California’s Workers’ Compensation Reform  
Effects on Return to Work

Key findings:

- Permanently disabled workers in California are returning to work in larger numbers since the 2004 reforms, which included employer incentives to rehire injured workers.
- Benefits to permanently disabled workers have declined by 26 percent since the reforms.
- Greater rates of return to work have helped offset declines in the long-term earnings of injured workers, which would have been 15 percent worse if employment rates had not increased.

In the early 2000s, California’s workers’ compensation system had the highest costs of any state in the country. Despite its expense, however, the system had poor outcomes for disabled workers, who had more uncompensated losses after an injury than workers in other states. One reason for these outcomes was that workers with permanent partial disabilities, who account for the highest costs to the system, were not returning to work at the same rate as they did in other states. Returning to the same employer after an injury leads to greater long-term earnings for the disabled, as well as reduced insurance premiums for employers.

In 2004, California passed Senate Bill 899 (SB 899), which introduced sweeping reforms to the workers’ compensation system designed to reduce employer costs and simultaneously improve outcomes for injured workers. It overhauled the permanent-disability rating system, reduced parties’ ability to “shop” for physicians, reformed medical treatment, and stimulated return to work by introducing a two-tier dis-

ability benefit scheme: Benefits would decrease by 15 percent when the original employer offered to rehire the disabled worker, and benefits would increase by 15 percent when it did not.

A RAND study, requested by the California Commission on Health, Safety and Workers’ Compensation, was the first to examine the effects of these reforms on rates of return to work among those with permanent partial disabilities. The study posed three research questions:

- Did return to work improve after the reforms?
- How have the reforms affected long-term earning losses?
- To what extent does return to work offset earning losses?

More Injured Workers Are Going Back to Work

Using methods developed in past RAND research, the authors matched injured workers to uninjured “control” workers to estimate the impact of a disabling injury on postinjury employment outcomes. The matching procedure eliminates the impact of economic trends and other confounding factors, isolating the causal impact of the disability on employment. The study applied these techniques to administrative data on workers’ compensation claims and earnings for injuries occurring between 2000 and 2007.

Figure 1 summarizes some of the key findings on return to work. The figure reports the relative employment ratio—the average likelihood that an injured worker is working compared with the average likelihood that a control worker is working—two years after the date of injury, by the quarter in which the injury occurred.1

1 The relative employment ratio for a worker injured in the first quarter of 2000, for example, is the likelihood that that worker is working relative to the likelihood that the control worker is working in the first quarter of 2002.
The figure shows an upward trend in return to work at the original employers two years after workers were injured, compared with the uninjured workers used as the control. The change is particularly dramatic for the most—seriously injured workers, identified as those with the highest medical costs. For example, workers who were severely injured in 2005 and 2006 were back to work within two years 60 percent of the time. That figure was just 50 percent five years earlier.

It is difficult to attribute this trend entirely to the reforms. As the figure shows, the trend toward improved rates of return to work appeared to begin before the 2004 reforms. There are several reasons that this trend began earlier, including changes to medical treatment in workers’ compensation or employers’ own initiatives to minimize rising costs by making greater efforts to reemploy workers injured on the job.

**Benefits Have Declined Sharply for the Permanently Disabled**

The changes to the disability rating system implemented by SB 899, particularly the adoption of the American Medical Association *Guides to the Evaluation of Permanent Impairment* (AMA Guides) as the basis for ratings, had a substantial impact on disability benefits for permanently disabled workers. Permanent-disability benefits in California are tied directly to the level of the disability rating, a numerical value assigned to represent the severity of disability. Ratings based on the AMA Guides were mechanically lower than those in the old California system, and adopting the AMA Guides without adjusting for the differences in levels led to sharp declines in permanent-disability benefits.

Figure 2 illustrates the effects that these reforms had on benefit levels. The two lines show the change in temporary- and permanent-disability benefits relative to their value as of the year 2000 for injuries incurred in any specific quarter. For example, a 90 in a given quarter indicates a 10-percent decline in benefits from the first quarter of 2000. Permanent-disability benefits remained fairly constant until about 2004, then fell sharply to about two-thirds of the baseline level by 2006.

**Long-Term Earnings Declined, but Gains in Return to Work Helped Offset Those Losses**

To evaluate the impact that declines in disability benefits had on injured and disabled workers, the research team compared the disability benefits to earning losses. The replacement rate of lost income is the fraction of earning loss that is replaced by workers’ compensation benefits. A key limitation of the data, however, is that there are few postinjury earning data for the later injuries in the sample: For workers injured in 2006, for example, there are just two years of postinjury losses to examine. To make up for this limitation, researchers used a statistical model to forecast the five-year earning losses to injured workers. This approach also allowed them to quantify how much of an effect the return-to-work gains had on earning losses.

The trend since 2000, as shown in Figure 3, is that permanently disabled workers experienced a dramatic drop in replacement rates after the 2004 reforms. In other words, their benefits replaced a much smaller proportion of their lost earnings. The split in the line shows the difference that improved return to work made in that trend. The top line shows actual replacement rates that include the effect of improved return-to-work rates shown in Figure 1: By 2006,
replacement accounted for just 37 percent of lost earnings, compared with about 50 percent in 2000—a decline of about 26 percent. The lower line shows what replacements would have been if return-to-work rates had not improved, showing a drop of about 6 percentage points. On average, improved return to work made the replacement rates 15 percent higher than they would have been otherwise.

**Policy Implications**
Previous RAND studies have questioned the adequacy of California's permanent-disability benefits, and this study shows that they have become less adequate since the 2004 reforms. The authors recommend a number of ways in which policymakers can bring replacement rates to their prereform levels, including a benefit increase. It is worth noting that employer costs have fallen sharply since the reforms, however, so a benefit increase could sacrifice some of those savings. The authors also make a number of recommendations for improving further on return to work, including efforts to integrate occupational and nonoccupational disability management, which could improve outcomes for injured workers and save costs for employers as well.
This research brief describes work done for the RAND Center for Health and Safety in the Workplace documented in Workers’ Compensation Reform and Return to Work: The California Experience, by Seth A. Seabury, Robert T. Reville, Stephanie Williamson, Christopher F. McLaren, Adam H. Gailey, Elizabeth Wilke, and Frank W. Neuhauser, MG-1035-CHSWC (available at http://www.rand.org/pubs/monographs/MG1035.html), 2011, 136 pp., $38, ISBN: 978-0-8330-5123-3. This research brief was written by Laura Zakaras. The RAND Corporation is a nonprofit institution that helps improve policy and decisionmaking through research and analysis. RAND’s publications do not necessarily reflect the opinions of its research clients and sponsors. RAND® is a registered trademark.
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