



Policy Research Perspectives

The Impact of Caps on Damages. How are Markets for Medical Liability Insurance and Medical Services Affected?

By Carol K. Kane, PhD and David W. Emmons, PhD

Introduction

The current crisis in the medical liability insurance market has been characterized by insurer exits and rapidly escalating premiums in certain states and specialties.¹ As a result, many physicians have reported that they have moved or plan to move to states where liability premiums are lower, or that they have stopped or intend to stop providing certain services so that they fall into lower risk classifications and are able to pay lower premiums.²

To stem the rise in premiums, many physician organizations including the American Medical Association have called for state or federal tort reform similar to the package of reforms included in California's Medical Injury Compensation Reform Act of 1975 (MICRA). The 1970s and 1980s were also marked by insurance crises in medical liability, and California and other affected states enacted a variety of tort reforms in response. Much of the current debate over medical liability reform is focused on whether MICRA-like reforms – in particular, a cap on non-economic damages – would reduce the growth in both indemnity amounts (insurer losses) and premiums paid by physicians in the future if enacted either at the federal level or in other states today.

Existing research on the impact of caps on non-economic damages on medical liability losses and premiums relies on data from the earlier periods of crisis because it offers the opportunity to compare states that enacted a cap with those that did not, and to compare states that enacted a cap before and after it became effective. This Policy Research Perspective provides a summary of research on the impact of caps including those on punitive and total³ damages in addition to those that apply only to non-economic damages. Our focus is on those papers that employ statistical techniques to control for potentially competing explanations of changes that are observed when simple descriptive statistics are used.

¹ American Medical Association (2004).

² American Medical Association, Division of Market Research (2004).

³ Total damages include non-economic and economic damages.

The literature clearly shows that caps reduce losses relative to what losses would have been without caps. Although premiums are ultimately linked to losses,⁴ it has been more difficult to empirically establish the link between caps and premiums than it has the link between caps and losses – however, more recent papers looking at the impacts of caps on premiums have found an effect.⁵ Finally, two studies published in 2005 reported positive impacts associated with caps on damages on physician supply.

The research summarized in this report measures the average impact of caps that differ in several dimensions including the amount of the cap and whether there are exceptions to the cap for certain types of medical outcomes. States also vary in the manner in which the cap applies to a claim. In some states a single cap applies regardless of the number of defendants named while in others the cap is per defendant. Similarly, in some states a single cap applies regardless of the number of causes of action on which the claim is based or the number of persons claiming damages and in others it is applied per cause of action and per person claiming damages.

Impact of Caps on Losses and Premiums

One branch of this literature relies on data from the end-of-year annual statements filed by insurers with state insurance departments. Those data are not on a per-claim basis or a per-physician basis. Rather, they reflect the aggregate medical liability losses and revenues of each insurer across all insured physicians and filed claims. Some researchers have used the data at the state-insurer level, where the losses and revenues of each insurer in the state remain distinct from one another. Others further aggregate the data so that it is at the state-level—the losses and revenues of each insurer in the state are added together.

- Viscusi and Born (2005) studied the impacts of reforms on premium revenues and incurred losses using state-insurer specific NAIC data for the period 1984 to 1991.⁶ They found that insurers in states that enacted caps on non-economic damages had losses 17% lower than those of insurers in other states and that earned premiums were 6% lower. In addition, losses and premiums of insurers in states where punitive damages were not allowed (i.e., in the case of states with zero dollar caps on punitive damages) were 16% and 8% lower than losses and premiums of insurers in states that allowed punitive damages. Viscusi and Born also reported the more general finding that states with a non-zero cap on punitive damages had incurred losses that were 7% lower than other states. They did not find a corresponding effect on premiums for the more general measure, however.
- Thorpe (2004) studied impacts of reforms on premium revenues and incurred losses using state-specific NAIC data for the period 1985 to 2001. Thorpe found that premium

⁴ Both the General Accounting Office (2003) and the National Association of Insurance Commissioners (Nordman, Cermak, and McDaniel, 2004) issued comprehensive reports that found losses to be the key driver of premiums.

