I. Cost benefit analysis, Efficiency, Maximize the social surplus

1. In performing a cost benefit analysis, the decision maker aims to identify the rule or policy that will achieve the greatest sum of social benefits net of costs. Materials for class #13. When such benefits and costs are measured by WTA/WTP, cost benefit analysis is a decision heuristic meant to maximize the social surplus (= efficiency).

2. Basic normative goal (efficiency): maximize the social surplus (“grow the pie”), where social surplus = consumer surplus + producer surplus (“mutual gain through trade”) as measured by WTA/WTP. Handout for class #14, “Social Surplus.” Well-functioning markets enable mutual gain through trade. Viewed from one angle, the social surplus represented on the “Social Surplus” diagram is simply wealth or better-offness as measured in dollars (difference between how much the consumer is willing to pay and the market price; difference between producer’s cost and the market price). But viewed from another angle, the consumers and producers have exercised their freedom in pursuit of their life plans. (Consumer has decided whether to save, buy a mug, or buy a hamburger; entrepreneur has decided whether to launch a mug company or a diner, etc.)

3. Implementing a legal policy moves the world from state A to state B. Typically such a move makes some people better off and some worse off, so neither move satisfies the Pareto superiority standard. P. 191 footnote 1.
   - The concepts of “better off” and “worse off” can be interpreted in different ways. If the law school gives one lucky 1L “dinner with the Dean,” is the winner made better off and no one made worse off? Or are the rest of us worse off because of envy?
   - When a move makes at least one person better and none worse off, how should the move be appraised from various equality standpoints?
   - Regret; future selves. I am WTP $10 for heroin (I prefer the heroin to the $10); I buy the heroin from dealer who is WTA $10; does the exchange make me “better off”?

4. Even if the legal policy that moves the world from state A to state B makes some people worse off, the move to state B might increase the social surplus, such that those people made better off by the move could in principle compensate those made worse off. Then state B is Kaldor Hicks superior to State A, p. 191 footnote 1.
5. **Kaldor Hicks efficiency** (the normative goal: maximize the social surplus) does not itself supply any reason for the winners to compensate the losers. (Within the efficiency framework, such compensatory payments are called transfer payments.) There could be other normative reasons for compensating the losers: reasons of fairness, or corrective justice, or utility-maximization. *(State v. Pauper: would enabling the father to block the mother’s surrender of the child advance efficiency? If not, and some fathers are made worse off by losing their parental rights/responsibilities, should the Infant Safe Haven law be changed so as to compensate fathers for their loss?)*

6. Viewed **ex post**, the operation of most institutions or practices will make some people better off and some worse off. But viewed **ex ante**, a practice or institution might **maximize the average expected benefit for all participants**. Such a practice is **ex ante Pareto superior** to the alternatives. Example: participants in the fishery commit to a duty to rescue one another. The institution of a binding pledge to rescue one another is a **commitment device** that constitutes a certain kind of **community**. (We can think of the participants as constituting themselves as an “efficiency community”—they come together to advance the common good or “promote the general welfare”)

7. **Negative externalities**, pp. 214-222. Apply the factory pollution scenarios, *Collated Handouts pp. 13-15*, to the consumer/producer surplus diagram, *Handout for class #14, “Social Surplus.”* When the negative externalities are high enough, then unless the producers internalize the externalities they will inefficiently overproduce (and consumers will inefficiently overconsume) the good.

8. **Coase Theorem**, materials and handouts for classes ##16-17; and see answers to Coase Theorem problems posted to Secure Documents. In the absence of **transaction costs**, mutual exchange will bring about mutual gain through trade, so the surplus-maximizing result will obtain regardless of whether the law assigns the initial entitlement to neighbors or factory, etc. But where transaction costs are high, the law should try to assign the initial entitlement in such a way as to maximize the social surplus.

9. Sometimes mutual gain through trade does not take place—or the mutual gain obtained through trade is not as big as it could be—due to **information problems**. Economic analysis proposes contractual and legal-regulatory solutions to those information problems. See **materials for class #14**.

