



BRIEFING

Exploring social insurance and other options to enhance financial support for displaced workers

Date:	18 December 2019	Priority:	Medium
Security classification:	In Confidence	Tracking number:	1954 19-20

Action sought		
	Action sought	Deadline
Hon Grant Robertson Minister of Finance	Agree to discuss next steps at a ministerial meeting in 2020.	28 February 2020
Hon Phil Twyford Minister of Economic Development		
Hon Chris Hipkins Minister of Education		
Hon Carmel Sepuloni Minister for Social Development		
Hon Stuart Nash Minister of Revenue		
Hon Iain Lees-Galloway Minister for Workplace Relations and Safety		
Hon Kris Faafoi Minister of Commerce and Consumer Affairs		
Hon Willie Jackson Minister of Employment		

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Jivan Grewal	Manager, Skills & Employment Policy	Privacy of natural persons	
Francis van der Krogt	Principal Advisor		✓

The following departments/agencies have been consulted
Ministry of Social Development, Inland Revenue, The Treasury

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Withdrawn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

The purpose of this paper is to seek ministerial direction on the focus for future work on the role of financial support in supporting displaced workers. The attached scoping study provides a longer discussion of these issues.

Executive summary

Enhancing support for displaced workers is an important aspect of the Government's transitions agenda, and an immediate priority for the Future of Work programme especially.

Where support for displaced workers is limited, there is a greater risk of unemployment and / or wage scarring (the marked falls in income that many displaced workers experience once they are re-employed). The OECD has observed that wage scarring effects appear to be particularly large in New Zealand.¹

There is work underway across government that will broadly enhance support for displaced workers including the Future of Work Tripartite Forum projects on Industry Transformation Plans, and measures to increase in-work training, and enhance worker protections. The welfare overhaul, Reform of Vocational Education, and Careers Strategy will also contribute through enhancing employment services, access to education and training, and careers information.

However, exploring options to enhance financial support through periods of displacement – and exploring how this complements other mechanisms – is not currently an active area of work. From a worker's perspective, the most effective financial support "smooths" income from displacement to re-employment, thereby ensuring a worker can maintain their standard of living. Income smoothing mechanisms are an integral aspect of support for displaced workers in many countries, and tend to be linked to participation in employment support, and education and training. The Productivity Commission has recently argued for the adoption of income smoothing mechanisms in New Zealand.²

Reflecting this gap in the work programme, Ministers directed the Ministry of Business, Innovation, and Employment, in collaboration with the Ministry of Social Development (MSD), to conduct a scoping study into options to enhance financial support, noting that the welfare overhaul is also reviewing the benefit system and the expansion of MSD employment services.

The objective of the attached scoping study was to identify whether there is value investing in a subsequent careful and considered policy process to explore any of the considered options further, or other options not yet identified. There is a particular focus on whether income smoothing

¹ OECD (2017), *Back to Work: New Zealand: Improving the Re-employment Prospects of Displaced Workers*

² New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, pp.1-2

mechanisms could be specifically designed to help minimise wage scarring through coupling them with tailored employment support.

The analysis is deliberately high level, seeking only to provide an indicative assessment of the options. The objective was solely to inform decisions about the scope of a future work programme, rather than to propose policy options for implementation.

The scoping study considered six options for enhancing financial support:

- access to KiwiSaver funds;
- modified tax credits;
- a displaced worker loan scheme modelled on the student loan scheme;
- statutory redundancy payments;
- statutory redundancy payments with a financing scheme; and
- social unemployment insurance.

Of the options considered, social unemployment insurance has the most potential to smooth incomes, and reduce wage scarring. The potential to reduce wage scarring arises primarily through designing and implementing the insurance scheme in a way that incentivises the scheme's managers to tailor support to improving displaced workers' future earnings prospects. This would be a difficult design challenge, but one that is worth exploring further.

A statutory redundancy scheme (potentially with a financing scheme) has potential to provide income smoothing, but has less potential to address wage scarring.

Officials propose that Ministers meet in the New Year to discuss the options and any further work.

Recommended action

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

Background

- a. **note** that enhancing support for displaced workers is an important aspect of the Government's transitions agenda, and an immediate priority for the Future of Work programme especially;

Noted

- b. **note** that there is work underway across government that will broadly enhance support for displaced workers - in particular through the Welfare Overhaul, Reform of Vocational Education, and Careers Strategy;

Noted

Scoping study into options to enhance financial support

- c. **note** that financial support can be one aspect of supporting displaced workers, alongside employment opportunities, employment brokerage and advisory services, and access to education and training;

Noted

- d. **note** that Ministers directed the Ministry of Business, Innovation, and Employment, in collaboration with MSD, to conduct a scoping study into options to enhance financial support, noting that the welfare overhaul is also reviewing the benefit system and the expansion of MSD employment services;

Noted

- e. **note** that the objective of the attached scoping study was to identify whether there is value investing in a subsequent careful and considered policy process to explore any of the considered options further, or other options not yet identified;

Noted

- f. **note** the study's conclusion that, of the options considered, social unemployment insurance has the most potential to:
- i. smooth incomes, and
 - ii. reduce wage scarring, primarily through designing and implementing an insurance scheme in a way that incentivises the scheme's managers to tailor support to improving displaced workers' future earnings prospects;

Noted

- g. **note** that a statutory redundancy scheme (potentially with a financing scheme) has potential to provide income smoothing, but has less potential to address wage scarring;

Noted

Next steps

- h. **note** that the scoping study is a preliminary analysis only, and that any further work on financial support would need to include investigation of option costs, option benefits and other issues; and

Noted

i. **agree** to meet in 2020 to discuss the options and any further work.

Agree / Disagree

Jivan Grewal
Manager, Skills & Employment Policy
Labour, Science, and Enterprise, MBIE

..... / /

Hon Grant Robertson
Minister of Finance

..... / /

Hon Phil Twyford
Minister of Economic Development

..... / /

Hon Chris Hipkins
Minister of Education

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Hon Carmel Sepuloni
Minister for Social Development

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Minister of Revenue

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Hon Kris Faafoi
Minister of Commerce and Consumer Affairs

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Hon Iain Lees-Galloway
Minister for Workplace Relations and Safety

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Hon Willie Jackson
Minister of Employment

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Background

1. Enhancing support for displaced workers is one of the Future of Work Tripartite Forum's priorities for further work, in support of an overarching theme of helping workers find and keep decent jobs.
2. While there are a number of steps underway to enhance support for displaced workers, exploring options to enhance financial support through periods of displacement – and exploring how this complements other mechanisms – is not currently an active area of work.
3. Noting this gap, Ministers agreed in September that MBIE should conduct a scoping study into the options for enhancing financial support, with a particular focus on social unemployment insurance.³ This briefing summarises the findings of the scoping study, a copy of which is also attached to this briefing.

Designing a system to help displaced workers find and keep decent jobs

4. Earlier this year, MBIE produced a research paper on the state of support for workers experiencing displacement arising from economic change, and the options to enhance that support.⁴
5. There are a number of reasons why a worker can become involuntarily displaced. These reasons include poor health, disability, the completion of temporary, seasonal, or fixed term contracts and trial periods. Self-employed people can also find themselves without work. A subset of involuntary displacement – and the main focus of this paper – is where displacement is due to *redundancy*.
6. While the main focus is on redundancy, and how financial support can be part of a system for supporting workers affected by redundancy, there is a key question as to the *preferred coverage* of any additional financial support instruments. The cause of displacement (such as redundancy, health conditions, disability, and so on) and nature of prior employment (such as full-time permanent employment or temporary employment) are key dimensions of coverage. Coverage choices are a central aspect of designing financial support instruments, and have major impacts on cost, complexity, equity and (potentially) employers' hiring preferences. These choices would be a fundamental element of any future work on the options discussed in this paper.
7. MBIE's earlier research paper identified four complementary forms of support for displaced workers, as illustrated in the table below:

³ *Support for Displaced Workers – Proposed further work*, 30 September 2019 refers, MBIE Tracking number: 01011 19-20

⁴ *Aide Memoire and discussion paper on support for displaced workers*, 14 June 2019 refers, MBIE Tracking number: 3866 18-19

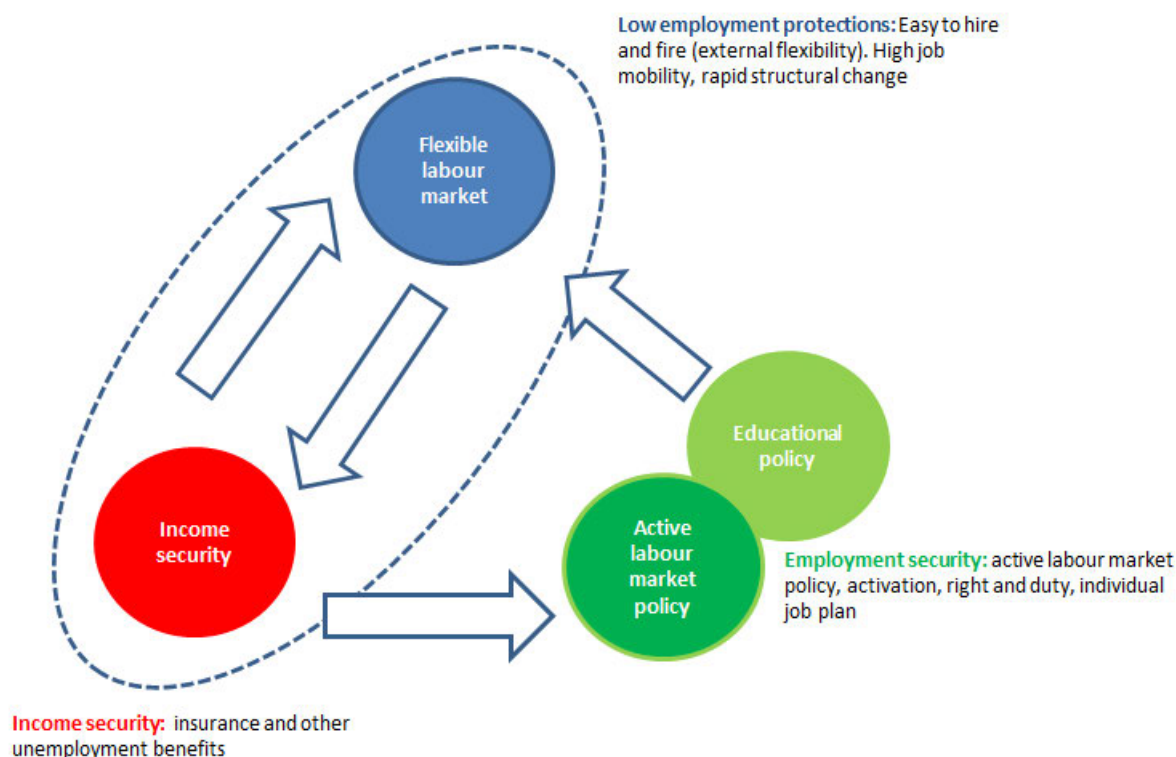
Forms of support for enabling smooth transitions	Description
Employment opportunities	A business and economic environment that ensures availability of employment opportunities will ensure workers can move into (or remain in) employment (can also include steps such as encouraging worker mobility, and coordinated economic development initiatives such as Industry Transformation Plans). It also includes the complex nature of job matching where several factors such as skills, location and work hours play a vital role.
Advice and brokerage services	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 Brokerage and job search assistance connects people with employment opportunities and tailors support to individual needs.
Education and training	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).
Financial support	Financial security through transitions minimises hardship and provides stability through job search and retraining. 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. The way financial support is funded and delivered and linked to the other forms of support can materially affect worker outcomes.

8. Ideally, these forms of support operate as a coherent system that promotes dynamic flows of workers between jobs, with an emphasis on effectively matching workers to jobs that suit them.
9. In such a system, workers may well be displaced from their jobs, but the impact of job loss is cushioned through a system of support that helps them to obtain either new work, or to engage in appropriate retraining and upskilling.

New Zealand can learn from the Danish approach to supporting displaced workers

10. The Danish “Flexicurity” model is widely regarded as a leading example of this approach. Flexicurity provides flexibility for businesses to grow and contract, and income security for workers. Flexicurity combines the mutually reinforcing elements of vigorous job search obligations, comprehensive employment support (Active Labour Market Programmes), financial support, and limited statutory employment protections. The focus of this approach is to protect workers rather than jobs, thereby harmonising a dynamic and highly productive economy with worker wellbeing.
11. It is unlikely there could be a simple transfer of the Danish model to New Zealand. That model operates within a different national context and a different set of circumstances including higher personal tax rates, very high union membership and a mature tripartite policy development infrastructure. However, there is value in examining the components of the Danish system and the principles underpinning it.
12. The Danish employment system's combination of flexibility and security is often described as a ‘golden triangle’. The flexicurity model combines high mobility between jobs with a comprehensive income safety net for the unemployed and high levels of investment in active

labour market programmes. Flexicurity operates as a cohesive system, as the following diagram illustrates.⁵



13. Income security in Denmark is provided through a generous social unemployment insurance scheme (funded by workers and the government) that serves to “smooth workers” incomes” through periods of unemployment, with the highest levels subject to minimum eligibility periods and contributions. The unemployment insurance scheme is complemented by a means-tested welfare system.

