MARKETS, METHODS, MORALS AND THE LAW

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I. INTRODUCTION

A. This Essay develops four distinct but related themes about markets. The first concerns the relationship between Pareto optimality and human welfare. The First Fundamental Theorem of Welfare Economics (FFT) holds that under conditions of perfect competition, rational agents pursuing their interests will yield a Pareto optimal allocation of resources in the core.[1] The concept of Pareto optimality is then interpreted in terms of human welfare, yielding the conclusion that perfect competition optimizes human welfare. The question posed in the first section is whether the relationship between Pareto optimality and human welfare supports this inference. I raise doubts about whether it does. I argue that the FFT is best understood as a claim about conditions under which individual and collective rationality converge, and not a claim about the welfare optimizing properties of competitive markets.

B. The second section of the Essay explores another putative implication of the FFT. This one concerns the methodology of the social sciences. The FFT is a claim about the conditions under which individually rational action is socially optimal: in particular that under idealized conditions, competitive markets are both individually rational and socially optimal.[2] If competitive markets can be both individually rational and socially optimal, it follows that when those conditions are met, there are no

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1. *See* ROSS M. STARR, GENERAL EQUILIBRIUM THEORY: AN INTRODUCTION 23–24 (2d ed. 2011).

2. *See id.* at 7.

grounds for rational *cooperation*. Cooperation is rational only if and when competition fails; and competition fails only when the ideal conditions are not satisfied. As it happens, those conditions often fail to materialize. This explains why forms of rational cooperation are ubiquitous. Our interest is in the general point that rational cooperation is to be explained in terms of failed competition. Put another way, competition comes first in the order of explanation in the social sciences. This claim is central to what I have called, "The Market Paradigm." In this section of the Essay, I demonstrate that the same considerations that are employed to show that competition comes first in the order of explanation can be employed to show that cooperation comes first in the order of explanation. If I am right, the way in which social scientists and legal theorists approach their projects must be radically reconceived.

C. In the third section of the Essay, I switch attention from ideal to actual markets. Markets are ubiquitous and important, yet they are remarkably philosophically under-theorized. Given the role any economy plays in the well-being of its citizens, one would think that market institutions would have received extraordinary attention from political philosophers. The fact is that philosophers have not offered very much beyond slogans, slurs, and the occasional, if equally banal, testimony. Supporters laud markets as the institutional embodiment of individual autonomy and a veritable wealth-producing machine.[3] Critics charge them with fostering inequality and exploitation.[4] Both sides of the debate miss important and valuable features of markets—aspects that are especially important in liberal political cultures.

Markets are social decision-making institutions. They are a means by which we decide what is to be produced, how much of it is to be produced, and how what is produced is to be allocated. As a general matter, markets make these collective decisions consequentially, that is, as a result of a large number of individual exchanges. Importantly, markets "decide" in ways that do not rely on individuals sharing a common sense of what makes a life worth living or what is of fundamental human value. Put another way, markets allow us to make important decisions in ways that do not normally highlight or bring to the surface the depth of the important value differences that divide us and that could become a source of significant social and political friction. In that way, markets contribute to political stability.

D. Markets cannot determine which decisions should be made by markets. Some objects change their character in virtue of their being

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3. *See, e.g.*, ROBERT H. FRANK & BEN S. BERNANKE, PRINCIPLES OF MICROECONOMICS 64 (5th ed. 2013); RICHARD A. POSNER, THE ECONOMICS OF JUSTICE 13–109 (1981).

4. *See* FRANK & BERNANKE, *supra* note 3, at 346–48.

exchangeable in markets. In many cases, that is reason enough to resist permitting them to be subject to market exchange. We do not, for example, allow individuals to sell their votes. By allowing an object to be exchanged in a market, it becomes a distinctive kind of asset. Of course, objects can be assets whether or not they are also commodities. Rights are assets whether or not they may be exchanged in a market. Many rights are assets in the sense of being commodities. The clearest examples are tangible property rights. It is one thing to have a right to exclude others from enjoying what you own or have title to. It is quite another thing to be able to sell what you own.

In this section of the Essay, I take up the question of whether certain categories of rights or moral powers are appropriate objects of market exchange: in particular, the right to impose liability on those who have wrongfully injured you and in doing so have incurred a duty to repair the damage they are responsible for.

The issue is pressing for at least two different kinds of reasons. It is clear that certain rights are exchangeable in markets: paradigmatically, those associated with the ownership of property. On the other hand, other rights can be neither gifted nor exchanged. The right that I have that you mow my lawn derived from your promise to do so is not a right I can gift to another nor is it one that I can exchange for something of value. Thus, it is natural to ask whether the right to impose liability or to secure repair as a result of one's being harmed by another's mischief is like a property right and thus subject to exchange and gift, or like personal service contracts and ineligible for either.

Secondly, in the typical case of liability for wrongdoing there is both the right to repair and the duty to impose it. I have long argued for the permissibility of insurance against liability for negligently-caused misfortune as a justifiable practice by which the duty to render repair for wrong done is dischargeable. Insurance is normally provided through markets, so there is apparently no problem in creating markets in which the duty to render repair is the object of exchange. If it turns out that there are good reasons to resist treating the right to secure repair as an asset exchangeable in markets—as there may well be—then this creates an important asymmetry in the kinds of secondary institutions that can permissibly grow up around the primary institutions of tort liability. Markets are permissible as means for providing insurance against liability for the damages owed to wrong done; at the same time, they are not permissible as a way of increasing or protecting the value of the rights that arise as a result of that wrongdoing. This asymmetry is puzzling and calls for an explanation—one I am not altogether sure I can provide.

Each of the sections of the Essay makes an independent argument about the place of markets in moral, political, and legal practice. At the

same time, my hope is to uncover insights about the place of markets in liberal political theory and practice. There is much ground to cover and many claims to address and evaluate. We begin with a discussion of the claim that idealized competitive markets are welfare optimizing.

II. MARKETS AND WELFARE

A. The FFT holds that under a set of ideal conditions, rational nontuistic[5] agents pursuing the satisfaction of their individual preferences will together secure a "Pareto optimal" allocation of resources "in the core." These ideal conditions—including full information, complete rationality, as well as the absence of transaction costs, strategic behavior, and externalities—define the conditions of "perfect competition." Therefore, another way of expressing the FFT is as the claim that perfect competition yields a Pareto optimal allocation of resources in the core.

The Second Fundamental Theorem (SFT) holds that any particular Pareto optimal outcome can be secured by a redistribution of holdings *ex ante* or *ex post*.[6] Putting the two theorems together, we get the following: given an initial distribution of resources, a perfectly competitive market will secure an outcome somewhere on the Pareto frontier,[7] Pareto superior to the initial distribution. Because the outcome secured is a function of the initial distribution of holdings or resources, we can ensure a (socially) preferred outcome by a redistribution of holdings either *ex ante* or *ex post*.

Taken together, the first and second theorems invite a distinctive division of the normative landscape into matters of welfare (FFT) and distribution (SFT). In the next section of the Essay, we will have occasion to review the implications of this approach to conceptualizing the normative landscape insofar as it bears on the methodology of the social sciences. In this section, the focus will be on whether the putative connections between the FFT and welfare, on the one hand, and the SFT and distributive justice, on the other, can be sustained. We begin with alleged connection between the FFT and human welfare.

B. There are two Pareto criteria, Pareto superiority and Pareto optimality, that together are employed to develop rankings or orderings of social states.[8] Social states are snapshot characterizations of the world taken as a whole at a given moment in time. Of the two criteria, Pareto

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5. Agents are nontuistic in that they are disinterested in the interests of others.

6. *See* STARR, *supra* note 1, at 209–11.

7. The Pareto frontier represents the set of all possible Pareto optimal outcomes given an initial allocation of resources.

8. *See* KLAUS MATHIS, EFFICIENCY INSTEAD OF JUSTICE?: SEARCHING FOR THE PHILOSOPHICAL FOUNDATIONS OF THE ECONOMIC ANALYSIS OF LAW 33 (Deborah Shannon trans., 2009).

superiority is the more basic in that Pareto optimality is defined in terms of it.

PS: A state of the world, S1, is Pareto superior to another, S2, if and only if no one prefers S2 to S1 and at least one person prefers S1 to S2.

PO: A social state, Si, is Pareto optimal if and only if there is no social state, Sn, Pareto superior to it.

The Pareto criteria make no explicit reference to human (or other) welfare, yet they are invariably treated as if they do. A Pareto superior move is invariably cast as welfare enhancing, and a Pareto optimal one is cast as welfare optimizing. This begs the question: what if anything is the connection between the Pareto criteria and welfare?

We can distinguish between two strategies for connecting the Pareto rankings with welfare, neither of which is unproblematic. Let's consider them in turn.

(1) The Pareto criteria rank social states in virtue of a particular property of those states.[9] That property provides the basis for comparing social states and in doing so grounds the preferences one has over those states. In this way, the Pareto rankings are connected to human welfare because social states are being compared in terms of their impact on welfare. So characterized, a rational agent—concerned only about welfare and nontuistic with regard to the welfare of others—prefers one social state to another if and only if the one increases his welfare in comparison to the other. This would be true of all such agents, and so a social state is Pareto superior to an alternative just in case it enhances overall welfare.

