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A Critical Consideration of Current Social Insurance Policy Developments in New Zealand

Abstract

Recent surprising announcements about the development of a social unemployment insurance (SUI) system by the Labour government are critically considered. Introducing SUI represents a major philosophical lurch from a welfare system mainly about family poverty alleviation towards one which has a stronger focus on market income replacement for individual low- and middle-income earners. We critically consider the policy process, the reasons why an SUI system might be desirable, and several alternative solutions to the likely proposal. We express scepticism about the democratic credentials of the process thus far and conclude that a persuasive case for such major reform has not yet been made.

Keywords social insurance, individual market income replacement, family poverty alleviation, middle-class welfare

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In the May 2021 Budget, Minister of Finance Grant Robertson announced that the government had committed to developing a social unemployment insurance (SUI) scheme for New Zealand (Robertson, 2021). Few details have been made public.[1] But Robertson indicated that the idea was at the 'urging' of the New Zealand Council of Trade Unions (CTU), and the employer group BusinessNZ suggested that the scheme would be 'ACC-like', and hinted that it would pay low- and middle-income earners who lost their jobs about 80% of their previous earnings up to some maximum cap for a period of time of less than a year. The proposal appears to be a form of conservative Bismarckian social insurance, which arose out of reforms by Otto von Bismarck during the period of the Second Reich in Germany after its 1871 unification, and which is the current norm across most continental European OECD countries.

This announcement was a considerable surprise. The majority Labour government elected in 2020 had not included any discussion of social insurance in their electioneering. In fact, in 2020 one of Labour's stated commitments was '[s]implifying the income support system and ensur[ing] the settings that underpin access to income support are fair and fit for purpose', a commitment arguably inconsistent with adding a whole new SUI layer.[2]

Work to develop the scheme has so far been carried out behind closed doors, initially through the government's Future of Work Forum and, since the Budget, by a dedicated working group comprising representatives of the CTU, BusinessNZ and officials from several government agencies. The announced public discussion paper is currently unreleased but is due later in 2021. From informal conversations with officials, it seems the scope of the paper is not to explore whether such a scheme should be introduced, what the range of alternatives to it might be and their various pros and cons. Rather, it will narrowly focus on details of a particular social insurance scheme, apparently for introduction in 2023. The proposal is likely to cover social insurance not just for those who become unemployed because of redundancy but also for those who lose their jobs on account of sickness.

This article considers the political economy of social insurance in New Zealand in the context of the policy process so far, and some of the possible implications of the major philosophical shift which SUI represents. It considers the major rationales for having a social insurance system, and the range of institutions which currently exist to solve insurance problems which may be crowded out by social insurance. It suggests two alternative policy responses, conditional on accepting certain assumptions underpinning the SUI reforms, to the Bismarckian SUI of Robertson's Budget speech, one based on strengthening the existing social welfare system and the other involving a form of social insurance, both of which, we believe, may have greater net equity and efficiency benefits. It concludes with considerable scepticism about where the policy process seems to be heading.

The political economy of social insurance

Introducing SUI represents a major philosophical shift from a welfare system which is mainly about family poverty alleviation towards a welfare system which has a stronger focus on market income replacement for individual low- and middle-income earners. Given that the introduction of a second, conceptually distinct and more generous tier into our core welfare system would represent the biggest change to social security policy in New Zealand since the 1974 establishment of the Accident Compensation Corporation (ACC), the lack of openness and apparent haste in the SUI policy process is a serious concern. By contrast, the establishment of ACC followed a lengthy royal commission of inquiry reporting in 1967 and many years of scrutiny thereafter. With change as significant as the proposed SUI scheme, there should be a comparable level of transparent and public discussion of all options, including non-insurance-based ones, before any final decisions are made.

As already touched upon, Labour did not go into the 2017 and 2020 elections with social insurance as a manifesto commitment. Nor was social insurance discussed as a policy issue in any of the media reporting on the elections which led in 2017 to a minority Labour government and in 2020 to a majority Labour government, and there was no consideration of social insurance in the Welfare Expert Advisory Group's major report on reforms to the welfare system in 2019. We suggest that a strong commitment to open government and the democratic process means that major policy shifts – which include introduction of radical changes like social insurance – should, before the fact, be broadly discussed and carefully considered as part of the process by which political parties try and persuade New Zealanders to vote for them.

