BOOK REVIEW

THE LIMITS OF UTILITARIANISM

Reza Dibadj*


INTRODUCTION

Professor Steven Shavell’s Foundations of Economic Analysis of Law offers a monumental overview of the application of economics to law. A work of major significance, it is likely to occupy a prominent position in the pantheon of law and economics books, alongside works by icons of the movement such as Ronald Coase, Guido Calabresi, and, of course, Richard Posner.

This review analyzes the strengths and occasional limitations of Shavell’s book, and proceeds in three parts. Part I provides a brief survey of the contents of the book, Part II highlights the book’s significant strengths, and Part III suggests a critique of the book. On the positive side, Shavell has written a lucid text that is accessible yet does not shy away from masterful exposition of complex topics such as externalities, informational asymmetries, and the divergence between private and social welfare. My critique, however, focuses on the notion that Shavell unnecessarily cabins welfare economics within a neoclassical and utilitarian box. In placing too much faith in the ability of the tax and transfer system to achieve distributional goals, and in eschewing deontological concerns, he too often ends up resorting to wealth maximization—ironically, the very method he chastises conventional law and economics scholars for adopting.

I. SURVEY OF THE BOOK

While not as encyclopedic as Posner’s Economic Analysis of Law, Shavell’s work is nonetheless inspiring in scope. Presented in twenty-nine


1 STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW (2004).
5 Posner’s treatise, now in its Sixth Edition, has the vast ambition of applying economic analysis to virtually every area of the law, including family law, sexuality, and federalism. See id.
chapters across seven sections, the book is perhaps best conceptualized in two major parts.

The first part provides an overarching perspective on the interaction between legal and economic discourses. It comprises the beginning and end of the book: the Introduction (Chapter 1), General Structure of the Law (Chapter 25), Welfare Economics (Chapters 26-28), and Concluding Observations (Chapter 29). Shavell’s perspective is neoclassical and utilitarian. In a nutshell, his views rest on the simple proposition “that actors are ‘rational.’ . . . [T]hey are forward looking and behave so as to maximize their expected utility.”

The second part, consisting of the bulk of the book, tries to apply this perspective to different doctrinal areas. As is typical of law and economics, the most substantial discussion is of the private common law: property, torts, and contracts. While his discussion of property focuses on real property and chattels (Chapters 1-6), Shavell also devotes one chapter to intellectual property (Chapter 7). Next, he tackles torts—where both individuals (Chapter 8) and firms (Chapter 9) are tortfeasors—with a focus on deterrence (Chapter 10), as well as liability and administrative costs (Chapters 11-12). After an introductory chapter (Chapter 13), discussion of contract law focuses on formation (Chapter 14), and three special forms—contracts to produce goods (Chapter 15), as well as contracts to transfer possession and donative contracts (Chapter 16). Having completed its tour of private common law areas, the book shifts gears, analyzing the litigation process through observations on civil procedure (Chapters 17-19). The book ends with a discussion of public law enforcement and criminal law, focusing on understanding the reasons behind punishment—whether deterrence (Chapters 20-22), or rehabilitation and retribution (Chapter 23). Finally, Shavell seeks to apply economic analysis to criminal law (Chapter 24). Methodologically, “the emphasis is on theory, but some statistical studies are noted.”

II. Significant Strengths

Professor Shavell’s book possesses a number of distinctive strengths that make it an indispensable reference text for scholars and students of law and economics. To begin with, it provides an excellent compendium of three decades of his influential articles. Shavell’s clear prose is to the point and eminently readable—he is even careful to spare less mathematically-inclined readers by relegating the technical exposition to footnotes. He has a gift for being able to explain very complex ideas in refreshingly simple terms. Examples abound: the elegant use of the concept of “incentives” to frame a discussion of property or “marginal deterrence” to structure a discussion of public enforcement; the use of “repetitive value” to discuss how intellectual property

---

6 Shavell, supra note 1, at 1.  
7 Id. at 5.  
9 See Shavell, supra note 1, at 518-19.
("IP") differs conceptually from real property, or the masterful application of the economics of agency relationships to discuss vicarious liability, to name a few.

In addition to its user-friendliness, Shavell’s economic analysis of law presents a number of striking advantages. While maintaining a necessary focus on the insights that economics’ ex ante perspective brings to law, Shavell’s book does not generally fall prey to the “law as science” dogma that haunts Posner’s work and much of law and economics. Indeed, Shavell—who laments how “many of the advocates of the ‘economic’ position appear themselves to be ignorant of the fundamental definitions and concepts of welfare economics”—provides a sobering summary of the bulk of existing economic analysis of law:

What, however, can be said of the notion of “wealth maximization,” a social goal advanced by many scholars who have analyzed legal rules in an economically oriented manner? As I will now explain, (a) the goal of wealth maximization is not one employed in welfare economics—indeed, it is not a well-defined goal, that is, it is theoretically incoherent—even though the impression in legal academic circles is that wealth maximization is the general normative goal endorsed by economists; (b) the goal of wealth maximization has been criticized by legal academics for reasons that are, ironically, largely consistent with welfare economics.

