

The Confluence of Justice and Efficiency in the Economics Analysis of Law

by

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Abstract:

Value in economics is usually measured by price (the market tradition) or satisfaction (the utilitarian tradition). This essay explores the relationship of price and satisfaction to corrective and distributive justice in law. I contend that corrective justice is relevant to all law. Corrective justice and efficiency converge in social norms, that evolve to coordinate behavior. Distributive justice, in contrast, is relevant to some bodies of law and irrelevant to many others, including private law.

Key Words: equity; efficiency; distribution; distributive justice; corrective justice; philosophy of law and economics.

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INTRODUCTION

As a boy I camped on a sand bar off the Carolina coast at the confluence of two ocean currents that made the waters rough but fertile. As an economist in a law school, I am at the confluence of two intellectual traditions. The contrast in methods between economics and law is stark -- one is quantitative, the other is verbal; one is empirical, the other is hermeneutical; one aspires to be scientific, the other aspires to be just. Given these differences, discourse between economists and lawyers is inevitably rough, but it has also been fertile in recent years.

Law has long been combined with economic thought, which is informal and discursive, but law's combination with economic theory, which is mathematical and analytical, is recent.² About forty years ago economic theory broke through the confines of antitrust law and began spreading into the common law subjects that are central to Anglo-American legal education.³ Now the major American law schools typically have several economists on the faculty and economic analysis has worked its way into the teaching of the core subjects in the first year of law school. Like the rabbit in Australia, economics is quickly filling a vacant niche in the ecology. The

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²The distinction between economic thought and economic theory was made by Schumpeter (1967). The combination of law with economic thought was, for example, an aspect of the Wisconsin school, notably the work of Willard Hurst (1959 and 1964).

niche is the intellectual ecology is the absence of a scientific theory to predict how people respond to laws.

This essay explores the relationship of efficiency to justice in law. According to a conventional distinction, distributive and corrective justice are two distinct ideas. Distributive justice concerns the economic well-being of classes of people. I will argue that private law is such an ineffective way to pursue distributive goals that distributive justice is mostly irrelevant to private law. Taxation and social welfare legislation are the right ways for the state to pursue distributive justice.

Corrective justice, in contrast, concerns private legal disputes, especially suits for damages. The parties to the suit are viewed as individual deserving justice, not representatives of social classes or groups. There is a practical reason why the sense of corrective justice is central to law. Learning law is far too costly a distraction for most people in business or government. People who are not lawyers mostly assume that law coincides with their conventional beliefs about corrective justice most of the time. When true, this belief enables people to obey the law while remaining largely ignorant of it. Consequently, I will argue that efficient law saves transaction costs by aligning with conventional beliefs about corrective justice most of the time. Thus an efficiency analysis is one way to defend corrective justice as a way of understanding law. Corrective justice and efficiency naturally converge on many matters. An efficiency analysis, however, is apt to be more critical of conventions than a corrective justice analysis, which introduces an element of tension between the two approaches.

1. What is the Economic Analysis of Law?

Earlier I said that economics found a vacant niche in law's intellectual ecology and rapidly filled it. To understand the niche, consider this classical definition of a law: "A law is an obligation backed by a state sanction." Lawmakers and adjudicators often ask, "How will a state sanction affect

³A watershed was the publication by Coase (1960).

behavior?” For example, if punitive damages are imposed on the maker of a defective product, what will happen to the safety and price of the product in the future? Or, will the amount of crime decrease if third-time offenders are automatically imprisoned? Lawyers answered such questions in 1960 in much the same way as they had in 60 b.c.e.—by consulting intuition and any available facts.

Economics provides a scientific theory to predict the effects of legal sanctions on behavior. To economists, sanctions look like prices, and presumably, people respond to these sanctions much as they respond to prices. People respond to higher prices by consuming less of the more expensive good, so presumably people respond to heavier legal sanctions by doing less of the sanctioned activity. Economics has mathematically precise theories (price theory and game theory) and empirically sound methods (statistics and econometrics) of analyzing the effects of prices on behavior.

Consider an example. Suppose that a manufacturer knows that his product will sometimes injure consumers. How safe will he make the product? For a profit-maximizing firm, the answer depends especially on two costs: first, the actual cost of safety, which depends in turn on facts about design and manufacture; and, second, the manufacturer’s legal liability. The manufacturer will need the help of lawyers to estimate second cost. After obtaining the needed information, the profit-maximizing manufacturer will adjust safety until the actual cost of additional safety equals the liability cost of additional accidents.

