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# PRODUCT LIABILITY: A NEO-AUSTRIAN BASED PERSPECTIVE

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## *Abstract*

The paper<sup>1</sup> is an exercise in a neo-Austrian based economic analysis of product liability. After a short historical introduction, we take two of the basic premises of Austrian economic thought and see which system of product liability results. If costs are subjective and entrepreneurship is the essence of an efficient market process, a system of *caveat emptor* and *vendor* results. For judges to assess damages, in the way others advocate judges to do, judges would need to measure costs, something that cannot be done according to Austrian economics. The paper also answers some possible criticisms from the mainstream neoclassical perspective.

Key words: Austrian economics; product liability, contract law  
JEL classification: B29; K12; K13

Product liability, which is part of tort law, deals with harms arising from commercial products. It is mostly about physical injuries to the consumer's life and property, caused by defective or unreasonably dangerous products. We want to investigate what an Austrian<sup>2</sup> system of products liability looks like. Under the neoclassical system, the development of liability seemed to be driven by a cost-benefit calculus based on standard criteria of efficiency. Mainstream law and economics in its positive dimension supposes that the liability system itself and every change in it are efficient. In its normative dimension, it addresses the issue of how legal rules might be formulated to maximize the value of production. The judge, using one of the most famous formulas in the economic analysis of law, the so-called Hand Formula named after Judge Learned Hand (cp. Cooter and Ulen 1988, pp. 360-362), balances expected accident costs against the costs of making the product safer. A defendant is guilty of negligence if  $P \times L$  is greater than  $B$ , where  $P$  is the probability that a loss will occur,  $L$  is the value associated with the loss, and  $B$  the cost associated with preventing it.

What was the development in liability the neoclassicals can explain? For the United States, Richard Epstein in his 1980 book on product liability law distinguishes three stages. From roughly 1850 till the end of the first World War, the burden was upon the consumer. He had to ferret out and correct all manners of product weaknesses and deficiencies. Otherwise, there was the fear of grave administrative complications. The courts threatened to be overwhelmed by the task of going through a full post-accident inquest in an ever-growing number of cases on how all the parties performed. There was also the fear of adverse social consequences: the economic ruin of the producer. Till the end of the 60s, the burden of loss was evenly distributed between producer and consumer. There was a balance between the dual constraints of substantive justice and administrative need. A negligence rule imposed an obligation to satisfy a legal standard of care, usually defined as a reasonable level of care. Today, the producer bears the burden. The

philosophical premises underlying the notion of liability have changed fundamentally. Administrative necessities and contractual models for setting liability are now not given much weight. Liability is a matter of public law models of regulation, such as risk spreading (producers act as insurers by spreading the cost of the accident across consumers through higher product prices) or deep pockets. In this third stage, strict liability dominates. It makes the injurer bear the cost, regardless of the extent of his precautions. No legal standard of precaution is relevant to the assignments of costs.

It has been said that the notion of strict liability is a misnomer. The Hand Formula is still often used to determine liability. Consider, for instance, the design defect test. Since the 1970s, courts instead of focusing on whether a product has isolated manufacturing defects, ask whether the products themselves are defective in design. Cost-benefit analysis asks if the benefits to the user of an improved safer design exceed the costs of providing such a safer design. If this condition is met, then the firm should be liable for an inadequate level of safety.

In general the change in the system of liability has worked to expose the manufacturer, distributor, and retailer to ever-greater liability. The consumer, once regarded as an essential and responsible link in the chain of product use, is now more the object of legal protection and less a bearer of independent responsibilities (Epstein 1980, p. 6). Suppose that the mainstream way of looking at torts in general and products liability in particular is the only one. Then, in a certain sense, the same analogy applies as that which Hayek said about the neoclassical notion of perfect competition. He said that full knowledge is not a defining element of perfect competition but of the situation when it has run its full course. Here too, in a sense, the neoclassical position is self-defeating. Tort cannot be committed in general equilibrium. Perfect knowledge of the future rules torts out. "Even an intentional tort could not occur, for a perfectly foreseen tort could surely be avoided by the victim" (Rothbard 1979, p. 93). In other words, with full knowledge, the market (prices) leads to the efficient outcome, no matter whether there is a system of products liability or not (Velthoven and van Wijck 1997, p. 208; cp. Rizzo 1980, p. 291; and Wonnell 1986, p. 514). What then of the real consumer who acts in a world of genuine surprise? What does an Austrian system of products liability look like? For Austrians claim—among all other schools of economic thought—to have most consistently adhered to the postulate of economic realism (Caplan, 1999; Block, 1999; Hülsmann 1999).

