THE ECONOMY 2030 INQUIRY
SHAPING A DECADE OF CHANGE

From safety net to springboard

Designing an unemployment insurance scheme to protect living standards and boost economic dynamism

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Centre for Economic Performance

Resolution Foundation

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The Economy 2030 Inquiry

The Economy 2030 Inquiry is a collaboration between the Resolution Foundation and the Centre for Economic Performance at the London School of Economics, funded by the Nuffield Foundation. The Inquiry's subject matter is the nature, scale, and context for the economic change facing the UK during the 2020s. Its goal is not just to describe the change that Covid-19, Brexit, the Net Zero transition and technology will bring, but to help the country and its policy makers better understand and navigate it against a backdrop of low productivity and high inequality. To achieve these aims the Inquiry is leading a two-year national conversation on the future of the UK economy, bridging rigorous research, public involvement and concrete proposals. The work of the Inquiry will be brought together in a final report in 2023 that will set out a renewed economic strategy for the UK to enable the country to successfully navigate the decade ahead, with proposals to drive strong, sustainable and equitable growth, and significant improvements to people's living standards and well-being.

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Summary

Losing your job in Britain is a very risky business. Low levels of out-of-work benefits are rarely an adequate safety net for those who experience job loss, and workers in the UK who move out of work are at greater risk of experiencing a large income loss than those in most other OECD countries, including almost all of the western European economies. Replacement rates for a single earner on an average wage in the event of unemployment are among the lowest in the OECD. This is driven by the UK having unemployment benefits that are flat-rate, unrelated to a recipient's previous earnings, as well as our approach to uprating working-age benefits, which indexes them to price inflation: as a result, basic unemployment support is now worth just 14 per cent of average earnings, down from 24 per cent in 1980-81, and replacement rates for a single earner on average wage in the event of unemployment are among the lowest in the OECD. Although means-tested benefits provide more support for those with extra needs and a low income, these are very low levels of protection in the event of unemployment, and this is one of the reasons why the Government had to invent the furlough scheme during the Covid-19 pandemic and temporarily increase Universal Credit entitlements by £20 a week.

What impact do meagre benefits have on wider labour market performance? Some argue that low levels of insurance in the event of unemployment are a positive feature of our social security system, contributing to the UK's flexible labour market. And it is indeed the case that the UK has low levels of unemployment, certainly from an international perspective. But other aspects of our labour market story are far more concerning: the UK's labour market has become less dynamic over time, with job moves and sectoral reallocation declining significantly in the period between the financial crisis and the Covid-19 pandemic, contributing to our woeful record on productivity. At the same time, unemployment benefits are providing less security to workers than in previous decades. The UK jobs market model now combines high levels of insecurity with low levels of dynamism. This is both a source and a symptom of our wider stagnation.

There are good reasons for thinking these two characteristics – insecurity and a lack of dynamism – are related: many workers will be risk-averse given the low (or non-existent) unemployment insurance on offer if things do not work out. As one worker told us in a recent focus group: "If I really wasn't happy, OK, I might look for other jobs, but I wouldn't just quit mine and walk…as main breadwinner, no, I see it as my job to keep my salary coming in." This is true for workers across the board but all the more so for those in middle- and high-income families, for whom moving from work onto unemployment-related benefits would represent a large income shock: in 2022-23, the median worker in the sixth income decile would have seen their family income drop to 51 per cent of its

previous level in the event of unemployment (with 30 per cent of workers in the sixth income decile having a replacement rate lower than 41 per cent), compared to 71 per cent for median workers in the lowest-income households.

Creating better unemployment insurance would both boost job market dynamism and productivity growth in the UK, while also protecting workers' living standards if they are hit by unemployment. Evidence shows that more-generous unemployment benefits support workers to find better-paid and longer-lasting jobs. By reducing the fear of not being able to meet financial obligations in the event of unemployment, it seems workers feel more confident in taking risky job moves.

We therefore propose a new and modernised system of unemployment insurance for the UK. Contributory Jobseeker's Allowance (JSA) – a vestigial part of a once much larger contributory social security system, with fewer than 25,000 claimants – should be scrapped and replaced with a system that provides real wage insurance and enables proper job search, but without putting excessive demands on the Exchequer. To deal with very low replacement rates, we propose that unemployment insurance should be paid at 65 per cent of previous wages, up to a cap set at the median earnings of £2,260 per month (a companion report has already recommended that Statutory Sick Pay also be paid at 65 per cent of previous wages). This echoes aspects of the furlough scheme, and, if it were in place now, would mean entitlements rose from £84.80 per week at present up to a maximum of £339. To ensure that unemployment insurance protects those in low-income households, unemployment insurance should be treated like earnings within Universal Credit, meaning that it reduces Universal Credit awards at the rate of 55p in the pound, in line with other payments designed to replace earnings, like Statutory Maternity Pay. (Contributory JSA is currently deducted pound per pound from Universal Credit, meaning there is no incentive for workers from low-income households to claim it.)

We propose a cautious approach of initially paying unemployment insurance for at most three months, after which eligible lower-income workers could continue to receive support through Universal Credit. This relatively short duration gives workers the time to look for a good job, but minimises the chance that workers' work-search activity turns into long-term unemployment (this 'moral hazard' issue is a common critique of unemployment insurance schemes). Crucially, this duration should flex with the economic cycle, with governments able to increase the length of coverage in downturns to protect workers while they spend longer looking for work. This would also allow the unemployment insurance scheme to contribute to our macroeconomic stabilisation toolkit, helping support both GDP and workers' welfare in times of need, without future governments needing to invent new social security payment systems overnight.

Unlike Contributory JSA, which has complex eligibility rules dependent on workers' National Insurance record over the past two complete tax years, our revitalised

unemployment insurance would be available to all employees who have been in employment for the past 12 months (regardless of their National Insurance contributions or whether they have switched employer). This would be possible to calculate using real time information (RTI) earnings data, with the Universal Credit digital benefits system providing a blueprint.

Our proposed scheme is – perhaps surprisingly – fairly modest in cost, at only £0.4 billion per year in 2024-25 prices, covering 50,000 eligible workers (or 4 per cent of all unemployed adults). This low cost – less than 1 per cent of the overall working-age welfare bill – reflects our choice to pay it for no more than three months, to condition it on being in work for at least a year previously, and not to pay it to those who quit their job voluntarily. But the cost also reflects the relatively low rate of unemployment in the UK: this stood at only 4.2 per cent in the second quarter of 2023, and was even lower on the eve of the pandemic, at just 4.0 per cent. We may expect the unemployment rate in the UK to increase as a result of introducing our proposed scheme, and this would have knock-on impact on its cost: for example, the cost of our scheme would increase by just under a third to reach £0.6 billion per year if unemployment rates in the UK increased to reach those seen in Denmark (a country with a more generous unemployment insurance system than the UK). The cost would also, of course, rise during economic downturns with higher unemployment, but would still remain modest compared to other parts of the welfare system. For example, in a recession like the one experienced after the financial crisis, we would expect the scheme to more than double in cost to reach £1.1 billion a year. The design of our scheme means that lower-income households would be better protected, but that the benefits would be shared across the income distribution: under our proposed scheme, 71 per cent of recipients would be in the lower half of the income distribution.

A better system of unemployment insurance, of course, will not by itself transform the UK's labour market, nor will a new £0.4 billion programme solve the problem of an inadequate benefit system. We have already set out in previous work that achieving shared growth will be impossible without a commitment to uprate all working-age benefits in line with earnings, relinking Local Housing Allowance rates to local rents, and reversing cuts such as the two-child limit. Stronger unemployment insurance is much more tightly focused on addressing the insecurity that comes with unemployment, and tackling low levels of job market dynamism. Our proposed system would protect workers from living standards shocks and reduce inequality (by reducing the proportion of adults who experience periods on very low incomes). If accompanied by higher labour market standards and stronger worker rights, it would help to create a more dynamic jobs market, and a higher-productivity economy where workers feel more able to take risks, resulting in higher-quality work for them and a more prosperous economy for all of us.

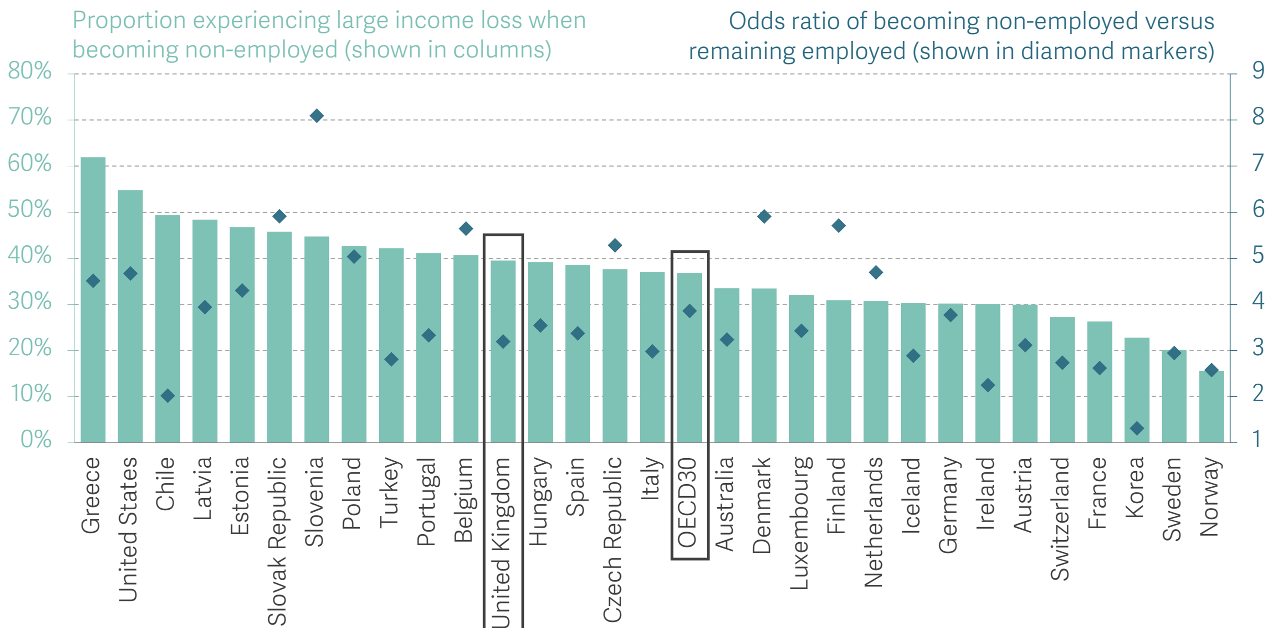
Workers in the UK are not well protected in the event of unemployment

The UK labour market is widely characterised as insecure. This insecurity manifests in a variety of ways, from the use of zero-hours contracts (which reached a record high at the end of 2020) to the woeful provision of sick pay on offer to low earners.[1] But another dimension to insecurity is the loss of income faced by workers who become unemployed.

This can be seen clearly in international comparisons: Figure 1 shows that workers in the UK who move out of work face a risk of experiencing a large income loss that is greater than that in most OECD countries, including almost all western European economies. More recent work confirms this, finding that the cost to a household of job loss is 22 per cent in the UK, more than double the rates in Denmark, Finland and Germany (at 10 per cent, 10 per cent, and 8.6 per cent respectively).[2]

FIGURE 1: **Although the risk of job loss is relatively low in the UK, two-in-five of those who do lose their job experience a large income shock**

Proportion of employed people experiencing a large income loss when becoming non-employed (left-hand axis) and odds ratio of becoming non-employed compared to remaining employed (right-hand axis): OECD countries, early 2010s or latest



NOTES: Large income losses are defined as those of 20 per cent or more from one year to the next. Data for the United States refers to bi-annual transitions. Data is for the working-age population (18-65).
SOURCE: OECD, A Broken Social Elevator? How to Promote Social Mobility.

