Poor process, poor policy: A public submission on the Forum's social income insurance proposal

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Executive summary

- Introducing a new social insurance scheme would be a serious philosophical shift in the weight of New Zealand's income support system from a Beveridge-style model of *family belonging* to a Bismarckian model where people have *a right to a degree of attained economic status*. It also involves a considerable expenditure of public funds. One would consequently expect a careful, democratic, and time-consuming policy process before any change was seriously contemplated. This has not eventuated.
- Social insurance was not included in Labour's 2020 full election manifesto. Nor did they campaign on it. Their 2020 policy discussion amounted to one sentence buried in a manifesto-linked FAQ on their tax policy. It simply committed to "investigating" such a policy. The social insurance policy discussion document was developed behind closed doors by unrepresentative "social partners". It has been presented to the public as a done deal in a short consultation process to be rapidly implemented in 2023. The process degrades democracy and hence undermines trust in democratic institutions.
- The primary problem that social insurance is intended to solve is unclear and the extent of the implied problem identified remains unassessed.
- Reverse engineering a lack of short-term consumption-smoothing as the main identified problem, there are many existing institutions which currently provide considerable support in event of job loss. No attempt is made in the discussion document to comprehensively acknowledge these, nor quantify their impact and estimate what *additional* short-term consumption-smoothing would be added to the mix by social insurance.
- The examination of policy alternatives to social insurance is cursory, dismissive, and hence seriously flawed. There is also no serious discussion of the many limitations of social insurance.
- No policy alternatives are considered to the two other policy problems implied in the discussion document – wage scarring (for which there is no clinching evidence in favour of social insurance as a solution) and macro stabilisation.
- Social insurance raises many complex static and dynamic equity issues which the discussion document fails to acknowledge, let alone seriously consider.
- Assertions in the discussion document that the benefits of a social insurance scheme outweigh the costs lack any serious evidence base and consequently are empirically unsustainable.
- Overall, the document is best seen as an exercise in advocacy for a pre-determined solution, rather than a serious, even-handed attempt to address the issues involved without cognitive bias and without consequently jumping to conclusions. New Zealanders deserve better.
- This submission recommends not going ahead with social insurance.

Introduction

This working paper is a public submission on the proposal by government, Business NZ and the NZ Council of Trade Unions (henceforth "The Forum") contained in the discussion document of 2 February 2022 entitled "A New Zealand Income Insurance Scheme. A discussion document" (henceforth "the discussion document" or "document"). Associated with the discussion document is a submission template which is clearly designed to work out policy minutiae for a considerable range of strategic choices which have tacitly or explicitly already been made behind closed doors.

This submission rejects the narrow consultation channel offered. The overarching view of this submission is that the Forum have adopted a dangerously non-consequentialist, imperative-driven decision-making sequence. They exhibit near complete cognitive closure to alternatives. The Forum appear to have decided from the outset that they want social insurance, and seek to justify this choice, rather than setting out a clear policy problem or problems, assessing its size and importance, and judiciously and even-handedly examining the strengths and weaknesses of a suite of policy alternatives, which may or may not include social insurance. In other words, they have completely failed Public Policy 101.

In the context of the submission template, this submission can be considered as a detailed answer primarily to the first question: "Do you agree New Zealand should introduce an income insurance scheme for displacement and loss of work due to health conditions or disabilities?".

A process undermining public trust in democracy

The discussion document advocates a serious philosophical shifting of weight of the New Zealand income support system from Beveridge-based social welfare state, focussed on setting family income floors to enable belonging and inclusion, towards a Bismarckian social insurance state, focussed on individual rights to attained economic status The Beveridge approach puts a floor on family income, hence aiming to limit family poverty. The Bismarckian model compensates for labour market income loss, thus embedding current individual market income inequality in the income support system. In addition to the considerable philosophical shift, the document also involves a large resource commitment, with the central estimate is $3.4 billion. These two major shifts – one philosophical and the other in terms of resources – mean that one would expect a very careful, democratic, broad, and open policy process. The discussion document and the process behind its creation doesn't deliver one. The consequence is a likely further erosion in public trust in the democratic process.

Let's start politically. Social income insurance policy was not in Labour's "full election manifesto" in 2020. One would have expected it in either of the sections on "Social services" or "Workplace relations". However, if one clicks on the link on page 10 of the full manifesto to their full revenue policy, and goes to the bottom of that page, and one further clicks on the FAQ, under in response to the first question "What other tax policies will Labour announce this election", one finds the following buried manifesto-linked sentence about social insurance:

> *We have also committed to **investigating**, along with Business NZ and the Council of Trade Unions, a social insurance scheme to protect New Zealanders' incomes and support their re-training if they lose their jobs. [bolding added]*

"Investigating" is the operative manifesto-linked – not manifesto – verb here. It is additionally worth noting that Labour included this sentence in discussion of their tax policies, explicitly acknowledging that a social insurance levy is a tax. Lastly, note no mention of compensating for job loss due to sickness in any of the 2020-election-related material.

On September 25, 2020, contrary to Labour's manifesto-linked position to investigate social insurance, the Minister of Finance Grant Robertson said "his party would design a social insurance scheme".[1] He also said he would "of course" seek a mandate for such change with the public.[2] On May 2021, following the election, Robertson made the following statement:

> *The Government, Business NZ, and the New Zealand Council of Trade Unions (CTU) are **jointly designing** a Social Unemployment Insurance scheme that would support workers to retain about 80 percent of their income for a period after they lose their jobs. This delivers on a commitment in Labour's manifesto. [bolding added]*

Robertson has clearly shifted Labour's goal posts here – the manifesto-linked (not manifesto) commitment was about investigating, not designing a social insurance scheme.

[1] See Jenée Tibshraeny, "Robertson talks up, but doesn't officially campaign on, social insurance; Says it's unlikely to be 'fully implemented' in next term of government should Labour be re-elected", https://www.interest.co.nz/news/107233/robertson-talks-doesnt-officially-campaign-social-insurance-says-its-unlikely-be-fully, 25 September 2020.

[2] Ibid.

Social insurance was barely discussed or debated on the 2020 campaign trail. If there were truly a problem needing $3.4b of spending, it's omission from basic democratic processes like election campaigns is a bit of a puzzle.

Further, the proposal arguably breaks two 2020 Labour election promises which had significant campaign emphasis. The first was to introduce no new taxes beyond raising the top income tax rate – "we've committed to no new taxes this term". A levy to fund social insurance is a tax, and Labour's 2020 FAQ response mentioned above clearly acknowledges it as a tax. The second was to simplify the income support system in the core manifesto – "we will prioritise….Simplifying the income support system and ensure the settings that underpin access to income support are fair and fit for purpose". Adding a further social insurance layer makes the overall system of income support more complex, not simpler. Again, broken manifesto promises damage democracy.

Now, consider the discussion document in relation to democratic processes. The document was produced behind closed doors by non-representative Business NZ, an organisation dominated by large private sector employers, and the NZCTU, representing a small non-representative group of those in paid employment many of whom are employed by the state. Even within the NZCTU, in terms of engaging with affiliate unions and their grass-roots membership before the discussion document was produced, there has little democracy on this matter. Union members whose unions are CTU-affiliates are basically being asked to rubber stamp decisions already taken by NZCTU elites.[3]

The discussion document involves a three-month period for submitters to respond. The period is short. It is shortened – in the case of this submission to about six weeks – by the fact that submitters have had to identify and then go through OIA processes to obtain a considerable number of background documents. Those documents then need to be carefully read, absorbed, and follow up questions asked before it can be used to develop an informed submission.[4]

It also seems likely that the Minister of Finance, who (as indicated above) had earlier acknowledged he would "of course" seek a democratic mandate on social insurance, now intends implementation before the 2023 election. This hasty timing seems to be being driven by political imperatives –

[3] Personal experience with my own trade union, the TEU.

[4] What has gone on in terms of policy development within and between Business NZ and the NZCTU is not accessible under the Official Information Act – a further black mark on this process in terms of transparency and good democratic practice.

