"Restrictions on Recovery of Damages for Pain and Suffering: A Case Overstated?"

by

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I: INTRODUCTION

Over the last several years there has been considerable concern expressed at the high cost of insurance in Ireland. For the general public, much of the focus has been on the costs of motor insurance, which is well known to be much higher in Ireland than in Britain, which for most people in Ireland serves as the standard reference point for comparison purposes. The public interest in motor insurance costs is part of a wider concern with insurance, which has led to some policy initiatives and proposals for further change. Less obvious to most people, but of increasing concern, is the rising cost of public liability insurance and employee liability insurance. These have become matters of controversy over recently as a result of well publicised disclosures of fraudulent claims against local authorities, which have had the effect of high-lighting what has been termed the "compo-culture". Important though it may be to eliminate fraudulent claims, it has not been suggested that the principal cause of the financial burden on local authorities from legal claims has arisen from fraud. In general, it has been said (especially by business interests) that there has been a growth in the cost of insurance because awards for damages in Ireland have risen and are too high by international standards. Insurance premium levels must reflect actuarially the level of awards. The costs are borne directly by firms as insurance costs, which are a tax on employment (employee liability) or on sales (product liability) or on being in business (public liability). They are also borne indirectly as local authorities are obliged to increase commercial rates to pay rising insurance premiums.

The success of the farm lobby in seeking and obtaining changes in the law affecting the liability of owners of land for damages to people entering onto the lands of others has made clear that (a) it is possible to reduce insurance costs by changing rights and liabilities, and (b) this can be a positive sum game: everybody gains, as easier access to lands for visitors will follow from a reduction in land-owners liability obligations. The same logic can be applied to insurance premium costs affecting firms: the establishment of what amounts to unlimited and absolute liability to compensate the victims of accidents or mistakes amounts to a barrier to employment and income generation in Ireland which may cost the country far
more than it is prepared to pay to protect potential loss-sufferers from the consequences of accidents or product defects.

Against this background, the Government recently proposed to alleviate the costs of insurance, especially on industry, broadly defined, by introducing a system of pre-determined maximum payments for pain and suffering damages. In doing this, it was following the principle which informed the change in the law on land-owners' liability. It sought to change the law on entitlement to recover damages. This in effect meant a change in the structure of property rights. It marked an extension of its previous approach to the question of the cost of damages. It will be remembered that several years ago, again responding to pressure from the insurance industry, the Government abolished the system whereby juries determined awards, and placed the determination of awards in the hands of the judiciary. The argument used was that juries, for a variety of reasons, incorrectly estimated the "correct" level of loss compensation, erring systematically in an upward direction. Since insurance costs reflect of necessity the level of awards, the logic of the abolition of the jury was that there was "over-insurance" which was resulting in a social cost in terms of output and employment. This logic underlies the capping proposal in so far as capping of pain and suffering damages is seen as placing a limit on damages which are recoverable.

The purpose of this paper is to suggest that the capping proposal (a) ignores other aspects of damages under tort law and (b) is unlikely to achieve the objectives set for it. The paper proceeds by first looking at the question of the role of insurance in dealing with pain and suffering (p/s). The conclusion in this section is that p/s damages can indeed under some circumstances lead to over-insurance. This, however, has nothing to do with whether judges or juries determine awards. To conclude, however, that p/s damages should be capped or even abolished, ignores the fact that damages under the law of tort are generally held to have two other functions besides insuring victims against losses. These are to act as a disincentive to potential tort-feasors, and to meet demands for redistributive justice. The second part of the paper looks at the question as to whether in fact it is plausible to ascribe the high level of insurance costs in Ireland to the level and incidence of p/s damages. The conclusion reached is that, at the very least, the case is not proved, and is in fact somewhat implausible.
II: THE ECONOMIC BASIS FOR CALCULATING DAMAGES TO BE AWARDED FOR PAIN AND SUFFERING

1: WHAT IS MEANT BY APPROPRIATE COMPENSATION?

One of the objects of general damages is in some way to compensate an injured party for the deterioration in his life-style arising from the injury he has suffered over and above costs incurred in the past and prospectively to be incurred, and any loss of income, actual or potential. Before considering actually quantifying such amounts, a problem arises in defining what this compensation actually means. Put at its simplest, there are two ways in which one might approach the problem:

(i) the first is to ask how much would someone pay to avoid the consequences of an accident if it were certain to happen;

(ii) the second is to ask how much would the person require after the accident to make up for the injuries he has suffered.

