

EFFICIENCY, UTILITY, AND WEALTH MAXIMIZATION

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A fully adequate inquiry into the foundations of the economic approach to law would address at least the following four related questions:¹

- (1) What is economic efficiency; what does it mean to say that resources are allocated in an economically efficient manner or that a body of law is efficient?
- (2) Does the principle of efficiency have explanatory merit; that is, can the rules and principles of any or all of the law be rationalized or subsumed under an economic theory of legislation or adjudication?
- (3) How should law be formulated to promote efficiency; in what ways must legal rights and duties be assigned and enforced so that the rules that assign and enforce them are efficient?
- (4) Ought the law pursue economic efficiency; to what extent is efficiency a desirable legal value in particular, and a normatively attractive principle in general?

The first set of questions concerns the analytic framework of law-and-economics, what one might call the philosophic foundations of the economic approach to law. The second set of questions concerns the capacity of certain principles of welfare economics to bring together in a coherent fashion a diverse body of existing law. The third set of problems is technical in nature. The fourth set concerns welfare economics as a normative discipline.

Until recently proponents of economic analysis have traded on the initial plausibility of utilitarianism in order to provide a normative basis for the various efficiency criteria. Utilitarianism, how-

1. This is the second in a series of papers on the economic analysis of the law. The first, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CALIF. L. REV. 221 (1980) [hereinafter cited as *Efficiency, Exchange, and Auction*], recently appeared in a special issue celebrating the inauguration of the Jurisprudence and Social Policy program at The School of Law at Berkeley. The third, *The Economic Analysis of Law*, will appear in the 1980 NOMOS volume. The fourth and last—I hope—Possible Strategies in Defense of Economic Analysis: Why They Fail, is currently in manuscript form.

ever, has been the target of powerful, and, in the minds of many philosophers, decisive objections. These objections fall into two categories: those which do not question the consequentialist character of utilitarianism and those which do. Objections of the first sort include: (1) Boundary problems—whose utilities or preferences should count and which of a person's preferences should count; (2) The total/average utility problem—whether utilitarianism is committed to promoting total utility without regard to its distribution; and (3) The interpersonal-utility comparison problem—how to determine if a course of conduct or policy that makes some individuals better off and others worse off increases total utility, and if it does, by how much.

Substantive criticisms of classical utilitarianism boil down to the claim that utilitarianism is an impoverished moral theory, incapable of accounting for the full range of moral obligation and right action. Because utilitarianism is a consequentialist or outcome morality it may require an individual to violate an important moral principle simply because doing so increases total utility. Further, the utilitarian principle might obligate one to act for the benefit of others and is therefore incompatible with a deeper commitment to personal liberty. Finally, utilitarianism can neither provide a theory of *moral* rights nor take either moral or legal rights seriously.²

In responding to these objections, economic analysis has confined itself to coping with utilitarianism's technical deficiencies, in particular, the problem of interpersonal-utility comparisons. The failure of economic analysis to address the substantive criticisms combined with the alleged connection between efficiency criteria and utilitarianism has led critics of utilitarianism to dismiss economic analysis outright.

In a recent controversial essay, Richard Posner attempts to fill this void in the literature by addressing many of the textbook objections to utilitarianism.³ "Address" may be the wrong word since Posner accepts most of the substantive as well as technical objections to utilitarianism. Because Posner also accepts the identification of traditional efficiency criteria with utilitarian moral theory, he concludes that utility-based efficiency criteria are subject to the same decisive objections.⁴ The problem, as Posner sees it, is to ex-

2. See Lyons, *Utility as a Possible Ground of Rights*, 14 *NOUS* 17 (1980).

3. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 *J. LEGAL STUD.* 103 (1979).

4. *Id.* at 111-19.

tricate economic efficiency from this unholy alliance with utilitarianism, an association once cherished but now to be eschewed. To free economic efficiency from the grip of a normatively unattractive moral theory, Posner introduces what he takes to be an efficiency criterion that is immune to the substantial criticisms of utilitarianism: the criterion of "wealth maximization."⁵

In contrast to the prevailing view, I argue that the familiar efficiency-related standards do not have the connection to classical utilitarianism necessary for the criticisms of utilitarianism to undermine the normative use of efficiency criteria. Therefore, even if utilitarianism is wrongheaded—as I think it is—it may be possible to construct alternative normative bases for economic efficiency criteria. Section I analyzes various familiar efficiency notions and explores their relationship to classical utilitarianism, arguing that while some relationships between efficiency criteria and utilitarianism exist, these relationships are not necessarily justificatory in nature. Section II turns to the system of wealth maximization first to consider whether it is an efficiency standard at all, and then to explore the conceptual foundations of the theory and some of its consequences as a guide to individual conduct and institutional choice. Section III discusses and rejects three different arguments for wealth maximization. Section IV discusses nonutilitarian strategies for defending the traditional Pareto-efficiency criteria, arguing that none of these is ultimately satisfactory.

I. EFFICIENCY AND UTILITY

Economists as well as proponents of the economic analysis of law employ at least four efficiency-related notions, including: (1) Productive efficiency, (2) Pareto optimality, (3) Pareto superiority, and (4) Kaldor-Hicks efficiency. If it constitutes a suitable efficiency criterion, Posner's wealth maximization would increase the total to at least five. In this section of the paper, I want to focus on the analytic and normative relationships between Pareto and Kaldor-Hicks notions of efficiency.⁶

A. *The Pareto Criteria*

Resources are allocated in a Pareto-optimal fashion if and only if any further reallocation of them can enhance the welfare of one

5. *Id.* at 103.

6. For a discussion of productive efficiency, see *Efficiency, Exchange, and Auction*, *supra* note 1, at 223-31.

person only at the expense of another. An allocation of resources is Pareto superior to an alternative allocation if and only if no one is made worse off by the distribution and the welfare of at least one person is improved. These two conceptions of efficiency are analytically related in that a Pareto-optimal distribution has no distributions Pareto superior to it.

Both Pareto concepts express standards for ranking or describing states of affairs. The Pareto-superior criterion relates two states of affairs and says that one is an improvement over the other if at least one person's welfare improves while no one else's welfare is diminished. The optimality standard relates one distribution to all possible distributions and says in effect that no Pareto improvements can be made from any Pareto-optimal state. In addition, Pareto-optimal distributions are Pareto noncomparable; the Pareto-superior standard cannot be employed to choose among them. Another way of putting this last point is to say that the social choice between Pareto-optimal distributions must be made on nonefficiency grounds.

B. *Kaldor-Hicks*

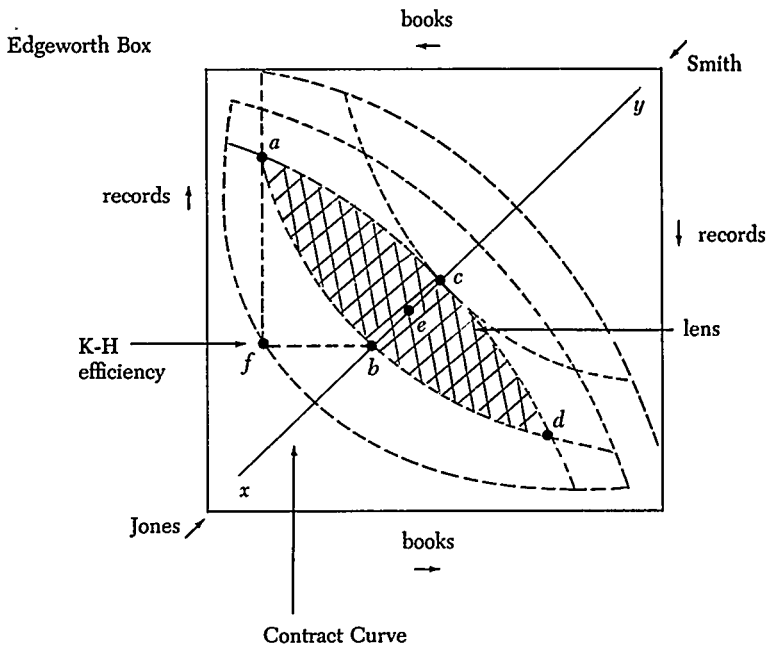
Like Pareto superiority, Kaldor-Hicks efficiency is a relational property of states of affairs. One state of affairs (E') is Kaldor-Hicks efficient to another (E) if and only if those whose welfare increases in the move from E to E' could fully compensate those whose welfare diminishes with a net gain in welfare. Under Kaldor-Hicks, compensation to losers is not in fact paid. Were the payment transaction costless and full compensation given to the losers, Kaldor-Hicks distributions would be transformed into Pareto-superior ones. This characteristic of Kaldor-Hicks has led some to refer to it as a "potential Pareto-superior" standard.⁷

Kaldor-Hicks-efficient distributions do not necessarily map onto Pareto-superior distributions. The failure to require compensation has the effect of making some individuals worse off and thus fails to satisfy the requirements of Pareto superiority. In general, a distribution that is Kaldor-Hicks efficient need not be Pareto optimal either. If a distribution is Kaldor-Hicks efficient then some individual has been made sufficiently better off so that he could—hypothetically at least—fully compensate those who have been made worse off. It does not follow that from their new rela-

7. See G. CALABRESI & P. BOBBITT, TRAGIC CHOICES 85-86 (1978).

tive positions the winners and losers are incapable of further mutual improvement through trade. Thus a Kaldor-Hicks efficient allocation need neither be Pareto superior nor Pareto optimal though it may be either or both.⁸

8. The difference between the concepts of Pareto optimality, superiority and Kaldor-Hicks efficiency are usefully illustrated by the following Edgeworth-Bowley Box.



Let a = initial distribution of all records and books between Jones and Smith.

- (1) The line drawn through a, b, d represents Jones' indifference curve with respect to records and books.
- (2) The line drawn through a, c, d represents Smith's indifference curve with respect to the same resources. (The slope of the respective indifference curves is given by the respective marginal rates of substitution of books and records.)
- (3) A move from a to b is Pareto superior because Jones is no worse off (b is on his indifference curve), while Smith is better off (b is farther out from her origin).
- (4) A move from a to c is also Pareto superior, because it makes Jones better off while Smith is no worse off.
- (5) A move from a to e is Pareto superior by making both Smith and Jones better off.
- (6) The shaded area formed by the intersection of indifference curves drawn through a is the *lens*, and it represents all possible Pareto-superior moves from a .
- (7) The points of common tangency of Smith's and Jones' curves represent Pareto-optimal distributions.
- (8) The line x, y drawn through these points is the contract curve. (Not every

C. *The Pareto Standards and Utilitarianism*

1. *Pareto Superiority*.—The Pareto-superior standard is often thought of as normatively rooted in classical utilitarianism. Briefly, the argument for identifying Pareto efficiency with utilitarianism is as follows: Allocations that are Pareto superior increase at least one person's utility without adversely affecting the utility of another; they produce winners but no losers. Consequently there is no need to compare the relative gains and losses of winners and losers in order to determine if a course of conduct increases total utility. Pareto improvements increase total utility, although not all increases in total utility constitute Pareto improvements.⁹ Because the Pareto-superiority criterion *appears* to obviate the need to make interpersonal-utility comparisons in order to determine if a course of conduct increases total utility, it is easy to see why one might be led to consider the justification for pursuing Pareto improvements to be utilitarian.

