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EXTERNALITIES EVERYWHERE?: MORALS AND THE POLICE POWER

RICHARD A. EPSTEIN*

Within the academy, it is possible to enter into two kinds of debate about the scope of economic, social, and moral regulation. One type of debate takes place across schools, between individuals who do not share any obvious common premises about how the world is or about how it ought to be. The second type of debate takes place within schools, where the disputants start from some common premises but differ on how these should be interpreted or applied.

In debates across schools, the struggle is usually over some fundamental methodological or normative assumption, the participants having such radically different views that they find it difficult to talk to one another. The debates over the proper domain of law and economics, especially those which ask how economics can deal with empathy, offer one illustration of that kind of sharp confrontation.

The disagreements between Eric Rasmusen and myself are not over fundamental world views.¹ Our disagreements are less a battle and more a dialogue, one which takes place within a framework which we both find comfortable and which has been applied to a wide panoply of economic and social regulation. This ecumenical note is not to say that we do not disagree. In Rasmusen's hands, law and economics is said to lend itself to a rather broad range of governmental regulation of what he sometimes calls "mental externalities."² He deals with a wide range of social legislation that, at one time, was called "morals" regulation under the police power of the state. The precise scope of morals regulation was always important to determine,

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1. See Eric Rasmusen, *Of Sex and Drugs, and Rock'n'Roll: Does Law and Economics Support Social Regulation?*, 21 HARV. J.L. & PUB. POL'Y 71 (1997).

2. See *id.* at 75. See generally RICHARD A. POSNER, *OVERCOMING LAW* 23-24 (1995) (arguing against taking mental externalities into account because of the illiberal implications).

for even in the so-called nineteenth-century heyday of laissez-faire, the legislature had unquestioned power to regulate on what were deemed to be morals questions.³

My first task, therefore, is to explain something about the general framework of regulation and then to show my reservations about Rasmusen's approach to these questions. The starting point for all theories of regulation is, in my view, not law but human biology. Given the forces of evolution, we should start with the assumption that all individuals are governed by a substantial dose of self-interest, which, if not properly directed, can result in socially destructive behavior. The trick of sound social design is to harness individual self-interest to socially-productive activities.

With this in mind, some points, at least, are relatively non-controversial. Generally speaking, most of us are content to accept a prohibition against the use of force. Indeed, the mutual renunciation of the use of force lies at the center of all important theories of social contract. The list can, I think, be extended. Most of us want to enforce most promises most of the time. We are uneasy about the use of monopoly power, especially when it is supported by the force of law. And, generally speaking, most of us recognize that private contracts between two individuals can easily have adverse consequences on third parties. A full and accurate account of the various doctrines of private property and private contract would therefore require us to go through a fairly systematic inquiry about the dangers that flow from various social arrangements. What are the costs of exclusion, of making various resources private? What are the costs of coordination, of making them public? And how should these be compared as we move from one resource to another?

One constant theme in any analysis of private property and ordinary contract centers on this theme of externalities. It makes sense to prohibit certain kinds of contractual arrangements when their external costs exceed their private gains. The antitrust concern with price fixing gains its force precisely because there is a strong economic theory that suggests that the

3. See *Lochner v. New York*, 198 U.S. 45, 53 (1905); ERNST FREUND, *THE POLICE POWER: PUBLIC POLICY AND CONSTITUTIONAL RIGHTS* (1904); Samuel Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365, 375-76 (1921) (noting that police powers are permissible to promote "safety, health, morals and the general welfare of the public").

revenue gains to the collusive sellers are systematically smaller than the losses that are sustained by the potential buyers who are faced with these arrangements.⁴ Simply to point out that these externalities exist, however, is not to demonstrate that they always exceed the private gains to the parties—or even that the costs of preventing the external harms is smaller than the harms themselves. Once we are aware of the contingent judgments that are required in a broad range of social contexts, we should be on guard against becoming too shrill in our defense of *laissez-faire*. Broad propositions are not the same as necessary truths, and wise general principles often admit important exceptions. To be sure, the final reckoning of any system should find a broad role for private contracts and private property.⁵ The methodology for reaching that result is more cumbersome and less deductive than we might wish. A simple assertion of natural rights to property and contract will not carry the day on grounds of self-evidence alone. We should prefer a position that is nonobvious but correct to one that is self-evident but wrong.

