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THE FRIVOLOUS CASE FOR TORT LAW CHANGE

Opponents of the legal system exaggerate its costs, ignore its benefits

by Lawrence Chimerine and Ross Eisenbrey

Tort litigation has been blamed for driving liability insurance premiums to excessive levels, reducing real wages and overall employment, undermining corporate profits, dampening productivity growth, discouraging research and development, and generally reducing the willingness of corporations and individuals to take reasonable risks (such as introducing new products) that may benefit themselves and society. There is scant evidence for any of these claims. To the contrary, macroeconomic trends since the early 1990s are especially inconsistent with the argument that supposedly high and rapidly rising tort costs have inflicted serious harm on the economy. Yet the legal system's critics continue to argue that there is a tort liability "crisis" that warrants changing the tort system, and that change is a key element in bolstering economic growth in the future. Yet these critics provide no credible evidence to support their assertions. In fact, what little effect changing the tort system will have on the economy might hurt job creation rather than help it.

A "tort" is "a wrongful act, damage, or injury done willfully, negligently, or in circumstances involving strict liability, but not involving breach of contract, for which a civil suit can be brought."[1] Proponents of changes in the U.S. legal system have tried to associate tort litigation with a host of ills, from driving doctors out of business to closing municipal swimming pools.[2] Increasingly, they argue that the tort system is a drag on the U.S. economy as a whole and, especially, on job creation and retention. President Bush, for example, has made "reducing the lawsuit burden on our economy" a key element of his jobs program. The

White House claims that its version of tort law change will "reinforce economic growth—and translate that growth into jobs for America's workers" (Executive Office of the President 2003).

A key proponent of the view that the tort system has large negative effects on the economy is Tillinghast-Towers Perrin, a company whose clients include most of the world's largest insurance companies. Tillinghast (or TTP) has for many years published a report on what it claims to be the costs of the U.S. tort system. The TTP reports are one-sided. TTP admits that the tort system has benefits (e.g., the peaceful resolution of disputes, deterrence of unsafe products and practices) but does not estimate their magnitude. It even suggests that "compensation for pain and suffering is seen as beneficial to society as a whole." But TTP makes no attempt to measure the benefits of the tort system and offers no insight into whether the tort system's costs outweigh its benefits (TTP 2004, 10).

Any work that relies on these seriously flawed reports is, to that extent, also unreliable. An example of work that is largely dependent on TTP's flawed reports is the *2004 Economic Report of the President*, which is published by the president's three-member Council of Economic Advisors (CEA). In 2004 the CEA devoted nearly 20 pages of its *Economic Report* to the tort system, relying extensively—and mistakenly—on TTP's flawed estimates for its facts.

A careful examination of available data and economic trends reveals the following:

- Half of the "costs" that Tillinghast-Towers Perrin attributes to the tort system are not costs in any real economic sense. They are transfer payments from wrongdoers to victims. As the Congressional Budget Office points out, costs that "merely shift money from injurers to victims…are not true costs to society as a whole." (CBO 2003, 19). (See part I of the discussion below.)

- There is no tort liability crisis. (See part II of the discussion below.)

- The tort system is not the cause of insurance premium increases in recent years. The actual causes are the collapse of the stock market; record low long-term interest rates, which reduced investment income for insurance companies; the recession, which increased claims in some lines of insurance; and high and rising medical costs, which pushed up health insurance premiums. (See part II of the discussion below.)

- No evidence has been presented that the tort system has reduced real wages and caused job loss. The claim that tort costs amount to a 5% "tax" on wages is founded on a gross overestimation of tort costs and extreme and false assumptions about tax shifting and the extent to which tort costs are random and excessive. (See part II of the discussion below.)

- There is no historical correlation between the inflated estimates of the costs of the tort system and corporate profits, product quality, productivity, or research and development (R&D) spending. Evidence suggests that the tort system, without the proposed restrictions, has actually been beneficial to the economy in all these areas. (See part III of the discussion below.)

- There is no basis for the claim that tort law changes now being considered will result in more jobs. Indeed, there is evidence that the significant changes in the tort system that have been proposed would slow job growth. (See part IV of the discussion below.)

This paper examines the major problems with TTP's estimate of tort costs and challenges the assertions on the economic effects of the tort system made by TTP and, in turn, by the Council of Economic Advisers. It finds that CEA has presented no evidence that the tort system can properly be blamed for excessive liability insurance premiums, reduced wages or employment, lower corporate profits or productivity, reduced research and development, or a failure to introduce new products. Most important, it concludes that the tort law changes advocated by the president will not have any substantial positive effect on national employment, research and development, productivity, or job creation.

I. TTP's tort cost estimate is grossly inflated

TTP's most recent report, *U.S. Tort Costs: 2004 Update*, asserts that "The U.S. tort system cost $246 billion in 2003." TTP's estimate of tort costs is grossly inflated and includes costs not attributable to the tort system.

The approach TTP takes to the measurement of tort costs is fundamentally misleading. To arrive at numbers large enough (hundreds of billions of dollars) to scare the public about the size of what it erroneously calls a tort crisis, TTP has to characterize the entire tort insurance system as a cost to the economy. By contrast, TTP's estimate of the actual litigation costs of the system (attorney fees for plaintiffs and defendants' legal defense costs) is less than a third of the total: $82 billion, or 0.7% of gross domestic product.[3] TTP makes it impossible to verify these figures because it claims that its data and methodology are "proprietary."

TTP includes a number of costs that do not belong in an estimate of tort costs: (1) transfer payments made from tortfeasors (those who commit a tort) to victims whether the subject of litigation or not; (2) unverifiable data from TTP's proprietary internal database; and (3) costs not attributable to the tort system (self-insurance costs and deductibles paid by insureds, anticipated increases in asbestos judgments, insurance companies' administrative costs, claims-handling costs, and benefits paid for non-tort losses). These are discussed in more detail below.

