

Chapter 9

Justice and Efficiency

[The] tradeoff [. . .] between equality and efficiency [. . .] is, in my view, our biggest socioeconomic tradeoff, and it plagues us in dozens of dimensions of social policy. We can't have our cake of market efficiency and share it equally.¹

9.1 Introduction

Two different goals – such as justice and efficiency – can essentially stand in three possible relations to one another:

- (1) Goal harmony,
- (2) Goal neutrality,
- (3) Goal conflict.

Where the relation is one of goal harmony, the pursuit of one goal would be beneficial for the other goal, too. For example, pursuing the efficiency goal would simultaneously bring about a just outcome; or vice versa, having just institutions would encourage efficiency at the same time. In a situation of goal neutrality, the pursuit of one goal has no effect on the achievement of the other.² The majority of economists would tend to assume that the relation between efficiency and justice is one of goal conflict. Here the assumption is that justice and efficiency are substitutable, up to a certain point. This relationship of interchangeability is known as a trade-off. To quote Brian Barry:

The fundamental idea [. . .] is that although two principles need not to be reducible to a single one, they may normally be expected to be to some extent substitutable for one another.³

Julian Le Grand distinguishes two types of trade-off: a trade-off on the values level – Barry's understanding of the term – and a trade-off on the production level.⁴ The values trade-off expresses how much justice a person or a society is *prepared*

¹ Okun, p. 2. Okun uses the term 'equality' which is geared towards distributive justice. Other authors more commonly use the term 'equity', and less frequently 'fairness' or 'justice'.

² Lukes, pp. 36 f.

³ Barry, p. 6.

⁴ Le Grand, p. 555.

to *sacrifice* in order to achieve more efficiency (or vice versa). With a production trade-off, on the other hand, the question is: how much justice *must be sacrificed* in order to achieve a certain level of efficiency (or vice versa)?⁵ And whereas the values trade-off is dependent upon individual values, the production trade-off is determined by empirical facts.

9.2 Justice

9.2.1 Types of Justice

A classic distinction between types of justice goes back to the fifth book of Aristotle's *Nicomachean Ethics*. Aristotle begins by assuming a universal justice which is the most perfect virtue and contains all the other virtues within it. Thereafter he distinguishes two particular types of justice: distributive and commutative justice:

(A) one kind is that which is manifested in distributions of honour or money or the other things that fall to be divided among those who have a share in the constitution (for in these it is possible for one man to have a share either unequal or equal to that of another), and (B) one is that which plays a rectifying part in transactions between man and man. Of this there are two divisions; of transactions (1) some are voluntary and (2) others involuntary – voluntary such transactions as sale, purchase, loan for consumption, pledging, loan for use, depositing, letting (they are called voluntary because the origin of these transactions is voluntary), while of the involuntary (a) some are clandestine, such as theft, adultery, poisoning, procuring, enticement of slaves, assassination, false witness, and (b) others are violent, such as assault, imprisonment, murder, robbery with violence, mutilation, abuse, insult.⁶

Distributive justice is applied in the allocation of benefits by the state. On this principle, rights are distributed to the people in accordance with their honour, i.e. according to their social status and their merit to the community. Although allocations may be meted out unequally, it must be done according to the same standard.

The first application of commutative justice is in private transactions (in bilateral contracts). It requires the equalization of goods with other goods, without distinction of person. For example, in a contract of sale, the goods tendered should correspond in value to the consideration paid. In addition to voluntary transactions, it also applies to involuntary transactions (torts or crimes): the compensation should be proportionate to the loss and the punishment proportionate to the wrong. The first type of commutative justice is also known as *justice in exchange*, and the second can also be called *corrective justice*.⁷

⁵ Schefczyk and Priddat, p. 428.

⁶ Aristotle, *NE V 6, 1130b–1131a*.

⁷ Höffe, *Gerechtigkeit*, p. 23.

When discussion turns on a possible conflict between justice and efficiency, usually the type of justice in question is *distributive justice*, with specific reference to the just distribution of income. When economists talk about justice, this is usually the type of distributive justice they mean. For economic analysis of law, however, this perspective is too narrow. After all, the efficiency criterion is applied primarily to non-contractual liability law, contract law and criminal law. Thus it is no less interesting to examine how *commutative justice* and *corrective justice* relate to efficiency.

9.2.2 Distribution Criteria

While the principle of equality applies without limitation in the case of justice in exchange and corrective justice, under distributive justice inequality is possible as long as all distribution is governed by the same standard. Hagel follows Perelman in distinguishing the following six distribution criteria:

9.2.2.1 To All in Equal Measure

According to this criterion, all people must be treated in the same way, i.e. without regard to any special characteristic which may distinguish them from one another. Such aspects as age, gender, skin colour, wealth, social status etc. must be disregarded. In this sense, death is undoubtedly just: it comes to all people without regard to any privileges they may have.⁸

In relation to income distribution, this criterion is generally associated with *equality of outcome*: that is, for every member of society to receive the same income. However, this interpretation is not compelling, given that a case can also be made for a concept of *equality of opportunity*,⁹ meaning that while everybody may not necessarily receive the same income, they should at least all receive the same initial endowment with production factors.

