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THE ETHICAL AND POLITICAL BASIS OF THE EFFICIENCY NORM IN COMMON LAW ADJUDICATION

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In a recent article I argued that a society which aims at maximizing wealth, unlike a society which aims at maximizing utility (happiness), will produce an ethically attractive combination of happiness, of rights (to liberty and property), and of sharing with the less fortunate members of society.[1] Evidently, I did not explain adequately why this combination was ethically attractive.[2] The present Article began as an attempt to extend the argument of the last one by considering this question in greater depth. But as the paper took shape, it became both narrower and broader than the original conception. It narrowed as my interest shifted to showing that wealth maximization was an ethically attractive objective to guide common law adjudication, rather than social choice generally.[3] It broadened as I began to see that the same considerations which made wealth maximization an ethically attractive norm in common law adjudication might help to explain why it has played an important role in shaping the substantive rules and procedures of the common law.[4]

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

2. *See* Dworkin, *Is Wealth a Value?*, 9 J. LEGAL STUD. 191 (1980); Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227 (1980). I reply to these critics in Posner, *The Value of Wealth: A Reply to Dworkin and Kronman*, 9 J. LEGAL STUD. 243 (1980).

3. I consider it an attractive objective to guide social choice generally, but do not pursue the argument for that position in this Article.

4. For a recent statement of the "efficiency theory" of the common law, see Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281, 288-95 (1979).

The main ethical argument of this Article, developed in the first section, is that wealth maximization, especially in the common law setting, derives support from the principle of consent that can also be regarded as underlying the otherwise quite different approach of Pareto ethics. The second section shifts the focus from normative to positive. I argue that the political counterpart of consent—consensus—explains the role of wealth maximization in shaping the common law. The principle of consent supports the wealth-maximization norm in the common law setting precisely because common law judges deal with problems, and by methods, in which redistributive considerations are not salient. This means that consent to efficient solutions can be presumed; but it also means that politically influential groups can do no better, in general, than to support efficient policies. Such policies maximize aggregate wealth in a setting where, by hypothesis, altering the shares (redistribution) is not a feasible means by which a group can increase its wealth. I also briefly discuss whether the common law is utilitarian or wealth maximizing.

THE CONSENSUAL BASIS OF EFFICIENCY

From Pareto to Kaldor-Hicks

Pareto superiority is the principle that one allocation of resources is superior to another if at least one person is better off under the first allocation than under the second and no one is worse off.[5] Pareto invented the principle as an answer to the traditional problem of practical utilitarianism, that of measuring happiness across persons for purposes of determining the effect of a policy on total utility.[6] The change to a Pareto-superior allocation must yield a net increase in utility, since no one is made worse off and at least one person is made better off by the change, even though the *amount* by which total utility has been increased may not be measurable.

But, as is well known,[7] the solution is apparent rather than real. Because of the impossibility of measuring utility directly, the

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5. For a lucid discussion of Pareto ethics by a philosopher, see Coleman, *Efficiency, Exchange, and Auction: Philosophic Aspects of the Economic Approach to Law*, 68 CAL. L. REV. 221 (1980). And for a good recent textbook treatment by an economist, see C. PRICE, WELFARE ECONOMICS IN THEORY AND PRACTICE (1977).

6. *See* V. TARASCIO, PARETO'S METHODOLOGICAL APPROACH TO ECONOMICS 79-84 (1968).

7. *See, e.g.*, G. CALABRESI & P. BOBBITT, TRAGIC CHOICES 83-85 (1978).

only way to demonstrate that a change in the allocation of resources is Pareto superior is to show that everyone affected by the change consented to it. If *A* sells a tomato to *B* for $2 and no one else is affected by the transaction, we can be sure that the utility to *A* of $2 is greater than the utility of the tomato to *A*, and vice versa for *B*, even though we do not know how much *A*'s and *B*'s utility has been increased by the transaction. But because the crucial assumption in this example, the absence of third-party effects, is not satisfied with regard to *classes* of transactions, the Pareto-superiority criterion is useless for most policy questions. For example, if the question is not whether, given a free market in tomatoes, *A*'s sale to *B* is a Pareto-superior change, but whether a free market in tomatoes is Pareto superior to a market in which there is a ceiling on the price of tomatoes, the concept of Pareto superiority is unhelpful. The price ceiling will result in a lower market price, a lower quantity produced, lower rents to land specialized to the growing of tomatoes, and other differences from the results of a free market in tomatoes. It would be impossible to identify, let alone negotiate for the consent of, everyone affected by a move from a price-regulated to a free tomato-market, so the criterion of Pareto superiority cannot be satisfied. Stating this conclusion differently, one cannot say that the movement to a free market would increase total utility or, conversely, that if we had a free market in tomatoes, imposing a price ceiling would reduce total utility.[8]

I have been speaking thus far of Pareto ethics and specifically of the concept of Pareto superiority as an answer, though not a practical one, to the utilitarian's problem of the interpersonal comparison of utilities. But 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

