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COVID-19 AND THE FUTURE OF SOCIAL WELFARE

Why the pandemic should change our approach to unemployment for good.

The arrival of the Covid-19 pandemic in early 2020 will have a profound and long lasting impact on every economy around the world. The impact of lockdowns and other restrictions over such a long period is likely to have far-reaching implications for the path of any post-pandemic recovery. For many businesses and workers, the after effects of this economic turmoil are likely to be felt for some time. It seems perverse then to look for any upsides or benefits from the experience of the pandemic, however some elements of the public policy response to the crisis do provide cause for optimism.

Whatever can be said of the range and effectiveness of individual governmental responses to the crisis, it can be said that the rapid and substantial expansion of social transfers has no parallel in any previous economic downturn. The circumstances of the pandemic are, of course, unprecedented, but it does not follow that we should have expected an almost overnight wholesale re-ordering of our welfare system.

Are the covid-era supports to our labour market merely an unprecedented response to an unprecedented crisis or do they represent a long overdue shift in our attitude towards unemployment?

Inevitably, these policy developments have led to conversations about what the response to future employment disruptions will be. Chief among these potential disruptions is the global response to the climate crisis. Most developed nations have set significant goals for carbon reduction to offset the impact of climate change over the coming decades. These reductions will, in many instances entail the curtailment or cessation of many economic activities that currently account for large shares of employment.

The parallels between the current pandemic and the climate crisis are almost unavoidable. In both cases workers are being asked to surrender their jobs in order to achieve a more optimal outcome for society as a whole. The industries that they work in may be profitable, but the activity that they engage in is harmful to society. The main difference is that in the case of the pandemic, it is expected that most workers will return to their jobs once the restrictions have ended. However, it is also the case that governments around the world have committed to the creation of new jobs to make up for any losses sustained in implementing climate reforms. In both cases, government policy removes a job, but is ultimately committed to returning impacted workers to employment.

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What has happened in the pandemic is that governments have decided that where its actions are intentionally responsible for the loss of employment, it owes a greater financial responsibility to the affected worker. If a government owes this greater responsibility to those unemployed by the pandemic, surely it owes the same to those who will become unemployed due to government action on the climate crisis. In granting greater financial assistance to workers affected by the pandemic, the aim of policy is clearly to maintain living standards for the duration of the period of unemployment. This is done to ensure that once employment resumes, that worker can continue their life in much the same way as they did before. This begs the questions as to why workers made unemployed by the direct actions of government are more deserving of financial support than those who lose work due to other structural changes in the economy or a change of direction in the business cycle. Why would this not be the goal of all government policy interventions for people who become unemployed?

Given the welfare system that operates at present in both the UK and Ireland, it may seem radical to suggest that government supports for the unemployed should seek to support incomes and living standards rather than merely provide subsistence payments. However, such policies are more common than one would think.

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Looking at the supports that were provided to unemployed workers before the crisis shows the scale and speed at which the pandemic upended the welfare system. In Ireland the highest rate of Job Seekers Allowance was €203 per week. This applied to all those who previously earned more than €300 per week. Anyone earning under €300 is either under 20 years of age or not working full-time as the Irish minimum wage is €10.20 per hour. For part-time workers then there are 3 graduated rates of payments between €203 and €91 per week. In the United Kingdom the standard rate of Job Seeker's Allowance is £73.10 (€83) per week with a lower rate of £57.90 (€65) applying to those aged 18-24.

In both the UK and Ireland the existing welfare system was cast aside to make way for a new suite of payments to assist people whose employment was impacted by the public health restrictions. In both countries it was decided that welfare supports as they had existed to date, were not sufficient or appropriate for people who would lose employment or earnings in the coming crisis period. Both existing welfare systems are considerably less generous than their covid era counterparts but the UK appears to have made the greatest leap. It has now moved toward providing earnings linked unemployment insurance despite operating one of the least generous flat rate payment schemes in Europe.

