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LEGAL ANALYSIS AND THE ECONOMIC
ANALYSIS OF ALLOCATIVE EFFICIENCY: A
RESPONSE TO PROFESSOR POSNER'S
REPLY

*Richard S. Markovits**

Agreed: debates must end. But occasionally, a *Reply* is so inadequate that a Response would be useful. My article in the *Hofstra Law Review Response Symposium on Efficiency as a Legal Concern*¹ developed a number of criticisms of claims that have been made for the capacity of economics to contribute to an understanding of law. These criticisms were then illustrated by more detailed analyses of portions of the "new law and economics" literature. Some of my comments applied particularly to Professor Posner's own work, though on the whole my objections were intended to be more general.

After the publication of the *Symposium*, Professor Posner was afforded the opportunity to answer the various critiques it contained.² I will not speak for the other participants. However, the portions of his *Reply* that relate to my own comments are so misleading that a Response is warranted. Professor Posner did not address the major criticisms I made both of his work and of the more extreme claims that he and others have made for the capacity of economics to illuminate the law. On several occasions, he attributed to me positions that I did not and would not take on various relevant matters. When Professor Posner addressed some of the things which I did, in fact, say, his *Reply* was simply incorrect.

Before proceeding, it may be useful for me to set the background for this Response to Posner's *Reply* by delineating the posi-

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1. Markovits, *Legal Analysis and the Economic Analysis of Allocative Efficiency*, 8 HOFSTRA L. REV. 811 (1980).

2. Posner, *A Reply to Some Recent Criticisms of the Efficiency Theory of the Common Law*, 9 HOFSTRA L. REV. 775 (1981).

tions that Posner and others have taken on the ability of economics to contribute to an understanding of law, and by outlining the basic criticisms my original article made of these contentions. Although Posner did moderate his claims for the economic positive theory of law in his *Reply*,³ he has claimed in the past that to his mind the common law (and perhaps constitutional law as well) can best be understood and explained⁴ (predicted?) by the assumption that judges try to “maximize wealth” when making common law decisions. Posner and others have tried to support this hypothesis in two different ways: (1) by showing that the common law does in fact “maximize wealth” (in my terms does in fact maximize “allocative efficiency”⁵) and (2) by giving a reasoned explanation of how this could have come about (for example, by showing why the common law might evolve in an allocatively efficient direction even if judges’ decisions were only randomly related to efficiency, or by demonstrating why judges might prefer to make allocatively efficient decisions—why it might be in their career interests to do so or why it might be just for them to do so).

The first four parts of my article⁶ were intended, *inter alia*, to cast doubt upon both this description of the common law and these attempts to account for its supposed evolution toward allocative efficiency. In particular, I offered three reasons for doubting the claim that economics can “explain” the common law in some sense—i.e., for rejecting the claim that the common law can best be “understood” or predicted on the supposition that judges behave “as if” they were trying to maximize allocative efficiency. First, I challenged the supposed empirical evidence for this claim in two ways: (a) by showing that at least some of the articles that seek to establish the allocative efficiency of some part of the common law are undermined by their authors’ adoption of a misleading definition of “wealth” or allocative efficiency, and more importantly (b) by delineating a number of theoretical reasons for doubting that the common law of torts

3. Thus, Posner now claims that his version of the new law and economics supposes only that judges behave “as if” they were trying to maximize efficiency and not that they in fact intend to achieve this goal. *Id.* at 775. He also admits that the evidence in support of his “efficiency” hypothesis is “at most suggestive, not definitive.” *Id.* at 777. Given the other reasons I have delineated for doubting his hypothesis, this admission is extremely damning.

4. See Posner, *Some Uses and Abuses of Economics in Law*, 46 U. CHI. L. REV. 281, 287 (1979).

5. I will continue my original article’s practice of substituting “allocative efficiency” for the more ambiguous “wealth.”

6. Markovits, *supra* note 1, at 814-80.

is allocatively efficient. Second, I delineated a number of general a priori reasons for doubting the allocative efficiency of the common law. In particular, I delineated a number of factors that are often crucial in moral and legal debates, factors to which economics is insensitive. And third, I demonstrated the inadequacy of the various attempts that have been made to account for the supposed allocative efficiency of the common law—i.e., to explain why the common law should be expected to evolve toward allocative efficiency.

My response will be organized in terms of these three different reasons for doubting Posner's claim that economics can "explain" law in some sense. Under each heading, I will first describe the various arguments I made and then respond to Posner's *Reply* to my arguments. Accordingly, this Response will provide a summary of my critique of Posner's version of the new law and economics, as well as an analysis of Posner's attempt to defend his position against my arguments.

I. THE EMPIRICAL CLAIM THAT THE COMMON LAW IS "WEALTH" MAXIMIZING

A. *My Arguments Against Posner's Evidence*

1. *Problems with Posner's Concept of "Wealth."*—My attack on Posner's description of the common law began by showing that Posner had been sloppy when defining his basic concept of an increase in "wealth."⁷ More specifically, I showed that the definition he eventually selected was (1) inconsistent with the layman's understanding of dollar costs and benefits, (2) inconsistent with the way in which such data are measured by sophisticated policy analysts, and (3) conservative in the sense that it favored the status quo (which in practice often meant that it generated the conclusion that common law or legislative interventions were "wealth-reducing" in cases in which the relevant decisions would in fact increase "allocative efficiency" in the popularly understood and most appropriate sense). For the most part, Posner's error related to the way in which he measured the winners' dollar gains and the losers' dollar losses. Roughly speaking, one should measure the former by the number of dollars the winners would have to be given (like manna from heaven) to make them as well off as they would be if the policy were adopted, and the latter by the number of dollars the losers would have to lose to be in as poor a position as the one in which the policy would leave

7. *Id.* at 814-27.

them. Like many welfare economists, Posner had the winners paying and the losers receiving instead of vice versa.