⁵ A number of factors make it difficult to find premium impacts. For one, there may be initial uncertainty about the impact of a cap on losses. As claims subject to a new cap are closed, this uncertainty lessens and insurers are better able to predict how losses will be affected and can appropriately reflect that change in their premiums. In addition, there may be uncertainty as to whether the constitutionality of the cap will withstand judicial scrutiny, and thus whether immediate impacts on losses will continue into the future.

⁶ Earlier papers by Viscusi, Born, and several co-authors have reached similar conclusions. Because the research has evolved over time and the results are robust to the changes in methodology, we have summarized only the 2005 paper which is the most recent. Earlier research includes Viscusi and Born (1995), Viscusi, Zeckhauser, Born, and Blackmon (1993), and Blackmon and Zeckhauser (1991).

revenue was between 13% and 17% lower in states that capped non-economic or total damages than in states that did not. Thorpe also reported a 13% reduction in loss ratios associated with discretionary collateral offset rules. Unlike Viscusi and Born (2005), Thorpe did not find any impacts that were attributable to limitations on punitive damages.

Other papers used per-physician premium data from surveys of insurers conducted by the Health Care Financing Administration.⁷

- Zuckerman, Bovbjerg, and Sloan (1990) examined the impact of a variety of tort reforms on premiums and claim severity using base-rate premium data and average (per-claim) indemnity data from 1975 to 1986. They found that capping physician liability (but not caps on non-economic damages) reduced premiums for general surgeons, general practitioners, and obstetricians and gynecologists on the order of 13% in the year following enactment of a cap and by 34% over the long term. Across all specialties, they found that caps on non-economic damages (but not caps on physician liability) decreased the average indemnity per paid claim (claim severity).⁸
- Sloan (1985) relied on the same source of information on premiums for his analysis but focused on the period 1974 to 1978. Sloan examined premiums paid by general practitioners, ophthalmologists, and orthopedic surgeons. He was unable to find any impact on premiums from either plaintiff recovery limitations or provider liability limitations.

In response to the crisis of the 1970s, the NAIC developed a national database of closed claims. The GAO conducted a similar study of claims closed in 1984.⁹ The following paper uses that information.

- Sloan, Mergenhagen, and Bovbjerg (1989) looked at the impact of tort reform using closed claim data for 1975 through 1978 and 1984. They found that caps on non-economic damages reduced insurer payouts by 31% and reduced payouts-plus-expenses by 23%. The impacts of caps on total damages were somewhat larger, 38% and 39%, respectively.

In a series of papers Daniel Kessler and coauthors examined the impact of “direct” and “indirect” tort reforms of the mid to late 1980s on the markets for medical liability insurance and health care services. Direct reforms include but are not limited to caps on non-economic damages.¹⁰ Viewed as a whole, the authors’ research shows that direct tort reforms reduce a variety of costs associated with the medical liability system.

- Kessler and McClellan (1996) compared hospital expenditures on Medicare beneficiaries with heart disease in states with direct, indirect, and no tort reforms. They concluded that states adopting direct reforms in the late 1980s exhibited reductions in hospital

⁷ HCFA’s name was changed to the Centers for Medicare & Medicaid Services in 2001.

⁸ The authors were not able to resolve the different impacts that caps on physician liability and caps on non-economic damages had on premiums and losses.

⁹ In 2004 the GAO’s legal name became the Government Accountability Office.

¹⁰ Direct reforms include caps on economic, non-economic, or total damages, abolition of punitive damages, no mandatory prejudgment interest, and collateral source rule reform. Indirect reforms include limits on contingency fees, mandatory periodic payments, joint and several liability reform, statute of limitations reform, and existence of a patient compensation fund.

expenditures of 5% to 9% within three to five years without substantial adverse effects on mortality or complications. Because outcomes were not affected, they attributed the cost difference to defensive medicine. If their results are applied to all medical spending, this would have amounted to an \$83.9 to \$151.1 billion reduction in national health spending in 2003.