9.2.2.2 To All According to Their Convictions

This criterion focuses on people's inner attitudes and values. Because we can only observe people's conduct, which may stem from worthy convictions, but we cannot observe convictions themselves, this is not an operational criterion. Nevertheless, from a theological perspective it can be a comfort to a morally decent person because it holds out the hope that, despite the many injustices of this life, there will be one final possibility of justice in the hereafter.¹⁰

⁸ Perelman, p. 16.

⁹ Hagel, p. 253.

¹⁰ Hagel, p. 257.

9.2.2.3 To All According to Their Rank

This is an aristocratic conception of justice which consists in treating people according to their social status. *Quod licet Jovi, non licet bovi*¹¹ as the Latin proverb says. In antiquity, native citizens and free men were accorded a privileged status compared to foreigners and slaves. In medieval times there were various classes, from the nobility and the clergy to the serfs who toiled on the land.¹² Other examples are the caste system in India – which still exerts a strong influence to this day, although officially abolished – and the former policy of apartheid in South Africa.

This aristocratic distribution principle is regularly extolled and vehemently defended by its beneficiaries. In reality, however, it is a strategy verging on the morally indefensible for upholding and defending privileges which, for their part, have mostly proceeded from dubious circumstances.

9.2.2.4 To All According to Their Legal Entitlement

This conception corresponds to the famed *suum cuique*¹³ of the Romans, whereby justice means rendering to all people what the law says is their rightful due. Thus, there is no more to being just than requiring the judge to follow the law.¹⁴ The drawback of this criterion is that it can only be applied at a secondary level, which is once the legal due has itself been normatively justified.¹⁵

9.2.2.5 To All According to Their Needs

Need-based distribution means that income is allocated in accordance with people's inner motivation to alleviate certain states of deprivation. But it is far from easy to determine what people's needs are. Clearly, dire need of the kind which stems from hunger or illness can be recognized directly. In contrast, needs which go beyond the provision of basic necessities are difficult to ascertain because they are not directly apparent. On the other hand, perhaps it is not even desirable to pander to people's every fancy, and the decision to meet only essential needs is a deliberate one. But the problem of defining a 'minimum subsistence income' illustrates how difficult it is to circumscribe which needs are essential.¹⁶

¹¹ What is permitted to Jupiter is not permitted to the ox.

¹² Perelman, pp. 18 f.

¹³ To every man his due.

¹⁴ Perelman, pp. 19 f.

¹⁵ Hagel, p. 258.

¹⁶ Perelman, pp. 35 ff.

9.2.2.6 To All According to Their Merit

If an action is directed towards achieving specific results, then it is appropriate to apply the principle of merit. An actor's endeavour is rewarded with corresponding remuneration or some other form of recognition. Classic examples of the application of this criterion are sporting or artistic contests, or the grading of school work.¹⁷

The principle of merit creates incentives for certain forms of work, although the rewards often depend on the circumstances. Work for which there is little or no demand or willingness to pay in the market will be poorly rewarded or even unrewarded, even if it is of high quality or great artistic value. So it was that the painter Vincent van Gogh spent his lifetime in abject poverty, even though the works of art he created are of inestimable value today.¹⁸

9.2.3 Static Versus Dynamic Concept of Distributive Justice

The classical distribution criteria just discussed are based on a *static* concept of distributive justice. Most contemporary theories of distributive justice are *dynamic*, however; that is to say, they advocate neither a specific just distribution nor an ideal distribution. They advocate institutional structures which enable individuals to do certain things or to realize life plans regardless of the exact result of the ultimate income distribution.

Rawls's understanding of distributive justice belongs firmly in this category. His approach is not primarily about defining a particular share of social resources. Endowments of material primary goods may indeed differ, as long as the difference principle is observed. Primary goods are necessary because they facilitate a certain freedom of choice, and hence the realization of individual life plans.¹⁹ If the appropriate just institutions are in place, distributive justice is satisfied even if the outcome is an unequal distribution of income:

[This] enables us to regard distributive justice as a case of *pure background procedural justice*: when everyone follows the publicly recognized rules of cooperation, the particular distribution that results is acceptable as just whatever that distribution turns out to be [. . .].²⁰

According to Rawls, static theories of distributive justice are based on a 'historical process view' whereas dynamic theories consist of a 'social process view'. His approach has the advantage of requiring only the establishment of '*background justice*', which marks out the framework for social cooperation without the constant need to make comparisons between the relative positions of individuals.²¹

¹⁷ Hagel, pp. 258 f.

¹⁸ HAGEL, p. 261.

¹⁹ See Sect. 7.3 above

²⁰ Rawls, *JF*, § 15.3, p. 54 (author's emphasis).

