

**SUBMISSION BY THE
NEW ZEALAND BUSINESS ROUNDTABLE**

**Accident Rehabilitation And
Compensation Insurance Bill**

JANUARY 1992

ACCIDENT REHABILITATION AND COMPENSATION INSURANCE BILL

1.0 Introduction

- 1.1 This submission is made on behalf of the New Zealand Business Roundtable (NZBR), an organisation of chief executives of major New Zealand business firms. The purpose of the organisation is to contribute to the development of sound public policies which reflect overall New Zealand interests.
- 1.2 The Business Roundtable has been a longstanding advocate of fundamental reform of the Accident Compensation Scheme.¹ It is a major policy programme with a significant impact on New Zealand's international competitiveness, the capacity of the economy to grow and create jobs, and individual well-being.
- 1.3 Our evaluation of the main policy reforms outlined by the government is contained in the attached document: *Submission on the Policy Statement 'Accident Compensation: A Fairer Scheme'*. As the proposals incorporated in the Accident Rehabilitation and Compensation Insurance Bill ('the Bill') involve only detailed variations on those announced in the 1991 budget, the attached submission essentially constitutes the views we wish to put before the select committee. This supplementary submission is accordingly in the nature of a summary and a commentary on issues that have been raised in public debate about the scheme.
- 1.4 In essence, the Business Roundtable has argued that the concept of the original Accident Compensation Scheme, involving a monopoly state insurer and a no-fault liability regime, was basically misconceived. We have advocated placing the scheme firmly on an insurance basis and allowing competitive provision of accident insurance. The government's recognition that the scheme is, indeed, an insurance scheme and the focus in the Bill on cost reduction, a more accurate allocation of costs and limits to the scope of the scheme are welcome developments. Nevertheless, we believe they represent no more than tinkering with an unsound scheme, will do little to solve its basic problems and will create some new ones. We expect dissatisfaction with the scheme will continue and that it will be prone to regular crises.
- 1.5 We favour a reform package along the lines of that advocated in the report of the Ministerial Working Party on the Accident Compensation Corporation and Incapacity ('the Working Party report'). It advocated a competitive insurance regime and the government has indicated a willingness to explore moving in this direction. Our basic submission is that further study of this option should be undertaken as a matter of urgency, either in parallel with the select committee's deliberations or following the enactment of the Bill.

¹ For a list of previous studies and submissions, see footnote 1 of the attached submission on the policy statement *Accident Compensation: A Fairer Scheme*.

2.0 The Current Accident Compensation Scheme: A Flawed Concept

2.1 The Woodhouse committee noted that "the proposals we make have no direct parallel elsewhere" and confidently asserted that "we do not doubt that before long they will begin to be acted upon" by other countries.² As is well known, few major jurisdictions have adopted the New Zealand approach, early initiatives in that direction having generally been halted or reversed, and it would be an embarrassment today to encounter the kind of economic analysis that pervades the Woodhouse report.

2.2 That there were major problems with the pre-1974 arrangements is not in dispute.³ No one, to our knowledge, advocates a return to those arrangements. The criticism of the Woodhouse exercise is that it incorrectly diagnosed what was wrong with the prior arrangements, both in respect of the insurance system and the legal regime, and consequently proposed the wrong remedies.

2.3 The claim is still made that by nationalising the previous private arrangements New Zealand has obtained cheap accident insurance cover by world standards. There is no reliable evidence for this claim. Among others,⁴ the following points should be noted:

- the claim is typically based on differences in overall levy rates, which are meaningless in the absence of data on benefits. The relevant issue is the economic costs of the scheme relative to its benefits;
- the New Zealand scheme is a pay-as-you-go scheme, and is underfunded;
- public hospital costs are not currently a charge on the scheme, and work-related motor vehicle accidents are not a charge on the earners' levy, as they typically are with workers' compensation schemes;
- the relatively low administrative costs of the scheme are not a meaningful indicator of cost-effectiveness: they could, for example, simply indicate that too little is spent on monitoring, or that the cost of claims is disproportionately high. Some of the administrative burden is also shifted to employers;
- costs have been growing at an exponential rate - around 16.5 percent per annum over the past 5 years. This cannot be explained by maturation of the scheme.⁵

² Report of the Royal Commission of Inquiry, *Compensation for Personal Injury in New Zealand*, December 1967, Government Printer, p. 25

³ For a summary of these problems, see New Zealand Business Roundtable, *Review of Accident Compensation, A Submission to the Law Commission, July 1987*, p. 1

⁴ See *ibid* p. 4

⁵ See Bernard Galvin, 'Accident Compensation', in G.R. Hawke (ed.), *A Modest Safety Net - The Future of the Welfare State*, Institute of Policy Studies, Wellington, 1991.

