Limiting the Economic Impact of the Covid-19 Virus

Graham Gudgin, Warwick Lightfoot, Gerard Lyons, and Jan Zeber

Photo Credit: Rishi Sunak Covid-19 Press Conference
26/03/2020. London, United Kingdom. Chancellor Rishi Sunak holds a digital Covid-19 Press Conference with Deputy Chief Medical Officer, Dr Jenny Harries in 10 Downing Street. Picture by Pippa Fowles / No 10 Downing Street.

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About the Authors

Dr Graham Gudgin is Policy Exchange's Chief Economic Adviser. He is currently Honorary Research Associate at the Centre for Business Research (CBR) in the Judge Business School at the University of Cambridge. He is also visiting Professor at the University of Ulster and Chairman of the Advisory Board of the Ulster University Economic Policy Centre, and was senior Economic Adviser at Oxford Economics from 2007 to 2015. He was Director of the ESRC-funded Northern Ireland Economic Research Centre from 1985 to 1998 when he became Special Adviser to the First Minister in the NI Assembly until 2002. Prior to this he was economics fellow at Selwyn College, Cambridge and a member of the Cambridge Economic Policy Group under Wynne Godley. He is the author of a large number of books, reports and journal articles on regional economic growth in the UK, the growth of small firms and electoral systems. He is currently working with Ken Coutts on a macro-economic model and forecasts for the UK economy and on the economic impact of Brexit.

Warwick Lightfoot is Head of Economics and Social Policy at Policy Exchange. He is an economist, with specialist interests in monetary economics, labour markets, and public finance. He has served as Special Adviser to three Chancellors of the Exchequer, and a Secretary of State for Employment. Warwick was a treasury economist at the Royal Bank of Scotland, and has also been Economics Editor of The European. His many articles on economics and public policy have appeared in the Wall Street Journal, the Financial Times, The Times, The Sunday Times, the Daily Telegraph, the Sunday Telegraph, and in specialist journals ranging from the Times Literary Supplement and The Spectator, to the Investors Chronicle and Financial World. His books include Sorry We Have No Money — Britain's Economic Problem.

Dr Gerard Lyons is a Senior Fellow at Policy Exchange. He is a leading expert on the world economy, global financial markets, and economic and regulatory policy. Formerly he was Chief Economic Adviser to the Mayor of London, Boris Johnson and he also has 27 years' experience in The City in senior roles with leading international banks, including Standard Chartered, DKB International, and Swiss Bank, where he had an excellent forecasting record. He is also Chief Economic Strategist at Netwealth Investments, and sits on the advisory boards at both Warwick Business School, and the Grantham Institute at the LSE and Imperial College. He co-founded Economists for Brexit, and his ebook, *The UK Referendum: An Easy Guide to Leaving the EU*, was released by Amazon. His first book, *The Consolations of Economics*, was serialised in the *Daily Telegraph*, and he is a regular press and television commentator. He frequently speaks at major domestic and global economic and financial conferences.

Jan Zeber is Deputy Head for Economics and Prosperity at Policy Exchange, where he primarily works on the Prosperity programme, helping to lead on a range of topics including corporate governance, competition and regulation. Prior to his current role he was a Policy Analyst at the TaxPayers' Alliance. He has worked for a number of other think-tanks as well as the private sector, producing legal and economic analysis in fields as diverse as the regulation of sharing economy in the UK and administrative justice reform in Kenya.

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Summary

- On Thursday the Chancellor unveiled his fourth round of policy measures. He announced what he called a coherent, coordinated and comprehensive scheme for the self-employed. It was also a courageous and credible package. This positive approach from the Chancellor, and the speed of the Government's response, is worthy of congratulations. Yet inevitably, in this fast-moving crisis, there remain some areas to iron out, largely linked to its likely execution and administration. The biggest challenge is the delay, as the measures unveiled will take a couple of months to implement, and the strain that this may place on those self-employed who do not have access to income during this time.
  - For some self-employed people they may have to turn to Universal Credit, in which case it becomes an issue as to whether the system has the capacity to cope with those forced to claim. This may require even more resources.
  - For others, who for whatever reason are not able to, or unwilling to, turn to the benefit system there may be the need to rely upon greater understanding from their banks in the near-term, in order to cope.
  - The Government has constructed a coherent and imaginative set of measures that address the employment challenges thrown up by the crisis and it needs to keep the details of these under review, with a view to tweaking and changing them if necessary, to ensure that individuals and businesses can access them. It needs to identify any complexities and delays that hinder them from working as effective relief measures. One lesson from previous measures unveiled is that the devil is in the detail. For instance, the generous loans in the Chancellor's second round of measures proved to be not accessible to non-investment grade firms and that criteria needs to be eased. Likewise here, it may prove that the requirements underpinning these measures for the self-employed leads to a small cohort who are not covered and who may need help. If this eventuality were to arise, then it would not be a surprise to see the Chancellor unveil further measures to fill any gaps
- While these shorter-term challenges – that may arise from the delay in access to funds from the latest measures - cannot be overlooked, they need to be seen within the context of a very positive approach from the Chancellor. The cost may be high, but it is necessary and the higher the cost the more the system is working to cope with the supply and demand side shock. There, too, will be a longer-term cost of possible tax changes for the self-employed but for now these are not the issue. Instead that issue is to recognise that the UK faces an imminent recession, and the Chancellor is trying to ensure as much of the economy survives it

in hibernation, able to return and recover later this year. Thus, our policy recommendations should be seen as tweaks to improve the workings, not a change in direction.

