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Issue 1 and Workers' Compensation in Ohio

by Mark S. Sniderman

The state of Ohio, which currently forbids private-insurance companies from competing with the state-run workers' compensation program, is now in the throes of deciding whether to allow private-insurance carriers to enter the market. A number of organizations have announced their opposition to this change, including the Ohio Manufacturers' Association, the Ohio Chamber of Commerce, the Greater Cleveland Growth Association, the Ohio AFL-CIO, and the Nationwide Insurance Company. Such a unique amalgam of interests opposing private competition for workers' compensation indicates the extent of confusion, complexity, and emotion in the Issue-1 debate. The passage of Issue 1 will not guarantee competition; it will merely permit private-insurance carriers to enter the market. The Ohio Department of Insurance will be responsible for regulating these carriers if Issue 1 passes.

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Both economic theory and economic experience demonstrate the benefits of competitive markets to consumers. Therefore, arguments in favor of a state monopoly are viewed with skepticism. This *Economic Commentary* discusses workers' compensation (WC) in Ohio and compares public and private systems in the United States using the criteria of costs, benefits, and quality of service. With proper supervision a competitive market has the potential of reducing employers' costs and improving service to employees, with no change in benefits.

Historical Perspective

The industrialization of America brought with it social concern over the employer's responsibility for safety in the work place. As was the case for many early social reforms, however, there was resistance to state control over private enterprise. The American system of compensation in the case of work-related injury was largely bound by precedents passed down from English common law. Under this legal framework it was difficult to hold an employer in any part responsible for injuries sustained by his employees. Moreover, where cases did fit some rather narrow liability definitions, the cost of litigation was often a major deterrent to employee action. There were relatively few WC claims prior to 1900.

In 1902, decades after insurance mechanisms for compensating injured workers had been legislated in many European communities, the state of Maryland enacted legislation establishing a cooperative accident-insurance fund providing benefits to families in the event of an employment-related death. The act soon was rescinded, as opponents successfully attacked its constitutionality. Similar efforts in other states either failed somewhere along the legislative process or were struck down by the courts. The resistance of legislatures and courts to early compensation laws was softened by criticism from Presidents Theodore Roosevelt and William Taft. In 1911, Wisconsin enacted the first effective WC legislation in the United States. That same year other states (including Ohio) enacted similar laws. Within five years a majority of states had followed the Wisconsin initiative.

While none of the state programs developed identically, most now have comparable features. Virtually all compel coverage of certain types of employers, especially those engaged in businesses where employees are exposed to hazards. Most states require employers to purchase WC from private insurers (Wisconsin's WC legislation gave rise to a number of private-insurance firms specializing in work-related injury protection). Some states, however, operate their own insurance programs as supplements to the private market; these programs originated because some employers could not purchase adequate coverage from private carriers. Today, all 50 states, the District of Columbia, and Puerto Rico have WC laws. In 34 states insurance is sold strictly through private carriers; in 12 states a state-insurance program competes with the private insurers. Ohio is one of six states where the state government operates a WC insurance monopoly (the others are Nevada, North Dakota, Washington, West Virginia, and Wyoming).

Ohio permits employers to self-insure (act as their own insurance company and not pay into the state fund) if they can demonstrate adequate financial solvency. Out of 240,000 employers in the state-WC system, 723 self-insure; though the self-insurers account for less than 1 percent of all employers, they represent almost one-third of the nearly 4,000,000 covered employees. Although the Issue-1 debate does not directly concern self-insurance in Ohio, self-insurance is an important aspect of Ohio's WC program.

