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The U.S. Experience with No-Fault Automobile Insurance

A Retrospective

James M. Anderson, Paul Heaton, Stephen J. Carroll



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Summary

To many commentators and policymakers in the 1970s, it appeared as though no-fault automobile insurance was a genuinely superior policy innovation that would displace conventional tort-based automobile-insurance regimes. More than 30 years later, no-fault has lost much of its popularity among insurers and consumer groups. What happened? This monograph provides an overview of the experience in the United States with no-fault automobile insurance and the factors that led to its decline in popularity among insurers, consumer groups, and legislatures. We explore the history of no-fault and examine its performance relative to other approaches for automobile-accident compensation. We draw from a variety of data sources, including qualitative interviews, surveys, and administrative databases, to evaluate the successes and failures of no-fault and consider its likely future in the United States.

Prompted by dissatisfaction with the traditional tort system for compensating the ever-rising number of automobile-accident victims, no-fault proponents advocated a less adversarial approach. The central idea of a no-fault system is that, rather than seek recovery against another driver under conventional principles of tort law, an injured automobile-accident victim could simply recover the costs of the accident from his or her own insurance company.

This “no-fault” approach involves three components: (1) a partial or total restriction on the right to sue other drivers for being at fault for automobile accidents, (2) a restriction on recovering for pain and suffering or other noneconomic damages, and (3) mandatory insurance so that the victim can recover his or her economic losses (including medi-

cal costs) from his or her own insurance company. In the United States, *add-on no-fault* is an important variation in which an injured party can recover from his or her own automobile insurance without any restriction on also filing a tort claim against another driver. Another important variation, *choice*, allows individual drivers to choose whether to accept, in exchange for lower premiums, restrictions on their right to sue other drivers.

No-fault approaches to automobile insurance were first proposed in the 1920s, modeled after the workers' compensation no-fault approach to workplace accidents. For the next 40 years, numerous academic studies decried the use of the tort system to compensate injured victims of automobile accidents. Commentators focused on the following failings of the tort system:

- (1) As a result of the fault standard, many victims were either not compensated at all or undercompensated.
- (2) There was a long delay in providing compensation to injured persons.
- (3) The seriously injured were often undercompensated while victims with minor injuries were often overcompensated.
- (4) The process of establishing fault created high administrative costs.
- (5) Victims and injurers had large incentives to be dishonest in their efforts to improve their cases. (R. Keeton and O'Connell, 1965, pp. 2–6)

Because it minimized litigation and administrative costs associated with determining who was at fault for an accident, supporters of no-fault supposed it to be less expensive than the tort system.

Massachusetts passed the nation's first no-fault automobile-insurance law in 1970, and many other states soon followed. A number of insurers and consumer groups supported no-fault over the opposition of the trial lawyers, and, for a while, it appeared as though it was a genuinely superior policy innovation.

Over time, however, dissatisfaction with no-fault grew, primarily because the hoped-for premium-cost reductions never materialized. Several states repealed no-fault laws and realized premium-cost reductions. Political debate about no-fault increasingly focused solely on the issue of consumer premium costs, and the other justifications for the no-fault approach on which its original proponents relied lost political

salience. Many insurers and consumer groups that once supported no-fault as a means of reducing rate increases no longer support it.

We demonstrate that the perception that no-fault auto-insurance claim costs were higher than other auto-insurance systems was largely accurate. Total injury costs per insured vehicle gradually began to diverge across systems in the late 1980s, with no-fault becoming substantially more expensive than tort. Whereas injury costs under no-fault were only 12 percent higher in 1987 than those under tort, this difference had ballooned to 73 percent by 2004. Surprisingly, we also found that states that restricted lawsuits against other drivers—in an attempt to reduce costs—actually exhibited higher claim costs than states that permitted these lawsuits.

Why were no-fault regimes unexpectedly more expensive? We identify medical costs as a primary contributing factor. Medical treatment in no-fault states was vastly more expensive than in other states. Controlling for a broad range of personal and accident characteristics, we demonstrate that claimants in no-fault states are more likely to claim the use of virtually every type of medical provider, from emergency room to chiropractor, and visit each type of provider more frequently than claimants in other states. We also show that the same medical care costs more to the auto-insurance system in no-fault states than in tort states and that most of this cost divergence occurred during the 1990s. In particular, prior to 1987, medical charges to the auto-insurance system for individuals in no-fault states were only slightly higher (5.7 percent) than for comparably injured individuals in tort states. However, by 1997, the disparity had grown beyond 40 percent. While we discuss plausible explanations for these trends, further research is necessary to determine exactly why medical costs in no-fault states grew so dramatically during this period. One possibility is that no-fault insurance shifts medical costs associated with auto accidents from the first-party health-insurance system to the automobile-insurance system.

We also demonstrate that, while no-fault states had lower levels of litigation activity and devoted a smaller share of payments to non-economic damages in the 1980s than did tort states, by 2007, the two systems had largely converged on these characteristics. No-fault has

shifted over time from a system with better medical benefits but reduced access to the courts to a system that simply offers more-generous medical benefits.

We conclude that the decline in no-fault's popularity is a result of (1) its unexpectedly high claim costs and (2) the political debate shifting from an overall assessment of the optimal insurance system to the impact of those high costs on consumers. No-fault's high claim costs are the result of very high medical costs. Further research is necessary to evaluate reforms that some no-fault states have introduced to control the growth of medical costs.