Steps to enhance New Zealand’s system to help displaced workers find and keep decent jobs

14. Compared to a more comprehensive system such as Denmark’s, support for displaced workers in New Zealand to find and keep decent jobs is modest.
15. The modest levels of support for displaced New Zealand workers may contribute to the marked falls in income that many displaced workers experience once they are re-employed (“wage scarring”). Wage scarring is a complex phenomenon, and other factors could be relevant in New Zealand, such as “thin” labour markets. The OECD has observed that wage scarring effects appear to be particularly large in New Zealand.
16. There is, however, work underway in a number of areas to enhance support.

Active Labour Market Policies and Programmes, Advice and brokerage services, Employment services

17. The First Principles Review of Active Labour Market Policy is taking a fundamental look at the roles of Active Labour Market Programmes in promoting a productive, inclusive and

⁵ Danish Agency for Labour Market and Recruitment, <https://star.dk/en/about-the-danish-agency-for-labour-market-and-recruitment/flexicurity/>

sustainable economy. This review intersects with the welfare overhaul, through which the Minister for Social Development proposes to expand MSD employment services over time to support more people experiencing difficulty finding and staying in suitable employment. This is likely to include enhancing MSD's proactive responses to larger scale redundancies, and the availability of active employment services.⁶

Education and training

18. A number of education and skills related initiatives will also potentially benefit displaced workers. The Reform of Vocational Education will ease access to vocational training. The Regional Skills Leadership Groups and the Workforce Development Councils will enhance how the skills system equips workers with the skills that employers demand. Further, MBIE, working with the Forum Partners, is exploring further measures to increase access to in-work training. The Careers System Strategy will improve the availability and quality of careers advice to workers.

Employment opportunities and economic development

19. The Government's Economic Plan is designed to deliver a strong economy that provides decent jobs, and higher incomes and opportunities. Industry Transformation Plans – partnerships with industries to transform economic sectors – are amongst the tools for delivering the plan.
20. Workforce transitions will be an integral component of industry transformation planning, for both sunrise and sunset industries. Such planning will be an important part of proactively managing the risks of displacement through identifying workers at risk and mapping a pathway to new jobs. Some of the factors such as job choice, work flexibility, relocation and redeployment are important for the redundant worker to consider. A Just Transitions approach is currently being delivered in Taranaki.

Income security

21. In addition to a focus on employment services, the welfare overhaul is also considering the adequacy of welfare payments and other transfers. Any enhancements, however, are unlikely to be sufficient to replace substantially the incomes lost by all workers who become redundant. The welfare system in New Zealand is primarily intended as a minimum income safety net and is unlikely to become an effective tool for smoothing incomes except for some lower-income workers.
22. This highlights a key point of difference between New Zealand and most other advanced economies. In most developed countries, welfare systems are complemented by mechanisms to smooth workers' incomes through periods of unemployment.⁷ With the exception of purely private arrangements, New Zealand lacks such mechanisms
23. Income smoothing mechanisms – unlike means-tested welfare payments – primarily seek to maintain a displaced worker's prior standard of living until they obtain a new job. Income smoothing mechanisms can reduce hardship where people face fixed costs of living that were based upon previous incomes, and (combined with extensive employment support) aim to enable a longer and more successful job search.

⁶ Future of Work Tripartite Forum, (2019), *Strategic Assessment, Priorities for New Zealand's Future of Work*, p.13

⁷ Fletcher, M. (2015). *The structure and generosity of financial assistance for beneficiaries: How New Zealand compares with other OECD countries*. pp.3-4

24. Exploring options to enhance financial support through periods of displacement – and exploring how this complements other mechanisms – is not currently an active area of work, although financial support appears to be an important part of a system to support displaced workers effectively if smooth transitions are the desired outcome.
25. The Productivity Commission has recently argued for the adoption of income smoothing mechanisms, noting that “There is a case to improve income security for displaced workers with income smoothing policies that cushion the financial shock of job loss. Doing so could:
 - make workers less fearful about switching jobs and more accepting of labour-market settings that promote dynamism in the economy but reduce job security;
 - achieve better labour-market matching – by enabling those who lose their jobs to take more time to search for a better, high-paying job that is a good match for their skills; and
 - improve attitudes towards technology – as effective support systems can reduce fears about job loss and so make workers more welcoming of policies that embrace technology.”⁸
26. It is plausible that a well-designed income-smoothing mechanism – as part of a wider system – could improve outcomes for displaced workers, and in particular reduce wage scarring effects.
27. The scoping study is a step towards addressing this gap. This is not to detract from the need also to address each of the three other elements – employment opportunities, employment support, education and training – and to ensure that policies are designed to be coherent.

⁸ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, pp.1-2

The scoping study identified six options for enhancing financial support

28. The scoping study identified six options for enhancing financial support, as described in the table below. The options are listed in order of the scale of potential policy change, from modest incremental change, to substantial change. The table also includes an indicative comment on how the options could interact with the existing transfer system (benefits and tax credits).

Six options for enhancing financial support		Indicative gross potential entitlement in one year (assuming gross pre-displacement income of \$60,000) ⁹
Access to KiwiSaver funds	This option assumes that eligibility for early access to KiwiSaver funds is widened to include redundancy. Displaced workers would be able to access a portion of their savings up to a cap, such as a percentage of the saved funds. The cap would help to ensure that funds intended for retirement are not fully depleted. This would require careful policy consideration as to whether it is intended to replace or supplement other government assistance (such as welfare payments and other transfers).	\$1,300 (assumes a worker accesses 10% of the median KiwiSaver balance, estimated to be \$13,000 in 2018. ¹⁰ The average KiwiSaver balance is \$19,000 in 2019.) ¹¹
Modified tax credits	This option assumes eligibility for the In-work Tax Credit and the Independent Tax Credit is relaxed so that displaced workers are entitled to these payments for a period following displacement. This could be complemented by reinstatement of the previous provision for tax relief for redundancy payments. Tax credits already form part of New Zealand's income support system and complement benefit payments, but this option may create new interactions.	\$656 (Assumes eligibility for these payments continues for a further 2 months. <i>In-Work Tax Credit</i> of up to \$72 per week for one child, for two months = \$576 <i>Independent Earner Tax Credit</i> = up to \$10 per week, for two months = \$80)
A displaced worker loan scheme modelled on the student loan scheme	This option assumes that State establishes a loan facility for redundant workers. This would require careful policy consideration as to whether it is intended to replace or supplement other government assistance.	up to \$48,000 (assumes a worker can borrow up to 80% of \$60,000, one year's salary)

⁹ These cost estimates are indicative only, and have not been reviewed by The Treasury or the Ministry of Social Development.

¹⁰ <https://www.stats.govt.nz/news/kiwisaver-nest-eggs-grow-5000-in-three-years>

¹¹ Financial Markets Authority, (2019), *KiwiSaver Annual Report 2019*, p.7

Statutory redundancy payments	<p>This option assumes the imposition of a statutory obligation on firms to make redundancy payments. Payment would be based on a (minimum) standard statutory formula based on length of service, such as 4 weeks for the first year of service and two weeks' pay for each subsequent year. Voluntary redundancy payments currently complement existing welfare payments – they only affect entitlements to some supplementary assistance.</p>	<p>\$15,000</p> <p>(assumes five years of service with an employer, with four weeks' pay for the first year (\$5,000) plus two weeks' pay for each of the subsequent four years (\$10,000)</p>
Statutory redundancy payments with a financing scheme	<p>A variation on the option above is for the State to manage a central fund from which redundancy payments are made. Employers, employees, and the government could contribute to such a fund.</p> <p>Payments could be based on a formula other than tenure with previous employer, and instead linked to unemployment risk.</p> <p>This would be a form of “portable” redundancy payment, not linked to a particular employer.</p> <p>Voluntary redundancy payments currently complement existing welfare payments – they only affect entitlements to some supplementary assistance.</p>	<p>\$15,000</p> <p>(assumes five years of service, with four weeks' pay for the first year (\$5,000) plus two weeks' pay for each of the subsequent four years (\$10,000)</p> <p>Could be more generous if the payment provided an insurance-style replacement rate for a fixed duration – as below – rather than being based on tenure.</p>
Social unemployment insurance	<p>This option assumes establishment of a social unemployment insurance scheme whereby displaced workers are entitled to a replacement income, while engaged in active job search, up to a fixed duration. The scheme would be designed in such a way that employment support, and education and training, are integral.</p> <p>This option would likely replace payments through the existing welfare system for the duration of eligibility, since insurance payments would be treated as income. Such interactions could be assessed through subsequent work.</p> <p>Insurance schemes can be designed to provide a range of alternative replacement rates. The ACC scheme provides a replacement rate of up to 80% of prior income.¹²</p> <p>A recent report produced for the Productivity Commission assumed a replacement rate of 50% of prior income.¹³</p>	<p>up to \$30,000 - \$48,000, depending on replacement rate, and duration of unemployment within eligibility period</p> <p>(\$30,000 assumes 50% of a \$60,000 salary paid over one year. \$48,000 assumes 80%.)</p>

¹² <https://www.acc.co.nz/im-injured/financial-support/weekly-compensation/>

¹³ New Zealand Productivity Commission, (2019), *Unemployment insurance: what can it offer NZ? Report for the Technology and the Future of Work Inquiry*, prepared by Kathy Spencer

Each option reflects different design principles

29. The key design choices are the extent to which payments aim to replace pre-displacement incomes (“smoothing”), whether funds are pooled or individualised, and who bears the costs.

Earnings related income replacement

30. “Earnings related income replacement” refers to whether a payment seeks to ensure that payments are close to a worker’s level of income prior to displacement. The closer the payment to pre-displacement income, the higher the replacement rate. Higher replacement rates are more effective at smoothing incomes. ACC’s 80% income protection replacement rate is an example of income smoothing.

Pooled funding

31. “Pooled funding” arrangements are those where all of the contributors’ funds are combined so that all members can access those funds as the need arises (ie – when a worker is made redundant). This is a form of risk-sharing. Pooled funding is distinct from individualised arrangements, where there is no combining of funds, or risk-sharing.
32. Where funding is individualised, members accumulate funds over time. If they do not draw on them, those funds can become available on retirement. Where funding is pooled, members do not accumulate funds, but it becomes possible to provide consistent replacement incomes to all members in the event of unemployment. Pooled funding is the usual tool for financing high replacement rates, and hence effectively smoothing incomes.

Costs

33. The direct cost of financing can lie with workers, firms, the government, or some combination of the three parties (though all parties will bear some of the cost indirectly as these costs will be passed-on between parties to some degree). The allocation of costs has important impacts on incentives and behaviour, and on worker outcomes.
34. The following table illustrates these design choices.

Options	Key design dimensions		
	Pooled / individualised funds	Earnings related income replacement	Direct liability for costs (who pays)
1 - Enabling greater access for displaced / redundant workers to their KiwiSaver accounts	individualised	partially	workers (own savings)
2 - Widening access to existing tax credits , and / or establishing new tax credits	N/A	no	government (taxation)
3 -Establishing a loan scheme for displaced / redundant workers	N/A	yes	workers & government
4- Mandating statutory redundancy payments	N/A	yes	employers
5- Mandating statutory redundancy payments with a financing scheme	pooled	yes	employers (and maybe workers and government)
6- Establishing an earnings-related social unemployment insurance scheme	pooled	yes	employers / workers / government

Findings

35. The scoping study conducted a very preliminary scan of the six approaches, primarily in terms of their potential to:
- encourage employers to support workers through transitions;
 - reduce significantly, for a majority of displaced workers, the adverse financial impacts of an unemployment spell (income smoothing); and
 - reduce significantly, for a majority of displaced workers, the wage scarring they can experience on re-employment
36. The scoping study also assessed the six approaches in terms of their risk and scale of change required. It was not possible in the time available to assess costs with any precision, but this could be the subject of future work.
37. The analysis was deliberately high level, seeking only to provide an indicative assessment. The objective was solely to inform decisions about the scope of a future work programme, rather than to propose policy options for implementation. Any further work would need to be much more thorough, with a more detailed consideration of policy objectives, and the costs and benefits of alternative responses.
38. The six options considered fall on a continuum of scale of policy change. The options to widen KiwiSaver access, establish a loans scheme, or adjust eligibility for existing tax credits constitute modest changes to existing policy settings. There appears to be little risk in such changes, but likely also little benefit. Some or all of these could be pursued if Ministers were interested in near-term, low cost responses.
39. The options to mandate redundancy payments or establish an insurance scheme are clearly more complex, more costly, and longer-term propositions. An insurance scheme also introduces the idea of sharing or “socialising” costs across the workforce through pooling funding. These options also offer greater prospects of smoother worker transitions, although with some risks and trade-offs.
40. As the Productivity Commission notes, under an unemployment insurance system, the insurer has strong incentives to support a displaced worker back into the workforce to minimise ongoing insurance payment costs.¹⁴ A social unemployment insurance scheme could be designed to exploit these incentives, so the insurer seeks not just to support the worker back to work, but to support them to work that maximises their earning prospects (ie minimise wage scarring). As the Commission further notes, “Responsibility for labour-market programmes for their clients might best be assigned to the insurer, who has the right incentives to design, evaluate and improve programmes for different types of client.”¹⁵
41. We are not aware of any existing models that expressly seek to reduce wage scarring. Further, international evidence suggests that participation in a social insurance scheme per se is only weakly associated with better re-employment outcomes.

