AUTO CHOICE: RELIEF FOR BUSINESSES & CONSUMERS

A JOINT ECONOMIC COMMITTEE STUDY

Prepared at the Request of

U.S. Representative Dick Armey (R-TX),
House Majority Leader
and
U.S. Senator Mitch McConnell (R-KY)

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Executive Summary

This study examines the cost of auto injuries and related legal expenses to employers, as well as the potential relief that the Auto Choice reform could provide.

- Businesses spent close to $21 billion on liability insurance for auto accidents in 1994, averaging more than $64,000 per on-the-job injury. Employers spent an additional $18 billion on fringe benefits for auto injuries.

- The tort system's perverse incentives increase the cost of doing business by diverting resources from worker payroll and capital investments, as well as increasing the costs of shipping goods to market.

- Lawsuits related to auto accidents are the most common type of tort litigation brought against businesses. Excessive liability insurance costs can easily bankrupt small businesses, most of whom have gross annual receipts under $25,000.

- Auto Choice would reduce the cost of commercial auto insurance by 27 percent on average, totaling up to $8.1 billion in the first year and $41 billion over five years.

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INTRODUCTION

Compensating auto injuries through tort litigation imposes significant costs on all types of businesses, ranging from small entrepreneurs to corporations with thousands of vehicles. For many businesses, auto insurance is an unavoidable cost of doing business that must be covered by the prices they charge consumers. Unfortunately, all the factors that make auto insurance too expensive for private policyholders also make it burdensome for commercial policyholders. These high costs, in turn, adversely impact productive business activity.

Transportation is one of the most fundamental aspects of commerce. At one level or another, the use of automobiles, buses or trucks affects virtually every business transaction. Highway transportation is by far the most common method of transporting goods in the United States, accounting for more than 72 percent, or $4.4 trillion, of the value of all shipments.[1] Even businesses that are not traditionally thought of as transportation services face auto insurance costs. For example, an activity as simple as restocking grocery store shelves or vending machines requires delivery trucks with liability insurance. Motor vehicles are critical in getting employees to work, with 88 percent of workers relying on personal vehicles for their commuting needs.[2] Employers are further affected when their employees are injured, either in on-the-job or off-the-job auto accidents. Whenever the cost of transportation increases, commercial activity suffers.

Ultimately, the costs of the tort litigation system are passed on to consumers in the form of higher prices and reduced profits and dividends paid to stockholders. Workers are further impacted when excessive liability costs lower employment by diverting resources from payroll and production purposes. One proposal that would help reduce the costs of auto injuries, while increasing compensation for measurable economic loss, is Auto Choice. This paper examines the cost of auto injuries and legal expenses for employers, as well as the potential relief that the Auto Choice reform could provide.

THE CURRENT SYSTEM AND AUTO CHOICE REFORM

The current auto insurance system suffers from two primary shortcomings. First, the incentives in the tort liability system encourage accident victims to inflate their insurance claims above their actual losses in order to increase their damage awards. Unlike traditional health or homeowners insurance plans, the lawsuit-based system for compensating auto injuries allows claimants to seek payment for their non-economic losses. Absent an objective way to value such non-economic ("pain and suffering") damages, the rule of thumb is simply to calculate these

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[1] U.S. Department of Transportation, Bureau of Transportation Statistics, *1993 Commodity Flow Survey – United States Highlights* (Washington, DC: Bureau of Transportation Statistics, 1997), 4.
[2] U.S. Department of Transportation, Federal Highway Administration, *Journey-to-Work Trends in the United States and Its Major Metropolitan Areas, 1960-1990* (Washington, DC: Government Printing Office, 1993), 2-3.

losses as two to three times the claimant's economic (i.e., lost wages and medical bills) losses.[3] Since pain and suffering awards are measured as a multiple of medical and wage losses, there is a powerful incentive to inflate one's claimed economic damages and pursue legal action.[4]

Overall, the RAND Institute for Civil Justice estimates that between 35 and 42 percent of all medical claims under auto insurance occur in response to the incentives of the tort liability system. These fraudulent claims resulted in $4 billion in excess health care consumption and $13 to $18 billion in higher auto insurance premiums in 1993.[5] Following a nationwide investigation into health insurance and auto insurance fraud related to auto accidents, FBI Director Louis Freeh estimated, "Every American household is burdened with over $200 annually in additional premiums to make up for this type of [insurance] fraud."[6]

The second shortcoming of today's auto insurance system is the failure to fairly compensate serious auto injuries. Despite the high price of insurance, injured victims rarely recover all of their economic losses when seriously injured in an auto accident. According to RAND, accident victims with between $25,000 and $100,000 of economic losses on average recover just 56 percent of their losses. Victims with catastrophic injuries over $100,000 recoup just 9 percent of their economic damages on average.[7]

