

**Submission  
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## **INQUIRY INTO NSW WORKERS COMPENSATION SCHEME**

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Business  
Council of  
Australia



# Submission to the Joint Select Committee Inquiry into the New South Wales Workers Compensation Scheme

MAY 2012

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*Working to achieve  
economic, social  
and environmental  
goals that will benefit  
Australians now and  
into the future*

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### About the BCA

The Business Council of Australia (BCA) brings together the chief executives of 100 of Australia's leading companies.

For almost 30 years, the BCA has provided a unique forum for some of Australia's most experienced corporate leaders to contribute to public policy reform that affects business and the community as a whole.

Our vision is for Australia to be the best place in the world in which to live, learn, work and do business.

The Business Council of Australia welcomes the commitment of the New South Wales Government to improving the performance of the WorkCover system. We are pleased to have this opportunity to provide input to the Inquiry into the New South Wales Workers Compensation Scheme being conducted by the Joint Select Committee on the NSW Workers Compensation Scheme.

### Introduction

Consideration of the New South Wales Workers Compensation Scheme indicates its current design and operation are out of step with other state schemes. The evidence suggests it is a major and rising cost on the state's employers, while at the same time it is not succeeding in providing the opportunities NSW workers need to support them in an early return to work.

The New South Wales Workers Compensation Scheme is both costly and failing to improve employment outcomes for injured workers.

Reforms to the scheme have the potential to improve its focus, realign incentives and improve its management. Such changes would put the scheme on a more sustainable footing, and could improve both outcomes for workers and reduce costs and compliance impacts on firms. This would then allow NSW businesses to redirect resources to higher-value uses, freeing up their capacity to create new, higher paying jobs and expand wealth creation in New South Wales.

An important outcome of this current review should be not only the identification of the changes required but a clear time frame and allocation of accountabilities to implement the needed reforms.

### Where are we: current policy settings

The NSW Workers Compensation Scheme Issues Paper clearly highlights a number of problems with the current NSW scheme.

- In its current form the scheme lowers the state's competitiveness.
- With a significant \$4 billion deficit, as at December 2011, and net outstanding claims liability of up to \$16 billion, the scheme is arguably in an unsustainable financial situation.
- Misaligned incentives and administrative complexity within the scheme are also resulting in sub-optimal targeting of benefits and utilisation of resources, and excessively high premium imposts on firms.

**Example: comparative firm impacts under different state jurisdictions**

The table below, previously released by the New South Wales Government, demonstrates that the current NSW scheme is more costly on many fronts than other state schemes, putting NSW businesses at a comparative disadvantage, which has implications for the job security of NSW workers.

**Interstate comparisons**

Employer description	Annual wages	Premium Rates			
		QLD rate & cost	VIC rate & cost	Current NSW rate & cost	NSW rate & cost plus 28%*
Small residential construction outfit	\$250,000	2.79% \$6,983	1.03% \$2,570	5.04% \$12,600	6.45% \$16,128
A regional café employing 11 staff	\$326,126	1.26% \$4,103	0.60% \$1,957	2.64% \$8,613	3.38% \$11,025
A regional club employing more than 460 people	\$19,096,377	1.90% \$361,876	1.08% \$206,623	3.12% \$595,616	3.99% \$762,388
A Sydney computer consulting firm	\$800,000	0.20% \$1,576	0.05% \$400	0.24% \$1,904	0.31% \$2,437
A small Western Sydney cleaning company	\$151,589	3.23% \$4,901	2.45% \$3,709	7.05% \$10,681	9.02% \$13,672
STATE AVERAGE		1.42%	1.34%	1.68%	2.15%

\*28 per cent is the estimated premium rise necessary to put the fund on a more sustainable footing.

Source: New South Wales Government media release, 23 April 2012.

## Where do we want to be

Policymakers should work to ensure NSW workers and businesses have access to a scheme that:

- ▶ is sustainable
- ▶ provides the right incentives
- ▶ achieves its policy objective at least cost
  - this objective should be to support workers through to an early return to work.

Excessively costly regulatory regimes lower employment and other opportunities, so care should be taken in scheme design. Compliance costs themselves have consequences, reducing the ability of firms to expand, innovate and invest.

Ensuring the scheme is adequately capitalised and sustainable is in everyone's interests.

The BCA, in its 2003 *Submission to the Productivity Commission on National Workers' Compensation and Occupational Health and Safety Frameworks*, previously identified the benefits of moving to a national workers compensation scheme.