The paper is structured as follows. Section one talks about how Austrians prefer stable rules rather than changing ones based on concepts such as cost-benefit analysis. Section 2 discusses how subjectivism makes it impossible for judges to accurately measure costs or assess damages based on some objective criterion. To solve the dilemma, we maintain that individuals can contract ahead of time to decide what liability rules they will follow in the event of an accident. Judges figuring out prices in the absence of market transactions are faced with the problems of central planners and only a system of ex ante contracts can eliminate these problems. Section 3 considers caveat emptor, since only consumers know their preferences. Section 4 examines the effects on third parties and the rights to value of property versus the rights to property itself, and argues that if physical harm is done to a third party this is a tort and strict liability is the answer. The paper concludes that contract law would allow people to negotiate resolution methods ex ante, eliminating the need for third party judges to measure costs when deciding liability settlements.

## **1. Strict liability**

Most Austrians (Christainsen, 1990; Cordato, 1992; Rizzo, 1985; Rothbard, 1982; cp. Teijl and Holzhauser 1997, p. 157)—with whom we do not agree as we will show later on—are said to prefer a system of strict liability. Why? Austrians prefer abstract rules: stable rules that the

government cannot change at will. Rules enhance the possibility of an order in which individuals pursue and attain their goals. "[I]n order to pursue goals and make plans it is necessary to have a system of property rights that is clearly defined and that each individual can count on into his foreseeable future. Any involuntary alteration of a given property rights structure will necessarily interfere [...]"(Cordato 1980, p. 402). Property rights are the spheres of freedom of action by each individual.<sup>3</sup>

Strict liability, indeed, circumscribes an explicit cost-benefit analysis of the judge. The injurer bears the cost of accidents that he causes, regardless of the extent of his precaution. No legal standard of precaution is relevant to the assignment of costs. But, Steve Hanke (1985) says, it brings it back later. Though a cost-benefit analysis is not used at the time liability is assigned, it is an integral part in seeking the form of compensation to be paid (Hanke 1985, p. 894). The judge has to determine whether damage payment or specific performance—the promiser has to perform as promised—is the appropriate remedy. For an Austrian, however, specific performance, from a subjective point of view, will always be preferred. Rights are to be honored independent of utilitarian cost-benefit considerations. No judge-made efficient breach of contracts is possible. Moreover, as far as compensation goes, Austrian subjectivism is useless. Someone else cannot decide on subjective cost. Compensation is an issue of corrective justice and rests on ethical premises of just compensation—principles of right and wrong (Cordato 1992, p. 106; cp. Rizzo, 1979a). Ethics is no value-free "positive" discipline.

To sum up, for an Austrian, liability is "analyzed in terms of institutional efficiency—the certainty and stability that these rules impart to the social framework" (Rizzo 1980a, p. 291). Strict liability fits in naturally. Costs and benefits do not have to be balanced. Negligence, however, always needs a balancing of interests. We need a particular hierarchy of means and ends. For the Austrians, tort is based on ethics, not economics (Rothbard 1979, p. 95; cp. Arnold, 1982). He who causes harm should compensate the victim.

Austrians reject dynamic change in the law on the basis of economic efficiency; they prefer a static, stable system. Appropriate rules of the game, here on product liability, however, are necessary. As Hayek said: "Competition is a procedure of discovery [...]. To operate beneficially, competition requires that those involved observe rules" (1988, p. 19). Competition is not unconditional, but competition is subject to certain constraints. So the question arises: how can competition and entrepreneurship be conditioned in their working properties by alternative rules for product liability? Is strict liability the only Austrian approach possible? We want to highlight the Austrian elements of subjectivism and entrepreneurship and see where they take us. And hence we give another Austrian perspective on product liability.

