From Natural Law to Social Welfare: Theoretical Principles and Practical Applications

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ABSTRACT: Many common accounts of natural law understand it in opposition to modern social welfare theory. Contrary to that wisdom this Essay shows how many of the fixed landmarks of the common law, including its rules on individual autonomy and the definition and acquisition of private property, comport with the natural law tradition. The modern welfarist positions only emerge through key decisions in 19th century law, which then help explain the choice among three welfarist positions: Kaldor–Hicks, Pareto, and a more rigorous standard that requires pro rata gains among all parties. This Essay uses a transaction costs framework to explain the proper deployment of these three rules.

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I. INTRODUCTION

The 2014 Levitt Lecture covered the relationship between natural law and social welfare theory over a period that extends to close to 2000 years. In some sense, this subject presents the intellectual challenge of explaining how ideas that have gained currency only in the last 150 or so years relate to legal approaches that were developed well over a thousand years earlier, when, in total ignorance of modern economic tools, it was impossible conceptually just to ask the question of how the determination of legal rules systematically related to any understanding of overall social welfare.

In this Essay, I hope to trace out the complex interconnections in three stages. The first part examines the approach to the natural law within the Roman and early common law traditions. The second portion examines the classical synthesis of these issues from mid-17th century to the late 19th century. The last section then makes explicit the transition from natural law to social welfare theory from the late 19th century to the present. In so doing, I shall address three measures of social welfare, the Pareto principle, the Kaldor–Hicks principle, and a third standard, often left unappreciated, that prorates the gains from any positive sum venture among the relevant parties. A brief conclusion follows.

II. THE NATURAL LAW TRADITION

There was, even within the natural law tradition, the sense that legal rules were designed to deal with self-preservation (if you are a pessimist about the world) or human flourishing (if you take a more optimistic view of your subject matter). But as a determined student and teacher of Roman law from my first day at law school in Oxford in the fall of 1964, it became clear that the expression "ratio naturalis" or natural reason concealed more than it revealed. The term was invoked at key points in the articulation of the fundamental rules of the legal system. It was thought that slavery was contrary to the law of nature,[1] (even in the face of the brute reality of slavery), and that children born of freed slaves must also be free.[2] Natural reason allowed people to capture and use things that were unowned in the state of nature,[3] and to transfer their property to others by some form of delivery either formal or informal,[4] and to form partnerships.[5] Natural law allows us to keep buildings erected on our land by others,[6] to impose guardianships on children

1. J. INST. 1.2.2 (J.B. Moyle trans., 1911).
2. G. INST. 1.89 (Edward Poste trans., 1904).
3. *Id.* at 2.66.
4. *Id.* at 2.67.
5. *Id.* at 3.154.
6. *Id.* at 2.73.

who are not of full age,[7] and to use force in self-defense;[8] more ominously, it provides that property taken from the enemy becomes ours by natural law.[9] With the possible exception of the last, these are all noble objectives, and they retain their relevance today as the fundamental building blocks of any viable legal system. Indeed one of the dominant claims of the Roman lawyers was that their view of natural law rested on three pillars: the support of reason, the universal adoption across cultures, and the durability within given legal systems.

Initially I was somewhat skeptical of this claim, but as the years rolled by I became convinced that Gaius and Justinian were on to something that it is best not to forget today. It is worth noting that the legal rules generated by this modest methodology have proved to be incredibly stable over time. Indeed, many of the key notions of Roman law have been specifically incorporated into Anglo-American common law, so much so that it is often possible to show a precise linkage between the common law rules, say on bailment, and their Roman law predecessors, which move comfortably from one system to another.[10] That combination of durability and portability is a powerful sign of the soundness of the basic structure.

This vision of natural law was reduced by Justinian in a famous passage to three maxims: "to live honestly, to hurt no one, to give every one his due."[11] At one level these look like genuine banalities. But they are banalities only because in well-ordered societies they are commonly observed. They become, however, well-nigh indispensable guides in those cases of social disarray where these principles are not followed.

To take these three elements in sequence, people surely act dishonestly when they put their own welfare above those who are their charges, whether the duties are those that a guardian owes to a ward or that a fiduciary owes to his or her beneficiaries. Indeed, in many contexts the duty to act honestly requires both full disclosure and the avoidance of even an appearance of a conflict of interest.[12] In those conflict situations, any fiduciary, both for traditional trusts or modern corporations, has the burden of showing that the transaction is entirely fair to his or her beneficiaries.[13] The fiduciary only gets

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7. *Id.* at 1.189.

8. DIG. 9.2.4 (Gaius, Ad Edictum Provinciale 7) (Alan Watson trans., 1985).

9. *See* G. INST. 2.69.

10. For the bailment case, see Coggs v. Bernard, (1703) 92 Eng. Rep. 107. For the modern economic rationale, see Richard A. Epstein, *The Many Faces of Fault in Contract Law: Or How to Do Economics Right, Without Really Trying*, 107 MICH. L. REV. 1461, 1466–70 (2009).

11. J. INST. 1.1.3 (J.B. Moyle trans., 1911).

12. *See* Sinclair Oil Corp. v. Levien, 280 A.2d 717, 722 (Del. 1971) (discussing the inappropriateness of applying the business judgment rule where there is evident self-dealing).

13. As one court described it:

> Entire fairness has two aspects: fair dealing and fair price. The Court must consider "how the board of directors discharged all of its fiduciary duties with regard to each

the benefit of the business judgment rule when there is no conflict of interest between his professional responsibilities and personal gain. The key purpose of that rule is to protect the fiduciary when a deal has turned sour as deals often do. A regime in which the beneficiaries get all the upside of good deals and none of the downside of bad deals is not sustainable in the long run.

On the second point, those people who kill and maim are a threat to society and the self-preservation of its members. Those people who do not render what is due do not pay their debts in full and in a timely fashion, which can lead to the slow disintegration of a credit economy. It is in general easy to keep a system in a steady state when few, if any, people deviate from these towering norms, because they are held in check by an uncertain combination of social pressures and legal sanctions. But it becomes a major task, and an often hopeless task, to put the pieces back together again once large numbers of individuals violate these simple precepts.

In dealing with these issues, lawyers typically get involved only in those cases where someone has or appears to have deviated from these principles. The lawyer specializes in deciding what is true or false, and in figuring out remedies for wrongs, defenses against prima facie wrongs, and further exceptions to these defenses.[14] The added element of complexity brought by litigation is unavoidable once any of Justinian's three principles are violated—which explains why it is so critical that they be widely observed and socially supported. In making these statements, therefore, it should never be thought that natural law just tracks the way in which individuals behave in fact in a state of nature, which is associated with a virulent form of naturalism, of the sort that proclaims it is the nature of man to attack, to lie, and to cheat. Yet the legal theory of natural law from the very beginning took the opposite tack. These nasty human tendencies are well known. A system of natural law is intended to devise ways to curb, not celebrate these aberrant practices.

Now how did early lawyers arrive at the principles of natural law? I think that to their credit, they thought of natural law as an extension of the biological sciences that deal with human beings as well as other living things. Great biologists proceed by observation and then organize the phenomena of nature into discrete categories, which are then divided and re-divided in order to create a usable organizational frame, which in biological settings progresses through kingdom, phylum, class, order, family, genus and species. The

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> aspect of the non-bifurcated components of entire fairness . . . ." In determining the transaction's overall fairness, the Court will conduct a unified assessment that involves balancing the process and the price aspects of the disputed transaction.

Ryan v. Tad's Enters., Inc., 709 A.2d 682, 690 (Del. Ch. 1996) (alteration in original) (citation omitted).

14. For a discussion of this complex pleading system, see generally Richard A. Epstein, *Pleadings and Presumptions*, 40 U. CHI. L. REV. 556 (1973).

natural lawyers, following Aristotle,[15] used the same overall strategy, even if they did not dig eight-ply deep. The genius comes in getting the right initial divisions, which in this instance deals with three questions: the acquisition of property rights, and the development of actions *ex contractu*, by contract, and the development of actions *ex delicto*, by way of wrong. That contract/tort distinction remains a key part of the modern law of obligations.

