

**STUDY OF THE WORKERS' COMPENSATION PROGRAM  
OF THE STATE OF HAWAII  
FINAL REPORT**

**Conducted by  
Haldi Associates, Inc.**

**A Report to the Legislature of the State of Hawaii**

**Submitted by the  
Legislative Auditor of the State of Hawaii**

**Report No. 84-16  
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## FOREWORD

Hawaii's first workers' compensation law was enacted in 1915. It was patterned after the uniform act drafted by the Commissioners on Uniform State Laws. Over the years, the law has been amended numerous times, and today, the Hawaii State Legislature is once again faced with the issue of considering changes to the law.

The program has become increasingly controversial mainly because of the significant increase in recent years of workers' compensation costs and insurance rates. In 1983, the Legislature enacted a moratorium on workers' compensation insurance rates as a temporary measure until more permanent solutions could be developed to control costs and improve the program. As a companion action to the moratorium, the Legislature requested our office to undertake a comprehensive study of the workers' compensation program and to submit an interim report to the 1984 legislative session and a final report to the 1985 session.

To conduct the study, our office engaged the services of the consultant firm, Haldi Associates, Inc. of New York City. We submitted the firm's interim report to the 1984 session. That particular report apprised the Legislature of some of the issues which were being evaluated and analyzed.

This report is a final report which culminates in the presentation of recommendations designed to control costs, provide fair and equitable benefits, and improve the effectiveness and efficiency of the workers' compensation program.

We join the director of the study, Dr. John Haldi, in expressing our appreciation to the many individuals, in government as well as in the private sector, who participated in the study by providing data and other information, presenting their views on the subject, and cooperating in every possible way. This study would not have been possible without their valuable contributions.

Clinton T. Tanimura  
Legislative Auditor  
State of Hawaii

December 1984

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## Chapter 1

### INTRODUCTION

In the 1983 legislative session, the Hawaii State Legislature adopted two concurrent resolutions relating to Hawaii's workers' compensation program: Senate Concurrent Resolution No. 61, S.D. 1, H.D. 1, and House Concurrent Resolution No. 172, H.D. 1, S.D. 1. While differing in detail, the two resolutions were similar in purpose and intent and called for a comprehensive two-year study of Hawaii's workers' compensation program. This final report is the result of that study.

#### Objectives of the Study

The objectives of the study are to:

- (1) identify the public policy objectives towards which the State's workers' compensation program should be directed;
- (2) evaluate the existing workers' compensation program in Hawaii;
- (3) develop and analyze alternatives to the existing program; and
- (4) recommend appropriate changes.

#### Scope of the Study

This study was completed using, for the most part, data which are currently available. The study (1) analyzed statistics on work injuries and illnesses to determine trends and deviations from national experience; (2) used data provided by the Disability Compensation Division and the National Council of Compensation Insurers to examine trends in the frequency and severity of compensation cost components;

(3) reviewed the competitive environment surrounding the determination of workers' compensation insurance rates; and (4) examined the general administration of the workers' compensation program.

#### Organization of the Report

This report is divided into six chapters and seven appendices.

Chapter 1 is this introductory chapter.

Chapter 2 briefly describes the current workers' compensation program in Hawaii.

Chapter 3 reviews the change in benefit payments that have occurred since 1970.

Chapter 4 examines the increase in benefit payments in greater depth. The purpose of this chapter is to identify those characteristics in Hawaii which are generally similar to and those which differ markedly from other states.

Chapter 5 analyzes the underlying causes why benefit payments have risen so rapidly in recent years and why insurance costs are high.

Chapter 6 contains recommendations designed to contain future costs of the workers' compensation program while making it a more effective and efficient benefit system.

Of the appendices, Appendix A describes how special workers' compensation state funds operate in Hawaii and other states.

Appendix B summarizes the rehabilitation programs provided in seven comparison states in connection with workers' compensation benefits.

Appendix C reviews recent major changes which six states have made to their workers' compensation laws.

Appendix D compares the trend in Hawaii's workers' compensation insurance rates with the trends of other states.

Appendix E contains selected statistical data concerning Hawaii's workers' compensation program.

Appendix F discusses the process for setting insurance rates for workers' compensation.

Appendix G evaluates the principal benefits and disadvantages of establishing a state fund to finance the workers' compensation program.

## Glossary

In this report and in connection with workers' compensation, various terms are used which are not in common usage. In this section, some of those terms are defined.

### *Disfigurement*

Any scar, deformity, discoloration, or other disfiguring consequences caused by the accident itself or by medical, surgical, and hospital treatment of the employee.

### *Hearing officers*

Employees of the Disability Compensation Division in the Department of Labor and Industrial Relations who are responsible for determining whether an injury is compensable and, if it is compensable, the type and amount of benefits that are appropriate. Decisions of a hearing officer can be appealed to the Labor and Industrial Relations Appeals Board.

### *Indemnity benefits, claims, and payments*

All benefits other than medical expense benefits and attendant services. Includes income replacement benefits for temporary partial and temporary total disability; permanent partial, death, or survivor benefits; plus benefits for permanent total disability, disfigurement, and vocational rehabilitation.

### *Manual insurance rates*

Insurance rates determined by the State Insurance Commissioner. Manual rates serve as the base rate charged by insurance companies for workers' compensation coverage prior to adjustments for policyholder dividends and individual employer's claims experience. A manual rate is calculated for each of several hundred business classifications (e.g., retail dry goods store). Manual rates are based on the expected average loss experience for each class.

### *Medical only*

Injuries, usually minor, for which only medical benefits are paid.

*Permanent partial disability*

Injury or illness which results in the complete loss of, or a permanent impairment to, any part of the body, short of total disability.

*Permanent total disability*

Any injury or illness which permanently and totally incapacitates the employee to such an extent that the employee has no reasonable prospect of finding regular employment of any kind in the normal labor market.

*Scheduled impairment*

Permanent impairments that are listed in a "schedule," which is contained in the benefits section of the workers' compensation law. Scheduled impairments involve loss (or loss of use) of limbs, eyes, and hearing.

*Second injury*

A subsequent injury to the same worker which, in conjunction with the prior injury, has a combined impact that exceeds the impact of either injury considered alone (e.g., loss of a second eye or second arm).

*Special compensation fund*

A fund administered by the Department of Labor and Industrial Relations that is often referred to as the second injury fund, even though the fund pays benefits under a variety of conditions. (See Appendix A for a detailed discussion.)

*Statewide average weekly wage*

An amount determined according to Section 383-22, Hawaii Revised Statutes, and used as the basis for determining the maximum amount of weekly indemnity benefits to be paid to injured workers. Data on the average weekly wage are contained in Appendix E, Table E-7.

*Temporary partial disability*

A type of disability where the work injury or illness causes partial rather than total disability for temporary periods. For the duration of the disability, the injured worker is paid a weekly benefit based on the difference between the worker's pre-injury and post-injury earnings.

*Temporary total disability*

Disability where the work injury or illness causes total disability for a temporary period, commonly referred to as "the healing period." The injured worker receives a weekly benefit amount based on pre-injury earnings.

*Unscheduled impairment*

Permanent impairments other than scheduled impairments. Most commonly involves back, neck, or shoulder injuries, but may involve other parts of the body.

*Washout settlements*

A negotiated settlement agreed to by the injured employee and the employer where the worker agrees to receive a "lump sum" settlement in lieu of future benefits.



## Chapter 2

### THE WORKERS' COMPENSATION PROGRAM IN BRIEF

The vast majority of employees in the State of Hawaii are entitled to compensation for job related accidents under Hawaii's workers' compensation statutes. In 1983, the Hawaii workers' compensation system covered a total of approximately 381,000 workers. Principal exclusions are those workers who come under (1) the Longshoremen's and Harbor Workers' Act, or (2) the Federal Employees' Compensation Act. These other acts cover longshore workers and employees of the federal government, respectively. Self-employed professionals and owners of unincorporated businesses are also not required to be covered under Hawaii's workers' compensation program.

#### Major Types of Benefits

For employees who incur work related injuries and illnesses, the workers' compensation program provides three principal types of benefits:

1. Reimbursement for medical and hospitalization expenses, unlimited as to amount;
2. Weekly cash payments to cover a portion of lost wages, subject to some maximum amount;
3. Rehabilitation services to aid early return to work.

Additional cash awards are made for disfigurement. For those severe accidents

that result in death, survivors receive a replacement income based on prior earnings of the deceased worker.

All benefits under the workers' compensation program are tax free to recipients. Total benefits paid for work injuries during 1983 amounted to approximately \$103 million. Actuaries sometimes refer to benefit payments as "pure loss costs," and all other payments as overhead costs of the program. Benefit payments represent the base of the pyramid of total costs. In Hawaii, pure loss costs represent just under two-thirds of total program costs. Other overhead costs include fees for attorneys, costs of claims managers and adjusters, recording costs (claims files, statistical data, etc.), taxes, and general overhead costs.

#### Benefit Distribution

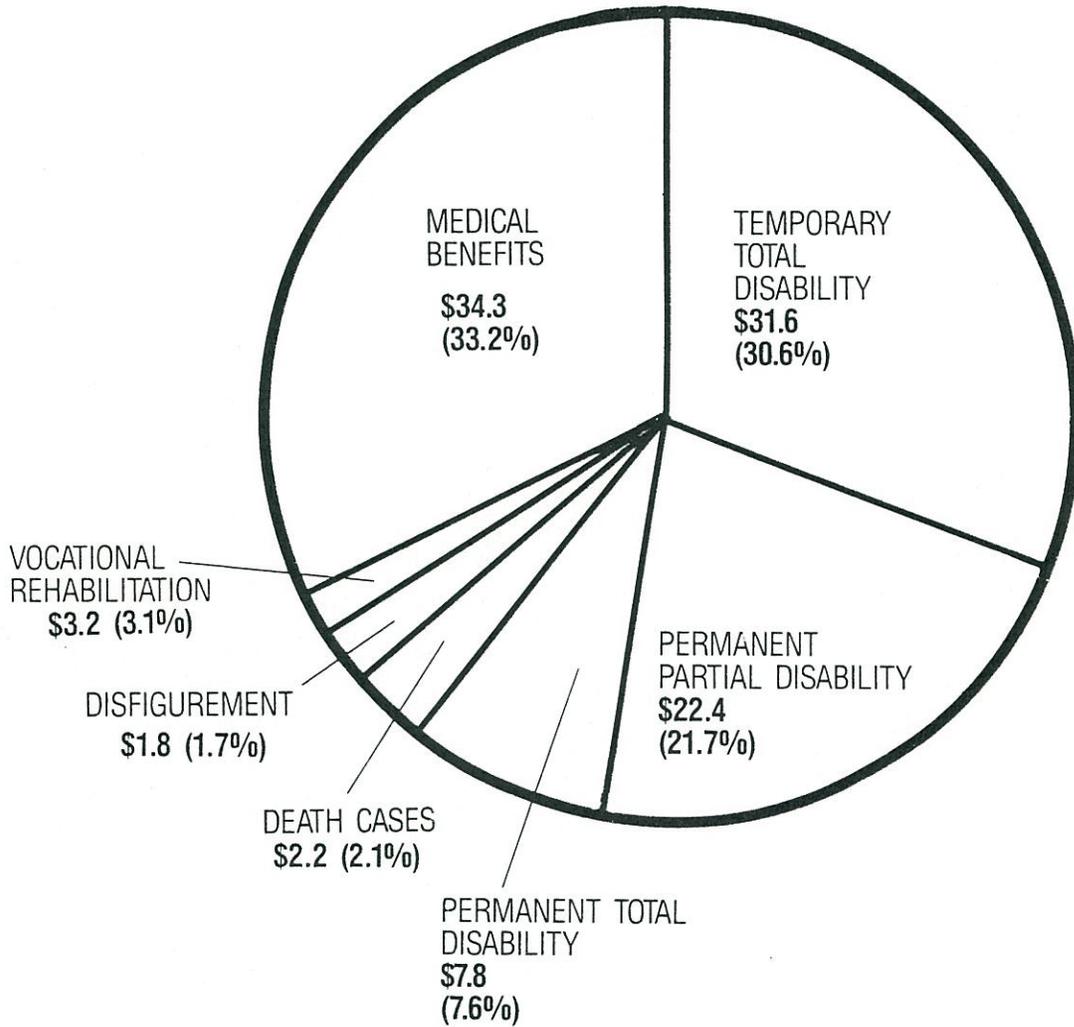
Benefit payments, by major category, are shown in Figure 2.1. The largest expense category was payment of medical costs, which represented almost one-third of total benefit payments.

The second largest expense category consists of payments for wages lost *during the healing period*. These payments are commonly referred to as indemnity for temporary total disability. In Hawaii, temporary total disability benefits have a two-day "waiting period." This means that an injured employee receives no wage loss indemnity for the first two days of the

Figure 2.1

# BENEFIT DISTRIBUTION OF WORKERS' COMPENSATION, STATE OF HAWAII 1983

( Millions )



Source: Appendix E, Tables E-1 and E-2.

healing period. The law further provides, however, that should the period of temporary total disability exceed five days, wages lost during the first two days are paid retroactively to the injured worker. In all cases where the injured worker is entitled to receive temporary total indemnity, the employer or the insurance carrier pays the injured worker a weekly benefit equal to 66.7 percent of the worker's average weekly wage not to exceed a specified weekly amount. Payments for temporary total disability represented 30 percent of total benefits paid during 1983.<sup>1</sup>

Payments for permanent partial disabilities represent the third largest category of benefits. These amounted to approximately 22 percent of total benefits paid in 1983. Permanent partial disability payments begin *after* the healing period is over. Each permanent partial disability award depends on the worker's degree of disability and is for a stated number of weeks.<sup>2</sup> This weekly payment is made regardless of the worker's employment status or earning capacity. Accordingly, if a worker with a permanent partial disability is either unemployed or is employed at a job which pays a lower wage than the worker was receiving at the time of injury, the permanent partial award represents an offset to the additional wage loss which the worker incurs. For those workers who are fortunate enough not to suffer any decline in earnings capacity, the permanent partial award represents extra tax free income.

In 1983, the other types of benefits provided under Hawaii's workers' compensation program represented, collectively, just over 15 percent of all benefits paid. About half of these remaining benefits was paid to workers judged to be permanently and totally disabled. A comparatively small amount of total benefits were paid to survivors of workers who died from work related

accidents or illnesses. Payments for disfigurement and vocational rehabilitation accounted for the balance.<sup>3</sup>

To sum up this overview of benefits, three types of benefits accounted for almost 85 percent of all workers' compensation benefits paid in 1983:

- . Medical costs;
- . Wage loss indemnity during the healing period; i.e., payments for temporary total disability indemnity; and
- . Wage loss indemnity after the healing period is over; i.e., payments for permanent partial disability.

It is the size *and growth* of these benefit payments that account for most of the increasing cost of workers' compensation during recent years.

### Disability Categories

For statistical purposes, an employee with a work related injury is classified as falling into one of the following five categories:

- . Medical only
- . Temporary Disability only

1. A substantial portion of wage loss indemnity payments are made to persons who are subsequently determined to have a permanent disability.

2. The way in which permanent partial disability awards are determined is discussed in more detail in Chapter 5.

3. Data on benefits paid are contained in Appendix E, Tables E-1 and E-2.

- . Permanent Partial Disability
- . Permanent Total Disability
- . Death

Statisticians treat these five categories as being mutually exclusive. After each claim is finally settled, that claim is classified as falling in one, and only one, of the five categories above. The way in which a claim is classified depends on the types of costs which were incurred in settling that claim.

By way of explanation and illustration, a worker classified as "medical only" will not have received any payment for lost wages, or any other benefit. In Hawaii, this means that the worker was away from the job no more than two days.

A worker classified as "temporary disability only" will have received payment for lost wages during the healing period, *in addition to* any medical costs which might have been paid. Workers in this category will *not* have received any other benefits, however.

Claims classified as "permanent partial disability" will show payments for either a permanent partial disability award or a disfigurement award (or both), *in addition to* any payments for medical costs and lost wages paid during the healing period (i.e., temporary disability indemnity).

Table 2.1 is designed to help the lay reader better understand the relationship between the five injury classifications used in the workers' compensation program and the different types of benefit payments. For each injury classification, this table shows the benefit payments that an injured worker might generally be expected to receive. As shown in Table 2.1, for example, vocational rehabilitation services are generally received only by those with a permanent partial disability. Vocational rehabilitation is not provided to workers who, after the healing period is over, return to the same job which they had prior to their injury. Nor is vocational rehabilitation provided to those considered to be permanently and totally disabled.

Table 2.1

Relationship Between Work Injury Categories and the Various Types of Benefits Paid by the Workers' Compensation Program

|                                       | <i>Medical Only</i> | <i>Temporary Disability Only</i> | <i>Permanent Partial Disability</i> | <i>Permanent Total Disability</i> | <i>Death*</i> |
|---------------------------------------|---------------------|----------------------------------|-------------------------------------|-----------------------------------|---------------|
| Medical expenses                      | x                   | x                                | x                                   | x                                 | x             |
| Temporary wage loss indemnity         |                     | x                                | x                                   | x                                 |               |
| Permanent wage loss indemnity         |                     |                                  |                                     | x                                 |               |
| Permanent partial disability benefits |                     |                                  | x                                   |                                   |               |
| Disfigurement benefit                 |                     |                                  | x                                   |                                   |               |
| Vocational rehabilitation services    |                     |                                  | x                                   |                                   |               |
| Attendant services                    |                     |                                  |                                     | x                                 |               |
| Survivors' benefits                   |                     |                                  |                                     |                                   | x             |

\*Workers who die from work related injuries or illnesses may receive payments for temporary wage loss indemnity prior to their death.

## Financing of Benefit Payments

Employers pay for workers' compensation in one of two ways:

- . They buy insurance, or
- . They self-insure, provided they have sufficient financial resources.

Employers who purchase workers' compensation insurance pay premiums based on (1) size of their payroll, and (2) the risk of injury or illness associated with their business. Business firms are placed in one or more of 600 risk categories or classifications. Theoretically, those with similar risk characteristics and loss experience pay the same rate. In practice, smaller firms typically purchase coverages at so-called manual rates,<sup>4</sup> while larger firms with good safety records are able to reduce their premium cost through various dividend schemes and rating plans that reflect their safety and claims experience.

Those large firms that elect to self-insure are insulated from the insurance rating and classification mechanism. They simply internalize their loss costs directly.

During 1983, some 286,000 workers, or three-fourths of all covered employees in Hawaii, worked for employers who provided coverage through private insurance carriers. The other one-fourth, or 95,000, worked for employers who were self-insured. (See Figure 2.2.) Self-insured employers include the State of Hawaii and all county governments in Hawaii, plus a number of larger employers who have the financial capability to self-insure. State government, which had approximately 42,000 employees in 1983, is by far the largest self-insurer in Hawaii.

Payrolls covered under Hawaii's workers' compensation program amounted

to over \$5.9 billion in 1983. Payrolls of self-insured employers represented 30 percent of total payrolls. (See Figure 2.3.) Those 95,000 who worked for self-insured employers earned an average annual wage of \$18,630 in 1983, while the 286,000 covered by insurance carriers earned an average annual wage of \$14,440.

Of the total \$103 million in benefits paid during 1983, some 67 percent were paid by self-insured employers, 26 percent were paid by insurance carriers, and 7 percent were paid from the State's special compensation fund. (See Figure 2.4.)<sup>5</sup>

## The Special Compensation Fund

The State of Hawaii operates a multipurpose special compensation fund which, among other functions, pays for: (1) inflation adjustments in benefit payments, and (2) compensation of "second injuries" of workers after the first 104 weeks of benefits. Revenues for the fund are obtained primarily through assessments on insurers and self-insured employers. Thus, either directly or indirectly, employers pay the entire cost of the workers' compensation program.

All other states have second injury funds. The purpose of such funds is to encourage re-employment of injured workers. Additional details concerning Hawaii's special fund and a comparative analysis of similar funds in seven other states is provided in Appendix A.

4. Manual insurance rates are similar to "standard" or "retail list" prices. As indicated in the text, these rates are subject to competitive discounts. See Chapter 5 and Appendices D and F for more discussion about insurance rates for workers' compensation.

5. Additional data on benefits payments, by source of payment, are contained in Appendix E, Table E-3.

Figure 2.2

# WORKERS COVERED

BY THE HAWAII WORKERS' COMPENSATION PROGRAM, 1983



EACH FIGURE REPRESENTS APPROX. 47,600 WORKERS

Source: Department of Labor and Industrial Relations, *Work Injury Statistics*, 1983.

Figure 2.3

# PAYROLL COVERED

BY THE HAWAII WORKERS' COMPENSATION SYSTEM, 1983



COVERED BY INSURANCE CARRIERS  
\$4,123 MILLION  
(69.5%)

SELF-INSURED  
\$1,777 MILLION  
(30.5%)

EACH SYMBOL REPRESENTS APPROX. \$590 MILLION DOLLARS IN PAYROLL

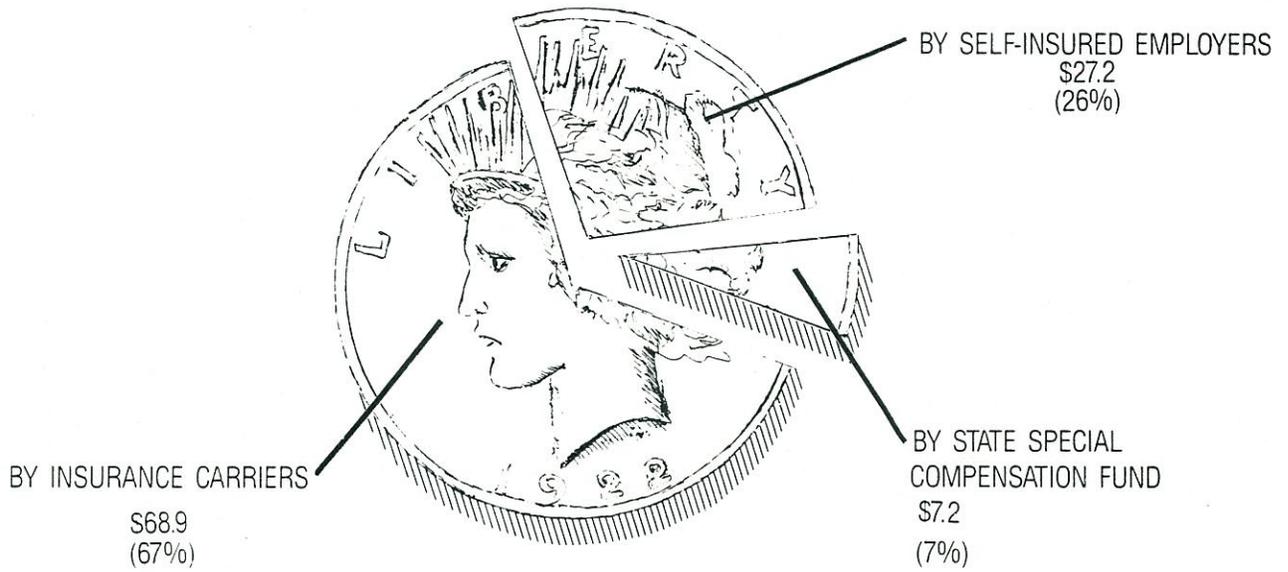
Source: Department of Labor and Industrial Relations.

Figure 2.4

# BENEFITS PAID

## BY WORKERS' COMPENSATION, STATE OF HAWAII, 1983

(MILLIONS)



Source: Appendix E, Table E-3.

## Claims, Hearings, and Appeals Process

The workers' compensation program is administered by the Disability Compensation Division (DCD) within the Department of Labor and Industrial Relations.<sup>6</sup> Employers file initial reports of accidents with the DCD. Subsequent reports of payments and disposition of cases are filed by self-insured employers and by insurers, on behalf of the employers whom they insure. Claimants who are not satisfied with the amount or terms of their benefit award are entitled to a hearing before one of DCD's hearing officers. If either party is not satisfied with the decision rendered by the DCD hearing officer, they may appeal their case, first to the Labor and Industrial Relations Appeals Board and then to the Supreme Court.

Figure 2.5 is a schematic diagram of the flow of cases through the Hawaii hearings and appeals system. Data on the number of hearings, decisions, and appeals provide insight into the degree of controversy and litigiousness in the Workers' Compensation Program. During fiscal year 1984, DCD's 14 hearing officers conducted 5,710 hearings for an average caseload of 408 cases per year. DCD data on

claims and decisions from 1971 to 1983 are shown in Table 2.2.

Approximately 7 percent of all DCD decisions are currently being appealed to the three-member Labor and Industrial Relations Appeals Board. The board's caseload since 1975 is shown in Table 2.3. Since 1975, the caseload at the board has virtually doubled, while the number of decisions rendered by the DCD has increased by about 20 percent. These trends indicate that litigiousness in the system is increasing.<sup>7</sup> Although every party has a right to appeal a case from the Labor and Industrial Relations Appeals Board to the Hawaii Supreme Court, only a small fraction are actually appealed—16 cases in fiscal year 1981, 12 cases in fiscal year 1982, 10 cases in fiscal year 1983, and 22 cases in fiscal year 1984.

6. The Insurance Commissioner, in the Department of Commerce and Consumer Affairs, is responsible for regulation of insurance policies which contain workers' compensation coverages.

7. Between 1971 and 1983, the number of DCD decisions have been an increasing percent of total claims. (See Table 2.2.) This trend is yet another indication that the amount of contention in the system has been increasing.

Figure 2.5

# HAWAII WORKERS' COMPENSATION HEARING AND APPEALS SYSTEM

(Chapter 386, H.R.S. and Related Administrative Rules, Chap. 10, Title 12)

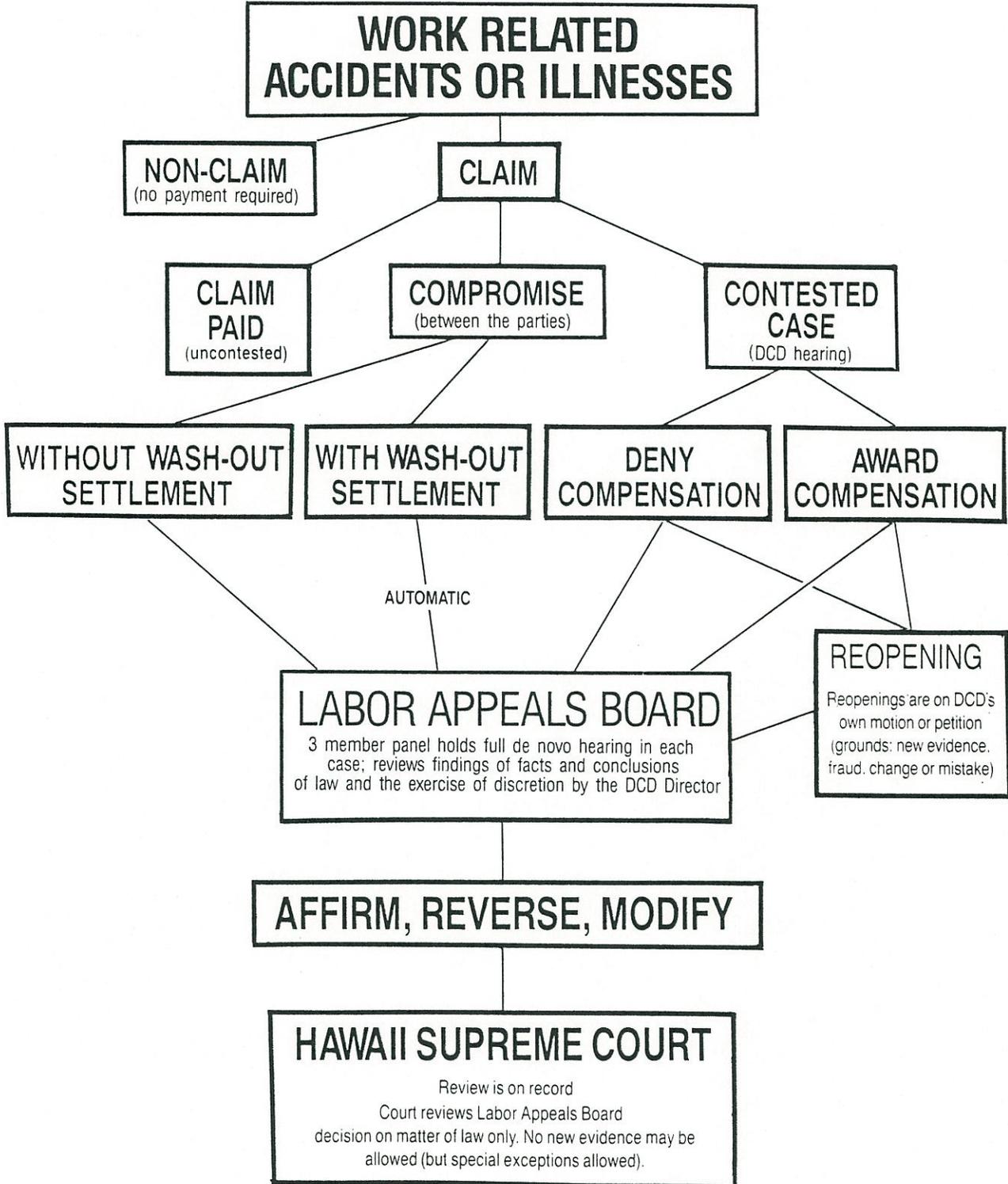


Table 2.2

Claims Received and Decisions Rendered by the  
Disability Compensation Division  
1971–1983

| <i>Year</i> | <i>Claims<br/>Received</i> | <i>Decisions</i> | <i>Decisions as<br/>Percent of<br/>Cases Received</i> |
|-------------|----------------------------|------------------|-------------------------------------------------------|
| 1971        | 34,561                     | 4,559            | 13.2                                                  |
| 1972        | 34,901                     | 4,895            | 14.0                                                  |
| 1973        | 36,277                     | 5,206            | 14.4                                                  |
| 1974        | 37,646                     | 4,596            | 12.2                                                  |
| 1975        | 40,435                     | 4,952            | 12.2                                                  |
| 1976        | 38,721                     | 5,007            | 12.9                                                  |
| 1977        | 37,393                     | 4,990            | 13.3                                                  |
| 1978        | 38,869                     | 5,302            | 13.6                                                  |
| 1979        | 43,057                     | 5,547            | 12.9                                                  |
| 1980        | 47,725                     | 6,294            | 13.2                                                  |
| 1981        | 44,320                     | 6,774            | 15.3                                                  |
| 1982        | 40,521                     | 6,542            | 16.1                                                  |
| 1983        | 39,013                     | 6,826            | 17.5                                                  |

Sources: *Report of the Workers' Compensation Program Commission*, January 1981, and data from the Department of Labor and Industrial Relations, Disability Compensation Division.

Table 2.3

Caseload of the Labor and Industrial Relations Appeals Board  
1975–1983

| <i>Fiscal Year</i> | <i>Cases Pending Beginning of the Year</i> | <i>Cases Filed</i> | <i>Cases Closed</i> | <i>Cases Pending End of the Year</i> |
|--------------------|--------------------------------------------|--------------------|---------------------|--------------------------------------|
| 1976               | 225                                        | 289                | 213                 | 301                                  |
| 1977               | 301                                        | 377                | 284                 | 394                                  |
| 1978               | 394                                        | 430                | 299                 | 525                                  |
| 1979               | 525                                        | 441                | 308                 | 658                                  |
| 1980               | 658                                        | 444                | 403                 | 699                                  |
| 1981               | 699                                        | 551                | 476                 | 774                                  |
| 1982               | 774                                        | 603                | 635                 | 742                                  |
| 1983               | 742                                        | 509                | 538                 | 713                                  |
| 1984               | 713                                        | 477                | 530                 | 660                                  |

Source: Labor and Industrial Relations Appeals Board.

## Chapter 3

### OVERVIEW OF BENEFIT PAYMENTS

This chapter reviews the changes in benefit payments that have occurred since 1970.<sup>1</sup> These are shown graphically in Figure 3.1. Over a 13-year period, 1970-1983, benefit payments have been the driving force underlying insurance rates. The final section in this chapter also reviews changes in insurance rates since 1970.

#### Total Benefit Payments, 1970-1983

Between 1970 and 1983, total benefit payments increased by over 700 percent. This was a period of widespread inflation. Consequently, in order to gain perspective on the extent to which "real" benefit payments increased, an adjustment for inflation needs to be made. Deflated benefit payments are shown by the solid line in Figure 3.1. Although somewhat less, these real benefit payments nevertheless increased by just over 250 percent between 1970 and 1983. It can be readily observed from Figure 3.1 that even after adjusting for inflation, total benefit payments reflect an underlying upward trend, especially since 1979.

#### Benefit Payments Per Employee, 1970-1983

A slightly different perspective is gained by examining benefit payments per covered employee. These are shown in Figure 3.2. Between 1970 and 1983, the number of employees covered by workers'

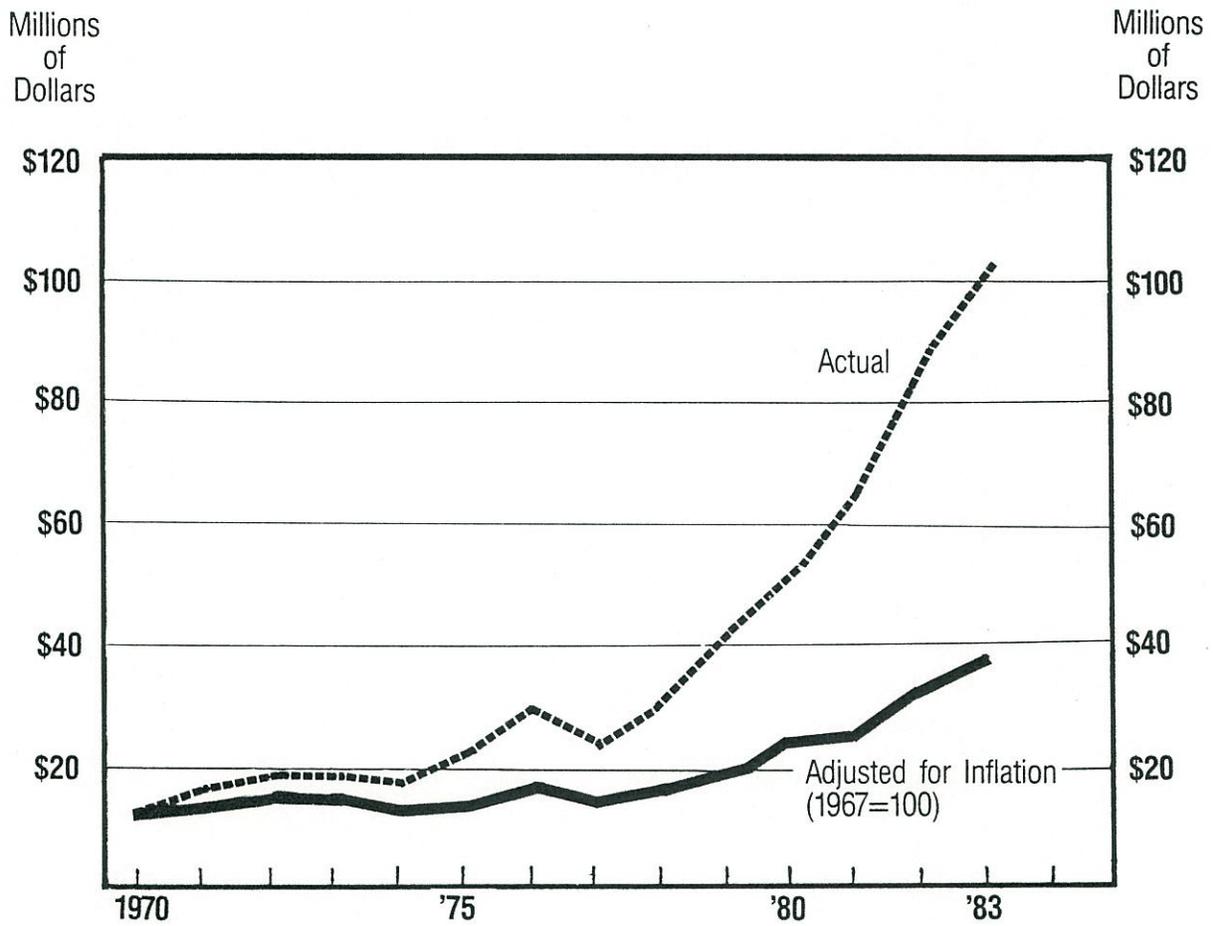
compensation increased by approximately 112,000, from 269,000 to 381,000. This was an increase in covered employment of some 42 percent. Benefit payments per covered employee increased by 482 percent, from \$46.60 in 1970 to \$271.41 in 1983. Inflation adjusted benefits, or real benefits per employee, are shown by the solid line in Figure 3.2. Between 1970 and 1978, there was no discernible trend in the amount of real benefits paid per employee. Since 1979, however, *real benefits per employee have increased at a compound annual rate of 15 percent per year.*

Four different measures of benefit payments are shown in Figures 3.1 and 3.2. No matter which measure one uses, benefit payments for workers' compensation have clearly risen since 1979. Of the four measures examined, the one which reflects the least increase is inflation adjusted benefit payments *per employee*, shown by the solid line in Figure 3.2. This particular measure eliminates (1) the effects of inflation, and (2) growth in the work force. Even after discounting the effect of these two influences, though, an increase in benefit payments of 77 percent has occurred since 1979.

1. Benefit payments reported by the Department of Labor and Industrial Relations (DLIR) reflect only the amounts paid for medical expenses, wage loss, and other indemnities. No overhead expenses of insurance carriers or self-insureds are included in DLIR data on benefit payments.

Figure 3.1

HAWAII WORKERS' COMPENSATION SYSTEM  
**TOTAL BENEFIT PAYMENTS**  
1970-1983



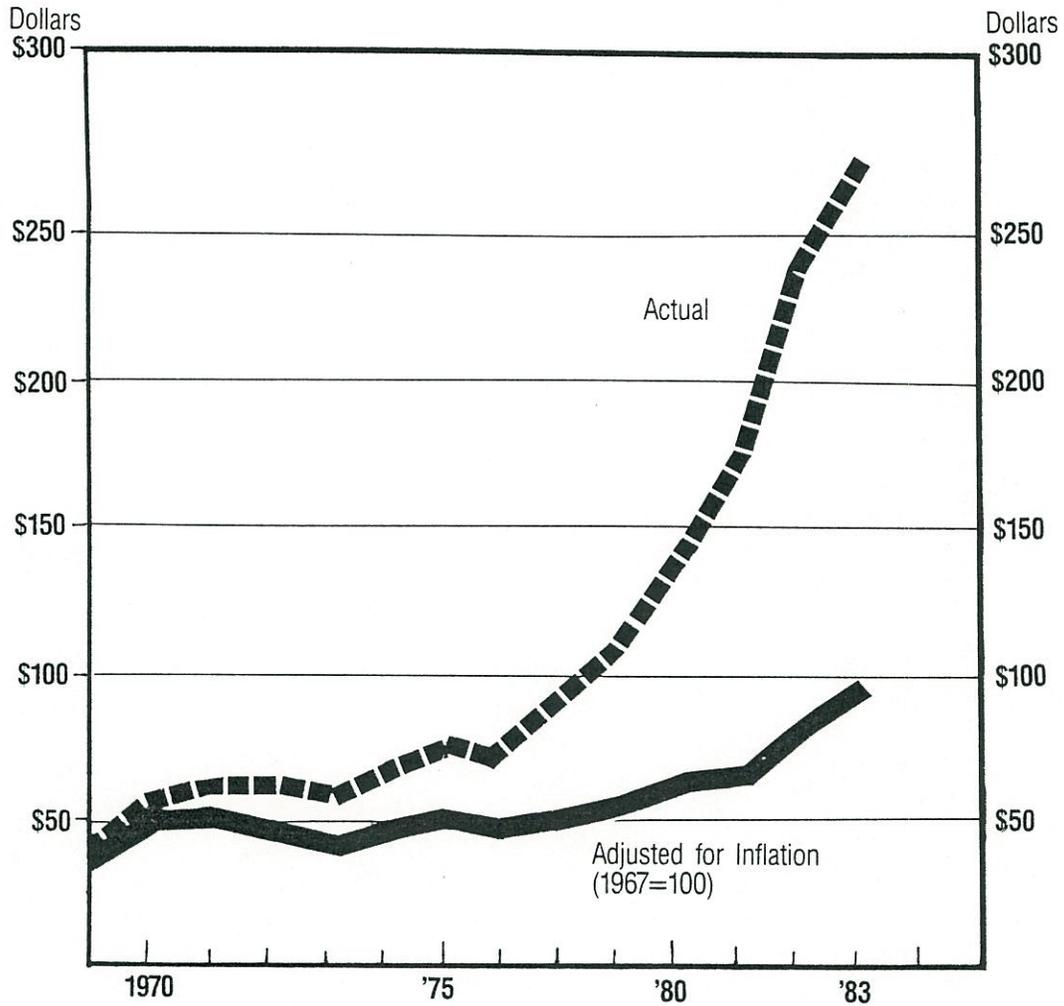
Source: Appendix E, Table E-4.

