

Two Economists, Three Opinions?  
Economic Models for Private International Law –  
Cross-Border Torts as Example

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## A. Introduction

## I. An Economic Approach to Private International Law

Two lawyers, three opinions – the frequent joke about the indeterminacy of the law and the variety of individual views seems particularly apt for private international law<sup>1</sup>. There is a discrepancy not only between the respective approaches in the United States and in Europe<sup>2</sup>, but also between approaches within each of these jurisdictions. In the United States, there is widespread disappointment with the multitude of equally unsatisfactory methods proposed by academics and judges<sup>3</sup>. In Europe, the clash between traditional conflict of laws theory and the country-of-origin principle is equally unsettling<sup>4</sup>. At least outsiders seem to agree that private international law does a poor job of leading to good and predictable results.

Can law and economics bring more scientific, objective foundations to the discipline of private international law? Some criticism of private international law has always been economic in nature. The preference for forum law in the United States is said to lead to inefficient forum shopping and plaintiff-favouring laws; the traditional choice-of-law rules in Europe clash with the economic ideal of a common market as promoted by the country-of-origin principle. Nonetheless, economic analysis long all but ignored private international law<sup>5</sup>. But recently, interest has risen sharply. There are now both an entire book<sup>6</sup> and an entire Course at the Hague Academy<sup>7</sup> as well as

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<sup>1</sup> This article uses the terms private international law and choice of law interchangeably. Private international law has two advantages: First, it is the standard terminology in many countries outside the United States. Second, and more importantly, it expresses more clearly the conflict inherent in the discipline between a private law and an international law conception.

<sup>2</sup> *Symeon C. Symeonides* (ed.), *Private International Law at the End of the 20th Century: Progress or Regress?* (1999).

<sup>3</sup> *William A. Reppy Jr.*, *Eclecticism in Conflict of Laws: Hybrid Method or Mishmash?* *Mercer L. Rev.* 34 (1983) 645; for an overview of different approaches, see *Eugene F. Scoles/Peter Hay/Patrick J. Borchers/Symeon C. Symeonides* (eds.), *Conflict of Laws* (2004) 5-110.

<sup>4</sup> *Ralf Michaels*, *EU Law as Conflict of Laws?: J. Priv. Int'l L.* (forthcoming).

<sup>5</sup> Some ad hoc economic arguments have always been used by private international lawyers. See for example *Ludwig von Bar*, *Das Fremdenrecht und seine volkswirtschaftliche Bedeutung* (1893) 26 et seq. An early economic analysis is *William F. Baxter*, *Choice of Law and the Federal System*: *Stan. L. Rev.* 16 (1963) 1; cf. *Erin A. O'Hara/William H. Allen*, *Second Generation Law and Economics of Conflict of Laws: Baxter's Comparative Impairment and Beyond*: *Stan. L. Rev.* 51 (1999) 1011.

<sup>6</sup> *Michael J. Whincop/Mary Keyes*, *Policy and Pragmatism in the Conflict of Laws* (2001); for reviews, see *Richard Garnett*, *U. Melb. L. Rev.* 26 (2002) 236; *Megan Richardson*, *Policy*

contributions to two encyclopaedias<sup>8</sup> and a considerable number of law review articles<sup>9</sup>. Almost all of these are normative<sup>10</sup> and efficiency-oriented<sup>11</sup>: they set out to yield criteria for better, more efficient, conflict-of-laws norms.

Economics, one may hope, can bring the conclusiveness to the field that doctrine could not. But alas, even a fleeting review of existing studies reveals a discrepancy of views or economic approaches that mirrors the discrepancy in the traditional private international law doctrine<sup>12</sup>. Some authors focus on individual interests, others on state interests. Some authors emphasize formal issues – predictability for parties, regulatory advantages for states – others substantive issues – optimal incentives for parties, maximizing of governmental interests. Some authors favour cooperation between states to overcome

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versus Pragmatism? Some Economics of Conflict of Laws: *Common Law World Review* 31 (2002) 189; *Michael J. Solimine*, *The Law and Economics of Conflict of Law*: *Am. L. & Econ. Rev.* 4 (2002) 208; *Roberta Wertman*, *N.Y.U. J. Int'l L. & Pol.* 35 (2003) 1160; *Peter Mankowski*, *RabelsZ* 69 (2005) 175.

<sup>7</sup> *Horatia Muir Watt*, *Aspects économiques du droit international privé (Réflexions sur l'impact de la globalisation économique sur les fondements des conflits de lois et de juridictions)*, *Recueil des Cours de l'Académie de droit international de la Haye* 307 (2004-I, published 2005) 25-383.

<sup>8</sup> *Francesco Parisi/Larry E. Ribstein*, *Choice of Law*, in: *Peter Newman* (ed.), *The New Palgrave Dictionary of Economics and the Law*, Volume 1 (1998) 236; *Erin A. O'Hara/Francesco Parisi*, *Conflict of Laws*, in: *Peter Newman* (ed.), *The New Palgrave Dictionary of Economics and the Law*, Volume 1 (1998) 387; *Erin O'Hara/Larry E. Ribstein*, *Conflict of Laws and Choice of Law*, in: *Boudewijn Bouckaert/Gerrit de Geest* (eds.), *Encyclopedia of Law and Economics*, Volume 5 (2000) 631-660, available at <<http://encyclo.findlaw.com/9600book.pdf>>.

<sup>9</sup> More recent foundational articles in the United States include the following: *Michael J. Solimine*, *An Economic and Empirical Analysis of Choice of Law*: *Ga. L. Rev.* 24 (1989) 49; *Larry D. Kramer*, *Rethinking Choice of Law*: *Colum. L. Rev.* 90 (1990) 277; *Joel P. Trachtman*, *Conflict of Laws and Accuracy in the Allocation of Government Responsibility*: *Vand. J. Transnat'l L.* 26 (1994) 975; *Lea Brilmayer*, *Maximizing State Policy Objectives*, in: *Brilmayer*, *Conflict of Laws* (1995) 169-218; *Erin O'Hara/Larry E. Ribstein*, *From Politics to Efficiency in Choice of Law*: *U. Chi. L. Rev.* 67 (2000) 1151; *Joel P. Trachtman*, *Economic Analysis of Prescriptive Jurisdiction*: *Va. J. Int'l L.* 42 (2001) 1; *Andrew T. Guzman*, *Choice of Law: New Foundations*: *Geo. L. J.* 90 (2002) 883. Two general articles on the economic analysis from a non-US perspective are *Kurt Siehr*, *Ökonomische Analyse des Internationalen Privatrechts*, in: *Dieter Henrich* (ed.), *Festschrift für Karl Firsching* (1985) 269; *Horatia Muir Watt*, *Law and Economics. Quel apport pour le droit international privé?*, in: *Gilles Goubeaux/Yves Guyon/Christophe Jamin/Paul Lagarde/ Geneviève Viney/Jean Waline* (eds.), *Le contrat au début du XXIème siècle – Etudes offertes à Jacques Ghestin* (2001) 685.

<sup>10</sup> For a positive analysis, see *Solimine*, *An Economic and Empirical Analysis of Choice of Law* (supra note 9).

<sup>11</sup> For criticism (and a promising alternative approach), see *Christian Kirchner*, *An Economic Analysis of Choice-of-Law and Choice-of-Forum Clauses*, in this volume p. \*\*\*.

<sup>12</sup> *Richardson* (supra note 6) 189-193 invokes “[t]he Myth of ‘The Economic Approach’ to Law” and advocates a different economic paradigm for analysis of common law jurisdictions; for her own approach, see *Megan Richardson/Gillian Hadfield* (eds.), *The Second Wave of Law and Economics* (1999).

regulatory prisoners' dilemmas, others regulatory competition to overcome national peculiarities. In short, the normative proposals from economics differ as widely as those from traditional doctrine. Even after accounting for differences in factual assumptions<sup>13</sup>, some normative differences in outcome remain.

This article sets out to test whether different models lead to different outcomes. If so, the formulation of the question and the model become determinative factor for the answer; different answers given are merely the consequence of different questions asked<sup>14</sup>. This leads to a hypothesis: the different results within different economic models are congruent with the different views within traditional doctrinal private international law, because economic analysis replicates the differences in doctrinal conceptions of private international law<sup>15</sup>. To this end, this article, rather unusually, makes arguments in three economic models – a private law model, an international law model, and a model combining the two. The hypothesis is that the debate whether private international law is “private law” or (public) “international law” is replicated in the economic analysis of private international law. Rather than resolve problems of private international law, economic analysis reformulates them. If this is so, the choice of one model over another cannot be justified in passing in a short introduction, as is the case in many economic analyses; rather, this choice and its justification must be central to an economic analysis.

The subject area for this analysis is private international law of torts, more specifically the question of the law applicable to cross-border torts. Tort law is interesting for an economic analysis of private international law for various reasons. First, no area of private international law has seen more turmoil and change than the law of torts, and few areas rest on less stable foundations today<sup>16</sup>. Second, tort law stands on the borderline between (public) regulatory interests of states and (private) individual interests in private ordering<sup>17</sup>; it is

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<sup>13</sup> The importance of empirical studies (albeit limited to actual behaviour of judges, lawyers, and litigants) to back up analyses is emphasized by *Solimine*, *The Law and Economics of Conflict of Laws* (supra note 6) 218 et seq.

<sup>14</sup> Similarly *Kirchner* (supra note 11) **\*\*\***: “The methodological approach chosen is a decisive factor for analysing issues of conflict of laws”.

<sup>15</sup> For a study of a similar case of interdisciplinary replication (between International Law and International Relations), see *Ed Morgan*, *International Law in the Interdisciplinary Mirror*: *Am. J. Int'l Law* 94 (2000) 595.

<sup>16</sup> For US law, see only *Scoles/Hay/Borchers/Symeonides* (supra note 3) 69-74; for American views of European reform proposals, see *Symeon Symeonides*, *Tort Conflicts and Rome II: A View from Across*, in: *Heinz-Peter Mansel/Thomas Pfeiffer/Herbert Kronke/Christian Kohler/Rainer Hausmann* (eds.), *Festschrift Jayme, Volume II* (2004) 935; *Russell J. Weintraub*, *Rome II and the Tension Between Predictability and Flexibility*, in: *Hans-Eric Rasmussen-Bonne/Richard Freer/Wolfgang Lüke/Wolfgang Weitnauer* (eds.), *Balancing of Interests – Liber Amicorum Peter Hay zum 70. Geburtstag* (2005) 451.

<sup>17</sup> *Leon Green*, *Tort Law Public Law in Disguise*: *Tex. L. Rev.* 38 (1959-1960) 1, 257; *Michael I. Krauss*, *Tort Law and Private Ordering*: *St. Louis U. L. J.* 35 (1991) 623; *John C.P.*

therefore an excellent testing case for the hypothesis that economic analyses of private international law are placed at an unsure position between these two sub-disciplines. Finally, party autonomy, a favourite “catch-all” solution in law and economics, has a necessarily reduced role to play in the area of tort law (although an economic analysis may well suggest broader applications than those currently accepted by doctrine)<sup>18</sup>.

Methodologically, this article’s focus is on efficiency, despite the intrinsic problems with that concept as a normative goal<sup>19</sup>. The simple reason is that efficiency is the focus of most other existing studies on the economics of private international law. Private international law norms act as independent variables in this analysis; a positive analysis of the development of these norms is beyond this article<sup>20</sup>. Some simplifying assumptions are used. First, this article disregards questions of jurisdiction and of forum shopping for more favourable laws. Second, it assumes that the substantive laws of states are not openly discriminatory against foreigners<sup>21</sup>. Third, normative implications are such as to guide a hypothetical global legislator passing private international law norms – a counterfactual institution on the global scene, but a realistic possibility in the European Union and at least a possibility within the United States. Finally, a general caveat is in order: although the analysis is detailed, the point is to provide plausible economic considerations rather than full-fledged, abstract economic models. As a consequence, the economic arguments made here, like those of other authors in the field, are non-formal and methodologically somewhat eclectic.

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*Goldberg*, Tort Law for Federalists (and the Rest of Us): Private Law in Disguise: Harv. J. L. & Pub. Pol’y 28 (2004) 3.

<sup>18</sup> *Whincop/Keyes*, Policy and Pragmatism (supra note 6) 78-79; *O’Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1210.

<sup>19</sup> *Mario J. Rizzo*, The Mirage of Efficiency: Hofstra L. Rev. 8 (1980) 641; *Duncan Kennedy*, Cost-Benefit Analysis of Entitlement Problems: A Critique: Stan. L. Rev. 33 (1981) 387.

<sup>20</sup> For positive analysis of the development of private international law, see *Solimine*, An Economic and Empirical Analysis of Choice of Law (supra note 9) (arguing that interest analysis enables states and interest groups to incorporate more plaintiff-friendly and forum-citizen-friendly laws); see also *Stewart E. Sterk*, The Marginal Relevance of Choice of Law Theory: U. Pa. L. Rev. 142 (1994) 949 (arguing that judges will ignore choice-of-law approaches and instead focus on substantive considerations in deciding cases).

<sup>21</sup> See *Guzman* (supra note 9) 927-930; *Dieter Schmidtchen/Roland Kirstein/Alexander Neunzig*, Conflict of Law Rules and International Trade – A Transaction Costs Approach: University of the Saarland, Center for the Study of Law and Economics, Discussion Paper 2004-01, 25, available at <[http://www.uni-saarland.de/fak1/fr12/csle/publications/2004-01\\_conflict.pdf](http://www.uni-saarland.de/fak1/fr12/csle/publications/2004-01_conflict.pdf)>.

