STATE LIABILITY: AN ECONOMIC ANALYSIS*

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I. Introduction

Traditional economic analysis of accident law has largely focused on individual utility maximizing actors as potential injurers and potential victims. On that basis a huge literature has been developed since the early publications of Calabresi in the 1960s[1] explaining under which conditions particular liability rules may be effective in promoting social welfare.[2] Moreover, the theoretical assumptions made in the literature have increasingly been met with empirical support as well.[3] However, less attention was paid to the situation where the tortfeasor would not be an individual actor or commercial enterprise, but a public authority or the state. Only during the recent years a few articles exploring public authority liability have been published, some of them focusing specifically on the liability of the state in public international law, asking e.g. to what extent states have incentives to comply with international conventions and more recently also applying economic analysis to the case where a public authority would be a tortfeasor in a more ordinary (domestic) tort case. However, the literature is still relatively recent and has perhaps not produced that clear conclusions as in the case of economic analysis of accidents generally. The goal of our contribution is to provide some insights on this literature and of course, where possible, to deepen and elaborate on this literature. This may be helpful since to some extent the literature may have a rather abstract character and may thus be less linked to specific problems that lawyers are dealing with when referring to public authority liability.

Our contribution is inevitably limited to an economic analysis and will hence not focus on legal issues which will be the core subject of other contributions to this volume. However, to some extent the economic literature also provides examples from various jurisdictions (often the US). These examples (and cases) will sometimes be discussed since they can provide useful illustrations of the economic reasoning.

The economic literature so far has mostly addressed public authority liability in a rather broad sense, assuming the public authority would be liable for behaviour (acts or omissions) of civil servants acting on behalf of the public authority. Less distinctions are made between the various public authorities on which liability could be imposed (e.g. local communities, provinces or states).

We will, to the extent possible, try to follow the questionnaire in order to provide uniformity and ease the work of both comparative rapporteurs and readers. However, for obvious reasons it may not always be possible to fit the economic analysis into a questionnaire aiming at obtaining information on public authority liability in selected jurisdictions.

Part I: Public authority liability; a theoretical economic approach

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[1] See for example Calabresi, G. (1961), Some thoughts on risk distribution and the law of torts, Yale Law Journal, 70, 499-553 and Calabresi, G. (1965), The decision for accidents: an approach to non-fault allocation of costs, Harvard Law Review, 78(4), 713-745.

[2] For a summary and overview of the literature see the contributions in Faure, M. (ed.), Tort law and economics. Encyclopaedia of law and economics, 2nd ed., Cheltenham, Edward Elgar, 2009.

[3] For an overview see Van Velthoven, B., Empirics of tort in Faure, M. (ed.), Tort law and economics. Encyclopaedia of law and economics, 2nd ed., Cheltenham, Edward Elgar, 2009, 453-498.

I. Introduction

A. Overview

We will briefly sketch the historical evolution of the economic analysis of public authority liability as it appears from the literature (B); then we will discuss the important question to what extent it is at all possible to apply traditional economic analysis of accident law to a public authority (C). The question also arises whether public authority liability needs separate procedures or courts (D) and whether remedies other than compensation may be indicated (E). The core of this part will be (F) the policy analysis, where we provide the arguments in favour and against public authority liability from an economic perspective. This basic economic policy framework (F) will subsequently be used to discuss in more detail liability for fault (II), compensation for lawful acts (III) and the cases in part II.

B. Historical Evolution

As already mentioned in the introduction the interest of law and economics scholars in public authority liability has risen at a relatively late stage, at least compared to the huge amount of literature written on economic analysis of accidents caused by more traditional tortfeasors. The first publications came from the (then) Chicago-based economist Alan Sykes and his co-author. A 1987-paper by Kramer and Sykes provided a legal and economic analysis of municipal liability under US law.[4] Fishell and Sykes subsequently analyzed the scope of government liability for breach of contract from an economic perspective.[5] The contractual liability of the state is, however, outside of the scope of this contribution. In a subsequent article with Eric Posner Posner and Sykes analyzed state and individual responsibility under international law.[6] In their paper Posner and Sykes consider state liability as a form of vicarious liability and hold that the goal of this liability is, like in the case of vicarious liability, to provide incentives to principals to control the wrongful behaviour of agents whom they can monitor. They provide economic arguments for state and individual responsibility and also point at differences between ordinary vicarious liability and state liability. Some of their arguments will be discussed here.

More recently Dari-Mattiacci, Garoupa and Gomez-Pomar provided an economic analysis of state liability.[7] They argue that state liability generally has three purposes (all of which will be discussed in further detail in this contribution):

1. To provide incentives to potential wrongdoers to act properly;

2. To remove incentives for private parties to engage in socially detrimental behaviour and

3. To generate information.

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[4] Kramer, Larry and Alan O. Sykes (1987), Municipal liability under Section 1983: a legal and economic analysis, Supreme Court Review, 249-301.

[5] Daniel R. Fishell and Alan O. Sykes, Governmental liability for breach of contracts, American Law and Economics Review, 1999, vol. 1, 313-385. See also Fishell, Daniel R. and Alan O. Sykes (1996), Corporate crime, Journal of Legal Studies, vol. 25, 319-349; in this paper their economic analysis is, however, limited to crimes committed by non-state corporate actors.

[6] Eric A. Posner and Alan O. Sykes, An economic analysis of state and individual responsibility under international law, American Law and Economics Review, 2007, vol. 9, 72-134. This builds on earlier work of Goldsmith and Posner on incentives of states to engage in binding obligations under international law (Goldsmith, Jacques L. and Eric A. Posner, The limits of international law, 2005, New York).

[7] Giuseppe Dari-Mattiacci, Nuno Garoupa and Fernando Gomez-Pomar, State liability, European Review of Private Law, 2010, vol. 18-811, also available at http://ssrn.com/abstract=1590874.

The most recent paper in this domain is a yet unpublished working paper by Gerrit De Geest on sovereign immunity.[8] Starting from the American law on sovereign immunity De Geest analyses why particular actors (mainly public authorities) are immune from tort liability. He argues that, differently than ordinary actors, public authorities are often so-called multi-task agents (MTA) who have to balance various external tasks that in principle could provide benefits and costs to others, but, differently than with individual actors, not necessarily to themselves. For these multi-task agents it is important to provide them discretionary power to balance all external costs in an appropriate manner. This may be a strong argument for a more reduced liability of multi-task agents (such as public authorities) than for ordinary actors.

In addition to these papers providing economic foundations for public authority liability or (under specific circumstances) immunity, Hans-Bernd Schäfer and some co-authors have to the contrary argued that it may be principally wrong to apply classic economic analysis of accident also to the state.[9] Following public choice literature on bureaucracies, they reason that states, differently than individual actors, do not maximize utility and that it may hence be wrong to apply classic economic analysis, based on an assumption of utility maximization, to the state or other public authorities. We will immediately discuss these arguments below, when defining the public sphere.[10]

c. The public sphere/Can traditional economic analysis be applied to a public authority?

The question of the type of activity for which public authority liability can arise is, in the context of economic analysis, related to the just mentioned issue of whether it is at all appropriate to apply the economic approach designed for individual (or corporate) actors to public authorities. In other words: is the public sphere for the economic analysis of accident law different from the private sphere?

It should be stressed that most of the economic literature concerning public authority liability focuses on liability of the state. We will, giving the goal of this project, rather refer to public authority liability. When, however, the economic arguments only refer to the situation of the state, this will of course be referred to as state liability.

c. The public sphere/ Can traditional economic analysis be applied to a public authority?

1. Public authorities don't maximize utility

[8] G. De Geest, "Who should be immune from tort liability?", 2011, *Working Paper, Washington University School of Law*, available via <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1785797>.

[9] Hans-Bernd Schäfer, "Can Member State liability for the infringement of European law deter national legislators?", in Thomas Eger and Hans-Bernd Schäfer (editors), *Research Handbook on Economics of EU law*, Cheltenham, Edward Elgar, 2012, forthcoming; R. van den Bergh and H.-B. Schäfer, "Liability of Member States for infringement of the EC Treaty: economic arguments in favor of a rule of obvious negligence", *European Law Review*, 1998, 552-567; R. van den Bergh and H.-B. Schäfer, "Member States liability for infringment of the free movement of goods in the EC: an economic analysis", 156 *Journal of Institutional and Theoretical Economics (JITE)*, 2000, 382-403 and R. van den Bergh, "Francovich and its Aftermath: Member State liability for breaches of European law from an economic perspective", in Miguel Poiares Maduro and Loïc Azoulai (editors), *The past and future of EU law. The classics of EU law revisited on the 50th anniversary of the Rome Treaty*, Oxford , Hart Publishing, 2010, 423-430.