Generalizing, we can say that economics provides a behavioral theory to predict how people respond to changes in laws. This theory surpasses intuition, just as science surpasses common sense. At this stage in the history of social science, economics is the most useful branch of behavioral science to law.

In addition to a scientific theory of behavior, economics provides a useful normative standard for evaluating law and policy. Laws are not just arcane technical arguments; they are instruments for achieving important

social goals. In order to know the effects of laws on those goals, judges and other lawmakers must have a method of evaluating laws' effects on important social values. Economics predicts the effects of policies on efficiency. Efficiency is always relevant to policymaking, because it is always better to achieve any given policy at lower cost than at higher cost. Public officials never advocate wasting money.

Besides efficiency, economics predicts the effects of policies on another important value: distribution. Among the earliest applications of economics to public policy was its use to predict who really bears the burden of alternative taxes. More than other social scientists, economists understand how laws affect the distribution of income and wealth across classes and groups.

While economists often recommend changes that increase efficiency, they often try to avoid taking sides in disputes about distribution, usually leaving recommendations about distribution to policy-makers or voters. Economic theory, however, complements the most important theories of distributive justice, as I will explain.

II. Distributive Justice in Economic Theory

A. Science and Nonsense

Economists are experts on two policy values – efficiency and distribution. The resolution of most legal disputes, such as whether the defendant must pay compensatory damages or whether the defendant must desist from a specific activity, has monetary value. The monetary value at issue is the “stakes” in the dispute. Deciding a legal dispute almost always involves allocating the stakes between the parties. The decision about how much of the stakes each party gets creates incentives for future behavior. Incentive effects predict the consequences of legal decisions, policies, rules, and institutions.

The division of the stakes in a legal dispute may affect classes of similarly situated people. To illustrate, if a plaintiff in a case is a consumer of

a particular good, or an investor in a particular stock, or the driver of a car, then a decision for the plaintiff may benefit everyone who consumes this good, invests in this stock, or drives a car. Most proponents of income redistribution, however, have something else in mind. Instead of contemplating distribution to consumers or investors or drivers, advocates of income redistribution usually target social groups such as the poor, women, or minorities. Some people passionately advocate government redistribution of wealth by class, gender, or race for the sake of social justice. A possible way to pursue redistribution is through private law -- the law of property, contracts, and torts. According to this philosophy, courts should interpret or make private laws to serve social justice by redistributing wealth to deserving groups of people. For example, if consumers are poorer on average than investors, then courts should interpret liability rules to favor consumers and disfavor corporations

In economics, the term "allocation" pertains to the efficient use of resources, and the term "distribution" pertains to the fair division of wealth among classes and groups. Some economists, such as those who estimate the demand and supply of goods, conceive of themselves as studying allocation but not distribution. Other economists, who work in such areas as taxation or cost benefit-analysis, which are closely tied to public policy, cannot dismiss the problem of distribution so easily. But in all branches of contemporary economics, the dominant normative concept is efficiency, not distribution. To illustrate, even in the tax area where questions of distribution arise forcefully, most of the economics literature concerns efficiently, specifically the problem of raising revenue by means that impose the smallest possible burden on the economy.⁴

⁴Less prominent than efficiency in this literature are the several concepts of tax equity in the economics tradition, such as vertical equity. See, for example, Musgrave and Peacock (1967). For a sophisticated treatment of the philosophy and economics of taxation, see Murphy and Nagel (2002).

For some economists, efficiency is not merely a more prominent concept than justice, but in addition they regard justice and other social values with contempt. This hostility was rationalized and systematized by an intellectual development called "ordinalism" that began in the 1930s and culminated in the 1950s.⁵ The ordinalists attempted to separate the hard, scientific core of economics from its soft periphery. Concepts in the periphery, including philosophical concepts like justice that are drawn from a 2,000 year old tradition, were lumped together as non-science. Like other social theorists who sought to de-mystify the world, economists often dismissed non-science as little more than nonsense.⁶ Fortunately, the attempt to quarantine social values and eradicate them from economics has lost its vigor. It seems that questions of distributive justice will persist as a significant, but secondary part of the subject.

