The Role(s) of Economic Analysis in Tort Law

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The economic analysis of tort law has never lacked ambition. The analytical approach was initially shaped by Richard Posner's strong claim that tort law should maximize wealth by minimizing accident costs.[1] The approach subsequently foundered as scholars, including Posner, recognized that cost-benefit analysis cannot determine initial entitlements.[2] This limitation of cost-benefit analysis was then addressed by Louis Kaplow and Steven Shavell, who have proven that a "fair" tort rule has the potential to make everyone worse off than the welfare-maximizing tort rule.[3] The apparent undesirability of such an outcome provides a normative rationale for a welfare-maximizing tort system. Such a system ordinarily relies upon cost-minimizing liability rules, thereby reestablishing the dominance of economic analysis in tort law.[4]

The conventional economic analysis of tort law accordingly provides only one role for economic analysis. *All* issues of concern to the tort system ought to be resolved in the cost-minimizing manner, the general method for maximizing social welfare and wealth.

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[1] RICHARD A. POSNER, THE ECONOMICS ANALYSIS OF LAW (1972); RICHARD A. POSNER, THE ECONOMICS OF JUSTICE (1981); WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW (1987).

[2] Cost-benefit analysis depends on prices which in turn depend on the initial allocation of property rights. *See* Lewis A. Kornhauser, *Wealth Maximization* in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 679 (Peter Newman ed. 1998). Posner now agrees that wealth maximization is limited in this manner. *See* Richard A. Posner, *Wealth Maximization and Tort Law: A Philosophical Inquiry*, *in* PHILOSOPHICAL FOUNDATIONS OF TORT LAW 99, 99-100 (David G. Owen ed. 1995).

[3] *See* Louis Kaplow & Steven Shavell, *The Conflict Between Notions of Fairness and the Pareto Principle*, 1 AMER. L. & ECON. REV. 63 (1999)[hereinafter "Conflict"]; Louis Kaplow & Steven Shavell, *Any Non-welfarist Method of Policy Assessment Violates the Pareto Principle*, 109 J. POL. ECON. 281 (2001)[hereinafter "Policy Assessment"]. The quotations around "fair" signify the particular analytic definition to the term given by Kaplow and Shavell that is discussed in Part II.A.

[4] *See* LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 85-184 (2002)[hereinafter "Fairness"](arguing that tort rules should be evaluated exclusively in terms of their impact on welfare, which ordinarily involves minimizing the total cost of accidents).

Not surprisingly, the claim that tort law is merely an exercise of welfare economics has provoked an equally extreme response from critics. The most forceful critique has come from those who maintain that the tort system implements the principle of corrective justice.[5] According to the principle of corrective justice, one who is responsible for the wrongful losses of another has a duty to repair those losses.[6] This conception of fairness "rules out the economic analysis of private law."[7]

The difference between the efficiency and fairness justifications for tort liability is glossed over by the *Restatement (Third) of Torts*.[8] The literature, however, clearly reveals the current divide.[9] The efficiency versus fairness debate continues to rage in torts scholarship, and for a good reason. The two forms of justification are incompatible.[10]

The debate so far has characterized economic analysis in extreme terms: either it is the only inquiry of relevance, or instead one lacking any relevance whatsoever. The debate, though, has only addressed the question of whether the appropriate norm of tort liability is one of economic efficiency or a rights-based conception of fairness such as corrective justice. Any claims about the conflict between economic analysis and a principle of fairness are limited to the incompatibility of these norms as justifications for tort liability. It is a largely unexplored question whether a rights-based fairness norm like the principle of corrective justice can be complemented by economic analysis.[11]

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[5] *See, e.g.,* JULES L. COLEMAN, THE PRACTICE OF PRINCIPLE: IN DEFENCE OF A PRAGMATIST APPROACH TO LEGAL THEORY 1-63 (2001) (arguing that corrective justice can provide an account of tort law whereas economic analysis fails to do so). For an account of the development and tenor of the efficiency versus fairness debate, see Gary T. Schwartz, *Mixed Theories of Tort Law: Affirming Both Deterrence and Corrective Justice*, 75 TEX. L. REV. 1801, 1802-11 (1997).

[6] *See* Part I.

[7] ERNEST WEINRIB, THE IDEA OF PRIVATE LAW 132 (1995).

[8] *See* RESTATEMENT OF THE LAW TORTS: LIABILITY FOR PHYSICAL HARMS (BASIC PRINCIPLES) § 6 cmt. b (Tent. Draft No. 1, March 28, 2001) (rationalizing negligence liability "as remedying an injustice inflicted on the plaintiff by the defendant" and "providing the defendant with appropriate safety incentives [which] improves the overall welfare of society, and thereby advances economic goals"); *id.* § 3, cmt. e (adopting a "cost-benefit test" for negligence).

[9] *See* Jules L. Coleman, *The Grounds of Welfare*, 112 YALE L. J. 1511 (2003) [hereinafter "Grounds of Welfare"].

[10] *See* Part I.

[11] The issue has been explored, though not systematically. *See* Robert Cooter, *Torts as the Union of Liberty and Efficiency: An Essay on Causation*, 63 CHI.-KENT L. REV. 523 (1987); Mark Geistfeld, *Economics, Moral Philosophy, and the Positive Analysis of Tort Law* in PHILOSOPHY AND THE LAW OF TORTS 250, 267-69 (Gerald Postema ed. 2001); Schwartz, supra note __, at 1824-28. A similar, though different approach seeks to ascertain the extent to which efficiency and

No doubt, many believe that this question has been ignored for good reasons. The conventional economic question is forward-looking: Would liability in this case minimize future accident costs? That inquiry seems to be utterly irrelevant to the backward-looking normative question: Is liability in this case warranted because the defendant was responsible for violating the plaintiff's right?

Despite superficial appearances, the idea that economic analysis is incompatible with or irrelevant to a principle of fairness is mistaken. Economic analysis has an important role to play in a fair tort system, one that significantly differs from its role in an efficient tort system. There are varied roles for economic analysis in tort law, not merely the one suggested by the ongoing efficiency versus fairness debate.

Part I locates the antinomy that divides the tort norm of allocative efficiency from a rights-based conception of fairness such as corrective justice. In an effort to guide the choice between these competing norms, Kaplow and Shavell have argued against fair tort rules on the ground that they can make everyone worse off relative to a welfare-maximizing rule, thereby violating the Pareto principle. Part II shows why corrective-justice tort rules are fully consistent with the Pareto principle, whereas cost-minimizing tort rules are only formally but not substantively consistent with the Pareto principle. Contrary to the claims of Kaplow and Shavell, the Pareto principle favors fair tort rules and not cost-minimizing rules.

Other possible justifications for a cost-minimizing tort system remain. Part III rejects the possibility that cost-minimizing tort rules can be justified as an appropriate instrument for implementing the principle of corrective justice. One tenet of the conventional economic analysis of tort law is that the tort system should minimize accident costs, because the income tax system has a comparative cost advantage in effectuating any redistributions required as a matter of fairness. Part III shows that the distributions required by the principle of corrective justice are effectuated at lower cost by the tort system than by tax transfers. The only remaining instrumental reason for rejecting fair tort rules pertains to the vagueness of those rules as compared to precisely specified cost-minimizing rules. Due to this vagueness, the guidance provided by cost minimization could make that approach a second-best instrument for implementing the principle of corrective justice. Part III concludes by showing why corrective-justice tort rules

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fairness justifications coincide or overlap. *See* Geistfeld, *supra*, at 265-67; Schwartz, *supra* note __, at 1815-23.

do not suffer from this problem of vagueness. Fair tort rules are no more vague than cost-minimizing tort rules, eliminating the possibility that cost-minimizing tort rules can be justified as the nonideal or second-best implementation of corrective justice.

The only remaining justification for a cost-minimizing tort system resides in some principle of justice, like utilitarianism, that rejects the individual right to physical security and the concomitant need to protect that right with fair tort rules. Part IV shows why this particular normative commitment is not essential to the economic analysis of tort law. Whereas welfare economics was once tied to utilitarian forms of justification, today welfare economists treat fairness as a constraint on allocative efficiency. The economic analysis of tort law can do the same.

Part V then shows how economic analysis can complement a rights-based theory of tort law, like one based on the principle of corrective justice. Although the protection of welfare is not the reason or justification for the individual rights of concern to corrective justice, the adequate protection of rights frequently reduces to a consideration of how tort rules affect welfare. In these circumstances, the concerns of fairness can be addressed by what I call distributive economic analysis, which seeks to determine how liability rules affect the distribution of welfare between right-holders and duty-holders. Insofar as a fair tort rule requires a fair distribution of welfare, the substantive content of the liability rule can be derived by distributive economic analysis. Part V uses the issues of reciprocity and nonmonetary damages to show how distributive economic analysis can complement corrective-justice theories of tort law by eliminating ambiguities or inconsistencies in the fairness inquiry.

The economic analysis of tort law thus has distinctive roles, depending on the underlying justification for tort liability. Having delineated the relation between normative justification and different forms of economic analysis, one can see more clearly the instances in which the requirements of fairness correspond to the requirements of efficiency, creating an overlapping consensus for some forms of tort law, including products liability. Progress can be made in these areas, despite continued disagreement about the appropriate purpose of tort liability. The varied roles of economic analysis therefore can improve our understanding of tort law in ways obscured by the conventional role of minimizing accident costs.

I. Efficiency versus Fairness?

Tort liability is a method for mediating the conflicting interests of individuals engaged in risky behavior. An automobile driver, for example, typically desires the transportation to promote her liberty interests. As an unwanted byproduct of that activity, the driver exposes pedestrians to a risk of injury. A pedestrian also transports herself in furtherance of her liberty interests. In the event the driver accidentally injures the pedestrian, by definition the pedestrian's interest in physical security has been harmed. The pedestrian also suffers emotional harms (pain and suffering) and intangible economic harm (like medical expenses). If the driver is obligated to compensate those harms, the monetary damages would be detrimental to her economic interests. Any precautionary obligations tort law imposes on the driver would also be detrimental to her liberty interests. Similarly, any precautionary obligations imposed on the pedestrian would be detrimental to her liberty interests. The way in which tort law regulates the risky interaction therefore means at least one party's interests will be burdened or harmed: Either the pedestrian's interests in physical security and liberty; or the driver's liberty interests, including the economic interest. The appropriate mediation of these interests is the basic question that must be addressed by tort law in this particular context.

Tort law traditionally has distinguished between liberty and security interests, giving "peculiar importance" to the nature of the interests and their social value.[12] Distinguishing the various types of interests only matters for purposes of priority. Tort law consistently has given one's interest in physical security priority over a conflicting liberty interest of another.[13] As a leading torts

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[12] RESTATEMENT (SECOND) OF TORTS § 77 cmt. i (1965). *See, e.g.*, OLIVER WENDELL HOLMES, THE COMMON LAW 144 (1881) (concluding that tort law "is intended to reconcile the policy of letting accidents lie where they fall, and the reasonable freedom of others with the protection of the individual from injury"); W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 3, at 16-17 (5th ed. 1984) (observing that "weighing the interests [of security and liberty] is by no means peculiar to the law of torts, but it has been carried to its greatest lengths and has received its most general conscious recognition in this field"). Throughout I will use rather simplistic notions of the relevant interests, such as "liberty" and "security" interests. The philosophical explication of these interests, however, is much more nuanced. *See* Stephen Perry, *Harm, History, and Counterfactuals*, San Diego L. Rev. (forthcoming 2004) (differentiating core interests from secondary or recursive interests).

[13] The priority of security over the liberty interest is the express justification for the various defenses to intentional torts involving property. *See, e.g.*, RESTATEMENT (SECOND) OF TORTS § 77 (1965). The priority also determines the issue of "reasonableness" regarding the conduct. *Id*. cmt. i. The question of reasonableness, which addresses the mediation of normatively acceptable, competing interests, is central to negligence law. Hence the priority applies to accidental harms. *Cf. id*. § 1 cmt. d ("[T]he interest in bodily security is protected against not only intentional

treatise states, "the law has always placed a higher value upon human safety than upon mere rights in property."[14]

The tort tradition of distinguishing between security and liberty interests is rejected by the conventional economic analysis of tort law. That distinction is an essential aspect of rights-based theories of tort law such as corrective justice, importantly differentiating the two theories of tort law.

Economic analysis assumes that individuals rationally maximize their welfare. A particular interest matters only as an input to individual welfare. Whatever interests the individual chooses to promote, doing so at the least cost would enhance her welfare as compared to more costly methods, all else being equal. Cost minimization promotes individual welfare while increasing individual (and social) wealth.

Because the minimization of costs does not require distinction among various types individual interests, the basic problem posed by tort law fundamentally changes from its traditional conception. The driver's liberty interest did not cause injury to the pedestrian's security interest. Rather, the two parties interacted, the interaction caused injury to one party, and shifting the loss to the other via tort liability merely makes that party the accident victim.[15] As a general proposition, social welfare would not be increased by tort rules that merely shift the loss between two parties. One party's gain is another's loss. The injury, though unfortunate, is like a sunk cost that cannot be recovered. A compensatory obligation is relevant to conventional economic analysis only insofar as it would alter incentives for future risky behavior in a manner that reduces expected accident costs and increases social welfare.

The fairness issue arises because a cost-minimizing tort system gives no special priority to the individual interest in physical security. The probability of injury, the injury itself, precautions and administrative expenses are all components of accident costs to be minimized. Consequently, the individual

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invasion but against negligent invasion or invasion by the mischances inseparable from an abnormally dangerous activity."); *id*. ch. 2, introductory note, at 22 (stating that "interest in freedom from bodily harm is given the greatest protection" by various intentional torts and also by tort rules concerning negligence and strict liability); *id*. § 281 cmt. b (stating that one element of negligence is "that the interest which is invaded must be one which is protected, not only against acts intended to invade it, but also against unintentional invasions").

[14] KEETON ET AL., *supra* note __, at 132.

[15] *See* Ronald Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 2 (1960) ("We are dealing with a problem of a reciprocal nature. . . . The real question that has to be decided is: should A be allowed to harm B or should B be allowed to harm A?").

interest in physical security must be compromised if doing so would increase social welfare. The compromise of a morally fundamental individual interest for reasons of social expediency is rejected by rights-based theories of tort law like those based on the principle of corrective justice.

