Real Benefits to Tort Reform

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Abstract

Civil justice reform should be examined in light of our knowledge about the optimal liability rule, originally proposed by Judge Learned Hand, which has evolved into an examination of the marginal benefits versus the marginal costs of care. However, this rule by itself ignores many of the aspects of the cost of liability. This paper develops a simple model of beneficial liability rules in the presence of liability system transactions costs. Researchers currently do not have access to all the costs and benefits of the liability system, so we cannot assess the total welfare effects of tort reform. However, we can assess if the reforms move us in a beneficial manner. I term a beneficial reform one which lowers these transactions costs including the cost of insurance, the cost of disproving liability, the cost of fraud, and the cost of damages which potentially over or under compensate victims. With these types of transactions costs a potential defendant may have an incentive to increase the level of care beyond that suggested by the suggested by the simple optimal liability rule. Beneficial tort reforms would be those that attempt to reduce the liability system’s transactions costs. This paper presents an examination of Texas’ 1995 tort reforms specifically testing whether there is evidence of beneficial liability reform. In fact, evidence suggest that suggest they were beneficial. For example, one of the benefits of tort reform could be the reduction of claimants to make claims where they hope to win the tort-lottery. This results in fewer, but more realistic claims. Further, the time between a claim and settlement should decreased and compensation for previously hard to value claims should increase. In addition, there is evidence that insurance prices fell for some types of companies and that settlement and litigation expense also decreased after the enactment of the tort reforms. In sum, the results are consistent with beneficial tort reform.