MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

AIDE MEMOIRE

Further advice on the proposed levy and wider impacts of social unemployment insurance

Date:	25 August 2021	**Priority:**	High
Security classification:	In Confidence	**Tracking number:**	2122-0664

Information for Minister	
Rt Hon Jacinda Ardern **Prime Minister**	**Deadline**
Hon Grant Robertson **Minister of Finance**	27 August 2021
Hon Chris Hipkins **Minister of Education**	
Hon Carmel Sepuloni **Minister for Social Development and Employment**	
Hon David Parker **Minister of Revenue**	
Hon Stuart Nash **Minister for Economic and Regional Development**	
Hon Michael Wood **Minister for Workplace Relations and Safety**	

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**		**1st contact**
Jivan Grewal	Policy Director, Employment, Skills and Immigration Policy	-	Privacy of natural persons	✓
Isaac Holliss	Principal Policy Advisor, Social Unemployment Insurance Working Group	-		

The following departments/agencies have been consulted
The Treasury, MSD, IRD, DPMC

Minister's office to complete:

☐ Approved ☐ Declined
☐ Noted ☐ Needs change ☐ Seen
☐ Overtaken by Events ☐ See Minister's Notes ☐ Withdrawn

Comment

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Purpose

1. The purpose of this note is to provide an update and advice in advance of your meeting on Friday 27 August, to enable the Social Unemployment Insurance Governance Group (SUIGG) to:

    a. agree on an approach to the duration of the scheme and its extendibility

    b. agree to an indicative levy for the purposes of public engagement

    c. understand the economic and distributional impacts of the scheme.

Privacy of natural persons

Jivan Grewal
Policy Director, Employment, Skills and Immigration Policy
Labour, Science and Enterprise, MBIE

25 / 08 / 2021

Annexes

Annex One: Briefing to the Social Unemployment Insurance Governance Group Ministers

Annex One has the following Annexes:

Annex A: New Zealand Income Insurance Scheme - key messages

Annex B: Updated cost estimates and modelling

Annex C: Updated draft Discussion Document

To: Social Unemployment Insurance Governance Group

From: Social Unemployment Insurance Working Group

Date: 25 August 2021

Briefing: Further advice on the proposed levy and wider impacts of social unemployment insurance

Purpose

1. Provide an update and advice in advance of your meeting on Friday 27 August, to enable the Social Unemployment Insurance Governance Group (SUIGG) to:

    a. agree on an approach to the duration of the scheme and its extendibility;

    b. agree to an indicative levy for the purposes of public engagement; and

    c. understand the economic and distributional impacts of the scheme.

Executive Summary

Discussion Document and the plan for public consultation

2. The Working Group has continued to refine the Discussion Document since Ministers considered an initial version in June. The latest version is attached as Annex C to this briefing.

3. The Discussion Document presents the case, and a proposed scheme design, for social unemployment insurance covering economic displacement and health conditions and disabilities. To ensure the document is accessible, it will be accompanied by a shorter summary document that will be translated into Te Reo Māori and cater for other accessibility needs.

4. The document will be updated with SUIGG's preferred policy settings after 27 August, then Cabinet will be invited to consider the near-final document on 13 or 20 September. The Tripartite Forum is expected to endorse the Discussion Document for public release at its meeting on 23 September.

5. The developing communications and engagement plan to support the consultation process will include in-person engagements with peak representative bodies across relevant communities, including health and disabilities and Māori and Pacific communities.

6. The plan will also rely on leveraging agency and social partner channels to raise awareness of the proposals more broadly with the above audience. To assist with this engagement, a draft set of key messages is attached as Annex A.

7. The expected timeline for consultation is a public release of the Discussion Document on 4 October followed by 10 weeks for consultation, closing on 10 December.

8. The name of the scheme will be an important part of how members of the public engage with it, and we recommend SUIGG agree to use the term 'New Zealand Income Insurance Scheme' for the purposes of the Discussion Document.

Extendibility, duration and bridging payment

9. The Working Group is seeking SUIGG's feedback on including the possibility of extending SUI entitlements for public consultation. Extension would occur on the grounds of approved training or vocational rehabilitation. Options include the ability to extend:

    a. Option 1: up to a maximum of 12 months (irrespective of the base duration).

    b. Option 2: for a maximum of three months or for duration of training or vocational rehabilitation (whichever is lesser).

    c. Option 3: based on contribution history.

10. While the scheme could allow for extensions from the time the scheme is implemented, another option is for extensions to be considered in the future once we understand more about the demand and required mechanisms.

11. The Working Group has previously recommended that employers pay a worker a bridging payment of 80% of the worker's salary or wages for one month, where the employer has made a person redundant or dismissed them for medical incapacity.

12. Following Ministerial feedback, the Working Group has modelled some of the impacts of a bridging payment on the levy. While this demonstrates a small reduction of levy costs, we think these estimates are a significant undercount as they do not account for behavioural changes that a bridging payment is intended to address (primarily preventing practices such as 'sham' redundancies).

13. A decision is also sought on the maximum base duration of the scheme, between:

    a. six months (plus a one month bridging payment, if agreed, for a total seven months duration); and

    b. eight months (plus one month bridging payment, if agreed, for a total nine months duration).

14. Indicative levy costs for both options are presented in this advice. In general, longer durations of entitlements provide claimants with more time to address skill gaps, complex health and social issues, and therefore assist with returning to good work. On the other hand, especially when combined with a generous replacement rate, longer

durations also come with risks that work incentives are diminished and people move further from the labour market.

Proposed levy for public consultation

15. Presenting SUIGG's best sense of what the initial levy will be if the scheme is introduced will help the public weigh the relative merits of the scheme.

16. The Working Group recommends the following indicative levies are used for public consultation, depending on SUIGG's decision relating to the duration of the scheme:

	7 month duration	9 month duration
Cost of economic displacement	1.08%	1.57%
Cost of health conditions and disabilities	0.8%	1.0%
Total levy (excl GST)	1.88%	2.57%
Total levy (incl GST)	2.16%	2.96%
Employer/worker share of the levy (incl GST)	1.08%	1.48%

N.B all figures are inclusive of 9.5% administrative overheads.

17. These indicative levies reflect our best estimate of the cost of the scheme, but there is still significant uncertainty; the true cost could be higher or lower. The uncertainty comes from the scale of the change and its impact on employer and worker behaviours, and also our level of confidence in existing New Zealand data for both redundancies and work incapacitation due to health conditions and disabilities.

18. The upper and lower bounds of the range of cost estimates the Working Group has produced are seen by most members of the Working Group to be under and over-estimates of the likely cost of the scheme, respectively. Nonetheless, the range that this produces is useful for highlighting the uncertainties in costing the scheme.

19. The true cost of the scheme will emerge only once it is underway. Although we expect to have a significantly better view of the actual cost after 1-2 years of operation, it may be as many as 2 to 3 complete economic cycles before the true long-term and ongoing operating cost (and benefit) of the scheme is fully known.

20. The indicative levy could therefore turn out to be an under or over-estimate of costs in the short-term. The over and under-collection of levies that result from these outcomes for these initial years will have different consequences.

21. Under-collection would place a burden on some combination of the Crown (as lender or funder of last resort) and future levy payers as future levies increase to make up for the short-fall. Over-collection would immediately remove funds from the economy and reduce potential economic growth.

22. On balance and faced with these two possibilities, the Working Group sees less risk associated with under-collecting compared to over-collecting. This is because we think behavioural change will take time to fully develop, meaning the indicative levy may be accurate in the long-term but over-state the cost in the short-term. We also consider the macroeconomic consequence of over-collecting is greater than under-collecting.

23. SUIGG’s choice of which indicative levy it wishes to set in the Discussion Document should reflect how it wants to respond to the uncertainty of what the actual cost of the scheme will be. There are two options for responding to this uncertainty (assuming that the levy rate is not set at the high or low end of the potential range produced):

    a. Setting the levy at the best estimated cost of the scheme (1.88% for 7 months and 2.57% for 9 months) and reviewing the levy after an initial period of two years, or sooner if there is sufficient data to indicate whether it is under or over-collecting.

    b. Setting the levy at the Option 1 level plus a prudential margin of between 0.2% and 0.23% to account for some of the risk of under-collecting.

