



AIDE MEMOIRE

Early evidence on potential costs of a Social Unemployment Insurance Scheme

Date:	18 May 2021	Priority:	High
Security classification:	In Confidence	Tracking number:	2021-3686

Information for Ministers		
	Action sought	Deadline
Hon Grant Robertson Minister of Finance	To forward the Annex of this report to the Social Unemployment Insurance Governance Group.	19 May 2021

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Jivan Grewal	Policy Director, Employment, Skills and Immigration Policy	Privacy of natural persons	✓
Melody Guy	Policy Director, Employment Skills and Immigration Policy		

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

Minister's office to complete:

Noted

Overtaken by Events

Approved

Needs change

See Minister's Notes

Declined

Seen

Withdrawn

Comments



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Purpose

The purpose of this note is to provide early evidence on the potential costs of a Social Unemployment Insurance Scheme.

Recommendations

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

- a) **Agree** to forward the Annex of this report to the Social Unemployment Insurance Governance Group

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

18 / 05 / 2021

Background

The Future of Work Tripartite Forum has commissioned work to design a Social Unemployment Insurance Scheme (the Scheme). As outlined in the Terms of Reference, this is being done by the Social Unemployment Insurance Tripartite Working Group (Working Group) made up of officials and social partners from MBIE, MSD, Treasury, MOH and IR, as well as NZCTU and Business NZ.

On 20 May, the Minister of Finance plans to publicly announce that this design work for the Scheme is underway. The Working Group has prepared the attached early evidence on the potential costs of the Scheme as context for this announcement. The figures provided should not be interpreted as costing estimates, but rather provide some indication of the potential magnitude of costs. A full costings analysis will be provided to support the Social Unemployment Insurance Governance Group's decisions on policy design in late June.

Annex

Annex One: Early evidence on potential costs of a Social Unemployment Insurance Scheme

Annex 1: Early evidence on potential costs of a Social Unemployment Insurance Scheme

To: Social Unemployment Insurance Governance Group

From: Social Unemployment Insurance Working Group

Date: 18 May 2021

Briefing: Early evidence on potential costs of a social unemployment insurance scheme

Purpose

1. This briefing provides early evidence on the potential costs of the proposed Social Unemployment Insurance Scheme (the Scheme) for New Zealand.

Executive summary

2. The Social Unemployment Insurance Tripartite Working Group (the Working Group) is undertaking an extensive programme of work to provide costings of a potential Scheme. A full report on the findings of this work will be provided to support the Social Unemployment Insurance Governance Group's (SUIGG) decisions on policy design in late June.
3. To provide context for upcoming public announcements, this report provides preliminary analysis of the potential aggregate costs of the Scheme. It makes assumptions about take-up rates based on international comparisons and historical displacements rates in New Zealand, and applies these to the Scheme in a way broadly consistent with the design parameters set out in the Working Group's Terms of Reference. The resulting figures should not be interpreted as costing estimates, but rather provide some indication of the potential magnitude of costs.
4. We used historically recorded employment displacement rates of New Zealand workers due to redundancy, health conditions or disability as a benchmark for the Scheme's take-up. This benchmark suggests a total levy of between around \$1.0 and \$1.5 (per \$100 of payroll) divided between workers and employers to fund a Scheme providing up to six months of cover. These estimates will understate the actual costs of the Scheme. This is partly due to limitations in the data, but also because the take-up and duration estimates do not incorporate any behavioural responses to the Scheme.
5. An advantage of using the take-up rates of international schemes as comparisons is that they incorporate behavioural responses. However, their applicability to New Zealand is hampered by differences in scheme design and labour market context. Applying take-up

rates of the Canadian and Netherland social insurance schemes to the proposed Scheme suggests a total levy of around \$4.0 (per \$100 of payroll) respectively.