The Auto Choice reform is designed to increase compensation for actual economic losses and remedy the tort system's perverse incentives.[8] In essence, Auto Choice would make insurance coverage for pain and suffering optional. Drivers who want to exit the liability system's pain and suffering regime would do so by purchasing personal protection insurance (PPI). Rather than suing other drivers or their insurance companies, drivers who elect PPI would automatically be compensated for all economic losses up to policy limits by their own insurance company, without regard to fault.[9] PPI drivers retain the right to sue for economic losses above policy limits. Since PPI provides insurance coverage for economic damages only, PPI drivers could neither sue nor be sued for non-economic losses, with the important exceptions of injuries inflicted intentionally or as the result of drug or alcohol use.

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[3] According to one legal textbook, "Pain and suffering and similar nonmonetary damages probably average three times the monetary damages in personal injury claims." Charles W. Wolfram, *Modern Legal Ethics* (St. Paul, MN: West Publishing Co., 1986), 528 at note 21.

[4] Evidence on the effect of such incentives can be found in Sarah S. Marter and Herbert I. Weisberg, "Medical Expenses and the Massachusetts Automobile Tort Reform Law: A First Review of 1989 Bodily Injury Liability Claims," *Journal of Insurance Regulation* 10, no. 4 (Summer 1992): 512; and Insurance Research Council, *Automobile Injury Claims in Hawaii* (Oak Brook, IL: Insurance Research Council, 1991), 26.

[5] Stephen Carroll, Allan Abrahamse, and Mary Vaiana, *The Costs of Excess Medical Claims for Automobile Personal Injuries*, (Santa Monica, CA: RAND, 1995), 23.

[6] U.S. Department of Justice, Federal Bureau of Investigation, Press Release (Washington, DC: Federal Bureau of Investigation, 5/24/95).

[7] Stephen J. Carroll, James S. Kakalik, Nicholas M. Pace, and John L. Adams, *No-Fault Approaches to Compensating People Injured in Automobile Accidents* (Santa Monica, CA: RAND, 1991), 187.

[8] The proposal is more fully described in Jeffrey O'Connell, Stephen Carroll, Michael Horowitz, Allan Abrahamse, and Paul Jamieson, "The Comparative Costs of Allowing Consumer Choice for Auto Insurance in All Fifty States," *Maryland Law Review*, 55, no. 1 (1996): 160-222. See also O'Connell et al. (1995) and O'Connell et al. (1993).

[9] Fault would no longer matter with respect to injury compensation only. Insurance rates would continue to penalize negligent drivers with higher premiums.

Alternatively, individuals could retain the same basic rights they currently have by purchasing tort maintenance coverage (TMC) to cover accidents involving PPI drivers. Compensation for accidents involving other drivers who stay with the current system would be unaffected. For accidents involving PPI drivers, TMC policies allow recovery of both economic and non-economic losses, much as existing uninsured motorist (UM) policies currently provide first-party coverage for such accidents. Thus, the limit on recovery for pain and suffering losses caused by a PPI driver is chosen by the TMC driver.[10] If losses exceed TMC policy limits, TMC drivers can sue negligent PPI drivers for all of the remaining economic loss.[11] Drivers who elect the TMC option could do so at essentially no extra cost.[12]

Bipartisan legislation has been introduced in Congress to implement Auto Choice. In the House of Representatives, the primary sponsors of the Auto Choice Reform Act (H.R. 2021) are House Majority Leader Dick Armey (R-TX) and Representative Jim Moran (D-VA). Similar legislation has been introduced in the Senate (S. 625) by Senators Mitch McConnell (R-KY), Joseph I. Lieberman (D-CT) and Daniel Patrick Moynihan (D-NY).

THE COST OF AUTO ACCIDENTS TO EMPLOYERS

According to the National Highway Traffic Safety Administration (NHTSA), there were 1.6 million commercial vehicle crashes in 1994. These crashes injured approximately 323,000 workers and caused 171,000 lost workdays in 1994.[13] One out of every five lost workdays is attributable to motor vehicle crashes.[14]

Both on-the-job and off-the-job auto injuries result in costs to employers. On-the-job auto injuries require employers to pay for auto injuries suffered by their employees (generally through

Table 1. Employer Costs from Auto Accidents in 1994 (billions)

	On the Job	Off the Job	Total
Fringe health benefits	$4.0	$14.3	$18.3
Liability insurance	$20.7	$0.0	$20.7
Property damage insurance	$7.2	$0.0	$7.2
Other costs	$7.6	$4.5	$12.1
Wages for risk-taking	$11.6	$0.0	$11.6
Total	**$51.0**	**$18.8**	**$69.8**

