

THE ACCIDENT COMPENSATION SCHEME: A CASE STUDY IN PUBLIC POLICY FAILURE

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Among groups challenging ACC policy during this decade, the New Zealand Business Roundtable offered the most passionate critique of the scheme and its founding assumptions. The New Zealand Business Roundtable argued that the public interest was better served by promoting consumer choice in insurance coverage, delivered in a competitive market by private insurers. This article explains the origins and rationale for this market-based critique, and provides a spirited statement of an economic philosophy that proved influential in shaping legislative reforms in the 1990s.

I PURPOSE

I have been asked to comment on how and when the notion of competing private insurers for accident compensation emerged in the New Zealand debate in the 1980s and 1990s.

I am an economist with a career in public policy and finance. I am not a historian. It is easier for me to explain the economics of the case for competing insurers than to suggest why the debate did not emerge until the 1980s and 1990s. Yet the contribution of economic analysis to the public debate was sadly neglected until the New Zealand Business Roundtable was formed and started commissioning diverse economic experts to research the issue. It has stuck to this task over the years and is surely by now the most substantial contributor to informed public debate on the matter.

The economic analysis is of enduring relevance to the question as to what issues must be addressed if New Zealand is not to spend another 25 years futilely tinkering with a system that lacks a coherent basis and endlessly shifts priorities because there is no sound basis for trading them off. To that extent the paper is forward-looking.

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For the history the paper relies heavily on source material, most particularly the detailed study published by Geoffrey Palmer (now Sir Geoffrey) in 1979.¹ It also uses the brief but more accessible New Zealand Employers Federation review in September 1995.²

From a public policy perspective the history is relevant to any study into the underlying causes of the numerous major policy failures in New Zealand during the last 50 years.³ If New Zealanders want a prosperous future the first step is to stop repeating past mistakes.

II THE ACC'S VERSION OF WHY AND WHEN

There is a succinct history of New Zealand's current accident compensation scheme (ACS) on the Accident Compensation Corporation's website. It first mentions the notion of competing insurers in the context of the terms of reference given in December 1990 to the *Working Party on the Accident Compensation Corporation and Incapacity*. It is probably no coincidence that this working party was commissioned by a new incoming government and convened by an economist – Bernard Galvin, a former Secretary to the Treasury.

Prior to this development, the policy focus had been on making the scheme more ambitious under the direction of Sir Geoffrey Palmer. Sir Geoffrey played a major part in the 1969 White Paper, and was deputy prime minister in the government that received the 1986 Officials Committee report and the 1987 and 1988 Law Commission reports when the Rt Hon Sir Owen Woodhouse presided over the Commission. The 1988 report recommended *inter alia* that entitlements should be extended to illness as soon as possible.

1 Geoffrey Palmer, *Compensation for Incapacity: A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington, 1979).

2 New Zealand Employers Federation *A New Prescription for Accident Compensation* (New Zealand Employers Federation, Wellington, 1995) 1-69.

3 The imposition of import licensing as a 'temporary' measure in response to the 1938 foreign exchange crisis formed the basis of the protectionist strategies of the next 40 years, while more successful countries adopted outward-looking strategies. Agricultural subsidies saw meat rendered into tallow. Energy policy failures led to the 'Think Big' projects. Lack of fiscal and monetary discipline in the 1970s and early 1980s saw major increases in effective tax rates without explicit parliamentary approval through fiscal drag, and the deferred tax increases implicit in deficit spending. The same short-termism saw new welfare programmes of potentially crippling proportions, notably the domestic purposes benefit and the 1975 national superannuation scheme. These were introduced without due regard for their future implications for tax rates, adult welfare dependency or child poverty and deprivation. The short-termism also led to the debilitating price, wage and interest rate freeze of 1982-1984 and the debt spiral that caused the 1984 foreign exchange crisis. The unnerving rise in welfare dependency during the last 25 years also arguably owes much to product and labour market regulations that destroy jobs, relatively high benefit levels and – as the United States success in reducing it is demonstrating – an undisciplined approach to eligibility conditions. The planned ratification of the Kyoto Protocol smacks of more short-termism and policy failure.