Aspects of this argument are misleading, others mistaken. First, the Pareto-superior criterion does not *eliminate* the need for a standard of utility comparison. If the Pareto-superior standard is to be an index of total utility, interpersonal-utility comparisons are necessary since the concept of total utility presupposes the capacity to aggregate individual utility functions which in turn requires a standard of comparison. Provided such a standard exists, Pareto improvements increase total utility; and because they do, one could argue that the justification for pursuing Pareto improvements relies on its connection to utilitarianism. That would be a mistake.

We presume that the concept of total utility is meaningful, and because we do, we must believe that some standard of interpersonal comparability exists. From this it follows that Pareto improvements increase total utility. Suppose, however, that the very idea of total utility were meaningless. In that case, we would be unable to make sense of claims concerning increases or decreases in total utility. We would, however, still be capable of talking meaningfully about Pareto improvements.

Pareto-optimal distribution, however, corresponds to a point on the contract curve.)

- (9) Point *c* represents a Pareto-optimal allocation that is also Pareto superior to *a* (as does point *b*).
- (10) The move from *a* to *f* is Kaldor-Hicks efficient, since at *f* Smith could compensate Jones so that Jones would be no worse off than at *b* and Smith would still be better off (farther from her origin).

9. For further discussion of this point, see Bebachuk, *The Pursuit of a Bigger Pie: Can Everyone Expect a Bigger Slice?*, 8 HOFSTRA L. REV. 671, 691-94 (1980).

There is an important distinction between individual-preference theories, total-utility theories and social-welfare theories.¹⁰ Pareto judgments are expressed in terms of individual-preference orderings rather than in terms of total utility. To say that an action is Pareto superior is to say only that at least one person is higher along his or her preference ranking, while no one else is any worse off with respect to his or hers. The existence of a standard of comparison enables us to bring these distinct judgments about the relative standings of individuals with respect to their preference orderings into a single judgment about total utility. As we have just seen, however, the Pareto judgment has empirical significance independent of its connection to utility.

At bottom is the distinction between the claim that Pareto judgments may warrant claims about utility and the claim that utility justifies the pursuit of Pareto improvements. Those committed to utilitarianism will no doubt embrace the Pareto standard since they are committed to a conception of the right and the good from which Pareto superiority follows as a particular instance, that is, as one way of promoting utility. But because Pareto judgments have empirical significance apart from their connection to utility, it is possible to conceive of alternative justifications for the pursuit of actions and policies that satisfy the Pareto-superior criterion.

For example, one could plausibly argue that the Pareto-superior standard is normatively defensible not because applying it gives an index of total utility, but because rational self-interested persons would consent to its use. That is, few would object to policies that made at least one person better off if doing so never required anyone else to suffer. This line of defense does not rest on the utility of the Pareto standard, but on the fact that rational, self-interested persons would consent to its use.

Alternatively, one might advance a normative defense of Pareto superiority that relies on a libertarian rather than a contractarian or utilitarian political morality: Exchanges among knowledgeable, rational persons in a free market are generally Pareto superior; rational individuals do not strike bargains with one another unless each perceives it to be in his or her own interest to do so. A successful exchange between such parties is, therefore, one in which the value to each of what he or she relinquishes is perceived as less than the value of what each receives in return. Such exchanges make no individual worse off; often they improve

10. See generally A. SEN, *COLLECTIVE CHOICE AND SOCIAL WELFARE* (1970).

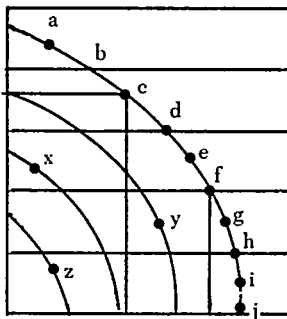
the lot of all concerned. Pareto superiority is connected in this way to the ideal of a free-exchange market.

We can imagine, then, at least three distinct normative defenses for the Pareto-superior standard, only one of which is utilitarian. These are the utilitarian argument, the contractarian or consent argument, and the libertarian argument. The important point for our present purposes is that one can remain unpersuaded by the utilitarian conception of the good and the right, yet stand prepared to endorse certain institutional arrangements that work to at least some person's benefit and to no one's detriment on the grounds either that rational self-interested persons would consent to such arrangements or that certain of these arrangements respect or are required by a deeper commitment to individual liberty or autonomy. Whether the use of the Pareto-superiority standard can be adequately defended on either contractarian or libertarian grounds is a question to which we shall return.¹¹ In any event, it simply does not follow that the normative use of the Pareto-superior criterion must be abandoned even if utilitarianism is wrongheaded.

2. *Pareto Optimality*.—Let us now turn to Pareto optimality in order to develop its relationship to utilitarianism. To say that resources are distributed in a Pareto-optimal fashion is to say that no further distributions are capable of enhancing anyone's welfare without making someone else worse off. Pareto-optimal distributions have no distributions Pareto superior to them.¹²

11. See Section IV *infra*.

12. The set of all possible Pareto-optimal distributions of resources that an economy in general equilibrium can generate is represented as points on the "contract curve." The points on the contract curve may be further represented as points on the grand utility/possibility frontier. The fact that all Pareto-optimal allocations may be represented as points on a utility/possibility frontier suggests a relationship of Pareto optimality to utilitarianism. That is, all points on the utility/possibility frontier are Pareto improvements over all points to their southwest. With respect to every other point, a point on the frontier is Pareto noncomparable. This is illustrated as follows:



1. *c* is Pareto superior to *x*, but Pareto noncomparable to *y*.
2. *f* is Pareto superior to *y* but Pareto noncomparable to *x*.
3. *c* and *f* are Pareto noncomparable.
4. *c* and *f* are Pareto superior to *z*.

From the fact that a distribution of resources is Pareto optimal two utility judgments follow: First, every Pareto-optimal distribution contains more total utility than some set of distributions represented by points within the utility/possibility frontier, because every distribution represented by a point on the utility/possibility frontier is Pareto superior to *some* distributions¹³ represented by points within the frontier, those to the southwest. Second, the overall utility of a Pareto-optimal distribution cannot be increased by a Pareto-superior move, because a Pareto-optimal distribution has no distributions Pareto superior to it.

From the fact that a distribution of resources is Pareto optimal it does not follow that the move to it increases utility, because not every move to a Pareto-optimal distribution involves a Pareto improvement. Pareto-optimal distributions may result from Kaldor-Hicks-efficient or non-Pareto-superior moves as well as from Pareto-superior ones. Moreover, no judgments about the relative utility content of the various members of the set of Pareto-optimal distributions is warranted. This is because the set of Pareto-optimal distributions cannot be compared by the Pareto-superiority standard.

Every utility judgment warranted by the optimality standard is a logical consequence of its definitional relationship to Pareto superiority. It follows, therefore, that whether Pareto optimality is rooted in utilitarianism will depend on whether Pareto superiority is. Moreover, the same consent and libertarian defenses for Pareto superiority may be brought to bear on Pareto optimality. First, the ultimate outcome of voluntary exchanges will be Pareto optimal: rational, knowledgeable persons will contract to a Pareto-optimal point, never away from it. Second, because rational, self-interested persons would presumably consent to Pareto-superior moves, they would theoretically consent to the ultimate consequence of such moves, Pareto-optimal distributions.

D. *Kaldor-Hicks and Utility*

Both Pareto-superiority and Pareto-optimality judgments entail certain total-utility claims provided the very weak condition that a

This is not to say, of course, that there are no distributions that contain more total utility than a Pareto-optimal distribution. Rather, given the constraints of the theory, we cannot determine, short of making actual interpersonal comparisons, which distributions they are.

13. It is Pareto superior to only some because some movements to optimality occur as a result of Kaldor-Hicks moves. *See* pp. 532-34 *infra*.

standard of comparability exists is satisfied. The same cannot be said for Kaldor-Hicks. First, in order to infer from the satisfaction of the Kaldor-Hicks test that there has been a net gain in utility, we need to know whether winners have won more than losers have lost, which requires interpersonal-cardinal comparability. Second, the Kaldor-Hicks test may lead to inconsistent preferences over social states, that is, two states of affairs may be Kaldor-Hicks efficient to one another. This is the Scitovsky Paradox.¹⁴

Consequently, from the satisfaction of the Kaldor-Hicks test it does not follow that there has been a net gain in utility, since (1) one can determine whether Kaldor-Hicks has been satisfied with-

14. Scitovsky, *A Note on Welfare Propositions in Economics*, 9 REV. ECON. STUD. 77 (1941). A demonstration of the Scitovsky Paradox follows.

Suppose there are two persons, *A* and *B*, and two commodities, *X* and *Y*. The following table gives the outputs in two states of the economy: *E* and *E'*.

	<i>E</i>		<i>E'</i>	
	<i>X</i>	<i>Y</i>	<i>X</i>	<i>Y</i>
<i>A</i>	2	0	1	0
<i>B</i>	0	1	0	2

In *E*, Mr. *A* has two units of *X* and no units of *Y*; Ms. *B* has no units of *X* and one unit of *Y*. In *E'*, *A* has one unit of *X* and none of *Y*. Suppose now that *A* and *B* have the following preferences for *X* and *Y*:

Mr. *A* prefers one unit of *X* and one unit of *Y* to two units of *X* and no units of *Y*, which is itself preferred to one unit of *X* and no units of *Y*. Ms. *B* prefers one unit of *X* and one unit of *Y* to no units of *X* and two of *Y*, which is itself preferred to no units of *X* and one of *Y*. *E* is Kaldor-Hicks efficient to *E'*, and *E'* is Kaldor-Hicks efficient to *E*. In *E* Mr. *A* has two units of *X* and one of *Y*; were he to give one unit of *X* to Ms. *B*, he would be exactly as well off as he was in *E'*; Ms. *B* would be better off. She would then have one unit of *X* and one of *Y* which she prefers to both *E'* and *E*. Compensation would make her better off and Mr. *A* no worse off. So *E* is Kaldor-Hicks efficient to *E'*.

In *E'*, Ms. *B* has no units of *X* and two of *Y*; Mr. *A* has one unit of *X* and none of *Y*. Suppose Ms. *B* gives Mr. *A* one unit of *Y*. Then she has no units of *X* and one of *Y*. He has one unit of both *X* and *Y*. She would then be exactly as well off as in *E*. Mr. *A*, however, would be better off, since he prefers one unit of both *X* and *Y*. Consequently, *E'* is Kaldor-Hicks efficient to *E*.

