COVID-19: Analysis of Extending the Coronavirus Job Retention Scheme

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Scottish Government, Office of the Chief Economic Adviser, September 2020

Summary

The fiscal response to COVID-19 has been unprecedented in scale and scope. Both the UK and Scottish Governments have provided significant support to help protect jobs and enable business to survive. The economic policy response is largely reserved and the Scottish Government does not have the full suite of fiscal powers to fully.

The UK Government's Coronavirus Job Retention Scheme (CJRS) has been the largest intervention, with the UK Government paying out almost £4 billion in a single week at its peak. The costs were highest during the most stringent restrictions, and have since fallen, reflecting both the return of employees to work and the reduction in the share of support coming from government. The Office for Budget Responsibility (OBR) estimates that scheme costs will fall to around £3.5 billion per month (after tax) in October, when government will be paying 60% of wages.

The CJRS is playing a key role in mitigating the impact on unemployment which is reflected in the low rates of unemployment across the UK. The UK Government has announced the scheme will close on 31st October 2020. Data published by HMRC show that the scheme has protected 779,500 Scottish jobs, around 32% of the total Scottish workforce. Although the number of people furloughed has fallen as the economy has reopened, more than 217,000 jobs in Scotland are still estimated to be supported by the scheme. Given the high number of furloughed workers, the closure of CJRS could precipitate a surge in unemployment.

The purpose of this paper is to explore the costs and benefits of extending the CJRS on a temporary basis through undertaking economic modelling of the impact on unemployment and employment over a three year period. The modelling suggests that

- Extending the CJRS on a temporary basis for eight months could reduce unemployment in Scotland by 61,000 through the first half of next year.
- The direct cost of extending CJRS for eight months for Scotland is estimated to be around £850 million.
- Even though this is only a temporary extension of the CJRS, it has a persistent, positive impact on the labour market, preventing unnecessarily higher levels of unemployment over the next few years.
- Wider economic benefits from the extension mean that it could pay for itself, increasing GDP and potentially lowering debt as a share of GDP.
- With Covid-19 cases on the rise, it may prove impossible for certain sectors to resume economic activity in a way that is economically viable before the current employment support schemes are due to expire in October 2020. Many of these businesses will have a viable long-term future, but only if they continue to be supported.
- This will help keep people in jobs while sectors of the economy currently unable to fully open recover and lead to sustained economic benefits at a relatively small cost.
- Of course, the furlough scheme cannot continue indefinitely and this paper has explored an extension to the end of June 2021. Some other countries have longer extensions planned, such as Germany (to the end of 2021) and France (to end June 2022).