The ACC's history states that the terms of reference for the Galvin report suggested that one way to reduce the cost of the scheme to society would be to provide greater freedom of choice between insurers and create competition between the public and private sectors. It attributed the pressure for change to "demands" by the Employers Federation and the Business Roundtable that employers stop paying for employees' non-work accidents and that the overall cost of the scheme be reduced.

III THE CONSUMER WELFARE RATIONALE FOR COMPETITION

Any unbiased reading of the Business Roundtable's submissions during this period would establish that its concerns were far broader right from the start. Its first foray into this area was a submission prepared in July 1987 with the assistance of an academic economist from Monash University, Ian McEwin. This submission did not propose, let alone demand, either of the goals mentioned. Instead it proposed a reduced role for government through user empowerment. The concluding recommendation in its executive summary was:⁴

By encouraging the competitive supply of innovative accident insurance, returning the accident insurance decision back to the consumer, and encouraging safety through the competitive insurance and liability system, overall community welfare would be improved.

Its follow-up submission in December 1987 stressed the lack of a sound analytical framework for the Law Commission's findings and their lack of economic sophistication. Again it emphasised the need for a principled re-evaluation of the whole approach:⁵

The appropriate starting point is a reevaluation, based on the best modern scholarship, of the proper government role (or community responsibility) in promoting more efficient insurance and safety arrangements to reduce accidents, foster rehabilitation and provide the desired level of income replacement. There is a wealth of literature and analysis available on this topic ... which the Law Commission does not appear to have examined and utilised.

Submissions to the Law Commission from organisations with strong professional economic expertise have laid out a basic framework and broad conclusions supporting those presented in the Business Roundtable's [July 1987] study. It is submitted that the Law Commission should be guided by this analysis, and apply its expertise to the development of legal and institutional arrangements that will support an approach to accident disability based on appropriate legal incentives to encourage safety, the competitive provision of private insurance, consumer choice as to disability insurance and a role for the state in ensuring minimum cover and the means to acquire it.

4 New Zealand Business Roundtable *Review of Accident Compensation: A Submission to the Law Commission* (submission to Law Commission, New Zealand Business Roundtable, 1987) ii.

5 *Review of Accident Compensation*, above.

Between 1988 and 1990 the Business Roundtable commissioned further reports and submissions from an impressive number of independent academic economists. In 1990 alone it commissioned independent reports from Patricia Danzon, Michael Porter, and my employer at the time, Jarden Morgan. All these reports stressed the importance of incentives and competition for community welfare.⁶

Where did these economic notions come from? A clearly articulated rationale for the desirability of competition has been with us for centuries. Adam Smith most famously explained the virtues of competition and free trade more than two centuries ago. If competition is a virtue its antithesis – monopoly – is harmful by association. Indeed, economic theory has provided the analytical basis for anti-monopoly policies in the United States and in the Commerce Act 1986 in New Zealand.⁷

Economists recognise that market forces will generally overcome a private monopoly in time through competition (and the elapse of patent rights). However natural and statutory monopolies are special cases that cannot be overcome by competition, essentially by definition. The degree to which natural monopolies are a problem is a controversial issue, but it is not relevant here.

Economists last century widely thought that statutory monopoly would be benign because governments were benevolent. This theory of regulation is known as the *public interest theory* or *normative analysis as a positive theory*. It assumes that governments actually behave in the public interest – that is, as an impartial spectator would wish them to behave. However, this theory has lacked supporters for several decades. There are two reasons for this: (1) no one has been able to provide an analysis that explains how the public could induce legislators and regulators to act in accordance with this theory and (2) a large amount of evidence refutes it.⁸

Everyday experiences with State monopolies illustrate the complexity of the political and bureaucratic environments in which they operate. The lack of competition exposes them to severe conflicts of interest. Often they empower those who control them at the expense of their customers and taxpayers. Politicians find they have far less power than many imagine. For example, state schools and hospitals, or a fire service, might be effectively controlled by unions and professional groups that may produce mediocrity rather than strive for performance. The great frustration that results for customers and the best professionals is easy to observe in our schools, universities and hospitals.

