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State Liability

GIUSEPPE DARI-MATTIACCI,† NUNO GAROUPA** & FERNANDO GÓMEZ-POMAR***

Abstract: Should states be liable towards individuals for failure to provide justice, good roads, or timely administrative decisions? In this article, we show that state liability can serve three different purposes, none of which implies that the state should be liable in tort, unless other specific conditions are met. One purpose is to provide incentives for state agencies and private individuals to act efficiently. Here, the effectiveness of liability depends on the channelling of incentives down the chain of command to the acting state employee. The second purpose of state liability is to remove incentives for private parties, when these incentives are distorted, as when compensating for wrongful conviction. The third aim of state liability is to allow a higher level of the administration to monitor the behaviour of a lower level. In this case, the judicial system and private parties are means towards the end of generating information about wrongful behaviour by public bodies and agencies. Within this framework, we discuss substantive and procedural aspects of state liability in torts. We provide an economic argument for court specialization in administrative law and explain why the different solutions around the world could be appropriate under local determinants.

Résumé: Les États devraient-ils être tenus responsables envers les individus pour leurs manquements à assurer une bonne justice, des voiries en bon état, ou à rendre des décisions administratives dans des délais raisonnables? Dans cet article il est démontré que la responsabilité de l’État peut servir trois objectifs différents, aucun d’entre eux n’impliquant la responsabilité civile de l’État, excepté dans les cas où certaines conditions spécifiques sont réunies. L’un des objectifs est d’inciter les institutions de l’État et les individus à agir efficacement. Ici, une responsabilité effective dépend de la canalisation des motivations le long de la chaîne de prise de décisions jusqu’au fonctionnaire chargé d’agir. Le deuxième objectif de la responsabilité de l’État est d’éliminer toute incitation pour les personnes privées, lorsque leurs motivations sont perverties, comme dans le cas de compensation pour erreur judiciaire. Le troisième objectif de la responsabilité de l’État est de permettre à l’échelon supérieur de l’administration de superviser la conduite des échelons inférieurs. Dans ce cas, le système judiciaire et les parties personnes privées constituent des outils d’information sur le comportement fautif des institutions et services publics. Dans ce contexte, il est discuté les aspects matériels et procéduraux de la responsabilité civile de l’État. Cet article fournit un argument économique en faveur de cours et tribunaux spécialisés en droit administratif et envisage

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la possibilité d’adapter les différentes solutions appliquées dans le monde à des facteurs locaux.


1. Introduction: The Issues behind State Liability and Sovereign Immunity

The state can be a significant source of negative externalities, both through actions of its employees, officials and agents and through the failure to act in a given way. States have armies, police forces, and prosecutors who can produce harm by their actions, as well as let harm happen by their omissions. States promote public works and build and maintain public infrastructures of many kinds, and private individuals can suffer physical and property harm as a consequence of both. States regulate, in varying degrees, many if not most economic activities, and they can impose, or fail to impose, regulatory measures that can result in economic losses for the individuals and firms undertaking the regulated activities. States can confiscate property (real estate, productive assets, firms, or cash) for temporary or for permanent purposes. Yet the observed legal treatment of the liabilities that may be attached to those instances of harm widely differs from the ordinary rules of tort law.¹

¹ Our article discusses tort liability of public authorities. State liability for breach of contract is beyond the scope of this article. See Daniel R. Fischel & Alan O. Sykes, ‘State Liability for Breach of Contract’, American Law and Economics Review 1 (1999): 313 and Abraham L. Wickelgren, ‘Damages for Breach of Contract: Should the State Get Special Treatment?’, Journal of Law, Economics & Organization 17 (2001): 12. There is also the possibility of state liability for other actions that are not tortious in nature (economic policies, legislative changes, or regulatory controls that raise costs for a particular industry, or even failure to legislate or bad laws), see Anthony Ocus, ‘Do We Have a General Theory of Compensation?’, Current Legal Problems (1984): 29. As to the particular case of takings, see Thomas J. Miceli, Economics of the Law (New York: Oxford University
The idea that external effects are a source of social loss and should therefore be internalized is one of the most, not to say the most, common theme in the economic analysis of law, which is mainly concerned with the identification of efficient legal rules to achieve this goal. The Coasean tradition\(^2\) has better qualified this endeavour by distinguishing between those situations that are characterized by low transaction costs, in which internalization of external effects occurs through voluntary agreements, and those in which transaction costs are high and where some legal intervention may be necessary. In the latter case, Gary Becker\(^3\) and Guido Calabresi\(^4\) have laid the foundations for the analysis of the two most widespread, historically and currently, legal devices employed to internalize externalities, namely, criminal law and tort law.

These two bodies of law are mainly concerned with providing incentives for individuals and firms not to impose harm on others. From here, the step towards advocating tort liability for public organizations such as states, regulatory agencies, local state branches, the police, or the judiciary is relatively short. In this article, we examine the incentive effects of state liability and show that they can be classified in three main categories: the provision of incentives for the state or for private parties to act properly in the service of socially desirable goals, the removal of incentives for private parties to engage in socially detrimental behaviour when those incentives are distorted, and the generation of information about wrongful behaviour by public agencies.

To illustrate, state liability for failure to maintain roads in adequate conditions for safe driving would fit a traditional internalization argument as follows: If the state (at the relevant level, depending on the administrative responsibility over the road) is liable for failure to maintain public roads, the prospect of paying damages can be regarded as providing incentives to the organization so that state employees, at the different levels of authority, choose the optimal level of maintenance expenditures. It would operate, thus, in just the same way as a firm's vicarious liability makes its employees internalize the harm to victims and hence choose the adequate levels of care in undertaking potentially harmful activities.\(^5\)

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In this case, state liability is supposed to produce good incentives for the state organs, bodies and officials. Another important example could refer to the provision of accurate information (such as weather forecasts) that significantly reduces individual search costs.

As to cases for removal of incentives, they include situations such as those in which a corrupt official refuses to issue a permit to an honest entrepreneur unless the latter pays a bribe to the former. In this case, the idea is not that state liability will produce incentives for public officials, but rather that letting the victim of the abuse rely on damage compensation paid by the state makes it less likely that he or she will feel inclined or compelled to bribe a public official. In this case, liability is supposed to remove incentives for private parties to engage in activities that corrupt state officials.

Most commonly, state liability has incentive effects both on the agency and on private individuals. However, while individual incentives usually reach those private individuals directly, incentives for state agencies are vulnerable to a fundamental failure in the chain of command; that is, making the public organization liable may fail to provide its employees with incentives to act efficiently, for the sanction imposed on the organization might not reach the responsible individuals. Absent sufficient incentives for individual officials, liability will not improve the actions taken by those who compose the public organization. The question whether incentives are transferred from the organization to its agents is not specific to state liability and is not novel in law and economics. An analogous issue arises when firms are vicariously liable for misconduct of their agents and is a manifestation of the costs, it is possible for the organization to design and implement internal incentive mechanisms inclining the employees to improve their behaviour concerning accidents. The same would be true of the state and public organizations. See Larry Kramer & Alan O. Sykes, 'Municipal Liability under §1983: A Legal and Economic Analysis', *Supreme Court Review* 6 (1987): 249, 275, arguing that the incentive problem of private and public organizations is, in its economic essence, the same and is thus amenable to the same kind of analysis. In turn, Eric A. Posner & Alan O. Sykes, 'An Economic Analysis of State and Individual Responsibility under International Law', *American Law & Economics Review* 9 (2007): 72, 81, argue that monitoring ability - ability of principals to induce agents to take greater precautions against harm - is the crucial factor affecting the desirability of the vicarious form of liability, be it of private firms or of governments.


7 The issue of whether or not the corrupt employee should be personally liable in this case is a problem that we do not discuss as it is beyond the scope of this article.

well-known agency problem between organizations and their subordinates.\(^9\) Public administrations that have fairly inflexible regimes of salaries and internal promotions (e.g., seniority prevails as the major factor for promotion) do not allow free renegotiation or readjustment in case of liability arising from the agent's actions. Public administrators can lose their jobs following a criminal conviction for particular crimes, and this scheme could be (though we have no evidence that it commonly is) extended to tort judgments based on a finding of negligence. Nevertheless, the problem remains in areas of strict tort liability, where a finding of negligence on the part of the administration is not necessary for the establishment of the agency's liability and hence the dismissal of the (potentially non-negligent) responsible official could be both legally unsound and economically inefficient in most cases.\(^10\) Moreover, even a reduction in the nominal salary as a consequence of causing an accident or misbehaviour might not be allowed. Due to such obstacles in the way of channelling responsibility through the employment contract, criminal law remains the main source of incentives for state officials, corruption being the most obvious example. However, criminal sanctions require lengthy and expensive proceedings and are likely to target only major violations, thus resulting in under-deterrence of misbehaviour by state officials.

Another serious problem posed by state liability is how organizations could structure themselves or respond in order to avoid liability. There are four important aspects. First, the likelihood that, within the state organization, effort may be made in order to cover-up misbehaviour or negligent behaviour by state officials, even the mere occurrence of accidents and harm if strict liability is imposed.\(^11\) Second, the build-up of a group of extremely expensive internal and external staff of legal councillors to argue the case for the state (here with potential conflicts of interest with state prosecutors who might represent the victims). Third, serious adverse selection with respect to hiring personnel and moral hazard across state departments depending on different degrees of exposure to state liability may arise. Fourth, liability may encourage timidity and abstention from action on the part of

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\(^10\) See Kramer & Sykes, supra n. 5, for argument in favour of individual immunity of the public employee in cases in which the harm - constitutional tort, more specifically - is not the product of wilful or grossly negligent behaviour.

\(^11\) This case is similar to the problem discussed by Arlen, supra n. 8; Chu & Qian, supra n. 8; and Arlen & MacLeod, supra n. 8: when the employer can actively supervise and control behaviour of the employees, this could speak in favour of the efficiency of vicarious liability in the circumstances. However, given that supervision and control can provide evidence against the employer at trial, the employer also has incentives to curtail monitoring or to destroy evidence.
the government (unless liability for omissions and over-precaution are imposed, a very unlikely situation) in order to reduce the liability bill. There is an argument of inaction and excessive caution as the necessary price to pay for liability. Compensation of victims of public conduct is a common argument in defence of immunity applied to personal liability of the individual public employee (of which more later). Nevertheless, it may well be relevant to the liability of the organization as such, given that some of the decisions of government action are taken at the higher echelons of the governmental organization, who may be concerned with the budgetary effects of liability payments from state action.