In addition, all New Zealanders benefit from carefully considered, stable policies which endure through time. Welfare has long been an important left–right political football. In other words, this is an area where a greater degree of considered bipartisanship and longer-term stability may be of value for New Zealanders' well-being. The degree of cross-spectrum political support for social insurance is unclear, but what is clear is that a bipartisan approach, at least politically, has not been adopted thus far and negotiating any such approach will be time-consuming.

The social insurance project appears to have been developed, promoted and endorsed by what some refer to as the government's 'social partners' – the CTU and BusinessNZ (McNamara, 2021). There are questions here about the representativeness of these partners. The CTU affiliates cover a small minority of those in paid employment and are disproportionately skewed in membership towards white-collar professionals – nurses, teachers, academics and other public servants – whose wages are largely funded by taxpayers. Via their 'major companies' group' of more than 100 private sector firms which produce over 67% of New Zealand's GDP, BusinessNZ perspectives are likely to be predominantly those of big business. These businesses operate in a largely non-unionised labour market.

An opportunity for democracy comes in 2023, which is when the scheme is expected to be introduced (ibid.). If Labour goes into the 2023 election with social

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insurance as part of its platform, then the proposal can at least be debated by politicians and interrogated by voters in a manner consistent with democratic norms. If Labour rushes its plan through before the election, significant public scrutiny will be avoided and democracy, arguably, significantly trampled upon.

Politicians are, not surprisingly, political, weighing up re-election impacts of their policies. It is worth considering the question: why is SUI politically attractive to the Labour government in the current moment? Some informed speculation on these matters is of value.

The first reason in part is likely driven by internal Labour Party politics. SUI throws a considerable bone to the trade union arm of the labour movement, some parts of which have decided they want social insurance. What is more, this part, crucially, has big business support. It is therefore a significant economic policy change which avoids conflict with big capital while supporting the CTU power bloc – somewhat similar, ironically, to constellation of social forces which led to introduction of Bismarckian social insurance during the Second Reich. It is possible that big business in New Zealand favours social insurance because it provides a socialised cushion which allows continuance of otherwise easy-hire, easy-fire labour market regulation under the umbrella of 'flexicurity', for which it has a preference. To the extent that a social insurance scheme allows big business to negotiate away existing terms and conditions in a largely non-unionised environment, at least some of the economic costs falling upon them can be shifted onto others, and this may also be a calculation they have made in offering their support.

The second advantage which a social insurance system has is in terms of Labour's announced tax policy. In 2017 Labour committed to maintaining government spending at under 30% of GDP, and in 2020 it committed to no new taxes in this term, beyond adding a new top PAYE rate.[3] However, a social insurance system allows a new tax to be sold politically as a levy, potentially side-stepping the taxation commitment. Introduction of a new levy is, of course, a politically risky judgement by Labour, since its effectiveness depends on spinning a persuasive political narrative to the voting public and the commentariat which is sufficiently plausible to ensure that the tax label and accusations of broken promises don't stick. The effect of the 'no new taxes' promise is to constrain promises to those which can be sold as a levy.

The third advantage from a Labour political perspective is that a social insurance scheme disproportionately benefits the employed middle classes with sufficiently stable employment histories to qualify for significant social insurance, playing on a classic middle-class fear of downward mobility.[4] These insecure middle classes are typically marginal voters, on whose votes New Zealand's elections generally swing. It is likely that Labour strategists will be aware of this insecurity.

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The dynamic political economy of a two-tier system

Establishing a stronger two-tier, social insurance/benefit structure in New Zealand's core welfare system runs some significant centrifugal dynamic risks, in terms of erosion of broad public support for the current social welfare floor and further impetus to the individual income replacement philosophy. An expansion of social insurance to sickness and unemployment will, to a large extent, remove from the social welfare system many of the remaining middle-class users, who are currently typically short-term users. Their focus will shift more strongly to improving that new income replacement system, to the neglect of the welfare floor, which will become even less important to them. The public perception that the social welfare system is predominantly for the underclass will also be reinforced. In addition, introducing SUI will remove much of the rump middle-class voice from the current working-age welfare system. If that removal is considerable, it will consequently create longer-term risks of an increasingly divergent two-tier system of 'good' and 'bad' welfare, with concomitant risks of erosion of the adequacy and quality of the family welfare floor, especially should a fiscal crisis eventuate. Overall, there is a significant risk of progressively improving the social insurance system and undermining the welfare system, driving further wedges between the two tiers. The risks of such a dynamic may be contested. Jonathan Boston, for example, suggests that countries with weak contributory systems have weaker safety nets (Boston, 2019, p.18). However, we are unsure if this cross-sectional relationship is causal, and OECD comparative evidence on changes through time in generosity of the social insurance system relative to the welfare system within countries does not confirm such patterns (Immervoll and Richardson, 2011).

