MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
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Officials' discussion document on support for displaced workers

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Enhancing support for displaced workers over the medium term: Work stream update for the Tripartite Forum, 27 July 2020

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New Zealand Government

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Purpose

This paper, and accompanying slides, provides the Forum with an update on medium-term work to enhance support for displaced workers. Forum partners may wish to:

- confirm their goals in supporting displaced workers,
- discuss alternative ways of supporting displaced workers, and
- discuss the high level design features of an unemployment insurance scheme, how the costs of a scheme might be shared, and how a scheme might be delivered.

Executive summary

This policy conversation is occurring against the backdrop of the COVID-19 pandemic and an unfolding recession. Rapidly increasing displacement is calling attention to the adequacy of support available to displaced and at-risk workers. New Zealand has already introduced new financial and employment support for displaced and at-risk workers. These new interventions are recognition of gaps in our system.

An ideal system for supporting displaced workers would both protect worker wellbeing, and support New Zealand’s transition to a more productive, sustainable, and inclusive economy. Such a system would protect workers and their re-employment in good jobs, not necessarily existing jobs.

Specific objectives could be to:

- **smooth incomes** and reduce the immediate hardship that displaced workers can experience when they lose their jobs, and thereby finance a period of job search (or retraining and upskilling), or adjustment to a lower income (such as a main benefit payment);
- **reduce wage scarring**, with gains flowing to workers who receive a better income, and to some firms who will benefit from better skills matching,
- **raise productivity** more widely, through greater openness to technological change, more productive risk-taking, and more investment in upskilling and retraining,
- **support macroeconomic stability** through downturns (counter-cyclical stimulus), through maintaining higher levels of consumption, and / or
- **replace ad hoc tools** (such as the CIRP) with a permanent form of financial support for displaced workers, rather than creating such support on an ad hoc basis.
- **prepare for the future of work and other industry transformation** which may require lengthy adjustment processes.
- **provide equity** in treatment of different groups of displaced workers (including by income, gender and ethnicity) and employment relationships (such as permanent, temporary and self-employed)

Achieving these objectives is likely to require some combination of enhanced access to effective active labour market programmes (employment brokerage, advice, upskilling and retraining), financial support, and employment opportunities. There are also risks and trade-offs to consider, depending on options chosen. These include direct costs, potential labour market distortions (introducing payroll tax may change behaviour), impacts on tax system efficiency, and perceptions of inequity if recently displaced workers appear to be treated more generously than others. These risks and trade-offs need to be considered against the benefits of enhancing support for displaced workers.

Forum partners have sought advice on three approaches (or packages) for supporting displaced workers:

- improving access to active labour market programmes, training and employment interventions
- introducing statutory redundancy payments (coupled with active labour market programmes) and
- introducing social unemployment insurance (also coupled with active labour market programmes, and perhaps a statutory redundancy payment).

Ensuring access to well-designed and delivered active labour market programmes is widely considered to be a necessary element of any policy package. The delivery and settings around financial support are less certain, and depend substantially on the objectives sought.

Forum partners have requested a particular focus on options for social unemployment insurance. Eligibility rules, entitlements, cost sharing, and administration are key aspects of designing an insurance scheme. In an insurance model, payment levels are pegged to smooth workers' incomes to a greater extent than welfare. The maximum duration of insurance payments could be tied to either a (relatively brief) period of job search or to a (lengthier) period of retraining and upskilling, or to enable adjustment to a lower income. In some circumstances, the period out of work may be longer, for example – an economic downturn, a whole industry undergoing change etc. There is also a range of delivery choices to consider, including government, tripartite, and market-led approaches. Costs are typically shared between governments, firms, and workers.

A key step forward is the initial modelling of the costs of making insurance payments to displaced workers. Cost estimates are highly sensitive to volumes of displacement, and these are uncertain. To take one scenario, at a displacement rate of 3.3% annually (75,000 employees displaced)[1] with an entitlement period of up to twelve months, and a replacement rate of 80% of lost income, the annual average cost per displaced worker would be around $14,000, or around $0.8-$1.3 billion per annum. Financing this cost could require an average annual payment around $350-$600, or around $0.65-$1.10 per $100 earned per worker. The paper presents several combinations of payment rate and duration. Further modelling will refine these initial estimates. The modelling currently excludes a number of costs, such as behavioural responses, and savings such as reduced welfare expenses. In addition, the

[1] We note that it is difficult to ascertain with any certainty what displacement rates are likely to be. The 3.3% displacement rate reflects the average number of new jobseekers we see in any year. During the GFC, the displacement rate could have reached as high as 16%. On the other hand the OECD average is closer to 1.6%.

above costs are for a year such as during the Global Financial Crisis when the rate of displacement is unusually high. The normal rate averages approximately half this.

One of the objectives of introducing a social insurance scheme is to allow people to have more time to look for a job. The hypothesis is that increased time for job search will allow jobseekers to find better matches (rather than take the first job they are offered to alleviate the financial pressures they may be facing). There is limited international evidence about the impact of increased time on job search. In such research, however, it is often difficult to distinguish between those who take longer to find *any* work, and those who take longer to find the *right* job.

Officials consider that one way of assessing the “return” from investing in social unemployment insurance (or other support for displaced workers) is to compare its cost to the potential reduction in the life-time and economy-wide costs of wage scarring arising from displacement. Officials have commissioned independent research to estimate these wage scarring costs. This research suggests that the lifetime wage scarring impacts arising from the displacement of workers in one year is equivalent to $9.76b, assuming 63,900 workers are displaced, or over 10 times the above estimated annual cost of social insurance. These are initial results subject to further refinement. However, there is limited research to suggest that social unemployment insurance actually reduces wage scarring, and preliminary work by MSD suggests that taking longer to find employment has no measurable impact on scarring.

The next steps in this work stream are to continue to prototype the alternative approaches, to estimate their costs, and to assess their potential impacts on worker outcomes.