The commonly made argument that public officials may be shielded from incentives, or that otherwise individuals acting on behalf of the state do not face effective mechanisms that penalize them for causing harm, thus making state liability ineffective, is not the whole story. We demonstrate, in fact, that the problem is more serious than that. Imposing liability on the state may not simply fail to improve incentives; it may even dilute them. If the aim is the reduction of accidents, the traditional sceptic would go so far as to say that state liability will, in the worst case, leave the number of accidents unvaried. We argue instead that accidents may increase because, while failing to improve the incentives of the state officials and employees, state liability may well weaken the incentives of private parties, who can now rely on state compensation of their losses. State liability ends up functioning as a taxpayer-funded accident insurance, which will obviously create a substantial moral hazard problem on the part of those who can benefit from this implicit coverage. We show that a contributory negligence defence better counters these problems than other liability arrangements.

Moreover, if state liability fails to provide incentives in general we are to expect the state to be found negligent in state liability cases. Thus, the likely outcome is either one in which both parties are negligent (but the victim effectively bears only a negligible part of the loss, or he or she would have been induced to behave non-negligently) or one in which only the state is negligent (and the victim bears no loss). Eventually, when incentives fail, the residual accident costs fall on the state with the consequent aggravation of budget constraints and the contraction of some state activities, albeit not necessarily the accident-producing activity in question. The latter statement may be understood with reference to the premise: if incentives fail with respect to care, it is difficult to see why they should succeed with respect to the level of activity.

Beyond the assessment of the conditions in which the state liability regime should be crafted and applied, there is a very important issue hitherto unmentioned.

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13 See Kramer & Sykes, supra n. 5.
The government is no single body but a conglomerate of entities and organizations enjoying a greater or lesser extent of public power. The state is not one and single-dimensional but a multidimensional and multibranch kind of organization. In a multilevel organization, state liability can have the function to police lower levels, or at least viewed as a mechanism to generate information about their performance. For example, the central government could place liability on a regional or provincial government or on the court system. In this case, effective monitoring depends on the operation of courts and on the decisions and actions of private individuals in terms of bringing suit against the state. These lawsuits convey information to the central government about the activities of these bodies. The waiver of sovereign immunity as a monitoring strategy does not go without costs, namely the costs of state liability borne by the central government. The relevant question is if using state liability as a form of monitoring strategy is the most efficient alternative given the problems we have identified.

Any state liability regime presupposes the state as a defendant. Given the specificities of the state as a defendant, it has been argued that a special legal framework, namely specialized courts and judges, specific or distinct procedural rules and a different regime for out-of-court settlements, should govern the liability of the state. Although the general reasoning behind our analysis relates to administrative law in the broad sense, our discussion focuses on the specific question of recognizing a special status to the state as a defendant. We cannot separate the state defendant in tort from other state functions and roles, and hence it is possible that a special legal framework makes sense in some jurisdictions but not in other jurisdictions, depending on the institutional environment.

Our analysis is carried out in this article from a welfare perspective, and we ask three fundamental questions: (i) whether or not state liability advances social welfare; (ii) if state liability advances social welfare, how should state liability be designed; and (iii) how should state liability be enforced.

In the following sections, we will make the point that an optimal design of state liability depends on a clear conceptual separation between the three distinct goals for which liability may be advocated: the production of positive incentives, the removal of negative incentives and the control of lower levels of government. In section 2, we will present state liability from a comparative and historical perspective and discuss existing theories concerning state liability, in the light of the fact that comparativists have identified state liability as a major difference across legal systems. Section 3 provides an economic interpretation of the three distinct functions of state liability. In section 4, we will discuss the desirability of a specialized legal framework for state liability. Some final remarks will be made in section 5.

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2. State Liability from a Comparative and Historical Perspective

2.1 The Liability of the State and Sovereign Immunity

Historically, states have enjoyed almost unlimited immunity against the legal claims for redress in tort by individuals. Both in the common law and the civil law traditions, the starting point has been that of sovereign immunity. Maxims such as *The King can do no wrong* or *Le Roi ne peut mal faire* reflect more or less accurately the common wisdom on the prevailing legal treatment of harm suffered by citizens as a result of state actions or failure to act. From the nineteenth century onwards, and especially in the twentieth century, the rule of absolute immunity has experienced significant erosion. In English law, for example, the Crown Proceedings Act of 1947 determines that the Crown is equated with a private person of full age and capacity in respect of liability for tort, although some exceptions in favour of the police and certain statutory corporations were kept.

The American history of state liability in tort, somewhat surprisingly, reflects the evolution from the unqualified and almost unquestioned reception of a common law doctrine of sovereign immunity, containing a strong flavour of the feudal privilege of the Lord over his vassals, to an apparent statutory basis for immunity, although with some important waivers, such as the Federal Tort Claims Act of 1946 and other state statutes along similar lines. The American legal tradition on state liability has been largely sceptical of imposing liability on the state, pointing at the uncertainty of its consequences, but also at the inconsistency of allowing the exercise of legal rights against the same authority (the government) that makes the law on which these rights depend.

The two concurring views were expressed in the well-known case of *Dalehite v. US* (1953). While the majority of the Court took the view that the Federal Tort Claims Act did not create broad state liability (alien to the common

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15 Under common law, the state is traditionally immune from liability for damages without its consent. Most state constitutions in the United States impose restrictions on suits against the state. Therefore, a court cannot hear a case asking it to force the state to pay damages absent legislative authorization for payment; the remedy is itself unconstitutional. In addition, the Eleventh Amendment protects states (but not the federal government since this one has immunity in common law) from liability in reaction to the 1793 decision by the Supreme Court in *Chisholm v. Georgia*, 2 U.S. 419 (1793). With respect to constitutional torts in particular, the immunity doctrines have been devised by the Supreme Court. See Lawrence Rosenthal, "A Theory of Government Damages Liability: Torts, Constitutional Torts, and Takings", *University of Pennsylvania Journal of Constitutional Law* 9 (2007): 797, fn 13, 14, and 83.


18 This was an action to recover damages for death under the Federal Tort Claims Act 1946. A disastrous explosion of ammonium nitrate fertilizer under the control of the federal government
by concluding that the government benefits from an exception of discretionary function, the dissenting minority argued that since the disaster was caused by actions completely controlled by the government, tort liability should be imposed on the government. The dissenting minority also expressed the view that the adoption of the government’s exception of discretionary doctrine would undermine the incentives for official responsibility in certain risky activities. Largely speaking, the view of the majority has prevailed so far.

In Europe, the English regime should be classified from the outset as one apparently not joining the major European trend in modern times of generously favouring state liability, at least in theory. Moreover, the English legal regime is the only one where the question of public immunity in general can be posed as a relevant legal problem. English courts repeatedly applied striking out procedures, refusing even to admit that public authorities were subject to a duty of care mainly based on policy concerns. Recently, this perspective has been revisited and the

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on 16 and 17 Apr. 1947 killed more than 500 people and wiped out an entire city (Texas City, Texas).

The majority of the Court rejected liability on any decision at any high level of the administration. The current scope of the federal government’s immunity is essentially the same that governs the states and has not changed: see Department of the Army v. Blue Fox, Inc., 525 U.S. 255 (1999) and West v. Gibson, 527 U.S. 212 (1999). In fact, Jeffrey A. Segal & Harold J. Spaeth, *The Supreme Court and the Attitudinal Model Revisited* (Cambridge: Cambridge University Press, 2002) argue that the Supreme Court has expanded state immunity and effectively constrained congressional authority to develop state liability in the last decade or so.


A comparative view of state liability in English law is provided by Raymond Youngs, *English, French and German Comparative Law*, 2nd edn (London: Routledge, 2007), Ch. 5. According to this author, the basis for state liability is narrow following *R v. Secretary of State for Transport ex p Factor tame Ltd and Others* (1996). The immunity was abolished by the Crown Proceedings Act 1947, but there is a defence in statutory authority. According to this defence, if the action was the inevitable consequence of the acts authorized, the defendant is not negligent following *Tate & Lyle v. GLC* (1983). Furthermore, there is no right of action if the nuisance is inevitable. See also for a discussion of the current situation in English law, Duncan Fairgrieve, ‘Pushing Back the Boundaries of Public Authority Liability’, in *Tort Liability of Public Authorities in Comparative Perspective*, ed. Duncan Fairgrieve, Mads Andenas & John Bell (London: British Institute of
emphasis is now more often put on the definition of the duty of care or on the level of due care, and not on its existence (therefore confirming a more favourable view of individuals’ rights against public bodies).\textsuperscript{23}

Legal systems in continental Europe were very much influenced by the French experience.\textsuperscript{24} The French Law of 1790 stated clearly that judges cannot and shall not interfere with the administration. Such rule in practice created an effective immunity from judicial review for administrative acts that was not necessarily intended by the 1790 legislators. Historically, it is not clear why that was so.\textsuperscript{25} Whatever the reasons, the fact is that the administration was placed outside of judicial review in the package of the Napoleonic transformation of the legal systems of the Ancien Régime (a package also including the codification of civil, commercial, criminal, and procedural laws) across Europe, with the specific purpose of preventing judges from interfering with the running of the new, reform-inspired state administrations.\textsuperscript{26} An obvious consequence is that state liability could not be developed until much later. Most legal systems initially made use of different means to ensure some compensation for wrongs imposed by public bodies on the life, limb and property of citizens: legal fictions, such as the nomination of an individual


\textsuperscript{23} The UK Law Commission has also expressed the need to develop a more pro compensation attitude regarding public liability. In recent document, titled ‘Remedies against Public Bodies’, <www.lawcom.gov.uk/docs/remedies_scoping_report.pdf>, 2006, the Law Commission (considering particularly the judicial review mechanism) explicitly claims that ‘This report sets out our plans for a substantive law reform project on the remedies available to the individual against public bodies’. The Commission’s major thesis is that the right to compensation still depends on judicial discretion no matter the Human Rights Act (1998), the EU, and the developments in governmental liability in tort.


\textsuperscript{25} Explanations include a conflictive interpretation or misinterpretation of the separation of powers throughout those years that go from the 1789 Revolution to the Napoleonic codes that formally established a differentiation between judicial and administrative powers in rulemaking. Other authors refer to the general feeling among French policy makers that customary law - French common law - was a significant nuisance for the administration because it allowed judges to be lawmakers and interfere excessively with the administration from the viewpoint of the bureaucrats. Others mention quite unconvincingly pure historical path dependence. See Paulo C. Rangel, Repensar o Poder Judicial, Fundamentos e Fragmentos (Porto: Universidade Católica Tema, 2001) [in Portuguese], Ch. 3 and Michael Troper, La Séparation Des Pouvoirs et l’Histoire Constitutionnelle Française (Paris: Librairie Generale de Droit et de Jurisprudence, 1980) [in French].