Labour is highly unlikely to continue post-2023 election as a majority government – rather than sound, careful public policy in the interests of all New Zealanders.

The job for running the new social income insurance institution has been already being advertised on SEEK, before any public feedback has been received. In other words, that what remains of the democratic consultation process is highly likely to be *pro forma* as far as the politicians driving this process are concerned.

It is worthwhile to contrast this rushed, undemocratic approach with the introduction of ACC. The process involved a Royal Commission over 1966/7 under a National government and led to the introduction of ACC eight years later under a Labour government. It was a careful, broad, time consuming and consensus project – everything that this proposal is not.

The poor process actively chosen adds to a wider public perception of an environment of undemocratic process and makes its contribution to loss of trust in government and politicians. The other major consequence of poor process is an extremely weak policy document for discussion. These weaknesses will be outlined below. The first major weakness is with the problem definition.

The problem definition (or, its absence)

Contrary to good policy making practice as endorsed by Cabinet procedures,[5] there is no clearly stated problem definition(s) in the discussion document. The closest to a problem definition is where the Forum describe three identified "objectives":

> *1. minimise the immediate financial impact of losing income and work for workers and their families*
>
> *2. support workers back to good jobs*
>
> *3. support the economy to adjust more rapidly to shocks or downturns.*

[5] See https://dpmc.govt.nz/publications/co-20-2-impact-analysis-requirements-html. It is noteworthy in the context of the Forum's decision-making processes that clear problem identification is advocated in the Cabinet guidelines to "avoid the potential pitfalls that arise from natural human biases and mental short-cuts".

These are, in fact, the objectives of the already chosen solution in the discussion document – social income insurance. However, three problems can be reversed engineered from each of these three objectives, as follows:

1. Lack of short-term consumption-smoothing vehicles for those losing their jobs from redundancy or sickness, arising out of private insurance market failure due to adverse selection.
2. Wage scarring, when workers lose their jobs reintegrate into the labour market at a lower wage than when they lost their jobs.
3. The lack of automatic fiscal stabilisers to maintain aggregate demand in event of a negative demand shock which is not compensated for (or cannot be compensated for because of an interest rate floor) by an active monetary policy.

Considering these three as the ultimate problems, it would seem *prima facie* unlikely that one policy – social income insurance – is going to be the best solution to three quite distinct problems.

Some further commentary on the objectives and their reverse engineering into problems is pertinent. In terms of objective 1, the international literature on social insurance systems makes it clear that the ultimate purpose of social insurance is *consumption-smoothing*. Income smoothing is simply a *means to that end*. The Forum is clearly familiar with this literature since it is well-referenced in Annexe 6 footnote xix of the discussion document. In this context, we take "immediate financial impact" to be a tacit acknowledgement of short-term consumption-smoothing as the core objective.[6]

The mention of private savings (p. 8) as an alternative solution is another tacit acknowledgement in the discussion document the problem is consumption-smoothing, not income smoothing. Savings

[6] In addition to not mentioning the core goal of social insurance of "consumption-smoothing", a further issue in the discussion document is the failure to even mention a second core conceptual notion behind insurance - "risk aversion". The fundamental reason for creating a demand for any form of insurance is that people are risk averse – they prefer lower consumption and incomes with certainty, than higher consumption and incomes with volatility. Intuitively, the optimal amount of insurance provided will, all other things being equal, depend on the strength of the degree of risk aversion in the population, and this is confirmed in the academic literature on the topic. The failure to consider these two core concepts indicates the intellectual inadequacies of the Forum's document and its detachment from the anchor of international intellectual endeavour. There is no empirical evidence offered by the Forum on the degree of risk aversion in the New Zealand population and, as we shall see, no estimate of short-term changes in consumption consequent on job loss.

can be drawn down upon to fund consumption but use or existence of savings has no impact on income smoothing.

The Forum further notes, in fashion tacitly accepting the ultimate problem is short-term consumption-smoothing, that:

> *The sudden loss of wages and salaries can cause financial hardship that is difficult to adjust to in the short term. Even high-income households can face large fixed expenses such as mortgage payments and other loans.*

And;

> *income loss can mean loss of spending power, and hardship….Many people have fixed costs that are hard to reduce rapidly, such as home or car loans*[7]

However, at other points the discussion document frames the problem simply in terms of income smoothing.[8]

Framing the problem simply in terms of income smoothing would be acceptable if short-term change in household consumption consequent on losing work were tightly tied to the income loss. However, all available evidence suggests that job loss results in a reduction in the nominal value of market consumption of between 5% and 15%.[9] The discussion document cites the first two papers

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[7] Mortgagee sales, when the costs of servicing a mortgage cannot be met from the current income of a mortgagee, are hard to numerically establish, but the consensus view is that numbers are very low. Corelogic data shows that quarterly mortgagee sales peaked at 777 in July 2009 and the latest data has them at a mere 6 in the January 2022 quarter. In other words, the consumption-smoothing problems created of this form of fixed expenditure are small to tiny. See https://www.stuff.co.nz/life-style/homed/real-estate/300563799/mortgagee-sales-hit-15year-low-but-theres-a-warning. In terms of the broader issue, most people can reschedule their mortgage and, *in extremis*, move to an interest-only mortgage if there are short-term consumption-smoothing issues.

[8] E.g. p. 30, p. 56, p. 74, p. 78, p. 119, p. 130 of the discussion document.

[9] Gruber, J. (1997). The consumption-smoothing benefits of unemployment insurance. *The American Economic Review*, 87(1), 192–205; Browning, M., & Crossley, T. (2001). Unemployment insurance benefit levels and consumption changes. *Journal of Public Economics*, 8, 1–23; Ganong, P. and Noel, P., 2019. Consumer spending during unemployment: Positive and normative implications. *American economic review*, *109*(7), pp.2383-2424; Landais, C. and Spinnewijn, J., 2021. The value of unemployment insurance. *The Review of Economic Studies*, *88*(6), pp.3041-3085.

supporting this proposition, so they clearly know short-term income-smoothing and consumption-smoothing are not identical.

This submission proceeds on the basis that the main tacitly identified problem is *short-term consumption-smoothing predicated on job loss due to redundancy or health conditions.* Given that the social insurance policy is designed around a six-to-seven-month period, the focus, insofar as possible is on that calendar definition of short-term.

In terms of objective 2, research indicates that the positive impact of social income insurance in supporting workers back into good jobs is theoretically ambiguous and empirically unsupported: "The empirical evidence suggests that increases in the generosity of unemployment payments do not significantly affect the quality of jobs that recipients end up in".[10] It is worth pointing out that no alternative solutions are even briefly considered to achieve this objective. The obvious solutions to getting unemployed workers back into work are active labour market programmes.

In terms of objective 3, the discussion document acknowledges social insurance is likely to make only a minor contribution as an automatic stabiliser, and if the appropriate first-best policy tool to mitigate a severe economic downswing is macroeconomic monetary policy, automatic fiscal stabilisers are redundant anyway. Again, no alternative solutions – different forms of automatic fiscal stabilisers – are even briefly considered to achieve this objective.

Lack of information on the size of the problem

This submission proceeds on the basis that the major policy problem is lack of short-term consumption-smoothing vehicles for those losing their jobs from redundancy or sickness. How big is this problem? The answer is one is little the wiser following reading of the discussion document.

The starting point for addressing problem size is seeking an answer to the apparently simple question: How many people annually lose their jobs because of redundancy or sickness? We don't have anything like a good idea. Nor does the Forum. According to the MBIE "Every year, more than 100,000 New Zealanders are made redundant, laid off, or have to stop working because of a health condition or disability".[11] The discussion document mentions 115,000 people on average on p. 24,

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[10] See Hyslop D, Maré DC, Noy S, Sin I. 2021, Involuntary job loss: welfare effects, earnings impacts and policy options. Motu Working Paper 21-06 April, p. 33.

