The Economics of Justice

Richard A. Posner

THE ECONOMICS OF JUSTICE

Richard A. Posner

Harvard University Press
Cambridge, Massachusetts
and London, England
1981

Printed in the United States of America

Library of Congress Cataloging in Publication Data

Posner, Richard A
The economics of justice.

Includes index.
1. Justice—Addresses, essays, lectures. 2. Social justice—Addresses, essays, lectures. 3. Economics—Addresses, essays, lectures.
I. Title.
JC578.P67 320'.01'1 80-25075
ISBN 0-674-23525-8

For Kenneth and Eric

Preface

The essays in this book deal with four subjects: the efficiency or "wealth maximization" theory of justice; the social, including legal, institutions of primitive and archaic societies; the law and economics of privacy and related interests; and the constitutional regulation of racial discrimination and "affirmative action." As explained in Chapter 1, these seemingly disparate subjects turn out to be interrelated from the standpoint of economics.

I use "justice" in approximately the sense of John Rawls. "For us the primary subject of justice is the basic structure of society, or more exactly, the way in which the major social institutions distribute fundamental rights and duties and determine the division of advantages from social cooperation. By major institutions I understand the political constitution and the principal economic and social arrangements" (*A Theory of Justice,* 1971, p. 7). This book is not a comprehensive analysis of "the political constitution and the principal economic and social arrangements," but it does examine a number of important political, economic, social, and legal arrangements, and it tries to show how economic analysis can advance our understanding of them. The book is nontechnical and is addressed to philosophers, political scientists, historians, anthropologists, sociologists, and classicists as much as to lawyers and economists. If the book seems overly ambitious in its sweep, I can defend only by emphasizing that the book is exploratory rather than definitive.

More friends and colleagues than I can hope to mention commented helpfully on prepublication drafts of the essays included in this book. I particularly want to thank Gary Becker, Lea Brilmayer, Ronald Coase, Jules Coleman, Frank Easterbrook, Richard Epstein, Charles Fried, Paul Friedrich, Victor Fuchs, Jack Hirshleifer, Gareth Jones, Stanley Katz, Anthony Kronman, John Langbein, William Landes, Bernard Meltzer, Frederic Pryor, James Redfield, Steven Shavell, George Stigler, Geoffrey Stone, and James White. Each of them made an important contribution to one or more of the chapters. I also want to thank the sponsors, participants, and audiences at various lectures and workshops at the University of Chicago, New York University, the University of Pennsylvania, the Centre for Socio-Legal Studies at Oxford University, the State University of New York at Buffalo, the University of Georgia, and the Public Choice Society, where drafts of some of these essays were first presented.

Robert Bourgeois was a devoted and effective assistant in my research for several of the chapters in this volume; other valuable research assistance was provided by Carole Cooke, Gordon Crovitz, Donna Patterson, Helene Serota, Susan Stukenberg, and Pamela Trow. I am grateful to the Center for the Study of the Economy and the State at the University of Chicago and to the Law and Economics Program of the University of Chicago Law School, for financial assistance. Above all I want to acknowledge my intellectual debts to the economists who have shaped my approach: Gary Becker, Ronald Coase, Aaron Director, and George Stigler. Without their guidance and inspiration, the papers gathered here would not have been written.

All of the chapters except the first have been published before in some form, but the revisions made for this book have been extensive. Chapter 2 is based on an article published in volume 19 of the *Journal of Law and Economics* (1976). Chapter 3 is based on an article in volume 8 of the *Journal of Legal Studies* (1979) and on pages 189–191 of my book *Economic Analysis of Law* (2d ed. 1977). Chapter 4 is based on an article in volume 8