\textsuperscript{26} See Benito Arrúñada & Veneta Andonova, ‘Judges’ Cognition and Market Order’, Review of Law and Economics 4 (2008), who emphasize how the most famous portion of the Napoleonic legal package, namely codification, was an effort to restrain the power of judges (presumably in favour of the Ancien Régime) against the reforms developed by revolutionary legislatures and administrations.
official as defendant, standing the state financially behind him; specific legislation imposing liability in areas such as public works, or local public services, and courts decision crafting exceptions to the general rule of immunity. The erosion of state immunity advanced notably over time. A broad principle of state liability became enshrined in several European constitutional provisions, as embodying an important ingredient of the Rule of Law (Rechtstaat, Estado de Derecho, Stato di Diritto). The broad legal-philosophical principle that government activity is to be carried out under the Law inspires Articles 24 and 28 of the Italian Constitution (1948), Article 34 of the German Constitution (1949) and Article 106.3 of the Spanish Constitution (1978).

Although there is definitely a general trend in Continental Europe towards a more generous state liability, this has been essentially advanced by means of case law almost inasmuch as in England. However, whereas in France case law created an independent body of rules for state liability (independent from private law rules of liability), in England courts have applied ordinary tort rules to government liability (the most developed category being negligence) and only one specific public law tort, misfeasance in public office, is consistently applied. France is said to have a liberal legal system towards state liability, especially due to the fact that French courts very early recognized a claimant right to damages for losses caused by central authorities (Blanco 1873) and later extended this principle to local authorities (Feutry 1908). Nowadays, the French legal system has to cope with an excessive number of claims and with the trend towards the replacement of faute lourde by faute simple in the areas of health care, emergency services, and regulatory activities with a consequent further expansion of litigation.

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27 For a summary of the historical evolution of state liability both in common law and civil law countries, see H. Street, Governmental Liability (Cambridge: Cambridge University Press, 1953), Ch. 1; Fairgrieve, supra n. 22, Ch. 2.

28 As Fairgrieve, supra n. 22, 17, aptly puts it: 'French Law is based upon the general principal that a claimant may gain damages for the fault of a public body which has caused loss'.

29 TC 8 Feb. 1873, Blanco Case, D.1873.3.17.

30 TC 29 Feb. 1908, Feutry, D.1908.3.4914.

31 See the summary by Youngs, supra n. 22. Faute de service (fault within the scope of duty) is dealt by administrative courts applying special liability rules different from those in the Code Civil applied to faute personelle (personal fault). They must be too serious to be regarded outside of the scope of duty or committed for intentional harm; it is generally easier to establish liability of public bodies; the state can be liable for malfunctioning of its judicial system in case of grave fault or denial of justice (developed by case law of the Conseil d'État).


33 See Pierre Laurent Frier & Jacques Petit, Précis de Droit Administratif, 4th edn (Paris: Montchrestien, 2006), 481 [in French]. The authors equate whether faute lourde is about to be fully abandoned in all policy matters.

34 See for a description of this trend towards faute simple, Fairgrieve, supra n. 22, 118. See also Frier & Petit, supra n. 33, 480-481.
In Italy, state liability has faced important developments in recent years also due to a major court decision of the Court of Cassation. A second substantial step towards a more generous state liability was made with a new law concerning a reform of administrative law and procedure. This law attributed the competence to award damages to administrative courts, reflecting the decision to attribute to administrative judges all matters of public administration civil liability (for juridical and non-juridical acts). This law overruled the above-quoted landmark decision in the part where it allowed civil courts to declare the unlawfulness of administrative decisions; thereby, this prerogative is attributed exclusively to administrative courts.

However, it is Spain that favours the most state liability, having chosen a broad, no-fault state liability regime. Fault is formally only important at most to determine the amount of damages. The situation in Spain has reached such a point that some legal commentators speak now of 'overcompensation' or a practical 'social insurance' system established under the veil of state liability. Another distinctive feature of the Spanish state liability system resides in the fact that the main impulse for the implementation of the current state liability system resulted from a synergy between the legislator and academic commentators rather than from court decisions.

These developments have not eliminated, however, the special status of the state and public bodies within the domain of liability for harm caused, nor the

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35 The decision from the Cassazione Sezioni Unite, no 500 from 22 Jul. 1999 performed a judicial novelty: it finally adopted the thesis of the reparability of harm (with interessi legiti) caused by the state and public authorities to private parties. The previous situation of Italian law is summarized by Thomas Glyn Watkins, The Italian Legal Tradition (Sudbury, MA: Dartmouth Publishing Company, 1997). Administrative courts were solely concerned with the legality of administrative measures (incompetence, excess of power, or violation of the law).

36 Legge 21 Luglio 2000 no 205 and, very recently, Decreto Legislativo del 2 Luglio 2010 no 104. See, for detailed references to the Italian case, Roberto Garanta, Attività Amministrativa ed Illecito Aquiliano: La Responsabilità della P.A. dopo la L. 21 Luglio 2000, N. 205 (Milano: Giuffré, 2001) [in Italian].

37 See Oriol Mir Puigpelat, La Responsabilidad Patrimonial de la Administración. Hacia un Nuevo Sistema (Madrid: Civitas, 2002) [in Spanish]. Others are less convinced that this stage has been actually reached in the concrete operation of state liability by Spanish courts: Fernando Gómez & Víctor Sánchez, El Problema de la Responsabilidad de las Administraciones Públicas en Derecho Español: La Visión del Análisis Económico del Derecho, 34 Sub Judice, Parte II 27 (2006) [in Spanish]. See also discussion by Teresa Rodríguez de las Heras Ballell, Introduction to Spanish Private Law (New York: Routledge-Cavendish, 2010), explaining state liability in Spain is subject to a so-called universal system since anyone injured in the provision of public services can claim damages and because there is direct liability of the state even if the public employee who caused the wrongdoing has not been identified. Furthermore, she argues that strict liability prevails since only force majeure is admissible as defence.


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differences between different legal traditions with respect to the grounds, scope and purpose of state liability. English law remains comparatively restrictive in the European context, providing for relatively ample space for individual liability by public officials – to which vicarious liability of the public body may also attach – and to broad exceptions to state liability established by courts on policy grounds. At the other extreme, Southern European legal systems such as France, Italy and Spain, on the one hand, proclaim very generous and indiscriminate principles of state liability in tort and, on the other hand, tend strongly and extensively to insulate their public officials and bureaucrats from individual liability, except in the most serious cases of personal misconduct and when criminal liability arises. It is true, nevertheless, that courts in those systems, even under the rule of an expansive regime of state liability and even without challenging the basic policy choices underlying this system, find numerous opportunities to make use of general doctrines in tort law – proximate causation, assumption of risk, equitable duty to suffer harm – to restrict the scope of state liability. Moreover, in these systems, we find specialized administrative courts deciding cases of state liability, which, one may think, may be more favourable to the legal arguments and the interests of the state than courts of general jurisdiction. German law would probably lie somewhat in between the English and the Latin systems of state liability, where the civil code contemplates official liability (Article 839 Bürgerlichen Gesetzbuches (BGB) but the Constitution effectively transfers the liability of the official to the public authority (Article 34 the German Constitution (GG), as we have seen). Still, German state liability has also advanced by means of case law by restricting the application of legal statutes limiting public liability. This positive trend is seen by German legal doctrine as still insufficient and roots itself in the need to protect the individual from ‘public powers’.

39 For instance, as illustrative real-world evidence of this potentially different attitude of general and specialized courts, we have conducted a simple descriptive study of the sample of 2006 cases in the Spanish Supreme Court. In our study, in ordinary tort cases decided by the Civil Chamber, the plaintiff prevailed in 69% of the decisions. In state liability cases, the plaintiff prevailed over public bodies as defendant only in 35% of the liability cases decided by the Administrative Chamber. Although many factors may be at play and therefore we should be quite careful making inferences from the probability of success at trial, the discrepancy is large enough to allow us to think that divergent attitudes may be influencing the outcome of this kind of litigation.


Perhaps not surprisingly, state liability has also attracted considerable attention by the European Union. At the European Union level, the question is no longer whether or not there is a state liability regime but its scope of protection and the chosen legal instruments to operate it. The role of the High Courts of Europe in promoting generous state liability contrasts with the trend in the United States. In particular, the difficult distinction between actions of the state in a public capacity and in a private capacity that varies across countries has been forced to conform with the European standard set by Francovich.

The reality of legal systems shows that personal liability of the individual public employee is a rare occurrence, except for the most egregious cases of personal misconduct individually ascertainable. Even in those jurisdictions, such as England, in which the vicarious liability paradigm continues to provide the broad legal basis for state liability, most public employees are practically shielded from liability either through statutory immunity — common in civil law systems — or through indemnity provisions in their favour. In the United States, in response to a Supreme Court decision restricting immunity, the Westfall Act of 1988 restored absolute immunity of federal employees for torts committed in the course of their employment, and many states also offer similar levels of statutory immunity to their employees.

State liability in Chinese law is complex. Under the 1982 Constitution, state liability was revived and the present rules and regulations concerning state liability are embodied by the State Compensation Law enacted in 1994. Largely

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42 A European Recommendation on the subject was enacted in 1985 (Recommendation No. R (84) 15 of the Committee of Ministers to Member States relating to Public Liability), whose first principle reads ‘Reparation should be ensured for damage caused by an act due to a failure of a public authority to conduct itself in a way which can reasonably be expected from it in law in relation to the injured person’. Such a failure is presumed in cases of transgression of an established legal rule. Moreover, this Recommendation could also be regarded as a first mature European sign of concern regarding the expansion of public authorities’ activity and potential damages caused.


44 See Youngs, supra n. 22, Ch. 5.

45 See, for example, Art. 145, Spanish Ley 30/1992, de Régimen Jurídico de las Administraciones Públicas, y del Procedimiento Administrativo Común.