Now that this general framework has been sketched, how does it apply to the general class of morals regulation to which Rasmusen has directed his remarks? It is at this juncture that my more cautious lawyer's instincts overtake my more programmatic philosophical concerns. Here the first difficulty is simply the familiar question of how we decide what counts as a "social"—as opposed to an "economic"—regulation, to use his terms,⁶ or what counts as a regulation that falls within the morals heading of the police power. The means of phrasing this question is not without significance. The morals heading of the police power could cover prostitution, blasphemy, gambling, adultery, and the like. Whatever its reach, it is surely somewhat narrower than the category of "social" regulation to which Rasmusen refers.⁷

But beware that once we decide that negative externalities justify regulation in the social context when they might not justify them in the economic context, we should expect

4. See, e.g., ROBERT H. BORK, *THE ANTI-TRUST PARADOX* (1978).

5. See generally RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* (1985).

6. See Rasmusen, *supra* note 1, at 71.

7. In Rasmusen's usage, "social regulation" seemingly includes any sort of regulation of conduct based on a rejection of the premise that "each person's conduct is his own affair." *Id.* at 71.

regulators to shift the border between these two spheres so that the economic regulation of the past generation becomes the social regulation of today. Any legislator who reads Rasmusen will be sure to insert into his favorite statute the appropriate preamble so that it becomes a form of social regulation entitled to general respect and judicial deference. The legislator will tilt his statute to enlarge the scope of governmental power.

Nor should we suppose that this enterprise is particularly difficult to undertake. Consider the family-leave statutes that have been enacted on both the federal and state levels.⁸ As a matter of first principle, I cannot think of any legislation less meritorious than these laws, no matter the cubby hole in which they are placed. There is no social justification for disrupting private contractual arrangements over the question of which circumstances generate leave, with or without pay, and which do not. It may be good that people are given leave without pay after the birth of a new child or to take care of a seriously ill family member. And certainly, I do not wish to be heard as banning these practices or encouraging employers to deny a request for leave.

Yet, no matter how the issue is classified, there is no reason why any decision over leave should not be made consensually by the parties instead of coercively by the state. The question in all cases is whether the gain to the employee from getting the leave is greater than the costs it imposes on the employer—costs that are measured by the need to shuffle the remaining workforce, to hire a temporary worker who requires training, or to forego some critical selling or developmental opportunity. There is no way in the abstract to be so confident that the relative costs always cut one way so that the leave can be ordered as a matter of right. The issue is one that could be negotiated up-front as part of the basic contract or negotiated on-the-spot at the pleasure of the parties. Additionally, letting an employer note that he can refuse to tolerate a particular leave could send an important signal, allowing workers to sort themselves out in terms of their likelihood of wanting to take leave for pressing family reasons. What the statutes do, however, is to leave

8. *See, e.g.*, Family and Medical Leave Act of 1993, 29 U.S.C. §§ 2601-54 (1994) (guaranteeing up to twelve weeks annual leave for family emergencies to employees of companies with fifty or more employees).

employers without protection from flight attendants who wish to take their family leave at the height of the travel season or from accountants who need to take leave between March 1 and April 15. Just figuring out what it means to have leave without pay, when work is bunched in one season and pay is spread out evenly over the calendar year, should be enough to make us cautious about intervention. Finally, saying that this legislation is social rather than economic—when it is so obviously both—hardly advances the argument.

The same logic applies to an even more intrusive regulation of employment markets, the antidiscrimination laws⁹. These laws, as applied to private firms in competitive industries, are often justified as a form of social regulation with strong and desirable symbolic effects.¹⁰ I might well agree that they have symbolic effects. It hardly follows that all effects are positive or that, even to the extent they are positive, they outweigh the economic dislocations that come in the wake of the antidiscrimination laws (dislocations caused by the inability to make hiring decisions that do not have to be justified to the EEOC, a federal jury, or a trial judge).¹¹ It may, for example, be said that the antidiscrimination laws give hope to the excluded and marginal individuals who have not had full rights of participation in society.¹² As such, these laws sound as though they embrace a set of laudable symbols. Perhaps they do, but perhaps the symbols embraced are not confined to those just mentioned. There is another, equally obvious, reading of antidiscrimination laws. This reading says that the only reason we adopt statutes of this sort is because we do not think that individuals in certain groups can make it on their own and need the assistance of the state at every stage of their careers. As such, antidiscrimination laws condemn such persons to a second-class citizenship characterized by a complete lack of self-reliance and

9. *See, e.g.*, Age Discrimination in Employment Act, 29 U.S.C. §§ 621-34 (1994) (prohibiting age discrimination against individuals over age forty); Civil Rights Act of 1964, 42 U.S.C. § 2000e (1994) (proscribing discrimination because of race, color, religion, sex, and national origin); Americans With Disabilities Act, 42 U.S.C. §§ 12101-213 (1994) (prohibiting discrimination against individuals with physical or mental disabilities).