In dealing with property rights, there is a peculiar disjunction in the law. The early texts spend an enormous amount of time explaining how it is that property is acquired, a topic to which I shall return. But they spend relatively little time on why the institution of private property makes sense in the first place. On that score, the Romans did draw very early on a distinction between those properties like water and air that should remain in common, and those other things that were classified as *res nullius* (things owned by no one) that any one could reduce unilaterally to his or her possession. There is much to be said about the wisdom of that distinction that I have addressed in other places,[16] but for these purposes it is useful to note the advantages of a private property system writ large with respect to land, animals, and chattels, which are amenable to that system. Much of the historical literature is silent about that question, but this passage from Thomas Aquinas provides an instructive first cut into the problem:

> Human beings have the power to manage and dispose of external things, and with regard to such managing and disposing, it is proper that a man should have things that are his private property. Indeed, this is necessary for human life for three reasons. First, surely, because everyone is more solicitous in caring for his own things than he is for caring for things that are common to all or to many, for everyone, shirking the work, leaves to another the care of what is common to all, as often happens in a household when there are many servants responsible for one task. Second, because human affairs are handled in a more orderly way if each thing is the proper care of some particular person, there being only confusion if the care of various things is imprecisely confided to the care of various people. Third, because peace is better preserved among men when each is content with what is his own. Whence we see that, among

15. *See generally* ARISTOTLE, NICOMACHEAN ETHICS (David Ross & Lesley Brown trans., Oxford Univ. Press 2009) (c. 384 B.C.E.). For a discussion on Aristotle's method, see J.L. Ackrill, *Introduction to Aristotle's* Ethics, *in* READINGS IN ETHICS 79, 80–82 (T.L. Moore & C.W. Hudlin eds., 1988).

16. *See, e.g.*, Richard A. Epstein, *On the Optimal Mix of Private and Common Property*, SOC. PHIL. & POL'Y, Summer 1994, at 17; Richard A. Epstein, *Property Rights in Spectrum, Water, and Minerals*, 86 COLO. L. REV. 389 (2015). For a general account, see generally Carol Rose, *The Comedy of the Commons: Custom, Commerce, and Inherently Public Property*, 53 U. CHI. L. REV. 711 (1986).

> those who hold something in common and undivided among them, quarrels frequently arise.[17]

To Aquinas, the stakes are indeed high, given that private property is "necessary for human life." But how good are his reasons? As to the first, shirking is a chronic problem in all cooperative activities. The question is to get a sense of its relative magnitude in different types of common ownership situations. In dealing with common ownership among individuals with no prior connections with each other, no bonds of affection and loyalty act as a counterweight to the forces of self-interest that lead to what is called today "the collective action problem."[18] The coordination and shirking problems are large, which is one reason why the Roman position limited common ownership to bodies of water and the air, where the regime was simply an open-access regime with two key features. First, no party who had access to the commons had any governance responsibilities over it, and second, there was no need to have rights of disposition since all persons in a state of nature were entitled to participate in the system. When it became clear that some management of the public waters was necessary, a public trust doctrine had to be developed which did assign to the state the responsibilities of management and control, which have been, to say the least, difficult to organize.[19] These common ownership problems are not cleanly solved in private arrangements. But what can be said with some confidence is that they are far easier to control with respect to concurrent interests in property created by voluntary agreement. First, the owners have the power to select each other, and they can also monitor their employees within, say, the household to guard against the risk of shirking, which means that they are better able to cope with both the management and disposition of property without the greater conflicts that inevitably arise from forced association. Even multiple common owners can (by private agreement, which often takes a partnership form) establish the parties who are entitled to conduct particular transactions with power to bind the other co-owners of the property.

Aquinas's second point is surely correct, but it, too, should not be overstated. The relative clarity of ownership avoids much of the confusion when property rights are indefinite.

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17. THOMAS AQUINAS, SUMMA THEOLOGICA pt. II–II, q. 66, art. 2 (Leonine ed. 1882) (Latin) (translation provided by Professor Robert T. Miller, University of Iowa College of Law).

18. *See generally* MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (2d ed. 1971).

19. *See generally* Ill. Cent. R.R. Co. v. Illinois, 146 U.S. 389 (1892). For my views, see generally Richard A. Epstein, *The Public Trust Doctrine*, 7 CATO J. 411 (1987); for an exhaustive discussion, see generally Joseph D. Kearney and Thomas W. Merrill, *The Origins of the American Public Trust Doctrine: What Really Happened in* Illinois Central, 71 U. CHI. L. REV. 799 (2004); for the expansionist impulse, see generally Joseph L. Sax, *The Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471 (1970).

The third point is perhaps a bit too optimistic. People ought to be "content" with what they own, but no system of private rights can eliminate the impulse to aggression based on envy, disrespect, status deprivation and the like. What can be said is that if property rights are well-defined, it is easier to control these impulses than in a situation where there is no boundary between persons that acts as an imperfect break of ambition.

So once again the issue is one of comparative imperfections, not categorical distinctions. The system of private property with respect to those objects that must be managed and traded works better than a system of common ownership, and better than a system of state-owned property, given the difficulty that governments have in making intelligent decisions about resource use.[20]

Private property then has its systematic institutional advantages. Creating private property interests in land, chattels, and animals is thus needed to set the system in motion, and for this task the classical writers uniformly relied on a rule of capture, which was justified again by the natural law.[21] I will postpone for the moment a discussion of this issue until I address John Locke's writing on the topic. For these purposes I would only note that the assignment of these property rights sets the stage for the role of both contract and tort. The former rules allow for voluntary transactions in labor and property, and the latter rules prevent any individual from skirting these basic rules by any combination of force and fraud. When there are violations of either of these norms, there are actions *ex contractu* or *ex delicto*. The Roman system thus tends to classify the *actions* for wrongful conduct rather than speak of the substantive *rights* that these actions vindicated. The Roman classification is, in retrospect, both simple and accurate, but historically it is worth noting that it took a very long time for the clarity of this contract/tort dichotomy to become clear in the English common law system, with its complex forms of action.[22]

Once the basic contract/tort line was drawn, it then became possible to divide each of these categories further, so that, for example, contractual obligations were divided into stricti iuris agreements for loans, the real contracts for loans of fungible goods (wine, salt) for consumption; in this last arrangement, repayment without interest was in kind. The consensual contracts dealt with bilateral arrangements replete with obligations to act in good faith.[23] Each category could then be further divided, so that the

20. *See generally* F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945) (written just at the end of the Second World War, with its disastrous socialist experiments in Nazi Germany and Soviet Russia).

21. *See* G. INST. 2.66 (Edward Poste trans., 1904); J. INST. 2.1.12 (J.B. Moyle trans., 1911).

22. For the evolution, see generally F.W. MAITLAND, THE FORMS OF ACTION AT COMMON LAW (A.H. Chaytor & W.J. Whittaker eds., Cambridge Univ. Press 1985) (1909).

23. For this classification, see BARRY NICHOLAS, AN INTRODUCTION TO ROMAN LAW 158–98 (1962). In stricti iuris contracts, all the obligations ran in one direction so that the strict enforcement was the norm. In the consensual contracts, the performance of each party was

consensual contracts, for example, were sale, hire, partnership, and agency. Once the categories were properly identified, it then became possible to attach the rights and duties to each of them. That task was done originally as a naturalist would do it. Lawyers would, as it were, stand outside the system and observe how ordinary people talked about their obligations to each other—which is still a sensible way of learning how moral and legal norms assert themselves in daily life in a kind of "descriptive sociology," a social cataloguing similar to that which a biologist makes of the behavior of living organisms. The advantage of this method is that it picks categories that are already in common use, which thus mesh with how ordinary people think of their own interactions.

It is worth noting that this method is still in use today by modern writers like C.S. Lewis, a noted Christian apologist, who in a few strokes manages to isolate the basic rules of property (first possession), contract (you promised), tort (he didn't harm you), and equality and reciprocity ("do unto others as you would have them do unto you") by observing the way people interact in arguments.[24] John Haidt, a modern psychologist, uses the same basic strategy—pay attention to gossip—to isolate the reciprocity principle, the harm principle, and the general disgust norm, which uses a methodology alien to Lewis, but with some instructive points of overlap.[25] In similar fashion, I have argued that the origins of most customs come from trial-and-error adaptations of particular practices that bind certain communities when their members find it just too expensive, inconvenient, or laborious to form individual contracts to deal with the rapid and near-random interactions of group members.[26]

One set of relevant examples comes out of the whaling industry, where some species of whales are too huge for a single ship to land. That simple fact means that the usual rule that allows someone to acquire ownership by

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dependent in whole or in part on the performance of the other side, so that good faith was required at each stage. For the modern application of these principles in relationship to bonds and employment contracts, see generally Richard A. Epstein, *The Upside Law of Property and Contract: Of Fannie Mae, Freddie Mac, and the City of San Jose*, 93 U. NEB. L. REV. (forthcoming 2015).

24. *See* C.S. LEWIS, CASE FOR CHRISTIANITY 3 (The MacMillan Co. 1946) (1943) ("Every one has heard people quarreling. Sometimes it sounds funny and sometimes it sounds merely unpleasant; but however it sounds, I believe we can learn something very important from listening to the kinds of things they say. They say things like this: 'That's my seat, I was there first'—'Leave him alone, he isn't doing you any harm'—'Why should you shove in first?'—'Give me a bit of your orange, I gave you a bit of mine'—'How'd you like it if anyone did the same to you?'—'Come on, you promised.'"). Note that these ethical propositions are not distinctly Christian, which in a strange way shows their universal power.