In general these will not be the same. This is easy to demonstrate (see diagram 1)\(^1\). In this example an accident has the effect of lowering an individual's welfare while leaving his pecuniary wealth unchanged. This is shown by a downward shift in the curve representing his utility of wealth (i.e., his welfare as a function of the level of his wealth). Starting at his initial wealth, A, he would be prepared to pay any amount up to AB to avoid the accident occurring. This amount of money is described technically in economics as the "compensating variation" of his wealth, and represents the maximum amount he would be prepared to pay to preserve his present status against an accident with a 100% probability of occurring. If the accident had occurred already, his money wealth would remain at A, but his welfare level would have declined to B on the vertical axis. Given the impact of the injury on his capacity to enjoy life (the downward shifted utility of wealth curve), to restore his welfare to the level he enjoyed before the accident would require that his monetary wealth be increased to C. This is called the "equivalent variation" of his wealth, and represents the minimum amount

\(^1\) This diagram and the argument by example in the next section are based on the analysis in Rubin and Calfee (1992).
of money necessary to make up to him for the welfare cost of the accident. As can be seen from the diagram, AC is not the same as AB, and if wealth is subject to diminishing marginal utility (which is what gives the schedules the shapes they have) and if the MU of wealth (the slope of the schedules) remains unchanged AC will be substantially greater than AB. The implication of this is that if damages for pain and suffering are based on willingness to pay to avoid that pain and suffering they will under-compensate the victim of an accident in terms of that objective of the Law of Tort which seeks to use damages to restore the position of the innocent victim of a tortious act as far as is feasible to what it was before the act took place.

2: OPTIMAL LEVELS OF INSURANCE: DO PAIN AND SUFFERING DAMAGES RESULT IN OVER-INSURANCE?

There exists a body of economic argument which casts doubt on the desirability of pain and suffering (p/s) damages per se on grounds of economic efficiency. The main thrust of this concerns the impact of strict liability on resources used up in accident prevention in the presence of p/s damages liability. The burden of this argument is that p/s damages are in themselves economically inefficient, and lead to a misallocation of resources and an unwarranted level of claims and premiums. The intuition behind this argument can be grasped by means of the following example. Suppose you send your child to a summer camp, in which there is a 1 in 10,000 chance of the child drowning. Suppose, further, that in the event of the accident occurring a court is confidently expected to award you £1.0m. The camp operators will presumably insure against this, and in a fair insurance market would expect to pay a premium of £100 per child, which will be rolled into the fee you pay. Thus, in effect you are insuring against a p/s loss of £1.0m. Now suppose that the loss of your child would be truly devastating ("£1.0m. doesn’t compensate us...nothing can restore our child, or make up for his death....."). The logic of this is that if the camp had no insurance you would not have taken out that insurance policy. You certainly wouldn’t have paid £100 for it. So, by insuring you indirectly by including a premium in your fee, the camp operators
unavoidably make you "over-insure". On the other hand, you would, perhaps, be willing to pay £100 to reduce the probability of the child's death by choosing a safer camp with more lifeguards, even if this reduced the risk to your child by, say, 1%. Now suppose that the courts operate on a willingness to pay for prevention as an indicator of valuation of loss. In this case, with full information camp fees will rise by £100, and you will have taken out insurance which is not worth the premium to you.

The key to understanding the issues here is the basic economic interpretation of the demand for insurance. Of necessity, insurance involves an agent reducing his present net worth (by making a premium payment) in return for a promise by the insurer to reimburse him for a defined loss in the event of that loss occurring. For a rational individual to pay such a premium it is a necessary condition that his present welfare is increased by so doing. This in turn implies that the cost to him of the premium (the marginal utility of income to him times the premium) is less than the loss multiplied by his evaluation of the probability of the loss occurring. Given a competitive insurance market, the premium will reflect the actuarial risk of the event and the loss. Thus, the premium for a 1 in 100 probability of a loss of £50,000 should be about £500. If I insure for £500 against such a loss I reduce my present wealth by £500, but the expected value of the insurance policy is also £500. How is my welfare increased? The answer is that my welfare is increased if and only if the marginal utility of income/wealth to me is diminishing. In that case, by insuring I increase my total utility, since the value of wealth to me would be higher at the margin were my wealth lower. This is demonstrated in diagram 2. My wealth is A on the bottom axis, and the utility I derive from wealth is given by the U(W) function. Point B represents A minus £50,000. As can be seen, the marginal utility of wealth at B (the slope of the U(W) function) is higher than at A. The line A'B' represents the expected value to me of my wealth given various probabilities of the loss occurring. If the probability were 1 in 3, my utility would be 2/3U(A) plus 1/3U(B), indicated by C', a utility level of U(C'). If however, I could buy an insurance policy for a premium of 1/3(£50,000), my actual wealth would fall from A to C, which yield me a utility of U(C), which is higher than U(C'). Hence, offered a "fair" premium, I will opt to pay the premium and be better off. What produces this result is the fact that the U(W) function is concave...or I experience diminishing marginal utility of
wealth. More generally, for me to insure it is necessary that the marginal utility of wealth in the event of the accident occurring must be greater than if the event does not occur. In the example above, the marginal utility of wealth would at best be unchanged and arguably would fall if I lost my child in an accident. Therefore it would not be rational to insure against that eventuality. The camp, to reduce its exposure to losses, takes out a policy which in effect I am obliged to pay. Hence I am taking out an undesired insurance policy.

