

BRIEFING

Social unemployment insurance: Government approach to the Tripartite Forum

Date:	4 March 2021	Priority:	High
Security classification:	In Confidence	Tracking number:	2021-2606

Action sought		
	Action sought	Deadline
Hon Grant Robertson Minister of Finance	Note the proposed design of a social insurance scheme for discussion at the 22 March Future of Work Forum Agree to meet with officials to discuss this paper, and confirm next steps	10 March 2021
Hon Chris Hipkins Minister of Education		
Hon Carmel Sepuloni Minister for Social Development and Employment		
Hon David Parker Minister of Revenue		
Hon Stuart Nash Minister of Regional and Economic Development		
Hon Michael Wood Minister for Workplace Relations and Safety		

Contact for telephone discussion (if required)			
Name	Position	Telephone	1st contact
Jivan Grewal	Director, Employment, Skills and Immigration Policy	Privacy of natural persons	√
Francis van der Krogt	Principal Advisor, MBIE		
Laura Berntsen	Senior Analyst, The Treasury		
Diane Anderson	Principal Analyst, MSD		
Matt Nolan	Senior Policy Advisor, Inland Revenue		

The following departments/agencies have been consulted
Department of the Prime Minister and Cabinet

- Minister's office to complete:**
- | | |
|---|--|
| <input type="checkbox"/> Approved | <input type="checkbox"/> Declined |
| <input type="checkbox"/> Noted | <input type="checkbox"/> Needs change |
| <input type="checkbox"/> Seen | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn |

BRIEFING

Social unemployment insurance: Government approach to the Tripartite Forum

Date:	4 March 2021	Priority:	High
Security classification:	In Confidence	Tracking number:	2021-2606

Purpose

This briefing provides Ministers with the high level case for a social insurance scheme, and suggests an initial government approach on key design features for discussion at the 22 March Future of Work Tripartite Forum.

We seek feedback on the key design features presented here, and the approach Ministers wish to take at the Forum on 22 March.

Executive summary

The Future of Work Tripartite Forum is meeting on 22 March to discuss the key design features of a social unemployment insurance scheme. The Forum's deliberations will inform a public discussion document, for release later this year.

It would be useful for Ministers to agree in advance to the approach they wish to take to the Forum. The choices Ministers make now are an initial position for the Tripartite Forum discussion only. These will need to be further developed (and if necessary, revised) following further work. Final policy choices will be influenced by further policy work (including further work on understanding the impacts of the development of such a scheme), the views of social partners through the co-design process, and the outcomes of the public consultation.

At this early stage, Ministers may wish to opt for a relatively narrow or limited scheme. This approach will allow Ministers to adopt a more ambitious or broader scheme subsequently. It would be harder to take the opposite approach, since winding back stakeholder expectations could be difficult once established.

Case for change

New Zealand has flexible employment legislation and a highly dynamic labour market. Job tenure in New Zealand is among the lowest in the OECD and there is a high degree of churn in the labour market. Evidence suggests that the effects of job loss are felt long beyond re-employment, and can include negative effects on health, child outcomes, earnings, and productivity. New Zealand also has relatively high levels of wage scarring compared to other OECD countries. About 30,000 people per month experience substantial falls in earnings, (360,000 per annum). Some of these income drops reflect voluntary exits from the labour market (resignations), or the planned end of fixed-term employment. However, others reflect a range of involuntary and possibly sudden exits, including redundancies and the onset of health conditions or disabilities that affect capacity to work.

While welfare smooths incomes to some extent for some lower income households, there are many others who face significant drops in income following involuntary job loss, especially for those not eligible for welfare support. Social insurance programmes have the potential to improve financial support for people who do not qualify for current support or for whom current replacement rates are comparatively low. Unlike welfare, social insurance programmes pay a replacement income linked to prior wages or salaries.

While insurance does improve financial security for eligible people, our previous advice from November (MBIE Briefing 2021-1213 refers) concluded that the case for unemployment insurance is finely balanced. On the one hand, unemployment insurance would mitigate the large income drops that can pressure workers to accept poor quality job matches, adversely affecting their long-run

earnings and productivity. On the other hand, there is limited international evidence that insurance would deliver improved labour market outcomes, such as reduced wage scarring, and improved productivity.

Ministers, in consultation with social partners, have since agreed to proceed with the design of a social unemployment insurance scheme. The key parameters of the scheme would be agreed at the 22 March Tripartite Forum, and then consulted on publicly following the August Forum meeting. This paper assists Ministers to confirm the Government approach ahead of the March Forum meeting. It could be useful to confirm this Government approach at Cabinet.

Preliminary design choice: Coverage for health conditions and disabilities

The exploration of social unemployment insurance to date has focussed mainly on coverage for working people who lose their jobs due to redundancy. There may also be a case to cover people who lose their ability to remain in their current jobs due to health conditions and disabilities, where these are not covered by the Accident Compensation (AC) scheme.

Compared to unemployment insurance for redundancy, defining, assessing, and managing eligibility for health or disability income insurance is more difficult. While effective support services are important at facilitating good labour market and broader well-being outcomes for both displacement arising from redundancy and the onset of HCD, an income only scheme for HCD would be unlikely to help facilitate good return to work outcomes (as the individual's capacity to undertake their previous work had been hindered as evidenced by the displacement). We note that while there are existing services available for rehabilitation following HCD and employment services to support re-attachment, we have not yet been able to assess the sufficiency of these services as a complement to an income only protection scheme. We also note that there is considerable uncertainty about the number of people who may be eligible for insurance on the grounds of job loss or reduced hours due to the onset of health conditions and disabilities.

Officials seek guidance on whether to continue to explore coverage for working people who lose their jobs or reduce their hours due to the onset of health conditions and disabilities.

A basic social unemployment insurance model

This paper sets out a basic model for a compulsory social insurance scheme and outlines the benefits and risks of different design choices. The basic model can be extended to include job loss or reduced hours due to health conditions and disabilities with some additions.

The model presented here is the result of rapid policy work, and describes a scheme that could be implemented reasonably quickly rather than agencies' first-best advice on how best to design social unemployment insurance. The net benefit of the basic scheme described here is likely to be less than the net benefit of a more comprehensive and sophisticated scheme, and may even deliver fewer benefits than costs. Allowing more time before the release of the discussion document could allow time for more work on a more comprehensive scheme, with a firmer proposal on support services.

To keep the scheme simple, the initial focus is on income replacement only, rather than the services that help displaced workers find employment. While this may mean the scheme is less effective at achieving labour market outcomes than it could be, it could be implemented more rapidly. Lack of additional supporting services would be particularly problematic if the scheme included health conditions and disabilities, since the scheme would incentivise some people to leave work while providing little assistance to return to work. We do not know the scale of the behavioural response to scheme.

