Next steps to support family incomes in the face of the coronavirus crisis

25 March 2020

Torsten Bell, Mike Brewer, Laura Gardiner, Karl Handscomb & Dan Tomlinson

The Government has set out an unprecedented package of support for family incomes, including paying 80 per cent of the wages of employees who currently have no work, via its Coronavirus Job Retention Scheme. Delivering that scheme should be the top priority, given its crucial role in preventing a very steep rise in unemployment and a deeper recession. However, the Government should also address significant gaps within the current response, which are the focus of this note. This should include – but certainly not be confined to – the important provision of more compensation for falls in income among self-employed people. Further measures should include support for those employees who still lose their jobs despite the retention scheme and measures to help others experiencing hours cuts, groups that are effectively in a similar position to the self-employed whose work has dried up. To address these gaps the Government should implement a further, broad policy package with three components:

First, the Government should make immediate changes to the social security system to ensure people receive more support if their income falls, recognising that means tests in the system currently prevent it providing much compensation;

Second, the Government should replicate the support of the Coronavirus Job Retention Scheme via a new Coronavirus Compensation Scheme, both for the self-employed and employees losing their jobs; and,

Third, the Government should extend the retention scheme to cover the proportion of earnings lost among those employees experiencing hours cuts, rather than just protecting those whose pay falls to zero.

Wherever possible, the policy response must protect family incomes from the economic hit of this crisis, and also avoid deepening that hit. This is why it is particularly important to include those whose working hours are cut in the retention scheme, so that those who are still able to do some work retain strong incentives to do so. At the same time, the details of the retention scheme must be got right, by making sure firms can use it to cover workers who are off sick, thereby addressing problems with the coverage and generosity of Statutory Sick Pay.

While a huge amount has been done by the Government in recent days in stepping up its economic response to this crisis, a huge amount remains to do. This note provides a practical set of recommendations of what those next steps should be.

The Government has announced a bold package to support family incomes, with operationalising and finessing the retention scheme now a top priority

Last week, the Chancellor announced the Coronavirus Job Retention Scheme, under which the state will reimburse firms for up to 80 per cent of the wages of their employees who are without work because of coronavirus. This is an unprecedented policy in the UK's peacetime economic history, but a vital one. The direct effect is to reduce wage bills for firms and ease the income shock for families. It should also give workers and firms more certainty about how they will get through the months ahead, which will reduce the scale of the coming recession by limiting further falls in consumption. And by encouraging employers to retain their workforce rather than fire people, it will help firms recover more quickly once the worst of the crisis is over.

The Government's top priority should now be to get this scheme operational as soon as possible. Policy makers should also communicate the details of how the scheme will work as swiftly as possible to firms (with information appearing here as we write this). For the scheme to deliver its core objectives, it will be important to ensure that:

- Firms cannot be selective in putting some employees on the scheme while also laying off, or giving no hours to, others;
- Prior earnings are assessed appropriately for those with volatile pay, by averaging over a number of pay periods;[i] and,
- Sick workers are covered by the scheme, which is the easiest way to address Statutory Sick Pay's coverage gaps and low generosity.

Alongside this, the Government also announced a £7 billion increase in means-tested benefits. As we analysed here, this includes increasing the basic rate of Universal Credit (UC) and Working Tax Credit by an unprecedented £20 a week, an additional £1 billion targeted at those who are renting, and scrapping the minimum income floor (MIF) in UC that limits the level of support for the self-employed. While the Chancellor missed the opportunity to reform tax credits so that they can respond immediately when earnings fall, the announced measures represent a significant strengthening of support that will benefit many millions of families whose earnings fall or jobs disappear.

Attention is now focused on the self-employed, but the challenge in terms of the coverage of the retention is much broader

The Coronavirus Job Retention Scheme is intended to encourage employers to hold onto their employees during the crisis, and its assessment system is based on those paid via PAYE. This means that it does not extend to the self-employed (apart from, potentially, people employed by their own companies).

