Hutt Valley Chamber of Commerce and Industry

New Zealand's ACC Scheme: Time for a Decent Burial

Roger Kerr
EXECUTIVE DIRECTOR
NEW ZEALAND BUSINESS ROUNDTABLE

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A study on accident compensation was one of the first research projects undertaken by the Business Roundtable when it was established in its present form in 1986. We concluded that the introduction of a state monopoly, no-fault accident compensation scheme in New Zealand had been a huge mistake, and argued for the introduction of choice and competition into accident insurance. Although the context of our research was one of the never-ending series of reviews of the ACC scheme, it was still at that time a national icon. No other business organisations were arguing that it should be scrapped.

The review in question was being undertaken for the Labour government by the Law Commission, which was then headed by Sir Owen Woodhouse, the principal architect of the scheme. Not surprisingly, our arguments fell on stony ground. The Law Commission team, which included Sir Kenneth Keith and was strongly backed by Sir Geoffrey Palmer, was still bent on steering accident compensation away from an insurance scheme and towards a social welfare concept, including a move to flat-rate levies and ultimately general taxation. Only an unreconstructed socialist dreamer could maintain such a vision today: it would quickly turn into a typical socialist nightmare as all incentives to take care and manage risks disappeared. No reforms of any consequence were adopted by the Labour government.

The first significant break occurred in 1991, with the report of a ministerial working party chaired by Bernard Galvin which advocated a competitive insurance regime. Unaccountably, the National government declined this recommendation. The legislation which it passed in 1992 had the virtue of establishing clearly for the first time that ACC is indeed insurance not welfare, but in other respects the changes merely amounted to tinkering with the scheme. Nevertheless, I believe the government has been somewhat unfairly criticised for the 1992 legislation. Essentially it amounted to what the Employers Federation was pushing for at the time. The changes went in the right direction - in particular towards some limited forms of competition - but the problem was that they did not go nearly far enough.

In our 1992 submission on the draft legislation, we said that because it did not change the fundamentals of the scheme it would not reduce its propensity to cost escalation, that it would create a new set of anomalies and boundary problems, and that ACC would be in a state of crisis again in a relatively short period of time. That is exactly what has happened. What has changed, however, is that the trickle of criticism of the basic concept of the scheme has now become a torrent.

In the last two years, the insurance industry, which for many years told governments it could not handle accident insurance and did not want to be in that market, has come out in favour of competitive insurance. So too has the Employers Federation. Some 11 organisations have now banded together in the Campaign for Choice in Accident Compensation. The Treasury, the OECD and Reserve Bank governor, Don Brash, have spoken in favour of opening up the accident insurance market to competition. ACT New Zealand is promoting a move to private insurance. Parliamentary Under-Secretary Warren Kyd has gone further and argued that in addition to deregulation the right to sue should be reintroduced. The union movement has come out favouring the reintroduction of the right to sue, the elimination of which was one of the pillars of

the Woodhouse model. Even the managing director of the Corporation has said that the ACC should be turned into a fully funded state-owned enterprise, although, consistent with the attitudes of a protected monopolist, he suggested that the introduction of competition should be deferred for 10 years!

A survey commissioned by the Insurance Council in 1995 found that a majority of the public supports competitive insurance. *Insight* surveys over the last two years have found that 55 to 65 percent of respondents view ACC unfavourably compared with less than half that number who have a favourable view. The Christchurch *Press*, ever hopeful, has suggested that the ACC scheme should be given "one more try". However, *The Herald*, *The National Business Review* and *The Independent* support deregulation, and *The Evening Post* has said that "a move towards privatising the scheme would again provide New Zealand with a system it could be proud of".

A recent letter to *The Herald* seemed to sum up the prevailing climate of opinion:

> More than 20 years have elapsed since New Zealanders were duped into accepting the 'no fault' accident compensation scheme. Initially, the new scheme may have appeared attractive enough - if only because of the propaganda expounded in its favour. However, on almost all counts, it has proved to be an abysmal failure.
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> Costs have continued to escalate rapidly and now consume a considerable proportion of the nation's wealth. On the other hand, the meanness of the benefits conferred bear absolutely no resemblance to the principles of compensation.
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> Unquestionably, the nobody's-fault mentality has been no deterrent to the negligent; indeed, quite the reverse. The negligent are shielded behind the canopy of the Accident Rehabilitation and Compensation Insurance Corporation, comforted in the knowledge that ordinarily no action for damages in respect of personal injury or death may be entertained in any court.
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> Whether it be the Department of Conservation, the railways, the negligent doctor or the reckless driver, they are in no way financially accountable for their actions. It is a travesty that our venerable common law rights were forsaken for such an extravagant yet manifestly unjust excursion into the realms of social engineering.