The principle of corrective justice "states that individuals who are responsible for the wrongful losses of others have a duty to repair those losses."[16] The principle accordingly entails a normative relationship of equality between the plaintiff and defendant. The right-holder is correlative to the duty-holder, a normative relationship that defines the plaintiff-defendant form of tort liability. The content of the right and duty, in turn, depends on some conception of responsibility: the duty to repair follows from one's responsibility for the right infringement. The relevant conception of responsibility is contested, but there is consensus that it minimally requires voluntary actions (the tort requirement of feasance) creating foreseeable risks of harm to the right-holder.[17]

According to corrective-justice theorists, the purpose of tort law is to protect the individual right to security of the person and tangible property. To be treated as a right, the security interest must have priority over competing interests; the individual interest in physical security cannot be compromised merely because doing so would confer greater wealth or welfare on others.[18] As Stephen Perry describes the position, "At least within nonconsequentialist moral theory, it makes sense to think of this [security] interest as morally fundamental, and hence as falling outside the purview of distributive justice; our physical persons belong to us from the outset, and are accordingly not subject to a social distribution of any kind."[19]

The interest in physical security is of fundamental moral importance for reasons of autonomy.[20] As Perry elaborates: "The main reason that personal

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[16] COLEMAN, THE PRACTICE OF PRINCIPLE, *supra* note __, at 15.

[17] Ernest J. Weinrib, *Correlativity, Personality, and the Emerging Consensus on Corrective Justice*, 2 THEORETICAL INQUIRIES IN LAW (Online Edition) 4 (Jan. 2001), *at* http://www.bepress.com/til/default/Vol2/iss1/art4.

[18] *See* RONALD DWORKIN, TAKING RIGHTS SERIOUSLY 194 (1977) (explaining why the "'rights' of the majority as such" "cannot count as a justification for overruling individual rights").

[19] Stephen R. Perry, *On the Relationship Between Corrective Justice and Distributive Justice* in OXFORD ESSAYS ON JURISPRUDENCE, FOURTH SERIES 237, 239 (Jeremy Horder ed.); *See also* WEINRIB, PRIVATE LAW, *supra* note __, at 202 n. 73 ("Under Kantian right, bodily integrity is an innate right and thus prior to acquired rights of property").

[20] *See, e.g.,* Weinrib, Consensus, *supra* note __, at 13-20 (arguing that "personality," which "signifies the capacity for purposiveness without regard to particular purposes," is the content of the correlative right and duty under the juridical conception of corrective justice); *see also* Gregory C. Keating, *A Social Contract Conception of the Law of Accidents* in PHILOSOPHY AND

injury constitutes harm [that may require redress as a matter of corrective justice] is that it interferes with personal autonomy. It interferes, that is to say, with the set of opportunities and options from which one is able to choose what to do in one's life."[21] Or as Jules Coleman puts it: "The capacity to live a life, and not merely to have a life happen to one, depends on being able to express one's autonomy and on being protected against persons who are unprepared to mitigate their action in light of the interests of others."[22]

One's capacity to live a meaningful life importantly depends on liberty and economic resources. The principle of corrective justice cannot protect physical security by negating any conflicting economic or liberty interests. To do so would ultimately undermine the autonomy of everyone, while failing to treat equally the parties to the normative, correlative relationship as required by the principle of corrective justice. Corrective-justice tort rules accordingly prioritize the individual interest in physical security while also recognizing the normative significance of the subordinate liberty and economic interests. The priority must be relative. Unlike an absolute or lexical priority, a relative priority of interests allows for some balancing of the conflicting interpersonal interests. Without some type of balancing, tort law would impermissibly ignore and negate the subordinate liberty interests of duty-holders.

The relative priority of interests implies that corrective-justice tort rules emphasize the individual interest in physical security while giving secondary importance to the liberty and economic interests of others. Cost-minimizing tort rules, by contrast, do not prioritize the security interest. Hence the debate between efficiency and fairness importantly centers on the relative weight given to liberty and security interests.[23] Should tort rules minimize accident costs, giving equal weight to liberty and security interests? Or should tort rules

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THE LAW OF TORTS 22, 34 (Gerald Postema ed. 2001)(arguing that under a Kantian conception of reasonableness, our "interest in security is entitled to more protection than our interest in liberty" for risks threatening severe physical injury, because such risks "threaten the premature end, or the severe crippling, of our agency" whereas the curtailment of liberty has less of a burden on "our capacities to pursue our ends over the course of complete lives"); ARTHUR RIPSTEIN, EQUALITY, RESPONSIBILITY, AND LAW 55 (developing a conception of reasonableness according to which "specific liberty interests and security interests are protected, based on a conception of their importance for leading an autonomous life").

[21] Perry, *supra* note __, at 256.

[22] Coleman, *Grounds of Welfare*, *supra* note __, at 1542.

[23] *See* Richard W. Wright, *Justice and Reasonable Care in Negligence Law*, 47 AMER. J. JURIS. 143, 145 (2002)(showing that "all of the leading justice theorists by now have recognized [that] the aggregate-risk-utility test [which gives equal weight to security and liberty interests] cannot be reconciled with the principles of justice").

prioritize the security interest as a means of protecting the individual right to physical security?

The question is normative and outside the competence of an economist *qua* economist. This does not mean, though, that economic analysis has nothing to say about the question. According to a proof recently established by Louis Kaplow and Steven Shavell, the Pareto principle is violated by any tort rule that gives weight to some factor not based exclusively on individual welfare.[24] Such a "fair" tort rule has the potential to make everyone worse off compared to an exclusively welfare-based rule. That outcome seems unacceptable, so Kaplow and Shavell conclude that tort law should be justified exclusively in welfare terms.[25]

The Pareto principle is integral to welfare economics, embodying one of the two concepts of economic efficiency (the other being allocative efficiency).[26] The Kaplow and Shavell proof therefore seems to provide economists with a compelling reason to reject corrective-justice tort rules. If only welfare matters for purposes of corrective justice, there would be no need to distinguish or prioritize the interest in security from other interests, as each would be a component of welfare. By prioritizing the individual interest in physical security, the principle of corrective justice attaches some significance to the interest apart from its impact on individual welfare. Corrective justice accordingly relies on considerations of fairness not grounded exclusively in concerns of welfare. These fair tort rules thus seem to be governed by the Kaplow and Shavell proof and apparently violate the Pareto principle.

The Kaplow and Shavell proof accordingly has the potential to provide normative justification for the conventional economic analysis of tort law. Cost-minimizing tort rules are exclusively welfare based and do not violate the Pareto principle. Cost-minimizing tort rules also maximize social wealth, which can then be redistributed via the tax system to maximize social welfare.[27] And

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[24] *E.g.*, KAPLOW & SHAVELL, FAIRNESS, *supra* note __ .
[25] *Id.* at 87-154.
[26] "First and foremost, this is because Pareto did not simply present this notion of optimality as an abstract criterion, but showed that competitive equilibrium would yield an optimal allocation of resources in this sense, thus making precise the notion of the 'invisible hand.' It is no exaggeration to say that the entire modern microeconomic theory of government policy intervention in the economy (including cost-benefit analysis) is predicated on this idea." B. Lockwood, *Pareto Efficiency* in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS 811, 811 (John Eatwell et al. eds. 1998).
[27] *See infra* Part IV.A. Although wealth is not a direct measure of welfare, Kaplow and Shavell recognize that "analysis that assesses policies based on their aggregate impact on wealth will often

because cost-minimizing tort rules are also allocatively efficient, they can satisfy both concepts of economic efficiency, whereas corrective-justice rules apparently satisfy neither.

Of course, the Kaplow and Shavell proof has not ended the efficiency versus fairness debate. Numerous scholars, including lawyer economists, are skeptical of the Kaplow and Shavell claim that legal rules should depend only on considerations of welfare.[28] The debate so far has been conducted in general analytic terms, the form of the Kaplow and Shavell proof. To evaluate this controversy in the context of tort law, we must determine whether the Kaplow and Shavell proof shows that fair tort rules violate the Pareto principle.

II. The Pareto Principle and the Principle of Corrective Justice

Although Kaplow and Shavell claim that corrective-justice tort rules violate the Pareto principle, their proof does not apply to any rights-based tort rule grounded in a concern for individual autonomy. There is no conflict between the Pareto principle and corrective-justice tort rules. Insofar as the Pareto principle provides a reason for choosing tort rules, it favors fair tort rules over cost-minimizing tort rules.

A. *The Consistency Between Fair Tort Rules and the Pareto Principle*

In showing that fair tort rules violate the Pareto principle, Kaplow and Shavell consider a world in which "individuals understand fully how various

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prove useful." KAPLOW & SHAVELL, FAIRNESS, *supra* note __, at 37. Apparently Kaplow and Shavell believe that wealth maximization and therefore cost minimization provides that type of useful analysis for tort law. Their discussion of the relevant tort factors influencing welfare involve the various costs that must be minimized to maximize wealth. *See id*. at 86. Their ensuing discussion of tort liability involves application of the cost-minimization model. *Id*. at 86-154.

[28] *See, e.g*., Howard Chang, *A Liberal Theory of Social Welfare: Fairness, Utility, and the Pareto Principle,* 110 YALE L.J. 173 (2000) (arguing that individual waiver of rights eliminates the inconsistency between fairness and the Pareto principle); Michael B. Dorff, *Why Welfare Depends on Fairness: A Reply to Kaplow and Shavell*, 75 S. CAL. L. REV. 847 (2002)(arguing that fairness concerns are necessarily reintroduced in the formulation of the social welfare function); Daniel A. Farber, *What (If Anything) Can Economics Say About Equity?*, MICH. L. REV. (forthcoming 2003)(arguing that the Kaplow and Shavell proof does not rule out fairness concerns because "[e]verything depends on the choice of SWF [social welfare function], and with the right choice of SWF we can justify practically any outcome we want.")(manuscript p.16); Lewis A. Kornhauser, *Preference, Well-Being, and Morality in Social Decisions*, 32 J. LEGAL STUD. 303 (2003)(arguing, among other things, that the Kaplow and Shavell proof inappropriately conflates individual judgments and preferences).

situations affect their well-being."[29] Their proof also implicitly assumes that transaction costs are sufficiently low to allow for any form of redistribution.[30]

Thus the Kaplow and Shavell proof can be evaluated in a world of perfect information and costless contracting (a form of feasible redistribution). Suppose, then, that well-informed pedestrians and drivers can costlessly contract over the allocation of risk. In these circumstances, is there a conflict between the Pareto principle and the principle of corrective justice?

The Pareto principle evaluates a change from the status quo, so determining the status quo or initial starting point is critical to the analysis. Initial entitlements cannot be determined by economic analysis. Costs depend on prices which in turn depend on initial entitlements.[31] To compare the fair tort rule with the efficient rule, then, we can assume that the principle of corrective justice justifies an entitlement for pedestrians that does not minimize costs. More precisely, the initial entitlement gives the pedestrian some right that is not allocatively efficient, a right protected by a fair tort rule.

In the absence of transaction costs, the pedestrian as right-holder will always exercise or waive her right in exchange for adequate compensation from the driver whenever it would be allocatively efficient to do so. This conclusion follows from the Coase theorem.[32] The entitlement or individual right underlying the fair tort rule therefore need not prevent drivers and pedestrians from reaching the cost-minimizing outcome.

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[29] Kaplow & Shavell, *Conflict*, *supra* note __, at 65.

[30] Kaplow and Shavell have two proofs. One involves individuals who are symmetric in all relevant respects, making distributional considerations (and distributional costs) irrelevant. Kaplow & Shavell, *Conflict*, *supra* note __. The other proof allows for individual differences. For the differences to be meaningful, the welfare gain in moving from (fair) *state-f* to (welfaristic) *state-w* must be unequally distributed across the individuals. Some individuals may be harmed by the change to *state-w*, so *state-w* need not involve a Pareto improvement over *state-f*. Kaplow and Shavell construct a new (redistributed) *state-r* with the same total welfare as *state-w*, in which the total welfare gain in moving from *state-f* to *state-w* is redistributed across all individuals so as to make each one better off in *state-r* than in *state-f*. Each person now prefers *state-r* over *state-f*, so adhering to *state-f* for fairness reasons would violate the Pareto principle. Kaplow & Shavell, *Policy Assessment*, *supra* note __. Clearly, *state-r* can be compared to *state-f* only if the redistribution of the total welfare gain (from *state-f* to *state-w*) is costless (as in the proof), or more generally, if the per capita welfare cost of redistribution is less than the per capita welfare gain.

[31] *See* Lewis A. Kornhauser, *Wealth Maximization* in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 679 (Peter Newman ed. 1998).

[32] Coase, *supra* note __ (showing that any allocation of entitlements does not block efficient outcomes in a world without transaction costs).

This aspect of the entitlement implicates the tort doctrine of assumption of risk. Pursuant to this doctrine, the agreement between the driver and pedestrian absolves the driver of liability for the risk.[33] Consequently, if the fair entitlement permits a right-holder like the pedestrian to assume the risk, there is no conflict between the requirements of fairness and efficiency in these circumstances. And if a fair entitlement always yields the allocatively efficient outcome, there can be no conflict between the principle of fairness and the Pareto principle.[34]

According to the principle of corrective justice, one who is responsible for the wrongful losses of another has a duty to repair those losses. A loss is not wrongful if the person who suffered the loss voluntarily consented to face the risk. "The person who in fact secures consent before acting does no wrong. If the victim believes himself or herself to have consented, no wrong is done."[35]

The fair entitlement permits the right-holder to assume the risk for reasons of autonomy. An individual's fully informed, voluntary choice to assume a risk expresses her agency and allows her to pursue the life plan of her choosing. Any tort rule that blocked such choices would undermine the right-holder's agency and disregard the responsibility attaching to the choices one makes. The tort doctrine of assumption of risk, therefore, is substantively compatible with the ideal of autonomy and individual responsibility, the justification for the individual right to physical security.

As a matter of consistency, the right protected by the fair tort rule must permit its holder to assume the risk. Consequently, the fair tort rule cannot conflict with the Pareto principle in the circumstances considered by Kaplow and Shavell.