This reversal is misleading because it produces results that differ from the common understanding of “winners’ dollar gains” and “losers’ dollar losses.” More particularly, the winners’ dollar gains are normally assumed to equal the number of dollars the winners would have to receive to make them as well off as the policy would make them, while the losers’ dollar losses are assumed to equal the number of dollars the losers would have to lose to make them as badly off as the policy would leave them. In other words, the conventional assumption is that gains can be envisaged as additions to bank accounts and losses as subtractions from bank accounts. Posner’s measure of gains and losses will not produce numbers that can be envisaged in this way because (1) the dollar value that affected parties place on some policy consequence (clean air, for example) may depend upon their wealth, and (2) Posner’s approach requires the relevant parties to value the relevant consequences on false assumptions as to what their wealth will be when the policy is put into operation. Thus, in effect, Posner asks the winners to value the consequences of the relevant policy on the false assumption that their wealth will be reduced (by the payment they make only hypothetically—not actually—to the losers) before the policy is adopted while, in effect, he asks the losers to value the policy’s consequences on the false assumption that their wealth will be increased (by the payment they receive only hypothetically—not actually—from the winners) before the policy is adopted. Hence, even in theory, Posner’s approach will not, in general, get the winners to provide him with a number that equals the bank credit that would be equivalent to the policy from their perspective. Nor will it, in general, get the losers to provide him with a number that equals the bank debit that will be equivalent to the policy from their perspective.

Unfortunately, as I have already suggested, the distortions I have just described are not random. Posner’s approach is not only misleading, it is also biased in a conservative (i.e., pro status quo or anti-policy change) direction. This conservative bias reflects two facts. The first critical fact is that, generally, both the demand for and the demand against any government decision are wealth-elastic. Thus, in general, winners who are worse off will, on that account, tend to place lower values on a decision they desire, while losers who are better off will tend to place higher negative values on a decision they oppose. In other words, winners who are worse off will consider

a desired decision to be equivalent to a smaller addition to their bank accounts, and losers who are better off will consider a decision which they oppose to be equivalent to a larger subtraction from their bank accounts. The second critical fact is that, as we have seen, Posner's approach asks winners to estimate their gains from a decision on the assumption that they will be worse off than they actually will be when it is adopted (by asking them to assume, contrary to fact, that they will have to pay the losers to secure the decision's adoption), while it will ask the losers to estimate their losses from a decision they oppose on the assumption that they will be better off than they actually will be when the decision is adopted (by asking them to assume, contrary to fact, that they will be compensated for their losses before the decision is adopted). Taken together, then, these two facts imply that Posner's approach will induce the winners to underestimate their gains and the losers to exaggerate their losses; it will bias decisionmaking in favor of the status quo (which in our society may turn out to be in an anti-interventionist, pro-laissez-faire direction).⁸

Posner's operational definition of wealth is also misleading for another reason. In particular, Posner assumes that dollar gains and losses should always be measured in terms of voluntary market transactions. In many situations, however, this paradigm is misleading. For example, it does not reflect the special self-definitional costs associated with voluntary transactions (e.g., the number of dollars for which an individual could sell his arm and remain equally well off is almost certainly higher than the number of dollars that would compensate him for an "act of God" that cost him his arm); nor does it reflect the special enjoyment some people may receive from obtaining a good "free" or "as a matter of right" as a member of the public, as opposed to paying for it commercially (e.g., some may get more enjoyment from "their" public park than from a physically

8. Posner's winners-compensating-losers approach is also inaccurate for two other reasons. First, to the extent that winners value or disvalue for its own sake the fact that they will have to compensate the losers, Posner's procedure will produce estimates of the winners' gains that are too high or too low on that account; similarly, to the extent that losers value or disvalue for its own sake their being compensated by the winners, Posner's procedure will produce estimates of the losers' losses that are too low or too high on that account. Second, to the extent that the winners' gains or the losers' losses would be affected by the second-order effects of any actual compensation that did take place (for example, to the extent that the winners were retailers who would make extra profits on the additional purchases that compensation would enable losers to make from them), Posner's procedure would distort his total estimates by making each individual party's estimates reflect second-order effects that would not in fact take place (since the compensation was only hypothetical, not actual).

identical, equally congested commercial park).

Admittedly, these objections to Posner's description of the common law may be less telling than those that follow. Nevertheless, to the extent that Posner's or others' conclusions that various aspects of the common law are allocatively efficient are affected by his peculiar definition of "wealth," they are less reliable on that account.

2. *Doubts About Posner's "Empirical" Evidence: A Theoretical Analysis of the Allocative Efficiency of Tort Law.*—My second attack on Posner's conclusion that the common law is allocatively efficient was more direct. Since a comprehensive empirical review of this claim would have taken both more knowledge and more space than I had available, I chose to develop a theoretical critique of Posner's position in relation to the common law of torts,⁹ the area in which his argument had been developed in most detail. In brief, I developed seven theoretical grounds for rejecting Posner's claim that the common law of torts was allocatively efficient: (1) The Hand formula for negligence, on which Posner and others primarily rely, does not (as Posner admits¹⁰) address the phenomenon of risk aversion or deal adequately with situations in which contributorily negligent victims are worse-situated than their tortfeasors to avoid the accident or limit the extent of any resulting damage; (2) contrary to Posner, the concept of negligence is not always captured by the Hand formula (for example, where accidents are caused inadvertently, a reasonable man model—which cannot be assimilated to the Hand model or an efficiency model—is often applied; in other circumstances, some factors are considered that the Hand or efficiency approach would deem irrelevant, while others are given weight that the Hand or efficiency approach would deem excessive); (3) even where courts have applied the Hand negligence formula, they have considered only a few of the various ways in which a defendant company might have reduced the probability of an accident (for example, the defendant company's choice among known production techniques, but not its production technique research decisions, its product-type decisions, its unit output decisions, its location decisions, or its staying-in-business decisions); (4) neither Hand's formula nor the negligence approach in general responds adequately to the fact that the costliness of dispute settling and the possibility of judge or jury error reduce the incentives the system gives prospective

