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# COMMON LAW AND ECONOMIC EFFICIENCY

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# Common Law and Economic Efficiency

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## **Abstract:**

This is an entry for the forthcoming Second Edition of the *Encyclopedia of Law and Economics* (2d ed., Francesco Parisi and Richard Posner eds.).

This essay reviews the origins and development of the debate over the “efficiency of the common law hypothesis.” The essay begins with the earliest explanation for the observed tendency of the common law as proffered by Richard Posner. It then examines the Rubin-Priest and contemporary models of demand-side models of common law efficiency and critiques thereof. It then turns to a supply-side analysis of the efficiency of the common law hypothesis, focusing on the nature of the constraints imposed on common law judges and changes in those constraints over time. This essay also examines public choice analysis of the efficiency of the common law and the Austrian economics critique of the standard neoclassical model of analysis.

**Keywords:** Posner, efficiency of the common law, Hayek, Buchanan, public choice

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## I. Introduction

From its inception, a foundational claim of law and economics is that the common law tends to the promotion of economic efficiency. (Posner 2007). Much of the traditional law and economics research agenda has been concerned with positive analysis testing the efficiency properties of rules across different common law doctrinal areas. The strength of this claim has been tempered over time, however, as some leading law and economics scholars have argued that the efficiency-enhancing attributes of the common law have weakened over time and that during the 20<sup>th</sup> century the common law has increasingly produced rules that promote wealth redistribution instead of efficiency. Nonetheless, the application of economics to determine the efficiency-promoting tendencies of various legal rules remains a defining research agenda for law and economics.

Since the articulation of the efficiency of the common law hypothesis, analysts have been concerned with a corollary question: if the common law does tend to efficiency, what is the mechanism or mechanisms that produce that result? The question is especially puzzling in light of the general absence from judicial opinions of any express stated concern with promoting efficiency or any obvious expertise or concern of

judges to further efficiency. Here we focus not on the postulated efficiency-enhancing properties of particular legal rules, but rather this corollary question of the common law process itself and whether that process tends to the promotion of efficiency enhancing rules. The analysis here is structural in nature: we observe the properties of the rule-generating system to determine whether the system's design tends to promote efficiency-enhancing rules. (Cooter 1996; Pritchard & Zywicki 1999; Zywicki 2006). Useful prior surveys of some of the literature discussed here can be found in Rubin (2005a), Parisi (2004), Aranson (1986), and Kornhauser (1980).

For purposes of explication, we can conceive of the production of common law rules as the interaction of supply and demand dynamics. Litigants demand judicial decisions by bringing cases for judges to decide. Judges supply legal rules according to their preferences (whatever those may be) as constrained by the set of incentives that they confront. This supply and demand heuristic can help to illuminate the rule-generating properties of the system to assess the mechanisms that produce efficient law. After reviewing the arguments about why the common law may or may not have incentives to be efficient, we conclude with a discussion about judges may be unable to identify, much less implement, economically efficient legal rules. This set of arguments questions whether efficiency as defined by Kaldor-Hicks efficiency or wealth maximization should be the goal of judges or a legal system.

### **I. Do Judges Seek Efficient Rules?**

Posner's initial foray into a positive explanation for the tendency of the common law to promote efficient rules postulated that this tendency arose from the preferences of

common law judges for efficient rules. (Posner 1979). These preferences may arise either because judges affirmatively choose to prefer efficiency as a normative value over alternative values (such as wealth redistribution or some measure of social egalitarianism) or alternatively because even if judges theoretically prefer the pursuit of other normative values they nonetheless pursue wealth maximization as the most practical to accomplish, as if by an implicit process of elimination where judges find other goals to be unattainable in light of the constraints of the judicial process. (For a discussion and summary of critiques of Posner's early hypothesis, see Zywicki 2003).

One possible explanation for the preference of judges for economic efficiency as compared to other social values is that utilitarianism is a dominant philosophical preference of judges. Because of the difficulty of measuring utility directly, Posner argues that judges instead seek to maximize economic efficiency, as defined as wealth maximization. Under this standard, also referred to as Kaldor Hicks efficiency, efficiency is attained when the net willingness to pay associated with different outcomes is maximized. (Posner, 1980a, p. 491; Posner 1980b, p. 243; Posner 2007). Posner, for example, has argued that during the formative period of the common law, English judges implicitly adopted the utilitarian philosophy of 19<sup>th</sup> century English liberalism and thus implicitly sought wealth maximization. (Posner 1979). To the extent that the common law has deviated from its orientation toward economic efficiency, a common claim, this presumably could be explained by a change in the philosophical orientation of judges during the 20<sup>th</sup> century toward a heightened focus on redistributive and social engineering goals of the law and away from a traditional concern for utilitarianism and classical liberal values. (Priest 1991; Priest 1985; Priest 1987a; Priest 1987b; Tullock 1997).

Explaining changes in the orientation of the common law toward or away from efficiency by changes in judicial ideology is highly contestable. First, it assumes that earlier judges were largely moral utilitarians, as opposed to promoting some notion of “justice” or rights (O’Driscoll 1980); Claeys 2010; Cordato 1992) or imposed no systematic moral philosophy on the common law but simply tried to apply existing precedent to the best of their ability (as implied by Hayek (1978) or Leoni 1991). Moreover, as a theory of preferences or tastes, the theory is difficult to verify as a testable hypothesis. On the other hand, there is a substantial body of literature that finds a relationship between judges’ ideology and case outcomes in many areas of the law, which suggests some plausibility to the thesis. (See Stearns and Zywicki (2009), Chapter 7, for a summary).

Posner has also articulated a weaker version of the argument. Rather than judges professing an affirmative preference for efficiency over other moral values, he suggests that even if judges prefer other values (such as redistribution) to efficiency, they will still be led to promote efficiency because these other values are unattainable as a practical matter because of the limitations of the judicial process. Unlike redistributive goals, which are highly contested as a social matter, there is a broad consensus that efficiency is a desirable social goal, even if it is not the only social goal. Thus, everything else being equal, most people (including judges) prefer rules that result in more rather than less wealth for society. Moreover, judges have limited tools to engage in effective and consistent wealth redistribution: because most common law rules are default rules that parties can alter by contract or relative price adjustments, while judges can alter the distribution between the parties in any given case, they lack the power to engage in systematic wealth redistribution such as a legislature can do through tax, spending, and

regulatory powers. Because common law judges “cannot do much ... to alter the slices of the pie that the various groups in society receive, they might as well concentrate on increasing its size.” But this explanation of judicial preferences also runs afoul of the concern about its untestable and potentially tautological nature. Moreover, this theory cannot explain the apparent trend of recent years for the common law to depart in many areas from the promotion of efficiency to the apparent motivation to satisfy other social goals, such as redistribution and the apparent growth in the number of judges dedicated to the promotion of redistributive goals for law (Krier 1974). In short, even if judges are constrained in their ability to engage in systematic wealth redistribution, they nonetheless appear to have increased their desire and efforts to do so, which seems to contradict the hypothesis of pursuing efficiency by default.