Even with a basic scheme only, there are still difficult financing questions to address. Ideally, the scheme would only collect contributions from people who were likely to benefit from the scheme. Designing a contributions and payment model that achieves this will be difficult to design and complex to administer. There will therefore be a trade-off between administrative practicality and equity.

There is a further overarching question of whether to establish an insurance model largely independent of existing systems (although complementary to them), or to build onto existing systems. The latter approach is more expedient, but may mean the scheme is less orientated towards Ministers' policy objectives for social unemployment insurance. This choice particularly

applies to services such as case management, employment support, and health and disability services. This overarching question is useful to bear in mind while considering the choices presented in this paper.

Key scheme design questions

The key questions for the design of a scheme are set out below. Unless otherwise noted below, the model proposed would apply equally to a scheme that covers HCD and one that does not.

- a. *Who should be covered?* As a general principle, it is desirable to provide insurance coverage to people in a wide range of working arrangements, such as standard work and different types of non-standard work. Excluding non-standard workers would leave a number of people in the workforce without cover. A simple scheme, however, would provide cover for all permanent employees resident in New Zealand only. While there are options to extend coverage (for example to premature termination of fixed term agreements) this would involve additional complexity.

In the interests of simplifying administration, to avoid distorting employment and hiring decisions, and to keep individual cost low, all working people would be required to contribute to the scheme, creating an inequity for those people who would contribute but would not be covered.

- b. *What would the scheme provide?* One option would be to provide short term cover that provides meaningful replacement rates for those who may be facing a significant shock. This could amount to providing cover for 80% of pre-displacement wages for a period of 6 months. To manage costs, coverage could be capped at double the median salary – around \$104,000. It would be equally viable to match the current AC scheme income cap of \$130,911. The AC Scheme cap is significantly higher than international comparators, but it is important to provide meaningful coverage to earners facing the most significant drops. At the same time, a high cap, and high replacement rate do lean against incentives to return to work.
- c. This payment would be treated as income for welfare purposes, and as such, existing welfare entitlements would be abated against the insurance payments.

The basic insurance model would rely on existing employment or rehabilitation support services. Given there is a range of both publicly funded and private provided support services already available, and the option of improving support services at a later stage, our view is that developing additional support services is not critical at this stage. Subsequent introduction of additional support services may have implications for the levy rates, if additional costs were met from levies.

- d. *What would be expected of people receiving insurance payments?* Insurance recipients would be expected to search actively for employment, participate in available employment services, complete agreed training programmes, or participate in health and rehabilitation services (where these are available). Clear expectations of participation are important for promoting good labour market outcomes, and for avoiding unnecessarily long spells of unemployment. A system of appropriate sanctions is useful for reinforcing expectations.
- e. In the basic scheme, there would be no obligations on employers. Ideally, however, employers would be incentivised to provide early notice of redundancies, and support people with health conditions to remain in their jobs or to move to new jobs where necessary.
- f. *How would it be funded and who would pay?* Ministers have indicated that they expect the cost of insurance to be fully funded through levies shared between employers and employees. We note a flat levy rate may result in equity issues (as lower income earners would benefit less from the scheme given the abatement of their existing welfare entitlements). A preferred alternative would be to develop a progressive levy system (for example by introducing a minimum income threshold before an individual is subject to the levy). We note there may be some need for transitional funding for the Crown to help

the scheme meet its short term liabilities before it has been able to collect sufficient levies to be self-sustaining.

- g. *How would it be delivered?* Given the similarities to the AC scheme, social unemployment insurance could be delivered by a similar crown entity model to the ACC, or by the ACC itself. This would see a Crown entity administer the scheme, including collecting levies, assessing and managing claims and providing dispute resolution and enforcement functions in a similar manner to the AC scheme. Officials have not discussed with the ACC the possibility of ACC delivering additional insurance functions.

The costs of the scheme

The potential costs of the scheme are uncertain and depend on design choices made, assumptions on the number of potential claimants and further work is required to confirm these estimates. Annex 2 shows the wide variation in pay roll levies across countries.

Previous advice has estimated that if 36,000 people were made redundant annually (consistent with a narrow scope of coverage), and were entitled to an 80% income replacement for up to six months, this could cost \$0.3 to \$0.5bn. If 75,000 people were made redundant annually, the estimated cost increases to \$0.6 to \$0.9bn. These initial estimates exclude important components such as administration costs, behavioural impacts, and the cost of supporting services (existing, or new). Extending coverage to include people who lose their jobs due to the onset of health conditions and disabilities would increase these numbers, but it is unclear how significant the increase would be.

Ministerial feedback

We particularly seek Ministers' feedback on:

- a. whether to continue to explore coverage for working people who develop health conditions and disabilities,
- b. whether to focus (for now) on a basic scheme that provides income replacement only, and
- c. the remaining key scheme design choices.

Following Ministers feedback, we will prepare material for Ministers to share at the 22 March Future of Work Forum setting out a proposed model for the scheme. We understand Ministers may also wish to discuss these matters at Cabinet, ahead of the Forum.

Recommended action

We recommend that you:

- a **Note** that the Future of Work Governance Group has agreed that the 22 March Tripartite Forum will discuss key design choices for a social unemployment insurance scheme, and that Ministers have requested advice on these choices to inform the Government's position at the Forum;

noted

- b **Indicate** whether you support the following policy settings for an unemployment insurance scheme, as the basis for the Government's approach to the discussion at the Forum:

Issue	Proposed setting	Ministerial feedback
What should insurance cover?	redundancy	<i>yes / no</i>
	onset of health conditions and disabilities	<i>yes / no</i>
Who should be covered?	permanent employees only	<i>yes / no</i>

What financial support should be provided?	six months coverage	<i>yes / no</i>
	80% replacement rate	<i>yes / no</i>
	income coverage capped at \$104,000	<i>yes / no</i>
	insurance treated as income for welfare assessment	<i>yes / no</i>
What supporting services should be provided?	status quo (initially)	<i>yes / no</i>
What would insurance claimants need to do?	make genuine attempts to find work. (initial right to refuse poor matches), and face sanctions for non-compliance	<i>yes / no</i>
	if HCD is included, attend any health rehabilitation services as directed by medical officers, and face sanctions for non-compliance	<i>yes / no</i>
	make genuine attempts to find work, if able	
How would insurance be funded?	levies split equally between employers and workers (with initial government establishment funding)	<i>yes / no</i>
	lower levy-free income threshold to reduce contributions from low income earners	<i>yes / no</i>
How would insurance be delivered	via ACC or a crown entity similar to the ACC	<i>yes / no</i>

c **Note** that Annex 1 summarises the proposed design choices;

noted

d **Note** that you are meeting with officials to discuss this paper, and to confirm Ministers' preferred unemployment insurance policy choices on Thursday 10 March; and

agree / disagree

e **Note** that the choices Ministers make now are for an initial approach to the Tripartite Forum discussion only, with final policy choices to be influenced by further policy work, the views of social partners through the co-design process, and the outcomes of the public consultation;

noted

f **Direct** officials to prepare a Cabinet paper based on Ministerial feedback on this paper, for Cabinet discussion on 15 March 2021.