## II. Private International Law: Private or International?

Private international law has traditionally been hard to situate between private law on the one hand and (public) international law on the other<sup>22</sup>. European laws, at least since *Friedrich Carl von Savigny*<sup>23</sup>, have been dominated by a private law conception<sup>24</sup>. A brief flirtation with more public law-inspired approaches in the 1970s<sup>25</sup> has, on this level, been largely ineffective. This conception of private international law is not “merely formalist”, as opponents sometimes claim; Europe has its own kind of “interest analysis”<sup>26</sup>. But the interests that are analysed are largely individual interests<sup>27</sup>. State interests in substantive policies are relatively unimportant.

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<sup>22</sup> *Nikitas Hatzimihail*, Pre-Classical Conflict of Laws (S.J.D. Thesis, Harvard, 2002) 113 et seq.; *Miguel Virgós Soriano/Francisco J. Garcimartín Alférez*, Estado de origen v. estado de destino – Las diferentes lógicas del Derecho internacional privado: InDret 4/2004 (No. 251) 2, available at <[http://www.indret.com/pdf/251\\_es.pdf](http://www.indret.com/pdf/251_es.pdf)>; *Horatia Muir Watt*, Droit public et droit privé dans les rapports internationaux (Vers la publicisation des conflits de lois?): Archives de philosophie de droit 41 (1997) 207; *Robert Wai*, Transnational Lifftoff and Juridical Touch-down: The Regulatory Function of Private International Law in an Era of Globalization: Colum. J. Transnat'l L. 40 (2002) 209; *Ian Mills*, The Private History of International Law: Int'l & Comp. L. Q. 55 (2006) 1.

<sup>23</sup> *Ralf Michaels*, Globalizing Savigny? The State in Savigny's Private International Law and the Challenge of Europeanization and Globalization: Duke Law School Legal Studies Paper No. 74 (September 2005), available at <<http://ssrn.com/abstract=796228>>. For other analyses of *Savigny's* approach to conflict of laws in English, see *Gerhard Kegel*, Story and Savigny: Am. J. Comp. L. 37 (1989) 39; *Mathias Reimann*, Savigny's Triumph? Choice of Law in Contracts Cases at the Close of the Twentieth Century: Va. J. Int'l L. 39 (1999) 571; *Paul Volken*, How Common are the General Principles of Private International Law? America and Europe Compared: Yb. Priv. Int'l L. I (1999) 85; *Hatzimihail* (supra note 22) 40 et seq. and passim; *Mills* (supra note 22) 34-37.

<sup>24</sup> *Gerhard Kegel/Klaus Schurig*, Internationales Privatrecht (2004) 23-24 (§ 1 IV).

<sup>25</sup> E.g. *Christian Joerges*, Die klassische Konzeption des Internationalen Privatrechts und das Recht des unlauteren Wettbewerbs: RabelsZ 36 (1972) 421; for criticism see *Kegel/Schurig* (supra note 24) 202 (§ 3 XI c); cf. also *Staudinger (-Sturm/Sturm)*, Kommentar zum BGB (2003) Einl zum IPR, No. 31-53. But see, recently, *Günther Kühne*, Die Entsavignisierung des Internationalen Privatrechts insbesondere durch sog. Eingriffsnormen, in: *Stephan Lorenz/Alexander Trunk/Horst Eidenmüller/Christiane Wendehorst/Johannes Adolff* (eds.), Festschrift für Andreas Heldrich (2005) 815. The situation is different in European private international law; see *Ralf Michaels/Hans-Georg Kamann*, Grundlagen eines allgemeinen gemeinschaftlichen Richtlinienkollisionsrechts – “Amerikanisierung” des Gemeinschafts-IPR?: Europäisches Wirtschafts- und Steuerrecht 12 (2001) 301 (for relations with third states); *Michaels*, EU Law as Conflict of Laws (supra note 4) (for relations between member states).

<sup>26</sup> The foundational article is *Gerhard Kegel*, Begriffs- und Interessenjurisprudenz im Internationalen Privatrecht, in: *Max Gerwig/August Simonius/Karl Spiro/Theodor Süß/Ernst Wolff* (eds.) Festschrift Hans Lewald (1953) 259-288. See also *Kegel*, The “Crisis” of Conflict of Laws: Recueil des Cours 112 (1964-II) 91-268; *Klaus Schurig*, Kollisionsnorm und Sachrecht (1980).

<sup>27</sup> *Kegel/Schurig* (supra note 24) 134-145 (§ 2 II); *Christian von Bar/Peter Mankowski*, Internationales Privatrecht (2003) 9 (§ 1 No. 12); *Axel Flessner*, Interessenjurisprudenz im IPR

The situation is different in the United States, where private international law traditionally focuses on the conflict of laws as the conflict of sovereigns who want their own laws to be applied. This is an international law conception, focusing on the interests of states or governments. The ground for applying foreign law is frequently comity, an obscurely antiquated kind of politeness that one sovereign accords another sovereign<sup>28</sup>. The most important criterion to determine the applicable law is the governmental interest in having one's own laws applied.

Of course, real world approaches to conflict of laws are neither fully private nor fully international. Three relations can be distinguished: overlap, compromise, sublation. First, there is an occasional overlap between "private" and "state" interests. Sometimes, private and international models suggest similar solutions, because the relevant considerations can be seen as private and state interests at the same time. For example, *Gerhard Kegel* and *Klaus Schurig* argue that the "interest in order" (*Ordnungsinteresse*), in consistent application of law, is an interest both of the state and of individuals<sup>29</sup>. When this consideration is determinative, both private and international law conceptions of private international law reach similar results.

Second, the divergence between models does not necessitate a strict dichotomy of actual private international law methods. Real-world methods are compromises; even predominantly private or predominantly international conceptions allow for other interests as exceptions. Thus in German private international law, state interests do play a role, even if that role is limited<sup>30</sup>. In particular, the theory of internationally mandatory laws has a strongly international/public law flavour. On the other hand, most approaches in the United States do not follow a purely governmental interest approach, but allow also for the consideration of private interests. For example, the Second Restatement<sup>31</sup>, provides an eclectic mixture of public and private concerns with no clear guidelines for their relative weight<sup>32</sup>; despite (or because of) this eclecticism, it dominates the judicial landscape today.

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(1990) (cf. the criticism by *Klaus Schurig*, *Interessenjurisprudenz contra Interessenjurisprudenz im IPR – Anmerkungen zu Flessners Thesen*: *RabelsZ* 59 (1995) 229).

<sup>28</sup> For its history, see *Hessel Yntema*, *The Comity Doctrine*, in: *Ernst von Caemmerer/Arthur Nikisch/Konrad Zweigert* (eds.), *Festschrift für Hans Dölle*, Volume 1 (1962) 65; reprinted with an introduction by *Kurt Nadelmann* in *Mich. L. Rev.* 65 (1966) 1; *Alan Watson*, *The Comity of Errors* (1992). For its current status, see *Lawrence Collins*, *Comity in Modern Private International Law*, in: *James Fawcett* (ed.), *Reform and Development of Private International Law – Essays in Honour of Sir Peter North* (2002) 89-110.

<sup>29</sup> *Kegel/Schurig* (supra note 24) 139 (§ 2 II 3).

<sup>30</sup> *Kegel/Schurig* (supra note 24) 148-158 (§ 2 IV); *Jan Kropholler*, *Internationales Privatrecht* (2001) 31-32 (§ 5 I 1); *Münchener Kommentar zum BGB (-Sonnenberger)* (4<sup>th</sup> ed. 2006) *Einl. zum IPR* No. 13.

<sup>31</sup> *American Law Institute*, *Restatement (Second) of Conflict of Laws* (1971).

<sup>32</sup> For criticism, see e.g. *Reppy* (supra note 3) 655 et seq.

The third combination between a private law and an international law concept can be called sublation. Given how problematic the distinction between private and public law is even in domestic law, the distinction is almost impossible to uphold in private international law, which is intrinsically both private and international. As private considerations can be translated into public considerations in domestic law and vice versa, so the private law conception of private international law can be translated into an international law conception and vice versa. On the one hand, it is possible to translate all private interests into state interests, provided governmental interests are defined as furthering a particular state's conception of justice and efficiency between individuals. For example, US cases occasionally propose state policies in promoting the interests of individuals that trump the state policies behind substantive law – for example the interest of states in being good market-places<sup>33</sup>. The European Court of Justice (ECJ) argued in *Ingmar GB Ltd. v. Eaton Leonard Technologies Inc.* that European rules about mandatory indemnification of commercial agents, aimed at protecting these agent's private interests, was required for a common market (a public interest) and therefore internationally mandatory<sup>34</sup>. Since all differences between the private law regimes of different states will ultimately have some relevance for the market<sup>35</sup>, this public interest can be used for all kinds of rules, including those that ostensibly protect only private interests. On the other hand, all state interests can be translated into private interests. The debate about whether Article 7 (2) of the Rome I Convention<sup>36</sup> protects private rights or only public interests provides a good example<sup>37</sup>. Sublation thus makes it possible to consider all arguments from a public law concept of private international law in a private law concept, and vice versa.

The choice between a “private law” and an “international law” conception of private international law is therefore not a decision that directly determines the answers to specific questions in the field. Within each model, differentiations are possible; neither model is conclusive. At the same time the distinction is not irrelevant. Whether one starts from a private law conception or an international law conception determines the relation between rule and exception, and it

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<sup>33</sup> Cf. e.g. *Lilienthal v. Kaufman*, 239 Ore. 1, 25 (1964): “the policy of both states, Oregon and California, in favor of enforcing contracts, has been lost sight of in favor of a questionable policy in Oregon” (Goodwin, diss.).

<sup>34</sup> ECJ 09.11.2000 – Case C-381/98 (*Ingmar GB Ltd. v. Eaton Leonard Technologies Inc.*) E.C.R. I-9305 (2000).

<sup>35</sup> Cf. *Michaels/Kamann* (supra note 25) 305 and 311.

<sup>36</sup> Rome Convention on the Law Applicable to Contractual Obligations of 19 June 1980 (consolidated version in O.J. C 27 of 16 January 1998, 34 et seq.).

<sup>37</sup> See *von Bar/Mankowski* (supra note 27) 262-269 (§ 4 No. 89-98) with numerous references. The authors themselves argue for restricting Article 7 to public interests.



determines the kind of arguments to be used and their respective force in legal argument.

### III. Cross-Border Torts in Traditional Doctrine

Possibly the most important issue for private international law of torts is which law applies when the conduct and injury occur at different places<sup>38</sup>. In the doctrine, four basic approaches exist. First, the law of the place of conduct might apply. This is the essence of Article 8 (1) of a Japanese reform proposal<sup>39</sup> and is reappearing, in disguise, in the European Union, under the country-of-origin principle<sup>40</sup>. This solution is justified, usually, with the injurer's interests – he knows where he acts and can be expected to know and comply with the laws of that place, but not with the (potentially multiple) laws of places where his conduct may cause injuries<sup>41</sup>. A second approach applies the law of the place of the injury, the general solution under Article 5 (1) of the Rome II Proposal<sup>42</sup>. A formal justification, once influential under the vested rights theory, has since lost ground: the injury was the last event necessary for the plaintiff's right to come into existence<sup>43</sup>. The more important substantive argument is the protection of the victim: unlike the injurer, the victim cannot control for conduct and effects, so he should be able to rely on the protections of his home law. One frequently made argument for applying the law of the

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<sup>38</sup> For a comprehensive analysis, see *Jan von Hein*, *Das Günstigkeitsprinzip im Internationalen Deliktsrecht* (1999).

<sup>39</sup> The Study Group of the New Legislation of Private International Law, Draft Articles on the Law Applicable to Contractual and Non-Contractual Obligations (2), Article 8 (1), published in English in *Japanese Annual Int'l L.* 40 (1997) 57: "Torts shall be governed by the law of the place where the conduct causing the damage occurs. If that place does not belong to any country, Japanese law shall be applied." The Draft Articles provide exceptions for the important areas of product liability (Article 9), Personality Rights (Article 10), Unfair Competition (Article 11) and Environmental Pollution (Article 12).

<sup>40</sup> See *Michaels*, *EU Law as Conflict of Laws* (supra note 4), also for differences.

<sup>41</sup> Cf. *Michael Anderson*, *Transnational Corporations and Environmental Damage: Is Tort Law the Answer?*: *Washburn L. J.* 41 (2002) 399, 417.

<sup>42</sup> Amended Proposal for a European Parliament and Council Regulation on the Law Applicable to Non-Contractual Obligations ("Rome II"), COM(2006) 83 final (hereinafter "Amended Rome II Proposal"): "Where no choice has been made under Article 4, the law applicable to a non-contractual obligation shall be the law of the country in which the damage arises or is likely to arise, irrespective of the country in which the event giving rise to the damage occurred and irrespective of the country or countries in which the indirect consequences of that event arise."

<sup>43</sup> *Joseph H. Beale*, *A Treatise on the Conflict of Laws*, Volume II – Choice of Law (1935) 1285 et seq. Another argument one occasionally finds – conduct without injury does not create liability – is inconclusive: injury not caused by conduct does not create liability, either. See *Kegel/Schurig* (supra note 24) 723 (§ 18 IV 1 a aa).

place of injury is that the law now emphasizes compensation over deterrence and punishment<sup>44</sup>.

