

RIGHTS, COMPENSATION, AND THE MARKET IN MALTESE CASE LAW

E. P. DELIA

Claims for compensation following infringement of human rights, accidental damage to property, loss of business arising from the abuse of copyright and patents, and loss of life through someone else's negligence are nowadays common in many countries. Even governments are demanding payment from unwilful transgressors for damage due to the natural wealth of the society they represent. A case in point is Egypt's recent claim from a British shipping line for damage to a coral reef in the Red Sea following the grounding of a passenger liner, the Cunard *Royal Viking Sun*. At the same time countries could be requested to pay other countries which suffer as a result of activity carried out in the process of business or research: Holland demanded payment from Switzerland for pollution of the River Rhine by Swiss chemical plants in 1986, and an Australian Royal Commission concluded in 1985 that Australia was entitled to charge Britain the costs of carrying out work on the decontamination of land affected by Britain's nuclear tests twenty years earlier.

It is therefore, of interest understanding those conditions which are conducive to such claims being made. In particular it is useful to identify the relationship between national and international law and decisions to seek redress. In turn, the impact of such decisions on the way in which people behave as producers or consumers could be addressed.

A world in which payment for any accidental harm done or benefits received is a real possibility is bound to be organised differently from one which ignores completely such rewards. Economies will have to adjust their productive systems in order to account for such payments. Besides as people become aware of the need to uphold basic human rights and safeguard the natural environment, the close interrelationship between the law, its interpretation, and the markets becomes evident.

Indeed, it may be claimed that Common Law, the system of legal precedents that has evolved over time from court decisions, promotes economic efficiency when it creates incentives for problems to be solved

in the least expensive way and when it acts to reduce transactions costs so that the parties to a dispute can reach low cost solutions not directly observable by the courts. A court's decision could affect future behaviour and have important consequences in a country as well as internationally.

Thus, a legal tradition which assigns liability on a *negligence* criterion is expected to induce different future behaviour from a tradition which emphasises *strict liability*. In general, negligence would provide incentives for individuals to take appropriate precautions once an activity, like driving or transporting fuel, is under way, whereas strict liability can provide incentives for people to make decisions about whether to undertake an activity in the first place, say manufacture cigarettes.

Common law could condition what is termed in welfare economics the 'initial position' and choice. An initial position is one where, once the basic rights are identified, all have an equal probability of being affected by the rules chosen. Because such a choice of position is likely to account for the utility of all, rather than the utility of the individual who makes the decision, it is consistent with the utilitarian philosophy which upholds that everyone's utility should count equally. In turn, choice in an initial position is consistent with a hierarchy of rights in which rights to choose are dominant (Harsanyi, 1955; Zerbe and Dively, 1994:263).

Since utility cannot be measured, proxy variables, like money income or wealth, are used instead. Analysis centering on utility distribution in a society could consider the distribution of income or wealth and express the impact of a person's behaviour on another person's welfare in monetary terms.

Analyses tend to focus on rights, in particular property rights. An important role for the courts is to maintain a system of well-defined property rights. Uncertainty about property rights can be an important source of economic inefficiency. In addition, public policy makers in a country, concerned with distributive justice beside efficient resource allocation, have to decide on a hierarchy of rights as the concept of initial position suggests. Conflicts could occasionally arise between expressed human rights, say, the right to work and the right to live in a clean healthy environment. From an economic efficiency perspective which right ranks first may be immaterial, but from an equity point of view it need not be so. Hence when duties or rights come in conflict, a moral judgment based on a conscious deliberation has to be made.

A society may believe in the libertarian principle: people are free to make their informed choices, even if these are self-destructive, and free to accept the consequences. Or it may believe that the young cannot make informed choices and therefore somebody ought to intervene on their behalf. The economic policies following from the first belief on, say, tobacco

or alcohol sales and production would consequently be different from those which emerge from the second.