agree / disagree

Paul Stocks
Deputy Secretary
Labour, Science, and Enterprise, MBIE
04 / Mar / 21

Simon MacPherson
Deputy Chief Executive
Policy, MSD
04 / Mar / 21

David Carrigan
Deputy Commissioner
Policy and Regulatory Stewardship, IR
04 / Mar / 21

Nick Carroll
Acting Director
Growth and Public Services, The Treasury
04 / Mar / 21

Hon Grant Robertson
Minister of Finance

..... / /

Hon Chris Hipkins
Minister of Education

..... / /

Hon Carmel Sepuloni
Minister for Social Development and Employment

..... / /

Hon David Parker
Minister of Revenue

..... / /

Hon Stuart Nash
Minister for Economic and Regional Development

..... / /

Hon Michael Wood
Minister for Workplace Relations and Safety

..... / /

Background

2. In November, officials briefed you on the high level case, and options, for a social insurance scheme (MBIE Briefing 2021-1213 refers). In response, Ministers directed officials to work with social partners to co-design an unemployment insurance scheme, and to develop a discussion document to inform a public consultation.
3. At its meeting on 24 February, the Future of Work Governance Group (Governance Group) agreed that the 22 March Forum would discuss all the design parameters for an insurance scheme, to inform a public discussion document for release in August.
4. Following the Governance Group meeting, you asked us for advice on key design parameters. This advice would enable Ministers to agree a Government position to take to the Forum.
5. This briefing provides that advice. The briefing focuses on the simplest options that can be designed and developed at pace and notes the limitations of those options. We seek Ministerial feedback on the options presented and whether Ministers wish to adopt these options as the initial Government position at the Forum on 22 March.

Case for change

6. As noted in our previous briefing (MBIE 2021-1213 refers), New Zealand has flexible employment legislation and a highly dynamic labour market. Job tenure in New Zealand is among the lowest in the OECD and there is a high degree of churn in the labour market. The effects of job loss are felt long beyond re-employment, and can include negative effects on health, child outcomes, earnings, and productivity. New Zealand also has relatively high levels of wage scarring compared to other OECD countries. About 30,000 people per month experience substantial falls in earnings (360,000 per annum). Some of these income drops reflect voluntary exits from the labour market (resignations), or the planned end of fixed-term employment. However, others reflect a range of involuntary and possibly sudden exits, including redundancies and the onset of health conditions or disabilities that affect people's capacity to work.
7. While the existing support smooths incomes for some lower income households, there are many others who face significant drops in income following involuntary job loss, especially for those not eligible for welfare support. Large income drops are likely to increase the pressure these workers feel to accept poor quality job matches, adversely affecting their long-run earnings and productivity.
8. Social insurance programmes have the potential to improve support for people who do not qualify for current support or for whom current replacement rates are often comparatively low. In particular, insurance can help reduce wage scarring by enabling a job search of a sufficient duration for a worker to obtain the best skill match, and also to participate in active labour market programmes (ALMPs) where skill development or retraining is needed. In the case of involuntary job loss due to a health condition and disability, unemployment insurance can enable time for effective recovery and rehabilitation, which is likely to result in better employment outcomes in the long-term (or support people to adjust to leaving the labour market).
9. There is a role for government in enabling further financial support for displaced workers, since the private market alone is unlikely to provide this function. Unemployment insurance is prone to the market failures of adverse selection and moral hazard. These effects undermine the coverage and affordability of unemployment insurance. Adverse selection occurs when high risk individuals opt into insurance, and low risk individuals opt out. Because of this, internationally, unemployment insurance is usually provided as social insurance, with participation compulsory or strongly encouraged. The Accident Compensation Scheme is a New Zealand example of social insurance.
10. While insurance does improve financial security for eligible people, our previous advice from November (MBIE Briefing 2021-1213 refers) concluded that the case for unemployment insurance is finely balanced. On the one hand, unemployment insurance would mitigate the

large income drops that can pressure workers to accept poor quality job matches, adversely affecting their long-run earnings and productivity. On the other hand, there is limited international evidence that insurance would deliver improved labour market outcomes, such as reduced wage scarring, and improved productivity.

11. Ministers, in consultation with social partners, have since agreed to proceed with the design of a social unemployment insurance scheme. At its meeting on 24 February, the Future of Work Governance Group agreed that the 22 March Forum would discuss all the design parameters for an insurance scheme, to inform a public discussion document for release after the August Forum.
12. This paper assists Ministers to reach a Government position ahead of the Forum. It could be useful to confirm this Government position at Cabinet.
13. The model presented here is the result of rapid policy work, and describes a scheme that could be implemented reasonably quickly rather than agencies' first-best advice on how best to design social unemployment insurance. The net benefit of the basic scheme described here is likely to be less than the net benefit of a more comprehensive and sophisticated scheme, and may even deliver fewer benefits than costs. Allowing more time before the release of the discussion document could allow time for more work on a more comprehensive scheme, with a firmer proposal on support services.

Key preliminary question – inclusion of displacement arising from health conditions or disability

There is a case for including health conditions or disability

14. Policy work on social unemployment insurance to date has focussed mainly on coverage for working people who lose their jobs due to redundancy. There is also a case to cover people who lose their ability to remain in their current jobs due to health conditions and disabilities (HCD). The inclusion of HCD will create some path dependencies for the design of the rest of the scheme (such as the nature of the insured's obligations).
15. People losing their jobs due to a health condition or a disability can face a significant drop in income, and re-employment earnings (wage scarring). Such income shocks can have flow on adverse impacts on the rest of the individual's wellbeing.
16. Long-term receipt of health and disability benefits is common in New Zealand and other jurisdictions once people lose their job. However, many people with health conditions and disabilities can work part-time or fulltime in suitable work, although their circumstances and support needs vary. Engaging in suitable work is supportive of material wellbeing and health outcomes, especially mental health.
17. Alongside a high risk of living in poverty, unemployment is strongly associated with poor health outcomes – especially if unemployment is prolonged. While there is generally limited evidence on the short and long-term health effects of disability insurance, some recent evidence suggests substantial positive health effects.
18. Social insurance provides a means to encourage and support employers to assist people with health conditions and disabilities to return to work, learning from the approach taken by AC scheme and other jurisdictions.

