MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

New Zealand Income Insurance – Further Levy Relief Information

Date:	2 September 2022	**Priority:**	High
Security classification:	In Confidence	**Tracking number:**	2223-0871

Information for Ministers	Deadline
Rt Hon Jacinda Ardern **Prime Minister**	5 September 2022
Hon Grant Robertson **Minister of Finance**	
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	Acting General Manager, Skills and Immigration Policy	Privacy of natural persons	✓
Ben Loughrey-Webb	Principal Policy Advisor, Income Insurance Policy		

The following departments/agencies have been consulted
n/a

Minister's office to complete:

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☐ Withdrawn

Comments

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Purpose

To provide further information on how different replacement rate options could fund levy relief.

Recommended Action

The Ministry of Business, Innovation and Employment recommends that you:

1. **Note** that the Social Unemployment Insurance Governance Group was provided with advice on 30 August on outstanding policy issues for New Zealand Income Insurance, including providing levy relief for low-income workers funded by reducing the scheme's replacement rate [2223-0592 refers]

Noted

2. **Note** that this paper provides further information on how various replacement rate options could fund levy relief

Noted

3. **Discuss** this advice at the Ministerial meeting on 5 September 2022.

Privacy of natural persons

Francis van der Krogt
Acting Manager, Income Insurance Policy
Labour, Science and Enterprise, MBIE
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Prime Minister
..... / ...... / ......

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Minister for Economic and Regional Development

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Further advice has been requested on how reduced replacement rates could fund levy relief

1. On 30 August 2022, the Social Unemployment Insurance Governance Group (SUIGG) was provided with advice on outstanding policy issues for the New Zealand Income Insurance scheme (NZII) [2223-0592 refers].
2. This included advice on providing levy relief for low-income workers by reducing the scheme's replacement rates.
3. Further advice has been requested on using alternative replacement rate options to fund relief. This paper should be read in conjunction with the 30 August advice, as it provides detailed analysis of the trade-offs of the replacement rates and levy relief options.

Previous advice identified several alternative reduced replacement rate options

4. The 30 August advice identifies three alternatives to the 80 percent replacement rate, which are broadly consistent with the scheme's objectives and are operationally feasible:
    - a reduced replacement rate to 70 percent, or
    - a stepped-down replacement rate based on the duration of the scheme. Claimants could receive an 80 percent replacement rate for three months and a 60 percent replacement rate for the remaining three months, or
    - a stepped replacement rate based on income. Income up to the median income ($56,836 in 2021) could be replaced at 80 percent, and income between the median and the maximum payment cap replaced at 40 percent [2223-0592 refers].
5. There is a further option of a stepped-down replacement rate of 80, 60, and 40 percent for two months each. This option provided identical levels of savings to the 80 – 60 percent duration-based replacement rate. However, multiple step-downs are more complex for claimants and administering agencies and provides significantly reduced income smoothing, and was therefore subject to less analysis than the other options.

A simple approach to modelling leads to cost savings of 8 – 11 percent

6. There are two ways to model the likely cost savings of these reduced replacement rates. The first is a simple model, which keeps the expected number of claims and average time spent on the scheme constant but reduces the amount of money paid to these claimants.

7. Using this simple model, the options reduce costs by between 8-11 percent:

Option	Distributional impacts	Reduction in cost of NZII payments (savings)
Reduced flat rate – 70% for six months	A 10% reduction in income soothing for all claimants. We expect lower-income workers to be more impacted by the reduced replacement rate.[1]	Approximately 9.2%
Duration-based replacement – 80% and then 60%	A 20% reduction in income smoothing for those remaining on the scheme after three months. A replacement rate of 80, 60, and 40% for two months each produces the same reduction in scheme costs. The three step option provides significantly less income smoothing for those remaining on the scheme for six months.	Approximately 8.2%
Income-based replacement – 80% up to the median, and 40% up to the cap	Income smoothing reduces based on income, with high income earners receiving a significantly reduced replacement rate.[2]	Approximately 10.7%

These savings can be used to provide different types of employee levy reduction

8. The simplest way to provide levy relief is to reduce the overall employee levy rate. The employer levy would remain the same at 1.39 percent, so employees would pay a lower nominal rate than employers.

Replacement rate structure	Employee levy rate	Weekly cost of levy - full-time minimum wage earner
80% for entire duration ('status quo')	1.39%	$11.79
Reduced flat rate option (70%)	1.16%	$9.81 (-$1.98)
Duration-based replacement (80%, then 60%)	1.18%	$10.03 (-$1.76)
Income-based replacement (80% up to the median, and 40% up to the cap)	1.12%	$9.50 (-$2.28)

[1] Lower-income people are more likely to be 'credit constrained', meaning they have limited ability to support themselves during periods of unemployment. International evidence indicates that 'credit constrained' workers feel greater pressure to return to any work quickly and are more likely to benefit from extended financial support to return to a good job.