This may be extended and generalised by considering an extreme example. Suppose an individual is considering taking out insurance against p/s arising from an accident which has a small but finite probability of happening to him. Let us characterise p/s loss as doing two things. First, as above, it is equivalent to a reduction in his net wealth. Secondly, however, it may affect his ability to derive satisfaction from income. It could be argued, for example, that if the injury was sufficiently disabling increasing his disposable income or reducing it marginally would have little effect on his well-being because of his condition: once his survival needs are met more or less money is of little importance (we ignore any motive of bequest or gifts inter vivos). In the extreme case we consider death as reducing the marginal utility of wealth to zero. Who would take out insurance which would reduce his present wealth and pay him money when he had no use for it? Less extremely, it would be irrational to pay £100 today for an actuarially fair policy which would pay off when the individual’s marginal utility of wealth was less than it is today (remember that the expected value of an actuarially fair policy will be the same as the premium paid).

2 This proposition may be proved as follows. Let \( U(Y) \) be an individual’s utility function, with \( U \) being increasing in \( Y \), income. Suppose an individual to have an initial income \( Y_0 \) and to face a possible loss, \( W \), which will occur with a known probability \( \pi \). The individual’s expected utility is then

\[
E(U) = (1 - \pi)U(Y_0) + \pi U(Y_1)
\]  

(1)

where \( Y_1 = Y_0 - W \). This can be rewritten

\[
E(U) = U(Y_0) - \pi U(W)
\]  

(2)

An actuarially fair insurance premium in this case would be \( P = \pi W \). If the individual pays that premium the change in his utility level is

\[
dU = -\delta U/\delta Y_0 \cdot P + \delta U/\delta Y_1 \cdot \pi W
\]  

(3)

which, given the expression for an actuarially fair premium, can be rewritten

\[
dU = (-\delta U/\delta Y_0 + \delta U/\delta Y_1)P
\]  

(4)

For this to be positive (for the individual to take out actuarially fair insurance) it is obviously necessary that the marginal utility of income in the event of the loss occurring should be greater than if the loss does not occur.
The contents of the last two sections may be summarised as follows: people in general are insured against p/s losses by the expenditure of firms which insure against such losses and/or take precautions to reduce the risk of damage occurring. The level of insurance and/or of precautions taken reflects the likely award of damages to victims of mishaps. There is a growing view that the level of awards, in so far as it is structured at all, is driven by the willingness of people to pay to avoid injury (this is what is meant by "hedonic" damages, and in the copious literature on the subject in the U.S. there is growing evidence that the level of awards appears to reflect the willingness to pay to avoid injury). The level of implied insurance is above what rational people would take out themselves in so far as an accident would reduce the value of an award to them. Hence the existence of p/s damages imposes a sort of tax on the population at large in order to benefit victims of accidents who would not have sought to cover themselves by insurance before the accidents occurred. Note that this argument implies that the existence of p/s damages leads to a misallocation of resources which takes the form of "unnecessary" or "unduly high" implicit insurance. In the current context of demands for the reduction of the burden of insurance costs by restricting p/s damages what is implied is that we are collectively over-insured, and are paying for this over-insurance via lost output and employment. Countries with lower p/s awards are less exposed to this problem, so we in Ireland should follow their lead and reduce p/s awards.

A critical element in this "over-insurance" story is the assumption that the injury reduces the marginal utility of wealth. It is interesting to note that where such an effect is likely, Irish law already provides for limits to p/s damages. Specifically, p/s damages for bereavement of a spouse or for the death of a child are limited to £7,500. Now consider what the position would be if an injury increased the marginal utility of wealth. A rational individual would be prepared to take out insurance, and would in an efficient market insure himself in such an amount that the marginal utility of wealth in the absence of an accident was equal to that after an accident. This is illustrated in diagram 3. The accident lowers the utility of wealth schedule but increases its slope. Offered an actuarially fair insurance, he would take out a policy which would give him a payment of up to AD in the event of the accident occurring (at D the marginal utility of wealth after the accident equals that of wealth before the accident, as given by the slopes of the utility of wealth schedules). Note, however, that this could be less than full compensation. If so, he would still be prepared to pay something to
prevent the accident taking place. The point is, nevertheless, that while there is no incentive to insure if the marginal utility of wealth is constant or decreasing, there is an incentive if it is increasing. Hence, any tendency for willingness to pay to reduce risk overstating the value of the implied insurance is diminished by increasing marginal utility of wealth.