On scrutiny, the concepts of justice used in economics often resemble efficiency. Indeed, at a mathematical level, it seems that the dispute about justice among economists is really a dispute about how broadly to interpret efficiency. The explanation of this curious fact is to be found in the structure of utilitarian thought, which requires a detailed explanation.

B. Utility and Distributive Justice

⁵A recent history is found in Cooter and Rappoport, (1984).

⁶A wide ranging philosophical attack on nonscientific concepts was part of the program of the logical positivists. Their view, in its starkest form, was that propositions with no predictive consequences cannot be proved true or false, even in principle, so these propositions must not have any meaning. This line of thought was summed up in the last sentence of Wittgenstein's Tractatus Logico-Philosophicus (1961): "What we cannot speak about we must pass over in silence." The ordinalists in economics, apparently under the influence of the logical positivists, insisted that economists qua economists have nothing to say about justice.

Economics acquired its contemporary mathematical form in the last quarter of the 19th century when Bentham's utilitarian philosophy was combined with Newton's calculus.⁷ The central insight was that a utility maximizing consumer would equate the price of each good to its marginal utility.⁸ Bentham described utility as a quantity that could be added up for different people like body weight. Unlike body weight, however, more utility is regarded as socially better: "The interest of the community then is, what?--the sum of the interests of the several members who compose it." (Bentham, 1973). Any legislation or moral norm that increases the sum of individual utilities is a social improvement by this standard.

Several approaches to distributive justice coexist in economics but the strongest tradition is utilitarianism. The concept of utilitarian justice is that one person's pleasure counts as much as another's. Thinking that one person's pleasure could count more than another's -- say, more weight should be given to the pleasures of patricians than plebeians, or more weight should be given to men than women -- is a misunderstanding of the metric, rather like thinking that a pound of lead weighs more than a pound of feathers. In Bentham's theory pleasure receives the same weight regardless of who enjoys it. Each person's utility receives equal weight in computing the sum that society should maximize, and therein lies utilitarian justice.

When this theory is applied to the distribution of wealth, the result can be egalitarian or anti-egalitarian, depending on other considerations. The first consideration is the relationship between utility and wealth. Most economists working in the utilitarian tradition assume that increases in a person's wealth cause utility to increase at a decreasing rate. Thus the utility gained from giving an additional dollar to a rich person is less than would be gained from

⁷These events are called the marginalist revolution. For a good history, see Blaug (1979).

⁸In England these conditions were first derived by Jevons (1871).

giving the dollar to a poor person. In technical terms, the standard assumption is that the marginal utility of income declines with wealth.⁹

The consequences for public policy can be illustrated by two practical examples. First, consider the theory of optimal income taxation. According to the usual models, an increase in tax rates discourages work and investment. Consequently, the higher the levels of taxation, the less wealth will be produced by society. However, redistributive taxation transfers wealth from the rich, whose marginal utility of income is low, to the poor, whose marginal utility of income is high. If the discouraging effects of taxation on production are not too great, and if the marginal utility of income is substantially higher for the poor than for the rich, the sum of utilities for society will be greatest when there is redistributive taxation.¹⁰

As a second example, consider cost benefit analysis as applied to public sector investments. According to utilitarian theory, the aim of cost benefit analysis should be ascertaining which investments will yield the largest sum of utilities for society as a whole. Government projects yield a stream of benefits and costs that fall on different classes of people. These benefits and costs have a market value, but, as measured by utilitarian theory, the market value is different from the social value. The utilitarian approach would apply different weights to the market value of the benefits and costs, depending on the wealth of the affected class. To illustrate, an investment that yielded improved housing to the poor might receive extra weight because its social value allegedly exceeds its market value. The excess of social value over market value is due to the fact that the marginal utility of income for the poor presumably exceeds the marginal utility of income for the average consumer.

⁹This line of thought was developed consistently in a tradition that culminated in the work of A.C. Pigou (1920).

¹⁰Fresh life was breathed into this line of thought by the introduction of control theory. The original paper was

An alternative to the utilitarian tradition is to proceed on the basis of market values alone. To appreciate the difference in approaches, consider what happens when market values are used in the preceding examples. The tax example assumed that taxation discourages investment and work, so the market value of the goods produced by the economy will be reduced as a consequence of redistributive taxation. The implication is that redistributive taxation undermines the policy goal of maximizing the nation's wealth, so redistributive taxation is not justified. Similarly, using market values in cost benefit analysis causes the decision makers to ignore the distributive considerations that favor low income housing over middle income housing.