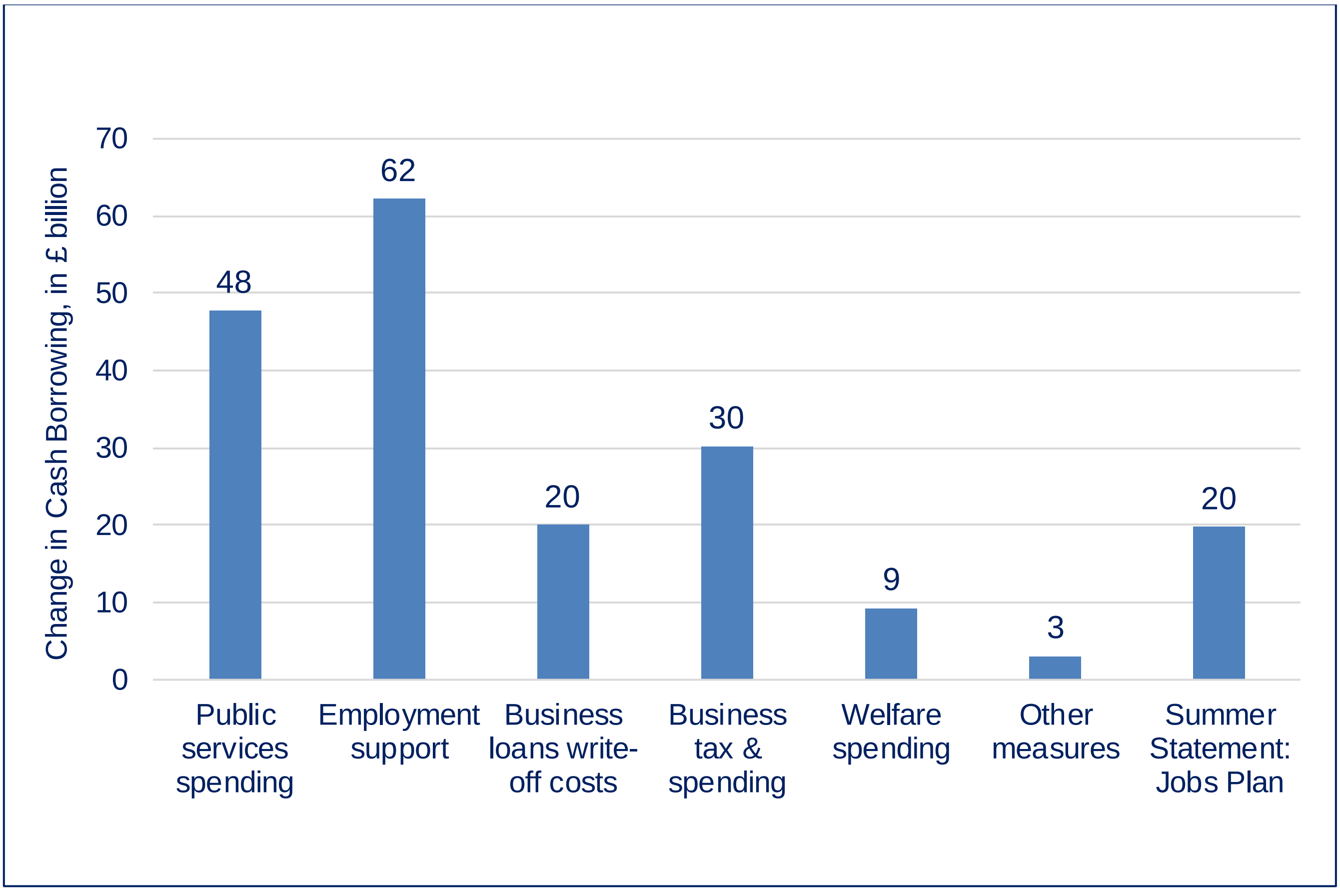
Introduction

The coronavirus pandemic has led to a significant contraction of economic activity and record levels of borrowing, as tax revenues have fallen and public spending has increased.

The Office for Budget Responsibility (OBR) estimates that the fiscal support provided by the UK Government to date will cost £192.3 billion, or around 10% of GDP, in 2020-21. This already exceeds the fiscal support provided at the height of the financial crisis in 2008-09 (0.6% of GDP in 2008-09 and 1.5% of GDP in 2009-10 respectively).

The Government's employment support schemes for workers and the self-employed are the most costly element of the fiscal interventions, accounting for around a third of the costs, or around £62 billion (see Chart 1).

Chart 1. Estimated costs of UK Government fiscal measures in 2020-21 (as of 14 July)



Source: OBR

The Uptake and Impact of the CJRS to Date

Under the UK's CJRS, furloughed workers receive 80% of their wages, up to £2,500 per month. Until the end of July, this was paid entirely by the UK Government and employers were allowed to voluntarily top up that amount.

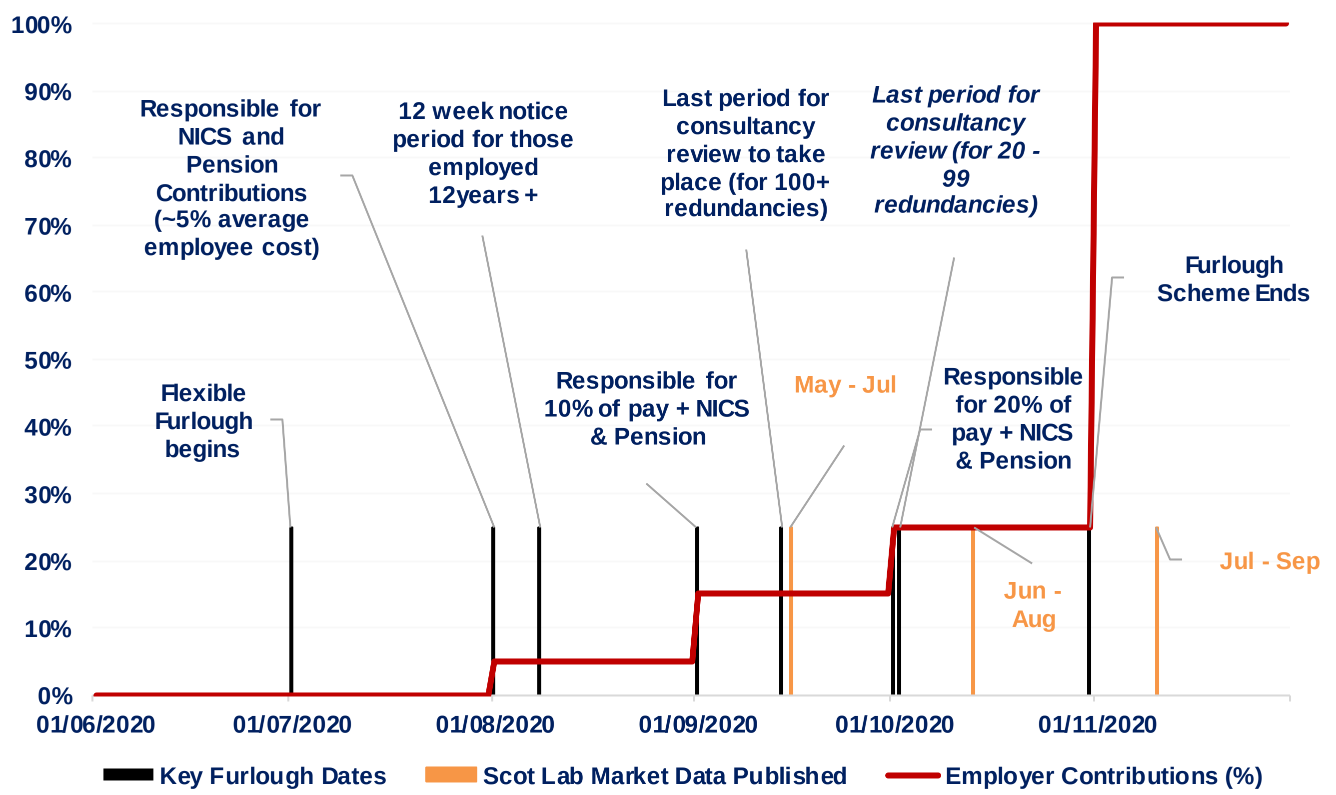
The UK Government's support is being phased out in a tapered way, with employers required to pay employers' NICs and pension contributions (around 5% of employment costs) in August; 10% of wages in September; and 20% in October. Employees will see no change to their wage subsidy. The scheme is due to close on 31 October 2020.

