

1990s: DECADE OF CHANGE

*David Caygill**

As market principles took firmer hold in New Zealand public policy in the 1990s, ACC received close scrutiny and passed through three legislative revisions. The idea of opening ACC to competition from private insurance providers was moving up the policy agenda—and was briefly enacted in 1999, prior to a change in government. New management practices within ACC focused attention on cost containment, benefit levels, and experience-rated premiums for employers. This paper, by the current Chair of ACC, summarises the history of formal reviews, administrative changes, and legislative reforms across the decade, including the increasing emphasis on administrative efficiency.

I INTRODUCTION

The 1990s saw three major revisions to ACC's governing legislation: those of 1992, 1998 and 2001. I include the last re-enactment, partly because otherwise there would be no place at this seminar to consider it and partly because it was foreshadowed in the amending legislation of 1999.

Over the years there have been three phases to debate about accident compensation:

- (1) the initial discussion as to the appropriateness of a compulsory, comprehensive scheme replacing tort liability;
- (2) the question of the range and level of benefits to which claimants under such a scheme should be entitled; and
- (3) the issue of how these benefits should be delivered.

These phases have overlapped. No logic has prevented simultaneous discussion of all three issues. Nevertheless debate understandably focussed first on the wisdom of the Woodhouse Report and the case for a comprehensive no-fault scheme. Once the government of the day accepted that advice, debate began to shift to such issues as the appropriate level of compensation, responsibility for the first week after injury, whether coverage should include accidents incurred in the course of criminal offending, sexual assault and so on. Issues continue to arise under the broad head of "the range and level of benefits". In addition, in the last decade attention has focussed on the means by

* Chair of the Accident Compensation Corporation since 1998.

which accident compensation (and indeed injury prevention and rehabilitation) might best be delivered.

The 1990s demonstrate that the scheme is still capable of generating controversy. The distinctive feature of debate in the 1990s was that for the first time discussion focussed on the administration of accident compensation, as distinct from the appropriateness of comprehensive coverage and the prohibition of tort liability, or the nature and level of benefits that should be provided. Put another way, in the 1990s debate turned to the fifth of Sir Owen's guiding principles, namely "administrative efficiency". In this paper I seek to understand why that occurred and what that might imply for the future of the scheme.

II THE 1991 WORKING PARTY AND THE 1992 ACT

The decade opened with a change of government. The reforms that Michael Cullen as Minister of Social Welfare and I announced in the final budget of the Lange/Palmer government were not to reach the statute books. Instead a new Minister of Labour, Hon W F Birch, established a Ministerial Working Party on the Accident Compensation Corporation and Incapacity. The working party was convened by Bernie Galvin, former Secretary of the Treasury.

The working party's terms of reference sought (*inter alia*):

... (to) minimise the cost to society of the system of compensation for incapacity. This may require:

- (1) greater freedom of choice among alternative insurers;
- (2) competition between public and private sector insurers;
- (3) minimising barriers to competition among insurers.

The working party recommended (*inter alia*):

- the reduction of entitlements at the margin, for example the maximum weekly earnings for earnings-related compensation (ERC) should be set at the average gross ordinary time weekly wage;
- claimants with impairments of less than 15 per cent should be assumed to be fit for work and should not be eligible for ERC beyond twelve months;
- relevant earnings should be based on ordinary time earnings only.

Other major changes recommended included that employers should be responsible for work injury cover only. Experience rating should be permitted. And private sector insurers should be allowed to operate in competition with the ACC.

Ministers had sought a reduction in the burden of costs falling on government. This was to be met in part through experience rating, but also through the working party's recommendation that individuals should bear some of the costs of their injuries through co-payments and pause periods.

The working party's report was considered in early April 1991 in conjunction with the reviews that were at that time also under way in relation to health and social welfare. Significantly (given later events), Ministers rejected the introduction of competitive provision and the related issue of full funding.

The working party had asserted that:

a good theoretical case exists for proposing that the delivery and administration of injury compensation insurance should be opened up to competing private insurers. However ... empirical evidence does not clearly demonstrate greater efficiency from competition.

