EIC0927

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Executive Summary:

• Phase the Coronavirus Job Retention Scheme into Universal Credit to ensure continued incentive to work

• Cut red tape burden on businesses to allow them to adapt to their new circumstances and new businesses to start

• Suspend 45 day redundancy consultation notice to discourage businesses from beginning to make staff redundant and encourage hiring

• Exempt microbusinesses with 9 or fewer employees from written Covid-19 risk assessments to reduce the red tape burden

• Raise the employer's National Insurance threshold to encourage hiring

• Defer the introduction of the single employment regulatory body to avoid new costs to hire

• Introduce a temporary Coronavirus Insolvency Limited Liability Forgiveness Scheme to protect viable businesses

• Scrap Sunday trading laws to enable greater social distancing and economic activity

• Extend Permitted Development Rights to help restore town centres

• Abolish the Factory Tax to support industrial heartlands

Introduction:

The protection of public health in response to Covid-19 is raising extraordinary economic challenges, particularly facing employment.

The Government has tried to "freeze" the economy by extending furlough through to March 2021, using the Job Support Scheme, generous business loans, and various handouts. But freezing the economy is the easy part. Just like we have not mastered the second phase in cryogenics — unfreezing a human — we do not know how to successfully unfreeze an economy. Both are complex systems that cannot simply be turned "on" and "off".

The economic scarring is well underway, and the 2nd lockdown, while much less damaging than the first, will likely lock in a greater degree of damage. With the return to the tier system, Thousands of businesses will have, and will have to again shut down, introducing very uncertain trading conditions and undermining the productive capacity of the economy. There have already been millions of job losses. Many who lose their job during a recession never find one again. Young people who are trying to enter the workforce could experience long-run lost earnings.

Freezing the economy has also had extraordinary fiscal costs: increasing government debt by hundreds of billions. While this was justified to prevent a total economic collapse, it is simply unaffordable for these sorts of measures or this level of state expenditure to be maintained.

Millions of people who are currently unemployed will struggle to find work, potentially taking years to return to pre-pandemic levels of employment. Many businesses now lack cash flow, won't be able to pay rent and bills, and could be forced to shut. Business investment is already frozen, reducing long-term capital stock, and will likely be down for some time. Consumer confidence and spending is likely to be down as well, as people save, creating what John Maynard Keynes' called the "paradox of thrift". Social distancing measures will likely stay in place even as the vaccination programme ramps up, significantly hindering the return of jobs in the hospitality, tourism and entertainment industries.

What changes to the economy are now permanent?

The coronavirus pandemic is causing substantial permanent changes to the economy. The experience of pandemic will almost certainly change the way people behave, in both predictable and unpredictable ways, and therefore have meaningful economic consequences. Some of this, like reduced hospitality spending, will likely be temporary. Other elements, such as the acceleration of moves to online shopping and and behavioural changes in remote working, will be permanent.

Working remotely will likely mean the reduction in consumption on the way to, in, and around the workplaces. It could, nevertheless, shift spending around where people live.

The shift to online retail has exacerbated the shift away from the high street as a designated retail destination, as can be seen by Arcadia, Topshop and Debenhams going into administration. The traditional concept of the "high street", which has already been struggling, will have to adapt to its new circumstances.

Another 18,000 high street units could be left vacant this year, nearly double last year's figures. These are not likely to improve in the very near term, particularly as Government support schemes start winding down around March.

There are also potential hangover effects of huge state borrowing and loose monetary policy, that while not permanent could have some long lasting consequences. A larger state risks undermining the private sector while loose monetary policy risks the misallocation of capital and the creation of inefficient "Zombie companies" that leads to stagnation.

What are the consequences of high national debt?

In addition to the broader economic challenge, there are substantial fiscal costs from the decline in economic activity, reducing tax receipts, automatic stabilisers such as Universal Credit during a downturn, and specific measures taken to "freeze" the economy. The "best case scenario" is reportedly now a £337 billion budget deficit this year, a substantial increase from the £55 billion projected in the March budget. The worst case is a £516 billion deficit, with a cumulative total of £1.19 trillion additional debt over five years.

The cost of borrowing is currently extremely low. In April bonds were three times oversubscribed and 5 year bonds were sold with a rate of between 0.63 percent and 0.654 percent, £2 billion of bonds maturing in 2049 had returns of between 1.021 percent and

1.046 percent. There is, nevertheless, a substantial multi-billion pound annual cost to service the interest on the debt.

There is also a possibility of higher borrowing costs in future years if market actors judge there is a risk of nonpayment. This is not unprecedented. The market's unwillingness to lend to the Government necessitated a loan bailout by the IMF in 1976. State spending or tax cuts, if not matched by spending reductions, are inevitably funded with debt. All borrowing is a form of taxation deferred.

Is there a need for a new state sponsored investment bank?

