

## PART 8 - FINANCIAL PROVISIONS

### XXV - THE COST OF THE SCHEME

433. The feature of the proposed scheme is that it widely extends the range and level of compensation and yet avoids large new expenditures. Total estimated expenditure is \$38 million<sup>164</sup> and this (including Health and Social Security contributions) is within \$1.5 million of the amounts at present flowing directly into the compulsory work-connected and road injury schemes.<sup>165</sup> In addition there will be important indirect savings.<sup>166</sup>

434. The application of two basic decisions has made this result possible. First, available funds are to be used where really needed and not spread uniformly, and consequently thinly, over the whole range of injured persons. Second, collection and distribution of the funds is to be handled by existing facilities and on a co-ordinated basis which will avoid all duplication and administrative waste.

#### ALLOCATION OF FUNDS

435. The first point can be explained by example. In the group of work-connected accidents those who are absent from work for less than a fortnight are about 30 times as numerous as those absent for three months or longer. If there must be a careful allocation of funds as there certainly has been in the past, the emphasis, in equity, should go to this second group. After three months all sorts of problems could be accumulating for a family. And as a matter of arithmetic it is much easier to lift the level of compensation for this more serious but numerically much smaller group than to make uniform adjustments for those affected by short-term and longer term incapacities alike.

436. Moreover, insignificant additions to the general level of compensation will achieve little for anybody. In our view people would much prefer the assurance of completely adequate compensation in the event of serious injury and are prepared to accept some part of the manageable strain which might be associated with a short break from work.

<sup>164</sup>See Appendix 9, table 11.

<sup>165</sup>See Appendix 9, table 12.

<sup>166</sup>See para. 466.

437. Accordingly a limit of \$25 has been put upon the weekly rate of compensation for the first four weeks. Thereafter the limit is removed, and if the incapacity extends for eight weeks or longer the compensation would be reassessed from the outset at the full rate. On the other hand it is proposed that the duration of payments should now be extended to cover the whole period of incapacity (if necessary for life); and that artificially low limits for all these payments should be avoided.

438. Putting to one side allowances for dependants the limit of weekly compensation under the Workers' Compensation Act has recently been \$23.75. A year ago it was only \$21.75. This limit may be compared with the proposed limit of \$25 weekly under the new scheme which would affect the first four weeks of incapacity; and the general limit of \$120 which subsequently would apply.

439. The provision of compensation up to a weekly maximum level of \$120 is necessary if a comprehensive scheme for all accidents is to have real meaning for citizens throughout the normal range of incomes. And it can be done without draining away any amounts which should be retained elsewhere. The explanation lies partly in the four-week limit; but principally in the fact that once the compensation level is lifted to a maximum figure of \$40 the vast percentage of all cases has been satisfied.

440. Appendix 7, table 10 (which has been checked by the Government Statistician), discloses the position in respect of temporary incapacities for all work-connected accidents for employees and the self-employed alike. An amount of \$5,621,000 is required to meet compensation payments if the maximum is fixed at \$40, another \$69,000 to take the maximum up to \$60 and no more than a further \$34,000 to go on to \$120. In the circumstances financial reasons do not require a ceiling at all. We have thought, however, that at some point there should be a break in compensation supplied by a general fund and in our view this fair point is reached at \$120 weekly.

441. There is an administrative problem associated with providing compensation for persons who have no earnings. It is necessary to ensure that all in this group are fairly compensated for any significant incapacity; but it would be extravagant to provide compensation for every minor bruise or laceration. For such reasons it is recommended that for this group of injured persons the compensation should commence on the fifteenth day after the day of

injury. The adoption of the principle carries with it the advantage of an associated and substantial saving to the fund since it will apply to those whose injuries are received in what can be described generically as domestic accidents, many of which are of a minor nature.

442. The final point which should be mentioned in considering the allocation of funds is the proposal that compensation should commence as from the day following the incapacity for cases other than those mentioned in the preceding paragraph. Few persons suffer an income loss for the day on which the injury occurred, and we think that the amount required to pay compensation for this initial day can profitably be used elsewhere.