Why insurance? Why social insurance?

This section considers the fundamental policy problems that a social insurance scheme may address. Orthodox public policy development begins with identification of a policy problem, followed by an assessment of how many people are affected, which people and how severely, and then considers the costs and benefits of the full range of possible policy responses (including doing nothing) against relevant efficiency and equity criteria. In this instance it appears the solution of an SUI system came first, with a case for it being developed afterwards.

A significant number of people have a desire for stability in their material circumstances, seeking to smooth their consumption over time, and, in particular, in response to future adverse contingencies to which a positive probability can be attached, such as job loss, sickness, death, theft of property or destruction of property (say, by fire or earthquake). In theory at least, these needs may be met privately via insurance. The buyer of insurance pays an insurance premium to the insurer, who provides the insurance by pooling the risks of these contingencies across a broad pool of customers. The insurer, in return, commits to making some payment to the buyer of insurance (or their beneficiaries) in the case of a particular event adverse to the buyer.

Two classic problems exist in private insurance markets, however, which mean that they underprovide relative to people's insurance needs. The first problem is adverse selection, which arises out of the fact that people seeking insurance have better information about the nature of the risks facing them than do the businesses which would like to profitably insure them, and have no good reason to disclose this information to providers. Insurers know that those queuing to buy insurance at any particular premium will be made up disproportionately of those who are at higher risk of claiming than the population at large, without being able to otherwise identify these customers. In order to make money, insurers set an insurance premium reflecting an average level of risk of those in the queue. Those who are lower than average risk in the queue find that their purchase costs exceed their expected benefits from insurance and stop queueing. Consequently, the average risk of those remaining in the queue rises, premiums must rise in order for insurance to be profitably provided, and a vicious cycle may commence, where the queue to purchase insurance becomes progressively smaller as lower-risk people leave and the premiums consequently rise. At the end of this sequence, little may remain of a private insurance market. Private insurance is under-provided and the social interest is unsatisfied.

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A further cause of the failure of private insurance markets to meet the social interest is moral hazard. Moral hazard arises because the risks of needing to access insurance payment are not independent of the purchase of an insurance policy. If, for example, a person has insurance, they may act to take on more risk, without the insurer knowing exactly which customers are adopting more risky behaviour. Again, the consequence is a higher market insurance premium than is socially desirable and less (or no) insurance resulting from that.

The market failure creates a possibility that careful, well-designed government intervention may meet the social interest, in particular via compulsion to insure, which addresses the adverse selection issue otherwise created by the exercise of private choice and asymmetric information between buyers and sellers.[5] At the same time, by ensuring that all people must be in the insurance queue and must purchase the product, a compulsory social insurance system considerably expands the scope for the problem of moral hazard, with people altering their behaviour to increase their eligibility for insurance payouts.

Yet solving the problem of insurance market failure is not the only problem definition which may be adopted. Solving other problems may also provide a rationale for government intervention. If there are scale economies, for example, there may be lower costs of providing insurance on a large scale which government may be able to directly capture. (Subsidising the private sector is an alternative to capturing these economies.) Additionally, there may be a view that some people are myopic and do not perceive a need to insure. The assumption, often tacit, is that policymakers can better perceive this need and can make a government insurance purchase on these people's behalf which makes them better off than simply giving them the money and allowing them to make their own choices about their purchase of goods and services, which may or may not include insurance. Often this value judgement is coupled with a belief that these myopic people are likely to be low-income and unable to afford insurance, introducing an equity as well as a paternalistic argument into policy discourse. Much of Rosenberg's discussion (Rosenberg, 2020), in fact, seems to argue for social insurance in terms of what we describe as redistributional paternalism. For example, he dismisses a state-subsidised private insurance system as having 'little ability to share … costs … more equitably', discusses social insurance policies in terms of a 'need' and mentions the 'unfair costs of adverse events' like redundancy.[6] It is not clear why Rosenberg concludes that some people should have a merit good in the form of insurance purchased for them by the state and some other people should pay for it. However, his argument implies a belief in a considerable degree of myopia about the need for unemployment insurance among low- and middle-income wage earners, so that (presumably well-informed) policymakers need to purchase it on their behalf.[7]