47 Goldberg, supra n. 16, 527; Rosenthal, supra n. 15, 813.

48 For example, Hong Kong has been influenced by the Crown Proceedings Act of 1947. Hong Kong passed its own Crown Proceedings Ordinance in 1957. Macao developed the principle of state liability stipulated by the 1976 Portuguese Constitution into law in 1991, under Decree Law 28/91. Art. 2 of this decree reads that ‘the administration, collective public bodies and agents shall be liable for the illegal acts during public management’. The State Compensation Law of Republic of China (Taiwan) (SCL) was promulgated in 1980, with the Enforcement Rules for State
speaking, in China, state liability is dominated by government, and only marginally with court intervention. According to Chinese law, the state body under compensatory obligation shall instruct its personnel or the entrusted organization or person who has committed intentional or grave mistake to bear part or all the expenses for damage. Besides, the individual public employee could also undertake administrative or criminal liability (under Article 24 of the State Compensation Law). The statistics show that there is a significant number of cases concerning state liability in China, in particular wrongdoings by public prosecutors, confirming the general impression that Chinese authorities use the State Compensation Law to monitor public employees and to make sure they act in a lawful way.\textsuperscript{49}

Using state liability primarily to monitor public employees seems common in Asian jurisdictions. In Japan, state liability is established by the 1946 Constitution (Article 17) and addressed by the 1947 Law on Compensation by the State (which greatly expands tort liability for the public administration).\textsuperscript{50} Ever since the abolition of the administrative courts, all state liability cases are adjudicated in ordinary courts. However, the characteristics of public laws are still preserved in actions against the government or its agencies.\textsuperscript{51} The reforms operated in the 1990s seem to rely on the monitoring of state employees by the public in general.\textsuperscript{52} In the case of Korea, state liability is regulated by the 1951 State Compensation Law (revised in 1967 and amended six times since then). This law regulates tortious conduct by public employees while performing official duties. Vietnam has passed in 2009 their Law on State's Liability to Pay Compensation while state liability is regulated in Thailand by two laws, the 1996 Act on Government Administrative

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Compensation Law being promulgated in 1981. The SCL as well as its enforcement rules were based on Art. 24 of the Constitution of Taiwan.
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\textsuperscript{50} In particular, the state is now liable for harms negligently or intentionally committed by public employees even though those employees are engaged in an ‘exercise of the public authority’, a condition that previously permitted the state to avoid most liability in tort. Of course, there is still debate as to exactly what is an ‘exercise of the public authority’. See, for example, Sawarabi Kabushiki, Kaisha v. City of Kyoto, 691 Hanrei Jiho 57 (Kyoto Dist. Ct. 1972). Moreover, large areas of discretion and partial immunity still exist. Nevertheless, most demands for pecuniary relief against the state are made under the Law on Compensation by the State. See discussion by Hiroshi Oda, Japanese Law, 3rd edn (Oxford: Oxford University Press, 2009), 195.


Practices and the 1999 Act on Establishment of Administrative Court and Administrative Court Procedure (but amended several times since then). In both countries, these legislative reforms were introduced in the context of enhanced transparency for public administration.

In Latin America, state liability tends to follow the European tradition, namely the French generous principles although with some limited actual enforcement. For example, the principle of sovereign immunity never really existed in Brazil. The 1988 Constitution guarantees state liability (Article 37) reinforced by the Brazilian Civil Code of 2002 (Article 43). There are important doctrines concerning state liability resulting from influential case law. However, the application of state liability has been tampered by the unwillingness of the state to fulfil some of its obligations. Likewise, in Argentina and in Chile, case law has developed state liability (including liability imposed on the legislative and judicial branches of government) but the application remains a practical issue. State liability is also explicitly mentioned in the Colombian 1991 Constitution (Article 90) as well as by the 2008 Constitution of Ecuador (Article 11) and by the 1967 Constitution of Uruguay (Article 24). In the case of Mexico, state liability is enshrined by the Constitution (Article 113) that was amended in 2000 to restrict immunity and has been developed by the new Law of Federal Liability of Public Servants enacted in 2002, as part of a reform for transparency and reduction of corruption.

2.2 Enforcement of State Liability

Many jurisdictions deal with state liability in administrative courts or other similarly specialized courts. Administrative courts are typical of the so-called French family of legal systems, although they are also present in the German family and in common law countries. The dualist approach to administrative law as opposed to the resolution of conflicts between private parties of the French approach has

54 See CELSO ANTONIO BANDEIRA DE MELLO, Curso de Direito Administrativo (Curitiba: Juruá, 2008) [in Portuguese], 1015-1016.
55 Including liability for legislative acts. Ibid., 988.
56 Ibid., 1029 ff.
57 Ibid., 1035 ff.
resulted in a rigid division between public and private laws, since review of the legality of administrative action by the ordinary judicial courts was originally regarded as unacceptable. Historically, administrative review emerged as a mechanism for higher levels of the administration to control lower levels of the administration throughout the nineteenth century. The review bodies of the higher administration have slowly become hybrid tribunals that are at the origin of the current French-style administrative courts.61

Procedurally, in the civil law tradition, administrative courts have exclusive jurisdiction over tort litigation against the state as sovereign, that is, disputes concerning the exercise of state or public power. However, when the state acts as a private entity then litigation can take place in regular courts as, for example, in contractual litigation. Jurisdictional ambiguity as to the competent forum to bring suit is likely to be problematic when the role of the state in the economy or in society is more complex. Common examples include medical malpractice litigation involving national health system medical doctors and accidents involving assets (such as cars or buildings) belonging to state-owned enterprises. In fact, the multiple roles played by the administration in the economy and in society make increasingly more difficult to have precise definitions of state actions while exercising public powers; for example, a car accident caused by a vehicle owned by a company in which the state holds 25% of the shares.

2.3 Theories of State Liability

Immunities in state liability have long been the subject of an extensive legal literature. Many scholars criticize immunities as undermining the rule of law,62 but other scholars have pointed out some economic advantages of these immunities. First, they protect the public budget from public officials who lack incentives to avoid misconduct and damages awards.63 Second, from the perspective of

61 A specialized review of judicial nature took place later in the nineteenth century, with the empowerment of the Conseil d'État in 1872, which was in essence an administrative body that evolved into a semi-judicial or hybrid review type of court.


compensation to victims (the so-called corrective justice perspective on torts), it has been noted that state liability, in terms of compensation to injured parties and legal costs, is paid by taxpayers, not by the injurers. Taxpayers have little control over state expenses, therefore funding far in excess of the actual exposure to liability (a rent-seeking argument). On top of that, we must consider deadweight losses from taxation. Finally, some scholars find these immunities to be justified under the separation of powers. On the one hand, state liability awards may undermine judicial independence. On the other hand, the fear of liability may negatively impact the tasks of the executive branch, by inducing the state to engage in defensive tactics to avoid liability, thereby distracting resources, both in terms of money and manpower, away from the central role of the executive, that is, the provision of public services.

As to incentives for the behaviour of state officials, many scholars have pointed out that the state’s objective is not profit maximization, hence potentially lacking the market discipline imposed on private injurers. In fact, it has been argued that the use of an incentive mechanism for an agent—such as the threat of paying damages when the risk from a given activity materializes in actual harm—depends crucially on the objective function of the agent, in this case, on the motivation or goal one assumes as the best fit for the behaviour of the state and its officials.

Nevertheless, one could claim that, whatever model one uses to characterize decisions and actions by public bodies, state liability imposes some political costs upon the government, which may counter some of the forces working towards the externalization of negative effects of government actions upon third parties. On

64 In contrast, some scholars have argued that taxpayers should be held responsible for state misbehaviour because they are the voters responsible for electing those who run the state. See BERNARD P. DAUENHAUSER & MICHAEL L. WELLS, ‘Corrective Justice and Constitutional Torts’, Georgia Law Review 35 (2001): 903.


66 These latter dimensions have been mainly raised by English Courts in support of a parsimonious and circumspect approach of the judicial branch to imposing liability upon state bodies. A discussion of these themes is given in FAIRGRIEVE, supra n. 22, 64ff. and 129ff.


69 KRAMER & SYKES, supra n. 5 point out that even if politicians and public officials (as opposed to shareholders of a private firm) do not have direct monetary incentives to externalize the accident costs of the activities of the public organizations, given that they are not (lawfully at least) the residual claimants of any surplus in the public budget, they have clear incentives for cost externalization due to the political opportunity costs of public funds described below in the text. Moreover, they underline several factors that may help (in the absence of state liability) the costly
the one hand, it provides media attention to misconduct by state officials, hence reducing their likelihood of re-election, as voters become more knowledgeable of instances of misbehaviour. Liability may also interfere with the political agenda of elected officials, by bringing into the focus of public attention – at least some of – its harmful consequences. On the other hand, liability payments divert public funds from other activities that are politically more profitable for the incumbent government, in terms of public perception and voters’ appeal, and channel them into compensatory awards and legal costs, which hardly can be deemed as vote gainers. Therefore, one could argue that, at least potentially, state liability may create some political incentives to prevent misconduct, and hence to monitor and punish state officials for their misconduct. It is true, however, that this effect is subject to timing distortions. Although depending on the time when losses are revealed, the time of suit, and the length of litigation or settlement, the political cost of the diversion of funds away from more visible and politically more appealing purposes may be paid not by the elected official who took the decision ending in the tort payment but by a later entrant into office.

Several agency problems, however, have been identified in the literature as strong impediments to the effectiveness of the political incentive function of state liability. Voters might have little ability to assess government performance with or without state liability. Moreover, the political incentives that may be powerful at the top echelons of government only affects a small number of public officials, namely professional politicians and elected officials. Many cases of harm to private citizens that could be redressed through state liability do not originate in the behaviour of the elected officials, but on that of non-elected public agents, such as state employees and bureaucrats who are the subordinates of the elected officials. In addition, elected officials might have little control over the actions of their subordinates in terms of selection of personnel, promotion, operation, and so on. On top of this, incentives created by state liability may be, in the margin, of little relevance, because there are important political mechanisms that already provide exactly the same incentives as state liability. When there is substantial political accountability,

externalization strategy of public officials hard to be perceived and to be uncovered by the citizenry: Accidents may happen infrequently and are non-salient political issues, while voters will be ill-informed about them, and their adverse consequences may disproportionately fall upon poorer segments of the population who are relatively more politically disenfranchised. Although the large variety of torts committed by public employees and officials may undermine the strength of some of these factors in various sets of circumstances, it seems intuitive that in many areas of accidents caused by state action, the cost externalization strategy may end up undetected and unpunished by the voting citizens. However, in most of them, precisely the same factors would also lead to a not so relevant role of legal liability of the state as a source of powerful political incentives for public officials and politicians.

See Posner & Sykes, supra n. 5.

These political opportunity costs of public funds used to pay out liabilities arising from torts committed by public officials are also underlined by Posner & Sykes, supra n. 5.