This theorising can be given flesh by considering four types of accident which might give rise to p/s damages:

(a) the suffering involved in undergoing unnecessary surgery due to a negligent diagnosis after which the victim is restored to full health;
(b) the suffering involved in losing a child in a summer camp accident;
(c) the suffering involved in being disfigured by burns in an industrial accident;
(d) the suffering involved in being made a paraplegic in a motor or industrial accident.

Against which of these do we expect to see people taking out insurance? In general, only the last. People do take out insurance against catastrophic injury. This implies that people believe that only the last type of injury results in an increasing marginal utility of income. In turn, this implies that in so far as p/s damages result in an implicit level of insurance which is excessive, the problem is likely to be smallest in relation to such injuries. If the focus of the Government in capping awards is to reduce economic inefficiency it is least warranted here.

3: DETERRENCE AND THE SUFFICIENCY OF DAMAGES

The arguments in the last section were concerned exclusively with one aspect of possible inefficiencies arising from p/s damages, namely that the level of awards, driven by willingness to pay, might result in over-insurance, so that insurance costs are too high in the sense that they exceed what the public would seek by way of insurance against the consequences of accidents. While there are circumstances in which this may be the case, this should not be allowed to obscure the fact that damages for tort are seen by jurisprudence as having other functions besides providing compensation on an actuarial basis. One of these is the establishment of incentives for potential tort-feasors to take steps to reduce the probability of accidents or product malfunctions in the first place.
It is beyond dispute that the level and probability of damages is a determinant of the safety precautions which will be taken by potential tort-feasors. This is not to say that they are the only such incentive: a producer of consumer goods or a major fast food chain has a strong reputation incentive to ensure product quality and safety. The same applies to a medical consultant. It is, however, the case that we can think of instances where such reputation effects are weak or non-existent. In such circumstances a prospective reduction in damages, for whatever the cause, has the unambiguous effect of reducing the incentive to take precautions.

This aspect of the problem has not been the subject of empirical work in Ireland, but some idea of its implications can be obtained from recent work in the area in the United States. Two studies are of particular interest. These studies suggest in the first place that insurance is a quantitatively superior mechanism to regulation in reducing workplace injury incidence. It is estimated that the impact of the Occupational Health and Safety Administrations regulatory and inspection regime was to reduce the impact of workplace sickness and injuries by between 1 and 2 man-days lost per thousand workers per year between 1973 and 1983. The compliance costs during this period ran into billions of dollars. The effect of liability to pay compensation, however, was estimated to reduce the level of fatalities by around 22%. It is difficult to extrapolate from impact on fatalities to impact on work-related sickness and injuries, but these results suggest that if compensation liability affects other risks by as little as one fiftieth of the effect of precautions taken to reduce fatalities it is between five and ten times more potent than regulation.

4: COMPENSATORY ASPECTS OF PAIN AND SUFFERING

An accepted goal of tort law is to restore the position of the victim of a tortious act to what it would have been before the act took place. It is obviously the case that in many circumstances this is not in effect feasible: the amount necessary can approach infinity. That does not mean that some movement in that direction is undesirable. The excess insurance story concentrates on one aspect alone: the role of tort law as a surrogate insurance mechanism. By encouraging potential tortfeasors to take action to reduce the probability of damage, the law of tort in effect insures the public at large to a greater or lesser extent against damage from tortious acts. It does this by obliging a tortfeasor to compensate those he hurts.

To argue that p/s damages should be eliminated even under conditions where it is unquestionably the case that they imply over-insurance is to misrepresent the basis of choice in economic policy making. This is best understood in terms of the question of the conflict between income redistribution and economic efficiency. It is impossible (other than in trivial cases) to redistribute income from one group to another without the mechanism used to redistribute imposing a net cost on the economy. For example, empirical work in Ireland suggested relatively recently that at the margin a pound of extra revenue raised by the Government for redistribution purposes probably reduced the net output of the economy by over one pound⁴. That doesn’t mean that there should be no redistribution. What it does mean is that we should be aware of the net cost of redistribution if we are to arrive at consistent decisions on how much redistribution to undertake.