Theoretical and empirical analysis suggests that strongly social insurance-based welfare systems, be they relatively lean like in the United States or relatively generous like the Nordics', are largely about intertemporal redistribution across a person's life course rather than redistributing income from long-term well-to-do people to long-term poorer people (see Feldstein, 2005 and Ståhlberg, 2007 respectively). SUI would most benefit full-time middle-income workers who lose their jobs, by providing them with a period of higher payments than the current welfare system. The most income cushioning would be experienced by full-time middle-income workers who are partnered with a person who is similarly employed.[8] It would be of less benefit, or no benefit at all, to the many ineligible who are likely to miss out on unemployment insurance, including business owners, the self-employed, precarious workers and dependent contractors, young new labour market entrants, sole parents caring for children, and people not able to work in the first place because of disability.

In effect, the tacit comparator group for consideration of equity for those who become redundant or lose a job through sickness are those people who remain in jobs. The equity judgement is that those people who become unemployed for other reasons, say because a relationship ends, or who decide to shift from home to market production (perhaps because a child has gone to school), or who have left education and training in hope of finding work are not considered sufficiently deserving of the higher payment; or the costs of providing support to such people are tacitly assessed as excessive.

There are further tacit equity value judgements or cost judgements in advocacy of social insurance as an equitable solution: for example, that employed people who have a low tolerance for redundancy risk and who consequently take stable but lower-paying jobs and who adopt healthy lifestyles that lower the risk of sickness should subsidise those who have a high tolerance for redundancy risk and who take less care with their health. That's the equity implication of the risk-pooling dimension of social insurance.

Lastly, an equity value judgement is hidden in the individual nature of social insurance entitlements. Family income has no influence on entitlements. If their employment and earnings histories are the same, a childless Remuera 60-year-old married to a lawyer earning $500,000 a year on being made redundant from a part-time life-style job in the local interiors shop could receive exactly the same social insurance compensation as a 30-year-old Manukau solo mother of three who loses her full-time office cleaning job. Some might consider this highly inequitable and others not, but promotion of individualised social insurance means accepting this newly created situation. (Of course, the sole mother will be better off under social insurance than on a main benefit.)

may be higher wages or better terms and conditions, including redundancy payout rights. A decade ago, more than half of displaced workers in New Zealand had a redundancy entitlement, with a mean value then measured at over $28,000 (OECD, 2017, p.61). Additionally, many workers will have some sick leave entitlement in their employment contracts, as well as accumulated annual leave, another margin of self-insurance which people can adjust.

Family can provide further non-market

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Current solutions to missing private insurance markets

Any consideration of social insurance provision by government needs to address the extent to which it crowds out current provision for the missing market. Crowding out may be considerable.

Individual employees can self-insure against job loss by putting financial resources aside to protect themselves against income volatility. Additionally, people may consciously acquire human capital or skills to cushion against known risks of job loss. Lastly, evidence which indicates that people who are unemployed can spend up to two hours a day on home production compared to those who are employed indicates that home production may function as partial self-insurance when market production is lost (Krueger and Mueller, 2012, Table 3, p.771).

Furthermore, if people use information regarding future income volatility in the segment of the labour market to which they have chosen to allocate their labour, compensating variations for job loss risks may arise. These compensating variations

insurance against individual income volatility. Much of the SUI policy focus appears to be on individual income smoothing. However, income-smoothing problems typically arise at a family, not an individual, level, due to family income sharing. If a single person or a one-earner family loses their job, they lose 100% of their market income, while if family with two full-time earners loses one job, they most likely lose considerably less than 100% of their market income.

