Accounting for Accidents: Social Costs of Personal Injuries

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The Social Framework: Two Levels of Accounts

The question of how New Zealand should pay for ACC has been around long enough to play a decisive role in the evolution of the scheme. Balancing the costs of ACC against revenues has led to periodic funding crises, which are frequent harbingers of legislative change. Over time, resistance to levies has shaped public conceptions of the overall purpose of the scheme, as in the current controversy over whether ACC should be seen as “insurance” or “welfare,” and what it means to call it “social insurance.” Accounting issues on this level mask larger questions about the complex risks associated with personal injury, and to what extent these risks can be reduced to financial terms. For such larger questions we must revisit the original vision for the scheme, going back to the 1967 Report of the Royal Commission. Indeed the Woodhouse Report was deeply concerned with accounting concepts. Its proposals for addressing personal injuries were framed by a fundamental accounting problem defined at the level of social costs. (By “social costs” I mean costs incurred outside of market exchanges—similar to what some economists call “external costs” or “spillovers.”)

This higher-order accounting framework appears on the first page of the Report. Personal injuries place a heavy toll on New Zealand society, we are told, as they do in other countries with similar levels of economic development. This toll of personal and public costs, along with society’s failure to offset them, provides the framework for all that follows. The toll includes a diverse mix of “direct” and “indirect” costs, both difficult to reduce to a single monetary figure—although Sir Owen cited estimates for the extended costs of workplace accidents. These costs fall initially on what the Report describes as “random but statistically inevitable” victims, with a series of effects that may include immediate pain, lost earnings, loss of future function, and reduced long-term economic prospects. The Report extends this accounting model to include the impact of serious injuries on victims’ families, on their workplaces, and onwards through the social and economic networks in which individuals are embedded. Acknowledging these network effects of personal injury, with their diffuse social costs, was one of many prescient insights found in this Report, which takes a whole-of-society perspective that has since found strong support in public health studies of injury and disease.

By 2003 injury researchers in New Zealand managed to assign a dollar figure to this complex toll—somewhere around NZ$6-7 billion per year. This sum is not a spending target dreamt up by a utopian social planner. Rather it signifies real losses accruing annually, extending from concrete victims to their families, to their associates, and to the community as a whole, in a cycle likely to repeat if nothing is done to prevent future injuries of the same type. These losses afflict individuals but are spread through social channels of interdependence, as the consequences of more serious injuries accrue over
time, encompassing past and future victims. These losses have already occurred and will continue to occur. By invoking this grim toll, the Woodhouse Report established an accounting framework for assessing the community’s combined efforts to remediate the damage. It was a heavy deficit that demanded immediate attention.

Responsibility for addressing these costs, according to the Report, belongs to the community that participates in the same risk-bearing activities that generate such losses. Remediating these costs requires multiple strategies. It means taking steps to reduce the likelihood of similar injuries in the future; it means halting the spread of loss through social and economic networks; and it means countering the impact on individual victims. Woodhouse identifies these three strategies as prevention, rehabilitation, and compensation, stressing that order of priority. From an accounting perspective, these coordinated responses from the whole community reduce the social deficit defined by the toll of personal injury. Defining injuries as a time series of social costs puts the mitigation emphasis on prevention and rehabilitation, anticipating models developed by public health research in later decades. Removing the compensation process from common law courts and social security allows society to address these losses more efficiently. A comprehensive plan for compensation reduces follow-on losses, and it builds an essential database for injury prevention. The Woodhouse Report, with its trademark clarity, balances all these remedial strategies against the scope of the underlying problem: the community mobilizes resources to meet the toll of personal injury. We may never close the gap, but we can move farther in that direction.

Today, the accounting issues surrounding ACC are confined to a different level from the one just described. These familiar issues focus on a more limited concept of injury loss, defined as the universe of claims properly filed under the ACC statute and its regulations. These statutory entitlements for compensation and rehabilitation must be funded by revenues of some kind, and the balance of claims and revenues must be consistent with generally accepted accounting practice used in the New Zealand public sector. Going back to the first ACC statute of 1972, entitlements under the compensation scheme have excluded many of the burdens contained in Woodhouse’s “toll of personal injuries,” certainly falling short of the annual figure of NZ$6-7 billion (using dollar values from 2003). Some of these burdens are ignored entirely; others are shifted to other programs (health and welfare payments; employers’ sickness benefits) and in some rare instances back to the tort system. By default, a portion of Woodhouse’s “toll” of costs remains where it falls—on the victims and extended members of the community. Along with these sunk costs, prevention strategies for future injuries have been slow to develop. The National Injury Prevention Strategy of 2003 was a welcome step. Even then, the priorities are targeted to reducing statutory claims, thereby easing pressure on ACC revenues. But prevention strategies cannot be entirely self-funded in this manner, and the question remains, who will pay the costs of future accident prevention?