8. The revealed-preference approach, *see generally* P. SAMUELSON, FOUNDATIONS OF ECONOMIC ANALYSIS 146-56 (1947), offers a method, unfortunately not very practical either, of determining whether a change is Pareto superior that does not require express consent. Imagine that *C* is a third party affected by the transaction between *A* and *B* in the example in the text. Before the transaction, *C*'s income is *X* and he uses it to purchase commodities *a* . . . *n*. The transaction may affect *C*'s income, as well as the prices of *a* . . . *n*. If, however, after the transaction *C*'s income, now *Y*, is large enough to enable him to purchase *a* . . . *n* at their current prices, then we may say (without having to consult *C*) that the transaction between *A* and *B* did not make him worse off. But the information necessary to apply this approach is rarely available, in part because some of the commodities that *C* buys may not be priced in any market (love, respect, etc.) and his ability to obtain them may be adversely affected by the transaction between *A* and *B*.

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. It is not the theoretical basis, at least if Pareto superiority is viewed as a tool of utilitarian ethics, because if the utilitarian could devise a practical utility-metric he could dispense with the consensual or transactional method of determining whether an allocation of resources was Pareto superior; indeed, he could dispense with the concept of Pareto superiority itself.

Suppose we consider consent an ethically attractive basis for permitting changes in the allocation of resources, on Kantian grounds unrelated to the fact that a consensual transaction is likely to increase the happiness at least of the immediate parties to it. We are then led, in the manner of Nozick and Epstein,[9] to an ethical defense of market transactions that is unrelated to their effect in promoting efficiency either in the Pareto sense or in the sense of wealth maximization.

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. But the setting is a special one. For example, suppose that a company decides to close a factory in town *A* and open a new one in *B*, and that in neither location are there significant pollution, congestion, or other technological externalities from the plant. The move may still lower property values in *A* and raise them in *B*, making landowners in *A* worse off and those in *B* better off. The parties to the move will not take account of these effects and their failure to do so makes it impossible for the plant's move to satisfy the criterion of a Pareto-superior move.[10]

That the third-party effects are merely "pecuniary" externalities, meaning that they result simply from a change in demand rather than from the consumption of some scarce resource (*e.g.*, clean air, in the case of pollution, which is a technological externality), or, stated otherwise, that they have no net effect on the wealth of the society, is irrelevant from the standpoint of Pareto superiority. Not only is it impossible to say that no one will be

9. *See* R. NOZICK, ANARCHY, STATE, AND UTOPIA (1974); Epstein, *Causation and Corrective Justice: A Reply to Two Critics*, 8 J. LEGAL STUD. 477, 487-88 (1979).

10. I ignore for the moment the possibility of ex ante compensation of the affected landowners. *See* p. 492 *infra*.

made worse off by the plant move, but it is in fact certain that some people will be made worse off—the landowners in *A* and others, such as workers in *A* who have skills specialized to the plant that is being closed and positive costs of relocating in *B*. By the same token—and here the relationship of the Pareto-superiority criterion to utilitarian thought is clear—one cannot be sure that the move will increase total utility.[11] The disutility to the losers from the move may exceed the utility to the winners, even though, by the assumption that only pecuniary externalities are involved, the total wealth of the people affected by, but not party to, the transaction is unchanged, so that the transaction is wealth maximizing.

In a case such as the one I have put, the wealth-maximization criterion elaborated in my previous Article indicates that the transaction should be allowed. So, equivalently, as Jules Coleman has pointed out, does the Kaldor-Hicks criterion (sometimes called "Potential Pareto Superiority"), which requires, not that no one be made worse off by the move, but only that the increase in value be sufficiently large that the losers could be fully compensated.[12] Since the decrease in land values in *A* is matched by the increase in *B*, in principle (*i.e.*, ignoring transfer costs) the landowners in *A* could be compensated and then no one would be worse off. But neither the Pareto criterion itself nor the utilitarian imperative underlying the Pareto criterion—to maximize utility—would be satisfied, because there is no way of knowing whether the utility to the winners of not having to pay compensation will exceed the disutility to the losers of not receiving compensation. Suppose the landowners in *A* incurred a loss of 100 utiles (an arbitrary measure of utility) because of the $1 million decrease in property values in *A* resulting from the move of the plant, while the landowners in *B* obtained only 80 utiles from the $1 million increase in their property values. The Kaldor-Hicks criterion would be satisfied but the Pareto-superiority criterion would not be.

Wealth Maximization and the Principle of Consent

I want to defend the Kaldor-Hicks or wealth-maximization approach, not by reference to Pareto superiority as such or its utili-

11. The externalities could be internalized by the cities' offering tax inducements to the plant's owner. But that would not make the plant's moving (or remaining) Pareto superior, since those people who paid the higher taxes necessary to finance these inducements would be worse off.

