LIMITS TO ECONOMICS AS A NORM FOR JUDICIAL DECISIONS

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A basic distinction in law and economics is between the effort to describe or explain what judges and lawyers actually do and the effort to say what they ought to do. In the jargon of social scientists, this is the divide between the positive and normative approaches. After a word on the distinction, I want to raise some questions about the normative approach—a prescription that judges and lawyers should explicitly try to pursue an economic goal such as wealth or utility maximization.

The positive approach to law and economics is—or at least seeks to be—essentially descriptive and value-neutral. Its objective is to try to identify common threads of economic principle running through both prevailing legal doctrines and the case law underlying them, and thus to generate predictions about legal decisionmaking. One such theory is that the common law is "efficient" in the general sense that it tends overall to minimize waste.[1] This is the positive theory whose prevalence I will assume here, but it is hardly the only possibility; another one might be that the common law favors the needier party, or the ruling classes. The positive approach also encompasses the various efforts to explain how it came about that the common law is efficient (assuming for the moment that it is), in the absence of evidence that courts have consciously pursued efficiency.[2]

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1. The word "efficient" has many varieties, but for my purposes this very general definition is enough. *Compare* WILLIAM M. LANDES & RICHARD A. POSNER, THE ECONOMIC STRUCTURE OF TORT LAW 16 (1987) (defining efficiency in the "Kaldor-Hicks . . . sense, in which a policy change is said to be efficient . . . if the winners gain more from the change than the losers lose") *with* Anthony T. Kronman, *Wealth Maximization as a Normative Principle*, 9 J. LEGAL STUD. 227, 227 (1980) (equating efficiency to Pareto superiority, in which no parties are losers).

2. *See, e.g.*, George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65 (1977); Paul H. Rubin, *Why is the Common Law Efficient?*, 6 J. LEGAL STUD. 51 (1977). *Cf.* Paul H. Rubin & Martin J. Bailey, *The Role of Lawyers in Changing the Law*, 23 J. LEGAL STUD. 807 (1994) (arguing that interest group pressures of the sort

The normative approach, on the other hand, is directly concerned with evaluating whether legal decisionmakers, here primarily judges and lawyers,[3] *should* directly pursue efficiency.[4]

Does a positive theory make the case for a normative theory? Assuming the common law is efficient, one might still object that there are better goals to pursue. Further—and this is my main subject—even if one set a very high value on efficiency, and thought that the common law now constitutes an efficient system of allocating liability (or, more plausibly, did so at an earlier date), it wouldn't necessarily follow that the common law will become more efficient, or keep its existing efficiency, when legal decisionmakers resolutely and self-consciously pursue efficiency. If a physiologist explains to a superb high diver exactly what he's doing with his muscles during his very best dives, it doesn't follow that the diver will improve if, in his next dive, he tries consciously to move his muscles according to the physiologist's observations. My guess is that the diver would do worse. Such is the nature of human performance. If we cannot control every variable in a situation (and we rarely can), the value of focusing on one variable or set of variables over any other is unpredictable.

This, of course, hardly means judges should excise economic reasoning from their decisionmaking. In many cases economic analysis is plainly central. For instance, in many cases involving review of government agencies a basic question is the probable effect of an agency rule in advancing a congressionally specified policy objective.[5] The validity of the rule depends on its effects—or rather, its expected effects: if, for example, the rule would undermine a result that all agree was the statutory goal, the appropriate decision would be that the agency had acted arbitrarily and capriciously in promulgating the rule. As economics is the outstanding social science for making testable

familiar from public-choice analysis are the driving forces in the evolution of judge-made law).

3. Judges react, of course, to the arguments framed by lawyers, but lawyers in turn choose among possible arguments based on their expectations of what will fly with judges.

4. *See, e.g.*, Richard A. Posner, *Utilitarianism, Economics, and Legal Theory*, 8 J. LEGAL STUD. 103, 107-11 (1979).

5. *See, e.g.*, Western Resources, Inc. v. Surface Transportation Board, 109 F.3d 782 (D.C. Cir. 1997); Associated Gas Distributors v. Federal Energy Reg. Comm'n, 824 F.2d 981, 1018-20, 1033-38 (D.C. Cir. 1987); Process Gas Consumers Group v. Federal Energy Reg. Comm'n, 866 F.2d 470 (D.C. Cir. 1989).

predictions, it would be bizarre if judges deliberately refrained from its use. Here, then, judicial use of economics is simply a necessity, subject of course to the obligation of the courts to defer to agencies' reasonable determinations. When a legal doctrine requires a court to assess consequences, there is often no substitute for economics.