Let me summarize these opening remarks by contrasting two separate levels on which accounts can be identified and balanced. On Level 1 we have what Woodhouse referred to as “the toll of personal injury” in New Zealand, to which later researchers have assigned a recurring annual figure of NZ$6-7 billion. Balanced against this sum are the combined remedial efforts of public and private programs devoted to prevention, rehabilitation, and
compensation. Even though we cannot begin to attach a dollar figure to this mitigation effort, it remains well below the overall injury toll. The Woodhouse Report articulated this vital social level of accounting more simply and elegantly than any other document of its kind.

Level 1

(L) Liabilities = “the toll of personal injury”
(A) Assets = all public and private efforts to mitigate L

On Level 2 we have a more concrete set of accounts, limited to individual claims for compensation and rehabilitation services under the ACC statutory scheme.

Level 2

(l) liabilities = claims properly filed under ACC statutory authority
(a) assets = revenues collected by ACC under its levy/tax structure

While there remains much to be said about (L) and (A) on Level 1, recent controversies in New Zealand have focused far more on (l) and (a) on Level 2, especially the difficulties of defining and allocating revenue burdens. Let me turn to these more immediate questions, while keeping in mind the larger framework provided by the Woodhouse Report.

**How should we pay for ACC?**

How New Zealanders should pay for ACC remains a sensitive issue, as the earlier presentations have explained. Susan St John’s historical survey shows the many twists and turns of this discussion during four decades. As an outside observer who has followed ACC for nearly its entire existence, I find this history useful for bringing the discussion back to basics. The problem of unmitigated social costs, presented with historic clarity by Sir Owen, has become even more urgent over time, and tells us something vital about our world. It parallels concerns arising within the environmental movement, and is closely related to discussions now taking place in Copenhagen.

So the problem of paying for ACC needs to be considered in light of the broader social purpose of the scheme. Funding a compensation scheme is one way to remedy the accounting imbalance at the higher level of social costs, as laid out in the Woodhouse Report. As that Report emphasizes, the toll of personal injury in New Zealand is already being paid—directly, by the injury victims, and also indirectly, by those who connect with them through families, workplaces, and communities. The question is how to shift some of these costs through taxation or levies to support a compensation scheme. One can also ask how the costs of preventing future accidents should be funded, since we know that real injuries will continue to accrue.

The Woodhouse Report made a strong effort to reconcile accounts at the level of (l) and (a). It offered practical reasons to build on existing funding streams associated with workers’ compensation and motor vehicle insurance, seeking to leverage these sources to provide the bulk of revenues needed to fund a comprehensive compensation scheme. It ultimately concluded that a small additional sum would be needed from general taxation to raise (a) to cover the proposed level of benefits under (l). During the years leading up to the 1972 statute, legislators trimmed back on the scope of benefits, excluding housewives
and other “non-earners” from the original scheme passed by the National government. These political battles have been chronicled many times, especially in Geoffrey Palmer’s detailed history.

As the accounting focus narrowed to the level of adjusting (l) and (a), the level of discourse frequently reverted to the pre-Woodhouse language of common law and workers’ compensation. Both fields embodied distinctive assumptions about when to shift injury burdens from victims onto others, each one posing a different question. In the common law tradition, cost-shifting turned on answers to the root question “who caused the injury?” In the case of workers’ compensation, the relevant question was “who was in a position to prevent (or mitigate) it?” The first question, which evolved early-on into the notorious “fault” principle, belongs conceptually to the nineteenth century; the second belongs to the first half of the twentieth. A third question emerged out of both traditions at about the same time as the publication of the Woodhouse Report: “who is in a position to prevent it most efficiently?” All three questions figure heavily in current ACC funding debates. The third one, in alliance with free-market advocates, opens the door to private insurance concepts, and has posed the strongest challenge to the Woodhouse framework.

(1) “Who caused it?” (“Whose fault was it?”) These questions shaped the long development of tort law from the early years of the 19th century. They reflect a moral asymmetry embedded in common law: that losses from injury stay with the victim, unless the injury was caused by a financially viable defendant. Even this condition was tightened up further to require that the defendant was “at fault,” that he or she had done something wrong in causing the injury. Questions about causation and fault are raised by defendants seeking to avoid shouldering the plaintiff’s loss: “it wasn’t my fault—I didn’t cause it—don’t hold me responsible.” Of course, the victims may also be blameless; but the loss remains with them unless someone else can be found who passes the fault test.

