Workers' compensation in California and Canada

This Issue Briefing provides a case study of a comparison of the cost of the workers' compensation scheme in the state of California with the cost of provincial workers' compensation schemes in Canada.

Workers' compensation schemes are the oldest social security programs in North America. In Canada and in the United States (as in Australia), legislative responsibility for workers' compensation rests at the sub-national level. As workers' compensation institutions have evolved over the past 100 years, one strong difference has emerged between U.S. and Canadian schemes. The provision of workers' compensation insurance through competitive markets is dominant in the United States. In contrast, in Canada, the founding principle of public administration has endured.

The economies of California and Canada are approximately similar in scale. In 2007, 15.2 million workers were insured for workers' compensation coverage in California and 14.0 million workers were insured for coverage in Canada.

Drawing on this broad contrast, we describe similarities and important differences in expenditures for wage replacement benefit costs, expenditures for health-care services, and administrative costs associated with each system. In this comparison, we draw two primary observations. First, the Canadian system distributes a larger share of benefit expenditures directly to disabled workers in the form of wage replacement benefits. Second, the public administration of the Canadian system provides lower and more stable costs to employers than the competitive market design of the California system. We draw conclusions concerning the benefits realized to workers and employers in Canada arising from the principle of public administration in the Canadian system.

California introduced its workers' compensation program through the Boynton Act in 1913, making the purchase of workers' compensation insurance compulsory for most employers (Dixon et al, 2009). The California system is a blending of for-profit insurance carriers and an insurance scheme operated by the state of California (the State Fund). With the exception of state government workers, all California employers must either obtain workers' compensation from insurers licensed by the California Department of Insurance, or obtain a self-insurance certificate from the California Department of Industrial Relations (Dixon et al, 2009). Currently, 70 per cent of work injuries in California occur to employees of insured employers, 26 per cent to employees of self-insured employers and four per cent to employees of the state government (CHSWC, 2008). Prior to 1995, workers' compensation insurance rates were governed by the minimum-rate law that was passed in 1915. Under this regime, insurers could not issue, renew or continue workers' compensation insurance at premium rates that were less than the rates approved by the Insurance Commissioner (Dixon et al, 2009). The minimum rate law was repealed in 1993 and replaced by an open-rating system that allowed insurers to set their own rates. Subsequent to this reform, the California workers' compensation insurance market has been extremely volatile, with large fluctuations in premium rates and substantial insurer insolvency.

In Canada, provincial workers' compensation schemes were established in most Canadian provinces over the period 1910-1930. They were founded on common principles, generally following the recommendations of an Ontario Royal Commission under the direction of Meredith (Saskatchewan Workers Compensation Board, 2009):

KEY MESSAGES

- The administrative costs of the workers' compensation system in California, where benefits are provided mainly through private insurers, are much higher than in Canada, where workers' compensation is provided mainly through a single public agency in each province.
- Both workers and employers realize benefits from the public administration of the Canadian system compared with the competitive private insurance market for workers' compensation in the state of California.

1) *No-fault compensation:* Workplace injuries are compensated regardless of fault. The worker and employer waive the right to sue.
2) *Collective liability:* The total cost of the compensation system is shared by all employers. All employers contribute to a common fund. Financial liability becomes their collective responsibility.
3) *Security of payment:* A fund is established to guarantee that compensation monies will be available. Injured workers are assured of prompt compensation and future benefits.
4) *Exclusive jurisdiction:* All compensation claims are directed solely to the compensation board. The board is the decision-maker and final authority for all claims. Nor is the board bound by legal precedent; it has the power and authority to judge each case on its individual merits.
5) *Independent board:* The governing board is both autonomous and non-political. The board is financially independent of government or any interest group. The administration of the system is focused on the needs of its employer and labour clients, providing service with efficiency and impartiality.

In 2007, workers' compensation in California had benefit expenditures of $9.9 billion for wage replacement benefits and health-care service reimbursements. For the same period, expenditures in Canada were $7.3 billion. Expressed as benefits paid per covered employee, expenditures in California ($650) were higher than in Canada ($523). (U.S. and Canadian cost and benefit estimates are recorded in respective national currencies.)