#### EFFECT OF ADMINISTRATION EXPENSES

443. Economic methods of administration provide the second explanation given in paragraph 434 for the fact that a great deal can be done without large new expenditures.

444. In earlier parts of the Report we have referred to the cost of administering the compulsory work-connected injury scheme.<sup>167</sup> The cost-claims ratio is 30:70, and accordingly more than 42 percent of the amount paid out in claims is required for expenses. This is a considerable drain on any fund and it is worth examining the effect it can have.

445. The estimated cost of the proposed scheme is set out in Appendix 9, table 11, which discloses that administrative expenses have been allowed at 11 percent on compensation. It is a figure equal to 10 percent of the total amount needed for claims and expenses. A similar amount is incorporated within the item for contingencies. Accordingly the overall cost of about \$38 million includes an item for administrative charges of approximately \$3.8 million. The two figures should be compared with the cost of a scheme designed to provide the same benefits but which would require for administration an amount equal to the ratio of cost to claims mentioned in the preceding paragraph.

446. On such a basis the provision of the same net benefits totalling \$34.2 million would demand an outlay for administration of \$14.65 million. Thus the overall cost for benefits and their administration would rise to \$48.85 million. The additional cost of such a scheme is \$10.85 million, and represents a steep increase of 28.5 percent on the total estimated costs for the scheme propounded in this Report.

<sup>167</sup> See paras. 182, 183, 213-217; and in general 207-212.

447. All this needs to be emphasised as it may be surprising to some people that so much can be offered by the proposed scheme for a superficially unlikely price. Comparisons cannot properly be made with the present achievements of the workers' compensation scheme, for example, unless the administrative charges under both schemes are allowed for on a similar basis. Accordingly if any realistic comparison is to be made with the present cost of the workers' compensation scheme then the proposed scheme should be thought of, not in terms of the actual estimated cost of \$38 million, but the much higher figure of \$48.85 million. As a corollary it may be said that by the adoption of streamlined methods of administration it is considered that the proposals avoid unnecessary extra charges of \$10.85 million annually.

#### ESTIMATED COST RATIO

448. We are in no doubt that the figure provided in the estimates for administrative charges is not merely attainable but probably in excess of the necessary allowance. In summary the reasons for this conclusion follow.

449. First, it is possible to examine the actual achievement of organisations elsewhere. We take the three different systems to be found in Ontario, California, and New South Wales. The results attained by the Ontario Workmen's Compensation Board during a period of seven years are set out in paragraph 213. They show that the expenses have ranged between 6.5 percent and 7.8 percent of income. Then there is the California State Fund which operates in competition with private carriers. During the five years to 1961 it achieved a cumulative average expense ratio of 6.96 percent; and even if all dividends paid are deducted from premiums earned the ratio is still no more than 9.5 percent.<sup>168</sup> Finally there is the Government Insurance Office of New South Wales which also operates in competition with private insurance companies. The part of premiums absorbed by administration in the workers' compensation branch of the business for the three years to 1966 was 7 percent, 5.9 percent, and 5.6 percent.<sup>169</sup> We have had the advantage of direct assistance from that office in analysing the figures and they provide a fair basis for comparison.

450. Second, there is the experience of the State Insurance Office which had a monopoly of workers' compensation business in New Zealand during a period of two years.<sup>170</sup> The experiment was a

<sup>168</sup>Stefan A. Riesenfeld, *Efficacy and Costs of Workmen's Compensation* (Occupational Disability and Public Policy, Ed. Cheit and Gordon), p. 312.

<sup>169</sup>Annual Report, 1967.