Figure 3.2

HAWAII WORKERS' COMPENSATION SYSTEM

# BENEFIT PAYMENTS PER EMPLOYEE

1970-1983



Source: Appendix E, Table E-4.

## Benefit Payments by Self-Insureds, 1976-1983

Total benefit payments shown in Figure 3.1 reflect payments made by three sources: (1) insurance carriers; (2) self-insureds; and (3) the special compensation fund.

Benefit payments for workers' compensation appear to have increased across the board. This is best illustrated by the experience of self-insureds. Employers who self-insure assume all risks and pay the entire cost of work related injuries, whatever that cost turns out to be. Self-insureds also manage their own cases and are thus fully insulated from the private insurance mechanism. Data showing benefit payments by self-insureds are shown in Figure 3.3.

Over the most recent five years, 1979-1983, benefit payments by all self-insureds in the State increased over 283 percent, while benefit payments by insurance carriers increased by only 230 percent.<sup>2</sup> Benefit payments by state and local governments showed the greatest increase of any sector, 341 percent. This rise in payments by self-insureds, including government, indicates that increased payments for work related injuries have not been confined to insurance carriers, but rather have been an across-the-board phenomenon.

In order to facilitate a comparison of the extent to which benefit payments have increased for each major sector, Figure 3.4 shows the increase as an index, with 1976 used as the base year.

## Days Lost

Days lost from work injuries are an important *nonmonetary* indicator of what

has been occurring with respect to workers' compensation. Between 1976 and 1983, the total number of days lost increased by 78 percent.

Government and self-insured private firms had an increase in lost time of 112 and 59 percent, respectively, while carrier-insured firms had an increase of 68 percent. The relative changes for these sectors since 1978 is shown in Figure 3.5. These statistics on the number of days lost thus reinforce the preceding data on benefits payments. That is, (1) government has experienced the greatest percentage increase in both days lost and benefit payments, and (2) the percentage increase in days lost by private self-insureds closely parallels the percentage increase experienced by carrier-insured employers. The fact that the number of days lost has increased sharply since 1979 means that:

- . More workers are suffering work related injuries; i.e., the *frequency* of work related injuries has increased, *or*
- . Those workers who become injured are taking longer to recover; i.e., work related injuries are becoming more *severe*, *or*
- . Some combination of the above is occurring; i.e., *frequency and severity* are both increasing.

The next chapter examines frequency and severity of workers' compensation claims in further detail.

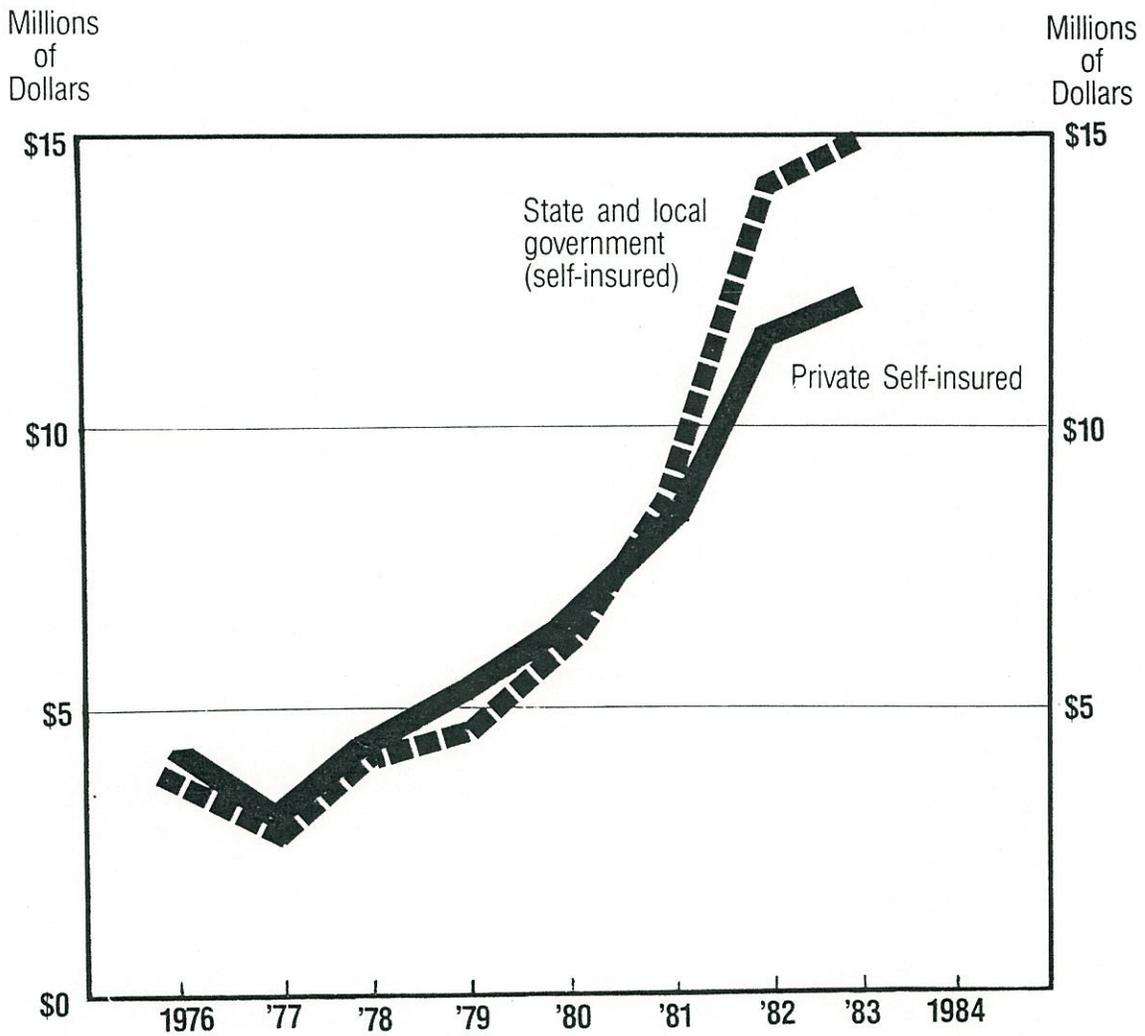
2. For data on benefit payments by insurance carriers, see Appendix E, Table E-3.

Figure 3.3

HAWAII WORKERS' COMPENSATION SYSTEM

# BENEFIT PAYMENTS BY SELF-INSUREDS

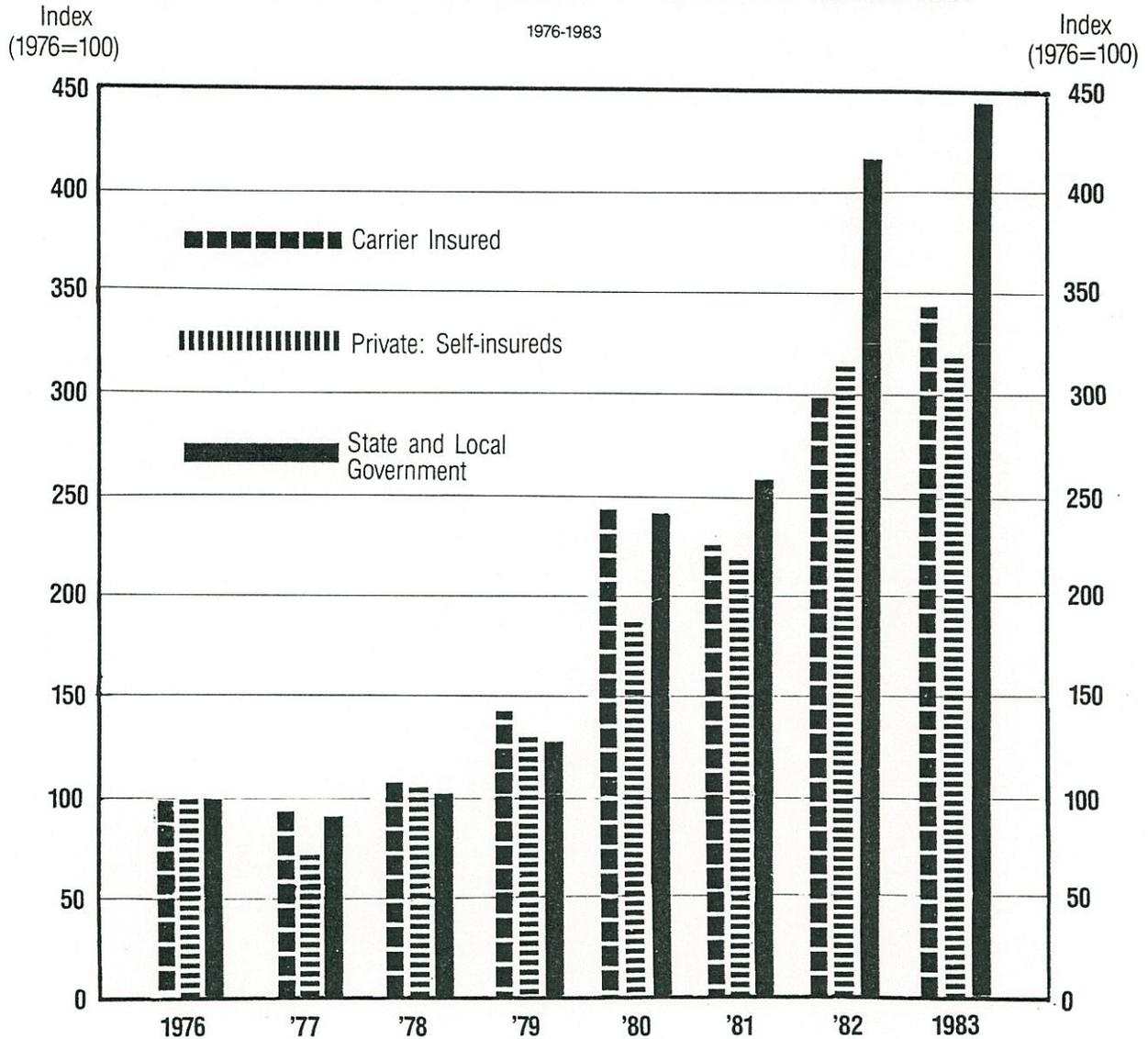
1976-1983



Source: Appendix E, Table E-3.

Figure 3.4  
HAWAII WORKERS' COMPENSATION SYSTEM

# INDEXED BENEFIT PAYMENTS BY SELF-INSUREDS AND INSURANCE CARRIERS

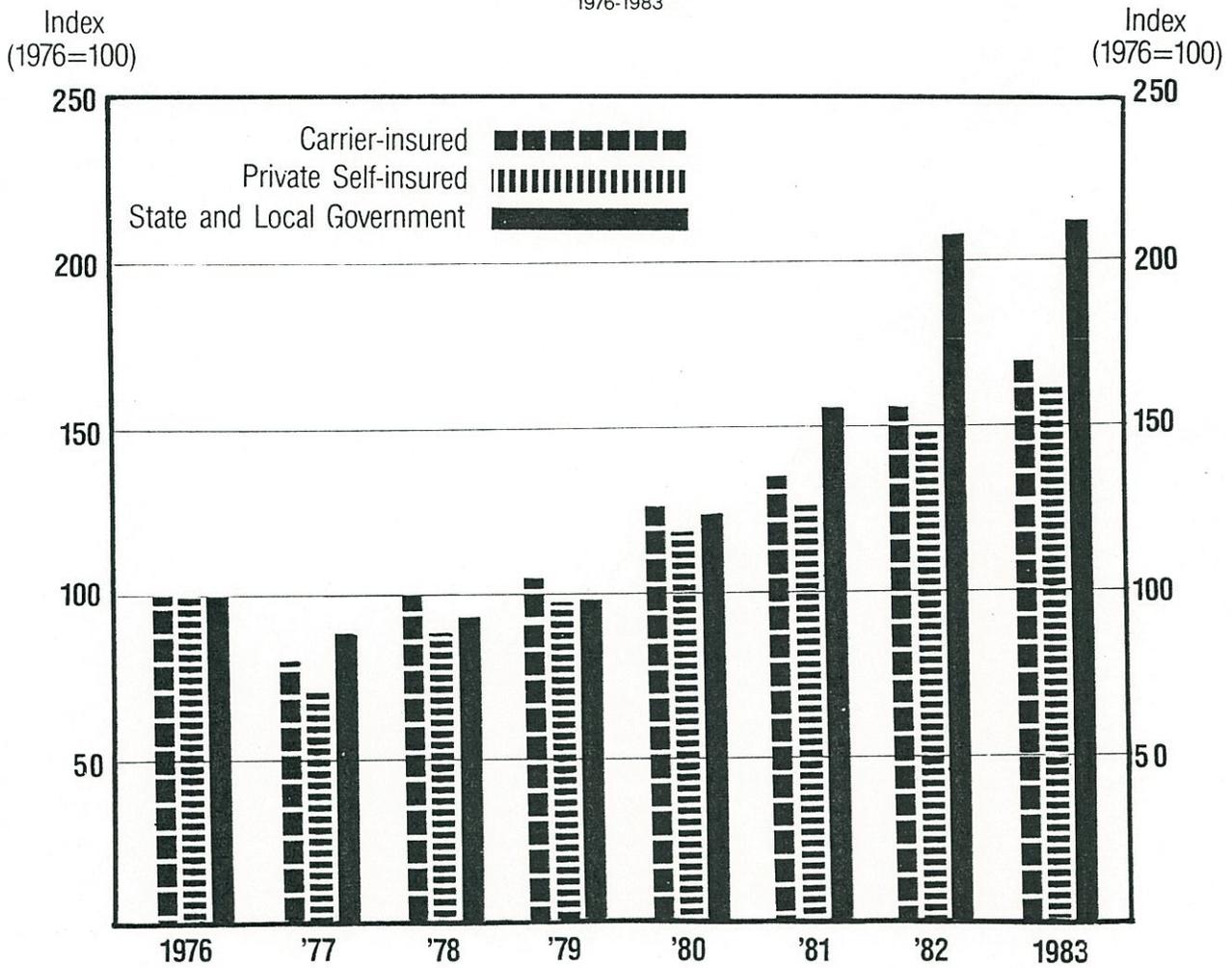


Source: Appendix E, Table E-3.

Figure 3.5

# DAYS LOST FROM WORK RELATED INJURIES IN HAWAII

1976-1983



Source: Appendix E, Table E-5.

## Insurance Rates for Workers' Compensation Coverage

In any given year, insurance rates may not be closely related to current benefit payments. Over time, however, insurance rates should move in tandem with benefit payments.

In 1983, Hawaii had the highest average rate for workers' compensation coverage in the United States (Figure 3.6). Rates in Hawaii did not increase in 1984 because of the moratorium imposed by the Legislature. Yet, even with the moratorium, it would appear that in 1984, Hawaii's rates were among the highest in the country.

Hawaii has had a relatively high rate for workers' compensation insurance at least since 1978. It is only since 1982, however, that Hawaii's rates have outstripped all other states. Average

earned rates (per \$100 of payroll) since 1978 are shown in Figure 3.7. Since 1978, average rates in Hawaii have grown by 150 percent, while the average earned rate in the United States has shown no significant trend.

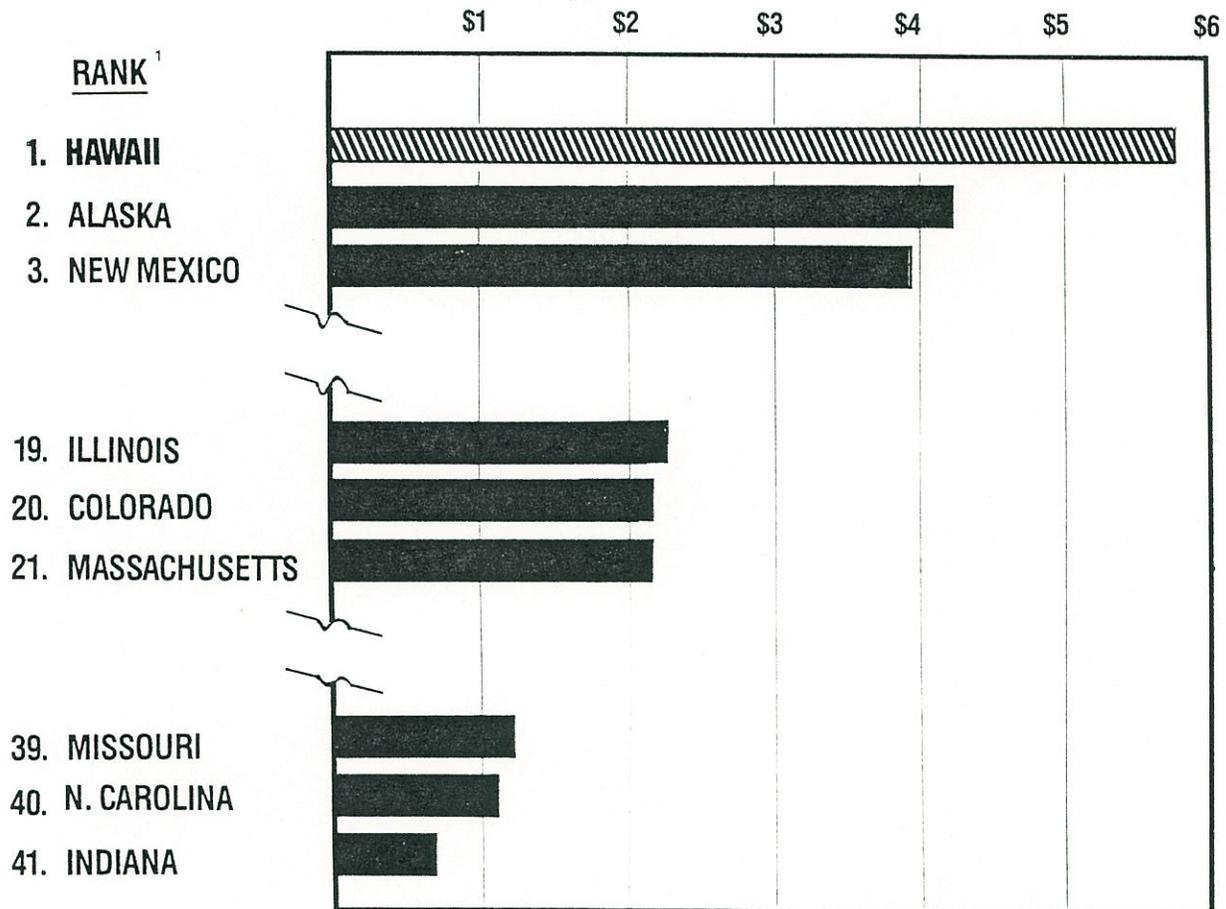
Individual business persons who must buy workers' compensation insurance sometimes regard high rates as *the problem*. Yet, in view of the increase in benefit payments discussed previously, including higher benefit payments by self-insureds, insurance rates are seen to be only a symptom of other, more fundamental forces at work in Hawaii's workers compensation system. If changes are to be made, they should preferably deal with root causes, and not just treat the symptoms. In order to develop a fuller understanding of what has been causing the surge in benefit payments and insurance rates, the next chapter presents a detailed analysis of trends in frequency and severity for different types of workers' compensation claims.

Figure 3.6

# AVERAGE RATES

## FOR WORKERS' COMPENSATION, 1983, RANKED BY STATE

(PER \$100 OF WAGES)



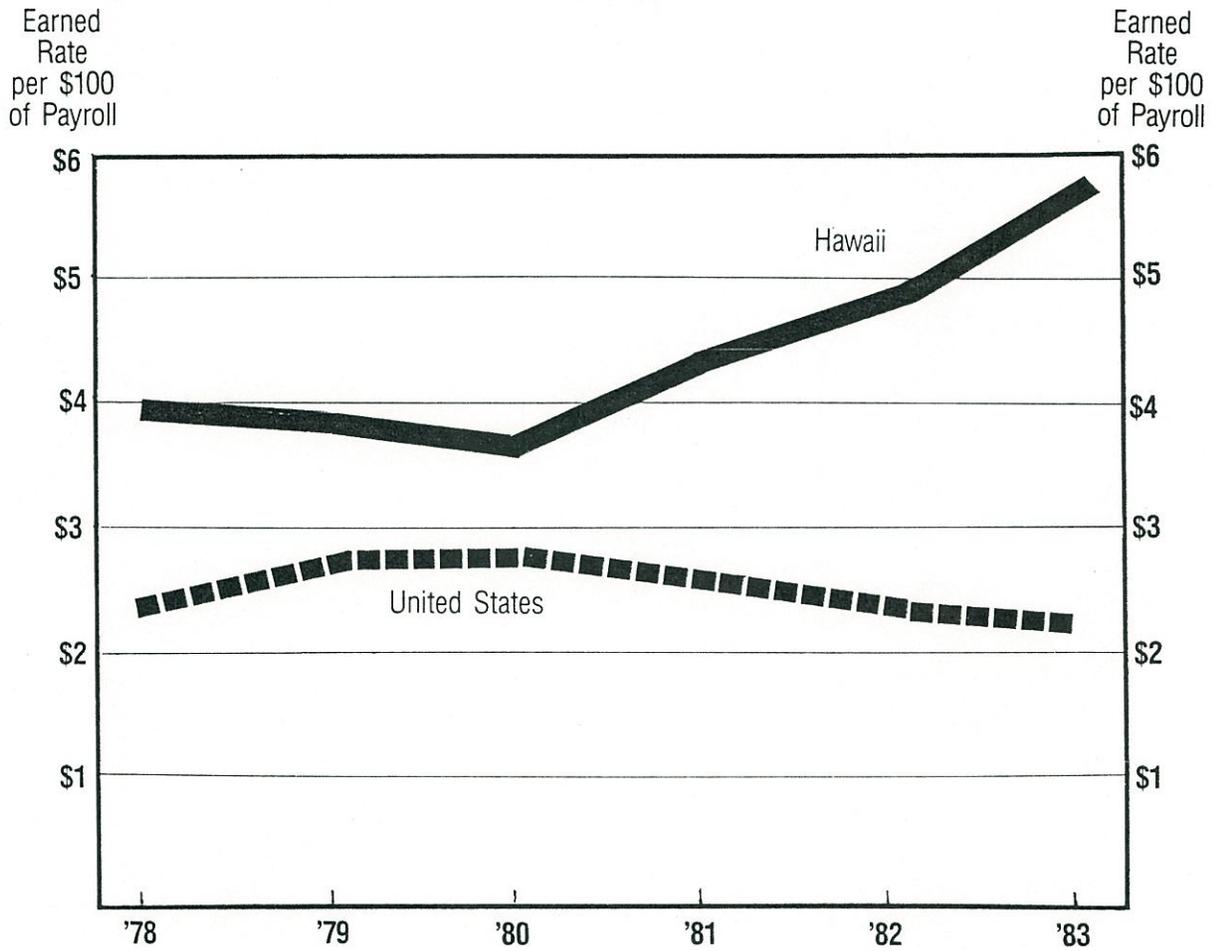
1. Rankings reflect all states which report data to the National Council of Compensation Insurers (NCCI). Monopolistic state funds do not report to the NCCI.

Source: NCCI, Average Earned Rate-Standard Premium Basis (Exhibit I.B), April 1, 1984.

Figure 3.7

# AVERAGE EARNED RATES FOR WORKERS COMPENSATION INSURANCE HAWAII AND THE UNITED STATES

1970-1983



Source: NCCI.

## Chapter 4

### ANALYSIS OF BENEFIT PAYMENTS

This chapter explores in greater depth the increase in benefit payments previously discussed. The purpose is to identify those characteristics in Hawaii which are generally similar to and those which differ markedly from other states. To summarize briefly, the following factors appear to be in line with other states and are *not* useful to understanding the increase in benefit payments:

- . Statutory increases in benefits;
- . The number of reported industrial accidents; and
- . The total number of claims for work related injuries.

Three factors which most distinguish Hawaii from other states and which stand somewhat high in relation to other states are:

- . The number of cases involving *some form of indemnity payment*;
- . The number of cases in which some form of *permanent* indemnity is paid; and
- . Medical costs per case.

The next chapter analyzes underlying forces that help explain why these last three factors are high compared to other states.

#### Statutory Benefit Comparisons

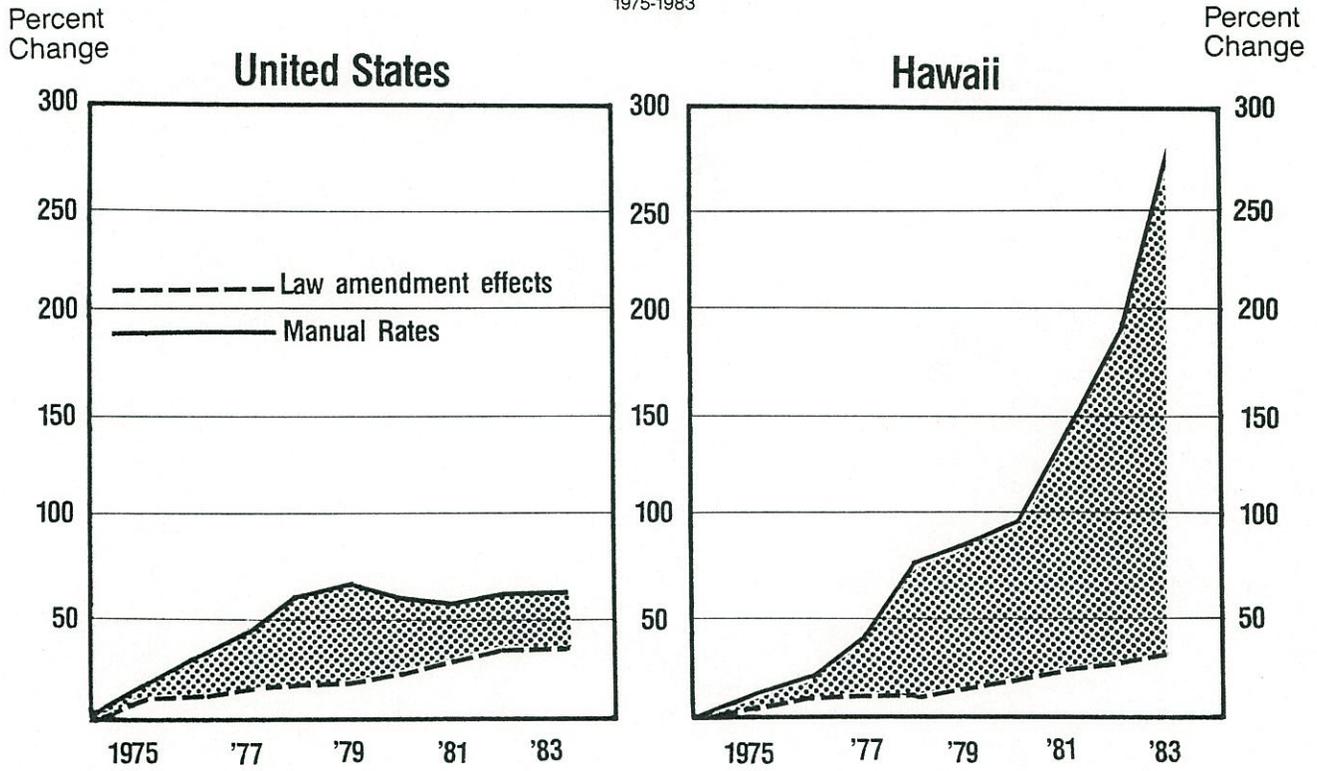
Statutory increases in benefits (i.e., law amendments) obviously explain part of the increased cost of workers' compensation in all states, including Hawaii. In Figure 4.1, the two lower dotted lines show the extent to which changes in statutory benefits alone would have caused insurance rates to increase in Hawaii and the United States since 1975. During this same period, Hawaii has *not* increased its *statutory* benefits relative to similar provisions countrywide. Those statutory benefit changes that have occurred since 1975 would have caused only a 33 percent increase in both Hawaii and the United States.

The top two lines in Figure 4.1 show the percentage change in insurance rates that actually occurred. It can be readily observed from the top two lines in Figure 4.1 that insurance rate increases in Hawaii have greatly exceeded the U.S. average, especially since 1979. Since January 1, 1975, manual insurance rates in Hawaii have increased 265 percent, while manual insurance rates for the entire United States have increased by 55 percent.

Comparison of major benefit provisions in Hawaii's statute with other states further indicates that, with few exceptions, Hawaii's benefits are *neither higher than nor out of line* with statutory benefits provided by other states. Table 4.1 compares the major statutory benefits provided by Hawaii and six comparison states. Only with respect to the waiting period does

Figure 4.1

### CUMULATIVE PERCENTAGE CHANGE IN MANUAL RATES AND LAW AMENDMENT EFFECTS HAWAII AND UNITED STATES 1975-1983



Source: *NCCI Annual Statistical Bulletin*, 1984.

Table 4.1

Comparison of Selected Benefit Provisions in Workers' Compensation Laws  
Hawaii and Six Other States, 1984

| State      | Temporary Total Disability |                        |                 |            | Permanent Total Disability Duration | Permanent Partial Disability Duration                                  |                                                                           | Fatal                                     |                     |           |
|------------|----------------------------|------------------------|-----------------|------------|-------------------------------------|------------------------------------------------------------------------|---------------------------------------------------------------------------|-------------------------------------------|---------------------|-----------|
|            | Percent of Wage Loss       | Maximum Weekly Benefit | Waiting Period* | Duration   |                                     | Scheduled                                                              | Unscheduled                                                               | Percent of Wage Loss Spouse, Two Children | Duration for Spouse |           |
| California | 66.7                       | \$224                  | 3/21            | Disability | Disability                          | Varies with percent of disability<br>619.25 weeks for 99.5% disability |                                                                           | 66.7                                      | 66.7                | \$ 70,000 |
| Florida    | 66.7                       | 288                    | 7/14            | 350 weeks  | Disability                          | Impairment benefit plus wage loss benefit                              |                                                                           | 50.0                                      | 66.7                | 100,000   |
| Hawaii     | 66.7                       | 281                    | 2/5             | Disability | Disability                          | Schedule                                                               | Total dollar benefit limited to \$281 x 312 weeks x percent of disability | 50.0                                      | 66.7                | 312 x 281 |
| Indiana    | 66.7                       | 166                    | 7/21            | \$83,000   | \$83,000                            | Schedule                                                               | 500 weeks x percent of disability                                         | 66.7                                      | 66.7                | 500 weeks |
| Minnesota  | 66.7                       | 313                    | 3/10            | Disability | Disability                          | **                                                                     | **                                                                        | 50.0                                      | 66.7                | 10 years  |
| New Jersey | 70.0                       | 255                    | 7/7             | 400 weeks  | Disability                          | Schedule                                                               | 600 weeks x percent of disability                                         | 50.0                                      | 60.0                | Life      |
| New York   | 66.7                       | 275                    | 7/14            | Disability | Disability                          | Schedule                                                               | Disability                                                                | 67.7                                      | 66.7                | Life      |

\*The first figure shown under this column is the waiting period in days and the second period is the retroactive period.

\*\*Impairment compensation related to handicap, not earnings if employer offers or obtains a suitable job. Potentially larger economic compensation based on the wage loss principle if the employer does not offer or secure a suitable job.

Hawaii provide what might be deemed a significantly higher statutory benefit. Hawaii has a two-day waiting period, with retroactive benefits payable after a worker has been disabled for five days.<sup>1</sup> Ramifications of Hawaii's waiting and retroactive periods are discussed in Chapter 5.

Another feature of Hawaii's law that has raised current costs are two benefits financed on a pay-as-you-go basis through the Workers' Compensation Special Compensation Fund.<sup>2</sup> *First*, workers disabled prior to 1973 had their benefit payments increased beyond the maximum amount for which the employer was then responsible.<sup>3</sup> *Second*, workers disabled on or before June 18, 1980 were given a retroactive benefit adjustment.<sup>4</sup> Both of these costs should gradually decrease and eventually disappear.

Aside from the exceptions noted, Hawaii's workers' compensation law *does not* provide benefits higher than those provided by the typical state. The few exceptions do not begin to explain the large increase in benefit costs and insurance rates since 1979. Moreover, certain of Hawaii's statutory benefits appear to be on the low side in comparison to the six other states shown in Table 4.1.<sup>5</sup> The solution to Hawaii's recent cost run up and its higher costs relative to other states necessarily involves considerations *other than changes in statutory benefits*.

## Industrial Accident Rate

Data on industrial accidents in Hawaii and other states are available through a program funded by the federal Occupational Safety and Health Administration and the Bureau of Labor Statistics (OSHA-BLS). The reporting concept encompasses virtually all compensable injuries under

Hawaii's workers' compensation statute. Since the OSHA-BLS program has been in existence for over 14 years, it provides sufficient data to discern historical patterns for both Hawaii and the United States.

Measures of incidence and severity are available for a broad array of industry groups. The *incidence rate* represents the number of reportable injuries and illnesses per 100 full-time workers. The *severity rate* is the average number of lost workdays per lost time case.

**Incidence.** The incidence of work injuries and illnesses in both Hawaii and the United States has fallen consistently over the past decade. (See Figure 4.2.) Hawaii's rate has been and continues to be higher than the U.S. rate. Significantly, the gap between Hawaii and the United States widened during the most recent years for which data are available, 1979-1981.

**Severity.** Severity of work injuries and illnesses, measured in terms of workdays lost, has been virtually *flat* over the past decade for both Hawaii and the United States. (See Figure 4.3.) On average, Hawaii's severity rate is slightly but consistently less than the U.S. average rate.

1. The waiting period in Hawaii has been two days at least since the 1960s. In 1975, the retroactive period was reduced from seven to five days. (Act 107, SLH 1975.)

2. Had the cost of these benefits been funded during the year in which the accident occurred, the effect would have been a small increase in rates in prior years and a small reduction in current rates.

3. Act 42, SLH 1972.

4. Act 298, SLH 1980.

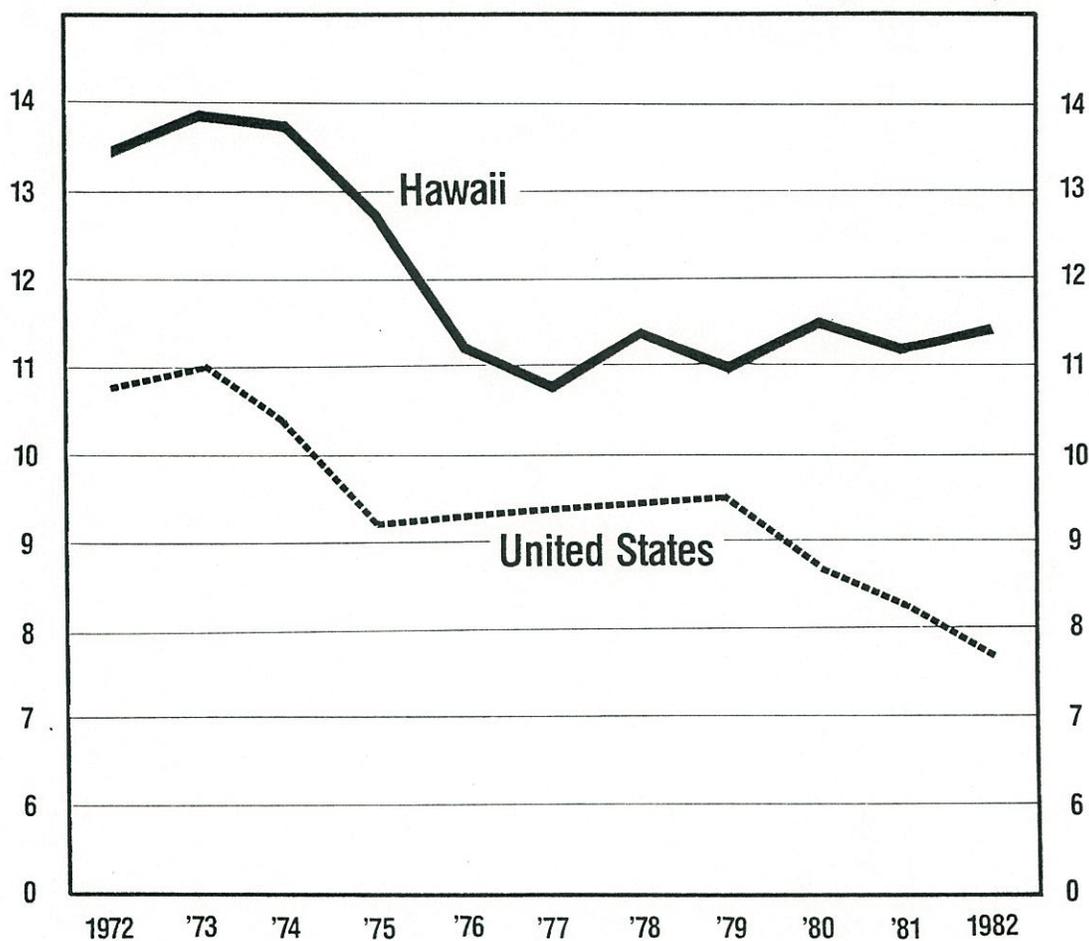
5. For example, in Hawaii, the maximum entitlement of a surviving spouse is \$266 times 312 weeks (6 years), or total maximum entitlement of \$82,992. This amount is exceeded by five of the six states shown in Table 4.1 (California, Florida, Minnesota, New Jersey, and New York).