Two other approaches use both places either cumulatively or alternatively. The third approach leads to cumulative application: liability is incurred only if both laws provide for it. A comparable solution (cumulative application of *lex loci delicti* and *lex fori*) existed formerly in English law and (for German defendants) in German law<sup>45</sup>; it is still the law in Japan<sup>46</sup>. The justification is a desire to protect defendants, especially forum domiciliaries, and the approach has been criticized for that. The fourth possibility, justified with the victim's interests, leads to alternative application: liability is incurred if either of the two laws provides for it. The determination which of the two laws should be applied may be made by the judge (this used to be the law in Germany<sup>47</sup> and has been proposed for the United States<sup>48</sup>), or by the plaintiff. In the latter case, the law can, absent a choice by the plaintiff, provide presumptively for the place of conduct, as in Germany<sup>49</sup> or the place of the injury, as in Italy<sup>50</sup> and

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<sup>44</sup> Proposal for a Regulation of the European Parliament and the Council on the Law Applicable to Non-Contractual Obligations ("Rome II"), COM(2003) 427 final (hereinafter "Rome II Proposal 2003"), 12 (referring to "the modern concept of the law of civil liability which is no longer, as it was in the first half of the last century, oriented towards punishing for fault-based conduct: nowadays, it is the compensation function that dominates, as can be seen from the proliferation of no-fault strict liability schemes."); *Kropholler* (supra note 30) 498 (§ 53 IV 2). Accordingly, some have proposed applying the law of the place of conduct to one type of tort and the law of the place of the injury to other types; see the references in *Kegel/Schurig* (supra note 24) 724 (§ 18 IV 1 a aa).

<sup>45</sup> *Phillips v. Eyre*, (1870) L.R. 6 Q.B. 1, 28-29; Article 38 of the Introductory Law to the Civil Code (*Einführungsgesetz zum Bürgerlichen Gesetzbuch – EGBGB*) (until 1999).

<sup>46</sup> Horei, Act on the Application of Laws (Law No. 10 of 1898) Article 11. The Act is published in English translation by *Kent Anderson/Yasuhiro Okuda* in: *Asian-Pacific L. & Pol'y J.* 3 (2002) 230, available at <<http://www.hawaii.edu/aplpj/pdfs/v3-08-Okuda.pdf>>. It provides:

Article 11 [Formation and Effect of Non-Contractual Claims]

(1) The formation and effect of claims arising from agency by necessity (*negotiorum gestio*), unjust enrichment, and tort shall be governed by the law of the place where the events causing the claims occurred.

(2) The preceding paragraph shall not apply where the events that comprise the tort occurred abroad and do not constitute a tort under Japanese law.

(3) Even where the events that occurred abroad constitute a tort under Japanese law, the injured person may not demand recovery of damages or any other remedy not available under Japanese law.

<sup>47</sup> E.g. RG 30.03.1903, RGZ 54, 198, 205.

<sup>48</sup> *Russell J. Weintraub*, *Commentary on the Conflict of Laws* (1986) 360. For revision, see *Weintraub*, *Commentary on the Conflict of Laws* (3d ed. 2001) 356: because tort laws have become more plaintiff-friendly, the rule is no longer desirable.

<sup>49</sup> Article 40 (1) EGBGB; English translation in *Peter Hay*, *From Rule-Oriented to "Approach"* in *German Conflicts Law: Am. J. Comp. L.* 47 (1999) 633, 650: "Claims arising from tort are governed by the law of the state in which the person liable to provide compensation acted. The injured person may demand, however, that the law of the state where the result took effect be applied instead. The right to make this election may be exercised only

enable choice of the respective other law. The European Rome II Proposal does not contain such a rule for two reasons: it would go beyond the victim's legitimate expectations, and it would lead to unpredictability<sup>51</sup>. The proposal does, however, in its Article 8 provide for the plaintiff's choice for a specific tort: injuries to the environment. Three reasons are given.<sup>52</sup> One reason for this solution is sympathy with the plaintiff<sup>53</sup>; critics see no reason to treat victims in international torts better than those in domestic torts<sup>54</sup>. A second reason is substantive: a desire for a high level of protection.<sup>55</sup> A third argument is economic in nature; it focuses on regulatory interests: Applying exclusively the law of the place where the damage is sustained could give an operator an incentive to establish his facilities at the border so as to discharge toxic substances into a river and enjoy the benefit of the neighbouring country's laxer rules. This solution would be contrary to the underlying philosophy of the European substantive law of the environment and the "polluter pays" principle, which forces injurers to internalise costs<sup>56</sup>.

#### B. The First Economic Model: A Private Law Model

A first way to look at these issues from an economic perspective is to use what I call an economic private law model. Main representatives of such a model in the literature are *Michael J. Whincop* and *Mary Keyes* as well as *Erin A. O'Hara* and *Larry E. Ribstein*<sup>57</sup>. For a private law model, an economic analysis of private international law should focus on individuals as rational agents<sup>58</sup> and set private international law rules so as to give the optimal incentives to these individuals in order to maximize global social welfare,

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in the court of first instance and then only until the end of the first oral proceeding or the end of the written pre-trial proceeding."

<sup>50</sup> Law No. 218 of 31 May 1995, English translation in I.L.M. 35 (1996) 760. Article 62 (1) provides: "Tortious liability shall be governed by the law of the State in which the damage occurred. Nonetheless, the person suffering damage may request the application of the law of the State in which the event causing the damage took place." For a slightly different translation, see *Rudolf Schlesinger/Hans W. Baade/Peter E. Herzog/Edward M. Wise*, *Comparative Law* (6th ed. 1998) 946.

<sup>51</sup> Rome II Proposal 2003 (supra note 44) 11-12.

<sup>52</sup> Amended Rome II Proposal (supra note 42), Preamble No. 14.

<sup>53</sup> *Kegel/Schurig* (supra note 24) 725 (§ 18 IV 1 a aa).

<sup>54</sup> *Kropholler* (supra note 30) 498 (§ 53 IV 2); cf. *von Bar/Mankowski* (supra note 27) 614 (§ 7 No. 105).

<sup>55</sup> Rome II Proposal 2003 (supra note 44) 19.

<sup>56</sup> Rome II Proposal 2003 (supra note 44) 19 et seq.

<sup>57</sup> Supra notes 6, 8.

<sup>58</sup> See e.g. *Whincop/Keyes*, *Policy and Pragmatism* (supra note 6) 4 (with a nominalist argument: "as befits private law, we emphasize parties and party interests"); *O'Hara/Ribstein*, *From Politics to Efficiency* (supra note 9) 1152 ("because political leaders cannot be expected to maximize social welfare").

defined as the sum of all individual utilities. Different legal regimes can be tested and chosen for their efficiency, and choice-of-law rules must be shaped so as to enable parties to minimize their costs while maximizing their benefits. Private international law becomes an extension on private law. This makes it necessary first to look at the economics of tort law.

### I. Basic Economics of Tort Law

Tort law, from the perspective of welfare economics, is not concerned with preventing behaviour that is wrongful in a moral sense, but rather with maximization of welfare<sup>59</sup>. In his seminal 1970 study, *The Costs of Accidents*<sup>60</sup>, *Guido Calabresi* recognizes the reduction of costs as one of two primary goals of accident law (the other being justice)<sup>61</sup>. *Calabresi* distinguishes three kinds of costs to be reduced – primary, secondary, and tertiary costs<sup>62</sup>. Primary costs are the costs to victims from accidents that take place as well as the costs to injurers from exercising care in order to avoid accidents<sup>63</sup>. Reduction of primary costs means reduction of the sum of the costs of accidents and the costs of avoiding accidents. The avoidance of accidents, in itself costly, is not always desirable but only when its costs do not outweigh its benefits. Secondary costs concern the spreading of risks arising from economically desirable conduct, especially through insurance systems and the “deep pocket theory”. Tertiary costs are the costs arising from administering the treatment of accidents, including the costs of effectuating the primary and secondary goals. These costs include the information costs for parties and judges regarding the content of the applicable law, a particularly important factor in private international law.

The goal of reducing all these costs can lead to tensions between primary, secondary, and tertiary cost reduction, because the reduction of costs on one level may entail the rise of costs on another level<sup>64</sup>. The goal may also lead to tensions between the interests of injurers and those of victims, because reduction of costs for injurers may well enhance costs of victims and vice

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<sup>59</sup> On some uncertainty about whether social welfare, efficiency, or wealth maximization is the goal of economic analysis, see *Anita Bernstein*, *Whatever Happened to Law and Economics?*: Maryland L. Rev. 64 (2005) 101, 109 et seq.

<sup>60</sup> *Guido Calabresi*, *The Cost of Accidents* (1970).

<sup>61</sup> *Calabresi*, *The Cost of Accidents* (supra note 60) 24 et seq. On the unclear place of justice in his analysis, see *Jules Coleman*, *The Costs of the Costs of Accidents*: Maryland L. Rev. 64 (2005) 337, 344 et seq.

<sup>62</sup> Cf. *Hans-Bernd Schäfer/Claus Ott*, *Lehrbuch der ökonomischen Analyse des Zivilrechts* (2005) 129-140. For a similar implicit structure, see *Steven Shavell*, *Foundations of Economic Analysis of Law* (2004) 177-256 (Chapter 8-10: primary costs), 257-279 (Chapter 11: secondary costs) and 280-287 (Chapter 12: tertiary costs).

<sup>63</sup> *Calabresi*, *The Cost of Accidents* (supra note 60) 226 et seq. and 73 et seq.

<sup>64</sup> Cf. *Schäfer/Ott* (supra note 62) 140 et seq.

versa. Here, the analysis aims at the overall minimization of costs: it considers it justified to raise the costs of one group of individuals if this raise is more than outweighed by the reduction of costs to the other individuals. The relevant criterion is Kaldor-Hicks (or “potential Pareto”) efficiency, regardless of the normative problems with this criterion<sup>65</sup>.

How are these goals achieved from a welfare economics perspective? To minimize primary costs, tort law should set incentives through liability rules so individuals engage in conduct that is beneficial (because its social benefits are higher than its social costs) and refrain from conduct that is not (because its social benefits are lower than its social costs). This applies to injurers and victims alike: to the extent that victims can avoid accidents more cheaply than injurers, it is economically efficient for them, rather than for injurers to invest in accident precaution<sup>66</sup>. To minimize secondary costs, insurance becomes relevant. (Because insurance lies outside the area of tort law, secondary costs will not be considered further here.) Finally, regarding tertiary costs, even liability rules that set the optimal incentives in the abstract may be inefficient if the cost of their administration is too great. In this case, plaintiffs may not bring suits that would be beneficial and injurers therefore engage in moral hazard, or plaintiffs may bring suits that are not beneficial because their costs are higher than the social benefits they provide, but they are able to force defendants into costly settlements.

## II. Consequences for Private International Law

An economic private law model will apply these considerations to the design of private international law rules<sup>67</sup>. Private international law rules should achieve two connected goals: they should reduce the costs of accidents, and they should enable individuals to coordinate their conduct. Multi-state situations provide a plurality of potentially applicable laws with different effects on the reduction of costs. The applicable law can be determined in accordance with two considerations. The first is similar to that in substantive law: Which law is best at

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<sup>65</sup> *Amartya Sen*, *On Ethics and Economics* (1987) 33 note 4 (“it is little consolation to be told that it is possible to compensate [the losers] fully, but [‘good God!’] no actual plan to do so”); *Jules L. Coleman*, *The Grounds of Welfare*: *Yale L. J.* 112 (2003) 1511, 1517 (“That [certain states of affairs] are potentially Pareto superior has as much bearing on how they should be treated as the fact that I am potentially President of the United States has on how I should be treated now.”). Another problem with Kaldor-Hicks efficiency is its potential intransitivity; cf. *Schäfer/Ott* (supra note 62) 32 et seq.

<sup>66</sup> See *Shavell*, *Foundations* (supra note 62) 182 et seq.; *Schäfer/Ott* (supra note 62) 221 et seq.

<sup>67</sup> *Whincop/Keyes*, *Policy and Pragmatism* (supra note 6) 3 (“the policies that underlie what we think of as ‘substantive’ private law areas should, where suitable, inform the private international law rules that apply in these areas.”), 89 et seq. (for what they call non-market torts).

reducing costs; which law is the “better law”? Social welfare can no longer, as in the ordinary context in which tort rules are evaluated, be calculated with reference to just one state’s economy, but this does not pose a big problem. For a private law model focusing on individuals, national economies are irrelevant anyway; instead, the goal is maximization of global social welfare understood as the sum of the utilities of all individuals worldwide<sup>68</sup>. It follows that it does not matter much whether the parties are from the same state and litigate over an accident that took place in that state, or whether the injurer is from Germany, the victim from Japan, and the accident happened in the United States. What can matter is that the laws of different states may each be efficient for different contexts, regional peculiarities, etc. This can be because different societies have different preferences<sup>69</sup>, or because different levels of care are efficient for different territories. These differences suggest that, *ceteris paribus*, the most efficient law in a given situation will be the law passed by the legislator with a regulatory advantage<sup>70</sup>.

The second consideration regarding the reduction of costs refers to predictability. Assuming perfect information, parties know in advance which law will apply and what the content of that law is, so they can adapt their conduct accordingly. If, however, information is costly to obtain, predictability of the applicable law reduces primary costs because individuals can adapt their conduct to the applicable laws and exercise the required level of care at lower costs<sup>71</sup>. Even if predictable rules of private international law lead to the occasional application of suboptimal substantive tort rules, the costs arising from their application may still be outweighed by the reduction in information costs, making their application still efficient overall. Predictable rules also help reduce tertiary costs<sup>72</sup>. They reduce the post-accident costs of determining the applicable law as well as the costs of litigation and thereby enable victims to bring claims to which they are entitled and enable injurers to defend themselves against unfounded claims at lower costs.