A. TTP improperly treats the transfer payments of the tort system as 'tort system costs'

Almost half ($113 billion) of TTP's estimated costs are transfer payments that are not true economic costs.[4] TTP admits that it includes transfer payments—all of the compensation tortfeasors pay to the persons they injure—as tort costs. But transfer payments merely shift money from the injurers or their insurers to the injured. They are not costs to society or the economy. The Congressional Budget Office has recognized that including transfer payments inflates the tort cost estimate:

> The most easily measured "costs" of the liability system are its direct costs—that is, those incurred by plaintiffs, defendants, and their insurance companies in litigating and settling specific claims, as well as the court costs that are ultimately paid by taxpayers. For the purposes of policy analysis, however, that measure of costs is too large in one respect and too small in another. It is too large in that some direct "costs" merely shift money from injurers to victims and thus are not true costs to

> society as a whole. In economic terms, payments that do not involve any use of resources to produce goods or services are called "transfer payments." Those that do involve using resources for production are known as "real resource costs" (also "social costs" or simply "costs"). Specifically, the portion of a settlement or judgment that goes to the plaintiffs is a transfer payment. The portion that goes to the plaintiffs' attorneys, in contrast, is a real cost because it reflects the value of the resources (attorneys' time, office space, equipment, and so on) devoted to that case and thus not available for other uses. (CBO 2003, 19; footnote omitted)

Transfer payments are not created by the tort system or by those who must resort to it for compensation. They are created by those who cause the losses and damage in the first place. Thus, the only way to reduce transfer payments is to prevent the injuries from occurring: the damage has been done, whether the victims are compensated or not. Someone—the wrongdoers, taxpayers (through government-sponsored social programs), other insurers (such as health insurance), charities, or the victim—will need to pay or absorb these costs.

B. TTP's cost data cannot be verified

Much of the remaining $133 billion of TTP's estimate is questionable because it is unverifiable. Although TTP's estimate is widely cited by journalists, politicians, and business lobbyists, it is impossible to know what the company is actually measuring in its calculation of tort costs, and impossible to verify its figures, because TTP will not share its data or its methodology, which it claims are "proprietary." Critics of the company's estimate, including former Texas Insurance Commissioner Robert Hunter, have made a plausible case that TTP's estimates are based chiefly on the premiums written by insurance companies and paid by their insureds— drivers, corporations, doctors, and hospitals.

> To reach the estimate, Tillinghast does not examine jury verdicts, settlements, lawyers' fees or any actual costs of what might generally be considered the legal system. Rather, Tillinghast's numbers are calculated from total liability insurance premiums, primarily as reported by the insurance reporting firm, A.M. Best, as well as Tillinghast's own "internal" sources. Had Tillinghast honestly measured tort system costs, these costs would have been lower, by at least 50 percent, because so much of what the company measures is not even vaguely related to the legal system. (AIR 2004)

Tillinghast admits that it does not measure actual costs, in the sense of money actually paid out by insurance companies to plaintiffs, lawyers, and others (TTP 2004, 7). Rather, it says that it derives its estimates mostly from the "incurred costs" —estimates of known claims and claims not yet reported or filed. Incurred costs are reported to state insurance commissions by insurance companies, and the data are collected by the insurance reporting service, A. M. Best. But with respect to medical malpractice, for instance, whereas A.M. Best reports incurred costs of liability insurers of less than $8 billion in 2003, Tillinghast uses its own "internal database" to reach an estimate more than three times greater: almost $27 billion.

Yet another huge component of TTP's estimate of total tort costs is derived from a third, even less transparent source: the costs of self-insurance, including the costs of deductibles (which insurance companies do not pay). TTP estimates these by using an undisclosed formula that yields a self-insurance figure of $43.6 billion for commercial risks.

The most recent Tillinghast report on tort costs, the *2004 Update*, undermines the firm's own claim that it is measuring incurred costs by stating that, "[i]n 2002 and 2003, the largest single contributor to the rise in tort costs was a significant upward reassessment of liabilities associated with asbestos claims" (TTP 2004, 3). This component of TTP's estimate is even less reliable than incurred costs. Use of this figure allows TTP simply to "reassess" liabilities associated with claims, a method that can lead to enormous swings in estimated costs. As TTP said in its *2003 Update*, "[w]e estimate that this reassessment accounts for $11 billion of the increase in 2002 tort costs over 2001 levels, a sizable increase over the $6 billion estimated impact in 2001." How much, *if any*, of these liabilities were paid in 2002 TTP doesn't say. But a measurement system that generates $11 billion of increased tort costs whenever insurance companies decide to set aside additional reserves (which they invest at a healthy profit) is unacceptable.

The use of speculative incurred costs rather than actual paid costs raises yet another problem with TTP's calculations. If the insurance companies and TTP can reassess liabilities—assuming, for example, that future asbestos litigation and shareholder suits will cost an additional $20 billion—how does TTP assign the various component tort costs, such as attorney fees, claims-handling costs, insurance industry overhead, and economic and non-economic benefits, none of which has occurred? This isn't measurement; it's guessing.

C. TTP includes costs that have nothing to do with the tort system

As noted above, TTP includes three categories in its definition of "tort costs": insured costs, medical malpractice costs, and self-insurance costs. All three categories include the following components:

- insurance company administrative costs;
- claims-handling and legal defense costs; and
- benefits paid or expected to be paid to third parties or their attorneys to compensate for injury or damages.

It is striking that the insurance industry's "administrative expenses" constitute almost 22% of TTP's total tort costs (TTP 2004, 7). These costs—$54 billion in 2003—are vastly above and beyond the actual costs of handling claims or the legal costs of defending them. TTP justifies including the entire $54 billion (which past *Updates* have called "overhead costs")—such as insurance industry executive salaries and advertising costs—in its estimate of tort costs because they "are a real cost," because the insurance industry is not "bloated or inefficient," and because they have grown at a slower rate than other costs (TTP 2004, 7). Yet most of these costs do not belong in an estimate of tort system costs, regardless of how consistently they are measured or even if they are real costs—because they are *insurance* costs, not tort costs.

Insurance industry overhead costs cannot be reduced through tort law changes such as limits on non-economic damages for victims.[5] Insurance industry salaries, for example, would be more likely to rise than to fall if profits rose because of a reduction in payouts for, say, asbestos-related disease. The insurance industry has hundreds of thousands of employees: 600,000 for direct insurers of risks other than health and life, 494,000 for direct property and casualty insurers, and 651,000 in insurance agencies and brokerages. Their salaries and compensation alone exceed $54 billion a year. But it is impossible to analyze how TTP apportions such costs to what it calls the tort system, since its supporting data are secret.

TTP's definition of tort costs also includes billions of dollars of insurance claims and related costs that have nothing to do with the tort system. For example, no one denies that insurance companies should make good on the promises in their insurance contracts to pay the first- or third-party damages of their insureds, but it is misleading to treat these obligations as tort costs. It is even worse to use these obligations as an argument for tort law changes such as limiting awards for punitive or non-economic damages, mandating structured settlements, or restricting jurisdiction (the place where a claim can be litigated). None of these legal alterations would change the cost of paying claims for fender-benders.

