Why does the ACC need a fund?
- isn’t PAYG better?

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Four points

1. Government not an insurer

2. Borrowing to invest risks ‘our’ balance sheet

3. Pure PAYG preferable

4. We must first discuss benefits; then re-set levies
Point 1: Government not an insurer

Let’s think about ‘our’ balance sheet assets

New Zealand Limited

- Welfare services
  - NZ Super Fund
- Trading operations
  - ACC fund
- Education services
  - State housing
  - NZ Post
  - Real estate
Point 1: Government not an insurer...2

‘Our’ balance sheet

(Financial Statements for the Government of New Zealand y/e 2009):

- **Assets**
  - $93.4bn (financial)
  - $123.8bn (other)
  - Total $217.2bn

- **Liabilities**
  - $14.6bn (financial)
  - $62.0bn (debt)
  - $41.1bn (other)
  - Total $117.6bn

Net worth $99.5bn
Point 1: Government not an insurer...3

ACC’s balance sheet (ACC’s accounts y/e 2009)

<table>
<thead>
<tr>
<th>ACC Assets</th>
<th>ACC Liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td>$14.53bn</td>
<td>$27.28bn</td>
</tr>
<tr>
<td>(net assets)</td>
<td>(gross liability)</td>
</tr>
</tbody>
</table>

Net liability $12.75 billion
Point 1: Government not an ‘insurer’..4

NZ Super’s ‘balance sheet’ – only current pensioners

NZS Assets
Nil

NZS Liabilities
$80bn

Net ‘liability’ $80 billion

This picture is of zero concern either today or tomorrow
Point 1: Government not an insurer...5

- Pre-funding and reporting standards are essential for private providers

- Two main reasons:
  1. Security of contractual ‘entitlements’:
     - A provider may disappear
     - So NZ IFRS 4 requires disclosure
     - But the government will never disappear
  2. Paying for the liabilities that accrue today
     - Intergenerational equity for private policy holders
     - Owners and markets need to know profits
     - Owners need a return on investment
     - But the government has the power to tax

- So, why pre-fund?
Point 1: Government not an insurer...6

- The accounting and reporting logic also applies to New Zealand Superannuation (and the NZSF)
- If pre-funding is a good idea, what about:
  - Future health spending?
  - Future spending on education, defence, police?
  - Or anything else?
- The accounting standard NZ IFRS 4 has no place in the government’s balance sheet
- The government is not an ‘insurer’
Point 2: Risking ‘our’ balance sheet

- Borrowing to invest leverages outcomes – positively and negatively
- Borrowing to invest either smoothes ‘lumpy’ commitments or is speculation
- Borrowing in the presence of invested assets is the same economically as borrowing to invest

The choice:
- Borrow and maintain invested assets – that includes all financial assets
- Not borrow and draw down on invested assets
Risking ‘our’ balance sheet .... 2
- the government’s role

- A government should clearly identify its role
- Can it add value to the portfolio investing function?
- Question not confined to the ACC fund
- Portfolio investing best left to private sector
Risking ‘our’ balance sheet .... 3
- the investment hurdle rate

- Cost of government’s marginal long-term debt
- Currently about 6% p.a. gross (tax not an issue)
- ACC fund must achieve 6% p.a., guaranteed
- Hurdle rate changes with cost of debt
- ACC fund’s gross returns over:
  - Last year to 30.6.09: 3.2%
  - Last three years: 3.9% p.a.
  - Last ten years: 8.5% p.a.
- True position - excess return over hurdle rate:
  - Last year: -3.2%
  - Last three years: -2.4% p.a.
  - Last 10 years: 2.4% p.a.
Point 3: Pure PAYG preferable

- The actuary’s basic job – to calculate next year’s premiums
- Answers are based on a mixture of:
  - **Experience**: actual claims, assets, investment returns, people data, accident rates etc.
  - **Assumptions** (‘guesses’): future experience of existing claims, new claims, future premiums, investment returns, interest rates
- NPV ‘future liabilities less future income’
- Compare with assets
- Adjust difference through premiums now or over time
Point 3: Pure PAYG preferable...

- Role of actuarial calculations for insurers:
  a) Ensure ‘solvency’ now or over a period
  b) Monitor equity between groups of employers/employees/policy holders
  c) Assess provider’s profitability for owners/markets

- Solvency irrelevant to ACC
- ‘User pays’ more relevant than equity for ACC
- Profitability irrelevant to ACC
Point 3: Pure PAYG preferable…3

- Alternative approach based on PAYG principles
- Can be occupation/employer/pay/motor vehicle specific (as now)
- Add up the expected payouts in 2010/11
- Strike a 2010 levy that is expected to recover those
- For more certainty, use a 3-5 year smoothing
- 2010 levy will be somewhat less than now
- $10.7 billion of assets no longer needed
Point 3: Pure PAYG preferable...4

- Advantages of PAYG
  - Removes uncertainty of investment returns
  - Avoids worry about actuarial ‘guesses’ that must ‘work’ over very long periods
  - Simple to administer and monitor
  - Easy to understand
  - Lowers political risk

- Everything else the government does is PAYG
- The actuary can then retire
- If ACC partially privatised, premiums on that business must be calculated as now (still no need for a fund)
Point 4: None of this need affect benefits

- We have only discussed how to pay for the ACC ...
- ... not what the ACC should pay for
- Today’s employers/employees/individuals/car owners should pay for today’s costs – not yesterday’s or tomorrow’s
- They must decide benefits/costs
- Tomorrow’s employers/employees/individuals can decide their own benefits/costs
A thought:

“Goals: The line of failed past objectives which form a trajectory of future points to aim for.”

The Management Contradictionary