ETHICS, EFFICIENCY, AND LAW AT THE LIMITS OF THEORY

John P. Anderson*

INTRODUCTION

In his seminal book, *Insider Trading and the Stock Market*, Henry Manne scoffs at objections to the practice of insider trading on the basis that it is “unfair” or violates “business ethics,” claiming that all such objections may be lumped together and dismissed as “it’s just not right” propositions.1 For Manne, if repetition of such moral exhortations “were a form of scientific proof, undoubtedly the case against insider trading would long ago have been proved.”2 Such cynicism concerning ethical justification in the law can be traced back to the early legal realists,3 but has been particularly pronounced more recently among members of the law and economics movement. The criticism seems to be that, by comparison to economic analysis, ethical justification is insufficiently “rigorous” or “scientific” to determine clear and effective legal rules and principles. For Richard Posner, the “compartmentalization of knowledge—so conspicuous a feature of the modern world—may have condemned [ethical theory] to irrelevance at the level of practice.”4 He adds, the problems facing rich liberal countries in the twenty-first century “present difficult analytical and empirical issues that can no more be understood, let alone resolved, by the intuitions and analytic procedures of persons schooled only in the humanities than problems of high-energy physics or brain surgery can be understood and resolved by the study of the *Tractatus Logico-Philosophicus.*”5 Economic analysis, by contrast, “epitomizes the operation in law of the ethic of scientific inquiry, pragmatically understood.”6

I argue that Manne and Posner are wrong to suggest that ethical reasoning has little or no place in legal justification, but they are right to criticize appeals to comprehensive ethical theories as trumps in deciding important legal questions. This is not because other forms of legal

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* Associate Professor of Law, Mississippi School of Law.
2 Id. at 15.
3 See, e.g., Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 464 (1897) (“I often doubt whether it would not be a gain if every word of moral significance could be banished from the law altogether.”).
5 Id. at 456.
6 Id. at 15.
reasoning, such as economic analysis, are more rigorous, scientific, or accurate than ethical justifications. It is because, as a pragmatist, I take for granted that we are all better off if we can move beyond the kind of essentialism that suggests one form of legal justification somehow “gets it right,” and should therefore form the basis of a single, unified theory of legal interpretation and justification. We should instead be asking ourselves “which descriptions of the human situation are most useful for which human purposes?” Since our legal purposes are manifold and infinitely varied, our forms of legal justification should be as well. Moreover, while some forms of legal justification may be more useful than others within a given context, they will never be complete or comprehensive. Every theory of legal justification reflects a value latent within the culture. At the limits of any given legal theory’s application, other theories, representing competing values, will inevitably be drawn upon to hold it in check. The picture that emerges is that of legal justifications (whether they be economic or ethical) as tools for advancing social values. I suggest that, given the pluralistic and dynamic nature of the problems facing our legal system, the more tools we have at our disposal the better. For if your only tool is a hammer, every problem begins to look like a nail.

This Article has both critical and positive goals. Its principle critical task is to expose the folly of relying exclusively on either economics or ethical theory as offering a unified and exclusive model for legal justification. Accordingly, Part I challenges the law and economics school’s claim to privilege based on its purported scientific rigor. Part II then looks to expose dependence on moral essentialism as an ultimate trump in legal justification as equally naïve and unhelpful. Part III fulfills this Article’s positive aim by outlining a pragmatist conception of legal reasoning that places economic, moral, aesthetic, and other considerations on all fours. [I only present the first half of Part I here.]

I. LAW, ECONOMICS, AND SCIENCE WORSHIP

The claim that economic reasoning, as science, should enjoy priority over ethical reasoning in the context of legal justification begs two questions. First, is the economic analysis of law “scientific”? And, second, if it is scientific, does this justify a privileged epistemic status for economic reasoning in the law?

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A. Just How Scientific Is the Economic Analysis of Law?