The actual costs of resolving tort claims through the legal system are a fraction of the total insurance industry costs TTP has estimated, and the fraction that would be affected by tort law changes affecting punitive damages, non-economic damages, or class action law suits is even smaller. TTP does not estimate the size of the real, incremental costs. If it did, it would be clear that the effect of those costs on the economy would be insignificant. TTP's approach is akin to estimating the cost of the criminal justice system by counting all of the costs of crime, rather than the lesser costs of law enforcement, the judiciary, and the prison system.

II. Tort system critics provide no reliable evidence that there is a tort crisis

TTP cites a number of misleading numbers to support its claim that there is a crisis in the tort system. These include claims that: (1) legal costs and case filings are rising precipitously; (2) tort costs as a percent of gross domestic product are too high; and (3) the tort system causes a diminution of earning power equivalent to a so-called "tort tax" of 5% of wages. In each case, TTP overstates available information to create a false appearance of a crisis when, in fact, no crisis exists.

A. The number of tort cases has declined significantly

Unlike TTP's unverifiable calculation of tort costs, the number of tort cases filed in certain U.S. courts is knowable and verifiable. Despite the nation's constantly growing population, the number of new tort suits has fallen in recent years. The National Center for State Courts (NCSC) tracking system, which closely monitors a sample of 16 states, shows that the absolute number of tort cases filed in those states declined significantly from 1996 to 2000—from 320,976 cases to 260,745. NCSC reports that for a larger group of 35 states, representing 77% of the U.S. population, tort filings declined by 4% over the decade from 1993 to 2002.

The longer-term trends indicate that the number of tort cases filed *per capita* has also been declining. The ratio of tort filings to population declined by 8% over the last quarter century—from 230 per 100,000 residents in 1975 to 212 per 100,000 in 2000. Thus, there is no basis for declaring a litigation crisis.

B. Tort costs as a percent of GDP are not rising

Until recently, tort costs, even using TTP's inflated estimates, have been falling relative to population and to GDP. The year with the highest ratio of tort costs to GDP is 1987, at 2.33%, and the ratio generally declined until 1999, when it reached 1.82% (TTP 2004, 6).

According to TTP's calculations, since 2001, when the economy was hit with a recession and the terrorist attacks of 9-11, tort costs have grown faster than GDP. Nevertheless, even using TTP's inflated estimates, total tort costs have been lower as a percent of GDP in the last decade (2.01%) than they were in the decade before that (2.16%).[6]

TTP's 2003 *Update* claimed that tort costs rose almost 30% from 2000 to 2002 and predicted that the trend would continue. By focusing on a highly anomalous two-year period in which premiums for all types of insurance increased dramatically for reasons unrelated to the tort system, TTP made it appear, contrary to the facts, that the costs of the tort system were exploding and predicted that tort costs as a percent of GDP would reach 2.45% in 2005. The 2004 *Update* abandons that prediction, finding that the rate of increase in tort costs fell to 5.4% in 2003 and projecting that tort costs as a percent of GDP will remain essentially flat.

Why did TTP make such an exaggerated prediction? Any trend analysis that tries to predict the future based on two inflated data points, as TTP's did, is highly suspect. But in 2003, TTP was apparently more concerned with creating the impression of a tort liability crisis than it was in providing a fair analysis.

The years 2001 and 2002 were aberrations for several reasons, and they were particularly poor choices as predictors of future trends. Most importantly, the investment portfolios of insurance companies were devastated by a combination of financial market developments and other factors—all completely unrelated to the tort system—that led to dramatic increases in insurance premiums and non-tort claim payouts by the industry (CBO 2004, 4). First, a variable but sizable portion of premiums is always invested by insurance companies in equities, and the stock market declined after the technology-driven bubble of the late 1990s burst. That collapse was brought about not only by previous overvaluation of technology and Internet stocks, but also by the recession that was developing in the U.S. economy, uncertainty over foreign policy and oil supplies, and a raft of corporate accounting scandals.

Second, and more important for those portfolios that had a larger ratio of bonds and other fixed-income securities than they did equities, long-term interest rates began to decline in early 2000, to levels not seen in decades. The fall in long-term rates, occurring even while the Federal Reserve was raising short-term rates, reflected the disinflation that characterized the U.S. economy, caused largely by more intense domestic and global competition, deregulation of many industries, and the increased role of discount chains. In addition, inflation was being held down by slowing demand as the forces of recession increased.

Insurance premiums are highly, but inversely, related to the insurance industry's investment income. In other words, when the stock market is down, insurance industry premiums tend to be higher, and vice versa. And when interest rates are low, the insurance industry's bond investments perform less well. Both of these conditions lead to increased insurance premiums as companies attempt to offset their investment losses. This is the major reason why premiums jumped sharply in 2001 and 2002. Even the *Wall Street Journal*, no fan of the tort system, acknowledged this relationship. As it said in a lead editorial:

> …tort claims are not the cause of premium increases, and premiums for many types of insurance have peaked. The insurance industry is well-known for price competition and a reverse roller coaster. As recently as 2003, the average commercial policy holder faced premium increases of 20-25 percent, yet the majority of businesses that are due to renew these policies in January 2005 will see decreases. (*Wall Street Journal* 2004)

Premiums were also pushed up in those years by other economic developments, including huge increases in medical costs, which created pressure on health care insurance premiums.

These large premium increases were a deliberate choice by the insurance industry, not an unavoidable consequence of an explosion of new tort cases—which, in fact, did not occur. But because TTP appears to measure "tort costs" by the premiums paid for all insurance coverage rather than through an actual accounting of tort payouts, TTP's 2001-02 cost estimates reflected the industry's own financial decisions rather than explosive, non-existent new costs imposed by tort litigation. Using insurance premiums as a proxy for tort costs guarantees substantial errors in the estimate. For example, if tort filings declined by 20% and payouts fell by 10%, if the insurance industry raised premiums by 15% TTP's estimate of tort costs would inevitably rise by 15%.

C. TTP's 'tort tax' claims are indefensible

Many proponents of legislation to restrict payments to tort plaintiffs cite TTP's unsupported assertion that, "At current levels, U.S. tort costs are equivalent to a 5% tax on wages" (TTP 2003, 1). TTP's calculation of this supposed tax is unsubstantiated, and the very concept of a "tort tax" (which is only a tax in the sense of cost rather than in the sense of a mandatory contribution in support of a government) is fundamentally illegitimate.