¹⁴ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, p.74.

¹⁵ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, p.83

42. However, there appear to be potential design choices that could increase the effectiveness of a social insurance model in minimising wage scarring. These design choices include, but would not be limited to:
- an initial “right of refusal period” whereby workers could decline wage-scarring job offers;
 - “experience ratings” applied (at industry level) to insurance premiums, so that employers that support workers pay lower premiums; and
 - the award of government contracts to the private employment agencies (and potentially unions) that *most effectively place workers into non-scarring jobs*.
43. The objective of these features would be to influence the insurer, or their agents, to target reductions in wage scarring. Devising a social unemployment insurance scheme that targeted reductions in wage scarring would be a difficult design challenge, but one that is worth exploring further.
44. A statutory redundancy scheme (potentially with a financing scheme) has potential to provide income smoothing. Such a scheme has less potential to address wage scarring, since employment service providers lack the strong incentives provided under insurance models to support workers.
45. The table on the following page presents a summary of the options analysis. The red, amber, green shading indicates respectively either a poor, reasonable, or good fit with the assessment criteria.

Fit with assessment framework	Poor			Reasonable			Good			
Options	Impacts on workers' outcomes						Other key impacts			
	encourage employers to support workers through transitions	to reduce significantly, for a majority of displaced workers, the adverse financial impacts of an unemployment spell			to reduce significantly, for a majority of displaced workers, the wage scarring they can experience on reemployment			Scale of change	Cost	Risk
1 - Enabling greater access for displaced / redundant workers to their KiwiSaver accounts			mixed impacts			mixed impacts		limited	low	low
2 - Widening access to existing tax credits , and / or establishing new tax credits								limited	low	low
3 -Establishing a loan scheme for displaced / redundant workers								moderate	moderate	moderate
4- Mandating statutory redundancy payments			mixed impacts					substantial	mixed impacts	substantial
5- Mandating statutory redundancy payments with a financing scheme								significant	mixed impacts	substantial
6- Establishing an earnings-related social unemployment insurance scheme								significant	mixed impacts	substantial

Consultation

46. This briefing and the attached scoping study were developed collaboratively with The Treasury, Ministry of Social Development, and Inland Revenue.
47. The New Zealand Council of Trade Unions and Business New Zealand were also consulted on this report and scoping study.
48. Comments from the social partners and The Treasury are provided below.

New Zealand Council of Trade Unions comment

49. The CTU considers that the personalised options (such as extending use of Kiwisaver, loan schemes, personal redundancy insurance) are likely to exacerbate existing disadvantage and scarring because those on lower incomes, in insecure jobs or in an industry which because of decline or rapid innovation is subject to high turnover will find it harder to save and pay for these. The approach fails to make a significant inroad into providing income replacement for those who most need it.
50. The CTU supports mandatory statutory redundancy payments, and is willing to discuss whether they are financed through an employer levy-funded financing scheme or directly by individual employers. It supports consideration of an earnings-related social income replacement scheme funded on similar lines to ACC. It further suggests that the option of an extension to a reformed social welfare system should also be considered. The CTU emphasises that while greatly improved income replacement arrangements are vital, they should be considered alongside active labour market policies such as much improved work-based education and training opportunities (lifelong learning), assistance with job search and career planning, and relocation assistance.

Business New Zealand comment

51. Business New Zealand agrees with the need for a comprehensive approach to support displaced workers. Social protection mechanisms, including income protection, redundancy compensation and the like however are likely to be ineffective on their own.
52. It is argued internationally that social protection should be seen as an investment rather than a cost. Business New Zealand agrees with this but notes that to be an investment, social protection must produce a return that makes it worth investing in. Otherwise it is just a cost.
53. Business New Zealand believes that the investment return comes in the form of employability of workers, as this is what will secure their futures. Optimising the employability of the workforce requires a lifelong, comprehensive and integrated approach which integrates the health and education systems (i.e. broader than training and development) with social protection systems. The current proposals do not address this wider perspective and should do so.
54. In terms of options for income protection per se, Business New Zealand's preference is for a broad based approach that is capable of integration with the education and health components of an effective system. Of the options identified, the social insurance approach is most consistent with Business New Zealand's thinking. Options that are essentially reactive in nature should be avoided in a long term approach.

Treasury comment

55. We are concerned that the analysis of the problem and case for intervention is not sufficiently robust, given the scale and costs of some of the proposed interventions. In particular we have concerns about the evidence around wage scarring, how amenable it is to intervention, and the impact on different groups of workers. We would like to see further work to define the

problem and affected population groups, particularly in relation to non-redundancy related involuntary job loss and the consequent income-effects for different groups.

56. The scoping study does not consider the wide range of impacts on the economy and the labour market because it takes a worker-centric focus. The focus on workers may result in policy solutions that limit flexibility and protect existing job holders (likely to favour older, male, skilled workers) with a corresponding disadvantage to lower-skilled, younger and female workers. Further work is needed in the exploratory stages of this work to model the flow-on effects of increasing the costs of labour and market exit, and the potential for reduced labour market participation and fewer, less flexible avenues for market entry.

Next steps

57. The purpose of the scoping study was to inform decisions about the scope of a future work programme on support for displaced workers.
58. Since the scoping study is a preliminary analysis only, any further work would need to include investigation of option costs, option benefits and other issues.
59. This work would need to consider costs and benefits at an economy-wide level, and consider a range of choices for coverage (both coverage of individuals, and the circumstances covered by new income security mechanisms).
60. Ministers may wish to commission further work from MBIE in collaboration with MSD on some or all of the options discussed in this paper, or other options not yet identified, and could discuss these choices at a meeting with officials in the New Year.

Annex

Annex One: Scoping study: Exploring social insurance and other options to enhance financial support for displaced workers

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Scoping study: Exploring social insurance and other options to enhance financial support for displaced workers

Purpose

This paper seeks to inform discussions about the next steps for the displaced workers policy work programme. The paper focusses on financial support for displaced workers, including the role of social unemployment insurance, exploring whether there is a prima facie case to conduct detailed policy work on options such as this.

Executive summary

Enhancing support for displaced workers is an important aspect of the Government's transitions agenda, and an immediate priority for the Future of Work programme especially.

This scoping study explores options to enhance financial support available to displaced workers, noting that the Welfare Overhaul is also reviewing the benefit system. The scoping study considered six options for enhancing financial support:

- access to KiwiSaver funds;
- modified tax credits;
- a displaced worker loan scheme modelled on the student loan scheme;
- statutory redundancy payments;
- statutory redundancy payments with a financing scheme; and
- social unemployment insurance.

Of the options considered, social unemployment insurance has the most potential to smooth incomes, and reduce wage scarring. The potential to reduce wage scarring arises primarily through designing and implementing the insurance scheme in a way that incentivises the scheme's managers to tailor support to improving displaced workers' future earnings prospects. This would be a difficult design challenge, but one that is worth exploring further.

A statutory redundancy scheme (potentially with a financing scheme) has potential to provide income smoothing, but has less prospect of addressing wage scarring.

Introduction

Improving support for displaced workers is central to the Government's transitions agenda, and one of the Future of Work Tripartite Forum's four focus areas.

Earlier this year, MBIE produced a research paper on the state of support for workers displaced by economic change, and the options to enhance that support.¹

The research paper found that support for such workers is limited (especially employment and financial support), and that this likely contributes to relatively high levels of wage reductions upon reemployment (wage scarring) in New Zealand relative to other OECD countries. These modest levels of support could become an even greater concern if rates of displacement accelerate.

There is work underway across government that will broadly enhance support for displaced workers including the Future of Work projects on Industry Transformation Plans, and measures to increase in-work training, and enhance worker protections. The Welfare Overhaul, Reform of Vocational Education, and Careers Strategy will also contribute through enhancing employment services, access to education and training, and careers information.

Financial security for displaced workers specifically is one key area not being directly addressed by any current work programme. Financial security through employment transitions minimises hardship, and provides stability during job search and or retraining. Financial security needs to be combined with other measures including access to employment services, education and training, and employment opportunities.

As a next step, Ministers agreed that MBIE should conduct a scoping study into the options for enhancing financial support, with a particular focus on social unemployment insurance.² If there is a prima facie case for any of these options, then Ministers may wish to commission further more detailed analysis, alongside other work to enhance support for displaced workers.

The analysis provided in this scoping study is deliberately high level, seeking only to provide an indicative assessment. The objective was solely to inform decisions about the scope of a future work programme, rather than to propose policy options for implementation.

This scoping study explores a number of approaches to enhancing financial support, with the important exception of options for reforming the welfare system. This scope exclusion is deliberate, since the welfare overhaul is reviewing the adequacy and eligibility of the main welfare benefits. If this scoping study results in further commission, officials will work together to ensure alignment between these work programmes. This paper *does* seek to understand the implications of other options for the functioning of the welfare system.

¹ *Aide Memoire and discussion paper on support for displaced workers*, 14 June 2019 refers, MBIE Tracking number: 3866 18-19

² *Support for Displaced Workers – Proposed further work*, 30 September 2019 refers, MBIE Tracking number: 01011 19-20

Defining the problem

A dynamic labour market that enables smooth transitions of workers between employers is desirable since workers' and employers' needs and preferences can change. A dynamic labour market allows for these changes through a continuous process of matching, and re-matching between workers and employers. The faster and more effectively this matching occurs the better for both parties and the economy, achieving high skills utilisation, maintaining workers' skills relevance and minimising disruption to worker income and business outputs, while allowing businesses and workers respond quickly and flexibly to market opportunities.

Involuntary job loss, displacement, and redundancy

The vast majority of such transitions are voluntary, and require no direct government intervention. Involuntary transitions, however, can lead to poor outcomes for workers, their families and communities; can impede overall productivity; and can create fiscal costs. In these cases, there can sometimes be a case for government intervention to support workers.

There are a number of reasons why a worker can become involuntarily displaced. These reasons include (amongst others) poor health, disability the completion of temporary, seasonal, or fixed term contracts and trial periods. Self-employed people can also find themselves without work. A subset of involuntary displacement – and the main focus of this paper – is where displacement is due to *redundancy*.

While the main focus is on redundancy, and how financial support can be part of a system for supporting workers affected by redundancy, there is a key question as to the preferred coverage of any additional financial support instruments. Cause of displacement (such as redundancy, or health conditions) and nature of prior employment (such as full-time permanent employment or temporary employment) are key dimensions of coverage. Coverage choices are a central aspect of designing financial instruments, and have major impacts on cost, complexity, equity and (potentially) employers' hiring preferences. These choices would be a fundamental element of any future work on the options discussed in this paper.

Wage scarring

For workers and their families, redundancy can have both immediate and long-term financial and psychological impacts.³ Without some form of financial support, redundancy is likely to cause immediate financial loss, potentially leading to hardship, until the worker is re-employed. Even when fully re-employed, a worker may experience wage “scarring”, and a consequent reduction in living standards.