This insurance may involve a spouse who has a job, or a spouse who chooses a low-risk job in order to insure a partner in a high-risk job and who is compensated for this act by sharing the bounty when times are good. Or, currently, it might be a young person who moves home with their parents when they lose employment due to redundancy or sickness, or whose parents take over their mortgage or pay their rent in similar circumstances. The existence of couple-based labour supply also allows people with families to access the private finance market to compensate: for example, an earner loses a job but maintains consumption via bank loans which are serviced by their spouse working and a higher loan–income ratio in the transition. (Banks are unlikely to provide loans to offset income volatility if there is no market income in family.)

Turning now to the profit-driven private sector, the primary private market failure creates profitable incentives for private providers to innovate and provide some form of insurance. Many households in New Zealand have some form of private income insurance. For example, Horizon Research in 2012 estimated that 15% of households had income protection for sickness or unemployment (Horizon Research, 2012, p.4). There are also but take-up, especially by people not on a first-tier benefit, may be an important issue due to lack of information about eligibility and stigma.

A further important existing institution is the student loans scheme. This scheme creates a set of individual accounts for people, at any stage of their life, aimed at overcoming the private capital market failure to fund education and training, including when pre-existing skills become redundant. Via the system of individualised accounts, personal incentives are better aligned with personal information and choices, and moral hazard in terms of socially excessive durations on the public coin is better avoided. Additionally, if

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imperfect means of overcoming the *ex post* capital market imperfection to smooth long-term consumption via use of various forms of overdrafts.

Of course, government also currently provides a range of policies to mitigate income volatility. The most obvious is the working-age welfare system, which has been eroded relative to wages in the last 35 years by CPI indexation of benefits. Hence it works less well than it used to for many people in providing for the missing private market. However, recent and announced rises in benefits have, at least to some degree, offset this, reducing space for a social insurance system. Current social welfare assistance also includes the accommodation supplement, which is available to pay financial commitments like mortgages should family income sink below certain market thresholds, and Working for Families if people have children and again meet a family income test. Eligibility for both the accommodation supplement and Working for Families benefits is not dependent on eligibility for first-tier working-age benefits, suffering significant hardship, the over three million people in KiwiSaver have the right to access their accounts (which had an average value of $26,000 in 2021).[9]

Lastly, in terms of unemployment insurance, a monetary policy which is effective in keeping unemployment at low and stable levels is likely to eliminate much of the need for an unemployment insurance system. Full employment rather than income support payments was the foundation of the New Zealand social welfare system for much of the post-war period (Chapple, 1996; Rosenberg, 1977).

All these imperfect substitutes go some considerable way to mitigating the primary market failure. Policymakers need to understand what these other institutions are doing to understand the size of the problem and therefore the extent to which an SUI solution is of net value. That institutional reach of imperfect substitutes appears to be considerable. Horizon Research indicated that one in five New Zealand households could maintain current living standards at existing levels for over a year if they lost their primary earner to unemployment or sickness (Horizon Research, 2012, p.12).[10]

If there remains a significant gap in this pre-existing portfolio of solutions, which we believe should be persuasively demonstrated analytically rather than assumed, then policy change which contemplates social insurance to fill this gap needs to consider: its deadweight, in terms of SUI simply substituting state provision for one or several of the pre-existing solutions, which are downsized when insurance is introduced; and whether reforming one or more of these pre-existing institutions may be preferable in terms of cost and effectiveness in addressing identified policy gaps.

Furthermore, like these other institutions, social insurance will itself be an imperfect substitute for the missing private insurance market. Social insurance is a set of rules where one size fits all; there is no allowance for human diversity. Even neglecting diversity among the employed in terms of their risk preferences for income volatility, the average income-smoothing service set by central fiat may be in excess of or below what the average person would want or need. And traditional social insurance creates a significant moral hazard problem for recipients, and incentives for both employers and employees to game the system to shift costs of performance management and personal grievances on to third parties – other levy payers.

Putting the problem in this fashion immediately suggests the following two central points. First, potential solutions may involve: (a) reducing the chances of redundancy or sickness which result in job loss (we might think of these as preventive fences at the top of the cliff); or (b) providing some forms of compensation – be that compensation in money or in goods and services such as training and job search assistance – to help adjustment consequent on finding oneself at the bottom of the cliff (i.e. the ambulances at the bottom of the cliff).

