

RISKS AND WRONGS

JULES L. COLEMAN*

The essays in this issue are often generous both in their interpretation of my book and their criticisms of it. I am extremely grateful to the authors for taking the time to work through a long and complex manuscript and for throwing enormous light on it. Rather than responding to particular objections raised in these papers, I take this opportunity to set out the major themes of the book, the motivation for them, and the aspiration that ties the work together.

In the late 1970s and early 1980s I wrote a series of papers critical of the economic analysis of law on two fronts—one analytic, the other normative. First, I showed that the notion of efficiency used in the literature was ambiguous and that in fact the dominant notion was neither Pareto-optimality nor Pareto-superiority, but Kaldor-Hicks. Kaldor-Hicks is problematic for a variety of reasons, the most important of which is that it is intransitive. I am grateful for the fact that the current literature more often than not owns up to its use of the Kaldor-Hicks formulation of efficiency, even if it does not own up as readily to the technical problems with it.

In addition to attempting to clarify the concept of efficiency and to articulating its logical structure, I criticized various claims made on behalf of its normative attractiveness. I argued against both the classical theory that efficiency could be defended on utilitarian grounds and Posner's claim that it could be defended on what he thought of as Kantian or deontological grounds.

Since no honest academic really believes that his work will make much of an impact on the course of a discipline, I have often been gratified and alternately disturbed by the effect of these essays. While advocates of law and economics, like Guido Calabresi, have taken my work to have shown the "pointlessness of Pareto,"¹ some critics of economic analysis have used my arguments to reject the entire enterprise. This disturbs me because I never felt my argument supported such a strong con-

* John A. Garver Professor of Jurisprudence and Philosophy, Yale Law School.

1. Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 YALE L.J. 1211 (1991).

clusion. I always took these articles to be "friendly," even if severely critical.

Most lawyer-economists have accepted neither Calabresi's conclusion that Pareto is pointless nor the stronger interpretation that economic analysis is indefensible. Still, it is fair to say that most foundationally-minded proponents of economic analysis have acknowledged the force of my arguments while at the same time viewing themselves as fully justified in ignoring them. Perhaps this is because the most serious objections I have previously raised were to the normative dimensions of economic analysis, whereas most economists and lawyer-economists are concerned primarily with the explanatory and predictive dimensions of efficiency. This response is understandable, but unpersuasive.

We can distinguish between normative and positive social science. Positive social science is concerned primarily with explanation and prediction. When logical positivism reigned supreme in the social and natural sciences, it was commonly thought that explanation and prediction were structurally connected. This is best seen in the work of Hempel and Oppenheim, who argued that nothing could count as an explanation of an event *ex post* if it could not have constituted an accurate and justified prediction of that event *ex ante*. Explanation and prediction have the same logical form; what differs is the temporal dimension.

Philosophers of the social and natural sciences no longer cling to this account of the relationship between explanation and prediction. The standard view is that a theory can have predictive value whether or not it serves as an explanation of a social practice or natural phenomenon. This may well be true of law, and true of the economic account of law in particular. If we assume that agents are utility maximizers, it might well be possible to predict a range of behavior. Under certain conditions, rational agents so conceived will settle disputes rather than fully litigate them, individuals and manufacturers will invest in certain levels of safety, and so on. But law is more than the summary of the behavior of relevant individuals. Law is normative in two important ways. First, to say that law is normative is to say that it provides the relevant individuals with *reasons* or grounds for their actions, in the sense that the mere fact that a norm is law gives an agent a reason for acting (in

compliance with it). Second, law involves the exercise of coercive authority. Coercion itself requires a justification.

Understanding law requires giving an account of its normativity. Efficiency cannot help us to understand law if efficiency has no normative dimension or foundation. That is why it is not enough for advocates of economic analysis to be content with ignoring the arguments I and others have advanced against them. If efficiency is not something of value, how can the coercive authority of the state be justifiably imposed to promote or secure it? How would pursuing efficiency honor the practice of adjudication? Why would anyone have an intrinsic reason for acting in compliance with it? And so on.

