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The Best Right Laws: Value Foundations of the Economic Analysis of Law*

Robert D. Cooter**

The economic analysis of law, like the great sphinx in the desert, intrudes on the landscape of legal scholarship, provoking the philosophically curious by its enigmatic stare. What is it? Utilitarianism? Science? Materialism? Ideology? Economists seem indifferent, even condescending, toward these questions, rather like a composer’s attitude toward music critics. For pure economists, predicting market prices is far more important philosophizing. Unlike prices, however, laws are made after much debate and deliberation in which questions of value and meaning have a role. Legal theory and philosophy shade into each other by imperceptible degrees. Developing a philosophical understanding is important to bring economics into contact with legal theory and speed its acceptance into law and the courts.

One approach is to subsume the economic analysis of law under an older and larger tradition of philosophy. Thus economics might be viewed as a modern form of utilitarianism or materialism, or possibly, a new science. That is not the approach taken in this Article. Rather than assimilating the economic analysis of law to other traditions, it will be explained on its own terms. The concept that seems most central for this purpose is efficiency. When used in ordinary conversation, “efficiency” usually means something like “without waste.” Economists have greatly refined the concept, but its core meaning for them is “without wasting money.” As a policy objective, this has appeal. Who, after all, publicly advocates wasting money?

Of the several different concepts of efficiency that economists apply to law, the one most treasured in the economic tradition is undoubtedly Pareto efficiency. This idea grew out of utilitarianism, but, like a rebellious son, it is hostile to its parent. Although a relative of pure science, it is not a member of the immediate family. Further, while its behavior is exemplary when it keeps good company, materialism and ideology are weaknesses to which it is prone. Pareto efficiency is, consequently, a “mixed” concept in the sense that it cuts across the familiar categories of older and larger traditions.

Pareto efficient laws satisfy individual preferences better than the feasible alternatives. The economic analysis of law offers practical directions for making laws best in this respect. Different tendencies and factions in the state, however, advance different conceptions of right and

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wrong. Laws that embody such a conception are "right" with respect to it. The economic conception of the "best" laws is consistent with a variety of these conceptions of the "right" laws. The theory of the relationship between Pareto efficiency and other values underlying law that will be developed in this Article are expressed by the phrase, "the best right laws."

I. History of an Idea

A sketch of the history of ideas from which Pareto efficiency emerged will convey an appreciation of it. Economic theory began to assume its contemporary shape in the late 19th century when utility theory and calculus were conjoined. The realization that the optimum bundle of goods purchased by a consumer could be expressed mathematically as the point where marginal utility equals price provided the essential insight. Focusing upon marginal utility, rather than total utility, clarified many traditional puzzles about prices. For example, why do diamonds cost more than water? A clean answer to the "paradox of value" is that, while water is more useful and its total utility exceeds diamonds', the relative scarcity of diamonds makes their marginal utility exceed water's. This approach yielded insights and discoveries that were so sweeping as to be called the "marginalist revolution."

An unanswered question that continued to puzzle economists in the early part of the 20th century was the connection between "marginal utility" as used in price theory and the conception of utility in the tradition of Bentham. Bentham, who freely interchanged "utility," "pleasure," and "happiness," erected a whole system of thought upon the assumption that public policy should maximize the sum of individual utilities. This objective assumes that utilities of different people can be added together like body weight. While Bentham thought this was possible, he offered no general theory or concrete examples of how to make the necessary measurements.

Marginalists realized that a consumer usually consults her subjective values to decide which combinations of goods to buy. The relevant values are subjective in the sense of being the consumer's personal preferences. If, however, the values of two different people are to be added together as Bentham required, there must be an interpersonal standard. Furthermore, there must be an objective basis, above and beyond the personal preferences of an individual, to be persuasive in debates over public policy.

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1 Standard histories are M. BLAUG, ECONOMIC THEORY IN RETROSPECT (3d ed., 1978), and J. SCHUMPETER, A HISTORY OF ECONOMIC ANALYSIS (1954).
2 To be more precise, the marginal rate of subjective substitution between any pair of goods equals their price ratio. In England this formula was first derived by Jevons. See W. JEVONS, THEORY OF POLITICAL ECONOMY 138-39 (4th ed. 1931).
3 The history of the paradox of value is reviewed by J. SCHUMPETER, supra note 1, at 300-01.
4 For example, Jevons insisted that marginal utility concerned subjective feeling, not objective value. "The reader will find, again, that there is never in any single instance, an attempt made to compare the amount of feeling in one mind with that in another. I see no means which such comparison can be accomplished." Id. at 14.
The differences between objective and subjective utilities can be appreciated by an example from Pareto. Pareto observed that, even though people want potatoes, a variety of evils follow from too heavy reliance upon them, as evidenced in his view of famine in Ireland. These thoughts led Pareto to observe that the term “utility” was applied to two distinctly different things. On the one hand, the term refers to people’s subjective estimation of the contribution goods made to their own happiness or pleasure. For example, the market price of potatoes reflects their subjective marginal utility to buyers. Subjective value, however, sometimes diverges from the objective contribution that goods actually make to happiness or pleasure. Thus potatoes are, in Pareto’s view, overvalued by many Irish farmers. To avoid confusion, Pareto purposed a new term, “ophelimity,” for subjective values and reserved “utility” for objective values.

Although the names Pareto suggested did not take, various forms of the distinction between subjective and objective utility became important to economists. Decades after Pareto wrote, the subjective-objective distinction acquired special salience through events in the 1930’s known as the “ordinalist revolution.” A technical distinction between ordinal and cardinal utility is needed to explain these events. Suppose that members of a class at school are ranked by weight from low to high. From a knowledge of rank, there is no way to compare the difference in weight of different people. The person ranked fourth, for example, is not necessarily twice as heavy as the person ranked second. Nor is information about rank sufficient to find the total weight of everyone in the class. The person ranked fourth and the person ranked second obviously do not weigh a total of six. Comparing and adding weights requires a precise scale of measurement, not just a ranking.

Suppose that a person can rank states of the world from good to bad. The real numbers can also be ranked from low to high. Thus numbers can be associated with states, the higher numbers standing for better states. Such an association is called an ordinal utility function (“ordinal” for “ordering”). The only information conveyed by an ordinal utility function is the person’s ranking of the underlying states. An ordinal utility function does not provide the information needed to compare utilities of different people or to add them. Comparing and adding utilities requires a more precise scale or measurement, called an “interpersonally comparable scale of cardinal utility,” or simply, a cardinal utility function.