- **The justification for the aggressive measures taken is not just the collapse in demand but the fact that, as we outline below, as many as 5.3 million people[1] – or one in six of the working population – were in jobs most at risk –** including, in the context of the latest measures from the Chancellor, many self-employed going out of businesses as a result of the COVID-19 containment measures. Rising unemployment threatened to severely put a brake on the economy. While unemployment will rise, it is hard to quantify by how much, but because of the measures unveiled last week for employed and now for self-employed, this increase in joblessness will be far less than feared. This justifies the steps supporting those most at risk of destitution and preventing otherwise sound firms from going out of business, which would have resulted in productive capital being destroyed and the long-term productivity of the economy being further compromised.
- The 80 per cent limit of wages are to be compensated as part of the Job Retention Scheme (JRS) still runs the risk of extensive layoffs where a company has to cease trading completely and has no revenues coming in. There is already anecdotal evidence of companies still preferring to lay people off than to furlough the workers. **We recommend that employee wages should be covered in full,** but to limit costs not all company employees need to be eligible for furlough since some will still be working, and to stick to the existing cap per worker.
- The issue of the self-employed was the most pressing economic problem that had to be addressed ahead of these latest measures. There are 5.025 million self-employed of which 3.5 million are full-time, and 865,00 are in the three most exposed sectors (distribution, accommodation and catering, and transport). The proposals are a significant, positive step towards alleviating the issues faced by the self-employed. However, understandably, the new system will not be accessible for quite some time, with Universal Credit the main lifeline in addition to the loans, grants and other benefits as pointed out by the Chancellor in his speech. **An option to close this gap may prove to be using the existing Universal Credit administration infrastructure to institute a temporary and targeted Coronavirus Bridging Payment (CBP) on top of the UC entitlement,** to which any self-employed person of a specific but easily identifiable definition (for example anyone who filed a self-assessment and is not on the PAYE system) would be entitled to, which would increase the £409.98 entitlement to a payment closer the level afforced by the protection scheme for the self-employed.
- Ease complexity around the UC system. **Since the UC**

1. Policy Exchange's estimate based on data from the Annual Business Survey: https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/methodologies/annualbusinesssurveyabs

administration system is already overwhelmed, its capacity will need to be greatly increased quickly, but a different way to reduce the need for administrative capacity is to strip back conditions and checks associated with disbursing the payments – in the extreme, the Government could institute a rule that the sole condition for accessing the new CBP noted above, is not being covered by the JRS. While expensive, this needs to be considered against the economic cost of not getting the funds out quickly enough.

- The Government is deferring VAT and self-assessed income tax payments – an important aid to cashflow - and has declared a tax holiday for business rates for firms in the retail, hospitality and leisure sectors. **Coverage should be extended to all directly affected sectors.**

Overview

The UK economy is heading into recession. It is already clear that this will be a severe hit to the economy, but the hope is that it will be short-lived. That is the view of the Chancellor. It is our view too. One way to think of it is that large sections of the economy will effectively be in hibernation for the next three to six months. The global lack of understanding about the virus and the associated uncertainty that implies makes it harder than usual to predict what lies ahead, and it is only when the health issues have turned the corner and are expected to be past the worst that we can be clearer about the future economic path. Both here, and overseas, this has led to a supply and demand side shock to both the UK and global economy. It has also justified the supply and demand side economic and financial policy response that has been unveiled in the UK.

On Thursday the Chancellor unveiled his fourth policy round of measures.

The first being the Budget, the second focused on the £330 billion of loans to investment grade firms and the third centred on the Job Retention Scheme. That scheme constitutes a wage subsidy of 80% for those employed workers who might otherwise have been made unemployed as a result of the economic downturn, but who will now be furloughed, and thus retained. This was a very positive measure and even though it may not have eliminated all job losses among employed workers, it will have reduced them significantly.

The nature of the shock to the economy – and the subsequent lock-down – means that large swathes of the labour force will see no work and thus receive no direct income during the time of this crisis.

We are positive that a Whole of Government approach has been adopted as these fiscal measures have been supported by monetary and financial measures led by the Bank of England. We will return to these monetary measures in a forthcoming research paper, but it goes without saying that the **unorthodox fiscal, monetary and financial measures**

have been justified.

We have been supportive of the approach taken, given the speed and scale of the crisis, and the shock that the economy has been subjected to. However, there have been gaps. That has been widely acknowledged, and this fourth package was an attempt to address some of those gaps, particularly with respect to the self-employed. It might be tempting to view this as work in progress, as there are ways to tighten up and improve previous measures, while also strengthening what has been outlined now, for the self-employed. Yet, to criticise would be wrong, the measures were generous.

One of the recognised strengths of the UK economy has been its flexible labour market. This has contributed to the health of the labour market in recent years, with record numbers in work. However, even in good economic times there were challenges with this, as over two in five workers are in what are termed (perhaps inappropriately) low skilled but also low waged and low productive jobs. The government's welcome response ahead of the crisis has been to reduce taxes for this group, but the need to address low productivity remains. An additional challenge about this type of labour market is now evident in this crisis, with the danger that jobs would be shed quickly. As outlined below, we outline that about one in six workers are in areas impacted by the economic collapse we are seeing.

Thus, rising unemployment threatens a hard brake to the economy and justifies the Chancellor keeping his foot to the floor on the economic policy accelerator.

Of the 33 million workers, about 5.25 million, or just under 16% are self-employed. These cover a vast array of occupations, from low to high income. The self-employed take more risk by their very nature than those in employment, as their income and security is less secure. Normally, in economics, higher risk is associated with higher return but not, it seems, in employment. For the latest fiscal year, 2017-18, official data shows that the average self-employed person earned £1,160 per month versus £1,500 per employed person.

As we are witnessing one of the challenges is in execution of policy. The universal credit system, already heavily criticised in recent years given the five-week delay, is creaking under the pressure of the sharp rise in new applicants. The other challenge highlighted by this crisis is the poor data sets available. Self-employed tax returns relate to 2018-19, and we know that there is a large turnover in self-employment, with firms going bust and new ones being formed at a steady pace. Also, unlike those who are paid through the PAYE system, it appears that even though it has been decided to make payments to the self-employed it is not easy to do so, as bank account and other details may not be readily available .

One alternative route that could have been adopted would have been cash payments – so called helicopter money – to all adults. While the funds would not have been targeted this would have been a speedy and simple way to get income to all, recognising that many will not have revenue coming in and thus ensuring that rent and groceries could have been paid for. It is, however, not the route that has been taken, not yet at least. Instead, as we have seen in these latest measures to help the self-employed and in the previous measures aimed at those in employment, there has been more direct, and targeted intervention to minimise the rise in unemployment and to provide income to those most impacted by the crisis.

We believe that there is still scope to strengthen some of the existing measures. For instance, for those small firms that despite the job retention scheme may still face a cash flow problem, cancellation of national insurance may be called for. It is also our view that the measures announced in the Budget, while welcome, could be enhanced further. For instance, statutory sick pay of £94.25 appears too low. Also, the increased access for the self-employed to Universal Credit is too complex, and does not provide enough money, and this despite some easing of the criteria, including the suspension of the 'minimum income floor', at an increased rate of £409.89 per month, up from £317.82.[2] Thus it was right that the Government stepped in to help the self-employed just as it did with those in employment.