25. *See* Jonathan Haidt, *The Emotional Dog and Its Rational Tail: A Social Intuitionist Approach to Moral Judgment*, 108 PSYCHOL. REV. 814, 817–19 (2001).

26. Richard A. Epstein, *The Path to* The T.J. Hooper*: The Theory and History of Custom in the Law of Tort*, 21 J. LEGAL STUD. 1, 12 (1992).

capture, which received its most famous articulation in *Pierson v. Post*,[27] could not work in a case where combined efforts of two or more actors are necessary to reduce a whale to possession. The actual dynamics with the whale can be quite complicated, as is well illustrated by the famous case of *Ghen v. Rich*,[28] which presented a coordination problem that could not be solved by explicit agreements. The fin-back whale, when killed with bomb lances that were made expressly for this purpose, sank to the bottom of the ocean, only to surface again some one to three days later.[29] Many of these whales would then wash up on shore.[30] It is often not possible for the crew that shot the whale to recapture it from the shore, so a practice developed whereby the crew in question put distinctive markings on its bomb lances to give notice to any finder of its claim.[31] The party who found the whale could then claim a finder's fee in excess of its costs, but could not claim the whale as its own.

The key point here is that this custom did not arise by voluntary agreements among individual whalers and finders. Instead, the custom evolved in response to recurrent situations, and it survived because it left both participants better off than before. If the finder could claim the whale, the entire process would collapse. Similarly, the process would collapse if the finder received nothing. Judge Nelson in *Ghen* held as he did so that all parties had an incentive to participate in the overall whaling enterprise. It is worth noting that this custom, in sharp contrast to the general capture rule announced in *Pierson*, is whale-specific. In other settings, with different whales that have different characteristics, the custom that emerges could be quite different, which indeed was the case. Thus Oliver Wendell Holmes in *The Common Law*, written in the same year as *Ghen* was decided, stated the decidedly different customs for different types of whales.[32] Yet he offered no

27. Pierson v. Post, 3 Cai. 175 (N.Y. Sup. Ct. 1805). The opinion contains ample references to Roman and classical writers—Justinian, Fleta, Puffendorf, Bynkershoek, Locke, Barbeyrac, and Blackstone. *See id.* at 177.

28. Ghen v. Rich, 8 F. 159 (D. Mass. 1881).

29. *Id.* at 159.

30. *Id.* at 160.

31. *Id.*

32. OLIVER WENDELL HOLMES, THE COMMON LAW 191–92 (Harvard Univ. Press 2009) (1881) ("In the Greenland whale-fishery, by the English custom, if the first striker lost his hold on the fish, and it was then killed by another, the first had no claim; but he had the whole if he kept fast to the whale until it was struck by the other, although it then broke from the first harpoon. By the custom in the Gallipagos, on the other hand, the first striker had half the whale, although control of the line was lost. Each of these customs has been sustained and acted on by the English courts, and Judge Lowell has decided in accordance with still a third, which gives the whale to the vessel whose iron first remains in it, provided claim be made before cutting in. The ground as put by Lord Mansfield is simply that, were it not for such customs, there must be a sort of warfare perpetually subsisting between the adventurers. If courts adopt different rules on similar facts, according to the point at which men will fight in the several cases, it tends, so far as it goes, to shake an *a priori* theory of the matter." (footnotes omitted)). For the decision by Judge Lowell, see Swift v. Gifford, 23 Fed. Cas. 558 (1872).

explanation for the divergence of custom, save the general remark that customs help avoid conflict, without indicating why any given custom is preferable to another. The willingness to offer a functional explanation for individual custom dates back to the pioneering work of Robert Ellickson, whose reference to "wealth-maximizing norms" illustrates a powerful shift to consequentialist explanations.[33]

It is important to note the startling and instructive contrast between the two methods. The modern approach seeks to explain the custom to show the connection between efficient norms and ancient behavior. The ancient tradition sought to document the custom and treat its longevity as evidence of its desirability. In so doing, the Romans chose these humble methods of observation not only out of respect to customary practices but also in order to develop and elaborate their categories of the law of persons, of the rules that govern the acquisition of property, its protection, and its transfer as part and parcel of every legal system. No group, tribe, or nation can thrive if individuals labor under personal insecurity, if property rights are indefinite or disregarded, if promises can be broken at will, if marriage is not used to nurture the young, and if the use of force represents an ordinary form of interaction between people. There are of course differences in details as to how these institutions are formalized and put into practice. For example, the formalities for the conveyance of land or the formation of contracts need not be the same across all cultures. Modern societies do not use the ancient mode of conveyance, the *mancipatio*, nor the Roman form of contract, the stipulation. Nor should they. But they must assuredly develop similar devices to memorialize land transactions and formalize key promises, often by way of deed and recordation, or written agreements. The variations that are observed in formalities are best understood as second-order questions on how best to implement normative structures that work powerfully across different systems.

III. THE CLASSICAL SYNTHESIS

The question then became how to develop an intellectual and institutional framework to deal with these challenges that arise in seeking to make good on Justinian's three basic maxims.[34] Skipping more than a few generations, the early efforts of Hobbes, Locke, and Hume moved smartly in that direction. For Hobbes, the great emphasis is on the prevention of the serious downside of mass destruction. The social contract is a device that allows individuals to avoid the fate of lives that are "solitary, poor, nasty,

33. *See generally* Robert C. Ellickson, *A Hypothesis of Wealth-Maximizing Norms: Evidence from the Whaling Industry*, 5 J.L. ECON. & ORG. 83 (1989). For a more extensive development, see generally ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES (1991).

34. *See supra* text accompanying note 13.

brutish, and short."[35] The aim is to find some way to escape that fate which comes from the lack of cooperation among individuals to achieve an end that they all desire separately but which they cannot generate individually. At this point the inquiry starts to turn to on need for what is commonly called the "social contract" to take us out of the most inhospitable state of nature.

In order to give content to that notion it is critical to have some understanding of what a contract is about, which is what makes Hobbes's *Leviathan*, flawed as it is, an immortal work of genius. How does Hobbes begin? First, he postulates that all individuals have preferences and desires, or "appetites" as he calls them.[36] He treats these preferences as largely fixed and given, at least in the sense that nobody can argue with other people about the nature and depth of their preferences. I know what my preferences are; you know what yours are. Given that fixity, what an agreement does is use the instrument of contract to secure mutual subjective gains, whereby I only surrender those things for which my appetite is low in order to obtain those things for which my appetite is higher. Yet for me to procure your consent means that I have to offer you something that you value more than the property you are asked to surrender. The logic of exchange is joint gain measured by these subjective preferences. It is just this logic that gives rise to the modern terminology of a "win/win transaction" to encapsulate the sunny version of the MBA world-view.

One consequence of this logic is that the enforcement of contracts depends only on knowing the external manifestations of the content of the promises, not the value of the promised performances to each player, which is a private and not a social question. Enforce these deals, and encourage their proliferation, and there is a road that step-by-step leads to social improvement. Indeed this enforcement element is critical, for without it the only kind of agreements that work are those that call for (near) simultaneous performance, which means that the possibility of gains from trade over the temporal dimension are no longer possible. Legal enforcement solves what Hobbes understood as the "assurance" problem. No one will go first unless he is assured that the second party will keep his promise when the time comes. Reputation may succeed in some cases to achieve that result, but the added fillip of legal enforcement makes possible larger deals with longer time horizons. In effect, within the framework of stable social institutions, the law of contract allows for the emergence of cooperation among actors who are

35. THOMAS HOBBES, LEVIATHAN 89 (Richard Tuck ed., Cambridge Univ. Press 1991) (1651) ("In such condition [as the state of nature], there is no place for Industry; because the fruit thereof is uncertain: and consequently no Culture of the Earth; no Navigation, nor the use of the commodities that may be imported by Sea; no commodious Building; no Instruments of moving, and removing such things as require much force; no Knowledge of the face of the Earth; no account of Time; no Arts; no Letters; no Society; and which is worst of all, continual[] fear[], and danger of violent death; And the life of man, solitary, poor, nasty, brutish, and short.").

36. *See id.* at 38–39.

now protected from aggression by the basic norm against the use of force. The basic logic of contract is that once background stability is assured, all persons are free to contract with whom they like for their mutual advantage. That privilege is open to all, so that the general framework of the legal system leads to decentralized power. Each individual exchange relationship tends to produce greater opportunities for third persons, so that this underappreciated *positive externality* leads to generally positive social consequences. There are, of course, some exceptions to the basic rule, which chiefly involve contracts in restraint of trade, usually in the form of cartels or other monopolistic arrangements that can create systematic social losses that offset the general positive externalities. Some restriction on these situations fits into the overall picture that now has basic rules on individual autonomy, voluntary contract, property acquisition, and the control of force. The natural law system actually has rules that can work over the long-run.

