Resolution Foundation

BRIEFING

Getting Britain working (safely) again

The next phase of the Coronavirus Job Retention Scheme

Torsten Bell, Laura Gardiner & Daniel Tomlinson

Acknowledgements

The authors would like to thank those who took part in roundtable discussions to help develop the thinking and recommendations in this report. Any errors, of course, remain the authors' own.

Download

This document is available to download as a free PDF at:

https://www.resolutionfoundation.org/publications/

Citation

If you are using this document in your own writing, our preferred citation is:

T Bell, L Gardiner & D Tomlinson, *Getting Britain working (safely) again: The next phase of the Coronavirus Job Retention Scheme,* Resolution Foundation, May 2020

Summary

The Coronavirus Job Retention Scheme (JRS) has been a major public policy success. The unprecedented step of paying 80 per cent of the wages for 6.3 million jobs has made it possible to ask people to stay at home to save lives. In so doing, the scheme has protected livelihoods, prevented an almost unimaginable rise in unemployment, and reduced the depth of this economic crisis.

The scheme has been expensive, at £8 billion to date. Far from this price tag being a problem, it reflects how badly needed the JRS was, and is. The first priority for the Government, therefore, should be to do nothing that endangers the core objective of the scheme: enabling the necessary response to fight the virus, while avoiding a deep economic hit for families and economy as a whole.

Those advocating simply ripping the JRS plaster off immediately fatally misunderstand the context within which we are operating. Britain is heading for horrendous unemployment levels, with even benign forecasts suggesting we will have the highest unemployment rate in more than 25 years. The record employment of the past decade has made us too complacent about the risks of lasting worklessness. This crisis may well pose deeper challenges on that front, with low inflation likely ruling out the downward real wage flexibility that protected jobs, but hammered incomes in the aftermath of the financial crisis. Crucially, the traditionally labour-absorbing sectors in recoveries are the very ones most likely to be shedding labour in this one. In 2010 and 2011, hospitality and non-food retail accounted for just 10 per cent of employment, but 22 per cent of employment entries from unemployment.

So high costs or ideological opposition to the JRS are bad reasons for immediately ending it in the face of the unprecedented circumstances of the current crisis. Instead, the motivation for JRS reform should be changes to the lockdown policy itself, which mean our economic objectives will shift too. Given that the timetable for adapting the lockdown is highly uncertain, so necessarily must be the timetable for any changes to the JRS. Indeed, crucially, the ordering of policy decisions must never be reversed, so that changes to the JRS drive decisions about the lockdown itself. Easing restrictions too fast could lead to a second wave of the virus, with huge economic and health costs.

But we should also reject the idea that the scheme should continue as it is until we're back to normal. As the lockdown begins to be lifted, we move to actively wanting some economic activity to take place. This will be a long road. Policy makers should not be thinking in terms of bouncing back to an old world, but instead aiming to optimise policy for a messy interim period dominated by social distancing.

The decisions to come about the JRS are much more complex than those taken upon its unprecedented, but ultimately relatively straightforward, introduction. The JRS must be flexible enough to varying timetables for change and very different impacts across our economy. Trade-offs between objectives will also be more acute than during the hard lockdown. For individuals, we will want to minimise unemployment while also avoiding long periods on furlough that do not lead to a successful return to a previous job, given the scarring risk to wages and human capital in the future that such periods entail. And the reality that firms face big uncertainty about the level of demand for their output as they reopen brings risks of going too fast in phasing out the JRS (if changes force firms into bigger-than-necessary lay-offs), or too slowly (with individual firms worried about weak demand creating a self-fulfilling prophesy in aggregate).

Against that difficult backdrop, policy makers should focus first on some easy wins. The JRS needs to move as soon as possible to supporting partial furloughs, where workers can do some work, albeit less than they did pre-crisis. Such a shift would support incomes now, with three-in-ten businesses still in operation reporting that they had reduced staff hours, and ensure that the JRS encourages – rather than discourages – a return to economic activity in the months ahead. Proposals for flexibility based on each week being either on or off work are not likely to offer enough flexibility. **We recommend that full (hourly) flexibility is introduced from the start of June onwards.** This greater flexibility will bring with it an increased risk of fraud, which should be taken seriously and addressed. **We recommend that firms are required to report the days on which workers are working, and that enforcement measures are ramped up. This should include significant fines, aggressive naming and shaming of firms abusing the system, and HM Revenue and Customs writing to some employees to confirm the details of furloughs their employer has claimed for.**

We must also separate out the role of the JRS in directly aiding measures to limit the spread of the virus from its broader economic role. The complex trade-offs above will not apply to people fully embracing the new testing and tracing regime by staying at home when required. Similarly, we will need a scheme to protect the incomes of those required to shield, or parents who cannot work when individual schools are closed. **We recommend providing clarity now that the current JRS will continue indefinitely for these purposes that directly support health outcomes, until a vaccine renders them redundant.**

The Government cannot remove uncertainty about changes to the JRS, because it is rooted in uncertainty about our ability to lift the lockdown and the effects of such measures on the economy. So, proposals for a fixed timetable for phasing the scheme out should be rejected. But the Government can reduce firms' uncertainty by moving away from the current month-by-month extensions, signalling that change is coming, and linking it explicitly to the phasing out of the lockdown. **We recommend that all firms should be told they will have access to the current JRS until the beginning of August for workers already on furlough, and access to the JRS in some form until at least the end of September. Within that broad timetable, decisions on continuing or starting to change the JRS should be based on both our success in lifting lockdown measures, and that feeding through to aggregate demand and labour market recovery.**

When it comes to the fundamentals of how the scheme should be changed, there has been a big debate about the incentives the JRS creates. That has mainly focused on the incentives for individuals to return to work. It is true that individuals do not face a significant incentive to find other work if they can receive 80 per cent of their prior wages anyway (and much more of their net income if they are in receipt of in-work benefits), with much reduced effort and, in many cases, costs. This has led to proposals to reduce the 80 per cent replacement rate swiftly. But it is important to be absolutely clear about the incentives that we want to prioritise in the initial period, namely, getting people back to work for their previous employer. If that firm asks the employee to begin working again, the employee has a very strong incentive to do so, because not doing so means losing 100 per cent of earnings, not 20 per cent.

Instead, our focus initially should be on the incentives firms face to bring back workers. That is the incentive that will play the biggest role in determining activity levels, and that should be the focus for policy makers. Because firms currently pay none of the costs of furloughed workers' wages, they have a weak incentive to bring them back to work if doing so brings risks of whether sufficient extra revenue will follow. Here there are lessons from much longer-established retention schemes in many European countries that require the employer to cover elements of the costs of furloughs. **We recommend that the Government sets out that, when the phasing out of the JRS begins, firms will be asked to contribute towards the costs of furlough – rising from 10 per cent of previous wages over a number of months.**

That phasing out strategy will also include a range of wider policy shifts and timing questions that collectively have the goal of incentivising large parts of the economy to safely get moving again, but not removing support so quickly as to create a second-round shock to incomes and demand. In managing that process, the risks from going too fast are significantly bigger than those associated with going too slowly. **We recommend that the Government announces a draft phasing out that includes an end to new entrants (firms and employees) to the JRS from the beginning of July, the gradual increasing of firms' contributions from August and the end of full furloughs from the start of**

September. Such a timetable should explicitly be a draft, to be rolled out when lockdown and economic developments allow, and be departed from if they do not.

A major policy decision facing the Government is whether the JRS should remain one-size-fits-all across the sectors of our economy. Clearly, it is difficult to treat sectors differently, with political barriers to sectoral policy being reinforced by very real technical ones related to identifying which firms constitute a sector. But this crisis is, at its heart, a sectoral one, with the variation in initial output falls by sector almost six times as large as during the financial crisis. The sectoral nature of this crisis will persist, not least in terms of the timetable on which restrictions are lifted. The pace of supply adapting and demand recovering will also vary hugely, with the large hospitality sector likely to be particularly slow.

We recommend limited sectoral differentiation, with a core scheme timetable for the vast majority of the economy, but longer phasing out for specific sectors most affected by ongoing social distancing, like hospitality. This should cover not just the sectors themselves, but any firm deriving over half of its revenue from them.

Advocates of this approach need to recognise that some rough justice will inevitably arise, as the price for not being forced into a one-size-fits-all approach. If the Government does not want to take this differentiated approach then it will need to be much more cautious on the timetable for making changes to the JRS than that suggested above. Otherwise, the risk is that a large proportion of the estimated 1.7 million hospitality workers currently furloughed are laid off en masse.

What marks these sectors out as needing a longer period of support is that it is close to impossible that supply or demand in them will increase to its new (probably at least somewhat lower) steady state in short order. In addition, these sectors face at least some uncertainty about how big output in that new steady state will end up being. Allowing them more time to slowly expand and figure this out during the autumn is better than risking premature mass unemployment.

But these sectors should not be supported in this way forever. As time passes, the danger that a worker is furloughed for a very extended period and does not ultimately return to their job grows. This means resources are expended that would be better focused on that worker finding new work, and that the employee is in a weaker position to find that new work when the time comes after many months out of employment.

So, in the sectors in which the JRS is extended for a longer period, the financial incentive to take another job rather than just to return to an existing one becomes increasingly important. **We recommend strengthening incentives for individuals in these sectors to take a new role as the wider labour market starts to recover.** The Government should start by reducing the £2,500 cap on furlough payments to £1,500 in the autumn (pro-rated for those on the short-time working scheme), when the scheme begins to be phased out for these sectors. As a secondary priority, the Government could also consider bringing down the 80 per cent replacement rate over time.

Taken together, the changes we have suggested to the JRS in this report could limit the cost of the scheme to £48 billion, with the majority of this spending (£28 billion) taking place in April, May and June. In later months, spending falls quite quickly because take-up is assumed to decline as scheme generosity is tapered away.

If the lockdown is successfully lifted then looking beyond this autumn, the JRS is not the appropriate way to continue to support firms in the hardest-hit sectors, as the risks of prolonged worklessness grow and sectors approach their new smaller size. **We recommend that if there are elements of these sectors that the Government wishes to continue to support, for example pubs that face lower revenues in future, then grants and equity injections are more appropriate policy responses.**

While the JRS has done the lion's share of the work over the first phase of this crisis, its success in this next phase is much more contingent on broader economic policy measures. While focusing demand support via targeted measures like the JRS made most sense when we were almost completely locking down the sectors where the biggest income hits were happening, **we recommend dialling up generalised demand support as we dial down these targeted measures.** This is particularly crucial if the labour market recovery is slow to take hold. And even if the policies set out above are entirely successful, high unemployment is going to be a feature of Britain in the early 2020s, so **we recommend very significant back-to-work support, the priority for which is the already unemployed rather than those currently on furlough.** Such measures should include job guarantees (especially for the young), wage subsidies, additional training provision and the creation of green jobs to make progress on priorities that will endure once this virus is long gone.