Beyond that, however, it should give us pause that economics is a tool of the social engineer—and the record of the social engineer in our century has not exactly been triumphant. Of course an obvious answer is that the century's great social engineers were, when using economics at all, using a bastard and ignorant form. I would not for a minute dispute that. Nonetheless, I think it quite likely that the tendency for social engineering to go awry, though less for efficiency-seeking judges than for commissars, is still enough to instill doubt.

The first area of law to be subject to explicit economic analysis—other than areas with economics self-evidently built in such as antitrust—was tort law. And the bulk of twentieth-century common law developments in tort law can, I think, largely be attributed to judges consciously pursuing economic goals. Although it is true that many important torts cases were decided before the law-and-economics movement burst into bloom, the language of the decisions bespeaks a conscious effort to use economics to mold the legal rules.[6]

Of course one response would be to acknowledge the role of explicit economic analysis in modern tort theory and to proclaim it a triumph. That seems unconvincing to me. Tort law is rife with the same problems that plague other experiments in social engineering. When dealing in liability between parties with direct or indirect contract relations (for example, medical malpractice, landlord-tenant, and manufacturer-consumer), it displaces freely negotiated contractual relations with what amounts to compulsory insurance contracts, defined in all their characteristics by the state (in the form of judges).[7] In molding

6. *See, e.g.*, Escola v. Coca Cola Bottling Co. of Fresno, 150 P.2d 436 (Cal. 1944) (Traynor, J., concurring) (invoking insurance effects and incentives toward safer products as justification for strict liability); Greenman v. Yuba Power Products, Inc., 377 P.2d 897 (Cal. 1963) (asserting that such goals require disregard of parties' contract).

7. *See, e.g.*, GRANT GILMORE, THE DEATH OF CONTRACT 89-99 (1974) (observing that obligation dictated by tort law is "swallowing up" the type of obligation traditionally assumed under contract law); Richard B. Stewart, *Crisis in Tort Law? The Institutional Perspective*, 54 U. CHI. L. REV. 184, 187 (1987) ("In short, tort law has become a system of

tort law, the courts have established by state fiat a system of insurance that fails the ordinary test of insurance markets. It seriously limits the ability of the insurers (here, the manufacturers and other suppliers, and, of course, their insurers in turn) to control for moral hazard through deductibles and co-insurance, to match premium levels to risk levels, and to exclude kinds of insurance for which there is little or no market (for example, for pain and suffering).[8] And as a system of deterrence tort likely overdeters in broad areas; particularly in medical goods or services, the result of imposing on the supplier what the judicial system finds to be "full cost" may often be to leave people with inferior options, or none at all.[9]

Another possible strategy for reconciling a prescription for judges to pursue efficiency with the state of modern tort law is to add a crucial qualification, so that a barrier to centralized state control is embedded in the prescription itself. Recognizing that judging in the explicit pursuit of efficiency may carry a risk of unduly shifting decisionmaking from private ordering to the state, the prescription would be for courts to temper their pursuit of efficiency by a recognition that centralized political institutions (for instance, institutions from which exit is impossible or at least very costly) will usually be unable to secure the information necessary for framing efficient solutions. The high cost of exit stifles the production of information because it insulates the decisionmaker (for example, the state, acting through courts or otherwise) from feedback in the form of customer resistance.

But even a view so constrained may not be cautious enough. People wielding the power of the state may be resistant to exhortations to remember their incapacities. Further,

compulsory insurance that converts the risk of a large loss to a few individuals into a small surcharge borne by each consumer of the goods and services that the enterprise produces.").

8. The reason there is little or no market for pain-and-suffering insurance seems clear: although insureds seek through insurance to maximize expected utility over various possible states of the world (for example, states with or without an accident), income is of limited value as an offset for pain. And on the insurers' side of the transaction, the relatively large variance of pain-and-suffering compensation (which would remain large even if determined within dollar limits set by contract) means that risk pools are more costly. Thus it is hardly surprising that insurers find it unprofitable to offer pain-and-suffering insurance at rates that insureds are willing to pay. *See generally* George L. Priest, *The Current Insurance Crisis and Modern Tort Law*, 96 YALE L. J. 1521 (1987).

