

Liability

W. Kip Viscusi

■ Until recently, property and liability insurance was a small cost of doing business. But the substantial expansion in what legally constitutes liability over the past thirty years has greatly increased the cost of liability insurance for personal injuries. For U.S. producers of private aircraft, liability insurance expenses now average \$100,000 per plane produced, leading Cessna to cease production and Beech Aircraft to all but eliminate private aircraft production as well. These substantial costs arise because accident victims or their survivors sue aircraft companies in 90 percent of all crashes, even though pilot error is responsible for 85 percent of all accidents.

Riders on the Philadelphia Mass Transit system pay 17 percent of every fare dollar to cover liability insurance costs for passenger injuries. Similarly, 15 to 25 percent of the cost of every ladder purchased is used to defray liability expenses. Major firms, such as A. H. Robins, and entire industries, such as the asbestos industry, have been shut down by the rising liability burden. Ten of the thirteen companies manufacturing vaccines for the five serious childhood diseases exited the market because of rising liability costs.

The dominant legal criterion for determining a firm's liability had traditionally been that of negligence. Firms were responsible for accidents arising from their products only if they did not provide an efficient level of safety (see LAW AND ECONOMICS

for an explanation of how the term *efficient* is used in this case). Over the past three decades, however, broader liability doctrines, some of which have nothing to do with negligence, have placed greater responsibilities on product manufacturers. The adoption of what is called strict liability in the sixties required producers to pay for accident costs in a much broader range of circumstances. One of the stated rationales that the courts have given for this expansion was that producers could serve as the insurers of the accident victims' costs and spread these costs among all consumers through a higher product price.

Another expansion in liability has occurred through a broader concept of what constitutes a design defect. This had been reflected in, for example, a surge of litigation claiming that an inadequate warning—a warning that does not fully inform the user of a product's risks—is enough to deem a product's design to be defective. A federal appeals court found Uniroyal liable for the death of a professional truck driver because it failed to warn of the risks from underinflated tires. FMC lost a product-liability suit involving a crane because there was no warning in the cab about hitting power lines with the machine. Many asbestos cases have focused on whether companies properly informed workers of the cancer risk and the need to avoid breathing asbestos dust.

Increases in liability enhance the incentives to provide safer products. But liability

costs also discourage product innovation. In a 1990 report the National Academy of Sciences concluded that the United States had fallen a decade behind Europe in the development of new contraceptives, partly because of the chilling effect of rising liability costs. In one case, G. D. Searle and Company spent \$1.5 million in a single year to successfully defend itself against four lawsuits for its intrauterine device Copper-7. Since annual sales of the product were only \$11 million, the company chose to discontinue it.

The substantial increase in liability is reflected in the extent of litigation. Between 1974 and 1989, product-liability lawsuits in the federal courts increased sixfold. The product-liability share of all federal civil litigation rose from 2 percent in 1975 to 6 percent in 1989. These increases cannot be accounted for by greater product riskiness. For the period 1977 to 1987, federal product-liability lawsuits increased by 400 percent, whereas total U.S. accident rates declined by 20 percent, motor vehicle accidents by 11 percent, work accident rates by 25 percent, and home accident rates by 26 percent.

The price tag associated with liability suits is also substantial. Million-dollar liability awards have become increasingly common, even for less highly publicized accidents. The median verdict in product-liability cases doubled in nominal terms from 1980 to 1988. Whereas the median product-liability verdict was under \$100,000 in 1971, it had risen to \$405,000 in 1988, a 48 percent increase after adjustment for inflation.

The principal components of these awards are economic damages (lost earn-

ings and medical expenses) and compensation for pain and suffering. Economic damages have risen in part because the cost of medical care has risen. Pain and suffering damages have attracted the most attention from product-liability reformers because their conceptual basis remains ill defined. The legal criteria for such compensation are not well articulated. On an economic basis pain and suffering represents an economic loss that one would generally not choose to insure.