If the goal of economic analysis is predictive only, it does not matter whether efficiency has a normative grounding or, if it does, whether that grounding is itself defensible. All that matters is its capacity to predict. But prediction is not the same thing as explanation. And economic analysis that is only a predictive tool contributes nothing to an understanding of our practices, practices that are essentially normative. Indeed, one could argue that, understood in this way, economic analysis simply alienates us from our practices.

Even when I wrote articles critical of economic analysis, I believed that the economist or lawyer-economist could do better. In the mid-1980s, I took up the task of seeing if I could do better on the economist's behalf. Whereas I did not believe that defenders of economic analysis had presented a compelling defense of efficiency's normativity, I believed that such a defense was possible. I started a manuscript, entitled *The Market Paradigm*, the purpose of which was to provide that defense.

Instead of arguing that the pursuit of efficiency could be defended on classical utilitarian grounds or on Kantian grounds, I developed the idea that economic analysis could fall out of a general political philosophy I called rational choice contractarianism. Rational choice contractarianism has its roots in Hobbes. In turn, rational choice contractarianism would fall out of a general reductionist approach to the social and moral sciences I called the market paradigm.

The market paradigm begins with two primitives. The first is the principle of individual rationality. The second is the perfectly competitive market as the idealized embodiment of indi-

vidual rationality. The basic idea is this: Norms provide reasons for acting. Many of the interesting norms in the social sciences, including legal and moral ones, impose constraints. Constraints are limitations on the extent to which individuals can act on the basis of their rational self-interested motivation. But if we assume that agents are motivated only by rational reason (primitive 1), then the norms that constrain that motivation can be acceptable to them only if they are rational for them. Only rationality can constrain rationality.

Under what conditions, if any, does rationality counsel constraint on rationality? My view is that we should answer this question by first answering another: Are there any conditions under which it is not rational to constrain one's rationality? If there are, then it will be rational to constrain one's rationality when those conditions are not met.

In fact, it is not rational to constrain one's rationality under conditions of perfect competition (primitive 2). Under these conditions, each agent acting in a purely self-interested way does as well as he might given the welfare of others. Any individual, therefore, who imposes constraints or limitations on his self-interested behavior must do less well for himself than if he had not so constrained himself. Under these conditions, constraint is not rational for individuals. It follows that constraints are rational only if the conditions of perfect competition are not met. Constraint is rational if it is a response to market failure.

Law is a set of constraints on individually utility-maximizing behavior. Law is rational only under conditions of market failure. Thus, the best way to understand law is to see it as a response to the generic problem of market failure. In addition, law is a set of constraints imposed on all those individuals within its domain of operation. Its justification depends on its being rational for each of them (*ex ante*). Thus, legal authority is justified provided it could have been agreed to by those individuals against whom the authority is exercised. Law represents a rational (but hypothetical) contract among them. Thus law and economics falls out of a form of rational choice contractarianism that itself falls out of the market paradigm, which we have identified with the two primitives of rationality and the market.

Part I of *Risks and Wrongs* develops but ultimately rejects the

market paradigm. In particular, it rejects the second primitive, namely the perfectly competitive market as the analytic and normative point of departure for our understanding of cooperative interaction, including law. Schemes of mutually imposed constraints are schemes of rational cooperation. In the market paradigm, cooperation is rational as a response to failed competition. Against this analysis, Part I argues that the market is itself a scheme of cooperation and, more generally, that competition presupposes cooperation. Thus, it rejects the idea that all cooperative schemes, including legal ones, are best understood as responses to market failure.

Part I does not abandon the possibility of presenting a defense of economic analysis, however. Indeed, it accepts both the principle of rationality and the centrality of the market. It gives a different understanding of the rationality of the market and of its place in liberal political theory, however. The basic idea is this: Markets allow individuals to interact with one another over a specified domain without those individuals first having either to share a conception of the good, or what is good in life, or to openly express and resolve their differences on these matters. Markets raise but do not require resolution of fundamental value differences. This property of markets is especially valuable in large, heterogenous, liberal cultures like our own, or so I argue.