[2] For example, a person with a prior income of $130,000 per year would have an effective replacement rate of 56%.

9. For a flat-rate 1.39 percent levy, it is expected that around 1.39 million households would pay an average of $30 per week in levy *per household* (not per individual worker). Households with higher incomes pay more than the average, and lower-income households less, as the levy paid is proportionate to income. **Annex A** provides more detailed analysis of the levy's impact on households.

10. Reducing the levy rate to 1.16 percent (the mid-point of the replacement rate options) would provide households an average relief of $5 per week per household. The relief is proportionate to the amount of levy paid, so higher income workers receive more relief. For example, a minimum wage worker would receive between $1.98 relief per week, whereas someone earning $130,000 would receive $5.19 weekly relief.

11. As noted in the SUIGG paper, a flat-rate levy is administratively simpler than a levy with multiple thresholds and rates.

Levy relief could be targeted to lower income earners via different levy rate thresholds, but would provide a similar level of levy relief to a reduced overall rate

12. To target levy relief more effectively to those on low incomes, the reduced costs from a lower replacement rate could be used to offset the cost of introducing progressivity into the levy. The savings from the replacement rate options would lead to the following levy rates below $14,000:

Replacement rate	Employee levy rate below $14,000	Employee levy rate above $14,000	Weekly levy for a full-time minimum wage earner
80% for entire duration (Cabinet proposal)	1.39%	1.39%	$11.79
Reduced flat rate, (70%)	0.54%	1.39%	$9.51 (-$2.28)
Duration-based replacement (80%, then 60%)	0.64%	1.39%	$9.76 (-$2.02)
Income-based replacement (80% up to the median, and 40% up to the cap)	0.41%	1.39%	$9.15 (-$2.63)

13. As noted in the SUIGG paper, using a $14,000 threshold aligns with existing income tax thresholds, creating significant administrative efficiencies.

14. The average annual income for casual workers is $18,564. Those with highly intermittent work (who would be less likely to be eligible for the scheme) likely earn less than this. The $14,000 threshold is therefore reasonably well-targeted to casual workers, though it would also disproportionately benefit permanent part-time workers, as well as providing relief to all income earners (as all workers have income below the threshold).

15. An even lower threshold could be chosen (e.g. $5,000), which would provide more relief to those within that threshold, but this would increase the administrative complexity of the option.

16. Taking the mid-point option of 0.54 percent, a targeted lower levy rate provides households an average of $4 per week of levy relief, similar to the reduced flat rate option.

17. However, as the lower rate only applies to the first $14,000, everyone above that threshold receives the same dollar amount of relief: both minimum wage and high-income earners would receive $2.28 in relief. The targeted lower levy rate is therefore more targeted than a reduced overall rate, but both provide a similar quantum of relief to low-income workers.

Including potential behavioural changes produces significantly more savings, though with greater uncertainty

18. The above savings estimate does not allow for any behavioural changes from the reduced replacement rate. As noted in the SUIGG paper, international research is clear that reduced payments will lead to behavioural change, with fewer people receiving support for a shorter period. This means that the savings are likely higher than the above estimates. By way of comparison, the 70 percent replacement rate leads to savings of 9.2 percent without behavioural assumptions, increasing to between 17 – 27 percent with behavioural impacts.

19. In the time available, officials could only model the behavioural changes of the 70 percent replacement rate. This replacement rate is also likely to lead to the largest cost savings. The SUIGG paper provides further advice on the associated levy relief options, as well as options which maintain the replacement rate but increase costs for others (e.g. higher income earners or employers).

20. Some of the behavioural impacts would undermine the scheme's objective of supporting people into good work. This is particularly important for lower-income people who are more likely to be 'credit constrained' and feel greater pressure to return to any work quickly and are more likely to benefit from extended financial support to return to a good job. The options to reduce income replacement to provide levy relief will alter the benefits provided by the scheme, particularly to those who are most credit constrained.

Annex A: Impacts on households by equivalised disposable income decile

21. Note: These numbers are based on equivalised disposable income, which adjusts household income by household size and composition to allow comparisons between different households. The first column shows the amount of levy paid by each income decile for the 1.39% flat rate. The following columns show the winners and losers compared to the 1.39% flat-rate.

	Flat rate: 1.39%		**Flat Rate: 1.16%**		**0.54% levy rate under $14,000**	
	Levy paid		Levy relief provided		Levy relief provided	
1	58k	$6	55k	$1	58k	$2
2	67k	$10	64k	$2	68k	$2
3	116k	$14	113k	$2	115k	$3
4	149k	$19	148k	$3	149k	$3
5	163k	$24	162k	$4	163k	$4
6	169k	$29	169k	$5	169k	$4
7	171k	$34	172k	$6	172k	$4
8	173k	$41	171k	$7	171k	$5
9	169k	$44	168k	$7	168k	$4
10	157k	$44	154k	$8	156k	$4
ALL	1,392k	$30	1,376k	$5	1,390k	$4