## **2. Subjectivism and Entrepreneurship**

For liability to be Austrian, the scope permitted by the institutional environment—which a system of product liability is a part of—to cope with subjectivism is essential. This cannot be ignored. Some, however, believe that it is impossible to incorporate it in a system of liability. Subjectivism is said to lead to a system in which all compensation is astronomically high. Why not punish someone who makes a scratch on my car with capital punishment (De Geest 1994, p. 496, cp. p. 491; cp. Barnett 1985 and Stringham 1998)? But what is the alternative? For the Austrian, notions of objective specificity and precision widely used in the natural sciences have no place in a science of human action. Facts deployed in social science are merely opinions: they never exist as a consistent and coherent body. It is better to adhere to Hayek who said "it is probably no exaggeration to say that every important advance in economic theory during the last hundred years was a further step in the consistent application of subjectivism" (1952, p. 31). For the subjectivist, a price (money) does not measure value. In the act of exchange, we only

compare one thing with another thing. Value is an internal, subjective state that is immeasurable and not amenable to comparison. In other words, value cannot be compared among persons and money cannot be used for such comparisons (Mises 1953, p. 38).

De Geest (1994, p. 497) says that certain things, such as subjectivism and encouraging entrepreneurship seem to follow in the Austrian tradition almost as if they belong to a logical category. Without any discussion or motivation, no other costs, such as transaction costs are considered to exist at all, or are important. In a sense, this is true; it is praxeology we are talking about. But that does not mean it is not a reasoned conclusion, reached by verbal-deductive logic. To speak of Austrianism means to speak of individualism and subjectivism. Human action is based on individual purposes; gains and losses are personal, non-comparable, and non-additive. Cost comparisons done by an outside observer are impossible. The question arises, how can this element be incorporated into a system of liability? Fortunately, "[j]ust as most intentional assaults involve assailants and victims who already know each other well, most unintended injuries occur in the context of commercial acquaintance [...]" (Huber 1988, p. 5). Accidents are part of the realm of human cooperation, and not of unchosen relationship and collision. In other words, accidents are part of consent (private choice) not of coercion (public choice). If this is the situation, what comes to the fore as the element to focus on is the implicit or explicit contract made. It "allows us to weight the risks and benefits of our actions in the objective coolness of the beforehand rather in the emotional heat of the aftermath" (Huber 1988, p. 226). The best protection against accidents are not measures taken after an accident happens, but "in the freedom to make considered, binding choices beforehand" (Huber 1988, p. 18). Private choice and individual consent—both deliberately made—are what it is all about. We make a distinction between harmful acts and tortuous ones. What makes the difference is consent, or lack of it. Not all harmful acts are torts. No harm is done to one who is willing. A person who comes willingly to a risky situation assumes the risk of his activities and cannot blame someone else later for the accident. Parties allocate risks and responsibilities in any way they choose. First party insurance, specified compensation, and assumption of risk prevail over liability-driven compensation.

However, are not transaction costs (cp. Buchanan 1985) too high to make contracts? First, transaction costs are costs like any other. We live in a world of costs. Everybody wants them lower, just as every consumer wants prices to be as low as possible. Second, of course people cannot contract with every firm individually. Firms will compete in offering different packages of liability. As standard contracts are developed, transaction costs go down. Third, it is surely not possible to find a measure of efficiency---as the neoclassicals are inclined to do---from a world without transaction costs. What judges are asked to do is to allocate when transaction costs are prohibitively high. But that is the same as the solution to use hypothetical markets in the so-called calculation debate (O'Driscoll 1980, p. 356; Rizzo 1979b, p. 87; cp. Huber 1988, p. 220). Indeed, it is the old problem again: "Can we do without the market?" Austrians emphasize the division of knowledge and its growth. Freedom of contract is necessary, not because it produces perfect efficiency, but because it produces more efficient outcomes than judicial intervention does. The system encourages the full use of human knowledge. This brings us to our second Austrian characteristic.

Next to subjectivism, entrepreneurship is also a central tenet of Austrianism. "[E]ntrepreneurial incentives and the conditions required for dynamically competitive markets intersect crucially and fruitfully" (Kirzner 1985, p. 87). If contract is the norm, people suffer or enjoy the consequences of their decisions. One is alert; entrepreneurship is encouraged. New things can be discovered; we can be genuinely surprised. Strict liability implies coercion and less choice. But what is needed is not less but more choice (Huber 1988, p. 224). A system of tort says no. The only freedom left is not to discover, not to innovate. Contract gives the individual the freedom to make his own private choices. It stands against the judge's public choice under a

system of strict liability.