10. *Cf.* PATRICIA J. WILLIAMS, *THE ALCHEMY OF RACE AND RIGHTS* 44-49 (1991).

11. *See* RICHARD A. EPSTEIN, *FORBIDDEN GROUNDS: THE CASE AGAINST EMPLOYMENT DISCRIMINATION LAWS* 20-58 (1992) [hereinafter EPSTEIN, *FORBIDDEN GROUNDS*].

12. *Cf.* WILLIAMS, *supra* note 10, at 44-49.

self-sufficiency. Symbolic arguments can cut both ways. How one sorts these arguments ought to be a matter for spirited debate, but this debate is not tipped in one direction or the other by our choice of whether to call antidiscrimination laws “social” or “economic” regulation.

The necessary task is to take into account all the economic effects and all the symbolic effects and total them. Here, the economic effects of the antidiscrimination statutes are negative. They embody high administrative costs and disrupt private contractual behavior. So, the burden is on those who defend the legislation to show that the negative external effects that occur without such legislation dominate the positive ones.

There is today a dangerous tendency to assume that the simple *mention* of a negative externality is sufficient to overwhelm the very large economic disruptions. For some reason, this entire area invites people to make two very large leaps. From the observation that symbols matter, it is falsely assumed that they all cut in one direction. Then, following the observation that in a particular case the symbolic effects are negative, it becomes too easy to forget that both symbolic and economic costs are in play simultaneously. This truncated vision is a very bad way to look at the world.

In contrast, I would start at the other extreme by assuming that the symbolic effects of government regulation are generally negative. The logic of competition is extraordinarily powerful when there are many players on both sides of the market. The ability to compete successfully in markets carries with it many positive symbolic effects. It also encourages the habits of reliability, thrift, imagination, and integrity, which should be praised on moral grounds both in business and in ordinary social relations. From my point of view, the symbolic externalities associated with the advancement of private market behavior are generally positive.¹³

If this analysis is correct, it offers strong instruction as to how we should proceed. In principle, when brokering the difference between these various kinds of externalities, we have to ask whether we should examine “the business” on a wholesale or retail basis. The wholesale basis requires that we consider the full range of external effects at one sitting. They are all in one

13. See EPSTEIN, FORBIDDEN GROUNDS, *supra* note 11, at 28-58.

large bucket, and our only question is to decide whether we want to keep that bucket full or empty. And, with symbolic externalities, I think that the proper approach is to cordon them off in all cases and ignore them. It is not that we do not take these consequences and effects into account in our ordinary lives. Indeed, they are typically the stuff of social interactions. It is one thing, however, to take them into account in setting social sanctions and quite another to incorporate them into legal policy.

One reason to be very cautious about basing regulation on social externalities stems from how these regulations are likely to be incorporated into the legal system. Laws are made by politics, and often a political coalition can enact its particular preferences into law solely by appealing to the intensity of its preferences. Once the law is passed, the nation speaks with a single voice that generates a powerful engine that can be brought to bear on the dissenters who thought that the original policy was misguided. The various extensions of the antidiscrimination law to disabilities¹⁴ and age¹⁵ certainly show the cohesive power of that form of political rhetoric.

By leaving these symbolic effects to the social arena, we no longer get the "all or nothing" effect. Shifts in individual sentiment can be aggregated continuously over time. As the sentiment against various forms of discrimination grows, as it has grown, the social disapproval of certain practices increases. The cost to those who practice these forms of behavior will increase as individual consumers simply direct their business, without fanfare or celebration, elsewhere. As the social sentiment starts to shift, the social frequency of practices will shift as well. But we shall never have the unfortunate situation that occurs as a result of regulation, whereby a shift in public sentiment from 53% to 47% one way to 53% to 47% the other works a complete reversal of legal consequences from 0 to 100.