## **II. A Demand Side Analysis of Common Law Efficiency**

In response to the theoretical and empirical imitations of the original “judicial tastes” model of efficiency in the common law, scholars instead proposed various “demand” theories of the evolution of the common law that argue that there will be a tendency toward the promotion of efficient common law rules through an invisible hand process of selective relitigation of judicial precedents. In these models, a tendency toward efficiency will be observed regardless of judicial tastes or preferences for efficiency.

Zywicki (2003) argues that the process of litigation and common law rule production can be conceived of as a demand for judicial rule outputs, just as public choice theorists have modeled the process by which interest groups lobby (or bid) for

favorable legislation or regulation (or to avoid unfavorable legislation or regulation). Zywicki argues that as with standard models of the legislation process (Tullock 1967) parties will invest in the process of legal change in order to procure favorable judicial rules, and that in equilibrium, parties will be willing to invest up to the expected present value of the stream of economic rents to be generated by the beneficial legal precedent (or to preserve a beneficial precedent) in securing that precedent. Zywicki thus offers a stylized demand function to illustrate the process of legal change in these expected present value terms, where the demand ( $D$ ) for legal change is a function of two variables: (1) the expected total value of wealth to be transferred by the law in question ( $V$ ), and (2) the expected durability or longevity of the favorable legal rule to the favored party, in terms the expected length of time over which the valuable law will produce benefits to the parties ( $L$ ):

$$D = (VL)$$

*Where*

$D$  = demand for a particular legal rule,

$V$  = the annual value of the amounts to be transferred, and

$L$  = the expected longevity of the law and the number of periods over which wealth will be transferred.

Zywicki thus argues that where the value of a given rule increases (in terms of the amount of wealth to be transferred per period) or the expected durability of the rule increases (in terms of its protection from being overruled or reversed) parties will be willing to invest greater amounts in litigation. As a corollary to this observation, it follows that parties who are repeat players will be more willing to invest in the promotion



of favorable rules than those who are not repeat players. A favorable legal rule can thus be analogized to a sort of capital investment, in which an up-front investment in litigation to gain a favorable rule may be amortized by a subsequent stream of economic rents to the party benefited by that rule.

As with standard public choice analysis of the legislative process, there is a second-order collective action problem that arises in terms of the ability of parties to effectively organize in order to litigate strategically in order to bring about legal change. Thus, even if a group will gain a substantial benefit or incur a substantial cost from a legal rule change, they face the additional problem of organizing in order to bring about the desired rule changes.

Paul Rubin provided a demand-side model of the evolution of efficiency in the common law that is consistent with this model and which he argues tended to the production of efficient common law rules, at least during the formative periods of the common law. (Rubin 1977). Rubin argues that at least to some extent the ability of one party or the other to prevail in a given case will be a reflection of the amount of money that they are willing to expend litigating the case. Higher stakes in any given case will tend to produce larger investments in lawyers and litigation expenses. But the potential for precedent to be created by a case further raises the stakes, as a precedent increases the stakes in future cases as well as the current case. Thus, parties who have a particular stake in precedent, such as repeat players, will be willing to invest more in litigation than those who have lower interests, such as non-repeat players.

Rubin suggests that the evolution of legal rules can thus be divided into three categories depending on whether the litigants are repeat players. When both parties are

repeat players then they both have a continuing interest in future precedent and they will both be expected to fully and vigorously litigate actions, such that their investments will essentially cancel out. In such cases, Rubin predicts that we will tend to see a tendency toward efficiency-enhancing rules. When neither party is a repeat player with an interest in precedent beyond the current case, and thus have relatively equal stakes, we would expect to see no systematic bias in the law toward one party or the other and might instead observe either random drift or a slight tendency toward efficient rules. Finally, where one party is a repeat player and the other is not, we would expect to see a tendency for the law to favor the repeat player at the expense of the other party. This may come about either because the repeat player has a greater incentive to litigate certain cases more aggressively or alternatively because the repeat player has an incentive to avoid litigating unfavorable cases that might be expected to produce unfavorable outcomes, such as by settling a case before it results in an unfavorable judgment and precedent.

Rubin argues that this model explains trends in the common law over time. He argues that in the early nineteenth century (and presumably before), rule making (both common law and statutory) was dominated by individual actors acting independently, rather than by organized special interests acting collectively. (Rubin 1982). These interests generally were not repeat players and even if they were, they were unlikely to be consistently found on one side of a dispute. For example, small independent businesses were unlikely to systematically be plaintiffs or defendants in contract, tort, or property cases. Rubin argues that the 19<sup>th</sup> century brought about the development of large-scale manufacturing enterprises that produced repeat players with systematically biased preferences in favor of liability-limiting legal rules on issues such as nuisance and tort

law (such as for workplace accidents). In the latter half of the 20<sup>th</sup> century, by contrast, a new interest group arose: trial lawyers who had an interest in expanding legal liability rules. Thus, with respect to mass torts and other similar issues, even though injured individuals are not repeat players, the lawyers who represent them often are, and thus are willing to engage in litigation and other activities in order to expand the reach of liability under law. (Bailey & Rubin 1994; Rubin & Bailey 1994). Moreover, changes in communications technology and changes in legal procedure both have made it easier for interest groups (such as lawyers) to organize more effectively to promote legal change (Rubin & Bailey 1994) as well as raising the stakes in current and future cases by making it easier to aggregate plaintiffs' claims and launch expensive litigation (Zywicki 2000).

George Priest (1977) offered a complementary story to Rubin's demand side model. Priest argues that inefficient rules will tend to produce more societal conflict which, because litigation only arises when parties' expectations clash, will lead to more litigation involving those rules than efficient rules. He postulates that even if judges reverse precedents at a stochastic rate, the tendency for inefficient rules to arise more frequently in litigation will lead to them being disproportionately overruled relative to efficient precedents (which are tested less often). This largely random process will thus lead to a tendency for inefficient rules to be tested, and thus corrected, more often than efficient rules. Of course, to the extent that other factors tend to promote efficiency as well (such as a preference by judges or parties for efficient rules), this will amplify this tendency toward efficiency.