[11] See https://www.mbie.govt.nz/have-your-say/income-insurance/.

but this figure is belied by Figure 1 on the same page, which suggests that over the 2007 to 2020 period, 100,000 was a maximum annual number (in 2009) and that 50,000 to 60,000 people is more normal – about 20,000 of which lose their jobs because of sickness or illness (some will be on ACC) and 30,000 to 40,000 lose jobs via redundancy. Note, in this data numbers losing their jobs for reasons of redundancy are larger than those losing their job because of sickness.

MBIE estimates of what the system would cost once introduced, developed for the Forum, and supplied to us by officials, indicate that should the scheme be introduced in 2023, 112,300 people would lose jobs from redundancy and 135,300 people – a larger number – would leave work for health-related reasons, for a total of 247,600 people. These numbers are higher than those cited in the paragraph immediately above because:

(1) the HLFS data undercount job losses for those reasons, and

(2) behavioural changes following introduction of the scheme would raise the numbers.

According to information provided by MBIE officials, the economically displaced estimated figure of 112,3000 people was entirely unrelated to the available New Zealand data used in the Forum's document. It was created by applying the Massachusetts claims rate (6.3%) as a % of New Zealand workers and then adjusting it (by means unknown to us) for scheme differences, removing 40% of claims as being out of scope, but then adding an additional 35% in to account for the greater generosity of the New Zealand scheme, based on behavioural elasticities for replacement and duration generosity summarised by Motu. Given that introduction of the Massachusetts scheme (replacing 50% of earnings for 30 weeks) would itself have caused behavioural change increasing the queue, behavioural change in New Zealand would add well over 35% or 40,000+ workers to the claims queue. That's a lot of inefficiency created by generosity of the scheme.

The health-related estimation was drawn by applying the proportion of Danish sickness claims over 22 days (6.1%) as a percentage of NZ workers . This resulted in 135,000 estimated claims flow per year.[12] Behavioural adjustments involved under introduction of the scheme, if any, are unclear in this case.

[12] Note that the Danish scheme caps out in a similar fashion to their unemployment insurance benefit at a very low replacement rate (less than $50,000NZD annually at current exchange rates). As it is much less generous than the proposed New Zealand scheme for those above the median in

So, we have no solid estimation as part of the Forum's policy process of the base number of people losing their jobs because of redundancy and sickness annually in New Zealand, nor an exact estimate of likely behavioural changes to these numbers following introduction of the scheme. Extraordinary stuff from a policy perspective.

What's more, we also have no estimate of the proportion of those losing a job have a family consumption-smoothing problem because of it, let alone how large the consumption-smoothing issue is and what its inter-temporal profile looks like. That's not a solid basis of information for such a major policy change.

Consideration of alternative policies

The discussion document's consideration of policy alternatives is cursory and completely unsystematic (it is of course fundamentally difficult to examine alternatives in a coherent fashion in the absence of a clear problem definition, so the Forum do have some proximate excuse). It contains virtually nothing in the way of analysis (pp. 8-9, pp. 45-7). Even then, it only (tacitly) addresses the short-term consumption-smoothing policy problem, not the other two problems.

Four policy alternatives are listed regarding objective 1 on p. 8 – redundancy payments, personal savings and loans, welfare payments, and private insurance. The list of alternatives is seriously incomplete, while p. 45 mentions only three, unaccountably excluding private insurance from the p. 8 list. The truncated treatment, the lack of consistency in options and the lack of depth tells us policy alternatives were not to be taken seriously.

Then the Forum tautologically advocates for social income insurance, on the basis that only a social insurance scheme is – by replacing lost wages - a social insurance scheme, as follows:

> *compared with other approaches, an income insurance scheme could most effectively and affordably ensure a replacement income that is close to lost wages, for a reasonable time, with wide coverage.*

It's relative ability to smooth short-term consumption – the actual problem - is not considered.

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the earnings distribution, one would expect applying the Danish rate may be under-cooking sickness claims.

Existing institutions for smoothing short-term consumption consequent on job loss

Given the existence of consumption-smoothing challenges, people don't sit around wringing their hands waiting for big government to do something. They have agency and they actively seek solutions, always imperfect, to problems of market failure. The extent to which they do so will impact on the size of the ultimate problem social insurance is supposed to solve. Consideration in the discussion document of what currently helps people smooth their consumption is dismissive, cursory, and incomplete. It dismisses what is in place on the basis that they are all, in isolation, imperfect. That's not a strong argument, as everything, everywhere falls short of perfection, including social insurance.

There are many more short-term consumption-smoothing institutions currently existing than the four (or three) mentioned in near-passing by the Forum. Many of these consumption-smoothing possibilities will be more accessible to those on higher incomes. This greater accessibility is almost certainly due to the demand for avoiding risk being a normal good with a positive income elasticity.

Second, these consumption-smoothing institutions are not identical to social insurance (and vice versa) – they are all *imperfect substitutes* for it. All – including social insurance – will invariable solve some but not all short-term consumption-smoothing problems. Additionally, claims in the discussion document that private savings and the welfare system are not imperfect substitutes for one another, but the welfare system *complements* social insurance are, in the economic sense, deeply misleading.[13]

Additionality: A central policy issue

[13] See for example p. 9 and p. 45. This misconception has been echoed by the Minister of Finance: "Any Social Unemployment Insurance scheme would be about supporting workers through a job transition. It *complements* the support available through the welfare system for those out of work for a variety of reasons. The Government remains committed to ongoing reforms to the welfare system" [emphasis added] https://www.beehive.govt.nz/release/building-stronger-support-workers-post-covid.

Overall, the core issue which policy makers need to explicitly grapple with is one of additionality. How much additional support would social insurance *add* to existing institutions[14] to cushion families' short-term consumption when people lose jobs?[15]

The honest answer is that the discussion document doesn't have a quantitative clue regarding additionality. In fact, the document does not contain any convincing evidence that they are even aware of the central additionality issue. Yet, in a situation of clear and substantial ignorance, the Forum is prepared to gamble massive public resources on filling a missing space which might simply not in fact be very big.

However, we can conclude that those who are strongly risk averse, and therefore have the highest demand for short-term income smoothing vehicles, have the strongest incentive to acquire such vehicles in the absence of social insurance. These will be the people who logically scale down other forms of income protection following introduction of income insurance. Then there are the people who will be mandated in by social insurance provision. Some of these people may not be using existing consumption-smoothing vehicles because they cannot afford them. In that case, the problem is their low income, not the fact they haven't made provision for short-term income volatility. Address their low income directly: there is no need for a paternalist scheme to force them to purchase something they may or may not want. Hence, mandated social insurance will sweep up considerable numbers of people who are much less risk averse and may not want such a scheme and/or many people who have low wages and have better things to spend their money on than social insurance levies.

Currently, what do we know about Kiwis' ability to smooth consumption in the face of a negative income shock? Using data from the 2021 Financial Capability survey conducted by the Retirement Commission, Table 1 shows the ability of employed New Zealanders to completely smooth a one third fall in their incomes.[16] In total, a large minority of the employed (45%) believe that they can

[14] Or in the case of the welfare system, where reforms are currently being considered, to the welfare system as it will exist *at the time of introduction of social insurance*.

[15] The additionality issue is also directly pertinent to the assessment of the efficacy of social insurance for the other two identified problems: sub-optimal duration of job search and short-term macro-stabilisation. The greater the efficacy of existing short-term consumption smoothing institutions, (1) the less constrained is people's job search by current income and (20 the less fiscal stabilisation will be added by social insurance.

[16] We thank Dr Suzy Morrisey and Dr Jo Gamble from the Retirement Commission for kindly providing us with this data to analyse.

completely smooth a one third fall in income for more than six months. Just over a half (55%) do not, but many of these people will have an ability to completely consumption smooth for some of the six-month period – 20% can, for example, completely smooth their consumption for a period of 3 to 6 months. Those with less ability to consumption smooth are more likely to have lower income, but of the 39% of the employed earning less than $50,000 annually (slightly less than median earnings), one third (13%) can completely consumption smooth for over six months. Thus, even at the bottom end of personal income, quite a large minority of the employed can completely consumption smooth. The data do not, however, provide a clear indication of the *sources* of people's considerable consumption-smoothing ability, nor do they inform us about the income smoothing capacity of people who become redundant, which may be greater than or less than that of the employed population.