As the book correctly and refreshingly argues, “[t]otal wealth is not a function of the utilities of individuals, so is not, on its face, a social welfare function.” Defining “utility” brings with it its own set of challenges, but one cannot underestimate the importance of a scholar of Shavell’s stature urging law and economics to get beyond its fascination with wealth maximization, which typically manifests itself as cost/benefit analysis. In addition,

10 See id. at 138-66.
11 See id. at 232-36. Curiously, Shavell does not deploy the principal/agent framework when discussing the role of lawyers in litigation. See id. at 435-37.
12 See id. at 268 (“Rarely, however, does one encounter the belief that the main purpose of accident law is deterrence and not compensation.”); id. at 345 (“This suggests that the buyer and the seller would agree, ex ante, to employ the expectation measure rather than any other remedy for breach.”). Cf. Bruce A. Ackerman, Foreword: Talking and Trading, 85 COLUM. L. REV. 899, 900 (1985) (discussing the importance of ex ante economic analysis.)
13 See, e.g., Posner, supra note 4, at 3-4. For a critique of this dogma, see Reza Dibadj, Beyond Facile Assumptions and Radical Assertions: A Case for “Critical Legal Economics”, 2003 UTAH L. REV. 1155.
14 Shavell, supra note 1, at 669.
15 Id. at 667-68. Shavell goes on to observe that “legal academics who do not understand the basic elements of welfare economics attach what they incorrectly perceive to be the conventional normative economic framework, and employ arguments that are intrinsically those of welfare economics.” Id. at 669.
16 Id. at 668.
17 See infra notes 102-06 and accompanying text.
18 Wealth maximization is a variation on Kaldor-Hicks optimality which “says that a change is desirable if gainers hypothetically can compensate losers.” Per-Olov Johansson, An Introduction to Modern Welfare Economics 5 (1991). Since no compensation need be paid, Kaldor-Hicks ignores distributional considerations.
his detailed analysis in three areas—informational asymmetries, externalities, and the divergence between private and social welfare—simply shines.

The first distinctive strength of Shavell’s work is a willingness to tackle the informational asymmetries inherent in economic transactions. In marked contrast to much of mainstream law and economics that seems enraptured by an illusory world of perfect information, Shavell is willing to face reality. In his discussion of conflicts among property owners, for example, he discusses the “asymmetric information between parties that leads to miscalculations in bargaining and failure to agree.” For its part, state intervention in property sales may be justified “to cure a problem of lack of information on the part of a participant in the sale.” When discussing contracts, he is careful to note that one “major reason for intervention in private contracting is lack of information by contracting parties.” Informational problems may also justify mandatory disclosure, public intervention into remedies, and doctrines that allow one party to escape performance, such as fraud or mistake. More broadly, Shavell notes that “contracts are in fact incomplete, due to the cost of including provisions and to the difficulty courts would have in verifying contingencies.” In torts, he acknowledges that “customers do not have enough information to determine product risks at the level of individual firms.” And in discussing litigation, he astutely observes that going to trial may not be the best resolution, but merely one “considered to be due to asymmetry of information.” Shavell’s focus on informational realities debunks simplistic ideas in the public choice tradition that simplistically extol private contract.

With few exceptions, cost-benefit analyses have proceeded by simply adding up total money costs and benefits regardless of who receives them. . . . Aggregate money gains and losses measure the efficiency gains of a project in the following sense. If the aggregate is positive, this is taken to indicate that the gainers could compensate the losers and still be better off after the project is undertaken.

As explored below, the great irony in Shavell’s work is that it too often itself devolves to the wealth maximization norm it so eloquently criticizes. See infra notes 124-31 and accompanying text.

---


21 Shavell, supra note 1, at 90. Shavell also makes this point with regard to contract renegotiations. See id. at 315 (“even if the parties are in contact with one another, asymmetric information between them may lead to breakdowns in bargaining”).

22 Id. at 56.

23 Id. at 437 n.29.

24 See id. at 331-35.

25 See id. at 353 (“buyer’s value of performance may not be known to the seller at the time of contracting, and this may influence the remedy for breach that courts will employ”).

26 See id. at 334.

27 Id. at 343. See also id. at 299-301.

28 Id. at 214.

29 Id. at 408.

Second, Shavell devotes significant attention to externalities, especially in his discussion of property. It is worth remembering that mainstream law and economics scholars tend to diminish the importance of externalities. Conventional commentary relies on the so-called “Coase Theorem” which famously postulates that:

It is always possible to modify by transactions on the market the initial legal delimitation of rights. And, of course, if such market transactions are costless, such a rearrangement of rights will always take place if it would lead to an increase in the value of production.

Shavell, however, aptly notes that “it may be socially desirable to limit private contracting when contracts have external effects.” The reason is simple: we do not live in a world of zero transaction costs, and it is thus quixotic to believe that all parties affected will bargain around these externalities. After all, “the explanation for why bargaining may not occur . . . when mutually beneficial agreements exist is that the costs of bargaining—including the costs of coming together and the time and effort devoted to the bargaining process itself—outweigh the expected benefits.” Additional complexities, such as judgment-proof defendants and the distortionary effects of insurance, make bargaining all the more difficult. As a consequence, “market resolutions of externality problems [are] unlikely[,]” making the Coase Theorem “not necessarily a good guide for thinking.”