[10] For a comparative law and economics analysis of public authority liability see Markesinis, B.S., Auby, J.B., Coester-Waltjen, D. en Deakin, S.F., *Tortious Liability of Statutory Bodies. A comparative and economic analysis of five English cases*, Hart, Oxford, 1999.

As we already indicated, economic analysis traditionally assumes utility maximizing and profit maximizing individuals. This assumption is crucial to make predictions about how private entities respond to the incentives created by liability. Public authority however, unlike corporations, do not maximize profits. As a result public authorities may also lack the market discipline which is imposed on private injurers and traditional incentives mechanisms may therefore not work.[11] If profit maximization is not the goal of a public authority it is less clear what objective functions public authorities strive for.[12] The question to what extent imposing liability will provide incentives, e.g. to prevent harmful behaviour, is of course crucially linked to the functions the particular agent strives for.[13]

This is precisely the reason why Schäfer argues that it may not be possible at all to apply traditional economic analysis of torts to the case of state liability.[14] He has argued this more particularly with respect to the liability of Member States in the European Union for breaches of community law. Both the European Court of Justice and commentators had stated that they expect that liability of Member States will provide Member States an incentive to better comply with obligations under European law. In other words state liability would have a deterrent effect and prevent breaches. Schäfer strongly doubts this and principally argues that it is wrong to use traditional models of profit maximization to explain the behaviour of the state since the state does not aim at profit maximization but should rather, in terms of public choice and political economy, be analyzed via the incentives of their main actors, e.g. politicians. Their main concern would not be profit maximization, but re-election as a result of which they would tend to benefit interest groups that support their re-election.

2. But still public authority liability can give incentives to politicians…

Schäfer is obviously right that public authorities are different than individual actors. However, concluding from this that public authority liability may not have any deterrent effect at all is probably a too strong conclusion. In the end, some government entity must pay the costs created by liability. This entity will often face a budget constraint, and will not like to waste resources. Kramer and Sykes (1987) state that bureaucracies may respond to liability with behavior *approximating* cost minimization, and will thus adopt cost-effective measures to economize on liability.[15] Indeed, the government (or more accurately, its officials) can be motivated by the desire to provide public services at minimum cost, since many officials confront demands for both increased levels of public services and lower taxes. They are likely to explore all opportunities for cost reduction. Taking reasonable preventive measures to reduce the burdens of liability is one such opportunity. Put differently, liability may affect the behavior of government officials through its political consequences. Liability diverts government funds and leaves political officials with fewer resources to satisfy the demands of their constituencies.[16] Governments may then respond to liability with measures to avoid it that are "politically cost-effective", though not necessarily "economically cost-effective".[17]

[11] See Darryl L. Levinson, Making government pay: markets, politics and the allocation of constitutional costs, University of Chicago Law Review, 2000, vol. 67, 345; Matthew L. Spitzer, An economic analysis of sovereign immunity in tort, Southern California Law Review, 1977, vol. 50, 515.
[12] See Eric Posner and Alan O. Sykes, 2007, 87.
[13] Dari-Mattiacci, Garoupa and Gomez-Pomar, 16.
[14] Schäfer, 2012.
[15] Unfortunately, there is no empirical data available to support this thesis.
[16] See Dari-Mattiacci, Garoupa and Gomez-Pomar, 16.
[17] See Posner and Sykes, p. 89.

It's realistic to expect a positive correlation between political and economic cost-effectiveness. However, the exact relation between them is unclear.[18]

3… and to bureaucrats

Schaëfer further argues that since state liability procedures (under European law) may only have effect years after the politician was in office, a finding of liability would not affect his incentive to comply with European law.[19] Schaëfer therefore concludes that, differently than held by European legal commentators, one cannot expect any deterrent effect from state liability. Schäfer is of course right in arguing that the political consequences of liability can be limited due to timing distortions.[20] Losses may be revealed only after years, and trials or settlement negotiations may take a long time. In such cases, the political cost may not be paid by the elected official who took the decision ending in the tort payment, but by a later entrant into office. We must stress however that much of the work of the government is carried out by bureaucrats, who often have a longer time perspective than elected officials. The most commonly applied rational choice model of bureaucratic behavior assumes that a bureaucrat will seek to maximize the size of her agency's budget.[21] They may thus have an incentive to take reasonable precautions in order to reduce the burdens of liability, even though they are not directly politically accountable and even though elected officials may have little control over the actions of these bureaucrats (in terms of selection, promotion, operation). This could also be held against Schäfer who claims that Member State liability may not prevent breaches of European law. For bureaucrats (who stay of course longer in office than the elected politicians) a conviction by the European Court of Justice for a failure to implement European directives correctly (and hence a breach of European law) does not only lead to a loss of budget, but also to a reputational loss which may precisely provide them incentives to prevent those breaches.

4. Political control insufficient

One may argue that even if the government cannot be held liable, it will have a sufficient incentive to prevent careless behavior because the political consequences of harmful behavior on itself can serve as a deterrent. If costs are externalized on citizens, this may affect their voting behavior. If this were true, a costly system of government liability would not be necessary. In reality however, the political consequences of cost externalization may be limited. Voters may not act as an effective check on liability for several reasons: accidents may happen infrequently, voters will often be ill-informed about them, and even if well-informed, voters probably view the problem of uncompensated injuries caused by the state not as important as other issues. Also, the costs of uncompensated injuries may disproportionately fall upon poorer segments of the population with limited political power. In other words, the cost externalization strategy of the government may end up undetected, or at least unpunished by the voters.[22]

[18] Posner and Sykes, p. 90.
[19] It is related to the well-known Nimtof-syndrom (not in my term of office).
[20] See also Dari-Mattiacci, Garoupa and Gomez-Pomar, 16.
[21] See Niskanen, William A. Jr., Bureaucracy and Representative Government, 36-42, 1971. The reason is that the size of an agency's budget is likely to correlate positively with some goods that bureaucrats may value such as their own compensation and perquisites, prospects for career advancement and prestige.
[22] See Kramer and Sykes (1987, p. 279).

5. Public authority liability can (theoretically) deter

In sum, the mere fact that public authorities have different incentives than private actors (in a potential accident setting) may indeed draw some caution with respect to the application of classic models of accident law to public authority liability. However, it may be a bridge too far to argue that as a consequence public authority liability would have no effect at all. Incentives may still result from public authority liability and even though they may only imperfectly affect the behaviour of politicians (given agency problems with voters and timing distortions), public authority liability may still have a deterrent effect since it could reduce the budget and reputation of bureaucrats who are equally affected by public authority liability and who may have a longer time horizon than politicians. The extent to which public authority liability does have a deterrent effect (which is the premise on which economic analysis of accident law is based) remains in the end of course an empirical issue, but empirical evidence to support or deny this claim is unfortunately lacking.

D. Courts and procedures

The issue of whether public authority liability is so much different that it would warrant distinctive courts and procedures has been briefly addressed by Dari-Mattiacci, Garoupa and Gomez-Pomar who argue that a special legal framework may indeed make sense.[23] Their main economic argument in favour of specialised, administrative courts dealing with public authority liability is the advantage in information and thus the greater ability of these courts to deal with specific features related to public authorities. Of course, there are other potential benefits of specialization in general (whether through administrative courts or not). Cabrillo and Fitzpatrick (2008) mention the following benefits.[24] First, specialization allows procedures to be adapted to the dispute matter. This can be important when costs can be saved by designing procedures proportional to the importance of the dispute. Second, specialization may also speed up the adjudication process, since procedures become more routinized as courts deal with the same issues repeatedly. Third, as already mentioned above for specialized administrative courts, specialization may lead to more accurate decisions if specialized judges have increased expertise in the area. Fourth, specialization can lead to greater harmony in the law since fewer courts are dealing with the same subject matter. Cabrillo and Fitzpatrick (2008) further mention two factors that may increase the value of specialization. First, the gains to specialization increase when there is a steady demand for adjudication in a particular area. In that case, specialized courts will not be vulnerable to fluctuations in caseloads. Second, increasingly complex cases increase the necessity for specialization. For such cases, there is a learning curve in deciding cases. Judges will be more willing to make the specific investments in acquiring knowledge of the special issues if they know thet will face many cases of the same type.

There is, however, a trade off since specialisation makes accountability more difficult and the risk of capture[25] increases.[26] To the extent that public authority liability cases are different than ordinary tort cases a specialisation of the courts may be indicated. This would also be the case if public authority liability cases would lead to court congestion of the ordinary courts.[27]

[23] Dari-Mattiacci, Garoupa and Gomez-Pomar, 7.