The result of this lack of a conceptual base has been substantial uncertainty in the determination of compensation for pain and suffering. But juries seem willing to see pain and suffering almost anywhere. After an Illinois refinery explosion, for example, a jury awarded \$700,000 to the victim's survivors, even though there was no evidence that the comatose victim was conscious and would have experienced any pain. (The award was overturned on appeal.) Nevertheless, the fact that such awards are granted is one reason why the U.S. Department of Justice and various legal reform groups advocate schedules and limits for compensating pain and suffering. Most recently, there has been a tremendous expansion of the pain-and-suffering concept as passengers on a plane that never crashed have successfully sued for the "fear of death," and witnesses of the death of a stranger have successfully sued for the emotional trauma they experienced by witnessing this death.

Perhaps the most dramatic change in the character of product-liability litigation has been the emergence of mass toxic torts. Agent Orange, asbestos, and the Dalkon Shield cases are the three most notable ex-

amples of such litigation. Each of these lines of litigation has involved more than 100,000 injury claimants—190,000 claimants against the Manville Corporation for asbestos exposures, 150,000 claimants in other asbestos cases, 210,000 claimants against the Dalkon Shield, and 125,000 claimants in the Agent Orange litigation. Asbestos litigation comprised 2 percent of federal product-liability litigation in 1975, but by 1989 the asbestos share had risen to 61 percent. The surge in mass toxic torts had overwhelmed the courts' capacity to process these claims.

These cases are distinguished not only by their number, but also by the difficulties they create for the liability system. Due to the substantial time lags involved, causality has been difficult to determine. It is noteworthy that in the Agent Orange case, legal doctrine (*Feres v. United States*) prevented soldiers from suing the actor primarily responsible for their injuries—the federal government. Consequently, they sought compensation from the deep and more readily available pockets of Dow Chemical Company and other Agent Orange producers. The judge who presided over the Agent Orange litigation could not find any clear-cut causality between Agent Orange and the veterans' ailments and, as a result, fashioned a "compromise" settlement for \$180 million.

Moreover, in the asbestos cases liability was imposed retroactively on firms that could not have anticipated the extent of the risks or the likely litigation costs. This means that one of the main modern rationales for expanded liability—that it gives companies an incentive to avoid accidents—does not apply in the asbestos cases.

The viability of insuring these losses by shifting accident costs onto companies has also come under fire as the Manville Corporation and others have reorganized under federal bankruptcy law and set up trust funds in excess of \$3 billion (in the case of Manville) to cover losses that will inevitably exceed that amount.

The costs of liability are reflected in the liability-insurance costs that firms must pay. Many of the largest firms self-insure. The Ford Motor Company, which insures itself, faced \$4 billion in product-liability damages claims in 1986. Liability costs have also exploded for those who still buy liability insurance. General liability premiums more than quintupled—from \$1.13 billion to \$6.49 billion—between 1968 and 1978. Then between 1978 and 1988, they tripled to \$19.1 billion. What is particularly remarkable is that virtually all of this tripling occurred between 1984 and 1986. Not surprisingly, during the mideighties people began to talk of an emerging liability crisis.

A number of explanations have been offered for this crisis. One is that it may have been caused by the so-called insurance underwriting cycle. Over the decades, insurance companies have periodically underpriced insurance as they competed for more business. Then, as the claims on these underpriced policies generated large losses, the insurers responded by raising prices substantially. Another explanation offered is that the insurance industry may have had a capital shortfall, causing it to decrease the amount of coverage it would write. It did so, according to this explanation, by raising prices. A third explanation is that the crisis was caused by changes in liability—the rise in liability costs; the increased uncertainty

of the liability system, and the presence of highly correlated risks that decrease the ability of insurers to pool offsetting risks in their portfolio. The long-run nature of the rise in insurance premiums and the linkage of this increase to the surge in litigation suggest that shifts in liability doctrine are the major contributors to the rise in liability costs.

Although the short-run crisis has abated,

a broad array of tort-reform groups, ranging from the U.S. Department of Justice to the American Law Institute, has concluded that the liability system must be restructured to provide an efficient level of deterrence, to provide appropriate incentives for the introduction of new products, and to meet the legitimate needs of accident victims.

—W. Kip Viscusi

Biography: W. Kip Viscusi is the George G. Allen Professor of Economics at Duke University. He served as associate reporter for the American Law Institute Study of Enterprise Responsibility for Personal Injury. While a student at Harvard, he spent two summers working for Ralph Nader.

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