10. **Collective action problems and free riders**, p. 226. When someone can get a benefit without reciprocating, we call him or her a **free rider**. To create an effective system of national defense, we need to protect everyone in the country, whether they contribute to such defense (pay taxes, fight) or not. Situations where everyone would be better-off if free-riding were controlled are called **collective action problems**. Viewed from one normative angle, the free rider is acting unfairly. Viewed from an efficiency standpoint, free riding (like information problems, transaction costs, or non-internalized externalities) is a problem when it limits the social surplus.

11. A **Prisoner’s Dilemma**, pp.223-226 and *Collated Handouts p. 16*, is a scenario in which individuals who pursue rational self-interest may end up worse off than if they had acted contrary to rational self-interest. Thus the Prisoner’s Dilemma shakes the foundations of mutual gain. In the scenario at pp. 223-226, cooperation would yield an outcome in which both suspects do two years of prison time. This is Pareto-superior to the equilibrium solution in which both suspects do five years of prison time. Isolation of the suspects and their inability to commit to one another (infinite transaction cost) doom them to an inefficient outcome.

- The Prisoner’s dilemma and the paradox of egoism and altruism. If the prisoners could act altruistically, they would maximize their self-interest. But if the prisoners pursue their self-interest, they will not achieve the efficient outcome.
- The prisoners lack a commitment device that would enable an “efficiency community” and a “moral (Golden Rule) community.”
A commitment device for lawyers: the California bar oath. “I solemnly swear (or affirm) that I will support the Constitution of the United States and the Constitution of the State of California, and that I will faithfully discharge the duties of an attorney and counselor at law to the best of my knowledge and ability.” (See exercise, Walk a mile in my shoes, note on integrity.)

II. Utility maximization, pp. 200-204

1. Basic normative goal of utilitarianism (lower left corner of triangle): achieve the greatest good (or greatest happiness) of the greatest number.

2. Unlike efficiency analysis (see I.4-5 above), utility-maximization is very concerned with transfer payments. Due to the declining marginal utility of money, transfer payments from the wealthy to the poor can advance overall happiness.

3. Utilitarianism explains why the WTP/WTA measure of value can be an unreliable indicator of the intensity of preferences (the amount of happiness to be obtained or unhappiness to be averted). (Consider whether parents’ WTP/WTA is an accurate indicator of their happiness or unhappiness in State v. Pauper; cf. WTP/WTA to avoid vaccination in Gould Virus.)

4. Should legal policy seek to maximize utility, or seek instead to maximize the social surplus as measured by WTA/WTP? (Is Phillip Becker’s “message of value” measured by his WTP/WTA? Should the worth of aquatic life, in Entergy, be measured only by their commercial and recreational value as measured by WTA/WTP? Should the pleasure or pain of fish count?)

5. Dworkin’s Derek/Amartya scenario, pp. 201-202. Two versions: one in which we don’t know anything about Derek and Amartya except WTA/WTP, and one in which we add some facts about them that are relevant to a utilitarian assessment, and also to a fairness or justice assessment.

- Version One: Only WTA/WTP. In the present state of affairs (state A), Derek has a book, and he values the book at $2. Amartya values book at $3. Tyrant takes book from Derek and gives it to Amartya, without compensating Derek. In state of affairs or world-state B, in which the book has been transferred, the resource has been transferred into the hands of its highest-value user. So the social surplus is bigger by $1 in state B than in state A. Dworkin’s argument is that society B, in which the tyrant transfers the book from Derek to Amartya, is not in any respect superior to society A. It’s not better; and when you take into account the injustice of the move, it’s worse. But recall the institutional relations between efficiency, freedom, and markets (I.2 above). The tyrant transfer serves efficiency but not freedom, and it does not engender a market. It creates no community (see I.6 & I.11, above). In a market, we’d not only have an exercise of freedom by Derek and Amartya; we’d have at least a formally fair way of apportioning the social surplus between them. If Derek is WTA $2, and Amartya is WTP $3, then negotiations between them might wind up with Derek getting anywhere between $2 and $3. There’s a distributional problem in the scenario: Amartya gets 100% of the social surplus. Now, we might say, fine, economics doesn’t care about distribution, only about maximizing the social surplus. But economics does care about having institutions in which something like free transactions take place, and which can set the equilibrium price (the $3 price on our Social Surplus handout).