Ordinal utility functions, if known, supply sufficient information about consumers to predict the combinations of goods that they will buy at different prices. Conversely, the combinations of goods that people will buy at different prices, if known, provides sufficient information to

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5 While the most commonly discussed difference is between ordinal and interpersonally comparable cardinal utility, a finer set of distinctions is usually invoked by economists. See e.g., the discussion of “level comparisons” in Sen, Equality of What, TANNER LECTURES (G. Hawthorn ed. Stanford, 1979).
infer their ordinal utility functions. Cardinal utilities, however, are not needed to explain consumer choices, nor can they be deduced from them. So the ordinal-cardinal distinction suggests that the utilities in price theory are very different from the utilities in Bentham’s theory.

The “ordinalist revolution” of the 1930’s saw the distinction between ordinal and cardinal utility reformulated mathematically with greater clarity and freighted with methodological significance. This was a period in intellectual history of intense interest in demarcating scientific from nonscientific modes of thought. The ordinalist-cardinalist distinction became implicated in this debate, especially through the work of Lionel Robbins. Robbins argued that ordinal utilities summarize observable behavior, which is the subject of science, whereas cardinal utilities draw upon value-judgments, which are outside science. Not only is inferring cardinal utilities impossible from market behavior, according to Robbins, it is impossible from observing any kind of behavior.

The failure of previous generations of economists and philosophers to distinguish sharply between ordinal and cardinal utility was seen as a form of the failure to sharply distinguish between facts and values, or between science and non-science. The general conclusion from this line of thought, which has been widely accepted among economists in American universities at least since the 1950’s, is that no scientific basis can be found for summing the utilities of different people as required by Bentham’s theories.

II. Structure of an Idea

If utilities cannot be summed, can economists say anything about public policy? This is the problem to which Pareto found a solution that proved far more successful than he could have hoped. A Paretian analysis, as proposed by its inventor and greatly refined by generations of economic theorists, first assumes that there is an initial distribution of resources, which is given outside the model. Once the initial distribution

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6 These propositions are developed in any microeconomic text book. See, e.g., H. Varian, Microeconomic Analysis (2d ed. 1984); for a collection of related essays, see Preferences, Utility, and Demand; A Minnesota Symposium (J. Chipman ed. 1971).

7 Hicks & Allen, A Reconsideration of the Theory of Value, 1 Economica (n.s.), 52-76 and 196-219 (1972) (Feb. and May 1934).


11 The argument that economists confuse themselves and their public by failing to distinguish sufficiently sharply between facts and values was made by G. Myrdal, The Political Element in the Development of Economic Theory 1-22 (1954).

12 For a different view, see Cooter & Rappoport, Were the Ordinalists Wrong About Welfare Economics?, 22 J. Econ. Literature 507 (1984); Little, Comment, and Cooter & Rappoport, Reply, 23 J. Econ. Literature 1186 and 1184 (1985); also Herriman, A New Look at the Ordinalist Revolution: Comments on Cooter and Rappoport, and Rappoport, Reply, 26 J. Econ. Literature 80 and 86 (1988).
is described, the analysis proceeds to ask whether any reallocation of resources can make at least one person better off without making anyone else worse off. If the answer is “Yes,” the reallocation is a Pareto improvement. If the answer is “No,” the initial allocation is Pareto efficient (also called “Pareto optimal”). Starting with an initial allocation that is inefficient, Pareto efficiency is achieved by reallocating resources until the opportunities for Pareto improvements are exhausted.

Notice that improvements are measured by each person’s own valuation of the resources allocated to him. To find out whether a change makes some one better off relative to his own preferences, without making anyone else worse off, we need only know their subjective rankings of the policy’s outcomes. To determine whether a state of the world is Pareto efficient, the ordinal utilities of the affected people must be known, but nothing needs to be known about their cardinal utilities. Comparisons do not have to be made between one person’s utility and another’s, nor do the utilities of different people need to be added together. Pareto efficiency thus provides a guide to policy that invokes purely subjective values, not cardinal utilities.

It is useful to see how this concept is applied in the economic analysis of law. A standard economic analysis, called “general equilibrium theory” in its most powerful form, characterizes mathematically the behavior of various actors and then tests to see whether an equilibrium exists in their interaction. Once an equilibrium has been shown to exist, its properties are explored, especially its uniqueness, stability, and Pareto efficiency. This kind of analysis, or a fragment of it, is often used in the economic analysis of law. An especially useful variant for law, called “comparative statics,” computes the equilibria induced by different legal rules and compares their efficiency.

To illustrate, the first noteworthy success in applying equilibrium theory to the common law was John Brown’s classic paper on tort liability. He tested the efficiency of precautionary behavior in response to alternative tort rules. A typical result is his conclusion that, when efficiency requires both injurers and victims to take precaution, a negligence rule creates incentives for efficient precaution under circumstances in which strict liability does not. In these circumstances, a change in rules from strict liability to negligence could in principle, according to Brown’s model, make some people better off without making anyone worse off.

A Pareto efficient economy can be described as maximizing the value of resources to the people who enjoy them. The same structure of reasoning characterizes the economic analysis of law, at least in so far as Pareto efficiency is the central concept. Think of legal rights, duties,
privileges, immunities, powers, liabilities, etc., as goods and bads allocated to people by law. Economic modes begin by assuming an initial allocation of legal resources that is given exogenously. The models then ask whether legal resources can be reallocated so as to make at least one person better off without making anyone worse off. Thus the economic analysis of law attempts to maximize the value of legal resources to the people who enjoy them. For every wasteful law, a more efficient one could be substituted and the savings could be distributed among the people affected by the change so that some are made better off without making anyone worse off. Waste is, consequently, an irrationality to expunge from law and policy.

An economic model usually focuses upon a few laws or legal practices, and holds the others constant in the background. The few endogenous laws are allowed to vary in the model in order to compare their efficiency properties. There are, however, no built in limitations upon which rules are to vary and which rules are to be held constant in the analysis. Repeated application of Paretian models can subject all rules to scrutiny and retain only those that make some people better off without making anyone worse off. Although the Paretian approach is piecemeal, over time all the laws may be modified or replaced, just as a ship’s carpenter may eventually replace all the planks in the hull while it remains afloat.