12. *See* Coleman, *supra* note 5, at 239-42.

tarian premise, but by reference to the idea of consent that I have said provides an alternative basis to utilitarianism for the Pareto criterion. The notion of consent used here is what economists call ex ante compensation.[13] I contend, I hope uncontroversially, that 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. Many of the involuntary, uncompensated losses experienced in the market, or tolerated by the institutions that take the place of the market where the market cannot be made to work effectively, are fully compensated ex ante and hence are consented to. Suppose some entrepreneur loses money because a competitor develops a superior product. Since the return to entrepreneurial activity will include a premium to cover the risk of losses due to competition, the entrepreneur is compensated for those losses ex ante. Similarly, the landowners in *A*, in my previous example, were compensated when they bought the land. The probability that the plant would move was discounted in the purchase price that they paid.[14]

The concept of ex ante compensation provides an answer to the argument that the wealth-maximization criterion, applied unflinchingly in market settings such as my plant-relocation example, would violate the principle of consent. A more difficult question is raised, however, by the similar attempt to ground nonmarket, but arguably wealth-maximizing institutions, such as the embattled negligence system of automobile accident liability, in the principle of consent. In what sense may the driver injured by another driver in an accident in which neither was at fault be said to have consented to the injury, so as not to be entitled, under a negligence system, to compensation?

To answer this question, we must consider the effect on the

13. The argument that follows is sketched in Posner, *Epstein's Tort Theory: A Critique*, 8 J. LEGAL STUD. 457, 460, 464 (1979). A similar argument is made independently in Michelman, *Constitutions, Statutes, and the Theory of Efficient Adjudication*, 9 J. LEGAL STUD. 431, 438-40 (1980). Both arguments resemble a position taken by many welfare economists: that the Kaldor-Hicks criterion for deciding whether to undertake a public project satisfies the Pareto-superiority criterion provided that there is a sufficient probability that an individual will benefit in the long run from such projects, though he may be a loser from a particular one. *See* Polinsky, *Probabilistic Compensation Criteria*, 86 Q.J. ECON. 407 (1972), and references cited therein.

14. A parallel, but because of possible information costs more difficult, case is that of the worker who loses his job and incurs positive relocation costs when the demand for his services collapses as a result of the development of a superior substitute product.

costs of driving of insisting on ex post compensation, as under a system of strict liability. By hypothesis they would be higher; otherwise the negligence system would not be the wealth-maximizing system and no issue of justifying wealth maximization by reference to the principle of consent would arise. Would drivers be willing to incur higher costs of driving in order to preserve the principle of ex post compensation? They would not. Any driver who wanted to be assured of compensation in the event of an accident regardless of whether he was at fault need only buy first-party, or accident, insurance, by hypothesis at lower cost than he could obtain compensation ex post through a system of strict liability.

This can be most easily visualized by imagining that everyone involved in a traffic accident is identical—everyone is the same age, drives the same amount, and so on. In these circumstances everyone will pay the same rate for both liability insurance and accident insurance. The difference between negligence and strict liability will be that under negligence, liability-insurance rates will be lower and accident insurance rates higher, because fewer accidents will give rise to liability, while under strict liability the reverse will be true. But if, as I am assuming, negligence is the more efficient system, the *sum* of the liability and accident insurance premiums will be lower under negligence,[15] and everyone will prefer this.

All this assumes, of course, that people are identical; the implications of relaxing that assumption will be considered later. It also depends on my initial assumption that negligence is a cheaper system of automobile accident liability than strict liability would be. But that assumption is immaterial to my basic point, which is that an institution predicated on wealth maximization may be justifiable by reference to the consent of those affected by it even though the institution authorizes certain takings, such as the taking of life, health, or property of an individual injured in an accident in which neither party is negligent, without requiring compensation ex post.

I have used the example of negligence versus strict liability because it has been used to argue that the wealth-maximization approach is inconsistent with an approach consistent with notions of

15. This assumes that all accident costs are reflected in insurance rates. Most accident-prevention costs (*e.g.*, the value of time lost in driving more slowly) are not. Presumably these costs would also be higher under strict liability if that is indeed the less efficient liability rule.

personal autonomy or, in the terminology of this Article, consent.[16] Other examples could be offered, but it is not the purpose of this Article to deduce the institutional structure implied by wealth maximization; it is to show that social institutions that maximize wealth without requiring ex post compensation need not on that account be viewed as inconsistent with an ethical system premised on the principle of consent.

Some may object to the above analysis on the ground that the consent on the basis of which I am prepared, in principle at least, to justify institutions such as the negligence system is fictitious because no one has given his *express* consent. It would indeed be naïve to regard the political survival of negligence in the automobile accident arena as evidence of such consent; the radical imperfections of the political system in registering preferences are the subject of a vast literature in social choice and in the economic theory of legislation.[17] Nevertheless, the objection founders, in my opinion, precisely on the unavailability of a practical method of eliciting express consent, not so much to individual market transactions—though even there the consent of third parties affected by those transactions often cannot feasibly be elicited[18]—as to *institutions*, such as the negligence system or indeed the market itself. If there is no reliable mechanism for eliciting express consent, it follows, not that we must abandon the principle of consent, but rather that we should look for implied consent, as by trying to answer the hypothetical question whether, if transaction costs were zero, the affected parties would have agreed to the institution. This procedure[19] resembles a judge's imputing the intent of parties to a contract that fails to provide expressly for some contingency. Although the task of imputation is easier in the contract case, that case is still significant in showing that implicit consent is a meaningful form of consent. The absence of an underlying contract is relevant to the confidence with which an inference of implicit consent can be drawn rather than to the propriety of drawing such inferences.