"Accident Compensation: a Fairer Scheme", issued with the Budget in July 1991, was a shade more equivocal. It said:

a number of studies have been carried out overseas which have set out to determine whether a sole-insurer or a multi-insurer environment is more efficient and effective. Overall these research findings reveal that it is very difficult to conclude that one method of delivery is superior to the other.

Accordingly the government decided that "at a later date consideration will be given to the extent to which aspects of the Corporation's activities can be opened to competition".

An obvious question is: what led the government at the beginning of the 1990s to consider competition? What lay behind this turn of events?

The 1991 working party identified four problems with accident compensation:

- (1) the cost of the scheme, which was seen as a function of both scheme design and the legislation;
- (2) the perception of unfairness, for example employer responsibility for non-work accidents;
- (3) cross-subsidies – because of the lack of experience rating; and
- (4) costs were not sheeted home to those who could influence them, that is, there was insufficient incentive to prevent accidents.

Reading between the lines of the working party's report one gets the strong sense that costs were the major issue. These had certainly increased significantly. Between 1985 and 1990 overall scheme costs had increased by 25 per cent per annum. That is 15 per cent each year more than the increase in the consumer price index over that period. In 1990 there were fewer actual claims than in 1986, partly because the workforce had contracted. But an increase in the average length of time on the scheme had contributed to rising costs. So too had the 1985 amendment to section 59 of the 1982 Act, which effectively allowed claimants to remain on the scheme even if they were fit to return to work, where they could find no suitable employment. As a New Zealand Law Society seminar described the situation the following year: "the perception, indeed reality, that the scheme was easy to get into and hard to get out of was a major factor". By 1990 it was being said that up to

10 per cent of long-term weekly compensation was being paid to claimants who were actually fit for work.

The working party and budget document led to the 1991 Bill and ultimately to the Accident Rehabilitation and Compensation Insurance Act 1992. This Act included a number of significant changes:

- the abolition of lump sum compensation and of payments for permanent partial loss;
- the introduction of insurance language, for example references to "premiums" and the change in title of the Act itself;
- the terms "personal injury" and "accident" were defined in detail;
- limits were placed on compensation for medical misadventure;
- there was an attempt to limit rehabilitation payments and other entitlements by regulation (which later led to a challenge in front of the Regulations Review Committee);
- work capacity testing was introduced (sections 49 - 53). A capacity for work of 85 per cent or more became grounds for exit after twelve months;
- the previous section 59(2) was repealed.

This legislation was contentious. As compared to the original enactment in 1972 and the re-enactment in 1982, the 1992 Act and its two successors have seen a departure from the legislative bipartisanship of the original accident compensation reform.

Two conclusions might be drawn. First, that the Government was particularly influenced by the attitudes of employers. Changes to accident compensation paralleled those to industrial relations legislation, which were clearly made at the behest of employers. Secondly, with the abolition of payments for permanent partial loss, ACC no longer compensated for the loss of a *particular* job. Increasingly its task was to become one of compensating only until such time as a claimant was ready to return to work or independence. ACC was no longer to be a surrogate form of unemployment compensation. However, the difference between the flat rate social security (including unemployment) benefits and ACC's income-related payments would often create strong incentives to remain on the ACC scheme.

III THE MIDDLE 1990s

Since its inception accident compensation legislation has been the subject of many amendments. Of the period between 1992 and 1998 mention should be made of two significant moves, the legislative basis for both of which was contained in the Accident Rehabilitation and Compensation Amendment Act (No 2) 1996. The first saw ACC win the right to contract directly for medical and surgical services. The second was an important refinement of work capacity testing.

The 1992 Act had allowed the Corporation to advance to a claimant part or all of the cost of any private hospital treatment if this would have the effect of reducing the Corporation's liability. It is unclear how much use was made of this. In part this provision may have been intended to "compensate" for the loss of lump sum payments, which had often been used in the past to pay for private surgery. This new provision is likely to have been limited to claimants entitled to earnings-related compensation and who had either private insurance or substantial means.

The 1996 amendment however allowed ACC to purchase non-urgent "elective" medical treatment for claimants directly from Crown Health Enterprises and private providers. This was initially trialled in 8 locations but was rapidly expanded. Today in the order of 80 per cent of "elective" surgery on ACC claimants is carried out privately, though contracts are also let to public hospitals (now run by District Health Boards) where price and service criteria are met. The key result is that claimants who need surgery or medical treatment no longer languish on public hospital waiting lists to their own and the community's disadvantage.