When judging whether a change is an improvement, a Paretian analysis does not impose anyone’s values upon anyone else. It is, consequently, consistent with value relativity and moral skepticism. Thus Brown’s model can be understood as starting from an initial allocation of legal rights much like the ones we currently enjoy, except that the rule of tort liability is subject to change. He then shows that under certain conditions, adopting a negligence rule can make some people better off and no one worse off, at least in principle, as compared to adopting a rule of strict liability. The demonstration does not presuppose commitment to any particular distributive ideal, as will be explained.

III. Distributive Ideals

Evaluating changes in policy from the standpoint of the status quo is certainly the style of analysis most popular among economists, who are inclined to leave politics and philosophy to others. Applying a Paretian analysis to the status quo is, however, a habit of mind among economists, not a necessity imposed by the analysis itself. The background distribution of rights assumed to be constant in a Paretian analysis need not be the status quo. Instead, the background rights might be given by a particular political or moral theory.

An example is provided by Rawls’ *A Theory of Justice* (1971). Rawls argues for a radically egalitarian principle of distribution (the “maximin”), according to which inequalities are only justified to the extent that they improve the well-being of the worst-off class of people.17 Rawls...
also argues that the resulting social arrangement should be Pareto efficient. Only the combination of the ideal income distribution and Pareto efficiency is, according to Rawls, the “best just arrangement.”

Starting from an initial situation of excessive inequality relative to Rawls’ ideal, moving towards the maximin requires redistributing income from rich to poor, which necessarily makes some people worse off. These distributional improvements are not Pareto improvements. Once the maximin is achieved, however, any further moves that benefit some people without harming anyone must be made in order to achieve the “best just” arrangement. In general, Pareto improvements cannot accomplish ideal redistribution, but the best ideal requires Pareto efficiency.

The distributive ideal proposed by Rawls is one of a number that can be combined with a Paretian analysis. The range of possibilities is suggested by Aristotle, who argued that different types of societies would adopt different distributive principles; thus democracies would adopt the principle that everyone gets an equal share, whereas aristocracies would adopt the principle that the best get more. What ever principle is adopted, the best just arrangement requires eliminating waste.

The pursuit of Pareto efficiency is consistent with views about the fundamental redistributive goals of society ranging from thorough-going skepticism to radical egalitarianism. When combined with skepticism, the initial situation relative to which Pareto improvements are measured is the historically determined present. When Pareto efficiency is combined with ideal theories, the initial situation relative to which Pareto improvements are measured is given by a theory of social justice. In so far as Paretian analysis is the core of the economic analysis of law, the later can be regarded as neutral, at least in principle, with respect to most principles of distribution.

IV. Why Not Utilitarianism?

I have explained that economic theory assumed its modern form when utilitarianism and calculus were joined. Economic analysis still retains some features of utilitarianism that are important in its application to law. First, the treatment of time in economics is consistent with its utilitarian foundations. Utilitarianism holds that goodness resides in certain mental states, characterized as “desirable feeling” by Sidgwick. The opportunity to enjoy such mental states lies in the present and future; the past only matters because it determines the causal propensities of the present, in particular the propensity to field desirable feelings. Thus a promise, according to utilitarians, should not be kept just because it was made, and a criminal should not be punished just because she committed a crime. Rather, the promise should be kept or the punishment imposed only if doing so maximizes present and future utilities.

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18 See id. at 78-79.
The past conditions opportunities for action, but their rightness or desirability in utilitarian thought depends upon future effects, including the effects of keeping promises or punishing criminals.

Similarly, the criterion of Pareto efficiency is concerned with satisfying people's preferences. The opportunity to satisfy preferences, as with desirable feelings, lies in the present and future. The optimal decision is directly determined from opportunities and tastes. So the past enters the calculation indirectly, by affecting present opportunities and tastes. This reforming and critical spirit towards the past, which colors the utilitarian tradition in jurisprudence,\(^{21}\) carries over into the economic analysis of law. Economists insist upon analyzing laws and court judgments from an ex ante viewpoint, that asks how the decision will affect future behavior.\(^{22}\) This is a rigorous application of the maxim, "Bygones are bygones." The sum-of-utilities and Pareto efficiency are both strictly forward looking criteria.

A second important characteristic of utilitarianism is the strictly individualistic character of value. Value is individualistic in utilitarianism because it resides in the desirable feeling that individuals enjoy. Cultural traditions, moral virtues, community life — in utilitarian theory, none of them receive weight independent of the satisfactions they give to individuals.\(^{23}\) Similarly, the Paretian standard is strictly individualistic in that value resides exclusively in satisfying the preferences of individuals.

The social atomism of economics, which is self-evident in the study of competitive markets, extends to law and policy. To illustrate, consider the way economists conceive of public goods. The technical feature of public goods is that they cannot be parcelled out to different consumers in different quantities. Supplying a public good to some people and excluding others from its enjoyment is costly or impossible. To illustrate, government cannot provide me with security from invasion by a foreign army without giving the same security to my neighbor. Further, one person's enjoyment of a public good does not reduce another's. Thus the fact that I am secure from military invasion does not diminish the amount of security available to my neighbor. In sum, public goods are characterized by non-exclusion and non-rivalry.\(^{24}\) In contrast, preventing others from eating my loaf of bread, which is a private good, is technically possible and not so expensive, and, further, the bread that I eat diminishes what is left for others to eat. With private goods there is exclusion and rivalry.

\(^{21}\) See e.g., Fry, Bentham and English Penal Reform, in Jeremy Bentham and the Law 20 (G. Keeton and G. Schwarzenberger eds. 1948).


\(^{23}\) "The interest of the community then is, what?—the sum of the interests of the several members who compose it." J. Bentham, Introduction to the Principles of Morals and Legislation ch. I, § IV (1948).