People have the freedom to take or limit liability through *ex ante* agreements. They have the opportunity through voluntary exchanges (the contracting process) to use their property rights. Circumstances change and people are different. That is why an exchange, if voluntary, always benefits the exchanging parties. Strict liability in modern product law, however, negates any attempt to limit liability through agreements. "[...T]he concept is associated with the nearly complete abandonment of contract and the idea that the plaintiff should never bear the costs of his or her actions" (Cordato 1992, p. 101). The world, however, is one of error and risk: genuine surprise. How can a contract with its implied distribution of liability be just if it is based on the erroneous valuation of one or both of the partners? The market process is all about the correction of error. Entrepreneurship depends on error, of which we are never fully aware. The question is, "Is the error—yes or no—induced by one party, either positively or tacitly, on the basis of which consent is fraudulently obtained?" (cp. Kirzner 1979, p. 217). Genuine error, however, is completely different. Genuine error and its counterpart genuine surprise are unexpected. Such a possibility is never imagined. The correction of these errors should be seen as a gain; as something that was not there before—for better or worse. The possibility of genuine error is the spark that switches on entrepreneurial alertness. For both consumer and producer it is the core of the market process (Kirzner 1989, p. 107).

The solution of Christainsen (1990) for incorporating entrepreneurship will not do.<sup>4</sup> He wants the courts to carry out the process of discovery. There should not be a static governmental monopoly, but a private legal process of discovery. Courts have to compete to attract customers. "[J]udges use the knowledge embedded in customs and precedents, knowledge that is dispersed among millions of people and tested by centuries of experience" (Christainsen 1990, p. 497). The consumer, however, cannot hire an entrepreneur and let him do the work. Entrepreneurship is not scarce resource in the usual sense. If it is, indeed, potential entrepreneurs must be rewarded to offset the costs of exercising entrepreneurship. Until, however, "an opportunity *has* been discovered, no one knows how much to offer as an incentive for its discovery [...]" (Kirzner 1989, p. 28). "To hire an 'entrepreneur' is to be an entrepreneur—simply shifting the problem back to the incentives that might galvanize *this* latter entrepreneur into action" (Kirzner 1989, p. 27). The notion of discovery is correct, but individuals must do it themselves. Why not bring liability back to the law of contracts—back, so to speak, to Epstein's stage one? Why not a contractual solution?

### 3. Contracts

The rule that has prevailed since times immemorial, or at least since the fifteenth and sixteenth centuries (Huber 1988, p. 22), is *caveat emptor*. "Let the buyer beware!" But since the seller was bound by the terms of the deal too, the rule would more correctly have read *caveat emptor et vendor*. The whole idea of contract law of making buyer *and* seller keep to their agreements and promises is rooted in a notion of consumer protection.

We have an innate sympathy, however, against the notion of *caveat emptor*. Indeed Adam Smith spoke of sympathy as one of the driving forces of the market. The invisible hand produces order. It manifests itself in two ways: first, in our sympathy for our fellowman and, second, in competition among producers and consumers. Both forces control our self-interest. And indeed, the most powerful agent in the change in tort law, from *caveat emptor* to the notion that the buyer should never bear the costs of his action, has been sympathy (Huber 1988, p. 190). "Who can fail to be angered by the devastating injury to a young child, or by the maiming of a woman in the prime of her life, or by the slow suffocation of a retired factory worker? Every accident was recharacterized as an assault, the victim then being invited to make a bid for our sympathy

in court" (Huber 1988, p. 191).

Contract law, however, seems to be returning to the dark days of the Middle Ages; back in time to when capitalism started. It negates the fundamental trend in today's society that forms the basis of liability, of a growing innate sympathy. Perhaps sympathy was too expensive in the old days, but today society can afford to help its fellowmen. Contract law places a heavy burden on the weak, ordinary consumer: the hapless victim of an accident. Who is he? Everyone. People are ignorant of most dangers and are not experts on product liability. It cannot be only the dullards who need protection. For "then the question becomes: How can one justify a comprehensive ban rather than a ban applicable to the dullards alone?" (Higgs 1994, p. 8). But then, who and on what basis can we select the dullards?

