What can New Zealand learn from its 40 years of Accident Compensation history?

Geoffrey Palmer

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Abstract:

This paper will examine the original blueprint for accident compensation in New Zealand contained in the 1967 Report of the Royal Commission of Inquiry Compensation for Personal Injury in New Zealand and compare it with subsequent policy developments. In particular, there is an analysis of the policy decisions relating to administration. There are also some observations on the source of funds recommended for the scheme and the subsequent sometimes turbulent events relating to that subject. An attempt will be made to evaluate the strengths and weaknesses of what has been achieved.

Introduction

New Zealand's accident compensation scheme remains unique. First enacted in 1972, it replaced the system provided by the law of torts for compensating personal injury. The method was by jury trial in what is now the High Court. Negligence had to be proved. That was something of a forensic lottery. If the plaintiff won he or she secured an award of damages in a single lump sum. Also replaced was the older Workers' Compensation Act that went back to 1900. It provided low periodic payments limited to a period of six years, medical expenses and some modest lump sums. Workers' compensation required proof that the injury arose out of and in the course of the worker's employment.

A tort is a civil wrong. Negligence actions were governed mainly by the common law, that is decisions made by the Judges over the centuries and followed under the doctrine of precedent. The great tort of negligence emerged quite late, in an effort to meet changing social and industrial circumstances. New Zealand, along with most other common law countries, repaired the legal injustices that prevented worthy recipients recovering damages and provided two systems of compulsory insurance to ensure that those who were found to have injured a plaintiff negligently could pay the damages awarded by a jury.

The Royal Commission that reported in 1967, chaired by Sir Owen Woodhouse, produced a revolution. All of tort law was to be swept away for personal injury. Everyone who was injured by accident whether it was at work, on the road, at play or anywhere else would be compensated. And virtually no new money would be needed. It would all be paid for out of the funds that were compulsorily exacted to fuel the tort system and the workers' compensation system. That was because these systems not only denied many people adequate compensation, they cost a lot to run and much of the money was chewed up by insurance companies and by the costs of litigation. The basic thrust of the Woodhouse reform was to collapse all the existing programmes and replace them with one comprehensive co-ordinated system of earnings-related compensation for all incapacity resulting from injury. The scheme provided twenty-four hour protection for all accident victims, without the need to exact new taxes to pay for it.

The Report of the Royal Commission attracted much attention overseas and it inspired Gough Whitlam, the Prime Minister of Australia, to invite Sir Owen Woodhouse to chair a similar inquiry there. That inquiry began shortly before the time the New Zealand accident compensation scheme began to work. I met Sir Owen Woodhouse when the Royal Commission visited the University of Chicago Law School where I was a post-graduate student. I drove him back to his hotel in the Loop one night in an uninsured 1955 Chevrolet-Illinois not requiring compulsory vehicle insurance! When I returned to New Zealand I was asked to write the 1969 government white paper or commentary on the Royal Commission report, as a result of the Judge's suggestion. The report had proved to be a big policy to swallow without some more aids to the political digestion. Working with officials of the then Department of Labour was my first exposure to the New Zealand policy making process, a process I have seldom been free from ever since.

When the Woodhouse inquiry began in Australia I was summoned by Sir Owen from the University of Virginia, where I was teaching, to become the Principal Assistant of the Australian inquiry. That was a memorable policy experience indeed. The Woodhouse project in Australia was more ambitious than the

production of a replacement of the tort system. Listen to the first two paragraphs of the 1974 Australian report:

> "This report is concerned with the responsibility of society for the injured and the sick. Its theme is their need for automatic rehabilitation and compensation-without tags and without discrimination. The recommendation is for generous earnings-related compensation at every level of income up to $26,000 per annum. *[In 2011 Australian dollars this would be more than $186,000 per annum*] In consequence the present social security system of pensions that aims merely at an income for subsistence would need to be replaced. At the same time the new scheme would supplant the action at law based on fault. And the general system of workers' compensation would disappear. In the absence of risks relating to those remedies there would, of course, no longer be a basis for any form of compulsory insurance.
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> Social problems in the past have been handled in a piecemeal fashion.
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> But half-measures and compromise are quite incapable of meeting modern needs and reasonable aspirations of disadvantaged citizens. The obligations of the community should be thought through from first principles. The report attempts to provide that analysis. It proposes a new deal for every Australian whose life has been disrupted or damaged by injury or disease."