<sup>170</sup>See paras. 182 and 183.

limited one, but not without significance. In the first year of operation (1950) the expense rate was 14.61 percent; and in the following year it came down to 9.5 percent. And this despite "considerable non-repetitive expenses in commencing the monopoly scheme which came to account and were written off during these years".<sup>171</sup> The State Insurance Office is of the opinion that because of this factor and also "because the Office would have become more efficient as its experience in handling the business as a monopoly increased, the expense rate for 1951 must be considered the maximum rate provided premiums had remained at the same level".<sup>172</sup>

451. Third, there is the opinion of three major New Zealand based insurance companies which consider that their costs (for workers' compensation business) "for pure administrative functions on the basis of current benefits, rates, and costs could be held in the vicinity of  $8\frac{1}{2}$  percent to 9 percent on gross premium". The companies emphasised that the ratio quoted excludes all ancillary out-go for agency commission and present levy to the Workers' Compensation Board; and also for catastrophe reinsurance protection, margin for extra benefits before premium adjustment, and for profit. But the first two and the last of these items would not affect the proposed scheme: and the two remaining items are usually recoverable if the charges actually arise. In any event the interest earned on provisions for claims outstanding and on the catastrophe reserve itself are not brought to account.

452. Fourth, there are the unusual administrative advantages which will work in favour of the new organisation. It will be able to operate in a clear field; there will be no need to set up offices throughout the country to handle merely routine aspects of administration; levies can be collected by the simple and extremely inexpensive processes mentioned in paragraph 478; it will be able to avoid the employment of a large staff; it will be equipped with an efficient medical section; and the compensation process itself will not be complicated by contention or the need for prolonged investigation. Provided with some of the foregoing advantages the direct costs of administration of the Social Security Department are 1.7 percent of benefits paid.

453. Finally it is necessary to mention the item of \$6.95 million (set out in the estimated costs) for public hospital treatment. This would need to be included in calculating the overall cost of administering any scheme which had to collect and then disburse this

<sup>171</sup> Submission of State Insurance Office, p.11.

<sup>172</sup> Ibid, p.12.

amount. But the proposals put forward avoid all these problems, and the amount itself and all that it involves will be administered directly by the Health Department. Accordingly the item could properly be excluded when calculating the costs of administering the proposed scheme, and in effect a margin has been left in the item for administration amounting to as much as \$0.76 million.

454. The Government Statistician was asked to accept our figure for administration when making the estimate of cost referred to in paragraph 460. In doing so he referred to the present expense ratio applicable to the workers' compensation scheme, and expressed the view that stream-lined methods of collecting premiums and administration generally would be needed to achieve the 11 percent ratio we had asked him to accept as the basis for calculation. He also referred to the problems which could arise from the administration of incapacity benefits for non-wage-earning groups. In making these comments he was unaware, of course, of our detailed proposals for administration.

455. The Government Statistician is in no way responsible for the estimate we provide of likely administrative expenses under the new scheme. The evaluation is our own and made as a result of analysis of all the evidence made available to us in New Zealand and overseas of schemes actually in operation. The conclusions we have reached are that entirely orthodox methods of administering a monopoly insurance fund of the sort operating in Ontario enable costs to be kept within the margin we have fixed. When the special advantages listed in paragraph 452 are superimposed we are left in no doubt that the estimate of 11 percent is generous.

#### THE RATIO FOR WORKERS' COMPENSATION INSURANCE

456. Although we have reached the firm conclusion that the comprehensive scheme can be operated with great economy in administration we prefer to express no opinion upon the cost ratio at present applicable to the workers' compensation scheme. The insurance companies were invited to assist us in this respect but finally advised that no accurate information could be given upon the point both because the business was intermingled with other branches of insurance, and because the external arrangement and organisation of the various companies differed the one from another. Subsequently the three New Zealand based companies provided the information mentioned in paragraph 451, but we have no other direct contemporary evidence.