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16. *See* Epstein, *A Theory of Strict Liability*, 2 J. LEGAL STUD. 151 (1973).

17. For further discussion of the economic theory of legislation, see pp. 502-06 *infra*.

18. *See* p. 489 *supra*.

19. One, incidentally, that many economists use to make judgments of Pareto efficiency. For a recent example see S. Shavell, Accidents, Liability, and Insurance 5-7 (June 1979) (Harv. Inst. Econ. Research, Discussion Paper No. 685).

To be sure, "[a] proposal is not legislation simply because all the members of the legislature are in favor of it."[20] But this is because there is a mechanism by which legislators can express actual consent to a proposal. Sometimes the mechanism is inoperative, as when a question arises as to the scope or meaning of a past legislative enactment, and then we allow the courts to infer the legislative intent. This is an example of implicit but meaningful consent.

Another objection to using consent to justify institutions which maximize wealth is that the consent will rarely be unanimous. Contrary to my earlier assumption, people are not identical ex ante. Even if the costs of driving would be higher under a system of strict liability than under a negligence system, why should nondrivers prefer the negligence system? To the extent that groups of this sort could actually be identified, one might grant them the protection of a strict liability system if one placed a high value on autonomy.[21] But this may not be required by the principle of consent. Most people who do not drive do not stay at home either; they use other modes of transportation—taxis, buses, or subways, to name a few—whose costs would by assumption be higher under a system of strict liability. Those costs, or a large fraction of them at least, would be borne by the users. Even the nondrivers might therefore consent to a negligence system of liability for transport accidents if it were cheaper than a system of strict liability.[22] No institution, of course, will command the implicit consent of everyone. But only a fanatic would insist that absolute unanimity is required to legitimize a social institution such as the negligence system.

To summarize, the wealth-maximization or Kaldor-Hicks criterion can sometimes be applied without violating the principle of consent. While Kaldor-Hicks is not a Pareto criterion as such, it will sometimes function as a tolerable and, more to the point, administrable approximation of the Pareto-superiority criterion. To attempt to defend wealth maximization on Pareto grounds, however, is to raise the following question: why should not the principle that guides society be the protection and enhancement of personal autonomy, the value that underlies the principle of consent, rather

20. Epstein, *supra* note 9, at 496.

21. As suggested in Fletcher, *Fairness and Utility in Tort Theory*, 85 HARV. L. REV. 537, 543-51 (1972). *But see* p. 496 *infra*.

22. This leaves open the possibility of further subdividing the transport industry for liability purposes, and of having one rule for buses, another for autos, etc.

than the maximization of wealth? One objection to using autonomy directly as an ethical norm, an objection well illustrated by the choice between strict liability and negligence, is that it requires an arbitrary initial assignment of rights. I assumed that the victim of an accident had some kind of moral claim to compensation, ex post or ex ante, even though the injurer was not at fault. One could equally well assume that people have a right not to be hampered in their activities by being held liable for accidents that they could not have prevented at reasonable cost. No liability denies the autonomy of the victim, and strict liability the autonomy of the injurer. To differentiate the two *when neither is at fault* is no simple task.[23]

Another objection to building an ethical system directly on the idea of autonomy is that, just as literal adherence to the Pareto-superiority criterion could be paralyzing, so the ethics of personal autonomy, interpreted and applied without regard for the consequences for human welfare, would lead to a great deal of misery. This is conceded by the adherents to the ethics of personal autonomy in modern jurisprudential thought, such as Charles Fried and Richard Epstein.[24] Wealth maximization as an ethical norm has the property of giving weight both to preferences, though less heavily than utilitarianism does, and to consent, though less heavily than Kant himself would have done. Also, as explained in my previous article, it gives weight to the human impulse, apparently genetically based, to share wealth with people who are less effective in producing it.[25]

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23. For the divergent view of Kantian philosophers on this question, see Posner, *supra* note 1, at 115 n.43.

24. *See* C. FRIED, RIGHT AND WRONG 9-10 (1978); Epstein, *Nuisance Law: Corrective Justice and Its Utilitarian Constraints*, 8 J. LEGAL STUD. 49, 74-75, 79 (1979).

25. *See* Posner, *supra* note 1, at 123, 129 n.80, arguing that the producer puts more into society than he takes out, because he cannot (barring perfect price discrimination) appropriate the entire consumer surplus generated by his production. It is true that the marginal producer creates no consumer surplus—he takes out exactly what he puts in—and so if each producer is the marginal producer none would reduce the wealth of other people by withdrawing from the market. However, not every producer is marginal; we may be reasonably confident that the American people would have been poorer if Henry Ford had decided to become a Trappist monk rather than an automobile manufacturer. More important, even in an industry where each producer is marginal and his withdrawal from the industry would not reduce consumer surplus, the withdrawal of a group of producers would. Each producer's contribution to consumer surplus is negligible but the sum of their contributions is not.