A further question is how any insurance scheme will fit with the broader settings we have in our labour market, ACC and our broader tax and transfer system. In particular, questions have been raised about the interaction between a potential insurance system in New Zealand and broader welfare entitlements (including any potential changes to the welfare system arising out of the work on the Welfare Overhaul).

Background

In February, Ministers considered advice on options for improving financial security for displaced workers.[2] In response to that advice, and in consultation with the social partners, ministers set aside three options (tax credits, loans, accessing Kiwisaver accounts), and commissioned further work on three broader “packages” of support. These packages are not mutually exclusive:

1. strengthening non-financial active labour market policies, training and employment interventions
2. exploring statutory redundancy payments (coupled with active labour market programmes)

[2] MBIE Briefing: *Exploring social insurance and other options to enhance financial support for displaced workers*, 1954 19-20

MBIE Aide Memoire: *Ministerial discussion on financial security for displaced workers*, 18 February 2020, BR 2320 19-20

3. exploring social unemployment insurance (coupled with active labour market programmes).

This further work was to produce prototypes, and to identify costs and benefits at a high level. This paper provides an update on this ongoing work.

Strategic policy context

Supporting workers who are displaced or at risk of displacement is a Forum priority

The Tripartite Forum's *Strategic Assessment of the Future of Work* identifies four broad megatrends shaping the future of work: technological progress, demographic change, globalisation and climate change.[3] An increase in worker displacement is one possible consequence of these trends.[4]

In response, one of the Forum's four priority work areas is to *support workers who are displaced or at risk of displacement.* This is the main focus of this paper. That displacement could arise from gradual creeping change, or from episodic shocks such as pandemics. Systems to support displaced workers could be designed to respond to either circumstance, or both. Displacement may be localised or national.

In most countries, displacement levels hover around a trend, peaking during recessions. A displacement rate of around 2% seems to be the norm, as suggested in the OECD chart below.[5] However some analysis indicates that this could be higher, depending on how displacement is ultimately defined. The future of work trends could see rates of displacement increasing.

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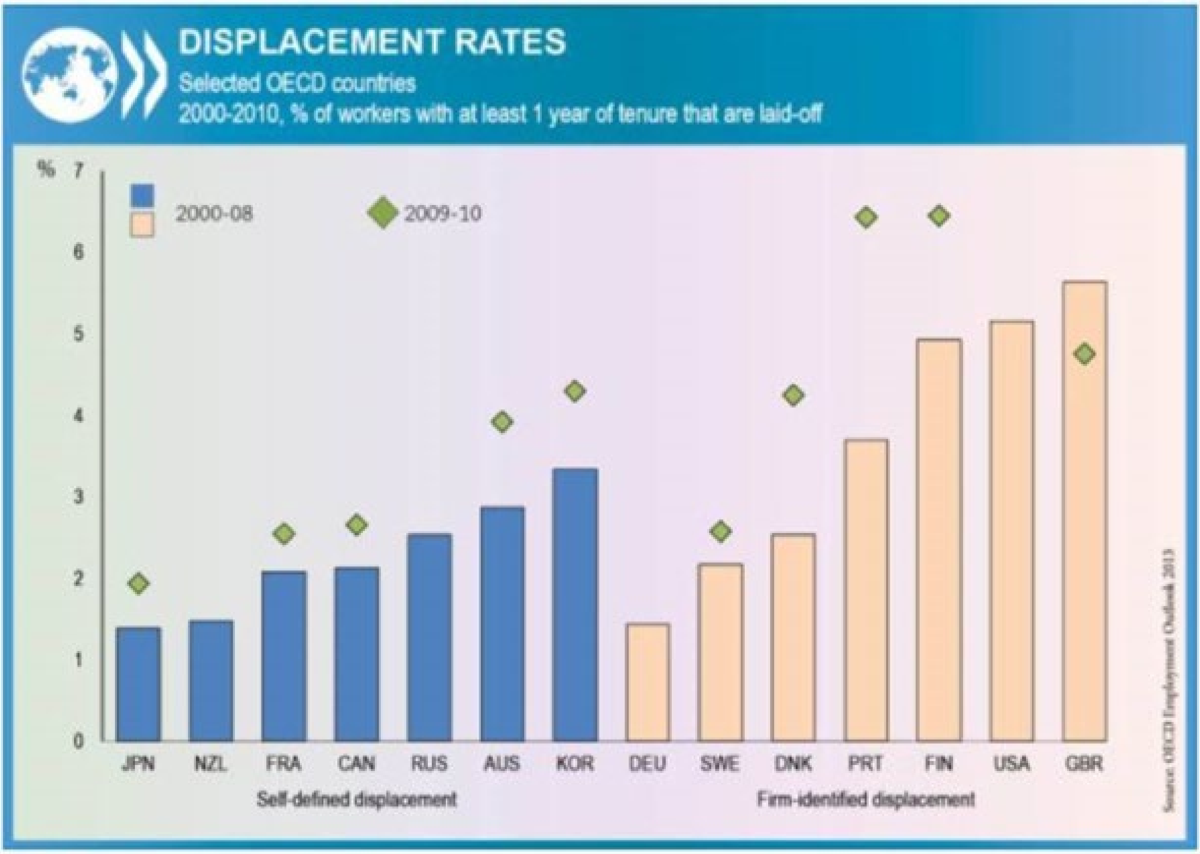
[3] New Zealand Government, (2019). *Future of Work Tripartite Forum Strategic Assessment*

[4] Consistent with OECD definitions, displacement is where workers are dismissed from their jobs for economic reasons such as plant closures, business downturns and changes in production technology. Displacement is synonymous with redundancy. (http://www.oecd.org/els/soc/12_Singh_Supporting_Displaced_Workers.pdf) Displacement is a subset of a much wider range of circumstances that cause unemployment (such as health conditions, disabilities and accidents; resignations; or not entering education, employment or training after leaving school (youth NEETs).