This conclusion remains valid in the contexts not expressly considered by Kaplow and Shavell, those in which redistributions are prohibitively costly. As before, suppose that the principle of fairness specifies some initial entitlement for pedestrians that does not minimize costs. Any shift to the cost-minimizing tort

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[33] RESTATEMENT OF THE LAW, TORTS: APPORTIONMENT OF LIABILITY § 2 (2000).

[34] The First Fundamental Theorem of welfare economics is that a competitive equilibrium is Pareto optimal. Allan M. Feldman, *Welfare Economics* in 4 THE NEW PALGRAVE DICTIONARY OF ECONOMICS 889, 890 (John Eatwell et al. eds. 1998).

[35] RIPSTEIN, *supra* note __, at 202. *See also* WEINRIB, PRIVATE LAW, *supra* note __, at 169 n. 53 (explaining why voluntary assumption of risk is part of the juridical conception of corrective justice); *id*. at 136-40 (explaining why the principle of corrective justice supports the enforcement of contractual obligations); RUSSELL HARDIN, MORALITY WITHIN THE LIMITS OF REASON 109 (1988)("it is obvious that among the most important of all rights in the liberal canon are the right of exchange and the correlative right of contract").

rule would make some pedestrians worse off.[36] These individuals cannot be adequately compensated for the change in tort rules when contracting and other forms of redistribution are prohibitively costly. Each pedestrian would not prefer the cost-minimizing tort rule over the fair tort rule. The Pareto principle therefore is not violated by the fair tort rule in these circumstances, just as it is not violated in circumstances involving feasible redistributions and the assumption of risk by right-holders. Contrary to the claim made by Kaplow and Shavell, corrective-justice tort rules do not violate the Pareto principle.

Tort law thus provides important support for Howard Chang's more general claim that the Pareto principle is not violated by liberal, rights-based legal rules due to the ability of individuals to exercise or waive their rights when it is in their interest to do so.[37] Chang's claim has been rejected by Kaplow and Shavell.[38] But when this particular debate is evaluated in the context of tort law, it is quite clear that Chang is correct. The Kaplow and Shavell proof relies upon assumptions that are inapplicable to corrective-justice tort rules, so the result of their proof is also inapplicable to those rules.

Kaplow and Shavell reject the claim that any serious or consistent theory of fairness would depart from the assumptions in their proof. They argue that one of the contested assumptions "is one that we imagined would be endorsed by anyone who believed that a notion of fairness was worth taking seriously…. Formally, our argument only requires that the principle of fairness be continuous *in something*. (Hence, corrective justice should not be given infinitesimal weight with respect to administrative cost savings, trivial aesthetic pleasures, or the consumption of some good—in other words, to some factor that is unrelated to the notion of fairness.)"[39]

As indicated by this response, Kaplow and Shavell misunderstand the nature of the individual right protected by the principle of corrective justice. A corrective-justice tort rule is not continuous in *anything*, since either the pedestrian assumes the risk or she does not. An either/or choice is not continuous. The pedestrian assumes the risk because she receives adequate monetary payment

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[36] In the event all pedestrians are identical in the relevant respects, the context effectively involves costless redistributions and is governed by that analysis.

[37] Chang, *supra* note __.

[38] Louis Kaplow & Steven Shavell, *Notions of Fairness Versus the Pareto Principle: On the Role of Logical Consistency*, 110 YALE L. J. 237, 243 (2000)[hereinafter "Consistency"]. Kaplow and Shavell have subsequently elaborated their response without changing its substance. *See* Louis Kaplow & Steven Shavell, *Fairness versus Welfare: Notes on the Pareto Principle, Preferences, and Distributive Justice*, 32 J. LEGAL STUD. 331, 342-51 (2003) [hereinafter "Notes"].

[39] Kaplow & Shavell, *Consistency*, *supra* note __, at 243.

in exchange. In principle, that payment could be infinitesimally small (to assume an infinitesimal risk). Consequently, it may look like corrective justice is given infinitesimal weight with respect to a penny (a factor unrelated to corrective justice), but that appearance does not make the principle of corrective justice meaningless or logically inconsistent. As long as the payment induces the choice, the principle of corrective justice is satisfied. The choice and not the size of the payment is the relevant normative concern, one required if corrective justice is to consistently protect individual autonomy across the range of circumstances, including those in which the individual assumes the risk for seemingly trivial reasons.

Kaplow and Shavell further argue in favor of their assumption on the ground that the contrary assumption means that "no matter how much unfairness is involved, it can be outweighed by the tiniest amount of administrative cost savings [shared per capita]."[40] This argument similarly misunderstands corrective justice. Presumably the unfairness to which they allude involves the behavior of the defendant. That is, as the defendant's conduct becomes more and more egregious, Kaplow and Shavell claim that the principle of fairness should become more important rather than less important. How, then, could the principle of fairness be satisfied by one penny when considered in relation to such morally egregious misconduct? The answer is that corrective justice is interested in the defendant's behavior only insofar as it affects the plaintiff's right to redress.[41] If the plaintiff exercises or waives her right, the defendant's behavior is irrelevant. There is no great "unfairness" as a matter of corrective justice that has been "outweighed" by the one penny that has induced the consent.

Finally, Kaplow and Shavell fail to appreciate the reasons why welfare considerations matter to the principle of corrective justice. According to Kaplow and Shavell, any principle of fairness that incorporates welfare concerns is a "hybrid" theory. They argue that "hybrid" theories inconsistently combine considerations of welfare with fairness:

> [S]uppose that there are three regimes, *A*, *B*, and *C*. Under a posited notion of fairness, *A* is perfectly fair, *B* is moderately fair (say five individuals are treated somewhat unfairly), and *C* is significantly unfair (an additional ten individuals are treated quite unfairly). Under a pure version of the notion of fairness, the regimes would be ranked *A* best, *B* second, *C* worst. But now suppose that the welfare of every individual in regime *C* is

[40] *Id*. at 242.
[41] *See, e.g.*, WEINRIB, PRIVATE LAW, *supra* note __, at 155.

> somewhat greater than it is in regime *A* (because some other aspect of the regime sufficiently benefits those treated unfairly in *C*). Under the hybrid approach, one is therefore compelled to hold that regime *C* is definitely morally superior to *A*. The problem, however, is that the same hybrid theory insists that regime *A* is definitely morally superior to … regime *C*.[42]

The inconsistency identified by Kaplow and Shavell would not arise under the principle of corrective justice. For regime *A* to be perfectly fair as a matter of corrective justice, it must perfectly implement the principle of corrective justice. The ideal instantiation of autonomy involves situations in which everyone gives their fully informed consent to the choice in question. If individuals are given the opportunity to choose between regimes *A*, *B*, and *C*, everyone will choose *C* under the conditions posited by Kaplow and Shavell. Hence regime *A* cannot be perfectly fair as a matter of corrective justice, contrary to the assumption made by Kaplow and Shavell. The falsity of the assumption renders invalid their conclusion that there is an inconsistency between the normative desirability of regimes *A* and *C*.[43]

As a matter of logical consistency, the principle of corrective justice can justify an outcome that also maximizes individual welfare. For purposes of corrective justice, the reason why individuals can assume the risk involves the promotion of autonomy by the fully informed choices of all affected parties. Those choices also maximize individual welfare, eliminating any potential conflict between the principle of corrective justice and the Pareto principle. By failing to recognize how a concern for autonomy can justify welfare-maximizing outcomes, Kaplow and Shavell erroneously conclude that any plausible moral theory must satisfy the assumptions in their proof. That error, in turns, underlies their mistaken conclusion that the principle of corrective justice violates the Pareto principle.

B. *The Pareto Principle and the Choice of Tort Rules*

The Pareto principle is not violated by corrective-justice tort rules, nor is it violated by cost-minimizing tort rules. But insofar as it is a *principle* rather than a *rule* requiring choice based on unanimous consent, there must be normative

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[42] Kaplow & Shavell, *Notes*, *supra* note __ , at 346.

[43] For further argument that "hybrid" theories are immune from the Kaplow and Shavell critique, see Richard A. Craswell, *Kaplow and Shavell on the Substance of Fairness*, 32 J. Legal Stud. 245, 249-57 (2003).

content to the Pareto principle. That normative content can provide a reason for choosing between fair and cost-minimizing tort rules.

As Richard Posner has argued, the normative appeal of the Pareto principle lies in the connection between consent and autonomy.[44] A change actually consented to by all affected parties promotes their autonomy and is desired for that reason. So understood, the Pareto principle favors corrective-justice tort rules.

In a tort system based exclusively on cost minimization and welfarism, the total amount of individual welfare is the only relevant concern for purposes of policy evaluation.[45] The source of welfare is irrelevant. (Otherwise one could easily construct a social welfare function that satisfies the principle of corrective justice.[46]) All that matters is the maximization of social welfare, defined in terms of individual welfare rather than its components or sources. Autonomy and unanimity are irrelevant.

For example, suppose there are 100 individuals in a community that is considering two tort rules. *Rule-1* would make each person in the community better off by one unit of welfare, satisfying the Pareto principle. *Rule-2* would make 99 people better off by 1.10 units of welfare, while making one person worse off by 8 units of welfare. Suppose the social welfare function gives equal weight to each individual's welfare as per utilitarianism, the best known form of welfarism. The welfare-maximizing social planner will choose *Rule-2*, which has a total welfare gain of 100.9 units, whereas *Rule-1* has a total welfare gain of 100 units. The unanimous approval of *Rule-1* is irrelevant to the welfare-maximizing

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[44] Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 488-97 (1980). Posner used this interpretation of the Pareto principle to justify wealth maximization in a problematic manner. *See* Coleman, *Grounds of Welfare*, *supra* note __, at 1515-20. But Posner's claim that the Pareto principle has appeal insofar as actual consent expresses the Kantian ideal of autonomy can be defended.

Note also that the Pareto principle has appeal as the analytical device for choosing between social states without having to rely upon interpersonal comparisons of utility. *See* Part IV (describing this role of Pareto principle in welfare economics). But even though the Pareto principle has an important role to play in utilitarian theory, its normative content is hard to understood in those terms for reasons to be discussed in text. Moreover, welfare economists have not interpreted the Pareto principle as merely an instrument of utilitarianism. *See id.*

[45] *See* Amartya Sen, *On Weights and Measures: Informational Constraints in Social Welfare Analysis* in CHOICE, WELFARE AND MEASUREMENT 226, 248-51 (1982)(defining "welfarism" as the "general approach of making no use of any information about the social states other than that of the personal welfares generated in them").

[46] Geistfeld, *Positive Analysis*, *supra* note __, at 267-69 (explaining how a corrective-justice tort rule could be translated into social welfare function based on the source of individual utilities).

planner. Welfarism in general, like utilitarianism in particular, merely compares total welfare under the two rules and places no weight on the fact that one rule is unanimously approved whereas the other is not.

As a formal matter, the planner's disregard of unanimity does not violate the Pareto principle. The Pareto principle requires a pair-wise comparison of the status quo with a proposed change. The principle does not apply to a comparison of *Rule-1* and *Rule-2* when evaluated from the perspective of the status quo, as in the example above. The pair-wise restriction of the Pareto principle makes it formally consistent with welfarism, because any change from the status quo satisfying the Pareto principle necessarily increases total welfare.

Despite the formal consistency between the Pareto principle and welfarism, the two are not substantively compatible. An exclusive focus on welfare excludes any consideration of the source of welfare. All that matters is whether total welfare has been increased or decreased. It is irrelevant whether the change in total welfare is brought about by actions that promote or undermine individual autonomy. By excluding consideration of autonomy or unanimity, welfarism effectively denies the normative appeal of the Pareto principle.

By contrast, the concern for autonomy is shared by the Pareto principle and the principle of corrective justice. The substantive compatibility does not mean that fair tort rules must adhere to the Pareto principle. The protection of individual rights does not necessarily entail a decision rule based on the Pareto principle, largely due to the limitations of pair-wise comparisons.[47] But if the rights-based decision rule departs from the Pareto principle, the choice reflects a decision that autonomy is better protected by departing from the Pareto principle in these circumstances. One who adheres to the Pareto principle for reasons of autonomy would have to admit that the principle should give way whenever doing so is required as a matter of autonomy.[48] The resultant conflict between individual rights and the Pareto principle therefore would be merely formal,

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[47] Lawrence G. Sager, *Pareto Superiority, Consent, and Justice*, 8 HOFSTRA L. REV. 913 (1980)(identifying limitations of Pareto superiority for a fairness-based model of justice).

[48] The same holds true of other "rules" when considered in terms of their normative justification. Consider the utilitarian rule. If "utilitarianism is best seen as an egalitarian doctrine, then there is no independent commitment to the idea of maximizing welfare. The utilitarian has to admit that we should use the maximizing standard only if that is the best account of treating people as equals." WILL KYMLICKA, CONTEMPORARY POLITICAL PHILOSOPHY: AN INTRODUCTION 35 (1990).

providing no substantive or autonomy-based reason for rejecting the rights-based decision rule.[49]

Hence the Pareto principle provides no compelling reason for choosing cost-minimizing tort rules. The consistency between the Pareto principle and cost-minimizing tort rules is only formal rather than substantive. Insofar as the normative appeal of the Pareto principle is based on individual autonomy, it favors tort rules based on the principle of corrective justice.

III. Would Cost-Minimizing Tort Rules Implement Corrective Justice?

Without the Pareto principle, what forms of justification remain for cost-minimizing tort rules and the conventional economic analysis of tort law? One possibility may seem surprising. The principle of corrective justice might justify cost-minimizing tort rules.

The implementation of a principle often requires indirect means. For example, according to a well-known theorem of welfare economics, the pursuit of efficiency under nonideal or second-best conditions may require inefficient policies.[50] The same phenomenon can occur for a theory of justice. One strand of utilitarianism, for example, maintains that agents are likely to maximize utility by following nonutilitarian rules or habits.[51] The question thus arises whether cost-minimizing tort rules can be justified as an instrument for indirectly implementing the principle of corrective justice.

Two arguments of this type can be made in support of cost-minimizing tort rules. The first acknowledges that fairness can be the ultimate social value, but maintains that matters of fair redistributions are best accomplished the tax system. Cost-minimizing tort rules may thus be capable of indirectly implementing fairness by complementing the tax system. The second argument proceeds from the premise that "fairness" is too vague for purposes of legal decision making. The resultant problems of excessive discretion and unpredictability might make these rules less fair, in practice, than cost-minimizing tort rules. This argument therefore could justify cost-minimizing tort rules as the second-best substitute for fair tort rules.

