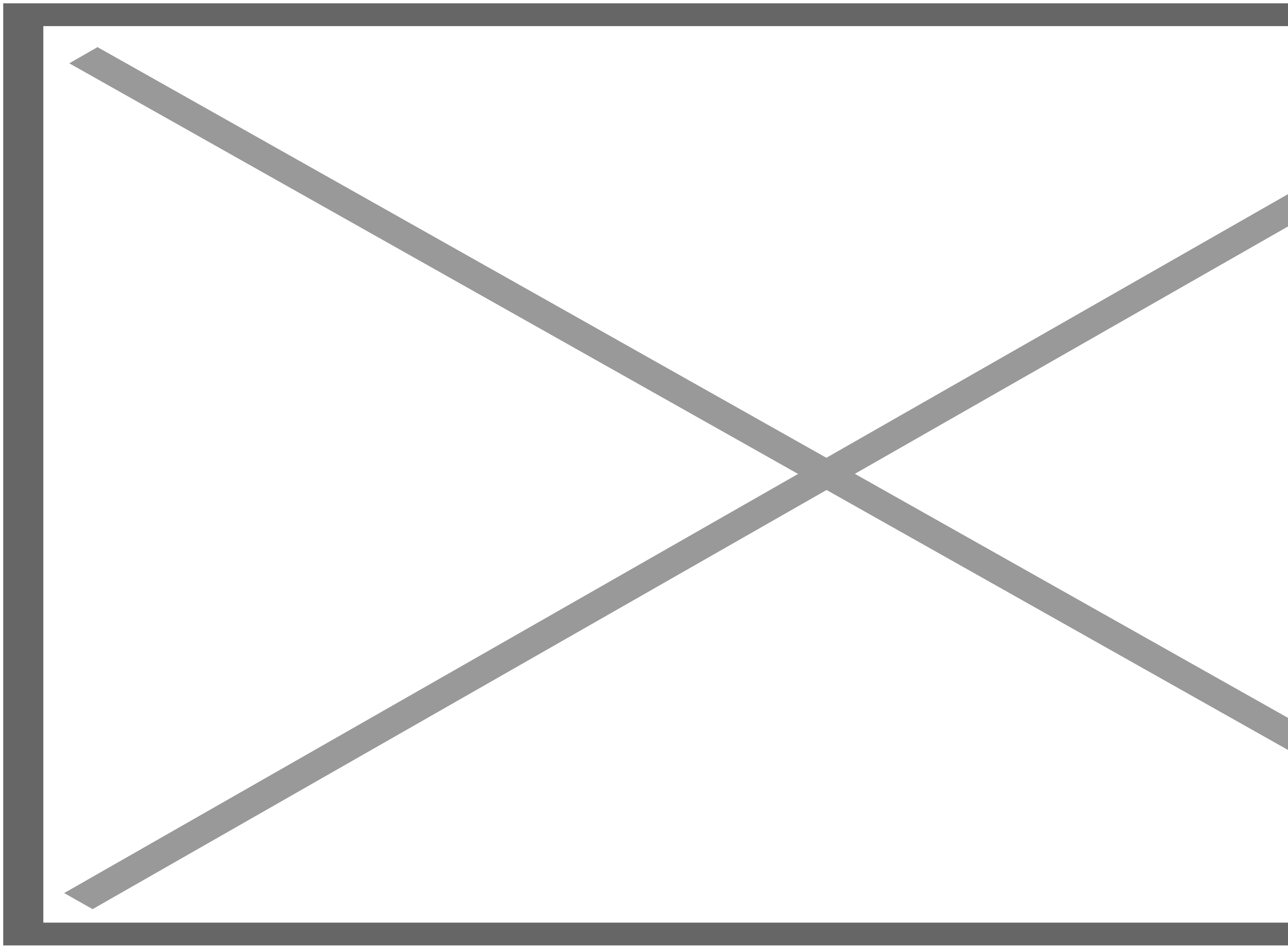
An uphill struggle

Employment Tax Personal tax



29 October 2020

Chris Sanger considers the evolution of the UK government's approach to COVID-19 and furlough in all its forms

Key Points

What is the issue?

