

# A Comment on *Some Uses and Abuses of Economics in Law*

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I, like Professor Posner, find economic analysis of law most interesting in its guise of a positive or descriptive theory about the making and content of law—positive as opposed to normative or prescriptive, “making and content of law” as opposed to “impact of law on conduct generally.”<sup>1</sup> I also agree, although for reasons of my own, with Posner’s insistence that the positive economic theory of law “deserves to be taken seriously.”<sup>2</sup> His reason for thinking so is the *prima facie* case he makes for the theory’s empirical validity. I would say that, whatever its validity (which certainly is not *nil*), the theory must be taken seriously because it is exerting and is destined to exert a strong influence on legal criticism. It does so by offering to provide, through objective empirical research, an organic, historical pedigree for a plausible, intelligible, and trenchant evaluative criterion on which scholars can proceed to base critical studies of legal rules and doctrines.

It is some years now since Arthur Leff shrewdly pointed out how economic analysis might serve as the answer to the modern legal scholar’s prayer for an objectively defensible critical standard.<sup>3</sup> Since I have elsewhere<sup>4</sup> discussed the ways in which we can all too easily pass “from descriptive law to legal norm”—“from the perception of a pervasive and simplifying regularity in law to a belief that law ought to conform to the perceived regularity”—I shall not dwell on those matters here, although I shall return to them briefly later on.

I further agree with Professor Posner that the positive economic theory of the common law is a pretty tough nut to crack empirically and that a number of the challenges to it have been misdirected. In order to offer him this friendly support, however, I must also emphasize the modesty of the theory as it is circumspectly displayed in this

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<sup>1</sup> See Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281, 285 (1979).

<sup>2</sup> *Id.* at 284.

<sup>3</sup> Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 Va. L. Rev. 451 (1974).

<sup>4</sup> Michelman, *Norms and Normativity in the Economic Theory of Law*, 62 MINN. L. REV. 1015 (1978).

most recent of Posner's papers. Even here, I daresay Posner misdescribes his own theory by calling it "the hypothesis that common-law rules and institutions tend to promote economic efficiency."<sup>5</sup> A more accurate statement of the hypothesis, I believe, would be that the rules, taken as a whole, tend to look as though they were chosen with a view to maximizing social wealth (economic output as measured by price) by judges subscribing to a certain set of ("microeconomic") theoretical principles.

My presumptuous attempt at restatement is meant to qualify Posner's version of his theory in one respect and clarify it in another. My qualification is that the hypothesis is correctly understood as directly concerned only with the behavior of judges, and not (or only secondarily) with the actual, measurable economic impact or virtue of the rules they choose. The claim, I believe, is only that judges *en masse* appear to act as if they were choosing rules according to the principles of microeconomic theory, not that these principles themselves are fully adequate or correct descriptions of the world. I say this for two reasons. First, I am not aware that Posner has made any systematic attempt to trace the real-world impacts of the rules he characterizes as "efficient."<sup>6</sup> Second, in espousing the claim that the rules promote efficiency, Posner takes on the burden of defending against attacks on the empirical reliability of microeconomic theory itself—that is, of refuting studies indicating that the effects of legal rules are not just what that body of theory would predict. For example, a recent essay by Philip Shuchman concludes, after analysis of data that seems at least initially persuasive, that a number of changes (or cross-jurisdictional variations) in bankruptcy law do not seem to have had the effects on behavior that microeconomic theory would have predicted.<sup>7</sup> The results seem to suggest that there are motivational forces at work not fairly capturable by any noncircular notion of price or cost.<sup>8</sup>

It must be left up to Posner whether he will treat such a study (until refuted) as a problem for his theory. He must so treat it if he really wants to claim not only that judges act as if guided by micro-

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<sup>5</sup> Posner, *supra* note 1, at 285; see *id.* at 288.

