CTBA | Center for Tax and Budget Accountability

70 East Lake Street, Suite 1700
Chicago, IL • 60601
www.ctbaonline.org

TURNAROUND FACT SHEET #1: WORKERS' COMPENSATION

March 16, 2017

ABOUT THIS SERIES

This is the first in a series of CTBA Fact Sheets reviewing the proposals in Governor Bruce Rauner's "Turnaround Agenda." These initiatives have taken on great significance in Illinois, given the Governor's decision to make enacting his Agenda a condition of passing a final General Fund budget—something the state has failed to do in the first two years of Rauner's gubernatorial term.

As many of the policies included in the Turnaround Agenda are not traditionally part of the state budget process, the Rauner Administration has justified their inclusion in a budget deal by arguing that they will speed economic growth, thereby increasing the tax base and easing the state's revenue shortfalls.

This series will identify whether there is evidence to indicate that the individual elements of the "Turnaround Agenda" will promote economic growth, and identify how Illinois compares to other states in these policy areas.

1. INTRODUCTION

1.1 Workers' Compensation Background

Workers' compensation insurance plays two critical roles. First, it helps ensure that employees who are injured on the job and either unable to work (those with "total disability"), or are limited in their ability to work ("partial disability"), are not impoverished. Second, it limits the exposure of businesses to liability as a result of injuries suffered by their workers while on the job.

Originally mandated by state laws in the early twentieth century, workers' compensation systems generally require employers to pay premiums to either public or private insurance funds.[i] In Illinois, these insurance funds are private.[ii] When an employee is injured, they are eligible to receive benefit payments based on a schedule set by state law. These schedules are generally prorated to a standardized measurement of the extent to which the injury limits the employee's ability to work. In exchange for paying into this system, employers are protected from lawsuits alleging negligence leading to worker injuries, significantly mitigating their risk.[iii]

1.2 Workers' Compensation Reform in Illinois

Workers' compensation insurance has long been criticized by business groups, which claim that its premiums unduly burden employers, and therefore reduce employment and business growth. In 2011, the Illinois General Assembly passed, and Governor Pat Quinn signed, a major reform bill aimed at reducing workers' compensation insurance costs by cutting reimbursement rates to medical providers by 30 percent, among other measures.[iv]

As part of his Turnaround Agenda, Governor Rauner has proposed further reducing the fees paid to medical providers, as well as limiting the benefits paid to workers. This would be accomplished by requiring that work activities be the "major contributing cause" of an injury. That is a much higher standard than current law, which simply requires that work activities be a cause of the injury suffered. In addition, Governor Rauner would narrow the types of work-related travel that are eligible for coverage under workers' compensation.[v]

In justifying his workers' compensation initiatives, Governor Rauner has identified increased economic growth as the intended outcome, maintaining that: "We need to make Illinois a growth state again. That means structural reforms to major cost drivers for businesses."[vi]

However, there is very little independent research linking lower workers' compensation costs to higher rates of employment or economic growth. In addition, the strategy of reducing the cost of workers' compensation to employers by cutting worker benefits is dubious, as recent national trends show employer costs rising even as worker benefits fall.

2. WORKERS' COMPENSATION COSTS IN ILLINOIS VERSUS OTHER STATES

2.1 Employer Costs

There are two primary ways to evaluate the costs of workers' compensation: the direct costs to employers, and the benefits paid to covered workers. Since the goal of Governor Rauner's proposals is to reduce employer costs, those will be analyzed first.

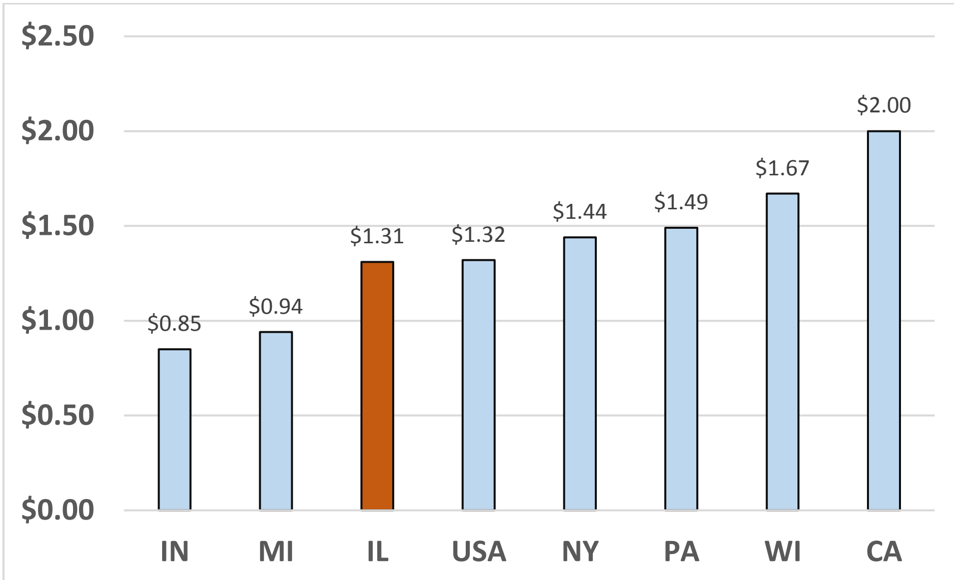
According to data collected by the National Academy of Social Insurance, worker compensation costs for employers in Illinois are slightly less than the national average. (For more on the choice of data in this Fact Sheet, see the Methodological Note.) In 2014, Illinois employers paid $1.31 in workers' compensation costs per $100 of covered payroll, just under the national average of $1.32, as shown in **Figure 1**. However, employer costs in Illinois are higher than some other Midwestern states, which have workers' compensation costs that are significantly below the national average, including Indiana ($0.85) and Michigan ($0.94). Wisconsin ($1.67) is a notable exception, with employer costs that are higher than Illinois'. Other large industrial states also tend to have higher employer costs than Illinois, such as New York ($1.44), Pennsylvania ($1.49), and California ($2.00).