Table 1: Ability to completely consumption smooth by personal income of the employed[17]

	Ability to cover expenses if income falls by one third					
Personal income	0 – 1 months	Between 1 – 3 months	Between 3 – 6 months	Between 6 – 12 months	More than 12 months	Total
Under $50,000	10%	8%	7%	6%	7%	39%
$50,000 to $99,999	7%	8%	11%	14%	11%	50%
Over $100,000	1%	2%	2%	3%	4%	11%
Total	18%	17%	20%	23%	22%	100%

However, the Financial Capability Survey does offer some hints as to how do households achieve this consumption-smoothing. Table 2 shows that many households hold significant liquid assets – both immediately liquid assets and other financial instruments, many of which will be fungible - which can be used in the short-term to maintain consumption levels. Patterns here in Table 2 are very similar

[17] The question is whether the person could cover a one third fall in income while meeting all expenses ("If your income fell by a third, for how many months could you meet all your expenses without needing to borrow?"). Thus, it provides an indicator of consumption-smoothing in the face of income loss.

to those in Table 1, suggesting that precautionary savings are a significant buffer for consumption-smoothing, a finding consistent with the international literature.[18] [19]

Table 2: Household savings resilience by personal income of the employed

	Household savings as a percentage of household income					
Personal income	0 – 1 months	Between 1 – 3 months	Between 3 – 6 months	Between 6 – 12 months	More than 12 months	Total
Under $50,000	13%	8%	6%	6%	6%	39%
$50,000 to $99,999	11%	9%	10%	11%	9%	50%
Over $100,000	1%	2%	2%	2%	3%	11%
Total	25%	18%	19%	20%	18%	100%

What are other ways consumption-smoothing can currently take place?

This section aims to provide a list, as complete as possible, of avenues which are currently available for someone who loses a job via redundancy or sickness to smooth their short-term consumption. It also aims, as far as possible given massive information deficiencies, to assess how important these avenues may be. The key policy issue here is parsing all the available information to be as well informed as possible about additionality of a social insurance scheme. We find a very long list of imperfect substitutes which collectively provide for short-term consumption-smoothing (and other things), in the absence of any social insurance system. That provision is qualitatively likely to be considerable, although it is impossible on current information sources to quantify the amount. Consequently, we still do not know, the exact extent to which these will be crowded out by social insurance – a fundamental issue in making an informed policy decision based on rational cost-benefit criteria. All these imperfect substitutes and the extent to which they result in policy deadweight will need to be quantified to do a cost-benefit analysis, since they lower net benefits from introducing social insurance.

[18] Andersen, A.L., Jensen, A.S., Johannesen, N., Kreiner, C.T., Leth-Petersen, S. and Sheridan, A., 2021. "How do households respond to job loss? Lessons from multiple high-frequency data sets".

[19] The cross-plot of the Table 1 question with the Table 2 question (not included in this submission) shows a very strong principal diagonal, supporting this contention.

Private insurance

While an important motivation for social insurance is a failure in the private insurance market, there remains an existing private income insurance market that is substantial. A significantly sized minority of New Zealanders likely have some form of private income protection insurance. In 2011, one in five New Zealand households, or 21% have income protection insurance.[20] For those with (2011) household income of between $5001 and $50,000 the figure is about 16%. The gradient continues to rise with household income to 33.6% of those households with more than $150,000 of income, indicating income insurance may be a normal good. It is not clear what reasons for income loss are covered by these policies. Monthly income insurance pay-outs seem to range from about $2500 to $5000 depending on family types (using the adjustments for inflation and productivity growth to get rough 2022 numbers). The monthly minimum wage is currently in the vicinity of $3000. There is no assessment of how much of this market will be crowded out by social insurance.

Compensating wage variations

There are other market solutions to consumption-smoothing challenges provided by risky jobs. One that bosses “buy out” this undesirable feature of the labour market by compensating workers for taking on a more-or-less-known risk of job loss. Workers get higher wages (called compensating variations by economists), for taking on job loss

[20] Naylor, M, C. Matthews and S. Birks, *Exploring Underinsurance within New Zealand*, FSC Underinsurance Project 2011, Massey, p. 22. More recent data show that over 600,000 income protection policies exist – see https://blog.fsc.org.nz/more-kiwis-sign-up-for-life-insurance-in-2021?hsLang=en and in 2021 private insurance premiums were $462M. Assuming a low gross claims ratio of fifty percent, that means roughly $230M was paid out annually for income protection insurance. It is unclear how much of this money goes to short-term consumption-smoothing. On the gross claims ratio, see Jinny Leong and Adrian Allott, An overview of the life insurance sector in New Zealand, *Reserve Bank Bulletin*, Vol 83. No. 1 January 2020.

risks.[21] In other words, their lower consumption following redundancy has already been compensated for by firms paying them higher wages.[22] No need for ex post insurance.

Methodologically, such compensating variations are difficult to identify using observational data but are supported by experimental studies (which have their own limitations). Some studies show that the compensating wage differentials can be large. One study shows compensating variations for job loss risks of between 2% and 6% (note that this is in an environment with an unemployment insurance programme – such differentials are likely larger in the absence of unemployment insurance, due to crowding out).[23]

It might, for example, be that observed "wage scarring" is to some extent an observation of the compensating variation. Rather than explaining the "low" post-redundancy wage, it explains the high pre-redundancy wage as a compensation for being made redundant.

Firms insure workers

Additionally, there is good US evidence that firms take on more liquidity to ensure they are less likely to have to make people redundant to signal to workers they are desirable employers. When social insurance coverage goes up, firms cut back on this liquidity and

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[21] The discussion document does acknowledge compensating variations. On p. 41, for example, the scheme will mean "less need for entrepreneurs to offer premium wages to attract workers' into start-ups". This sentence is an acknowledgement compensating variations will be crowded out by social insurance, reducing additionality. This analysis is not, however, at all integrated into the policy analysis and no attempt, to address additionality, is made to quantify their size and what might happen to them following introduction of social insurance.

[22] See for example Abowd, J.M. and Ashenfelter, O., 1981. Anticipated unemployment, temporary layoffs, and compensating wage differentials. *Studies in labor markets*, pp.141-70; Hamermesh, D.S. and Wolfe, J.R., 1990. Compensating wage differentials and the duration of wage loss. *Journal of Labor Economics*, *8*(1, Part 2), pp.S175-S197; Hartog, J., Plug, E., Serrano, L.D. and Vieira, J., 2003. Risk compensation in wages–a replication. *Empirical Economics*, *28*(3), pp.639-647; Moretti, E., 2000. Do wages compensate for risk of unemployment? Parametric and semiparametric evidence from seasonal jobs. *Journal of Risk and Uncertainty*, *20*(1), pp.45-66; Moore, M.J., 1995. Unions, employment risks, and market provision of employment risk differentials. *Journal of Risk and Uncertainty*, *10*(1), pp.57-70; Elliott, R.F. and Sandy, R., 1998. Adam Smith may have been right after all: A new approach to the analysis of compensating differentials. *Economics Letters*, *59*(1), pp.127-131; HomRoy, S., 2016. Was Adam Smith Right? Evidence of Compensating Differential in CEO Pay. *The Manchester School*, *84*(1), pp.1-24.

[23] Abowd and Ashenfelter op. cit.

workers become likely to lose their jobs.[24] Again, the addition of social insurance reduces this form of privately offered worker protection. We have no idea of the extent to which this is a form of job condition offered to New Zealand workers nor how much of it may be crowded out by social insurance.