³ See for example:

Dieckhoff, M. (2011). *The effect of unemployment on subsequent job quality in Europe: A comparative study of four countries*, Social Science Research Centre Berlin

and:

Radio New Zealand, (2018). *Why being made redundant in NZ is so tough*,

Wage scarring describes the reduction in wages that displaced workers often experience on re-employment. These effects can last for many years. Wage scarring implies 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. This also suggests loss of tax revenue, and the possibility of increased transfer costs for Government.⁴

Two recent New Zealand studies have looked at outcomes for workers who reported involuntarily job loss, both employment and earning and income effects. Hyslop and Townsend estimate that displaced workers' employment rates were 20-25% lower in the year following displacement than comparable non-displaced workers and, although their employment gradually improved, was still 8-12% lower five years later. In addition, they estimated their earnings were 25-30% lower in the first year and 13-22% lower after five years being displaced. Impacts were stronger for workers displaced from jobs during the great recession from 2008.⁵

Hyslop and Townsend described their sample of displaced workers as more likely to be male (57% compared to 49% of non-displaced workers), slightly younger on average, slightly more likely to be Maori, and have lower qualifications than never displaced workers. Displaced workers were also less likely to be partnered, and have slightly smaller families. Displaced workers with less than one-year's tenure accounted for almost 30% of all potentially displaced workers. These workers were relatively more likely to be female, younger, Asian or Maori, and single, than those with longer job tenure.

Dixon and Maré, with a smaller sample, estimated the employment rate of displaced workers was on average 27 percentage points lower 0–1 years after displacement, 14 percentage points lower 1–2 years after, and 8 percentage points lower 2–3 years after, than that of the matched comparison group. The average wage of re-employed displaced workers was 12 percent lower 0–1 years after displacement, 11 percent lower 1–2 years after and 7 percent lower 2–3 years after.⁶

Recent evidence suggests that wage scarring has the most pronounced effect on more highly educated workers. Hyslop finds that “displaced workers with degree-level education experience larger adverse short-term employment effects, smaller medium to longer term employment effects, but larger and enduring earnings losses, than other displaced workers.”⁷

While wage scarring is an international phenomenon, and international comparisons are difficult, the OECD has observed that wage scarring appears to be more pronounced in New Zealand.⁸ This may in part result from comparatively low-levels

⁴ Given the theoretical nature of these costs, it would be useful to estimate the costs of wage scarring to workers, firms and Government in any subsequent analysis of the costs and benefits of policy interventions reduce wage scarring.

⁵ Hyslop, D. R. and Townsend, W. (2017), *The Longer Term Impacts of Job Displacement on Labour Market Outcomes*, Motu Working Paper 17-12, Motu Economic and Public Policy Research

⁶ Dixon, S. C., & Maré, D. C. (2013). *The Costs of Involuntary Job Loss: Impacts on Workers' Employment and Earnings*

⁷ Hyslop, D. (2019), *The impacts of job displacement on workers by education level*, p.ii

⁸ OECD (2017), *Back to Work: New Zealand: Improving the Re-employment Prospects of Displaced Workers*

of support afforded to displaced workers. New Zealand's thin labour markets may also help to explain why scarring is more pronounced here.

Rates of displacement

Rates of displacement are also important. All things being equal, a higher rate of displacement suggests a greater incidence of wage scarring, and employment effects. In early 2016, 1.1% of the New Zealand working age population – or 29,000 workers – reported being laid off, dismissed, or made redundant from their previous job.⁹

Dixon and Mare found that the average annual rate of displacement for employees with at least one year's tenure in their jobs was fairly constant from 2003 to 2007, at around 1.5 percent a year. It increased to 3.3 percent during the 2008–2009 recession.¹⁰ They found the average annual rate of displacement was higher for men than women, for young adults and older adults than the age groups in between, and for less educated employees than the more highly educated. Employees with more years of service in their jobs were substantially less likely to be displaced than those with shorter tenure. By industry, employees in government and defence, education, and health and community services had the lowest displacement rates (0.7–0.9 percent), while employees in manufacturing, utilities and construction, wholesale trade, and transport and storage had the highest rates (2.7–2.9 percent).

The incidence of displacement, and hence the risk of wage scarring, is widely expected to increase as the impacts of the future of work trends take effect. These include both the impacts of the trends themselves and also the impacts of Government initiatives to mitigate or exploit those trends.

These trends include technological progress, demographic change, globalisation and climate change. These trends will impact what kind of work is done, who does it, and where and how it is done. There is a very high level of uncertainty and debate about these impacts. As the Future of Work Tripartite Forum Strategic Assessment notes: “There remains a high degree of uncertainty about how these megatrends will impact New Zealand, and the scale and timing of those impacts. The megatrends will impact on different countries in different ways and at different times, and their impact will be filtered through a number of local factors, such as regulatory practices, social norms and political pressures.”¹¹ Estimates of the scale and pace of change vary widely.

Notwithstanding the high levels of uncertainty about future trends, it is clearly socially and economically desirable for workers to transition smoothly through periods of change, with minimal time spent unemployed, and obtaining new employment in jobs that make best use of their skills. That said, the benefits of achieving such outcomes need to be weighed against the costs of achieving them.

⁹ OECD (2017), *Back to Work: New Zealand: Improving the Re-employment Prospects of Displaced Workers*, p.11

¹⁰ Dixon, S., & Mare D. (2013). *The Costs of Involuntary Job Loss: Impacts on Workers' Employment and Earnings*, Motu Working Paper 13-03, Motu Economic and Public Policy Research

¹¹ Future of Work Tripartite Forum, (2019), *Strategic Assessment, Priorities for New Zealand's Future of Work*, p.4

Designing a system to help displaced workers find and keep decent jobs

Earlier this year, MBIE produced a research paper on the state of support for workers experiencing displacement arising from economic change, and the options to enhance that support.¹²

MBIE’s earlier research paper identified four complementary forms of support for displaced workers, as illustrated in the table below:

Table 1: Forms of support for enabling smooth transitions	Description
Employment opportunities	A business and economic environment that ensures availability of employment opportunities will ensure workers can move into (or remain in) employment (can also include steps such as encouraging worker mobility, and coordinated economic development initiatives such as Industry Transformation Plans). It also includes the complex nature of job matching where several factors such as skills, location and work hours play a vital role.
Advice and brokerage services	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 Brokerage and job search assistance connects people with employment opportunities and tailors support to individual needs.
Education and training	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).
Financial support	Financial security through transitions minimises hardship and provides stability through job search and retraining. 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. The way financial support is funded and delivered and linked to the other forms of support can materially affect worker outcomes.

Ideally, these forms of support operate as a coherent system that promotes dynamic flows of workers between jobs, with an emphasis on effectively matching workers to jobs that suit them.

In such a system, workers may well be displaced from their jobs, but the impact of job loss is cushioned through a system of support that helps them to obtain either new work, or to engage in appropriate retraining and upskilling.

New Zealand can learn from the Danish approach to supporting displaced workers

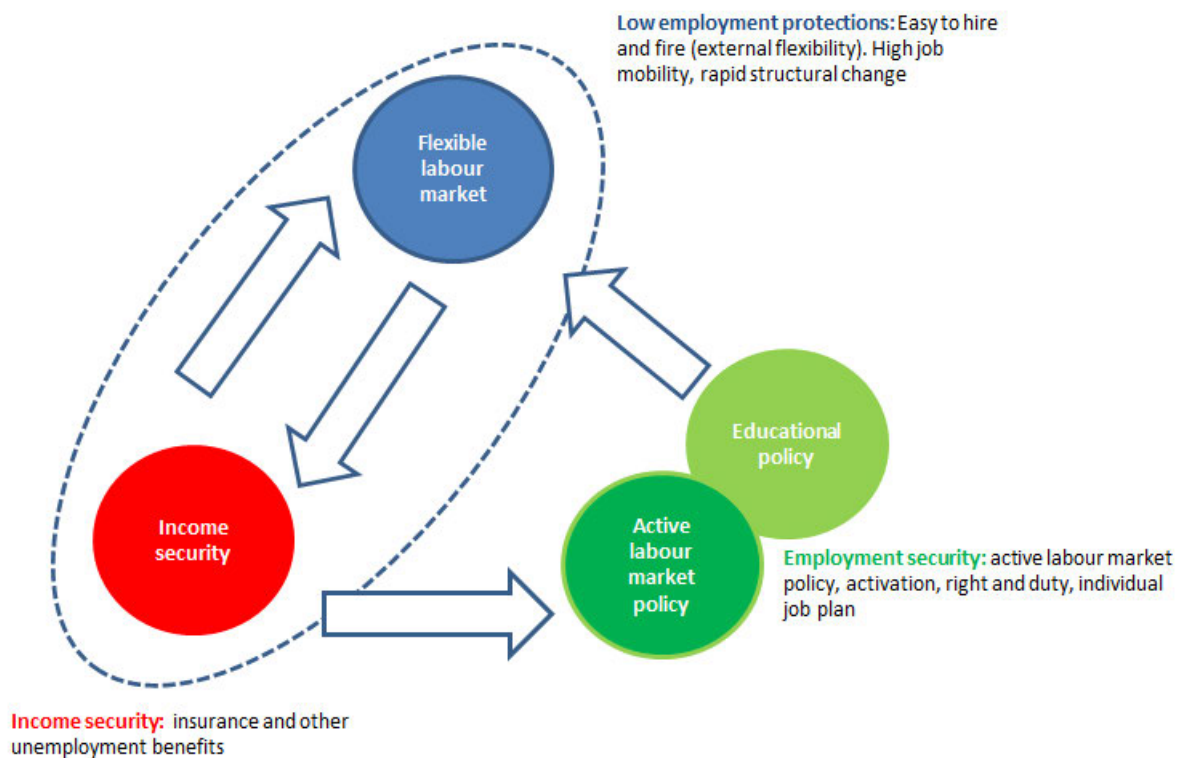
The Danish “Flexicurity” model is widely regarded as a leading example of this approach. Flexicurity provides flexibility for businesses to grow and contract, and

¹² *Aide Memoire and discussion paper on support for displaced workers*, 14 June 2019 refers, MBIE Tracking number: 3866 18-19

income security for workers. Flexicurity combines the mutually reinforcing elements of vigorous job search obligations, comprehensive employment support (Active Labour Market Programmes), financial support, and limited statutory employment protections. The focus of this approach is to protect workers rather than jobs, thereby harmonising a dynamic and highly productive economy with worker wellbeing.

It is unlikely there could be a simple transfer of the Danish model to New Zealand. That model operates within a different national context and a different set of circumstances including higher personal tax rates, very high union membership and a mature tripartite policy development infrastructure. However, there is value in examining the components of the Danish system and the principles underpinning it.

The Danish employment system's combination of flexibility and security is often described as a 'golden triangle'. The flexicurity model combines high mobility between jobs with a comprehensive income safety net for the unemployed and high levels of investment in active labour market programmes. Flexicurity operates as a cohesive system, as the following diagram illustrates.¹³



Income security in Denmark is provided through a generous social unemployment insurance scheme (funded by workers and the government) that serves to “smooth workers” incomes” through periods of unemployment, with the highest levels subject to minimum eligibility periods and contributions. The unemployment insurance scheme is complemented by a means-tested welfare system.

¹³ Danish Agency for Labour Market and Recruitment, <https://star.dk/en/about-the-danish-agency-for-labour-market-and-recruitment/flexicurity/>

Steps to enhance New Zealand’s system to help displaced workers find and keep decent jobs

Compared to a more comprehensive system such as Denmark’s, support for displaced workers in New Zealand to find and keep decent jobs is modest.

The modest levels of support for displaced New Zealand workers may contribute to the marked falls in income that many displaced workers experience once they are re-employed (“wage scarring”). Wage scarring is a complex phenomenon, and other factors could be important in New Zealand, such as “thin” labour markets. The OECD has observed that wage scarring effects appear to be particularly large in New Zealand.

There is, however, work underway in a number of areas to enhance support.

Active Labour Market Policies and Programmes, Advice and brokerage services, Employment services

The First Principles Review of Active Labour Market Policy is taking a fundamental look at the roles of Active Labour Market Programmes in promoting a productive, inclusive and sustainable economy. This review intersects with the welfare overhaul, through which the Minister for Social Development proposes to expand MSD employment services over time to support more people experiencing difficulty finding and staying in suitable employment. This is likely to include enhancing MSD’s proactive responses to larger scale redundancies, and the availability of active employment services.¹⁴

Education and training

A number of education and skills related initiatives will also potentially benefit displaced workers. The Reform of Vocational Education will ease access to vocational training. The Regional Skills Leadership Groups and the Workforce Development Councils will enhance how the skills system equips workers with the skills that employers demand. Further, MBIE, working with the Forum Partners, is exploring further measures to increase access to in-work training. The Careers System Strategy will improve the availability and quality of careers advice to workers.

Employment opportunities and economic development

The Government’s Economic Plan is designed to deliver a strong economy that provides decent jobs, and higher incomes and opportunities. Industry Transformation Plans – partnerships with industries to transform economic sectors – are amongst the tools for delivering the plan.

Workforce transitions will be an integral component of industry transformation planning, for both sunrise and sunset industries. Such planning will be an important part of proactively managing the risk of displacement through identifying workers at risk and mapping a pathway to new jobs. Some of the factors such as job choice,

¹⁴ Future of Work Tripartite Forum, (2019), *Strategic Assessment, Priorities for New Zealand’s Future of Work*, p.13

work flexibility, relocation and redeployment are important for the redundant worker to consider.