Social deliberations like these are reflected also in case law. The Maltese position is examined in this paper. In particular, analysis is made of the contributions of Maltese courts towards the upholding of rights and towards economic efficiency. The economic concepts of externalities, transactions cost and marketable property rights are defined within the context of the Coase Theorem, a proposition which relates property rights, liability and potential government intervention to optimal resource allocation in an economy. In turn, an examination is made of some emerging positions identified in Maltese case law in so far as these bear on those factors considered important for efficiency by the Coase Theorem. The courts would be considered efficiency conscious, apart from championing human rights, if their decisions lead to the reduction of search and waiting costs in the future. A summary of the main deductions concludes the paper.

1. Externalities and Property Rights

An external effect arises when the behaviour of an individual or firm generates direct effects, beneficial or detrimental, on some other individual or firm. An externality is an accidental by product of a person's behaviour. When externalities arise private costs and benefits diverge from social costs and benefits which include harm or gains accruing to third parties. Under such conditions resources are inefficiently allocated: the scale of activity would be too large or too small to attain a social optimum.

A common example of a divergence between private and social cost is that of factory smoke which harms people in a neighbourhood, or cigarette smoking in an office, or noise from a discotheque. The issue is whether or not the rate of activity and smoke discharge, or noise, is too high and if so by what mechanism it is best reduced. Following A.C. Pigou (1920) economists considered the following options:

- i. introducing zoning regulations, excluding certain activity from specific areas;
- ii. imposing a tax on the pollutor, ideally with the proceeds assigned to the party suffering harm;
- iii. assigning liability to the one causing externalities;
- iv. assigning property rights to those suffering externalities.

However, a critical evaluation of the Pigovian tradition by R.H. Coase (1960) highlighted two important aspects regarding economic efficiency. Firstly, social costs are mutual. When A accidentally inflicts harm on B,

a policy which avoids harm to B by restraining A implies inflicting harm on A. Policy's objective is therefore the avoidance of the more serious harm. Secondly, the existence of a problem of social cost in itself indicates the presence of transactions costs, defined as the costs of negotiating or enforcing contracts.

Coase concluded that in the absence of transactions costs the assignment of property rights or liability rules has no effect on resource allocation and, hence, on social welfare. Therefore there was no need for government intervention via taxes, subsidies or public provision. So long as property rights already exist the market system would induce an optimal resource allocation.

Property rights are legal entitlements which could operate in exchange like other goods and services. It has been shown that markets for such titles can operate effectively; contractual arrangements arise to account for services rendered or inconveniences caused (Cheung, 1978). Thus, the factory owner in the above example can 'bribe' neighbours to compensate them for the discomfort they receive if the right to a smoke-free air, or a peaceful environment, is assigned to them. Conversely, neighbours can pay the factory to reduce smoke if the producer is free to behave as required by trade. Similarly, votes may be 'traded' at election time, even though the right to vote may not be considered marketable!

However, although the choice of property rights might not affect economic efficiency it would affect the distribution of income. The initial allocation of rights therefore matters to transactors. So those who are suffering an external cost would prefer to collect a Pigovian tax, a compensation for the discomfort they have to live with. But those who create the externality would prefer to be 'bribed'. Consequently, if the reallocation of property rights changes people's wealth enough to have significant effect on market demand curves, then it might cause resources to be diverted from one efficient allocation to another.

Besides, the initial distribution of rights conditions the amount of compensation requested. For a normal good, one whose consumption adds to the welfare of an individual, a person being asked to give up a right, say, to tranquillity so that a discotheque could operate nearby, would demand a higher sum than the one the person would have been prepared to pay the owners of the discotheque to move away. The distribution of property rights lead to differences in the optimal resource allocation because they condition the total money worth of people's willingness to pay (WTP) and of their willingness to accept (WTA). Giving up a right to which one is entitled by law implies a loss of welfare and therefore requires a higher compensation than the sum offered to obtain that right.

Settling for clearing price involves transactions costs. In their presence it might not be possible to negotiate side-payments leading to efficient outcomes. Consequently, Coase's conclusion regarding the relevance for economic efficiency of property rights allocation need not hold.