²¹ Rawls, *JF*, § 15.3, pp. 54 f.

With regard to the goal conflict between distributive justice and efficiency, to be discussed below, the *assumption* will be made that a more equitable distribution of income is fundamentally preferable to a less equitable distribution. The same thing will apply *a fortiori* to starting opportunities. The efficiency goal, in contrast, gives due recognition to the merit principle.

9.3 Efficiency

9.3.1 The Concept

When people talk about efficiency – during a political discussion, for instance – what they usually mean is productivity or the performance of the economy. This is reported in terms of domestic product or, for a comparative figure over time, the rate of economic growth.²² With this in mind, Polinsky’s definition of efficiency is straightforward enough to be understood by anyone:

[E]fficiency corresponds to the “size of the pie”, while equity has to do with how it is sliced.²³

But does this account of efficiency lend itself to a more technical interpretation of efficiency, i.e. as Pareto efficiency or Kaldor-Hicks efficiency? – Depending on whether or not it is acceptable for some people to lose out from an increase in efficiency, one efficiency criterion or the other will be applicable. Polinsky leaves this question open. Let us therefore look at the following example, quoted by von Weizsäcker in order to justify the benefits of rationalization measures:

Let us consider, for example, a rationalization project. Its negative impact is heavily concentrated on a small group of affected employees, who will perhaps lose their jobs, and competitors, who will fall behind the rationalizing competitor. The beneficial impacts of rationalization – apart from increased profits for the firm undertaking rationalization – are distributed among many people who profit from the lower price of the product. [...] Each individual may be negatively affected by one such project, but will be positively affected by all the others at the same time. Since every single rationalization project generates more benefit than harm, it can be expected that the individual citizen will typically derive more benefit than harm from rationalization on aggregate. This may be valid typically; but perhaps not in every individual case.²⁴

According to von Weizsäcker, rationalization programmes always give rise to winners and losers. Although on average everyone reaps the benefits in the long-term, such benefits cannot be guaranteed in any given instance. Hence it is evident that von Weizsäcker can only mean the Kaldor-Hicks type of efficiency, as one

²² Sometimes efficiency is confused with ‘effectiveness’. Effectiveness is the extent to which a defined goal is attained using specific means (also known as a ‘target-actual comparison’). Cf. von Arnim, p. 51.

²³ Polinsky, p. 7.

²⁴ von Weizsäcker, p. 130.

would almost always expect in the context of such discussions. This permits the following conclusion:

An increase in efficiency normally means an increase in economic output without regard for income distribution. If we now replace the somewhat vague concept of ‘economic output’ with Posner’s term ‘wealth’, then we arrive at Kaldor-Hicks efficiency in the technical sense. For ultimately, according to Posner, wealth maximization and Kaldor-Hicks efficiency mean the same thing.

9.3.2 *Is Efficiency a Goal At All?*

Before the relationship between justice and efficiency can be discussed, it is necessary to resolve the question of whether efficiency can be viewed as a goal at all. As we know, Posner abandoned his earlier position that wealth in itself, and hence efficiency, represented the goal of society. Efficiency is far rather an *instrument* for achieving other social goals. According to Dworkin, a trade-off between means and ends makes no sense – unless efficiency is thought of as a ‘false target’ for other goals:

It makes no sense to speak of trading off means against ends [...]. Someone who speaks this way must have in mind an entirely different point. He might mean, for example, that sometimes we achieve more of the desired end if we aim only at what is (in this sense) a means. That is the “false target” instrumental theory [...].²⁵

Likewise, Le Grand does not view efficiency as an actual goal in itself, but as a means of striving towards another possible goal, such as increasing social utility.²⁶ As we know, however, only an increase in Pareto efficiency – and not Kaldor-Hicks efficiency – will always bring about an increase in social utility. Therefore efficiency is only of limited use as a ‘false target’ for increasing social utility in the utilitarian sense.

9.4 Specific Goal Relations

9.4.1 *Justice In Exchange and Efficiency*

Let us imagine that in a society, goods were distributed more or less equally, but the members of that society only had certain tradeable goods at their disposal. Some people would have sugar, others tobacco. Soon these people would probably realize that they had different goods, and would start wanting to exchange certain goods. Then somebody might trade, say, two kilograms of sugar for a kilogram of tobacco. The trade would go ahead by voluntary consensus, the parties involved being fully

²⁵ Dworkin, ‘Wealth’, p. 204.

