

## Joint report: Enhancing support for displaced workers, and other people who lose their jobs

<b>Date:</b>	16 November 2020	<b>Priority:</b>	Medium
<b>Security classification:</b>	In Confidence	<b>Tracking numbers:</b>	DPMC: DPMC-2020/21-269 Treasury: T2020/3457 MSD: REP/20/11/1080 MBIE: 2021-1213 IR: IR2020/464

Action sought		
	Action sought	Deadline
Hon Grant Robertson <b>Minister of Finance</b>	Agree to discuss next steps with officials.	1 December 2020
Hon Carmel Sepuloni <b>Minister for Social Development and Employment</b>		
Hon David Parker <b>Minister of Revenue</b>		
Hon Stuart Nash <b>Minister for Economic and Regional Development</b>		
Hon Michael Wood <b>Minister for Workplace Relations and Safety</b>		

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Elizabeth Gerard	Manager, Skills & Employment Policy, MBIE	Privacy of natural persons	
Francis van der Krogt	Principal Advisor, MBIE		✓
Katrina Quickenden	Strategy Unit, DPMC		
Laura Berntsen	Senior Analyst, The Treasury		
Diane Anderson	Principal Analyst, MSD		
Matt Nolan	Senior Policy Advisor, Inland Revenue		

The following departments/agencies have been consulted
N/A

Minister's office to complete:

 Approved Declined Noted Needs change Seen Overtaken by Events See Minister's Notes Withdrawn

**Comments**

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### Purpose

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1. This paper provides advice on enhancing support for displaced workers and other people who lose their jobs. It proposes that Ministers meet with officials to confirm the objectives and scope for future work.
2. This advice was prepared by the Ministry of Business, Innovation and Employment, the Ministry of Social Development, Inland Revenue, the Treasury, and the Department of the Prime Minister and Cabinet (Strategy Unit and Child Poverty Unit).

### Executive Summary

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3. The Future of Work Tripartite Forum has called for further investigation of support for displaced workers, including consideration of social unemployment insurance (SUI).
4. While New Zealand has flexible employment legislation, and a highly dynamic labour market, there are some persistent and emerging challenges that highlight potential gaps in support for displaced workers and others who lose their jobs:
  - a. Some workers face significant drops in income following displacement, and existing income support does not significantly smooth this transition.
  - b. The changing nature of work means that labour market resilience and flexibility will be critical to support people to adapt and take risks.
  - c. New Zealand experiences relatively high levels of wage scarring (reduced wages on re-employment) compared to other OECD countries<sup>1</sup>.
  - d. There are significant disparities in employment outcomes by population subgroup.
5. The costs and benefits of any reform to support displaced workers and others who lose their jobs will depend on scope and design choices, which in turn depend on the weighting of objectives for reform and the trade-offs and risks that are acceptable.
6. There is a spectrum of possible approaches, from SUI with different types of coverage, to modifications to the existing income support system.
7. The case for introducing SUI is finely balanced. There is significant uncertainty about behavioural responses to the possible approaches and, therefore, the costs and benefits. By design, SUI is most likely to have a net benefit for median-income, higher-income and

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<sup>1</sup> According to the OECD's 2017 *Back to Work New Zealand* study, "While not directly comparable with other OECD countries due to differences in data sources, wage losses in New Zealand seem to be large compared with OECD countries".

second-income earners. Because of this, further work on SUI is most worthwhile if the main objectives are economic: support future of work transitions, improve income smoothing, and reduce wage scarring and contribute to productivity. It would also add to New Zealand's automatic stabilisers in economic downturns (whether these are national or regional in nature).

8. Changes to the existing income support system are more likely to be effective at reducing inequality and supporting lower income and/or casual or temporary workers who are displaced.
9. Reform of financial assistance aimed at supporting the future of work also needs to be accompanied by active labour market policies that enable retraining and upskilling.
10. Officials have set out some illustrative models to highlight the benefits, trade-offs and challenges presented by different approaches, to inform a discussion with Ministers. These models are representative of the main payment choices, but not the only options available, and there is potential for a mixed model.
11. As this work evolves, it will be important to consider a number of macroeconomic issues related to implementation including the potential consequences of introduction relative to the point in the economic cycle (given it would add additional costs to employers, employees and/or the government depending on burden sharing arrangements) and the impact on the fiscal position. It will be important in developing design details to have implementation and timing issues in mind.
12. To progress this work, officials seek a discussion with Ministers about the objectives, scope and the process for further work.

## Recommendations

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1. **note** that the 27 July meeting of the Future of Work Tripartite Forum discussed an *Officials Discussion Paper on Enhancing support for displaced workers*, and invited officials to continue developing advice on options  

*noted*
2. **note** that, since the Forum, officials have identified some broad approaches to reform that cover a continuum from introducing a form of social unemployment insurance, to modifications to the existing income support settings that provide a stronger link to previous income  

*noted*
3. **note** that, since the Forum, officials have:
  - identified a range of objectives and design principles
  - developed a stronger understanding of the strengths and weaknesses of the welfare system in mitigating income loss
  - identified the family groups that could benefit from enhanced financial support
  - outlined some broad alternative financing arrangements

- developed illustrative models for enhancing support, and commented on these in light of the objectives and principles

*noted*

4. **note** that officials now seek guidance from Ministers on next steps

*noted*

5. **note** that there is a range of options for how to conduct further work

*noted*

6. **agree** to meet officials to provide direction on the objectives, scope, and process for conducting further work

*agreed*

*Minister of Finance*

7. **forward** this briefing to the Prime Minister for her information.

*agreed*

Paul Stocks  
**Deputy Secretary**  
Labour, Science, and Enterprise, MBIE

13 / Nov / 20

Simon MacPherson  
**Deputy Chief Executive**  
Policy, MSD

13 / Nov / 20

David Carrigan  
**Deputy Commissioner**  
Policy and Regulatory Stewardship, IR

13 / Nov / 20

Vicki Plater  
**Director**  
Growth and Public Services, The Treasury

12 / Nov / 20

Paul O'Connell  
**Director, Strategy Unit**  
Department of the Prime Minister and Cabinet

12 / Nov / 20



Hon Grant Robertson  
**Minister of Finance**

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Hon Carmel Sepuloni  
**Minister for Social Development and  
Employment**

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Hon David Parker  
**Minister of Revenue**

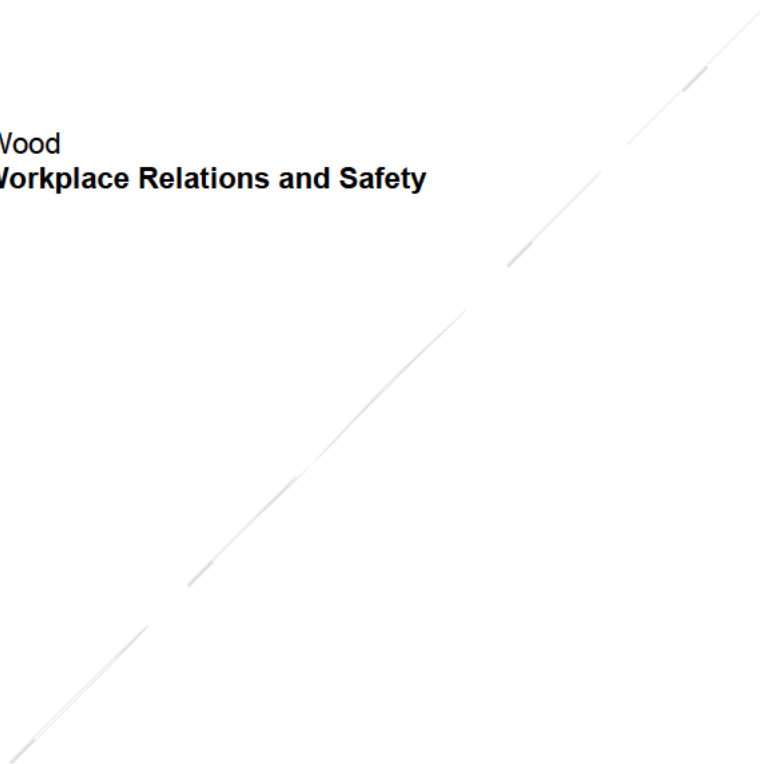
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Hon Stuart Nash  
**Minister for Economic and Regional  
Development**

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Hon Michael Wood  
**Minister for Workplace Relations and Safety**

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## **Background: The Future of Work Tripartite Forum has called for further investigation of support for displaced workers and others who lose their jobs**

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13. Displacement, and the support available for displaced workers have been focus areas for the Future of Work Tripartite Forum.<sup>2</sup> The social partners invited Ministers to consider an enhanced package of support for displaced workers, with key components including:
- a. social unemployment insurance (SUI), more closely aligned to the treatment of workplace accidents through the Accident Compensation Scheme; and
  - b. enhanced access to employment services, retraining and upskilling.
14. Following the July Forum meeting, officials were invited to continue developing advice on the advantages and disadvantages of adopting a social unemployment insurance scheme, in addition to the current systems for supporting displaced workers.

## **The labour market is flexible and dynamic but there are gaps in support for workers losing their jobs**

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15. The Government's aspiration is for a productive, sustainable and inclusive economy, including labour market settings that encourage investment in the new skills the workforce will need now and for the future.
16. New Zealand has flexible employment legislation and a highly dynamic labour market. Employment legislation is less strict than in other OECD countries and redundancy notice can be very short. Job tenure in New Zealand is among the lowest in the OECD<sup>3</sup> and there is a high degree of churn.
17. The New Zealand workforce is overwhelmingly comprised of full-time permanent employees (62.7%), and part-time permanent employees (11.3%). Additionally, there is a small number in various forms of temporary employment (6.6%, or 8% as a proportion of all employees). The balance are employers (6.3%) and self-employed people (12.0%).<sup>4</sup> The Productivity Commission has found little change in working arrangements over the past 10 to 15 years.<sup>5</sup> Non-standard working arrangements – such as temporary and casual work – are not synonymous with labour market precariousness, but many non-standard workers are at high risk of poor labour market outcomes.
18. Prior to the onset of COVID-19 there were sustained increases in average incomes and labour market participation, as well as relatively low levels of unemployment<sup>6</sup>, including among groups with persistently poorer outcomes. However, there were still significant

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<sup>2</sup> See *Future of Work Tripartite Forum Strategic Assessment*, <https://www.treasury.govt.nz/information-and-services/nz-economy/future-work-tripartite-forum>

<sup>3</sup> OECD. (2017). *Back to Work: New Zealand: Improving the Re-employment Prospects of Displaced Workers*. Paris: OECD Publishing.

<sup>4</sup> Statistics New Zealand. (2018). *Survey of Working Life*. <https://www.stats.govt.nz/reports/survey-of-working-life-2018>.

<sup>5</sup> New Zealand Productivity Commission. (2019). *Labour market trends: What we know...* <https://www.productivity.govt.nz/assets/News/a7448b620a/Labour-market-trends-What-we-know.pdf>

<sup>6</sup> New Zealand's unemployment rate fell to 4% in the last quarter of 2019 from 4.2% in the previous period and below market expectations of 4.2%. The number of unemployed people dropped by 3,000 to 111,000, driven by 3,000 fewer unemployed women. At the same time, the underutilisation rate went down to 10% from 10.4% in the third quarter, its lowest level since the June 2008 quarter.

disparities in employment measures by population subgroups, which SUI is unlikely to address. COVID-19 has led to significant job losses across a range of sectors.

***Involuntary job loss has a substantial impact on wellbeing***

19. Evidence suggests that the effects of job loss are felt long beyond re-employment, and can include negative effects on health, child outcomes, earnings, and productivity.<sup>7</sup>
20. Displacement, or redundancy, routinely occurs in dynamic economies and tends to increase substantially during periods of significant economic change, with effects that are not distributed evenly.
21. New Zealand has had relatively low rates of redundancy compared to similar OECD countries. Only a small fraction of people who leave a spell of employment each month are formal redundancies. Estimates are that, under normal economic conditions, about 30-40,000 employed people (out of a workforce of 2.7 million) are likely to be made redundant each year.
22. By comparison, about 30,000 people per month experience sudden and substantial falls in earnings. Some of these income drops reflect voluntary exits from the labour market (resignations). However, others reflect a range of involuntary exits, including:
  - a. the onset of health conditions or disabilities that affect people's capacity to work
  - b. the need to care for children or other dependents
  - c. the termination of seasonal or fixed-term work with no follow-on employment
  - d. dismissals.<sup>8</sup>
23. There is currently no statutory provision in New Zealand for redundancy payments, or for defined notice periods, although these may be included in employment agreements. Data on redundancy provisions and payments in New Zealand are limited, especially for those workers not covered by collective agreements.
24. Approximately 20% of employees are covered by collective agreements and the vast majority of these are entitled to redundancy payments. However, most workers are covered by individual employment agreements.
25. Research from 2008 found that only 20% of staff employed in small- to medium-sized enterprises on individual employment agreements were entitled to redundancy payments.<sup>9</sup> Most employees work for large enterprises, however, and we do not know if people on individual agreements in these enterprises are entitled to redundancy payments. Annex One provides more information on redundancy payments.

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<sup>7</sup> Von Wachter, T. (2016). *Unemployment insurance reform: a primer*. Washington: Washington Center for Equitable Growth, US. <https://equitablegrowth.org/unemployment-insurance-reform-primer/>

<sup>8</sup> Internationally, almost all SUI schemes exclude people who are dismissed or voluntarily leave a job. Income support provided via welfare systems typically include such people, although sometimes longer stand-down periods are applied.

<sup>9</sup> New Zealand Productivity Commission. (2019). *Employment, labour markets and income: Technological change and the future of work*. <https://www.productivity.govt.nz/assets/Documents/cda798cbb9/Draft-report-2-Employment-labour-markets-and-income-v3.pdf>



***Labour market resilience and flexibility will be important in responding to future labour market shocks and the changing nature of work***

26. Alongside cyclical labour market changes there are broader changes that may also lead to job loss. The trends described in the Tripartite Forum's *Future of Work Strategic Assessment* – rapid globalisation, technological change, climate change, and demographic change – are widely expected to lead to more frequent worker displacement and possibly an increase in income inequality and in non-standard work. The extent to which New Zealand will follow these trends is unclear.
27. Prior to COVID-19 there was little evidence of significant long-term unemployment, but it is unclear to what extent the current recession will contribute to deeper structural changes already underway in the labour market or prompt new structural changes, that potentially require more significant retraining to support labour market transitions.
28. Because of these broad international trends, the OECD, the Productivity Commission, the Welfare Expert Advisory Group and the social partners have all emphasised the need for support for displaced workers. Additional and/or more certain financial support in the event of involuntary job loss would provide improved flexibility and security that could enable workers and employers to take risks in new and emerging sectors. This also relies on effective labour market transitions, including support that enables shorter- and longer-term retraining and upskilling. Annex Two presents an overview of the support that promotes smooth transitions.