Section 51 of the 1992 Act had allowed for assessments of the degree of a claimant's incapacity. Indeed, it had required that:

where any person who has been assessed under this section as having a capacity for work of 85 per cent or more refuses, without good reason, an offer of permanent employment in which that person could earn more than \$245 a week ... that person shall not be entitled to any further compensation for loss of earnings ...

No doubt the provision proved controversial. For reasons I have not been able to identify it was not used. The Corporation's explanation is simply that "they couldn't make it work".

The 1996 amendment provided a detailed procedure for the assessment of capacity for work. In case anyone was unclear, the new section 50(5) provided that:

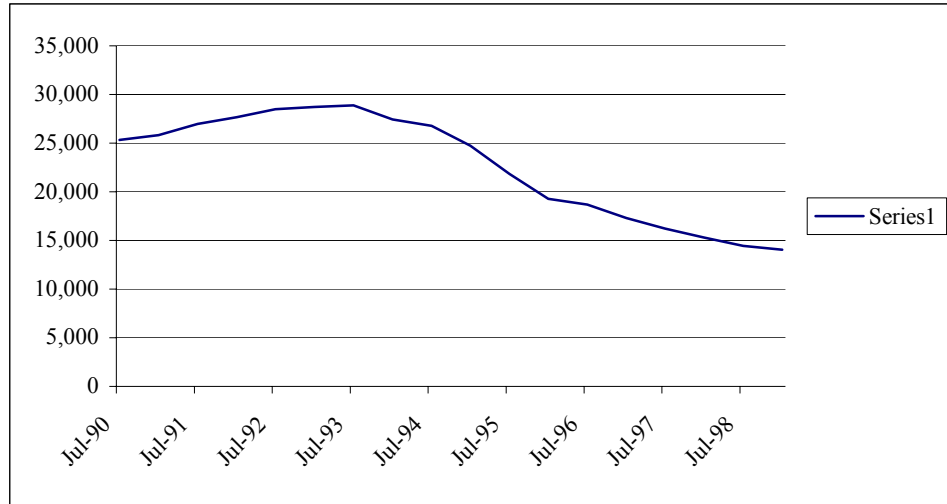
the object of the procedure is to provide a reasonable method of making assessments under section 51 of this Act.

One way of viewing this change is that henceforth accident compensation was not to be an alternative to an unemployment benefit. Once the victim of an accident had sufficiently recovered (either through the Corporation's rehabilitative assistance or their own devices) they were no longer to be entitled to earnings-related compensation. If work was not available then assistance in addressing their unemployment lay elsewhere.

The results of these two changes can be seen starkly in retrospect. The "tail" of those on the scheme for more than 12 months had been growing since the scheme's inception – as one would expect with any scheme which provided potentially permanent compensation. A question which must have been exercising people's minds in the years before 1996 was: at what point would overall costs level off? The answer is that long term claimant numbers began to level off in 1996 but then, surprisingly (in the sense that this is not the normal pattern of long-run insurance schemes), from the

third quarter of 1997 they began to decline. From a peak of almost 30,000 long term claimants five years ago there has been a gradual, but steady reduction to the present time where the figure at 30 June 2002 was just on 14,500. That is a spectacular, if not unprecedented outcome. It has made a significant difference to the Corporation's finances and to the costs faced by levy payers (as the legislation once again terms them).

(B) TOTAL NUMBER OF LONG-TERM CLAIMANTS



Source: ACC

The next significant change was the move during 1998 from pay-as-you-go to full funding. Unquestionably this was undertaken as a precursor to the introduction of competition from insurance companies. Nevertheless, it can be justified on its own merits and indeed has been retained by the present government notwithstanding the return to monopoly provision. One important consideration here is the decision to consolidate the Corporation's financial performance onto the Crown's balance sheet. So long as the Crown uses accrual accounting (as the Public Finance Act now requires) then the Crown's balance sheet will need to acknowledge the gross liabilities reflecting the Corporation's responsibility to meet the ongoing costs of the seriously injured. If on the other hand the Corporation's revenue meets only its current needs there will be a gaping hole in the public balance sheet. This may seem a trivial justification for retaining full funding and indeed there are stronger arguments (for example, the more accurate costing required of any proposed change to the level or form of future benefits). On the other hand, I suspect the balance sheet argument would be sufficiently persuasive for any future Minister of Finance.