On 20 March, the Chancellor announced the first of what has been, to date, four versions of 'furlough', intended to address a Covid-19 pandemic which was considered at that time likely to trigger a 'V-shaped recession'.

What does it mean for me?

Since then, the mindset in Treasury has clearly changed. We are now looking at targeted interventions seemingly intended merely to take the edge off the harsh realities, in the move from a ‘Job Retention Scheme’ to a ‘Job Support Scheme’.

What can I take away?

In response to Covid-19, the Chancellor and the Treasury have taken strong and impactful action to date. However, the current plan may not ultimately deliver what the chancellor is wanting to achieve, leading to further changes.

Many Chancellors aim to deliver a coherent programme of policy changes, built around a clear manifesto, that results in economic success that is demonstrably linked to the choices that have been made along the way. In this way, they can be ready to face the electorate at the end of the government’s term. Few manage this and the current Chancellor Rishi Sunak, when he has a chance to reflect, may well consider how ‘events’ have taken hold of the usual Treasury agenda, placing him more constantly in the limelight than is normally the case for holders of this esteemed job. With the advent of Covid-19, the Chancellor has seen the government’s wider plans play second fiddle to the fundamental role of the Treasury in protecting, nurturing and enhancing the UK’s economy. Such is the way of politics sometimes.

This article looks at the approach that the government has taken to providing economic support, reflecting on the changes from job retention to job support, and looking ahead to what may be needed in the future.

The overall framework

This Chancellor’s first Budget, on 11 March this year, was notable for many reasons: one being that some of the largest changes to the economy were not in the included economic forecast published alongside by the Office for Budget Responsibility. And, at the end of the following week, the Chancellor announced even more interventions in everyday life, with the first of what has been, to date, four versions of ‘furlough’.

Furlough 1.0

The Chancellor’s action, backdated to the start of March, was intended to address a Covid-19 pandemic which was considered at that time likely to trigger a ‘V-shaped recession’; i.e. one in which there was a sudden drop in commercial activity as businesses went into lockdown, but recovered equally fast once lockdown was over. This called for what the OECD describes as ‘support’ measures, ensuring that businesses and their employment relationships with their employees are maintained, ready to be reactivated once conditions return to normal.

This is what gave rise to the Coronavirus Job Retention Scheme, or Furlough 1.0 as it later became known, paying 80% of the wages of employees (up to a set limit) provided that employees were not working. It was clearly envisaged that this would cover businesses that had to shut up shop and mothball the business whilst the pandemic raged past.

