CURRENT ISSUES IN WORKERS' COMPENSATION

James Chelius, editor

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Editor's Note

In response to the 1972 recommendations of the National Commission on State Workmen's Compensation Laws, most states substantially broadened coverage and increased benefits for injured workers. The cost increases associated with these reforms have brought workers' compensation to the forefront in the debate over labor market regulatory policy. Substantial changes to workers' compensation continue, although the attention has shifted from the relatively straightforward issues of coverage and benefit levels to subtle and difficult matters such as permanent partial disability benefit arrangements, disease compensation, administrative efficiency, and competitive rate-making.

One of the alleged virtues of workers' compensation is the flexibility and learning from others afforded by the decentralized state-run programs. Unfortunately the ongoing reform debate in virtually every state is taking place in isolation from the experiences and lessons of others. The papers in this volume begin to fill that void by reporting and analyzing a range of workers' compensation issues that are key to every state's disability income policy. The emphasis is on what can be learned from the experience of other jurisdictions. The papers were presented at a conference held at Rutgers, The State University of New Jersey, in 1983.

James Chelius

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The Status and Direction of Workers' Compensation

An Introduction to Current Issues

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The substantial increase in injury rates during the 1960s that gave rise to widespread federal involvement in occupational safety and health also spawned a period of significant change in the workers' compensation system. The Occupational Safety and Health Act of 1970 provided for a national commission to study workers' compensation.[1] This commission recommended that the states broaden coverage and increase benefits. Eighty-four specific suggestions were made, 19 of which were deemed essential to the commission's notion of a well-functioning workers' compensation system. If the states did not meet the 19 essential recommendations, the commission urged that federal standards be issued and the states forced to comply. Most states responded to either the commission's vision of the appropriate way to improve the workers' compensation system or perhaps to the threat of federal involvement. Substantial changes were made in both coverage and benefit levels. These changes, however, were not sufficient to meet all of the 19 essential recommendations. Several bills mandating federal standards were introduced in Congress but none passed.

The substantial changes of the 1970s in workers' compensation coverage and benefits, together with increased system usage by workers, resulted in dramatic increases in employer costs. Burton and Krueger (see chapter 7) estimate that workers' compensation costs as a percentage of payroll increased over 80 percent from 1972 through 1978, approximately double the increase from 1950 through 1972. Whereas the initial response to the commission's recommendations was a series of relatively straightforward changes in coverage and benefit levels, the resulting cost increases generated pressure for attention to the more subtle aspects of workers' compensation.

Issues such as eligibility for permanent partial benefits, pricing regulation, and administrative arrangements that were largely ignored in the initial round of reform following the commission's report became the focus of a second wave of reform that continues. Workers' compensation, therefore, is an increasingly important and changing aspect of the labor market regulatory environment. Every indication is that this importance and fluidity will continue.

Evaluation of any regulatory policy is desirable; however, it is usually difficult. One source of difficulty, particularly for recent labor market regulatory initiatives such as OSHA, is that they are uniformly applied throughout the country. Such a universal policy, whatever its advantages as a regulatory technique, does not provide for ready comparisons. One of the advantages of the state-based workers' compensation system is that one can compare the various state laws and evaluate their effectiveness and efficiency. This potential advantage of the state systems has not been utilized to any significant degree. The workers' compensation laws of each state tend to operate and even change in isolation from the experiences of others.

The conference from which this book arose is the first in a series examining the workers' compensation system. The goal is to provide scholars and practitioners with the insights of the workers' compensation experience in a variety of jurisdictions.

There are three main themes examined in this review of current issues in workers' compensation. We first describe and analyze the *process* of reforming workers' compensation with papers on a variety of states that have recently undergone attempts at significant change. While only some of these efforts have resulted in comprehensive change, there is much to be learned from failed as well as successful attempts. Of course, the process of change is not distinct from the attempted or actual outcome of the reform process. Several of the papers primarily focusing on the process of reform give us significant insight into the nature of the workers' compensation system in these states. A second group of papers examines the ongoing *operation* of several key states. These essays specifically examine the regulation of insurance rates, the differences in employer costs, and the administrative structure of New Jersey, New York, and Connecticut. The third section of the book deals with one of the most difficult of workers' compensation issues—*occupational disease.* These papers address how workers' compensation currently deals with this problem and suggest guidelines for directing future change.