Transactions costs arise as an outcome of several factors two of which have direct legal connotations. These are:

i. the inadequacy of legal and political institutions, particularly in international issues. Unless there is a recognised competent legal authority which can evaluate a claim and decide on an issue time will be lost in searching for such authority. Witness the long search for a court of law recognised by all parties concerned with the case of the Pan Am passenger aircraft which blew up over Scotland in 1988.

ii. the inadequate specification of property rights.

Social costs often arise in resources which shift from being free to being scarce as a consequence of economic activity. Clear air is slowly polluted as industry expands. In such circumstances, the right to pollute or not to pollute would not be determined as the industrial development proceeds gradually. Without an initial delineation of property rights there cannot be market transactions of the legal entitlements and industries' output would remain socially inefficient. Sometimes an unequivocal decision on property rights may be all that is required to resolve the difficulty and internalise economic activity.

Faced with a great deal of uncertainty about the costs of various solutions, a judge could assign property rights according to some secondary criterion and then attempt to reduce transactions costs between the parties. If the judge can do so, say by appointing a spokesman for the 'party' in which many persons are involved to speak on their behalf with the other party, then any mistake in the initial allocation of property rights could be mitigated by the action of the Coase Theorem.

Rights are not all of equal value. The right to life, say, supercedes the right to smoke and pollute. There exists a hierarchy of rights which represents the 'initial position' on which resource allocation and any compensation arising therefrom are derived. In its strong version, the Coase Theorem states that the allocation of property rights is immaterial for economic efficiency; any allocation is said to be Pareto-symmetric. But it need not be equity-symmetric because rights are not equal. The simple utilitarian principle of assigning equal weights to individual utilities has to be qualified. The utility a thief gets from spending stolen money ranks surely lower than the utility loss suffered by the person whose money had been stolen; hence the demand for restitution. Expressed in generic terms, the difficulties involved in reaching a solution - the transactions costs - may look trivial. But they may be not, even when a

consensus exists on the ranking of rights. Decisions made by law courts could be critical in this context. The long history of law suits made by Americans against the tobacco industry is instructive. At stake are the lives which could be saved from not smoking, the principle of free choice, and the millions of dollars in investment, income and the thousands of jobs involved in the production of tobacco and related products. Product-liability suits have driven into bankruptcy businesses notably asbestos firms in the 70's and 80's and procedures of silicone breast implants in the 90's. (The Economist, 1996: 19-21).

In situations where the nature of the externality itself may not be clear, such as the cause of death of a particular individual which is attributed to smoking, or where the number of persons involved is large, then transactions costs would probably be very high. The search for internalising negative externalities would be long. It could deter the working of the market mechanism which induces an economy to respond to the new conditions. In this situation, output and consumption would be higher than the social optimum. The additional social costs would not be accounted for in producers' and consumers' decisions.

In sum, by ranking and defining clearly property rights a society could attain an optimal resource allocation in consonance with a set of expressed moral convictions. A market could attain such a state provided that transactions costs are nil or lower than the expected benefits. The law supports such an efficiency-generation process when it defines property rights unequivocally thereby minimising transactions costs.

The contribution made by Maltese case law to the process of internalisation of costs and benefits is reviewed below. Analysis is carried out in three stages, namely, court decisions which affect directly transactions costs; the stand made by Maltese courts with regard to human rights infringement; and the award of compensatory payments to persons who suffer disability or to relatives of persons who lose their life in a wrongful manner.

2. Maltese Case Law, Externalities and Economic Efficiency

A market solution to externalities needs to be supported at law. Court decisions could be effective in reducing transactions cost enough to render viable the inclusion of externalities in producers' and consumers' decisions. Maltese courts have enunciated legal principles which could guide behaviour in the future or which could speed up the resolve of a claim making it worthwhile for plaintiffs to seek redress and compensation. Three examples are illustrated below. They refer to the right to compensation by a third party for harm accidentally received; the linkage

between negligence and liability; and the responsibility of employers for the harm to third parties caused by incompetent employees.

2.1. Quasi-Contracts, Externalities and Compensation

Maltese law upholds the principle that damages to third parties have to be compensated. By whom depends on the circumstances of the case. In 'A.I.C. Herbert Debono vs Mario Ellul and Paolo Agius' (1989) the Commercial Court laid down that an employer and a contractor were responsible to damages caused to third parties: the employer, if he knew that the works were not being carried out properly and did not take any step to ensure that the damage was avoided; the contractor if he did not carry out such works with due care and diligence. The court ordered compensation be paid to plaintiff.