6 Geoffrey Palmer *Compensation for Incapacity: A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington, 1979) 200, acknowledges the failure of the Woodhouse report to engage in economic analysis.

7 For a brief history of economic regulation, see W Kip Viscusi, John M Vernon, and Joseph E Harrington Jr, *Economics of Regulation and Antitrust* (2 ed, MIT Press, Cambridge (Mass), 1995) 311-317.

8 Viscusi, above, 326.

Most commonly, State monopolies cannot be managed purposefully and cannot be held to account. This is because they lack a single overriding objective. Consider, for example, a decision that would increase output but reduce quality. If the State-Owned Enterprise (SOE) has the goal of increasing output and quality (for a given cost) the decision is arbitrary. Purposeful management is impossible.

The statutory monopoly that is the Accident Compensation Corporation has a host of conflicting objectives. "Key" objectives encompass safety, rehabilitation and insurance. In every direction there are trade-offs between quantity and quality, speed and care. The history of the ACC is in good part a story of changing, politically driven priorities. Politicians (and the ACC itself) lack the information and incentives necessary to determine the actual priorities of the public when it comes to trading off choice, quality, quantity and cost. When consumers are disempowered, changes in priorities probably reflect changes in interest group pressures.

The (SOE) model attempted to rectify this problem in other cases by imposing a single, overriding objective – the profit motive. However, the incentives to monitor SOEs in the interests of taxpayers or consumers are limited and management is not constrained by an active takeover market.⁹ In any case, the SOE model is unstable. Sooner or later politicians will (re)introduce conflicting multiple objectives for political purposes that may not be laudable.

The benefits of competition are difficult to secure when even one competitor is state-owned. State ownership creates a conflict of interest for governments. Its very existence can inhibit competition and price discovery. State ownership presents other problems for governments. For example, they do not know the SOE's cost of capital or how to best mimic market disciplines for under-performing management teams. For many years there was a debate in the empirical literature as to how much state ownership mattered for economic efficiency. This is more an issue of the vitality of the competitive process than the survival of the privatised firm. Privatisation is usually associated with deregulation in order to secure the gains from competition. To survive, the privatised firm will usually have to improve its performance markedly, but doing so will not guarantee its survival. As the recent near-demise of Air New Zealand demonstrated, this is not the way State-owned media, or many other journalists, will portray business failure. In the popular view, and alas in the view of some academic economists, business failure is a story of private sector failure and management incompetence rather than an inevitable product of the market's verdict on the relative merits of competing products or strategies.

Moreover, since competition is the key to consumer welfare, it is not clear that a heavily regulated privatised industry will perform much better than a state-owned industry. Much depends on the quality of regulation. Intensive regulation inevitably creates artificial distinctions between the regulated firms and the rest. These become entry barriers that impede competition.

9 See Treasury *Economic Management* (Government Printer, Wellington, 1984) 293.

The benefits of competition are often not readily measurable. It is a common (self-serving) fallacy amongst antitrust regulators to point to lower prices as a benefit of 'introduced' competition. However, lower prices are not inherently desirable. Lower prices may herald lower quality and future supply problems, as in the Californian electricity crisis. One virtue of competition is that it should lead prices to *track* costs, where costs are subjective and forward-looking. Another virtue is that competition allows choice between quality and variety, and usually eliminates queues. Regulation (and monopoly) commonly takes on a 'one-size-fits-all' character. People resent its arbitrariness and lack of choice. Competition empowers the common consumer – and thereby civil society. This benefit is not readily measurable either, but that does not mean that 'reformers' should ignore it.

While economists have usually agreed about the benefits of competition, there has been more debate about the issue of government ownership. This was in part because of the problems of disentangling the issues of monopoly, ownership more generally, and regulation. However, by the early 1990s a strong consensus was developing that ownership matters for consumer welfare, with the World Bank to the fore in making the case in favour of private ownership.¹⁰ That consensus has consolidated in the economic literature in the intervening years.¹¹ Moreover, it now accords with world-wide practice.

IV WHY WAS COMPETITION FROM PRIVATE INSURERS NOT AN ISSUE EARLIER?