9. Markovits, *supra* note 1, at 828-48.

10. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* §§ 6.2, 6.3 (2d ed. 1977).

tortfeasors to avoid accidents by reducing the expected cost to them of any accidents they may cause by: (a) inducing victims to accept settlements for less than their actual damages, (b) creating the possibility that courts may systematically undercompensate victims, and (c) ensuring that some negligent defendants will not be found negligent; (5) the Hand system does not take into account the fact that some of the relevant actors (including organizations) may not be perfectly informed maximizers; (6) the Hand system assumes that private costs and benefits equal their allocative counterparts—that is, fails to consider the fact that distortions in such private costs and benefits caused by Pareto imperfections such as imperfect competition might result in negligent behavior's being allocatively efficient and non-negligent behavior's being allocatively inefficient (if negligence were defined in Hand's sense);¹¹ and (7) the Hand approach's allocative efficiency may also be undermined by the transaction cost of operating such a negligence system. Of course, one might respond that although the Hand negligence formula does not overcome these difficulties, the common law does by employing strict liability or other doctrines in situations in which the Hand formula has not been applied to all relevant types of behavior, as well as in situations in which a Hand-type negligence approach would not be allocatively efficient. I argued, however, that strict liability doctrines (or other non-Hand doctrines such as reasonable man concepts) cannot be rationalized in this fashion—although I have no doubt that they do, at times, further allocative efficiency goals. My article also argued that one cannot rescue Posner's claim in the tort law field by citing the supposed institutional limitations of courts or by claiming that features that are inconsistent with his model have been declining over time or will decline in the future. If I wanted to be generous, I would say that "Posner has not demonstrated his conclusion that the common law of tort is allocatively efficient."¹² If I wanted to be accurate,

11. To take an extreme, though easily explained, example: What would Posner make of the "negligence" of a tax lawyer whose failure to spend sufficient time on a project increased his client's tax liability—that is, transferred income from his client to the government? Would he say that this lawyer's error was negligent because the relevant tax provision was allocatively efficient and a rule penalizing such lawyers would be efficient because it would encourage other taxpayers to take advantage of the rule in question, or of similar rules? I doubt it. Or would he say that this lawyer's error was negligent because, otherwise, future clients would spend additional resources (hire two separate firms to do one job independently) to prevent such errors? I doubt this as well. Certainly, some such argument must be devised, since the direct effect of the defendant lawyer's failure to spend enough time from his client's perspective was to save resources (his own time) at no direct allocative cost.

12. See Markovits, *supra* note 1, at 847.

I would say that "Posner's hypothesis begins to look very much like a theory in search of a phenomenon."¹³

B. *Posner's Reply to My Critique of this Evidence*

1. *Posner's Concept of "Wealth."*—Posner's only explicit response to my comments about his treatment of the concept of wealth and wealth maximization is to assert that I falsely suggested that wealth maximization (when viewed as an ultimate goal) does not assign distinct weights to the winners' dollar gains and the losers' dollar losses.¹⁴ Posner maintains that my alleged assertion is incorrect: wealth maximization does assign weights to dollar gains and losses—it assigns the weight of one to each person's dollar gain or loss, regardless of whether he is a winner or a loser. I am almost embarrassed to respond. Still, two points are relevant here. First, Posner's accusation does not deal with my argument about the appropriate way to measure the effect of a policy on wealth. It focuses instead on the different issue of whether wealth maximization is a defensible goal (which I will discuss later). Second, at no point have I ever denied that wealth maximization (taken as a goal) implicitly places equal weight on each person's dollar gain or loss; indeed, as I have stated explicitly elsewhere,¹⁵ this feature of wealth maximization is precisely what makes it unattractive to me. Posner knows this perfectly well. His verbal game is just silly.

Moreover, Posner does take a position in his *Reply* that shows that he does not fully grasp one of the problems with his operational definition of wealth. This particular problem relates to the fact, already noted,¹⁶ that some people may suffer special displeasure from engaging in voluntary market transactions and obtain special pleasure from obtaining goods or services without paying for them. Posner addresses this fact in the context of discussing the evaluation of rape,¹⁷ i.e., the decision whether to grant control over a woman's body to the woman herself. Posner acknowledges that a prospective rapist might obtain extra pleasure from the dominance he would be exercising by imposing himself on his victim (without obtaining her

13. *See id.* at 848.

14. Posner, *supra* note 2, at 793.

15. Markovits, *A Basic Structure for Microeconomic Policy Analysis in Our Worse-Than-Second-Best World: A Proposal and Related Critique of the Chicago Approach to the Study of Law and Economics*, 1975 WIS. L. REV. 950, 984.

16. *Supra* text accompanying note 8.

17. Posner, *supra* note 2, at 791.

voluntary agreement by paying her for her services). However, Posner claims that this extra pleasure should not count in any evaluation of rape because under his approach, value must be measured by the price that would be established through a voluntary market transaction or contract (unless conventional transaction costs would preclude such an arrangement). But clearly, the concomitant exclusion of the pleasure an individual obtains by taking something without paying for it is arbitrary, or at least unjustified. The whole point of Posner's approach is to measure dollar gains and losses. If certain benefits cannot by definition be obtained through voluntary market transactions, this fact should lead one to reject the voluntary market transaction paradigm rather than to exclude the benefits in question. Of course, there may be (and undoubtedly are) perfectly legitimate grounds for excluding some such pleasures when making an overall evaluation of some related policy option (at the stage at which dollar gains and losses are weighted), but these grounds have nothing to do with the direct claim that only those things that are or could be reflected in voluntary market transactions are of value. Nor should one think that this voluntary market transaction approach will always lead to the inclusion of all benefits/losses that should count in any allocative or overall evaluation of some decision and the exclusion of all benefits/losses that should not count. Thus, in some cases, Posner's approach would fail to include the "legitimate" satisfaction some individuals derive from the fact that they receive certain services without having to pay for them. For example, it would exclude the special satisfaction some people obtain when they receive free medical care as a matter of right—a satisfaction that would not be generated by, and hence would not be reflected in, the price they would be willing to pay for otherwise identical private medical services. Similarly, in other cases, Posner's approach would include non-existent costs that clearly should not be counted. Take, for example, a case in which the present owner of his family's historic home is suing a tortfeasor for the loss he sustained as a result of his home's destruction through the latter's alleged negligence. The fact that the owner would not have been made better off had he been paid one million dollars to agree to the destruction of the house in a voluntary market transaction (as part of a redevelopment plan, for example) does not imply that a significantly lower payment would fail to compensate him fully for the house's destruction through a series of events over which he had no control. The voluntary market transaction price may have reflected the special "disloyalty" cost to him of