6. The wide range of potential costs demonstrates the high level of uncertainty associated with the potential effects of the proposed Scheme. This uncertainty results from the lack of directly relevant domestic or international evidence in relation to nature of the proposal. Although the Working Group expects to be able to provide more precise estimates to inform the SUIGG's policy decisions, high levels of uncertainty about take-up will remain until the Scheme is implemented.
7. The uncertainty creates significant fiscal or scheme design risks that will need to be managed. If the SUIGG wishes to mitigate these risks there are design options, summarised in this report that can both directly mitigate the unintended behavioural responses and/or reduce the overall scale of the Scheme. These options may involve trade-offs with the agreed objectives of the Scheme.

Recommendations

8. The Social Unemployment Insurance Working Group recommends that you:
 - a) **Note** that this briefing provides early thinking on the potential costs of a Social Unemployment Insurance Scheme.

Jivan Grewal
Lead, Social Unemployment Insurance Working Group

18 / 05 / 2021

Introduction and Overview of Costings Work Programme

9. The Working Group is undertaking an extensive programme of work to provide analysis of the costs of a potential Social Unemployment Insurance Scheme (the Scheme). This includes work to understand:
 - historical patterns of worker displacement
 - behavioural changes that could be generated by the Scheme, drawing from international evidence
 - costs associated with administering the Scheme
 - potential costs and cost-reductions associated with different design choices
 - implications of demographic change (especially population ageing) that could affect future scheme take-up
 - fiscal offsets created through the Scheme because of reduced take-up of other income support measures
 - the costs of schemes of other countries (although they differ in important ways from the proposed Scheme for New Zealand)
 - the distribution of net impacts across the population.

10. A full report-back on this work and costing estimates will be provided by the end of June and will incorporate an independent expert review. Drawing on the work completed to date, this report provides a:
 - preliminary analysis of the potential aggregate costs of the Scheme using various assumptions for Scheme take-up of a broadly consistent with the design parameters set out in the Working Group's Terms of Reference
 - brief summary of the likely behavioural changes that the scheme will generate
 - brief summary design options that relate to the biggest cost and/or behavioural change drivers.

Early Costings Evidence

11. A key finding from the work so far is that there are extremely high levels of inherent uncertainty about potential costs of the Scheme. While the Working Group's ongoing costings work will provide indicative estimates to inform policy decisions, much of the uncertainty will not be resolvable until after the Scheme is implemented. The practical implications of introduction of the Scheme would involve managing significant fiscal or scheme design risks.

12. The following table provides preliminary indicative estimates for the total levy (employer plus employee) that would be required to fully fund a Scheme broadly based on the design parameters set out in the Working Group's Terms of Reference. Separate estimates are provided for a Scheme covering job losses because of economic displacement or a health condition or disability (HCD). The estimates should

not be interpreted as costing estimates, but rather provide some indication of the potential magnitude of costs.

Table 1: Indicative estimates of required levy (per \$100 of payroll under \$130,000) to fund a Social Unemployment Insurance Scheme providing up to six months of cover at 80% replacement rates

Figures do not sum exactly because of rounding.

Insurance type	Take-up based on historical displacement rates in NZ (2009–18)		Take-up based on Canada scheme (2018), entitlements based on NZ median income	Take-up based on the Netherlands scheme (2018), entitlements based on NZ median income
	Entitlements based on income of historically displaced	Entitlements based on NZ median income		
Economic displacement	\$0.4	\$0.7	\$1.9	\$2.3
HCD	\$0.5	\$0.8	\$1.7	\$4.8*
Total	\$1.0	\$1.5	\$3.6	\$7.1*

*This estimate is of limited comparison value to New Zealand as explained further in paragraph 18.

13. The methodologies underlying these estimates are explained briefly below with a fuller set of underlying calculations, parameter assumptions and caveats set out in the annexes. Importantly, none of the estimates above incorporate:

- establishment costs
- administration costs, which are currently estimated to add around 7.5 per cent to costs to allow for some level of case management assuming these are not borne by the Crown
- the potential net impact of fiscal offsets generated by additional tax revenue or savings from lower supplementary income assistance.

