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Benefit Adequacy in State and Provincial Workers' Compensation Programs

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Benefit Adequacy in State and Provincial Workers' Compensation Programs

For over 30 years, the Upjohn Institute has been involved in research and analysis of state and provincial workers' compensation programs for workers disabled by their employment in Australia, Canada, and the United States. These programs mandate medical treatment to promote recovery and return to work, as well as wage-replacement benefits to enable workers to maintain themselves during the recovery, and are financed by employer contributions, either through private insurance or public funds.

It is still not possible to make acceptably accurate and meaningful comparisons among systems across different studies.

A major focus of this policy work at the Upjohn Institute has been the adequacy of wage-replacement benefits for these workers. If benefits are too low, injured workers will struggle to recover and perhaps become a burden on society. If benefits are too high, employers will bear unnecessary expense and injured workers may be tempted to malingering.

A highlight for the Institute was the publication in 2004 of *Adequacy of Earnings Replacement in Workers' Compensation Programs* (Hunt 2004), developed by the National Academy of Social Insurance, Study Panel on Benefit

Adequacy of the Academy's Workers' Compensation Steering Committee. This monograph reviews the analytical options and endorses what they call "modern wage loss studies" as the preferred way to address the issue of benefit adequacy.

Previous Empirical Work

Reville et al. (2001) evaluate the benefit adequacy of workers' compensation for permanent partial disability (PPD) claimants in New Mexico using this wage loss design. In addition, they compare replacement rates for PPD claimants in New Mexico to PPD claimants in California, Wisconsin, Washington, and Oregon. To calculate loss replacement rates, they examine the degree to which workers' compensation benefits, which are tax-free in all states, offset the earnings differences between workers with partially disabling occupational injuries and similar workers without injuries during the 5 years after the injury.

During the first 5 years after the injury, the pretax loss replacement rate in New Mexico was 65 percent, nearly identical to the two-thirds statutory standard. But projections for the 10 years after the injury show the pretax loss replacement rate falling to 46 percent, as benefit payments were completed, and wage losses continued into the future. In fact, there seems to be a permanent loss of

earnings among workers' compensation claimants that remains unexplained. Ten-year pretax replacement rates were estimated at 37 percent in California, 42 percent in Oregon, 41 percent in Washington, and 29 percent in Wisconsin. Thus, New Mexico had the highest replacement rates in any of the states. However, after adjusting for differences in industry composition among the states, it was apparent that New Mexico had a replacement rate that was in the middle.

This was the state of benefit adequacy research when the National Academy of Social Insurance and the Upjohn Institute for Employment Research published their book in 2004. The study panel concluded that "... for all categories involving substantial lost time from work or permanent disabilities, aggregate replacement rates are considerably below the two-thirds standard when considered over the 10-year period following the injury" (p. 132).

In addition, the study panel called for more wage loss studies from other jurisdictions, especially studies that included temporary disability claims and studies from states that used alternative methods for setting permanent partial disability benefits. The expectation was that additional studies would provide more guidance to policymakers seeking the most adequate, equitable, and efficient wage replacement policy. Unfortunately, no further studies were forthcoming for the next five years.

More Recent Studies

Tompa et al. (2010) have contributed a more recent Canadian perspective to this body of work. In a path-setting study for the Workplace Safety and Insurance Board in Ontario, they compare the benefit adequacy of three Canadian compensation regimes: 1) the permanent impairment regime in place in Ontario before the 1990 reforms (impairment); 2) the loss of earnings capacity regime installed in Ontario by the 1990 reforms (loss of earnings capacity); and 3) the "bifurcated" compensation regime (claimant gets the higher of the impairment or loss of earnings capacity benefit) in British Columbia before 2002 (bifurcated).