Third, Shavell’s careful attention to informational asymmetries and externalities contribute to what is perhaps the major achievement of Foundations of Economic Analysis of Law: a sophisticated depiction of the differences between private and social welfare. At several points throughout the book,

---

31 These include nuisances, pollution, risky behavior, or the use of common resources. For a more detailed discussion of externalities, see Carl J. Dahlman, The Problem of Externality, 22 J.L. & ECON. 141 (1979).
32 Indeed, he devotes Chapters 5 and 6 to externalities.
33 Coase, supra note 20, at 15.
34 Shavell, supra note 1, at 437.
35 Id. at 87. See also id. at 54; Dahlman, supra note 31, at 141 (Transaction costs include "search and information costs, bargaining and decision costs, policing and enforcement costs.").
36 Notably, judgment-proof defendants can externalize their costs on society. See Shavell, supra note 1, at 230-32.
37 To his credit, Shavell devotes substantial attention to insurance issues. See, id. at 261-67, 437-43, 526-28.
38 Id. at 91.
39 Id. at 106. See also id. at 84 (simplistic variations of the Coase Theorem are "an immediate tautology"). Coase himself has convincingly argued that he presented the world of zero transaction costs merely as a baseline against which economists should examine transaction costs. See, e.g., Coase, supra note 2, at 174 (“The world of zero transaction costs has often been described as a Coasian world. Nothing could be further from the truth. It is the world of modern economic theory, one which I was hoping to persuade economists to leave.”) (emphasis added).
40 Early twentieth century welfare economists, notably Arthur Pigou, also understood this difference. See, e.g., A.C. Pigou, Economic Essays and Addresses 6 (1931) (Emphasizing the "distinction between private net product and social net product."). However, this insight has been all but forgotten through decades of the Chicago School’s laissez-faire law and economics.
Shavell acknowledges that government has an important role in enhancing social welfare—a far cry from the laissez-faire predilections of mainstream law and economics.\textsuperscript{41} Indeed, recognizing the differences between private and social welfare has sweeping policy implications, which Shavell begins to explore across a variety of doctrinal areas, including property, torts, and procedure.

At the simplest level, he correctly appreciates the importance of public goods.\textsuperscript{42} Put simply, “[w]hen individuals value services at less than their social value, the privately sold quantity of the services will be undesirably low, and thus there is an argument for their public provision, or for subsidy of their purchase.”\textsuperscript{43} As a consequence, public ownership of roads and rivers,\textsuperscript{44} and public provision of services such as “national defense, certain educational and health-related services, and fire and police protection”\textsuperscript{45} can enhance social welfare. Shavell drives home the point with a touch of humor, noting wryly that “[w]ere a private company to own the Gettysburg battlefield, it might decide to sell the land to a real estate developer.”\textsuperscript{46} Similarly, he points to the need for a public intellectual property regime.\textsuperscript{47} The book’s appreciation of the divergence between private and social welfare also allows the reader to ponder a number of insightful questions in property theory—notably, the “relationship between the social value of an innovation and the optimal length of [private] property rights,”\textsuperscript{48} and whether “the argument that compensation for takings is necessary to induce government to behave better is in some tension with our attitude toward government behavior outside of the domain of takings.”\textsuperscript{49}

Though perhaps strongest when discussing property, the book is also thought-provoking in other doctrinal areas. It aptly argues that the “socially ideal and the privately desired degree of search effort”\textsuperscript{50} for contractual opportunities diverges and that a “basic rationale for legislative or judicial overriding of contracts is the existence of harmful externalities.”\textsuperscript{51} Moreover, Shavell shows that private parties have incentives to break contracts if not for their public enforcement.\textsuperscript{52}

\textsuperscript{41} This is precisely why many scholars who argue for cabining government find information asymmetries and externalities so infuriating. \textit{See, e.g.}, Daniel D. Polsby, \textit{Should Government Attempt to Influence Consumer Preference?}, 23 \textit{Harv. J.L. & Pub. Pol’y} 197, 200 (1999) (“Externality regulation is not a limiting principle but an illimitable one.”).

\textsuperscript{42} \textit{See infra} notes 43-49 and accompanying text. Public goods can be conceptualized as those which present positive externalities.

\textsuperscript{43} \textit{See} \textit{Shavell}, \textit{supra} note 1, at 121.

\textsuperscript{44} \textit{See id.} at 116-17.

\textsuperscript{45} \textit{Id.} at 120. As Shavell summarizes, the “main justifications for public property are either that the private sector cannot profit sufficiently to be led to supply certain property when it would be socially desirable, or that a private supplier of property would charge too high a price for, and thus undesirably discourage, its use.” \textit{Id.} at 111.

\textsuperscript{46} \textit{Id.} at 119.

\textsuperscript{47} \textit{See id.} at 161. For a discussion of the dangers of current efforts to privatize intellectual property, see Reza Dibadj, \textit{Regulatory Givings and the Anticommons}, 64 \textit{Ohio St. L.J.} 1041 (2003).

\textsuperscript{48} \textit{See} \textit{Shavell}, \textit{supra} note 1, at 146.

\textsuperscript{49} \textit{Id.} at 130.

\textsuperscript{50} \textit{Id.} at 325.

\textsuperscript{51} \textit{Id.} at 320.

\textsuperscript{52} \textit{Id.} at 297-98.
In the realm of torts, Shavell correctly reminds readers that “the private incentives to use the [accident law] system are generally different from the socially desirable incentives to do so.” Shavell is even willing to buck the conventional wisdom in law and economics that believes strict liability somehow to be inefficient: He argues that under a strict liability regime, “the level of production will be optimal, because the price will equal the social costs of production per unit.” Strict products liability, for instance, helps protect consumers who simply do not have the knowledge to identify a wide range of risks inherent in the products and services they consider purchasing.