14. The estimates assume that levies are not paid on income earned above the maximum pay-out cap of approximately \$130,000, consistent with the ACC approach. However, this is a policy choice. If levies were applied to income earned above that threshold, the required levy rates would be slightly lower.

Take-up based on historical displacement rates

15. This approach applies the historical employment displacement rates of workers in New Zealand due to redundancy, or health conditions or disability, averaged over 2009-2018 (i.e. approximately one full economic cycle, including the global financial crisis) to the Scheme parameters. In the first column (table one), the assumed level of pay outs are based on the previous income of historically displaced workers. In the second column, we have assumed that the average income of those claiming increases to be equivalent to the median income in New Zealand, reflecting likely broader take-up of the Scheme across the income distribution. In the Working Group's view, both of these sets of figures will underestimate the true costs of the Scheme because they do not incorporate:
 - workers who transition quickly into new roles (as they are not captured in the available data),
 - workers who reduce their hours of employment but stay employed or are multiple job holders who lose one job (as these are difficult to isolate from the data) or
 - any other behavioural responses to the existence of the Scheme.
16. A 12 month maximum duration Scheme based on historical data, with no behavioural response, would increase the estimated costs by around 50%. As discussed below, a parameter change like this would also result in behavioural impacts that would further increase the additional cost.

Take-up based on international schemes

17. This approach applies social unemployment insurance take-up rates in Canada and the Netherlands to the New Zealand working age population and income distribution.¹ An advantage of using the take-up rates of international schemes as comparisons is that they incorporate behaviour responses. However, their applicability to New Zealand is hampered by differences in scheme design and labour market context.
18. These two countries were selected because their labour markets and social unemployment insurance schemes are somewhat comparable to the proposed scheme for New Zealand. However, there are clearly still significant differences in labour markets and scheme design, particularly for HCD coverage. More detail about the schemes is provided in Annex 3.

¹ Take-up rates are only drawn from 2018 because of data limitations – the inclusion across a full economic cycle would therefore likely increase these numbers. The assumed pay out rate is based on New Zealand's median wage, which means any claims for partial loss would be overstated.

19. In the Netherlands, relatively high replacement rates, broad coverage (to include the partially disabled, for example), and an uncapped duration (generally following two years of employer-paid benefits) mean there are a high number of ongoing claimants, many of whom are long term. This limits the value of the Netherlands' HCD estimate in particular as a direct comparison for New Zealand. Although there are other aspects of both the Netherlands' and Canadian schemes that are more generous than the proposed Scheme, there are also aspects that are much less generous.² Therefore, it is possible that the international comparators in this note understate or overstate likely take-up and the associated costs of the proposed Scheme.

The implications of a progressive levy

20. The SUIGG will be provided with initial advice on levy design in early June. There is an equity argument for some progressivity in levy settings so that higher income earners pay relatively more (given they will be receiving greater benefit). To illustrate the potential impact of some progressivity on levy rates, if a levy-free threshold was set at around \$20,000 of earned income (to match current benefit settings), the levy rate for income earned above that level would need to increase by approximately 50 per cent.

Potential behavioural responses

21. Differences in labour market settings and scheme design will explain some of the variation between the estimates presented. However, the large differences in take-up rates in Canada and Netherlands likely also reflect behavioural responses to those schemes.
22. Given the high level of support and breadth of coverage being considered for the proposed New Zealand Scheme, its introduction will create large behavioural responses. Some of these behavioural responses will be consistent with the objectives of the Scheme, and some will be unintended. The likely behavioural responses that are most relevant to costs include:
- more employees affected by health or disability conditions deciding to stop work or reduce hours
 - some employees deciding not to take a new job immediately after becoming redundant, when they otherwise would have, or choosing to take longer to search for a new role
 - some employees 'negotiating' redundancies when they leave
 - some short-term roles that would otherwise have been fixed term contracts start being offered as permanent roles but are then followed by redundancy at the end of the short term

² For example, Canada also provides uncapped HCD-insurance, but only for those with a grave or terminal disability. The maximum for those with a sickness-related work incapacity is 15 weeks.

