Worker’s Compensation Reform Shows the Power of Privatization

As I’m sure you’ve read by now, West Virginia completed the process of privatizing its worker’s compensation system on June 30. When the process began, West Virginia was one of only five states (North Dakota, Ohio, Washington and Wyoming were the others) to provide worker’s compensation insurance exclusively through a state fund. Now, in a move towards capitalism, West Virginia has taken after the rest of the Union—and businesses here are seeing the benefits of markets at work.

The process started during the 2005 Legislative Session with SB 1004, which converted the state run fund to a private mutual company by the name of Brickstreet. Starting on January 1, 2006, Brickstreet was given a state-protected monopoly on offering worker’s compensation insurance to the companies of West Virginia. Now, as of June 30, the state granted protection for Brickstreet has ceased, and any private insurance company is free to compete within West Virginia.

Generally, consumer protection groups like to fight against “monopolies” and the supposedly too-high prices they charge. Without delving into this issue—monopolies and the misconceptions about them are separate topics worthy of their own column—it is generally assumed that fewer companies operating in a marketplace retain a bit more of an advantage in being able to favorable price goods. (In contrast, companies have no pricing power in the textbook example of “perfect competition.”) But consider this: Even with a state-granted monopoly on offering insurance over the last two and a half years, Brickstreet saved West Virginia employers over thirty percent in worker’s compensation costs. Now that the market has opened up, expect companies to not only pay less still, but to be offered with a greater range of products. Paying less is fantastic, but do not undervalue the ability to purchase a more suitable insurance package. As of June 30, 162 private companies have filed with the West Virginia Office of the Insurance commissioner, which will allow them to operate within the state. Of these, 24 are newcomers to the Mountain State.

Comparing the state’s provision of worker’s compensation insurance to Brickstreet’s highlights the superior ability of the private sector to supply goods and services. Both systems had a state-granted protection against competition and operated in the same market, yet the private system provided the same services at a 30 percent discount on the public system. The crucial difference comes in the role of profits.

Brickstreet is responsible for, and gains from, its own actions; in economics terms, we would call them a “residual claimant.” As such, Brickstreet—its owners, shareholders and employees—stands to benefit in direct proportion to how well they provide insurance. Should they provide a quality product that companies value, they will profit; their protection from competition, or monopoly status, is separate from the fact that they still have the incentive to provide the best service possible since they gain from doing so. Profits are often wrongly blamed for a range of society ills, yet they are the sole reason why the cost of worker's compensation insurance to West Virginia businesses fell over the last thirty months.

Now turn to the provision of worker's compensation insurance by the West Virginia state government. When providing goods and services, the government—the people filling the public roles—is rarely the residual claimant. Public servants have less of an incentive to perform their duties as best as possible since they do not stand to benefit from more efficient production, or a more useful project. This is no slight against those serving public roles; instead, it speaks to the outcome of placing otherwise productive individuals in an environment where they do not stand to benefit in proportion to their ability to provide valuable services to society. Further, companies must generate profits or cease operations—sadly, the government can never close up shop due to a lack of profitability.

When I write about different aspects of West Virginia, I usually try to provide a ranking or some sort of metric to place our scenario in relation to the rest of the country. We're generally at the wrong end of the spectrum regardless of the measure, but in looking for a comparison of state worker's compensation systems I encountered a scenario that was a first for me. One group that ranks worker's compensation systems refused to include West Virginia in their rankings; the pre-2006 worker's compensation system was so archaic that it actually couldn't be ranked along with the others.

Last is one thing, but being dropped from the list? Here's to West Virginia joining the rest of country. Let's hope it doesn't stop here.

Matt E. Ryan is the Charles G. Koch Doctoral Fellow at West Virginia University and an associate fellow for the Public Policy Foundation of West Virginia. He is an editor of "Unleashing Capitalism: Why Prosperity Stops at the West Virginia Border and How to Fix It." He can be reached at matt.ryan@mail.wvu.edu.