In the UK the Coronavirus Job Retention Scheme (CJRS) and the subsequent Self Employment Income Support Scheme (SEISS) were introduced in April 2020. Both provided for a government funded payment to the value of 80% of previous wages or self-employment income. Under the CJRS, workers were furloughed, meaning they remained employed by their employer, but were not 'at work'. In Ireland, the process of supporting workers was more evolutionary and in the first instance focused on providing out of work support. The immediate response was to introduce a single flat rate Pandemic Unemployment Payment (PUP). It was initially set at the same level as the existing Job Seeker's Benefit of €203 per week, but it was quickly uprated to €350. The Irish government did introduce a form of furlough payment in the form of the Temporary Wage Subsidy Scheme (TWSS). The TWSS provided a subsidy worth up to 70% of the previous earned income. However, the cap of

€410 per week was considerably lower than that of the UK scheme. The TWSS was eventually replaced by the Employer Wage Subsidy Scheme which offered even less generous payments. At the same time as the introduction of the EWSS, the PUP was moved to a 4 tier payment linked to previous earnings. The EWSS caps and PUP payments are now aligned meaning that an employer receives no more from the EWSS than an employee receives from the PUP. The EWSS is intended to provide support for employees working in firms that experience an interruption to business rather than firms who are closed or forced to close. In the UK the CJRS allows employers to partially or fully furlough employees.

Ireland ultimately then opted for a twin track approach of in-work and out-of-work supports. The first iteration of Ireland's welfare response was out-of-work supports and here the initial policy was to extend and expand its existing welfare system. When this proved inadequate, the generosity of the scheme enhanced. When this proved too blunt, a link to earnings was introduced. This evolution of policy making is quite telling. It shows that existing benefits were not thought to be appropriate for those unemployed in the pandemic, but it also shows that simply increasing the existing benefit was not thought to be appropriate either.

In the UK the new furlough payments were obviously more generous than the existing out of work benefits, but the most important factor was that they sought to make payments directly proportionate to the income that the claimant received from employment. The introduction of earnings based benefits was the first response of the UK government. In Ireland the link to earnings is less exact and was very much an afterthought in policy terms.

While the systems of supports that are now available to workers in both the UK and Ireland have distinct differences there are three elements that distinguish it from existing welfare systems that they superseded. Firstly, the support is widely available with very little conditionality attached. Secondly, it is significantly more generous than existing pre-covid payments. And finally, it has some linkage to the previous earnings of individual workers.

The evolution of Ireland's policy response to the crisis is instructive because it shows how the government implemented each of these features sequentially as opposed to the UK government response which introduced them simultaneously. On paper at least the UK has gone much further from its existing welfare system, whereas Ireland's approach appears to be a gentler evolution from its baseline. In the UK those who have become unemployed and are on the CJRS are now receiving income replacement rather than income support. This is quite a remarkable policy shift, even if it is linked to time-bound pandemic restrictions.

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While the new suite of unemployment and furlough supports put in place in both the UK and Ireland seems impressive when marked against what has gone before, it does not look all that impressive when put into context with long standing unemployment insurance schemes across Europe. Unemployment insurance is individual to the person receiving the payment and is usually a function of previous earnings. Unemployment benefits tend to be fixed payments that a person qualifies for. Unemployment benefits can be linked to previous earnings or work history, but they can also be a universal entitlement with no variation in payment. Nearly all EU countries operate some form of unemployment insurance with varying degrees of coverage and a wide variation in terms of replacement rate of previous income. In some countries, unemployment insurance stands separate to other unemployment benefits and in other cases, unemployment insurance interacts with unemployment benefits. In Sweden unemployment insurance stands alone. The inkomstbortfallsförsäkring (income-related benefit) provides 80% of pre-unemployment benefit for 200 days, falling to 70% for the following 100 days. Both rates are subject to maximum awards. At the other end of the scale, Estonia pays 50% of previous earnings for the first 100 days followed by 40% thereafter. In the case of Finland unemployment allowance and insurance interact. There is a basic unemployment allowance of between €33-38 per day. The earnings related unemployment allowance then pays 45% of the difference between the basic allowance and what the pre-unemployment earnings of the recipient were. This rate falls to 20% for very high earners.

