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Is Compensation for Workplace Injuries Adequate?

The issue of the adequacy of compensation for workers who are disabled by their employment generates great controversy. State-regulated workers' compensation programs provide wage replacement (or "wage-loss") benefits to workers while off work due to a work-related disability, as well as medical treatment and rehabilitation services to assist such workers in returning to work. Since employers apparently pay the costs of workers' compensation programs and workers apparently derive the benefits, the situation is ripe for misunderstanding and hyperbole.¹ Nevertheless, policymakers must make such judgments when they set benefit schedules under workers' compensation statutes.

Wage-loss benefits are usually stated as a percentage of the worker's previous weekly earnings; typically two-thirds of gross wages or 80 percent of net (take-home) pay.² The latter formula has arisen to ensure that injured workers are not "overcompensated" for lost wages when viewed from an after-tax perspective, since workers' compensation benefits are free of all income and payroll taxes.

What is Benefit Adequacy?

Unfortunately, there is no universally accepted definition of benefit adequacy. The National Commission on State Workmen's Compensation Laws recommended 30 years ago that states provide at least two-thirds wage replacement up to a maximum of 200 percent of the state average weekly wage. This standard was subsequently adopted by the Council of State Governments in 1974 when they amended their "Model Act for Workmen's Compensation." Because this represents the closest thing we have to an accepted adequacy standard, and because 35 states actually use two-thirds of gross wages as their replacement formula, the Sub-committee on Benefit Adequacy of the Workers' Compensation Steering Committee at the National Academy of Social Insurance (NASI) has also been using this standard in its review of benefit adequacy (see www.nasi.org for more details). Given these precedents, I will also adopt two-thirds of gross wages as the measure of adequacy.

What Does the Research Say?

Recently, three separate empirical studies carefully explored the level of workers' compensation wage-loss replacement in the states of California, Washington, and Wisconsin. Both the Washington and Wisconsin studies estimated losses for the full range of injured workers, while the California study included only workers with permanent partial disability benefits. All the studies used administrative data on actual earnings of individuals who were not injured, or not seriously injured, to estimate the wages that workers' compensation claimants would have earned in the absence of the disability.

In a recent volume published by the Upjohn Institute for NASI, the three primary authors of these state-specific studies derived comparable estimates of the losses suffered and compensation received for permanent partial disability (PPD) claimants in the three states (see Budetti et al. 2001). While this analysis is not as broad as the earlier ones (at least for Washington and Wisconsin), it does cover a very interesting workers' compensation subpopulation that accounts for about 60 percent of all benefit payments and includes many of the most contentious cases in the workers' compensation programs. It is also the group of cases which raise the most significant questions about benefit adequacy because of the likely permanency of wage losses.

Workers' compensation benefits in these studies are defined to include both temporary and permanent wage-loss benefits, cash settlements (which can include payments for future medical benefits in California and Wisconsin), and vocational rehabilitation maintenance allowance. For this comparison, the authors chose to ignore the effects of taxation, so results are presented in pretax dollars. Injured workers are compared to noninjured workers of similar preinjury wage levels employed at similar (or the same) firms. Using the wages of similar uninjured workers standardizes the comparison for unemployment, inflation, job promotions, and other labor market changes.

Benefits paid and wages lost are measured for at least 3.5 years after the point of injury. They are projected beyond the observed 3.5 years by carrying the final observed year's losses and benefits forward for an additional 6.5 years and discounting all amounts back to the point of observation. It is worth noting that attorney fees and other potential medical/legal costs have not been deducted from the gross benefits paid, nor have any lost fringe benefits been counted as economic losses.³

Table 1 shows the total wage-loss benefits paid in the first 3.5 years following the injury, the estimated wage losses for the first 3.5 years, projected losses for the 10 years following the injury, and the estimated wage-loss replacement rate for 10 years in California, Wisconsin, and Washington.

Table 1				
Average Losses and Pretax Replacement Rate for Permanent Partial Disability Cases in Three States				
State ^a	Total income benefits (\$)	Losses by years from injury (\$)		Replacement rate of 10-yr. losses
		3.5 yr.	10 yr. ^b	
California	21,229	26,383	56,340	38
Wisconsin	14,196	17,602	32,427	46
Washington	14,975	15,358	30,746	46

^a All dollar values measured in constant (1984) dollars

^b Projected. Assuming wage-losses and benefit payments continue at same rate as in final observed year.

SOURCE: Biddle, Boden, and Reville (2001), p. 276.

