

OF SEX AND DRUGS, AND ROCK'N'ROLL: DOES LAW AND ECONOMICS SUPPORT SOCIAL REGULATION?

ERIC RASMUSEN*

The economic approach to law is usually associated in people's minds not with conservatism per se but with a libertarian approach to public policy, the idea that each person's conduct is his own affair and not that of his fellow citizens. Libertarianism and traditional Anglo-Saxon social conservatism are both skeptical of economic regulation, but they differ completely in their attitude toward social regulation. Indeed, using the taxonomy of Table 1, libertarians have as much in common with liberals as with conservatives.¹

TABLE 1: ATTITUDES TOWARDS REGULATION²

SOCIAL REGULATION		
	FOR	AGAINST
FOR	European Conservatives	Modern Liberals
ECONOMIC REGULATION		
	AGAINST	Libertarians
	Anglo-Saxon Conservatives	

* Associate Professor, Indiana University School of Business.

1. This article will not address the concerns of the "modern liberal" and "European conservative" in Table 1, because neither, in their purest forms, accepts the arguments of economic laissez-faire.

2. For a similar quadrotomy which contrasts views on regulation of commercial and non-commercial speech, see Kathleen M. Sullivan, *Free Speech and Unfree Markets*, 42 UCLA L. REV. 949, 952 (1995).

But law and economics is an analytical approach, not a political position. It does not automatically imply that laissez-faire is the best economic policy, nor that regulation of vice and virtue is outside of the scope of government. The approach is based on the idea that people respond to incentives, balancing costs against benefits, and that the law should aim for efficient outcomes, where "efficient" means that no change is possible that would help the winners more than it would hurt the losers. "Win" and "lose" are defined in terms of people's own preferences, rather than any higher taste or morality. The ultimate aim is to satisfy people's desires: "If it feels good, do it."

Usually, efficiency implies minimal government involvement. If Rasmusen pays forty dollars for Epstein's copy of *Simple Rules for a Complex World*,³ it must be that Rasmusen and Epstein both benefit, or they would not both agree to the transaction. Rasmusen values that copy of the book at more than forty dollars, and Epstein at less. The efficient outcome is for Rasmusen to have the book. The situation will not be improved if the government picks the price or decides whether Rasmusen really will like the book or not. The Invisible Hand does a fine job of getting the book to end up in the hands of the person who values it most. Laissez-faire is optimal.

Notice, by the way, that if the government did allocate the book, it should give it to Rasmusen, since he values it more. But we do not need government action to get that result.

The government does play a role in allocating property rights. It can decide that Epstein initially owns the book and Rasmusen must pay for it. Alternatively, the government could decide that the book belongs to Rasmusen, and Epstein would have to buy it if he wanted it. Or, the government could claim ownership itself and auction it off. However the government allocates the property right, though, Rasmusen will have the book in the end, because he is willing to pay the most for it. Even in the government auction, Epstein would bid only \$35, and Rasmusen would bid up to \$45. Rasmusen would become the owner of the book—the efficient result. As long as market transactions are

3. RICHARD A. EPSTEIN, *SIMPLE RULES FOR A COMPLEX WORLD* (1995).

allowed, property ends up in the hands of whoever values it most.⁴

Laissez-faire's success does depend on certain conditions. The parties to the transaction must have good information and realize what they are buying and selling. Property rights must be clearly defined. Monopoly and strategic behavior can cause problems. (In this example, however, Epstein's copyright monopoly on his book does give him an incentive to write more books.) And, there must be no externalities—no spillover effects on third parties who are not involved in the transactions. All of these problems, listed in Table 2, are ordinarily avoided in conventional markets.

TABLE 2: VARIETIES OF MARKET FAILURE

1. *Asymmetric Information*: Some people know things about product quality and likelihood of events that other people do not.
2. *Imperfect Competition*: Some buyers or sellers are large in the market and can influence prices by how much they buy or sell.
3. *Externalities*: An activity helps or harms other people without the actor being able to charge them or having to pay them.
4. *Incomplete markets*: Some potential products cannot be bought or sold.