Earlier I suggested that when economists argue about justice they are usually arguing about how broadly to interpret efficiency. The contrast between utilitarian values and market values illustrates this point. The utilitarian theory takes the view that the marginal utility of income declines with wealth, and, consequently, utilitarians favor income redistribution in order to maximize the sum of utilities. The alternative approach in economics, called the wealth maximizing approach, takes the view that markets measure value. The wealth maximizing approach opposes redistribution whenever it reduces the total wealth of society. Both approaches reduce distributive justice to maximization, but the two approaches disagree over whether to maximize utility or wealth.

C. Individual Utility

I have discussed the utilitarian tradition, which adds the utility of different people and guides public policy to increase the sum. In contrast, the economic analysis of market behavior attributes utility to individuals, but does not necessarily add the utility of different people as a guide to public policy. Earlier I discussed the difference between maximizing utility and wealth. The question of whether or not the utilities of different people can be added or otherwise is another major divide in the economic tradition. On one

by Mirrlees (1971). For a summary of results, see Cooter,

side of the divide are the “ordinalists” who believe in individual utility and disbelieve in adding utilities. They favor an analysis based on what I will call “individual utility.” On the other side of the divide are the “cardinalists” who believe in adding the utilities of different people. They favor an analysis that I will call “social welfare.” I choose this term based on its entrenched use among economists, even though it easily misleads non-economists.

Now I will explain the difference between individual utility and social welfare. Economists assume that a rational individual can rank alternative bundles of commodities from bad to good according to his preferences. In the ranking, better commodity bundles are placed farther to the right, as in the top of the figure below, and worse commodity bundles are placed farther to the left. Similarly, the real numbers can be ranked from small to large, as in the number line in the bottom of the figure. Since goodness and real numbers are both ordered, they can be associated with each other. Higher numbers can be associated with the better bundles of commodities, and lower numbers can be associated with worse bundles, as depicted below for three commodity bundles:

his choice of commodity bundles. Using individual utilities to guide public policy requires more information about them. Whereas market exchange usually benefits both parties, public policies often benefit one person at another's expense. Consequently, public policy must trade off one person's interests against another's. Using individual utilities to make the trade off requires a lot more information than knowing the individual's ranking of commodity bundles, as I will explain by discussing social welfare

D. Social Welfare

As explained, the utility function of an individual is a mathematical expression of his preference ordering over commodity bundles. Just as the individual has a preference ordering over commodity bundles, so it is possible to imagine that society has a preference ordering over public policies. Social preferences can be expressed mathematically just like individual preferences: larger number can be assigned to socially preferred states. A function assigning a larger number to socially preferred states is a "social utility function." A social utility function is an ordering of public policies by society, just like an individual utility function is an ordering of commodity bundles by a person.

I want to connect social utility functions to my earlier discussion of social welfare functions. I have discussed the utilitarian tradition, which adds the utility of different people and guides public policy to increase the sum. Summing is one way to combine individual utilities to guide public policy. Generalizing, economists refer to *any* function that combines individual utilities for purposes of public policy as a "social welfare function" (Bergson, 1938).

A social welfare function is a particular kind of social utility function. Specifically, a social welfare function assigns larger numbers to socially preferred states *based on individual utilities*. Bentham's sum of individual utilities is a particular form of a social welfare function, specifically an additive form. Other forms are possible -- for example, instead of adding individual utilities, they could be multiplied. By appropriate choice of the function's form,

the social welfare function can encompass the two alternatives of utility maximization or wealth maximization, as well as many others.

The crucial step in constructing a social welfare function is to find a way to combine the utilities of individuals by anchoring their ordering. To illustrate the problem using the sum of utilities, it makes a big difference to the sum whether the utility numbers assigned to an individual's ordering of the three bundles in Figure 1 is (0,10,40) or (10,20,30). Thus adding utilities requires more information than ordering an individual's choices. To add up utilities, the utility numbers must be anchored. Unanchored individual utilities suffice to explain markets, but anchored social utilities are needed to guide policy.

E. Maximizing Social Welfare: Impossible? Unjust?

Fundamental laws of the state and social science cause people to produce and distribute wealth. The fairness of the distribution of wealth across classes and groups is the concern of distributive justice. At least since Plato's Republic, distributive justice has been a major topic of political and ethical philosophy. Combining individual utilities into a social welfare function is the economist's way of describing the task of reconciling the competing interests of different classes and groups. Compared to science, philosophy is more vulnerable to contending schools and competing traditions. Theories of social welfare are seen by philosophers as one family among contending traditions that proposes a solution to the problem of distributive justice.