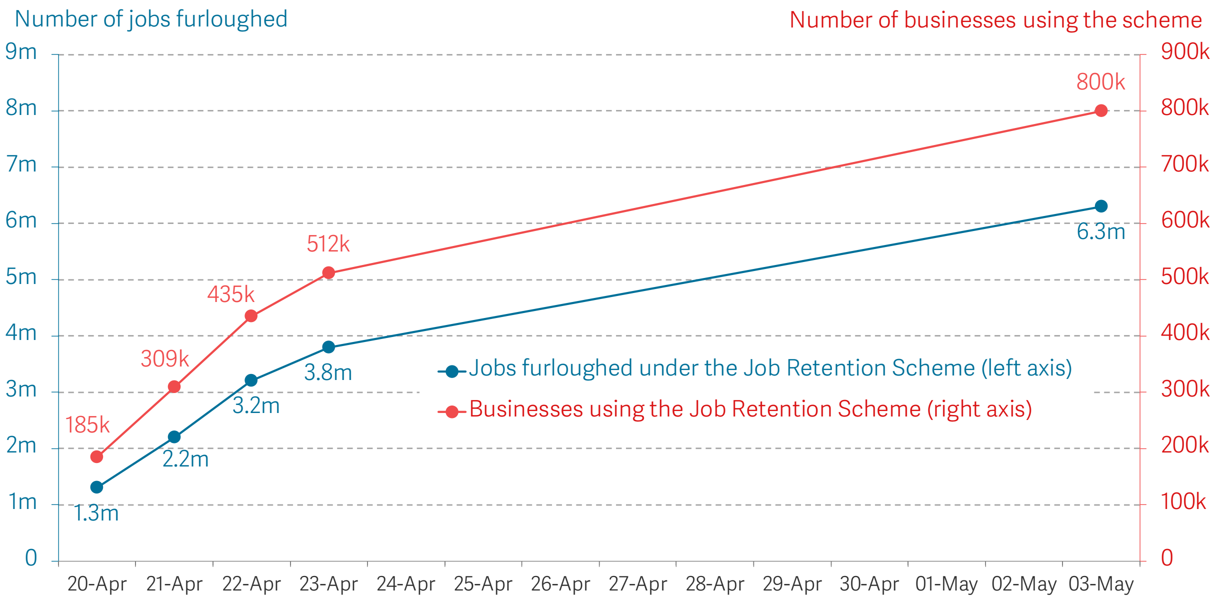
Policy makers face a range of very tough decisions in the months ahead relating to the JRS. But the cause of those challenges is the virus and the economic crisis it has created, not the scheme itself. In the context of huge unemployment that risks scarring us for years, the priority is to do nothing rash and ignore calls for a premature end to the JRS. Instead, the Government should plan for a clear, transparent phasing down of the scheme, in a way that supports health and economic objectives. Policy makers should also ensure that the timing of any changes is entirely conditional on the (very uncertain) pace of health and economic developments. And as the furlough scheme steps back from its current central role, other forms of policy must step up. That is the way to help Britain navigate the difficult times that lie ahead.

The Job Retention Scheme has done a good job to date of delivering against its original objectives

The Coronavirus Job Retention Scheme (JRS) is the main plank of an unprecedented economic policy package introduced following the outbreak of coronavirus in the UK, and the lockdown this necessitated. Alongside loans to firms, stimulus measures from the Bank of England and grants for self-employed people, the JRS was introduced to pay 80 per cent of the wages of employees without work to do. At the latest reckoning, 6.3 million jobs have been furloughed by 800,000 businesses (Figure 1), with the number of workers furloughed expected to rise further, perhaps to between seven and nine million.[1]

FIGURE 1: **The Job Retention Scheme has already supported 6.3 million jobs**

Number of jobs furloughed and businesses using the Job Retention Scheme: UK



SOURCE: HMRC.

The JRS has done a good job to date of delivering against its original objectives, which centred on facilitating the right health response and therefore saving lives, while also protecting livelihoods and reducing the depths of the economic crisis that Britain is facing. Alongside these objectives, the JRS specifically targeted putting us in a good position for a speedy economic recovery, by keeping firms afloat and maintaining productive economic relationships between them and their employees. We can summarise the five key original objectives of the JRS as follows:

1 A Verity, Coronavirus: More than 9 million expected to be furloughed, BBC, April 2020.

1. Facilitate the health response by disincentivising economic activity (to get the virus' reproduction number below one as soon as possible);
2. Support living standards with generous replacement rates;
3. Support aggregate demand with targeted cushioning of income falls and reductions in uncertainty;
4. Maintain the attachment between businesses and employees to speed up the recovery; and,
5. Limit firm insolvency through covering the cost of otherwise unaffordable wage bills.

With such high numbers already on the scheme, the JRS carries a heavy price tag. The Exchequer cost totals £8 billion to date,[2] and previous Resolution Foundation estimates suggest that costs could total £30 billion or more over three months.[3] Figures such as these have led some to suggest that the JRS represents an unaffordable burden on the public finances.[4] But this is to misunderstand the situation we are in. The Government would not want to pay the bulk of the wages of more than a quarter of private-sector employees under normal circumstances, but the cost of the JRS shows not that it is unaffordable,[5] rather it emphasises how badly needed it was, and is, in these exceptional times.

Rather than cost, or ideological opposition to the scheme, it is the changing landscape of the health-driven lockdown and its economic impact that should motivate the design and timetable for changes to the JRS that are the focus of this paper. Because the timetable for these things is highly uncertain and subject to change (Box 1 details the Government's current plans, which underpin the analysis and recommendations in this report), so, necessarily, must be any plan for changes to the JRS. It follows that if the easing of the lockdown follows different timetables in different parts of the country, then changes to the JRS may need to follow geographically divergent timetables, too.

2 HM Revenue and Customs Twitter feed.
3 R Hughes et al., Doing more of what it takes: Next steps in the economic response to coronavirus, Resolution Foundation, April 2020.
4 S Boscia, Norman Lamont: Britons not prepared for the economic hardship 'around the corner', City A.M., May 2020.
5 Previous Resolution Foundation analysis shows that even under a 12-month lockdown scenario, the ratio of debt interest payments to government revenues remains broadly stable and never rises above the Government's 6 per cent threshold. See: R Hughes et al., Doing more of what it takes: Next steps in the economic response to coronavirus, Resolution Foundation, April 2020.

BOX 1: The timetable for easing the lockdown

The timing of the easing of restrictions on daily lives is very uncertain. The Prime Minister laid out a "conditional plan" for reopening society on 11 May, but stressed that this is highly contingent on evidence on the spread of the virus.[6] This plan includes:

- People who cannot work from home returning to the workplace immediately, but avoiding public transport if at all possible;
- A phased reopening of shops, and some primary pupils returning to school, by no earlier than 1 June;
- Some hospitality businesses and public places reopening by no earlier than 1 July; and,
- Secondary pupils facing exams next year to get at least some time with their teachers before the summer holidays.

In this paper, our analysis and costings take as a given that the Government is planning its economic policy on the basis of this roadmap. However, we are clear that whether restrictions are eased on anything like this timetable remains highly uncertain, and dependent on the health data. It follows that any changes to the timetable for easing the lockdown should flow directly into the timetable for adjustments to the JRS.

In addition, we acknowledge that timetables may be different in different parts of the country. There has not been much divergence so far, despite somewhat different messaging across the different nations. But the possibility that local infection rates may diverge in future necessitates being prepared to develop the JRS in a geographically divergent manner.

Policy makers also need to recognise that the economic impacts of microeconomic policy, including around the JRS, are minor compared to the direct impact of whether or not we successfully ease lockdown without triggering a second wave of the virus. The risks here are asymmetric, however, with failed attempts to go too fast much more damaging than a slightly too slow reopening.[7] In fact, health and economic considerations do not have the supposedly stark trade-off often supposed: restarting economic activity while maintaining the reproduction rate of the virus below one is clearly desirable from both economic and wider health perspectives. And, equally, easing social distancing measures prematurely could lead not only to more deaths via a second wave, but

6 B Johnson, PM address to the nation on coronavirus, Prime Minister's Office, 10 Downing Street, May 2020.
7 R Hughes et al., Doing more of what it takes: Next steps in the economic response to coronavirus, Resolution Foundation, April 2020.

could also lead to even stricter and longer-lasting restrictions later. By creating such uncertainty about when restrictions might ever be successfully lifted, such an outcome would also undermine the broader goals of the reassurance to firms and families that the JRS exists to provide.

Underpinning all of this, the first priority is to avoid endangering the enduring core objectives of the Government's economic policy response: enabling people to do the right thing to reduce the spread of the virus, while avoiding a deeper than necessary economic hit for families and the economy as a whole.

There are big risks to removing support too quickly – we are heading for an unemployment disaster as it is

Those advocating a swift end to the JRS underestimate the huge upheavals currently happening in our labour market. Even relatively optimistic scenarios from the Bank of England and the Office for Budget Responsibility (OBR) suggest the unemployment rate will peak at 9-10 per cent in the second quarter of 2020.[8] This would be the highest unemployment we have experienced in over 25 years. And these scenarios account for the support that the JRS has been providing. Evidence from the US – where nothing akin to the JRS is available – shows unemployment quadrupling in a matter of a couple of months.[9] Given the scale of GDP falls that the Bank of England and OBR are forecasting, if we withdraw support too rapidly we can expect unemployment to soar.

While it is inevitable that, whenever support is withdrawn, a significant number of currently furloughed employees will lose jobs rather than resume working for their current employers, how significant that number is, and when this shift happens, matters. As Figure 2 shows, unemployed people have a much lower chance of exiting unemployment when the overall unemployment rate is high.

Further, it is possible that the experience of lower-than-expected unemployment during the financial crisis, and record employment over the past half-decade have made us too complacent about the risks of high unemployment. By contrast with that experience, this crisis may well pose deeper challenges – two of which are worth highlighting.

8 J Leslie & J Smith, Optimism in a time of coronavirus: While undoubtedly gloomy, today's Monetary Policy and Financial Stability Reports from the Bank of England envisage little lasting damage to the economy or financial system, Resolution Foundation, May 2020.
9 BBC, Coronavirus: Pandemic sends US jobless rate to 14.7%, May 2020.

FIGURE 2: **The chances of leaving unemployment fall when the labour market is weak**

Unemployment and the unemployment to employment transition rate: UK

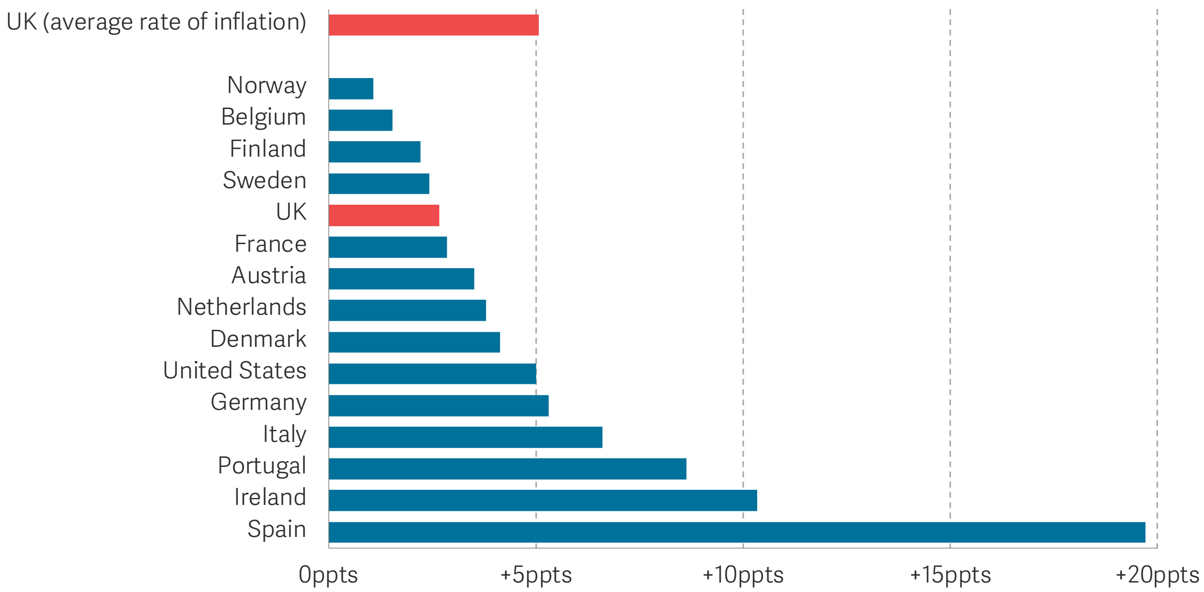
SOURCE: RF analysis of ONS, Labour Market Statistics.