As it stands, Kaldor-Hicks does not provide an adequate efficiency basis for preferring one state of the economy to another. The Kaldor-Hicks criterion may be reformulated so that one state of affairs is Kaldor-Hicks preferable to another if and only if the winners could compensate the losers in going from *E* to *E'*, but the winners could not compensate the losers in going from *E'* to *E*. This eliminates the paradox, but then Kaldor-Hicks will not be transitive. See K. ARROW, SOCIAL CHOICE AND INDIVIDUAL VALUES 38-45 (2d ed. 1963).

out appealing to any *particular* standard of interpersonal comparison, but, in cases in which there are both winners and losers, one cannot tell whether total utility has been increased by a Kaldor-Hicks improvement without appealing to such a standard; and (2) E can be Kaldor-Hicks superior to E' and E' to E whereas E cannot have more utility than E' while E' has more utility than E .¹⁵

Of the three efficiency-related criteria only Pareto superiority may be transformed into an index of utility. Utility judgments warranted by Pareto optimality are a consequence of its analytic relationship to Pareto superiority. Kaldor-Hicks efficiency is paradoxical as a standard of utility and therefore cannot be transformed into an index of utility even if interpersonal-utility comparisons were possible.

Further, it does not follow from the fact that utilitarianism is mistaken that the normative use of the Pareto standards must be abandoned. Even though Pareto superiority can be employed as a standard of utility, it has content aside from this connection, and its application in social and legal policy matters may be justified on nonutilitarian grounds, in particular, on the basis of consent and/or liberty. If utilitarianism is wrong, a proponent of economic analysis has a choice: He or she can either abandon the normative use of the Pareto criteria in favor of a nonutility-based efficiency criterion or try to construct nonutilitarian normative arguments for the Pareto criteria.

II. THE CONCEPTUAL BASIS OF WEALTH MAXIMIZATION

The discussion in the previous section suggests that Professor Posner may have been too hasty in abandoning utilitarian in favor of wealth-maximizing conceptions of efficiency. Nevertheless, Richard Posner offers the system of wealth maximization¹⁶ as an alternative both to utilitarian moral theory and to Pareto efficiency. Wealth maximization is supposed to be a more attractive moral

15. See note 14 *supra*.

16. Posner, *supra* note 3, at 119. Posner defines wealth in its relationship to the system of wealth maximization as follows:

the value in dollars or dollar equivalents . . . of everything in society. It is measured by what people are willing to pay for something or, if they already own it, what they demand in money to give it up. The only kind of preference that counts in a system of wealth maximization is thus one that is backed up by money—in other words, that is registered in a market. *Id.*

Instead of imploring individuals to act to promote utility, the system of wealth maximization requires them to act to increase social wealth—defined as the dollar equivalents of everything in society, including producer and consumer surplus.

principle than utilitarianism, and wealth maximization is supposed to replace the Pareto criteria, which, in Posner's view at least, are rooted in utilitarian moral theory. Wealth maximization, however, is neither more defensible than utilitarianism nor is it an alternative efficiency criterion. Indeed it is not an efficiency criterion at all. I want to make this last point abstractly first, then concretely.

A. *Wealth and Efficiency*

A distinction must be drawn between tests for ordering or ranking states of affairs and the characteristic(s) in virtue of which the states of affairs are to be ranked. The Pareto standards rank social states; they do not provide the characteristic in virtue of which one state may be compared with another. On the other hand, both wealth and utility maximization express characteristics of states of affairs that enable them to be compared by use of the Pareto standards. For example, we might say that S_1 is a Pareto improvement over S and mean that in S_1 , no one's *utility* decreases, whereas at least one person's utility increases; or we could mean that in S_1 , no one is less *wealthy* than in S while at least one person is wealthier. The traditional Pareto standards are not abandoned under a system of wealth maximization: they are employed to rank or describe social states in terms of the wealth, rather than the utility, relationships among them.¹⁷

The concrete example I will use to illustrate the relationships between wealth maximization and the Pareto criteria comes from Coase.¹⁸ Suppose that a rancher and farmer own land adjacent to one another. Each seeks to maximize his or her revenue from the relevant activity. In the absence of the other activity, the rancher would raise cows until the marginal benefit of his doing so equaled his marginal cost; the farmer would grow corn until her marginal benefit equaled her marginal private cost. Where marginal revenue equals marginal private cost, revenue is maximized; any additional ranching or farming will be more costly than profitable.

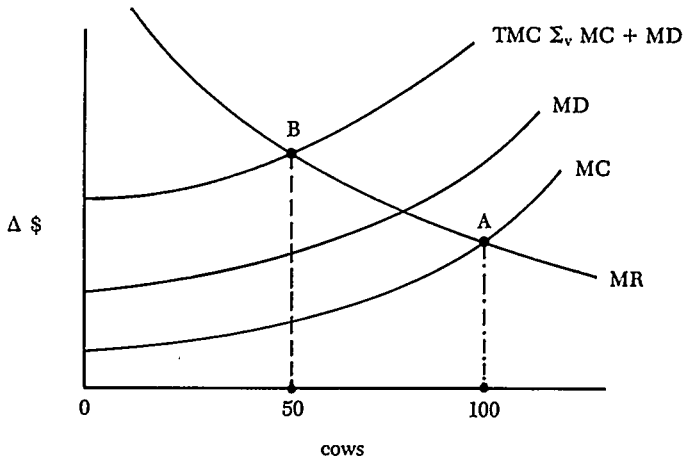
Where the two activities affect one another, more cows will mean less corn and vice versa. This is the essence of an externality problem. In the efficient resolution of this externality problem, marginal revenue again is equal to marginal cost, but marginal cost

17. This fact alone should shed some doubt on the claim that Paretianism is rooted in utilitarianism, since it is perfectly possible to employ the Pareto standards to compare social states in terms of their wealth rather than their utilities.

18. See Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 2-8 (1960).

(for the rancher) is equal to the sum of his marginal cost in raising cows plus the marginal damage each cow causes the farmer's corn crop. The problem is illustrated by Figure 1.

Figure 1.



In the absence of farming, the rancher will ranch to A; with farming he will ranch to B. B represents the wealth-maximizing solution to the externality problem—on the assumption that the rancher and farmer are interested in their land and its productive uses for the purposes of profit only. If either had preferences other than increasing his or her respective wealth, B would not necessarily reflect the optimal solution to the externality problem.

It is easy to show, moreover, that B is not only wealth maximizing but Pareto optimal as well. To see this, consider two possible alternative starting points. In one, the rancher has the right to raise as many cows as he wishes. He is free to act as if there were no corn crop that would be damaged by his cows; in the other, the farmer has an absolute right to prohibit cows. In the first case, the rancher starts out ranching 100 cows (the number of cows represented by A); in the other case, he starts out with no cows. Consider the last case first. Because the loss the rancher incurs by not being able to ranch the first cow is far greater than the damage the cow will cause the corn crop, the rancher will buy the right to the first cow from the farmer by compensating her for the damage the cow will cause. This move will be Pareto superior to the starting point. For every cow up to the 50th one, a similar Pareto-superior move can be made whereby the rancher raises an additional cow and reimburses the farmer for the associated crop

damage, thus making the farmer no worse off than before each additional cow is added. No Pareto-superior moves from *B* can be made, however, since in order to add a 51st cow, the rancher must pay more in damages to the farmer than the cow is worth to him. He could purchase the right to the 51st cow only by making himself worse off. *B* is then Pareto superior to any point to its left or right. A similar argument can be advanced to show that if negotiations begin at *A*, they will end up at *B* through a series of Pareto-superior moves and that no Pareto-superior move from *B* is possible. *B* represents not only a wealth-maximizing but a Pareto-optimal solution to the externality problem. Because it does, wealth maximization cannot be viewed as an alternative to the traditional Pareto criterion.

Instead, because wealth is a characteristic of certain states of affairs that enables them to be ranked by the use of both the Pareto and the Kaldor-Hicks criteria, wealth maximization, in conjunction with these criteria, can provide a basis for preferring one state of affairs to another. For example, a Pareto-superior exchange is, in the system of wealth maximization, a good thing—not because it increases welfare, but because it increases wealth. Wealth maximization is not an efficiency criterion; it is an alternative to the utilitarian basis for justifying the pursuit of efficiency.

B. Consequences of the Reliance of Wealth on Prices

1. *Exchange*.—Exchanges between rational, self-interested, well-informed individuals usually increase welfare or utility. Individuals do not in general engage in transactions that are not in their interest. It is not clear, however, that such exchanges are wealth maximizing. That is because in the absence of either market or quasi prices, exchange has no effect on wealth. In the absence of prices, *A*'s exchange of his last orange for *B*'s last two apples is neither wealth maximizing nor wealth reducing. While we can infer from the exchange that *A* prefers *B*'s last two apples to his last orange—that *A*'s utility increases when he has the two apples—and that *B* prefers *A*'s last orange to her last two apples—that her utility increases when she has that one orange—we cannot say anything at all about whether the transaction has increased wealth—*A*'s, *B*'s, or society's—in the absence of prices. Therefore, free exchange need not be wealth maximizing; indeed, exchange simpliciter is not wealth maximizing at all. Only exchanges that involve prices can be wealth maximizing.

Because wealth maximization relies on the existence of prices,

utilitarianism, but not wealth maximization, can provide the outline of a consequentialist argument for free exchange. Very roughly, the utilitarian argument would be that free exchange under the constraints of, among others, substantial knowledge and rationality increases utility and is desirable for that reason. In contrast, the system of wealth maximization can support free exchange only where exchanges involve prices. It is hard to see why free exchange is a good thing when it involves prices, but morally neutral, as it would be on wealth-maximizing grounds, otherwise.

2. *Scarcity*.—Because the principle of wealth maximization necessarily involves the existence of prices, a proponent of wealth maximization would have to condemn as wealth reducing any recommendation to eliminate scarcity. Prices, after all, are necessary only in so far as scarce goods must be allocated. The elimination of scarcity eliminates the need for prices. The elimination of scarcity eliminates prices and, therefore, wealth.¹⁹ I do not mean to suggest that the elimination of scarcity is *necessarily* a good thing. The point is that for the proponent of wealth maximization, the elimination of scarcity is necessarily a bad thing. In fact, whether abundance is good or bad, it is *contingently* so.

3. *Theoretical Incompleteness*.—The reliance on prices reveals the fundamental incompleteness of wealth maximization as a moral maxim. The principle of wealth maximization purports to provide a general invocation to action: Actions are right or obligatory to the extent they promote wealth. Unfortunately, wealth maximization can tell us nothing of our rights and liberties, nor of our duties and responsibilities in the absence of a system of fixed relative prices. Surely some things are right and others wrong, even in the absence of prices.

