



December 10, 2009

Honorable John D. Rockefeller IV  
United States Senate  
Washington, DC 20510

Dear Senator:

This letter responds to questions you posed about the Congressional Budget Office's (CBO's) recent analysis of the budgetary effects of proposals to limit costs related to medical malpractice ("tort reform"), as described in a letter to Senator Hatch.<sup>1</sup> In particular, this letter addresses your questions about how recent empirical studies affected CBO's analysis, why CBO's latest estimates of the budgetary effects of tort reform are larger than the agency's previous estimates, and whether tort reform would have a negative impact on patients' health.

In the letter to Senator Hatch, CBO concluded that tort reform would lower costs for health care both directly, by reducing medical malpractice costs, and indirectly, by reducing the use of health care services through changes in the practice patterns of providers; the agency estimated that enacting a package of proposals outlined in that letter would reduce federal budget deficits by about \$54 billion during the 2010–2019 period. Previously, the agency had found that tort reform would lower health care costs only by reducing medical malpractice costs, and it had estimated significantly smaller effects of tort reform on the federal budget. In the letter to Senator Hatch, CBO noted that imposing limits on suits for damages resulting from negligent health care might have a negative impact on health outcomes but concluded that the evidence is less clear about the effects of tort reform on health outcomes than it is about the effects on health care costs.

### **Recent Research Findings**

CBO's latest assessment of the effects of tort reform on spending for health care draws on a considerable amount of analysis that the agency has undertaken during the past several years and a stream of recent research studies that have used a

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<sup>1</sup> Congressional Budget Office, [letter to the Honorable Orrin G. Hatch regarding effects of proposals to limit costs related to medical malpractice](#) (October 9, 2009).

variety of data and empirical techniques.<sup>2</sup> Despite that analysis, estimates of the budgetary effects of tort reform are unavoidably uncertain, as is true for many other issues that CBO studies. In dealing with uncertainty, the agency consistently strives to produce estimates that lie in the middle of the distribution of plausible outcomes based upon available knowledge.

After a careful evaluation of the research relevant to tort reform, along with discussions with members of the agency's Panel of Health Advisers who have particular expertise in this topic, CBO concluded that the weight of empirical evidence now demonstrates a link between tort reform and the use of health care services. The estimates from CBO's own empirical analysis in 2006 implied that implementing the package of tort reforms described in the recent letter to Senator Hatch would reduce the use of health care services and, thereby, health care spending—a finding that was consistent with the results of some studies done by outside researchers.<sup>3</sup> However, the studies available at that time (including CBO's) reported estimates that varied considerably in magnitude and contained some anomalous results, so CBO concluded that there was not sufficient evidence to incorporate in its budget estimates an effect of tort reform on health care utilization. More-recent studies have provided further support for the hypothesis that tort reform would slightly reduce the use of health care, and they have helped to resolve some apparent anomalies in earlier findings.<sup>4</sup>

For example, studies by Lakdawalla and Seabury and by Avraham, Dafny, and Schanzenbach analyzed data that had not been used in previous research and used statistical methods that strengthened the evidence regarding the effects of tort reform on health care utilization and spending. Previous research had generally compared changes in health care spending over time in states that had and had not adopted tort reforms, controlling for other observable differences among states. Lakdawalla and Seabury used an approach that did not rely on comparisons of state tort reforms; they found that a reduction in medical malpractice costs was

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<sup>2</sup> For CBO's earlier analyses, see *The Effects of Tort Reform: Evidence from the States* (June 2004) and *Medical Malpractice Tort Limits and Health Care Spending* (April 2006).

<sup>3</sup> See Daniel Kessler and Mark McClellan, "Do Doctors Practice Defensive Medicine?" *Quarterly Journal of Economics*, vol. 111, no. 2 (1996), pp. 354–380; and Daniel Kessler and Mark McClellan, "Malpractice Law and Health Care Reform: Optimal Liability Policy in an Era of Managed Care," *Journal of Public Economics*, vol. 84, no. 2 (2002), pp.175–195.