In addition to these three basic themes, a final essay broadens our perspective by presenting information about the unusual accident compensation scheme used in New Zealand.

The Process of Workers' Compensation Reform

The difference between reform and tinkering seems to depend on whether one is for or against the changes. Virtually

every state makes some changes in its compensation statute annually; however, without getting more specific, the notion of reform as used here is of a fairly major change in the system with no connotation as to the desirability of the change.

The papers on the reform process examine a range of state experiences—California (Alan Tebb), Michigan (H. Allan Hunt), Minnesota (Steve Keefe), Florida, Louisiana, New Mexico, Delaware, and Alaska (John Lewis). While the political process is never a tidy one, several themes do emerge. First, research and the resulting insights into the specific problems of a state's system provide a necessary beginning to the reform process. Second, educating a wide range of individuals, including study commission members, key employer and labor leaders, and legislators, is also critical. Finally, substantive communication among the leaders of the various interest groups cannot be completely replaced by dialogue among their specialized representatives.

The necessary research for reform need not be sophisticated scholarly treatises; often the only requirement is that it adequately document what is happening in the system. The recurrent theme of research as a precondition for substantial change is well-illustrated by the Minnesota experience described by Keefe. For several years the high cost of workers' compensation made it an important political issue. However, no response to industry complaints was forthcoming, in part because the only publicized evidence for high costs was a series of anecdotes on payments to undeserving individuals. Only when credible data were developed, indicating that Minnesota was indeed a high cost state, did the reform effort develop momentum. Interestingly, the most cogent basis for cost comparison was with neighboring Wisconsin—a key competitor for many Minnesota industries. The research effort also pointed to the

primary reason for the high costs. Whereas early reform proposals focused on general benefit levels, the analyses demonstrated that it was the amount of disability compensated rather than benefit levels that made Minnesota costs high.

The analyses documented that in Minnesota compared to Wisconsin: (1) the rate of permanent total disability per lost-time injury was 20 times higher; (2) the average duration of temporary total disability was 50 percent longer; (3) the frequency of permanent partial disability cases was 60 percent higher; (4) the average payment for partial disability was 20 percent higher even though the scheduled benefits were similar; and (5) the average medical cost per case was 50 percent higher. Based on these findings, it became obvious that the fundamental cost problem with the Minnesota system was not a high benefit schedule *per se.* The importance of such fundamental research is retold in the successful reform efforts of Florida and Louisiana and the failures of Delaware and New Mexico.

Educating key actors in the reform process is also crucial to success. One of the first requirements is to educate members of the ubiquitous study commissions as to the fundamentals of workers' compensation. Without such knowledge, commission members tend to get locked into the specific proposals of the groups they represent. As events change and bargaining intensifies, such rigidity frequently blocks useful compromises. Legislators comprise another group that invariably requires such attention. An attempted workers' compensation reform that tries to reduce the long time frequently required for education is likely to be unsuccessful.

A closely related issue is the requirement of dialogue among the leaders of the affected interest groups. While this is perhaps obvious, the papers reviewing recent state changes

reveal several interesting points. Because of the complexity of workers' compensation in general, and in particular the obscurity of the currently debated nonbenefit issues, many affected parties have delegated their role in the reform process to specialists. While this is typically not a problem, the papers note that in several states, labor unions frequently turned to their workers' compensation attorneys for advice on reform. However, since many of the proposed reforms include attempts at reducing the amount of litigation, the attorneys have an inherent conflict of interest and have often been a source of organized labor's opposition to reform. A similar delegation of authority on the employer's side was one of the reasons cited by Tebb as contributing to the languishing of reform efforts in California during the 1970s. Apparently senior management relied solely on trade associations to represent their interests just at the time when the associations lost many of their senior lobbyists. The point, therefore, is that it is desirable for leaders of business and labor to understand and communicate on workers' compensation.