Moving towards a best practice national regime would provide significant administrative and cost savings to businesses that operate across jurisdictions – currently there are schemes in every state and territory and three federal schemes in operation around Australia. As the Productivity Commission argued in 1995, resources that should be dedicated to the prevention of injuries and improving productivity in workplaces are instead directed to determining which legislation, regulations and guidance are to be complied with.

Noting the 2007 moratorium on the ability of firms to opt-in to the federal Comcare scheme, the BCA urges all governments to continue to work together to streamline rules and lower unnecessary costs on businesses that operate across multiple jurisdictions.

Notwithstanding the recent absence of progress in streamlining such arrangements, the BCA provides comment below on the general direction of reform that New South Wales may wish to consider.

## Policy objective

The BCA recommends that New South Wales should review the objectives of its workers compensation policy to ensure a focus on supporting workers in an early return to work.

It could be argued that the current poor state of the scheme is due to incremental and ad hoc changes to the scheme over time, which have diluted the scheme's central objectives – resulting in a significant misallocation of resources and worsening outcomes for both workers and business.

In considering change, a central objective of the scheme should be to:

- ▶ Focus on supporting the early return to work of injured and ill workers
  - noting that early participation in work, proportional to their abilities and new medical circumstances, has economic, social and self-esteem benefits for workers themselves.

The BCA is strongly supportive of ensuring all citizens can realise their potential, so as to optimise their participation in economic and social life. The objective of normalising a return to work should be a key objective of the scheme.

It is important to bear in mind that poorly targeted, overly generous benefits are not always in the longer-term interests of workers, let alone the broader community. For example, extensive scientific evidence<sup>1</sup> suggests being on compensation results in worse health outcomes for workers.

1. Numerous scholarly articles support this claim and the related claim that being in work is generally beneficial for health. See, for example, the Royal Australasian College of Physicians Realising the Health Benefits of Work 2011 program (<http://www.racp.edu.au/page/afom-health-benefits-of-work>).

Extended absences from work also deteriorate human capital, through loss of skills, confidence and foregone training and development opportunities. Removing incentives which create perverse outcomes and expanding opportunities for economic and social engagement can thus benefit everyone.

Getting workers healthy and back in the workforce (and being valued for their input) will obviously have positive effects for workers themselves and will also help minimise scheme costs.

A related objective should be to ensure the scheme is:

- ▶ Focused on managing the risk of *work-related* injury and illness
  - it should thus give employers incentives to manage risks they have the capacity to address.

Currently the scheme pays benefits for some injuries which are not clearly work-related, or injuries which occur where the employer has no capacity to address the cause of the injury (for example, regular travel to work). This simply raises scheme costs and reduces its ability to meet its central objectives.

- ▶ Furthermore, the scheme should reward prevention strategies.

This could be achieved through the introduction of a risk assessment process where data is analysed to identify the key types of workplace injury and illness and options for prevention, as well as incentives to employers who demonstrate robust prevention policies and have an exemplary injury reduction record.

A greater focus on prevention is in everyone's interests.

### Comparison of the objectives of the Victorian and New South Wales Acts

While both the Victorian and the NSW Acts express similar aims, Victoria's is arguably much more focused on helping workers return to work, while prudently managing costs. The NSW Workers Compensation Act 1987 does not contain an objectives clause, while the NSW Workplace Injury Management and Workers Compensation Act 1998 tangentially mentions the need to 'to promote [injured workers'] return to work as soon as possible'. In contrast, the second and third objectives – after prevention – of the Victorian Accident Compensation Act 1985 are to [emphasis added]:

- 'make provision for the effective occupational rehabilitation of injured workers and their *early return to work*'
- 'increase the provision of suitable employment to workers who are injured to enable their *early return to work*'.

A strong focus on enabling workers to rapidly return to work is likely to have helped Victorian workers retain valuable workforce attachment and social engagement while also contributing to Victoria's superior scheme cost and sustainability outcomes.

### Specific observations

While the BCA is largely supportive of all the reform options presented in the issues paper (from p. 21 onward), we would make the following additional observations.

#### Getting incentives right

Improving incentives, and removing perverse incentives, will improve the allocation of resources in and of itself. It will consequently also help raise productivity and worker engagement.

### ***Incentives for workers***

Consistent with the desire to help rehabilitate workers, the scheme should give workers an incentive to return to work, and ensure that this is the norm.