First, we should remember that the key reason unemployment rose far less during the financial crisis than in the previous two recessions, despite a deeper downturn, is real wage flexibility. The depreciation of sterling fed through into higher domestic prices for imports, with consumer price inflation rising particularly sharply as a result. This meant that employers were able to adjust to lower output by allowing real wages to fall rather than cutting jobs, despite no real weakening of longstanding resistance to actual cash wage falls (downward nominal rigidity).[10] Had this not happened we might have had double the unemployment increase, as Figure 3 shows. No such opportunity is likely to present itself this time round, with inflation below the Bank of England's 2 per cent target, and according to the Bank's recent assessment, likely to fall further.[11] The global nature of the shock also means that exchange-rate-driven pressures are unlikely to significantly push inflation up in the near term.

10 S Clarke & P Gregg, Count the pennies: Explaining a decade of lost pay growth, Resolution Foundation, October 2018.
11 For more details, see: Monetary Policy Report, Bank of England, May 2020.

FIGURE 3: **High inflation held back unemployment in the previous crisis**

Change in unemployment (trough-to-peak) in the financial crisis, various countries and a modelled UK scenario based on lower inflation



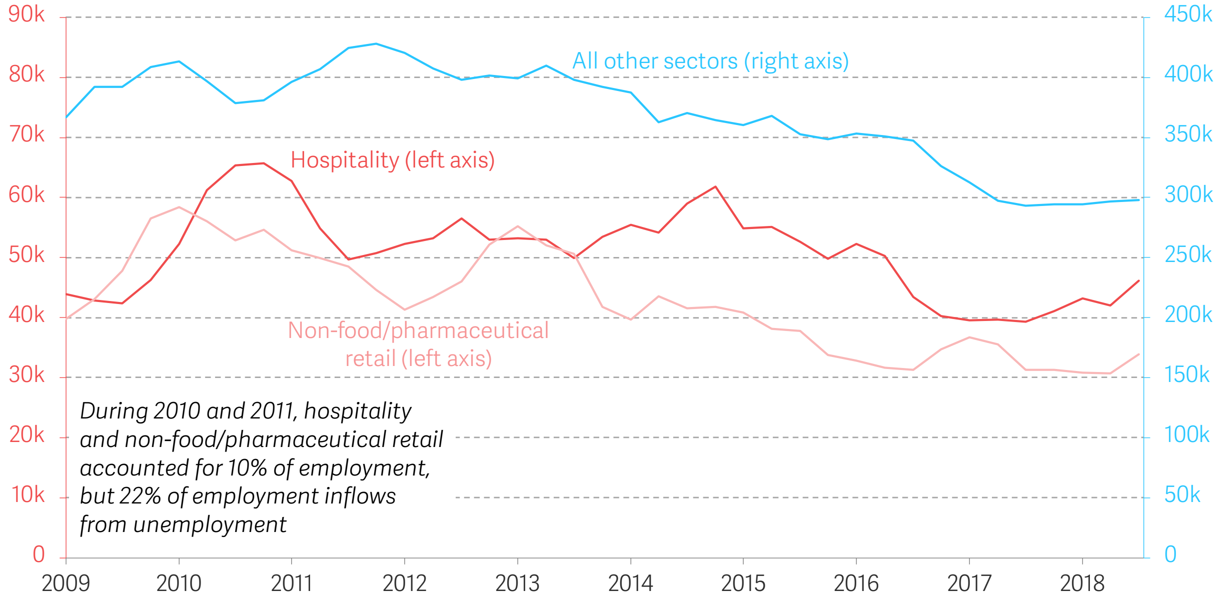
NOTES: Modelled UK scenario based on an estimate of what the change in the unemployment rate would have been had the UK experienced the average rate of inflation across the other countries shown, rather than the inflation spike induced by sterling's depreciation. Independent variables are change in consumer price inflation and change in GDP-per-capita (peak to trough).
SOURCE: Eurostat, All-items HICP, Euro per capita chain linked volumes; OECD, Unemployment.

Second, we must recognise that the sectors that traditionally drive employment recoveries are the very ones facing severely reduced activity in this crisis, and are likely to remain significantly smaller employers in the recovery that follows. To take two of the hardest-hit, we note that the hospitality and retail (excluding food and pharmaceuticals) sectors accounted for 10 per cent of employment during 2010 and 2011, but their high turnover and the lower-skilled nature of many of the jobs meant that they comprised more than a fifth (22 per cent) of inflows to employment from unemployment. Furthermore, as Figure 4 shows, these two sectors experienced marked upticks in inflows from unemployment soon after the recession itself was over in 2009. In other words, they swiftly snapped back into action to provide the way back into jobs for many unemployed people.

Given these unemployment risks – which represent a problem both for the individuals experiencing unemployment and the objective of supporting demand in the economy – the dangers of removing the support of the JRS too quickly loom large. No-one should simply assume workers flowing into unemployment will swiftly flow back out again.

FIGURE 4: **Hospitality and retail drove employment entry after the previous crisis**

Quarterly flows from unemployment to employment, by sector, 16-59/64-year-olds: UK



NOTES: Four-quarter rolling average.
SOURCE: RF analysis of ONS, Labour Force Survey two-quarter longitudinal datasets.

We should also reject the idea that the scheme should continue until normality returns – instead new objectives mean new policy choices

However, we should also reject the idea that the scheme should continue as it is until we're back to normal. This is because as the lockdown begins to be lifted, our economic objectives shift to actively wanting some economic activity to take place. The period between lockdown and a return to normality could well be a long one, dominated by continued social-distancing restrictions, and lasting to some degree until we have a vaccine.

So, policy makers should not think in terms of bouncing back to an old world, but instead face up to the fact that we are entering a messy interim period with very different effects on different parts of the economy. This means an additional set of policy objectives to underpin the next phase of support for jobs and workers:

1. Continue to protect family finances;
2. Encourage safe returns to work and economic activity;
3. Secure the re-attachment of employees to employers;

4. Minimise both unemployment today and non-working on furlough, in order to prevent long-term damage to human capital and employment prospects; and,

5. Facilitate the evolving health strategy, particularly in terms of effective test and trace.

Crucially the decisions now facing policy makers are much more complex than the very important but relatively straightforward one of introducing the JRS. First, the situation is more likely to be different across parts of the economy. We are moving from a world in which large parts of the economy experience an incredibly coordinated shock, to one of different timetables that affect different sectors very differently.

Second, trade-offs between objectives are much more apparent now than they were during the initial lockdown phase. Key among these is the tension between maintaining firm-specific human capital in terms of employer-employee attachments and avoiding the scarring risks that come from long periods out of work. There was, initially, little conflict between these aims in the design of the JRS, but the risk that these two conflict with one and other is likely to increase over time. In particular, a wide body of literature details the damage that periods out of work (particularly while young) do to an individual's employment chances and earnings potential over years, if not decades.[12]

It remains to be seen whether time spent on furlough does the same damage as time spent unemployed, but it seems reasonable to suggest that at least some of the same mechanisms are at play (such as atrophy of skills and disillusionment with labour market prospects). In particular, the furlough experience is likely to feel more like unemployment the longer it goes on (and the lower the chance that there is a job to return to at the end of it). And scarring has been evident in countries with earnings replacement unemployment insurance systems that are more similar to a furloughing arrangement than our own welfare system. Crucially, there is evidence that these effects accumulate non-linearly as the time out of work increases, with longer spells out of work leading to particularly large scarring effects.[13]

In other words, we should not be blasé about an additional few months not working on furlough for large swathes of our workforce, given the assumption that the likelihood that a job exists for these employees to return to is diminishing over this period. These trade-

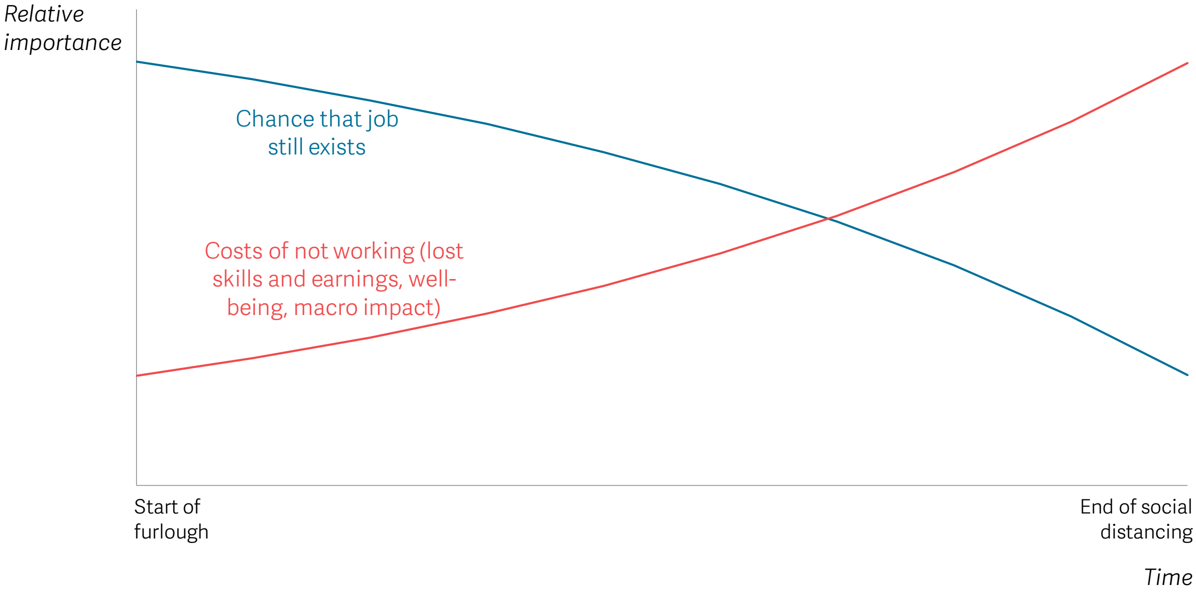
12 For a summary, see: S Clarke, Growing Pains: The impact of leaving education during a recession on earnings and employment, Resolution Foundation, May 2019.