Figure 4.2

# INCIDENCE RATE PER 100 FULL-TIME WORKERS OCCUPATIONAL INJURIES AND ILLNESSES UNITED STATES AND HAWAII

Number  
of  
Injuries / Illnesses

Number  
of  
Injuries / Illnesses



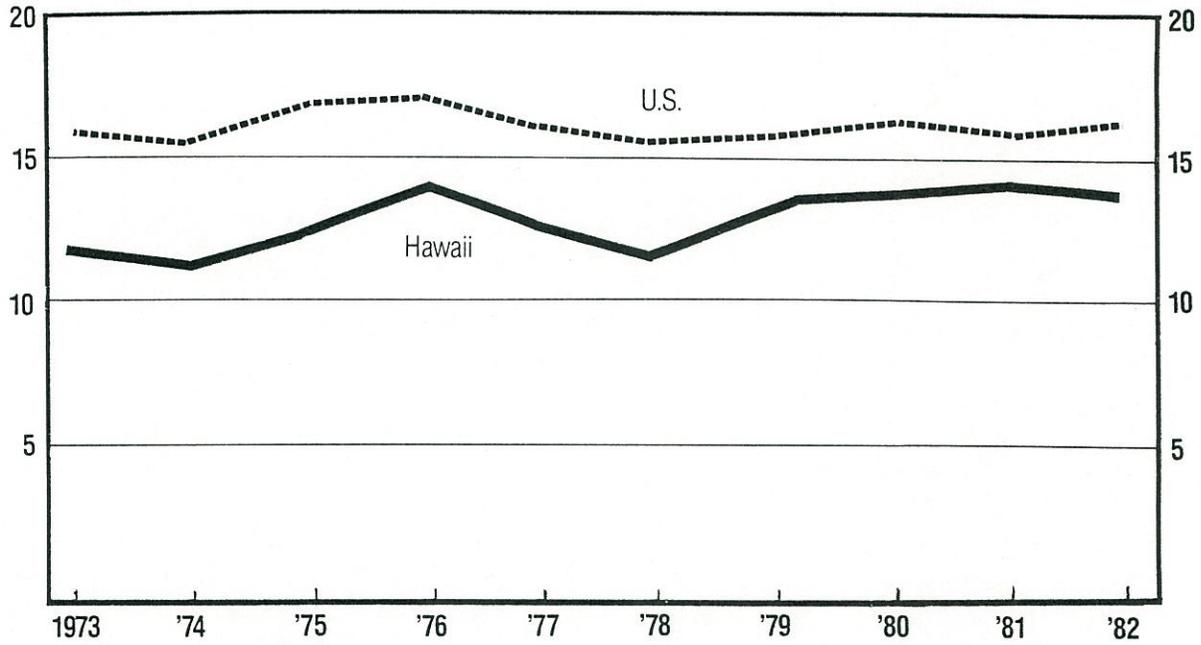
Source: Appendix E, Table E-8.

Figure 4.3

# SEVERITY OF OCCUPATIONAL INJURIES AND ILLNESS UNITED STATES AND HAWAII 1973-1982

Average  
lost workdays  
per lost  
workday case

Average  
lost workdays  
per lost  
workday case



Source: Appendix E, Table E-8.

**Conclusions.** The data on industrial accident rates indicate that the incidence and severity of accidents in Hawaii differ from the U.S. average, but in offsetting ways. That is, in Hawaii, incidence is higher and severity is lower than the U.S. average. The trends in Hawaii are generally parallel to the nationwide trends. Since 1979, however, the incidence of accidents in Hawaii has not improved as much as the U.S. average (Figure 4.2), while the severity of accidents has slightly worsened relative to the U.S. average. (See Figure 4.3.) These differences in trend may be part of the explanation why, since 1979, the cost of workers' compensation benefits in Hawaii has soared, relative to most other states. (See Figure 4.1.)

### Frequency of Total Claims

The total number of claims filed per 100,000 workers in Hawaii does *not* appear out of line with other states. Hawaii's claim frequency *vis-a-vis* other jurisdictions is shown in Figure 4.4. Over the two-year period 1978-80, Hawaii ranked 16th out of 41 states for which comparable data are available. The number of workers' compensation claims filed annually in Hawaii was only 4 percent above the median state, Tennessee (12,397 versus the median of 11,976 claims per 100,000 work years).

Figure 4.5 show changes in Hawaii's claims frequency since 1973. Over the years, the frequency of total claims has shown a tendency to decline. This generally coincides with the decline in accident rates discussed in conjunction with Figure 4.2. The data shown in Figures 4.4 and 4.5 indicate that little correlation exists between frequency of total claims and higher aggregate benefit payments in Hawaii. Consequently, it is necessary to look elsewhere to ascertain those factors in Hawaii that differ significantly from other states.

### Frequency of Indemnity Claims

Virtually all workers' compensation claims involve some medical cost, if only for an office visit. Moreover, many claims require nothing more than payment for medical treatment; i.e., no additional payment is required for lost time from the job. Such claims are typically referred to as *medical only*. Claims that do require some form of payment to the injured worker—either for lost wages, disfigurement, permanent or total disability, or in those extreme cases where the worker dies, to survivors—are referred to as *indemnity claims*.

Indemnity claims represent a much larger share of total claims in Hawaii than in other states. Figure 4.6 shows how selected states rank *vis-a-vis* indemnity claims as a percent of all claims. In the median state (Iowa), about three-fourths of all claims are medical only, and only one-fourth involve some form of indemnity payment. In Hawaii, by contrast, about half of all claims involve some form of indemnity payment.<sup>6</sup>

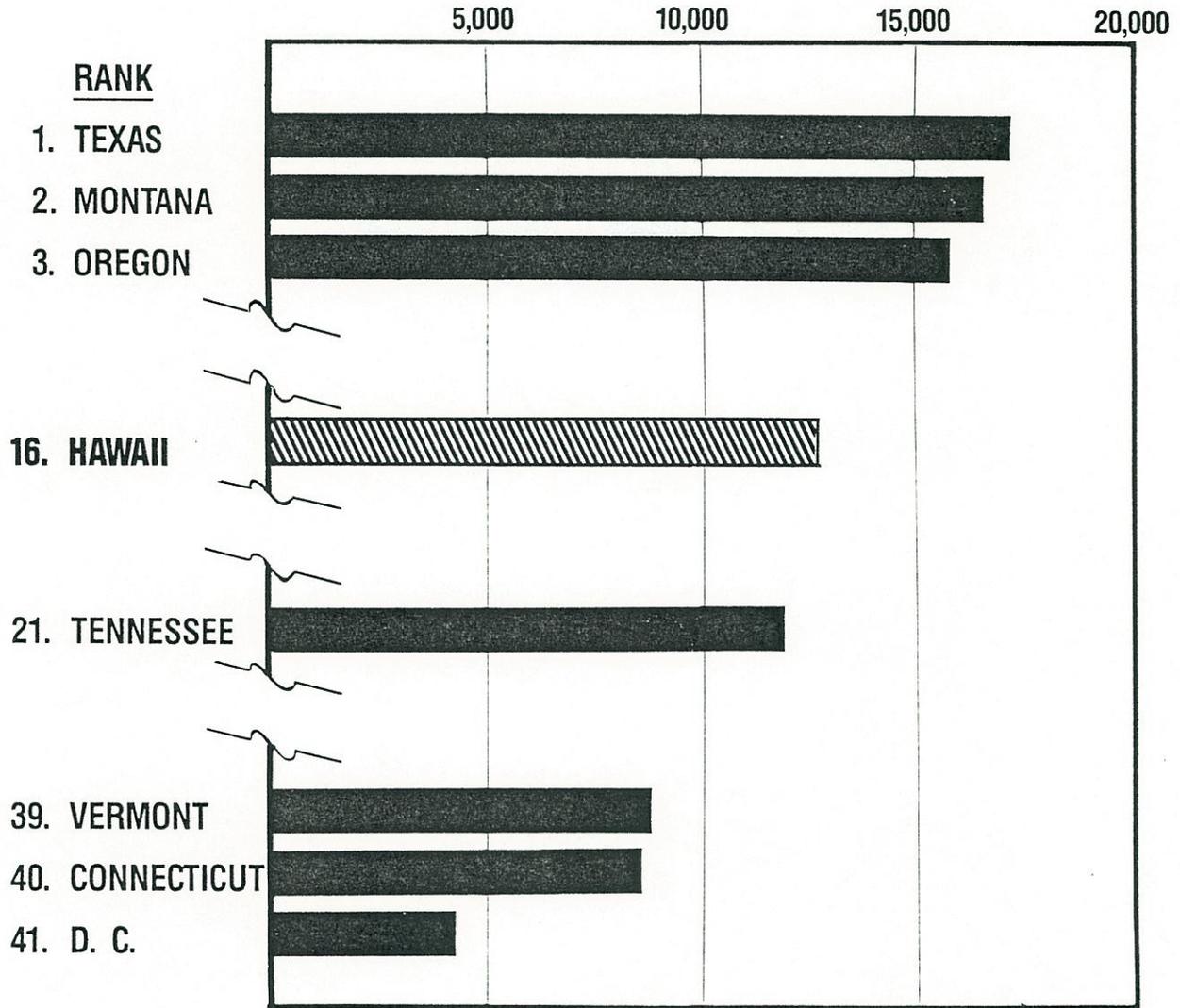
The high incidence of indemnity claims is clearly one factor which requires further investigation. Since more workers are disabled for three days than for seven or more days, Hawaii's shorter waiting period helps explain, in part, the high rate of indemnity claims. This, however, explains only one of the possible impacts of the waiting period on costs. Possible financial incentives not to return to work are discussed in Chapter 5.

6. Had absolute numbers of claims been used for Figure 4.6, instead of percentages, the results would have been similar. In 1979-80 Hawaii had 5,989 indemnity claims per 100,000 work-years, over twice the median rate of 2,560.

Figure 4.4

# FREQUENCY OF TOTAL CLAIMS PER 100,000 WORK YEARS

1978-1980, Ranked by State

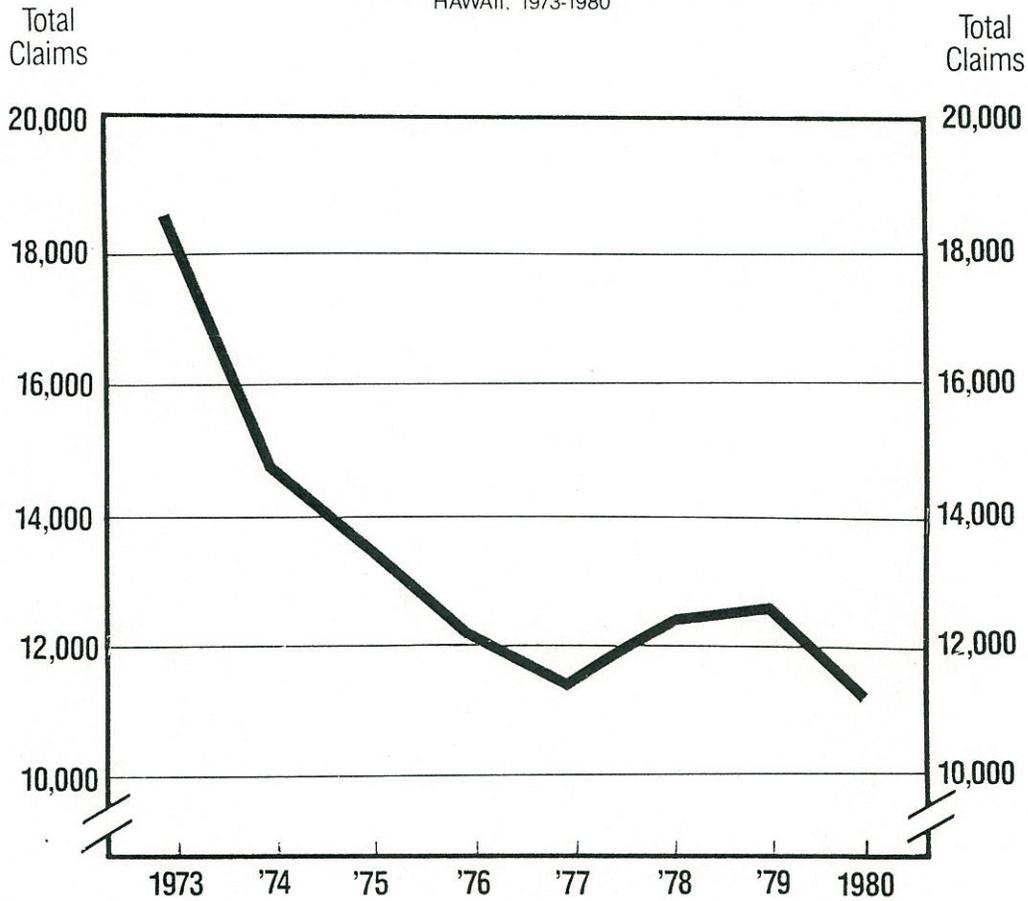


Source: *NCCI Annual Statistical Bulletin*, 1983, p. 209, and 1984, pp. 287-288.

Figure 4.5

# FREQUENCY OF TOTAL CLAIMS PER 100,000 WORK YEARS

HAWAII, 1973-1980

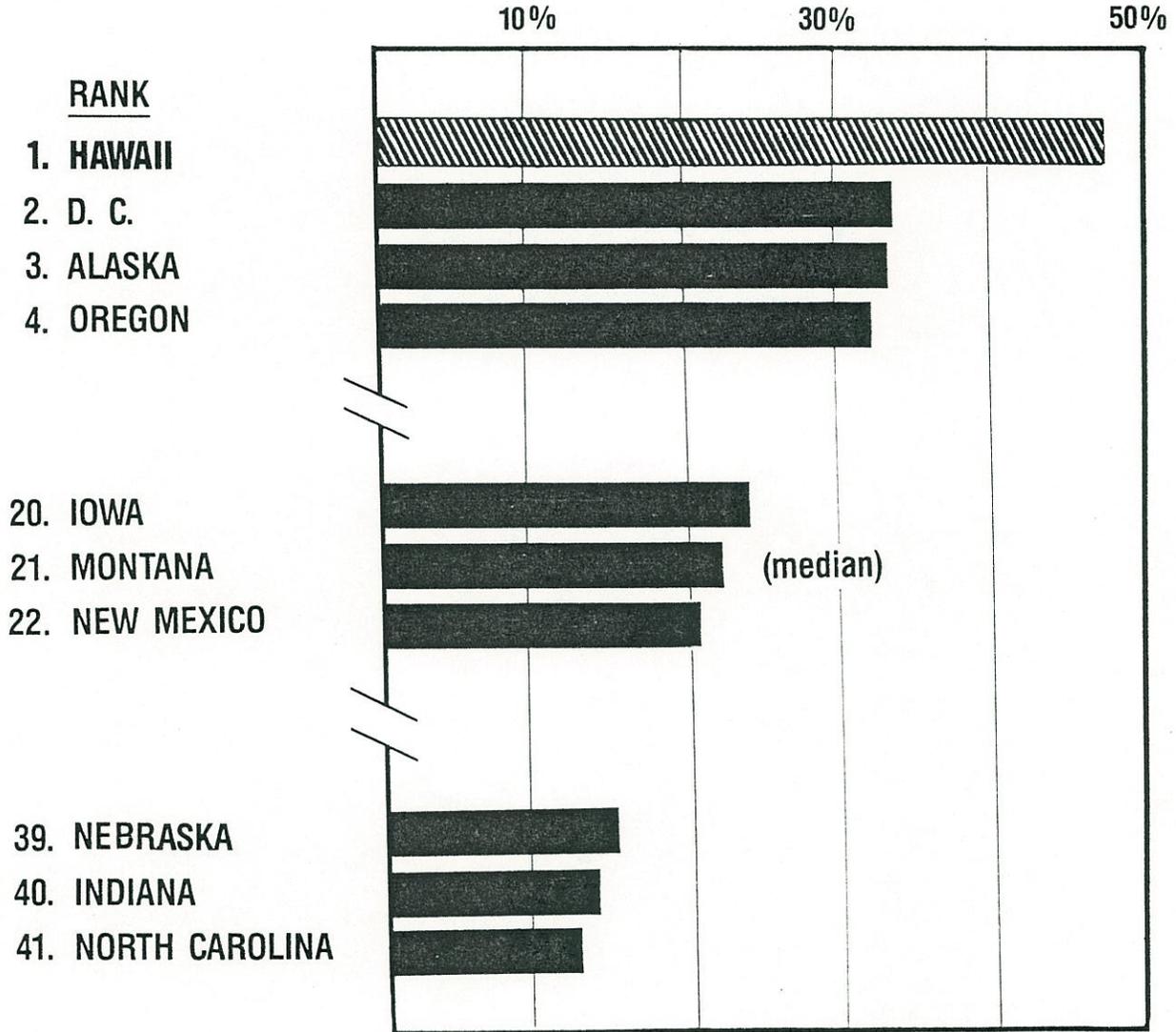


Source: NCCI.

Figure 4.6

# INDEMNITY AS A PERCENT OF TOTAL CLAIMS

1979-1980, Ranked by State



Source: NCCI Annual Statistical Bulletin, 1984, pp. 287-288.

While the number of indemnity claims is high in Hawaii, it must also be observed that the percentage of indemnity claims has historically been high, at least since 1977. This can be observed from Figure 4.7. Between 1977 and 1983, the frequency of indemnity claims grew gradually, from about 44 to 51 percent of total claims. Since the number of indemnity claims was high even before 1979, only a small portion of the recent increase in benefit payments can be attributed to this factor.

### Frequency of Permanent Claims

The total cost of all indemnity claims depends upon the mix of types of indemnity claims as well as the average cost of each type of claim. Those claims involving *permanent* benefits—i.e., permanent partial, permanent total disability, or death—are more serious and will usually involve costs in excess of claims that involve temporary total disability only. Department of Labor and Industrial Relations data indicate that, at least since 1977, permanent claims have been an increasing percentage of total indemnity cases processed. (See Figure 4.8.) In 1977, permanent claims were 11.1 percent of all indemnity claims processed, and by 1983, they had grown to 17.3 percent.<sup>7</sup>

The number of permanent claims per 100,000 work years in Hawaii is also high in comparison with the rest of the country. (See Figure 4.9.) In 1979-80, Hawaii's frequency was second only to New Jersey (1,581 versus 1,738 claims per 100,000 work years, respectively). This high percentage of permanent claims, coupled with the increasing share of such claims, appears to be a significant factor in explaining why workers' compensation program costs are relatively high in Hawaii.

### Medical Costs

As shown previously (Figure 2.4), in 1983, medical costs represented approximately one-third of all benefit payments for workers' compensation. The most recent insurance data on medical costs for other states covers the period 1979-81.<sup>8</sup> Among 41 states for which comparable data are available, Hawaii had the third highest medical cost per case. (See Figure 4.10.) The fact that Hawaii's medical costs are high in relation to other states, and are also the largest single source of benefit costs, indicates that medical costs play a material role in the high cost of the workers' compensation program in Hawaii.

Medical costs not only represent the largest single category of benefit payments, but the share represented by medical costs has fluctuated upwards over the past decade. (See Figure 4.11.) Since 1979, medical costs have represented an increasing share of an escalating total cost. This means that the rise in total medical costs has been substantial. In 1979, total medical costs were \$11.8 million, and by 1983, they had almost tripled, to \$34.3 million.

### Summary of Claim Frequency and Claim Severity Analysis

The cost of workers' compensation in Hawaii has been subdivided according to the

7. Insurance industry data also support the conclusion that the number of permanent claims is an increasing percentage of total indemnity claims in Hawaii.

8. Insurance industry data represent "policy year" data. A substantial time lag is involved in reporting such data. To illustrate, a 1979-80 policy year which begins on July 1 will encompass policies which *begin* between July 1, 1979 and June 30, 1980. Such policies will not *expire* until the period starting July 1 of the following year; i.e., between July 1, 1980 and June 30, 1981. First statistical reports are due 20 months after the policy year begins. Thus, for this 1979-80 policy year, first statistical reports will be due March 1, 1982.

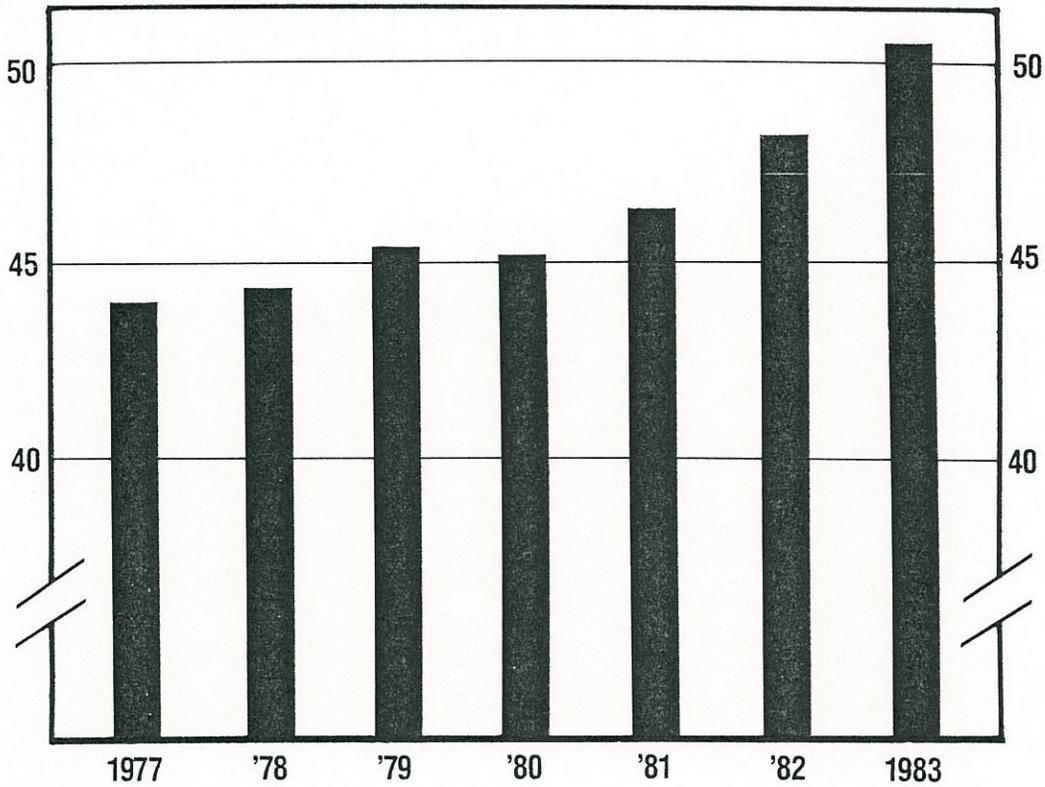
Figure 4.7

# INDEMNITY CASES AS A PERCENT OF TOTAL PROCESSED CASES

IN HAWAII  
1977-1983

Percent of  
Indemnity  
Claims

Percent of  
Indemnity  
Claims

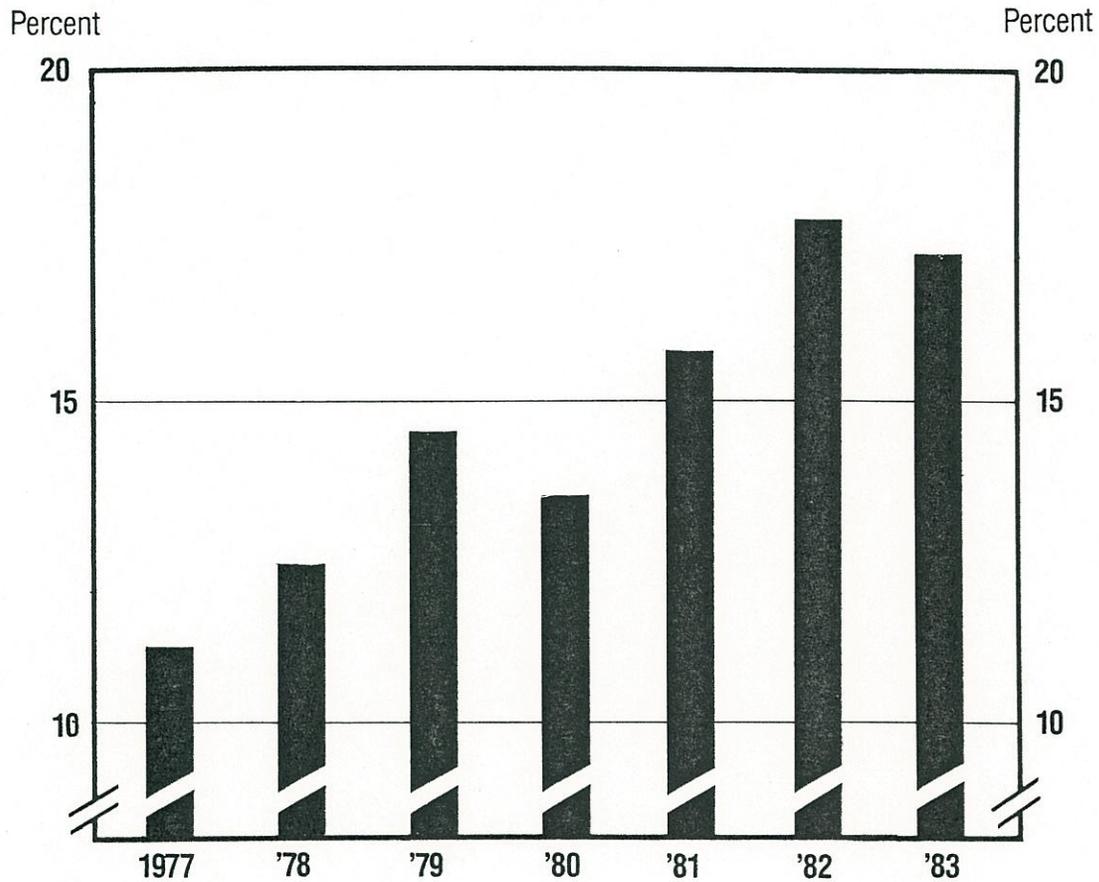


Source: Appendix E, Table E-9.

Figure 4.8

# PERMANENT CLAIMS PROCESSED AS A PERCENTAGE OF ALL CASES PROCESSED WITH INDEMNITY COSTS

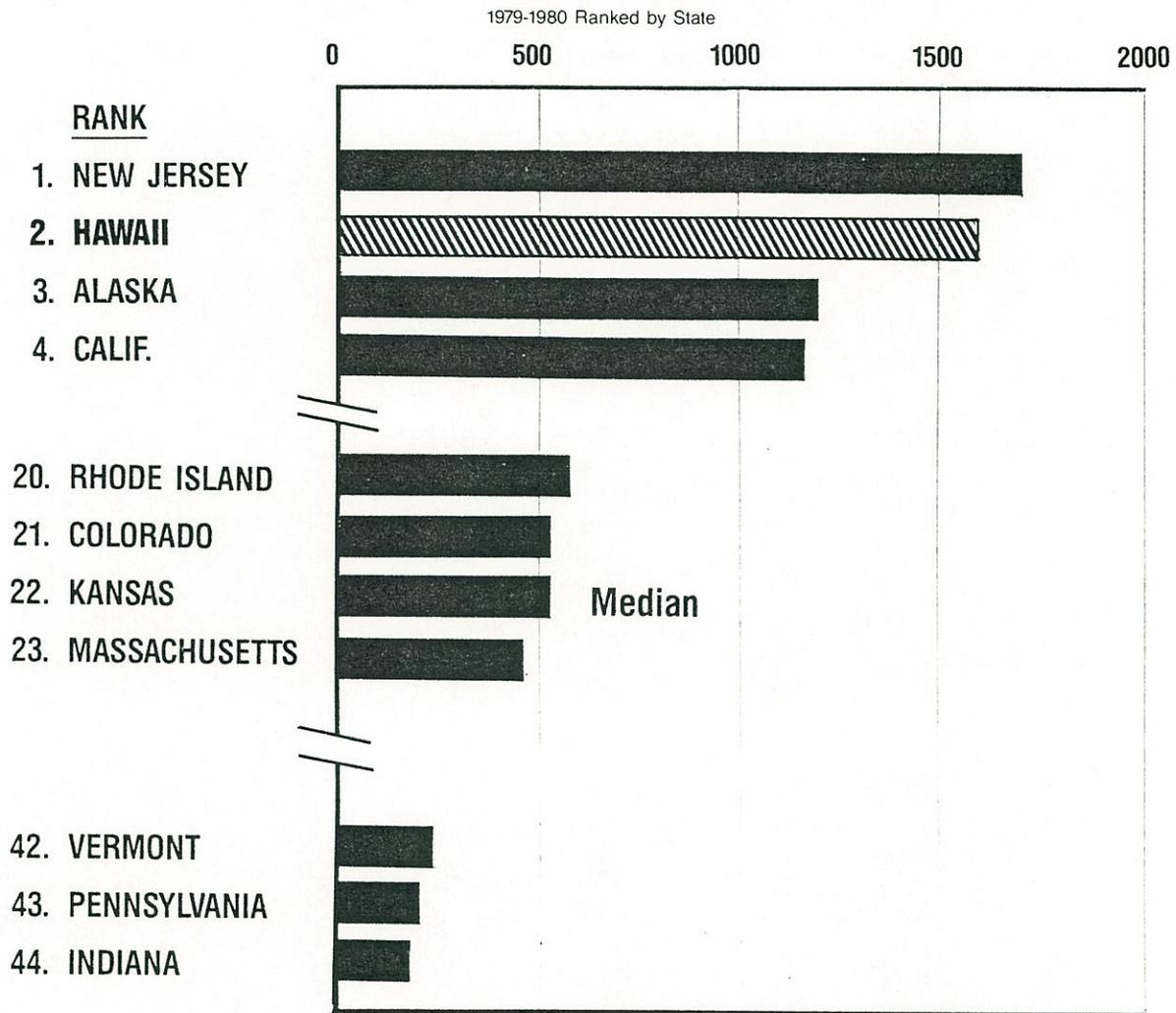
1977-1983



Source: Appendix E, Table E-10.

Figure 4.9

# FREQUENCY OF PERMANENT INDEMNITY CLAIMS PER 100,000 WORK YEARS

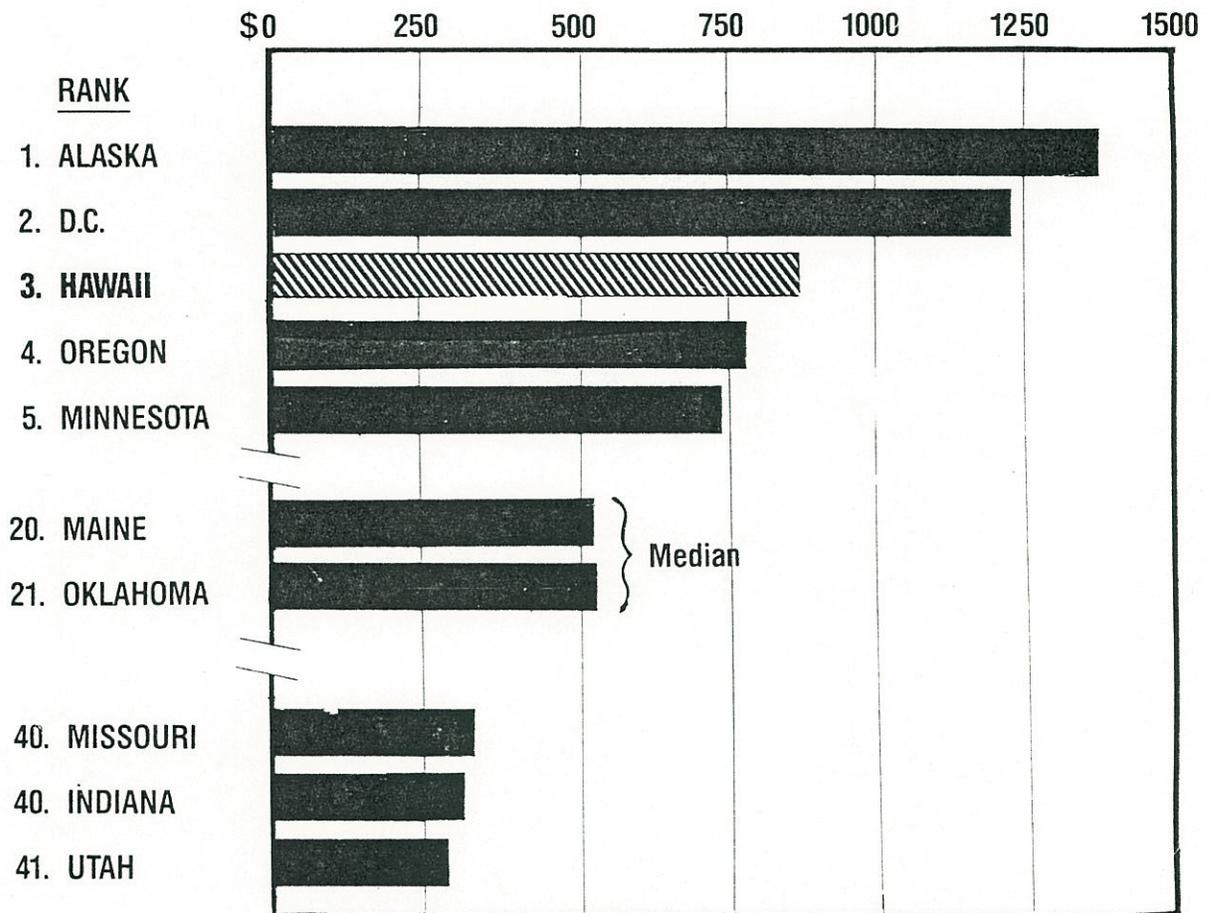


Source: *NCCI Annual Statistical Bulletin*, 1984, pp. 287-288.

Figure 4.10

# MEDICAL COSTS PER CASE

1979-80, Ranked by State

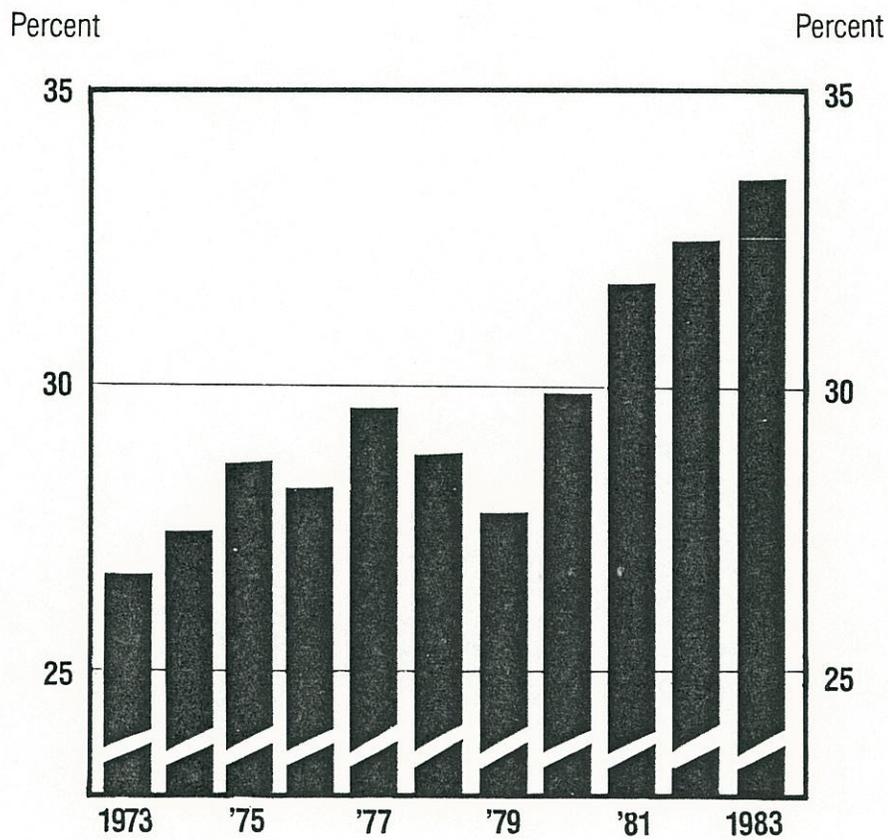


Source: NCCI Annual Statistical Bulletin, 1984, pp. 284-285.

Figure 4.11

# MEDICAL COSTS AS A PERCENTAGE OF TOTAL WORKERS' COMPENSATION BENEFITS

1973-1983



Source: Appendix E, Table E-1.

major types involved: (1) temporary total indemnities, (2) permanent indemnities, and (3) medical costs. Each of these has been analyzed over time and in relation to other states. Table 4.2 summarizes that portion of the analysis which shows how Hawaii ranks *vis-a-vis* other states.<sup>9</sup>

- The higher proportion of cases which require payment for a permanent claim.
- The higher average medical cost per claim.

The more important *negative* results can be summarized as follows:

- Increases in Hawaii's mandated benefits have caused only a small portion of the increases in total program cost since 1977.
- Hawaii's total claim frequency is 16th highest in the United States, only 4 percent more than the median claim frequency, and not seriously out of line with other states.

In brief, in comparison with other states, Hawaii is relatively parsimonious in the average amount it pays for the different types of indemnities such as permanent partial, permanent total, or survivor benefits. At the same time, Hawaii gives awards to far more people than most other states, and it has relatively high medical costs per case. Chapter 5 will explore the underlying causes of those frequency and severity factors that appear out of line in Hawaii.

The claim frequency and severity factors that most stand out are:

- The higher proportion of cases which require temporary total indemnity payments.

9. Differences among states may be caused by many factors, such as: variations in the statute; administration of the statute; judicial interpretation of the statute; mix of industries in the state; and medical care provider costs.

Table 4.2

Summary Showing How Frequency and Severity Combine to Affect Total Cost  
(Hawaii's position relative to other states, per 100,000 work years, based on 1979-1980 data, shown in brackets)

|                                                     |                                                                                                |   |                                                                                                  |   |                                                                                       |
|-----------------------------------------------------|------------------------------------------------------------------------------------------------|---|--------------------------------------------------------------------------------------------------|---|---------------------------------------------------------------------------------------|
| COST OF CLAIMS INVOLVING TEMPORARY TOTAL DISABILITY | Frequency of temporary indemnity claims<br>[Hawaii ranked <i>highest</i> in the United States] | x | Average cost of temporary indemnity claims<br>[Hawaii ranked <i>lowest</i> in the United States] | = | Total temporary indemnity cost<br>[Hawaii ranked <i>20th</i> , just above the median] |
| COST OF CLAIMS INVOLVING PERMANENT DISABILITY       | Frequency of permanent indemnity claims<br>[Hawaii ranked <i>second</i> highest]               | x | Average cost of permanent indemnity claims<br>[Hawaii ranked <i>24th</i> of 44]                  | = | Total permanent indemnity cost<br>[Hawaii ranked <i>third</i> highest]                |
| MEDICAL COSTS                                       | Frequency of medical claims<br>[Hawaii ranked <i>16th</i> , slightly above median]             | x | Average medical cost per claim<br>[Hawaii ranked <i>third</i> highest]                           | = | Total medical cost<br>[Hawaii ranked <i>third</i> highest]                            |
| TOTAL COST, ALL BENEFITS                            |                                                                                                |   |                                                                                                  |   | SUM OF ABOVE<br>[Hawaii ranked <i>third</i> in 1979-80]                               |



## Chapter 5

### DIAGNOSIS OF THE PROBLEM

The preceding analysis of trends in work related injuries, claims frequencies, and severities helped isolate the particular factors in Hawaii that appear out of line with other states. It did not explain, however, what is causing these factors to be different. This chapter investigates hypotheses and reasons as to why:

- . The frequency of temporary total disability claims is high;
- . Hawaii had the third highest cost of permanent claims and the second highest frequency of permanent claims in the United States;
- . Total medical costs and average medical costs per case are third highest in the United States.

Hawaii has both similarities and differences with those states that have recently reformed their workers' compensation programs. The overall conclusion of this chapter is that the crux of the problem with Hawaii's workers' compensation program is the presence of incentives and disincentives, often implicit, that prevent the system from working in both an equitable and efficient manner. These incentives and disincentives, acting in concert, lead the actors in the system—injured workers and claimants, employers, service providers, insurers, program administrators, the appeals board—to behave in ways that substantially raise costs without increasing the efficiency or improving the equity of the system.

In short, the presence of these incentives and disincentives contributes to further escalation of pure loss costs for workers' compensation in Hawaii.