Posner is fond of dismissing moral reasoning as a mode of legal justification by claiming that such exhortations may “persuade, but not with rational arguments.” For Posner, “[a]t its best, moral philosophy, like literature, enriches; it neither proves nor edifies.” The implication is that good economic analysis of the law, by contrast, can offer firm, rational grounds for its conclusions that are objectively verifiable. But just how firm are the conclusions reached by economic analysts of law such as Posner?

1. Controversy over Rational Choice

There is not just one microeconomic strategy for legal analysis; there are many. The “neoclassical” model, of which Posner and Lewis A. Kornhauser are among leading proponents, centers on “the science of rational choice,” which begins with the assumption that “human beings [and firms] are rational maximizers of their satisfactions.” With this model of practical reason in place, combined with the assumption that economic agents do not commit errors, sellers are homogenous, and transaction and information costs are zero, Ronald Coase’s theorem is applied to conclude that “resources will instantaneously flow to their highest valued use.” Any distribution of goods under this model will be “efficient” in the sense that “no reallocation would increase their value.”

If the economic analysis of the law can be associated with a value, it is that of achieving something like this efficiency through legal rules and institutions.

But the rational choice model does not enjoy consensus among economists. Indeed it is quite controversial. John Maynard Keynes and
Coase, two of the greatest economists of the twentieth century, were united in their skepticism of rational choice.\textsuperscript{17} According to Coase, the rational choice model is “unnecessary and misleading” in that “there is no reason to suppose that most human beings are engaged in maximizing anything unless it be unhappiness, and even this with incomplete success.”\textsuperscript{18}

Even those who accept the rational choice model disagree over its application to legal analysis. Consider, for example, the “policy analysis” and “public choice” schools. While both these schools adopt the same assumptions about private choice, they disagree about whether the model should apply to judges and legislators.\textsuperscript{19} Needless to say, these two schools often reach radically different conclusions concerning the economic analysis of law and legal institutions.\textsuperscript{20} But what empirical research program could decide issue between them?

Another critique of the rational choice model has developed into competing theory of the economic analysis of law, “behavioral law and economics.”\textsuperscript{21} Even the most hard-core proponent of rational choice will admit that people do not always behave rationally. But the neoclassical model accounts for this by concluding that “random deviations from rational behavior will cancel out.”\textsuperscript{22} Recent studies suggest, however, that some departures from rational choice are not random but systematic, resulting from individuals’ cognitive biases.\textsuperscript{23} Perhaps the most important cognitive bias for behavioral economists is the “endowment effect.”\textsuperscript{24} The endowment effect is the cognitive bias of “valuing what we have more than we would value the identical thing if it were offered to us.”\textsuperscript{25} This systematic cognitive bias is particularly devastating to proponents of the rational choice model in that it undermines application of the Coase Theorem.\textsuperscript{26} The result is that “market transactions may not lead to an efficient allocation of resources, which in turn has implications for virtually

\textsuperscript{17}See POSNER, ECONOMIC ANALYSIS at 23-24.
\textsuperscript{19}See Kornhauser, Economic Rationality, at 69.
\textsuperscript{20}Id. at 70.
\textsuperscript{22}POSNER, ECONOMIC ANALYSIS OF THE LAW at 18-19.
\textsuperscript{23}See, e.g., DANIEL KAHNEMAN, THINKING, FAST AND SLOW (2011).
\textsuperscript{24}See Wright & Ginsburg, at1042.
\textsuperscript{25}POSNER, ECONOMIC ANALYSIS, at 18-19.
\textsuperscript{26}Id. at 19.
every area of substantive law.” Indeed, Cass Sunstein and Richard Thaler have applied behavioral economics to justify what they refer to as “libertarian paternalism,” the position that, in order to account for cognitive bias, private and public institutions should “self-consciously” use default and incentive structures to “steer people’s choices in directions that will improve the choosers’ own welfare.” Though any such paternalism is anathema to the dyed-in-the-wool neoclassical economist of law, it has nevertheless been embraced in contemporary American politics and the legal academy.