13 For example, estimates by Gregg and Tominey found that the scarring effect of youth unemployment on male wages at age 23, controlling for a range of family and individual characteristics, was more than twice as large for a three-to-four-month unemployment spell as for a one-to-two-month unemployment spell, and similarly more than twice as large for a spell over 13 months as for a seven-to-twelve-month spell. See: P Gregg & E Tominey, The wage scar from male youth unemployment, Labour Economics 12(4), August 2005.

offs are depicted illustratively in Figure 5. The task is to minimise unemployment, while at the same time, avoiding long periods on furlough that do not result in a successful return to the job.

FIGURE 5: **At some point, the costs of extended furloughing will outweigh the benefits**

Illustrative employment retention versus scarring trade-offs from ongoing furloughing



Third, policy faces much more of a challenge to hit sweet-spots in this new phase. Firms face potentially significant uncertainty about the future level of demand for their output. In that context, going too fast to phase out access to the JRS could force firms into bigger-than-necessary lay-offs, which would push down on aggregate demand. But policy remaining as it currently is for too long could mean that firms reopen only slowly in the face of that uncertainty. That may make sense at the level of the individual firm, but if done across the economy will create a self-fulfilling prophesy of weak demand in aggregate, akin to a paradox of thrift scenario.

So, for a wide range of reasons, the hard policy work on the JRS comes not with its unprecedented introduction but with the next stage of its policy development.

Easier policy decision 1: Add a short-time work element to the JRS

Against that difficult backdrop, there are some easy wins that policy makers should focus on getting right in the short term. The most significant of these is the introduction of short-time working (or partial furloughs).[14] Such an extension to the JRS would

14 Many other organisations have called for this. See, for example: Trades Union Congress, Preparing for the return to work outside the home: A trade union approach, April 2020.

cushion falls in pay for individuals who are working fewer hours than normal because of coronavirus. The same replacement rate should apply to this part of the scheme as the 'full furlough' element, i.e. 80 per cent, and any cap should be pro-rated too. To avoid claims being made for small changes in hours, only those asked to work 90 per cent of their usual hours or less should receive support in this way. Many short-time working schemes in other advanced economies have such minimums – more detail on such schemes is presented in Box 2.

BOX 2: **Use of short-time working schemes in other countries**

The proposal to introduce a part-time work element to the JRS may seem like a major innovation in policy from a UK perspective, making a significant addition to a new and already unprecedented scheme. However, not only is this the right thing to do in order to support the return of economic activity and to cushion pay falls, it's a much less radical change when viewed from an international perspective. At least 25 countries made use of such schemes during the financial crisis.[15]

The most prominent and well-used is the German Kurzarbeit (short-time work) system. This system provided pay top-ups to 1.4 million German employees at its peak usage in the aftermath of the onset of the financial crisis.[16] The latest data suggests that take-up of Kurzarbeit in Germany will run many multiples higher than during that crisis, with 10.1 million applications for short-time working made in March and April this year.[17]

Under the Kurzarbeit system, the state provides a minimum of 60 per cent of the 'lost' wages from reduced-hours working, with a higher replacement rate of 67 per cent for those workers with children. At the start of the coronavirus crisis, the scheme's eligibility was expanded. Previously, payments were only made for firms within which at least one-third of the workforce had experienced a 10 per cent hours reduction. From March 2020, only 10 per cent of the workforce needs to have experienced an hours reduction of 10 per cent for a firm to be able to claim through the scheme. At the same time, the scheme was extended to temporary workers.[18]

Internationally, there is significant variation in eligibility for short-time work schemes: ranging from the Canadian

15 A Hijzen & S Martin, The role of short-time work schemes during the global financial crisis and early recovery: a cross-country analysis, IZA Journal of Labor Policy, April 2013.
16 G Giupponi & C Landais, Building effective short-time work schemes for the COVID-19 crisis, Voxeu.org, April 2020.
17 Federal Employment Agency (BA), The labor market in April 2020: Under pressure from the Corona crisis, May 2020.
18 European Trade Union Confederation, Short Time Work Measures Across Europe, March 2020.

scheme in which only when individuals have lost 60 per cent of their usual pay do they become eligible for top-ups, to the French and Italian schemes in which hours reductions of any size are eligible for top-ups. There is a similarly wide range in the 'cap' beyond which the replacement rate starts to reduce, and in replacement rates themselves, stretching from 49 per cent (in Poland) to 100 per cent (in Hungary).[19]

The majority of short-time work schemes in advanced economies require firms to make minimum contributions towards cost of the hours not worked. This way the risk of 'deadweight' loss is minimised. Deadweight arises where firms are reducing their workers' hours and claiming under short-time work schemes, even though they would otherwise be able to keep workers on full-time hours and maintain their employment. For example, in Italy firms receiving payments must contribute 17 per cent of the cost of pay top-ups.

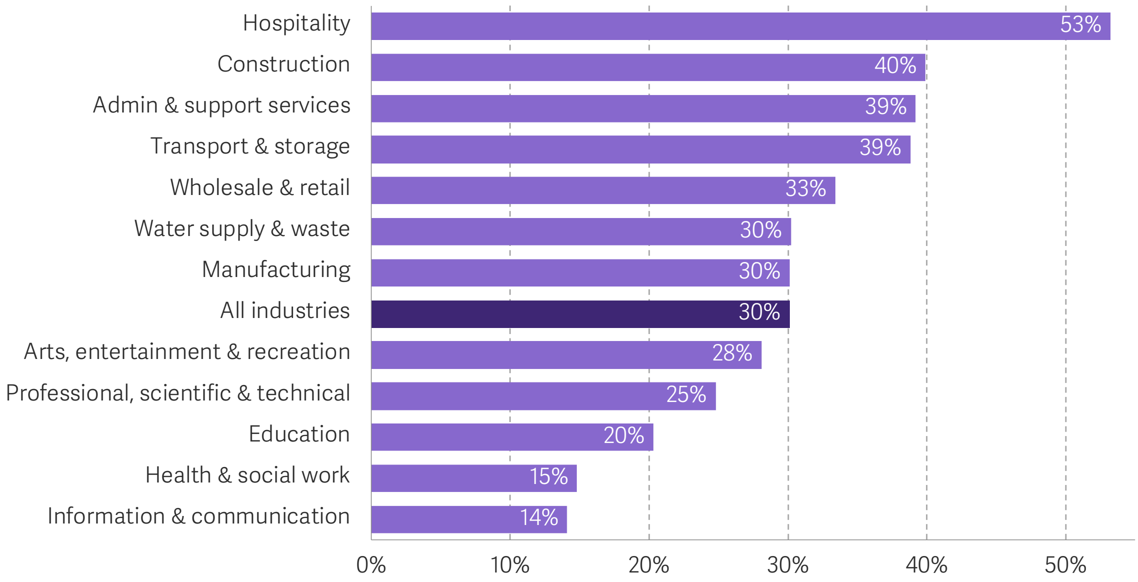
A key decision for policy makers is how to wind down such schemes after crises take place. The central tool used in almost all countries is the placing of a limit on the maximum amount of time for which any individual can receive wage top-ups as part of the scheme. These limits are often extended during economic crises: for example, in Germany the maximum length of scheme usage was extended from six to 24 months during the financial crisis. There is little evidence of countries tapering down support through reductions in generosity for either firms or workers.

Short-time working should be incorporated into the JRS as soon as possible, not least because it would provide financial support to non-furloughed workers across the economy whose hours have been reduced in recent weeks. Evidence, shown in Figure 6, suggests that three-in-ten businesses continuing to trade have reduced hours of work for some staff, with hours reductions most common in the hospitality, construction, administration and transport sectors.

19 A Hijzen & S Martin, The role of short-time work schemes during the global financial crisis and early recovery: a cross-country analysis, IZA Journal of Labor Policy, April 2013.

FIGURE 6: **Three-in-ten businesses have reduced staff working hours as a result of coronavirus**

Proportion of businesses continuing to trade that have decreased staff working hours, by industry: UK, 6 April 2020 to 19 April 2020



SOURCE: RF analysis of ONS, Business Impacts of Coronavirus Survey.

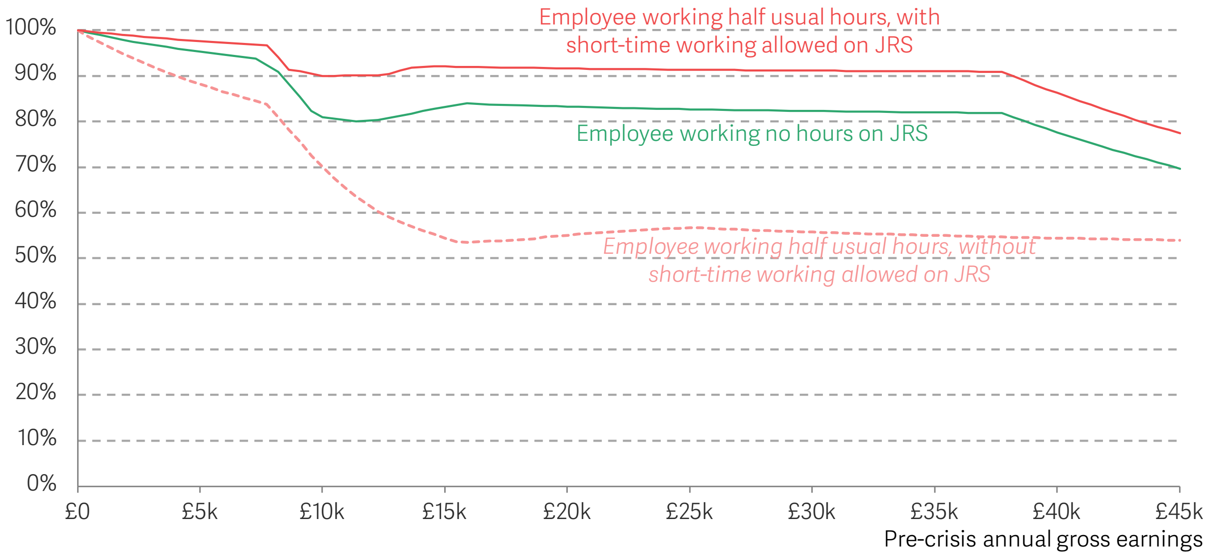
The impact of a short-time work component on the living standards of individuals who have experienced large reductions in hours worked would be significant. For example, as shown in Figure 7, an individual with normal annual gross pay of £20,000 whose hours of work have been cut in half by their employer would take home 92 per cent of their previous income if their pay is topped-up through a short-time work scheme, compared to 55 per cent in the absence of such a scheme. Most importantly, these individuals' net incomes would (rightly) be lifted above those who started out with the same gross earnings as them but have been fully furloughed.

Supporting the living standards of families whose finances have been most severely impacted by this shock is one good reason for adding the capability to support short-time work. But, this element will also play a crucial role in the ability of the JRS to support safe increases in economic activity in the months ahead.

Short-time work wage top-ups will mean that every extra hour of work a previously fully furloughed employee carries out will be financially rewarding, relative to staying furloughed. In contrast, a furloughed employee asked to return to work on less than 80 per cent of their usual hours would currently be worse off in work than they are on furlough. This lack of support for partial returns to work is a minor defect within the JRS today, but in the months ahead as both demand and supply slowly move back towards more normal levels, a lack of short-time work support would be a large impediment to the JRS's effectiveness.