[5] https://www.oecd.org/employment/displaced-workers.htm



Protecting workers, not jobs

Displacement occurs when firms change their labour needs, or exit the market. That this can occur is an important element of a productive, dynamic economy. However displacement (or "redundancy") can adversely affect workers, communities and broader society. The adverse impacts of displacement for workers can include unemployment, underemployment, and loss of income even when fully re-employed ("wage scarring").[6] The Productivity Commission has suggested that better support for displaced workers, and income smoothing in particular, might promote more positive attitudes to technology adoption.[7]

The goal is therefore not to eliminate displacement. The goal is rather to protect workers while allowing for a continual process of displacement and re-employment in good jobs. In such an economy, firms would have the continued option of changing their labour needs, while workers could be assured of support towards suitable reemployment, without substantial loss of income through a period of job search, and retraining. Working people could be confident that displacement would be more of a "sideways step" in the labour market, rather than (potentially) being a significant "downwards step". This is the essence of the flexicurity approach, where the objective is to protect displaced workers, not jobs. The approach promotes both productivity, and inclusion.

[6] Hyslop, D., & Townsend, W., (2017). *The Longer Term Impacts of Job Displacement on Labour Market Outcomes*
[7] New Zealand Productivity Commission, (2020). *Technological change the future of work*

The potential benefits from enhancing support for displaced workers are therefore both social and economic. The Forum may wish to confirm its key objectives in supporting displaced workers. Specific objectives could be to:

- **smooth incomes** and reduce the immediate hardship that displaced workers can experience when they lose their jobs, and whether this is for all unexpected job losses or only redundancy
- **reduce wage scarring**, with gains flowing to workers who receive a better income, and to firms through better skills matching,
- **raise productivity** more widely, through greater openness to technological change, and productive risk-taking,
- **support macroeconomic stability** (counter-cyclical stimulus) through downturns, through maintaining higher levels of consumption, and / or
- **replace ad hoc tools** (such as the CIRP) with a permanent form of financial support for displaced workers, rather than creating such support on an ad hoc basis.
- **prepare for the future of work and other industry transformation** which may require lengthy adjustment processes.
- **provide equity** in treatment of different groups of displaced workers (including by income, gender and ethnicity) and employment relationships (such as permanent, temporary and self-employed).

A system that operates on a permanent, rather than ad hoc basis, is more likely to promote worker confidence, and give certainty to employers.

Forms of support for enabling smooth transitions

Earlier reports to ministers identified advice and brokerage services, financial support, education and training, and employment opportunities as the key elements of support for displaced workers (as described in the table below). Much of this support is also relevant to people who are unemployed due to reasons other than displacement.

Support is more effective when it is available early. Unlike other groups of workers who need employment support, displaced workers can be assisted proactively through redundancy notice periods and redundancy notification to public employment services.

Forms of support for enabling smooth transitions	Description
Advice and brokerage services	Brokerage and job search assistance connects people with employment opportunities and tailors support to individual needs. Career / vocational / training and educational advice enables informed choices about career options, and training pathways. Advice can be informed by skills assessments, and recognition of prior learning
Financial support	Financial security through transitions minimises hardship and provides stability through job search and retraining. Financial support reduces the urgency to find work, and hence increases the possibility of finding a job that is a good match to a worker's skills, experience, preferences and aspirations. The way financial support is funded and delivered and linked to the other forms of support can materially affect worker outcomes.
Education and training (particularly upskilling and retraining)	Education and training equips workers with skills relevant to sustainable industries (so people can remain skilled for their current jobs, can make planned transitions to new jobs, and can transition to new jobs if displaced).
Employment opportunities	A business and economic environment that ensures availability of employment opportunities will ensure workers can move into (or remain in) employment (can also include steps such as assisting worker mobility, and coordinated economic development initiatives such as Industry Transformation Plans). It also includes the complex nature of job matching where several factors such as skills, location and work hours play a vital role.

Understanding these elements of support is important for designing and assessing policy options. If, for example, income smoothing is considered essential for enabling a sufficiently long job search or period of retraining and upskilling, then options that lack such income smoothing are unlikely to be effective in substantially reducing wage scarring. Smooth transitions can also minimise other negative impacts on households, such as being unable to service mortgages and other debt, or having to sell assets quickly or shift to lower cost accommodation.

Current state: Support to enable smooth transitions

Financial and non-financial support for displaced New Zealand workers is substantially less than in many OECD countries.[8] Relative to the flexicurity principles, New Zealand shows higher degrees of flexibility, and lower degrees of security.

The economic impact of the pandemic has further highlighted the concerns with our current system of support for displaced workers, leading to temporary increases in financial supports, job matching and training packages.

Income smoothing options are currently limited

From a worker's perspective, the most effective financial support "smooths" income from displacement to re-employment, thereby ensuring a worker can maintain their standard of living. Smooth transitions can minimise other negative impacts on households, such as being unable to service mortgages and other debt, or having to quickly sell assets or shift to lower cost accommodation.

Income smoothing can be seen as an objective in itself through facilitating adjustment, or as part of a wider package of facilitating job search, retraining and upskilling, and reducing wage scarring.

Until the implementation of the COVID Income Relief Payment (CIRP), displaced workers in New Zealand only had access to means-tested social assistance benefits. These payments are not linked to prior earnings. For many workers who lose their jobs, there is a sharp drop in income for their earnings from paid employment to that provided by a means-tested benefit – if they are eligible. Inclusion of a partner's income in means-testing of benefits means many displaced workers are ineligible[9]. Private income insurance is not a significant source of income security in New Zealand and is unlikely to be affordable to low income workers and those in less secure employment.

Because payments to displaced workers, especially at higher replacement rates, enable households to maintain consumption, they can also act as important economic stabilisers in an economic downturn such as that created by COVID-19. Such payments can therefore help to smooth economic activity at a macro level, as well as the household level.