One must not be so naive as to assume that once the "right" people begin a dialogue, all roadblocks to reform will be erased or even smoothed. However, there are many aspects of reform that can yield gains for both employers and employees. Taking advantage of these potential mutual gains, and fashioning optimal compromises on other aspects where both gains and losses are necessary, is greatly facilitated by the direct involvement of key leaders. Unfortunatly such attention is frequently lacking.

These papers on the reform process give us many insights into the dynamics of the states described, as well as providing evidence for the broad theme of what brings about reform. Anyone with an interest in substantial workers' compensation change must be prepared to deal with the issues addressed by these authors.

The Regional Experience in Workers' Compensation

Given the joint sponsorship of the conference by universities in the States of New Jersey, New York, and Connecticut, it was appropriate to focus the attention of one session on the operation of workers' compensation in these states. The issues addressed—cost differences, pricing regulation, and administration—are important concerns in all jurisdictions. The general context of the issues represents the bulk of the analysis, with the three states serving as examples.

The importance of thorough and well-documented research has already been noted. An excellent example of such analysis is the interstate cost comparison data presented by John F. Burton, Jr. and Alan Krueger. They begin by describing some inappropriate measures of cost differences among the states (earned premium-to-payroll ratios and average premiums per state). While the incorrectness of these measures may seem obvious once their inadequacies are demonstrated, such measures are in fact frequently used. The reason for the scarcity of valid data on costs becomes apparent upon examining the Burton and Krueger technique for constructing such measures—it is very complicated. The authors make a convincing case as to why such an elaborate procedure is necessary. Without attempting to summarize their technique, it should be noted that they take into account factors such as industry mix, payroll limitations, premium discounts, dividends, experience rating, expense and loss constants, and schedule rating.

The resulting cost data, across years and states, are then reviewed to demonstrate some of their more important uses. For example, it is noted that from 1950 through 1983 workers' compensation costs as a percentage of payroll almost tripled, with a particularly large increase in the period from 1972 through 1978. The apparent increase in the interstate variation of workers' compensation costs over time

and even since the National Commission's recommendations is also an interesting finding, particularly in light of the commission's goal of greater equality across states.

While a formal statistical analysis of the reasons for these cost differences is beyond the scope of their paper, Burton and Krueger present some preliminary evidence on this important issue. Using New Jersey, New York, and Connecticut as examples, they compare the relative costliness of these states over time with the level of benefits available to injured workers. They conclude ". . . that changes in benefit levels are an important determinant of changes in the employers' costs of workers' compensation. . . ." The importance of other potential factors such as coverage, use of state insurance funds and self-insurance, and administration of the law are left for future analysis.

This paper also yields an interesting insight into a key aspect of the reform process. Certainly one of the important phases of this process is to determine changes that can yield gains for both workers and employers. Unfortunately, at least in the short run, many changes simply benefit one party at the expense of the other. However, data on the cost response to the New Jersey reform of 1979 indicate that benefits to most injured workers increased while employer costs declined. The thrust of the reform was to de-emphasize the role of minor permanent partial disability payments by requiring objective evidence of disability. While fewer workers are now receiving such benefits one would not imagine that, given the standard of eligibility, this is a significant problem for deserving individuals. Interestingly, the general level of benefits increased at the same time as relative employer costs were decreasing. This concern about the handling of permanent partial benefits is a key aspect of the reform debate in many states, including several of those discussed in the first section.