- Kessler and McClellan (1997) examined “malpractice pressure,” measured by liability premiums and claim frequency, and how that pressure was affected by tort reform. Both the premium and frequency data were from 1985 through 1993 surveys of physicians conducted by the AMA. They found that direct reforms reduced premiums by 8.4% within the first three years after a reform, and reduced the likelihood that a physician would be sued by 2.1%.

A number of literature reviews have also concluded that caps on non-economic damages work to reduce claim severity and premiums.

- Using a variety of data sources, Hamm, Wazzan, and Frech (2005) concluded that MICRA has led to a reduction in medical liability costs both through a reduction in the filing of weak claims and a reduction in the severity of paid claims. After comparing claim frequency in California to that in other states they also concluded that MICRA did not reduce access to the courts.
- The Congressional Budget Office (1998) concluded that caps on non-economic damages were one of two reforms that “have been found extremely effective in reducing the amount of claims paid and medical liability premiums.” The other reform was collateral source offset provisions.
- The Office of Technology Assessment (1993) concluded that “caps on damage awards were the only type of State tort reform that consistently showed significant results in reducing the malpractice cost indicators.”¹¹

The research summarized in this report controls for state differences in a wide variety of factors. For this reason it is more credible than reports which simply compare unadjusted state averages in premiums, losses, or physician supply. Nevertheless, sometimes a simple comparison speaks directly and clearly to the heart of the matter.

- A comparison of annual data on insurers’ earned premium revenues shows that while premiums in California increased by 282% between 1976 and 2003, they increased by 920% in the rest of the country (National Association of Insurance Commissioners, 2004).

Impact on Physician Supply

Debate has also focused on whether physicians respond to premium increases by moving to lower-premium states or by retiring early. This question is not easy to answer because of the difficulty of tracking the movements of nearly 700,000 patient care physicians in “real time.” The American Medical Association’s Physician Masterfile, the sole national, annual source of

¹¹ The OTA was nonpartisan analytical agency that provided assistance to the U.S. Congress for 23 years through 1995.

demographic information on physicians, should only be used to look at longer term changes in physician supply. Two recent papers have used the Masterfile data to do just that.

- Kessler, Sage, and Becker (2005) examined physician supply from 1985 to 2001. They found that direct tort reforms increased physician supply by 2.4% relative to non-reform states. They also looked at the impact on a number of high-risk specialties and found that the impact on emergency physicians was particularly large, 11.5%.
- Encinosa and Hellinger's paper (2005) also looked at the impact of caps on physician supply. They looked specifically at the impact of caps on non-economic damages from 1985 to 2000. They concluded that caps increased the supply of physicians per capita by 2.2% relative to states without caps.

Conclusion

The impacts from caps summarized in this report are average effects found in analyses that have implemented statistical controls for other factors (or potentially competing explanations) for the changes being studied. They measure the average impact of caps that were set at different levels and implemented in states with different pre-cap payment (loss) distributions. The actual impact of a cap in any particular state may be higher or lower than the impacts found in this literature.

Clearly, the body of research on the impacts of tort reform shows that caps have resulted in lower growth in medical liability losses in states that passed caps than in states that did not. The more recent literature on premium effects has found that caps result in lower premium growth. And, two very recent papers based on sufficiently many years of the AMA's Masterfile data have found that non-economic caps and direct tort reforms more generally have a positive effect on the number of physicians per capita in a state.

