Yukon *Workers' Compensation Act* Subsection 105.(1) Research Series:

Role and Use of Indexing of Benefits

Commissioned by the Yukon Workers' Compensation Health and Safety Board of Directors in preparation for the 2003 *Workers' Compensation Act* Review

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1.0 Introduction

The Yukon Workers' Compensation Health and Safety Board is responsible for the administration of the *Workers' Compensation Act*. Subsection 105.(1) of the *Workers' Compensation Act* requires that a review of selected concepts embodied in the *Act* be initiated no later than January 1, 2003. The concepts identified for consideration include:

(a) expansion of disability, within the meaning of the Act
(b) the effectiveness and appropriateness of the board administering both the *Workers' Compensation Act* and the *Occupational Health and Safety Act*
(c) the use of deeming
(d) the effect of retirement on entitlement
(e) the role and use of indexing of benefits
(f) the method and limitations on calculating the maximum wage rate
(g) the role and effectiveness of the workers' advocate
(h) the adequacy of the system for spouses

This paper presents the results of the review undertaken by Vector Research in respect of concept (e), the role and use of indexing of benefits.

The main methodology employed in the study was a document review. Since many workers' compensation research issues are decades old, research efforts included the review of selected reports prepared by task forces and review committees in other jurisdictions over the last 20 years. The review of those reports was undertaken during a November 2002 visit to the British Columbia Workers' Compensation Library.

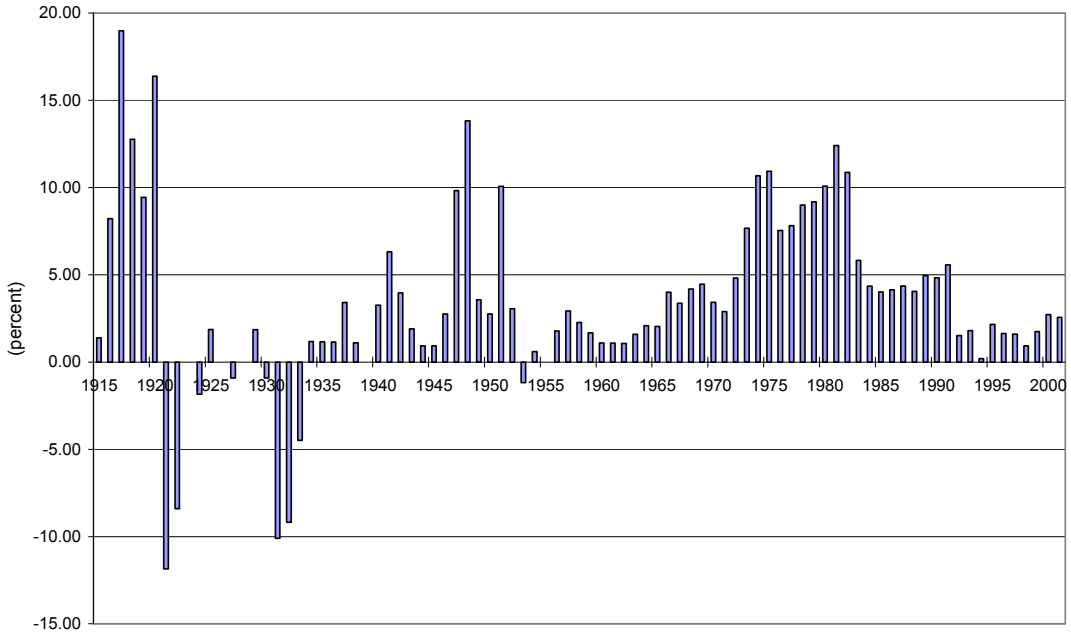
The analysis contained in this paper is fundamentally from a public finance perspective; the absence of discussion about the psychological and sociological impacts of worker injury and disability is not intended to diminish the importance of those impacts to workers, employers and their families.

The remainder of this research paper consists of four sections. The next section (2.0) looks at some of the theoretical aspects of price inflation and indexing. Section 3.0 describes the current and past approaches to the indexing of workers' compensation benefits in the Yukon. Section 4.0 contains a discussion of indexing from an interjurisdictional point of view and section 5.0 identifies some key issues thought to warrant further discussion by the Board.

