, though, is not going to be like the old normal. Shocking figures unveiled last week, including those showing an eightfold increase in universal credit claims, are one early indication that, for all the government's efforts, many jobs and livelihoods are being lost. If we get out of this with a fiscal deficit of much less than £200 billion next year, we'll be lucky. Debt as a fraction of national income will ratchet sharply upwards. Disruption to education, to supply chains, almost certainly to mental health, will have long-term consequences. So, perhaps, will exposing millions of people to our rather meagre welfare system.

Even if the economy is released from lockdown by the summer, the policy priorities and choices facing government will be utterly different from those of what seems like a lifetime ago when it assumed office in December. How it makes those choices could prove even more important than the immediate response to the crisis. Here are only some of the decisions it will face.

First, how to respond to the elevated debt and deficit. If we're lucky, the economy will recover much more quickly than it did after 2010 and, after a huge spike, the deficit will fall rapidly — although that is by no means guaranteed. Accumulated debt will be higher. More austerity on the spending side is surely implausible. That suggests living with yet further elevated debt for many years, or tax rises, or both.

So, second is what to do with the tax system. The government has protected businesses and incomes. There will be a reckoning. Rishi Sunak, the chancellor, has made clear already that the quid pro quo for the very generous support offered to many self-employed last week will be some levelling up in the tax they pay to something closer to that paid by employees. Perhaps we will see higher rates of tax more generally. Successful businesses and individuals can surely expect to end up repaying some of the costs of the present support through higher taxes on profits and incomes.

Third, we might well have to deal with a surge in inflation. That's certainly the view of Charles Goodhart, former member of the Bank of England's monetary policy committee and a guru among monetary economists. Fiscal giveaways on the scale announced in the past two weeks, alongside an additional £200 billion of quantitative easing, followed perhaps by a surge in demand once we are let back out to enjoy ourselves and a probable period of supply constraints, must make that a risk. Accept the hit to living standards and the potentially profound distributional consequences, while enjoying the erosion of real debt, or push against it with tighter monetary or fiscal policy? To a large extent, that, of course, would be a question for the Bank. It has its remit, but, if it faces that decision, it will be one with profound political consequences as well as economic ones. My guess is that higher inflation will be accommodated for a while. Savers beware.

Fourth, when to withdraw support for jobs and businesses? Withdraw too soon and the whole purpose of the support — to keep viable jobs and businesses going — will be undermined. Withdraw too late and we risk propping up zombie businesses and losing the creative destruction necessary to push up productivity and living standards. The political pressure will be all for keeping support going as long as possible, probably longer than is economically optimal.

Fifth, what about the younger generation, those who have had their educations interrupted or their opportunities in the job market blighted? Children from less well-off backgrounds almost certainly will suffer a greater educational hit from losing a term of schooling than will the better off. How can we ensure that those who are due to enter the labour market this year are not permanently disadvantaged? We surely can't impose yet more burdens on younger generations and fail to act to support them while forever protecting the old?

Sixth, over the past decade the welfare system has become less generous while minimum wages have been raised sharply. Very strong employment growth, stagnating earnings and public spending restraint made this an attractive policy combination. There is a very immediate question on which the government must make a decision. The national living wage has gone up by 15 per cent over the past five years and is due to rise by another 51p an hour from Wednesday this week. That decision was taken well before the coronavirus crisis. It's hard to believe that it remains the right decision, given how many companies are struggling for survival.

It is an illustration of the political difficulty of doing anything that smacks of being ungenerous that this is one nettle the chancellor has chosen not to grasp. He will need to take a dispassionate look at commitments to continue raising the minimum wage once we know more about the future state of the labour market. He also may find recent increases in the generosity of universal credit and housing benefits hard to unwind. Returning to the status quo ante next year will immediately reduce benefit payments by £1,000 a year and more from what universal credit recipients will have become used to. That will be a tough policy to sell. Returning the housing benefit system to one based on local rents as they were in 2012 (which believe it or not is what we had until now) would surely be bizarre.

And that's just the first half-dozen issues that spring to mind. The facts have changed. We will need to be equal to the task of adapting to new realities.

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