There is nothing in the Pareto rankings that precludes employing them to rank social states in terms of their impact on welfare. On the other hand, there is nothing about them that requires we do so—and thus no basis for inferring that all Pareto improvements enhance welfare.

In fact, the Pareto rankings are neutral with regard to the properties in virtue of which social states are to be ranked.[10] So, for example, states may be compared with one another by their impact on the number or security of the rights they confer on individuals. Individual preferences over social states are formed accordingly. A nontuistic rational agent will then prefer one social state to another provided it confers or secures more rights for him. This would be true of all such rational nontuistic agents, and so a social state is Pareto superior to an alternative just in case it enhances the overall number or security of rights.[11]

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9. Amartya Sen, *Social Choice Theory*, *in* 3 HANDBOOK OF MATHEMATICAL ECONOMICS 1073, 1154 (Kenneth J. Arrow & Michael D. Intriligator eds., 1986).

10. *See* E.J. MISHAN, ECONOMIC EFFICIENCY AND SOCIAL WELFARE 116 (1981).

11. *See* MATHIS, *supra* note 8, at 38.

Again, just as we would be unwarranted in inferring that a Pareto improvement necessarily enhances welfare, we would be likewise unwarranted in inferring that it enhances the number or security of rights. Of course, once a property of social states is chosen, a suitable interpretation of the Pareto criteria is available. But the Pareto criteria themselves do not specify their interpretation. Thus, the conventional reading of the FFT cannot be presumed to express a claim about the relationship between ideal or perfect competition and human welfare. Rather, as I read it, the FFT expresses a logical consequence of the conjunction of a certain conception of rationality and certain set of idealized conditions: namely, under certain idealized conditions, individually rational action converges on socially optimal outcomes. This is an interesting and important claim about the conditions under which social optima can be secured by individually rational actions, but it is not a claim about human welfare and cannot be treated as such.

(2) Formally, the concept of Pareto superiority is itself expressed in terms of "preferences over social states."[12] S1 is Pareto superior to S2 iff no one prefers S2 to S1 and at least one person prefers S1 to S2. Preferences over social states are preferences after all, and their satisfaction, like the satisfaction of any preference, one might argue, constitutes or contributes to the welfare of the individual whose preference it is. According to this strategy, the key connection is between preferences over social states and welfare.[13]

a. It is important to distinguish between the claim that satisfying preferences contributes to welfare and the claim that it constitutes (fully or partially) welfare. The latter analyzes welfare in terms of preference satisfaction. The former does not, but it holds that the satisfaction of preferences contributes to welfare, however that notion is understood.

If the satisfaction of a preference enhances welfare, it follows that any Pareto improvement is welfare enhancing. This would be true regardless of the criterion in virtue of which agents compare social states. Suppose that we employ the Pareto rankings to order social states in terms of their impact on rights. If the state in which more rights are secured is preferred by at least one person and no one prefers any alternative to it, then not only is that state Pareto superior to the alternatives in the sense that it increases overall rights, it is welfare enhancing as well. Importantly, its being welfare enhancing is a function of it constituting a Pareto improvement, not in virtue of any connection between conferring or protecting rights on the one hand and human welfare on the other. Therefore, any Pareto improvement

12. *See* JULES L. COLEMAN, RISKS AND WRONGS 18 (1992).
13. *Id.*

regarding rights is a Pareto improvement regarding welfare, thus dissolving any apparent conflict between rights and welfare.

Alas, substantive issues are rarely, if ever, resolved by conceptual maneuvers, and this case is no exception. Consider two social states: S1, in which everyone has more rights than they have in any other alternative state except for Smith has fewer rights than he does in any other social state, in particular S2. Now suppose that Smith prefers his having fewer to more rights (he finds them burdensome and stressful); whereas everyone else prefers S1 to S2 because they have more rights in S1 than in S2. In that case, S1 is Pareto superior to S2 and welfare enhancing accordingly. The problem is that in this case, the relative reduction in rights is welfare enhancing; whereas, in the former case the increase in rights is welfare enhancing. This establishes that whether rights increase or decrease is independent of the actual impact of having rights on human welfare. It depends instead entirely on preference and not on any substantive connection between having secure rights and one's well-being!

The problems multiply quickly. Suppose now that Jones prefers the state in which his welfare is diminished while the welfare of others remains intact or increases; whereas everyone else also prefers the state in which their welfare remains intact and improves. Because they are nontuistic, they are simply disinterested in the state of Jones's welfare. So, that state is Pareto superior to several if not all alternatives. This means that the state is welfare enhancing even though it is welfare reducing. Jones's welfare diminishes; everyone else's remains intact; thus a net loss in welfare. Yet that state is Pareto superior, and because it is, it is welfare enhancing. So, a state can be both welfare reducing and welfare enhancing. This conclusion follows from characterizing welfare in terms of the satisfaction of preferences over social states! It is an unhappy one for those endorsing the conventional view.

b. Matters don't improve if we shift our focus to consider the claim that satisfying preferences contributes (causally) to welfare. Here, the argument hinges on the relevant notion of "satisfaction," for the key claim must be that satisfying preferences necessarily contributes to an increase in welfare.[14] We can distinguish among three relevant senses of satisfaction, and therefore among three senses in which preferences we can speak of preferences as being satisfied. My preferences are satisfied in the "logical or formal sense" when the world turns out as I prefer it to be: that is, when the world conforms to my preferences. My preferences are satisfied in the "psychological sense" when I experience joy, pleasure, or some other positive emotion as a result of the world conforming to my preferences. My

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14. *See* DANIEL M. HAUSMAN & MICHAEL S. MCPHERSON, ECONOMIC ANALYSIS, MORAL PHILOSOPHY, AND PUBLIC POLICY 67–77 (2d ed. 2006).

preferences are satisfied in the "normative sense," when the joy, satisfaction, or happiness I experience is apt or fitting, when such emotions are justified or called for, or when such responses would be fitting or called for—whether or not I experience them.

The world conforming to my preferences is neutral with regard to whether its doing so brings me joy, pleasure, or happiness.[15] Although one can experience psychological satisfaction as a result of the world realizing a state of affairs one prefers, at other times, one can feel let down as a result. By the same token, one can feel relieved when one's preferences are not realized and, in the extreme case, outright joy should the world turn a blind eye to one's preferences, especially those preferences that represent unhealthy desires and longings.

Some secure psychological satisfaction engaging in wrongdoing. Whatever satisfaction (in the psychological sense) they derive from their misdeeds, the joy or pleasure they experience is not an apt or fitting response to what they have done. It is hard to imagine an argument that can demonstrate that these inappropriate responses contribute to the agent's welfare. Taking pleasure in wrongdoing is unfit and not appropriately endorsed or looked upon favorably. To be sure, taking joy in causing others misery and suffering may sometimes be understandable or even excusable; and when it is, we are prone to forgive the response; but in doing so, we do not look upon the emotion as contributing to a person's overall moral or psychological health.

It is plain then that one's preference can be satisfied in the sense of the world conforming to them, and yet the world's doing so can prove to be a source of pain or unhappiness rather than pleasure or joy. At the same time, one can experience pleasure or satisfaction that is inapt or unfitting—that is an inappropriate response to what one has done.

Welfare is a normative notion. If welfare is a matter of satisfaction, it must be satisfaction aptly or fittingly experienced. Yet this is not the notion of preference satisfaction that is invoked in the notion of Pareto superiority. The notion of preference satisfaction that is involved in the Pareto rankings is the formal or logical one. Whether one state is Pareto superior to another depends on whether its being brought about conforms to the choice or desire of one person while also not being contrary to the choice or desire of others. It is a further question whether conformity yields gratification or is met with a positive response; another question is still whether, if it is, that response is fitting or apt and thus a contributor to human well-being.

(3) The relationship between preference satisfaction and welfare is more attenuated than we have argued to this point, in part because the

15. *See id.* at 64–67.

notion of "satisfaction" is itself ambiguous. We can distinguish between at least two senses of "preference": "preference-as-desire" and "preference-as-judgment."

Sometimes in characterizing a state as preferred, I am calling attention to the joy or pleasure I expect to take from its realization. In other cases, in characterizing a state as preferred, I am *judging* it as superior by some measure or criterion. In the latter case, I am prepared to defend that judgment by appeal to the relevant standard, and there is no reason to presume that I should anticipate joy or pleasure from its realization. Even if I expect to do so, that fact need not be part of the grounds of my judgment.

It is common to understand preference in terms of a disposition to "choose." If I prefer one state of affairs to another, then given the opportunity to do so (other things being equal), I would choose the one over the other. Even so, that will not help us determine whether the ground of the choice is desire or judgment. We do not know whether to treat the notion of "preference over social states" in the Pareto rankings as expressing a desire or a judgment. If we treat it as a desire, we face all the problems to which I have already drawn the reader's attention. If we treat it as a judgment, there need be no connection with welfare at all. One who prefers a social state to another judges it superior by some relevant criteria that may have nothing to do with any property of the state that has to do with welfare.[16]

D. Having exhausted the ways in which we might connect the Pareto criteria to the concept of welfare, we turn now to the notion of the core. A core solution is both Pareto optimal and Pareto superior to the starting point.[17] This means that if the initial conditions of perfect competition are satisfied, the outcome of exchange among rational nontuistic agents will be a state of affairs that is (1) Pareto superior to the point at which exchange originated and (2) which has no states Pareto superior to it. The latter captures the concept of Pareto optimality; the former expresses the central idea of a core solution.

