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Submission on the Future of Work Tripartite Forum's Discussion Document *A New Zealand Income Insurance Scheme*

**Michael Fletcher
Institute for Governance and Public Policy
Te Herenga Waka Victoria University of Wellington**

Executive Summary

1. This submission is in response to the Future of Work Tripartite Forum's paper, released on 2 February 2022, *A New Zealand Income Insurance Scheme: A discussion document*. I do not support the proposal.
2. If introduced, the proposal would be highly inequitable, creating a two-tier structure in New Zealand's welfare system. It would divide the insured from others who are reliant on the welfare system if unable to earn an income. The insured would receive generous insurance pay-outs, a less onerous work-test and other preferential provisions. Others, including large groups of low-income people, such as long-term Supported Living Payment recipients, sole parents on benefit, and those with insecure labour market attachment would be considerably less likely to benefit from the scheme, if at all.
3. Over time, this division risks undermining societal support for a welfare system that provides a standard of living that allows people to participate in the community as insured workers become increasingly insulated from welfare. The scheme would form part of New Zealand's income support system so cannot be considered separately from these issues, or as simply an arrangement between workers and employers.
4. Such a fundamental philosophical change to the basis of New Zealand's welfare system – and the very high annual estimated cost of \$3.5 billion – requires a careful and thorough assessment of the full range of options and a convincing case that an insurance model is the best approach. This is not done in the discussion document (or other papers), and more time is needed for that to take place before decisions are made.
5. With respect to rationales for the proposal, my conclusion is that the 'wage scarring' argument has no evidential basis. There is no evidence to indicate that a high insurance pay-out will result in better post-layoff job matches. Regarding consumption smoothing across a short period between jobs, there *is* evidence that some lower-earning people and households may face difficulty, but little evidence that many higher-earners would. Addressing the needs of lower earners can be achieved through changes to the welfare system. A broad approach for doing so is discussed in Section V below.
6. The proposed cap of over \$130,000 per annum is set far too high, when set in conjunction with an 80 percent replacement rate. It is totally out of line with Scandinavian and other European unemployment insurance schemes (see Figure 1). There are many other highly problematic

features of the proposal. For example, the work-test requirements, abatement regimes and definition of income for abatement purposes are very different from those applying in the welfare system, exacerbating the two-tier nature of the proposed change.

7. If the scheme does proceed in any form, delivery of it should be through Work and Income, not ACC. This would provide continuity and consistency of provision of case management, active labour market and training programmes, and would reduce boundary issues where people are part of both. Delivery through ACC would also be detrimental in that it would greatly reinforce the two-tiered nature of the proposal. Unified delivery through Work and Income has the potential benefit of reducing stigma by broadening the range and number of people who that agency deals with. The welfare-based model I outline would have a similar effect.
8. If Ministers do decide to pursue an insurance scheme for job loss due to displacement or ill-health, I include in Section V a broad outline of an insurance-based approach. I am not recommending this as my view is that the problems which do exist can be addressed within the existing single-tier welfare structure. However, the alternative insurance-based approach outlined does at least reduce the inequities, better target the identifiable need and would be considerably less costly.

I. Introduction

9. This submission is in response to the Future of Work Tripartite Forum's paper, released on 2 February 2022, *A New Zealand Income Insurance Scheme: A discussion document*. The submission is in four parts. Section II sets out general problems with the proposal and with the introduction of a second tier to New Zealand's main welfare system. Section III discusses the case for change put forward in the discussion document and aims to identify what genuine problems exist that do require consideration of a policy response. Section IV comments briefly on some of the specific problems with the proposal. This section is not by any means exhaustive but is intended only to identify some of the more serious problems with the proposal. Section V sets out, in light of the previous sections, two possible broad alternatives that in my view would be more equitable, more efficient, better address the identified problems and fit better with other elements of New Zealand's welfare system. The first of these, which is my recommended approach, is based on amending the existing welfare system to address the problems. If this approach is not accepted however, I outline an insurance-based model, which although I do not recommend it does avoid some of the most problematic features of the proposal, such as the very high cap and separate delivery through ACC.
10. Notwithstanding the criticisms of the proposal made in this submission, my conclusion is that *some* of the problems the proposal is seeking to address are real and warrant policy responses. The two broad alternative approaches I put forward are therefore presented in good faith and I would urge the Forum and Ministers to give them due consideration.

II. General problems with the proposal

11. *Process and timetable.* The proposed change is philosophically very significant, systemically very large, and practically highly complex. It is evident from the discussion document many of the issues have not been adequately considered. The problem identification analysis is weak and there has only been the most cursory of attempts to consider the range of possible policy responses. There is a glaring lack of critical information needed for a proper policy development process, including cost-benefit analyses of various options, to the point where it is hard to avoid the conclusion that some form of social unemployment insurance scheme was the pre-decided best solution. Given the radical philosophical shift in New Zealand's welfare state that is being proposed, and the very large cost estimate of \$3.5 billion annually all options should be properly assessed and consulted on before any such change is made. I submit that this cannot be done adequately within the proposed timetable of implementation in 2023 and that the process should be extended by at least another year.
12. *Creating a division between the insured and others.* One of the general problems with the proposal is that it creates a strong division between those who are covered by insurance and others who must rely on the much less generous welfare system. The discussion document acknowledges this equity problem but then more or less ignores it. This is a fundamental inequity and a very strong policy rationale is required to outweigh it. The legislative removal of the right to sue in the ACC system is an example of such a rationale, but no such equivalent applies in this case (see discussion in Section III). The problems that do exist in our welfare system, and with job-loss, can be addressed by strengthening the welfare system and without introducing an inequitable division between people receiving generous insurance pay-outs and others reliant on benefit.¹
13. In addition to the immediate inequality inherent in the proposal, it will create a dynamic that further undermines public social support for welfare. Those who are protected by a generous insurance scheme will have less reason to support a strong welfare system that provides an adequate standard of living for all to participate in their communities. The argument, sometimes advanced, that countries with generous insurance system also have generous minimum social assistance systems is flawed. There is no evidence of any *causal* link between increases in insurance generosity and an increase in minimum assistance generosity, only that some countries tend to better fund all their health and welfare systems than do others. In the New Zealand context, it is most likely that the insurance proposal would weaken support for other 'less worthy' groups of beneficiaries. The effect – and it appears to be the intended effect – of the scheme would be to insulate the majority of employees from the risk of having to engage with Work and Income or to rely on the welfare system.
14. Related to this is that the implementation of a second-tier insurance scheme such as this increases the risk that future Governments with less regard for child poverty or minimum welfare rates could cut back welfare support with even less political risk to themselves because they leave the