Geoffrey Palmer has provided an interest group analysis of how the private insurers lost their battle in 1971-72 to preserve a role for themselves, notwithstanding the presence of a National government at the time.¹²

The impetus for the Woodhouse reforms came from a small group (notably lawyers), not public demand.¹³ The reformers desired to replace a private insurance and liability regime by a social insurance regime – essentially for reasons of collectivist ideology and expediency. Socialism and confidence in the beneficence and competence of big government were at their height in the 1970s. The principles espoused in the Woodhouse report were based on collectivist values. In Geoffrey

10 For a review, see New Zealand Business Roundtable *The Public Benefit of Private Ownership – The Case for Privatisation* (New Zealand Business Roundtable, 1992).

11 See, for example, William Megginson and Jeffrey Netter "From State to Market: A Survey of Empirical Studies on Privatization" [2001] *Journal of Economic Literature* 321.

12 Geoffrey Palmer, *Compensation for Incapacity: A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington, 1979) 115-123. He reports a senior Government Minister as commenting that the fire and accident companies failed to contribute to National Party funds and also suggests that they earlier adopted a too accommodating strategy.

13 Palmer, above, 66-67, 69 and 83-84.

Palmer's sympathetic assessment they were: "... a deliberate attempt to provide a reformulation of social aims on which a new sort of welfare state could be built".¹⁴ In so doing they "assume[d] the legitimacy of a large area for government action, the justification for which was never argued".¹⁵

Social insurance precludes the actuarially fair premiums that drive competitive (unregulated) insurance markets. Actuarially fair premiums provide individuals with an incentive to reduce their premiums by taking more care or providing more self-insurance. Healthier lifestyles and a better balancing of risk and reward should result. Flat premiums are a subsidy for risky activities and irresponsible behaviour. This can affront public opinion and undermine civil society.

These effects worry those who take incentives seriously. They may not worry those who take an optimistic view of human nature. Geoffrey Palmer no doubt rightly stressed the noble aspect of the collectivists' vision.¹⁶

The vision ... was warm-hearted and humane. It took an optimistic view of human nature. The basic idea was that those in distress should be helped, that the well-being of each was a concern for all. Whether the vision and the efforts made to implement it represent significant social progress I leave it to others to observe.

Nothing in this paper should be read as a challenge to the sincerity of the sentiments that underlay the 1967 Woodhouse report and its aftermath. However, public policies must be grounded in a sound appreciation of the flaws in human nature and the problems of information and incentives that commonly confound government action. Incentives do matter. One incentive is to exploit the power of the state. That power is readily abused and the natural tendency is for government to grow and liberty to retreat, as Thomas Jefferson famously observed. Another incentive is to take less care when the costs fall on others. Systems of social insurance are intended to delink costs and rewards.¹⁷

For example, a private accident insurance scheme would tend to only insure against accidents that have yet to occur or harms that have yet to be revealed. Those making false declarations concerning their pre-existing health status would not have a right to the premiums paid by others. In contrast, social insurance may pay out on harms that may not exist arising from long past events

14 Palmer, above, 56.

15 Palmer, above, 205. Palmer also describes at 93 how the 1969 Gair Committee avoided the question of the relationship between ACC and the welfare system.

16 Palmer, above, 407.

17 Richard Epstein sums up the differences between private and social insurance in Richard Epstein *Accident Compensation: The Faulty Basis of No-fault and State Provision* (New Zealand Business Roundtable, 1996) 38-39.

that may or may not have occurred – and if they did were deliberate crimes, not accidents.¹⁸ But the most important benefit is that a private insurance system would not compel any person to contribute to a policy that was so open to abuse. Choice and variety would prevail.

The Woodhouse proposals were consistent with social insurance in that they proposed flat premiums that did not respond to risk differentials, but they were inconsistent in not proposing social insurance for loss of earnings from accidents *and* sickness. The inconsistency was presumably expedient – a halfway house was better than nothing.

In the event, the social insurance aspect was further undermined when the scheme that was implemented provided for industry risk rating in the assessment of premiums. The ACS is not the Woodhouse scheme, but Woodhouse is its father.

Sir Geoffrey Palmer acknowledged one of these inconsistencies in proposing legislation to extend coverage to sickness in the second half of the 1980s. However, this ambitious task was thwarted by the change of government following the 1990 general election.