2.0 Price Inflation and Indexing

While the founding principles of workers' compensation in Canada date back 90 years, debate around the issue of price inflation is much more recent. As Chart 1 demonstrates, sustained levels of high inflation were not experienced in Canada until the 1970s. Beginning in 1973, the year-over-year change in the consumer price index exceeded five percent for 11 years running and remained above 4 percent for another eight years. The public policy response to sustained levels of inflation was to begin to apply indexing measures to workers' compensation payments. Before proceeding to examine how indexing workers' compensation benefits has been approached in the Yukon, it would perhaps be useful to look briefly at how inflation affects workers' compensation payments.

Chart 1: Annual Change in the Consumer Price Index (Price Inflation) for Canada 1915 to 2001 All Items, 1992=100



Source: Statistics Canada Cansim Table 326-0002

One of the residual impacts of the inflationary environment of the 1970s and 1980s was a general belief among individuals that inflation is inherently "bad" or "harmful". Economic practitioners now generally agree that price inflation is, on balance, neither good nor bad. It is true that an increase in price inflation, as measured by the increase in a price index from period to another, means that individuals face higher prices. On the surface, higher prices would suggest that individuals have become worse off as result of lost purchasing power. A reduction in purchasing power means that more dollars are needed to purchase the same volume and quality of goods and services. Note, however, that while the purchase cost of the goods and services consumed by some individuals has increased, the individuals on the other side of those transactions

are receiving more revenue from the sale of their goods and services. To the extent that individuals who are buying goods and services at higher prices are also receiving more for the sale of their own services in the form of higher wages and salaries, no one is any better or worse off. Thus, current economic theory suggests that inflation is not necessarily bad or harmful.

A caveat is in order here. The "no-one worse or better off" line of reasoning is based on an assumption of averages. A more accurate way of stating the inflation-is-a-wash argument would be to say that as long as wages and salaries increase at the same rate as prices then, on average, no one is worse or better off as a result of price inflation. Unfortunately, in the real world, not everyone fits the average.

Specifically, individuals who do not fit the average include those who are no longer active in a labour market where the price of labour (wages and salaries) can adjust to changes in the general economy. In the absence of a mechanism to adjust their incomes individuals living on fixed incomes face a genuine erosion in their purchasing power as the cost of living increases. The longer the duration of price increases the more acute the loss of purchasing power.

Another way to describe the effect of inflation on fixed-income individuals is in terms of the distribution of wealth. As already noted, inflation erodes the purchasing power of individuals whose incomes do not adjust with price-level increases. The erosion of purchasing power results in a redistribution of wealth from those on fixed incomes to those who receive higher revenues as a consequence of higher prices.

Wage loss benefits paid to Yukon workers are based on a workers' average weekly wage at the time of disability. A disabled worker's wage loss entitlement, or conversely, the compensation fund liability represented by that entitlement, is calculated on a fixed set of assumptions current at the time of disability. If the set of assumptions do not allow for inflation, the worker is in receipt of a fixed income. As described above, individuals living on fixed incomes are exposed to the loss of purchasing power which accompanies price inflation.

The wealth redistribution effect of inflation on workers with fixed incomes is a transaction that occurs outside of the trio of workers' compensation equation described in Part A of this paper. While it is true that a very small amount of the redistributed wealth may be received by employers who sell goods and services to workers on fixed incomes, the bulk of the redistributed wealth is spread throughout the national and international economies. In other words, the redistribution of wealth is not necessarily between workers and employers within the same jurisdiction.

3.0 Indexing in the Yukon Context[1]

Since 1983, three approaches to the indexing of wage loss benefits have been used in the Yukon.[2] The three approaches are described in this section of the paper.

3.1 Yukon *Workers' Compensation Act* (1983)

The formula used to calculate wage loss benefits under the 1983 version of the Yukon *Workers' Compensation Act* was similar in structure to the formula in place under the current legislation. Workers' compensation benefits were calculated as 75% of a worker's weekly loss of earnings from all employment. A workers weekly loss of earnings was the difference between average weekly earnings before injury and what the worker could earn in a suitable occupation after the injury arose, as determined by the Board.[3]

Under section 47 of the 1983 Act, all workers had their wage loss benefit entitlements reviewed on an annual basis. A worker's average weekly earnings before injury were varied by the rate of inflation during a previous 12 month period.[4] The rate of inflation was derived from the year over year percentage change in the consumer price index established each year by Statistics Canada. The increase in wage loss benefits was limited by the maximum wage rate in effect at the time of the review.