In the summer of 1975, an investigation of the Ohio WC program revealed questionable uses of funds and general mismanagement. In April 1976, Governor Rhodes appointed a new chairman of the Ohio Industrial Commission (OIC), whose first act was to request an audit of the state fund. In March 1977 the audit concluded that the fund had a substantial actuarial deficit ($1.3 billion). Soon after the release of the audit, the new OIC chairman speculated that complete recovery of the fund could take as long as a decade. That same month, a Cleveland newspaper editorial planted the seeds of what has now become Issue 1:

> . . .In view of the horrendous bureaucratic problems historically experienced by the Ohio system and the rising employer contribution rates, this would be a fit moment for the General Assembly to undertake a careful feasibility study of the benefits of turning the state monopoly over to private insurance companies.[1]

1. See "Avoiding Financial Ruin," *The Plain Dealer* (Cleveland, Ohio), editorial, March 26, 1977, p. A20.

Even prior to the audit, some reforms had been initiated. A system designed to protect fund outlays and improve accounting procedures was implemented. Even more significant was a new state law that mandated the OIC to set employer-contribution rates at levels assuring actuarial soundness. The immediate result was an average rate increase of 28 percent in 1976 and another 22 percent increase in 1977. Rates declined 19 percent in 1978 and have been relatively stable since.

The recovery of the Ohio fund will probably not take as long as most had feared. The state-fund deficit has been greatly reduced during the past four years, though it is uncertain whether the deficit has yet been eliminated. The recovery stems in part from the increases in employer-contribution rates, the 1976 reforms, and fund-investment gains. The current and prospective actuarial condition of the state fund figure prominently in the opposition to Issue 1. For example, some opponents actually favor the entry of private carriers into the WC market, but not until the actuarial soundness of the state fund is assured. Another Issue-1 opponent contends that the Ohio fund need not be subjected to the same accounting standards as private-insurance carriers, in the belief that the state of Ohio ultimately guarantees fund solvency.

Costs, Benefits, and Services

Most Issue-1 opponents fear that a competitive WC system would increase employers' costs and reduce injured-workers' benefits. Issue-1 proponents take the opposite stance. Each side cites supporting studies and statistics, and, indeed, there are a host of "facts" from which to choose.

In comparing the costs of the WC systems in the United States, Elson and Burton (1981) estimate employers' costs for WC with several measures: manual rates, adjusted manual rates, and net costs of WC insurance per employee.[2] Manual rates are the insurance costs in dollars per $100 of weekly earnings per employee as listed by each state in its official schedule. However, employers in general pay less than the manual rates. Their insurance costs are reduced by premium discounts for quantity purchases, dividends received from insurance companies, and modifications resulting from the employers' own accident experience. Adjusted manual rates, which provide a more accurate measure of employers' costs, are derived from these considerations.[3] The net costs of insurance per employee are simply the product of the state's adjusted manual rate and its average weekly wage. Elson and Burton provide estimates of these three measures as of July 1978, for a diversified group of 45 employer-types in 47 jurisdictions (see table 1). Where a rank of 1 denotes the least expensive jurisdiction, Ohio ranks 26 out of 47 in manual rates, 35 in adjusted manual rates, and 36 in net costs of insurance.[4] These figures illustrate that Ohio is not a low-cost WC state for employers.

Issue-1 opponents claim that Ohio employers enjoy a cost advantage, because state funds have lower operating costs than private carriers. A study by Price (1979) supports this view.[5] State funds, in general, spend very little money to obtain business, and exclusive state funds spend almost nothing for this purpose. In 1976, the ratio of administrative expenses to premiums written for all public funds was 10.1 per-

2. See Martin W. Elson and John F. Burton, Jr., "Workers' Compensation Insurance: Recent Trends in Employers' Costs," *Monthly Labor Review*, vol. 104, no. 3 (March 1981), pp. 45-50. This study analyzes 47 jurisdictions: the 50 states plus the District of Columbia, less Nevada, North Dakota, Washington, and Wyoming. These four states and all self-insuring employers are excluded because of data limitations. The cost estimates assume that the distribution of employees by industry in each state is identical to the national distribution.

3. See Elson and Burton, p. 46.

4. The average adjusted manual rate is 1.376; Ohio's rate is 1.550.

5. See Daniel N. Price, "Workers' Compensation Programs in the 1970's," *Social Security Bulletin*, vol. 42, no. 5 (May 1979), pp. 3-24.

