Transnational Forum Shopping as a Trade and Investment Issue

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Abstract

Plaintiffs regularly bring cases in U.S. courts seeking damages for harms that have occurred abroad, attracted by higher expected returns than are available in the jurisdiction where the harm arose. In recent years, many claims have been filed by tort plaintiffs from developing countries, who often argue that the remedies available to them in their home jurisdictions are deficient or non-existent. This paper focuses on a potential inefficiency of such forum shopping that is of special importance in transnational tort litigation against business defendants – the potential distortion of trade and investment patterns that can result from implicit discrimination in the applicability of liability rules to producers or investors of different nationalities. These distortions are akin to those caused by discriminatory tariff or tax policies, and can reduce global economic welfare. In appropriate cases, the welfare costs can be averted by limiting foreign tort plaintiffs to the law and forum of the jurisdiction in which their harm arose, although such a rule is not efficient in all cases. The analysis has implications for a number of areas of legal doctrine, including the doctrine of forum non conveniens, the construction of the Alien Tort Statute, and the rules governing choice of law in transnational tort cases.

Forum shopping by tort plaintiffs is a commonplace in the American legal system. In recent years, it has also become an international affair. Plaintiffs regularly bring tort and tort-like cases in U.S. courts seeking damages for harms that have occurred abroad, attracted by higher expected returns than are available in the jurisdiction where the harm arose. The scenarios addressed in these cases are wide-ranging, including products liability claims, aviation accidents, industrial accidents, groundwater pollution, common law intentional torts, and various "human rights"

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abuses.[1] A number of recent claims have been filed by plaintiffs from developing countries, who commonly argue that the remedies available to them in their home jurisdictions are deficient or non-existent.

As others have noted, forum shopping often entails inefficiencies because plaintiffs do not internalize all of the costs and benefits of their forum choice. An obvious inefficiency arises if forum shopping causes a dispute to become subject to comparatively inefficient legal standards. This paper focuses on a further potential inefficiency, however, that has not been discussed elsewhere to my knowledge, and that is of special importance in transnational tort litigation against business defendants (although it can also be important with domestic litigation) – the potential distortion of trade and investment patterns that can result from implicit "discrimination" in the applicability of legal rules to producers or investors of different nationalities. Such distortions are akin to those associated with discriminatory tariff or tax policies. In particular, the application of more stringent U.S. liability standards to some, but not all, firms doing business in a foreign jurisdiction may cause efficient firms subject to suit in the United States to be displaced by inefficient firms that are not subject to suit, or may cause inefficient corporate restructuring to avoid the reach of U.S. law. Global (and national) economic welfare may decline as a result, affording an argument in appropriate cases for limiting foreign tort plaintiffs to the law and forum of the jurisdiction in which their harm arose. This argument can hold even if the substantive or procedural law of the foreign jurisdiction in question is demonstrably inferior to U.S. law from an economic standpoint.

The argument for limiting the plaintiff to the remedies available in its home jurisdiction does not hold in all cases, however, and the policy implications of the analysis are thus more nuanced. When U.S. law is superior and its application to conduct abroad will not divert production to inefficient firms, the application of U.S. law will enhance global welfare. Further, if tort liability in a foreign jurisdiction is inadequate but consumer demand for the goods or services of an industry that causes external harm is sufficiently elastic, the substitution of higher cost firms for lower cost firms may cause such a large reduction in output and the attendant tort injuries that a welfare gain can arise. In addition, the application of less stringent foreign tort standards to harms that occur abroad may induce domestic companies to

[1] See cases cited in Section III infra.

relocate production facilities abroad inefficiently. Finally, when harms are suffered by well-informed parties who stand in a market relationship with the tortfeasor, it is desirable to apply the more efficient law regardless of where the harm occurs.

The implications of the analysis in any given case thus turn on possibly cross-cutting empirical issues. The primary goal of the paper is to illuminate those issues, and thus to assist courts in the exercise of their discretion over whether to entertain the suits that are the focus of this paper and what law to apply in them. The analysis implicates several pockets of legal doctrine, including the *forum non conveniens* principles applied in cases such as *In Re Union Carbide*,[2] the interpretation of the Alien Tort Statute at issue in cases such as *Sosa v. Alvarez-Machain*,[3] and the choice of law rules applicable in transnational tort cases governed by domestic tort law.

The plan of the paper is as follows. Section I briefly surveys the legal landscape, noting the doctrinal issues that arise in tort and tort-like litigation in American courts by foreign plaintiffs. Section II develops the economic analysis. The centerpiece is a formal model analyzing the global welfare effects of discriminatory tort rules in a competitive industry, followed by a discussion of important extensions and caveats to the results. Section III reviews recent transnational tort litigation in light of the economic analysis, while Section IV concludes with some comments about the relevance of the analysis to forum shopping by domestic plaintiffs.

I. Legal Background: Foreign Tort Litigation in American Courts

[2] 634 F. Supp. 842 (S.D.N.Y. 1986), aff'd 809 F.2d 195 (2d Cir. 1986).

[3] 542 U.S. 692 (2004).

It is not difficult to imagine why foreign tort plaintiffs[4] might prefer to bring cases in U.S. courts for harms suffered abroad, despite potentially higher costs of pursuing the cases in the United States. On substantive tort issues, U.S. law is frequently more favorable to plaintiffs than foreign tort law. U.S. precedent may impose strict liability, or allow for punitive damages, when foreign law does not. Compensatory damages awards in the United States may be higher on average, in part because of the jury system. Procedurally, U.S. law may allow plaintiffs greater opportunities to build their case through more liberal discovery rules, or may allow the consolidation of claims in class actions that are impermissible abroad. U.S. law also shows no hostility to contingent fee arrangements, while many foreign jurisdictions prohibit them.[5] Finally, U.S. courts may be more efficient, less biased, and better insulated from corruption. This list of potential advantages is no doubt incomplete.

The cases of interest in this paper involve business defendants, typically corporations. To pursue a claim in U.S. court against such a defendant for a harm that occurs abroad, a foreign tort plaintiff must first secure personal jurisdiction over the defendant in a U.S. court. U.S. constitutional law requires that the defendant have certain "minimum contacts" with the jurisdiction in which suit is brought for personal jurisdiction to exist. Roughly speaking, this requirement means that a business defendant is subject to personal jurisdiction where it is incorporated, where its principal place of business is located, or where it

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[4] Throughout the paper I refer to suits brought by "foreign tort plaintiffs," although much of the analysis also applies to suits brought by domestic citizens who are injured abroad. For such a case, see Spinozzi v. ITT Sheraton Corporation, 174 F.3d 842 (7th Cir. 1999), which is discussed at some length in Goldsmith and Sykes (2007). Likewise, although my focus is on potential discrimination against "U.S. defendants," the problem of discrimination also arises when suits are brought against foreign defendants who are subject to personal jurisdiction in the United States and whose assets can be reached by U.S. courts.

[5] For a comparative study of tort law in Western nations touching on these issues, see Pfennigstorf and Gifford (1991). See also Posner and Sunstein (2005) (noting that wrongful death awards abroad tend to be lower than in the United States); Aguinda v. Texaco, Inc., 303 F.3d 470 (2d Cir. 2002) (plaintiff objecting to dismissal on grounds of *forum non conveniens* because, *inter alia*, alternative forum does not allow class actions, procedures are less streamlined, and judicial system subject to corrupt influences).

engages in commerce.[6] Plaintiffs must also bring suit in a court where "venue" is proper, which again typically implies that the defendant must have a physical presence within the jurisdiction or engage in commerce within the jurisdiction.[7]

The rules governing personal jurisdiction and venue usually pose minimal obstacles to plaintiffs seeking to bring cases against U.S. defendants. Almost invariably, there will exist some state or federal jurisdiction (typically many) where a U.S. business defendant is amenable to suit. By contrast, many (though by no means all)foreign defendants are beyond the reach of U.S. courts both as a legal and practical matter. This last point is a crucial one, for it explains why forum shopping by foreign plaintiffs can result in the discriminatory application of legal rules to some but not all businesses operating in a foreign jurisdiction.

Beyond securing personal jurisdiction over the defendant in a proper venue, a foreign tort plaintiff must also bring a substantive claim over which the court has subject matter jurisdiction. In recent years, much academic attention has been paid to a particular Federal statute in this regard – the Alien Tort Statute[8] enacted as part of the Judiciary Act of 1789 – which provides in its entirety: "The district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States." The scope of the claims permitted under this statute has been controversial for many years. Claims within the Alien Tort Statute are by no means the only ones over which U.S. courts have subject matter jurisdiction, however, and most tort law in the United States is state law within the subject matter jurisdiction of the respective state courts. In cases involving foreign plaintiffs, "diversity of citizenship" will commonly arise between the plaintiff(s) and defendant. If so, and if the amount in controversy exceeds a monetary threshold, foreign tort plaintiffs can also bring claims based on state tort law in Federal court.[9]

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[6] See James, Hazard and Leubsdorf (2001), §§2.5-2.6.

[7] Id. §§2.23, 2.32.

[8] 28 U.S.C. §1350.

[9] See James, Hazard and Leubsdorf (2001), §2.24.

In cases governed by domestic tort law, foreign tort plaintiffs must nonetheless worry that a court will decline to apply the plaintiffs' desired substantive law under its "choice of law" principles. Many years ago, the prevailing view in tort cases was that the court should apply the law of the jurisdiction in which the tort occurred – the rule of *lex loci delicti.* The great majority of American jurisdictions have discarded *lex loci delicti*, however, in favor of a variety of other approaches that afford the courts more discretion over what law to apply.[10] As Section III will indicate, by making a careful strategic choice about where to file a case, foreign tort plaintiffs may well find a U.S. court that will apply substantive U.S. tort law to the dispute.

