
Do Not Federalize Tort Law

A Friendly Response to Senator Abraham

William A. Niskanen

Congress may soon pass the first major federal tort statute. Federalizing tort law would be quite inconsistent with the general devolutionary theme of the Republican agenda. The Republicans should trust their principles; federalizing tort law would also be a major mistake.

In March the House approved a broad bill that would limit damages in all civil cases, including those filed in state courts. The House bill would impose a cap of \$250,000 on noneconomic damage awards in most medical malpractice cases and would preempt state tort laws unless they are more stringent than federal provisions. The bill would also cap punitive damages in all civil cases at three times the award for economic damages or \$250,000, whichever is greater, and would eliminate joint and several liability in all civil cases.

In May the Senate approved a narrower bill limited to product liability cases, including those filed in state courts. The Senate bill would cap punitive damages in most cases at twice the award for compensatory damages or \$250,000, whichever is greater, allowing judges to waive the limit under specific conditions. The Senate bill would also eliminate joint and several liability.

William A. Niskanen is chairman of the Cato Institute and editor of Regulation.

As I write, the conference committee has yet to resolve the differences between the House and Senate bills, and an early floor vote is not anticipated. President Clinton has signalled that he is likely to sign some version of a tort reform bill.

May I first acknowledge that American tort law, especially as it has developed during the past 30 years, should be changed. Many victims are undercompensated, some victims receive outrageous awards, and the transaction costs are unduly high. Insurance premiums for medical malpractice and product liability have become a major burden without any significant incremental effect on health and safety conditions. Not all nationwide problems, however, demand national solutions. The problems of American tort law are serious and demand attention, but federalizing tort law would be a major mistake. Let me count the ways:

Congress May Lack the Authority to Make Tort Law

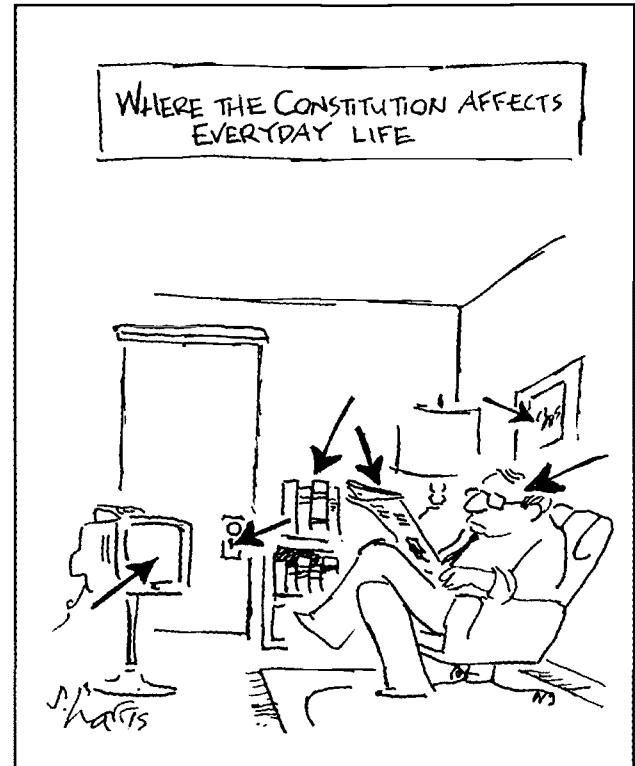
The Constitution authorizes Congress "To regulate Commerce . . . among the several States," a power first authorized and long interpreted as a protection against state barriers to interstate commerce. For the past 60 years until the recent *Lopez* case, however, the Commerce Clause was interpreted to authorize federal regulation of

almost any type of activity within individual states; Congress cited this broad interpretation of the Commerce Clause, for example, as the authority for federalizing much of the criminal code in 1994. The general issue, thus, is whether the Commerce Clause is to be interpreted narrowly or broadly. In the *Lopez* case, the Supreme Court ruled that the federal government lacks the authority to ban guns within 1,000 feet of a school on the basis that this condition constitutes neither commerce nor an interstate act. A majority of the current Court, however, would probably affirm federal regulation of an activity that has a substantial effect on interstate commerce, even if it does not represent a barrier.