A general principle of tort law is that a victim should be compensated, and that this is based on an idea of distributive justice, not just of economic efficiency (i.e., making an agent internalise into his decisions their consequences on the welfare of others). Consider the case of the victim of an anaesthesiology failure who, while immobilised, feels the excruciating pain of an operation. Suppose that he makes a full and quick recovery, and is not traumatised by the event. Suppose, further, that his ability to function and enjoy life is unimpaired. It is

⁴ Honohan and Irvine (1987).
easy to show that he will not have insured against the event, that implicit insurance is over-
insurance (and, therefore, a waste of resources), and that there may be strong reputation
effects leading to anaesthesiologists taking steps to reduce the risk of such an occurrence.
None of this alters the fact that he has suffered a hurt, which he would have been prepared
to pay to avoid. As such, it is analogous to an act of theft from his point of view. No one
would question his right to retrieve the value of what had been stolen from him, even if the
thief had destroyed it in flight. Enforcing property rights is costly...but we enforce them.
One's right to bodily and mental integrity is a property right, and as such is enforceable only
by legal sanction unless individual sanction is permitted. Any society must be prepared to use
resources (incur costs) in establishing and enforcing a given set of property rights. To decry
such an exercise of such rights simply because this imposes costs on society is fatuous.

This does of course leave open the possibility that the costs are excessive, are
disproportionate to the objective sought. In the present case the Government is proposing
drastic action because it seems to believe that the costs of p/s are excessive. Its rationale for
saying this is entirely based on a comparison (and a dubious one at that) between the costs
of insurance here and those in other countries.

III: PAIN AND SUFFERING DAMAGES AND INSURANCE COSTS IN
IRELAND

No proper independent study has been done which establishes clearly what is the level and
structure of court awards in Ireland and which would enable reliable cross country
comparisons to be made. Two recent studies have received considerable publicity and which
purport to show that Irish awards are higher than in most other EU countries\(^5\). The first of
these, published in 1990, looked at a set of hypothetical cases of personal injuries and
obtained from lawyers in the countries concerned their estimates of what likely awards would
be. The second study reported on the cost of private motor insurance in Ireland and the U.K.

\(^5\) McIntosh and Holmes (1990) and Coopers and Lybrand (1991).
This was commissioned by the Irish Insurance Federation in 1991. A more recent and detailed study, published in 1993, but confined to six countries, not including Ireland, followed more or less the same approach as the 1990 personal injuries study, in that it sought estimates of amounts payable from practitioners in the countries studied⁶.

In the introduction to the 1993 study the following passage appears:

"...the amounts mentioned as results in the different reports for the model cases are not meant, and should not be used, as reliable indicators of results to be expected in similar cases in the future. Much less can the figures mentioned in this study be a suitable basis for comparison, either among the different countries included in the study or with other countries. The focus of this study...is on procedures and considerations applied in determining and coordinating compensation from different sources. Actual compensation always depends on the unique facts of each individual case."

Since the same methodology was used in the 1990 study it would be reasonable to take this caveat as applying in that instance as well. It should be noted, however, that the great overlap between English and Irish approaches to the calculation of damages, and the similarity in both the law and practice relating to tort cases lead to the conclusion that some considerable credibility may be attached to results for the U.K. and Ireland, while the reservations have to be taken very seriously in making comparisons with countries outside the British Isles.

The 1991 study is confined to motor insurance, but in that area it establishes convincingly the higher premium levels in Ireland, controlling for all the locational and demographic factors which are relevant, and that this reflects the higher average cost of claims. It also identifies the personal injury awards as a major source of the disparity between costs in Ireland and the U.K. This it attributes in some measure to p/s damages which (citing the previous personal injuries study) it asserts are 59% higher than the average for other EC countries. It does not, however, offer a breakdown of personal injury costs in Ireland, nor any basis for comparing the actual experience in Ireland and the U.K. What is clear,

moreover, from the report is that in so far as personal injuries are driving motor insurance costs in Ireland relative to Britain it reflects the higher incidence of serious injuries in accidents here as well as any possible higher level of award for any given injury. Fatal and serious injuries per 10,000 cars registered are 2.5 and 1.25 times higher than in Britain. Minor injuries are significantly lower than in Britain.

The data published in the 1991 study suggested that non-comprehensive insurance was over twice as expensive in Ireland as in England. Comprehensive premiums in the U.K. were about 40% lower than in Ireland. The latter reflect damage to vehicles for the most part, while the former cover personal injuries, too. It is reasonable to conclude that about half the difference between non-comprehensive insurance costs as between Ireland and Britain result from higher personal injury costs. In the accompanying table we show comparable figures for awards for a set of different injuries which are contained in the 1991 study for Ireland and England (the British values in the study are in £STG, and we have multiplied them by 1.05 to reflect the £IRL/£STG exchange rate in 1990). Notwithstanding the reservations already noted about making comparisons using such estimates, it is interesting to note that

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for what these figures are worth they cast serious doubt on the proposition that a substantial reduction in premium costs could be expected by reducing p/s damages to the presumed U.K. level. As far as motor insurance costs are concerned, these figures discredit the idea that the higher costs of insurance here are largely due to higher awards for any given injury. Instead they support the obvious conclusion to be drawn from the motor insurance study's finding that serious injuries are more frequent in Ireland. If this is accepted it follows that capping as suggested by the Government will do relatively little to get the average level of premium down, at least as far as motor insurance is concerned.