²⁶ Le Grand, 561 f.

informed about the alternative trades they could otherwise make. What would be the effect of this trade on the utility of the parties involved? Would they simply have exchanged goods of equal value, and now be as well off as they were before? Or would the transaction leave them better off?²⁷

According to Aristotle, the exchange of goods is a question of price justice. The just price (*iustum pretium*) should be determined in such a way that the payment and what is rendered in return are in equilibrium. If the traded goods are equal in value in this sense, then based on the Aristotelean view, nobody is better or worse off after the trade. Now economic theory questions the validity of this equality principle: the person who wants the tobacco does in fact value a kilogram of tobacco more highly than two kilograms of sugar. By the same token, two kilograms of sugar are worth more to the other person than one kilogram of tobacco. Consequently, those involved benefit from the trade and are better off than they were before. In other words they experience a utility gain. For if both parties to the trade were not to benefit, they would not have any incentive to trade.²⁸

The different valuations of goods are based on people's differing preferences. Some prefer apples, others prefer pears: *de gustibus non est disputandum*.²⁹ People will trade goods as long as both parties involved can benefit – or if at least one stands to benefit without making the other worse off. Thus society's utility increases for as long as somebody can be made better off without putting someone else in a worse position. This fits the definition of a Pareto-superior change. The lesson is that social utility can be increased through trade until efficient consumption has been achieved.³⁰

This line of argument does, however, presuppose the model of perfect competition.³¹ In reality, business firms try to stifle competition through monopolies or cartels – and there is sufficient incentive for them to do so.³² A state *cartel control authority* can intervene correctively here. This has the desired effect not only upon efficiency but also, as a rule, on distribution because consumers benefit from lower prices. A further possibility is to institute *direct price controls* – in the form of price monitoring, for instance – or *statutory price regulation*, examples of which can still be found in Swiss rent law and in some aspects of the regulation of agriculture. However, interventions in the price mechanism on the grounds of efficiency are not without their problems. It is true that a price control system – in a similar way to a cartel control authority – can tackle inflated monopoly prices, which encourages efficiency. But it becomes problematic when price control or any other form of state regulation is used to try to keep prices artificially above or below the competitive price. This was how price support in agriculture led to excessive production, for example.

²⁷ Cf. Fletcher, p. 156.

²⁸ Cf. Fletcher, p. 157.

²⁹ There is no disputing about taste.

³⁰ Cf. Fletcher, p. 157; see Sect. 3.2.1.2.

³¹ See Sect. 3.2.2.

³² See end of Sect. 5.4.3.

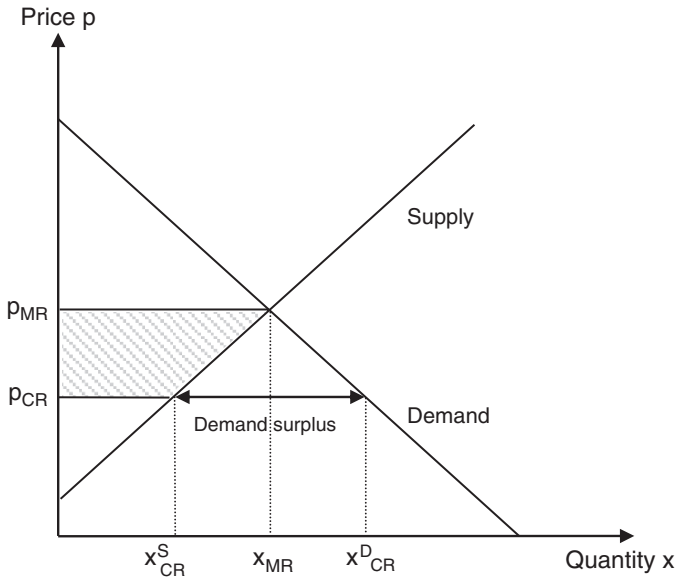


Fig. 9.1 Housing market with price-elastic supply

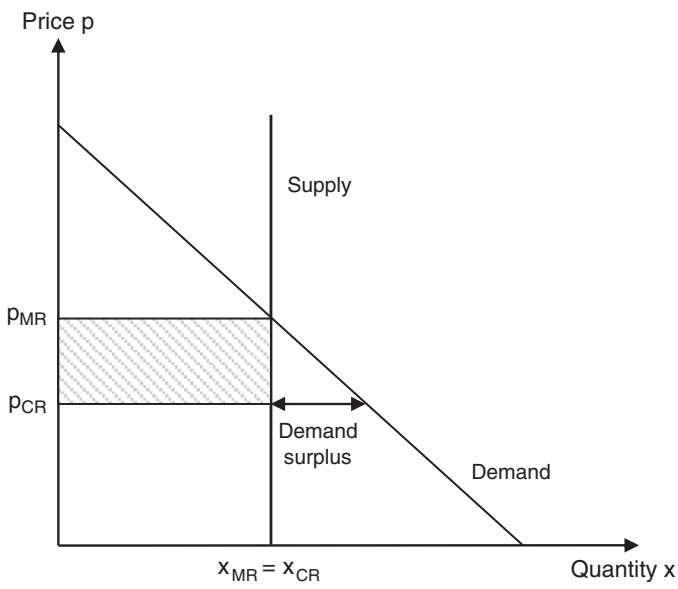


Fig. 9.2 Housing market with price-inelastic supply

The same problem can arise in private Fair Trade initiatives, such as the Max Havelaar Foundation, for example. Its approach, once again, attempts to impose prices which are higher than the market norm. If plunging prices in world markets are caused by oversupply, then any artificial price stabilization gets in the way of the necessary adjustment processes. Thus, in the long term, the effects are counterproductive. If, on the other hand, Fair Trade campaigns engage with this problem and foster sustainable development, they are entirely worthwhile.