2.1 Employee Benefits

As with employer costs, Illinois' employee benefits are also just below the national average.

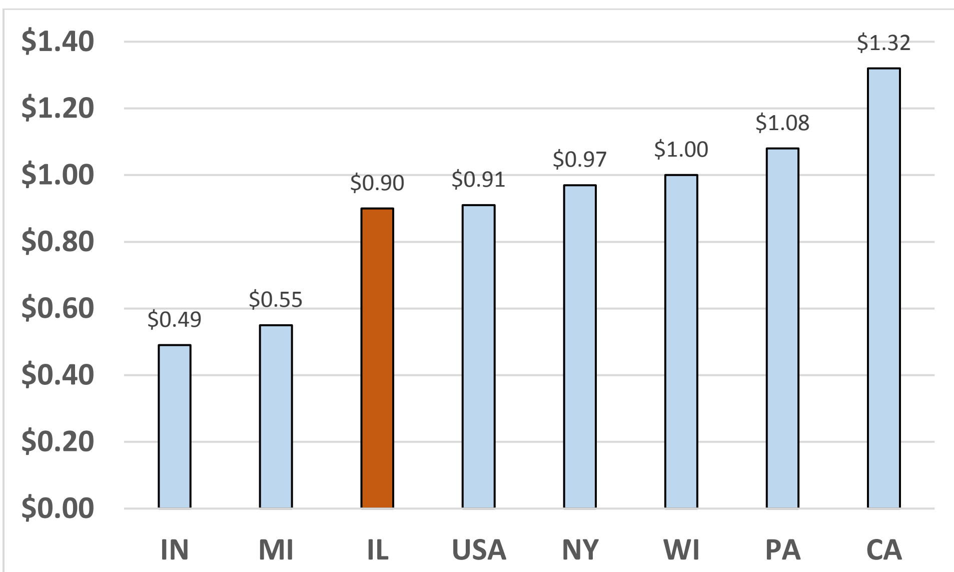
In 2014, Illinois workers' compensation insurance paid $0.90 in benefits per $100 of covered payroll. The national average was $0.91. Meanwhile, the state's Midwestern neighbors Michigan ($0.55) and Indiana ($0.49) had much lower benefits—among the lowest in the country—while Wisconsin ($1.00) had slightly higher benefits, as shown in **Figure 2**. Other large industrial states, such as New York ($0.97), Pennsylvania ($1.08), and California ($1.32), also have higher worker benefits than Illinois.