The enforcement of the fundamental social arrangement calls for, in Hobbes's view, the concentration of power in the hands of a single ruler or a small group of leaders, which can create the very risk of abusive use of force that civil society was supposed to prevent. It is on this issue, rather than on the logic of contractual consent, that Locke takes issue with Hobbes. For Locke, in his *Two Treatises on Government*, the inquiry into political order was laced with heavy religious overtones. In the beginning of his Chapter V, Of Property, in the *Second Treatise*, Locke refers in the opening paragraph to both revelation and reason as sources of law, as he tries to develop a coherent system.[37] Locke accepts that the system of private property engenders higher levels of productivity in husbandry. But he devotes most of his energy to explaining how the system arose in the first place. He thus starts from the Biblical position that God gave the earth and all the living creatures on it to mankind in common[38] to undercut the claim that any one person could receive them in their entirety as monarch or despot. But the Lockean formulation then creates the serious question of how to establish any system of private property out of that most inconvenient commons, for which his proposal—just take what you need so long as you leave as much again and as good[39]—does not comport with the usual rules governing common ownership—rules that never allow one person to implement unilaterally any partition in disregard of the rights of others

To bolster his somewhat rickety conception, Locke has to offer another rationale for allowing individuals to take things from the commons without the consent of others. On this case he strikes pay-dirt by pointing to the hold-out problem that necessarily arises if one person has to obtain the consent of

37. JOHN LOCKE, TWO TREATISES OF GOVERNMENT 184 (Classics of Liberty Library 1992) (1698).

38. *Id.*

39. *Id.* at 185–86.

everyone else on earth to gain the right to eat anything.[40] This is why he allows a person to take things out of the common by "mixing" his or her labor with natural elements.[41]

In this regard, Locke's position is at sharp variance with both the common law and Roman-law rules that allow for the initial occupancy, possession, or capture to establish ownership, no matter how little labor it takes. Indeed, to the classical common or Roman law, the less work, the better. This older, first-possession rule works better because it allows one person, via possession, to distinguish himself from everyone else, just as Locke would want. At the same time, it avoids the need to insist on some minimum level of labor added and explains why ownership is conferred on the thing taken when much of its value is not created by labor at all.

Indeed, it is important to grasp the perverse nature of the labor theory of value if it takes the neo-Marxist form under which the greater the amount of labor that is invested, the stronger the entitlement to the item in question.[42] Yet that theory of economics is beside the point for this inquiry because the legal inquiry is to determine how anyone acquires property in an external thing, not how a thing, once reduced to ownership, is valued either in exchange or in use. Thus the point of an acquisition rule is to maximize the level of surplus that comes out of the things that are reduced to ownership in accordance with the applicable legal rule. If one additional dollar of value in property depends on the additional investment of one dollar in work, then the entire extra effort is a waste. The point here is to find a way to privatize that maximizes surplus, which is what the capture rule does by *minimizing* the amount of labor required for acquisition. Under that rule, we can be sure at the very least that no one will expend more money or effort to acquire a new asset than that asset is worth, so that we will observe under the capture rule efforts made only in those cases where they are worth making.

A second constraint is every bit as important, because no potential owner will spend more than is needed to meet the minimum requirements of occupancy. A Lockean labor rule that increases a set of entitlements as additional labor is expended has the perverse consequence of reducing the potential gains of private ownership. The slimmed-down capture rule acts as a filter whereby people do not invest unduly when the returns are too low, so that those things that are not worth very much may never be reduced to private ownership. Notice to the world and separation of one person from others are the key elements of the common law theory of acquisition—not the investment of labor as such.

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40. *Id.* at 186–87.

41. *Id.* at 185–86.

42. *See, e.g.*, KARL MARX, VALUE, PRICE AND PROFIT ch. IV (Eleanor Marx Averling ed., ElecBook London 1998) (1865).

Notwithstanding the famous line that property is created when a person mixes his labor with an external object, the instructive point is that when push comes to shove Locke really has no use for his own theory. His one example involves the conclusion that any one who "pick[ed] up" an acorn is entitled to eat it.[43] The rest of the sentence is itself a refutation of the labor theory of value that he announced earlier:

> I ask then, when did they begin to be his? When he digest? Or when he eat? Or when he boiled? Or when he brought them home? Or when he picked them up? And it is plain that if the gathering did not make them his, nothing else could. That *labour* put a distinction between them and the common.[44]

But that labor added only a tiny fraction to the value. The key point was to make first possession sufficient so that thereafter he had the right to take it home, which the capture theory does. But why was consent not needed from mankind? "If such a consent as that was necessary, man had starved, notwithstanding the plenty God had given him."[45]

Even before the term was invented, Locke senses what in modern terms is called a "transaction costs problem."[46] The first problem that the capture rule avoids is the need to get uniform consent from all individuals, which is an impossible task even if all people were of good will. Getting these people together and having them take the same view on the underlying problem is a hopeless endeavor. The situation only becomes more difficult if even some tiny fraction of that amorphous group decides for selfish reasons to hold out for a disproportionate share of the social pie. The combined force of these two alternatives dooms any such consensual solution, which is why in the end the rule has exerted such force in the historical evolution of property rights. To Locke, the ultimate judgment is easy: he thinks that it is better for each person to take from the commons than to starve, and he allows all others the same right, given their equal status in the state of nature. Put in modern terms, the private necessity faced by each person in a state of nature makes it better if everyone can take from the commons rather than if no one can.

At this critical juncture, it becomes clear that the notion of consent starts to morph into an implicit notion of utility, whereby those societies that allow land and other goods to be removed from the commons will indeed flourish, while those that refuse to allow that transformation of things to private ownership will, quite literally, see fruit wither on the vine. It is just that point that Locke stresses later on in Chapter V, in comparing the productivity of English farmland with the American Indian territories. From there it is only a short step away in Locke's framework to say that the utility of the rules is the

43. LOCKE, *supra* note 37, at 186.

44. *Id.* (emphasis added).

45. *Id.* at 197.

46. On the issue, see generally R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

evidence that they are in conformity with divine will, after which it is easy to kick away (for those who are so inclined) the theological scaffold and make utility the sole test of the soundness of human institutions. These rules require that there be some estimate of the tendencies of human nature, both with respect to the ends they achieve and the means used to achieve them.

On this point, Hume's observation in his *Treatise of Human Nature* starts from the assumption that "it is only from the selfishness and confined generosity of men, along with the scanty provision nature has made for his wants, that justice derives its origin."[47] The point here is that there is some variation in sentiment, but that self-interest nonetheless remains that great driver in thinking on how to divide the "scanty" goods that nature has provided. In answering the allocation question, Hume seeks to address these problems of scarcity by looking to the Roman-law categories on his thought: remember Scottish law was heavily Roman in its origins. Thus in his section "Of the Rules, Which Determine Property," Hume reestablishes the connection to earlier Roman law in his treatment of such issues as the definition and stability of possession under general rules and the modes of acquisition, be it by occupation, prescription, accession, or succession.[48]

The cycle is in one sense complete. There is no appeal to divine rights in Roman private law of property, which is therefore more congenial to modern thought than are various theological explanations. Indeed one reason why the work of Aquinas survives as well as it did is because his arguments do not contain any explicit theoretical base, but work as well in a world without divine origins, a point that was deeply troublesome to the scholastic writers who followed in his wake and for whom divine validation was a pressing issue. Consider in this context the writings of Francisco Suarez, for whom the matter revolved around this hypothesis: "Even if God does not issue the prohibition or commands which are part of natural law, it will still be wicked to lie, and to honour one's parents will still be a good and dutiful act."[49]

IV. THE TRANSITION FROM NATURAL LAW TO SOCIAL WELFARE

In dealing with the evolution of legal and political thinking, the newfound appeal to notions of utility forces thinkers to develop what utility means. It cannot be some disembodied entity that lurks above human society. It must to some extent reflect the condition of the individuals who are subject to governance under any given set of rules. But how then does one make the judgment about the success or happiness of these entities without relating it to the success or happiness of the individuals that compose them? Surely, it

47. DAVID HUME, A TREATISE OF HUMAN NATURE 322–30 (David Fate Norton & Mary J. Norton eds., Oxford Univ. Press 2000) (1740).