See Rosenthal, supra n. 15.
it is likely to provide sufficient protection against misbehaviour by public officials, and there is very little, if any, need for damages to achieve the optimal amount of safety in public services and in the provision of public goods.73

Given this sceptical but, we believe, realistic attitude towards the effective provision of incentives through legal liability in tort of the government, what seems to emerge from the literature as possibly the sole virtue of state liability is that state liability guarantees some form of compensation to victims. However, such an objective could in many circumstances be achieved by publicly funded insurance or other publicly organized compensation funds when private insurance fails. Certainly, transaction costs will be reduced by substituting those cheaper alternatives for expensive tort litigation.74

These apparently bleak observations about the aptitude of state liability for safety incentive provisions and satisfactory compensation of losses have led legal scholars to explore and, eventually, to find other explanations apart from (costly) compensation of injured parties and (weak) incentives for state officials. Some have noted that state liability may be able to produce information and publicity about the activity of state officials that could have an important and valuable effect on assessing the performance of politicians and elected officials more generally. It might also help the development of articulation between legal principles and rights in cases where other types of legal intervention have largely failed.75 It is to be noted, however, that media attention is likely to be only attracted by egregious events and it is not clear whether it is the accident itself or the subsequent payment of damages that generates information. Likewise, in this context, there are serious arguments against settlement in state liability litigation.76 Moral hazard may be a large problem here, since taxpayers would pay the bill of the settlement, but the officials would enjoy the benefits of it; politicians want to minimize embarrassment or electoral costs, so they are willing to settle more often and for higher amounts, leading to many and excessive settlements.77 This outcome would undermine not only the production of information but also the development of precedents.

74 This is one of the points made by Rosenthal, supra n. 15. Obviously, state-provided insurance is adequate if it is the cheapest available mechanism to society. However, the mere existence of profits by private insurance companies does not make the state-provided insurance necessarily the cheapest option.
76 In fact, many European legal systems impose severe restrictions on settlement of claims (not only state liability claims) involving the government. See further discussion in s. 4.2.
Finally, as discussed in the previous subsection, although differences between common law and civil law jurisdictions are important in several respects, these systems have delivered similar results in many areas and legal scholars note that state liability has been expanding at not so different paces in common law as well as in civil law countries. The rationales for this development seem to be still unclear.

3. The Economics of State Liability

3.1 State Liability to Provide Incentives

When state liability is expected to provide incentives to engage in accident-reducing behaviour, we need to ask whether the imposition of liability on the state is likely to result in incentives for state officials and agents at various levels. If it is so, the now classical economic theory of tort liability offers guidance on how liability should be determined and apportioned. However, if the chain of command fails to transmit incentives from the liable organization to its decision-making employees in the relevant context (high ranking in case of policy or far-reaching organizational decisions, low level for many other kinds of precautionary behaviour), otherwise optimal liability rules might fail to produce the desired outcome in terms of incentives: first of all, the imposition of liability on the state might result in an increase rather than a decrease in the number and/or severity of accidents; second, to minimize these adverse effects, contributory negligence should generally be preferred to simple or comparative negligence and strict liability with defence of contributory negligence should be preferred to other forms of the strict liability rule. Finally, if the chain of command fails, any form of state liability is likely to result in a deterioration of the state budget but not necessarily in a reduction of the accident-producing activity. We will prove these three statements in turn.

If the chain of command fails, state liability might result in an increase in the number or severity of accidents. If the chain of command fails to transfer incentives, a most obvious outcome is that state liability fails to reduce the number or the severity of accidents. This happens in unilateral precaution accidents, when victims cannot take any form of precaution to protect themselves from harm. Examples of

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80 We refer here to the pure form of comparative negligence. Many jurisdictions employ a modified form completely baring the victim from recovery if he or she is grossly at fault as, for example, when the victim bears 50% or more of the fault. Such correction makes comparative negligence partially approximate contributory negligence but does not totally bridge the gap at low levels of negligence. See, on the different versions of comparative negligence, from an economic perspective, Mireia Artigot & Fernando Gomez, ‘Contributory and Comparative Negligence’, in Encyclopedia of Law and Economics: Torts, ed. Michael Faure (Northampton, MA: Edward Elgar, 2009).
81 Formal proofs for the first two claims are available from the authors; the third claim is proven informally.
these types of accidents, where the state is the only party that can take precaution, are police shootings on passers-by and latent pollution by city waste.

In contrast, in bilateral precaution accidents, both the state and private parties can take precaution in order to diminish the expected accident harm. Examples of this are car accidents in badly kept roads, pedestrian accidents on dangerous pavement, or harm to residents from severe weather conditions, when warning or rescue by public bodies has failed, and also accidents in which the injury falls upon a public employee (police or military personnel harmed by friendly fire, for instance). In these cases, if victims observe or can expect that the state will not take precaution, they might be induced to take less precaution when the state is liable – as they will be compensated – than when the state is not liable – and hence they would have to pay for their own losses. By insuring victims effectively and gratuitously – this is an implicit insurance coverage ultimately paid for by taxpayers – state liability might dilute the victims’ incentives to take precaution and hence might increase rather than reduce the number or severity of accidents.

To prove that state liability might worsen accident prevention and hence social welfare, assume that a governmental body is liable under the simple negligence rule\(^\text{82}\) for failure to maintain roads in a certain area. Assume further that drivers can make up for lack of maintenance by taking some extra care on their part and that this action would be socially desirable. Absent state liability, drivers would have incentives to drive slowly. In contrast, with state liability, drivers expect the state to be negligent and, according to the simple negligence rule, expect to receive full compensation irrespective of their behaviour in case of accident. State’s precaution is the same with or without state liability, but drivers’ precaution is less with state liability, thus more accidents or more severe accidents occur. Finally, note that a reduction in drivers’ care brings about a reduction in social welfare. This is because, by hypothesis, it would have been efficient that drivers increased their precautions in response to the state’s lack of precaution.

*If the chain of command fails, contributory negligence is generally the desirable negligence rule.* State liability might dilute victims’ incentives, but this outcome crucially depends on the liability rule in place. The reason why victims’ incentives are diluted in the example above is that the victim is insured against the accident loss irrespective of his or her behaviour. Rules of simple negligence and strict liability with dual contributory negligence guarantee the victim compensation whenever the injurer is negligent and even if also the victim is negligent. It follows that victim’s incentives can be restored by making the victim bear as large as possible a part of the accident loss when the injurer is negligent. Contributory negligence and strict liability with defence of contributory negligence do so by denying altogether compensation to negligent victims. This restores victims’ incentives and generally improves social welfare. Comparative negligence and strict

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\(^{82}\) The victim receives no compensation unless the injurer (the state) is found negligent.
liability with comparative negligence lie somewhere in between the two extreme cases just described.\textsuperscript{83}

As we have noticed above, when the state can be expected to take less than socially optimal precaution, the level of precaution that victims should take is typically different from the ideal level. In fact, victims might be called upon to make up for the state's lack of precaution, as in the example above - a situation in which the parties' precautions are substitute to each other - but it could be also desirable that victims reduce their levels of precaution - a situation in which parties' precautions are complements to each other - as their precaution becomes less useful absent state's precaution, as it happens when the state fails to organize and manage a reliable weather alert system and hence victim's effort to check information provided by the system becomes useless. Therefore, it is generally desirable that victims alter their precaution (either by increasing or by reducing caretaking) in response to the state's lack of precaution.

A socially optimal negligence rule should take these considerations into account and define the victims' negligence standard not with reference to the theoretically optimal precaution level, but according to the level that is optimal given the precaution actually taken by the state (a second best). Thus, the negligence standard should be either higher or lower than the first-best level of precaution, depending on whether precautions are substitutes or complements, respectively. If the negligence standard is set in such a way, contributory negligence guarantees that victims abide by such standard and hence minimizes the social cost of accidents. The intuition behind this result is simple. Contributory negligence makes the victim bear the full accident loss unless the victim takes the due level of care. Such level of care is the most convenient choice for the victim as it minimizes the accident loss given the actual behaviour of the state, and hence minimizes the victim's liability costs. Other rules reduce the negligent victim's liability partially (comparative negligence) or completely (simple negligence) and hence dilute the incentives to abide by the due care standard.

In summary, we can manipulate the negligence standard under a contributory negligence rule in order to achieve the efficient precaution on the victim's side. However, this is usually an expensive legal policy. Setting negligence standards in such a way might be a cumbersome exercise, as it requires an accurate knowledge of the behaviour of the state, which might not yet be known while setting negligence standards. Moreover, setting the second-best negligence standard requires an

\textsuperscript{83} Analytically, the case in which the victim expects the injurer to be negligent can be treated as a sequential case in which the victim moves second after observing that the injurer (the first mover) is negligent. See DONALD A. WITTENBERG, 'Optimal Pricing of Sequential Inputs: Last Clear Chance, Mitigation of Damages and Related Doctrines in the Law', \textit{Journal of Legal Studies} 10 (1981): 65; STEVEN SHAVELL, 'Tort in Victim and Injurer Act Sequentially', \textit{Journal of Law and Economics} 26 (1983): 589; and MARK F. GRADY, 'Common Law Control of Strategic Behavior: Railroad Sparks and the Farmer', \textit{Journal of Legal Studies} 17 (1988): 15.
implicit admission (and almost a justification) by one body of the state (a regulator or a court) that another body of the state is performing suboptimally. In practice, it might be easier to set negligence standards simply at the first-best level. In this case, the superiority of contributory negligence still holds but is not absolute. To see why, consider the case of complementary precaution, where victim’s precaution should be below the first-best level. That is, social welfare is maximized if the victim takes less precaution than required by the negligence standard; in other words, it might be desirable that the victim be negligent.

Under contributory negligence, the victim will either take the required precaution (which is higher than the second-best level of precaution) or choose to be negligent and take the second-best level of precaution. There might be cases in which comparative negligence prevails over contributory negligence because it is less costly for the victim to be negligent under comparative negligence than under contributory negligence, and hence the victim will be negligent more often. However, this outcome is desirable only under some circumstances. In fact, under comparative negligence, a negligent victim takes a level of precaution that is lower than the second-best level of precaution, because the victim does not bear the full accident loss. Thus, the choice is between possibly too high a level of precaution under contributory negligence and too low a level of precaution under comparative negligence. The balance could go either way. In all other cases, contributory negligence performs better and hence seems to be the preferable rule.

Concluding, note that were the state to take optimal precaution all rules would induce similar levels of victim’s precaution, under perfect information and no court error. Note also that strict liability with contributory negligence performs as well (or as badly, with respect to the state incentives) in our setting as the negligence with contributory negligence rule. The difference between the two only concerns the residual bearer, that is, the party who bears the accident loss when both are non-negligent. The choice between these two rules does not affect our result in any way; moreover, if the state is expected to be negligent, it will not occur in equilibrium that both parties are non-negligent.