<sup>4</sup> See Ronen Avraham, Leemore S. Dafny, and Max M. Schanzenbach, *The Impact of Tort Reform on Employer-Sponsored Health Insurance Premiums*, Working Paper No. w15371 (Cambridge, Mass.: National Bureau of Economic Research, September 2009); Katherine Baicker, Elliot S. Fisher, and Amitabh Chandra, "Malpractice Liability Costs and the Practice of Medicine in the Medicare Program," *Health Affairs*, vol. 26, no. 3 (2007), pp. 841–852; Janet Currie and W. Bentley MacLeod, "First Do No Harm? Tort Reform and Birth Outcomes," *Quarterly Journal of Economics*, vol. 123, no. 2 (2008), pp. 795–830; Darius N. Lakdawalla and Seth A. Seabury, *The Welfare Effects of Medical Malpractice Liability*, Working Paper No. w15383 (Cambridge, Mass.: National Bureau of Economic Research, September 2009); and Frank A. Sloan and John H. Shadle, "Is There Empirical Evidence for "Defensive Medicine"? A Reassessment," *Journal of Health Economics*, vol. 28, no. 2 (2009), pp. 481–491.

associated with a reduction in health care spending that exceeded what would arise solely from the direct effect of that reduction in malpractice costs. Avraham, Dafny, and Schanzenbach analyzed the impact of tort reform on health insurance premiums; they found that tort reform was associated with a reduction in premiums for self-insured plans that, again, exceeded what would arise from the direct effect of tort reform on malpractice costs.

In addition, a study by Baicker, Fisher, and Chandra found that use of diagnostic services, especially imaging, showed the largest changes in response to a change in malpractice costs. That result is consistent with a common view that ordering additional diagnostic services is a preferred strategy for reducing exposure to medical malpractice liability. That study reinforced the findings from other studies that tort reform would affect health care utilization by changing the practice patterns of providers. A study by Sloan and Shadle found mixed evidence of an effect of tort reform on health care spending. The authors estimated that certain types of tort reform had no effect on total spending by hospitals, while other types decreased it.

Previous research by CBO and others had found that replacing “joint and several” liability laws with a “fair share” rule appeared to increase health care spending—in contrast with other tort reforms, such as caps on noneconomic damages, which appeared to decrease spending. A study by Currie and MacLeod explained that a fair share rule is unusual among commonly discussed tort reforms because it increases the risk of financial liability perceived by most physicians. In CBO’s view, if physicians generally react to greater liability pressure by performing more procedures, then a fair share rule would be expected to increase overall health care utilization and spending.<sup>5</sup> That explanation helped to make sense of previously counterintuitive results and therefore gave CBO greater confidence in those earlier results.

### **CBO’s Updated Estimates of the Budgetary Effects of Tort Reform**

In CBO’s December 2008 *Budget Options* volume, a common package of tort reform proposals was estimated to decrease spending by about \$4 billion and to increase revenues by about \$1 billion from 2010 to 2019.<sup>6</sup> In CBO’s letter to Senator Hatch, those proposals were estimated to decrease spending by roughly \$41 billion and increase revenues by roughly \$13 billion over that same period. The latest estimates are substantially larger than the earlier ones for four principal reasons:

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<sup>5</sup> Seemingly contrary to that logic, Currie and MacLeod estimated that adopting a fair share rule decreased utilization. However, their analysis focused on a single procedure, births by Caesarean section.

<sup>6</sup> See Congressional Budget Office, *Budget Options, Volume 1: Health Care* (December 2008), pp. 21–22.

- They include a larger estimate of the effect of tort reform on medical malpractice costs;
- They incorporate the effect of a gradual reduction in the utilization of health care services resulting from changes in the practice patterns of providers;
- The estimated effect on federal revenues was substantially smaller in the previous estimate (which reflected only a reduction in malpractice costs) than the estimated effect on revenues in the current estimate (which reflects the combined effects of the reduction in malpractice costs and the change in spending attributable to changes in practice patterns); and
- The reduction in utilization is projected to generate a proportionately larger reduction in federal spending on health care than in other spending on health care.