In unveiling his fourth round of policy measures the Chancellor described the measures as coherent, coordinated and comprehensive. The scheme was also a courageous and credible one. However, there are challenges, largely linked to its likely execution and administration. The biggest challenge is the delay, as the measures unveiled will take a couple of months to implement, and the strain that this may place on those self-employed who do not have access to income during this time.

For some self-employed people they may have to turn to Universal Credit, in which case it becomes an issue as to whether the system has the capacity to cope with those forced to claim. This may require even more resources.

For others, who for whatever reason are not able to, or unwilling to, turn to the benefit system there may be the need to rely upon greater understanding from their banks in the near-term, in order to cope.

The Government has constructed a coherent and imaginative set of measures that address the employment challenges thrown up by the crisis and it needs to keep the details of under review, with a view to tweaking and changing them if necessary, to ensure that individuals and businesses can access them. It needs to identify any complexities and delays that hinder them from working as effective relief measures. One lesson from previous measures unveiled is that the devil is in the detail. For instance, the generous loans in the Chancellor's second of measures proved to be not accessible to non-investment grade firms and that criteria needs to be eased. Likewise here, it may prove that the requirements underpinning these measures for the self-employed leads to a small cohort who are not covered and who may need help. If this eventuality were to arise, then it would not be a surprise to see the Chancellor unveil further measures to fill any gaps

2. DWP, 'Coronavirus and claiming benefits', https://www.understandinguniversalcredit.gov.uk/coronavirus/

While these shorter-term challenges – that may arise from the delay in access to funds from the latest measures - cannot be overlooked, they need to be seen within the context of a very positive approach form the Chancellor for which he should be congratulated. The cost may be high, but it is necessary and the higher the cost the more the system is working to cope with the supply and demand side shock. There, too, will be a longer-term cost of possible tax changes for the self-employed but for now these are not the issue. Instead that issue is to recognise that the UK faces an imminent recession, and the Chancellor is trying to ensure as much of the economy survives it in hibernation, able to return to recover later this year. Thus, our policy recommendations should be interpreted as tweaks to improve how the system works.

The Government should recognise that these measures may turn out to be the start of large programme of fiscal and monetary measures that may be needed to be more audacious to stabilise the economy. The Chancellor described it as a generous scheme, and it is, but the lesson from elsewhere across the globe is that the UK's Whole Of Government approach may have to do even more, if needed.

Box 1: Summary of main economic measures to date[3]

1. **Self-Employed Income Support Package –** taxable grants of up to 80 per cent of the average profits across the last three years, up to a cap of £2,500 per month. Open to anyone with trading profits of up to £50,000 per annum, whose majority of income comes from self-employment and who was already self-employed when the pandemic struck.
2. **Coronavirus Job Retention Scheme** – any employer is eligible for a grant through HMRC covering 80 per cent of 'furloughed' workers wage costs, up to £2,500 per month, meaning an annual salary guarantee of up to £30,000 per year.
3. **Coronavirus Business Interruption Loan Scheme –** government loans of up to £5 million for businesses employing less than 250 employees (SMEs) through the British Business Bank, out of a total put of £330 billion, amounting to a loan scheme of approximately 15 per cent of GDP.
4. **Statutory Sick Pay (SSP) relief package for SMEs –** businesses of up to 250 employees will be able to reclaim the costs of providing SSP from the first day for up to two weeks.
5. **12-month business rates holiday for all businesses in the hospitality, leisure and nursery businesses in England, and grant funding of £25,000 for all such businesses with premises at a rateable value between £15,000 and £51,000 –** a full exemption from having to pay business rates for any business in hospitality, leisure and nursery sector, as well as grant funding for selected businesses in this sector based on rateable value of property.
6. **All VAT and Income Tax payments remitted –** all business payments on VAT will be deferred for three months until 20 June, while Income Tax will be due in one year, deferred until 31 January 2021.
7. **COVID-19 Corporate Financing Facility –** the Bank of England will inject liquidity into the economy by buying short-term debt from corporate issuers, in order to allow them to finance any short-term liabilities they suddenly may not be able to finance.
8. **The Bank of England reduced interest rates to 0.1%, boosted its QE and announced other measures aimed at adding liquidity and helping stabilise the economy,** the Bank has arranged to increase the liquidity of commercial banks so that lines of credit of commercial firms can be extended. It has reduced capital buffers for commercial banks and introduced a new term lending scheme, both of which should make sufficient loans available for small and medium-sized firms.

3. https://www.gov.uk/government/news/coronavirus-business-support-to-launch-from-today

   https://www.gov.uk/government/news/chancellor-gives-support-to-millions-of-self-employed-individuals

Context

The UK economy and the world economy are confronted by an extraordinary emergency. It takes the form of a double shock. The economic consequences of the Covid-19 virus are the succession of financial adverse shocks that anxiety about the virus has crystallised in the credit and financial markets. For several years, very low interest rates, unconventional monetary policy measures and asset purchase schemes such as the QE programme between 2009 and 2012 have resulted in the miss-pricing of credit and risk, asset price valuations that were not realistic and huge leverage in international bond markets. At the same time, the consequences of changed prudential regulation to diminish system risk in the banking system and financial markets resulted in a reduction of liquidity in markets[4] and importantly in the US Treasury bond market.[5] Anxiety about the COVID-19 has served merely to crystallise risks that were latent if not fully exposed. Even though few, if any, expected this pandemic to hit now, it has provided a severe shock to an economic and financial system that appeared vulnerable to shocks.

These combined crises are unusually difficult for policy makers to respond to. Normally a shock that contracts economic activity would invite a macro-economic stabilisation response to maintain demand. In the present circumstances, the principal purpose of public policy is to slow economic activity in order to reduce social contact as part of the public health agenda of reducing morbidity and mortality from the virus. The economic challenge is to find policies to encourage people to stay at home, and to encourage employers to discourage their employees from going to their places of work for as long as necessary.

This lack of economic activity will undermine the cash flow of businesses and households. The starting point has to be direct government expenditure to help damaged commercial sectors, households and individuals. The fundamental approach should be to ensure that economically, people survive to fight another day: that fundamentally strong businesses do not go under, that households do not go hungry, homeless, have their cash savings destroyed or lose their homes. It will require direct grants and subsidies of a significant scale.

The Government has already announced a suite of measures more radical than seen at any previous point in recent history, and it is right to do so, reflecting the magnitude of the economic challenge.