But such plaintiffs must also confront the possibility that a U.S. court may decline to hear a case even when jurisdiction and venue are proper, and even when it would otherwise apply U.S. law. Over the years, Federal and state courts have developed the doctrine of *forum non conveniens*, which allows them to dismiss a case because the plaintiff has chosen an "inconvenient" forum in which to file it. In considering whether to invoke this doctrine, the courts will inquire whether there is an "adequate alternative forum" that is on the whole a better one (the details of the doctrine will be considered in Section III).[11] A decision to dismiss a case for *forum non conveniens* will generally send a foreign tort plaintiff back to its home jurisdiction to pursue whatever remedies are available there.

As should now be clear, various strands of doctrine can affect the ability of foreign plaintiffs to pursue tort remedies in U.S. courts. In many cases, courts will have considerable discretion over what law to apply to a case, and even over whether to hear the case at all.

II. Economic Analysis

We now turn to the central normative issue of the paper – when *should* U.S. courts be receptive to tort actions by foreign tort plaintiffs for harms suffered abroad? The answer here embraces a welfarist perspective,

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[10] See Scoles, Hay, Borchers and Symeonides (2004), §§2.19-2.21.

[11] See James, Hazard and Leubsdorf (2001), §2.20.

with the hope that readers will find it relevant even if not necessarily conclusive.

A. Prior Literature

To my knowledge, this paper is the first to offer an economic analysis of the welfare effects of the potential trade and investment discrimination associated with transnational tort litigation. A limited economic literature exists on forum shopping and the Alien Tort Statute, however, along with a more substantial literature on conflicts and choice of law.

Regarding forum shopping and the doctrine of *forum non conveniens*, Baxter (1963) notes that forum shopping may promote uneconomically early filing of lawsuits, and it may result in unduly high litigation costs because of geographic inconvenience or disputes over peripheral issues such as personal jurisdiction. Posner (1998) suggests that *forum non conveniens* might in principle be used to select the forum that will minimize overall litigation costs. White (2006) offers an empirical study of the effects of forum shopping on modern asbestos litigation. None of these commentators address the issues that are the focus of this paper.

Most of the literature on the Alien Tort Statute is non-economic, although its potential impact on U.S. commerce is the subject of Hufbauer and Mitrokostas (2004). Writing prior to the decision in *Sosa*, they contend that a broad interpretation of the statute would discourage trade and investment by U.S. firms. They offer some back of the envelope estimates of the potential impact on U.S. exports and export sector jobs. Koh (2004) replies to their analysis, arguing that it grossly overstates the likely impact of litigation under the Statute. These authors do not address the broader economic consequences of discrimination or its global welfare implications.

Economic analysis has been brought to bear to a greater extent on the field of conflicts and choice of law, although most of it has little bearing on the issues that this paper emphasizes. A large strand of literature argues for allowing market transactors to choose the law that will apply to their disputes. See, for example, Romano (1998) and O'Hara and Ribstein (2000a). The "comparative impairment" principle set forth in Baxter (1963) suggests that courts should apply the law that best promotes the collective interests of the jurisdictions with a stake in the outcome of the controversy (roughly speaking, a call for Kaldor-Hicks efficient choice of law decisions).

Kramer (1990) further suggests that states can achieve mutually beneficial non-cooperative equilibria in this regard through implicit reciprocity in choice of law decisions. Guzman (2002), focusing on the regulatory areas of bankruptcy, securities and antitrust, offers some recommendations for overcoming the inefficiencies that may result from the self-interested pursuit of national welfare by governments acting noncooperatively.

Other writers have considered the interplay between choice of law rules and underlying substantive law. McConnell (1988) argues that state products liability law will tend to allow overgenerous recoveries to plaintiffs because most plaintiffs are in-state residents while most defendants are out-of-state manufacturers – courts applying the law of their own jurisdiction can thus transfer rents to the state by creating pro-plaintiff substantive rules. Hay (1992) counters that most states now choose the applicable law based on interest analysis and its variants, which they can manipulate to justify the application of out-of-state law when it favors in-state actors. This practice will dampen any tendency of states to adopt overgenerous products liability laws.

Finally, on the empirical front, a small literature has developed on the question whether state courts manipulate modern choice of law rules to favor in-state actors. See Solimine (1989), Borchers (1990), and Thiel (2000). The economic literature on conflicts and choice of law is surveyed in Parisi and O'Hara (1998) and O'Hara and Ribstein (2000b).

One bit of literature on choice of law with direct bearing on the issues addressed here is Richard Posner's defense of the *lex loci delicti* principle in domestic tort cases. Posner (1998) suggests that states will typically have a comparative regulatory advantage with respect to events occurring within their jurisdiction. As an example, he suggests that the rules governing highway travel in each jurisdiction are "presumably" better tailored to driving conditions in that jurisdiction. Thus, if an accident occurs in a particular jurisdiction, it is likely that the tort law of that jurisdiction provides the better guide to the disposition of any resulting tort suit. Section C will return to this argument.

B. A Note on National vs. Global Welfare Perspectives

A welfarist response to the normative question posed by this paper requires a prior judgment as to *whose* welfare is at stake. One possible assumption is that national governments should maximize the welfare of their own citizens, "national economic welfare," with little or no regard for the consequences of their decisions for foreign citizens. Indeed, positive economic analysis of international interaction regularly supposes that national governments behave in precisely that fashion.[12] Another possible view is that governments should be other-regarding, and give considerable weight to the welfare of non-citizens. When the welfare of domestic and foreign individuals counts equally, the normative criterion becomes "global economic welfare."

The national welfare perspective leads to an obvious argument against allowing foreign tort plaintiffs to pursue cases against U.S. defendants in U.S. courts. When a foreign tort plaintiff brings such an action, it does so because the U.S. legal system is more generous or favorable to the plaintiff in some way than is the plaintiff's next best alternative. The foreign plaintiff is thus asking the court to transfer additional economic surplus from the U.S. defendant to the plaintiff relative to the expected outcome of the case elsewhere. A national welfare maximand suggests that U.S. policy should resist such efforts. This point is subject to two caveats.

The first involves cases of altruism. Instances may arise in which a transfer of rents to foreign tort plaintiffs increases U.S. welfare because the welfare of U.S. actors also depends on the plaintiffs' welfare. Perhaps the plaintiffs comprise a group of especially needy or deserving individuals, for example, or perhaps a sense of responsibility for their plight leads U.S. citizens to desire to help them. I take no position on the empirical importance of altruism in the cases of interest in this paper, or on the ability of courts to identify situations in which altruism considerations are material. But if altruism is important, the distinction between the national and global welfare perspectives blurs considerably and a global welfare analysis becomes relevant.

A second caveat concerns the possibility that the noncooperative pursuit of national welfare by individual nations may lead to global inefficiencies that can be avoided through explicit or implicit international

[12] The theory of the "optimal tariff," which demonstrates how nations with power over their terms of trade may seek to enhance their own economic welfare at the expense of global welfare, provides a classic example. See Johnson (1953).

cooperation. This point is made by Kramer (1990) in the domestic setting, who urges states to seek mutual gains through policies of reciprocity in their choice of law decisions, and by Guzman (2002) at the international level, who discusses the problem in bankruptcy, security, and antitrust settings. In the tort context, one might imagine that the pursuit of narrow self interest will lead nations to deny remedies to foreign tort plaintiffs, and that the result might be inadequate precautions against accidents and excessive scale of risky activity.[13] One might also imagine the opposite scenario, in which nations provide overgenerous tort remedies to domestic tort plaintiffs who proceed against foreign tort defendants, distorting scale and possibly care decisions in the opposite direction.[14] This was the essential point in McConnell (1988). Either way, explicit or implicit agreements to provide proper tort remedies in cases involving foreign plaintiffs or defendants might not only enhance global welfare but also enhance the national welfare of cooperating nations if the gains are sufficiently reciprocal.

Although the potential value of cooperation is apparent, the chances of achieving it are less clear. Aside from national treatment obligations under WTO law,[15] no mechanism is presently in place for explicit international cooperation on substantive aspects of tort law, choice of law, or forum choice. One might also doubt whether the chances for implicit cooperation based on "tit for tat" or similar policies in national courts (akin to the state-level behavior urged by Kramer (1990)) are promising. Nevertheless, the possible gains from cooperation may provide some justification for policies grounded in global welfare considerations even for those who prefer the national welfare maximand in general. The remainder of Section II will focus on the global welfare effects of forum shopping by foreign tort plaintiffs.

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[13] For a thorough welfare analysis of how liability levels affect care and scale decisions by potential injurers, see Shavell (1987).

[14] International law already provides some limitations on such behavior, at least when the unfavorable treatment of foreign defendants implicates trade in goods and services. WTO "national treatment" obligations, which apply generally in goods markets and more spottily in services markets, would preclude nations from treating foreign defendants less favorably than domestic defendants. See generally Jackson, Davey and Sykes (2002), chapters 12 and 19.

[15] See note 14 supra.

C. Posner's Defense of *Lex Loci Delicti* and Its Deficiencies

Richard Posner's argument for *lex loci delicti* in the domestic context, noted above, can readily be adapted to afford a global welfare defense of *lex loci delicti* at the international level. Posner posits that geographic variations in tort law are efficient, reflecting the "comparative regulatory advantage" of the jurisdiction in which the harm arises. Extending this reasoning to the international context, one might argue that international variations in tort law, and perhaps in other aspects of the law such as procedure, are efficient adaptations to differing conditions in different countries. If one accepts such an argument, then tort cases involving foreign tort plaintiffs and U.S. defendants should generally be decided under the law and procedure of the jurisdiction in which the harm arises. By contrast, if foreign tort plaintiffs are allowed to proceed in U.S. courts under U.S. law for harms that occur elsewhere, inefficient substantive and procedural rules will apply, distorting behavior in the future and lowering global welfare.

