

The Medical Malpractice Myth by Tom Baker

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What I liked about the book

- Good Use of Evidence
 - Malpractice data
 - Empirical studies
- Good Understanding of Institutions
 - Tort System
 - Medical Malpractice Insurance Carriers

Epidemic of Malpractice ... Not Lawsuits

- Idea is that we need lawsuits to send proper signals to providers so that they internalize the costs of mistakes.
- Question is whether Med Mal lawsuits can do that?
 - No one sues (possibly for rational reasons).
 - Physicians/Defendants often are winners in lawsuits.

Medical Injuries

- It is hard to talk about medical injuries out of context with other injuries.
- Example, medical injury claims rates are really different than claims rates for non-medical injuries.
 - Auto insurance is given as an example, but this is a well oiled *ex post* compensation system which is relatively unique in our compensation system. The costs of claim resolution are also quite low compared to claims resolution for med mal.

Evidence of Resolution Costs

	Loss Adjustment Expenses	
	Medical Malpractice	Private Passenger Auto
Direct Adjustment Services Expenses	\$ 1,728,600,000	\$ 1,083,901,000
Total Loss Adj Expenses Incurred	\$ 2,047,139,000	\$ 4,274,615,000
Ratio of Adj. Services/Total Adjustment Exps	84.44%	25.36%
Loss Adjustment Expenses to Premiums Earned	34.00%	14.00%

Source: *AM Best Aggregates and Averages, 2004*

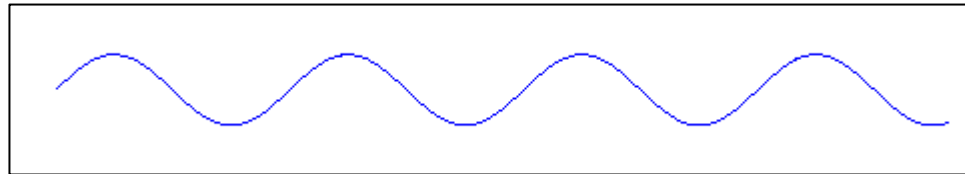
An Insurance Crisis, Not a Tort Crisis?

- Problem of insurance markets is harder than described by Professor Baker.
 - Mutuels are important suppliers of med mal cover
 - Captives and RRG's are also important
 - Offshore insurance is also important
 - May have 50 percent of coverage supplied by alternative market mechanisms
 - Thus, insurance is potentially provided by non-profits
 - Single state
 - Single line of business
 - Little access to capital markets
 - More difficulty in underwriting
 - Estimation of frequency and loss severity is difficult the smaller the insurer becomes.

Cycle?

- A quibble about the Insurance Cycle
 - We normally think of cycles as smooth sine waves with certain well known properties