The 1991 study estimates that the personal injury cost of the average claim in Ireland is nearly four times its British equivalent. This is not broken down into p/s and other damages, and no authoritative published figures are known to us which could produce such a breakdown. Insurance Industry Federation sources have been quoted as saying the p/s could account for up to 50% of personal injury awards in motor cases. It is extremely difficult to reconcile such a claim with the findings published in the 1990 study. The latter are not easily compared directly with those in 1993 study, since the details of the cases differ. In one case, however, the latter considers a comparable case to one included in the former report: a case of total blindness arising from an accident. Allowing for the differences in income assumed for the victims before the accident, the 1993 results suggest an award of about £STG 540,000 of which £STG 75,000 represents p/s, while the 1990 estimate was £STG 583,000 of which £STG 80,000 was for p/s. In general, this suggests that the conclusions of the DAC report seem to be borne out by the later study. The conclusion we draw from this is that although as noted this methodology means that great care has to be taken in making comparisons and predictions, it is straining credibility to assert that p/s awards could amount to anything like 50% of personal injury awards unless the experience of the insurance companies is based on a totally separate statistical universe from that with which practising lawyers have had experience. It has been represented to the Government recently that p/s awards amount to up to 75% of the compensation awarded in the High Court. The data on which this claim was

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7 This assertion is based on the text of a memorandum to the cabinet prepared in late 1993 or early 1994 which has come into the author's possession.
based has not been released, which makes detailed analysis impossible. The following points, however, need to be noted in interpreting this assertion. The first is that by definition this figure excludes cases settled elsewhere. The second is that it cannot even address claims which are not high enough to be the subject of High Court proceedings. The third is that the relatively easy computation of actual and prospective pecuniary losses (given that actuarial advice underpins these) means that unresolved differences are likely to concern p/s damages rather than pecuniary damages. Given the costs and risks associated with a High Court action, cases which appear there will in these circumstances be heavily biased towards cases involving larger p/s claims. In the light of the foregoing, it would be totally unwarranted statistically to treat the High Court awards record as a representative picture, statistically speaking, of personal damages in terms of size or composition.

In the 1990 study (and by implication in the 1993 study) evidence is offered to the effect that p/s damages are higher in Ireland than elsewhere. Given the close comparability between the two systems, the evidence that they are higher here than in Britain carries more weight than comparisons with other countries. The 1994 British Law Commission report gives grounds for suspecting that a comparison with U.K. damages may be misleading. 60% of the sample of victims stated that the awards they had received had been sufficient to meet pecuniary expenses up to the time of the interview. Roughly 40%, however, felt that the awards were sufficient to meet future expenses. There are, of course, problems with interpreting responses like this, but at the very least they do not suggest that pecuniary losses, actual or prospective, had been over-compensated at trial or in settlements before trial. The responses also suggested that the more serious the accident and the greater the initial award the greater the probability that damages for pecuniary losses would subsequently be regarded as insufficient.

Not surprisingly, given the discussion above on the basis for compensation, when the matter of damages for non-pecuniary losses was considered, there was close to unanimity that the award had been insufficient.

General damages, which include p/s damages, are supposed to cover prospective as opposed to incurred costs. If it is accepted that on average the level of general damages awarded at the time of trial or settlement was less than sufficient to cover the prospective costs, it
follows that some or all of the p/s award will have been swallowed up in making good this
deficiency. Now suppose that the p/s award is capped, and that courts de facto treat the p/s
element in the awards as providing a margin of safety. It follows that in so far as they have
discretion to alter the non-p/s element in the payment they will be motivated (and, from the
victims’ point of view, correctly) to adjust the non-p/s award to take into account the
inability to cushion against unforeseen pecuniary expenses adequately as a result of the
imposition of a capping procedure.

Ireland differs from other EU and from non-EU countries in the extent and depth of social
security and health cover. This has an effect on the level of damages which are to be
expected in a representative personal injury case. Thus, for example, the 1990 report (page
6) in commenting on the low apparent level of Danish awards has the following to say:

"The level of awards in Denmark may seem surprisingly low, given its
comparatively high standard of living. The reason that Denmark is so far down
the list is that medical expenses, which account for the major part of the
awards in quite a considerable number of countries, are not relevant in
Denmark. This is because there is little private care available. The state care
is of an extremely high standard. The state pays for all medical expenses and
does not make any claim from the parties."