¹ A counter-argument raised with me in my meeting with officials was that looked at over the life cycle the two tiers were much less important because the same person will be entitled to the two different forms of coverage at different points in their lives. This argument is specious. A large proportion of people – largely the healthy, middle classes – would be likely to only ever have contact with the proposed insurance scheme. A considerable number of others – including those with disabilities from birth or childhood, sole parents, and those with minimal labour force attachment – would be far more likely to be reliant on the bottom tier welfare benefits.

insurance scheme untouched. The current Government has made significant improvements to welfare rates, and, while there can never be any certainty about what future governments might do, the existence of the proposed insurance scheme increases the risk of welfare cuts.

15. The discussion document also states that the insurance scheme is an arrangement between workers and their employers and is therefore independent of welfare. This claim is simply incorrect. The scheme would be legislatively based and backed by state funding when necessary. As in any country which has a two-tier system, the insurance scheme would form part of the overall social security income support package.² The proposed scheme is unquestionably public social policy and as such government must consider it in light of the interests of all and as one part of New Zealand's welfare system. I should add that my impression is that Government probably *does* consider it in that light and that the argument that it is simply an arrangement between workers and employers is a position advanced by the NZCTU and Business NZ. Government needs therefore to assess whether this is the best way to spend an additional \$3.5 billion per annum on social assistance.
16. Economically, in terms of broader labour supply, the scheme is highly likely to have the reverse effect of what is claimed. Far from improving efficiency and productivity through better matching (see discussion below), the scheme in its present design will result in many skilled workers 'sitting out' of the labour market for six or seven months, or working only a few hours to top up their insurance pay-outs. The very high cap, the weak job-search obligations, the lack of substantial resources dedicated to re-skilling and re-training mean that this proposal is nothing like the Danish flexicurity model and will arguably worsen productivity and labour market efficiency, not improve it. These issues are discussed further below.

III. Clarifying the problem identification

Chapter 3 of the discussion document: 'Objectives: What we want to achieve and the challenges we face'

17. The discussion document's problem identification (Chapter 3) is particularly weak. A proposal of this magnitude and structural significance requires a clear problem definition, and a compelling case. The weakness of the case for the proposal and the closed approach to considering the full range of options is highlighted by the lack of precision in the problem identification chapter. Because being clear about the problems to address is critical to assessing the proposal I examine these in detail.

18. The chapter identifies four problems the Forum says it is seeking to address:

"Job loss due to displacement or a health condition or disability is common in New Zealand" (p24)

19. As the discussion of the number of job losses shows, the fact is that the size of the problem is not known. Figure 1 on p24 of the document indicates economic displacement of between 25,000 and

² So, for example, the OECD tax-benefit model models unemployment insurance, unemployment assistance and social assistance for each country as appropriate.

45,000 per annum typically rising during the global financial crisis to about 75,000. The text then says that the Household Labour Force Survey undercounts displacements if the person is only unemployed for a short while (or not at all) or if they have multiple jobs. It says that adjusting for these undercounts they estimate 115,000 total redundancies per annum on average. Even if one does accept an 'adjustment' that more than doubles the observed estimate, both the undercount reasons are ones where there would in most cases be considerably less need for insurance.

20. Contrary to the assertion in the discussion document, the best available evidence suggests that job losses due to displacement are relatively low in New Zealand compared to other countries:

Dixon and Maré (2013) and Hyslop and Townsend (2016) report annual displacement rates in New Zealand of less than 2 per cent before, and 3 per cent during, the 2008 recession.³ These compare to 5 – 6 per cent in Britain and Australia (Borland et al.2002), and 2 – 7 per cent across a range of countries (OECD 2013).

(Hyslop and Townsend, 2019, p175, note 2)

21. The numbers of HCD-caused job losses are similarly imprecise, but the final assumption of “likely to be much higher than 30,000” (p27) is unwarranted. This is particularly so because no adjustment appears to be made for the fact that some people entering Jobseeker Benefit – Work Ready and later transferring to JS-HCD would not have been in ill-health when they left their job (or left it for that reason) and so would not qualify for insurance.

22. Note that the issue here is attempting to estimate the numerical size of the problem. There is a quite separate issue, discussed further below, about the impact behavioural responses to the introduction of the scheme has on the number of claims. Should the scheme go ahead, the actual number of claims could be much larger than the true size of the problem because of behavioural responses induced by the scheme itself.

23. The considerable uncertainty over the number of relevant job losses should have been made clear in the discussion document by giving a range with upper and lower estimates. It would then have been possible to explain clearly to the public that the estimated cost and, therefore the levy rates, was arrived at by picking a certain point in that range, such as the mid-point, or (with a suitable rationale) some other point.

“Harmful effects of job loss”

24. I fully agree that job loss will often have harmful effects – as will unemployment generally. The discussion document fails however to be clear as to what harms and in what situations there is a policy problem to address. Three effects are put forward:

- ‘Sudden large falls in income that can be difficult to adjust to’. This is a critical issue and it relates to the ability to smooth *consumption* for a period after income has fallen. That is, the issue is consumption smoothing not the loss of income per se. I return to this below.
- ‘coming to terms with job loss and unemployment’. It is not clear what is meant here, but presumably it relates to psychological and psycho-social impacts. These apply to all unemployed and, besides, why would a flow of insurance payments change these effects

³ At around 56,000 people per annum, the 2 percent figures is slightly above the Figure 1 average.

(especially if, as apparently intended, the insurance payments prolong the period of unemployment)?