Adjustable goods

An obvious direct way which people use to cushion themselves following job loss is cutting back or defer spending on unnecessary luxuries – going out drinking on Saturday night, upgrading the car - and avoiding job-related spending – on work lunches and commuting. The more such “”adjustable goods” as part of the household consumption bundle, the less the need for an insurance solution. Richer people will have more of them.

Statistics New Zealand’s household spending data indicates at least 27 percent of consumer spending of the average household is discretionary or avoidable to a family facing financial challenges - including Alcohol and tobacco (7% of spending), new housing (9%), car purchase (5%), holidays (1%) and Restaurants (5%). There are other components as well where fat is likely. Of course, this tells us little directly about adjustability of expenditure of those who lose their jobs, another key information dimension for decision making where we know very little.

Redundancy pay

Redundancy pay can function as a fund to allow workers who lose their jobs to smooth short-term consumption. There is limited evidence on core dimensions of redundancy pay in New Zealand available to workers. None of the quantitative evidence is cited by the Forum.

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[24] Agrawal, A.K. and Matsa, D.A., 2013. Labor unemployment risk and corporate financing decisions. *Journal of Financial Economics*, *108*(2), pp.449-470; Dou, Y., Khan, M. and Zou, Y., 2016. Labor unemployment insurance and earnings management. *Journal of Accounting and Economics*, *61*(1), pp.166-184; Devos, E. and Rahman, S., 2018. Labor unemployment insurance and firm cash holdings. *Journal of Corporate Finance*, *49*, pp.15-31; Ben-Nasr, H., 2019. Do unemployment benefits affect the choice of debt source? *Journal of Corporate Finance*, *56*, pp.88-107.

Work done in 2012 for the 2002-2009 period by Dixon and Maré suggest that more than half of redundant workers (54%) received some redundancy pay.[25] Allowing for consumer price growth and productivity growth of one percent per annum from 2012, their work suggest a 2022 median redundancy payment in the order of 20,000 (about half of the annual full-time (35 hours) minimum wage of $38,000) and a mean payment of about $37,000. So, this data suggests that more than one in four redundant workers get more than $20,000 in redundancy pay.

The total amount paid out annually in redundancy pay can be crudely estimated thus. 2,750,000 people are employed. Assuming 2% are made redundant annually gives 55,000 redundant people who get paid $37,000 on average gives about $2 billion dollars of redundancy pay. That's considerable short-term consumption-smoothing potential.

We know that most workers on collective employment agreements have a redundancy pay clause. However, we do not know rights under individual employment agreements, which cover a very large majority of the workforce. In addition, because accumulation of redundancy pay is typically employment-duration dependent, we have no idea of redundancy entitlements of the existing stock of employed workers. The discussion document does acknowledge the potential for crowding out of redundancy payments by social insurance (p. 46), but, once again, it provides no quantification and no insight into the extent to which it undermines the case for social insurance.

Accumulated holiday pay and sick leave

Holiday pay and sick leave are not insignificant for many to use to generate some short-term consumption-smoothing options. Workers often accumulate holiday pay if they are aware that they may become redundant, and clearly many have forewarning. The legislated minimum holiday pay is four weeks per year.

Legislated minimum sick pay is five days' sick leave a year after the first six months of continuous employment, and an additional five days after each subsequent 12 months. Employers must also carry over unused sick leave into the next year, although the maximum accumulation remains at 20 days.

[25] Reported in OECD 2017.

Again, as with redundancy pay rights, we do not know what worker entitlements exist above this legal minimum across the labour market – a major gap in our knowledge. Collective agreement data indicates that 35% of employees on such agreements could accumulate more than 99 days of sick leave and about 4% had no limit. 10% had 21-49 days and 10% had 50 to 99 days.[26] In terms of the sickness component of social insurance, we do not know, however, what entitlements the current stock of people employed and at risk of losing a job through sickness have accumulated, however, and thus the extent to which they are already provided for in the absence of social insurance. Again, crowding out of sick leave is a very real potential consequence introducing insurance for sickness-related job loss.

Welfare support and other income-related payments and deductions

The Forum pretty much ignores the welfare system. Where it is touched on, it focuses very much on the first-tier benefit floor as an imperfect substitute for social insurance in event of job loss (although they incorrectly claim it analytically as a complement, as discussed above). However, the full panoply of income-tested payments and deductions need to be considered in terms of the role of the broader existing welfare system. In 2019 over 200,000 families with dependent children got the in-work tax credit (IWTC) (there will be more employed people than this getting support from the IWTC, as some families who get the IWTC will be two earner families). If their market incomes go down, over certain income ranges their IWTC goes up, replacing some lost earnings. Many families also get the income tested Family tax credit and the Accommodation Supplement and will develop a greater right for it if their incomes fall due to job loss, even if they are not eligible for a first-tier welfare benefit.[27] Income-tested payments consequently create a cushion, between the gross loss of income consequent on job loss and the net loss, even absent first-tier benefit eligibility.

There are other income-related wedges which cushion families when a job is lost which are not considered in standard modelling of effective marginal tax rates. For example, many Kiwis – 1.37 million in 2020 – have a student loan, which they repay at 12% for personal annual income over a

[26] Data on collective contracts supplied by Stephen Blumenfeld of the Centre for Labour, Employment and Work, Victoria University.

[27] Low take-up of the Accommodation Supplement due to poor information or stigma may be a problem in the case of job loss due to redundancy or sickness, especially where those losing jobs are not eligible for first-tier benefits. If so, this issue should be addressed directly.

threshold of about $20,000.[28] There are also child-care subsidies to low and middle-income families which can kick in when market income falls due to job loss.[29] Lastly, formal child support payments (and, presumably, many informal arrangements) may mean lower deductions if a non-custodial parent's income falls due to job loss.

The issue here is the size of the cumulative "effective marginal tax rates", taking into consideration all income-related payments and deductions, their distribution across different household levels of market income, and their distribution across different households and in particular those households facing job loss. We are far from having this key information for quantitatively assessing additionality in terms of the overall income support system of introducing social insurance.

Household Savings

Households have considerable savings, much of which is in fungible form. Precautionary savings provide a buffer to allow maintenance of short-term consumption following job loss. Table 2 shows that these buffers are likely significant for many households.

Kiwisaver

The discussion document does not appear to be aware that Kiwisaver (a sub-set of household savings) currently operates as a *de facto* Unemployment Account (UA). Unemployment accounts have similar consumption-smoothing abilities to unemployment insurance schemes.[30] The 2019 MBIE options paper briefly looked at eligibility widening of Kiwisaver to include redundancy and illness.[31] But Kiwisaver *already* includes hardship as grounds for fund access, which clearly includes

[28] See https://www.educationcounts.govt.nz/publications/series/student_loan_scheme_annual_reports/student-loan-scheme-annual-report-2020.

[29] See https://oece.nz/public/information/fees/childcare-subsidy-a-tax-deduction/. Effectively, this is slower debt reduction as a short-term consumption-smoothing device.

[30] Pallage, S. and Zimmermann, C., 2010. Unemployment benefits vs. unemployment accounts: A quantitative exploration. *Federal Reserve Bank of St-Louis. Mimeo*. Setty, O., 2017. Unemployment Insurance and Unemployment Accounts: The Best of Both Worlds. *Journal of the European Economic Association*, *15*(6), pp.1302-1340. Feldstein, M. and Altman, D., 2007. Unemployment insurance savings accounts. *Tax policy and the economy*, *21*, pp.35-63.

[31] On Kiwisaver, the 2019 MBIE policy options paper ("Exploring social insurance and other options to enhance financial support for displaced workers", Briefing 18 December 2019) provided as background to the Forum stated:

hardship because of redundancy. People can currently access Kiwisaver in times of “significant financial hardship” and “serious illness”. Equally, as, which may be the person with the Kiwisaver accounts’ job loss or job loss of their partner – this includes implicitly or explicitly for *family* reasons.