24. Levy-setting is not the only way to manage cost uncertainty. SUIGG can also manage uncertainty by reviewing the levy after a shorter initial period of time (the Working Group recommends two years), making changes to operational policy to ensure the scheme delivers on SUIGG’s policy intent, and investing in complementary areas that reduce the cost of the scheme (for instance investing in active labour market policies).

25. Regardless of the option taken, the Crown will carry some fiscal risk relating to the scheme. If there is a funding shortfall and the scheme’s reserves are exhausted, the Crown may be called on. This could happen particularly in the early days of the scheme, where we expect a surge of claims.

26. There would be a lower ongoing fiscal risk if the Crown is a lender of last resort, because the costs of initial under-collection would be met by Crown loans to ACC, repaid by future levy-payers. This would have an impact on the Crown’s plans for future debt. If the Crown is a funder of last resort, there would be greater ongoing fiscal implications.

27. Fiscal offsets are an important factor in the long-term cost of the scheme. Fiscal offsets, such as increased PAYE and reduced welfare support, are likely to reduce Crown costs by approximately 10-20% of the scheme’s cost.

Distributional and economic impacts

28. Social unemployment insurance will have distributional impacts across different population groups, and across income levels.

29. The scheme’s coverage of non-standard workers in particular will have a positive impact on certain population groups and more vulnerable workers as this category of worker covers a disproportionately high number of Māori, Pacific, women, and younger workers.

30. Initial TAWA modelling indicates that the distributional impacts across different income deciles are different for redundancy and HCD. For redundancy, recipients are more likely to be at the higher end of the income distribution deciles. For HCD, claimants are more evenly spread over the income deciles.

31. The burden of the levy will have a direct impact on workers and businesses. For instance a full time minimum wage earner would pay between $8.64 to $11.84 per week in levies. A business with 10 employees would pay, on average, between $5,568 and $7,631 per year.

32. The scheme will also have important broader economic impacts. A SUI scheme could help to improve job matches and reduce wage scarring for some people by enabling better matching between skills and jobs. In some cases, however, a SUI scheme could worsen outcomes for other people by increasing the risk that they are detached from the labour market.

33. A SUI scheme could also put upwards pressure on displacement and possibly overall unemployment. However, a SUI scheme is also likely to improve the resilience of New Zealand's economy and labour market to shocks. One of the mechanisms for doing so is that it will automatically stabilise the economy by disbursing relatively more funds in an economic downturn, and collecting fewer levies.

Recommendations

The Social Unemployment Insurance Working Group recommends that you:

Discussion Document

1. **Note** the updated draft Discussion Document and provide feedback.

Noted

2. **Note** further changes will be made, including editorial changes, and changes to reflect SUIGG's decisions.

Noted

3. **Agree** that, subject to these changes, SUIGG Ministers will present a draft discussion document to Cabinet, seeking Government endorsement to the publication of the Discussion Document following the Future of Work Forum on 23 September.

Agree / Disagree

4. **Agree** that that the Discussion Document be released by 4 October, with consultation closing on 10 December (10 weeks).

Agree / Disagree

5. **Agree** to use the label 'New Zealand Income Insurance Scheme' for the purposes of the Discussion Document.

Agree / Disagree

6. **Agree** that the Working Group will do further work on branding of the scheme, with further advice to be provided to SUIGG in early 2022.

Agree / Disagree

Extendibility, bridging and duration of the scheme

7. **Agree** to seek feedback from the public consultation on the option of enabling extensions of social insurance entitlements, on the grounds of training or vocational rehabilitation.

Agree / Disagree

AND, if you agree,

a. **Indicate** your preferred option for extending entitlements for inclusion in the discussion document:

EITHER

i. Extendibility Option 1: extend to a maximum of 12 months irrespective of the base duration.

Yes / No

OR

ii. Extendibility Option 2: extend for a maximum of three months or the duration of training or rehabilitation (whichever is lesser).

Yes / No

OR

iii. Extendibility Option 3: Link extensions to contribution history, with contributions over the required minimum providing a longer extension.

Yes / No

8. **Agree** that employers pay a worker a bridging payment of 80% of their salary or wages for one month where the employer makes a person redundant or dismisses them for medical incapacity.

Agree / disagree

9. **Indicate** your preferred approach to scheme duration:

EITHER

a. Duration Option 1: a maximum duration of six months (plus a one month bridging payment, if agreed – a total seven months duration).

Yes / No

OR

b. Duration Option 2: a duration of eight months (plus one month bridging payment, if agreed – a total nine months duration).

Yes / No

Proposed indicative levy for public consultation

10. **Note** the uncertainty inherent in both the cost estimates and translating those estimates into an appropriate levy rate with the risk of under and over-collecting depending on where the levy is set.

Noted

11. **Agree** to include an indicative levy rate of 2.16% (inclusive of GST) in the public consultation document (for a seven month scheme), or 2.96% (for a nine month scheme), to be split equally between workers and employers.

Agree / Disagree

12. **Agree** to indicate in the Discussion Document that if the scheme proceeds, levy rates would be reviewed two years after the scheme is introduced or once sufficient data becomes available to determine the actual cost of the scheme more accurately.

Agree / Disagree

Distributional and economic impacts

13. **Note** the distributional impacts of the scheme, including the likely impact of the levy on the net income of low income workers.

Noted

Privacy of natural persons

Jivan Grewal

Lead, Social Unemployment Insurance Working Group

25 / 08 / 2021

Rt Hon Jacinda Ardern
Prime Minister

..... / ...... / .....

Hon Grant Robertson
Minister of Finance

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Hon Stuart Nash
Minister for Economic and Regional Development

..... / ...... / .....

Hon Michael Wood
Minister for Workplace Relations and Safety

..... / ...... / .....

Richard Wagstaff
President, New Zealand Council of Trade Unions

..... / ...... / .....

Kirk Hope
Chief Executive, Business New Zealand

..... / ...... / .....

Discussion Document

1. The Discussion Document is the Tripartite Working Group's principal output. Ministers considered an initial version of the Discussion Document in June, and it has also been consulted with agencies. Since June, the Working Group has continued to refine the document, and to update it as the SUIGG agrees policy settings.

2. The document presents the case for introducing a new social insurance scheme for job loss due to economic displacement and health conditions & disabilities, and presents the proposed scheme design. Given the scale, cost, and complexity of the proposals, the Discussion Document is necessarily substantial.

3. The document poses two main questions:

    - should New Zealand introduce a social insurance scheme?
    - what should a New Zealand social insurance scheme look like?

4. Scheme settings have a significant impact on who benefits, by how much and for how long which in turn impacts on the cost. To this end, the Discussion Document also includes a large number of more specific questions related to the scheme's policy settings. To ensure the material is accessible, we also propose to produce a shorter summary document.

5. A further edition of the Discussion Document is attached to this briefing (Annex C), for the SUIGG's comment. This version is largely complete. Subsequent work will focus on:

    - responding to the SUIGG's feedback,
    - ensuring the document reflects the SUIGG's agreed policy settings, and agreed estimates of scheme take-up and cost, and
    - copy-editing to improve readability, and ensure consistent use of language.

6. The Working Group will update the document following the 27 August SUIGG meeting with the preferred policy settings, and cost estimates from the preferred costing method.

7. Cabinet will be invited to consider the near-final Discussion Document on 13 or 20 September, and the Tripartite Forum is expected to endorse the Discussion Document for public release at its meeting on 23 September.[1]

Approach to the Future of Work Tripartite Forum on 23 September

8. The Discussion Document submitted to the Forum will be all but final, with only minor revisions made as needed following the Forum discussion, as well as editing and proof-reading changes.

[1] Assuming COVID-19 Alert levels allow, the Forum will take place on 23 September. The Working Group will work with relevant offices on a viable alternative should New Zealand, or Wellington, be in Alert Levels 2-4 on the date of the proposed Forum.

9. At the Forum, members of the SUIGG may wish to provide an overview of the work to date and what the proposed scheme for consultation looks like, with a chance for questions and discussion following. A presentation could cover:

    a. A general introduction and overview of the work undertaken to date

    b. The case for change and objectives that social insurance aims to achieve

    c. The broad parameters of the proposed scheme, including displacement and health conditions and disabilities

    d. The plan moving forward including the plan for implementation.