The paper discussing pricing is also quite timely as these issues are currently being debated in many states. Reflecting the general deregulatory trend in other lines of insurance as well as other sectors of the economy, the fundamental question is the appropriate role of competition in the pricing of workers' compensation insurance. Arthur Williams first provides a very readable account of the rate determination process—a review necessary for all but those thoroughly steeped in this arcane subject. The rate regulation process—ranging from prior governmental approvals to open competition—is then described. A final section of the paper summarizes three of the specific issues forming the heart of the debate on price regulation of workers' compensation insurance: the arguments for and against open competition, the appropriate role of investment income in regulated rates, and the use of excess profit statutes.

While most of the arguments for and against open competition are the same as those used in other areas of regulation, from bus fares to liquor prices, the unique aspect of the workers' compensation debate concerns whether the data base used to calculate rates will be less reliable under competition. Opponents of deregulation are concerned that competition will lead to a withering away of the rate-making data base pooled from most insurance companies. It is difficult to imagine why insurance companies would not want to maintain such a valuable pricing tool even if it were not mandated by regulation; however, in the spirit of neutrality, Williams chooses not to reveal his interpretation of the validity of the arguments.

The role of investment income in regulated rate-making is significant in workers' compensation because of the time lapse between collection of premiums and the dispersal of benefits. While the role of income earned on such investments would be moot under genuine open competition,

its importance in the various regulated price environments will continue. The difficulties of determining a fair or efficient price without significant help from the marketplace are well illustrated by the debate on the appropriate role of investment income.

The final issue addressed by Williams is that of excess profits statutes. While only a minor part of the workers' compensation system, with only Florida currently having such a law, the issue may become more important if more states deregulate workers' compensation insurance. Such statutes can be used as a mechanism for easing into more competition in rate-making by serving as a guarantee that the deregulated firms will not generate "windfall" profits.

The efficient administration of workers' compensation is an important but extremely difficult issue addressed in the paper by Monroe Berkowitz. He reflects on the frustration of developing guidelines for how workers' compensation should be run, echoing the common theme of the "overuse" of litigation. It is ironic that most commentaries on workers' compensation emphasize the inefficiency of its extensive use of lawyers, while many other legal areas point to the "streamlined" workers' compensation system as a model to be emulated. Unfortunately, the characteristics of efficient administration remain illusive; Berkowitz, however, offers the hope that ongoing conferences and resulting books such as this one can provide a vehicle for invigorating the search process. Certainly excellent essays on the operation of workers' compensation such as the ones contained in this section will foster the process by which those concerned about workers' compensation will learn from the views and experiences of others.

Occupational Disease

One of the most significant of workers' compensation problems is how to deal with occupational disease victims.

Unfortunately, the magnitude of the problem has only recently been appreciated. For many years occupational disease was seen largely as a phenomenon of the past with the major problems resolved.[2] The growing awareness of work-related health problems and in particular the asbestos issue have intensified the search for an effective and efficient mechanism to deal with these issues. There is currently a series of bills before Congress that propose to circumvent the state workers' compensation system by establishing a federal occupational disease compensation program.

The papers presented at the conference demonstrate the inadequacies of the current system as well as the difficulties of coming up with a solution. Donald Spatz illustrates the nature of the compensation problem with its most visible manifestation—asbestos. Most state workers' compensation laws have significant roadblocks that make it quite difficult for victims or survivors to collect benefits. These "artificial barriers" include recency of employment rules and statutes of limitations that are frequently inconsistent with the latency periods of occupational disease. The performance of workers' compensation within a state with no such barriers (New Jersey) illustrates that even at its best, the current system does not appear to be fairly compensating victims. The data on three groups of workers clearly indicate that the problem goes well beyond the law *per se.* Fewer than half of the victims or survivors of asbestos-associated diseases even filed a claim. The failure to claim benefits was particularly striking among a group of workers with typically short term exposures in a factory that closed in 1954. Only nine survivors of the 87 workers who died from asbestos-associated diseases filed workers' compensation claims. Apparently, the lack of recognition of the association between asbestos and disease was not as limiting a factor as was the lack of knowledge that the survivors were potentially eligible for benefits. Even among those filing claims, the settlements