IV COMPETITIVE PROVISION AND THE 1998 ACT

I do not propose in this paper to set out the provisions of the Accident Insurance Act 1998. Their key feature is that the Act facilitated competition in the provision of accident insurance by private sector providers. Indeed, in the area of "workers' compensation" or workplace accidents to employees, the Act went beyond merely allowing the private sector to compete with the Corporation and positively prohibited the Corporation from offering this insurance. The exception was the self-employed, where the Corporation in fact retained 90 per cent of this business. It is interesting to contrast this outcome with the 1991 Working Party proposal to allow the private sector to compete with the Corporation.

The competitive provisions of the 1998 Act were repealed following the 1999 election. Its passage and repeal represented a major legislative struggle, not unlike the passage and ultimate repeal of the Employment Contracts Act. Except that in that case, passage and repeal were separated by nine years. Between 1998 and 2000 the ACC had to gear up for, and then gear down from, a period of competition which ultimately lasted less than 12 months. The result challenged the Corporation, the insurance industry, claimants and the public.

In retrospect, the origins of the 1998 experiment with competition can be seen in the advice of the 1991 Working Party. Six years later however the equivocal language of the Working Party and the 1991 Budget document were forgotten. Instead the debate was conducted on both sides in black and white terms. Proponents of change argued that competition would reduce costs. Opponents replied that competition would undermine standards of service, by such means as under-reporting of accidents and under-investment in accident prevention. They also suggested that if insurance costs did fall in the short term that would only be because insurers were under-charging to acquire employers' business.

One obvious problem with debates of this character is that we cannot run social experiments which spool back to the start to be replayed if we are dissatisfied with the original outcome. Nor can one easily reason by analogy from international evidence – though some certainly tried. The differences between New Zealand and other countries, not least in our total prohibition of tort liability, arguably limit the applicability of foreign experience. To some extent the two sides simply talked past each other. In particular, the Parliamentary debates saw each side making almost no effort to persuade the other, but rather concentrating on recording their own arguments – presumably leaving the public to act as the ultimate judge.

As the chairman of the Corporation from September 1998 (and a former Labour Cabinet Minister) I was frequently expected to explain to incredulous (largely business) audiences why my former colleagues were intent on overturning the legislation allowing competition. My answer was simply, "they are not convinced that this is right". I could equally have said "because they believe that competition is wrong". However I put the matter in a negative form, because I believe that is the more apposite explanation. The government in 1998 had not convinced, indeed had perhaps not

even tried to convince, the then Opposition that the introduction of competition made sense. As with the Employment Contracts Act, the government simply used its majority in Parliament to enact legislation which was not going to last.

Under the 1998 Act, in respect of workers' compensation the Corporation was restricted to providing case management services, on an arms-length basis. It was obliged to organise its case management activities into a subsidiary company, managed at arms-length from the Corporation. The Government's objective was to ensure that such services would be available to the private sector so as to remove this potential barrier to competitive entry. In the event few private companies used the Corporation's services. Arguably however this nevertheless provided a useful focus on case management. The subsidiary (called Catalyst) even considered whether its case management skills might be applied beyond the management of return to work following accidents, to other causes of lost time such as illness. At the time of writing however this remains merely an intriguing vision.

ACC chose also to place its medical contracting and injury prevention services into two further subsidiaries, each with their own board of directors. Appeals against ACC decisions, previously heard by a distinct unit within ACC, were organised not into a subsidiary, but a joint venture with the one private insurer, Farmers Mutual, who expressed an interest in sharing this service.

During the debates on the 1998 Bill, the Labour Party signalled its intention to repeal this legislation if it were elected in 1999. Along with the Alliance, who had made a similar commitment, it was so elected. And the legislation was repealed, though the government's original intention of a complete replacement was achieved in two parts, in order to avoid delaying the restoration of the Corporation's monopoly. So it was not until 2001 that the 1998 legislation was repealed in its entirety.