Second, there are consequently a wide variety of potential policy choices to address the problem which need to be considered as a portfolio, and which need to be examined in the context of their impact on the currently existing suite of solutions, both fences and ambulances. All these solutions will have their pros and cons and all will be imperfect substitutes for one another. That is to say, expanding one solution will reduce the potential benefits of expanding other solutions, but never eliminate the problem entirely.

An alternative based on existing social welfare foundations

Should some form of income support be perceived as a core solution to any equity and efficiency issues, building on existing institutions rather than creating a new set is a strong option. Consequent on 30 years of real erosion of working-age welfare benefits relative to average wages from 1990, the main welfare system has increasingly failed to work for some because of poor income replacement for those who are made redundant, amongst others. (Again, we note that recent real increases in welfare benefits and their indexation to wages are going to eliminate some of this space, and substitute for SUI to some significant extent.) If addressing low replacement rates is the objective of the SUI proposal, welfare reform could go a long way towards cushioning the poverty impact of redundancy while avoiding the inequities and divisiveness of a two-tier system and the large costs and uncertainties of setting up an entirely new tier.

For example, main benefit rates could be returned to levels set following the 1972 report of the Royal Commission on Social Security – 40% of the average weekly wage for a single adult and about 67% for a couple. This would mean a single adult rate (in 2021) of around $520 per week and a couple rate of $436 for each person per week. In this example, and including the accommodation supplement, a single person who loses their job at the average wage could be entitled to assistance equal to a little under 60% of their previous net income.[11] While less than the 80% apparently proposed under the SUI scheme, they would be entitled to it for as long – or as short – as they need it, and without discrimination on the basis of the reason they became unemployed. Of course, there is an issue of the political economy of how to fund such an increase when a government has committed to no new taxes this term.

If the concern is with relatively low-paid dual-earner couples where one person loses their job, there are alternatives within existing institutions which can be considered. In particular, the current benefit system's couple-based unit of assessment means that where one partner in a dual-earner couple loses their job, their entitlement to the jobseeker allowance is abated at 70% for each dollar the partner earns (or they both earn) above $160 per week. If the partner earns $809 gross per week, there is no entitlement at all.[12] On the assumption that the couple share income, the loss of one job lowers their standard of living less than the situation of a single person losing their employment, but they would nevertheless experience a significant income cut. One option for addressing this which avoids the problems of SUI is to introduce an element of individualisation into the welfare system, perhaps through a spousal earnings disregard set, say, equal to average weekly earnings. There are pros and cons to this option too (of course), but one advantage is that it could apply more widely, beyond redundancy and sickness, including to supported living payment recipients and sole parents, reducing the partnership penalty for people forming new relationships.

An alternative social insurance model

If one conditionally accepts that government is committed to introducing an entirely new institution in the form of a social insurance-style system which focuses on individual income replacement, following Feldstein (2005, pp.14–16) there is an option which addresses the major moral hazard problems in the Bismarckian model. The alternative social insurance system would involve each employed person being required by law to accumulate funds in a personalised unemployment (and sickness) insurance savings account sufficient for a payout proportional to their earnings for a fixed duration if they become unemployed.

Conditionally accepting paternalistic equity concerns about the ability of those on low individual earnings to contribute, their contributions could be wholly or partly government-subsidised. If funds in the personalised accounts were used up by too many unemployment spells,

Creation of a new agency ignores the expertise ACC and MSD have in managing systems with some significant similarities ...

the accounts would turn into an individual loans system, to be repaid in better times with an interest rate as in the student loans scheme. If a positive balance exists at retirement or the death of the person, balances would be paid out to the person or as bequests. Because balances are individualised, this system eliminates much (but not all) of the moral hazard inherent in traditional social insurance, as longer durations on SUI are directly costly to individuals, while directly addressing the lack of a private insurance market. Additionally, such an individualised system gives more scope to individual agency and human diversity than does the Bismarckian system under contemplation.

There are, of course, disadvantages to this sketched approach too, but if social insurance options are being proposed, its pros and cons should be carefully considered.

If the Bismarckian approach is adopted, who should manage a social insurance system?