<sup>6</sup> Thus Posner describes the studies on which his hypothesis relies as having shown "a convergence, frequently subtle and unexpected, between common-law rules and . . . economic theory." *Id.* at 290 (emphasis added). He does, however, call attention to other studies of selected legal interventions, which support the practical applicability of economic theory. See *id.* at 286.

<sup>7</sup> Shuchman, *Theory and Reality in Bankruptcy: The Spherical Chicken*, 41 LAW & COMP. PROB. 66 (1977).

<sup>8</sup> For example, making bankruptcy objectively less costly or onerous for the bankrupt seems not to escalate the bankruptcy rate.

economic theory, but also that they actually bring about economically virtuous results by so acting. He need not so treat it, however, if he will be satisfied with my more modest version of his claim. (As we shall see later, though, even the modest version will be in some trouble if microeconomic theory is not itself thought to be reliable or "good.")

The respect in which I intend my restatement to clarify Posner's version of his theory pertains to the use of the word "efficiency," which you will note is omitted from my restatement. "Efficiency" is too loose and evocative a term for scientific usage, too likely—as I shall shortly explain—to mask some serious questions about the plausibility of Posner's hypothesis. For some, "efficiency" will connote a state of affairs in which, taking into account all individual preferences of whatever kind or nature, whether or not responsive to variations in price (or cost in some other noncircular conception), no general improvement is possible. But it explicitly is not Posner's hypothesis that the common-law data reflect a judicial purpose of attaining efficiency in anything like that sense. Rather, according to his analysis of the data, the reflected judicial purpose is to bring about a "wealth maximizing" allocation of resources—that is, to bring about the production of just that mix of goods, services, and environmental states for which the total of the maximum individual offering prices, given the extant distribution of wealth, would be highest.<sup>9</sup> The criterion thus "counts" all and only those goods, services, and states that market observation and common sense can show us, with reasonable certainty, to have an approximately measurable economic exchange value. Omitted from the calculus, then, are two kinds of items: (1) goods, services, and states that in principle have discoverable private exchange values but for which in practice no such values can be objectively estimated,<sup>10</sup> and (2) goods, services, and states that have no private exchange value even in principle, such as the classical utilitarian aim of general improvement through an equalizing redistributive process exploiting the (supposed) diminishing mar-

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<sup>9</sup> Posner is explicit that he uses "efficiency" to mean wealth maximization. Posner, *supra* note 1, at 291. His claims would be clearer (and one of their weaknesses would be too) if he would simply stop saying "efficiency" when wealth maximization is what he means. See text and notes at notes 13-18 *infra*.

<sup>10</sup> Objective estimates are impossible where there are neither explicit markets generating prices for the goods (services, states) in question, nor implicit substitution or exchange relations between those goods and other goods having explicit prices from which "shadow prices" might be inferred for the goods in question. An example would be the "good" consisting of assurance that defaulting debtors will not be thumbscrewed as a means of inducing them to pay up.

ginal utility of wealth.

Once we have the theory cast in terms of wealth maximization rather than efficiency in any broader sense, two objections that have prominently been urged against the theory fall away. Some critics, as Posner notes, have dwelt on the incoherence of the efficiency criterion<sup>11</sup> if it is not tied to some initial distribution of wealth and so claimed there is circularity in the criterion Posner would use to explain the content of law.<sup>11</sup> The critics' argument is that since we cannot know what allocation is efficient until we know who controls what share of the purchasing power, we cannot talk of fashioning the network of legal entitlements (that is, sharing out the purchasing power) by reference to the dependent efficiency criterion. But a sharp focus on the notion of wealth maximization does much to contain (though it cannot absolutely demolish) this criticism. A litigated case presents a judge with a sharply restricted set of choices of liability awards and rule formulations. Probably no choice within the available set will significantly alter the price system or wealth distribution then observable in the economy. The judge, then, can intelligibly be supposed to choose an award and a formulation with a view to maximizing economic output as gauged by observable prices and inferable shadow prices.