By way of example, consider worker A who was injured in 1986 and had average weekly earnings of $400. If, after a period of time, worker A returned to work and had post-injury average weekly earnings of $200, then their weekly wage loss benefit would be $150.[5] If after a year, the worker continued to receive wage loss benefits, their average weekly earnings before injury would be adjusted according to the rate of inflation in the reference year. If the rate of inflation during the reference year was, say, 5 percent, the workers average weekly earnings before injury ($400) would be

[1] In addition to indexing wage loss benefits to counter the effects of price inflation, the YWCHSB also adjusts, or indexes, other benefit payments, such as pensions for spouses and children of fatally injured workers and clothing allowances. The focus of this paper, however, is the indexing of wage loss benefits as contemplated in section 34 of the *Workers' Compensation Act* (1992).

[2] The phrase "wage loss benefits" refers to the same concept described by the phrase "loss of earnings benefits" used in the Yukon *Workers' Compensation Act.* Both phrases are used interchangeably in this paper and throughout the Subsection 105.(1) Research Series.

[3] Note that while the structure of the formula was the same, the definition of average weekly earnings used during the 1983 to 1992 period differs from the definition currently in use. Also, under provisions of the 1983 version of the Yukon *Workers' Compensation Act,* eligibility for compensation required that a worker suffer an injury while the 1993 version of the *Act* requires that a worker suffer a disability.

[4] Under the 1983 Act, the Board could choose when the 12 month reference period started and stopped. For example, the year could run from January to December or from July to June.

[5] Calculated as 0.75 x (400 - 200).

increased by 5 percent to $420. The worker's weekly wage loss after the cost of living adjustment would then be $165, or $15 more per week than without the adjustment.

Note that the increase of $15 assumes that the worker's average weekly earnings after the injury of $200 remain the same. If the worker's post-injury earnings increase in response to increased inflation then the worker will receive less than a $15 per week increase in the form of wage loss benefits. In such a situation, the worker's purchasing power is still fully protected but the cost of that protection is shared between the compensation fund and the labour market. In a situation where a worker's injury resulted in 100 percent impairment the cost of inflation protection would be borne entirely by the compensation fund.

Price inflation has a spatial dimension. This means that changes in price level can vary among different geographic locations at the same point in time. Variations in price inflation between geographic locations are the result of variations in the demand for goods and services between different cities and regions.

For example, the announcement of a new mine in the Whitehorse area would likely result in people moving to Whitehorse to take jobs at the new mine. The additional people would purchase accommodation and food in the new location causing an increase in demand for those items which would in turn result in price inflation in the near term. As the supply of accommodation and food was increased in response to the new demand the pressure on prices would level off. Note that all people living in the Whitehorse area would face higher prices and not just the recently-arrived.

As a result, adjustments for increases in the cost of living tend to be calculated using a price index specific to the geographic area which corresponds to where a worker was injured or disabled. Thus, the consumer price index for Nova Scotia is not used to make cost-of-living adjustments for wage loss benefits in British Columbia. A compromise solution to matching a price index with a particular location is to use an index which covers all regions such as the consumer price index for Canada.

It is not immediately obvious from the 1983 Yukon *Workers' Compensation Act* just which price index was intended to be used for adjusting Yukon wage loss benefits. Section 47 of the Act simply refers to "the average annual consumer price index established each year by Statistics Canada". In practice, the Consumer Price Index for Canada has been used.

Before 1982 a price index specific to the Yukon could not have been used to make cost of living adjustments because prior to that time Statistics Canada did not calculate any price indexes for the northern territories. It was not until March 1982 that the first price index was calculated for a location north of 60^0 when consumer price surveys were carried out in Whitehorse and Yellowknife. Residents of the territories outside Whitehorse and Yellowknife have never been represented by the

consumer price index. Because a price index which uses the Yukon as its geographic base remains unavailable to this day, the consumer price index for Canada has been used for cost of living adjustments related to injuries incurred during the 1983 to 1992 period.