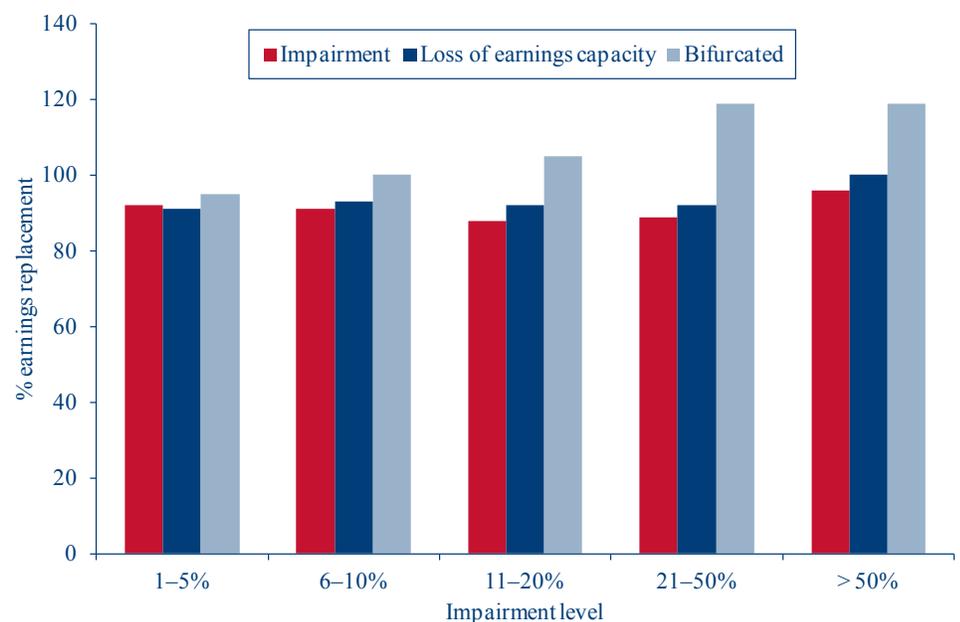
Tompa et al. (2010) also develop an additional measure of benefit adequacy, differentiating between the loss replacement rate used in the previous studies in the United States and what they call the "earnings replacement rate." The loss replacement rate uses the gap between postinjury earnings of injured workers and comparison group earnings as the denominator, with workers' compensation benefits paid as the numerator to calculate the rate. The earnings replacement rate adds the postinjury earnings of injured workers to the numerator, thereby taking into account the residual earning capacity of injured workers. The result is a significantly higher measured replacement rate, but also recognition of the fact that most injured workers will return to work and their earnings losses will be temporary.

Figure 1 compares the postinjury earnings plus workers' compensation benefits paid to injured workers with the after-tax earnings of an uninjured comparison group in Canada. Benefit adequacy is expressed as the percentage of earnings that are replaced by the sum of workers' compensation benefit payments plus earnings for the 10 years

following the injury. The figure displays these estimates for a range of impairment levels, from the minor (1–5 percent impairment) to the very serious (more than 50 percent impairment). It is worth noting that all three of the Canadian workers' compensation systems achieve at least 85 percent earnings replacement rates, with the British Columbia bifurcated system coming out on top (which is predictable, given that this scheme pays whichever of the other two benefits is higher).

These earnings replacement rates cannot be precisely compared with the earlier studies in the United States because of the differences in methodology. However, since Tompa et al. (2010) did report the aggregate loss replacement rates for these three workers' compensation regimes, this facilitates rough comparisons with the U.S. studies cited earlier. For the Ontario pre-1990 impairment rating system, the aggregate after-tax loss replacement rate was 76 percent. For the post-1990 Ontario loss of earnings capacity rating system, the aggregate after-tax replacement rate was 80 percent. And for the British Columbia bifurcated system, the aggregate after-tax replacement rate was 95 percent.

Figure 1 Aggregate Earnings Replacement Rates



SOURCE: Developed by the authors from Tompa et al. (2010).

It is also interesting to note that the loss replacement rates and earnings replacement rates both increase with the severity of impairment. Clearly, all three of these Canadian regimes were substantially more generous in replacing lost earnings for injured workers than any of the U.S. jurisdictions studied previously.