- ‘poorer wages or conditions in subsequent employment (wage scarring)’. The issue of wage scarring is mentioned at various points in the discussion document. The argument has no validity. Lower wages in subsequent jobs may be the result of a number of reasons including that in their previous job the worker may have enjoyed the wages benefits of firm-specific skills or a share of rents if the firm has a degree of product market power but lose these in their new job. Income insurance would only help reduce observed wage scarring if the scarring was due to financial constraints causing the worker to spend too little time searching for the optimal match for their skills. Hyslop, Maré, Noy and Sin address this in their 2021 paper and specifically reject it:

The empirical evidence suggests that increases in the generosity of unemployment payments do not significantly affect the quality of jobs that recipients end up in. A meta-analysis by Schmieder and von Wachter (2016) concludes that generous unemployment benefits have very small and imprecisely estimated negative effects on the re-employment wages of recipients. Meanwhile, a meta-analysis by Tatsiramos and van Ours (2014) concludes that unemployment benefits have no average effect on re-employment outcomes, though these zero net effects probably mask some individual-level heterogeneity. This suggests that increased search duration does not produce benefits in the form of higher-quality job matches.

(Hyslop, et al, 2021, p33)

A further point regarding wage scarring effects, which relates to the consumption smoothing comment above, is that those who have higher earning jobs prior to displacement are likely to be able to have the savings or other means to fund an optimal period of job search (see discussion of Figure 1 below which supports this assumption). The discussion document’s (correct) statement that ‘individual effects of wage scarring are greater for displaced workers with degree level qualifications’ (p25) reinforces the evidence that the lower re-employment wages are likely to be due to factors other than the lack of a high replacement-rate income insurance for this group as a much larger proportion of highly qualified workers will already have the ability to manage an optimal period of job search without social insurance.

Job displacement and the future of work

25. The so-called future of work ‘megatrends’ are important labour market – and economic and social - policy issues. As the discussion document points out how these trends will affect New Zealand is highly uncertain. Over the last decade or two there have been various attempts to estimate the numbers of jobs likely to disappear due to technological change. Some of these, of the ‘end of work’ vein have been wildly speculative to put it mildly. A more realistic estimate is probably the OECD study which concluded 12 percent of New Zealand workers being in jobs that can be seen as at risk of being automated in the near future is probably a more realistic figure (Nedelkoska and Quintini, 2018, cited in Allan and Sanderson, 2021, p3). That rate of change must be compared with the usual rate of change in job types and job content in the past. As the discussion document points out future of work trends *may* increase the rate of skill obsolescence – or it may not. The available data do not show any rise so far in either technology-induced structural unemployment or a rise in non-standard forms of employment (Rasmussen and Fletcher, 2018). If the rate of skills obsolescence does increase in future, then (as is acknowledged in the discussion document)

it is policies and programmes for lifelong education and training that is the primary area for additional focus.

26. The discussion document refers to past New Zealand examples of large-scale job losses, including forestry in Kawerau, freezing works in Whakatū and Tomoana. They could also have referred to Pātea, New Zealand Rail or a number of other examples. The key point about these situations is that the existence of a six-month income insurance scheme would have done little to address the needs of those workers and communities. Indeed, many of those workers were actually covered by redundancy provisions. If those structural changes were necessary in the first place, then comprehensive multi-year packages of individual, family and community support was needed including regional economic development, retraining and educational opportunities, relocation assistance where appropriate as well as income support.
27. The same is true of the major economic and labour market changes that will be required for climate change and environmental reasons. Work is already underway (as I understand it) on Just Transitions strategies for some sectors and regions, such as the ending of the gas industry in Taranaki and coal mining in the West Coast. An expensive, nation-wide income insurance is not an effective or efficient way to address Just Transitions processes. It is inadequate for the workers who need it, too thinly spread, and poorly targeted.

“Workers with health conditions and disabilities are also at risk of sudden falls in income, unemployment, and possibly long-term wage loss” (p26)

28. The impact of ill-health and disability on earning capacity is indeed a significant social and public policy problem. As with displacement, however, the first key question in respect of a high-replacement rate insurance scheme is consumption smoothing, not income smoothing: what subset of those facing a temporary loss in income due to sickness would experience a serious decline in their material standard of living because they are unable to maintain a reasonable level of consumption spending during that period? The case for social insurance cover for is much weaker for those who are able to manage up to seven months with out significant decline in their standard of living. There is far too little data the inability of people to short-term consumption smooth through a period of ill-health to justify the proposal.
29. Ill-health and disability can strike at any stage in the life course, the discussion document proposal concerns only cases where the event happens at a time when a person is employed. It is therefore presumably focused on either a) a temporary need, or b) providing a cushion to adjust to a long-term or permanent loss of earning power for employed people. Those whose long-term work capacity is reduced by disability or illness from birth or during childhood or who do not happen to be in work at the time of the are not assisted at all. This will include a considerable proportion of the approximately 85,000 people in receipt of the Support Living Payment at any given date. This is a further example of the inequity: a two-tier approach leaves many people with health conditions or disabilities out in the cold.

“In New Zealand support is limited for displaced workers and workers with health conditions and disabilities” (p27)

30. Chapter 3 concludes by arguing that New Zealand offers less support than many other countries to displaced workers and workers with health conditions and disabilities. This is true compared to some European countries with a Bismarckian social security heritage, but only in respect of the subset of working people who would qualify for and receive insurance. Here, as elsewhere, the discussion document wants to try to present the scheme as somehow separated from the wider social security system; that an unemployed person who became unemployed via job loss should be seen in policy terms as different from other unemployed people. This goes back to the point above – is there a short-term, consumption smoothing need which can be legitimately seen as different from the situation of any other unemployed person?
31. The document also refers to flexicurity, the Danish social-labour market approach which combines voluntary unemployment insurance, flexible hiring & firing provisions with extensive re-training and education support. As mentioned above, the discussion document insurance proposal is very different from Danish unemployment insurance which is very deliberately focused on meeting need and is capped at around the median wage. Although the discussion document emphasises that active labour market programmes (ALMPs) and effective retraining options are critical to the success of the proposal, in fact it does not propose that ALMPs be funded out of the levy. Rather, it appears that other jobseekers – many of whom also need greatly improved ALMP services – will have to compete with insurance recipients for the same Crown funding. Moreover, given the actuarially based nature (if delivered as an insurance scheme through ACC), and the high pay-outs of the scheme, there will be a very strong incentive to tilt the provision of ALMPs and retraining in favour of better-off insurance claimants rather than less costly Jobseeker Support recipients. This inequitable redirection of resources would be a perverse outcome and detrimental to the needs of lower skilled unemployed jobseekers.

What can we say about the size of potential need for greater financial support for those who lose employment due to displacement or ill-health?