4. *Assigning Basic Entitlements*.—The problem of relying on prices arises once again when we reach the question whether one could employ wealth maximization to assign basic entitlements. Wealth maximization requires a fixed set of relative prices. The prices of goods depend, among other things, on the relative demand for them. The demand for goods depends in turn on the distribution of wealth. And the distribution of wealth is of course a function of what individuals are entitled to. Therefore, the system of wealth maximization must presuppose a set of initial entitle-

19. A related point is developed by Professor Kornhauser, who argues that wealth maximization encourages monopolization. See Kornhauser, *A Guide to the Perplexed Claims of Efficiency in the Law*, 8 HOFSTRA L. REV. 591, 596-97 & n.9 (1980).

ments in order to get started; and these initial entitlements cannot, by hypothesis, be accounted for on wealth-maximizing grounds. The system of wealth maximization therefore cannot provide a basis for an initial assignment of entitlements.

5. *Circularity of Preferences.*—The questions that arise in virtue of the role the *existence* of prices plays in the system of wealth maximization are different from those we might have concerning the role price *changes* play in wealth maximization. One way in which price changes may have an adverse effect on the system of wealth maximization surfaces in connection with an analog of the Scitovsky Paradox.

Prior to the publication of *Utilitarianism, Economics, and Legal Theory*,²⁰ Posner professed to employ utility-based notions of economic efficiency. In a previous article, I argued that Posner justified market interventions as well as particular assignments of rights on the basis of the Kaldor-Hicks criterion.²¹ In his contribution to this symposium Professor Posner acknowledges and accepts my argument that he applies the Kaldor-Hicks test.²² Posner acknowledges using Kaldor-Hicks, but Kaldor-Hicks is subject to the Scitovsky Paradox, and for that reason alone cannot constitute a utilitarian efficiency criterion. The Scitovsky Paradox arises when the Kaldor-Hicks test is employed to rank social states in terms of their utility. Wealth maximization ranks social states in terms of dollar equivalents, not utilities. Unlike utilities, dollars are comparable. Therefore, whatever its deficiencies may be, the system of wealth maximization—even to the extent it employs the Kaldor-Hicks test—is not subject to the Scitovsky Paradox.

Although wealth maximization avoids the Scitovsky Paradox, it is subject to an informal circularity-of-preference problem that results from its reliance on prices. The system of wealth maximization assumes at any given time a set of fixed prices for all commodities. On the basis of the prices at t_1 , imagine that the principle recommends a shift in legal rules from strict liability to negligence. At t_2 the negligence rule is therefore instituted. The changeover in liability rules causes a change in relative prices. At t_3 , suppose we reevaluate from the wealth maximization point of view the efficiency of strict liability and negligence. It is perfectly plausible to

20. Posner, *supra* note 3.

21. *Efficiency, Exchange, and Auction*, *supra* note 1, at 237-47.

22. Posner, *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*, 8 HOFSTRA L. REV. 487, 491 (1980).

suppose that, in at least some cases, the principle of wealth maximization, given the prices of goods at t_3 , will recommend a change from negligence to strict liability. The problem is straightforward. Wealth maximization requires and affects prices. Prices must be fixed to employ the principle but employing the principle to recommend structural changes in the law affects prices.

To meet this objection one can restrict the use of the principle to those cases in which applying it will not affect prices, except perhaps minimally. But then the principle would have been stripped of its power in helping to frame or shape the common law. For it is precisely the landmark cases effecting structural changes in the law that are supposed to be explained and warranted by the principle of wealth maximization.

In sum: Contrary to Posner, the system of wealth maximization is not an alternative efficiency criteria. It is not a means of ranking social states, but is instead a characteristic of social states that enables them to be ranked by both the Pareto and Kaldor-Hicks criteria. Because it avoids the Scitovsky Paradox, wealth maximization, unlike utilitarianism, can be employed in conjunction with the Kaldor-Hicks test. Therein lies one reason other than the ones Posner advances for preferring wealth maximization to utilitarianism.

Unfortunately the system of wealth maximization has its fair share of drawbacks—many of which arise because of the conceptual or logical connection of wealth maximization to the existence of prices. First, because the reliance on prices is necessary and not merely contingent, the system of wealth maximization cannot tell us anything about right conduct where no prices exist. Second, prices are in part the result of demand, demand the result of prior entitlements. Consequently, wealth maximization cannot generate an initial set of entitlements. Rearrangements of entitlements, once assigned, may be further restricted by the feature of wealth maximization that applying it both requires and affects prices—and, therefore, value.

III. THE ETHICAL BASIS OF WEALTH MAXIMIZATION

Suppose we could overlook the serious conceptual problems its reliance on prices creates for the system of wealth maximization. We would still have to ask whether wealth maximization constitutes an attractive moral maxim, one the law in particular ought to promote. There are two kinds of questions we could ask about the normative appeal of wealth maximization: one narrow, one general.

The narrower question concerns the relative attractiveness of wealth maximization vis a vis utilitarianism. The point of the choice is this: If one is committed to pursuing efficiency as a fundamental social goal, are one's arguments for doing so enhanced if efficiency is understood as maximizing wealth or maximizing utility?

The more general question concerns the attractiveness of wealth maximization vis a vis the full range of alternative moral theories, including other consequentialist theories as well as nonconsequentialist ones, for example, libertarianism or Rawlsian justice. This question does not focus on alternative reasons for pursuing efficiency, but on the issue of whether the pursuit of efficiency, rooted either in utility or wealth maximization, is preferable to some other conception of right action or justice. This is the question of whether and to what extent social institutions should be arranged to pursue efficiency.

Because there are two kinds of questions involving wealth maximization, there are two ways of reading Posner's arguments on its behalf: narrowly, to the effect that wealth maximization is more attractive than utility; or generally, to the effect that wealth maximization is a correct first principle. I think it is fair to say that Posner's arguments are to be taken both ways: narrowly because he believes wealth maximization is a more desirable basis for efficiency than utility; generally, because of the overall importance he accords efficiency in the determination of the institutional basis of society.

Unlike happiness or well-being, wealth is not something of intrinsic value. If the pursuit of wealth is a good, it must be because pursuing wealth promotes other things of value. So one kind of argument for the attractiveness of wealth as a normative system is instrumentalist. This is the argument Posner advocates in *Utilitarianism, Economics, and Legal Theory*.²³

Another line of argument one might take on behalf of wealth maximization relies on a different methodology. In this view, a set of normative principles is justified if individuals under certain constraints would have consented to or chosen them. This is a familiar line of moral justification, especially fashionable since publication of John Rawls' *A Theory of Justice*.²⁴ One would then have to argue that under a set of constraints, individuals conceived of in a certain way would have consented to or chosen the principle of wealth

23. Posner, *supra* note 3.

24. See J. RAWLS, *A THEORY OF JUSTICE* 3-53 (1971).

maximization as the fundamental moral maxim. This is the consent or contractarian argument.

A final, more limited argument is based on the premise that individuals exercising their liberty through market behavior act in a wealth-maximizing way. Because voluntary exchange is wealth maximizing, wealth maximization may be defended by its connection to liberty. This is the libertarian argument. In his contribution to this symposium,²⁵ Posner seems to advance both contractarian and libertarian arguments to support the system of wealth maximization.

A. *The Instrumentalist Argument*

Because wealth is not something of intrinsic value, its claim to moral worth depends on its extrinsic value, that is, on its capacity to secure other things of value. Posner's view is that a society that aims at maximizing wealth will "produce an ethically attractive combination of happiness, of rights (to liberty and property), and of sharing with the less fortunate members of society."²⁶ If individuals value liberty, equality, security, and happiness, as well as wealth, why will they achieve a more attractive package of these goods if they act as if they prefer only wealth than they will if they act as if they prefer one or another particular mixture of liberty, equality, happiness, and security?

I do not mean to deny that people value wealth: they obviously do. But since any instrumentalist defense of wealth maximization must presuppose that individuals value things other than wealth, there is no basis for the belief that individuals, by acting as if they were interested only in wealth, would achieve a more attractive mix of preference satisfaction than they would if they act on the basis of the complex set of preferences they have. Moreover, it is at least plausible that individuals who act as if they desire only wealth might secure more wealth and less of other things than they would secure if they act as if they prefer all the things they in fact do.

Posner contends that a system predicated on the wealth principle would not only secure desirable levels of liberty, equality, and security, but that it would confer moral rights and impose moral obligations. This claim is ambiguous. Does Posner mean that in order to maximize wealth, certain rights will be conferred and

25. Posner, *supra* note 22, at 494-97.

26. *Id.* at 487 (footnote omitted).

obligations imposed; or does he mean to advance the very different claim that people acting to maximize wealth will invariably respect those rights that other individuals have—rights which can be derived from principles other than wealth maximization? In other words, are the rights Posner refers to “instruments” in the pursuit of wealth, or independent of the pursuit of wealth?²⁷

If the rights Posner refers to are *not* mere instruments of the pursuit of wealth, the claim that pursuing wealth would not interfere with them is implausible. For example, it is easy to imagine that pursuing wealth may require violating the right to a minimal level of economic security. One might counter, on Posner’s behalf, that there is no right to economic security of this sort. No doubt any particular theory of rights will be controversial. But it begs the question to assert that a putative right is no right at all if it does not coincide in every case with the pursuit of wealth.

The *instrumentalist* conception of rights is troublesome for a number of reasons. I will discuss only two problems with it. First, by treating all rights as instruments of wealth maximization, it suggests that wealth maximization is the only good in society; rights are conferred and duties imposed in order to secure that good. Such a view is incompatible with the claim that wealth is valued instrumentally as a means to other social ends. This is in sharp contrast to a utilitarian theory of rights in that, unlike wealth, utility is valued in itself, and therefore rights and duties are established precisely to secure that end. But if there are ends other than wealth—for example, welfare, security, autonomy—why should the only rights individuals have be means to the end of wealth maximization? Why not confer rights to a certain level of welfare, security, freedom, and so on? If there are such rights, then they exist apart from the principle of wealth. If such rights exist independent of the pursuit of wealth, then the pursuit of wealth may at times require disrespecting them. If it does, either we pursue wealth or respect the relevant right.

If, in the event of conflict, the right is respected though doing so is not wealth maximizing, then there exist values more important than wealth—which apparently are best pursued not by pursuing wealth, but by failing to do so. In addition, these rights could not be mere instruments in the pursuit of social wealth. On the other hand, failure to respect the right in favor of an incremen-

27. Posner specifically refers to rights as instruments in the pursuit of wealth. Posner, *supra* note 3, at 127.

tal advantage in the pursuit of wealth implies that the principle of wealth maximization is unable to account for fundamental features of what it means to have a right. For at the very least, a right provides its holder with authority to foreclose policies or actions that could otherwise be justified in the name of the common good. Rights need not be trumps in order for them to alter the normative status of both individuals who possess them and others affected by them. But if a right is a mere instrument of some conception of the common good, whenever pursuing the common good would require disrespecting or ignoring a right, so much the worse for rights and right holders. A mere instrument can never be a right in that part of what it means to have a right is that incremental arguments on behalf of the common good—or wealth—need not be decisive against a valid right claim.