The following example illustrates the concept of the core. Suppose an initial distribution of resources in which you have seven and I have three. After some interactions between us (e.g. fraud or force), resources are

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16. Those who have been drawn to the FFT have presumed what philosophers are quite certain needed to be explained, and that is the connection between its precise formulation and the underlying idea of human welfare. If I am right, the connections between the Pareto criteria, in which the FFT is couched, and the normatively (even psychologically) significant concept of welfare call for considerably more rigorous scrutiny than it has achieved to this point.

I take it that one reason economists have been slow to engage in the kind of inquiry I have is that they have never seen the need to do so. The Pareto criteria were introduced to solve a problem in utilitarian theory and so there was no thought given to the various ways in which the criteria could be employed or understood that had nothing at all to do with welfare—understood in utilitarian terms.

17. COLEMAN, *supra* note 12, at 88.

redistributed such that you have ten and I have zero. This new allocation is very likely Pareto optimal in that the only way in which my holdings can be increased is by reducing yours, and we can assume for the sake of the argument that this would not meet with your approval. The outcome of our interactions is Pareto optimal but not in the core, because I do not prefer the final distribution to our starting point. The same would hold were I to secure ten and you zero upon redistribution.

We can also provide an intuitive grasp of the formal proof that under perfect competition, exchange would yield a core solution. Were each of us fully informed, rational, and disinterested in one another's interests, we would only agree to exchanges or transfers that both of us preferred—unless one of us defrauds or forcefully takes what the other possesses. Thus, under the conditions of perfect competition, we would keep trading with one another provided each exchange is preferred by both of us to the alternatives, and we would cease trading when this condition cannot be met. Thus, each exchange is Pareto superior to the past situation, and the end result is Pareto optimal. That's the basic idea. Lest we forget, while the concept of the core is formally easy to grasp, its reliance on the concept of Pareto superiority means it will face all the same concerns we have already identified should we seek to explain it in terms of its impact on human welfare.

E. It is crucial that, taken together, the first and second theorems provide a certain kind of closure over the normative landscape. The FFT captures the connection between markets, efficiency, and welfare; and the SFT captures the distributive concerns that fall within the domain of justice—at least distributive justice.[18] We have focused to this point on a significant number of problems with the alleged connection between the FFT and the concept of human welfare. We should pause for a moment to consider some of the many problems that arise in connecting the SFT to relevant conceptions of distributive justice.

The key idea of the second theorem is that any desired outcome on the Pareto frontier can be secured either by a reallocation of holdings *ex ante* or by wealth transfer *ex post*.[19] The underlying intuition expressed by the first and second theorems is the familiar one that we should adopt policies that grow the pie as large as possible then slice it into pieces as desired, thus securing both efficiency and justice.

There are at least two kinds of problems with treating the second theorem as capturing the relevant concerns of justice. The first is that it identifies the demands of justice with those of distributive justice; the second is that it characterizes those demands in terms of norms governing

18. *See* STARR, *supra* note 1, at 209–13.

19. *Id.*

the relative shares of wealth or welfare. Let's take these problems up in reverse order. First, any relative shares conception of distributive justice is going to be what Nozick calls an "end-state" conception of it.[20] In fact, there are many views of distributive justice according to which the justice of what one has depends on the means by which one secures it, and not on how it compares with what others have.[21] Second, insofar as justice is a matter of the relative distribution of something valuable, many hold that the test applies to opportunities, resources, or something else other than wealth or welfare.[22] Thirdly, and most importantly perhaps, the prevailing view is that distributive justice does not apply to allocations at all but to the deep structure of the important institutions of a social, political, or legal order.[23]

It is, moreover, a mistake to identify the demands of justice with those of distributive justice. The principle that one has a duty to remedy or repair the untoward consequences of one's mischievous wrongdoing states a requirement of *corrective*, not distributive, justice. Though in discharging such a duty, resources will be redistributed; the norms that determine the justice of the redistribution are those of corrective, not distributive justice.

F. To sum up, the first and second theorems of welfare economics taken together are thought to provide a putative closure over the normative landscape: that is, they identify in principle the considerations that ought to bear on the assessment of social and legal policy. These are welfare and fairness. If any reader has doubts about my formulation, he or she need only remember the highly influential but seriously confused and controversial opus by Kaplow and Shavell, *Fairness v. Welfare*.[24] In that book, the authors argue not only that considerations of welfare and justice are the only factors by which social, legal, and economic policies are to be assessed, but also that only considerations of welfare are ultimately appropriate to the task.[25] In this section, I have done all anyone could ever be asked to do to dismantle all aspects of this ludicrous claim. First, fairness is not a matter of distribution only; nor is it a matter of distribution of welfare or wealth. Fairness invokes other concepts of justice, including corrective justice. Indeed, to the extent fairness is a matter of distributive justice, the criteria of justice apply to the structure of our most basic institutions and not to particular allocation decisions. Second, the notion of welfare with which Kaplow and Shavell are working is completely impoverished. Their focus is on the Pareto criteria, and as I have

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20. *See* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 153–55 (1974).

21. *See id.*

22. *See* ERIC RAKOWSKI, EQUAL JUSTICE 43 (1991).

23. *See generally* Jules Coleman & Arthur Ripstein, *Mischief and Misfortune (Annual McGill Lecture in Jurisprudence and Public Policy)*, 41 MCGILL L.J. 91 (1995).

24. LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE (2002).

25. *Id.* at 3–13.

painstakingly shown, those concepts bear little if any connection to the notion of welfare of normative significance.

III. COMPETITION AND COOPERATION

In the previous section we considered the relationship of the First and Second Fundamental Theorems to the normative landscape of political theory. In this section, we focus primarily on the FFT in order first to demonstrate its extraordinary influence on the methodology of the social sciences and legal theory and then to raise serious concerns about the line of argument that is supposed to warrant that influence.

A. The overarching organizing theme is what I have called "the market paradigm," the central claim of which is that competition comes first in the order of explanation—or put another way, that cooperation can be rationally explained only as a solution to failed competition. Roughly, the idea is this: under conditions of perfect competition, individually rational action secures a socially optimal outcome which renders social cooperation otiose, and thus without a rational grounding. Cooperation makes rational sense only if it is in response to failed competition. Derivatively, cooperation is rational only to the extent to which it aims to overcome the problems of failed competition.

In explaining the underlying thought, we need to address one immediate concern or objection. The objection is that markets, and especially market exchanges, do not present themselves as paradigms of competition. Yet if the market paradigm is to be understood in terms of the claim that competition precedes cooperation in the order of explanation, then market exchange must be understood as a form of competition.

To be sure, we often characterize participants in an exchange as trading partners—that is, as engaging in a cooperative enterprise. Certainly, many contracts display cooperative aspects, and even the most ardent practitioners of "law and economics" often characterize contractors as joint wealth maximizers.[26] On its face, this way of speaking suggests that contracting is something the parties do together: something they engage in as a joint activity of sorts.[27] The burden, then, is to explain the sense in which ordinary market exchange represents a paradigm of competition.

In part, the answer surely depends on how we characterize cooperation. Cooperative activity is a form of joint action. If we adopt a view of joint

26. *E.g.*, Tess Wilkinson-Ryan, *Legal Promise and Psychological Contract*, 47 WAKE FOREST L. REV. 843, 867 (2012) ("[C]ontract law itself nudges individuals to be rational wealth maximizers . . . .").

27. It is no small irony of course that the philosopher Margaret Gilbert analyzes the notion of acting together as a normative idea rather than a social psychological one and that the normative model she has in mind is that of the contract.

activity—along the lines advanced by Michael Bratman, among others—agents acting together are committed to helping one another complete their tasks under the terms of a shared or joint plan of their making.[28] Most market exchanges do not involve planning in this sense, nor are trading partners typically committed to playing their role in seeing to it that their trading partner is able to complete his role successfully. If and when they do, it is most likely to insure or protect one's own interest, not the goal of the joint venture.

The deeper point is that competitiveness is a property of markets, not of particular exchanges. A market is competitive insofar as its forces drive the terms of individual exchanges.[29] Of course, there are interpersonal aspects of individual exchanges and partners to an exchange that are not competing with one another in the way in which runners in the hundred-yard dash are. Yet the terms of an exchange are largely determined by the competitiveness of the market taken as a whole. In a competitive market, the terms you can offer me are determined in effect by what others are willing to offer me: others who are in competition for my business with you, and vice versa. The net effect drives prices towards marginal cost, and that is the heart of the insight that markets are paradigmatically competitive.

With this preliminary worry set aside, we can now formulate the basic tenets of the market paradigm:

1. Market failure is defined as the lack of convergence between individual and collective rationality.
2. Market failure occurs when the conditions of perfect competition are not realized.
3. Only then is there rational space for cooperation.
4. Forms of cooperation are rational insofar as they eliminate or reduce the sources of market imperfections or, if that is too costly and thus not rational, if they impose the outcomes that would have been secured had the conditions of perfect competition obtained.
5. All forms of rational cooperation thus have the same general purpose or function: to respond to market failures—or to the extent possible, narrow the gap between individual and collective rationality.
6. Thus, forms of rational cooperation are not distinguishable from one another by their function, but by their structure and the approach they take to achieving their function.