That said, the Chancellor has announced significant changes to social security support for the self-employed. As well as the removal of the MIF in UC, changes to contributory Employment and Support Allowance (ESA) were announced in the Budget, intended to support the self-employed during periods of sickness (see Box 1 for details of how the social security treatment of the self-employed has changed in the past two weeks).

Box 1: Recent changes to social security benefits for the self-employed

Historically, the self-employed have not been entitled to Statutory Sick Pay or the same social security benefits as employees (notably contributory Jobseeker's Allowance), although recent State Pension reforms have dramatically equalised their treatment. In return, the self-employed pay lower National Insurance contributions (and other taxes on labour income, if incorporated).

In addition, Universal Credit's minimum income floor meant that low-earning self-employed people received less support than in the tax credits system. In order to prevent fraud and avoid the state subsidising unprofitable instances of self-employment, the MIF used to mean that, when assessing the circumstances of the self-employed, UC assumed that anyone whose business had been operating for more than a year earned an amount at least equivalent to 35 hours of work per week on the National Living Wage. Such a policy is wholly inappropriate in our current circumstances, prompting last week's temporary abolition of the MIF. This means that self-employed people whose businesses have collapsed can claim UC and potentially be entitled to a full award, equalising the treatment of self-employed people whose work has dried up and employees losing jobs. For example, a self-employed person earning around £20,000 annually would now have an income replacement rate of 85 per cent if their earnings fall to zero, compared to 59 per cent with the MIF in operation, a very substantial boost.

This change follows the Budget announcement of the removal of the seven-day waiting period for entitlement to contributory ESA. This affects both self-employed people and eligible employees, but was specifically targeted to allow the self-employed to better use this benefit as a substitute for Statutory Sick Pay in the current crisis, albeit at reduced generosity (£74.35 for adults aged 25 and over from April, compared to the SSP rate of £95.85).

There are some policy grounds for treating the self-employed differently, not least given the objective of retaining the link between workers and firms. Moreover, it would not be desirable to have a scheme that disincentivised the self-employed from working during this period. Nonetheless, the degree of inequity in the treatment of otherwise similar people is very significant, with a self-employed worker whose business collapses currently entitled to much less income protection than an employee earning a similar amount whose employer makes use of the Coronavirus Job Retention Scheme. For example, a single adult working as an employee earning £30,000 who is furloughed under the retention scheme would see their net income (after taxes) fall from £22,800 to £18,700 (implying an 82 per cent 'replacement rate'). In contrast, a self-employed single adult with the same gross earnings whose work dries up and who therefore moves onto UC would experience a drop in net income of £23,200 to £4,700 (a much lower replacement rate of 20 per cent). However, self-employed renters in this situation would get substantially more support to account for their housing costs: if that same self-employed adult were renting a typical one-bed at the 30th percentile of market rents, their income (before housing costs) would only fall to £10,200 (a replacement rate of 44 per cent). The picture in this final example has been improved by the recent increase to Local Housing Allowance rates.

On this basis, pressure is rightly increasing on the Government from a number of quarters to offer more income support to self-employed people during this crisis. However, this is too narrow an approach to thinking about how to fill the gaps in the retention scheme. Two other gaps stand out.