When the Whitlam administration fell in 1975 the scheme, the legislation for which had reached the Senate, fell with it. Had Sir John Kerr's intervention not taken place it likely would have been enacted.

The New Zealand accident compensation scheme remained and has been through many iterative policy ups and downs in the forty years since it was first passed by Parliament in 1972. What has remained constant has been the failure to avoid discrimination in the treatment of public programmes that relieve the consequences of some misfortunes but not others. One lottery replaced another. The person laid low by cancer or a heart attack is treated much less generously that the person who suffers an accidental injury resulting in the same incapacity.

The explanation as to why this occurred is simple enough. First, in 1975 there was an election campaign in which superannuation for people over 60 was the single most important issue. It led to the introduction of what was an extremely generous universal scheme that effectively removed the issue of financing an extension of the accident compensation principles to sickness and invalidity off the agenda from then until now. Expenditure on the aged as a result went up 57.6 per cent. The second reason for failure to act, although less important than the first, was the fact that the Royal Commission on Social Security in 1972 chaired by Sir Thaddeus McCarthy had not recommended anything along the lines of the 1967 Woodhouse report. There had been suggestions made to Sir Owen Woodhouse by officials that he chair that Royal Commission but that did not occur.

In light of this history it is worth examining how the Woodhouse reports, both in New Zealand and Australia, envisaged the relationship of the bold new accident scheme with the rest of the income maintenance system. What this will tell us in my view is that New Zealand has made some unfortunate decisions in relation to the administration of accident compensation. Those decisions have not only produced a poorly administered accident compensation scheme. They have also prevented coherent policy from emerging. The Woodhouse reports can be best understood as a superior system of the type proposed by Lord Beveridge in his 1942 report *Social Insurance and Allied Services* in the United Kingdom. This report made suggestions as to measures to adopt when the Second World War finished. Beveridge said "The advantages of a unified social security are great and unquestionable."

I am sure an interesting analysis could be carried out in New Zealand on the significance of various name and organisational changes in the relevant government agencies over the years. We once called it social security and there was a special social security tax. We had a Social Security Department in the days when the accident compensation scheme was devised, administering benefits under the Social Security Act 1964. Later came the Department of Social Welfare established by the Department of Social Welfare Act 1971. In 1992 there was a major restructuring of the Department into five business units. In

1998 and 1999 we got the Department of Work and Income and the Ministry of Social Policy. In 2001 the Ministry of Social Development arrived with the amalgamation of the Ministry of Social Policy and the Department of Work and Income.

What the New Zealand Woodhouse Report Recommended

The mists of time envelope most policies that survive for lengthy periods and produce misunderstandings, myths and manufactured explanations about what was done. So it has been with the Woodhouse report. The accident compensation reform was adopted by a National government in legislation passed in 1972. When Labour won the general election that year they extended it to non-earners, as had been recommended in the Woodhouse Report. But there have been different approaches over the years between National and Labour to what the appropriate accident compensation policy should be. At the beginning it was bi-partisan. Both parties still agree on the major policy issue, that a return to the tort system would be wrong and should not occur. But on issues of administration there have been divergent views.

It is not now well understood that the original Woodhouse blueprint never was followed in important respects from the very beginning. If it had been some of the cost issues that have arisen in the life of the scheme would not have happened-the report recommended very limited compensation for the first four weeks of incapacity, where the incapacity lasts no more than eight weeks. In 1981 I presented a paper to the triennial conference of the New Zealand Law Society in which it was pointed out that the adoption rate of Woodhouse policy as recommended in 1967 was about half. Of 36 major policy issues the Woodhouse report prevailed in 17. Successes included such vital questions as the removal of the common law action for damages and the principle of earnings-related compensation as opposed to flat-rate benefits.

There were major policy issues upon which the Woodhouse approach did not prevail. These included:

- administration
- the appeal mechanism for dealing with disputes
- limitations on the amount of short-term compensation

- compensation for permanent partial incapacity
- the method of raising levies, especially differential rating and penalties that Woodhouse was against
- widows' benefits
- a notional earnings floor for non-earners

Another matter that is relevant in light of recent experience flows from the manner in which the Royal Commission envisaged claims being dealt with. At paragraph 309(b) the Commission said:

> "Informal and simple procedure should be the key to all proceedings within the jurisdiction of the Board. Applications should not be made to depend upon any formal type of claim, adversary techniques should not be used, and a drift to legalism avoided."