The difficulty with such an argument lies in its premise. If country A allows punitive damages but country B does not, it is hardly clear that punitive damages are efficient in the first jurisdiction and not the second. Likewise, differences in the standard of liability or the available affirmative defenses may have little to do with efficient geographic variability in the law. It is also perhaps difficult to imagine that class actions are efficient in some countries but not others, or that the efficiency of contingent fee arrangements turns on geography. Instead, differences in substantive and procedural rules may well reflect such diverse factors as legal culture, the political efficacy of trial lawyer lobbies and business lobbies, and other considerations bearing no systematic relationship to efficiency.

One must entertain the possibility, therefore, that the *lex loci delicti* as well as the court system of the jurisdiction where the harm arises may be inefficient, and that U.S. law and courts may be economically superior in some respects. The problem may be especially acute with respect to developing nations, where the court system may be weak or corrupt and plaintiffs may have great difficulty obtaining effective remedies. Of course, the reverse possibility exists as well. American tort and procedural law is certainly not without its critics, many of whom focus on economic considerations.[16]

In light of these possibilities, one might suppose that a global welfare maximizing policy requires a comparison between the law and court system of the U.S. forum, and the law and court system of the alternative forum available to the plaintiff. If the U.S. law or court system is clearly superior by economic criteria, the argument might run, global welfare maximization would require U.S. courts to take the case. Such thinking is mistaken in significant part, however, for a reason that has not been appreciated to date. Even if U.S. law or U.S. courts are superior by sound economic criteria, it does not follow that the *discriminatory application* of U.S. law by U.S. courts will enhance global welfare. And if U.S. courts can only entertain suits against U.S. defendants and not their foreign competitors (or only some of them), discrimination is sure to arise.

D. A Model of Discriminatory Tort Law in a Competitive Industry

This section develops a formal model to illustrate the potential global welfare effects of discrimination in the application of liability rules (or related legal procedures). The model may be interpreted in two ways. First, it can be viewed as a trade model, in which exporters from one nation are subject to more stringent tort rules than their domestic competitors in the importing nation or in some third exporting country. Alternatively, it can be viewed as an investment model, in which firms doing business in a foreign market are subject to different tort rules based on their nationality.

Because the emphasis is on the welfare effects of discrimination in the application of tort rules across firms, one must assume that the initial state of affairs, relative to which "discrimination" will be introduced, is somehow suboptimal. Otherwise, discrimination is obviously of no utility and the inquiry is of little interest. Thus, we will employ the model to ask the following question: Suppose that the tort law of some jurisdiction imposes inadequate tort liability, resulting in inefficiently little care by firms and inefficiently high output by firms that create risks. Starting from this position, can global welfare be enhanced through the application of superior

[16] See, e.g., Polinsky and Shavell (1998) (critique of modern punitive damages law); Epstein and Sykes (2001) (critique of class actions in tort setting).

tort law – tort law that promotes greater cost internalization by firms -- only to *some* of the firms in the industry?

1. Notation and Assumptions

The model here depicts partial equilibrium for a competitive industry, similar to the general approach in Polinsky (1980). The assumption of competition is of course somewhat restrictive, but the essential effects of discrimination that are the focus of the model would also arise under alternative market structures, a point that is addressed further in Section E.

Assume that firms suffer no market penalty for the torts that they cause. Perhaps injurers and victims are "strangers" in the common economic parlance or, if they have some market relationship to one another, market imperfections exist that insulate firms from market penalties for torts. Section E below will briefly address market-mediated cases under other possible assumptions. Assume in addition that victim incentives are not in play – victims do not alter their care levels or their scale of activity in response to changes in the legal liability of injurers. The model also ignores litigation costs.

Finally, assume for simplicity that each firm serves only one jurisdiction. Section E will discuss the implications of relaxing this assumption.

Thus, imagine that firms in an industry produce a single good for sale in a foreign jurisdiction. Let the inverse demand function for the good (price as a function of quantity) be p(z). Assume that two types of firms serve the market, indexed by *i,* i=1,2. The number of firms of each type in equilibrium is n_i.

All firms of each type have identical cost functions, but we allow for the possibility that firms of different types have different cost functions. The cost function for type *i* is $c_i(q_i)$, where q_i is output by a firm of type *i*. Each firm has some fixed cost of production plus a marginal cost of production. We make the standard assumption that marginal cost is increasing at a non-decreasing rate, i.e., $c_i^{'} > 0$ and $c_i^{''} \geq 0$. Average (total) cost is "U-shaped" -- it declines over some range of output and then begins to rise.

The activities of each firm impose a non-pecuniary external harm on citizens of the jurisdiction. Let the harm caused by firm of type *i* per unit of output be $h_i(x_i)$, where x_i is a monetary care expenditure per unit of output by the firm. An increased expenditure on care reduces the harm per unit of output at a decreasing rate, i.e., $h_i^{'} < 0$, and $h_i^{''} > 0$. Finally, let $t_i(x_i)$ equal the liability per unit of output imposed on a firm of type *i*. To keep the analysis simple, let this liability be "strict" (firms cannot avoid liability by exercising "due care").[17]

We begin with some basic results that may seem old-hat to readers familiar with the economic literature on torts, but that are needed to set up the analysis of discrimination that follows.

2. Welfare Maximization

Denote aggregate output of the industry by $Q = n_1q_1 + n_2q_2$. Total welfare associated with production and consumption[18] in the industry can then be written:

$$(1)\quad W = \int_0^Q p(z)dz - \sum_{i=1}^{2} \{n_i c_i(q_i) + n_i h_i(x_i) q_i + n_i x_i q_i\}$$

Maximization of this expression with respect to the q_i, x_i and n_i yields three pairs of Kuhn-Tucker first-order conditions (second-order conditions are satisfied given the assumptions above).

Differentiation with respect to the q_i yields, after simplification:

$$(2)\quad p(Q) \le c_i^{'}(q_i) + h_i(x_i) + x_i$$

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[17] Broadly similar results could be derived under a well-functioning negligence rule, although the analysis would be complicated by the extent to which non-negligent firms externalize some costs. With an imperfect negligence system that resembles strict liability in important respects, the results would converge to an even greater extent.

[18] I rely on the standard assumption that consumer surplus is captured by the area under the Marshallian demand curve, which is not quite right in general. For elaboration, see Willig (1976).

which must hold with strict equality if $q_i > 0$. This expression states that price cannot exceed the marginal social cost of production for firms of type *i*, and must equal marginal cost if firms of type *i* are producing any output.

Differentiation with respect to the x_i yields:

(3) $-h_i'(x_i) \leq 1$

which must hold with strict equality if $x_i > 0$. This condition says that the marginal benefit of care expenditure cannot exceed its marginal cost, and must equal its marginal cost if care expenditure by firms of type *i* is positive.

Finally, differentiation with respect to the n_i yields, after some rearrangement:

(4) $p(Q) \leq \dfrac{c_i(q_i) + h_i(x_i)q_i + x_i q_i}{q_i}$

which must hold with strict equality if $n_i > 0$. This expression states that price cannot exceed the *average* social cost of output by a firm of type *i*, and must equal its average social cost if firms of type *i* are present in the industry.

Conditions (2) and (4) together imply that if it is optimal to have firms of type *i* in the industry, price should equal *both* the marginal and average social costs of such firms. This circumstance can arise only where the marginal social cost curve intersects the average social cost curve from below, which will occur at the minimum point on the average cost curve. If all of the firms in the industry operate at that point, the social cost of output will be minimized.

Likewise, if both type 1 and type 2 firms are present in the industry, they must have identical average and marginal social costs. It is possible for the presence of both types of firms to be optimal, for example, if the two types of firms have identical cost functions and cause identical amounts of external harm per unit of output.

3. Competitive Equilibrium

Short Run Equilibrium. In the "short run," the number of firms of each type is fixed. Competitive firms take price as given, and choose q_i and x_i to maximize their profit, $\pi_i = pq_i - c(q_i) - t_i(x_i)q_i - x_iq_i$. The first-order condition for q_i implies:

(5) $p \leq c_i^{'}(q_i) + t_i(x_i) + x_i$

an expression that must hold with equality if $q_i>0$. The first-order condition for x_i implies:

(6) $-t_i^{'}(x_i) \leq 1$

again holding with equality if $x_i>0$. Condition (6) is identical to condition (3) above if tort liability is set equal to the value of the external harm, i.e., if $t_i(x_i) \equiv h_i(x_i)$. Condition (5) will be identical to condition (2) under that liability rule as well *if* the prevailing price, *p*, is the price that arises at the welfare optimum. But the prevailing price in short-run equilibrium need not equal the welfare-maximizing price.

Long Run Equilibrium. In addition to the conditions for profit maximization noted above, the long run is characterized by free entry and exit of firms of each type. Equilibrium then requires that all firms present in the industry earn zero economic profits. Setting $\pi_i = 0$ implies immediately that price is equal to (private) average cost in equilibrium. If $t_i(q_i) \equiv h_i(q_i)$, private average cost for each firm will equal social average cost, and the number of firms in the industry of each type will satisfy condition (4) above. Conditions (2) and (3) will be satisfied as well, and thus a long run competitive equilibrium achieves the welfare optimum if tort liability is equal to value of the non-pecuniary external harm, a result that is hardly surprising.

A few other points about competitive equilibrium warrant mention. If tort liability falls short of the non-pecuniary harm inflicted by firms, care levels will be inefficiently low and output levels inefficiently high. Suppose, in particular, that $t_i(x_i) = \lambda_i h_i(x_i)$ where $0 \leq \lambda_i < 1$. Differentiation of the first-order condition for care expenditure with respect to λ_i yields $\partial x_i / \partial \lambda_i = -h_i^{'}(x_i) / \lambda h_i^{''}(x_i) > 0$ -- as λ_I decreases, the care level chosen by a competitive firm will fall farther and farther below the optimum. Similarly, differentiation of the first-order condition for output with respect to λ_i yields, after simplification, $\partial q_i / \partial \lambda_i = h_i(x_i) / \{p^{'}(Q)n_i - c_i^{''}(q_i)\} < 0$ -- as λ_i decreases, the output level chosen by a competitive firms increases farther and farther above the optimum for that firm. Finally, if λ_i<1 then private marginal and average cost are below social marginal and average cost; aggregate industry output will thus be inefficiently high in long run competitive equilibrium.