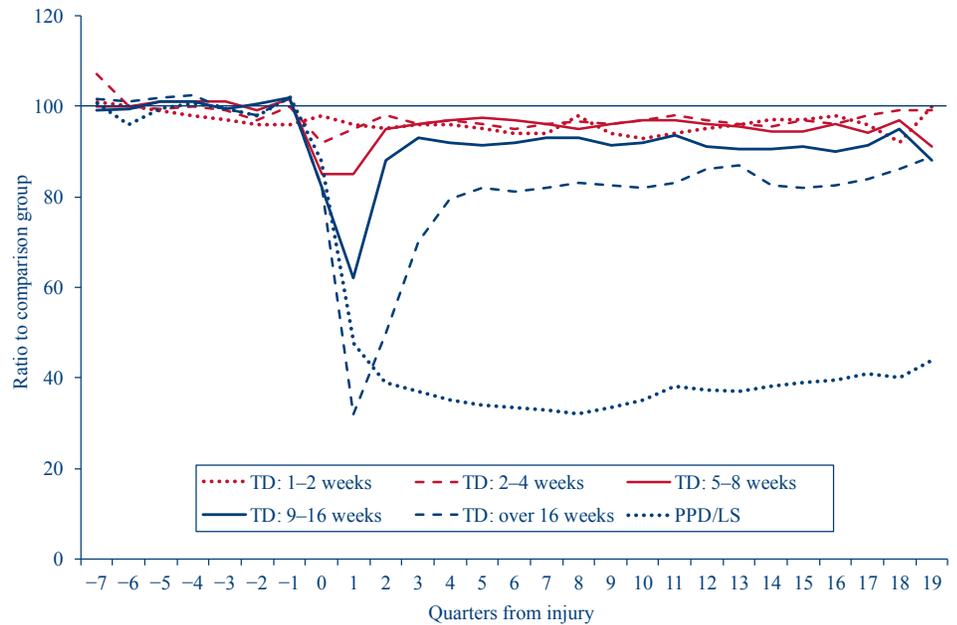
Workers Compensation Research Institute Michigan Study

The Workers Compensation Research Institute in Cambridge, Massachusetts, and the W.E. Upjohn Institute for Employment Research recently collaborated on a study of benefit adequacy of the workers' compensation system in Michigan. Michigan does not use an independent assessment of the degree of impairment for injured workers. As a proxy for severity of injury, the number of weeks of wage loss compensation that are paid to the injured worker is used. It is logical that an injury that requires more weeks away from work is probably more serious, but there may be other things that influence the duration of disability payments, so this is not the equivalent of an estimate of residual disability that would be available from an impairment system (as in Ontario).

Figure 2 shows the proportional earnings losses by duration of weekly compensation payments compared to the after-tax baseline earnings of the comparison workers (set at 100 percent) in Michigan. It is apparent from the figure that the largest losses are sustained by claims with disability durations over 16 weeks (about 20 percent losses) and those receiving lump-sum settlements of contested claims (about 60 percent losses). The workers with less serious injuries show earnings losses of 3–10 percent of comparison group earnings. As in previous studies, these losses appear to persist for many years.

