

2005 Policy document



The Litigation Explosion Myth

The Australian media regularly blames the so-called 'litigation explosion' for skyrocketing liability insurance premiums, and is particularly fond of citing this negative impact on worthy but penurious community groups and voluntary organisations that can no longer afford adequate insurance to hold their events.

These claims are based on the widely held assumption that the number of public liability and other civil claims being made in Australian courts is increasing. It is not. Data collected by the Productivity Commission from courts across Australia every year shows that civil court filing rates are static, or declining in some areas, and that this has been the trend for a number of years.

Nor are Australians becoming 'more American' and more litigious, or being consumed by a culture of blame, despite the constant media spin on this theme. Australians are suing at the same, or lower, rates than at any time in our history.

Insurers and politicians are also responsible for generating these spurious claims, keen to explain the 'hard' insurance market.

Economic downturns are experienced in every market sector and the insurance industry is no different. Hard insurance markets recur periodically and are usually the result of reduced profits following a period of aggressive competition among insurers. Occasionally periods of aggressive price-cutting are followed by a downturn in either the local or the global economy, resulting in capital flooding out of the insurance market and the liquidation of less prudently managed insurers.

This last happened in Australia in 2001-2003, when HIH/FAI and a number of associated insurers failed, triggering a collapse in competition. The surviving insurers were able to increase their premiums quickly and with few restraints, a phenomenon known as 'market failure'.

Sudden premium increases naturally worry consumers, particularly when they have become used to cheap and accessible insurance during periods of intense price competition between insurers. Instead of being easy and cheap, insurance becomes hard and expensive, and consumers clamour for explanations. In this instance, the easy way out for both insurers and politicians was to blame lawyers, litigation rates and the courts.

We say 'easy' because both sectors stood to benefit more from propagating the litigation blow-out myth than from acknowledging the truth.

When profits decline, insurers derive no benefit from admitting the true causes. Like politicians, insurance executives tend to take credit for increasing profits but blame declining profits on other factors 'beyond their control'. Blaming the litigation system for their woes had the added bonus of enabling them to lobby governments to pursue further 'tort reform' to reduce their risk exposure under already written policies. In short, not only could they blame someone else for the consequences of their own mismanagement, but they were rewarded for their trouble!

Even with depressed profits, insurers spend massive amounts on PR to reinforce their lobbying efforts. Often they find willing (though naïve) allies in consumers who are faced with paying steeply increased premiums. The injured, on the other hand, are out of work, struggling to make ends meet and unable to counter insurance propaganda. Lawyers who rise to their defence are accused of having a vested interest (an allegation which, curiously enough, is rarely levelled against insurers who have a far greater interest in propagating their claims).

Politicians, meanwhile, are expected to fix things. They know that market failures are regular events, but also that there are no votes in acknowledging that this can happen for reasons over which they have no control. Nor are there any votes in opposing insurers' claims that increased premiums are the result of a litigation explosion.

'Tort reform' was the response. It allowed politicians to appear to be doing something which not only satisfied the insurers, and reinforced public opinion but passed the financial burden of having to subsidise the profits of failing insurers on to vulnerable, injured people by reducing their injury compensation.

To summarise: contrary to popular belief - whipped up by a combination of media spin and the dishonesty of politicians and the insurance industry - there has been no litigation explosion in Australia. Periodic premium increases are driven by normal market forces, and are not affected by tort reform. The insurance industry pushed for tort reform at a low point in its cycle. Now that the cycle is turning and insurers are announcing record profits - without any commensurate benefits flowing to consumers in the form of reduced premiums - we must oppose the erosion of our rights and campaign for their reinstatement.