Table 1 Employers' Average Weekly Costs of Workers' Compensation Insurance
As of July 1, 1978

Jurisdiction	Manual rates (per $100 of payroll): 45 types of employers	Rank	Adjusted manual rates (per $100 of payroll): 45 types of employers	Rank	Net costs of insurance (per employee): 45 types of employers	Rank
Alabama	$1.043	9	$0.855	9	$1.544	9
Alaska	2.149	38	1.762	38	4.879	44
Arizona	3.055	44	2.505	44	5.294	45
Arkansas	1.576	23	1.292	23	2.078	17
California	2.604	43	2.135	43	4.816	43
Colorado	1.475	20	1.210	20	2.554	25
Connecticut	1.650	25	1.353	25	2.768	29
Delaware	1.742	32	1.428	31	2.922	33
District of Columbia	4.271	47	3.502	47	8.199	47
Florida	3.221	45	2.641	45	4.793	42
Georgia	1.313	16	1.077	16	1.912	16
Hawaii	2.508	42	2.057	42	3.964	40
Idaho	1.569	22	1.287	22	2.238	20
Illinois	1.685	30	1.382	28	3.063	34
Indiana	0.585	1	0.480	1	1.015	2
Iowa	1.322	17	1.084	17	2.190	19
Kansas	1.072	11	.879	11	1.659	13
Kentucky	1.685	29	1.382	29	2.781	30
Louisiana	1.844	35	1.512	34	2.909	32
Maine	1.684	28	1.380	27	2.581	26
Maryland	1.539	21	1.262	21	2.526	24
Massachusetts	1.674	27	1.373	26	2.757	28
Michigan	2.305	41	1.890	41	4.370	41
Minnesota	2.220	40	1.821	40	3.733	38
Mississippi	1.100	14	0.902	14	1.457	6
Missouri	0.903	4	0.740	5	1.196	3
Montana	1.712	31	1.404	30	2.795	31
Nebraska	0.865	3	0.710	4	1.484	7
New Hampshire	1.422	18	1.166	18	2.128	18
New Jersey	2.057	36	1.687	36	3.651	37
New Mexico	1.757	33	1.441	32	2.479	23
New York	2.158	39	1.770	39	3.844	39
North Carolina	0.649	2	0.532	2	0.899	1
Ohio	**1.664**	**26**	**1.550**	**35**	**3.352**	**36**
Oklahoma	1.763	34	1.446	33	2.654	27
Oregon	3.558	46	2.918	46	6.288	46
Pennsylvania	1.431	19	1.173	19	2.382	21
Rhode Island	1.589	24	1.303	24	2.387	22
South Carolina	1.020	7	0.836	7	1.360	5
South Dakota	1.027	8	0.842	8	1.649	12
Tennessee	1.101	15	0.903	15	1.666	14
Texas	2.137	37	1.753	37	3.293	35
Utah	1.087	13	0.892	13	1.701	15
Vermont	1.067	10	0.875	10	1.646	11
Virginia	1.074	12	0.880	12	1.525	8
West Virginia	0.962	6	0.660	3	1.229	4
Wisconsin	0.917	5	0.752	6	1.582	10

SOURCE: Martin W. Elson and John F. Burton, Jr., "Workers' Compensation Insurance: Recent Trends in Employers' Costs," *Monthly Labor Review,* vol. 104, no. 3 (March 1981), p. 46.

cent, whereas the corresponding ratio for exclusive state funds was 5.8 percent. The administrative-expense ratio of private carriers is more likely to be in the area of 23 percent.[6] The cost advantage enjoyed by state funds should be available to employers in the form of lower rates. However, as the Elson and Burton study demonstrated, Ohio's rates are above the national average.

Higher-than-average costs for Ohio's employers simply might be the result of higher-than-average WC benefits for Ohio's employees. According to Price (1979), benefits paid in Ohio appear to surpass the national average, although the benefit scale is typical of other states. Ohio seems to grant more claims and perhaps larger benefits per claim. For instance, benefits in Ohio in 1976 were about 1 percent of payrolls in covered employment, placing them above the national average: only 15 other states paid at a rate at least as great as Ohio's. By comparison 14 other states (including New York, Illinois, and Pennsylvania) paid 0.50 percent to 0.69 percent of payroll in total benefits.