A simple scheme focussed solely on financial support would reduce complexity, but limit effectiveness

19. A scheme focussed solely on financial support (and not supporting services) would reduce the complexity of including health conditions and disability. However, the OECD has found that employment programmes and vocational rehabilitation have a significant influence in decreasing the number of persons receiving a disability benefit. The promotion of work

incentives also contributes to reduced levels of disability recipiency rates.¹ This is the approach taken by the AC scheme, which helps claimants recover from injury and return to work. In short, the inclusion of support services can support better labour market outcomes and reduce the total cost of providing financial support to those who have lost their jobs as a result of HCD.

20. However, support for people with health conditions and disabled people to remain in or return to work is currently limited in New Zealand. Employers have few requirements to support the ongoing employment of people with health conditions or disabilities not caused by an injury. There is also little support for people in work with a health condition or disability to remain in work, once limited statutory sick leave expires.
21. If social unemployment insurance focuses solely on financial support (and not supporting services), there is an increased risk of incentivising people to opt for insurance instead of working (ie reducing return to work incentives). We do not know the scale of this behavioural response.
22. Establishing the right mix of supporting services that are both more specialised and scarce would increase the effectiveness of the scheme for people with HCD, but would also be significantly more complex to design. Rehabilitation services would need to address both the underlying health condition or disability and aim to re-engage an individual in work that matches their capabilities following the onset of their health condition or disability.

There is significant uncertainty around the costs of including HCD as it depends on who you cover and how tight access to the scheme is

23. Estimating the number of claims is essential for estimating costs, but the number of claims is highly uncertain. The number of claims would be greater than the number of people who receive benefits for health conditions and disabilities currently, but fewer than the total number of job losses per annum.
24. The Ministry of Social Development (MSD) estimates that between 1,600 and 2000 people come onto Jobseeker-HCD and Supported Living Payment benefits from employment per month (around 19,200-24,000 a year).²
25. The number of people eligible for insurance would be higher than this since there are also people who leave work due to health conditions, but who are not eligible for current assistance (eg because they have an earning partner or other sources of income). Further work would be needed to estimate with any accuracy the number of people who might take-up a scheme that provided income protection for people who lose their jobs due to the onset of health conditions and disabilities.
26. The actual cost will crucially depend on who is covered by the scheme. For example, including the following groups may help meet some of the objectives of the scheme, but would also increase cost:
 - a. Including people with more **subjectively defined disabilities** – eg mental health, substance use disorders and musculoskeletal issues – is a more inclusive approach, but will increase the number of potential claimants. International research demonstrates that this group of people represents a large and growing portion of claimants. Research indicates many are able to work,³ but achieving employment outcomes for this group can be difficult because of the lack of services available to address the harm associated with these conditions.
 - b. Including people who leave work because they have **permanently, and severely reduced work capacity**, would provide them with time and funding to adjust to their

¹ OECD (2009) Pathways onto (and off) Disability Benefits: Assessing the Role of Policy and Individual Circumstances. In OECD Employment Outlook, Tackling the Jobs Crisis. <https://www.oecd.org/els/emp/45219540.pdf>

² While 44% of JS-HCD recipients remain on the benefit for more than two years, others only receive JS-HCD for a short time before exiting the benefit. Source: Ministry of Social Development, 2018

³ Moore, T. 2015 The employment effects of terminating disability benefits, Journal of Public Economics, Volume 124, Pages 30-43, <https://www.sciencedirect.com/science/article/pii/S0047272715000171>

changed circumstances, supporting the objective to smooth income and improve transitions for people who are displaced. However, if Ministers place greater weight on the objective of returning people to work, then it may not be desirable to include this group.

- c. Allowing **people who return to work, but relapse claim multiple times** would meet the objective of income smoothing. This would be particularly important for people with chronic conditions who experience frequent relapses. However, the scheme would need to be designed in a way that helps these people manage their condition while incentivising and supporting a return to work. Employers may need to be incentivised to employ people who have previously received social insurance payments.

- 27. These costs, on the other hand, could be managed by creating exclusions. However, this would raise line-drawing difficulties and increase the risk of arbitrage. For this reason, eligibility for health and disability benefits generally relies on some 'gate-keeping' or assessment of the extent to which recipients' work capacity is affected by their health condition or disability. We note any exclusions could likely exclude a number of people whose health and labour market outcomes would improve as a result of coverage (and as a consequence impede the overall effectiveness of the scheme).
- 28. Effective gate-keeping is expensive, and requires carefully managing incentives. General practitioners may lack incentives to manage entry to the scheme. This could be managed by developing sickness certification guidelines for GPs, medical certification practice monitoring and/or use of designated doctors. Insurers, on the other hand, may be overly zealous in strictly assessing claims leading to eligible people being denied access.

Ministers may wish to decide whether to include HCD ahead of the Tripartite Forum

- 29. A simple scheme focussed solely on financial support reduces the complexity of including HCD. However, this will also limit the effectiveness of the scheme in supporting people with health conditions and disabilities rehabilitate and return to work.
- 30. In addition, there is significant uncertainty around the costs of including HCD. The actual cost will crucially depend on who is covered by the scheme and how tight access to the regime is. Creating exclusions and building in a "gate-keeping" function would manage costs, but increase the complexity of including HCD.
- 31. Officials seek guidance on whether to continue to explore coverage for working people who develop health conditions and disabilities.

Key design choices for a basic unemployment insurance scheme

- 32. This section sets out a basic "income-replacement only" model for a compulsory social insurance scheme, and outlines the benefits and risks of different design choices. The model can include health conditions and disabilities with the choices and trade-offs described above.
- 33. The model focuses on "income-replacement only" model because Ministers have indicated they wish to move at pace. Focussing on income replacement only means leaving the design, delivery, and funding of any additional supporting services to a later stage. These services include (additional) help for displaced workers to find employment, or to address health conditions and disabilities.
- 34. Income-replacing insurance payments will improve financial security in the short term for covered workers, but on their own are less likely to achieve the desired labour market outcomes than a more comprehensive package that includes supporting services.
- 35. Even with a basic income-replacement only scheme, there are still difficult financing questions to address. Ideally, the scheme would only collect contributions from people who were likely to benefit from the scheme. Designing a contributions and payment model that achieves this will be difficult to design and complex to administer. There will therefore be a trade-off between administrative practicality and equity.

Who should be covered?