Various refinements of these models have been offered over time. Goodman (1979) argued that efficient precedents were worth more to parties who would benefit

than inefficient precedents were to their beneficiaries, and thus litigants would be willing to invest greater amounts in the pursuit of efficient precedents than inefficient precedent, producing a tendency toward efficiency. While this assumption may be true (although contestable), Goodman does not consider the potential for collective action problems to undermine the ability of parties to effectively litigate in favor of efficient rules if the benefits are widely dispersed and are received by parties other than the litigating party as discussed below. Combining the tools of economics and evolutionary biology, Terrebonne (1981) presented an evolutionary model of the common law that concludes that where legal rules are inefficient, both plaintiffs and defendants adopt behavioral strategies that lead to a high rate of litigation and when rules are efficient they adopt strategies that lead to low rates of litigation. As a result, when rules are efficient the evolutionary stable strategy for both plaintiffs and defendants is to avoid litigation and take appropriate care instead and when rules are inefficient the evolutionary stable strategy is to not take the mandated care and instead to litigate. This leads, via a Priest mechanism of more frequent litigation of inefficient rules and to the elimination of inefficient rules and the preservation of efficient rules, except in the narrow situation when litigation costs exceed the costs of the inefficient rule to the potential litigant, and thus the inefficient rule is not actually litigated. Landes and Posner (1979) extended the original models by noting that relitigation of precedent might not result only in overturning precedent, but repeated relitigation and reaffirmation of a precedent might actually strengthen and entrench the precedent.

Others have argued that there is no theoretical reason to believe that the common law will tend to the production of either efficient or inefficient rules. Cooter and

Kornhauser (1980) argue that invisible hand evolutionary models of efficiency in the common law can provide at best a very weak tendency toward efficiency in the common law, but that the most likely result is an unstable cycle of efficient and inefficient rules and a chronic coexistence of both. They conclude that a strong tendency toward stable efficiency in the common law requires the affirmative commitment of judges. Wangenheim (1993) similarly concludes that cycles of efficiency and inefficiency are more likely than stable efficiency. He argues that judges follow a sort of herd behavior, which leads them to follow one another's opinion, regardless of whether they trend toward or away from efficiency. Thus, he predicts the generations of broad cycles of efficiency and inefficiency as judges follow one another. He does suggest, however, that there may be a systematic tendency toward inefficiency in a dynamic sense that results from the unusually difficult collective action problems faced by innovators, who will have an especially difficult time identifying one another and organizing to have their views heard. Drawing on evolutionary biology and evolutionary game theory, Hirshleifer (1982) argues that evolutionary models provide little reason to believe that there will be any strong tendency toward efficiency in economics or law. He also stresses that a complicating factor in the context of law is the public goods nature of more efficient law, which raises substantial collective action problems in organizing to litigate for more efficient law.

Others have argued that the common law might be predicted to actually exhibit a tendency toward inefficiency. A student comment in the *Yale Law Journal* (Comment 1983) observes that in theory the combination of the tendency of inefficient rules to be litigated more often (as described by Priest) together with the phenomenon described by

Landes and Posner that repeated reaffirmation of rules in litigation might entrench inefficient rules could perversely lead the common law to favor rules that inefficiently lead to more accidents and greater social costs. He argues that these “reckless” rules will be both deeper rooted (because repeatedly reaffirmed) but also more sophisticated and well-developed intellectually, thus they will cast a larger shadow and bear more weight as persuasive authority, thus reckless principles will gradually displace efficient principles which are less-frequently litigated and less-developed. Thus, he argues, reckless rules will come to dominant the common law and further speculates that the growth in legislation displacing the common law in the 20<sup>th</sup> century might result from a perceived need to correct reckless common law doctrines. Hathaway (2001) similarly argues that the use of *stare decisis* in the common law could lead to lock-in or path-dependency in the common law, potentially preserving inefficient precedents (or precedents that are originally efficient but which become inefficient as social conditions change) as much as efficient ones. She argues that judges should be alert to situations where the costs of path dependency are especially high and should relax the binding force of precedent in those situations. Stearns notes that this problem of path dependency gives rise to problem of strategic litigation as parties seek to engage in “path manipulation” in order to gain favorable precedents. (Stearns 1995). He argues that judges use procedural rules such as the standing requirement in order to reduce this threat of strategic path manipulation.

These contrarian theorists thus provide several theoretical arguments as to why the mechanisms of common law adjudication should not lead to the production of efficient rules. On the other hand, these articles do not seem to rebut the central empirical phenomenon to be explained: the apparent tendency of the common law to

produce efficient rules over time, even if that tendency is weaker than in prior eras. While some of these authors provide some isolated examples where the phenomena they describe arguably explains inefficient rules, they do not seem to rebut the central claim of common law efficiency that the original generation of scholars sought to explain. Thus, it is not always clear whether they reject the premise that the common law tends toward efficiency or whether they accept the proposition but not the models that had been offered to explain it.

### **III. A Supply Side Model of Common Law Efficiency**

Todd Zywicki (2003) has supplemented the models developed by Rubin and Priest with a supply side analysis that explains what he characterizes as the rise and fall of efficiency in the common law. Rather than focusing on judicial preferences, as Posner's original model did, Zywicki instead points to the constraints imposed upon judges. Like the Rubin-Priest demand-side models, Zywicki suggests that the preferences of judges are largely irrelevant to the efficiency of the common law if the demand and supply structure provides meaningful constraints on judges from indulging their preferences. But Zywicki focuses on the incentives of judges rather than litigants and, in particular, traces changes in legal institutions over time that he argues explains the strong tendency toward efficiency in the common law during its classical period and the more recent susceptibility to rent-seeking litigation of the modern era.

In particular, Zywicki focuses on the polycentric legal order that characterized the English legal system during the formative centuries of the English common law system, when England had in many areas a competitive and non-coercive legal order. During the

Middle Ages multiple courts with overlapping jurisdictions existed side-by-side throughout England (and Europe generally, see Berman 1983), including: ecclesiastical (church) courts, law merchant courts, local courts, the Chancery court, and three different common law courts, the King's Bench, the Court of Common Pleas, and the Exchequer Courts. For many legal matters a litigant could bring her case in several different courts. For instance, church courts had jurisdiction over all matters related to testamentary succession, but if the deceased owed a debt at the time of his death this suggested the possibility of jurisdiction in other courts as well.