[24]

[25] In this particular case meaning that the public authorities themselves would be better able to influence the specialized judges.

[26] Dari-Mattiacci, Garoupa and Gomez-Pomar, 28.

[27] Empirically this does not seem to be a strong argument since public authority liability cases may not lead to a serious overburdening of the ordinary courts (Dari-Mattiacci, Garoupa and Gomez-Pomar, 29).

The capture danger not only exists because of specialisation. Creating a specialized court may also lead courts to act strategically and e.g. push for an expansion of their budget to attract new business. In other words: creating a specialized court may lead to a floodgate of cases simply because it is in the interest of the court itself. In other words, if capture problems are considered to be serious and more important than the advantages in information, economists would probably argue that specialisation of the court system may do more harm than good. This is especially the case if ordinary courts seem well able to deal with liability cases involving public authorities (in the sense that they are not significantly different than other accident cases) and do not lead to overburdening the courts.[28]

E. Remedies

Other remedies, like injuctive relief, may have certain advantages compared to damages.[29] One advantage of injunctive relief is that courts do not have to estimate damages, which may reduce litigation costs. Also, in those instances in which state liability for damages does not have a deterrent effect or only a very weak one, injunctive relief may be superior.

Schäfer and Van den Bergh point to the fact that one problem with state liability is that it will often lead to pure financial losses Generally, economic analysis is reluctant as far as the compensation for pure economic loss is concerned.[30] Schäfer and Van den Bergh hold that state liability (under European law) may only lead to efficient outcomes if the private losses of those who suffer are larger than the social losses.[31]

Another point to be mentioned in the literature is that if the sole goal of public authority liability were to provide compensation to victims, this goal could also be realised via cheaper alternatives than public authority liability such as a publically funded insurance or a publically organised compensation fund. The transaction costs of those may be lower than of public authority liability with costly tort litigation. However, that argument of course disappears when compensation is not seen (as it is in economic analysis) as a goal in itself, but as a means to provide incentives to a potential tortfeasor.

F. Policy Considerations

In the law and economics literature, some potential advantages of public authority liability as well as some potential dangers have been identified. It seems useful to summarize these arguments pro and contra public authority liability since they also play a role in addressing the further questions of the questionnaire.

1. Advantages of public authority liability

As mentioned before, in theory public authority liability can fulfil three important economic functions: (a) it can provide incentives for public authorities to act properly; (b) it can remove incentives for private parties to engage in socially detrimental behaviour and finally (c) it can also generate valuable information.[32]

[28] And note further that overburdening of the courts can also be alleviated with other measures.
[29] Of course, for harm that already occurred, other remedies than damages may not be helpful at all.
[30] See Jef de Mot, "Pure economic loss", in Faure, M. (ed.), *Tort Law and Economics*, Cheltenham, Edward Elgar, 2009, 201-214.
[31] Schäfer and Van den Bergh, 1998, 554-557.
[32] Dari-Mattiacci, Garoupa and Gomez-Pomar, 3.

a. Internalisation of costs

Just like private entities, public authorities can be a source of negative externalities. Actions and failure to act of public authorities organs, bodies and officials may indeed cause substantial harm. An example of the former (actions) is a police officer who intervenes in a conflict too aggressively. An example of the latter (failure to act) concerns a police officer who impounds a driver's vehicle and leaves her stranded in a high-crime area in the middle of the night.[33] A first advantage of public authority liability is that it may internalize negative externalities. Liability stands as a deterrent to intentional harms and creates incentives to take precautions against accidental injuries.[34] These precautions create benefits in the form of a reduction in the magnitude and number of accidents.[35] For example, if a public authority is liable for failure to maintain public roads in adequate conditions for safe driving, the prospect of having to pay damages may provide incentives to choose the optimal level of maintenance expenditures. Likewise, liability can be a stimulus to persuade a (e.g. financial) supervisor to perform the tasks assigned to him with (greater) care.[36]

b. Public authority liability to remove incentives

In theory, public authority liability may also remove incentives for private parties to engage in socially detrimental behaviour when incentives are distorted.[37] Take for example a corrupt official who refuses to issue a permit to an honest entrepreneur unless the entrepreneur would pay a bribe. In such a case public authority liability has the advantage that the victim of the wrongful behaviour can rely on damage compensation paid by the public authority, which would make it less likely that the entrepreneur will be compelled to bribe the public official. Public authority liability thus removes the incentives for private parties to cooperate with corrupt state officials.[38] Another example concerns wrongful conviction. From an ex ante perspectiven such a conviction might generate incentives to engage in illegal activities.[39] The reason is that the possibility to be wrongfully sanctioned reduces the relative advantages of engaging in legal activities. The possibility to have state liability (and thus compensation) in case of a wrongful conviction may then correct these distorted incentives of citizens.[40] In these cases, public authority liability is not only meant to provide the public authority with incentives, but also to realign the behavior of private parties with the socially desirable behavior by granting compensation for losses.

c. Public authority liability as a monitoring device

[33] See the US case *Wood v. Ostrander* (879 F.2d 583, 9th Cir. 1989).
[34] See for example Kramer, Larry and Alan O. Sykes, Municipal Liability Under §1983: a Legal and Economic Analysis, Sup. Ct. Rev. 249, 1987, p. 267. Regarding the US, Congress enacted §1983 to deter state officials from depriving state residents of federally protected rights. See Kramer and Sykes, p. 268.
[35] Of course, they also impose costs on the entities subject to liability. Economic analysis undertakes to identify which rule creates the greatest excess of benefits over costs.
[36] Before we already pointed to the fact that some literature doubts whether it is possible to fully apply the model of profit maximization to public authorities. We have however argued that even if there may be some limits in applying this model, liability rules may still have an important function in providing incentives for the prevention of accidents.
[37] See Dari-Mattiacci, Garoupa and Gomez-Pomar, 3.
[38] Dari-Mattiacci, Garoupa and Gomez-Pomar, 4.
[39] See on this point also Vincy Fon and Hans-Bernd Schäfer, State liability for wrongful conviction: incentive effects on crime levels, Journal of Institutional and Theoretical Economics, 2007, 269.
[40] Dari-Mattiacci, Garoupa and Gomez-Pomar, 22.

A final advantage of public authority liability is that it may provide accurate information about wrongful behaviour by public agencies.[41] Public authority liability can indeed generate information on the performance of public authorities and could thus increase transparency of actions of civil servants within the public authority and increase the accountability of public authorities. In this case liability would be seen as a device whereby the public at large as a principal would monitor the behaviour of officials (as agents).[42] However, it can be argued that this argument is not unproblematic: although the generation of information can be economically valuable, using the tort litigation system (only) to generate this information may be very costly. Moreover, public authority liability could be (ab)used to disfavor certain branches of government (e.g. the judiciary) and independent bodies (e.g. an independent regulatory agency), thus undermining the normal status quo of checks and balances.[43]

2. Disadvantages of public authority liability

a. A fundamental problem: uncertainty and the chilling effect

Legal standards of due care are often uncertain. There are various factors that contribute to the existence of uncertainty. First, courts may err in determining due levels of care. For example, they may hold a civil servant negligent for granting a permit for an activity that later caused substantial harm, even though granting the permit was reasonable from an ex ante perspective. Conversely, the court may also erroneously not hold a civil servant liable for granting a permit. Second, courts can make errors in assessing a party's true level of care. For example, a physician may have performed a diagnostic test[44], but the court might think that he didn't. Coversely, the court may believe that the physician performed a diagnostic test while he did not. Third, a party may be unable to control completely his momentary level of care. For example, a driver may not be able to control his level of care at each instant, because of a lapse of attention, a sneeze, etc.[45]

We will now examine the consequences of uncertain legal standards on the behavior of potential injurers in two situations: (1) the potential injurer acts on his own behalf, and (2) the potential injurer acts on behalf of a public authority. As we will see, the influence of uncertainty and potential solutions vary strongly across these two situations. For reasons of simplicity, we will focus on the first type of uncertainty (courts may err in determining due levels of care). Courts may either be too severe (holding the defendant liable, even though he did not behave negligently, this is called a "type I-error"), or too lenient (not holding the defendant liable, even though he behaved negligently, this is called a "type II-error").

1. The potential injurer acts on his own behalf

The significance of type I and type II errors is not the same. We can see this with a simple example. The first column represents the level of care a potential injurer can take. The second column represents the costs of each level of precaution (one unit of precaution costs 100

[41] Dari-Mattiacci, Garoupa and Gomez-Pomar, 4.
[42] Generally, the monitoring ability of the public authority is advanced as an important criterion to judge whether public authority liability is desirable. See e.g..Posner and Sykes 2007, 75 and 81.
[43] Dari-Mattiacci, Garoupa and Gomez-Pomar, 23.
[44] For example: listening carefully to a person's heartbeat after some exercises. Such a test may not be easily verifiable, unlike for example an electrocardiogram. See Shavell, Steven. 2004, Foundations of Economic Analysis of Law, Cambridge, Harvard University Press, p. 225.
[45] See Shavell (2004), p. 227.