Profit

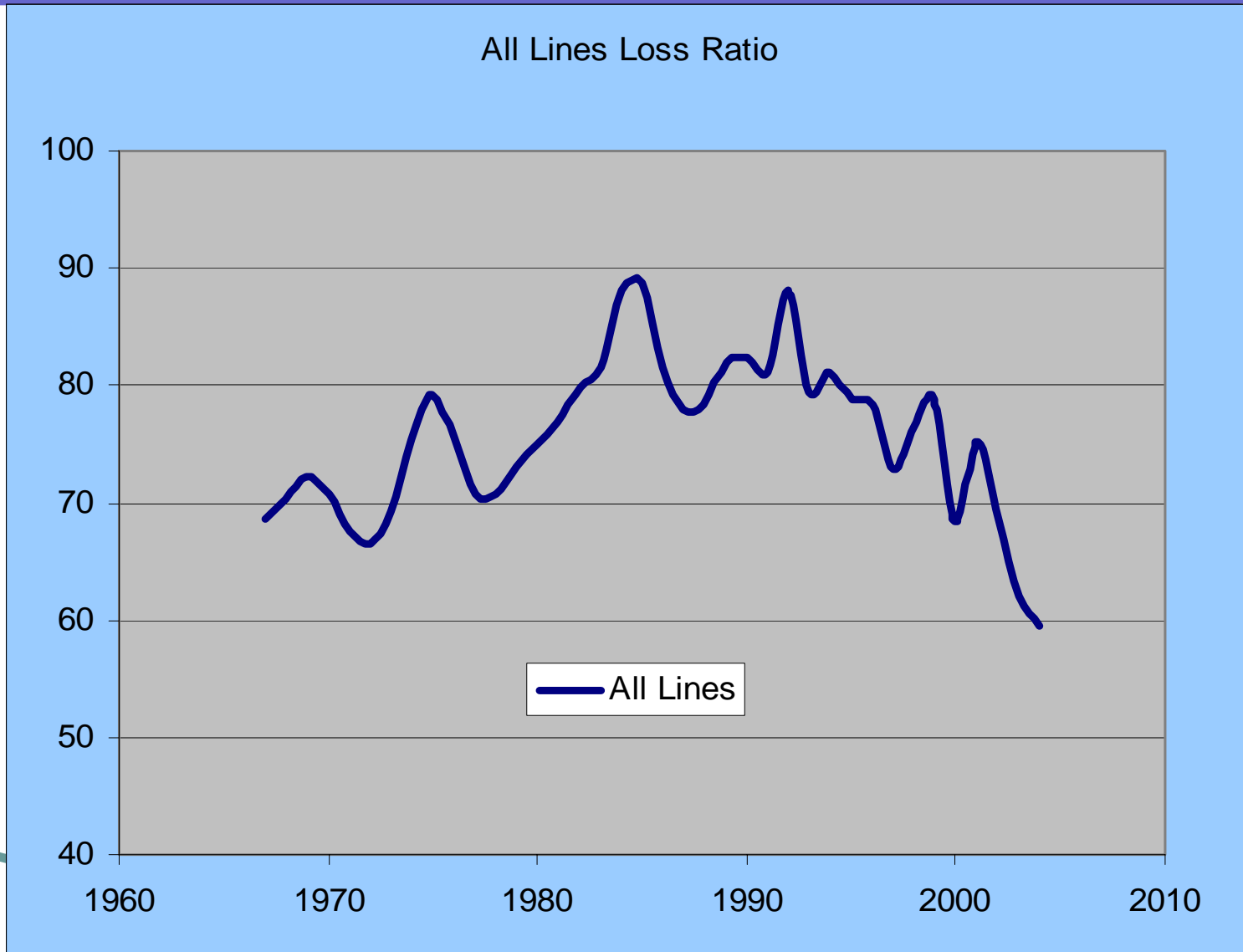


Time

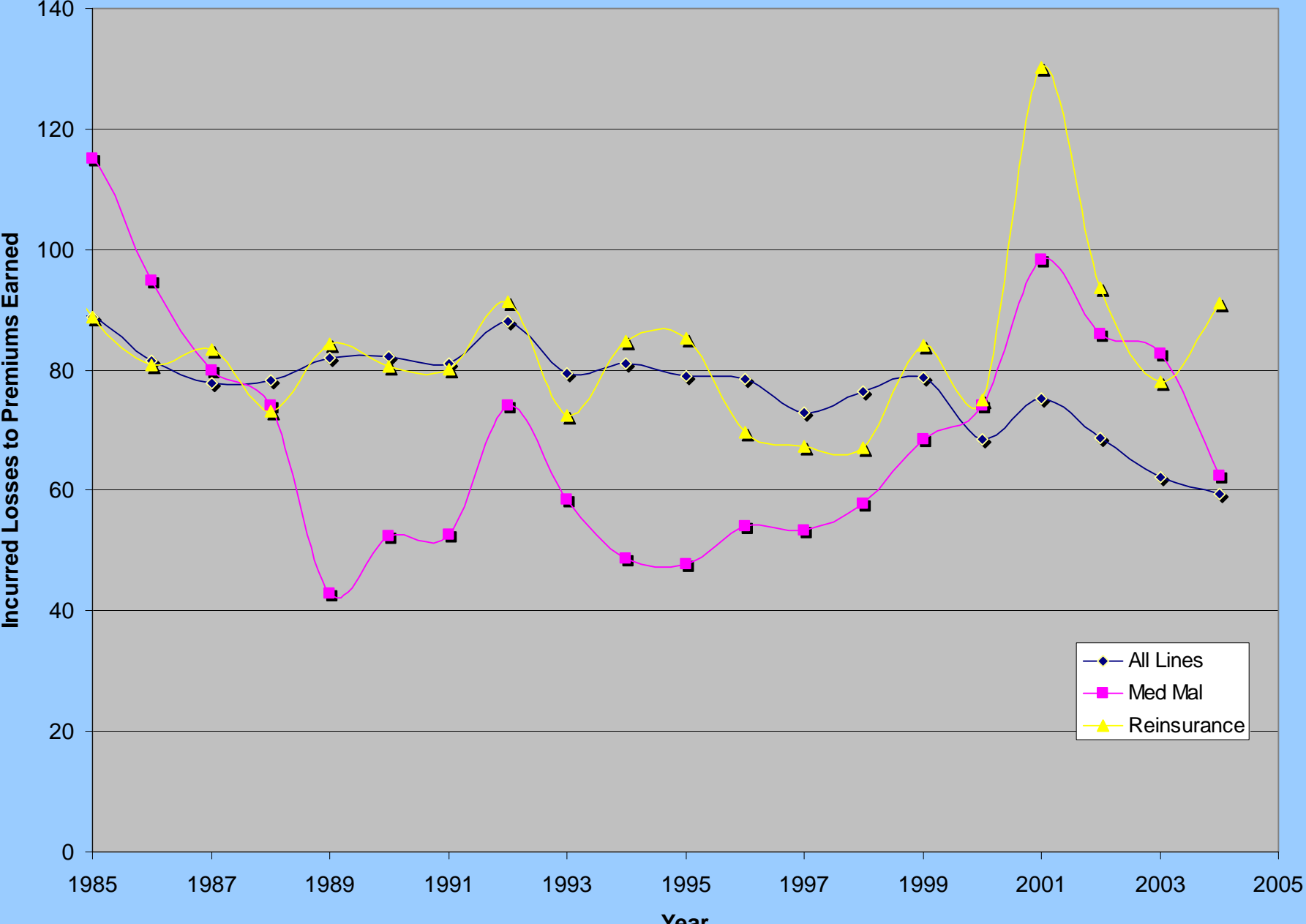
Proper Characterization

- Random Shocks and return to an equilibrium.
- Thus, not predictable and not something that can be managed by regulators or firm managers.
- What Professor Baker does state, which is quite important, is that increased losses do not cause the crisis. However, increased losses concurrent with an external shock is what we see.