To understand where we went wrong, it is necessary to go back to the origins of the scheme. It is one of the least savoury episodes in public policy formation in New Zealand. Sir Geoffrey Palmer, although one of the supporters of the scheme, has been remarkably honest about the strategies employed by the reformers. These included:

- the appointment of a Royal Commission in 1966 with a sympathetic judge as chairman after the 1963 Committee on Absolute Liability failed to recommend the abolition of common law rights;

- one-sided criticism of the common law remedies for negligence on the grounds of delay, costs, protracted litigation and the 'forensic lottery';

- a refusal to investigate how tort law could be improved in these respects;
- a freeze on the amounts which could be paid under workers' compensation, in order to maintain agitation for reform;
- the misrepresentation, as mutually exclusive, of the systems of:
    - *tort*, with its values of fairness and justice and its goals of punishment for negligence, deterrence and education for all, and
    - *insurance*, which is the means of relief for medical costs and loss of earnings; and
- selling the case for mandatory insurance on the unbalanced assessment of the weakness of tort and the proposition that the savings in the costs of legal remedies would offset the loss of the freedom to sue and the choice of insurer.[1]

In a nutshell, and contrary to all the myth-making, what was basically wrong with the previous scheme was not that it was some kind of out-of-control American tort liability regime. Sir Geoffrey has said that:

> ... really, the level of litigation in those years was extraordinarily low by American standards. It is true there was not a lot to hate in the New Zealand common law, except in the view of the reformers.

Rather, what was basically wrong was the operation of the insurance market, which was plagued by government intervention. Under the fault scheme that was in place, the courts decided the awards while the government controlled the premiums insurers could charge. Insurers were placed in the hopeless position of being unable to control either their claims costs or their income. The only people who made money were the lawyers.

Instead of reforming both the legal regime and the insurance market, the Woodhouse Commission went down precisely the wrong track and abolished both. They replaced them with a wall-to-wall no-fault regime and a state monopoly insurer.

It is absolutely essential to recognise that these two key features of the ACC scheme are distinct and independent. People continue to make the mistake of saying that opening up the state monopoly to competition means a return to the right to sue - the current minister responsible for the scheme is one who has often made this error. It does not automatically mean anything of the sort. A competitive insurance market could operate perfectly well within the current no-fault legal regime. It is a separate question as to whether it would work even better with some form of tort liability.

The most important issue in the debate is the nature of the insurance market - whether competition or monopoly is the best deal for consumers. It is not the job of the legal

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[1] On these points, see the contributions by Sir Geoffrey Palmer, Professor Lewis Klar and Professor Richard Miller in the *University of Hawai'i Law Review*, Vol 15, No 2, Fall, 1993.

regime to provide compensation - the alternative to insurance is not the right to sue. If my house burns down because of the action of an arsonist, I want to be able to claim on my insurance policy. I do not want to have to find the arsonist and take him or her to court to recover my losses. But we do not have a no-fault regime for house fires: the role of the law with respect to arson is to deter people from burning down other people's houses. The key argument for some kind of liability regime in the case of accidents is not to provide compensation but to create incentives to reduce the frequency and severity of accidents.

The abolition of all forms of liability for accidents was the smaller of the Woodhouse mistakes. The gigantic error, which took us over the cliff and into the river, was the leap of logic that concluded that if the common law were to be abolished it should be replaced by a state-operated, state-funded scheme.

One of the naive beliefs of the reformers was that by eliminating litigation, combining all previous sources of funding and putting all our eggs in the ACC monopoly basket, the costs of accident cover would go down. In the short term, that may well have been the case, but what the reformers failed to reckon on was the change in people's behaviour over time due to the new incentives they faced. In the first year that no-fault accident claims became possible, the number of accidents reported jumped by 400 percent. Since then, costs have spiralled upwards. Expenditure on the scheme today is more than 50 times greater in nominal terms than it was in 1975. The consumer price index has risen almost six-fold during the same period, so expenditures have risen around nine-fold in real terms. World-wide experience with state insurance schemes is similar: they are prone to excessive use, poor control of claims, inattention to rehabilitation and expansion of their scope. Medicare in the United States began as a small scheme but has now become a budgetary time bomb for the US government and is approaching bankruptcy.

