

Welfare Working Group Forum

Will the benefit system deliver for NZ in the future?

I don't have a crystal ball. I take the real question (for the forum) to be how can we ensure the welfare system meets the country's future needs?

This question has been asked before. I'm sure Gary Hawke will remind us of the 1972 Royal Commission on Social Security:

" We found it hard to isolate basic principles, and to establish criteria for appropriate levels of income support ... where people's aspirations and consumption habits and society itself are constantly changing." (p 2)

And *" ... unless our system is to be fundamentally changed and based on something other than the relief of need, some sort of income testing is necessary." (pp 4-5)*

Arguably the McCarthy review was the last able to describe itself as taking place against a background of *"economic buoyancy"* (p6). It famously described the overall goal in these terms: *"the community must strive to ensure that everyone in it is able to enjoy a standard of living close enough to the general community standard for him (sic) to be able to feel a sense of participating in the community and belonging to it."* (p14).

There is still much wisdom here, including powerful arguments – the essential nature of which hasn't changed – against compulsory superannuation.

I have an abiding recollection of the reaction of Norman Kirk, as Leader of the Opposition. In response to the Royal Commission he began to advocate compulsory earnings-related superannuation. He saw this as appealing to higher-income, semi-professional groups, e.g. engineers, and trades-people, for whom the welfare system meant a significant reduction in income. (Earnings-related "welfare" had of course been introduced the same year with ACC). That advocacy kicked off at least 30 years of debate about superannuation: NZ Super led to dancing Cossacks campaign ads and National Super. Except that because

National Super wasn't accompanied by any tax adjustment, it arguably broke the bank and contributed to the fiscal distress of 1975-84, leading to the Super surcharge (1984), raising the qualifying age (1991) and the establishment of NZ Super Fund (1999?). So now we have a partial fund of what is still essentially a welfare (i.e. tax paid), flat rate benefit.

Except arguably ACC isn't earnings-related welfare. Arguably it's a form of insurance. You don't get anything unless an unlikely random event occurs. Contributions are compulsory. Entitlements are mandated by law (in return for the prohibition of tort liability – as with Workers' Comp that preceded it). It's also a monopoly – but I'm not going into that today. Except to say we could retain tort prohibition, compulsion and mandated entitlements and still lose the monopoly. Arguably we would then have a better means of assessing ACC's performance.

It's interesting to reflect on the differences between ACC and the welfare system. ACC collects levies to cover not just the current cost of treatment, rehabilitation and compensation paid out each year. Levies also cover all anticipated future costs of each year's accidents (as would those collected by an insurance company). I.e. it's "actuarially funded". Which provides considerable reserves – that ultimately reduce the dollar cost (but not necessarily the opportunity cost) of levies.

ACC's actuarial approach to funding carries several implications. It means the true cost of changes in entitlements are more readily identified – though not necessarily at the outset. Also that the trade-off between cost and affordability is more transparent than in a pay-as-you-go system.

The full-funding system provides a strong incentive to make preventive expenditure, where the benefits (in reduced future liabilities) can be realised immediately. Examples have included ACC giving away wrist guards to snow-boarders, hard-wiring smoke alarms into homes in regions with a high fire risk, and paying GPs to file claims electronically (thereby reducing the length of time claimants spend on the scheme).

In one sense ACC is unlike “normal” insurance. With only limited exceptions ACC levy-payers aren’t simply insuring themselves – and so the costs they face do not reflect their own risks or experience. The exceptions relate to the self-employed who are able to nominate the amount of cover they wish to purchase. And the limited extent to which pools of common risks have been created, notably in relation to the employers’ account (and to a limited extent in relation to classes of motor vehicles and motorcycles).

That the actuarial nature of the ACC scheme has led its administrators to identify and manage scheme costs can be seen in the scheme’s focus on long-term claimants, especially those on the scheme more than 12 months. These are a tiny fraction (less than 1%) of each year’s claimants. Yet they constitute in the order of 80% of the total costs.

At times this focus has seen dramatic improvements: from a peak of almost 30,000 “tail” claims in 1996, the number on the scheme more than 12 months fell to less than 14,000 by 2004. Two policy changes helped: the ability for ACC to contract for private surgery (rather than seeing claimants needing surgery waiting on public waiting lists), and the introduction of ‘work capacity’ testing.

In effect ACC changed from a scheme which insured the injured against the loss of a particular job (including permanent partial compensation if their new job was less remunerative) to a scheme which sought to prevent injuries in the first place, to rehabilitate those who regrettably were injured, and to compensate those (earners) who it hadn’t yet managed to rehabilitate. Although it is still popularly viewed as a compensation scheme (ACC) for some years it has spent more on treatment and rehabilitation than on compensation.

The question is: what lessons might ACC hold for the welfare system? I might tentatively suggest perhaps two. The more obvious perhaps is that if we could afford to move our system to a fully-funded basis we might in some respects be better off. For one thing we would have an enormous pool of capital (not unlike that in Singapore) to invest in

infrastructure or our share market. It is unlikely that we would be concerned with the country's savings rate.

On the other hand, every such move from pay-as-you-go to funding faces one inescapable difficulty: how to pay for the transition, i.e. the period during which one is simultaneously attempting to build up the fund from which to pay future costs, whilst at the same time meeting today's current claims. One can see exactly this challenge being played out in respect of our ACC scheme (where Parliament recently postponed the full funding date) and the on-again-off-again history of payments to our NZ Super Fund.

The second lesson is perhaps more positive, though perhaps of more limited application. It is simply that a focus on underlying costs can pay dividends. Of all the successes in the ACC's nearly 40 year history its near halving of the long-term claims from 1996-2004 is one of the most noteworthy. Equally the fact that the tail then crept back up in the next 5 years in significant part explains the blow-out in the scheme's liability, the subsequent need to increase levies, and the inevitable backlash. Even without actuarial funding there must be lessons here.

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