But The Reality is Different



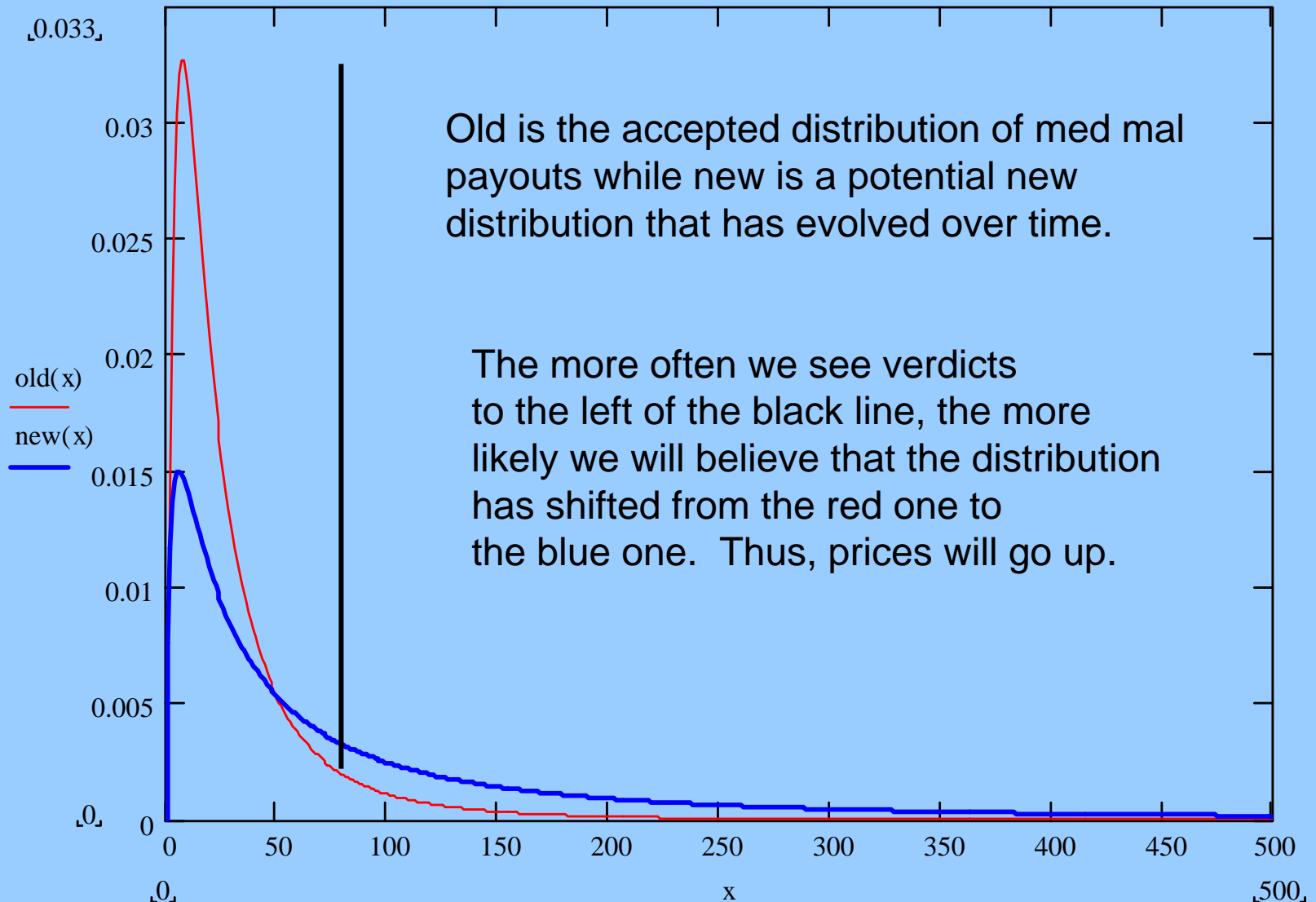
Loss Ratio Over Time for All Lines, Medical Malpractice and Reinsurance



Issue of Insurance Pricing

- Pricing Problem is accurately described
 - Price = $f(\text{Losses, Investment Return, Risk})$
 - But Risk = $f(\text{Uncertainty about Future Losses})$
- While current losses investment income might be relatively certain, most recently we see that there is much increased uncertainty about future losses.
- Because future losses tend to be (currently) increasingly uncertain, we see no real entry into the market to undercut firms that raise prices “too much”.