- Version Two: Added facts about Derek and Amartya. Derek is poor and sick, and the book is one of his few comforts. Amartya is wealthy and happy, and might not ever read the book. Now Dworkin has driven a wedge between utility-maximization and maximizing the social surplus. Pretty clearly, adding the book to Amartya’s sagging shelves does very little to increase his happiness, while taking away one of Derek’s few comforts greatly increases his unhappiness. So utilitarianism would tell the dictator, “Do not transfer the book. Or if you do transfer it, you must also transfer big compensation from Amartya to Derek.”
III. Ex post normative frameworks

1. All of these frameworks (represented in the lower right corner of the triangle) have one thing in common: they understand the decision maker as obligated to vindicate the rights of the parties (under what Dworkin calls reasons or arguments of “principle,” p. 362) as viewed ex post; while the maximizing frameworks, to the left of the dotted line on the diagram, understand the decision maker as properly choosing the rule or policy that maximizes some state of affairs (social surplus or greatest happiness) going forward, i.e., ex ante. (See pp. 34-35, 193-194, 295.) In other respects the normative frameworks collected in the lower right corner of the triangle are different from one another (affirming or rejecting one does not require affirming or rejecting others).

2. Ethics of character and legal story-telling, p. 456. Judge Fernandez, faced with a hard case in Phillip Becker, made the decision that enabled him to be the person he should be (the redeemed Scrooge; Solomon; not Pilate, etc.) and that responded to Phillip’s “message of value.” Col. Couch, faced with a dilemma, made the decision that enabled him to emulate Bonhoeffer, and to fulfill the oath he swore when he became a member of the North Carolina bar, and to live according to the proposition that “all men are created equal and endowed by their creator with certain unalienable rights” (Declaration of Independence). Margaret Montoya spoke out in her Criminal Law class because otherwise she would have been complicit and failed to honor the braiding of her integrity.

3. Kull’s anti-instrumentalism, pp. 274-275, 282-292, 295-297. Kull criticizes economic efficiency approaches to the common law. He argues that such approaches sever the common law from the source of its legitimate authority in vindicating ordinary expectations associated with social relations and institutions such as the giving and receiving of gifts.

4. Nozick’s libertarianism, pp. 323-334. Critique of social maximization positions (to the left of the dotted line on the diagram) as wrongly treating individual human persons as cells in a social organism, and (especially as to utilitarianism) wrongly treating experiential states (such as pleasure or happiness) as ultimate goals. Nozick presents morality as consisting not only of goals or the pursuit of end-states but also as moral side-constraints (pp. 324-325).

5. Rawls’ ethics of fairness, pp. 334-340. Rawls offers three ideas about fairness:
   • Fairness principle, p. 335. Participants in a shared practice (a game or other joint activity) ought to abide by rules and principles which they can propose to one another as free and equal persons, not as reflecting inequalities of bargaining power or social position.
   • Fair distribution of the surplus. Sometimes, when there is a surplus left over after justice has been done or the common good achieved, there is a fair way to distribute the surplus. The picture is one of taking turns, or rotation, p. 337. Example: In a drought, once the water needed for public health and drinking is safeguarded, and there is still more water (surplus), then it can be apportioned fairly by taking turns (first one side of the street, then another, etc.)
   • Duty of fair play, p. 336. This duty requires one to abstain from an advantage that cannot be distributed fairly to those whose efforts have made it possible. In other words, Rawls is suggesting that sometimes there is no effective way to arrange rotation or taking turns. Then everyone is under a duty to abstain from the advantage.

6. Golden Rule, promise-keeping, faithfulness. By making binding promises to one another, persons can exercise their freedom in such a way as to live by the Golden Rule (see I.11, above, on how a commitment device might enable the prisoners to create for themselves a Golden Rule community and an efficiency community). Promises change moral relations; see, e.g., the promise of fidelity (Handout for class #17, see “Maximizing fidelity v. acting under the principle of fidelity,” and the California Bar Oath.) Law as like a promise (a promise creates an excluding reason and an authorizing reason). Law as supplying commitment devices that enable people to create loving communities. Law like love (Class #28, supplemental materials pp. 16-18).