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28. *See* MICHAEL E. BRATMAN, STRUCTURES OF AGENCY: ESSAYS 291–93 (2007).
29. *See* FRANK & BERNANKE, *supra* note 3, at 184–90.

7. The choice among different forms of cooperation is to be made by their fit to the particular sources of market failure to be addressed and considerations of comparative advantage. For example, if the source of market failure is incomplete information, then the appropriate institutions for addressing the problem are those that are well designed to reveal and distribute information, and so on.

We can of course distinguish among different kinds of explanations we may have of our collaborative or social lives. Some of these will be causal, others perhaps teleological. But if we seek to explain our social lives as grounded in rationality (understood in a particular way), then we must begin with the idea of rational competition, for only its failure can make cooperative forms of collaboration rational and explicable in that sense. To my mind, this is the central organizing methodological commitment of contemporary social science, though most would disagree with my assessment. Instead, they would confer that honor on so-called "methodological individualism"; others might give the title to "rational choice."

I don't mean to diminish the importance of either rational choice or methodological individualism, but neither is distinctive of the projects of social science in the way in which the market paradigm is. In the first place, methodological individualism has a far broader domain than contemporary social science. It is as much a part of Michael Bratman's views in action theory as it is part of any anti-holist political scientist's view of legislative behavior.[30] Still, Bratman is not a rational-choice theorist, though most social scientists are. Then again, David Gauthier and Ned McClennen are rational-choice theorists just as much as any rational-choice economist or game theorist is.[31] The fact is that the FFT of welfare economics plays a role that is distinctive in the social sciences, for it sets out the framework within which social institutions are all to be understood: as solutions to problems of market failure.

B. Arguably, the market paradigm has had its strongest impact in economics, political science, and legal theory. There is perhaps no better example than that provided by the Coase Theorem. The idea behind the Coase Theorem can be expressed roughly as follows. Suppose Activity A (ranching) imposes costs on adjacent Activity B (farming). A's cows trample B's corn: more cows, less corn. In standard economic analysis, cows trampling corn would be characterized as an *externality* of ranching—costs that ranching imposes on farming. Because the rancher

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30. *See generally* BRATMAN, *supra* note 28.

31. *See generally* DAVID GAUTHIER, MORALS BY AGREEMENT: FOUNDATIONAL EXPLORATIONS (1986); EDWARD F. MCCLENNEN, RATIONALITY AND DYNAMIC CHOICE (1990).

does not have to bear the costs his cows impose on the farmer's corn, there is less farming than there would have been in the absence of ranching and more ranching than would exist where the rancher is held responsible for his cows' mischievous activity. Externalities are classic market failures. In this case, the price of goods associated with cows and corn is mispriced, and thus, the allocation of cows and corn is inefficient. The conventional view is that we have before us a case that is ripe for a political or cooperative—that is, non-market—solution.[32]

Prior to Coase, the prevailing wisdom was that this inefficiency in the number of cows and corn could only be remedied in any of three ways: (i) by granting the farmer an injunction that would allow him to prevent the rancher from raising any cows that might threaten his corn crop; (ii) by imposing tort liability on the rancher for the damage his cows cause; and (iii) by imposing a tax on the rancher equal to the marginal damage each of his cows cause to the corn crop. Granting the farmer an injunction would entitle him to demand payment from the rancher for each cow the rancher wanted to raise. Imposing liability would require the rancher to pay the farmer for the damage caused and would compensate the farmer for his loss. If the rancher would have to pay more in damage costs than the next cow is worth to him, he will not raise the cow. This leads to the same result as would conferring an injunction on the farmer. In both cases, the farmer gets paid for the damage each cow causes, and the rancher ceases raising cows when the costs of paying the farmer conjoined with the private costs he incurs in raising the cows exceeds the benefit of the cow to him.

The tax situation is somewhat different because, whereas the rancher has to pay for the damage his cows cause, the farmer is not compensated for the damage his corn suffers. This approach is called a Pigouvian tax,

32. Readers familiar with the argument developed by Arthur Ripstein and me first in *Mischief and Misfortune* know that I reject the underlying claim that an externality is to be understood in causal terms. *See generally* Coleman & Ripstein, *supra* note 23. There is no doubt that the cows trample the corn. Of this much I am sure. The standard view is that it is thus a cost of ranching that is being externalized on to the farmer. I disagree. For the central question is whether the cost in terms of lost corn crop is a cost of ranching or farming, and that is not settled by causal inquiry, but by determining whether the rancher has a duty to fence in or the farmer a duty to fence out. And that is not settled by the causal inquiry. So if farmers are much better able to fence out than ranchers are to fence in, the farmer would have a duty to protect his corn and thus his failure to do so, which leads to the mess created by the cows, is a cost of farming, not ranching. It would not be an externality of ranching though it is a causal consequence of it. This is why Ripstein and I advance the view that the notion of an externality is a normative one, not a naturalistic one. Our view is that the notion of externality is a normative one, not a causal or factual one. It depends on what individuals have a right to do and not just on what they do. This is one reason why we think that moral theory is a prerequisite of economic theory and thus why it is a mistake to think of the domain of moral theory as partially fixed by economic theory. This view is undoubtedly correct, and its many implications for law and economics continue to go unnoticed by those we have criticized. This is the very familiar stance of those who practice law and economics: an unwillingness to engage any of the foundational issues that get in the way of the research project.

and it runs the risk that because the farmer is not compensated by the rancher, he too will invest in precautions to limit the damage his corn crop suffers. In that case there may be too little corn being raised.

Coase argued that there is another way to solve the externality problem.[33] If the rancher and farmer are rational and fully knowledgeable and transaction costs between them are negligible, then the externality problem can be solved by bargaining or exchange. We do not have to confer a right on the farmer to enjoin the rancher, nor do we have to impose a liability or a tax. All that is necessary is that we set up an initial set of property rights, and the parties will negotiate to an efficient allocation of cows and corn. The key idea is that the particular allocation of property rights is arbitrary. We might confer on the rancher a property right to as many roaming cows as he would like or confer on the farmer the right to bar all cows—roaming or otherwise. Whatever the allocation of initial rights, the outcome will be the same, and it will be efficient.[34] This is the Coase Theorem. The conclusion then is that when the market fails to secure an optimal result we need not turn to a tax, subsidy, or tort remedy. Instead, a *secondary* or *Cosean* market may solve the problem through bargained exchange. In other words, some market failures are in principle rectifiable by markets! This was Coase's remarkable insight.

C. Like many truly remarkable insights, it can be made to seem obvious in retrospect. The conditions required for a Coasean market are precisely those of the perfectly competitive market, with one exception—the absence of externalities. The Coasean insight is that this defect in the conditions of perfect competition can in principle be approached through a market provided the other conditions of the perfectly competitive market are satisfied. And that is because an externality problem is really just a bargaining problem about the value of the content of the relevant property rights. If property rights are assigned and the costs of negotiations are negligible or non-existent, then it is just a matter of leaving it to the parties to determine the consequential content of those rights: that is where the liberty associated with the right ends and liability begins. In this sense, the logic of Coase's argument has the same structure as the argument for the FFT. And like the FFT, the particular outcome Coasean bargainers reach will depend on the initial allocation of property rights. That outcome will have distributional consequences that can be altered by redistribution *ex post* or by choosing a different distribution of property rights *ex ante*. This, of course, has the familiar ring of the SFT.

33. FRANK & BERNANKE, *supra* note 3, at 283–87.

34. It is not, strictly speaking, true that the outcome will be the same, as the distribution of wealth between the rancher and farmer will depend on which property right regime is chosen. What will be the same is the balance of cows and corn, and that distribution is an efficient one.

One reason why a truly brilliant insight may seem obvious in retrospect is because, in some sense, it really is obvious. There is actually nothing in Coase's argument that isn't already captured in the FFT. The argumentative strategy is exactly the same. The insight is in seeing the application of the argument to a problem that no one had previously thought was amenable to it!

From our point of view, this is the market paradigm at work in all its glory. When markets fail, we look for cooperative solutions. The Coase Theorem, in fact, requires cooperation or collaboration—but of a very minimal sort. It requires the existence of a collaborative institution whose sole purpose is to put a scheme of property rights in place. Everything after that is taken care of by market exchange or competition. So when markets fail in this sense, the kind of cooperation that is necessary is that which is required to create the conditions for further competition.

D. The conditions under which the Coasean approach is likely to work are obviously quite demanding, which raises the question of how externalities are to be eliminated or reduced when those conditions are not satisfied. The set of available options is substantial: taxes, subsidies, tort liability, penal sanctions, regulations, moral norms, conventions, and more. It should come as no surprise that different disciplines in the social sciences have tended to emphasize different solutions. Philosophers like David Gauthier and Ned McClennen have emphasized moral norms and the capacity of rational agents to adopt and comply with resolutions to comply with moral norms.[35] Beginning perhaps with Michael Taylor, some political scientists have focused on the advantages of small communities in which relationships among community members is repeated and multi-dimensional to encourage compliance with informal norms.[36] Relatedly, other political scientists like Russell Hardin have emphasized the place of conventions that are self-enforcing, and sociologists like Michael Hechter have drawn attention to the value of solidarity.[37] These are, in many ways, informal forms of cooperative collaboration. In contrast, legal theorists have been drawn to formal legal solutions—especially judicial decisions. The exceptions are those legal theorists who follow Robert Ellickson's seminal work on ranchers and farmers in Shasta County, California, where informal practices substitute for formal legal rules.[38]

Let's consider a particularly interesting example of the way in which legal theorists have been inspired by the Coase Theorem and thus indirectly

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35. *See* GAUTHIER, *supra* note 31, at 8–10; MCCLENNEN, *supra* note 31, at 261–64.