Even if the concept of a "tort tax" were valid, TTP's calculation of the "tax" is, in any case, totally erroneous. Even the Bush Administration's Council of Economic Advisors, which relies heavily and mistakenly on TTP's flawed estimates, has not accepted it. In its April 2002 paper, "Who Pays for Tort Liability Claims? An Economic Analysis of the U.S. Tort Liability System," the CEA lays out numerous economic scenarios and assumptions. Only the most extreme assumptions—that TTP's full, vastly inflated estimate of tort costs, including all transfer payments, is accurate; that 100% of TTP's estimated tort costs are "excessive" and random and provide no offsetting benefits; that an additional $50 billion in "deadweight loss" is imposed on the economy; and that all of the costs are shifted onto workers as a wage tax—could yield a 5% "tax" on wages.

The CEA identifies more reasonable "intermediate" assumptions, including a tax-shifting formula that better reflects the consensus (according to CEA) of "economists who specialize in public finance." That formula would shift only 25% of a corporate "tax" burden onto wages.

Without choosing among them, CEA suggests that the cost of "excessive tort" could be equivalent to either "a 2 percent tax on consumption, a 3 percent tax on wages, or a 5 percent tax on capital income." How does CEA arrive at the possibility of a 3% tax on wages? Only by rejecting the virtually unanimous view of the experts it cites with respect to tax shifting, in order to assume, without proof, that 100% of the "excessive" costs of the tort system are shifted onto employees in the form of reduced wages. This assumption is wrong, and CEA provides no rationale for rejecting the majority view that such costs to corporations are shared with consumers and employees and no convincing evidence that non-economic damages are imposed randomly.[7] Further, CEA has to make the extreme assumption that all non-economic damages are excessive, as are all litigation costs for both plaintiffs and defendants. CEA also assumes that all administrative costs in excess of 23% of the economic damages awarded to plaintiffs are excessive; that is less than one-third of the "administrative costs" TTP reports, which are made up primarily of insurance industry overhead. As extreme as these assumptions are, they represent CEA's intermediate assumptions.

A more reasonable analysis of the size of a supposed tort system impact on wages would begin with a far smaller starting estimate of the costs of the tort system than TTP's inflated number. It would accept the consensus that consumers, investors, and workers all pay part of corporate income taxes. And a reasonable analysis would not assume that most tort costs are excessive. As noted above, the Congressional Budget Office points out that, "Costs can be considered excessive if they do not contribute positively to either efficiency or equity" (CBO 2003, 20). The tort system contributes to equity by punishing wrongdoers, deterring potential future harms, and compensating victims. Even the defense costs and attorney fees paid by tortfeasors contribute to their accountability and punishment and, therefore, to equity. No one can fairly argue, therefore, that three-quarters of the real tort costs are excessive. By making such an argument, CEA undermines the credibility of its analysis.

Nevertheless, let us assume—generously, and only for the sake of argument—that TTP's tort cost estimate is not inflated and that 25%, or $66 billion, of the total amount contributes nothing either to equity or efficiency and is, therefore, excessive. Adopting CEA's example of the impact of a "litigation tax" that is shared by capital and labor—that 25% of those excessive costs are shifted onto workers through lower wages—the economic effect is insignificant: $14.5 billion on a $6.5 trillion national wage bill. This yields a negligible "tort tax" of 0.2% on U.S. wages, salaries, and fringe benefits. If, as we have argued, TTP's estimate of tort costs is inflated by including transfer payments, the alleged tort tax would be even smaller. The true impact on U.S. wages is probably much lower: there is no substantial evidence that even 10% of tort costs are excessive, and, if TTP's overall tort cost estimates are grossly inflated, so is this estimated "tort tax."

III. There is no evidence that tort costs have had significant effects on R&D spending, health costs, employment, productivity, or the macroeconomy

The 2004 *Economic Report of the President*, which devotes an entire chapter to the tort system, claims that, "Tort liability leads to lower spending on research and development, higher health care costs, and job losses" (Executive Office of the President 2004, 203). In addition, the *Report* suggests that tort costs hurt the economy by slowing productivity or growth. Yet the *Report* makes no real attempt to substantiate these claims, and the available evidence indicates that each of these assertions is false.

A. No evidence of significant effects on R&D spending

The relationship between changes in tort costs and changes in industry research and development investments (as a share of GDP) is displayed in **Figure A**. As tort costs were rising from the late 1970s to the mid-1980s, R&D spending rose rather than fell. Moreover, R&D spending has been relatively stable as a percent of GDP over the last 20 years, but tort costs declined from 1987 until 2001. It should not be surprising, therefore, that formal Granger causality tests indicate no causal relationship between R&D spending and tort costs.[8]

Others have also found, contrary to the *Report*, that there is a generally positive relationship between liability costs and product R&D. Research by W. Kip Viscusi and Michael J. Moore found that, for most industries, increased product liability costs have led to higher spending on product R&D and more innovation, not less. "It is clear, however, that net expenditures on product R&D relative to sales rise with increases in product liability costs up to some level and that the portion of sales due to new products is similarly affected. We infer from these results that the development of new, safer products is the primary outcome engendered by the recent growth in the cost of product liability to firms" (Viscusi and Moore 1993, 192).

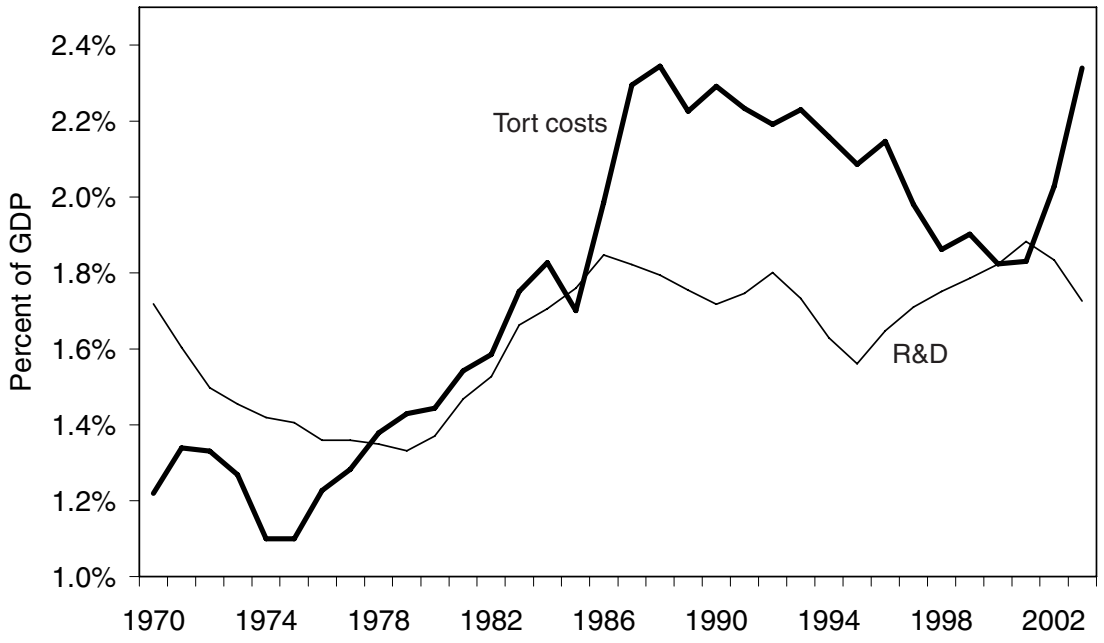
B. No evidence of significant effects on health care costs