The value of public goods, as understood by economists, is the individual satisfactions afforded by them, just as with private goods. For example, the economic value of military security is the satisfaction people take in it. Public goods are, consequently, distinguished from private goods by technical characteristics of their supply (non-exclusion and non-rivalry), not by non-individual values. Attempts to bring a more social concept of value into economics, called “merit goods,” according to which cultural traditions or communities have value beyond what individuals place on them, have never caught on among economists.\(^\text{25}\)

Most normative systems that respect individual values may yet impose some restrictions on preferences that are irrational or destructive, especially those short run preferences that undermine the decision maker’s ability to follow his long run preferences. Selling oneself into slavery is the classic example. A modified Paretoian analysis would apply the standard of making someone better off and no worse off relative to their long run interests, which may correspond imperfectly to their immediate preferences. By this route, a Paretoian analysis may support laws that restrict choice by allowing precommitment or enforcing the inalienability of some rights.\(^\text{26}\)

A third characteristic common to utilitarianism and economics is self-interest. The utilitarian tradition of Bentham and modern economics tends to conceive of people as acting out of self-interest,\(^\text{27}\) and, further, the concept of “self” is narrow, focusing upon the person as the locus of pleasure or pain, and ruling out broader conceptions of self-fulfillment. Self-interested behavior is not, however, a logical requirement of either the sum-of-utilities criterion or Pareto efficiency. If people...


\(^{26}\) To illustrate, Elizabeth Scott has recently argued that obstacles to easy divorce could be explained as strategies of precommitment to marriage. See E. Scott, Rational Decision Making About Marriage and Divorce (Feb. 1989, University of Virginia School of Law). For an economists approach to inalienability, see Rose-Ackerman, Inalienability and the Theory of Property Rights 85 COLUM. L. REV. 931 (1985).

\(^{27}\) Bentham’s self-interested approach, as applied to labor markets, is the subject of Marx’s caustic irony. The labor market, he writes, [I]s in fact a very Eden of the innate rights of man. There alone rule Freedom, Equality, Property and Bentham. Freedom, because both buyer and seller of a commodity, say of labour-power, are constrained only by their own free will. They contract as free agents, and the agreement they come to, is but the form in which they give legal expression to their common will. Equality, because each enters into relation with the other . . . and they exchange equivalent for equivalent. Property, because each disposes only of what is his own. And Bentham, because each ilks only to himself. The only force that brings them together and puts them in relation with each other, is the selfishness, the gain and the private interests of each. Each looks to himself only, and no one troubles himself about the rest, and just because they do so, do they all, in accordance the auspices of an all-shrewd providence, work together to their mutual advantage, for the common weal and in the interest of all.

K. Marx, CAPITAL: A CRITIQUE OF POLITICAL ECONOMY pt. II, ch. VI, at 195 (1906) (trans. S. Moore and E. Aveling) Marx also calls Jeremy Bentham “that insipid, pedantic, leather-tongued oracle of the ordinary bourgeois intelligence of the 19th century. Bentham is among philosophers what Martin Tupper is among poets. Both could only have been manufactured in England.” Id. at 668.
ple's satisfactions are intertwined, like feelings in a close family, one person's utility level directly affects another's, and the distinctiveness of self-interest is effaced. Directly dependent utilities, which are a form of externality in economics, can be analyzed in terms of Pareto efficiency. The extension of economic theory to externalities is, indeed, a valuable and comparatively recent addition to the subject. Externalities, however, complicate economic analysis and defeat some of its theorems. For example, the model of perfect competition breaks down when utilities cannot be separated. Thus the assumption of self-interest, while not logically required by the Pareto concept, increases the power of its application.

I have discussed three structural similarities between utilitarianism and the economic analysis of law. There is, however, a central feature of utilitarianism that separates it from economics, specifically the assumption that utilities are cardinal and measurable, which few economists accept. The disagreement is focused by disputes over income distribution. Cardinal utility theory builds into its core a conception of value that can be used to identify the ideal income distribution. This ideal, however, is rejected by most economists.

To illustrate, utilitarians believe that additional money, like wine or socks, is decreasingly valuable to its recipients. Given this assumption, the transfer of dollars from the rich to the poor is equivalent to transferring money from people who value it less to people who value it more. If the transfer were costless, it would increase the sum of utilities. When transferring dollars, however, some money disappears into administrators' salaries and some money is lost due to the discouraging effects of taxes or welfare payments on work effort and savings. Income distribution policy is utilitarian-optimal when these benefits and costs of transferring wealth are balanced. Specifically, the sum of utilities achieves its maximum at the point where the utility gained by transferring additional money from the rich to the poor is exactly offset by the utility lost from the cost of effecting the transfer.

The belief in interpersonally comparable cardinal utilities, with its implication for the ideal income distribution, leaves little room for moral skepticism and relativism. Modern economics, which affords a safe harbor for skeptics and relativists, has sought to keep clear of such commitments. The standard of Pareto efficiency permits economists to pronounce on some policy issues without taking sides on deeply divisive disputes about the ideal income distribution.

A helpful way to view this deep difference between economics and utilitarianism is through the mathematical ideas at their core. Recall that economists tend to analyze behavior as an equilibrium in the interaction of maximizing individuals. According to modern economics, each individual alters her behavior until she can find no preferred way of acting, and an equilibrium is achieved when everyone is in this situation simulta-

28 This form of externality has been called "consumer-on-consumer," as opposed to "producer-on-consumer," "producer-on-producer," or "consumer-on-producer." See Mishan, The Postwar Literature on Externalities: An Interpretative Essay, 9 J. Econ. Literature 1 (1971).
neously. Such an analysis draws upon two mathematically distinct ideas, a maximum and an equilibrium.\textsuperscript{29}

Obstacles can arise to prevent an equilibrium in market exchange from being efficient, such as congestion ("the tragedy of the commons") and pollution. Even when these problems are absent and market exchange is efficient, it still does not achieve a distributive ideal, such as the sum of utilities, except fortuitously. Achieving a distributive ideal requires intervening in the market to redistribute income. Thus modern economics recognizes that an equilibrium is not necessarily a social optimum. Bentham, in contrast, wrote as if the interaction of maximizing individuals achieved a social optimum automatically, without offering any details about how this occurred. His writing thus ran together the two distinct ideas of a social optimum and an equilibrium.