agreeing to his family home's sale and destruction. Since no such disloyalty cost would be generated when the house is destroyed through another's independent act, all of us would presumably disapprove of the voluntary market transaction approach's inclusion of these disloyalty costs when valuing the house for the purpose of determining the alleged tortfeasor's negligence or calculating the damages for which an actual tortfeasor is liable. Hence, not only is the voluntary market transaction approach inconsistent with its supposed rationale, it also leads to the inclusion (exclusion) of various costs and benefits that many of us (including those who reject a pure allocative efficiency method of evaluation) would want to exclude or weight less heavily (include or weight more heavily). Posner's discussion of this issue therefore continues to manifest his insistence on measuring wealth or changes in wealth in terms of available market data relating to voluntary market transactions, even when such data is clearly not suitable from his or indeed anyone else's value perspective. In short, then, Posner made no attempt to answer my arguments about his fundamental concept of wealth and continued to use this concept in ways that suggest that he is still unaware of its inadequacy.

2. *The Allocative Efficiency of Tort Law.*—I will ignore Posner's various *ad hominem*s and focus on the three substantive comments Posner makes about my direct theoretical critique of the supposed allocative efficiency of the law of torts. First, he accuses me of assuming that the argument for the allocative efficiency of the tort law depends on the Hand formula's universal applicability.¹⁸ I did no such thing. I did focus initially and primarily on Hand's formula—at least in part because Posner has claimed that “[t]he Hand formula expresses a general test of liability at common law.”¹⁹ However, I did not assume that the common law would be inefficient to the extent that it departed from the Hand formula or would be efficient to the extent that it adhered to the Hand formula. Thus, I explicitly addressed the issue of whether strict liability doctrines that do depart from the Hand formula might promote allocative efficiency by reducing transaction costs;²⁰ pointed out the possibility that other strict liability doctrines that appear to be inconsistent with the Hand formula might actually apply the formula to acts to which it mistakenly has not been directly applied (and concomitantly might increase

18. *Id.* at 784.

19. R. POSNER, *supra* note 10, § 8.1, at 179.

20. Markovits, *supra* note 1, at 847.

allocative efficiency by imposing liability on allocatively inefficient accident-causers);²¹ admitted that deviations from the Hand formula (such as the reasonable man model in some of its applications) might be efficient since they release from liability parties who might be unlikely to respond to the incentives a negligence rule would provide;²² found it necessary to point out explicitly that particular interpretations of the Hand formula that diverge from Posner's interpretation (such as that of the *Restatement (Second) of Torts* (sections 291-293)²³) are inconsistent with the goal of maximizing allocative efficiency;²⁴ addressed the possibility that Posner might be able to establish the allocative efficiency of apparently inefficient judicial doctrines that depart from the Hand formula by arguing that the various institutional limitations of courts would make it inefficient for them to apply apparently more efficient doctrines;²⁵ and explained why other Pareto imperfections might destroy the correlation between the negligence of behavior in the Hand sense and its allocative inefficiency—i.e., might result in some negligent behavior's being allocatively efficient and some non-negligent behavior being allocatively inefficient.²⁶

In summary, then, I argued: (1) Even if there were no other Pareto imperfections in the general economic system than the externalities directly generated by the allegedly tortious conduct, and even if the transaction costs and errors generated by the legal system could be ignored, the application of the Hand formula would not always produce allocatively efficient results, since the formula does not handle risk properly and produces incorrect results where tortfeasors are better-placed to avoid accidents than victims whose contributory negligence was also a necessary cause of the accident; (2) even if one could ignore risk and contributory negligence problems as well as legal transaction costs and errors, various Pareto imperfections that exist in the general economy (imperfect information, individual and institutional nonmaximization, imperfect competition, etc.) would make the Hand formula allocatively inefficient in a substantial number of cases; (3) even if all these imperfections in the actual economy could be ignored, the transaction costs and er-

21. *Id.* at 830, 834.

22. *Id.* at 832.

23. RESTATEMENT (SECOND) OF TORTS §§ 291-293 (1965).

24. Markovits, *supra* note 1, at 832.

25. *Id.* at 834, 839, 844.

26. *Id.* at 840-45.

rors that are present in the legal system would tend to make the Hand formula allocatively inefficient; (4) the tort system does not universally employ the Hand formula; (5) although some non-Hand doctrines such as strict liability and the reasonable man model may sometimes be allocatively efficient, such doctrines cannot be universally rationalized with the goal of maximizing allocative efficiency—i.e., they do not always either (a) correct misinterpretations of the Hand approach where the Hand formula would be efficient if properly applied or (b) produce allocative efficiency by departing from the Hand approach where it would not be efficient had it been applied; (6) the inefficiencies of the actual tort law cannot be explained by claiming that the institutional limitations of courts preclude such bodies from generating or implementing more efficient doctrines. I trust that this summary makes clear that Posner is incorrect in asserting that I had assumed that the allocative efficiency of the tort law depends on the Hand formula's universal applicability.