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[49] *Cf.* Coleman, *The Grounds of Welfare*, *supra* note __, at 1540-43 (showing that whatever makes welfare valuable—presumably the promotion of autonomy—also makes fairness valuable).

[50] Richard G. Lipsey & Kelvin Lancaster, *The General Theory of the Second Best*, 24 REV. ECON. STUD. 11 (1956); *see also* Peter Bohm, *Second Best* in 4 THE NEW PALGRAVE DICTIONARY OF ECONOMICS, *supra* note __, at 280.

[51] KYMLICKA, *supra* note __, at 20 (discussing indirect utilitarianism).

A. *The Income Tax System and the Fair Distribution of Wealth*

As compared to an allocatively inefficient rule, overall social wealth would be increased by the cost-minimizing tort rule. When that increased wealth can be redistributed by the tax system in whatever manner is required by the principle of fairness, there is no necessary conflict between efficiency and fairness. Cost-minimizing tort rules can complement other rules (those of taxation and transfer) that directly implement the principle of fairness.

Any system of distributive justice patterned on some simple static formula like "to each in equal shares" can create such a complementary role for cost-minimizing tort rules. A tort system that minimized the cost of accidental harms would maximize social wealth, thereby maximizing the amount to be fairly distributed by the tax system.[52] The tax system could then determine the wealth of each individual in the community, much like it determines individual income, and then redistribute income via taxes and transfers to equalize wealth across the community. Consequently, the possibility of wealth redistribution via tax transfers makes it possible to justify cost-minimizing tort rules with a principle of fairness (strict equality of wealth) not based on efficiency or wealth maximization.[53]

Principles of distributive justice based exclusively on individual wealth or welfare suffer from well-known problems. The fact of inequality matters, not its source or reason. By ignoring the source of individual inequalities in wealth or welfare, these principles of distributive justice disregard individual choices. At the end of the day, hard workers have no more money than couch potatoes.

To address this deficiency, philosophers have advocated principles of distributive justice allowing for inequalities created by individual choices. Once everyone has the same, just starting point, each can pursue her conception of the good life. Different pursuits typically generate different levels of individual wealth. Hence only certain types of inequalities should be eliminated, depending on the source of the welfare in question. As Thomas Nagel puts it, "The essence of this moral conception is equality of *treatment* rather than impartial concern for

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[52] *See supra* note __ and accompanying text.

[53] Such a principle of fairness, though, is one of distributive justice (strict equality of wealth) rather than corrective justice. *Cf.* Perry, *supra* note __, at 257 (emphasizing that "the harm-based understanding of corrective justice can only be regarded as conceptually independent of distributive justice if distributive justice is conceived dynamically rather than statically, i.e., if it is conceived in terms of abstract rather than simple patterning [like to each in equal shares]").

well-being. It applies to inequalities generated by the social system, rather than to inequalities in general."[54] To use Ronald Dworkin's terminology, allowing for inequalities based on choice means that a distributive principle should be "endowment-insensitive" and "ambition-sensitive."[55] One's position in life should reflect ambitions and choices rather than the arbitrary circumstances of endowment beyond one's control.

The source of one's wealth or welfare thus matters for many liberal egalitarian principles of distributive justice.[56] Such conceptions of equality translate into a distributive principle that ought to resonate with economists: "Treating people with equal concern requires that people pay for the costs of their own choices."[57]

Once the appropriate distribution of social wealth depends on the choices made by individuals, cost-minimizing tort rules no longer complement the appropriate rules of taxation and transfer. The inequalities generated by accidental harms are best addressed by tort rules based on individual rights and responsibility.

Consider the following distribution of wealth that is deemed to be fair because the inequalities stem from individual choices and not endowments.

Pre-Accident Distribution of Wealth

Brad	Others	Mark
$2 million	$1 million	$110,000

Suppose Mark accidentally injures Brad while driving, causing Brad $50,000 of damages. Without a tort system, the accident would result in the following distribution of wealth:

Actual Post-Accident Distribution of Wealth

Brad	Others	Mark
$1.95 million	$1 million	$110,000

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[54] THOMAS NAGEL, EQUALITY AND PARTIALITY 106 (1991). Nagel identifies five sources of inequality that can be morally distinguished: discrimination; class; talent; effort; and luck. *Id*. at 103.

[55] Ronald Dworkin, *What is Equality? Part 2: Equality of Resources*, 10 PHIL. & PUB. AFF. 283, 311 (1981).

[56] *See generally* KYMLICKA, *supra* note __, at 40-41, 73-77 (surveying different theories of distributive justice).

[57] KYMLICKA, *supra* note __, at 75.

The $50,000 reduction in Brad's wealth occurs only because he had the misfortune of being injured in the crash. But what if that injury is Mark's responsibility, because Mark infringed upon Brad's right? In that event, the principle of fairness would deem Mark to be the "owner" of the injury costs, making him responsible for the compensation of Brad's injuries.[58] This compensatory obligation is not retributive and can be satisfied by consensual arrangements like insurance contracts. Assuming Mark has no insurance, the compensatory obligation would require the following distribution of wealth:

Fair Post-Accident Distribution of Wealth

Brad	Others	Mark
$2 million	$1 million	$60,000

The movement from the actual post-accident distribution of wealth to the fair distribution requires a transfer of $50,000 from Mark to Brad. How would the tax system decide to make this transfer? That determination requires the same inquiry that could be made by the tort system. All that matters is the risky interaction between Brad and Mark; the wealth held by Others is irrelevant. Brad and Mark are the two parties to the tort suit. By applying the relevant principle of responsibility, the tort system would determine that Mark is liable to Brad, creating an obligation to compensate Brad for his $50,000 injury. *A fair tort rule defines the appropriate transfer rule*.

Consequently, it makes no sense to separate the tort inquiry from the appropriate transfer inquiry, the type of separation that otherwise occurs when cost-minimizing tort rules complement another distributive mechanism like the tax system. A legal regime that first determined tort liability on grounds of cost minimization would then have to make a separate, costly determination for transfer purposes. That transfer would then yield the same outcome that could have been attained more directly by the fair tort rule, the transfer of $50,000 from Mark to Brad. Nothing is gained by the separate tort inquiry on cost minimization, because the parties would ignore that rule and instead make their

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[58] *Cf.* Jules L. Coleman & Arthur Ripstein, *Mischief and Misfortune*, 41 MCGILL L. REV. 91 (1995)(arguing that the ownership of accident costs is a normative question). Although the example assumes an antecedently just distribution of wealth, that assumption is not critical. The initial distribution can be distributively unfair, requiring further distributions as a matter of distributive justice. Those distributions, however, are distinct from the $50,000 transfer between Mark and Brad required by corrective justice. On this view, corrective justice is "an independent moral principle [protecting the individual right to security] that operates within the context of distributive justice, but not as part of it." Perry, *supra* note __, at 247.

decisions on safety and the like by reference to the final transfer rule.[59] The unnecessary tort inquiry concerning cost minimization would be wasteful.

Total costs would be reduced if the tort system directly implemented the appropriate transfer rule between Brad and Mark by basing liability on the principle of corrective justice. Fair tort rules are thus the most cost-effective method of achieving the fair distribution of accident costs, so cost-minimizing tort rules cannot be justified as the appropriate complement to another distributive mechanism like the tax system.[60]

B. Cost Minimization as a Second-Best Rule of Fairness

The possibility remains that cost-minimizing tort rules can be justified on grounds of autonomy. Insofar as corrective-justice tort rules are overly vague, the indeterminacy threatens individual autonomy. As a matter of equality, the principle of corrective justice is concerned about the autonomy of both the right-holder and duty-holder. Overly vague tort rules threaten the autonomy of duty-holders by subjecting them to indeterminate liability, undermining their ability to pursue their conception of the good life. Insofar as cost-minimizing tort rules are more determinate and concrete, the resultant predictability may better satisfy the autonomy-based justification for corrective justice. In that case, cost-minimizing tort rules can be justified as a second-best rule of corrective justice.

The vagueness of corrective-justice tort rules has long been a complaint of lawyer economists, including those without normative commitments to wealth maximization or welfarism.[61] As Gary Schwartz observed a few years ago, "in

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[59] The problem can be modeled as an extensive game in which the first stage involves care decisions; the second stage involves the risky interaction; the third stage involves the cost-minimizing tort suit; and the final stage involves the tax transfers. The concept of subgame perfect Nash equilibrium requires a strategy that is Nash equilibrium for the entire game and for every subgame (played at each stage to the end). *See* ERIC RASMUSSEN, GAMES & INFORMATION: AN INTRODUCTION TO GAME THEORY 91 (3d ed. 2001). This concept of rationality therefore requires each agent to consider any move by reference to the final stage. The care decisions in stage one therefore are made by reference to the final stage involving the tax transfers. In effect, each player "sees through" the intermediate stage of the cost-minimizing tort suit and instead considers the problem in terms of the ultimate tax transfers.

[60] For more extensive argument of this point, see Mark Geistfeld, *Reconciling Cost-Benefit Analysis With the Principle that Safety Matters More Than Money*, 76 N.Y.U. L. REV. 114, 155-58 (2001)[hereinafter "Safety Principle"].

[61] *Cf.* Kornhauser, *Preference*, *supra* note __, at 305 n.3 (rejecting the Kaplow and Shavell claim regarding the appropriateness of resolving all legal question in terms of individual welfare preferences, but finding "broad agreement with their dissatisfaction with the imprecision and poor specification of these [fairness] claims").

any number of private encounters I've had with economically minded scholars, I have heard them dismiss corrective justice writings as out of date, empirically unverifiable, and inherently 'mush.'"[62] Schwartz concludes that economists are unable to appreciate the principle of corrective justice, but economists rightly worry about mushy rules for a reason that ought to be acceptable to the proponents of corrective justice. Vagueness and unpredictability can undermine autonomy.

According to some corrective-justice scholars, vagueness is inherent in the principle of corrective justice. As Jules Coleman explains:

> Corrective justice claims that when someone has wronged another to whom he owes a duty of care, he thereby incurs a duty of repair. This means that corrective justice is an account of the second-order duty of repair. *Someone* does not incur a second-order duty of repair unless he has failed to discharge some first-order duty. However, the relevant first-order duties are not themselves duties of corrective justice. Thus, while corrective justice presupposes some account of what the relevant first-order duties are, it does not pretend to provide an account of them.[63]

This conclusion stems from the few limits that corrective justice imposes on tort liability. The principle of corrective justice entails a normative relationship of equality between the plaintiff and defendant. The defendant's duty to repair the plaintiff's injury follows from the defendant's responsibility for the right infringement. The relevant notion of responsibility is not fully specified by the principle of corrective justice, which is why Coleman concludes that corrective justice "presupposes some account of the relevant first-order duties."

For this reason, Richard Posner has claimed that a first-order duty of cost minimization would satisfy the principle of corrective justice.[64] However, such a duty is a form of distributive justice (maximization of social wealth or welfare) and not one of corrective justice. The principle of corrective justice requires a

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[62] Schwartz, *supra* note 1, at 1808.
[63] COLEMAN, PRACTICE OF PRINCIPLE, *supra* note __, at 32.
[64] RICHARD A. POSNER, THE ECONOMICS OF JUSTICE 73-74 (1983)("The Aristotelian concept of corrective justice is consistent with, and indeed required by, the wealth-maximization approach…. It prescribes rectification for wrongful acts that cause injury … but it does not define what acts are wrongful…. So it is compatible with that concept to define an act of injustice as an act that reduces the wealth of society….").

duty-right nexus not grounded upon a principle of distributive justice.[65] This analytic requirement makes corrective-justice tort rules adequately determinate for purposes of specifying the first-order duty of care that must first be breached in order to create the second-order duty of repair, eliminating the potential problem of indeterminacy suggested by Coleman's account.[66]

1. The Analytic Content of Corrective-Justice Tort Rules

Corrective-justice tort rules give the security interest interpersonal priority over competing liberty interests in order to protect "our physical persons" from "a social distribution of any kind."[67] The interpersonal priority of the security interest accordingly derives from a principle of fairness distinct from a principle of distributive justice and its required social distributions. Prioritization of the security interest is thus a core feature of corrective-justice tort rules, distinguishing those rules from ones of distributive justice.

Priority of the security interest finds justification in the concern for autonomy. To protect the autonomy of right-holders consistently with the requirement of equality, corrective-justice tort rules must also respect the autonomy of duty-holders. Hence the principle of corrective justice ordinarily requires a duty defined in terms of voluntarily acts creating foreseeable risks of harm to the right-holder, requirements grounded in the need to adequately respect the autonomy of duty-holders.[68]

The logic of corrective justice thus requires an interpersonal priority of the security interest within a duty limited by feasance and foreseeability. As I've argued elsewhere, these requirements yield a well-structured tort inquiry that adequately describes the important substantive doctrines of tort law, including the

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[65] Corrective justice, in other words, is not a part of distributive justice, even though it necessarily operates within a scheme of distributive justice. *See supra* note __ [prior subsection].

[66] The following analysis thus supports Coleman's conclusion that "there must … be certain paradigm cases of the relevant first-order duties if we are to be able to understand their enforcement by tort law as a matter of corrective justice." COLEMAN, PRACTICE OF PRINCIPLE, *supra* note __, at 34.

[67] Perry, *supra* note __, at 239.

[68] *See, e.g.,* OLIVER WENDELL HOLMES, THE COMMON LAW 95 (1881) ("The requirement of an act is the requirement that the defendant should have made a choice. But the only possible purpose of introducing this moral element is to make the power of avoiding the evil complained of a condition of liability. There is no such power where the evil cannot be foreseen."); Liam Murphy, *Beneficence, Law, and Liberty: The Case of Required Rescue*, 89 GEO. L.J. 605, 662-63 (2001) (concluding that the compensatory obligations associated with a duty of rescue would unreasonably burden the liberty interests of duty-holders).

important limitations of liability.[69] The question now is whether that inquiry is unacceptably vague compared to cost-minimizing tort rules.