An approximate estimate is that a 5.25 million employees and self-employed people work in the sectors directly impacted by the virus. This accounts for just over 14% of the employed and self-employed in the UK. Most of these will be out of work as a result of virus-related closures of businesses. The overall cost of subsidies and loss of tax revenue might be of the order of £50 billion for a three-month period. If large numbers of employees and self-employed in other sectors are also furloughed the cost could be much higher than this. The £50 billion estimate is equivalent to 2.5% of annual GDP. This would double government borrowing for the current fiscal year but should have almost no consequences for inflation

4. PwC, 'Global financial markets liquidity study', August 2015, https://www.pwc.com/gx/en/financial-services/publications/assets/global-financial-market-liquidity-study.pdf
5. U.S. Department of the Treasury, 'Assessing fixed income market liquidity: Presentation to the TBAC', July 2013, https://www.treasury.gov/resource-center/data-chart-center/quarterly-refunding/Documents/Charge_2.pdf

or interest rates

Government has ample room for manoeuvre

The first thing to say is that any measures can come with almost no financial cost to the Government since they can be financed through printing money. The new governor of the Bank of England asserts that he is not in the business of printing money but this assertion may be intended to calm markets since the consequence of the QE measures already announced is in effect to fund extra public spending through printing new money.

In addition to reducing the bank rate to 0.1% the Bank has arranged to increase the liquidity of commercial banks so that lines of credit of commercial firms can be extended. It has reduced capital buffers for commercial banks and introduced a new term lending scheme, both of which should make sufficient loans available for small and medium-sized firms. In addition, the Government has made available £320 billion to provide 80% guarantees for bank loans to commercial companies, although this facility needs to be extended to be available to non-investment grade firms as well.

All of this is helpful, especially for larger firms, although the reduction in interest rates is of only marginal value. The measures are less likely to aid smaller firms especially in sectors largely closed down by government fiat or by consumer resistance to using face to face services. Many firms are reluctant to take on additional debt in circumstances in which their revenues have largely dried up. If such firms are to avoid laying off employees or closing permanently, they require direct grant assistance rather than loans. The Bank of England could provide cash through direct transfers into company bank accounts but thus far the Government has preferred its own 'Job Retention Scheme' as a means of injecting cash directly into firms. This is the correct approach but however it is done, the important thing in the unique circumstances of a major supply shock to the economy is to directly give money to companies and the self-employed rather than expecting them to increase their indebtedness under adverse and indeed extreme circumstances.

The most important action of the Bank of England has been to announce a further £200 billion of bond purchases (Quantitative Easing), to bring their total purchases of government bonds to £645 billion. These are large amounts of money and the new QE is equivalent to 10% of GDP. The ostensible aim of the latest round of QE is to reduce long-term interest rates (buying bonds raises their price and reduces their yield or interest rate) but the more important impact is to inject new money into the economy. This has the consequence that government spending can effectively be financed by the BoE printing money rather than borrowing. This works through the Treasury issuing bonds to finance new spending and the Bank of England buying government bonds in the market. This is less direct than the Treasury selling bonds directly to the Bank, but the outcome is essentially the same. Since the Bank of England is an arm of government there is little advantage in the Treasury paying interest to another part of the public sector. Interest payments on past QE were suspended by George Osborne as Chancellor in 2012 and this can be repeated now[6]. The result would be no increase in the Government's interest payments even in the face of a large increase in public spending on economic measures to combat the virus.

During the banking crisis of 2008 bailouts were commonly described as 'tax-payers money' but there was no rise in taxation and the finance for the bailouts was really generated through printing money in the way described above. Some media reports refer to this as a Zimbabwe option, but this is naïve. Inflation is a real concern when money is printed to boost demand to a higher level than the economy can supply. Under current conditions with the virus the issue is instead to ameliorate the consequences of the contraction of the economy as sectors are closed down to combat the virus. In effect the Government can spend large additional amounts without worrying about future indebtedness or debt interest payments.

The Bank of England has provided for enough credit for larger companies for the immediate future. Car companies and other large firms have suspended operations and their cash requirements will be large until government assistance for furloughed workers becomes available. If their fixed costs do not receive subsidies, longer term borrowing will be necessary, and some companies may become insolvent. The problem is made worse by the collapse in oil prices and several oil exploration companies will not survive of the world oil price settles at below $30 a barrel. The financial stress will depend on how long the economy remains shut down and this is of course unknown at present.

The economic impact of the virus

The virus impacts the economy in a number of ways, with four of the key ones outlined here:

- A number of sectors are shut down either by government fiat or by a public refusal to use the services while the virus is raging. These sectors include airlines and holiday operators, hotels, restaurants, pubs and entertainment and event venues and most recently a large part of the retail sector (with potential knock-on impacts on suppliers and wholesalers). **These sectors employ close to 5.25 million people with a wage bill of £26 billion for a 3-month period.** There are also knock-on impacts on related sectors. To take one small example, taxi operators are affected by the loss of fares to airports, and to restaurants, pubs and entertainment venues. They also lose business from people working at home and from the ending of school runs. Their income may be reduced to almost nothing.
- Some business including supermarkets, online retailers and medical device manufacturers will gain, while for most non-food retailers the problem is likely to be a temporary loss of a proportion of sales. Since this may be recovered later in the year the downturn is

6. https://www.theguardian.com/business/2012/nov/09/bank-of-england-gilts-interest

potentially manageable via loans**.** The small number of retailers not forced to close their premises may find their revenue dwindling as consumers are at home or restrict their spending.
- Withdrawal of labour by those with increased childcare responsibilities due both to the closure of schools and to the withdrawal of grandparents from childcare.
- Self-isolation of those potentially affected by the virus plus those hospitalised.

We can consider whether the Government needs to do more under each of these four headings.

Maintaining incomes in affected sectors

1. The Government has established a 'Job Retention Scheme' and is working urgently to set up a scheme for reimbursement of 80% of the wages of 'furloughed' workers up to a maximum of £2500 per month. It is important that the scheme has been backdated to March 1st and also important that it includes workers already made redundant. However, the 80 per cent limit still runs the risk of extensive layoffs where a company has to cease trading completely and has no revenues coming in. We therefore recommend that employee wages should be covered in full to the limit of £2,500 per week. The aim should be full compensation for a circumstance beyond the control of the business or its employees. There should be no incentive for firms to dismiss employees or for employees to wish to evade the government's intention for businesses to cease operating. We estimate the cost for operating this scheme for three months to be £26 billion for the most directly affected sectors. If there are large numbers of furloughed workers from other sectors the cost could be much higher possibly twice as much.
2. The scheme should resist being applied solely to key workers whom businesses need to retain to restart operations once the epidemic subsides, as in the German Kurzarbeit scheme. The Government intends the scheme to apply to all workers, but some employers appear to take the view that workers can be dismissed if there is any cost to the firm at all. The huge rise in applications for universal credit suggests that many employees have been made redundant already. It will be important for public trust and support for social distancing measures that all employees are treated fairly. The scheme should be seen as partly supporting public solidarity and not just a way of preventing businesses from closing permanently. The scheme should be based on the principle that all workers employed on March 18th should be included even if they have already been declared redundant.
3. The issue of the self-employed was the most pressing economic

