Discussion of Morantz's paper *"Workers' Compensation at a Crossroads"*

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Learning with Purpose

Main Contributions

- Frame discussion of Workers' Comp system
  - As one of the Four Pillars affecting prevalence and costs of injuries including attention to:
    - Incentives faced by stakeholders
    - Failure of free market assumptions
    - Benefit adequacy and cost shifting
  - Through an international perspective
    - To avoid taking "the basic features of the system for granted"

Some brief suggestions

- Consider a **5th pillar** or a more general 1st "labor market" pillar?
  - The *cyclical* and *structural* changes of the economy and labor market beyond decline of unions (distributions of skills and income, fissured employment)
- In **international comparison** focus more on
  - Partial compensation (US) vs. legislated (UK, Finland, Luxemburg) or "de facto" full compensation (other comparator countries)
  - Differences in anti-retaliation policies between US and comparator countries to explain RTW patterns

About Moral Hazard

- Moral Hazard : "the tendency for insurance against loss to reduce incentives to prevent or minimize the cost of the loss" (Baker 1996)

→ insurance produces a price distortion so that the individuals do not face all the consequences of their actions.

- Prediction: *the higher WC benefits the more often workers will claim and the longer workers will stay off work*

→ social **inefficiency** because of lost production and adjustment costs

Moral Hazard Beliefs Support:

- Mistrust of injured workers: “fraud and malingering”
- Along with “race to the bottom,” main justification for
  - Barriers to compensation
  - Low benefits
- Result: Continual decline of WC benefits as share of payroll (NASI, 2015)

Usage going forward (following Morantz)

- "**Reporting effect**" instead of "claims reporting moral hazard"
- "**Duration effect**" instead of "claims duration moral hazard"

Our Focus:

Work-Leisure Tradeoff vs. Liquidity Constraint?

- Economists' discussion:
  - Adequacy vs. inefficiency caused by reporting and duration effects (Butler and Worrall 1991, Dionne and St-Michael 1991)
- Alison's remark (p.36):
  - "*workers' incentives…may be driven less by considered optimization decisions than by responses to short-term exigencies ...to obtain medical treatment and meet basic needs.*"

Are Benefits Reporting and Duration Effects Important?

- **Theory**: Inefficiency because WC benefits induce substitution between work and *unproductive* leisure: but is time to heal equal to leisure? Or is it investment in health?
  - Health problems if RTW too soon (McEachen et al. 2007)

Reporting Effects: Empirical Evidence

- Effect on REPORTING behavior overstated:
  - Recent findings show little if any reporting effects since the 1990. Instead:
    - Employers' claim management practices and experience ratings are stronger predictors (Guo and Burton 2010; Thomason and Pozzebon 2002)
    - Pre injury earnings level plays a large role (Bronchetti and McInerney 2011)
  - Workers face disincentives to report (***fear effect***)

Duration Effects: Empirical Evidence

- Effect on DURATION overstated:
  - Role of unobserved differences across workers as socio ec. characteristics, pre injury employment history (Butler et al. 2001)

  - International evidence where 100% replacement rate does not lead to longer time off work than in US (Galizzi et al. 2016)

  - Workers may be starved back to work (***liquidity effect***)
    - Evidence: injuries ⟶ large reduction in **consumption** (Galizzi and Zagorsky 2009, Bronchetti 2011)

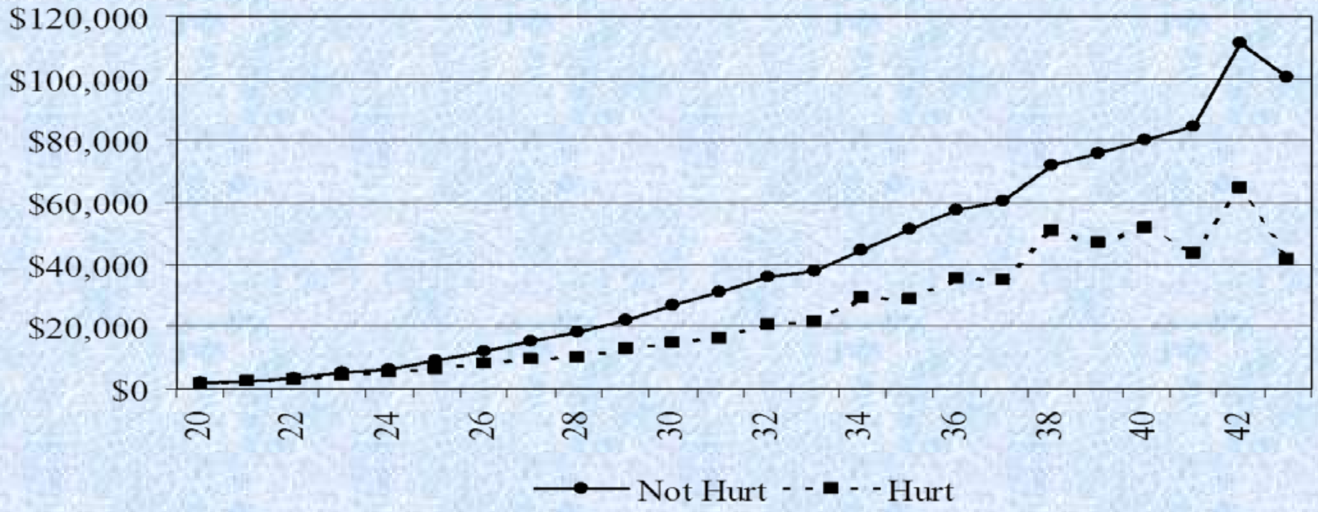
Could Liquidity EFFECT be the Other Explanation?