Predictability of the applicable tort rules thus becomes the most important consideration for the private law model. *Ex-ante* predictability enables parties to optimise their conduct vis-à-vis the incentives set by the applicable tort rules. *Ex-post* predictability enables parties to either settle rationally in the shadow of a defined substantive law or litigate matters of that substantive law

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<sup>68</sup> *Siehr* (supra note 9) 274; *Guzman* (supra note 9) 898.

<sup>69</sup> See e.g. *Shavell*, *Foundations* (supra note 62) 202 et seq. and 205 et seq.

<sup>70</sup> *Richard A. Posner*, *Economic Analysis of Law* (2003) 602-603; for discussion, see *Solimine*, *An Economic and Empirical Analysis of Choice of Law* (supra note 9) 59-68; *O’Hara/Ribstein*, *From Politics to Efficiency* (supra note 9) 1179-1180 (2000); *Whincop/Keyes*, *Policy and Pragmatism* (supra note 6) 20.

<sup>71</sup> *Whincop/Keyes*, *Policy and Pragmatism* (supra note 6) 91 et seq.

<sup>72</sup> See *Michael J. Whincop/Mary Keyes*, *Towards an Economic Theory of Private International Law: Austral. J. Leg. Phil.* 25 (2000) 1, 14 et seq.

without too much regard to issues of choice of law. *Ex-post* predictability also ensures, for the same reason, that courts will face no substantial additional costs from determining the applicable law. Given the high information costs attributed to private international law problems, the substantive content of the applicable law becomes comparatively negligible.

Not surprisingly, party autonomy is the preferred instrument even beyond its traditional application to matters of contract law, because it minimizes these information costs<sup>73</sup>. Where party autonomy is unsuitable, proponents of private law models often propose application of the *lex loci delicti* rule as relatively easy to predict<sup>74</sup>. This high emphasis on predictability is in accordance with goals of traditional methods of choice of law, both in the United States and in Europe<sup>75</sup>. Policy considerations that led to the demise of *lex loci delicti* in the United States and, to some extent, in Europe, have little influence on this model because these considerations are generally based on regulatory state interests, and regulatory state interests are typically considered nonexistent, irrelevant, or possibly even pernicious in a private law model.

### III. Reducing Accident Costs

How does all of this play out for cross-border torts? The main issue in cross-border torts are primary costs. This has several components: the costs of having to ascertain the content of the rule, the potential costs from having to comply with that rule or more than one set of rules, and the costs arising from application of that rule.

As for the first two components, it is impossible to say in the abstract whether a place-of-conduct rule or a place-of-injury rule reduces costs. If the law of the place of conduct applies, the injurer faces low costs for ascertaining its content because it is typically his home law and because only one set of laws will apply to him. The victim, on the other hand, faces high costs of ascertaining the content of the applicable law, which is foreign to him, and several laws may apply to the victim if he must take precautions against injurers in different countries. If, on the other hand, the law of the place of injury applies, the reverse situation exists. The injurer faces high costs for ascertaining its content and several laws may apply in respect to injuries

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<sup>73</sup> *Whincop/Keyes*, Policy and Pragmatism (supra note 6) 5 et seq. (general) and 78 et seq. (for “market torts”); *Whincop/Keyes*, Towards an Economic Theory of Private International Law (supra note 72) 17-22; *O’Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1186 et seq. (general) and 1210 et seq. (for “market torts”).

<sup>74</sup> *Whincop/Keyes*, Policy and Pragmatism (supra note 6) 97 et seq.; *O’Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1216-1218.

<sup>75</sup> But see e.g. *Kegel/Schurig* (supra note 24) 143 (§ 3 II 3 c) (predictability only one among many interests); for a brief analysis of the tension between predictability and fairness, see *Kropholler* (supra note 30) 29-31 (§ 4 IV).

occurring in different countries. The victim, on the other hand, faces low costs of ascertaining the content of the applicable law, and only this one law applies to him.

Some argue that the place of injury is more predictable for both parties because the injurer generally knows and has some control over that place, whereas the victim may not know where the harmful conduct will occur<sup>76</sup>. In other words, the injurer is the cheaper cost-avoider regarding information and control costs. Although intuitively plausible, this intuition cannot be dependably generalized. In the case of a polluting plant, for example, the place of conduct is easy to predict and control for both injurers and victims, whereas the place of injury depends on many contingencies such as wind, vulnerability of different local crops, etc. As for control, the Internet provides another counter-example: filtering software now enables injurers to avoid certain markets for their potentially tortious conduct, but it also enables victims to bar information from certain countries and thereby avoid injuries<sup>77</sup>. It is not clear generally whether it is cheaper for injurers to control for accidents occurring to victims at certain places than it is for victims to control for accidents caused by injurers acting at certain places<sup>78</sup>.

What about the different incentives given by these rules? Assume an injurer, acting in country A, causes some injuries in country A and some in another country B. Assume accidents are unilateral – only injurers can influence the accident risk with their behaviour – and liability regimes in A and B can be either strict liability regimes or negligence regimes<sup>79</sup>. Then four distinct scenarios are possible. In the first, both countries have the same liability regimes – either strict liability regimes, or negligence regimes setting the same level of due care. Here choice of law does not matter.

In the second scenario, country A has a strict liability regime and country B has a negligence regime. Under a place-of-conduct rule, the injurer will exercise the globally optimal level of care because the applicable strict liability regime of country A forces him to internalise all accident costs. Under a place-of-injury rule, the injurer will overinvest in care if the due level of care under country B's liability regime is higher than the global optimum and the injurer's marginal costs of raising his level of care from the global optimum to that of

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<sup>76</sup> *O'Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1217; cf. Hamburg Group for Private International Law, Comments on the European Commission's Draft Proposal for a Council Regulation on the Law Applicable to Non-Contractual Obligations: *RabelsZ* 67 (2003) 1, 11.

<sup>77</sup> Cf. *Horatia Muir Watt*, Yahoo! Cyber Collision of Cultures – Who Regulates?: *Mich. J. Int'l L.* 24 (2003) 673, 693 et seq.

<sup>78</sup> Although *O'Hara/Ribstein* think the place of the conduct has a regulatory advantage for the regulation of conduct, they prefer a place-of-injury rule: *O'Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1217.

<sup>79</sup> Cf. *Shavell*, Foundations (supra note 62) 180-182 for the efficiency or negligence regimes and strict liability regimes for unilateral torts.



country B's regime are lower than the sum of benefits from avoiding all liability costs with regard to injuries in country B and the benefits from the reduction of injuries in country A. He will underinvest in care if the due level of care under country B's liability regime is lower than the global optimum and his marginal costs of raising the level of care from that of country B to the global optimum would be higher than his marginal benefits from reducing accident costs in country A. (He will not internalise the marginal benefits from a reduction of accident costs in country B because once he reaches the due level of care of country B's laws, he will not be liable for accidents there, anyway.)

In the third scenario, country A has a negligence regime while country B has a strict liability regime. A place-of-conduct rule is inefficient because it will lead the injurer to exercise the due level of care under country A's law, which may be too high or too low globally. If the due level of care under the law of A is too low, he will underinvest in care. If the due level of care under the law of A is too high, he will exercise a globally optimal level of care only if his marginal benefits (the reduction in costs for care) are higher than the liability costs. Yet a place-of-injury rule is also inefficient. The injurer will still overinvest or underinvest in care depending on the due level of care under country A's law and its impact on his marginal costs and benefits.

In the fourth scenario, both country A and country B have negligence regimes with different levels of due care. Now the injurer will either underinvest or overinvest under either private international law rule. Under a place-of-conduct rule he will again, like in the third scenario, adopt the due level of care of country A, which may be too high or too low on a global level. The analysis of a place-of-injury rule is more complex. If the due level of care is higher in country B than in country A<sup>80</sup>, the injurer avoids liability to victims in country A by exercising the due level of care of country A's laws and avoids all liability by exercising the due level of care of country B's laws. Between these two, the injurer will exercise the due level of care of country B's laws if the marginal benefits of avoiding all liability costs are higher than the marginal costs of raising the level of care. Provided that the expected injury costs in state B are sufficiently high, this is the likelier outcome. Injurers will frequently exercise more care than the global optimum.

Assuming both countries A and B have negligence regimes and set the due level of care at the nationally optimal level, and assuming this level to be higher in A than in B, the global optimum must lie between the two due levels of care. Lantermann and Schäfer argue that this makes a place-of-injury rule superior. Under a place-of-conduct rule, the injurer will overinvest or underinvest in care regarding the injuries in another state, depending on

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<sup>80</sup> The analysis applies *mutatis mutandis* if the due level of care is stricter in country B than in country A, because under a place-of-injury law it does not matter which of the two countries is the place of conduct.

whether the law of the place of conduct is stricter or less strict than that of the place of injury. Under a place-of-injury rule, he will exercise a level of care somewhere between the levels of the place of conduct and the place of injury and therefore closer to the optimal level<sup>81</sup>. But does the injurer ever have an incentive of exercising a level of care X between those of the laws of countries A and B? He does not have such an incentive under a place-of-conduct rule, and he has such an incentive under a place-of-injury rule only under two conditions. First, the marginal costs of raising the level of care from the standard of country B to X must be lower than the marginal benefits from a reduction of accident costs in country A. (Note that the injurer can externalize the costs for accidents arising in country B to the victims of these accidents because he will not be liable to them, so he will exercise less care than would be globally efficient.) Second, the further marginal costs of raising the level of care from X to the standard of country A (and thereby avoiding all liability) must be higher than the liability costs at X (which equal the accident costs in country A at the level of care X). Whether this is indeed the case depends on the respective values of the variables, an empirical matter. The globally optimal level of care may or may not be reached<sup>82</sup>.

The insights from this analysis are therefore quite limited. A globally optimal level of care will be reached if the choice-of-law rule designates a system with strict liability. This is trivial, because strict liability is always efficient for unilateral accidents<sup>83</sup>. If one or more negligence regimes are designated, however, the injurer may or may not exercise the globally optimal level of care. A place-of-conduct rule leads the injurer to exercise too much or too

<sup>81</sup> *Hans-Bernd Schäfer/Katrin Lantermann*, Choice of Law in Economic Perspective, in this volume, p. **\*\*\***. One problem with this argument is that it does not distinguish sufficiently between the optimal level of care in a given country and the liability regime in that country. The globally optimal level of care will indeed frequently lie between the nationally optimal levels in different countries. But this is less a function of different laws than it is a function of different factual situations. How high the optimal level of care is in a country depends on many local facts (the costs of building fences, the value of assets at risk of being injured, etc.) that are unaffected by the applicable law.

<sup>82</sup> For illustration of the fourth case (two negligence regimes), see the following table.

Level of care	Liability under country A	Liability under country B	Total expected costs for injurer under a place-of-injury rule
0	$CA_0(A)$	$CA_0(B)$	$CA_0(A) + CA_0(B)$
due level of B	$CA_A(A)$	0	$CC_B + CA_0(A)$
X ( $B < X < A$ )	$CA_X(A)$	0	$CC_X + CA_X(A)$
due level of A	0	0	$CC_B$

Costs of care are defined as  $CC_{\text{standard of care}}$ :  $0 < CC_A < C_X < C_B$ . Total costs of accidents are defined as the sum of costs of accidents in country A and costs of accidents in country B:  $CA_{\text{standard of care}} = CA_{\text{standard of care}}(A) + CA_{\text{standard of care}}(B)$ :  $CA_0 > CA_A > CA_X > CA_B$  and  $CA_0(A) > CA_A(A) > CA_X(A) > CA_B(A)$  and  $CA_0(B) > CA_A(B) > CA_X(B) > CA_B(B)$ . Level X of care will be attained if  $(CC_X - CC_B) < (CA_X(A) + CA_0(A))$  AND  $(CC_B - CC_X) > CA_X(A)$ .

<sup>83</sup> *Shavell*, Foundations (supra note 62) 179-180.

little care, depending on whether the due level of care under the law of A lies above or below the global optimum. A place-of-injury rule will frequently lead the injurer to exercise too much care. This is so if one of the countries has a negligence regime that sets the due level of care above the global optimum and if the marginal benefits from avoiding liability under that law (plus the marginal benefits from reducing liability under the other state's regime if that law is a strict liability regime) are higher than the marginal costs of exercising care at that level instead of at the global optimum.

#### IV. Injunctions and Punitive Damages

As long as injuries lead only to a duty to compensate, an injurer could simply decide to ignore the requirements of the law of the place of the injury and just pay compensation. He will have an incentive to do so if that state has a strict liability system, but not necessarily if it has a negligence system, because the benefits from complying with the requirements will frequently be higher than the costs. He cannot opt to just pay compensation, though, if the law of state A grants victims a property right instead of a liability right by giving them the power to enjoin the conduct altogether. A similar problem arises if the law of the place of the injury provides for punitive damages. By granting injunctions or punitive damages, the law of the place of the injury effectively regulates beyond the injuries to its own state: it regulates the whole conduct. As a consequence, the injurer must comply with this law in addition to the laws of other places of injury. This combination may lead to inefficient overinvestment in care.

Of course, if transaction costs between injurers and victims are sufficiently low, neither injunctions nor punitive damages will prevent efficient conduct from taking place. Instead, victims will trade their right to an injunction or to punitive damages for a compensation higher than their actual injuries. This reduces the benefits that the injurer derives from his conduct, but because he still derives a benefit, he will still proceed. The effect is only one of distribution between injurers and victims. However, giving the victim a monopoly over the injurer's conduct can lead to holdout and transaction costs. This provides an additional argument for a place of injury rule.