This difference between utilitarianism and economics finds a forceful expression in discussions of regulation. Economists are impressed by the fact that many forms of regulation are designed to redistribute wealth, not necessarily from the rich to the poor, but from the politically favored to the politically disfavored.\textsuperscript{30} This kind of behavior, which is called rent seeking because its aim is to transfer a pure entitlement, seldom coincides with maximizing the sum of utilities or any other desirable social goal. Political equilibria, including the politics of regulation, tend towards Pareto efficiency at best, but not towards the sum of utilities.\textsuperscript{31}

V. Why Not Materialism?

Although economic theory, which is formal, assumed its modern form in the second half of the 19th century, economic thought, which is informal, assumed its modern form much earlier. Indeed, the consensus view traces modern economic thought to Adam Smith's *Wealth of Nations* (1st ed., 1776). Smith's view about economic policy, as exemplified by the title of his book, is that it should aim, not at accumulating precious metals, but rather increasing the nation's wealth as measured by the market value of what it produces. That is also the goal of law recommended by one of the founders of the economic analysis of law.\textsuperscript{32}

Nations often show more enthusiasm for power, glory, or religious purity than wealth, and few people acknowledge that accumulating wealth is their life's purpose. Does economic thought command an

\textsuperscript{29} The mathematical idea of a maximum was grasped through the calculus in the second half of the 19th century. A maximum is usually expressed graphically as a "saddle-point." The idea of an equilibrium was originally understood by economists as the simultaneous solution of two or more equations, which is usually expressed graphically as the intersection of the supply and demand curves. It was not until after 1950 that economists generally appreciated that the more general mathematical idea underlying equilibrium is a fixed point in a functional relationship. For a brief history with citations see K. Arrow & F. Hahn, supra note 14, at 8-11.

\textsuperscript{30} See, e.g., G. Stigler, The Citizen and the State: Essays on Regulation (1975). This insight is the motivating force behind much of the "public choice" movement. See any issue of the journal Public Choice.

\textsuperscript{31} If an arrangement is Pareto inefficient, there is scope for mutual benefit by changing it. This fact creates some tendency towards Pareto efficiency. The sum-of-utilities criteria, however, requires income redistribution in favor of people with a higher marginal utility of money. It is hard to see why there should be any natural tendency towards such redistribution.

unappealing materialism? Answering this question requires tracing the connection between wealth and Pareto efficiency. An objection to Pareto improvements as a guide to law or policy is that there are none, because changes in law or policy have both winners and losers. There are nevertheless many changes for which the winners could compensate the losers and still have wealth left over. These changes would be Pareto improvements if the losers were actually compensated. Economists refer to them as “potential Pareto improvements,” or, invoking the inventors’ names, improvements by the “Kaldor-Hicks” criterion.33

To illustrate, imagine the situation contemplated by Brown’s model in which a change from a rule of strict liability to a negligence rule induces potential accident victims to begin taking highly effective precautions. Further, suppose potential injurers gain more than is lost by the potential victims. In principle, the surplus could be redistributed so that potential victims and potential injurers are both better off, say, by taxing the benefits received by potential injurers and giving tax revenues to potential victims. In practice, however, the redistribution probably will not occur. The change in law is, consequently, a potential Pareto improvement but not an actual Pareto improvement.

A cost benefit analysis commends changes for which the sum of benefits exceed the sum of costs. Whenever the benefits exceed the costs, there is a surplus that, with suitable redistribution, could be used to make some people better off and no one worse off. Thus the choice criterion in cost benefit analysis is in fact the potential Pareto criterion. Cost benefit analysis is a set of techniques for systematically applying the criterion of potential Pareto improvements to law and policy.

Now the connection between cost benefit analysis and wealth can be stated precisely. Cost benefit analysis equates the value of things with the amount that people are willing to pay for them. If markets work effectively, the amount that people are willing to pay for goods and services equals their price. Further, the wealth of a nation, as those terms are ordinarily understood, equals the value of its goods and services measured at market prices. Making potential Pareto improvements and making changes that increase wealth thus coincide in so far as subjective values are accurately and completely expressed in the market prices of goods and services. The criteria diverge when the objects of value are not goods and services, or market prices fail to reflect the amount that people are willing to pay for them.

To illustrate the divergence, suppose that a law professor, whose main interest is advancing jurisprudence, accepts a few consulting jobs and turns down many others. She could greatly increase her wealth by accepting more consulting jobs, but doing so would cut into her time for jurisprudence. Assuming that she is economically rational, the value that she places on a little more time devoted to jurisprudence equals her consulting wage. She would, consequently, not count herself any better off if

33 See Hicks & Allen, supra note 7, and Kaldor, Welfare Propositions of Economics and Interpersonal Comparisons of Utility, 49 Econ. J. 549 (1939). The application of the criterion to law is explained by Coleman, Efficiency, Utility, and Wealth Maximization, 8 Hofstra L. Rev. 509 (1980).
she consulted a little more. While more consulting produces more wealth, it does not result in an improvement by the cost benefit standard. The divergence arises because wealth as the term is usually understood does not include the values of time devoted to nonpecuniary activities.

As another example, suppose that Blackacre, whose sale value is five million dollars, has been in the family for so many generations that its proud owner would not part with it for less than ten million dollars. When computing the owner's wealth, as the term is used in ordinary speech, Blackacre would be valued at five million dollars, but when the Department of Highways conducts a study to determine whether to build an expressway through Blackacre, the valuation of its current use for purposes of cost benefit analysis should be ten million dollars.

Cost benefit analysis is not the choice criterion uniquely switch to plutocracy. Power, glory, purity, truth, sentiment, or the like are not precluded as controlling values. In general, cost benefit analysis is not committed to any substantive goals in its own right, material or nonmaterial. The methodology insists, however, on valuing all things according to how much people are willing to pay for them. The values of individuals thus entirely determine the goals that cost benefit analysis commends. The measuring rod of money makes different goals, material and nonmaterial, commensurable. In addition to providing a metric, cost benefit analysis provides a rule for making social choices. Cost benefit analysis is, consequently, a logic of choice, not a substantive theory of value.

Federal law already requires cost benefit analysis of proposed changes in regulations.34 The proposition that this mode of reasoning should extend to all law cannot be dismissed easily. To avoid misleading, however, proponents of this view would be better not to describe the purpose of law as maximizing wealth and instead say something like, "Law should be evaluated by cost benefit standards."35

VI. Why Not Pure Science?

Some economists are fond of proclaiming that their models are purely positive in character; hence the phrase "a positive economic theory of . . . ." The economic analysis of law has made some significant contributions that warrant this claim. For example, when lawmakers contemplate several alternative possibilities, the best choice depends in part upon how people will behave in response to different laws. Many traditional lawyers appear to rely upon what can be called the imperative theory, which holds that most people will do what the law requires, especially if the penalties for nonconformity are sufficient. Economists, in contrast, hold an incentive theory of law, according to which people respond to penalties much like they respond to prices. The incentive

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34 The cost benefit requirement imposed by the OMB is limited to "major" rules, which has several alternative definitions, the main one being any rule having an economic impact of $100 million or more. The OMB action is based upon Executive Order 12291, supplemented by EO 12498. The orders do not apply to independent agencies, although many apparently conform. (I am grateful to Glen Robinson for these facts.)