#### Factors Influencing Temporary Disability Costs in Hawaii

Payments for temporary total disability amounted to over \$30 million in 1983. (See Figure 2.1.) The following discussion reviews factors that contribute materially to the cost of temporary total disabilities in Hawaii, especially the high frequency of claims.

**Impact of short waiting and retroactive periods.** Hawaii has the shortest waiting and retroactive periods in the United States. The meaning of these terms will become clear from the subsequent discussion.

Payments for lost time begin after a waiting period of two calendar days (*not* working days). Moreover, the Disability Compensation Division (DCD) counts the day of injury as the first day of the waiting period. Since even minor injuries may require three or four days to heal, the short waiting period helps explain the high frequency of claims noted in Chapter 4.

Payment for the initial two-day waiting period is received retroactively when an absence from the job of six or more *calendar* days occurs. In other words, the "retroactive period" is six calendar days.

This makes it possible for a person to be injured on a Thursday or Friday, return to work on the following Wednesday or Thursday, respectively, and receive full compensation for each calendar day of absence, *including weekend days*. *Daily compensation is set at one-seventh of the worker's weekly benefit.*

Table 5.1 shows the number of cases with lost time which the Disability Compensation Division processed during 1982. A total of 22,341 cases involved some time lost from work. Of these, some 2,691 lost time cases fell within the current Hawaii waiting period and were excluded from receiving workers' compensation

benefits. That left 19,650 claims with varying amounts of compensable lost time.

The frequency of short-term cases with no more than 15 days of lost time is shown in Figure 5.1. The chart indicates that after seven calendar days of absence from the job, a sharp drop in frequency occurs. This may reflect the implicit incentives in the present system, which rewards well those workers who are able to stretch their absence from the job to six days, thereby enabling them to become eligible for retroactive pay. The reward comes in the form of tax free indemnity benefits for time off the job, inclusive of what are customarily nonwork days.

Table 5.1  
Hawaii Workers' Compensation System  
Total Processed Cases With Time Lost, 1982

|                            | <i>Number<br/>of<br/>Cases</i> | <i>Percent</i> |
|----------------------------|--------------------------------|----------------|
| Total cases with days lost | 22,341                         | 100.0          |
| 1-2 days                   | <u>2,691</u>                   | <u>12.0</u>    |
| Compensable cases          | 19,650                         | 88.0           |
| 3 days                     | 1,307                          | 5.8            |
| 4-5 days                   | 359                            | 1.6            |
| 6-7 days                   | 2,525                          | 11.3           |
| 8-10 days                  | 1,936                          | 8.7            |
| 11-15 days                 | 2,474                          | 11.1           |
| 16-20 days                 | 1,272                          | 5.7            |
| 21-25 days                 | 829                            | 3.7            |
| 26-30 days                 | 658                            | 2.9            |
| 30+ days                   | 8,290                          | 37.1           |

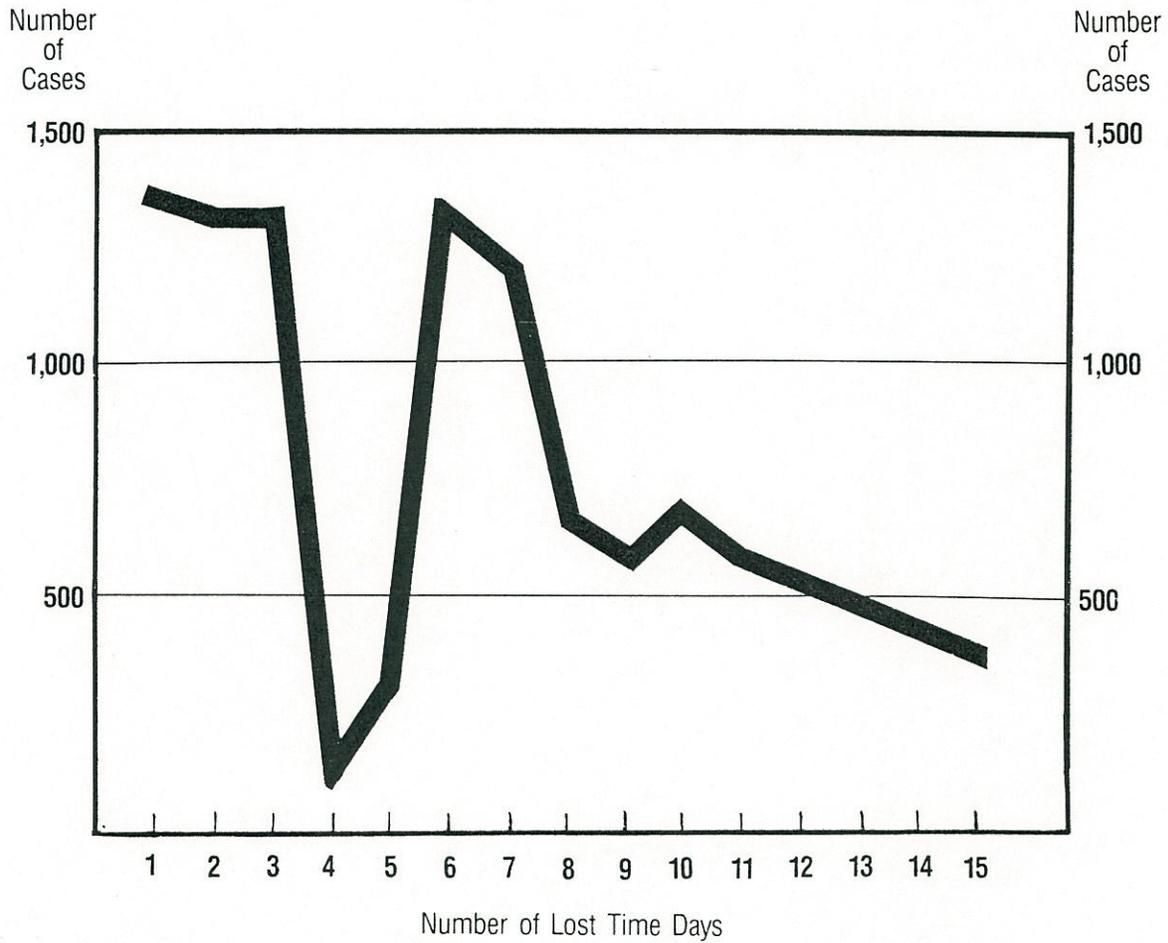
Source: Department of Labor and Industrial Relations, Disability Compensation Division, unpublished tabulations.

Figure 5.1

HAWAII WORKERS' COMPENSATION SYSTEM

# DISTRIBUTION OF CASES PROCESSED WITH 1 TO 15 DAYS LOST TIME

1982



Source: Department of Labor and Industrial Relations, Disability Compensation Division.

**Tax effects of workers' compensation benefits in Hawaii.** Workers' compensation benefits are tax free in all states including Hawaii. In Hawaii, injured workers receive two-thirds of their average weekly earnings, subject to a maximum.<sup>1</sup>

Because of the high income tax rates in Hawaii (inclusive of federal, state, and FICA tax deductions), this tax free status of benefits enables some claimants, especially those with short-term disabilities, to replace more than 100 percent of their after tax earnings. In any discussion about the adequacy of benefits, the important factor to bear in mind is the proportion of *net* wages that is effectively replaced after adjusting for income tax rates. When spendable earnings is the basis for comparison, the following examples illustrate how weekly benefits may exceed pre-injury net earnings. The example is for a single worker with the following characteristics:

|                                                                       |         |
|-----------------------------------------------------------------------|---------|
| Gross weekly wage (before taxes)                                      | = \$420 |
| Same, averaged over five working days                                 | = \$ 84 |
| Average effective tax rate (including federal, state, and FICA taxes) | = 30%   |
| Weekly benefit (two-thirds of gross)                                  | = \$280 |
| Daily benefit                                                         | = \$ 40 |

Table 5.2 illustrates the effects of temporary total disability benefits for a single worker assumed to be injured at the middle of a working day and returning to work one week later. On the day of injury, the worker receives half a day's pay, reflecting the time actually worked.<sup>2</sup> Table 5.2 shows on both a daily and cumulative basis: (1) the extent of lost gross earning (i.e., before taxes) and net earnings (i.e., after taxes); and (2) temporary total disability benefits received to replace lost earnings.

The key indicator, shown in the last column, is the ratio of benefits to lost net earnings. Under Hawaii's current system of temporary total disability awards, this worker's benefits for six or seven days (\$240 and \$280, respectively) amount to 117 and 106 percent of the worker's lost *net* income.

The tax rate used in Table 5.2 presumes that the worker's gross earnings will be \$420 a week for the entire year. For those workers who are in fact employed most or all of the year, it is also enlightening to see how a short-term injury affects their annual income tax liability. As almost every taxpayer knows, income tax rates increase as one's income increases. Economists describe this by saying that the marginal tax rate is higher than the average tax rate. Because marginal tax rates are higher than average tax rates, tax free benefits from temporary total disability benefits can be even more advantageous than indicated in Table 5.2. The example in Table 5.2 can be readily extended to illustrate this important point.

Succinctly, assume that the short-term injury of one week is the only reduction in the worker's gross reportable income for the year. At the end of the year, the worker's taxable income will be affected as follows:

|                                               | <u>Without<br/>Injury</u> | <u>With<br/>Injury</u> |
|-----------------------------------------------|---------------------------|------------------------|
| Gross earnings, 52 weeks<br>at \$420 per week | \$21,840                  | \$21,840               |
| Less: Wages lost on account<br>of injury      | —                         | —378                   |
|                                               | 21,840                    | 21,462                 |
| Less: Exemption for self                      | —1,000                    | —1,000                 |
|                                               | \$20,840                  | \$20,462               |

1. The maximum weekly benefit in 1983 was \$281. See Appendix E, Table E-7 for more detail.

2. If the worker is injured earlier or later in the day, the partial payment for the first day would need to be adjusted accordingly.

Table 5.2

Example of Tax Effects of Temporary Total Disability Workers' Compensation Awards in Hawaii

| <i>Workers' Tax Status and Earnings</i> |         | <i>Tax Implications</i>                                         |  |     |                                                                                     | <i>Benefits</i>          |  |         |      |
|-----------------------------------------|---------|-----------------------------------------------------------------|--|-----|-------------------------------------------------------------------------------------|--------------------------|--|---------|------|
| Single worker, one deduction            |         | Effective average tax rate (including federal, state, and FICA) |  | 30% | Temporary total disability benefits per week at two-thirds of gross weekly earnings |                          |  | = \$280 |      |
| Gross weekly wage (before taxes)        | = \$420 |                                                                 |  |     |                                                                                     | Averaged over seven days |  |         | = 40 |
| Same, averaged over five working days   | = 84    |                                                                 |  |     |                                                                                     |                          |  |         |      |

| <i>Day of Injury</i> |            | <i>Lost Earnings During First Week of Disability</i> |                   |                          |                   | <i>Temporary Total Disability Benefits</i> |                   | <i>Cumulative Benefits as a Percent of Cumulative Lost Net Earnings</i> |
|----------------------|------------|------------------------------------------------------|-------------------|--------------------------|-------------------|--------------------------------------------|-------------------|-------------------------------------------------------------------------|
| <i>Day of Week</i>   | <i>Day</i> | <i>Gross (before taxes)</i>                          |                   | <i>Net (after taxes)</i> |                   | <i>Daily</i>                               | <i>Cumulative</i> |                                                                         |
|                      |            | <i>Daily</i>                                         | <i>Cumulative</i> | <i>Daily</i>             | <i>Cumulative</i> |                                            |                   |                                                                         |
| Friday               | 1          | \$42.00                                              | \$ 42.00          | \$29.40                  | \$ 29.40          | -0-                                        | -0-               | -                                                                       |
| Saturday             | 2          | -0-                                                  | -0-               | -0-                      | 29.40             | -0-                                        | -0-               | -                                                                       |
| Sunday               | 3          | -0-                                                  | -0-               | -0-                      | 29.40             | \$ 40.00                                   | \$ 40.00          | 136%                                                                    |
| Monday               | 4          | 84.00                                                | 126.00            | 58.80                    | 88.20             | 40.00                                      | 80.00             | 91                                                                      |
| Tuesday              | 5          | 84.00                                                | 210.00            | 58.80                    | 147.00            | 40.00                                      | 120.00            | 82                                                                      |
| Wednesday            | 6          | 84.00                                                | 294.00            | 58.80                    | 205.80            | 120.00*                                    | 240.00*           | 117                                                                     |
| Thursday             | 7          | 84.00                                                | 378.00            | 58.80                    | 264.60            | 40.00                                      | 280.00            | 106                                                                     |

\*Includes retroactive payment for the first two days of disability.

On earnings in excess of \$18,200 (and up to \$23,500), a single resident of Hawaii would in 1984 be subject to the following tax rates:

|                           |       |
|---------------------------|-------|
| Federal income tax        | 26.0% |
| Hawaii income tax         | 10.0  |
| FICA <sup>3</sup>         | 6.7   |
| TOTAL APPLICABLE TAX RATE | 42.7% |

Thus, if the worker had not been injured and had earned the additional \$378, that additional income would have caused the worker to incur an additional tax liability of \$161.41 (i.e., 42.7 percent of \$378), and the worker's net after tax earnings would have increased by only \$216.59. The tax free weekly benefit received by this worker amounts to \$280, which is 129 percent of the \$216.59 reduction in net after tax income suffered by this hypothetical worker.

Since taxes are collected at higher rates in higher brackets, the loss of only one or two week's pay will have a tax effect that corresponds to the highest federal and state income brackets applicable to the taxpayer's income. At higher income levels, the true tax effects cannot be calculated at the average rates. For short-term injuries of one to two weeks, the marginal tax rate (which is higher than the average rate) provides a more correct basis for comparison than the average tax rates shown in Table 5.2.

An example similar to that in Table 5.2 has been developed for a married working couple with two dependents (i.e., a total of four deductions), and with gross earnings by husband and wife of \$840 a week, or \$43,680 per year. The applicable tax rates for such a married couple, assuming they file a joint return, are even higher than for those of a single worker. These higher rates reflect the so-called "marriage penalty." For such a

married couple, the average and marginal tax rates are, respectively, 34.8 and 49.7 percent (inclusive of federal, state and FICA taxes). Because the tax rates are higher, the net take home pay is less and the temporary disability benefit is an even higher percentage of spendable earnings. If the husband or wife were to incur a short-term injury and lose the same gross earnings as the single worker shown in Table 5.2 (i.e., lose \$378 in earnings), the \$280 temporary total disability benefit for the first week would amount to 147 percent of the family's take home pay based on annual income.<sup>4</sup> This illustrates that the results for a single worker are not an isolated example, but rather are applicable to many potential claimants in Hawaii.

In conclusion, the high marginal tax rates in Hawaii can cause the temporary total disability benefit to equal or exceed pre-injury net earnings for many workers, and may provide a significant disincentive for early return to work.

**Extensive supplementation of temporary total benefits.** Many private employers in Hawaii provide generous wage supplements to workers who become eligible to receive temporary total disability benefits. Information on the extent of supplements to workers' compensation in Hawaii has been developed from research on personnel practices and analysis of collective bargaining agreements conducted by the Hawaii Employers Council.

3. The tax rate of 6.7 percent represents the employee's share of the FICA tax. The employer pays an equal amount. Higher FICA taxes paid by a worker may someday result in a higher retirement benefit to the worker, depending on the benefit formula in use at the time when the worker reaches retirement age.

4. That is, a \$378 reduction in annual income would reduce this family's total tax liability by \$187.87 and spendable income by \$190.13. A temporary total disability benefit of \$280 amounts to 147 percent of the lost spendable income of \$190.13.

The Council report was based on responses from over 252 firms employing more than 87,000 persons in both office and production activities in the State. The Council found that virtually all responding firms (94 percent) had some form of sick leave plan in addition to the statutorily mandated workers' compensation and temporary disability income (TDI) programs. Among responding firms, approximately 50 percent of all office employees and 37 percent of all production employees could use sick leave benefits to supplement their workers' compensation benefits. In other words, they could use sick leave to recover any wages lost during the initial two-day waiting period.

In a research report dated March of 1984, the Council released its findings on the extent to which collective bargaining agreements in Hawaii provided some form of workers' compensation supplementation. Nearly half (49.3 percent) of the 270 collective bargaining agreements examined by the Council were found to provide some form of supplementation. Of those collective bargaining agreements providing supplementation, 77 or nearly three-fifths (57.9 percent) charged the supplements against the employee's sick leave.

Within Hawaii, temporary total disability benefits are also widely supplemented by private employers in yet another way. Namely, a number of employers give injured employees the difference between their temporary total disability benefit and their gross wage. The way in which this form of supplementation works can best be illustrated by referring to the example contained in Table 5.2. In that example, the worker's gross weekly wage amounted to \$420, and the weekly benefit was two-thirds of the gross wage, or \$280. Weekly supplementation (by those employers who provide it) would amount to \$140. This extra \$140 would of course

represent taxable income. The worker in Table 5.2 had a marginal tax rate of 42.7 percent, so that after taxes (at the higher marginal rate), the \$140 supplement would provide the worker an additional \$80.22 to spend. This amount plus the tax free benefit of \$280 would provide the injured worker with a total net after tax income of \$360.22. With this supplement, the worker receives 136 percent of lost net earnings based on the average tax rate, and 166 percent of lost net earnings based on the marginal tax rate. This type of supplementation may increase any disincentive for early return to work.

Employees in Hawaii are covered to a significant extent by such supplements to workers' compensation benefits. About one worker in two covered by a collective bargaining agreement in Hawaii has such supplements. Moreover, two out of every three organized workers so covered have 100 percent of their pre-injury earnings replaced under these supplemental benefit programs. Because these supplements are provided in addition to tax free benefits received under workers' compensation, virtually all workers covered under such programs will have greater than 100 percent replacement of their pre-injury earnings.

**The 35-hour a week rule for part-time workers.** Hawaii compensates injured part-time workers at their hourly rate times 35 hours a week, regardless of the number of hours actually worked. Both the Disability Compensation Division and the Labor and Industrial Relations Appeals Board have strictly interpreted this 35-hour a week standard.

With the widespread growth of part-time jobs in hotel, restaurant, and other service employment in the State, this concept of protection may have become distorted. Since it has been shown that

some full-time workers receive benefits that exceed 100 percent of their lost after tax earnings (Table 5.2), it is safe to assume that most, if not all, part-time workers receive a temporary total disability benefit well in excess of their lost after tax earnings. Such overcompensation can create a strong disincentive for early return to work.

**Compensation of youthful employees.** Under present rules followed by the Disability Compensation Division, an injured worker below the age of 25 initially receives compensation based on the worker's average wage, which would generally be below the average wage earned by persons older than 25 years of age in that occupation. However, if such a worker receives any kind of permanent disability award (either permanent partial or permanent total), then the minimum compensation for that worker is based on wages which the worker could have been expected to have earned in the worker's employment had the worker been over 25 years of age. This minimum is set to the average wage earned by workers over 25 years of age in that occupation.

The rule is applied retroactively to the day of injury and includes all temporary total disability payments which the worker has received. This means that any claimant below the age of 25 with a permanent partial disability award, no matter how minor, will receive compensation benefits in excess of the rate based on his or her actual earnings, except in those highly unusual cases where a young person had earned wages above the average of older workers in the same occupation.

While such generosity may be well intentioned, it also creates a disproportionate incentive among young workers to seek a permanent partial disability award, no matter how minor or trivial the injury.

## Factors Influencing Permanent Disability Costs in Hawaii

Of the total \$103 million in benefits paid in 1983, over 21 percent consisted of indemnity payments for permanent disabilities (Figure 2.1). In 1979-80, the frequency of permanent disability cases in Hawaii was second only to New Jersey (Figure 4.9), and from 1978 to 1983, the frequency of permanent disability cases in Hawaii increased by 50 percent (Figure 4.8). Since the vast majority of permanent disability cases consists of permanent *partial* disability, growth in the frequency of these cases cause them to represent a large and rapidly growing cost factor in the Hawaii workers' compensation system.

The way in which permanent partial disabilities are dealt with under the present statute is somewhat complex. This section describes and evaluates the way the system now works, including certain inconsistencies in the way permanent partial disability awards are made under the existing system in Hawaii.

**Scheduled impairments.** Hawaii's statute specifies the number of weeks of disability benefits that are to be awarded for a variety of impairments. These are commonly referred to as "scheduled" impairments. Scheduled impairments pertain to loss of vision, loss of hearing, or amputation (or loss of use) of a limb—e.g., loss of a finger, hand, or an arm.<sup>5</sup>

**Unscheduled impairments.** The law also provides for "other" cases involving permanent partial disability. These are

5. Hawaii's statute is similar to the laws in many other states, which also specify a list of scheduled impairments.

commonly referred to as “unscheduled” impairments. Unscheduled impairments frequently involve back or neck problems, but any permanent impairment not listed in the schedule is an unscheduled impairment.

**Compensation for scheduled versus unscheduled impairments.** For reasons not altogether clear, the amount of compensation which is provided for a *scheduled* impairment may be less than the amount for an equivalent *unscheduled* impairment.<sup>6</sup> The way in which this arises is as follows.

Injured workers with a *scheduled* impairment receive a weekly benefit at the rate of two-thirds of their *average* weekly wages, subject to the maximum weekly benefit. Workers with an *unscheduled* impairment first have their impairment rated as a percentage of total loss. They then receive a benefit which is their percentage impairment multiplied by “312 times the effective *maximum* weekly benefit rate.” Thus, the total compensation payable

for unscheduled impairments is based on the *maximum* weekly benefit *regardless of the worker’s actual earnings*. At the same time, the amount of money which a worker receives each week (i.e., the weekly benefit) is always based on the worker’s actual earnings.

**Illustration.** Table 5.3 presents some specific examples. They consist of four workers: A, B, C, and D. Workers A and B suffer scheduled impairments, whereas workers C and D suffer unscheduled impairments.

For simplicity and ease of comparison, the two workers with scheduled impairments are assumed to receive 78 weeks of disability, which is equal to 25 percent of 312 weeks (i.e., 25 percent of the “whole man”). The two workers with unscheduled impairments are assumed to be

6. “Equivalency” of injuries is based on the percentage of 312, which represents the “whole man.”

Table 5.3

Illustration of Compensation for Scheduled and Unscheduled Permanent Partial Disabilities Under Hawaii’s Workers’ Compensation Statute

| Worker | Type of Impairment | Disability Award |                 | Worker's Average Weekly Wage | Workers Weekly Benefit | Total Compensation Payable* | Number of Weeks Benefits Paid** |
|--------|--------------------|------------------|-----------------|------------------------------|------------------------|-----------------------------|---------------------------------|
|        |                    | Percent          | Number of Weeks |                              |                        |                             |                                 |
| (1)    | (2)                | (3a)             | (3b)            | (4)                          | (5)                    | (6)                         | (7)                             |
| A      | Scheduled          | (25%)            | 78              | \$390                        | \$260                  | \$20,280                    | 78.0                            |
| B      | Scheduled          | (25%)            | 78              | 300                          | 200                    | 15,600                      | 78.0                            |
| C      | Unscheduled        | 25%              | (78)            | 390                          | 260                    | 21,918                      | 84.3***                         |
| D      | Unscheduled        | 25%              | (78)            | 300                          | 200                    | 21,918                      | 109.6***                        |

\*Column 3b times column 5.

\*\*Column 6 divided by column 5. Actual payments are made at the worker’s weekly benefit rate, and continue for the number of weeks shown.

\*\*\*Partial payment during the last week.

rated at 25 percent disability. The disability awards are shown in columns 3a and 3b of Table 5.3. To the extent that the rating system succeeds in comparing fairly the severity of scheduled and unscheduled impairments, these four workers are considered to suffer from an approximately equal degree of economic disability.<sup>7</sup>

Weekly gross earnings of each worker (i.e., each individual's average weekly wage) are shown in column 4 of Table 5.3. Each worker's weekly benefit rate, which is two-thirds of the worker's gross earnings, is shown in column 5. To facilitate certain subsequent comparisons, workers A and C are each assumed to earn \$390 a week, while workers B and D are each assumed to earn \$300 a week.

The total compensation which each worker is entitled to receive on account of his or her permanent partial disability is shown in column 6 of Table 5.3. The total compensation for workers A and B is determined by their *actual* weekly benefit (column 5) times 78 weeks. Total compensation for workers C and D is determined by multiplying the *maximum* weekly benefit (\$281 during 1984) times 78. Differences in total compensation are apparent from inspecting column 6 of Table 5.3. Worker D will receive almost one-third more than worker B, even though both have a permanent impairment of approximately 25 percent, and both have the same weekly earnings.

Finally, the number of weeks over which each worker receives his or her permanent partial disability benefits is shown in column 7 of Table 5.3. The number of weeks shown in column 7 is derived by dividing column 5 into column 6. All workers receive weekly benefits equal to the amount shown in column 5. Workers A and B will each receive benefits for 78 weeks, whereas workers C and D will receive

weekly benefits for a longer period, until their total compensation equals the amount shown in column 6.<sup>8</sup>

#### Rating of unscheduled disabilities.

An important facet of the Hawaii workers' compensation system is the way in which unscheduled permanent disabilities are rated. The DCD ratings, which underlie awards for unscheduled permanent partial disabilities, are based on the *economic losses* which workers *are expected* to encounter because of their work related impairment. Expected economic losses include, but may go beyond, medical ratings of physical impairment.

When expected economic losses are the criterion for determining the degree of disability, awards will diverge from medical impairment ratings. For example, the employer's physician may opine that the physical disability resulting from worker's impairment is 10 percent, the employee's physician might state that in his opinion the disability is 15 percent, and yet, the hearing officer may award 20 percent disability because the hearing officer will take into account economic factors which are not and would not be considered by any physician.<sup>9</sup>

7. This example intends no criticism, implied or otherwise, of the way in which DCD hearing officers rate injuries. The sole purpose of this example is to focus on the way in which the workers' compensation statute compensates permanent partial disabilities. For purposes of this illustration, it is helpful for the reader to assume that DCD's rating procedures are as perfect as is humanly possible.

8. Table 5.3 shows the amount and timing of permanent partial disability payments if paid as weekly installments in accordance with the present law. The law also permits lump-sum settlements to occur. Workers with permanent partial disabilities who are able to return to work full-time immediately after the healing period often prefer to receive a lump-sum settlement.

9. Examples of economic factors would be the worker's prior training, skills, and education (or lack thereof), local labor market conditions, and the likelihood that the worker will be able to find and retain a suitable job in the local labor market.

**Entitlement to compensation.** The previous illustration of how the present system works is also useful for illustrating entitlement to compensation. Of the four workers described in Table 5.3, each is entitled to receive the total compensation shown in column 6, regardless of whether or when they return to work, and regardless of their earnings when they do return to work. In other words, the amount of permanent partial disability award does not depend on the extent of economic losses which a worker actually suffers on account of his or her disability. Those workers who are fortunate enough to return to work immediately following the healing period, at their previous rate of pay, receive their tax free permanent partial disability benefits *in addition to* their regular pay, as extra spendable income. Those who are unable to find work receive their permanent partial disability benefits *in lieu of* other income; i.e., as replacement for lost wages.

The way in which Hawaii makes awards for permanent partial disability conforms generally to what John Burton describes as a pure *ex ante* approach.<sup>10</sup> That is, at the end of the healing period, and before the employee returns to work, the DCD hearing officer makes a decision based on what he thinks the economic losses are likely to be. Many states use an *ex ante* approach more or less similar to Hawaii.

Some degree of subjectivity is necessarily required by an *ex ante* approach which incorporates both medical and economic factors. This subjectivity, coupled with the increasing frequency of permanent partial disability cases, may help explain the increasing amount of litigiousness noted in connection with the discussion of Tables 2.2 and 2.3.

Burton contrasts the *ex ante* approach with the *ex post* approach. A "pure" *ex post* approach would make all payments for

permanent partial disability contingent upon actually suffering economic losses on account of the injury. A pure *ex post* approach to compensation would entail a "pure" wage loss system. Burton notes, however, that no state has adopted pure wage loss. That is, those states which rely heavily on wage loss theory have also retained impairment awards for at least some impairments, such as amputations.

In conclusion, the current system of permanent partial disability awards provides inconsistent and possibly inequitable treatment of eligible claimants as between scheduled versus other unscheduled awards. Further, the size of awards is based not on physical impairment, but on expected economic loss. Yet, economic losses subsequently suffered by the worker have nothing to do with the amount of benefits actually paid. The disability standards used in Hawaii should, if properly applied, result in equitable treatment of all claimants whether high or low wage, or service worker, or professional. They do not because while attempting to compensate for apparent economic disability, the awards provide both a floor and a ceiling for all claimants. The resultant system is inconsistent, inequitable, and costly.

**Payment for prior injuries.** As explained previously, all permanent partial disability awards can be figured as a percentage of the "whole man," which under current law is established at 312 weeks. To revert to the examples in Table 5.3, a worker with a scheduled injury who is entitled to

10. John F. Burton, Jr., "Compensation for permanent partial disabilities," in *Safety and the Work Force*, John D. Worrall, ed., ILR Press, New York State School of Industrial and Labor Relations, Cornell University, 1983, pp. 18-60. Throughout this seminal article, Burton stresses the importance of building correct incentives into the compensation system.

receive benefits for 78 weeks and a worker with an unscheduled injury who is rated at 25 percent permanent disability can be considered to have an equivalent degree of disability.

After workers with permanent partial disabilities go back to work, it is obviously possible for them to incur another work related injury. When this occurs, the worker is said to have a second injury. The second injury may involve yet another impairment. For example, it may be an aggravation and worsening of a prior impairment (e.g., a new sprain to a back that was previously sprained) or it may be a new impairment unrelated to the prior impairment. Following the occurrence of a second permanent impairment, the injured worker must again be rated for purposes of a permanent partial disability award.

A worker with a previous disability rating of 25 percent might, following a second injury, be rated at 37.5 percent disability. In other words, the worker's impairment *has increased by 12.5 percent*, or by one-eighth of the "whole man." In some other jurisdictions the worker with such a second injury would typically be awarded 39 weeks of *additional* benefits (i.e., one-eighth of 312 weeks), on grounds that the worker had already been compensated for the first 25 percent of disability. In Hawaii, however, the worker with such a second injury would currently receive 117 weeks of benefits (i.e., three-eighths of 312), in addition to the 78 weeks of benefits previously awarded. Critics of Hawaii's system sometimes refer to this result as "double dipping."<sup>11</sup>

Since Hawaii determines permanent partial disability awards on the basis of expected economic loss, but pays the full amount of the award regardless of whether the worker actually sustains any economic loss, it is indeed possible that the first and

second awards could both represent extra tax free income, so long as the injured worker is able to return promptly to his or her prior job. Succinctly, the system clearly enables double dipping and even triple dipping. Unfortunately, the available data do not permit the extent of double dipping to be readily measured or estimated.

### **Lack of Coordination with Social Security Disability and Retirement Benefits**

Hawaii probably has more mandated insurance programs than any other state. Failure to coordinate mandated insurance programs inevitably leads to overcompensation of some people relative to others and will tend to drive up costs for those who must pay the bill. This realization has led a number of states to coordinate social security benefits with benefits provided under their workers' compensation program.

**Disability benefits.** A worker who becomes permanently and totally disabled, either as a result of a work related injury or otherwise, may qualify for social security disability benefits. If the worker is entitled to receive workers' compensation benefits, however, federal law limits the combined amount of benefits from social security disability and workers' compensation so as not to exceed 80 percent of the worker's average weekly wage at the time of injury. In other words, if workers' compensation payments *are not reduced*, then the worker's entitlement to any social security disability benefit *is reduced*. Making social security disability benefits primary to workers'

11. A third injury, resulting, say, in cumulative 50 percent disability, would provide the worker with an additional 156 weeks of benefits. In Hawaii, such a worker could receive a cumulative total of  $78 + 117 + 125 = 351$  weeks of benefits.

compensation benefits helps injured workers in a number of ways, and it also achieves a meaningful reduction in the cost of the state workers' compensation program.

An analysis of state workers' compensation laws performed in 1983 by the U.S. Department of Labor shows that 12 jurisdictions provide for a social security offset to workers' compensation or unemployment benefits.<sup>12</sup> Hawaii does not presently provide for such an offset under its present law.

**Retirement benefits.** A fundamental concept underlies the indemnity benefit paid to workers who are permanently and totally disabled. Namely, a worker is entitled to replacement of the wages which the worker would have received had the worker been employed (subject to the limitation on maximum weekly benefits). Further, it is presumed that the worker would have been continuously employed but for the injury. When a worker is permanently and totally disabled, it seems altogether proper to give the injured worker the benefit of any doubt concerning his or her continuous employability, *at least up to retirement age*. Once a person reaches retirement age, however, and commences drawing social security retirement benefits, the presumption that the worker would nevertheless be employed and earning a weekly income becomes less valid. Workers who are not disabled and who elect to continue working after reaching age 65 may not be entitled to any of their social security benefits until they reach age 70, depending upon their earnings. Upon reaching age 65, those persons who are permanently and totally disabled receive a full permanent total disability benefit plus a social security retirement benefit.<sup>13</sup> At this point they may receive considerably more than those who retire and simply receive only the social security benefit.

Inasmuch as employers pay for all wage loss indemnity benefits and one-half of all social security benefits, a number of states reduce the wage loss benefit after workers start receiving social security retirement benefits. This reduction is commonly referred to as a social security *retirement* offset provision. Hawaii does not have such an offset.<sup>14</sup>

### The Presumption of Work Related Injury

Workers' compensation benefits are for work related injuries. Demonstrating occupational causality in individual claims is not always simple, however. Accidents occurring at work are relatively clear-cut, but it is often more difficult to make determinations about causation of disabling injuries which are related to a multiplicity of pathological conditions (e.g., heart attacks).

Reflecting humanitarian objectives of workers' compensation programs, state legislatures and courts have developed a variety of statutory provisions and judicial doctrines which tend to help an injured worker demonstrate occupational causality in the sometimes difficult legal process. The general philosophy has been that it is better to err by compensating a possibly invalid claim than to err by failing to compensate a claim that was valid. It also reflects a

12. The 12 states which provide an offset for social security disability benefits include: Alaska, Colorado, Florida, Louisiana, Minnesota, Montana, New Jersey, North Dakota, Oregon, Washington, Wisconsin, and Wyoming.

13. Alternatively, some may elect to receive a reduced social security benefit upon reaching age 62.

14. States with a social security offset provision for workers who are permanently and totally disabled include Alaska, Colorado, District of Columbia, Florida, Louisiana, Michigan, Minnesota, Montana, New Jersey, North Dakota, Oregon, Washington, and Wisconsin.

presumption that employers and insurance companies are more knowledgeable about workers' compensation laws than the individual worker and are better able to afford expert legal representation. In consequence, a widespread preference has evolved for resolving doubts about the merit of a claim in favor of the claimant.

For Hawaii, any analysis of the high cost of workers' compensation would not be complete without a discussion about the presumption clause contained in Chapter 386-85, the Hawaii Revised Statutes, under which it is presumed that a claim is for a covered work injury unless there is *substantial* evidence to the contrary. Certain landmark rulings by the Hawaii Supreme Court are widely viewed as significantly broadening the basis for workers' compensation eligibility and rather dramatically increasing the evidentiary burden on employers and insurers.

The question of how much these judicial interpretations have added to total program cost is not readily amenable to analysis. Presumption does not pertain to a specific type of injury or illness. From a narrow legalistic viewpoint it relates solely to an evidentiary standard. Broadly, though, it potentially relates to any type of injury or illness.

To help appreciate the analytic problem involved, suppose the Supreme Court were to issue a precedent setting decision that some particular disease is henceforth to be considered occupationally related (e.g., asbestosis). Insurance companies would thenceforth code each such compensable case as, for example, "asbestosis." After a few years of accumulating statistical records, it would be possible to develop fairly reliable estimates on the cost of covering this new disease under workers' compensation insurance.

Presumption is different. Once a precedent is established and a certain type of disease (or injury) is presumed to be work related, statistical classification and coding systems attribute individual cases to the disease, not to "presumption." There is no place for "presumption" in a statistical coding or classification scheme. As a consequence, meaningful data on the effect of presumption do not exist.

In point of fact, only a few decisions of the Supreme Court and the Labor and Industrial Relations Appeals Board explicitly address the issue of presumption. These few cases *by themselves* have almost no measurable impact on the aggregate statistics (e.g., on the frequency, severity, or cost) for the workers' compensation program. From the viewpoint of statistical impact, the real issue concerns the way in which presumption is applied by DCD's hearing officers, whose decisions become the *de facto* final decision in over 90 percent of all cases. Detailed written decisions are not rendered by the hearing officers. Consequently, it is not possible to determine how often hearing officers invoke presumption, or whether they interpret and apply presumption within the evidentiary guidelines laid down by the court.<sup>15</sup>

Other states have faced the problem of causality in recent years. Motivated primarily by cost concerns, they have chosen to modify the standards of evidence for occupational causation and develop an appropriate "balance" between the needs and rights of employers and claimants.

15. It has been asserted that in a number of instances DCD hearing officers have invoked presumption with little or no evidence, and in a conclusory manner that goes far beyond the rulings or intent of the court. Given the lack of formal written decisions, however, it was not possible to verify any such instances.

## High Average Medical Costs in Hawaii

In 1983, medical costs comprised one-third of all workers' compensation benefit costs paid in Hawaii (Figure 2.1). Data available for 1980-81 also show Hawaii with the third highest medical cost per case in the United States (Figure 4.10). Further, medical costs have in recent years accounted for an increasing share of the escalating amount of total benefits paid (Figure 4.11). Control over medical costs must be a key part of any effort to contain the overall cost of the workers' compensation program.

Hawaii has for many years required that the Department of Labor and Industrial Relations publish a schedule of medical fees applicable to treatments rendered under the workers' compensation program.<sup>16</sup> Medical services provided under the workers' compensation system are billed in accordance with this fee schedule. Hawaii's fee schedule appears to be working reasonably well. On an overall basis, it is in line with Hawaii Medical Service Association rates, it is less than Civilian Health and Medical Program of the Uniformed Services (CHAMPUS) rates,<sup>17</sup> and greater than the Medicaid fee schedule.<sup>18</sup> The principal alternative to a uniform fee schedule would be to have individual physicians use their "usual and customary" fees. There is no evidence to indicate, though, that usual and customary fees would result in any material reduction in medical costs.

Costs for medical services in Hawaii are in line with costs in other major states such as California, Florida, or New York. Since unit fees are not out of line, it is reasonable to conclude that the high medical cost per case points to injured workers in Hawaii receiving, on average, a greater volume of health care services than injured workers in

other states. This could occur for any of several reasons: (1) medical care given to injured workers in Hawaii may be more adequate; (2) compensable injuries or illnesses suffered by workers in Hawaii may be more serious and hence more expensive to treat; or (3) there may be more unnecessary overtreatment of injured workers in Hawaii than elsewhere.

If the health care provided to injured workers in Hawaii is measurably better than elsewhere, then the system is to be commended. There is no *a priori* reason, however, to believe that medical care in Hawaii is markedly different—either better or worse—than in such states as California, Florida, or New York.

Available data on the severity of accidents is sketchy, at best. As shown in Figure 4.3, however, the average number of days lost per lost workday case is slightly lower in Hawaii than elsewhere, pointing to more or less comparable severity. Further, Hawaii does not have any employment in many of the industries known to have relatively high frequencies of severe injuries such as offshore oil drilling, mining (especially coal mining), or logging and timber. It is conceivable that judicial interpretation of the presumption clause in Hawaii may have made certain more serious events—such as strokes and heart attacks—compensable under the workers' compensation system in Hawaii, while such incidents are not compensable elsewhere. Each heart attack case can involve many thousands of dollars worth of intensive hospital care, especially if an open-heart

16. Section 386-21, HRS.

17. The federal government uses the CHAMPUS fee schedule to reimburse private medical providers for services rendered to military personnel and their dependents.