Even when it uses TTP's unverifiable and inflated calculation of malpractice costs, the Congressional Budget Office estimates that the tort system contributes less than 2% to total health care spending and concludes that "even a reduction of 25 percent to 30 percent in malpractice costs would lower health care costs by only about 0.4 to 0.5 percent" (CBO 2004, 6). The entire $27 billion cost of medical malpractice claims that TTP estimates, including every legitimate claim that was settled without a trial and every claim proved in a court of law, amounts to only 1.6% of national health care expenditures.[9]

Interestingly, paid malpractice claims against doctors and other medical professionals totaled only $4.6 billion in 2004, according to data compiled by the U.S. Department of Health and Human Services (Treaster and Brinkley 2005). TTP has found in the past that awards to plaintiffs are generally about 46% of total tort costs and that physicians' costs are about 58% of total malpractice costs.[10] (TTP divides malpractice costs into three categories: "hospital, physician, and other.") Assuming that the past held true in 2004, then the $4.6 billion paid for malpractice claims against physicians in 2004 should represent 46% of the physicians' share of total medical malpractice tort costs, which in turn should be $10.0

FIGURE A

Tort costs and R&D as a percent of GDP, 1970-2002



Source: National Science Foundation,Tillinghast-Towers Perrin (2002), and Economic Policy Institute.

billion. If $10.0 billion represents 58% (the physicians' share) of total malpractice costs, then total malpractice costs are $17.24 billion, not the $27 billion claimed by TTP. This represents less than 1% of national health expenditures in 2004, which grew to $1.78 trillion.

C. No evidence of significant effects on employment

The evidence that the tort system causes significant job loss is no stronger than the evidence that it reduces R&D spending or raises health care costs. In fact, the only solid evidence of job loss attributable to the tort system in the *Economic Report of the President* involves asbestos-related bankruptcies. The *Report* cites a single study, which estimated that between 52,000 and 60,000 jobs were lost over the 24-year period from 1978 to 2002, an average of 2,167-2,500 jobs per year. The net job loss in the economy, after factoring in employment gains at competitor firms, was undoubtedly smaller.

Asbestos-related bankruptcies are not random events. The legal claims that led to these bankruptcies were the result of an epidemic of disease, suffering, and death caused by the products sold by the bankrupt firms, many of which knew of the dangers but concealed them. In other words, the costs were created by the companies, not those they injured. Between 1979 and 2001, at least 43,000 Americans died from mesothelioma and asbestosis, and more than 44,000 more may die by 2014 (EWG 2004).

In an April 2002 paper, the CEA examined the economic impacts of the tort system in somewhat greater depth. But that paper, too, failed to demonstrate any employment effects of the tort system and made no prediction about the impact of tort law change.

It is a mystery why the president, or anyone else for that matter, speaks of changing tort law as a job creation device. Even if we assume that asbestos liability legislation could somehow have prevented the loss of 2,500 jobs per year resulting from asbestos-related bankruptcies (by, for example, limiting compensation for non-economic damages to the victims or their survivors, or by denying awards of punitive damages), the effect on overall employment and the national unemployment rate in an economy with more than 130 million payroll jobs would have been imperceptible (a change of less than two-thousandths of 1%).

D. No evidence of significant effects on productivity

The *Economic Report of the President* suggests that tort costs harm the economy by diverting resources to non-productive uses (Executive Office of the President 2004, 207). However, no analysis in the *Report* or elsewhere substantiates this claim or even describes how the tort system significantly affects productivity or growth. There is no reliable research available that quantifies the tort system's effect on the economy that would enable one to judge whether the effect is economically significant.

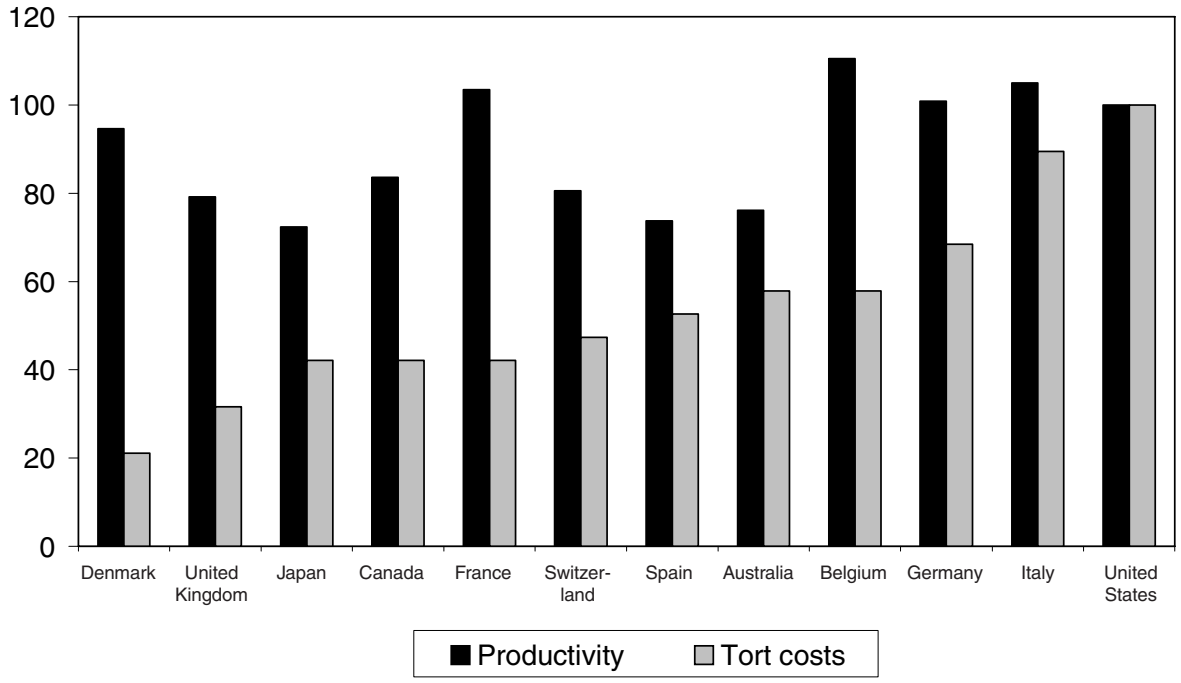
In fact, the evidence provided by the *Report* itself substantially undermines its argument. CEA's Chart 11-6 presents an international comparison of tort costs as a percent of GDP, ranking a dozen countries, from Denmark with the lowest tort costs as a percent of GDP to the U.S. with the highest. This ranking of countries by tort cost as a percent of GDP is problematic for several reasons. No one outside of TTP knows with any certainty how TTP estimated the tort costs of the U.S., let alone the other countries portrayed. And the CEA chart does not take into account the fact that all or almost all of the other countries have national health insurance programs that remove the cost of compensation for medical injuries from the tort system. It is not legitimate to count the medical care victims of torts receive in the U.S. as a tort cost, but not the medical care victims receive overseas. In a like manner, nearly every country has a much more generous unemployment insurance system than does the United States, so compensation for lost wages will artificially appear greater in the U.S. tort system than elsewhere, even when the injured party is made whole to the same extent overseas. But if we accept TTP's ranking of international tort costs, it leads to the conclusion that higher tort costs do not lead to lower productivity. If high tort costs are a brake on productivity, countries with the highest costs should have the lowest productivity. But no such relationship holds true. To the extent that there is a relationship, higher tort costs appear to be loosely associated with *higher* productivity.