35 This is the concluding point in the article often cited as the beginning of the economic analysis of law. Coase, The Problem of Social Cost, 3 J. L. Econ. 1 (1960).
approach is more powerful than the imperative approach, especially when applied to regulations and civil duties, as opposed to criminal laws. Indeed, the substitution of a superior behavioral theory is alleged by one scholar to be the most significant contribution of economics to law.36 Predicting whether, say, the frequency of accidents will increase or decrease in response to a change in liability law, much like estimating consumer demand curves, is free from value judgments.

The same claim to be value free cannot be extended to Pareto efficiency. As a graduate student in economics in the 1970s, I heard some of my professors say things like, “The economist qua economists makes no value judgments.” What can a scholar possibly mean who, having proved that law A is more efficient than rival law B, insists that he is not making any value judgments? “Efficient” is a desirable property of law, just as “nutritious” is a desirable property of food. “Nutritious” is a term of praise for food because it implies predictions about the effect of food on health, which is one of food’s most important values. That is why it would seem odd if a person said, “This food is nutritious but I am not making any value judgments.” Similarly, “efficiency” commends and “inefficient” condemns in law and economics. Law A’s efficiency relative to law B is a reason for policy makers to prefer the former over the latter.37

The story of how economists came to think of their models as value-free, which cannot be told here, is itself an intriguing episode in intellectual history. The psychological impulse for this puffery is the wish that economics should be science, not philosophy. A distinction more relevant for economics than science-philosophy, however, is “policy science—pure science.” I use the term “policy science” to refer to theories that offer useful advice to policy makers by predicting the way alternative courses of action impinge upon significant values. The models must be scientific in the sense of providing accurate predictions. That is their positive aspect. The predictions, however, must be practical, rather than pure, in the sense that the phenomena being predicted are themselves values. An example is the prediction that a particular rule of tort liability induces Pareto efficient precaution; another example is the prediction that a particular food benefits health in a specified way. Economics is so useful because it predicts the way alternative courses of action impinge upon important values that are operationally defined and built into the core of the predictive models. If economics really were value free, it would not be so useful.

To illustrate by Brown’s model, “efficiency” as he uses the term is a clear concept of value that his model defines operationally. Further, it is a significant value to law makers. In so far as Brown’s model predicts the conditions under which some liability rules are more efficient than others, it provides useful information for making policy choices. Because


37 One reason, however, is seldom dispositive for a policy decision. Just as we do not always prefer the more nutritious food, so we do not always prefer the more efficient law.
Brown's model predicts the efficiency of alternative tort laws, it belongs to policy science. Astronomers, in contrast, make predictions about the movements of heavenly bodies, not predictions about values. Some astronomical predictions may have practical value, but the value is not built into the predictions, which is one reason why astronomy is a pure science.

VII. Why Not Pure Ideology?

For a policy science to be useful to policy makers of different political persuasions, the values at its core must be sufficiently general and flexible to bend with changing political currents. That is why economics has done well to install a concept of value at its core that is neutral with respect to most distributive ideals. Along with the distributive neutrality of Pareto efficiency comes a distressing weakness already mentioned where policy is concerned—actual changes in law or policy are almost never Pareto improvements. The really useful guide to policy is cost benefit analysis, but it is not generally neutral with respect to distributive ideals. It can, however, become neutral in a particular institutional context that I will describe.

A compelling vision of how to combine cost benefit analysis with distributive ideals, which was proposed by Musgrave, separates branches of government according to their function. One branch of government is assigned the task of supplying public goods efficiently. The efficiency branch must decide how much of each public good to supply and the best means for doing so. To achieve this end, it would apply cost benefit criteria to proposals for public projects, and proceed with those for which the sum of benefits exceed the costs. Another branch of government is assigned the task of redistributing income in order to maintain the ideal income distribution. The ideal income distribution is supposed to be identified by the political process in light of an ethical ideal, not by economists. To illustrate the separation of functions, the interstate highway program would fall under the efficiency branch, and welfare programs would fall under the distributive branch.

The efficiency branch, instead of being constrained to making Pareto improvements, can make changes whose benefits exceed their costs. The redistributive branch will respond by redressing any resulting distortions in income distribution. This division of labor permits the economists who staff the efficiency branch to proceed without any concern for income distribution. The separation of branches satisfies the desire that economics should be useful and also remain uncommitted to a distributive ideal.

Income redistribution, like every other policy goal, should be pursued by its least costly methods, which apparently include progressive income taxes, cash subsidies like ADC (Aid for Dependent Children), and government provision of some necessities like medical care or low in-
come housing to needy people. When separated from other government activities and assembled under a single administration, these activities would constitute the redistributive branch of government.

Unfortunately, some opportunities for cheap redistribution cannot be shaved off of more general activities and assigned to the redistributive branch. To illustrate, many utilities like electricity, gas, and telephone have in recent years reversed the usual practice of offering quantity discounts and instead offered lower rates, called "lifeline services," to low volume purchasers, who tend to be relatively poor. Many government activities mix redistribution with the provision of public goods, as exemplified by large public subsidies for education. The efficiency and redistributive aspects of these activities cannot be separated and placed under different administrations.

Given the fact that low cost redistribution activities do not separate cleanly from other government activities, the distinction between the efficiency and redistribution branches cannot be understood literally. Rather, the distinction should be understood as a parable for teaching that redistribution should proceed by its cheapest means, and activities that can only accomplish distributive goals at high cost should not be freighted with them. Some government activities are mixed in the sense that efficiency and redistribution mingle as goals. The mixed character of government requires the intellectual support of a mixed policy science. That is why economic theory cannot stand wholly apart from distributive ideals. To illustrate, standard cost benefit techniques give equal weight to willingness to pay, regardless of ability to pay. Thus an additional opera ticket enjoyed by a rich person, who is willing to pay $1 for it, receives the same weight as additional food to a poor person, who is also willing to pay $1 for it. Cost benefit techniques can be modified, however, to allow greater weight for benefits received by the poor. Under this approach, an additional $1.00 of food to the poor might be weighted so that its value is $1.50. The "welfare weighing" of costs and benefits is routine in agencies concerned with economic assistance for poor countries.