36. As a general principle, it is desirable to provide insurance coverage to people in a wide range of working arrangements, such as standard work and different types of non-standard work. Further, the insurance scheme would seek to cover loss of income a person reasonably expected to earn from their labour. These principles can be difficult to apply in practice, however.
37. Unemployment insurance is most readily administered for people who lose full-time permanent employment (standard work) since there is a clear triggering event, and a clear loss of income. For displaced permanent workers, employer-initiated redundancy is the triggering event. For people developing health conditions and disabilities, the triggering event could be medical certification of inability to continue in their current employment.
38. The vast majority of people do work in standard working arrangements, so a scheme for limited to this this group would cover most workers. Excluding non-standard workers, however, would leave a large minority of the workforce without cover, while requiring them to contribute. This group would include some people in precarious working arrangements.
39. Extending coverage to people with fixed-term employment agreements could also be reasonably straightforward. In this case, the insurance entitlement would be triggered when an employer prematurely terminated the fixed term agreement. There are technical issues to consider with the loss of fixed term employment, such as defining a minimum insurable period of lost employment.
40. Those people who are mis-classified as casual or fixed-term workers, or mis-classified as contractors, but whose work is actually in the nature of permanent employment, would be covered.⁴
41. The scheme would *not* cover “true casual” workers, these being workers who have no reasonable expectation of ongoing work. Nor would the scheme cover authentic self-employed people, given the technical difficulties in determining what triggers insurance coverage, and calculating income loss. Subsequent policy work could explore the options for covering self-employment.
42. In the interests of simplifying administration, to avoid distorting employment and hiring decisions, and to keep individual cost low, all working people would be required to contribute to the scheme. This creates an inequity where some people contribute – the self-employed, fixed-term employees, and true casual workers – who are not eligible for coverage (or will not receive significant additional benefits over and above existing income support).

What would the scheme provide?

Duration of entitlement

43. The duration of an entitlement influences the opportunities available to the insured, and their behaviours. A short duration creates a relatively stronger incentive to find work before coverage ends, and incentivises job search as distinct from retraining or upskilling. A longer duration reduces the imperative to find work, and creates greater opportunity for retraining or upskilling. Duration of cover is also a key cost driver.
44. The reasonable options range from six to twelve months. A simple model that enables effective job search, enables some upskilling, and manages costs could provide six months coverage.
45. Ministers could consider, in the light of experience, whether a longer duration (at higher cost) could be justified to enable more meaningful retraining and upskilling, and (where appropriate) to receive treatment for health conditions and disabilities. Internationally,

⁴ Their eligibility would be based on the “real nature of the relationship” in the Employment Relations Act, 2000

governments sometimes choose to extend the duration of coverage temporarily, such as during significant recessions, when finding work is particularly difficult.

46. A brief stand down period, similar to the AC scheme, could be useful for encouraging employers to bear some of the cost of a redundancy, and to deter claims for very minor health conditions, if these are covered.

Replacement rate

47. Replacement rates need to strike a balance between incentivising workers to reject poor quality job matches, while incentivising active job search. Replacement rates are also key drivers of scheme costs.
48. A replacement rate of 80% of average income over the previous six months would meaningfully replace lost income while still incentivising people to search for a job that pays a wage closer to the lost income. A replacement rate of 80% is also equivalent to the coverage provided by the Accident Compensation Scheme. Parity with the AC scheme would be particularly important for people receiving income insurance on the grounds of health conditions and disabilities.
49. A more complex option is to provide for a step-down in the replacement rate after a given duration of unemployment. Step downs are useful for managing scheme costs, and encouraging job search. Step downs are most appropriate for long-term schemes (such as a 12 month entitlement) but may still be used for shorter-term schemes (primarily as a cost mitigation initiative).

Income coverage caps

50. Insurance schemes usually set maximum levels of insurable earnings. Income above the maximum level is neither levied, nor insured. Income caps manage scheme costs, but also mean that high earning people are less well-covered than others. Since a key objective of the scheme is to support those at the high risk of wage scarring into well-matched jobs post-displacement, it is desirable to set a relatively high cap. Displaced high earners (including people displaced due to health conditions) are more exposed to wage scarring given their specialised skills, and the risk of wasted human capital is greater.
51. Coverage could be capped at double the median salary – around \$104,000. It would be equally viable to match the current AC scheme income cap of \$130,911. The AC Scheme cap is significantly higher than international comparators, but it is important to provide meaningful coverage to earners facing the most significant drops. At the same time, a high cap, and high replacement rate do lean against incentives to return to work. Financial modelling will identify the impact of a high cap on levy costs.

Abatement of welfare entitlements

52. The interface between payments received under an insurance scheme and the welfare system will likely be a key point of contention because of the risk of creating perceived inequities.
53. Means-tested welfare payments are abated against additional income received. Income received under the AC scheme, for example, abates welfare entitlements. If unemployment insurance payments are treated as income, they will also abate means tested welfare payments. This could be perceived as inequitable, especially for those lower wage people who lose their jobs, and for whom the welfare system already provides a comparatively high replacement rate.
54. People in this situation will have contributed both to the costs of welfare (via taxation) and insurance (via levies) yet only benefit from insurance, because welfare is abated away. On the other hand, the tax and transfer system does not create a direct link between tax contributions and welfare (or other) entitlements. Many people already receive transfer

payments substantially greater than their tax payments, while other people pay tax yet do not access the welfare system.

55. The inequity facing lower income earners can be reduced by setting a minimum income threshold for levy payers. Income below this level would not be subject to the levy. This would effectively only levy those who would stand to receive substantial cover through the insurance scheme irrespective of the abatement rules. We note that AC scheme sets a minimum threshold before levies become payable.

What supporting services are provided?

56. In its most basic form, unemployment insurance simply provides an alternative income to replace wages lost due to redundancy, or the onset of health conditions and disabilities. It is likely that insurance alone will reduce the personal shock of income loss, reduce the pressure to accept poor job matches, and lower the opportunity costs of undertaking retraining or upskilling.
57. Insurance payments alone, however, are likely to be less effective in promoting return to good jobs than a package of support that includes:
 - employment services to help insurance recipients to plan their next steps, and to find work,
 - support to retrain and upskill (either through short or longer courses), and
 - services to address health conditions and disability that impact on work capacity, and promote rehabilitation and return to work.
58. Such a package not only *supports* insurance recipients, but also helps offset the moral hazard risk that insurance recipients defer job search activity while they remain eligible for high replacement rate insurance payments. Internationally, eligibility for income insurance is usually contingent on participation in employment and related services.
59. To some extent, the wider package of services is already available to displaced workers, and people who leave work due to health conditions and disabilities. Employment services for displaced workers have expanded substantially as part of the COVID response.
60. The Ministry of Social Development is also strengthening a service for people at risk of job displacement as part of shifting focus from reacting when people come on to benefit towards early intervention. This service will work proactively with a range of businesses, associations, government and community stakeholders in regions to ensure people at risk of displacement are aware of, and can access, the services and supports that MSD and partners offer to help them retain their employment or transition to new good and appropriate employment or training. There is also some private provision of employment services (such as job search services).
61. Other reforms – such as the Careers Strategy, and the Reform of Vocational Education – are also making it easier for working people to identify their career options, and to access retraining and upskilling. Unemployment insurance can complement this wider range of training opportunities by providing a replacement income while people receive training.
62. For the basic model, then, the most straightforward approach would be to focus on establishing income replacement payments only, and considering a wider package of support services subsequently.
63. Insurance recipients would still be required to participate in services that promote their return to work, and/or recovery. The insurance provider would monitor compliance, and apply sanctions for non-compliance (discussed further below).
64. Focussing solely on income replacement is not without some risk. The existing suite of services is limited, especially for people with health conditions and disabilities. Enhancing the current suite of services would promote better outcomes. If Ministers decided subsequently to enhance services, this could involve substantial costs, especially services for people with health conditions and disabilities. Those costs would need to be met from either an increase to the insurance levy, from general taxation, or from both sources. It would be prudent to include an allowance in the estimated levy costs to allow for this cost.