In the case of Ireland, it bases the award in the case of a quadriplegic victim on an assumed
£350,000 sub-total for prospective nursing care which is included in general damages; in the
case of England, it is £STG 375,000. In the case of Denmark it is zero. In the case of
Portugal, it is assumed to be half the British level. Medical expenses allowed for in Britain
included only those not covered under the national health service. The difference in awards
for prospective nursing and medical expenses alone account for 50% of the difference
between the estimated award in Denmark for quadriplegia (£240,000) and the estimated Irish
award (£1,010 m). Similar considerations apply to loss of income. Countries with generous
and universal income related social welfare systems deduct benefits payable to injured parties
from damages in making awards for prospective income loss. In the case of the Netherlands,
this has the effect of cutting by 20% the relevant award made for a middle aged doctor who
is made quadriplegic. In Ireland the basic social welfare payments are much lower, and the
court awards correspondingly higher. In Denmark, high marginal taxes plus high social
welfare payments result in an estimated award of seven years income as a lump sum to cover net income loss for a forty two year old doctor. In Ireland, the multiple is 13. That factor accounts for a further 25% of the gap between Denmark and Ireland.

The implication of the last paragraph is that awards in Ireland are higher in no small measure as a consequence of the absence of adequate health and income social insurance. It implies further that if industry is to be relieved of the burden of insurance via negligence liability while victims’ health and income status are to be protected the level of health and social welfare insurance charges will have to be increased. In a serious sense, high employee and public liability premiums are in part a price we pay in order to avoid higher level of employer and employee PRSI, and an extension of full PRSI to all, regardless of income ceilings or employment status.

**IV: THE PROPOSAL TO CAP PAIN AND SUFFERING DAMAGES.**

Capping such awards raises issues of economic efficiency and equity. The proposal to impose limits must imply that at present awards made by the courts are in some sense "too high", and that they are not consistent with, for example, the maintenance of competitive advantage for Irish firms faced with high insurance costs. If this is to be taken as implying that court awards exceed what is necessary to achieve the ends outlined earlier in this paper it will indeed follow that some restrictions on awards will improve economic efficiency by reducing unwarranted insurance costs, while not offending against equity, since injured parties will expect to receive adequate compensation, whatever that means. The economics question which then arises is whether a scheme as outlined by the two Ministers actively involved is likely to produce a reduction in awards and insurance costs without offending against equity.

If awards are not "too high" in this sense, then capping must by definition involve under-compensating at least some injured parties. This implies a net transfer from potential victims of accidents to the rest of society. The statistical costs of accidents will be borne by accident victims to that extent in order to keep down the production costs for goods or services which
are borne by firms. This does not reduce costs overall, but merely reallocates them. It is a net transfer from an ex ante unidentified, but ex post defined, group to the rest of society. Whether this is consonant with the public good, or in other respects constitutional we are not in a position to judge.

The case for capping p/s payments is that in Ireland these payments are "too high", and impose costs on firms which reduce those firms' competitiveness. The evidence offered to support this proposition is far from being persuasive. First, there is the question of the actual cost of p/s awards. No objective data survey exists demonstrate the proportion of total awards which represents payments for p/s. Equally, there does not appear to exist any reliable data on the size distribution of awards under the law of tort. Without such data it is not possible either to estimate the actual cost of p/s awards to insurers nor to estimate what reduction in insurers' costs would result from capping, let alone what reductions in employers' premiums could be expected. Note that such data could be obtained, as is immediately evident from the data and methodology employed in the report for the Law Commission in the U.K. on the adequacy of personal injury compensation which was published in September, 1994.

A report recently prepared by IBEC* on the costs of employers and public liability insurance which is based on a survey of 314 member firms. This work reveals that insurance premium costs for this insurance amounted to 2.7% of payroll costs in 1991. There is no reason to believe that it is anything but representative of the problem facing IBEC's member firms. This, it has to be said, is not a trivial amount, and it is an average, with the insurance burden being substantially higher in some sectors on a highly predictable basis. In terms of the proposed capping, however, this cost should be viewed in the context of other, similar costs, especially that of PRSI. Even if we make the heroic assumption that employers bear none of the cost of the PRSI levied on employees, the burden of PRSI in terms of payroll costs amounts to about 10%. This demonstrates how small the change in competitive position overall is involved in a reduction of such insurance costs.