The Woodhouse Report repudiates this moral framework, which had been riddled with exceptions and anomalies during the first two-thirds of the twentieth century. By the late 1960’s many commentators across the common-law realm had lost confidence in the fault principle. It failed to capture the complex causality of motor vehicle injuries, let alone diseases linked to environmental sources. It was ruinously costly to administer, mired in fictions and abstractions, and subject to inconsistent results across similar cases. Woodhouse made at least two significant contributions to this growing critique. First, he measured the performance of common law from the accounting level of social costs. Common law methods come up scandalously short as tools for mitigating the toll of personal injury, leaving a large deficit of social costs. Second, based on his analysis that “all industrial activity is interdependent,” Woodhouse emphasized that personal injuries stem from multiple causes, too complex to disentangle, and too expensive even if we could. This view of causation had radical implications for funding the new compensation scheme. Injury victims would be entitled to compensation regardless of the cause of injury; and by the same token, those funding the scheme could not avoid responsibility by saying: I didn’t cause it—it wasn’t my fault.

As a long-time observer of the New Zealand scene, I have been struck by the paradox of a pioneering “no-fault” scheme in which all the vagaries of the fault system reappear in
debates about funding and levies. A scheme that was inspired by clear-headed accounting at the level of social costs has acquiesced over time in the old common-law ethic, which relieves the levy payer because he or she did not cause the injury—or was not “at fault.” The intuitions that haunt this discussion are ancient, of course, and can be excused as part of human nature. But the dominance of early ACC administration by lawyers may have helped perpetuate this style of contesting levies. Most recently it is the motor-bikers who protest that they don’t actually cause the serious injuries that many of them succumb to. And so it goes.

(2) “Who is in a position to prevent (mitigate) it?” In historical terms, a very different kind of question emerged to address the social costs of personal injury in industrial workplaces. Shifting these burdens onto industry came early to New Zealand and spread throughout the industrial world in the early twentieth century. Historians disagree on the motivations behind this movement, but it signalled a growing awareness that the incidence of personal injury is governed by collective factors—by organizations, technologies, and environments. The Woodhouse Report expresses a forward-looking version of this perspective:

“People have begun to recognize that the accidents regularly befalling large numbers of their fellow citizens are due not so much to human error as to the complicated and uneasy environment which everybody tolerates for its apparent advantages. The risks are the risks of social progress, and if there are instinctive feelings at work today in this general area they are not concerned with the greater or lesser faults of individuals, but with the wider responsibility of the whole community.” (Par 89).

Further evidence for this growing feeling, according to Woodhouse, was the widespread acceptance of private insurance, with its capacity to spread losses across vast segments of the population. In the early twentieth century, businesses had been asked to underwrite comprehensive insurance, not because they were the “cause” of workplace injury, but because they were in the best position to mitigate it through insurance, and to pass costs on to consumers. But compensation was only one aspect of the larger movement for progressive reform. Industrial safety specialists believed, perhaps naively, that individual companies could and would engineer their way to reducing future injuries. The basic intuition seems correct that injury prevention requires an organizational focus. But the competitive pressures of industrial capitalism made it difficult for any single enterprise to invest in safer work conditions, or indeed in safer technologies.

Shifting the toll of personal injury to those who could prevent or mitigate loss was a promising idea at first, but lost its focus as the twentieth century progressed. In the case of motor vehicle injuries, which posed a crisis at mid-century, the larger safety issues fell to the state, and the trend to “no-fault” insurance reflected the high cost of trying to apportion burdens according to causation or blame. As Woodhouse emphasized, limited no-fault regimes backed by compulsory insurance could mitigate only one portion of the larger toll of personal injuries. Many people suffered injuries outside of work and off the highways. And more strenuous mitigation was needed beyond pooling the costs of compensation, requiring some state-directed efforts at injury prevention. At the time of the Woodhouse Report American law was beginning to confront the surge of “products
liability” claims, and some American commentators were looking to collectivize both compensation and prevention by promoting the judicial doctrine of “enterprise liability”—having decided that companies were in the best position to prevent (and mitigate) injuries from manufactured products. But even this way of shifting injury losses relies too much on the older concept of causation. Given the “interdependence” of all industrial activity (par. 467), the Report argues that the problem of injury prevention cannot be apportioned to separate industries, let alone to individual companies. Much can be done to promote safety at the company level, but the oversight comes rather from health and safety regulations, not the tort system.