- WC insurance buffers the impact of earnings losses
- Economic models assume that workers can borrow or use savings

Could Liquidity EFFECT be the Most Important Explanation?

- But many injured workers have low income and savings and face difficulty borrowing

Pre-injury median net worth



Age

(Galizzi and Zagorsky, 2009)

- Not taking extra leisure time because of WC benefits (not “taking advantage” of the system)
- But may be *starved* back to work

- Then higher benefits lead to *longer time off work* because workers with **minimal liquid assets** use benefits to pay the rent, to buy food, and so they can heal
- Empirical evidence:
  - Among UI recipients (Chetty, 2008)
    - Increase in benefits have larger effect on duration for liquidity-constraint households.
    - 60% of the UI duration effect is being “starved back to work”
  - Among WC recipients (Bronchetti, 2012)
    - A 10% increase in benefits offsets drops in consumption by 3-5%
    - With low benefits, consumption drops by 30%

Evidence on economic hardship beyond income losses

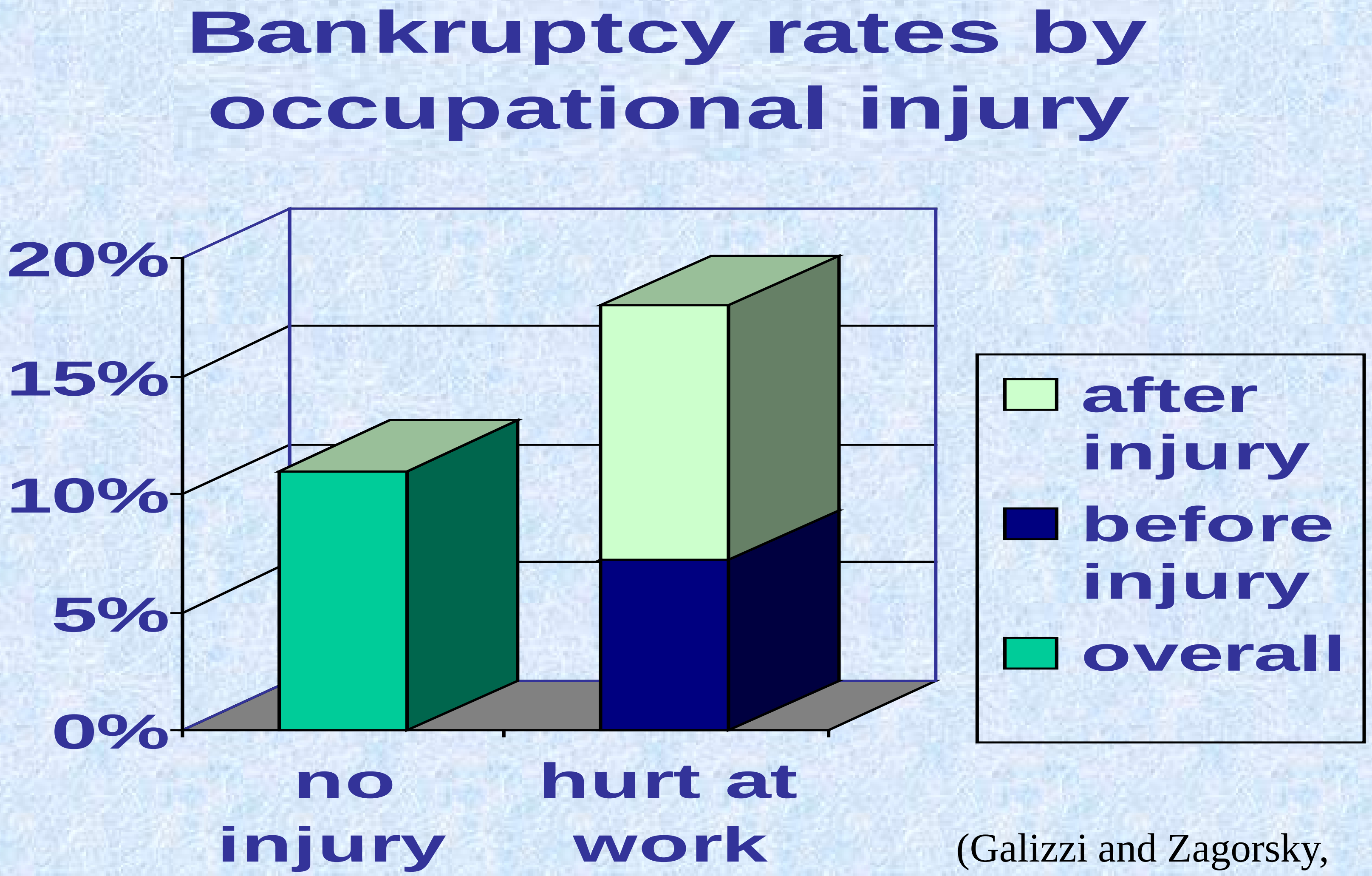
- 1/3 of workers borrowed money and was contacted by collection agencies (Keogh et al. 2000)

- Workers lost their cars and homes (Morse et al. 1998)

- Workers experience substantial drop in net worth and household consumption (Galizzi and Zagorsky 2009)

- Qualitative evidence (Sullivan et al. 2000)

- Effect on Personal Bankruptcy



(Galizzi and Zagorsky, preliminary results)

Final Thoughts

- Strong evidence that WC is failing to provide adequate insurance to injured workers
- This is a political and social problem that is abetted by misleading economic assumptions
- Workers’ experiences must be studied within the wider set of economic constraints they face
- The race to the bottom is a structural problem leading to inadequate compensation.
- Most effective way to address this would be the threat of federal standards