Box B: A Targeted Furlough Scheme to help the economy in downturns

By Christoph Görtz, Danny McGowan and Paul Mortimer-Lee[1,2]

Proposal

The Coronavirus Job Retention Scheme (CJRS) is an important success story of the Covid-19 pandemic in the UK. The policy supported household finances by guarding employees from redundancy while also relaxing businesses' financial constraints by lowering their wage bills. However, it is often overlooked that the CJRS was vital in making possible national lockdowns during 2020 and 2021, thereby curtailing the spread of the disease. For a future lockdown to be feasible would require the simultaneous reintroduction of a furlough scheme (Görtz et al., 2021) and there may be applications of a version of this scheme in any future economic downturn. In principle, this could be an automatic stabiliser that complements other fiscal policy responses to a downturn. Germany and Switzerland have long-standing furlough schemes that were successfully deployed during the great recession and have remained in place since. Evidence shows these schemes help firms reorganise their operations during episodes of severe financial distress and that they tend to recover without capital and jobs being destroyed through bankruptcy. These are targeted schemes such that only affected sectors would be eligible. Ultimately, this is a question for politicians who would need to decide whether public finances are able to bear the scheme's cost.

While further measures may not be required to contain Omicron, given its lower level of severity, new more virulent mutations may emerge, and the government should be ready with suitable measures if that occurs. Even in the absence of lockdown measures, firms and workers in certain industries are more severely affected by a high incidence of Covid-19 as people change their consumption habits and reorient their lifestyle choices towards those activities involving less contact with others to avoid infection. Government communications advising 'working from home' also contribute to these behavioural changes. The adjustment in household behaviour to different levels of infection risk has been widely observed during previous waves of the pandemic due to its importance for the aggregate economy, it is an integral part of the transmission mechanism in virtually any macroeconomic-epidemiological model (see e.g. Eichenbaum et al., 2021).

Impact of CJRS

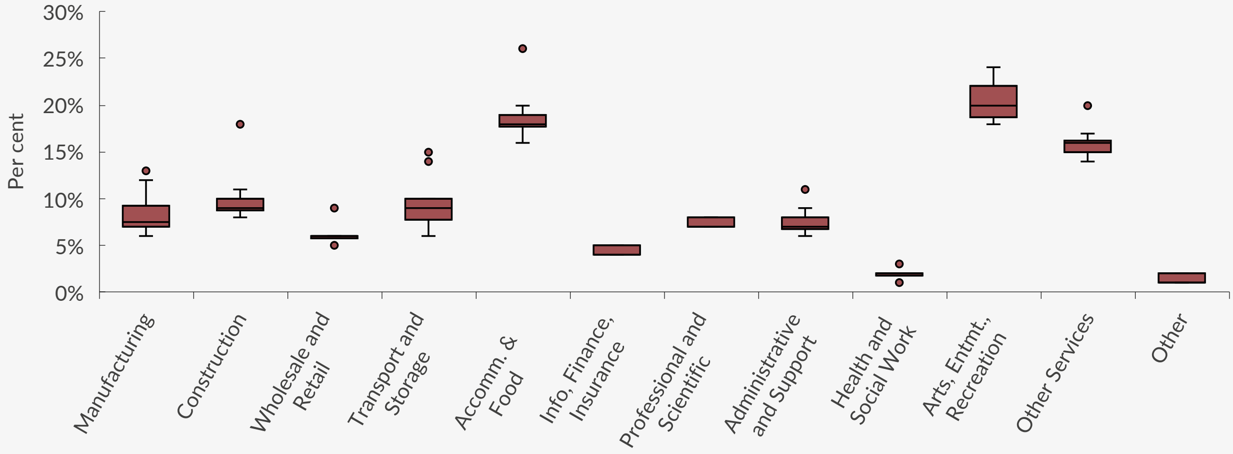
Employers in hospitality, tourism, and sectors where social distancing is difficult to implement are more adversely affected by high Covid-19 caseloads through falling custom and lost revenue. Ultimately, this puts pressure on jobs in these industries that is felt to a lesser extent elsewhere in the economy. Indeed, sectors that rely on online delivery and can remotely deliver services may benefit from a wave of infection as demand increases. The CJRS was used by 1.3 million employers and supported 11.7 million jobs. At the peak in May 2020, it applied to 8.9 million jobs. Implemented in a hurry, it was a hugely expensive blanket scheme, costing almost £70 billion (not including the cost of the Self Employment Income Support Scheme). ONS data show that 27 per cent of businesses experienced a decline in turnover compared to normal expectations during the pandemic. While not all of these firms experienced the 15 per cent turnover decline that we outline, this suggests that, conservatively, the targeted scheme would have saved a minimum of £51.1 billion compared to the universal CJRS.

Our assessment is that it did not need to be so all-encompassing since the take up rates were so variable. Figure B1 shows how much take-up rates varied by industry across regions. Some industries were far more affected than others, with Food and Accommodation, Arts and Entertainment and Other Services sectors having take-up rates in June last year of about 20 per cent, double that in other sectors. In some sectors, regional take-up rates showed considerable variation. Designing a furlough policy that supports firms and employees through the pandemic should therefore be targeted towards certain firms, as is the case in other countries, rather than broad based and free of eligibility criteria as the CJRS was during previous lockdowns.

1 Christoph Görtz is Associate Professor in Macroeconomics at the University of Birmingham, Paul Mortimer-Lee is Interim Deputy Director at the National Institute of Economic and Social Research, Danny McGowan is Professor in Finance at the University of Birmingham.