Chart 2 below provides a timeline that highlights critical decision / information points for employers with regard to the CJRS.

It is expected that as employer contributions increase over time and as we approach the end of the formal scheme, the end point will become a cliff edge by which time firms must make decisions on staff retention. For those obligated to hold specific consultation periods for redundancies, the last point is beginning of October.

These key dates work back from the end of the CJRS at the end of October. Some employers may already have made or are currently making retention decisions prior to these dates. Given the high number of furloughed workers, the closure of CJRS presents a cliff edge that could precipitate a surge in unemployment in the second half of the year.

Chart 2. Timeline for key Furlough Dates and changes to Employer Contributions



Source: HM. Treasury; ONS

To date, 9.6 million jobs in the UK have been protected by the Coronavirus Job Retention Scheme at some point since March. Data published by HMRC show that the scheme has protected 779,500 Scottish jobs, or around 32% of the total Scottish workforce. As the economy has reopened, the number of people on the scheme has fallen, but more than 217,000 jobs in Scotland are still estimated to be furloughed according to survey data.

Scottish Government earlier analysis[1] shows that the CJRS, alongside the other measures taken, is playing a key role in mitigating the impact of the shock on unemployment. While the full outlook remains uncertain we have estimated that the CJRS alone is responsible for keeping the unemployment rate between 3 to 4 percentage points lower than it otherwise would have been, as well as helping to prevent and longer-term "scarring" to the labour market.

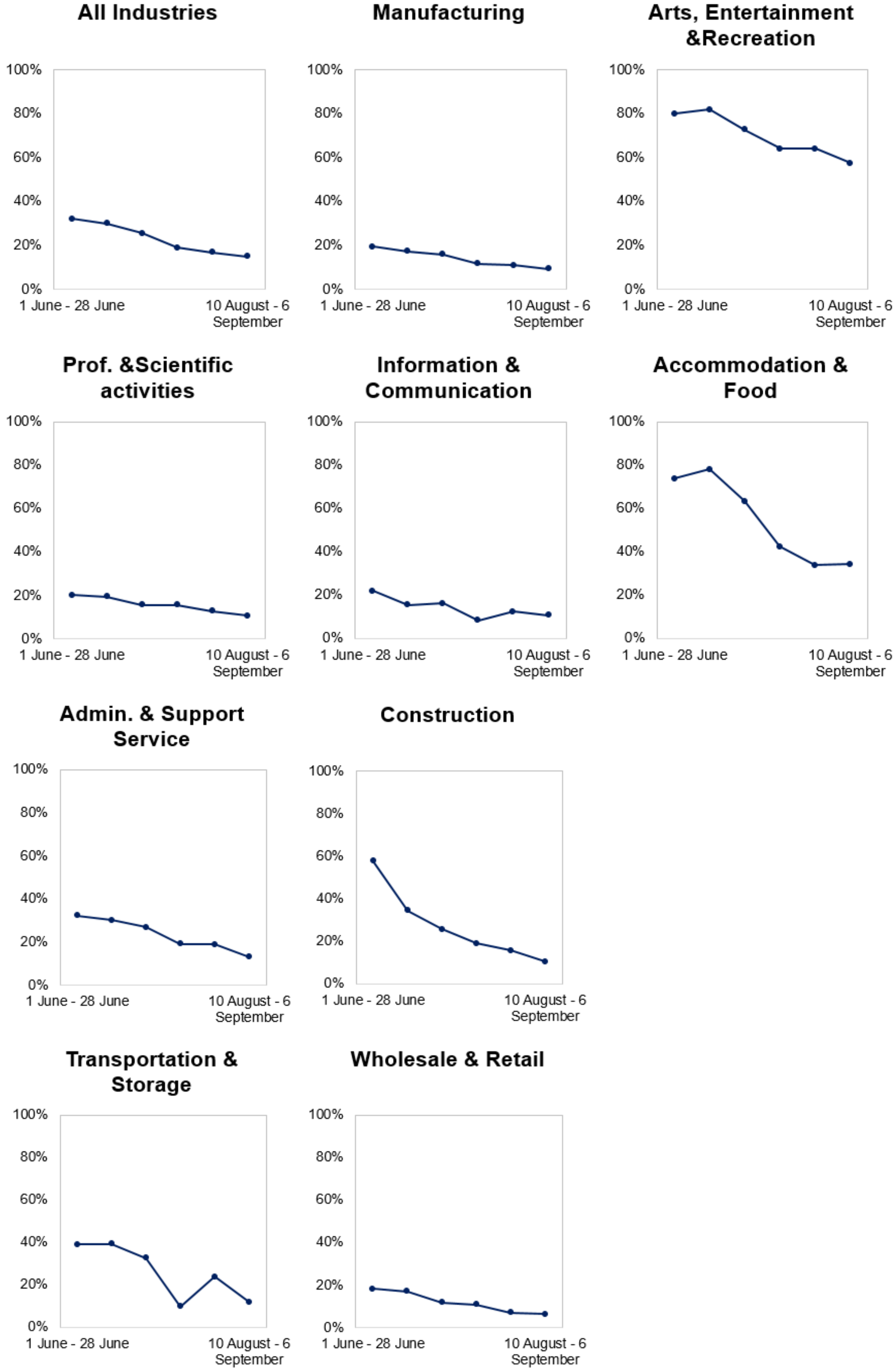
Our modelling also suggests that the UK Government's fiscal policy response to date could have prevented Scottish GDP falling by a further 7.5% in Q2. This highlights the importance of not unwinding the current support schemes too quickly and also removing demand from the economy at the moment when it is most critical to supporting the recovery.