Given the endless difficulties with the ACS, it was only a matter of time before the need was felt to clarify its conceptual basis. *Was it part of the welfare state or was it a system of insurance?* The debate on this issue in 1991 was the first to occur in front of those competent to assess economic arguments, and the Galvin report found in favour of the insurance model and competitive private insurance. This recommendation was not picked up until 1998 when competition was introduced for the employers' account.

The current Government's decision to return to a State monopoly appears to have been entirely political and at odds with professional advice. It solves none of the problems that arise from statutory monopoly and persuades no new constituency of its merits. It can have no stability.

V WHAT ABOUT THE FUTURE OF THE RIGHT TO SUE?

The Woodhouse report was also expedient in its drive to abolish the right to sue. Sir Geoffrey Palmer summed up the rationale for abolition as follows:¹⁹

Strategically it was essential to the Woodhouse style of reform that a compelling case be developed against the common law. If the common law survived, a comprehensive system for injury was unattainable. If the common law remained, the financial logic of the reform was destroyed – new sources of revenue would be needed rather than making better use of the existing money.

18 See, for example, the opinions reportedly expressed by Dr Felicity Goodyear-Smith in Leah Haines "Sex Abuse: 47,000 get Compo of \$100m" (14 March 2001) *The Dominion* Wellington.

19 Palmer, above, 25.

The argument at the time was that the money spent on litigation could be better spent on helping the victim. Viewed from an insurance perspective, lawyers siphon off too much of any award from a successful action under a tort system.

This political argument successfully confused an insurance system with a liability system. A tort liability system is concerned with determining cause or blame and penalising the same. Its economic value lies in the salutary signal it gives to onlookers and the incentives it thereby generates to avoid future accidents.²⁰ It also accords with a deep desire for justice – those who cause injury to others through irresponsible behaviour are held to account and confronted with the costs if found to be at fault. In contrast, an insurance system is concerned to provide relief to the victim regardless of fault. The two systems form an harmonious whole; they are complementary. Woodhouse's 'success' was to present them as substitutes.

The rationale for denying common law remedies for personal injuries may have been more defensible if they were having irredeemably perverse effects. However, at least one of the scheme's proponents freely acknowledges that this was not the case:²¹

While the right to sue existed in New Zealand, it was not availed of nearly with the same vigour or with the same determination that it has been in the United States. Contingent fees, of course, were unlawful in New Zealand. There were a number of actors which tended to make this a moderate system. The judges controlled it. Even though the juries made the findings of liability and the awards of damages, the judges controlled it much more than is possible in the United States because they were allowed to comment on the evidence. When judges comment on the evidence in New Zealand, the juries tend to take notice of them.

You cannot find, therefore, in the legal system of New Zealand or in the jurisprudence relating to the tort system anything that has any explanatory power in relation to the accident compensation scheme. There was little in the way of abuse or excess. It was a most mild-mannered little tort system.

Unprincipled arguments produce stable policies only by chance. Although in 1979 the right to sue might have looked well dead and buried, subsequent developments point to a different conclusion. In recent years, judges appear to have restored a system of liability through judicial activism in the form of awarding exemplary damages in favour of the victims of accidents.²² Furthermore, the abolition of lump-sum payments in 1992 and their replacement by an independence allowance appear to have reduced trade union support for retaining the abolition. It is

20 For a dialogue involving Richard Epstein and Geoffrey Palmer on the deterrence effects of tort processes in relation to empirical work by Michael Trebilcock and others, see Epstein, above, 20-21 and 39-41.

21 Sir Geoffrey Palmer "The New Zealand Experience" (1993) 15 *University of Hawaii L Rev* 612.

22 The paper to this conference by Ailsa Duffy "The Common Law Response to the Accident Compensation Scheme" (2003) 34 *VUWLR*, 367 outlines this evolving response and concludes that the pressures to revive the right to sue will grow.

also interesting to note that the greatest opposition to the original proposal to abolish the right to sue came from the insurers.²³ Presumably, the return to a system of competing insurers will add to this constituency.