Significant financial hardship includes when a person:

- cannot meet minimum living expenses
- cannot pay the mortgage and the mortgage provider is seeking to enforce the mortgage
- needs to pay for medical treatment for themselves or a dependent family member
- has a serious illness

The hardship application forms asks for information on *partner* income and assets, as well as personal income and assets, and *household* expenditure. The nudges in the system are designed, however, to discourage people from using their balances to smooth short-term consumption during the working life course.

Figures from the Financial Markets Authority's annual KiwiSaver report show that in 2021, there were over 3 million people with an account. The average value of *individual* funds was $29,000 in 2022, up from $26,000 in 2021. [32] 21,000 Kiwis took $159.3 million out of their accounts in the year

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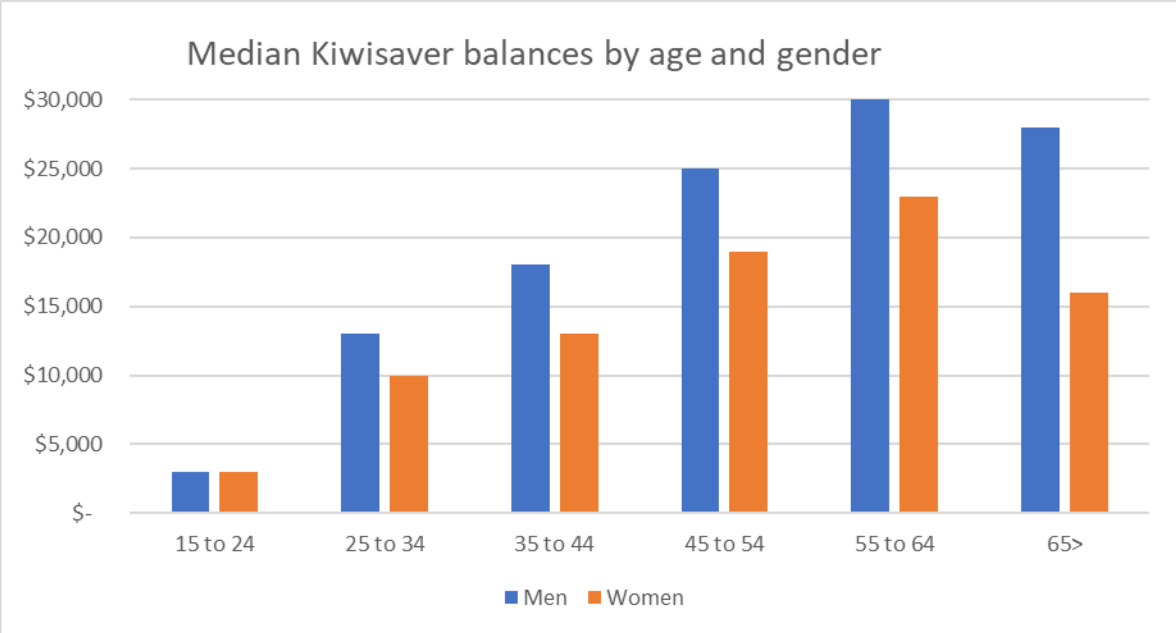
> *This option assumes that eligibility for early access to KiwiSaver funds is widened to include redundancy. Displaced workers would be able to access a portion of their savings up to a cap, such as a percentage of the saved funds. The cap would help to ensure that funds intended for retirement are not fully depleted. This would require careful policy consideration as to whether it is intended to replace or supplement other government assistance (such as welfare payments and other transfers).*

Clearly, if redundancy causes hardship, people can *already* access Kiwisaver on account of redundancy. It is additionally unclear why a withdrawal cap is necessary. If workers withdraw funds for redundancy, their revealed preference is that consumption-smoothing during the working years is preferable to consumption-smoothing in retirement. Why stop those with Kiwisaver for making the best decision for them under the circumstances they face by capping withdrawals?

The MBIE options paper also noted (p. 2, emphasis added): “The analysis is *deliberately high level*, seeking only to provide an *indicative* assessment of the options” and described it as a “a very preliminary scan” (p. 15).” It thus does not provide a robust consideration of policy options in the face of a short-term consumption smoothing problem even as background to the discussion document.

[32] https://retirement.govt.nz/news/latest-news/new-data-reveals-for-the-first-time-largest-breakdown-of-kiwisaver-balances-across-all-ages-and-genders/.

to March 31, 2021, on account of hardship - an average of $7,584 each. At the same time there were $58.7 million serious illness withdrawals (the number of such withdrawals is not provided). In other words, Kiwisaver currently provides for $219 million of working age consumption-smoothing.[33] Given Kiwisaver is already addressing consumption-smoothing during both working age and during retirement, it would be an obvious institution on which to build. The extent to which social insurance will crowd out these withdrawals is unclear.



Source: stats NZ, https://www.stats.govt.nz/news/kiwisaver-nest-eggs-grow-5000-in-three-years#:~:text=The%20median%20value%20of%20New,investment%20gains%20or%20other%20contributions. 2018 year.

A working spouse functions in a variety of ways to smooth short-term consumption

If one has a working spouse, or more broadly a spouse generating market income, the proportional fall in household income and consequently consumption if it is in fact income constrained) is lower if a job is lost than for a single person or a single earner household. The proportional need for short-term consumption-smoothing is consequently less. Being in such a working couple directly supplies short-term consumption-smoothing. Equally, having a spouse will mean generally greater access to shared savings to smooth short-term consumption, including to Kiwisaver (discussed above). Lastly,

[33] Financial Markets Authority's annual *KiwiSaver Report* for 2021.

having a market income earning spouse allows much better access to credit markets to allow consumption-smoothing to take place.

There is also indirect support. There is also the possibility of an added worker effect, where household income changes are cushioned by the spouse who remains in employment seeking more hours or a better paid job on account of the primary job loss.

Evidence suggests that over one third of people (35%) who become redundant have a partner working who contributes about on average about $50,000 2016 dollars to family income. The fact that many redundant workers have earning partners implies that they also will have better access to credit markets to smooth their consumption, since credit market access typically requires current earnings to secure.[34] A working partner not only provides income to directly smooth consumption, but also allows much better access to credit markets than for those without a spouse, or without a working spouse. The extent to which social insurance will merely substitute for the insurance benefits of a working partner is, again, unclear.

Wider family members

Many New Zealanders have access to financial support to smooth short-term consumption from "the bank of mum and dad", or from wider family and friends. Many people will have access to a family trust, widespread in New Zealand.[35] Available evidence suggests more than one million Kiwi parents financially support adult children in terms of free rent, groceries, and paying a variety of bills, which may include help with mortgages.[36] According to the 2021 Financial Capability Survey, 41% of households in financial difficulty have family or friends they feel they can call on for financial help, along with 51% of those in households in financial risk.

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[34] Hyslop, D. and Townsend, W., 2017. The longer term impacts of job displacement on labour market outcomes. Motu Working Paper 17-12 Motu Economic and Public Policy Research May.

[35] The Ministry of Justice estimate there are between 300,000 and 500,000 family trusts in New Zealand. See https://www.justice.govt.nz/justice-sector-policy/key-initiatives/trust-law-reform/#:~:text=Trusts%20are%20an%20important%20part,and%20500%2C000%20trusts%20in%20Aotearoa. We do not know the extent to which family trusts smooth short-term consumption of a trust's beneficiary in event of job loss from redundancy or sickness, but it is likely to be significant in at least some cases.

[36] See Cameron Smith, "Bank of Mum and Dad: One million Kiwi parents subsidising adult children", 5 April 2022, *New Zealand Herald*, https://www.nzherald.co.nz/business/bank-of-mum-and-dad-one-million-kiwi-parents-subsidising-adult-children/TOWIMZULB3C2HV6UY7SKI35W3I/.

Increases in home production smooth consumption

There is evidence that those who lose jobs and find themselves unemployed put some of their additional time to use by increasing household home production and hence non-market consumption as a substitute for market production. Empirically, this increase is exclusively for those who are single and aren't able to rely on a partner to help support them (in this latter case typically the unemployed person expands home production while the employed spouse reduces theirs, leaving little net change).[37] Home production may involve going fishing, growing vegies, painting the garage instead of paying someone to do it, doing more of one's own cooking and cleaning, or taking the children out of paid child-care and doing it oneself.