Much could be said about all these issues and people interested in the history of the policy decisions should read my book published in 1979 by the Oxford University Press *Compensation for Incapacity-A Study of Law and Social Change in New Zealand and Australia.* For present purposes I will concentrate upon the issue of administration. Indeed, it has been in the administration that the most serious difficulties that have confronted the scheme over the years have their origins. It may be instructive, therefore, to compare what was recommended with what actually happened.

Fundamental to the logic of the scheme was the recommendation that the insurance companies should play no part in its administration. At paragraph 15 the Royal Commission said "The principal reason is that such a comprehensive and compulsory scheme of social insurance could not reasonably be handed to private enterprise." The scheme was founded upon the principle of community responsibility. Directly or indirectly everyone must contribute to it, and "clearly it should be handled through an agency of the Government." "It is our opinion," the Commission said at paragraph 209, "that private enterprise can have no claim to handle a fund such as the compulsory fund in New Zealand which has arisen not because employers have been persuaded to provide the business, but because Parliament has ordained that employers must do so." The prime reason for this was inefficiency. The Commission pointed out in paragraph 485(4) that

administration and other charges absorbed "as much as $40 for every $60 paid over to successful claimants."

Following the original conclusion reached by Lord Beveridge, the New Zealand Royal Commission said the solution lay "in a completely unified scheme for disability without demarcation by the cause of disability." The scope of the field was physical misfortune. This led the Royal Commission to the view, expressed at paragraph 249, "There would be great advantage in the integration of a comprehensive scheme of accident compensation into the present social security framework." After a discussion of the difficulties of reconciling the social security approach with the earnings-related approach the Commission said "some form of income-related benefits will be introduced as a modification or supplement to the present social security system."

The Commissioners also made observations in 1967 on compensating the sick.

At paragraph 290 they said:

> "It is possible to argue that if incapacity arising from accidental injury is to be the subject of comprehensive community insurance then interruption of work for reasons of sickness or unemployment, or other causes which cannot be guarded against should equally be included."

Despite the attractions of the argument the Commission reasoned it could not cross that bridge at the time. Nonetheless, it is clear that the relationship between accident compensation and social security was so close that integration ultimately was essential and the administrative arrangements recommended by the Royal Commission reflected the point. It is worth spelling out in full what was said on this subject at paragraph 307:

> "(a) The scheme outlined involves a partial merger with some aspects of the present social security system. There are important differences in principle, however, and the general philosophy of the scheme has no exact parallel elsewhere.
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> (b) We think, therefore, it should be brought to life and set upon its course by an independent authority whose whole responsibility it would be to

ensure the successful application in every respect of that general philosophy.

(c) It must be provided with all necessary administrative arrangements, nonetheless. With all these considerations in mind *we recommend that an independent authority be set up by the Government which should operate within the general responsibility of the Minister of Social Security and be attached to his Department for administrative purposes."*(emphasis added)

The Royal Commission did recommend that the authority should be under the control of three Commissioners. This was because of the powerful effect upon the Commission's thinking of the Ontario Workmen's Compensation Board. Nonetheless, the key point was that the scheme was to be associated with the social security scheme as it then was known.

That, of course, never occurred. The Accident Compensation Commission was established and one of the early decisions it made was to appoint the State Insurance Office as its agent to receive claims all round New Zealand. The Act contained power for the Commission to decide on the appointment of agents and it negotiated with the insurance industry. But in the end it appointed a single agent, the State Insurance Office. The issue was complicated by the change of government in 1972 and the necessity to extend the coverage of the scheme to non-earners and to do this quickly. The decision to use the State Insurance office sent the wrong signal in terms of Woodhouse principles

The National Government decided during the time the policy issues were in front of the Gair Select Committee that it wished to avoid any suggestion that the accident compensation system was connected to the social security system. Thus, the Department of Social Welfare was omitted from the Interdepartmental Compensation Committee and the Minister of Labour and his Ministry were the main drivers of the decisions leading to the parliamentary passage of the legislation. The connection with social security was severed then and it never returned, even when the Labour government extended the scheme to non-earners before it began to operate in 1974. Lawyers and trade unionists who had been active in the common law system had viewed with some alarm the possible involvement of the Department of Social Welfare.

The first big effort to revise the scheme came in the late 1970s. I wrote in my 1979 book "The administration of the Act in New Zealand has not matched the vision of the original blueprint. The style of administration has too often been characterized by an abundance of caution, a stubborn inflexibility, and an undue sensitivity to public criticism." I see no reason to revise that judgment in retrospect. But the scheme did accomplish successfully its biggest policy point, the removal of the common law action for damages.