Other critics have attacked the hypothesis imputing an efficiency characteristic to law as tautological, "analytic," nonempirical, or nonfalsifiable. We can see how the hypothesis can become nonfalsifiable if we begin, for example, with the (safe) assumption that no court would award Shylock a pound of Antonio. Professor Posner subscribes to this prediction, remarking that it is "puzzling" from an economic standpoint.<sup>12</sup> I suppose he means that an economist would have to observe about the case that Shylock and Antonio must both have expected to improve their welfares by agreeing to the secured loan in the first place, and that if the law refuses to enforce in *terrorem* sanctions voluntarily agreed to by borrowers, thus destroying their credibility to lenders, the effect will be an inefficient syndrome of increased costs to borrowers, reduced demand for loans, and diminished profits to lenders. It thus looks as though the presumed unenforceability of Shylock's contract is significant evidence against the positive economic theory of law.

Some, though not Professor Posner, might reject this evidence. If we will adhere doggedly enough to the hypothesis (assumption) that judges *always* choose the efficient course, they might say, all

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<sup>11</sup> See Posner, *supra* note 1, at 291-92.

<sup>12</sup> R. POSNER, *ECONOMIC ANALYSIS OF LAW* 187 (2d ed. 1977).

will yet be well. From that assumption, combined with any observation we make of judicial refusals to enforce, we can deduce that the judges have somehow divined that members of society at large would be distressed enough by contemplation of the mayhem on Antonio that all together, if they could only overcome the transactions costs, would actually offer Shylock enough to make it worth his while to relent. This method of reifying moral values into quasi-economic commodities known as "moralisms" easily can be deployed to bring all possible judicial decisions and formulations within the economic theory, which will then be nonfalsifiable and worthless.<sup>13</sup> But Professor Posner is impervious to this attack. For him, the Shylock case is really counterevidence to his theory—a "puzzle"—and will remain so until, if ever, he can figure out how to rationalize it in terms of an economic-efficiency calculus that counts only objectively appraisable commodities: goods, services, and states that can fairly be said to have prices or shadow prices.

Now if there are some criticisms of Posner's theory that can be blunted by care in specifying wealth maximization rather than "efficiency" as the imputed judicial aim, it must also be admitted that this same care may aggravate a different weakness. It is, after all, a striking—a remarkable—notation that the mass of judicial decisions and rules should turn out to meet the standard of wealth maximization. Why should we expect anything like that to happen, unless the standard itself possesses a strong moral appeal—either for moral philosophers, if we want to suppose judges to be such, or for the members of society generally, judges included? Of course a standard of "efficiency" in the all-encompassing sense I earlier mentioned would have the requisite appeal, but it also would leave the theory unable to explain anything, and in any case we know it is not the standard Posner has in mind. On the other hand, the wealth maximization standard he *does* intend, and which (in principle) *can* explain things, is less intuitively appealing. As various critics have pointed out, the wealth maximization standard for choice of law is (at least in its immediate applications) apparently biased in favor of the wealthy, is oblivious to questions of distributive justice, and in general disregards all human valuations or motivations that are not responsive to considerations of price, or cost, in a sense approximately measurable by methods available to economic science.<sup>14</sup> But if wealth maximization is such an inadequate standard of justice as

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<sup>13</sup> See the discussion in Michelman, *supra* note 4, at 1035-37.

<sup>14</sup> See, e.g., Baker, *The Ideology of Economic Analysis of Law*, 5 PHILOSOPHY & PUB. AFF. 3 (1975).

that short diatribe suggests, why should we expect to find judges relying on it?