A two-fold increase in the value of unemployment insurance reduces time spent on home production by the unemployed by 22%. The effect is largest and most significant for singles time, at 45%. The coefficient is small and not significant for couples. This finding suggests that a spouse's income is a form of insurance that singles don't have. Hence singles are more likely to increase their home production to smooth their consumption.

Making a consumption expenditure dollar go further

In addition, there is also good evidence that the unemployed pay lower prices for goods and services, as they have more time to sniff out a bargain, thus making a dollar go far further than when they were employed.[38] One study shows that lower prices paid by the unemployed offsets one sixth of the total difference in consumption between the employed and unemployed.[39] That's a significant amount of consumption-smoothing, which social insurance will tend to reduce.

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[37] Guler, B. and Taskin, T., 2013. Does unemployment insurance crowd out home production? *European Economic Review*, *62*, pp.1-16; Been, J., Rohwedder, S. and Hurd, M., 2020. Does home production replace consumption spending? Evidence from shocks in housing wealth in the Great Recession. *Review of Economics and Statistics*, *102*(1), pp.113-128; Been, J., Suari-Andreu, E., Knoef, M. and Alessie, R., 2021. *Consumption and time use responses to unemployment*. Netspar, Network for Studies on Pensions, Aging and Retirement.

[38] Aguiar, M. and Hurst, E., 2005. Consumption versus expenditure. *Journal of Political Economy*, *113*(5), pp.919-948.

[39] Campos, R.G. and Reggio, I., 2020. Do the unemployed pay lower prices? A reassessment of the value of unemployment insurance. *Journal of the European Economic Association*, *18*(5), pp.2135-2181.

Liquidation of valuables and consumer durables

People can also liquidate non-housing non-financial assets, including valuables and consumer durables to short-term consumption smooth. Trade me, for example, creates a "thick market" which makes these assets and valuables highly liquid in a competitive market. Some which are potentially highly liquid include: cars, jewellery, art, musical instruments, and electronic equipment. Trade me and other internet-domiciled buying sites makes these highly liquid.[40] There is no empirical evidence regarding the extent to which people use this channel for short-term consumption-smoothing which we are aware of.

Non-labour ("non-personal exertion") income sources

A person, for family, may self-insure labour market earnings by having diverse forms of income, such as income from financial assets or from rental properties or other businesses (obviously this also applies to partners' incomes as well). About five percent of household income comes from other regular sources and investments, so non-labour market income may be important for some who lose their jobs.

Student loans scheme

The government's student loans scheme provides a financial market for consumption-smoothing source when acquiring human capital in tertiary education. People who lose their jobs by redundancy or sickness can access the student loans scheme to retrain. The scheme provides an income of $242 per week for consumption-smoothing, which is not tested on family income. Again, we have no information on the number of people losing their jobs who access the student loans scheme.

Access to consumer credit

Short-term consumption-smoothing can occur, consequent on job loss, by access to consumer credit, including bank loans and building up credit card debt. This solution is likely to be more available where people can service the debt, either by having a working partner (already discussed above) or other regular sources of income.

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[40] Statistics New Zealand's net assets survey 2021 contains numbers for such assets and amounts involved are not inconsiderable.

Slower debt reduction

Short-term consumption-smoothing can also occur by re-scheduling debt repayment, including mortgage re-scheduling. While it has already been mentioned in passing several times above, it is mentioned again here for completeness.

Assessing benefits versus costs

Overall, the Forum airily and confidently assert the scheme generates an excess of benefits over costs: "the benefits of income insurance for job loss due to displacement or health conditions would outweigh its costs" (p. 48). There is no intellectual basis in the discussion document for this strong quantitative assertion, since the additionality issues discussed in detail above have not been raised, let alone examined and quantitatively assessed. Only where additionality has been addressed and satisfactorily quantified, can benefit-cost conclusions start to be constructed. It should be plain that the New Zealand information base is currently incapable of supporting a coherent benefit-cost assessment.

Equally, international research suggests, quite strongly, that there is very little basis for drawing coherent cost-benefit conclusions from introducing new social insurance schemes:

> *The reduced-form empirical estimation that the literature [on social insurance] uses to make quantitative welfare predictions [the authors are referring to the Baily/Chetty three parameter model, where optimal social insurance change is determined in a simplified model by societal risk aversion, the decline in consumption following job loss and the moral hazard impact of change on unemployment] are identified using local variation around the currently observed environment. This makes it difficult to extrapolate out-of-sample to impacts of policies which have not been observed [which the Forum's proposal clearly is].*[41]

Because of this fundamental uncertainty of benefit and costs, the proposed intervention involves rolling an enormous dice on which expected net benefits values have no coherent point estimate and are highly uncertain around the unknown– suggesting an extraordinarily high appetite of the

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[41] Chetty, R. and Finkelstein, A., 2013. Social insurance: Connecting theory to data. In *Handbook of public economics* (Vol. 5, pp. 111-193). Elsevier.

central planner for taking income risks on a policy whose fundamental justification is predicated on high levels of societal income risk aversion! Putting aside for the moment the immorality of gambling with other people's income, the analytical irony is delicious.

Problems with social insurance

Social insurance is an imperfect solution to the private insurance market problems, but these imperfections are not fully discussed in the document. The problems with social insurance include:

- It creates incentives for various forms of gaming and moral hazard by people. Some of these moral hazard problems, but not all, are discussed. These problems of course cannot be eliminated. But they can be managed and reduced by incurring various forms of administrative costs, which themselves use up resources.
- Identifying moral hazard also costs legitimate claimants in terms of inevitable false positives – people who are entitled but the system incorrectly throws out or places an administrative burden upon them.
- Because people have no choice about belonging to the social insurance system, the designed contribution rate and the amount and duration of pay-out will not reflect many people's diverse preferences, including for income risk, and individual and family circumstances, for consumption-smoothing. Hence the scheme likely involves giving some people more income smoothing than they would privately choose at the levy rate and others less. The greater the population's diversity, the less the amount of desirable consumption-smoothing which the "one size fits all" scheme targeted at the average preference (and we don't know the average preference!) offers, all other things being equal. This issue is not discussed at all.
- Some people and forms of employment have no access to the scheme, but a potential demand.

Which institutions on which to build?

Of the above institutions which currently exist, which ones might one build on if one concluded there was a sufficiently large policy problem? This section examines Kiwisaver. Unemployment and sickness accounts have similar consumption-smoothing goals to social insurance schemes – when one loses a job because of redundancy or sickness, one can dip into them to maintain short-term consumption. The current purpose of Kiwisaver is to provide a vehicle to transfer consumption, via current savings, from a person's working life into retirement. So, it is a programme inherently set up to smooth consumption - exactly the main problem social insurance seeks to address, but simply later in the life course.

Policy advantages of building on Kiwisaver as an unemployment account include:

- It is already currently in use for working age consumption-smoothing
- Many people are already in it (about 3 million people)
- Significant, positive existing balances exists for many
- It is a pre-existing institution which is easy to build on, with high buy-in
- Competition between private providers drives down costs
- Those who lose a job can access the Kiwisaver balances of other family members, in addition to their personal Kiwisaver, since the definition of hardship is already family focussed. This risk pooling will improve the efficacy of the UA approach.
- Avoids the considerable moral hazard inherent in social insurance due to individualised accounts: the consequences of higher unemployment durations fall on the person concerned, not third parties
- The choices to pay in and draw down are choices which can be tailored to individual preferences and circumstances, rather than a one size fits all mandated system of social insurance
- Nudges can be cheaply created which better signal to people the possible use of their Kiwisaver to smooth short term-consumption when job loss strikes
- It is simple to increase provision for job loss, if considered desirable, via raising the employer-matched contribution

Policy disadvantages of Kiwisaver for job-loss induced needs for consumption-smoothing include:

- People who don't have Kiwisaver or who exhaust their balances may miss out on consumption-smoothing. This problem could be partly addressed by a lump sum government contribution at the beginning of a working life/Kiwisaver enrolment.
- Risks of income volatility are not pooled across wage and salary workers (but are across family members)
- It may undermine the explicit objective of Kiwisaver, which is consumption-smoothing in retirement
- Contribution matching may need to rise.