The reality is that the incentives in the scheme - to take appropriate levels of care, to provide cost-effective treatment, to stay on ACC no longer than necessary, to undertake rehabilitation and to encourage an efficient allocation of economic resources among risky industries are weak and distorted and are leading to ongoing cost escalation which will not be significantly checked by the current reforms. Unlike competitive private insurance, the scheme also generates significant economic costs in the form of deadweight losses because effective marginal tax rates are raised by the amount of the compulsory levy.

- 2.4 Moreover, even if the scheme were shown to be comparatively cheap in measured financial terms, this would not be a reliable indicator of its benefits relative to its costs. A nationalised industry producing a single product (e.g. an Indian motor car) may (at least initially) do so cheaply, but at the expense of many other attributes that consumers value. Accident insurance is no different - people have a large range of needs and preferences for cover, and differ in their capacity, both physical and economic, to deal with the risks that they confront. A 'one size fits all' scheme is inherently inefficient and unfair - many women, for example, are penalised because they incur fewer accidents from sport, crime and motor vehicles than men.
- 2.5 For these reasons, a growing number of organisations - including the Business Roundtable, the Economic Development Commission, the Treasury and now the Ministerial Working Party - have argued that the basic flaws of the ACC model are beyond simple remedy and have advocated the deregulation of the accident insurance market and the corporatisation/privatisation of the ACC. The New Zealand Employers Federation, Federated Farmers and the Top Tier group have also commended the SOE model. It was therefore disappointing that the government opted to set aside the Working Party's recommendations. We believe that many of the current criticisms of the government's proposals arise ultimately from the deficiencies of the basic model and cannot be met without fundamental changes to it.

3.0 The Role of Competition

- 3.1 The benefits of deregulating the accident insurance market and allowing competition to develop are summarised in the enclosed submission and detailed in the other references cited. They relate both to the 'demand' side of the market - the scope for a much wider set of offerings of insurance products to emerge, catering for a diverse range of preferences - and to the 'supply' side - through stronger incentives to differentiate more accurately between risk categories, contain costs and innovate. At present poor performance, in the form of failure to contain the overall costs of the scheme, simply leads to increases in the statutory levy rates.
- 3.2 A competitive, multi-insurer system would provide a much more satisfactory basis for finding solutions to some of the more controversial problems which are currently being raised, and which are virtually intractable within a state
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monopoly scheme. Questions of coverage, for example, would be readily handled through the variety of categories of cover that different insurers would offer. The efficient extent of differentiation of levy categories and experience rating would be discovered through the competitive process. There would be no need to ban the use of lump sum payments - although such insurance would not be part of any compulsory minimum level of cover.

3.3 Objections which are typically raised in response to proposals for deregulation and corporatisation or privatisation are covered in the attached submission (section V). A claim sometimes made is that the private sector is not interested in covering accident risks. In response it may be noted that:

- the claim is patently untrue. There is a huge worldwide accident insurance industry, and considerable interest in New Zealand and offshore in entering the market;
- the claim has its origins in the earlier unsatisfactory history of government interference in the private insurance market. Stable rules and a minimum of regulation would encourage market entry;
- there is sometimes a self-interested element in the case of claims by existing insurers who would not welcome the prospect that new entrants might also compete in their existing markets;
- even if early market entry did not eventuate, the ACC would face much stronger incentives to improve and maintain its efficiency as a result of action to make its services contestable in the same way that other SOEs raised their performance even before new competitors began operating;
- it is ironic that the claims of a lack of interest on the part of the private sector tend to come from the same people who argue that the reason other countries have not gone down the New Zealand state monopoly route is because of opposition from the private insurance industry.

Already top-up private accident insurance is being offered in New Zealand and we believe it would take no more than 6-12 months for new entrants to become established in a deregulated market. The Insurance Council of Australia has endorsed a competitive multi-insurer approach.⁶

3.4 A second difficulty raised is the transitional problem which would be posed by the need to move from a pay-as-you-go scheme to a funded scheme in order to establish a neutral basis for private sector competition. There is a range of options for dealing with this problem which are sketched briefly in section 5.4 of the attached submission. Essentially it needs to be recognised, first, that the liabilities exist now, and the issue is simply how they should be crystallised. Secondly it needs to be recognised that despite the initial incidence of workplace accident compensation costs on employers, ultimately the costs are

⁶ See Ministerial Working Party on the Accident Compensation Corporation and Incapacity (1991), *Report*, pp 68-69, quoted in the attached submission p. 12.

largely, if not totally, borne by employees.⁷ (The Woodhouse belief that the costs fell in large part on consumers of final products was one of the many errors of analysis in that report.) One consequence is that it could be regarded as unfair for new employees (or employers) to be required to meet the costs of existing liabilities, and an issue for analysis would be a fair allocation of costs between taxpayers and other contributors to the scheme, and over what time period.