- ‘Step downs’ in benefits (Reform Option 5) will help normalise the need to return to work, and increase the incentive to do so, and is thus supported. (Evidence suggests the longer someone is off work, the less likely they are to return; this bolsters the need to increase incentives in favour of an early return to work.) Capacity testing at regular intervals (Reform Option 7) is supported for the same reasons.
- Dollar cost and time caps on weekly benefits (Reform Option 8), and related caps on medical treatments (Reform Option 13), are similarly supported for both cost and incentive reasons (and will also help normalise the return to work).
- Regarding incentives under partial incapacity, the scheme should ensure NSW workers have a financial incentive to return fully to work – they need to receive more dollars if they return to their former job rather than stay on benefit – therefore Reform Option 6 is supported. (Consideration should also be given to examining the taper rate on benefit withdrawal, to increase marginal incentives to work more hours.)
  - BCA member feedback notes, for example, that the current Workers Compensation Act 1987 Section 38 can create a perverse incentive – encouraging workers to remain on benefit for 12 months, even while they may be capable of, and be better off being supported through to a return to work.

Refocusing and improving the targeting of benefits is very important. Such a reprioritisation can deliver an important dividend for severely injured workers. To this end, the BCA is supportive of well-designed, prudent implementation of Reform Option 1 (better benefits for severely injured workers). Moreover, if wider use of ‘step downs’ is enacted, then there may also be some capacity to adjust upward the initial 13-week income support amount closer to other states’ maximum level.

In relation to the use of lump sum payments, the BCA understands there are concerns about whether these are always in workers’ long-term interests. Given the central need to rehabilitate workers, so as to allow them to return to work, we note that some research has highlighted that lump sum payments may not be as effective for facilitating consistent use of rehabilitation health services over time, so as to allow a timely return to work. Careful examination of the evidence on both sides of this argument should be considered if changes to lump sum arrangements are envisaged.

### ***Coverage, and incentives for employers and healthcare providers***

In order to target coverage to *work-related* claims, Reform Options 2, 3 and 16 are supported. Employers should be able to manage risks they have some control over. It is not clear this is the case for the everyday journey to work, psychological impacts on family members or non-work-related diseases and events such as heart attacks.

A key area where incentives are not currently well controlled for is health costs. While overservicing is not likely to be widespread, it cannot be ruled out where providers are assisting a payer whose spending is effectively unlimited. Therefore the BCA is strongly supportive of Reform Option 14, regarding incentives under a health provider framework.

Management should be allowed to set up systems to ensure rehabilitation health service expenditures are not misallocated. To this end there should be a strong default requirement to select evidence-based treatments wherever possible. Management should also have the right to order medical reviews of high-cost or widely used procedures, and to set limits on them where this is medically supported. Reforms in this direction will increase the incentive on providers to deliver value-for-money, efficacious (evidence-based) care. This may also have the positive side-effect of reducing dependence and increasing the capacity of individuals to re-engage in the workforce, which will have broader psychological benefits to them.



Similarly, regarding medical assessments of patients, BCA member feedback suggests that there may be benefit in reviewing the operation of the Nominated Treating Doctor framework. In this regard, there may be a case for a move towards a more independent (and binding) medical assessment structure, to avoid any bias in assessments and to reduce delays in accessing assessments.

### **Good management**

Notwithstanding reforms to the scheme's benefit structure, NSW should also carefully consider reforms to allow more active management of claims and costs.

Detailed work to allow the implementation and enforcement of rules currently on the books may be just as important as reforms to improve existing rules.

Management improvements in Victoria – for example, implementing legally robust frameworks for enforcing tail risk management – have delivered significant cost control benefits over the last decade, and should be carefully considered by New South Wales. Better management of tail risks, including through reorganising the assessment and management of early and longstanding claims, is likely to help management target emerging costs more directly, before they become a problem (see more below under 'Transparency and governance').

The BCA broadly supports Reform Option 4, which entails simplifying the administration of benefit arrangements. Firms should also be able to understand their premiums more easily, and the factors that affect them. This may mean a greater investment in IT to deliver user-focused web-based information and tools (which may also reduce administration costs overall).

Additionally, BCA member feedback has highlighted concerns about volatility in premiums resulting from current grouping rules. For example, a BCA member has provided an example of a 500 per cent increase in a business unit in one year – with the premium, by percentage of wages, rising from 0.28 per cent in 2011–12 to around 1.69 per cent in the next policy period. Such increases create significant budgeting and planning difficulties for business.

In the interests of administrative simplicity and reducing large transaction costs from litigation (anecdotally up to 40 per cent of claims can be lost in legals), the BCA supports the general direction of Reform Options 9, 10 and 11 (raising lump-sum thresholds, removing the potential for separate awards for pain and suffering and removing re-claiming).

Similarly, consideration should be given to encouraging greater use of non-legal dispute resolution, and to ensuring that dispute resolution bodies' rulings align with the overarching policy objective of supporting workers through to an early return to work.