Euro). The third column represents the expected accident costs (the probability of an accident times the loss in case an accident happens) for each level of precaution.

Precaution level	Costs of precaution	Expected accident costs	Total social costs
0	0	10.000	10.000
1	100	5.000	5.100
2	200	3.000	3.200
3	300	2.500	2.800
4	400	2.300	2.700
5	500	2.250	2.750

From the figures above, it's easy to see that the optimal level of precaution equals 4 units. The total social costs – the sum of precaution costs and expected accident costs – is smaller for 4 units (2.700) than for any other unit level (respectively 10.000, 5.100, 3.200, 2.800 and 2.750). Under a perfect negligence rule, in which all judges set due care at 4 units, a potential injurer will take optimal care. If he takes less care (0,1,2 or 3), he bears his precaution costs and the expected accident costs (respectively 10.000, 5.100, 3.200 and 2.800). In other words, he bears the total social costs. But total social costs are lowest for 4 units (2.700), and if he takes 4 units, he doesn't even bear all costs, but only the costs of precaution (400). Thus he will not take less than 4 units. Similarly, the potential injurer will not take more precaution than the socially optimal level of due care (5 units). The reason is that there's no benefit for the injurer to take more than 4 units. As soon as he takes 4 units, he will never have to pay damages. If he takes 4 units, his cost equals 400. If he takes 5 units, his cost equals 500. So taking 4 units is cheaper.

Things change however when we introduce the possibility of judicial error. Suppose the injurer knows that judges set due care at 3 units instead of 4. Then it's easy to see that a potential injurer will take 3 units instead of 4. As soon as he takes 3 units of care, he will not be held liable for any damages. His private cost is minimal when he takes 3 units of care (300 versus respectively 10.000, 5.100, 3.200, 400 and 500). Note that the advantage for the potential injurer for this type of judicial error equals 100. Without the error, the injurer would have spend 4 units of care (cost of 400), with the error he only spends 3 units (cost of 300). Lets now look at the other type of error. Suppose the potential injurer knows that judges set due care at 5 units. Then we can see that he will effectively take 5 units of care. For any lower number of units, the injurer will bear all the costs (10.000, 5.100, 2.800, 2.700). If he takes 5 units, he only bears the costs of precaution (500). Note that the advantage of taking too much care is quite large. If the injurer only takes 4 units, he bears an expected cost of 2.700. If he takes 5 units, he only pays 500. So in conclusion, the effect of type I and type II errors is different. Even when both type of errors are equally likely from an ex ante perspective (e.g. there's a 10 percent chance for a Type I error and a 10 percent chance for a Type II error), potential injurers will be more inclined to take too much care than too little care. In the next section, we will see that the incentive to take too much care may be exacerbated when a public authority is involved.

2. The potential injurer acts on behalf of a public authority

Above we have seen that liability with uncertain due care standards may lead to inefficient levels of precaution (most often overprecaution). We now argue that this problem is much worse where a public authority is involved. A (private) tortfeasor typically balances an external cost (the expected accident cost) against an internal cost (the precaution cost). The incentive of such a tortfeasor to take too much precuation is limited, since he has to pay all the costs of overprecaution. However, public authority officials typically balance two *external* costs. Unlike the private tortfeasor, the public authority itself does not bear the costs of overprecaution. The public authority is thus much faster inclined towards taking too much precaution, since others are bearing the costs of it. For example, firefighters balance damage caused by water (due to an intervention) against damage caused by fire (the costs of inaction). Both of these costs are externalized. Likewise, a safety inspector balances the expected accidents costs against the precaution costs. The former are borne by the victims (in case of an accident), the latter by the inspected firm.[46] Briefly summarized, uncertainty of legal standards together with the possibility of the government to externalize the costs of overprecaution, may lead to a strong *chilling effect.*[47]

The chilling effect explains several aspects of legal rules that deal with public authority liability:

(1) Immunity for judges

Judges enjoy a privileged status regardless of the legal regime. In the US, judges enjoy absolute immunity when performing judicial tasks. When they perform administrative or executive tasks, they only enjoy qualified immunity (like other administrative officials). They also lose their absolute immunity when they act "in the clear absence of all jurisdiction over the subject-matter". As a matter of principle, US judges cannot be sued for mistakes in the application of the law. In France, judges may not be sued personally for errors while performing their duties. However, the State has to compensate damages in case of grave judicial error and denial of justice. If the State has compensated the injured party, it has a right of recourse against the judge who issued the erroneous decision. However, recourse is hardly ever filed.[48] In Germany, the plaintiff can sue the state and the judge for damages suffered due to judicial misconduct.

It's not difficult to see what the chilling effect would contain if judges would not enjoy any immunity or only a weak type of immunity when performing judicial tasks. First of all, there's a danger that a judge deciding a case with the knowledge that the losing party may bring a liability suit, would have an incentive to rule against the party which is least likely to do so.

[46] As De Geest (2011) arguers, these injurers are in a *multitasking agent* situation. The multitask agent literature shows that incentives usually need to be softer for these agents than for single-task agents, because hard incentives for one output can distort the incentives for the other output. For example, professors who are paid per publication may neglect their teaching efforts, when these teaching efforts are hard to verify (and thus to sanction). In the context of liability, multitask agents should be allowed to exercise discretion within a well-defined zone with clear minimum constraints. The reason is that uncertainty has a strong *chilling effect* in a multitask agent situation, because the multitask agent does not internalize the precaution costs. For example, if a public servant needs to decide whether a firm should get a permit or not to carry out a risky activity that can cause substantial harm to third parties. See G. De Geest, "Who Should be Immune from Tort Liability?".

[47] However, Markesinis *et al.* qualify this chilling effect as "just speculation", arguing that there would be no empirical evidence supporting this chilling effect. See Markesinis, B.S. and others, *Tortious liability of statutory bodies*, 78-81.

[48] See Canivet, G., and Joly-Hurard, J. 2004. La déontologie des magistrats.Paris: Dalloz.

This will be especially the case when, after careful examination of the case, the judge still has some residual uncertainty as to what the correct solution is for the case. Of course, this can systematically increase the error rate of the judicial system. A judge may be 80 % certain that party A should win, but if he knows that party A is unlikely to have the funds to bring a liability case, he may decide in favor of party B, who is more likely to bring such a suit if he loses. More generally, without immunity for judges, more sophisticated, less capital-constrained parties will win more often because they are more likely to retaliate against a judge. Second, without judicial immunity judges could, as long as there's some ambiguity, have an increased incentive to conclude that they do not have jurisdiction over a complex case, for which making mistakes is not unlikely. Third, judges would take considerably more time in deciding cases, so as to minimize the risk of error. Judges would spend much more time on a case than is warranted from a social cost perspective. Suppose a judge could reduce the error rate with 5 % (e.g. improve his accuracy from 90 % to 95 %) by working another week on a case. From his personal perspective, this could be worthwhile if he would be liable for an erroneous decision, especially in cases that involve large amounts. However, from a social perspective, the benefit may be much smaller, given that a relatively small reduction in the error rate (5%) probably does not have a substantial impact on potential injurers. Note that these several types of chilling effects would be more likely in jurisdictions where judges have heavy workloads. Heavier caseloads mean a greater chance of making an error.

This theoretical framework explains the types of decisions and actions for which judges enjoy (no) immunity. Uncertainty is the key issue. In a recent article Tsaoussi and Zervogianni (2010)[49], without explicitly relying on the framework we have discussed above, describe the concept of "inexcusable judicial error". They aim at identifying cases where the act or omission of the judge can be qualified as unacceptable. The categories are:

(1) Intentional behavior on the part of the judge (e.g. bribery)

(2) Denial of justice or inordinate delays in pending cases. Of course, judges cannot be held accountable for excessive caseloads, but they can be better or worse managers of their caseloads.

(3) Serious violations of the procedural rules which influence the outcome of the trial (e.g. violation of the right to be heard, failure of the judge to disqualify himself because of conflict of interests etc.)

(4) Grave legal errors in the judicial opinion itself (e.g. applying an important law that had been abrogated, especially if the attorney has mentioned the new law; an interpretation incompatible with the letter of the law as well as the unanimous opinion of legal theory and case-law)

(5) Grave error in the evaluation of the facts of the case (e.g. the judge confuses the facts of different cases)

(6) Abuse of power, which often demonstrates a lack of impartiality (e.g. determining maintenance after divorce at an amount which is manifestly beyond the ability of the defendant to pay).