However, the coverage and cost of the scheme have fallen as more sectors of the economy are opening up and demand returns, with 6.8 million furloughed across the UK at the end of June. Analysis of survey data for Scottish businesses (Chart 3) shows that the rate has continued to fall across sectors. While there is no publically available estimate of the number of people on furlough since June, ONS survey responses suggest that in the second half of August around 15 per cent of employees in surveyed businesses in Scotland were on furlough leave as furloughed employees have returned to work.

Some sectors have been unable to resume economic activity and have faced large turnover shocks (see Annex A). As we move into a new phase of the pandemic, with cases of Covid-19 rising it may still prove to be impossible for certain sectors to resume economic activity in a way that is economically viable before the current employment support schemes are due to expire in October 2020. Sectors that may require further emergency support beyond October include, but may not be limited to, tourism and hospitality, arts and culture, oil and gas, childcare, and retail.

[1] UK Fiscal Path – A New Approach

Chart 3. Estimated share of workforce in Scotland on furlough leave (Businesses trading with 10+ employees), 10 Aug to 06 Sep



Source: ONS; SG Analysis

Wage Subsidy Schemes in Other Countries

The COVID-19 pandemic is having profound economic consequences and there has been an unprecedented fiscal policy response from governments around the world although the scale and design of the fiscal stimulus varies across countries.

As part of their fiscal packages, many countries have also provided targeted labour market policies, including wage subsidy schemes similar to the UK's CJRS, to mitigate the rise in unemployment and sustain the link between employers and employees.

However, some countries have already signalled a more gradual removal of their comparable schemes than the UK, albeit sometimes with reduced generosity and tighter eligibility criteria. Six countries - Australia, Austria, France, Germany, Ireland and Switzerland - have extended their furlough schemes beyond this year, while Italy and Canada have extended them to the end of this year.

For example, France has already committed to extending its employment support scheme until July 2022 while Italy confirmed an 18 week extension until the end of 2020. Germany has confirmed that its COVID-adjusted scheme will continue until the end of 2021. Spain is also considering an extension into 2021.

In four countries – Belgium, Canada, Italy and France – furlough schemes make special provisions for businesses, or sectors, that have been hit hardest by the pandemic: Belgium has extended its furlough scheme for hard-hit businesses until the end of the year; Canada offers up to 25% extra on its wage subsidy for these businesses; Italy makes companies contribute to employees compensation based on their revenue loss and France maintains a more generous furlough scheme for hotels, restaurants, travel agencies, sport clubs, airlines, and other businesses that have been more affected by the crisis.

Belgium and Germany's wage subsidy schemes predated the pandemic but have been adapted and simplified to reflect the COVID-19 crisis.

The UK scheme compares favourably to wage subsidy schemes in other countries. At 80% the rate of coverage is broadly on par with other schemes. The UK is, however, different from other countries in terms of length of the scheme as 9 countries have extended their programs beyond the UK timeframe. Table 1 summarise the design of the furlough schemes in several advanced economies.