These characteristics of wealth maximization are not, as Professor Dworkin has suggested, accidental.[26] The perfectly free market, in which there are no third-party effects, is paradigmatic of how utility is promoted noncoercively, through the voluntary transactions of autonomous, utility-seeking individuals. The system of wealth maximization consists of institutions that facilitate, or where that is infeasible approximate, the operations of a free market and thus maximize autonomous, utility-seeking behavior. Because utility seeking in a market requires inducing others to enter into transactions advantageous to them, wealth is automatically transferred to those who have productive assets, whether goods or time. By the same token, those who have no productive assets have no ethical claim on the assets of others. This is not necessarily a result that maximizes utility; it is of course uncongenial to those who believe that the individual is separable from his endowments of skill, energy, and character. It is consistent, however, with a desire, rooted in the principles of autonomy and consent, to minimize coercion.

The system of wealth maximization outlined in this and my previous Article could be viewed as one of constrained utilitarianism. The constraint, which is not ad hoc but is supplied by the principle of consent, is that people may seek to promote their utility only through the market or institutions modeled on the market. As I have been at pains to stress, transactions that are consensual between the immediate parties may be coercive as to third parties. But as the negligence example showed, the amount of coercion in a system of wealth maximization is easily exaggerated; where it is wealth maximizing to deny compensation ex post, ex ante the potentially affected parties may prefer that such compensation be denied.

Comparison to Rawls' Approach

My discussion of the choice that the individual is assumed to make between negligence and strict liability systems before an accident occurs—a choice under uncertainty from which consent to a social institution is then inferred—may seem derivative of Rawls' analysis of justice.[27] In fact, both Rawls' analysis and the analysis in this Article have common roots. The "original position" approach was apparently first used by economists seeking to establish the

26. *See* Dworkin, *supra* note 2.
27. *See* J. RAWLS, A THEORY OF JUSTICE 17-22 (1971).

consensual foundations of utility maximization in a somewhat similar fashion to what I have done here.[28] As Kenneth Arrow has explained, they

> start[ed] from the position . . . that choice under risky conditions can be described as the maximization of expected utility. In the original position, each individual may with equal probability be any member of the society. If there are n members of the society and if the ith member will have utility u_i under some given allocation decision, then the value of that allocation to any individual is $\Sigma u_i\ (1/n)$, since $1/n$ is the probability of being individual i. Thus, in choosing among alternative allocations of goods, each individual in the original position will want to maximize this expectation, or, what is the same thing for a given population, maximize the sum of utilities.[29]

The twist that Rawls gave to choice in the original position was to argue that people would choose to maximize, not expected utility, but the utility of the worst outcomes in the distribution.[30] Again in the words of Arrow:

> It has, however, long been remarked that the maximin theory has some implications that seem hardly acceptable. It implies that any benefit, no matter how small, to the worst-off member of society, will outweigh any loss to a better-off individual, provided it does not reduce the second below the level of the first. Thus, there can easily exist medical procedures which serve to keep people barely alive but with little satisfaction and which are yet so expensive as to reduce the rest of the population to poverty. A maximin principle would apparently imply that such procedures be adopted.[31]

If, with Arrow, one finds expected utility a more plausible maximand than maximin is, one will be driven to the startling conclusion that utilitarianism has a firmer basis in the principle of consent than Rawls' "justice as fairness." But any theory of consent that is based on choice in the original position is unsatisfactory, not only because of the well-known difficulties of describing the preference functions of people in that position, but also because the original-position approach opens the door to the claims of the unpro-

28. *See* Arrow, *Some Ordinalist-Utilitarian Notes on Rawls's Theory of Justice*, 70 J. PHILOSOPHY 245, 250 (1973).

29. *Id.*

30. J. RAWLS, *supra* note 27, at 150-61.

31. Arrow, *supra* note 28, at 251.

ductive. In the original position, no one knows whether he has productive capabilities, so choices made in that position will presumably reflect some probability that the individual making the choice will turn out not to be endowed with any such capabilities. In effect, the choices of the unproductive are weighted equally with those of the productive. This result obscures the important moral distinction, between capacity to enjoy and capacity to produce for others, that distinguishes utility from wealth.[32] I prefer therefore to imagine actual people, deploying actual endowments of skill and energy and character, making choices under uncertainty. I prefer, that is, to imagine choice under conditions of natural ignorance to choice under the artificial ignorance of the original position.

Limitations of Wealth Maximization as an Ethical Norm Founded on Consent

The domain within which the principle of consent can supply an ethical justification for social institutions that maximize wealth is limited in at least two principal respects.