The technical notes which accompany Statistics Canada's monthly Consumer Price Index publication simply state that northern residents living outside of Whitehorse and Yellowknife are excluded "for practical reasons".[6] Presumably, those practical reasons include the sparsity of the population base outside of those two cities. No mention is made in the Statistics Canada publication of a consumer price index for Iqualuit, the capital city of Nunavut.

Even by limiting the geographic base of the consumer price index to the cities of Whitehorse and Yellowknife, the calculation of the index in the north is not without its difficulties. The technical notes also indicate that because of the relatively small size of the housing market in Whitehorse and Yellowknife it is difficult to construct reliable price indexes for new houses. While proxy information is utilized to the extent possible, Statistics Canada advises that the all-items indexes published for these two cities are not strictly comparable with the same indexes calculated for the provinces or cities.[7]

As a brief aside, it is worth noting that while the intent of inflation indexing is to ensure that individuals on fixed incomes can maintain a stable standard of living the use of the consumer price index to make adjustments is an approximation at best. The consumer price index is not a true cost-of-living index since it does not attempt to measure changes in expenditures necessary for consumers to maintain a constant standard of living. When prices change consumers switch between products which provide similar levels of satisfaction.

For example, if an individual gets the same satisfaction from eating butter or margarine they will eat less butter and more margarine in response to a price increase for butter. Because the basket of goods and services for which price changes are recorded is fixed (i.e., substitutions are not allowed) the consumer price index reflects only changes in prices and not the standard of living. To compute a cost-of-living index for an individual would require complete information about that person's taste and spending habits. The cost of building a cost-of-living index which represents taste and spending habits of the population at large would likely not be worth the effort. As a result, Statistics Canada publishes price indexes based on the fixed-basket concept rather than the cost-of-living concept.

[6] Statistics Canada, *The Consumer Price Index, October 2002,* Cat. No. 62-001, page 49.
[7] Statistics Canada, *The Consumer Price Index, October 2002,* Cat. No. 62-001, page 51.

3.2 Yukon *Workers' Compensation Act* Amendment (1990)

An amendment made to the Yukon *Workers' Compensation Act* in May 1990 significantly altered the way cost of living adjustments were applied to wage loss benefits. Prior to that time, cost of living adjustments were made by increasing a worker's pre-injury average weekly earnings by the rate of inflation during a previous 12 month period. Under the provisions of the 1990 amendment, a workers' pre-injury average weekly loss of earnings was to be adjusted by the sum of two percentages.

The first percentage was set equal to two percent and represented the annual increase due to the worker from "promotion and advancement which the worker might reasonably be expected to have received but for the accident or injury."[8]

The second percentage used was to be the greater of:

> "a) the percentage change in the average annual industrial aggregate weekly earnings for Canada, excluding overtime, between in the two most recent calendar years;[9] and
>
> b) the percentage change in the consumer price index for Canada between in the two most recent calendar years." [10]

Given that the rate of inflation was likely to be above zero percent, workers' were effectively guaranteed a two percent increase in their pre-injury earnings as a result of the 1990 amendment. On top of the two percent increase, workers' could also benefit from increases in average wages or price inflation, whichever was greater at the time the a cost of living adjustment was made. An additional benefit of the 1990 provisions, which has become obvious only after the indexing methodology was again altered in 1992, was that by having price inflation in the mix, workers' were also protected from declines in average weekly earnings.

Consider worker B who was injured in 1991 and had average weekly earnings of $500. If, after a period of time, worker B returned to work and had post-injury average weekly earnings of $350, then their weekly wage loss benefit would be $112.50.[11] If after a year, the worker continued to receive wage loss benefits, their average weekly earnings before injury would be adjusted according to the sum of two percent and the greater of the change in average weekly earnings and the rate of

[8] S.Y. 1989-90, chapter 33. *An Act to Amend the Workers' Compensation Act (No. 2).*
[9] This percentage is not to be confused with the "quotient" described in Table 3 in the maximum wage rate paper which compares the average wage in a given year against the average wage in 1993. The annual change in the average wage calculation is akin to the year-over-year percentage change in consumer price index calculation used to derive the rate of inflation.
[10] S.Y. 1989-90, chapter 33. *An Act to Amend the Workers' Compensation Act (No. 2).*
[11] Calculated as 0.75 x (500 - 350).

inflation in the previous two calendar years. If average weekly earnings for Canada had increased by 4 percent and inflation had increased by 3 percent then the workers' pre-injury average weekly earnings would be adjusted by 6 percent (or, $30)[12] to $530. If worker B's average weekly earnings after the injury remain the same at $350, then the wage loss benefit would be increased by $22.50 to $135.00.