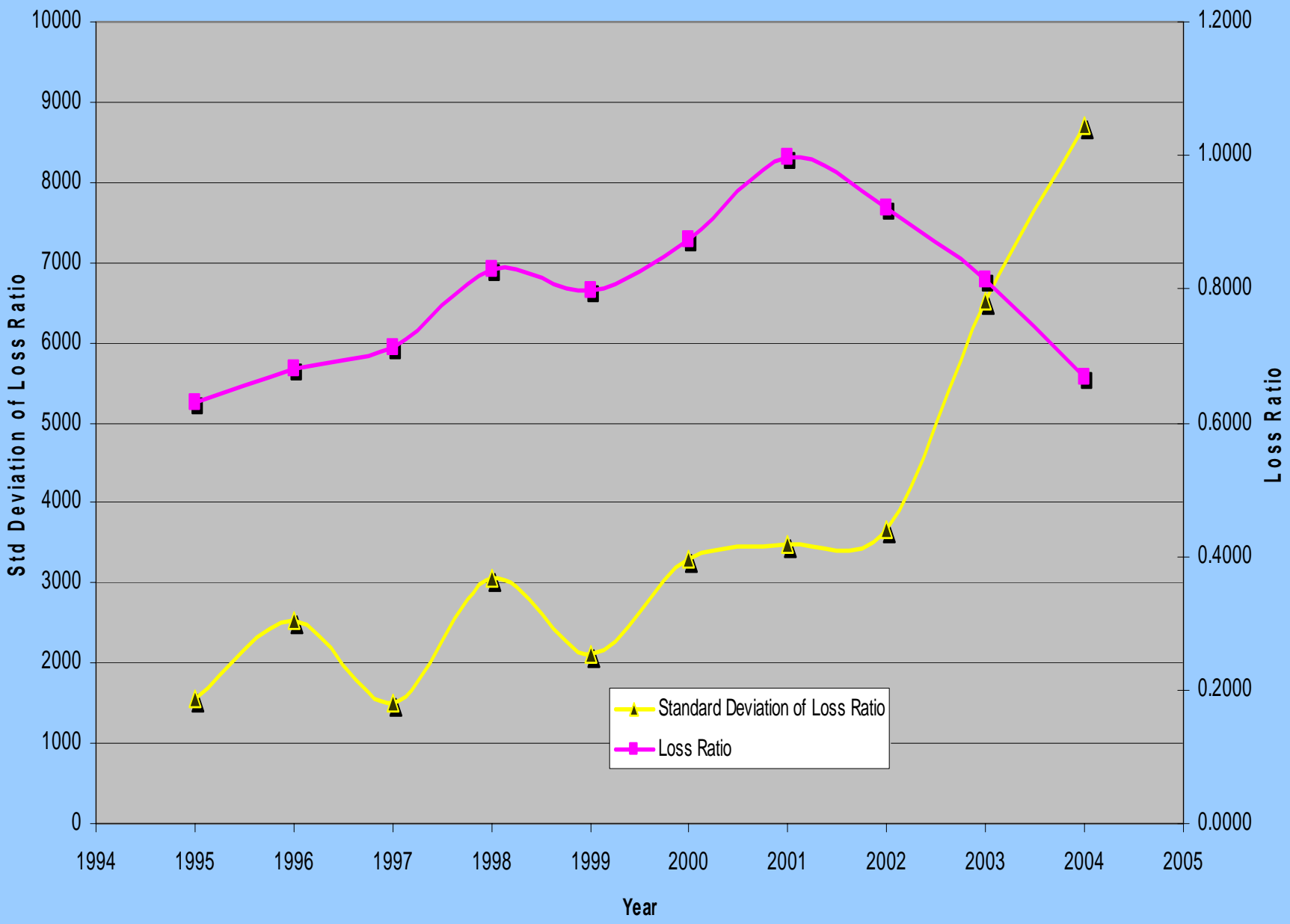
Future Uncertainty (example)



Future Uncertainty is Caused by

- Increased litigation rates
 - Seem constant
- Increased payout-outs
 - Medians seem to be growing slowly, but
 - Prices are not based on Median, but Average
- Increased jury verdicts
 - Anecdotally, the largest verdicts seem to be increasing
 - It doesn't matter (much) that these large verdicts
 - May be in a different state or
 - May be eventually overturned

Average and Standard Deviation of Medical Malpractice Industry Loss ratio, 1995-2004



Conclusions

- Society wants med mal lawsuits to act as both a deterrent and a compensation system.
 - Tort system is an inefficient method of compensating certain injuries.
 - Not clear that it is a good deterrent either.
- Professor Baker's book looks at a lot of evidence and basically says its not the tort system, its not the insurance industry, but it may be the insurance market.
 - He provides a potential solutions such as:
 - Disclosure
 - Enterprise liability

Enterprise Liability

- Because some physicians are practicing in high risk fields, make hospitals pay for mal practice insurance.
 - Hospitals can better manage the risk
 - Hospitals can better negotiate with insurers, health insurers, and government.
 - In many respects this is a way to subsidize high risk specialties by taxing low risk specialties.
 - Could cause hospitals to stop undertaking certain kinds of procedures.
 - Doctors will migrate to fields/hospitals that provide them with the most income all other things equal.
 - Enterprise liability taxes “low risk” physicians and new providers will form leaving potentially the same problem except that it will be by hospitals exposed to “the cycle” rather than individual physicians.