457. The issue, in our view, is secondary to the central fact that private enterprise and a universal compulsory and non-litigious system of compensation are incompatible; and secondary also to the other matters outlined in paragraphs 209 to 212. Accordingly it has not been thought necessary to pursue the matter—a task which would involve much research, time, and expense. It is enough to draw attention to the fact that the ratio is by no means a modern one. It has its origins in an agreement<sup>173</sup> reached between the insurance companies and the Home Office in the United Kingdom as long ago as 1923.<sup>174</sup>

#### CALCULATION OF COSTS

458. The estimated cost of the scheme is summarised in Appendix 9, table 11. The summary is the result of calculations made at our direction by two mathematicians employed on our staff for the purpose. In order to make use of the available statistics a considerable number of assumptions have been made, and these were all settled by the members of the Commission after evaluating the evidence in regard to them.

459. Periodic payments have been commuted to present capital sums by the application of the conservative interest rate of 4 per cent. Official statistics for industrial accidents have been increased by 24.6 per cent because there is a discrepancy between the cost of these accidents as reported to the Government Statistician by the insurers and the actual cost of the accidents as reported by the insurers to the Workers' Compensation Board. It has been assumed for the purpose of the calculations that the difference represents numbers of accidents short-reported over the whole range of work-connected injuries, although it can be argued that such an approach unnecessarily inflates the overall cost. The road accident statistics have been applied on the basis that 4 per cent of all injuries involve permanent disabilities. The Commissioner of Transport can give no accurate indication as to the number of persons so injured, but with this qualification he has advised that his department considers "that the number of persons permanently disabled would be something under 4 per cent of the total reported as injured in motor accidents".

460. The calculations were forwarded to the Government Statistician to be checked together with all the assumptions upon which the calculations were based. He has commented that as well as assessing the likely errors in these assumptions directly, "I have

<sup>173</sup>Cmd. 1891.

<sup>174</sup>See Wilson and Levy, *op. cit.*, 165; A. F. Young, *op. cit.*, 70; and see para. 214.

made an entirely independent estimate of the cost of your proposed scheme. Starting with the recent claims experience under employers' liability insurance I have pro-rated up to allow for various extensions and modifications in your proposed scheme. The coverage of your scheme I have taken as set out in your paper entitled *Proposed Social Insurance Scheme*. You have assessed the cost at close to \$38 million. On the information available I am unable to calculate the cost as closely as this, but, on the basis of 1967-68 populations, wage rates, and expenses, I believe the total annual cost including administration would be in the range of \$35 million to \$45 million". In making this estimate the Government Statistician has accepted our request that he should regard the cost of administration as requiring no more than 11 percent of other costs, as we mention in paragraphs 453 and 454.

## XXVI—SOURCE OF FUNDS

461. A comprehensive system of social insurance involves community responsibilities which should be accepted by the State and supported by contributions from citizens generally. On this basis it can be argued that the State should finance the proposed scheme from taxation. Our recommendation is different, for two reasons.

462. First, the comprehensive scheme is intended to embrace two compulsory insurance schemes already operating. To the extent that the necessary insurance premiums can be built into the costs of industry or transport this has long since been done. If these premiums were wholly rebated in favour of a general system of taxation there would be a continuing advantage to industry at the expense of the general taxpayer. A logical argument is an insufficient reason for shifting these costs in such a fashion.

463. Second, to the extent that the amount of these premiums has been passed on by industry their cost is already being shared by the whole community, even though indirectly. Accordingly the broad principle of community responsibility is in this way being satisfied already.

464. Accordingly we recommend that subject to appropriate adjustments the amounts at present flowing into the compulsory workers' compensation and third-party insurance schemes should be made available for the purposes of the proposed comprehensive scheme. These amounts require to be supplemented to reach the figure of \$38 million contained in the estimate of overall costs and provide some margin on the side of income. The details of all these proposals are contained in Appendix 9, tables 12 and 13. It is convenient to set them out in summarised form at this point.