Before the onset of the pandemic, the only other countries in the European Union beyond Ireland and the UK not to offer earnings linked unemployment insurance were Greece, Poland, Malta and Romania. These countries, along with the UK and Ireland, operate flat rate unemployment benefits with degrees of variation. Malta is the only EU country to operate a flat rate scheme with no relationship to previous labour market status. Within the other flat rate schemes there are linkages to previous earnings and employment, but they do not proportionately determine the level of payment. For instance, in Greece, the basic unemployment allowance is €399.25 per month, but this is also the maximum basic allowance. There are two lower band monthly payments of €299.50 and €199.75 which are paid if the claimants income falls below a certain percentage of the average wage. In this case previous earnings determine the level of flat benefit, but they do not proportionately determine the level of that benefit. In Poland, there is a similar system, but it is determined by years of employment rather than previous earnings. There is a basic unemployment allowance of PL 881.30 (€197) per month. However, depending on the years of economic activity a claimant may be entitled to either 80%, 100% or 120% of the basic unemployment allowance. In both cases the key difference is that previous earnings and experience influence what pre-determined allowance the claimant is entitled to unemployment insurance model.

At first glance the CJRS operating in the UK looks quite like the Swedish employment insurance except for the fact that it is a furlough scheme. All this means is that the support for employees is channelled through the employer, rather than directly from a government department or agency as would be the case in Sweden. The policy response in Ireland looks more like the Greek scheme. Both countries sought a new approach to tackling unemployment, but not the same approach.

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Initial evaluations of the effect of Covid supports on incomes in Ireland and the UK appear to show that even though both countries used different schemes, the impact on household incomes was quite similar. Lower income households received a small increase in some cases (mainly due to temporary boosts in welfare payments) and most households saw a drop off of between 1 and 10% as support progressively dropped off up through the income distribution. This may seem a somewhat surprising outcome given that on the face of it, the UK scheme appears to be much more generous than the supports available in Ireland. However, the effect of these support schemes on overall income levels is very much dependent on who takes up the scheme. In this regard it is not clear that Ireland's policy approach would measure up just as well if the profile of workers affected were different.

Further research on the impact of Covid income supports in Ireland shows that almost 60 per cent of workers in the sectors of employment most severely affected by the crisis had pre-pandemic earnings in the two lowest quintiles of the income distribution. What this means is that even though the flat rate PUP payments would provide significantly less support than the CJRS to a person in the upper half of the income distribution, the level of support in the lower half of the distribution is quite comparable in terms of replacement rates. If most of the take-up of support is from the lower half of the income distribution, then the outcomes for overall household income change are likely to be quite similar. The EWSS provided support further up the income distribution in much the same way as CJRS did for partially furloughed workers.

Viewed through this lens one can see why the Irish government may have adopted the policy response that they did. They could achieve much the same outcome for household income by increasing the generosity of its existing scheme whilst also introducing a more comprehensive link to previous earnings. Such an approach may have been easier to administer from existing agencies and may also be easier to unwind as the crisis comes to an end. However, what this means is that the Irish response to the current crisis is likely only to be suitable for the current crisis. It was built for a very specific and uniquely predictable labour market disruption. The labour market disruption that will come from tackling climate change will not be as predictable.

Research has sought to try and identify the types of jobs that might be at risk from decarbonising our economy, but it is difficult to be definitive about this. Furthermore, most of this research focuses on first round effects, i.e. direct job losses from action to decarbonise. But as we know from the experience of deindustrialisation in the 1970s and 80s it is the indirect or second round effects which are much harder to predict and also much harder to tackle. That is why the support schemes that Ireland put in place for the pandemic may not be adequate for the disruptions of the future. The UK scheme on the other

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hand was designed to deal with unpredictability and is therefore more agile if it were to be utilised in a future crisis. That is the policy challenge that we now face as we look to the future and the disruptions to our labour market.