of the *Hofstra Law Review* (1980) and also on an article in volume 9 of the *Journal of Legal Studies* (1980). Chapter 5 is based on an article in volume 90 of *Ethics,* published by the University of Chicago (1979). Chapter 6 is based on Part I of an article in volume 23 of the *Journal of Law and Economics* (1980), and Chapter 7 on Part II of that article. Chapter 8 is based on an article published in volume 9 of the *Journal of Legal Studies* (1980). Chapters 9 and 10 are based on two articles: one published in volume 12 of the *Georgia Law Review* (1978) and one in volume 28 of the *Buffalo Law Review* (copyright © 1979 by *Buffalo Law Review*). Chapter 11 is based on an article in the 1979 volume of the *Supreme Court Review,* edited by Philip B. Kurland and Gerhard Casper, published by the University of Chicago. Chapter 12 is based on Chapter 27 of *Economic Analysis of Law.* Chapter 13 is based on an article in the 1974 volume of the *Supreme Court Review,* edited by Philip B. Kurland, published by the University of Chicago; and Chapter 14 on an article in volume 67 of the *California Law Review* (copyright © 1979, California Law Review, Inc.). I thank the copyright holders for permission to use this material.

I regret not having seen the articles, apart from Jules Coleman's and my own, that appeared in the "Symposium on Efficiency as a Legal Concern," in volume 8 of the *Hofstra Law Review* (1980), after this book was in page proof. Many of the papers in the symposium deal with issues examined in Part I of this book; although they do not change my conclusions, I would have liked the opportunity to refer to some of them. I console myself with the reflection that the last word has not been said on any of the topics discussed here.

Richard A. Posner

September 1980

The Economics of Justice

CONTENTS

1

An Introduction to the Economics of Nonmarket Behavior

This book takes an economic approach to issues—including the meaning of justice, the origin of the state, primitive law, retribution, the right of privacy, defamation, racial discrimination, and affirmative action—that are not generally considered economic. Is not economics the study of the economic system, the study of markets? None of the concepts or activities in my list are market concepts or activities.

Although the traditional subject of economics is indeed the behavior of individuals and organizations in markets, a moment's reflection on the economist's basic analytical tool for studying markets will suggest the possibility of using economics more broadly. That tool is the assumption that people are rational maximizers of their satisfactions. The principles of economics are deductions from this assumption—for example, the principle that a change in price will affect the quantity of a good by affecting the attractiveness of substitute goods, or that resources will gravitate to their most remunerative uses, or that the individual will allocate his budget among available goods and services so that the marginal (last) dollar spent on each good and service yields the same satisfaction to him; if it did not, he could increase his aggregate utility or welfare by a reallocation.

Is it plausible to suppose that people are rational only or mainly when they are transacting in markets, and not when they are engaged in other activities of life, such as marriage and litigation and crime and discrimination and concealment of personal information? Or that only the inhabitants of modern

Western (or Westernized) societies are rational? If rationality is not confined to explicit market transactions but is a general and dominant characteristic of social behavior, then the conceptual apparatus constructed by generations of economists to explain market behavior can be used to explain nonmarket behavior as well.

The question of how fruitful this extension of economics is cannot be answered on logical grounds and should not be answered on intuition. I happen to find implausible and counterintuitive the view that the individual's decisional processes are so rigidly compartmentalized that he will act rationally in making some trivial purchase but irrationally when deciding whether to go to law school or get married or evade income taxes or have three children rather than two or prosecute a lawsuit. But many readers will, I am sure, intuitively regard these choices, important as they are—or perhaps because they are so important—as lying within the area where decisions are emotional rather than rational. The only way to assess the fruitfulness of extending economics into the nonmarket sphere is to make economic studies of nonmarket behavior and evaluate the results.

At the outset of the modern development of economics stands one man who believed that people were rational maximizers of their satisfactions in all areas of human life. This was Jeremy Bentham, who plays a prominent, if somewhat sinister, role in Part I of this book. Bentham's application of economics to crime and punishment was neglected by economists for almost two hundred years, although it had an enduring influence on penology. Bentham did not try to marshal evidence for his view that people were always and everywhere in rational pursuit of their self-interest. He merely asserted it, and subsequent generations of economists apparently found the assertion too implausible to want to test it.

