

Submission

by

**THE
NEW ZEALAND
INITIATIVE**

to

The Future of Work Tripartite Forum

on

A New Zealand Income Insurance Scheme

23 March 2022

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0 Introduction

- 0.1 This submission on The Future of Work Tripartite Forum's proposal 'A New Zealand Income Insurance Scheme' is made by The New Zealand Initiative, a think tank supported primarily by chief executives of major New Zealand businesses. The purpose of the organisation is to conduct research and contribute to developing sound public policies in New Zealand to help create a competitive, open and dynamic economy and a free, prosperous, fair, and cohesive society.
- 0.2 The Initiative has, since its founding, taken a strong interest both in social policy and those policies affecting the functioning of the labour market. In this context, on 11 November 2021, we published *Unemployment Insurance - A recipe for more unemployment?* by Dr David Law. We also commented on the concept of social unemployment in the media.¹
- 0.3 We strongly oppose the proposed Social Unemployment Insurance. This submission explains why we believe that such an addition to the New Zealand welfare state is undesirable.
- 0.4 Our opposition to social unemployment insurance concerns the proposal as such, not any individual features of Tripartite Forum's scheme. We will thus not engage with consultation questions #2 to #94.
- 0.5 Instead, the following will be in response to Consultation Question #1: "Do you agree New Zealand should introduce an income insurance scheme for displacement and loss of work due to health conditions or disabilities?"
- 0.6 Our short answer is 'No'. We will give our reasons below.

1 There is no pressing need for unemployment insurance in New Zealand

- 1.1 Unlike most other developed economies, New Zealand does not have a problem with high and persistent levels of unemployment.
- 1.2 Indeed, the Tripartite Forum's consultation document shows in Figure 1 (p. 24) that job losses due to displacement, health conditions or injuries have been trending down since 2007 (with the notable exceptions of job losses around the Global Financial Crisis of 2009 and the Covid pandemic in 2020).
- 1.3 According to the consultation document, an estimated 115,000 people are displaced on average each year. But on its own, that number does not tell us anything about the need for unemployment insurance.
- 1.4 In a well-functioning labour market, displaced employees should be able to find new employment quickly. New Zealand is fortunate to have such a functioning labour market, as is evidenced by low rates of unemployment.
- 1.5 Both New Zealand's current rate of unemployment as well as its long-term unemployment rate average (from 2000 to 2020) lie well below the OECD average. In 2020, the annual unemployment rate for New Zealand was 4.6% compared to the OECD average of 7.2%. From

¹ Hartwich, Oliver, Social insurance lessons from Germany, *New Zealand Herald*, 7 December 2021; Crampton, Eric, Unemployment insurance: The rorts to come, *The Dominion Post*, 7 February 2022; Partridge, Roger, Unemployment insurance creates more problems than solutions, *New Zealand Herald*, 8 February 2022.

2000 to 2020, New Zealand's average annual rate of unemployment was 5%, compared to 6.9% for the OECD.²

- 1.6 Consequently, unemployment is a less pressing policy concern in New Zealand than in most other developed economics.
- 1.7 It is not just that the general level of unemployment in New Zealand is comparatively low. We should also note that long-term unemployment (defined as people unemployed for 12 months or longer) is rare in New Zealand.
- 1.8 From 2000 to 2020, New Zealand's average annual share of long-term unemployment in total unemployment was 11.8%, compared to 29.4% for the OECD and 44.7% for the EU.
- 1.9 Put differently, the average long-term unemployment rate for these 20 years was 0.59%. That means only 1 in 169 people in the labour market was affected by long-term unemployment.
- 1.10 These figures demonstrate that the New Zealand labour market offers people losing their jobs good opportunities of finding alternative employment.
- 1.11 This well-functioning labour market is complemented by a welfare setup which is targeted at those who need it the most. By OECD standards, New Zealand operates the most targeted welfare state in the developed world.
- 1.12 The combination of low unemployment, a low share of long-term unemployment and highly targeted support for those in need, there is no obvious need for any further, general schemes aimed at people losing their jobs.

2 Unemployment insurance prolongs unemployment

- 2.1 As shown above, social unemployment insurance is unnecessary in the New Zealand context because there is no obvious problem it could solve. However, it is worse than that because social unemployment insurance will create problems we did not have without it.
- 2.2 As a general rule in economics, if you pay more for something, you will get more of it. Unemployment is not different.
- 2.3 Payments from Social Unemployment Insurance provide an incentive to remain unemployed for longer. At the very least, they reduce the urgency with which people losing their jobs will seek alternative employment.
- 2.4 For example, an analysis of job search intensity of the unemployed in the U.S. showed that the more generous unemployment benefits are, the less time the unemployed spend to look for alternative employment. It also showed that job search intensity increases just before the benefits come to an end.³ Another study, analysing half a century of data, concluded that the

² Law, David, *Unemployment Insurance - A recipe for more unemployment?*, (2021), The New Zealand Initiative, Wellington.