The three different choice criteria employed by economists and discussed in this article are Pareto improvements, cost benefit improvements, and welfare-weighted cost benefit improvements. The Pareto criterion rests upon the value of efficiency and remains neutral with respect to redistributive ideals. The cost benefit criterion weights every-

39 "Administrative costs for the food stamp and public housing programs have been estimated at 11 and 7 percent, respectively, in comparison to estimated administrative cost for an NIT [negative income tax] of 3 percent." E. Browning & J. Browning, Public Finance and the Price System (1979). In contrast, plaintiffs attorney routinely takes a contingent fee of 33% or more from any recovery. When overhead costs alone are compared, redistribution through litigation is much less efficient than administered forms of redistribution. These remarks are just the beginning of a difficult discussion. For consideration of some of the hidden costs of redistribution, see Browning & Johnson, The Tradeoff Between Equality and Efficiency, 92 J. Pol. Econ. 175 (1984), and Ballard, The Marginal Efficiency Cost of Redistribution, 78 Am. Econ. Rev. 1019 (1988).

one's willingness to pay equally, regardless of their ability to pay. The
cost benefit criterion can be regarded as neutral with respect to redistrib-
utive ideals only to the extent that efficiency and redistributive activities
of government are separated. Finally, the welfare-weighted cost benefit
criterion, which rests upon an ideal favoring redistribution from rich to
poor, may be used to the extent that efficiency and redistribution are
mixed in government activities.

Part of the ideological power of economics to give political choices
the appearance of neutral techniques consists in moves from one of these
choice criteria to another that are imperceptible to the general public.
To illustrate, consider a public investment project in which redistributive
goals would be pursued at relatively low cost. It would be disingenuous
to argue that cost benefit analysis should control the decision and rule
discussions of welfare out of bounds. Rather, this is a case in which dis-
putes about the ideal income distribution are relevant. Alternative ideals
must contend against each other to decide whether welfare weights
should be attached to costs and benefits.

The popular image of economists today, derived apparently from
the deregulation movement, is that of market conservatives. The logical
character of economic theory certainly favors decentralized equilibria
and remains uncommitted to distributive ideals. Only a short historical
memory, however, could tie the ideological use of economics exclusively
to any one political tendency or persuasion. In the mid-19th century, the
Manchester school in England earned for economics the title of the “dis-
mal science” because of its view that government policies could do little
or nothing to alleviate poverty or unemployment. By the early years of
the 20th century, however, when the material welfare school was in asc-
cendancy in England, leading economists believed that government
should actively intervene to alleviate poverty. The school’s most promi-
nent figure, A.C. Pigou, who is now remembered principally as Keynes’s
opponent, was close to the Fabian socialists in his economic persuasions.
When Keynes’s theories captured economics in the 1940s and 1950s, the
public apparently thought of economists as the people who favor govern-
ment budget deficits. Arguably the greatest economist of the post war
period, Kenneth Arrow, whose work did not concern the Keynesians or
their opponents, wrote an essay in the 1970s called “A Cautious Case for
Socialism.” The image of economists as untrustworthy left-liberals ap-
parently lingered in the Reagan administration, even as the President re-
nounced Keynes’s approach to deficits in principle and followed it in
practice. It is the deregulation movement of the 1970s and 1980s, how-
ever, that now defines the public’s image of economists as market
conservatives.

VIII. Redistribution Through Courts?

The metaphor of the two branches of government, one concerned
exclusively with efficiency and the other concerned exclusively with redis-
tribution, however unrealistic in general, may fit well enough when ap-
plied to many areas of law. The meaning of the metaphor, as noted, is
that redistribution should be left to activities in which it is relatively cheap. There are a variety of reasons why redistribution through courts is costly.

First, the transactions costs of trials far exceed that of alternative means of redistribution like progressive taxation. Trial lawyers routinely take a third or more of damage awards, which is far more than the Internal Revenue Service charges to collect taxes.

Second, income redistribution needs to be systematic in order to be cheap, effective, or fair, whereas trials are sporadic. To illustrate, whatever the case may be for assessing punitive damages against corporate tortfeasors, it cannot possibly rest upon the general goal of redistributing income from the rich to the poor. As a device for taxing the rich and subsidizing the poor, punitive damages are about as effective as a lottery.

Unlike trials, common law rules are systematic in application and general in scope, which holds out more promise for income redistribution. For example, a standard of strict liability for defective products might be adopted for the sake of more income equality. To achieve that goal, the cost of liability for defective products must fall upon corporate stockholders rather than consumers. There is reason to believe, however, that these costs are translated into higher prices paid by all consumers, rather than lower profits for stockholders. Priest has argued that the move toward absolute liability of corporations was motivated in part by a faulty theory about the incidence of the benefits and costs. In general, income redistribution requires a sophisticated use of incidence theory. Courts have not mastered the theories and cannot gather the data to apply them. The third objection to income redistribution by courts is, then, the inability of courts to predict incidence accurately.

A final objection to redistribution by courts, which is related to cost considerations, is based on fairness. The general view that courts should be neutral among classes would be seriously undermined by a court that acknowledged income redistribution as one of its goals. To illustrate, the wealth of the plaintiff and the poverty of the defendant are not generally recognized by courts as a reason to decide the case in the latter's favor. Nor is a disparity in wealth recognized as grounds for determining the level of damages required to compensate the victim. The tendency of juries to disfavor wealthy defendants, which has been documented, receives no official endorsement in law.

41 See supra note 39. For a discussion and citations on transaction costs of tort litigation see Cooter, Towards a Market in Unmatured Tort Claims, 75 VA. L. REV. 383, 395 (1989).

42 In long run competitive equilibrium, capital earns the normal rate of return in all industries, so the cost of liability cannot fall upon stockholders in the long run. Equivalently, prices in a long run competitive equilibrium equal the cost of providing the good, including the liability awards, so consumers must pay the price of liability awards in the long run. The historical argument is presented in Priest, The Invention of Enterprise Liability, A Critical History of the Intellectual Foundations of Modern Tort Law, 14 J. LEGAL STUD. 461 (1985).