Judges were paid in part from the litigant filing fees, thus providing competitive incentives respecting the scope of jurisdiction and expansion of judicial dockets. This encouraged judges to compete for litigants. Depending on the institutional context, competition could provoke judges to compete either by offering pro-plaintiff or pro-efficiency law. As Adam Smith (1976, pp. 241-42), writing in the eighteenth century, observed, the competition of the Middle Ages generally encouraged the production of efficient law:

The present admirable constitution of the courts of justice in England was, perhaps, originally in a great measure, formed by this emulation, which anciently took place between their respective judges; each judge endeavouring to give, in his own court, the speediest and most effectual remedy, which the law would admit, for every sort of injustice.

Smith also noted that requiring judges to compete for fees motivated them to work harder and more efficiently, thereby removing incentives for judges to shirk or to indulge their personal preferences. Zywicki claims that this judicial competition helped drive the early common law toward efficiency as courts competed to provide the law and procedures most appropriate to parties' needs. (See also Rowley 1989). Choice of court was either



implicitly or explicitly made ex ante (at the outset of the contract), which would be expected to lead parties to prefer efficient rules that minimized transaction costs. (Stringham and Zywicki 2010). Moreover, many of these competing courts (most notably the law merchant and ecclesiastical courts) provided law that was rooted in principles of reciprocity derived from merchant custom or religious belief. Reciprocity tends to promote efficient legal rules as well, as parties who don't know ex ante whether they are likely to be the plaintiff or defendant in a subsequent dispute will tend to favor fair and cost-minimizing rules. Many of these substantive and procedural rules were incorporated into entered the common law and equity courts during the mid-nineteenth century. In fact, many of the doctrines which are often identified as demonstrating the efficiency of the common law, especially contract law, were originally created in these non-common law courts and incorporated into the common law by judges such as Mansfield.

Zywicki further explains that the polycentric legal order in which the common law emerged as a result of judicial competition, spurred in part by the judges' own financial incentives, produced an additional beneficial effect. The regime allowed dissatisfied parties to opt out of inefficient legal regimes and into more efficient ones. For instance, merchants rarely resorted to common law courts, opting instead for law merchant courts, thus limiting the reach of sometimes archaic common law rules in commercial transactions. Zywicki also explains that the coercive element necessary for judicial rent seeking was largely absent giving potentially burdened parties an exit option. For parties to successfully rent-seek via litigation it is necessary for beneficiaries of wealth transfers to be able to involuntarily capture the wealth of otherwise unwilling

parties to provide the transfer. In this sense, choice among competing courts can be thought of as a radical form of federalism, providing a heightened version of the exit and matching (Tiebout) functions of federalism.

Easy exit provided by a polycentric legal system enabled parties to avoid being the source of involuntary transfers. Authors such as Benson (1990) describe how many of these courts did not involve compulsion but judgments were enforced by threat of ostracism and reputational sanctions. Zywicki argues that in the United States, the legal regime of competing courts that prevailed prior to *Erie Railroad v. Tompkins* served a similar function of reducing the opportunities for rent-seeking via litigation by enabling out-of-state corporate defendants to avoid the clutches of state legislatures and judges responding to incentives to transfer wealth from out-of-state defendants (often corporations) to in-state plaintiffs. Federal courts were generally considered to be less susceptible to these parochial political forces than state courts. Over time, however, the common law became more monopolized to which Zywicki attributes the subsequent tendency toward inefficient common law rules in the 20<sup>th</sup> century. The reduced ability of litigants to choose their court or to exit inefficient courts dampened the incentives for judges to be responsive to parties' needs, raised the agency costs associated with judicial decision making, and increased the incentives and opportunities for rent-seeking litigation. Under a monopolized system judges have a much greater ability to infuse ideology, such as redistributive goals, into their judicial opinions and to respond to pressures for rent-seeking litigation.

In a recent article, Daniel Klerman has explored some of the historical facts that underlie these conclusions (Klerman 2007). Contrary to the argument of Adam Smith

and Zywicki, Klerman argues that inter-jurisdictional competition actually spurred the development of pro-plaintiff rules rather than efficiency-enhancing rules at least in the common law courts of the King's/Queen's Bench, Common Pleas, and Exchequer. Klerman observes that statutes enacted in 1799 and 1825 shifted judges to a salary-based compensation system, stripping them of their right to collect fees from litigants. Klerman claims that this reform led to a gradual elimination of the pro-plaintiff bias in the common law courts and to the adoption of a variety of pro-defendant rules instead. Although highly illuminating with respect to those areas under his scope, Klerman's analysis is limited just to cases in the Royal courts and ignores others, such as the law merchant, ecclesiastical, and Staple Courts (Stringham & Zywicki 2010). He also notes that the pro-plaintiff bias of the common law court was constrained to some extent by the Chancery, to which disputes could be removed, and which frequently served to restrain some of the rule-bound decision making of the Royal courts that produced problematic results. Other scholars have raised doubts about the importance and autonomy of the law merchant courts, but as noted by Benson (forthcoming) and Stringham and Zywicki (2010), inferences drawn from these findings are highly overstated.

#### **IV. Public Choice Critiques of the Common Law**

As the foregoing discussion suggests, interest groups have the potential to influence both the judiciary and legislatures, although the nature of such influence might differ from institution to institution. In his article, *Does Interest Group Theory Justify More Intrusive Judicial Review?*, Elhauge (1991) claims that judicial processes are subject to the same sorts of interest-group pressures as are legislatures. In particular,

those groups seeking to change the law through litigation (as in Rubin's model of legal evolution) will confront many of the same collective action problems as groups seeking change (or to prevent change) through the legislative process. Discrete well-organized groups, for instance, will tend to be more effective in organizing strategic litigation in much the same manner that they will in organizing for effective lobbying. Well-organized groups may also be able to bring about settlements that prevent "bad" cases from establishing undesirable precedents (Stearns & Zywicki 2009) or seek to influence judicial appointments or elections (Zywicki 2000; Rubin 2005b).

This analysis suggests that it might not be enough for a group to be a repeat player to effect legal change. If the group members are heterogeneous, dispersed, or otherwise difficult to organize they might be unable to monitor contributions effectively to ensure sufficient resources to bring about doctrinal change. As noted, Paul Rubin and Martin Bailey (1994) have argued that one reason trial lawyers have been effective in changing tort law in recent decades has been their considerable ability to organize and to engage in strategic litigation through organizations such as the American Association for Justice (formerly the Association of Trial Lawyers of America).