Income security

In addition to a focus on employment services, the welfare overhaul is also considering the adequacy of welfare payments and other transfers. Any enhancements, however, are unlikely to be sufficient to replace substantially the incomes lost by all workers who become redundant. The welfare system in New Zealand is primarily intended as a minimum income safety net and is unlikely to become an effective tool for smoothing incomes except for some lower-income workers.

This highlights a key point of difference between New Zealand and most other advanced economies. In most developed countries, welfare systems are complemented by mechanisms to smooth workers' incomes through periods of unemployment.¹⁵ With the exception of purely private arrangements, New Zealand lacks such mechanisms

Income smoothing mechanisms – unlike means-tested welfare payments – primarily seek to maintain a displaced worker's prior standard of living until they obtain a new job. Income smoothing mechanisms can reduce hardship where people face fixed costs of living that were based upon previous incomes, and (combined with extensive employment support) aim to enable a longer and more successful job search.

Exploring options to enhance financial support through periods of displacement – and exploring how this complements other mechanisms – is not currently an active area of work, although financial support appears to be an important part of a system to support displaced workers effectively if smooth transitions are the desired outcome.

The Productivity Commission has recently argued for the adoption of income smoothing mechanisms, noting that “There is a case to improve income security for displaced workers with income smoothing policies that cushion the financial shock of job loss. Doing so could:

- make workers less fearful about switching jobs and more accepting of labour-market settings that promote dynamism in the economy but reduce job security;
- achieve better labour-market matching – by enabling those who lose their jobs to take more time to search for a better, high-paying job that is a good match for their skills; and

¹⁵ Fletcher, M. (2015). *The structure and generosity of financial assistance for beneficiaries: How New Zealand compares with other OECD countries*. pp.3-4

- improve attitudes towards technology – as effective support systems can reduce fears about job loss and so make workers more welcoming of policies that embrace technology.”¹⁶

The Productivity Commission’s analysis suggests net benefits arising across the economy, and not just for displaced workers.

It is plausible that a well-designed income-smoothing mechanism – as part of a wider system – could improve outcomes for displaced workers, and in particular reduce wage scarring effects.

The scoping study is a step towards addressing this gap. This is not to detract from the need also to address each of the three other elements – employment opportunities, employment support, education and training – and to ensure that policies are designed to be coherent.

¹⁶ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, pp.1-2

A Framework for considering options

While the overarching criterion for evaluating options is how well they enable workers to transition with minimal wage scarring, we need a more nuanced tool to evaluate options critically. To do this, it is useful to distinguish between policy **impacts**, **costs**, and **critical success factors**. Each provides a lens for evaluating options.

Policy impacts refer to the objectives sought from a policy intervention. We have identified three objectives, each corresponding to the three phases of a redundancy event: pre-redundancy, unemployment, and re-employment.

The first objective - reduced wage scarring - is the principal objective. The other two objectives are supporting objectives.

The three objectives are:

- ***to reduce significantly, for a majority of displaced workers, the wage scarring they can experience on reemployment.*** This objective reflects the desirability of ensuring that workers are reemployed in jobs that make full use of their skills, availability for work, and earning potential.
- ***to reduce significantly, for a majority of displaced workers, the adverse financial impacts of an unemployment spell.*** This objective reflects the desirability of mitigating the financial hardship caused by unemployment. This objective could be satisfied through either increased payment levels and eligibility for financial support, or through shortening the unemployment spell through prompt reemployment.
- ***to encourage employers to support workers through transitions.*** This objective reflects the desirability of firms making efforts to reduce the incidence of redundancy (such as through retraining, or redeployment) or facilitating direct job-to-job transitions to other firms so that redundancy does not lead to unemployment. The objective is not to avoid redundancy per se – since this would curtail market dynamism – rather to ensure that firms consider alternatives to redundancy, and support workers to transition when it does occur.

Other unintended consequences can also arise from policy interventions, such as distributional impacts. Where relevant, the analysis sought to identify such consequences.

If the policy impacts above represent the benefits to be gained, the costs indicate what must be sacrificed to obtain those benefits. All the options involve at least some additional cost. The analysis identified who would bear the costs, and gives an estimation of costs (where possible).

Critical success factors describe the practical feasibility of options, in particular the capability of the government or markets to deliver the options effectively.

Design choices

There is a range of choices that can inform the design of policy options. These choices influence the cost and complexity of policy options, their impacts, and the roles for firms, workers, and Government.

The key design choices are whether funds are pooled or individualised, whether payments aim to replace pre-displacement incomes, and who bears the costs.

Earnings related income replacement

“Earnings related income replacement” refers to whether a payment seeks to ensure that payments are close to a worker’s level of income prior to displacement. The closer the payment to pre-displacement income, the higher the replacement rate. Higher replacement rates are more effective at smoothing incomes. ACC’s 80% income protection replacement rate is an example of income smoothing.

Pooled funding

“Pooled funding” arrangements are those where all of the contributors’ funds are combined so that all members can access those funds as the need arises (ie – when a worker is made redundant.) This is a form of risk-sharing. Pooled funding is distinct from individualised arrangements, where there is no combining of funds, or risk-sharing.

Where funding is individualised, members accumulate funds over time. If they do not draw on them, those funds can become available on retirement. Where funding is pooled, members do not accumulate funds, but it becomes possible to provide high replacement incomes to all members in the event of unemployment. Pooled funding is the usual tool for financing high replacement rates, and hence effectively smoothing incomes.

Costs

The cost of financing can lie with workers, firms, the government, or some combination of the three parties. The allocation of costs has important impacts on incentives and behaviour, and on worker outcomes.

Costs can also be non-financial. Statutory redundancy payments and social unemployment insurance schemes, for example, can be seen as forms of employment protection legislation, which can have adverse impacts on firm dynamics and productivity. A related issue is the compliance and transaction costs on firms and government agencies that more complex options entail. Funding via general taxation avoids these problems, but forgoes a key lever for influencing firm behaviour, and it may not be equitable for government to meet all costs.

Overview of options considered

The scoping study identified six options for enhancing financial support, as described in the table below. The options are listed in order of the scale of potential policy change, from modest incremental change, to substantial change. The table also includes an indicative comment on how the options could interact with the existing transfer system (benefits and tax credits).

Table 2: Six options for enhancing financial support		Indicative gross potential entitlement in one year (assuming gross pre-displacement income of \$60,000) ¹⁷
Access to KiwiSaver funds	This option assumes that eligibility for early access to KiwiSaver funds is widened to include redundancy. Displaced workers would be able to access a portion of their savings up to a cap, such as a percentage of the saved funds. The cap would help to ensure that funds intended for retirement are not fully depleted. This would require careful policy consideration as to whether it is intended to replace or supplement other government assistance (such as welfare payments and other transfers).	\$1,300 (assumes a worker accesses 10% of the median KiwiSaver balance, estimated to be \$13,000 in 2018. ¹⁸ The average KiwiSaver balance is \$19,000 in 2019.) ¹⁹
Modified tax credits	This option assumes eligibility for the In-work Tax Credit and the Independent Tax Credit is relaxed so that displaced workers are entitled to these payments for a period following displacement. This could be complemented by reinstatement of the previous provision for tax relief for redundancy payments. Tax credits already form part of New Zealand's income support system and complement benefit payments, but this option may create new interactions.	\$656 (Assumes eligibility for these payments continues for a further 2 months. <i>In-Work Tax Credit</i> of up to \$72 per week for one child, for two months = \$576 <i>Independent Earner Tax Credit</i> = up to \$10 per week, for two months = \$80)
A displaced worker loan scheme modelled on the student loan scheme	This option assumes that State establishes a loan facility for redundant workers. This would require careful policy consideration as to whether it is intended to replace or supplement other government assistance.	up to \$48,000 (assumes a worker can borrow up to 80% of \$60,000, one year's salary)

¹⁷ These cost estimates are indicative only, and have not been reviewed by the Treasury.

¹⁸ <https://www.stats.govt.nz/news/kiwisaver-nest-eggs-grow-5000-in-three-years>

¹⁹ Financial Markets Authority, (2019), *KiwiSaver Annual Report 2019*, p.7

<p>Statutory redundancy payments</p>	<p>This option assumes the imposition of a statutory obligation on firms to make redundancy payments. Payment would be based on a (minimum) standard statutory formula based on length of service, such as 4 weeks for the first year of service and two weeks' pay for each subsequent year. Voluntary redundancy payments currently complement existing welfare payments – they only affect entitlements to some supplementary assistance.</p>	<p>\$15,000</p> <p>(assumes five years of service with an employer, with four weeks' pay for the first year (\$5,000) plus two weeks' pay for each of the subsequent four years (\$10,000)</p>
<p>Statutory redundancy payments with a financing scheme</p>	<p>A variation on the option above is for the State to manage a central fund from which redundancy payments are made. Employers, employees, and the government could contribute to such a fund.</p> <p>Payments could be based on a formula other than tenure with previous employer, and instead linked to unemployment risk.</p> <p>This would be a form of “portable” redundancy payment, not linked to a particular employer.</p> <p>Voluntary redundancy payments currently complement existing welfare payments – they only affect entitlements to some supplementary assistance.</p>	<p>\$15,000</p> <p>(assumes five years of service, with four weeks' pay for the first year (\$5,000) plus two weeks' pay for each of the subsequent four years (\$10,000),</p> <p>Could be more generous if the payment provided an insurance-style replacement rate for a fixed duration – as below – rather than being based on tenure.</p>
<p>Social unemployment insurance</p>	<p>This option assumes establishment of a social unemployment insurance scheme whereby displaced workers are entitled to a replacement income, while engaged in active job search, up to a fixed duration. The scheme would be designed in such a way that employment support, and education and training, are integral.</p> <p>This option would likely replace payments through the existing welfare system for the duration of eligibility, since insurance payments would be treated as income. Such interactions could be assessed through subsequent work.</p> <p>Insurance schemes can be designed to provide a range of alternative replacement rates. The ACC scheme provides a replacement rate of up to 80% of prior income.²⁰</p> <p>A recent report produced for the Productivity Commission assumed a replacement rate of 50% of prior income.²¹</p>	<p>up to \$30,000 - \$48,000, depending on replacement rate, and duration of unemployment within eligibility period</p> <p>(\$30,000 assumes 50% of a \$60,000 salary paid over one year. \$48,000 assumes 80%.)</p>

²⁰ <https://www.acc.co.nz/im-injured/financial-support/weekly-compensation/>

²¹ New Zealand Productivity Commission, (2019), *Unemployment insurance: what can it offer NZ? Report for the Technology and the Future of Work Inquiry*, prepared by Kathy Spencer

The following table shows how the options vary according to the key design choices discussed earlier.

Options	Table 3: Key design dimensions					
	Pooled / individualised funds	Earnings related income replacement	Direct liability for costs (who pays)	Role for government	Role for employers	Role for workers
1 - Enabling greater access for displaced / redundant workers to their KiwiSaver accounts	individualised	partially	workers (own savings)	regulator	contributor	-
2 - Widening access to existing tax credits , and / or establishing new tax credits	N/A	no	government (taxation)	regulator / administrator	none	-
3 -Establishing a loan scheme for displaced / redundant workers	N/A	yes	workers & government	regulator / administrator	none	repay loans
4- Mandating statutory redundancy payments	N/A	yes	employers	regulator	contributor	-
5- Mandating statutory redundancy payments with a financing scheme	pooled	yes	employers (and maybe workers and government)	regulator / administrator / contributor	contributor	-
6- Establishing an earnings-related social unemployment insurance scheme	pooled	yes	employers / workers / government	regulator / contributor (outsourced employment services)	contributor	job search obligations

Enabling greater access for displaced workers to their KiwiSaver accounts

Option description

This option aims to allow displaced workers to access their KiwiSaver funds as a means for a smoother transition to reemployment. The following analysis assesses this option in regards to its impact, costs and practicality.

Rationale

Workers can smooth their own incomes by saving a stock of “surplus” income when it is earned, and then drawing on it when their flow of income ceases. The need to access savings could arise from either planned reasons, such as retirement or to finance a major planned expense (purchasing a home), or unplanned reasons, such as redundancy or other adverse events. The contract between the fund manager and the saver defines the circumstances under which the saver may access the funds.

Since accounts are individualised, there is no pooling of funds between savers, so the total amount the saver may access is limited to the amount that has been paid into the account over time, plus interest earned. This is the key difference from insurance models, where members continuously draw on each other’s contributions as circumstances trigger need, with no individual accumulation of funds. The principal contributor to savings accounts is usually the individual worker. Employers and government can supplement workers’ contributions. Savings schemes are a type of *defined contribution* scheme.