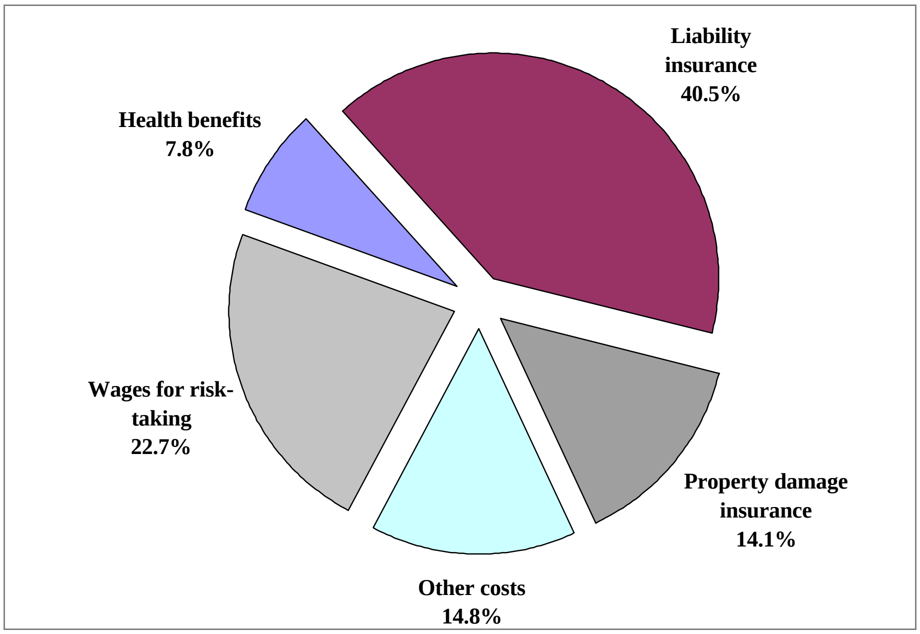
Source: Joint Economic Committee calculations and National Highway Traffic Safety Administration. See note 16.

[10] Under the current tort system, the limit on pain and suffering recovery is typically set by the negligent driver's insurance policy, or set at zero in the case of uninsured drivers.
[11] The version of Auto Choice examined here requires PPI drivers to also purchase supplementary liability insurance to provide additional coverage for certain situations, such as injuries to pedestrians and excess economic losses.
[12] The RAND Institute for Civil Justice estimates that the cost of remaining in the current system would be no greater than it is today. For drivers who wish to remain with their state's current system, the extra cost of purchasing a TMC policy would be offset by the reduced cost of liability insurance, since they would no longer be liable to PPI drivers for non-economic losses. See *infra* note 34, Carroll and Abrahamse, 22-23.
[13] U.S. Department of Transportation, National Highway Traffic Safety Administration (NHTSA), *What Do Traffic Crashes Cost? Total Costs to Employers by State and Industry*, DOT HS 808-478 (Washington, DC: National Highway Traffic Safety Administration. 1996), 5, 13.
[14] Ted R. Miller, "Injuries to Workers and Their Dependents," *Journal of Safety Research* 26, no. 2 (Summer 1995): 83.

workers' compensation insurance), higher wages for risk-taking[15], property damage losses, and liability insurance. Although employers do not generally face liability costs for off-the-job accidents, their health benefit plans pick up much of the health costs of such injuries to workers and their dependents.

The total cost to employers for auto injuries was $70 billion in 1994 (Table 1).[16] On-the-job auto accidents cost employers $51 billion. Liability insurance was the single biggest expense, accounting for close to $21 billion, or 40.5 percent of total costs (Figure 1).[17] Auto liability insurance costs average nearly $13,000 per crash and more than $64,000 per on-the-job injury.[18]

Figure 1. Costs of On-the-Job Auto Injuries to Employers



Source: Joint Economic Committee calculations using data from the National Highway Traffic Safety Administration.

In addition, since the tort liability system is so inefficient at compensating accident victims, employer-provided fringe benefits often pay the costs of auto injuries. Fringe benefits primarily include workers' compensation insurance, health insurance, life and disability insurance, and sick leave.[19] Auto injuries cost employers more than $18 billion in such fringe benefits in 1994, approximately half of which went for