problem that had to be addressed ahead of these latest measures. There are 5.025 million self-employed of which 3.5 million are full-time, and 865,00 are in the three most exposed sectors (distribution, accommodation and catering, and transport). The proposals are a significant, positive step towards alleviating the issues faced by the self-employed. However, understandably, the new system will not be accessible for quite some time, with Universal Credit the main lifeline in addition to the loans, grants and other benefits as pointed out by the Chancellor in his speech. **An option to close this gap may prove to be using the existing Universal Credit administration infrastructure to institute a temporary and targeted Coronavirus Bridging Payment (CBP) on top of the UC entitlement,** to which any self-employed person of a specific but easily identifiable definition (for example anyone who filed a self-assessment and is not on the PAYE system) would be entitled to, which would increase the £409.98 entitlement to a payment closer the level afforced by the protection scheme for the self-employed.

4. Ease complexity around the UC system. **Since the UC administration system is already overwhelmed, its capacity will need to be greatly increased quickly, but a different way to reduce the need for administrative capacity is to strip back conditions and checks associated with disbursing the payments** – in the extreme, the Government could institute a rule that the sole condition for accessing the new CBP noted above, is not being covered by the JRS. While expensive, this needs to be considered against the economic cost of not getting the funds out quickly enough.
5. Since the UC administration system is already overwhelmed, its capacity will need to be greatly increased quickly, but a different way to reduce the need for administrative capacity is to strip back conditions and checks associated with disbursing the payments – in the extreme, government could institute a rule that the sole condition for accessing CBP is not being covered by the JRS, which is likely to be extremely expensive and amount to a programme of 'helicopter money', but this needs to be considered against the economic cost of not getting the funds out quickly enough.
6. Other costs of business need to be considered. HMG is deferring VAT and self-assessed income tax payments – an important aid to cashflow - and has declared a tax holiday for business rates for firms in the retail, hospitality and leisure sectors. Coverage should be extended to all directly affected sectors. Leasing payments, such as those of taxi operators could be deferred. The cost of deferring all VAT payments for three months is £30 billion but this will recouped later. Advanced payments on self-assessed income tax due in July will be deferred until January. The cost is unknown but again will be recouped.

7. Businesses with less than 250 employees can reclaim sick pay for employees off sick for up to 2 weeks. This should be extended to all business of any size. A general principle should be that all businesses losing revenue as a consequence of the epidemic should receive full compensation. This extension will approximately double the cost of this measure
8. Even with these subsidies listed above, profits of many business will either disappear or be greatly reduced. One reason is the burden of rents and property leases. Legislation should be passed to enable firms and the self-employed to share the burden of rents with landlords so that the full impact of lost business does not fall on the renter or lessee alone.
9. Direct payments of £10,000 are being made to small firms currently eligible for small firm or rural rate relief. In some sectors revenues and hence profits may recover later in the year if lost business is made up by a rebound in economic activity. Some retailers will be this position. Florists' business will pick up as delayed weddings take place, for instance. In other sectors the loss of business may be permanent. Taxi firms will not regain all of their lost revenue and this probably applies to restaurants and hotels. Some compensation could be considered for loss of profits even where it is likely that a recovery will restore some of the losses. Again, the aim is to maintain incomes and spending.
10. The large fall in share prices has dented consumer confidence and firm's confidence in investing. Our estimate is that a 10% fall in equity prices would under normal circumstances lead to £2 billion reduction in GDP through such things as wealth effects in consumer spending. Reductions in profits may feed through to delayed or cancelled investment plans and hence to lost business for companies making investment goods. Some of these losses may be temporary but others could be permanent or cause investment goods firms to go pout of business. Equity prices will eventually recover much of their recent 30% fall and indeed the recovery may have already begun. The Bank of England should support equity prices by adding equities to its portfolio of asset purchases as part of QE. QE may need to be extended to achieve this.

How much will the wage-bill subsidies cost the Government?

1. UK Labour market context

In the three months leading to January 2020, the UK labour market continued to display historically very low levels of unemployment. According to latest Labour Force Survey (LFS) estimates, a record 32.98 million people (76.5 per cent) were in employment an increase by 271,000 on the previous year.[7] The rate of unemployment – the most

7. ONS, 'Employment in the UK: March 2020', 17 March 2020, https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/bulletins/employmentintheuk/march2020

widely watched labour market parameter – was at a 3.9 per cent, has been steadily falling since 2011, and it has not been above 4 per cent since the end of 2018.[8] Such low levels of unemployment have last been seen between 1974 and 1975.

One of the most important economic effects of the COVID-19 crisis is the threat of a total reversal of this trend. As labour-intense service industries such as hospitality and leisure are forced to cease trading altogether due to mandated social distancing measures, many will be forced into extensive layoffs: a reported 200,000 people have lost their jobs since mid-February,[9] with a grand total of 1 million jobs at risk according to UKHospitality, a trade body.[10]

2. Estimating costs of wage subsidies

The wage bills for most exposed sectors are as follows:[11]

- Restaurants and canteens employ 1.2 million people and have a monthly wage bill (including national insurance) of £1.4 billion.
- Pubs and clubs employ 0.5 million people with a monthly wage bill of £0.5 billion
- Hotels and other accommodation employ 0.5 million people with a wage bill of £0.6 billion.
- Airlines employ 80,000 people with a monthly wage bill of £0.4 billion.
- Taxi operators employ 50,000 with a monthly wage bill of £0.05 billion
- Rail and bus operations employ 250,000 with a monthly wage bill of £0.8 billion
- Retail distribution employs 3.2 million people with a monthly wage bill of £5 billion. Just over a million of these are in supermarkets
- Vehicle assembly and parts employs 0.19 million people with a monthly wage bill of £0.7 billion – closures have occurred due to supply chain issues but production may resume soon.
- Culture, sport and gambling employ 0.65 million with a monthly wage bill of £1 billion

The purchases of restaurants and pubs in food and drink etc come to around £2 billion month. Not counting the fuel purchases of airlines, the total loss of revenue to businesses in and around these sectors comes to close to £5 billion a month.