There is a further aspect to the cost of employees liability which is ignored by the IBEC approach. It is a common-place finding in labour economics (and intuitively plausible) that, ceteris paribus, higher risk occupations involve higher wage costs. Workers seek higher wages to offset the increased risk attached to the occupation. The amount reflects the costs they will bear if an accident occurs. If there is compensation, logic suggests that the risk premium in the going wage will be reduced. This implies that the net cost of employee liability insurance to an employer is less than the premium, since in the absence of a liability to make such payments the employer would have to pay higher wages. In addition, since the existence of employee liability insurance gives employers an incentive to reduce the risk of accidents, we might expect that overall riskiness would be reduced, which in turn would further reduce the wage demands facing the employer. The empirical work for the U.S. cited earlier in this paper found that the consequence of these two complementary influences on wage costs was that at least 20% of the cost of insurance against employee compensation was in effect an offset for higher wages. Given the higher marginal effective tax rates which apply in Ireland, this is almost certainly a lower bound estimate of the impact here. Put another way, the true cost of employee liability insurance to employers is probably less than 80% of the premiums paid.

The recent experience in the U.K. as described in the Law Commission Report on personal injury compensation should make the Government think twice before adopting the simplistic solution of capping the p/s element in personal injury awards. That is not to suggest that there is nothing the Government can or should do about insurance costs. There is plenty of evidence of increased compensation litigation, even if much of it is settled out of court. The so-called compensation culture is a serious problem. In addition, there is evidence of fraudulent claim levels having risen. The Government (correctly) feels that the compensation culture and increased litigiousness can both be reduced by lowering potential claimants' expectations. The device they have chosen, however, is a crude one, will be unfair to genuine victims, and smacks of administrative convenience rather than a well thought out attempt to solve the problem. A proper solution will involve more thought and effort. The

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9 See Viscusi (1989). It should be noted that the author explicitly takes into account the possibility of "moral hazard" (whereby the existence of insurance can reduce the incentive to take precautions) in computing these estimated effects.
fists part of such an approach will lie in redefining the kind of p/s which will be considered, tightening up the law, and imposing tougher burdens of proof on claimants. A second element would involve reducing the incentive for solicitors to encourage litigiousness.

The Government’s capping proposals appear to be based on the view that there is no objective way of measuring p/s loss, which means that an arbitrary amount cannot be shown to be unreasonable. This view of the awards process is seriously out of date. There is evidence available from the U.S. concerning jury awards in personal injury cases which shows that "hedonic" damages for pain and suffering characterise p/s awards. Hedonic damages are in effect payments which reflect valuation of life and non-pecuniary damage in terms of a willingness to pay to avoid the injury in the first place.

V: CONCLUSIONS

The logical case for capping (or abolishing) damages for pain and suffering in principle rests on the proposition that if courts award such damages, and to the extent that they do so, there is "over-insurance". This means that people are indirectly being insured through the prices they pay for goods or services against losses for which they would not take out insurance. The proposition that there is over insurance in turn rests on an assumption that the marginal utility of wealth is unchanged or declines as a result of a pain and suffering loss. This may or may not be the case, and it is possible to suggest plausible scenarios in which the marginal utility of wealth would actually increase after an accident involving pain and suffering. In practice, however, there is evidence that courts use pain and suffering as a means of building in a margin of safety in awarding damages for pecuniary losses.

10 "The assessment of compensation for pain and suffering is largely a subjective process and in individual cases is based, to an extent, on convention and precedent". This is taken from page 6, para. 15 of the memorandum to Government mentioned in the text.

To treat pain and suffering damages from the perspective of optimal insurance alone is to ignore other and possibly equally important aspects of the function of damages under tort law, in particular, that of deterrence. Evidence from the U.S. suggests that employee liability is a more effective incentive to take precautions against workplace injuries than regulation, and this increases with the degree of liability. If Ireland is similar, to reduce liability will mean an increase in the accident rate.

The arguments about the costs of insurance on business can be shown to be exaggerated: part of the premium payments is in effect in lieu of higher wages. In any case, against the background of other payroll related costs, insurance premium payments are only a fraction of the total of these costs facing employers. If they were to be reduced, and if employees and/or the public were to be assured of the same accident cover it would be necessary for PRSI (or equivalent) charges to be increased dramatically. The case of Denmark demonstrates both the partiality of the arguments concerning the supposed high level of awards here, and the degree to which social welfare provision entitlements would have to be extended were abolition of pain and suffering and reductions in other awards to be implemented so as to bring insurance costs down to Danish levels without leaving people badly exposed to financial loss arising from accidents.

It is hard to avoid the conclusion that inadequate thinking has gone into the proposals which were aired during 1994. The very least that needs to be done is for these proposals to be deferred until the type of problem raised in this paper have been satisfactorily addressed.
REFERENCES