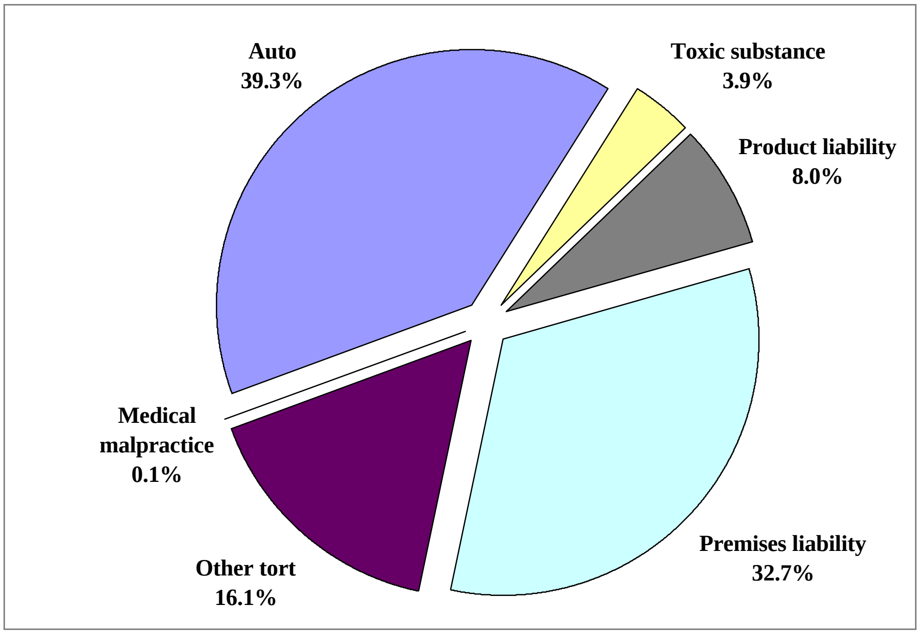
[15] Higher wages for risk-taking refers to the additional wages employers must pay to compensate workers for the risk of injury associated with motor vehicle accidents.
[16] The basic data for this estimate come from a NHTSA study estimating 1994 costs at $54.7 billion. The $69.8 billion figure updates the NHTSA estimate to incorporate newer premium data as well as self-insurance costs that were not accounted for in the NHTSA report. U.S. Department of Transportation, *What Do Traffic Crashes Cost?*.
[17] Figure includes the cost of both conventional and self-insurance plans. Self-insurance refers to companies that choose to assume all liability risks themselves, rather then paying a third-party insurance company to assume such liability. Conventional premium data from A.M. Best, and self-insurance costs are estimates based on data provided by Conning & Co. See Joint Economic Committee, Congress of the United States, *Auto Choice: Impact on Cities and the Poor* (Washington, DC: Joint Economic Committee, 1998), 33-38.
[18] No estimate exists of the number of non-employees injured in accidents with commercial vehicles. The available data suggest, however, that the figure would be less than the 323,000 employee injuries (since some injuries are sustained in single-car accidents where no other drivers or passengers are hurt).
[19] Although workers' compensation nominally covers all work-related injuries, it is possible for some individuals to sue their employers based on tort liability under certain conditions. See Nancy H. Kratzke and Michael J. McNamara, "Workers Compensation v. Tort Liability," *CPCU Journal* 50, no. 4 (Winter 1997): 246-252.

health care expenses. The vast majority (78 percent) of these fringe benefit costs resulted from off-the-job crashes.

As noted above, upwards of 35 percent of claimed medical costs are fraudulent, induced by the perverse incentives of the tort system. Employers end up bearing the costs of excessive claiming behavior in at least three ways. First, employers pay more for liability insurance to cover inflated injury claims. Second, employer-provided benefit plans pay substantial amounts to injury claimants who game the system by receiving duplicate payment for the same injury ("double-dipping").[20] Third, when individuals engage in excessive claiming behavior for off-the-job auto accidents, some costs are shifted to employer-provided fringe benefit plans. For example, individuals may choose to bill their own work-based health plan for the attendant medical costs or call in "sick" to increase their "lost" income.

Tort lawsuits related to auto accidents are easily the most common type of tort litigation brought against businesses (Figure 2). Close to 39 percent of all tort lawsuits against businesses are auto-related, significantly more than either premises liability (33 percent) or product liability (8 percent).[21] Business defendants also suffer from a "deep pockets" syndrome that makes it more likely they will get hit with a large damage award. Business defendants account for more than one-half (53 percent) of automobile jury verdict cases with settlements over $1 million, even though commercial vehicles represent just 6.6 percent of crash-involved vehicles.[22]

Figure 2. Tort Cases Where a Business Is the Primary Defendant



Source: U.S. Department of Justice.

[20] A Lewin-VHI study estimates that health plans spent $600 million in 1996 on auto injury costs that were already reimbursed by some other source. Al Dobson, Andrew Swire, and Gilbert Lo, "Savings from Improved Coordination of Automobile and Health Insurance Claims Payments" (Lewin-VHI, Inc., 1996), 3. Although employers generally have the right to subrogation when injured employees pursue litigation against third parties, the costs of enforcing such rights frequently outweigh the benefits. See John G. Fleming, "The Collateral Source Rule and Loss Allocation in Tort Law," *California Law Review* 54, no. 4 (October 1966): 1478-1549.