Posner suggests at various points that he need not face that question squarely in order to defend his positive theory,<sup>15</sup> but I am not so sure. In science, there may be some purely empirical hypotheses to which the data conform so clearly, so strikingly, so uniformly, that we are persuaded of their truth (in the pragmatic sense) although we haven't a clue to any causal mechanism that may be producing the phenomena we observe. In other instances, the conformity of data to an empirical hypothesis, while detectible, is also irregular enough, the available measurements are lax enough, the general picture is murky enough, that a plausible causal explanation is required to make us believe in the theory. For me, the positive economic theory of the common law is definitely in the latter class. There are highly significant "anomalies" among the phenomena, as Posner always honorably confesses.<sup>16</sup> The Shylock problem can stand as a symbol for an important category of these: the powerful strain of antiforfeiture doctrine that has coursed through our law at least since the chancellors of old began inventing the "equity of redemption" on behalf of mortgagors.<sup>17</sup> In addition to the problem of clear counterinstances, it is often difficult to distinguish between confirmatory and contradictory instances, a result of the loose, rather jerry-built structure taken on by the empirical hypothesis as it is elaborated to accommodate the various phenomena presented to it.<sup>18</sup>

I read Posner not as denying the need for a causal part to his explanatory theory of law (such as, "judges strive, more or less consciously, to make the law wealth-maximizing because of a widespread social intuition that it is good to have wealth-maximizing law"), but as admitting the need and suggesting how it might be filled. He refers to explanations that have been advanced for the law's wealth-maximizing properties that entail no supposition about judicial preference or intention, but indicates that he is, him-

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<sup>15</sup> See Posner, *supra* note 1 at 285, 286, 291.

<sup>16</sup> *E.g.*, *id.* at 290-91.

<sup>17</sup> Posner is quite aware that antiforfeiture doctrine poses a major problem for his theory. See *id.* For an extended consideration of the value of mercy as displayed in our legal doctrines and practices, see Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

<sup>18</sup> The hypothesis moves back and forth, none too predictably, among several levels of analysis: the comparative private valuations of interacting activities, the costs of errors in judicial attempts to estimate these private valuations, the comparative administrative costs of particularized inquiry under broad principles and categorical application of more specific ("per se") rules, and the costs of risk, uncertainty, and legal instability.

self, uncertain of their validity.<sup>19</sup> He also suggests that “efficiency” (meaning wealth-maximization) may have a stronger moral appeal than critics allow, especially when we are looking for a criterion to govern law-choice *by judges*, where “[c]onsiderations of the just distribution of wealth or other ‘justice’ factors on which a social consensus is lacking would introduce an unacceptable degree of subjectivity and uncertainty into the judicial process.”<sup>20</sup>

Here I believe we are getting close to the heart of the Posnerian theory of law. When Posner says that “efficiency . . . may be the *only* value that a system of common-law rulemaking can effectively promote,”<sup>21</sup> we need not understand him as denying that some cognizable “value” is “promoted” by ant forfeiture doctrine or by declining to carve up Antonio, and certainly not as asserting that the value in such decisions is that of wealth-maximization. Rather, he can be understood as insisting on confining the politically unaccountable judiciary to furtherance of the set of *socially uncontested* values—a set of which the value of maximizing wealth (other things equal) is evidently thought to be a member, indeed the only known member. But if it is thus “the [politically irresponsible] system of common-law rulemaking” that is supposed to condition the suggested judicial predilection and societal tolerance for law guided by no “value” save wealth-maximization, it remains for the theory to explain why society would (or might, or ought to) have hit upon a system of judicial lawmaking having such a momentous and (as some would have it) monstrous entailment. To this separate question,<sup>22</sup> I shall offer here only my conclusion, which is that the degree to which one is comfortable with the argument (and there is one) leading to preference for such a lawmaking system depends upon how thoroughly one is imbued with a cautious positivistic view of the capacity and reliability of human speculative reason, intuition, and insight. Insofar as one shares in this antimetaphysical and value-skeptical spirit, one may see no acceptable alternative, for principled lawmakers, to setting aside unobservable entities such as welfare and contested evaluational concepts such as justice in favor of observables such as willingness to pay and incontestable values such as those actually manifested in choices individuals make.