The court of Appeal further specified that the undertaking of a project implies a tacit agreement or quasi-contract between the agent and owners of adjacent property ensuring them that the rights they enjoy would not be disturbed as a result of the changes the project may induce. In addition, an agent can only be held responsible for harm suffered by third parties as a result of factors directly related to the project. (Carmelo Wismayer *et noe* vs Chev. Anthony Falzon *et noe*, 29th April 1996). The plaintiff's claim for compensation was not upheld.

The verdict of the Court of Appeal refers to a case which happened in 1965. The case took three decades to establish a legal principle. If such ruling could free resources in the future from settling issues to generating wealth by reducing settlement time, then it would contribute to economic efficiency.

2.2. Compensation and Indemnity Insurance

Only grave mistakes and lack of diligence and attention expected from a **bonus pater familias** would find Maltese courts favourable to upholding claims for damages following intervention by medical practitioners.

This ruling given by the First Hall of the Civil Court in a rare case against doctors in Malta - Josephine Borg *et noe* vs Dr Anthony Fiorini (1994) - was considered important by the medical profession and insurance companies. It was seen shielding doctors against frivolous and capricious action. Doctors in Malta are generally not covered by insurance and insurance premia are considered relatively high in relation to doctors' fees.

Thus, an indemnity limit of Lm250,000 has an annual cost of Lm1,125 for pathology, dermatology, geriatrics and general medicine. Cardiology,

general surgery and neurology would cost Lm1,800; plastic surgery, ENT and anaesthesia cost Lm2,700; while a high of Lm4,500 is asked for insurance in obstetrics and gynaecology (Curmi, 1996).

What applies to medical doctors could hold for other professionals. Auditing firms, for example, could be sued for damages suffered by economic agents who undertook business transactions guided by audited reports. Indeed, auditing firms abroad have started changing their status from partnerships to limited liability companies. In cases of proved negligence, they could be made to pay for damages arising to parties who acted on accounting reports audited by them.

Heavy indemnity insurance costs would alter the existing pricing structure of professional firms. Hence, the lower such costs are maintained the cheaper of services could be profitably provided and the greater the volume of services consumed. Clear rulings by the courts on which claims are acceptable at law for consideration of compensation would reduce the number of law suits saving resources for the courts, service providers and customers. They lead to an economic system which concentrates more on wealth generation than on avoidable litigation.

2.3. Respondeat Superior

The principle of respondeat superior holds employers liable for torts committed by employees. It creates an incentive for employers to select capable employees and to oversee their activities. Supervision is costly. And it would be more effective to place the burden of care entirely on the employee. However, since liability for accidents cannot deter an employee with a low income respondeat superior means that someone who is wealthier will have an incentive to take appropriate safety precaution. Otherwise the employer will have to pay for claims which are proven justified.

Maltese courts follow in a way these general principles. Employers are held responsible only for **culpa in eligendo** i.e. the fault in choosing and appointing persons that are or may be incompetent in carrying out the work entrusted to them. Otherwise the individual is responsible for damage caused as a result of lack of diligence, prudence or attention. It still has to be seen whether employers in the private and public sector will be required to finance compensation on behalf of their employees who cannot pay a reward!

Maltese courts distinguish clearly the liability of employers and employees. In a case in which an employer, the Commissioner of Police, referred to the **culpa in eligendo** principle, claiming that the police officers involved in the case were 'competent personnel', the First Hall of

the Civil Court rejected this plea on the ground that the officials concerned had repeatedly shown incompetence in carrying out their duties. The Commissioner was consequently responsible for damages caused by his subordinates for failing to supervise them effectively (Dr Joseph R. Grech vs the Commissioner of Police, 1986).