If the chain of command fails, state liability might result in an aggravation of the state budget but not necessarily in a reduction of the accident-producing activity. The economic analysis of tort liability is based on a distinction between care and activity level. Care encompasses all those precautionary measures that the court uses in the determination of negligence. However, there are other measures that affect the likelihood or the severity of accidents, which are not considered when determining whether a party has been negligent. Those measures are referred to as

85 Wittman has shown that the marginal cost liability rule achieves higher levels of social welfare than contributory negligence. This rule, however, is difficult to apply in its pure form as it requires compensation of precaution costs even when an accident does not happen. See Wittman, supra n. 83.
activity level.\textsuperscript{86} If the chain of command works, economic theory predicts that both parties will take the due level of care and hence the residual accident costs will be paid by the injurer if the rule in place is strict liability (with or without negligence defences) or by the victim under a negligence rule. This ideal outcome is challenged by a failure in the chain of command.

If the chain of command fails to channel incentives down to the responsible individual, we are to expect the state to be found negligent most of the time in a state liability claim. In turn, negligence by the victim is to be expected only when he or she bears no or only a negligible portion of the accident costs – such as under simple negligence or some forms of comparative negligence; otherwise, the victim will find it advantageous to be non-negligent, leaving the state as the sole negligent party. Thus, either both parties are negligent and the state bears most of the accident costs, or only the state is negligent and the state bears all of the costs. Note that this outcome results irrespective of whether the rule is strict liability or negligence and, thus, due to the chain-of-command failure, liability rules cannot be designed as to choose which party will be the residual bearer. To a large extent, the state will bear the residual loss under all circumstances.

Analysts have noted that the party who bears the residual loss will have incentives to control his or her level of activity.\textsuperscript{87} Thus, we should expect the state to have such incentives. To give an example, accidents in public playgrounds can be avoided by regularly maintaining child slides (care) or by refraining from installing them in the first place (activity level). Let us assume that there is a chain-of-command failure and hence the state official responsible for the maintenance of the child slides does not act according to his duties even if the state is exposed to tort liability – the state acts negligently by not supplying the required level of care. Will the same official or another official in the administration respond to the increased costs in liability payments by removing the child slides? That is, will the state adjust its level of activity? Given the hypothesis (the chain-of-command failure), it seems difficult to imagine that this will happen. Most likely, the same reasons that induce state officials to adopt a suboptimal level of care will prevent them from choosing the desirable level of activity. This situation is likely to result in an aggravation of the state budget and in the curbing of some state activities but not necessarily in a reduction of the accident-producing activity in question.

\textbf{3.2 State Liability to Remove Incentives}

State liability is also invoked, more or less explicitly, for an opposite goal: that of removing incentives. In the Introduction, we have discussed an example of corruption. Other examples include involuntary takings, customs and immigration laws,


\textsuperscript{87} See Shavell, 1980, supra n. 86.
taxes, and publicly conferred grants, such as patents or public subsidies, where corruption could play a major role. Note, however, that the removal of incentives we have in mind covers a broader set of cases than just bribing. For example, it has been observed that wrongful conviction might generate incentives to engage in illegal activities\(^{88}\) because the possibility to be wrongfully sanctioned reduces the relative advantages of engaging in legal activities. Moreover, wrongful conviction might induce wasteful investments in litigation or in avoiding apprehension. Compensation for wrongful conviction could remove or at least correct such incentives. Similar considerations apply to misconduct concerning the protection of witnesses (which might induce witnesses to avoid cooperation with enforcement authorities), irregularities in the granting of patents (distorting R&D incentives and the use of innovations), unlawful collection of evidence or other irregular police activities (which induce bribing and avoidance behaviour),\(^9\) or the exposure of people working with or for the state to risk (e.g., the Gulf War syndrome,\(^{90}\) which could reduce participation levels in such activities).

A different example is the case where sovereign immunity would allow corporations to avoid product liability and shift responsibility from the corporation to the state that cannot be sued (e.g., the pharmaceutical industry could use approval by government to shield it against any responsibility). In this case, litigation by consumers would be impossible and therefore would have no deterrent effect in products liability.

In our examples, the argument is that imposing a cost onto innocent citizens (the wrongful denial of a permit by a corrupt official, the wrongful conviction following a court error or undermining products liability) lowers the relative advantage of engaging in legal activities, due to the fact that the legal activity may still result in a (wrongful) disadvantage. Thus, legal activities are made comparatively less desirable than illegal activities, something that distorts incentives to abide by the law. To remedy this problem, innocents who have been unjustly denied a permit or wrongfully convicted, for example, should be compensated, as to at least partially remove the cost due to the wrongful state action and restore the correct incentives.\(^{91}\)

In these and similar cases, liability is not only meant to provide the state with incentives. The idea is that the behaviour of private parties may be realigned with the socially desirable behaviour by compensating for losses. Absent compensation,


\(^{91}\) See supra n. 88.
private parties would react to these losses by altering their choices (corrupting the official or engaging in criminal activities). This goal is carried out simply by awarding compensation to the victim. As compared to the previous case, the important analogy is that in these cases, incentives of private parties are affected by state liability. In the case of accidents, the presence of liability might reduce the incentive of private parties to take care. In this case, it is the absence of liability that could distort incentives.

3.3 State Liability to Monitor Certain Public Bodies and Branches of Government

State liability can be used to monitor certain public bodies or other branches of government. This can happen when liability immunity is waived for tortious actions by independent bodies such as regulatory agencies or when new legislation introduces liability for wrong judicial decisions. These cases can be framed within the general model describing the production and removal incentives (e.g., in order to increase the quality of judicial decisions or reduce corruption and court congestion). However, since policing the judiciary, independent regulatory agencies or public bodies by means of state liability can be an effective way for the executive to influence them, these examples raise other efficiency concerns.

The generation of information about performance is economically valuable; however, it is far from clear that using state liability to generate that kind of information is the least costly mechanism. Litigation and the tort liability system are expensive devices to obtain information that presumably could be made available if public administration and state organization were improved. For example, using state liability to gather information about the performance of courts or the national health system does not seem to be cost effective.

Furthermore, invoking state liability to monitor certain public bodies or other branches of government generates serious political economy concerns. State liability can be used to disfavour other branches of government and independent bodies, thus undermining the status quo checks and balances. One immediate concern is the extent to which this legal development embodies rent-seeking by the government, therefore increasing transaction costs. The argument that such shift enhances accountability is also problematic, since state liability does not seem to be the most cost effective way to do that. In fact, a comprehensive reform of the institutional design of executive and judicial powers (e.g., a judicial council\textsuperscript{92}) seems more appropriate than the use of state liability. Although state liability is likely to produce information that can be used by the upper levels of government in order to assess the performance of lower levels, it seems to be a possibly very costly

way to do so, somewhat similar to waiting for the Chernobyl nuclear power plant to explode in order to gather information on the competence of its management.

3.4 Fixing the Problem

3.4.1 Making the Chain of Command Work

The problem with the provision of incentive resides in the failure of the chain of command within the state apparatus. Evidently, if the state could effectively delegate liability down the chain of command, the shortcomings identified in our discussion would be solved. Apart from possible impediments to such a solution already mentioned, delegating liability within the chain of command raises other serious problems. Some of the objections follow easily from the economic literature on vicarious liability. Vicarious liability, that is, the liability of firms for the misconduct of their employees, is normally advocated as a correction for three possible types of failures connected with the personal liability of the employee: (i) the employee may be insolvent; (ii) the employee may be difficult to identify and apprehend; (iii) the contract between employee and firm may fail to optimally distribute risk. Imposing liability on the organization may solve those problems as the firm is usually more solvent than individual employees, more readily identifiable and easier to sue, and a more efficient risk bearer. The question here is, therefore, whether liability should be imposed on the firm or on the individuals and not, as when discussing state liability, whether there should be liability at all. Nevertheless, this literature offers some interesting conclusions that are applicable in our case.

Under vicarious liability, the legal system essentially delegates the control of the individual conduct of employees to the firm. As we have observed for state liability, this mechanism works if incentives are transferred from the liable firm to the employees whose behaviours affect the risk giving rise to vicarious liability. This issue is taken into account both in legal doctrines and in economic analyses.

Legal doctrines of respondeat superior stress the point that the firm is liable for acts committed by employees within the scope of the employment. This is to ensure that liability is in fact imposed in situations in which the firm can exert control over the employees' conduct and not otherwise. Legal economists have recently pointed out that imposing liability for employees and not for independent contractors discourages firms from asserting control over the conduct of their

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93 See Sykes, supra n. 5; Kornhauser, supra n. 8; and Caroupa, supra n. 8, for a comprehensive discussion.
94 Imposing liability on the firm also avoids the problem of those firms that delegate dangerous tasks to insolvent employees for the only purpose of escaping liability. See also Kramer & Sykes, supra n. 5, and Arlen, supra n. 8, on perverse effects of vicarious liability.
95 See Dari-Mattiacci & Parisi, supra n. 8.
96 See Sykes, supra n. 5, on this point.
97 See Arlen & MacLeod supra n. 8.
agents and, in fact, induces the structuring of the relationship as an independent contract rather than as an employer-employee relationship. The core of this criticism points to the normative implication that the scope of vicarious liability should be defined as to include all those cases in which the firm factually has within its choice the ability to control the conduct of its employees. Empirically, there seems to be evidence suggesting that the threat of liability induces firms to strategically disintegrate, create subsidiaries with limited liability, and make heavier use of outside contractors, in order to reduce their liability burden. These sorts of arguments and evidence, however, would apply only in a weaker form to state liability, given that the use of subsidiaries is not available for the state, and even the use of independent contractors may be limited for legal, and possibly also political, constraints.

From the opposite perspective, it has been argued that when the firm cannot control the conduct of its employees, individual liability is more efficient than vicarious liability. Legal economists make this point in connection to white-collar crimes and argue in favour of personal criminal liability when it is difficult for the firm to monitor the behaviour of its employees. If individual state officials would be frequently and effectively punished for harm arising from malfunctioning or failed public services, some unintended and undesirable consequences may ensue. The risk of liability would determine a decline of public administration relative compensations, unless the state is willing to effectively increase salaries for the employees suffering from the exposure to personal liability. This responsiveness in the level of compensation seems unlikely to us, due to different factors: public attention and public distrust of high levels of compensation of public officials appear to be widespread; politicians, who would be the ones taking the decision to increase compensation for the employees, would bear the political costs of the measure but would not capture the entire value generated by the actions of public employees, thus diluting the incentive to absorb the risk of individual liability through higher compensation for the public employees. This deterioration of the actual levels of compensation would create a problem of adverse selection in the access to public employment, and thus lower the expected qualification of state employees and the overall quality of the public administration.