Thomas Merrill (1997a; 1997b) has argued that although it is true that interest groups influence both judges and legislatures, the pattern of influence is not identical and, most notably, the demand curve for legal change differs in these two contexts. Merrill claims that in general, interest groups seeking to lobby the legislature probably have to spend substantially more money to gain influence than do those seeking to effect legal change judicially. Specifically, he claims that the marginal return on each dollar invested in legislative lobbying is likely to decline much more slowly than for investments in

litigation. Simply put, politicians always need more money for reelection. In contrast, Merrill claims that the marginal return from increased financial investments in litigation will likely fall off very rapidly. Thus, Merrill argues, even if some groups are likely to outspend in absolute terms, the *relative* difference in terms of the influence is likely to be much smaller in adjudication than in legislative lobbying.

Adam Pritchard and Todd Zywicki (1999) have argued that in addition to the difference in the demand function that Merrill identifies, there might also be a difference in the relevant supply curves of legal change. The authors begin with the public choice premise that legislators generally seek election and reelection. In contrast, the judicial utility function is more elusive. Nonetheless, an important component appears to include the opportunity for judges to infuse their legal policy preferences in the cases that they decide. The authors further claim that judges are likely motivated by the desire for status and prestige. In the case of judges, the authors posit that status is substantially derived from perceptions of practicing lawyers and commentators in the academy and media. Thus, if lawyers and legal commentators have any sort of consistent ideological preferences, judges may tend to issue opinions that reflect those views.

Pritchard and Zywicki also suggest that judges might be biased in the direction of trying to enhance judicial power by absorbing a broad range of social issues under their jurisdictional umbrella. Moreover, the authors note, judges might not be entirely insulated from interest group pressures. Judges are obviously less susceptible than legislatures to influence produced by various forms of financial contribution. Instead, interest groups “appeal to judges’ interest in status, power, and ideological voting, rather than pecuniary gains or political support.” (Pritchard Zywicki 1999, p. 499). Interest

group tools include strategic litigation, filing amicus briefs in pending cases, or organizing judicial rallies. Those seeking judicial influence also might write scholarly or popular articles. Thus, in earlier eras when judges were drawn from a commercial class of lawyers, they were favorably disposed to business interests. Today, however, judges often reflect intellectual class values and seek the esteem of academics and journalists, which are often hostile toward commercial interests and more interested in social issues. Thus, while legislators are likely to be more responsive to those groups that can offer electoral and financial support, judges might be more receptive to those groups whose expressed views find reflection in the opinions they produce.

One implication of Pritchard and Zywicki's model is that it suggests that different interest groups will have a comparative advantage in pursuing their competing interests in different forums and will rationally allocate their resources and efforts to influence policy accordingly. The analysis thus implicates the demand function of interest group litigants and the supply functions of judges and legislators. Legal change can be produced in several different institutional arenas: most commonly courts and legislatures, as well as regulation by executive or independent agencies. In some situations, however, formal constitutional processes are used (Boudreaux & Pritchard 1993; Crain & Tollison 1979), including initiative, referendum, and other direct democratic means. (For an overview, see Stearns and Zywicki (2009)). In some areas of law "private legislatures" such as the American Law Institute which drafts the various Restatements of the Law or the National Conference of Commissioners on Uniform State Laws which drafts and revises the Uniform Commercial Code and other uniform laws which are then typically adopted by state legislatures as binding law (Schwartz & Scott 1995). Pritchard and Zywicki argue

that interest groups will allocate their lobbying efforts among these various institutional decision-makers in the manner designed to maximize the marginal return from their lobbying activity, a calculation that implicates the interaction of the demand function of various interest groups on one side and the supply of legal rules by judges, legislators, private legislators, or constitutional processes on the other. Rubin, Curran, and Curran (2001) and Osborne (2002) propose similar models of interest groups deciding whether to use litigation or legislative lobbying as a method for rent seeking. Crew and Twight (1990) provide a comparative analysis of rent-seeking in the common law and legislative processes.

A related problem is that of forum shopping to advance rent-seeking goals. As noted in the discussion of the polycentric and competing legal systems of the middle ages, forum shopping can promote economic efficiency by enabling parties to contract for law that closely matches their expectations, encourages judges to compete for cases by being responsive to the parties needs, and discourages rent-seeking litigation by enabling those who otherwise would be forced to provide wealth transfers to avoid doing so by exit. This benevolent forum-shopping competition can arise where the parties agree *ex ante* to the body of law that will govern any disputes that arise under the contract encouraging the parties to agree to be governed by the law that minimizes the transaction costs of entering into and performing the contract. (Zywicki 2006). On the other hand, where court choice is unilateral, such as by allowing a plaintiff to file a case without the defendant's implicit or explicit agreement, this can give rise to malign forum shopping, as plaintiffs can involuntarily drag defendants into jurisdictions favorable to the plaintiff. In this situation, judges competing for cases will do so by aggressively promoting pro-

plaintiff law in order to attract cases to their jurisdiction. (Zywicki 2006; DiIanni (Forthcoming); Stringham & Zywicki 2010). Fon and Parisi (2003) provide a similar insight: since plaintiffs decide in which court to file, those with marginal cases will file cases with judges who favor rules that expand liability. This creates a problem of adverse selection, as judges who favor expanded liability will have more cases filed in their court, providing them with more cases on which to imprint their stamp on the law. As a result, those judges will also have greater long-run influence on the path of the law as well. Fon and Parisi observe that this theoretical model of strategic forum shopping is consistent with an observed trend in the law over time toward more expansive liability. In other situations whether the results of forum shopping will be benign or malign will be ambiguous as an *a priori* matter rendering the inquiry empirical in nature (Zywicki 2006).

## **V. The Common Law as a Rent-Seeking System**

Scholars have also explored the implications of public choice theory for evaluating the relative merits of the adversary process within common law systems and the inquisitorial process within civil law systems. Gordon Tullock argues that the adversarial feature of common law adjudication is fundamentally a rent-seeking, or rent-dissipating, system. (Tullock 1997; Tullock 2005). As applied to a civil lawsuit, for example, Tullock assumes that the parties are exclusively concerned with the distributional consequences determined by which party prevails. Tullock posits that the parties within adversarial systems can increase their likelihood of prevailing by investing additional financial resources, thus transforming the litigation process into something



akin to a rent-seeking game. Tullock likens the resulting litigation to an arms race in which each party has an incentive to expend increasing amounts with the risk that the overall process might dissipate the entire value of the dispute through lawyers' fees and other costs.