KiwiSaver funds have grown to almost \$60 billion since 2007, with about 3 million New Zealanders contributing.²² Employers and the government also contribute, up to fixed amounts. It is designed principally to supplement income during retirement, with additional circumstances specified where savers may obtain early access to a portion of their savings, notably hardship and to purchase a first home. Redundancy per se is not sufficient grounds to access a KiwiSaver account.

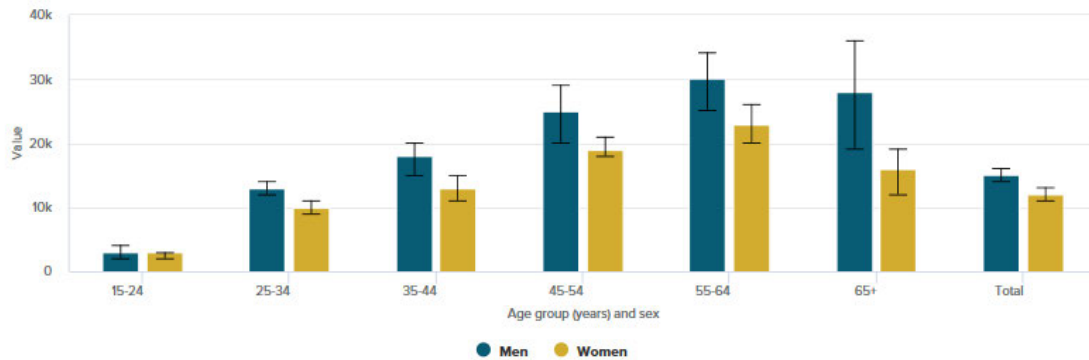
The Statistics New Zealand charts below show estimates of KiwiSaver balances by age group and sex, and the proportion of people with KiwiSaver accounts by age group.²³

²² <https://www.kiwisaver.govt.nz/statistics/annual/joining/>

²³ <https://www.stats.govt.nz/news/kiwisaver-nest-eggs-grow-5000-in-three-years>

GRAPH TABLE

Median value (\$) of KiwiSaver schemes, by age group and sex, year ended June 2018

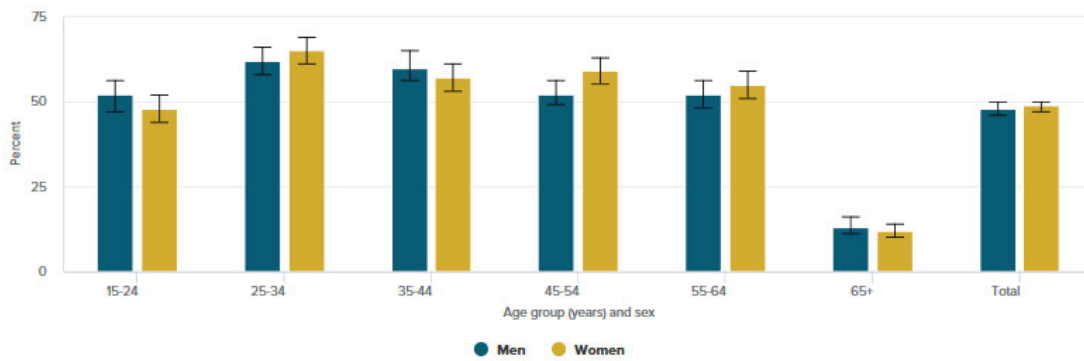


Error bars show the variability in the estimates.

Stats NZ

GRAPH TABLE

Proportion of people with a KiwiSaver scheme, by age group and sex, year ended June 2018



Error bars show the variability in the estimates.

Stats NZ

The median KiwiSaver balance was estimated to be \$13,000 in 2018.²⁴ The average KiwiSaver balance is \$19,000 in 2019.²⁵

The Productivity Commission has recently recommended investigating “portable redundancy accounts” as an option for improving income smoothing. Such accounts would closely resemble KiwiSaver, and could be closely integrated with KiwiSaver, or be a ring-fenced fund within a KiwiSaver account.²⁶ Importantly, they would remain individualised, without the advantages of risk pooling, which serves to

²⁴ <https://www.stats.govt.nz/news/kiwisaver-nest-eggs-grow-5000-in-three-years>

²⁵ Financial Markets Authority, (2019), *KiwiSaver Annual Report 2019*, p.7

²⁶ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work*, p.68

smooth out differences in contributions. The Public Advisory Group on Redundancy and Restructuring also noted this possibility.²⁷

Option discussion

This option is effectively creating an “insurance” purpose for KiwiSaver, and one consequence could be to reduce uptake of (more suitable) insurance products.

Creating an insurance purpose for KiwiSaver would be a change to the original purpose of KiwiSaver, which is to ensure the financial well-being of individuals in retirement.

There is currently a high bar for withdrawing funds from KiwiSaver. A person can withdraw for significant financial hardship, but (for example) being in debt is not enough to withdraw under the significant hardship grounds.

From a redundancy perspective, the main impact of this option is on reducing the adverse financial impacts of an unemployment spell. The scale of that impact depends entirely on the size of individual displaced workers’ KiwiSaver balances, and whether they have accounts. A displaced worker with a large balance may find that access to KiwiSaver funds would substantially offset their loss of income. The reverse is true for people with low balances.

Further, since KiwiSaver is intended to supplement retirement income, savings drawn mid-career could adversely affect a person’s financial preparedness for retirement. This effect would be magnified for people drawing funds at a late stage in their working lives, when there is less prospect of recouping the drawn funds. At the same time, if access to KiwiSaver funds led to a better re-employment match, then savings could be boosted over time.

This option would not appear to have any impact on employer incentives and likely only a modest impact in aggregate on wage scarring (through enabling workers to finance a longer search period).

The strengths of this option are that it causes no (immediate) costs, and would be very simple to administer from the Kiwisaver perspective. Interactions with the benefit system would need to be carefully considered: if received as a lump sum this could affect asset-tested assistance (e.g. Accommodation Supplement), and if received as income could affect all assistance a person is eligible for. At a minimum, current settings for hardship assistance would need to be examined (as this assistance is predicated on all of a person’s available assistance being used first).

Overall, this option only weakly supports the desired outcomes. The costs are so low, however, that it may be a useful complement to other options.

²⁷ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work*, p.68

Widening access to existing tax credits, and tax relief for redundancy payments

Option description

This option aims to allow displaced workers to easily access tax credits and tax relief for redundancy payments as a means for a smoother transition to reemployment.

Rationale

Government transfer payments can serve to *supplement* or *replace* incomes. Variations to payment levels and eligibility for these transfers could help to offset the income lost by displaced workers. Or new payments could be devised.

In New Zealand, the three main benefits – Jobseeker Support, Sole Parent Support, and the Supported Living Payment – serve as income replacement payments. A wide range of supplementary payments is also available, including the tax credits administered by Inland Revenue. The welfare overhaul is reviewing the structure, eligibility criteria, and levels of these transfer payments.

Eligibility for two existing tax credits – the In-work Tax Credit and the Independent Earner Tax Credit – is linked to hours worked or a minimum earnings level. This means that eligibility is lost when the hours or earnings threshold is not met. Redundancy is one of the reasons why this might occur. In this situation, the loss of earned income (wages or salary) is compounded by the worker's loss of eligibility for their transfer payments (although families would remain eligible for the Family Tax credit).

Relaxing eligibility criteria could mitigate the impact on displaced workers. A further option is to introduce (or re-introduce) a dedicated tax credit for displaced workers who receive redundancy payments. Between December 2006 and September 2011, a tax rebate of six cents in the dollar, capped at the first \$60,000 of redundancy payment was available for people receiving redundancy payments.²⁸

Option discussion

The main impact of this option is on reducing the adverse financial impacts of an unemployment spell. This impact would likely be very minor, since the value of the In-Work Tax Credit, the Independent Earner Tax Credit, and tax relief on redundancy payments is very low. These payments are intended simply to supplement incomes, not replace them. The coverage of these impacts would also be highly uneven.

This option would not appear to have any impact on employer incentives and minimal impact on wage scarring.

Further, since the In-Work Tax Credit, the Independent Earner Tax Credit are intended to provide incentives to work, decoupling eligibility from employment

²⁸ <https://www.classic.ird.govt.nz/technical-tax/legislation/2007/2007-97/2007-97-relief-for-redundancy-payments/leg-2007-97-relief-for-redundancy-payments.html>

status/hours worked would diminish the intended effects of these payments and could have other unintended consequences.

The costs of this option would fall to the government. These costs have not been modelled, but would likely be modest. This option would be straightforward to implement as it uses existing transfer mechanisms. Overall, this option only weakly supports the desired outcomes, and may undercut some of the objectives of the tax and transfer system. Restoring a tax credit (rebate) on redundancy payments may be a useful complement to other options.

Establishing a loan scheme for displaced workers

Option description

This option aims to establish a loan scheme for displaced workers as a means for a smoother transition to reemployment.

Rationale

Workers can smooth their incomes by borrowing from others. Where access to savings accounts allows workers to draw on their own *previous* earnings, loans allow workers to borrow from others against their own *future* earnings. They are, in effect, borrowing other people's savings. Access to loans, therefore, is usually closely tied to a person's expected ability to repay a loan, either with income or assets (collateral). A displaced worker borrowing funds following redundancy would expect to repay the loan with income earned once they are re-employed.

Savings and loans markets are both well-developed. However, as with savings, there can be equity and efficiency reasons why markets fail to provide optimally. Tertiary education is the best example in New Zealand, where the Government ensures finance is available to pay tuition fees, and meet living costs.

A case could also be made for the Government to ensure finance is available for displaced workers, given that private lenders are likely to be wary of lending to people who – by definition – lack the present stream of income to repay loans.

Option discussion

The main impact of this option is on reducing the adverse financial impacts of an unemployment spell. Subject to a displaced worker taking out a loan commensurate with lost income, this impact could be large, in the near term. The treatment of this income within the benefit system would need to be considered, to ensure additional benefit for these people over the status quo.

This option would not appear to have any impact on employer incentives. There could be some positive impact on wage scarring through financing extended job searches.

The cost of this option is highly uncertain, since it depends on uptake by displaced workers. It is possible that displaced workers would be highly averse to taking on debt without a clear pathway to repay such loans. Borrowers would likely face high effective marginal tax rates as they repay their loans.

Costs would fall principally to the government. Assuming a similar arrangement to the student loan scheme, borrowers would be expected to repay their loans on income above a threshold, thereby offsetting fiscal impacts. However, with an average life-time cost of 44.43% of new student loan borrowing in 2017/18, the cost to the Crown is still substantial.

Given that the government already operates a student loan scheme, extending coverage to displaced workers would be straightforward to implement, though there likely would be additional operating costs.

Overall, this option only weakly supports the desired outcomes, and creates a risk for borrowers of compounding financial difficulties through increasing debt.

Mandating statutory redundancy payments (with and without a financing scheme)

Option description

This option aims to provide workers with a final payment as compensation for lost earnings.

Rationale

Redundancy payments are usually calculated on the basis of a standard formula, based on tenure, and the wage or salary of the worker at the time of dismissal. A common formula is a redundancy payment that provides four weeks' pay for the first year of service, and then two weeks' pay for every subsequent year, up to a maximum of 26 weeks per year.

In New Zealand, unlike many countries, such as Australia, there is no statutory requirement for employers to provide a redundancy payment. This means that redundancy payments are only provided where these are negotiated by employers and employees. The Productivity Commission has estimated that about 30% of employed workers are entitled to some level of redundancy payment.²⁹ Lower-skilled workers, younger workers and those with shorter tenure periods are less likely to receive redundancy payments, and the median amount paid tends to increase with tenure and seniority.³⁰

Option discussion

The main impact of this option is on reducing the adverse financial impacts of an unemployment spell. How effectively statutory redundancy performs this function would depend in part on the entitlement formula, and also whether the firm is in a position to meet its obligations.

The generosity of the payment would influence a displaced worker's job search period, and hence their potential to find a job that minimises scarring effects.

Statutory redundancy also offers the side benefits of enabling workers to pursue options other than seeking new employment, through providing a cash settlement without job search obligations. On the other hand, those job search obligations may be important in ensuring that workers do eventually return to work.