The huge retail sector has monthly purchases of £30 billion of which £12 billion is in supermarkets. There will be knock-on impacts on some of these suppliers outside the food sector and wholesale distribution and road haulage companies will also be affected.

An approximate estimate is that around 5 .25 million employees and self-employed people work in the sectors listed above excluding supermarkets and assuming a 20% loss of rail and bus jobs. This accounts for 16% of the employed and self-employed in the UK. Most of these

8. *Ibid*, Figure 5
9. Strauss D et al, 'Millions of UK jobs at risk owing to virus shutdown', *Financial Times*, 18 March 2020, https://www.ft.com/content/175f1646-690a-11ea-800d-da70cff6e4d3
10. UKHospitality, '24 Hours to save a million jobs', https://www.ukhospitality.org.uk/news/494294/24-hours-to-save-1-million-jobs.htm
11. All figures from ONS, Annual Business Survey 2018, https://www.ons.gov.uk/businessindustryandtrade/business/businessservices/methodologies/annualbusinesssurveyabs

will be out of work as a result of virus-related closures of businesses. To fully compensate these employees and self-employed the Government may need to find up to £26 billion for a three-month wage-bill subsidy scheme on top of the £20 billion it has already earmarked for council tax relief and sick pay. If large numbers of firms outside these sectors declare furloughed workers, then the three-month bill could be much larger. The three-month wage bill of the manufacturing sector excluding food, drink and vehicles is for instance £21 billion.

The costs above include employees and employer's national insurance contributions which HMRC can recoup (or not transfer to employers in the first place) which reduces the wage-bill subsidy by 13%. It is assumed that income tax will be collected in the normal way. There will losses of revenue from VAT and from corporation tax. These generally low wage and low profit sectors do not generate large tax revenues but the losses in VAT could amount to £2.5 billion over three months with a further £1 billion lost from corporation tax revenues. In addition, £30 billion of VAT payments will be deferred for a quarter.

The overall cost of subsidies and loss of tax revenue might this be of the order of £50 billion for a three-month period if we include employees in sectors not listed above but nevertheless losing revenue for reasons connected with the epidemic. The deferred VAT can be added to this. Altogether, this is equivalent to 3.7% of annual GDP. This would more than double government borrowing for the current fiscal year but should have almost no consequences for inflation or interest rates. The costs of not providing these subsidies could be as large or larger and the priority is to prevent firms from going out of business or laying off staff and thus precipitating a general recession.

Options for the self-employed

1. Self-employment in the UK: context

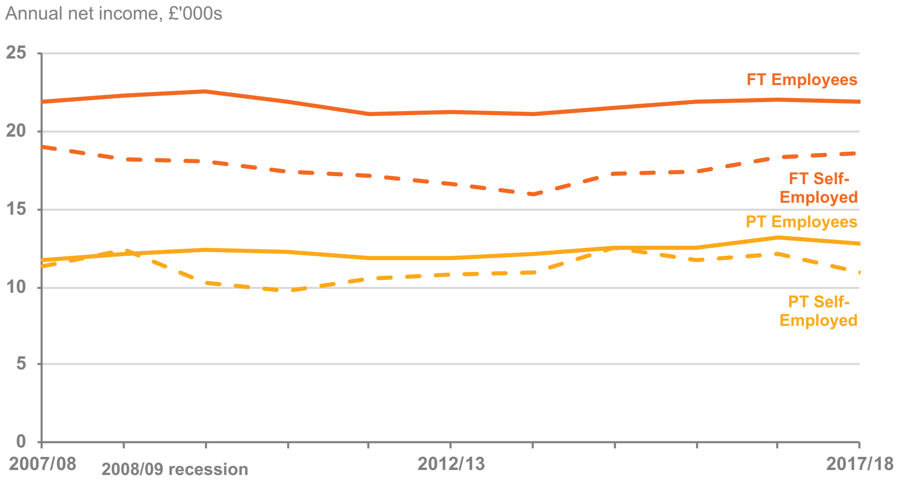
A key difficulty the Government is still grappling with in its coronavirus response is the level of support afforded to the self-employed. As of 25 March 2020, the only support available to the self-employed is enhanced access to more generous Universal Credit, increased to £409.89 per month. According to research from charity Turn2us, self-employed households are facing a decrease of monthly income by an average of £781 if they have to turn to Universal Credit.[12]

Of the 33 million employed people, around 5 million are self-employed, meaning they make up approximately 15.3 per cent of total employment.[13] In recent years there has been a considerable increase in self-employment, with the number of self-employed people rising to the current levels from just 3.3 million (12 per cent) in 2001.[14] The level of income for the self-employed is difficult to estimate, but data from the Family Resources Survey (FRS), which captures median net earnings (funds earned from work) and total income (funds from work *and* social transfers like benefits and pensions) reveals a consistent trend: between

12. Turn2us, 'Coronavirus: poverty charity highlights the plight of the self-employed', 23 March 2020, https://www.turn2us.org.uk/About-Us/Media-Centre/Press-releases-and-comments/Coronavirus-Poverty-charity-highlights-plight-of-s
13. *Ibid*, Figure 3
14. ONS, 'Trends in self-employment in the UK: Analysing the characteristics, income and wealth of the self-employed.', 7 February 2018, https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/articles/trendsinselfemploymentintheuk/2018-02-07

2007-08 and 2017-18, full time employees were better off than full time self-employed by an average of £4,000 per year in terms of total income, though the difference was less stark for part-time employees and self-employed: an average of £1,155 per year.[15]

Chart 1: Median net total income of working-age employees and the self-employed, 2007-08 – 2017-19



Looking more closely at sectors, of the 5 million self-employed, 8 per cent worked in retail and associated sectors, 6 per cent in air, water and ground transport, and 3 per cent in accommodation and food services.[16] This suggests that the good news might be that exposure of the self-employed to the most adversely affected sectors is limited, but given the all-encompassing nature of the crisis, it would be unwise to make any judgement of that sort.