#### V. Firms as Injurers and Competitive Markets

What if injurers are firms that produce in state A and sell in states A and B, so they cause accidents in both states? Accident costs will have an impact on the price of products because they are part of the costs associated with production. This does not change the incentives for the parties to exercise care, but it affects the price of products: the higher the expected liability, the more

expensive the products will be<sup>84</sup>. This in turn has implications for the efficiency of choice-of-law rules. If a place-of-injury rule creates higher costs for injurers than a place-of-conduct rule, then injurers involved in cross-border activities must either raise the price for their product or reduce production.

The latter is often desirable from an efficiency perspective. As long as negligence regimes do not account for the level of activity<sup>85</sup>, producers have an incentive to produce too much and thereby to cause too many accidents under a negligence regime because, provided they exercise the due level of care, they do not have to internalize the additional accident costs<sup>86</sup>. This tendency is countered if injurers in turn face higher liability costs as a consequence from the plurality of applicable laws under a place-of-injury rule. A problem is that only firms that cause accidents outside their place of conduct face these additional costs; domestic firms are subject only to their own law. This gives domestic firms a competitive advantage over international firms, and this in turn would prevent full competition and thereby create efficiency losses. In state B, domestic firms from B can have a competitive advantage over firms from state A.

If, on the other hand, the applicable law is the law of the place of conduct, injurers from state A do not face these additional costs in the market of B. A priori this seems to put them on an equal playing field with domestic firms from state B, who only face the costs arising from one law as well. However, the fact that the laws of state A and state B differ may prevent full competition. If state A has a stricter liability regime than state B, producers from state A are still at a competitive disadvantage<sup>87</sup>. If state A has a less strict regime, producers from state A exporting their goods to state B can have a competitive advantage over domestic producers from state B; this can likewise prevent full competition and create efficiency losses. Two additional considerations must be kept in mind. First, foreign firms face additional transaction costs from cross-border trade (although some of these may be made up for by efficiency gains due to economies of scale from their cross-border trade). Second, even if foreign firms have a competitive advantage over domestic firms, under a place-of-conduct rule this makes it easier for them to enter a foreign market. This in turn leads to more market participants and, presumably, to more competition

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<sup>84</sup> *Shavell*, *Foundations* (supra note 62) 207-209.

<sup>85</sup> For this problem in general, see *Shavell*, *Foundations* (supra note 62) 193 et seq.; *Schäfer/Ott* (supra note 62) 131-133.

<sup>86</sup> *Shavell*, *Foundations* (supra note 62) 210-211; referring to *A. Mitchell Polinsky*, *Strict Liability vs. Negligence in a Market Setting*: *Am. Econ. Rev.* 70 (1980) 363; *Steven Shavell*, *Strict Liability versus Negligence*: *J. Legal Stud.* 9 (1980) 1.

<sup>87</sup> Cf. *Alan O. Sykes*, *The Economics of Public International Law*: Chicago John M. Olin Law & Economics Working Paper No. 216 (2d series) (2004) Section 5. B. viii. ("Conflict of Laws"), available at <[http://www.law.uchicago.edu/Lawecon/WkngPprs\\_201-25/216-aos-handbook.pdf](http://www.law.uchicago.edu/Lawecon/WkngPprs_201-25/216-aos-handbook.pdf)> and in *A. Mitchell Polinsky/Steven Shavell* (eds.), *Handbook of Law and Economics* (forthcoming).

and therefore to efficiency gains, provided the liability regime in the place of conduct is not severely more lax than that in the place of injury.

### C. The Second Economic Model: An International Law Model

#### I. Basic Economics of International Law

An international law model, whose most prominent representatives in the literature are *Lea Brilmayer*, *Larry Kramer*, and *Joel P. Trachtman*<sup>88</sup>, is different. Structurally, the economics of international law, which underlies an international law model of private international law, look very similar to the economics of private law<sup>89</sup>. (This is not surprising, given that international law in its early formulation by *Hugo Grotius* looked very similar to, and was in fact based on, private law.) Like the economic analysis of private law, the economic analysis of international law assumes that actors are rational in the sense that they maximize their own utilities; its normative goal is efficiency, and the instrument to achieve efficiency consists in rules that set optimal incentives for the actors or that mimic contractual agreements between them, ensuring that they engage in efficient and refrain from inefficient conduct. For an international law model private international law is an extension of public international law. As a consequence, an economic analysis must focus on states as rational agents whose relevant conduct is the enforcement of their laws. Indeed, most studies on the economic analysis of (public) international law, at least in the United States, are based on a “realist” perspective in which states are the only relevant actors<sup>90</sup>. In this model, choice-of-law rules must be shaped so as to enable states to maximize the sum of their interests.

While a focus on the interests of individual actors seems unproblematic, looking at states as rational actors seems to clash with the credo of (classical and neo-classical) economics, “methodological individualism”<sup>91</sup>. How can one author simultaneously endorse methodological individualism and focuses on states as actors<sup>92</sup>? This question entails two answers, one theoretical (Is it

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<sup>88</sup> *Supra* note 9.

<sup>89</sup> For comprehensive works on the economics of international law, see *Jeffrey L. Dunoff/Joel P. Trachtman*, *Economic Analysis of International Law*: *Yale J. Int'l L.* 14 (1999) 1; *Sykes* (*supra* note 87); *Jack L. Goldsmith/Eric A. Posner*, *The Limits of International Law* (2005).

<sup>90</sup> *Sykes* (*supra* note 87) Section 3. A (“States as Rational Actors”).

<sup>91</sup> Methodological individualism was a cornerstone especially of the Austrian and Chicago schools of economics; in the form of “new institutional economics”, it has also entered the study of institutions. However, not all economists studying institutions universally apply methodological individualism.

<sup>92</sup> *Joel P. Trachtman*, *The Methodology of Law and Economics in International Law*: *International Law FORUM du droit international* 6 (2004) 67.

possible to create a model in which states are rational actors?) and one normative (Is such a model appropriate?).

The theoretical question on the level of modelling is easier to answer. It is possible to focus on states as actors even if states are not real actors, because it is irrelevant for a model whether its agents are accurate descriptions of their real-life counterparts, as long as the actions relevant for the model can be attributed to those agents. People frequently speak of the actions of “states”, and the policies and interests of states (as incorporated in their laws), although they know states do not really act as individuals and do not really have interests of their own. The assumption of states as monolithic actors is a simplifying assumption. Such simplifying assumptions are frequent in economic analysis<sup>93</sup>. For example, economic analysis frequently treats firms as individuals although they are not individuals. States are different insofar as they are not under the same kind of competitive pressure, but they are similar insofar as both firms and states are incapable of building preferences of their own. Similarly, classical economics assumes individuals to be rational actors, although it is well known that individuals rarely act rationally in fact<sup>94</sup>.

More pertinent is the normative question whether a model that focuses on states as actors can be appropriate. Four general considerations suggest that, at least for private international law, such a model should not be rejected a priori. First, private international law deals with the conflict of laws between states. In other words, its objects are laws, and the creating of these laws, as well as their binding force, are attributed to states. Conceiving of states as monolithic actors for an economic model reflects the similar simplification occurring in private international law<sup>95</sup>: private international law norms designate the law of a state, rather than the views of the legislators versus those of the courts, etc.<sup>96</sup> The main normative criticism against a concept of the state as a monolithic actor is the public choice argument that legislation and adjudication in the name of states are really carried out by individuals with special interests and under special influence from certain subgroups of society<sup>97</sup>. In other words, individuals acting in the name of the state do not properly represent the interests of

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<sup>93</sup> Sykes (supra note 87) Section 3. A (“States as Rational Actors”).

<sup>94</sup> Keith N. Hylton, *Calabresi and the Intellectual History of Law and Economics*: Maryland L. Rev. 64 (2005) 85, 96-106.

<sup>95</sup> Cf. for a comparable point Joel P. Trachtman, *Economic Analysis of Prescriptive Jurisdiction* (supra note 9) 21, 77: “[I]f choice of law and prescriptive jurisdiction is not about governmental preferences, then it is not about law, as law is the expression of governmental preferences”.

<sup>96</sup> Cf. Nils Jansen/Ralf Michaels, *Die Auslegung und Fortbildung ausländischen Rechts*: ZZP 116 (2003) 3, 19-24.

<sup>97</sup> See, in the context of choice of law, Solimine, *An Economic and Empirical Analysis of Choice of Law* (supra note 9) 68-74; O’Hara/Ribstein, *From Politics to Efficiency* (supra note 9) 1156-1160; Paul Stephan, *The Political Economy of Choice of Law*: Geo. L. J. 90 (2002) 957.

its people. This criticism may well be true, but it points to a problem of substantive law that is not enhanced by private international law and can therefore be left to the economic analysis of lawmaking<sup>98</sup>. A separate question is the impact of public choice considerations on the formulation of choice-of-law rules by the states<sup>99</sup> – a question not addressed here because choice-of-law rules are treated as independent variables and because the focus is on a hypothetical global lawmaker.

Second, in a world with imperfect information, a working assumption that states have the best abilities to determine (domestically) efficient rules for individuals seems justifiable<sup>100</sup>. This makes it possible to use state preferences as proxies for sums of individual utilities within one state<sup>101</sup>. Third, although law and economics may postulate that overall social welfare maximization should trump all other public considerations<sup>102</sup>, actual substantive laws do effectuate considerations other than the maximization of social welfare. Since these other considerations are responsible for a number of differences between the laws of different countries, an economic analysis of private international law that disregards these reasons will simultaneously strip private international law as its object of analysis of much of its scope. This leads to a fourth consideration. At least in democratic states, such differences in preferences rest, presumably, on the voters' decisions. Public choice can account for imperfections in the democratic process, but it is not normally used to deny the legitimacy of democratic lawmaking altogether. Rather, the enforcement of democratically enacted laws may in itself be considered a relevant factor in an efficiency analysis even between individuals<sup>103</sup>. In this sense, even seemingly inefficient laws may be assumed to maximize domestic social welfare in a wider sense<sup>104</sup>.

States can thus be modelled, like individuals, as rational in the sense that they care only about their own costs and preferences, and not those of other

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<sup>98</sup> Cf. *Trachtman*, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 16.

<sup>99</sup> *Erin O'Hara*, Economics, Public Choice and the Perennial Conflict of Laws: *Geo. L. J.* 90 (2002) 941.

<sup>100</sup> *Trachtman*, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 5 f. It may well be that regulatory competition is a superior discovery mechanism for efficient rules. The point here is only one about plausibility.

<sup>101</sup> *Trachtman*, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 21.

<sup>102</sup> The relationship between economic efficiency and justice remains a seminal subject in economic analysis; see only recently against distributional concerns *Louis Kaplow/Steven Shavell*, Fairness versus Welfare (2002); against concerns about morality as an independent factor, see *Shavell*, Foundations (supra note 62) 595-646 (Chapter 26-27); for criticism from law and economics, see e.g. *Howard F. Chang*, A Liberal Theory of Social Welfare: Fairness, Utility, and the Pareto Principle: *Yale L. J.* 110 (2000) 173; *Howard F. Chang*, The Possibility of a Fair Paretian: *Yale L. J.* 110 (2000) 251. See also *Coleman*, The Grounds of Welfare (supra note 65) 1511.

<sup>103</sup> Cf. *O'Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1155.

<sup>104</sup> Cf. *Guzman* (supra note 9) 896.

states. But what are state preferences, and what do states maximize in private international law? One answer is that states do not maximize anything, but instead merely minimize the costs of regulation. In this case the efficient solution is to apply the law of the state which can regulate most efficiently, *Richard Posner's* concept of regulatory advantage<sup>105</sup>. A second answer is that societies maximize their own welfare, understood as the sum total of the costs and benefits for its own citizens<sup>106</sup>. A third answer is that states maximize the effectiveness of their own policies as embodied, especially, in their legislation<sup>107</sup>. States want to maximize the effectiveness of those laws they care about and minimize the effectiveness of foreign laws in situations in which this impairs their own policies. Even when states have policies that appear inefficient or even irrational, these rules become relevant factors in a global efficiency analysis. Just as an economic analysis of private law will accept individuals' preferences as given, whether they appear sound or not, so an economic analysis of international law must accept the policies of states as their preferences, whether they make sense or not.

Another important question is whether global efficiency should be defined in terms of Pareto efficiency or Kaldor-Hicks efficiency. Kaldor-Hicks efficiency, already problematic between individuals<sup>108</sup>, becomes even more unattractive internationally. One reason is that differences both in wealth and in preferences between states are often much larger than within one society; this makes wealth effects much more influential<sup>109</sup>. More importantly, one important justification for Kaldor-Hicks in domestic settings is largely unavailable in the international arena. Within one state, the avoidance of distributional questions inherent in the Kaldor-Hicks criterion is often justified with the existence of a tax system, which is deemed superior for (re-)distribution<sup>110</sup>. International law, however, does not operate within a system that enables easy redistribution through a tax system or through some other side-payment system from one national economy to the other<sup>111</sup>. States therefore have no reason to accept rules that are detrimental to them unless they can hope, in the long run, to be compensated for doing so. For similar reasons, it is questionable whether a hypothetical

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<sup>105</sup> *Richard A. Posner*, *Economic Analysis of Law* (supra note 70) 602-603; for discussion, see *Solimine*, *An Economic and Empirical Analysis of Choice of Law* (supra note 9) 59-68; *O'Hara/Ribstein*, *From Politics to Efficiency* (supra note 9) 1179-1180 (2000); *Whincop/Keyes*, *Policy and Pragmatism* (supra note 6) 20.