3.3 Yukon *Workers' Compensation Act* (1992)

The 1992 recasting of the Yukon *Workers' Compensation Act* preserved the intent of the 1983 version of the Act in that it continued to provide for cost of living adjustments to wage loss benefits. Changes were made, however, to the mechanics of the cost of living adjustment calculation introduced in 1990. As before, a worker's pre-disability average weekly loss of earnings were to be adjusted by the sum of two percentages. The first percentage remained the same as in the 1990 amendment, namely, two percent. And, as before, the two percent increase was said to represent the annual increase due to the worker from "promotion and advancement which the worker might reasonably be expected to have received but for the work-related disability."[13]

The calculation of the second percentage was altered. Instead of adding the greater of the change in average weekly earnings and price inflation, the second percentage was now specified as "the percentage change between the average wage for the year and for the immediately preceding year."[14] Taken together with a change in the definition of "average wage for the year" made when the Act was recast in 1992, the second percentage now consisted solely of the annual change in Yukon average weekly wages between in the two most recent years ending on June 30. Price inflation was no longer considered in the calculation. In addition, the average wage calculation was now to be made using a Yukon measure of average weekly earnings instead of a measure based on average weekly earning across Canada.

The 1992 changes to the Yukon's compensation legislation in respect of cost of living adjustments for wage loss benefits produced a curious result. Neither of the two percentages which are to be summed and applied to pre-disability average weekly earnings in order to adjust for increases in the cost of living actually make reference to the consumer price index.

Consider worker C who was disabled in 1995 and had average weekly earnings of $600. If, after a period of time, worker C returned to work and had post-disability average weekly earnings of $400, then their weekly wage loss benefit would be $150.[15] If after a year, the worker continued to receive wage loss benefits, their average weekly earnings before disability would be adjusted according to the sum of the two

[12] Calculated as 500 x 0.06.
[13] Paragraph 34.(1)(a) *Workers' Compensation Act,* S.Y. 1992 (February 2000 office consolidation).
[14] Paragraph 34.(1)(a) *Workers' Compensation Act,* S.Y. 1992 (February 2000 office consolidation).
[15] Calculated as 0.75 x (600 - 300).

indexing factors. With an average Yukon wage of $36,516 in 1995 and $36,127 in 1996 the percentage change in the average wage between the two periods works out to -1.06 percent.[16] The sum of the two indexing factors is 0.94 percent. If worker C's average weekly earnings after the disability remain the same at $400, then the wage loss benefit would be increased by $5.64 to $154.23.

The example above was calculated using actual average weekly wage figures for 1995 and 1996. The result demonstrates the downside risk of using an average wage measure as a proxy for price inflation in a jurisdiction such as the Yukon which is prone to large swings in economic output. Since average wage levels tend to be correlated with economic output average wage levels can fall as well as rise. As can be seen from Table 1 below, another feature of an adjustment mechanism which uses Yukon average wages is that the size of the year-to year-change in average wages can be relatively large.

Table 1: Annual Change in the Yukon Average Wage[a]

Reference Period	Year	Average Wage ($)	Annual Change	Annual Change + 2%
July 1991 to June 1992	1993	34,964		
July 1992 to June 1993	1994	36,145	3.38	5.38
July 1993 to June 1994	1995	36,516	1.03	3.03
July 1994 to June 1995	1996	36,127	-1.06	0.94
July 1995 to June 1996	1997	35,860	-0.74	1.26
July 1996 to June 1997	1998	37,212	3.77	5.77
July 1997 to June 1998	1999	37,332	0.32	2.32
July 1998 to June 1999	2000	36,118	-3.25	0.00[b]
July 1999 to June 2000	2001	37,464	3.73	5.73
July 2000 to June 2001	2002	37,806	0.91	2.91
July 2001 to June 2002	2003	38,558	1.99	3.99

Source: Statistics Canada Cansim Table 281-0026 (Industrial Aggregate excluding overtime)
Notes: [a] The average wage figures above were calculated using Statistics Canada data which were revised in 2001 in order to conform with the North American Industrial Classification System (NAICS). As result, the average wage figures and quotients may differ from those actually used by the YWCHSB which were based on the Standard Industrial Classification (SIC).
[b] YWCHSB practice has been to limit decreases in the year-to-year change in the Yukon average wage to -2.0%.

