The Economics of Healthcare Litigation
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Introduction
The adversarial tort system in the United States is a significant burden on the economy and its cost exceeds 2% of the gross domestic product (GDP). These costs have grown 4 times faster than the US economy between 1930 and 1994. In the next few years, tort costs could increase twice as fast as the economy, going from $200 billion in 2001 to $298 billion, or 2.4% of GDP, by 2005. The current system returns “less than 50 cents on the dollar and less than 25 cents for actual economic loss to claimants.” Tort costs per US citizen have increased from $12 in 1950, $67 in 1970, $204 in 1980, and $518 in 1990 to $636 in the year 2000.

Do Malpractice Costs Significantly Influence Premiums and Overall Cost of Healthcare?
At a minimum, 5% and possibly 8% of the gross income of healthcare providers is paid out in malpractice premiums. In the past this was passed on to consumers, but with fees that are fixed by Medicare, Medicaid, and most private insurers, a large share of the cost is being absorbed by physicians. Plaintiff attorneys mislead the public by protesting that since physicians and hospitals paid out $4 billion annually in liability premiums, which is less than 66 hundredths of 1% of national healthcare expenditures, changes in the system would not result in significant savings. They use as the denominator a figure of $752 billion, which the Health Care Financing Administration (HCFA) stated was the amount spent on health care in 1991. This dollar amount included all expenditures including over the counter drugs, research, nursing home care, and other expenses that have nothing to do with services affected by medical malpractice liability. A more accurate denominator is $431 billion, which was the amount that was directly related to hospital care and physician and other professional services where medical malpractice would be a factor.

According to the Health Care Liability Alliance, 57% of the total malpractice premium goes to attorneys, and patients retain 43% as compensation. The GAO estimates that 43% of insurance defense costs are spent on meritless malpractice claims.

Is Defensive Medicine a Major Factor in Healthcare Costs?
An American Medical Association survey estimates that defensive medicine (practice of proce-
dures done to avoid or limit a physician’s exposure) amounts to 2 1/2 times the actual coverage costs. In essence, if one adds the 5–8% malpractice premium costs of physician gross income to 2 1/2 times the 5–8% (cost of defensive medicine), total malpractice costs may be closer to 17.5–28%, rather than the 0.66% suggested by trial attorneys.

The Congressional Budget Office (CBO) maintains that specifically caps on noneconomic damages have been extremely effective in reducing severity of claims and medical liability premiums. It has been estimated that if tort reform were to be enacted in all States, a $50 billion reduction in national health care spending could be realized, certainly a major down payment for possibly a prescription drug program or coverage of the uninsured. Federal tort reform may be the only answer to the current malpractice crisis. The CBO also estimates that federal tort reform will save $22.1 billion in federal and state monies that are part of the waste of our current tort system.

Many State reforms, once enacted, have proven to be all too easily overturned by State court systems swayed by the influential trial bar. An exception is the California MICRA reforms, in place for more than 2 decades that have proven to be effective. At the Federal level, House Bill H.R. 4250 (the Patient Protection Act of 1998) passed the House of Representatives only to stall in the Senate. One of the underpinnings of the bill would have permitted regulations allowing medical liability reforms to preempt or supersede State laws governing regulation of healthcare. The CBO estimated that this section of the bill alone would reduce private health plan premiums by 0.3% to 0.5%, in addition to the savings in government-sponsored programs such as Medicare. The House of Representatives recently passed and sent to the Senate a bipartisan bill called the Help Efficient Accessible, Low-Cost, Timely Health Care (HEALTH) Act (H.R. 4600).

Are the Current Premium Increases Due to Losses Incurred by Insurance Carriers in the Stock Market?

One of the arguments made by plaintiff attorneys against reform and their explanation for the current crisis is that stock market losses are the cause of insurers’ premium increases. A comprehensive study by Brown Brothers Harriman’s (BBH) Insurance Asset Management Group of the Physician Insurance Association of America (PIAA) member companies’ showed that assets are on an average only 10% invested in equities. In 2001, the equity allocation was 9.03% and 80% of assets were invested in high-grade corporate and government bonds. Unlike stocks, high-grade bonds are carried at amortized value on insurers’ financial statements. Consequently, any change in market value has no effect on asset value unless the underlying securities are sold. The BBH study also indicated that medical malpractice insurers had a well-diversified investment strategy, with returns similar to the market (Standard & Poors).