***Current income support settings focus on providing a minimum level of family income***

29. Current income support settings are designed to provide a minimum level of income to those who are not in work, adjusted for particular essential costs households face. In the event of involuntary job loss, workers who face a sudden loss of income may struggle to meet fixed costs, potentially leading to significant hardship. Low replacement rates for people can exacerbate challenges for those adjusting to involuntary job loss. Evidence from the United States indicates that SUI payments help stabilise housing costs for those eligible for the duration they receive payments and can help avoid mortgage defaults (although with some potential unintended consequences for bank lending and the ability to move to where jobs are).<sup>10</sup>
30. For some people, New Zealand's current income support system provides relatively high income replacement rates when people are displaced. This is particularly the case for:
  - a. lower income earners receiving supplementary assistance
  - b. people with dependent children
  - c. people who are unable to work following an injury (via the Accident Compensation scheme).
31. Those with lower income replacement rates tend to be people who have a partner still earning, people who have previously had higher family incomes, or people with cash assets. Annex Three provides some example families and shows replacement rates for a range of different circumstances.

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<sup>10</sup> Hsu, J. W., D. A. Matsa and B. T. Melzer. (2018). *Unemployment insurance as a housing market stabilizer*. *American Economic Review* 108 (1), 49–81. <https://pubs.aeaweb.org/doi/pdf/10.1257/aer.20140989>  
Hsu, J. W., D.A. Matsa and B. T. Melzer. (2014). *Positive Externalities of Social Insurance: Unemployment Insurance and Consumer Credit*. NBER Working Paper No. 20353. <https://www.nber.org/papers/w20353>



32. In recent years, New Zealand has introduced bespoke initiatives to provide additional financial assistance and widen eligibility for assistance following events causing large scale economic distress, highlighting concern about the adequacy of income support for some groups. For example, additional financial support has been made available following the Global Financial Crisis in 2008, the Canterbury earthquakes in 2010 and 2011, and this year in response to COVID-19.

***New Zealand has relatively high levels of wage scarring compared to other OECD countries***

33. Wage scarring describes the reduction in wages that displaced workers often experience on re-employment. Estimates of wage scarring effects are a useful quantifiable proxy for how economic disruption affects workers. Wage scarring represents a personal loss for households and can imply that workers are producing less value than their potential. As such, wage scarring has an adverse impact on productivity, which in turn implies lost value for firms.

34. Using New Zealand data, Hyslop and Townsend (2017, 2019) show that in the first year after a displacement event, displaced workers are 20-25% less likely to be employed and receive 30% lower earnings conditional on being employed. In addition to these short-term effects on earnings and consumption, Hyslop and Townsend (2017) find that, five years after displacement, displaced workers still suffer from an 8-12 percentage point employment deficit and a 14-20% conditional earnings deficit. These are average results, and there is significant variation in outcomes between individuals.

35. In aggregate, this suggests a large overall cost to individuals in the form of lost wages. The five-year wage scarring impacts arising from the displacement of workers in a single year of economic 'upswing' could be approximately \$3.3b, assuming 31,000 people are displaced. This estimate increases to \$8.8b, assuming 65,000 people are displaced in an economic downturn.<sup>11</sup>

36. Job loss is the trigger for wage scarring, but a wide range of factors influence future incomes and their impacts are not well understood in New Zealand. Some degree of wage scarring is inevitable in a dynamic labour market. Relatively high levels of wage scarring could be due partly to modest levels of support afforded to displaced workers. Low levels of income replacement and modest employment support could lead to shorter and less effective job searches. New Zealand's small and thin labour markets also make it harder for workers – particularly those in specialised fields – who lose a job to find suitable new employment. These factors make it difficult to quantify the potential impact of SUI on reducing wage scarring, but the scale of wage effects and their economic impacts means it is worth considering further.

***The private insurance market is unlikely to fill this gap***

37. There is a role for government in enabling further financial support for displaced workers, since the private market alone is unlikely to provide this function. Unemployment insurance is prone to the market failures of adverse selection and moral hazard. These effects undermine the coverage and affordability of unemployment insurance. Adverse selection occurs when high risk individuals opt into insurance, and low risk individuals opt out. Because of this, internationally, unemployment insurance is usually provided as *social insurance*, with participation compulsory or strongly encouraged. The Accident

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<sup>11</sup> Hyslop, Mare, Noy and Sin. (2020). *Involuntary Job loss: Welfare effects, earnings impacts, and policy options*. Wellington: Motu Economic and Public Policy Research.

Compensation Scheme is a New Zealand example of social insurance.

## **Possible objectives and principles for reform**

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38. This section sets out a broad range of possible objectives for introducing different settings to support displaced workers, with a focus on the gaps or opportunities they address, and the challenges and trade-offs they raise. It also sets out some proposed principles to underpin any reforms.
39. It will be important for Ministers and officials to have an early discussion about the preferred weighting of objectives, any additional objectives, and the trade-offs and desired balance between them.

### ***Objective 1: Improve income smoothing or transition support for displaced workers***

40. The earlier discussion highlights the challenges some people face meeting costs when they are displaced. There is potential to improve support for people who do not qualify for income support or for whom current replacement rates are often comparatively low:
- a. median and higher income earners
  - b. two income families when one partner is displaced
  - c. people leaving work due to illness or disability not caused by an injury, or to undertake caring responsibilities.
41. Greater income smoothing has some trade-offs: higher replacement rates for and related financing of financial assistance can reduce work incentives and lead to longer periods of unemployment. Furthermore, higher replacement rates increase the overall cost of a scheme, including government contributions.

### ***Objective 2: Responding to future labour market shocks and the changing nature of work***

42. Paragraph 26 above notes the trends underway that are likely to disrupt the economy and workforce over time. It is important to ensure that financial support systems are responsive to frequent, unpredictable changes in earnings; and that there are employment services that are effective in enabling transitions.
43. The social partners argue that protection against large income drops is needed to reduce anxiety arising from the future of work trends, to share the costs of change widely across society, and to build the social licence for economic transitions. The Productivity Commission has noted that effective income support systems can contribute to productivity growth and greater wellbeing by making workers less fearful about switching jobs.
44. Internationally, social unemployment insurance schemes have struggled to support a growing number of non-standard workers (particularly casual, fixed term and seasonal work). Unemployment insurance can be technically difficult to administer for some types of non-standard working arrangements, and can lead to perverse incentives on working people and employers, contributing to higher scheme costs.
45. This objective will need to be balanced against overall costs (including government contributions) and the impact on work incentives for different groups.



**Objective 3: Reduce wage scarring**

46. Paragraph 33 presents estimates of the impact of wage scarring in New Zealand. Wage scarring effects are a quantifiable proxy for how economic disruption affects workers' incomes, and their productivity in subsequent employment. Reducing wage scarring is therefore a desirable economic objective, with benefits extending beyond the individual workers.
47. Reducing wage scarring is challenging given the range of factors that bear on workers' outcomes, and the modest effectiveness of labour market interventions, such as active labour market programmes (ALMP). This means we need to be realistic in seeking to reduce wage scarring effects. At the same time, an intervention that was even modestly effective could still represent value for money, given the broader impacts that wage scarring could have on productivity.
48. An income-contingent payment for displaced workers (and other people who involuntarily lose their jobs) could help reduce wage scarring by enabling a job search of a sufficient duration for a worker to obtain the best skill match, and also to participate in ALMPs where skill development or retraining was needed.
49. Empirical research does not show a strong link between search duration and re-employment wages.<sup>12</sup> This may in part be because existing support systems for displaced workers in other countries do not expressly target reduced wage scarring as an objective. Equally, an overly long job search can lead to skills atrophy, loss of labour market attachment, loss of confidence, and may send a negative signal to prospective employers.
50. Reducing wage scarring in New Zealand would require very careful design of the level and duration of financial support; the availability of employment support and education and training (including settings that support participation); and the obligations placed on job seekers.

**Objective 4: Strengthen automatic stabilisers to enhance New Zealand's response to recessions or widespread economic distress**

51. At a macroeconomic level, widespread job losses that lead to large decreases in income can deepen and prolong recessions through reduced consumption. Existing transfer payments act as quick automatic stabilisers during downturns: when more workers file for benefits, the welfare system automatically accommodates this need by providing income support and employment interventions. However, main benefits provide a low wage replacement rate for some household types (particularly higher earners and those with earning partners). More closely linking income to lost wages and salaries reduces the need for people to abruptly reduce consumption while meeting broader economic stimulus objectives. This can apply at a regional level where there are regional shocks (e.g. national disasters).
52. As noted in paragraph 32, New Zealand has introduced bespoke settings to respond to crises in recent years, and a stronger automatic stabiliser may reduce the need to do this in the future. Stronger automatic stabilisers are also likely to be particularly beneficial when very low interest rates make it more difficult for monetary policy to respond to negative fluctuations in the economic cycle. However, it is worth noting that most comparable countries have also amended their welfare or SUI systems and settings to

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<sup>12</sup> Farooq, A, Kugler, A.D. and Muratori, U. (2020). *Do Unemployment Insurance Benefits Improve Match Quality? Evidence from Recent U.S. Recessions*. NBER Working Paper No. 27574 July 2020. <https://www.nber.org/papers/w27574.pdf>

recognise the impact of COVID-19, so it may not be possible to eliminate the need for bespoke settings in future crises.

## **Any reform needs to be underpinned by some key principles**

### ***Principle 1: Enhance or maintain work incentives***

53. Evidence suggests that adequately paid sustainable work is generally beneficial for individuals and their families<sup>13</sup>, and reduces the rate of child poverty<sup>14</sup> in households, so it is important for any changes to settings to focus on maintaining or enhancing incentives to take up suitable work.
54. The principal trade-offs of financial assistance are between the generosity of payments, the relation of the payments to contributions, and the maintenance of work incentives. Generous payments support people who are displaced or unable to work, but dampen their incentives to engage in job search, potentially leading to increased unemployment. Unemployment insurance may also lead to a risk of reduction in work effort once sufficient contributions have been made.
55. The following settings assist in maintaining work incentives:
  - a. time limits on SUI benefit receipt
  - b. encouraging return to work through monitoring and enforcement of work search requirements
  - c. the use of effective ALMPs to retrain and upskill displaced workers.

### ***Principle 2: Treating similar people in a similar way, and improving outcomes for the most disadvantaged***

56. A broad range of equity considerations arise depending on decisions about the scope and coverage of any scheme being investigated. Poor scheme design could potentially entrench or exacerbate existing inequalities. There are two types of equity considerations to keep in mind when considering reform:
  - a. *Horizontal equity*: Treating people in similar circumstances in a similar way.
  - b. *Vertical equity*: Redistributing from those with the ability to pay to those in need.
57. There are significant trade-offs between overall cost, income adequacy for people in different circumstances, horizontal and vertical equity, and work incentives. All options analysis needs to be clear about equity implications and identify the people who are likely to benefit most or least.

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<sup>13</sup> Cumock, E., Leyland, A.H., & Popham, F. (2016). *The impact on health of employment and welfare transitions for those receiving out-of-work disability benefits in the UK*. *Social Science and Medicine* 162: 1–10. <http://doi.org/10.1016/j.socscimed.2016.05.042>; OECD. (2018b). *Mental Health and Work: New Zealand*. Paris: OECD Publishing. <https://doi.org/10.1787/9789264307315-en>; Rea, D., Anastasiadis, S., Benny, V., Jhe Lee, W., Smith, C., and Vandenbroucke, B. (2018). *Exploring a new approach to wellbeing measurement: Are people who move from benefit to paid employment better off?* Prepared for the Welfare Expert Advisory Group, October 2018, Wellington: Ministry of Social Development & Social Investment Agency.

<sup>14</sup> Perry, B. (2019). *Household incomes in New Zealand: Trends in indicators of inequality and hardship 1982 to 2018*. Wellington: Ministry of Social Development.



***Principle 3: Overall cost and distribution of cost impacts avoids unintended consequences***

58. Decisions about the scope and coverage of any change to settings will have costs, which may accrue to the government, employers and employees. These need to be balanced against the likely outcomes and possible unintended consequences. Introducing new levies could affect employers' hiring decisions and individual or household decisions about employment participation.
59. There are some integrity risks that may arise from the introduction of an insurance model and levies for employers and employees, including:
- a. Employers and employees may agree to classify voluntary separation as redundancy to enable access to higher payments.
  - b. Workers may be miscategorised to avoid levies, affecting other worker protections or entitlements.

***Principle 4: Coherence and consistency with wider settings***

60. Judgements will be needed about how to integrate any new initiatives or changes to settings with existing settings across a range of areas (existing income support, tax settings, ACC, labour market settings and employment regulation, and health).

**Illustrative models for reform**

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61. There is a continuum of approaches to reform, including insurance models with different scope and coverage, and approaches within the existing income support system that create a stronger link to previous incomes.
62. Table 1 presents models to illustrate the general trade-offs and better identify who is supported by possible approaches to providing greater support to displaced workers. Table 2 assesses the models against the potential objectives and principles. These models are representative of the main payment choices, but not the only options available, and there is potential for a mixed model:
- a. **Approach A: Individualised payment linked to income loss for standard workers.**
  - b. **Approach A1: Individualised payment linked to income loss: standard and non-standard workers.** This is a variation on the choice above that focuses on the inclusion of non-standard workers (particularly those in more precarious casual, fixed-term, or temporary arrangements).
  - c. **Approach A2: Individualised payment linked to income loss that includes workers with health conditions and disabilities.** A further variation on approach A, focusing on the inclusion of people who exit work due to health conditions and disability and who are not currently supported by ACC.
  - d. **Approach B: Adjust the welfare system to provide a time-limited individualised payment.** Settings that could be adjusted to provide increased support to displaced workers include higher earnings disregards, disregarding partner income, and payment rates.

63. It is worth noting that each of these approaches could also be compatible with a wage subsidy or short-time compensation scheme to enable more firm and worker-specific decisions related to the prioritisation and sustainability of attachment vs. reallocation.
64. Funding for reform can be raised in three ways: through the general fund (and implicitly from one of or a combination of higher general taxation, higher debt, or cuts elsewhere), through a payroll tax or flat employee levy, or through a mix of employee and employer levies with experience/risk ratings attached. In general, it is more justifiable to use levies for insurance-based models (A, A1 and A2), while changes to the welfare system would be funded from general taxation (B). Pages 18 - 20 below provide more information on potential costs and financing arrangements.
65. These approaches are high level and focus on scope and coverage questions. Further work will need to focus on design issues not addressed here, such as abatement regimes, levy rates and who pays. The illustrative approaches make some assumptions about some aspects of change that would need to be considered further, including replacement rates, the duration of payments and the provision of active labour market programmes. Annex Four provides some selected international comparisons to show the variety of settings different countries use.
66. Alongside any reform of financial assistance, there are complementary mechanisms to provide support to displaced workers, including active labour market policies (Annex Five) and statutory redundancy payments (Annex One). Statutory redundancy payments and social insurance both provide financial support for displaced workers, and they may partly be substitutes for each other. For example, a more generous insurance payment would reduce the role of a statutory redundancy payment. The two instruments have different effects on incentives however, so there may well be a role for both, and they ought to be considered together.