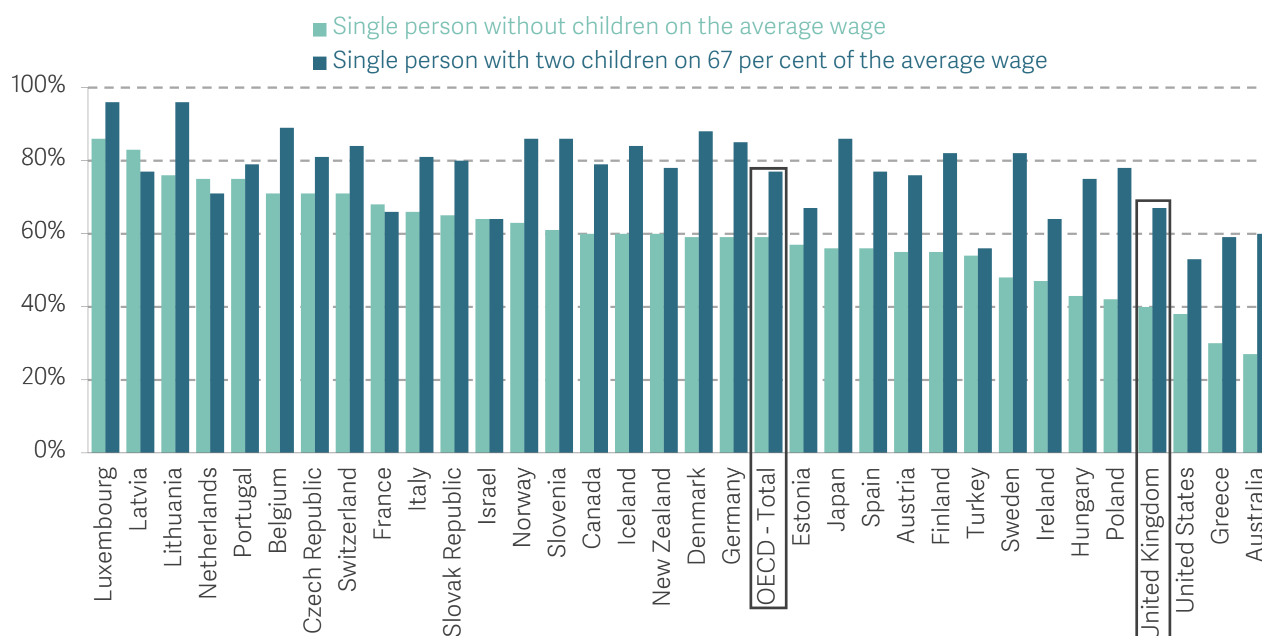
1 N Cominetti & H Slaughter, Good news in the latest labour market data for the Bank and the Chancellor, but bad news for the general public, Resolution Foundation, February 2023; N Cominetti et al., Low Pay Britain 2023: Improving low-paid work through higher minimum standards, Resolution Foundation, April 2023.

2 S Bedük et al., Insurance against risk? Economic cost and compensation of job loss in different welfare states, Working Paper, September 2023.

Both pieces of research discussed above are based on longitudinal data tracking individual households, but we can see the same pattern if we look at workers' hypothetical entitlements to taxes and benefits if they were to become unemployed, which we do in Figure 2. This shows that income 'replacement rates' in the event of unemployment in the UK are low by international standards, falling below the OECD average. This is particularly true for single adults without children: a single person without children on the average wage has a replacement rate of just 40 per cent (including support for housing), compared to the OECD average of 59 per cent.

FIGURE 2: **Replacement rates in the event of unemployment are low in the UK – especially for single adults without children**

Net income replacement rate in the event of unemployment: OECD countries, 2020



NOTES: Replacement rates shown are for one month of unemployment and include social assistance and housing benefits.
SOURCE: OECD, Net replacement rate in unemployment.

There are two main reasons for these low replacement rates. First, since 1982, the UK has had a solely flat-rate unemployment benefit system, i.e. one where the amount that is received in unemployment benefit is not related to that worker's previous earnings.[3] With unemployment benefit paid at £84.80 per week, and average earnings currently at £533 per week, it is clear why replacement rates are often very low, particularly for relatively high earners.[4] (The UK's current system of unemployment benefits – delivered via New Style JSA and Universal Credit – is summarised in Box 1.)

3 For a longer discussion of the history, see: N Timmins, Why has the UK's social security system become so means-tested?, IFS Deaton Review of Inequalities, February 2023. We are using the phrase 'unemployment benefit' loosely. As discussed more in Box 1, unemployed individuals can currently claim new style JSA or UC; before UC was introduced, the choice would have been between 'contributory' or 'income-related' JSA. Before JSA was introduced, the options would have included Unemployment Benefit or Income Support.

4 ONS, Earnings and employment from Pay As You Earn Real Time Information, UK: September 2023.

BOX 1: How does unemployment insurance currently operate in the benefits system?

In the UK, there are currently two main benefits available to jobseekers: Universal Credit and New Style Jobseeker's Allowance.

Universal Credit (UC) is a means-tested benefit available to jobseekers as well as those who are out of work due to ill-health or caring responsibilities, and to those who are in work but on a low income. Not all unemployed adults will qualify for UC due to its means-test which assesses adults based on their savings and the earnings of other family members.[5] In July 2023, there were 1.4 million people in receipt of UC who were in the 'Searching for work' conditionality regime – this is broadly equivalent to the number of unemployed adults in receipt of UC, though will also include some adults who are working but with very low earnings.[6]

New Style Jobseeker's Allowance (JSA) is a contributory benefit available to unemployed adults who have previously worked and paid National Insurance (NI). The name 'New Style JSA' is a recent – and likely temporary – change away from the more familiar names of 'contributory JSA' or 'contribution-based JSA', intended to differentiate it from income-based JSA which is being phased out and replaced by UC.[7] For simplicity, we use the phrase 'Contributory JSA' to refer to New Style JSA and its predecessors for the remainder of this report.

Contributory JSA is not a means-tested benefit, so is available to adults regardless of their savings or other family income.[8] However, it has strict eligibility criteria based on adults' National Insurance contributions during the previous two complete tax years (for example, for an adult claiming in September 2023, the relevant two tax years are 2021-22 and 2022-23): to qualify, adults must have paid at least 26 weeks' NI contributions on earnings at the NI 'Lower Earnings Limit' (LEL) in one of those two years, and have paid NI contributions, or received NI credits, on earnings of at least 50 times the LEL in each of the two years.[9] In 2021-22, the total Contributory JSA caseload was just 48,000, down from an average of 210,000 in the decade from 2000-01 to 2009-10, and it is expected to be just

5 www.gov.uk/universal-credit, accessed 15 September 2023.
6 Analysis of DWP, Statxplore.
7 Social Security Advisory Committee, Government response: SSAC report on the future of working age contributory benefits for those not in paid work, 12 September 2023.
8 www.gov.uk/guidance/new-style-jobseekers-allowance, accessed 11 September 2023.
9 For a more detailed explanation of the Contributory JSA eligibility criteria, including exceptions to the conditions set out above, see: Child Poverty Action Group, Welfare Benefits and Tax Credits Handbook, 2023/24, April 2023.

17,000 in 2023-24, just 1 per cent of the size of the UC jobseeker caseload.[10]

Both UC and Contributory JSA are flat-rate payments, and a single adult with no dependents or additional costs and no other sources of income would receive the same amount from either benefit. In 2023-24, these benefits were worth £84.80 per week or £368.74 per month. (Adults aged under 25 receive less: just £67.20 per week or £292.11 per month.)

A recent report by the Social Security Advisory Committee highlighted that the rollout of Universal Credit – a benefit which, especially after the Covid-19 pandemic, has very high brand recognition – means that there is often a sense among both the public and DWP staff that Contributory JSA is playing second fiddle.[11] Indeed, during the Covid-19 pandemic, the well-publicised £20/week 'uplift' to Universal Credit did not apply to Contributory JSA. One DWP work coach summed up this sentiment:

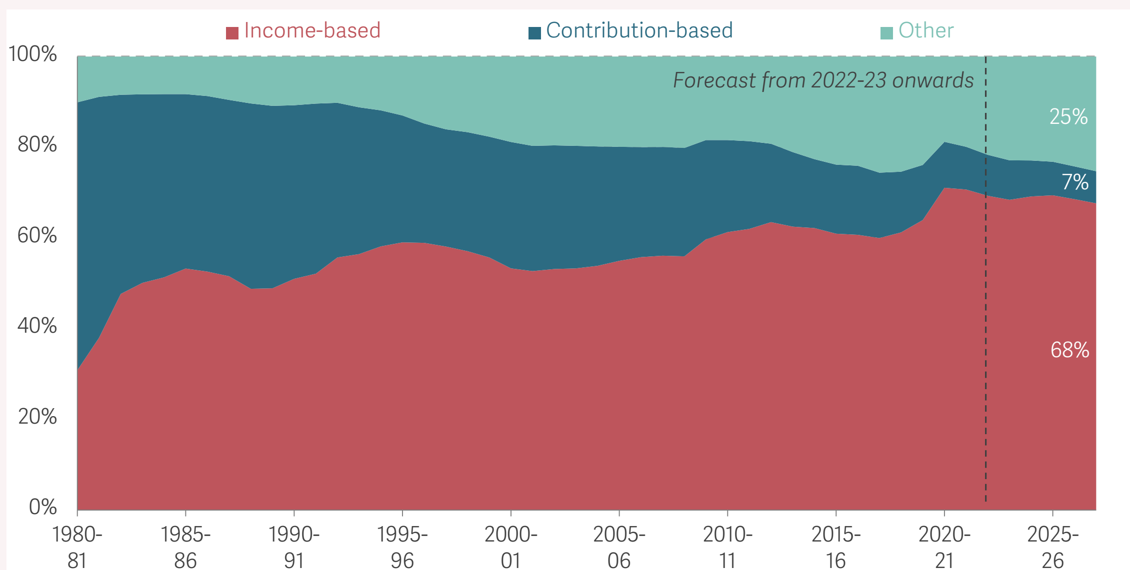
> *"It sometimes feels as if contributory claimants are forgotten. All messaging is Universal Credit. New Style claimants have paid in, but they are not spotlighted. We have some really good New Style claimants who don't get opportunities like Kick-Start."*
>
> *DWP Work Coach (Wales)*

This is symptomatic of a decades-long downgrading of the social insurance-type benefits and the importance of the contributory principle.[12] The share of working-age benefit expenditure spent on contribution-based benefits is expected to be just 7 per cent in 2027-29 – down from over half in the 1980s (59 per cent in 1980-81) and 28 per cent per cent at the turn of the century in 2000-01 (Figure 3).

10 Analysis of DWP, Benefit expenditure and caseload tables 2022, December 2022.
11 Social Security Advisory Committee, The future of working age contributory benefits for those not in paid work, July 2022.
12 This trend has been noted by many commentators, including: K Bell & D Gaffney, Making a Contribution: Social Security for the Future, TUC, May 2012; A Harrop, H Reed & E Sacares, In Time of Need: Building employment insurance for all, Fabian Society, March 2023; A Mackley & R McInnes, Contributory benefits and social insurance in the UK, House of Commons Library, October 2020; Social Security Advisory Committee, Jobs and benefits: the COVID-19 challenge, March 2021; Social Security Advisory Committee, The future of working age contributory benefits for those not in paid work, July 2022.

FIGURE 3: **Contribution-based benefits make up less than a tenth of total working-age benefit expenditure**

Proportion of total working-age benefit expenditure, by benefit type: GB



NOTES: Figure labels refer to the end of the series in 2027-28.
SOURCE: Analysis of DWP, Benefit Expenditure Tables.