Figure B presents this information graphically. Each country's productivity and tort costs are displayed as a percent of the U.S. results, which are set at 100. Note that the four countries (U.S., Germany, Italy, Belgium) with the highest productivity (meaning they are the most efficient at translating work effort into economic output) also have the highest tort costs. To be sure, there are also some countries with relatively low tort costs and high productivity, such as France and Denmark, but overall there is no reason to believe that tort costs are a major driver of a country's efficiency or productivity level.

In fact, the adverse impact of tort costs on productivity that is claimed by TTP and other advocates of tort law changes is also contradicted by trends within the United States. First, while productivity num-

FIGURE B

Productivity and tort costs across countries as percentages of U.S. levels (U.S.=100)



Note: Productivity as measured in 2002, GDP per hour worked.

Source: OECD, Tillinghast-Towers Perrin (2000), and Economic Policy Institute (2004).

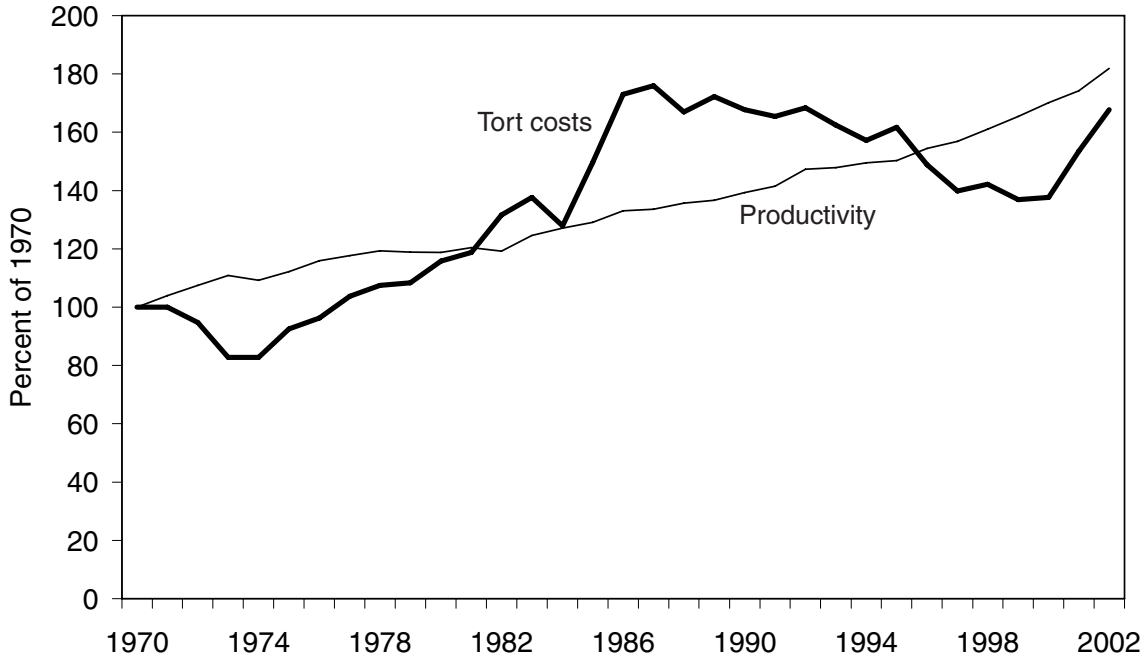
bers on a state and regional basis are of limited value, there does not appear to be any correlation across states between the number of tort filings and productivity. Second, the measurement of tort costs developed by TTP shows no correlation with productivity growth on a national basis over time. This is especially true when underlying macroeconomic conditions are taken into account, since there is a close relationship between productivity growth and overall economic growth.

Figure C shows the growth of both productivity and tort costs in the U.S., indexed to 1970.[11] Productivity growth during the recession and stagnation of 2000 and 2001 was extraordinary for such a period of economic weakness—in fact, no recession since World War II has experienced such strong growth in productivity. These are the years in which TTP's exaggerated measure of tort costs jumped sharply. And, while tort costs were supposedly high over the 1985-95 period, this period was followed by a unique acceleration of productivity growth in the later 1990s. Similarly, the fall in tort costs in the early 1970s was followed by years of productivity stagnation.

A Granger causality test examining whether lagged values of changes in tort costs can predict changes in productivity found there was a weak relationship in the short run but no effect after 10 years.

FIGURE C

Productivity and the cost of the tort system as a percentage of GDP, 1970-2001 (1970=100)



Source: Bureau of Labor Statistics, Tillinghast-Towers Perrin (2000).