REFERENCES

- American Medical Association, Division of Market Research and Analysis. *AMA Member Connect Survey: 2004 Medical Liability Reform*. (May 2004).
- American Medical Association. *The Physician Professional Liability Market and Regulatory Environment*. (Chicago, IL: American Medical Association, 2004).
- Blackmon, Glenn and Richard Zeckhauser. "State Tort Reform Legislation: Assessing Our Control of Risks." *Tort Law and the Public Interest*. P.H. Schuck editor (New York, NY: W.W. Norton & Co, 1991): 273-300.
- Encinosa, William E. and Fred J. Hellinger. "Have State Caps On Malpractice Awards Increased The Supply Of Physicians?" *Health Affairs* (June 27, 2005): W5-317-W5-325
<<http://content.healthaffairs.org/contents-by-date.0.shtml>> (accessed on July 7, 2005).
- Hamm, William G., C. Paul Wazzan, and H. E. Frech, III. *MICRA and Access to Healthcare*. (February 2005) <<http://www.micra.org/MICRAStudy22805.pdf>> (accessed on July 7, 2005).
- Kessler, Daniel and Mark McClellan. "Do Doctors Practice Defensive Medicine?" *Quarterly Journal of Economics* 445 (May 1996): 353-389.
- Kessler, Daniel P. and Mark B. McClellan. "The Effects of Malpractice Pressure and Liability Reforms on Physicians' Perceptions of Medical Care." *Law and Contemporary Problems* 60 (Winter 1997): 81-106.
- Kessler, Daniel P., William M. Sage, and David J. Becker. "Impact of Malpractice Reforms on the Supply of Physician Services." *JAMA* 293 (June 1, 2005): 2618-2625.
- National Association of Insurance Commissioners. *Report on Profitability By Line By State in 2003*. (Kansas City, MO: NAIC, 2004).
- Nordman, Eric, Davin Cermak, and Kenneth McDaniel. *Medical Malpractice Insurance Report: A Study of Market Conditions and Potential Solutions to the Recent Crisis*. (Kansas City, MO: NAIC, 2004).
- Sloan, Frank A. "State Responses to the Malpractice Insurance 'Crisis' of the 1970s: An Empirical Assessment." *Journal of Health Politics, Policy and Law* 9 (Winter 1985): 629-647.
- Sloan, Frank A., Paul M. Mergenhagen, and Randall R. Bovbjerg. "Effects of Tort Reforms on the Value of Closed Medical Malpractice Claims: a Microanalysis." *Journal of Health Politics, Policy and Law* 14 (Winter 1989): 663-669.
- Thorpe, Kenneth E. "The Medical Malpractice 'Crisis': Recent Trends And The Impact Of State Tort Reform." *Health Affairs* (May 31, 2005): W5-250-W5-258.
<<http://content.healthaffairs.org/contents-by-date.0.shtml>> (accessed on July 7, 2005).
- United States Congress, Congressional Budget Office. *Preliminary Cost Estimate, H. R. 4250 Patient Protection Act of 1998*. (July 24, 1998).
<<http://www.cbo.gov/ftpdocs/7xx/doc701/hr4250.pdf>> (accessed on July 7, 2005).

United States Congress, Office of the Technology Assessment. "Impact of Legal Reforms on Medical Malpractice Costs." OTA-BP-H-119 (Washington, DC: United States Government Printing Office, September 1993)
<<http://www.wws.princeton.edu/cgi-bin/byteserv.prl/~ota/disk1/1993/9329/9329.pdf>> (accessed on July 7, 2005).

United States General Accounting Office. "Medical Malpractice Insurance: Multiple Factors Have Contributed to Increased Premium Rates." GAO-03-702 (Washington, DC: United States General Accounting Office, June 2003) <<http://www.gao.gov/new.items/d03702.pdf>> (accessed on July 7, 2005).

Viscusi, W. Kip and Patricia Born. "Medical Malpractice Insurance in the Wake of Liability Reform." *The Journal of Legal Studies* 25 (June 1995): 463-490.

Viscusi, W. Kip and Patricia H. Born. "Damage Caps, Insurability, and The Performance of Medical Malpractice Insurance." *The Journal of Risk and Insurance* 72 (March 2005): 23-43.

Viscusi, W. Kip, Richard J. Zeckhauser, Patricia Born, and Glenn Blackmon. "The Effect of 1980s Tort Reform Legislation on General Liability and Medical Malpractice Insurance." *Journal of Risk and Uncertainty* 6 (April 1993): 165-186.

Zuckerman, Stephen, Randall R. Bovbjerg, and Frank Sloan. "Effects of Tort Reforms and Other Factors on Medical Malpractice Insurance Premiums." *Inquiry* 27 (Summer 1990): 167-182.