Similarly, there exists potential divergence between private and social welfare at every step of the litigation process: Bringing suit may not be socially desirable, private parties externalize a portion of their costs of litigation on society, and might have “excessive or insufficient” incentives to conduct discovery or even provide inaccurate information. For its part, “asymmetric information leads parties to fail to settle because they may misgauge each others' situations.” Readers are also left to ponder whether the “social incentive to have a trial may sometimes exceed the private incentive”—after all, trials can deter socially undesirable behavior by revealing information publicly, establishing precedent, and reinforcing social norms. More generally, Shavell is willing to challenge those who present private legal systems as a panacea to what ails public law.

---

53 Id. at 176.
54 Id. at 211. See also id. at 218.
55 See id. at 215:

Customers' knowledge of the risks attending use of a wide class of modern-day products (automobiles, drugs, machines) is, one assumes, limited in significant ways because of customers' quite natural inability to understand how the products function. And customers' knowledge of the quality of most professional services (medical, legal, architectural) is, one supposes, similarly limited. Unfortunately, Shavell later manages to undercut his own argument by suggesting that perhaps “consumer information is often tolerably good and that, on net, the marginal deterrence engendered by the threat of product liability is not great.” Id. at 396. Shavell's embrace of neoclassicism most likely explains this ambivalence. See infra note 72 and accompanying text.

56 See SHAVEL, supra note 1, at 391.
57 See id. at 411 (“[P]arties involved in litigation do not bear the salaries of judges and of ancillary personnel, the value of jurors' time, the implicit rent on court buildings, and the like . . . .”).
58 Id. at 428.
59 See id. at 454 (“A plaintiff may want to conceal facts in order to prevail against a defendant who is in fact innocent or may want to exaggerate his losses; a defendant may have similarly perverse incentives to prevent the truth from becoming known.”).
60 Id. at 411.
61 Id. at 414.
62 See id. at 413.
63 See id.
64 Id. Shavell even notes that because some private parties might not have the resources to bring legal claims that would otherwise be socially useful, there is justification for “certain social efforts to promote access to the legal system, such as legal aid programs and small claims courts.” Id. at 287.
65 See id. at 445-50. Shavell's observations are remarkably consistent with new research into the limitations of private legal systems. See, e.g., Amitai Aviram & Avishalom Tor,
To his immense credit, then, Shavell acknowledges the importance of public law in a world in which putative "Coasian" bargaining is but a fanciful abstraction. Notwithstanding this major accomplishment, Foundations of Economic Analysis of Law does have its own shortcomings.

III. Some Limitations

I begin my critique by nit-picking. The book occasionally indulges in overly simplistic legal descriptions that will strike lawyers reading the book as platitudes. It also tends to place too much faith in the efficiency of financial markets as risk-hedging mechanisms. More generally, Shavell spends too much time describing how the common law is efficient, rather than pushing for legal reform. Readers are simply told that a host of doctrines—from laws restricting dead hand control of property, to providing for expectation remedies, to requiring intent as an element of criminal culpability—make sense. This type of analysis, however, is not new and has been put forth extensively by scholars such as Richard Posner. Shavell thus misses an opportunity to differentiate his approach and perhaps emphasize doctrines needing reform.

A. Constraints of a Neoclassical Toolkit

The root of the issue may simply be that Shavell unnecessarily limits the economic tools that should be brought to bear when analyzing law. Like the vast majority of preeminent law and economics scholars, he remains wedded to the assumption that individuals are rational actors behaving according to the predictors of neoclassical price theory. Methodologically, such an assumption necessarily de-emphasizes important tools such as game theory and behavioral economics. Substantively, it contributes to a bias against administrative regulation.

Overcoming Impediments to Information Sharing, 55 Ala. L. Rev. 231, 231-32 (2004) ("[W]hen deciding whether to share information, firms consider their private welfare. Discrepancies between social and private welfare may therefore lead firms to share information excessively to anticompetitive ends . . . . Sub-optimal information sharing can generate significant social costs.").

66 See, e.g., Shavell, supra note 1, at 237 ("The starting principle in most legal systems is that a liable party should pay for the actual level of losses caused, whether they be high or low."); id. at 461 ("The optimal investment in, and accuracy of, the trial process is less than it would be if there were no appeals process and no opportunity to correct errors."); id. at 543 ("Society requires criminal law in order to constrain certain behavior that could not otherwise adequately be controlled.").

67 See, e.g., id. at 61 ("The existence of a well-functioning annuities market, however, substantially qualifies the argument that individuals must hold property until death to assure themselves necessary support if they live unexpectedly long."); id. at 261 ("Now let us assume that insurance is available and sells at actuarially fair rates.").

68 See id. at 72.

69 See id. at 378.

70 See id. at 552-56.

71 See Posner, supra note 4.

72 See supra note 6 and accompanying text. See also Shavell, supra note 1, at 207 ("Firms will be presumed to maximize profits and to do business in a perfectly competitive environment.").
To begin with, Foundations of Economic Analysis of Law could have presented a wider range of analytical tools. There is no mention of game theory, one of the most exciting new areas of research in economics which models transactions as games among economic actors. For instance, with regard to costs of litigation, the book does not take a position on the desirability of fee-shifting or hourly fee versus contingency-based compensation, and similarly suggests ambiguities as to whether expectation or reliance damages should be preferred in contract. When discussing property rights, Shavell merely tees up the advantages of liability rules and questions whether the “one-size-fits-all” duration of intellectual property protections makes sense. Concrete suggestions for reform might have emerged had he used game theory to try to model interactions between lawyers and clients, or holders of intellectual property and potential infringers.