Table 1: Example models and the broad settings to illustrate the general trade-offs and better identify who is supported by possible approaches to providing greater support to displaced workers

	Approach A: Individualised payment linked to income loss for standard workers.	Approach A1: Individualised payment linked to income loss: standard and non-standard workers.	Approach A2: Individualised payment linked to income loss that includes workers with health conditions and disabilities (HC&D).	Approach B: Adjust the welfare system to provide a time-limited individualised payment.
<b>Triggering event</b>	Redundancy	Redundancy (or equivalent)	Redundancy, employment loss due to a health condition or disability	Employment loss
<b>Workers covered</b>	Standard workers	Standard and non-standard workers (eg casual, seasonal, fixed-term, self-employed) with sufficient recent work history	Standard and non-standard workers with sufficient recent work history involuntarily unemployed due to redundancy or exited work due to a health condition or disability	Standard and non-standard workers
<b>Duration</b>	6 months	6 months. May be less for NS workers	6 months	3 months
<b>Rates</b>	50 – 80%	50 – 80%	50 – 80%	Individualised, flat-rate payment at the main benefit rate or somewhere between minimum wage and the main benefit rate
<b>Annex 3</b> estimates the incomes of 12 example families under two theoretical social insurance schemes and the existing welfare system to illustrate the extent to which different approaches smooth income.				
<b>Partial payments</b>	No	Yes	Yes	No
<b>Jobseeker obligations</b>	Yes, moderate	Yes	Yes	Yes, high
<b>ALMPs</b>	Job search support and career advice with a focus on efficient matching		Job search support and career advice with a focus on efficient matching Integrated health and employment case management Access to vocational rehabilitation services	Job search support and career advice with a focus on efficient matching
<b>Employers</b>	Possibly regulations that promote re-employment and discourage unnecessary redundancies (eg notice periods, statutory redundancy, notification to public employment services)		As per A & A1 Regulations that promote re-employment for HC&D eg notification of sick leave, requirements to cover the first 2 weeks of sick leave, experience rating, requirements to maintain employment relationships	Possibly regulations that promote re-employment (eg for HCD) and discourage unnecessary redundancies (eg notice periods, statutory redundancy, notification to public employment services)
<b>Caps</b>	ACC caps weekly compensation at \$134,328 per annum (as at 1 July 2019) but this is high in comparison with international SUI schemes A cap could be closer to a proportion of or above minimum or median wages			Partner earnings above a certain threshold (eg eligibility for the COVID Income Relief Payment is capped at \$2,000 in partner earnings per week).
<b>Cost sharing/ Financing</b>	Government, employers, workers			General taxation
<b>Type of fund</b>	There is a range of choices			Pay as you go
<b>Who administers the insurance and employment support</b>	Range of choices for delivering insurance and employment functions: departmental, ACC, new crown entity, regulated markets			MSD



**Table 2: Assessment of the illustrative models against the principles and objectives**

	Objective 1: Improve income smoothing or transition support for displaced workers	Objective 2: Responding to future labour market shocks and the changing nature of work	Objective 3: Reduce wage scarring	Objective 4: Add an automatic stabiliser to enhance New Zealand's response to recessions or widespread economic distress	Principle 1: Enhance or maintain work incentives	Principle 2: Treating similar people in a similar way, and improving outcomes for the most disadvantaged	Principle 3: Overall fiscal cost and distribution of cost impacts avoids unintended consequences	Principle 4: Coherence and consistency with wider settings
<b>Approach A: Individualised payment linked to income loss for standard workers.</b>	- Greatest additional income smoothing benefit to median and higher income earners with established work histories and second income earners in a household.	- A direct link to previous income loss may support greater security and flexibility. - Could change incentives for employers and for design and targeting of ALMPs.	- Targets those with an established work history. - The additional impact on wage scarring over and above existing settings or approach B is difficult to quantify.	- Direct link to incomes likely offers a higher level of automatic stimulus in a recession. - However, if job loss is concentrated among lower income, temporary or casual workers who are less likely to be eligible for the scheme, the marginal impact over existing settings or approach B may not be significant.	- Design choices on replacement rates and payment durations are critical, as higher payments may reduce work incentives.	- Provides support proportionate to contributions into the scheme. - Differentiates based on the reason for job loss. - Is likely not to be targeted to the most disadvantaged.	- Risk of creating incentives for employers to miscategorise workers (if some types of worker attract employer contributions while others don't). - Potentially high establishment costs, and ongoing administration costs. - If high costs are passed on to employers, there is a risk of negatively affecting hiring decisions.	- Requires a new system to collect and administer levies. - Adds an additional layer to existing settings (on top of existing income support and ACC).
<b>Approach A1: Individualised payment linked to income loss: standard and non-standard workers.</b>	<p>- The difference from Approach A is that a broader range of employment types would be covered by the scheme. Discussion below focuses on the aspects that would be different from Approach A. The social partners strongly favour extending insurance coverage (costs and benefits) to non-standard workers to the fullest extent possible. In recent years, other countries with social insurance schemes have struggled to effectively cover a growing number of non-standard workers.</p> <p>- Some non-standard working arrangements do not naturally fit an insurance paradigm, particularly casual, fixed-term, seasonal and temporary work. There is a challenge in determining the appropriate way to collect taxes or levies from those in some forms of non-standard employment and determining who is the employer, particularly for contractors and self-employed people.</p> <p>- A key design consideration is the tension between payment generosity and work incentives. Coverage for such employment may rely on setting minimum payments above benefits and not having significant contribution requirements – this has to be traded off against reduced work incentives or perverse incentives (eg higher payments than they received while in work or gaming of seasonal or contract work to maximise entitlements).</p> <p>- Annex Six provides more detail on non-standard employment.</p>							
<b>Approach A2: Individualised payment linked to income loss that includes workers with health conditions and disabilities.</b>	<p>- This approach is another variation of Approach A, which focuses on including people exiting work because of a health condition or disability, who have no or limited work capacity. Discussion below focuses on the aspects that would be different from Approach A.</p> <p>- People with impairments resulting from an injury receive support from ACC while those with the same impairments arising from an illness receive different levels of financial and non-financial support from the welfare and health systems. Including people with health conditions or disabilities in a scheme providing time-limited individualised payments linked to loss of employment would potentially address some of the equity issues between benefit and ACC.</p> <p>- However, the potential cost of including people with a health condition or disability in a scheme is significant. It would likely be much larger than a scheme focused on displacement, given the larger volumes (especially given the risks of unintended consequences and behavioural effects from employers and workers), and the lengthy durations of many health conditions and disabilities.</p> <p>- In most countries, health and disability insurance programmes are large and growing, both in expenditure and in number of recipients for a range of reasons. There have been efforts to manage the increasing costs associated with disability insurance schemes, but success has been limited.</p> <p>- Annex Seven provides more detail on the pros and cons on including people exiting work with a health condition or a disability.</p>							
<b>Approach B: Adjust the welfare system to provide a time-limited individualised payment.</b>  This approach also has coverage choices re standard / non-standard workers, and people with health conditions & disabilities.	- Provides greater income smoothing for a broader range of people than current settings, especially for those on lower incomes. - Potentially particularly beneficial for second income earners in a household who are displaced. - Higher income earners would still be likely to face relatively low replacement rates if they qualify for assistance.	- Minor contribution by itself as an incremental addition to current settings.	- It may have some impact on wage scarring through enabling longer job search and better job match for those who qualify. - May support young workers, who are disproportionately impacted by economic downturns, to make better matches.	- Provides some additional level of automatic stabilisation in economic downturns over current settings, but probably less than Approach A and its variations.	- Design choices on replacement rates and payment durations are critical, as higher payments may reduce work incentives. - Higher earnings disregards may improve incentives for people to take up work.	- Provides a flat-rate payment regardless of contributions or losses. - Is relatively more targeted to people losing low incomes (since replacement rate more closely approximates loss, and since low-income earners contribute less tax).	- Less costly to establish and administer, as it is likely to work within existing systems.	- Does not represent a significant change to existing settings.



## **There is likely to be little impact on progress towards the child poverty targets**

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67. Any impact on child poverty would depend on a number of factors such as the design of the scheme, length of entitlement, replacement rate, and coverage. It would also depend on what other policy options were progressed in the tax/welfare space, such as potential changes to Working for Families or other changes to welfare settings. The approaches discussed here of individualised payments linked to prior income are likely to have little to no impact on progress towards the child poverty targets.
68. An example family analysis (Annex Three) estimates the incomes of 12 example families under two theoretical social insurance schemes (a 60 and 80% replacement rate) and the existing welfare system to illustrate the extent of income smoothing for the different approaches.<sup>15</sup>
69. The analysis shows that a sole parent displaced from a full-time low-income job receives the same level of income whether they are on a benefit or receiving social insurance (at a 60% replacement rate). At an 80% replacement rate they are marginally better off on social insurance. When housing costs are accounted for, this sole parent family is below the poverty line on a benefit and on social insurance (at a 60% replacement rate), but just above the threshold on an 80% replacement rate.
70. The graphs show that for those displaced from low and median-income jobs, they are still getting considerable support from the welfare system, whether they are receiving social insurance or welfare support alone, due to the Accommodation Supplement and Working for Families payments and, in some cases Temporary Additional Support. They also do not reflect the additional income a person can earn by working part-time while on a benefit – and the proposed changes to increase the benefit abatement threshold would mean people can work for more hours before their benefit is reduced. It is unclear how social insurance payments might be affected by working part-time while receiving payments – it would depend on the design but it is reasonable to assume the replacement rate would be lower.
71. As the other example families show, social insurance has a more positive impact for higher earners, and for households where one partner is still working, as welfare support is significantly reduced with an earning partner (refer to Annex Three).

## **Providing individualised payments to displaced workers will come at a significant cost**

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72. Direct costs include the higher payments, the cost of ALMPs, establishment and administration costs. The more generous a scheme (and the greater the demand), the greater the costs.
73. As discussed by the Tripartite Forum in July, the Ministry of Social Development has conducted a first round of modelling to estimate the costs of an unemployment insurance scheme, assuming different combinations of rate and duration.
74. The modelling includes full-time, part-time, permanent, and fixed-term employees, but excludes the self-employed. The modelling assumes a cap on income that is eligible for replacement cover, similar to the ACC model. ACC caps weekly compensation at

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<sup>15</sup> The results reflect assumptions chosen and should be viewed as preliminary and indicative only.

\$134,328 per annum (as at 1 July 2019).<sup>16</sup>

75. The modelling estimates the costs of insurance payments, excluding the costs of operating the scheme itself, or delivering new ALMPs. The cost of additional ALMPs would likely be substantial. This cost would depend on the number of people claiming insurance and for how long, the conditions attached to the insurance, and the nature of the employment support provided (more or less intensive).
76. The modelling also excludes any behavioural impacts (such as people taking longer to search for work), or impacts on firm decision-making. Undesirable behavioural effects could be particularly significant if coverage included people with a high degree of control over whether they work or not, such as the self-employed. Equally, the modelling excludes the particular recovery and adjustment costs that could arise from supporting people with health conditions or disabilities. The modelling also excludes any indirect and unintended costs.
77. Cost estimates are highly sensitive to volumes of displacement, and these are uncertain. To take one scenario, at a displacement rate of 3.3% annually (75,000 employees displaced) with an entitlement period of up to twelve months, and a replacement rate of 80% of lost income, the annual average cost per displaced worker would be around \$14,000, or around \$0.8-\$1.3 billion per annum. Financing this cost could require an average annual payment of around \$350-\$600, or around \$0.65-\$1.10 per \$100 earned per worker. By comparison, the average ACC levy for the Work Account is \$0.67 per \$100 of liable earnings, and the average ACC levy for the Earners' Account is \$1.21 per \$100 of liable earnings. As such, accident compensation costs are shared by employers and workers.
78. A 3.3% annual displacement rate likely overstates the displacement that occurs in an average year, but usefully illustrates the cost of a large number of claims.
79. Any subsequent work would need to include more detailed cost modelling. The cost modelling would need to account for variables not yet considered (such as behavioural impacts), and reflect the coverage of the scheme (such as whether to cover people developing health conditions and disabilities.) Cost modelling could then inform assessment of financing arrangements.

## **Financing arrangements are critical**

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80. In conjunction with the income replacement provided, the way any scheme is financed is central in determining the efficiency/behavioural, equity, compliance, and administrative implications of the overall SUI system. Considerable work is needed to determine a preferred funding mechanism.
81. It is difficult to compare the funding of SUI overseas to the funding of a hypothetical scheme in New Zealand, as the funding mechanisms are often linked to the provision of other non-contributory benefits. As noted above, there are three broad possible funding mechanisms (general taxation, a tax on payroll, or a mix of employee and employer levies).
82. Although financing the payment from the general fund/general taxation (non-contributory funding) would be the administratively easiest option, this would need to be consistent with the overall fiscal strategy (see next section). The cost of a scheme could exceed

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<sup>16</sup> Note that this cap is nearly \$85,000 NZD higher than the cap in Denmark, which is the highest (excluding Finland who is uncapped, but reduces the replacement to 20% of income).



amounts available in the budget allowances, so for a given debt target, funding of a scheme through general taxation will involve higher tax rates, reduced expenditure elsewhere, or some combination of these. These costs and trade-offs will need to be taken into account when assessing the overall impacts of a scheme. Further, general taxation may be perceived as more inequitable as benefits are individualised but costs would be public.

83. Funding based on contributions that link payments into the system to real or expected utilisation (risk weighted employer and employee levies) could technically be the most consistent with the policy rationale however, such a policy is likely to generate considerable compliance and administrative costs and may also be distortive as they increase incentives for gaming. Further funding through a mechanism such as a payroll tax should be considered in light of the overall design of the tax system, and for example the current burden of tax on labour income.
84. The literature on the efficiency and equity impacts of SUI financing is mixed and not necessarily comparable to the New Zealand situation. At present, officials do not have a firm view on the efficiency and equity trade-offs associated with different ways of funding a given income-contingent payment, and this is an area that will require further work.
85. The greater the level of income replacement, and the larger the maximum payment associated with the SUI is, the more public desire there may be to use a transparent contributory funding mechanism rather than general taxation. However, even countries with relatively low flat UI payments (Ireland, UK, Portugal) use a levy/contributory funding mechanism for their SUI.
86. There is a risk that any new funding mechanism could be regressive if it ignores interactions with existing assistance (eg for people whose insurance entitlements would be at or below the current benefit rates). A comprehensive analysis of the distributional implications of both the payment and the means of financing will be necessary to ensure that those who are most vulnerable are not made worse off.
87. Ultimately, funding decisions will depend on balancing what is efficient from a policy and administrative/compliance standpoint and what the key policy objective is (ie insurance versus macro stabilisation) with what is acceptable from a social licence standpoint.
88. Decisions will also be required about whether to fund the liabilities as they occur (a pay as you go, or PAYGO system) or to pre-fund future expenditures (save as you go, or SAYGO). These decisions are important from an intergenerational equity perspective. While a SAYGO system will pay a cohort of individuals on the basis of the cohort's contributions, a PAYGO system raises the funds from a different cohort. When the future liability is 'risky' a purely PAYGO system would require higher levies or a government injection in the case of a bad outcome while a SAYGO (or prefunded) system would not. For SUI, the preferred funding system will depend on expected redundancy patterns, the design of the payment, and social views regarding how to share the burden of redundancy through time. The preferred model for ACC and retirement savings will not necessarily fit SUI. As a result, this is an issue that will require significantly more work.

## **Fiscal context and macroeconomic considerations**

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89. The economic impact of COVID-19, together with the Government's response, has had a significant impact on the Government's fiscal position. Net core Crown debt was 19% of GDP in 2019 and is currently forecast by the Treasury to peak at 56% in the mid-2020s. This is driven by higher expenditure, largely from COVID-19 spending, and lower tax revenue, due to the economic cycle.