No V-shaped recovery

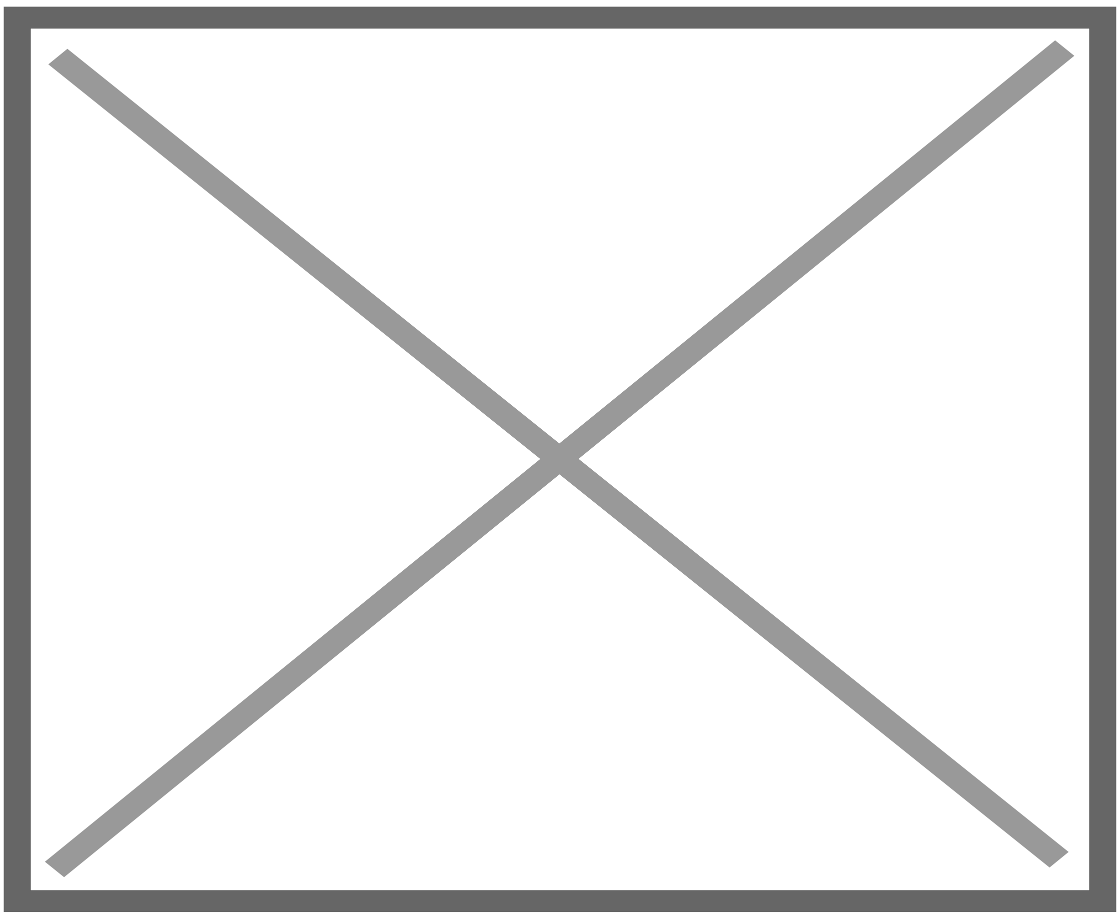
In the event, however, the UK did not experience a short hit followed by a V-shaped recovery. As noted by the EY ITEM Club, the reduction in Q1 was followed by a further hit in Q2, driven particularly by the reduction in consumer spending.

Furlough 2.0

Faced with a longer-term recession, the Chancellor was forced to consider the viability of continuing to pay employees not to work. It was at this point that the Treasury started raising concerns of ‘zombie jobs’; i.e. employees that were furloughed in posts that, should furlough be removed, would not be sustainable. This gave rise to the evolution towards Furlough 2.0, a version that ran through to the end of October. It addressed the constraint that the employee couldn’t work by allowing the furlough scheme to apply to the hours not worked, rather than requiring no work at all. It also was intended to reduce the government subsidy gradually, such that it was clear that businesses need to address the issue of zombie jobs.

So, where does that leave government support today and what should we expect.

Image



Furlough 3.0

This version of furlough, the Job Support Scheme (JSS), provides a far lower intensity of support. For six months, it is intended to provide some government support for employees who are retained in their jobs but are not working their originally contracted hours. For the time not worked, the government expects the employer to pay a third and the employee to give up a third, in which case it will pick up the final third. So, for an employee moving down from a five day week to a two day week, one extra day will be paid by the employer, one by the government and one not paid at all. This version of the JSS requires employees to work at least a third of their usual hours (and this will be reviewed after three months).

So, is this going to work?

In order to consider whether this policy is going to work, it's important to examine the rationale. The mindset in Treasury has clearly changed. Gone is the intention to support jobs in place for a short-term V-shaped recession. Instead, we are now looking at targeted interventions seemingly intended merely to take the edge off the harsh realities. The clue is in the name – a move from a 'Job Retention Scheme' to a 'Job Support Scheme'.

The approach seems designed to encourage the retention of employees, but at fewer hours per week. This appears at first to be a sensible approach, ensuring that employees continue in a job, receive a wage that is not much reduced from their original wage (unless wages are above the cap) and the employer is part funded to retain the role. However, to slightly misquote Helmuth von Moltke, the Prussian military commander:

> 'No plan survives first contact with the enemy.'