Figure 1: Workers' Compensation Employer Costs per $100 of Covered Payroll, 2014



Source: National Academy of Social Insurance

Figure 2: Workers' Compensation Benefits per $100 of Covered Payroll, 2014



Source: National Academy of Social Insurance

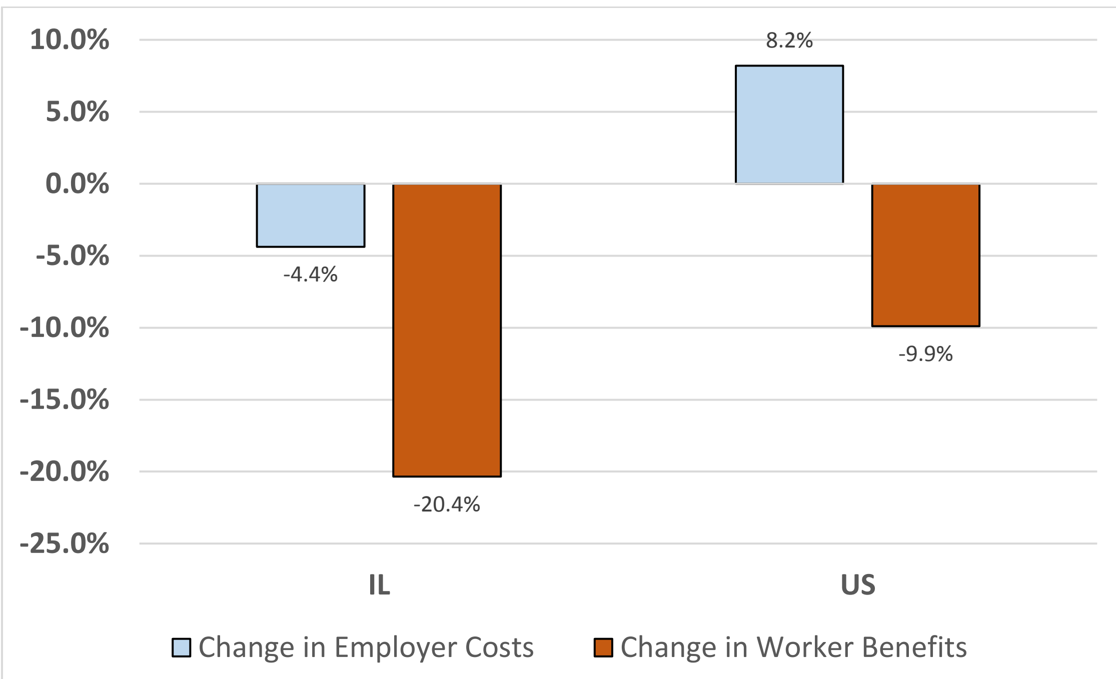
2.2 The Divergence of Employer Costs and Employee Benefits

This distinction between employer costs and worker benefits is important, as the reforms proposed by the Rauner Administration aim to shrink costs to employers by further reducing benefits to workers. However, as **Figure 3** shows, worker benefits per $100 of covered payroll have fallen precipitously in Illinois between 2010 and 2014, dropping over 20 percent from $1.13 to $0.90. But at the same time, employer costs have fallen just 4.4 percent, from $1.37 to $1.31 per $100 of covered payroll. In other words, for each one percent decline in worker benefits, employer costs have fallen just 0.2 percent.

Even more strikingly, while workers' compensation costs for employers in Illinois have been declining, employer costs nationally have actually increased by 8.2 percent. Moreover, that national spike in workers' compensation employer costs occurred despite the fact that worker benefits fell by 10 percent over the same period. **In other words, substantial reductions in worker benefits have been associated with very weak declines in employer costs in Illinois, and *increases* in employer costs nationwide.**

Therefore, the assumption that reducing benefits for injured workers will result in concomitant reductions in workers' compensation premiums for employers is simply not supported by the real world evidence. This is troubling, given that the Rauner Administration's proposed reforms make precisely this assumption, and rely on lowering worker benefits as a path to reducing employer costs.

Figure 3: Change in Workers' Compensation Employer Costs and Employee Benefits per $100 of Covered Wages in Illinois and the US, 2010-2014



Source: National Academy of Social Insurance

3. RESEARCH SHOWS LITTLE CONNECTION BETWEEN WORKERS' COMPENSATION AND ECONOMIC GROWTH OR EMPLOYMENT

Workers' compensation reform, though not a budgetary issue in the sense that it is not directly related to state expenditures or revenues, has nevertheless been included as part of the "Turnaround Agenda" that the Rauner Administration says must be part of any agreement to end Illinois' budget crisis. The

Administration argues that workers' compensation is crucial to any budget solution because it will spur economic and employment growth, increasing the size of the state's tax base.

This argument, however, does not appear to be supported by independent analysis of the link between workers' compensation costs and economic growth. In fact, there has been surprisingly little research on the question.[vii] But what has been done mostly suggests that there is no significant link.

In a 2005 paper, the Federal Reserve Bank of Kansas City found that **"workers' compensation costs are not a likely cause of jobs woes in most states."**[viii] The paper found that a 10 percent increase in workers' compensation benefits reduced employment by just 0.11 percent, and wages by 0.10 percent. By contrast, gas prices had a five times greater effect on wages. A 10 percent increase in employer costs reduced employment by even less—0.07 percent, with an even smaller effect on wages. The author concluded: **"Recent claims by policy makers, businesses, and chambers of commerce that workers' compensation costs are driving away jobs probably is unwarranted."**

Another study by researchers at Marshall University's Lewis College of Business found that in nearly half of all states, there was no correlation between workers' compensation benefits and economic development. Furthermore, even in those states that showed a statistically detectable correlation, the authors concluded that "the impact is so small that it is economically insignificant."[ix]

Moreover, according to the Workers' Compensation Research Institute, an independent research organization based in Cambridge, MA: "Our researchers note that workers' compensation is a very small percentage of total compensation, so the impact of changes in workers' compensation on a state's fiscal health is presumably negligible."[x]

It is necessary to go back to the early 1990s to find a study that suggests that higher workers' compensation costs have economically significant effects on employment.[xi] And that study was undertaken at a time when workers' compensation costs nationwide were significantly higher than today, and so presumably a more important cost factor for businesses. Indeed, between 1994 and 2014, workers' compensation costs fell by 57 percent.[xii] Since that significant national decline in workers' compensation costs, research has found no meaningful correlation between workers' compensation costs and economic growth.