Next I will discuss two critiques of social welfare functions. By casting traditional problems of political philosophy in the novel language of social welfare, economists brought them into contact with mathematics. As it turns out, mathematical economics revealed a formidable obstacle to implementing any measure of social welfare in a democracy. Democracies decide many questions of distributive justice through voting. A mathematical analysis reveals a potential inconsistency between voting and maximizing social welfare.

Assume that a citizen must choose among alternative candidates, or that a legislator must choose among alternative bills. Majority rule can easily lead to circular outcomes. Thus it is easy to construct examples in which alternative A beats B, B beats C, and C beats A.¹¹ In these circumstances, majority voting does not rank the alternatives A, B, and C. Instead of a ranking, each one beats one, and each one loses to one. Although each individual ranks the alternatives and thus has a utility function, majority voting does not rank the alternatives and thus does not reveal a social welfare function.

Arrow generalized this problem of majority rule and demonstrated a stunning conflict between political and economic values. Verbal statements of his mathematical results are inevitably facile, so the scrupulous reader must puzzle through Arrow's proof to appreciate it.¹² What he proved, approximately, is that it is impossible to construct a political constitution that is both democratic and efficient over all the choices that the society might face (see Arrow, 1951). A democratic constitution in Arrow's theorem is one in which no individual dictates all public choices. An efficient constitution in Arrow's theorem is one that cannot be modified to make at least one person better off without making anyone else worse off ("Pareto efficient").¹³

Arrow's theorem implies that any democratic constitution must yield inefficient choices over some alternatives. This result comes as no surprise to anyone who has loitered in the halls of Congress, but it is deeply troubling to social theorists in the utilitarian tradition. Recall that a virtue of social welfare functions is that they guide public policy according to preferences of individuals. Arrow's theorem shows, however, that a democratic constitution

¹¹Suppose there are three voters. Voter I's preferences are $C > B > A$. Voter II's preferences are $A > C > B$. Voter III's preferences are $B > A > C$. In a majority vote, then, B beats A, C beats B, and A beats C. Check it for yourself.

¹²The easiest exposition is given by Sen (1970).

¹³This is the definition of Pareto efficiency.

sometimes yields outcomes that frustrate the preferences of individuals. Preferences are frustrated in the sense that an alternative decision would make someone better off without making anyone worse off. Thus constructing a democratic constitution that guarantees the maximization of social welfare is impossible. This is true regardless of the form of social welfare's – whether additive like Bentham, or multiplicative, or a more complex form.

Arrow's theorem seems like a devastating blow to any theorists who advocates democracy and maximizing social welfare. While the theorem is undoubtedly true, its significance is remains in doubt. There may be ways to escape its implication that democracy is inconsistent with utilitarian goals. For example, Arrow's theorem shows that the rules of a democratic legislature cannot *guarantee* efficient legislation. However, the representatives of rival classes and groups in the legislature can bargain with each other, achieve agreement, and cooperate to produce efficient legislation. Arrow's theorem implies that the legislature's organization and rules cannot guarantee a cooperative solution, but cooperation is still possible and its outcomes can combine democracy and efficiency.¹⁴

I have discussed a problem of combining social welfare functions and democracy that mathematical economics revealed. Instead of pursuing these ideas, I turn to another critique of utilitarianism that contemporary philosophers apply to social welfare functions.¹⁵ With a social welfare function, including the sum of utilities, the aim is to maximize social welfare. What matters is total social welfare, not its distribution among individuals and classes. The only role of individuals and classes is to contribute to total social value. The individuals count only as sources of welfare or utility.

¹⁴ Specifically, in The Strategic Constitution (2000), I argue that intransitivity is the non-cooperative solution to legislative bargaining, but a cooperative solution is possible that avoids inefficiency or intransitivity.

To illustrate, assume that the particular social welfare function in question assigns decreasing marginal utility of money to individuals as they get richer. Consequently, a poor person could claim that he is entitled to transfer payments from the rich because he gets more welfare from money at the margin than the rich get. The social welfare theorist does not recognize any other independent reasons why the poor person should receive transfer payments. Claims of justice that do not involve social welfare are not recognized. Specifically, the social welfare theorist will not recognize the poor person's claim that fairness demands that he receive transfer payments.