It is a property of markets that is important, moreover, because of the contribution it makes to *social stability*. The underlying consensus that binds us together in liberal cultures is both difficult to secure and fragile. Allocation decisions that require us constantly to confront the extent of that consensus strain it unduly. Markets allow us to finesse those questions over whatever domain they range.

In the market paradigm, law and morality are solutions to market failure. In the alternative view I develop, law and morality give effect to value commitments not expressed through markets. In political and moral debate, a community asks itself what ought to be allocated through markets, what the distribution of holdings ought to be, and so on. Such debate provides the framework through which the community uncovers its identity. Rather than seeking to promote efficient allocations of resources when markets cannot, the law, morality, and political

discussion provide us with the opportunity to give voice to fundamental values that markets are poorly suited to express.

I call my account of the market “rational choice liberalism.” Like the market paradigm, it is committed to the principle of rationality and to the market. Unlike the market paradigm, rational choice liberalism does not take the market as an analytic point of departure in terms of which social cooperation is to be explained. Rather, it takes the market as a form of cooperation, rational under circumstances likely to arise in liberal cultures like our own.

The market paradigm promised a defense of economic analysis in the sense that law would be understood as a scheme of rational cooperation for mutual advantage, the point of which is to secure efficiency when markets cannot. Rational choice liberalism does not promise a defense of efficiency as an independent moral ideal or value. Indeed, I argue against the claim that it does. Instead, rational choice liberalism defends the importance of *markets*, not efficiency. So, the kind of economic analysis I favor emphasizes the importance of markets in liberalism, and in doing so it downplays both efficiency and libertarian accounts of the market.

Suppose I am right that markets are important to the liberal because of the contribution they make to social stability under circumstances likely to arise in modern, liberal political democracies. Markets are important, however, precisely where they are most difficult to create and sustain: under conditions in which individuals have very different values, and where interactions among them are one-dimensional and non-repeating. Market transactions or exchanges can be viewed as local cooperation problems. Under these conditions, cooperation is difficult. Individuals with vastly different values will have considerable difficulty in determining whether cooperation can be mutually beneficial. Formally, we might say that they will have difficulty identifying the contract curve or its location. Moreover, strangers are not in a position to rely on reputation effects to insure compliance with whatever agreements they reach, and so on.

Suppose markets are sets of discrete, local cooperation problems. Uncertainty makes markets desirable, but it also makes market interactions difficult. Whereas we reject the idea derived from the market paradigm that law serves to promote

efficient outcomes, we accept the alternative hypothesis that at least some parts of the law can be understood in the light of the role they play in creating and sustaining markets—that is, in solving local cooperation problems. If exchanges are primarily threatened by uncertainty, then these parts of the law can be understood in light of the role they play in reducing uncertainty. That is precisely the approach to contract law that I take up in Part II of the book.

The central idea in Part II is that markets are sets of local cooperation problems. A local cooperation problem can be modeled (heuristically) as a bargaining problem embedded in a Prisoner's Dilemma. There are three aspects of rational cooperation expressed in the model: coordination, division, and compliance. The parties must first determine whether there are gains to be had; then they must divide the gains; then they must enforce their understanding or agreement. On the other hand, it makes no sense for them to bargain over the terms if compliance is not forthcoming. Uncertainty regarding all three elements of the problem makes its resolution difficult. The claim is that various contractual norms can best be understood in light of the role they play in reducing the relevant sort of uncertainty. In this regard, I discuss both disclosure and default provisions in contracts.

Let me say a word about default provisions. Contracts are invariably incomplete. We can distinguish between two different kinds of rules for filling in the blanks. The first are gap filling rules that a court might impose *ex post* in the event some contingency arises for which the parties have made no provision. Default rules are background norms that apply to the parties unless they contract around them. In the book, I give both default and gap filling rules the same kind of analytic treatment.