9. *See* Stephen F. Williams, *Second Best: The Soft Underbelly of Deterrence Theory in Tort*, 106 HARV. L. REV. 932 (1993).

application of the idea may require a better ability to grasp the workings of markets than courts commonly possess. As Judge Easterbrook has said, "Judges move slower than markets but faster than the economics profession—a deadly combination."[10]

A more realistic goal for economics in judicial reasoning might be—to pursue the physiologist-diver metaphor—as a check on bad habits when they arise. Suppose that courts stumble into a notion that they must, in every case before them, make everything come out "right." And suppose that this leads to a persistent pattern of judicial overcontrol, of failure to recognize that in most contexts, over a large run of cases, systems of decentralized power (through clear property rights and freedom of contract) will generate better results than hierarchical, centralized systems. Just as the physiologist might give a useful tip to the diver on some discrete pattern of error, the economist might try to nudge the judge or lawyer out of such patterns. Even here, however, the economist may be struggling in the face of human nature and the attractions of wielding the power of the state and of doing good ad hoc.

Finally, there remains the difficulty that the law is likely to be effective only to the extent that it corresponds with basic understandings of the people.[11] By that I do not mean the result of the latest poll indicating that some particular viewpoint is favored 55 percent to 45 percent. I mean the genuine understandings on which people operate in their private lives. To the extent that a prevailing, centrally determined allocation of liability—to the manufacturer of a product, for instance—has become such a genuine understanding, a decision by judges suddenly to restore freedom of contract may not generate acceptable results.[12]

Here the state of the post-communist societies provides a useful lesson. An optimist observing the fall of communism

10. Frank H. Easterbrook, *Allocating Antitrust Decisionmaking Tasks*, 76 GEO. L. J. 305, 308 (1987).

11. *See, e.g.*, DAVID HUME, A TREATISE OF HUMAN NATURE 484-513 (L.A. Selby-Bigge ed., 2d ed. 1978) (1739-1740); William W. Fisher III, *Reconstructing the Fair Use Doctrine*, 101 HARV. L. REV. 1661, 1692 (1988) (noting the "limited power of the positive law and the degree to which it must and should track customs and popular understandings").

12. Curiously, there seems to be considerable judicial resistance even to the efforts of legislatures, which presumably are more directly in touch with the public, to trim down the tort system. *See generally* Victor E. Schwartz et al., *Who Should Make America's Tort Law: Courts or Legislatures?* (1997) (collecting decisions invalidating state tort reform laws on purported constitutional grounds).

might have said, "Well, the state at last, as Marx predicted, has withered away, and the market can flourish." But it turned out that some critical understandings of the people were missing. Seventy-four years of communism turned out to have drastically eroded social capital—the habit of keeping promises, respect for private property, trust, independence, initiative, capacity to join in cooperative, risky, long-run ventures, readiness to refrain from violence—many of these, of course, in short supply even in 1917. Even if some brilliant person with a full command of the best ideas in market economics—hardly an accurate description of Yeltsin—had taken charge of the state, it would be fantastic to suppose that a flourishing market economy would have come into being.[13] By the same token, even judicial pursuit of efficiency qualified by a deeper sense of the inadequacy of centralized power could not, I suspect, quickly restore the social capital depleted, in significant part, by the decisions of economically inclined judges.

This last point—the constraint imposed by past decisions that have tended to erode private ordering—of course may leave open a substantial field where private ordering still prevails, and in which pursuit of efficiency, if restrained by a strong intuition of the perils of centralized power, might function well.

The alert reader will have noticed the paradoxical character of this paper. Suggesting that judges be cautious in the use of economic reasoning, I have also called it "the outstanding social science for making testable predictions." Am I to be taken as exhorting judges to use some inferior instrument for assessing the effects of the legal rules that they "find," to use one model, or "create," to use another? What would this instrument be, and why would one prefer an inferior to a superior tool? If the monopoly power of courts to form the common law makes them social engineers, do we not want the best social engineering we can get?

Perhaps the best answer is to refer the reader to the fate of Icarus, who was done in by his exuberant use of new learning. As everyone knows, he and his father Daedalus were trapped in the Labyrinth in Crete because Daedalus had offended King Minos. But Daedalus ingeniously devised wings, enabling him and

13. As someone pointed out at the time of the fall of communism, it is easy to turn an aquarium into fish soup, but very hard to turn fish soup into an aquarium of lively fish.

Icarus to escape by air over the sea. Icarus, swept away by feelings of joy and power, and disregarding his father's exhortations, flew so high that the sun's heat melted the wax of his wings and he fell into the sea.