What would be expected of people receiving insurance payments?

65. Most social insurance schemes place some obligations on people receiving unemployment insurance payments, usually focussed on encouraging people to return to suitable employment.
66. In the case of redundancy, insurance recipients would be obliged to seek work, or engage in approved training. Insurance recipients might initially have a right to refuse wage scarring job opportunities, but might lose this right after sustained unemployment. A system of appropriate sanctions is useful for reinforcing obligations.
67. People with health conditions and disabilities may have obligations to undertake appropriate rehabilitation services, where these are available. These people may be able to resume work with their existing employer, when their conditions have improved.
68. Most systems require people to participate in assessment processes, work with their employers on return to work plans, to undertake appropriate rehabilitation or treatment. In New Zealand, the AC scheme requires claimants receiving earnings related compensations to engage in assessment processes and vocational rehabilitation (see Appendix on international comparisons).
69. If a return to their previous role is not possible and people are assessed as having part or full-time work capacity, recipients of social insurance payments for reasons of a health conditions or a disability would likely have job search obligations. Where people have permanently and severely restricted work capacity, some schemes simply make payment without any corresponding obligations.
70. In the basic scheme, there would be no obligations on employers. Ideally, however, employers would be incentivised to provide early notice of redundancies, and support people with health conditions to remain in their jobs or to move to new jobs where necessary.

How would it be funded and who would pay?

Cost sharing between government, workers and employers

71. Ministers have indicated that the scheme would need to be funded via a levy imposed on employers and working people. A simple assumption is that the levy cost would be split equally between workers and employers. Levying employers does risk reducing labour demand, and lowering wages (through deferred pay rises).
72. A government contribution would be needed to establish the scheme, and the government would likely remain the “funder of last resort” if claims ever exceeded the scheme’s available funds, such as during a severe economic downturn.
73. It could also be appropriate for the Crown to meet the costs of supporting people with health conditions and disabilities who exit the labour market (this would be complex and costly to design).

Estimated cost and levy design

74. International experience shows that there is a wide variation in costs depending on the coverage of the scheme and the nature of different labour markets (see Annex 2). Estimated costs are very sensitive the number of claims (level of displacement), replacement rates, and duration of entitlements.
75. Officials completed initial cost modelling for the July 2020 Tripartite Forum meeting. This previous advice estimated that if 36,000 people were made redundant annually (consistent with a narrow scope of coverage), and were entitled to an 80% income replacement for up to six months, this could cost \$0.3 to \$0.5bn. If 75,000 people were made redundant annually, the estimated cost increases to \$0.6 to \$0.9bn. These initial estimates exclude important components such as administration costs, behavioural impacts, and the cost of supporting services. Extending coverage to include people who lose their jobs due to the onset of health

conditions and disabilities would increase these numbers, but it is unclear how significant the increase would be.

76. A number of additional costs need to be included to calculate the levy. These include:
 - administration costs to deliver the scheme,
 - behavioural impacts (in particular, how unemployment spells are likely to be longer if people receive unemployment insurance, or choose not to work if they are currently working with health conditions and disabilities), and
 - additional services (such as employment services, or health services).
77. Officials propose to conduct further financial (and fiscal) modelling to estimate the cost more robustly to inform the discussion document.
78. There is wide range of choices in the specific design of the levy, and its incidence. The simplest approach is a flat rate levy charged on every dollar earned. This is likely to be inequitable for working people who are already effectively insured by the welfare system. Such people would find that any insurance payment simply “cancels out” their welfare entitlements, leaving them net losers from the new scheme.
79. Ideally, the levy would apply “progressively”, requiring only modest (if any) contributions from working people who are already effectively insured by the welfare system. A progressive levy is technically very complex. A simple version may be possible, however, such as introducing a minimum income threshold before an individual is subject to the levy, similar to the AC scheme. However, given the difference in eligibility for this payment (and levy) and eligibility for benefits, such a scheme would also distribute from single individuals to couples.
80. Similarly to the AC scheme, the levy would apply to all working New Zealanders. Mandatory participation is a defining feature of social insurance. Mandatory participation overcomes the tendency of private markets to provide high cost insurance to only a selected small proportion of the labour market. Mandatory participation also eases administrative complexity (since there are no exclusions), and helps to avoid incentives to misclassify workers to avoid levy costs. The downside of compulsion is requiring some people (such as the self-employed) to contribute to a system from which they do not benefit.

How would it be delivered?

81. There is a range of government and market-based approaches for delivering some or all of the insurance scheme. There are also options to build on existing structures – such as the the AC scheme and MSD’s employment services.
82. The core unemployment insurance scheme functions comprise raising levies, managing funds, assessing claims, making payments, monitoring compliance, and dispute resolution. Raising levies is necessarily a role for a government agency. The remaining functions could be delivered via a regulated market (similarly to Kiwisaver), or via a government entity such as a relevant department, or a crown entity.
83. Given the similarities to the AC scheme, social unemployment insurance could be delivered by a similar crown entity model to the ACC, or by the ACC itself. This would see a Crown entity administer the scheme, including collecting levies, assessing and managing claims and providing dispute resolution and enforcement functions. Supporting services could be contracted from third parties, including other government agencies.
84. If Ministers are comfortable with potentially delivering social unemployment insurance via a crown entity, including through the ACC, officials propose to begin initial discussions with the ACC. The purpose of these discussions would be to understand better how this delivery option could work. Officials have not discussed with the ACC the possibility of ACC delivering additional insurance functions.