- some self-employed workers manipulating their business operations to take advantage of the scheme (this could include churning between unemployment insurance and new self-employed ventures).
23. Quantitatively estimating the net impact of these impacts is a challenging task. As an initial step, the Working Group has contracted Motu to summarise the available international empirical literature examining the relationship between the generosity and take-up of social insurance programmes. The early findings from this work are that many studies show changes in generosity have substantial effects on take-up.
24. However, importantly, this evidence draws from changes in, or differences between, existing social insurance programmes, rather than the introduction of a broad coverage scheme with an 80% replacement rate. It therefore has limited applicability when trying to understand the impact of introducing a new scheme.

Key design options for influencing the cost

25. Although there will be an unavoidable level of costing uncertainty with this Scheme, design choices can directly mitigate the unintended behavioural responses and/or reduce the overall scale of the Scheme. These choice could substantially reduce both the overall scale of costings and the uncertainty level associated with estimating costings. But they may involve trade-offs with the agreed objectives of the Scheme and some deviation from the parameters agreed in the Terms of Reference.
26. Participation in effective ALMP programmes could influence cost in terms of raising the probability of finding a job and level of earnings but at the cost of lengthening job search. At this stage, there is some uncertainty around the profile of the Scheme claimants and the effectiveness of the current ALMP programme offerings for the Scheme claimants..
27. Options to reduce the coverage or tighten eligibility criteria of groups where there are likely to be the highest behavioural response could include the following:

Table 2: Options to reduce coverage or tighten eligibility criteria

Option	Indication of potential impact
Excluding or reducing coverage for harder to measure health conditions (such as mental health)	Currently around half of Jobseeker- HCD are receiving the benefit because their work capacity is primarily impacted by a mental health condition. However, secondary incapacities due to other health conditions are also common.
Excluding or reducing coverage for non-standard work from redundancy	There would be a reduction in both levy revenue generated and entitlements paid out. However, there would be a reduction in the additional costs created by employers and

insurance – casual work, seasonal work, contract work, self-employment	workers rearranging their affairs to take advantage of these non-standard work arrangements. Additionally, these groups may exhibit greater behavioural response so this will reduce some of the uncertainty.
Tightening eligibility criteria – stand downs, contribution history, criteria for receipt	Difficult to assess, will depend on details of the particular measure.
Experience rating of employer levies or employer payment of initial period out of work	Difficult to assess, will depend on details of the particular measure.

28. There are also options to reduce the generosity of the scheme which would directly reduce costs and behaviour response.

Table 3: Options for Scheme generosity

Option	Indication of potential impact
Reduce the pay-out rate	A 10% reduction in the replacement rate (for example) would reduce total costs by <i>more</i> than 10% after allowing for behavioural effects.
Reduce maximum cap for pay outs	The effects of reducing the cap will depend on whether an upper income threshold is applied to levy payments. If there is no upper threshold for collecting levies, a 10% reduction in the maximum cap is expected to reduce the total costs (and levies) by less than 10%, because pay outs would only be reduced for high earners. Alternatively, similar to ACC, levies are not collected on income above the threshold and there are proportionally more claims at lower income levels (as is currently the case), then lowering the cap would reduce revenue proportionally more than costs and levies would have to rise.
Reduce the maximum duration of payments	A 10% reduction in maximum duration (for example) would lead to a direct reduction in costs by <i>less</i> than 10%. This is because some

	<p>recipients receive payments for a shorter period than the new maximum and therefore would be unaffected by changes in the maximum. However, the reduction in costs would be larger if, by lowering the potential benefit of deferring a new job, a reduced maximum duration reduced the number of recipients who chose to extend their job search.</p>
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Annex 1: Summary of Assumed Policy Parameters

The cost of a Social Unemployment Insurance Scheme depends on a range of parameters. The calculations in this paper are based on the following assumed policy parameters of the proposed scheme. In some cases data constraints mean the parameter assumptions differ from those set out in the Terms of Reference document.