1. Where the distributive impact of a wealth-maximizing policy is substantial and nonrandom, broad consent will be difficult to elicit or impute without actual compensation. I mentioned this possibility in connection with the choice between negligence and strict liability to govern traffic accidents but it seemed unimportant there. Suppose, however, the issue was whether to substitute a proportionate income tax for the current progressive one. The substitution would increase the wealth of society if the increase in output (counting both work and leisure as output) by upper bracket taxpayers, whose marginal-tax rate would be lowered by the substitution, exceeded the reduction in output caused by raising the marginal tax rate of lower bracket taxpayers. However, unless the net increase in output was sufficiently great to result in an increase in the after-tax incomes even of those taxpayers who would be paying

32. My concept of wealth includes, as noted in the previous article, Posner, *supra* note 1, at 105 n. 11, the dollar value (or cost) that people who are not risk-neutral attach to uncertain outcomes. Thus, my concept is similar to what most economists mean when they say expected utility. I avoid the latter word, however, because utilitarian philosophers (and perhaps implicitly therefore those economists who think of themselves as applied utilitarians) do not differentiate between preferences backed by willingness to pay and preferences backed simply by desire. In my analysis, only the former preferences enter into a determination as to which choices are wealth maximizing.

higher taxes under a proportionate than under a progressive income tax—and let us assume it was not—the lower bracket taxpayers could hardly be assumed to consent to the tax change, even though it would be wealth maximizing.

I was first stimulated to investigate the ethical foundations of wealth maximization by the suggestion that it was too unappealing a value to ascribe to common law judges.[33] Yet it is precisely in the context of common law adjudication, as contrasted with the redistributive statutory domain illustrated by my tax example, that a consensual basis for wealth maximization is most plausible. The rules that govern the acquisition and transfer of property rights, the making and enforcement of contracts, and liability for accidents and the kinds of naked aggression that were made crimes at common law are supported by a broad consensus and distribute their benefits very widely. For example, only a naïve analysis of the economic consequences of refusing to enforce the leases that poor people sign with presumably wealthier landlords would conclude that the poor would be better off under such a regime. Landlords would either charge higher rentals because of the greater risk of loss or shift their property into alternative uses, so that the low-income housing supply would be smaller and its price higher.[34] If we can generalize from this example that the choice between common law rules usually does not have systematic distributive consequences, then it is reasonable to suppose that there is—or would be, if it paid people to inform themselves in these matters—general consent to those common law rules that maximize wealth. If so, a common law judge guided by the wealth-maximization criterion will at the same time be promoting personal autonomy.

2. Another area in which the principle of consent and the principle of wealth maximization are potentially in conflict, aside from redistributive policies such as those embodied in the progressive income tax, is in the initial assignment of property rights, the starting point for a market system.

What if *A*'s labor is worth more to *B* than to *A*? Then it would be efficient to make *A* the slave of *B* but this result would hardly comport with the principle of consent. Such cases must be very rare. Not only will *A* probably have a better idea than anyone else

33. For a recent statement of this argument, see Michelman, *A Comment on Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 307, 308 (1979).

34. Komesar, *Return to Slumville: A Critique of the Ackerman Analysis of Housing Code Enforcement and the Poor*, 82 YALE L.J. 1175, 1187-91 (1973).

where he could be most productively employed, but the costs of overcoming *A*'s disincentive to work hard when the benefits of his hard work would enure exclusively to another are likely to make the net value of his labor less than if he owned it himself. If there are cases where the costs of physical coercion are so low relative to the costs of administering contracts as to make slavery a more efficient method of organizing production than any voluntary system, they either arise under such different social conditions from our own as to make ethical comparison difficult,[35] or involve highly unusual circumstances (*e.g.*, military discipline) to which the term slavery is not attached.

A related problem is that where large allocative questions are involved, as in the initial assignment of rights, the very concept of wealth maximization becomes problematic. Since the wealth of society is the output of all tangible and intangible commodities multiplied by their market values, it is difficult to compare the wealth of two states of society in which prices are different. The prices in a social order in which one person owned all the other members of society might be different from the prices in a social order where everyone was his own master. But even here guesses may be possible. For example, if we started with a society where one person owned all the others, soon most of the others would have bought their freedom from that person because their output would be greater as free individuals than as slaves, enabling them to pay more for the right to their labor than that right was worth to the slave owner.[36] It would be clear, then, that the slave society was inefficient, even though the prices in a slave and free society might be different for many commodities.

Consider the following example of how the initial assignment of rights might appear to have such an effect on prices that the wealth of society under alternative assignments could not be compared.[37] Imagine that *A*, if a free man, would derive a lifetime market income of 100 in present value from working and a nonmarket income of 50 from leisure, for a total income of 150, but that if *A* is *B*'s slave, *A* will be forced to produce an output having a market value of 110 and will obtain zero nonpecuniary income.

35. On the costs of monitoring economic activity in primitive societies, see Posner, *A Theory of Primitive Society, with Special Reference to Law*, 23 J.L. & ECON. 1 (1980).

36. The slave would borrow against his future earnings to finance the purchase of his freedom.

37. A similar example is analyzed in Dworkin, *supra* note 2, at 208-10.

A's wealth is higher in the free than in the slave state (150 versus zero), so that if he has the right to his labor he will not sell that right to *B*. Freedom is therefore wealth maximizing if *A* is free to begin with. But if *B* owns the right to *A*'s labor, then it may seem that *A* will not be able to buy it back from *B*. How can *A* pay more than 100 since that is the value of his output as a free man? *A*'s output is worth 110 to *B*, and *A* cannot use his nonpecuniary income in the free state to buy his freedom because his leisure has no value to anyone else.[38] Therefore, it seems that slavery is wealth maximizing if the initial assignment of rights is to make *A* the slave of *B*.