[21] For cases in state general jurisdiction courts. U.S. Department of Justice, Bureau of Justice Statistics, *Tort Cases in Large Counties*, NCJ-153177 (Washington, DC: Bureau of Justice Statistics, 1995), 2.

[22] Jury verdict figure is for cases in state general jurisdiction courts. U.S. Department of Justice, Bureau of Justice Statistics, *Civil Jury Cases and Verdicts in Large Counties*, NCJ-154346 (Washington, DC: Bureau of Justice Statistics, 1995), 5. Commercial vehicle crashes from U.S. Department of Transportation, National Highway Traffic

In contrast to the exorbitant cost of liability insurance, commercial vehicles are actually less accident-prone than private passenger vehicles. According to a 1993 NHTSA study, commercial vehicles have an injury rate of 9.1 per 1,000 vehicles, one-third the 30.6 rate of personal vehicles.[23] Other NHTSA data indicate that large trucks (defined as having gross vehicle weight rating over 10,000 pounds) are involved in just 2.3 percent of all auto accidents that result in injuries, even though they account for 7.4 percent of all vehicle miles traveled. Measured on a per-vehicle basis, large trucks have an injury rate that is 20 percent below the national average.[24] Even in fatal accidents involving large trucks (8.3 percent), the vast majority are not the truck driver's fault. In 71 percent of two-vehicle fatal accidents involving large trucks, police reported at least one error or other factor related to the other driver's behavior, and none for the truck driver. In contrast, errors or factors related only to the truck driver were cited in just 16 percent of fatalities, and errors or factors were reported for both drivers in 11 percent of such cases.[25]

Expensive auto insurance costs also hurt U.S. international competitiveness. The uniquely litigious nature of auto insurance in the United States is a cost that foreign firms simply do not have to face. Evidence of how auto insurance hurts American businesses can be found by comparing auto insurance costs here in the United States with those in other countries. In a survey of 12 industrialized nations by Tillinghast-Towers Perrin, the United States ranks higher than any other country in terms of auto liability costs.[26] Auto liability costs in the U.S. consume approximately 1.24 percent of gross domestic product, nearly twice as high as the 0.64 percent average of the other 11 countries. The U.S. level is more than twice as high as Canada's rate, and three times the rate of England or Japan. Thus, excessive auto insurance costs constitute a significant barrier to U.S. competitiveness abroad.

AUTO INSURANCE AND SMALL BUSINESSES

Small businesses are particularly at risk of being bankrupted by a big damage award. While large corporations tend to have more knowledge about their liability risks, smaller businesses frequently are unaware of their exposure. For example, a local florist that delivers flowers requires a commercial auto liability policy. Personal automobiles that are used for at-home businesses generally are not covered by the owner's private passenger insurance – a

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Safety Administration, *The Cost of Injuries to Employers – Methods Supplement*, by Ted R. Miller, DOT HS 807-971 (Washington, DC: Government Printing Office, 1993), 8.

[23] U.S. Department of Transportation, *Traffic Safety Compendium*, 4-6.

[24] U.S. Department of Transportation, National Highway Traffic Safety Administration, *Traffic Safety Facts 1996*, DOT HS 808-649 (Washington, DC: National Highway Traffic Safety Administration, 1997), 15-17, 28, 62.

[25] No factors were reported for 2 percent of cases. U.S. Department of Transportation, National Highway Traffic Safety Administration, *Traffic Safety Facts 1996 – Large Trucks* (Washington, DC: National Highway Traffic Safety Administration, 1997), 3.

[26] Includes both commercial and private passenger insurance costs. Although the U.S. has higher car ownership rates, most other countries have higher motor vehicle fatality rates. The U.S. disparity remains even after efforts to control for such factors, although data limitations prevent a thorough analysis. International data are from Tillinghast-Towers Perrin, *Tort Cost Trends: An International Perspective* (Tillinghast-Towers Perrin, 1995). U.S. estimate comes from Joint Economic Committee calculations using data from Tillinghast-Towers Perrin; A.M. Best, *Best's Aggregates & Averages – Property/Casualty* (A.M. Best, 1997); and Conning & Co (1997).

separate policy is required for commercial uses. If a car is registered in the company's name, insurance can cost up to 30 percent more than a personal car registered for business use.[27]

The high costs of insurance and legal defense illustrate how easily liability from a single auto accident can bankrupt a small business. As noted above, the high cost of liability insurance averages more than $64,000 per on-the-job auto injury. Since most small businesses have gross revenues under $25,000 per year, such costs can exceed annual gross revenues.[28] Moreover, the Small Business Administration warns small business owners, "When an employee or a subcontractor uses a car on your behalf, you can be legally liable even though you don't own the car or truck."[29]

Even businesses that are not thought of as transportation-intensive have to face high liability insurance costs. For example, Warner Corp. in Washington, DC is a plumbing, heating and air-conditioning service that employs 220 driver-mechanics and operates 180 vans. In 1993, Warner spent approximately $180,000 to purchase auto insurance for these vehicles.[30] As fraud, litigation, and defense costs rise, the costs of insuring against liability also increases.