Second, Posner accuses me of failing to accept his own attempt to demonstrate the allocative efficiency of the reasonable man doctrine in tort law, which diverges from the Hand approach to negligence.²⁷ In particular, Posner has argued that this reasonable man approach is used to enable courts to avoid inquiries into the costs that a particular party would have had to incur to avoid an accident (1) when there is an allegation that this particular party's costs would have been abnormally high or low and (2) when it would be expensive for the court to evaluate such a claim.²⁸ Although this explanation works for some of the uses to which the reasonable man model has been put, it does not cover the practice on which I focused of selectively interpreting the doctrine to excuse plaintiffs who would have been contributorily negligent under the Hand formula and to hold liable professionals who are not at fault (who used an optimal procedure which did not eliminate the possibility of an injury that, for example, all surgeons cause a small percentage of the time). If Posner would like to reconsider his initial accusation, he might like to note that I then continued: "However, I must admit that the use of a reasonable-man model in cases of inadvertent accidents might make economic sense since actors who cause harm inadvertently may not respond to economic incentives in the way that theories that presuppose maximizing individuals would predict."²⁹

27. Posner, *supra* note 2, at 785.

28. R. POSNER, *supra* note 10, § 6.4.

29. Markovits, *supra* note 1, at 832.

Third, Posner derides my supposed assertion that “strict liability probably is always allocatively superior to negligence.”³⁰ The derision is associated with my supposed failure to realize that a move to strict liability might increase accident costs by reducing accident-avoidance by victims as well as with my “consider[ing] only the effect of a liability rule on the incentive to avoid accidents, and ignor[ing] the costs of administering the rule.”³¹ In fact, I ignored neither victim reactions nor transaction costs. Thus, my actual words were: “[T]he allocative efficiency of the negligence standard can be [assessed] only empirically. . . . [I]n my opinion, transaction costs aside, strict liability would probably be allocatively superior to a negligence standard, particularly where victims are unlikely to reduce the cost of accidents and their avoidance.”³² After having considered the transaction cost issue in some detail, I then added: “My own guess . . . is that transaction costs are likely to be higher under a negligence standard and that strict liability is therefore more allocatively efficient than negligence.”³³ Of course, I admitted that others’ suspicions might be to the contrary.³⁴ In any case, in the real world, one would not have to choose between a universal strict liability and a universal negligence system. Doctrines can, are, and should be adjusted to situations. Both Posner and I know this, and he knows from this piece and from others I have written that I do not support the position he attributed to me.

Why then did Posner make all these misstatements and misattributions? Perhaps it is significant that he did not choose to address any of the substantive points I made under this heading.

II. THE GENERAL A PRIORI CASE FOR THE CAPACITY OF ECONOMICS TO EXPLAIN THE COMMON LAW

A. *My Own Argument*

My second basic attack on Posner’s claim that the common law (and possibly constitutional law) can be “explained” by the eco-

30. Posner, *supra* note 2, at 785.

31. *Id.*

32. Markovits, *supra* note 1, at 847. One can protect somewhat against victim reaction by combining strict liability with contributory negligence, though not all such negligence will be provable and any such doctrine will decrease the tortfeasor’s incentive to avoid accidents. (I should note that the word “expressed” mistakenly appears in the original article in place of “assessed.”)

33. *Id.* (footnote omitted).

34. *Id.*

conomic analysis of allocative efficiency focused on specific limitations of economics that make it extremely unlikely that the economic analysis of allocative efficiency will be able to generate or predict the conclusion of a legal analysis of many common law (or constitutional) duties, liberties, rights, or powers.³⁵ In particular, I described and analyzed the significance of the inability of economics (1) to distinguish prejudices from other tastes; (2) to deal with the right of an individual to choose his or her own life plan and the related distinction between "entitlement" interests and other sorts of psychological or welfare interests; (3) to analyze liberty and its constraint in the way that is relevant for moral and legal discourse; (4) to decide upon the moral or legal status of the interests of the unborn (fetuses, future generations, etc.); or (5) to evaluate choices that cannot be evaluated through voluntary market transactions. As I suggested, if economics suffers from these various disabilities, the economic analysis of allocative efficiency will not be able to decide the many legal issues that turn on the various distinctions and concepts in question. Hence, there are good a priori reasons for doubting Posner's claims for the explanatory power of economics in legal contexts.

B. *Posner's Reply*

Posner has often argued that "the limitations of economics cannot be determined a priori . . ." ³⁶ As I have just indicated, my original article attempted to establish various a priori limitations on economics by pointing out a number of distinctions to which economics is insensitive but which are often crucial in legal and moral debates. Posner made no attempt to respond to my arguments on this issue.

III. THE EXPLANATION FOR THE SUPPOSED ALLOCATIVE EFFICIENCY OF THE COMMON LAW

At least four different explanations have been offered for the supposed allocative efficiency of the common law: a Darwinian explanation, a materialist-career explanation, a justice explanation, and a consent explanation. My original article analyzed in detail each of these types of explanation for the supposed allocative effi-

35. *Id.* at 873-80.

36. Posner, *supra* note 4, at 297.

ciency of the common law.³⁷ Posner had virtually nothing to say about my comments on these matters.

A. *My Own Arguments*

1. *The Darwinian Argument.*—The Darwinian argument is ingenious but doubtful. It purports to account for the supposed allocative efficiency of the common law by arguing that the law would evolve toward efficiency even if judges had no tendency to make efficient decisions because allocatively *inefficient* rules tend to be litigated and hence overturned far more often than allocatively efficient ones. In part, this conclusion is said to reflect the fact that in some areas (torts, for example) disputes (accidents) are less likely to occur where efficient rules are in force. But primarily, it is said to reflect the fact that disputes are more likely to be settled rather than litigated when the law is efficient. The argument for this conclusion is that where some litigants are repeat players, they will hesitate to challenge an efficient rule whose operation does not disfavor them relative to their litigation opponents in the long run, even if it does hurt them in the case at hand, since in such cases the relevant rule will be in the long-run interests of all litigants *ex ante* (assuming that its efficiency does not depend on its third-party effects). My article argued that although this contention has some force, it cannot establish the kind of strong, pervasive tendency toward efficiency that the efficiency hypothesis requires.³⁸ I justified this conclusion not only by questioning the importance of repeat players but also by listing seven reasons why repeat players may challenge efficient rules before the courts as well as four reasons why they may refuse to challenge inefficient rules. Three examples may serve as illustrations: First, when the efficient common law rule does have distributional consequences, a repeat player who would benefit in the long run from an inefficient rule could very well find it profitable to challenge an efficient rule since his litigation opponent might not adjust his settlement offer sufficiently on this account to deter the challenge (either because the inefficient rule would harm the opponent less than it benefitted the challenger or because the opponent concluded that someone else would be likely to overturn the efficient rule even if this challenger did not). Second, a party who would be harmed more in the long run by the establishment of a new, inefficient rule