Table 1: Summary of countries that have extended their furlough schemes

Country	Scheme end date	Eligibility	Compensation
Australia	28 Mar 2021	Prove 30-50% decline in turnover for businesses (15% for charities)	$1,500 per fortnight until 28 Sep 2020; then $1,200 until 3 Jan 2021 and $1,000 until 28 Mar 2021;
Austria	End Mar 2021	Employees must work 30-80% of normal hours.	80 to 90% of gross salary, according to income level
Belgium	31 Dec 2020	Prove 20% temporary unemployment due to "force majeure" or fall under a sector particularly hit.	70% of wages (capped at €2,755)
Canada	31 Dec 2020	Demonstrate any drop in revenue but subsidy rate reflects revenue loss	Initially 75% wages but reduced to base rate of 60% as of July 2020; declining to 20% towards the end of the scheme.
France	July 2022	Face decrease in activity and impossibility to keep all employees full time	Initially 70% of gross salary but reduced to 60% of gross salary from October. The gov. covers only 85% of this, but 100% of this for hard-hit sectors; 100% net salary for minimum wage earners.
Germany	End Dec 2021	At least 10% reduction of workload for at least 10% of employees	Employees receive 60% of net salary (67% if they have children). Compensation increases to 70-77% from month 4; 80-87% from month 7. This increase is limited until 31 December 2020.
Italy	End Dec 2020	Suspension or reduction of working activities	80% of total wages for unworked hours, capped at €1,200
Ireland	31 March 2021	Expect 30% loss of company's trade or revenue	From September, a flat rate subsidy of €151.5 or €203 per week depending on income level. No subsidy paid for employees earning €1,462 gross or more per week
Sweden	End of 2020	Prove reduction of 20-60% of normal working time and financial difficulty	Employee receives 92-96% of regular salary (capped at SEK 44,000), with the state covering up to 45% of it.
Switzerland	31 Dec 2021	Work loss that equals 10% of total hours normally worked.	80% of lost earnings due to reduced working hours

Modelling the Impact of Extending the CJRS

Background

The National Institute of Economic and Social Research (NIESR) has undertaken economic modelling of extending the CJRS in the UK. They argue that ".. the planned closure of the CJRS seems to be a mistake, motivated by an understandable desire to limit spending. The furlough scheme was intended by the Chancellor to be a bridge through the crisis and there is a risk that it is coming to an end prematurely."[2]

NIESR provide some quantification of the costs and benefits of extending the CJRS for an additional eight months into the middle of 2021. In this scenario, the direct cost of extending the scheme in the UK would amount to around £10 billion

They conclude "...Unemployment would have stayed lower had the government extended the furlough scheme beyond the end of October. This would have been a relatively inexpensive measure, and by preventing a rise in long-term unemployment might have paid for itself."[3]

Scenario modelling

We have replicated the NIESR modelling on the costs and benefits of a temporary extension of CJRS for an additional 8 months.

The economic modelling uses the Scottish Government Global Econometric Model. The model compares the "baseline" situation (no extension to CJRS) with a scenario where the CJRS is extended until the end of June 2021. The scenario is modelled as follows:

- A direct increase in employment in Scotland and the rest of the UK for 2020 Q4 until 2020 Q1.
- This is associated with an increase in government spending in 2020 and 2021.
- The model then incorporates spillovers from these interventions, which in the longer term have a greater impact than the initial intervention and raise levels of employment persistently across the scenario horizon until 2023.

The costs of these changes in unemployment and employment are then calculated as follows:

- The direct costs of extending the scheme (paying the wages of furloughed workers) are offset to a degree by the taxes that are paid by furloughed workers and by avoiding having to pay unemployment benefits for these workers.
- NIESR estimate that the total cost is £2,000 per job, per month and that 25% of the direct costs of the extension is offset from additional tax revenue or forgone social security expenditure. We use the same assumptions.

The benefits of extending the CJRS are as follows:

- The immediate economic benefits of extension come from higher levels of economic activity. The income of furloughed workers generates higher consumer spending than would otherwise be the case and has the wider effect of supporting employment elsewhere in the economy.
- Over time a further potential benefit is that the extension can help to keep people in work and prevent long term unemployment and the unnecessary labour market "scarring" such

[2] National Institute Economic Review, No. 253, August 2020
[3] https://www.niesr.ac.uk/media/niesr-press-release-%E2%80%98premature%E2%80%99-end-furlough-push-jobless-rate-10-14351