The Productivity Commission has recently questioned the role of statutory redundancy payments as a tool for smoothing incomes, recommending instead adoption of alternative tools (such as insurance-based models) while allowing firms

²⁹ New Zealand Productivity Commission, (2019), *Unemployment insurance: what can it offer NZ? Report for the Technology and the Future of Work Inquiry*, prepared by Kathy Spencer, p.5

³⁰ Dixon, S. C., & Maré, D. C. (2013). *The Costs of Involuntary Job Loss: Impacts on Workers' Employment and Earnings*. Available at SSRN 2247198., p.iv

and workers to continue to negotiate redundancy payments where this is mutually beneficial.³¹ Shortcomings listed by the Commission include:

- *poor targeting*, since payments based on tenure do not reflect the actual costs that displaced workers experience
- *lack of certainty of payment*, since failing firms may be unable to meet their commitments to redundant workers
- *disincentives for workers to seek new jobs pre-displacement*, since entitlements are tied to particular employment relationships and workers may be reluctant to lose tenure-based entitlements
- *disincentives facing firms from hiring permanent employees*, since they face the potential obligation to make redundancy payments

At least some of these problems can be wholly or partly addressed by establishing a central redundancy insurance fund, financed through continuous contributions from firms, workers, and or / the government. This option was noted in the *Report of the Public Advisory Group on Restructuring and Redundancy*.³²

Such a scheme eliminates the risk of individual employers being unable to make redundancy payments, and ensures portability since funds are held centrally and not tied to a particular employer. This also raises the possibility of payments being linked to a variable other than tenure. Such a scheme could include non-permanent employees, with their eligibility for payments being triggered by the planned end of a contract, rather than redundancy (though the potential moral hazard implications would need to be carefully examined, as this could encourage workers and firms to have additional breaks in employment). Where employers contribute to such a scheme, an “experience rating” can be applied to incentivise firms to have greater regard for worker outcomes.

The costs of a standard statutory redundancy scheme fall on employer, in the first instance. The costs of statutory redundancy with a pooled redundancy fund can readily be shared between employers, government and employees.

A standard statutory redundancy scheme would be straightforward to implement. The statutory formula could provide a “minimum base” for employers to provide, with the option for workers and employers to negotiate more generous provisions.

A statutory redundancy scheme with a pooled redundancy fund would involve similar challenges to developing a full social insurance unemployment scheme.

Overall, a standard statutory redundancy scheme is a reasonable fit with the three main investment objectives, while the option of a statutory redundancy scheme with a pooled redundancy fund is a stronger fit.

³¹ New Zealand Productivity Commission, *Redundancy Pay: A Redundant tool?*

³² Public Advisory Group on Restructuring and Redundancy, (2008). *Report of the Public Advisory Group on Restructuring and Redundancy*, p.7

Establishing a social unemployment insurance scheme

Option description

This option would assume establishment of a social unemployment insurance scheme whereby displaced workers would be entitled to a replacement income (eg up to 80% of prior income), while engaged in active job search, up to a fixed duration.

Rationale

Unemployment insurance provides a replacement income for the period a displaced worker remains unemployed, up to a set duration. Unemployment insurance schemes are usually operated by state or federal governments, with compulsory participation, and vigorous expectations and support for benefit recipients to seek work. These features are the necessary counters to the moral hazard and adverse selection problems that inhibit the broad-based provision of unemployment insurance by private markets. Moral hazard, in this case, is the risk that displaced workers have reduced incentives to seek work, since they are receiving unemployment insurance benefits. Adverse selection, in this case, is the risk that only people with a risk of becoming redundant seek insurance. Both of these effects undermine the private provision of insurance.

Beneficiaries of unemployment insurance schemes receive a percentage of their prior income for a defined period while they seek re-employment. Unlike family-means-tested welfare payments, or redundancy payments, insurance payments are intended largely to replace the wage or salary income lost by displaced workers. Insurance schemes therefore pay benefits directly linked to prior earnings, with replacement rates sometimes approaching 90%. Historically, insurance schemes have catered best for “standard workers”, leaving substantial coverage gaps for non-standard workers.

Eligibility periods can last from months to years, and a worker typically remains entitled to support subject to active job search, and participation in active labour market programmes. Workers receiving insurance payments are often obligated and supported to seek work promptly. This “activation” is especially important in insurance-based schemes, since the high income replacement rate can otherwise diminish incentives to return to work.

This strong focus on activation and employment support distinguishes insurance-based financial support (and welfare) from the approaches described earlier: access to savings accounts, loans, tax credits, or redundancy payments. Activation and employment support are not natural features of these instruments because there is no ongoing liability for payments pending reemployment. The strong incentives to return a person to work are absent in those other instruments.

Unemployment insurance is typically financed through employer contributions and payroll taxes paid by workers. In many countries the government supplements insurance funds from general tax revenue either routinely or during times of economic downturns. The contribution rates, as a percentage of gross earnings, vary

between around 1 and 3 percent, are often split evenly between workers and employers.

Denmark and Finland are notable exceptions, where insurance is a voluntary programme that is subsidized by the government. In Denmark, employers are not required to contribute. In Chile, benefits are drawn from individual savings accounts (similar to KiwiSaver) supplemented by a traditional insurance component.

Where unemployment insurance schemes operate, such as in northern European countries and the United States, the schemes complement, rather than substitute, welfare-based support. Displaced workers who reach the end of a period of insurance-based income payments without securing employment may transition to welfare-based support, if they are eligible.

One of the principal concerns with such schemes is the risk that access to unemployment insurance benefits can increase the frequency and duration of unemployment. This risk arises since income insurance reduces the impact of losing work, and can diminish incentives to find new work. There is a broad consensus in the academic literature that receipt of unemployment insurance payments *does* extend the duration of unemployment spells. This effect does not appear to be large however. That such an effect is muted may well be due to the time limits placed on eligibility combined with the effects of the stringent activation and obligation and sanction regimes that are typically integral to social unemployment regimes.

While there is a large literature investigating – and confirming – the impact of unemployment insurance on extending the duration of unemployment, there has been much less empirical research into the effect of an extended job search on re-employment wages – that is, whether insurance receipt mitigates wage scarring.

From the perspective of job search theory, insurance acts as a search subsidy, with longer searches improving the prospect of securing a non-scarring job. An alternative, less charitable, interpretation, is that the period of entitlement to insurance creates a moral hazard that incentivises leisure over job search.

Noting that this is an under-researched field, the evidence appears to be that access to unemployment insurance per se has limited effects on re-employment wages. One commentator has recently summarised the research to date as follows:

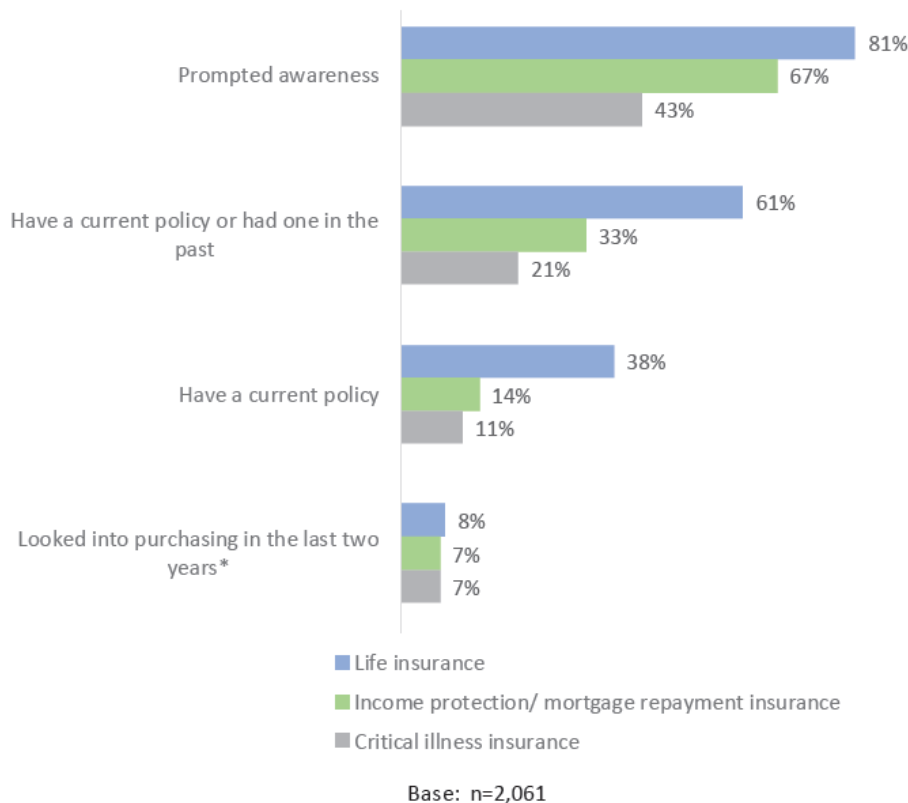
*Findings on the effects of UI generosity (in terms of benefit duration or benefit level) on the match quality of jobs found after a period of unemployment are mixed. On average, there are either no effects or some positive but small effects on wages received in the new job and on the time the individual remains in that job, or in employment.*³³

Unemployment insurance is not a core feature of income security in New Zealand, making us an outlier in the OECD. The Accident Compensation Corporation is an exception, being the only social provision in New Zealand paid for by a separate payroll levy, with earnings-related benefits for loss of employment through accident.

³³ Tatsiramos, K., (2014). *Unemployment benefits and job match quality: Do unemployment benefits help those seeking work to obtain better jobs?*

Uptake of private income protection insurance in New Zealand appears to be low. A recent Financial Services Council survey found that only 14% of respondents maintained either income protection or mortgage protection insurance, as depicted in the chart below.³⁴ Given that mortgage protection insurance is often required by lenders, it is possible that this comprises the bulk of this figure.

AWARENESS, USAGE AND CONSIDERATION OF RISK PRODUCTS



*Although the consideration questions were asked only of those who did not have current policies, the results shown are based on the full sample of n=2061

Source: Financial Services Council

The Productivity Commission has recently recommended investigating unemployment insurance as an option for improving income smoothing.³⁵

³⁴ Financial Services Council, (2019), *Risking Everything: Insight into how New Zealanders manage risk*, p.20.

³⁵ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work*, p.70

Option discussion

This option has the potential to make a positive impact on each of the key desired outcomes. As a dedicated income smoothing instrument, income protection insurance (assuming broad coverage and reasonable replacement rates) would effectively smooth the incomes of displaced workers.

To have a reasonable change of reducing scarring effects, this objective would need to be integral to the scheme. An income protection insurance scheme could also be specifically designed to minimise wage scarring effects through:

- an initial “right of refusal period” whereby workers could decline wage-scarring job offers,
- experience ratings applied (at industry level) to insurance premiums, and
- the award of government contracts to the private employment agencies (and potentially unions) that most effectively place workers into non-scarring jobs.

The experience rating function that rewards employers who invest in their staff or support them through transitions could also reduce the incidence of redundancies that lead to unemployment.

Assuming an annual displacement rate of 3%, the Productivity Commission has estimated an annual cost of \$470m to provide unemployment insurance to displaced workers, funded by a 0.4% levy on employment income (including income from self-employment).³⁶ This calculation assumes an average payment period of three months, and a 50% replacement rate. The 3% displacement rate is about double the New Zealand baseline rate. Assuming a lower displacement rate would offset the cost of a higher displacement rate, and longer payment duration.

A range of cost sharing options is available, including combinations of government, worker, and employer contributions. Further, there are financing choices, including general taxation and levies.

General taxation is the simplest option.³⁷ Levy-based approaches are more complex, but allow for the use of experience-rated premiums, which may be an important tool for influencing firm behaviour.

While establishing a social unemployment insurance scheme would be a significant policy shift, New Zealand does have long experience with social insurance through the operation of the ACC scheme, including raising levies (and taxes) to fund the scheme.

Job search obligations and provision of employment services are usually integral to unemployment insurance schemes. These could be provided by a Public Employment Service funded by the insurance scheme (perhaps similar to Sweden’s Job Security Councils), or employment services could be contracted from the private sector (similar to Australia’s approach to providing employment services) or unions.

³⁶ New Zealand Productivity Commission, (2019), *Unemployment insurance: what can it offer NZ? Report for the Technology and the Future of Work Inquiry*, prepared by Kathy Spencer, p. 18

³⁷ Funding insurance through general taxation is not “insurance” in the strict actuarial sense, but is insurance in the broader sense of providing protection against adverse events. Such approaches are closer to social assistance, than social insurance

This shift would likely require extensive policy and operational changes for the welfare system in order to ensure consistency and fairness in any transition. This could be expected to be highly complex, and therefore require a long implementation timeframe.

The potential positive impacts on worker outcomes makes social unemployment insurance the most promising option. Establishing a social unemployment insurance scheme is also relatively more costly and complex than other options, with more uncertain impacts.

Discussion of Findings

The six options considered fall on a continuum of scale of policy change. The options to widen KiwiSaver access, establish a loans scheme, or adjust eligibility for existing tax credits constitute modest changes to existing policy settings. There appears to be little risk in such changes, but likely also little benefit. Some or all of these could be pursued if Ministers were interested in near-term, low cost responses.