But this analysis overlooks the possibility of converting nonpecuniary into pecuniary income. *A*'s preferred mixture of work and leisure is such as to yield 100 in market income and 50 in nonpecuniary income from leisure, but *A* could work harder, as he does for *B*. Suppose by working harder (but not all the time), *A* could earn a market income of 120 and leisure income of 10. *A* could then buy his freedom from *B*. It is true that, having done so, *A* would be worse off than if he had had the right to his labor in the first place. The point of the analysis, however, is that freedom is indeed more efficient than slavery, because by giving *A* his freedom in the first place we obviate the need for a transaction whereby *A* buys his freedom from *B*.

Thus, while the theoretical possibility exists that efficiency might dictate slavery or some other monstrous rights assignment, it is difficult to give examples where this would actually happen. I conclude that it is possible to deduce a structure of rights congruent with our ethical intuitions from the wealth-maximization premise.

SOME IMPLICATIONS FOR THE POSITIVE ECONOMIC ANALYSIS OF LAW

Why the Common Law Is Efficient

Scholars like myself who have argued that the common law is best explained as an effort, however inarticulate, to promote efficiency have lacked a good reason why this should be so—making them seem, perhaps, the naïve adherents of the outmoded "public interest" theory of the state.[39] This is the theory that the state op-

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38. *A*'s leisure might have value to another, but let us assume that it does not.

39. For a review of the rival theories of government discussed in this part of

erates, albeit imperfectly, to promote widely shared social goals— of which wealth maximization is surely one, regardless of how important a goal it may be. The state promotes efficiency by arranging for the provision of "public goods," that is, goods that confer benefits not limited to those who pay for them and hence that are produced in suboptimal amounts by private markets. One of these public goods is a legal system that corrects sources of market failure such as externalities.

The public-interest theory of the state has been under severe attack from the proponents of the "interest group" or, more narrowly, the "producer protection" theory of the governmental process.[40] This theory assigns primary importance to redistribution as an object of public policy. The redistributive emphasis stems from treating governmental action as a commodity, much like other commodities, that is allocated in accordance with the forces of supply and demand. The focus of research has been on demand. The characteristics that enable an industry or other group to overcome free-rider problems and thereby outbid rival claimants for governmental protection and largesse have been studied, and the conclusion has been reached that compact groups will generally outbid diffuse ones for government favor.

The interest-group theory is an economic theory because it links governmental action to utility maximization by the people seeking such action. The public-interest theory is a description, rather than an economic theory, of the political process because it does not show how utility maximizing by individuals results in governmental action that promotes the interest of such diffuse groups as the "public," consumers, or taxpayers. The implication of the interest group theory that diffuse groups are likely to lose out in competition with more compact groups for government protection undermines the plausibility of the public-interest theory even as description.

However, common law doctrines that satisfy the Pareto-superiority criterion in the "principle of consent" form in which I have cast it in this Article (no common law doctrine would satisfy a literal interpretation of the Pareto criterion) are plausible candi-

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the Article, see Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGT. SCI. 335 (1974).

40. The seminal article in the economic theory of interest-group politics (as distinct from the earlier political-science theory) is Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGT. SCI. 3 (1971).

dates for survival even in a political system otherwise devoted to redistribution. The reason is that a rule or institution that satisfies the principle of consent cannot readily be altered, at least not by the remedies available to common law judges, in a way that will redistribute wealth toward some politically effective interest group. This is particularly clear in cases, such as the landlord-tenant case discussed earlier,[41] where the parties to litigation have a preexisting voluntary relationship. In effect, the court would be changing only one term of a contract, and the parties could alter the other contract terms in the future.[42] This is not an effective method of redistributing wealth. Even if the dispute does not arise from a contract, the parties may be interrelated in a way that totally or largely cancels any wealth effects from a change in the rule of liability. For example, since farmers were the major customers of railroads in the nineteenth century, it would not have made much sense to try to transfer wealth from railroads to farmers or vice versa simply by increasing or decreasing the liability of railroads for damage caused to crops growing along railroad rights of way.

The potential for using the common law to redistribute wealth is not great even in cases involving complete strangers. Consider again the negligence system of automobile-accident liability. It is hard to see how moving to a system of strict liability would increase the wealth of a compact, readily identifiable, and easily organizable group in the society. The principal effect would simply be to increase or decrease most people's wealth a small amount, depending upon whether strict liability is more or less efficient than negligence in the automobile setting.

There is a literature that contends that the common law has been biased in favor of the rich—has served, that is, systematic and perverse redistributive ends.[43] The above analysis makes this an implausible contention, though it would carry me too far afield

41. *See* p. 500 *supra*.