32. Very little evidence is provided in the discussion document on the true size of the need for such a scheme. As discussed above, there is no empirical support for the notion that financial constraints are forcing people into sub-optimal job matches leading to wage-scarring. The discussion document makes (highly questionable) estimates of the total number of job losses annually, but not of the percentage of those who might face hardship due to difficulty smoothing consumption over a short period without work.
33. One source of useful information, not drawn on in the document, is the 2021 Financial Capability Survey conducted by Te Ara Ahunga Ora, The Retirement Commission.⁴ That survey includes the question “If your income fell by a third, for how many months could you meet all your expenses without needing to borrow?” That question isn’t perfect for assessing need as, on the one hand, losing a job may mean a greater fall in income, depending on interactions with the welfare system, Working for Families, Accommodation Supplement, and whether it was the person’s only job, etc. On the other hand, the question doesn’t take into account the extent to which people are able to

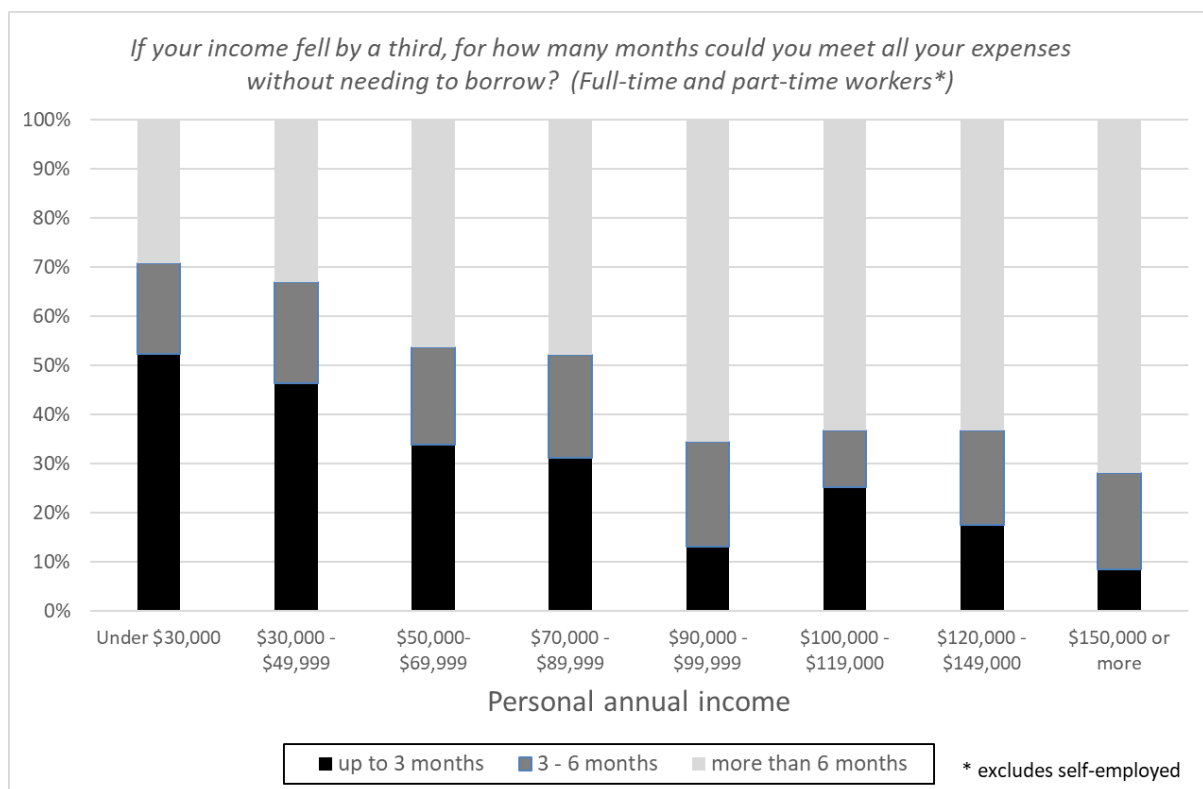
⁴ I thank Dr Suzy Morrissey and Dr Jo Gamble from Te Ara Ahunga Ora for providing data from the survey.

manage income falls through reductions in expenses associated with working, such as transport etc, or any economising on expenditure the household might make.

34. Nonetheless, the responses to the question reveal several highly relevant findings (see Figure 1):

- Almost half (46%) of all full- and part-time workers could meet all their expenses for six months or more.⁵
- Two-thirds (66%) could meet all their expenses for three months or more.
- There is a strong correlation between personal income and ability to meet expenses. Even in the \$50,000 - \$69,999 income bracket two-thirds could meet all current expenses for at least three months. For those over \$100,000 the figure is over three-quarters. These data strongly suggest that to the extent that workers may face consumption smoothing constraints the problem is heavily concentrated among those earning under \$50,000 per annum. A figure that is a far cry from the cap of over \$130,000 in the proposed scheme.

Figure 1



Source: Author's calculations using Te Ara Ahunga Ora, Financial Capability Survey 2021

35. Another source of information is StatsNZ's Household Net Worth Statistics 2021. These data are not ideally structured for assessing the question of the extent to which households could smooth consumption across a period with reduced income but they do reinforce the view that there is likely to be little problem for the majority of households with incomes in the upper half of the household income distribution. For example, households in the middle-income quintile (annual income

⁵ These figures exclude the 8% who said they didn't know how many months they could meet expenses for.

between \$71,397 and \$108,614) have an average of \$394,000 in financial assets and a median of \$67,000.⁶

Problem Identification conclusions

36. The above analysis suggests several conclusions regarding the problems that may (or may not) be needing to be addressed:

- There is no case for the proposal on wage-scarring grounds. There is no empirical evidence that using a high-replacement ratio insurance pay-out to permit a longer period of job search would result in better job matching and better re-employment outcomes. Indeed, it may worsen outcomes if the negative effects of skill atrophy and diminished labour force attachment outweigh any job-search benefits.
- There is no case for the proposal in respect of Just Transitions or 'future of work' considerations. Just Transitions require targeted intensive packages of measures that go well beyond a labour-market-wide six-month insurance pay-out. A generalised increase in the rate of redundancies due to technological change has yet to occur, and if it does the need for and design of policy responses – including education and retraining options – should be based on which parts of the economy and which workers are most affected/most need assistance.
- There is evidence to suggest that consumption-smoothing will be a problem for some workers who lose their jobs. This group is strongly clustered among those with low earnings or low household incomes; that is, the proportion of higher-earning displaced workers who would be unable to manage a six- or seven-month loss of income with significant hardship appear to be low. The rider to this though is that, even here, the evidence as to just how many people would face a consumption smoothing problem or hardship is uncertain.

