

# Commentary on Alexander Volokh's Paper

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# Introduction

- Basic Point
- Econometric Issues
- Implications
- Conclusion

# Basic Point

- Volokh's paper is a first attempt to Look at the effects of liability on labor markets outside of just Worker's Comp.
- Expansions in Product Liability influenced wages by potentially affecting the demand for labor and the supply of labor.

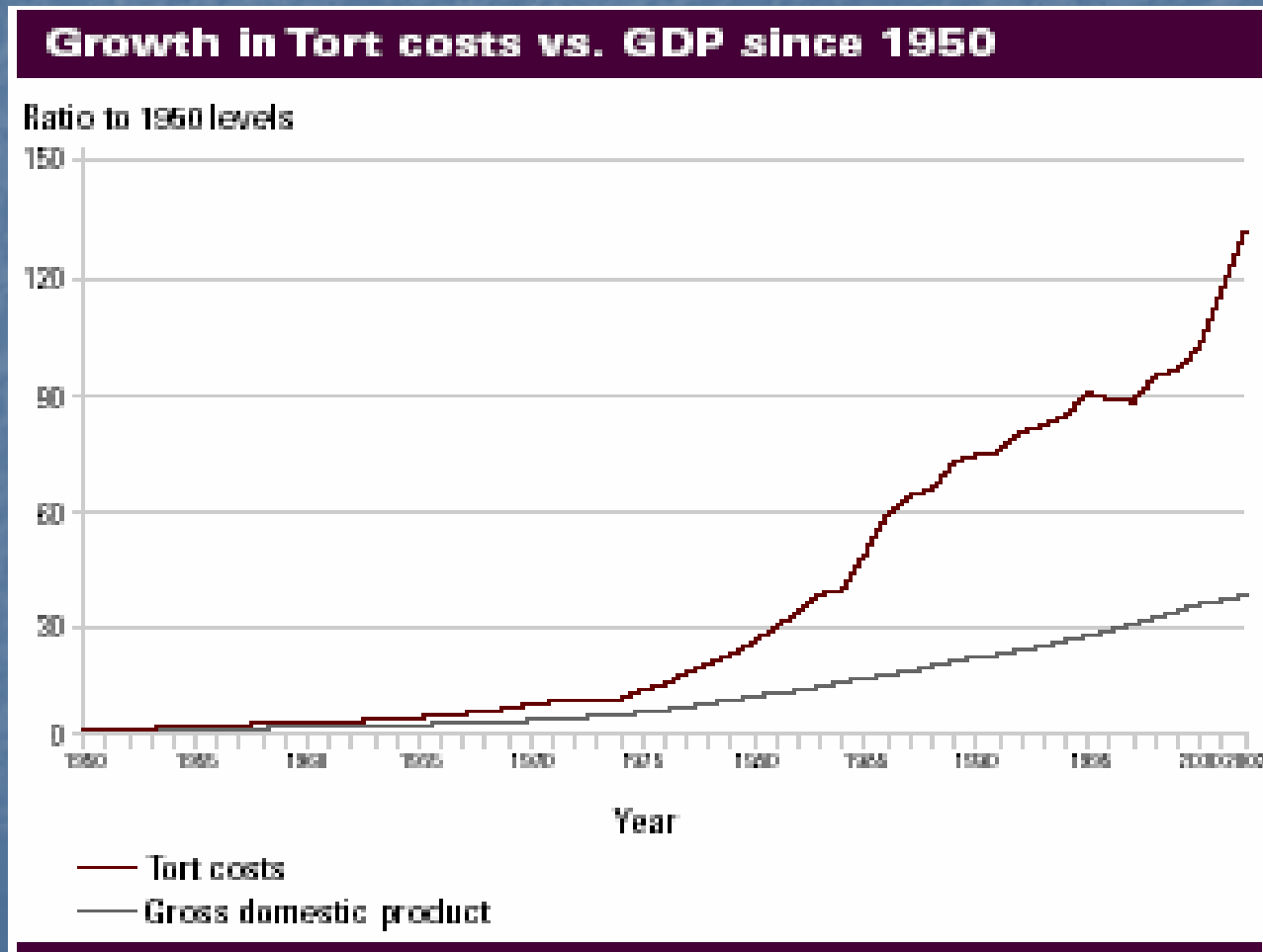
# Some Partial Equilibrium Effects

- **Demand side:** Worker's marginal product decreases (and thus his wage) due to incidence of expansion of liability to producers.
- **Supply side:** Worker's wages decrease due to increased ability to sue from the expansion of tort liability on product manufacturers.

# Econometric Issues

- Worker's Compensation Maximum Benefits are actually determined by a political economic process. Volokh assumes that it is exogenous, but one can probably endogenize it.
- For that matter the decision to adopt a new liability law might also be endogenous.

# Implications: Tort Costs Must be Paid By Someone



Source: Tillinghast, *US Tort Costs 2003 Update*.

# Current Literature

- Some Part of the Liability Regime Influences:
  - Public Transportation Prices
  - Prices for Ladders
  - Stock Prices
  - Organization and Structure of the Liability Insurance Industry
  - R&D and Innovation
  - Frequency and Severity of Losses
  - Workers' Compensation and Wages
  - Physicians' Decisions to Leave Practice

# General Equilibrium Effects

- The future of liability analysis lies in the examination of the general equilibrium effects of liability expansion or liability reform.
- Who bears the burden of tort liability?
  - Example: rural hospital.
  - MedMal Premiums Increase ->
    - Hospitals cut services, Doc's leave because of economies of scale issues, rural income decreases, rural area can not attract new employers due to lack of medical services, area languishes.
    - Effects on residents (current and future)
    - Effects on local business (current and future)
    - Effects on local tax base
    - The person least able to leave bears the highest burden.