If one conditionally accepts a Bismarckian social insurance scheme, an obvious issue is where to institutionally locate the administration of the system. There are at least four options: ACC, the Ministry of Social Development (MSD), Inland Revenue (which manages the student loans scheme and KiwiSaver) or a new, separate agency. Creation of a new agency ignores the expertise ACC and MSD have in managing systems with some significant similarities, and, in addition, is likely to be more resource intensive in terms of building something new from ground up. In addition, it would mean adding a third stand-alone institution to the existing environment, adding additional complexities in terms of information and coordination and reducing opportunities for scale economies, so it is not further examined here. Our focus is on MSD and ACC, as Inland Revenue has no particular expertise in labour market issues of any sort.

There are strong arguments for locating social insurance provision within MSD. MSD already has expertise in dealing with people who lose their jobs from sickness and redundancy in terms of paying people income support, work-testing people and providing them with active labour market assistance. ACC would have to build more such capability. MSD-based delivery would ensure that people on social insurance would be better connected with the higher-tier elements of the welfare system, such as the accommodation supplement and Working for Families, should they need it. MSD has a relatively dense network of offices and infrastructure around the country, considerably more so than ACC. MSD would have better incentive alignment in terms of reducing the numbers of people in the system at or near the point of transition out of social insurance and into social welfare.

ACC does have experience, which MSD does not, in running a levy-funded system, so if such a system is chosen this may favour choice of ACC. ACC doesn't have the stigma associated with it that MSD does, which makes it more attractive to the middle classes (the 'good' versus 'bad' welfare distinction). On the other hand, locating provision with MSD may mitigate some of the risks of a two-class welfare system, as, even if some people have rights to better seats, at least they come in the same MSD door.

Conclusion

The current policy process involves an apparent leaping to a particular social insurance design without seeking any coherent answers to many critical and logically prior questions. In proposing a particular roof design before setting it on solid foundations, as a nation we are risking constructing a very shoddy house.

A much better process, in our view, would have been setting up a royal commission-driven process to examine the *entirety* of the New Zealand income support and taxation systems as an integrated whole in terms of meeting efficiency and equity goals, and other relevant objectives, something which is well overdue and that has been avoided by successive governments across the political spectrum.

Creating a system of social insurance would be a considerable philosophical change in New Zealand's structure of income support, shifting its emphasis away from a poverty-focused, family-based system of interpersonal life-course redistribution towards an individual income replacement-based system of redistribution across a person's life course. It is our view that, because of the substantial costs should the policy go wrong and because of the path dependence of policy change in this space (once committed, reversal becomes very costly), revolutionary changes need:

- broad public consensus, including across the ideological spectrum;
- careful and time-consuming open public consideration in terms of a coherent, well-articulated problem definition and consideration of all the many potential policy options and their pros and cons; and
- a high evidential bar for significant change.

It is our belief that the secretive and elitist policy process so far shows little indication of getting anywhere near to meeting these criteria.

Putting aside fundamental matters of good democratic practice and rational public policy processes, based on current information we do not see an efficiency problem of sufficient size which would convince an undecided and fair-minded person of the merits of introduction of SUI, especially given the costs of the creation of new institutions and the longer-term risks of undermining the welfare floor. If, on the other hand, the argument for social insurance is primarily an equity one, we struggle to see that an income replacement-based welfare system is more equitable than a poverty elimination welfare model.

Additionally, it is hard to see why someone moving into unemployment has greater merit for income support if they lose their job due to redundancy or sickness than those becoming unemployed or moving onto welfare for other reasons. If the rationale is one of equity, the case remains to be made that the relevant equity concept is individual rather than family income. We are not convinced of the paternalist arguments implicit in some of the offered rationales for social insurance. If the argument is that there are no alternatives, we have offered several alternatives, conditional on accepting some of the questionable assumptions underpinning proposals for Bismarckian social insurance. However, our minds remain firmly open to new evidence.

1 As social partner discussion will likely not be covered by the Official Information Act, almost certainly a significant amount of policy discussion will have occurred outside public purview. This is not open government.