This crisis has raised the bar in terms of what society expects for those who become unemployed. We must ask how we can reshape our labour market policy in the future to be ready to meet those future disruptions with the same effort we gave to this crisis. This is why the UK's response to pandemic is the most interesting. It could have simply expanded and improved existing entitlements as Ireland did, but instead it turned to a new more European form of welfare. There are indeed many reasons why unemployment insurance is the norm in Europe and why a pandemic stricken UK was so attracted by it.

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There are three main benefits of income related unemployment insurance. They are consumption smoothing, risk pooling and security benefit. The idea here is that unemployment insurance gives households the reassurance that in the event of losing a job, they will not experience a sudden drop in available income that they must prepare for. Consumption smoothing means that households can manage their finances over the longer term without having to make adjustments to their present consumption in anticipation of not being able to meet future consumption.

Having unemployment insurance therefore avoids individuals having to make their own savings pot to deal with unemployment. This is one of the benefits of any type of insurance whether it be for cars, travel or indeed life itself. Insurance covers contingencies that could happen but might not happen. If everyone makes allowance for the fact that they might become unemployed, you have a situation where every household is saving money for an event that is only likely to affect a small minority. By any analysis that is not an efficient outcome. Unemployment insurance therefore enables 'risk-pooling' whereby all workers pay a fraction of the cost of providing the cover that ends up paying out to those unfortunate enough to experience unemployment.

The benefits of insurance are not just limited to the payments that are forthcoming in the event of adverse outcomes. There is also a 'security benefit' that such insurance provides. In other forms of insurance, this security effect can be troublesome if it goes too far and encourages risky behaviour. However, with unemployment insurance the reduction in risk aversion can have a significantly positive effect by pushing people towards newer and better jobs. Jobs in newer areas of economic activity may not seem as secure and workers may be unsure about moving to such jobs, irrespective of higher potential salaries. This is crucial when we consider the kind of shift in jobs that will be necessary to tackle climate change. Many of these jobs will be with new firms and the jobs themselves may be unknown to most people. Unemployment insurance removes this risk and enables workers to take a punt on one of these new jobs. More broadly unemployment insurance can encourage entrepreneurship, as starting a business or expanding a business requires taking a significant risk with an individual income. Without unemployment insurance, that risk can be too high for many households. Therefore, unemployment insurance also has the benefit of boosting economic performance even if it never has cause to pay out any significant amount.

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Household earnings are therefore a natural candidate for insurance, however the benefits outlined above could just as easily apply to private insurance schemes as they do to state social insurance schemes. Why then is state provision of unemployment insurance as pervasive as it is? If the alleviation of risk aversion is the key benefit of providing insurance of any type, the countervailing disadvantage is moral hazard. In the example of car insurance, providing cover can allow people to make full use of their car without fear of being finically crippled by accidents. On the other hand, it can also encourage some people to go too far and increase risky behaviours such as speeding. It is not possible to know whether the person you are insuring will go too far and this problem is referred to as information asymmetry. To combat this, car insurers have several strategies to screen customers and apply price premiums appropriately along with conditionality to benefits to tame such behaviours. Such strategies do not apply to unemployment insurance. It is one thing to seek to identify whether personal traits, financial circumstance and other behaviours are likely to indicate whether a person is a responsible driver or not. It is quite another matter to be able to glean from these data whether a person is likely to become unemployed at any time of their working life. The information asymmetry involved in unemployment insurance is simply too complex to overcome and for this reason state provision has always been the norm. The state has the financial clout and can amass the scale of risk pool necessary to make any such scheme financially viable.

There is a broad consensus then that information asymmetries related to unemployment are too complex to be compared to that of other insurance products. However, this consensus does not extend to issues of moral hazard related to unemployment insurance. As advanced economies grappled with the problem of long term unemployment in the 1980s and 1990s, a large body of research sought to build a programme of reform which placed a much greater emphasis on issues of moral hazard without really grasping that the same complexities that applied to information asymmetries might also apply to issue of moral hazard.