All instrumentalist defenses of wealth maximization are doomed to failure. First, the very idea of an instrumentalist defense of wealth maximization is paradoxical. According to wealth maximization wealth *is* the good, and maximizing it the right. Yet in order to defend the normative use of wealth maximization, the instrumentalist argument presupposes that there are other goods, that wealth is *not* the ultimate social good. Next, all instrumentalist defenses of wealth maximization rely on the very implausible claim that a society will achieve a more attractive combination of wealth and other social goods by pursuing wealth only than it would were it to pursue this or that combination of social goals. Moreover, the system of wealth maximization cannot give rise to a full moral theory, one that includes both moral rights and duties, since a mere instrument in the pursuit of some conception of the good can never be a right. Finally, the rights and obligations that would constitute instruments of wealth maximization would not prove particularly attractive.²⁸

28. Many of these criticisms of wealth maximization involve the consequentialist nature of moral reasoning and the instrumentalist conception of rights involved in it. To that extent, they may be directed against utilitarianism as well. It doesn't follow, however, that wealth maximization is no less attractive than utilitarianism—though, of course, Posner's claim is that it is *more* attractive.

First, though Posner claims that wealth maximization is a complete moral theory, whereas, because of its boundary problems, utilitarianism is not, wealth maximization cannot, whereas utilitarianism can, provide a guide to action in the absence of prices. Presumably, some acts are right and others wrong, even in the absence of scarcity. Second, whether the elimination of scarcity is a good thing on utilitarian grounds is a contingent matter depending on the effect of eliminating scarcity on the well-being of the populace. On wealth maximizing grounds, the elimina-

B. *The Consent Argument*

1. *Wealth and Freedom.*—In *The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*,²⁹ Posner augments the instrumentalist defense of wealth maximization with arguments based on his understanding of the principles of liberty and consent.³⁰ The argument begins by drawing a distinction between alternative normative arguments for the traditional Pareto criteria. After arguing that Pareto superiority is rooted in utilitarianism, Posner notes that

tion of scarcity eliminates prices and, therefore, wealth, and for that reason, is necessarily a bad thing. Third, though on both utilitarian and wealth-maximizing grounds rights will be mere instruments in the pursuit of some conception of efficiency, the utilitarian theory can provide the basis for an initial distribution of them; the system of wealth maximization cannot.

According to wealth maximization, preference calculations undertaken by civil authority in the course of deciding among alternative legislative proposals are restricted to the preferences of those with money. In contrast, utilitarianism is committed to taking into account the preferences of all those who have an interest in some piece of legislation. Indeed, one source of utilitarianism's appeal is that it treats people as equals in the sense that each person's preferences count for one and no more than one before the utilitarian calculus. This practice of considering preferences equally is one way in which utilitarianism may be said to treat people as equals. Because wealth maximization fails to count everyone's preferences equally—indeed it fails to take everyone's preference into account—it is incompatible with the principle of equal consideration of interests. To that extent, wealth maximization fails to satisfy even this minimal conception of treatment as an equal. It is hard to imagine therefore that rational individuals, from a position of equality, would choose a system in which their interests were taken seriously only to the extent to which their preferences could be registered in a market.

My guess is that Posner is not particularly interested in the principle of equal consideration of interests or with treating persons as equals; but he should be. If civil authority is concerned with individuals' preferences, it is because legislation affects the welfare of those individuals; and part of what it means to be concerned with the welfare of individuals is to be concerned with the effects of legislation on the frustration or satisfaction of their preferences. But to take seriously only the preferences of those with money—and to do so only to the extent to which their preferences are expressed monetarily—is in effect to hold that in spite of the fact that the legislation will affect either adversely or favorably the interests of others, the fact that they are unable to express their interests monetarily excuses the government for failing to countenance them. Yet it is a person's capacity for satisfaction and frustration—not his or her wealth—that imposes the duty upon civil authority to take into account the effect of legislation upon him.

Obviously, Posner has an implicit moral theory concerning why the interests of some but not others should be countenanced, but because his principle will conflict with the principle of equal consideration, it will be *prima facie* an unattractive one to which the system of wealth maximization will be committed.

29. Posner, *supra* note 22.

30. *Id.* at 488-97.

it is also possible to locate Pareto ethics in a different philosophical tradition from the utilitarian, in the tradition, broadly Kantian, which attaches a value over and above the utilitarian to individual autonomy. One ethical criterion of change that is highly congenial to the Kantian emphasis on autonomy is consent. And consent is the operational basis of the concept of Pareto superiority.³¹

In this view, actions that are freely consented to by the relevant parties are normatively justifiable not because the transactions increase utility or wealth, but because they involve the exercise of liberty. Transactions that are wealth maximizing are justified because in exercising their liberty individuals consent to them. Thus, the system of wealth maximization is justified on consensual grounds.

The argument seems headed for trouble from the outset. If consenting to a transaction is what justifies it, then actions that are *not* wealth maximizing may be normatively justified—if they are consented to. It follows that consent is too weak a principle to justify the system of wealth maximization, that is, the theory of the good as the maximization of wealth.

Posner does not specifically address himself to what appears to be the obvious problem of nonwealth-maximizing market transactions in part because he seems to believe that no such cases exist: "In the setting of a market free from third-party effects, it is clear that forbidding transactions would reduce both the wealth of society and personal autonomy, so that the goals of maximizing wealth and of protecting autonomy coincide."³² In Posner's view then, voluntary market exchange is invariably wealth maximizing; otherwise forbidding exchange would not necessarily reduce wealth. This view is mistaken since transactions in the absence of prices are not wealth maximizing in his sense.³³ If I trade you one apple for one orange, social wealth is not increased.³⁴ Moreover, actual consent is an inappropriate justification for wealth maximization insofar as the principle of wealth is supposed to guide institutional design; that is, the development of alternative, as yet *unrealized*, wealth-maximizing institutions. The principle of actual consent justifies too much and is of the wrong sort to justify the system of wealth maximization.

2. *Kaldor-Hicks, Pareto, and Wealth.*—The problem Posner

31. *Id.* at 489-90.

32. *Id.* at 490.

33. This is because wealth maximization relies on prices. *See* Section II *supra*.

34. *See* Section II(B) *supra*.

faces goes even deeper. Not only can we distinguish wealth-maximizing from other institutions, we can also differentiate between wealth-maximizing institutions those that increase wealth through Pareto improvements—such as, in Posner's view, the free market³⁵—from those that maximize wealth through Kaldor-Hicks moves—such as, again in Posner's view, the negligence system in torts.³⁶ The distinction between Pareto-superior and Kaldor-Hicks wealth maximization is even more complex since we can further distinguish between two cases of Pareto-superior wealth improvements.

Consider the following three cases:

- (1) *A* and *B* exchange with one another. This is the paradigm of mutual gain through trade.
- (2) Because of a market failure *A* and *B* do not exchange with one another. A good is awarded to *A*, which had it been awarded to *B* would have been inefficient in that *B* would have sold it to *A* (as in 1 above). *A*, however, compensates *B* so that he (*B*) is indifferent between his current state and where he would have been had he been awarded the good originally.
- (3) Again because of a market failure *A* and *B* do not actually exchange with one another. A good is awarded to *A*, which had it been awarded to *B* would have been inefficient. *B*, however, is not compensated by *A* or anyone else, and is therefore worse off than he was prior to the assignment.

The first case involves a Pareto-superior move that is the result of individuals exercising their liberty. The second case involves a Pareto-superior move that is not the result of the exercise of liberty because the individuals do not consummate a mutually advantageous exchange. The third case involves a Kaldor-Hicks move. In terms of consent: In the first case individuals express their consent to the transaction through their market behavior; in the second case, individuals consent by accepting compensation *ex post*.³⁷ In the third case, however, individuals do not appear to consent to particular transactions through the exercise of their liberty or through their acceptance of compensation. In what sense can we say losing parties in Kaldor-Hicks wealth improvements, individu-

35. Posner, *supra* note 22, at 488-89.

36. *Id.* at 492-96.

37. See Section III(B)(3) *infra*.

als like *B* in the third case, consent to institutions that make them less well off but are wealth maximizing?

The remarkably bold claim Posner advances is not just that wealth maximization is justified because it is consented to; it is that wealth maximization of the Kaldor-Hicks variety (as in case 3) is justified because it is consented to. Posner puts the task as follows: "I want to defend the Kaldor-Hicks or wealth-maximization approach not by reference to Pareto superiority as such or its utilitarian premise, but by reference to the idea of *consent* that I have said provides an alternative basis to utilitarianism for the Pareto criterion."³⁸ The principle of consent is supposed to justify not simply the pursuit of wealth over other goals, but its advancement through a series of Kaldor-Hicks interventions. The obvious problem is that Kaldor-Hicks interventions produce losers; and why would a possible loser consent to a system that made him worse off—especially when he could be assured of being made no worse off by opting for Pareto-superior wealth-maximizing intervention.

The claim that rational individuals would consent to Kaldor-Hicks wealth-maximizing institutions over Pareto-superior ones must be modified. After all, rational persons would likely choose to leave a wide range of social choices to the market. A free market involves Pareto-superior rather than Kaldor-Hicks improvements. Posner's claim therefore cannot be that individuals would generally choose to forego the market. Suppose we understand Posner to be arguing not that Kaldor-Hicks institutions are preferred to the market, but that where the market breaks down or where structural changes in it are required rational individuals would choose to follow a Kaldor-Hicks path to wealth maximization.

3. *Consent and Ex Ante Compensation.*—For Posner, the question of whether Kaldor-Hicks wealth maximization is justified is the question of whether it is appropriate to say of the losers in Kaldor-Hicks interventions or institutions that they have consented to their losses.³⁹ By the way of an introduction to his argument Posner notes that he proposes to defend wealth maximization by appealing to a notion of consent, according to which, "if you buy a lottery ticket and lose the lottery, then, so long as there is no question of fraud or duress, you have consented to the loss."⁴⁰

This introduction is a warning of the confusions to follow. If I

38. Posner, *supra* note 22, at 491-92 (emphasis added).

39. *See id.* at 492-97.

40. *Id.* at 492.

buy the lottery ticket and lose my loss may be a fair or legitimate one, one that it may be appropriate to pin on me. It would be fair because I had willingly taken a risk by consenting to or voluntarily joining an enterprise that was risky in the relevant way. But it would hardly follow that I had consented to the loss. Consenting to or taking the risk is not equivalent to consenting to or taking the loss, irrespective of the fairness of the loss.

Posner argues not only that individuals who lose in Kaldor-Hicks institutions consent to their losses, but that their consent is given by their accepting ex ante compensation.⁴¹ The argument appears to be this: wealth-maximizing institutions by hypothesis are less costly than nonwealth-maximizing ones. A system in which compensation is paid and accepted ex post—that which is Pareto superior—is more costly than one in which compensation is not paid. The initial costs of wealth-maximizing, Kaldor-Hicks-based institutions are, therefore, lower. The difference in initial entrance costs constitutes a kind of ex ante compensation. So possible losers who engage in such activities consent by their acceptance of the lower entrance fee. They give their consent by accepting ex ante compensation in the form of lower costs.