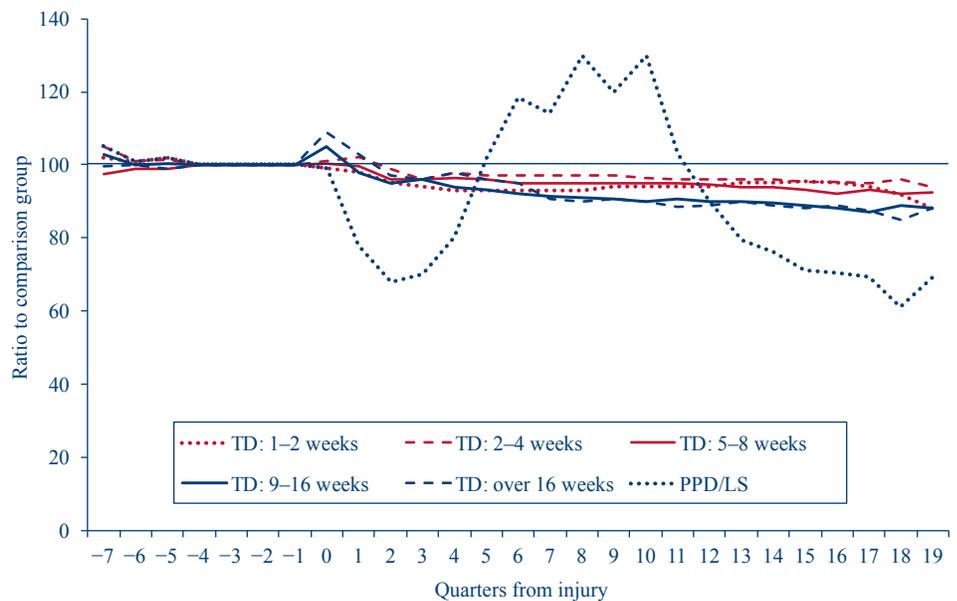
Figure 3 shows the time trend of average after-tax earnings replacement by disability duration for each calendar quarter around the injury. After-tax earnings replacement rates average 96 percent, and loss replacement rates

Figure 2 Proportional Earnings Relative to Comparison Earnings



NOTE: TD = total disability; PPD/LS = permanent partial disability/lump sum.
SOURCE: Savych and Hunt, forthcoming.

Figure 3 Total Compensation of Injured Workers (from Employment and Income Benefits) Relative to Comparison Earnings



NOTE: TD = total disability; PPD/LS = permanent partial disability/lump sum.
SOURCE: Savych and Hunt, forthcoming.

average 76 percent for all claims. However, the permanent nature of the earnings reductions associated with disability claims also stands out for

all groups as the trend lines fall below 100 percent and continue to decline gradually for 19 quarters (nearly 5 years). Projections out to 10 years based on the

results in year 5 drop estimated after-tax earnings replacement rates to 89 percent for all claims and 67 percent for the PPD/LS group.

One other notable feature of Figure 3 is that the lump-sum recipient group shows actual compensation above 100 percent of comparison group earnings in quarters 5–11 following the injury. This reflects the administrative delays associated with disputed workers' compensation claims that generally have to wait 1–3 years before their claim is settled and payments received. Obviously this raises questions about income adequacy during the interim period.

While Michigan shows a good short-term wage replacement performance compared to other states, the workers' compensation wage loss benefits in Michigan do not prevent the long-term earnings decline of injured workers relative to those with medical-only injuries. This remains one of the mysteries behind these studies.

Conclusions

It is disappointing that there have not been more of these empirical benefit adequacy studies in the 10 years since the National Academy of Social Insurance panel report. In the current political climate, perhaps it is not surprising, but given the gravity of the concerns expressed about the adequacy of benefits in workers' compensation programs, it is unfortunate. Our methods are improving, but the data requirements and sensitivity of results to analytical assumptions remain as daunting barriers. It is still not possible to make acceptably accurate and meaningful comparisons among systems across different studies. Although we have a better understanding of some of the determinants of adequacy, they are overwhelmed by the impact of methodological assumptions underlying the research results.

But there is hope from a new approach. The Workers Compensation Research Institute has initiated a worker-interview-based series, "Predictors of Worker Outcomes," in eight states, and plans to increase the number of states and repeat the survey in some states to provide benchmarks of

system performance as more evidence accumulates. Despite the fact that the measure of wage loss is a subjective one, this effort has two major advantages over the data-intensive wage-replacement studies conducted to date. First, it pairs the question of postinjury earnings recovery with parallel concerns about the access to and satisfaction with medical care, the perceived recovery of health and function, and the return to work performance for a random sample of individual injured workers. Second, a more holistic and less data-intensive approach promises more useful comparisons between states and a more thorough understanding of the adequacy of workers' compensation benefits.

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H. Allan Hunt is a senior economist emeritus, and Marcus Dillender is an economist, both at the Upjohn Institute.

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