43 A statistical study concluded that corporate defendants paid damage awards that were one-third larger than those that individual defendants had to pay, and government defendants paid even more. See Chin and Peterson, Deep Pockets, Empty Pockets: Who Wins in Cook County Jury Trials, (Rand Institute for Civil Justice Report R-3249-ICJ 1985).
These facts suggest that courts, whatever they may be, are not the redistributive branch of government. The pursuit of social equity by courts, understood as a just distribution of resources across economic classes, should be restricted to adjudicating statutes in which it adheres, as with progressive income taxation. This argument implies that common law does not embody an ideal income distribution. If such a view could be proved, not just suggested as has been done here, it would explain why economic models of law are convincing that draw upon Pareto efficiency and take the historically given income distribution as their starting point, rather than an ideal income distribution.

IX. The Best Right Laws: Conclusion

The legal system assigns rights, obligations, duties, responsibilities, privileges, etc., to people by common law, regulation, statute, and the constitution. These norms are often debated by different factions and tendencies in the state in terms of right and wrong. Lawmaking is, consequently, an activity in which different conceptions of the right compete with each other.

There are significant political choices in which the wills of different classes and groups oppose each other. Since these disagreements are real, they cannot be made to disappear altogether by the application of policy science, nor can they be resolved by a policy science that is neutral among them. A policy science can, however, find areas of common agreement and build upon them. The economic analysis of law thus tries to remain neutral at its core with respect to competing conceptions of right, including conceptions of the ideal income distribution.

That possibility is substantially realized by making Pareto efficiency its central normative concept. Models of Pareto efficiency demand that any law should be discarded if there is another that some people prefer and no one disprefers. This approach is not value neutral. Rather, it is committed to the view that, with laws as with commodities, people should get what they want. Many conceptions of right are consistent with individualism to this extent.

The Paretian conception of the economic analysis of law thus contains a vision of the connection between conceptions of the right and individual preferences. Philosophy and politics determine a person’s views about what is right in law and government, and economics determines what is best with respect to individual preferences. When combined, the result is a conception of the best right laws. The best right laws are the Pareto efficient allocations that satisfy the decision maker’s distributive ideal.

Besides distributive ideals, another value that is central to conceptions of the right is liberty. I have argued elsewhere that conceptions of right in which liberty is a central value, as in our own legal tradition, are not merely consistent with Pareto efficiency, but are committed to it.44

Liberty and Pareto efficiency are logically connected because they both follow from a political philosophy that stresses respect for individuals. In addition to this connection between liberty and Pareto efficiency at a logical level, other connections can be made based upon facts, such as the causal relationship between free markets and democracy, which will not be developed here. The best right laws, in any case, combine Pareto efficiency with individual liberty.

Respect for individual values causes people to agree that the best laws are Pareto efficient. Pareto efficiency, however, yields only limited direction to law and policy. Attempts to build a consensus upon a particular subset of these laws may come up against disagreements over conceptions of the right, including equality and liberty. This difficulty arises when economists try to pass from Pareto efficiency to cost benefit analysis or welfare-weighing.

To illustrate, in so far as legal entitlements are assigned to a person conditional upon the benefits exceeding the costs, individual liberties are insecure. How many college professors would want their freedom of speech to be contingent upon whether people would pay more to hear them speak or to shut them up? In general, the unflinching application of cost benefit analysis could seriously undermine individual liberties. This criticism of cost benefit analysis is similar to the criticism that utilitarianism, by making all social choices contingent upon maximizing the sum of utilities, does not take individual rights seriously. Liberties are entrenched in the Bill of Rights to protect them from aggregative standards of social choice, including majority rule and cost benefit analysis.

Individualism, equality, and liberty are three important values whose relationship with the economic analysis of law has been sketched in this Article. Three economic choice criteria discussed in this article are Pareto efficiency, cost benefit analysis, and welfare-weighing (my term for welfare-weighted cost benefit analysis). The relationships among them suggested by the Article are summarized in the following table. Each of the choice criteria is committed to individual valuations, according to the table, whereas only Pareto efficiency is committed to liberty, and only welfare-weighing is committed to wealth redistribution towards equality.

<table>
<thead>
<tr>
<th>Economic Criteria of Choice and Their Value Commitments</th>
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<tr>
<td></td>
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<tr>
<td>Pareto efficiency</td>
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<tr>
<td>cost benefit</td>
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<tr>
<td>welfare weighing</td>
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The table suggests the extent to which deference should be shown towards economic choice criteria as a function of values relevant to the policy in question. In so far as policy decisions should be directed by individual valuations, all three of the economic criteria can be applied.


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Conversely, each of the economic criteria break down when individual valuations are not dispositive. To illustrate, the members of the Sierra Club would be reluctant to agree that the decision whether to preserve the remaining nesting sites of the California condor should be made by determining how much people would be willing to pay to do so. The fact that many people apparently place little value on preserving nesting sites is, in the view of Sierra Club members, a failing in their individual values. Sierra Club members would presumably abandon the method of individual valuation before abandoning the California condor. Thus the decision would be forced out of the technocratic sphere and into the realm of politics.

Similarly, the table suggests that only Pareto efficiency is committed to liberty. A person committed to liberty would not, consequently, want a policy choice that impinged upon human rights to be decided by a cost benefit analysis. For example, the rules of criminal procedure often create benefits for the accused and impose costs upon the wider public, yet the cost benefit methodology, based as it is on willingness to pay, may not be the best way to choose among alternative rules.

Finally, welfare-weighing is the only choice criterion committed to wealth equality. In areas of law where pursuing redistribution among social classes is costly, cost benefit analysis is a better guide to policy than welfare-weighing. In spheres of action in which redistribution is relatively inexpensive, however, a person committed to wealth equality would prefer welfare-weighing rather than cost benefit analysis as a guide to policy.

Being a policy science, economics makes predictions about how policies affect values, especially the consensus value of efficiency. This Article tries to explain how efficiency relates to other values, such as equality and liberty. The economic analysis of law, which has come and gone as a fad, has taken hold as a policy science, and continues to provide the law with models of increased sophistication and breadth. Lawyers who want to make use of these models are not helped by over-simplification, whether by defenders who claim that economic analysis is value free science or critics who claim that it is the ideology of plutocracy. Like the sphinx in the desert, which is neither a god nor just another rock, the economic analysis of law is an impressive construction that is worth trying to understand on its own terms.