V THE PRESSURE FOR COMPETITION

Having dealt with the legislative history, let me backtrack and try to answer the question: "Why did New Zealand experiment with competition?" This is an important question, in part because competition still has its proponents. Clearly the answer was not, "because the Working Party advocated it in 1991". The common explanation of these two episodes (and common also to the Employment Contracts Act) is the attitude of employers.

Above all else, the government's prime concern about accident compensation in 1991 was the cost being borne by employers. At that time employers still covered the cost of non-work accidents to employees. In 1991 the government reported that "employers are now funding nearly 70 per cent of the total scheme, while work accidents account for only 40 per cent of total scheme costs".

As against the original Woodhouse estimate that injuries to employees could be met by a flat-rate levy of \$1 for every \$100 of payroll (20c of which was thought would cover non-work accidents), the average 1988 employer levy was \$2.53. In 1989 this was \$2.45. In 1990 it was dramatically reduced to \$1.65. But the (political) damage had been done. Moreover, to achieve the

reduction in 1990 the scheme dipped into its reserves. Otherwise the average employer levy would have been \$2.47, plus a levy for OSH.

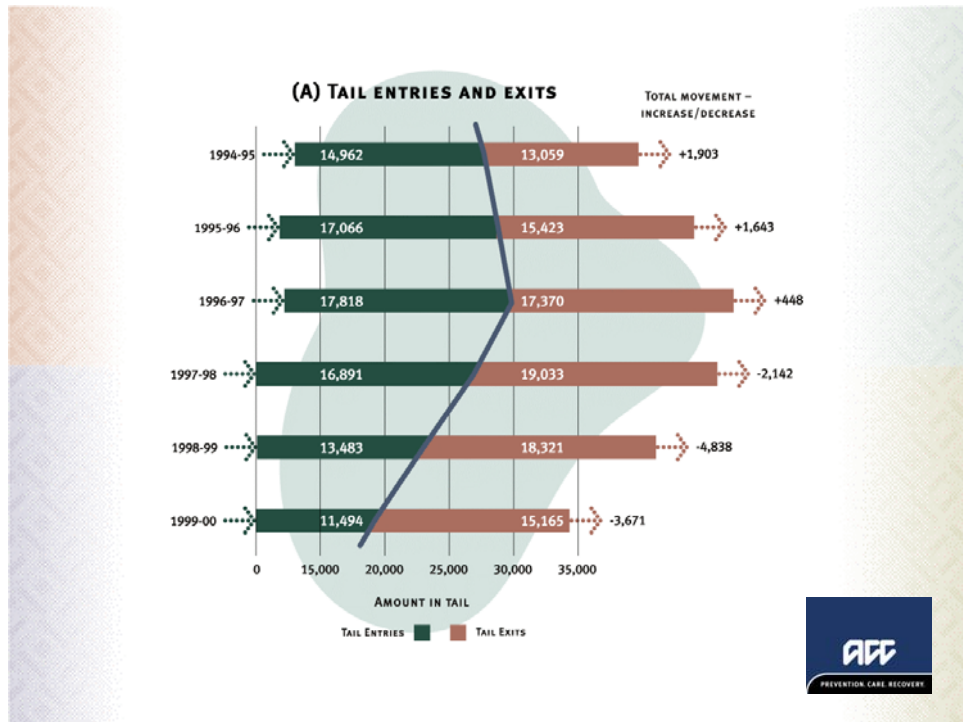
The second half of the 1990s, that is, the years prior to the introduction of competition, tell a similar story. In 1995/96 the average employer levy was \$2.17. It was \$2.61 the following year and \$2.61 again in 1997/98. This impost produced a revolt. Only this time employers could not pass the cost of non-work accidents back to the taxpayer. They had done that five years earlier. Instead they sought the safety-valve of competition.

It is worth completing the picture of the average employer levy. In 1998/99, the year prior to competition it was \$1.70. In 1999/00 it was \$1.47 (though arguably the private sector rate was an average of around \$1.20). The first year the Corporation resumed responsibility for workers' compensation the average levy was \$1.11 and for the last two years it has been 90c per \$100 of wages.

