

## Advice to UK Chancellor Rishi Sunak, April 2020

The Chancellor needs to rethink the way he is looking to support business through the current crisis. His rejection of guaranteeing 100% of loans to small business is particularly inopportune as it is slowing delivery of payments and likely to trigger unnecessary business closures. Beyond this, he needs also to ensure that the furlough scheme delivers maximum protection from individual hardship, redundancy and business failure.

Social distancing measures are clearly reducing Covid-19 infection rates and they must be maintained and refined to protect public health. The government will come under increasing pressure to return to some variant of the old status quo in the weeks to come owing to the effect the lockdown is having on the economy. Because many of these must be resisted, it is essential that the government's emergency economic interventions are both effective and can be sustained for as long as the health requirements dictate. Nothing short of a rock-solid, sustainable, hibernation strategy will do.

Nevertheless, we should not fall into the trap of thinking that economic damage is something theoretical and remote and not about people's lives. In actual fact, sustaining income and managing debt repayments constitute essential life-support for everyone living in a modern society.

### Two contagions

So the government has to tackle two contagions: a health one that has already exploded and an economic/debt contagion that is brewing.

I wrote to the Chancellor and my local MP asking for the government to consider launching a Temporary Retrenchment Scheme as part of a set of measures to ensure that businesses forced into hibernation have their costs met by government.

Three days later Rishi Sunak announced his Job Retention Scheme, in much the same spirit as my proposal. It is to the Chancellor's enormous credit that he has both the courage and wisdom to embark on such a radical course of action.

My concern, though, is that the narrative accompanying the action is of this being "support" or "assistance". This is reinforced by there being no indication made as to how the money expended is to be recovered.

It is a mistake to look at it this way. Businesses are denied revenue by the imposition of lockdown restrictions. This revenue would have largely come from UK residents and businesses buying goods and services. The government should look to restore the revenue flows, sufficient to meet the fixed costs of business, including staff salaries. This requires not just handing out of money but also taking (taxing) it back from whence it used to come.

In other words, the Chancellor should be setting a goal to **artificially circulate money** as close as possible to how it was before the lockdown. If this is done, society avoids an economic collapse and simply experiences what should be, in a rational society, the true cost of the measures i.e. the temporary loss of nonessential amenity.

### Current problems with the furlough scheme

There are three main problems with the action to date:

- Too many are falling through the cracks
- Circulation of money has been depressed by caps, haircuts and exclusions
- The furlough scheme does not prevent even those qualifying from falling into financial difficulty

If people cannot meet their financial commitments, a domino effect of unpredictable consequences is liable to rip through the economy. That fact itself immediately renders a huge swathe of *existing* loans sub-prime and a repeat of the financial meltdown of 2008 will be on the cards, especially if more pressure is placed on financial institutions to lend. Loans are not the way to finance enforced hibernation and they inflate the risk of a global solvency crisis.

### The cracks

Amongst those falling through the cracks are directors of Personal Service Companies who pay themselves through dividends rather than salary. Those whose contracts are outside IR35 can do so legitimately (though outlawing the practice might have been simpler and more effective than imposing the complex and irrational IR35 rules). Many, though, are now unable to work and rely on this income to meet their obligations every bit as much as the self-employed.

The scheme also punishes the honest self-employed who have declared all their income, for if that amounts to more than 50K p.a. they will get no assistance whatsoever. Those that have systematically hidden cash payments from the exchequer, meanwhile, are supported.

### Stifled circulation

If the goal is to replicate the circulation of money as before, it is clear that the cracks, caps, haircuts and exclusions all obstruct the achievement of this. You can put a patient on a ventilator, but if you don't provide enough oxygen you fail the patient and waste the resource.

If the government aimed to recover what it is expending through taxation, it could afford to be more generous and remove some of the restrictions, caps and percentage haircuts that both get in the way of the scheme achieving its objective. By increasing complexity, these also obstruct fast delivery. The profiles of the businesses that are likely to be in hibernation the longest will be providers of nonessential services that are paid for mostly from disposable income of UK taxpayers. This is money we cannot spend now because we can't buy these services and experiences. If the cost of keeping the economy stable, avoiding mass unemployment and indebtedness was a temporary 10p on the basic rate of income tax, most people would happily accept this as a small and affordable price to pay.

