Box B: Furlough and household financial distress during the Covid-19 pandemic – insights for future lockdowns

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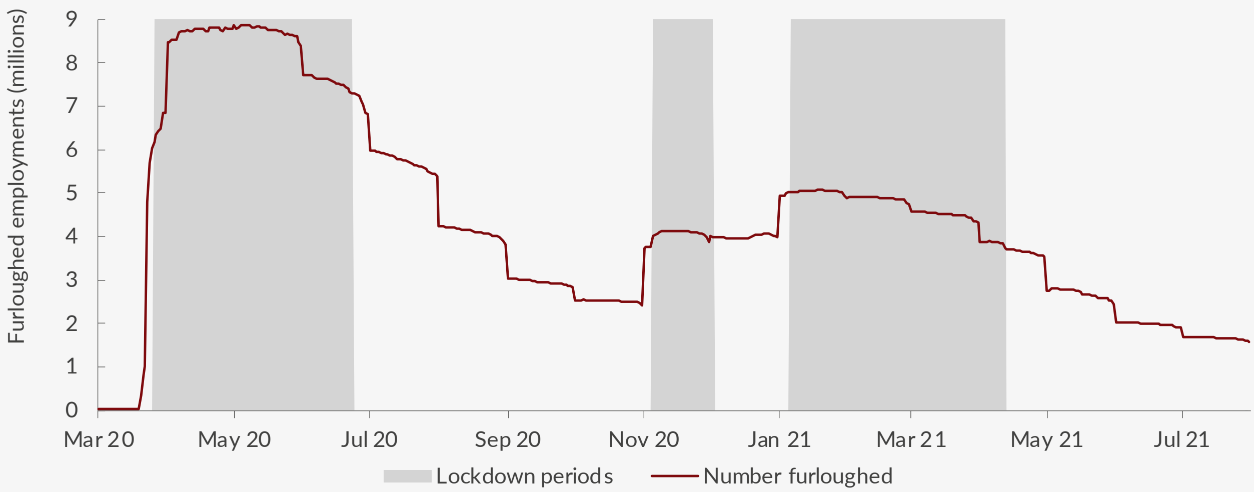
The Coronavirus Job Retention Scheme (CJRS) was a key element of the government's economic response to the Covid-19 pandemic. Introduced in March 2020, the CJRS aimed to safeguard jobs and income by allowing employers to place workers on temporary leave rather than making them redundant. A benefit of the scheme to employers was that they could reduce their wage bill while they closed during national lockdowns or in the face of low demand, as the government paid 80 per cent of furloughed workers' wages, up to a maximum of £2,500 per month. When business conditions returned to normal, employers could draw upon their furloughed workforce to reactivate their businesses without incurring hiring costs and delays. Additionally, by maintaining links between employers and employees, the scheme avoided the loss of firm-specific skills.

Figure B1 shows that firms furloughed staff primarily at the beginning of national lockdowns, as these were times of acute uncertainty surrounding future business conditions and when the government required many businesses to shutter. During the pandemic, 25 per cent of UK employees are likely to have been on furlough for at least one month, with the scheme supporting 11.6 million jobs.

Figure B1 Number of furloughed employments



Source: HMRC coronavirus (Covid-19) statistics. Note: Grey shaded bars show the times of national lockdowns

For workers, the CJRS provided an income safety net by preventing a large fall in income that would have arisen in case of redundancy. However, most employers chose not to contribute to furloughed workers' wages, so that the average person on the CJRS experienced a 17 per cent contraction in monthly income.

A key question is whether CJRS-induced income reductions provoked financial distress among furloughed workers. Görtz et al. (2021) provide evidence on this question using data from the Understanding Society database that tracks a household's finances at eight points in time between April 2020 and April 2021. This household survey is representative of the UK population and covers almost the entire time during which employees could be newly registered on the CJRS. From 11 June 2021, it became impossible to furlough new workers and the CJRS was gradually scaled down before it was discontinued at the end of September 2021. The CJRS was vital during lockdowns and facilitated their implementation by preventing widespread household default, thereby increasing their acceptability amongst the public. It is likely that a kind of furlough scheme would need to be reinstated should national lockdowns be necessary in future. For this reason, it is now a good time to take stock of the effects of the CJRS on household finances.