37. Markovits, *supra* note 1, at 848-72.

38. *Id.* at 853-56.

than he would be helped in the immediate case by its application might still attack the existing efficient rule on the assumption that he or others would be able to secure its judicial or legislative restoration in the future. And third, neither party might challenge an inefficient rule that did have a distributional effect if the inefficient rule benefited one party (who was more of a repeat player, e.g., an insurance company) more than it harmed the other (e.g., an individual claimant) since in such a case the inefficient rule's beneficiary would be willing to adjust his settlement offer sufficiently to induce its victim to forego his challenge.³⁹

2. *The Materialist-Career Argument.*—The second account of why the common law should be expected to become efficient focuses on the career motivation of the common law judge. More specifically, this account maintains that the common law is efficient because common law judges find it in their career interests to make efficient decisions since such decisions will provide material advantages to those individuals or groups best-placed to secure the judges' advancement. Although this argument need not rely on such a hypothesis, it is consistent with Posner's contention that efficient common law rules are in the ex ante long-run interest of everyone they affect.⁴⁰

I pointed out two problems with this explanation.⁴¹ First, I showed that the argument is inchoate and incomplete: It does not contain (a) an account of the career options judges want to pursue, (b) a description of the people or groups that would be influential in enabling a judge to obtain such positions, or (c) an analysis of the relevant distributional impact of allocatively efficient decisions. I also pointed out that Posner's assumption of distributional neutrality was incorrect—at least in the context of the example he proposed (warranties of habitability).⁴² Second, I argued that this theory's assumption that judges can obtain the support of particular groups by furthering their material interests was open to serious question. I would certainly hesitate to promote or hire to a position of personal trust someone who was clearly known to be corrupt in this sense. And I suspect that those with political or economic influence might have similar hesitations. In brief, then, my original article maintained that

39. *Id.* at 854-55.

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

41. Markovits, *supra* note 1, at 857-59.

42. See Posner, *supra* note 40, at 500.

this materialist-career argument was sketchy and unpersuasive at best.

3. *The Justice Argument.*—Posner’s own primary explanation for the supposed allocative efficiency of the common law also is premised on a tendency of judges to make allocatively efficient decisions.⁴³ Posner attributes this alleged tendency to the “fact” that allocatively efficient rules are just and legally correct in the sense that they enforce the rights and correlative duties of all parties before the courts. If this were true, I would expect that judges would choose efficient rules—primarily because I suspect that on the whole judges do try to do justice, but also because I believe that their own careers would be furthered most by doing properly the job they were assigned to do.

Unfortunately, as my article showed,⁴⁴ Posner’s argument for the justice of efficient rules suffers from three crucial deficiencies: (1) It is based on the incorrect assumption that justice in these contexts is a compromise-type mix of happiness, liberty and property rights, equality (in the sense of equality of outcomes), virtue (in particular, honesty and industry), virtue’s recognition (in the sense of rewards reflecting contribution), and individual autonomy (in some undefined sense); (2) it exaggerates the extent to which allocatively efficient rules will promote these various rights, goals, virtues and ideals; (3) it falsely assumes that if one grants this definition of justice, a demonstration that the pursuit of allocative efficiency is more compatible than one might suppose with the attainment of justice’s valued constituents would provide a good reason for believing in the justness of allocatively efficient rules.

In brief, Posner’s definition of justice is inappropriate because it applies the type of standard that is relevant for evaluating general social choices to situations in which rights and duties are at stake. Thus, even if I were content to use the items in Posner’s “ultimate value” list (weighted in some way he failed to specify) to assess the desirability of a policy choice that did not involve anyone’s rights, I would not apply it to the kinds of rights-duties questions that are at stake in common law and constitutional disputes. I do not have sufficient space here to delineate fully the difference between policy standards and rights-duties or obligation standards. However, one can illustrate the difference by focusing on the following situation. As-

43. R. POSNER, *supra* note 10, § 2.2, at 18-19, § 8.1, at 180-81.

44. Markovits, *supra* note 1, at 859-72.

sume that the American football star Tony Dorsett is visiting a friend in a hospital. A doctor approaches Dorsett and tells him that a child in the next room is a tremendous fan of his. The doctor asks Dorsett to visit the child, explaining that the child is in the midst of a disease crisis and that a visit from his hero would clearly cheer him and might even help him through. In this kind of situation, one can ask two different kinds of questions: ought Dorsett visit the child (an ultimate value or policy question) and does Dorsett have an obligation to visit the child (a rights-duties or obligation question). I have no doubt that one's approach to these two questions will be different—one will employ different standards, require different facts and often reach different conclusions when addressing these two issues. Although the Dorsett example almost certainly does not raise any legal issues, the distinction between "ought" questions and "obligation" questions is often as important in legal contexts. For example, I believe that our culture distinguishes clearly between the following two questions: (1) ought the state compensate victims of crime and (2) does the state have an obligation to pay such compensation (i.e., do such victims have a right to such compensation). And again, we distinguish clearly between (1) ought the state redistribute income to achieve greater equality of outcomes or some specified degree of such equality and (2) does the state have an obligation to effectuate such a redistribution (i.e., do the less well-off have a right to have their lot improved in this way). In each of these cases, just as in their moral nonlegal counterparts, our distinction between the "ought" and "obligation" questions is manifest in the fact that the standards or approach we use when trying to answer the "ought" questions differ from their counterparts for the "obligation" questions, as well as in the fact that our answers to the "ought" questions at least sometimes differ from our answers to the "obligation" questions. My point is that Posner seems to be assuming that the same standards apply to both of these sorts of questions. Even if I were to accept his incompletely specified standard for evaluating policy options ("ought" questions), I do not think that they would capture our society's approach to resolving rights-duties or "obligation" questions.