The major factor in the staggering increase in premiums is the cost of paying claims either through settlements or jury verdicts. The cost of the average paid claim has risen at almost three times the rate of inflation. According to A. M. Best (Best), the leading insurance industry rating agency, the medical liability insurance industry incurred $1.53 in losses and expenses for every dollar of premium they collected in 2001. For the year ended (2002), Best is forecasting that the industry will incur $1.41 in losses and expenses in 2002, and $1.34 in 2003. Rate increases by insurance companies account for decreasing losses. Each year, an independent actuarial firm Tillinghast Towers-Perrin analyzes detailed data provided by insurance carriers, including 32 physician-owned/operated companies, and filed with the National Association of Insurance Commissioners (NAIC). This is done on an annual basis, including individual components of the insurers’ financial performance and the results are provided to the PIAA.

Like any other business, insurance carriers have to collect more in premiums and investment income than the amount paid out to plaintiffs and expenses. A common insurance performance parameter is the combined ratio, which is calculated by dividing the losses and expenses incurred by insurers by the premiums they earn to offset these costs. For the year 2001, the combined ratio (including dividends paid) was 141, meaning that total losses and dividends paid were 41% more than the premiums collected. Net income was 4% in 2000 and a negative 10% in the year 2001. Medical malpractice is the least profitable property and casualty line of insurance in 2001, second to reinsurance, which was impacted by losses related to the World Trade Center. It is estimated by BBH that in order for the industry to
maintain a combined ratio similar to its past 27-year average, premiums would have to be increased by 59%.\(^1\)\(^3\)\(^9\)\(^10\) Looking at it another way, they calculated that the level of losses would have to decrease by 37% to achieve the mean loss ratio over the past 27 years. Clearly, this would require meaningful tort reform.

Americans for Insurance Reform (AFIR), an organization supported by plaintiff attorneys, has a different viewpoint in regard to the reason for the insurance industry’s woes.\(^11\) AFIR claims that over the past decade, medical malpractice insurance premiums have had a direct relationship to the state of the economy and that payouts have approximately tracked the rate of medical inflation. They also deny any real increase in lawsuits, jury awards, or any tort system costs in recent years and conclude that the astronomical premium increases are more related to declining interest rates and investments losses by insurance companies.

Is Tort Reform of the Civil Justice System in the Public Interest?

The tort system in the United States is the most expensive in the industrialized economies of the world and the estimated cost of $152 billion in 1994 has increased by 125% over the past 10 years.\(^1\) Businesses look at tort reform as one of the important factors in deciding where to locate a manufacturing or production facility. A recent study points out that 47% of US companies withdrew products from the marketplace and 39% did not introduce new product lines for fear of lawsuits.\(^12\) Lawyers argue that this action on the part of companies is good for consumers, implying that a fear of lawsuits is the only thing between consumers and business. Another study showed that when states pass tort reform, productivity increases by 7–8% and employment increases 11–12%.\(^13\) As an illustration, Illinois passed a major tort reform bill in 1995, leading to a 30% decline in the number of civil lawsuits filed in 9 of the largest jurisdictions. It is estimated that reforms saved the taxpayers about $150 million.\(^14\) In a previously heavily litigated area, Cook County experienced a 63% reduction in product liability suits and a 39.6% decrease in medical malpractice suits. However, in Illinois as in Ohio, the State Supreme Court overruled the legislature and ruled the amendments to be unconstitutional.\(^15\) In Ohio, in a 4-3 decision the Supreme Court ruled a comprehensive tort reform bill passed by the general Assembly unconstitutional and commented that “the General Assembly may not enter upon the judicial business of settling the constitutionality of its own laws, disregard a Supreme Court decision on the subject, reenact legislation previously declared violative of the Constitution, or in any other way exercise, direct, control, or encroach upon judicial power.” Following the 2002 election the legislature, after being pressured heavily by a united and energized medical and business community, again passed tort reform legislation.

It is clear that tort reform has become a political tussle between plaintiff attorneys along with their supporters and the business/medical community. This tug of war has unintended victims: Injured patients who are denied a speedy and fair settlement, physicians who are subject to frivolous suits along with a severe emotional penalty that no one talks about, and a judiciary that has become increasingly politicized. Trial lawyers have declared themselves to be the de facto “fourth” branch of government.\(^12\) A stellar example of the tussle is Jefferson County, Mississippi, populated by approximately 10,000 residents and well known to plaintiff attorneys for staggering amounts awarded against corporations. Between 1995 and 2000, 21,000 people filed suits, causing a lobbying group called the American Tort Reform Association to declare the county 1 of 10 “judicial hellholes.”\(^15\) Along with business groups, the ATRF launched a coordinated public relations campaign to inform the public about contributions by the 2 major political parties, labor, and auto companies gave to federal about lawsuit abuse, culminating in the Governor of the State to sign caps on damages into law after calling the legislature into special session.

REFERENCES


6. www.hcla.org