In California, approximately 55 per cent of benefit expenditures were associated with the reimbursement of health services (approximately $350 per covered employee). In Canada, in contrast, less than 30 per cent of benefit expenditures were associated with health-service reimbursement (approximately $150 per covered employee). This difference is generally understood to be due to two factors. The prices for health services are higher in California than in Canada. In addition, the intensity of health-care treatment services is typically higher in California than in Canada.

Administrative costs of the workers' compensation system in California, which combine insurance carrier profits ($2.0 billion) and system administrative expenses ($5.3 billion), totalled $7.3 billion. Including underwriting profits, administrative costs in California represented 40 per cent of total system costs in 2007 (Baker, 2009). Administrative costs in the Canadian systems totalled $1.3 billion, representing approximately 15 per cent of total costs. Administrative costs per dollar of benefits paid are much lower in Canada than in California.

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The lower costs of the Canadian workers' compensation system were documented in earlier work by Thomason and Burton, in an unusually thorough analysis of workers' compensation costs in 44 U.S. states and two Canadian provinces over a 20-year period from 1975 – 1995 (Thomason and Burton, 2000). This research was informed by a number of theoretical considerations centred on the relative efficiency of the publicly-administered system in Canada compared with the competitive insurance market in the United States. Thomason and Burton acknowledged that there were two contrasting predictions concerning relative efficiency. On the one hand, competitive insurance markets could result in higher costs than publicly-administered schemes for two reasons. A single public insurer will be able to capture economies of scale not available to private insurers in a competitive market and, unlike private insurers, public schemes will not incur marketing costs or require profits. On the other hand, the competitive pressures experienced by private insurers could result in lower administrative costs, more effective claims management and a higher investment in loss prevention services compared to single agency public insurance funds.

Thomason and Burton accounted for factors that might influence costs differences between Canada and the United States that are unrelated to the structure of the insurance system. Their study adjusted for differences in industry mix, differences in benefit generosity, union membership rates, the proportion of compensation claims awarded a permanent partial disability benefit, and differences in workers' compensation coverage of the active labour force. The results from a regression analysis adjusting for all these factors estimated that net workers' compensation costs per worker per week were approximately 49 per cent lower in British Columbia than in the United States and about 30 per cent lower in Ontario. In conclusion, Thomason and Burton stated that the findings from this work "…while not a result we expected…suggests that costs may increase by shifting from monopolistic provision to a private insurance model."

A similar finding of lower administrative costs under public administration has been observed in comparisons of health-care insurance schemes in Canada and the United States. Woolhandler et al reported substantially lower administrative costs in the publicly-administered, universal coverage Canadian schemes compared with the private insurance markets in the United States (Woolhandler, 2003). In 1999, health-care administration costs were estimated to represent $1,059 per capita in the United States, as compared with $307 per capita in Canada. Administrative costs, consolidating costs borne by insurers and providers, accounted for 31 per cent of health-care expenditures in the United States and 16.7 per cent of health-care expenditures in Canada.

Although the principles of workers' compensation are broadly equivalent in the California and Canadian systems, there are a number of characteristics that differ between the systems. These need to be acknowledged in drawing conclusions from the broad (and necessarily superficial) comparison between Canada and California. First, differences in the industrial mix of the two economies have not been considered in this briefing. A higher proportion of employment in higher risk industrial sectors, such as primary production, would in general result in a system with higher workers' compensation expenditures. Second, some Canadian schemes and the California system permit some classes of large employers to self-insure. In California, approximately 2.8 million workers in private industry and 1.6 million workers in the public sector are employed by self-insured employers (CHSWC, 2008). This briefing note includes estimates of the workforces employed by self-insured employers and have incorporated estimates of the costs borne by self-insured employers. Third, there are important differences in the structure of wage replacement benefits under the two systems. The benefit rate and maximum weekly benefit is lower in California than in Canadian systems. A much higher proportion of disability episodes are awarded a permanent disability benefit in California (25-30 per cent) than in the Canadian systems (10.3 per cent). This reflects statutory and regulatory differences in the definition of eligibility for permanent partial disability, a longer qualifying period for the initiation of benefits in California, and a greater reliance on legal representation and court decisions in California.