**Tort Reform Would Have a Greater Effect on Malpractice Costs.** CBO periodically updates its estimates of the effect of tort reform on malpractice costs as new data on malpractice costs and state laws become available and the agency improves its techniques for modeling the effects of tort reform. CBO currently estimates that the nation's direct costs for medical malpractice—which consist of malpractice insurance premiums and settlements, awards, and administrative costs not covered by insurance—would be reduced by about 10 percent (relative to the amounts under current law) if the common package of tort reforms was implemented nationwide. CBO's previous estimate was that tort reform would lower malpractice costs nationwide by about 6 percent.<sup>7</sup>

**Tort Reform Would Also Affect the Utilization of Health Care Services.** As described in CBO's letter to Senator Hatch and reiterated above, the agency's estimates of the effects of tort reform now incorporate a slight reduction in the utilization of health care attributable to changes in the practice patterns of providers. The combination of direct savings in malpractice costs and indirect savings in health care services would reduce national health spending in response to the proposed reforms by roughly 0.5 percent, CBO projects. The increase in CBO's estimate of the effects of tort reform on health care spending—arising from both the larger estimated change in malpractice costs and the incorporation of the change in utilization owing to changes in practice patterns—implies a significant increase in the estimated effects of tort reform on both federal tax revenues and federal outlays.

**The Effect of Reduced Health Care Spending on Revenues Would Be Greater.** On the revenue side, a reduction in spending on health care arising from

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<sup>7</sup> See Congressional Budget Office, *Key Issues in Analyzing Major Health Insurance Proposals*, pp. 150–154.

tort reform would shift some compensation from employment-based health insurance (which is excluded from income and payroll taxes) to taxable wages and salaries, thereby increasing tax revenues. That reduction in spending on health care—and the resulting revenue impact—would be the combined effect of three consequences of tort reform: a reduction in malpractice costs; a reduction in the use of health care services; and an increase in the amount of health insurance purchased because of lower insurance prices brought about by the two other factors. In CBO's previous estimate, the second factor on that list was not included, and the induced increase in insurance purchases offset a considerable share of the decrease in spending due to lower malpractice costs; as a result, the net reduction in spending was a good deal smaller than the 0.2 percent figure that represents CBO's current assessment of the effect of tort reform on health care spending due to the reduction in malpractice costs. In CBO's latest estimate, the reduction in spending owing to changes in providers' practice patterns significantly outweighs the induced increase in insurance purchases; as a result, the net reduction in spending incorporating all three factors listed above is 0.5 percent. Thus, the estimated increase in federal tax revenues from tort reform has risen by more than the ratio of 0.5 to 0.2.

**Changes in Utilization Would Have a Proportionately Greater Effect on Federal Spending.** On the outlay side, the reduction in the utilization of health care services due to changes in practice patterns would have a proportionately larger effect on federal spending for health care than it would have on other spending for health care. The most important reason for the difference is that, according to empirical evidence, utilization of care in Medicare would be reduced more than would utilization of care as a whole. The greater impact in Medicare can probably be explained by two factors. First, the bulk of Medicare services are provided on a fee-for-service basis, whereas most private health care spending occurs through plans that manage the utilization of care to some degree. Such plans may limit the use of services that have marginal benefit to patients to a greater degree than does Medicare, leaving less room for changes in pressures regarding malpractice to affect utilization. Second, when compared with the use of private health care services, the use of services in Medicare is less likely to be influenced by the effects of changes in malpractice costs on the premiums and cost sharing faced by patients.

#### **Effects of Tort Reform on Patients' Health**

As you noted in your letter, the potential impact of tort reform on the quality of health care and on health outcomes is an important consideration for policymakers. CBO's letter to Senator Hatch observed that imposing limits on patients' suits involving harm from negligent health care might be expected to have a negative effect on health outcomes. The letter also noted that there is less evidence about the effects of tort reform on people's health than there is about its effects on health care spending, because many studies of malpractice costs have not examined health outcomes.