465. The following table provides a comparison of present amounts expended in respect of the two compulsory insurance schemes and the contributions proposed for the new scheme:

				Present \$(millions)	Proposed \$(millions)
Insured employers .. .. .	..	..	..	15.0	15.0
Self insurers—					
Government .. .. .	..	..	..	3.1	3.5
Other .. .. .	..	..	..	1.0	0.8
Self-employed .. .. .	..	..	..	..	3.5
Owners of motor vehicles .. .. .	..	..	..	9.0	9.0
Drivers of motor vehicles .. .. .	..	..	..	..	2.0
Social Security Fund .. .. .	..	..	..	2.0	..
Health Department .. .. .	..	..	..	6.5	8.0
				36.6	41.8

466. Although the table provides a clear picture of present contributions to the two compulsory insurance schemes it fails to disclose the important indirect savings which the proposed scheme can effect. It is not possible to estimate these indirect savings. They include that part of the cost of servicing the adversary system which is not met by the insurance funds: the amount is not inconsiderable and includes unsuccessful litigation, costs of investigation, certain legal expenses, and the time occupied by medical and other specialists in providing reports or assisting in the preparation of a case. Then there is the present cost of public liability insurance in so far as it extends to the risk of personal injury. In 1965-66 total premiums paid in respect of "other forms of accident insurance"<sup>175</sup> (including public liability insurance) exceeded \$8 million. A different type of saving will arise in respect of personal accident insurance. It may be expected that some part of the total amount expended for this cover will not be required. In the year 1965-66 the total premiums were in excess of \$5 million. Next there is the sick pay which is provided by employers either by agreement or on a voluntary basis. The level of compensation proposed under the new scheme will provide a substantial saving in this connection. All these various items deserve to be considered when an assessment is made of the worth of the scheme propounded.

#### CONTRIBUTION FOR EMPLOYEES

467. The table discloses that at present insured employers provide sums totalling \$15 million for compensation which might become payable in respect of their employees. As we explained in paragraph 314, the premiums are classified in terms of the degree of risk supposed to be inherent in the industry concerned. There are 137 separate classifications at the present time, but despite this fact it is considered that the system does not always work justly as between industries. There is the even more important point of principle outlined in paragraph 314. All industrial activity is interdependent and there should be a general pooling of all the risks of accidents to workers. The same point is mentioned in paragraph 335, and in paragraph 336 we have expressed our conclusion that merit rating or experience rating has no significant effect in the interests of safety.

468. Accordingly we have recommended that the method of classification should give way to a uniform levy based upon salary or wages paid. The aggregate amount collected in the form of

<sup>175</sup>New Zealand Insurance Statistics, 1965-66, table 17.

insurance premiums is a little more than 1 percent of wages and accordingly a levy at this rate should be made in respect of wages in future.

469. The proposal will involve a readjustment of contributions to the fund as between various employers. In our view the adjustment is equitable for the reasons given. And to the extent that some industries will gain and others lose in the process of readjustment the movement will go in favour of the group of industries most directly involved with production.

470. For the reason briefly given in paragraph 316 the scheme must be compulsory and it should include all employees of the Government. For self-insurers there may be some small saving, as indicated in the table. For the Government there is likely to be an increase of about \$0.5 million. The fact is taken into account in the proposals outlined in the following paragraphs.

#### COST TO THE GOVERNMENT

471. It will be seen from the table that the apparent cost to the Government of the present system is \$11.6 million when payments made from the Social Security and Health Departments are taken into account. In making the various estimates we have received the assistance of the two Departments concerned. A number of incidental savings will be made which are not taken into account in the table. They include, for example, the fund for victims of criminal injury and the compensation made available by the Government for those injured in certain types of rescue work.

472. On the other hand it is part of the general proposals that the Health Department should assume responsibility for the cost of all hospital treatment of all injured persons in future. There will be a consequential loss of the amounts paid by the Workers' Compensation fund and recoveries through negligence actions. There is administrative waste associated with these various recoveries, and in addition we are unable to accept the principle that a comprehensive scheme of insurance for injury should relieve the health service of costs which it undertakes as a matter of national policy for the rest of the population.