2. Comparing the Cost-Minimizing and Fairness Inquiries

In determining the appropriate tort rules for nonconsensual risks, the principle of corrective justice minimally requires a positive act creating a foreseeable risk of harm to another. Assuming these conditions are satisfied, must any nonconsensual risk be permitted? Clearly not. The principle of corrective justice depends on the relevant conception of equality, so it necessarily bars risky interactions in which one party fails to treat the other with equal respect. An example presumably includes the sadist who forcibly harms others without their consent. Prohibition of certain activities need not violate the principle of equality, even though such prohibition negates or ignores certain liberty interests of the duty-holder.

This aspect of the tort inquiry accordingly asks whether the liberty interest in question deserves to be recognized or protected by tort law. The tort system already evaluates liberty interests objectively in terms of "the value which the law attaches to the conduct" rather than the actor's subjective valuation of the interest.[70] Does the objective valuation of interests makes fair tort rules more vague than cost-minimizing rules?

Ideally, cost-minimizing tort rules would rely upon subjective rather than objective valuations. In the driver-pedestrian setting, the pedestrian determines the cost of facing the risk, and the cost of risk avoidance depends on the driver's individual traits. Each cost will vary for different pedestrians and drivers. The individual or subjective valuations of cost, however, require interpersonal comparisons of utility. These measurements are hard to observe and verify, so economists have long eschewed this type of analysis.[71] And even if subjective valuations were feasible, the subjective valuation of interests would be more expensive to administer than objective valuations. All things considered, the cost of subjective valuations is likely to outweigh its benefits, so the conventional

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[69] Mark Geistfeld, *Negligence, Compensation, and the Coherence of Tort Law*, 91 GEO. L.J. 585 (2003) [hereinafter "Compensation"].

[70] RESTATEMENT (SECOND) OF TORTS § 283 cmt. e.

[71] The seminal work is LIONEL ROBBINS, AN ESSAY ON THE NATURE AND SIGNIFICANCE OF ECONOMIC SCIENCE (2d ed. 1935).

economic analysis of tort law accepts the objective valuation of interests for purposes of cost minimization.[72]

The objective valuation of interests therefore does not distinguish fair tort rules from efficient tort rules. The type of objective valuation, though, differs for each form of justification. Fair tort rules objectively value interests by reference to the relevant principle of equality; cost-minimizing tort rules objectively value interests in the statistically appropriate manner.

Objective valuation with statistics might seem to be more determinate than valuation by reference to the principle of equality, particularly as the requirements of equality are highly contested.[73] In this regard, though, the fairness inquiry derives adequate guidance from the criminal law. Criminal conduct does not involve the type of liberty interest that has been or should be protected by tort law.[74] Noncriminal behavior is normatively acceptable as long as such behavior is conducted in a reasonable manner. The issue of determinacy, in other words, involves the standard of care rather than the objective valuation of interests.

The standard of care specifies the first-order duties or behavioral requirements of tort law by mediating or balancing the individual interests implicated in the risky interaction. Fair tort rules mediate these conflicting interpersonal interests by giving the security interest priority over the liberty interest. The present issue is whether that priority yields an adequately determinate standard of care. And relatedly, what does the priority of interests imply for the choice between negligence and strict liability? Without an adequate resolution of these questions, fair tort rules would be too vague for juridical purposes, particularly when compared to the well-specified tort rules of cost minimization.

These important doctrinal questions faced by a fair tort regime can be answered with economic analysis. For normatively acceptable risky activities, the issue of fairness reduces to consideration of how the tort rule affects the welfare

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[72] LANDES & POSNER, supra note __, at 121-31; STEVEN SHAVELL, THE ECONOMIC ANALYSIS OF ACCIDENT LAW 76 (1987).

[73] *See generally* KYMLICKA, *supra* note __ (explaining how different conceptions of equality underlie different theories of justice).

[74] Originally, tort damages were awarded as an incident of criminal prosecution, and the linkage of criminal and tort liability meant that the early common-law courts "approach[ed] the field of tort through the field of crime." FREDRICK POLLACK & FREDERICK MAITLAND, II THE HISTORY OF ENGLISH LAW 530 (Cambridge Univ. Press, 2d ed. 1968) (1898). Tort actions continued to be quasi-criminal until the late seventeenth century. PROSSER AND KEETON ON TORTS, *supra* note __, at 8.

levels of the two parties. The activity of driving, for example, should be permitted, so the fairness inquiry must determine how safely one should drive and what obligations should arise in the event of injury. At this point in the inquiry, the best protection of the pedestrian's autonomy must reside in protecting her welfare. That is the only remaining factor for protecting or recognizing the pedestrian's individual right to security. The way in which tort rules affect individual welfare, in turn, poses a question answerable by economic analysis.

The importance of welfare considerations for a fair tort system follows from the nonideal or second-best nature of tort rights and obligations. The first-best or ideal instantiation of the individual right to security involves consensual risks, as consent protects and promotes the autonomy of the right-holder—the animating ideal of the individual right to security protected by the principle of corrective justice. Hence nonconsensual risks are not ideal, but are inevitable in a world of transaction costs. Under nonideal conditions, the tort system must devise second-best liability rules for protecting the individual right to security.[75] For normatively acceptable activities like driving, the second-best protection of the individual right to security involves adequate protection of the right-holder's welfare.

Once the duties of corrective justice are conceptualized in nonideal or second-best terms, many problems with the corrective-justice account of tort law can be addressed.[76] One such problem involves the relevance of welfare considerations, an issue of obvious importance that has been largely neglected by corrective-justice scholars. The importance of welfare is revealed by second-best analysis in a manner consistent with the few observations on welfare that have been made by corrective-justice theorists.

According to corrective-justice scholars, "[w]elfare serves only the secondary function of concretizing rights and making them quantifiable in

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[75] *Cf.* RONALD DWORKIN, A MATTER OF PRINCIPLE 72-103 (1985) (distinguishing a primary substantive right held by individuals from its nonideal implementation via a secondary right that individuals hold to enforce their primary right).

[76] Corrective justice theorists have focused on the duty of repair, making the theory vulnerable to the claim that corrective justice is essentially a remedial theory of tort law that is unable to account adequately for the primary duties of care and the varied tort practices that are not fully remedial or otherwise addressed to non-remedial concerns, as with injunctions or punitive damages. *See* Hanoch Sheinman, *Tort Law and Corrective Justice*, 22 LAW AND PHIL. 21 (2003); Benjamin C. Zipursky, *Civil Recourse, Not Corrective Justice*, 91 GEO. L.J. 695 (2003). As the ensuing discussion shows, a second-best account of tort duties explains how the principle of corrective justice can be translated into well-specified duties of care and damages remedies that are not fully compensatory.

particular cases. The reason that rights matter for tort law lies elsewhere."[77] Hence tort offences "are not just diminutions in value or welfare; they are diminutions without consent or approval."[78] The absence of consent or approval implies that tort rules governing nonconsensual risks are a second-best solution to protection of the right. Consent or approval is not ordinarily feasible, so at best the tort rule can evaluate the normative desirability of the risky activity as a partial substitute for consent (the objective valuation of interests), and then specify the standard of care to protect the welfare of the right-holder, the only remaining substitute for consent.

The fairness inquiry therefore ultimately requires a consideration of welfare levels, at which point it can be informed by economic analysis. The economic analysis is not one of cost minimization. Rather, the analysis strives to identify liability rules that would adequately satisfy the requirement of equality with respect to welfare. The objective is to determine liability rules that would adequately maintain the welfare levels of right-holders without overly burdening the welfare or liberty interests of duty-holders.

3. Is Distributive Economic Analysis More Vague Than Cost Minimization?

To compare the two forms of economic analysis, it first is necessary to define more precisely the distributive inquiry. Distributive economic analysis models the fairness problem as a transaction between the two parties to the risky interaction.[79] The priority of security over liberty determines the seller and buyer. The seller is the right-holder or potential victim—someone like a pedestrian facing a threat to her physical security. The buyer is the duty-holder or potential injurer—someone like a driver whose exercise of liberty threatens the other's security interest. To assume the risk, the right-holder as seller would receive compensation from the duty-holder as buyer of the right. The compensation ensures that the welfare level of the right-holder would not be reduced by the risky interaction. The exchange also would not reduce the welfare level of the duty-holder, who always has the choice to forego the risky activity and avoid the associated tort obligations.

The hypothetical transaction thus identifies the welfare concerns of relevance to the principle of fairness. To protect fully the welfare of right-holders

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[77] Weinrib, *Consensus*, *supra* note __, at 14.
[78] Jules L. Coleman, *Adding Institutional Insult to Personal Injury*, 8 YALE J. REG. 223, 230 (1991).
[79] For more detailed specification, see Geistfeld, *Safety Principle*, *supra* note __; Geistfeld, *Compensation*, *supra* note __.

(pedestrians), tort rules must try to equalize the individual's welfare levels across the risky and nonrisky states of the world (the outcome occurring in the transaction between the pedestrian and driver). This welfare ideal is embodied in the principle that tort damages are supposed to make the victim "whole" by restoring her welfare to the level in the pre-accident state of the world.[80]

The ideal welfare outcome, however, is not ordinarily attainable. Tort law protects individuals against "physical harm," which includes "physical illness, disease, and death."[81] Nevertheless, a defendant does not pay damages compensation for a decedent's loss of life's pleasures.[82] Such an injury is comprehensible only from the perspective of the living.[83] The tort obligation is owed to a deceased accident victim, and tort damages cannot compensate a dead person for the lost pleasures of living. Fatal accidents starkly illustrate the limited compensatory capabilities of a damages remedy, but the problem is more general. Tort damages do not realistically "make whole" the serious physical disabilities of accident victims.

In light of the limitations of the damages remedy, a fair tort system faces a difficult problem. How can tort law protect the individual right to security with respect to premature death and serious bodily injury, particularly when that right is "concretized" in terms of welfare?

The answer requires further recognition that tort rules are a second-best solution to the problem of protecting the individual right to security. Ideally, the duty-holder (driver) would fully compensate the right-holder (pedestrian) in exchange for her agreement to assume the risk. In the ideal exchange, the duty-holder compensates the right-holder for the prospect of premature death. Under nonideal conditions, not all risks are consensual. Drivers and pedestrians cannot contract over risk. To regulate nonconsensual risks, tort law must rely on the second-best solutions of precautionary obligations and damages obligations. The defendant does not incur a damages obligation to the victim of a fatal accident. This shortfall in the compensatory obligations of the duty-holder can be eliminated by increasing her precautionary obligations. The increased safety reduces risk and thus increases the welfare of the potential victim to an amount that more closely approximates her welfare level under ideal conditions.

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[80] RESTATEMENT (SECOND) OF TORTS § 901 cmt. a.
[81] Restatement (Third) of Torts: Liability for Physical Harm (Basic Principles) § 4 (Tentative Draft No. 1, 2001).
[82] *See* Andrew J. McClurg, *It's a Wonderful Life: The Case for Hedonic Damages in Wrongful Death Cases*, 66 NOTRE DAME L. REV. 57, 62-67 (1990).
[83] *See* THOMAS NAGEL, MORTAL QUESTIONS 1-10 (1979).

To illustrate, suppose an automobile accident will always kill the pedestrian. Suppose further that the amount of care exercised by the driver is continuous in the probability of accident, so that incrementally greater care incrementally reduces the probability of the fatal accident. Let *B* denote the total cost or burden of care incurred by the driver. For any given probability of suffering the fatal injury, the cost of the risk is determined by the pedestrian's willingness to accept money in exchange for facing the risk. This amount makes the pedestrian indifferent between (1) the state of the world in which the pedestrian does not face the risk and consequently receives no money, and (2) the state of the world in which the pedestrian faces the risk and receives payment for doing so. That payment, which is defined as the willingness-to-accept or WTA risk measure, is the monetary benefit that exactly offsets the cost of the risk for the pedestrian. The WTA measure thus defines the cost of the risk for the pedestrian in terms of the minimum monetary benefit the pedestrian must receive to assume the risk.

In the ideal, consensual exchange between the two parties, the driver as duty-holder must compensate the pedestrian as right-holder for any risks faced by the pedestrian. The appropriate compensation is determined by the WTA measure, which in turn depends on the probability of injury. The pedestrian would not accept any money to face the certainty of a fatal accident (the WTA measure equals infinity), although she would accept some finite payment to face lower level risks.[84] The driver therefore can reduce the total WTA payment by reducing the risk. The driver's total cost—the cost of precaution and the WTA payment—is minimized if the driver agrees to take precautions costing less than the associated reduction in the WTA measure. This amount of precaution *B** minimizes accident costs and is allocatively efficient. At the efficient level of care, the pedestrian still faces a positive probability of being killed in an accident and requires compensation WTA* in exchange for facing that risk. In the ideal exchange, then, the driver incurs safety precautions costing *B** and pays WTA* as compensation to the pedestrian for agreeing to face the residual risk.

Under nonideal conditions, the parties do not transact and the pedestrian does not receive the WTA payment from the driver. An accident would kill the pedestrian, eliminating the possibility that she could receive those proceeds as a damages remedy. As a second-best solution to this distributive problem, the standard of care can be formulated so that the driver makes the WTA payment in the form of safety precautions.

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[84] For more formal specification, see Geistfeld, *Safety Principle*, *supra* note __, at 188-89.

A negligence standard requiring the driver to take precautions costing ($B^* + WTA^*$) imposes the same total burden on the driver as the ideal, compensatory exchange. As compared to the cost-benefit standard of care, the more exacting liability standard reduces risk.[85] The risk reduction directly protects the security

[85] Contrary to a common understanding of the issue, a negligence standard can reduce risk below the cost-benefit amount. According to that understanding, a negligence rule requiring more than the cost-benefit amount of care is no different than strict liability. Under strict liability, potential injurers like drivers choose the cost-benefit amount of care, as care beyond that point will cost more than the expected reduction in liability costs. By this same reasoning, if the negligence standard requires more than the cost-benefit amount of care, potential injurers will choose to be negligent, as the expected liability costs are less than the cost of the required care in excess of the cost-benefit amount. Potential injurers therefore treat such a negligence standard no differently than a rule of strict liability. Despite this logic, negligence liability is not equivalent to strict liability. A negligence standard requiring more than the cost-benefit amount of care can reduce risk below the cost-benefit amount that would obtain under strict liability.