Tullock assumes that within each dispute one side's claim is consistent with revealing the truth to the factfinder, while the other side's expenditures primarily obstruct discovery of the truth. He further assumes that the most important normative criterion for comparing the adversarial and inquisitorial adjudicatory processes is the joint minimization of administrative and error costs (i.e., the highest level of accuracy at the lowest possible cost). Tullock contends that expenditures that obstruct the search for truth—or that would not arise but for the other side's tactical obfuscation of the truth—provide no social benefit. Within the inquisitorial system, the judges rather than the parties generally control the expenditure of resources in the quest for truth. Because inquisitorial judges internalize most of the costs of the litigation process, Tullock posits that they therefore lack incentives to expend resources in a manner that obstructs the quest for outcomes consistent with the truth. Tullock concludes that as compared with the adversarial systems, inquisitorial systems eliminate, or at least significantly reduce, incentives for rent dissipation. From a social perspective, Tullock maintains not only that the adversarial system is more expensive than the inquisitorial system, but also that the increased expense is unjustified given that as compared with the common law system the inquisitorial system produces more accurate judgments at lower cost.

Zywicki (2008) has evaluated Tullock's claim of the superiority of the inquisitorial system by noting that the efficacy of a legal system can be evaluated

according to two criteria: administrative costs and error costs. The most efficient dispute resolution system can be recognized as that which minimizes these joint costs. Zywicki notes that, in part for the reasons Tullock identifies, the administrative costs of dispute resolution in the adversary system is almost certainly higher than for the inquisitorial system. Thus, to the extent that the higher administrative costs of the adversary system can be justified, it must be on the basis that the error costs associated with the adversary system are sufficiently reduced so as to justify these higher administrative costs.

Surveying available experimental and empirical literature, Zywicki finds some scholarly agreement that the adversary system produces more accurate decisions than the inquisitorial system in cases where there relevant evidence that is difficult or expensive to locate. In more routine cases there is no noticeable difference in accuracy between the two systems. Finally, Tullock's argument rests in part on the assumption that judges in the inquisitorial system will act efficiently and diligently in pursuing the truth, an assumption that seems untenable in light of the absence of any obvious incentives for judges to engage in an energetic pursuit of the truth. Judges bear the full cost of additional work expended to increase the marginal accuracy of their decisions while externalizing much of the costs of errors on the parties and the public. Many adverse decisions are not appealed and among those that are, judges are rarely reversed on appeal. (Higgins & Rubin 1980). Moreover, there is an information asymmetry between trial court judges and appellate judges with respect to the facts of any given case. This may suggest substantial agency slack for judges which might permit them to engage in some degree of shirking. Parisi (2002) also compares the dynamics of rent-seeking and rent-dissipation in the adversarial and inquisitorial systems.

Zywicki (2003) argues that in addition to the ability of parties to exit inefficient jurisdictions there are various institutional elements of a legal system that can make the system more or less resistant to rent-seeking litigation. In particular, Zywicki notes the double-edged sword nature of a regime of strong *stare decisis* regarding judicial precedent in contrast to a regime of more flexible precedent, such as the view that prevailed in the formative centuries of the common law, where precedents do not become established at once, but rather only when a succession of several independent judges agree upon the proper resolution of the issue. Precedent in this view is treated as inherently persuasive rather than binding, with the degree of persuasiveness growing marginally with each affirmation of agreement. While strict *stare decisis* can theoretically increase the predictability of the law (although this is not clear as Zywicki (1996) and Leoni (1991) note) and reduce the administrative costs associated with relitigating issues until established as precedent, this comes at the cost of potentially encouraging greater rent-seeking litigation. Where one case establishes a binding precedent with just one favorable decision (as under *stare decisis*), this provides a target for interest groups to shoot at in seeking to establish a favorable precedent. By contrast, where precedent is established only after the independent agreement of several different judges, this opportunity and incentive to engage in rent-seeking litigation is less likely to be successful, more expensive to establish, and less valuable of a prize, thereby reducing both the incentives to engage in rent-seeking litigation and the value of the prize to be obtained. Zywicki argues that once rent-seeking costs are taken into account, the optimal level of adherence to precedent may be less than the strict rules of *stare decisis* but

instead may be some more moderate form of adherence to precedent similar to that in the earlier ages of the common law.

Oman (2009) argues that another feature of the common law that makes it more resistant to rent seeking than civil law is that it generally operates (with some exceptions) according to a conceptual framework that applies general abstract categories of doctrine to a wide range of specific subject matter disputes (such as the doctrines of consideration or negligence), rather than providing different rules and doctrines for specific subject areas (such as fundamentally distinct liability rules for cars versus trains or different standards of negligence for lawyers versus doctors). This requirement of generality and abstractness of principle, Oman argues, makes it more difficult for interest groups to manipulate the path of the law by carving out unique favorable rules for themselves, thereby insulating the common law from rent-seeking to some extent. (See also Zywicki (2003)). With legislation, or by implication civil law systems, discrete rules for particular categories of goods and services are more common, perhaps exposing those systems to greater rent-seeking pressures.

Luppi and Parisi (2009) offer a similar analysis of precedent and *stare decisis*, describing a tradeoff between the costs of judicial error and legal certainty. Like Zywicki (2003), they implicitly assume that a system of weaker precedent may be more likely to promote correct (or efficient) rules if a decision must be agreed to by several different judges deciding independently before maturing into a binding precedent as opposed to enabling a single decision to establish the law. In this sense, although they do not expressly develop the argument, both Zywicki and Luppi and Parisi may be implicitly invoking the logic of the Condorcet jury theorem by suggesting that the agreement of

multiple judges is more likely to generate a correct outcome than just one. Fon, Parisi, and DePoorter (2005) contrast the regime of *stare decisis* under the common law with the weaker form of precedent that prevails in the civil law system that resembles the older common law rule, such as the Louisiana doctrine of *jurisprudence constante* (“settled jurisprudence”) or the German concept of “permanent adjudication.” As noted by Fon and Parisi (2006)), under the doctrine of *jurisprudence constante* caselaw decisions are persuasive in nature and the force of judicial decisions derives from “a consolidated trend of decisions” on point, not a single decision. Luppi and Parisi (2010) also note that because one source of rent-seeking in Tullock’s model of the adversary system is the ability of parties to externalize some of their costs on their rivals, this problem can be mitigated by adopting the British “loser pays” that requires the losing party to pay the attorneys’ fees and expenses of the prevailing party, thereby forcing parties to internalize a greater share of the costs of meritless litigation.