However, analysing headline figures for self-employment necessarily involves a large degree of uncertainty and it yields no easy policy recommendations:

- Firstly, self-employed as a cohort experiences a high degree of 'churn', which last year was at 20 per cent, meaning of the 5 million current self-employed, 1 million were not self-employed last year but now are, and another 1 million were self-employed last year but now are not.[17]
- Secondly, any data on incomes is based on surveys, and is likely to be representative of those with steady incomes like established owner-managers in industries with low volatility, but much less representative for those with very irregular incomes like freelance sole-traders in fast-moving industries.
- Thirdly, it is not uncommon to be both full-time or part-time employed, and supplementing your income from freelance activities as a sole-trader, and therefore be both part of Pay-As-You-Earn (PAYE) system *and* self-assess tax returns – indeed, data

15. ONS, 'Family Resources Survey: financial year 2017/18', 28 March 2019, https://www.gov.uk/government/statistics/family-resources-survey-financial-year-201718
16. ONS, 'EMP14: Employees and self-employed by industry', 18 February 2020, https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/employmentandemployeetypes/datasets/employeesandselfemployedbyindustryemp14
17. Jack S, 'Coronavirus: Why is it taking so long to help the self-employed?', *BBC*, 24 March 2020, https://www.bbc.co.uk/news/business-52020234

> suggests that 1 million self-assessment tax-returns were for a figure of less than £2,000, suggesting a large percentage of self-employment was about supplementing income from full or part-time employment.[18]

The challenge therefore is not so much about finding the money, but about how to get it in the right hands quickly, so that damage is limited as much as possible.

2. Policy options

The biggest gap hitherto in the UK government's coronavirus response package has been the issue of self-employed, who are ineligible for being furloughed under the flagship Job Retention Scheme. Prior to the announcement on the 26 March, the only help available for the self-employed has been enhanced access to the Universal Credit programme, which has been made more generous at £409.98 per month. However, that is significantly less than protections under the Job Renetion Scheme, which would see a furloughed worker on minimum wage (as of April 2020) getting a gross pay of £1,138 per month.[19]

The Government has therefore announced a **Self-Employment Income Support Package –** taxable grants of up to 80 per cent of the average profits across the last three years, up to a cap of £2,500 per month. It will be open to anyone with trading profits of up to £50,000 per annum, whose majority of income comes from self-employment and who was already self-employed when the pandemic struck.

The system is a significant, positive step towards alleviating the issues faced by the self-employed. However, understandably, the new system will not be accessible for quite some time, with Universal Credit the main lifeline in addition to the loans, grants and other benefits as pointed out by the Chancellor in his speech.

This means that there are still two issues outstanding: firstly, how does the Government physically put money in the hands of the self-employed quickly, given it often holds no bank account information on them and it requires proof of and level of self-assessment (access will be based on tax returns from 2018-19) which will take time to process, and secondly, how does it deal with the issue of irregular income, where someone may have had a very good 2018-19 and therefore not qualify for the scheme but have no other savings to cope since 2018-19 was a standout year. Additionally, UK savings ratio in 2018 stood at 5.8, or 33 per cent below average for the past 56 years.[20]

An option to close this gap may prove to be using the existing Universal Credit administration infrastructure to institute a temporary and targeted Coronavirus Bridging Payment (CBP) on top of the UC entitlement, to which any self-employed person of a specific but easily identifiable definition (for example anyone who filed a self-assessment and is not on the PAYE system) would be entitled to, which would increase the £409.98 entitlement to a payment closer the level afforced by the

18. *Ibid*
19. Assuming April 2020 minimum wage for over 25s, £8.72 per hour, coming to a gross monthly pay of £1,421.88, 80 per cent of which coming to £1,138
20. ONS, UK Economic Accounts, Households (S.14): Households' saving ratio (per cent): Current price: £m: SA, 20 December 2019, https://www.ons.gov.uk/economy/grossdomesticproductgdp/timeseries/dgd8/ukea

protection scheme for the self-employed.The advantages of such a system is that it addresses the two problems outlined above, namely, that of a need to find an administration infrastructure system to physically get the money out, and secondly, those with irregular incomes falling through the cracks.

There is no way around the fact that the single most effective thing which could make the money reach the hands it needs to reach faster would be to strip back conditions and checks as much as possible, to the point the system effectively disburses something akin to 'helicopter money' or Universal Basic Income, which carries risk for work incentives, long-term affordability of the programme and the ease with which it can be withdrawn once the crisis is over. But the more checks and conditions are attached, the slower the system will be. So, we can either strip these back back to save money or spend money to expand existing capacity – it could well be that any savings as a result of imposing more conditions will be eaten away by resources spend on expanding administrative capacity.

That said, such a solution to helping those not included in the Job Retention Scheme would certainly not be without drawback. Administration infrastructure of Universal Credit is already overwhelmed even without adding potentially hundreds of thousands of applicants. The administrative capacity of the system would have to be radically expanded, which might be costly and take time. Yet expanding an existing system has to be easier than designing and running a new one from scratch, and in any case, those hundreds of thousands of potential applicants would still flock to the system since the Universal Credit payment is right now the only option available, so the administration capacity problem is something that will need a solution anyway. **The key point to make, once again, is that the fewer conditions and checks the system has to carry out, the quicker it can function.**

This is a crisis and overwhelmingly, the objective is to prevent a widespread destruction of productive capital as sound and viable firms and sole proprietorships go out of business. This means that the imperative of speed, efficiency and comprehensiveness trump that of preventing fraud, undeserving hands getting generous public pay outs or trying to limit future public indebtedness. Every bit of economic activity or productive capital we can save now will pay for itself later on.

A recovery stimulus

Government support for incomes in affected sectors will do much to sustain consumer spending but even those whose incomes are unaffected by the virus may reduce their spending for a range of reasons including the fact that they are not travelling and spending time at home, as well as a loss of confidence. Direct purchases in shops may be partially offset by rising internet shopping and many retailers are introducing or expanding their internet business. Some purchases will be delayed rather than cancelled and, if so, firm's profits will eventually revive, and extra loans incurred during the next few month can be repaid

The effects of a loss of confidence and self-isolation on general consumer demand are difficult to estimate since these will be temporary and losses for some retailers may be offset by gains to others, especially in online retailing. We might normally recommend that additional measures are put in place to offset potential reductions in consumer spending, but the situation has been complicated by the mandatory temporary closure of much of the retail sector.

Some have advocated a 'helicopter' drop of cash direct to households as that provides direct support that will cover those who will see no income. The need to self-isolate has reduced the case for a policy that might otherwise be effective in boosting consumption, such as a VAT cut.

The question now is whether any form of stimulus to spending is necessary or helpful since none of this will keep the tills ringing in shops which are no longer open. A technical recession is now unavoidable since at least 16% of the workforce will be mostly out of action for several months. How much will this matter?