In response to these and other challenges, the neoclassical economist often levels the same charges against competing schools of economic thought as she does against proponents of ethical theory in the law—that they are “irrational,” “unscientific,” and “lacking in rigor.” But when one realizes that behaviorists and others could, with equal force, level the same charges against the rational choice theorist, their claim to “objectively verifiable knowledge” falls flat.

2. Can the Economic Analysis of Law Be Separated from Ethical Theory?

Moreover, if we take seriously Posner’s claim that ethical reasoning is decidedly “unscientific,” then we have all the more reason to question rational choice’s claim to objectivity. This is so because there is good reason for believing that the neoclassical economic analysis of law is crucially interrelated with, and perhaps even dependent upon, ethical reasoning and value theory.

For example, Posner is fond of pointing out that rational choice theory is purely instrumental. It does not set ends, it merely suggests the most efficient means to achieving goals that are otherwise set by the public political culture. In other words, by “showing how a change in economic policy or arrangements would advance us toward a goal, [the economist] can make a normative statement without having to defend their fundamental premises.” But consider what this means, and whether this claim places

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27 Wright & Ginsburg, at 1042.
28 See Sunstein & Thaler, at 1175.
29 Id. at 1162.
31 See Wright & Ginsburg, at 1053.
32 See id. at 1054.
33 POSNER, ECONOMIC ANALYSIS at 31.
34 Id. at 16.
the economist on more solid epistemological footing than the ethicist.

To begin, instrumental reasoning must always be secondary and therefore subordinate to the ends set before it. As David Hume (a philosopher Posner cites with approval) famously asserted, “[r]eason is, and ought only to be, the slave of the passions, and can never pretend to any other office than to serve and obey them.”\(^{35}\) For Hume, “reason” would include what Posner has in mind when he articulates rational choice theory, and “passions” would include what Posner would group together under the heading ethics or morality. If rational choice is the slave to a given society’s ethical values, then can the former ever be immune to contamination or influence by the latter?

Many have argued, and some studies have concluded, that simply studying theories that depict people as self-interested leads people to actually become more self-interested.\(^{36}\) If this is true, then any purported Chinese wall between rational choice and the ethical goals to which it is set will be breached. For example, if one of a society’s principal ethical goals is inculcating or incentivizing pro-social behavior among its citizens, then it may turn out that merely articulating that society’s legal rules, institutions, and sanction structures in terms of rational choice theory may itself bring about the contrary result. In this way, a society’s ethical goals would do more than direct the application of the economic analysis of law, it may force one to revise its key elements—e.g., the model of rational choice itself. Of course the rational choice theorist might simply respond that if publicizing the rational choice model would impede its instrumental success, then it should not be publicized. But then one could hardly present rational choice as a theory of legal analysis. Publicity and transparency is typically regarded as a key element to the very concept of law.

Moreover, as was noted above, many rational choice theorists are quick to challenge the credibility of behavioral economists and the very concept of “libertarian paternalism” as driven by their political predispositions, rather than any commitment to discovering the truth of the matter.\(^{37}\) But, again, if it is the nature of the economic analysis of the law that it plays a purely instrumental role, that it is “slave” to the political goals set before it, can it be a criticism that those ends might have a say in the most effective


\(^{37}\) Wright & Ginsburg, at 1045.
means to their accomplishment—particularly if (as suggested above) the nature of the instrumental reasoning applied may help determine its effectiveness?