As mentioned above, management should also be allowed to work with healthcare providers to limit expenditures to cost-effective, efficacious treatments (Reform Option 14).

A key management shortcoming not mentioned in the issues paper is the investment management of assets under the scheme. The BCA urges New South Wales to consider reviewing the scheme's underlying investment strategy and management, with a view to optimising returns over time subject to appropriate prudential requirements.

Finally, there need to be efforts to promote an organisational culture change – to help realign expectations in favour of supporting workers through to an early return to work. This will necessitate building an executive group who can help rebuild the organisation.

### **Transparency and governance**

An important reform question to consider is whether the scheme could benefit from a structural split – whether outcomes could be improved if the policy and regulatory oversight arm was separated from day-to-day management.

Notwithstanding this, the BCA is strongly supportive of regular, genuinely independent actuarial reporting on the scheme's performance – arguing that this should be entrenched in new provisions.

This reporting provides important transparency benefits and an impetus to management to improve performance.

Related to this, New South Wales could consider whether new procedures to improve access to good data could help management to pinpoint where cost pressures are arising (allowing them to proactively manage these risks). This should not entail excessive new reporting requirements (BCA member feedback suggests reporting is already onerous). Consequently, consideration should be given to conducting a review to identify the most useful information for collection, and to eliminate all other redundant data collection requirements.

### **Benchmarking ownership and service provision**

Currently, claims management is outsourced, while underlying liabilities are effectively underwritten by the state. The BCA observes that, in principle, there is no reason why the private sector could not tender for provision of nearly all elements of the scheme.

Market testing of all scheme elements may not be possible at this time, but the BCA recommends New South Wales considers reviewing elements of the scheme over time. Such a benchmarking exercise should be used to determine whether scheme underwriting, claim management, and other modular elements of the scheme could be better and/or more cost effectively provided by the private sector. The BCA observes that in 2004 the Productivity Commission found that private provision was, on balance, preferred (noting that there were arguments on both sides).<sup>2</sup>

Greater contestability could benefit NSW taxpayers, firms and workers over the long term, by allowing greater access to specialised knowledge, and opportunities for greater innovation and lower costs.

There are also questions around whether current claims management outsourcing frameworks could be improved. The BCA recommends that New South Wales explores whether claims management would benefit from economies of scale under fewer, larger (similar) processors, or whether outcomes would improve with more, more specialised claim processors/managers. (This may entail specialised expert case managers for long-tail liabilities, with streamlined claim management for regular, short duration claims. It may also involve changes to agent contracting to increase incentives for them to manage long-term claim costs.)

2. This was on the grounds that: 'private capital is directly at risk; competition in the marketplace is likely to generate incentives for efficiency and innovation; and there is greater transparency of any governmental influence over premiums. Further, the risk of private insurer failure can be reduced by prudential regulation' – Productivity Commission, *National Workers' Compensation and Occupational Health and Safety Frameworks Inquiry*, March 2004, p. 323.

### Better outcomes, lower costs: comparing the large state scheme outcomes

The data bear out that reforms, such as those that have occurred in Victoria, can produce better outcomes for workers and business. Victoria's focus on good management and helping workers back into employment has improved its scheme's sustainability, lowered premiums significantly and has allowed it to achieve a lower serious injury claims rate.

	NSW	VIC	QLD
Funding Ratio (as at 30/6/11)	78%*	108%	112%
Average levy/premium rate as at 30/9/11 (% of payroll)	1.68	1.338	1.42
Number of serious claims per 1000 employees (2009–10)	14.2	9.5	15.5

Source: Safe Work Australia, *Comparison of Workers' Compensation Arrangements in Australia and New Zealand*, April 2012.

\*Based on PwC actuarial valuation as at 31/12/11 (attachment to the NSW Workers Compensation Scheme Issues Paper).

## Conclusion

Current outcomes under the New South Wales scheme are arguably unacceptable and unsustainable. Reforms are necessary to put it on a more sustainable footing.

Given the need to improve the competitiveness of the NSW economy, reforms should be judged on whether they deliver real premium reductions, so as to improve the state's competitive position.

The gains from reform could be significant. Victoria has demonstrated that reform can be win-win. Workers can gain from an earlier return to the workforce and reduced injury rates, while business can benefit from lower premiums – allowing them to create wealth and expand employment.

BUSINESS COUNCIL OF AUSTRALIA

42/120 Collins Street Melbourne 3000 T 03 8664 2664 F 03 8664 2666 [www.bca.com.au](http://www.bca.com.au)

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