How then does the market protect us? First, suppose we know we are ignorant. If the producer knows more, the development of goodwill (and fear of losing it) of the producer can be an answer. The producer protects us out of self-interest; he wants to see us again, we pay him more. Personal relations can be the solution—not the problem. A solution not found in the neoclassical ideal of perfect competition (cp. Wonnell 1986, p. 522). Second, what about the standard contracts we just mentioned? Of course, no one has to start from scratch and do all the work himself. But what about weak bargaining power, especially if no standard contracts are available? In a market economy, this will never be a problem. As Böhm-Bawerk demonstrated in his article "Control or Economic Law?" ([1914] 1962), competition provides an alternative to bargaining: the range of indeterminacy where bargaining is necessary tends to narrow as competition becomes more vigorous (cp. Wonnell 1986, p. 538). The competitive process protects the weak consumer; his bargaining skills are not that important. Or perhaps the market is not all that close to bargaining. As Kirzner says, the market, first and foremost, is a process in which not bargaining but the alert grasping of new profit opportunities followed by the erosion of them takes centre stage. Third, the world will change. At this moment "[w]e no longer have a functioning law to encourage and enforce the settlement of accidents before hand, through deliberate choice, private insurance, and specified compensation or assumption of risk" (Huber 1988 p. 222). But this does not mean that the situation cannot change.

Is there no easier way to get the same result: the protection of the consumer? Jevons already said that no "consumer wants to buy putrid sausages, poisonous pickles, dangerous guns, or fraudulent plate" (1882, p. 43). He concluded that consumer protection should rely on the government inspector who is a far better judge than the individual purchaser. "*Laissez faire* policy might still be maintained if everybody understood his interests. But the very point of the matter is that ignorant people cannot take precautions against dangers of which they are ignorant" (1882, p. 42). For Jevons there were no hard-and-fast rules, every case had to be treated in detail upon its merits. It is all very well, he said, "to argue about what people ought to do; but if we learn from unquestionable statistical returns that thousands of hapless persons do, as a matter of fact, get crushed to deaths, or variously maimed, by unfenced machinery, these are calamities which no theory can mitigate" (1882, p. 2). And so, "the first step is to throw aside all supposed absolute rights or inflexible principles" (Jevons 1882, p. 9). If the consumer is not the best judge of what he wants, the result will be that "[b]y degrees inspectors will make their way into our houses to see that our drains are in good order, our rooms well ventilated, our kitchen boilers safe, our cisterns clean, our children at school" (1882, p. 40). Although, he was aware that a lot of the laws supposed to protect the consumer "were mere class laws, intended to support the pride of an aristocracy by restraining the tastes of the lower classes" (1882, p. 40).

Carl Menger (1994), however, at about the same time, gave priority to the market. For him, the government never knows best. It is better to rely on the dispersed wisdom of even the most ordinary people. "Government cannot possibly know the interest of all citizens, and in order to help them it would have to take account of each of the diverse activities of everybody" (Menger

1994, p. 111). Even in the case of a severe famine, the best the government can probably do to help is to alert people "to the impending danger with informative brochures in plain language" (Menger 1994, p. 195).

But still if society knows less and the government knows more, why not take a short-cut and let the government ban dangerous products right away? In other words, if we possess imperfect information and have a limited capability of processing complex information---which no doubt we have---would it not be expedient to let the government ban dangerous products? Is working through markets really necessary? The problem is to decide what will guide the government in its decision making. Next to all sorts of public choice failures—regulators, for instance, usually assume the worst in each situation (Higgs 1994, p. 7)—there are the already Austrian-noted failures of social cost-benefits analysis. Social aggregation is impossible. The consumers themselves evaluate their welfare and demonstrate it in their actions.