It was in 1979 that a National Government Cabinet-Caucus Committee began a full scale review of the scheme led by Derek Quigley. Two bills based on the recommendations were introduced. One dealt with administration and passed quickly, the other cut down the benefits and contained a number of controversial changes the most important of which did not survive Select Committee scrutiny. The administrative change, however, set a pattern that essentially survives to this day. The administrative change was to abolish the Accident Compensation Commission and to substitute for it a statutory corporation presided over by a board. The Board was part time but a full time managing director was provided to control day to day administration. This was overseen by a policy unit in the Department of Labour which became the main policy adviser to government on the scheme, and indeed the Department had been central to the policy making process from the beginning. Section 267 of the Accident Compensation Act 2001 provides for a Board of not more than 8 members appointed by the Minister under the Crown Entities Act 2004.

In 2003 I published a paper that made a judgment on these issues in the following terms:

> "By setting up an independent Accident Compensation Commission of three Commissioners in the first instance and later a Corporation, neither of which were organised as part of the core State Services in New Zealand, the accident compensation system became something of a policy orphan within government. The Department of Labour maintained responsibility for policy development but, in practice, this was developed by the Commission and later the Corporation itself. There is now a small coterie of officials in the Department of Labour that provide advice. The policy-generating capacity

of the ACC turned out to be somewhat haphazard and unsatisfactory. Further, the organisation was left aside from deliberations within the core government departments for long periods of time, with the result that there was no integration of policy advice within the workings of central government."

The administrative problems that have been encountered by the accident compensation scheme over the years would, in my opinion, have been avoided to a substantial extent if the original policy prescription had been followed. At the outset the Department of Social Welfare should have been made the claims agent, not the State Insurance Office. The Corporation itself has not been a success. It is an outlier within the government system. The controversies that have beset it in recent times have been the result of poor decision-making, poor direction and slack administration coupled with a failure to appreciate the essential nature of the scheme. Over time efforts have been made to turn the scheme into something that it is not and was never meant to be. Having a Board has not in my view added value. A department of state would never have behaved in the way that the corporation has done in respect to recent controversies. It would be better to hand the administration over to a department of state operating on the conventional principles of ministerial responsibility.

Neither do I think the Department of Labour has been an effective adviser. It has no obvious policy expertise in the area and has not been able to provide advice to avoid various policy disasters being visited upon the government. The problem is structural and will not be cured until that structure is altered.

One further point. The Royal Commission report stressed the primacy of accident prevention and rehabilitation of accident victims as having priority over the issue of payment of compensation. That aim never seems to have been achieved and that is most unfortunate. New Zealand never received what was envisaged: a "unified and comprehensive scheme of accident prevention, rehabilitation and compensation."(paragraph 488(1). What prevented that being achieved more than anything else were the overlapping responsibilities of various government departments.

A few Remarks on Funding

I do not have time to go through the funding issues in detail since they are intricate. Suffice it to say that if New Zealand had retained the common law action for damages we would be a great deal worse off and the scheme would be costing much more but delivering less to fewer injured people.

The single most persuasive reason why the original scheme was adopted lay in the fact it called for no new money and made much better use of the money that was then being wastefully spent on the existing compensation schemes. Twenty-four hour cover for all injured people came at no significant extra cost. The levies that are now raised on employers and motor vehicles have their origins in the old insurance systems schemes. There was scepticism that the costs could be correct and that was a significant reason why the whole scheme was re-costed in the 1969 *Commentary.*

It is at this point that it is necessary to face the important issue of pay-as-you-go compared with a fully funded a scheme. Private insurance schemes have to be fully funded in order to ensure that the insurance company can meet the costs as the claims run off. This can take many years, especially in a scheme that pays benefits for a long time in the case of those seriously injured and incapacitated when young. Actuaries can assess these risks, based on a combination of empirical data and assumptions, and arrive at assessments of how much must be gathered in order to meet the future payments. Governments do not have to do this. They can increase or reduce the levies as things change. Obviously it is prudent to have substantial reserves in case of catastrophe so that collecting more than is needed for a period is wise-this is called a partially funded scheme.

Clearly, at the beginning there are only a few people who are permanently incapacitated and it takes fifteen years or even more for the scheme to reach its full costs-therefore it is wise to cost the whole thing on a "plateau" basis, even though during the first year only those injured during the first year would be paid. Thus, substantial funds are available for investment.