Most obviously, a negligence standard can be equivalent to strict liability only if potential injurers make decisions entirely with a cost-benefit calculus, only following the law when it is in their self-interest to do so. Insofar as potential injurers care about following the law, they will adhere to a more exacting negligence standard, even if in some cases it would be cheaper for them to forego a required precaution and risk liability.

Even if potential injurers are self-interested and make safety decisions entirely on a cost-benefit calculus, they will adopt cost-benefit precautions and choose to be negligent only if their liability is limited to those injuries caused by the unreasonable risk as opposed to the total risk created by the conduct in question. *See* ROBERT COOTER & THOMAS ULEN, LAW AND ECONOMICS 270-75 (2d ed. 1997); Marcel Kahan, *Causation and Incentives to Take Care Under the Negligence Rule*, 18 J. LEGAL STUD. 427 (1989). However, courts confronting evidentiary problems are unlikely to limit liability to the unreasonable risks, which is likely to be a general phenomenon. *See* Stephen Marks, *Discontinuities, Causation, and Grady's Uncertainty Theorem*, 23 J. LEGAL STUD. 287 (1994); *see also* DAN B. DOBBS, THE LAW OF TORTS § 173, at pp. 420-21 (2000) (stating that courts are "avowedly liberal" with causation issues "if the defendant's conduct is deemed to be negligent for the very reason that it creates a core risk of the kind of harm suffered by the plaintiff"); Zuchowicz v. United States, 140 F.3d 381, 390 (2d Cir. 1998) (holding that causation can be established if "(a) a negligent act was deemed wrongful *because* that act increased the chances that a particular type of accident would occur, and (b) a mishap of that very sort did happen") (Calabresi, J.). Once a defendant is liable for all injuries caused by its conduct rather than merely those injuries caused by its *negligent* conduct, it has sufficient incentive to avoid liability altogether by adhering to the standard of care in excess of the cost-benefit amount. *See* COOTER & ULEN, *supra.*

Finally, damages importantly differentiate negligence liability from strict liability. For otherwise identical cases, jurors are more likely to award higher damages for negligence liability than strict liability, creating another deterrence advantage for negligence liability. *See* Richard L. Cupp & Danielle Polage, *The Rhetoric of Strict Products Liability versus Negligence: An Empirical Analysis*, 77 N.Y.U. L. REV. 874, 936-37 (2002) (summarizing empirical study finding higher pain-and-suffering awards when jury instructions are framed in terms of negligence rather than strict liability). And for negligence cases in which the defendant consciously chooses to violate the standard of reasonable care, punitive damages are available. *See*, *e.g.*, DOBBS, supra, §

interest and increases the welfare of the pedestrian by making it less likely that she will be killed. This negligence standard more closely approximates the distribution of welfare that would obtain under ideal conditions of consensual risks, making it more fair than the cost-minimizing standard.

Nevertheless, an interpretive problem remains. The negligence standard ordinarily is defined in very general terms.[86] If the fair tort rule can be defined with analytic precision, why define the standard of care in general terms? It may seem that the vagueness is attributable to some unacceptable indeterminacy in the principle of fairness. An alternative explanation can be derived by distributive economic analysis, which shows how a very general negligence standard responds to the normative problem posed by nonconsensual risks threatening serious bodily injury and death.

Although the negligence standard can be precisely defined to ensure that duty-holders incur the same total burdens they would otherwise incur in a perfectly compensatory regime, that standard does not fully protect the welfare of right-holders. The more exacting standard of care required by a fair negligence rule still means that the pedestrian faces some chance of being killed in a car crash. Due to this prospect, nonconsensual fatal risks make pedestrians and other right-holders worse off than they would be in a world without the risk. The tort solution, after all, is second best, unlike the first-best solution in which the risky interaction is consensually regulated to protect perfectly the welfare of the right-holder while also letting the duty-holder engage in the risky activity.

The amount of undercompensation depends on the amount of nonconsensual risk permitted by the tort system. How much undercompensation is fair—that is, how much nonconsensual risk should be permitted by the negligence standard—therefore is a distributive problem between right-holders and duty-holders. Understood in that light, it becomes apparent why the tort system defines the negligence standard in general terms and lets the jury determine its content on a case-by-case basis, even when the facts are not in

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381, p. 1065 ("A deliberate policy of corporate misconduct may suffice" for punitive damages). The threat of punitive damages, in turn, can give potential injurers the incentive to adhere to a negligence standard requiring care in excess of the cost-benefit amount. *Id*. at 1063 ("Courts usually emphasize that punitive damages are awarded to punish or deter …. The idea of deterrence … is that a sufficient sum should be extracted from the defendant to make repetition of the misconduct unlikely.").

[86] Most commonly, jury instructions first define negligence as the failure to exercise ordinary care, and then define ordinary care in terms of the conduct of the reasonably careful or reasonably prudent person. *See* Patrick J. Kelley & Laurel A. Wendt, *What Judges Tell Juries about Negligence: A Review of Pattern Jury Instructions*, 77 CHI.-KENT L. REV. 587, 622 (2002).

dispute.[87] A generalized negligence standard gives juries latitude to resolve a distributive problem that has no obviously correct answer even when the facts are not in dispute, and there are good reasons for concluding that jurors are likely to base their decision on community norms and the other factors most relevant to the distributive problem.[88]

In addition to specifying the standard of care, a rights-based principle of fairness can also determine the duty limitations of negligence liability. Duty is limited by the requirements of feasance and foreseeability, two limits imposed by the principle of corrective justice.[89] The remaining limits follow from the priority of the security interest over other types of conflicting interpersonal interests.

Imposing liability on a negligent defendant for all foreseeable harms would predictably bankrupt defendants in most cases, leaving the defendant unable to fully compensate the physically injured victims. To help ensure that physical injuries are adequately compensated, tort law relies on a categorical rule that limits the duty of negligent defendants to exclude stand-alone emotional harms and economic losses, subject to a few exceptions involving a small number of claimants.[90] The various rules limiting duty can thus be justified as a means of adequately protecting the welfare of physically injured accident victims, protection justified by the priority of the security interest.[91]

As this discussion suggests, the welfare analysis of tort rules is no more vague than the analysis seeking to minimize costs.[92] The reason is straightforward. In the circumstances under consideration, the adequate protection of welfare is the method by which tort law recognizes or protects the

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[87] Even if no fact is in doubt, the jury decides on the reasonableness of the defendant's conduct. Mark P. Gergen, *The Jury's Role in Deciding Normative Issues in the American Common Law*, 68 FORDHAM L. REV. 407, 432 n.121 (1999).

[88] *See* Geistfeld, *Safety Principle*, *supra* note __, at 166-68 (identifying factors relevant to distributive problem and arguing, with support from empirical studies, that jurors are likely to apply the reasonable-person negligence standard in the distributively appropriate manner); Steven P. Hetcher, *The Jury's Out: Social Norms' Misunderstood Role in Negligence Law*, 91 GEO. L. J. 633 (2003) (arguing that community norms are largely relied upon by jurors in applying the reasonable-person negligence standard).

[89] *E.g.*, RESTATEMENT (SECOND) OF TORTS § 314 (1965) (no duty for mere failure to act); § 289 cmt. b (relevant act must "involve a risk which the actor realizes or should realize").

[90] *See* DAN B. DOBBS, THE LAW OF TORTS § 308 (2000) (describing duty limitations for emotional harms); § 452 (describing duty limitations for economic loss).

[91] *See generally* Mark Geistfeld, *The Analytics of Duty: Medical Monitoring and Related Forms of Economic Loss*, 88 VA. L. REV. 1921 (2002) (showing how duty limitations based on the type of harm are best understood in terms of the priority of the security interest over other interests).

[92] For discussion of the choice between negligence and strict liability, see Part V.A.

individual right to security. This associated analysis accordingly emphasizes the role of compensation in tort law as per the corrective-justice emphasis on the duty of repair. Compensation ordinarily is not relevant for the minimization of costs, but that analysis contemplates a compensatory exchange between buyers (the duty-holder) and sellers (the right-holder) without actually requiring it.[93] Consideration of compensatory concerns therefore does not make the fairness inquiry less determinate than the cost-minimizing tort inquiry.

Indeed, the fairness inquiry requires less information than one seeking to minimize the social costs of accidents. The onerous informational requirements for minimizing accident costs make it impossible for the tort system to derive allocatively efficient rules.[94] A global cost-benefit inquiry is more demanding than an inquiry seeking to ascertain the fair distribution of welfare by reference to the hypothetical transaction between the two parties in a risky interaction.

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Fair tort rules must consider nonideal conditions and second-best solutions. Those solutions, however, do not require wholesale resort to cost-minimizing tort rules. Any concerns about implementation do not justify the rejection of fair tort rules in favor of cost-minimizing tort rules.

IV. Economic Analysis and Utilitarian Forms of Justice

One justification for a cost-minimizing tort system remains. Such a system is sanctioned by "welfarism" or utilitarian forms of justice that do not distinguish between liberty and security interests, thus denying the priority of the security interest as a matter of individual right.[95] A cost-minimizing tort system stands or falls with utilitarian forms of justice and the denial of individual rights. Must the economic analysis of tort law do the same?

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[93] In the driver-pedestrian exchange, the cost of the risk is determined by the amount of money the pedestrian would be willing to accept in exchange for facing the risk (the WTA measure). The WTA measure necessarily contemplates an exchange in which the potential victim receives compensation for the risk exposure. Without any such exchange, the WTA measure collapses into the risk measure based on the potential victim's willingness-to-pay to eliminate the risk. Geistfeld, *Safety* Principle, *supra* note __, at 189. Risks that are appropriately measured in terms of the WTA measure accordingly involve a transactional analysis that contemplate the type of exchange required as a matter of fairness.

[94] Gillian Hadfield, *Bias in the Evolution of Legal Rules*, 80 GEO. L.J. 583 (1992).

[95] *See supra* notes __ and accompanying text (describing welfarism). [Part I]

Guidance on this question can be derived from the history of welfare economics. Like the situation now faced by the conventional economic analysis of tort law, welfare economics once was tied to utilitarianism. Welfare economics no longer relies on utilitarian forms of justification for reasons that ought to be persuasive to the economic analysts of tort law.

Traditional welfare economics of the late nineteenth and early twentieth centuries compared alternative situations by relying on the assumption that individual utilities can be measured (cardinal utility) and then compared across individuals. This decision rule selects utility-maximizing outcomes, making its normative justification dependant on utilitarianism.[96]

The need to make interpersonal utility comparisons troubled welfare economists. In the late 1930s, prominent economists rejected the utilitarian decision rule in favor of the new welfare economics, which posits that interpersonal utility comparisons are impossible or otherwise outside the scope of economic analysis. The new welfare economics compares alternative economic situations by relying on the Pareto principle.

The new welfare economics recognizes that few policies satisfy the Pareto principle, so it relies on potential Pareto improvements to compare alternative economic situations. This decision rule, widely known as the compensation or Kaldor-Hicks criterion, deems one state of the world to be better than another if those who would gain from the change could compensate the losers for their losses and still be no worse off than in the original state. The compensation criterion selects policies with benefits (the gains of the winners) in excess of costs (the losses of the losers) and forms the basis of cost-benefit analysis.

Any normative justification for cost-benefit analysis based exclusively on hypothetical compensation is troubling.[97] Consequently, economists maintain that welfare economics can defensibly ignore distributive questions only if the government can redistribute income via costless or lump-sum transfers between households.[98] A lump-sum transfer does not involve administrative or other costs and does not affect the behavior of anyone who pays or receives benefits. By

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[96] Amartya Sen, *The Possibility of Social Choice*, 89 AM. ECON. REV. 349, 351-52 (1999) (tracing origins of traditional welfare economics to influence of utilitarianism of Jeremy Bentham). The ensuing discussion of the new welfare economics draws on this source and on E.J. MISHAN, COST-BENEFIT ANALYSIS 301-14 (3d ed. 1982).

[97] I.M.D. Little, A CRITIQUE OF WELFARE ECONOMICS (2d ed. 1957).

[98] RICHARD W. TRESCH, PUBLIC FINANCE: A NORMATIVE THEORY 39 (1981); HAL R. VARIAN, MICROECONOMIC ANALYSIS 405 (3d ed. 1992).

relying on such transfers, the government can convert hypothetical compensation into real compensation, turning the potential Pareto improvement identified by cost-benefit analysis into an actual Pareto improvement. No one loses under a cost-benefit rule, and some people gain. Everyone presumably would consent to the rule, thereby satisfying the Pareto principle and giving welfare economics a broader normative appeal than the "old" welfare economics with its exclusive reliance on utilitarian forms of justification.

The new welfare economics thus relies on the same set of methodological commitments as the conventional economic analysis of tort law. Each relies upon the Pareto principle as the justification for cost-benefit analysis. Each separates questions of allocative efficiency from distributional issues by assuming that the income transfers necessary for satisfying the Pareto principle can be handled by the tax system.[99] Allocatively efficient outcomes can be turned into fair outcomes, eliminating any conflict between the requirements of efficiency and fairness.

By relying on the methodological commitments of the new welfare economics, the conventional economic analysis of law has not kept up with advances in welfare economics. Today welfare economists no longer assume that questions of distribution can be separated from those of allocative efficiency.

The "new" new welfare economics recognizes that the government often does not have the information required to make lump-sum tax redistributions: "It is this limitation on the information of the government which results in taxation being distortionary, and which gives rise to the trade-off between equity and efficiency."[100]

For example, suppose that principles of distributive justice require a redistribution from more able to less able individuals. To effectuate such transfers, the government must determine whether someone is of high or low ability. The government cannot rely on self-reporting, because anyone who says she is of high ability would be submitting voluntarily to a higher level of taxation used exclusively for the benefit of someone else. Everyone has an incentive to identify herself as being of low ability, so the government cannot observe

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[99] The Kaplow and Shavell proof assumes that transaction costs do not render infeasible any transfer required to satisfy the Pareto principle. *See supra* note __ and accompanying text. [Part II].