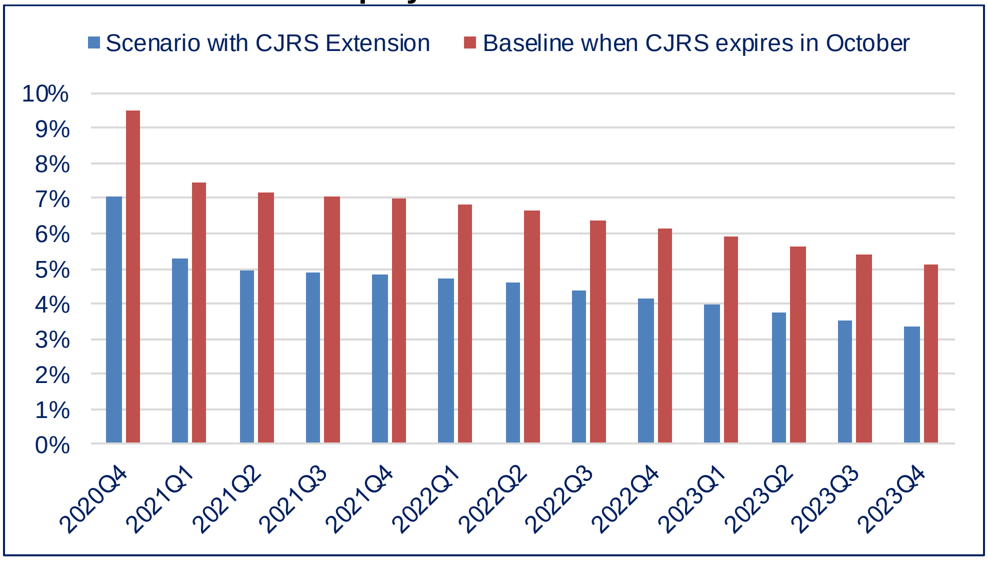
as from skill depletion or avoiding job seekers becoming discouraged and economically inactive. This effect is more difficult to quantify but is an important part of the equation.

Labour Market Results of a Temporary CJRS extension

The impact of the extension on unemployment is to reduce the rate of unemployment in Scotland by 2.5 percentage points in Q4 2020 (to 7% instead of 9.5%) and keep the rate of unemployment lower than it otherwise would have been without the extension to the end of 2023 (see chart 4 below).

This is the equivalent of reducing the number of unemployed people in Scotland by 61,000 through the first half of next year.

Chart 4. Scottish Unemployment Rate with and without CJRS Extension



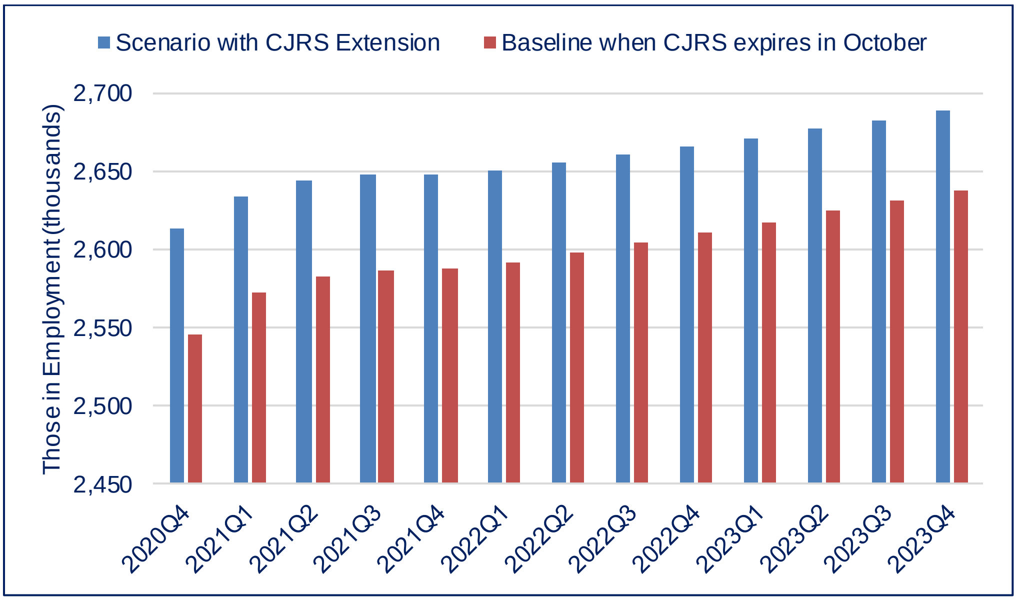
Source: Scottish Government Global Econometric Model (SGGEM)

The fall in the unemployment rate is driven by a persistently higher level of employment relative to the baseline when the CJRS expires in October. Effectively the temporary extension means that higher initial levels of employment, supports additional consumer spending in the economy, which in turn supports additional levels of employment and activity that otherwise would have been lost.

As a result, by the end of 2023 the level of employment is 1.9% higher than if the CJRS was wound down in October. This is the equivalent of around 50,000 jobs by the end of 2023 which are protected by the as a result of the extension as can be seen in Chart 5

Even though the extension of the CJRS is only temporary, there is evidence it can have a persistent, positive impact on the labour market and help to prevent unnecessarily higher levels of unemployment over the next few years.