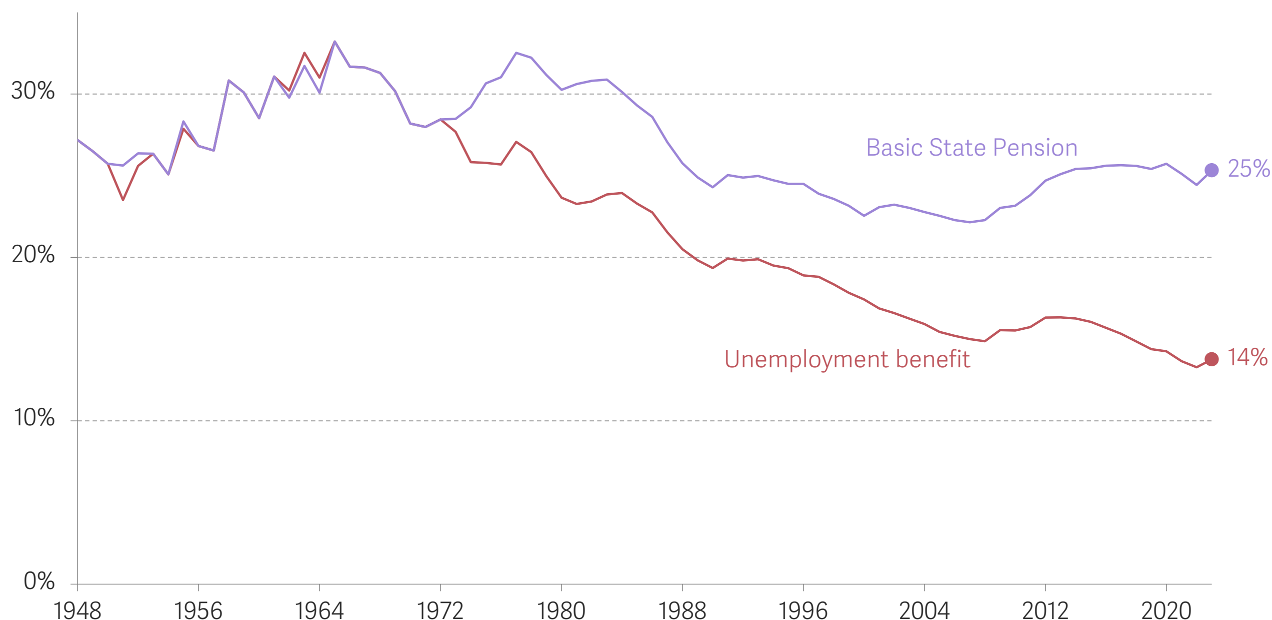
Second, since the early 1980s, the UK's unemployment benefits have been uprated only in line with price inflation – at best – and so have not kept up with growth in earnings. The outcome of these two key policy choices is shown in Figure 4: our main unemployment benefit is worth just 14 per cent of average weekly earnings in 2023-24, down from 24 per cent four decades ago.

By contrast, the (old) State Pension is now worth 25 per cent of average earnings, up from its low point of 22 per cent in 2007-08, and the ratchet effect of the triple lock means this will rise further in the long run.[13]

13 J Cribb, C Emmerson & H Karjalainen, The triple lock: uncertainty for pension incomes and the public finances, Institute for Fiscal Studies, September 2023.

FIGURE 4: **Unemployment benefits have become less generous compared to average earnings**

Value of unemployment benefit and basic State Pension as a proportion of average weekly earnings: UK



NOTES: Unlike Universal Credit, Contributory JSA was not boosted by £20/week during the Covid-19 pandemic.
SOURCE: Analysis of DWP, Abstract of Statistics; OBR, Economic and Fiscal Outlook; OBR, Fiscal Risks and Sustainability.

Of course, there is more to the UK's social security system than our core benefits paid to people who are unemployed. And, for adults living in couples, the income of the other partner can also provide some form of cushion in the event of unemployment. The impact of these two factors mean that the reality for many families is not as bad (this can be seen in Figure 2 by comparing the series for a lone parent to a single adult without children).

In Figure 5, we therefore show our own estimates of replacement rates in the event of unemployment for all those currently in work, and how they vary across the distribution of household income.[14] It shows that replacement rates are lowest for those at the middle and top of the income distribution: in 2022-23, the median replacement rate for those in the top income decile was 47 per cent, compared to 51 per cent for those in the sixth decile and 71 per cent for those in the lowest income decile.[15]

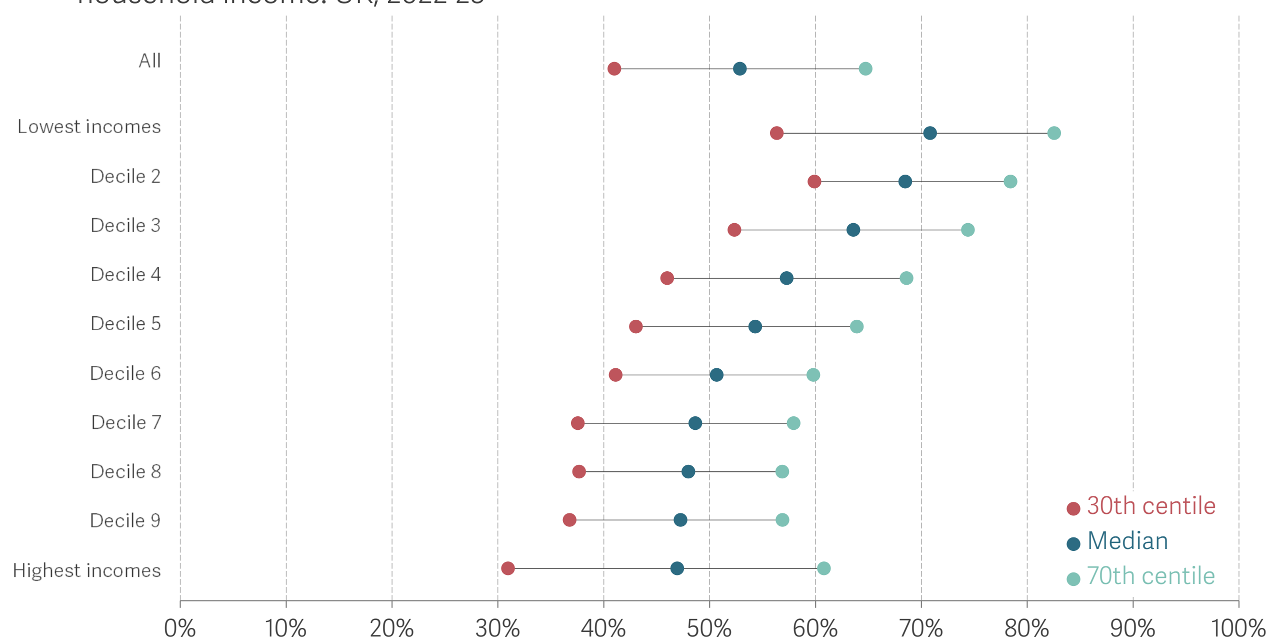
But it also shows that there is a lot of variation in replacement rates within each decile – this will be driven by variation in family circumstances, and particularly on whether there is another adult in work in the family – but that extremely low replacement rates are not

14 The data in Figure 5 first appeared in: M Brewer et al., Social Insecurity: Assessing trends in social security to prepare for the decade of change ahead, Resolution Foundation, January 2022.
15 By this, we mean that the family was towards the top of the income distribution before the (hypothetical) spell of unemployment.

uncommon, especially along middle-to-higher income families. For example, 30 per cent of workers in the top decile have a replacement rate lower than 31 per cent, and over 30 per cent of workers in the top four deciles have a replacement rate lower than 40 per cent.[16]

FIGURE 5: **Replacement rates in the event of unemployment are higher for workers on low incomes than those on high incomes**

Distribution of replacement rates in the event of unemployment within each decile of household income: UK, 2022-23



NOTES: Household income measured after housing costs and equivalised. For details of modelling assumptions, see Annex 1 in: M Brewer et al., Social Insecurity: Assessing trends in social security to prepare for the decade of change ahead, Resolution Foundation, January 2022.
SOURCE: Analysis of DWP, Family Resources Survey, using the IPPR Tax Benefit model.

The UK has a productivity problem and declining dynamism

We have shown that the UK provides meagre income insurance in the event of unemployment. Some might argue that this is a positive feature of the UK's social security system, and that it contributes to the UK's modern, dynamic, flexible labour market. And it is certainly the case that the UK has fairly low levels of unemployment, certainly from an international perspective. For example, the overall risk of job loss in the UK is relatively low.[17]

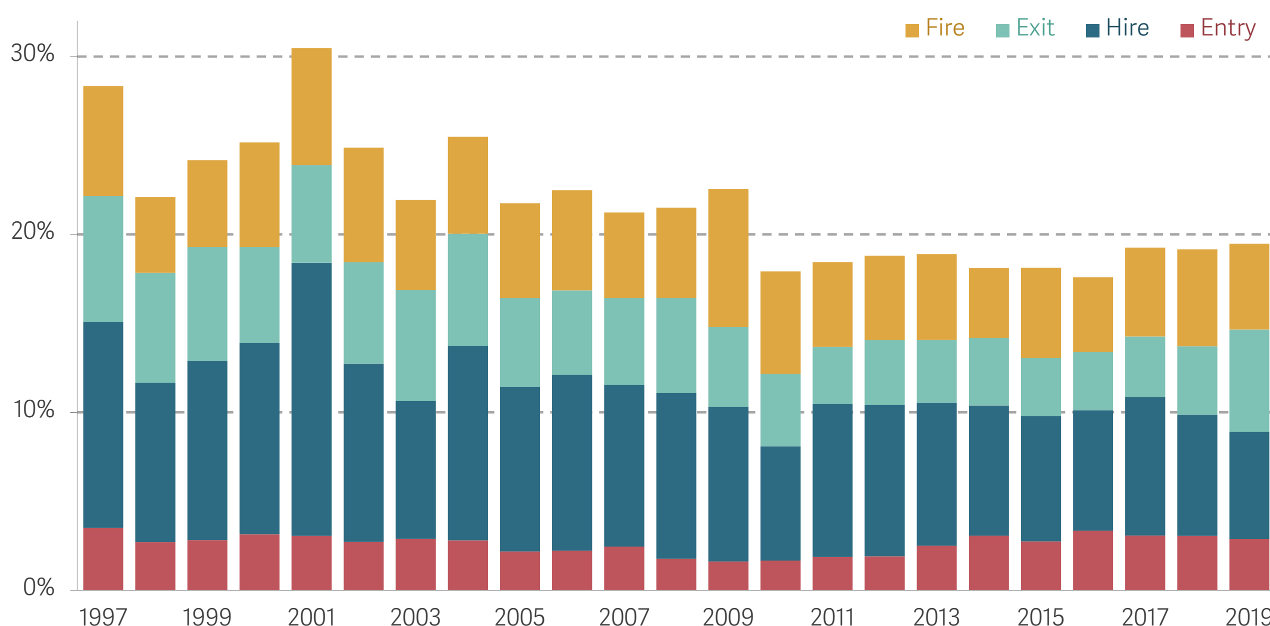
But we have shown in past work that the UK's labour market has become less dynamic over time (and forthcoming work will extend this to look at other aspects of our

16 Replacement rates have fallen over time: this largely reflects the falling value of working-age benefits relative to earnings.
17 This is shown in Figure 1, which reports the odds ratio of job loss compared to remaining in employment: this stands at 3.2 in the UK, 3.9 across the OECD overall, and 4.7 in the US. A similar result is shown in: S Bedük et al., Insurance against risk? Economic cost and compensation of job loss in different welfare states, Working Paper, September 2023.

economy).[18] For example, until the start of the Covid-19 pandemic, the rate at which workers move jobs had slowed compared to two decades ago: in 2019, the job-to-job move rate was 2.5 per cent, up from a low of 1.7 per cent in 2009, but down from a rate of 2.9 per cent in 2002.[19] The reallocation of workers between firms has also slowed over the same time period, with the reallocation rate falling from 23 per cent in 2009 to 19 per cent in 2019 (see Figure 6).[20]

FIGURE 6: **The reallocation of labour has fallen since the financial crisis**

Jobs created and destroyed by entry, exit, growing and shrinking firms: UK



NOTES: Rates for date t compared to date t+1. Rates are percentages as a proportion of the total workforce. Non-market sectors (education, healthcare) and the financial and real-estate sectors are excluded.
SOURCE: Analysis of ONS, Business Structure Database.