2 The authors would like to thank Jagjit Chadha and Rory Macqueen for valuable comments and Amber Rivett for research assistance.

Figure B1 Furlough Take-up Rates by Industry; Regional Spread, June 2021



Source: ONS

Targeted Furlough Scheme

We suggest introducing a new policy tool, the Targeted Furlough Scheme, as a response to the challenges that lie ahead during the pandemic. This scheme incorporates the successful elements of the CJRS. Research shows the UK government's 80 per cent contribution to a furloughed worker's monthly wage up to a limit of £2,500 each month was effective in minimizing the incidence of household financial distress at low cost to taxpayers (Görtz et al., 2021). The CJRS avoided widespread household default due to mass unemployment and relaxed firms' financial constraints during lockdowns. It also helped to revive economic growth following the lifting of lockdown measures as retained employer-employee links allow firms to quickly reactivate their operations without having to incur time and monetary costs of hiring new workers.

However, the CJRS was effectively available to all firms as employers could self-assess whether their finances had been detrimentally affected by the pandemic. The lack of eligibility requirements and compliance monitoring exposes public finances, and taxpayers, to potentially high costs as firms that experience non-Covid-19 related financial difficulties may use the scheme. A further unintended consequence is that zombie firms remain active rather than closing down, thus preventing the reallocation of resourcesto more productive firms and reducing UK productivity growth (Gemmell et al., 2016). Media reports also highlight instances of workers being asked to commit furlough fraud by their employer demanding they continue working while furloughed (McCullough, 2020). This raises questions about working conditions.

While the scheme's detailed design had some flaws, the timing of the scheme could have been optimised. This is important as the CJRS is a heavy burden for public finances. When the CJRS ended on September 30 last year, there were 1.16 million people on the scheme, working for 410,000 employers. However, when the scheme ended, there was no noticeable increase in unemployment questioning whether the scheme could have been ended earlier than September without severely impacting unemployment. At the end of October, 16 per cent of businesses who were still trading reported that they had employees on furlough when CJRS ended. Two-thirds of those businesses' employees went back to work on full hours and only 3 per cent were made redundant. When the scheme ended, 28 per cent of the jobs on furlough, or 328,000 employments, had been continuously on furlough since March 2020. The lack of a noticeable unemployment response to furlough indicates that the scheme was prolonged unnecessarily, inflating its cost. What was needed was a targeted approach, giving businesses support when they needed it, but not providing artificial aid to businesses who would likely have failed in the absence of Covid-19.

The Targeted Furlough Scheme we propose contains eligibility and compliance monitoring measures. For example, as is the case in other countries, firms would have to be able to demonstrate, by reference to annual and management accounts and bank statements that an employee's work has been stopped by Covid-19, and that turnover had fallen by at least 15 per cent because of pandemic-related reasons, to access the scheme. With large numbers of firms applying, self-assessment with a risk-based ex post assessment of eligibility might be adopted. These features would ensure support is targeted towards businesses in hard-hit sectors, ensuring that taxpayers' money is used prudently while also limiting competitive distortions. This approach has been widely used abroad, e.g., in Ireland, France, Canada, Australia and Sweden. In Ireland firms were only eligible to place employees on furlough if they experienced a 25 per cent fall in turnover and were unable to pay normal wages and outgoings. Sweden explicitly made eligibility conditional on a company suffering from 'temporary and significant financial difficulties due to Covid-19. A combination of the Irish and Swedish criteria seems also suitable for a Targeted Furlough Scheme for the UK.

The CJRS was very successful in shielding most of the workforce from being in financial distress. The absence of the scheme would have resulted in a sharp rise in unemployment. GDP in April and May 2020 was almost 25 per cent lower than in the final two months of 2019, which could have translated into a rise in the unemployment rate of up to 8 percentage points on the basis of previous relationships (though without lockdown, the fall in GDP could have been smaller). Many firms would have ceased trading, leaving permanent labour-market scarring. In those circumstances, lockdowns would have been very difficult to introduce and enforce. When redesigning a furlough scheme for the UK, it must be noted though that particularly for those with below median incomes and without a university degree, being furloughed during 2020 and 2021 implied a substantially heightened risk of being in severe financial difficulties (Görtz et al., 2021). For those at the poverty line, even the smallest adverse income shocks mean struggling to pay bills. Over 80 per cent of furloughed individuals earning minimum wages were in severe financial difficulties during furlough resulting in late bill and housing payments. Household default is not costless for our society and implies severe hardship for the affected families. A Targeted Furlough Scheme for the UK should shield those at the poverty line from income shocks. This can for example be achieved by providing a 100 per cent government contribution to wages of furloughed individuals employed at minimum wage. This additional 20 per cent government contribution for those individuals would have cost the taxpayer less than 1 per cent of the total spending on the CJRS during 2020 and 2021. Alternatively, one could also introduce a mandatory 20 per cent employer contribution for furloughed individuals at minimum wage that complements the 80 per cent wage payments covered by the government.

The suggested Targeted Furlough Scheme reaches those firms and their employees in financial difficulties during a severe time of the pandemic. It builds on the success of the UK CJRS during previous lockdowns. Germany and Switzerland have shown that a well-targeted furlough scheme can be an effective policy tool also outside of lockdowns – these countries used it very effectively to dampen the economic effects of the 2007 Financial Crisis. Outside a national lockdown, the CJRS in its current form seems a less desirable policy instrument as it lacks elements such as eligibility restrictions and compliance monitoring. However, the Targeted Furlough Scheme may provide a complement to other automatic stabilizers.

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