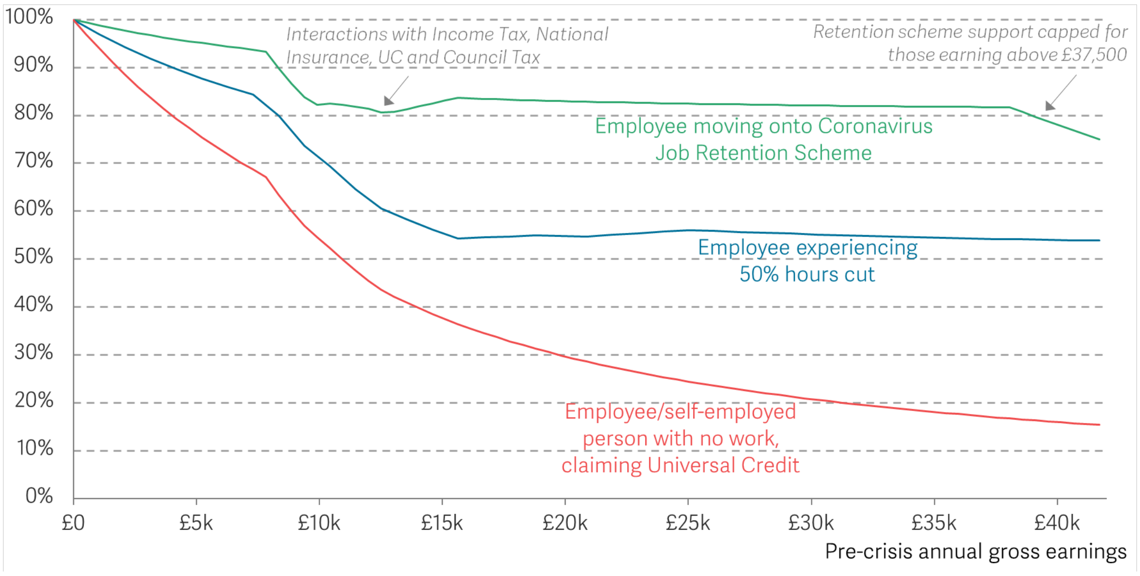
First, many employees have already lost their job, and others will still do so in the months ahead despite the job retention scheme, not least as some firms go bust. Evidence from other countries shows sharp and immediate unemployment increases in recent weeks, and a recent YouGov survey suggests that 9 per cent of all employees have already had lost their job during this the crisis. All these ex-employees will be in exactly the same boat as the self-employed whose work is drying up.

Second, those who face cuts in their contracted hours but are still able to do some work cannot benefit from the retention scheme (the same YouGov survey points out that 16 per cent of employees have already had their pay cut). For this group, cuts to their working time create a problem for family incomes. But there is a much greater issue of these workers preferring to be furloughed entirely rather than having their hours reduced. Given our wider objective of maintaining whatever economic activity we can amidst necessary measures to combat the virus, this is deeply undesirable.

Figure 1 summarises the disparities in net income replacement rates (the proportion of net income before the crisis started that is retained during the crisis) across these groups. It shows that from pre-crisis annual earnings of around £14,000 upwards, replacement rates for employees and self-employed people moving out of work and onto UC are less than half those of comparable employees on the retention scheme with the same pre-crisis earnings.

Figure 1 **Employees and self-employed people missing out on work face much bigger income losses than employees on the retention scheme**

Net income replacement rates for example single adults experiencing work reductions: 2020-21



Notes: Single adult assumed to be aged 25+ and a home owner. Employees and self-employed people actually have very slightly different replacement rates due to different National Insurance payments, but these differences are very small and so the red line simply shows results averaged across the two.
Source: RF analysis using the RF microsimulation model.

The task for policy makers, then, is to plug these three gaps in the income support package as a matter of urgency, given there is no strong case for treating these groups so differently. When doing so, it is important not only to protect incomes but to design a system that avoids making the economic hit from the crisis any deeper than it needs to be. But finding solutions for these other groups is far from straightforward. This note proposes a three-part policy package to address these gaps. The Government should:

- Make immediate changes to the social security system to ensure more people receive significant support if their income falls, recognising that means-tests in the system currently prevent it providing much compensation;
- Replicate the support of the Coronavirus Job Retention Scheme via a new Coronavirus Compensation Scheme both for the self-employed and employees losing their jobs; and,
- Extend the already-announced Coronavirus Job Retention Scheme to employees experiencing hours cuts, so as to cover 80 per cent of the earnings lost, rather than just protecting those whose pay falls to zero.