According to the critics, social welfare functions do not take differences among individuals seriously. People do not differ from each other simply in their capacity to generate social welfare from wealth. ***The critique is based on a contrast between individual utility and social utility. The economic theory of individual utility relies on the idea that rational individuals can rank states of the world from bad to good, and that they will try to obtain the best state that is feasible given the constraints on their choice. Similarly, a utilitarian theory of social choice, including social welfare functions, relies on the idea that the state can rank public policies from bad to good, and the state will choose the best policy that is feasible. Thus the utilitarian tradition treats a society of many people as if it were a single rational person.

The critics contend that so long as society is treated as a single rational person, the differences among individuals and groups are inadequately represented. By inadequately representing differences among individuals and groups, social welfare theory cannot produce a satisfactory account of justice.¹⁶ Philosophers have argued eloquently that an adequate theory of justice must regard individuals and classes as more than producers

¹⁵The most systematic critique of utilitarianism in political philosophy is by Rawls (1971). Many of his themes are echoed in the study of law by Dworkin (1977).

¹⁶ A theme in Rawls's Theory of Justice is that utilitarianism does not take differences among persons seriously.

of wealth or utility. As I will explain later, corrective justice takes such a perspective with respect to individuals

The concept of a social welfare function is an abstract formulation that encompasses various traditions about distribution with the utilitarian tradition, including the two traditions favoring maximization of satisfaction and wealth. The social welfare function, however, does not comprehend other traditions of distributive justice, much less silence the disputes. In spite of these limitations, the social welfare function provides a useful device to develop utilitarian theories of distribution that are important to areas of public law, notably constitutional law and social welfare law. However, distributive justice, under any reasonable conception, is mostly irrelevant to private law, as I explain next.

F. Efficient Redistribution : Irrelevance of Distributive Justice to Private law

Pursuing redistributive goals is an exceptional use of private law that special circumstances justify, not the usual use of private law. Here is why. Like the rest of the population, economists disagree among themselves about redistributive ends. However, economists generally agree about redistributive means. By avoiding waste, efficient redistribution benefits everyone relative to inefficient redistribution. By avoiding waste, efficient redistribution also builds support for redistribution. For example, people are much more likely to donate to a charitable organization that efficiently redistributes wealth than to one that spends most of its revenue on administration.

A piquant example will help you to appreciate the advantages of efficient redistribution.²⁴ Assume that a desert contains two oases, one of which has ice cream and the other has none. The advocates of social justice obtain control over the state and declare that the first oasis should share its ice cream with the second oasis. In response, the first oasis fills a large bowl with ice cream and sends a youth running across the desert carrying the bowl to the second oasis. The hot sun melts some of the ice cream, so the first oasis gives up more ice cream than the second oasis receives. The melted

ice cream represents the cost of redistribution. People who disagree vehemently about how much ice cream the first oasis should give to the second oasis may agree that a fast runner should transport it. Also they might agree to choose an honest runner who will not eat the ice cream along the route.

Many economists believe that progressive taxation and social welfare programs can accomplish redistributive goals in modern states more efficiently than modifying or reshuffling private legal rights. There are several reasons why reshuffling private legal rights resembles giving the ice cream to a slow runner.

First, the income tax precisely targets inequality, whereas redistribution by private legal rights relies on crude averages. To illustrate, assume that courts interpret a law to favor consumers over corporations in order to redistribute wealth from rich to poor. “Consumers” and “investors” imperfectly correspond to “poor” and “rich.” Thus consumers of Ferrari automobiles, skiing vacations, and the opera tend to be relatively rich. Many small businesses are organized as corporations. Furthermore, the members of unions with good pension plans own significant investments in the stocks of large companies. By taxing income, law distinguishes more precisely between rich and poor than than by taking the indirect approach of targeting “consumers” and “investors.”

Second, the distributive effects of reshuffling private rights are hard to predict. To illustrate, the courts cannot be confident that holding a corporation liable to its consumers will reduce the wealth of its stockholders. Perhaps the corporation will pass on its higher costs to consumers in the form of higher prices, in which case the court’s holding will redistribute costs from some consumers to other consumers. The mobility of capital precludes reducing the return to investors in the long run.