10. Subject to your agreement to the approach, the Working Group will prepare supporting materials for the Forum. An alternate approach, should SUIGG prefer, could be to have the Working Group present at the Forum.

Approach to communications and engagement

11. The Working Group continues to develop its communications and engagement plan to support the consultation. Our activities have been scaled to focus on targeted engagement and leverage existing stakeholders' channels, and no longer includes a broad-based marketing component, following feedback from Ministers.

12. The plan includes in-person engagements with peak representative bodies for health professionals, health and disabilities communities, the vocational education sector, Māori and Pacific communities, the finance industry, business and union groups, and economists. It also includes leveraging agency and social partner channels to raise awareness of the proposals more broadly in the above audiences.

13. We will make it easy for individuals to provide feedback, with a summary of the proposals and an option to complete a short survey.

14. Our summary will be translated into Te Reo Māori and accessible versions will be created, including audio, Easy Read, sign language video, Braille and large print. We expect these accessible versions will be complete in October, due to the short turnaround between decisions being made and the intended launch in late September, and competing demands for providers as a result of Alert Level changes. We will print copies of the summary document for BusinessNZ and regional associations, the New Zealand Council of Trade Unions and affiliates, Ministers and agencies to use in their in-person engagements.

15. To support Ministers and social partners in communicating the proposals and rationale, we have provided suggested key messages in Annex A. We seek feedback from SUIGG on the proposed key messages.

16. Forum agreement will be sought for the release of the Discussion Document as the start of public consultation. Following the Forum the Working Group anticipates the Discussion Document will be published by 4 October, and close submissions on 10 December. This would provide 10 weeks for consultation.

We recommend that SUIGG agree to a name for this proposal

a. Following Ministerial feedback we understand the preferred name is the New Zealand Income Insurance Scheme. This name is most clearly linked to the function of the scheme: insuring people's income.

17. Other options considered include:

    a. **Social Unemployment Insurance Scheme**. This name is most clearly linked to the trigger for accessing support, and has been used to date. However it is not available to people already unemployed, and could be misconstrued or highlight differences between the scheme and the supported provided through the welfare system.

    b. **A brand name,** similar to that of other schemes, such as KiwiSaver or Apprenticeship Boost.

18. If SUIGG prefer a brand name, we do not recommend a brand name be decided now, and instead recommend further work be done on this, in consultation with ACC. Advice on this can be provided in early 2022, and announced alongside final decisions.

19. Announcing a brand name now could pre-empt genuine consultation, and could cause confusion in the general public, who may be more likely to believe a scheme is already in place, and request access through ACC or MSD.

20. Agreeing a brand name at a later date would allow a name to be considered in greater detail; allow for consideration of a Te Reo Māori name and consultation with Māori; and align with ACC's work underway on brand revitalisation. It would also be informed by operational design, including whether to operate the scheme as a separate public-facing service, or a combined ACC and SUI public-facing offering.

21. Regardless of whether a brand name is chosen now or later, we recommend the SUIGG still agree a descriptive term for the proposals and propose 'New Zealand Income Insurance Scheme' as the best option.

22. Pending SUIGG agreement to a title, this briefing and the draft Discussion Document still use the term social unemployment insurance (SUI).

Extendibility, bridging and duration of the scheme

We seek your preference for public consultation on extending social insurance entitlements

23. The working group seeks your agreement to publicly consult on the possibility of extending social insurance entitlements, on the grounds of training or vocational rehabilitation, for public consultation. If your preference is to consult on this matter, we seek an indication of your preference to broadly pose the option to extend social insurance entitlement on the grounds of training or vocational rehabilitation.

24. Ministers expressed a preference to seek public feedback on the merits of enabling social insurance entitlements to be extended for training and vocational rehabilitation.

On 30 July 2021, the Working Group provided the SUIGG with advice on the following options [2122-0152 refers]:

a. Option 1: the ability to extend the duration up to a maximum of 12 months (irrespective of the base duration).

b. Option 2: the ability to extend the duration for maximum of three months or for duration of training or vocational rehabilitation (whichever is lesser).

c. Option 3: link extensions to contribution history, e.g., every two months of contributions over the required six months would provide an additional one-month extension.

25. Further advice on the costs to extend social unemployment insurance was requested. Any options for social insurance extensions would increase the cost of the scheme but there is difficulty in estimating the costs with any certainty due to a lack of data to inform what the uptake of extensions could be. The uptake would be largely dependent on the nature of the extensions being undertaken, needs of claimants and the availability of job-relevant training.

26. Allowing for extensions of social insurance would enable those who require it sufficient time to undertake approved training or vocational rehabilitation. However, this needs to be balanced against the risk that claimants may enter programmes that do not improve return to work outcomes just to extend entitlements. This would be managed by requiring approval and requiring claimants to make a decision on whether to undertake training early in their maximum period on SUI (e.g. within the first three months). It could also create inequities between the level of assistance provided under social insurance on one hand and the welfare and education systems on the other.

27. The scheme could allow for extensions at day one implementation or enable a more flexible approach to be considered in the future once we understand more about the need for extensions and that the mechanisms are in place to ensure claimants are referred to and undertake programmes that support good labour market outcomes.

28. We seek feedback from SUIGG about its' preference to consult on the possibility of enabling extendibility and if it is inclined to do so, its' preference about the types of options it wishes to consult on.

Inclusion of a bridging payment

29. The Working Group has previously provided advice to SUIGG on the bridging payment, recommending that:

a. In cases of redundancy, employers pay a worker 80% of their salary or wages for one month. Payments under SUI would commence after the first month. The worker would be eligible for a maximum of either seven months or nine months, with employers paying the cost of the first month.

b. In cases where a worker is eligible for HCD payments under the scheme, employers would pay the bridging payment only if they make the worker redundant (this may or may not occur at the beginning of someone's claims period with SUI).

Workers would be eligible for a maximum of six or eight months when there is no redundancy involved, or seven or nine months if redundancy is involved.

34. SUIGG has requested the cost implications of not having a bridging payment. Our initial estimate is that a 6 and 8 month scheme would cost:

	6 months (no bridging)	8 months (no bridging)
Total levy (including administration costs, excl GST)	2.48%	3.17%

35. We think these estimates are a significant undercount as they do not account for behavioural changes that a bridging payment is intended to address (primarily preventing practices such as 'sham' redundancies). The above estimates solely reflect the scheme taking on the full cost of six or eight months of claims.

36. Should SUIGG wish to present an option for a scheme without a bridging payment, we recommend adding a premium to account for such possible changes in behaviour. It is difficult to model what a prudent margin would be, but a 20% increase added to the above estimates may be a useful starting point.

37. Overall, we consider that the merits of including a bridging payment within the scheme are likely to outweigh the costs.

38. We are also starting to explore an option of allowing small businesses to buy additional insurance to cover the bridging payments. This may mute some of the impact of bridging payments on the employer, but it would provide cost relief to the firms most likely to need it.

The Working Group is seeking SUIGG's direction on the duration of the scheme

30. A decision is sought on the maximum base duration for social unemployment insurance entitlements. The generosity of social insurance is typically measured by the replacement rate, the income cap, and maximum duration of entitlement.

31. Previous advice to Ministers has identified two main options:

   a. maximum duration of six months (plus a one month bridging payment , if agreed for a total seven months duration).

   b. duration of eight months (plus one month bridging payment, if agreed for a total nine months duration).

32. Either option could also provide for the ability to extend the maximum base duration for training or vocational rehabilitation.

33. This briefing presents indicative costs for both duration options.

34. Longer duration of entitlement does provide claimants (especially those with significant skill gaps or more complex health and social issues) with more time to address these issues and return to good work (provided timely access to effective support and

services). But longer durations can create risks that work incentives are diminished and people reduce their job search efforts, moving them further from the labour market. This risk is greater where a longer duration is combined with a generous replacement rate.

35. In either case, the availability of appropriate active labour market programmes will be vital to maximise the opportunities to find good jobs for economic displacement claimants during their period on social unemployment insurance entitlements and to encourage continuing and effective job search efforts. Similarly, effective and timely medical treatment, rehabilitation and employer support will assist quicker recovery for those with health or disability conditions preventing them from working.