Another example of a business hurt by rising liability costs is the relatively new service of child transportation. In response to the growing needs of two-income families, numerous small businesses have arisen around the nation to provide additional transportation services for children. Such van services commonly are employed to ferry kids to and from school, day care and sports practices. However, excessive liability premiums can easily force fledgling enterprises out of business. For example, "Kids on the Go" was a child transport service based in Norton, Massachusetts. Founded in 1994 by Carol Pitou, "Kids on the Go" operated two vans, employed four drivers and had 100 clients. After her annual liability premiums shot to nearly $14,000, Pitou was forced to shut down "Kids on the Go" after less than a year in operation.[31] Often these businesses are started by enterprising moms who see the need for such services in the neighborhood. As one such mother-businesswoman in Santa Cruz, California, stated, "Our insurance cost is outrageous. It's far and away our highest expense."[32]

A 1997 survey by the National Child Transport Association reveals how damaging excessive liability costs can be.[33] The survey of child transport services found that most carry at least $1 million in liability coverage. On average, these generally-small firms spend more than $13,000 each on auto liability insurance, costing between $1,200 and $6,000 per vehicle. That is a disproportionately large expense considering close to one-half (44 percent) of vehicles generate

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[27] Peter Weaver, "Are You Covered for Business Use of Your Car?" *Nation's Business*, 5/95.
[28] More than 70 percent of partnerships and nonfarm sole proprietorships have gross receipts under $25,000. Joint Committee on Taxation, Congress of the United States, *Impact on Small Business of Replacing the Federal Income Tax*, JCS-3-96 (Washington, DC: Government Printing Office, 1996), 57-58.
[29] U.S. Small Business Administration, "A Checklist for Insurance," online at http://www.sba.gov/score/ca/inscheck.html.
[30] John S. DeMott, "Finding the Best Auto Coverage," *Nation's Business*, 2/94.
[31] Robert Corriea, "Have Children, Need a Ride; Shuttle Vans Can Help Parents, But Owners Face High Costs" *The Providence Journal-Bulletin*, 2/5/95.
[32] *Ibid*.
[33] National Child Transport Association, "Results of the 1997 Nation Wide Survey of the Private Child Transport Industry" (1998), online at http://gator.naples.net/clubs/ncta/results.htm.

just $10,000 in gross revenue each year. For the most part, these businesses are small, self-owned firms, with the vast majority having less than four employees.

AUTO CHOICE SAVINGS FOR COMMERCIAL POLICIES

The premium savings from Auto Choice have been well documented in a series of studies by Stephen Carroll and Allan Abrahamse of the RAND Institute for Civil Justice. The most recent RAND analysis, based on newer data, indicates that Auto Choice would reduce the cost of compensating private passenger auto injuries by approximately 45 percent on average.[34]

A 1998 Joint Economic Committee (JEC) study used the RAND findings to estimate aggregate and average premium savings.[35] According to the JEC analysis, total nationwide savings from Auto Choice would average approximately 24 percent. If all drivers choose to switch to the new system, premiums savings would amount to more than $35 billion in the first year and up to $193 billion over five years. Premiums for private passenger policies would be reduced 23 percent, saving up to $27 billion in 1998, or $184 per car.

Commercial auto insurance policies would save more than 27 percent on average, totaling up to $8.1 billion in the first year and $41 billion over five years.[36] Table 2 lists potential Auto Choice savings to businesses by industry (columns one and two).[37] Total potential savings over five years range from a high of $10.3 billion in service industries to $447 million in the mining industry.

Table 2. Commercial Auto Choice Savings by Industry

	Potential Savings (millions)		**Savings per Employee**	
	1998	**1998-2002**	**1998**	**1998-2002**
Agriculture, Forestry & Fishing	$759	$3,869	$209	$1,067
Mining	$88	$447	$161	$862
Construction	$627	$3,197	$114	$571
Manufacturing	$631	$3,216	$34	$176
Transportation & Public Utilities	$1,850	$9,431	$288	$1,431
Wholesale Trade	$694	$3,540	$105	$523
Retail Trade	$1,058	$5,393	$48	$240
Finance, Insurance & Real Estate	$365	$1,862	$52	$259
Services	$2,026	$10,325	$57	$274
Total	**$8,099**	**$41,281**	**$77**	**$379**

Source: Joint Economic Committee calculations.