But there is more. Consumers exchange goods to improve their position. Goods, however, have a risk dimension, just as they have colour and quality. Life's risks cannot be avoided, but have to be coped with one way or another. To restrict choice to goods without risk (for the sake of the argument let us suppose this is possible) or with a lower risk dimension makes no one better off, and some or all worse off. Why? First, people who prefer risk are worse off. We all make a different trade-off between price, quality, and risk. Second, no one will be better off. Choice is always prospective. Even if someone is disappointed with the product later on, and regrets having bought it, at the moment of choice his range of freedom shrinks. He is worse off. It is through disappointment that the market works; that is how we learn. Choosing not only implies regret, but also being surprised by correcting genuine errors.

To let an expert choose is no solution. It would mean the end of the market economy. Indeed, some know more than others. But "[i]f consumer choice were to be permitted only to consumers whose knowledge, whether of risk or any other dimension, equalled or exceeded that of all other persons, then persons in general would not be permitted to choose anything for themselves, and no genuine market order could exist" (Higgs 1994, p. 7). Who determines who knows best, not just of one but of all qualities of a product? Who can give the comprehensive judgement of a good? The market cannot be surpassed. Actions show the preferences and knowledge of the individuals.

#### **4. The innocent bystander**

We could say that parties in an exchange can contract all damages between themselves. But what about the innocent bystander: the stranger? He certainly cannot; he is not a partner in the exchange. As we showed earlier, as far as product liability goes, the stranger is the exception to the rule. It is unnecessary to build our whole system of products liability around him. However,, some Austrians, by advocating a system of strict liability, are inclined to do so. But still he is the exception we have to consider. In other words, what to about negative externalities? For the neoclassical, negative externalities arise because the private and the social net product differ. The normative conclusion follows that with positive or negative externalities, the market leads to sub-optimal results. If externalities are positive, output is less than the Pareto optimal amount. If they are negative, output is greater than the Pareto optimal amount. Through the provision of subsidies or the imposition of taxes, the policy remedy is to try to induce the market to conform to the optimal amount. The optimal situation is the one that results from a competitive equilibrium in the absence of transaction costs.

As we have already pointed out, Austrians disagree with this Pareto norm of optimality. First, the market is an open-ended process in time. A static, timeless Pareto optimum is not a meaningful measure of performance for actual market processes. The market is first and

foremost a process, not a state or an institution that facilitates exchange. Second, all costs and benefits are inherently private. It is impossible to say that externalities generate a divergence between private and social costs or benefits. As with all costs, externalities are experienced subjectively; they cannot be added together to arrive at a measurement of social cost (Cordato 1992, p. 7). Third, the regulator does not have the necessary information to calculate the difference between social and private costs. If he could get the information without the actual market process, the process of discovery would no longer be needed (cp. Rizzo 1980b, p. 641). But there is no efficient non-market resource allocation. This was the insight the Austrians tried to bring to the fore in the socialist-calculation debate that began with the question "Is an efficient non-market resource allocation possible?" Market based prices are necessary to signal scarcity, to transmit knowledge, and to stimulate discovery.

For Austrians, policy relevant externalities are those that involve a conflict of property rights that are not clearly defined or enforced. External costs "are failures to maintain a fully free market, rather than defects of that market" (Rothbard 1962, p. 944). For Mises, all negative externality problems "could be removed by a reform of the laws concerning liability for damages inflicted and by rescinding the institutional barriers preventing the full operation of private ownership" (Mises 1966, p. 658). The problem is that non-owners allocate resources. The same is true, for example, for the problem of air pollution. No one has a right to clean air; no law protects against pollutants emerging from natural processes. But there is a right not to have air invaded by pollutants generated by an aggressor. For an Austrian, terms as "reasonable" air pollution or balancing of equities are out of the question. If someone causes pollution, he is an aggressor. Damages should be paid in accordance with strict liability, unless the polluter was there first (the principle of homesteading) and had already polluted the air before the other property was developed (Rothbard 1982, p. 77).

Positive externalities do not in general involve a conflict in the use of property. So, for Austrians, positive externalities are not the inversion of negative ones. External benefits are not viewed as either market or institutional failure. They are an unintended benefit of the market. one cannot conclude that the resulting prices and quantities are sub-optimal. "These outcomes simply reflect the freely made decisions of market participants to trade or not to trade under one of an infinite number of cost-benefit relations" (Cordato 1992, p. 19). If someone takes an action to his own advantage and a third party benefits, he does not have the right to ask others to subsidize him. In the extreme this will result in the good, such as a public good as consumer information, not being produced at all. Free riders reduce the effective demand almost to zero. For the neoclassical, an excise subsidy must encompass the market output. But, as well as asking that no property rights be violated, the Austrian would ask how much free information is enough before allowing individuals to make their own decisions. Who then decides when consumers are well enough informed?