36. *See generally* MICHAEL TAYLOR, COMMUNITY, ANARCHY, AND LIBERTY (1982).

37. *See generally* MICHAEL HECHTER, PRINCIPLES OF GROUP SOLIDARITY (1987).

38. *See generally* ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991).

by the FFT to fashion a formal legal solution to a classic externality problem. This example will provide ever stronger insight into the influence of the market paradigm, and particularly the claim that competition comes first in the order of explanation.

Driving is sometimes dangerous and always risky. The risks motorists impose on one another and on pedestrians and property owners are, in classical economic terms, externalities. Were the conditions of the Coase Theorem satisfied, motorists and pedestrians would be able to negotiate with one another and solve the relevant externality problem. Alas, search and transaction costs are too high for the Coasean approach to work. We know neither who our motoring puts at risk nor those whose motoring, bicycling, jogging, or walking puts us at risk. The costs of finding our bargaining partners are too high for bargaining to work.

That there is no Coasean solution is plain, and for the vast majority of legal theorists, this means that we must turn to a "legal solution." The problem is to formulate that solution. Traditionally, the answer has been to fashion tort liability rules: norms specifying what motorists owe other motorists, pedestrians, and property owners when their risky driving leads to misfortune. The problem is to determine what the rules of tort liability governing these activities should be.

The solution takes its cue from the Coase Theorem. Of course, the costs of transacting are too high actually to create a Coasean market. Thus, the right approach is for the legal regime to mimic the outcome of a Coasean market. We can determine the result of a hypothetical Coasean market by determining what rules of liability—rules for allocating risks associated with motoring, walking, owning property, etc.—the parties would have reached had they been able to negotiate with one another. By definition, that outcome would have been efficient. Thus, we adopt those legal liability rules that would have the same outcome as the Coasean market would have secured. The appropriate legal rules are thus those that would lead to the optimal investment in safety: that is, the optimal legal rules are those that mimic the outcome of the Coasean bargain.[39]

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39. One implication of this approach is that this segment of tort law is conceptualized as default rules in contract. Fully specified contracts are efficient (see Coase Theorem; FFT; it's all the same point). Contracts are not fully specified, however, because the costs of doing so are too high. Thus, the need for rules to impose risk in the absence of contract arises. Many of these rules are either default or gap-filling rules. Arguably such rules should impose risks as the parties would have, had transaction costs been low enough for the contract to be fully specified. This is yet another implication of the market paradigm. Once you look at the law and economics literature and strip away the technicalia, what you are left with is a very small number of animating principles, many of which are simply plays on or direct implications of the first and second theorems. Even the Coase Theorem is. So most of the analytic power resides in the basic theorems mediated in the legal literature by the Coase Theorem. Please don't read me as being critical. I admire the ability to draw so many strong conclusions over so many domains from so few basic building blocks. My objection has been that the conclusions lack the normative force claimed for them because they derive from or are otherwise driven by a set of basic

To sum up, the influence of the market paradigm is doubly visible in the legal literature. When the conditions of the Coase Theorem are satisfied, externality problems should be solved by setting up a Coasean market. The conditions of the Coasean market are very much those of the perfectly competitive market (but for the existence of externalities). When the conditions of the Coasean market cannot be met, the law should reach a solution that mimics the one the Coasean market would have. Here, we have all the pieces of the market paradigm at work. The externality problem represents a market failure. The market failure calls for collaboration or cooperation. Cooperation in the one case takes the form of setting up the framework for a Coasean market; once in place, competitive factors take over to solve the problem. When the Coasean market cannot be established, different forms of collaboration or cooperation are required to solve the market failure. In these cases, the law must put in place the outcome which the Coasean market would have, and the Coasean market itself mimics the perfectly competitive market in almost all of its fundamental dimensions.

E. For all its influence in establishing the form of the basic research agendas in the social sciences, the market paradigm is deeply problematic. Many of its critics focus on what I treat as subsidiary features of the market paradigm: either its reliance on methodological individualism or its rationalistic conception of human motivation.[40] I am differentially moved by these objections, both of which I recognize as serious and worthy of all the attention they have received. On the other hand, I do not believe that the projects of the social sciences depend essentially on either. The work of Kahnemann and Tversky, among others, demonstrates that traditional approaches to the social sciences can be pursued while adopting a somewhat different theory of human motivation.[41] At the same time, the work of Margaret Gilbert, Philip Pettit, and Christian List demonstrates that one can pursue the rationalistic approach to the social world without being committed to methodological individualism.[42]

For these and other reasons, my focus has been on the centrality of the market itself in framing the projects of the social science. It is the strategy

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principles that similarly lack the normative force claimed for them—or so I have argued here and elsewhere.

40. *See generally* MARGARET GILBERT, LIVING TOGETHER: RATIONALITY, SOCIALITY, AND OBLIGATION (1996).

41. *See generally* DANIEL KAHNEMAN, THINKING, FAST AND SLOW (2011); Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979).

42. *See* GILBERT, *supra* note 40, at 2; *see generally* PHILIP PETTIT, RULES, REASONS, AND NORMS (2002); Christian List & Kai Spiekermann, *Methodological Individualism and Holism in Political Science: A Reconciliation*, 107 AM. POLITICAL SCI. REV. 629 (2013).

of explanation that troubles me—in particular, the claim that rational competition comes first in the order of explanation.

1. One objection to the claim that competition comes first in the order of explanation is based on the observation that several preconditions of a perfectly competitive market presuppose collaboration, coordination, or other forms of cooperation. For example, market exchange requires enforceable property rights. It is pretty hard for you and me to exchange anything if we can't settle in advance what belongs to each of us and what we are entitled to do with what is ours. A scheme of property rights is a collective good, and collective goods often have the structure of Prisoner's Dilemmas or coordination problems.[43] This means they are sources of market failure themselves and not amenable to solution by a competitive market. In addition, competition presupposes the existence of norms against force and fraud, but each individual has an incentive to free ride on the compliance of others with these prohibitions, and as a result, rational persons cannot rely on anyone's compliance. So how can markets be first in the order of explanation when the very idea of competition presupposes cooperation? If anything, the objection suggests that rational cooperation comes first in the order of explanation.

Before we can assess the objection, we must first clarify its exact nature. Importantly, the objection can be read as making either a conceptual or a causal claim, and these are quite different. If we interpret it as a conceptual claim, then the idea is that the very concept of competition presupposes the concept of cooperation. Specifically, if the concept of a property scheme is the concept of something cooperative, then the concept of competition presupposes the concept of cooperation. In that case, cooperation comes first in the order in which the concepts are to be explained.

Or we can interpret the objection as making a causal claim. So understood, it asserts that competitive markets require that certain features of the world are in place, and these features of the world—e.g. property rights and norms against force and fraud—exist only through cooperative action. In that case, cooperation would come first in the order of causal explanation. Is either form of the objection persuasive?

(a) The causal form of the objection requires some further clarification. After all, there are many ways in which events can be brought about. It is surely possible that competitive markets could arise entirely randomly owing to no planning or rational activity. So we have to amend the claim as follows. It must be understood as a claim about rational activity. Rational competition presupposes cooperation. But that can't be

43. *See* Richard E. Levy, *Federalism and Collective Action*, 45 U. KAN. L. REV. 1241, 1268 (1997).

true because property rights schemes and norms governing compliance with prohibitions against force and fraud can arise randomly as well. As a causal matter, there are just too many paths to competitive markets to support any claim about rational cooperation being essential to the explanation of rational competition. There is no causal story of the appropriate sort in the offing.

There is another problem with this objection that runs even deeper. Suppose for a second that there could be no competitive markets without the parties first rationally establishing particular schemes of rational cooperation—for example, a property rights scheme. The problem is that a property rights scheme is itself a collective good that invites free riding. Just as there are impediments to competitive markets, there are structural and motivational impediments to schemes of rational cooperation. So we face the problem of what we might call "rational cooperation" failures. How are rational parties to solve their cooperation problems in the face of the incentives to free ride? This just pushes the problem back one step further. The existence of rational competitive markets (let us suppose) requires rational cooperation, but rational cooperation creates defection problems that have to be somehow resolved. If we insist on a rational explanation of competition and cooperation that relies on the narrow conception of rationality, the fact is that we may not be able to get the process of creating competitive markets going. Of course, if we relax the conception of rationality or relax the constraints on acceptable causal paths, these problems are mitigated and perhaps eliminated altogether, but at the cost of not being able to sustain the underlying objection!

(b) The most plausible interpretation of the objection treats it as making a claim about the conceptual relationship between competition and cooperation: namely, the concept of rational competition presupposes the concept of rational cooperation. The market paradigm holds that the concept of competition comes first in the order of conceptual explanation. The objection holds that, in fact, the same considerations that are adduced to support this claim can be adduced to support the opposite conclusion: namely, that rational cooperation comes first in the order of explanation. This is a much stronger objection. The argument for it follows.