Another methodological gap is the text’s extremely minimal emphasis on behavioral economics, whose central tenet is that “assumptions about behavior should accord with empirically validated descriptions of actual behavior.” Shavell does on a few occasions refer to the behavioral literature—the “endow-

74 See Shavell, supra note 1, at 432 (“[I]t is apparent that the influence of fee-shifting on settlement might be socially beneficial or detrimental . . . and that the effect of fee-shifting on trial expenditures could be similarly ambiguous from a social standpoint.”).
75 See id. at 436 (“[I]t appears that either hourly fee or outcome-based contingency arrangements could be superior to the other, because either could lead to a higher expected gain minus litigation costs.”).
76 See id. at 360 (“There does not exist any damage measure that provides optimal incentives both to perform and to rely: only the expectation measure provides optimal incentives to perform, yet it does not provide proper incentives to rely.”).
77 See id. at 42-43 (“A type of rule that is superior to a finders-keepers rule and also to the original ownership rule is an original ownership rule combined with a mandatory reward paid by the owner to the finder.”); id. at 98 (“Liability rules possess a general administrative cost advantage over the other rules in that under liability rules the legal system becomes involved only if harm is done . . . .”). For a discussion of the advantages of liability rules, see Dibadj, supra note 47.
78 See, e.g., Shavell, supra note 1, at 154 (“The uniform nature of the duration of patents stands in significant contrast to the highly elaborated legal consideration given to whether to award patents and to their proper scope. One suspects, therefore, that the fixed twenty-year patent length could be improved.”); id. at 157 (“[W]hy, for example, the duration of protection [for copyright] should be so much more generous than for patents, is not evident, and one surmises that it has no clear rationale.”).
ment effect,"^81 miscalculation of risk,^82 overconfidence,^83 and hyperbolic discounting.\^84 The discussion, however, is skeletal and all too often relegated to footnotes. This lack of emphasis on behavioral realities has repercussions that unfortunately detract from the overall force of the book. Sometimes, Shavell makes bold behavioral assertions with precious little proof.\^85 Depictions of individuals as utility-maximizing automatons occasionally stretch common sense notions of how people behave.\^86 Shavell's copious discussion of deterrence, for instance, assumes an inverse linear correlation between enforcement efforts and the degree of punishment,\^87 leading him to conclude that "a low probability-high magnitude sanction policy is socially advantageous."\^88 In fact, research into how people actually behave points to precisely the opposite conclusion: A high certainty of punishment, even with a low severity penalty, is perhaps the most effective way of deterring individuals from anti-social behavior.\^89

Beyond a limited toolkit, the book also displays a bias against administrative regulation, typical of neoclassical theorists. The assumption underlying this belief seems to be that the state does not possess good information:

Another general avenue for improvement would be to reduce the amount of regulation, given that it requires regulators to have more information than they can be expected to possess, and to substitute for regulation publicly imposed sanctions based

\footnote{See Shavell, supra note 1, at 104 n.36. The "endowment effect" occurs when a person demands more to sell a product than she is willing to pay to purchase it. See id. at 216 ("Customers can readily be imagined to exaggerate certain kinds of risks, because, for instance, of their vivid aspect (dying in an airplane crash), and they can well be thought to underestimate other kinds of risk, because, say, of the innocuous appearance of the products creating the risks . . . .")); id. at 481 ("[I]ndividuals often experience difficulty in assessing and interpreting probabilities . . . .").}

\footnote{See id. at 405 (mentioning the "natural optimism about one's chances").}

\footnote{See id. at 71 n.74 ("[T]hose alive today might care very little about the well-being of individuals ten generations in the future, but a social welfare measure might accord similar weight to the well-being of individuals ten generations in the future as it does to the well-being of the present generation.").}

\footnote{See, e.g., id. at 225 ("[A] fairly general consequence of uncertainty in the assessment of true levels of care is that parties will tend to take more than due care—and thus to take socially excessive levels of care . . . .")}
on harm: namely, fines for harm (or fines inflated by the probability of discovery of harm), and corrective taxes for expected harm.90

This stance is surprising for a number of reasons. Why would administrative agencies have less information than courts, for example?91 Are courts really best equipped to address the informational asymmetries and externalities Shavell so eloquently describes?92 Indeed, as Coase suggests in his seminal work, government regulation can lower, not increase, transaction costs:

[T]here is no reason why, on occasion, such governmental administrative regulation should not lead to an improvement in economic efficiency. This would seem particularly likely when . . . a large number of people are involved and in which therefore the costs of handling the problem through the market or the firm may be high.93

It is precisely the most difficult problems—those involving multiple constituents and posing high transaction costs—where government regulation may be the most helpful. To his credit, Shavell occasionally seems to appreciate this reality, but only in very limited applications.94

B. A Utilitarian Vision for Welfare Economics

Beyond its embrace of neoclassicism, perhaps the biggest weakness of Foundations of Economic Analysis of Law is the simplistic equivalence it makes between welfare economics and utilitarianism. Shavell’s project rests on one central claim:

According to the framework of welfare economics, social welfare is assumed to be [solely] a function of individuals’ well-being, that is, of their utilities. An individual’s utility, in turn, can depend on anything about which the individual cares: not only material wants, but also, for example, aesthetic tastes, altruistic feelings, or a desire for notions of fairness to be satisfied.95

