Growth Gusher: As Labor Markets Recover, Will Workers Compensation Take the Lead?

By Robert P. Hartwig, PhD, CPCU
President and Economist
Insurance Information Institute

And although that good news/bad news scenario has indeed come to pass, there is—on balance—more good news to report than bad. That bodes well for workers compensation insurers in 2013 and beyond.

JOB-S: No Longer a Four-Letter Word

Last year marked the third consecutive full year of uninterrupted monthly gains in private sector employment. In all likelihood, 2013 will be the fourth. In the 37 months from January 2010 through January 2013, the US economy created 6.1 million jobs. (See Exhibit 1.)

Naysayers will be quick to point out that nearly 9 million jobs were lost during the crisis (3.8 million in 2008 and 5.0 million in 2009), leaving a gap that even today exceeds 2 million jobs. In other words, barely two-thirds of the jobs lost during and immediately after the Great Recession have been recouped. More sobering is the criticism that it will be well into 2014 before employment crawls back to its late-2007 pre-crisis peak if job growth continues at its recent pace.

Fair enough—but considering the minefield of financial and political disasters the economy has had to navigate through over the past four years—including the recent Fiscal Cliff fiasco and brinksmanship over the debt ceiling and federal
spending “sequester”—it is nothing short of a miracle that the economy did not plunge headlong into another recession, destroying a couple million jobs in the process.

But there is a broader point—6.1 million jobs is not a small number, by any stretch of the imagination. When 6.1 million jobs are created, the nation’s psyche changes along with it. People and businesses are spending more. Car and home sales are up as are construction and manufacturing activity. All bode well for workers compensation insurers and the commercial lines’ growth prospects in general.

Meet Ben: Workers Compensation’s New Best Friend

What does Federal Reserve Chairman Ben Bernanke have to do with workers compensation, you ask? He’s never been quoted on the topic of workers compensation (clearly an oversight on his part), never been seen at NCCI’s Annual Issues Symposium (no doubt on his bucket list), and probably has no idea what last year’s combined ratio was (I’m willing to cut him some slack on that one). That said, Chairman Bernanke unquestionably holds in his hands more power to influence the growth rate of the workers compensation line than any insurance company CEO. This is because the Federal Reserve, under his direction in late 2012, adopted a fundamentally new policy position when it comes to helping the US economy emerge from the doldrums. Specifically, the Fed said that it would keep interest rates low until the unemployment rate drops below 6.5%. This was a significant policy shift away from its historical practice or targeting a specific interest rate or rate of inflation—or its most recent practice of stating a certain date through which rates would be held low.

This shift is important to workers compensation insurers because it makes explicit the Fed’s intention to do everything in its power to buoy the labor markets and, in the process, expand employer payrolls. In effect, there is now a direct pipeline from the Fed to the workers compensation line’s payroll exposure base. Thank you, Ben!

The Fed’s policy shift does, however, beg a very fundamental question. How much longer will the US central bank need to keep the pedal to the metal—minting new dollars and expanding its balance sheet—before the unemployment rate finally descends to 6.5%? Exhibit 2 displays optimistic, pessimistic, and consensus unemployment rate forecasts by quarter through the end of 2014. Only under the optimistic forecast does unemployment hit 6.5% by year-end 2014. Under the consensus and pessimistic forecast scenarios, the unemployment rate remains one-half point and one full point, respectively, above the Fed’s unemployment target, suggesting that the Fed’s efforts to juice job growth (and hence payrolls) will continue well into 2015.

An important caveat to this analysis is that Chairman Bernanke’s term expires in January 2014. He is unlikely to stand for a third term, so there is some risk that his (as-of-yet unknown) successor could change course as early as next year.

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Managing the Growth Gusher

The Fed’s veritable guarantee of growth is a gift that should keep on giving for the next few years, but by no means does it guarantee a profit for workers compensation insurers. Underwriting performance in this growth gusher of a line is entirely under the control of insurers (and to some extent state insurance regulators). Exhibit 3 shows that workers compensation insurance has now come full circle in terms of growth—shifting from the fastest contracting of all major property/casualty lines to the fastest expanding in just a few years. At the same time, underwriting performance on an industrywide basis remains unsatisfactory, with combined ratios in the 115-plus range for the past several years. To be sure, some insurers are posting much better results—even turning in underwriting profits in some instances. But for many, that goal remains elusive, and it will be several years before the combination of higher rates and system reforms pull the combined ratio down to a level consistent with today’s ultra-low interest rate environment.

Unemployment: Enormous Differences Persist

There’s no question that workers compensation is on a trajectory to record its strongest growth in nearly a decade. This means that labor markets—and hence wage and salary exposures—are improving from coast to coast. Yet despite more than three years of unbroken private sector job growth, job prospects continue to vary widely from state to state. Exhibit 4 shows the unemployment rate by state as of year-end 2012. At the high end, Nevada and Rhode Island—states that suffered mightily during the Great Recession—still endured double-digit unemployment rates—with joblessness at 10.2%. Populous states like California and New Jersey weren’t faring much better, with unemployment rates of 9.8% and 9.6%, respectively. At the other end of the unemployment spectrum is North Dakota, where unemployment is just 3.2%. The state’s oil and gas boom has led to a near doubling in commercial lines premiums written over the past five years. This would suggest a breakout performance for workers compensation insurers if North Dakota was not one of the few remaining monopolistic fund states. That said, eight other states had unemployment rates below 5.5% as of year-end 2012. It is important to note that all of these states are relatively small, suggesting that top line premium growth for the workers compensation insurance lines could surge as the economies of key large states, including California and Florida, enter a more robust phase of recovery over the next two years.

Engine of Growth

So what might fuel a more robust recovery and push payroll materially higher? Last year in these pages, I discussed the likelihood that employment in the health, energy, and manufacturing sectors were likely good bets to drive growth over the next several years. Indeed, employers in these key industries created hundreds of thousands of jobs in 2012. Yet despite these gains, overall employment and economic growth remained tepid as one of the historically important growth drivers—construction—remained in its deep slumber. That is now beginning to change, with important consequences for workers compensation insurers and commercial insurers in general.

Exhibit 5 displays construction industry employment from January 2003 through January 2013. The impact of the Great Recession and the implosion of the housing bubble led to an eye-popping loss of 2.3 million construction jobs—a net drop of 29.7%. In others words, nearly one-third of all construction jobs in the United States disappeared. The collapse in construction employment began 20 months before the “official” beginning of the recession in December 2007 and lasted 19 months beyond its official end in June 2009.

Since bottoming out in January 2011, the construction sector added 296,000 jobs through January 2013. Though this 5.4% gain in employment may seem trivial in comparison to the losses sustained, there are signs that growth will likely continue through 2013 and may even accelerate. Private sector construction spending in late 2012 was up 15%. Leading the way was residential construction, which was
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up by more than 20%. The combination of job growth, associated payroll growth, and the fact that construction is a high-hazard classification industry suggests that a disproportionately large lift in the top line of workers compensation insurers could be ahead.

**Final Thoughts**

The year ahead will present an array of opportunities and challenges for workers compensation insurers. In 2013, that challenge involves capitalizing on strong growth in premiums and pushing through much needed reforms in a number of states. Taken together, this critical line’s underwriting performance should soon improve.

Robert P. Hartwig, PhD, CPCU, is president of the Insurance Information Institute. Dr. Hartwig previously served as director of economic research and senior economist with NCCI. He has also worked as a senior economist for the Swiss Reinsurance Group and as senior statistician for the US Consumer Product Commission.