Note also that special conditions must exist for both type 1 and type 2 firms to survive in long run equilibrium. Free entry and exit will drive price down to the level that equals the minimum average cost for either type of firm. Thus, the two types of firms must have the same minimum average cost (and thus the same marginal cost) if both are to survive in the long run.

These points provide the starting point for the analysis to come. In particular, imagine an initial competitive equilibrium in which tort liability is "too low." What is the effect on welfare of increasing the tort liability imposed on one type of firm only, leaving the liability on the other type of firm fixed? The answer differs importantly between the short run and the long run.

4. Short Run Effects of Discrimination

To make the analysis interesting, we must assume that firms of both types exist in the initial equilibrium -- otherwise, "discrimination" is impossible in the short run. Let us therefore assume that the industry is initially in a long run equilibrium with both types of firms present. As the analysis above establishes, firms of both types must then have identical marginal and average costs. For purposes of this section, therefore, assume that firms of both types have identical cost functions $c(q_i)$ and identical external harm functions $h(x_i)$. Assume further that firms of type *i* are initially subject to socially inadequate tort liability in the amount $\lambda_i h(x_i)$ per unit of output, where $\lambda_1=\lambda_2=\lambda<1$. It follows that in the initial equilibrium, all firms take too little care, and industry output is too high. Lastly, note that in the initial equilibrium, all firms have identical output and care expenditures, and that the derivatives of the functions $c(q_i)$ and $h(x_i)$ will be the same for both types of firms, evaluated at the initial level of output.

We wish to inquire whether, starting from this non-discriminatory equilibrium, welfare can be enhanced by imposing greater (but not excessive) tort liability on firms of one type only. Thus, consider the effects of a small increase in λ_1 holding λ_2 constant.

Proposition 1: If the industry is initially in long run equilibrium, and tort liability is both inadequate and nondiscriminatory, a small increase in tort liability for one type of firm only will improve welfare in the short run.

The proposition can be established by differentiating the welfare function (1) above with respect to λ_1 and rearranging terms, utilizing the fact that output and care levels are initially the same across types of firms as are the derivatives of the cost and external harm functions. One then obtains:

$$\frac{\partial W}{\partial \lambda_1} = \{n_1 \frac{\partial q_1}{\partial \lambda_1} + n_2 \frac{\partial q_2}{\partial \lambda_1}\}[p(Q) - c' - h - x] - n_1 \frac{\partial x_1}{\partial \lambda_1}[h' q + q] - n_2 \frac{\partial x_2}{\partial \lambda_1}[h' q + q]$$

To sign this expression, consider its three terms separately. The first term is an "output effect" on welfare. The expression in square brackets, equal to price less the social marginal cost of production, is negative because firms set price equal to private marginal cost, yet private marginal cost is below social marginal cost [$\lambda h<h$]. The expression in squiggly brackets is the effect of the increase in λ_1 on total output. That effect is also negative because an increase in λ_1 shifts the supply curves upward for firms of type 1, thus shifting the aggregate supply curve upward and resulting in reduced total output. It follows that the output effect on welfare is positive – an increase in λ_1 leads to a reduction in output that lowers the welfare loss attributable to the fact that price is below social marginal cost.

The second term is a "care effect" on welfare associated with type 1 firms. Using the first-order condition (6) above for a privately optimal care decision, the term in square brackets is again negative [$\lambda h'$ is a smaller negative number than h']. It was also established above that $\partial x_1 / \partial \lambda_1 > 0$. The care effect on welfare for firms of type 1 is thus positive as well -- an increase in λ_1 leads to more care which enhances welfare because the marginal social benefits of care exceed its marginal social cost.

Finally, the third term is zero. As condition (6) indicates, a change in λ_1 will have no effect on the care decision by type 2 firms [$\partial x_2 / \partial \lambda_1 = 0$].

The overall effect on welfare of a small increase in λ_1 is thus positive. If the analysis were to stop with this short run result, one might conclude that discrimination in the application of tort rules will enhance welfare as long as the rules that are applied on a discriminatory basis are economically superior to the rules that would otherwise apply on a nondiscriminatory basis. This conclusion is mistaken, however, once we allow for the number of firms of each type to adjust.

4. Long Run Effects I: Identical Cost Structures

The long run presents two cases to consider. First, we can imagine that both types of firms exist in the initial equilibrium, and consider the effects of imposing greater tort liability on type 1 firms only. Second, we can imagine that only type 1 firms exist in the initial equilibrium, and consider imposing greater tort liability on those firms but not on type 2 firms should they choose to enter. This section considers the first case, while the next considers the second.

Proposition 2: If the industry is initially in long run equilibrium with both types of firms present, and tort liability is both inadequate and nondiscriminatory, an increase in tort liability for one type of firm only will have no effect on welfare in the long run.

The logic is straightforward. Again suppose that firms of type *i* are initially subject to socially inadequate tort liability in the amount $\lambda_i h(x_i)$ per unit of output, where $\lambda_1=\lambda_2=\lambda<1$. In an initial equilibrium with both types of firms present, both type 1 and type 2 firms must have identical marginal and average costs. An increase in λ_1 raises the marginal and average costs of type 1 firms, so that the minimum average cost for type 1 firms must now exceed the minimum average cost for type 2 firms. In the long run, all type 1 firms exit the industry and a new equilibrium is achieved with only type 2 firms serving the market, at the same price as before (minimum average cost for type 2 firms remains unchanged). Total output remains the same, as does the level of care chosen by each firm and the attendant non-pecuniary external harm per unit of output. It follows that welfare is unchanged – the only difference between the two equilibria is the substitution of type 2 firms for type 1 firms.

Combining the analysis of the short run in the last section with the analysis here, one can summarize as follows: If both types of firms are present in the initial equilibrium and tort liability is both inadequate and nondiscriminatory, a small increase in tort liability on one type of firm only yields a short-term gain in welfare that decays to zero over time.

5. Long Run Effects II: Type 1 Firms Have an Initial Cost Advantage

The second, and considerably more complex, long run case to consider arises when type 1 firms have a cost advantage and have the market to themselves in the initial equilibrium. Discrimination then entails an increase in tort liability on type 1 firms that will not apply to type 2 firms in the event that they subsequently enter.

Proposition 3: If the industry is initially in long run equilibrium with only one type of firm present and tort liability is inadequate, an increase in tort liability for incumbent firms that will not apply to new entrants of the other type will increase welfare if it does not eliminate the incumbents' cost advantage. If it eliminates the incumbents' cost advantage, welfare can decline due to the substitution of high-cost, inefficient firms for low-cost, efficient firms.

This proposition is most easily understood diagrammatically as it turns on a discontinuity in the effects of increased liability. Note that in long run equilibrium, supply is perfectly elastic for each type of firm at a price equal to that type of firm's minimum average cost. Assume that type 1 firms have a minimum average cost of production exclusive of tort liability and care expenditures [i.e., the minimum over q_1 of the function $c_1(q_1)/q_1$] equal to α. Let the corresponding average cost for type 2 firms equal β, where $\beta>\alpha$. Let us further assume for ease of notation that both firms cause identical non-pecuniary external harm per unit of output given by the function $h(x_i)$. With tort liability initially at $\lambda h(x_i)$ for both types of firms (initially, $\lambda_1=\lambda_2=\lambda<1$), either type of firm would then choose a care level x' such that $-\lambda h(x')=1$. The long run supply curve for type 1 firms is thus perfectly elastic at $\alpha+\lambda h(x')+x'$; for type 2 firms it is perfectly elastic at $\beta+\lambda h(x')+x'$. It follows that type 1 firms have the market to themselves at a price equal to $\alpha+\lambda h(x')+x'$.

QuickTime™ and a
TIFF (LZW) decompressor
are needed to see this picture.

Figure 1

Figure 1 depicts this initial equilibrium. Equilibrium output is Q′. Consumer surplus is given by the area *dcp′*, while the social cost of output Q’ is given by the rectangle *OebQ′*. Total net surplus is thus given by the area *dae* less the area *abc*. The triangle *abc* may thus be termed a deadweight loss triangle – it measures the loss due to the fact that social marginal cost exceeds consumer willingness-to-pay for all units of output in excess of a quantity equal to the distance *ea*.

A welfare loss relative to the first best arises in this equilibrium, of course, because tort liability is inadequate. A welfare maximizing equilibrium, by contrast, would arise if all firms internalized the non-pecuniary external harm fully, and all production then came from the lowest cost (type 1) firms. Price would then equal $\alpha + h(x^*) + x^*$, where x^* is the solution to $-h'(x^*)=1$. The level of output would be Q*, yielding net surplus of *dfp**.

Starting from the equilibrium in Figure 1, a sufficiently small increase in tort liability imposed on type 1 firms will increase welfare in the new long run equilibrium. In particular, choose $\lambda_1 h(x)>\lambda h(x)$ as the new level of tort liability for type 1 firms. Type 1 firms will then choose care level x" such that $-\lambda_1 h(x'')=1$. Restrict the choice of λ_1 so that $\alpha+\lambda_1 h(x'')+x'' < \beta+\lambda h(x')+x'$. Such a choice ensures that type 1 firms retain their cost advantage. The marginal social cost of output declines[19] from its level in Figure 1 to $\alpha+h(x'')+x''$. The reader can readily verify that total surplus rises – the positive surplus corresponding to area *dae* in Figure 1 becomes larger, and the deadweight loss corresponding to triangle *abc* becomes smaller. The welfare gain has two components – a gain from a reduction in (socially excessive) output due to the higher prevailing price, and a gain due to the reduction in marginal social cost attributable to the increase in care level from x' to x". The first part of Proposition 3 has thus been established.