In effect, Shavell is proposing a return to “old” school welfarism96—reminiscent of the eighteenth century English philosopher Jeremy Bentham.97 It is

90 Shavell, supra note 1, at 591. See also id. at 37 (“The chief problem . . . with any regulatory approach, concerns the quality of the state’s information about proper regulation and the bluntness of its rules.”); id. at 590 (“Desirable regulation requires the government to obtain information that is unlikely to possess for many acts affecting risk.”).
91 See, e.g., id. at 180 n.6 (“It is assumed here (and elsewhere in this chapter) that a court can determine a party’s level of care with complete accuracy.”).
92 See supra notes 20-30 and accompanying text.
93 Coase, supra note 20, at 18.
94 See, e.g., Shavell, supra note 1, at 32 (“If it would be difficult for the many individuals living in a neighborhood to contract with each other to keep lot sizes from being too small, regulation of lot size would be necessary to accomplish their common goal.”); id. at 232 (“A regulatory authority might mandate that milk be pasteurized or that trucks carrying explosives not travel through tunnels. Such regulation could force parties to reduce risks in socially beneficial ways that would not be induced by the threat of liability.”); id. at 278 (“Regulation of [liability insurance] coverage may help to increase an otherwise too low effort to reduce risk.”).
95 Id. at 2. See also id. at 634 (“Arguably, the only overarching principle that could rationalize all these diverse rules is that of a general utilitarianism, of social welfare maximization.”). For a more technical exposition of the idea, see id. at 597 n.4.
97 Indeed, Shavell acknowledges a debt to Bentham in the first few pages of the book. See Shavell, supra note 1, at 4.
worth emphasizing that, although I do not find the Benthamite tradition within welfare economics convincing, its perspective can represent an improvement over the ordinalist conception of welfare economics that dominated the second half of the twentieth century. Ordinalism generated magnificent theoretical puzzles, but almost drove welfare economics into irrelevance. Shavell thus deserves enormous credit for helping make welfare economics relevant again by refocusing on an earlier, more pragmatic, paradigm.

While Shavell's utilitarianism might be a great improvement over ordinalism, it nonetheless stumbles on three fronts: utility is ill-defined, distributional questions are ignored, and moral concerns are assumed away. First, the definition of “utility” is too broad to be of practical use:

The utility of a person is an indicator of his well-being, whatever might constitute that well-being. Thus, not only do food, shelter, and all the material and hedonistic pleasures and pains affect utility, but so also does the satisfaction, or lack thereof, of a person’s aesthetic sensibilities, his altruistic and sympathetic feelings for others, his sense of what constitutes fair treatment for himself and for others.

Readers searching for a better definition are told, somewhat unhelpfully, “that there is a measurable level of a chemical, or of electrical activity in a region of the brain, that is higher the higher the person’s reported well-being is, and that this particular quantity serves as utility.” Even if we assume, arguendo, that utility could somehow be measured, its use presents additional problems. As Amartya Sen has observed, “[m]ental reactions, the mainstay of classical utility, can be a very defective basis for the analysis of deprivation. Thus, in understanding poverty and inequality, there is a strong case for looking at real deprivation and not merely at mental reactions to that deprivation.” Second, by defining social welfare as “a function solely of individuals’ (subjective) utilities,” Shavell makes aggregating utilities tricky. After all, some type of objective measure is needed to permit interpersonal comparisons of the sort Shavell suggests when he notes that “there is a vast

---

98 Welfare economists would assume that only an ordinal ranking of a person’s preferences is possible, but no more. Cardinality, as opposed to ordinality, provides a scale to measure intensity of preference. See, e.g., Matthew D. Adler & Eric A. Posner, Rethinking Cost-Benefit Analysis, 109 YALE L.J. 165, 191-92 (1999). Cardinality, of course, is a prerequisite to performing interpersonal comparisons.


100 For a detailed discussion of the ordinalist revolution in welfare economics, see Reza Dibadj, Weasel Numbers, 27 CARDOZO L. REV. ___ (forthcoming 2006).

101 Shavell, of course, is not alone. Perhaps the economist who has done the most to rethink welfare economics is Amartya Sen. See, e.g., Amartya Sen, The Possibility of Social Choice, 89 AM. ECON. REV. 349, 352 (1999). Some legal commentators have also joined the fray. See, e.g., Adler & Posner, supra note 98, at 195; Dibadj, Numbers, supra note 100.

102 Shavell, supra note 1, at 596.

103 Id. at 596 n. 2.

104 Sen, supra note 101, at 363 (emphasis added). Sen advocates a need to look to “other indicators of individual advantages, such as real incomes, opportunities, primary goods, or capabilities.” Amartya Sen, Rationality and Social Choice, 85 AM. ECON. REV. 1, 8 (1995).