[100] Joseph E. Stiglitz, *Pareto Efficient and Optimal Taxation and the New New Welfare Economics*, in 2 HANDBOOK OF PUBLIC ECONOMICS 991, 992 (Alan J. Auerbach & Martin Feldstein eds., 1987).

costlessly whether someone is of high or low ability. To address this problem, the government must base the tax structure on observable characteristics having some relationship to individual ability. Typically the government relies on income measures as such a proxy. These measures are imperfect, as higher incomes can be associated with higher levels of ability, effort, or greater luck. Moreover, taxation based on income influences individual incentives to earn income. Efforts to distribute income from an allocatively efficient outcome are likely to distort individual behavior, yielding allocatively inefficient outcomes. Hence the tradeoff between equity and allocative efficiency.

Due to the linkage between issues of efficiency and fairness, welfare economists no longer evaluate transfer mechanisms, such as income taxes, solely in terms of allocative efficiency. According to the current welfare criterion, any given transfer is economically optimal if it is the least costly method of satisfying a given distributional need.[101] This criterion minimizes the loss of allocative efficiency for any given distributive requirement, which is why it is called, somewhat misleadingly, the efficiency-equity tradeoff.[102] Welfare economics accordingly treats fairness concerns as a constraint on the pursuit of efficiency.

This advance in welfare economics has left behind the conventional economic analysis of tort law. The economic analysts of tort law conventionally assume that the government has the necessary information for using the tax system to redress fully any distributive inequity. In the example previously discussed, a perfectly informed government could effectuate the transfer between Mark and Brad by assessing a tax levy on Mark for $50,000 and giving a tax subsidy to Brad for the same amount. Such a government could then use the tort system to minimize accident costs, thereby simultaneously satisfying the requirements of fairness and efficiency. The conventional economic analysis of tort law therefore ignores distributive questions by assuming that the government has the requisite information for making any desired distributive transfers, an informational assumption no longer made by welfare economists.

By adopting the informational assumption currently made by welfare economists, the economic analysis of tort law fundamentally changes. A

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[101] TRESCH, *supra* note __, at 13-14.

[102] The term is misleading because it assumes that equitable advances necessarily come at the expense of efficiency. The general problem that makes lump-sum transfers impossible also may make it impossible to achieve allocatively efficient outcomes, creating the possibility that regulations can yield outcomes that are more efficient and equitable than unregulated outcomes. Louis Putterman, John E. Roemer & Joaquim Silvestre, *Does Egalitarianism Have a Future*?, 36 J. ECON. LITERATURE 861, 862-65 (1998).

government with limited information would not minimize costs by using the tax system to effectuate the transfer between Mark and Brad. Instead, such a government would collect the necessary information in the tort suit and then effectuate the appropriate transfer with the liability rule. The resultant tort rule is no longer cost-minimizing, so the transfer leads to a loss of allocative efficiency. But the tort rule minimizes the cost of attaining the appropriate distributive outcome between Mark and Brad, thereby satisfying the efficiency-equity tradeoff.

The problem of limited information thus profoundly affects the economic analysis of tort law. A government with limited information cannot rely on tax transfers to convert allocatively efficient outcomes into Pareto efficient outcomes. Cost-minimizing tort rules no longer find justification in the Pareto principle, so economic analysis must seek guidance from some other norm or principle of fairness. The specification of that norm falls outside the realm of economic analysis, which is why the "new" new welfare economics treats fairness as a constraint on the pursuit of allocative efficiency. The economic analysis of tort law should do the same.

V. The Importance of Distributive Economic Analysis

Like the current practice of welfare economics, the economic analysis of tort law need not be tied to utilitarianism. As the prior discussion has shown, a nonutilitarian principle of fairness can determine the conditions under which the individual right to security is appropriately protected in welfare terms. So constrained, economic analysis can then determine how different liability rules affect individual behavior and the distribution of welfare. In this manner, distributive economic analysis complements corrective-justice tort rules.

The importance of distributive economic analysis for a fair theory of tort law can be further illustrated by the ways in which the economic analysis helps to eliminate vagueness and inconsistencies in the normative conceptualization of reciprocity and nonmonetary damages.

A. *Reciprocity*

Reciprocity involves risky interactions in which each party threatens physical injury to the other. Two drivers, for example, each impose a risk of physical injury on the other, and each face the risk of being physically injured. In the extreme case of perfect reciprocity, the interacting individuals are identical in all relevant respects, including the degree of risk that each imposes on the other,

the severity of injury threatened by the risk, and the liberty interests advanced by the risky behavior.

In a highly influential account of reciprocity, George Fletcher argued that reciprocal risks should be governed by negligence, because "a rule of strict liability does no more than substitute one form of risk for another—the risk of liability for the risk of personal loss"[103] Nonreciprocal risks, by contrast, involve an inequality between the two parties and are appropriately governed by strict liability. Other fairness theorists agree that the reciprocity of risk determines the choice between negligence and strict liability.[104]

So described, the reciprocity rationale for negligence liability is incomplete. The rationale assumes that strict liability would inappropriately substitute one form of reciprocal risk for another, whereas one instead could assume that negligence liability would inappropriately substitute one form of reciprocal risk for another. Negligence liability, more precisely, could involve substituting the reciprocal risk of personal loss for the reciprocal risk of liability that otherwise would obtain under strict liability. Why is this substitution any more or less appropriate than the substitution that would be effected by strict liability? The question must be answered by reference to the appropriate background rule, but reciprocity does not justify negligence or strict liability.[105] Instead, reciprocity arguments assume that either negligence or strict liability is the appropriate background rule. What, then, is the significance of reciprocity for purposes of choosing between negligence and strict liability?

The normative appeal of reciprocity lies in its evident connection with equality—the two parties are equal in all relevant respects. The strict equality that obtains between perfectly reciprocal parties implies a strict equality of the relevant welfare levels. Assuming that protection of the associated individual rights appropriately reduces to a consideration of welfare—an assumption that seems to be particularly appropriate in contexts of strict equality between the parties—then economic analysis can provide guidance on the liability rule.

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[103] George P. Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537, 547 (1972).
[104] Gregory C. Keating, *A Social Contract Conception of the Tort Law of Accidents* in PHILOSOPHY AND THE LAW OF TORTS, *supra* note __, at 22, 30-42; Stephen R. Perry, *Responsibility for Outcomes, Risk, and the Law of Torts* in PHILOSOPHY AND THE LAW OF TORTS, *supra* note __, at 72, 111-115
[105] JULES L. COLEMAN, RISKS AND WRONGS 266-69 (1992); RICHARD A. EPSTEIN, CASES AND MATERIALS ON TORTS 152 (Aspen Law & Bus. Ed., 7th ed. 2000) (arguing that "the norm of reciprocity is consistent with either general system, whether negligence or strict liability").

In the case of a perfectly reciprocal risky interaction, whatever safety precautions are required of one individual will be required of the other. Whatever safety benefits accrue to one person will accrue to the other. Because the costs and benefits of tort liability inure equally to both individuals, the two can be conceptualized as one entity. Just as an individual maximizes her welfare by minimizing costs, the welfare of each perfectly reciprocal party is maximized by the cost-minimizing tort rule.[106] Negligence is less costly than strict liability, all else being equal, due to the higher cost of tort compensation as compared to other insurance mechanisms.[107] Negligence liability for reciprocal risks accordingly provides the best protection for the welfare levels of the right-holders, thereby adequately protecting the individual right to security.

Nonreciprocal risks have different distributive properties. For such risks, if negligence and strict liability would each attain identical risk levels, then the guarantee of injury compensation gives strict liability a decisive advantage in protecting the welfare of right-holders. This reasoning explains why the rule of strict liability for abnormally dangerous activities applies to highly significant, nonreciprocal risks whenever negligence and strict liability would attain identical risk levels.[108]

This rule has not been adequately explained by fairness theorists, nor can it be explained by the conventional economic analysis of tort law.[109] By contrast, the rule and the associated roles of negligence and strict liability can be explained by the normative concept of reciprocity as complemented by distributive economic analysis, illustrating how our understanding of tort law can be furthered by distributive economic analysis.

An important question remains. How should reciprocity be conceptualized? In any given risky interaction like that involving the driver and pedestrian, the risk is decidedly nonreciprocal. Yet the interaction can be conceptualized as being reciprocal insofar as the pedestrian over time also engages in a like amount of driving. The pedestrian's right to drive, and her

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[106] For a more complete demonstration of this point, see Mark Geistfeld, *Placing a Price on Pain and Suffering: A Method for Helping Juries Determine Tort Damages for Nonmonetary Injuries*, 83 CAL. L. REV. 773, 851-52 (1995)(hereinafter "Pain and Suffering").

[107] Mark Geistfeld, *Should Enterprise Liability Replace the Rule of Strict Liability for Abnormally Dangerous Activities?*, 45 UCLA L. REV. 611, 625-33, 639-46 (1998).

[108] RESTATEMENT (THIRD) OF TORTS, *supra* note __, at §20.

[109] This rationale for strict liability does not require risk reduction, whereas the conventional economic analysis of tort law finds strict liability to be justified only when it would reduce risk below the level attainable in a negligence regime. Steven Shavell, *Strict Liability Versus Negligence*, 9 J. LEG. STUD. 1 (1980).

exercise of that right over time, may mean that driving confers an adequate benefit on her, making a particular risky interaction with a driver reciprocal. Should reciprocity as compensation be conceptualized in long-run terms or relative to each risky interaction?

The issue involves distributive considerations that can be uncovered by economic analysis, bringing the normative question into sharper relief. As a normative matter, the position of the two parties for tort purposes can be considered from a variety of perspectives. As each party's position becomes further removed from a particular risky interaction, the resultant perspective loses focus of the right-holder. Anyone, when placed in a wider context, will be both a duty-holder and right-holder. A normative concern about protecting the security interest of the right-holder becomes transformed into a concern for protecting the individual's full range of interests. The most long-run conception of all, which places everyone behind the veil of ignorance, can completely eliminate individual differences and justify liability rules that maximize average utility.[110]

By potentially justifying liability rules that maximize average utility, the long-run conception of reciprocity may be inconsistent with the rationale for tort rules based on individual rights. Utilitarianism, after all, is thought to be inconsistent with rights-based forms of justice, so tort rules that maximize average utility would seem to be inconsistent with rights-based tort rules. To avoid this inconsistency, reciprocity cannot be conceptualized in long-run terms and must be framed in terms of risky interactions.

This conclusion finds further support in distributive analysis. The pedestrian undoubtedly benefits from the right to drive. But that benefit varies across individuals, as does the risk that anyone faces from any type of risky interaction. Reciprocity defined in terms of each risky interaction is more capable of accounting for individual differences than is long-run reciprocity, which effectively converts individual case-by-case differences into some sort of collective average. What is true on average need not be true in every case: some people will be exposed to abnormally high degrees of nonconsensual risk and will impose lower than normal risks on others. These individuals are the ones who would be most disadvantaged by tort rules permitting nonconsensual risks. Protecting the individuals most disadvantaged by nonconsensual risks would seem to be an issue of great normative concern for a fair theory of tort law.

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[110] *See* John Harsanyi, *Can the Maximin Principle Serve as a Basis for Morality? A Critique of John Rawls's Theory*, 59 AM. POL. SCI. REV. 594, 596-97 (1975); John C. Harsanyi, *Morality and the Theory of Rational Behavior* in UTILITARIANISM AND BEYOND 39 (Amartya Sen & Bernard Williams eds. 1982).

Distributive considerations accordingly provide further support for a conception of reciprocity defined in terms of risky interactions like those between drivers and pedestrians.

The way in which reciprocity should be conceptualized ultimately involves a distributive matter that cannot be fully resolved by economic analysis. But the distributive dimensions of the problem are usefully illuminated by economic analysis, showing how a normative problem can be clarified by distributive economic analysis.

B. *Tort Damages for Pain and Suffering*

Tort damages for pain and suffering provide compensation for limited types of nonmonetary injuries.[111] These damages may be allocatively inefficient. Pain and suffering reduce welfare but not one's need for money. A rational, well-informed person would not spend money on insurance premiums to guarantee monetary compensation for an injury that does not increase the need for money.[112] Like insurance, tort damages guarantee compensation in the event of injury. The inefficiency of insurance for nonmonetary injuries thus establishes the inefficiency of tort damages for pain and suffering.[113]

The conclusion that pain-and-suffering tort damages are allocatively inefficient has engendered proposals to eliminate them.[114] The availability of

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[111] Pain-and-suffering damages encompass the various types of nonmonetary injuries compensable in tort, such as physical pain, anxiety, fright, grief, indignity, nervousness, and loss of life's pleasures for nonfatal accidents. 22 AM. JUR. 2D DAMAGES §§ 239-40 (1988).

[112] The foundational analysis showing that risk-averse individuals may not want to "fully insure an irreplaceable commodity" is Philip J. Cook & Daniel A. Graham, *The Demand for Insurance and Protection: The Case of Irreplaceable Commodities*, 91 Q. J. ECON. 143 (1977).

[113] *See* Robert Cooter, *Towards a Market in Unmatured Tort Claims*, 75 VA. L. REV. 383, 389-91 (1989); Patricia M. Danzon, *Tort Reform and the Role of the Government in Tort Reform*, 13 J. LEGAL STUD. 517 (1984); David Friedman, *What is "Fair Compensation" for Death or Injury*?, 2 INT'L REV. L. & ECON. 81 (1982); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 218 (5th ed. 1998); George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L.J. 1521, 1546-47 (1987); SHAVELL, ECONOMIC ANALYSIS OF TORT LAW, *supra* note __, at 248-49. Others have limited the claim to product transactions. John E. Calfee & Paul H. Rubin, *Some Implications of Damage Payments for Nonpecuniary Losses*, 21 J. LEGAL STUD. 371 (1992); Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 YALE L.J. 353, 362-67 (1988).

[114] The most common proposal replaces pain-and-suffering tort damages with a system of administrative fines and rebates. Danzon, *supra* note __, at 520-22; SHAVELL, *supra* note __, at 233-34; Michael Spence, *Consumer Misperceptions, Product Failure and Producer Liability*, 44 REV. ECON. STUD. 561 (1977).

such damages has been curtailed in many states.[115] A cap on these damages is the tort reform for medical malpractice favored by the American Medical Association.[116]

In defense of the damages, fairness scholars have criticized the economic argument equating tort damages with insurance. "The insurance theory's fatal flaw is that it makes the kinds and amount of tort recovery depend upon individual preferences for insurance, rather than communally-agreed-upon normative judgments about the impact of a personal injury upon the victim's overall well-being…."[117]

This critique correctly defines the problem in welfare terms rather than by reference to the plaintiff's insurance preferences. Yet the argument need not justify tort awards for pain and suffering for reasons made clear by distributive analysis.