Despite some differences among the states in the method of compensating PPD cases (although all three use disability ratings), the replacement rates for 10-year losses are quite similar and remarkably low. Workers' compensation programs replace about 38 percent of lost earnings for injured workers with permanent partial disabilities in California and 46 percent in Washington and Wisconsin (see Biddle, Boden, and Reville 2001, p. 276). After-tax replacement rates would be higher, since workers' compensation benefits are free of income tax. However, it is clear that gross wage replacement rates fall well below the two-thirds standard generally specified by statute, at least for this group of injured workers with permanent partial disabilities.

Differences by Disability Rating

A major policy issue is benefit adequacy as a function of the degree of disability. Presumably, more seriously disabled workers are less likely to eventually return to work and therefore more likely to be dependent upon workers' compensation or other social insurance benefits⁴ Table 2 reports projected losses for 10 years following injury and 10-year replacement rates for workers' compensation claimants according to their disability rating in the three states. The disability rating is a rough attempt to quantify the degree to which an individual is disabled. It estimates the percentage of impairment to the "whole man." This is the most common way of setting compensation for permanent disabilities among U.S. jurisdictions (Barth and Niss 1999). Since permanent partial disability benefits are largely determined by the disability rating, rather than vice versa, we are looking for confirmation that estimated wage losses increase regularly (proportionally?) with disability rating. Such a finding would provide evidence that workers' compensation systems are at least getting the wage-loss replacement dollars to the right people.

Table 2
The Relationship of Losses and Income Benefits by Disability Rating

		Permanent disability rating				
		0-20	21-40	41-60	61-80	81-100
California 1993 injuries	Losses projected 10 yr. (\$)	24,120	29,948	43,107	55,754	114,226
	10-yr. replacement rate (%)	7	19	29	44	54
Washington 1993-94 injuries	Losses projected 10 yr. (\$)	30,512	28,834	34,555	32,485	35,775
	10-yr. replacement rate (%)	14	31	41	56	82
Wisconsin 1989-90 injuries	Losses projected 10 yr. (\$)	8,255	13,816	20,957	32,036	65,713
	10-yr. replacement rate (%)	40	45	47	46	58

NOTE: "Benefits" means temporary plus permanent partial disability benefits.
SOURCE: Biddle, Boden, and Reville (2001), p. 281.

The table shows that while 10-year losses increase steadily with disability rating, at least in California and Wisconsin, compensation more than keeps up, as wage-loss replacement rates rise with disability rating. This is very pronounced in California, with replacement rates rising from 7 percent for the least serious injuries to 54 percent for the most serious. Wisconsin shows a more

gradual increase, from 40 percent replacement in the least serious to 58 percent in the most serious injuries. In Washington, losses do not increase with disability rating, indicating that disability ratings are not well correlated with earnings losses.

Conclusions

These recent studies based upon administrative data and using carefully selected comparison groups improve our estimates of wage replacement adequacy in workers' compensation programs significantly. Research to date indicates that wage-loss replacement adequacy seems to be better for low-wage workers, for employees at smaller, insured firms (which is likely the same thing), for more severely disabled workers, and in certain states. However, very few of the before-tax replacement rates reported here even came close to the two-thirds standard of adequacy. Thus our conclusion must be that workers' compensation wage-replacement benefits are not adequate, at least for workers with permanent partial disabilities in these particular states. As usual, more research is needed to shed more light on these questions.

NOTES

1. We say "apparently" because labor market analysts believe that both costs and benefits can be shifted between workers and their employers by the market forces of labor supply and demand.
2. Actually 35 states maintain temporary total workers' compensation benefits at two-thirds of gross earnings, while 4 states use 80 percent of net, and 2 states are at 75 percent of net. Six states pay more than two-thirds of gross, two states pay less than two-thirds, and one state uses a variable replacement rate.
3. Of course, analyzing only permanent partial disabilities also biases the wage-loss result, since these cases are the most likely to be disputed and to result in compromise settlements. See Barth and Niss (1999).
4. See Barth and Niss (1999) for a description of the variety of PPD methods.

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Suggestions for further reading

Barth, Peter S., and Michael Niss. 1999. *Permanent Partial Disability Benefits: Interstate Differences*. Cambridge, MA: Workers' Compensation Research Institute.

Biddle, Jeff, Leslie I. Boden, and Robert T. Reville. 2001. "Permanent Partial Disability from Occupational Injuries: Earnings Losses and Replacement in Three States." In *Ensuring Health and Income Security for an Aging Workforce*, Peter P. Budetti, Richard V. Burkhauser, Janice M. Gregory and H. Allan Hunt, eds. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research, pp. 263–290.

Budetti, Peter P., Richard V. Burkhauser, Janice M. Gregory and H. Allan Hunt, eds. 2001. *Ensuring Health and Income Security for an Aging Workforce*. Kalamazoo, MI: W.E. Upjohn Institute for Employment Research.