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# **Empirical Research on the Civil Justice System: Current Findings from Law and Economics**

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14 January 2006

# Empirical Research on the Civil Justice System

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- Largely shaped by Coase theorem (1960): in the absence of transaction costs, any well-specified allocation of legal rights is efficient, because interested parties will bargain to assign rights to those who value them the most
- Two big questions: when the Coase theorem does not hold,
  - How large are efficiency losses?
  - What legal rules are second-best efficient?
- Review empirical research on three areas of law: contract, property, and tort

# Empirical Research on the Civil Justice System

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- Not discussed today: research on litigation process
  - Rules allocating attorneys' fees: under what circumstances is "loser pays" optimal?
  - Rules governing class actions: under what conditions is it optimal to allow an attorney to compel small claimants to be aggregated into a class represented by the attorney?
  - Alternatives to litigation: arbitration and mediation
- For details and specific citations, see my chapter in the Handbook of Law and Economics with Daniel Rubinfeld, also available as NBER Working Paper 10825

# **Contract: importance of failures of Coase theorem**

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- Litigation costs in contract law, as measured by “procedural formalism,” have significant effects on measures of efficiency such as time to resolve a claim (Djankov et al. 2003)
- However, when the official system imposes high litigation costs, or parties have low private bargaining costs (e.g., ongoing relationships), unofficial extra-legal systems of contract supplant the official system to mitigate this effect
  - Bernstein (1992, 1996): diamond merchants, grain and feed
  - McMillan and Woodruff (1999): manufacturing in Vietnam

# Contract: second-best efficient legal rules

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- When there are both litigation and private bargaining costs, assignment and mechanisms for enforcement of contract rights affects efficiency:
  - Default rules that fill in the gaps in incomplete contracts can enhance efficiency because of network effects in interpretation of contract terms (Kahan and Klausner 1997)
  - Mandatory contract terms can enhance or reduce efficiency (contrast Rice 1992 with Ayres 1995)
  - Official systems can crowd out unofficial systems, leading to smaller gains than would otherwise be obtained (Kranton and Swami 1999)

# Property: importance of failures of Coase theorem

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- Poorly defined property rights reduce efficiency and economic growth
  - Cross-national studies (Barro 1991; Keefer and Knack 1997; Norton 1998; LaPorta et al. 1999)
  - Geographic-area studies: Africa (Migot-Adholla et al. 1991); Ecuador (Lanjouw and Levy 1998); Native North Americans (Demsetz 1967, Anderson and colleagues)
- Unofficial extra-legal systems of enforcement can supplement official systems (Ellickson 1991: US cattle ranchers), although there is not as much evidence of this in property as in contract law

# Property: second-best efficient legal rules

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- As in contract law, when there are both litigation and private bargaining costs, assignment and mechanisms for enforcement of property rights affects efficiency:
  - Efficient assignment of property rights in shared resources trade off magnitude of external effects with litigation and bargaining costs: Fisheries (Grafton et al. 1996, 2000); Air resources (Joskow et al. 1998); Parking (Epstein 2001)
  - Enforcement of property rights by injunction is less efficient than enforcement with tort-like liability rules when there are hold-up problems and other transaction costs (Miceli and Sirmans 2001: real estate)

# Tort: importance of failures of Coase theorem

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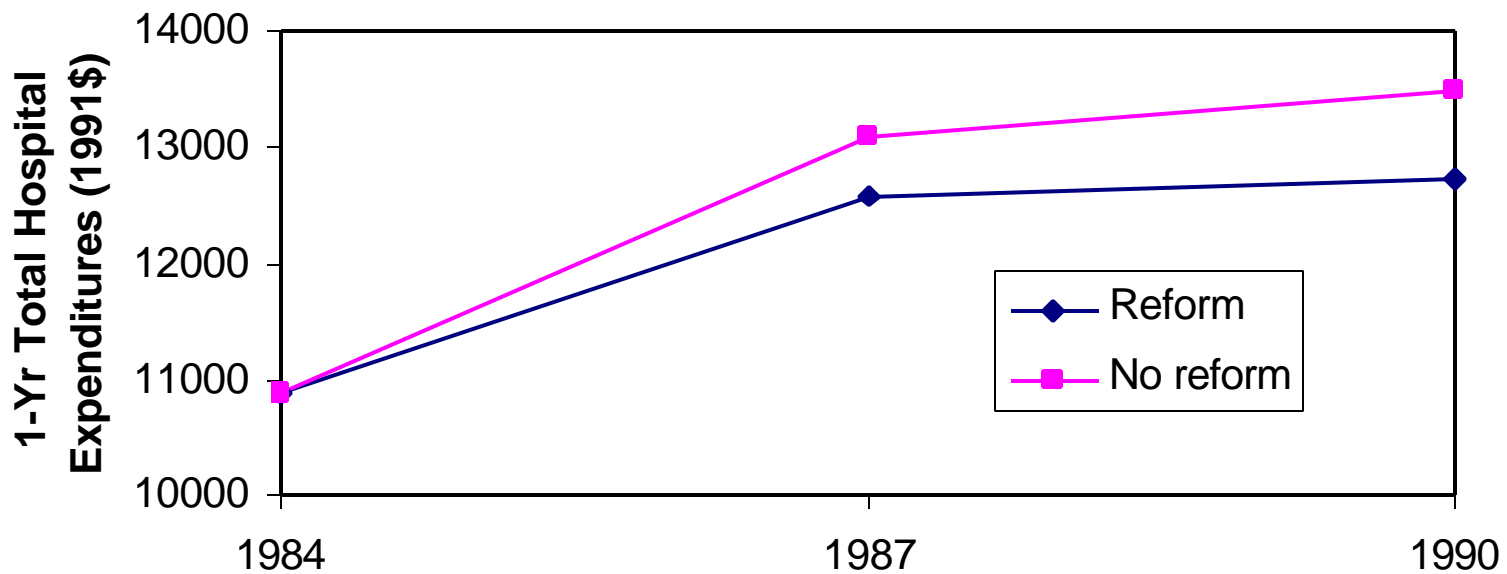
- Inefficiencies from tort law due to failures of the Coase theorem are important in three situations:
  - Auto accidents, because of the volume of legal claims (Urban Institute 1991: US \$100bn/year)
  - Products liability, because spillover effects of innovation, combined with bargaining costs, mean small changes in litigation costs and assignments of liability can lead to large changes in investment decisions (Viscusi and Moore 1993)
  - Medical malpractice, because failure of patients or physicians to bear full costs of treatments mean small changes in litigation costs and assignments of liability can lead to large changes in behavior (Kessler and McClellan 1996, 2000)

## Tort: second-best efficient legal rules

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- For auto accidents, the debate is between no-fault and tort: no-fault would reduce transaction costs by 40 percent (= US\$13bn/year), but would also weaken financial incentives for careful driving and increase accidents (Sloan et al. 1995, Cohen and Dehejia 2003)
- For products liability and medical malpractice, the debate is over the extent to which reductions in liability (through, e.g., limitations on non-economic or punitive damages) increase or decrease productivity and innovation (products liability: Campbell, Kessler, and Shepard 1998; Viscusi and Moore 1993; medical malpractice: Kessler and McClellan 1996, 2000)

## Medical Spending, States With and Without Liability Reform, Elderly Heart Attack Patients



Source: Kessler and McClellan (1996)

## Health Outcomes, States With and Without Liability Reform, Elderly Heart Attack Patients