IV. Specific issues and problems with the proposal

37. This section discusses some other problems with the proposal as set out in the discussion document. It is not intended to be comprehensive, only to cover a few of the issues that I see as particularly problematic.

The \$130,000 earnings cap is far too high

38. The proposed \$130,900pa earnings cap is set far too high.

39. The evidence discussed above is that a need for consumption-smoothing is concentrated on lower earners. There is no evidence to support the argument that wage-scarring is occurring because of a lack of ability for higher-earners to manage an optimal period of job search. Note that a lower cap would not mean displaced higher earners are not covered and they get nothing, only that their pay-out (and their levies) would be lower.

40. There is no logical reason for setting the cap equal to the ACC cap. The ACC cap is high because ACC is a no-fault scheme which legislatively removes the tort right to sue for losses where another person or firm has responsibility for having caused the injury. ACC removes the 'legal lottery' of

⁶ Financial assets include cash and deposits, pension funds, bonds, shares and other equity and life insurance funds and annuities, and other financial assets. Thus, some, but not all, of these funds would be fungible.

court action and replaces it with the principle of ‘real compensation’. Fault is not an issue (at least in a direct and legal sense) in displacement and job loss for health reasons.⁷ Any suggestion that the cap should be the same as for ACC on the grounds of simplicity and ease of understanding is a very weak justification almost to the point of insult. Moreover, there is much more scope for moral hazard problems in an unemployment insurance scheme than in ACC. In ACC, claim duration is largely, if not entirely, determined by a third party – a medical professional. In unemployment insurance, the recipient has a greater ability to extend their duration of receipt. The high cap will greatly exacerbate this problem.

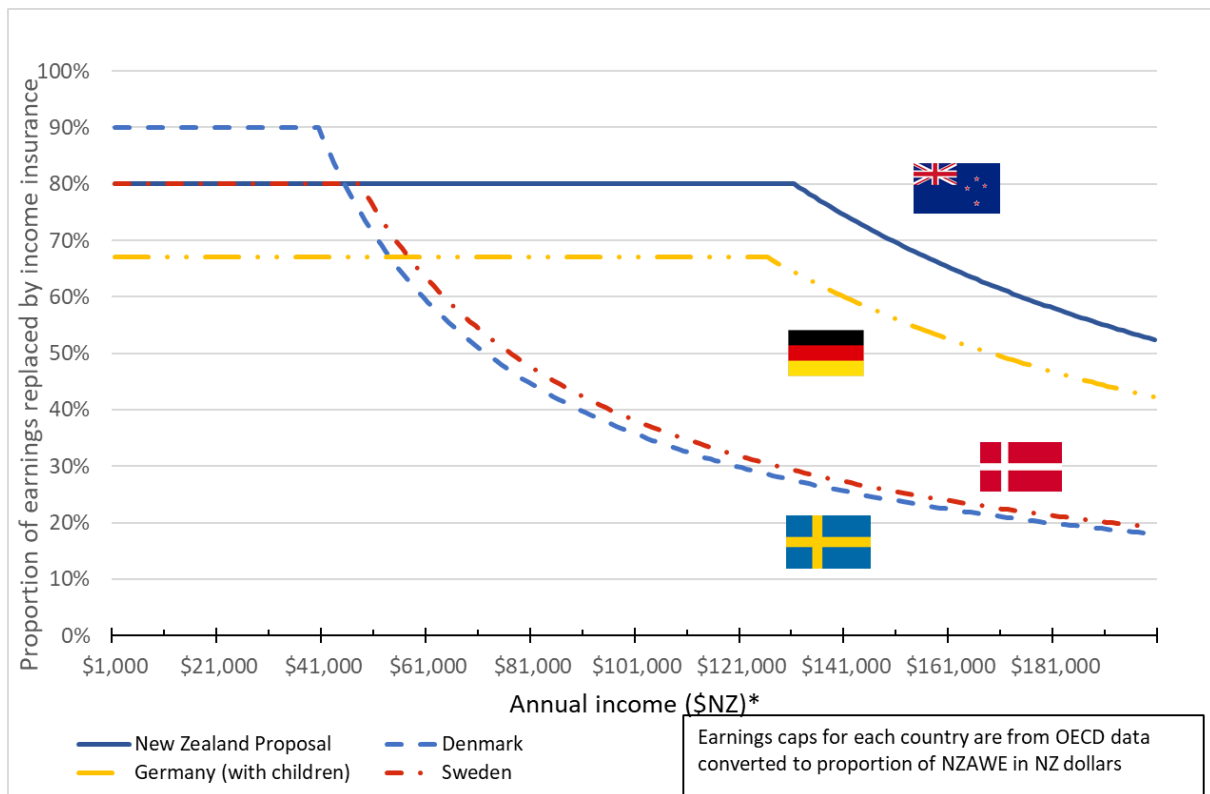
41. The argument that a high cap doesn’t matter because the levy would also be higher and therefore higher earners are funding their own higher pay-outs also does not follow. The risk of job displacement (and ill-health) is not distributed randomly and with zero information. That is, some people face a higher or lower ex-ante risk than others, and know this, so that some employees will effectively be subsidising others. A worker in a skill-shortage occupation, like medicine, health or teaching must still pay the levy but has much lower than average likelihood of benefitting. Compulsion in social insurance systems can be justified as a way of minimising adverse selection (at the cost of increasing moral hazard), but is not sufficient in itself - any scheme needs some other justification such as harm or need. As this submission has argued, to the extent such a justification exists it does not apply at high earnings.
42. As proposed the scheme would mean that a well-paid worker who was earning \$130,900 prior to being laid off would receive \$2,014 per week gross, or \$1,542 per week net for up to seven months. By comparison, the median wage and salary income in June 2021 was \$1,093 per week gross or \$899 per week after tax.
43. In addition, of course, the insurance pay-out is individualised and unaffected by any amount of spousal earnings if the person is partnered however high those earnings might be.
44. For these same reasons, earnings (and pay-out) caps are set much lower in European (and as far as I am aware, all other) unemployment insurance schemes. Schemes differ in their maximum duration entitlement, eligibility rules, replacement ratio and earnings caps. The last two of these interact arithmetically in that an 80 percent (say) replacement ratio declines progressively to a lower ratio for earnings in excess of the cap. A high replacement ratio and low cap, as in Denmark is more tightly targeted on need than a lower replacement ratio and higher cap, as in Germany. The current NZ proposal is at the higher end of replacement ratios (but not as high as Denmark’s 90 percent) but is wildly out of line with other countries in term of the cap as percent of average earnings. For example, in Denmark and Sweden the earnings caps are approximately 57 and 66 percent of average earnings respectively. The less targeted Germany scheme has an earnings cap of around 175 percent of average earnings but with a lower replacement ratio of 67 percent for people with children (and 60 percent if no children).⁸ The discussion document proposes a scheme