Indicative levy and funding model

Background

36. The Working Group provided advice to Ministers last week on the estimated costs of social unemployment insurance. Three different approaches, with different assumptions underpinning each approach, were used to provide a robust basis for the setting of a levy (further information on these methods is provided in Annex B).

37. Since that advice, there has been further quality assurance on the cost modelling, and further work to refine the likely numbers of those making claims under the scheme.

38. The Working Group now has a joint recommendation to SUIGG for presenting an indicative levy for the purposes of public consultation.

The Working Group recommends the following indicative levies for public consultation

39. The Discussion Document should reflect the Government's best sense of what the initial levy will be if the scheme is introduced. This in turn reflects the best estimate of the actual cost of the scheme as well as SUIGG's preference for managing uncertainty relating to those estimates.

40. The actual levy set when the scheme is introduced will depend on the final design of the scheme, for instance if changes to the scheme are made as a result of feedback. While there will be opportunities after public consultation to recalculate the levy based on final scheme design choices, time constraints mean there will be very limited opportunities to consult on it. While the Discussion Document is not in itself a consultation on the levy, it does need to provide the public with enough sense of the likely cost of the scheme in order to properly weigh the benefits.

If a seven month scheme with a bridging payment is adopted

41. The Working Group recommends that an indicative levy of 1.88% (GST exclusive) is used for public engagement, subject to whether SUIGG wants to add a prudential margin.

42. This levy is made up of:

    a. A rate of 1.08% for economic displacement/redundancy

b. A rate of 0.8% for health conditions and disabilities

c. These figures include a 9.5% administration overhead

43. This would result in a core levy 1.08% (half of the total levy of 2.16% and including GST). Employers and workers would each pay this levy.[2]

44. We note that for HCD, the proposed approach to bridging payments means the scheme will be six months, with an additional month paid by employers if they make a worker redundant, for instance while receiving HCD payments. Without this payment, the maximum scheme duration would be six months, and with this payment the maximum scheme duration would be seven months. The same applies for the nine month scheme.

If a nine month scheme with a bridging payment is adopted:

45. The Working Group recommends that an indicative levy of 2.57% is used for public engagement, subject to whether SUIGG wants to add a prudential margin.

46. This levy is made up of:

a. A rate of 1.57% for economic displacement/redundancy

b. A rate of 1.00% for health conditions and disabilities

c. These figures include a 9.5% administration overhead

47. This would result in a levy of 1.48% (half of the total levy of 2.96% including GST). Employers and workers would each pay this levy.[3]

This indicative levy reflects our best estimate of the cost of the scheme, but there is still significant uncertainty; the true cost could be higher or lower

48. Cost estimates are inherently uncertain because of the scale of the change being made to the labour market and our current data on redundancies and those with a HCD is limited. It is difficult to predict the way that behaviours will change as incentives for workers and employers change. While there are uncertainties relating to both redundancy and HCD, our level of confidence is lower for HCD, where there is relatively less New Zealand data, which can provide a reference point against which we can test assumptions.

49. In addition, while we are certain that there will be significant behavioural changes from the introduction of the scheme, some changes could be immediate while for others there may be a time lag. Similar effects are observed with tax changes; for example, some immediate changes can be seen when the top personal tax rate was increased to 39%, such as a spike in dividends being distributed before the rate came into effect. However, structural changes to the derivation of income through companies and trusts, may take place over a number of years.

[2] GST is payable on ACC levies. While GST will directly impact workers and employers, employers will be able to offset GST against their income.

[3] GST is payable on ACC levies. While GST will directly impact workers and employers, employers will be able to offset GST against their income.

50. In the context of labour markets, this lag is because there are many inputs to worker/employer behaviours which will not change, or only change gradually. These include tax and transfer systems, labour mobility, industry composition, industrial relations systems, firm dynamics, and wider economic context, labour rules, regulations and enforcement (such as redundancy processes). Culture also influences worker/employer behaviours and we expect that this will take time to change. Although introducing social unemployment insurance would be a large change to the labour market, behaviours will be anchored by these other factors so that changes in behaviour may occur over time.

51. On 13 August the Working Group provided advice to SUIGG on cost estimates based on three different methods. These produced estimates of a levy ranging from 1.18% through to 2.9% for a 7 month scheme, and 1.46% through to 3.84% for a 9 month scheme. Further quality assurance of the modelling approach means estimated costs were reduced to a levy ranging from 1.12% to 2.69% for a 7 month scheme, and 1.46% to 3.62% for a 9 month scheme.

52. Alongside the Working Group advice, Treasury advised Ministers that the upper estimates of each range represented their preferred methodology for estimating costs.

53. Members of the Working Group are of the view that the upper end of the range is an over-estimate of the likely cost of the proposed SUI scheme, and the lower estimate is an under-estimate of the proposed SUI scheme. Given the uncertainties in the data, the range provided by these is nonetheless useful in demonstrating the risk that an indicative levy under or over-collects.

The indicative levy could over or under-collect relative to the true cost in the first years of the scheme; each has consequences

54. Given the uncertainty, further changes to the levy will almost certainly be required after trend data has been collected after the scheme operates for some time (the Working Group recommends a levy review after two years). There are economic and employment consequences to both under and over-collecting for an initial period of time before the levy is reviewed.

55. Under-collecting would place a burden on some combination of the Crown (to provide bridging funding or fulfil its role as lender-of-last-resort), and future levy payers (as levies may need to increase to cover both the projected higher costs, and account for the previous shortfall).

56. Under-collecting would result in the levy needing to be increased over time. This may generate uncertainty among workers and employers seeking to make decisions based on the rate, and if there is a perception that the true cost of the scheme is still unknown, they and other stakeholders may not be confident that the levy is stable.

57. Over-collecting will also have economic consequences. Every 1% of additional levy on wages and salaries represents approximately 0.4% of GDP. Removing these funds from the economy without them being paid out in replacement income to members of the scheme risks reducing potential economic growth. Over-collection would also impact

household incomes, with more significant impacts for those on lower incomes, as well as hiring decisions by businesses.

58. Both under and over-collecting represent transfers from later levy-payers to early levy-payers (in the case of under-collecting), or from early levy-payers to later levy-payers (in the case of over-collecting).

On balance, the Working Group sees less risk associated with under-collecting compared to over-collecting

59. In general, the Working Group considers that the risk associated with under-collecting the levy is lower than over-collecting. This is due to three key factors:

    a. The proposed levy rate reflects an estimated steady-state cost of the scheme, but we think behavioural change will take time to fully develop. This suggests that the indicative rate may overstate the early cost while behaviours change even if it is accurate in the long-term.

    b. The macroeconomic consequence of over collecting may be greater than under-collecting. As the scheme is introduced, the consequence will be a large withdrawal of demand from the economy. The risks of over vs under funding will depend on when in the economic cycle a scheme is introduced. There will also be efficiency issues arising from over-taxing (all tax is distortionary and costly by nature). The impact this could have on economic output (and employment) would occur regardless of whether future levies are decreased to account for the over-collection.

    c. The risk of under collecting is limited by time; the Crown will have some indication in the first 2-3 years if levies need to be increased (for instance if costs indicate a higher than expected behavioural response). This would limit any potential under or over-collection to that period. After an initial surge of claims (as workers and employers 'save' claims until the scheme is in place), we expect to have a much better sense of the true cost of the scheme after it has been in place after two years.

SUIGG's choice of indicative levy for the Discussion Document should reflect how it intends to ultimately set the levy, for instance by responding to the uncertainty of costs

60. In choosing what indicative levy to include in the Discussion Document, the SUIGG needs to choose how the levy will ultimately be set to respond to cost uncertainty. The key judgment required by the SUIGG is therefore how it intends to set an initial levy that reflects our best estimate of the cost in the early years of the scheme, and manages the risks of under or over-charging.