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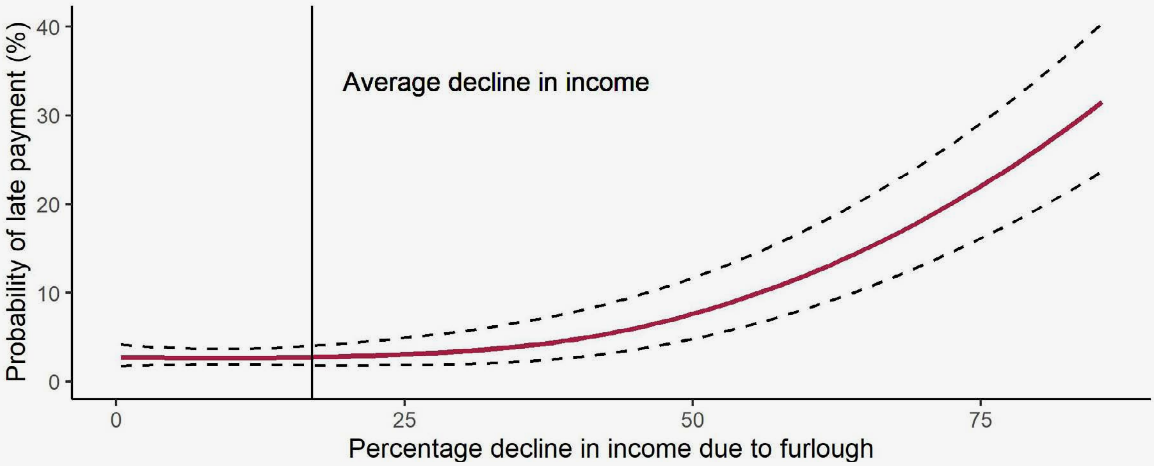
Evidence shows that a furloughed worker was approximately 30 per cent more likely to be late on housing payments, and 9 per cent more likely to be late on bill payments, relative to a non-furloughed worker. Despite these seemingly large effects, the overall rise in the incidence of financial distress in the UK during the pandemic due to the CJRS was modest, equivalent to a 2 percentage point increase. A key question in light of the potential future need to reinstate a furlough scheme is whether increasing the generosity of government contributions to furloughed workers' wages would have alleviated financial distress. Figure B2 shows a similar probability of being late on either housing or bill payments between workers who experienced a furlough-induced income fall, for falls of up to 20 per cent. The rise in probability of financial distress was however increasing in the extent of income fall above 20 per cent, which only occurred for workers whose earnings fell foul of the CJRS' £2,500 monthly cap i.e. those towards the top of the earnings distribution.

Raising the government contribution above 80 per cent would therefore have a limited effect on mitigating financial distress. Raising the cap may have a larger effect, though a future government would need to consider the distributional consequences and policy desirability of such a move. In contrast, cutting the government contribution below 80 per cent would likely produce large increases in financial distress. Figure B2 shows that a 40 per cent furlough-induced income contraction increased the probability of financial distress by approximately 10 percentage points (30 per cent) whereas a 60 per cent cut to monthly income raised the likelihood by almost 70 per cent compared to non-furloughed workers. While lowering the government's contribution to wages would reduce pressure on public finances, this would likely contribute to a much higher incidence of financial hardship during the pandemic.

Internationally, there are vast differences in the design of furlough schemes, which partly result from the variety of different complementary social security mechanisms in place. Abstracting from details, in France the government wage contribution only accounted for 70 per cent of a worker's gross income; in Germany it was 60 per cent for workers with children and 67 per cent for those without. Evidence in Görtz et al. (2021) shows that the 80 per cent government contribution to furloughed workers' wages under the UK CJRS minimised the incidence of household financial distress at the lowest cost to the taxpayer.

Figure B2 Effects of decline in income due to furlough on probability of financial distress.



Source: Görtz et al. (2021) based on Understanding Society Data. The solid line denotes estimated probabilities. Dashed lines indicate 95% confidence intervals.

References

Görtz, C., McGowan, D. and Yeromonahos, M. (2021) 'Furlough and Household Financial Distress during the Covid-19 Pandemic' (August 31, 2021). Available at SSRN: htt ps://ssrn.com/abstract=3914975 or htt ps://dx.doi.org/10.2139/ssrn.3914975