The intellectual imperialism of economics has taken it far beyond conventional markets. James Buchanan and Gordon Tullock have applied it to politics.⁵ Eric Posner has applied it to social norms.⁶ Gary Becker has applied it to crime, race

4. The conclusion that under these conditions goods are allocated efficiently regardless of initial ownership is known as the First Theorem of Welfare Economics. See, e.g., HAL VARIAN, *MICROECONOMIC ANALYSIS* 326 (3d ed. 1992).

5. See, e.g., JAMES M. BUCHANAN & GORDON TULLOCK, *THE CALCULUS OF CONSENT* (1962).

6. See, e.g., Eric A. Posner, *Law, Economics, and Inefficient Norms*, 144 U. PA. L. REV. 1697 (1996).

discrimination, and child rearing.⁷ Richard Posner has applied it to law, aging, and sex, and even, I think, to all of these in combination.⁸ Such breadth in applying economic methods is quite appropriate. Cost and benefits matter everywhere; markets of a sort operate; and efficiency is always a worthy goal. The problem is that the economist's instinct is still *laissez-faire* and libertarian in these new domains of application. Apparently conservative economists, for example, often surprise people by supporting abortion and drug legalization.

The economist's *laissez-faire* instinct is, I think, mistaken there. The method of economics can certainly be transplanted to the social arena, but it does not necessarily reach the same *laissez-faire* conclusions. Economics does not *assume* that *laissez-faire* is best—it *shows* that *laissez-faire* is best under certain common conditions. Government coercion is not bad in itself, but only because it is usually inefficient. Virtue is not directly a consideration, which may dismay social conservatives, but neither is the libertarians' and liberals' *summum bonum* of personal autonomy. The efficiency criterion can thus lend support to traditionalist moral positions when the standard assumptions needed for the optimality of *laissez-faire* fail, as they often do when the transactions are not in dollars.

Indeed, the social arena is almost defined by the failure of those assumptions. When two people consider divorce, for example, their information is poor, their behavior strategic, and their property rights ill-defined. As a result, their decisions result in externalities on their families, friends, and society. We cannot expect the Invisible Hand to operate well under such handicaps.

I would like to concentrate on one of these handicaps: externalities. Any time person A would be willing to pay to stop person B's action, there is what economists call an externality—B's action has spilled over onto A.⁹ Externalities justify government regulations such as rules restricting air pollution.

7. See, e.g., GARY S. BECKER, *ECONOMICS OF DISCRIMINATION* (1971); GARY S. BECKER, *TREATISE ON THE FAMILY* (1981); Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169 (1968).

8. See, e.g., RICHARD A. POSNER, *AGING AND OLD AGE* (1995); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* (2nd ed. 1992); RICHARD A. POSNER, *SEX AND REASON* (1992).

9. See generally A.C. PIGOU, *THE ECONOMICS OF WELFARE* (4th ed. 1932) (a classic reference on externalities and market failure); Francis Bator, *The Anatomy of Market Failure*, 72 Q.J. ECON. 351 (1958) (same).

Under *laissez-faire*, a factory might be willing to inflict \$10 million in air pollution on its neighbors to save itself one million dollars in costs. This is an inefficient outcome, quite apart from the morality of the factory's actions. To be sure, the Coase Theorem tells us that the allocation of property rights does not matter if it is easy for the affected parties to bargain with each other.¹⁰ Even if the government gives the factory the right to pollute, the neighbors could conceivably get together and pay the factory *not* to pollute. The efficient result would be obtained, just as when Rasmusen buys the book from Epstein because Rasmusen values it more but Epstein has the initial right to the book. If there were just one neighbor, the factory selling the pollution right to him would be quite feasible. But if there are 100 neighbors, bargaining breaks down because each neighbor would like to free ride and have the other 99 neighbors pay. Such being the case, efficiency requires not giving the factory the right to pollute in the first place.