When the parties have not explicitly allocated risk *ex ante*, it is reasonable to ask what allocation should be imposed upon them *ex post*. Some might argue for the view that courts should allocate costs *fairly*, using the occasion provided by the silence of the parties as an opportunity to do justice. Others may feel that the courts should take the opportunity to encourage future parties to reveal information that will help in their negotiations. In the view presented in Part II, legal norms are transaction resources on which the parties can draw when their supply of

endogenous resources has run down. These exogenous norms are used to conserve endogenous transaction resources. Thus, default and gap-filling rules should serve this function. They will if they impose those rights and responsibilities on the parties to which the parties themselves would have agreed *ex ante*.

Uncertainty is a transaction cost. Sometimes transaction costs are sufficiently high to prevent individuals from completing or fully specifying a contract. Other times transaction costs are so high they prevent individuals from entering into contractual relations altogether. Transaction costs can keep us strangers. Contract law helps allocate risk among non-strangers. What part of the law allocates risks among strangers? What principle for allocating risk should apply among them?

Tort law allocates risks among strangers. Tort law is simply a default rule writ large. Instead of completing a contract between parties, tort law *writes* a contract among individuals who are not in a contracting position. But what contract? The answer is simple. The norms of tort law should be those to which the parties would have agreed *ex ante*. Such a contract, given the assumed rationality of the parties, would be efficient. Thus, we have the economic theory of torts.

In Part III, I consider, but do not advance an entirely economic theory of torts. I do not deny that the economic approach will illuminate aspects of tort law. Indeed, I defend such a view of products liability law. The rational choice liberal position I defend in Part I invites us to see certain parts of the law in terms of the roles they play in creating and sustaining markets. But I deny that tort law is central to that objective. It allocates costs among strangers. It does not help parties solve a local cooperation problem. Thus, I look to other liberal ideals in understanding tort law. The view I advance in Part III is that tort law implements the principle of corrective justice.

I contrast my conception of corrective justice with those put forth by Ernest Weinrib, Richard Epstein, and George Fletcher as well as with a conception of corrective justice that I have previously advanced.² I call my earlier view the annulment thesis. In the annulment thesis, corrective justice requires annulling wrongful gains and losses. I now reject this view. In its

2. See, e.g., Jules L. Coleman, *Tort Law and the Demands of Corrective Justice*, 67 *IND. L.J.* (forthcoming 1992).

place I defend the view that corrective justice imposes a duty to repair the wrongful losses for which one is responsible.

The difference between the annulment view and the new view, which I call the mixed view, has to do with the kinds of reasons for acting that corrective justice gives. In the annulment view, wrongful losses ought to be annulled, but corrective justice appears to give no person an agent-relative reason for acting. It appears that no one in particular has a duty to repair the loss. The mixed view argues that part of what is distinctive about corrective justice is that it gives rise to agent-relative reasons for acting.

In Part III, I develop an account of “wrongful loss” and “responsibility” implicated by the principle of corrective justice. Because corrective justice imposes a duty to repair on those individuals who have wronged or wrongfully injured others, it has the effect of sustaining or protecting some underlying set of norms. Which norms can be sustained or protected by corrective justice? Must those norms express or implement the demands of distributive justice? If so, does that make corrective justice merely an ancillary principle of distributive justice?

I argue against the idea that corrective justice must be layered on norms that implement distributive justice. I also argue that corrective justice can be layered on norms that are efficient. Corrective justice is compatible with an economic theory of wrongdoing or wrong. On the other hand, my view is that the norms on which corrective justice is layered are neither just nor efficient—at least not necessarily. The view I advance is that corrective justice is layered on norms or conventions that emerge in various communities as ways of giving expression at the local level to the general norm of reasonable risk-taking. These norms are not necessarily absolutely just nor are they necessarily efficient in the narrow sense. They are norms that arise in various circumstances for the purposes of coordinating interaction among individuals. The law does not find efficient or just norms and then reinforce them by a practice of corrective justice. Rather, it finds norms, already existing in a community, which coordinate behavior among members of the community. Often these norms will have efficiency properties. It is unlikely, after all, that such norms could arise if they made individuals worse off than they were before. But the norms need not be welfare-maximizing; they need not be the best or

most efficient norms in order to serve their coordinating functions. Similarly, the norms sustained by corrective justice are likely to be reasonably fair, especially if they are to endure within a community of equals. But it is neither their fairness nor their efficiency that gives rise to the moral duty to repair departures from them, or so I argue.