[34] Stephen J. Carroll and Allan F. Abrahamse, *The Effects of a Choice Automobile Insurance Plan on Insurance Costs and Compensation: An Updated Analysis* (Santa Monica, CA: RAND, 1998); Abrahamse and Carroll, *The Effects of a Choice Automobile Insurance Plan Under Consideration by the Joint Economic Committee of the United States Congress* (Santa Monica, CA: RAND, 1997); and Abrahamse and Carroll, *The Effects of a Choice Auto Insurance Plan on Insurance Costs* (Santa Monica, CA: RAND, 1995).
[35] For an explanation on methodology, see Joint Economic Committee, 33-38 and notes 124-127.
[36] Average percentage savings for commercial policies are somewhat higher than private passenger policies because commercial policies tend to spend relatively more on liability coverage.
[37] Industry-specific savings were inferred using the distribution of non-health fringe costs in U.S. Department of Transportation, *What Do Traffic Crashes Cost?*, 10-11.

The wide variation in types of commercial insurance policies prevents calculation of a meaningful average savings per company. Savings to a specific firm will vary based on a number of factors. However, to put the magnitude of the potential savings into perspective, Table 2 lists average savings per employee (columns three and four).[38] Nationwide, annual Auto Choice savings would average $77 per employee. State-by-state savings are listed in Table 3 at the end of the paper.

Although Auto Choice offers policyholders substantial premium savings, accident victims would on average experience an increase in the amount of available compensation. Even drivers with minimum policy limits would have access to greater amounts of compensation. Whereas the current tort system allows injured drivers to recover losses up to the policy limits of the negligent driver,[39] Auto Choice drivers could recover economic losses from both their own PPI policy as well as the negligent driver's liability policy. Commercial vehicles that negligently injure other drivers would continue to be liable for all uncompensated economic loss. Thus, individuals who suffer catastrophic injuries (and whose economic losses are grossly under-compensated by the current tort system) would retain the right to sue the negligent commercial vehicle owner for all uncompensated medical bills, rehabilitation costs, diminished earnings capacity and future health expenses related to the injury. In addition, the Auto Choice legislation would not affect litigation relating to accidents caused by drug or alcohol abuse, injuries to lawfully uninsured motorists (i.e., pedestrians), or the awarding of punitive damages.

Because of data limitations, the RAND analysis did not specifically consider the effect of Auto Choice on commercial policies. The JEC analysis therefore assumed that commercial policies would experience the same personal injury savings as private passenger policies. Although the two types of policies differ in a number of ways, this assumption may actually understate the savings to commercial policyholders. There are at least three reasons why commercial savings may be even greater than the estimates presented in Table 2 and Table 3.

First, RAND's estimated savings of 45 percent include the cost of buying additional first-party health coverage. The implementation of Auto Choice would in fact result in two changes for drivers who switch to the new system: an increase in the amount of first-party health coverage combined with a decrease in the amount of third-party liability exposure. Based on the RAND study, the costs associated with increasing first-party coverage for economic losses are more than offset by the savings from reduced liability exposure. Employers, however, already have insurance (in the form of workers' compensation) to cover on-the-job injuries sustained by their employees. Thus, employers stand to enjoy even greater savings since they would not have to purchase much additional health or disability coverage under their auto insurance policy.

Second, because the tort liability system is so inadequate at compensating auto injuries, employer-provided fringe benefits end up paying for much of these costs. As noted above, off-

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[38] Average savings per employee were calculated using employment projections from James C. Franklin, "Industry output and employment projections to 2006," *Monthly Labor Review* 120, no. 11 (November 1997): 39-57.

[39] Although injured drivers technically have the right to seek damages above policy limits, in reality the prospects of such recovery is limited. According to the Insurance Research Council, individual financial resources account for less than 2 percent of all compensation paid to accident victims. Insurance Research Council, *Paying for Auto Injuries* (Oak Brook, IL: Insurance Research Council, 1994), 15.

the-job auto injuries cost employers more than $14 billion in fringe health benefits in 1994. Some of these expenses stem from drivers injured in off-the-job auto accidents who are unable to recover their losses from the tort system. Other expenses occur when injured parties collect payment for the same losses from multiple sources ("double-dipping"). Either way, their medical bills and lost wages are paid by their employer-provided health plans. Under the proposed Auto Choice reform, drivers who elect the PPI option would increase their amount of first-party coverage for auto injuries. As PPI drivers reduce their use of work-based coverage, employers could receive additional savings.

Finally, the savings may be understated because they assume no change in claiming behavior. That is, most of the savings estimated by RAND derive from reduced transactions costs (primarily attorney fees) and pain and suffering damage awards. One of the fundamental goals of this reform, however, is to address the perverse incentives of the current tort liability system to inflate actual losses. Consequently, substantial savings could be realized from a reduction in unnecessary medical treatment and lost work. Such savings could materialize with respect to claiming behavior associated with both on-the-job and off-the-job auto accidents.