(3) “Who is in the position to prevent it most efficiently?” At nearly the same moment that the Woodhouse Report was published, a new theory was floated among scholars of law and economics, initially following the progressive cost-shifting strategies of the workers’ compensation movement. Prevention, not cause, was the main focus, but exactly how much prevention is warranted, and how can prevention be efficiently organized? Among the pioneers of this movement were scholars with liberal leanings, including the famous Professor Calabresi. But the rhetoric of “efficiency” was soon captured by the market-friendly political movements of the 1980’s, expressed nowhere more purely than in writings by the New Zealand Business Roundtable. The key point was that injury burdens should be balanced through the framework of market exchange. The alleged social costs of injury should be addressed by creating new markets for insurance and risk management. Any government mandates that could not pass the test of market efficiency came under strong suspicion. In practical terms, that suspicion tends to strengthen the market status quo. From this perspective, it is less important to compensate past injuries than to treat past events as financial signals to risk managers, who then decide how much to invest in future prevention. A public compensation scheme is rather anomalous, since injured people should already have purchased first-party insurance. Going forward, society should strive to achieve only that level of prevention it is willing to pay for, taking into account the scope of future claims. Risk reduction is an investment decision best left to individual companies and persons.

This analytical approach to allocating injury burdens first entered into the ACC debate in the 1969 White Paper, which provided the conceptual bridge between the Royal Commission and the 1972 legislation. The White Paper explains the logic of market allocation as follows:

“Some say it is best to make the enterprise producing the accident liable for the risks. The losses should be spread among those whose activities create the risk of accidents. It has been argued that such a system would be more efficient in deterring accidents than if the costs of accidents are spread throughout the community. The idea is that, to the extent that the claims met by the fund result from injuries that can be attributed to identifiable activities, the claims should be a charge on those activities.” (par 205)

The Woodhouse Report had little patience for this approach, for all its novelty and sophistication. The White Paper logic assigns injuries to specific risk-creating “activities” and the individual enterprises that “produce” them. It was a step backward to causal
notions reminiscent of common law, combined with the workers’ compensation belief that separate industries and discrete enterprises could fine-tune risk-bearing behavior. By contrast, the Woodhouse Report maintained that all risk-bearing activities were interdependent, and microeconomic calculation cannot sort them out. When bikers are seriously injured, should we assign the risk to bike-riding alone, or does part of it belong also to motor vehicle drivers, to law enforcement officials, and to roading engineers? Should we expect all these groups to bargain among themselves over risk-reduction, and should we trust the market to produce the right answer?

Woodhouse concluded that payments for compensation and prevention should ideally be funded from general taxation, with no further allocational criteria. As a practical matter, however, the Report found most of the needed resources in two existing insurance streams for workplace accidents and motor vehicle accidents. It was prepared to abandon the classification scheme setting differential workers’ compensation payments by industry. A contrasting view was expressed at the same time by Prof. Terence Ison, whose work is often compared to the Woodhouse Report. Ison had absorbed the market-allocation model and feared that uniform levies across industries would require the low-risk industries to “subsidise” the high-risk ones. (Ison, The Forensic Lottery, p. 58) Ison’s view was shared at the time by the influential Ontario Workman’s Compensation Board.

The market allocation model differs profoundly from the Woodhouse framework. It shifts the focus away from social losses that have already occurred, and toward risk-management investments that turn a future profit. There is much more that could be said about these differences, but time is short. Suffice it to say that using levies as a tool for managing personal injuries imagines a world in which the risks of modern living have been fully reduced to financial terms. The New Zealand proponents of this approach accept the ability of private insurance markets to perform these reductions. But it seems clear that insurance markets today depend on more esoteric financial instruments for managing large-scale risks. And, of course, the recent meltdown of global financial markets shows that such instruments can be overused.

In retrospect, the late 1960’s can be seen as a turning point for personal injury policies. One could choose either the political remediation of social costs, as in the Woodhouse Report, or the market management of future risk—which took up residence within the ACC levy system. The risk-allocation philosophy introduced in the White Paper, endorsed by the Gair Committee, and built into the early statutes was destined to emerge in periodic disputes about levies, currently distributed across six separate levy accounts. This feature of the scheme has fueled four decades of debate about cross-subsidization and distorted economic incentives. Its logic collides with the basic principles of the Woodhouse vision, and it remains the leading source of political conflict within the scheme.

**Conclusion: The Funding Debates**

So what does all this mean for today’s main topic about ACC funding? Two frameworks stand behind these discussions and compete for middle ground in a statutory scheme that has drifted rather far from its original vision. The two levels of accounts explained earlier
in my talk define these alternative viewpoints, each one creating a force field within the overall scheme.