Making public employees responsible may also produce incentives for defensive behaviour in those exposed to liability. They would conduct the operation of public services to maximize their expected personal utility, which would imply, to a large extent, given the essentially output-independent level of compensation, minimizing their expected total personal accident costs (personal costs of precaution,

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typically modest, given that safety equipment is borne by the state, plus expected personal liability) and not to maximize citizen's welfare. Risk aversion of individual employees as agents (contrasting with the risk neutrality of society as a whole as the principal, at least with respect to the ordinary risk of harm from public service) would exacerbate this deviation from the optimal running of public services induced by personal liability of public agents.

Summing up, the chain-of-command failure undermines the production of adequate incentive and questions the deterrence effect of state liability. However, there are serious practical impediments and substantive arguments to think that achieving an effective chain of command is easily done. Our analysis suggests that, if the function of state liability is to produce incentives, state liability should be a function of the institutional design of state agencies. Paradoxically, however, this may lead to the perverse outcome that better organized agencies - that is, agencies with clearer and more responsive hierarchies - should be 'punished' by exposing them to more liability than less organized agencies.

3.4.2 The Liability of State Employees

Having in mind the serious shortcomings identified in the previous sections, a different approach is the overall substitution of state employees' liability for state liability.\(^{100}\) However, this alternative does not go without problems. We suggest at least four serious shortcomings afflicting this proposal: (i) it imposes a cost on victims in order to identify which state officials were negligent or caused the accident (which, given the complexity of modern states, in some cases will be quite costly, if possible at all);\(^{101}\) (ii) since in many situations the observed output of state activity is the product of a team, we would have the usual problem of punishing only some members of a team (those who are perceived to be at fault by the victim and by the court) with the result of well-known distortions in behaviour within the relevant team; (iii) insolvency by state officials; (iv) potential adverse selection problems across state departments, since not all state jobs are equally exposed to liability as perceived by victims or the need to compensate state officials for the larger exposure to liability due to their functions. We should realize that punishing elected officials for the behaviour of state officials (only a minority of which are directly appointed by the elected officials) will introduce yet another agency problem that would further develop cover-ups and liability avoidance activities as discussed before.

Moreover, given the high fixed cost component of litigation, tort, or otherwise, the disaggregated character of separate lawsuits against individual public employees would add on the costs of bringing more aggregated tort claims against

\(^{100}\) See KRAMER & SYKES, supra n. 5, for an examination of the choice between personal liability and vicarious liability.

\(^{101}\) See supra n. 5 and n. 8.
the state based on state liability principles. When liability insurance was used to shift risks away from the potentially liable party (even if paid by the state, and not by the individual employee, as is the rule in private firms with managers with respect to Directors and Officers (D&O) liability insurance), the costs of handling a much larger number of individual insurance policies would also be higher than a global policy for the relevant public body (the city, statutory corporation, government, and so on).

In conclusion, personal liability imposed on state employees is an obvious solution to the shortcoming identified in the previous subsections; that is, it could theoretically provide the missing incentives for avoiding accidental or wilful misconduct, as well as making sure that victims and innocent citizens are compensated. There are, however, several arguments that may justify why, in practice, this instrument is unlikely to provide an adequate solution to risks arising from public actions, and hence justify resorting to state liability (albeit its second-best nature).

3.4.3 Market Pressure

A further particular case of actions that deserve attention is the ones involving state provision of private goods. The distinction between torts committed by the state while providing public goods or while regulating markets and those committed by the state while providing private goods in competition with private entities (subject to tort liability) is important. Sovereign immunity extending to the state provision of private goods gives an advantage to the state over private companies. Consequently, the liability immunity in actions that are not exclusive competences of the state can distort the market for those private goods and services in a significant way.

A similar reasoning applies to the state provision of private goods in a monopolistic market. Absent any market discipline as well as any form of tort liability, there will be disproportionate losses to taxpayers (who could be expropriated of the monopoly rents by the politically appointed management) and for consumers (who bear the cost of monopoly power).

The analogy between state and corporate liability is stronger for those activities that can be provided concurrently by states and private corporations. An economic analysis suggests that a sharp distinction should be made between activities that are exclusively provided by the state (which should be framed in the general model we have developed) and those that are concurrently provided by the state (for which the economic analysis of corporate liability should be the appropriate model given the market context).

4. Specialized Courts and Procedures for State Liability

If state liability is to exist, then it has to be enforced. As usual, the enforcement must be provided by courts (by court awards) or in the shadow of the courts (by out-of-court settlements). A natural question is if state liability should be in the realm of specialized courts given that the state is a very particular type of defendant, and
state liability over tortious acts committed by the administration might be very distinct from other torts and wrongdoings as we have discussed previously. Establishing specialized courts raises important issues, namely the extent to which state liability should be enforced by courts with a specialized jurisdiction for administrative matters, the degree of specialization exhibited by the judges staffing those courts, and the particularities of a specialized set of procedural rules distinct in nature from civil and criminal procedures. In many countries, state liability is under the jurisdiction of administrative courts with specialized judges and operating under their own procedural rules. In other countries, state liability is litigated in regular courts under standard rules of civil procedure. Moreover, in some jurisdictions, the state is not allowed to engage in out-of-court settlements (or at least faces very serious limitations). This characteristic increases transaction costs for state liability and makes it quite different from civil and criminal cases. Certainly, the variance of experiences across countries permits a useful analysis of the advantages and disadvantages of using specialized jurisdiction for state liability, although as we have noticed the practical results do not seem to be extremely dissimilar.

4.1 Specialized Courts for State Liability

Given the focus of this article, our analysis concentrates on the use of specialized courts for state liability, but the relevance of the topic hinges upon the controversial relationship between courts and administrative lawmaking.\(^\text{102}\) Separation between regular and administrative courts encourages specialization in state liability and in administrative matters more generally. Hence, better training, better particularized information, tailored procedures in court to deal with the special features of the defendant (the state), better technology in evidence production, and so on is possible when judges have the training and the incentives to become specialists in administrative law. On the other hand, separation makes capture by the state or by special interests easier. As usual, specialization makes accountability more difficult, as knowledge of administrative law becomes a specific asset in human capital for the judges and therefore they are more dependent on (or more easily constrained by) the government (state officials) as in the typical hold-up problem, and the marginal cost for the judge of deciding against the state is much higher in administrative than in ordinary judicial courts. If specialization is more important than capture, that is, the benefits from specialization outweigh the costs of capture, then administrative courts should exist for purposes of enforcing state liability.

Understanding the exact nature of the benefits and costs of court specialization is therefore of the outmost importance. We start by specifying these benefits and costs as widely discussed in the literature and assess the extent to which they are relevant for state liability. Table 1 summarizes the arguments in favour and against specialization.

A specialized court could assure correct and legally coherent decisions in a complex area given the difficulties in establishing state liability and the technical nature of the underlying facts. Obviously, this argument only makes sense if indeed the determination of state liability is substantively different from tort liability. It could be argued, though, that at least a fraction of state liability cases (for instance, accidents caused by school buses or police cars, both owned by the state) share a substantial portion of legal issues with ordinary tort cases (causation, proximate causation, determination of fault, estimation of harm), thus decreasing the benefits of specialized courts in administrative law to deal with these cases. It is true, nevertheless, that other cases share fewer issues with ordinary tort cases among private individuals or firms (illegal denial of permits or licenses). Therefore, the critical issue

<table>
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<tr>
<th>Advantages</th>
<th>Disadvantages</th>
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<td>Higher quality of decisions</td>
<td>Administrative costs of running a new network of courts</td>
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<td>(in content and in timing)</td>
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<tr>
<td>Legal coherence</td>
<td>Capture by specialized interests (including a specialized bar)</td>
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<tr>
<td>Uniformity of judicial decisions</td>
<td>Costs of coordination with regular courts (include losses to incoherence between different areas of the law and procedure)</td>
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<tr>
<td>Reduction of regular courts’ workload</td>
<td>Development of vested interests by specialized judges and court services or the creation of new state agencies</td>
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<td>Costs of appeal from specialized courts to non-specialized appeal courts (depending on the locus of specialization)</td>
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<td></td>
<td>Costs of less geographical proximity of courts to populations (since specialized courts are usually located in large cities)</td>
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is not the complexity of state liability but the extent to which such complexity is intrinsic to determining liability when the state is the defendant. This argument does not seem to us to be overwhelming. In fact, state liability for state provision of private goods does not seem to satisfy the argument for a specialized jurisdiction.

A different advantage refers to uniformity of judicial decisions, usually echoed in the American legal system with the objective of producing a uniform interpretation of federal administrative law, absent inter-circuit stare decisis. It is plausible that uniformity over state liability is more important than over tort liability because of the federal implications of adjudicating state liability, not least in terms of the costs to the federal budget.

Court workload is another argument, in particular when we have court congestion with an increased volume of litigation and a potential reduction in quality in sentencing as a response. In other words, the need to keep high-quality generalist courts might justify transferring jurisdiction of state liability to specialized courts. In fact, one should notice that by alleviating the dockets of regular courts, one expects to increase the general understanding of the law (due to fewer people writing about the same law) that generates less litigation and less workload in the future. The natural question here is why state liability, or any other administrative matter, and not other relevant areas of the law. The answer seems to be that what should be transferred are cases characterized by a high volume of routine cases with significant workload for regular courts, which is untrue in many countries when it comes to state liability. However, this argument has serious empirical deficiencies since state liability litigation does not seem to be overburdening the court system.

On top of pure efficiency considerations of specialization, there are political economy arguments. The standard justification is that state liability cannot be adjudicated by administrative bodies due to their lack of impartiality since they combine rulemaking, adjudication and enforcement functions. The creation of specialized courts to deal with state liability could be part of a broader course of action that effectively reverses the process of delegation of authority to administrative agencies (since it reallocates some of their competences to the benefit of the courts). Yet, it is not obvious why specialized courts would be willing to confront the administration more frequently than regular courts (in fact, if we believe in the capture hypothesis, they might be less willing to do so). In other words, it could be that specialized courts are more willing to impose state liability than administrative agencies, but the relevant comparison should be between specialized and generalist courts. Furthermore, if specialized courts are to be used as a mechanism to limit administrative authority, it can always generate a backlash in terms of future delegation or new legislation. Another line of reasoning is to argue that specialized courts, by limiting and supervising agencies, reduce the need for further administration supervision and therefore provide a good signal of which areas of the administration are more prone to generate state liability. Yet, as we have seen in
the previous section, such a conclusion presupposes that incentives within the administration are fairly aligned (i.e., that the upper levels of the administration are interested in determining state liability from wrongdoings by lower levels of the administration), and hence courts are more effective in sanctioning negligent bureaucrats than the administration itself. As to the signal sent to the general public, although presumably important, it would probably be stronger coming from a generalist court, given that the state there enjoys exactly the same privileges as any other private party.

