Tort Law Reform

• Does the tort system work well?

Let’s see how it can break down.

There is a probability \( p \) that a surgeon will have an accident during an operation, and impose damages \( D \).

If the surgeon is not liable, damages are borne by the patient, either directly or via an insurance policy.

If the surgeon is liable, he purchases an insurance policy and passes the cost to the patient.
A Model of Torts

• Suppose that $p$ is a function $p(x)$, the surgeon’s investment in safety.
• We want the surgeon to bear the risk himself. But the costs of transferring the risk to the surgeon may exceed the efficiency gains.

<table>
<thead>
<tr>
<th>Item</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Probability of Accident w/o liability</td>
<td>0.03</td>
</tr>
<tr>
<td>Probability of Accident w liability</td>
<td>0.02</td>
</tr>
<tr>
<td>Damages from Accident</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Value of savings</td>
<td>10,000</td>
</tr>
<tr>
<td>Cost of saving</td>
<td>5,000</td>
</tr>
<tr>
<td>Net social gain</td>
<td>5,000</td>
</tr>
<tr>
<td>Transactions cost</td>
<td>1/3 for lawyers for plaintiff and 1/3 for defendant = (2/3) (1,000,000)(0.02) = 13,333</td>
</tr>
<tr>
<td>Net Social Loss</td>
<td>$8,333</td>
</tr>
</tbody>
</table>

Efficient Risk Bearing

General Product Liability

• In the case of product liability, we have a strict damage rule.
• Is this efficient?
General Product Liability

- Perhaps it is, as long as we have a defense of failure to use the product properly.
- But the potential for abuse is there.

A General Conclusion

- Let
- \[ Z = \Delta PD - \Delta X \]
- be the gains from efficient risk bearing.
- \[ T = \text{Transactions cost of suits (} \cong \frac{2}{3}D \text{?)} \]

If \( Z > T \), tort law makes sense

If \( Z < T \), tort law does not

Three Topics

- Workman’s Compensation
- Product Liability
- Malpractice

End

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