In a similar case, the defendants, employees this time, again referred to the same principle contending that the case was not correctly instituted. The Court concluded that since the defendants could be considered technically competent in their jobs, their employer was not responsible for their action. They were condemned to pay damages. (Alfred Zammit vs Charles Xuereb and Raymond Briffa, 1994). The two court rulings could be considered an application of the same principles. But the effect of the court's decision on market efficiency could be significantly different. In the second case, the compensation was paid by the defendants from their own income. They have a direct incentive to avoid committing similar mistakes in future. In the first case, however, the damages paid for by the Commissioner of Police were financed from taxpayers' money. There may be no direct pressure on a public official to behave differently in future, and hence rectify a system which has been generating negative external effects, because the costs of such negligence are not borne out of own income.

Unless such asymmetric effects on resource allocation are adjusted, the results of court decisions would refer solely to a retarded compensation for a harm received in the past, but they would not condition behaviour in the provision of public services in future. The positive contribution the courts can make to economic efficiency would be lost as a result. This point is developed further in the following subsection of the paper.

The situations examined above referred to states where legal principles were enunciated and amplified in the process of their application. They could therefore guide future behaviour. However, where certain institutions are missing, or where conventions are inapplicable in the first place, the law could be neutralised as an instrument of justice and economic efficiency. A legal system lacking instruments to operate effectively would lead to a rise in transactions costs and market failure. This could be the situation in Malta with regard to parents seeking the return of an abducted child.

The Maltese government has not ratified the Hague Convention and the Council of Europe's Convention on Recognition and Enforcement of Decisions Concerning Custody of Children and on Restoration of Custody of Children. Countries adhering to the Hague Convention agree to return wrongfully removed or retained children to the State of the child's habitual residence so that the authorities in that State may exercise the power to

determine the long term custody between the disputing parties. The convention requires signatories to establish an office whose function is to act on behalf of the person seeking the return of the abducted child and to discharge the duties imposed by the convention upon such authorities.

Failure to ratify the conventions means an increased burden on lawyers and financial costs for persons seeking recontrol over their children. At the same time it conditions the legal parameters within which Maltese courts operate. According to one interpretation, recent court decisions on two cases, Tracey Sample vs Joseph Portelli, Melanie Anne Farrugia vs Paul Michael Farrugia, risk projecting Malta as 'a safe haven for abductors' (Sullivan, 1996).

In sum, Maltese case law established clear guidelines regarding external effects and liability. In general, damages to third parties have to be compensated. Everyone is responsible for damages caused as a result of lack of diligence, prudence and attention. Employers are responsible for damages committed by their subordinates if they employ incompetent persons and/or fail to supervise them effectively.

If compensation is paid out of one's pocket it could be assumed that more attention would be made while carrying out duties in future. This assumption need not hold in the case of public officials where payments are made from tax payers' funds. Besides, in cases where certain executives officers are missing, the search for redress could be more expensive and time consuming than desired, with the result that nothing would be done to remedy the situation. Transactions costs would be high enough to discourage the internalisation of social costs.

3. Human Rights Violations and Market Failure

Acts committed by public officers in the exercise of their duty could result in accidental physical and/or moral violence on individuals. Such effects remained for many years either unrecognised or uncompensated by Maltese courts. Indeed, Human Rights were codified in Malta in 1961, but it was only in 1986 that a Maltese court awarded compensation for a breach of human rights, namely, political victimisation (The Sunday Times, Malta, 1989: p13). Since then the courts awarded compensation for material damages, pain and suffering, illegal arrest and for moral damages (The Sunday Times, Malta, 1991: p13).

Court decisions refer to a fairly wide range of Human Rights. They include Protection from Arbitrary Arrest, Protection from Inhuman Treatment, Privacy of the Home, Freedom of Conscience, Freedom of Expression, Freedom of Association, and Protection from Discrimination (The Sunday Times, Malta 1990: p13). Since the late eighties such rulings

have been complemented by the decisions of the Injustices Commission which recommends to the Prime Minister what action could be taken to redress a situation brought to its attention. In future, court rulings would add to the verdicts reached by the Office of the Ombudsman, instituted in 1995, in addressing claims of discrimination or injustices and remedies for them. The process of internalising in the market system a wider range of external effects is extended and accelerated by the setting up of such institutions as the Ombudsman's office.