Another example of price regulation is found in Swiss rent law, where cost-covering rent is given priority over market rent (i.e. a maximum price limit is set for rent). The extent to which this has a negative influence on efficiency depends mainly on the price-elasticity of the supply of housing, i.e. the responsiveness of the quantity of homes on offer to a change in rent.

Two contrasting cases will be analysed below. In the first case, the supply-side response is price-elastic, which is reflected here in a rising supply curve (Fig. 9.1). In the second case, the supply is completely price-inelastic, i.e. it remains constant, represented by the vertical supply curve (Fig. 9.2). In the case of a price-elastic supply curve, at the cost-covering rent (p_{CR}) the supply of housing declines to x_{CR}^S as compared with the supply at the market rent (p_{MR}), and a market disequilibrium occurs (demand surplus).

Where the supply curve is price-inelastic, a market disequilibrium also arises, but the supply of housing at the cost-covering rent remains the same as at the market rent ($x_{CR} = x_{MR}$).

In respect of distribution, in both cases it is the tenants who benefit to the detriment of the landlords (shaded trapezium, shaded rectangle). Because the supply of housing declines in the first case, the efficiency losses are substantial. In the second case, on the other hand, no such efficiency losses occur because there is no reduction in the supply of housing.³³

The patent method favoured by economists is to give the market free rein and conduct social policy via the national budget. In our example, however, price regulation has a decisive advantage over this solution, namely that no social transfer or administration costs are incurred; in other words, there is no burden on the public purse. And since the supply of living accommodation in Switzerland is determined primarily by spatial planning, the introduction of market rents would hardly increase the supply of housing. But the distributive effects of a market rent might well be very significant, considering that the costs of rent generally constitute a substantial proportion of household expenditure. Which solution is preferable here must be determined in the course of the political process. The decision ultimately depends upon how the impacts on efficiency and distribution are assessed and evaluated.³⁴

³³ However, the market is still in disequilibrium, which is itself somewhat problematic. As a result, other allocation criteria beside price are bound come into play, which cannot always be designated as 'just'.

³⁴ See also Sect. 9.4.3 below.

9.4.2 *Corrective Justice and Efficiency*

According to the traditional view, the fundamental role of tort law is to provide the injured party with *compensation for the damage sustained* (principle of redress), whilst its *preventative function*, that of reducing damage, is a desirable by-product that is of secondary importance at best.³⁵ It does not systematically pursue the goal of efficiency. Nevertheless, efficiency is certainly desirable as long as it does not clash with corrective justice.

Guido Calabresi shares the opinion that legal rules in tort law should primarily be just, and need only be efficient as a secondary concern.³⁶ He nevertheless maintains that when it comes to the analysis of legal rules, the question of efficiency should be examined before the question of justice. The efficiency of legal norms can be determined on the basis of clearly comprehensible rules. In contrast, whether a legal rule is just is usually a thorny question. According to Calabresi, it is always easier to say what is *unjust*. Hence he suggests examining the question of whether liability rules are efficient first, and eliminating those rules which are deemed unjust as the next step:

The fact that what is unfair is easier to define than what is fair, like the fact that what is fair in one system may be unfair in another, indicates that it would be better to examine the requirements of accident cost reduction first and then see how various untried methods and systems suggested by that goal compare in terms of fairness we use today [...].³⁷

Following this procedure, attention could be given to both goals – compensation and efficiency –, whilst wholly inefficient legal rules would be excluded from the outset. Whether any of the efficient legal rules would also satisfy society’s conceptions of justice remains an unanswered question.

For Coleman or Weinrib it is the concept of corrective justice that best explains the relationship between the injurer and the injured party. This view merits acceptance. But it does not necessarily rule out taking social costs into consideration when liability rules are being defined.³⁸

9.4.3 *Distributive Justice and Efficiency*

In his book, *Equality and Efficiency: The Big Tradeoff* (1975), Arthur M. Okun describes the antagonism between efficiency and distributive justice as the greatest socioeconomic goal conflict of all, because the concept of efficiency follows the principle of the insatiability of needs:

This concept of efficiency implies that more is better, insofar as the “more” consists of items that people want to buy.³⁹

³⁵ Schäfer and Ott, p. 113.

³⁶ Calabresi, *Accidents*, p. 24.

³⁷ Calabresi, *Accidents*, p. 26.

³⁸ See more extensive discussion in Sect. 4.4.1.8 above.

³⁹ Okun, p. 2.