Approaching the Tripartite Forum and next steps

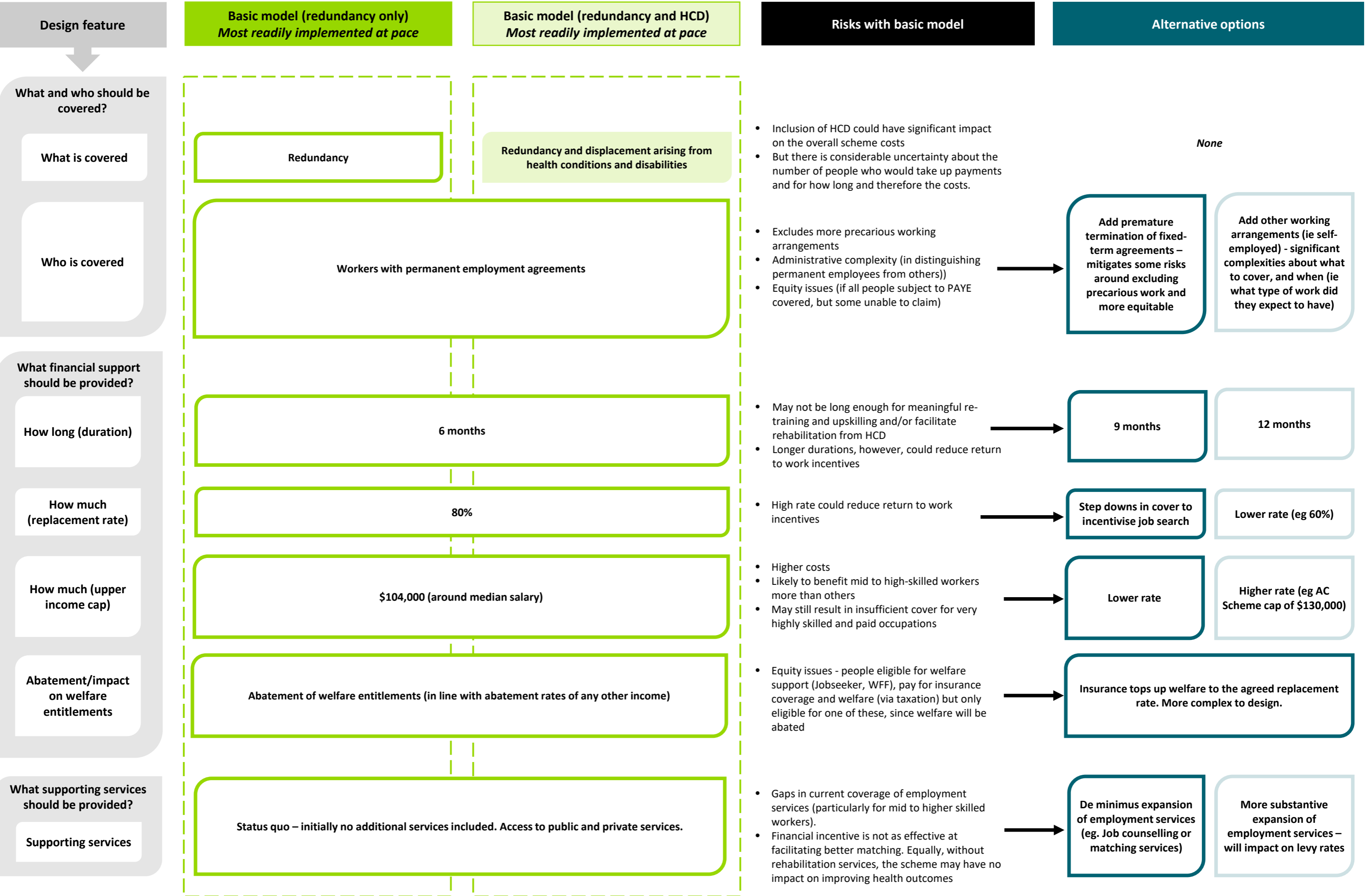
85. The choices Ministers make now are an initial position for the Tripartite Forum discussion only. Final policy choices will be influenced by further policy work, the views of social partners through the co-design process, and the outcomes of the public consultation.
86. At this early stage, Ministers may wish to opt for a relatively narrow or limited scheme. This approach will allow Ministers to adopt a more ambitious or broader scheme subsequently. It would be harder to take the opposite approach, since winding back stakeholder expectations could be difficult once established.
87. Subject to your agreement, we will prepare material for you to discuss the key design choices at the 22 March Forum. You have also indicated an intention to take an item to Cabinet following the Ministerial discussion (but ahead of the Forum) to confirm the Government's approach). Subject to Ministerial feedback, the material provided in this note could form the basis for your report to Cabinet.
88. The discussion at the March Forum will inform the content of the discussion document, scheduled for release after the August Forum.
89. In developing detailed material for the discussion document, further work is required on:
 - a. impact analysis (including the distributional impacts) of the preferred model,
 - b. financial modelling and costing (including the impact on the levy design), and identifying fiscal impacts,
 - c. calculating effective marginal tax rates, and assessing the impacts of the scheme on work incentives,
 - d. assessing the impacts of a social insurance scheme on employers, and their hiring practices,
 - e. assessing the impacts of a social insurance scheme on the insurance and employment services market, and the role these markets could provide in delivering aspects of the scheme, and
 - f. developing detailed designs (including identification of alternatives where the impact analysis reveals significant risks that can be mitigated through better design).
90. The social unemployment insurance work programme is a large public policy project that will require significant staff resources, and a modest consultancy budget. Officials are developing a project plan that will clarify the resourcing impacts across agencies. Officials will also provide advice on where ministers may need to trade-off their policy priorities, given the volume of work that draws on the same policy capacity.
91. Officials will also begin to design a public consultation process, and associated publicity to encourage participation. If Ministers wish the scheme to cover health conditions and disabilities, this will necessitate additional targeted consultation.