90. The greatest challenge is that underlying government spending now exceeds revenue, and this deficit is expected to continue for the foreseeable future. Our long-term structural position needs to be stabilised, although any fiscal tightening should only begin once the economy has recovered.
91. The risks are exacerbated if a scheme required large government contributions, had design or implementation shortcomings, and/or was implemented during a recession. Funding would require major policy settings to be reconsidered, and would involve higher taxes, reductions in public service provision, higher deficits, efficiency gains or some combination of these.
92. In that context, a social unemployment insurance scheme, depending on the funding method, could increase New Zealand's ongoing structural deficit significantly. This could exacerbate pre-existing challenges relating to how the government should manage long-term cost pressures, particularly relating to the ageing population. Given the significance of any such changes and ongoing economic and fiscal uncertainty, any new scheme would need to be carefully aligned with the Government's fiscal strategy and any other programmes of structural or macroeconomic reform. In addition, to the extent that costs would fall on businesses and depending on the point within the business cycle that any scheme was introduced, it would also be important to consider how that may impact on businesses during an economic recovery.

## **Summary of the risks and potential unintended consequences of reform of financial support for displaced workers**

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93. Introduction of new financial support for displaced workers, whether financed through general revenue or a new tax or levy creates risks and trade-offs. The magnitude of risks, the extent to which they can be mitigated, and the associated trade-offs depend on policy design. Risks can be summarised in seven overarching (and sometimes overlapping) categories:
- a. **Fiscal cost:** Scheme costs will need to be met through a combination of reduced spending elsewhere or higher general taxation, higher levy rates and/or increased debt. The fiscal cost associated with a generous social unemployment insurance scheme is significant (depending on the extent costs are borne by government, employers or employees) and involves trade-offs in funding (or defunding) other Government priorities. Depending on the complexity of the scheme, there is also the potential for significant costs of administration.
  - b. **Increased unemployment and labour market distortions<sup>17</sup>:** Although an objective of SUI is to improve matching in the labour market, there is also the risk of employment-related distortions:
    - o *Higher marginal tax rates for workers if funded from levies on wages:* A higher marginal tax rate for a worker reduces their incentive to work more hours, or potentially to even enter the labour force.
    - o *Excess search and higher unemployment (moral hazard):* Additional income support may reduce re-employment incentives in the short-term, meaning a potential employee may reject job offers with which they match well.

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<sup>17</sup> These effects are likely to be less severe during recessions when the appetite for risk is lower and unemployment effects of SUI may be offset partially by the economy-wide stimulatory effects of benefits due to their propensity to be quickly spent.



- *Moral hazard for those in work:* As payments depend on displacement, a worker who wants to leave their job may have an incentive to make themselves replaceable to receive the payment. This could be especially acute among workers nearing retirement age and for non-standard workers who have a greater ability to control their workload and employment status.
- c. **Potential to increase scarring and reduce matching:** The generosity (both duration and level of benefits) of the system poses risks and evidence is unclear where the appropriate balance lies. Overly generous benefits risk increasing wage scarring by reducing work incentives and potentially contributing to skills depreciation. If levels are too low, SUI may not meet the objectives of sufficient income smoothing or providing workers with income levels needed to support a prolonged job search (to enhance matching and reduce scarring). The appropriate level may be different for different workers.
- d. **Compliance and hiring costs for business:** The extent to which SUI will increase compliance and hiring costs will depend on the model. Features aimed to more directly tie system utilisation to system funding (for example, experience rating) will increase compliance costs by requiring differential tax rates. Inclusion of self-employed workers will also make self-employment more costly and complex if workers are required to pay both an employer and employee-side levy, especially if experience-rated by industry. Furthermore, by increasing the length of time individuals search for a job, the costs of hiring (both in terms of search and the reservation wage) will likely increase for businesses.
- e. **Equity considerations:** Depending on the design of additional assistance there are potential vertical and horizontal equity concerns:
- *Vertical equity:* The current welfare system provides a high replacement rate to many low-income individuals, especially those with children. As a result, depending on the design, there is a risk the system could largely be targeted at supporting high income individuals and second earners in high income families. Depending on the funding structure, lower income workers who may gain little or nothing from the new income support may be made worse off if their taxes increase to fund it.
  - *Horizontal equity:* Given the different employment law (and potentially tax law) treatment of different types of workers and their income, funding and benefits within a SUI system will treat people differently even when they are earning similar amounts in similar ways (eg a casual worker and a standard worker).
  - *A disjoint between who pays and who expects to receive the payment – especially due to mismatches in the treatment of sources of income – may lead to equity concerns:* Depending on the design, the financing of such a scheme may exacerbate equity and perceived fairness concerns about certain forms of capital income being taxed less than wage and salary income – which has related consequences for equity and efficiency. Similarly, if capital income is taxed to finance a payment that is only given to wage and salary earners this will have both equity and efficiency implications. Officials have not formed a view on how these issues should be addressed and significant further analysis of any likely policy will be necessary.
  - *Eroding support for welfare system:* There is a risk that the perception of a two-tier benefit system for people that society deem as deserving or undeserving may erode social capital and undermine support for basic

income assistance and associated fairness objectives.

- f. **Potential for misclassification and fewer employment relationships:** Given the challenges around coverage for non-standard workers, it is possible they would be covered but with lower (or voluntary) contributions and lower benefits. This is common practice overseas. As a result, employers may choose to reclassify or misclassify their workers to avoid higher taxes. The result could be a shift away from standard work and fewer workers covered by employment protections. These are trends NZ has largely avoided in recent decades.
- g. **Increased pressure on the Labour Inspectorate (or alternative compliance and enforcement entity):** Creating new costs associated with different types of employment relationships may also create incentives to shift to business models that avoid such costs. This may lead to increased pressure on labour standards officers to ensure compliance and aid with dispute resolution. This will be especially true if eligibility is based on a prescribed definition of redundancy and/or if levies are experience-rated based on use of the system.

## Conclusion

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94. There are gaps in the assistance available to displaced workers in New Zealand. Improved assistance is fundamental to building resilience in the labour market as the future of work changes substantially and rapidly. A range of measures will be needed to address these gaps, including:
- potential changes to financial assistance
  - up-to-date employment regulation
  - active labour market programmes that provide employment services and short-term retraining and upskilling
  - support for longer-term retraining and upskilling.
95. The OECD has noted the importance of social protection, particularly for non-standard forms of work (particularly those with irregular earnings patterns), to adapt to eliminate damaging incentives and ensure that emerging risks are managed efficiently and equitably.<sup>18</sup>
96. The case for introducing SUI is finely balanced and dependent on a wide range of detailed design choices that will need to be made (eg eligibility rules and contribution requirements, replacement rates, duration of payments, obligations for recipients, abatement rates, levy rates and who pays them, and interaction with the tax and benefit systems). There is significant uncertainty and potential for unintended consequences, and in some cases, available data and evidence is not sufficient to quantify the likely outcomes (e.g. impact on wage scarring).
97. By its nature, SUI is most likely to have a net benefit for median-income, higher income and second-income earners. Further work on SUI is most worthwhile if the main objectives are economic: support future of work transitions, improve income smoothing, and reduce wage scarring and contribute to productivity. It would also add to New Zealand's automatic stabilisers in economic downturns (whether these are national or

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<sup>18</sup> OECD. (2019). *Preparing for the Changing Nature of Work in the Digital Era*, <https://www.oecd.org/going-digital/changing-nature-of-work-in-the-digital-era.pdf>

regional in nature).

98. Changes to the existing income support system are more likely to be effective at reducing inequality and supporting lower income and/or casual or temporary workers who are displaced.

## **Next steps**

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99. To develop further the work set out in this paper, officials now seek a discussion with Ministers to discuss the next steps, focusing on:
- a. whether Ministers want further work to be done
  - b. the relative prioritisation and sequencing of this work compared to other work streams
  - c. how this work should complement possible reforms to broader system settings and Government's overall fiscal strategy
  - d. the desired weighting and balance between proposed objectives and principles, and whether there are any additional objectives for the work
  - e. whether to rule out any choices at this stage
  - f. the process for further work.
100. As part of further work, officials can:
- a. broaden the evidence base by looking at the levels of wage scarring for ACC claimants, and evidence on the impact of large income drops on wellbeing
  - b. work in collaboration with the Future of Work Forum, and technical experts to provide further advice on more detailed design of the alternative models.
101. Following this, public engagement would help to test and build the social licence for change and inform practical design choices. This could be facilitated by a discussion document or Green Paper, with consultation results informing advice to Ministers on next steps.



## **Annex 1: The role of statutory redundancy payments**

### ***Statutory redundancy payments are one way to enhance financial support***

1. Statutory redundancy payments are one-off lump-sum payments provided by employers to displaced workers. Redundancy payments are usually calculated on the basis of tenure and salary at the time of displacement. There is currently no statutory provision in New Zealand for redundancy payments, or for defined notice periods, although these may be included in employment agreements.

### ***A statutory redundancy payment could allow a displaced worker to “buy more time” for job search or retraining.***

2. Consultation on improving minimum redundancy protection for workers affected by restructuring, giving regard to the recommendations of the 2008 Ministerial Advisory Group report on redundancy and restructuring was a 2017 Labour Party manifesto commitment. A statutory redundancy payment could reduce the pressure to find a new job, and thereby provide more time for job search, and to engage with ALMPs. Because payments are closely linked to tenure, a worker of long-standing will receive a much larger payment, and hence be able to finance a longer period of job search or retraining, than a worker with a shorter tenure.
3. Further, a statutory redundancy payment would allocate some of the cost of redundancies and restructuring to employers. Currently, the costs of redundancies and restructuring are heavily borne by displaced workers. Requiring employers to make a statutory payment would also create some ‘friction’ in restructuring, incentivising employers to consider alternatives. A statutory payment could usefully complement an insurance payment by discouraging employers from classifying resignations as redundancies.
4. Whether a statutory redundancy payment was effective in supporting transitions back to work would depend on the size of the entitlement, and the time needed for either job search or retraining. This in turn could indicate the level of redundancy payment necessary to finance a period of job search. It is likely that a much larger payment would be needed to finance a period of retraining.

### ***Statutory redundancy payments also carry a number of risks for workers and firms***

5. Larger statutory redundancy payments may have a chilling effect on employers’ hiring decisions. Firms may also attempt to avoid potential redundancy costs by moving to fixed-term agreements, contracting or other work arrangements.
6. Tenure-based formulas also reduce labour force mobility, as experienced workers may be discouraged from voluntarily changing employers, since this could mean sacrificing entitlements. Employers may also be reluctant to displace such employees since severance costs are greater. These effects would tend to discourage labour market dynamism. The Productivity Commission has also described redundancy payments as a blunt means to smooth incomes because all workers receive the payment regardless of whether they start a new job immediately or after several months.<sup>19</sup>
7. A further risk is that insolvent employers may be unable to meet their commitments to make statutory redundancy payments. This makes statutory redundancy an unreliable source of financial support.

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<sup>19</sup> New Zealand Productivity Commission. (2020). *Technological change and the future of work*.

8. Further work could consider whether a low level of statutory redundancy payments, or other redundancy requirements (such as minimum notice period or notification requirements), could be considered as part of a larger system of financial support (such as social unemployment insurance or enhanced welfare payments).

## Annex 2: Forms of support for enabling smooth transitions following displacement

Forms of support for enabling smooth transitions	Description
Employment opportunities	<p>A business and economic environment that creates employment opportunities will ensure workers can move into (or remain in) employment.</p>
Advice and brokerage services	<p>Career / vocational / training and educational advice enables informed choices about career options, and training pathways. Advice can be informed by skills assessments, and recognition of prior learning.</p> <p>Brokerage and job search assistance connects people with employment opportunities and tailors support to individual needs.</p>
Education and training	<p>Education and training equips workers with skills relevant to sustainable industries (so people can remain skilled for their current jobs, can make planned transitions to new jobs, and can transition to new jobs if displaced).</p> <p>Short-term education and training for job seekers may be described as ALMPs.</p>
Financial support	<p>Financial security through transitions minimises hardship (relative to established standards of living).</p> <p>Financial support reduces the urgency to find work, and hence increases the possibility of finding a job that is a good match to a worker's skills, experience, preferences and aspirations.</p> <p>Financial support, depending on duration, can also enable some retraining and upskilling.</p>



## **Annex 3: Example families and social insurance: Initial analysis**

### ***Purpose***

- 1 This appendix estimates the incomes of 12 example families under two theoretical social insurance schemes and the existing welfare system to illustrate the extent to which different approaches smooth income.
- 2 The families differ based on relationship status (single or couple), number of children (none or two), incomes (minimum wage, median wage, and higher wage), and rent costs.
- 3 The incomes are benchmarked against a before housing cost (50 percent of median income) poverty threshold. The incomes of four lower income example families are compared to an after-housing-cost threshold (50 percent of median income) to illustrate the potential poverty impacts of social insurance schemes.

### ***Assumptions***

- 4 The example family analysis is subject to several limitations. The results reflect the assumptions chosen for the example families and the theoretical social insurance schemes. Only a limited number of variations to these assumptions have been considered at this stage. This means these results should be viewed as preliminary and indicative only. We warn against generalising the results of the example families, as changes to the assumptions (particularly relating to the welfare system's Accommodation Supplement) can lead to materially different results.