Either way, the decline in worker mobility experienced over the past two decades is bad news for the dynamism and productivity of the country, since reallocation of employment between firms can be an important mechanism through which average productivity increases as workers move to more-productive or better-matched jobs.[21] But it is also bad news for workers, since moving job is associated with a pay boost: between 1975

18 Our past work is: N Cominetti et al., Changing jobs? Change in the UK labour market and the role of worker mobility, Resolution Foundation, January 2022. In the week after publication of this report, we will publish an in-depth look at the lack of dynamism in the UK economy; see: R Davies, N Hamdan & G Thwaites, Ready for change: How to make the UK economy more dynamic, Resolution Foundation, forthcoming.

19 Job-to-job moves picked up in the aftermath of the Covid-19 pandemic, reaching a high of 3.1 per cent in 2021, reflecting post-pandemic economic restructuring, and the tight labour market we have seen in the past couple of years. However, job-to-job moves have more recently started to decline.

20 Figure 6, alongside further discussion of the reallocation of labour, will appear in: R Davies, N Hamdan & G Thwaites, Ready for change: How to make the UK economy more dynamic, Resolution Foundation, forthcoming. Figure 6 is based on analysis in: R Davies, Productivity, Responsiveness and Adjustment in a Service Economy, in Macroeconomics with Micro Data, PhD Thesis, NYU Stern, September 2022.

21 The evidence on this is discussed in: R Davies, N Hamdan & G Thwaites, Ready for change: How to make the UK economy more dynamic, Resolution Foundation, forthcoming.

and 2020, those who moved job benefited from a pay premium averaging 4.1 percentage points compared to those who did not move job.[22] And we know that some groups, for example mothers, are less likely to move job in a way that benefits their pay or career prospects. Although overall mobility rates are similar for men and women, mothers are the group who are most likely to change job for family-related reasons – moves which typically lead to significant wage losses – and are least likely to move for wage or career reasons.[23]

A related wider problem is that of poor matching in the labour market, with certain groups particularly likely to be in badly-matched and unproductive jobs. In 2022, around a third of all graduates were working in non-graduate roles, but this rises to 37 per cent among graduates in the North East and 39 per cent in Scotland, compared to 27 per cent in London.[24] This mismatch in the labour market is just one reason why the UK has such a weak performance when it comes to productivity growth: in the 12 years following the financial crisis labour productivity grew by just 0.4 per cent a year in the UK, half the rate of the 25 richest OECD countries (0.9 per cent).[25]

A reimagined unemployment insurance system would boost dynamism and tackle some of the UK's poor performance on productivity

With the UK economy suffering from declining dynamism, contributing to its poor record on productivity, and workers suffering under our lack of protection in the event of unemployment, a renewed system of earnings-related unemployment insurance is a vital part of the toolkit we need to turn things around.

The immediate impact of an improved unemployment insurance system would be that workers face a smaller income shock upon job loss. But it is also well-evidenced that a better-designed unemployment insurance scheme can lead to productivity gains by facilitating unemployed people to find better jobs, in terms of their subsequent wages or subsequent job duration (this is sometimes referred to as better 'matching'). The literature on the links between unemployment insurance and productivity and job matching is summarised in Box 2.

22 N Cominetti et al., Changing jobs? Change in the UK labour market and the role of worker mobility, Resolution Foundation, January 2022.
23 S Avram, S Harkness & D Popova, Gender differences in job mobility and pay progression in the UK, CeMPA Working Paper Series, March 2023.
24 Table 7 of ONS, Graduates and non-graduates employed in graduate and non-graduate roles, numbers and proportions for UK countries and regions, 2021 and 2022, August 2023.
25 The specific evidence on this is discussed in: R Davies, N Hamdan & G Thwaites, Ready for change: How to make the UK economy more dynamic, Resolution Foundation, forthcoming.

BOX 2: **The link between unemployment insurance and productivity**

There is extensive literature on the link between the duration and generosity of unemployment insurance and both the duration of unemployment and the quality of the subsequent job.

A long-standing finding is that paying more generous unemployment insurance tends to lengthen unemployment spells. This is due to two different impacts: more generous unemployment insurance might reduce an unemployed worker's incentive to look for new work (the 'moral hazard' effect), and more generous unemployment insurance facilitates a longer job search (the 'liquidity' effect).[26] One paper finds that the majority of the increase in unemployment durations due to unemployment insurance payments comes from the 'liquidity effect' ; this is consistent with findings that more generous unemployment insurance payments have a larger effect on unemployment duration among liquidity-constrained households. That paper also estimates that the optimal unemployment insurance scheme is one that pays at least 50 per cent of previous wages.[27]

But a more recent literature has shown that doing so can also improve the quality of the subsequent job, either in terms of its wage, productivity or duration. Below, we summarise some of this work.

- One paper finds that, when unemployment insurance is made more generous, workers tend to end up in more productive jobs, increasing overall worker productivity. This is because workers with low levels of wealth or insurance search for low-productivity jobs because those offer a low risk at the cost of low productivity and a low wage. Providing unemployment insurance allows workers to spend longer searching for a new job, so they can apply for more competitive jobs, knowing that they have enough assets to finance the duration of their job search. However, the authors also note the trade-off: the longer work-search durations associated with more generous unemployment insurance means there are fewer filled jobs in the economy.[28]
- Another paper, using data from the US, finds that more generous unemployment insurance leads to longer spells of unemployment. But it also finds positive effects: more generous unemployment insurance

26 It is also the case that unemployed workers skills may depreciate while they are unemployed, which is one of the suggested reasons why off-flow rates tend to fall as the duration of unemployment rises. See: ONS, Which groups find it hardest to find a job following a period out of work?, March 2021.
27 R Chetty, Moral hazard versus liquidity and optimal unemployment insurance, Journal of Political Economy, 116(2), April 2008.
28 J Eeckhout & A Sepahsalari, The Effect of Wealth on Worker Productivity, The Review of Economic Studies, July 2023.

leads to higher reemployment wages for workers. This happens through two main channels: by increasing the quality of the match (between the worker and the employer) and by increasing the quality of the job obtained. Notably, they find that the effects on unemployment insurance and match quality are larger for workers who are more likely to be liquidity constrained, including women, ethnic minorities, and lower-educated workers.[29]

- Another paper looks at the links between wealth more generally (i.e. not just unemployment insurance) and the quality of unemployed workers' job search. It finds that less-indebted households are able to spend longer searching more widely for a new job, leading to higher wages upon reemployment. In particular, they find that a 25 per cent decline in workers' debt-to-income ratio leads to a 3.3 percentage point increase in wages. This is in comparison to other displaced workers who experience a 7.4 percentage point fall in wages.[30]
- Another paper also finds a positive impact of unemployment insurance on future wages. It finds that unemployment insurance raises reemployment wages by improving the quality of the reemployment firm, and by reducing the chance that workers will experience a large fall in wages compared to their previous job.[31]

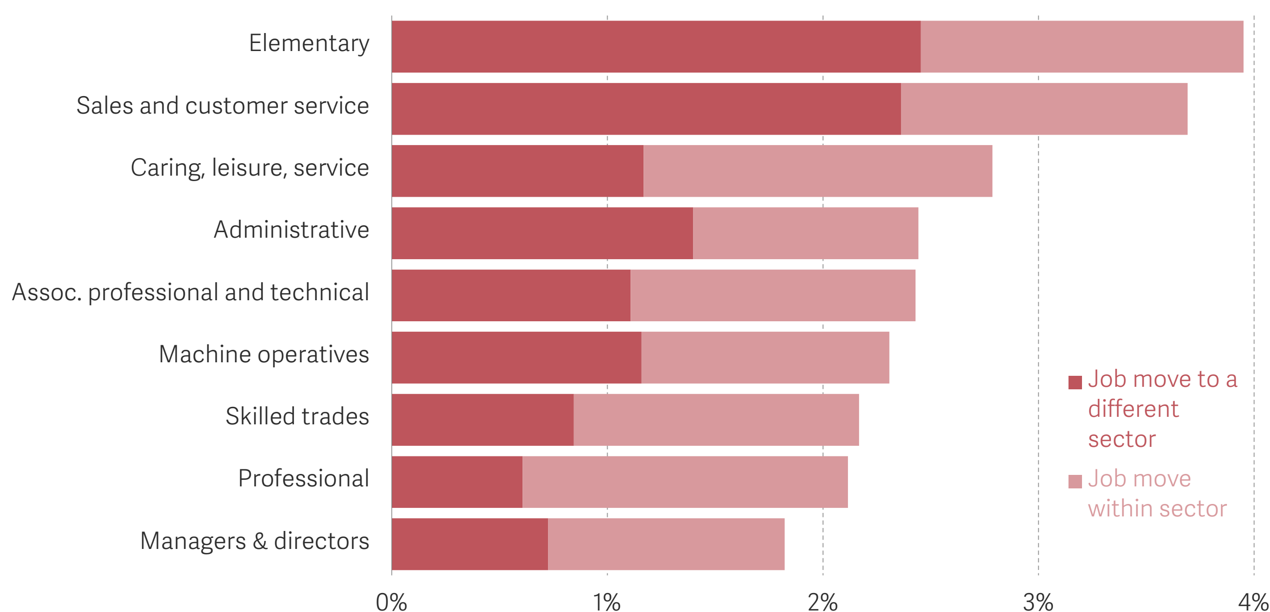
The way in which a better unemployment insurance scheme might encourage risk-taking is more nuanced. Theoretically, the link is clear: if workers are better-insured against risk, they will be more likely to make riskier job moves: they might worry less (for example) about the risk that their new employer goes bust, or that a job with a fixed-term contract turns out to be unsuitable. This would be particularly true among middle-to-high earners, for whom the potential for a large income shock is currently the highest (as shown in Figure 5).

It is certainly true that middle-to-high earners are the least likely to move job at present: there is a clear gradient in job moves: between 2015 and 2019, the proportion of workers moving job between quarters was twice as high among those from elementary occupations (4 per cent) than managers and directors (1.8 per cent) (see Figure 7).[32]

29 A Farooq, A D Kugler & U Muratori, Do Unemployment Insurance Benefits Improve Match And Employer Quality? Evidence From Recent U.S. Recessions, NBER Working Paper 27574, April 2022.
30 G Kabas, K Roszbach. The price of leverage: Learning from the effect of loan-to-value constraints on job search and wages, VoxEU, May 2023.
31 A Nekoei & A Weber, Does Extending Unemployment Benefits Improve Job Quality?, American Economic Review 107(2), February 2017.
32 The data in Figure 7 first appeared in N Cominetti et al., Changing jobs? Change in the UK labour market and the role of worker mobility, Resolution Foundation, January 2022.

FIGURE 7: **Workers from higher-paying occupations are less likely to move job than those from lower-paying occupations**

Proportion of workers who moved jobs between and within sectors since previous quarter, by occupation: UK, 2015-2019



NOTES: The characteristics set out above relate to the worker before the job move.
SOURCE: Analysis of ONS, Two-quarter longitudinal Labour Force Survey.