105 Shavell, supra note 1, at 598.
multitude of ways of aggregating individual utilities into a measure of social welfare." \(^\text{106}\)

Second, Shavell’s brand of welfare economics simplistically assumes that distributional questions should be the exclusive province of the tax system. This may seem curious at first, since—based on the idea that “redistributing a dollar from a rich individual with a low marginal utility of income to a poor individual with a high marginal utility of income will raise social welfare” \(^\text{107}\)—the book clearly acknowledges that “the distribution of utilities generally matters.” \(^\text{108}\) Nonetheless, his view is apparently that “if one assumes that the income tax and transfer system will be used to bring about desirable changes in the distribution of income, the distributional effect of the choice of legal rules should not matter.” \(^\text{109}\)

Much like with his discussion of the difference between private and social welfare, Shavell’s approach is akin to that of Pigou, \(^\text{110}\) who preferred to address questions of redistribution through “bounties and taxes.” \(^\text{111}\) It is also consistent with the Second Fundamental Theorem of welfare economics which assumes that “almost any Pareto optimal equilibrium can be supported via the competitive mechanism, provided appropriate lump-sum taxes and transfers are imposed on individuals and firms.” \(^\text{112}\) The Second Theorem appears captivating, \(^\text{113}\) except for the inconvenient fact that it has virtually no application to reality. As Daniel Farber and Brett McDonnell observe, “the well-known problem with the second theorem is that lump-sum taxes and transfers are not achievable in the real world. Any actual system of taxing and transferring will affect the behavioral incentives of some persons, and hence lead to some

---

\(^{106}\) Id. at 597. On the subject of interpersonal comparisons, see generally Interpersonal Comparisons of Well-Being (Jon Elster & John E. Roemer eds., 1991).

\(^{107}\) Shavell, supra note 1, at 648 n.2. This idea is, once again reflective of the “old” school welfare economics which emerged in the early twentieth century. See, e.g., Jacob Viner, The Utility Concept in Value Theory and Its Critics, 33 J. POL. ECON. 369 (1925); A.C. Pigou, Income: An Introduction to Economics 83 (1948). Of course, too much redistribution is bad public policy. There needs to be a balance, which Shavell clearly recognizes. See Shavell, supra note 1, at 652 (discussing “two costs associated with redistribution: administrative costs and the implicit costs of the dulling of work incentives.”).

\(^{108}\) Shavell, supra note 1 at 597.

\(^{109}\) Id. at 3. See also id. at 592 (“[A]ltering the design of the legal system to achieve distributional equity might needlessly compromise achievement of other social goals.”); id. at 647 (“[L]egal rules should be selected on the basis of nondistributional objectives.”).

\(^{110}\) See supra note 40.


\(^{112}\) John M. Gowdy, The Revolution in Welfare Economics and Its Implications for Environmental Valuation and Policy, 80 LAND ECON. 239, 240 (2004) (emphasis added). For its part, the First Fundamental Theorem can be summarized as follows: “Assume that all individuals and firms are selfish price takers. Then a competitive equilibrium is Pareto optimal.” Id.

\(^{113}\) Indeed, there is a long tradition in welfare economics amenable to achieving redistribution via taxes and transfers. See, e.g., Kevin Roberts, The Theoretical Limits to Redistribution, 51 REV. ECON. STUD. 177, 193 (1984); Susan Rose-Ackerman, Triangulating the Administrative State, 78 CALIF. L. REV. 1415, 1425 (1990).
degree of inefficiency.” Indeed, as Coase implies, Pigovian taxes are only one ingredient in social choice theory. Curiously, however, Shavell devotes precious little analysis to contrasting the costs of the tax system to other administrative means of redistribution. Perhaps, then, an exclusive reliance on the tax system to achieve redistribution is just one manifestation of a stance opposed to administrative regulation.

A third major limitation in the welfare economics Shavell proposes is the exclusion of deontological concerns. In his conception, “notions [of morality] should not be given importance in social welfare evaluation beyond that associated with their functionality and with our taste for their satisfaction—no deontological importance should be accorded them—for doing so would conflict with social welfare and lead to its reduction.” Inexplicably, Shavell even seems to accord greater importance to law than to morality; to him, “law is fairly flexibly designed to promote social welfare, whereas our system of morality has a relatively unrefined character.”

One does not need to resolve the centuries-old debate between deontologists and consequentialists to note that this argument leaves much to be desired. In essence, Shavell first defines morality as separate from utility, then conveniently states that only utility should matter: “I am defining a

---

114 Daniel A. Farber & Brett H. McDonnell, Why (and How) Fairness Matters at the IP/ Antitrust Interface, 87 MINN. L. REV. 1817, 1824 (2003). See also id. at 1825-26 (“[R]edistribution through tax and transfer policies may not work well. They may not be politically feasible.”). Cf. Joseph E. Stiglitz, The Invisible Hand and Modern Welfare Economics 2-3 (NBER Working Paper No. 3641) (1991) (“The first theorem states that (under certain conditions) the competitive economy is always Pareto efficient; the second theorem says that every Pareto efficient allocation can be attained through the price system. All (!) the government needs to do is engage in some initial lump sum transfers (taxes and subsidies).”).

115 See supra note 93. See also Dahlman, supra note 31, at 160-61 (“[T]he Coase line of reasoning does not limit attention to tax rates alone . . . . Not only Pigovian taxes, but all other weapons in the government’s arsenal becomes available as well.”).

116 Comparisons are between the income tax system and common law courts. See, e.g., SHAVELL, supra note 1, at 660 (“[W]here the administrative costs of the income tax system exceed those of legal rules as a means of transferring income, then legal rules might be selected on the basis of their distributional effects . . . .”). Other commentators seem to ignore administrative agencies in their comparative analyses as well. See, e.g., A. MITCHELL POLINSKY, AN INTRODUCTION TO LAW AND ECONOMICS 153 (3d ed. 2003) (“Roughly speaking, to transfer a dollar through a private lawsuit from a defendant to a plaintiff costs on average about a dollar in administrative costs . . . . To transfer a dollar through the tax and transfer system costs only a fraction of this amount.”); Louis Kaplow & Steven Shavell, Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income, 23 J. LEGAL STUD. 667, 675 (1994) (“[I]t seems unlikely that courts can accomplish significant redistribution through the legal system without attracting the attention of legislators.”).