For our present discussion, the specific issue is whether the developments in the common law and state statutory tort law are a barrier to interstate commerce or are merely a burden on all commerce. In the former case, there is no question of the federal authority. In the latter case, a federal tort law would probably be affirmed by the current Court, but not by a more strict constructionist Court.

Sen. Spencer Abraham (R-Mich.) addressed these issues this summer in a thoughtful article in the Heritage Foundation's *Policy Review*. Senator Abraham first acknowledges that "We must . . . limit intervention from Washington according to the principles of federalism and with an understanding that the potential risks of national intervention are always high." He makes the case for federal authority, however, on the basis that the burden of tort law constitutes a "litigation tariff." And he concludes that "the status quo is bad enough that congressional intervention . . . is quite unlikely to make it worse." On both issues, I respectfully disagree.

The cost of tort law is a burden on all commerce in a state, but it is not a specific barrier to commerce among the states. The effects are more like those of a retail sales tax on all products sold in a state than of a differential tariff on products imported from another state. The average effective liability tax rate is probably about 2.5 percent, but the effective rates differ substantially by product and by state. There is ample evidence that courts favor in-state plaintiffs over out-of-state defendants, but there is no evidence (to my knowledge) that the courts favor in-state defendants over out-of-state defendants. In the absence of evidence of relative discrimination against out-of-state defendants, there is no basis



for considering the cost of tort law to be a litigation tariff. The tort law or sales tax in a state may be unduly burdensome on commerce in that state, but that should not be sufficient basis for federal measures to harmonize either tort law or sales taxes.

My judgment, in addition, is that Senator Abraham underestimates the potential for Congress to make things worse. There are several serious concerns about the House and Senate bills by other than the trial lawyers. And the scope of the effects of mistakes by the federal government is much larger than that of the same mistakes by an individual state. More important, over time, federal mistakes are subject to a weaker corrective process than the evolutionary processes that affect the common law and state statutory law. (More on this issue is in the subsequent sections.)

In the end, it is not clear that Senator Abraham believes his own case. For example, he would allow states to opt out of the federal tort law for disputes between parties in the same state and to opt out of specific provisions of the federal law such as the cap on punitive damages and the ban on joint liability. In the near term, a federal tort law would change the law in ways some states might not otherwise choose. In the long term, a federal law with Senator

Abraham's opt-out rules is not likely to be different from the ways in which the common law and state statutory law would otherwise evolve. If current tort law is a barrier to interstate commerce, states should not be allowed to opt out of a federal law that protects against such barriers. If current tort law is not a barrier to interstate commerce, there is no constitutional authority for a federal tort law.

States Have a Strong Incentive to Improve Tort Law

The evolutionary process that shapes the common law and state tort law may be biased and slow, but it is powerful. A recent study by the prestigious National Bureau for Economic Research finds that changes in the rules of legal liability in a state have strong effects on the productivity and employment in that state. In "The Causes and Effects of Liability Reform: Some Empirical Evidence," Thomas Campbell, Daniel Kessler, and George Shepherd find that a reduction of liability increased productivity in 13 of the 17 industries studied. The adoption of one additional reform measure increased output per worker by up to 9 percent, depending on the industry. And increases in liability reduced productivity in 14 of the 17 industries.

The effects of liability rules on employment appear to be even stronger. A reduction of liability increased employment in 14 of 17 industries studied. The adoption of one additional reform measure increased employment by up to 25 percent, depending on the industry. And increases in liability reduced employment in 14 of the 17 industries.

The authors find that the causes of liability reform are more difficult to identify. Interestingly, the number of doctors or lawyers per capita has no apparent effect on the direction of change in liability rules. In general, the strongest correlates of liability change are measures of the partisan balance in the state legislature and the state's representation in the U.S. Senate.

Courts and state legislatures, of course, make many mistakes, even over a sustained period. Most of the costs of those mistakes, however, are borne by the employees, residents, and voters in that state. As a consequence, those mistakes are more likely to be corrected by a decentralized legal and political process than by the federalization of tort law. The major remaining concern, a

legitimate basis for federal attention, is whether there is any net bias against products imported from another state.