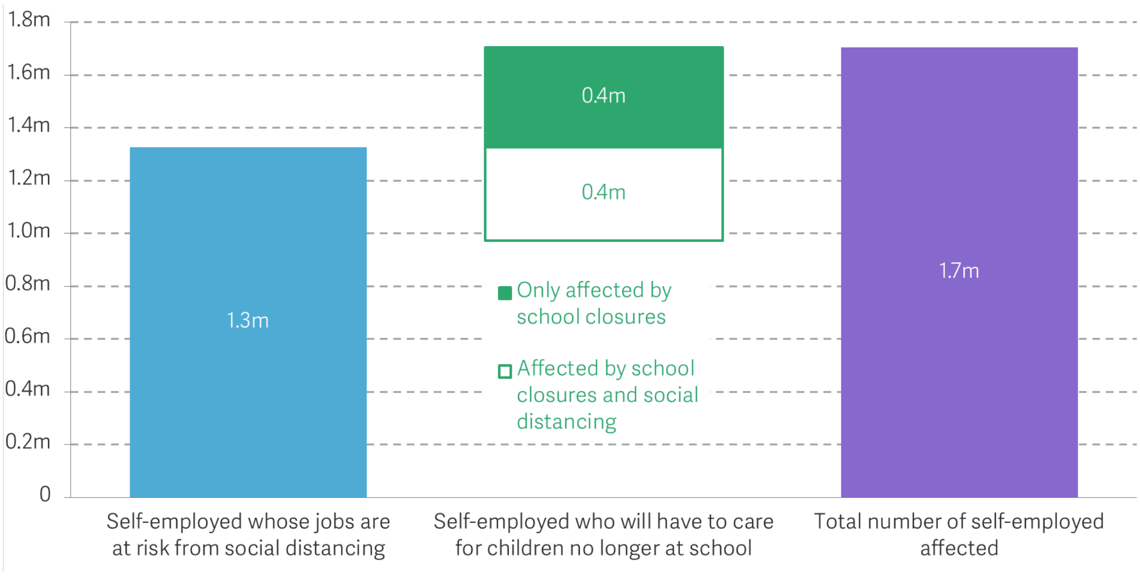
The self-employed are a diverse group and many do face significant risks in this crisis

The Government's initial focus on employees has attracted criticism, but it is understandable given that 90 per cent of those working in some of the largest and hardest-hit sectors – such as hospitality and non-food retail – are employees. Given that firms faced immediate decisions about laying workers off, and that addressing the needs of employees without work is relatively straightforward (given the existence of PAYE data), this was the right priority.

However, it is also right to turn now to support for the self-employed, many of whom face material threats to their livelihood during this crisis. We estimate, for example, that over one-third of Britain's five million self-employed people may have to stop working either because they work in sectors most heavily affected by social distancing, or in order to care for children who would have otherwise been at school (Figure 2). The number of self-employed people at risk will grow significantly if in the coming days the recent restrictions on movement are tightened further: there are hundreds of thousands of self-employed construction workers, for example. Others will also be affected by the general economic slowdown.

Figure 2 **Over one-third of the self-employed are at risk of losing their income due to government restrictions on work and movement**

Estimated number of self-employed people affected by the Government's response to the coronavirus crisis: UK, 2019



Notes: For detail on those at risk from social distancing, see: Resolution Foundation, Doing what it takes: Protecting firms and families from the economic impact of coronavirus, March 2020. The number of self-employed who will have to care for children no longer at school estimated based on sectors 'critical to the Covid-19 response' as set out in Government guidance. All those in relevant sectors (assigned according to SIC2007 four-digit level codes) are deemed 'critical'. We assume that in the first instance any non-working adult aged 19-69 who is not sick, injured or disabled will care for any children no longer able to attend school. If no such adults are in the household, then one existing worker from the household is assumed to be affected by school closures. We do not account here for children who are able to attend school for other reasons e.g. vulnerable children.
Source: RF analysis of ONS, Labour Force Survey.