48. *See id.*

49. *See* FRANCISCO SUÁREZ, *De Legibus*, *in* SELECTIONS FROM THREE WORKS OF FRANCISCO SUÁREZ 187, 200 (Gwladys L. Williams et al. trans., Oxford Clarendon Press 1944) (internal quotation marks omitted).

cannot be said that rules that lead to massive death and destruction are worthy of any kind of defense on the ground that they advance some undefined transcendent value that benefits no discrete person at all. In essence, the challenge is to develop a system of what is sometimes called "methodological individualism," such that statements about the success of any aggregate entity can be derived from statements about the utility of the system of rules to all the individuals who comprise that entity. On this view, it becomes possible to find a way to link together the descriptive and the normative, so that we can find a way to show that those things which are desired are in fact desirable. Logically of course, there is the Humean gap between the "is" and the "ought," so that any proposition about the latter cannot be reduced to one about the former, because of the linguistic leap.[50] However, from this insight it hardly follows that propositions about virtue and vice are not capable of being true and false, even if they cannot be derived logically from such indubitably descriptive propositions as that John has blue eyes. In fact, normal moral discourse of the sort exemplified by C.S. Lewis rests not on the possibility that these judgments are possible after superhuman effort, but are made routinely and almost effortlessly every day. It is not that people are oblivious to the possibility of difficult cases. It is that they are keenly aware of the ubiquity of the easy ones.

The next question is how to establish the framework in which this occurs. In the simplest case, if A desires X and B desires not-X, how can it be possible to forge any connection between desired and desirable?[51] Since it is not by logic, Hume's *next* sentence after insisting on the "is/ought" distinction moves sharply in a different direction: "Thus the course of the argument leads us to conclude, that since vice and virtue are not discoverable merely by reason, or the comparison of ideas, it must be by means of some impression or sentiment they occasion, that we are able to mark the difference betwixt them."[52]

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50. On the point generally, see generally HILARY PUTNAM, THE COLLAPSE OF THE FACT/VALUE DICHOTOMY AND OTHER ESSAYS (2002); Michael Moore, *Moral Reality*, 1982 WIS. L. REV. 1061.

51. HUME, *supra* note 47, at 302 ("In every system of morality, which I have hitherto met with, I have always remark'd, that the author proceeds for some time in the ordinary way of reasoning, and establishes the being of a God, or makes observations concerning human affairs; when all of a sudden I am surpriz'd to find, that instead of the usual copulations of propositions, *is*, and *is not*, I meet with no proposition that is not connected with an *ought*, or an *ought not*. This change is imperceptible; but is, however, of the last consequence. For as this *ought*, or *ought not*, expresses some new relation or affirmation, 'tis necessary that it shou'd be observ'd and explain'd; and at the same time that a reason shou'd be given, for what seems altogether inconceivable, how this new relation can be a deduction from others, which are entirely different from it. But as authors do not commonly use this precaution, I shall presume to recommend it to the reader; and am perswaded [sic], that this small attention wou'd subvert all the vulgar systems of morality, and let us see, that the distinction of vice and virtue is not founded merely on the relations of objects, nor is perceiv'd by reason.").

52. *Id.* ("Moral distinctions deriv'd from a moral sense").

That statement is not a broad claim of cognitive skepticism. It is a request for a new approach to a hard problem. So now the question arises on how to spot the difference between them. On this matter, there is no logical contradiction between saying that anything which is desired by everyone is bad, and that which is desired by no one is, at the same time, good. But taking either of those positions would be odd in the extreme. Yet by the same token it would be odd to say that which is desirable to one person should trump if others are opposed, and conversely it is also dangerous to say that any position that is desired by all individuals should necessarily be imposed upon the one hold-out who does not approve. If two-party conflicts are difficult to resolve, n-party conflicts can never be any easier. The question therefore arises on how best to create some measure for social decisions that does not slight the preferences of any person nor give the preferences of any person undue weight.

Serious intellectual efforts to develop that system formally only took place toward the last half of the 19th century, and it only became systematized by about 1940 or so.[53] At this point, two general standards emerged that were intended to link together the preferences, or the utilities, of all persons who were involved in the same system, so as to show how best to draw some systematic linkage between what was desired and what was therefore desirable.

The first of these is the Pareto Principle, whereby any change in position for all persons is regarded as a social improvement only if each party is at least as well off after the change and at least one person is better off thereafter. Once all the gains have been exhausted, such that it is only possible to make one person better off by making some other person worse off, then the system is now Pareto optimal or Pareto efficient. The rival principle, somewhat more forgiving, is the Kaldor–Hicks principle, whereby a government or private initiative counts as a social improvement only if the gains to the winners are sufficiently large that compensation could be paid *hypothetically* to the losers and leave enough left over so that the party who paid would still have been better off than before.

As will become evident later, variations on these principles, bridge the is/ought gap by attending to the requisites of methodological individualism, by insisting that all statements about the overall welfare of the group be decomposed into statements about the welfare of the individuals who compose that group. It does so without requiring that there be a common metric that allows for interpersonal comparisons of utility. Indeed, it is both a strength and weakness of this system that it offers no clue as to the magnitude of the differences between different states of the world, because such is only

53. *See generally* J.R. Hicks, *The Foundations of Welfare Economics*, 49 ECON. J. 696 (1939); Nicholas Kaldor, *Welfare Propositions of Economics and Inter-personal Comparisons of Utility*, 49 ECON. J. 549 (1939). For the standard definitions of Pareto and Kaldor–Hicks efficiency, see RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 17–20 (8th ed. 2011).

possible with cardinal comparisons that purport to quantify these gaps, a task that sometimes seems easy and in other crisis-like situations, totally daunting. It leaves that to the subjective realm and thus blocks any "utility monster" from dictating the source of the social outcome.

It is worth noting that under this position, which I hold, there is really no separate field of macroeconomics to the extent that this field rests on an assumption that there is analytically separate notion called "aggregate demand" which is different from the sum of the demands of all the individuals within the system. Similarly, there are no aggregate utilities for players within the system. There is only the need to build up large judgment about social states from smaller ones about individual welfare. In those cases where all individuals, acting independently, have identical preference functions, there is no obvious harm in treating their activities together, and thinking as if there are aggregates. But that position becomes dangerous when it is allowed to conceal differences in preferences and tastes among other individuals, which are then netted out without any justification of precisely parallel and independent interests.

At this point, it should be clear how these observations relate to the general tradition of social contract theory, which lies close to the surface in modern social welfare thinking. The first point to note is the terminological uneasiness of this most familiar expression, with its effort to conjoin the words "social" and "contract" into one undivided whole. The first of these terms points to collective, if not state, domination. The second speaks to individual consent and voluntary agreement. These two visions do not easily coalesce into one uniform vision. But in fact there is a way to make these twin conceptions coherent. The key proposition is that the object of any well-designed social rule is to get a group into the same position that it would achieve through voluntary arrangements, if the transaction costs were low enough to facilitate them.

In other words, the object here is to use state coercion to get the same win/win outcomes that private contracts would achieve whether we deal with two people or 2000 people, where the latter configuration offers by far the greater challenge because transaction costs increase exponentially when many people are involved and unanimous consent is required. To make matters worse, when the issue turns to the control over the threat and use of force, supermajorities in favor of nonaggression are of no real help, because you can be murdered only once, and that can be done by the lonely dissenter turned outcast or outlaw. It is therefore the one outlier who places everyone else at a risk for their own security. The good behavior of everyone else does not bring a dead person back to life. What is needed therefore is a comprehensive, mutual renunciation of force for each and every person, because the stability of social institutions is lost even if one person drops out of the system, after which some self-interested others will surely follow, such that the system of social order will quickly unravel. What the social contract

does is address that issue by coercing people to refrain from the use of force, such that, if you do it correctly, all individuals are better off than they would have been if no coercion had been imposed on any member of the group. In the customary construction, the "social" indicates coercion, and the "contract" indicates the mutual gain similar to that from voluntary cooperation. At this point, some notion of social welfare has to be imported, at least implicitly, to make this model work so that social contract theory rests on a firmer foundation than revelation or intuition, neither of which carries weight in today's secular and skeptical times. There is the apt use of a phrase by classical writers who were less than explicit about its analytical roots.

V. THE LEGAL TRANSFORMATION

As often happens in these matters, the de facto introduction of these measures of social welfare into the law came long before their formalization, in the search for a practical solution to routine litigation that was far removed from these grand theoretical issues. In this particular instance, the early messenger of the modern social welfare position is Baron George Bramwell (1808–1892), an extraordinary English judge, with no evident training in economic theory but with an exceptional theoretical bent.[54] The prosaic origin of his theoretical dispute arose in *Bamford v. Turnley*, where a group of plaintiffs brought suit against a defendant who emitted fumes to the entire neighborhood when he burnt bricks in his kiln in order to build his own home.[55] At the lower level, the trial judge came to the conclusion that the lawsuit must fail because the defendant had used the kiln in question for a reasonable end, namely building his house.[56] The implicit logic of this opinion was that the gains that the defendant internalized for himself were sufficient to justify the infliction of harm on a stranger, even without any precise calibration of their relative magnitudes. One benevolent way to read that statement is to assume that the decision rested on the view that the gains to the defendant exceeded the losses to the plaintiffs, so that the decision was Kaldor–Hicks efficient. But even that conclusion is incorrect unless the net gain exceeds the net loss, which is not strictly required by any formulation that marks as reasonable any decision that produces substantial gains to the defendant, without any precise measurement of the losses to the plaintiff. Indeed, Bramwell's conclusion was that for large nuisances, the harm was actionable no matter what the size of the gain that it produced for the

54. For an account of his life, see *George Bramwell, 1st Baron Bramwell*, WIKIPEDIA, http://www.en.wikipedia.org/wiki/George_Bramwell,_1st_Baron_Bramwell (last visited Mar. 4, 2015). I have written twice on his general role. *See generally* Richard A. Epstein, *Introduction: Baron Bramwell at the End of the Twentieth Century*, 38 AM. J. LEGAL HIST. 241 (1994); Richard A. Epstein, *For a Bramwell Revival*, 38 AM. J. LEGAL HIST. 246 (1994).