473. After balancing these various considerations we recommend that although the Social Security fund is likely to be relieved of outgoings of approximately \$2 million, no direct grant to the new comprehensive fund should be made by that Department. In the result it is estimated that the proposed Government contribution

for employees together with the cost to be borne by the Health Department will total \$11.5 million, or approximately the amount at present being expended, as explained in paragraph 471.

#### THE SELF-EMPLOYED

474. The contribution proposed in respect of self-employed persons is new. It can be argued that if the community is to accept a general responsibility for a comprehensive scheme then it is undesirable to invite special groups to make direct contributions unless similar contributions have been made in the past. If the community as a whole bears the real cost of employee-insurance then the community through taxation should bear the cost of employer-insurance. However, we think this argument is an oversimplification and that to adopt it would be to deprive employees of an advantage they have enjoyed in this respect insofar as work-connected accidents are concerned.

475. Accordingly we recommend that self-employed persons should contribute an amount equal to 1 percent of net income, subject to an annual minimum levy of \$5 and the same maximum levy of \$80 payable in respect of an employee. Obviously this rate could not be justified unless the self-employed were able to deduct the amount involved in assessing income for taxation purposes. If the Government will permit employers to deduct the similar contributions made on behalf of employees then similar treatment must in equity be given the group of self-employed persons. The matter is referred to in paragraph 315.

#### MOTOR DRIVERS

476. In the past motor *drivers* have not been given automatic insurance under the compulsory scheme in regard to their injuries which might arise from their own negligence or mere "accident". Moreover, the new scheme will widely extend the compensation available to all victims of road accidents.

477. It is equitable that those concerned should provide some additional contribution to the overall funds needed. In our opinion, however, the levy should not be made against the owners of vehicles. It should be provided by those who drive them. The matter is mentioned in paragraph 313. Accordingly we recommend that a small annual levy of \$1.50 be charged in respect of all driving licences, and that this sum should be collected on behalf of the compensation fund by local authorities.

478. In a broad sense the amounts which will be subscribed to the comprehensive fund may be regarded as a form of taxation. Economical methods of assessment and collection of funds should be employed. We make the following recommendations in this regard—

- (a) The Inland Revenue Department should be used for the purpose of collecting the levies from both employers and self-employed persons. A separate section of the income return could be used for the purpose of the comprehensive insurance fund levy. The proposal has the advantage of avoiding the need for assessments, and it will enable the appropriate levy to be calculated and checked by processes already being used.
- (b) Owners of motor vehicles should provide as at present the appropriate levy to the Post Office at the time of re-licensing the vehicle concerned.
- (c) The various local authorities can be used, as we have suggested, for the purpose of collecting the levy from drivers of motor vehicles.
- (d) The Government contributions can, of course, be arranged by direct grant.
- (e) The Health Department charges will be self-administered by that Department.

By these means we believe cost of collecting the various levies can be kept to a minimum.

#### INVESTMENT OF FUNDS

479. The estimate of costs includes calculations of periodic payments after capitalisation at 4 percent. Actual income will accordingly exceed actual payments until the fund has been in operation for a number of years. A decision must be made as to whether a system of funding should be operated or the unused income set aside and invested on the basis that the scheme should be self-supporting from year to year. We recommend that the second of these alternatives be investigated with a view to adoption. As part of the proposals put forward we recommend an automatic review of benefits to keep pace with the cost of living. Adjustments of this sort add to the complications of actuarial calculation. As the scheme will be a Government scheme of social insurance it must in the final resort receive 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 whole scheme. However, whichever method is adopted clearly surplus funds should be invested.

480. The investment of such surplus funds will achieve the double purpose of replacing the investment of funds at present surplus to immediate requirements of the insurance companies; and the interest so earned will justify the estimate of cost provided with this Report and the estimate made by the Government Statistician.

481. Finally we recommend that the levies proposed in respect of earnings and in respect of the owners and drivers of motor vehicles should be pegged. To the extent that additional funds might be needed in the future quite clearly these should be provided from general taxation.