This chimes with what we heard from middle-to-higher earners in recent focus groups.[33] Some were hesitant about moving job, with the knowledge that a period out of work would translate to a big hit to their household finances front of mind:

> *"I'm the main earner of the house. ... If I really wasn't happy, OK, I might look for other jobs, but I wouldn't just quit mine and walk. If my wife really wasn't happy in her job, we could probably get by without her working while she was looking for something else. But as main breadwinner, no, I see it as my job to keep my salary coming in."*
>
> *Headteacher, Chippenham*

> *"Ultimately if you've got a mortgage and you're doing a job, then you're feeling like, if I lose my job then I don't know what's going to happen."*
>
> *Manager, Paisley*

33 K Handscomb, L Judge & H Slaughter, Listen up: Individual experiences of work, consumption and society, Resolution Foundation, May 2022.

Moving to a new, more generous unemployment insurance system would be an important part of a wider set of changes – alongside moves to higher labour market standards and stronger worker rights, including the right to a contract with reflecting a worker's usual work pattern, stronger protection against unfair dismissal, and higher Statutory Sick Pay (SSP) – that could support a more dynamic and productive labour market that better protects workers from income shocks. [34]

In the remainder of this Briefing Note, we consider how such a scheme should be designed to protect workers' living standards when they experience job loss while boosting labour market dynamism and productivity without increasing the cost to the Treasury unduly.

How should a revitalised unemployment insurance system be designed?

We consider four design elements central to designing a new unemployment insurance scheme: who should provide and fund it, eligibility, generosity, and duration.[35] In doing this, we can learn from a variety of unemployment insurance schemes operating in different countries; these are summarised in Box 3.[36]

BOX 3: **Learning from other countries' unemployment insurance schemes**

When designing a new unemployment insurance scheme for the UK, we can draw on the variety of unemployment insurance schemes currently operating across the world. These are summarised in Table 1 below.[37]

34 For a discussion of how to improve minimum standards including sick pay, parental pay, holiday entitlement and shift notice, see: N Cominetti et al., Low Pay Britain 2023: Improving low-paid work through higher minimum standards, Resolution Foundation, April 2023. For a discussion about how to better enforce labour market rights such as payment of the minimum wage and proper holiday entitlement, see: L Judge & H Slaughter, Enforce for good: Effectively enforcing labour market rights in the 2020s and beyond, Resolution Foundation, April 2023.

35 A fifth could be 'conditionality', i.e. what activities do claimants have to undertake in order to receive the benefits. These considerations apply to all benefits, though, not just income insurance, and so we do not consider it in this note.

36 For a recent report which details different unemployment insurance schemes, including international comparisons, see: A Harrop, H Reed & E Sacares, In Time of Need: Building employment insurance for all, The Fabian Society, March 2023. For a report making a positive case for retaining contributory benefits – including unemployment insurance – in the modern benefits system, see: K Bell & D Gaffney, Making a Contribution: Social Security for the Future, TUC, May 2012.

37 Table 1 summarises information from: J F Schmieder & T von Wachter, The Effects of Unemployment Insurance Benefits: New Evidence and Interpretation, Annual Review of Economics Vol. 8, October 2016; OECD, Income support for jobseekers: Trade-offs and current reforms, February 2023; OECD, Income support for jobseekers: Trade-offs and current reforms, February 2023; A Harrop, H Reed & E Sacares, In Time of Need: Building employment insurance for all, The Fabian Society, March 2023; www.gov.uk/jobseekers-allowance, accessed 18 September 2023. For a discussion of the Ghent system of unemployment insurance, see: J Lindellee & T Berglund, The Ghent system in transition: unions' evolving role in Sweden's multi-pillar unemployment benefit system, Transfer: European Review of Labour and Research, 28(2), April 2022; Y K Shin & P Böckerman, Unemployment insurance in Denmark, Finland and Sweden: the Ghent system, Nordics.info, March 2020; A Ilsøe & T Pernille Larsen, Flexicurity and the future of work: Lessons from Denmark, Resolution Foundation, June 2023.

TABLE 1: **Comparing Contributory JSA with examples of unemployment insurance from other countries**

	UK (Contributory JSA)	Examples from other countries
Who should provide it, and how is it funded?	State-run and funded by general taxation.	Most countries have unemployment insurance schemes that are run at the national or state level. However, there are some examples of countries having unemployment insurance schemes that are administered by employers or unions – for example, the Ghent system of union-provided unemployment insurance that has existed in Denmark, Finland and Sweden.
Eligibility	Based on National Insurance record in the past two complete tax years.	Most countries have similar eligibility criteria based on previous work history. Many countries require claimants to have worked (and, in many cases, paid taxes) for six or 12 months. For example, in the US, most states require claimants to have worked for at least 20 weeks, with earnings over a certain baseline, to qualify for unemployment insurance.
Generosity	Flat rate: · £84.80 per week for those aged 25 and over. · £67.20 per week for those aged 24 and under.	Many countries have replacement rates ranging between 50 per cent to 65 per cent, for example: · Austria: 55 per cent · Belgium: 65 per cent · Canada: 55 per cent. But there are also some countries with more generous schemes, including: · Denmark: 90 per cent · Luxemburg: 80 per cent · Netherlands: 75 per cent. Some countries also have gradually-declining replacement rates, with the generosity of unemployment insurance falling over time. For example: · Netherlands: Drops from 75 per cent to 70 per cent after two months · Sweden: Drops from 80 per cent to 70 per cent after nine months.
Duration	Up to six months.	Varies considerably: from around six months in the US and Slovakia, up to 35 months in Sweden and 36 months in Iceland. Some countries vary unemployment insurance duration by age and/or previous work history. For example, in countries such as France, Germany, and South Korea, unemployment insurance duration is a function of age and duration of previous employment. In various countries, such as Chile, South Korea, and the US, unemployment insurance duration increases during downturns when unemployment is high.

1. Who should provide it and how should it be funded

The UK benefits system has long included some contributory 'something for something' benefits, where those who have worked and payed National Insurance receive non-means-tested benefits in the event of unemployment.[38] It is therefore unsurprising that much commentary around unemployment insurance in the UK tends to assume that the state-run social security system is the main – or only – way of providing this type insurance.

But looking to many of our neighbours in Europe shows that this is not the case: there is a strong tradition in some Northern European countries of unemployment insurance being provided by employers or unions rather than the state. For example, the Ghent system – where the main responsibility for administering unemployment benefits is held by trade unions rather than the state – is widespread across Nordic countries.[39]

These alternative systems can and do work in other economies, but the UK lacks the necessary institutions, and a state-run system has been a steady feature since the creation of our modern welfare state. On top of this, low union membership rates mean that any union-provided system would fail to function as a proper safety net. The UK has a union density rate of just 24 per cent and collective agreement coverage of 27 per cent – this is well below the rates seen in many other parts of Northern Europe. In Denmark, for example, 67 per cent of all employees are union members and 82 per cent are covered by collective agreements.[40]

Finally, the liberal nature of the UK labour market makes an employer-provided unemployment insurance system practically difficult, and any such system would be risky given that the insurance would be at risk if a firm went bust, at precisely the time when workers would be needing to rely on unemployment insurance. (The UK does have one form of widespread employer-provided insurance – Statutory Redundancy Pay – which is discussed in Box 4 below.)

BOX 4: **The role of Statutory Redundancy Pay (SRP)**

The UK does currently have a form of employer-provided unemployment insurance: Statutory Redundancy Pay (SRP).[41] Workers are usually entitled to SRP if they have been employed with

38 N Timmins, The Five Giants: A Biography of the Welfare State, 2001.
39 See the references in footnote 37.
40 A Ilsøe & T Pernille Larsen, Flexicurity and the future of work: Lessons from Denmark, Resolution Foundation, June 2023
41 This box is based on: www.gov.uk/redundancy-your-rights/redundancy-pay, accessed 18 September 2023.

their current employer for two years or more.

The generosity of SRP depends on an employee's age and their length of service. Employees get:

- Half a week's pay for each full year they were under 22;
- One week's pay for each full year they were 22 or older, but under 41;
- One and half week's pay for each full year they were 41 or older.

The length of service used to calculate SRP is capped at 20 years, and the weekly pay used is the average earned per week over the 12 weeks before being made redundant. Finally, in the 2023-24 tax year, the weekly pay used to calculate SRP is capped at £643 and the maximum amount of SRP that can be paid is £19,290. Although SRP is paid by employers, there is a generous tax break: currently, SRP under £30,000 is not taxable, and in 2022-23 this tax relief cost £610 million spread across 200,000 people, translating to a benefit of £3,050 per person.[42]

SRP should not be viewed as an alternative to a state-provided unemployment insurance scheme. First, SRP is only available to a subset of unemployed adults who were made redundant. Those who were not formally made redundant, or who have not been employed in the same job for the past two years, do not qualify. Second, SRP is inherently risky, with workers having to instead apply for SRP through the Redundancy Payments Service if a worker's employer is insolvent. In fact, it is possible to imagine that the role of SRP could be downplayed – or the tax relief phased out – if a more generous unemployment insurance system was implemented.

There are other alternatives too: two that are often suggested include purely market-based solutions, and options that (in effect) compel individuals to (in effect) self-insure. Our view is that neither of these are likely to be successful in adequately protecting workers' living standards. The first of these options, whereby individuals take out insurance with insurance companies, is likely to run into the problems of moral hazard or adverse selection that apply to any private system of unemployment insurance. The second option – a typical proposal would be that working individuals are compelled to save into a pot which they can then run down in the event of unemployment – can be seen as an attempt to raise the very low rates of saving in the UK – at present, 43 per cent of families in the lowest wealth decile report that they would run out of money within

42 HMRC, Non-structural tax relief statistics, January 2023.

a week if they lost their main income source – but it is not reasonable to think that low earners in the UK could build up enough savings to self-insure against job loss.[43]

Instead of solutions provided by unions, employers or the private market, and instead of a system of forced self-insurance, our view is that only a state-provided and state-funded unemployment insurance system is likely to provide enhanced insurance to a large proportion of the workforce.

2. Eligibility

Most unemployment insurance schemes have some eligibility criteria based on previous work history. The main reason is to reflect the 'contributory' nature of unemployment insurance: that those who have worked and paid into the system (via tax or National Insurance) receive a benefit award that reflects this.

Currently, eligibility to Contributory JSA is limited to employees who have paid National Insurance at some point in each of the two previous full tax years, and paid credits in at least 26 weeks in at least one of those two years (see Box 1). This complex rule, whereby eligibility depends on work history that could be up to 36 months old, was introduced to avoid problems caused by delays in processing and sharing National Insurance records in a pre-digital world. But it is not the sort of rule one would devise if starting from scratch. First, many people will be unsure if they qualify for Contributory JSA, due to the complexity of the eligibility criteria which cannot be easily explained on online advice websites or reflected accurately in benefit calculators. Second, it in effect denies any unemployment benefit to everyone until they enter the third tax year of their working lives.

In general, when deciding what the eligibility conditions should be, requiring longer spells of previous employment is going to reduce the proportion of unemployed workers who would be eligible for the insurance, but might strengthen the perception that the subsequent benefit has been 'earned' through a long spell of work. Moving in the other direction, and requiring only very short spells of previous employment, risks encouraging employers either to offer very short-term jobs in the knowledge that the worker would receive benefits afterwards, or even to collude with workers to game the system.[44] Neither of these would be desirable.

43 M Broome & J Leslie, Arrears fears: The distribution of UK household wealth and the impact on families, Resolution Foundation, July 2022.