The modern revival of interest in applying economics to nonmarket behavior begins with Gary Becker of the University of Chicago, although, as always in the history of thought, one can

find predecessors.[1] Beginning with the publication of his doctoral thesis on the economics of racial discrimination in 1957,[2] Becker and his students and disciples pushed economics into such diverse areas as education, fertility, the utilization of time in the household, the behavior of criminals and of prosecutors, charity, prehistoric hunting, slavery, suicide, adultery, and even the behavior of rats and pigeons.[3] This is not the place to attempt an evaluation of a large, diverse, and frequently technical literature—much of it controversial even within the economics profession[4]—that attempts nothing less than a redefinition of economics as the study of rational choice, not limited to the market. It is enough to say that because of this literature it is no longer absurd to suggest that justice, privacy, primitive law, and the constitutional regulation of racial discrimination might be illuminated by the economic approach.

My interest in the economics of nonmarket behavior began with, and remains centered on, the field known as economic analysis of law or, somewhat confusingly, "law and economics." This book represents a broadening of my interests to include aspects of social experience beyond the strictly legal. But everything in the book grew out of the economic analysis of law. It may therefore be helpful if I describe the field briefly and relate it to the specific problems addressed in this book.[5] The eco-

1. E.g., Sidgwick's discussion of externalities in 1883 and Mitchell's of household production in 1912. See Henry Sidgwick, *The Principles of Political Economy* 406–408 (3d ed. 1901); Wesley C. Mitchell, "The Backward Art of Spending Money," 2 *Am. Econ. Rev.* 269 (1912), reprinted in his book *The Backward Art of Spending Money, and Other Essays* 3 (1950).

2. See Gary S. Becker, *The Economics of Discrimination* (2d ed. 1971).

3. The best introduction to the economics of nonmarket behavior is Becker's book of essays, *The Economic Approach to Human Behavior* (1976). See especially his introductory chapter. Other such analyses include *Essays in the Economics of the Family* (Theodore W. Shultz ed. 1975); John H. Kagel et al., "Experimental Studies of Consumer Demand Behavior Using Laboratory Animals," 13 *Econ. Inquiry* 22 (1975).

4. See, e.g., Ronald H. Coase, "Economics and Contiguous Disciplines," 7 *J. Legal Stud.* 201 (1978).

5. For a general survey of the field, see Richard A. Posner, *Economic Analysis of Law* (2d ed. 1977), and for a recent review article, Richard A. Posner, "Some Uses and Abuses of Economics in Law," 46 *U. Chi. L. Rev.* 281 (1979).

nomic analysis of law has two branches. The older—the analysis of laws regulating explicit economic activity—dates back at least to Adam Smith's discussion of the economic effects of mercantilist legislation. Such studies remain an important part of the economic analysis of law today—indeed, quantitatively the most important part. They include studies of antitrust, tax, and corporation law; public utility and common carrier regulation; and the regulation of international trade and other market activities.

The other branch, the analysis of laws regulating nonmarket activities, is for the most part very recent. It is this branch that provides the background of the present book. The pioneers here are Ronald Coase and Guido Calabresi. In his famous article on social cost, published in 1961, Coase analyzed the relationship between rules of liability and the allocation of resources.[6] This was also the subject of Calabresi's first article on accident law, written independently of Coase's work and published the same year as Coase's article.[7] Coase observed—almost in passing, for this was not the focus of his paper—that the English courts, in interpreting the common law doctrine of nuisance (the doctrine governing pollution and related types of interference with the enjoyment of property), had decided cases in a way that seemed to accord with the economics of the problem. In fact they had exhibited a surer, if wholly instinctive, grasp of those economics than the economists had! Coase's insight into the economizing character of common law doctrines remained for a time undeveloped. Since 1971, however, in a series of studies that is now quite extensive, I and others have examined the hypothesis that the common law is best explained as if the judges were trying to maximize economic welfare.[8] The hypothesis is not that the judges can or do duplicate the results

6. See R. H. Coase, "The Problem of Social Cost," 3 *J. Law & Econ.* 1 (1960). (This issue was actually published in 1961.)