<sup>106</sup> *Sykes* (supra note 87) Section 3. A ("States as Rational Actors"); *Guzman* (supra note 9) 895.

<sup>107</sup> See *Trachtman*, *Economic Analysis of Prescriptive Jurisdiction* (supra note 9) 15 et seq.

<sup>108</sup> Supra note 65.

<sup>109</sup> *Ronald A. Cass*, *Introduction: Economics and International Law*, in: *Jagdeep S. Bhandari/Alan O. Alan O. Sykes* (eds.), *Economic Dimensions in International Law* (1996) 1, 21-23.

<sup>110</sup> *Shavell*, *Foundations* (supra note 62) 647-660.

<sup>111</sup> Cf. *Guzman* (supra note 9) 898 et seq.



global legislator should be entitled to pass private international law rules that benefit some states while hurting others.

Kaldor-Hicks efficiency is a less attractive criterion for international situations for another reason. States, at least when they are democratic, are accountable to their own citizens, while a global legislator, hypothetical or real, is not. An analysis of international law that forces one society to bear costs so another society can benefit not only will gain little support within a democratic system, but it raises costs if any positive value is assigned to democratic legitimacy and accountability<sup>112</sup>. This means that if states themselves decide about their conflict-of-laws rules, there may be situations in which each state would be justified in applying its own law because applying a foreign law would leave it worse off. For global legislators, this suggests that choice-of-law rules stripping a state of the jurisdiction to apply its law to a situation in which it is interested can be justified as Pareto efficient only if the state is compensated, either because it acquires the right to regulate other at least equally important situations, or through side payments.

## II. Consequences for Private International Law

What, then, is the task of private international law rules in a model that focuses on states as rational agents? It should make sure that legislative jurisdiction lies with the state that values it most, and it should help overcome coordination problems between states. But because states, not individuals, are the relevant actors, the analysis looks quite different from that in a private law model.

Private international law should maximize the sum of all benefits, and/or minimize the sum of all costs, that arise from pursuing government policies. This suggests applying the law of the state that has the regulatory advantage and/or that cares most about a particular transaction<sup>113</sup>. Because maximization of one state's welfare is not the same as maximization of global welfare in a Kaldor-Hicks sense (defined as the sum of the utilities of all states), a certain conduct may benefit the overall welfare of state A but reduce the overall welfare of state B. Regardless of whether the conduct is efficient globally (because the benefits outweigh the costs), state A will *ceteris paribus* want to encourage the conduct and state B will want to deter it. In order to be efficient in a Kaldor/Hicks sense, private international law rules must make sure that the state with more to lose from application of the other law (or more to win from application of its own) will see its law applied. This ensures that transaction

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<sup>112</sup> Cf. William Dodge, An Economic Defense of Concurrent Antitrust Jurisdiction: *Tex. Int'l L. J.* 38 (2003) 27. This concern for democratic legitimacy already underlies Brainerd Currie's oft-lamented preference for application of *lex fori*.

<sup>113</sup> Trachtman, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 34 et seq.

costs between states are minimized because no further agreements between states are necessary to reallocate jurisdiction<sup>114</sup>.

The analysis is not very different if states merely maximize their own welfare. If the efficiency criterion is Kaldor-Hicks efficiency, then the results will not be very different from those in a private law model. Global efficiency between state economies will then equal global efficiency between individuals. If the relevant criterion is Pareto efficiency, a mechanism for side payments or redistribution between states must be found. However, if the focus is on the effectiveness of states' policies regardless of whether they are welfare-enhancing in an objective sense, the questions for private international law become more complex. In cases that affect the policy interests of more than one state (true conflicts), choice-of-law rules must find a way to make these rules commensurable in order to determine which state has the greatest interest in regulation.

The most important consideration in this model is not predictability for parties (as in a private law model), but effectiveness of state policies<sup>115</sup>. Consequently, whereas authors in the private law model emphasize predictability over everything, one author in the international law model prefers "muddy" entitlements of jurisdiction<sup>116</sup>. There is a preference in the international law model, as in the private law model, for "private" ordering. But when the actors are states, private ordering is achieved not between individuals but between states, through treaties<sup>117</sup>. Outside of treaties, the applicable law can then be determined either as the result of a hypothetical bargain between states (based on the Kaldor-Hicks criterion for efficiency) or by the forum (based on the Pareto criterion).

This model can account for the fact that states may pursue goals other than efficiency (domestic or global) between individuals and that these goals are relevant for an economic analysis insofar as they determine the states' own preferences. Economic analysis can now be used to formalize findings of traditional interest analysis in efficiency terms. If only one state is interested in regulation ("false conflict"), it is efficient, under both Pareto and Kaldor-Hicks criteria, to give jurisdiction to that state. If no state is interested ("unprovided-for case"), it is efficient to apply the law of the forum, because this reduces litigation costs. What if both states are interested ("true conflict")? For example, state A may have very lax liability rules in order to protect its

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<sup>114</sup> *Trachtman*, Accuracy in Allocation (supra note 9) 1047 et seq.

<sup>115</sup> This does not rule out that predictability for parties may be necessary for the effectiveness of state policies, too.

<sup>116</sup> *Trachtman*, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 45 et seq.

<sup>117</sup> *Guzman* (supra note 9) 932-933; *Joel P. Trachtman*, Externalities and Extraterritoriality: The Law and Economics of Prescriptive Jurisdiction, in: *Alan Sykes/Jagdeep Bhandari* (eds.), *Economic Dimensions in International Law: Comparative and Empirical Perspectives* (1997) 642, 656 et seq.

producers, while state B has very strict liability rules, possibly even coupled with punitive damages rules, to protect its own victims. Moving away from a system in which each state applies its own law cannot be Pareto efficient, because each state loses if the other state's law applies. It is likewise doubtful how a Kaldor-Hicks efficient solution can be found. The regulatory interests of state B may not be impaired under a place-of-conduct rule if the non-application of its laws has no impact on the incentives for the parties. But in most cases, the benefits to one state from application of its laws will be the costs to another state of non-application of its laws. The criticism in the traditional doctrine of conflicts theories such as comparative impairment or weighing of interests<sup>118</sup> as essentially unpredictable<sup>119</sup> apply to attempts of maximizing efficiency in private international law, too<sup>120</sup>. Outside an actual agreement between states on choice of law, these policies are non-comensurable, so it will be difficult to determine which is the more efficient rule.

### III. Effectuating Regulatory Advantage and Substantive Policies

“[T]he place of conduct,” *O’Hara* and *Ribstein* suggest, “arguably has a regulatory advantage in generating conduct rules, while the place of injury and of the parties’ domiciles might be better situated to decide issues that allocate losses.”<sup>121</sup> If this is true, then a place-of-conduct rule should be efficient in an international law model. Why the place of conduct should have this regulatory advantage, however, is not clear for an international law model. It may have an advantage in enforcing regulations, but this is not the same as regulatory advantage in a private international law setting. The place of conduct has better information about the costs of care for injurers, but the place of injury has better information about the expected injuries and about the cost of care for victims. Optimal regulation would be achieved by cooperation between both places, but private international law cannot bring such cooperation about.

This suggests that substantive policies may be more helpful. Which private international law rule maximizes state interests? This depends again on whether state interests are defined as the maximization of domestic welfare or as something more. If social welfare is nothing more than the sum of all individuals’ costs and benefits, and if the relevant efficiency criterion is Pareto efficiency (or Kaldor-Hicks efficiency with an effective system of side payments between states), then the result is congruent with the result from the

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<sup>118</sup> See e.g. *Eger v. E.I. Du Pont Denemours Co.*, 110 N.J. 133 (Sup. Ct. N.J. 1988); *Kaiser-Georgetown Comm. Health Plan, Inc. v. Stutsman*, 491 A.2d 502 (D.C.App. 1985).

<sup>119</sup> *O’Hara/Ribstein*, *From Politics to Efficiency* (supra note 9) 1174; *Allen/O’Hara*, *Second Generation Law and Economics* (supra note 9) 1014, 1031-33.

<sup>120</sup> *Brilmayer* (supra note 9) 171-172.

<sup>121</sup> *O’Hara/Ribstein*, *From Politics to Efficiency* (supra note 9) 1217.

private law model. The choice-of-law rule that is most efficient between parties must then also be the most efficient one between states because it will create the highest degree of global welfare, which states can then redistribute.

The situation is more complex regarding the maximization of governmental policies. Many prefer a place-of-injury rule over a place-of-conduct rule because they believe regulatory interests of states are directed primarily at the regulation of markets<sup>122</sup>. This is not obvious. One might argue that the place of conduct may have a policy of allowing certain conduct and keeping it free from liability (provided the place or its economy benefits from it) no less strong than the interest of the place of injury in banning the conduct or in assessing damages for it. Regulation is not only the prevention, but also the enabling, of conduct<sup>123</sup>. But states have a stronger interest in regulating what goes on at home than what goes on abroad, and they have a mutual interest of applying one and the same law to conditions in a market. Presumably, every state would prefer to have a monopoly on the regulation of conduct that affects its own markets rather than have a monopoly on the regulation of conduct that takes place in its own state. The reason is that states have an interest in setting common rules under which a national market works, and they will be better able to regulate markets under a place-of-injury rule than under a place-of-conduct rule. This is the background for the rise of the effects doctrine in choice of law, a variation on the place-of-injury rule<sup>124</sup>.

#### IV. Injunctions and Punitive Damages

Injunctions and Punitive damages are less of a problem for an international law model than for a private law model. They are not suspect per se. Rather, a state granting an injunction or punitive damages against certain conduct thereby signals that it has a particularly strong policy on the desirability of this conduct. This policy can be assumed, at least typically, to be stronger than the other state's policy of allowing the conduct, or even of shielding it from liability. Of course, this is hard to know for sure – a state cannot express a preference for allowing certain conduct through tort law more strongly than by allowing it – but given how rare at least punitive damages are, the generalization may be admissible. Other than a private law model that aims at avoiding injunctions

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<sup>122</sup> Cf. *Peter Mankowski*, *Wider ein Herkunftslandprinzip für Dienstleistungen im Binnenmarkt*: IPRax 24 (2004) 385; *Virgós Soriano/ Garcimartín Alférez* (supra note 22).

<sup>123</sup> This point, long familiar in interest analysis, is now also made in economic analyses: *Guzman* (supra note 9) 916 et seq.

<sup>124</sup> *Dieter Martiny*, *Die Anknüpfung an den Markt*, in: *Jürgen Basedow/Klaus J. Hopt/Hein Kötz* (eds.) *Festschrift für Ulrich Drobnig zum 70. Geburtstag* (1998) 389; *Mankowski*, *Wider ein Herkunftslandprinzip* (supra note 122) 386.

and punitive damages, an international law model has reason to ensure that injunctions and punitive damages become available.

In theory, both the place of the conduct and the place of the injury may have laws granting punitive damages. However, a state's desire to protect its own citizens can be assumed to be stronger than its desire to punish its citizens. It is not necessary to borrow the credo from governmental interest analysis that states are interested only in the benefit of their own citizens to make this assumption. Rather, the assumption is justified that states are interested rather in the effects of conduct than in its moral desirability, and that they care more about the effects at home than the effects abroad. It follows that the place of the injury has a stronger interest in having its punitive damages statute applied than does the place of the conduct, so punitive damages do not alter the preference in the international law model for a place-of-injury rule.

#### V. Firms as Injurers and Competitive Markets

If, as the private law model suggests, a place-of-conduct rule favours firms engaged in cross-border commerce and thereby enhances competition, it may be clear why an international model would favour a place-of-injury rule. Of course, intensified cross-border commerce should enhance the social welfare of all states, so it should be in the interest of states as well. But this is not certain. Under a place-of-conduct rule, victims in state B may not be able to recover for injuries caused by an injurer in state A, while the benefits from the conduct will all be reaped by state A. The global welfare enhancement may not be Pareto efficient between states.

When states pursue policies other than the maximization of welfare, those policies may well be undermined under a place-of-conduct rule. States will be unable to enforce their policy preferences in their home markets. In addition, states may be under pressure to make their own laws more efficient in order to enable their own firms to compete with foreign firms that would otherwise have a competitive advantage. Domestic producers may be forced out of business by competitors profiting from more beneficial laws. Not surprisingly, the decline of international commerce may be bad for individuals, for all state economies combined, and for globalisation, but it may be good for state policies other than the maximization of welfare. This suggests superiority of a place-of-injury rule.

## D. The Third Economic Model: Incentivising States to Pass Efficient Laws

### I. Basic Economics of Incentivising States

A variation brings both models together. This approach, here called an incentivising model, is represented (though not purely) by *Andrew Guzman*<sup>125</sup>. The overall goal is again, as in the private law model, global efficiency as between individuals, but now substantive laws are modelled as dependent variables rather than exogenous factors. In this model it is assumed that states are rational in the sense that they pass substantive laws that are efficient domestically, because they maximize the benefits and minimize the costs to the state's own economy. Domestic efficiency is not the same as global efficiency, however. States may, through the laws they pass, externalize costs to other states' economies<sup>126</sup>. Such costs do not appear in the cost-benefit analysis of the state's domestic efficiency analysis.

Whether states can thus externalize the costs of their substantive laws is, at least in part, a matter of private international law. Private international law rules are efficient in such a model if they give incentives to states to pass rules that in turn maximize overall efficiency as between individuals. In addition to the state-state relation reflected in the state-based model, and the individual-individual level reflected in the individual-based model, this model accounts for the state-individual relation.