Some, like Ross Wilson of the Council of Trade Unions, continue to claim that ACC is a cheap scheme. In the next breath, however, he says it is mean and nasty. Of course it is possible to provide a cheap and nasty insurance product, but is that what consumers really want? Moreover, it is now far from clear that ACC cover is cheap. Much is made of the scheme's low administration costs, but these are now at least 11 percent of claims and rising. Also, low administration costs tell us nothing about the efficiency of an insurer: they may be a sign of insufficient claims investigation and monitoring, and therefore a source of higher overall costs. A further major point is that the apparent costs of the scheme are distorted by the fact that it has not been paying its way, and has accumulated a massive $7 billion in unfunded liabilities.

Sir Owen Woodhouse has continued to argue that the cost increases have been due to the maturation of the scheme but the chairman of the 1991 working party has pointed out that this claim is invalid. Last year Sir Owen also claimed that costs had "grown roughly as expected in 1987". The Business Roundtable challenged him to point to a single statement in his report indicating that he envisaged the outstanding liability for weekly compensation for people who are fit to return to work but are still on ACC would amount to $1.4 billion by the early 1990s (as estimated by the ACC's actuary). There has been a deafening silence.

From the consumer perspective, the issue is not only cost but choice and value - the relationship of benefits to costs. Henry Ford once said that his customers could have

any car provided it was black. Who wants that kind of product today? Individuals have a large range of needs and preferences for cover, and differ in their capacity to cope with risks. The ACC is a one-size-fits-all scheme which is inherently inefficient and unjust - many women, for example, are penalised because they account for fewer accidents from sport, crime and motor vehicles than men, yet pay the same levies.

The raft of other endemic problems with the scheme is well known. Levy rates do not accurately reflect industry accident records, so that resources are misallocated across industries in the economy. Experience rating is rudimentary and safe employers within an industry cross-subsidise ones with poor safety records. The focus of the scheme is on a myriad of routine small claims rather than the low probability/high cost events that people generally choose to insure against. Lump sum cover is not available, whereas such cover is often a feature of insurance contracts favoured by insureds and insurers alike. The scheme discriminates on no logical grounds between sickness and accidents. Accident victims face ever-changing rules on benefits and eligibility - they have no policy contract on which they can rely. The ACC's performance has been criticised by the Auditor-General. Levy increases are making the Reserve Bank's job more difficult and weakening the economy's international competitiveness. Arbitrary inter-generational transfers are occurring because of the growing unfunded liability. Judicial activism continues to expand the scope of the scheme. There are regular news reports of abuse of the scheme by health professionals and claimants. It absorbs an inordinate amount of politicians' time. This list is not exhaustive.

The arguments in favour of moving away from a state monopoly scheme are now equally well known. Where state monopolies have been opened up to competition in New Zealand - such as airlines, rail transport and telecommunications - the benefits to consumers have been enormous. Accident insurance would be no different. There is a huge and experienced international accident and health insurance industry, and a significant and growing market in New Zealand.

Opening up the insurance market to competition would enhance consumer choice by allowing a much wider range of insurance products to emerge. It would increase incentives to innovate, to improve safety and to rehabilitate accident victims. Pressures to reduce bureaucratic inefficiencies and control opportunism and malingering would be stronger. Consumers would be protected by insurance contracts against changes in rules.

If even terms of competition were established with private insurers, the ACC could continue as a state-owned insurance business and its claims of being a low-cost insurer could be put to the test. However, there is no need for the government to remain involved in accident insurance. The state of Michigan has recently disposed of its accident insurance business.

The arguments that are sometimes made against competitive private provision are not compelling. A case for government provision cannot be made on market failure grounds - clearly private insurance options are readily available for medical expenses and loss of income. The cream-skimming argument - that insurers would only take the best risks - is no more valid than it was in the case of other state monopolies such as rail transport - encouraging proper pricing through risk-related premiums would be one of the benefits of private provision. A variety of solutions, canvassed in the

studies by the Business Roundtable, the Employers Federation and the Insurance Council, are available to deal with problems of affordability and high-risk individuals. These could be further analysed and refined.

The minister has also appeared spooked by the transitional problem of the unfunded liability that would have to be dealt with in order to put the scheme on to a pay-as-you-go basis and establish a neutral basis for private sector competition. The essential point to make is that the liability exists now and should be dealt with in any event, and the issue is simply how it should be crystallised. The problem should be partitioned. From the date of any change, all future accident cover should be on a fully funded basis. In respect of the tail of past claims, the first task should be to review outstanding cases as was done in Victoria where it was possible to significantly reduce the numbers on the books. The remaining issue is then how to deal with the residual liability.