The general argument can be illustrated by example. Suppose, as Posner does,⁴² that the negligence system is less costly than a system of strict liability. One way in which strict liability and negligence differ concerns the likelihood of a victim recovering damages. In strict liability a victim is more likely to recover than in negligence where the conditions of liability are more demanding. For example, victims can recover in strict liability in cases in which the injurer is not at fault, whereas in negligence liability the victim will not recover unless the injurer is at fault.

Posner apparently believes that in strict liability a victim's acceptance of compensation ex post constitutes consent to the activity that caused the harm.⁴³ In negligence liability the lower costs of the system, as exemplified in insurance premiums, constitute a form of ex ante compensation, the acceptance of which constitutes for each victim consent to an uncompensated loss.⁴⁴

Even if it made sense to say that everyone under the fault system *accepted* the lower costs, it would hardly follow that by ac-

41. *Id.*

42. *Id.* at 493-95.

43. *See id.* at 493-97.

44. *See id.*

cepting the reduced costs the actual victims had *consented* to the loss, any more than it would follow that by accepting ex post compensation for a loss, one had consented to the activity that caused the loss. I may never approve of, let alone consent to, reckless driving, but I would certainly accept, indeed demand, compensation were I the victim of another's carelessness. My acceptance of compensation ex post would not signify my consent to being injured. Instead, it would signify that I had been wronged by another's misdeeds. Compensation enforces my right to security; it is not the instrument through which I express my consent to having the level of my security reduced.

In Posner's view, accepting full compensation for a loss amounts to giving one's consent to the activity that caused the loss. If accepting compensation constitutes consent then it does not matter from a moral point of view whether compensation is accepted ex post or ex ante; the temporal dimension carries no moral weight. The problem with Posner's argument does not concern the difficult epistemic questions of how to determine if an individual has accepted ex ante compensation. The real question is whether accepting compensation constitutes consent.

Were we to follow Posner, it would be impossible to accept full compensation and not thereby give one's consent. So the only way traffic victims, for example, could refuse to consent to being run over would be to refuse to accept compensation. If they demand, are offered, and then accept compensation because their right to freedom from unnecessary risk has been violated, they have, in Posner's view at least, consented to being harmed. They have in effect waived their right to security from undue risk. Surely the victims do not see it that way. If they tell us that they refuse either to give consent or to waive their right, then we must tell them, following Posner, that they must refuse compensation. But if they refuse compensation for an injury—when compensation is ordinarily due them—would we not be likely to take *that* as a sign that in fact they had, unknown to us, waived their right, that they had given their consent to being injured, or, at the least, that they had willingly assumed the risk. Something is deeply wrong in Posner's account of the relationship between consent and compensation.⁴⁵

45. Consider the following example. Suppose you accept a teaching position at the University of Chicago and are deciding whether to live in Evanston, where house prices are very high but where the crime rate is relatively low, or in Hyde

The mistake arises because Posner is misled by his own paradigm of justification via consent. In the paradigm case *A* and *B* consummate a free exchange. By accepting one another's offerings each gives consent to the transaction and to the resulting redistribution, thereby justifying both. In the first sort of derivative case *A* and *B* do not exchange. *A* benefits at *B*'s expense; *A* however compensates *B* ex post. For Posner, *B*'s acceptance of ex post compensation constitutes his consent to the activity and to the resulting redistribution. In the third case, the one that particularly interests Posner, *A* again benefits at *B*'s expense. The risks of being a loser however were accounted for in the initial costs of the game, so that even though neither *A* nor anyone else compensates *B* ex post, *B* is compensated ex ante by accepting lower costs. Therefore, he consents to the activity that caused the loss and to the loss itself.

The derivative cases however are not illuminated by the paradigm. If *A* gains at *B*'s expense, *B*'s acceptance of compensation need not constitute his consent to *A*'s gaining at his expense, any more than a traffic victim's acceptance of compensation constitutes his or her consent to being a traffic victim. The same individual therefore does not consent to being a traffic victim by supporting the wealth-maximizing negligence system. Compensation, whether ex post or ex ante, neither constitutes nor is a surrogate for consent. Once this is made clear, it is also easy to see why Posner's claim⁴⁶ that the system of wealth maximization can be rooted in the libertarian political morality of Nozick and to a lesser extent Epstein is mistaken.⁴⁷

The prevailing view is that economic analysis falls on the other end of the political spectrum from libertarianism. Libertarianism,

Park, where the crime rate is higher but the house prices, though high, are low compared to Evanston. Knowing this, suppose you decide to purchase a house in Hyde Park. The difference you pocket between the prices for comparable housing in Evanston and Hyde Park constitutes a kind of ex ante compensation. Suppose now that your house is burglarized. Is it at all plausible to say that you had given your consent to the burglary by accepting ex ante compensation in the form of a reduced housing price? Could the burglar introduce your consent as a defense in court? Hardly.

This example illustrates not only the mistake in thinking that compensation—either ex post or ex ante—is equivalent to consent; it demonstrates as well that *knowledge* of a risk does not always amount to either explicit or implicit waiver of a right or, in other words, to an assumption of risk.

46. Posner, *supra* note 22, at 490.

47. See generally R. NOZICK, *ANARCHY, STATE, AND UTOPIA* (1974); Epstein, *Nuisance Law: Corrective Justice and its Utilitarian Constraints*, 8 J. LEGAL STUD. 49 (1979).

as Nozick defends it, opposes market interventions for whatever reasons—egalitarian, paternalistic, or utilitarian. It would hardly favor market intervention for the purpose of promoting efficiency.⁴⁸ One interesting claim Posner makes is that the consent justification of wealth maximization forges a merger of libertarianism and economic analysis. The argument is that economic analysis requires promoting wealth through Kaldor-Hicks moves. Individuals would give their consent to this endeavor; winners do so by accepting their gains and losers consent by accepting *ex ante* compensation. Giving consent is an exercise of one's liberty. Therefore the pursuit of wealth (economic efficiency) is justified on libertarian grounds. Unfortunately, compensation, whether offered and accepted *ex post* or *ex ante* does not constitute consent. Freely accepting *ex ante* compensation does not amount either to consenting to a loss should it arise, or to the activity or institution that gives rise to the loss. All this is quite apart from the question whether the loss is justifiably imposed on someone; the only point is that even if it is justified it is not because the loser consents to her loss through the exercise of her liberty.

Posner's effort to forge an alliance with the libertarians is interesting because once we abandon the hopeless effort to justify Kaldor-Hicks wealth-maximizing institutions on the grounds that the losers consent to their losses by accepting *ex ante* compensation we are left with the much more sensible argument that such institutions are justified because rational persons in a position of uncertainty would have chosen them. We are left defending wealth maximization by the use of a Rawlsian argument from the principles of rational choice under conditions of uncertainty.

Posner is confused both about what he has to argue for and how to go about arguing for it. Since compensation does not constitute consent, by accepting compensation losers do not consent to their losses or to the activities that cause them. To defend wealth maximization through the principle of consent Posner does not have to show that each individual loser consents to the loss; he has to show only that each individual would choose to take the risk of losing. Individuals do not have to consent to the loss for the losses they suffer to be fairly imposed upon them or for the institutions that give rise to the losses to be justified. The institutions themselves may be justified because they are agreed upon, and the

48. See generally R. NOZICK, *supra* note 47.

losses they give rise to justified accordingly—even if each particular loss is not consented to.

Instead of the argument Posner advances we should ascribe to him a more plausible one: Risk-neutral, rational persons facing economic choice under uncertainty would choose to pursue wealth through Kaldor-Hicks institutions. The argument for this claim would then rely on *ex ante* compensation not as constituting consent, but as a reason for preferring Kaldor-Hicks to Pareto-superior wealth improvements. If individuals would have chosen to pursue wealth through Kaldor-Hicks moves then their losses would be justified because they freely risked them, not because they have consented to them. The question then is whether the argument from rational choice can be sustained.

4. *Choice Under Uncertainty and Wealth Maximization.*—

There are really two distinct but related claims here: First, that individuals under uncertainty⁴⁹ would choose the pursuit of wealth over other social goals; second, that in pursuing wealth they would opt for Kaldor-Hicks rather than other institutional arrangements. The striking feature of Posner's argument is that he ignores entirely the first claim. His entire argument, especially its reliance on the idea of *ex ante* compensation, is directed at demonstrating that principles of rational choice would favor *ex ante* compensation, that in order to maximize wealth and minimize cost rational, risk-neutral people would choose Kaldor-Hicks over Pareto superiority.

I leave it up to the economists to worry about the validity of Posner's argument on this score, though it seems to me interesting, if ultimately implausible.⁵⁰ The real problem, however, is the one Posner fails to confront: whether rational choice under uncertainty would dictate the pursuit of wealth as opposed to, say, Rawls' two principles of justice, or to some variant of utilitarianism.

49. Posner does not impose the constraint of uncertainty while Rawls and others do. However, it is the power of Rawls' argument that he can derive or purport to derive principles of justice from an agreement involving people who do not know their current or future station in life. Why Posner leaves this constraint out is a mystery and his doing so weakens his argument significantly.

50. The argument stands or falls on the risk aversion of individuals who are supposed to make the relevant choice under uncertainty, and whether Posner is committed to any principle of equal respect that would give to each a veto over the choices of others. If each person has a veto, the most risk averse will demand a more conservative strategy than that associated with the Kaldor-Hicks test. The argument against Kaldor-Hicks is going to follow the lines of Rawls' argument against individuals in the initial position choosing the principle of utility. See J. RAWLS, *supra* note 24, at 167-83; Coleman, Possible Strategies in Defense of Economic Analysis: Why They Fail (manuscript).

After all, the claim Posner has to make is that wealth maximization is a normatively defensible first principle; not the weaker and less interesting claim that Kaldor-Hicks wealth maximization is more morally defensible than are all alternative means of promoting wealth. The latter claim may be true and the former false.

The fact is that Posner does not argue that rational individuals under uncertainty would prefer wealth maximization simpliciter to the pursuit of any or all other goals. More significantly, because wealth is not something of intrinsic value, any argument that rational persons facing uncertain choice would prefer to pursue wealth to anything else would have to be instrumentalist in nature: rational people facing uncertainty would choose to pursue wealth maximization because in doing so they would secure a desirable combination of wealth, freedom, security, and happiness, and so on. The instrumentalist argument therefore cannot be circumvented by the argument from consent. Moreover, if the instrumentalist argument is a good one, there is a sense in which the argument from rational choice is excess baggage. However, for precisely the reasons already discussed the instrumentalist argument fails.⁵¹ Because it does, any argument that relies on it, such as the putative argument from consent or rational choice, must fail as well.

IV. NONUTILITARIAN ARGUMENTS FOR PARETIANISM

I concluded Section I of this Article by noting that the weaknesses of utilitarianism as a theory of right action and obligation left the proponent of economic analysis with a choice. Either he could abandon the efficiency criteria he views as normatively unjustifiable because of their connection to utilitarianism in favor of nonutility-based efficiency criteria, or he could try to construct nonutilitarian defenses for those efficiency criteria otherwise conceived of as utilitarian. In Sections II and III, I explored and evaluated one instance of the former strategy, Richard Posner's effort to introduce and defend a nonutilitarian efficiency criterion: Wealth maximization. In this section I want to pursue the search for other nonutility-based justifications for the traditional Pareto criteria.