Chart 5. Scottish Employment with and without CJRS Extension



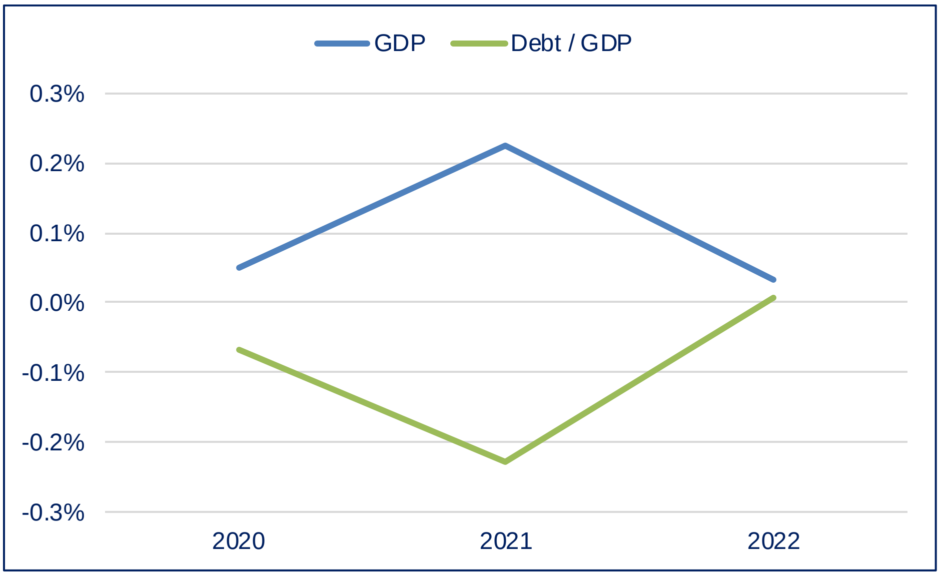
Source: Scottish Government Global Econometric Model (SGGEM)

Costs and benefits

Based on the latest evidence and in a similar proportion to assumptions made by NIESR we assume that around 102,000 people are still on the furlough scheme as of the end of October and remain so in November and December as the scheme is extended (at a cost of approximately £300 million). We then assume that this falls to 61,000 people across January to June (at a cost of approximately £550 million), resulting in a total cost of approximately £850 million for the 8 month extension. On a per capita basis, this is very similar to the NIESR estimate of £10 billion for the UK as a whole.

Although the costs of the extension are estimated to add to the total UK debt, the modelling finds that the increase in domestic demand from the extension of the scheme boosts GDP in the short term by more such that the debt to GDP ratio falls (up to 2021). Wider economic benefits from the extension mean that it could pay for itself, increasing GDP and potentially lowering debt as a share of GDP over 2020 and 2021. In this sense the extension "pays for itself" in the short term.

Chart 6. Change (%) in GDP and Debt/GDP ratio (Scotland) relative to a baseline where the CJRS end in October



Source: Scottish Government Global Econometric Model (SGGEM)

Value for Money – CJRS Extension versus the Job Retention Bonus Scheme

Another consideration is how the £10 billion cost of extending the CJRS in the UK compares to the costs of the UK job retention bonus scheme announced in the Summer Economic Update,[4] which has a similar cost if all employers had taken up the scheme. This scheme provides a one-off payment to employers of £1,000 for every employee who they previously claimed for under the scheme, and who remains continuously employed through to 31 January 2021. The scheme has been criticised as being less targeted than an extension of the CJRS, and indeed some large employers have already indicated that they will not take up the bonus.[5] They cite a risk that money will be paid to cover jobs which weren't actually at risk and hence, with similar concerns being raised by the Chief Executive of HMRC.[6] There is therefore a reasonable case to be made that an extension of the CJRS could be more effective, and potentially better value for money, at saving jobs most at risk and supporting the wider labour market.

Conclusion

As we deal with the on-going health response to the pandemic, economic uncertainty remains high particularly for sectors of that economy that have been disproportionally impacted. The support by Government during the early period has been substantial but risks remain elevated for the business base and for the labour market in Scotland.

Our analysis suggests that a temporary extension of the CJRS could reduce unemployment in Scotland by 61,000 through the first half of next year. We estimate that the direct cost of extending CJRS for eight months for Scotland is around £850 million. The equivalent cost at UK level is £10 billion and would represent a modest cost in comparison to the £192 billion direct

[4] HM Treasury, Plan for Jobs, July 2020
[5] See for example
[6] https://www.gov.uk/government/publications/job-retention-bonus-ministerial-direction

fiscal stimulus from the UK government to date and in comparison to the potential cost of the Job Retention Bonus Scheme.

The analysis has focused on one variant an extension of the CJRS could take, that is, a temporary extension of CJRS. There are other options for extending the scheme, as highlighted by the analysis of wage subsidy schemes in other countries, including targeted extensions for hard hit sectors.

With Covid-19 cases on the rise, it may prove impossible for certain sectors to resume economic activity in a way that is economically viable before the CJRS ends in October 2020. Many of these businesses will have a viable long-term future but only if they survive this immediate period. The pandemic has had a material impact on sectors of the economy which has induced structural change to business models. We know many businesses are also operating at reduced capacity levels and dealing with the uncertainty relating to their market given potential COVID restrictions.

Given the uncertainty relating to the pandemic, a temporary extension of the CJRS until next year will provide a degree of certainty and flexibility for business in dealing with the pandemic. It will keep people in jobs while sectors of the economy currently unable to fully open recover. It will avoid the tipping point of a large increase in unemployment at a time when the economy remains substantially below its operating level and we are dealing potentially with a second recurrence of the virus over the winter months.