The acknowledgement by the courts and similar institutions of a breach of human rights without effecting compensation would not be conducive to economic efficiency. Human rights may not be open to trading, but so long as the costs in utility lost are not given a monetary value and included in the total costs of producing a service, say, the maintenance of law and order, there is no way in which the number of violations can be optimised. The optimal number of human rights breaches is not likely to be zero, because the costs of supervising an entire population would be exorbitant. But the fact that individuals, including public officials, will be liable to pay could minimise the number of human rights violation per period. Indeed, if punitive penalties were to be levied against anyone who violates human rights, that is, the compensation would be equal to a full liability for the damage and a criminality penalty, the private cost could be raised above the social cost, thereby over-restricting the violations to below the optimal. But such a procedure, though morally justified perhaps, could be economically inefficient unless it is applied to those cases where evidence can be brought to support the claim that the breach of human rights was premeditated, deliberate and not accidental.

Over the past decade the demand for compensation claiming human rights violation gave rise to Maltese courts distinguishing between recognising a breach of rights and deciding on whether compensation is due. Thus in the case 'William Tanti Bellotti vs Melita Cable TV Ltd', 1995 the First Hall of the Civil Court accepted the plaintiff's claim that his rights, as protected by article 37 of the Constitution, had been violated when a tap lock box was clandestinely attached to the facade of his home causing him damages. But the court could not provide a remedy because the Constitution expressly provided that the 1934 Ordinance regulating the supply of electricity, cited by defendants, could not be deemed to violate the Constitution.

Instead the court ordered that the case be remitted before an independent and impartial tribunal so that compensation could be provided for, and ruled that sections of the 1934 ordinance violated the Constitution and the European Convention of Human Rights.

This case could be described as one where the property right is

incomplete. As a result transactions costs are higher than warranted. It is also a case where the courts are assessing the compatibility of existing legislation with the evolution in thought regarding human rights as expressed in charters enacted after certain laws came into effect. In doing so, the courts remove the deficiencies or incompleteness in property rights definitions, thus facilitating the internalisation of future accidental effects of economic activity.

State officials have been repeatedly found guilty of violating human rights in Malta. This fact raises again the issue of the effectiveness of compensation in inducing adjustment in costs of providing a service thereby optimising output. Unless such compensation is paid directly by the officials concerned, or unless it leads to steps being taken to reprimand or dismiss some officials, the deterrent to desist or to think carefully before acting could be lost. The number of human rights violations per time period would be higher than the optimal as a result.

Furthermore, if the compensation given by the courts is very high, and the official is not financially well-off to pay, it remains to be seen whether the Government would pay according to the **respondeat superior** doctrine. Such a payment would lead again to the effectiveness of such rewards on future employee behaviour and service organisation.

If instead, the employer is a company subsidised by taxpayers' money it could react to shouldering the compensation awards by topping up its losses. This could be the case of the Malta Drydocks. The company was ordered by the Employment Commission to pay a worker for denied overtime work for the period January 1, 1992 to November 19, 1993. This person had already been awarded by the same commission compensation for denied overtime for the period 1989 - 91. The employee was compensated for income lost, but the company did not remedy the factors which made the claim for compensation necessary in the first place. The incentive to adjust, the addition to the private costs of the company, is not present. Whatever losses are made they are not borne by the company, the workers in this case since the Malta Drydocks is a self-managed concern, but by Maltese taxpayers.

In sum Maltese courts presently acknowledge the right of compensation for both physical and moral damages. They decide on payments awarded. Indeed, they could even resort to other tribunals to foresee compensation if the courts are not in a position to award payment because of legal constraints. This approach implies a direct contribution to economic efficiency defined as the attainment of the 'optimal' human rights violations per year. However, such a mechanism is thwarted unless eventual payments are accounted for in personal considerations. Paying from taxpayers' funds for breaches of human rights by officials in the

public sector is not conducive to a change of officials' behaviour in the future with the result that human rights violations could remain higher than optimal.