2 See https://www.labour.org.nz/news-labour_2020_manifesto, p.14.

3 See https://www.labour.org.nz/tax, where the Labour Party states: 'we've committed to no new taxes this term'.

4 Boston (2019, pp.18–19) presents this political economy argument in a more positive fashion.

5 One of the arguments for introducing social insurance now is the assertion that a sea change is coming in the labour market which will make work increasingly insecure. Hence, the problem that SUI solves will become dominant in the future. The growth of work insecurity story has been seriously questioned (World Bank, 2019) and the mere assertion that large changes are coming seems a very weak reed on which to hang such major policy change, particularly when potentially better solutions lie unexamined. Another thin argument is that social insurance would have helped in terms of Covid-19 adjustment, or major structural changes in particular industries due to carbon pricing or removal of subsidies. We are not persuaded that the Covid-19 challenges that have faced New Zealand would be any more than marginally effected, and then perhaps not positively, by the presence of SUI. In terms of SUI being a solution to the need for phased exits from particular industries, due, say, to loss of a sector (like the Tiwai Point aluminium smelter or Marsden Point), a bespoke package is likely to be a stronger policy option.

6 In discussing policy options, Rosenberg mentions no advantages of subsidised private insurance. However, an appropriately set subsidy for private insurance may fully compensate for the missing private market, crowding in rather than out the private sector, and allows for private sector innovation and can be tailored to the individual risk preferences and other individual and family circumstances of each worker (for example, for mortgage commitments). In other words, a market-based solution is advantaged in dealing with dispersed knowledge, and human diversity and creativity. If there is a further residual concern about equity, differential subsidies could be set for different equity groups defined by socio-demographics or earnings. Also, Rosenberg does not mention any disadvantages of a system of social insurance, when obviously it possesses some. This

note's discussion does not, of course, mean that a market subsidy is necessarily better than social insurance. It merely indicates that policy choices are more complex and subtle than allowed by Rosenberg's analysis, which we must acknowledge is limited by both a time and space constraint.

7 Another argument sometimes advanced for social insurance is that it addresses wage scarring – that those who lose their jobs (predominantly via redundancy) tend to re-enter the labour market at an earnings rate which is below what they previously earned, and that discrepancy endures over time (OECD, 2017; Rosenberg, 2020, p.68). New Zealand studies suggest that scarring may be higher in New Zealand than the OECD average (Dixon and Maré, 2013; Hyslop and Townsend, 2019; OECD, 2017). A system which pays redundant workers a premium over and above the existing welfare system provides incentives to remain unemployed longer (Krueger and Mueller, 2012; Feldstein, 2005). Hence, it is suggested by social insurance advocates that this allows expanding job search along the extensive margin, resulting in a better job match quality and potentially less wage scarring. However, Hyslop and Townsend (2019, p.159) find that earnings effects of job displacement are 'substantially larger' for older workers (and 'generally small and insignificant' for young workers), which, they point out, is 'consistent with the notion that they are due to the loss of firm- or industry-specific skills', not the inability of workers to search for a better job. Moreover, time-use evidence indicates that the average amount of a day that unemployed people search for work is very low – varying from a few minutes to half an hour across a variety of rich countries – so time for searching may not be a particularly binding constraint (Krueger and Mueller, 2012, Table 4, p.775). The overseas empirical evidence also suggests that the time unemployment insurance recipients spend on job search is inversely related to unemployment benefit generosity (Krueger and Mueller, 2010). SUI may worsen overall search outcomes, as the intensive job search margin declines, offsetting greater job search along the extensive margin. Additionally, extended duration of time out of employment may result in an erosion of human capital, and hence more rather than less scarring. Finally, the job-search argument makes it plain that the actual purpose of SUI is to increase the unemployment rate, as unemployment durations rise to permit more job search. Whether the higher unemployment arising from the policy will improve well-being, which all evidence suggests is significantly and negatively affected by unemployment over and above the income loss, is unclear.

8 To illustrate, imagine, say, an 80% replacement rate and a couple both earning $50,000 a year where one person loses their job: family income declines by 10%. On the other hand, a single person who earns $50,000 experiences a 20% reduction in their family income if they lose their job.

9 See https://www.fma.govt.nz/assets/Reports/Kiwisaver-AR-2021.pdf.

10 They describe this number as 'only' 20%, an adverb which reveals something of their priors.

11 The precise amount depends on the accommodation supplement, which varies by area and rent paid.

12 The figure is $848 per week if the couple has dependent children.

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