In discussing this question the Royal Commission said it was necessary to take in more than was needed in the first few years. But it observed at paragraph 479:

> "As the scheme will be a Government scheme of social insurance it must in the final resort have the backing of the State. It is for this reason that a formal system of funding cannot be regarded as essential to the stability of the scheme."

The extraordinary gyrations over the funding of the scheme over the years indicate misunderstandings as to the real nature of the arrangement.

Ill-judged changes in policy in New Zealand at various times have caused the costs of the scheme to become items of public controversy when a more sophisticated understanding and better policies would have avoided the problems. Employers objected in the 1980s to the levies they were paying because reserves were being accumulated by the scheme. They had also sought and obtained variable levies rather than the flat rate levies recommended by the Woodhouse Report. The 1982 Act removed the requirement that levies should be set on a fully funded basis allowing future levies to be a set on a pay-as-you-go basis. This produced a short-term reduction in levies and a subsequent blow-out in the levy rates and a running down of the reserves. When the levies had to be put up again as a result there was further criticism. The result has been that these levies are not regarded so much as a tax as an insurance premium in which the employers and self-employed have a vital interest. They see it as an opportunity where they can minimise their costs, for example by reclassifying the risk category into which their staff fall.

Related to these efforts by employers were the efforts there have been to privatise the scheme. The Accident Rehabilitation and Compensation Insurance Act 1992 was a mean and rather nasty set of amendments to the scheme most of which did not endure. The changes included the abolition of lump sum compensation and payment for partial loss, the introduction of insurance language into the Act, limits on compensation for medical misadventure, limits on rehabilitation payments and work capacity testing.

Then there was the short lived experiment to allow private insurance companies to write insurance for the earners' scheme that was passed in 1998 and repealed by the new Labour Government that came into office in 1999. But the scheme was changed in 1998 to provide for full funding, a necessary prelude to the introduction of competition from insurance companies. But when Labour repealed the privatisation it retained full funding. This seems to have been because of the decision to consolidate the Corporation's financial performance onto the Crown's balance sheet. With the accrual accounting required by the Public Finance Act 1989 this means that the future costs of the scheme and those seriously injured who will be on it for many years need to be reflected in the government accounts. I cannot see that this requirement makes a sufficient difference to the fundamentals to justify retaining full funding.

There have been suggestions within the last two years that the privatisation experiment may be repeated and extended, although there may be less enthusiasm for that now than there was before the Corporation erupted in crisis that produced the resignation of the Chief Executive, the chairperson of the Board, and two other directors. These events precipitated an urgent debate in Parliament on an issue of public importance on 13 June 2012. A new Board had been appointed by a Minister with an agenda. He suggested that the scheme was a financial mess. Massive increases in levies occurred in 2009 only to be reduced in 2011. A programme of changing the approach to the processing of claims by taking a more restrictive approach was introduced but without changing the legal entitlements. There were significant breaches of privacy by corporation staff that attracted widespread public concern.

More than a generation after the fault system was abandoned and the insurance companies with it private insurance company administration, on a competitive model was argued for and even briefly enacted. It was a triumph of optimism about private enterprise over very poor New Zealand experience in this field. While it was asserted such involvement would be superior to the state running a comprehensive system, there is no evidence to support that view. How could it not be wasteful, with many companies competing as it was before? How could it

not be that the incentives would be to avoid paying people when they deserved to be paid?

Do we have to re-live the lessons of history in order to believe them? Social insurance is quite a different thing from private insurance. The Woodhouse scheme is about the social goals and social purposes of a compassionate society. Some of the attacks by economists on the scheme are full of assertion about inefficiency and moral hazard. It seems to me that a proper understanding of the purpose of the accident compensation reform suggests that privatisation is no more appropriate for accident compensation than for New Zealand superannuation or Social Security in the United States.

Conclusion

I have only one observation to make in conclusion. The anomaly created by the accident compensation scheme remains. People who are injured are much more generously treated by the state than those who are sick, who suffer from incurable disease or have congenital deformities. We abandoned the common law because it was unprincipled. For the same reason I wrote about in 1977: "The unfair and unjust discrimination results because the choice of benefit depends on the cause of the misfortune." The Law Commission, when chaired by Sir Owen Woodhouse, recommended in 1988 that sickness should be covered by the scheme "as soon as possible."

We are still waiting.