Capture is the standard argument against specialization. It can take place at the appointment level. Examples include dependence of a specialized bar or of a specialized judicial council and other devices by which the interests of the administration can make its influence felt in the appointment mechanism. Capture can also take place at the level of the adjudication.103 There are very strong arguments to consider capture of specialized courts a major issue.104 The costs of capturing are lower given the specificity of the issues at stake and the relatively low chances of being exposed. On the other hand, the perspective of specialized judges forming a cohesive group, fairly insulated from other magistrates and less likely to be accountable, increases potential benefits. Finally, in the case of state liability we might suspect important structural biases. Indeed, the influence of the administration and of special interests will tend to align the profile of the state bureaucracy with that of the specialized bench (favouring, e.g., the administration in producing evidence or raising the costs for private parties to show lack of due care by the administration). We could say that many of the particularities of administrative procedure observed in many jurisdictions are in part consequences of this alignment.

There is also the possibility of internal capture or the development of vested interests. Courts could behave strategically as any other bureaucracy and push for expansion of budget and resources, attract new business to justify their existence, or develop confusing and incoherent procedure (discovery, pleading, or trial methods) that make cross-relationships unproductive (therefore keeping the monopoly of specialized courts over a particular subject matter, in this case, state liability). A potential ratchet effect should not be neglected. Specialized courts push for idiosyncratic procedures, a specialized bar and hence a particular market for legal services. Thus, we might be creating a completely different legal environment for state liability.

103 See discussion of illustrative empirical evidence, supra n. 39.
Finally, the highly significant influence of specialized courts on administrative law and administrative procedure in determining state liability reduces effective supervision by higher regular or generalist courts. Not least, such ineffective supervision increases the possibility of mistakes that will increase the need for new legislation.

Many of the benefits and costs are exacerbated if state liability is assigned to specialized courts on the basis of exclusivity (administrative courts hear every case of state liability) and limitation (administrative courts hear only cases of an administrative nature).\textsuperscript{105} Similarly, if specialized courts are staffed with specialized judges rather than generalist judges. Obviously, increased collegiality of the specialized judiciary promotes faster learning in specific areas of the law but generates two important drawbacks. First, a specialized bench might not enjoy the reputation of a generalist judiciary and hence an adverse selection effect might take place (it could be harder for administrative courts to attract talent). Second, a specialized bench might have to interact with higher courts staffed with generalist judges (depending on the locus of specialization; some countries have a specialized bench at all levels of the judiciary). This hierarchical relationship might create serious conflicts, not least because the use of particular procedures in specialized courts (i.e., procedures that are modified for specific goals) might disturb the whole court system.

In our view, this striking difference between a specialized court system for state liability and administrative law of the French type and less so for common law does not necessarily mean that one arrangement is superior to the other. We argue that there are certain characteristics of the French system that might justify its design for certain jurisdictions.

General complexity of administrative law. One should look not only at overall complexity but also at variance within administrative law: the higher the variance in the legal issues among different types of administrative law cases (state liability versus review of agency regulations, tax law, environmental law, or public employment rules), the less the benefits of specialization for each sub-field of administrative law, including state liability. It has been recognized that French-style administrative law is extremely complex and varies across substantive areas (such as taxes, licensing, and regulation and public employment, for example).\textsuperscript{106} To this legal complexity, one needs to add the assessment of state actions that are market-oriented in economic nature but of legal public nature (public provision of public goods and services).

\textsuperscript{105} See discussion of terminology by REVEZ, supra n. 102.
\textsuperscript{106} See BELLO \textit{et al.}, supra n. 24. For Italian law, see WATKIN, supra n. 35, recognizing special areas of administrative law (tax, pensions and public waterways). For German law, see NERHAUS, supra n. 40, explaining that administrative law is highly specialized and usually defined according to the different branches of the administration such as public construction and zoning law, civil service, local administration, or environmental administrative law.
Strong state intervention in the economy and in society. A large size of the public sector naturally increases the complexity of administrative law and also the likelihood of more litigation between private victims and the state. It also makes the distinction between state regulatory actions and those of a private nature more relevant.

Strongly unionized and substantial public employment. It is likely that there will be important conflicts between the unionized public workers and the state (as an employer) when state liability becomes more effective.

A weak system of independent regulatory agencies and a strong system of administrative-dependent agencies. Independent regulatory agencies play an important role in providing expertise on administrative law and state liability in their own fields of regulation; they also provide informal review of administrative justice. The judiciary would be, in general, less distrustful (in the political view of the judiciary as a check against the excesses of a partisan executive branch) of an independent agency than of purely political decisions of an administrative agency. Hence, where we find strong and independent expert agencies we expect less need for specialized administrative courts; they are, to some degree, substitutes, both in expertise in administrative law and in political independence from the executive. Note that our conclusion looks at independent regulatory agencies and specialized courts as providers of high-quality reviews of administrative decisions. A different viewpoint refers to accountability where the appeal process plays an important role in keeping independent regulatory agencies constrained.

4.2 Out-of-Court Settlements with the State

Of particular importance are rules governing out-of-court settlements. The arguments against out-of-court settlements for state liability litigation are that the value of the information provided by litigation for assessing the performance of the government and elected officials will be lost and the willingness of officials to pay too much for settling (avoiding disclosure to the general public). Even more importantly, if we take the principal-agent model, settlement could be reached without the principal knowing about the occurrence of the wrongdoing as well as the facts and the amount of the settled compensation, something quite unlikely in corporate organizations; for the shareholders to be kept ignorant of a non-trivial settlement involving ultimately managerial action, one would need to cook the books to hide the facts and the amount of the settlement, an action that is in itself both a tort and a crime.

Both arguments, however, need some careful thinking. Information provided by litigation is only politically relevant when the media takes notice of it; otherwise, taxpayers and voters would hardly pay any attention to it. The question is whether

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the media pursues the wrongdoing itself or only notices once the consequent litigation takes place. Media attention to wrongdoings could pressure elected officials to avoid out-of-court settlements if they are perceived as a signal of mismanagement. Furthermore, there is no obvious interest for plaintiffs to avoid media attention since it might increase their bargaining position. As to the argument that officials are willing to pay too much, this is surely constrained, at least to some extent, by the need to increase taxation to raise the necessary amounts, and by governmental budgetary and accountability rules.

_State liability generates information about the quality of state actions._ The more often damages are paid by the state, the more information about the quality of state actions is provided to the voters. Obviously, the interests of the voters and those of taxpayers are not fully aligned, but at least to some extent political elections provide for the possibility to send signals to politicians showing discontent concerning the behaviour of state officials. In corporate liability, there are two agency problems to be solved, between shareholders and agents, on one hand, and between the authorities and the corporate owners, on the other hand. Therefore, the shareholders are at the same time agents of the state – as embodying, at least ideally, social welfare – and principals for corporate managers. In state liability, there is one principal (taxpayers) and one agent (the state official). Hence, the information revelation problem is of a different nature in corporate liability than in state liability. Whereas in corporate liability, information revealed by adjudication is not a good alternative to information revealed by internal control mechanisms in the corporation (which shareholders as an agent of the state also may want to hide); in state liability, information revealed by adjudication may be the only reliable one that taxpayers observe. 

_State liability could provide a focal point for the rest of the society._ Many citizens are unsure about the appropriate behaviour and state liability provides them with a focal point to answer that question. The impunity of the state as a major player in modern economies would undermine societal trust in the rule of law and in the desirability of adjusting behaviour to legal rules. Such arguments are similar to those that argue for liability, in particular, corporate liability, as a framework to manage or mould social and individual preferences. There are reasons to suspect that this goal is more efficiently achieved by other means, educational in particular. Furthermore, empirically it has to be shown that state immunity actually undermines individual liability perceptions.

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108 Furthermore, in the corporate context, to alleviate the agency problem between the government and the shareholders, there are gatekeepers – mainly auditors. In the public sector, there may be surrogates of this: Ombudsmen, independent public auditors (courts of auditing such as the Spanish *Tribunal de Cuentas* or the Italian *Corte dei conti*), and so forth. Although see Lorenz Blume & Stefan Voigt, "Supreme Audit Institutions: Supremely Superfluous, A Cross Country Assessment", SSRN Working Paper, <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=965434>, March 2007.
5. Conclusions
We have discussed three main functions of state liability, namely to produce incentives to optimally deter wrongdoings, to remove incentives for inefficient behaviour by third parties, and to monitor certain public bodies or other branches of government. With respect to the first argument, we have contended that the optimal design of state liability is a function of the ability of the state to control and efficiently delegate decision-making powers within the bureaucracy. This raises questions concerning risk sharing, employment contracting in state jobs, and information asymmetries with respect to the functioning of state administration. We have also added potential focal point gains, of which, nevertheless, we remain more than doubtful. As to the second function, we have observed that, contrary to state liability to produce incentives, state liability to remove incentives is independent of the ability of the state to control behaviour and its optimal design does not involve notions of responsibility. Quite the opposite, state liability to remove incentives only makes sense if cheaper private or public alternatives are not available. We can identify a range of situations where market-oriented solutions are potentially ineffective, but even when the system is to be publicly funded, it can be structured as a compensation fund rather than being managed through the tort liability system. Finally, as to the third function, we recognize that state liability can play an important role in generating information about performance of public bodies, but it does not seem to us that this is usually the cheapest device available to the central government.

A very important point we make in the article is that not only might state liability not be a social welfare enhancing institution but it could be counterproductive, precisely for the reasons that policy makers tend to use to support the expansion of state liability. Compensating victims of state wrongdoings might generate moral hazard in an environment where the injurer is not incentivized to exert precaution; hence, the outcome might be more accidents, more litigation and more state expenditures (to be borne by taxpayers via distortionary taxation).

The point we make is not that state liability is in itself a bad idea, as many scholars have suggested, but rather that state liability is an integral part of the broader design of public institutions. The challenge for states should be to develop state liability within the conditions we have identified in this article. In fact, these are not exogenous conditions; states can shape the adequate institutions to meet the conditions we have described.

At the same time, we have identified circumstances under which state liability should be adjudicated in specialized courts with specific procedural rules. A very critical observation is that from the mere existence of a specialized adjudication system for state liability we cannot infer the efficiency or inefficiency of a specific legal regime. Certain factors, namely general complexity of administrative law, strong state intervention in the economy and in society, strong and relevant public employment, and weak independent regulatory agencies might justify a system of specialized judicial review for state liability.