Third, the transaction costs of redistribution through private legal rights are typically high. To illustrate, a plaintiff’s attorney working on a contingency fee in the United States routinely charges one third of the judgment. If the

defendant's attorney collects a similar amount in hourly fees, then attorneys for the two sides will absorb 2/3rds of the stakes in dispute. In contrast, the fee paid to an accountant who prepares someone's income tax return is a small fraction of the person's tax liability. Private rights of action that prompt trials rather than settlements are especially wasteful.

Besides these three reasons, there is fourth: Redistribution by private law distorts the economy more than progressive taxation. For example, assume that a law favoring consumers of tomatoes causes a decline in the return enjoyed by investors in tomato farms. Investors will respond by withdrawing funds from tomato farms and investing in other businesses. Consequently, the supply of tomatoes will be too small and consumers will pay too high a price for them. In general, relying on broad-based taxes, rather than narrowly focused laws, reduces the distorting effects of redistributive policies.

For these reasons and more, economists who favor redistribution and economists who oppose it can agree that private legal rights are usually the wrong way to pursue distributive justice. Unfortunately, these facts are not appreciated by many lawyers who have not studied economics.²⁶

We have presented several reasons against basing property law on redistributive goals. Specifically we discussed imprecise targeting, unpredictable consequences, high transaction costs, and large distortions in incentives. For these reasons, the general principles of private law cannot rest on wealth redistribution. In special circumstances, however, private law can redistribute relatively efficiently. To illustrate, consider laws requiring employers to construct buildings that provide access to people in wheelchairs. If properly designed, these laws can precisely target handicapped people in predictable ways. Also private enforcement can be cheap and effective, and the distortion in incentives can be modest. Designing such laws to produce these desirable outcomes for the disabled, however, requires more careful attention to the underlying economics than regulators typically show.

IV. Corrective Justice and Efficiency

The practical problem of justice raised by a law suit is to resolve the dispute in a way that is fair to the parties. One aspect of courtroom fairness is legality -- the idea that cases should be decided by the application of consistent rules that are reasonably interpreted. But legality is a formal aspect of justice, and an adequate theory must be substantive. There are approximately as many substantive theories of legal justice as there are ethical theories -- utilitarian, Kantian, Aristotelian, etc. Attempting a summary of these theories in this article is hopeless. Instead, I will explain how the economic analysis of law has affected legal thinking about corrective justice, including the re-evaluation of these older traditions. I will also explain how corrective justice affects an efficiency analysis of private law.

In one of the great metaphors of social theory, Adam Smith stated that the participants in markets serve the public as if guided by a hidden hand. Economists have asserted that courts decide common law disputes according to principles of economic efficiency as if guided by a hidden hand. Market efficiency is seldom the explicit aim of courts -- their aim is more typically to reach a just resolution to the dispute -- yet the economic analysis of law has shown a surprising correspondence between common law rules and the efficient allocation of legal entitlements. If judges explicitly follow principles of justice and implicitly follow economic principles, so that the two types of principles track each other in many common law disputes, market efficiency must be the content of common law justice.

To appreciate this claim, it is helpful to explain what market efficiency usually means in a legal dispute. If one person values a car more than another, there is scope for a mutually beneficial exchange. Efficiency requires exchange to proceed until the owner of each good, including a car, values it at least as much as anyone else. Whenever the owner of a good values it less than someone else, exchange has not yet proceeded to the point where the pattern of ownership is efficient. When a state is reached in which the owner of each good values it at least as much as anyone else, the

scope for mutually beneficial exchange is exhausted and the allocation of goods is efficient.

These propositions about goods also apply to legal entitlements. Efficiency requires the allocation of legal entitlements to the parties who value them the most. To illustrate, consider the entitlement to compensation for harm caused by accidents. The potential victims would be willing to pay a sum of money to secure this right. Similarly, the potential injurers would be willing to pay a sum of money to escape the duty to compensate. Efficiency requires the entitlement to be allocated to injurers or victims, depending on which one values it more. If potential victims value the right to compensation more than potential injurers value freedom from liability, then the law should require injurers to compensate victims of tortious accidents. On the other hand, if the potential injurers would pay more to escape liability than the potential victims would pay for the right to compensation, then the law should not require injurers to compensate the victims of tortious accidents.