- 3.5 A third set of issues, also dealt with in the attached submission and in the other reports cited, concern equity and affordability. Again a variety of solutions are available, both to handle problems of income adequacy (the ability to obtain a basic level of cover) and to deal with problems of poor risks. These are in many respects comparable to those which the government is now implementing in the context of health reform. Giving individuals (and groups of individuals) the freedom to bundle accident and health insurance together has attractions not just in terms of providing more efficient cover but in terms of offering a sound solution to the longstanding anomalies between the forms of compensation available for accidents and illness. Some of the government's moves to align the treatment of accidents and illness announced in the budget document appear to have been eroded, and some of the high and open-ended medical benefits appear to have been restored.

4.0 Conclusions and Recommendations

- 4.1 There are grounds for believing that the costs of accident compensation, a major element in non-wage labour costs in New Zealand, are unnecessarily high due to the inefficiencies of the present scheme and are causing income losses and reduced job opportunities for New Zealand workers. Workers and unions should have an even greater interest than employers in the benefits that a more competitive accident insurance market would bring. Because the Bill does not change the fundamentals of the scheme it will not reduce in any fundamental way its propensity to cost escalation and its constraints on choice in obtaining cover for accident risk. It is also likely to create a new set of anomalies and boundary problems.⁸ We predict that the scheme will again be in a state of crisis within a relatively short period of time. Accordingly we urge the select committee and the government to reconsider the compelling arguments for introducing a competitive insurance regime and moving to corporatisation /privatisation of the ACC or its successor organisation as rapidly as possible. A corporatised ACC would enable the demonstrated benefits of the SOE model to be realised and substantial improvements in efficiency and accountability could be expected. A further advantage would be a more commercial allocation of its investment portfolio, with benefits to New

⁷ For a fuller analysis of this issue, see New Zealand Business Roundtable, *op cit.*, Appendix I.

⁸ One likely anomaly that has not to our knowledge attracted widespread comment is the tax treatment of levies for non-work accidents. We understand that tax deductability will be denied in the case of employees but allowed (as at present) for those in self-employment. This is likely to lead to artificial employment structures and tax avoidance.

Zealand's debt and equity markets. Those benefits would be enhanced with privatisation.

- 4.2 As a second and subsequent priority, we believe there is a case for a fuller examination of the contribution a modified tort system could make to accident prevention. It would be perfectly feasible to operate a competitive insurance system with the present no-fault regime. There could be additional advantages, however, in establishing some form of legal sanctions for gross negligence *not* as a source of compensation - which is the function of insurance - but to encourage greater safety, as discussed in section 5.5 of the attached submission. This is perhaps most clearly the case with motor vehicle accidents, where there is increasing evidence that the adoption of 'no-fault' regimes has led to reduced incentives for care and increases in the costs resulting from accidents. Options such as subrogation rights to insurers, limits on the amounts recoverable and the use of administrative tribunals should be considered to avoid the excesses that have occurred under some tort regimes. Insufficient work has been done in New Zealand to evaluate the relative merits of different fault- and no-fault-based liability regimes, and we believe that the issue warrants careful study.
- 4.3 Within the framework of the existing model, we believe that the changes proposed by the government generally go in the right direction. We agree with the changed treatment of non-work accidents and with the proposed allocation of hospital costs, and we are particularly supportive of the proposals to introduce experience rating and to allow employers the option of self-insurance as a step towards greater choice and competition (provided they are allowed to go to the market for cover if they wish). We suggest in the attached submission (p. 8) some ways in which this option could be enhanced. We also note in that section of the submission (pp 6-8) the rather crude and inefficient mechanisms adopted for non-work and motor vehicle accident levies and we endorse both the Working Party's comments on these issues and their preferred solutions. Finally, we are aware that the New Zealand Employers Federation and other private sector organisations are commenting on the proposals at a greater level of detail than we have sought to examine in this submission and we commend their submissions for the committee's consideration.