In the perfectly competitive market, we suppose there are producers and consumers. Producers are driven by competition to price at marginal cost, but they do not desire to price at marginal cost. In fact, they prefer to price above marginal cost which would allow them to secure what economists refer to as "rents." This implies that the rational strategy for producers is *not to compete but to cooperate* with one another and fix prices. To fix prices, they would have to come to an enforceable agreement to distribute the rents that would be made available by fixing prices above marginal cost. Doing so means they have to solve a bargaining problem

(how to distribute the rents) embedded in a Prisoner's Dilemma (a situation in which each producer has an incentive to free ride on the compliance of other producers). In the absence of an already existing enforcement mechanism, each producer has an incentive to free ride on the compliance of others, and the promise of a cooperative price-fixing solution comes to naught. Unable to solve their problem of rational cooperation, they are left as competitors with one another. Competition is the outcome of failed cooperation and not the other way around!

We reach the same conclusion if we begin with rational consumers rather than rational producers. In a competitive market, no consumer wants to pay marginal cost. Each would like to suppress prices below marginal cost and thus secure rents. To secure rents, consumers would have to band together and pressure producers into charging less than marginal cost. Once again, this requires that they solve a bargaining problem embedded in a Prisoner's Dilemma. And once again, what we call competition is merely the failure of consumers to solve their cooperation problem.

In short, neither producers nor consumers want to charge or pay marginal cost. The former prefer to band together and charge above marginal cost. The latter want to band together and pay below marginal cost. Both sides face analogous collective action problems that they cannot solve on their own. The consequence of their inability to do so is what we call competition. What we call competition is the consequence of failed cooperation. One natural inference is that, contrary to the market paradigm rationale, cooperation comes first in the order of explanation in the sense that its failure is what explains competition. So, this objection turns the conventional story on its head.[44]

F. One has to be careful not to overstate the conclusion this objection establishes. In fact, it does not establish that cooperation comes first in the order of explanation. Rather, it establishes that the argument designed to demonstrate that competition comes first in the order of explanation is inadequate to the task: inadequate because the very same considerations that are adduced to support that claim can be employed to support the view that cooperation comes first in the order of explanation.

Of course, this just means that if competition or cooperation comes first in the order of explanation, we have yet to uncover the argument that warrants either conclusion. My instinct is to resist searching further, for I see no insight to be gained by determining the order of explanation, if there is one. The aim of the social sciences is to help us understand the social

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44. I am happy to take credit for this line of argument as I have never seen it anywhere but in my work, and it has been acknowledged accordingly. Still, I want to resist the conclusion that others have been inclined to draw from it, for it is not my view that this argument establishes that cooperation comes first in the order of explanation.

world and our place within it.[45] We have no more to gain by approaching our social life together by emphasizing its competitive dimensions than we do by emphasizing its cooperative dimensions.

IV. MARKETS AND POLITICAL STABILITY

In this section we turn from ideal markets to actual ones. Free markets are veritable, wealth-producing machines. History is replete with examples of developing nations that have been transformed upon adopting markets and the institutions associated with them—especially private property rights.[46] Even critics of markets acknowledge this feature of them, emphasizing instead that for all their ability to create wealth, markets encourage inequality and promote exploitation. If there is something unfair about the natural lottery, don't expect the market to repair it. If anything, markets are likely to exacerbate inequities than to rectify them.

A. Classical liberals do not reject the market's ability to promote wealth, nor are they likely to resist the claim that markets are prone to exacerbate rather than to rectify inequalities in resources and opportunities.[47] They don't defend markets as such. If anything, they limit their defense to free markets, which begs the question: what makes a market "free"? The usual answer to this question is that free markets are defined by the absence of force and fraud—as well as other forms of coercion—and maximize the set of options or powers that rights confer on their holders.[48] The key to this defense of the free market is the connection between market exchange so conceived and personal autonomy.

It is easy to make too much of this connection between the kind of freedom that characterizes a free market and the normatively significant notion of "autonomy." To be sure, my market choices are both choices and mine—mine in the sense of being made by me. They are free in that they are neither coerced nor based on deception, which is just another way of saying that they are legitimately attributable to me as mine and not someone else's. This notion of free market exchange represents a very thin conception of autonomy.[49] The choices I make and the actions I undertake may well reflect pressures I am under, the limited set of options open to me

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45. *See generally* GILBERT, *supra* note 40.

46. *See* FRANK & BERNANKE, *supra* note 3, at 63–64.

47. *See id.*

48. *Id.*

49. David Velleman has rightly pointed out to me that it would be a mistake to disparage autonomy in this thin sense for it may well be the only kind of autonomy that each of us can claim as a matter of right. Though the point is well taken, it has limited force. The question is not necessarily what forms of autonomy each of us can claim as a matter of right, but what forms of autonomy are worth possessing.

(think of the all-volunteer armed forces), and so on. Such choices, though free in the relevant sense, need not reflect who I am, what I aspire to be, or why freedom to choose is important to me and thus something I value. The value of autonomy as self-direction and self-regulation requires more than the autonomy that is necessarily reflected in un-coerced market choice.

B. Markets are decision-making institutions. In them, collective decisions about what to produce, how much of it to produce, and how what is produced is to be allocated are consequences of individual exchanges. Take any commodity that is usually allocated through a market: say, automobiles or homes. In principle, we could ask our political decision-making processes to address the question of whether to produce various forms of shelter and transportation; then ask them which sorts of each to produce; then ask them how much of each and who will be authorized to produce them and how; and then ask them who is to receive shelter and transportation and at what cost—not to mention how the relevant items are to be delivered. Or, we can simply leave the entire process to the market. Individuals decide whether to produce autos and homes, and that depends on the costs of doing so, the demand for such products, and so on.

It is easy to miss that one striking feature of the market is its ability to reveal information. All of these individual exchanges provide bits of information that are accumulated by the market that enable us to determine how much of a given product to create, at what price, and how it is to be allocated. Compare this with trying to make the same decisions through the political process. The right decision depends on securing the right information, yet the political process seemingly lacks the mechanisms to accumulate and assess the information, let alone to be confident of its accuracy. None of this is novel (and certainly not to a student of economics or of markets), though this role of markets is far too often missed by many of its critics.

I want to emphasize the social decision-making role of markets for a different reason—however, one that bears on fundamental issues in political philosophy. To see this, let's focus on one truly mundane and otherwise uninteresting but paradigmatic market exchange: the case in which I exchange my apples for your oranges. In order successfully to complete this exchange, it is necessary that we respect the basic conventions of property and the norms prohibiting force and fraud. On the other hand, I need not know what you find valuable in life or worth pursuing, nor need I know anything about your religious or metaphysical commitments (nor do you need to know anything about mine—or even your own for that matter). And if I did know what you found valuable and why, I need not approve of it or condone it. All that this successful exchange requires is that I prefer your oranges to my apples and that you prefer my apples to your oranges.

In this way, markets allow us to make an extraordinary number of important social decisions about what to produce, how much of it to produce, and how to allocate what is produced without bringing into relief or calling attention to whatever fundamental disagreements about value, the meaning of life, the purposes to which one should direct one's efforts, the place of the state, the appropriate conception of the good and the right, and so on: disagreements that are very likely to be real and substantial—especially in diverse liberal cultures and political communities. These are precisely the differences that are almost always brought to the forefront when similar issues are addressed through the political process.

We forget sometimes—I would suggest more often than we would care to admit—that liberal community depends on a very thin, but not at all trivial, consensus that is difficult to secure and fragile once achieved. It is not a consensus that could easily survive the constant pressure it would face were the bulk of collective decisions made through the political processes.

In a liberal culture, we are required to tolerate significant forces that divide us: fundamental religious, moral, social, cultural, metaphysical, and epistemic differences. I am not as sanguine as others may be in believing that cultivating the disposition to tolerate such fundamental differences provides all the protection liberal consensus requires. Institutions that provide us with ways to set aside such differences as a matter of course as we nevertheless make difficult, yet essential, production and allocation decisions are as important to our political stability as is the cultivation of the personal and political virtues of open-mindedness and tolerance.

C. It may be helpful to note some of the similarities between the argument of this section and Rawls's discussion of the role of an overlapping consensus to political liberalism and its cognate commitment to what he calls "public reason."[50] Public reasons are those that do not rely on particular comprehensive theories or views that reasonable groups within a well-ordered political community are likely to hold. These comprehensive views are likely to conflict deeply with one another. Reasons offered on behalf of some fundamental political decisions cannot appeal to considerations that draw their force entirely from particular comprehensive views. The only reasons that are appropriate grounds for political decisions (in certain domains) are those that could be accepted from the point of view of any reasonable comprehensive view. These are public reasons that constitute the domain of rational considerations in a society drawn together by an overlapping consensus.

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50. *See* John Rawls, *The Idea of Public Reason Revisited*, 64 U. CHI L. REV. 765, 766–73 (1997).

The idea of an overlapping consensus and the derivative notion of public reason plays the role of setting aside certain kinds of considerations from political discussion (over certain issues). In doing so, it contributes to the political stability of a liberal political culture, so too the market. It is not that the market sets aside especially controversial reasons. Rather, its capacity to gather accurate information and to make collective decisions does not draw attention to moral, religious, political, and other differences that threaten to divide us. Such reasons have no role to play in market exchange. In this way, markets contribute to political stability. That is their distinctive value in liberal political theory. If it is not a distinctive virtue, it is surely a widely underappreciated one.

