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# MYTHBUSTER!

## LAWSUITS AND THE ECONOMY

On November 21, 2006, Treasury Secretary Henry Paulson called the civil justice system “an Achilles heel for our economy. This is not a political issue,” said Paulson. “[I]t is a competitiveness issue ...”<sup>1</sup> The only data he used to support this statement were Tillinghast Towers-Perrin statistics about the so-called “cost” of the tort system, data that is wildly-exaggerated and easily debunked by experts.<sup>2</sup> In fact, litigation is down in almost every sector,<sup>3</sup> including securities class actions.<sup>4</sup>

Despite the lack of any credible evidence to support Paulson’s claim, the notion that lawsuits, judges, juries and lawyers are to blame for economic problems that may exist in this country is a common myth often perpetuated by business lobbies to justify pressure on lawmakers to restrict the legal rights on injured Americans.<sup>5</sup> It is without any basis in fact.

### NO CREDIBLE STUDY BLAMES THE U.S. LEGAL SYSTEM FOR ANY U.S. COMPETITIVENESS PROBLEMS

- In the fall of 2006, the Geneva-based nonprofit World Economic Forum released a report showing the U.S. economy slipping behind that of other nations in terms of global competitiveness, suggesting this was due primarily to the country’s large budget deficits, although pointing out that the United States “continues to enjoy an excellent business environment.”<sup>6</sup> No mention is made of the U.S. legal system.
- As *Business Week* pointed out, “While the U.S. excelled in such business categories as market efficiency and innovation, its score in the World Economic Forum’s annual ranking was dragged down by government-related measures. Out of 125 countries, the U.S. was 40th in health care and primary education and a lowly 69th in macroeconomy, reflecting its large budget and trade deficits<sup>7</sup>. No mention is made of the U.S. legal system.
- In 2005, the Economic Policy Institute (“EPI”) released a study debunking common myths about the costs of the legal system and its burden on consumers.<sup>8</sup> According to EPI, “There is no historical correlation between the inflated estimates of the costs of the tort system and corporate profits, product quality, productivity, or research and development (R&D) spending. Evidence suggests that the tort system, without the proposed restrictions, has actually been beneficial to the economy in all these areas.”

### IN OTHER FORUMS, “TORT REFORM” ADVOCATES AND THEIR WHITE HOUSE ALLIES TOUT THE U.S. ECONOMY AS STRONG.

- The White House boasted recently that the national economy has grown over 2.9 percent in the last four quarters, a faster rate than other major industrialized nation<sup>9</sup>.

- According to the White House, the U.S. unemployment rate is currently low, creating more jobs than the Japanese and 25 European Union economies combined.<sup>10</sup>
- The President and CEO of the U.S. Chamber of Commerce Thomas Donohue, while addressing his membership in 2006, announced, “Corporate profits are up, lots of new jobs are being created, workers are earning more per hour in real terms than they did at the height of the 1990s expansion, and household wealth is at an all-time high. The unemployment rate is lower than the averages of the last three decades, nearly 70 percent of Americans own homes, and interest rates and inflation remain low by historical standards<sup>11</sup>.”
- The President of the National Association of Manufactures, John Engler, has been praising the U.S.’s economy as a whole, and the manufacturing industry in particular, to his membership: “Our nation’s economy grew in the first three quarters of 2004 at an estimated 4.0 percent, with the manufacturing sector rebounding from a long downturn to grow 5.8 percent. It was the first time in five years that manufacturing growth has outpaced the overall economy... U.S. exports are rising, home ownership is at record levels and the overall outlook for 2005 is positive.<sup>12</sup>”

### **U.S. INDUSTRIES ARE HAVING PARTICULAR SUCCESS INNOVATING AND COMPETING WORLDWIDE.**

- As reported by *Foreign Affairs* in late 2004, total U.S. expenditures on Research & Development (R&D) are expected to top \$290 billion—more than twice the total for Japan, the next biggest spender. In 2002, the U.S. R&D total exceeded that of Canada, France, Germany, Italy, Japan, and the United Kingdom combined.<sup>13</sup>
- The White House boasts that American spending on R&D far exceeds that of any other nation to such a degree that “with about 5 percent of the world’s population, the United States... accounts for one-third of global R&D spending.”<sup>14</sup>

### **INDUSTRIES WITH HIGH LIABILITY EXPOSURE ARE HAVING GREAT SUCCESS INNOVATING AND COMPETING IN WORLD MARKETS.**

If the U.S. civil justice system was harming U.S. competitiveness, companies in sectors with high liability exposure, like the pharmaceutical industry, would be having a difficult time profiting, developing new products or succeeding in worldwide competition. But evidence suggests that the opposite is true.