61. There are two broad options for responding to this risk (assuming that SUIGG's preference is not to set the levy at either end of range identified by the previous methods):

    a. Option 1: (Recommended by the Working Group) Set the indicative levy at the best estimated cost of the scheme (1.88% combined for 7 months, 2.57% combined for 9 months, excluding GST) and review the levy after an initial period of two years, or sooner if there is enough data to indicate whether it is over or under-collecting.

b. Option 2: Set the levy at the best estimated cost (Option 1) plus a prudential margin which accounts for some of the difference between this levy rate and the initial higher estimate. For instance, the prudential margin could account for 25% of this difference, which would result in adding 0.20% to the 7 month levy for a total of 2.08% (excl GST) and 0.23% to the 9 month levy for a total of 2.80% (excl GST).

SUIGG's choices around when to recommend the levy be reviewed, and ongoing operational policy work will also help to manage funding risks

62. Besides the levy, when a scheme is established there are options which can be combined with those above to manage risks relating to under or over-collecting the levy.

The length of time between the scheme starting and the initial levy review

63. A shorter period of time would generally reduce the risk of over or under collecting because the levy rate can be adjusted more quickly. This would need to provide enough time to collect meaningful data, which means that the shortest reasonable period would be two years' worth of data.

64. The Working Group recommends that SUIGG agree their intention to review the levy two years after the commencement of the scheme.

65. This provides some time for data to be collected about how the scheme is being used (after "looking through" what we expect will be an initial surge of claims). Reviews can occur earlier than that and, if supported by sufficient data, could make a levy recommendation. This initial review would compare actual uptake to expected uptake and support a more accurate levy to be set. Following this initial review, it is expected that the scheme would move into longer levy review cycles (this is discussed further in the funding model section of this advice).

66. We note, however, that depending on what the economic conditions are in those first few years, this approach will not be able to account for expected behaviour in certain economic conditions (e.g. a recession), so we likely won't know the complete steady state costs and associated levies for two to three business cycles.

Further operational policy work to ensure the intent of the scheme is met

67. Within the bounds of the legislation, there are operational policy changes that can be made after the introduction of the scheme, which could have implications for managing the cost of the scheme. Operational policy will play a significant role managing the 'gateway' into the health conditions and disability scheme, for instance ensuring that guidance to medical practitioners accurately reflects SUIGG's intent to cover HCD which last more than 4 weeks. The cost estimates included in this advice are based on an assumption that design parameters effectively manage this gateway. However, under the current HCD policy design described in the Discussion Document, there may also be a sizable share of shorter-term claims than end up being covered. If this happens, the current estimates are likely understate the HCD costs.

Spending in complementary areas

68. There are likely to be strong interdependencies between the number of claims made under the scheme, and settings in the wider labour market and health and disability system. Spending in these areas will impact the cost of the scheme. More active labour market policies could improve job matching and reduce the duration people spend on the scheme. Similarly, investments in vocational rehabilitation and treatment could reduce the duration people with a health condition or disability spend on the scheme. These types of investments present options for managing the future cost of the scheme. There are significant uncertainties here and we do not yet know what the interactions would be between these systems would be.

Regardless of the option taken, the Crown will carry some fiscal risk relating to the scheme

69. Even if SUIGG adopt the levy rate associated with the higher cost estimate, the significant uncertainties involved mean the Crown may be called on if there is a funding shortfall with the scheme and the reserve fund (recommended by the Working Group on 2 August) is exhausted.[4]

70. These costs can be considered as set-up costs, and ongoing fiscal risk.

71. Some of the Crown's obligations relate to the commencement of the scheme, where the Crown has options for providing initial 'seed funding' for the scheme (as distinct from set-up costs). This initial funding would be required to cover what we expect will be an initial surge in claims, and to cover payments while levies are collected and a fund is established. The Crown could choose to bear this cost in the form of 'seed funding' for the scheme either through lending or direct support. Alternative options include placing the burden of the early cost of the scheme on early levy-payers (by setting a higher initial levy rate to account for the higher cost) or on future levy-payers (where early costs are recovered over time by higher future levy rates).

72. When called on, Government has choices to make with respect to whether the Crown will act as lender of last resort or funder of last resort. There is a low ongoing fiscal risk to the Crown if the indicative levy under-collects compared to the actual cost of the scheme, so long as levies are adjusted to meet this shortfall and there are legislative provisions to enable this. The Crown could smooth this process by providing loans to ACC, which are repaid (including interest) through levies paid by future levy-payers. If the Crown is instead funder of last resort, there would be ongoing fiscal implications. In either case the Government may need to make decisions relating to scheme

[4] On 2 August the Working Group provided SUIGG with advice on the funding of the scheme, recommending the creation of a small reserve fund, providing the advantage of a "save-as-you-go" (SAYGO) approach of allowing some financial buffer to account for the cyclical nature of the economy, while being a largely "pay-as-you-go" PAYGO approach to minimise concerns around intergenerational transfer. Further advice will be provided on options for establishing this fund, including potential Government pre-funding.

sustainability, with options to adjust the scheme's design and/or changing the scheme's funding policy.

73. The Crown liquidity profile would need to accommodate this contingent liability, particularly in the early years of scheme funding. This assumes the Crown in most instances would not grant money to the scheme (and instead only serve as a lender, except in truly exceptional circumstancesa). However, there will be implications of under or over-funding the scheme with respect to the Crown appetite for risk, willingness to debt-finance other Government priorities, and the broader pricing of Crown debt. Future fiscal decisions, strategy, and the pricing of government debt will reflect expectations regarding demands for Crown funding. Whether the scheme is fully funded through levies and whether Crown is used as a *funder* of last resort or a *lender* of last resort will also have implications to the Crown as well as across both levy payers and the general tax base. If the Crown has a role as *funder* of last resort, potential fiscal risks would be reflected in the Specific Fiscal Risks section of the Budget Economic and Fiscal Update (BEFU) and Half-Year Economic and Fiscal Update (HYEFU). This is the case with a range of current public agencies, and in recent history only EQC has called upon additional Crown funding due to illiquidity.

74. We note also that as an employer, there will be a cost to the Crown from paying the employer portion of the levy. Further work would be required to calculate the full cost of the levy for the Crown, however with Core Crown personnel expenditure of $8.48b (in 2020), for every 1% of levy, the Crown would incur approximately $85m per year in levies.

Fiscal offsets are likely to reduce Crown costs by approximately 10-20% of the scheme's cost

75. The figures in this report do not account for the potential offsetting effects from the tax and welfare system, and we expect these to be a net positive for Crown finances. For example, a portion of displaced workers who might otherwise apply for the Jobseeker Benefit will instead receive social unemployment insurance, leading to welfare savings. There will also be savings from second tier assistance such as the Accommodation Supplement. The interaction with the tax system is more complex:

    a. For workers who would otherwise have a gap in income, social unemployment insurance income will increase the Crown's receipt of PAYE.

    b. For workers who would otherwise quickly get reemployed (thus pay PAYE on their reemployment income), the Crown may make less in PAYE if social unemployment insurance earnings are, on average, lower than earnings from employment displaced workers would be foregoing.

    c. GST would be paid on the levy. Some of this will come from spending that a levy payer would have done in the absence of the levy, but overall we expect the levy to result in a net increase to GST receipts.

    d. All social unemployment insurance payments will be subject to PAYE. Main benefits are paid net of taxation, and secondary benefits are paid without taxation consequences.

76. More generally, better job-matching will result in better long-term incomes and productivity with a fiscal benefit to the Crown as well as to workers and employers. Some of the cost to the Crown of automatic stabilisers during downturns will be carried by the scheme. These fiscal and economic benefits are difficult to quantify.

77. The offsetting effects are all highly driven by the underlying assumptions about the impacts of social unemployment insurance on redundancy rates, workers' decisions to forego earned income in favour of social unemployment insurance income, and the broader flow-on effects. TAWA modelling cannot predict these behaviours and does not account for the fact that the jobs that workers on social unemployment insurance decide to forego will likely be filled by other workers in the economy. TAWA does however confirm that currently, workers are on average receiving significantly less income in the jobs that they find than what they received in the jobs they lost.