The private sector has weathered a lot of the economic damage wrought by coronavirus. But it has also had a strong response; many British businesses have adapted well to their new circumstances, continuing to pay their employees and taxes as well as safely providing innovative goods and services to their customers. They have kept us fed, our internet flowing and ensured we are entertained and informed. They have adapted their supply chains to meet increased demand for certain goods, their production lines to manufacture personal protective equipment. The rapid development of the Pfizer and Astrazeneca vaccines are also a testament to the private sector's capacity for innovation and ability to deliver in times of crisis.

By contrast, state-sponsored investments, while sometimes successful, have a fair weaker track record. The National Investment Board of the 70s saw the state intervene to protect certain businesses and industries, usually fizzling out with little success. A productive, high-potential enterprise can currently borrow at extremely low rates. If the state begins providing loans it will inevitably chase those enterprises that are less efficient, wasting taxpayer money.

A National Investment Bank risks crowding out private sector investment. The enormous amount of borrowed money required for initial financing would mean issuing extra bonds, which in normal times means competing with private firms for investment funds. Private firms would have to pay more to borrow, or re-consider their own investments — meaning less private capital spending on factories, machine tools, training, R&D, and housing, all of which will be vital in returning to sustained growth post pandemic. So when the government borrows to fund its own investment, private investment has to fall.

Removing obstacles to recovery and going for growth:

There are a number of measures that would help, both now in terms of easing the severity of the crisis on business and employment, and in the future in terms of giving businesses a smoother and more open path to recovery and expansion.

It will be necessary when the economy is unfrozen that businesses are able to dynamically respond to its new circumstances. Removing barriers to businesses will be essential. This is not the time for policy experimentation or a new model of capitalism, like some have brazenly claimed. Excessively directing the economy, and pursuing policies that are either unproven or debunked, risks prolonging the downturn.

It is important to remember businesses themselves are social goods: they create useful products and provide people with salaries, as well as pay their taxes which will be necessary to fund COVID-19 related debt for many years to come. The goal must be simple: jobs and growth. We need policies that deliver economic growth and jobs to the millions of people who are being sacked.

Restoring the job market to health:

Employment-based support, in the form of the Coronavirus Job Retention Scheme, has been largely a success. It has kept individuals employed with companies that they can immediately work with again without costly human resources or retraining procedures, and linking corporate welfare in large part to the ongoing goal of high employment. It is precisely the model of state support that focuses on people not businesses.

Nevertheless, there will be difficult times ahead. A rise in unemployment has already begun. It is highly likely that the scheme has at least in part masked inevitable unemployment. As the economy recovers, the goal of the Government will change. It will no longer be to “freeze” people in their existing employment but rather to ensure people are where they are most wanted.

Retaining a worker that is not adding value to a company on a company’s books is financially unsustainable for a firm, economically inefficient if multiple firms act in the same way, and actively reduces the ability of the worker in question to progress or have an impression of earned worth in a job. Japan’s strict labour laws result in firms instituting “chasing-out” rooms for employees that didn’t take early retirement options — places where individuals would be sent with no responsibilities but also no corresponding possibility of recognition of work. In the United States public school system, a similar fate befell teachers that were falling well below expectations, as they were sent to “rubber rooms” until they chose to leave the profession. Workers stuck in these purgatories feel that they are failed by their companies but more often than not they are failed by the law.

Policy recommendations:

Abstain from increasing taxes that hamper economic activity:

It is essential that the Government does not mistake the short term health of its own accounts for the nation’s economic position. It is absolutely necessary that, particularly in the short to medium term, that the Government does not pursue tax increases that hamper economic recovery. Any tax increase that actively undermines business and employment will send a message to investors that Britain is “closed for business”. The Government should distinguish between an increase in the stock of debt, to pay for measures during this crisis, and a structural deficit, like the permanent unsustainable spending that needed to be tackled after 2010. Avoiding tax increases and allowing for economic growth will “pay” off for the state coffers in the long run: a bigger economy generates more tax revenue.

Cut red tape burden on businesses

The Government should be seeking to assess existing regulatory burdens and making an effort to cut all unnecessary red tape: regulation that is beyond necessary to achieve a stated goal. This will allow existing firms to reduce costs, hire more staff and boost wages. It will also make it easier for new firms to enter the workplace, to create those new enterprises and jobs the economy will desperately need to recover.

Suspend 45 day redundancy consultation notice:

Businesses are in the process of making tricky decisions about their future viability in a fog of uncertainty about future trading conditions. There is a risk that, in order to limit future expenses in a time of uncertain revenues, companies will begin to consult on laying off staff. Under the existing law this requires a 45 day process. This could mean beginning consultations on sacking staff very soon, particularly considering the planned withdrawal of the Job Retention Scheme. In order to maintain the productive capacity of the economy, this strong incentive to pursue redundancies should be withdrawn for the coming months. This flexibility will encourage employers to hold onto their staff for longer, rather than starting to lay them off now, as well as reduce the risk of hiring new staff.