FIGURE 7: **Introducing a short-time working element to the JRS dramatically improves replacement rates for those whose hours have been cut**

Net income replacement rates for an example single adult without children experiencing work reductions: 2020-21



NOTES: Modelled based on the Universal Credit system, assuming that the adult in question is eligible. Single adult assumed to be aged 25+ and a home owner.
SOURCE: RF analysis using the RF microsimulation model.

There has been discussion of the benefits of introducing partial-furlough to the JRS by reducing the minimum furlough length from three weeks to one week, thus allowing week-on/week-off working. In the very short term, this tweak would be desirable particularly if it can be implemented quickly. But such an approach would remain far from ideal, failing to provide the flexibility that many businesses will require and the right incentives for this new phase.

Given the many different arrangements of shift patterns across the economy and the need to offer maximum flexibility to businesses to adapt to changing demand and supply constraints, full hourly flexibility should be offered to businesses and employees wishing to make use of the short-time work element of the JRS. The only restriction we suggest is that a minimum hours reduction of 10 per cent should be required before wage top-ups can be claimed.

This full-flexibility does come at the cost of a bigger risk of fraud than if a day-on/day-off or week-on/week-off approach is taken. Tackling the risk of fraud (for example via whistleblowing) is marginally easier under a day-on/day-off approach, with complete clarity on which days a worker was or was not furloughed for, than if full flexibility in how short-time work can be carried out were allowed. However, ultimately, firms will be reporting hours worked (relative to full-time hours) to HM Revenue and Customs (HMRC), so staff could still be asked by managers to work longer days than implied by the hours submitted to HMRC.

Recommendation: Fully-flexible (hourly) short-hours working wage top-ups should be introduced to the JRS as soon as possible, with the same cap (pro-rated) and replacement rate as offered to those fully furloughed.

Although this is a temporary scheme, it still matters a lot that unscrupulous businesses are disincentivised from making illegitimate claims. For this reason, the introduction of a short-time work scheme should be accompanied with a very aggressive enforcement regime – large fines alongside naming and shaming of firms abusing the system. Firms should have to detail the days on which their short-hours working staff were working in their JRS claims. HMRC should also write to employees on a risk-assessed basis, setting out the days and hours their employer has said that they worked and were furloughed for. Employees who suspect a mismatch between the actual hours worked and the claims made on their behalf should be able to simply and directly raise concerns with HMRC, and indeed be required to do so.

Recommendation: Firms should be required to report the days on which workers are working, and enforcement measures should be ramped up. This should include significant fines, aggressive naming and shaming of firms abusing the system and HMRC writing to some employees to confirm the details of furloughs that their employer has claimed for.

Easier policy decision 2: Separate out the health and economic components of the JRS

As well as its role in limiting the economic impact of the measures taken to protect health, the JRS is also playing another more direct role in supporting the effectiveness of measures to curtail the virus, not least because it can be used by firms to pay the wages of some of those self-isolating. This dual function should be clearly communicated, and separated out from the 'economic' component of the scheme.

This is important not just so employees are aware of the options available to them, but also because in the coming months the design of the economic component of the JRS is likely to be modified (and eventually withdrawn altogether) to facilitate returns to work. It would be counterproductive to mirror these changes for the health components of the JRS.

Specifically, those who are unable to work because their children are not at school, or because they are shielding following Government advice, should be indefinitely entitled to the JRS at its existing level of support. It should be noted that if some groups within the population are asked to shield for very long periods, a range of measures to prevent them from becoming detached from the world of work will need to be considered, beyond income replacement. For example, the Government might consider extending the scope of the Access to Work scheme, which provides support to work for those with disabilities and health conditions.

Similarly, any individual who has to self-isolate as part of the test and trace programme should also be able to be furloughed if they are unable to work while self-isolating. Currently the Government suggests that Statutory Sick Pay (SSP) is sufficient to cover periods of self-isolation, but allows firms to furlough workers not entitled to SSP. It is, however, far from clear why individuals who have had the misfortune of being in close proximity of someone suspected of carrying coronavirus should also suffer a large living standards hit. Further, given the importance of self-isolation to any test and trace strategy, it would seem sensible that individuals are not overly penalised for any periods of self-isolation.

Recommendation: The Government should clarify that the use of the JRS for health reasons (shielding, self-isolating and childcare for children off school) will continue as long as individuals are expected to take such measures.

Easier policy decision 3: Reduce firm uncertainty by moving away from month-by-month extensions

The Chancellor has already extended the JRS by one month, and both business groups and trade unions are asking him to do so again this week – meaning the scheme is likely to be in place until at least the end of July. But this pattern of repeated monthly extensions is not helpful – creating unnecessary uncertainty about whether a cliff-edge in support is imminent.

Proposals for a fixed timetable for the phasing out of the JRS should be rejected. The Chancellor instead should be upfront about the fact that he cannot give precise dates about the scheme's end-point. This is for the reason that its winding down and closure is intrinsically linked to our ability to lift the lockdown safely in the coming weeks and months – something that is itself subject to high levels of uncertainty (see Box 1, above).

Rather than month-by-month extensions, the Chancellor should this week announce a roadmap for the future of the scheme. This should include certainty that while new applications to the scheme will end at the start of July, all firms relying on the JRS will have access to the current scheme until early August, with no changes to generosity (for firms or employees) until that point, and that access to the scheme in some form will be available to all firms until the end of September.

The Government should be clear that this is a provisional timetable, that will only be extended (and not shortened), and that the JRS's longevity is tied to the Government's success in lifting lockdown and the extent to which this leads to increases in demand and a recovery in the labour market.

Recommendation: All firms should be told they will have access to the current JRS until at least the beginning of August, and access to the JRS in some form until at least the end of September.

Difficult decisions about the scheme's future need to be made soon to equip it for the months ahead, but only implemented when the time is right

Equipping the JRS for the months ahead is about much more than clarity of communication and adding a short-time work element, crucial though these easier 'quick wins' for policy makers are.

Instead, decisions are needed on how this scheme can be made to work as effectively as possible throughout this interim period where social distancing will constrain firm supply and demand. We need to navigate the trade-off between prioritising job retention, living standards and low unemployment with the need for employees in so-called 'zombie jobs' to find employment elsewhere, rather than remaining furloughed with little hope of returning to work with the same employer. We must also face the challenge of helping firms recover to a new normal level of activity, without policy changes coming too fast (creating a surge of unnecessary lay-offs) or too slowly (creating a self-fulfilling problem of low demand).

This is about incentives (how big they should be and where they should be focused), timing (when to implement changes to the scheme) and sectors (the extent to which the policy should be different for different parts of the economy). Making the right decisions in each of these three areas will equip the JRS for the months ahead.

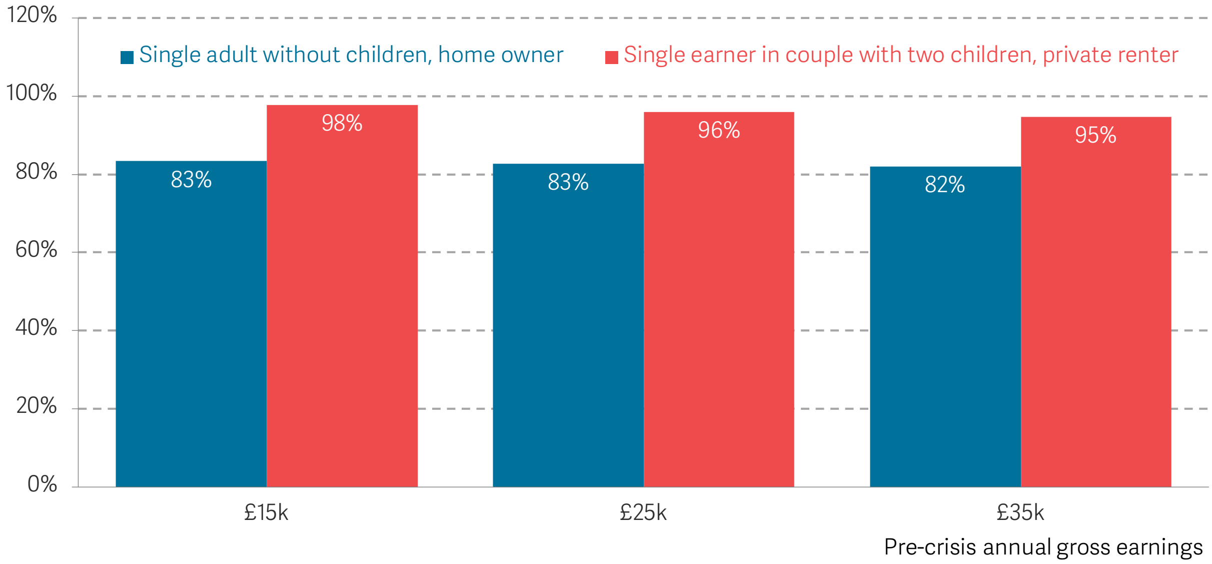
Debate has focused on employee incentives to find new work

The incentive to move back into work and off furlough has been a big feature of discussion in recent weeks. The focus has been almost entirely on employees' incentives, and what level of support is the right amount for the coming months as the need to encourage economic activity increases and costs mount. Reports have tended to focus on rumoured thinking from the Treasury that the 80 per cent replacement rate is unsustainably high. One option reported to be under consideration is to "gradually cut" the rate over the coming months, first to 60 per cent, and then 40 per cent.[20]

It's certainly true that there is not a strong incentive for those who are furloughed to look for alternative employment if they can receive at least 80 per cent of their wages without having to work. Although a fall in wages of up to 20 per cent will be difficult for lower-income families, many furloughed employees will also benefit from reduced transport costs and, in some cases, will have a significantly reduced exposure to coronavirus while not working. In addition, as Figure 8 shows, the replacement rates for those on Universal Credit will be higher still as the system plays its role in cushioning falls in earnings. In fact, a single earner in a couple with two children and renting, with usual earnings of £15,000 a year, will have a replacement rate of 98 per cent of previous income while on furlough.

FIGURE 8: **Employee replacement rates for those receiving benefits could be very high**

Net income replacement rates for example adults furloughed without work on the JRS, by pre-crisis earnings: 2020-21



NOTES: Modelled based on the Universal Credit system, assuming that the adult in question is eligible. Adults assumed to be aged 25+. The couple with two children rents at average 30th percentile rents.
SOURCE: RF analysis using the RF microsimulation model.

Figure 8 shows just how important both the JRS and the welfare system have been in protecting individuals and families from large falls in their living standards during this crisis. But only focusing on these high replacement rates is to miss the crucial point about which incentive is most important in the early phase of lifting lockdown: a strong incentive to return to work in the previous role.

20 G Parker & D Thomas, Sunak plans 'gradual' wind-down of job support scheme, Financial Times, April 2020.

After all the JRS is about maintaining the vital connection between employees and their employer: job retention is about getting people back to work in jobs that match their skills and experience, not just tiding people over until they can find another job. It would be a bad outcome if a lower replacement rate incentivised an employee to find employment in a new industry on less than their previous full-time wage, when if they'd only remained furloughed for another few weeks, their old job would have returned.