[49] See Tsaoussi, A. and Zervogianni, E.. 2010. "Judges as Satisficers: a Law and Economics Perspective on Judicial Liability", *European Journal of Law and Economics*, 29: 333-357.

Note that these categories fit relatively well in the framework we have described above. Reasonably prudent judges can be virtually certain that they will not make any of these types of error.

Of course, we need to mention that broad immunities for judges come at a cost. Compared to a situation with full liability, judges may on average take less effort to reach good decisions. Also, there are other instruments available that may have some deterrent effect on judges.[50] First, in most jurisdictions, litigants can appeal against decisions which they consider erroneous. It is however unknown how strong the deterrent effect of appeals is. Judgments can be reversed also for minor defects, and they can even be reversed in the absence of an error (e.g. because of different political preferences between the initial judge and the appeal judge(s)). Note further that the possibility of appeals can even increase the number of erroneous decisions. If judges in the lower courts know that their mistakes can still be corrected by the higher courts, their conscience may be relieved when they take a hasty decision. Second, judges are in principle liable for the criminal offences they commit when performing their duties (e.g. bribery). Although criminal liability may create strong incentives, its scope is limited since it focuses only on intentional behavior of the judge. Third, there is the possibility of disciplinary liability which aims to maintain a minimum professional standard and prevent deviations from judicial deontology. While the scope of disciplinary liability is much larger than the scope of criminal liability, its deterrent effect is much lower. The initiative for the initiation of the procedure often rests with the Minister of Justice or the magistracy itself.[51] Furthermore, the body that needs to decide is often comprised of judges (solely or in majority).[52] Because of a strong sense of collegiality among judges, we may expect a rather low number of convictions. Also, except for severe sanctions like disqualification, the reputational costs of a conviction may be quite low because of limited publicity or because of confidentiality.[53]

Also Schäfer and Van den Bergh argue that the uncertainty concerning legal standards (for example in European law) is a strong argument to be very reluctant with a strict state liability. They argue in favour of a rule of "obvious negligence", since otherwise overdeterrence may occur.[54]

(2) Qualified immunity for civil servants

In many jurisdictions, civil servants enjoy qualified immunity. For example, in Belgium they can only be held personally liable in the event of intentional negligence, gross negligence or a

[50] See Tsaoussi, A. and Zervogianni, E.. 2010. Judges as Satisficers: a Law and Economics Perspective on Judicial Liability. European Journal of Law and Economics. 29: 333-357.

[51] See e.g. Wagner, G. (2006). The civil, criminal and disciplinary liability of judges. National Report: Germany, XVIIth congress of the international academy of comparative law, Utrecht, 16–22 July 2006; Canivet, G., & Joly-Hurard, J. (2004). La déontologie des magistrats. Paris: Dalloz; Verde, G. (1999). The Italian judicial system. Available online at: <http://www.csm.it/documenti%20pdf/sistema%20giudiziario%20italiano/inglese.pdf>.

[52] See Kerbaol, G. (2006). La responsabilite´ des magistrats. Paris: Presses Universitaires de France; Verde, G. (1999). The Italian judicial system. Available online at: <http://www.csm.it/documenti%20pdf/sistema%20giudiziario%20italiano/inglese.pdf>.

[53] Schuck, P. H. (1989). Civil liability of judges in the United States. American Journal of Comparative Law, 37, 655–673.

[54] Schäfer and Van den Bergh, *European Law Review*, 1998.

frequently occurring normal negligence.[55] In many US states, firefighters enjoy immunity for firefighting mistakes (for emergency situations), as long as they did not involve gross negligence or wanton or willful conduct.[56]

What is the purpose of these immunities? We can see this by examining what would happen in the absense of such immunities. An official (e.g. a policeman, a firefighter etc.) can often cause damage that is far beyond his or her financial means. This damage may be caused even by a slight mistake, a memory lapse etc. Without immunity many risk-averse officials will invest a portion of their earnings in a third-party insurance to overcome the possibility of losing his wealth by such faults. By paying a premium, the uncertainty about future income is removed. However, if every single official has to buy his own insurance policy, the transaction costs will be quite high. It may be cheaper to let the public authority take out insurance for all officials and reduce the wage by the amount of the premium, or to let the public authority to insure itself. In these cases, the transaction costs would be a lot smaller or fall away altogether. Note that without immunity, it will be necessary to compensate the official for the risk he's taking (a small, unintentional mistake may lead to huge claims) in the form of a higher wage. For some functions that could give rise to very serious claims, this increase in wage may be quite substantial. This higher wage may especially attract individuals who overestimate their own capabilities. This can be seen as a form of the "winner's curse". Those individuals who make the largest errors about their own capabilities, are most likely to try to obtain the job with the higher wage.

So the economic rationale for qualified immunities seems to be the savings of transaction costs. However, this immunity also tackles the chilling effect to some extent. As we have argued above, without immunity, risk-averse government officials will take insurance. However, to avoid problems of moral hazard, insurance coverage will seldomly be complete. Most insurance contracts include some form of co-insurance (deductibles etc.). Also, premia may increase after a civil servant has been convicted of (even the slightest) negligent behavior. To prevent all this, civil servants may engage in chilling behavior. For example, in the absence of immunities, civil servants may take too much time and effort to check whether certain conditions are fulfilled to grant a permit.

Of course, there is a downside to these qualified immunities. The immunities may reduce the incentive of some civil servants to behave cautiously. There is thus a risk of moral hazard. However, the scope of the immunities may reduce this risk significantly. For example, as we have seen in Belgium, there's no immunity for frequently occurring negligence. Also, civil servants may face other sanctions which may have some deterrent effect.[57]

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[55] See Tison, M. Belgium. In van Dam, C. Aansprakelijkheid van Toezichthouders. Deel II. Achtergrondstudies, WODC, Ministerie van Justitie, 2006, via http://wodc.nl/onderzoeksdatabase/aansprakelijkheid-van-toezichthouders-met-publieke-taken.aspx.

[56] See for instance N.C.G.S. 58-82-5(b) – North Carolina (immunity to firefighters and fire departments at the scene of reported fires unless gross negligence, wanton conduct or intentional wrongdoing); M.C.L.A. 41.711a – Michigan (immunity for firemen rendering emergency care, unless gross negligence or willful and wanton misconduct); La. R.S. 37:1735 and La. R.S. 37:1732 – Louisiana (immunity for firefighters who render emergency or rescue services unless grossly negligent); Ala. Code 1975 § 6-5-335 – Alabama (immunity for firefighters during fire unless wanton misconduct); O.R.C. 2744.02 – Ohio (immunity for fire department for traffic accident at a fire, proceeding toward a fire or answering any other emergency alarm, unless willful or wanton misconduct).

[57] Note however that there are often obstacles in the way of channeling responsibility through the employment contract. For example, a reduction in the salary as a consequence of causing an accident might not be allowed.

b. May dilute the incentives of potential victims

If public authority liability would fail to provide correct incentives to civil servants it may in the end increase the accident risk.[58] In so-called bilateral accident situations, e.g. where both the potential injurer and the potential victim can influence the accident risk public authority liability may induce potential victims to take less precautions since they count on being compensated by the public authority.[59] Of course the usual mechanism to deal with this potential moral hazard on the side of the victim is to introduce a contributory negligence rule. Such a rule leads to a reduction of the compensation for the victim to the extent that the victim contributed to the loss.[60] Take the example of a bad road: normally victims, being aware of the bad state of the road, should take more care and drive slowly to prevent an accident. Public authority liability for failure to maintain the road may dilute the incentives of victims for taking proper care. Of course this problem only arises in so-called bilateral accident situations. If the accident is one of so-called unilateral precaution (where only the injurer, e.g. the public authority can take efficient care to prevent the accident) victims cannot take efficient measures to reduce the accident risk and the moral hazard problem does not arise.[61]

c. May lead to less monitoring or a cover-up (in case of strict vicarious liability)

Arlen (1994) has argued that corporate criminal liability, or more generally vicarious liability of firms for their agents' intentional wrongdoing, can generate perverse incentives.[62] Her argument is that when the misconduct of the agent is difficult to detect, the firm will have a substantial advantage in monitoring the behaviour and finding out the wrongful acts. However, under a vicarious liability regime the corporation may not have optimal incentives (or none at all) to monitor the behaviour of its agent since finding out a mishap can potentially lead to its own liability, thus raising the firms expected liability costs. A similar perverse effect could equally arise under public authority liability: given that supervision and control can provide evidence against the public authority and lead to liability, such liability may provide a disincentive to monitor and an incentive to cover up misbehaviour by officials. Note however that this is mainly an argument which arises in case of strict vicarious liability, but not necessarily in case of a duty based liability system (based on negligence).