55. Bamford v. Turnley, (1860) 3 B. & S. 62, 62–63.

56. *Id.* at 65.

offending parties. Of special interest is the explicitly social nature of his calculation, where the key passage runs as follows:

> The instances put during the argument, of burning weeds, emptying cesspools, making noises during repairs, and other instances which be nuisances if done wantonly or maliciously, nevertheless may be lawfully done. It cannot be said that such acts are not nuisances, because, by the hypothesis they are; and it cannot be doubted that, if a person maliciously and without cause made close to a dwelling-house the same offensive smells as may be made in emptying a cesspool, an action would lie. Nor can these cases be got rid of as extreme cases, because such cases properly test a principle. Nor can it be said that the jury settle such questions by finding there is no nuisance, though there is. . . .
>
> There must be, then, some principle on which such cases are excepted. It seems to me that that principle may be deduced from the character of these cases, and is this, viz., that those acts necessary for the common and ordinary use and occupation of land and houses may be done, if conveniently done, without submitting those who do them to an action.. . .There is an obvious necessity for such a principle as I have mentioned. It is as much for the advantage of one owner as of another for the very nuisance the one complains of, as the result of the ordinary use of his neighbour's land, he himself will create in the ordinary use of his own, and the reciprocal nuisances are of a comparatively trifling character. The convenience of such a rule may be indicated by calling it a rule of give and take, live and let live. . . .
>
> The public consists of all the individuals of it, and a thing is only for the public benefit when it is productive of good to those individuals on the balance of loss and gain to all. So that if all the loss and all the gain were borne and received by one individual, he on the whole would be the gainer. But whenever this is the case,—whenever a thing is for the public benefit, properly understood,—the loss to the individuals of the public who lose will bear compensation out of the gains of those who gain. It is for the public benefit there should be railways, but it would not be unless the gain of having the railway was sufficient to compensate the loss occasioned by the use of the land required for its site; and accordingly no one thinks it would be right to take an individual's land without compensation to make a railway.[57]

Bramwell's endorsement of a general social welfare scheme was thus made clear in the sentence: "The public consists of all the individuals of it,

57. Bamford v. Turnley, (1860) 3 B. & S. 66, 83–84.

and a thing is only for the public benefit when it is productive of good to those individuals on the balance of loss and gain to all."[58] It is not instantly clear, however, whether this proposition is meant to adopt either the Kaldor–Hicks or Pareto version of improvement. But the inclination toward the Pareto standard is confirmed by his conviction that a just compensation requirement should attach to taking land for a railway, which becomes more evident when Bramwell returned to these themes 20 years later in *Powell v. Fall*:

> It is just and reasonable that if a person uses a dangerous machine, he should pay for the damage which it occasions. If the reward which he gains for the use of the machine will not pay for the damage, it is mischievous to the public, and ought to be suppressed, for the loss ought not to be borne by the community or the injured person. If the use of the machine is profitable, the owner ought to pay compensation for the damage.[59]

Bramwell displays major impatience with the uneasy asymmetry that arises when one side gets the gain and the other suffers the loss. His examples moreover hint that one collateral use of the damage remedy is to isolate those activities that should go on from those that should not. Having the defendant pay the damages and continue with its operations is another way of saying that there is a Pareto improvement whereby one side is better off and the other side is not worse off. But if he cannot afford to pay the damages then there is not even a Kaldor–Hicks improvement because the business cannot make a profit and still pay the losses. Having the enterprise fail is the right answer in those cases, at least on the assumption that the activities in question are accurately priced, which is essential in this case.

This same notion works itself into American constitutional law, most notably by the decision of Justice Mahlon Pitney in *Coppage v. Kansas*, where he explicitly supported the view that freedom of contract allows for mutual improvement between parties, even if, as is often the case, it increases the gaps in wealth between them:

> Indeed a little reflection will show that wherever the right of private property and the right of free contract co-exist, each party when contracting is inevitably more or less influenced by the question whether he has much property, or little, or none; for the contract is made to the very end that each may gain something that he needs or desires more urgently than that which he proposes to give in exchange. And, since it is self-evident that, unless all things are held in common, some persons must have more property than others, it is from the nature of things impossible to uphold freedom of contract and the right of private property without at the same time

58. *Id.* at 84–85.

59. Powell v. Fall, [1880] 5 Q.B. 597 at 601 (Eng.).

> recognizing as legitimate those inequalities of fortune that are the necessary result of the exercise of those rights.[60]

At this point, it is simple enough to conclude that one term in a private agreement could require the worker, as a condition of employment, not to join a union while in his employment. To this argument comes the response that the interests of the union cannot be ignored. The answer to that point comes from the simple observation that the key objective of the union is to cartelize the labor market in a given industry, which under standard economic theory, all too easily overlooked in political discourse, produces systematic social losses. This is why I have long defended the right of an employer to insist on the "yellow dog" contract, whereby a worker agrees with his employer not to join the union so long as he remains an employee because I believe these devices are critical to maintain a competitive market in labor relations.[61]

That one contractual device thus helps to preserve a competitive equilibrium in labor markets, and led to the conclusion that Pitney defended some two years later in *Hitchman Coal v. Mitchell*: that a union could be sued for inducement of breach of contract if it asked workers, with an eye toward their becoming union members, to remain on the job until it called them out in unison.[62] The single injunction against the union is a far more efficient remedy than a set of damage actions against individual employees. Pitney was right to fear that mandatory collective bargaining could disrupt the efficient operation of competitive markets in order to create a measure of equality between the two sides. Even if that goal works out ideally, it necessarily involves transfer payments from one side to the other that, being costly to implement, shrink the total size of the pie. Even if some movement toward equality can be achieved, there is no reason to believe the process will yield the equal distribution that is both desired and expected, without productivity losses. Third persons' opportunities are diminished when unions gain the exclusive right to bargain, and a full range of customers and suppliers have to endure major uncertainty in the event of a strike or lockout in the event of bargaining breakdown, which the bilateral monopoly arrangements make far more likely. Given these losses, it is not possible to imagine that any institutionalized collective bargaining arrangement meets *either* the Pareto *or* the Kaldor–Hicks standard. The greatest system-wide protection for all persons comes from a regime that moves toward a competitive equilibrium. The only thing we can say about statutes of this sort is that they spend public resources to move economic activity into the wrong position by imposing artificial barriers to gainful exchange. I have attacked the conception of the

60. Coppage v. Kansas, 236 U.S. 1, 17 (1915).

61. Richard A. Epstein, *A Common Law for Labor Relations: A Critique of the New Deal Labor Legislation*, 92 YALE L.J. 1357, 1370–75 (1983).

62. Hitchman Coal & Coke Co. v. Mitchell, 245 U.S. 229, 260–61 (1917).

modern labor law more than once.[63] There is no need to go through the painful details yet again.

In this regard, however, it is instructive to compare Pitney's accurate account of the situation with Oliver Wendell Holmes's view that explicitly rejects the proposition that voluntary transactions do not produce mutual gains:

> I think the judgment should be affirmed. In present conditions a workman not unnaturally may believe that only by belonging to a union can he secure a contract that shall be fair to him. If that belief, whether right or wrong, may be held by a reasonable man, it seems to me that it may be enforced by law in order to establish the equality of position between the parties in which liberty of contract begins. Whether in the long run it is wise for the workingmen to enact legislation of this sort is not my concern, but I am strongly of opinion that there is nothing in the Constitution of the United States to prevent it, and that *Adair v. United States*, 208 U.S. 161 [1908] and *Lochner v. New York,* 198 U.S. 45 [1905] should be overruled.[64]

It is important to note the slips in logic of this opinion. First, Holmes claims that a workman "may not unnaturally believe" that he needs a union to secure a contract. But there is no explanation as to what happens to the workman who does not take that view but thinks that union solidarity stands as an obstacle to his individual advancement. Nor does Holmes ever explain why those beliefs should govern the situation, when it represents only the wishes of one side, not that of the other. There is an effort to privilege the desires of one side over the other, and to do so with an appeal to a notion of fairness that presupposes there is something about either the process of collective bargaining or its stated ends that somehow make collective bargaining fair. Whatever that something may be, it cannot be cast in the language of mutual gains. Nor is there any reason to think that "an equality of position between the parties" is a presupposition for either freedom of association or contract, or, as the National Labor Relations Act would have it, that "full" freedom of association or "actual" freedom of contract, where it is unclear what work the words "full" or "actual" do.[65] The theory of mutual gain

63. *See generally* Epstein, *supra* note 61; Richard A. Epstein, *Common Law, Labor Law, and Reality: A Rejoinder to Professors Getman and Kohler*, 92 YALE L.J. 1435 (1983); Richard A. Epstein, *Labor Unions: Saviors or Scourges?*, 41 CAP. U. L. REV. 1 (2013).