³ Krueger, Alan and Mueller, Andreas, (2010), Job search and unemployment insurance: New evidence from time use data, *Journal of Public Economics*, 94, issue 3-4, p. 298-307, <https://EconPapers.repec.org/RePEc:eee:pubeco:v:94:y:2010:i:3-4:p:298-307>.

number of weeks worked per worker dropped significantly when unemployment benefits were more generous.⁴

- 2.5 In this way, Social Unemployment Insurance tends to prolong times of unemployment, thus increasing the unemployment rate and reducing economic output. This is the consensus view in labour economics and is well-documented.⁵
- 2.6 Beyond these macroeconomic effects, the longer time spent unemployed also has microeconomic implications. From empirical research, we know that the longer people spend out of work, the less employable they become.
- 2.7 In labour economics, this effect is known as ‘scarring’. It is well-documented, especially as it results from times of recession.⁶ The most important lesson learnt from such experiences is the importance of getting people who lost their jobs back into work as quickly as possible. Rapid re-employment is the best way of preventing long-term wage scarring effects.
- 2.8 Empirical research has also shown that employers use job candidates’ unemployment duration as a sorting criterion. The longer people are out of work, the worse their chances are of finding new employment.⁷
- 2.9 The presence of Social Unemployment Insurance counteracts this quick re-employment objective. Inducing people to stay out of the labour market for longer than they otherwise would then risks wage scarring.
- 2.10 In making its case for Social Unemployment Insurance, the Tripartite Forum warns of wage scarring of another kind: the fear that people losing their jobs might settle for new jobs below their actual qualifications. However, with a labour market as tight as the New Zealand market is and has been, that danger looks remote although it cannot be ruled out for the future.
- 2.11 Risks would then run in two directions. In the absence of credit constraints, we might expect that an unemployed person would balance the risks, engaging in job search until further search would do more to hurt future earnings because of the extended duration of unemployment than to help future earnings by providing chances of better job offers.
- 2.12 A person facing credit constraints might be tempted to strike earlier than would be optimal from a lifetime earnings perspective. Still, risks run both ways. Employment insurance would largely abate credit constraints that might result in a job search too short, relative to some first-best. But the unemployed person will instead weigh the cost to lifetime earnings of a too-lengthy job search against the enjoyment of a longer spell on a very high fraction of their prior earnings – a paid holiday. And a too lengthy job search would result, relative to the optimal amount for avoiding scarring. Similarly, employment insurance could encourage unemployed

⁴ Kuhn, Peter and Riddell, Chris, (2010), The Long-Term Effects of Unemployment Insurance: Evidence from New Brunswick and Maine, 1940-1991, *ILR Review*, 63, issue 2, p. 183-204, <https://EconPapers.repec.org/RePEc:sae:ilrrev:v:63:y:2010:i:2:p:183-204>.

⁵ Schmieder, Johannes and Trenkle, Simon, (2020), Disincentive effects of unemployment benefits and the role of caseworkers, *Journal of Public Economics*, 182, issue C, number S0047272719301574, <https://EconPapers.repec.org/RePEc:eee:pubeco:v:182:y:2020:i:c:s0047272719301574>.

⁶ Carrington, William J. and Fallick, Bruce, (2017), Why Do Earnings Fall with Job Displacement?, *Industrial Relations: A Journal of Economy and Society*, 56, issue 4, p. 688-722, <https://EconPapers.repec.org/RePEc:bla:indres:v:56:y:2017:i:4:p:688-722>.

⁷ Belle, Eva & Di Stasio, Valentina & Caers, Ralf & Couck, Marijke & Baert, Stijn. (2018). Why Are Employers Put Off by Long Spells of Unemployment?. *European Sociological Review*. 34. 1-17. 10.1093/esr/jcy039.

people in high unemployment communities to delay shifting their job search to places with more employment opportunities.