78. Our view is that it is reasonable to assume that about 10-20% of the costs of the scheme will be offset by the tax and welfare system. However, given the high degree of uncertainty relating to this offsets, at this stage we do not recommend that the levy is set at a rate that anticipates this offset. Ministers will then have decisions about how they wish to use the potential system savings that may arise. Options for using the offset may include:

    a. Contributing directly to the scheme in order to reduce the levy;

    b. Contributing towards ongoing Crown costs resulting from the scheme, including the cost of the levy as a component of Crown payroll and continued policy design and implementation costs that are not funded by the levy;

    c. Addressing the impact of the levy on low income households, such as through increases to existing income support;

    d. Active labour market policies, should the Government choose to pursue and fund these (note these are not currently part of the scheme).

79. Further advice can be provided on options for applying offsets to the SUI scheme.

Distributional and macroeconomic impacts

80. Social unemployment insurance will have distributional impacts across different population groups, and across income levels. This advice provides an overview of these different impacts through the lens of scheme coverage and income decile.

Coverage

81. Coverage of work arrangements and other qualifications for unemployment insurance can influence the share of workers of who are eligible for assistance, and skew distribution to certain types of work and therefore profile of workers.

82. Based on December 2020 figures there are 1,702,600 workers in permanent fulltime work and a substantial number (291,600) are in permanent part-time work and most

people are displaced from permanent work. Men are somewhat over-represented in permanent fulltime work while women dominate permanent part-time work.

83. As at December 2020, the non-standard workforce comprised:

    a. 108,600 casual workers

    b. 49,600 fixed term workers

    c. 11,900 temporary agency workers

    d. 22,200 seasonal workers

    e. 343,900 self-employed workers

84. Casual workers are more likely to be women (55 percent) and are generally younger with 44 percent aged 15 to 24 years. While the greatest number of Māori are in permanent fulltime work, as a proportion they overrepresented in casual work as are Pacific People. Self-employed workers are more likely to be men and disproportionately New Zealand European.

85. Inclusion of non-standard work in unemployment insurance schemes is more complex than standard work but coverage exclusions would have significant impacts for some population groups and more vulnerable workers in New Zealand. Coverage exclusions would disproportionately impact Māori, Pacific, women, and younger workers and could further disadvantage more vulnerable workers on lower incomes, especially if they are contributing to a scheme that they cannot access.

Income deciles

86. Most displaced workers (economic or health and disability) are on lower incomes. The median average monthly income from the previous job before displacement (in March 2021 dollars) was $3,368 which is just above the adult minimum wage. Most workers displaced due to a health condition or disability were previously on very low incomes. The median average monthly income from the previous main job for this group was $2,269 in March 2021 dollars which is below the full-time adult minimum wage. This suggests a higher proportion of workers displaced due to a health condition or disability were in less than fulltime work. Health outcomes tend to be worse for those on low incomes and people on lower incomes are greater risk of acquiring a health condition or disability. Māori and Pacific People make a disproportionate share of this group.

87. Except for fixed-term work, non-standard work appears to be lower paid on average (63 percent of people earn less than $500 a week on average) and most people in permanent part-time work also earn less than $500 a week on average.

88. TAWA modelling for a 7 month scheme shows that for redundancy, recipients are more likely to be in the higher end of the family income distribution deciles, although there are still a considerable number in the lower end. In the case of health and disability, recipients are evenly spread over the family income distribution deciles, although they are slightly more likely to be at the top end of the distribution. In the health and disability

scenario, recipients are more likely to receive smaller weekly payments, which is likely linked to the lower income they received in their previous job.

89. The TAWA modelling also shows that for people displaced due to a health condition or disability, families in higher income deciles would gain more due to a higher level of income being replaced by the scheme, and that higher income families are less likely to be get support from welfare. But for redundancy, higher income families are worse off due to a longer gap in employment and receiving less from the scheme payments than they would from wages or salary.[5] On the other hand, the replacement income received by workers displaced for either reason is strongly skewed in favour of individuals on lower income.

90. Most people displaced for economic or health and disability reasons are in couple households (with and without children) and are less likely to be eligible for benefit payments. As the scheme proposes individual entitlement more workers are likely to be able to access financial assistance if displaced and take the time needed to return to similar skilled and paid jobs.

91. Initial TAWA modelling shows there is no statistically significant impact on child poverty.

Impact of the levy

92. With the introduction of SUI, all employees and some self-employed[6] will bear the cost of the levy. This will reduce a worker's net income. How this affects households depends on individual and family circumstances however, low-income families and the working poor are likely to feel the effects most materially, including those with children. This is particularly important in the context that broadly half of children in poverty in New Zealand are in working households.

93. The actual levy and reduction in net income individuals will face will depend on their gross income. A reduction in net income is likely to be material for families already struggling to meet their fixed outgoing costs. Given entitlement to the existing suite of support through the welfare system is based on gross income, rather than net income, entitlements to other support (such as the Accommodation Supplement and Working for Families tax credits) will not increase, even with a net decrease in income from the levy

94. Non-standard workers cover a wide range of working arrangements in New Zealand. However, not all non-standard workers have access to the full set of employment rights and responsibilities. As all working arrangements will bear the cost of the levy (though most genuinely self-employed will only pay the levy for health and disability conditions), some working arrangements are more likely to feel the effects.

95. Based on a proposed indicative levy of 1.08% for a 7-month scheme or 1.48% for a nine-month scheme (the worker portion of the total levy inclusive of GST), the reduction in net income per week for workers would range as illustrated below:

[5] Assumes people will spend less time in unemployment and not return to similar wage and skill level jobs more quickly in the absence of social insurance.

[6] All employees, including self-employed, will pay HCD levies. The details of which self-employed would also be required to pay the redundancy levy is still subject to further policy work.

- full time minimum wage earner (working 40 hours per week earning $800 per week) between $8.64 to $11.84 per week

- median wage earner (approximately $1,060 per week at June 2020) between $11.45 to $15.69 per week

- worker earning $500 or less a week between $5.40 to $7.40 per week

- worker earning $1,000 or more a week between $10.80 to $14.80 per week.

96. If social insurance replaces some support from the existing benefit system for a short time, the likely social insurance payment received by some low-middle income earners on top of current transfer payments[7] could be less than what they pay into the scheme under a flat levy. Internationally, unemployment insurance systems do not face this issue as their welfare systems are also funded from social security contributions, rather than the two being funded separately.

Impact on businesses

97. Like employees, all employers will bear the cost of the levy. However, empirical evidence from overseas has shown that to the extent to which the levy is salient to the employee (i.e. they recognise the future benefit they will receive from participating in this scheme), the cost to the employer will be passed through to the employee in the form of lower wages. Therefore, while there is a statutory cost of a levy to employers, this does not necessarily mean they bear the full burden of this cost.

98. New Zealand has approximately 136,000 businesses with 1-19 employees (small businesses). Of these, 69% have fewer than 5 employees and small businesses employ 28% of all employees. The average median income of employees in a business this size is $51,561 (adjusted to March 2021 value). For a business with 10 employees, the additional cost per year would be $5,568 (1.08% levy) or $7,631 (1.48% levy). We note that businesses would be able to claim back the GST portion of the levy.

99. Based on median wage earner (approximately $1,060 per week at June 2020), the cost of a 4-week bridging payment for a business would be $3,392.

The scheme will also have broader economic impacts

100. Introducing a SUI scheme is likely to change the operation of New Zealand's labour market and economy, though there is some degree of uncertainty regarding the nature and scale of the potential impacts.

A SUI scheme could help to improve job matches and reduce wage scarring for some people, but could worsen outcomes for other people

101. New Zealand has a relatively flexible and efficient labour market with few impediments in the movement of workers to expanding industries. However, workers tends to experience comparatively higher levels of wage scarring from unemployment.

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[7] Not all low-middle income earners would have otherwise been eligible for assistance through the welfare system.

102. With the introduction of a SUI scheme, people made redundant are likely to take more time to search for a job or retrain so they can access a better job. Some workers who would otherwise move straight to the next job could instead opt to search for longer between jobs on the SUI scheme.

103. These behaviours could help to improve job matches and limit wage scaring for some people. Because they are not competing for jobs that are a poor match, they will open opportunities for workers better matched to those jobs. However, other people are likely to spend longer periods of time unemployed, and obtain similar or even worse jobs than they otherwise would have, or detach from the labour market. The net effect is highly variable across studies, and may be influenced by factors such as the business cycle context.