Turning to the second part of Proposition 3, larger increases in tort liability can reduce welfare by eliminating the cost advantage of type 1 firms and inducing the substitution of comparatively inefficient type 2 firms. For example, starting from the initial equilibrium in Figure 1, imagine that type 1 firms become subject to tort liability that induces full cost internalization of the non-pecuniary harm, i.e., $t_1(x_1)\equiv h_1(x_1)$. Type 1 firms will then choose the care level x*, and their marginal cost rises to $\alpha+h(x^*)+x^*$. They will then be driven from the market by type 2 firms, which have marginal cost equal $\beta+\lambda h(x')+x'$.

[19] Recall condition (3). Because x" comes closer than x' to minimizing h(x)+x, it follows that $h(x'')+x''< h(x')+x'$.

QuickTime™ and a
TIFF (LZW) decompressor
are needed to see this picture.

Figure 2

The welfare effects may be seen in Figure 2. The displacement of type 1 firms by type 2 firms results in a new equilibrium at the price-quantity combination $p_2^{'}, Q_2^{'}$. Consumer surplus is given by the area $dn\,p_2^{'}$ while the social cost of output is equal to area $\mathrm{Okm}\,Q_2^{'}$. Net surplus is now equal to area *dkl* less area *lmn*. In comparison to the original equilibrium of Figure 1, note that triangles *abc* and *lmn* are congruent. Net surplus has thus declined by the area *klae*.

A bit of reflection will make clear that the same outcome would result from *any* increase in the magnitude of liability on type 1 firms that destroys their cost advantage. Type 2 firms would then take over the industry in the long run, resulting in the equilibrium depicted in Figure 2 and the attendant welfare loss.

The reason for the welfare loss owes to the fact that an increase in tort liability on type 1 firms that is large enough to destroy their cost advantage (and so to induce the substitution of type 2 firms) produces a discontinuous and adverse effect on welfare owing to a jump in the social marginal costs of production. The new equilibrium entails production at higher social cost with no greater care level by the type 2 firms that escape the increment in tort liability, and thus no reduction in the external harm per unit of output. In the diagram, the deadweight loss triangle *abc* has simply shifted upward and to the left to become *lmn*, while the positive surplus lying above the social marginal cost and below the demand curve has diminished.[20]

It is also worth noting the *distribution* of the welfare loss. In the long run, competitive firms earn zero economic profits. Thus, the welfare effect in the model falls entirely on the consumers and tort victims of the jurisdiction in question. This need not be so, of course, under other assumptions about market structure. The important point, however, is that under any plausible assumption about market structure, the welfare consequences are not simply borne by the tortfeasor.

Readers familiar with the literature on international trade will note a parallel here between discriminatory tort rules and discriminatory tariffs. It is well known that tariff discrimination can cause a welfare loss due to "trade diversion." Discriminatory tariffs induce the substitution of higher cost producers in the nations subject to favorable tariffs for low cost producers in the nations subject to unfavorable tariffs. The potential welfare gains from the avoidance of trade diversion afford one justification for most-favored-nation obligations under WTO law, which generally prohibit discrimination in tariffs and related trade measures in goods and services markets. See Schwartz and Sykes (1996).

Before leaving the model, note that the result in Figure 2 is not altogether robust. For example, imagine a highly elastic demand curve superimposed on Figure 2 that intersects the vertical axis at a point below $\beta+\lambda h(x')+x'$ but above $\alpha+\lambda h(x')+x'$. Let Q′ again be the equilibrium level of output in the initial situation where type 1 firms control the market. Net surplus created by the industry is plainly negative because the social

[20] A non-linear demand curve would change this result somewhat, but nothing fundamental turns on the linearity of demand in the diagram.

marginal cost of production exceeds consumer willingness-to-pay for every unit of output. Now suppose that tort liability increases so that type 1 firms bear the full social costs of the external harms that they cause. Because demand is highly elastic, output declines to zero. Net surplus clearly increases even though type 2 firms gain a cost advantage.

The more general point is that the displacement of type 1 firms by type 2 firms always yields some gross benefit due to a reduction in equilibrium output and the attendant external harm (which is assumed to be an increasing function of output). It is possible to construct conditions under which the gain in surplus associated with the reduction in output exceeds the loss of surplus attributable to higher social marginal cost of production for each unit of output supplied by type 2 firms after the imposition of discriminatory liability. A highly elastic demand curve tends to make this result more likely.

But this possibility comes with an important caveat. Any net welfare gain under these circumstances is a partial equilibrium result. When demand is highly elastic, however, close substitutes for the good or service in question will typically exist. If those substitutes are produced by industries that cause similar levels of external harm, any socially beneficial reduction in output by the industry subject to higher tort liability may well be offset by a harmful expansion of liability in the industries that escape it. Indeed, instead of imagining as in the model that type 1 and type 2 firms produce a homogeneous product in a single industry, one might instead suppose that they operate in different industries producing close substitutes. If only one industry is subject to higher levels of tort liability, the resulting expansion of output by firms in the other industry may produce a net welfare loss -- a general equilibrium analogue to the welfare loss depicted in Figure 2.

E. Extensions and Caveats

The model above excludes several potentially important considerations. This section briefly addresses their implications.

1. Corporate Restructuring

In the model, the status of a firm as "type 1" or "type 2" is implicitly fixed. Firms are not given the option of making a costly investment to change their type. In practice, however, firms that do business in a foreign jurisdiction and that are subject to tort liability in the United States may seek to avoid U.S. liability by changing their corporate structure. They may set up foreign subsidiaries, for example, spin off their foreign operations into separate companies, or sell off foreign operations to other companies that are not amenable to suit in the United States. Such restructuring is typically a costly process, and the resulting corporate entity(ies) may well operate less efficiently that their predecessor(s).

If firms fearful of U.S. liability restructure to avoid it, therefore, the result will often be an increase in their costs of doing business with no change in their incentive to take care. Note that this problem does not require a prospect of discriminatory liability, only that firms potentially subject to U.S. liability have a costly restructuring alternative. With or without any liability discrimination, the welfare effects are similar to those in the model. A loss of surplus arises to the degree that post-restructuring output is produced at higher cost while marginal incentives for care remain the same. As in the model, it is conceivable that a reduction in output due to higher marginal costs (and prices) will reduce the amount of external harm enough to offset this loss of surplus, particularly if the elasticity of demand in the industry is high.

2. Imperfect Competition

The model assumes perfect competition. As noted, other assumptions about market structure would affect the distribution of welfare gains and losses to the extent that firms share in the net surplus in the long run. But imperfect competition can affect the analysis in other ways as well, with the details dependent on the precise nature of the competitive imperfection.

In many models of imperfect competition, such as single-price monopoly, a dominant firm with a competitive fringe, and most oligopoly models, the prices set by (at least some) firms exceed marginal costs in equilibrium. In any setting where equilibrium price exceeds marginal cost, output will tend to be too low from a social standpoint, other things being equal. If tort liability is inadequate, however, private marginal cost is often less than social marginal cost,[21] which tends to result in a socially excessive

[21] Private marginal cost is lower than social marginal cost when harms occur to parties who have no market relationship with the injurer; the situation is potentially different in "market-mediated" cases, to be discussed further below.

level of output. These two output distortions are thus to a degree offsetting, raising "second-best" issues as to the appropriate policy.[22] For example, one can readily show that social surplus may be greater with a single-price monopolist subject to inadequate tort liability than if the same monopolist fully internalizes all external harm – what is required is that the gains from full cost internalization associated with an improved care level be less than the costs of the additional output restriction that results from full cost internalization and the attendant upward shift of the marginal cost curve. More generally, whenever price exceeds marginal cost in equilibrium and no policy instruments are available to cure the attendant output distortion, the "second-best" optimal level of liability may involve less than full cost internalization.

Another possible difference between the model of Section D and cases of imperfect competition concerns the conditions of entry. In the competitive model, the potential welfare loss from discriminatory tort liability arises because inefficient firms subject to lower tort liability may enter and displace more efficient firms subject to greater liability. In many standard models of monopoly and oligopoly, however, entry is assumed not to occur – indeed, it is the absence of competitive entry that allows firms to sustain supracompetitive profits. If incumbent firms are protected against entry, of course, inefficient entry cannot arise.

In an oligopoly setting, however, discrimination against some subset of the oligopolists raises the possibility of welfare costs analogous to those in the competitive case even if the incumbent firms do not face a threat of entry. Specifically, if the oligopolists that become subject to higher levels of tort liability reduce their output as their marginal costs increase, and other oligopolists with higher marginal costs (exclusive of tort liability) respond by expanding their output, the social costs of producing industry output will increase. An offsetting gain arises to the degree that some of the oligopolists are motivated to take higher levels of care, and perhaps as well from any net contraction in industry output (subject to the caveat above for cases where price exceeds marginal cost). The net effect on welfare would depend on the details of the oligopoly model.

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[22] The possibility that full cost internalization may exacerbate the output distortion that results from market power and justify some reduction in liability is considered in Polinsky and Rogerson (1983).

Of course, in some models of imperfect competition, such as various limit pricing models and models of monopolistic competition, entry is possible. Here, the mechanism by which a welfare loss may occur with discriminatory liability is more similar to the competitive case – discrimination against incumbents may lead to entry by less efficient firms (or firms with a price-quality mix that is less valuable to consumers). The potentially offsetting gains are also much the same.