D. Some might be inclined to read my defense of the market as suggesting a way of criticizing Rawls's emphasis on public reason and an overlapping consensus. Roughly, because we already have the market as a basic institution that allows us to engage in broad and rich forms of interaction without calling attention to the differences in comprehensive views that pose a threat to liberal stability, we should be freer than he allows to have political discourse evoke precisely the fundamental differences that are so close to the hearts of those who seek to live together in a liberal political culture. Why double up on excluding certain kinds of considerations from the basic allocation decisions? Doesn't the market offer protection enough? Shouldn't political discourse be heated? Shouldn't those differences that matter most be given an airing in some institutional forum, and isn't the political domain the proper place for that?

Though it is easy to see the attraction of the objection, it is nevertheless without merit, and I certainly don't see any of the argument I offer on behalf of the market as sustaining or encouraging it. Rawls's point is not that political discourse should be empty of considerations that express conflicting comprehensive views. Rather, his claim is that appeal to the more limited domain of public reason is called for in deliberations about the basic structure of society.[51] The basic structure of a liberal society perhaps, as Rawls contends, should reflect the balance of public reason, but its doing so is perfectly compatible with much ordinary political debate remaining heated precisely because it reflects the deeper divides characteristic of the diversity of comprehensive views.[52]

Political decision making should be reasoned and informed, but it should not be soulless. It cannot be the case that all political decisions are to be made in ways that set aside our most cherished political and moral commitments. To be sure, even in the political context, ignorance,

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51. *See* ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA 183–231 (1974); *see generally* JOHN RAWLS, A THEORY OF JUSTICE (1971).

52. *See generally* RAWLS, *supra* note 51.

intolerance, and hostility must be reined in, but that follows from the basic commitments of liberal community. There is much to be lost by demanding more, especially when markets already exist to maximize allocation decisions in a relatively anonymous environment not nearly so burdened by political and moral disagreement. But there is nothing in these remarks that is incompatible with Rawls's commitment to public reason. If anything, the argument I have offered in defense of markets compliments Rawls's argument about basic structure. For markets are part of the basic structure of a liberal society, and public reason supports them precisely because they offer a buffer to ordinary political debate and contribute to political stability by maximizing opportunities for collective allocation decisions to be made in ways that respect individual autonomy and difference—especially passionate differences regarding the nature of the good and the constituents of a valuable and meaningful life.

IV. Rights, Wrongs and Marketable Assets[53]

A. As Guido Calabresi pointed out long ago in *Tragic Choices*, we would not want all allocation decisions made through markets.[54] He argued convincingly that we would not want either the question of how many kidneys or who should receive them to be determined by markets.[55] His main, but by no means only, objection to employing markets in such circumstances was that such allocation decisions should not unduly reflect an individual's capacity and willingness to pay—an unavoidable feature of markets.[56]

Constraints must be imposed on the domain in which markets are to decide what is to be produced and who is to receive it, and it may well be that at this point in time, access to replacement kidneys or dialysis should not be determined by markets. This may well be because markets invariably reflect capacity to pay, and access to these resources should not be as influenced by capacity to pay as they would be in a free market.

One has to be careful though not to put too much emphasis on the fact that markets invariably reflect capacity to pay—and for two reasons. First, differentials in capacity to pay can always be mitigated by wealth transfers or by having price reflect capacity to pay. Second, and more importantly, overemphasizing the reliance of markets on relative capacity to pay may blind us to much more pressing concerns that bear on the aptness of

53. Some of the most interesting and important ideas here about the marketability of certain rights are owed to Jed Lewinsohn who two years ago first brought these questions to my attention.

54. *See* GUIDO CALABRESI & PHILIP BOBBITT, TRAGIC CHOICES 31–34 (1978).

55. *Id.* at 189–91.

56. *Id.*

allocation through markets. Indeed, for the purposes of this discussion, the impact of relative capacity to pay is among the least interesting features of markets on the question of what decisions are to be left to them.

The most pressing fact about markets as decision-making institutions is that by treating resources as assets exchangeable in markets, we run the risk of influencing the character of the resource, and not always in desirable ways. We prohibit individuals from selling themselves into slavery or indentured servitude, and we prevent them from alienating by exchange or otherwise their right to vote and to own property. The fact that the right to be free, to vote, and to own property are not assets exchangeable in markets has little if anything to do with the fact that markets reflect an individual's relative capacity to pay. These and other rights have a moral character that renders them unfit for market exchange.

Interestingly, we do not view these rights as appropriate for gifting either. This is further evidence that our objection to treating them as commodities has anything to do with the fact that markets invariably reflect relative capacity to pay. On the other hand, it raises an important issue that we will return to below, and that is why such rights cannot be gifted to others. After all, many resources that we are not free to trade or exchange in a market can be nevertheless permissibly gifted.

B. My focus is a subset of the category of rights that can be variously characterized as the right to repair (or compensation) from the wrongdoer, or the right to impose liability on the wrongdoer. The question is whether these rights should be treated as assets exchangeable in markets or permissibly gifted to others. These are rights that are typically conferred on the victims of torts who have successfully prosecuted their claims against those who have wrongfully injured them. Tort claims arise as a result of private actions brought by victims against those they feel have failed to display the proper regard for their interest in security and whose failure has resulted in damage or loss. If the victim's litigation is successful, he is entitled to repair for the damage he has suffered, which in turn confers a power on him to impose a liability on the defendant.

There is a disagreement among tort theorists regarding how exactly to characterize the normative relationship between the successful plaintiff and the defeated defendant. Historically, those who have defended a corrective justice view of tort law have characterized the outcome of a successfully prosecuted tort action as one in which the defendant incurs a duty or obligation to repair or compensate the victim and in which the victim has secured a right to compensation. Others who have defended what has come to be called a "recourse" view of tort law characterize the outcome as one in which the plaintiff is awarded a legal power to impose liability on the defendant.

Nothing in what follows turns on this rather fine-grained set of distinctions, and I will use both ways of characterizing the normative structure of a successful tort suit interchangeably. The key question before us concerns whether the plaintiff's right to repair (or his power to impose liability) is the sort of asset that can or ought to be exchanged in a market or permissibly gifted to others.

The issue is pressing for several reasons, some of which will emerge as we proceed, but others of which we can identify from the outset. In the first place, many rights that result from legal relations are commonly exchangeable in markets. A common example is the rights associated with the mortgage your bank holds against your home. These rights are regularly sold in secondary markets. You may have secured your mortgage from one bank who has a claim to your mortgage payment only to find that a few years down the road your mortgage has been packaged with others and sold to yet another financial institution who has obtained thereby the right to demand your mortgage payment.

More generally, the very idea of property rights relies on the ability of those who possess them not only to exclude others from use but to trade, sell, or gift what they have a right to. Arguably, these two elements of property rights—exclusion and transfer—constitute their very nature.

On the other hand, there are all sorts of rights that arise from legal relations that are not exchangeable or permissibly gifted. Suppose I contract with you to mow your lawn once a week. You secure thereby a right to demand of me that I do so, and I am under an obligation to do so. Suppose now that your neighbor has done you a good deed, and you are looking for a way to reward his kindness. It dawns on you that his lawn is in as much need of care as your own, and you decide to gift him the right you have secured by our contract to have me mow your lawn. Your vision of the gift is that now he has a right to demand of me that I mow his lawn. But can your gift secure the desired result? No. For when I show up at your home to mow your lawn only to be told by your neighbor that I am now somehow bound to mow his instead, it is perfectly plausible for me to resist doing so on the grounds that there is no relationship between the two of you that calls for me to mow his lawn. The "gift" you bestow upon him does not create a normative relationship between the neighbor and me, for the right you have against me is not something whose content you can change in this way without my consent. If I agree to mow your lawn, fine; if all three of us agree to restructure the claims we have against one another, fine. But what is not fine is for you to do so unilaterally without my consent.

Of course, part of what makes this case interesting is the fact that in the bank case, this is precisely the power you have. You do not have to ask my

permission to sell, transfer, or even gift my obligation to make mortgage payments. Whoever holds the mortgage secures the claim against me.

To make matters more interesting, let's shift focus from the plaintiff's side of the equation to the defendant's. Surely similar questions arise, though the forms they take are somewhat different. Consider two cases. In one case, let us imagine a group of twenty persons each of whom is relatively unlikely to commit an offense, but all of whom are roughly equally likely to do so. The group bands together to form an "insurance collective," according to which if any one of them were to commit the crime (and be convicted for it) each of them would serve one-twentieth of the time in prison. In effect, this is an effort to exchange or create a market for sharing liability or the risk of liability, and although there were times in history when it was not only permissible but relatively common for some to serve the prison terms of others, that is no longer the case. This form of insurance market as a way of discharging one's liabilities would be impermissible.

Now suppose that the same group of twenty came together to create an insurance collective for sharing liability or the risk of liability that would arise in the event of tortious wrongdoing. Again, each is equally, if not particularly, likely to cause harm to others that would result in, say, a million dollars of damage. Within very broad constraints, such an insurance pool would be viewed as not merely permissible but desirable—from both the victim's and the wrongdoer's perspective. Such a scheme would mean that the wrongdoer is unlikely to be bankrupted from what may well be just a small error in judgment. At the same time, the victim is much more likely to be able to secure compensation from a pool of contributors than he or she would be from a particular individual wrongdoer!