It has been noted that protecting workers from income shocks that may arise from displacement can reinforce inequities that already exist in the labour market (ie. higher income earners will receive higher replacement rates; those with less labour market attachment may not be eligible). These effects may be particularly pronounced when it comes to gender given women tend to take more time away from work or work part-time to balance the responsibilities of parenthood. Moreover, if all workers pay into the system through taxes, lower-income workers may be required to pay into a system that they don't ultimately use. This is because, for many low-income workers and families, the existing

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[8] OECD, (2017). *Back to Work New Zealand: Improving the Re-employment Prospects of Displaced Workers*;
Welfare Expert Advisory Group, (2019). *Whakamana Tāngata: Restoring Dignity to Social Security in New Zealand, The report of the Welfare Expert Advisory Group*.

[9] As an example, a person with no children and a partner earning over about $31k (gross) per year would not be eligible for support. In 2015, about 43% of displaced workers did not qualify for support because of their partner's income.

welfare system already provides a relatively high wage replacement rate. These distributional impacts can be limited by setting replacement cover at rates that properly balance the income smoothing and the distributional outcomes, exempting low-income workers from paying into the system, and/or having eligibility settings that aren't directly tied to most recent work history.

Wage scarring is one important measure of displaced workers' outcomes

The limited support that is normally available is likely to be part of the reason for New Zealand's higher rates of wage scarring amongst displaced workers.[10] Wage scarring refers to the wage reductions that workers can experience in resuming employment after adverse events that interrupt employment, in particular following displacement. This is one important measure of displaced worker outcomes.

Reduced hours of work and a lower wage can both contribute to wage scarring. Non-monetary conditions of work can also be adversely affected. These impacts could, theoretically, extend many years beyond the displacement itself (life-time impacts). The impacts on *workers* are most obvious, but there may also be costs for *government, firms*, and the economy overall. Wage scarring becomes a greater problem if widespread labour market disruption develops.

Workers can also experience income loss during a spell of unemployment, prior to resuming work. A preferred system for workers would be one that minimises income losses both during a spell of unemployment (or retraining) and upon re-employment.

Further research to understand wage scarring impacts better

Understanding better the causes and consequences of wage scarring is important for assessing the scale of the wage scarring problem (and hence scaling the response) and also for targeting responses.

The causes of wage scarring, however, are unclear, and they may well vary across time and place, and for individual workers. The following are likely to be among the key drivers of wage scarring.

- *financial pressure* due to loss of income may limit time for job search or re-training & upskilling,
- *lack of expert employment support* may mean people do not know where to look or how to look for work,
- *geographic stickiness* may mean people do not / cannot move to obtain better jobs,
- *thin labour markets* make it harder for workers – particularly those in specialised fields – who lose a job to find a suitable new employment,

[10] OECD, (2017). *Back to Work New Zealand: Improving the Re-employment Prospects of Displaced Workers*, "While not directly comparable with other OECD countries due to differences in data sources, wage losses in New Zealand appear to be large compared with other OECD countries", p.40.

- *displaced workers' skills* may be fundamentally mismatched to what employers demand due to technological and other changes, meaning workers are more likely to be displaced, and more likely to become wage scarred, and
- *employer prejudice* may mean that displaced workers are the objective of discrimination (eg simply due to the redundancy, or other factors such as age or gender).

Behind each of these of these drivers are likely to be further contributing causes. This analysis of wage scarring drivers points to areas to target – such as relieving financial pressure, improving access to employment support, and to education and training. The analysis is consistent with earlier advice on the services that best support displaced workers. Annex 1 presents a framework of these effects.

MBIE has contracted Motu Public Policy Research to extend their earlier research on wage scarring impacts. The objective is to estimate lifetime (career) impacts on workers, and costs to government and firms.

Initial research results suggest the lifetime wage scarring impacts arising from the displacement of workers in one year could be approximately $9.76b, assuming 63,900 employees are displaced. These are initial results subject to further refinement. We note specifically that this rate of displacement seems low compared to the monthly numbers of new jobseekers – but is also higher than the OECD average displacement rates.

Approaches for enhancing support for displaced workers

In February, Ministers considered advice on options for improving financial security.[11] In response to that advice, and in consultation with the social partners, ministers set aside three options (tax credits, loans, access to Kiwisaver accounts), and commissioned further work on three broader "packages" of support. This further work was to produce prototypes, and to identify costs and benefits at a high level. This remains a work in progress. The following discussion provides an update.

1 Enhancing access to Active Labour Market Programmes (ALMPs)

ALMPs are services that help people to find work, but also can be defined to include upskilling and retraining more broadly

Ensuring access to well-designed and delivered ALMPs is widely considered a necessary element of any policy package for displaced workers.[12] Enhancing the ALMP offering for displaced workers can refer simply to "core ALMPs", or to upskilling and retraining more generally, or to both.

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[11] MBIE Briefing: *Exploring social insurance and other options to enhance financial support for displaced workers*, 1954 19-20

MBIE Aide Memoire: *Ministerial discussion on financial security for displaced workers*, 18 February 2020, BR 2320 19-20

“Core ALMPs” are the practical tools provided by governments to help people to find and keep jobs. These ALMPs are often designed for, and delivered to, the most disadvantaged people in the labour market who face multiple disadvantages, but many other workers can also benefit from suitably designed programmes Key amongst these ALMPs are job brokerage and related advisory services (such as careers and training advice), wage subsidies, and short training courses that improve work readiness or provide basic skills (such as foundational education).

ALMPs can also be defined much more broadly, to include upskilling and retraining. As such, there can be a large overlap between ALMPs (broadly defined) and mainstream vocationally-focussed education and training. Upskilling and retraining may be especially relevant for displaced workers who need to adjust to structural labour market shifts, such as technological changes.