42. It is noteworthy that Professor Ackerman, a leading advocate of using tort law to force landlords to increase the quality of slum housing, couples this with a proposal for a public subsidy to prevent tort liability from leading to a reduction in the supply of housing for the poor. *See* Ackerman, *Regulating Slum Housing Markets on Behalf of the Poor: Of Housing Codes, Housing Subsidies, and Income Redistribution Policy*, 80 YALE L.J. 1093 (1971).

43. *See, e.g.*, M. HORWITZ, THE TRANSFORMATION OF AMERICAN LAW, 1780-1860, ch. III (1977).

to attempt to refute it in detail here.[44] If I am correct that the common law is not an effective method of redistributing wealth,[45] whether from rich or poor, farmers or railroads, tenants or landlords, or between any reasonably well defined, plausibly effective interest groups, then there is no reason to expect the common law to be dominated by redistributive concerns even if legislatures are.

To say what the common law is not is not to say what it is, but that too can be derived from the preceding analysis. There are numerous politically effective groups in the society; the question is what their rational objectives are likely to be in areas regulated by common law methods. Probably their self-interest is promoted by supporting the efficiency norm in those areas. By doing so they increase the wealth of the society; they will get a share of that increased wealth; and there is no alternative norm that would yield a larger share. To be sure, none of them will devote substantial resources to promoting the efficiency norm in the common law, because the benefits that each group derives will be small and because each will be tempted to take a free ride on the others. But few resources have to be devoted to promoting the efficiency norm for it to survive: its distributive neutrality operates to reduce potential opposition as well as support.

This analysis implicitly treats judges simply as agents of the government and hence does not confront the difficulties that judicial independence from political control poses for any self-interest theory of judicial behavior. That is a problem in the economics of agency. The utility of the analysis is in relating the efficiency theory of the common law to the redistributive theory of the state, albeit some of the links in the chain are obscure. Notice that it is an implication of the theory that where legislatures legislate within the area of common law regulation—as with respect to rights and remedies in torts, contracts, property, and related fields—they too will be trying to promote efficiency. For, in this view, it is not the nature of the regulating institution,[46] but the subjects and methods

44. For some criticism of the literature, see R. POSNER, ECONOMIC ANALYSIS OF LAW § 8.2 (2d ed. 1977).

45. As also argued on theoretical grounds in S. Shavell, A Note on Efficiency vs. Equity in Legal Rulemaking: Should Equity Matter, Given Optimal Income Taxation? (1979) (unpublished paper Harv. Univ. Dep't of Econ.).

46. In this analysis, the features of the judicial process that I have argued elsewhere tend to suppress distributive considerations, *see, e.g.*, R. POSNER, *supra* note 44, § 19.2, are thus viewed as effects rather than as causes of the judicial emphasis on efficiency.

of regulation, that determine whether the government will promote efficiency or redistribute wealth.

The relationship of the above political analysis to the ethical discussion in the earlier parts of the Article should now be clear. The principle of consent that I extracted from the Pareto-superiority criterion was another name for an absence of systematic distributive effects. The probabilistic compensation discussed in connection with the negligence system of automobile accident liability made it possible to ignore ex post distributive effects in evaluating that system. By the same token, no group can hope to benefit ex ante from a change in the system, assuming the system is the most efficient one possible, and those few and scattered parties who lose out ex post are a diffuse and therefore ineffective interest group. If this example can be generalized to the common law as a whole, it provides a reason for believing that the political forces in the society will converge in seeking efficiency in common law adjudication. In this instance what is ethical is also politic.

Is the Common Law Efficient or Utilitarian?

I want to consider finally and very briefly whether it is possible to distinguish empirically between the efficiency theory of the common law and a theory that says that in the heyday of the common law the judges subscribed to the dominant utilitarian ideology of the nineteenth century. My previous article noted that some influential figures in legal scholarship described the common law as utilitarian.[47] Did they mean utilitarian in contradistinction to economic? I think not, for I can think of no instances in which utilitarian deviates from economic teaching where the common law followed the utilitarian approach. For example, income equality, protection of animals, and prohibition of begging are all policies that were advocated by Bentham,[48] the most thoroughgoing utilitarian, yet no traces of these policies can be found in the common law. Bentham also believed in imposing a legal duty to be a good Samaritan, but the common law, perhaps on economic grounds, rejected such a duty.[49] There is also no trace in the common law of sympathy for thieves, rapists, or other criminals who seek to de-

47. *See* Posner, *supra* note 1, at 106.

48. *See* Posner, *Blackstone and Bentham*, 19 J.L. & ECON. 569, 590-600 (1976).

49. *Compare* J. BENTHAM, THEORY OF LEGISLATION 189-90 (R. Hildreth ed. 1864), *with* Landes & Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. LEGAL STUD. 83, 119-27 (1978).

fend their crimes on the ground that they derived more pleasure from the act than the pain suffered by their victims. Of course utilitarianism is a flexible enough philosophy to accommodate arguments as to why allowing a criminal such a defense would not really maximize happiness over the long term. But this is just to say that enlightened utilitarianism will incorporate the sorts of constraints that makes wealth maximization an appealing ethical norm.