In sum: we have a range of puzzling data on both the victim and the defendant side of the ledger. In both cases, we have some rights and duties that can be treated as ordinary assets subject to market exchange and transfer and other rights and duties in which any form of transfer—whether it involves money or not—is prohibited.

This makes our initial question of somewhat greater interest and importance. For we want to know now not only whether the right to repair or the power to impose liability is or should be a commodify-able asset; we want to know how we can distinguish among those rights and duties that are tradable assets from those that are not in a principled way.

C. I find it helps to focus attention if we work in some detail with a single example and start out with a relatively uncontroversial case. Suppose you have won a judgment against me in tort for one million dollars. As a result, you have a right to demand one million dollars from me. It is absolutely clear that you can gift the judgment—the money—to anyone you like (within the constraints the law establishes). You can of course

exchange the million dollars in a market for anything you think worth that much or more (again, within the constraints on everyday market exchange the law creates). You can trade your winnings for a small apartment in New York City or an even smaller one in London. You might even be able to use your potential victory as collateral to secure a loan temporarily if doing so were necessary to lay claim to the apartment for a specified period of time.

There are all manner of things you could do with the actual judgment that involve markets, transfers, gifts, and exchanges. It would be odd otherwise. After all, a tort is an infringement on your liberty; typically it involves depleting or diminishing resources under your control that figure in your projects, plans, and goals. The point of compensation, or so I have argued, is to put you in a position where you are able to have resources at your disposal that would enable you to reconstruct your life—to reformulate your projects and plans in the light of the change in your circumstances. Providing you with a monetary reward is a desirable way of doing that precisely because of what money allows you to purchase in a market. It would amount to little more than adding insult to injury to deny the victim of wrongdoing the opportunity to exchange, transfer, or gift the judgment he receives in a successfully prosecuted tort action.

The philosophically pressing issue is whether it is permissible for the victim to exchange, transfer, or gift the right or the power itself rather than its object. In other words, is it permissible for the plaintiff to market or gift the power to impose liability or the right to demand repair. This is the same kind of question as whether it is permissible for the person with whom I have a contract to mow his lawn to exchange, transfer, or gift his right to demand of me that I mow his lawn to his neighbor. It is not the mowing that is the issue, but the power or the right to demand it. Same here: it is not the money damages, but the power to demand it. And part of what is important in thinking about this issue is the fact that in being awarded the power to impose liability on the defendant, the successful plaintiff has also been granted thereby the power to waive liability. That is, what the plaintiff has secured in a legal judgment is a kind of authority—a freedom to make a demand or to waive the right to do so. That is something earned as a result of normatively significant features of the interactions between the parties: features that do not obtain between the defendant and others the plaintiff may be inclined to exchange with. But this is really just a further invitation to inquire as to why some powers that derive from distinctive normative relationships between persons are free to "travel," whereas others are not. It is data not a conclusion.

D. Suppose you are engaged in litigation with an extremely well-funded pharmaceutical company. You allege that they have created a defective drug and fraudulently represented it. You took the drug as

prescribed and now find yourself seriously ill. Your lawyer informs you that you have a good case and stand a decent chance of successfully pursuing your claim against the company. Unfortunately, you have few financial resources and your current illness leaves you unable to work and thus hard pressed for resources to live on, let alone to litigate with.

The company knows this and takes steps to slow down the legal process and introduce motions, all of which make it ever more expensive for you to prosecute your claim. Fortunately for you, you have a generous friend who sympathizes with your plight and comes to the rescue. He loans you the money necessary to keep your action afloat. As a result, you are able to maintain the action, and ultimately you win. In appreciation of his efforts on your behalf, you not only repay him the money he loaned you, but provide him with an additional one-fourth of your winnings. Nothing to object to here. Let us suppose now that your friend had made it a condition of his helping you out by loaning you money that he would share in the winnings in the event your suit succeeded. Again, this seems perfectly reasonable and permissible. In effect, your friend is doing very much what a lawyer working on a contingent fee basis is doing.

It turns out that there are lots of people who are in situations similar to yours. They lack the resources to press their cases; sometimes the claims they have, though nontrivial, are not worth the resources they would have to expend to press them. So they decide that a market in unrealized but potential claims would serve them well. They collectively offer their claims to those who would buy them and thereby create a market.

We have to be somewhat careful in characterizing the market they have created. Are they creating a market in the proceeds from the claims, or are they actually selling the claims and giving control over the claims to those who purchase them? The latter is the one that interests us here; the market is for the claims themselves. This means that the lawsuits—if any—are controlled by the purchasing parties. The "victims" who have sold their claims are now basically witnesses and not claimants. What purchasers would be willing to pay for claims will depend, among other things, on how strong the underlying claims are and how reliable and convincing the former claimants are as witnesses on behalf of what is now the new owner's claims.

There may be good reasons to endorse such a market. All sorts of perfectly good claims would otherwise not be pursued, and the victims would secure little if anything for those claims. Wrongdoers would escape liability for wrongs they have committed otherwise. There is also much to worry about as well. By treating claims as assets in this way, we may create unsavory incentives and increase certain kinds of distributive inequities that we already find unacceptable or at least problematic.

It is an important feature of our example that it involves the sale of claims prior to their being litigated. In the example we considered earlier, the helpful friend was seeking to secure the claim as the litigation was in process. We can now add to our list of examples the case in which once the plaintiff has won the suit and been awarded the power to impose liability on the defendant, he seeks to sell, transfer, or otherwise exchange it to another. The "timing" of the purchase is an important difference, but is it a morally relevant one?

One reason for thinking that timing (as is often the case) makes all the difference derives from the following consideration. After the suit is over, the plaintiff has in effect established that he was wrongfully injured by the defendant and for that reason is entitled to demand recovery. No one else has established anything of the sort, and thus no one else has a right to demand repair or to impose liability.

The situation is different if we think about the cases in which the claim is being sold in advance of the lawsuit taking place, for if such exchanges are deemed permissible, it goes without saying that the success of the suit could not possibly be taken to communicate that the defendant has wronged the plaintiff, and thus the plaintiff is entitled to demand repair for that reason. After all, the plaintiff shows that the defendant wrongfully injured someone whose claim he (the plaintiff) now holds, and it is that fact that warrants his demanding liability from the defendant. In other words, if exchanging the claims *ex ante* is permissible, then the grounds for conferring the power to impose liability at the end of the lawsuit must be different than they are in the other case we just considered.

Indeed, if exchanging such claims in a market *ex ante*—prior to the law suit commencing—is permissible, then not only can the purchaser lay claim *ex post* to imposing liability on the defendant, he would surely be entitled to exchange his right to do so to someone else. Why? There are two parts to the answer. First, it has been established at trial that the defendant has wrongfully damaged someone, and that suffices to establish that the defendant must answer to someone; that is, he has no objection to a demand to make repair being made against him. Second, the right to make that demand is simply a matter of holding the relevant "chit." The initial purchaser secured the chit by exchange, thus establishing that exchange is a permissible way to secure such a chit. That implies, *ceteris paribus*, that the chit can once again be legitimately secured via exchange!

E. The fact is that these considerations aren't conclusive and, without more, can cut either way. If we think it is permissible to exchange unrealized tort claims in a market, then one way of understanding our comfort with doing so is that we think what is important is that someone establish that the defendant has committed a tort for which he must answer, and that having been established, it is of no real importance to whom he

must answer. The tort action is aimed at getting at wrongdoing and insuring that the wrongdoer answers for his mischief.

If we approach the issue in this way, then we should likely revise our intuitions about the case in which the plaintiff seeks to exchange his claim *ex post*—that is, after the conclusion of a successful suit. For while it may be desirable that the victim impose the liability, there is no reason why he must. If he prefers what someone else has to offer him instead in trade, why should he be prevented from making the relevant trade? All that matters is that the defendant's normative situation is unchanged. He must be liable to answer for his mischief, and that has not changed.

On the other hand, if we think that the case in which it is impermissible for the successful plaintiff to exchange his claim *ex post* is correct, then we should understand this to mean that what is important in a tort suit is not that the wrongdoer be held to account, but that he be *accountable to* the individual whom he has wrongfully injured: namely, the victim. The reason the plaintiff victim cannot exchange or transfer the claim *ex post* is that defendant is not accountable to anyone else, and thus no one else stands in the right moral relationship to him. No one else has a moral right to demand repair or compensation. No one else has the power to waive that demand either. No one other than the victim could have legitimately sought an injunction against the wrongdoer *ex ante*; no one therefore can secure the power to impose liability *ex post*.

If we adopt this line of reasoning, then we should reconsider our willingness to allow for markets in unrealized tort claims and thus resist the temptation to permit unrealized tort claims to be exchanged or transferred *ex ante*.

How shall we choose between these two alternatives? The answer depends on what we take the relationship of liability to accountability to be. If we take liability in tort to be a form of liability for—that is, the wrongful defendant is liable for the costs of his mischief and must answer for them—then there is no compelling reason to resist treating the right to repair or the power to impose liability as an asset exchangeable in markets. If, on the other hand, we take liability in tort to be a form of liability to—that is, a vulnerability to those one has a duty to take care not to harm to respond to the demands that they therefore have a right to make and enforce—then we have all the reason we need to reject the view that rights to repair or compensation or the powers to impose liabilities are permissibly exchanged in markets.

What we need, of course, is an argument that can establish which, if either, notion of accountability is constituted by liability in tort. That, I fear, is an issue for another day.