Current state and options

In New Zealand, the core ALMPs are primarily delivered by the Ministry of Social Development with access to employment services closely tied to beneficiary status. A range of other agencies also deliver ALMPs. If ALMPs are defined to include upskilling and retraining more generally, then large parts of the tertiary education sector could also be said to be part of an ALMP system. The Reform of Vocational Education is intended, amongst other goals, to facilitate retraining and upskilling.

Prior to the pandemic, there was very little support directly targeting displaced workers or those at risk of losing their jobs as distinct groups. Further, access to active employment support has tended to be closely tied to receipt of a main welfare benefit.

Through the welfare overhaul, the Ministry of Social Development is enhancing its employment service offering, and widening the range of people served. This could mean greater access to active labour market programmes for newly displaced workers regardless of benefit receipt.

The Government is also rolling out a series of Employment Action Plans to support the most disadvantaged labour market participants, some of whom may be displaced workers. In response to the recession, the Government is also investing in a range of new and enhanced services that support displaced and other disadvantaged workers. Some of these services could be maintained beyond the recession.

Through Budget 2020, the Government is investing $26 million to develop Tiro Whetū, an online career planning solution that will provide targeted quality careers information and support for all New Zealanders to understand their current skills and experience, the future demand of their career ambitions, what gaps they have in skills and experience and how they could address those gaps through training and on the job experience.

Further enhancement of core ALMPs for the newly displaced could require extra investment, but there may also be scope to realise efficiencies from reducing duplication and inefficiencies in the current ALMP system.

Possible impacts of enhancing services

Active labour market programmes generally have mixed ratings, and even when ALMPs are effective, the net impacts are not large.[13] However the overall mixed effectiveness of ALMPs masks significant variation in the nature of the programmes, and the people served.[14] Relative to other users of ALMPs, displaced workers are more strongly attached to the labour market, are likely to have (at least) basic literacy and numeracy skills, and are less likely to have health conditions and disabilities that limit their ability to work.[15]

Where displaced workers have labour market relevant skills and only require limited intervention, then an approach focussed on brokerage and advisory services could be useful. Brokerage and advisory services would be most likely to make a difference for those who simply need some good advice on their options, and advice with applying for, and looking for jobs.

Brokerage and advisory services would be less effective for people who need longer to search for work. This could be due to unfavourable labour market conditions, because workers have specialised skills, or because they need time to enhance their skills. In these circumstances, and without financial support, such workers may still face strong pressure to accept any available employment which could lead to wage scarring. These factors would be exacerbated for those who face high fixed costs. Even if public employment services were strongly incentivised to reach displaced workers promptly, and to offer services aimed at supporting them into good jobs, there would likely still be strong pressure to settle early.

2 Introducing statutory redundancy payments

Statutory redundancy payments are one way to enhance financial support

Statutory redundancy payments are one-off lump-sum payments provided by employers to displaced workers. Redundancy payments are usually calculated on the basis of tenure and salary at the time of displacement. There is currently no statutory provision in New Zealand for redundancy payments, or for defined notice periods, although these may be included in employment agreements.

A statutory redundancy payment could allow a displaced worker to “buy more time” for job search or retraining.

A statutory redundancy payment could reduce the pressure to find a new job, and thereby provide more time to engage with active labour market programmes. Because payments are closely linked to tenure, a worker of long-standing will receive a much larger payment, and hence be able to finance a longer period of job search or retraining, than a worker with a shorter tenure.

Statutory redundancy payments could also help to limit unnecessary dismissals (by incentivising firms to consider other options for minimising costs without resorting to

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[13] Martin, J. (2015). *Activation and Active Labour Market Policies in OECD Countries: Stylized Facts and Evidence on their Effectiveness*

[14] OECD, (2017). *Back to Work New Zealand: Improving the Re-employment Prospects of Displaced Workers*

[15] OECD, (2017). *Back to Work New Zealand: Improving the Re-employment Prospects of Displaced Workers*

redundancies) and help balance the costs / profits borne by workers and firms when workers are made redundant in order for firms to become more profitable.

Whether a statutory redundancy payment was effective in supporting transitions back to work would depend on the size of the entitlement, and the time needed for either job search or retraining. This in turn could indicate the level of redundancy payment necessary to finance a period of job search. It is likely that a much larger payment would be needed to finance a period of retraining.

Statutory redundancy payments also carry a number of risks for workers and firms

Larger statutory redundancy payments may have a chilling effect on employers' hiring decisions. Firms may also attempt to avoid potential redundancy costs by moving to fixed-term appointments, contracting or other work arrangements.

Tenure-based formulas also reduce labour force mobility, as experienced workers may be discouraged from voluntarily changing employers, since this could mean sacrificing entitlements. Employers may also be reluctant to displace such employees since severance costs are greater. These effects would tend to discourage labour market dynamism. The Productivity Commission has also described redundancy payments as a blunt means to smooth incomes because all workers receive the payment regardless of whether they start a new job immediately or after several months.[16]

A further risk is that insolvent employers may be unable to meet their commitments to make statutory redundancy payments. This makes statutory redundancy an unreliable source of financial support. Making employees preferential creditors could help to address this problem.

Further work could consider whether a low level of statutory redundancy payments, or other redundancy requirements (such as minimum notice period or notification requirements), could be considered as part of a larger system of financial support (such as social unemployment insurance, or enhanced welfare payments).

[16] New Zealand Productivity Commission, (2020). *Technological change and the future of work.*

3 Introducing Social Unemployment Insurance

Social unemployment insurance provides a dedicated income smoothing instrument

The social partners have requested a focus on social unemployment insurance, coupled with active labour market programmes, as a preferred approach for supporting displaced workers.

The defining feature of an income insurance scheme is the payment of a replacement income at a rate linked to pre-displacement salary or wages. In this way, insurance schemes "smooth" incomes for the period of entitlement. Replacement rates closer to 100% more effectively smooth incomes. A replacement rate of 80%, for example, provides much greater income smoothing than a rate of, say, 50%. Payment rates at these levels enable people to meet their current 'fixed' expenses while they find alternative work and income.