A. *The Pareto Criteria and Liberty*

One set of arguments for the normative use of the Pareto criteria relies on the fact that exchanges in free markets are generally

51. See Section III(A) *supra*. See also Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191, 194-97 (1980).

Pareto superior. Individuals transact when it is in their interest to do so, when each views the transaction as liable to make him or her better off. Moreover, the ultimate outcome of Pareto-superior market behavior is Pareto optimality. Individuals will engage in transactions until it is no longer in the interest of at least one of them to do so. At that point negotiations cease because there are no further mutual gains through trades to be had. In the ideal world of noncoercive markets free from transaction costs and third party effects, in which individuals are both rational and knowledgeable, the exercise of liberty leads to Pareto-optimal states of affairs through a series of Pareto-superior exchanges.

These considerations provide the bases for a number of related arguments for pursuing Pareto improvements. One argument, analogous to the one Posner briefly discusses in connection with wealth maximization, emphasizes that in exercising their liberty individuals promote efficiency. Consequently, the pursuit of Pareto efficiency is justified not because of its relationship to net utility, but because noncoercive market behavior is efficient. The moral value we attach to individual autonomy is transferred to the pursuit of efficiency.

This line of argument fails for a number of reasons. First, not all markets are Pareto efficient. For example, lack of adequate information may transform free choice into something less than Pareto-superior action. Further, it is at least plausible that some individuals acting freely make themselves worse off; freedom does not necessarily ensure increased happiness. This much we know.

One could respond that choices based on insufficient information are not totally free.⁵² To the extent market failures or inefficiencies result from inadequately informed choice, they are less than fully free. Consequently, an action that is not Pareto superior must be the result of a choice that is less than fully free.

One has to be careful not to build too much into the conditions for free, rational choice, thereby making contradictory the claim that a rational person could act freely to his detriment. As long as it is logically possible to act freely to one's detriment, it is possible that at least some market exchanges will not be Pareto superior.

A more telling objection to the autonomy argument is that pursuing Pareto superiority or optimality may require intervention in the exchange market—both at the individual and institutional

52. See Feinberg, *Legal Paternalism*, 1 CAN. J. PHILOSOPHY 105, 110-12 (1971).

level. Where the conditions of competitive equilibrium are not satisfied, a market will not secure an efficient outcome. To secure the efficient outcome, the political order must intervene in the market. In sum, not every free exchange is Pareto superior, and pursuing efficiency may sometimes require abandoning noncoercive markets. Consequently the argument from autonomy is both too weak and too strong to adequately justify the pursuit of Pareto improvements.

This discussion suggests a simple but important distinction between the market and economic approaches to social-policy problems. According to one form of economic analysis, the fundamental goal of social policy is efficiency. When the initial conditions of the Coase theorem, for example, are satisfied, efficiency may be secured through noncoercive markets. When the conditions for equilibrium are not met, however, markets will not necessarily be efficient. Consequently, pursuing efficiency often requires coercive intervention in the market.

The breakdown in symmetry between markets and efficiency suggests a tension in the underlying political morality of economic analysis. Does the proponent of economic analysis support the market because of its connection to personal autonomy in spite of its inefficiency; or does the defender of the economic approach to law advocate pursuing efficiency, even if this means abandoning the free market. In other words, is the underlying political morality of economic analysis libertarian or utilitarian?⁵³

Posner's principle for justified market intervention, the principle of "mimicking or simulating the market"⁵⁴ appears to exacerbate the problem since it is unclear which aspect of the market—autonomous free exchange or efficient outcomes—the legal order is supposed to mimic.⁵⁵ Following Posner, proponents of economic analysis seem to hold the view that where markets fail and coercive intervention is required legal rules should be formulated to produce the result the market would have had the market been capable of exchanges that lead to efficient outcomes.⁵⁶ They opt, in other words, for the efficient outcome aspect of markets rather than their autonomous exchange component.

As I have argued here and in more detail elsewhere,

53. It may turn out to be neither. See pp. 543-46 *infra*.

54. See *Efficiency, Exchange, and Auction*, *supra* note 1, at 239.

55. See *id.* at 242-46.

56. See Posner, *supra* note 3, at 120.

entitlement assignments according to the principle of mimicking markets involve the Kaldor-Hicks efficiency standard.⁵⁷ This assignment rule is meant to *replace* free, but inefficient, market exchanges; therefore, the rule cannot be justified as involving the exercise of liberty.⁵⁸ Second, since the assignment rule involves the Kaldor-Hicks rather than the Pareto-superior efficiency criteria, no *particular* assignment based on it can be justified on utilitarian grounds simply because Kaldor-Hicks is not an index of utility.

This is paradoxical. Market failures reveal the tension that exists between the apparently competing moralities of libertarianism and utilitarianism in economic analysis. In responding to market failure by the use of Kaldor-Hicks interventions, however, one's policies do not receive support from either principles of liberty or utility. Intervention by its very nature is coercive and therefore incompatible with the free exchange ideal of libertarianism; and an intervention that is Kaldor-Hicks efficient may or may not increase utility. Certainly in the absence of a *known* standard of interpersonal-utility comparison we have no reason to think that any particular assignment of legal rights does.

One way out of this paradox is to argue as follows: Suppose market interventions and subsequent assignments of entitlements are restricted to cases in which the result is Pareto optimal. Those interventions would be both Kaldor-Hicks efficient and Pareto optimal. We could argue that the interventions are justified not because they are Kaldor-Hicks efficient, but because they are Pareto optimal. Yet that will not take us very far if what we are seeking is some normative justification for the intervention. Once again, the mere fact of intervention precludes the possibility of the libertarian defense. The fact that the result of the intervention is Pareto optimal will not suffice to tell us anything about whether the intervention increases total utility. In short, intervening in the market to secure a Pareto-optimal result may not be justifiable on either libertarian or utilitarian grounds.

The claim that a market intervention is justified because it is Pareto optimal, not because it is Kaldor-Hicks efficient, is problematic in a much deeper way. Indeed, the entire enterprise of normative law-and-economics, which would have us justify intervening in

57. See *Efficiency, Exchange, and Auction*, *supra* note 1, at 237-42.

58. The libertarian is not opposed to all intervention. He restricts the justification of intervention to those cases involving one person's harming another. The proponent of economic efficiency, however, endorses intervention wherever conduct is inefficient, even if it is otherwise unharmed.

inefficient markets to promote or secure efficiency, involves a deep theoretical error. The error is in thinking that any Pareto-optimal point or distribution is better from the point of view of economic efficiency than any non-Pareto-optimal, inefficient distribution. That this is a mistake is easy enough to show. The claim that intervention to promote efficiency is justified whenever the market is inefficient presupposes that efficiency (Pareto optimality) is preferable to inefficiency. As everyone familiar with economic theory knows, however, not every Pareto-optimal distribution is preferable to every non-Pareto-optimal one. Pareto-optimal distributions are preferable on economic grounds only to distributions represented by points to their southwest. All other points are Pareto noncomparable.

The only way out of this problem is to require compensation of losers in all interventions. Then, if the result is Pareto optimal, it is secured via a Pareto-superior path, one that increases utility and may be justifiable at least on utilitarian grounds. Unfortunately, an assignment rule that required compensation would be inefficient whenever the costs of compensation were nontrivial, that is, most of the time.⁵⁹

This point can be made in the following manner. You are a proponent of normative economic analysis of law. You believe that the law should keep its hands clear of free exchanges between individuals, provided their exchanges are efficient. When markets fail to promote efficiency you contend that the law ought to intervene and rearrange affairs among the relevant parties to produce the efficient result the market would have had it not failed.

I ignore the enormous information problems involved in trying to determine which outcomes the market would have reached. Instead, I ask you this question: why do you think intervening in the market is justified?

You respond first that the intervention increases utility. (You are too smart to claim that the economic intervention is justified on *libertarian* grounds.)

I respond that the intervention most likely involves a Kaldor-Hicks improvement. Because of both the interpersonal-comparability problem and the Scitovsky Paradox, a Kaldor-Hicks improvement, I point out, need not increase utility. Certainly, from the fact that the intervention is Kaldor-Hicks efficient, we have no reason to suppose that it does.

59. *Efficiency, Exchange, and Auction*, *supra* note 1, at 242-46.

Then you point out that the intervention not only involves a Kaldor-Hicks improvement, but—information-cost problems again set aside—the result is a Pareto-optimal arrangement of resources. You tell me that because the resulting distribution is Pareto optimal, not because it is Kaldor-Hicks efficient, there is a net increase in utility. I point out that it does not follow from the fact that a distribution of resources is Pareto optimal that the move to it increases total utility.

You agree, but then you say that the justification for the intervention has really little to do with utilitarianism anyway. Rather, while the conditions of free exchange have led to inefficiency, the legal order has secured efficiency. Efficiency is preferable to inefficiency.

But you are wrong. In economic theory, not every efficient distribution is preferable to every nonefficient one. Only points to the southwest of a point on the utility/possibility frontier represent less preferable distributions. About the relationships between the points representing the remainder of possible distributions of resources, economics has precious little to say. So I ask, rhetorically this time: what is the economic efficiency-related justification for the intervention?

The overall point is not just that a tension exists in the underlying political morality of economic analysis between libertarianism and utilitarianism. It is that once one uses economic analysis to recommend market interventions, one may be doing so without the support of either libertarianism or utilitarianism or, for that matter, simple economics.

B. Paretianism and Consent

An adequate nonutilitarian defense of Paretianism cannot rely entirely on the efficiency of free choice as revealed in noncoercive market behavior, for it is possible to envision efficient institutions other than the market. The free-market argument for Paretianism is at best a tie breaker—whenever a Pareto-efficient state of affairs may be secured through market and nonmarket means, choose the market because of its reliance on individual free choice.

Suppose one could argue, as Posner does, that an action is justified if it is consented to. An individual might consent to an action that is Pareto superior either by freely engaging in a transaction or by accepting full and adequate compensation for a loss resulting from some institutional arrangement or policy. In both cases the move is Pareto superior; in both cases, the relevant par-

ties give their consent to the course of action or policy that promotes efficiency. In both cases, the action is justified because it is consented to. The only difference between these cases is the action that constitutes or specifies consent. In the first case, consent is given by free exchange; in the second, it is given by the relevant parties accepting compensation *ex post*.⁶⁰

Suppose then we try to construct an argument for both Pareto superiority and Pareto optimality from consent.⁶¹ On its behalf, we can note that the argument from consent is more general than the argument from liberty. Indeed, the argument from liberty is just a particular instance of the argument from consent; in some cases consent is given by free and rational exchange. Moreover, the consent argument will justify Pareto superiority in cases in which Pareto improvements are not secured through free and rational exchanges.