It would be gratifying to observe that we have finally achieved the Woodhouse Commission's forecast of an average employer levy below one per cent. Unfortunately this is not quite the case, because Sir Owen's estimate included the cost of non-work accidents which, I am afraid, now exceed the cost of accidents at work. All the same, this seems a remarkable performance.

No doubt some would argue that the improvement since 1997 was the result of the impending threat of competition. This is not my view. In the first place, the turnaround began before the legislation changed – indeed before there was any discussion of competition (apart from the rejected recommendation of the 1991 Working Party). If credit for the Corporation's improved financial performance is due to the previous government it is not for threatening competition, but for the remedial changes in 1996 to allow medical contracting and work capacity assessments. But the government did not allow these reforms to do their work before embracing more radical reform.

In my view the true explanation for the Corporation's improved performance is altogether more complex. No single measure explains the turnaround. Rather a combination of improved management measures are responsible – above all a significant reduction in the average time spent on the scheme. While the overall tail of long-term claimants has fallen since 1997, the number of claimants exiting the scheme has actually decreased in each of the last five years. But the total of those receiving earnings-related compensation for more than 12 months has fallen even more dramatically. This point is well illustrated by the chart on page 33 of the 2000 Annual Report.



In addition to the gains from contracting directly for surgery, the Corporation has developed such tools as treatment profiles and electronic claiming. Treatment profiles identify for case managers the normally expected recovery times and the recommended length and form of treatment. This information has been well received by general practitioners who typically do not specialise in accident work. The lodgement electronically of claims from general practitioners and other primary providers has meant the Corporation now receives more accurate claims earlier, which in turn has meant faster rehabilitation and reduced time on the scheme. Treatment profiles are an example of an improved management tool in the hands of busy case managers (though caseloads have also reduced significantly in the last two years). Call centres now stream claims so that the seriously injured are identified earlier and receive the attention they require. These management techniques together explain far more of the Corporation's improved performance than the legislative incentives of either competition or monopoly.

Finally, it needs to be acknowledged that the employer levy is not the only measure of performance and in any event arguably not the best one. Worthwhile cost reductions are the result of delivering improved benefits more efficiently. There is no point in scrimping on rehabilitation, for example, and claiming that as efficiency. Nor in taking a niggardly approach to the assessment

of incapacity and claiming that as cost containment. In reality the very opposite has happened with respect to injury prevention and rehabilitation. It might be said that the Corporation has moved from being a compensation agency which occasionally managed to rehabilitate its claimants, to a rehabilitation agency which compensates in the meantime those it has not yet managed to rehabilitate. In short, the title of the latest accident compensation Act, that is the Injury Prevention, Rehabilitation, and Compensation Act 2001 (however ungainly) has not been lost on the Corporation.

In 1989/90 the Corporation spent \$25 million on rehabilitation (from a total income of \$1.34 billion). In the latest year to 30 June 2002 the comparable figures are \$216 million from an income of \$2.45 billion. In 1989/90 the amount paid by employers and the self-employed was \$865 million. In 2001/02 it was \$780 million (including \$315 million to the residual account, covering accidents – still including non-work accidents - incurred prior to 1 April 1999). Arguably perhaps this \$780 million should be inflated to include the costs faced by accredited ACC employers, who currently cover approximately a quarter of the workforce. Even so, it is clear that in real terms employers contribute significantly less to accident compensation than twelve years ago despite (or rather because of) a great deal more effort going into social and vocational rehabilitation – reflecting, apart from anything else, the current government's priorities.

VI CONCLUSION

The 1990s were indeed a decade of change. They were also a decade which saw an experiment with competition considered, rejected, then tried and rejected once more. Despite that saga real gains in administrative efficiency were made – but not from competition so much as from a combination of improved management techniques. The real story of the 1990s – or at least of the second half of the 1990s - is the extent to which the Corporation's attention has been focussed on understanding and addressing the drivers of its business, that is what causes injuries and how best to speedily rehabilitate the injured whilst managing the liability for compensation. The realisation that the Corporation sits on a mountain of data which is capable of being mined through technologies unimaginable thirty-five years ago has led to dramatic improvements in the delivery and cost of accident compensation. That is the most significant change to occur to ACC in the decade of the 1990s.