Among the analyses that have investigated health outcomes, the study by Lakdawalla and Seabury cited earlier reported that lower malpractice costs were associated with an increase in mortality, while the study by Currie and MacLeod found positive impacts on health from reform of joint and several liability and negative impacts from caps on noneconomic damages. Studies by Kessler and McClellan (1996 and 2002) and Sloan and Shadle (2009) found that state tort reforms had no significant effects on health. Thus, the limited evidence currently available about the effects of tort reform on health outcomes is much more mixed than the larger collection of evidence currently available about the effects of tort reform on health care spending.

Those mixed results related to health outcomes may arise, in part, because of the complicated relationship between malpractice claims and medical errors. As CBO discussed in its December 2008 *Key Issues in Analyzing Major Health Insurance Proposals*, an estimated 181,000 severe medical injuries attributable to negligence occurred in U.S. hospitals in 2003.<sup>8</sup> However, the correlation between errors and malpractice claims is weaker than might be supposed. An analysis using data from the state of New York, called the Harvard Medical Practice Study, showed that a majority of hospital patients who suffered injuries because of negligence never filed claims and that a substantial fraction of claims that were filed involved health problems that did not appear to be caused by negligence (as judged by a panel of medical professionals)—although patients who suffered injuries due to negligence were more likely to file claims and to receive higher compensation than patients who did not suffer injuries due to negligence.<sup>9</sup>

Your letter raised the concern that, if tort reform led to worse health outcomes, future health care spending could be higher. CBO's estimates of the likely effects of tort reform are based on research that links changes in malpractice costs to changes in health care spending, including not only the spending changes caused by providers' responses to changes in the medical liability environment but also the spending changes resulting from associated changes in health status. With all of those factors taken into account, the weight of evidence indicates that tort reform would reduce the utilization of health care services and, thereby, spending. Nevertheless, spending might increase for certain patients, providers, or procedures, while decreasing for others.<sup>10</sup> In addition, currently available research

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<sup>8</sup> See Congressional Budget Office, *Key Issues*, pp. 150–154.

<sup>9</sup> See Paul C. Weiler and others, *A Measure of Malpractice: Medical Injury, Malpractice Litigation and Patient Compensation* (Cambridge, Mass.: Harvard University Press, 1993). Similar patterns of results have been documented in subsequent studies, including David M. Studdert and others, "Negligent Care and Malpractice Claiming Behavior in Utah and Colorado," *Medical Care*, vol. 38, no. 3 (2000), pp. 250–260; and David M. Studdert and others, "Claims, Errors, and Compensation Payments in Medical Malpractice Litigation," *New England Journal of Medicine*, vol. 354, no. 19 (2006), pp. 2024–2033.

<sup>10</sup> For example, Currie and MacLeod found that the rates at which Caesarean-section deliveries were performed increased when caps on noneconomic damages were implemented.

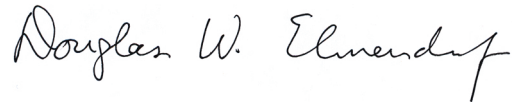
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might not capture the effects that changes in health outcomes due to tort reform could have on health care spending over the long run; hopefully, future research can fill that gap.

I hope you find this information useful. If you have any further questions, please contact me or my staff. The primary staff contact is Stuart Hagen.

Sincerely,

A handwritten signature in black ink that reads "Douglas W. Elmendorf". The signature is written in a cursive, flowing style.

Douglas W. Elmendorf  
Director

cc: Honorable Orrin G. Hatch

Honorable Patrick J. Leahy  
Chairman  
Senate Committee on the Judiciary

Honorable Jeff Sessions  
Ranking Member  
Senate Committee on the Judiciary

Honorable John Conyers, Jr.  
Chairman  
House Committee on the Judiciary

Honorable Lamar Smith  
Ranking Member  
House Committee on the Judiciary