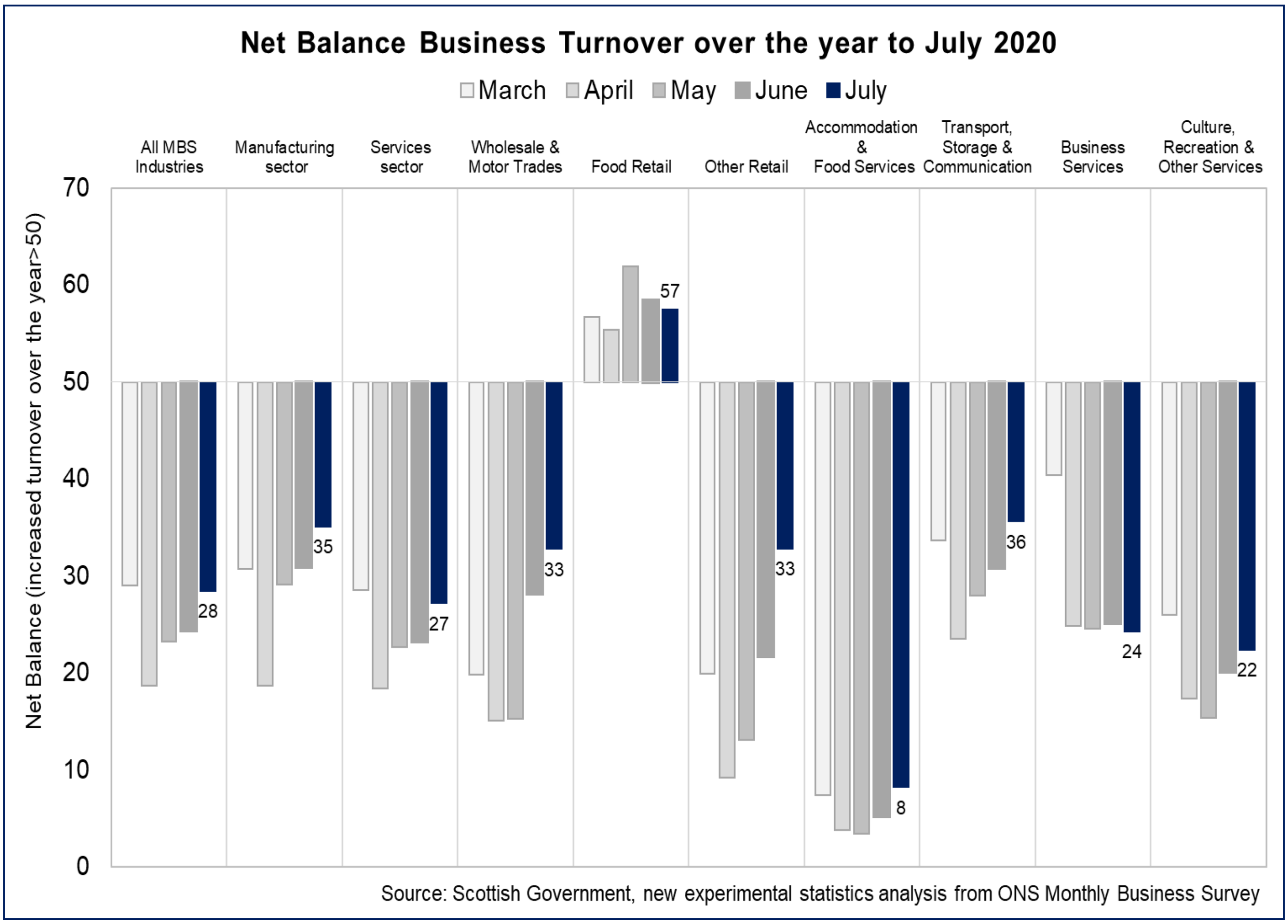
Although it will require fiscal support it has the potential to provide to sustained economic benefits at a relatively small cost and arguably at better value for money than the Job Retention Bonus Scheme. Given the importance of government support at the outset of this crisis, managing the exit to this scheme is important. Other countries have expanded their schemes to some extent reflecting the risks to the economy and jobs.

Finally, if managed well, wider economic benefits from the extension mean that it could pay for itself, increasing GDP and potentially lowering debt as a share of economic output over 2020 and 2021.

ANNEX A: Monthly Business Turnover Index, Scotland

The chart shows the latest Monthly Business Turnover Index for Scotland for July and shows the extent to which turnover is lower than last year overall and by sector. In July 2020, the all industry business turnover index was 28.5, up from 24.4 in June and from its recent low of 18.7 in April.

The rise in the index since April indicates that there has been a gradual increase in business activity in recent months as lockdown restrictions have eased, however total output is still notably lower than last year (50 = same as last year). Compared to last year, business turnover remains lower across both Manufacturing (35) and Service (27), however both sectors continue to strengthen over the month. Within the Services sector, Accommodation and Food Services continued to be the industry with most businesses reporting a decrease in turnover over the year, followed by Culture and Recreation Services.



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