⁷ It is disappointingly disingenuous that the DD describes the proposed insurance scheme as ‘no fault’, implying a false connection with ACC, when it is the exact opposite – ACC deals with situations where fault may exist and legislatively over-rides common law ways of dealing with these. The insurance proposal deals with situations where no fault exists in the first place.

⁸ For consistency, these figures are all based on OECD tax-benefit model descriptions of social assistance policies and OECD data on average earnings. Average wage and salary earnings are used because I could not access a consistent set of median wage figures. Data are for the 2020 year. The maximum entitlement used here for Germany is higher than is reported in Appendix 5.

that would have an 80 percent replacement ratio plus an earnings cap that would be approximately 180 percent of the average wage (and well over twice the median wage). These differences are illustrated in Figure 1 below.

Figure 1: Comparison of replacement ratio and maximum payment of proposed New Zealand scheme and Danish, Swedish, and German unemployment insurance schemes



Notes and sources: Data on schemes are taken from the OECD tax-ben model policy descriptions (2020 year). Data on average weekly earnings are taken from OECD database (2020 year) (The NZ figure differs slightly from StatsNZ figure but is used for internal consistency reasons. Maximum entitlement used here match those reported in Appendix 5 of the discussion document in respect of Denmark and Sweden but the Appendix 5 maximum for Germany is lower than the OECD figure I have used here. I have not been able to clarify the reason for the difference. The earnings cap for each European country has been converted to a proportion of the NZ AWE to allow cross-country comparisons. Other methods of comparison, such as PPPs or direct currency conversions, would produce slightly different results.

The work-test requirements and the abatement regime are highly inequitable (and inefficient)

45. The work-test obligations in the proposal are massively out of line with the same test applying to other beneficiaries and to those which apply in many other countries’ unemployment insurance schemes. As proposed, an insurance recipient would not have to take any job which ‘did not offer pre-displacement wages and conditions’ (p113). This takes to the extreme the wage scarring assumption that the previous job reflected the worker’s true marginal productivity in perfect

labour and product markets and that any loss in pay or conditions must be the result of liquidity constraints preventing the worker from sustaining an optimal period of job search.

46. It stands in stark contrast to the requirement under the Social Security Act that beneficiaries be willing to accept all suitable employment with no presumption of meeting prior wage levels or conditions.
47. This is compounded by the proposed abatement rules that would apply if the scheme went ahead as set out. An insurance recipient would be entitled to top-up their insurance pay-out up to 100 percent of prior earnings with no abatement. In this situation no rules apply regarding lesser wages or conditions. A person could work for a day or two a week receiving the same total income (up to \$130,900pa) for seven months and only be under an obligation to take an alternative permanent job if it paid as much or more and had at least as good conditions as the pre-redundancy job. By comparison, other jobseekers lose 70 cents of their benefit for each dollar earned in excess of \$160 gross per week.
48. Moreover, in a further glaring, example of the two-tiered nature of the proposal, the document recommends that only 'personal exertion income' would abate entitlements (p80). This is a far narrower definition of income than applies in the welfare system (or for Working for Families tax credits). If the rationale for the scheme is to manage short-term consumption smoothing why exclude income from other sources such as investments, rental properties and so on? Even if one were to accept the wage-scarring argument, income from these other sources would make it easier for people to manage an optimal period of job search so should not be ignored in the abatement of insurance pay-outs.
49. In addition to the inequity in the differences between these rules, the effect will be to incentivise many workers to withdraw fully or partially from the labour market for the duration of their insurance pay-outs. This will lead not only to a loss of productivity in the immediate term but a longer-term loss as workers' human capital and skills erode.

Delivery through Work and Income not through ACC

50. If an insurance scheme does proceed, I strongly oppose delivering it through ACC. The payments, case management, and active labour market and training programme delivery should be carried out (or in the case of the last of these, at least overseen by) Work and Income.
51. The insurance proposal is effectively an extension to New Zealand's existing welfare provisions and should be managed as such. A number of insurance recipients will go on to become Work and Income welfare recipients after the end of their insurance period. Others will simultaneously be both insurance and welfare recipients.
52. Given the importance of ALMPs and training options, not only for those who lose jobs due to displacement or health reasons, but also for the great majority of beneficiaries, it is vital that these be delivered appropriately and in a co-ordinated way to all jobseekers. More broadly it is vital that New Zealand up its game overall in its commitment of expenditure on and the quality of ALMPs. I note the Welfare Expert Advisory Group's strong recommendations on this (recommendations 35 – 37 (Welfare Expert Advisory Group, 2019). These should be co-ordinated through one agency, Work and Income, rather than having a two-tier ALMP delivery.

53. The proposal to deliver the scheme through ACC also strongly reinforces the divisiveness of the two-tier system being suggested. It is hard not to draw the conclusion that a large part of the thinking behind the idea of separate ACC delivery is so that the insured can avoid dealing with Work and Income and can 'fly Business Class'.
54. In my view, if the scheme was to proceed, one of the benefits it could have if it is delivered through Work and Income is to help destigmatise and transform that agency and welfare itself by putting a wider group of New Zealanders in contact with Work and Income. This would be good for the agency and good for all existing and future clients. Likewise, my preferred welfare-based alternative approach set out in Section V would have a similar effect.
55. Delivered through Work and Income, the collection of levies can still be carried out by Inland Revenue. The management of funds is not like ACC, as there is no fully-funded 'long tail' requiring with multi-year claims requiring actuarial assessment. In the case of this proposed scheme, no claim is longer than six months. Levy adjustments will presumably depend on the number of claims, their rate and duration over the short-term. A buffer fund for cyclical variation in fund income and costs could be managed by a number of agencies including those that already manage State mandated funds. These include ACC, the New Zealand Superannuation Fund and the Government Superannuation Fund Authority.

