

## Math Divides Critics As Startling Toll of Torts Is Added Up

By LIAM PLEVEN, *Wall Street Journal*

NEW YORK -- It's easy to raise the blood pressure of an American chief executive. Just talk about rising tort costs and the burdens of asbestos exposure, medical malpractice, product defects and other lawsuits. The tort system is designed to compensate people who feel they've been wronged -- and rightfully so. But the extremes of litigation and the volume of lawsuits considered frivolous drive CEOs nuts.

That's why a new report by consulting firm Tillinghast, a unit of Towers Perrin, is bound to get some attention in executive suites when it's released today. For 20 years, Tillinghast, an insurance-industry consulting firm, has been putting an often-criticized dollar value on what it calls the cost of the nation's tort system. And it says those costs will rise sharply in the next few years.

The latest study puts the cost in 2004 at \$260 billion, almost equal to the annual sales of Wal-Mart -- nearly \$900 for every man, woman and small child in the nation. It projects that cost will rise to nearly \$315 billion by 2007, outpacing the expansion of the overall economy.

Tillinghast's calculations get lots of attention in Washington, where the Bush administration has used the figures as a rallying cry to reform the nation's tort system, lament-

ing the "deadweight losses" to the economy. "The U.S. tort liability system is the most expensive in the world, more than double the average cost of other industrialized nations that have been studied," the Council of Economic Advisers said in a 2002 study of the subject that cited the Tillinghast research extensively.

But here's the problem: critics of past years' studies -- and there are many -- say the number and the projections that come with it are deeply flawed. For instance, they include payments that don't involve the legal system at all. Say somebody smashes his car into the back of your new SUV and his insurance company sends you a \$5,000 check to fix the damage. That gets counted as a tort cost in Tillinghast's number. Critics say it's just a transfer payment from somebody who wasn't driving carefully to somebody who has been legitimately wronged. How is that evidence of a system run amok?

"It's just so inflated," J. Robert Hunter, the director of insurance for the Consumer Federation of America and a former Texas insurance commissioner,

says of the Tillinghast figure. Critics also argue that other insurance-industry costs that aren't the fault of a burdensome tort system -- such as the salaries of insurance-industry CEOs -- show up in its calculations.

But the Tillinghast study's primary author, Russ Sutter, says the figures that go into it "are appropriate for measuring the costs of the tort system."

Just how open to interpretation are tort costs? Consider a study performed by the Rand Corp.'s Institute for Civil Justice back in the 1980s. The study covered 1985, and estimated that tort costs that year were between \$29 billion and \$36 billion. Tillinghast's figure for that same year is \$83.7 billion.

To come up with its estimate, Tillinghast wades through data that insurance companies file with regulators, adding up the multitude of payments to people or companies claiming losses on anything from a fender bender to a hospital mishap. It adds in the costs of mounting defenses and investigations in tort cases, and administrative costs in the insurance industry.

The result is a sometimes startling snapshot of how

much money is spent by insurers and others on everything from car accidents to product-liability cases to investor lawsuits, and how dramatically that amount has risen over time.

The \$260 billion for 2004 is almost twice the amount spent in 1990, according to the Tillinghast study. As a percentage of total economic output, tort costs, as defined by Tillinghast, actually fell during the economic boom of the 1990s, but have begun rising again, and could hit 2.27% of gross domestic product by 2007, the highest level since 1989, the study says.

Many economists who have looked at this subject find the numbers game somewhat frustrating, because it misses some bigger questions about how the tort system influences human behavior.

Ultimately, economics is the study of how people respond to incentives. So how should an economist calculate the cost to society of a medical student who chooses not to become an obstetrician because malpractice insurance in that field is getting more expensive? Or the loss to society when a company decides not to roll out a new product because its executives are afraid of potential liability claims if something goes

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wrong? Neither scenario figures in the Tillinghast calculations.

"A big part of the cost is a black hole," says Douglas Holtz-Eakin, a fellow at the Council on Foreign Relations who was director of the Congressional Budget Office in 2003 when it published its own look at the economics of tort liability.

"Costs alone are not a justification for reform," says W. Kip Viscusi, an economist at Harvard Law School who has studied the impact of liability on product innovation. More important, he says, are costs that may be "altering behavior in undesirable ways."

There's a flip side. How do you calculate the value to society of a tort system that deters negligent behavior? Isn't it a good thing, for instance, if fears of liability prevent an executive from fudging his quarterly numbers, a surgeon from walking into an operating room after having a few drinks, a driver from tailgating?

The Tillinghast study is upfront about not even trying to count that. "The tort system has costs and it has benefits," says Mr. Sutter. "We're just trying to do the one side." Nor does Tillinghast pass judgment on what is or is not a frivolous tort.

Nonetheless, Mr. Holtz-Eakin says: "It's an imperfect indication of something that's a big deal."

Given all the factors that are difficult or impossible to add up, perhaps it is no surprise that Rand decided not to repeat its study. "We kind of asked ourselves," says Nicholas Pace, a Rand researcher who worked on the project, "what does the number mean?"

When it comes to economic policy debates, that question is asked far too infrequently.