If incomes are largely protected through government assistance, but spending is restricted on things like tourism, eating out or shopping, then the impact will have a similar effect to a bank holiday or weekend when many shops are shut. Households will spend less and save more but do not lose income. The pent-up demand should lead to a rapid recovery once the epidemic subsides, but there is little need to control this since inflation is tamed for now and not an issue unless the pound collapses.

If the economic recovery proves to be slow once the shops re-open this may be the time for an additional spending stimulus. A reduction in the VAT rate, at that time, from the current 20% down to 15% would cost HMRC £9 billion in lost revenue over three months but would allow retailers to declare a reduced-price 'sale' period for the next three months. Our estimate is that a would reduce consumer prices by 1% and increase real consumers expenditure by £8 billion (0.5%) although part of this would come from imports rather than domestic production. This is line with estimates of the impact of the 2.5 percentage point reduction in the VAT rate in 2008 to stimulate spending during the banking crisis[21].

Panic buying in food shops will have the opposite effect of temporarily increasing incomes of food retailers. There have been some calls to introduce rationing, but this seem itself a panic reaction. Stocking up on basic food and sanitary supplies should slacken off as people become used to the new situation and needs no government intervention.

Offsetting Reductions in the Workforce

The decision to close schools could have a large economic impact. There are 8 million children aged under 15 in our schools and at least the 4 million primary school children will need full-time childcare. If each primary school child needed one carer this would involve 4 million adults. Since a proportion of the children will be siblings the numbers could be closer to 3 million. Some carers will be at home anyway or might be furloughed, so we might be talking about withdrawing say 2 million or

21. https://www.researchgate.net/publication/46525993_Impact_of_VAT_reduction_on_the_consumer_price_indices

6% of people from the labour force. Some can work from home others will be in closed-down sectors, hopefully with incomes now subsidised by the government.

It remains to be seen how many people actually withdraw from work due to childcare duties. It is clear that a much higher proportion of highly paid workers are able to work from home whereas the great majority of low paid employees cannot. With 15% of the workforce employed in low-wage hospitality and retail sectors there is scope for people to stay at home looking after children without further damage to the economy. Even so, any associated loss of incomes will have negative consequences for the wider economy. The loss to the economy could be 3% for a three-month period, leading to a 0.75% loss to annual GDP. This is enough to halve annual growth in 2020. Alongside other shocks to the economy it is likely to mean a major recession for this year.

The issue once again is the potential loss of income and the knock-on impacts on consumer spending. Consideration could be given to extending the Job Protection Scheme to parents who are unable to continue working due to a need to remain at home to look after primary school-age or younger children. This could last as long as the schools remain closed and grandparents are prevented from looking after young children.

Lessons from abroad

Two countries stand out in terms of the boldness of their innovative measures: Norway and Denmark.

Norway has instituted a package of measures not unlike that introduced in the UK, including postponing due date on VAT payments and cutting the rate for business from 12 to 8 per cent, and postponing payments of corporation and net wealth taxes.[22] The most eye-catching measure was taken on 13 March, and involved allowing companies to carry back their losses incurred in the next few months against their taxable profits for the past two years.[23] Relief would be allowed for up to 30 million NOK, and could allow particularly adversely affected companies to reduce their corporate tax liabilities potentially to zero. Like in most Nordic countries, the rate of corporation tax in Norway stands at 22 per cent alongside a net wealth tax, therefore those measures will have more of an impact there than they would in the UK, but this is something that could be considered.

Denmark was one of the first countries to institute a wage subsidy, which is differently calibrated to the subsidy in the UK: it is less generous for salaries employers (covering 75 per cent of their wages, up to a cap equivalent of £2,800 per month) but is more generous to employers paid by the hour, covering 90 per cent.[24] Such a calibration assumes that salaried workers are generally better off and therefore are more likely to have savings and support networks they can rely on, which won't be the case for as many workers paid by the hour. Further, it also assumes that businesses that employ many staff paid by the hour will be particularly adversely affected by the crisis – hotels, restaurants, pubs etc, and therefore will be particularly eager to lay off staff even with a wage subsidy, since

22. KPMG, 'Norway: Economic, tax measures to address coronavirus (COVID-19) situation', 18 March 2020, https://home.kpmg/us/en/home/insights/2020/03/tnf-norway-economic-tax-measures-to-address-coronavirus-situation.html
23. KPMG, 'Norway: Tax relief proposals in coronavirus-related measures (COVID-19)', 16 March 2020, https://home.kpmg/us/en/home/insights/2020/03/tnf-norway-tax-relief-proposals-coronavirus-related-measures.html
24. Olsen M, 'Denmark: How a 'high-tax' state responds to coronavirus', EUObserver, 23 March 2020, https://euobserver.com/coronavirus/147827

they will be forced to completely stop trading. Such an approach could be considered in the UK.

Endnote

The necessity for unprecedented and draconian closures of whole sectors of the economy mean that a recession is now inevitable. Unlike previous recessions the government is taking measures which should limit any serious rise in unemployment or loss of incomes. Many companies should thus survive the downturn and recover when business revives. There are still problems associated with fixed costs and we recommend that additional assistance be given to firms to ensure that these costs do not cause closures.

The need for public acceptance of what are extraordinary measures of social control mean that the protection of incomes should be complete and widely seen as socially fair. Since there is little constraint on the availability of finance for additional spending, the Government should err in the direction of generosity the Job Protection Scheme should for instance insist that firms guarantee 100% of the wages of all furloughed employees and that the furlough should apply to all levels and not just to key workers. As far as possible no-one should be made unemployed as a result of the virus and all should be supported.

Bank of England measures to ensure a full supply of credit to both the public and private sectors have been both timely and adequate for the present circumstances. A prolonged epidemic will however lead to severe problems of debt and insolvency for many large companies. Even though the epidemic may prove less dramatic than some have predicted it is obviously necessary to plan for additional interventions to prevent the collapse of companies.

These expensive measures can be afforded because low inflation and historically low interest rates have largely removed previous constraints on the Bank of England printing money via buying the bonds issued by the Treasury to fund its subsidies and loss of tax revenue. All measures necessary to prevent major and arbitrary losses of income are now possible and it is most encouraging that the Government and Bank of England have firmly grasped this nettle. The task now is to ensure that the measures are complete, generous and fair. A prolonged recession in the sense of reduced provision of private services and delayed purchases of goods may then not have the damaging consequences of past recessions.

As we previously noted, thus rising unemployment threatens a hard brake to the economy and justifies the Chancellor keeping his foot to the floor on the economic policy accelerator.

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8 – 10 Great George Street
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London SW1P 3AE

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