Externalities do not have to be physical effects such as neighborhood trees dying from air pollution. In particular, mental externalities are possible which are purely states of mind. Consider cigarette smoke. Common justifications for banning smoking in elevators are (a) that it is a fire hazard, and (b) that it causes lung cancer in nonsmokers. Those are not the real reasons. The real reason is that nonsmokers dislike the smell of smoke. To the economist, if not to the liberal, this is a fully legitimate reason for objecting, if smoking bothers nonsmokers more than it helps the smoker.

We can also apply the idea to illegal drugs. If ten people would each pay \$100 to prevent Jim from injecting heroin, and he would only pay \$400 for the right to do so, it is efficient to stop him, regardless of any considerations of morality. In economics, we take tastes as given. We do not need to ask whether it is reasonable that these ten people would pay \$100. It could be that they are friends of Jim and care about his health. It could be that they are friends of Jim who want to go bowling with him instead of watching him doze. Or, it could be that they do not know Jim personally but have moral objections to heroin use.

10. See Ronald Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

Economists are not, contrary to common belief, materialists. The value of something is what people are willing to pay for it, and if people are willing to pay for something abstract like a heroin-free society, efficiency demands that they be given the right to purchase that society. Such a society restricts Jim's liberty, but no more than a society in which he is forbidden to drive off in someone else's car. When people want different things, society must resolve the conflict, and efficiency suggests resolving it in favor of whoever cares more about it.

The efficiency argument will not take the social conservative as far as he might like. It is not an argument for the government to make people more virtuous against their will, for example. One must go outside of externality analysis for that. But efficiency is an argument for letting people stay as virtuous as they are already, and for allowing them to indulge their taste for a virtuous society.

Mental externalities do not have many implications in the purely economic sphere. I may not like it that you listen to rock music, but I am not willing to pay much to stop you. I don't care at all if you eat cheddar cheese, even though I do not care for it myself—unless, that is, I'm in an elevator with you. In the social sphere, however, friends and relatives care a lot about each other, and they even care what neighbors do in the privacy of their homes.

The idea of mental externalities does allow a fresh look at many social issues, from pornography and flag desecration to blasphemy and abortion.¹¹ It is often said that a person should be able to do anything he likes so long as he does not hurt anybody else:¹² *sic utere tuo ut alienum non laedas*. But if person A is bothered by person B's actions, B is hurting A. The only question is how much.

Law and economics scholars already recognize that much of traditional criminal law is justified on efficiency grounds.¹³ Stealing is inefficient because the thief does not value the stolen

11. See, e.g., Eric Rasmusen, *The Economics of Desecration: Flag Burning and Related Activities*, J. LEGAL STUD. (forthcoming 1998).

12. See, e.g., John Stuart Mill, *On Liberty* (1859), reprinted in ON LIBERTY, REPRESENTATIVE GOVERNMENT, THE SUBJECTION OF WOMEN 5, 92-114 (Oxford Univ. Press 1946).

13. See, e.g., A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS, 75-86 (2d ed. 1989).

goods as much as the owner did. Rape and murder help the criminal less than they hurt the victim. Should we not suspect that traditional laws against victimless crimes are also efficient? Drunkenness, prostitution, adultery, pornography, sodomy, and blasphemy have all been banned. Why, unless many people felt harmed by them? One must balance the willingness of some individuals to pay to commit these actions against the willingness of others to pay to prevent them. If the willingness to pay to prevent is the greater, then efficiency justifies a rule against sodomy as much as a rule against theft. The public policy issue is the empirical question of whose desires sum to the greater amount: the people who want to engage in vice, or the people who want to stop them. Which is greater, Jim's desire to use heroin, or others' desire to prevent him?

When I said that efficiency means, "If it feels good, do it," I exaggerated. External effects need to be counted too. Your favorite vice may feel good, but don't do it if it feels bad enough to someone else. Economics gives as much weight to moral principles as to immoral pleasures.