4. CONCLUSION

Governor Bruce Rauner's "Turnaround Agenda" has made workers' compensation reform a major priority for any Illinois budget deal. Although workers' compensation does not directly affect state expenditures or revenues, the Rauner Administration has argued that reducing workers' compensation costs for employers is key to improving the state's economic growth and building the tax base. The Governor proposes to reduce employer costs principally through cutting benefits for injured workers.

CTBA's review of the evidence suggests that this plan is flawed in a number of ways. First, recent trends show that the connection between worker benefits and employer costs is weaker than is often assumed. Between 2010 and 2014, worker benefits in Illinois fell by over 20 percent, but employer costs fell just 4.4 percent. At the same time, employer costs actually *increased* nationwide, despite the fact that worker benefits declined. There is no evidence that further reductions to worker benefits will yield significant savings to employers.

Furthermore, most independent studies have found that there is no economically significant relationship between workers' compensation costs and either economic growth or employment. This seriously calls into question the appropriateness of making workers' compensation reform a critical part of a budget deal.

METHODOLOGICAL NOTE

Reports on workers' compensation costs by state commonly cite either the National Academy of Social Insurance (**NASI**) or the Oregon Department of Consumer and Business Services (**Oregon DCBS**). NASI and Oregon DCBS use different methodologies that lead to sometimes widely differing results. Specifically, Oregon DCBS creates an index of workers' compensation employer costs based on a sample of 50 industries common to Oregon, and then applies weights based on the industry mix of Oregon's state economy.

Because workers' compensation costs vary substantially by industry, these weights and sampling are significant. For example, Illinois' workers' compensation cost ranking is quite high in industries related to logging (it has the highest costs of any state in the Saw Mill sector, for example), but is much lower in some other areas (34^{th} highest costs in Clerical Office Employees, and 36^{th} in Home/Public Healthcare, according to Oregon DCBS). A weighting system that reduces the significance of Clerical Office Employees and increases the significance of Saw Mill workers will make Illinois' workers' compensation costs appear to be higher.

The Oregon DCBS itself warns that "Because not all premium classes were included in the study, the actual average premium rate for a state will differ from the weighted premium rate index, which is based on the characteristics of Oregon's economy. **If different classes had been selected, or payroll from a state other than Oregon had been used to weight the rates by class, the results would be somewhat different.**" (Emphasis added.)

The NASI data, on the other hand, report true average costs and benefits based on the existing industry mix in each state. For that reason, CTBA has chosen to use NASI data in this report.

ENDNOTES

[i] National Academy of Social Insurance. "Workers' Compensation: Benefits, Coverage, and Costs." October 2016. https://www.nasi.org/sites/default/files/research/NASI_Workers_Comp_Report_2016.pdf

[ii] Congressional Research Service. "Workers' Compensation: Overview and Issues." August 3, 2016. https://fas.org/sgp/crs/misc/R44580.pdf

[iii] Ibid.

[iv] Nyhan Bambrick Kinzie & Lowry. "2011 Illinois Workers' Compensation Reform Key Components." Undated. http://www.nbkllaw.com/articles/Law_Changes_Effect_June_28_2011.pdf

[v] The Illinois Turnaround. https://www.illinois.gov/gov/Documents/CompiledPacket.pdf

[vi] Ibid.

[vii] Tannenwald, Robert. "State Regulatory Policy and Economic Development." *New England Economic Review*, March/April 1997.

[viii] Edmiston, Kelly. "Workers' Compensation and State Employment Growth." April 2005.

[ix] Hatcher, Richard; Hicks, Michael; and Wilburn, Kristy. "Workers' Compensation Fiscal Structure and Economic Growth – A West Virginia Issue?" *State Tax Notes*, Vol. 23 No. 11. March 18, 2002.

[x] Email correspondence with Karen Holt, Assistant Director, Membership, Workers' Compensation Research Institute. January 5, 2017.

[xi] Durbin, David. "Workers' Compensation: Business at Risk." *NCCI Digest*, vol. 8, no. 1. May 1993.

[xii] Oregon Department of Consumer and Business Services, "Oregon Workers' Compensation Premium Rate Ranking." December 2016.