64. *Coppage*, 236 U.S. at 26–27 (Holmes, J., dissenting) (citations omitted).

65. *See* National Labor Relations Act § 1, 29 U.S.C. § 151 (2012) ("The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the corporate or other forms of ownership association substantially burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners in industry and by preventing the stabilization of competitive wage rates and working conditions within and between industries.").

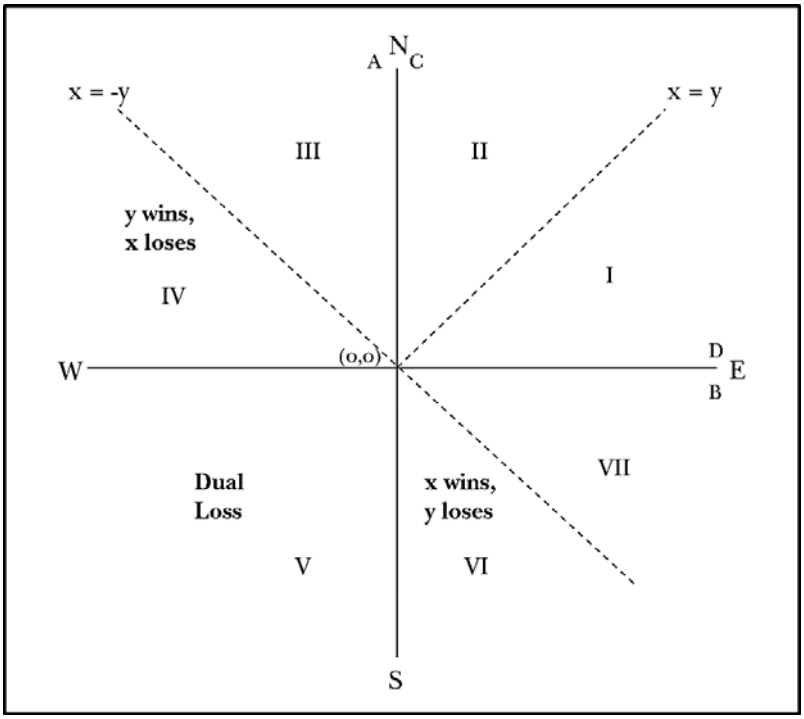
presupposes any existing distribution of wealth between the parties and lets them bargain to joint improvement. To insist that some minimum equality is needed diminishes the opportunities of those with lesser resources to find trades that work. And the position leaves open the question of why or how unionization creates that condition. It is very clear that this level of coercion blocks all sorts of Pareto improvements. It is equally clear, given the shrinkage of the pie, that it cannot create a Kaldor–Hicks improvement either. It should be no wonder that Holmes joined Justice Brandeis's dissent in *Hitchman Coal*.[66]

We are now in a position to see how these observations tie into general measures of social utility. For these purposes I shall confine the exposition to two-party arrangements, knowing that the results can be generalized to three or more parties. For ease of exposition assume that the initial position of both parties places them jointly at the origin (point <o,o>) of the real plane, with the x-axis representing the welfare of the first party, the y-axis the welfare of the second party (see Figure 1 below). From the initial position at the origin, the parties can move to other points, either as a result of their own actions or the requirements of law. The question is how to figure out which of these movements from the original position are legitimate and which are not. In dealing with this situation, I have identified on the accompanying graph four different areas. The first is demarcated by a line, x = -y that runs through the origin with a slope of minus one. A move to any point below this line is not a social improvement, whether measured by the stringent Pareto test or the more-forgiving Kaldor–Hicks standard. This is clearest for the points in the southwest quadrant where both parties are losers, but the same conclusion applies to the points in the lower left half of the Northwest and Southeast quadrants, where the gains to the winners are less than the losses to the losers. Moreover, this large section of the graph covers all those cases where government action seeks to disrupt the operation of competitive markets. That action necessarily shrinks the pie even if the administrative costs of the system are zero.

Descriptively, every claim made is wrong: corporate ownership does not matter. What matters is the number of alternatives available to workers, often from other corporations. The real burden of commerce comes from the disruptions of strikes fostered under the Act. Business depressions are not caused by market conditions but by a variety of government monetary and fiscal policies. Competition raises wages as productivity increases, which in turn helps purchasing power. Unionization reduces the purchasing power of nonmembers and in general shrinks the size of the social pie. Stabilization of wages need not be a good thing, and indeed can lead to rigidities that make it hard for market wages and other terms of employment to respond to changes in supply and demand.

66. *Hitchman Coal*, 245 U.S. at 263.

Figure 1.



At this point, it is clear that this two-party analysis is incomplete because it cannot explain why any two parties would choose voluntarily, or support legislation, to drive them into the southwest quadrant. The explanation for that outcome only comes with the introduction of a third person, who gains from their mutual losses, which in this instance is the labor movement supporting this legislation. In practice, therefore, we should tend to see virtually no legislative schemes with no winners, but many that are strongly Kaldor–Hicks inefficient.

One line of opposition to this point is that its implicit reference to competitive markets is something of an exaggeration because pure competition can never exist in any social setting, given its rigorous assumptions on such matters as the perfect divisibility of goods and full knowledge by all players. But here again it is critical not to make the perfect the enemy of the good and to adopt the same institutional awareness that should inform the earlier discussion on the formation of property rights generally. The competitive paradigm is routinely used in antitrust cases to deal with monopolies and cartels, and there is no economist or lawyer of any stripe who thinks that this body of enforcement should be suspended because conditions of perfect competition are unattainable in the real world. The question that is asked has this institutional dimension: given the various social

imperfections, are the gains from antitrust enforcement larger than the administrative and error costs needed to combat it?

With labor relations, that question is extraordinarily easy if the issue is whether they should receive, as they do today, an exemption from enforcement under the antitrust laws. They should not, and a similar critique about shrinking the social pie also applies to implementing systems like minimum wage and collective bargaining laws, where the administrative costs are very large, even as between the parties. To be sure, legislative efforts are never intended to create losses for both sides. But it is clear that the efforts of X to move eastward and Y to move northward will both be met with strategic responses. It is therefore highly likely that these initiatives will, when all is said and done, produce losses for both parties. The situation is, moreover, not made any easier when third parties are added into the mix. In the labor case, for example, the disruption of markets through strikes and lockouts moves any such initiative further to the southwest on the graph, as between the parties, even if in three dimensions a union may benefit, at least in the short run, from legislation whose stated purpose is the protection of workers.

The next area to look at in this two-party diagram are those two triangles in the northwest and the southeast that represent Kaldor–Hicks improvements insofar as the total gains exceed the total losses, all without compensation. The first thing to note about points in both these triangles is that the net social gain is the difference between the gains and the losses of the two players. There is a vast difference in social gains between changes in the northeast quadrant (zone I and II), where the result is always $\Delta x + \Delta y$. In either zone III (in the northwest quadrant) or zone VII (in the southeast quadrant), the gain is always the absolute value of the differences $|\Delta x - \Delta y|$ in the other cases. There is potentially a vast difference between situations in the northeast quadrant where both Δx and Δy are positive and the situations in the portion of the northwest quadrant above the $y = -x$ line and the portion of the southeast quadrant above the $y = -x$ line, where one of these is positive and the other negative. This difference is relatively small if one only compares point A with point C, or point D with point B. But this difference becomes ever more dramatic as A and C or B and D, move ever further from the y- or x-axis respectively. In the limit, the struggle becomes complete where points A and B are both on the line $x = -y$ and points C and D are on the line $x = y$.

From this observation several simple conclusions follow. First, the argument holds regardless of whether we think that one party is vastly richer than the other at point (o,o) because the investigation here is solely into the impact of changes on prior states of affairs. Second, the ideal level of investment in a Kaldor–Hicks improvement should normally be reduced as points A and B tend to move further from the y- or x-axis respectively. Third, as the gains to A go up and to B go down (or conversely) any Kaldor–Hicks improvement will also be far more costly to achieve than one might hope.