4. Wrongful Death Claims and Compensation

Compensation is also awarded by Maltese courts for accidental harm leading to partial or complete disability or loss of life. Assigning a value to life could be considered unethical and immoral. It could be argued that lives should only be discussed in terms of rights and justice. However, from an economic perspective determining the value of life is no different from determining the value of any other good. Individuals, companies and governments must make implicit or explicit determinations of the value of life all the time especially when the value of life must be compared with the value of other goods such as health and safety standards or environmental protection.

The value placed on human life depends on the purpose of evaluation. Life may be valued *ex post* for the purpose of compensation, or *ex ante* for the purpose of preventing death and injury. Lives may be considered in the abstract, where no names are known, as in the construction of a dam to avoid floods or a guard rail to prevent accidents. Lives may, instead, be given names and faces such as people trapped in a fire. Valuing life does not lend itself to a single and direct approach which applies to all occasions.

Indemnification for a life wrongfully lost, or for permanent disability, should not be considered a payment for life. It is a pragmatic approach to a situation where a person has been disabled or a life wrongfully lost. However, efficient compensation promotes greater care and could reduce accident, and is desirable from resource allocation point of view.

In determining compensation Maltese courts follow the foregone earnings approach which sees the value of life as flowing from one's lifetime income or consumption. The value of life is approximated by what a person would add to the national output over a time period (*lucrum cessans*) discounted to the present using a zero discount rate. A percentage, generally 20% is deducted from the damages to be liquidated, to arrive at a lump sum payment. (Vid: First Hall of the Civil Courts - Saviour Caruana, Antoinette Caruana, Dolores Caruana vs John Busuttil and Paul Grech 1985; John Mary Muscat vs Charles Gatt, 1987; Silvio Farrugia vs Anthony Theuma, 1994; Joseph Desira *proprio et nomine* vs Joseph Cassar, 1995). The individual characteristics considered by the court are: age, health condition, present job, potential earnings growth, the percentage to be deducted from damages to arrive at the lump sum

payment, the nature of disability, and the relation of beneficiaries to disabled or deceased.

The approach adopted by Maltese courts, like other courts abroad, has the advantage of being subject to fairly objective calculation. It makes sense as a measure of the economic loss to survivors. Some courts abroad deduct a person's estimated consumption to reach an estate value, that is the expected value of savings that the deceased might have had built up to leave to others. But compensation for death must necessarily be arbitrary.

The foregone earnings approach, however, bears little theoretical relationship to the concepts of Willingness to Pay (WTP) or Willingness to Accept (WTA) for risk which underlies the economists' approach. Economists' estimates of the value of life are estimates of the WTP for additional safety or the WTA payment for bearing additional risk to life. Assuming a right to life, the value of accepting an increased risk is the amount one is willing to accept to undertake it. This approach aims to identify what one accepts as monetary compensation to undertake an additional risk. Generally, WTP measures benefits and WTA measures costs.

The different values obtained in the foregone earnings approach and the economists' methodology could be seen from the following example. According to the foregone earnings method, a person with a lifetime earnings of Lm4,000 per year for 20 years has a present value of Lm80000 at zero discount rate, from which 20%, or Lm16,000 are deducted to arrive at the lump sum payment of Lm64,000. If this person would be willing to pay Lm4,000 for a reduction in risk of 1×10^{-3} , the implicit value of life would be Lm4,000,000. This value exceeds by far the sum of Lm64,000, confirming the view that the awards made by courts for wrongful death are not payments for the life lost or the permanent disability incurred. The court's estimates are objective, the economist's estimates are subjective: they are based on an individual's own willingness to pay for small reductions in risk or the individual's willingness to accept payment for accepting small increases in risk. 'Danger money' and bonuses to Formula One drivers fall under this category.

Maltese courts are guided by the prudence or otherwise applied by actors before deciding on liability. Under these conditions all have an equal responsibility of safeguarding life. Unlike a strict liability rule, where, for example, drivers would always be liable to compensate pedestrians, no-matter how recklessly these may dart into traffic, the stand adopted by local courts instigate responsibility in all concerned. And only those who fail to show prudence could be found guilty and made to pay.