18. This reflects a cost comparison in which more frequent treatments were given proportionately greater weight.

bypass operation is involved. Unfortunately, as discussed previously, available data do not permit determining whether judicial interpretation of the presumption clause has had a material impact on the observed frequency of workers' compensation cases of the severe type.

The third possibility, overtreatment by health care suppliers, would on the face of it, appear to be distinctly plausible. The law says that after a work injury is sustained, the employer shall furnish "all medical care, services and supplies as the nature of the injury *requires*. [Emphasis added.]" Determining the amount of medical services which are required for a particular work injury is known as "utilization control." The Department of Labor and Industrial Relations, which administers the workers' compensation system in Hawaii, has made no effort whatsoever to develop, much less implement, any form of utilization control. This is a critical omission. Even states with lower medical costs per case than Hawaii have found that some form of utilization control is a necessary and integral part of moderating medical costs in the workers' compensation program. The Department of Labor and Industrial Relations relies entirely on the insurance carriers and self-insured employers to control any overutilization of medical services.<sup>19</sup> If an insurance carrier or self-insured employer feels that unnecessary medical services are being charged, a complaint can be made to the DCD. Complaints are referred to hearing officers, who hold hearings and issue decisions. Aside from having hearing officers make decisions to resolve disputes, the DCD takes no other action to control or prevent overutilization by medical providers.

The decision in a dispute between the insurance company and the worker's physician is put into the worker's case file. DCD does not keep any record of which cases involved disputes over medical treatment.

Since DCD is unable to retrieve systematically cases that have involved disputed bills, it is virtually impossible to analyze questions such as: (1) Does DCD always or almost always find in favor of the worker's physician; (2) Are certain physicians recurrently involved in disputes; or (3) Do disputes disproportionately involve one category of provider such as hospitals, clinics, medical doctors, chiropractors, or other providers?

In order to develop more information on this subject, an investigation of more expensive cases was undertaken with the cooperation of several insurance companies.<sup>20</sup> The investigation included cases that were treated both by doctors of medicine as well as by chiropractors.

Overutilization may occur in a number of guises. Among chiropractors, overtreatment is related primarily to the number and frequency of visits. Among doctors of medicine, it may involve unnecessary referrals to specialists, unnecessary tests (sometimes called "defensive" medicine), or treatments that are not indicated by the diagnosis. The investigation included a total of 59 cases treated by chiropractors and 19 cases treated by physicians.

19. Only property and casualty insurance companies write workers' compensation coverage. The experience of these companies in medical cost control is not as extensive as that of life and health insurance companies. Most self-insured employers have little or no ability to control overutilization by medical providers.

20. More expensive cases were those that were substantially in excess of the average cost per case which is nothing more than a statistical average. It represents many cases which may involve only one or two visits to a physician, other cases involving treatment which is moderately more extensive, and yet other cases which involve cost considerably above the average. If extensive overtreatment and overutilization exist, they are far more likely to be found in these higher cost cases, not among cases involving limited visits and treatments.

For the 59 cases treated by chiropractors it was necessary to have a yardstick against which the frequency of visits could be compared. In January of 1984, the workers' compensation program in the State of Oregon adopted guidelines for the maximum frequency of visits that are appropriate.<sup>21</sup> The Oregon guidelines stipulate that the maximum number of visits during the first two months shall not exceed 15, and thereafter, they shall not exceed two visits per month. These guidelines would allow, for example, up to 35 visits during the first year (15 visits during the first two months, and 20 visits during the ensuing 10 months). Table 5.4 summarizes the results for the 59 cases treated by chiropractors.

The total number of visits during the peak two months is shown in column 2 of Table 5.4. Actual visits as a percent of the Oregon guideline (15 visits) is shown in column 3. Of the total 59 cases investigated, 46 cases, or 78 percent of the total, exceeded the two-month guideline. The extent to which the two-month guideline was exceeded ranged from 287 percent (43 visits in two months) down to 167 percent (16 visits in two months).

The total number of months during which the patient went to see the chiropractor is shown in column 3 of Table 5.4, and the total number of visits is shown in column 4. The maximum number of visits that would be permitted under the Oregon guidelines is shown in column 5. Column 6 shows the actual number of total visits as a percent of the Oregon guidelines. The total number of visits exceeded the Oregon guidelines in 51 cases. In two instances, total treatments exceeded the guidelines by over 500 percent: (1) 310 visits in 21 months, which was 585 percent of the guideline, and (2) 137 visits in eight months, which was 507 percent greater than the guideline.

The total cost of chiropractic treatment for each case is shown in the last column.<sup>22</sup> Chiropractic care for these 59 cases aggregated some \$268,580, or about \$4,550 per case.

It should be stressed that the Oregon "standard" is only a guideline. The fact that a particular case exceeds the guideline does not necessarily mean that the number of treatments was excessive. The large number of cases in which frequency of treatments exceeded the guidelines is an indication, though, that some practitioners may be overtreating.<sup>23</sup>

The results for the 19 cases treated by physicians are summarized in Table 5.5. The first column shows the nature of the injury. The second column shows the total duration of treatment, the third column shows the total number of visits, and the fourth column shows the total cost of medical treatment. The final column gives a capsule summary as regards possible overtreatment in each case. To summarize, the results sometimes point to overtreatment; in some instances, they point to inadequate monitoring by an insurance company; and sometimes neither. In some instances, the treatments appear to be indicated by and in line with the diagnosis. In others, the case file contained insufficient information to determine whether all treatments were indicated by the diagnosis.

21. The guidelines issued by the workers' compensation program in Oregon are applicable only to the attending physician and do not include referrals to specialists. These guidelines may be exceeded, provided that the attending physician first submits and receives approval for a plan of treatment calling for greater frequency of visits.

22. A number of these cases involved medical treatment from providers other than chiropractors. Hence, the total cost shown in the last column of Table 5.5 is not necessarily the total cost of the case.

23. The number of cases reported in Table 5.4 is only a sample of cases that were available to the study team. Time and resources did not permit further investigation into this aspect of the study.

Table 5.4

## Frequency of Treatment by Chiropractors in Hawaii Compared With Oregon Guidelines

| <i>Case No.</i> | <i>No. of Visits During Peak Two-Month Period</i> | <i>Percent of Oregon Guideline</i> | <i>Total Duration of Treatment (months)</i> | <i>Total Visits</i> | <i>Oregon Guideline</i> | <i>Percent of Oregon Guideline</i> | <i>Total Cost of Treatments</i> |
|-----------------|---------------------------------------------------|------------------------------------|---------------------------------------------|---------------------|-------------------------|------------------------------------|---------------------------------|
| 1               | 40                                                | 267                                | 21                                          | 310                 | 53                      | 585                                | \$17,119                        |
| 2               | 41                                                | 273                                | 8                                           | 137                 | 27                      | 507                                | 15,381                          |
| 3               | 30                                                | 200                                | 11                                          | 113                 | 33                      | 342                                | 8,208                           |
| 4               | 28                                                | 187                                | 11                                          | 109                 | 33                      | 330                                | 6,757                           |
| 5               | 19                                                | 127                                | 24                                          | 189                 | 59                      | 320                                | 7,978                           |
| 6               | 29                                                | 193                                | 10                                          | 99                  | 31                      | 319                                | 6,246                           |
| 7               | 25                                                | 167                                | 25                                          | 194                 | 61                      | 318                                | 9,276                           |
| 8               | 28                                                | 287                                | 7                                           | 76                  | 25                      | 304                                | 3,498                           |
| 9               | 24                                                | 160                                | 8                                           | 82                  | 27                      | 304                                | 3,903                           |
| 10              | 27                                                | 180                                | 8                                           | 72                  | 27                      | 267                                | 3,756                           |
| 11              | 43                                                | 287                                | 21                                          | 141                 | 53                      | 266                                | 12,583                          |
| 12              | 24                                                | 160                                | 19                                          | 130                 | 49                      | 265                                | 8,557                           |
| 13              | 24                                                | 160                                | 9                                           | 74                  | 29                      | 255                                | 3,057                           |
| 14              | 28                                                | 187                                | 6                                           | 57                  | 23                      | 249                                | 3,158                           |
| 15              | 19                                                | 127                                | 13                                          | 91                  | 37                      | 246                                | 4,467                           |
| 16              | 17                                                | 113                                | 41                                          | 228                 | 93                      | 245                                | 5,032                           |
| 17              | 26                                                | 173                                | 9                                           | 71                  | 29                      | 245                                | 3,751                           |
| 18              | 26                                                | 173                                | 12                                          | 82                  | 35                      | 234                                | 4,113                           |
| 19              | 20                                                | 133                                | 15                                          | 93                  | 41                      | 227                                | 5,481                           |
| 20              | 22                                                | 147                                | 16                                          | 96                  | 43                      | 223                                | 6,160                           |
| 21              | 26                                                | 173                                | 5                                           | 45                  | 21                      | 214                                | 2,551                           |
| 22              | 23                                                | 153                                | 5                                           | 44                  | 21                      | 210                                | 1,806                           |
| 23              | 23                                                | 153                                | 12                                          | 73                  | 35                      | 209                                | 4,713                           |
| 24              | 23                                                | 153                                | 13                                          | 77                  | 37                      | 208                                | 5,859                           |
| 25              | 17                                                | 113                                | 37                                          | 177                 | 85                      | 208                                | 7,305                           |
| 26              | 34                                                | 227                                | 7                                           | 52                  | 25                      | 208                                | 2,769                           |
| 27              | 16                                                | 106                                | 22                                          | 112                 | 55                      | 204                                | 7,186                           |
| 28              | 21                                                | 140                                | 17                                          | 91                  | 45                      | 202                                | 4,316                           |
| 29              | 16                                                | 107                                | 16                                          | 86                  | 43                      | 200                                | 4,988                           |
| 30              | 34                                                | 227                                | 12                                          | 69                  | 35                      | 197                                | 4,246                           |
| 31              | 18                                                | 120                                | 46                                          | 201                 | 103                     | 195                                | 11,142                          |
| 32              | 18                                                | 120                                | 10                                          | 58                  | 31                      | 187                                | 3,655                           |
| 33              | 19                                                | 127                                | 7                                           | 46                  | 25                      | 184                                | 2,081                           |
| 34              | 24                                                | 160                                | 6                                           | 42                  | 23                      | 183                                | 2,229                           |
| 35              | 26                                                | 173                                | 13                                          | 66                  | 37                      | 178                                | 4,626                           |
| 36              | 17                                                | 113                                | 13                                          | 62                  | 37                      | 168                                | 3,694                           |
| 37              | 14                                                | 93                                 | 6                                           | 38                  | 23                      | 165                                | 1,175                           |
| 38              | 16                                                | 107                                | 16                                          | 68                  | 43                      | 158                                | 3,208                           |
| 39              | 17                                                | 113                                | 22                                          | 87                  | 55                      | 158                                | 3,786                           |
| 40              | 21                                                | 140                                | 21                                          | 84                  | 53                      | 158                                | 5,604                           |
| 41              | 13                                                | 87                                 | 9                                           | 45                  | 29                      | 155                                | 2,231                           |
| 42              | 16                                                | 107                                | 12                                          | 52                  | 35                      | 149                                | 3,396                           |
| 43              | 16                                                | 107                                | 11                                          | 49                  | 33                      | 148                                | 2,912                           |
| 44              | 14                                                | 93                                 | 12                                          | 51                  | 35                      | 146                                | 2,505                           |
| 45              | 16                                                | 107                                | 18                                          | 67                  | 47                      | 143                                | 3,441                           |
| 46              | 13                                                | 86                                 | 12                                          | 45                  | 35                      | 129                                | 1,384                           |
| 47              | 15                                                | 100                                | 13                                          | 47                  | 37                      | 127                                | 2,166                           |
| 48              | 17                                                | 113                                | 6                                           | 29                  | 23                      | 126                                | 1,497                           |
| 49              | 12                                                | 80                                 | 14                                          | 49                  | 39                      | 126                                | 2,684                           |
| 50              | 12                                                | 80                                 | 132                                         | 308                 | 275                     | 112                                | 7,203                           |
| 51              | 12                                                | 80                                 | 5                                           | 22                  | 21                      | 105                                | 957                             |
| 52              | 13                                                | 87                                 | 4                                           | 19                  | 19                      | 100                                | 780                             |
| 53              | 15                                                | 100                                | 2                                           | 15                  | 15                      | 100                                | 1,015                           |
| 54              | 18                                                | 120                                | 11                                          | 32                  | 33                      | 97                                 | 1,586                           |
| 55              | 12                                                | 80                                 | 11                                          | 31                  | 33                      | 94                                 | 1,834                           |
| 56              | 15                                                | 100                                | 26                                          | 54                  | 63                      | 86                                 | 3,836                           |
| 57              | 10                                                | 67                                 | 4                                           | 14                  | 19                      | 74                                 | 1,049                           |
| 58              | 9                                                 | 60                                 | 8                                           | 19                  | 27                      | 70                                 | 1,785                           |
| 59              | 7                                                 | 47                                 | 6                                           | 13                  | 23                      | 56                                 | 899                             |

Table 5.5

## Frequency and Cost of Treatment by Doctors of Medicine in Hawaii—Selected Cases

|     | <i>Nature of Injury</i>                     | <i>Duration<br/>(months)</i> | <i>Visits</i>    | <i>Oregon<br/>Guideline</i> | <i>Cost</i> | <i>Comment</i>                                                                                  |
|-----|---------------------------------------------|------------------------------|------------------|-----------------------------|-------------|-------------------------------------------------------------------------------------------------|
| 1.  | Back pain                                   | 14                           | 21               | 37                          | \$ 881      | Inadequate documentation.                                                                       |
| 2.  | Bruised wrist/thigh                         | 15                           | 25               | 39                          | 2,367       | Inadequate documentation; otherwise, services rendered and duration of care seemed appropriate. |
| 3.  | Strained wrist                              | 32                           | 58               | 75                          | 2,480       | Frequency and duration of visits seem excessive.                                                |
| 4.  | Strained ankle                              | 24                           | 56 <sup>a</sup>  | 59                          | 1,469       | Length of care and frequency of visits both seemed inappropriate.                               |
| 5.  | Back strain                                 | 13                           | 79 <sup>b</sup>  | 37                          | 4,655       | Physician visits and physical therapy both appear excessive.                                    |
| 6.  | Lower back strain                           | 16                           | 167 <sup>c</sup> | 43                          | 9,879       | Initial treatment okay. Continuation of treatment seemed excessive.                             |
| 7.  | Fractured ankle                             | 4                            | 25               | 19                          | 710         | Inadequate documentation; unclear whether treatment was excessive.                              |
| 8.  | Bruised wrist/<br>fracture at elbow         | 10                           | 34               | 31                          | 3,802       | Very poor documentation; treatment may be appropriate or excessive.                             |
| 9.  | Wrist injury                                | 7                            | 13               | 25                          | 2,300       | Treatments generally appropriate in view of complications.                                      |
| 10. | Shoulder injury                             | 10                           | 40               | 31                          | 5,047       | Injury exacerbated by prior fracture; treatment appears reasonable.                             |
| 11. | Abdominal gunshot<br>wounds                 | 8                            | 21               | 27                          | 7,020       | Minimal documentation, but appears generally appropriate.                                       |
| 12. | Back injury                                 | 21                           | 58               | 53                          | 1,525       | Frequency of visits seem excessive.                                                             |
| 13. | Knee/back injury                            | 26                           | 171              | 63                          | 4,429       | Treatment seems excessive.                                                                      |
| 14. | Back injury                                 | 67                           | 212              | 145                         | 6,733       | Frequency of visits seems inappropriate.                                                        |
| 15. | Back injury                                 | 45                           | 347              | 101                         | 12,433      | Limited documentation; no judgment possible.                                                    |
| 16. | Shoulder strain                             | 53                           | 73               | 117                         | 3,492       | Treatment seems appropriate.                                                                    |
| 17. | Back injury                                 | 12                           | 50               | 35                          | 5,203       | Frequency seems inappropriate.                                                                  |
| 18. | Head injury<br>with mental<br>complications | 20                           | 247              | 51                          | 18,197      | Insufficient documentation.                                                                     |
| 19. | Back injury                                 | 172                          | 127              | 365                         | 15,715      | Treatment seems appropriate.                                                                    |

<sup>a</sup>Thirty-four whirlpool treatments.

<sup>b</sup>Forty short wave diathermic treatments.

<sup>c</sup>One hundred fifty plus manipulation and ultrasound treatments.

As a result of this investigation, it would appear that within the area of utilization control, there exists considerable room for improvement, both by the DCD as well as by insurance carriers and self-insured employers. The workers' compensation program is mandated by the State, but the State does nothing whatsoever to help control program costs. Unless and until some effective controls are established, there would appear to be no reason to expect any abatement in the rate at which total medical costs have been escalating.

### Insurance Rates

Hawaii has a "prior approval" system for establishing rates for workers' compensation insurance. In short, this means that before insurance companies can implement new rates, they must first obtain approval from the Insurance Commissioner. The Insurance Commissioner reviews requests for new rates to determine whether the proposed rates are adequate, fair, and yet not excessive.

The rates approved by the Insurance Commissioner are not necessarily the rates charged by insurance companies. Under the prior approval system, a number of discounts or refunds are permitted. These include: (1) dividends to policyholders; (2) services such as safety and loss prevention studies; (3) plans for experience and retrospective rating, cash flow plans, and other cost reducing options; (4) "account pricing" in which insurers make price concessions on other lines of insurance in order to obtain a workers' compensation account; (5) self-insurance and group self-insurance; and (6) deviation from manual rates (allowed but not heretofore used in Hawaii).<sup>24</sup>

In an information filing submitted by the Hawaii Insurance Rating Bureau to the Insurance Commissioner early in 1984, the filing indicated that in order to achieve "rate adequacy," manual rates should be increased by an additional 39.7 percent over existing manual rates. The moratorium on rates enacted in the 1983 legislative session prevented these higher rates from becoming effective in 1984.

To determine both the range of competitive products and the estimated premium for such products, the study team surveyed major writers of workers' compensation in Hawaii. The eight companies which responded to this survey accounted for over four-fifths of the premiums written in this insurance line in 1983. The results indicate that competition for this line of commercial insurance is, so to speak, "alive and well" and quite diverse.

The following comment from one of the leading underwriters in Hawaii capsules the real world dynamics of competition for the workers' compensation insurance dollar:

"In many instances, we find ourselves in a competitive bidding situation where the independent agent has submitted an account to a few—or sometimes many—different insurance companies to obtain quotes where the business is awarded to the lowest bidder. Because of the competitive nature of this bid process we are often not favored with an account we find desirable. There is a lot of business out there that we would like to write but cannot because we have been undercut by the competition. We spend a great deal of our resources and in-house talent trying to keep ahead of 'the other guy' but constantly changing pricing products make this an ever ongoing process."

Our survey of market competition in Hawaii based on the experience of leading

24. Appendix F gives additional information on the current insurance ratemaking system in Hawaii, including a more complete description of the various plans used for giving discounts and refunds.

writers of workers' compensation insurance revealed the following:

- Over half of premium for workers' compensation insurance is typically written on a dividend plan basis.
- Retrospective rating plans account for not less than one-fifth of workers' compensation premiums written, and upwards of two-fifths in some leading companies with significant market share (e.g., 10 percent).
- Five of the leading writers surveyed had some form of so-called cash flow plan. In the instance of one of these, underwriting in this category accounted for between 20 and 30 percent of its total workers' compensation written premiums.

Over the five years covered by the survey, there were some significant shifts in various rating plans, indicating intensification of competition. One leading writer indicated a drop in participating dividend plans from 42 percent of the total premium in 1982 to less than 14 percent in 1984. Another said that while 95 percent of premiums in 1981 was written through dividend plans, by 1984 only 60 percent was accounted for by this type of rating plan.

To sum up, despite assertions that rates need to be increased by as much as 40 percent, price competition is intense in Hawaii. There appear to have been shifts from participation dividend programs to more sophisticated net retention and retro dividend plans and cash flow underwriting.

## Program Administration

Principal activities of the Disability Compensation Division fall into three categories: (1) accident reporting and analysis; (2) claims processing and adjudication; and (3) benefit delivery.

Accident reporting activities relate principally to receipt of mandatory employer reports of injury, which are required within seven days of the accident. These reports are analyzed to determine the cause and nature of reported injuries. They are used subsequently when developing the injured workers' basis for claims to benefits.

Claims processing and adjudication activities involve opening and maintaining a claimant's case file until it is closed and any necessary adjudication provided. To that end, the DCD usually receives: (1) a notice of claims from the injured worker; (2) the physician's report of treatment; (3) notice of first payment of compensation; and (4) notice of compensation termination or request for hearing. The DCD also maintains a hearing calendar, a case tracking system, and a digest of case decisions.

In the area of benefit delivery, the DCD monitors physician compliance with the requirement to submit initial medical evaluation of injured workers within seven days of examination. Carrier performance is measured in terms of promptness of making first payments. Under Hawaii's present law, these are supposed to be paid within 31 days of award and are subject thereafter to a 10 percent interest penalty of the amount due to injured workers. The DCD also examines insurer compliance with

standards for referral of injured workers for rehabilitation evaluations.<sup>25</sup>

DCD checks on compliance through periodic audits of insurers. These audits: (1) measure the timeliness of filing employer injury and physician treatment reports; (2) measure the time lag in making first compensation payments; (3) determine the accuracy of income replacement benefits; (4) determine the correctness of eligibility denials; and (5) check on acceptance of employer liability for the claim. The most recent audits were conducted between October 1982 and November 1983. Eight insurers were audited. The results indicated considerable variation and shortfall in performance.

- *Employer Reports of Injury:* fewer than half of the reports examined were submitted within the seven day standard.
- *Physician Reports of Initial Treatment:* less than one-third of all physician reports were submitted within the seven day filing requirement.

• *Promptness of Payments:* none of the eight companies made all the payments within 31 days from date of award.

Compliance with the prompt payment standard, shown in Table 5.6, was quite divergent and ranged from 53 to 91 percent. The negative incentive of the interest penalty on late payments was not sufficient to induce prompt payment from several of the insurers.

The spotty compliance record in Hawaii may explain some of the delays in adjudicating cases. The Legislature has enabled the DCD to obtain temporary staff and system support to reduce a six to eight

25. Standards of compliance reporting and performance measurement vary among other jurisdictions. The states of California, Nebraska, New York, and Wisconsin are among the leaders in reporting compliance and measuring performance. See: Jerome Gordon and Allan Akman, "Methods for Analyzing the Costs and Benefits of Uniform Reporting Under Workmen's Compensation," *Supplemental Studies for the National Commission on State Workmen's Compensation Laws*, Volume II, Washington, D.C., U.S. Government Printing Office, 1973.

Table 5.6  
Timeliness of First Payments for Workers' Compensation Claims  
Results of Compliance Audits of Eight Workers' Compensation Insurance Writers in Hawaii  
(in percent)

| Time Lag in First Payment | Company |       |       |       |       |       |       |       |
|---------------------------|---------|-------|-------|-------|-------|-------|-------|-------|
|                           | 1       | 2     | 3     | 4     | 5     | 6     | 7     | 8     |
| Under 20 days             | 89.4    | 31.8  | 71.0  | 50.0  | 68.0  | 64.0  | 38.0  | 80.0  |
| 21-30 days                | 2.2     | 28.0  | 7.0   | 20.0  | 12.0  | 8.0   | 15.0  | 6.0   |
| 31-60 days                | 3.3     | 25.6  | 10.0  | 20.0  | 12.0  | 23.0  | 29.0  | 5.0   |
| Over 61 days              | 5.1     | 14.6  | 12.0  | 10.0  | 8.0   | 5.0   | 18.0  | 9.0   |
| TOTAL                     | 100.0   | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 | 100.0 |

Source: Department of Labor and Industrial Relations, Disability Compensation Division, audits of selected workers' compensation insurance carriers, conducted over the period August 1982 through November 1983.

month backlog to less than two months by mid-1985. The DCD now has a special program to accelerate hearings and render decisions.

A uniform management reporting and case tracking system is needed to further enhance adjudication productivity. Other jurisdictions, notably California, Florida, and New York, have developed computerized management systems to assist in monitoring and adjudication responsibilities. Florida, by way of example, established a sophisticated system following its reform of workers' compensation in 1979. That system employs toll-free access to compensation advisers who are supported by a computerized case management information system. This program reportedly helped to reduce materially the level of controversy in the Florida system.

## Conclusion

This chapter has examined the more important underlying forces that affect the way the workers' compensation system operates in Hawaii. Diagnosis of the problem is not simple. No single reason can explain the high costs of the workers' compensation program in Hawaii. A multiplicity of factors appear to be at work. Most important, perhaps, are the incentives and disincentives implicit in the system. Collectively, they do not provide checks and

balances for effective control over program costs while achieving desired results.

Attention has been directed first to benefits, secondly to administration of the system and overhead costs. Since benefit payments comprise almost two-thirds of total program costs, meaningful cost reduction will not be possible without addressing benefit provisions in the law. The current law appears to be overly generous in some instances, particularly to those who suffer only minor injuries or little or no economic loss because of work related injuries. At the same time, the law can be described as skimpy or inadequate in a number of instances where people suffer substantial economic losses. Because workers' compensation is a state mandated program, the administering department, the Department of Labor and Industrial Relations, needs to assume heavy responsibility for controlling the cost and improving the effectiveness of the program.

Since it is not possible to single out one or two root causes for the high program cost, it will not be feasible to design simple solutions built around one or two "quick fixes." Instead, recommendations will need to be custom tailored for each major area of benefit expenditure as well as for administration and overhead costs of the system. The next chapter contains more than two dozen recommendations for improving the system.



## Chapter 6

### RECOMMENDATIONS

When formulating recommendations, it is important to state explicitly all principal public policy objectives, and to evaluate recommendations in terms of their contribution to achieving these objectives. For the Hawaii workers' compensation system, the overriding objectives which appear applicable are that the system be both *effective* and *efficient*.

An *effective* compensation system should provide: (1) broad coverage of the working population; (2) coverage for all work related injuries and diseases; (3) sufficient medical care and rehabilitation services to achieve maximum and prompt restoration of the injured worker's physical condition and earning capacity; (4) substantial and prompt protection against interruption of income; (5) fair and equitable replacement of a high proportion of the spendable income lost by workers who suffer permanent disabilities; and (6) correct incentives to all concerned parties—i.e., to injured workers, employers, employers' insurance carriers, and providers of rehabilitation services. The last item means, for example, that (a) workers should have no disincentive for prompt return to work, especially among those with relatively minor injuries; (b) employers should have an incentive to help their injured employees return to meaningful employment; (c) employers and insurers should have incentives to provide vocational rehabilitation services to those employees who need such services; and (d) providers of services should be motivated to help workers return to work as promptly as feasible.

An *efficient* compensation system requires that (1) a substantial portion of all outlays for workers' compensation should be used to rehabilitate injured workers and provide for their losses; (2) rehabilitation services be provided in a cost-effective manner; (3) the law, inclusive of all implementing rules and guidelines, should seek to minimize the number of disputes and the cost of resolving fairly and equitably those genuine disputes that do arise; and (4) the system be administered effectively, with lowest feasible overhead costs.

The workers' compensation system in Hawaii essentially fulfills a number of the preceding objectives, such as providing broad coverage of all work related injuries for the working population. As indicated in Chapter 5, though, the system falls short of meeting several of the preceding objectives. Most notably, the system often fails to provide proper incentives: it does not assure that payments are made promptly; some workers may receive far in excess of their economic losses, while others may receive only a portion of their lost income; and administrative efficiency of the system has room for improvement.

The recommendations that follow are designed to help contain future costs of the workers' compensation program without compromising any of the preceding objectives. Effective cost control of program costs has two material but related aspects: (1) achieving *immediate reductions* in administrative benefit costs; and (2) more important over the long term,

moderating the sharp upward trend in benefit payments, previously shown in Figures 3.1 and 3.2. Unless the forces that drive this upward trend are checked, any reductions in the present level of benefit costs will likely turn out to be merely palliative; i.e., benefit costs and insurance rates will rapidly climb back to the present level and beyond.

## TEMPORARY TOTAL DISABILITY BENEFITS

### Use After Tax Earnings as the Basis for Benefit Payments During Periods of Temporary Disability and Increase the Maximum Weekly Benefit

As explained in Chapter 5, the proper yardstick for assessing the adequacy of *tax free* wage loss benefits for temporary disability is to compare them to a worker's net after tax earnings.<sup>1</sup> The present benefit, which is equal to two-thirds of the worker's average weekly wage, falls short of equaling the after tax income of low wage earners. At the same time, for someone earning 50 percent more than the state average weekly wage, the benefit may amount to more than the after tax net income. Thus, in terms of after tax income, the present weekly benefit formula is inadequate for some, while it is more than adequate for others. This should not be surprising, since the formula used to calculate a worker's weekly benefit makes no attempt to assess the impact of federal and state income taxes.<sup>2</sup>

*It is recommended that the amount of wage loss replaced during periods of temporary disability be based on the employee's after tax earnings. It is recommended that the director of the Department of Labor and Industrial*

*Relations issue a schedule or table showing wage loss replacement based on the employee's filing status, the number of exemptions claimed by the employee, and using standard deductions.<sup>3</sup> It is also recommended that the amount of wage loss replacement be based on 80 percent of after tax earnings.<sup>4</sup>*

Basing the temporary total disability benefit on after tax income, instead of gross earnings, will more closely correlate the wage loss benefit to the amount of spendable income actually lost. This will particularly benefit workers in low tax brackets, which include (1) workers with below average wage rates; (2) part-time workers; and (3) workers with numerous dependents. For workers in higher tax brackets, the proposal would slightly reduce the weekly benefit in a manner commensurate with the lower percentage of take-home pay. The net effect of these recommendations is to make the wage loss benefit for temporary disability more equitable, while maintaining a small but significant financial incentive for the worker to return to work. For reasons to be explained below, this recommendation needs to be weighed and considered in conjunction with the following one. Accordingly:

1. The Report of the National Commission on State Workmen's Compensation Laws (1972) contained this recommendation.

2. Over the last 25 years, the formula for calculating the weekly wage loss benefit has not changed. Federal and state income tax rates have changed a number of times.

3. Whenever the federal and state tax laws are changed, the director will have to revise the schedule. In this way, the weekly benefit schedule will be kept current with the tax code.

4. Other jurisdictions which base the benefit on spendable income include the District of Columbia, Iowa, and Michigan.

*Conditional upon implementation of the preceding recommendation, it is also recommended that the maximum weekly benefit be increased to 110 percent of the statewide average weekly wage.*

It should be clearly understood that this recommendation is strongly conditioned upon implementation of the preceding recommendation that the weekly benefit be calculated on the basis of after tax income. In view of the marginal tax rates that now are applicable in 1984 income, it is likely that the existing maximum weekly benefit already exceeds the after tax income of most people who earn close to 50 percent more than the state average weekly wage. An increase in the maximum weekly benefit *under the current formula* would tend to exaggerate further the disparity between the tax free weekly benefit and net after tax income. This would tend to increase the disincentive for return to work rather than reduce it. Accordingly, this recommendation to increase the maximum weekly benefit depends entirely upon acceptance of the preceding recommendation to base the weekly benefit on after tax income.

Other recommendations concerning temporary disability benefits will enable small reductions in the cost of the workers' compensation program. By itself, the recommendation to increase the maximum weekly benefit will increase cost slightly. At the same time, it will provide more equitable treatment for those members of the labor force who earn at least 50 percent more than the state average weekly wage. Premiums for workers' compensation insurance include and are based on such higher wages. Hence there is a certain fairness in providing income protection to those with higher wage levels. Moreover, higher wages tend to reflect more training and skill, or greater seniority, or both. In this way the wage rate is an indication of a person's attachment to the labor force.

Increasing the amount of wages that are protected from loss on account of work related injuries will help assure that the workers' compensation program continues to be regarded by the general public as an important work related benefit based on participation in the labor force, and does not become thought of as a mere adjunct to the general welfare system.<sup>5</sup>

### **Use Actual Earnings to Compute the Average Weekly Wage of All Workers, Including Casual and Part-Time Workers**

Part-time jobs are usually defined as those requiring fewer than 32 hours of work per week. Yet, some people who work fewer than 32 hours per week consider themselves to be fully employed. Still others may be fully employed by virtue of holding two, or even three part-time jobs. The "standard" or "normal" work week, consisting of five consecutive eight-hour days, long ago ceased to be the standard for a large portion of the labor force. An increasing number of people, both in Hawaii and in other states, work fewer than 35 or 40 hours a week. The diversity of work schedules is expected to increase yet further as the labor force is augmented by more students and married women (especially mothers with children living at home) and as the service economy grows relative to manufacturing.

Under the present workers' compensation law in Hawaii, casual and part-time workers who are injured on the job receive temporary disability benefits that are calculated as though they worked

5. Had these two recommendations both been in effect during 1984, the maximum weekly benefit would have been \$309 instead of \$281. The maximum effective weekly wage would vary, depending on the individual worker's tax status. In general, though, the maximum effective weekly wage would have ranged between \$500 and \$600, instead of being fixed at \$421.50. See Appendix E, Table E-7 for prior year data on the maximum weekly benefit.

full-time. As a result, the tax free wage loss benefit for casual and part-time workers will generally exceed the after tax income which they earned while working. In some instances, the benefit may exceed prior earnings by a wide margin, giving workers a somewhat greater net benefit for *not* working than they receive for working, and thereby providing them with an economic incentive to exaggerate and prolong the disability. A few people may not respond to such incentives, nor attempt to take advantage of the system. It is to be expected, though, that most people will act on them, especially when they are spelled out and provided under the law.

That people respond to economic incentives is, after all, a premise of our free market system. Indeed, many parents teach their children from an early age—through allowances and supplemental payments for work around the house—to respond to economic incentives. So long as there are competitive checks and balances, it is good that people respond as they do. Otherwise, the competitive enterprise system would not work as well as it does. Likewise, under a regulated system operating in a market context, it is important that the implicit incentives guide participants to respond in ways that are consistent with fundamental public policy objectives.

*It is recommended that the average weekly wage of all workers, including casual and part-time workers, be computed on the basis of these workers' prior earnings. At the same time, when computing prior earnings, it is recommended that the system treat all workers equally, giving each person the benefit of reasonable doubt about their prior earnings. To be specific, it is recommended that a worker's average weekly earnings be computed as the greater of earnings during (1) the seven calendar days immediately preceding the*

*day of injury, or (2) the four weeks immediately prior to injury, or (3) any consecutive 13-week period during the year prior to the date of injury. It is also recommended that, for purposes of this computation, workers be entitled to include all earnings during the period selected, from any source whatsoever, so long as those earnings were covered under the State's workers' compensation program or were reportable for federal or state income taxes if prior earnings were in another state.<sup>6</sup> In other words, earnings from the so-called underground economy, or nonreportable earnings paid "off the books," or income derived from illicit activities would not be included.*

Computation of prior earnings along the lines recommended here would give each worker the benefit of reasonable doubt, while at the same time retaining and even emphasizing attachment to the labor force as a determinant of the amount of wage loss replacement to which the worker is entitled for periods of temporary disability. Although some people may receive less under this recommendation, it would be those casual or part-time workers who heretofore have received wage loss compensation as though they were full-time workers. Such workers are being overcompensated in relation to (1) those whose weekly benefit is based on their actual earnings, or (2) those whose weekly benefit does not reflect their earnings because their earnings exceed the maximum. Although this recommendation may reduce the weekly wage loss benefit of some casual or part-time workers, it should be noted that all medical costs will continue

6. If a worker's earnings from other employers causes weekly benefit for temporary disability to exceed the liability of the employer at the time of injury, the employer's liability will continue to be limited and the excess will be paid from the special fund.

to be paid by the employer, and all workers will of course be entitled to the minimum benefit provided by law.

### **Require a Waiting Period of Two Regularly Scheduled Working Days for Entitlement to Temporary Disability Wage Loss Benefits**

Under the present law it is entirely possible, and perhaps even likely, that a large number of people with short-term disabilities receive more after tax income for *not* working than they receive when working. (See Chapter 5.) The statutory benefit by itself can result in an after tax gain that ranges from a few percent to upwards of 30 percent. When wage supplements provided by many private employers are added to the statutory benefit for temporary disability, it appears that a substantial percentage of short-term disabilities in Hawaii are compensated quite well—far in excess of the worker's normal after tax take-home pay.

Hawaii's law governing short-term disabilities can fairly be described as overly generous *vis-a-vis* many of those with relatively minor, short-term disabilities. Such generosity, when fully understood by those affected, creates a strong disincentive for early return to work.

*It is recommended that the waiting period consist of the next two regularly scheduled working days following the day of injury, but with a provision that under no circumstances shall the waiting period exceed four calendar days and, further, that an injured worker who is unable to return to work for one calendar week following the day of injury shall receive no less than three-fifths of his or her full weekly entitlement for temporary total disability.*

This recommendation makes two basic changes: (1) it shifts the beginning of the waiting period to the day following the day of injury, and (2) regularly scheduled working day is added to the definition of waiting period, thereby providing for a waiting period that entails an initial loss of two days pay, or 40 percent of a normal week's wage. For example, if the employee normally works Monday through Friday and is not scheduled to work Saturday and Sunday, then for an injury which occurs on Thursday, the waiting period would consist of Friday and Monday, and wage loss benefits would commence on the following Tuesday.

The recommendation contains a safeguard to protect those whose jobs do not require a five-day per week schedule. This is necessary because work schedules are in a state of continuing evolution, generally in the direction of greater flexibility and diversity. Within the context of a 40-hour work week, for example, some people may work four days a week, 10 hours a day, while others may have their 40 hours spread over six days a week. Other schedules call for four days on, followed by four days off. The variations are endless. If an employee happened to have a schedule which required fewer than five days of work during a seven-day period, that employee would be protected by the provision specifying a minimum of one-, two-, or three-fifths of their full weekly entitlement after their injury has kept them unable to report for work for five, six, or seven days, respectively.

### **Eliminate the Payment of Retroactive Benefits for Temporary Disability**

The retroactive provision of the current system provides a strong incentive for people with comparatively minor injuries to stretch their absence from work to at least six days, so as to collect a full temporary

total disability allowance from the day of injury. Judging by the comparatively large number who return on the sixth or seventh day, it appears that a large number of people respond to this positive incentive. (See Figure 5.1.) It is this retroactive provision, more than any other, which enables many workers to receive well in excess of 100 percent of the after tax income which they lose during the first five days after they are injured.

*It is recommended that the payment of retroactive benefits be eliminated and, accordingly, that the retroactive period be dropped.*

This recommendation will have greatest impact, percentage-wise, on those with relatively minor injuries of the type that would normally cause someone to be away from work for a period of one week or less. Those who in fact require a healing period of two or more days will stand to lose two days' pay (unless they have accumulated sick leave which they are able to use), and the loss of pay which any worker absorbs will be comparatively small, in absolute dollars, but as a percentage of the first week's total wages it will be a meaningful fraction. For example, a worker who is out for three normal work days will receive a wage loss benefit for one day while losing two days' pay. A worker who is out for five normal working days will receive a wage loss benefit equal to 60 percent of the full weekly benefit. For all subsequent lost time, the worker will receive his or her full benefit.