#### *Example family assumptions*

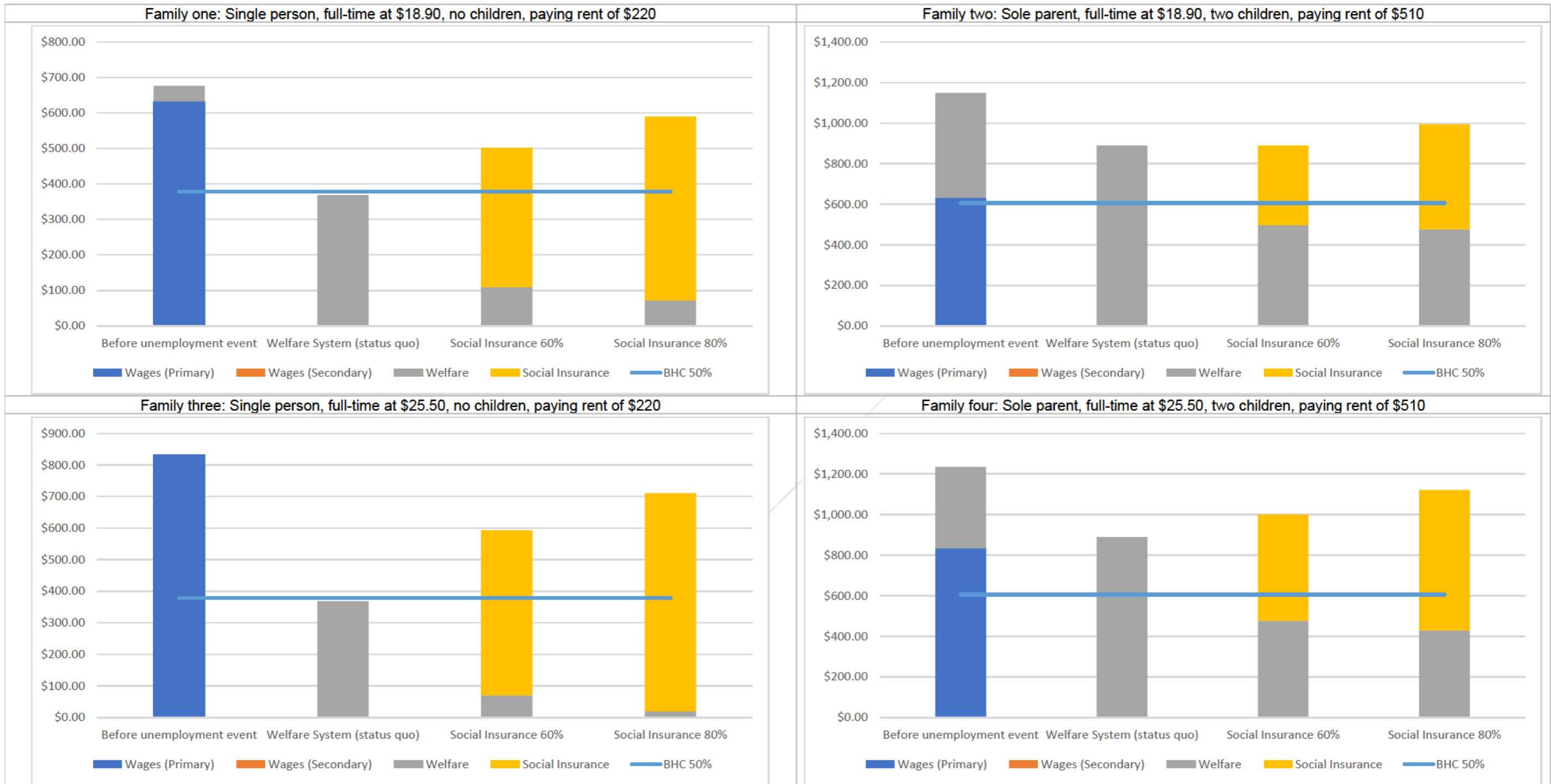
- 5 The key assumptions relating to the families are:
  - 5.1 Rent prices are based on rent prices in Mangere, Auckland. The low- and middle-income families have lower quartile rents, where a single adult and couples have a single room each, plus an extra room for each child (e.g. a sole parent with one child has two rooms, a couple with two children has three rooms). The higher income earners pay median rents. The data is drawn from Tenancy Services.
  - 5.2 Example families have no assets. There is a cash asset test for Accommodation Supplement and Temporary Additional Support; so assuming no assets means families are eligible for these benefits.
  - 5.3 Families have full-time care of their child, and do not share care. Sharing care of a child would likely lead to reduced welfare assistance.
  - 5.4 The children of families are teenagers; so are not eligible for the Best Start Payment.
  - 5.5 Full-time work is assumed to be 40 hours; and part-time work is 20 hours.
  - 5.6 No families have student loan repayments or received childcare assistance or received Child Support.

#### *Policy assumptions*

- 6 The key policy assumptions are:
  - 6.1 Two payment rates are considered; 60 and 80 percent of gross income. The individual's point-in-time income is assumed to determine the person's social insurance payment.

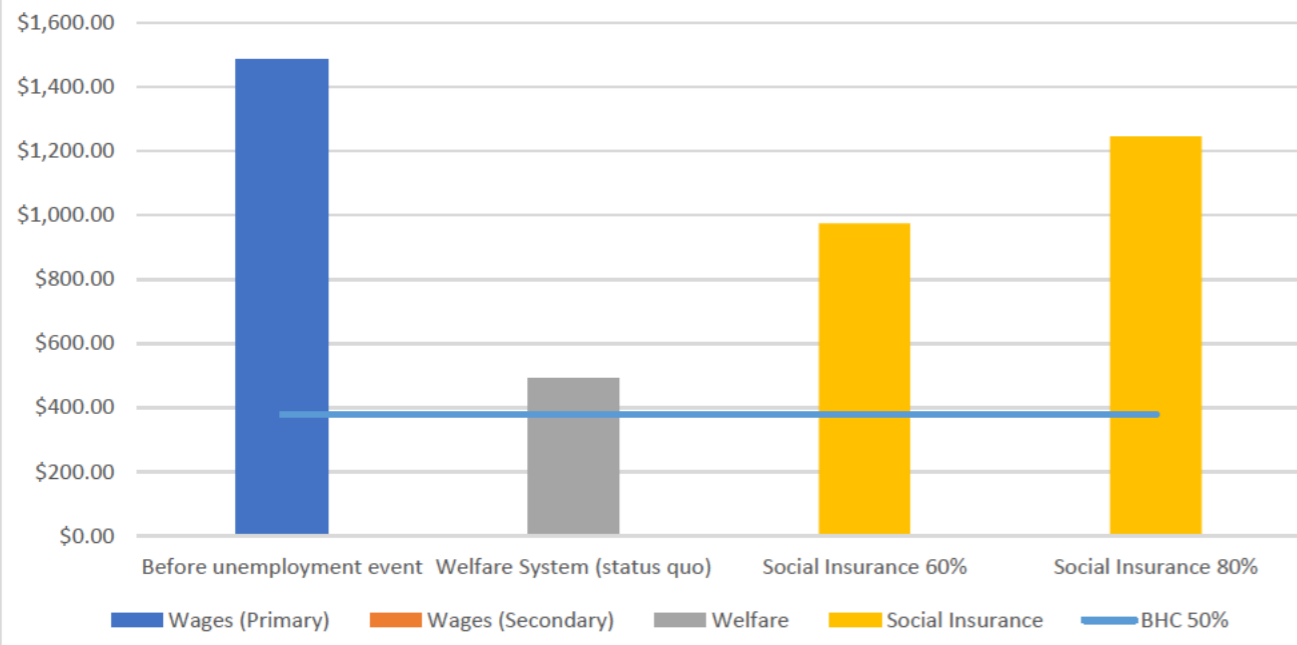
- 6.2 social insurance will be treated the same as ACC payments. Insurance payments are reduced on a dollar-for-dollar basis for main benefits but treated as income for supplementary assistance and Working for Families.
- 6.3 all families are eligible for the social insurance scheme. This reflects the purpose of the analysis to consider income smoothing, rather than to explicitly inform the eligibility settings.
- 6.4 receiving an insurance payment does not make individuals eligible for the In-Work Tax Credit in their own right.
- 6.5 the payment period does not include the Winter Energy Payment.
- 6.6 the funding of the scheme is not considered, i.e. officials have not added a social insurance levy to taxation on incomes.

**Example Families Analysis: Twelve families' incomes under welfare and social insurance schemes**

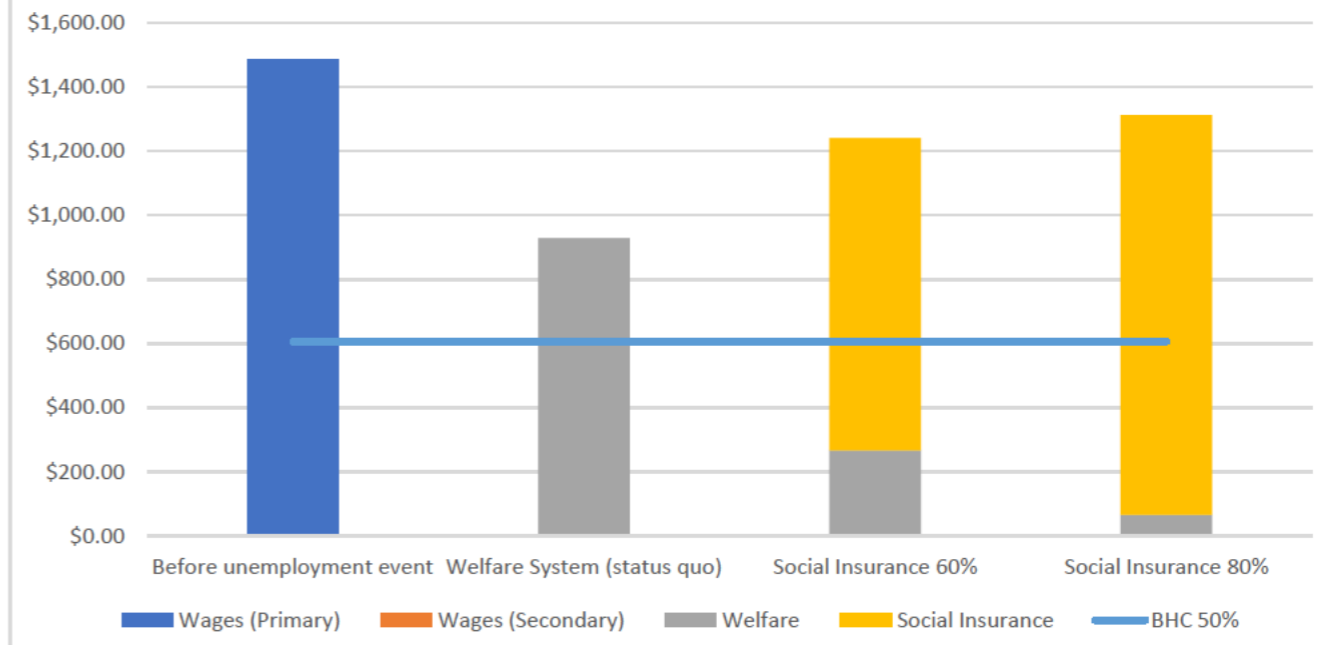




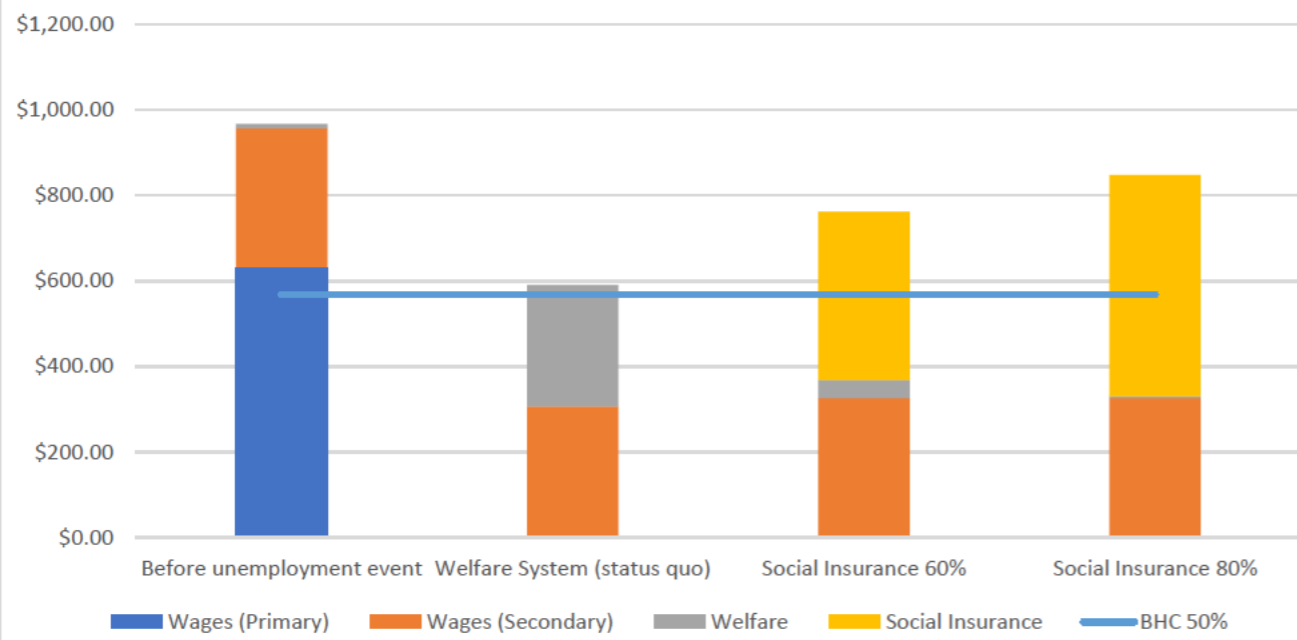
Family five: One earner, full-time at \$50, no children, paying rent of \$362



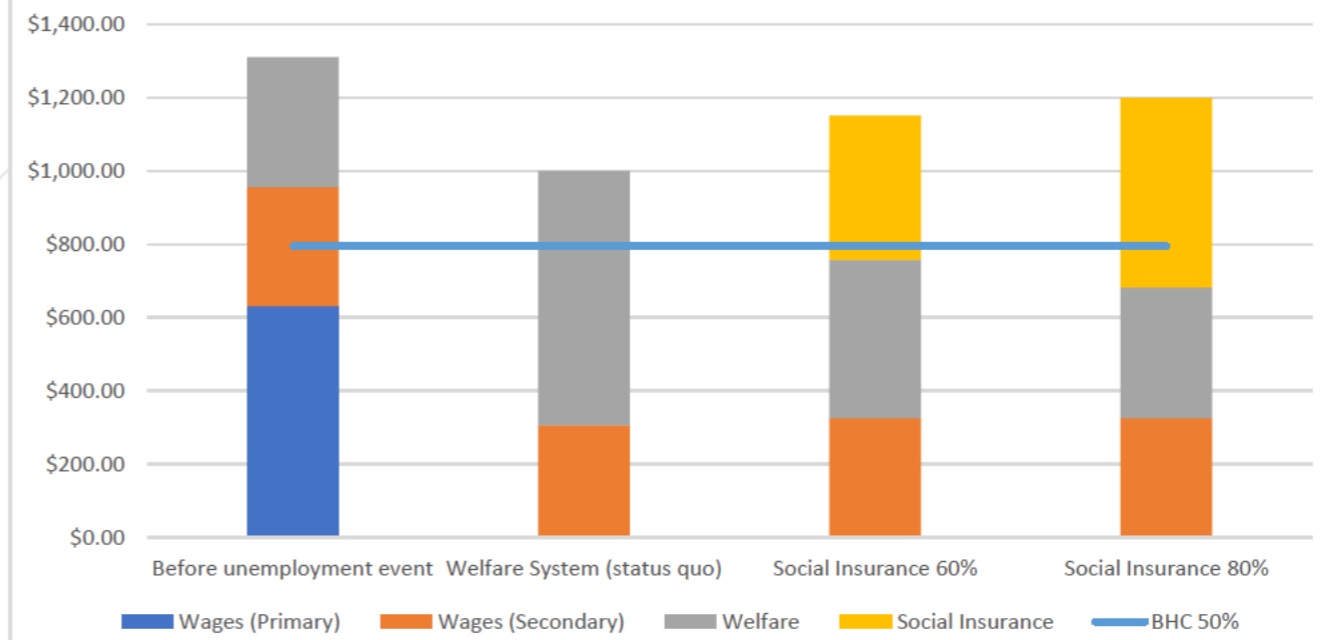
Family six: Sole parent, full-time at \$50, two children, paying rent of \$550