Collusion, game-playing, and expensive administrative enforcement costs

56. While not set out specifically in the Employment Relations Act 2000, there are three accepted grounds for dismissal of an employee: gross misconduct, lack of capacity or ability to perform the required duties, and economic reasons (Anderson et al, 2005, cited in Rasmussen, 2009, p372). The intention of the proposed scheme is to cover only the last of these. However, there are considerable grey areas at the boundaries between these three categories and a variety of incentives and costs affecting both parties depending on which category the job loss is deemed to have been caused by. These include possible redundancy clauses in employment agreements and the direct and transactions costs associated with unjustified dismissal claims made to the Employment Tribunal.
57. The scheme opens up wide possibilities for collusion in this regard. The addition of the one-month bridging payment will somewhat reduce this but still leave many situations where it is financially better for both employer and worker to quietly agree to a redundancy rather than enter a disputed capability or misconduct dismissal. The agency administering the scheme will then be faced with accepting the cost of claims that are not justified or the cost of investigation and enforcement action.
58. This is in addition to job displacements that fit entirely within the rules but are behavioural responses to the scheme and would not have occurred in the absence of the scheme.

Job reclassification incentives

59. Incentives on employers to reclassify work and workers as self-employed contractors rather than employees is already a significant labour market problem, affecting many so-called gig and

platform jobs, as well as couriers, screen production workers and others. The existence of the proposed scheme would considerably increase these problems as it saves employers from any levy obligations. If the self-employed are included in the scheme, then the effect is additional costs on those workers, as well as the many problems associated with covering the self-employed (see below). If the self-employed are not covered then they simply become one more group excluded from the scheme.

60. Job reclassification incentives will add an unknowable but probably large amount to the administration costs of the scheme, both at the 'front end' with workers seeking to establish that they are entitled to coverage as employees and at the 'back end' with administrative – and court costs – associated with workers claiming that they should have been covered.

Coverage of the self-employed, seasonal, and casual workers

61. The difficulties of providing clear, and equitable coverage for these groups of workers highlights one of the problems with the scheme. Contributory insurance-based unemployment schemes are products of, and designed for the full-time, permanent (and predominantly male) model of the labour market.
62. Seasonal workers would have first to meet the contributions history and then be able to demonstrate that their employment ended before the season ended. In addition, if not re-employed the following season they would need to be able to demonstrate a prior 'regular pattern of work' with that employer. The discussion document is silent on how, if at all, a distinction would be drawn between individual capability or performance, and genuine displacement in the event of non-reemployment. This opens up yet another area of greyness in the scheme and risks of integrity problems.
63. Despite the discussion document's implications to the contrary, most casual employees are unlikely to be covered by the scheme. They will need to a) meet the contributions requirements; b) prove that a regular pattern of casual work existed (itself something of an oxymoron); and c) that an event such as the employing firm's liquidation, or a weather event triggered their loss of employment. For the claim to succeed, the employer must also certify that they would have continued to employ them but for the triggering event.
64. Despite the uncertainties in coverage for fixed-term, seasonal and casual employees all these groups, and their employers, will be required to pay the scheme levies. The discussion document attempts to argue that the Forum's preferred options for these groups enhances equity within the scheme. The reality is that it further highlights the fundamental inequity of it.
65. The discussion document chapter on the self-employed is a well-written chapter which highlights the fundamental problems unemployment insurance schemes have in dealing with the issue. It is one of the few chapters where a range of options is fully summarised, and no prior conclusion reached.⁹ The discussion document is correct that internationally many unemployment insurance schemes do not include the self-employed or, if they do, it is in the context of voluntary schemes.

⁹ And as such, it gives the distinct impression of having been written by different authors.

66. I am not proposing any particular solution to the issue of coverage of the self-employed. Rather, I would point out three facts. First, the self-employed are a large group (over 500,000 according to the discussion document, p63), so effective and fair coverage of them is an important issue. Second, a large number of the self-employed have low incomes and therefore many may face the consumption smoothing problems I discussed above (see discussion document Figure 2, p64). Third, effective and fair coverage of the self-employed is a problem far more easily dealt with under an enhanced single-tier benefit structure.

Exclusion of migrant workers on temporary visa from benefits but their inclusion in the levy charges

67. Yet another inequity is proposed by the exclusion of temporary work visa holders and other short-term migrants from the entitlement to benefits from the scheme while simultaneously charging them and their employers the levy to pay for the scheme.

68. This section reinforces the impression that the scheme is intended to privilege employed New Zealanders over all others, both not-employed New Zealanders and employed, not-New Zealanders. The justification for imposing the levy on migrant workers is so not to give them a wage-cost advantage in the labour market. The justification for not paying the insurance pay-outs is 'because access to the scheme would generally be inconsistent with the basis for their eligibility to be in New Zealand' (p72). This is disingenuous – that is true of some migrant workers whose visa is linked to a specific employer, but not to many others, including students and working holiday visa holders.

69. The document then says '[t]he Forum recognises that this could be perceived as unfair by temporary migrants' (p72) – a sentence that might be more accurately worded as '[t]he Forum recognises that this could be perceived as unfair by many people. It then waves this inequity aside by saying simply '[h]owever, such arrangements are common in other countries'.

V. Alternative approaches

70. The scheme as proposed adds relatively little that is beneficial to New Zealand's social welfare, has significant negative implications and is very costly. A considerable part of the cost will fall on people with little likelihood of ever benefitting and at the same time, the two-tier nature of the insurance scheme means many others who need income support will not be entitled to its more generous provisions. As argued above, it is my view that an insurance scheme of this sort is not in the best interests of the wellbeing of New Zealanders; certainly the case for such a scheme has not been made in the discussion document.