4.0 Interjurisdictional Comparisons: Indexing of Benefits

As demonstrated in Table 2, a variety of approaches to making cost of living adjustments to compensation benefits are used in jurisdictions across Canada. With the exception of the Northwest Territories/Nunavut and the Yukon all jurisdictions use some variation of the consumer price index (CPI) to make automatic adjustments to benefit levels on an annual basis.

[16] Calculated as ((36,516 - 36,127)/36,127) x 100.

The Workers' Compensation Board of the NWT and Nunavut undertakes an annual review of compensation payments. Recommendations are made to the responsible Ministers who are not bound to accept the recommendations. The two approaches used in the Yukon since 1983 were described in detail in section 3.0. The Yukon's use of an adjustment for forgone promotion and advancement opportunities is notable in that it appears to be the only jurisdiction which does so.

Several jurisdictions use the full amount of the annual percentage change in the consumer price index to adjust compensation benefit levels. They include Manitoba, New Brunswick, Newfoundland, Quebec and Saskatchewan. Ontario also uses the full amount of the annual percentage change in CPI but only for individuals who a) are 100% disabled, b) have suffered 100% future economic loss, and c) are survivors to workers who suffered fatal injuries. In Manitoba, annual adjustments are limited to six percent.

Table 2: Interjurisdictional Comparison of Wage Loss Benefits Indexation

	Cost of Living Adjustment	Geographic Base for CPI	Timing of Adjustment
Alberta	Annual change in CPI less 0.5%.	Alberta	annual
British Columbia	Annual change in CPI less 1% (4% cap).	Canada	annual
Manitoba	Ratio resulting from dividing the CPI for June in the previous year by the CPI for June in the year before that (capped at 1.06)	Manitoba	
New Brunswick	Full annual change in CPI.	Canada	annual
Newfoundland	Full annual change in CPI.	Canada	annual
NWT/Nunavut	ad hoc	n/a	annual review
Nova Scotia	One half of annual change in CPI.	Nova Scotia	
Ontario	Full amount of annual change in CPI for workers with 100% disability, 100% future economic loss and survivors. One half of annual change in CPI for all others.	Canada	annual
Prince Edward Island	Lesser of 75% of annual change in CPI or 4%.	Charlottetown/ Summerside	annual
Quebec	Ratio of current year CPI to previous year's CPI.	Canada	annual
Saskatchewan	Full annual change in CPI.	Saskatoon/Regina	annual
Yukon	Pre-disability earnings x (1 + (2% + (average wage for year/average wage for previous year).	n/a	annual

Sources:
(1) *Comparison of Workers' Compensation Legislation in Canada 2002,* Association of Workers' Compensation Boards of Canada, 2002.
(2) *Core Services Review of the Workers' Compensation Board,* report prepared for the Government of British Columbia by Alan Winter, March 2002.
(3) Workers' compensation legislation in various jurisdictions.

Jurisdictions which use less than the full amount of the annual percentage change in the consumer price index include Alberta, British Columbia, Nova Scotia and Prince Edward Island. In addition to using less than the full amount of the annual

percentage change in the consumer price index British Columbia and Prince Edward Island also specify caps on their annual increases.

In terms of the geographic base for the consumer price index used in the adjusting calculations, one half of provincial jurisdictions use the CPI for Canada. Those jurisdictions include British Columbia, New Brunswick, Newfoundland, Ontario and Quebec. Alberta, Manitoba and Nova Scotia use the province-specific consumer price index calculated for each of their jurisdictions. Two jurisdictions use consumer price indices specific to city-pairs located within their borders. Saskatchewan uses an average of the CPI for Saskatoon and Regina while Prince Edward Island uses an average of the CPI for Charlottetown and Summerside.