The interrelatedness of economics and ethical theory also comes to the fore when one considers the concept of “preference” in rational choice theory. In microeconomic theory, preference is a “technical term that refers to a mathematical structure over a domain of ‘objects.’”\textsuperscript{38} As Kornhauser explains, preference is “a relation $R$ over a domain that is symmetric, complete, and transitive.”\textsuperscript{39} The Relation $R$ can be expressed as “at least as good as” or “at least as preferred as.”\textsuperscript{40} Symmetry means that “for every $x$ in the domain, $xRx$.” Completenss means that “for every $x$ and $y$ in the domain, either $xRy$ or $yRx$.\textsuperscript{41}" And, finally, transitivity means that, for any $x$, $y$, and $z$ in the domain, if $(xRy$ and $yRz)$ then $xRz$.\textsuperscript{42} For a value pluralist such as Isiah Berlin, the very idea of, say, completeness, so understood, may be unrealistic. But assume the concept of preference within rational choice theory is not inherently confused; when applying rational choice theory to the analysis of law, how does one interpret the relation, “at least as good as” or “at least as preferred as”? Kornhauser explains that preferences in rational choice theory are assumed to be self-interested, but this can mean either (a) a narrow “concern only for the agent’s own consumption of goods and services,” or it can be interpreted more broadly to mean (b) “any concern of the agent,” to include altruistic or other ethical motivations.\textsuperscript{43}

Kornhauser is convinced that the formal concept of preference is consistent with both the narrow interpretation and the broad interpretation, and that problems for rational choice theory only arise when they are applied inconsistently.\textsuperscript{44} But consider whether this is true. Assume one adopts the broader, “any concern” interpretation of preference that permits moral considerations to influence preference orderings. Application of rational choice theory to the economic analysis of the law requires that a judge or legislator be able to ascertain the all-things-considered self-interest of individuals, but, where the interests of individuals conflict, it must decide conflicts of interests between individuals. If a conflict between two or more

\textsuperscript{38} Kornhauser, Economic Rationality, at 68.
\textsuperscript{39} Id.
\textsuperscript{40} Id.
\textsuperscript{41} Id.
\textsuperscript{42} Id.
\textsuperscript{43} Id. at 69.
\textsuperscript{44} Id.
individuals turns on their competing moral or religious preferences (for example, concerning the issues of capital punishment, abortion, or same-sex marriage), then how does the rational choice theorist resolve this conflict? To rank outcomes, it would seem the judge or legislator would be forced to rank the moral preferences. How can this be done without making moral judgments? Moreover, once moral preferences are taken into consideration, the practical usefulness of rational choice is called into question. It is at least conceivable that one may be able to identify and weigh individuals’ preferences for the consumption of goods and services (under the narrow interpretation of preference), but how can a judge or legislator even begin the project of identifying and weighing individuals’ moral preferences by methods that can be regarded as “objective,” “rigorous,” or “scientific.”

If, alternatively, the rational choice theorist falls back on the narrow interpretation of preference, it will lack predictive power in that it will fail to account for the motivational power of ethical commitment. Even Kornhauser observes that “one must accept that obligation does in fact influence behavior.”

Consequently, unless the rational choice theorist can offer a reductionist account of ethical obligation (promise-keeping, justice, fairness, etc.) that ultimately cashes this motivation out in terms of pure self-interest (i.e., successfully argue that only incentive structures can determine action), then the theory will be incomplete and presumably fail in its principal objective, predictive accuracy. If the economic analyst of law does offer a reductionist account of ethical obligation in terms of pure self-interest, then the resulting model will fail to account for one of our core intuitions concerning the concept of law—it obligates; it does not merely oblige.

The aim thus far has not been to diminish or discredit the economic analysis of law. It has been to give reason for doubting some of its proponents’ pretentions to scientific certainty. I have attempted to show that rational choice theory is highly controversial and has by no means achieved anything approximating consensus. It is fraught with controversy from within and without. Moreover, to the extent proponents of the economic analysis of law such as Posner insist that ethical reasons are to be viewed skeptically as sources of legal justification, given the interdependence of ethics and economics, this criticism may have equal force against the economist. But even if one is unconvinced by the arguments above and remains convinced of the scientific rigor of the

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45 *Id.*
46 *Id.*
economic analysis of the law, the question still remains whether scientific knowledge should enjoy some more privileged status in legal reasoning.

B. *Science on All Fours with Ethics*......