As with those employees most at risk from this economic shock, the at-risk self-employed are lower paid than their counterparts working in other parts of the economy. Typical weekly earnings for at-risk self-employed people are 27 per cent lower, at £210, than the median weekly earnings of the self-employed group as a whole (£280).[ii] At-risk employees have typical weekly pay of £320, 30 per cent lower than typical pay for all employees.

It's worth noting, however, that while many self-employed people are relatively low earning and at risk of work drying up in the current crisis, not all are. There is clear evidence of 'two tribes' among the self-employed: previous research shows that while lower-earning self-employed people (sole traders) have very low earnings that have fallen since the financial crisis, they are quite a distinct group from partners and company owner-managers, who have much higher earnings.

More could be done to help the self-employed through the tax system, but this would be poorly targeted

As well as changes to the social security system, the Government's coronavirus response for the self-employed includes a delay to their self-assessment tax payment due on 31 July. More could be done through the tax system, for example by delaying these payments further if the crisis continues. Or, more ambitiously, the Government could lower bills for the self-employed, including by raising their National Insurance threshold, or by temporarily abolishing their flat-rate Class 2 National Insurance payment of £159 per year. But this approach does not seem appropriate to the current crisis because it is very poorly targeted at those self-employed people most in need of support. It would be worth nothing to self-employed people whose businesses collapse altogether, while giving a large tax cut to better-off and higher-earning self-employed workers. The tax system could play a major role in a future crisis, but it doing so will require major systems changes, building on those the Government has been slowly progressing as part of the Making Tax Digital project.

Further support for the self-employed and workers who lose their jobs should be provided through the social security system

The social security system has so far been the vehicle via which the Government has sought to provide swift support to the self-employed during this crisis. Box 1 (above) set out how recent announcements have changed self-employed people's entitlements to social security benefits. These changes have partially unwound the long-standing idea that the self-employed should receive less support through the social security system than employees, in return for lower National Insurance contributions. However, there is scope for the Government to go further in a way that will benefit both self-employed people whose work dries up and employees who lose their jobs.

Like most means-tested benefits, entitlements to UC are assessed against both family income and savings, with payments reduced if a family has savings above £6,000, and falling to zero for those with more than £16,000 put aside. This means that a self-employed worker who lives with a partner with their own earnings or who has high levels of savings may not be able to access UC at all even if their business collapses. Of course, exactly the same situation is faced by an employee who is made redundant rather than being placed on the Coronavirus Job Retention Scheme, or whose employer goes bust.

For such families who cannot access UC, the only support they will receive from the state is the residual of our contributory, non-means-tested benefits system. Subject to having paid enough National Insurance contributions (broadly speaking, having been in work and paying in for most of the past two years), these people may be able to access contributory ('new-style') ESA if they are off sick or have work-limiting health problems, or, for employees only, contributory ('new-style') Jobseeker's Allowance (JSA). These benefits have historically paid at the same rate as the basic rate of UC (a main adult rate of £74.35 from April), but unlike UC, they were not increased in the Chancellor's announcements last week.

There are, therefore, two solutions that would help people in this situation who are unable to benefit from the Coronavirus Job Retention Scheme and also receive only minimal compensation via the benefits system.

First, the Government could increase the value of those non-means-tested elements of the current system by raising rates of contributory JSA and ESA, at least equalising them with the new, more generous, rates of UC, at £94 a week, and potentially going further. We recognise that operationalising such increases is much harder than making changes to UC, but – if it can be done – it should be. To ensure support reaches the self-employed, the Government would need to (temporarily) amend contributory JSA to allow self-employed workers with sufficient National Insurance contributions to claim. The exclusion of the self-employed from contributory JSA has always been justified by virtue of their lower contributions, and the challenges of assessing their work status. Given the way that this crisis is affecting the demand for many types of self-employed work, and the considerable support being offered to employees, neither of these concerns should be a priority right now.