44 To give an extreme example of how such 'gaming' might happen, consider the Job Retention Scheme (JRS). During the Covid-19 pandemic, any individual who was registered with HMRC as being in work on 28 February 2020 could be put onto the Job Retention Scheme (JRS), after which they could have some of their earnings covered by government payments for up to 18 months. Had this scheme been announced in advance, then it would undoubtedly have encouraged fake employments to have seen set up. As it was, the date was announced retrospectively, and no-one on 28 February 2020 could have anticipated the subsequent creation of the JRS. But the creation of 'fake' employment spells could easily arise if an unemployment insurance scheme paid out benefits after very brief employment spells.

3. Generosity

As we showed in Figure 2 and Figure 4, the current UK system is ungenerous, both compared to the past (with unemployment benefits representing a lower share of average earnings than in previous decades) and compared to other countries.

An obvious way to make unemployment insurance payments more generous would be to move away from flat-rate payments towards a system which calculates benefit awards based on previous earnings. This is common across many European countries (as set out in Box 3), and was in fact a feature of the UK social security system between 1966 and 1982 (as summarised in Box 5). This is also how other earnings-replacement payments such as Statutory Maternity Pay (SMP) are currently calculated, so would not be a wholesale departure from the status quo in the UK.

BOX 5: **The UK's experience of unemployment insurance in the 1960s-1980s**

It is important to reflect on the UK's short history of earnings-related unemployment insurance payments.[45] Between 1966 and 1982, the Earnings-Related Supplement (ERS) supplemented flat-rate unemployment benefits, and was payable for 26 weeks (from the third to the 28th week of the unemployment benefit claim). The value of the ERS was based on workers' previous earnings, and the maximum weekly supplement was worth 1.75 times the single person's flat-rate benefit payment at the time of its introduction, but this maximum payment fell to become worth less than the flat-rate benefit by 1980. Its strict entitlement rules meant that only a minority of unemployment benefit recipients received the ERS: this peaked at 23 per cent in November 1980, not long before it was scrapped. (The ERS scheme was abolished in the 1980 Social Security Act, to little opposition.)

The reasons behind the ERS's demise are complex, but its poor design and administration have been highlighted as major problems. The scheme put a great deal of administrative burden on claimants, with claimants having to prove their employment history by producing a P60 form. This inevitably led to delays: in November 1971, for every three unemployed claimants with an ERS included in their award, there was one unemployed person missing their ERS due to an undetermined earnings record. In addition, the complicated calculation based on previous earnings made it almost impossible for workers to know if they would qualify for the ERS or not.

45 This draws heavily on: J Micklewright, The Strange Case of British Earnings-Related Unemployment Benefit, Journal of Social Policy Volume 18 Issue 4, January 2009. See also: G Kelly, Preparing for a decade of economic change: lessons from the era of White Heat, July 2021.

When deciding exactly how generous to make unemployment insurance payments, there is a trade-off to consider. As we discussed earlier (see Box 2), making unemployment insurance more generous is shown to improve workers' job matching and reemployment wages – but if we make it too generous, there is the possibility that it dulls workers' incentives to look for work. So, we must aim to design an unemployment insurance scheme which is generous enough to give people the breathing space to search properly for a suitable job – but not so generous that it distorts workers' job search incentives.

4. Duration

Currently, Contributory JSA is paid for up to six months (though Universal Credit, available to those in low income households, is available indefinitely) and, as we showed in Box 3, payment durations in other countries vary enormously, and can last for as long as three years.

The choice over the duration raises similar issues to the choice of the generosity: longer durations allow unemployed workers to look for longer, making it more likely they will find a better job, but a duration that is too long may end up dulling incentives and significantly lower job mobility.

But it is also important to recognise that the duration of unemployment insurance need not be fixed over the economic cycle. Designed properly, unemployment insurance can play a small but important part of our macroeconomic stabilisation toolkit, reducing the need for governments to invent new programmes or instruments overnight. In particular, one feature is to have the maximum duration of unemployment insurance increase during downturns, as happened in the past in countries such as Chile, South Korea, and the United States. It makes sense to provide more insurance in periods when it inevitably takes longer for jobseekers to find employment, although there will be always be a trade-off between providing insurance and discouraging moves into work.[46] We discuss this more in Box 6.

BOX 6: **An unemployment insurance programme is a small but important part of the macroeconomic stabilisation toolkit**

In recent years, particularly in the context of constrained monetary policy, there has been increased discussion around the role of unemployment insurance as a macroeconomic stabiliser: that is, many argue that a well-functioning unemployment insurance scheme is an important way

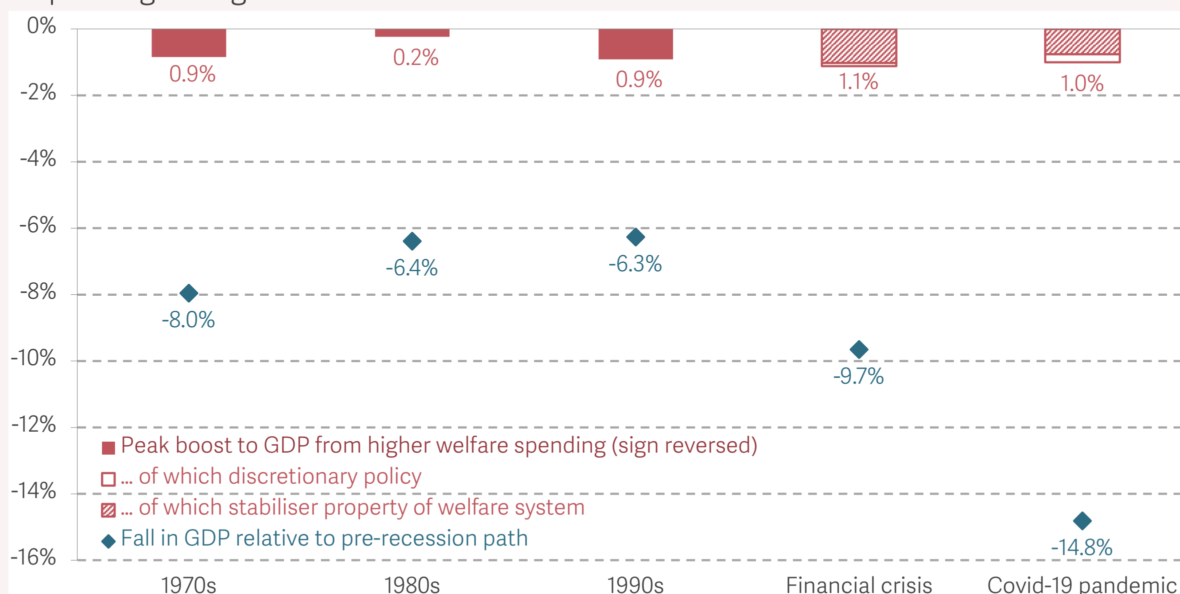
46 Increasing the maximum duration is more appealing than increasing the replacement rate, as it targets the extra generosity on those who have taken longer to find work.

that we can stabilise the economy by keeping unemployed workers' consumption up during recession, when unemployment typically rises.[47]

Obviously, macroeconomic stability is an important aim, and any unemployment insurance system will play a role in reducing the impact of downturns. But the scale of unemployment insurance that would be needed to deliver significant portion of the macroeconomic stabilisation required during a downturn would be highly distortionary outside of a recession. This is illustrated in Figure 8 which shows welfare spending during recessions. It shows that, although welfare spending does provide a tangible boost to GDP, it tends to be small compared to the overall hit to GDP. For example, during the Covid-19 pandemic, higher welfare spending led to a boost to GDP of 1 per cent – but the overall fall in GDP relative to the pre-pandemic path was 15 per cent.

FIGURE 8: **Welfare spending plays a supporting – rather than central – role in stabilising the economy**

Fall in GDP relative to pre-recession path and GDP impact of increases in welfare spending during the recession: UK



NOTES: Fall in GDP is the peak-to-trough fall during the recession relative to the pre-recession path calculated on a financial-year basis. For the Covid-19 recession that path is taken from the OBR forecast, for the 1990s and financial crisis recession it is taken from HM Treasury forecasts and the 1970s and 1980s recession it is simply the pre-1970s recession average growth rate (2.9 per cent). The boost to GDP from welfare spending is calculated as the change in welfare spending as proportion of nominal GDP multiplied by the OBR's fiscal multiplier for 'other annual managed expenditure'. For the Covid-19 pandemic and the financial crisis the change in welfare spending is split between discretionary policy measures (as identified in the OBR's Policy measures database and HM Treasury scorecards) and a residual which is taken to be the automatic stabiliser component of welfare policy.
SOURCE: Analysis of OBR, Historical public finances database, Policy measures database & Public finances databank; HMT, Budget publications, various; DWP, Benefit expenditure and caseload tables, 2023.

47 Key references are: A McKay & R Reis, The Role of Automatic Stabilizers in the US Business Cycle, Econometrica 84, January 2016, and: A McKay & R Reis, Optimal Automatic Stabilizers, Review of Economic Studies, 88(5), March 2021. Automatic stabilisers appear to have declined over time, as discussed in: J Smith et al., Recession ready?: Assessing the UK's macroeconomic framework, Resolution Foundation, September 2019.

An important question is whether governments should do more during downturns to help ensure macroeconomic stability than what is achieved by the conventional automatic stabilizers like unemployment insurance, and we will return to this in a future Economy 2030 report.[48]

Our proposal

Having explored the key parameters that should be carefully considered when designing an unemployment insurance scheme, we propose a new scheme with the following features.

On eligibility: it would be available to all employees who have been in employment for at least the last 12 months; that is, workers must have been in employment for each of the last 12 months, but that need not have been with the same employer (very small breaks between employments would not disqualify someone). This would be assessed not using NI contribution records, but using HM Revenue and Customs' Real Time Information (RTI) earnings data.[49]

As we show in Figure 9, about half of those in unemployment who were previously in work had been in work for at least a year, so this is meaningful restriction (and a large fraction of the unemployed were not previously in employment – they were previously economically inactive). Our choice is intended to be a cautious approach that keeps the cost to the Exchequer low. Compared to the current Contributory JSA, this would result in winners and losers: winners would include someone who has been in work for the past 12 months, but not in the past two full tax years, and losers would be those who have not worked continuously over the past 12 months but do meet the current Contributory JSA conditions.[50] The self-employed would not be eligible, as is the case under Contributory JSA.

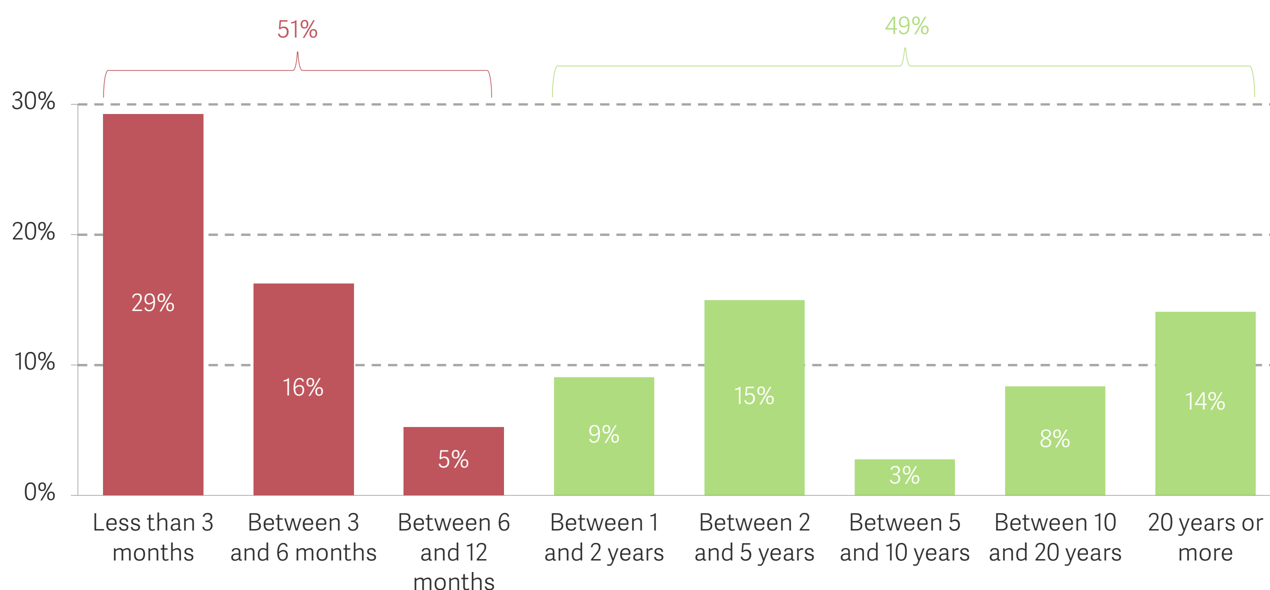
48 For a discussion of the US and UK experience in the Covid-19 pandemic, see: G Giupponi, C Landais & A Lapeyre, Should We Insure Workers or Jobs During Recessions? Journal of Economic Perspectives, Volume 36 Number 2, Spring 2022, and: M Gelman & M Stephens Jnr, Lessons Learned from Economic Impact Payments during COVID-19, in W Edelberg, L Sheiner & D Wessel (eds.), Recession Remedies: Lessons Learned from the U.S. Economic Policy Response to COVID-19, The Brookings Institution, April 2022.