The options to mandate redundancy payments or establish an insurance scheme are clearly more complex, more costly, and longer-term propositions. An insurance scheme also introduces the idea of sharing or “socialising” costs across the workforce through pooling funding. These options also offer greater prospects of smoother worker transitions, although with some risks and trade-offs.

As the Productivity Commission notes, under an unemployment insurance system, the insurer has strong incentives to support a displaced worker back into the workforce to minimise ongoing insurance payment costs.³⁸ A social unemployment insurance scheme could be designed to exploit these incentives, so the insurer seeks not just to support the worker back to work, but to support them to work that maximises their earning prospects (ie minimise wage scarring). As the Commission further notes, “Responsibility for labour-market programmes for their clients might best be assigned to the insurer, who has the right incentives to design, evaluate and improve programmes for different types of client.”³⁹

We are not aware of any existing models that expressly seek to reduce wage scarring. Further, international evidence suggests that participation in a social insurance scheme per se is only weakly associated with better re-employment outcomes.

However, there appear to be potential design choices that could increase the effectiveness of a social insurance model in minimising wage scarring. These design choices include, but would not be limited to:

- an initial “right of refusal period” whereby workers could decline wage-scarring job offers;
- “experience ratings” applied (at industry level) to insurance premiums, so that employers that support workers pay lower premiums; and
- the award of government contracts to the private employment agencies (and potentially unions) that *most effectively place workers into non-scarring jobs*.

The objective of these features would be to influence the insurer, or their agents, to target reductions in wage scarring. Devising a social unemployment insurance

³⁸ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, p.74.

³⁹ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, p.83

scheme that targeted reductions in wage scarring would be a difficult design challenge, but one that is worth exploring further.

A statutory redundancy scheme (potentially with a financing scheme) has potential to provide income smoothing. Such a scheme has lower potential to address wage scarring, since employment service providers lack the strong incentives provided under insurance models to support workers.

The table on the following page presents a summary of the options analysis. The red, amber, green shading indicates respectively either a poor, reasonable, or good fit with the assessment criteria.

Fit with assessment framework	Poor			Reasonable			Good			
Options	Impacts on workers' outcomes						Other key impacts			
	encourage employers to support workers through transitions	to reduce significantly, for a majority of displaced workers, the adverse financial impacts of an unemployment spell			to reduce significantly, for a majority of displaced workers, the wage scarring they can experience on reemployment			Scale of change	Cost	Risk
1 - Enabling greater access for displaced / redundant workers to their KiwiSaver accounts			mixed impacts			mixed impacts		limited	low	low
2 - Widening access to existing tax credits , and / or establishing new tax credits								limited	low	low
3 -Establishing a loan scheme for displaced / redundant workers								moderate	moderate	moderate
4- Mandating statutory redundancy payments			mixed impacts					substantial	mixed impacts	substantial
5- Mandating statutory redundancy payments with a financing scheme								significant	mixed impacts	substantial
6- Establishing an earnings-related social unemployment insurance scheme								significant	mixed impacts	substantial

Further work

The purpose of the scoping study was to inform decisions about the scope of a future work programme on support for displaced workers.

Since the scoping study is a preliminary analysis only, any further work would need to include investigation of option costs, option benefits and other issues. This work would need to be an integral part of a wider programme to enhance the system of support for displaced workers.

A key consideration is the preferred coverage and eligibility for any new financial support instrument, including whether or not it is appropriate to extend coverage to people who are displaced for reasons other than redundancy.

A scheme with narrow eligibility criteria will have limited coverage, and hence provide limited support to displaced workers. All things being equal, it is desirable for any scheme to provide broad workforce coverage, especially where there is an element of government funding.

Besides the equity consideration, a broad coverage of costs and entitlements across classes of worker avoids the risk of driving wedges between the labour costs of different categories of workers, and hence biasing firms' hiring decisions.

Compulsion vs voluntary participation is a further dimension. This is especially relevant to insurance schemes, where broad coverage is usually desirable to overcome adverse selection and to lower costs. "Auto-enrolment with opt-out opportunities can serve as a "soft" form of compulsion while preserving choice for workers, and perhaps firms.

Ministers may wish to commission further work on some or all of the options discussed in this paper, and could discuss these choices at a meeting with officials early in the New Year.

Annex: The welfare system is part of the answer

The scoping study did not directly consider the role of the welfare system – and the benefit system specifically – since the structure, eligibility criteria, and payment levels for benefits are under review through the welfare overhaul. Any further work on social insurance or related options would need to ensure these workstreams are closely aligned. For the purpose of the scoping study, it is still useful to provide the following brief discussion of how the benefit system can support displaced workers.

In New Zealand, compared to other countries, the welfare system plays an unusually important role in supporting displaced workers since other sources of support are absent – such as statutory redundancy payments,⁴⁰ or social unemployment insurance. Further, participation in public employment services is closely linked to receipt of welfare payments.

The key features of welfare-based financial support are the provision of family income means-tested payments, paid at a minimum level, and funded through general taxation. Welfare payments are intended to provide a minimum safety net for those unable to earn an income from work. Receipt of welfare payments is often conditional on efforts to find work, hence the term “Jobseeker Support” benefit.

Welfare payments are not effective as an income smoothing instrument because of the combined effects of:

- tight family-based means testing, which means that many displaced workers in a relationship are not eligible for welfare payments
- low payment levels for those who are eligible, which mean that replacement rates are relatively low (particularly for people without children).

In most OECD countries, instruments such as statutory redundancy payments, or, more commonly, social unemployment insurance usually complement welfare systems. Together, they ensure both fixed-duration income smoothing for displaced workers, and a more open-ended minimum safety net.

Some of the trade-offs associated with a tightly-targeted means-tested benefit system are evidenced in New Zealand. According to the Productivity Commission and the OECD, about two-thirds of people who reported losing a job did not receive Jobseeker Support in 2015: “Ineligibility due to too high partner income explains more than half of these instances. Some people may not have accessed support because they were enrolled in education, were avoiding stigma attached to receiving a benefit, or lacked information on eligibility”.⁴¹

Further, the gap between earned income and Jobseeker Support is stark even for people on low incomes, and is much greater for people on middle or high incomes. The current adult minimum wage gives a person working 40 hours per week \$708 gross per week. Jobseeker Support currently provides between \$203.88 (gross, single adult 20-24) and \$388.90 (gross, sole parent), with variation between these

⁴⁰ While there is no statutory requirement to provide redundancy payments, around 30 percent of workers are eligible for some form of redundancy payment.

⁴¹ New Zealand Productivity Commission, (2019), *Employment, Labour Markets, and Income, Technological Change and the Future of Work, Draft Report 2*, p.54

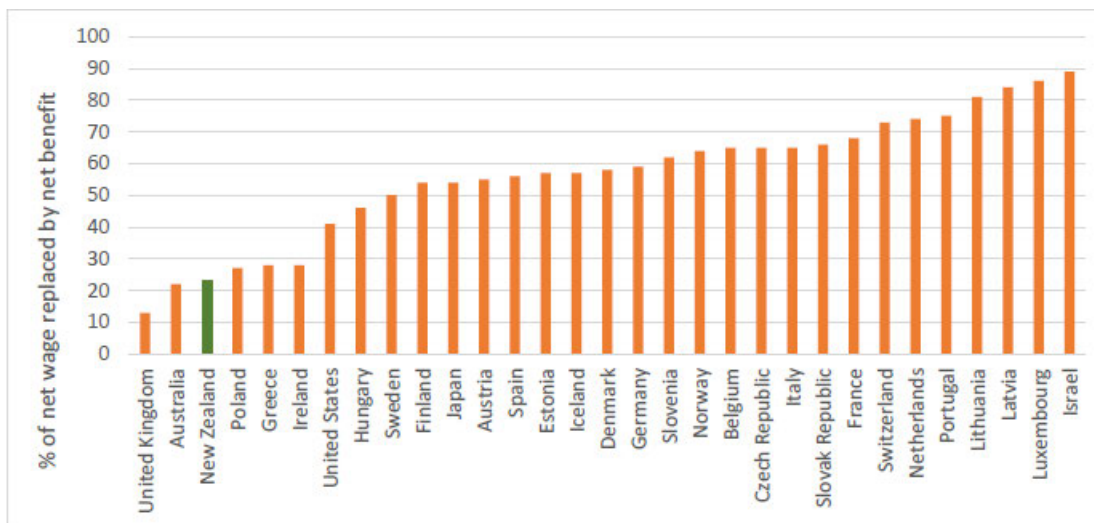
amounts depending on age and whether or not the recipient has dependents. Whether in work or receiving a main benefit, these people may also be eligible for tax credits or supplementary assistance (such as Accommodation Supplement).

People will face different drops in income if they are displaced. For example, modelling of tax year 2022 incomes projects that a single person working full-time (40 hours) on minimum wage in Auckland may have a net weekly income of \$749. If they are made redundant and experience a period without employment, they could face a drop in income of around \$300 or 40% (to \$449 per week) once they become eligible for Jobseeker Support (there is a stand-down period of at least 1-2 weeks). A single parent with one young child may have a net weekly income of around \$1,007, and face a drop of around \$230 or 23% (to \$777 per week).

A low-wage earner losing their job could also face losing their home (not being able to meet housing costs (rent or mortgage) because of the substantial drop in income), not be able to meet other living costs (food, health, transport) and generally also have low financial resilience. However, it should be noted that the welfare and tax transfer system has a range of financial assistance that is targeted to support people with these specific costs (both when receiving benefit and in employment).

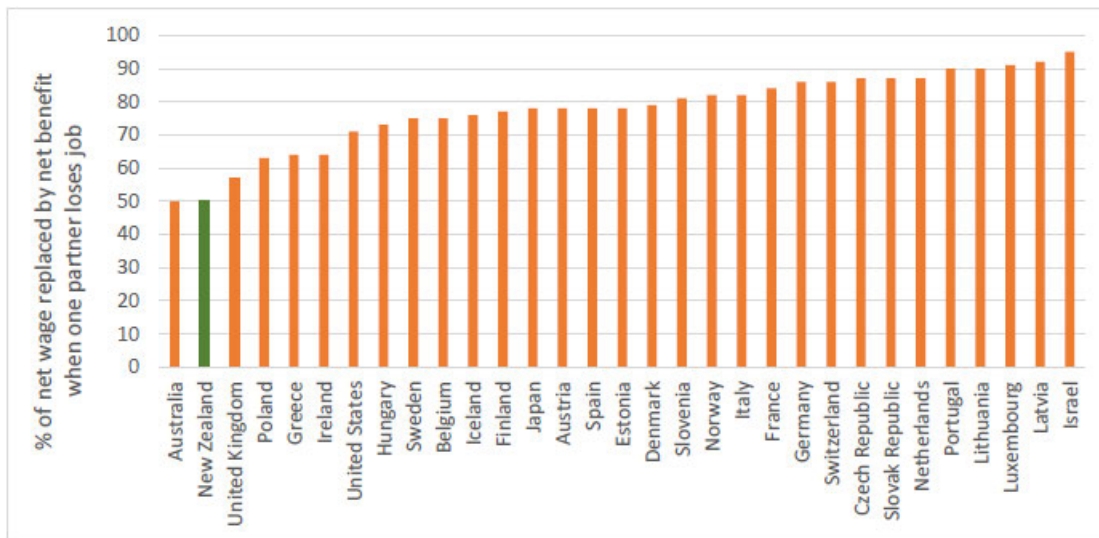
OECD comparisons show that financial support for displaced New Zealand workers is at the lower end of the spectrum.⁴²

Net replacement rate for single person without children, earning average wage



⁴² OECD.Stat, Net replacement rates in unemployment, <https://stats.oecd.org/>

Net replacement rate for couple without children – each earning average wage



One of the trade-offs against providing higher rates of welfare payments is that levels of income support that provide relatively low replacement rates create strong financial incentives to work for some job seekers. However, in some cases this will strongly increase the imperative for a displaced worker to find work promptly, even if this necessitates a substantial fall in wages, ie wage scarring.

Finally, as an institution funded and managed entirely by the State, the income support aspects of welfare systems operate at arms-length from firms in most cases. Although complementary employment and education systems have close engagement with firms, welfare payments in and of themselves provide no incentives to firms to reduce the likelihood of redundancies leading to unemployment or to support workers back to jobs that match their skills.

Reforming the welfare system to support displaced workers better is an option. The welfare overhaul is exploring the structure, eligibility settings, and payment levels of transfer payments, including main benefits.

One design option is to adopt the Welfare Expert Advisory Group recommendation to disregard spousal incomes for a defined period (thereby widening eligibility for support), as well as broader changes such as increased benefit levels or changing the unit of assessment (eg individual rather than family-based means testing). This would increase the level of support available, but would still fall well-short of providing genuine income smoothing.

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