The effect of this change on a single self-employed person or employee with prior earnings of £30,000, and not eligible for UC due to savings, would be an improvement in net income replacement rates from 16 per cent to 20 per cent (an increase in out-of-work incomes of £1,040 per year). A typical self-employed worker in the sectors most at risk from the latest lockdown measures (earning £210 per week), would maintain half (51 per cent) of their net income after this change.

This focus on JSA and ESA raises another equity concern, which relates to the fact that, while UC has been in operation for all new benefit claims for over a year, a not insignificant number of people are still in receipt of the legacy (income-based) JSA and ESA under the old benefit regime. These people are principally the longer-term unemployed or those with lasting health conditions. Box 2 sets out the reasons why the Government would be advised to carry the recent increase to UC rates over to this group, avoiding a problematic additional inflow into UC at just the wrong time.

Box 2: Legacy benefit uprating in light of recent changes to Universal Credit

Like contributory JSA and ESA, last week's announcements did not affect the income-based versions of these benefits. Income-based JSA and ESA were closed to new claims across the country by the end of 2018, with claimants instead directed to Universal Credit. Nonetheless, there remain around 100,000 income-related JSA claimants today, who will now receive £20 per week less in benefits than their out-of-work counterparts who are already on UC or who move onto it in the coming weeks and months as the crisis escalates.

This disparity between older and newer claims is hard to justify on equity grounds, drawing an arbitrary distinction between existing claimants who are on UC and benefit from the uplift, and longer-term existing claimants on legacy benefits, who do not. This inequity is analogous to the inequity between employees and the self-employed as a result of the Coronavirus Job Retention Scheme. Moreover, this difference creates a strong incentive for the entirety of the legacy JSA caseload to close down claims and make a new claim for UC.

There are also around 200,000 remaining income-related ESA claimants in the work-related activity group. Many of these people will have protected elements in their claim so would be likely to want to stay put. But some will not and so, like the legacy JSA caseload, may be motivated to close down their claim and make a claim for UC as soon as possible. (The roughly 1.2 million income-related ESA claimants in the support group are unlikely to be motivated to make the switch, as the loss of their extra support group income during the 13-week assessment period would offset the one-year increase in the UC standard allowance.)

Given the current pressures on Jobcentre Plus services, processing tens of thousands of new UC claims unrelated to the rise in unemployment would be an extremely undesirable addition to the workload. For these reasons, and subject to the practical challenges of operationalising such a change quickly, the Government should apply the recently announced benefit uplift to income-based JSA and ESA, too.

The second approach that the Government could take in order to reduce the impact of means testing on income support from the social security system is to reduce that means testing. Within UC, the Government could limit, or temporarily suspend, the so-called capital tests on savings. Scrapping this test entirely would bring UC intp line with the legacy system of tax credits, where entitlements do not depend directly on capital at all. Although the UC IT systems would take a considerable time to operationalise formally a suspension of the savings means-test, the Government could legislate to allow both claimants and Jobcentre Plus staff to say that a family has zero savings, whatever their actual savings levels.

The Government should partner the Coronavirus Job Retention Scheme with a new Coronavirus Compensation Scheme

While many calls for greater protection for the self-employed have asked for them to be included within the Retention Scheme, that is not the right approach. This is for two reasons. First, there is a very practical issue that neither the self-employed nor employees who have lost their jobs have an employer to make a claim to HM Revenue and Customs (HMRC) on their behalf, and HMRC does not have the equivalent of recent PAYE data for the self-employed (we mention this as this looks to be the test that HMRC will use to confirm that an employee was in fact in post before the outbreak). This means that the delivery mechanism for the retention scheme just can't work for these other groups. More importantly, what those facing income hits in these groups need is compensation, rather than retention pay, and so to get it a new scheme will need to be established – a Coronavirus Compensation Scheme – operating alongside the retention scheme.