The issue of the return to the right to sue was addressed in considerable detail by the author with the assistance of Richard Epstein and other lawyers in a chapter of a report by Credit Suisse First Boston for the Business Roundtable in November 1998.²⁴ The only factors that stopped a clean favourable recommendation were the concerns about judicial activism and the absence of guidelines for behaviour and cost awards, particularly during any transitional phase. The concerns focused on the need for sanctity of contract in relation to assignments of risk and the need to guard against capricious and excessive awards. These concerns are capable of being addressed.

VI LESSONS FOR PUBLIC POLICY

In its 1995 annual report the Law Commission identified six recurring sources of poor quality regulation. The following convenient summary is taken from a recent Business Roundtable publication:²⁵

First, *inadequate problem definition*. Framing the problem too narrowly or too broadly, or wrongly identifying it, results in policies and legislation which are inappropriate and ineffective.

Secondly, *an assumption that legislation is needed when it may not be*. This may be the result of inadequate and delayed legal advice.

Thirdly, *a failure of the legislation to give effect to the intended policy*. This is often a reflection of the first problem and the next.

Fourthly, *premature introduction of legislation*. This is a growing problem in the Commission's view. It leaves large and complex issues to be grappled with by select committees. Resolving those issues takes time and resources which are more profitably used at the drafting and policy development stages. Under-prepared legislation also compromises the public submissions process, especially when the need for further development is acknowledged at the time of its introduction.

Fifthly, *a failure to comply with accepted constitutional principle*. One example is the use of open-textured drafting. This could be a legitimate choice (for example, to leave the development of the law in

23 Geoffrey Palmer, *Compensation for Incapacity: A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington, 1979) 67.

24 New Zealand Business Roundtable *Accident Compensation: Options for Reform* (New Zealand Business Roundtable, 1998) chapter 6.

25 New Zealand Business Roundtable *Constraining Government Regulation* (New Zealand Business Roundtable, 2001) 39.

certain areas to the courts), but there must as well be proper and comprehensive policy development before the legislation is introduced.

Sixthly, *a failure to draft law which is as understandable and accessible as possible*. Improvements can be observed, but much legislation could be written more plainly, with major advantages to those affected by it.²⁶

A Inadequate Problem Definition

Sir Geoffrey Palmer's study of the policy processes makes it clear that there was little public demand for change:

- "a balanced assessment" of the pressures for change "would not have concluded that much change was needed";²⁷
- the assessment of the virtues and deficiency of the common law in the Woodhouse report was one-sided, neglecting in particular issues of justice, pain and suffering and intangible loss;²⁸ and
- in contrast, "everyone agreed" that the regulated benefits for workers' compensation, which had not been reviewed since 1956, needed to be "substantially upgraded and that the need to do so was urgent". Palmer expresses the view that it is possible that "anything resembling a full Woodhouse scheme" would not have come to pass if this upgrade had occurred.²⁹

B An Assumption that Legislation is Needed When it May Not Be

It is clear that the contemplated legislation was not needed in order to address the problem that benefit levels were undesirably low because of the failure to review an existing regulatory imposition. The legislation was only necessary for the pursuit of an ideological goal.³⁰

C Premature Introduction of Legislation

Palmer comments that the original New Zealand Bill would not have passed the scrutiny of the Australian Senate Standing Committee for Legal and Constitutional Affairs. In his assessment the New Zealand Bill was primitive compared to the Australian Bill: "The deliberate approach in New

26 New Zealand Law Commission *Annual Report 1995* (Report 33, Wellington, 1995) 14–15.

27 Geoffrey Palmer, *Compensation for Incapacity: A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington, 1979) 69.

28 Palmer, above, 31.

29 Palmer, above, 88.

30 Peter McKenzie's address to this conference: Peter McKenzie "The Compensation Scheme No-One Asked for: The Origins of ACC in New Zealand" (2003) 34 VUWLR 193 illustrates the point.