Parameter	Parameters used for historical take-up benchmark estimates
Eligibility of cover	Only allows for complete displacement (i.e. not partial job loss or loss of one part-time job when multiple jobs are held)
Work types covered	Assumed that the experience observed for full-time permanent employees is also experienced by all other working arrangements.
Minimum work history	Currently assumes a minimum of 3 months employment
Replacement rate	80% with no minimum
Maximum duration	Either 6 months or 12 months
Maximum cover amount	Consistent with ACC at about \$130,000
Stand-down / wait-period	Assumed that there will be no stand-down
Ongoing eligibility requirements	Requirement such as work testing are not relevant as the historical benchmark does not include a behavioural response
Upper threshold for levy payment	Levies do not apply to annual earnings above \$130,000, consistent with ACC

Annex 2: Summary of approach for the historical comparison

Income data from Statistics NZ's Integrated Data Infrastructure (IDI) was used to identify how many people ceased earnings, how long they remained without earnings, and how much they were originally earning. This has been supplemented with data from the Household Labour Force Survey (HLFS) to indicate what proportion ceased work because of redundancy or HCD.

Limitations of the historical comparison:

- The biggest limitation of the historical comparison, by an order of magnitude, is that it does not allow for any behavioural responses to the scheme.
- Redundancies that do not result in at least a full calendar month of unemployment were not able to be included (but could be eligible for up to seven weeks of payment).
- In some cases, HLFS respondents will not have correctly identified the reason they ceased work (either over or understating the proportions used).
- Collected data allows an understanding of how many people cease earning completely for HCDs, for at least one full calendar month, but does not provide information on how many people reduce their hours of work due to an HCD. This means that the number, and cost, for HCD cover will be understated, if reductions in hours are covered by the scheme.
- This analysis assumes that cover ceases once someone starts earnings again.

The following table summarises the key parameters and resulting outcomes from this analysis. It indicates that the average annualised income is low for those who, in the past, were more likely to stop working. If any of the parameters or out workings change, then the estimated costs will also change.

Data averages January 2009 to December 2019 (this includes the GFC period)

Replacement rate	Maximum duration (months)	Cover type	Workers	Displacement rate	Claims per year	Average Annualised Income (capped)	Average monthly income	Average Duration (months)	Impact of discounting and duration	Average Cost per claim	Total Annual Cost
			A	B	C = A x B	D	E	F	G	H = E x F x G	I = C x H
80%	6	Redundancy	2.7m	2.2%	60,000	\$36,000	\$2,000	4.1	1.1	\$ 10,700	\$0.8b
		HCD		16%	43,000			4.7	1.5	\$ 17,300	\$0.8b
		Total		3.8%	103,000			4.4	1.3	\$ 13,500	\$ 1.4b
80%	12	Redundancy	2.7m	2.2%	60,000	\$36,000	\$2,000	4.1	1.6	\$ 16,700	\$0.9b
		HCD		16%	43,000			4.7	2.6	\$ 28,800	\$1.3b
		Total		3.8%	103,000			4.4	2.0	\$ 21,200	\$ 2.2b

Note: figures do not sum exactly because of rounding

In addition, these estimates have also been scaled up by assuming the average income of those claiming increases to be the same as the median income in New Zealand. This reflects likely broader take-up of the scheme across the income distribution.

Annex 3: Comparison of Proposed Scheme with the Canadian and Netherlands' Schemes

The international comparisons are based on the Canadian and Netherland schemes, as set out in the Treasury report T2021/1049. For redundancy cover, both schemes both lower replacement rates and lower maximum pay-out amounts but this should be seen in the context of statutory redundancy payments applying in both jurisdictions (these are called “transition payments” in the Netherlands, reflecting their wider applicability). Both schemes also provide lower replacement rates for HCD, and the Canadian scheme has a lower maximum cap, although both offer potentially uncapped durations for some situations. It is important to note that in the Netherlands, employers are required to fund the first two years of HCD income replacement, providing a strong incentive to encourage employment attachment. For other employees who are dismissed after illness, the transition payments apply.