Which of us really thinks this way? To test whether *you* do, you

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<sup>19</sup> Posner, *supra* note 1, at 289 n.31, 292.

<sup>20</sup> *Id.* at 292.

<sup>21</sup> *Id.* (footnote omitted).

<sup>22</sup> For an exploration of this issue at greater length, see Michelman, *Economic Appraisal of Constitutional Law: A Methodological Preface*, in *ESSAYS ON THE LAW AND ECONOMICS OF LOCAL GOVERNMENT* (D. Rubinfeld ed. 1979) (forthcoming).

might ask yourself what is to be done if: (1) we become persuaded by Posner's empirical claim that the mass of common-law data show a marked though imperfect tendency to regress on the norm of wealth maximization, and (2) we do not know how to formulate any other explanatory norm (at a roughly comparable level of simplicity) that seems able to explain or organize any sizeable fraction of the data. Shall we conclude that we have now glimpsed the law's true "implicit economic logic,"<sup>23</sup> and that the nonconforming data, then, are excrescences to be cast off? If not, why not?

A related question, I believe, is: What does Posner mean when he says that judges should be "cautioned" not to adopt economic discourse explicitly?<sup>24</sup> If, as he suggests, wealth maximization is "the *only* value that a system of common law rulemaking can effectively promote," and if allowing judicial consideration of other " 'justice' factors . . . would introduce an unacceptable degree of subjectivity and uncertainty into the judicial process," how are we not forced to insist that our judges both learn economics correctly and use it openly? One does not, presumably, want judges acting irresponsibly, unaccountably, vagrantly, capriciously, or in a muddle. If one also does not think "justice factors" (wealth maximization aside) can supply a coherent or intelligible discipline for judges, how does one avoid the conclusion that a judge is censurable for not mastering and correctly applying economic theory? How, for that matter, does one avoid the conclusion that Shylock must have his pound of flesh?

Is it possible, while persisting in the belief that judges act rightly only insofar as they act subject to the constraints imposed by an extant collection of authoritative legal materials and a disciplined method for construing them, to think that it would be wrong and irresponsible for a judge to grant specific relief to Shylock? Certainly Posner's empirical findings do not rule out such a possibility as long as we are prepared to let the Shylock case make us believe the true law contains some principle or principles, value or values, rule or rules, other than wealth maximization. His findings will then strike us—as Posner himself puts it—as having revealed "one explanatory variable among several linked together in a more complex model,"<sup>25</sup> and Posner's observation that attempts by scholars to formulate the others have been "perfunctory"<sup>26</sup> will not dispel the conviction that they are there all the same, or that it would be

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<sup>23</sup> R. POSNER, *supra* note 12, at 179-81.

<sup>24</sup> Posner, *supra* note 1, at 300.

<sup>25</sup> *Id.* at 293.

<sup>26</sup> *Id.* at 294.

a radical alteration of existing law to reduce it to the principle of wealth maximization.<sup>27</sup>

Here, then, is a possible reason for caution about systematic indoctrination of judges with economic learning. By such indoctrination we might contrive to squeeze out of the law the poorly defined noneconomic variables or "other justice factors." But some—including Posner, it appears—would hesitate before thus exchanging the vices of "subjectivity and uncertainty" for the beatitude of economic purity.

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<sup>27</sup> See Michelman, *supra* note 4. It seems that Posner would agree. On the one hand, he does speak of the "unacceptable degree of subjectivity and uncertainty" that results from judicial consideration of "other 'justice' factors on which a social consensus is lacking." Posner, *supra* note 1, at 292. On the other hand, the ant forfeiture doctrine is clearly established, not uncertain, and perhaps can be taken to reflect a social consensus even if no one can say on precisely what point or principle. Moreover, Posner concedes, *id.* at 302, that it is "reasonable" for "a practicing lawyer" to refuse to "ignore any part of the jumble," and that probably is meant to hold for judges too.