5.0 Issue Identification: Indexing of Benefits

Between January 1, 1983 and May 13, 1990 wage loss benefits paid by the Yukon Workers' Compensation Board were adjusted for cost of living increases using the full amount of the annual percentage change in the consumer price index. In 1990, the YWCHSB began using an approach which is unique in Canada. Cost of living adjustments in the Yukon began to be made using a combination of two distinct concepts: a) lost promotion/advancement opportunities and b) changes in the cost of living as approximated by changes in average wages in Canada and price inflation. The cost of living adjustment approach introduced in 1990 was modified in 1993 with a switch to a Yukon measure for average wages and the removal of price inflation from the adjustment equation.

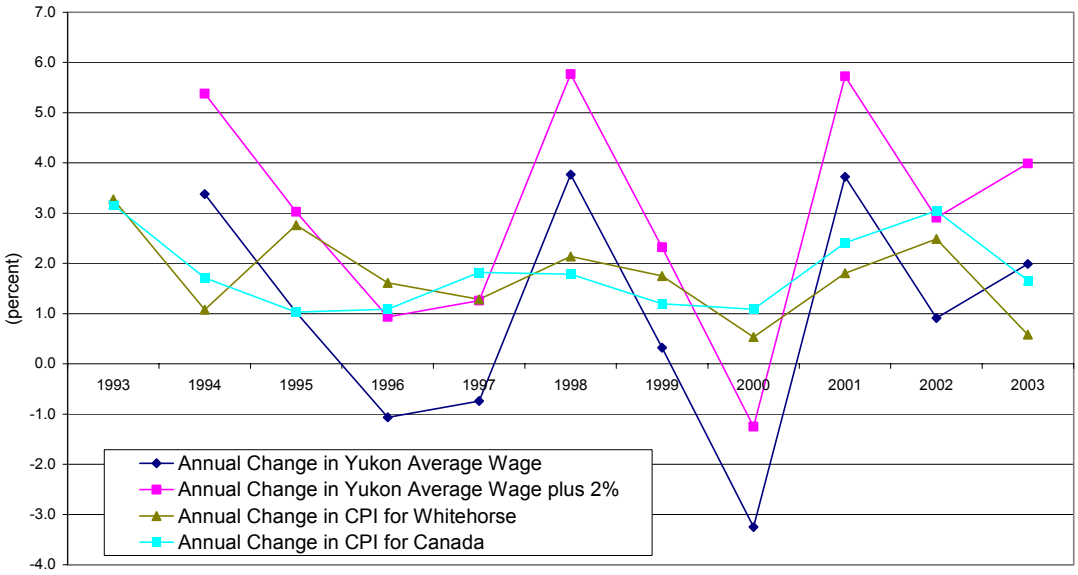
With one exception, the policy response to the negative impact of price inflation on the purchasing power of disabled workers by workers' compensation authorities across Canada has been the same. Compensation benefits are indexed to some measure of price inflation such as the consumer price index (CPI). The exception to this is in the Yukon where compensation benefits are indexed according to a pair of factors which do not make direct reference to price inflation.

Chart 2 below has been assembled in order to allow readers to assess whether the Yukon's current indexing approach has resulted in a reasonably accurate proxy for changes in the cost of living in the Yukon. As can be seen from the chart, annual changes in the Yukon's average wage have been highly variable over the 1993 to 2003 period. The high degree of variability in the Yukon's average wage has contributed to wage loss benefit cost of living adjustments as high as 5.8 percent and as low as 0.0 percent. A steep drop in average wages in the 2000 reference year would have resulted in a rollback of wage loss benefits if not for the Board practice of implementing only positive adjustments to wage loss benefits.

In comparison, the two CPI-based approaches to adjusting for increase in the cost of living have been much more stable over the same period. Using the same reference

period definition as specified for the calculation of annual changes in the average wage, the annual change in the CPI for Whitehorse during the 1993 to 2003 period ranges from a low of 0.5 percent to a high of 3.3 percent. The annual change in the CPI for Canada exhibited similar stability over the same period ranging from a low of 1.0 percent to a high of 3.2 percent.

Chart 2: Comparison of Cost of Living Adjustment Methodologies
1993 to 2003



Sources: Statistics Canada Cansim Tables 281-0026, 326-0001 and 326-0002.
Note: reference periods for all series have been adjusted to match the current Yukon *Workers' Compensation Act* definition.

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