CONCLUSION

Compensating auto injuries through tort litigation is extremely costly and ineffective. Although premiums are already too expensive, accident victims with serious injuries rarely receive full compensation for their losses. Moreover, auto-related litigation continues to rise even though cars have become safer and accident rates are steady or falling. In Washington, DC, for example, the number of lawsuits stemming from auto accidents increased 137 percent between 1985 and 1995, even though the number of auto accidents actually fell 22 percent.[40]

Fraud, excessive claiming behavior and unnecessary litigation significantly increase the cost of doing business in America. Auto liability is the most common type of tort litigation brought against businesses. Businesses spent close to $21 billion for auto liability insurance in 1994, averaging more than $64,000 per on-the-job auto injury. Moreover, the uniquely litigious nature of the U.S. auto tort system is a cost that competing businesses in other countries simply do not have to face.

Auto Choice would go a long way toward rectifying the shortcomings of the current auto insurance system. Granting drivers, both commercial and private, the option to purchase a policy that covers medical and wage loss only would reduce spiraling health care and legal costs. At the same time, all accident victims would be assured quicker and more complete compensation for their medical bills and lost wages up to the limits they choose. Auto Choice would particularly benefit low-income and urban drivers, who spend a disproportionate share of their income on auto insurance, as well as city governments that are plagued by unnecessary lawsuits.

Dan Miller
Economist

[40] Lan Nguyen, "Auto Lawsuits Rise, Despite Fewer Accidents," *The Washington Post*, 6/23/96.

Table 3. State-by-State 1998 Commercial Savings from Auto Choice*

State	Personal Injury Savings	Overall Savings for Commercial Policies	Potential Commercial Savings (millions)	Total Potential Savings (millions)
United States	**45%**	**27%**	**$8,099**	**$35,513**
Alabama	43%	23%	$106	$346
Alaska	53%	30%	$21	$80
Arizona	45%	29%	$115	$641
Arkansas	60%	32%	$100	$354
California	42%	26%	$777	$3,739
Colorado	50%	28%	$110	$639
Connecticut	44%	27%	$129	$596
Delaware	44%	29%	$33	$141
Florida	50%	34%	$546	$2,677
Georgia	44%	24%	$190	$718
Hawaii	47%	32%	$55	$248
Idaho	18%	9%	$12	$46
Illinois	38%	20%	$241	$1,002
Indiana	51%	26%	$178	$691
Iowa	67%	31%	$115	$370
Kansas	27%	12%	$35	$137
Kentucky	38%	20%	$77	$357
Louisiana	60%	41%	$239	$962
Maine	51%	29%	$40	$148
Maryland	52%	33%	$178	$882
Massachusetts	63%	40%	$382	$1,591
Michigan	30%	17%	$160	$866
Minnesota	39%	23%	$118	$568
Mississippi	46%	26%	$83	$249
Missouri	44%	22%	$124	$524

* Assumes 100% of drivers switch to PPI policies. Based on state laws as of 1988.
Source: Carroll and Abrahamse (1998) and Joint Economic Committee (1998).

Table 3. State-by-State 1998 Commercial Savings from Auto Choice, cont.*

State	Personal Injury Savings	Overall Savings for Commercial Policies	Potential Commercial Savings (millions)	Total Potential Savings (millions)
Montana	57%	28%	$36	$119
Nebraska	36%	17%	$37	$126
Nevada	49%	31%	$50	$291
New Hampshire	52%	31%	$41	$171
New Jersey	47%	32%	$465	$1,800
New Mexico	35%	19%	$31	$157
New York	63%	40%	$920	$3,729
North Carolina	32%	20%	$154	$639
North Dakota	75%	34%	$29	$93
Ohio	44%	24%	$248	$1,092
Oklahoma	52%	27%	$95	$399
Oregon	48%	28%	$88	$426
Pennsylvania	37%	22%	$323	$1,398
Rhode Island	57%	37%	$45	$224
South Carolina	38%	21%	$82	$337
South Dakota	8%	4%	$4	$13
Tennessee	45%	23%	$138	$484
Texas	47%	29%	$608	$2,826
Utah	61%	31%	$55	$271
Vermont	26%	15%	$10	$36
Virginia	37%	22%	$138	$652
Washington	60%	37%	$188	$1,034
West Virginia	55%	35%	$62	$298
Wisconsin	23%	12%	$70	$261
Wyoming	69%	32%	$18	$68

* Assumes 100% of drivers switch to PPI policies. Based on state laws as of 1988.
Source: Carroll and Abrahamse (1998) and Joint Economic Committee (1998).

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