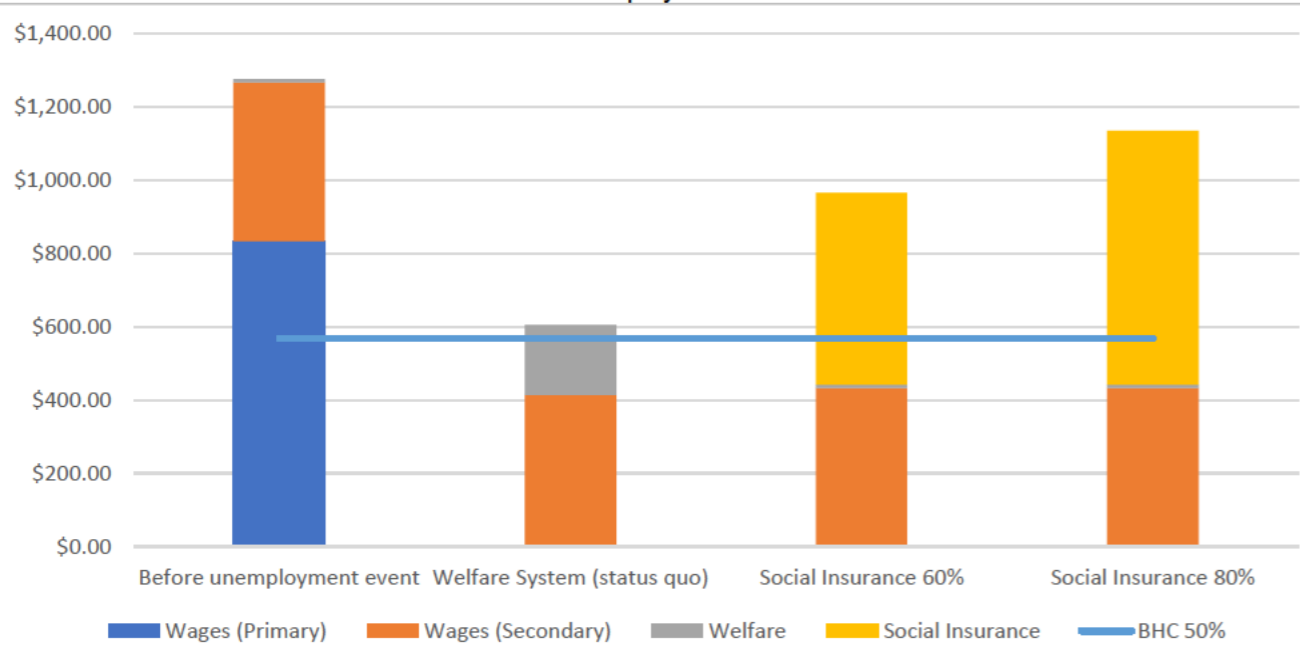
Family seven: Two earners, full-time/part-time at \$18.90, no children, paying rent of \$220, full-time earner loses employment



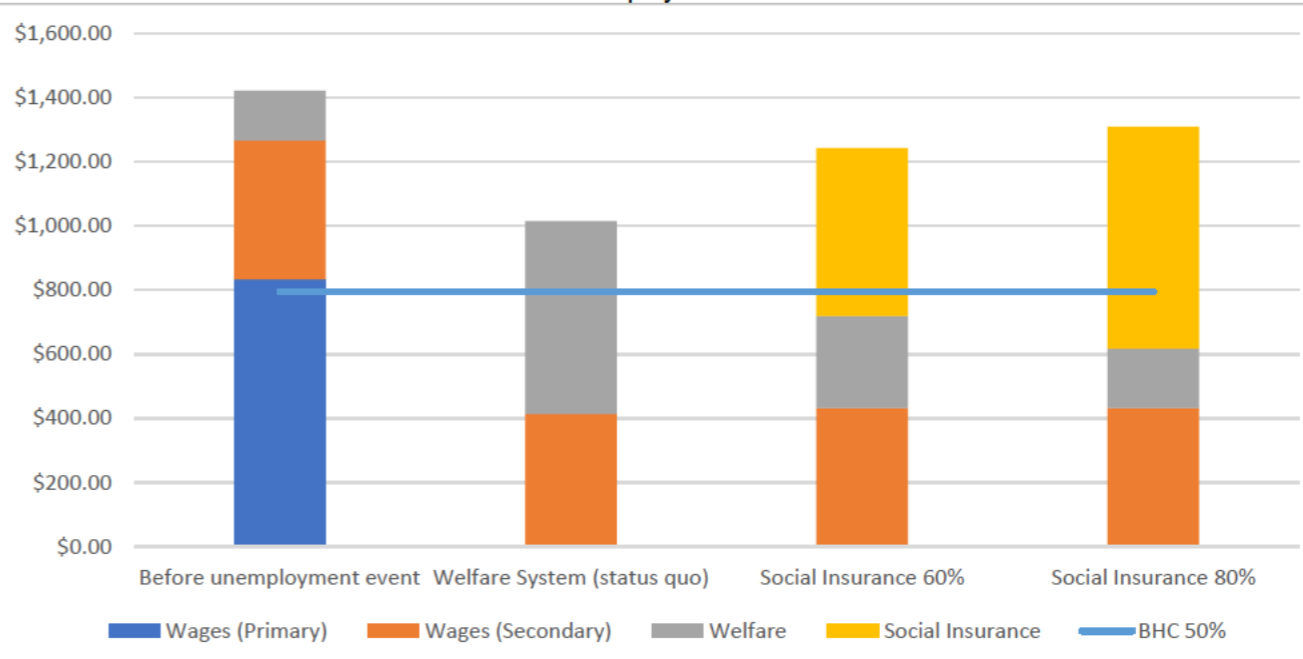
Family eight: Two earners, full-time/part-time at \$18.90, two children, paying rent of \$510, full-time earner loses employment



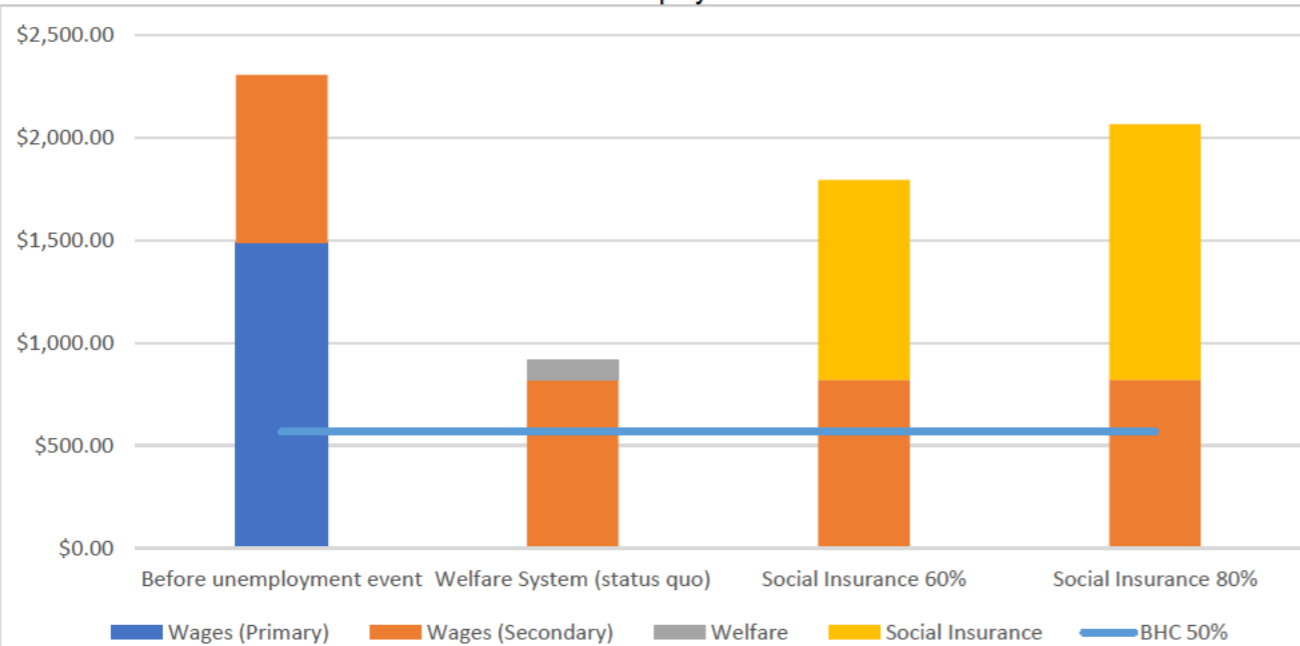
Family nine: Two earners, full-time/part-time at \$25.50, no children, paying rent of \$220, full-time earner loses employment



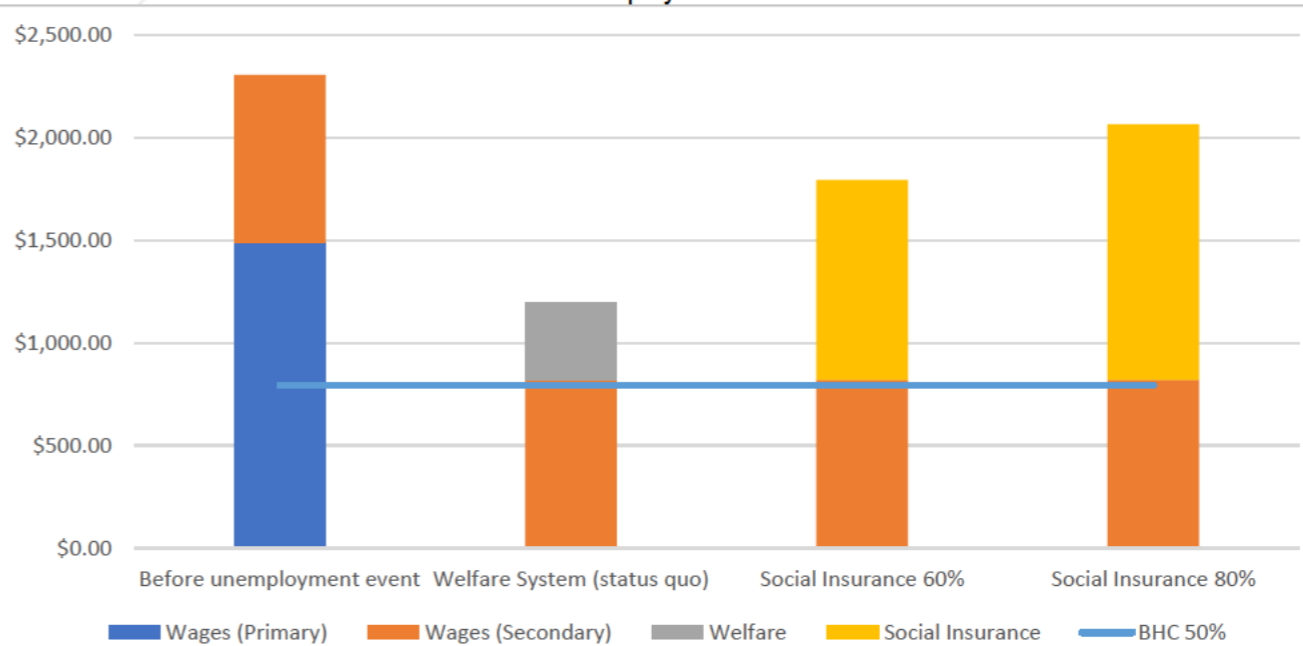
Family ten: Two earners, full-time/part-time at \$25.50, two children, paying rent of \$510, full-time earner loses employment



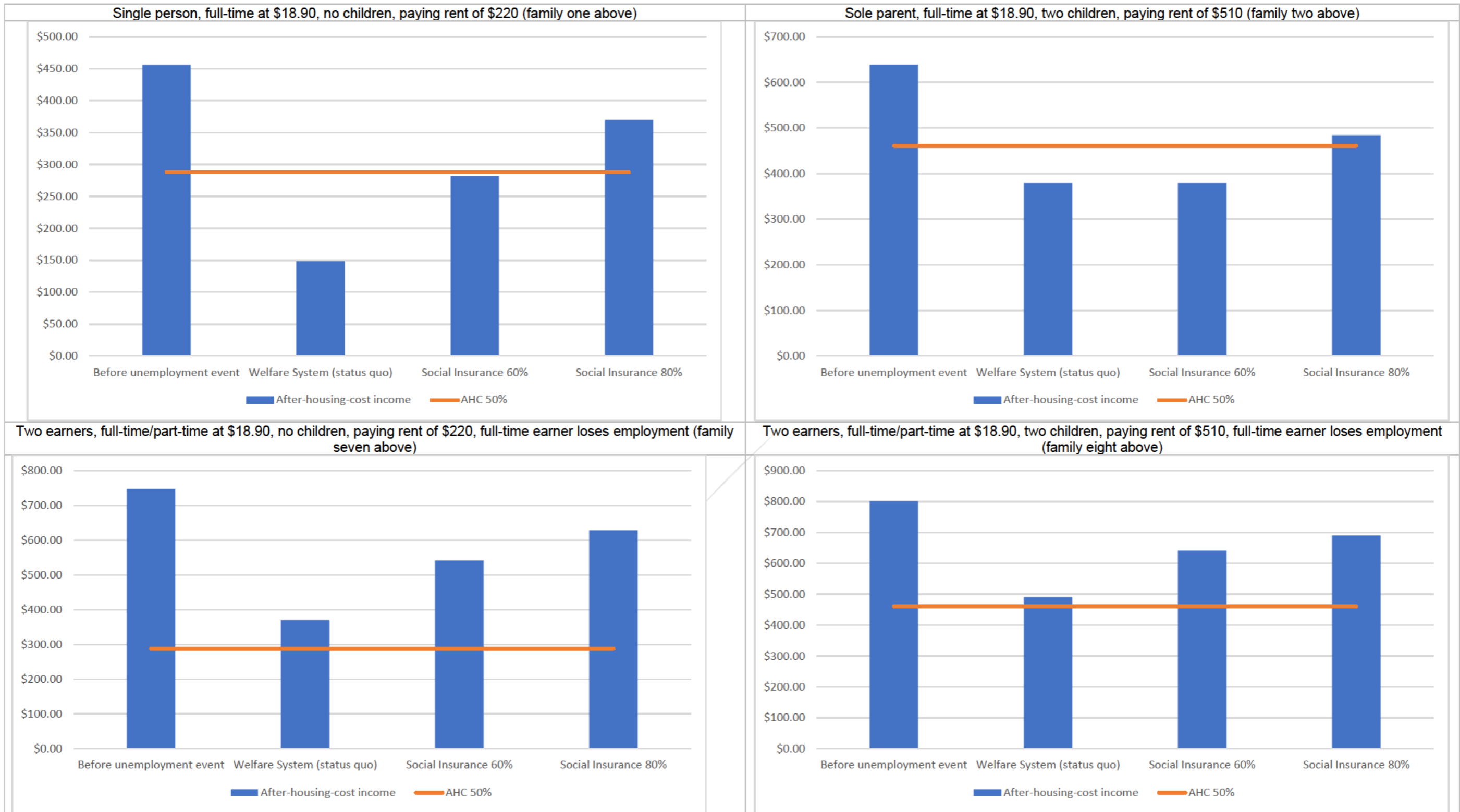
Family eleven: Two earners, full-time/part-time at \$50, no children, paying rent of \$362, full-time earner loses employment



Family twelve: Two earners, full-time/part-time at \$50, two children, paying rent of \$550, full-time earner loses employment