Workers who are disabled for substantial periods of time stand to receive thousands of dollars worth of medical treatment plus wage loss replacement (and, perhaps, vocational rehabilitation), promptly and without regard to fault, all in return for absorbing a small "deductible"—equal to two days' pay—on

the front end. In serious injury cases, the portion of the total cost absorbed by the injured worker is minimal. The loss of two days' pay should not create a true hardship on anyone, and it certainly will not result in a basic change in anyone's lifestyle.<sup>7</sup> This recommendation, together with the preceding recommendation concerning the waiting period, have been designed to restore work related incentives *while at the same time* keeping Hawaii reasonably in the forefront of progressive states. For example, Hawaii would continue to be the only state in the country with a two-day waiting period.

The concept of a retroactive period was reasonable when the initial waiting period was typically one to two weeks, not two days, and the retroactive period itself ranged from two to four weeks. With a waiting period of only two days, any retroactive period is something of an anachronism, and is counterproductive to incentives for early return to work.

In terms of the objectives proposed at the outset of this chapter, these recommendations are designed to improve the incentive for early return to work. Having all workers absorb a loss of up to two days' pay is at least as equitable as having those workers who return to work within five days receive nothing at all, or only a small fraction of their lost take-home pay, while letting others who are out for six days receive well in excess of 100 percent of their lost take-home pay.

The present recommendation is probably the most effective one in terms

7. It should be borne in mind that the workers' compensation system has never attempted to compensate every worker for all of his or her economic losses. For example, the cap on maximum weekly benefits means that injured workers with relatively high incomes may be grossly undercompensated *vis-a-vis* those with average incomes.

of achieving immediate savings by eliminating irrational and counter-productive incentives within the system, without reducing in any significant way, the benefits provided to those workers with real needs. Whatever is given up by the class of individuals who have benefited from these irrational incentives will be more than balanced by other recommendations that liberalize benefits for those whose losses are not fully compensated.

### PERMANENT PARTIAL DISABILITY BENEFITS

The following subsections contain a number of recommendations for changing permanent partial disability benefits. To facilitate the presentation, each one is discussed individually. It should be understood, however, that some of the proposals are contingent upon adoption of certain other recommendations. Collectively, these recommendations constitute a "package."

The package has been designed to provide more equitable treatment for all workers with permanent partial disabilities. Emphasis is on giving workers *more protection*, and more *equitable protection* against economic losses on account of permanent impairments. *Protection* is an insurance concept. It means that workers will be protected from economic loss, up to a maximum limit, *provided* they suffer economic loss on account of their impairment. Providing insurance protection does not mean, though, that every worker will collect the maximum limit just because they have suffered an impairment. The purpose of the maximum limit is to protect those who subsequently suffer adverse circumstances on account of their impairment.

An appropriate analogy would be to a homeowner's fire insurance policy, where the maximum limit covers the entire value of the house. A kitchen fire that is promptly controlled does not entitle one to collect the maximum limit. Rather, the maximum limit should go only to those who suffer the most adverse circumstances; e.g., those whose home is destroyed by fire. Further, if the fire is promptly controlled, so that damage is confined chiefly to the kitchen oven, the fire insurance protection is limited to compensating the homeowner for expenses necessary to replace the oven and repair any smoke or water damage—not for complete remodeling of the entire kitchen, including replacement of all appliances.

Under normal circumstances, those who do not collect the maximum limit on their insurance protection should consider themselves fortunate. If the system awards the maximum limit for each incident to everyone who incurs that incident, then (1) it must necessarily create a number of "winners" who are overcompensated in relation to their losses, while concurrently creating a number of "losers" who are undercompensated and underprotected, *or* (2) if everyone is fully protected and fully compensated from their losses, then the "protection" system will necessarily create many "winners" and will be somewhat expensive.<sup>8</sup>

8. The terminology "winners" and "losers" is associated more commonly with gambling or sporting events than with insurable incidents. A fundamental principle of insurance protection is that the occurrence of an insurable incident or event should not create "winners," because people are then encouraged to "play the game." A system that creates "winners" will tend to increase frequency. This insight may help explain the high frequency of permanent partial disabilities in Hawaii.

### **Base All Permanent Partial Disability Awards on a Worker's Earnings at the Time of Injury**

The different amounts of compensation awarded for similarly rated impairments, illustrated previously in Table 5.3, do not appear to promote the objective of treating injured workers equitably. For this reason:

*It is recommended that benefits for all permanent partial disability awards be based on the worker's average weekly earnings.<sup>9</sup>*

Using average weekly earnings to compute the maximum amount payable will eliminate the disparate and anomalous treatment that now occurs between scheduled versus unscheduled injuries.

### **Continue to Base Permanent Partial Disability Awards on Expected Economic Losses**

As explained previously, the size of an award for permanent partial disability is based on expected economic loss.

*It is recommended that (1) awards for permanent partial disability continue to be based on economic loss; and (2) awards not include any "residuals" for pain and suffering.*

As part of this recommendation to continue basing permanent partial disability awards on expected economic loss:

*It is also recommended that (1) in all cases where the permanent partial disability award exceeds the highest estimate of medical impairment, the hearing officer will provide all parties with a written decision giving a full explanation for the basis of the award; and (2) the Disability Compensation*

*Division develop and promulgate written guidelines for those economic factors that are to be considered in making permanent partial disability awards.*

The guidelines developed by DCD should endeavor to be as objective as possible, thereby minimizing the degree of subjectivity inherent in such awards. The guidelines should strive to achieve the following results: (1) more uniform treatment of all claimants; (2) better understanding by all parties as to what they can expect, in light of the claimant's physical and economic circumstances; and (3) a reduction in the number of disputes and litigiousness (including appeals) within the workers' compensation system.

### **Make A Portion of the Permanent Partial Disability Award Conditional on Loss of Earnings, and Pay the Remaining Portion Regardless of Lost Earnings**

As explained in Chapter 5, full permanent partial disability benefits are paid regardless of whether the injured worker actually suffers any economic loss whatsoever.

*It is recommended that (1) 20 percent of the total award be payable regardless of economic loss; and that (2) after 20 percent has been paid, the remaining 80 percent be payable only to those who suffer a diminution of their average weekly wage on account of their impairment.*

9. This recommendation envisions that average weekly earnings for permanent partial disability benefits will be the same as for temporary total disability; see the earlier recommendation concerning calculation of average weekly earnings.

Adoption of this recommendation will retain use of expected economic losses as the basis for determining size of the award, while linking subsequent entitlement to economic reality as it pertains to each individual worker. Employees who return to work promptly at their pre-injury work rate will receive less. Benefits will continue up to the full maximum amount for workers who suffer unemployment or who can only find jobs at reduced wage rates on account of their impairment. Adoption of this partial wage loss concept for permanent partial disability awards should also give employers a strong incentive to support all vocational rehabilitation programs that are cost-effective. That is, it gives employers the right incentives regarding vocational rehabilitation.<sup>10</sup>

#### **Use 500 (Weeks) When Determining The Maximum Amount of Benefits For Unscheduled Permanent Partial Disabilities**

The existing statute uses 312 weeks, or six years, as the "whole man" equivalent. Many other states use a similar approach. Although the number of weeks used by those other states varies somewhat, the 312 weeks used by Hawaii is among the lowest.

*Should the Legislature adopt the previous recommendation to make the payment of a major portion or permanent partial disability benefits conditional upon actual loss of wages, then it is recommended that when calculating the maximum of benefits payable for an unscheduled permanent partial disability, the figure 500 be used instead of 312.*

This recommendation, in conjunction with the previous recommendation concerning wage loss, will provide more

amply for those who suffer economic losses from permanent work related disabilities.

#### **Establish a Maximum Duration for Permanent Partial Disability Benefits**

Workers who suffer an impairment and receive permanent partial disability awards now receive the full amount of the award regardless of their post-injury earnings. The award is paid at the rate of each individual's weekly benefit, until the full amount is paid. (See Table 5.3.) The time period over which the benefits are to be paid is absolutely clear.

Under the partial wage loss approach recommended here, injured workers with permanent partial disability awards will receive their weekly benefit until they have received 20 percent of the total award. After 20 percent of the award has been paid, subsequent weekly benefits depend upon whether the worker is employed, and the worker's weekly earnings. Workers who earn less than they earned previously will receive a partial payment, based on the difference between their prior average weekly wage and their current earnings. The duration over which workers are entitled to receive permanent partial disability benefits needs to be clarified.

10. Should the Legislature reject the recommendation to base receipt of a major portion of permanent partial disability benefits on actual loss of wages (i.e., should the full amount of every permanent partial disability award continue to be paid regardless of post-injury earnings), then it is suggested that the Legislature strictly limit the size of all permanent partial disability awards to the extent of physical impairment as determined by an objective standard such as *Guides to the Evaluation of Permanent Impairments* (American Medical Association, 1971), or by testimony of competent physicians. Absent an economic loss criterion for entitlement to benefits, the standard impairment rating should be as objective as possible; i.e., it should incorporate objective factors such as age and education by formula, not by subjective evaluation of facts.

*It is recommended that permanent partial disability benefits be payable until the maximum dollar amount of the benefit has been exhausted, or until a period of time equal to twice that used to calculate the total benefit award elapses, whichever occurs first.*

The system should encourage people to return to work, even if such work is only a part-time job, or a job which pays less than the job previously held. Creating a "use it or lose it" situation should be minimized, without leaving the duration for permanent partial disability awards entirely open-ended.<sup>11</sup> Under this approach, workers with more serious impairments will have wage loss protection for longer periods of time.

Following are two illustrations of how the proposed system would operate. First, consider a worker with a 10 percent disability. This worker would be awarded permanent partial disability benefits in an amount not to exceed the worker's weekly benefit rates times 50 (i.e., 10 percent of the proposed 500 weeks). For ease of calculation, assume that the worker is entitled to a benefit of \$200 per week. This worker could receive total benefits up to \$10,000. The worker would automatically receive 20 percent of this amount, or \$2,000, in the form of 10 weekly payments. After the first 10 weeks, the worker would be entitled to receive up to \$8,000 over the next 90 weeks, contingent upon actual loss of earnings. If the worker is reemployed at earnings equal to or greater than the pre-injury earnings, no further benefits would be paid after the first 10 weeks. After 100 weeks (i.e., twice the initial 50-week period used to calculate the maximum amount of the award), any remaining benefits under the award would lapse.

Next, consider a worker with a 40 percent disability. This worker's maximum potential benefit would equal the worker's weekly benefit rate times 200 (i.e., 40 percent of the proposed 500 weeks). If this worker's weekly benefit is also equal to \$200, maximum benefits available to the worker would be \$40,000. Twenty percent of this amount (\$8,000) would be payable initially, at \$200 a week, regardless of the worker's earnings. After the first \$8,000 has been paid, subsequent payments will depend on the worker's earnings. If this worker is able to return to work on either a part-time basis, or at a lower rate of pay than before the injury, he or she will receive partial payments until an additional \$32,000 in benefits has been paid, or until 400 weeks have elapsed, whichever occurs first. More seriously injured workers will thus have a longer period of time over which their income will be protected.

### **Change Provisions for Compensating Youthful Employees**

As noted in Chapter 5, should an employee below the age of 25 receive a permanent partial disability, that employee will receive permanent partial disability benefits at the average wage rate earned by workers 25 years of age in that occupation and, in addition, temporary total disability benefits will be paid retroactively at the higher rate. This can result in weekly benefit levels well in excess of what the person would earn if working.

*It is recommended that those under 25 years of age with a permanent partial disability have their weekly benefit payments based on prior earnings.*

11. Making the duration of all permanent partial disability awards open-ended would force insurers to accumulate large reserves for potential losses, and this would have the undesirable effect of forcing up the rate base.

It was previously recommended that permanent partial disability awards continue to be based on expected economic losses. This means that age of the workers will be an appropriate factor to take into account (along with other economic factors) when determining the amount of a permanent partial disability award. Implementation of the prior recommendation should obviate any need for the law to single out for special treatment youthful workers with permanent partial disabilities.

Special provision does need to be made for young people who become permanently and totally disabled, or who die from a work related injury or disease. For these instances,

*It is recommended that the age limit be increased from 25 to 30, and that compensation continue to be based on full time average earnings of someone 30 years old in the same occupation.*

Under this recommendation, for any employee under 30 who becomes partially and totally disabled, or who dies from a work related injury or disease, weekly benefits would be based on what the worker could have been expected to earn had the worker been fully employed in his or her occupation at age 30. In many occupations, average weekly earnings increase between the age of 25 and 30. In almost no occupation do average weekly earnings decrease between age 25 and 30. Consequently, this change will provide more amply for those who suffer the greatest economic losses.

### **Continue Giving Full Awards To Those Who Suffer Subsequent Injuries**

If the Legislature adopts the prior recommendations to use the wage loss concept for a substantial portion of the permanent partial disability award, then:

*It is recommended that second injury awards continue to represent the full cumulative amount of disability; i.e., no change in the present policy is recommended.*

This policy will provide additional income protection to those workers who, in good faith went back to work and then had the misfortune to have a second injury serious enough to result in additional disability.

Should the Legislature elect to reject the wage loss concept for at least a major portion of the permanent partial disability benefits, then:

*It is recommended that all benefits paid for prior permanent partial disability awards be deducted from any subsequent awards.*

Double dipping should not be permitted if all permanent partial disability awards are to be paid *in full, regardless of economic loss*, because such awards more often than not will represent a tax free bonus to the recipient. This alternate recommendation will prevent double dipping and will bring Hawaii into conformity with other states.

### **Provide an Offset for Social Security Retirement Benefits**

Certain of the prior recommendations could, if adopted, provide seriously impaired workers with protection against interruption of income for a somewhat longer period than they would be entitled to under the present law. This is fully in keeping with the basic objectives discussed previously. At the same time, it should be recognized that lengthening the period over which benefits are potentially payable also increases the possibility that older workers with a permanent partial disability award

for an impairment may (1) reach retirement age, (2) elect to retire and commence receiving social security benefits, and (3) claim a permanent partial disability benefit for loss of income, even though they voluntarily elected to retire and forego their income.

*It is recommended that any weekly benefits payable under the workers' compensation law be reduced by 50 percent of the initial amount of any social security retirement benefit which the worker receives.*

Inasmuch as employers pay for one-half of all social security benefits, as well as all workers' compensation benefits, a number of states reduce workers' compensation benefits when the workers receive social security benefits. This reduction is commonly referred to as a social security offset provision.<sup>12</sup> This proposed reduction in the workers' compensation benefit represents the portion of the social security benefit that was paid for by employers.

### **Limit the Duration of Vocational Rehabilitation That Can Be Mandated**

**Goals.** Hawaii's law does not contain any statement of the purposes or goals of vocational rehabilitation that is paid for by the workers' compensation program. Since the present law does not permit any reduction in permanent partial disability benefits on account of early return to work, vocational rehabilitation is entirely for the benefit of the injured worker. The present system provides employers no economic incentive to support any kind or any amount of vocational rehabilitation, no matter how cost-effective it might be. At the same time, injured workers with rights to vocational rehabilitation have no apparent incentive to shorten the period of training. In fact, if

workers' temporary total disability benefits exceed their previous net take-home pay, they may have an inducement to prolong the duration of any vocational rehabilitation training program.<sup>13</sup>

The lack of any legislative goals or guidance, coupled with the implicit incentives, mean that the vocational rehabilitation program could rapidly grow out of control and become yet another part of the problem of Hawaii's workers' compensation system.

*It is recommended that the Legislature enact stated goals to the effect that the purposes of vocational rehabilitation are (1) to restore an injured worker's earning capacity as cost-effectively as possible to that level which the worker was earning at the time of injury, and (2) to return the injured worker to the active labor force as quickly as possible.*

**Limits.** The complete lack of any limit on the amount or duration of vocational rehabilitation that can be mandated by the Department of Labor and Industrial Relations is clearly subject to potential abuse.

*It is recommended that the maximum amount of vocational rehabilitation that the Department of Labor and Industrial Relations may assign to a worker be limited to 26 weeks.*

Additional vocational rehabilitation beyond 26 weeks may be paid for by the employer (or by the employer's insurer) if

12. States with a social security offset provision for workers who have permanent partial disabilities include Alaska, Colorado, District of Columbia, Florida, and Michigan.

13. In Hawaii, it is quite possible for the temporary disability benefit to exceed net take-home pay. See Chapter 5 for more detailed discussion and explanation.

the employer feels that such additional vocational rehabilitation will reduce the employer's total cost of subsequent permanent partial disability benefits. Employers will have a substantial incentive to approve additional cost-effective vocational rehabilitation training if the Legislature adopts the prior recommendations (1) to make a major portion of the permanent partial disability award contingent upon actual loss of income, and (2) to lengthen the maximum period of permanent partial disability awards.<sup>14</sup>

Under Hawaii's statute, the employee has the freedom of choice. It is recommended that this provision be unchanged, but that after an employee elects to decline an approved vocational rehabilitation plan, the employee should have no further right to vocational rehabilitation benefits. After refusal by the employee, any further vocational rehabilitation benefits shall be at the discretion of the employer or the insurer.

#### **Terminate Permanent Partial Disability Benefits For Fraudulent Claims**

Hawaii's existing statute provides that payment of temporary total disability benefits shall be terminated "if the employee has filed a false claim."<sup>15</sup> Yet, the law does not expressly provide for termination of permanent partial disability benefits when a false claim has been filed.

*It is recommended that all permanent partial disability benefits be terminated if a false claim has been filed.*

Under the existing law it is possible for an employee or insurance carrier to prove that a false claim has been filed, yet still have to continue making permanent partial

disability payments on the claim. This recommendation is designed to cure this potential problem.

#### **PERMANENT TOTAL DISABILITY BENEFITS**

The number of workers who are permanently and totally disabled is relatively small, but each such case entails substantial costs. In addition to all medical costs associated with the work related injury, employers (or their insurance carrier) also pay a weekly benefit equal to two-thirds of the worker's average weekly wage at the time of injury, subject to a maximum. This weekly indemnity benefit, which is designed to replace the worker's lost wages, is paid for the life of the worker. In Hawaii, almost 8 percent of all benefits paid in 1983 consisted of weekly indemnity benefits to people with permanent total disabilities. (See Figure 2.1.)<sup>16</sup>

#### **After Injured Workers Begin Receiving Social Security Retirement Benefits, Provide an Offset to the Workers' Compensation Benefit Equal to 50 Percent of the Social Security Retirement Benefit**

As discussed in Chapter 5, when workers reach retirement age and begin

14. Providers of vocational rehabilitation services will also have an incentive to prove to employers and insurance carriers (1) that they can do an effective job of helping injured workers return to gainful employment, and (2) that they can not only do it effectively, but better than other competing providers of vocational rehabilitation services.

15. Section 386-31(b).

16. Workers who are permanently and totally disabled may also receive an amount for attendant services. Only a relatively small amount is paid each year for attendant services. During 1983, it amounted to \$188,862. (See Appendix E, Table E-2.)

receiving social security retirement benefits, the presumption that the workers would nevertheless be employed and earning a weekly income becomes less valid.

*It is recommended that the weekly wage loss indemnity benefit be reduced by 50 percent of the initial amount of any social security retirement benefit which the injured worker receives.*

This proposed reduction in the wage loss benefit, equal to 50 percent of the initial social security benefit, represents the amount of the social security benefit that was paid for by employers. The other 50 percent of the social security benefit is paid for by workers' contributions. Hence, it is presumed that injured workers are entitled to half the social security benefits by virtue of the social security taxes which they paid while employed.

#### **Provide an Offset for Social Security Disability Benefits, Conditional Upon Federal Enabling Legislation**

Prior to 1981, it was possible for states to enact legislation to the effect that workers' compensation benefits would be reduced by the amount of the social security disability benefits received by totally disabled workers. A federal law, H.R. 3982, enacted August 13, 1981, precludes states from newly enacting an offset against social security disability. The twelve states which had the foresight to adopt such an offset provision prior to 1981 were allowed to retain it under a grandfather clause.<sup>17</sup> Had Hawaii taken timely action, it too could have benefited from a social security disability offset. In light of the now existing federal law, it is not feasible to recommend enactment of such an offset.

*If the federal law should change, however, it is strongly recommended that*

*Hawaii make social security disability benefits primary to workers' compensation benefits.*

## **SURVIVOR BENEFITS**

### **Implement Social Security Offset**

*When survivors are entitled to receive social security survivor benefits (e.g., widows' benefits), it is recommended that the amount of workers' compensation benefits which are payable be reduced by an amount equal to one-half of the social security benefit.*

An offset of 50 percent reduces the workers' compensation benefit by the share of the social security benefit paid for by the employer. A social security offset for survivors is consistent with the proposal for a similar offset for those with a permanent disability.

### **Increase the Maximum Amount of Survivor Benefits**

It was noted in Chapter 4 that Hawaii's statutory benefits for survivors are relatively low in comparison with several other states. Consistent with this, Hawaii's average cost for cases involving death is comparatively low. Under the existing law, survivors have no guaranteed entitlement to workers' compensation benefits beyond the maximum weekly benefit rate at the time of death multiplied by 312.

17. The 12 states which provide an offset for social security disability benefits include Alaska, Colorado, Florida, Louisiana, Minnesota, Montana, New Jersey, North Dakota, Oregon, Washington, Wisconsin, and Wyoming.

*In order to provide more equitability for survivors of those who die from work related injuries or illnesses. It is recommended that the number used to compute the maximum entitlement for survivors be doubled to 624.*

## CONTROL OF MEDICAL COSTS

Approaches taken to utilization control by other states include (1) peer review; (2) utilization guidelines issued by the agency responsible for administering the workers' compensation program; (3) a licensing procedure that qualifies (and disqualifies) physicians as providers under the workers' compensation program; (4) limitation on the employee's choice of physician; and (5) implementation of extensive data gathering, analysis, and monitoring of physician services by the agency responsible for administering the workers' compensation program.

Peer review appears to be the form of utilization control most preferred by physicians and their professional associations. Peer review undertaken by a professional association at the request of insurance companies or self-insured employers is subject to legal challenge, however. The Supreme Court has ruled that such peer review violates the Sherman Antitrust Act, and under the act members of the peer review panel may be liable to the extent of triple damages for restraint of trade.<sup>18</sup> In light of this decision, it is not reasonable to expect that insurance companies or self-insured employers can independently use peer review to obtain meaningful utilization control.

As indicated in Chapter 5, Oregon is an example of a state that has issued utilization guidelines, and it has reportedly

had at least partial success in controlling overtreatment abuse.

New York uses a licensing procedure to qualify physicians as providers under the workers' compensation program. Disputes concerning overutilization are referred to an arbitration review panel, which issues a decision. Physicians who repeatedly overtreat may be disqualified as providers under the workers' compensation program.<sup>19</sup>

Virginia is an example of a state that limits the patient's choice of physician. In Virginia, an injured employee selects a physician from a list provided by the employer. Should a particular physician engage in overtreatment and overbilling, that physician's name would likely be dropped from the employer's list. The system in Virginia can be described as use of the market mechanism to control overutilization.

Florida is establishing an extensive data system for monitoring and analyzing the extent and cost of treating injured workers. When the system becomes fully operative, it reportedly will help detect patterns of overutilization and overtreatment.

### **The Department of Labor and Industrial Relations Should Issue Guidelines for Frequency of Treatment**

The Department of Labor and Industrial Relations has not been alert to cost problems stemming from overutilization, and it has exhibited no

18. Nos. 81-389 and 81-390, *New York State Chiropractic Association vs. A. Alexander Pireno*.

19. Such disqualification pertains only to reimbursement under the workers' compensation program, and does not affect the physician's license to practice medicine generally.

initiative or leadership to help control the cost of the program which it administers. Accordingly:

*It is recommended that the Department of Labor and Industrial Relations be required to issue guidelines for the frequency of treatment that is considered necessary and reasonable under the workers' compensation program.*

These guidelines should provide for a review mechanism whereby proposed treatment plans can be submitted and additional treatment can be authorized in unusual cases where it might be necessary. Development and use of guidelines would be a cost-effective approach that should not add materially to the overhead expense of the program.

#### **The Department of Labor and Industrial Relations Should Qualify Providers of Medical Services**

The Department of Labor and Industrial Relations needs to be able to exert some control and authority over medical providers which, collectively, billed over \$34 million to the workers' compensation program in 1983.

*It is recommended that the Department of Labor and Industrial Relations establish a procedure for qualifying physicians, clinics, and hospitals as providers under the workers' compensation program.*

Initial qualification should generally be based on the provider's license to practice medicine. At the same time, the qualification procedure should enable the Department of Labor and Industrial Relations to disqualify any physician, clinic, or hospital that repeatedly overtreats and overcharges for medical services provided under the workers' compensation program.

#### **Health Insurers Should Be Allowed to Write "Medical Only" Policies**

Self-insurers have almost no in-house expertise for ascertaining or monitoring possible overtreatment by medical providers, and property and casualty insurers need a strong incentive to do a better job of utilization control.

*It is recommended that insurance companies be explicitly authorized to issue (1) policies that cover only medical services under the workers' compensation program, and (2) policies that cover all obligations of the employer except medical services.*

This recommendation will enable self-insured employers to buy insurance coverage for medical services while continuing to administer the rest of their workers' compensation program. It will also enable health insurers to provide workers' compensation coverage in the area where they have expertise, without having to provide other coverages under the workers' compensation program. Enabling employers to buy their workers' compensation insurance *ex med* from their insurance carrier will also provide employers with the option of self-insuring their medical costs or buying *medical only* coverage from another insurance company. This will encourage additional competition among insurers. While additional competition does not guarantee a decrease in rates, it will certainly help contain any tendency to increase rates above competitive levels. Increased competition will also give property and casualty insurers stronger incentive to improve their utilization control procedures.

#### **Terminate Medical Payments for Fraudulent Claims**

Hawaii's existing statute provides that payment of temporary total disability

benefits shall be terminated "if the employee has filed a false claim."<sup>20</sup> The law does not expressly provide for termination of medical benefits if a false claim has been filed. Under the existing law, it is conceivable that an employer or insurance company might prove that a false claim had been filed, and yet might have to pay outstanding medical benefits on the claim.

*It is recommended that the employer have no responsibility under workers' compensation for any medical benefits if a false claim has been filed.*

The workers' compensation system should only be charged with the cost of work related injuries and illnesses. This recommendation is designed to cure the potential problem of incorrectly charging medical benefits to the workers' compensation system when a false claim has been filed. Any unpaid medical benefits incurred by a person who has filed a false claim should be paid under other health insurance coverage or, if not covered, by the employee.

## THE ISSUE OF PRESUMPTIONS

### **Require a *Preponderance of Evidence* Rather Than *Substantial Evidence* to Overcome the Presumption of Work Injury**

The controversy that has centered around judicial interpretation of presumptions goes to the very heart of the objectives discussed at the outset of this chapter. The workers' compensation program covers all personal injuries suffered "either by accident arising out of and in the course of employment or by disease proximately caused by or resulting from the nature of the employment."

In doing away with a worker's right to tort action, the intent clearly is to cover every type of injury or illness that is known to be caused by work, and also to cover those afflictions that may reasonably be related to work but which are not yet known to be caused by work. At the same time, there is no intent to include under the workers' compensation system such occurrences as (1) illnesses caused by hereditary factors or by communicable or mental diseases that are not work related; (2) health problems arising from the normal aging process; or (3) injuries sustained from nonwork related accidents. For these types of events, employees have available other insurance systems; e.g., health insurance for diseases, and no-fault automobile or temporary disability insurance for accidents.

Although it is possible to identify easily and clearly some events which are covered under the workers' compensation program and some which are not, a serious problem exists with respect to a large "grey area" of health problems. Advances in science and medicine do not always reduce uncertainty. In fact, it is possible that such advances may be increasing the "grey area."

For traumatic injuries caused by accidents such as falls, slips, etc., determination of whether they were work related is fairly straightforward. In those instances where there is some doubt or ambiguity as to whether the accident was work related (e.g., the injury occurred while in route to or from work or while in a travel status), a substantial body of case law provides guidance for settling many disputes.

Diseases such as mental illnesses or those which involve a multiplicity of pathological conditions (e.g., heart disease)

20. Section 386-31(b).

present more difficult problems for determining whether a condition is work related. Succinctly, the problem arises from the fact that modern medicine, despite many advances, often does not know what is causing or aggravating a worker's condition. This is particularly true of mental illnesses, but it is also applicable to many other health problems, such as cardio-vascular disease.

New inventions bring many benefits to mankind, but they can also create new hazards at the workplace. These hazards sometimes have long gestation periods so that the afflictions which they cause are not and cannot be known for many years. Even within an office environment, which many consider relatively safe, there exist widespread hazards which have the potential for causing serious physical harm and impairment, with an adverse effect upon mental and physical well-being, especially when the exposures are repeated and long term. To cite just a few, some video display tubes emit low levels of radiation in regions of the non-ionizing electromagnetic spectrum for which no standards have been established. Whether such radiation produces any harmful effect on cataracts, on the reproductive system, or on pregnancy is simply not known. Similarly, the effect of using laser lights, which are becoming more common in supermarkets, printing devices, and elsewhere is not known.<sup>21</sup>

New occupational illnesses and diseases are not diagnosed every month, nor even every year, yet each passing decade witnesses the addition of newly diagnosed and recognized occupational diseases. To cite a few: asbestosis, black lung disease, brown lung disease, carpal tunnel syndrome, and illnesses arising from on-the-job

exposure to a variety of toxic or carcinogenic substances.

In order to serve its basic purpose, the law needs to be sufficiently flexible to provide compensation to victims without forcing them to accumulate a veritable mountain of evidence. At the same time, resolving all doubts about the merit of a claim in favor of the claimant has the potential of converting the workers' compensation program to a broad-based system of unlimited health care plus general *income continuation for all workers, virtually without regard to cause*. Even the most comprehensive health insurance plans do not attempt to provide for income continuation, as this would unquestionably be expensive, and it could even be financially hazardous. Accordingly:

*It is recommended that the presumption clause be retained but that a preponderance of evidence, rather than substantial evidence, be required to overcome the presumption.*

Retaining presumption will continue to give injured workers the benefit of the doubt. Permitting the presumption to be overturned by a preponderance of evidence will maintain the burden of proof on employers while giving them a reasonable opportunity to prove that a particular claim does not represent a covered work injury.<sup>22</sup>

21. For elaboration on this subject, see *Potential Office Hazards and Controls*, Office of Technology Assessment, U.S. Congress (September, 1984) 160 pp.

22. A *preponderance* of evidence generally requires less proof than *substantial* evidence.

## SPECIAL COMPENSATION FUND

### Establish a Special Compensation Fund Conciliation Panel to Resolve Disputes Involving Payments for Second Injuries

A certain amount of controversy arises over allocation of payments between, on the one hand, the second injury fund and, on the other hand, insurance carriers or self-insured employers. The issue in such cases is whether the cost of a particular injury is to be borne by (1) the individual carrier or employer, or (2) through the fund spread over all employers.

In an effort to reduce the amount of controversy, the Legislature in 1982 adopted a formula for resolving at least some of these issues.<sup>23</sup> Despite this legislation, a number of cases involving payments by the second injury fund continue to be appealed to the Labor and Industrial Relations Appeals Board. Such appeals tend to increase the amount of litigation in the system and drive up overhead costs of the workers' compensation program. In line with the objectives set forth at the outset of this chapter, it is generally desirable to minimize the number and cost of such appeals, consistent with resolving disputes fairly and equitably.

One reason for continued appeals originates in what many see as a conflict of interest on the part of the director of the Department of Labor and Industrial Relations, who is in the position of reviewing decisions by his own examiners and concurrently acting as overseer of the special compensation fund. The director is seen to be acting as advocate, judge, and jury. To summarize the situation, the feeling is widespread that the director resolves most second injury disputes by finding against the individual insurance carrier or employer and in favor of the fund.

It was not considered necessary to investigate or sample individual decisions by the director. The problem is likely to persist so long as the *perceived* conflict of interest exists, regardless of how objective the director's decisions may in fact be. To resolve this particular issue:

*It is recommended that the Legislature establish a Special Compensation Fund Conciliation Panel for resolving disputes about second injuries.*

It is envisioned that this panel would function somewhat along the lines of the Medical Claims Conciliation Panel.<sup>24</sup> To summarize briefly, the panel would be established within the Department of Labor and Industrial Relations. A separate panel would be appointed for each dispute arising from a hearing officer's decision. The panel would deal only with issues relating to apportionment of payment to the second injury fund. Disputes over all issues that pertain to the claimant's rights would be appealed directly to the Labor and Industrial Relations Appeals Board. The individual panels would consist of three persons, with one representative selected from each of the following: (1) the insurance industry, (2) private self-insured employers, and (3) state and local government. Panel members would be selected from three separate lists of names submitted by the concerned entities. Panel members would serve without pay, and any required staff support would be provided by the Department of Labor and Industrial Relations.

The panels would first encourage informal resolution of claims through voluntary disposition or settlement. Any

23. Act 93, SLH 1982.

24. Act 219, SLH 1976.

claim that could not be resolved informally would be heard by the panel, which would then issue written advisory decisions apportioning liability between the fund and either the self-insured or the insurance carrier. These advisory decisions would be nonbinding and could not be introduced as evidence in subsequent proceedings. Any issues not resolved by the panel could then go to the Labor and Industrial Relations Appeals Board.

## THE INSURANCE SYSTEM

### Ensure that Insurance Rates Are in Accordance with Similar Risk Characteristics

It was shown in Chapter 5 that intense price and service competition characterizes the sale of workers' compensation insurance in Hawaii. This competition is marked by large shifts away from basic manual rates developed under the prior approval system to a variety of rating plans involving substantial price deviations. This resort to *de facto* competitive rating may be fraught with problems of adverse selection, i.e., undercharging large preferred risks while overcharging small businesses which, individually, do not generate much premium income. These widespread discounts have occurred in the face of insurance industry claims of general rate inadequacy and requests for significant basic rate increases.

What is undoubtedly not being protected has been appropriately described by one industry observer as "equity in classifications." The reality of the current marketplace for workers' compensation insurance is that competition is bending the rules of prior approval ratemaking. It appears that the rating classifications in the

current prior approval system are being "honored in the breach." With this in mind, it is not recommended that competitive rating without prior approval of rates and classifications be adopted at this time. However, action is needed to ensure that the present system operates fairly.

*It is recommended that the Insurance Commissioner examine the underwriting practices of companies writing workers' compensation insurance to assure that businesses are being charged in accordance with similar risk characteristics. The Insurance Commissioner should determine the extent of adverse selection in the assignment of risks to classifications, deviations, and experience modifications and take appropriate action.*

Everyone desires a competitive market for most goods and services. However, the realities are that competition exists in workers' compensation insurance for the few with great purchasing power, while it is virtually nonexistent for the many who lack purchasing power. When the Legislature mandates that workers' compensation coverage be purchased by everyone except those who are able to self-insure, it must also assure the public that rates are fair, adequate, and not unduly discriminatory.

## PROGRAM ADMINISTRATION

### Improve Program Administration By the Disability Compensation Division

Administration of the present workers' compensation program in Hawaii has two critical problem areas: (1) ineffective monitoring of benefit delivery; and (2) extensive delays in claims adjudication. Present monitoring of benefit delivery does

not enforce a discipline on insurers, self-insurers, and medical providers to report on a timely basis. With regard to improving this area of program administration:

*It is recommended that the Disability Compensation Division establish a system of effectively monitoring compliance with benefit delivery standards by employers, insurers, and providers.*

This reporting system should continue to be supplemented with periodic audits of insurers and self-insurers so as to identify problem areas and secure cooperative corrective actions.

Until recently, the DCD has not adjudicated claims swiftly, nor has it exercised control to eliminate the unnecessary time delays which led to the current backlog in filings and decisions. Resources provided by the Legislature are helping the DCD to reduce its backlog to less than two months by mid-1985. To help assure that DCD does not regress in this area:

*It is recommended that the DCD streamline the present filing, scheduling, and determination process.*

The system should have a data base that can be used (1) to provide management information on the status of all cases; (2) to schedule hearing and prepare basic adjudication documents; and (3) to generate uniform management reports. Implementation of these improvements will first require a feasibility study and system design effort.

### **Facilitate the Process of Hearings and Decisions**

For workers with longer-term disabilities, weekly wage loss payments may

continue for many months. Serious injuries may require extended healing periods, and these will necessarily entail extended wage loss payments. It may also occur, however, that wage loss payments are unduly extended because of a failure by the Disability Compensation Division (DCD) to hold hearings and issue decisions promptly. In other words, control of long-term temporary wage loss payments must focus on facilitating the hearings and decision processes within the DCD.

In the 1984 session, the Legislature provided the Department of Labor and Industrial Relations with an additional \$170,000 to facilitate the hiring of more hearing officers. This is a step in the right direction. It is not yet possible to determine whether this amount is sufficient for at least two reasons. *First*, not enough time has elapsed. *Second*, the DCD does not have any statistics whatsoever on the time lag between filing of cases and time to hearing, backlog, etc. Accordingly:

*It is recommended that the DCD develop and implement the customary statistical performance indicators and monitor its performance in reducing the delay in adjudicating cases.*

Finally, the Legislature can give some useful guidance to at least one facet of the hearing process. Namely, a statutory time limit can be set for issuing a decision after a hearing has been held.

*It is recommended that, after the DCD completes a hearing, examiners be required to issue their determinations within 60 days.*

DCD issues many decisions within one to two weeks. Some decisions, however, linger unnecessarily for extended periods. DCD reports that extended delays often result from requests for extensions from the

parties involved. Sixty days after completion of a hearing is a sufficient amount of time for lawyers and insurance companies to settle cases, if they are indeed serious about settling them. This, then, is a minimal recommendation to help clean out the backlog and keep the process moving.<sup>25</sup>

A final suggestion that might help the process without adding unduly to overhead cost would be to change all *temporary* hearing officer positions to *permanent* positions. These jobs require extensive training and experience. Since there is no foreseeable opportunity to eliminate any of these existing positions, pretending that they are "temporary" only amounts to self-deception. Maintaining such positions as temporary can also be penny-wise and pound foolish. It may increase the turnover of trained employees, thereby increasing the cost of hiring and training replacements, while saving only minimal amount of money in terms of employee benefits.

#### IMPACT ON COSTS AND INSURANCE RATES

This report has developed more than two dozen recommendations for reform of Hawaii's workers' compensation program. The recommendations are designed to improve on the dimensions of program effectiveness and efficiency cited at the outset of this chapter. Many of the recommendations will reduce program cost. A few recommendations—those designed to provide more equitably for those most likely to have uncompensated losses—will tend to increase cost.

Changes suggested with regard to temporary and permanent disability benefits, coupled with those on medical management, *if adopted in their entirety, can*

*potentially lower the general rate level by at least 20 percent.*<sup>26</sup> This is the best available estimate of what might be achieved.

#### CONCLUSION

This study represents a comprehensive examination of the workers' compensation system in Hawaii. Our review includes, but is not limited to, factors such as the benefit structure; available data on program performance; incentives and disincentives implicit in the way the system operates; and the roles played by the many parties at interest. An overall effort has been made to design a comprehensive package of reforms which, taken together, will improve the system.

The recommendations contained in this chapter have been designed to fulfill the basic policy objectives set forth initially. They have not been designed with the special interest of any particular group in mind. It seems unlikely that each and every recommendation contained in this chapter will be endorsed by any of the various parties at interest.

To summarize briefly, it is recommended that the Legislature modify the workers' compensation system toward greater equity and improve performance by

25. Minnesota has adopted a similar requirement, and the state suspends the pay of any hearings examiner who fails to issue a decision within 60 days after completion of a hearing.