- The drug industry regularly ranks at the nation’s second-most profitable industry only trailing behind the banking sector<sup>15</sup>. As recently reported in the *New York Times*, “Drug makers continued to post strong profit gains yesterday, led by Pfizer, the world’s biggest pharmaceutical company, which reported that its third-quarter earnings had more than doubled from a year earlier. Eli Lilly, Novartis and Wyeth also said yesterday that their profits were up for the quarter, with the gains driven by price increases and growth in new prescriptions, mainly in the United States.”<sup>16</sup>
- Merck, the third-largest American drug maker and Vioxx manufacturer, anticipates profits relating to newly developed drugs accounting for over \$2 billion in profits by the year 2010<sup>17</sup>.
- According to Public Citizen, as the threat of an economic downturn loomed in 2002, “the combined profits for the ten drug companies in the Fortune 500 (\$35.9 billion) were more than the profits for all the other 490 businesses put together (\$33.7 billion).”<sup>18</sup>
- Members of the Pharmaceutical Research and Manufacturers of America, including companies like Merck, invested an estimated \$39.4 billion in 2005 discovering and developing new medicines. Industry wide research and investment for drug companies reached a record \$51.3 billion in 2005.<sup>19</sup>
- Reflecting the company’s confidence in the growth potential of its research and development pipeline, Pfizer plans to invest approximately \$8 billion in R&D in 2005, compared with \$7.7 billion in 2004. Pfizer, along with the U.S. drug industry, has raked up third-quarter earnings that were double what they were a year ago, with a 14 percent increase in domestic sales alone.<sup>20</sup>

- The issue of patent expirations looms as a far larger problem in the pharmaceutical world than that of lawsuits.<sup>21</sup> In fact, when Merck announced the closing of five manufacturing plants by 2008 and job cuts, the decision had nothing to do with lawsuits. As reported in the *New York Times*, “The cuts ... come after a similar announcement from Pfizer in April and are the latest sign of the problems faced by major drug makers as patents on some of their most profitable medicines expire. Next June, Merck will begin to face low-priced generic competition on Zocor, a cholesterol-lowering drug that is its top-selling medicine, with sales of \$4.5 billion expected this year.”<sup>22</sup> As Scott Henry, an analyst at Oppenheimer & Company told the *New York Times* earlier this year, “[t]his is an industry built on new drug approvals — patents run out for everyone, and research and development productivity remains the key to long-term success.”

## January 2007

## NOTES

<sup>1</sup> Remarks by Treasury Secretary Henry M. Paulson on the Competitiveness of U.S. Capital Markets Economic Club of New York, New York, NY, <http://www.treasury.gov/press/releases/hp174.htm>.

<sup>2</sup> See, Center for Justice & Democracy Mythbuster, “The Real Costs of the Tort System,” January 2007, [http://centerjd.org/MB\\_2007costs.htm](http://centerjd.org/MB_2007costs.htm)

<sup>3</sup> See, Center for Justice & Democracy Mythbuster, “Facts About Civil Litigation in the United States,” January 2007, (add URL).

<sup>4</sup> “The number of securities fraud class actions filed in 2006 was the lowest ever recorded in a calendar year since the adoption of the Public Securities Litigation Reform Act (PSLRA) of 1995, notes the Securities Class Action Filings 2006 Year in Review report released today by the Stanford Law School Securities Class Action Clearinghouse, a joint project between Stanford Law School and Cornerstone Research. The study reports securities fraud class actions decreased by 38 percent since 2005, plunging from 178 filings to just 110, making this year’s numbers nearly 43 percent lower than the ten-year historical average of 193. ... The study attributes the record low numbers of securities fraud class action filings in 2006 to three primary factors. First, the strengthened federal enforcement environment reflected in the pressure that the SEC and Department of Justice now bring to bear on corporations to conduct internal investigations that implicate the individual executives responsible for the fraud, may be reducing the amount of fraud in the market. Second, a strong stock market combined with lower stock price volatility typically reduces the number of cases filed. Third, the overwhelming majority of securities fraud class actions that were filed in the late 1990s to the early 2000s are now behind us. While the boom and bust cycle of this era may have contributed to the peak, the numbers in 2006 are low even when compared to pre-peak activity. News Release, “Securities Fraud Class Actions Tumbled to an All-Time Low in 2006, Finds New Study by Stanford Law School and Cornerstone Research; Strong Federal Enforcement Activity and Stable Stock Market Contribute to Decline,” January 2, 2007. <http://securities.stanford.edu/>.