Focusing on this incentive also shows why examining high replacement rates does not accurately describe the incentive the employee faces to return to work. As and when the time comes for employers to ask furloughed staff to return to work, the incentives for individuals change rapidly. Employees are then faced with a choice between a return to usual pay (or short-hours pay with the JRS topping up the rest), or losing 100 per cent of pay and entering unemployment. When it matters, the incentive to return to work in a previous role – if a short-time work component is added to the JRS – is strong.

In the main, employee incentives are not the key driver of less-than-optimal levels of working, or more-than-optimal levels of furlough – after all, it's businesses that will predominately take decisions about how many people work, and on how many hours, in this phase of the economic cycle.

Since employee retention and return to work are predominantly firm decisions, this is where incentives are best changed

Job retention and returns to work will be determined primarily by firms, not employees, and so it's business decisions that should be the focus of policy makers' attention when considering incentives in the JRS that will shape the return to more normal economic activity levels.

In the coming weeks and months, as lockdown measures are lifted, the 800,000 or more employers making use of the JRS will have to decide how fast to return staff to work based on assessments of workplace safety and, crucially, the extent to which demand for their goods and services is returning.

Collectively, these decisions will have a big influence on the short-term trajectory of the economic recovery in the UK, because the scale of economic output is far from predetermined. It is not just government-imposed restrictions that limit economic activity, but caution and risk aversion on behalf of firms and customers. Much of this caution is warranted, certainly where there are doubts about keeping staff safe. But for some businesses, the risky decision of bringing people off furlough and attempting to serve clients or customers is much more about the assessment of economic risk. We can see this already in the way in which, even though some firms are able to continue operating (as long as social distancing could be maintained), activity in the manufacturing and construction sectors slowed much faster than the Government expected during lockdown.

If employers have no 'skin in the game' financially when furloughing staff, then there is a risk that they will err on the side of caution and make more use of the JRS than would be optimal for the wider economy. This can happen in two ways. At the level of aggregate demand, if firms all use the JRS to facilitate a slower-than-necessary reopening because of concerns about the level of demand for their output, this could create a self-fulfilling prophecy (one akin to the paradox of thrift that sees households each rationally increase their savings rates and thus collectively deepen a recession, reducing their own incomes). There are also considerations for individual workers (much more relevant in particularly hard-hit sectors) as to whether firms are furloughing staff with little to no intention being able to bring them back to work in the future. Where employees are unknowingly being furloughed in a 'zombie job', the risk is that their return to some employment is significantly delayed.

For these reasons, in many other countries in which similar schemes to the JRS exist, an element of firm contribution is included. Limiting the 'deadweight' from longer-than-economically-optimal furloughs, or from furloughs that have no realistic prospect of resulting in job retention, is best achieved via forcing firms to face up to these decisions – not through reducing further the living standards of furloughed employees.

Optimal firm furlough decisions are best incentivised in the here-and-now

There are two broad options for shifting firm incentives around the use of the JRS. The first involves no outlays in the present, but commitments about the future. For example, businesses could be asked to certify that they intend to re-employ furloughed workers after the end of the JRS, and made to pay back any relevant furlough moneys received out of profits in future years if they fail to do so.

This has the distinct advantage of not placing any additional cash pressure on firms today. However, the downsides of this future-commitments approach are larger. First, such an approach does little to incentivise firms to increase activity as fast as is safely possible when demand increases. Instead, it's entirely focused on the 'zombie jobs' element of the deadweight loss described above. Second, uncertainty about the future is very high (certainly higher than in a normal crisis). So, while this approach might make sense in smaller crises, it's quite a big ask of firms to have them accurately calibrate the number of furloughed employees today to demand levels in six or nine months' time. Third, and relatedly, this policy does risk loading more debt onto firms that just manage to survive, but are smaller than they expected. Although the state can be patient in recouping furlough costs from firms who do let staff go contrary to earlier commitments, it may not be wise to add to such firms' debts when the aim of policy should be to enable firms that are able to expand to do so.

Rather than ask for commitments about the future, a preferable option – used by other countries with similar schemes (see Box 2, above) – is to ask firms to make small commitments today. For example, when the time is right, firms that are still furloughing staff could be required to pay 10 per cent of the lost wage (with HMRC still providing the remaining 70 per cent). This would give firms some skin in the game, meaning they will weigh the trade-offs involved in continuing to furlough staff, without employees facing reductions in their pay while on furlough.

A here-and-now commitment of this sort will bring with it an increase in lay-offs as firms decide that some furloughs are not worth continuing. It will also heap additional pressure on firms struggling with cashflow. This is why it is crucial that such a policy change is not introduced too early in the recovery, and is only introduced gradually.

Recommendation: The Government should be clear that when the phasing out of the JRS begins it will ask firms to contribute towards the costs of furlough – rising from 10 per cent of previous wages initially.

An outline of the planned phasing out of the JRS should be provided soon, but its implementation should not be rushed

Introducing business commitments to the scheme is one of a number of changes that will need to be made as support from the JRS is wound down over the rest of this year. As set out above, it's important that a broad roadmap for this process is clearly communicated to businesses and employees sooner rather than later.

The timing of this wind-down is crucial. The goal of incentivising large parts of the economy to safely get moving again may lead to the conclusion that the answer to 'when?' is 'the sooner the better'. But the risks from starting the phase-out too soon are high. If support is withdrawn while the economy is still very weak, uncertainty still elevated and demand not clearly returning, then the risks of a larger-than-necessary spike in unemployment, and shock to incomes and demand, will be high. This is just the sort of outcome the JRS was designed to avoid.

The Government may wish to rely on timely indicators of economic activity to make the final call on the phasing out of the JRS. If so, data on inflows to and outflows from Universal Credit and other out-of-work benefits (not available to the public), and detailed vacancies data, are likely to be the most useful. But such data is unlikely to be timely or informative enough to fully determine the roadmap – judgments about the way that the easing of restrictions and shifts in public attitudes and behaviour interact with economic objectives will need to be made. Conditional on a successful opening up of the economy as far as virus transmission is concerned (as set out in Box 1, above), it would be sensible for the Chancellor to set out a provisional timetable of this sort of order:

- June 2020: Short-time working introduced
- July 2020: Scheme closed to new furloughs
- August 2020: Firm contribution introduced
- September 2020: No full furloughs supported, short-time working still supported
- End of September 2020: Scheme closed.

Any timetable is subject entirely to progress in reducing the spread of the virus and the Chancellor should make clear that these dates could be delayed – and that they will not be brought forward.

Recommendation: The Government should announce a draft JRS phasing for the bulk of firms that could entail the end of new entrants (firms and employees) to the JRS from the beginning of July, the gradual increasing of firms' contributions from August, and the end of full furloughs from the start of September. Such a timetable should explicitly be a draft, to be rolled out when lockdown and economic developments allow.

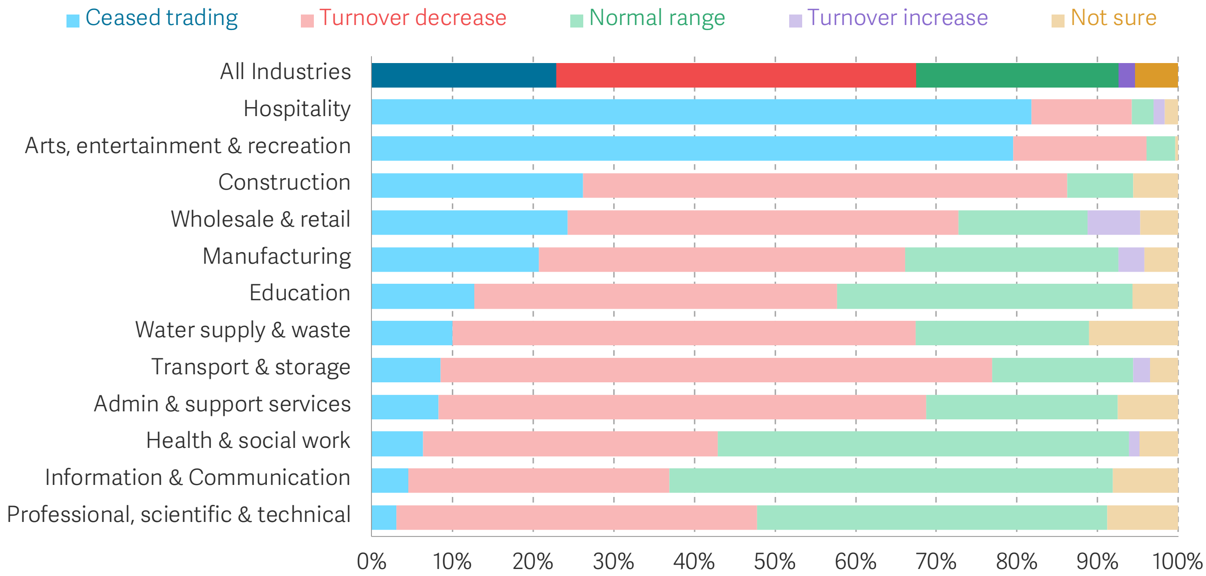
Although a detailed sectoral approach isn't wise, the pace of wind-down of the JRS should reflect vast differences in sectoral impacts in this crisis

A major policy decision facing the Government is whether the JRS should remain one-size-fits-all across the sectors of our economy. Clearly it is difficult to have sectors treated differently, with political barriers to sectoral policy being reinforced by very real technical ones relating to identifying which firms fall into which sector. Even within sectors, large differences in firm impacts will be evident – bringing various pleas from the long list of hard-case businesses to the Chancellor's inbox. It's not surprising that the Treasury might be resistant to taking a detailed sectoral approach.

But policy making during an economic crisis needs to reflect the specific nature of that crisis. And this crisis is at its heart a sectoral crisis. Unlike in the years following the financial crisis when the hit to GDP was relatively uniform across the economy, all the evidence so far points to this economic crisis being concentrated on particular sectors. For example, as Figure 9 shows, 80 per cent of hospitality and recreation businesses had ceased trading as of mid-April, compared to less than 5 per cent of businesses in the information and Communication sector.

FIGURE 9: **The vast majority of businesses in hospitality and recreation have ceased trading**

Trading position of businesses, by industry: UK, 6 to 19 Apr 2020



SOURCE: RF analysis of ONS, Business Impact of Coronavirus Survey.