Speaking more generally, the usual argument about rent-seeking in a legislative context notes that the amount invested to bring about or oppose some change is a function of the size of the private gains and losses, and the probabilities of obtaining successes. As the stakes get higher in the opposite direction between the two groups, it follows that the factional conflicts from a Kaldor–Hicks improvement will increase as well. The combination of these two points means that more money is spent on changes that have less social value. Accordingly, as a general matter, the Kaldor–Hicks standard is far from ideal except in those cases where point A is located where Δx is strongly positive and Δy is weakly negative, as at point B, or conversely where Δy is strongly positive and Δx is weakly negative as at point A. Put otherwise, the differences between point A and point C (here represented as $2\Delta x$) are small enough to justify the change, and similarly, the same is true about points D and B.

All in all, this overall analysis suggests in constitutional terms that there are only limited cases where the requirement of just compensation should be eliminated in dealing with legislative changes, namely in those cases where the disparities between gains and losses are huge, such as at points A and B, while the cash payments needed to bring about just compensation are so large relative to $2\Delta x$ or $2\Delta y$ that it is just best to let matters stand because the introduction of compensation costs will generally produce net losses on the overall system.[67]

It is also the case that the political instability of the Kaldor–Hicks measure offers a clear explanation of why the Pareto standard should be preferred—at least so long as it is obtainable in practice. The requirement of just compensation reduces the shift in wealth between two parties, and it increases the prospects that the entire transaction will be a positive sum. The former reduces the gains from factional struggle and thus creates a strong inducement for people to sign on. To be sure, a just compensation system may in many cases require some valuation of the property lost through government action, be it occupation or regulation. Awarding compensation in takings cases offers an institutional stability that makes just compensation a central feature of both classical liberal theory[68] on the one hand and the

67. For a discussion of this and other permutations, see generally Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967).

68. The most famous articulation of this principle is found in William Blackstone's *Commentaries on the Laws of England*, where he notes the importance of the just compensation principle when the government takes land for a new road:

> In this and similar cases the legislature alone can, and indeed frequently does, interpose, and compel the individual to acquiesce. But how does it interpose and compel? Not by absolutely stripping the subject of his property in an arbitrary manner; but by giving him a full indemnification and equivalent for the injury thereby sustained. The public is now considered as an individual, treating with an individual for an exchange. All that the legislature does, is to oblige the owner to

Fifth Amendment to the Constitution on the other, where the formula is that the government may force the taking of the property for public use, but only upon payment of just compensation.[69]

The need for cash compensation is not true, however, in all cases, given that many comprehensive measures, such as statutes of limitation and the statute of frauds, for example, provide increased certainty that from the *ex ante* perspective is likely to benefit both sides. The former shortens the period for suit, and thus reduces the cost of litigation and error. From the *ex ante* perspective neither side knows whether it will be the future plaintiff or defendant, and thus both benefit from the new rule. Similarly, a statute of frauds also increases the security of transactions, which from the *ex ante* perspective operates to the mutual gain.

Yet even here, there are residual elements of instability. All Pareto improvements from the origin move in the northeast direction. But just as a movement hugging the y-axis from (0,0) to (0,10) is a Pareto improvement, so too is the movement from (0,0) to (10,0), which hugs the x-axis. In an effort to get rid of these extreme cases, it has been suggested that the appropriate normative test is one of "weak Pareto efficiency," which means that we reach the optimal position only in that case "which there are no possible alternative allocations whose realization would cause every individual to gain."[70] That "weak Pareto" alternative rules out any movement along either the x- or the y-axis in the two-party game. What remains missing from that formulation is any explanation of why we should want to block improvements of that sort, especially if the weak test can be satisfied by giving nominal compensation to all the other players in the game.

Nonetheless, the invocation of the weak Pareto test highlights a weak point of the Pareto formula, which is that it gives no clear guidance as to which of the many possible movements within the northeast quadrant should be preferred or why. The answer to that question comes, I think, in two parts. First, in ordinary private transactions, it is usually best to let the parties strike whatever price they choose in order to achieve mutual gain. It is most unwise for the state to intervene to upset the terms of any concluded bargain on the grounds that it is appropriate to equalize the gains from voluntary trades. Second, the situation is quite different when the government uses coercion to change the balance between private individuals. In these circumstances, the competition between the two parties means that the player on the y-axis has every incentive to move to a point on a line whose slope is greater than one.

> alienate his possessions for a reasonable price; and even this is an exertion of power, which the legislature indulges with caution, and which nothing but the legislature can perform.

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69. U.S. CONST. amend. V.

70. *Pareto Efficiency*, WIKIPEDIA, http://en.wikipedia.org/wiki/Pareto_efficiency (last visited Mar. 4, 2015).

By the same token, the player along the x-axis has incentives to move to a point on a line whose slope is less than one. The competition over the division of the surplus is thus reduced, relative to what it would be under the Pareto standard, but it is positive nonetheless.

The question then arises whether it is possible to find some way to avoid that competition while still allowing for the movement in the northeast direction. In this regard, it makes sense to invoke the familiar pro rata standard, whereby costs are proportionate to gains. That one standard has immense versatility. It means that shareholders with equal investments are treated equally with respect to dividends. It means typically that in ordinary negotiations for joint ventures people just split the costs of the trip to make matters easy. This simple rule of thumb has the benefit of restricting all movement along the line where x = y, so that the only way in which the player on the x-axis can improve his position is to make sure that the position of the player on the y-axis is improved as well, and visa versa. The point here is not to imagine that in the shareholder case that each shareholder has the same utility for each dollar of dividend, which is virtually never the case. It is only to make sure that the dividends are equally paid—so that there is a rule of decision that rules out making detailed inquiries into subjective utility that consume the transactions cost that pro rata rules are intended to eliminate—by looking at observables and not worrying about internal states of mind.

The same constraint holds in many transactions. It is just this instinct that explains why in much of constitutional law a nondiscrimination rule has such power. That rule says, in effect, that the court is not sure which particular rule is best, but it does know enough to confine the players to the line x = y, at which point the players can find the point on that line that works for their mutual advantage. A rule that says, for example, that the party who wishes to impose a tax on another must bear the same tax himself will tend to induce a search for the optimal level of taxation. To be sure, there will always be efforts to find ways to impose uniform rules on two parties who are not in identical circumstances, so that care must be taken to avoid those hidden asymmetries in initial position. A rule, for example, that prohibits further building on two neighboring lots will have massively lopsided consequences if one owner has already built and the other has not. But it will in general have far less dramatic consequences if neither party has built at all.

Yet even with these unavoidable complexities, the effort to impose a pro rata rule will tend to limit wasteful political competition over the spoils of government action. The principle in question, moreover, has especially durable properties as the number of parties subject to the regulation increases from two. Thus a system which imposes a flat tax on all income in a given society is likely to reduce competition over economic rents than a system that allows the government to impose progressive taxation based on income on the one hand, or to impose special taxes on particular lines of activities, such as the notorious excise tax on medical devises that has created powerful

economic distortions under the Affordable Care Act. Again, it is never the case that the subjective benefits from a flat tax will come out equally. But the same can be said of any other form of taxation whose levels of complexity make it highly unlikely that they could produce any equality of subjective benefits across all players within the system.

VI. CONCLUSION

The point of this lecture is to develop the complex set of connections from the original formulations of natural law doctrine to their modern realizations, both in private and public law contexts. The great advantage of the modern approach is that it sets a firmer foundation under the traditional normative framework, which all too often appealed to intuitive notions of justice that are as easy to deny as to affirm. The same point applies today, where the new theories of justice often fly thick and fast. But once it is clear that all the rules of the legal system can be designed to achieve the single objective of generating Pareto improvements, with proportionate gains (as measured in dollars) whenever possible, then the whole legal system falls into place.

I have stressed here the normative framework of entitlements, but a similar analysis could also explain why the traditional formal protections of federalism and separation of power have consistently appealed to the defenders of the classical liberal position. The protection against the dangers of factions and self-interest is a full time job for which no single set of safeguards is sufficient. The correct constitutional strategy thinks in terms of redundant systems, some structural and some substantive, to keep the ship of state from running aground. It is, therefore, no accident that in the progressive run-up to the New Deal, the three major attacks on the original constitutional structure concentrated on using administrative agencies to undermine the restraints that derived from the standard doctrines of separated powers with checks and balances—eroding the doctrine of enumerated powers by the expansive readings of the taxation and commerce power and truncating the constitutional protection of property and contract rights. Those maneuvers are intended to increase the scope of government action by insisting that it is not for the government to limit the direction of moves from the origin, whether in a game of two players or a whole society. The social losses that come from this added measure of government freedom stand in stark contrast to the traditional efforts to draw tight connections between the theory of natural rights, the classical liberal philosophy of Locke and Hume, and the basic design of the American Constitution, many of whose key protections have been frittered away in recent years.