While the vast majority of European economies still operate earnings replacement unemployment insurance schemes, there have been significant waves of reform which have altered the structure of these schemes considerably. As mentioned previously, these reform programmes mostly occurred under conditions of persistently high unemployment and proponents of these reforms sought to link this to the generosity of existing unemployment insurance schemes. In this sense, the generosity of the payments was said to create a moral hazard whereby people in receipt of benefits were not incentivized to return to the workforce and would remain unemployed.

The reform programmes obviously varied considerably across economies but the main themes were tightening eligibility criteria, increasing conditionality, reducing duration of benefits and reducing the replacement rate of benefits. Interestingly, reducing replacement rates has been the least common form of unemployment insurance reform, eligibility, conditionality and duration have all been much more prevalent.

The Hartz reforms that took place in Germany in the early 2000s were probably among the most significant reform package to one of the oldest employment insurance schemes in the world. They are credited with revitalising the German economy and significantly reducing long term unemployment. The Hartz programme covered each of the four reform areas outlined and within that it reduced the rate of income replacement in unemployment payments from 67/63% to 57/53%. It is almost impossible to evaluate any one particular element of the Hartz reforms in isolation but the reduction in income replacement is often cited as a key driver of the subsequent reduction in unemployment. If one applies the logic of moral hazard the theoretical basis for this claim seems sound. However, the reduction in the replacement rate also coincided with a wider labour market reform in Germany which saw a significant liberalisation of part-time and casual employment. Indeed, research shows that the supposed 'jobs miracle' that occurred in Germany from 2005 to 2010 was entirely due to growth in part-time employment.

The German experience points to a very important aspect of the supposed employment effects of social insurance reform. Rather than seeing social insurance as a labour market stabiliser, proponents of reform have sought to cast it as a labour market inhibitor. Of course moral hazard plays a role in social insurance but concerns about moral hazard were always balanced by the benefits of securing the most efficient allocation of resources in the labour market. Yes, unemployment insurance might keep some people out of employment slightly longer than desired, but the net gain to the economy from getting the right people into the right jobs can more than counter that dynamic. However, what the German experience really shows is that undermining unemployment insurance can play a role altering the long term structure of employment in the labour market.

If Germany had kept its replacement rate at existing levels while liberalising its employment practices, there might have been a more moderate increase in part-time employment. Part-time employment is an important part of any labour market but there is no escaping the fact that, on average, it tends to be of lower quality and ultimately a lower contributor to productivity. Instead the effect of lowering replacement rates at that time likely contributed to more people opting for part-time jobs. If these people would ordinarily have held out for jobs more appropriate to their skills and their experience, then the Hartz reforms violated one of the key benefits of social insurance.

A question that does arise from the Hartz reforms is whether lowering the replacement rate of unemployment insurance would have had an effect on lowering unemployment without the liberalisation of part-time employment? Evidence from other social insurance systems wouldn't seem to bear this out. As mentioned earlier, it is hard to make causal claims about the effect of replacement rates, not only because social insurance reforms tend to be introduced as part of a package, but also because it is difficult to construct a counterfactual. If the replacement rate is dropped for everyone how can we compare outcomes between groups? There have however, been some instances where replacement rates were changed for particular groups of workers and a study of such an instance in Switzerland in 2003 provides some indication of its effects. The Swiss reform actually increased replacement rates for a cohort of workers and found that it had no significant impact on future employment or indeed future earnings outcomes.

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The question that faces us now is what will Covid-19's legacy be for our labour market? We have seen that, when faced with potentially mass unemployment, governments can act to transform welfare systems almost overnight. As we move out of this crisis period, we cannot allow a reversion to our previous welfare systems, particularly if we want to begin the process of decarbonisation. The response of the Irish government may well have averted the worst of the current crisis, but as it looks toward the future, it will have to widen its scope to manage future crises. The forthcoming Commission on Taxation and Welfare provides the best opportunity for this. It is clear that the UK saw a system of unemployment insurance as its best defence against the pandemic. Despite misguided reform programmes over the last two decades, unemployment insurance remains the norm for European economies. If we are going to learn any lessons from this pandemic and prepare ourselves for a very uncertain future, a system of unemployment insurance surely presents an obvious policy choice.