COMPARISON OF COSTS AND BENEFITS, CALIFORNIA AND CANADA WORKERS' COMPENSATION, 2007 (1)

	California (2)	Canada (3)
Covered employees	15,250,000	13,980,000
Wage replacement benefits ($ million)	$4,532	$5,255
Medical care and vocational rehabilitation ($ million)	$5,385	$2,052
Sub-total: Benefits paid ($ million)	**$9,917**	**$7,307**
Insurer underwriting profit (loss) ($ million)	$1,976	$0
Administration expenses (4) ($ million)	$5,323	$1,306
Total cost ($ million)	**$17,601**	**$8,613**
Total premium revenue (5) ($ million)	$13,200	$8,998
Benefits paid per covered employee	$650	$523
Administrative expenses per covered employee	$478	$93

(1) U.S. and Canadian cost and benefit estimates are recorded in respective national currencies.

(2) 2008 Annual Report. California Commission on Health and Safety and Workers' Compensation (CHSWC). State of California, Department of Industrial Relations, December 2008. An estimate of amounts paid by self-insured employers and the State of California, representing $4.175B, are included in this system-wide cost and benefit summary.

(3) Key Statistical Measures, 2007. Association of Workers' Compensation Boards of Canada, June 2009. Estimate of the insured workforce is obtained from the Institute for Work & Health, http://www.iwh.on.ca/compensation-fact-sheets

(4) Expenses for the California system include: loss adjustment expenses ($2.59B), commissions and brokerage fees ($0.94B), other acquisition expenses ($0.44B), general expenses ($0.99B) and taxes ($0.35B). Expenses for the Canadian system include incurred expenses related to the administration and management of provincial workers' compensation boards.

(5) Total premium revenue for the Canadian schemes combines the amount reported by the Association of Workers' Compensation Boards of Canada (2) for all jurisdictions except Quebec with total employer assessment income ($2.277B) reported in the 2007 financial statements of the Quebec CSST.

Administrative costs for the Canadian schemes include expenditures of $480 million for occupational health and safety programs. In some Canadian schemes, legislative obligations require workers' compensation agencies to provide funding for labour inspection services and other occupational health and safety services. As of 2007, the California Department of Industrial Relations was funded entirely by employer assessments. This department is responsible for labour inspection services and administrative law services. Administrative costs for the Canadian schemes also include operational costs of appeal tribunals.

Following the deregulation of insurance rates in 1995, the California workers' compensation system has been highly volatile. Premium rates per $100 of assessable payroll increased from approximately $2.50 in the mid-1990s to $6.00 in the 2003-2004 period (Baker, 2009). Very significant reforms enacted over the period 2002-2004 reduced benefit expenditures and premium costs by more than 60 per cent between 2003 and 2008.

In drawing this comparison between the Canadian schemes and the California system, 2007 reflects a period of much lower workers' compensation costs in California compared to earlier in the decade. We note that the volatility in the California workers' compensation market was not typical of the majority of U.S. states, most of which also rely on private insurance markets for the provision of workers' compensation insurance.

Conclusion

The California and Canadian workers compensation system have approximately similar benefit expenditures per insured worker. However, compared with California, the Canadian workers' compensation system distributes a larger share of benefit expenditures directly to disabled workers in the form of wage replacement benefits. Administrative costs are much higher in the California workers' compensation system compared with the Canadian systems. The public administration of the Canadian system provides lower and more stable costs to employers than the competitive market design of the California system. Both workers and employers realize benefits from the principle of public administration in the Canadian system compared to the cost profile of the competitive private insurance market for workers' compensation in the state of California.

Policy implications

The public administration of workers' compensation in the Canadian systems provides a strong economic benefit to employers, arising from the lower administrative costs of a single public agency compared with the costs arising in a competitive insurance market. There is very little evidence that competitive insurance markets are more efficient in the provision of health-care services or in providing wage replacement benefits to injured workers.

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