Insurance schemes thereby relieve the financial pressure that displaced workers may feel to seek reemployment promptly to gain the income need to meet current expenses. The more that this pressure to find work contributes to wage scarring – through curtailing time to search for work, or to retrain and upskill – the more important it is to provide an income smoothing mechanism. The extent of financial pressure experienced will depend in part on levels of savings, and the ratio of expenses to income on fixed costs such as housing and car loan repayments.

Welfare payments tend to smooth incomes ineffectively since they provide flat rate payments below the minimum wage, although these are often complemented by supplementary payments such as Working for Families, and the Accommodation Supplement. These payments may smooth incomes somewhat effectively for people on low incomes, but will be much less effective for people accustomed to higher incomes, and who have higher fixed costs, or where one person in a couple loses work, while the other continues to earn. However, workers losing higher income jobs are also more likely to have savings or may be able to cut back on discretionary spending (such as holidays) to help smooth their consumption in the nearer-term. Statutory redundancy payments may also smooth incomes, but only if they are relatively generous.

The recently introduced COVID-19 Income Relief Payment (CIRP) has some resemblance to an insurance payment, while being delivered as part of the welfare system. Eligibility for the CIRP is contingent on (COVID-19-related) displacement, is largely individualised, is time-limited, and pays more than a main benefit. In these respects, the CIRP resembles an insurance payment. CIRP payments are not, however, linked to pre-displacement incomes. The Forum could consider the role of a payment like the CIRP against its agreed objectives.

Smoothing worker incomes to maintain consumption can also have wider benefits for the economy by serving as 'automatic stabilisers' that can reduce the impact of economic recessions. Maintaining the spending of middle and high earning families is particularly important since they are more prone (and more able) to cut their spending in a recession.

Choices in designing, delivering, and financing social unemployment insurance

The table below summarises key “first order” choices in designing, delivering, and meeting the cost of a social unemployment insurance scheme. The subsequent discussion elaborates on these points.

	Impacts	**Choices**
Eligibility	• scheme coverage	• all workers, or exclude the self-employed? • limited to economic displacement, or include other life-shocks? • voluntary, auto-enrol or compulsory?
Entitlement duration	• effectiveness in enabling job search, and retraining & upskilling	• link duration to job search (3-6 months?), or • link duration to retraining and upskilling (up to 12 months or longer)?
Entitlement rates	• effectiveness in smoothing incomes	• substantially smooth incomes (eg 80% replacement rates), or • only moderately smooth incomes (eg 60%), or gradual step-downs?
Delivery	• respective roles of the market, government, and social partners	• a state-administered model like the Accident Compensation Scheme? • a tripartite model like Sweden’s Job Security Councils? • a market-based model like Kiwisaver?
Cost sharing	• respective costs borne by government, workers, and / or firms	• whether to share costs between government, workers, and / or firms, and relative share

Eligibility

There are three key aspects to eligibility for coverage by an unemployment insurance scheme. The first aspect is the range of events that qualify for coverage. At this stage, the Forum partners have sought advice solely on providing insurance for people unemployed as a result of redundancy or displacement. Insurance against other events that cause unemployment is also possible, such as health conditions and disabilities. Widening the scope would ensure support for many more people, but would increase costs very substantially. The Forum may wish to consider the merits of including events other than redundancy in any social unemployment insurance scheme.

The second aspect of eligibility is whether coverage is extended to people in all working arrangements. In suggesting criteria for evaluating an income smoothing tool, the Productivity Commission has noted that, ideally, the tool would be neutral towards work arrangements (eg, self-employed, casual, fixed-term, permanent). This is desirable because a scheme that is limited to only some categories of workers, with additional costs and compliance associated with hiring such workers, could bias employment decisions in undesirable ways. Furthermore, including a wider range of workers than just permanent and fulltime workers –such as casual employees, and contractors – would ensure support for people in more precarious forms of employment.

At the same, there are practical issues to consider. Entitlement to insurance is clearly triggered for a permanent employee through redundancy. Contractors and casual employees, however, are unlikely to be made redundant, since they have no guarantee of ongoing work. If they were included in an insurance scheme, there would need to be a different “trigger” for entitlement to insurance payments. Officials will consider these eligibility choices further.

The third key aspect is whether coverage for eligible workers is universal, or voluntary. Most social insurance schemes are universal by definition. The AC Scheme is one example. Social insurance schemes address the problem of low uptake and adverse selection that can undermine voluntary schemes. Adverse selection occurs when high risk individuals opt into insurance, and low risk individuals opt out. Adverse selection and low uptake can cause voluntary schemes to be financially unviable, or cause premiums to be very expensive. For these reasons, a high level of scheme participation is desirable. Auto-enrolment is a soft-form of universal coverage. Kiwisaver offers one example of auto-enrolment.

It is also important to consider whether eligibility and financing should be linked. Such linking can create difficult administrative boundaries but may be perceived as fairer. The alternative is often to finance the scheme from a broader base through the tax and transfer system. This is operational and easier to administer, but can be seen as charging people for a benefit that would not accrue to them.

Entitlement duration and rates

Replacement rates and entitlement periods are especially important influences on worker outcomes, and costs. These choices should be guided by the objectives of the scheme, and its cost.

If the objective is simply to enable an extended (and supported) job search, a shorter duration entitlement (perhaps 3-6 months) could suffice, with a replacement rate of between 60% and 80%. This could be a good choice if the main challenge facing displaced workers was insufficient opportunity and support to find suitable work.

If the objective is also to enable a period of retraining and upskilling, then a much longer entitlement (perhaps 12 months) could be appropriate. Such a scheme would be much more expensive, especially at higher replacement rates. This could be a good choice if a significant challenge facing displaced workers was a need to address skills gaps. A longer period could also be appropriate during industry-wide transformation or a recession. Student loans offer an alternative financing option for meeting displaced workers’ living costs while retraining and upskilling.