[58] Dari-Mattiacci, Garoupa and Gomez-Pomar, 6.
[59] Dari-Mattiacci, Garoupa and Gomez-Pomar, 19.
[60] We provide here the usual European legal interpretation of contributory negligence, in which case the compensation to the victim (under negligence of the tortfeasor or under strict liability) is only reduced to the extent that his fault contributed to the loss. A traditional American interpretation of contributory negligence is that the claim of the victim would totally fail under contributory negligence.
[61] There is another aspect of moral hazard which is not so much an argument against public authority liability, but rather an argument against settlements: politicians may want to minimize the embarrassment or political costs resulting from public authority liability. Hence, they may have incentives to settle rapidly, providing the tax payers with the bill of the settlement. See Dari-Mattiacci, Garoupa and Gomez-Pomar, 18. This is hence not an argument related to a potential moral hazard on the side of victims, but rather on the side of politicians. If that moral hazard problem arises it would be an argument to limit the possibilities of settlement with the public authority. See Dari-Mattiacci, Garoupa and Gomez-Pomar, 31-32 for a critical discussion of this argument.
[62] Jennifer H. Arlen, The potentially perverse effects of corporate criminal liability, Journal of Legal Studies, 1994, vol. 23, 832-867.

d. Litigation costs

Although tort liability for a public authority may have several benefits (e.g. deterrence), any liability system also entails litigation costs. Litigation costs may serve as an argument against public authority liability, but only when these costs outweigh the benefits. Unfortunately, there's no decisive empirical evidence available.

e. Aggravation of budget constraints

Posner and Sykes (2007) explain that public authority liability remains in a way a vicarious liability system which should provide the state an incentive to control the behaviour of civil servants of whom they can monitor the behaviour. After all, it is not the public authority itself that acts. Ordinary people act on its behalf.[63] A basic assumption in a vicarious liability system like public authority liability is that the public authority subsequently has an *ability* to monitor their civil servants and correct their behaviour. For a variety of reasons however, the possibilities for such monitoring may sometimes be rather limited.[64] In these cases, the public authority may be left with a finding of liability and a duty to compensate whereas the positive effects (providing better incentives for behaviour) may be doubtful. The accident costs which as a result of liability fall on the public authority will lead to further budget constraints, but not necessarily for the activity which produced the accident.[65] The budget constraint may also affect other activities of the public authority which could have been socially beneficial.[66] [67]

f. The case of supervision: public authority liability may reduce incentives of the supervisee

A potential disadvantage of supervisor liability is that the supervisee might be inclined to become less careful, in the knowledge that he is watched by the supervisor. The thought process of the supervisee may go as follows: "If I take less care and this leads to a potentially negative situation (e.g. the house of the supervisee collapses; the airplane of the supervisee crashes etc.), there are two possibilities. Either the supervisor corrects me, and then I adopt the necessary changes. Or the supervisor doesn't correct me, and then there's a chance that the supervisor will also be held negligent if something goes wrong. In such a case I don't have to pay the full damage". Of course, whether a supervisee will actually behave like this (and the extent of it), depends on many factors, like how easy it is for the supervisor to detect suboptimal behavior of the supervisee ex ante, whether there are significant administrative or criminal sanctions available when the supervisor detects less than optimal behavior, whether suboptimal care of the supervisor is verifiable ex post, whether there is a rule of comparative negligence or contributory negligence, whether the supervisee could be personally hurt etc. In general, we shouldn't expect the moral hazard problem to be so great that supervisory liability should be abolished completely. To preserve the incentives of the supervisor, there should at least be liability for intentional harm and for gross negligence. The argument for simple negligence for the supervisor however is weaker, and this is true not only because of a

[63] Posner and Sykes 2007, 74.
[64] Posner and Sykes 2007, 87.
[65] Dari-Mattiacci, Garoupa and Gomez-Pomar, 6.
[66] Indeed, if incentives fail with respect to care, they could also fail with respect to the level of activity.
[67] On the other hand Dari-Mattiacci, Garoupa and Gomez-Pomar also argue that liability payments divert public funds from other activities that are politically more profitable for the incumbent government into compensation awards and legal costs, which can hardly be seen as vote gainers (Dari-Mattiacci, Garoupa and Gomez-Pomar, 16). This would again point at the positive effects of public authority liability in providing (political) incentives to politicians to avoid public authority liability.

potential moral hazard problem. If the government is liable even for small errors, in the end these costs may still be borne by the supervisees, for example through fees. This comes down to a sort of compulsory insurance system. Perhaps some firms would have preferred to self-insure, but this will not be possible if the supervisor is liable even for very small mistakes. Note that the case of excluding liability for small mistakes *towards third parties* (others than the supervisee) may be quite weak. These third parties often do not have any influence on the occurrence of a negative event (little risk for moral hazard) and the government may also be the better risk bearer towards these third parties.

II. Liability for unlawful conduct or fault

Building further on the fundamentals of the economic analysis of public authority liability described above, we can now address a few more specific issues from the questionnaire related to liability for unlawful conduct or fault.

A. Basic principles and B. Definitions

One of the fundamental theories of the economic analysis of tort law is the Learned Hand formula. According to this formula developed by Judge Learned Hand[68], a tortfeasor should be held liable if he didn't take a precautionary measure whose cost was less than the reduction in expected harm that would have resulted from taking this measure. If C is the cost of prevention, P the reduction in the probability of harm due to the precautionary measure and H is the harm in case of an accident, then the tortfeasor should take the precaution if $C < P \times H$. A tortfeasor should be held liable if he didn't take the precautionary measure while $C < P \times H$, no matter how small the difference between C and P x H is. In other words, a tortfeasor should be liable even for the slightest fault.

In a world with perfect information, courts should apply this formula to a public authority as well, without exceptions. As discussed before however, uncertainty in determining optimal standards and the fact that public authorities have to be considered as multi-task agents, make things more complex. Since a multi-task agent has to balance various *external* costs, there is a serious danger that such an agent will take too much precaution.[69] Consequently, negligence rules for multi-task agents (like public authorities) should be more precise and predictable. This means that negligence regimes will often take the form of gross negligence or recklessness for multi-task injurers, or that some discretion will be granted (see further). These norms have the characteristics of minimum norms and are therefore more predictable norms.[70]

However, a difference should be made when officials violate a clearly defined norm which removes any degree of choice. De Geest presents the example of an agency that issued a licence for an all-round polio vaccine without first receiving test data that the manufacturer must submit according to the law. The plaintiff alleged that thereby the bureau violated its own clear standards of testing all vaccine lots. This is a case where no immunity would exist and liability would hence be accepted.[71] The same would be the case when agencies make a policy choice that no reasonable person could ever make. The example he provides is the decision to offer a service but do it negligently. It considered the case of the US coastguard

[68] See *United States v. Carroll Towing Co.* 159 F.2d 169 (2d. Cir. 1947).
[69] De Geest, 3.
[70] De Geest, 3-4 and a formal analysis in 11-14.
[71] De Geest, 23.

who decided to provide a particular lighthouse service as a result of which it was obliged to keep it in good working order once it had decided to provide the service. Once it announced the lighthouse service and ships started to rely on it, it seems clearly unreasonable not to maintain it properly.[72]

When there are hence clearly defined norms (either statutory norms, or policies or guidelines) which are violated, the arguments for deviations from the general principles of tort law disappear. The reason is obviously that when a clearly defined norm exists the uncertainty problem is then indeed eliminated.