My article also showed that for a variety of reasons Posner has exaggerated the ability of allocatively efficient rules to produce the other things he values. Thus, as I had argued before,⁴⁵ efficient rules

45. See Markovits, *supra* note 15, at 983-90.

will often not maximize utility (since winners may gain fewer utils per dollar gained than losers lose per dollar lost), promise-keeping (since it may be inefficient to keep promises in a variety of circumstances), or industriousness (since the financial incentives that are necessary to induce efficient production from some may make it attractive for them or their children to indulge their tastes for leisure thereafter). Moreover, although egalitarianism may be more allocatively efficient than Posner believes even now, I fear that there still is a real trade-off in the end between allocative efficiency and equality of outcomes. Similarly, even if one granted that a realistic allocatively efficient economy would tend to reward people according to their productivity in one sense (the marginal allocative product of the last equally skilled and industrious person to do their job), it would not reward people according to their productivity in what I take to be the relevant sense (the average allocative product of all equally skilled and industrious people in their line of work).

Finally, I argued that Posner's justice argument is undermined by a basic structural flaw. One cannot justify allocatively efficient rules by showing that they would promote a variety of "goods" to a greater extent than may have been expected. Even if justice could be represented as a compromise-type mix of rights, goals, and virtues, and even if efficiency were more compatible with such rights, goals, and virtues than one supposed, systematic departures from efficiency would still be likely to promote further the desired package of such "goods"—i.e., allocatively efficient rules would still not be likely to be just.

4. *The Consent Argument.*—Posner's final attempt to account for the efficiency of the common law is similar to its predecessor—only now the justness of efficient rules is traced to the "hypothetical" consent of those they affect.⁴⁶ Thus, Posner argues that such rules are just because all the parties they affect would have consented to them had they had the opportunity to do so since the operation of such rules would increase the ex ante weighted average expected dollar welfare of all they affect, given the "fact" that such rules have no ex ante distributive impact. My article responded to this contention in two ways:⁴⁷ first, by rejecting Posner's hypothesis that efficient common law rules have no ex ante distributive impact and concomitantly his premise that all parties would favor them; sec-

46. Posner, *supra* note 40, at 491-96.

47. Markovits, *supra* note 1, at 871-72.

ond, and more fundamentally, by pointing out that consent arguments require real consent, not hypothetical, counterfactual consent. In other words, I argued that the argument was based on a false factual premise and was in any case totally spurious.

B. *Posner's Reply*

Posner's *Reply* contains only two comments that address any of the points I made under this heading. First, Posner attacks my comment that unless positive theorists can show why the common law is efficient, the theory cannot "explain or help us to understand anything,"⁴⁸ claiming that this position amounts to an assertion that "we can have no knowledge of a subject until our knowledge is complete."⁴⁹ I do not understand this assertion. My point was simply this: (1) Since there is no good reason to value allocative efficiency for its own sake, a correlation between allocative efficiency and the law would not help us characterize the law unless, unlike Posner, we could establish some link between allocative efficiency and other values that we are committed to recognizing in such contexts; and (2) since there is no obvious theory explaining why the law should have evolved toward efficiency in the first place (assuming that it has), such a correlation will also not help us characterize the legal process. Throughout all his work, Posner seems to use words like "explain" and "understand" interchangeably with words such as "predict." I take it that the claim I have just addressed somehow reflects his failure to discriminate among these terms.

Second, and finally, Posner closes his *Reply* with a curious comment on my refutation of his claim that the patent system necessarily undercompensates successful inventors by limiting their monopoly to seventeen years.⁵⁰ As I pointed out, since some inventors make discoveries that would have been made by someone else fewer than seventeen years hence, this system will overcompensate some and undercompensate others.⁵¹ This point seemed relevant to me because it suggested that the well-to-do will not always be, as Posner implies, "undercompensated" (paid less than their allocative product). Posner admits his error, but then asserts that it does not undermine his point, which he now claims is that "wealth maximization automati-

48. Posner, *supra* note 2, at 784.

49. *Id.*

50. See Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 129 n.80 (1979).

51. Markovits, *supra* note 1, at 871.

cally redistributes a certain amount of the successful people's wealth in the society to the less well off."⁵² This point, he suggests, is true because "even if the first inventor is overcompensated, inventors as a class are not,"⁵³ since the 17-year limit and the infeasibility of perfect price discrimination imply that the returns to all such inventors will be less than the value of the invention to its consumers. I will address this argument in detail in the accompanying footnote.⁵⁴ In

52. Posner, *supra* note 2, at 793.

53. *Id.* at 794.