49 Such a rule would separate entitlement to unemployment insurance from National Insurance contributions – seen by some to be an important part of the contributory system – but such a change would be more symbolic than practical, given that payment of Contributory JSA does not reflect how many National Insurance payments a claimant has made.

50 There is no principled reason why there should be a requirement to work over a minimum number of hours, or earn more than the National Insurance Lower Earnings Limit, but there may be administrative reasons that in effect exclude people with very low levels of weekly pay.

FIGURE 9: **Half of all adults who would otherwise qualify for our unemployment insurance scheme have not been in continuous employment for the previous year**

Length of time continuously employed before becoming unemployed, among adults who otherwise qualify for our unemployment insurance scheme: UK, 2019-20



NOTES: Eligibility for our unemployment insurance scheme is defined earlier in the note.
SOURCE: Analysis of ONS, Labour Force Survey; ONS, Two Quarter Labour Force Survey.

On generosity: it would be paid at 65 per cent of workers' previous earnings, calculated using an average over the past 12 months.[51] The earnings used in this calculation would be capped at median monthly earnings (£2,260 in August 2023).[52] As with Contributory JSA, payments would be liable to Income Tax. Compared to the current Contributory JSA eligibility rules, almost all unemployed workers would gain from this change.[53]

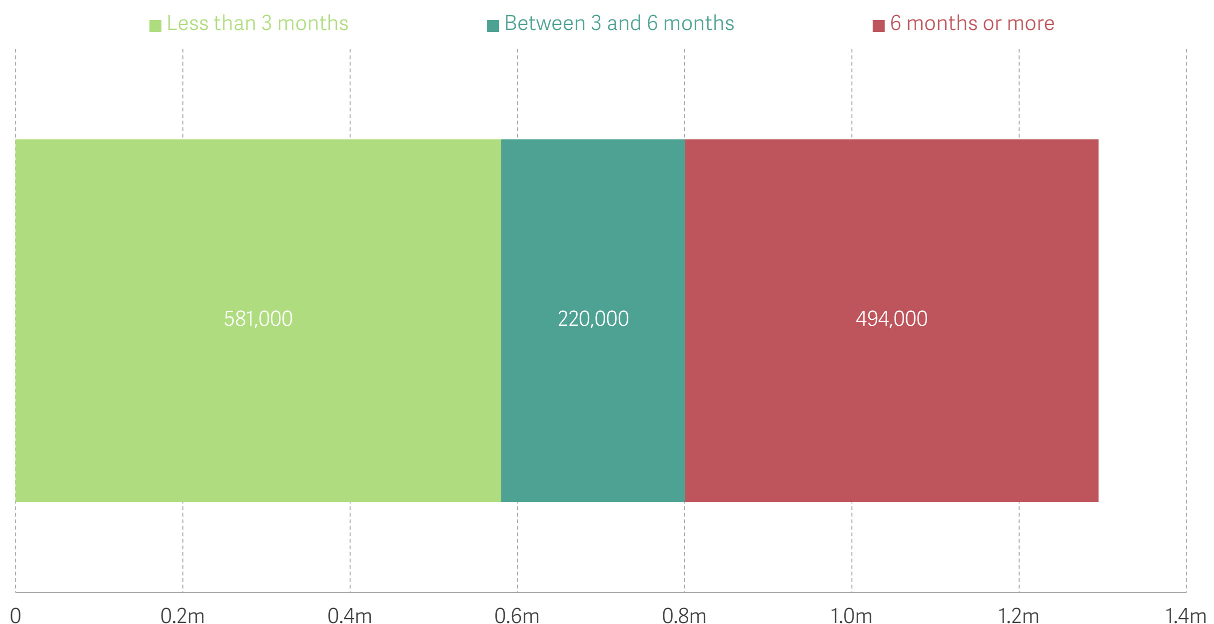
On the duration: in normal economic times, the unemployment insurance would be paid for a maximum of three months; as we show in Figure 10, nearly a half (44 per cent) of unemployed people have been unemployed for less than three months. Our proposal of initially paying insurance for this relatively short period is a cautious one that attempts to strike the balance between giving workers the time to look for a good job, but minimising the chance that workers' work-search activity turns into long-term unemployment (this 'moral hazard' issue is a common critique of unemployment insurance schemes, as set out in Box 2). Crucially, this unemployment insurance duration should be extendable

51 This is aligned with our proposal to reform Statutory Sick Pay, as outlined in: N Cominetti et al., Low Pay Britain 2023: Improving low-paid work through higher minimum standards, Resolution Foundation, April 2023.
52 ONS, Earnings and employment from Pay As You Earn Real Time Information, UK: September 2023.
53 Someone who earned at or very slightly above the current National Insurance lower earnings limit of £123 a week could end up with a very slightly lower entitlement to unemployment insurance if it were paid at 65 per cent of past earnings compared to the current Contributory JSA rate of £84.80.

during recessions, or in other instances where it would be unreasonable to expect workers to find employment within three months (such as in a pandemic). Compared to the current Contributory JSA, this would lead to higher payments in the first three months of an unemployment spell. After three months, eligible low-to-middle income households would be able to continue receiving support through Universal Credit.

FIGURE 10: **Of the 1.3 million adults unemployed in 2019-20, 800,000 had been unemployed for less than 6 months**

Duration of unemployment among adults who are unemployed: UK, 2019-20



SOURCE: Analysis of ONS, Labour Force Survey

On conditionality: we propose that a form of conditionality very similar to that currently in place would apply to this new programme (so as to avoid creating a two-tier system with those receiving Universal Credit); that is, recipients will be expected to look for work and engage with the DWP. But, importantly, we suggest that all unemployed workers, whether receiving this new programme or Universal Credit, should be allowed to look for a job only of a similar nature, level and pay as their previous job for the first three months of unemployment – they should not be expected to apply for 'any job'. This is not a radical change, but instead brings the conditionality regime back in line with the system that was in place before a 2022 change in regulation.[54]

Below, we explore how this newly designed unemployment insurance system should be administered in the social security system, including how this would interact with Universal Credit.

54 For information about how conditionality and work-search requirements are applied at present, see: DWP, ADM Chapter J3: Work-related requirements. For information about the 2022 regulation change, see: The Universal Credit and Jobseeker's Allowance (Work Search and Work Availability Requirements - limitations) (Amendment) Regulations 2022.

How should an enhanced unemployment insurance system be administered?

Given the low awareness of Contributory JSA (as discussed in Box 1), as well as the limitations on reform imposed by its old IT system, we propose that Contributory JSA is replaced with a new, modern unemployment insurance system.[55] We note three important points relating to the administration of this new programme.

First, we should build on the success of Universal Credit and use RTI earnings data to calculate eligibility for unemployment insurance. This is a departure from the current Contributory JSA system, but should be straightforward if built using Universal Credit as a blueprint. This will allow for unemployment insurance to be awarded quickly and accurately, using up-to-date work history information.

Second, to ensure that workers from low-income households benefit from our unemployment insurance scheme, it is crucial that Universal Credit is amended upon the introduction of our new unemployment insurance system. At present, one of the reasons for such low claims of Contributory JSA is the fact that households in receipt of Universal Credit have no financial incentive to claim Contributory JSA upon job loss. This is because Contributory JSA is treated as unearned income, meaning that the Universal Credit award is reduced by an amount that is identical to the Contributory JSA award. We propose that Universal Credit is amended so that it treats unemployment insurance as earnings; as such, it would be subject to a 55 per cent taper rate within Universal Credit, rather than a 100 per cent taper. This change would bring unemployment insurance in line with Statutory Sick Pay and Statutory Maternity Pay, which are already treated as earned income within Universal Credit.[56]

Third, although our new unemployment insurance system should be administered separately from Universal Credit, it will be important to make the two systems work smoothly together. For example, there should be clear and consistent signposting between unemployment insurance and Universal Credit, so that workers from low-income families who may be eligible for both are able to receive their full benefit entitlement, and that other unemployed workers reaching the end of their entitlement to unemployment insurance move seamlessly onto Universal Credit if eligible. Relatedly,

55 The current Contributory JSA system is heavily constrained by its IT system. For example, in recent correspondence with the SSAC, the DWP said that tweaking parameters within Contributory JSA would be difficult: "There are no current plans to change the JSA payment frequency, which would, in any event, likely be constrained by the IT limitations of the Jobseekers Allowance Payment System, (JSAPS)." Social Security Advisory Committee, Government response: SSAC report on the future of working age contributory benefits for those not in paid work, 12 September 2023.

56 Universal Credit Regulations 2013, Chapter 2: Earned Income.

DWP should ensure that the support on offer to jobseekers claiming Universal Credit is also offered to those on unemployment insurance.[57]

Taken together, our reimagined unemployment insurance system would make the most of the technology that has made Universal Credit a success, and would benefit workers from low-, middle- and high-income families better than the current system. The design and administration of our proposed system, in comparison to Contributory JSA is summarised in Figure 11 below.

FIGURE 11: **Our proposed unemployment insurance is more generous than Contributory JSA – but would be available for three months rather than six months**

Design parameters of Contributory JSA (left) and our proposed unemployment insurance scheme (right)

	Contributory JSA	Our proposal: unemployment insurance
Digital by design?	No	Yes
Strong brand recognition?	No	Yes (if integrated with UC brand)
Eligible if savings >£16k?	Yes	Yes
Eligible if partner has earnings?	Yes	Yes
Eligibility criteria:	Complex, based on past two tax years	Employed for at least one year
Benefit award:	Flat rate, £84.80/week	65% of prev. earnings, max £339/week
Maximum duration:	6 months	3 months
Treatment within UC:	Deducted pound per pound	Tapered away at 55p per pound
Conditionality:	Must look for 'any job' after 4 weeks	Can look for job of similar type/pay

NOTES: The detailed eligibility rules for Contributory JSA are set out in Box 1 earlier in this note
SOURCE: Analysis of GOV.UK.

57 For example, during the Covid-19 pandemic, Contributory JSA claimants were unable to take part in the Kickstart employment support scheme. It is welcome that the DWP has agreed to this recommendation, which was included in a recent Social Security Advisory Committee report. See: Social Security Advisory Committee, Government response: SSAC report on the future of working age contributory benefits for those not in paid work, 12 September 2023; Social Security Advisory Committee, The future of working age contributory benefits for those not in paid work, July 2022.

The outcomes of our reimagined unemployment insurance system

How much would such a scheme cost?