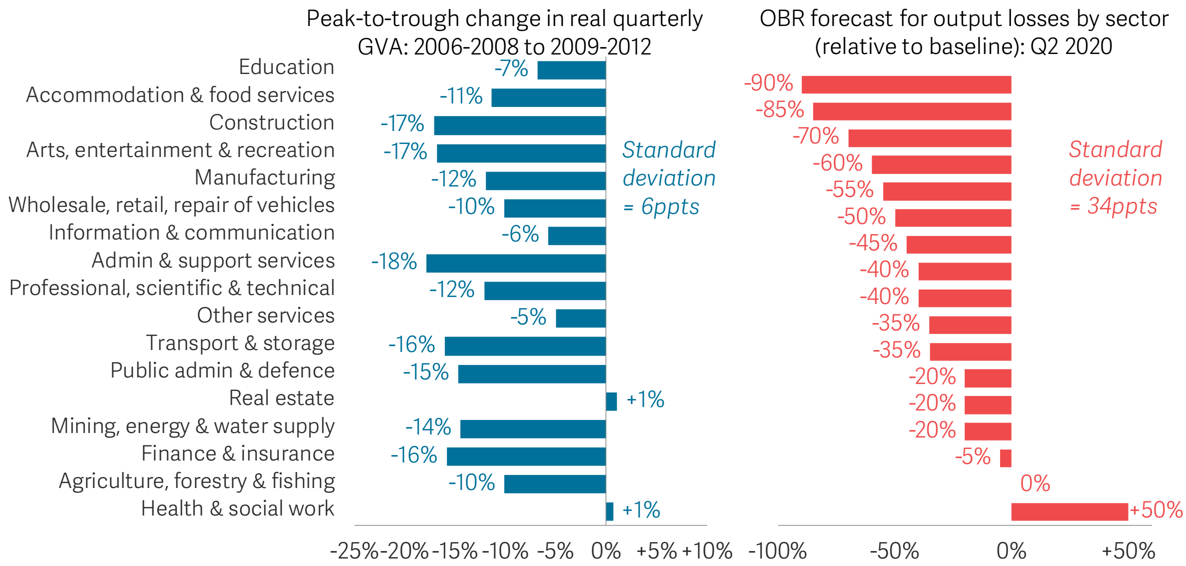
These effects are set to persist, too. As the Prime Minister's recently announced timetable for lifting the lockdown showed, the pace of easing restrictions will be managed on a sectoral basis, with construction and manufacturing activity encouraged to get going again immediately, while the reopening of shops will wait until June, and our hospitality sector will need to wait until at least July for the first signs of reopening.[21] But with social distancing requirements (and the health risks driving them) set to last well into 2021, it is not just the pace of restrictions being lifted that will be highly sectorally differentiated. The pace of supply capacity returning will vary, too, with sectors' different abilities to adapt business models to a socially distanced world. The recovery of demand will also vary significantly, with demand for non-essential social spending likely to be slowest to return. Critically, we should not only be concerned about the fact that demand will return more gradually for the hardest-hit sectors, but also that the extent of that demand is far more uncertain in these parts of the economy than in other sectors.

Although all these effects aren't captured in any detailed forecasts, to date, the OBR's coronavirus reference scenario suggests that the falls in output in Q2 2020 are set to vary across sectors almost six times more than the variation recorded in the years following the financial crisis. These actual and forecast output falls are depicted in Figure 10.

21 B Johnson, PM address to the nation on coronavirus, Prime Minister's Office, 10 Downing Street, May 2020.

FIGURE 10: **Sectoral variation in output losses could be almost six times larger in this crisis than in the financial crisis**

Actual/forecast change in GVA/output: UK



SOURCE: RF analysis of ONS, GDP output approach – low-level aggregates; OBR, Coronavirus Reference scenario, April 2020.

The sectoral nature of this crisis demands at least some element of sectoral response.[22] The vast majority of the economy should be treated in the same way, with support being phased out during the third quarter of 2020, subject to the timetable for lifting the lockdown. In contrast, those specific sectors that have been – and will continue to be – some of the hardest-hit should follow a similar pattern of phasing out but delayed by three months to the final quarter of 2020, with the scheme ending in full by the end of the year. In broad terms, the hardest-hit sectors could sensibly be defined as encompassing all of the hospitality and recreation industries plus the parts of the retail sector most affected by the lockdown (i.e. not food-retail, garages and other businesses that have remained open during the lockdown). Given supply chains cut across sectors, any firm deriving more than half its revenue from these hardest-hit sectors should also be eligible for JRS support on this same delayed timetable.

It's crucial to note that the case for differentiation here isn't rooted simply in the benefits of retention per se, given that the sectors most affected by ongoing social distancing will largely have less of the firm-specific human capital that makes retention so important. Instead what marks these sectors out is, first, that it is close to impossible that supply or demand in them will increase to its new (probably somewhat lower) steady state in short order. In addition, businesses in these parts of the economy face huge uncertainty about how big output in that new steady state will end up being. With an estimated 1.7 million

22 A similar degree of limited sectoral differentiation is recommended in: J Portes & T Wilson, We need an exit strategy for jobs—and it should look like this, Prospect, May 2020.

hospitality workers currently furloughed, for example, allowing these sectors more time to slowly expand and figure this out during the autumn is better than risking premature mass unemployment.

Yes, there will be some rough justice between firms in this approach, but there are risks in proceeding with no sectoral differentiation whatsoever. Treating all sectors the same would require a significantly slower timetable for making changes to the JRS, at a sub-optimal rate for the rest of the economy that holds back the pace of any economic recovery.

Recommendation: The Government should implement very limited sectoral differentiation in the phasing out of the JRS, with a core timetable for the vast majority of the economy, but longer phasing out for sectors most affected by ongoing social distancing, like hospitality. This should cover not just the sectors themselves, but any firm deriving over half of its revenue from them.

To the extent that the labour market is recovering well, there will be a case for a reduction in scheme generosity for those still furloughed in the hardest-hit sectors during the autumn

As discussed above, firm incentives – introduced at the right time – should provide much of the impetus for decision making around whether job retention is a realistic prospect.

However, the incentives for employees to take new jobs will be particularly important for the worst-affected sectors, once the reopening of the economy is well established and the labour market starting to recover. The risks that come with an extended furlough in these sectors if a worker does not ever return to their job because it doesn't exist are two-fold. First, the resources involved could have been better utilised helping the worker transition to a different role via support and training. And second, the longer furloughing goes on, the weaker the position the worker may be in to get a new role as the period of worklessness moves them further from the jobs market.

To reduce these risks, the issue of incentives to search for new work for employees currently furloughed in the hardest-hit sectors should be revisited. A first step would be a reduction in the cap on furlough payments, from £2,500 to £1,500 (pro-rated for those working short hours) in the autumn. This will have less effect on the low paid, but will incentivise higher earners who are still furloughed to seek work elsewhere. The Government could also consider bringing down the 80 per cent replacement rate over time.

Recommendation: The Government should strengthen incentives for individuals in the hardest-hit sectors towards the end of the year to take a new role elsewhere, as the wider labour market starts to recover.

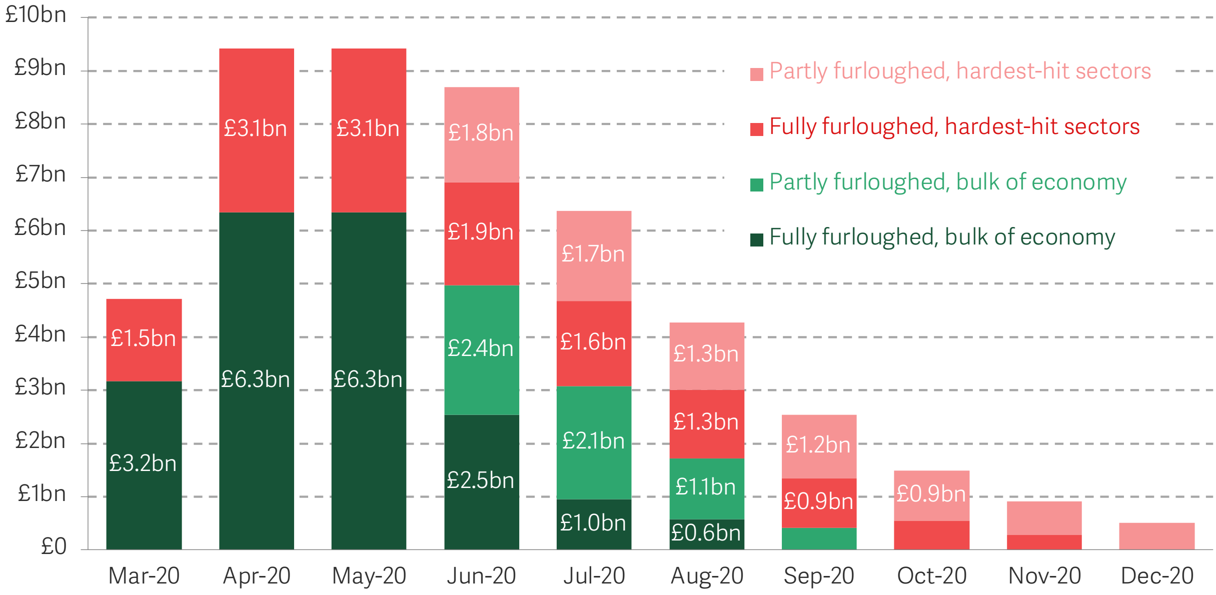
The recommendations in this report imply a total cost of the JRS of £48 billion

Taken together, the changes we have suggested to the JRS in this report could limit the cost of the JRS to less than £50 billion over the 10 months for which the scheme operates, if its winding-down followed the indicative timetable we have sketched above.

Broadly, this can be understood in three phases: in Q2 2020 take-up is at its peak, with short-time working introduced in June; in Q3 2020 JRS generosity for firms in the bulk of the economy is phased out, leading to large falls in take-up, with full-furlough ended by September for these firms; and in Q4 2020 the generosity of the scheme for the hardest-hit sectors is phased out, before the scheme closed on 31 December 2020.

FIGURE 11: **Over 10 months, the JRS could cost a total of £48 billion**

Job Retention Scheme costing, by month, sectoral grouping and scheme component: UK



NOTES: Costs in April and May 2020 in-line with take-up assumptions implied by the latest ONS business surveys (7.4 million people). Changes to scheme design that bring down costings in the months ahead are set out in Table 1 below.
SOURCE: RF analysis of ONS; Labour Force Survey.

Increases in take-up from the extension of the scheme to cover short-time working are counterbalanced over time by the reductions in take-up assumed to take place as the economy recovers and firms are required to contribute towards furlough payments.

The profile of the gross (before tax and benefits) cost of the scheme under these broad assumptions is set out in Figure 11. This is the cost of the core economic element of the scheme only, and excludes the costs of the health components of the JRS (for example payments to those shielding).

Costs in April to June 2020 total £28 billion, with costs in subsequent months totalling £16bn. This profile of spend is entirely predicated on a successful opening up of the economy on the timetable the Government plans, and the view that this, coupled with change to business incentives, will drive take-up and costs down relatively fast.

These cost estimates show that this vital scheme need not cost as much as the NHS this year (the NHS budget was over £140 billion in 2019-20), if economic growth and good policy making combine to drive down take-up as the economic and health picture improves. Their significant scale shows that the JRS is undoubtedly the central plank of the Government's economic policy response to coronavirus, but it is not the only means of supporting firms and families. Indeed, labour market and economic policy in the coming months is hard precisely because it will need to go far beyond a well-calibrated JRS.

This roadmap for the JRS should form just one part of a broader economic policy package

As we move through the stages of the reopening of society and the economic recovery, a scheme explicitly setting out to maintain the old world becomes a less appropriate tool for achieving economic policy objectives. We do not explore the full range of other policy measures that will be needed here, which we will return to in future work, but we do briefly touch on the key areas for consideration.