### The supported still cannot meet their obligations

Someone earning 50,000 a year would lose about 16,000 net income under the furlough scheme meaning they may struggle to meet their mortgage commitments or rent payments and still feed their families. I have modelled the effect of adding 10p to the basic rate of tax but paying people's salaries in full and without a cap and then comparing this with how they would fare under the furlough scheme.

The increase in tax would make the worker previously earning 50K just 3,750 worse off, a much more manageable figure. The additional cost to the government for that furloughed worker would be an extra 12,250, but for each worker (furloughed or otherwise) the additional tax revenue received is 3,750 (see below). This means that the increase in tax should comfortably pay for completing the coverage, even if one worker in three was furloughed.

### Pay full salary, Raise Tax

Gross Salary	10,000	20,000	30,000	40,000	50,000	
Pers allowance	12,500					
Old Tax rate	20%					
New Tax rate	30%					
Salary net of PAYE	10,000	17,750	24,750	31,750	38,750	
Govt Revenue	0	2,250	5,250	8,250	11,250	1
Govt Cost	10,000	17,750	24,750	31,750	38,750	2
Addn Revenue ratio	0.0%	30.6%	57.4%	52.4%	30.6%	3
Personal Loss of Earnings	0	750	1,750	2,750	3,750	4
Total shared cost	10,000	18,500	26,500	34,500	42,500	

### Current Furlough scheme

Salary 80%, capped	8,000	16,000	24,000	30,000	30,000	
Salary net of PAYE	8,000	15,300	21,700	26,500	26,500	
Govt Revenue	0	700	2,300	3,500	3,500	1
Govt Cost	8,000	15,300	21,700	26,500	26,500	2
Personal Loss of Earnings	2,000	3,200	4,800	8,000	16,000	5
Total shared cost	10,000	18,500	26,500	34,500	42,500	

NI and Pension contributions not factored in

1. Income tax receipts
2. Salary minus tax receipts
3. Additional Revenue raised as a percentage of additional costs incurred.  
Relevant since costs not incurred for non-furloughed workers
4. Net Salary lost to additional tax burden
5. Net Salary lost through capping and haircut

This exemplifies my point about not providing enough oxygen. Under the current furlough scheme, the 16,000 loss of income is completely lost to the global economy. The economic patient cannot self-isolate but passes on their economic contagion in the form of unpaid debts. The government's money may have helped in mitigation, but potentially creates a problem for itself at a later date. Under the fund and tax alternative, the economic patient passes to the government their entertainment budget, and they cause no further harm to the economy.

### Finally

What is true of individual is true for corporations. Further revenue could be recovered through raising corporation tax and those receiving support should first pay back any benefits received out of their profits.

A fully-funded furlough scheme gives the government moral authority to call upon a team of temporary workers to help with implementing a number of measures to help us through the transition (e.g. testing, contact tracing, helplines, deliveries, fruit-picking, regional checkpoint setup – a whole medley of activities may require temporary labour).

The OBR thinks GDP is heading for a 35% fall and one can understand the Chancellor's worries. But GDP can be a fickle indicator, rising in response to traffic accidents and oil spills every bit as much as production and innovation. It will rise in response to fakery too. For GDP is primarily a measure of velocity and quantum of circulation and does not care whether the "product" being delivered is good, bad or non-existent. Maximise circulation of money and the dip in GDP will be minimised.

Raising taxes or imposing austerity *after* the crisis (when we want there to be economic recovery) is the wrong time to be paying for these measures, especially when those in work are currently generating unspent earnings. Fully covering hibernation costs and raising taxes now to pay for it will ensure that everyone bears some of the burden rather than it falling disproportionately on the few. The "failure" of these businesses is the direct result of them complying with government rules and guidance and hence supporting the NHS. It is neither acceptable nor sensible in the long term to hang them out to dry.

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