5. Summary

Societies are engaged in a continuous process evaluating their fundamental beliefs and adapting the behaviour of consumers and producers to such values. The courts have an important role in this deliberation process. They interpret the legislators' vision of how society works. They could also initiate a reconsideration of the framework within which judges have to operate in reaching their decisions. In doing so, the courts condition future behaviour of market players. Market failures arise from uninformed decisions. Market agents would be deciding on the wrong premise if some costs or benefits arising from their decisions are not considered before a decision is reached. Hence, by integrating such costs in the form of compensation, actual or potential, the courts would induce a change in the parameters on which transactors decide. Account will have to be taken of an eventual compensation for accidental harm to third parties either through the purchase of indemnity insurance, or through more attention and investment in carrying out work. In this way costs would change, so do prices, and in turn, the value of goods and services produced and consumed.

Maltese case law is conducive to economic efficiency. The courts uphold that damage to third parties has to be compensated. They consider prudence, or its absence, in determining liability, hence exerting pressure on all transactors to behave diligently. Such guidelines lead to a reduction in transactions costs, the costs incurred in search, waiting and implementing contractual obligations.

Indemnity in the case of wrongful deaths is based on an objective criterion, forgone earnings. This approach is different from the subjective one in which value of life is measured from a person's willingness to pay to reduce risk or willingness to accept payment for marginal increase in risk. But it is an approach used by courts in many countries and it is pragmatic.

Maltese courts had failed in the past to consider compensation for human rights violation. This position has now changed. They acknowledge both physical and moral damages and remedy, financially, for both. Indeed, they have sometimes gone further: when unable to award compensation because of a legislative constraint they recommended an independent tribunal be set up to treat specifically the question of compensation of a case under consideration.

Compensation is meant to translate former social costs into the private domain. So long as such payments are made by private citizens or firms out of own resources the incentive exist for a change in future behaviour. Social costs, now internalised, would condition decision making. But if a

defendant is in public office, either as an employee or as an employer facing liability claims for harm resulting from the performance of incompetent subordinates, the compensation would be funded from taxpayers' money. In such circumstances, the internalisation of costs for the official in question would not take place. The deterrent to behave differently arising from potentially higher private costs would remain missing. The volume of harm emanating by accident in the course of performing official duties, and the number of human rights infringement, would exceed the optimal level which is greater than zero.

E P Delia is Head of Department of Economics at the University of Malta and former director of the Central Bank of Malta. His publications focus on demography, the labour market and macro-economic issues

References

- Cheung, Steven N.S. (1978) *The Myth of Social Cost*, Institute of Economic Affairs, U.K.
- Coase, R.H. (1960), 'Problem of Social Cost', *Journal of Law and Economics*, October, pp 1-44.
- Curmi, David G. (1996) 'Medical Malpractice Insurance - The Maltese Scenario' *Insurance Quarterly*, March, pp 17-21.
- Harsanyi, J.C. (1955) 'Cardinal Welfare, Individualistic Ethics and Interpersonal Comparisons of Utility' *Journal of Political Economy*, August, reprinted in Phelps, E.S. (1973).
- Phelps, E.S. ed (1973) *Economic Justice*, Penguin Education, U.K.
- Pigou, A.C. (1920) *The Economics of Welfare*, Macmillan, U.K.
- Sullivan, Vanessa (1996) 'Parents turned Kidnappers' *The Malta Independent*, 17th March p 16.
- 'The Cigarettes Wars', (1996) *The Economist*, May 11-17, p 19-21.
- Page Thirteen, (1989) 'Human Rights Violations: The obstacle race to financial compensation', *The Sunday Times*, Malta, 12th November, p 13.
- Page Thirteen, (1990) 'All the Human Rights Violations established by the Courts', *The Sunday Times*, Malta, 21 January 1990, p 13.
- Page Thirteen, (1991) 'Tourist Guide Wins Lm14000 damages', *The Sunday Times*, Malta 10th February, p 13.
- Zerbe, Richard O. Jr & Dwight D. (1994) *Benefit Cost Analysis In Theory and Practice*, Harper Collins College Publishers, U.S.A.