Unfortunately, this argument is of the wrong sort to justify Paretianism. It justifies only a given set of Pareto-superior states of affairs, namely those that are consented to. It does not provide a moral reason for pursuing Pareto improvements. This argument says that there are Pareto improvements that are consented to and that are justified on that basis. The argument is of the wrong sort to show that every Pareto-superior move would be consented to or that it would be consented to because it would be Pareto superior.⁶²

60. But, as I have already argued, accepting compensation *ex post* need not constitute consent. See Section III(B)(3) *supra*.

61. Interestingly enough, Nicholas Kaldor (of the Kaldor-Hicks test) early on conceived of the Pareto-superior test as rooted in the principle of consent. In discussing a reference to the employment of the Kaldor-Hicks principle Kaldor notes, "This principle, as the reader will observe, simply amounts to saying that there is no interpersonal comparison of satisfactions involved in judging any policy designed to increase the sum total of wealth just *because any such policy could be carried out in a way as to secure unanimous consent*." Kaldor, *Welfare Propositions of Economics and Interpersonal Comparisons of Utility*, 49 *ECON. J.* 549, 551 n.1 (1939) (emphasis added).

Kaldor was here defending his "hypothetical compensation principle" by arguing that *were* compensation actually paid a Kaldor-Hicks move would be a Pareto-superior one, one which would be justified because—as a Pareto-superior one—it would be consented to.

62. Kaldor's argument is inadequate in its own terms, since one cannot extend the consent argument from Pareto superiority to Kaldor-Hicks simply because Pareto superiority is *not* Kaldor-Hicks. To say that people *would* consent to a Pareto-superior move is not to say that they in fact consent to a Kaldor-Hicks move just because it *could* be a Pareto-superior move. In fact it is not; and because it is not, there is no reason to think people would consent to it in virtue of its potential to be some-

An adequate defense of the normative use of the Pareto criteria requires an argument from hypothetical not actual consent. One would have to argue that individuals under certain constraints would choose Paretianism as a moral maxim. The argument would go as follows: An action is Pareto superior if it makes no one worse off and at least one person better off; rational, self-interested individuals would offer no objection to such policies; therefore, such policies are justified, and because they are justified in the abstract, it is no wonder that in particular cases individuals give their consent to them either by exchange or through their acceptance of compensation.

This argument is of the right sort, but it is not persuasive. Whether an individual would consent to all policies and institutional arrangements that worked to the advantage of some but which were harmless to the interests of others would depend on his theory of rights and deserts. For example, monopolies are sometimes inefficient. In breaking up a monopoly in the name of efficiency, we can either compensate the monopolist or fail to. If we compensate her, the policy is Pareto superior; if not, it is Kaldor-Hicks efficient. What moral argument could one advance in favor of pursuing the Pareto-superior rather than the Kaldor-Hicks-efficient policy? Generally, a policy that makes *A* better off and no one worse off would be Pareto superior, even if *A* had no right to be made better off, or if he deserved to be made worse off, or even if *B* not *A* should have been better off. Until we know something about the rights and deserts of individuals affected by alternative courses of conduct, we should remain agnostic about the moral value of those policies that would otherwise be recommended to us as Pareto superior. In the absence of a prior nonefficiency-based theory of rights and moral deserts, it would be irrational to consent to Pareto superiority as a moral maxim.⁶³

Can a similar but more successful argument be made for

thing other than it is. If a move is Pareto superior that does not mean it has been consented to; remember the traffic accident case. We could always *define* Pareto superiority in a way that obviated this problem: *S*₁ is Pareto superior to *S* if and only if everyone prefers *S*₁ to *S*. In that case, a move that is Pareto superior is consented to, since in order to be Pareto superior everyone must prefer it. However, the connection between Pareto superiority and consent is then *analytic* or conceptual. The fact that one state of affairs is Pareto superior to another state of affairs could not then constitute a *reason* for consenting to the move since the claim that it is Pareto superior would mean by definition that it had been consented to.

63. See also *Efficiency, Exchange, and Auction*, *supra* note 1, at 247-49.

Pareto optimality? The set of Pareto-optimal states of affairs that can be generated by an economy in general competitive equilibrium is represented by points on the "contract curve." The contract curve gets its name from the fact that it connects points in an Edgeworth box that represent states of affairs producers and consumers would freely exchange (or contract) to.⁶⁴ Because Pareto optimality may be represented as the outcome of free exchanges, one could argue that rational persons would consent to institutional arrangements and courses of conduct that are efficient. In other words, what objection would an individual have to pursuing an efficient allocation of resources if such an allocation would have resulted from one's free action.

This argument will not work. One can secure Pareto-optimal outcomes through Pareto-superior, non-Pareto-superior, or Kaldor-Hicks-efficient steps. In other words, we can reach a Pareto-optimal result in a particular case by making no individuals worse off or by making some individuals worse off. It is unlikely that a rational individual would have no objection to pursuing optimal outcomes without regard to the path used to reach them. Once the question of path arises, however, the question of whether in every case to prefer Pareto superior to Kaldor-Hicks follows, and as we have just seen, a resolution of that matter requires a nonefficiency based theory of rights and moral desert.

V. CONCLUSION

I want to close with two related remarks. One concerns the limits of economic analysis; the other concerns the economic theory of adjudication.

A. *Positive and Normative Economics*

One can do economic analysis of law in two seemingly related, but really quite distinct ways. The first way, which I will call "positive economic analysis," involves evaluating, for example, a set of possible tort rules to determine which, if any, would be efficient in the sense of securing the optimal number of accidents. John Brown and William Holahan's article *Taxes and Legal Rules for the Control of Externalities When There are Strategic Responses*⁶⁵ is a good example of this sort of economic analysis as is the majority of

64. See note 8 *supra*.

65. Brown and Holahan, *Taxes and Legal Rules for the Control of Externalities When There are Strategic Responses*, 9 J. LEGAL STUD. 165 (1980).

work by A. Mitchell Polinsky⁶⁶ and Steven Shavell.⁶⁷ In all of this work, the authors are committed to the existence of a Samuelson-like social-welfare function,⁶⁸ of which Pareto optimality is a necessary but not a sufficient condition. As economists they seek to determine which sort of rules or policies would be efficient in the abstract. At its purest, this sort of economic analysis says nothing about the types of policies governments should impose at the present time or the kinds of judicial opinions judges should reach.

The second sort of economic analysis views economic efficiency as a goal both of current social policy and judicial behavior and argues that governments should intervene in human affairs or rearrange sociopolitical and legal institutions to promote efficiency. This sort of economic analysis is exemplified by much, though not all, of Posner's work, and it is economic analysis of this sort that is subject to the kinds of criticisms I have been advancing. That is, once one advocates a change in the existing order the question of the justification for doing so arises. With that question follow others about the dislocation effects of the change—who will be made worse off, who better, and by how much. Then the issue of Kaldor-Hicks versus Pareto superiority comes to the fore, and with it all the questions regarding their alleged utilitarian or libertarian normative bases. The point is that when proponents of economic analysis do what most of them normally do, that is, propose social policy, they get into trouble of the sort I have been drawing attention to. In the more restrained quarters, economists avoid many, but not all of these problems.⁶⁹

B. *Economics and Adjudication*

Suppose that none of my objections to the various normative strategies for defending the pursuit of Pareto efficiency are persua-

66. See, e.g., Polinsky, *Private Versus Public Enforcement of Fines*, 9 J. LEGAL STUD. 105 (1980); Polinsky, *Probabilistic Compensation Criteria*, 86 Q. J. ECON. 407 (1972).

67. See, e.g., Shavell, *Strict Liability Versus Negligence*, 9 J. LEGAL STUD. 1 (1980); Shavell, *Accidents, Liability, and Insurance*, Harv. Inst. Econ. Research Discussion Paper No. 685 (June 1979).

68. P. SAMUELSON, *FOUNDATIONS OF ECONOMIC ANALYSIS* 219-30 (1947).

69. After all, we could wonder why we should be concerned about which liability rules are efficient. There must be a policy reason behind interests; and as long as there is, the question of the normative roots of efficiency will be with us. Still, there is a difference between saying—if you want to promote utility or wealth then these are the rules you should adopt—and saying—because these rules would promote utility or wealth in the abstract we should adopt them.

sive and that Paretianism constitutes an adequate moral theory. Suppose even that wealth maximization does so as well. It still would not follow that judges in particular cases had the authority to resolve disputes on the basis of efficiency criteria. It does not follow from the fact that in general we ought to pursue efficiency that every actor or agent, regardless of his or her institutional role and circumstance, has the obligation or authority to promote efficiency. An argument that judicial behavior should be structured by efficiency considerations, requires a further theory of institutional competence. The question is whether judges have the authority to seize upon a private dispute framed by and in terms of the respective litigant's interest as an opportunity to promote desirable social policies, for example, efficiency and distributional justice.

The alternative and I believe common sense view is that the responsibility of a judge is to determine which of the litigants in a dispute has the relevant legal right.⁷⁰ It may be that in determining which party is entitled to a decision in its favor the judge must take account of efficiency considerations. He or she might hold that an individual who suffers harm caused by the unreasonably risky conduct of another is entitled to compensation. Following Learned Hand,⁷¹ he or she might then go so far as to provide an economic analysis of fault or negligence. The fact that an economic argument is relevant to determining fault, for example, does not show that liability based on fault is justified on efficiency grounds, or that in awarding compensation to the plaintiff in a particular negligence case the judge is following an economic theory of adjudication. It is perfectly possible to describe the judicial behavior as follows: The judge is trying to determine which party has a right to the decision; the theory of legal rights he or she believes is correct has as a consequence that individuals who suffer from the economically inefficient conduct of others are entitled to compensation. Consequently, determining whether a particular plaintiff is entitled to recompense would require some sort of economic argument.

The difference between proponents of economic analysis and critics such as Dworkin and myself—on this question at least—is that we have different theories of institutional competence generally, and of adjudication in particular. The advantage of our way of

70. See R. DWORKIN, *TAKING RIGHTS SERIOUSLY* 35-36 (1977).

71. *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947) (so-called Hand Formula).

looking at the problem is this: We draw a distinction between what, on balance, it is morally right or defensible to do, and what a particular person, occupying an institutional role, has authority to do. Even were we to agree that pursuing efficiency would be morally defensible, we would argue that it is a further question whether judges have the authority to do so. In addition, we argue that adjudication primarily—or always—concerns rights rather than the promotion of some useful social policy while at the same time it provides a substantial and meaningful role for economic argument. The economic theory of adjudication, however, because it views private disputes in terms of global interests and social goals explains the reference to economic argument in adjudication at the expense of the common sense view of law as concerned with rights and obligations—rights and obligations it is the court's duty to enforce rather than create.⁷²

72. For a fuller discussion, see Coleman, Book Review, 66 CALIF. L. REV. 885 (1978) (reviewing R. DWORKIN, *supra* note 70).