Zealand was to pass the Bill and start the scheme working. Amendments were to be made in the light of experience".³¹

D A Failure of the Legislation to give Effect to the Intended Policy

The actual legislation was a compromise between social insurance concepts and private insurance that (inevitably) lacked a coherent basis. F A Hayek has observed that the process of decision making by factions and majority rule can be expected to produce outcomes that a majority would oppose.³²

What we call the will of the majority is thus really an artifact of the existing institutions, and particularly of the omnipotence of the sovereign legislature, which by the mechanics of the political process will be driven to do things that most of its members do not really want, simply because there are no formal limits to its powers.

The payout of over \$100 million to 47,000 people for sexual abuse claims, particularly in the absence of adequate validation in all too many cases, surely demonstrates such a situation.³³

E A Failure to Comply with Accepted Constitutional Principle

The overriding by statute of the common law is a serious matter in relation to constitutional government and the preservation of liberty and democracy. Respect for common law rights is a bulwark against despotic government.³⁴

Palmer acknowledges the significance of the decision in New Zealand to end the right to sue in relation to personal injury from accidents. His study highlights how much weaker the constitutional constraints were in New Zealand at the time than in Australia:

- in New Zealand the collectivist vision of community responsibility in the Woodhouse report was "never attacked". Yet if it was accepted, much had to be conceded. In

31 Palmer, above, 203.

32 Fredrich A Hayek "Economic Freedom and Representative Government" in Basil Blackwell *Economic Freedom* (Institute of Economic Affairs, Oxford, 1991) 385–386.

33 New Zealand Business Roundtable *Constraining Government Regulation* (New Zealand Business Roundtable, 2001) 42.

34 *Constraining Government Regulation*, above, cites Bruno Leoni as positing that legislation in matters of private law is fundamentally incompatible with political freedom and is not really compatible with free markets (see *Constraining Government Regulation*, above, 81). It proposes that regulatory proposals be explicitly tested for the degree to which they preserve venerable common law causes for action against harm (see *Constraining Government Regulation*, above, 212).

Australia the same idea was attacked in parliamentary debate as "the death of individualism";³⁵

- in Australia, the Prime Minister had to obtain formal constitutional advice. The power of the federal government to bar proceedings for damages that were a right under State law was in question and only a decision by the High Court in Australia was authoritative;³⁶
- in Australia, the constitutional argument in relation to the proposed blocking off of the common law ability to sue on behalf of injured children "was decisive";³⁷ and
- in Australia, the opposition could thwart a determined Prime Minister because the government at the time did not have a majority in the Senate.³⁸

Since this address is to a legal audience I will not bore it with more than a few brief remarks about how an institutional economist might evaluate the ACS. An economic analysis starts with exactly the same question as a legal analysis – what problems are people actually experiencing that the government intervention is intended to address? The analysis should move from symptoms to causes. If government action is still to be contemplated, its objective should be determined in the light of those causes. Proposed interventions should be evaluated against that objective. The evaluation would take into account such matters as the quality of the incentives the intervention would put in place and the degree to which it made it more or less costly for people to transact. For example, if the problem were that benefit levels were perceived to be too low, the problem definition phase might ask what was stopping those who wanted higher benefit levels from funding them.

It is almost inconceivable that any competent economic analysis could have identified actual harms to the common person with existing arrangements for which the solution was a state monopoly insurer and the abolition of the right to sue.

In contrast to a practical approach to problem definition, the Woodhouse report conceived the problem to be that the world was not how the reformers would like to see it. They dreamed of a world in which everyone was collectively responsible for everyone's actions but their own. In their world incentives did not matter because they had "an optimistic view of human nature". In contrast, the common law freedoms of choice and contract and the system of tort remedies that the government overturned so lightly was a product of over a thousand years of testing against actual

35 Geoffrey Palmer *Compensation for Incapacity: A Study of Law and Social Change in New Zealand and Australia* (Oxford University Press, Wellington, 1979) 205.

36 Palmer, above, 279-283.

37 Palmer, above, 209.

38 Palmer, above, 209.

human nature. Its evolutionary path is undoubtedly flawed but this is not a case for its displacement by flawed political decision making. We have yet to escape the folly of utopian thinking and the *hubris* of the anointed.³⁹

VII CONCLUDING REMARKS

Some might argue that the survival of the ACS for over a quarter of a century demonstrates that it is here to stay. However, much greater follies lasted longer – import licensing, communism, the Berlin Wall and apartheid. The longevity of the ACS is trivial in comparison to that of the common law regime it so cavalierly displaced.