Equity

The Forum's consideration of the equity dimensions of social insurance is seriously inadequate.

There is a very old and stubborn trope in the community distinguishing the "deserving" from the "undeserving" poor. The proposed scheme seems designed to reinforce this vision of the world, right down to running a different institution providing income support for the "deserving" poor – those are entitled to some form of income replacement, with far gentler eligibility rules than for the "undeserving" in the social welfare system. What's more, by diverting a significant amount of middle-class voice – those out of jobs for the short-term – from the welfare system, the risks of further reducing the dignity of people reliant on welfare are dynamically exacerbated. If the Forum are aware of these issues (and it is unlikely that they are not), they choose not to mention them.

This section considers vertical equity of social insurance in the context of the main income support alternative – a social welfare system. The 1972 Royal Commission on Social Security provide a good summary of the critical differences between the two systems:

> *The "adequacy" of benefits is defined quite differently in each [of the systems]. A flat-rate system should define it in terms of the "belonging" aim, with "need" being judged as the difference between a prescribed minimum and an actual level of individual income. An earnings-related system defines adequacy in terms of the amount of earnings (not income) lost, with "need" being assumed from this fact alone, and benefits thus being varied to match various individual earning levels.*[42]

The Royal Commission further point out:

> *The main [equity] issues, as we see it, is whether the community should be responsible for maintaining the past individual economic status of those who through age or other disability lose earning power.*
>
> *The "equity" principle ("the greater the loss, the greater the need"), must itself be approached with some reserve. There can be "equity" in preserving income differentials only if there was "equity" in the differentials themselves. But differentials in market*

[42] *Report of the Royal Commission on Social Security*, Government Printer, Wellington 1972, p. 169.

earnings are based on ability to take advantage of the market rather than considerations of equity.

> *Loss of earnings can be only a crude measure of need because earnings themselves are only a crude measure of the standard of living attained. They take no account of family responsibilities, which themselves vary over the life cycle. They take no account of other income or the possession of capital goods and amenities.*[43]

It is disappointing but interesting that the Forum appear to be wholly innocent of discussions of the 1972 Royal Commission.

In summary, there are three major equity dimensions on which a social insurance model differs from a social welfare model. These are:

- Payment in a social insurance system is triggered by a reduction in individual market income, not in terms of being in a low-income family as in a welfare system. Many people who lose market income from job loss live in middle- or high-income families.
- Payment in a social insurance system is paid based on a previously achieved recent individual market income and income history, whereas in a welfare system it is based on a family income floor.
- Payment in a social insurance system is typically time limited. The recipient either slots back into the earnings distribution or exits the market. If their family is poor, they fall into the welfare system. In other words, the system addresses *temporary* loss of market income and consumption.

If one's vertical equity concern is for the bottom end of society, social insurance is less equitable than social insurance. Unsurprisingly, micro-simulation evidence suggests that societies whose income support systems are geared towards individual income replacement redistribute more across an individual life course and less from rich to poor families than societies whose income support systems are geared towards family income floors.[44] If one's distributional priors are poor families,

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[43] Ibid., p. 170.

[44] Ståhlberg, Ann-Charlotte (2007), Redistribution across the Life Course in Social Protection Systems: An Overview. *Modernising social policy for the new life course*, OECD: Paris. https://www.oecd.org/els/38614049.pdf.

$3.4 billion spent on social insurance is far less equitable than spending the same sum on the social welfare system.

What is more, increasing spending on middle class social insurance programmes hurts low-income families in two other ways. First, it puts a drain on the overall fiscal situation, reducing the availability of funds to help the poor. Second, the efficiency cost of a marginal tax dollar rises with the share of income taken in taxes. Thus, introducing middle-class social insurance requires a higher tax burden and consequently increases the efficiency loss of any incremental taxes which may be used to finance a more generous family welfare floor. In short, large scale social insurance programmes, such as the Forum's proposal, reduce the optimal generosity of the family income floor. [45] The 1972 Royal Commission (p. 173) note that introduction of an earnings-based system means:

> *Pressure will build up to save costs by holding down minimum benefits. To the extent to which this occurs, the "belonging" aim will have been sacrificed for the "continuity of economic status" aim.*

The Forum stubbornly fail to discuss these possibilities.

Next, turn to the employer and employee levy. The Forum presents the legal incidence as follows: "this is a scheme where both the employer and employee are expected to contribute to – and benefit from" (p. 139), with the implication this vertical redistribution is fair.[46] Their position confuses the legal distribution with the ultimate economic distribution of the levy. The advice that the Forum has received from IRD clearly indicates that the employer levy will be shifted onto workers in the form of lower wages and much if not all of the employer levies will fall on workers.[47] The consequence is likely to be an ultimate decline in real take home wages because of the policy of close to the total amount of the levy of 2.8% – not something the Forum appears keen on

[45] Feldstein, M., 2005. Rethinking social insurance. *American Economic Review*, *95*(1), pp.1-24.

[46] Page 39 appears to indirectly acknowledge the possibility of the employer levy falling on workers, but, like so much in the discussion document, it is not taken anywhere.

[47] IRD file note, "Incidence of employee and employer levy", 20 April 2021: "Overall, the literature indicates that taxes on payroll — irrespective of whether they are levied on the employer or the employee — largely result in a reduction in the take-home pay of the employee" p. 6.

publicising, especially not in the current environment where wages are being rapidly eroded by high inflation.

Now, turn to horizontal equity. Social insurance will mean our income support system will treat unemployed people – a set of people who face the shared problem of wanting a job, actively looking for one but not having one – differently according to:

- The state from which they become unemployed. People who become employed from redundancy or sickness have a more generous income support regime and an easier work test than people who become unemployed when they leave education or seek a job when their children go to school, for example. People who quit a job to become unemployed because they are being bullied or sexually harassed do not have access to social insurance
- The income of their spouse. Unemployed people on social insurance are not tested based on their intimate relationship and the income of their partner, whereas unemployed people on social welfare are tested on this basis.

Social insurance also means our income support system will treat sick or ill people differently according to the same dimensions – the market state they become sick from and their spousal status and spousal income.

The least-worst social insurance scheme

If the Forum is dogmatically attached to some form of social income insurance, as it appears to be, what is the least-worst social insurance system in terms of smoothing short-term consumption?

The following features commend themselves as building a less-worse system for achieving short-term consumption-smoothing following job loss. All the suggestions below aim to increase additionality by defining eligibility more tightly in terms of consumption-smoothing need, as well as maintaining as much philosophical consistency as possible between social insurance and social welfare, and creating as much vertical equity and middle-class welfare connection as possible:

- Set a low cap where income replacement cuts out. The maximum payment could be the full-time minimum wage, or 80% of the median wage (the amounts involved are similar).
- Rapidly abate social insurance payments against the same definition of *family* income used in the welfare system.
- Have the same employment test for social insurance as for Jobseeker benefits.

- Require the claimant to draw down monthly on Kiwisaver balances more than a minimum amount (say, $5000) at an amount up to the monthly insurance cap, before access to social insurance is granted.
- Run the system through Work and Income to ensure middle-class voice is retained in the welfare system and avoid the worst of the two-tier approach.

Overall policy recommendation: Don't go ahead with social insurance

However, there is insufficient high-quality information to having any degree of confidence in the Forum's evidence-free assertion that the benefits of introducing social insurance exceed the costs or even support for the least-worst system sketched above. Collection of higher quality information, undertaking of serious analysis and widespread proper public consultation is essential before making systemic changes of this magnitude. There may be a convincing case to be made for social insurance, but the discussion document falls far short of even the minimum expected policy standards required to make such a case.