This scheme would see employees who lose their jobs, and the self-employed whose work dries up, applying direct to the state for compensation, without using employers as the delivery mechanism. The approach should be consistent across the self-employed and employees losing work, which would suggest that payments could be made at the same 80 per cent level as that seen in the retention scheme, but crucially that the mechanisms for proving past income would be different.

For the self-employed, as in schemes being introduced in countries like Norway, compensation levels should be based on an average of up to (depending on how long someone has been self-employed for) three years of past profits, as reported on self-assessed tax returns. To make such a system implementable, individuals should report those profits to HMRC. This is not a perfect solution, especially given the volatility of income of the self-employed: we estimate that the earnings of the average self-employed person changed by one-third between 2016-17 and 2017-18, compared to a change of just 9 per cent for the average employee.[iii] But it seems the best that can be done in relatively short order.

For laid-off employees, the information required is much easier to provide via recent pay slips. Again, HMRC has access to PAYE data to check for fraud.

The Government should also extend the Coronavirus Job Retention Scheme to cover employees facing hours reductions

Although the existing retention scheme cannot be used to cover the self-employed, it should be used to reduce the income hits for those experiencing reductions in hours. The scheme should be extended to cover the portion of pay lost for those experiencing hours reductions at the 80 per cent rate, rather than the current binary approach which just replaces pay for those whose hours fall to zero.

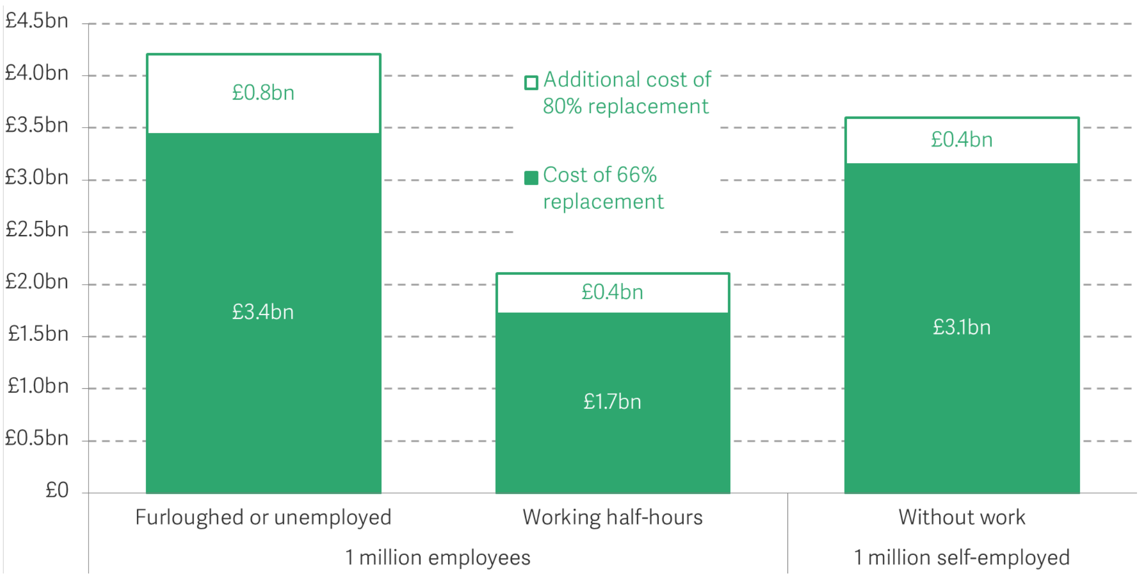
This is important both to reduce the fall in family incomes for those affected by cuts in hours, but also crucial in avoiding accidently increasing the hit to economic output that will arise from the outbreak. Specifically, this extension will remove the incentive for individuals to not work at all (and thereby receiving 80 per cent of their previous pay), rather than continuing to, for example, work half time (and have their pay cut in half).