26. The estimated rate reduction is based on an actuarial costing that includes the interactive effects of these recommendations. The assistance and cooperation of the National Council of Compensation Insurers in preparing studies which underlie the cost estimate is gratefully acknowledged. Haldi Associates, Inc., assumes full responsibility for the final estimate given here.

(1) relating compensation more closely to the economic losses actually suffered by employees on account of work related injuries; (2) increasing timeliness of payments to injured workers; (3) eliminating any medical treatment not required for rehabilitation; and (4) having the Disability Compensation Division improve its case management system, including scheduling of hearings and adjudication of disputes.

It is recommended that efficiency be improved by (1) eliminating unnecessary delays in the Disability Compensation Division; (2) reducing the number of disputes and the amount of litigation; (3) increasing competition among insurers to better manage cases and control costs;

and (4) improving incentives implicit in the present system.

The first step in any reform of the system depends on action by the Legislature. If legislative action on these recommendations is forthcoming, the hope and expectation are that the insurance pricing mechanism will react, lower general rate levels will be the result, and that lower costs will be experienced by self-insurers also.

The final outcome, however, will depend critically on whether all concerned parties perceive that these recommendations achieve the basic objectives of effectiveness and efficiency, and on how the parties act in response to legislative changes.



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APPENDICES

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## Appendix A

### SPECIAL WORKERS' COMPENSATION STATE FUNDS IN HAWAII AND SEVEN OTHER STATES

Special workers' compensation state funds pay benefits or administrative expenses when a specified contingency occurs. All states, including Hawaii, have at least one type of special fund.

Some concerns have been expressed about the special fund in Hawaii. This appendix presents relevant background information on how special funds operate in Hawaii and the following seven states: (1) California, (2) Florida, (3) Louisiana, (4) Michigan, (5) Minnesota, (6) Rhode Island, and (7) Wisconsin. Principal types of special funds found in Hawaii and other states are as follows.<sup>1</sup>

1. *Second or subsequent injury funds* which are designed to remove one perceived disincentive to the hiring of handicapped workers (all 50 states plus the District of Columbia).

2. *Benefit guarantee funds* which protect workers against (a) insolvent insurers (all states except those with an exclusive state fund); (b) uninsured employers (19 states plus the District of Columbia); and (c) insolvent self-insurers (12 states).

3. *Funds for continuation of payments* which continue payments in long-term cases for which the employer's liability is limited by law. The funds may continue medical expenses (4 states) or cash benefits (5 states).

4. *Benefit adjustment funds* for long-term beneficiaries which attempt to preserve, at least in part, the purchasing power of some long-term disability or death benefits (16 states plus the District of Columbia).

1. This section on special funds is based on: (1) Lloyd W. Larson and John F. Burton, Jr., *Special Funds in Workers' Compensation*, an unpublished report prepared for the Employment Standards Administration, U.S. Department of Labor, July 1981; (2) *State Workers' Compensation Laws, July 1984*, also published by the Employment Standards Administration; (3) *Analysis of Workers' Compensation Laws 1984*, published by the U.S. Chamber of Commerce; (4) materials provided by the states included in the more detailed comparison; (5) corresponding state statutes; and (6) information from Hawaii's Department of Labor and Industrial Relations.

5. *Rehabilitation funds* which finance partially the rehabilitation services provided under the law (14 states plus the District of Columbia).

6. *Occupational disease funds* which compensate workers disabled by job related chronic diseases, especially long-lasting cases (7 states).

Some states have a single multipurpose fund; others have separate funds for each purpose. Funds in each category differ greatly according to (1) events that trigger any payments, (2) the amount of those payments, and (3) how the funds are administered and financed. Most funds are financed primarily through assessments paid by carriers and self-insurers, but formulas for determining the assessment vary widely. For example, the assessment may be a percent of either (1) the gross premiums of insurers and the hypothetical premiums of self-insurers, or (2) the benefits paid. Many states also assess a stated dollar amount on fatal cases with no dependents. Some funds operate on a pay-as-you-go basis, while others accumulate reserves against future payouts for injuries or diseases that have already occurred.

### **Hawaii Workers' Compensation Special Compensation Fund**

Prior to 1963, Hawaii had a special fund with the sole purpose of serving as a second injury fund. That is, the fund paid a portion of the compensation for permanently disabled workers whose disability was in part caused by a previous disability. Hawaii's special multipurpose fund plus a separate insurance guarantee fund now serve four of the six purposes listed above, plus three others. The roles played by Hawaii's Workers' Compensation Special Compensation Fund (WCSCF) are as follows.

1. *A second injury fund.* In 1982, Hawaii established a formula for determining when the fund would pay for second injuries.<sup>2</sup> If a worker with a previous permanent partial disability that would have supported an award of 32 weeks or more subsequently suffers an injury that results in greater permanent partial disability or in permanent total disability or death, the employer pays the

2. Act 93, SLH 1982.

weekly benefits for the combined disability during the first 104 weeks unless the worker is only partially disabled, in which case the employer is responsible only for the permanent partial disability caused by the second injury or loss. The second injury fund pays the excess.

For injuries that occurred prior to 1982, the employer's responsibility was always limited to the disability caused by the second injury. The second injury fund paid the excess. No 32-week requirement was imposed on the previous permanent partial disability for the fund to be involved.

2. *A benefit guarantee fund.* A separate insurance benefit guaranty fund protects workers against nonpayment of benefits by insolvent insurers. The WCSCF pays benefits to the employees of uninsured employers and insolvent self-insurers.

3. *A retroactive benefit adjustment fund.* A worker who was disabled on or before June 18, 1980 had his or her benefit increased on that date. A supplemental allowance from the fund increases the prior benefit by the ratio of the maximum weekly benefit as of June 18, 1980 to the maximum weekly benefit as of the date of the work injury.

4. *A continuation of payment fund.* For workers permanently disabled prior to May 15, 1972, the law provides indemnity benefits for a permanently disabled worker that may exceed the maximum dollar responsibility which the law imposes on the employer for that disability. The WCSCF pays the excess. The 1967 Legislature set the aggregate responsibility of the employer at \$35,100. Prior to that action the aggregate employer's liability was less in some cases. The 1972 Legislature removed the dollar limit on the employer's aggregate liability, thus eliminating any WCSCF responsibility for continuing benefits for injuries or diseases incurred on May 15, 1972 or later.

5. *An attendant services adjustment fund.* If the maximum amount allowed for procurement of attendant services is increased, the fund pays a supplemental allowance that increases the prior benefit by the ratio of the new maximum to the former maximum. This fund could be considered to be a prospective benefit adjustment fund.

6. *A prompt payment fund.* The fund pays a disabled worker who, though eligible, does not receive prompt and proper compensation from his or her employer. The fund then takes over all of the rights and remedies of the person receiving the payments against the employer or insurer. Almost all of the payments under this fund are paid to the employees of uninsured or insolvent employers, most of whom are unable to reimburse the fund.

7. *A concurrent employment fund.* For a worker who is disabled while concurrently engaged in more than one employment, the fund pays the amount by which the benefits that the worker is entitled exceeds the liability of the employer in whose employment the injury occurred.

Figure A-1 shows graphically how payments by the WCSCF have increased since 1973 (supporting details are shown in Table A-1). The benefits paid in 1973 were 3.0 percent of the \$19.5 million workers' compensation benefits paid that year. In 1983, WCSCF payments were 7.1 percent of the \$103.3 million total benefits paid.

Table A-1  
Hawaii Workers' Compensation Fund Payments—By Type of Payment  
1973-1983  
(thousands of dollars)

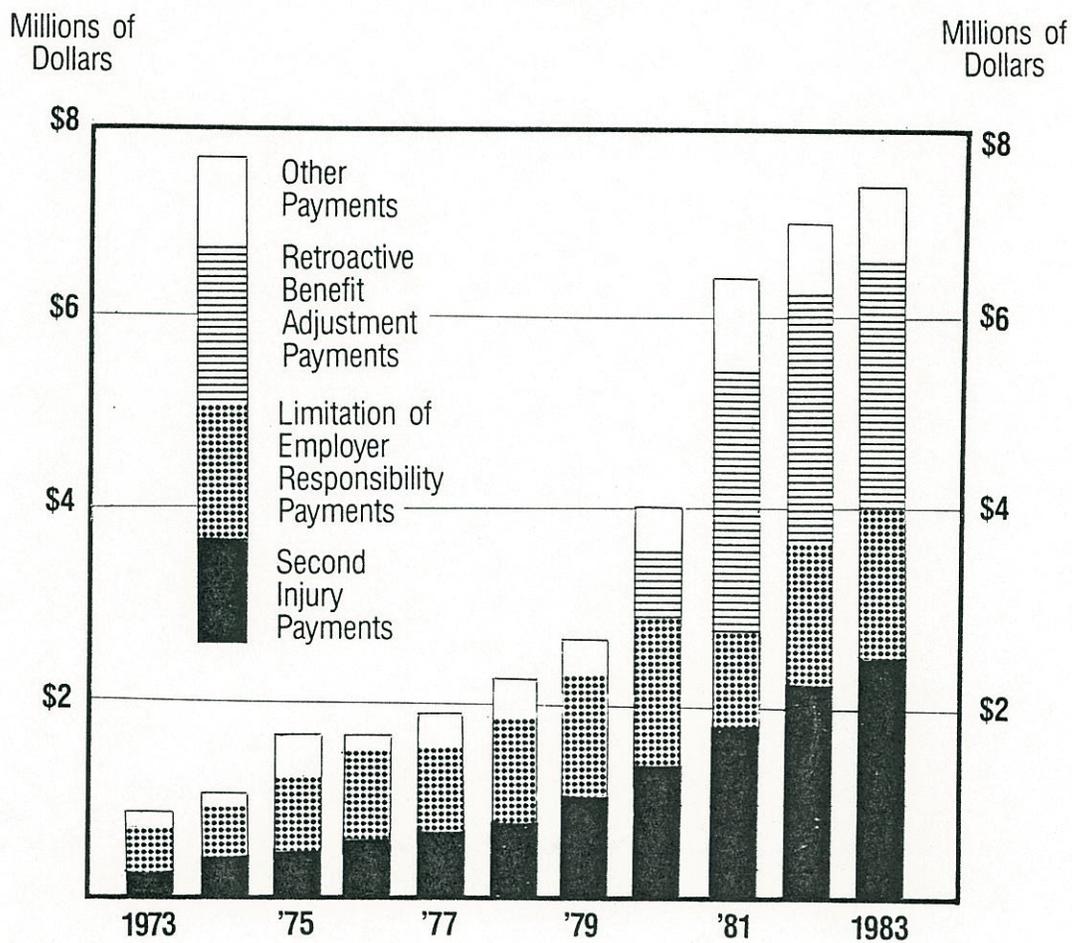
| Calendar Year | Total    | Second Injuries | Limits on Employer Responsibility | Retroactive Benefit Adjustments | Other                |                    |                       | Expenses |
|---------------|----------|-----------------|-----------------------------------|---------------------------------|----------------------|--------------------|-----------------------|----------|
|               |          |                 |                                   |                                 | Defaulting Employers | Attendant Services | Concurrent Employment |          |
| 1973          | \$ 593.8 | \$ 235.9        | \$ 260.6                          | \$ —                            | \$ 47.3              | \$ 16.8            | \$ 23.0               | \$ 10.2  |
| 1974          | 911.8    | 397.5           | 420.1                             | —                               | 28.6                 | 31.0               | 14.5                  | 20.1     |
| 1975          | 1,235.3  | 468.4           | 638.7                             | —                               | 32.3                 | 54.0               | 26.0                  | 15.9     |
| 1976          | 1,759.8  | 617.4           | 956.2                             | —                               | 69.7                 | 63.5               | 35.0                  | 18.0     |
| 1977          | 1,919.3  | 778.1           | 939.0                             | —                               | 42.2                 | 101.6              | 37.1                  | 21.3     |
| 1978          | 2,300.8  | 870.2           | 1,170.5                           | —                               | 105.0                | 84.9               | 41.1                  | 29.1     |
| 1979          | 2,681.8  | 1,044.1         | 1,378.8                           | —                               | 71.4                 | 83.6               | 67.6                  | 36.3     |
| 1980          | 4,118.3  | 1,454.2         | 1,604.2                           | 796.4                           | 58.7                 | 85.5               | 61.1                  | 58.2     |
| 1981          | 5,571.9* | 1,790.6         | 1,419.8                           | 1,920.3                         | 160.7                | 98.4               | 82.2                  | 85.5     |
| 1982          | 6,981.0* | 2,375.8         | 1,436.3                           | 2,581.7                         | 199.9                | 109.4              | 138.4                 | 117.7    |
| 1983          | 7,357.5* | 2,696.4         | 1,510.8                           | 2,555.3                         | 197.1                | 115.8              | 115.3                 | 119.4    |

\*The data shown in the body of this table excludes miscellaneous benefits paid in the following amounts: \$14,400 in 1981, \$21,900 in 1982; and \$47,400 in 1983.

Figure A-1

# PAYMENTS BY THE HAWAII WORKERS' COMPENSATION SPECIAL COMPENSATION FUND

1973-1983



Source: Table A-1.

As Figure A-1 indicates, most payments made by the fund fall in one of three categories: (1) second injury benefits; or (2) continuation of benefits for workers injured prior to May 15, 1972 beyond the aggregate liability of the employer; or (3) benefit adjustments for those injured on or prior to June 18, 1980. Addition of the benefit adjustments in 1980 was the primary reason for the more rapid increase in fund payments from 1979 to 1982. However, both the benefit adjustment and continuation of payment components appear to have reached a plateau. Because only persons injured prior to June 18, 1980 or May 15, 1973 qualify for these two types of payments, respectively, their total should decrease gradually during coming years and eventually disappear.

The WCSCF payments are financed in several ways, principally assessments on insurers and self-insured employers. In 1983, the revenue sources were as follows:

|                                                                                   |               |
|-----------------------------------------------------------------------------------|---------------|
| Percentage assessments on:                                                        |               |
| 1. Insurance company gross premiums                                               | 67.9%         |
| 2. Self-insured hypothetical gross premiums                                       | 27.2          |
| Insurer and self-insurer \$8,775 assessments<br>on fatal cases with no dependents | 1.1           |
| Defaulting insurer reimbursements                                                 | 0.3           |
| Penalties for failure to obtain insurance                                         | 0.1           |
| Interest earned                                                                   | 3.2           |
| Other                                                                             | <u>0.2</u>    |
| TOTAL                                                                             | <u>100.0%</u> |

From 1973 through 1983, total revenues exceeded total expenditures, causing the fund balance to increase moderately as shown in Table A-2.

The WCSCF is administered by the Department of Labor and Industrial Relations, Disability Compensation Division. The State Director of Finance makes all disbursements upon orders by the Director of Labor and Industrial Relations.

### Special Funds in Seven Other States

The seven states compared with Hawaii also have special funds that, singly or combined, serve several purposes. The principal types of funds in these states plus Hawaii are shown in Table A-3.

Table A-2

Receipts and Payments of the Workers' Compensation  
Special Compensation Fund  
1973-1983  
(thousands of dollars)

| <i>Calendar Year</i> | <i>Revenues</i> | <i>Payments</i> | <i>End of Year Balance in Fund</i> |
|----------------------|-----------------|-----------------|------------------------------------|
| 1973                 | \$ 812.3        | \$ 593.8        | \$ 413.2                           |
| 1974                 | 1,214.2         | 911.8           | 765.7                              |
| 1975                 | 1,894.5         | 1,235.3         | 1,374.8                            |
| 1976                 | 1,397.6         | 1,759.8         | 1,012.6                            |
| 1977                 | 1,945.3         | 1,919.3         | 1,038.6                            |
| 1978                 | 2,410.2         | 2,300.8         | 1,148.0                            |
| 1979                 | 2,654.0         | 2,681.8         | 1,120.2                            |
| 1980                 | 4,059.8         | 4,118.3         | 1,061.8                            |
| 1981                 | 7,812.4         | 5,571.9         | 3,302.3                            |
| 1982                 | 7,548.7         | 6,981.0         | 3,870.0                            |
| 1983                 | 7,112.5         | 7,357.5         | 3,625.0                            |

Table A-3

Purposes of Workers' Compensation Special Funds  
In Hawaii and Seven Comparison States

| <i>State</i> | <i>Second Injury Fund</i> | <i>Benefit Guarantee Fund</i> | <i>Continuation of Benefit Fund</i> | <i>Benefit Adjustment Fund</i> | <i>Rehabilitation Fund</i> | <i>Occupational Diseases</i> |
|--------------|---------------------------|-------------------------------|-------------------------------------|--------------------------------|----------------------------|------------------------------|
| California   | x                         | x                             |                                     | x                              |                            | x                            |
| Florida      | x                         | x                             |                                     | x                              | x                          |                              |
| Hawaii       | x                         | x                             | x                                   | x                              |                            |                              |
| Louisiana    | x                         | x                             |                                     |                                |                            |                              |
| Michigan     | x                         | x                             | x                                   | x                              |                            | x                            |
| Minnesota    | x                         | x                             |                                     | x                              |                            |                              |
| Rhode Island | x                         | x                             |                                     |                                | x                          |                              |
| Wisconsin    | x                         | x                             |                                     | x                              |                            | x                            |

## **Second Injury Funds**

All eight states have second injury funds. Table A-4 compares these funds as to (1) any requirements imposed on (a) the prior injury, (b) the subsequent injury, and (c) the combined effect of the prior impairment and the subsequent injury; (2) the financial responsibilities of the employer and the special fund; and (3) the way the fund is financed.

Some states make payments from the second injury fund only when the subsequent injury meets narrow, well-defined requirements. Michigan is an example of a state with narrow requirements. Only when the prior injury and the second injury involve the loss of a hand, arm, foot, leg, or eye, resulting in permanent total disability, are benefits paid by Michigan's second injury fund. (See Table A-4.) Other states, including Hawaii, have a broad requirement that, potentially, allows a variety of subsequent injuries to qualify for payments from the second injury fund. Florida, Louisiana, Minnesota, and Rhode Island are examples of states with a broad requirement.

Disputes about payments from the second injury fund are virtually nonexistent in states with a narrow requirement. In states with a broad requirement, there is greater potential for disputes about liability of the second injury fund versus the employer's liability. At the same time, states with a broad requirement do not necessarily have extensive disputes over liability of the second injury fund. Florida, Louisiana, and Minnesota, for example, report that most cases are settled expeditiously at the administrative level.

## **Benefit Guarantee Funds**

Benefit guarantee funds differ according to whether they cover one or more of the following: (1) uninsured employers, (2) insolvent insurers, and (3) insolvent self-insurers. The coverage in Hawaii plus the other seven comparison states is shown in Table A-5.

Table A-4

## Some Key Characteristics of the Second Injury Funds in Hawaii and Seven Comparison States

| State        | Requirements Imposed On                                                                                                                                         |                                                                       |                                                                                                                     | Financial Responsibility                                                                                                                                                                                      |        | Method of Financing Fund                                   |
|--------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|------------------------------------------------------------|
|              | Prior Injury                                                                                                                                                    | Subsequent Injury                                                     | Combined Effects                                                                                                    | Employer                                                                                                                                                                                                      | Fund   |                                                            |
| California   |                                                                                                                                                                 | At least 35% disability.                                              | At least 70% disability.                                                                                            | Portion of disability caused by subsequent injury alone.                                                                                                                                                      | Excess | Appropriations, assessments on insurers and self-insurers. |
|              | Loss of hand, arm, foot, leg, or eye.                                                                                                                           | Opposite member affected.                                             |                                                                                                                     |                                                                                                                                                                                                               |        |                                                            |
| Florida      | Permanent disability that would hinder employment. Presumed eligible if one of over 20 listed impairments or at least 20% disability.                           |                                                                       | Greater permanent partial disability permanent total disability or death.                                           | Varies by type of disability or death benefit.                                                                                                                                                                | Excess | Assessments on insurers and self-insurers.                 |
| Hawaii       | Permanent partial disability that would have supported a 32-week workers' compensation award.                                                                   |                                                                       | Greater permanent partial disability, permanent total disability or death.                                          | First 104 weeks or actual permanent partial award for second injury if less.                                                                                                                                  | Excess | Assessments on insurers and self-insurers, penalties.      |
| Louisiana    | Permanent partial disability that would hinder employment. Presumed eligible if one of 30 listed impairments.                                                   |                                                                       | Disability that is materially and substantially greater than would have resulted had prior injury not been present. | Permanent partial disability—40%. Permanent total disability—104 weeks. Death—175 weeks. Medical expenses—50% of first \$10,000.                                                                              | Excess | Assessments on insurers and self-insurers.                 |
| Michigan     | Loss of hand, arm, foot, leg, or eye.                                                                                                                           | Loss of hand, arm, foot, leg, or eye.                                 | Permanent and total disability.                                                                                     | Portion of disability caused by subsequent disability alone.                                                                                                                                                  | Excess | Assessments on insurers and self-insurers.                 |
| Minnesota    | One of 19 listed impairments plus any other impairment that would produce a disability rating of at least 10%. Pre-injury registration or record of impairment. |                                                                       | Substantially greater than would have resulted from subsequent injury alone or caused by prior injury.              | First 52 weeks and \$2,000 of medical expenses unless subsequent injury alone results in permanent partial disability in which case employer is responsible for disability caused by subsequent injury alone. | Excess | Assessments on insurers and self-insurers.                 |
| Rhode Island | Work-related injury that would hinder employment.                                                                                                               |                                                                       | More than 104 weeks of disability.                                                                                  | More than 104 weeks of disability.                                                                                                                                                                            | Excess | Assessments on insurers and self-insurers.                 |
| Wisconsin    | Permanent disability that would have supported 200 weeks of payments.                                                                                           | Permanent disability that would have supported 100 weeks of payments. |                                                                                                                     | If permanent partial disability, fund pays smaller of two disability awards. If permanent total, fund pays permanent total minus previous award amount.                                                       |        | Assessment on insurers and self-insurers.                  |

Table A-5

Coverage of Benefit Guarantee Funds  
In Hawaii and Seven Comparison States

| <i>State</i> | <i>Uninsured<br/>Employers</i> | <i>Insured<br/>Employers</i> | <i>Insolvent<br/>Self-Insurers</i> |
|--------------|--------------------------------|------------------------------|------------------------------------|
| California   | x                              | x                            |                                    |
| Florida      |                                | x                            |                                    |
| Hawaii       | x                              | x                            | x                                  |
| Louisiana    |                                | x                            |                                    |
| Michigan     |                                | x                            | x                                  |
| Minnesota    | x                              | x                            | x                                  |
| Rhode Island |                                | x                            |                                    |
| Wisconsin    |                                | x                            | x                                  |

### Benefit Adjustment Funds

Benefit adjustment funds can be divided into three categories: (1) funds that automatically adjust certain benefits on new cases for future increases in wages or prices;<sup>3</sup> (2) funds that make certain ad hoc retrospective adjustments on old cases; and (3) funds that automatically make certain retrospective benefits on old cases. As shown below, one or more of the three types of funds exists in at least one comparison state or Hawaii. Minnesota requires prospective adjustments but has insurers include the cost of these adjustments in their pricing. (See Table A-6.)

Florida and Minnesota provide the highest adjustments. Once each year, Florida increases by 5 percent the permanent total disability benefits that started after June 30, 1955. Florida also increases annually by 5 percent (but never more than the increase in the consumer price index) all wage loss benefits paid workers with permanent partial disabilities starting two years after the workers have reached maximum medical improvement. Minnesota also makes two adjustments.

3. Of 17 states that adjust benefits prospectively, 10 have insurers and self-insurers include estimated costs of these future adjustments in their workers' compensation premiums or reserve calculations. The other seven states have special prospective benefit adjustment funds. All retrospective adjustments are financed through special funds and, in one case, general revenues.

Table A-6  
Benefit Adjustment Funds  
In Hawaii and Seven Comparison States

| <i>State</i> | <i>Prospective<br/>Adjustments</i> | <i>Retroactive Adjustments</i> |                  |
|--------------|------------------------------------|--------------------------------|------------------|
|              |                                    | <i>Ad Hoc</i>                  | <i>Automatic</i> |
| California   |                                    |                                |                  |
| Florida      | x                                  |                                | x                |
| Hawaii       |                                    | x                              |                  |
| Louisiana    |                                    |                                |                  |
| Michigan     | x                                  |                                | x                |
| Minnesota    | Premiums                           |                                | x                |
| Rhode Island |                                    |                                |                  |
| Wisconsin    |                                    | x                              |                  |

*First*, on each anniversary date of a totally disabled worker's injury or death, Minnesota adjusts the weekly benefit upward by the percentage increase in the state average weekly wage, but no more than 6 percent. *Second*, after a worker has been totally disabled 204 weeks, the minimum weekly benefit becomes 65 percent of the current and future state average weekly wage.

Michigan provides two benefit adjustments for certain permanently and totally disabled workers. The first increases the benefit for workers who have been (1) totally disabled for two years, and (2) receiving a weekly benefit equal to less than half the state average weekly wage on the date of their injury if the worker can demonstrate that because of the worker's age, education, training, experience, or other evidence, his or her wage could have increased since that time. The benefit can be increased up to half the state average weekly wage on the date of injury. The second adjustment affects workers who were permanently and totally disabled on or after June 25, 1955. This adjustment raises the weekly benefit of any worker who received the maximum weekly benefit at the time of the worker's injury to the amount the worker would be receiving had the current maximum weekly benefit been in effect. This same adjustment also continues benefits for workers whose benefits would have stopped under earlier duration limits. A third adjustment

raises benefits for workers disabled between September 1, 1965 and December 31, 1979 to approximately the level they would have received if their salaries at the time they were injured had been increased by the annual increases in the state average weekly wage (limited to 5 percent) since the date of their injury through 1979. This third adjustment also applies to death benefits.

Wisconsin has made retroactive adjustments in a manner similar to the retroactive benefit adjustment described previously in connection with Hawaii.

### **Rehabilitation Funds**

Rehabilitation funds finance some of the rehabilitation services to which a worker is entitled under the workers' compensation law. Among the seven comparison states, only Florida and Rhode Island have such a special fund. Through the special fund, both states finance a workers' compensation rehabilitation unit that provides rehabilitation services directly to claimants. Claimants, however, have the right to secure their services elsewhere. In Rhode Island, the Dr. John E. Donley Rehabilitation Center is usually selected for medical rehabilitation services because it is well equipped and staffed to provide these services, and insurers, who support the Center through assessments, pay less for its services. The Center provides only limited vocational rehabilitation services.

### **Other Special Funds**

Other special funds found in the eight states compared here include three occupational disease funds (California, Michigan, and Wisconsin) and two concurrent employment funds (Hawaii and Michigan).

California has an Asbestos Workers' Account that pays benefits to workers disabled by asbestos when the responsible employer either cannot be located or does not pay any benefits within 30 days. California finances this fund with general revenues but hopes to receive from the responsible employers most of the money spent.

Michigan has a silicosis, dust disease, and logging industry compensation fund that reimburses insurers for (1) sums paid in excess of \$12,500 for disability or death benefits from silicosis or other dust disease or arising out of employment in the logging industry, and (2) benefits paid for disability or death causes, contributed to,

or aggravated by previous exposure to polybrominated biphenyl. Michigan also has a special concurrent employment fund that closely resembles the corresponding Hawaii fund described earlier. One major difference is that, in Michigan, the employer is responsible for all benefits if the employer paid more than 80 percent of the employee's total wages.

Wisconsin's special occupational disease fund pays benefits to workers whose occupational disease did not disable them until the statute of limitations on such claims had expired.

Hawaii is the only state with an attendant services adjustment fund. Only Wisconsin has a special fund that continues death benefits for children after the 300 week maximum duration on regular death benefits has expired.

Minnesota has created a unique Workers' Compensation Reinsurance Association that, in exchange for premiums received, reinsures all insurers and self-insurers against losses per occurrence in excess of specified amounts. The Workers' Compensation Reinsurance Association, however, is not a special fund.

### **Multiple Funds Versus Single Fund**

Except for special funds that protect employees against uninsured employers, insolvent insurers, or insolvent self-insurers, three of the eight states included in this analysis have a single multipurpose fund. These states are Hawaii, Minnesota, and Wisconsin. Designation of the single fund is as follows:

|           |                                                 |
|-----------|-------------------------------------------------|
| Hawaii    | Workers' Compensation Special Compensation Fund |
| Minnesota | Special Compensation Fund                       |
| Wisconsin | Work Injury Supplemental Benefit Fund           |



## Appendix B

### REHABILITATION IN OTHER STATES

All states provide some rehabilitation benefits, but details vary widely. All states entitle workers to medical rehabilitation either as part of their medical expense benefit or separately, and all but six states provide statutorily for some form of vocational rehabilitation. A brief summary of major provisions of these statutes follows.<sup>1</sup>

All states have state workers' compensation rehabilitation units except 19.<sup>2</sup> Thirty-one states plus the District of Columbia provide services as follows:

|                                              |    |
|----------------------------------------------|----|
| Provide services directly                    | 9  |
| Refer to state agencies or private companies | 7  |
| Refer and monitor referred cases             | 11 |
| Provide and refer                            | 2  |
| Provide, refer, and monitor                  | 3  |

An employee is statutorily required to accept physical rehabilitation in all but 12 states.<sup>3</sup> Of the states that require vocational rehabilitation, about half penalize workers who do not accept an approved program.<sup>4</sup> The usual penalty is a suspension of benefits, but some states only reduce the benefits, generally by 50 percent.

In most states, an employee undergoing vocational rehabilitation continues to receive temporary total disability benefits plus books or tools needed, necessary travel, and board and lodging if away from home. Some limit the weekly maintenance costs paid, the number of weeks of vocational rehabilitation or both.

1. See *State Worker's Compensation Laws, July 1983* (Washington, D.C.: U.S. Department of Labor, Division of State Workers' Compensation Programs, July 1983). This section on rehabilitation is based on this publication plus materials provided by the eight states included in the more detailed comparison, the corresponding state statutes, and interviews with Hawaii's Department of Labor and Industrial Relations personnel.

2. The 19 states without rehabilitation units are: Alabama, Arizona, Arkansas, Delaware, Illinois, Indiana, Louisiana, New Jersey, New Mexico, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, Wisconsin, and Wyoming.

3. These 12 states are California, Hawaii, Iowa, Idaho, Massachusetts, New Mexico, New York, Ohio, Oklahoma, West Virginia, Wisconsin, and Wyoming, plus the District of Columbia.

4. The states which penalize workers are Alabama, Alaska, Delaware, Florida, Georgia, Kansas, Kentucky, Louisiana, Maine, Maryland, Michigan, Minnesota, Montana, Nebraska, Nevada, New Hampshire, New Jersey, North Dakota, Oregon, Rhode Island, Utah, Vermont, Virginia, and Washington.

## Rehabilitation in Comparison States

Like Hawaii, the other seven comparison states (California, Florida, Louisiana, Michigan, Minnesota, Rhode Island, and Wisconsin) provide statutorily for some form of physical and vocational rehabilitation. Further details are presented below.

**Workers' compensation rehabilitation units.** Five states (California, Florida, Michigan, Minnesota, and Rhode Island) have rehabilitation units in their workers' compensation division. Louisiana and Wisconsin do not have such units, but Wisconsin does have a rehabilitation specialist in its division.

**When and how employees are referred.** Some states specify certain times after which a worker's situation must be reviewed relative to potential rehabilitation, but most states depend upon the initiative of either the employer or the employee. The practice in each of the comparison states is as follows:

|              |                                                                                                                                                                                                                                 |
|--------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| California   | Employer or employee initiative.                                                                                                                                                                                                |
| Florida      | Employer or employee initiative plus identification by bureau of workers' compensation rehabilitation as part of its case monitoring.                                                                                           |
| Louisiana    | Employer or employee initiative.                                                                                                                                                                                                |
| Michigan     | Employer or employee initiative or the director on his own motion. Insurers are required to report at the end of three months from the date of injury and each subsequent four months concerning provisions for rehabilitation. |
| Minnesota    | Rehabilitation consultation required within 5 days after the employee has lost 60 days of work time (30 days for back injuries).                                                                                                |
| Rhode Island | Evaluation report required by department of labor every three months after compensation begins.                                                                                                                                 |
| Wisconsin    | Referral required if worker probably disabled at least 100 weeks.                                                                                                                                                               |

**Voluntary or mandatory.** California and Wisconsin (like Hawaii) permit a disabled worker to refuse rehabilitation. The other five states require the worker to accept both physical and vocational rehabilitation. Florida and Louisiana penalize the worker refusing rehabilitation by reducing the benefit by 50 percent; Michigan gives its director the right to order a loss or unspecified reduction of benefits; and Minnesota and Rhode Island suspend disability benefits during the refusal period.

**Employee benefits during vocational rehabilitation.** For an employee undergoing vocational rehabilitation, most states pay temporary total disability benefits plus such extra costs associated with rehabilitation as travel, tuition, board, and lodging. All comparison states provide these benefits, but six of the seven limit either the amount or the timing in some way:

|              |                                                                                                                                                                |
|--------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------|
| California   | Vocational rehabilitation must be requested within 15 days after the date of injury.                                                                           |
| Florida      | Vocational rehabilitation benefits are limited to 26 weeks but may be extended another 26 weeks.                                                               |
| Louisiana    | Vocational rehabilitation benefits are limited to 52 weeks, but may be extended another 52 weeks.                                                              |
| Michigan     | Vocational rehabilitation benefits are limited to 52 weeks, but may be extended another 52 weeks.                                                              |
| Minnesota    | Retraining limited to 156 weeks; in unique circumstances Minnesota may also provide additional compensation up to 25 percent of the weekly disability benefit. |
| Rhode Island | No limit.                                                                                                                                                      |
| Wisconsin    | Vocational rehabilitation benefits are limited to 40 weeks, but this may be extended.                                                                          |



## Appendix C

### RECENT LAW CHANGES IN SIX OTHER STATES

This section summarizes major changes since 1978 in workers' compensation laws of six other states. Some changes were important because of a serious problem that existed in a particular state. Others may be more general in their application. Whether any of these changes are applicable to Hawaii require further study. Inclusion of these changes in this appendix should not be construed as a recommendation.

#### Florida

- 1979** Wage-loss approach adopted for permanent partial disability claims. Florida thus became the first state to adopt such an approach. Wage loss benefit is 95 percent of the difference between 85 percent of the employee's prior monthly earnings and his or her post-injury earnings after reaching maximum medical improvement. The worker also receives an impairment benefit equal to \$50 for each percentage of impairment up to 50 percent plus \$100 for each additional percentage.
- 1982** The impairment benefit was increased to \$250 for each percentage of impairment up to 10 percent, plus \$500 for each additional percentage. In Florida, impairment usually applies to cases involving amputation or loss of vision in excess of 80 percent.

#### Louisiana

- 1983** Wage loss approach introduced for permanent partial disabilities. "Wage loss" benefit is 74 percent of difference between 90 percent of the prior monthly earnings and the post-injury earnings. This benefit, called a supplemental earnings benefit, is limited to 520 weeks.

Impairment awards are also paid for specified impairments. Anatomical loss of use or loss of function must exceed 50 percent as established in the American Medical Association's *Guide to the Evaluation of Permanent Impairment*. Impairment awards are reduced by any temporary total, permanent total or supplemental earnings benefits.

Employer required to provide rehabilitation services.

First Office of Workers' Compensation Administration created.

### **Michigan**

**1979** Payments for exposure to polybrominated biphenyl were authorized from Silicosis and Dust Disease Fund.

**1980** Weekly benefits changed to 80 percent of an employee's spendable or "after tax" wages, subject to a maximum weekly benefit equal to 90 percent of the statewide average weekly wage. Minimum weekly benefits for disability were eliminated; minimum weekly benefits for death cases was set at 50 percent of the statewide average weekly wage.

**1981** Worker required to accept an offer of reasonable work or lose benefits. Partial benefits are provided if the new job pays less than the old job. Workers with a scheduled impairment receive a weekly benefit for the scheduled number of weeks. If they still have a wage loss resulting from the disability after the prescribed number of weeks, they will receive non-scheduled permanent partial disability payments after that time.

After a disabled worker has been employed for 100 weeks, loses a job through no fault of the worker, and is still disabled, an administrative judge will determine whether compensation should be based upon the worker's earnings in the former employment or the new employment. If the new employment has lasted more than 250 weeks, the new wage earning capacity is assumed. If the new employment has lasted less than 100 weeks, the prior earning capacity is assumed.

**1982** Open competition rating law.

### **Minnesota**

**1979** Rehabilitation provisions substantially strengthened to require rehabilitation consultation within specified time.

**1981** Duration of spouse-only death benefits shortened from widowhood or widowerhood to 10 years.

Open competition rating transition ordered to become fully effective in 1986.

**1983** Duration of temporary total disability benefits limited to 90 days after an employee reaches maximum medical improvement or completes an approved retraining program. If during this 90-day period the employer makes a suitable job offer to the employee (or secures a job for the employee from some other employer), the employee receives an *impairment compensation*. This impairment compensation is a stated dollar amount that is related to the percent of disability. A schedule prepared by the Commission relates the percent of disability to the injury sustained. If the employer does not make a suitable job offer, the employee receives as *economic compensation* a weekly benefit based on prior wages for the number of weeks indicated by the percent of disability. Because economic compensation is higher than impairment compensation, employers have an incentive to offer a job to the worker.

Other changes: statement of intent that law is not to be interpreted in favor of employee or employer; strengthened medical provider rules and reviews; rehabilitation referrals required within 5 days after 60 days of lost work and employee required to accept rehabilitation; new competitive state fund; open competition fully effective date advanced to 1984.

Administrative changes: sizeable staff increases; administrative conference introduced as the initial step in resolving disputes; time limits on when compensation judges must render a decision.

## **Rhode Island**

**1982** An earning capacity for a partially incapacitated worker is established by an employer's offer of suitable employment. Prior to this change, two State Supreme Court decisions (1973 and 1977) had caused partial disability cases to receive the same benefits as totally disabled workers. Under the new law, if an employer offers any suitable alternative employment, the employer is liable only for two-thirds of the difference between the worker's prior earnings and the earning capacity determined by the job offer.

The current second injury fund replaced a narrower version. Binding decisions can now result from pre-trial conferences.

A modified form of competitive rating was enacted. Large insurers are required to file their own rates instead of filing through the National Council on Compensation Insurance. All rates, however, must still be approved by the insurance commissioner.

Rhode Island became the second state (Florida being the first) with a workers' compensation insurance excess profits statute.

### **Wisconsin**

1981 Work Injury Supplemental Benefits Fund made responsible for occupational disease cases barred by statute of limitations.

## Appendix D

### INDEX OF MANUAL RATES: COMPARISON OF HAWAII AND EIGHT OTHER STATES

It is well known that workers' compensation rates in Hawaii have increased rapidly over the last decade. This might be said of other states as well. In order to assess rate increases over time and *vis-a-vis* other states, rate increases in Hawaii were compared with those in eight other states: California, Florida, Louisiana, Michigan, Minnesota, New Jersey, Rhode Island, and Wisconsin, from 1966 to 1982. During this period, manual rates in Hawaii increased by 500 percent, far more than in the other states. The next highest increase, 242 percent, was experienced in Florida. Four states—Louisiana, Michigan, Minnesota, and Rhode Island—experienced increases of between 140 and 170 percent. California, New Jersey, and Wisconsin exhibited increases of less than 120 percent. Effective in 1983, some states adopted open competition, and manual rate information is no longer available for these states.