First, even our suggestion of a slower timetable for the winding down of the JRS for the hardest-hit industries will not prevent output shrinking in the worst-affected parts of our economy. These include some bars, pubs and theatres, where supply and demand will continue to be affected by the legal requirements and public wish for social distancing. Parts of the tourism sector may also experience lasting effects, which give particular pause for thought because, while the hardest-hit sectors in this crisis are generally quite evenly spread across the country, some local areas are extremely reliant on tourism. For example, in local authorities including Richmondshire in North Yorkshire (which contains the Chancellor's constituency), South Lakeland in Cumbria and West Devon, more than one-fifth of those in employment are directly employed in the tourism sector.[23]

23 Source: RF analysis of ONS, Business Register and Employment Survey.

The concentration of ongoing economic pain on particular sub-sectors and places into 2021 is a cause for concern, but the JRS is not the appropriate way to provide ongoing support. As discussed above, the risks of human capital atrophy grow for the individuals concerned, and firms should not be prevented from transitioning to a smaller headcount indefinitely.

A continuation of the current subsidised business loan schemes may be part of the answer here, to the extent that policy makers want firms to face up to their long-term sustainability challenges once the future looks somewhat clearer. But for businesses facing years of lower revenues, loans are unlikely to be a sufficient solution. The Government will need to consider grants and equity stakes if it wishes to continue support to the hardest-hit firms, with tough choices about which firms it is prepared to see disappear entirely.[24]

Recommendation: If there are elements of sectors that the Government wishes to continue to support beyond the autumn, then grants and equity injections should be prioritised, recognising that the JRS is not an appropriate vehicle for such support and that there are limits to the role loan-based financing can play in these cases.

Beyond this focus on the most acutely affected sectors, policy makers must recognise that while the JRS has forged a path largely on its own to date, its future success is much more contingent on the broader policies that sit alongside it. There are three key areas of focus.

First, as we move away from the targeted demand support provided by the JRS, more generalised support for demand in the economy will need to fill the breach. Traditionally this has been the role of monetary policy, but low interest rates mean that the Bank of England has little policy space for supporting the economy this time round (with the space it did have largely already used up).[25] The Bank's main role is therefore now a supporting one – making sure that the Treasury can provide the necessary demand support via fiscal policy.[26] As the JRS winds down and the reopening of the economy and opportunities to spend take hold, there will be more potential for traditional fiscal stimulus measures to be effective. Such stimulus will be particularly crucial if the labour market recovery is slow to take hold.

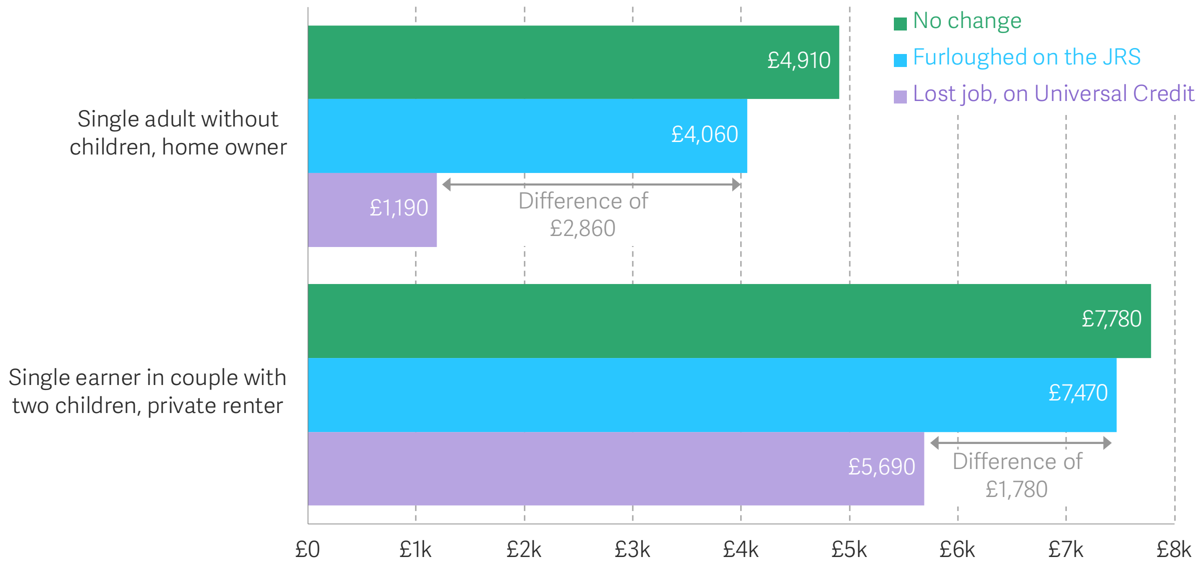
Second, we must recognise that the JRS has unavoidably created inequities in terms of the level of support that similar families receive. Those furloughed have experienced

24 Equity injections have also been recommended by the Learning and Work Institute. See: S Evans & J Dromey, Next steps for the Coronavirus Job Retention Scheme, Learning and Work Institute, May 2020.
25 J Leslie & J Smith, Optimism in a time of coronavirus: While undoubtedly gloomy, today's Monetary Policy and Financial Stability Reports from the Bank of England envisage little lasting damage to the economy or financial system, Resolution Foundation, May 2020.
26 J Smith & T Yates, Helicopters on standby? With rates at all-time lows, the Bank of England needs a different playbook for this crisis, Resolution Foundation, March 2020.

high income replacement rates, while those who have lost jobs have experienced large income falls. Figure 12 demonstrates this for two example median-earning families, showing that the difference in income for employees furloughed for three months and those spending three months claiming Universal Credit (UC) can be as large as almost £3,000. Indeed, the inequities are likely to be both 'horizontal' (with employees starting out with similar earnings experiencing vastly different outcomes) and 'vertical' (on the assumption that better-paid employees are more likely to be furloughed, while less-well-paid employees are more likely to lose jobs[27]).

FIGURE 12: **Similar employees losing jobs have experienced much sharper income falls than those furloughed**

Net household income over three months for example median earners prior to the current crisis, in different scenarios: 2020-21



NOTES: Modelled based on the Universal Credit system, assuming that the adult in question is eligible. Adults assumed to be aged 25+. The couple with two children rents at average 30th percentile rents. Earners assumed to earn £480 per week.
SOURCE: RF analysis using the RF microsimulation model.

The fact that the JRS was so badly needed means that this unfairness can't be overcome entirely. Beyond the tweaks to generosity for furloughed employees as the scheme moves into the autumn, mentioned above, the solution to this unfairness should not be levelling down, but getting the broader policy package right. This must include making further changes to the welfare system to complement recent increases in generosity. Steps that we have previously recommended include removing the capital test in Universal Credit, halting the repayment of benefit advances, and raising contributory

27 On the other hand, better-paid employees may be less likely to be eligible for Universal Credit, due to savings or other earnings in the household.

benefits to mirror recent changes in UC and tax credits.[28] If it proves to be much harder to lift restrictions on economic activity than the Government currently hopes, then policy makers will need to return to the question of the equity of how different groups are treated with regards to income support.

Even with a high degree of policy success, high unemployment is going to be a feature of Britain in the early 2020s, and many furloughed workers will move into unemployment in the coming months. So, third and finally, we will need a renewed and very significant focus on active labour market policy, something that had become less of a priority given the very low unemployment of recent years. The approach should include a return to a strong focus on job-search support for all unemployed claimants; an expanded training offer; and job guarantees delivered via wage subsidies (especially for the young). The latter should build on the lessons of previous subsidised job programmes including the Future Jobs Fund, which facilitated funded, six-month paid jobs for young adults in the aftermath of the financial crisis, with sizable positive effects.[29] The activation approach should be linked to the creation of green jobs and the expansion of green industries, reflecting the challenges our economy was facing before coronavirus and will be facing long after it is gone. Crucially, to avoid any further inequities, and given that those already without work tend to suffer most in downturns,[30] the priority for such policies should be those already unemployed, not just those currently furloughed. We need a comprehensive activation policy, not a fast-track for those closest to jobs that overlooks those further down the pecking order.

Recommendation: The next phase of the JRS should be supported by a broader policy package including the dialling up of generalised demand stimulus, further improvements to benefits, and comprehensive investment in back-to-work support for the unemployed.

Finally, the Government will need to be clear on what, if any, continued support is available for the self-employed, beyond the significant Self-Employed Income Support Scheme which has made grants of up to £7,500 available to most self-employed people, paying out in May. That question is beyond the scope of this paper. Here, we simply note that the answer for the self-employment scheme is likely to be very different to that for the JRS. That said, some of the themes and objectives discussed here – including

28 For more details, see: M Brewer & K Handscomb, No work, no pay: Supporting unemployed people through coronavirus, Resolution Foundation, April 2020.
29 R Hughes et al., Doing more of what it takes: Next steps in the economic response to coronavirus, Resolution Foundation, April 2020.
30 T Wilson et al., Getting Back to Work: Dealing with the labour market impacts of the Covid-19 recession, Institute for Employment Studies, April 2020.

supporting safe economic activity, encouraging moves away from those parts of the economy that are set to be smaller in the coming years, and an eye to fraud prevention – will be equally important considerations in this case.

Conclusion

Policy makers face a range of very tough decisions in the months ahead. Difficult policy design and timing questions relating to the JRS will be near the top of ministers' in-trays. But the cause of these challenges is the virus, and the economic crisis it has created, not the scheme itself. In the context of huge unemployment that risks scarring the workforce for years, the priority is to do nothing rash, and ignore calls for a premature end to the scheme. Instead, the Government should plan to phase down the JRS in a way that supports health and economic objectives. An illustrative timetable is set out in Table 1, but the Government should be clear that this plan is entirely conditional on the (very uncertain) pace of health and economic developments. That is the way to help Britain navigate the difficult times that lie ahead.

TABLE 1: **The Government should plan to phase out the Job Retention Scheme over the course of 2020**

Illustrative timetable for phasing out the Job Retention Scheme, conditional on the easing of lockdown measures proceeding as planned and wider developments in the economy

Sector	Date	Policy change
Whole economy	1 June	Short-time work element added
	1 July	Scheme closes to new entrants
Bulk of economy	1 August	Business contributions introduced at 10% of wage
	1 September	Business contributions increased to 20% of wage
	1 September	Full furlough no longer possible
	30 September	Last date of scheme
Hardest-hit sectors	1 October	Business contributions introduced at 10% of wage
	1 November	Business contributions increased to 20% of wage
	1 November	Salary cap reduced to £1,500 (pro-rated)
	1 December	Business contributions increased to 30% of wage
	1 December	Full furlough no longer possible
	30 December	Last date of scheme

The Resolution Foundation is an independent think-tank focused on improving living standards for those on low to middle incomes. We work across a wide range of economic and social policy areas, combining our core purpose with a commitment to analytical rigour. These twin pillars of rigour and purpose underpin everything we do and make us the leading UK authority on securing widely-shared economic growth.

The Foundation's established work programme focuses on incomes, inequality and poverty; jobs, skills and pay; housing; wealth and assets; tax and welfare; public spending and the shape of the state, and economic growth.

For more information on this report, contact:

Daniel Tomlinson
Economist
Daniel.tomlinson@resolutionfoundation.org

Resolution Foundation, 2 Queen Anne's Gate , London, SW1H 9AA