The model is closely related to analyses of regulatory competition. Like regulatory competition analysis, the incentivising model sees states under external pressure to pass efficient laws. Unlike in regulatory competition, however, this pressure comes not from the competition of other states, but rather from the pressure of private international law rules to internalise costs. Traditional analyses of regulatory competition, if they focus on private international law at all, typically emphasize party autonomy as a tool for competition because it is a cheaper tool for exit than physical relocation. But party autonomy is insufficient for three reasons. First, it may not be available in all circumstances. Tort law is one example: parties will frequently not be able to agree *ex ante* on the applicable law. Second, party autonomy may not always lead to applicability of the most efficient law because parties have no interest in taking third-party externalities into account. Third, it is still unclear whether states actually have an incentive to improve their laws in the light of party

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<sup>125</sup> *Supra* note 9.

<sup>126</sup> *Guzman* (*supra* note 9) 904. This is formulated as a public choice problem by *Erin O'Hara/Larry E. Ribstein*, *Interest Groups, Contracts and Interest Analysis*: 48 *Mercer L. Rev.* 765, 766-767.

autonomy<sup>127</sup>. States may in fact have fewer incentives to change their laws if parties can simply opt out of them<sup>128</sup>.

## II. Consequences for Private International Law

What does this mean for the design of private international law rules? Using a bit of game theory, the analysis can be modelled as a three-stage game. In the first stage, a hypothetical global lawmaker passes its private international law rules. In a second stage, states react to these rules when they pass their substantive law rules. In a third stage, finally, the parties adapt their conduct to the incentives set by the combination of substantive laws and private international law rules. In passing their substantive laws, states must have in mind both the applicable private international law rules and the predicted conduct of individuals. The hypothetical private international law lawmaker, in turn, must be able to predict how states will react to different rules of private international law. Private international law rules are efficient if they give states the incentives to pass substantive laws that in turn give individuals the right incentives for efficient conduct. This may show why this model is a combination of the first two. Like the private law model, it looks at individuals and their utilities to determine efficiency. Like the international law model, it looks at states as the relevant actors whose conduct must be coordinated.

It must be noted that the incentives set by private international law rules for states and their substantive laws are frequently negligible, especially in the realm of tort law. If a state's substantive laws affect predominantly that state's own economy, then the state internalises most costs and benefits from its laws regardless of the private international law situation. The same applies if a state's economy consists of roughly similar numbers of injurers and victims. Whether a private international law rule benefits injurers and hurts victims or vice versa is then equivalent to that state. The model becomes relevant, however, when states are small, so a majority of interactions is international. It becomes relevant also when great differences between the relation of injurers to victims exist between economies. For example, one state may have lots of plants that cause pollution, while another state has lots of farmers whose crops suffer from the pollution. Or, one state is situated upstream, another downstream, so the pollution caused by plants in the first state will affect the second state, but not the other way round.

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<sup>127</sup> See *Eva-Maria Kieninger*, *Wettbewerb der Privatrechtsordnungen im Europäischen Binnenmarkt* (2002); *Parisi/Ribstein* (supra note 8) 241.

<sup>128</sup> *Erin O'Hara*, *Opting out of Regulation: A Public Choice Analysis of Contractual Choice of Law*: *Vand. L. Rev.* 53 (2000) 1551.

### III. Incentivising Efficient Substantive Laws

Assume that the conduct takes place in state A, while a variable portion of the injuries take place in state B. Assume further that the injurer is a domiciliary of state A and that all benefits from his conduct are similarly benefits to the economy of state A, while the injuries in state B are injuries of citizens (voters and taxpayers) of B. In this situation, all social benefits from the conduct flow to the economy of state A. It is now possible to see how the model plays out for unilateral and for bilateral accidents. Starting with unilateral accidents, assume first that only injurers can prevent accidents and that states can adopt the following liability regimes<sup>129</sup>: (1) no liability, (2) negligence with differing levels of required care, and (3) strict liability. Assume that all injurers are situated in state A. Thus state A has the injurer and possibly a number of victims, while state B has only victims. The states are likely to adopt liability regimes that will maximize domestic social welfare. State B will reap no benefits from the conduct (because the conduct takes place in state A), while suffering all costs from the injuries to citizens of state B, minus the amount that its citizens can claim from the injurers. State A, on the other hand, will reap all benefits from the injurer's conduct and suffer all the costs due to injuries to its own domiciliaries, plus the costs arising from damages paid to state B domiciliaries for their injuries. (Whether victims in state A are compensated or not is irrelevant for efficiency because this concerns only redistribution within state A's economy.) The factors determining social welfare in state A and in state B are thus quite different. Moreover, the choice-of-law rule will have an effect not only on the incentives of individual parties but also on the domestic economies of the states. Whereas, for example, an injurer may face similar incentives in a system of strict liability as in a system of negligence, his state's economy does not, because a system of strict liability means that more money will pass to another state than under a system of negligence. Consequently, although the state would be indifferent as between a system of negligence and one of strict liability in a purely local economy, it will not be indifferent for transnational activities.

What is the impact of different choice-of-law rules on liability regimes for unilateral accidents? Assume, first, a purely domestic case: all injuries occur in state A, none in state B. In this case, the law of state A is both the law of the conduct and the law of the effects. Under neither rule will the law of state B ever apply. State A's rule is irrelevant to state B, there are no incentives for B's substantive law either way. On the other hand, state A has an incentive to adopt an efficient liability regime, because its economy will bear all costs from the

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<sup>129</sup> This means in particular that the state can neither enjoin certain conduct altogether nor assign punitive damages.



conduct. Not surprisingly, for purely domestic cases the choice-of-law rule is irrelevant.

Now assume that all injuries are felt in state B. Now the injury costs are borne by state B and the costs of care are borne by state A. Under a place-of-conduct rule, state B has no incentives either way (because its laws will be inapplicable), while state A's incentive is to pass a no-liability regime because any costs from such care are not outweighed by any benefits to the state economy. Under a place-of-injury rule, state A has no incentives to pass any laws while state B will adopt a strict liability regime. What will the injurer's conduct be under either of these two regimes – the law of the place of conduct, or the law of the place of accident? Under a place-of-conduct rule, he will not exercise any care because he will not be liable for any damages. Under a place-of-injury rule, on the other hand, he will internalise all costs of his conduct, and so will take the globally optimal level of care. Clearly, in this context, the law of the place of the injury is superior. Just as strict liability between individuals forces the injurers to internalise all costs, so a place-of-injury rule for choice of law forces the economy of the state of conduct to internalise all costs of conduct by its citizens.

However, many activities cause injuries both in the state of the conduct and in other states. Assume that some of the injuries are felt in state A, and some are felt in state B. Again, state B has no incentives under a place-of-conduct regime, while it will opt for a strict liability regime under a place-of-injury rule because its interests are still similar to those of the victims, and this enables its victims to recover for all their accidents. State A, on the other hand, is more interesting. Because state A reaps all benefits and bears all of the costs of care but only half of the injury costs, the locally optimal level of care will be lower than the globally optimal level of care. Under a place-of-injury regime, state A will be indifferent as between a strict liability rule and a negligence rule. Under a place-of-conduct regime, on the other hand, state A will adopt a negligence regime and set the due level of care so that the marginal costs of care equal the marginal reduction of injury losses in state A, regardless of those in state B. This level will be lower than the globally optimal level of care, because state A receives all benefits from a reduction of care from the globally optimal level, while suffering only some of the losses, namely those to its own domiciliaries. Whenever more than half of the injuries occur in state A, any decrease in the level of care will hurt domestic social welfare in state A more than it reduces costs in state B.

This analysis thus far leads to these conclusions: the law of the place of injury is always globally superior to the law of the place of conduct if some of the injury occurs outside the state of conduct (otherwise it is equally efficient). It is globally efficient if 100% of the injury takes place outside the state of conduct, or if 100% of the injury occurs inside the state of conduct, provided states cannot have stricter liability regimes than strict liability. If some of the

injury occurs in the state of conduct and some in the state of injury, a place-of-injury rule does not lead to optimal results but is still superior.

How do bilateral accidents change this picture? Again, three scenarios are possible. First, if all injuries occur in state A, that state has an incentive to pass optimal liability rules that give optimal incentives to both plaintiffs and defendants. In this situation, a strict liability regime without a defence of comparative or contributory negligence is inefficient; it induces victims to take no care at all, even when the costs of such care would be more than outweighed by the reduction to the overall risk. A negligence regime is efficient because victims must assume that the injurer will take no more than due care, so they will take some care themselves. Similarly efficient is a strict liability regime or a negligence regime together with a rule for contributory or comparative negligence.<sup>130</sup> The content of the law of state B is irrelevant and will not depend on the choice-of-law rules.

However, this result changes when all injury occurs in state B. Because state B does not profit from expenditures on care by its citizens (the victims), the law of state B will provide for strict liability without the defence of comparative or contributory negligence if its law is applicable under a place-of-injury rule. State A, on the other hand, has an incentive to adopt a no-liability regime because the conduct causes no harm at all within its economy under a place-of-conduct rule. In this case, neither a place-of-conduct rule nor a place-of-injury rule leads to efficient incentives for both parties. To determine which of them is superior would require knowing whether strict liability without defence or no liability is the more efficient liability rule. This in turn depends on whether injurers or victims are the cheaper risk-avoiders – a plausible criterion for substantive law rules, but unattractive for a choice-of-law rule.

The most interesting scenario is again the third one, in which some of the injuries occur in state A and some in state B. Under a place-of-conduct rule, state A will have a rule of negligence together with a rule on comparative or contributory negligence. The due level of care for the injurer will be too low from a global level; as a consequence the due level of care for the victim will be too high. Under a place-of-injury rule, state A also has an incentive to adopt a regime providing for negligence and comparative or contributory negligence. The only difference is that no costs can be reduced with respect to victims in state B, so the divergence from the global optimum will be less extreme. State B, on the other hand, will still have a liability regime granting strict liability with no contributory negligence, regardless of how many of the injuries occur in state B under a place-of-injury rule. This choice-of-law rule is inefficient. It gives victims in state B no incentive to exercise any care at all. At the same time, victims in state A will have an incentive to exercise a high level of care in

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<sup>130</sup> *Shavell*, *Foundations* (supra note 62) 183 et seq.

order to avoid accidents if they expect the injurer to take too little care. How much care the injurer will take depends on the circumstances.

#### IV. Injunctions and Punitive Damages

Thus far, the place of the injury may seem more efficient. One important reason for this is, however, that under the assumptions, state B cannot seriously over-regulate, as it has a choice only between strict liability and negligence regimes. This changes once injunctions and punitive damages are options.

Normally, punitive damages are considered inefficient except in two situations: if injurers are likely to escape some liability, and (controversially)<sup>131</sup> if certain conduct is thought generally socially undesirable regardless of whether it brings individual benefits. Both these situations, rare in the domestic context, may appear frequently in the cross-border tort situation from the perspective of one state. First, if injurers comply with the requirements of the laxer of two laws, they escape some liability under the harsher of the two, and the legislators of the latter may use punitive damages to set optimal deterrence. Second, from the perspective of one state, conduct that is globally efficient may be deemed socially undesirable because the benefits it produces arise outside that state.

If state A underregulates, punitive damages can thus well lead to optimal incentives, provided they are set at the right level. The problem is that state B has no incentive to restrict injunctions and punitive damages in this way. Because state B does not at all benefit from the conduct, it may be thought to have an incentive to grant injunctions more freely, and to grant punitive damages at higher levels than the globally optimal level. This would make a place-of-injury rule inefficient, because that rule would enable state B to prevent efficiency-enhancing conduct. This is the intuition behind opposition to extraterritorial regulation<sup>132</sup>. But this opposition frequently focuses only on public regulation by way of banning certain conduct altogether. Injunctions and punitive damages give states more flexible tools.

However, the complete banning of foreign punitive damages can be both over-inclusive and under-inclusive. It can be over-inclusive insofar as it bans punitive damages that would be globally beneficial. The rule can be under-inclusive insofar as it focuses only on foreign, not domestic, punitive damages. If the courts of the place of the injury adjudicate litigation between victims from the forum state and the injurer, they would not have any reason, under choice of law, not to apply their own law's super-punitive damages rule. The

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<sup>131</sup> A. Mitchell Polinsky/Steven Shavell, Punitive Damages: An Economic Analysis: Harv. L. Rev. 111 (1998) 869, 905-910. On the broader argument from economics for multiple damages to counter underenforcement, see, most recently, Keith N. Hylton/Thomas J. Miceli, Should Tort Damages Be Multiplied?: J. L. Econ. & Org. 21 (2005) 388.

<sup>132</sup> Guzman (supra note 9) 907.

risk of such litigation might deter the injurer from his conduct altogether, although the conduct can be globally efficient. What would be needed, therefore, is a multilateral choice-of-law rule that restricts punitive damages at an appropriate level, but does so for all international transactions, regardless of the forum.

If transaction costs between injurers and victims are sufficiently low, victims will trade their right to an injunction or to punitive damages for a compensation higher than their actual injuries. If transaction costs are prohibitively high, then such a transaction will not take place. In this case, injunctions and punitive damages at a high level are inefficient, because they prevent efficient conduct from taking place. This makes it irrational for state B to pass such rules. True, by passing these rules, state B prevents conduct that leads to injuries to its own citizens, but by preventing beneficial conduct, state B also prevents its own citizens from partaking in the benefits from the conduct. It is more rational for state B to avoid injunctions, and to set punitive damages lower than the expected benefits to the injurer. This ensures that the conduct is still beneficial to the injurer so it takes place and victims can recover more than their actual injuries. Again, all that happens is redistribution. No inefficient conduct is prevented.