The indices of workers' compensation rates, displayed in Table D-1, were developed as follows:

1. For each state, the effective rate for January 1, 1966, was used as a starting point;
2. Effective rates were adjusted to give effect to increases in manual rates instituted after that date, as published by the National Council for Compensation Insurance;
3. The rates were then converted into indices by dividing by the rate in effect on October 1, 1979.

The relative increase in rates and the pattern of change in rates is often dominated by changes or reforms in the workers' compensation system.

#### California

Rates in California started from a relatively higher level than those in Hawaii in 1966, but underwent little change through 1972. From this date, they increased

Table D-1

Indices of Manual Rates in Various States  
As of January 1 of Each Year  
(October 1, 1979 = 1.00)

| Year | Index |       |       |       |       |       |       |       |       |
|------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|      | CA    | FL    | HI    | LA    | MI    | MN    | NJ    | RI    | W     |
| 1966 | 0.468 | 0.302 | 0.343 | 0.377 | 0.333 | 0.353 | 0.475 | 0.467 | 0.619 |
| 1967 | 0.513 | 0.302 | 0.358 | 0.377 | 0.318 | 0.361 | 0.496 | 0.442 | 0.621 |
| 1968 | 0.505 | 0.308 | 0.377 | 0.374 | 0.325 | 0.417 | 0.640 | 0.422 | 0.618 |
| 1969 | 0.487 | 0.327 | 0.364 | 0.372 | 0.323 | 0.418 | 0.640 | 0.422 | 0.605 |
| 1970 | 0.475 | 0.334 | 0.404 | 0.404 | 0.360 | 0.416 | 0.654 | 0.545 | 0.590 |
| 1971 | 0.486 | 0.350 | 0.447 | 0.432 | 0.365 | 0.429 | 0.613 | 0.545 | 0.597 |
| 1972 | 0.486 | 0.350 | 0.414 | 0.442 | 0.365 | 0.470 | 0.632 | 0.511 | 0.594 |
| 1973 | 0.549 | 0.399 | 0.414 | 0.460 | 0.460 | 0.479 | 0.663 | 0.532 | 0.598 |
| 1974 | 0.556 | 0.487 | 0.414 | 0.520 | 0.480 | 0.583 | 0.662 | 0.576 | 0.656 |
| 1975 | 0.654 | 0.487 | 0.572 | 0.559 | 0.522 | 0.651 | 0.645 | 0.651 | 0.673 |
| 1976 | 0.701 | 0.754 | 0.704 | 0.757 | 0.572 | 0.727 | 0.656 | 0.803 | 0.747 |
| 1977 | 1.007 | 0.938 | 0.790 | 0.860 | 0.666 | 0.766 | 0.734 | 0.919 | 0.723 |
| 1978 | 0.980 | 1.176 | 0.790 | 0.969 | 0.875 | 0.918 | 0.867 | 0.919 | 0.810 |
| 1979 | 0.976 | 1.176 | 1.000 | 1.000 | 0.875 | 1.000 | 0.922 | 1.000 | 0.907 |
| 1980 | 1.002 | 1.000 | 1.117 | 1.180 | 1.089 | 1.000 | 1.111 | 1.000 | 1.000 |
| 1981 | 0.967 | 0.949 | 1.401 | 1.233 | 1.089 | 1.000 | 1.200 | 1.137 | 1.075 |
| 1982 | 0.965 | 0.749 | 1.617 | 1.265 | 0.847 | 0.950 | 1.129 | 1.137 | 1.174 |
| 1983 | 1.111 | 0.912 | 2.086 | 1.485 | O/C*  | 0.950 | 0.962 | O/C*  | 1.190 |

\*O/C indicates open competition. Manual rate information is not available for states which have adopted open competition.

gradually until 1977. In Hawaii, the increase started earlier and from a lower base. After 1977, California rates remained stable while those in Hawaii continued to increase at a rate comparable to that exhibited in 1974 to 1978.

### **Florida**

Rates in Florida started, in 1966, at a relative level which is comparable to that for rates in Hawaii. The two indices increased at about the same rate until 1973, after which the index for Florida increased faster and to a relatively higher level than in Hawaii. This continued until 1979, the year in which workers' compensation wage loss reforms in Florida were adopted. In ensuing years, the Florida rate index decreased by some 22 percent while that in Hawaii increased by almost 110 percent.

### **Louisiana**

Rates in Louisiana followed the same pattern as rates in Hawaii, though the Louisiana rates began to increase somewhat earlier in the seventies than those in Hawaii. After 1980, rates in Louisiana continued increasing until 1982, when Louisiana adopted a series of reforms of its workers' compensation laws. Since 1982, rates have fallen, while rates in Hawaii continued increasing.

### **Michigan**

From 1966 to 1979, rates in Michigan experienced the same total increase as those in Hawaii. Experience in Michigan is characterized by a fairly stable rate of increase throughout the period 1969 to 1979. Since 1979, the rates in Michigan have undergone a decrease of about 25 percent. In Michigan's case, these decreases reflect a mandatory rate reduction ordered by the state insurance department, as well as recent legislative reforms which coordinate workers' compensation benefits with other benefits.

### **Minnesota**

Rates in Minnesota have paralleled those in Hawaii except during two periods:

1. From 1971 to 1976, Minnesota rates increased at a uniform rate, whereas those in Hawaii remained constant from 1971 to 1974 and increased sharply in the next two years.

2. Since 1979, Minnesota rates have remained stable while Hawaii rates have increased by over 100 percent.

Minnesota recently adopted reforms of its workers' compensation system of which major aspects went into effect on January 1, 1984.

### **New Jersey**

Rates in New Jersey started from a much higher relative level in 1966 and increased faster than those in Hawaii until 1977. Since then, rates in New Jersey have increased very little. The rapid increase experienced in Hawaii between 1975 and 1977 brought levels in the two states into relative parity in 1977. Between 1977 and 1980, rates in the two states paralleled each other, but in 1982 and 1983, New Jersey rates declined slightly while those in Hawaii increased by 49 percent. New Jersey passed significant reforms of its workers' compensation program in 1980, following several years of debate among all parties. New Jersey has its own state compensation rating bureau, which is controlled by the state insurance department.

### **Rhode Island**

Rates in Rhode Island started from a relatively higher level in 1966 and terminated at a relatively lower level in 1982 (open competition was adopted in 1983). Thus, the overall increase has been substantially smaller, amounting to about 140 percent in Rhode Island versus about 500 percent in Hawaii. Timing of the increases has corresponded fairly closely in these two states. Rhode Island adopted major workers' compensation reform legislation in 1982.

### **Wisconsin**

Rates in Wisconsin started from a higher relative level and ended at a relatively lower level. The overall increase in Wisconsin was less than 100 percent, or one quarter of that experienced in Hawaii. There are also substantial differences in the timing of rate changes. Wisconsin rates remained substantially unchanged from 1966 to 1973 and increased at a steady rate after 1973; Hawaii rates experienced some increase in the sixties, were stable from 1971 to 1974 and have increased thereafter at a rate which is much larger than that experienced in Wisconsin.

**Appendix E**

**SELECTED STATISTICAL DATA  
PERTAINING TO  
HAWAII WORKERS' COMPENSATION PROGRAM**



Table E-1  
 State of Hawaii  
 Workers' Compensation Benefits Paid  
 1973-1983

| Year | Total<br>Benefits<br>Paid | Medical<br>Benefits<br>Paid | Indemnity<br>Benefits<br>Paid | Percentage |           |
|------|---------------------------|-----------------------------|-------------------------------|------------|-----------|
|      |                           |                             |                               | Medical    | Indemnity |
| 1973 | \$ 19,547,713             | \$ 5,231,431                | \$14,316,282                  | 26.8       | 73.2      |
| 1974 | 18,340,945                | 5,045,274                   | 13,295,671                    | 27.5       | 72.5      |
| 1975 | 22,502,542                | 6,421,115                   | 16,081,427                    | 28.5       | 71.5      |
| 1976 | 27,760,402                | 7,789,950                   | 19,970,452                    | 28.1       | 71.9      |
| 1977 | 23,652,284                | 7,026,293                   | 16,625,991                    | 29.7       | 70.3      |
| 1978 | 32,847,329                | 9,399,695                   | 23,447,634                    | 28.6       | 71.4      |
| 1979 | 42,572,568                | 11,838,327                  | 30,734,241                    | 27.8       | 72.2      |
| 1980 | 55,331,292                | 16,545,221                  | 38,786,071                    | 29.9       | 70.1      |
| 1981 | 66,949,693                | 21,174,823                  | 45,774,870                    | 31.6       | 68.4      |
| 1982 | 90,777,582                | 29,236,459                  | 61,541,123                    | 32.2       | 67.8      |
| 1983 | 103,337,910               | 34,267,471                  | 69,070,439                    | 33.1       | 66.9      |

Sources: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, (1) *Workers' Compensation in Hawaii*, 1976; and (2) *Work Injury Statistics*, 1977-1984.

Table E-2

State of Hawaii  
Total Indemnity Benefits Paid—By Type of Benefit  
1977-1983

| <i>Year</i> | <i>Total Indemnity Benefits Paid</i> | <i>Temporary Total Disability*</i> | <i>Permanent Partial Disability</i> | <i>Disfigurement</i> | <i>Vocational Rehabilitation</i> | <i>Permanent Total Disability</i> | <i>Attendant Services</i> | <i>Death Benefits</i> |
|-------------|--------------------------------------|------------------------------------|-------------------------------------|----------------------|----------------------------------|-----------------------------------|---------------------------|-----------------------|
| 1977        | 16,625,991                           | 9,018,181                          | 4,922,986                           | 815,278              | N/A                              | 955,868                           | 73,015                    | 840,663               |
| 1978        | 23,447,634                           | 12,258,563                         | 6,702,804                           | 1,305,835            | N/A                              | 1,917,689                         | 83,169                    | 1,179,574             |
| 1979        | 30,734,241                           | 14,553,677                         | 10,465,804                          | 1,751,621            | N/A                              | 2,390,737                         | 155,950                   | 1,416,452             |
| 1980        | 38,786,071                           | 19,139,671                         | 11,202,831                          | 1,764,104            | N/A                              | 4,193,927                         | 168,036                   | 2,317,502             |
| 1981        | 45,774,870                           | 22,306,224                         | 14,940,810                          | 2,063,829            | 395,707                          | 4,359,027                         | 88,091                    | 1,621,182             |
| 1982        | 61,541,123                           | 28,085,982                         | 19,833,041                          | 1,913,720            | 1,671,532                        | 7,043,444                         | 136,354                   | 2,857,050             |
| 1983        | 69,070,439                           | 31,564,996                         | 22,418,172                          | 1,819,361            | 3,206,512                        | 7,634,342                         | 188,862                   | 2,238,194             |

\*Includes temporary partial disability payments.  
N/A indicates not applicable.

Sources: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, (1) *Workers' Compensation in Hawaii*, 1976; and (2) *Work Injury Statistics*, 1977-1984.

Table E-3  
 State of Hawaii  
 Total Benefits Paid—By Source  
 1976-1983

| Year          | Total<br>Benefits<br>Paid | Carrier<br>Insured | Self-Insured |            | Special<br>Compensation<br>Fund |
|---------------|---------------------------|--------------------|--------------|------------|---------------------------------|
|               |                           |                    | Private      | Government |                                 |
| A. In Dollars |                           |                    |              |            |                                 |
| 1976          | 27,760,402                | 20,138,095         | 3,841,691    | 3,365,928  | 414,688                         |
| 1977          | 23,652,284                | 17,122,118         | 2,817,857    | 2,770,981  | 941,328                         |
| 1978          | 32,847,329                | 23,115,044         | 4,126,370    | 3,478,445  | 2,127,470                       |
| 1979          | 42,572,568                | 29,977,865         | 5,236,753    | 4,375,311  | 2,982,639                       |
| 1980          | 55,331,292                | 38,168,533         | 6,690,205    | 6,590,041  | 3,882,513                       |
| 1981          | 66,949,693                | 45,755,843         | 8,597,576    | 8,650,967  | 3,945,307                       |
| 1982          | 90,777,582                | 58,563,900         | 11,517,703   | 14,026,887 | 6,669,092                       |
| 1983          | 103,337,910               | 68,926,065         | 12,257,617   | 14,930,908 | 7,223,320                       |
| B. In Percent |                           |                    |              |            |                                 |
| 1976          | 100.0                     | 72.6               | 13.8         | 12.1       | 1.5                             |
| 1977          | 100.0                     | 72.4               | 11.9         | 11.7       | 4.0                             |
| 1978          | 100.0                     | 70.4               | 12.5         | 10.6       | 6.5                             |
| 1979          | 100.0                     | 70.4               | 12.3         | 10.3       | 7.0                             |
| 1980          | 100.0                     | 69.0               | 12.1         | 11.9       | 7.0                             |
| 1981          | 100.0                     | 68.3               | 12.9         | 12.9       | 5.9                             |
| 1982          | 100.0                     | 64.5               | 12.7         | 15.5       | 7.3                             |
| 1983          | 100.0                     | 66.7               | 11.8         | 14.5       | 7.0                             |

Sources: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, (1) *Workers' Compensation in Hawaii*, 1976; and (2) *Work Injury Statistics*, 1977-1984.

Table E-4

State of Hawaii  
Total Benefits Paid, Consumer Price Index, and Covered Employees  
1970-1983

| Year | <i>Total<br/>Benefits<br/>Paid<br/>(Current<br/>Dollars)</i> | <i>Consumer<br/>Price<br/>Index<br/>Honolulu</i> | <i>Total<br/>Benefits<br/>(Constant<br/>Dollars)</i> | <i>Covered<br/>Employees</i> | <i>Benefits/<br/>Employee<br/>(Current<br/>Dollars)</i> | <i>Benefits/<br/>Employee<br/>(Constant<br/>Dollars)</i> |
|------|--------------------------------------------------------------|--------------------------------------------------|------------------------------------------------------|------------------------------|---------------------------------------------------------|----------------------------------------------------------|
| 1970 | 12,578,217                                                   | 114.5                                            | 10,941,674                                           | 268,829                      | 46.79                                                   | 40.70                                                    |
| 1971 | 16,665,013                                                   | 118.9                                            | 14,015,990                                           | 277,776                      | 60.00                                                   | 50.46                                                    |
| 1972 | 18,772,931                                                   | 122.8                                            | 15,287,403                                           | 289,027                      | 64.95                                                   | 52.89                                                    |
| 1973 | 19,547,713                                                   | 128.3                                            | 15,235,941                                           | 304,378                      | 64.22                                                   | 50.06                                                    |
| 1974 | 18,340,945                                                   | 141.9                                            | 12,925,260                                           | 311,671                      | 58.85                                                   | 41.47                                                    |
| 1975 | 22,502,542                                                   | 155.0                                            | 14,517,769                                           | 319,358                      | 70.46                                                   | 45.46                                                    |
| 1976 | 27,760,402                                                   | 162.8                                            | 17,051,843                                           | 326,385                      | 85.05                                                   | 52.24                                                    |
| 1977 | 23,652,284                                                   | 171.0                                            | 13,831,745                                           | 337,279                      | 70.13                                                   | 41.01                                                    |
| 1978 | 32,847,329                                                   | 184.1                                            | 17,842,112                                           | 354,520                      | 92.65                                                   | 50.33                                                    |
| 1979 | 42,572,568                                                   | 204.6                                            | 20,807,706                                           | 371,264                      | 114.67                                                  | 56.05                                                    |
| 1980 | 55,331,292                                                   | 228.5                                            | 24,215,007                                           | 382,301                      | 144.73                                                  | 63.34                                                    |
| 1981 | 66,949,693                                                   | 252.4                                            | 26,525,234                                           | 384,446                      | 174.15                                                  | 69.00                                                    |
| 1982 | 90,777,582                                                   | 267.6                                            | 33,922,863                                           | 376,298                      | 241.24                                                  | 90.15                                                    |
| 1983 | 103,337,910                                                  | 273.5                                            | 37,783,513                                           | 380,749                      | 271.41                                                  | 99.23                                                    |

Sources: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, (1) *Workers' Compensation in Hawaii*, 1976; and (2) *Work Injury Statistics*, 1977-1984; and (3) Department of Planning and Economic Development, *State of Hawaii Data Book*, 1983.

Table E-5  
 State of Hawaii  
 Total Days Lost--By Type of Insurance  
 1976--1983

| Year          | Total<br>Days<br>Lost | Carrier<br>Insured | Self-Insured |            | Special<br>Compensation<br>Fund |
|---------------|-----------------------|--------------------|--------------|------------|---------------------------------|
|               |                       |                    | Private      | Government |                                 |
| A. In Dollars |                       |                    |              |            |                                 |
| 1976          | 642,911               | 467,689            | 85,924       | 87,887     | 1,411                           |
| 1977          | 492,149               | 356,591            | 57,645       | 76,231     | 1,682                           |
| 1978          | 620,876               | 467,446            | 70,056       | 79,939     | 3,435                           |
| 1979          | 660,278               | 485,622            | 82,802       | 87,340     | 4,514                           |
| 1980          | 816,127               | 597,974            | 102,401      | 109,864    | 5,888                           |
| 1981          | 894,058               | 636,007            | 111,465      | 138,211    | 8,375                           |
| 1982          | 1,057,504             | 722,325            | 128,360      | 185,499    | 21,320                          |
| 1983          | 1,141,746             | 784,796            | 136,763      | 186,873    | 33,314                          |
| B. In Percent |                       |                    |              |            |                                 |
| 1976          | 100.0                 | 72.7               | 13.4         | 13.7       | 0.2                             |
| 1977          | 100.0                 | 72.5               | 11.7         | 15.5       | 0.3                             |
| 1978          | 100.0                 | 75.3               | 11.3         | 12.8       | 0.6                             |
| 1979          | 100.0                 | 73.6               | 12.5         | 13.2       | 0.7                             |
| 1980          | 100.0                 | 73.3               | 12.6         | 13.4       | 0.7                             |
| 1981          | 100.0                 | 71.1               | 12.5         | 15.5       | 0.9                             |
| 1982          | 100.0                 | 68.3               | 12.1         | 17.6       | 2.0                             |
| 1983          | 100.0                 | 68.7               | 12.0         | 16.4       | 2.9                             |

Sources: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, (1) *Workers' Compensation in Hawaii*, 1976; and (2) *Work Injury Statistics*, 1977-1984.

Table E-6

State of Hawaii  
 Employment, Reported Injuries, and Compensation Costs  
 in Construction as Compared with State Totals  
 1973--1983

| Year | Percent of<br>State Total<br>Employed in<br>Construction | Reported Injuries |                         |         | Compensation Payments |                   |         |
|------|----------------------------------------------------------|-------------------|-------------------------|---------|-----------------------|-------------------|---------|
|      |                                                          | Construction      | Total<br>Labor<br>Force | Percent | Construction          | All<br>Industries | Percent |
| 1970 | 9.6                                                      | 11,856            | 37,405                  | 31.7    | 4,855,429             | 12,528,212        | 38.8    |
| 1971 | 8.4                                                      | 9,230             | 34,561                  | 26.7    | 6,369,958             | 16,665,013        | 38.2    |
| 1972 | 8.2                                                      | 8,647             | 34,901                  | 24.8    | 6,616,524             | 18,772,931        | 35.2    |
| 1973 | 8.7                                                      | 9,570             | 36,277                  | 26.4    | 6,940,153             | 19,547,713        | 35.5    |
| 1974 | 9.0                                                      | 10,452            | 37,646                  | 27.8    | 6,282,799             | 18,340,945        | 34.3    |
| 1975 | 8.2                                                      | 10,850            | 40,435                  | 26.8    | 7,437,616             | 22,502,542        | 33.1    |
| 1976 | 6.6                                                      | 7,112             | 38,721                  | 18.4    | 8,981,225             | 27,760,402        | 32.4    |
| 1977 | 5.9                                                      | 5,683             | 37,393                  | 15.2    | 6,707,653             | 23,652,284        | 28.4    |
| 1978 | 5.9                                                      | 6,091             | 38,869                  | 15.7    | 8,780,327             | 32,847,329        | 26.7    |
| 1979 | 6.4                                                      | 7,972             | 43,057                  | 18.5    | 11,846,875            | 42,572,568        | 27.8    |
| 1980 | 6.4                                                      | 9,124             | 47,725                  | 19.1    | 15,097,527            | 55,331,292        | 27.3    |
| 1981 | 5.7                                                      | 7,705             | 44,320                  | 17.4    | 18,536,408            | 66,949,693        | 27.7    |
| 1982 | 5.1                                                      | 5,240             | 40,521                  | 12.9    | 21,764,858            | 90,777,582        | 24.0    |
| 1983 | 4.7                                                      | 4,572             | 39,013                  | 11.7    | 23,861,397            | 103,337,910       | 23.1    |

NOTE: Reported injuries (Columns 3 and 4) reflect injuries during the year while compensation payments reflect current year payments from all cases (current and prior year injuries).

Source: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division.

Table E-7

State of Hawaii  
Maximum Effective and Average Weekly Wage  
1973-1984

| <i>Year</i> | <i>Maximum Effective<br/>Weekly Wage—<br/>Total and Permanent<br/>Disability*</i> | <i>Average Weekly Wage—<br/>Private Employment</i> | <i>Maximum Weekly<br/>Benefit Amount</i> |
|-------------|-----------------------------------------------------------------------------------|----------------------------------------------------|------------------------------------------|
| 1973        | 168.75                                                                            | 151.00                                             | 112.50                                   |
| 1974        | 168.75                                                                            | 162.50                                             | 112.50                                   |
| 1975        | 232.50                                                                            | 175.00                                             | 155.00                                   |
| 1976        | 250.50                                                                            | 184.35                                             | 167.00                                   |
| 1977        | 268.50                                                                            | 192.87                                             | 179.00                                   |
| 1978        | 283.50                                                                            | 207.73                                             | 189.00                                   |
| 1979        | 300.00                                                                            | 225.62                                             | 200.00                                   |
| 1980        | 322.50                                                                            | 244.17                                             | 215.00                                   |
| 1981        | 352.50                                                                            | 261.04                                             | 235.00                                   |
| 1982        | 378.00                                                                            | 273.52                                             | 252.00                                   |
| 1983        | 399.00                                                                            | 286.33                                             | 266.00                                   |
| 1984        | 421.50                                                                            | N/A                                                | 281.00                                   |

\*The maximum weekly benefit amount is two-thirds of the maximum effective weekly wage.

Source: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division.

Table E-8

Occupational Injuries and Illnesses Per 100 Full-Time Workers  
1972-1982

| <i>Year</i>      | <i>Total Cases</i> | <i>Lost<br/>Workday Cases</i> | <i>Lost<br/>Workdays</i> | <i>Average<br/>Workdays Lost<br/>Per Lost<br/>Workday Case</i> |
|------------------|--------------------|-------------------------------|--------------------------|----------------------------------------------------------------|
| A. United States |                    |                               |                          |                                                                |
| 1972             | 10.9               | 3.3                           | 47.9                     | 14.5                                                           |
| 1973             | 11.0               | 3.4                           | 53.3                     | 25.7                                                           |
| 1974             | 10.4               | 3.5                           | 54.6                     | 15.6                                                           |
| 1975             | 9.1                | 3.3                           | 56.1                     | 17.0                                                           |
| 1976             | 9.2                | 3.5                           | 60.5                     | 17.3                                                           |
| 1977             | 9.3                | 3.8                           | 61.6                     | 16.2                                                           |
| 1978             | 9.4                | 4.1                           | 63.5                     | 15.5                                                           |
| 1979             | 9.5                | 4.3                           | 67.7                     | 15.7                                                           |
| 1980             | 8.7                | 4.0                           | 65.2                     | 16.3                                                           |
| 1981             | 8.3                | 3.8                           | 61.7                     | 16.2                                                           |
| 1982             | 7.7                | 3.5                           | 58.7                     | 16.8                                                           |
| B. Hawaii        |                    |                               |                          |                                                                |
| 1972             | 13.4               | 6.0                           | N/A                      | N/A                                                            |
| 1973             | 13.9               | 6.2                           | 73.0                     | 11.8                                                           |
| 1974             | 13.8               | 6.5                           | 75.6                     | 11.6                                                           |
| 1975             | 12.7               | 6.4                           | 80.4                     | 12.6                                                           |
| 1976             | 11.1               | 5.6                           | 78.7                     | 14.1                                                           |
| 1977             | 10.7               | 5.5                           | 71.2                     | 12.9                                                           |
| 1978             | 11.3               | 5.9                           | 72.2                     | 12.2                                                           |
| 1979             | 11.0               | 6.1                           | 83.7                     | 13.7                                                           |
| 1980             | 11.5               | 6.3                           | 87.8                     | 13.9                                                           |
| 1981             | 11.1               | 5.8                           | 83.2                     | 14.3                                                           |
| 1982             | 11.4               | 6.2                           | 86.5                     | 14.0                                                           |

Sources: (1) U.S. Department of Labor, Bureau of Labor Statistics, *Occupational Injuries and Illnesses in 1982, 1983*; (2) State of Hawaii, Department of Labor and Industrial Relations, Occupational Safety and Health Research Section, *Occupational Injuries and Illness Survey, 1973-1982*; and (3) State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division.

Table E-9

Number of Hawaii Cases Processed With Cost  
1977-1983

| Year | All Cases |        | Indemnity Cases |         | Medical Only Cases |         |
|------|-----------|--------|-----------------|---------|--------------------|---------|
|      | Number    | Index* | Number          | Percent | Number             | Percent |
| 1977 | 30,754    | 100    | 13,559          | 44.1    | 17,195             | 55.9    |
| 1978 | 35,619    | 116    | 15,786          | 44.3    | 19,833             | 55.7    |
| 1979 | 43,578    | 142    | 19,861          | 45.6    | 23,717             | 54.4    |
| 1980 | 47,931    | 156    | 21,662          | 45.2    | 26,269             | 54.8    |
| 1981 | 49,749    | 162    | 23,081          | 46.4    | 26,668             | 53.6    |
| 1982 | 47,329    | 154    | 22,899          | 48.4    | 24,430             | 51.6    |
| 1983 | 45,388    | 148    | 23,042          | 50.8    | 22,346             | 49.2    |

\*Index calculated using 1977 equals 100.

Source: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, *Work Injury Statistics*, 1978-1984.

Table E-10

Percent of Hawaii Cases Processed With Cost—By Type of Benefit  
1977-1983

| <i>Year</i> | <i>Temporary<br/>Total<br/>Disability</i> | <i>Permanent<br/>Partial<br/>Disability</i> | <i>Permanent<br/>Total<br/>Disability</i> | <i>Death</i> |
|-------------|-------------------------------------------|---------------------------------------------|-------------------------------------------|--------------|
| 1977        | 87.9%                                     | 9.8%                                        | 1.3%                                      | 1.0%         |
| 1978        | 86.4                                      | 10.6                                        | 1.8                                       | 1.2          |
| 1979        | 84.5                                      | 12.8                                        | 1.8                                       | 0.9          |
| 1980        | 85.5                                      | 11.3                                        | 2.2                                       | 1.0          |
| 1981        | 83.4                                      | 13.5                                        | 2.2                                       | 0.9          |
| 1982        | 81.3                                      | 15.1                                        | 2.6                                       | 1.0          |
| 1983        | 81.9                                      | 14.5                                        | 2.8                                       | 0.8          |

Source: State of Hawaii, Department of Labor and Industrial Relations, Disability Compensation Division, *Work Injury Statistics*, 1978-1984.

## Appendix F

### INSURANCE RATEMAKING

Setting rates for workers' compensation insurance usually requires participation by insurance companies, a rating bureau, and the insurance department. Though the exact roles may differ, the institutional rates can be characterized in general, and for Hawaii in particular, in a fairly straightforward manner.

#### **Insurance Commissioner**

The Hawaii Insurance Commissioner is charged with the responsibility of ensuring that rates are neither excessive, nor inadequate, nor unfairly discriminatory. To discharge this function, the Insurance Commissioner has authority to review and approve all rate filings before they are implemented. The review may include requests for specific information on items underlying the rate proposal.

The Insurance Commissioner may also be called upon to approve specific elements of the classification and rating of risk. The classification system governs the ways in which data are collected and aggregated. Different classes may have different rates reflecting different loss costs. Consequently, control of the classification system is an important element in controlling potential discrimination.

#### **Rating Organization**

Under Hawaii's insurance laws, the Insurance Commissioner may appoint a rating advisory organization to collect and process data for each line of business and to file, on behalf of member insurers, for changes in rate level indications, risk classification systems, and policy forms. Hawaii is one of 13 states with rating organizations purportedly independent of the principal national rating advisory bureau for workers' compensation, the National Council on Compensation Insurance (NCCI). In actuality, the Hawaii Insurance Rating Bureau (HIRB) compiles rating data from member companies and then contracts with the NCCI for preparation of the Hawaii experience data base and filings made before the Insurance

Commissioner. The NCCI is a licensed rating organization in 30 states and the District of Columbia. Of the 13 state rating bureaus, all but New Jersey are controlled and funded by their member insurance companies.<sup>1</sup> In New Jersey, it is controlled by the insurance department and funded by the industry.

The rating organization typically is charged with calculating rates that its member insurers require to meet loss costs, operating and marketing expenses, plus a fair profit. In order to perform this function, the rating organization obtains from its members data related to past operations. The data include premiums earned at established manual rates and losses incurred. The rating organization may also obtain, from time to time, additional information such as the relation between expenses and size of the risk, which relate to specific elements in the ratemaking process.

Insurance companies which are members or subscribers of the rating organization are generally required to provide necessary data. Such insurers may adopt rates which have been filed by the bureau, once these rates have been approved. Insurers which are not members or subscribers of the bureau must make their own data available to the Insurance Commissioner and may be required to file rates independently. Insurers who belong to the rating organization may choose to file independently if they believe their own experience justifies a rate level or rating system which is different from that filed by the rating organization. Until 1984, the Hawaii Insurance Commissioner had no record of independently filed rates or any deviations. During 1984, one company reportedly filed for a 25 percent discount. In addition to the reporting requirements imposed on companies by the ratemaking structure, insurers must also file reports with the Department of Labor and Industrial Relations, Disability Compensation Division, whenever injuries are reported to them or payments are made by them to satisfy, in whole or in part, any claim for an employment-related injury or disability.

For that large segment of the market which insures through the private insurance mechanism, the cost of insurance begins with the applicable rates. These rates result from filings made by the HIRB and approved by the Insurance

1. States with independent rating organizations are: California, Delaware, Hawaii, Indiana, Massachusetts, Michigan, Minnesota, New Jersey, New York, North Carolina, Pennsylvania, Virginia, and Wisconsin.

Commissioner. As discussed in Chapter 5, however, many workers' compensation policies contain an experience rating or retrospective rating plan which incorporates prior or current experience of the insured into the rates. In Hawaii, these plans also are subject to regulatory approval. The following is a brief description of various plans.

**Dividend plans.** Insurers offer dividend plans whose purpose is to reduce the net cost of workers' compensation insurance to the employer. These dividends cannot be "guaranteed" and must be declared by the board of directors of the insurer offering such plans.

Some insurers pay the same dividend rate to all insureds. Others use sliding scale dividend plans, or similar retention plans, in which dividends reflect the insured's own loss experience. The dividend usually depends on the loss ratio and on the premium size of the insured. Safety groups combining small- to medium-sized employers are a variation in the use of dividend plans by insurers.

**Retrospective rating.** Insurers also offer retrospective rating plans approved by the State. The plans are a contractual agreement and do not require that an insurer's board of directors declare dividends.

There are five different retrospective rating plans. Four of the plans are uniform and approved by the particular state or states. A fifth one, known as plan D, is actually a set of formulas and factors that are used to develop a tailor-made plan which may include general and auto liability and some other lines of insurance as well. Only this "D" plan appears to be used in Hawaii.

**Schedule rating.** Schedule rating refers to the method by which an underwriter debits or credits an employer's premium based on physical characteristics of the risk at hand. Our survey of major insurers suggests that this is not used in Hawaii.

**Cash flow plans.** Cash flow plans are premium payment plans that delay remittances and result in a different net cost to an insured based on the time value of money. The premium payment option contained in the workers' compensation rating manual in effect in most states is an example. Under this plan, an insured pays a deposit premium and the balance of the premium is paid over the policy period. Insureds with workers' compensation premiums in excess of \$500,000 might

be offered more sophisticated cash flow plans. For example, under a "paid loss" retrospective rating plan, the insured pays a negotiated initial deposit and thereafter reimburses the insurer for losses actually paid.

**Self-insurance.** Individual self-insurance, as permitted in most states, allows an individual employer to self-insure its workers' compensation exposures. Each state must approve an employer desiring to self-insure and appropriate bonds may have to be posted to guarantee financial solvency. As a rule of thumb, employers do not consider self-insurance unless their annual premium volume in one state is in excess of \$200,000.

**Group self-insurance.** Group self-insurance allows smaller employers to band together and pool their risks. In California, Illinois, Minnesota, and Texas, group self-insurance has been confined primarily to governmental associations. In other states, commercial employers as well as governmental agencies may engage in group self-insurance. Our survey has not developed any information on group self-insurance in Hawaii.

**Safety groups.** The method of grouping smaller employers into safety experience "pools" has long been used to provide added inducements for safety. This is accomplished by providing to members of the group a reward of loss sensitive dividends that can range up to 30 percent of premiums or more. Most often insurers offer group participation to trade association members that fit a particular rating classification, representing a particular hazard. For example, members of the Hawaii Chapter of the American Bus Association participate in a group endorsement to solicit the safety dividend program. The program, arranged through Alexander of Hawaii, the Honolulu affiliate of the national brokerage firm of Alexander and Alexander, Inc., provides for a guaranteed cost reduction to participants of 10 percent with additional participating dividends calculated at 18 months. These future cost reductions in the form of dividends have averaged 17 percent, and could range as high as 30 percent.

### **Market Competition and "Open Rating"**

The principal alternative to prior approval is the so-called "competitive rating" or "open rating" system, under which insurers do not have to obtain prior approval for rate increases. This system has been advocated as a means of giving insurers

more pricing flexibility and a better opportunity to adjust prices up or down more quickly in response to changing market conditions. Although smaller insurers might continue to rely on pooled experience data to project accurate rates, larger writers would be expected to make rates on the basis of their own data and thereby to generate more variability—and competition—in rate levels.

Competitive rating for workers' compensation insurance was endorsed by the National Association of Insurance Commissioners in 1980. Some regulators felt that prior approval was not resulting in rate indications that achieved regulatory standards of being adequate, fair and yet not excessive.<sup>2</sup> Some insurers felt that market competition was forcing deviation from rates filed by the principal industry rating bureau, the NCCI, and several major independent state units.

Some advocates of open rating claim it would permit insurers more freedom to adjust classifications, thereby rewarding employers with more favorable claims experience. Critics argue that this kind of pricing flexibility might result in unfair pricing discrimination against some classes of insureds,<sup>3</sup> especially small businesses with little or no bargaining ability. Free competition is generally to be favored. With a mandated line of social insurance, however, it may not be good social policy to give the insurance industry totally unfettered freedom to classify buyers in any way they see fit. For this reason, it is not recommended that Hawaii adopt open competition at this time. The ongoing experiment in other states should be monitored, however, to ascertain whether such a shift might be warranted in the future.

2. Open rating for workers' compensation has been adopted recently in Illinois, Kentucky, Louisiana, Minnesota, and Rhode Island, and is under consideration in other states.

3. Critics also argue that rating bureaus, which will continue to collect certain pooled information from workers' compensation writers, may run into problems with maintaining the integrity of the data base because the companies may elect to use different classes. This could be mitigated by requiring all participating companies to pool information using so-called "standard" rating classifications.



## Appendix G

### WORKERS' COMPENSATION STATE FUNDS

While workers' compensation coverage in Hawaii is provided only through private carriers or self-insurance, a number of states or provinces in the United States and Canada rely on either exclusive or competitive state funds. Employers in six states insure with an exclusive state fund (four of these states also permit self-insurance). Thirteen states have competitive state funds. All Canadian provinces have boards and commissions similar to exclusive state funds in the United States. In 1982, Minnesota created a competitive state fund, the first one enacted since 1933. A legislative study commissioned in Maine in early 1984 has also recommended adoption of a competitive fund. (See Table G-1.)

Adoption of either a competitive or exclusive state fund in Hawaii is not recommended for the following reasons. *First*, sufficient market capacity appears to be available to satisfy the requirements of all risks in the State. *Second*, the problems of the workers' compensation system do not reflect a breakdown of competition in the private insurance mechanism. In fact, competition amongst insurers appears to be intensifying, which is a healthy sign. The Legislature can further enhance this competition by adopting the recommendation to enable the sale of workers' compensation "medical only" and "ex-med" coverages. *Third*, the State lacks the sufficient background and expertise in underwriting, claims handling, data processing, and financial expertise to effectively launch such a program within the foreseeable future. The following discussion elaborates on the principal benefits and drawbacks of establishing a state fund.

Two principal benefits of state funds are: (1) they assure an available market for workers' compensation for all risks; and (2) they provide, generally, prompt delivery of benefits at low overhead cost. To illustrate the latter point, the average expense ratio for the period 1974 to 1978 as compiled by Best's insurance industry reporting organization was 7.1 percent for state funds, 13.8 percent for mutuals, and 18.8 percent for stock carriers. Several of the exclusive state and provincial funds have also innovated the delivery of benefits and have facilitated the introduction of new technologies for helping injured workers. The Canadian exclusive provincial

Table G-1

Types of Workers' Compensation Systems  
in the United States

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A. Exclusively by private insurance:

Texas

B. By private insurance or by authorized self-insurance:

|             |               |                |
|-------------|---------------|----------------|
| Alabama     | Iowa          | New Jersey     |
| Alaska      | Kansas        | New Mexico     |
| Arkansas    | Kentucky      | North Carolina |
| Connecticut | Louisiana     | Rhode Island   |
| Delaware    | Maine         | South Carolina |
| Florida     | Massachusetts | South Dakota   |
| Georgia     | Mississippi   | Tennessee      |
| Hawaii      | Missouri      | Vermont        |
| Illinois    | Nebraska      | Virginia       |
| Indiana     | New Hampshire | Wisconsin      |

C. Exclusively by State Fund:

North Dakota  
Wyoming

D. By either State Fund or authorized self-insurance:

Nevada  
Ohio  
Washington  
West Virginia

E. By any one of three means: Private insurance, State Fund  
or authorized self-insurance:

|            |           |              |
|------------|-----------|--------------|
| Arizona    | Michigan  | Oklahoma     |
| California | Minnesota | Oregon       |
| Colorado   | Montana   | Pennsylvania |
| Idaho      | New York  | Utah         |
| Maryland   |           |              |

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Sources: *Analysis of Workers' Compensation Laws—1983 Edition.*  
*Best's Insurance Reports, Property and Casualty Edition, 1983.*

funds in Ontario and British Columbia have led in providing comprehensive services to injured workers through a network of resident facilities and outpatient rehabilitation nurses and counselors. Exclusive funds in Washington and Nevada have adopted similar comprehensive approaches. The California, Ontario, Oregon, and Washington funds have adopted highly sophisticated computer technologies for automatic claims handling and team management of cases.

One problem with state funds is that in recent years, large, particularly exclusive, state funds have had serious financial management problems. This has been true of state funds in Ohio, Pennsylvania, and Washington. Further, despite increasing premium volume, some state funds, notably Colorado, have been effectively barred from meeting insurance demands because their state legislatures have refused increases in budgetary requests. More practically, state funds are limited in that they can only write coverage for employers within their respective states. This means that they cannot cover the exposures of multistate employers, and they cannot design integrated packages that afford premium savings when other insurance needs are integrated. None of the state funds pay premium or real estate taxes.