Richard Epstein and I are in agreement that efficiency can justify some forms of social regulations, and also that it is not enough just to say that.¹⁴ A social regulation must be justified by its efficiency in its particular context. Negative externalities can indisputably justify air pollution regulation, but acknowledging this effect does not end the policy debate. That is only the starting point for scientists and economists to determine the amount of needed regulation. The works of Goodman and Kindt cited by Professor Epstein are good examples of this type of pinpointed policy research.¹⁵

It is necessary to keep in mind, however, that mental externalities, despite the need for evidence of their existence and size, do not require physical effects. The medical externalities of venereal disease are one argument for regulation of homosexuality, but simple repugnance is another. Both arguments require evidence: how much disease is associated

14. See Richard A. Epstein, *Externalities Everywhere?: Morals and the Police Power*, 21 HARV. J.L. & PUB. POL'Y 61 (1997).

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

with the practice to be regulated, and how much repugnance and pleasure does it generate? Magnitudes matter.

Professor Epstein's observations that (a) political and legal arguments often skip the quantitative analysis of externalities, and (b) appeals to "symbolic" effects are particularly suspect are both correct. It is not enough to cite individual cases of disease or repugnance. These merely show the existence of negative externalities, not their weight compared to positive benefits. Nor is it enough to say that a certain regulation symbolizes an issue about which citizens deeply care. We cannot infer that they care anything at all about the symbol, as opposed to the issue itself.

So, Professor Epstein and I agree in principle and call for further research. This is a boring outcome, perhaps, given such exciting issues, but a good sign, I think, for the scientific method in law and economics.

Three other objections have been made to the efficiency approach, based on politics, morality, and equality. The political critique is that public choice might operate in a manner opposite to that which I have suggested. The legalization of homosexual activity might not be an example of a special interest group gaining favor despite an overall efficiency balance to their detriment. Instead, perhaps a small group was not organized for a long time, causing its preferences not to appear in the political process. Other people, who opposed homosexuality, might not have been willing to pay an economic price to stop it, as with a boycott, but would nonetheless vote for restrictions on sexual behavior. Similarly, blacks in the South could not vote, and although white bigots might not have been willing to pay a premium to ride in a segregated car, they would vote for segregationists because casting a vote is practically free.¹⁶

The political argument fails to recognize that politics is not just a matter of casting one's vote on a single issue. In American politics, the tyranny of the majority is not a given outcome. A tyranny of the minority—a group that benefits from legislation and lobbies harder because the benefit is concentrated and the cost diffused—is equally likely. Moreover, a vote is never free. If a citizen casts his vote for a candidate only on the basis of the

16. This argument was suggested at The Sixteenth Annual National Student Federalist Society Symposium on Law and Public Policy (1997) by Professor David Bernstein of George Mason Law School.

homosexuality issue, he loses his chance to cast it on the basis of a tax issue.¹⁷

This response to the political critique must distinguish between a minority that can vote and one that cannot. If a group of people cannot participate in the process, the political market will not work. Southern blacks could not vote, and political decisions did not include their preferences. Disenfranchisement aside, however, the smaller the group, the easier it is to organize. The more intense its preferences, the more each member of the group will be willing to engage in political action.

Morality provides the basis for a second objection to efficiency-based social regulation. Consider a child who says to his parents, "I am trying to decide whether I approve of pornography or not. What should I think about?" The efficiency argument seems to suggest that the parents should go out and survey people on how much they would be willing to pay to have pornography. They could then report back to the child, "There is \$100 million for it, and \$10 billion against it, so pornography is immoral." This reasoning is circular, because the child is trying to decide what his initial preference should be. If everyone followed this approach, they could never reach a conclusion. The efficiency criterion skirts the real issue of which desires are morally correct.¹⁸

The objection that efficiency cannot aid in determining personal preferences points out that this study is about political philosophy, not ethics. In this, I am following the usual path of economics. Consider Michael Jackson's music. In deciding whether to regulate the price of his recordings, the most salient issue is not economic efficiency but the quality of the music. Economists do not follow this route, even though aesthetics can have philosophical underpinnings as sound as ethics or politics. Instead, economists are content to say that the restriction of record sales is inefficient, taking consumers' willingness to pay as given and not inquiring into whether their taste is vulgar or refined. This paper shows that social regulation should, when

17. For an enjoyable exposition of the point that no vote is costless, see J. MARK RAMSEYER, *PUBLIC CHOICE* (Chi. Law and Econ. Working Paper No. 34, 2d Series, 1995).