If the objective is mainly to smooth the transition to a lower income, then a lower rate, and shorter duration, could be appropriate. Such a scheme could be similar to the design of the COVID Income Relief Payment, but with payments linked to prior income, and potentially reducing over time. Such a payment would also provide some relief from the financial pressure to accept poor job matches.

High replacement rates, while effectively smoothing incomes, can also dampen work incentives. This is why insurance schemes are usually established on the basis of mutual obligations, where job seekers are obliged to participate in job search or retraining/upskilling while receiving income replacement payments

Scheme delivery

An insurance scheme – and associated job search support[17] – could be administered by the state, by a tripartite model, or via a market model:

- A state-administered model could resemble the Accident Compensation Scheme, with a dedicated crown entity to manage the scheme. Job search support could be delivered in-house, or contracted to specialist providers (as with ACC), or provided via the Ministry of Social Development.
- A tripartite model would be more novel, and could draw from international examples, such as Sweden's Job Security Councils. The Job Security Councils are bipartite (business and union) institutions that manage unemployment insurance claims and support workers return to work.
- A market-based model could be similar to the Kiwisaver model, whereby workers nominate accredited providers to manage their insurance policies and claims. Such a model would leverage private providers to deliver government policy, similarly to Kiwisaver. To be accredited, insurers would have to accept any worker that wished to bring their "account" to the insurer. A market model could enable providers to compete for workers as customers by offering attractive income and employment support packages. Providers could be incentivised to support displaced workers into "non-wage scarring" jobs.[18] A market model could still include tripartite governance, and government contributions.

Since administering insurance payments is essentially a technical role, capability and incentives to deliver high quality employment outcomes should probably be a factor in making institutional choices.

[17] The Productivity Commission has commented that "Under an unemployment insurance system (section 3.8), for example, the insurer has strong incentives to get a displaced worker back into the workforce. Responsibility for labour-market programmes for their clients might best be assigned to the insurer, who has the right incentives to design, evaluate and improve programmes for different types of client." p.91, New Zealand Productivity Commission, (2019). *Employment, labour markets and income Draft report 2, Technological change and the future of work*

[18] Private providers would be incentivised to support workers back to work through a desire to minimise insurance payment liabilities. As a check against perverse incentives, workers could be entitled to decline job offers with a substantial income drop (ie wage scarring jobs). Providers might also receive a commission for placing workers into non-scarring jobs.

Costs and cost sharing

Social unemployment insurance would come at a substantial cost, and need to be paid for. Direct costs would include the insurance payments, the cost of active labour market programmes, and administration costs. The more generous an insurance scheme (and the greater the demand), the greater the costs.

The costs of unemployment insurance schemes are typically shared between government, working people, and employers (as per ACC). However other combinations are also possible, such as funding schemes entirely from general taxation (as per welfare or superannuation), or funding insurance solely from employer and employee contributions.

The following considerations could inform a discussion about cost-sharing arrangements:

- Government contributions – Government contributions are necessary since only the government can act as “funder of last resort” when calls on the scheme exceed available funds. This is particularly a risk in recessions, when volumes of displacement are greatest, and unemployment spells are longest. The Government can also ensure that the scheme can afford to provide equitable income to all workers, such as those in insecure work, on low incomes, interrupted work patterns, or who are new to the scheme. Government funding from general taxation is also likely to be less distortionary than other sources of funding.
- Employer contributions – A rationale for employer contributions is that employers are ultimately responsible for displacement, and the negative externalities arising from displacement. Employers also tend to benefit from displacement. Employer contributions internalise the negative externalities of displacement. The imposition of a statutory redundancy payment could offset an employer contribution.
- Employee contributions – A rationale for employee contributions is that employees are the ultimate beneficiaries of income protection. By paying a proportion of their wages or salaries as levies, their contributions can be directly linked to benefits received.

Over time the wages available to workers will adjust based in the relative employer and employee contributions – as a result, both will function as a payroll tax whose burden will fall on both employers and employees.

The Ministry of Social Development has conducted a first round of modelling to estimate the costs of an unemployment insurance scheme, assuming different combinations of rate and duration. The modelling includes full-time, part-time, permanent, and fixed-term employees, but excludes the self-employed. To help minimise costs, the modelling assumes a cap on income that is eligible for replacement cover, similar to the ACC model. ACC caps weekly compensation - currently at $134,328 per annum (at 1 July 2019).

The modelling estimates the costs of insurance payments, excluding the costs of operating the scheme itself, or delivering active labour market programmes. The modelling also excludes any behavioural impacts (such as people taking longer to search for work), or impacts on firm decision-making, or savings from avoided transfer payments. Subsequent rounds of modelling will allow for such impacts. The modelling also excludes any indirect and unintended costs.

The table on the following page summarises the modelling results. The modelling estimates the costs for different levels of displacement, replacement rates, and maximum durations of payment. The shorter duration payments (3-6 months) would support a period of job search, adjustment to a lower income, and some retraining and upskilling. The longer duration payments (6-12 months) would support those same objectives, and a more substantive period of retraining and upskilling.

This modelling is an initial estimate that is subject to further refinement.