E. Little if any evidence of significant effects on the U.S. macroeconomy

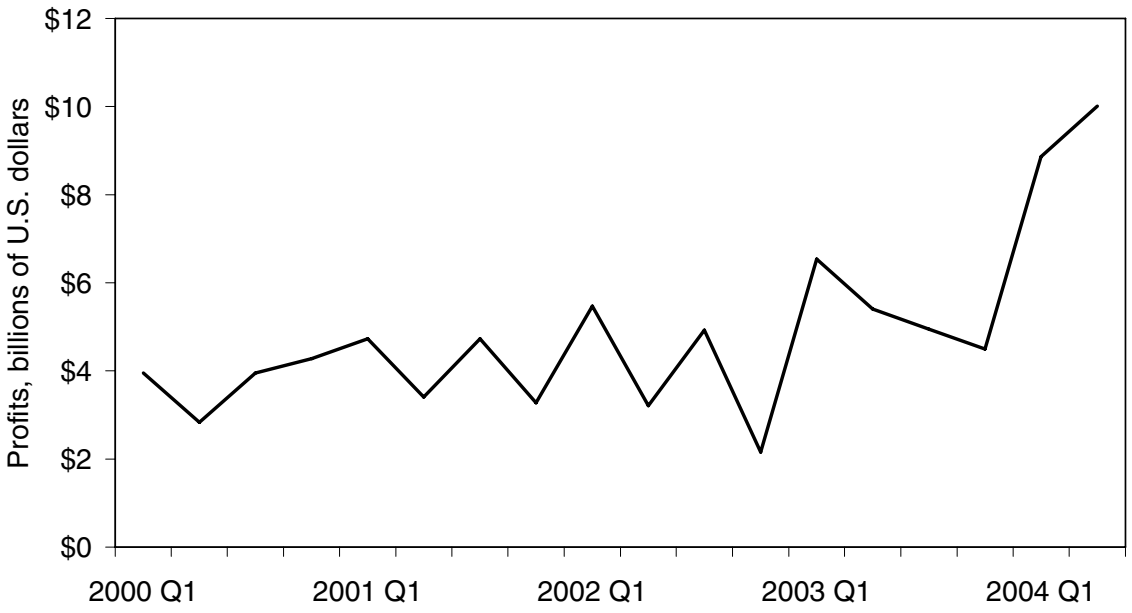
It is hard to find any evidence that allegedly excessive tort costs have harmed the U.S. economy. As we have seen, there appears to be no relationship between tort costs and national productivity, and any "tort tax" on wages is negligible.

If tort costs have a significant impact on the economy, it should be apparent in corporate profits. However, despite TTP's claim of decades of steadily mounting tort costs, U.S. corporate profits increased by 14% in 2002 and 17% in 2003, reaching an all-time high of more than $1 trillion. (U.S. Department of Commerce, Bureau of Economic Affairs, NIPA Table 6.16D.)

Virtually all aspects of the U.S. economy have performed in a manner completely inconsistent with the claims made by most advocates of tort law changes. Despite decades of supposedly skyrocketing tort costs, the performance of the U.S. economy during the 1990s, especially the mid-1990s, was extraordinary. It was the first time in many decades that real incomes grew at all levels of income, that inflation was low and falling, that corporate profits were rising sharply, and that jobs were being created at a rapid rate. All of this was an outgrowth of the productivity explosion that began in the mid-1990s. Since then, in some respects the U.S. economy has continued to do well during the recession and slow growth that has characterized recent years. In particular, as mentioned earlier, productivity has climbed

FIGURE D

Insurance industry profits, 2000-04



Source: *Business Week.*

despite relatively weak economic conditions, and corporate profits have risen sharply, a trend that is virtually unheard of during a period of lackluster economic performance. As shown in **Figure D**, despite the alleged explosion in tort costs since 2001, insurance industry profits have also risen strongly, more than doubling from 2001 to 2004.

Other gross measures of the effects of the tort system appear to indicate that its effects have been positive rather than negative. Highway deaths, for example, have fallen to the lowest rate ever recorded—1.48 deaths per 100 million miles traveled, down from 4.80 deaths per 100 million miles in 1970. Cars are safer than ever before, and no one doubts that the tort system has played a role in encouraging the production of safer vehicles, though there are many factors involved in highway safety. In a study of the relationship between motor vehicle safety and the tort system, John D. Graham—before he became the Bush Administration's regulatory czar—concluded that product liability had contributed in many ways to highway safety. Examining five case studies, Graham found that liability considerations had been a significant "contributing factor" in 11 of 14 auto safety improvements, including fuel tank design changes in the Ford Pinto, roll-over protection in the Jeep Wrangler, the installation of rear-seat shoulder belts, and the phase-out of belt tension relievers (Graham 1991, 181). Graham concluded that, in some cases, "liability seemed to cause safety improvements to occur more quickly than they would have in the absence of liability" (Graham 1991, 183-84). Overall, Graham found product liability to contribute to safety, but not to be the most important cause of improvements: "Although product liability

risk is rarely a necessary condition for improved vehicle safety, it is often a sufficient or contributing cause of safety improvements" (Graham 1991, 184).

One of the major arguments made by advocates for tort law change is that rising tort costs have supposedly reduced the willingness of companies to develop new products and to take other reasonable business risks. Apart from the fact that they grossly overstate the costs of the tort system, it is hard to understand how these claims can be made. In particular, virtually every study conducted, covering a variety of consumer products, shows that the quality, variety, and safety of products made in the United States has improved dramatically in recent decades, in large measure as a result of the tort system. Perhaps the best example is the auto industry. J.D. Power and Associates reported that defects in American cars have dropped by 32% since 1998. (Christie 2004). Studies by *Consumer Reports*, Harbour and Associates, and others have confirmed this improving trend in product quality and safety. Similar improvements have been noted for consumer appliances, television sets, medical devices, and other products. While this progress reflects the fact that all of these industries are now characterized by more competition than ever before, the implementation of such improvements is inconsistent with the position taken by critics of the tort system.

And casual observation suggests that, not only are products now better than ever, there are more of them. In fact, while difficult to measure, it seems likely that the rate of technological change has accelerated in recent decades. This, combined with increases in spending by corporations on research and development designed to exploit these new technologies, has resulted in a proliferation of new products—a proliferation that is again inconsistent with the claims made by tort system critics. Indeed, it is likely that the right to sue has given companies incentives to be more careful in the design of their products.[12]

IV. The claimed employment effects of tort system changes would be insignificant

As we have seen, there is little reason to believe that tort law change would have any significant positive effect on the economy. In particular, there is no evidence that changes in tort law would lead to a burst of job creation. Nevertheless, to estimate how changes in the tort system might affect job creation, Mark Zandi, chief economist of the well-respected econometric consulting company Economy.com, conducted a macroeconomic simulation of the effect of changes to the tort system. The simulation assumed that: (1) changes to the tort system would be so effective that over four years (2004-09) tort costs would increase at the slow 3.3% per annum pace experienced during the 1990s; (2) the baseline against which changes should be measured forecasts that tort costs will rise at the double-digit pace reported by TTP since 2000; (3) corporate tax liability will be reduced by an amount equal to the tort cost savings (this incorporates the unproved notion that tort costs impose a "tort tax" on employers); and (4) proprietors' (law firm) income and personal transfer payments (tort awards) will be reduced accordingly.