**Example Families Analysis: Four family's after-housing-cost incomes under welfare and social insurance schemes**





## Annex 4: Selected international SUI comparisons

Country	Type of scheme	Duration of benefits	Replacement rates	Contribution	Mandatory?	Eligibility	Considerations
<b>Germany</b>	Social insurance and social assistance	6-24 months. depending on age / work history	60% (67% for workers with children) up to a cap of 2,805 euro/month. (\$800 NZD/week max; no marginal benefit for those making above ~\$69,300/year)	Payroll deduction 1.5% (employer), 1.5% (employee)	Yes	Employees and voluntary for self-employed. Excludes those in irregular employment.	Built in short-time work benefit and short-time transfer allowance. This system is largely reliant on social partners' collaboration.
<b>Denmark</b>	Subsidized voluntary insurance and social assistance	24 months.	90% up to a cap of 2,473euro/month. (\$1100 NDZ/week max; no marginal benefit for those making above ~\$57,800/year)	Vary depending on fund, but avg. payroll deduction 8% (employee)	No (covers 77% of labour force)	Employees, self-employed workers, recent vocational school grads Must be members of unemployment fund	Coverage is voluntary but maps with unionisation rates.
<b>UK</b>	Social insurance and social assistance system	6 months.	Flat £73.10 per week is paid if aged 25 or older; £57.90 if younger than age 25; £116.80 for those claiming income-related JSA as a couple (\$568 NZD/week max individual, \$1000 for couples)	Payroll deduction 13.8% (employers), 12% (employees) but funds ALL social insurance (old age, survivors, workers comp, etc)	Yes	Employees; covers voluntary job loss	Most similar to COVID Income Relief Payment. The regular benefit is based on contributions history, but couples' benefit based on income. The UK also has needs-based universal credit System has been in a constant state of reform in recent years; more changes to come as universal credit phase-in continues.
<b>Canada</b>	Social insurance	14 to 45 weeks depending on work history and regional UE	55% of lost earnings up to a cap of \$573 per week CND. (\$1010 NZD/week max; no marginal benefit for those making above ~\$95,500/year)	1.66% payroll deduction (employee), 2.32% (employer)	Yes	All employees (excludes self-employed)	Welfare provision is province-based, so interaction is determined at local level
<b>Sweden</b>	Social insurance and voluntary income-related insurance system	42 weeks	235 euro/wk for basic coverage; 80% of former wages for voluntary scheme capped at 616 euro/week initially but max benefit phases out. (\$1100 NZD/week max; no marginal benefit for those making above ~\$71,500/year)	Membership fee for voluntary program, 2.64% payroll deduction for both voluntary and mandatory system (employer)	Both	All workers including self-employed	Membership for income-related insurance voluntary and available to employees in a specific occupation or industry who join a union-run fund. Those who pay into voluntary scheme are ineligible for basic scheme.

## **Annex 5: ALMPs to support displaced workers and others losing their jobs**

### ***Managing the trade-off between providing financial support and maintaining work incentives***

1. ALMPs aim to facilitate displaced workers' transitions and other groups of people unemployed to re-employment. ALMPs cover a heterogeneous and inconsistently defined group of programmes and policies. They broadly cover job training programmes, job placement programmes, and job search assistance programmes but the boundaries between these categories are blurred.
2. A key trade-off with providing financial support to unemployed people is between the generosity of payments (whether from insurance or welfare) and the maintenance of work incentives. Generous payments may support those unemployed but dampen their incentives to engage in job search, leading to increased unemployment. Consideration needs to be given to mitigating the risk that people will not return to work. A combination of unemployment cash benefits and policies to support re-employment is the most effective approach.

### ***There is a need for a coherent system of supports to achieve employment outcomes***

3. To achieve the government's employment goals, there is a need for a coherent system of ALMPs. The OECD and the Welfare Expert Advisory Group (WEAG) both recommended the system of ALMPs be improved. Future of work trends are likely to increase job loss and the need for return to work support.
4. Welfare, education, and labour market sectors lead active labour market policy and programmes in New Zealand. New Zealand ALMPs primarily focus on those with the highest needs and barriers to employment, but some focus on the labour market more generally.
5. MSD plays a key role in the provision of ALMPs. MSD works alongside people who are unemployed or are having difficulty in the labour market, so they are ready for work and are supported to find sustainable and meaningful employment. The COVID-19 response presented an opportunity to leverage MSD's employment services infrastructure and fast-track the expansion of MSD's employment services in line with Cabinet's agreed direction for the Welfare Overhaul<sup>20</sup>.
6. There is work planned to improve the system of ALMPs.
  - In the shorter term there are various initiatives across government that will contribute to improving ALMPs<sup>21</sup> but this work is not taking a systems approach.

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<sup>20</sup> The Government's vision for a welfare system is to ensure people have an adequate income and standard of living, are treated with respect, can live in dignity and are able to participate meaningfully in their communities. In November 2019, Cabinet agreed to a long-term work programme to overhaul the welfare system, in response to the report from the Welfare Expert Advisory Group [CAB-19-MIN-0578 refers]. This committed MSD to progress a number of areas of work across the income support system; the health and disability system; MSD's employment services and supports; the community sector.

<sup>21</sup> This work includes:

- Future of Work and Transitions work items such as encouraging employer-led workforce training
- the Taranaki partnership
- the welfare overhaul work to support employment through the welfare system, including its interaction with other systems such as health (PTO)

- The Labour Market Ministers Group instructed officials on 25 July 2019 to undertake a longer term first principles review of ALMPs. Progress on this work has been paused as a result of other urgent employment policy work.

***Different employment interventions may be needed to meet the needs of new groups accessing individualised financial support***

7. In supporting displaced workers, a key question is which specific types of ALMPs should be used and how does this fit with the current mix of ALMPs.

**Job search assistance**

8. Job search assistance that emphasises "work first" has relatively large short-term impacts, on average.<sup>22</sup> Job search assistance on its own is unlikely to help benefit recipients who lack the skills needed by the employers.
9. Job search assistance is best suited to those closer to the labour market who need help with matching. Many displaced workers would fit this description. MSD has traditionally focused on jobseekers at the lower end of the labour market. However, in response to COVID-19, MSD has put in place services aimed at assisting newly displaced workers<sup>23</sup> - many of whom are skilled workers with no previous contact with the welfare system.

**Overcoming loss of skills**

10. Displaced workers may need retraining to overcome the loss of industry-specific skills. ALMPs can assist with retraining but the evidence on effectiveness is mixed.
  - ALMPs focused on helping the unemployed acquire skills are more beneficial in the long-run (though their effects take longer to materialise). Formal education or training shows promise in the longer term if completed at NQF level 4+, especially for sole parents.
  - While training can facilitate the re-integration of younger low-skilled workers, policies to address the future of those who are no longer employable is more challenging.<sup>24</sup>

**Preventing discouragement and poorer health outcomes**

11. Displaced workers are at risk of experiencing substantially worse mental health and

- 
- the Employment Strategy and its Action Plans, from delivering the Youth Employment Action Plan to developing the Māori Employment Action Plan
  - the Better Later Life Strategy and its support for paid employment
  - the implementation of the Reform of Vocational Education
  - the establishment of Regional Skills Leadership Groups and Workforce Development Councils
  - immigration system reforms.

<sup>22</sup> Card et al. (2015). *What Works? A Meta Analysis of Recent Active Labor Market Program Evaluations*. IZA Discussion Paper No. 9236 <http://ftp.iza.org/dp9236.pdf>

<sup>23</sup> These include:

- Services for people seeking employment who are not necessarily beneficiaries have been expanded, including additional staffing for Rapid Response Teams (regional teams intervening early by helping staff impacted by displacement into alternative employment).
- Continued delivery of Rapid Return to Work, a phone-based employment service that supports newly displaced workers with work readiness for a quick return to work.
- Continual promotion and enhancements of the Work and Income Recruitment Tool, a digital platform that connects employers directly with people looking for work.

<sup>24</sup> Graham, C., Pinto, S. (2019). *Men without work: A global well-being and ill-being comparison*. IZA World of Labor 2019: 464 doi: 10.15185/izawol.464



becoming discouraged in their job searching. Involuntary separations also worsen the physical health and increase the mortality risk of displaced workers, especially men. There is a role for ALMPs in mitigating these impacts:

- Using ALMPs to assist people to quickly find suitable work can limit discouragement and the development of poor health outcomes. Suitable work is protective of mental health. The impact of suitable work on physical health is less clear but having a suitable job may reduce stress, a key contributor to a range of physical health problems.
- Providing evidence-based return to work support for people with mental health conditions has been demonstrated to improve employment outcomes. However, the WEAG and the OECD report on mental health and work in New Zealand were critical of support available to support people experiencing poor mental health into work. If a social insurance scheme included people with health conditions, further investment would be required to provide evidence-based return to work services for this group.

### ***There are trade-offs and risks to consider***

#### **ALMPs are crucial but the impacts are likely to be modest at best**

12. The composition of ALMPs matters in terms of what works and what does not at different points of the economic cycle<sup>25</sup>, as does programme design and implementation. Without effective ALMPs, there is a risk that unemployment benefits reduce work incentives and deepen labour market exclusion, especially where the benefits are generous. However, even with significant investment on ALMPs, there are limits to what they can achieve.<sup>26</sup> Even when ALMPs are effective, the net impacts are not large.<sup>27</sup>
13. Nevertheless, the low cost of ALMPs (especially relative to alternatives such as formal education) does mean that where they are effective, they can offer high rates of return on investment. The Productivity Commission argues that any investment in labour-market assistance needs to be accompanied by robust systems to evaluate effectiveness; to redesign, retarget or close poorly-performing programmes; and to move resources to better-performing alternatives.<sup>28</sup> This approach could produce good outcomes for displaced workers.<sup>29</sup>

#### **Balancing the need to quickly find work against the need to find the right job**

14. Job search obligations (especially where they are strict) or a short payment period may pressure job seekers to take less suitable work. There is no strong evidence that

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<sup>25</sup> Brown, A.J., Koettl, J. (2015). *Active labor market programs - employment gain or fiscal drain?*. *IZA J Labor Econ* 4, 12. <https://doi.org/10.1186/s40172-015-0025-5>

<sup>26</sup> Denmark is a world leader in formal evaluations of ALMP and spends more per person on ALMPs than other OECD countries. Despite this level of investment, the impact of ALMPs on outcomes have been relatively modest. Overall on average, ALMPs reduce the duration of unemployment by about two weeks in Denmark (OECD, 2016). There remain serious questions about effectiveness of the ALMP spend – especially that associated with training.

<sup>27</sup> Martin, J. (2015). *Activation and active labour market policies in OECD countries: stylised facts and evidence on their effectiveness*. *IZA J Labor Policy* 4, 4. <https://doi.org/10.1186/s40173-015-0032-y>

<sup>28</sup> New Zealand Productivity Commission. (2020). *Technological change and the future of work: Final report*. Available at [www.productivity.govt.nz](http://www.productivity.govt.nz)

<sup>29</sup> Hyslop, Mare, Noy and Sin. (2020). *Involuntary Job loss: Welfare effects, earnings impacts, and policy options*. Wellington: Motu Economic and Public Policy Research.

unemployment benefit programs help people find better job matches<sup>30</sup> and long periods of unemployment are harmful. Benefits enable recipients to prolong their search for better offers, but the overall benefit to society of better matches may not outweigh the cost of supporting longer periods of unemployment.<sup>31</sup>

### **People may need substantial retraining, but this is costly**

15. Where the goal is to support displaced workers to upskill or retrain, there is the question of how the government overcomes the certain cost of re-training with the uncertainty of future gains in employment or income.
16. ALMPs tend to have a shorter-term focus. However, the ability to adjust human capital to changing labour market demand is not instantaneous and displaced workers may need a substantial period of re-training. Without sufficient support, displaced workers may be unwilling to make such a long-term investment, especially if they are mid-career or with family commitments, limiting their opportunity to regain lost earnings.

### **ALMPs for newly displaced workers may crowd out ALMPs for more disadvantaged workers**

17. Many ALMPs in New Zealand are aimed at ensuring equitable access to employment. Unemployed people with greater labour market disadvantages are given preferential access to employment opportunities through the selective provision of ALMPs such as wage subsidies. If a social insurance scheme for displaced workers was introduced, it would be important to ensure those within the welfare system retained access to ALMPs.

### **Private provision of ALMPs does not necessarily lead to better outcomes**

18. Whether ALMPs for displaced workers are delivered privately or publicly is an important consideration. The evaluation evidence in New Zealand and internationally suggests there is merit in the use of quasi-market models for employment services. However, the experience in Australia and the UK, where these models have been trialled most extensively, shows that care and attention are required with respect to how these models are implemented and managed. The cost-effectiveness of an outcome-based funding model will depend entirely on how well it is implemented and doing this well is challenging.

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<sup>30</sup> Moffitt, R. (2014). *Unemployment benefits and unemployment*. IZA World of Labor 2014: 13 doi: 10.15185/izawol.13

<sup>31</sup> Tatsiramos, K. (2014). *Unemployment benefits and job match quality*. IZA World of Labor: 44 doi: 10.15185/izawol.44

## Annex 6: Non-standard employment

### Prevalence and nature of non-standard working arrangements

1. Standard employment (full-time, permanent employment) fits the insurance model well because it is easy to assess and collect contributions, and easy to calculate income replacement payments based on lost income. If a standard worker is made redundant, there is a clear contributions history, a clear trigger for an insurance claim (redundancy), and a straightforward counter-factual for lost income. It is more difficult to perform these functions for people whose work is casual, fixed-term, part-time and the self-employed. Some people also hold multiple jobs.
2. The New Zealand workforce overwhelmingly comprises full-time, permanent employees, and there is little sign of this changing. The term 'non-standard' captures the fact that these arrangements remain in the minority as modes of labour market participation in New Zealand. The permanent employment relationship (whether full- or part-time) remains prevalent: of the 'paid employee' population (which comprises around 80 per cent of all employed people), close to 90 per cent are 'permanent employees' (ie party to an employment relationship of indefinite duration). Ten per cent are 'temporary employees' of various kinds: casual workers, temporary agency workers, seasonal workers, and fixed-term employees.
3. Typically, around 12 per cent of all employed people identify as being self-employed with no employees, and this proportion has been relatively stable for the past twenty years. Slightly less than half of the 'self-employed, no employees' group – or around 140,000 people – are contractors (although we note that the survey that this 'contractors' estimate is based on has been conducted only once, in late 2018).
4. The relatively low prevalence of non-standard employment suggests that the ability to extend insurance coverage to non-standard workers need not be a principal consideration in choosing between models of support.
5. While the New Zealand workforce is overwhelmingly comprised of full-time, permanent employees, other countries have seen a rising proportion of people in non-standard working arrangements. Those trends are not currently apparent in New Zealand but may emerge in the future. An increasing prevalence of non-standard employment could make an insurance-style model less desirable.
6. There is a broad consensus among commentators and stakeholders that it is desirable to extend social insurance coverage (costs and benefits) to non-standard workers to the fullest extent practical. The social partners' starting presumption is that all working arrangements would receive insurance coverage, unless this is impracticable.<sup>32</sup>
7. Broad coverage is desirable to:
  - lower insurance premiums<sup>33</sup>
  - avoid incentivising employers to hire non-standard workers (or miss-classify

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<sup>32</sup> New Zealand Council of Trade Unions and BusinessNZ. (2020), *Our view on support for displaced workers*.

New Zealand Productivity Commission.,(2019). *Employment, labour markets and income Draft report 2, Technological change and the future of work*.

OECD. (2019). *Employment Outlook 2019, The Future of Work*.

OECD. (2017). *Back to Work New Zealand*.