<sup>5</sup> See., e.g., The National Association of Manufacturers, “The Escalating Cost Crisis: An Update on Structural Cost Pressures Facing U.S. Manufacturers,” September 27, 2006 (“The burden of litigation and tort costs increased only modestly since the 2003 study, largely due to legislative and judicial developments that have reduced incentives to file frivolous lawsuits.”) The NAM report, which seeks to outline the overall costs to business from factors including “health care benefits, regulation, litigation and energy,” places a much heavier emphasis on what they deem the negative costs associated with our judicial system. In fact, the report is seemingly designed to provide business interests with “evidence,” as the *Washington Post*’s Steven Pearlstein puts it, which they can then use to “warn of impending economic ruin unless the government adopts the Republican agenda of less regulation, lower taxes, tort reform, and relieving companies of health-care and pension costs.” Pearlstein, Steven, “No Longer No. 1, and No Wonder,” *Washington Post*, September 27, 2006.

<sup>6</sup> Marcus Walker, “Economic Forum Warns U.S. Of Budget Deficit's Ill Effects,” *Wall St. Journal*, September 27, 2006; [http://blogs.usatoday.com/ondeadline/2006/09/us\\_falls\\_from\\_f.html](http://blogs.usatoday.com/ondeadline/2006/09/us_falls_from_f.html)

<sup>7</sup> Peter Coy, “Is the U.S. Losing Its Competitive Edge?,” *Business Week*, September 27, 2006

<sup>8</sup> See, Economic Policy Institute, “The Frivolous Case for Tort Law Change,” <http://www.epi.org/content.cfm/bp157>.

<sup>9</sup> See <http://www.whitehouse.gov/infocus/economy/>

<sup>10</sup> See <http://www.whitehouse.gov/news/releases/2006/05/20060519-2.html>

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- <sup>11</sup> See [http://www.uschamber.com/press/speeches/2006/060329\\_trala\\_keynote\\_speech.htm](http://www.uschamber.com/press/speeches/2006/060329_trala_keynote_speech.htm)
- <sup>12</sup> [http://www.nam.org/s\\_nam/doc1.asp?CID=202310&DID=232929](http://www.nam.org/s_nam/doc1.asp?CID=202310&DID=232929)
- <sup>13</sup> Adam Segal, "Is America Losing Its Edge?," *Foreign Affairs*, 17 November 2004
- <sup>14</sup> <http://www.whitehouse.gov/news/releases/2006/01/20060131-5.html>
- <sup>15</sup> Terence O'Hara, "Oil Industry Seeks to Cast Huge Profits as No Big Deal," *Washington Post*, October 28, 2005
- <sup>16</sup> Alex Berenson, "Pfizer and Other Drug Makers Report Higher Profits," *New York Times*, October 20, 2006.
- <sup>17</sup> See [http://www.merck.com/finance/annualreport/ar2005/emerging\\_markets.html](http://www.merck.com/finance/annualreport/ar2005/emerging_markets.html)
- <sup>18</sup> See [www.citizen.org/documents/Pharma\\_Report.pdf](http://www.citizen.org/documents/Pharma_Report.pdf)
- <sup>19</sup> See [http://www.phrma.org/about\\_phrma/](http://www.phrma.org/about_phrma/)
- <sup>20</sup> Alex Berenson, "Pfizer and Other Drug Makers Report Higher Profits," *New York Times*, October 20, 2006.
- <sup>21</sup> Amy Barrett, "Merck could use a few pep pills," *Business Week*, December 17, 2001
- <sup>22</sup> Alex Berenson, "Revamping At Merck To Cut Costs," *New York Times*, November 29, 2005.