In my view, the conventional nature of corrective justice is the most striking and controversial feature of the argument in Part III. The most controversial claim I defend, however, is the following, related one: Corrective justice is a norm that links agents with wrongful losses. It gives agents who are responsible for the losses a reason for acting in the form of a duty to repair. That relationship between agents and wrongful losses can be severed, or replaced by other practices. Suppose we adopted a social insurance scheme of the sort in place in New Zealand. That plan gives rise to agent-neutral reasons for acting. We might say that such a plan replaces the agent-relative reasons for acting under corrective justice, or we might say that when such a plan is in effect there are *no* duties in corrective justice. Indeed, that is the view I advance. Whether or not corrective justice imposes *moral* duties in a particular community depends, in my view, on the existence of other social or legal practices. My view, then, is that in a New Zealand-like situation corrective justice imposes no moral duty to repair! Whereas standard legal theory presupposes that a just legal system enforces rights and responsibilities derived from moral principles whose status is independent of law, I argue for the very different thesis that the status of corrective justice is not necessarily independent of legal or other relevant social practices. In other words, legal practices can affect the existence and scope of moral principles.

The corrective justice account of tort law embodies liberal ideals of autonomy and responsibility as well as concern for individual well-being. The economic account of contract embodies the liberal ideal of stability. Is there a connection between these liberal ideals that might unify the argument of the book or must we accept the idea that different parts of the law are animated by entirely different (if not incompatible) liberal ideals? When I first began this project, I had no preconceived ideas about whether its various component parts were connected by a unified political theory. On the other hand, I did

not believe that they were incompatible. One could plausibly argue that the emphasis on stability in Parts I and II seems Hobbesian, whereas the emphasis on autonomy and responsibility in Part III seems Kantian. Indeed, Jean Hampton argues in her contribution to this issue that I am more Kantian than Hobbesian.³ In contrast, David Gauthier fights the Hobbesian battle for my soul.⁴ Both see a tension in the underlying political theory expressed in the book, either explicitly in Parts I and II, or implicitly in Part III. Largely as a consequence of their papers, I have had to rethink my underlying political commitments.

The last chapter of the book takes up this question. My current thinking is that I am neither Hobbesian nor Kantian. I see this enterprise as more Humean in spirit and commitment than anything else. Setting aside the more abstract question about the spirit of the book, the issue I take up in Chapter 21 is the relationship among the Parts of the book. What I have to say there is merely preliminary, however. In the theory developed in Part I, rational choice liberalism is not a political philosophy itself. Rather, it is part of a liberal political theory. It is part of a theory that feels bound by the principle of rationality and the centrality of the market. It is an alternative to the market paradigm. The difference is that the market paradigm is committed to nothing else but rationality and the market. Rational choice liberalism says in effect that even with the rational choice framework there is a different place for the market than that provided by the market paradigm. The market is a scheme of cooperation—cooperation by competition—that is suitable under a broad range of empirical circumstances likely to arise in liberal cultures. It is a scheme of cooperation that is *rational*, and it is rational because of the contribution it makes to social stability.

But stability is not an end in itself. Individuals have projects, plans, and goals. These provide them with reasons for acting. Formulating and executing these plans requires stable frameworks of choice and action. Stability is important because of its contribution to autonomy, that same principle of autonomy that animates the practice of corrective justice. Thus,

3. See Jean Hampton, *Rational Choice and The Law*, 15 HARV. J.L. & PUB. POL'Y 649 (1992).

4. See David Gauthier, *Jules and the Tortist*, 15 HARV. J.L. & PUB. POL'Y 683 (1992).

rather than being in tension with one another, the various parts of *Risks and Wrongs* stand together as a whole, although my efforts in the book to draw the picture that unites them are sketchy at best.