The goal conflict arises, he says, because redistribution is often bound up with efficiency losses. To illustrate this problem, Okun uses the image of the 'leaky bucket': a bucket is used to scoop water from a full container and pour it into another container which is empty. But because this bucket leaks, some water is lost on the way from one container to the other.⁴⁰ Okun goes on to list various factors which cause such leakage losses:

- (1) Redistribution entails *administrative costs*. The state must employ officials to collect taxes and hand out the money to claimants. Private individuals also face administrative costs, from form-filling to lawyers' fees in the event of legal disputes. These aspects absorb resources which could otherwise be deployed productively.⁴¹
- (2) Redistribution can have a negative effect on *work incentives*, both for taxpayers and for recipients.⁴² For recipients of social transfers, there is little incentive to work if earnings from employment are penalized by deducting the full amount from the social transfer. In any case, higher income taxes lower the effective rate of post-tax pay for all working people. This presumably reduces the incentive to work. However, the opposite effect can also occur: households may increase their working hours to make up for higher taxes, in order to maintain their household income at a constant level (tax recovery). This second effect occurs primarily among high earners and in families in which both parents are not working full-time.
- (3) It is also possible for redistribution to have a negative effect on *saving and investment*.⁴³ Since poorer people normally have a higher rate of consumption than the wealthy, the fear is that less will be saved or invested, which holds back growth in the national economy. The counter-argument is that as consumer expenditure rises, the self-financing of business firms improves thanks to higher profits. The reserves built up by firms can thus compensate for the decline in savings by households.
- (4) Okun also fears that people's *values* could be negatively affected by redistribution, and anti-productive tendencies could detract from their attitude to work. Furthermore the population's sense of self-reliance could be weakened.⁴⁴ The counter-argument is that major income disparities in a society can foster far more destructive tendencies. Both poverty and extreme wealth lead to decadence and decay. Moreover, large income disparities weaken a society's cohesion.

The trade-off between justice and efficiency is often represented by means of a *transformation curve* (Fig. 9.3).⁴⁵

⁴⁰ Okun, pp. 91 ff.

⁴¹ Okun, p. 96.

⁴² Okun, pp. 96 ff.

⁴³ Okun, p. 98.

⁴⁴ Okun, p. 100.

⁴⁵ See e.g. Stiglitz, p. 60.

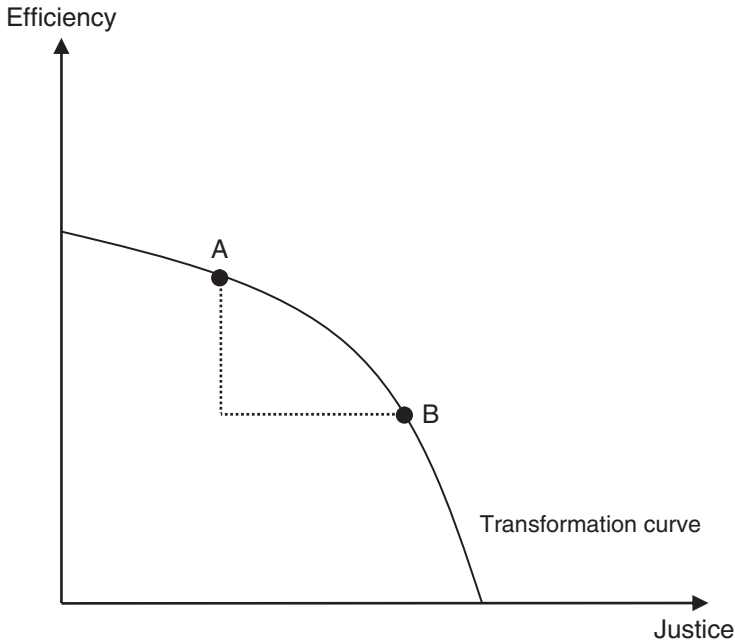


Fig. 9.3 Trade-off between justice and efficiency (cf. Stiglitz, p. 60)

This transformation curve represents all the possible combinations of justice and efficiency. The negative slope means that more justice is associated with less efficiency, and vice versa. The concave line of the curve expresses that with growing concentration on one of the two goals, sacrifices increasingly have to be made in respect of the other goal. In order to establish the limits of redistribution according to this concept, there are two aspects to consider:⁴⁶

- (1) On the one hand, there is an empirical question to clarify: what *actual trade-off* can be observed in a society between just income distribution and the efficiency of the economy (cf. the line of the transformation curve).
- (2) On the other hand, it is necessary to resolve the problem of *value competition* between efficiency and distributive justice. That is, society has to decide what mixture of justice and efficiency it wants (i.e. the choice of the optimal point on the curve).

Okun leaves open the empirical question of what line the transformation curve takes in individual countries; it has not been answered conclusively to this day. It is undeniable that redistribution entails administrative costs. Meanwhile the other arguments raised by Okun are very speculative, and the relevant research findings are contradictory and do not yield consistent results.⁴⁷

⁴⁶ Hagel, p. 266.

⁴⁷ See e.g. Alesina and Rodrik: 'Distributive Politics and Economic Growth' or Persson and Tabellini: 'Is Inequality Harmful for Growth?'