These measures will bring will bring further significant costs for the Exchequer

These new measures would extend an already unprecedented package of measures set out by the Government. To illustrate the scale of the costs involved, Figure 3 sets out the gross costs to the state of an example caseload of one million people in each of the different groups discussed moving onto a new compensation scheme, or the existing retention scheme, over an initial three-month period, with incomes replaced at 80 per cent. Given the significant pressure these schemes collectively will place on the Treasury, we also provide costings for a lower 66 per cent replacement rate, although the Government may well feel it cannot now row back on the 80 per cent promised for retained employees.

Figure 3 **Retention and compensation schemes in the current crisis entail significant Exchequer costs**

Estimated costs of the Coronavirus Job Retention Scheme and Coronavirus Compensation Scheme per one million beneficiaries, over three months: UK, 2020-21



Notes: The total size of populations shown is broadly in line with the increase in unemployment that took place following the financial crisis (1.09 million). The composition of the population is determined such that those at 'high risk' of unemployment are four times as likely to use the scheme as those at 'low risk', and those at 'medium risk' are twice as likely to use the scheme as the 'low risk' group. 'High risk' is defined as those working in industries most likely to be directly affected by the public health response to coronavirus, e.g. retail of non-food products, passenger air transport, recreation, hotels, restaurants and pubs. 'Medium risk' is defined as those who work in occupations for which home-working is all but impossible, assumed to be Standard Occupational Classification codes 5-9. 'Low risk' is all other employees/self-employed people. We assume that some low-risk employees will need support not because of the direct impact of the public health response, but because of the broader hit to demand that it causes. Costed using 2019 figures for gross weekly pay for employees, and 2017-18 figures uprated by inflation to 2019-20 prices for self-employed.
Source: RF analysis of ONS, Labour Force Survey; DWP, Family Resources Survey.

The cost for self-employed people is slightly lower than an equivalent scheme for employees – £3.6 billion if one million were to move on a retention scheme with an 80 per cent replacement rate – given their lower earnings. Given these costs, the lower typical earnings of the self-employed, and the need to avoid incentivising highly-paid self-employed workers to stop work, there is a case for considering a lower payment cap in the Coronavirus Compensation Scheme than the £2,500 per month that exists in the retention scheme for employees. This would mirror the approach taken in France, where support for the self-employed is limited to a payment of 1,500 Euros.

Designing such a compensation scheme at the same time as building and widening the existing retention scheme will not be easy. As well as the cost of the payments, building a scheme will take focus and time. Given the huge pressures on the Government right now, prioritisation is important. Crucially, to ensure firms don't lay huge swathes of staff off, and to reduce the scale of the demand shock in the months ahead, the immediate priority must be getting the Coronavirus Job Retention Scheme up and running. Alongside that, work should proceed on a new Coronavirus Compensation Scheme, but with less time pressure. This is because those self-employed people and those made redundant who face deep hardship will be able to access the social security system (especially if amended as we recommend), and people would be reassured that wider compensation for lost income was coming.

Conclusion

Income hits will happen during this crisis. The Government's objective should be to reduce their impact by sharing the burden, thus preventing hardship and reducing the overall demand shock to the economy that could arise from fear of huge, long-lasting reductions in families' income. Alongside implementing the Coronavirus Job Retention Scheme set out last week, the immediate priority for Government should be to continue making the benefits system even more supportive to the self-employed and to employees who lose their jobs, so that people experiencing big income falls get something from state. Beyond that, the Government should work on a Coronavirus Compensation Scheme to address the income replacement gaps that would still be faced by the self-employed and employees still losing their jobs.

The Government took unprecedented action last week, for which it should be commended. But while a huge amount has been done, a huge amount remains to be done. The steps above aim to provide a practical and implementable guide as to how Government should proceed.

---

[i] Given many workers, for example those on zero-hours contracts, have fluctuating earnings, it would be prudent to assess 'prior' earnings over a longer period than just the most recent pay check. For example, Statutory Maternity Pay averages earnings over eight weeks prior to the relevant pay check.

[ii] Source: RF analysis of DWP, Family Resources Survey.

[iii] Source: RF analysis of ISER, Understanding Society.