71. This section outlines an alternative welfare-based approach which in my view addresses those parts of the problem which are real issues and in need of a policy response and does so in a way which is more equitable. This is followed by a section outlining an insurance-based option which I am not recommending but which does, in my view, avoid some of the main problems with the current proposal (and is much less costly).

72. To reiterate, my conclusion is that the key job-loss related facts which do require policy consideration are:

- Some lower-earning workers have difficulty managing consumption-smoothing over a short(-ish) period of unemployment and may face hardship as a result. The data on numbers are imperfect but it is clear that the number of higher earners who face such problems are low.
- The couple-based unit of assessment, in conjunction with abatement rules, can make this a particular problem for partnered people, especially if they have two relatively low incomes, and more so if they have dependent children.
- For single people, the proportional drop in household income will often be greater than a couple as a result of job loss, if the latter still has one person in employment.
- Most unemployment spells following displacement are short-term (58 percent are less than six months) but more than one quarter (27 percent) lead to long-term unemployment (longer than 12 months) (discussion document, p158).
- Child poverty rates are low among two-parent households where both adults work but are considerably higher where one is full-time and the other is not employed (Perry, 2019, p169). A situation that relates back not only to employment but to the couple-based assessment of welfare referred to above.

An alternative single-tier welfare-based approach that is more equitable, less costly, and better targets the needs

73. The basic structure I propose is:

- Retain the proposed 1 month bridging payment for displaced workers. This could be phased in at the beginning of employment by, for example, making entitlement 1 week after two weeks' employment, etc until the full month's entitlement after eight weeks. A worker with a redundancy-pay clause in their employment agreement could opt for that or the bridging payment, but not receive both. The payment would be at 100 percent of prior usual earnings. Given the shortness of most unemployment spells it is like that this, plus any entitlement to holiday pay etc, will by itself go a long way to meeting short-term consumption smoothing needs.
- Introduce a spousal earnings disregard into the welfare system. I suggest this be set at the median wage (currently in the order of \$55,000pa); but if tighter targeting was felt necessary it could be set at, say, 80 percent of the median. It would mean any beneficiary could receive a single rate of benefit which would be abated in the usual way against their own earnings but his or her spouse's earnings would only abatement entitlement if over the disregard (the excess being accumulated with the beneficiaries own earnings). A similar, albeit less generous, spousal disregard has been in place in Australia for some years now. This approach goes a long way towards the individualisation inherent in insurance models but has two important advantages. First it targets lower-income working families (couples); and, second, it solves a substantial problem affecting most long-term Supported Living Payment recipients who cannot enter a relationship unless their partner is willing and able to support them (and they themselves are willing to become financially dependent on the partner).

- Raise core benefit rates. The bridging payment provision will help many single people who lose their jobs either through displacement or ill-health or disability, and the disregard will provide considerable extra ongoing assistance to partnered people. However, and notwithstanding the increases the Government has already put in place, there remains a strong case for further increases in core benefit rates to alleviate hardship, whether caused by job loss or any other reason a person is without work. A side benefit (although it may be a claw-back from the beneficiary's point of view) is that higher base rates would reduce reliance on the Accommodation Supplement and Temporary Additional Support payment, both of which tend to add to distortions in the rental housing market.
- Deliver the package – along with much enhanced re-training and active labour market programmes – through the existing Work and Income network. As mentioned above, the broadening of the Work and Income client base offers a significant opportunity to 'mainstream' its activities and interactions with people and to destigmatise the process of engagement with social security.

74. These changes would provide substantial protection to low- and middle-income people and families against the risk of job loss due to displacement, ill-health or disability. They would also significantly improve social protection for two groups the New Zealand social welfare system does not deal with well, namely low earning couples who need two incomes, and people with long-term health problems or disabilities who are reliant on the Support Living Payment.

75. The proposal is obviously not without additional cost, and it is well beyond my resources to estimate the cost. However, it is clear that the cost would be considerably less than the \$3.5 billion estimated for the insurance scheme. The administrative costs would also be vastly less than the estimate \$500 million necessary to administer the insurance proposal. The additional cost should be funded out of general taxation, rather than a pay-roll tax.

An alternative insurance-based model

76. If Ministers do not accept the view that the problems are best solved through maintaining and improving a single-tier welfare system and favour introducing a two-tier, insurance scheme, then I suggest a much revised version of what has been proposed in the Forum discussion document would better meet the needs, be less costly and reduce the inequities.

77. In broad outline, I suggest the following structure

- Retain cover for both displacement and job loss due to ill-health or disability.
- Retain the proposed one month bridging payment. As mentioned above this is likely to go a good way to meeting short-term consumption smoothing needs. Also retain the one-month notice requirement for redundancy.
- Retain the replacement ratio of 80 percent of prior earnings.
- Substantially reduce the earnings cap from \$130,900 to the median wage (current in the order of \$55,000+ pa). This would target the insurance much more closely to where the need is, while also ensuring that higher-earning workers who lose their jobs through displacement or ill-health will still be entitled to around \$40,000 on annualised basis. As discussed above, this change would make the scheme much more like the Danish and

Swedish unemployment insurance provisions. It will also significantly reduce the overall cost of the scheme. In addition, it will reduce the incentive for collusion between worker and employer and make the scheme easier to enforce.

- Reduce the maximum duration of the insurance pay-out to three or four months (plus bridging payment). There is no strong grounds for choosing six months and there is clear evidence that job search intensity is related to insurance duration, falling off and only rising towards the end of the entitlement period. If a scheme does go ahead, it would be easier to start with a shorter duration and extend it if it proves warranted rather than to cut back from six to three months later.
- Introduce a spousal income disregard into the main benefit system set at the maximum level as the insurance cap (80 percent of median earnings). The effect of this is to substantially reduce the inequity of having a second-tier insurance scheme, to better recognise the situation of long-term Supported Living Payment recipients, and to address the needs of long-term unemployed including those whose insurance cover is exhausted.
- Deliver the scheme through Work and Income, with the payroll levies collected by Inland Revenue.
- Considerably increase and enhance provision of training and active labour market programmes co-ordinated by Work and Income and targeted based on need, not on an actuarial assessment of a claimant or beneficiary's likely cost to the scheme or Vote: Social Development.
- Drop the 'part-time' entitlement for those who reduce work hours due to sickness. It is not evident that this is warranted and there is too much scope for collusion and misuse.

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