Annexes

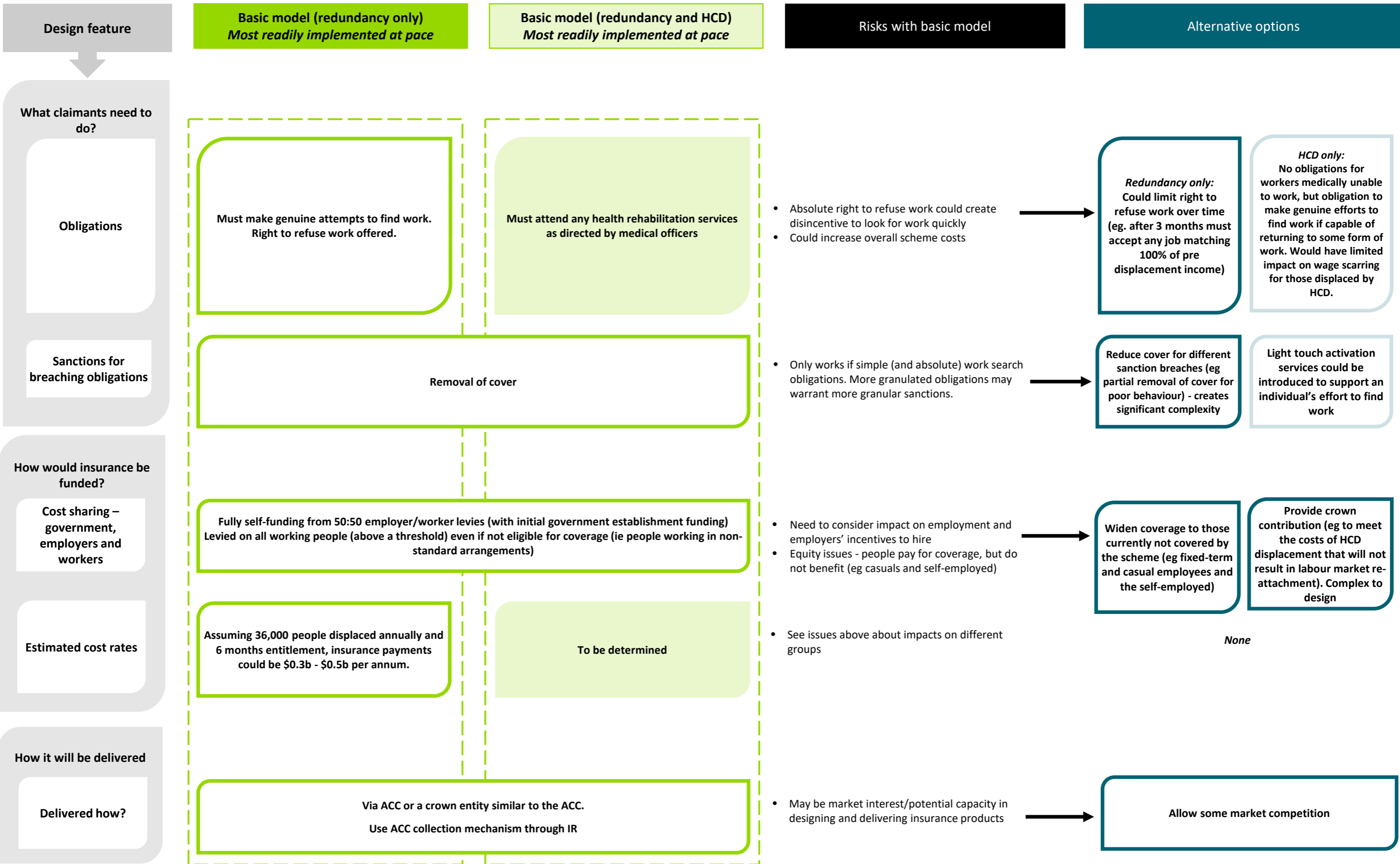
Annex One: Key design choices for a social unemployment insurance scheme

Annex Two: Selected international social unemployment insurance comparisons

Annex 1: Key design choices - basic model plus alternative options



Annex 1: Key design choices - basic model plus alternative options



Annex Two: Selected international SUI comparisons

Country	Type of scheme	Duration of benefits	Replacement rates	Contribution	Mandatory?	Eligibility	Covers sickness/disability	Considerations
Germany	Social insurance and social assistance	6-24 months depending on age / work history	60% (67% for workers with children) up to a cap of 2,805 euro/month (\$800 NZD/week max; no marginal benefit for those making above ~\$69,300/year)	Payroll deduction 1.5% (employer), 1.5% (employee)	Yes	Employees and voluntary for self-employed. Excludes those in irregular employment.	Disability is covered as part of broader old age, disability and survivor structure (taxed at 9.3% of monthly earnings). Sickness is covered as part of broader sickness, maternity, and medical benefits structure (taxed at 7.3% of monthly earnings).	Built in short-time work benefit and short-time transfer allowance. This system is largely reliant on social partners' collaboration.
Denmark	Subsidized voluntary insurance and social assistance	24 months	90% up to a cap of 2,473euro/month (\$1100 NDZ/week max; no marginal benefit for those making above ~\$57,800/year)	Employees pay flat fees which vary depending on fund with considerable supplementation from state funds. Average payroll deduction is roughly 8%, paid solely by employer and covers both unemployment and early retirement.	No (covers 77% of labour force)	Employees, self-employed workers, recent vocational school grads Must be members of unemployment fund	The unemployment insurance fund will pay out a sickness benefit during the first 14 days of sickness. After this period, local government will pay sickness benefits up to a total of 22 weeks (which can be extended in some situations).	Coverage is voluntary but maps with unionisation rates.
UK	Social insurance and social assistance system	6 months	Flat £73.10 per week is paid if aged 25 or older; £57.90 if younger than age 25; £116.80 for those claiming income-related JSA as a couple (\$568 NZD/week max individual, \$1000 for couples)	Payroll deduction 13.8% (employers), 12% (employees) but funds ALL social insurance (old age, survivors, workers comp, etc)	Yes	Employees; covers voluntary job loss	Unemployment benefits do not cover sickness or disability. Statutory sick pack (SSP) is part of broader coverage package and funded under same payroll tax structure.	Most similar to COVID Income Relief Payment. The regular benefit is based on contributions history, but couples' benefit based on income. The UK also has needs-based universal credit System has been in a constant state of reform in recent years; more changes to come as universal credit phase-in continues.
Canada	Social insurance	14 to 45 weeks depending on work history and regional UE	55% of lost earnings up to a cap of \$573 per week CND (\$1010 NZD/week max; no marginal benefit for those making above ~\$95,500/year)	1.66% payroll deduction (employee), 2.32% (employer)	Yes	All employees (excludes self-employed)	Public employment insurance does cover sickness (and caring for gravely ill family members). Disability coverage is part of Canada's broader old aged/survivor/disability system covers disability with a tax rate of 5.95%.	Welfare provision is province-based, so interaction is determined at local level.
Sweden	Social insurance and voluntary income-related insurance system	42 weeks	235 euro/wk for basic coverage; 80% of former wages for voluntary scheme capped at 616 euro/week initially but max benefit phases out. (\$1100 NZD/week max; no marginal benefit for those making above ~\$71,500/year)	Membership fee for voluntary program, 2.64% payroll deduction for both voluntary and mandatory system (employer)	Both	All workers including self-employed	Sick pay is funded under a different system but under overall social security structure. Employers pay 4.35% of payroll to support sick leave which covers illness, injury or disability for those who were covered at time of incident/illness.	Membership for income-related insurance voluntary and available to employees in a specific occupation or industry who join a union-run fund. Those who pay into voluntary scheme are ineligible for basic scheme.

Netherlands	Social insurance and social assistance	Basic benefit is 6 months with additional benefits depending on work history up to cap of 38 months	Phases out over time but starts at 75% of lost wages up to a cap of \$220NZ/working day (\$1100NZD/week; no marginal benefit for those making over \$82,000/year)	Payroll deduction on employers (2.94% for permanent employees or 7.94% for fixed-term)	Yes	All employees (excludes self-employed)	Three schemes are all covered by the employer payroll deduction - unemployment benefit scheme, the invalidity insurance scheme, and the work and income (capacity for work) scheme which deal with disability.	Particularly interesting model on the health condition and disability side. One payroll tax pays for three systems, but each has different eligibility and administrative structures. Also interesting to note the variable payroll deduction meant to encourage permanent employment.
--------------------	--	---	--	--	-----	--	--	--

DRAFT