104. Many schemes recognise these risks, and invest heavily in ALMPs, such as job search assistance, education and job training to mitigate against unnecessarily long unemployment durations and increase earnings capacities in new job areas. The design and level of investment in the scheme's case management system, and the across Government review of ALMPs will be important contributors to the scheme's performance.

A SUI scheme could put upwards pressure on displacement and possibly overall unemployment

105. Compared to many OECD countries, limited data suggest New Zealand tends to have lower levels of economic displacement (averaging ~2.3% of employment, or ~56,000 people per year) and unemployment (currently ~4%).

106. With a SUI scheme in place, employers could become more inclined to make people redundant, or workers in declining firms could wait to be made redundant rather than seeking other employment. These effects could increase economic displacement. The costing estimate assumes that behavioural changes could result in an apparent increase in the displacement rate to ~5% of employment, or ~112,000 people per year on average for a seven month scheme (this figure was calculated based on a 10-year average with rates increasing and decreasing over the economic cycle). However, we note that this figure largely comprises those who previously would not have taken a significant gap between jobs after being made redundant now taking a gap due to the introduction of SUI.

107. However, such effects would not necessarily affect overall unemployment. Those made redundant only contribute to a portion of the unemployed population, limiting the direct effect of a SUI scheme on unemployment. While it is possible that unemployment could be amplified due to social/peer influence effects on others in the labour market, the effect could also be counteracted by jobs being freed up for other jobseekers entering or returning to the labour market, for instance from study or parenting. The overall impact is highly uncertain. A number of countries with SUI schemes have lower unemployment rates than New Zealand (Japan, Netherlands, Germany, Korea), whereas others have higher rates of unemployment (eg. Canada, Spain).[8]

[8] June 2021 Quarter harmonised unemployment rates in OECD countries, Statistics NZ

108. The proposed scheme has features which could help to mitigate some of these risks, but also features that could exacerbate risks. It has features which are likely to lend to narrower coverage than many schemes, for instance in not covering voluntary quits (in contrast to Denmark, France, Germany, Canada), which would limit overall take-up. It also has a maximum duration in the shorter-average range (for the seven month option), which should encourage more intensive job search. The prospective requirement for employer bridging payments would help to mitigate unnecessary redundancies, tempering pressure on displacement rates, but it could also increase risk aversion in hiring, and reduce overall labour market flexibility. The proposed 80% income replacement rate and high cap on replaceable earnings (~$130,000) would be amongst the most generous internationally, and is a feature strongly associated with higher scheme uptake and duration. Under the proposed settings, employers would notify ACC upon making a redundancy so that all workers automatically access the system (subject to claimants signing or agreeing to their obligations). This near auto-enrol feature would likely increase take-up compared to other countries (where claimants must apply on their own if they wish to receive benefits).

A SUI scheme is likely to improve the resilience of New Zealand's economy and job market to shocks

109. Modelling by the OECD suggests that New Zealand has comparatively moderate resilience to shocks. For instance, countries where taxes fall and spending increases relative to GDP to a larger degree automatically following a shock tend to maintain economic stability more effectively than countries where budget components do not react much to the cycle or are very small. The OECD estimates that New Zealand's existing welfare and tax policies provide automatic stabilisation to the economy at the OECD average.[9] Modelling also indicates New Zealand jobs have a relatively higher exposure to challenges associated with the future of work and climate change.

110. A SUI scheme would contribute to automatically stabilising the economy following shocks at a macroeconomic level, limiting the severity of recessions and unemployment.

111. It would do so by helping displaced workers maintain their consumption during a downturn. This would enable businesses to maintain output and jobs, avoiding further increases in economic displacement. These effects would in turn help to stabilise the tax base and offset the need for other forms of government expenditure such as welfare payments related to unemployment.

112. Treasury analysis suggests that introducing a SUI scheme could make a small to moderate expenditure contribution to New Zealand's automatic stabilisers.[10] Treasury's analysis assesses to what degree the introduction of a SUI would change the sensitivity of government's budget balance (the difference between the Government's revenue and expenditure as a percentage of GDP) to changes in economic activity. It essentially

[9] The existing automatic stabilisers in New Zealand are estimated to change the budget balance by 0.51% of GDP for every percentage point change in economic activity with respect to its potential level (output gap). This is slightly above the OECD average of 0.50% of GDP. However this does not take account of second- and third round effects of the expenditure which are important ingredients of stabilisation. Refer OECD. (2015). Adjusting fiscal balances for the business cycle.

[10] Assuming a scheme costing around 0.8% of GDP (~$2.5 billion) per annum with medium to high responsiveness of SUI payments to the business cycle, the budget balance ratio increases by 6% to 7% compared to the current setting. This is a relatively moderate addition to the overall budget balance ratio of 0.51% of GDP for New Zealand.

estimates the effect a SUI would have in releasing additional Crown expenditure for consumption for a given shock.

113. It is important to note that this analysis does not capture the subsequent effects that increasing disposable income and consumption during a downturn would have on avoiding further increases in economic displacement, nor the resulting economic and fiscal costs associated with it. Fiscal multipliers associated with SUI are also not captured in the analysis.

114. The degree of impact would depend on the size of the scheme. The stabilising effects of the scheme could be enhanced and economic efficiency could be improved during recessions by making temporary adjustments, such as extending unemployment insurance entitlement durations during a downturn. The proposed scheme includes provision for such adjustments (with Crown, rather than levy funding).

Levies are expected to be at the low end, but are nonetheless an additional cost for workers and businesses and could affect participation and labour demand

115. New Zealand employment costs are comparatively low in many regards within the OECD, for instance New Zealand has a low tax wedge associated with work.[11]

116. The estimated levies are at the lower end compared to international schemes, and in fact more in keeping with less developed country than OECD country schemes. As noted in the levy-setting part of this advice, there is significant uncertainty surrounding the costs that drive the levy rates, and there is potential that levy rates would need to rise above projections.

117. We do not foresee any structural reasons why scheme costs should increase in real terms in the short to medium term, however. New Zealand's labour force upper age profile is not expected to significantly change in the short to medium term and therefore materially affect redundancy and HCD claims costs, but it could in the longer term (given the relationships between age and the probability of redundancy, HCD and earnings).[12] Morbidity and mortality trends have for the most part improved over time, but it will be important to monitor the impacts of mental health on the HCD scheme, as prevalence appears to have risen over time.[13]

118. It is also important to note that the introduction of a levy will add to employment costs, for both workers and employers which could impact labour market participation and hiring choices. On the other hand, greater employment security may encourage greater labour participation. Evidence suggests a levy on employment may also lead to a shift towards forms of non-standard work that is not subject to an employer levy (e.g. independent contracting). It will be important to make sure that the settings in this area inhibit this practice, as intended by including dependent contractors. Furthermore, while

[11] The tax wedge is the ratio between the amount of taxes paid by a worker on average earnings without children and the corresponding total labour cost for the employer. The average tax wedge measures the extent to which tax on labour income discourages employment. This indicator is measured in percentage of labour cost. Refer OECD (2021), Tax wedge (indicator).

[12] Current Statistics NZ projections suggests that material changes in the age profile could be some time off. The labour force will age over the next 50 years, reflecting general ageing of the population and the increasing labour force participation among people aged 50 years and over. However, the proportion of over 45s in the labour force is expected remain reasonably stable until around 2043.

[13] Ministry of Health (2019). Wai 2575 Māori Health Trends Report.

the costs are proposed to be evenly split between workers and employers, there is evidence that employers pass on such costs to workers over time, for instance by supressing wage increases. This is most likely to occur for workers with relatively less bargaining power.

Annex A: New Zealand Income Insurance Scheme - Key messages

119. These are initial suggested draft key messages for how to describe the scheme and the rationale for it. A further set of suggested key messages will be provided on scheme design features (when agreed), and some audience specific key messages.

120. These key messages use the 1+3 model. Each main message is supported by three proof points. In general, use the headline key messages, and expand with the +3 proof points only where needed.