7. See Guido Calabresi, "Some Thoughts on Risk Distribution and the Law of Torts," 70 *Yale L. J.* 499 (1961).

8. For discussion and references see Posner, "Some Uses and Abuses of Economics in Law," 46 *U. Chi. L. Rev.* 281, 288–291 (1979).

of competitive markets, but that within the limits set by the costs of administering the legal system (costs that must be taken into account in any effort to promote efficiency through legal rules), common law adjudication brings the economic system closer to the results that would be produced by effective competition—a free market operating without significant externality, monopoly, or information problems.

Evidence for the implicit economic structure of the common law has been found in many studies of legal rules, institutions, procedures, and outcomes. These studies are not limited to the occasional instances where the courts have adopted a virtually explicit economic formulation of the law, as in Judge Learned Hand's formula for negligence.[9] He said that negligence is a failure to take care where the cost of care (he called it the "burden of precautions") is less than the probability of the accident multiplied by the loss if the accident occurs. An economist would call the product of this multiplication the expected costs of the accident. The Hand formula is a tolerable, although not perfect, approximation of an economically efficient concept of care and negligence.[10] But the economic logic of the common law is more subtle than this. In analyzing a wide variety of legal doctrines—a few scattered example are assumption of risk in tort law, the degrees of homicide, the principles of tort and contract damages, proximate cause, mistake and fraud in contract law, the principles of restitution, the doctrine of "moral consideration," the structure of property rights in water, the law of joint tortfeasors, and the rules of salvage in admiralty law[11]—economists and economically minded lawyers have found that the law uncannily follows economics.

9. See United States v. Carroll Towing Co., 159 F.2d 169 (2d Cir. 1947); Conway v. O'Brien, 111 F.2d 611 (2d Cir. 1940).

10. See John Prather Brown, "Toward an Economic Theory of Liability," 2 *J. Legal Stud.* 323 (1973); Richard A. Posner, *Economic Analysis of Law* 122–123 (2d ed. 1977).

11. See references in Posner, supra note 8, at 290; William M. Landes & Richard A. Posner, "Joint and Multiple Tortfeasors: An Economic Analysis," 9 *J. Legal Stud.* 517 (1980).

The Plan of the Book

Part I deals with the relationship between the concept of efficiency as wealth maximization, which has guided the positive economic analysis of the common law, and an acceptable concept of justice. The relationship of efficiency to justice is an interesting subject in its own right, but my interest derives mainly from the occasional suggestion that the efficiency theory is implausible because no judge could be guided by so crude a concept of justice as wealth maximization.[12] One possible reply is that the judge's preferences do not enter into his decisions. Efforts have been made to show that the common law would evolve in the direction of efficiency even if the judges' decisions were random,[13] but the argument is persuasive only under strong assumptions.[14] My reply is different. It is that efficiency as I define the term is an adequate concept of justice that can plausibly be imputed to judges, at least in common law adjudication. The reasons for this conclusion, it turns out, also point the way toward a reconciliation of the efficiency theory of the common law with the interest-group or redistributive theories that dominate current economic analyses of legislation. Part I also attempts to explicate the differences between economics and classical utilitarianism as guides to legal and political action.

Part II of the book deals with the social and legal order of primitive, including ancient, societies. Many common law doctrines have ancient roots, and most law in primitive societies, like the common law itself, is customary rather than legislated or codified.[15] It seems worth inquiring, therefore, whether the economic theory of the common law might be able to explain the law of primitive societies as well. Furthermore, a study of primitive law may illuminate questions in the positive economic

12. See, e.g., Frank I. Michelman, "A Comment on *Some Uses and Abuses of Economics in Law*," 46 *U. Chi. L. Rev.* 307 (1979).

13. See references in Posner, supra note 8, at 289 n.31.

14. See William M. Landes & Richard A. Posner, "Adjudication as a Private Good," 8 *J. Legal Stud.* 235, 259–284 (1979).

15. Customary law is defined more precisely in Chapter 6.