It follows that a place-of-injury rule can still be efficient. State B has an interest in passing laws that transfer as much of the benefit from the conduct to its own citizens, but it has no interest in preventing that conduct from happening altogether.

## V. Firms as Injurers and Competitive Markets

The analysis changes once firms as injurers and competitive markets are taken into account. This is where the frequent fears for a race to the bottom become relevant. This is not the place to repeat the whole debate on regulatory competition, and to discuss whether it leads to a race to the bottom, a race to the top, or something in between. However, it is useful to see how the debate can be linked with the incentivising model.

We have seen that a place-of-conduct rule would enable producers from state A to produce at lower costs, because state A would shield them from liability to victims in its own state. State A's lax tort law functions as a subsidy to its own producers. As a consequence, they may be able to offer their products in state B at a lower price than producers from state B, thereby putting the latter at a competitive disadvantage. Consumers in state B benefit from the reduced prices, but state B's economy at large may well suffer, because the losses to its producers are greater than the benefits to its consumers. In such a case, state B cannot react with stricter regulations for producers from state A, because its laws are not applicable. Its only possible reaction is to lower the restrictions to

its own producers, by relaxing its own tort law, to keep producers from state B competitive<sup>133</sup>.

A place of injury rule, by contrast, gives state B an incentive to overregulate. The reason is that victims in state B receive all benefits from over-regulation (which puts them at a superior bargaining position vis-à-vis injurers), while it bears only some of the costs: precaution costs must be borne by injurers in both state B and in state A. State A on the other hand still has an incentive to underregulate. It depends on the ratio of victims in both states, whether the under-regulation in state A can outweigh the effects of over-regulation in state B. Since producers face less liability costs to victims in their home states, they are still able to offer their products at lower prices in state B than producers from state B.

Whether a place-of-injury or a place-of-conduct rule is more efficient, cannot be decided in this model. One leads to under-regulation, the other to over-regulation<sup>134</sup>.

## E. Analysis

### I. Results

The original suspicion has been verified. Two economists – or rather, two economic paradigms, one based on individual interests, the other on state interests – indeed lead to three models that in turn create three different opinions. A private law model supports a place-of-conduct rule in order to empower markets, while an international law model supports a place-of-injury rule in order to maintain state policies. (The dispute between the European Union, favouring a country-of-origin rule, and the member states, favouring a place-of-injury rule, can thus easily be explained – the member states are afraid of losing influence, while the Union is interested in creating the common market<sup>135</sup>.) An incentivising model finally stands in the middle of the two; it has a weak preference for place-of-injury rules for liability regimes, but not for damages.

This result suggests that the discrepancy in traditional private international law between private and international law concepts is replicated in the discrepancy between private and international models in economic analysis. The private law model favours a place-of-conduct rule because it enhances competition and reduces the impact of state policies; the international law

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<sup>133</sup> *Guzman* (supra note 9) 910-912.

<sup>134</sup> This parallels *Guzman*'s lessons # 2 and # 3: extraterritoriality (as in a place-of-injury rule) leads to over-regulation, territoriality (as in a place-of-conduct rule) leads to over-regulation. *Guzman* (supra note 9) 906, 909.

<sup>135</sup> See *Michaels*, EU Law as Conflict of Laws (supra note 4).

model favours a place-of-injury rule because it enables states to regulate their own markets and protect domestic firms from foreign competition. The discrepancy can be made more general: the economic private law model leads to results favoured by private law conceptions in doctrine: hard and fast rules, preference for party autonomy, preference for free markets over protective state policies, and regulatory competition. The economic international law model, by contrast, leads to results favoured by international law conceptions in the doctrine, especially governmental interest analysis: discretionary principles, only limited use of party autonomy, preference for protective state policies over free markets, and cooperation between states and comity.

The differences are not surprising; they are functions of the different assumptions underlying the models. A private law model aims at avoiding inefficient substantive laws; an international law model protects them as embodying the preferences of states as rational actors. Authors writing in a private law model assume that the risk of third-party externalities from party autonomy is smaller than the public choice risk from inefficient mandatory laws. Authors in an international law model, on the other hand, seem to assume that the public choice risks are smaller than the risks coming from parties undermining state policies. In a private law model, Kaldor-Hicks provides a relatively uncontested criterion for global efficiency; in an international law model, Pareto efficiency is better able to account for sovereignty and the lack of a system for side payments between states. If the public/private distinction is seen as a struggle between states on the one hand and individuals on the other, it is not surprising that a model that focuses only on individuals as actors will enable individuals to avoid constraints from states, whereas a model which focuses only on states as actors will enable states to constrain individuals.

## II. The Choice between the Models

Can the models be reconciled? One may think that different models are simply appropriate for different areas of the law. Indeed, authors in the private law model focus on the classical areas of private law: contracts, “everyday” torts, property, etc<sup>136</sup>. They seem to assume that in areas like contract law, countries pursue fewer regulatory goals, and because each system has equal numbers, e.g., of sellers and buyers, all rules are likely to be neutral between the two groups and therefore presumably more or less efficient. As a consequence, the content of the rules plays a much less important role than clarity and predictability, and differences between legal systems, if they exist at all, are considered irrelevant for interpersonal efficiency. If there are policy differences, the problem is not national preferences but rather problems of public

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<sup>136</sup> *O’Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1197-1221.

choice, which can be overcome through regulatory competition. On the other hand, authors in the international law and in the incentivising model focus on regulatory areas of the law like antitrust and securities regulations<sup>137</sup>, traditional areas of public law. Here the assumption is that the content of the substantive rules of different states and states' freedom to determine such policies, play a great role. States actually pursue economic strategies depending on the strength of their industries, and legal regimes are very different because different economies may have significantly more exporters or more importers, so substantive rules are likely to be twisted in favour of one group or the other. It might then follow that the models are not really in conflict but rather apply to different areas of the law, private law on the one side and public law on the other. Such a distinction would mirror the traditional distinction, more prominent in Europe than in the United States, between relatively technical and apolitical private international law on the one hand, and the more political question of extraterritorial applicability of public law.

Or perhaps the relationship between the two models is one of rule and exception. Indeed, neither the private law nor the international law model is seen as exclusive; both allow for the other model. Thus *O'Hara* and *Ribstein* leave an exception from the private law model for public law matters, especially criminal law<sup>138</sup>. And *Trachtman* allows an exception from the international law model for areas with no or with attenuated governmental preferences<sup>139</sup>. These relations of rule and exceptions reflect differences in traditional private international law. *Savigny*, who could be considered the ancestor of individual-based approaches, wrote for a legal environment in which different countries had structurally very different legal systems, yet largely agreed on the apolitical substance of private law. Consequently, a main task of private international law was a question of technical coordination. Indeed, *Savigny's* approach assumed the equivalence and gradual convergence of legal systems in the Western world were equivalent. Where this was not the case, his system had to allow for exceptions. *Brainerd Currie*, on the other hand, perhaps the extreme proponent of an international law approach, was confronted with a legal landscape in which different states of the United States have similar methodologies but differences in individual rules, and these differences are often inspired by political differences. In the American system, almost every difference between laws represents a difference in regulatory policies.<sup>140</sup> Where policies are (exceptionally) similar, *Currie* sees no true conflict of laws and considers the solution a largely technical matter. In this sense, the difference

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<sup>137</sup> *Trachtman*, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 64 et seq.; *Guzman* (supra note 9) 933 et seq.

<sup>138</sup> *O'Hara/Ribstein*, From Politics to Efficiency (supra note 9) 1217 note 312.

<sup>139</sup> *Trachtman*, Economic Analysis of Prescriptive Jurisdiction (supra note 9) 20 et seq.

<sup>140</sup> *Ralf Michaels*, American Law (United States), in Jan Smits (ed.), *Elgar Encyclopedia of Comparative Law* (2006) 66, 70.

between *Savigny* and *Currie* concerns mainly the relation between rule and exception: the rule for one is the exception for the other, and vice versa.

Yet the problem for compromise is that the boundary must be drawn somewhere, and it is difficult to devise objective criteria as to where it should be drawn. Tort law is a good example: is it primarily private law, so a private law model should prevail? This argument succeeds when tertiary costs are high and regulatory interests, including incentives to parties, are low, for example, because no significant differences between different laws exist. Or is it primarily public law, so an international law model should prevail? This would be the case when states pursue strong regulatory interests with their laws, possibly in explicit opposition to the laws of other states. But what if both come together?

The greatest hope seems to lie with the third model, the incentivising states model. That model is the only one that does not replicate a traditional approach to private international law, because traditional doctrine usually considers substantive laws as given. Here, law and economics might have something new and original to contribute to the debate on private international law. The problem is that the model has a very restricted scope of application. It becomes relevant only where injurers are predominantly situated in one state, while victims are predominantly situated in the other state. Only in these situations do internal and global efficiency differ, so states have an incentive to pass statutes that are efficient for their own economy but not efficient globally. While *Guzman* seems to think of this as the standard case<sup>141</sup>, in reality it is a relatively rare case. The wide variety of cases in which states simply pursue different policies that they deem appropriate for their own societies cannot be resolved with this model.

If therefore the incentivising model is no full alternative, and if no meta-model exists to decide the conflict between the private international law models, the boundary must be taken from one of the two models. Indeed, each model provides for a definition of the boundary. *Trachtman* wants to draw the border from the side of the state. For him all law is “public law”, and “[t]he proper distinction to draw is not between private and public law, but in the degree to which law implicates state preferences.”<sup>142</sup> *Whincop* and *Keyes*, on the other hand, draw the boundary from the side of private parties when they emphasize the need for party autonomy precisely as a tool to avoid inefficient state preferences and deny it only in order to avoid negative externalities<sup>143</sup>. Obviously, these boundaries differ from each other. We end up with a new

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<sup>141</sup> *Guzman* (supra note 9) 904-906.

<sup>142</sup> *Trachtman*, *Economic Analysis of Prescriptive Jurisdiction* (supra note 9) 21.

<sup>143</sup> *Whincop/Keyes*, *Policy and Pragmatism* (supra note 6) 5; *O'Hara/Ribstein*, *From Politics to Efficiency* (supra note 9) 1152.



(true!) conflict, that between international and private, between state and individual, and the neutral conflicts rule to resolve it is nowhere to be found.

### III. The Promises and Limits of Economics

The choice of a model, though not per se determinative for the result, determines the relative strength and weakness of arguments. For example, a private law model may emphasize regulatory competition, while an international law model may emphasize cooperation between states. For a private law model, mandatory norms represent inefficient results of public choice problems, for an international law model they represent emanations of sovereignty. None of these assumptions is intrinsic to the models: cooperation can be justified in a private law model, and regulatory competition can be justified in an international law model; democratic legitimacy can be reconceived as the result of private bargains, inefficient norms can be reconceived as improper. But the choice of one model over the other brings with it a certain baggage of preconceptions that allow focusing on some aspects in an economic analysis while dismissing others as irrelevant. The choice of the appropriate model is the crucial step.

Yet the analysis suggests that economic analysis cannot resolve the important underlying policy questions in private international law through an efficiency analysis. Economic analysis can tell us what is efficient within one model, but it then needs to make certain assumptions about which costs should be taken into account and which costs should not matter. Economic analysis can tell us which model to use for which areas of the law, but it cannot draw the boundary or tell us what belongs into which area. If one tries to overcome these problems by incorporating everything, economic analysis becomes inconclusive. Through and through, the public/private distinction that the economic analysis aims at overcoming comes back to haunt it.

This does not mean that economic analysis has no role to play in private international law. First, the economic analysis provides a useful heuristic on private international law, both on the importance of deciding for one or the other model, and on the plausibility of arguments within each model. In fact, rephrasing private international law debates in economic terms reveals more sharply the underlying political conflicts within the discipline of private international law. Second, economic analysis provides tools for a much more rigorous analysis of the impact that rules of private international law have on the conduct of individuals and of states. Economic analysis can show that private international law is neither merely a neutral technical meta-law that designates the applicable law according to some transcendent criterion, nor that it incorporates only ex-post (or even ex-ante) justice. Rather, private international law plays an active role in the regulation of international transactions not unlike that of substantive law. And economic analysis can enable us to

quantify the incentives of choice-of-law rules and set them into relation with conflicting incentives.

These insights should all be used for a more informed analysis of private international law rules. They should not be used, however, to replace the vain hope for a neutral and objective private international law with the equally vain hope for a neutral and objective economic analysis, to replace the elusive notion of “conflicts justice” with the equally ambiguous notion of “global efficiency”. Before strong normative claims of efficiency can be made, economic analysis should be used for the more modest task of positively analysing the effects that different choice-of-law regimes will have, and leave normative decisions to the political process. The choice of one or the other model is not an ad hoc decision but ultimately a political decision. As a consequence, it does not help much to present the results of an efficiency analysis as scientifically proven normative conclusions, if the choice for the model itself has been made on an ad hoc basis. Rather, the results from the models should be used to enlighten us as to which model is more attractive for one situation or the other. Once the regulatory force of private international law is realized, it becomes clear that the ultimately political debates about the goals of regulation cannot remain in the sphere of substantive law or at the level of the state, but rather must be taken up at the level of private international law and at the level of global society as well. Law and economics can guide us towards better regulation, but the ultimate decisions must be taken elsewhere.