States Have Already Made Many Changes in Tort Law

The recent flurry of measures to restrict liability under tort law, in fact, is the third wave of such changes over the past two decades. For better or for worse, California is often the wave of the future. California courts were the first to promote a strict liability standard in the 1960s, but the legislatures of California and Indiana were the first to set a cap on medical malpractice awards in 1975. In the mid-1980s the focus of state legislative action shifted to product liability; more than 30 states tightened their rules on joint and several liability. On a national basis, the cost of tort law has increased sharply since 1984, and the current flurry of legislative measures includes a broader set of tort reforms. State legislatures have addressed more than 70 new tort law bills during their current sessions, and major reforms have been approved in six states. Most of the problems of our system of tort law are not due to lack of attention. As is often the case, federal politicians seem to be rushing to take credit for measures that are already being considered and, in some cases, have already been approved by state governments.

A Simple Federal Law Would Address the Remaining Problems

Manufacturers that sell in the national market have been the strongest supporters of federal product-liability bills. They have two concerns that are not likely to be addressed by the evolution of the common law and state tort law:

- Plaintiffs may file a product liability case in their state of residence, the state in which the alleged tort occurred, or the state in which the product is manufactured, depending on the venue rules in each state. That creates a pro-plaintiff bias and restricts the opportunity of the courts and state legislatures to change the balance of interests between consumers and producers.
- Manufacturers face as many different liability standards as the number of states in which their products are sold. That probably increases their legal costs, the variance of potential judg-

ments, and the average premiums for liability insurance (although I know of no evidence of such effects). For these reasons, conservative members of Congress from the major manufacturing states have been the primary sponsors of federal product-liability bills.

A federal product-liability law, however, is not necessary to meet these two concerns. Corporations do not face similar problems in cases bearing on their corporate charters, even though there is no federal corporate charter law, because all such cases are adjudicated under the law of the state in which a corporation is chartered. A similar approach would be sufficient to address both of the concerns about product liability. A single-sentence federal law may be sufficient: "All cases involving the liability of firms for products sold in interstate commerce shall be adjudicated under the law of the state in which the firm has the largest employment or of the state through which the product is imported."

In one sentence, this law would eliminate court shopping; would provide the courts and the legislature in each state a better opportunity to balance the interests of consumers and producers; and would make each manufacturer subject to only one liability standard. Moreover, these concerns would be addressed without requiring a harmonization of product liability law across states or across firms.

A concern has been raised that this approach would lead to "a race to the bottom" in liability standards, as is alleged to be the effect of choosing the state in which a corporation is chartered. In this case, I suggest, this concern is misplaced. This approach should lead to a better balance of the interests of consumers and producers, because a state government would have a stronger incentive to consider the employment effects of that state's product liability standards. On the other hand, except in extraordinary cases, there are more voters in each state who are consumers of a product than those who are employed by the manufacturer of that product, so consumers will generally be well represented. Moreover, manufacturers could choose the liability standard to which their products are subject only by making a major investment in the state.

A liability standard more favorable to producers, thus, would not be sufficient to attract employment unless other conditions are also favorable to producing in that state. This approach maintains the authority of each state to set its own liability standards and to learn from its own experience and that of other states, but with better incentives than is now the case.

Conclusion

In summary, the principles by which I evaluate proposed federal legislation are the same as those of Senator Abraham. These principles, however, lead me to quite different conclusions:

- Congress should not approve any bill that would establish federal tort-liability standards.
- Congress should consider a simple federal law that establishes a single venue in which product liability cases against a firm are adjudicated.

On reflection, I hope that Senator Abraham will lead the effort to avoid a rush to judgment on the tort reform bills now before Congress.

Selected Readings

Abraham, Spencer. "Litigation Tariff: The Federalist Case for National Tort Reform." *Policy Review* (Summer 1995).

Campbell, Thomas; Kessler, Daniel; and Shepherd, George. "The Causes and Effects of Liability Reform: Some Empirical Evidence." National Bureau of Economic Research Working Paper No. 4989 (Summer 1995).

LeBoeuf, Jacques. "The Economics of Federalism and the Proper Scope of the Federal Commerce Power." 31 *San Diego Law Review* 599 (1994).

Middleton, Martha. "A Changing Landscape: As Congress Struggles to Rewrite the Nation's Tort Laws, the States Already May Have Done the Job." *ABA Journal* (August 1995).