117 See supra notes 90-94 and accompanying text.

118 SHAVELL, supra note 1, at 608. See also id. at 611 (“[T]hat any person who believes that a measure of social welfare should rise whenever the utilities of all individuals rise . . . must abandon any view that ascribes independent importance to a notion of morality, that is, any deontological view.”).

119 Id. at 617.

120 For instance, the importance society should accord to individual autonomy and absolute notions of morality are subjects of enduring debate.

121 Interestingly, no definition of morality is offered. See id. at 548 (“I will not attempt to define here the moral quality of an act, but will rely on the reader’s intuition as a guide.”).
(nondistributional) notion of morality to be a principle for the evaluation of situations that (a) does not depend exclusively on the utilities of individuals, and (b) is associated with the distinctive psychological attributes leading, as described, to virtue and guilt, praise and disapproval." 122 The argument is plainly circular, making it difficult to take seriously. 123

The overarching irony is that Shavell’s inability to define utility and attempt to duck deontological and distributional questions lead him in many places to adopt in practice precisely the standard he has critiqued so well: wealth maximization. 124 After all, if distributional and deontological concerns are set aside, one can simplistically assume that social welfare consists of “the benefits that individuals obtain from acts minus the harms done and the costs of enforcement of law.” 125 Indeed, across all doctrinal areas—property, 126 torts, 127 contracts, 128 procedure, 129 and public law 130—cost/benefit analysis unfortunately becomes the order of the day. 131

CONCLUSION

There are, of course, other paths to welfare economics and the economic analysis of law that Shavell might have explored. One alternative approach, as I argue elsewhere, 132 uses a critique of wealth maximization as a new foray into social choice theory. I propose a social welfare function that takes both

122 Id. at 601.
123 In an earlier article, Shavell even admits the tautology. See Louis Kaplow & Steven Shavell, Fairness v. Welfare, 114 Harv. L. Rev. 961, 971 (2001) (“Our first argument, that advancing notions of fairness reduces individuals’ well-being, is in fact tautological on a general level.”). Critics have pounced. See, e.g., Michael B. Dorff, Why Welfare Depends on Fairness: A Reply to Kaplow and Shavell, 75 S. Cal. L. Rev. 847, 857 (2002) (“If ‘fairness’ consists of any philosophy that ignores welfare, then it seems virtually inevitable that applying determinative fairness criteria will, at least in some instances, decrease social welfare.”); David Dolinko, The Perils of Welfare Economics, 97 Nw. U. L. Rev. 351, 353 (2002) (calling the argument “logically circular, thus carrying no weight at all”).
124 See supra notes 14-19 and accompanying text.
125 SHAVELL, supra note 1, at 575. See also id. at 492-93 (“Social welfare is assumed to equal the benefits that parties obtain from their acts, less the harm done by the acts, less the costs of enforcement, and less the costs associated with the imposition of sanctions.”).
126 See, e.g., id. at 39 (“Our social welfare criterion will continue to be the expected value of property minus the costs of effort . . . .”).
127 See, e.g., id. at 178 (“The social goal here will be minimization of the sum of the costs of care and of expected accident losses. This sum will be called total social costs.”).
128 See, e.g., id. at 339 (“[M]utually beneficial completely specified contracts call for performance if and only if the value of performance exceeds its cost.”).
129 See, e.g., id. at 403 (“[A] mutually beneficial settlement exists as long as the plaintiff’s estimate of the expected judgment does not exceed the defendant’s estimate by more than the sum of their costs of trial.”).
130 See, e.g., id. at 513 (“We might define the effectiveness of a sanction to be the disutility it generates per dollar of social cost.”).
131 The devolution to welfare maximization also occurs in one of Shavell’s famous earlier articles. See Kaplow & Shavell, supra note 123, at 1054-58 (applying welfare maximization to torts); id. at 1125-29 (applying welfare maximization to contracts).
132 See Dibadj, supra note 100.
consequential and deontological perspectives into account. My framework avoids the intractable question of defining utility as well-being. Instead "utility" is re-defined with respect to how closely a set of individual preferences maps to a set of welfare-enhancing preferences. The social welfare function begins with a set of individual preferences, but then effectuates transformations through paternalism and redistribution. Regardless of whether readers will agree with such an approach, the overarching message should hopefully be clear: It is time to get beyond stale debates between "old" and "new" welfare economics, between utilitarians and ordinalists. Foundations of Economic Analysis of Law misses an opportunity to join such a debate.

Despite this limitation and its concomitant adherence to neoclassical tools, I unhesitatingly recommend Foundations of Economic Analysis of Law to anyone interested in the intersection of legal and economic discourses. Professor Shavell treats readers to an immensely informative, enjoyable, and thought-provoking book. However, had the book not remained wedded to the limits of neoclassicism and utilitarianism it would be even better.

133 For a thought-provoking discussion of the importance of morality in economics, see Amitai Etzioni, The Moral Dimension (1988).
134 More precisely, I argue that (i) paternalism is a function that transforms a set of individual preferences into a set of modified individual preferences, and (ii) redistribution is part of the aggregation function from these modified individual preferences to social welfare. See Dibadj, supra note 100.