Key messages

- **Every year tens of thousands of Kiwis lose their jobs. Last year's COVID-19 outbreak was a stark example, but widespread job losses have occurred all-too-frequently over the last 40 years. As we rebuild the economy, we have an opportunity to put better protections in place.**
  - The Global Financial Crisis saw our unemployment rate almost double from 3.4% to 6.6%.
  - The Canterbury earthquakes saw successful businesses close down and jobs lost almost overnight after their facilities were damaged.
  - Regional communities have faced long-term economic impacts after major employers shut down, such as the closure of Kawerau's forestry industry and timber mill and Hawkes Bay's Whakatu and Tomoana freezing works.
- **The Government, Business New Zealand and the New Zealand Council of Trade Unions are proposing a New Zealand Income Insurance Scheme to support workers with xx% of their income for up to xx months if they lose their job through no fault of their own.**
  - Payments would begin following redundancy, layoffs or when a health condition or disability which means they have to significantly reduce how much their work or stop working entirely.
  - People who quit or are fired for misconduct or poor performance would not be covered.
  - There would be obligations and support for people to look for work, rehabilitate or retrain, where they are able to do so.
- **This scheme would be a very significant change, but it's one we think is necessary. We want to get this right, and look forward to your views on everything we've proposed.**
  - Our consultation will run for 10 weeks to give everyone a chance to have their say.
  - It takes just xx minutes to have your say through a short survey on mbie.govt.nz.
  - The Government, Business New Zealand and the New Zealand Council of Trade Unions will be reaching out to key stakeholders over these 10 weeks.
- **Our proposed scheme would give people the time and financial security to find a good job that matches their skills, needs and aspirations, or take part in training or rehabilitation for a new, fulfilling career path.**
  - The income shock of a job loss is significant, and people often have to take the first job they find, which is often lower-paid and can lead to lower life-time earnings.

- These wage losses have historically been estimated at almost $5-10 billion a year, rising to $10 billion in economic crises.
- Equally, health conditions and disabilities are another significant reason why some people have to stop working, and then face a significant loss of income, and the risk of later wage losses

- **It could play a key role in better protecting workers and incomes, matching skills with businesses that need them, and helping communities and industries during economic shocks and transitions.**
  - Income insurances gives workers more time to find a suitable job search, that could better match their skills with businesses that need them, boosting business productivity.
  - By keeping money flowing into communities, it could cushion the impact of a major employer shutting down, giving workers and communities the time to establish new ventures or expand existing businesses and opportunities.
  - We know changing demands and technologies might impact some communities more than others. Income insurance could be a key tool in keeping communities supported during these transitions.
- **Like ACC for accidents, nearly all workers would have to contribute to our proposed New Zealand Income Insurance Scheme, to spread the costs widely and ensure more can benefit.**
  - The scheme would be funded through levies, paid equally by workers and employers.
  - [Note further proof points will be provided on costs once decisions are made]
- **The Government, Business New Zealand and the New Zealand Council of Trade Unions have jointly developed these proposals.**
  - These three partners all recognise the benefits an income insurance scheme could provide to workers, businesses, communities and the economy.
  - A true tripartite process was put in place, with a joint team, housed in MBIE and with staff from all three partners, developing these proposals.
  - These three partners form the Future of Work Tripartite Forum, which aims to support New Zealand businesses and workers to respond to a rapidly changing world of work.
- **Income insurance schemes are common across the developed world, and temporary schemes have been set up here after economic crises. We think it's time for an enduring solution in Aotearoa.**
  - During economic crises, including the Global Financial Crisis, the Canterbury earthquakes and the COVID-19 pandemic, Governments have introduced temporary income relief payments to cushion the blow.
  - Equally, health conditions and disabilities are another significant reason why some people have to stop working, and then face a significant loss of income, and the risk of later wage losses. Overseas, some income insurance schemes help cover this situation.
  - Many independent reports all point to the need for better support for workers who lose their job. These include reports by the Public Advisory Group on Redundancy and Restructuring, the OECD, the Welfare Expert Advisory Group, and the Productivity Commission.

Annex B: Updated cost estimates and modelling

121. Further quality assurance has been conducted on the initial cost estimates provided to Ministers last week. This has identified slightly lower scheme cost when applying the methods explained in previous advice. This produces the following figures across the three methods used in the initial cost advice.

Cost method	7 month scheme	9 month scheme
Method 1 (New Zealand data plus elasticities)	**Total – 1.12%** Total cost - $1.628b (Redundancy – 0.57%, HCD – 0.56%), (Employee/ employer levy = 0.56%)	**Total – 1.46%** Total cost - $1.806b (Redundancy – 0.76%, HCD – 0.71%), (Employee/employer levy = 0.73%)
Method 2 (New Zealand data for redundancy and international data for HCD)	**Total – 1.45%** Total cost - $2.083b (Redundancy – 0.95%, HCD – 0.50%), (employee/ employer levy = 0.73%)	**Total – 1.93%** Total cost - $2.641b (Redundancy – 1.27% HCD – 0.66%), (employee/ employer levy = 0.97%)
Method 3 (International benchmark applied to New Zealand data)	**Total – 2.69%** Total cost - $3.817b (Redundancy – 1.73%, HCD –0.96%), (employee/ employer levy = 1.35%)	**Total – 3.62%** Total cost - $4.881b (Redundancy – 2.39%, HCD – 1.23%), (employee/ employer levy = 1.81%)

122. These methods assumed the following numbers of those eligible for redundancy claims:

	Method 1	Method 2	Method 3
6 month scheme (no bridging payment)	59,700	87,700	134,550
7 month scheme	61,500	90,500	138,000
9 month scheme	64,500	95,000	144,900

123. These methods assumed the following numbers of those eligible for claims relating to health conditions and disabilities:

	Method 1	Method 2	Method 3
6 and 8 month scheme	54,200	103,000	204,000

124. The Working Group has considered further how these claims numbers fit into a New Zealand context and sought further data to ensure that the international schemes are applied accurately to the New Zealand context (for example, accounting for different coverage seen in international schemes). We propose the following approaches as the best reflection of the likely scheme costs in the first few years after it has been

established, and these form the basis of the proposed indicative levy in the main body of this briefing.

Economic displacement

125. To account for the international comparator scheme having wider coverage (for instance broader than New Zealand's definition of redundancy), the Working Group proposes that these claim numbers are the best estimates for the first years of the scheme. (Note that these figures do not allow for any 'surge' in claims that may occur when the scheme starts, resulting from workers or employers holding back on making decisions until after the scheme is in place.)

	7 months	9 months
Number of claims	**112,300**	**117,900**

126. Adjustments have also been made to reflect more realistic estimates of the income replacement rate in the international comparator scheme, and the income distribution of recipients of the new scheme.

Work loss due to health conditions and disabilities

127. The key difference between Method 2 and Method 3 was the proportion of claims to include from the Danish scheme which fall between 8 and 30 days. Method 2 derived a claims rate by only looking at the number of Danish claims which were over 30 days. Method 3 derived a claims rate by including half of all claims between 8 – 30 days, and all claims over 30 days.

128. The Working Group considers that neither of these claims numbers fully captures the comparison between the Danish scheme and the New Zealand scheme. Instead, the Working Group has sought to provide a cost estimate as close as reasonably possible to the proposed scheme which would only cover someone where their work capacity has been reduced by between 50-100% for a minimum of 4 weeks due to a health condition or disability.

129. For this reason, the Working Group proposes to use a revised number of **135,000** claims, which derives a claims rate from the Danish system by considering all claims which have a duration of 22 days and more (as compared to only claims over 30 days (Method 2), and some claims between 8 – 30 days, (Method 3)). This rate produces the following cost estimates, which are the basis for the proposed indicative levies contained in this briefing.

130. Ensuring that the actual costs are close to this estimate will require the policy settings to effectively limit entry to the scheme to those who SUIGG intends to cover. In looking at international comparisons, it is clear that this part of scheme design (what we refer to as the 'gateway') is difficult and other countries have typically struggled to find the ideal balance between preventing unnecessary benefit claims and ensuring access to those who need it. For instance, where there is a time-based cut-off (for instance 30 days), we expect to see 'bunching' occur, where a disproportionately large number of claims sit at

or just over the minimum threshold for eligibility. Although tightening scheme design and operational policy may address some of this issue, it is unlikely to ever be able to fully exclude claims which are under 30 days.

Annex C: Updated draft Discussion Document

Free and frank opinions