Let's first consider this from the employer's perspective. Employers are already facing hard choices about their staffing choices and this plan seems unlikely to deliver enough to change retention plans.

- First, consider an employer who is considering the choice of either reducing three people to one third hours (the minimum allowed under the JSS) or maintaining one person full time and releasing the other two. Ignoring the human factor and the costs of redundancy (neither of which should be ignored), it will remain much cheaper for the employer to retain one person full time than to reduce the hours of the others.
- Next, consider the employer who does indeed need three employees but for fewer hours (such as a shop that now had restricted opening hours). In this case, if the employer did want to retain the three people on a third of their hours, it would be cheaper for the employer to negotiate this with their employees without government support, even if they ended up paying a slight premium for the reduced hours.
- Lastly, consider the employer who has the ability to attract new workers on shorter hours. Such an employer could start these workers on the reduced hours, without having to fund its third share of the non-worked hours.

Of course, as noted above, this blunt analysis ignores the human factor and indeed the cost of redundancies. There will be businesses for which this scheme is helpful – these are likely to be those whose employees have hard-to-replace skills, whose employees have long history with the firm (both from a 'corporate memory' and a redundancy cost perspective) and whose businesses are set to return to higher activity swiftly.

> The mindset in Treasury has clearly changed. Gone is the intention to support jobs in place for a short-term

There is also the employee's perspective. An employee who is reduced to two days a week will receive full pay for two days and two-thirds pay (half from the employer and half from the government) for the remaining three days. This means that the employee will be working for two days but receiving pay for four days – effectively earning double time, with the employer funding time and half. This may be attractive to those who can fill the extra hours but not to those who could potentially get a full time job. As a side point, this may also create a deterrent for employees moving to a, potentially more sustainable, new job since they will be looking to increase the pay they receive after the JSS support, not just the pay for the hours they work. Such restrictions on incentives are not normally seen as good policy, but may well be the lesser evil in a time of pandemic.

Furlough 3.1

Just as the plans for the JSS were settling and these challenges identified, the government announced the Job Support Scheme ‘Expansion for Closed Business Premises’, as some of the country was going into or facing further lockdown in response to a rise in infections. This seems to be a return in part to the principles of Furlough 1.0, with the support focused on those businesses which, as a result of restrictions set by one or more of the four governments in the UK, are legally required to close their premises. This includes premises restricted to delivery or collection only services from their premises.

In contrast to Furlough 1.0 however:

- the scheme will only pay two-thirds of wages (up to the cap);
- the employer will have to fund employer’s national insurance contributions and any pension obligations (this was introduced as part of Furlough 2.0); and
- the scheme only applies to those businesses directly required to close.

It is this last constraint that is the most restrictive, meaning that businesses cannot of themselves decide to avail of the support, unlike Furlough 1.0.

The support for those businesses which are forced to shut as a result of the lockdown measures, such as bars and restaurants, is of course to be welcomed. However, the scheme fails to acknowledge and support businesses in the supply chain which support those closed businesses. Those suppliers are now faced with the prospect of having their customers taken out of the supply chain, but aren’t themselves forced to shut and hence have no access to the benefits of the new scheme.

The economic impact of the local lockdowns permeates further than just the immediate area impacted. Many businesses just outside those areas affected are likely to be significantly impacted economically but will have no way of accessing the much needed support available to those that fall in the geographic areas.

Conclusion

In response to Covid-19, the Chancellor and the Treasury have taken strong and impactful action to date, delivering essential support to businesses and employees as the pandemic hit. Now, as we are more aware of the impact that this pandemic is going to have on our society, it is right that the support measures should change.

That said, however, it does seem that the current plan may not ultimately deliver what the Chancellor is wanting to achieve. This may yet provide the impetus for a Furlough 3.2 or even 4.0 as we look to refine policy in an area of need.

As Chris forecast, the Chancellor announced improvements to the Job Support Scheme and other Covid-19 support measures on 22 October (seebit.ly/3dKSdSg).