- 2.13 Which effect dominates is an empirical question, but there seems substantial risk of doing harm through the policy. Unemployment in New Zealand is typically low. And involuntary job severance is rarer in New Zealand than elsewhere. A few years ago, a Motu working paper summarised work showing annual job displacement rates of 2-7% in international data, and of 5-6% in Britain and Australia.⁸ New Zealand estimates are between 1.8 and 2.2%.
- 2.14 Hyslop and Townsend find wage scarring among displaced New Zealand workers, through a combination of fewer hours worked after job displacement and lower hourly wages. But they do not distinguish between reductions in wages that might result from loss of job-specific human capital, and that which might result from a worse future job match that might be reduced through more lengthy job search.
- 2.15 The benefits from allowing a longer job search thus seem rather hypothetical. Meanwhile, there are clear and substantial wage scarring risks in encouraging insurance payment recipients to stay out of the labour market for any longer than necessary.

3 Unemployment insurance: the wrong proposal at the wrong time

- 3.1 In our view, there is no pressing need to introduce Social Unemployment Insurance. There are significant negative side effects from such a policy for the functioning of the labour market. There is a risk that such a policy will harm the long-term employability of those people it purports to help.
- 3.2 But even leaving all of this to the side, there remains one important reason against the introduction of this scheme now. Because economic circumstances are such that businesses can ill afford any additional costs right now.
- 3.3 Though the contributions to the scheme are technically made by employees and employers in equal parts, in economic terms this differentiation makes no difference. Who bears the economic costs of the scheme (the so-called tax incidence) depends on the relative price elasticity of labour supply and demand and the institutional set-up of the labour market.⁹
- 3.4 With a labour market as tight as it is, we may expect employers to shoulder a large part of the additional burden. That is because employees would have a relatively easy time finding alternative employment and are therefore in a stronger bargaining position vis-à-vis their employers. They could demand their insurance premium to be factored in when it comes to renegotiating their salaries, thus passing on the tax to their employers.
- 3.5 Still, how much of the additional burden remains with the employers is difficult to predict, but it is likely to be higher than employers' notional share of the scheme.

⁸ Hyslop, Dean and Townsend, Wilbur, (2017), *The longer term impacts of job displacement on labour market outcomes*, No 17-12, Working Papers, Motu Economic and Public Policy Research, https://EconPapers.repec.org/RePEc:mtu:wpaper:17_12.

⁹ González-Páramo, José, and Melguizo, Ángel, Who Really Pays Social Security Contributions and Labour Taxes?, VOX, CEPR Policy Portal, vox.eu.org, 6 February 2013, <https://voxeu.org/article/who-really-pays-social-security-contributions-and-labour-taxes#:~:text=On%20average%2C%20in%20the%20core,conventional%20wisdom%20on%20distributive%20incidence.>

- 3.6 We can expect that the cost of employment will increase due to the introduction of this scheme.
- 3.7 In the current inflationary environment, in which companies face higher costs for many of their factor inputs, increased labour costs will be a further blow to companies.
- 3.8 Though many companies would be able to absorb additional costs during good or at least normal business circumstances, the New Zealand economy in 2022 is facing a multitude of challenges. From getting out of the Covid restrictions, dealing with labour market shortages, facing a plethora of new regulations and now also the fallout of the war in Ukraine, there is no shortage of problems for New Zealand businesses, and many result in cost increases.
- 3.9 To introduce yet another costly scheme during this extremely difficult and demanding time borders on economic recklessness.
- 3.10 Note that we have not even discussed whether the introduction of this scheme could also result in collusion between employers and employees. Providing months of redundancy payments at the fundamentally changes the nature of redundancy processes. Redundancy has typically been adversarial. The worker made redundant would rather not be made redundant and will contest the redundancy if it was inappropriate.
- 3.11 Under the proposed scheme, it is easy to foresee situations in which employer and employee agree that a redundancy would be in their interest, at the Crown's expense. If a worker is made redundant at age 64, could the government tell whether it was a real redundancy or an early retirement gift? Redundancy at the insurance scheme's expense may also be easier than HR processes in dealing with employment relationships that have become toxic – to the benefit of both parties, and the expense of everyone paying into the insurance system. These problems are inherent to a scheme that does not risk-adjust premiums paid by employers and employees, and will have pervasive consequence. Policing against these kinds of arrangements will not be hard.

4 **Conclusion**

- 4.1 Superficially, Social Unemployment Insurance sounds like an appealing addition to the New Zealand labour market set-up. However, it is not. It is a policy for which there is no need, which will create significant negative side effects and which comes at the worst possible time for many New Zealand companies.
- 4.2 The New Zealand Initiative urges the Tripartite Forum, and especially the Government, not to progress with the scheme – at least not at this time.