In summary, imperfect competition affects the analysis but does not fundamentally change it. In many imperfectly competitive settings, discriminatory tort liability will cause firms that avoid liability to expand their output or to enter, and the social costs of output will increase to the degree that those firms have higher marginal costs (exclusive of tort liability) than the firms subject to higher liability. In this respect, imperfect competition is analogous to the competitive case. An offsetting benefit will arise to the degree that firms subject to higher levels of liability remain in the market and increase their care levels. This offset does not arise in the model of Section D because firms that lose their cost advantage exit. A further offsetting benefit *may* arise if industry output contracts from a level that was socially excessive initially. This offset always arises in the competitive case, because output is always excessive when tort liability is inadequate under conditions of competition (subject to the caveat for market-mediated cases). Depending on the nature of imperfect competition, however, the initial output level may be too low from a social standpoint because firms elevate price above marginal cost.

3. Investment Distortions and "Capital Export Neutrality"

The model shows how discriminatory liability can confer a competitive advantage on less efficient firms operating in the same jurisdiction, thus resulting in the possibility of a global welfare loss. But consider another possible type of distortion. Assume that U.S. tort liability is efficient, while foreign tort law is inefficiently low as in the model. Under such conditions, it is possible that the most efficient location for production is the United States, but if firms can escape U.S. liability by building production facilities abroad, they may choose to do so inefficiently because of the "tort subsidy" to foreign operations. If U.S. firms that build production facilities abroad remain subject to U.S. liability standards, by contrast, they cannot avail themselves of any tort subsidy and will locate wherever the social costs of production are lowest.

The issue does not arise to the degree that firms are subject to suit in the United States in their capacity as exporters rather than investors. To clarify, suppose that a U.S.-based firm exports goods or services to customers in some foreign jurisdiction. Its export activity causes harm in that foreign jurisdiction. Assume as in the model that tort liability in the foreign jurisdiction is inefficiently low, and an injured party wishes to bring a claim under U.S. law in a U.S. court, which by hypothesis would impose liability equal to the full social cost of the harm. Might the rejection of that claim, limiting the plaintiff to the inadequate remedy available in its home jurisdiction, lead U.S. firms to invest abroad inefficiently? The answer is seemingly no – allowing U.S. exporters to take advantage of weaker liability rules abroad will not induce inefficient capital flight from the United States, and may instead prevent inefficient capital flight if firms could avoid U.S. liability by relocating their production. When the foreign harm is caused by *investments* abroad by firms subject to suit in the United States, however, the application of different liability standards depending on the location of the investment may indeed distort investment decisions.

The issue has a close analogue in international tax policy. Tax scholars have long debated the merits of "capital export neutrality" on the one hand, and "capital import neutrality" on the other. Tax policy aimed at capital export neutrality seeks to tax the investments of firms at the same rate whether they are located in their "home" country or abroad so as to avoid distorting the investment location decision (the decision whether to "export" capital). One possible problem with capital export neutrality, however, is that it may place "home" firms at a competitive disadvantage relative to foreign firms that are not subject to taxation by the "home" country, or may induce "home" firms to change their nationality and relocate to countries with lower taxes. Tax policy aimed at capital import neutrality, by contrast, aims to tax all firms operating in a given jurisdiction at the same rate. Among other things, such a policy levels the playing field among firms in each jurisdiction by taxing all capital the same irrespective of the country from which it was "imported." See generally Roin (2007). Tax scholars have long debated the relative merits of the two systems.

The model in Section D highlights a potential welfare cost associated with a failure of liability law to achieve the parallel to capital import neutrality. Because it does not contemplate capital mobility among jurisdictions, however, it omits the potential cost associated with failure to achieve the parallel to capital export neutrality.

The model does highlight, however, an important obstacle to the achievement of capital export neutrality through liability rules. If investors amenable to suit in U.S. court face substantial competition from investors who are not, the latter group may simply displace the former. Alternatively, the investors subject to U.S. liability may engage in inefficient restructuring to avoid it. Efforts to avoid investment distortions in an inherently discriminatory liability system may thus be futile. This observation too has its parallel in the international tax literature. As some tax scholars have argued, a goal of capital export neutrality perhaps made good sense at a time when the United States was the world's largest supplier of capital and U.S. investors dominated international capital markets. With the diminishing significance of U.S. capital and increasing competition from investors elsewhere, tax policy aimed at capital export neutrality becomes less appealing. See Hubbard (2004).

4. Market-Mediated Cases

The analysis to this point presupposes that firms suffer no market penalty for the "external harm" that they create. This assumption is plausible in many cases where the harm does not arise out of any contractual relationship between the injurer firms and the victims of the harm. If a contractual relationship exists between injurers and victims, of course, the analysis changes for familiar reasons.

If we suppose, for example, that the harm arises in connection with a contractual relationship in which contracting costs are low and both sides have perfect information about the risks and the available legal remedies, then we would expect the parties to contract for the efficient tort remedy and for the contract price to adjust to cover firms' cost of providing it. Such thinking motivates a common refrain in much of the choice of law literature noted in Section A, which argues that courts should respect choice of law clauses in contracts, including the parties choice of a regulatory regime (such as a choice among national securities laws). In such a well-functioning market setting, the potential inefficiencies of international forum shopping evaporate if contractual choices by the parties are respected everywhere (indeed, the tort system may become irrelevant if parties contract directly over care levels).

One can, of course, consider the implications of various other assumptions about the contracting environment. Suppose that transaction costs impede contracting over care levels or customized remedies, but that parties are perfectly informed as to the liability rule that will apply *ex post*. Prices will then adjust *ex ante* to reflect the expected liability costs of firms. Other things being equal, victims will prefer to transact with the firms that are subject to efficient liability rules. Even though the contract price will adjust to cover firms' expected liability costs, victims will gladly pay that cost if they know that it buys them the efficient care level (or the best combination of care level and litigation costs). In this scenario, the results of the model above clearly do not hold. In particular, suppose that U.S. law is efficient and the remedy available to plaintiffs in another forum is inefficient. U.S. courts can then *enhance* the competitive position of U.S. firms (and global welfare) by accepting foreign tort claims predictably and applying the more efficient U.S. remedy.

As a final example, one might imagine settings in which potential tort victims are ill-informed about the risks that they face and the remedies that will apply *ex post*, or in which bounded rationality leads them to ignore such matters. If firms cannot credibly reveal information about which victims are ignorant, and induce them to act rationally in response to it, then the existence of the contractual relationship can become immaterial to the analysis – firms again suffer no market penalty for the harms that they cause. The imposition of "efficient" tort liability on one type of firm only will cause that type of firm to suffer a cost disadvantage with no offsetting increase in customer willingness to pay, and the results in the model are again applicable.

5. Firms that Produce for Multiple Markets

In the model, each firm is assumed to produce solely for a single jurisdiction. This assumption will not always hold in practice, however, and the implications of relaxing it warrant brief attention. It is useful to divide cases into two categories – first, cases in which firms can establish a separate price for each market, taking into account tort liability in that market, and second, cases in which firms cannot price in this fashion because of arbitrage across markets.

In the first class of cases, the key results in the model apply with minimal modification. Prices in every jurisdiction will reflect the expected tort liability of that jurisdiction. Discriminatory tort rules will drive a wedge between the prices of competing firms, and less efficient producers may then capture the market simply because they enjoy the benefits of lower expected liability. The most important difference relates to the nature of the "short run." If firms do not possess sunk capital that is dedicated to production in a particular jurisdiction, they can quickly shift sales from one jurisdiction to another. An emergent cost disadvantage in one market can lead them to withdraw from that market very quickly as long as they face sufficiently elastic demand elsewhere. In such cases, the "short run" is of little significance, as is the transitory welfare gain noted in proposition one. This situation is perhaps fairly common when firms engage in trade with multiple *international* markets. A combination of trade barriers and transport costs will often impede arbitrage across markets, and allow firms to price separately for each.

In the second class of cases, arbitrage across markets makes it impossible for firms to charge separate prices in each. This circumstance will often arise, for example, when firms produce for multiple jurisdictions in a federal system (like the United States). It may be difficult for a producer of appliances in California, for example, even to predict the state where a particular unit will be sold, let alone to price each unit according to its point of sale. And even if pricing according to the initial point of sale is feasible in principle, consumer (or internet) arbitrage may result in transshipment that makes such a pricing policy largely useless.

This possibility raises the issues that are the focus of McConnell (1988) and Hay (1992), who consider the interplay between choice of law rules and substantive state tort law when states seek to transfer rents to predominantly in-state plaintiffs from predominantly out-of-state defendants. Such opportunities for rent transfers do not arise when sellers can price separately for each jurisdiction.

With regard to the issues that are central to the model above, the analysis becomes somewhat more complicated in these cases and I will merely sketch some differences. Suppose that some jurisdictions impose tort liability that is too low, as in the model. What is the effect of an increase in the level of tort liability on only some of the firms that serve such a jurisdiction? With "strict" liability as in the model, firms subject to greater liability will be induced to exercise somewhat greater care. If their care level was initially too low (as in the model), a short run welfare gain arises in all jurisdictions served by those firms. If firms are subject to negligence-based liability, by contrast, care may not change at all – the liability imposed by other jurisdictions may have been sufficient to induce "due care." Of course, if some jurisdictions impose too little liability, one must also consider the possibility that other jurisdictions impose excessive liability. One can thus imagine situations in which care was initially optimal or even excessive despite the existence of a few jurisdictions where liability is too low.

The long run effects of discriminatory tort liability remain potentially similar to those in the model, albeit perhaps dampened. If some firms are subject to higher tort liability across the set of jurisdictions that they serve, they will suffer a cost disadvantage that may eventually drive them from the market(s). These firms may be more efficient than the firms that replace them, while any inadequacies in the level of care may persist as firms subject to higher levels of liability exit. The process can be dampened because the effects of policy in any one jurisdiction on firms' cost structures may be fairly small. Section IV will say a bit more about these issues in its discussion of domestic forum shopping.