Next we consider the question whether in establishing liability, the test should be the unlawfulness of the conduct or the fault of whoever was responsible for it. From an economic perspective, *ideally*, fault should be the key issue, not unlawfulness. An example may illustrate this. Suppose a civil servant has to take a decision in 1000 (e.g. building) cases each year. In each case, he needs to check whether the 10 specific regulations are complied with. It may very well be that it's economically optimal that the civil servant invests his time and effort in these cases until there will be on average 995 cases decided correctly, and 5 not. It may thus be the case that further investments by the civil servant are not socially desirable, even though they could still reduce his error rate. This will be the case when the benefits of further investments (reduced error costs) are smaller than their costs (extra time, effort etc.). So even when the civil servant behaves optimally (no fault), there may still be an unlawful decision on his part (e.g. on average 5 in 1000). Now there are two possibilities: either the amount of time and effort the civil servant spends on his tasks are verifiable for the courts, or either they are not. In the former case, the courts can simply check whether the civil servant acted negligently or not. Even though the conduct may have been unlawful, it could very well be that he didn't make a fault. In the latter case, unlawfulness should generally lead to the conclusion that there has been a fault. The alternative would be not ever to hold the civil servant liable, because he could always claim that the unlawfulness was a mere accident (occurring 5 in 1000 times even when he behaves without fault). In other words, when behavior is not verifiable (at all), it may be wise to assimilate unlawfulness with fault, to preserve incentives. Otherwise put, this comes down to creating a pocket of strict liability into the negligence rule.[73]

C. Discretion and Justiciability

A general feature of multi-task agents like public authorities is that they make discretionary decisions. Discretion in this particular context means a balancing. De Geest (2011) provides the example of fire-fighters who balance the damage caused by water (costs of the intervention) against damage caused by the fire (costs of omission). Both costs are externalised by the fire-fighter. In general for discretionary decisions, several costs (or benefits) have to be balanced in order to choose the policy that (hopefully) minimises the costs or maximises the benefits for society.[74] Decisions by public authorities as multi-task agents often require a balancing and they are hence qualified as "discretionary decisions". In addition to the example of the fire-fighter one can also refer to the example of an

[72] Ibidem.
[73] This is an application of the theory of Grady (1988). See Grady, M.F., "A new positive theory of negligence", *Yale Law Journal*, vol. 1992, 1983, 799-822; Grady, M.F., "Discontinuities and information burdens: review of the economic structure of tort law by William M. Landes and Richard A. Posner", *George Washington Law Review*, vol. 56, 1988, 658 ff. and Grady, M.F., "Untaken precautions" *Journal of Legal Studies*, vol. 18, 1989,139-156.
[74] De Geest, 20.

administrative agency that has to decide on approving a particular drug: it has to balance the potential costs of not allowing the drug (losing the beneficial effects of the drug and hence more illnesses which cannot be prevented) against yet another external cost (the potential danger of side effects or other negative effects resulting from the use of the drugs).

Latitude is often given to public authorities in the exercise of their discretion. The idea is that public authorities making discretionary decisions must balance the different interests affected as they think fit. It is quite generally accepted that the courts should not always review this process by imposing liability. For example, in 1945 in the US, the Federal Tort Claims Act (28 U.S.C. 1346) introduced governmental liability for common law torts against federal officials. One important exception in that Act is the "discretionary function exception" (28 U.S.C. 2680). The Act does not define what discretionary activities are, so the courts have attempted to define the concept. Generally, discretionary acts are of a "judgemental, planning, or policy nature".[75] "Ministerial activities", which merely involve the execution of set tasks, do not enjoy this immunity.

This immunity for discretionary acts is in accordance with the uncertainty framework we have described above. When there's no room for discretion (the law specifies the precise actions the official must take), there's no uncertainty on behalf of the government official and no need for immunity. When the law fails to specify the precise action that the officer must take, there's room for uncertainty and a chilling effect may result in the absence of immunity. However, this does not imply that discretionary duties should always be immune from tort liability. When an official (or agency…) makes a policy choice that no reasonable person would ever make, there should be no immunity. This exception will not lead to chilling behavior.

D. Individual and Institutional Liability

1. Agent immunity and vicarious liability of the public authority?

Economic theory has argued that under some conditions, the division of liability between the public authority and its agents does not matter from the perspective of efficiency.[76] These conditions are: (1) The employee has sufficient assets to pay any conceivable judgment against him in full; (2) There is no difficulty in identifying the employee who caused the harm; and (3) the transaction costs of contracts that include terms to allocate liability between the public authority and the employee are small. The intuition behind this proposition is very simple. Suppose that an optimal allocation of liability between the public authority and its employee exists for each possible accident. Such an allocation will take into account differences in risk aversion and the moral hazard associated with shifting liability away from the active wrongdoer. When transaction costs are low, regardless of the initial locus of liability, the public authority and its employee can reconstruct this optimal allocation by an appropriate provision in the contract between them.[77] Consequently, the employee will face

[75] See e.g. Valanzuela v. Snider, 889 F.Supp 1409, 1422 (D.Colo. 1995)
[76] See Kramer, Larry and Alan O. Sykes. 1987. Municipal Liability Under §1983: A Legal and Economic Analysis. Supreme Court Review 249, 249-301.
[77] This is of course an application of the well-known Coase theorem (Coase, R.H., "The problem of social cost", *Journal of Law and Economics*, 1960, 1-44).

the same incentives for care, the public authority will face the same incentives to monitor, and each party will face the same risks. Conditions one and two ensure that the total amount paid to the plaintiff by the public authority and the employee remains the same (with or without liability for the public authority). Thus the renegotiated agreement in a system of personal and public authority liability can exactly replicate the division of liability agreed to by the public authority and the employee in the absence of public authority liability (but with personal liability).

Of course, the conditions required for this benchmark case will not hold in many settings. First, at times it may be impossible for an injured party to identify the government employee that caused the harm. Second, many employees do not own enough personal assets to pay anything more than the most modest tort judgments awarded against them. Third, various transaction costs of contracting may prevent the public authority and its employees from allocating liability between them in an optimal way. In these cases, the locus of liability may matter a lot.

We now look at the differences between personal liability (only the civil servant can be held liable) and vicarious liability (also the public authority can be held liable if a civil servant acted negligently) when the civil servant is judgment proof or when it's difficult to identify the civil servant who caused the harm. Personal liability allows the public authority to externalize the costs of its activities by passing off all or part of the losses occasioned by the commission of a tort onto the victim. One may wonder why the public authority would have an incentive to actually externalize costs. Some may think that we may expect such behavior from private firms, but not from the public authority who is not motivated by the desire to maximize profits. However, this argument is flawed. As argued before, the public authority (or more accurately, its officials) can be motivated be the desire to provide public services at minimum cost, since many officials confront demands for both increased levels of public services and lower taxes. So also for the public authority there may be powerful incentives to take advantage of the opportunity to externalize liability.[78] We now examine the consequences of this potential to externalize costs. First, it may lead to inadequate incentives to take precautions against wrongdoing. Civil servants may exercise too little care in performing their duties. Also, the incentive of the public authority to institute supervision, monitoring and training may be diminished. In theory, also the opposite problem could occur: risk-averse civil servants may exercise inefficiently high levels of care. However, we are focusing on cases for which there's no economic rationale for immunity. These torts involve intentional harms or reckless behavior and usually reflect indifference to well-settlled legal requirements. Most of these torts are easily avoidable. Few civil servants need fear that they will accidentally commit them. So the problem of inefficient high levels of care is largely academic under these circumstances. We now turn to a second consequence of the potential to externalize costs: inefficiency in risk allocation. The costs of injuries will fall on the victim and the individual wrongdoer, who are often risk averse. The efficiency of risk bearing can be improved by shifting the risk to a less risk-averse entity. Note that first-party insurance is not always a satisfactory method of risk distribution: not all torts are insurable in the insurance market (e.g. loss of liberty and income due to unlawful confinement). Third, externalization of costs may increase the scale of activity of the public authority. However, it's unclear whether this is inefficient or not. The reason is that there's no generally accepted theory of how the scale of public sector activity is determined. Some theories predict that the scale of government activity will tend to be inefficiently small, and some predict the opposite.[79]

[78] See Kramer and Sykes (1987), p. 279.
[79] See Kramer and Sykes (1987), p. 282.

We now analyze how vicarious liability may change things. First, vicarious liability can motivate the public authority to adopt cost-effective measures to reduce the incidence of misconduct. These measures can include better training programs, improved incentive schemes (penalty/reward), greater supervision of employees etc. However, if the transaction costs of these measures are high, the government may decide not to take them. In such a case, vicarious liability may have a serious downside. Under vicarious liability, successful plaintiffs tend to collect their judgments from the public authority (who has deep pockets), even if the individual wrongdoer remains liable. But if the individual wrongdoer does not bear the cost of his wrongdoing, his incentive to avoid misconduct will decrease. In other words, when transaction costs are large, vicarious liability may insulate potential wrongdoers from liability. Clearly, the economic benefits of vicarious liability are greater, the smaller the transaction costs to the public authority of creating effective incentives for civil servants to avoid wrongdoing. Second, vicarious liability may not only affect incentives, it also has implications for the distribution of risk. Generally, vicarious liability will ameliorate the inefficient allocation of risk that would result under a rule of personal liability. The public authority is typically a superior risk bearer that can distribute the risk among the broad taxpaying public. Third, the greater cost internalization under vicarious liability can reduce the scale of government activity. However, as argued above, we don't know whether this is a good or bad thing.

2. Immunity for the agent: should the immunity extend to the public authority?

Above we have already seen that civil servants in many countries enjoy a qualified immunity and that judges generally enjoy broad immunities. Now the question rises: should the state enjoy the same immunity as its agent? Does the economic rationale for agent immunity equally apply to the public authority? Do other arguments argue in favor of state immunity?