Samers and Kelly (1980) studied a third dimension of comparison between state funds and private carriers—the promptness with which claims are paid.[7] This aspect of WC generally has been overlooked in the Issue-1 debate. Since WC is designed to protect against the interruption of income, timeliness of payment is an important factor in evaluating insurance programs. Delays in the payment of uncontested claims are fundamentally administrative in origin; contested-claim payments are subject to delay until a hearing process is completed. Samers and Kelly's study of this attribute of the WC program concludes that differences among state and types of carriers are substantial. Their data indicate that nationwide 72 percent of all uncontested cases were paid (i.e., first payment) within one month, and 91 percent were paid in three months; comparable figures for Ohio are 41 percent in one month and 75 percent in three months. Only a few states had a worse record of promptness. In contested cases nationwide, 78 percent of the claims were paid in three months. In Ohio, only 62 percent of contested claims were paid in three months (13 states had a worse record). Ohio contested about 18 percent of all cases, about average for the cases in the national sample.

Perhaps more relevant to the discussion of service quality are the differences among state, private, and self-insured carriers. In the national sample, private-insurance carriers have the best promptness record, and self-insurers have the worst. These findings are of some consequence in Ohio because of the large proportion of employees covered by self-insuring employers.

Given the different records of promptness between uncontested and contested cases, the incidence of contested cases also can provide some clues as to quality of service. While Ohio contested cases at the same rate as the national sample (18 percent), state funds on average contested fewer (10 percent); insurance companies contested slightly more (20 percent to 22 percent); and self-insurers contested the most (29 percent). Since private-insurance companies contested roughly the same percentage of cases as Ohio and paid no less promptly, it is not clear that Ohio claimants would suffer in this regard from private-insurance coverage.

6. The estimate of 23 percent is based on my reconciliation of the data reported by Price in his tables 8, 9, and 11. Table 11 reports expenses as 10.1 percent of *premiums written* for state funds in 1976. Table 9 reports expenses of $1.77 billion and *premiums earned* of $6.67 billion for stock and mutual companies in 1976. Table 8 reports the ratio of *premiums written* to *premiums earned* for all private carriers in 1976 as 1.13. Thus, *premiums written* in 1976 by stock and mutual carriers are approximated by 1.13 times $6.67 billion, or $7.57 billion. Therefore, for stock and mutual companies in 1976, expenses constituted approximately 23 percent of *premiums written*.

7. See Bernard N. Samers and Dorothy I. Kelly, "Promptness of Payment in Workers' Compensation," in *Research Report of the Interdepartmental Workers' Compensation Task Force*, vol. 3, U.S. Government Printing Office, 1980, pp. 63-90. Data refer to a national sample of over 40,000 WC claims that closed in 1975.

By another measure of service quality—successful litigation—state insurers seem inferior to other insurers. Samers and Kelly demonstrate that state funds are much less willing to compromise contested cases than other carriers, yet they still lose a much greater proportion of the litigated claims than other insurers.

Concluding Remarks

WC is currently a much-debated topic throughout the nation. Several states recently modified or considered modifications in rate-setting or benefit provisions. State legislatures set the benefit levels and establish oversight rules and market structure; the latter influences the economic cost of insurance and the administrative process governing claims and payments. Issue 1 does not call for a change in benefits or costs, but a change in market structure from monopoly toward competition.

Despite the difficulty in making comparisons, the wide variation in WC systems among states provides some information that bears on the Issue-1debate. The Ohio WC system entails both larger costs and benefits than the national average, although not much different from the national average in either case. Private coverage would appear to offer the possibility of an improvement in the promptness with which claims are handled.

Evidence reported in this *Economic Commentary* does not strongly indict Ohio's current WC system, but neither does a basis for praise emerge. Perhaps the most fundamental aspect of the Issue-1 debate is the choice between two very different regulatory mechanisms for WC in Ohio. At issue is whether the long-term public interest is best served by monopoly or by competition. In light of Ohio's experience just prior to 1976, this is a meaningful choice. Those concerned with workers' welfare might press for reforms in the claims handling of Ohio's WC system rather than prevent private carriers from entering the WC-insurance business. Experience in other states suggests that opportunities for significant improvement in Ohio's WC system do exist.

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