Option / scenario	Replacement rate			Maximum duration (months)	Estimated average cost per displaced employee (income capped at $134k)	Estimated cost per year depending on the displacement rate (income capped at $134k for 2.3m employees)					Cost per employee (36,000 - 375,000 job losses)
						1.6% displacement rate (36,000 job losses) (consistent with OECD displacement rates)	3.3% displacement rate (75,000 job losses) (similar to the number of new Jobseekers per year)	5.0% displacement rate (114,000 job losses)	9.7% displacement rate (219,000 job losses) (potential during 'Normal' times)	16.5% displacement rate (375,000 job losses) (potential during the GFC)	
High rate, long duration	80%			12	$14k	$0.4b - $0.6b	$0.8b - $1.3b	$1.3b - $2.0b	$2.4b - $3.7b	$4.7b - $5.8b	$180 - $2,600
High rate, short duration	80%			3	$7k	$0.2b - $0.3b	$0.4b - $0.6b	$0.6b - $1.0b	$1.1b - $1.8b	$2.1b - $2.8b	$90 - $1,200
Low rate, long duration	60%			12	$11k	$0.3b - $0.5b	$0.6b - $1.0b	$1.0b - $1.5b	$1.8b - $2.8b	$3.5b - $4.3b	$130 - $1,900
Low rate, short duration	60%			3	$5k	$0.1b - $0.2b	$0.3b - $0.5b	$0.4b - $0.7b	$0.9b - $1.4b	$1.6b - $2.1b	$40 - $900
Variable rate, long duration	80% first 4 months	70% second 4 months	60% third 4 months	12	$13k	$0.4b - $0.6b	$0.8b - $1.2b	$1.2b - $1.8b	$2.3b - $3.4b	$4.3b - $5.3b	$180 - $2,300
Continue the COVID-19 Wage Subsidy	100% replacement up to $585.80 p/w			6	$8k	$0.2b - $0.4b	$0.4b - $0.7b	$0.7b - $1.1b	$1.3b - $2.1b	$2.4b - $3.2b	$90 - $1,400

These cost estimates can be converted into annual costs per worker. To take one scenario, at a displacement rate of 3.3% annually (75,000 employees displaced) with an entitlement period of up to twelve months, and a replacement rate of 80% of lost income, the annual average cost per displaced worker would be around $14,000, or around $0.8-$1.3b per annum. This is less than 10% of the estimated annual costs of wage scarring shown above.

It should be noted that this is at a displacement rate for a year such as during the Global Financial Crisis when the rate of displacement is unusually high. The normal rate averages approximately half this.

Financing this cost could require an average annual payment around $350-$600, or around $0.65-$1.10 per $100 earned per worker. This is similar to international comparators. Further modelling will refine these initial estimates.

Policy choices in scheme design: Financing arrangements

How scheme costs are met can also cause a range of indirect costs, and tradeoffs. Among the issues to explore in more detail are:

- Compliance and hiring costs for business: Payroll taxes are often perceived as compliance heavy by business, especially for small firms.
- Taxing labour more highly than capital: A payment financed through a payroll tax or levy implies that labour income will be taxed at an even higher rate than capital income. This generates potential fairness concerns about passive income being taxed more lightly than earned income.
- Efficiency of the tax system: Funding insurance through a payroll tax, or equivalently a levy system, increases the efficiency costs of taxation. Beyond equity considerations and labour market distortions, this also implies a greater risk of individuals reclassifying income to avoid tax or receive a payment.

The introduction of a levies or a payroll tax is a significant design decision that will have administrative implications for the agency in charge of collection. These will become more complex the more the financing of the social insurance payment is linked to eligibility.

Interface with the welfare system

The tax and transfer system is already complex for users and administrators. The welfare system alone comprises three tiers, with additional support provided through the Working for Families tax credits, and other types of payment, such as student allowances. There are also stark differences between the support available through different parts of the system, most obviously at the boundary between the social insurance-based ACC system, and the welfare system.

Introducing an insurance scheme for displaced workers would increase this complexity, but not necessarily lead to incoherence. For displaced workers, it would lead to greater equity with the ACC system. Countries with time-limited insurance schemes tend also to operate open-duration social assistance (welfare) schemes. In such countries, a displaced worker who exhausts their insurance entitlement without finding work may then become eligible for social assistance.

There are also questions of equity to consider. The introduction of the COVID-19 Income Relief Payment has received some criticism for creating a "two tier welfare system". This is because the payment provides around twice the amount of the Jobseeker Support benefit, and is less tightly tied to family incomes. This raises questions about whether a social insurance system – paying a replacement rate linked to prior incomes – would invite similar critique. This argument implies that paying (recently) displaced workers a higher rate than other unemployed people is unfair.

Any insurance scheme would have a different – though related – purpose from the welfare system. Both insurance and welfare seek to reduce financial hardship through income replacement payments, and to support people into employment. However, where insurance schemes aim to prevent displaced workers from "losing ground in the labour market", welfare systems aim to place a minimum floor under family incomes, and thereby to reduce poverty. Introduction of an insurance scheme does not preclude the continuing work to overhaul the welfare system.

Implementation pathways

Ministers have sought advice on implementation pathways to deliver packages of support. Developing these pathways will reveal whether there are any "least regrets" actions that are common to each pathway and provide a clearer sense of the practicality and feasibility of the packages. Exploring implementation pathways may also reveal "scaled options" that allow for an assessment of impact while limiting risk.

For example, one pathway could include the following elements as an initial step:

- enhancing access to active labour market programmes for displaced workers (potentially buttressed by minimum notice periods, and notification to employment services if feasible), and
- introducing a short duration unemployment insurance payment designed to support job search only.

If necessary, ministers could then choose to invest further in active labour market support, introduce a low-rate statutory redundancy payment, or make the insurance payment more generous in duration and / or rate. Subsequent advice will identify alternative pathways such as a more generous insurance scheme.

Next steps

The next steps in this work are to continue to prototype the alternative approaches, to refine cost estimates, and to assess their potential impacts on worker outcomes. Agencies will continue to work closely with the social partners.

Comprehensive advice on the alternative approaches is likely to be available around September / October. Officials therefore propose to make this advice a feature of briefings to incoming ministers, followed by a detailed dedicated report. After considering this advice, Ministers may wish to agree-in-principle to a preferred approach, and commission detailed advice on that approach.

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Annex 1: A framework for thinking about the causes of wage scarring

Causes – Wage scarring is a wicked problem that we don't understand well.

There is likely to be a range of contributing factors to wage scarring.