In a democracy, the second question is answered in the course of the democratic process. The taxation system, the social security system, the education sector and the public services all play a central role in redistribution. One particular approach to equalizing income distribution is to manipulate the initial endowment with resources, i.e. to equalize people's starting opportunities. An individual's initial endowment is heavily dependent on the parents' incomes and assets. Here corrective interventions could be made by means of *inheritance taxes*. On the other hand, starting opportunities can also be equalized by means of an *education system* which is accessible to all, either free of charge or at least on an affordable basis.⁴⁸

It must also be borne in mind that the relation between efficiency and distributive justice need not always be a trade-off; on the contrary, in many areas there is a *positive correlation*:

- (1) An education system geared towards equalizing starting opportunities increases the number of *highly skilled workers*, and these can make a major contribution to value creation.
- (2) Sociopolitically motivated integration programmes for the unemployed foster their *reintegration* into the labour market.
- (3) Sociopolitical measures are fundamentally integrative in their effects and are thus a *means of counteracting crime*. This not only gives the population more security, but also reduces the costs of prosecution and law enforcement.
- (4) Societies with less inequality of income distribution generally have greater social and political stability. This makes such countries more attractive to investors.

These considerations show that the trade-off concept only highlights one aspect and is thus *one-dimensional*. There is no monocausal connection between efficiency and justice. In point of fact, there are *multiple interdependencies* between the two goals, and while they conflict in some respects, in many other ways they actually stand in a harmonious or at least a neutral relationship to one another.⁴⁹

9.5 Separating Justice and Efficiency?

Posner proposed that the civil courts should be committed to the efficiency principle, whilst the public sector could concern itself with distributive justice.⁵⁰ So a modern legal system would have to be subdivided into two sections: the first, which would regulate the private exchange of goods and services, should be guided by the efficiency goal. The second, dealing with tax and social law, should counterbalance this

⁴⁸ From this perspective, both the raising of university tuition fees and the abolition of inheritance taxes are to be decisively rejected.

⁴⁹ Cf. Lukes, p. 37.

⁵⁰ Posner, *Jurisprudence*, p. 388.

by pursuing the goal of distributive justice.⁵¹ In simplified terms: private law would have to prioritize the efficiency criterion, and public law would have to prioritize the principle of justice. Kaplow and Shavell share Posner's view:

[R]edistribution through legal rules offers no advantage over redistribution through the income tax system and typically is less efficient.⁵²

In their book *Fairness versus Welfare* (2002), Kaplow and Shavell even assert that giving independent consideration to principles of justice (especially corrective justice) in assessing legal rules – specifically within liability and contract law⁵³ – reduces welfare, and in certain instances actually makes everyone worse off:

Under welfare economics [...] the analyst would not take into account factors that do not bear on individuals' well-being, notably, whether liability under the negligence rule is required by corrective justice or other notions of fairness that some would accord independent significance.⁵⁴

They go on to try and prove this point using various constructed examples, and with apparent success. But there is a problem with this approach: in the context of their utilitarian analytical framework⁵⁵ the assertion that, compared to a policy which is exclusively social-welfare-oriented, separate consideration of non-utilitarian principles of justice diminishes welfare cannot be anything other than true. However, it would be necessary to give a rationale for preferring a utilitarian over a deontological ethic. That would require adopting a meta-ethical position. The idea that from a (preference-) utilitarian perspective of utilitarianism, deontological or mixed conceptions must be superior, should come as no surprise.⁵⁶ It is an utter *tautology* as Kaplow and Shavell frankly admit:

[I]t is true that it is virtually a tautology to assert that fairness-based evaluation entails some sort of reduction in individuals' well-being, for notions of fairness are principles of evaluation that give weight to factors unrelated to individuals' well-being.⁵⁷

The two authors emphasize that they are only averse to the independent consideration of principles of justice; whereas if these were integrated into the utility function of individuals as matters of preference ('tastes for fairness') and thus made a contribution to the welfare of society, it would be unproblematic:

⁵¹ Schäfer and Ott, p. 31.

⁵² Kaplow and Shavell, 'Income Tax', p. 667.

⁵³ See Kaplow and Shavell, *Fairness*, pp. 85 ff. and pp. 155 ff.

⁵⁴ Kaplow and Shavell, *Fairness*, p. 17.

⁵⁵ They themselves talk about 'welfare economics' and the consideration of 'well-being', explicitly distancing their utilitarian viewpoint from wealth maximization. Kaplow and Shavell, *Fairness*, pp. 5 and 35 ff. Even so, they continue to treat wealth as a proxy variable for social welfare. Kaplow and Shavell, *Fairness*, p. 37.

⁵⁶ For discussion of the advantages and disadvantages of such conceptions, see Chapters 6 and 7 above on utilitarianism and on John Rawls's theory of justice.

⁵⁷ Kaplow and Shavell, *Fairness*, p. 58; a similar statement is also found on p. 7.