With respect to damages rules, the plaintiff's right must obviously be considered in welfare terms. "[T]he law of torts attempts primarily to put an injured person in a position as nearly possible equivalent to his position prior to the tort."[118] Monetary damages for pain and suffering do not "restore the person to his previous position," but merely "give the injured person some pecuniary return for what he has suffered or is likely to suffer."[119] The payment of monetary damages is an attempt to make the plaintiff whole by restoring welfare.

As a matter of justice, the duty to repair the plaintiff's injury by the payment of monetary damages is an obligation of the defendant. Why should it matter whether the plaintiff would find it rational to purchase insurance for the injury?[120] The defendant is obligated to protect adequately the welfare of the

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[115] For example, in 1986 and 1987, 22 states enacted tort-reform legislation limiting the availability of pain-and-suffering tort damages, 12 specifically for medical malpractice claims. Randall Bovberg, *Legislation on Medical Malpractice: Further Developments and a Preliminary Report Card*, 22 U.C. DAVIS L. REV. 499, 543 (1989). Since then, states have continued to enact tort-reform legislation limiting such damages. James Cahoy, *Tort Reform Legislation Since 1994*, 12-6-96 WEST'S LEGAL NEWS, 1996 WL 699299.

[116] *See* http://www.ama-assn.org.

[117] Heidi Li Feldman, *Harm and Money: Against the Insurance Theory of Tort Compensation*, 75 TEX. L. REV. 1567, 1599 (1997).

[118] RESTATEMENT (SECOND) OF TORTS § 901 cmt. a.

[119] Id. § 903 cmt. a.

[120] *E.g.*, Gregory C. Keating, *The Idea of Fairness in the Law of Enterprise Liability*, 95 MICH. L. REV. 1266, 1375 (1997)(arguing that under Kantian social contract theory individuals "have no general duty to insure ourselves against the wrongdoing of others").

plaintiff. Hence fairness theorists correctly conclude that the plaintiff's welfare, rather than her insurance preferences, ought to determine tort damages.

That conclusion, though, does not necessarily justify tort damages for pain and suffering. In important contexts, the plaintiff's welfare is appropriately evaluated in light of her insurance preferences. If those preferences exclude insurance for pain and suffering, then the adequate protection of the right-holder's welfare need not include tort awards for nonmonetary injuries.

When the parties to an accident have no pre-existing relationship, tort law provides the primary means of allocating the benefits and burdens of the risky behavior. The driver benefits from the activity of driving, whereas the pedestrian faces the risk of injury. Each incurs her own precautionary costs. How tort law should distribute these benefits and burdens between the two parties is an issue of fairness not posed by contexts in which the parties have a pre-existing contractual relationship, like product cases involving consumers and manufacturers. As products liability law acknowledges, any tort burdens incurred by the manufacturer are passed onto the consumer in the form of higher prices, eliminating any consideration of how tort liability affects the manufacturer (the potential injurer).[121] The distributive question in product cases fundamentally differs from that posed by other tort cases, like those between drivers and pedestrians. Due to this distributive difference, adequate protection of the right-holder's welfare in contractual settings can depend upon her insurance preferences.

In the vast majority of product cases, the potential victim can be conceptualized as a consumer who both pays for and benefits from safety investments or guarantees of injury compensation.[122] The costs and benefits of tort liability are largely internalized by the consumer, and consumer welfare is maximized by tort rules that minimize the cost of product accidents. The adequate protection of consumer interests thus appropriately considers whether consumers would prefer to pay for tort insurance, since consumers do in fact pay for the tort liability incurred by manufacturers.[123] The consumer preference to

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[121] RESTATEMENT OF THE LAW THIRD, TORTS: PRODUCTS LIABILITY § 2 cmt. f at 23 (1998)(stating that "it is not a factor … that the imposition of liability would have a negative effect on corporate earnings or would reduce employment in a given industry").

[122] A consumer for this purpose includes one who uses the product with the purchaser's permission, assuming that the purchaser gives equal consideration to the welfare of users, typically family and friends, in making the purchase decision.

[123] The equilibrium price must cover all of the manufacturer's costs, including its liability costs. At this baseline, each consumer pays the full cost of tort liability. Another baseline, of course, could alter the conclusion. Given a baseline of no liability, the adoption of tort liability would

forego tort insurance for pain and suffering accordingly becomes a powerful reason for eliminating these damages. The adequate protection of consumer welfare need not justify tort damages for nonmonetary injuries, although in my view it does.[124]

Fairness theorists have largely ignored the distributive differences between products liability and other tort cases.[125] The fair distribution of welfare, though, is an important aspect of corrective justice. For risky interactions like those between drivers and pedestrians, the fair rule does not minimize costs, and the desirability of damages does not depend on the insurance preferences of potential victims. For risky interactions in contractual settings, the fair rule is no different than the allocatively efficient rule, and the desirability of damages depends on the preferences of potential victims (like consumers). Hence there would be no inconsistency in a tort system that allows nonmonetary damages for automobile accidents while limiting such damages for medical malpractice.

Just as economists have failed to recognize the distributive dimension of tort law, fairness theorists have failed to recognize the conditions under which the demands of fairness coincide with the demands of efficiency. Like other tort issues, the debate concerning pain-and-suffering tort damages illustrates how tort law can be improved by distributive economic analysis.

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increase cost and price, which in turn could decrease aggregate demand and thereby reduce price. The price reduction induced by the reduction in demand means that from a baseline of no liability, consumers need not bear the full cost of tort liability, depending on the relevant elasticities. The appropriate baseline thus determines whether consumers fully pay for tort liability. For tort purposes, the appropriate baseline involves the equilibrium governed the normatively justified tort rule. *Cf. supra* note 2 and accompanying text (explaining why normative justification must determine initial entitlements). At this equilibrium, each consumer pays the full cost of tort liability.

[124] The deterrence value of the tort award makes it second-best efficient to give victims at least some pain-and-suffering damages. Geistfeld, *Pain and Suffering*, *supra* note __, at 845-47. The deterrence value is not enough to make fully compensatory damages efficient, but since other injuries are not optimally compensated, the total amount of tort damages received by consumers arguably is efficient. *Id*. at 800-03.

[125] *E.g*., Feldman, *supra* note __; Keating, *supra* note __. For a notable exception, see COLEMAN, RISKS AND WRONGS, *supra* note __, at 407-29. Even Coleman's analysis would be improved upon by distributive economic analysis. He justifies product liability rules based upon the "rational contracting model" because the parties are already in a contracting relationship and so "the tort rules extend the contract approach, thereby enhancing the overall rationality and, as a consequence, the predictability of the scheme of risk allocation." *Id*. at 418-19. Although this is true, distributive economic analysis more persuasively shows why the "rational contracting model" is appropriate for formulating these tort rules. The rationale is not that it extends the contract approach, but that it best protects the welfare of right-holders consistently with the tort principle of fairness.

Conclusion

The conventional economic analysis of tort law formulates liability rules to minimize total accident costs. This single role does not seem limiting, because the conventional view maintains that the tort system should minimize costs. Under this conception, the single role of economic analysis occupies the entire field of tort law.

The claim that tort law should minimize costs, of course, is normative. For economists, "the modern interpretation of 'common good' typically involves Pareto optimality."[126] The allocatively efficient tort rule is Pareto optimal.[127] Consequently, the proponents of the conventional economic approach have sought to justify a cost-minimizing tort system with the Pareto principle.

Richard Posner was the first to justify cost-minimizing tort rules in these terms.[128] The Pareto principle requires any change in liability rules that would make at least one person better off and no one worse off. Posner argued that the appeal of the Pareto principle lies in the fact that everyone would consent to such a change, making the Pareto principle a means of promoting individual autonomy. Pareto optimal tort rules are in the interest of everyone, so Posner concluded that each person would give her ex ante consent to such a tort rule if given the opportunity.

Posner' argument ultimately fails because it relies on hypothetical consent, undermining its normative significance.[129] The argument is also problematic because it does not justify a cost-minimizing tort system. Such a system would specify initial entitlements in the manner that minimizes costs, but cost-benefit analysis is not capable of determining initial entitlements.[130] Any change from the status quo, defined in terms of initial entitlements, will create winners and losers. A cost-reducing change therefore is not required by the Pareto principle unless the losers are adequately compensated for the change. Lacking such compensation, a cost-minimizing tort system is effectively promoting allocative efficiency rather than Pareto efficiency.

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[126] *Id*.
[127] *See supra* note __ and accompanying text [in Part I].
[128] Richard A. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 488-97 (1980).
[129] *See* Coleman, *Grounds of Welfare*, *supra* note __, at 1516-20.
[130] *See supra* notes __ and accompanying text. [Part II.A]

A different tack to the problem was then taken by Louis Kaplow and Steven Shavell. Rather than show that cost-minimizing tort rules always satisfy the Pareto principle, Kaplow and Shavell have proven that such rules do not violate the Pareto principle. They then prove that "fair" tort rules, defined in analytic terms, can violate the Pareto principle. Insofar as this possible outcome is undesirable, the Pareto principle provides a reason for rejecting tort rules that do not minimize costs.

This argument also founders. Kaplow and Shavell assume that all rights-based tort rules, like those of corrective justice, satisfy their analytic definition of "fairness" and are governed by their proof. Corrective-justice tort rules are not "fair" in this analytic sense. Instead, they are "hybrid" rules explicitly justified by a concern of fairness that implicitly permits welfare considerations to dictate those choices that would satisfy the Pareto principle. The concern of fairness involves the individual right to security as justified by the "fair" concerns of autonomy and equality. This individual right permits individuals to assume the risk. Individuals will assume a risk when it is in their interest to do so, so the right-specification implicitly allows the right-holder to exercise the right in a welfare-maximizing manner. Hence if some change in the status quo would make everyone better off, all right-holders would consent to the change and there would be no conflict between the individual right and the Pareto principle. The Pareto principle therefore is not violated by right-based tort rules like those based on the principle of corrective justice, eliminating the Kaplow and Shavell justification for a cost-minimizing tort system.

Lacking support from the Pareto principle, the conventional economic analysis of tort law now finds itself in the same normative space occupied by the "old" welfare economics. Economic analysis limited to cost minimization is limited to those rationales for tort liability based upon utilitarian forms of justification. That limitation is not inherent in economic analysis, however. Other roles are available.

In any tort system, including those based upon individual rights, the resolution of tort issues often requires consideration of welfare levels. The computation of tort damages provides the most obvious example, but welfare considerations are likely to be relevant for other issues as well. The tort system must permit many forms of nonconsensual risks. In these cases, protection of the individual right to security involves adequate protection of the right-holder's welfare in some manner that does not unfairly burden the welfare of the duty-holder. The way in which tort liability affects welfare levels can be ascertained by distributive economic analysis.

The economic analysis of tort law therefore is not limited to a utilitarian-type tort system. Other rationales for tort liability create other, important roles for economic analysis. For example, ambiguities and inconsistencies in right-based tort rules can often be eliminated or uncovered by distributive economic analysis.

Distributive economic analysis also identifies the conditions under which the requirements of fairness correspond to the requirements of allocative efficiency. In many important settings like driver-pedestrian interactions, adequate protection of the right-holder's welfare requires tort rules that do not minimize costs. Here there is a conflict between fairness and efficiency. But in other important settings like those involving reciprocal risks and most product risks, adequate protection of the right-holder's welfare involves the minimization of accident costs. In these contexts, there is no important difference between the requirements imposed by the different normative theories of tort law. The "overlapping consensus" of the different forms of justification means that one does not have to choose a particular justification in formulating products liability rules, for example.[131] As distributive economic analysis makes clear, in most product cases the fair rule is also allocatively efficient.

Economic analysis can improve upon our understanding of tort law, then, in ways unrelated to the minimization of costs. Recognizing these other roles brings the economic analysis of tort law into the present. Today welfare economists routinely analyze distributive questions by treating fairness as a constraint on economic analysis. So understood, the economic analysis of tort law also returns to the role envisioned by one of its pioneers, Guido Calabresi.

The scholarly emphasis on minimizing accident costs originated with an article by Guido Calabresi that was published around the same time as Ronald Coase's famous article establishing the Coase theorem.[132] Although Calabresi analyzed how tort liability affects accident costs, he did not make the stronger claim that tort law should minimize accident costs. For Calabresi, justice or fairness is not "a goal of the same type as cost reduction but … a veto or

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[131] *Cf.* JOHN RAWLS, POLITICAL LIBERALISM (1993) (arguing that a political conception of justice can accommodate a plurality of incompatible doctrines by focusing on the overlapping consensus of reasonable, comprehensive doctrines)..

[132] Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 YALE L.J. 499 (1961); Coase, *supra* note __.

constraint on what can be done to achieve cost reduction. Viewed in this way fairness becomes a final test which any system of accident law must pass."[133]

As the economic analysis of tort law has evolved, Calabresi's observations have been confirmed. Justice or fairness has always served as a veto or constraint. This limit is obscured by the conventional economic analysis of tort law, for which the constraint is not binding or limiting. Utilitarian forms of justice ordinarily require cost-minimizing tort rules. But other principles of justice or fairness do not justify a cost-minimizing tort system. These principles limit the relevance of cost minimization while sanctioning an important role for economic analysis regarding issues of welfare. Different normative theories accordingly provide different roles for economic analysis. Once the varied roles are recognized, the validity of Calabresi's claim becomes evident. The economic analysis of tort law serves whatever role is required by the normative justification for tort liability.

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[133] GUIDO CALABRESI, THE COSTS OF ACCIDENTS 24 n. 1 (1970); *see also* Guido Calabresi, *First Party, Third Party, and Product Liability Systems: Can Economic Analysis of Law Tell Us Anything About Them?*, 69 IOWA L. REV. 833, 847 (1984) (observing that economic analysis "certainly does not tell us what weight to give to other distributional goals that the society seems to value…. It does, however, give us an analytical structure that allows us to see far better what is at stake in the choice of systems [governing accidents]."