This makes it look as if the Austrian and Coasian traditions have much in common. Both, indeed, blame the standard Pigouvian analysis for ignoring the importance of property rights. But the similarity is superficial. For Coase, prices are equilibrium prices. If the transaction costs are high, the judge should mimic the Coasian theorem result. If the transaction costs are low, regardless of who bears the costs *ex ante*, the parties will bargain. The result will maximize the combined value of the product they produce.

As we have said, the Austrian objections to this procedure are (1) knowledge is decentralized, (2) values are subjective, and (3) not all prices are equilibrium prices. But the way the Austrian regards property rights differs from the Coasian one too. The judge should not decide who should have the property rights—but who already has them. For Coase, rights are a variable to be granted by the judge on the basis of who stands to benefit most or to lose least from a particular rights assignment (Cordato 1980, p. 401). For Austrians, what is necessary is not cost-

benefit analysis, but for instance a closer look at contractual arrangements. If the owner of a right is known, strict liability comes to the fore, strictly enforcing property rights. Not the internalization of costs, as the Pigouvian goal would be, gives rise to this rule. For Austrians, strict liability is based on the prima facie notion of he who causes harm is liable. Causation is an integral part of strict liability. For Coase, however, the notion of causation is almost irrelevant. The optimal allocation is achieved by whoever has the property rights.

For the innocent bystander who has—no doubt—a right to his life and just property, strict liability fits in naturally. The property right is one of integrity for physical violence. Every one has a right to have the physical integrity of his life and property inviolated. No property rights are violated if, for instance, a better and cheaper product comes into the market. The consumer as well as the producer who possesses the old product cannot ask for any compensation. "[N]o one has the right to protect the value of his property, for that value is purely the reflection of what people are willing to pay for it. That willingness solely depends on how *they* decide to use their money. No one has a right to someone else's money [...]" (Rothbard 1982, p. 62). We, however, look at physical violence.

## 5. Conclusion

The paper has shown that two of the most basic premises of modern Austrianism, subjectivism and entrepreneurship, can be met in a system of product liability. Strict liability need not be the Austrian answer to improve the position of the consumer on the market. The proclaimed “death of contract” was not necessary for that reason. On the contrary, since people are in contact with each other beforehand, for most product-related accidents, contract law is sufficient. The general rule is buyer and seller beware. If people are not in contact beforehand (the case of the innocent bystander) a wrong, a tort is done, and strict liability is the answer. At no stage in dealing with accidents can a third party calculate (subjective) costs. At no stage does the market process of discovery (entrepreneurship) have to be stifled.

## Notes

1. We want to thank two anonymous referees for their positive and constructive criticism on an earlier draft of this paper.

2. For modern (neo-) Austrians, the main difference between the mainstream (Chicago) neoclassical market model and their own is that in theirs, adjustment processes and market disequilibria are central. Adjustment copes with dispersed knowledge and lack of it. The central point of their approach is the incurable ignorance of most of the particular circumstances that determine the course of society. In contrast to the neoclassicals, for the modern Austrian, correct foresight, full knowledge, is not a precondition for the attainment or equilibrium, but the defining characteristic of the state of equilibrium. In the modern Austrian market model, action does not—as is mostly the case in the neoclassical model—primarily follow from an optimal choice in a given ends-means relation. At the centre of the Austrian market model is the process of conceiving the end-means relationship.

3. For Murray Rothbard, two axioms are basic to the system of property rights. One, every man is a self-owner. He has absolute jurisdiction over his own body (the axiom of self-ownership). And two, each person justly owns whatever previously unowned resources he appropriates or "mixes" his labor with (the axiom of "homesteading") (1982, pp. 60-61).

4. As far as the problem, however, is to solve disputes between contracting parties: to enforce property rights—a subject untouched in this paper—Christiansen's option of private courts, probably, is the Austrian solution.

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