There appears to be no principled defence of a state monopoly insurer. The benefits from the introduction of competition were dramatic and it is only a matter of time before ideology must bow to reason.⁴⁰ Nor is there any detectable stability in the debate going back to 1969 between the social insurance model and the private insurance model. The evolving rorts and inequities of the social insurance approach will continue to affront public opinion when they are drawn to its attention.

The stability of the abolition of the right to sue must also be in question. It is plausible that there is a deep need for justice to be done in cases of serious negligence – witness the public's response to the Erebus and Cave Creek disasters.

A greater constitutional respect for the preservation of common law rights in New Zealand might have prevented the unprincipled and opportunistic abolition of the right to sue that was critical to the success of the Woodhouse scheme. It is ironical that the charge to abolish it was led by (some) lawyers. Perhaps in 20 years' time the verdict will be that this was yet another folly associated with the New Zealand dream to 'lead the world' in social reform.

The advent of competing insurers and the restoration of the right to sue would not end the debate about the proper role of the state in relation to workers' compensation. The history of state intervention in workers' compensation is about a century old. It predates the enthusiasms that led to the Woodhouse proposals.

Prior to 1900, workers in New Zealand relied on the common law for compensatory redress. Legislative changes in Britain in 1897 and a major mining accident in New Zealand in 1896 led to

39 The reference is to Thomas Sowell *The Vision of the Anointed: Self-Congratulation as a Basis for Social Policy* (BasicBooks, New York, 1995).

40 I note David Caygill's paper to this conference (David Caygill "1990s: Decade of Change" (2003) 34 VUWLR, 395) that argues that the ACC's improved performance is not due to competition (or monopoly). Hopefully, it would have indeed improved its performance in the absence of competition. However, this barely touches on the issues of information and incentives, choice and variety that underlie the case for competition. The ACC cannot offer value for money because consumers cannot signal what they really value.

the Workers' Compensation for Accidents Act 1900. After 1900, employers were liable for all work accidents except those caused by serious misconduct by the employee. This Act was rapidly replaced by the Workers' Compensation Act 1908. The 1908 Act substantially increased the maximum compensation payable and, though frequently amended, formed the basis of workers' compensation for the next 65 years. Under this Act employers were liable for all accidents, with a prescribed schedule for maximum payments and a proportional scale of compensation for incapacity. In 1947 it became compulsory for employers to insure against accident liability. At the same time a Workers' Compensation Board was set up to cover workers whose employers had failed to insure, recover those payments from the employer and set the maximum rates that state or private insurers could charge. Common law remedies for personal injury or property damage were also available for work and non-work accidents. Workers could take common law actions against negligent employers in order to augment their compensation, although damages awarded were likely to take into account the amounts already received.⁴¹

Notwithstanding the growth in collectivism during this period, an enduring theme is the humanitarian concern with the plight of law-abiding workers and their families when they suffer serious injury and are inadequately insured.

Even so, humanitarians must be concerned with the human plight rather than its cause – accident or sickness. In the absence of a monopoly accident insurer we would expect to see a much deeper market for income-replacement insurance and health insurance that covered both accidents and sickness. Then there would be the issue of the interface between this system and the welfare state and its relationship to private, voluntary, humanitarian activities and organisations in general.⁴²

The focus on workers' compensation is much too narrow from a humanitarian perspective and the attack the ACC represents on common law rights smacks of an elitist disregard for constitutionalism. Until someone can produce a principled public policy defence for monopoly and the removal of common law rights, the ACC's tenure looks fragile.

41 The historical information here is based on section 1 in New Zealand Employers Federation *A New Prescription for Accident Compensation* (New Zealand Employers Federation, Wellington, 1995) 1-69. See also Statistics New Zealand *Official Yearbook 2000* (Government Printing Office, Wellington, 2000) 197.

42 For a discussion of the issue of the uninsured, see Richard Epstein *Accident Compensation: The Faulty Basis of No-Fault and State Provision* (New Zealand Business Roundtable, 1996) 33-35.