One implication of Zywicki’s model is that strict adherence to *stare decisis* has the potential to increase the stability of both efficient and inefficient precedents, including those that result from rent-seeking litigation. Moreover, stronger *stare decisis* doctrine increases the societal costs of rent-producing precedents by making overruling more difficult, and thus simultaneously increases the value of the “prize” *ex ante* by increasing the precedent’s lifespan. Zywicki contends that to the extent that rent-seeking litigation dynamics approximate those in legislatures in favoring well-organized discrete groups, the result is may be to increase the production and maintenance of inefficient precedents relative to efficient precedents. Zywicki posits therefore that interest groups might prefer a more costly common law *ex ante* that produces more stable rules (and

hence longer payouts) ex post and that this is most likely to hold for those groups that are better suited than their competitors to engage in judicial rent-seeking.

Tullock also argues that the civil law system of lawmaking is superior to the common law system. This claim is susceptible to economic testing. If Tullock is correct that the civil law is a better and more efficient system of rule generation than the common law, then countries that have adopted the civil law system should be wealthier than those that have adopted the common law system. Based on this criterion, Tullock's expressed preference for the civil law is difficult to justify. Mahoney (2001), for example, finds that current countries with common law legal origins tend to have more economic freedom and tend to be wealthier. The underlying causal explanation for these observed relationships, whether freedom or legal origins matter most, remains open. Several possible mechanisms about the importance of legal origins have been postulated. First, is a "political" theory that points to a general preference for private ordering in the common law versus the civil law. Second, an "adaptability" theory that points to the flexibility of the common law system to respond to societal and economic changes more rapidly and sensibly than the civil law (Beck et al. 2002). Others have explained the relationship by pointing to differences in norms and social trust among countries, which may hold some correlation with the development of the common law system (Coffee 2001). Some authors argue that the rights of financial investors are stronger in common law countries, leading to greater levels of investment and economic growth (Levine 1998, Laporta et al. 1997, 1998).

On the other hand authors such as Rajan and Zingales (2003) and Mussachio (2008) point out that many of the correlations between legal origins and current economic

outcomes may be specious. For example, although in today's world well-developed financial markets happen to be in countries with common law origins, this was not always the case. Mussachio (2008, p.80) concludes, "there is too much variation over time in terms of bond market size, creditor protections, and court enforcement of bond contracts to assume that the adoption of a legal system can constrain future financial development." If one looks to the world's first two successful stock markets in 17<sup>th</sup> century Amsterdam (not in a common law country) and 18<sup>th</sup> century London (in a common law country), the fact that government did not enforce most contracts yet markets developed indicates that limited government intervention and successful self-policing were far more important than any positive legal action (Stringham, 2002; Stringham 2003). Such findings lend support for Zywicki's (2003) hypothesis that if one wants to understand the legal order in a country, one must look to more than just government courts.

## **VI. Austrian Critique and Theory of Efficiency in the Common Law**

Beginning with Hayek (1978) there has been an alternative model of efficiency in the common law deriving primarily from the Austrian economic theory. Austrian theories of the common law are grounded in significantly different assumptions and methodologies than those that drive the standard neoclassical model of efficiency in the common law. (Zywicki & Sanders 2008). In particular, those writing in the Austrian tradition stress the substantial knowledge problems that confront judges seeking to even determine, much less to implement, their preferred vision of an efficient common law rule. In this sense, judges seeking to promote the economic efficiency of the law are in a

similar position to a Soviet-style central planner seeking to allocate resources in an efficient manner. Austrians also emphasize the subjective nature of individual cost and choice and the challenges this provides for any judge seeking to ascertain the efficient rule in any scenario. Austrian economists also stress the dynamism and constantly-changing nature of the economy and society, thereby highlighting law's primacy in providing a stable rule-bound framework within which people can coordinate their individual plans. Austrian economists also recognize the radical uncertainty that confronts a judge seeking to improve the efficiency of the law by tweaking the details of any particular rule. This fails to appreciate the delicate intertwining of any particular rule with the myriad of other rules that comprise the legal system such that an adjustment to any particular rule may have profound implications for other rules within the legal system. For instance, a movement from contributory to comparative negligence may have implications not only for other elements of the tort system (such as liability rules or damages), but also contract law, procedure, and remedies. For Hayek, therefore, the relevant level of analysis and selection for evaluating the law is at the level of the legal *system* or collection of relevant rules rather than at the level of any particular rule studied in isolation. (Zywicki & Sanders 2008). Given this complexity, when confronted with an ambiguous case, Hayek argues that the task of the judge should be to try to determine the individual rule that provides the best fit or coherence with the existing overall rule structure, rather than seeking to determine the best rule in isolation, which could disrupt the smooth functioning of the overall rule structure and thereby undermine predictability and coordination.



Hayek (1978) argued that the classical common law was a spontaneous order system in which the doctrines and principles of the law were emergent properties of individual judges deciding individual cases. (Leoni (1991) argued that the classical Roman Law had similar spontaneous order properties). Hayek analogized the common law process to the spontaneous order of markets: just as the prices for various goods and services that emerge from the “market” are really the byproduct of millions of individual consumer decisions, he argues that the legal principles that emerged under the classical common law reflected the decentralized decisions of many litigants and judges acting independently over time. Thus, just as no single person sets the price of apples, no single person makes the body of law that comprises contract or tort law, or even the concepts that lie within them, such as consideration, negligence, or strict liability. This decentralized process of law-making has two key elements that support a general preference for the common law over centralized legislative rule-making or the quasi-legislative rulemaking of a Posnerian judge seeking to maximize social efficiency. First, it draws on the local and decentralized knowledge of many judges and litigants resolving many cases in concrete factual disputes that arise from particular conflicts, rather than a judge essentially articulating a rule for the economy. Second, because rules emerge from the interaction of many judges not just one there is no central decision-maker for interested parties to capture which reduces the opportunity and incentive for rent-seeking litigation. This combination of the benefits of decentralization and the use of local knowledge and insulation from rent-seeking litigation was reinforced by the common law’s traditional reliance on custom as a source of legal principles, which manifests these

characteristics in an even more robust manner than the traditional common law itself. (Zywicki 2003; Pritchard & Zywicki 1999; Parisi 1995).