The results, using these assumptions extremely favorable to the arguments in favor of changing the tort system, are completely contrary to the claims of the advocates of change (**Table 1**). Far from stimu-

TABLE 1
Comparison of a scenario with tort system change vs. a baseline with no change

	Year 0	Year 1	Year 2	Year 3	Year 4
Real GDP (billions 2000 $)					
Tort system change	10,632.3	11,000.3	11,360.9	11,764.4	12,182.6
Baseline	10,632.3	11,003.7	11,368.6	11,775.3	12,199.8
Real consumer spending (billions 2000 $)					
Tort system change	7,493.5	7,696.5	7,937.4	8,200.6	8,465.2
Baseline	7,493.5	7,699.5	7,944.9	8,212.3	8,483.5
After-tax corporate profits (billions $)					
Tort system change	687.8	761.1	852.8	940.0	1,017.4
Baseline	687.8	727.7	797.8	863.2	913.0
S&P 500 Index (end of year)					
Tort system change	1,122.8	1,219.4	1,406.9	1,579.6	1,724.2
Baseline	1,122.8	1,208.9	1,384.2	1,542.0	1,671.2
Employment (millions)					
Tort system change	130.328	132.503	134.780	136.438	138.103
Baseline	130.328	132.528	134.868	136.580	138.323
Real median household income (2000 $)					
Tort system change	41,461	41,735	42,126	42,529	43,022
Baseline	41,461	41,776	42,212	42,662	43,209

Note: The four-year period used is 2004q3 to 2008q2.

Source: Economy.com.

lating job creation, *the model predicts that a tort law change effective enough to reduce tort cost increases by more than 10 percentage points per year would lead to lower employment, not greater*. As Table 1 illustrates, Zandi found that, four years after such a change took effect, employment would be 220,000 less than if no changes were enacted and tort costs continued to increase at double-digit annual rates. Equally worrisome, both real GDP and real median household income are predicted to be lower if tort law changes are enacted and prove effective in lowering the costs of the tort system.

V. Conclusion

The economic case made by critics for changing the U.S. tort law system can only be called frivolous. They have claimed that there is a tort liability "crisis," when the facts show that the number of tort cases has declined steadily for years. They have grossly exaggerated the costs of the tort system, and have made unfounded claims about the tort system's impact on insurance premiums, corporate research and

development funding, product innovation, productivity, wages and employment, and business profits. And they have claimed without any evidence whatsoever that changing the tort system will stimulate economic growth and produce jobs.

These economic claims have gone largely unchallenged despite the failure of the tort system's critics to substantiate them with credible evidence. With respect to job creation in particular, significant tort law change would be more likely to slow employment growth than to promote it. Endlessly repeating that so-called "tort reform" will create jobs does not make it true.

A one-sided focus on the costs of the tort system that excludes an examination of the potential effects of changes on the system's benefits is inherently dangerous. Professor Marc Galanter of the University of Wisconsin, a leading nonpartisan academic observer of the U.S. tort system, points out that changes to the U.S. tort liability system, even if undertaken for legitimate reasons, have the potential to reduce the rights of tort victims, leaving injured individuals, their families, and, ultimately, the taxpayers to cover losses that should be compensated by those who cause them. Galanter (1996) writes, "that it costs so much to effectuate [transfers of compensation from tortfeasor to victim] calls for remedy, but controlling these transaction costs should not be confounded with reducing the rights of claimants. Indeed, the potential exists to have the worst of both worlds by reducing the rights of the injured without significantly reducing the transaction costs of the system."

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Endnotes

1. *The American Heritage Dictionary, Second College Edition*, Houghton Mifflin Co., Boston 1982.

2. Neither of these allegations is the subject of this paper, but recent research reveals that malpractice claims have had little effect on the tendency of doctors to remain in practice. See Baicker and Chandra (2004).

3. TTP combines claims-handling costs with legal defense costs. According to TTP, the two together were 14% of total costs in 2002, and claimants' attorney fees were 19% (TTP 2003, 17).

4. A small part of this $113 billion is punitive damages, which, though awarded to the plaintiffs, are not true transfer payments. A study of 45 large trial courts found that punitive damages were awarded in 4% of tort cases and were less than 8% of compensatory damages (Eisenberg et al. 2000). Extrapolating from TTP's estimates, punitive damages would be less than $9 billion of the total damages awarded to plaintiffs nationwide. Many of these awards are reduced on appeal or by settlement and do not become actual costs.

5. It is possible that asbestos legislation could lead to reductions in insurance industry personnel and overhead by making approval of certain claims and denial of others automatic. The insurance industry has not put this idea forward as a reason to support tort law change.

6. These figures are based on an unpublished analysis by EPI of TTP 2004, Appendix 1A. Details are available from the authors.

7. Indeed, nonpartisan scholarly research provides evidence that, in fact, juries do not make awards of non-economic damages randomly, and that their conclusions correlate well with those of judges and other legal professionals. See Vidmar and Rice (1993) and Croley and Hanson (1991). Only those found guilty of tortious conduct are exposed to such damages. One can avoid such damages by avoiding negligent conduct.

8. "In econometrics the most widely used *operational definition* of causality is the *Wiener-Granger* or *Granger definition of causality.*…It can be formulated in a simplified way as follows:

> Definition: *x* is a *Granger cause* of *y* (denoted as *x-y*), if present *y* can be predicted with better accuracy by using past values of *x* rather than by not doing so, other information being identical" (Charaemza and Deadman 1997, 165).

9. Total health expenditures in 2003 were $1.66 trillion, according to the Centers for Medicare and Medicaid Services of the U.S. Department of Health and Human Services.

10. TTP 2003 Update, Appendix 5.

11. When the line representing one or the other factor on the chart rises it means that that factor has increased relative to its 1970 value.

12. Nicholas Ashford and Robert Stone (1991) found the relationship between product liability and innovation in the chemical industry, especially with respect to process technology, to be positive. They conclude that there would be *more* innovation if tort liability for dangerous products and practices were even greater.

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