Unlike in the previous section, making the public authority vicariously liable cannot lead the agent to exercise less care. The reason is that the agent is already immune. So adding a deep-pocket defendant (the public authority) does not alter the incentives of the agent. Next, vicarious liability can motivate the public authority to adopt cost-effective measures to reduce the incidence of negligent conduct. We should, however, refer to the discussion above, explaining that one of the disadvantages of public authority liability is that the deterrent effect of liability rules may not work because the principal (the public authority) may lack an adequate chain of command to control the agent (the civil servant). In this respect Posner and Sykes note that there are important differences between vicarious liability for corporations (employers for their employees) on the one hand and for a public authority on the other hand. For example imposing vicarious liability on firms may lead to a disintegration of firms to avoid liability; this is of course not an option for a public authority.[80] Also, the firms have the possibility to increase the salary for employees that would have to pay fines. Such a possibility may not exist within public administrations, where increasing salaries is bound to specific rules. The fact that actual compensation for employees would not be possible may also create a risk of adverse selection since the public service would then only become attractive for lower qualified staff.[81] The problem therefore arises that it may not be possible to remedy problems due to failures in the chain of command.[82]

[80] Dari-Mattiacci, Garoupa and Gomez-Pomar, 24.
[81] Dari-Mattiacci, Garoupa and Gomez-Pomar, 25; obviously this is rather an argument against individual liability of the civil servant and hence in favour of an immunity for the agent.
[82] Dari-Mattiacci, Garoupa and Gomez-Pomar, 25-26.

Although vicarious liability may motivate the public authority to adopt cost-effective measures to reduce the incidence of negligent conduct, it's also possible that the public authority will engage in inefficient self-protective behavior. For example, it may give instructions to civil servants that permits should not be granted as soon as there's a possibility, no matter how small or remote, that the underlying activity could cause harm. Indeed, such behavior is by no means unique to a regime of personal liability. The emergence of self-protective behavior may justify governmental immunity just as its emergence under personal liability may justify individual immunity (see Kramer and Sykes, 1987, p. 300). So when the risk of self-protective behavior is large, immunity of the public authority may be a wise option. Here we can refer to our discussion of discretionary decisions.[83]

Turning from incentives to risk, one advantage of public authority liability may be a better risk allocation. Generally, a public authority is a better risk bearer than the injured party. However, risk sharing benefits may not suffice to justify the imposition of civil liability on the public authority: there may be alternative mechanisms available that redistribute the risk far more cheaply than the costly litigation system.[84]

E. Range of Application

We have previously argued that the chilling effect may provide a rationale for government immunities. The chilling effect is highly dependent on the level of uncertainty. So logically, when there's a lot of uncertainty, there should be broad immunities. According to De Geest (2011), this explains why legislators often have absolute immunity: "… for some functions, the set of minimum norms may be virtually empty-that is, it may be impossible to define a set of decisions that all reasonable persons believe to be clearly wrong. This may indeed explain why members of congress and the US President enjoy "absolute immunity": Their job is making policy decisions, and the set of policy decisions they could realistically make that all reasonable persons consider unreasonable is virtually empty… The point is that in a modern democracy with many checks and balances it is nearly impossible to make policy decisions that 99 % of the people find manifestly unreasonable.

Put briefly, the starting point should be that public authority liability should extend to all public bodies. However, depending on the extent of uncertainties that these bodies face, broad or narrow immunities may enhance social welfare.

F. Violations of Human Rights

From an economic perspective, one important problem with violations of human rights is the fact that it can be hard to quantify the damages suffered because of these violations. In those cases where tort law has a deterrent effect, setting damages too low may weaken this deterrent effect.

[83] Regarding the judiciary, we can say the following. In almost all countries, judges enjoy broad (though not complete) immunities. In some countries like the United States, the injured party may also not recover damages from the state in case of judicial misconduct. In other countries, like Belgium and France, the state is required to compensate damages caused by defective judicial services. So the question is: what are the pros and cons of immunity on the level of the state? As in the previous section, state liability may lead to a better risk allocation. However, the advantages of risk sharing will only be relevant in the absence of other, cheaper mechanisms to redistribute the risk of legal error.

[84] An obvious alternative would either be first party insurance by victims or a compensation fund.

G. Defences

Defences that the claimant failed to exhaust all available appeals, complaint, procedures etc. before claiming on the basis of public authority liability can make sense from an economic perspective. First, using appeals, complaints etc. will often mitigate the loss of the victim. Allowing a defence that the claimant failed to exhaust all procedures will thus give the victim an incentive to mitigate his losses. Second, these procedures can produce valuable information, which the court can then use to determine whether or not the public authority should be held liable.

H. Special Categories of Case

Some countries like Germany, England and Belgium have introduced immunities for financial supervisors through statute. For Germany, the *Finanzdienstleistungsaufsichtsgesetz* has introduced a general immunity (for the *Bundesanstalt für Finanzdienstleistungsaufsicht*).[85] In Belgium (Commissie voor het Bank- en Financiewezen; Controledienst voor de Verzekeringen) and England, liability is not entirely excluded. In Belgium, liability is limited to cases of intent and gross negligence.[86] In England, liability is only possible for cases of bad faith or breach of the Human Rights Act of 1998.[87] These immunities can be seen as a measure to prevent chilling effects. Financial supervisors often have to weigh delicate interests. If a financial institution has problems and the financial supervisor reacts too strict, this can create substantial harm to the financial institution under supervision. For example, the market can get a wrong signal, with a loss of credibility as a consequence. It will often (but of course not always) be better to follow a more lenient strategy, but of course in some situations this can backfire, and without immunity the financial supervisor could be held liable for the damages, which can be enormous.[88] Without immunity, financial supervisors would be often inclined to take too strict measures, at least if they won't have to pay for the consequences of these measures.[89]

III. Liability for Lawful Conduct

A. Principles and B. Justifications

As the questionnaire makes clear conduct should be considered lawful if it complies with all relevant legislative requirements and is pursued with reasonable care even if it in fact causes harm. If liability were to be found in this particular case it would amount to a strict liability of the public authority. As De Geest (2011) shows, for multi-task agents (like public authorities) strict liability leads to overprecaution. The reason is that strict liability for harm internalises the harm, but not the precaution costs which are externalised by a multi-task agent.[90] From an economic perspective, this is a serious economic disadvantage of imposing strict liability on public authorities.

[85] Gesetz die integrierte Finanzdienstleistungsaufsicht, 22 April 2002, BGBL 2002, I, blz. 1310 ff.
[86] See Art. 68 Wet van 2 augustus 2002 betreffende het toezicht op de financiële sector en de financiële diensten, B.S., 4 september 2002.
[87] See Shedule I section 19 (3) Financial Services and Market Act 2000.
[88] See for example L. Wynant, De aansprakelijkheid van overheidstoezichthouders, Rechtskundig Weekblad 2003-2004, p. 1570 e.v.; H. Mc Lean, Negligent regulatory authorities and the duty of care, Oxford Journal of Legal Studies, 1988 vol. 8, nr. 3, p. 450.
[89] Note that it will often be difficult to prove that the supervisor acted too strict.
[90] De Geest, 3 and 10.

Next, one could argue that a public authority is a superior risk bearer compared to most victims. However, the fact that private insurance is usually available may significantly weaken this argument.[91] Furthermore, it has been stressed in the literature that public authority liability as a compensation mechanism may be far too costly given high litigation costs of the tort system. If compensation is the goal to be achieved, this can better be realised via alternatives such as (state provided) insurance or a public compensation mechanism. The transaction costs of those mechanisms may be lower than a costly liability system for lawful conduct.[92]

IV. Conclusions

In those cases in which tort law has a deterrent effect, public authority liability can be efficient. The chilling effect of liability may necessitate some exceptions, but these exceptions should not go further than necessary to prevent this effect. A partial immunity, one that makes allowance for ordinary negligence, may be desirable. However, the chilling argument does not apply to bad faith behavior or gross negligence. Also, the case for immunity will be weaker when chilling behavior can be easily detected and sanctioned. Also, discretionary duties should not always be immune for tort liability. When an official (or agency…) makes a policy choice that no reasonable person would ever make, there should be no immunity.

[91] Indeed, in many legal systems liability insurance for public authorities is widely available. For an overview see C. van Dam, *Aansprakelijkheid van Toezichthouders*, WODC, p. 158-159, via <wodc.nl/images/1189_deel1_volledige%20tekst_tcm44-59297.pdf>.
[92] Dari-Mattiacci, Garoupa and Gomez-Pomar, 17.