III. Legal Policy Implications

The implications of the analysis above in any given case may be relatively straightforward or may turn on difficult empirical issues. The goal in this brief section is not to provide definitive decision rules but merely to highlight some issues that courts ought perhaps consider in the exercise of their discretion over whether to entertain claims filed by foreign tort plaintiffs, and what law to apply if they do. In the interest of brevity the discussion is limited to three strands of doctrine.

A. *Forum Non Conveniens*

U.S. courts can invoke *forum non conveniens* to force plaintiffs to proceed in their home forum, and have done so on a number of occasions. The most noteworthy example is *In Re Union Carbide Gas Plant Disaster at*

Bhopal, India,[23] which held that claims brought on behalf of those killed or injured in the release of toxic gas in Bhopal should be litigated in India..[24]

Forum non conveniens can do more than the choice of law rules discussed in Section C below to level the playing field among competitors. It not only ensures that substantive law will apply in a nondiscriminatory fashion, but it eliminates differences in the outcome of cases that owe to international differences in procedure (such as U.S. rules of discovery and the potential advantages to plaintiffs of jury trials). These procedural advantages to plaintiffs who can proceed in the United States should not be underestimated.

The leading case on *forum non conveniens* at the Federal level is *Gulf Oil v. Gilbert*,[25] which held that Federal courts should consider a mix of "private interest factors" and "public interest factors." The private interest factors include such matters as the ease of access to proof and the availability of compulsory process to secure necessary witnesses. The public interest factors include the level of court congestion, the challenges that may arise if it is necessary to apply foreign law to the case, and the burden on citizens that must serve on the jury.

The analysis in this paper suggests an additional "public interest factor" that deserves serious consideration in transnational tort cases, and that can weigh in favor of dismissal on grounds of *forum non conveniens* -- the potential economic costs due to the discriminatory treatment of U.S. defendants (or other defendants subject to personal jurisdiction in the United States). To my knowledge, no prior court or commentator has noted this issue.

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[23] 634 F. Supp. 842 (S.D.N.Y. 1986), affirmed 809 F.2d 195 (2d Cir. 1987), related case at 1992 U.S. Dist. Lexis 1909 (S.D.N.Y. 1992).

[24] Claims relating to pollution damage abroad were likewise dismissed on grounds of *forum non conveniens* in *Flores v. Southern Peru Copper Corp.* 441 F.3d 233 (2d Cir. 2003) and in and in *Aguinda v. Texaco, Inc.* 303 F.3d 470 (2d Cir. 2002). A claim predicated on the alleged failure of a pharmaceutical manufacturer to obtain informed consent for experimental drug testing was dismissed in *Abdullahi v. Pfizer, Inc.* 2005 U.S. Dist. Lexis 16126 (S.D.N.Y. 2005).

[25] 330 U.S. 501 (1947).

A potential tension between the doctrine of *forum non conveniens* and the analysis here arises because *forum non conveniens* can only be invoked if an adequate alternative forum is available to the plaintiff. The question of what constitutes an "adequate" forum is sometimes a bit murky. The Supreme Court confronted one aspect of the issue in *Piper Aircraft Co. v. Reyno,*[26] which involved an aviation accident in Scotland. The Scottish plaintiffs brought an action in the United States seeking to hold Piper Aircraft and its supplier strictly liable for the accident, while Scottish courts would require proof of negligence. The Court of Appeals held that dismissal was improper because the substantive law of Scotland was less favorable to the plaintiffs. The Supreme Court reversed, however, holding that a mere difference in substantive law is not sufficient to render the alternative forum inadequate.

The outcome in *Piper* fits nicely with the analysis here. If Piper Aircraft is held strictly liable for aviation accidents in the United Kingdom but its competitors are not, one can readily imagine that UK purchasers of small aircraft might shift their purchases to less efficient producers.[27] This point is doubly telling when there is no reason to suppose that the law of the plaintiff's home forum is inadequate to induce proper care – negligence liability is generally as effective as strict liability at inducing due care by injurers. See Shavell (1980).

Other aspects of the decision in *Piper* are perhaps more troubling. In the course of its opinion, the Court remarked: "Of course, if the remedy provided by the alternative forum is so clearly inadequate or unsatisfactory that it is no remedy at all, the unfavorable change in law may be given substantial weight ; the district court may conclude that dismissal would not be in the interests of justice."[28] The Court had also remarked in *Gilbert* that

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[26] 454 U.S. 235 (1981).

[27] The caveat, of course, is that the relationship between Piper Aircraft and its customers is market-mediated. If customers are aware that a strict liability rule will apply to accidents involving Piper aircraft but not others, and value the benefits of strict liability as much as the costs to Piper, then no distortion arises. But information deficiencies in the market, and externalities due to the fact that injured parties may not be customers, can assuredly arise. Indeed, if customers were fully informed and valued strict liability as much as it cost the seller, then we would expect the contract of sale to provide for strict liability (or to include a choice of law clause invoking U.S. law).

[28] 454 U.S. at 254.

the plaintiff's choice of forum should "rarely be disturbed.[29]" Taking its cue from such language, the Second Circuit stated in *Bigio v. Coca-Cola Co.* that "the more that a plaintiff, even a foreign plaintiff, chooses to sue in a United States court for 'legitimate reasons', the more deference must be given to that choice."[30]

Such reasoning is not difficult to understand. Courts are reluctant to send plaintiffs away with no remedy whatsoever. But the economic analysis here raises some genuine concerns about allowing cases to go forward under these circumstances. The cases where the remedy elsewhere is most inadequate are precisely the cases in which discriminatory liability on companies amenable to suit in U.S. courts may place them at the greatest cost disadvantage relative to their competitors, other things being equal. The potential welfare costs of discrimination may this be of particular importance in those cases. The doctrine of *forum non conveniens* would be enhanced if courts at least took this issue into consideration, and if claims could be dismissed in appropriate cases even if the remedy available in an alternative forum may be quite "inadequate."

B. The Alien Tort Statute

The 1980 Second Circuit decision in *Filartiga v. Pena-Irala*[31] revived interest in the Alien Tort Statute, a jurisdictional statute that allows suits by aliens for torts committed in "violation of the law of nations." Nothing in the Statute limits jurisdiction to violations that occur within the territory of the United States.

In suits against business defendants under the Statute, a question arises as to whether corporations bear liability under international law. If not, then alleged torts by corporations would not violate the "law of nations." Courts addressing this issue have generally concluded, however,

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[29] Some precedent exists, however, for the proposition that a foreign plaintiff's choice of forum is entitled to less deference. See Reyno v. Piper Aircraft, 479 F. Supp. 727, 731 (M.D. PA 1979) (collecting cases).

[30] 448 F. 3d 176 (2d Cir. 2006).

[31] 630 F.2d 876 (2d Cir. 1980).

that corporations can be liable for violations of international law, at least for certain types of misbehavior.[32]

A question remains, however, as to exactly what conduct rises to the level of a violation of the law of nations. The Supreme Court weighed in on this issue in *Sosa v. Alvarez Machain*,[33] holding that when Congress enacted the Alien Tort Statute in 1789, it intended that the Statute "would provide a cause of action for the modest number of international law violations with a potential for personal liability at the time," which included only a few things such as offenses against ambassadors and piracy. Although the Court indicated that actions for other types of misconduct might be recognized in modern times, the "courts should require any claim based on the present-day law of nations to rest on a norm of international character accepted by the civilized world and defined with a specificity comparable to" the conduct that was considered actionable in 1789.[34]

Although *Sosa* narrows the potential range of actions under the Alien Tort Statute,[35] it still leaves significant room for actions based on conduct that is arguably prohibited under international law by norms "accepted…and defined with…specificity." For example, in *Presbyterian Church of Sudan v. Talisman Energy Corp.*,[36] an action was allowed to go forward against a Canadian oil company that was subject to personal jurisdiction in the United States. The plaintiffs alleged that the defendant was complicit in ethnic-cleansing operations in Sudan. *Aldana v. Del Monte Fresh Produce, N.A.,*

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[32] See Presbyterian Church of Sudan v. Talisman Energy Corp., 374 F. Supp. 2d 331 (S.D.N.Y. 2005) (collecting citations); Sarei v. Rio Tinto, PLC, 456 F.3d 1069 (9th Cir. 2006).

[33] 542 U.S. 692 (2004).

[34] 542 U.S. 724-25.

[35] See, e.g., Abdullahi v. Pfizer, 2005 U.S. Dist. Lexis 16126 (S.D.N.Y. 2005) (alleged failure to obtain informed consent from patients undergoing experimental drug testing was not actionable under the Alien Tort Statute); Aldana v. Del Monte Fresh Produce, 416 F. 3d 1242 (11th Cir. 2005) (allegations predicated on "cruel, inhuman, degrading treatment or punishment" not actionable).

[36] 244 F. Supp. 2d 289 (S.D.N.Y. 2003), 347 F. Supp. 2d 331 (S.D.N.Y. 2005).

Inc.[37] allowed an action to go forward against a U.S. corporation and its foreign subsidiary predicated on acts of alleged "torture" purportedly committed by local authorities during the course of a collective bargaining dispute in Guatemala. *Bowoto v. Chevron Texaco Corp.*[38] allowed an action to go forward against a U.S. corporation for "aiding, abetting or ratifying" the acts of its Nigerian subsidiary, which was alleged to have been complicit in violence against the plaintiffs by the Nigerian military. The ostensible conspiracy was also deemed sufficient to permit a civil RICO claim to proceed. Each of these actions is still pending at this writing. Finally, *Doe v. Unocal Corp.*[39] allowed an action to proceed against a U.S. corporation for allegedly enlisting the Myanmar military to commit human rights abuses in connection with a natural gas production and pipeline project. Unocal subsequently settled the case rather than proceed to trial.[40]

Each of these cases presents a scenario in which the remedy abroad was apparently quite inadequate, even non-existent. One thus has considerable sympathy for the plaintiffs in these cases, and it is assuredly difficult to defend conduct that amounts to "ethnic cleansing," "torture," or similar human rights abuses. Nevertheless, the analysis here suggests some basis for concern about the wisdom of entertaining even these actions in U.S. courts. When U.S. companies do business in nations such as Sudan, Nigeria, or Myanmar, they operate in an environment where repressive regimes commit oppressive acts regularly. If plaintiffs can extract substantial amounts from U.S. defendants by alleging their complicity in such acts and persuading (or threatening to persuade) a jury that the U.S. defendant was somehow involved, the result may simply be a shift of business opportunities from U.S. firms to their less efficient competitors with little effect on the level of objectionable behavior.