The basic choices here are either taxpayer funding or funding from other sources such as employers or employees over a period of time. Arguably it would be unfair for new employers or employees to be required to face the costs of existing liabilities, for which they bear no responsibility. Moreover, levies based on past accident experience provide no incentives to reduce future accidents. Essentially the funding of the outstanding liability is a tax issue and should be considered in terms of optimal taxation principles, where the tax base could be income, consumption or payroll. The fact that it is not government policy to have a payroll tax for general taxation purposes suggests that the government does not consider a payroll tax to be efficient. If existing taxes are the best available means of raising government revenue, the conclusion is that the outstanding liability should probably be treated like public debt and amortised over time out of general taxation.

The priority is clearly to deal with the mistakes of the Woodhouse reformers on the insurance side, but nobody - least of all the business community - should be afraid of re-examining the issues raised by the union movement in respect of the legal regime. We should not lightly dismiss the role that a legal liability regime can play in promoting safety. Jim McLay recently informed me, in connection with the collapse of the Cave Creek platform, that, in the second millennium BC, King Hammurabi had a most effective - and simple - building code: If you constructed a building which fell down and killed someone, then you were killed. While records are incomplete, it appears that very few buildings fell down. We can apply the principle, if not the penalty.

It is almost certainly the case that the current no-fault system is better than the tort liability regime in the United States today. But those are not the only options - the United Kingdom, for example, has a much more conservative tort regime than the United States. Again we should be careful about adopting one-size-fits-all solutions. Well-conceived liability rules might differ as between categories such as motor vehicle accidents, workplace accidents, medical malpractice and product liability. To the extent that the government must override voluntary contracting, and in accidents involving strangers where there may be no contractual possibilities, 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.

A number of moves have been made in Australia in recent years to bring the costs of workers' compensation schemes under control and expand consumer choice through competition. The Kennett government in Victoria has made some significant reforms which include a move to full funding, limits on benefit entitlements, introducing a partial no-fault/common law system and opening up claims management and rehabilitation to private sector participation. Even though the Victorian model is far from ideal, the reforms have been highly successful. Claims have come down by 40 percent, premiums have been almost halved and return to work rates have skyrocketed. There has been widespread support for the changes.

Clearly there is now a much greater constituency for ACC reform in New Zealand. While business organisations have been most prominent to date in pushing for change, in reality representatives of groups such as workers and motor vehicle owners should be the strongest advocates. Yet another of the mistakes of the Woodhouse Commission was to believe that the costs of levies would be largely passed forward on to consumers. It is much more likely, especially given the disappearance of a cost-plus environment, that in the case of employer levies the costs are largely passed back to workers. Consumers now have much greater ability to buy overseas products if the domestic product is too expensive. Because workers largely bear the costs, even though employers pay the levy in the first instance, the average increase of 20 percent in employer levies in April this year is likely to reduce wages over time by nearly half a percent. To the extent that such an adjustment does not occur, the result is likely to be higher unemployment since employers cannot maintain employment if their products become uncompetitive.

Thus workers' representatives should have an even greater interest than employers in the problems of an inefficient accident compensation scheme. It is noteworthy that unions around the world do not clamour for state-operated and state-funded monopoly provision of accident insurance. They are aware of the benefits of competition which are the norm in most other countries. It is surely not too much to hope that unions in New Zealand will come to a similar conclusion.

Currently there is a bill before the House proposing further amendments to the ACC scheme. This was introduced with some fanfare by the government as yet another final solution to the problems of the scheme following a review last year - the eleventh since the scheme began. There now seems to be some doubt as to whether it will be passed before the election. If not, it will be no great loss: the changes proposed are generally sensible but they merely represent another round of tinkering and, as in 1992, it can be confidently predicted that the fundamental problems will persist.
These problems are the ones inherent in the basic Woodhouse model of a state monopoly scheme. The Woodhouse report noted that "the proposals we have made have no direct parallel elsewhere" and asserted that "we do not doubt that before long they will begin to be acted upon" by other countries. This was a revealing exercise in self-delusion - no country has followed the New Zealand path. It would be an embarrassment to find the kind of shoddy analysis that pervades the Woodhouse report in any official inquiry today.

The Campaign for Choice in Accident Compensation has called for a back-to-basics review of accident compensation arrangements where the arguments that it has put forward can be put to the test. There is surely no reason why that call should not be supported by all the major groups affected by the ACC scheme and all political

parties. The country was sold a pup which has turned into a pitbull terrier that mauls everyone it comes in contact with - accident victims, employers and politicians alike. There is no doubt in my mind that an open and impartial enquiry would conclude it is a dog of a scheme which should be humanely put down since its victims increase daily.