Exempt microbusinesses from written Covid-19 risk assessments to reduce the red tape burden:

The Government is requiring all businesses with 5 or more staff to undertake a written Covid-19 risk assessment, and publish it online if the organisation has more than 50 staff. This regulatory burden is inconsistent with the Government's definition of a microbusiness. To bring these in line, and reduce the red tape burden on the smallest businesses at this difficult time, the Government should update their Covid-19 risk assessment guidelines to state that businesses with 9 or fewer employees are exempt. The Government should, in the longer term, commit to a review of all health and safety, employment, and pensions legislation for firms that have five or more employees but fewer than nine, in line with the formal definition of a microbusiness.

Raise the employer's National Insurance threshold:

Employers' National Insurance is an unnecessary drag and cost to employment. Employees currently pay National Insurance at the following rates on their earnings. For the first £7,605 they pay 0 percent, for the next £34,870 a rate of 12 percent is levied, and a further 2 percent is levied for amounts over £42,475. Employers pay 13.8 percent on every pound the employee earns over £7,488 with no cap.

If the government wants to encourage firms to hire they should immediately raise the bottom threshold for employer's National Insurance to £12,500.

Defer the introduction of the single employment regulatory body:

The Government has expressed an interest in introducing a single enforcement body for employment rights. While there may be some longer term justifications for simplifying employment law regulation in the UK, which is currently undertaken by various departments and bodies, a time of wide scale unemployment is not it. Such a body would have a strong bureaucratic impetus to "crack down" on businesses to show its weight and importance. This would discourage businesses from hiring, including those acting completely legally, because of heightened regulatory enforcement costs. While this may have little impact on employment during an economic boom, it could have a large impact when unemployment is high. Now is not the time for new regulatory arrangements.

Introduce a temporary Coronavirus Insolvency Limited Liability Forgiveness Scheme:

If large numbers of businesses cease trading who have taken out loans, creditors stand to lose one way or another, with taxpayers being asked to foot a considerable portion of the bill. It would also come with a catastrophic loss of productive capacity. It may be necessary to introduce a scheme that allows firms that have borrowed unsustainable amounts to keep their operations alive by forgiving some debt. This must be extremely limited, only be available for companies that (1) are effectively bankrupt; (2) can show a substantial fall (50-75 percent) in revenue due to coronavirus; and (3) display long-term viability through cash and cash equivalents ratio to short-term liabilities (above a certain level).

Scrap Sunday trading laws (particularly ahead of Boxing Day and New Year sales):

The inability for larger shops to trade for more than six hours between 10.00am and 6.00pm on Sundays has always appeared highly arbitrary. Recent innovations, in particular online deliveries and the expansion of smaller supermarkets, combined with the need to maintain social distance, makes these laws increasingly antiquated. Sunday trading laws reduce transactions and make people's lives more difficult, in particular for those with set working schedules. Having larger shops open on Sundays will also offer more hours for workers, likely with greater pay. With the Christmas shopping season around the corner and likely more footfall in shops, it would be a sensible issue to reform.

Extend Permitted Development Rights:

The National Planning Policy Framework, in its current form, stands in the way. In effect, its guidance encourages local plans to restrict 'town centre uses', to make them more competitive by preventing retail development outside the 'primary shopping area' of the high street. While retail still has its place, its capacity to provide a strong offering alone to residents and visitors is falling. Permitted Development Rights should be extended, facilitating the rapid repurposing of commercial into residential real estate. Where this occurs, councils should be allowed to continue to charge business rates to prevent significant revenue losses, although there is certainly a case for lowering them once relief ends next year.

Abolish the Factory Tax:

The Factory Tax is the inability to fully expense investments in machinery and buildings. Unlike expenditure on running costs, expenditure on fixed investment can only be written off over time, which fails to account for inflation and a real return on capital. This means, in real terms, firms pay a tax — a Factory Tax — on investment in buildings and machinery. This disproportionately affects capital intensive, industrial businesses based in the Midlands and North.

By allowing for the immediate full write off on capital investments, the Government could boost investment by 8.1 percent and labour productivity by 3.54 percent (£2,214 per worker) in the long-run, fitting well with the 'levelling up' agenda.

Conclusion:

Our recommendations are designed to support people, not businesses in and of themselves. Rather than try and likely fail to preserve the economy and employment in its pre-pandemic form, the Government should accept that the immediate post-pandemic period will be difficult, and that some businesses will inevitably downsize or die out altogether. Ultimately, rather than try to protect jobs through subsidy and propping up ailing businesses, the Government must focus its efforts on a buoyant job market and a growing economy. To accomplish this, it must facilitate free, spontaneous innovation, entrepreneurial activity and lower the cost of employment.

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