I do not mean to suggest that this concern should be dispositive. The welfare implications of these types of cases may turn on potentially difficult

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[37] 416 F. 3d 1242 (11th Cir. 2005).

[38] 312 F. Supp. 2d 1229 (N.D. Cal. 2004).

[39] 495 F.3d 932 (9th Cir. 2002).

[40] See http://www.sourcewatch.org/index.php?title=Unocal (last visited July 19, 2007); Doe v. Unocal Corp., 403 F. 3d 708 (2005) (notice of dismissal following settlement).

empirical questions, and non-welfarist considerations may lead many observers to prefer that plaintiffs be allowed to proceed in the United States in any event. The point is simply that even when plaintiffs allege egregious conduct in violation of international law, and even when their remedy for alleged conduct abroad is non-existent, it does not necessarily follow that a U.S. remedy enhances global (or national) welfare.

C. State Tort Claims and Choice of Law Principles

In many cases where the "tort" in question is not actionable under the Alien Tort Statute, plaintiffs may nonetheless have a plausible claim under state tort law. Consider two recent examples.[41] In *Doe v. Exxon Mobil Corp.,*[42] Indonesian plaintiffs brought suit against a U.S. defendant as an "aider and abettor" of certain alleged acts of violence against the plaintiffs by the Indonesian military, which was providing security for the defendant's liquid natural gas facility. The plaintiffs had little chance of obtaining any relief in Indonesia, and indeed found it necessary to conceal their identities from Indonesian authorities. Claims under the Alien Tort Statute were dismissed, but state law claims were allowed to proceed. Although the defendant argued vigorously that Indonesian law should apply rather than U.S. law, the court held that U.S. law would govern, including the opportunity under U.S. law to obtain punitive damages. Applying "interest analysis" to the choice of law question, the court reasoned that "the United States has an overriding interest in applying its own laws to defendants, all of whom are U.S. companies." It quoted with approval from another District of Columbia opinion that stated: "[F]oreign jurisdictions have no interest in applying their law to damages issues if it would result in less protection to their nationals in a suit against a United States corporation."[43]

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[41] See also *Bigio v. Coca-Cola Co.,* 448 F. 3d 176 (2d Cir. 2006).

[42] The case has two opinions at 393 F. Supp. 2d 20 (D.D.C. 2005) and 2006 U.S. Dist. Lexis 11732 (11732).

[43] 2006 U.S. Dist. Lexis 11732, at 5-6.

Similarly, in *Bano v. Union Carbide Corp.,*[44] Indian plaintiffs brought suit for environmental damage, including groundwater pollution, allegedly attributable to the explosion at the Union Carbide plant in Bhopal, India (the litigation over the injuries caused directly by the explosion will be noted in the next section). The Alien Tort Statute claims again failed, but claims under New York law for public and private nuisance, strict liability, medical monitoring, trespass and equitable relief were allowed to proceed,[45] the plaintiffs having stipulated that no remedy was available to them under Indian law.[46] The court noted along the way that "New York law applies in cases in which the harm occurs abroad, and where there is no conflict with the law of the foreign jurisdiction."[47] The New York claims were eventually dismissed as time-barred by the statute of limitations, and because equitable relief was deemed impractical. But the case illustrates again how a plaintiff may secure the advantages of proceeding under U.S. law if it files in an appropriate forum.

The welfare effects of allowing these claims under state tort law are potentially adverse for the reasons that have been explored at length above. Contrary to what the court said in *Doe v. Exxon Mobil*, both the United States and the plaintiffs' home jurisdiction have an important potential "interest" in the application of the *lex loci* in appropriate cases. Courts can utilize their discretion under modern choice of law principles, such as interest analysis or the most significant relationship test under Section 145 of the Restatement (Second) of Conflicts, to take the potential economic costs of discriminatory liability into consideration, and to apply foreign law to the case if those costs loom sufficiently large.

IV. Implications for Domestic Forum Shopping

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[44] A number of opinions in the case touch on the issues here. They may be found at 200 U.S. Dist. Lexis 12326 (S.D.N.Y. 2000), 273 F.3d 120 (2d Cir. 2001), 2003 U.S. Dist. Lexis 4097 (S.D.N.Y. 2003), 361 F.3d 696 (2d Cir. 2004), and 2005 U.S. Dist. Lexis 22871 (S.D.N.Y. 2005).

[45] 2003 U.S. Dist. Lexis 4097, 8.

[46] Id. at 9.

[47] Id. at 10.

This paper has emphasized the economic consequences of forum shopping by foreign tort plaintiffs, but the analysis has implications for domestic foreign shopping as well. Domestic forum shopping can also lead to situations in which some domestic defendants are subject to more stringent rules of tort liability than their competitors. These circumstances are perhaps most likely to arise when the law of the plaintiff's jurisdiction is less favorable to plaintiffs than the law of other jurisdictions, or where the law of the plaintiff's jurisdiction is for some reason inapplicable. Then, if defendants can be sued under the law of their home jurisdiction, and if some of those jurisdictions have laws that are more favorable to plaintiffs than others, a disparity can arise. Some defendants may be subject to punitive damages when others are not, some may benefit from damages caps when others do not, some may benefit from more favorable defenses, some may be subject to strict liability when others are not, and so on.

The empirical importance of this problem is unclear, in part for reasons noted in Section II concerning firms that serve multiple markets. Further, as noted earlier, Hay (1992) argues that this potential problem will discourage states from enacting pro-plaintiff tort laws. Domestic capital is highly mobile, and states that create problems for their in-state firms may well lose them. This observation may help to explain why tort law is perhaps more similar across American jurisdictions than it is different. Finally, the problem will not arise at all if the law of the plaintiff's home jurisdiction is more favorable to plaintiffs and can be applied to the dispute. All defendants operating in the jurisdiction will then be subject to the same rules. For these reasons, the cost differentials for defendants attributable to domestic forum shopping may be more modest than in transnational cases, which is why I have emphasized the latter group of cases in this paper.

Nonetheless, we do observe significant heterogeneity in tort law across U.S. jurisdictions with the potential to produce discrimination among defendants if tort plaintiffs are able to take advantage of it by forum shopping. This observation provides some economic support for the old rule of *lex loci delicti* which, as noted earlier, tends to ensure that defendants doing business in a particular jurisdiction are all subject to the same tort rules, at least in cases where the place of the injury is clear. The case for *lex loci* is further strengthened if the tort law of all U.S. jurisdictions is more or less "adequate" to induce injurers to take proper precautions – there is then no tradeoff between the welfare costs of discrimination and the favorable effects that discrimination may have on care levels as in the model of Section II.

A possible counter argument is that *lex loci* might expose injurers to conflicting legal standards that may *increase* their costs. Suppose, for example, that the specific standard of care under a negligence rule requires one set of precautions by a certain type of manufacturer in Texas, another set in Illinois, and yet another in California. A product manufacturer located in California, say, but also doing business in Texas and Illinois, may be forced to choose between the added costs of meeting all of these standards, or the costs of being deemed "negligent" in one or more states. In contrast, if the courts of Texas and Illinois applied the standard in California to all California defendants, and if that standard is adequate to yield proper levels of safety, then welfare may be enhanced by applying the law of the defendant's home jurisdiction in all cases. The empirical importance of this problem is once again unclear, but it seems a more plausible concern in the domestic context than in the international context – because U.S. law as a whole is considerably more generous to plaintiffs than most foreign tort law, the notion that applying U.S. law to U.S. defendants doing business abroad will *lower* their costs seems fanciful.

One might also argue that the welfare costs of possible discrimination due to forum shopping are a second-order consideration in the domestic context. The real problem may lie in the heterogeneity of state tort law. Unless such heterogeneity can be defended on the grounds that optimal tort rules vary geographically as Posner (1998) suggests, a proposition that seems dubious as noted earlier, or on the grounds that it represents valuable regulatory competition that will eventually converge on optimal policy, the variation in state law appears troubling from an economic standpoint. And if many U.S. jurisdictions are applying suboptimal tort law, significant welfare losses will arise quite independent of any discrimination attributable to forum shopping.

Nevertheless, discrimination can compound the matter. The international trade analogy is once again apt – uniform tariffs cause welfare losses, but discriminatory tariffs tend to cause greater losses because of trade diversion.

Conclusion

If forum shopping by tort plaintiffs results in discrimination among business defendants as to the standards for liability or the quantum of damages, an economic welfare loss arises to the degree that less efficient firms subject to lesser liability displace more efficient firms subject to greater liability. This economic loss is similar to the problem of trade diversion that results from discriminatory tariffs, or to the distortion of investment patterns that can result from discriminatory taxation. Because U.S. tort law is often far more generous to plaintiffs than the law of foreign jurisdictions, this problem may become particularly acute in transnational tort cases. The problem may also become more acute when the remedy available to the plaintiff in an alternative forum is most inadequate, as it is in precisely such cases that the cost differentials attributable to discrimination among defendants may be the greatest. These concerns urge caution in accepting certain types of claims filed by foreign tort plaintiffs in U.S. courts, and toward the application of more stringent U.S. liability standards to harms that occur abroad.

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