International Labour Organisation. (2016). *Non-standard employment around the world: Understanding challenges, shaping prospects*

<sup>33</sup> Low levels of coverage limit the extent to which UI can act effectively, both on a micro level by protecting households from poverty, and on a macro level by automatically countering downturns in the business cycle.



employees) to avoid insurance costs<sup>34</sup>

- recognise that people may move between standard and non-standard employment, and it could be impractical to adjust coverage to match changing working arrangements.
8. Accommodations can be made to extend coverage to non-standard workers. This is easier for some groups (eg casual employees with a clear pattern of work, or fixed term employees) than for others (eg the self-employed). The costs of extending coverage for any insurance scheme to the full range of non-standard workers may well exceed the benefits of doing so.

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<sup>34</sup> The OECD argues that treating standard and non-standard work differently in social protection arrangements has created incentives for employees to choose non-standard work to avoid the payroll taxes that fund UI.

## **Annex 7: The pros and cons of including people with health conditions or disabilities**

1. A key question is should an enhanced support for people involuntarily exiting employment only include workers who are made redundant or should it also include people who are unemployed or have reduced hours due to a health condition or a disability not caused by an injury?

### ***The onset of health conditions and disabilities is a common reason for job loss***

2. The onset of health conditions and disabilities is a significant reason many people find their ability to earn an income partially or entirely reduced, either temporarily or permanently.
3. Within the welfare system as at end of September 2020,
  - 71,280 people were receiving Jobseeker Support for a health condition and disability (JS – HCD) because their capacity to seek, undertake or be available for full-time employment is limited due to a health condition or disability.
  - 85,075 people were receiving Supported Living Payment on the grounds they have a health condition, injury or disability that permanently and severely restricts their capacity for work.
4. This is likely to be an underestimate of the number of people with reduced earnings due to a health condition or a disability. Health and disability information is not collected for people receiving other benefits such as sole parent support. Moreover, the income test may exclude unemployed people who have an earning partner from accessing MSD income support.
5. Between 1 July 2018 and 30 June 2019, ACC<sup>35</sup> provided 126,077 people with weekly compensation because they couldn't work due to their injuries and made 111,085 decline decisions. Most ACC claims do not result in claimants receiving earnings related compensation<sup>36</sup>.

### ***There are good arguments for establishing insurance-based income protection for people with non-injury related health conditions or disabilities***

6. People with impairments resulting from an injury receive support from ACC while those with the same impairments arising from an illness receive different levels of financial and non-financial support from the welfare and health systems – a situation many have argued is inequitable.
  - The amount of financial assistance that people may receive from ACC is usually higher than that provided by MSD for the same level of incapacity (see table at the end of this annex).
  - Welfare recipients with health conditions or disabilities receive limited employment support and have limited access to vocational health and disability support. There is little emphasis on vocational rehabilitation within the health system to support people to stay in or return to work.

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<sup>35</sup> <https://www.acc.co.nz/newsroom/media-resources/injury-claim-statistics/>

<sup>36</sup> ACC accepted 2,027,789 new claims, most (97%) of which were decided within one week.

7. When the Accident Compensation scheme was established many more people worked in jobs where there was a significant risk of physical injury. Structural changes in industrialised countries make classical work accidents less prevalent, while incidence rates of chronic conditions (eg mental health conditions, back pain) have increased.<sup>37</sup>
8. There is a greater recognition of the impact work can have on employees' health and vice versa.<sup>38</sup>
9. The current arrangements distinguish between physical disability caused by an injury and disability from other causes. However, there is considerable evidence indicating that mental and physical wellbeing cannot be neatly separated.<sup>39</sup>
10. The requirements on employers to help rehabilitate employees with non-injury related disabilities and illnesses are less clear. Under the *Accident Compensation Act 2001*, employers have an obligation in relation to work-related (vocational) rehabilitation. The duty on employers to help rehabilitate injured employees applies to both work-related and non-work-related injuries. They do not have the same obligation to assist in the rehabilitation of people with non-injury related disabilities and illnesses.<sup>40</sup>

***However, the costs are likely to be significant***

11. The potential cost of a health condition and disability scheme is a major concern. It would likely be much larger than a scheme focused on displacement, given the larger volumes of cases (especially given behavioural effects), and the lengthy durations of many health conditions and disabilities.
12. In most countries, health and disability insurance programmes are large and growing, both in expenditure and in the number of recipients for a range of reasons. There have been efforts to manage the increasing costs associated with disability insurance schemes, but success has been limited.

***Implications for design of including people exiting employment with health conditions and disabilities***

13. There are significant trade-offs and risks to be managed in the design.
  - A key trade-off is between providing coverage for individuals who are genuinely in need and avoiding giving benefits to those who are healthy and able to work. Determining who is genuinely in need is more difficult than the case for unemployment insurance eligibility as the 'true' disability status of an individual is unobserved and the screening imperfect. As a result, some people who should receive a payment do not (type 1 error) and some who do not have a disability receive a payment (type 2 error). There is always a trade-off between these two types of error: a stricter control reduces the probability of type 1 errors but increases the probability of type 2 errors, and laxer control has the opposite effect.

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<sup>37</sup> SSA (2019) Trends in Social Security Disability Insurance, Briefing Paper No. 2019-01. <https://www.ssa.gov/policy/docs/briefing-papers/bp2019-01.html>

<sup>38</sup> WorkSafe's Strategic Plan for Work-Related Health 2016 to 2026. <https://worksafe.govt.nz/topic-and-industry/work-related-health/work-related-health-strategic-plan/>

<sup>39</sup> Potter, J., Poulton, R., Gluckman, P., McNaughton, S., & Lambie, I. (2017) *Toward a Whole of Government/Whole of Nation Approach to Mental Health*. Wellington, New Zealand.

<sup>40</sup> OECD (2018) *Mental Health and Work: New Zealand*, Mental Health and Work. Paris.



- Claims increase with the replacement rate<sup>41</sup>.
  - There have been many attempts to improve employment outcomes for health and disability insurance claimants, but success has been limited. Those at greater risk of long-term disengagement from work are older workers, young people, people with mental health conditions and musculoskeletal disorders and, low-wage workers, and people with low educational qualifications.
  - Engaging employers to support a return to work is critical.
  - There is a severe paucity of evidence on the short- and long-term health effects of disability insurance. However, recent evidence for the existence of substantial health effects implies that policy makers need to carefully balance the welfare gains from reduced moral hazard against losses not only from less coverage of income risks but also from deteriorated health.<sup>42</sup>
14. There are arguments for and against combining unemployment insurance and health and disability benefit insurance. There is some evidence that creating a distinction between unemployment insurance and health and disability benefit insurance is unhelpful in supporting return to work. This is because 1) as benefit spells become longer, the ultimate causes behind the claims often become more ambiguous, and 2) benefit claims may also result from a combination of several labour market barriers.<sup>43</sup> Internationally existing empirical evidence indicates a significant degree of substitution between unemployment and disability-related social insurance programme utilisation.<sup>44</sup>
15. However, there is a case to establish unemployment insurance for displaced workers independently of coverage for health conditions and disabilities. An insurance scheme to support people with health conditions and disabilities not currently covered by ACC will be more complicated:
- Insurance benefits can be full or partial, temporary or permanent.
  - Eligibility for disability insurance may not be linked to previous earnings or time in work (eg those disabled from birth or as a child). ACC currently provides financial support to people permanently and severely disabled as a result of an injury as a child. Adults who were non-earners when permanently and severely disabled as a result of an injury typically receive support from the welfare system if eligible. Consideration will need to be given to how to best support non-earners with health conditions and disabilities and who pays for this support.
  - There are complex interfaces with ACC and the health system in addition to the welfare system and IR.
  - Considerable work will be needed to provide sufficient return to work support.
16. Additional coverage for people who develop health conditions and disabilities could be

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<sup>41</sup> Mullen, K. J. & Staubli, S. (2016). *Disability benefit generosity and labor force withdrawal*. *Journal of Public Economics*. <https://doi.org/10.1016/j.jpubeco.2016.08.007>

<sup>42</sup> García-Gómez, P., & Gielen, A. C. (2018). *Mortality effects of containing moral hazard: Evidence from disability insurance reform*. *Health Economics*, 27 (3), 606-621. <https://doi.org/10.1002/hec.3617>

<sup>43</sup> A claimant may be unemployed with respect to one job, disabled with respect to another, and perhaps unwilling with respect to a third. Health problems may make it difficult to perform some kind of tasks, while being irrelevant for others.

<sup>44</sup> Andersen, A.G., Markussen, S. & Røed, K. (2019). *Local labor demand and participation in social insurance programs*. *Labour Economics*, Volume 61. <https://www.sciencedirect.com/science/article/pii/S0927537119300934>

provided as a later step, for example:

- as a stand-alone scheme
- as an extension of the AC Scheme
- as an extension of a displaced worker scheme
- through improving existing systems. This could involve improving health treatment, rehabilitation and income support (eg time-limited individualised payments) within the existing parameters and system structures. A system view of solutions would involve focusing on the existing structures in place, and how these can be improved or adapted to better address problems or produce outcomes.

17. This could be the subject of further dedicated work involving the Ministry of Social Development, Ministry of Health and Ministry of Business, Innovation and Employment.

### ***The differences between support provided by ACC and MSD***

18. The table below was completed in late 2018 to illustrate the differences between support provided by ACC and MSD. Updating the table to reflect income support changes made as part of Budget 2019 and Budget 2020 will result in some adjustments to the amounts but not the overall direction of the differences.

**Table 1: Income assistance for a person with a health condition, disability or injury as at October 2018**

<b>Scenario<sup>1</sup></b>	<b>Health condition, disability or injury not covered by ACC</b>	<b>Personal injury covered by ACC<sup>2</sup></b>
<b>Scenario 1.</b> <i>A person over 25 years old, with no dependents, working 40 hours a week at the minimum wage, develops a health condition that temporarily affects their ability to work</i>	<b>MSD main benefit</b> JS-HCD <b>\$215.34</b> net in hand a week <sup>3</sup>	<b>ACC earnings-related weekly compensation</b> 80% of the recipient's average weekly income: <b>\$447.11</b> net in hand a week <sup>4</sup>
	<b>MSD supplementary assistance</b>	<b>MSD supplementary assistance</b>
	AS <b>\$105</b> net in hand a week (maximum AS rate)	AS <b>\$70</b> net in hand a week <sup>5</sup> (maximum AS rate after calculating income reduction)
	DA <b>\$23</b> net in hand a week (average DA rate)	DA <b>\$23</b> net in hand a week (average DA rate)
	<b>Total</b> <b>\$343.34</b> net in hand a week	<b>Total</b> <b>\$540.11</b> net in hand a week
<b>Scenario 2.</b> <i>A couple, both over 25 years old, with no dependents, both working 40 hours a week at the minimum wage, where one person develops a health condition that temporarily affects their ability to work</i>	<b>MSD main benefit</b> Not eligible for main benefit (benefit is fully abated due to income test for a couple)	<b>ACC earnings-related weekly compensation</b> 80% of the recipient's average weekly income: <b>\$447.11</b> net in hand a week
	<b>MSD supplementary assistance</b>	<b>MSD supplementary assistance</b>
	AS <b>\$154<sup>6</sup></b> net in hand a week (maximum AS rate for a couple after income reduction)	AS <b>\$7</b> net in hand a week (maximum AS rate for a couple after income reduction)
	DA <b>\$23</b> net in hand a week (average DA rate)	DA Not eligible (above maximum income limit for couple)
	<b>Total:</b> <b>\$177</b> net in hand a week	<b>Total:</b> <b>up to \$454.11</b> net in hand a week
<b>Scenario 3.</b> <i>A person</i>	<b>MSD main benefit</b>	<b>ACC earnings-related weekly</b>

In Confidence

Scenario <sup>1</sup>	Health condition, disability or injury not covered by ACC	Personal injury covered by ACC <sup>2</sup>
<i>over 25 years old, with no dependents, if the person develops a health condition or an injury that permanently and severely affects their ability to work</i>	SLP <b>\$269.15</b> net in hand a week	<b>compensation</b> 80% of the recipient's average weekly income: <b>\$447.11</b> net in hand a week <b>MSD supplementary assistance</b>
	<b>MSD supplementary assistance</b>	AS <b>\$70</b> net in hand a week (maximum AS rate for this recipient after income reduction)
	AS <b>\$105</b> net in hand a week (maximum AS rate)	DA <b>\$23</b> net in hand a week (average DA rate)
	DA <b>\$23</b> net in hand a week (average DA rate)	<b>Total: \$540.11</b> net in hand a week
	<b>Total: \$397.15</b> net in hand a week	<b>ACC compensation for permanent impairment</b> Lump sum payment within a range from \$3,455.24 to \$138,209.55, depending on the level of impairment <sup>7</sup> or Independence allowance assessed weekly but paid quarterly, with rates ranging from \$197.73 to \$1,186.64 <sup>8</sup>

**Notes:**

ACC = Accident Compensation Corporation; AS = Accommodation Supplement; DA = Disability Allowance; JS-HCD = Jobseeker Support – Health Condition or Disability; MSD = Ministry of Social Development; SLP = Supported Living Payment.

1) All scenarios are based on the following assumptions:

- The recipient/couple lives in Area 2 (<https://www.workandincome.govt.nz/map/deskfile/extra-help-information/accommodation-supplement-tables/definitions-of-areas.html#Area23>) and receives the maximum Accommodation Supplement (AS), which factors in an income reduction where applicable.
- The recipient/couple has no cash assets and the only source of chargeable income is their wage earnings or earnings-related weekly compensation.
- The recipient/couple does not receive Temporary Additional Support or the Winter Energy Payment.
- DA received is the average amount of \$23 per week, based on data as at the end of March 2018. Note however, that 36% of all recipients receive \$10 or less a week, and over half of these receive \$5 or less a week.

Any available MOH funding has not been included in the scenarios.

2) Any health condition, disability or injury that is 'covered' as a 'personal injury' under ACC's statutory eligibility criteria. Note that a person who is covered by ACC for personal injury may also qualify for MSD supplementary assistance. However, most of their personal injury costs are likely to be fully funded by ACC, meaning they are less likely to receive the average DA rate.

3) The recipient would be eligible for Jobseeker Support on the grounds of a health condition or disability (JS-HCD) that temporarily affects their ability to work. A stand-down period may apply.

4) The first week is usually paid by the employer if the injury occurs at the place of work. ACC weekly compensation, based on 80% of the adult minimum wage of \$660 for a 40-hour week, is approximately \$447.11 net (excluding KiwiSaver and Student Loan deductions).

5) This assumes that the person will take up AS. However, take-up rates for AS are considered low among non-beneficiaries.

6) The maximum payable for a couple with no dependents in Area 2 is \$155 per week. However, based on the partner's income level this is reduced by \$1 a week.

7) Claims for injuries that occurred on or after 1 April 2002 are eligible to be considered for this lump sum. Earlier claims are eligible to be considered for an independence allowance. The lump sum payment for impairment is not treated as income for MSD benefit purposes and is not subject to the ACC direct deduction. It is also excluded as a cash asset for Accommodation Supplement, Residential Care Subsidy and hardship benefits for the first 12 months.

8) Claimants can elect to receive a one-off payment covering five years, in lieu of quarterly payments. The allowance is not income and not a direct deduction. It is excluded as a cash asset for AS or Residential Care Subsidy and hardship benefits for the first 12 months.