This example is stark, even shocking, yet its harshest critics must admit that market efficiency works better in explaining torts and other branches of the common law than anyone would have anticipated twenty five years ago when the economic analysis of law was just beginning.¹⁷ Assume for the sake of argument that market efficiency often explains common law adjudication. This presumptive fact poses a puzzle to traditional theories of justice: Why is efficiency the substance of justice in these cases?

Many different answers can be given. One way is to argue that maximizing wealth is such an important social goal that it becomes embodied in social norms.¹⁸ I prefer arguments that are less materialistic in their foundation. Here is an example. Equal concern and respect for others is a fundamental moral value. A person who can avoid the risk of harming others at little expense to himself, but fails to do so, treats others with contempt. In

¹⁷See for example Shavell, (1987), or see the torts chapters by Cooter and Ulen (2003).

many contexts, equal concern and respect for others demands that we give similar weight to the benefits our actions create for them as to the costs they impose on us. For example, we ought to take precautions against accidents whenever the cost of the precautions to us is less than the value of the reduction in risk for others. But this is exactly what efficiency requires with respect to precaution against tortious accidents. Both economic efficiency and the principle of equal concern and respect require that, in the context of tortious accidents, we give equal weight to our costs of precaution and to the resulting benefits to others.

I have been discussing how ethical concepts like equal concern and respect align with efficiency. To understand the alignment better, I need to discuss social norms. Norms arise in communities where people interact repeatedly. The norms enable people to resolve problems of efficiency and distribution in mutually beneficial ways. Social norms compete for peoples' allegiance, and, under certain conditions, the more efficient norms win the competition. Judges sometimes enforce social norms. If judge-made law evolves in the same direction as social norms, then competition in the "market for norms" will drive judge-made law toward efficiency.

The traditional account of the "law merchant" provides an example. Medieval merchants engaged in a variety of commercial practices, such as paying each other with bills of exchange. These practices competed against each other and the more efficient ones prevailed. A practice that prevailed was raised to the level of an obligation among merchants. These obligations constituted the social norms of the community of medieval merchants. The merchants in the medieval trade fairs of England developed their own courts to regulate trade. As the English legal system became stronger and more unified, English judges increasingly assumed jurisdiction over disputes among merchants. The English judges often did not know enough about these specialized businesses to evaluate alternative rules. Instead of making rules,

¹⁸The view that the law should maximize society's wealth

the English judges then tried to find out what rules already existed among the merchants and selectively enforced them. Thus, the judges dictated conformity to merchant practices, not the practices to which merchants should conform. The law of notes and bills of exchange in the eighteenth century especially exemplifies this pattern.²⁸

The model of the law merchant once enjoyed a special place in the philosophy of law. According to an old theory of jurisprudence, courts should find the common law, not make it. Judges find the common law by identifying social norms and selectively raising them to the level of law. When judges follow this pattern, the common law has the authority of custom behind it. This philosophy is not limited to common law. The makers of legal codes often follow this philosophy. For example, Karl Llewellyn, the scholar who directed the creation of America's most successful code, The Uniform Commercial Code, explicitly identified the best business practices and wrote them into the code. Similarly, the creators of the great European codes often tried to identify and enact the best business practices of the day.

We now live in an age of a new law merchant. The modern economy creates many specialized business communities and norms arise in them to coordinate the interaction of people. The formality of the norms varies from one business to another. Self-regulating professions, like law and accounting, and formal networks like VISA promulgate their own rules. Voluntary associations, like the Association of Home Appliance Manufacturers, may issue guidelines. Informal networks, such as the computer software manufacturers, may have inchoate ethical standards. All of these social norms provide a rich source for decentralized law-making by judges. As the economy develops and becomes more complex, social norms should become more important as a source of law.

is defended by Posner (1981).

V. Conclusion

By cooperating with each other, people can increase their productivity. Creating a cooperative surplus requires coordination, which mostly occurs through social norms. Social norms ideally direct people to cooperate in efficient ways and divides the resulting production fairly. The fair division of the product from cooperation follows principles described in theories of corrective justice. The efficient organization of production is analyzed in economics. Thus fairness and efficiency converge in the concept of the social norm.

Modern society is far too complex for people to coordinate primarily through formal law. Instead people coordinate through social norms. When the law aligns with social norms, people mostly know how to act by consulting their moral intuitions. Acting this way is a lot cheaper than consulting a lawyer. When people social norms evolve under competitive pressure, and law follows social norms. efficiency and fairness align in morality and law. This fact explains the fertility of the confluence of law and economics.

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