54. Posner is correct that in an otherwise Pareto optimal world, the consumer surplus that inventions yield would reduce the profits they generate below the allocative gains produced by their creation and use. He is also correct in asserting that the 17-year limit to the inventor's monopoly implies that inventions that are useful for more than 17 years will, on that account as well, tend to yield less profits to the inventor than allocative gains to society. In fact, the same result will also arise where the monopoly is undercut within the 17-year period by successful attempts to invent around the patent by inventors who never would have been able to proceed without the original inventor's discovery. However, the world is not and cannot be made Pareto optimal, and there is good reason to believe that the existing imperfections (say in competition) tend to distort upwards the private profitability of some inventions (particularly product innovations) by reducing the private cost of their creation and use below their allocative counterparts. Indeed, in my opinion, such distortions will often, if not normally, outweigh the effects of the consumer surplus and limited monopoly on which Posner focuses—i.e., will often result in the patent-holding inventor's receiving profits that exceed his allocative contribution. *See* Markovits, *supra* note 15, at 1012-36. Moreover, in many cases, this result will also apply to the inventor class taken as a whole. (Posner seems to imply that for each successful inventor, there exists a large number of hard-working inventors who make their discovery too late. However, the fact that the successful inventor's discovery would have been made by someone else within the 17-year period does not imply that any inventor, much less a substantial group of inventors, actually did expend substantial efforts in this direction; the successful inventor's patent may deter others who would have made such a subsequent discovery from expending any efforts on such a project.) Thus, in the real world, it is not clear that allocative efficiency will be increased by all or even most profitable (product) inventions (despite the consumer surplus their consumers realize). Nor, correlatively, is it clear that such inventors as a class are paid less than their allocative product.

In any case, even if inventors as a class were "under-rewarded" in this sense, it is debatable whether this result would establish Posner's point. Admittedly, if one ignored second best and granted that successful inventors' wealth included their allocative product, the "under-rewarding of inventors" would imply that their inventing did transfer some of their "wealth" to the less well-off. However, in the real world, and I would say in a Pareto optimal world as well, the supply of labor by the less well-off (the less skilled) will generate an offsetting benefit to the well-to-do (i.e., will also transfer some of the less well-off's "wealth" to the better off). In a Pareto optimal world, each person will be paid a wage rate equal to the marginal allocative product of the last unit of his type of labor to be performed. In virtually all cases, this marginal allocative product will be less than the average allocative product of the relevant type of labor, both because the marginal physical product of labor tends to decline as the number of units of labor increases and because the allocative value of successive units of any product tends to diminish. In fact, for the same reasons, the marginal allocative product of any worker will also be less than the average allocative product of all the units of such labor *he* supplies (since each worker will generally supply more than one unit of labor). Hence, unless Posner is claiming that the "wealth" of suppliers of non-unique labor reflects their productivity only to

the text, however, I will confine myself to stating the two basic reasons why Posner's attempt to rescue his point fails: First, because the existing Pareto imperfections (particularly in competition) raise the private returns from many inventions (particularly product innovations) above their allocative counterparts, it is far from clear that inventors as a class are paid less than their allocative contribution (despite the consumer surplus their inventions' consumers realize); second, because less well-to-do workers are not paid their marginal allocative product in our imperfectly competitive economy and would not be paid their average allocative product in a Pareto optimal economy, there would be no a priori reason to believe that our actual economy or an allocatively efficient economy would on balance transfer "wealth" from the better-off (including successful inventors) to the worse-off, even if inventors were "undercompensated" in Posner's sense (since the economy would also transfer some of the less well-to-do's "wealth" to the better off—i.e., would also "undercompensate" the less well-to-do—regardless of whether their wealth was deemed to include, *inter alia*, their marginal or average allocative product).

Posner has nothing else to say in reply to my detailed critiques of the various explanations that have been offered for the supposed allocative efficiency of the common law. I have just argued that even the points he has made are misguided. The preceding summary of my own analysis should make clear that his comments are in any

an extent equal to the number of units of labor they supply times their labor type's marginal allocative product, their efforts will be seen to transfer their own "wealth" to consumers of their efforts (including the better-off). If I were to adopt this approach at all, my values would lead me to include in each person's "wealth" the average allocative product of equally skilled and industrious workers of his type. But even if one credited each person only with the allocative value of the extra output he personally produced, that value would exceed his total wage to the extent that he provided more than one unit of labor. Moreover, since imperfections in competition will abound in the most wealth-maximizing economy we could arrange in the real world, workers who are producing units of output in such a world will not even be paid a wage rate equal to the allocative product of the last unit of their type of labor performed. This conclusion reflects the fact that the value to imperfectly competitive firms of the additional units of output which a marginal unit of labor produces is less than the value of these units to their consumers (given that the former is a function of the marginal revenue such sellers can obtain by selling these units, while the latter is a function of the higher price for which the units in question can be sold). Thus, in the most allocatively efficient economy we could arrange, employees of imperfect competitors will be deprived of their "wealth" on Posner's implicit definition of this term. Since, then, the less well-off will generate gains for (will increase the wealth of) the well-to-do just as the well-to-do generate gains for the less well-off, there is no a priori reason to believe that a wealth-maximizing economy would in Posner's sense transfer wealth on balance from the well-to-do to the less well-off. Hence, even if one grants Posner's terms of reference, his attempt to reconstruct and rescue his point fails.

case peripheral to my critique of this aspect of the positive economic theory of the common law.

CONCLUSION

My contribution to the *Hofstra Response Symposium on Efficiency as a Legal Concern* contained a detailed, critical assessment of the role that the economic analysis of allocative efficiency can play in legal analysis. It showed (1) that there are good theoretical reasons for doubting the supposedly empirical claim that a particular area of the common law (tort law) is allocatively efficient, (2) that no cogent account has ever been given of why the common law might have evolved toward allocative efficiency, and (3) that there are good, general, noneconomic, a priori reasons for rejecting the hypothesis that the economic analysis of allocative efficiency provides an algorithm for the determination of common law duties and rights.

Posner did not design his *Reply* to be an exhaustive discussion of his *Hofstra* critics,⁵⁵ much less of my article in particular. I accept the legitimacy of a respondent's focusing on points that he takes to be of particular merit or interest. Clearly, however, at least in relation to my work, Posner could not be said to have adopted such an approach. Although he referred to my article sufficiently often to make it appear that he was addressing the thrust of my analysis, his *Reply* failed to undermine my critique of the positive economic theory of law to any extent whatsoever. In fact, Posner's *Reply* failed to comment on almost everything significant I had to say, attributed positions to me that I explicitly did not adopt, and responded irrelevantly or incorrectly to the one or two points it did attempt to meet. That just will not do.

55. Posner, *supra* note 2, at 778.