Working within this tradition, O'Driscoll (1980), Rizzo (1980b), Aranson (1992), and Zywicki and Sanders (2008) focus on the challenges that a Posnerian judge would confront in seeking to even identify, much less to implement, economically efficient legal rules. To consciously determine the efficient legal rule or allocation of rights in any given case presents challenges very similar to that of a Soviet-style economic central planner, a feat that was shown to be impossible during the so-called Socialist calculation debate of the 1920s. Given the inherent limitations of the litigation process on the ability of judges to acquire and assess the information necessary to determine the efficiency properties of any particular rule, and limits on their ability to acquire feedback necessary to fine-tune their rules, judges will have even greater difficulty in engaging economic planning than a central planning board.. Hadfield (1992) makes a similar but more narrowly-focused argument, that even if judges sought to improve the operation of the law through conscious effort, they would be unable to do so coherently because the cases that come to trial are a small and non-random sample of all of the interactions in society and the economy that are governed by legal rules. In order to assess the full efficiency implications of any decision, however, judges must possess information about all of the non-litigant parties who are affected by the decision but are not before the court. It is far from obvious how judges could possibly obtain the necessary information to conduct this inquiry. Given this radical ignorance, judges cannot have any reasonable expectation that they will improve the efficiency of the law.

An important difference between Austrian and neoclassical theories of efficiency in the common law is that of the nature of law and legal rules. An ideal Posnerian judge presumably would seek to ascertain the efficient rules and allocation of rights at any given time, using an explicit or implicit cost-benefit analysis of the marginal impacts of alternative rules. As optimal rules governing behavior and use changed, judges presumably would be encouraged to reallocate rights and responsibilities to reflect this new reality. This model implicitly assumes that at any given time the rest of the world is in equilibrium, enabling judges to estimate with confidence the costs and benefits of different allocations of rights and to reallocate those rights when necessary. Legal rules operate within and fine-tune this system of equilibrium relationships.

In the Austrian theory, by contrast, the world is in a state of constant disequilibrium as billions of consumers around the world seek to constantly adjust to millions of constant and simultaneous interactions that disrupt relationships and produce conflict among individuals. (Zywicki & Sanders 2008). Equilibrium, Hayek (1981) argues, cannot describe the world in the abstract, but is rather a relationship that describes the ability of individuals to mesh their particular plans at any given time and to form expectations about how parties will perform in the future. In this view, the primary purpose of the law is not to try to impose rules that promote overall efficiency, but instead to provide a stable institutional framework that will enable individuals to plan and coordinate their affairs in a world of constant “flux.” (Rizzo 1980a; Rizzo 1987). Economic efficiency arises as a byproduct of enabling individuals to plan and coordinate their affairs, not by direct design. In this vision of the relationship between law and economics, there is a primacy on the legal system providing a set of clear, stable rules

that enable people to predict one another's behavior, rather than on judicial tinkering and fine-tuning fine points of law, which might not only be impossible (because of the knowledge problem of central planning) but undesirable and welfare-reducing if such tinkering makes it more difficult for parties to predict the law and conform their behavior to it. As Hayek (1978), Epstein (1980), and Zywicki (1998) observe, clear and stable rules creates boundaries for property rights and other legal obligations enable individuals to use their local knowledge and to adapt their behavior to the ever-changing world that surrounds them. Adding a constantly-changing legal system—even one animated by a search for more efficient rules—to this chaotic world could create uncertainty and undermine the ability of individuals to coordinate their plans in the face of constant need for adaptation. For example, once these larger concerns of clarity and stability are considered, strict liability might be more conducive to social coordination and wealth production than a more fine-tuned but complex rule such as negligence, or equitable remedies such as injunctions or specific performance might be more predictable and clear than damages.

A final challenge for a Posnerian judge is dealing with the presence of subjective value. Posner justifies wealth-maximization as a desirable normative value as being a proxy for ethical utilitarianism, and one that is arguably more workable in practice than utilitarianism. But wealth maximization is an imperfect proxy at best, and the divergence between the two yardsticks widens if subjective value is taken seriously. Some economists argue that the only reliable evidence of whether an exchange is efficient is the voluntary consent of the parties to the transaction, and the only conceptually permissible framework for assessing social efficiency is Pareto optimality in which all exchanges are

carried out. (Buchanan 1969; Buchanan 1981; Buchanan 1959; Buchanan 1987; Buchanan 1982).

The wealth maximization framework relies on Kaldor-Hicks efficiency which relies on hypothetical compensation rather than actual agreed-upon compensation as the yardstick for efficiency. If subjective value is important, however, then judges may have no idea how much people value outcomes, so this conceptual move from Pareto optimality to Kaldor-Hicks efficiency is not defensible. (Stringham & White 2004; Stringham 2001; Zywicki 1996). Indeed, attempting to measure net willingness to pay at most only makes sense with a given legal system and allocation of rights, and that if one changes a legal system one changes net willingness to pay associated with different outcomes. As Skitovsky (1951) and others (Rizzo 1980b) have pointed out, as one changes the distribution of property rights the economically “efficient” outcome can change leading to a non-commensurability of different regimes, even within the same system under two hypothetically different property right allocations. In addition, the assumption that one can assume away the relevance of wealth effects is untenable to the extent that wealth distributions change individual budget constraints (and hence the willingness to pay) and because of the diminishing marginal utility of wealth. (Rizzo 1980b).

Instead, in order to promote economic efficiency it arguably follows that the role of the judges and the law should be to establish a clear, predictable legal framework that encourages consensual exchanges with a minimum of judicial intervention beyond enforcing consensual contracts. (Aranson 1990). Acknowledging the presence of subjective value suggests that where possible the law should seek to promote voluntary

market-based exchanges, such as by the use of property rules versus liability rules in many situations or a broader use of injunctive remedies that promote subsequent bargaining rather than damages as remedies. DeAlessi and Staaf (1991) argue that not only does the presence of subjective cost makes determining Kaldor-Hicks efficiency infeasible with any degree of confidence but it also creates a conflict with Arrow's (1963) General Possibility Theorem by implicitly assuming that all actors in society share the same preference ordering as the litigants before the court or even the average litigant. Following Buchanan (1954) they argue instead that the virtue of the common law is not in its promotion of Kaldor-Hicks efficiency, but rather that it provides parties with a stable institutional framework of default rules and then parties to voluntarily contract around those rules, thereby respecting subjective cost by promoting unanimity and Arrovian values. With respect to non-consensual transactions such as torts, where consensual transactions are not always present, Zywicki (1996) suggests that the protection of subjective value might be furthered by reliance on juries applying their intuitions about the degree of subjective value present in any given case. Inherently, however, non-consensual interactions present challenges for any economic theory of law that seeks to take subjective cost seriously.

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