It is true that the entire system of checks and balances is designed to moderate these effects within the world of legislation, so the contrast that I am making is somewhat overdrawn. But, even after due allowance is made for these structured complexities, political reversals are more

14. See Americans With Disabilities Act, *supra* note 9.

15. See Age Discrimination in Employment Act, *supra* note 9.

discontinuous than changes in social practices. Before we decide that social sanctions are insufficient, we should ponder the wisdom and danger of using old-fashioned state-based coercion to counter soft externalities. So long as people do not threaten your bodily integrity or obtain a stranglehold over critical goods and services, we are well advised to let decentralized social sanctions deal with these soft social issues.

Once that basic position is staked out, proponents of the legal regulation of social behavior face a strong uphill battle. It is fair to ask whether there are any sensible exceptions to this operating presumption. Here it may help to shy away from Rasmusen's broader term "social regulation"¹⁶ and to instead use the more limited term "morals regulation"—the latter being used as it is in the traditional phrase recognizing the police power of the state in matters of "safety, health, morals and the general welfare."¹⁷ Because this last term, "general welfare," is notoriously mischievous, I shall leave it aside for the moment and concentrate on the morals heading of the police power.

To figure out why that heading was so important traditionally, it is useful to think of the state of social and scientific knowledge in the United States during the critical ante-bellum period, from approximately 1820 to 1860. Recall that this was a time before anyone knew that bacteria were microscopic agents capable of propagating disease. In a world in which medical knowledge had but a weak toehold over our imagination, moralisms played a very large role in individual and social protection. Maxims like "cleanliness is next to Godliness" probably saved more lives than the rudimentary forms of public sanitation that were available during this period.

Knowledge changes attitudes towards the dominant legal categories. Once it becomes clear that the state now has the resources to attack some of these issues, what they called moral legislation is probably better understood as an imperfect and indirect form of safety or health regulation that could easily be justified on other grounds a century later. So, regulation on public waste and of sexual contact could easily be conceptualized as morals regulation—when in fact it was aimed at the transmission of deadly diseases. Once the mechanism of

16. Rasmusen, *supra* note 1, at 71.

17. Williston, *supra* note 3, at 375-76.

infection is better understood, the nature of the regulation can be more focused on the dangers in question, and justifications are likely to shift from morals to health and safety. It is perhaps in this form that we would put regulation designed to close bath houses or to regulate prostitution. Note that as we let our moral guard down in the Twentieth Century, AIDS is to us what syphilis was a century ago. Some sort of legal regulation of sexual behavior, then, is perhaps in order, although it does not matter whether we call this morals or health regulation.

It should be possible to repeat this kind of demonstration for some of the traditional types of social regulation. Certainly the recent study of gambling suggests that it has powerful negative economic consequences that are not borne by the communities that sponsor these activities and that in turn surely account for much of the huge resistance to gambling that has surfaced in recent years.¹⁸ So, I suspect that there is some very narrow category of cases for which Rasmusen's general concerns are correct, but if so, they must be defined far more narrowly than he has done in his general presentation. At this point, there is a wonderful, if improbable, congruence between modern social and classical constitutional theory. This approach does not begin to touch the ordinary commercial arrangements, the so-called "labor" statutes, which were prohibited during the heyday of economic liberties.¹⁹ It does explain, perhaps, why the same judges that were suspicious of mandatory unions and minimum wage laws took a more deferential view to regulation in the area of morals before the rise of the New Deal when the categories reversed. Today intimate forms of personal association are frequently protected from legislative intervention, while ordinary forms of economic activity are routinely subject to direct and powerful regulation. What an odd inversion of constitutional theory indeed.

18. See ROBERT GOODMAN, *LEGALIZED GAMBLING AS A STRATEGY FOR ECONOMIC DEVELOPMENT* (1994); John W. Kindt, *U.S. National Security and the Strategic Economic Base: The Business/Economic Impacts of the Legalization of Gambling Activities*, 39 ST. LOUIS U. L.J. 567 (1995).

19. See *Lochner*, *supra* note 3; *Adair v. United States*, 208 U.S. 161, 172 (1908) (where Justice Harlan switched sides to protect "yellow-dog" contracts once the health issues raised in *Lochner* were no longer plausible); see also *Coppage v. Kansas*, 236 U.S. 1 (1915) (invalidating similar state laws).