Absent further detail on the New Zealand Scheme, these figures represent a starting comparison given the similarities between the countries' labour markets, but are highly uncertain. They do not represent an upper or lower bound and should not be taken as a costing.

The comparisons were calculated by applying unemployment and disability insurance take-up rates in Canada and the Netherlands to the New Zealand working age population to reach a total point in time estimate of the number of beneficiaries. These respective figures were then multiplied by 80 per cent of median pre-tax income in New Zealand. This approach assumes that those taking up insurance to cover partial income loss are paid out as though they experience full time loss, creating some upward bias to the estimates.

The approach taken does not fully account for the impact of including self-employed workers creating some downward bias to the estimates.

Table 2: Generosity of the assumed parameters of the New Zealand scheme, compared with Canadian and Netherlands social unemployment insurance schemes

	Assumed parameters of NZ scheme	Canadian 2019 benchmark ³	Netherlands 2019 benchmark ⁴
Redundancy cover			
Replacement rate	80% to a maximum of NZ\$134,000	55% up to a weekly cap of \$562CN (~\$650NZ), supplemented by	75% first two months, 70% thereafter. Daily cap of 219 euro (a weekly cap of

³ Scheme design and data up to 2019 was choose as some scheme parameters have been subsequently relaxed due to COVID-19.

⁴ The Netherland's scheme is complex. This table attempts to provide a high-level summary.

	(\$2,577 per week)	statutory redundancy payments Less generous	~\$1,850NZ), supplemented by statutory redundancy payments Less generous
Minimum work history	3 months	Employed for 420 hours of work in the preceding 52 week period (in areas of high unemployment) or 700 hours (in areas of low unemployment) Generally less generous	Tier 1: worked 26 weeks in the last 36 weeks Tier 2: in addition worked 4 of the last 5 years Less generous
Maximum duration	6 months	Between 14 and 45 weeks depending on a claimant's employment history (in normal economic times the average duration is about 3 months) More generous for standard workers; less generous for those with less work history	Tier 1: 3 months Tier 2: 4 months up to 24 months depending on employment record More generous for standard workers; less generous for those with less work history
Coverage	Includes non-standard jobs/self-employed, full and part-time jobs	Self-employed can opt into voluntary limited scheme covering health and caregiving but not economic displacement. Underlying scheme does include paid maternity leave of 15 weeks and parental benefits for up to 35 weeks as well as caregiving leave. Hard to compare	Self-employed not included but can voluntarily opt into the scheme Reduced compulsory coverage
HCD cover			
Replacement rate	80% to a maximum of NZ\$134,000	55% to a maximum of \$510.85CN per week, with potential employer add-ons Insurance payout is less generous	Around 70%, but depends on whether paid by insurance or employer and ability to work part-time, supplemented by statutory redundancy payments

			Depends on circumstances
Maximum duration	6 months	Uncapped for disability 15 weeks for sickness Less generous for sickness more for disability	Uncapped but generally only available <i>after 2 years</i> of employer-paid benefits More generous
Stringency	To be determined	Sickness: income dropped by more than 40% for at least one week when unable to work for medical reasons Disability: must be grave or terminal Unclear	Varies depending on claimant's ability to work, but generally covers illness or disability with variance based on work capacity Unclear

IDI Disclaimer

These results are not official statistics. They have been created for research purposes from the Integrated Data Infrastructure (IDI) which is carefully managed by Stats NZ. For more information about the IDI please visit <https://www.stats.govt.nz/integrated-data/>.

Access to the data used in this study was provided by Stats NZ under conditions designed to give effect to the security and confidentiality provisions of the Statistics Act 1975. The results presented in this study are the work of the author, not Stats NZ or individual data suppliers.

The results are based in part on tax data supplied by Inland Revenue to Stats NZ under the Tax Administration Act 1994 for statistical purposes. Any discussion of data limitations or weaknesses is in the context of using the IDI for statistical purposes, and is not related to the data's ability to support Inland Revenue's core operational requirements.