We further note a particular source of well-being [...], namely, the possibility that individuals have a taste for notions of fairness, just as they may have a taste for art, nature, or fine wine.⁵⁸

This would overcome the conflict between a utilitarian conception and principles of justice. Nevertheless, as a solution to the problem, it is dubious: it is dangerous to leave principles of justice to the taste, and hence the discretionary whim, of individuals, for it is uncertain whether these principles will be sufficiently weighted in a utilitarian calculus to warrant observance. Principles of justice are in danger of sinking in the morass of the social 'good' unless they are accorded some weight in their own right, as a corrective.

Although the concept put forward by Kaplow and Shavell fails to convince, their analysis does bring to light one or two useful insights. They conclude, for example, that any welfare loss that might arise as a consequence of taking principles of justice into account should be made transparent:

[B]ecause notions of fairness sometimes result in a reduction of individuals' well-being – and in certain cases lead to a reduction in every-one's well-being – when they are given weight as independent evaluative principles, the manner in which a notion of fairness sacrifices welfare should be identified clearly so that it will be possible to appreciate what is at stake in adopting the principle.⁵⁹

This demand certainly merits approval: what it calls for is a legislative impact assessment regime (ex ante or prospective analysis) that determines what effects future laws will have,⁶⁰ as well as an evaluation of the effects of existing laws (ex post or retrospective analysis). However, Kaplow and Shavell provide no criteria for weighing up fairness and welfare – and their concept has no need of them, because fairness enters the equation only, at best, as a subjective preference in the utility function. Yet it remains equally unclear how these individual utility functions should be aggregated into a societal utility function. Nor do they resolve the known methodological problems of utilitarianism regarding the intrapersonal and interpersonal comparison of utility.⁶¹

Polinsky considers redistribution measures in contract law – e.g. via stricter seller's liability – to be ineffective, because the expected costs of liability would be shifted onto the consumer via the product price.⁶² Conversely, according to Polinsky, redistribution via non-contractual liability law would be a fundamental possibility, since involuntary transactions do not normally offer cost-shifting opportunities.⁶³ In spite of this, he too prefers redistribution via the tax and transfer system, because it is not only cheaper but can also be effected with much greater precision:

⁵⁸ Kaplow and Shavell, *Fairness*, p. 21.

⁵⁹ Kaplow and Shavell, *Fairness*, p. 471.

⁶⁰ See for example the relevant arguments on regulatory impact analysis in Switzerland in Chapter 10.

⁶¹ On these problems see Sect. 6.3.3 above. More generally, see also Coleman, 'Grounds', esp. pp. 1514 ff. and 1538 ff.

⁶² Polinsky, p. 123.

⁶³ Polinsky, p. 124.

[R]edistribution through the government's tax and transfer system may be cheaper and is likely to be more precise. In other words, the potential conflict between efficiency and equity when income redistribution is costly should be considered in the design of the government's tax and transfer system, but not generally in the choice of legal rules.⁶⁴

The proposition that social policy goals can be realized more effectively via the tax and transfer system than via private law is probably more accurate than not. Nevertheless, the idea of dividing the sectors to pursue the two goals of justice and efficiency separately remains unconvincing, for the following reasons:

- (1) Allocation and distribution are indivisibly linked to one another. It is not possible to have efficient production on the one hand and just distribution on the other. *Taxes and transfers also have an influence on work incentives and the use of production factors.* Hence, redistribution via the state administrative apparatus is not necessarily always more efficient than redistribution through regulation of the private sector.
- (2) On the contrary, it is more than likely that low-cost and effective redistribution can be carried out *equally well, specifically by means of private law.* As the example of rent law shows, redistribution by fine-tuning legislation under private law can indeed work well. In principle, there is absolutely no reason not to use private law – as a complement to tax law and social law – as an instrument of redistribution in certain cases.⁶⁵
- (3) *In specific instances it could lead to very absurd outcomes* if private law were focused solely on efficiency. Particularly in civil litigation, the parties are intent upon a ruling which is in tune with their conceptions of justice. They are unlikely to be satisfied with the reasoning that, although the ruling is not just, it encourages economic efficiency instead.

9.6 Summary

The demand that private law should exclusively pursue the goal of efficiency and public law the goal of justice must be rejected. *It is rather the role of the legislator, and the courts in their turn, to strike a subtle balance between conflicting rights in all areas of the law.* In doing so, the multiple interdependencies between efficiency and justice must be borne in mind. Moreover, the discussion should not be confined merely to the two goals of justice and efficiency, but should also be extended to other goals such as legal certainty or human dignity.⁶⁶ In every case a multitude of legal policy goals exist which could step forward to compete with the efficiency goal in instances where, perhaps, it is not so worthwhile to use private law for the pursuit of distribution policy goals.⁶⁷

⁶⁴ Polinsky, p. 10.

⁶⁵ Eidenmüller, p. 321.

⁶⁶ Cf. Eidenmüller, p. 273.

⁶⁷ Eidenmüller, p. 316.