18. Both the morality argument and the equality argument that follows it were raised at The Sixteenth Annual National Student Federalist Society Symposium on Law and Public Policy (1997) by Professor Eric Posner of the University of Pennsylvania School of Law.

appropriate, be supported even by law and economics extremists who are unwilling to impose their morality or religion but are willing to consider the citizen's moral preferences as data similar to musical preferences.¹⁹

The final objection to efficiency-based social regulation concerns equality: the efficiency criterion is dubious because it relies on willingness to pay, which depends on the distribution of wealth.²⁰ Suppose our hypothetical parents doing the pornography survey found ninety-thousand people willing to pay ten or fifteen dollars to keep pornography legal but encountered one person, Bill Gates, who said, "Oh, I'd pay \$2 billion to make it illegal." Should Bill Gates's willingness to pay trump that of everybody else? Efficiency says that it should. He is willing to pay more than all the people on the other side of the issue, so he wins.

This equality critique is an old and important criticism of laissez-faire economics. A house exists, and society must decide who gets to live in it. We let Bill Gates have it, because he is willing to pay the most. Some people will complain that Bill Gates is rich: Why should he have the house merely because he is willing to pay more? The economist replies that if one believes inequality of wealth is wrong, then the solution is to tax it away rather than use inefficient regulation or apply laws differently to the rich and the poor.²¹

Moreover, it is unclear how income distribution affects social regulation. To the extent that poor people are more supportive

19. For intriguing attempts to link efficiency with morality, see George J. Stigler, *Wealth, and Possibly Liberty*, 7 J. LEGAL STUD. 213 (1978) (suggesting that wealth and liberty maximization are conceptually similar); HERBERT HOVENKAMP, *ENTERPRISE AND AMERICAN LAW 1836-1937*, at 67-78 (1991) (distinguishing Adam Smith's Scottish Realism from Bentham's utilitarianism and connecting them with American and English law respectively). Adam Smith's *Theory of Moral Sentiments* is largely about mental externalities; his principle of "sympathy" states that human feelings are often inspired by imagining the feelings of other people. See ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS* (1759), reprinted in *THE ESSAYS OF ADAM SMITH* 9 (Joseph Black & James Hutton eds., Alex. Murray & Sons 1869).

20. For a more favorable view on the effects of distribution of wealth, see RICHARD A. POSNER, *THE ECONOMICS OF JUSTICE* 88-115 (1981); see also Lloyd Cohen, *A Justification of Social Wealth Maximization as a Rights-Based Ethical Theory*, 10 HARV. J.L. & PUB. POL'Y 411 (1987) (analyzing Richard Posner's views on the correspondence between moral intuitions and wealth maximization).

21. See, e.g., Louis Kaplow & Steven Shavell, *Why the Legal System is Less Efficient Than the Income Tax in Redistributing Income*, 23 J. LEGAL STUD. 667 (1994).

of morals regulation than rich people,²² efficiency analysis would lead to less morality regulation, not more. Indeed, one explanation for the decline of social regulation is the increased importance of the courts, which give greater weight to wealth and education than the electoral process.

All three of these objections—the workings of the political process, the basis for fundamental moral preferences, and the problem of income distribution—are worthy topics for study. It is not clear, however, whether further analysis of them will strengthen or weaken the argument for efficiency-based social regulation.

22. Cf. George Gallup, Jr. & Frank Newport, *Americans Back Bush on Flag-burning Amendment*, THE GALLUP POLL MONTHLY, Jun. 1990, at 2 (reporting a poll finding that all income levels supported laws against flag desecration but finding lower income Americans more likely than higher income Americans to support such laws).