To begin, it is important to be clear that, in normal economic times, moving to the sort of earnings-related unemployment insurance system that we have set out is relatively inexpensive: we estimate that, on current patterns of low unemployment, our proposed system would cost £0.4 billion per year in 2024-25 – this is just a fraction (less than one per cent) of the overall working-age welfare bill, which is expected to reach £113 billion in 2024-25 (see Table 2, which also shows the impact of varying the maximum duration, and of how the costs would fall if Universal Credit were not reformed to treat the payments as earned income).[58]

TABLE 2: **Our proposed unemployment insurance scheme would cost around £0.4 billion per year in a period of low unemployment**

Scenario	Duration	Net cost of our proposed unemployment insurance scheme (in 2024-25 prices)	Caseload
Unemployment insurance treated as **earned** income within UC	3 months	£0.44bn	50,000
	6 months	£0.87bn	93,000
Unemployment insurance treated as **unearned** income within UC	3 months	£0.35bn	50,000
	6 months	£0.80bn	93,000

NOTES: The details of our modelled unemployment insurance scheme are set out earlier in this note.
SOURCE: Analysis of ONS, Labour Force Survey; ONS Two Quarter Labour Force Survey; DWP, Family Resources Survey, using the IPPR tax-benefit model; DWP, Benefit expenditure and caseload tables 2023, April 2023.

58 Our estimates of cost are based on analysis of DWP, Family Resources Survey, using the IPPR tax-benefit model, combined with analysis of DWP, Benefit expenditure and caseload tables 2023, April 2023, ONS, Labour Force Survey and ONS Two Quarter Labour Force Survey. We use matching between the LFS and FRS so as to impute, for each unemployed individual in the FRS, measures of the duration of the unemployment, length of previous employment, reason for leaving their previous job, and earnings in previous job. Full details are available on request. Our costings allow for the fact that higher unemployment insurance would reduce spending on Universal Credit.

This (relatively) low cost reflects two things: the design of our scheme and our low unemployment rate.

First, our eligibility criteria mean that only a small proportion of unemployed adults will qualify for unemployment insurance payments. The way in which our eligibility criteria apply (based on 2019-20 data) is as follows:[59]

- There was a total of 1.3 million unemployed adults in 2019-20;
- Of these, 600,000 had been unemployed for three months or less (with a further 200,000 unemployed for between three and six months – see Figure 10);
- Of these, around 400,000 left their last job due to resigning, retiring, starting education, or for health or caring reasons, and so would not be eligible for unemployment insurance; this leaves 200,000 adults unemployed for three months or less (and 300,000 for six months or less) who could be eligible.
- Of these, only around a half entered unemployment after a period of employment, leaving 100,000 adults unemployed for three months or less and 200,000 unemployed for six months or less (see Figure 10);
- Of these, only around a half had previously been in continuous employment for at least 12 months before becoming unemployed, leaving us with 50,000 adults unemployed for three months or less, and 90,000 for six months or less.

Second, both in 2019-20 (the period of data we use when costing our scheme) and in 2023, unemployment was low: in the second quarter of 2023, the unemployment rate stood at just 4.2 per cent.[60] But it is possible that one of the many reasons that the UK has a low unemployment rate is the low level of unemployment insurance, and so we might expect there to be more people becoming unemployed, or unemployed people taking longer to find work, if we had more generous unemployment insurance – indeed, this would be an intended impact of this policy reform (and the international evidence we summarised in Box 2 tends to conclude that more generous unemployment insurance does lead to more unemployment).

But if the unemployment rate in the UK was to increase to reach the rate of Denmark (a country with a more generous unemployment insurance than the UK, but that is not entirely dissimilar to the UK), the cost of our scheme would increase by just under a third to reach £0.6 billion per year.[61] And even if were to return to the unemployment rates

59 Analysis of ONS, Labour Force Survey; ONS Two Quarter Labour Force Survey.
60 ONS, Labour Market Statistics.
61 In 2019, the unemployment rate in 2019 was 3.8 per cent in the UK compared to 5.0 per cent in Denmark. Analysis of OECD, Unemployment data. See also: A Ilsøe & T Larsen, Flexicurity and the future of work: Lessons from Denmark, Resolution Foundation, June 2023.

seen in 2009-10 after the financial crisis, we would expect our scheme to cost a modest £1.1 billion per year (or £2.6 billion if the duration was extended to six months, as we propose could happen during downturns).[62]

Who would benefit from our proposed scheme? Despite the caricature of earnings-related unemployment insurance systems being that they benefit middle-to-higher earners at the expense of low-earners, our proposed scheme benefits those from across the income (and earnings) distribution. It is, of course, true that many middle-to-higher-earners see the biggest benefits: any unemployed worker who previously earned above median earnings would see their benefit award rise from £84.80 per week at present to £339 per week.[63]

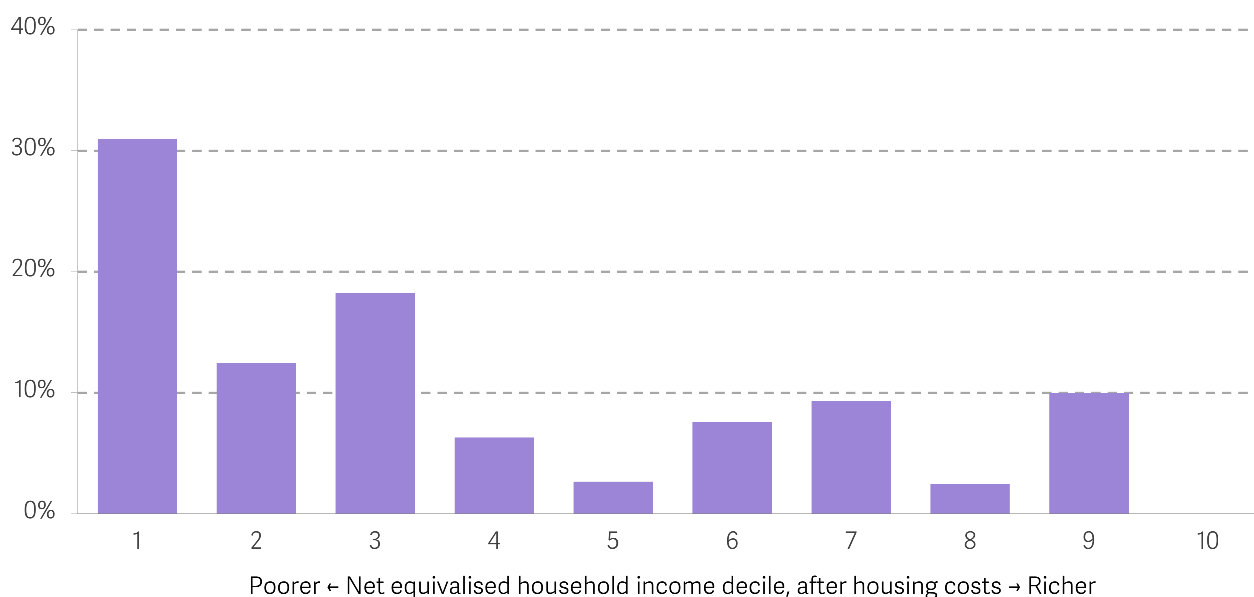
Our modelling suggests that those from higher-paying occupations are slightly overrepresented in our group of unemployment insurance recipients: 8 per cent of recipients are those whose previous role was as a manager, director or senior official, whereas among unemployed people not eligible for income insurance, this is only 6 per cent. On the flipside, those from lower-earning occupations are underrepresented: those who previously worked in 'elementary' roles make up 19 per cent of our group of unemployment insurance recipients, compared to 26 per cent of unemployed non-recipients.[64]

But that is not to say our scheme is regressive overall. First, low earners are most likely to be in families claiming Universal Credit, so will benefit from our proposed change that would allow families to retain some of their unemployment insurance while also claiming Universal Credit. Second, many low earners are excluded from Contributory JSA at present due to the restrictive eligibility rules based on National Insurance contributions.[65] Finally, patterns of unemployment in the UK mean that it is those from lower-income families that are most likely to qualify for our unemployment insurance scheme – 71 per cent of recipients are from the lower half of the income distribution, as is shown in Figure 12.[66]

62 It is worth noting that we do not model the possible cost savings that may result from the introduction of unemployment insurance, for example as a result of better job matching and improved productivity.
63 £339 per week is the maximum award due to our cap on eligible earnings being £2,260 per month.
64 Analysis of ONS, Labour Force Survey; ONS, Two Quarter Labour Force Survey.
65 As flagged earlier, there will be some who lose out from our revised eligibility rules – those with unstable patterns of employment such that they have not been in employment for the past 12 months continuously, but do meet the current Contributory JSA conditions when assessed over the past two complete tax years.
66 We are not attempting to model this in a revenue neutral way.

FIGURE 12: **While workers from across the income distribution would benefit from our proposed unemployment insurance scheme, those from low-to-middle income families are the biggest group of recipients**

Distribution of unemployment insurance recipients, by net equivalised household income decile, after housing costs: UK



NOTES: The modelled unemployment insurance scheme is outlined earlier in this note. In our modelling, there are no recipients from the top income decile.
SOURCE: Analysis of ONS, Labour Force Survey; ONS Two Quarter Labour Force Survey; DWP, Family Resources Survey, using the IPPR tax-benefit model; DWP, Benefit expenditure and caseload tables 2023, April 2023.

Finally, given that our proposal marks a large change from the status quo, it is worth remembering that this is not an 'all or nothing' choice. Many of the changes proposed in this note could be incorporated into the current system if it was seen as being more viable than creating a new benefit payment altogether, for example by amending the generosity of Contributory JSA, or its treatment within Universal Credit.

Creating better unemployment insurance can boost job market dynamism and productivity growth, while also protecting workers' living standards

Our starting point for this work is that unemployment benefits in the UK are providing less security to workers than in previous decades, and the UK's labour market has become less dynamic over time, with job moves and sectoral reallocation declining significantly in the period between the financial crisis and the Covid-19 pandemic, contributing to our poor record on productivity. The UK jobs market model features high levels of insecurity but without the positive impacts of dynamism.

In earlier Economy 2030 reports, we have already suggested improvements to minimum labour market standards and stronger worker rights. These are important in themselves (by affecting the quality of low-paid work), but they could also help address some of the barriers to mobility among lower earners. But those changes are less likely to make a difference for middle or higher earners, where it is the financial consequences of job loss that can weigh more heavily. So this paper has proposed a reinvigorated unemployment insurance system that would pay 65 per cent of previous earnings, capped at median earnings, for up to three months in normal economic circumstances, and conditional on having been in work for 12 months before the unemployment spell.

There are trade-offs behind all these choices, where policy makers will need to balance a desire to provide jobseekers with more opportunity to look for and find better-quality jobs with the risk of over-lengthening spells out of work. Our proposal represents a cautious approach, and produces a programme that, in normal economic times, would be payable to 4 per cent of the stock of unemployed people. But should early evidence on its impacts prove to be favourable, then some of the entitlement conditions could be relaxed.

A better system of unemployment insurance, of course, will not by itself transform the UK's labour market, nor will a new £0.5 billion programme solve the problem of an inadequate benefit system. We have already set out in previous work that achieving shared growth will be impossible without a commitment to uprate all working-age benefits in line with earnings relinking Local Housing Allowance rates to local rents, and reversing cuts such as the two-child limit. Stronger unemployment insurance is much more tightly focused on addressing the insecurity that comes with unemployment, and tackling low levels of job market dynamism. Our proposed system would protect workers from living standards shocks and reduce inequality (by reducing the proportion of adults who experience periods on very low incomes). If accompanied with higher labour market standards and stronger worker rights, it would help to create a more dynamic jobs market, and a higher productivity economy where workers feel more able to take risks resulting in higher quality work for them and a higher productivity economy for all of us.

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