Level 1  
(L) Liabilities = “the toll of personal injury”  
(A) Assets = all public and private efforts to mitigate L

Level 2  
(l) liabilities = claims properly filed under ACC statutory authority  
(a) assets = revenues collected by ACC under its levy/tax structure

The framework of social costs shifts the discussion of ACC levies to a different level. One difference is the scope of liabilities—(l) is only a subset of (L). Another is the potential scope of remedies (A), which far outstrip the strategies and resources used by ACC (a). The notion of “social” insurance rests on this higher level of accounting. If ACC’s mission is guided by these accounting concepts, then it serves the social insurance principle. Many New Zealanders acknowledge this larger mission as the “social contract” background of ACC. In practical terms it means that ACC entitlements are elevated to a preferred position above those of standard welfare goals. Seen as social insurance, ACC programs remediate the “toll of personal injury,” which presses forward, regardless of limitations on ACC levies.

The market-based challenge to social insurance principles has had spectacular success throughout the world in recent decades. The market alternative puts all its energy into category (a) on Level 2, and sees injury prevention and compensation as constrained by the need to ensure that all revenues contributing to (a) promote more efficient risk management. Safety thus becomes a commodity competing on the basis of price with other commodities, regulated only by sovereign consumers. Having abolished common law actions for personal injury, New Zealand would be in a unique position to implement this market philosophy in its purest form, relying entirely on private first-party insurance and the free purchase of financial risk instruments. This utopian goal is essentially what the New Zealand Business Roundtable has been advocating for more than two decades. To them, any concern with social costs on Level 1 is special pleading for social welfare.

This clash of visions summarizes much of what has happened elsewhere in public life over the past half-century. From an international perspective, New Zealand is important because of the Woodhouse Report and its unique eloquence in making the case for “community responsibility.” New Zealand is also important because this vision was powerful enough to support large institutional changes, including the abolition of most personal injury lawsuits. On a practical level, however, these two frameworks now seem caught in a stalemate, where neither side can gain much ground. After nearly four decades, the New Zealand public generally accept ACC as a noble experiment; but interest groups still resist their portion of the levies. When changes of government take place, these two views seem fated to collide. And we then hear the familiar clash of labels: “insurance” versus “welfare,” and “social insurance” versus “privatization.”

Earlier presentations today have focused on the competing models of full-funding versus pay-as-you-go. From the standpoint of social costs (L), it seems artificial to talk about the full costs of statutory claims (l), when the boundaries of the scheme may expand to include more social costs on the higher level (L). By its nature the statutory ACC scheme has
addressed only a portion of the “toll of personal injury” cited by Woodhouse, limited by available revenues. The constraints on prevention are even greater than those on the more visible entitlements of compensation and rehabilitation. Parts of (L) not included in the scheme will be shifted to other public programs or left with the victims themselves. Of course, there have been moments, as in the 2005 Amendments adding treatment injuries to the ACC scheme, when (L) has expanded to reflect more social costs. In light of these transitions between accounting levels, it makes little sense to speak of full-funding for (L).

Assuming one is concerned with fairness to future generations, it may be more important to expand the scope of social costs recognized by (L)—including more injury prevention—than to ensure that (L) and (A) are in full balance.

The goal of full-funding follows directly from the logic of financializing risk. What matters most is justifying the cost of levies (A), based on a full specification of liabilities (L). The practical effects of full-funding may be to reduce coverage, but the immediate goal is to bring all elements of the scheme within the scope of financial calculation. Before markets can price risks properly there must be a full assessment of liabilities, notwithstanding that future prices are discounted to present value, and reconstructed in accordance with actuarial assumptions. This preoccupation ignores the “social contract” aspects of the scheme—or pretty much everything that happens on Level 1, including the original vision on which the entire no-fault scheme was based. If the goal is to integrate injury costs into the market calculus of risk management, getting the prices right on Level 2 becomes an end in itself. The most ardent full-funders make frequent reference to the practices of private insurance, which remains their conceptual standard, as well as the most likely policy goal they hope to achieve.

Here too the probable outcome is a pragmatic middle ground. Paraphrasing St. Augustine, it is possible to ask for full-funding, but not just yet. The difference between 2014 and 2019 is something both sides have chosen to finesse. PAYG proponents are willing to accept a range of modifications for purposes of smoothing, reserving, and buying peace with political opponents waiting to pounce on the next accounting blip. Despite the likely stalemate, the significance of this controversy should be understood in terms of the larger clash of principles discussed throughout this paper. ACC has muddled through nearly four decades, but the future of the scheme is certainly not guaranteed. The world is watching carefully how New Zealanders mobilize their arguments, and how this unique system will survive the policy battles yet to come.