# Some General Equilibrium Results

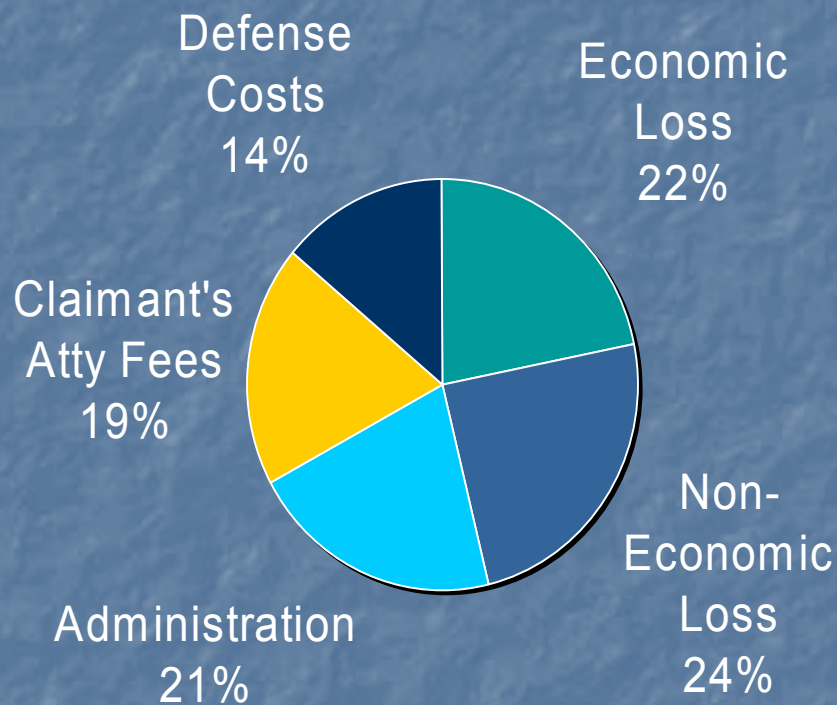
- If damages are random then they act as a tax rather than a deterrent.
- Questionable Link Between Safety and R&D Expenditures in High Liability Industries. This exposure to liability looks like a tax rather than a punishment.
- If damages are supposed to punish, then they should punish the wrong doer. However, the liability “tax” can be passed on to the least able to avoid the tax (workers, investors, consumers). (Viscusi 1998)

# Other Tax Evidence\*

- Tort System Cost (circa 2000) \$180 billion
- Tort System Cost (circa 2002) \$233 billion
  - Does not include avoidance costs.
  - Does not include value of products withheld from market.
  - Does not include dynamic costs (innovation)

\*CEA, Who Pays for Tort Liability Claims (April 2002) and Tillinghast-Towers Perrin( 2003).

# Distribution of Tort Costs, 2002



Only 46% of Tort Cost \$ goes to paying claimant.

# In Contrast

- Workers Compensation Costs
  - 22% for Administration
  - 78% to Claimant
- Using 22% as a conservative guideline, then Tort System has excess tort costs.
- If this excess tort cost is assigned in a random manner, then it is like a tax and has tax effects.

# CEA Rough Attempt to Examine Incidence

Incidence Assumption	Equivalent Tax Base	Annual "Excessive" Tort Costs		
		\$87 billion	\$136 billion	\$230 billion
Fully shifted forward Through prices	Consumption Tax	1.3%	2.0%	3.4%
Fully shifted backward Onto workers	Wage Tax	2.1%	3.3%	5.7%
Fully borne by Investors	Capital Tax	3.1%	4.9%	8.2%
25% shifted through prices, 25% shifted through wages, 50% borne by investors	Consumption Wage Capital	0.3% 0.5% 1.6%	0.5% 0.8% 2.4%	0.8% 1.4% 4.1%

Source: CEA calculations. The taxes are calculated by dividing the annual excessive tort costs by the appropriate base. The consumption base is total personal consumption expenditures which totaled \$6,728 billion in the year 2000. The wage base is total wage and salary disbursements to private industries, which totaled \$4,069 billion. The capital base is non-labor payments in national income, which totaled \$2,789 in the year 2000.

# Conclusions

- Sasha Volokh's paper is a great first step in the development of the literature to examine how tort liability affects markets other than product markets.
- More work like this is needed!

# Some References

- W. Kip Viscusi, "Why There is No Defense of Punitive Damages," *Georgetown Law Journal*, November 1998.
- Tillinghast-Towers Perrin, *US Tort Cost Update 2003* at [http://www.towersperrin.com/tillinghast/publications/reports/2003\\_Tort\\_Costs\\_Update/Tort\\_Costs\\_Trends\\_2003\\_Update.pdf](http://www.towersperrin.com/tillinghast/publications/reports/2003_Tort_Costs_Update/Tort_Costs_Trends_2003_Update.pdf)
- Council of Economic Advisors, *Who Pays for Tort Liability Claims* (April 2002) at [http://www.whitehouse.gov/cea/tortliabilitysystem\\_apr02.pdf](http://www.whitehouse.gov/cea/tortliabilitysystem_apr02.pdf)