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law-and-economics from the perspective of critical legal studies. Critical legal studies was a left-wing political/academic movement that now exists only as a school of thought in legal academia. Between the late 1970s and the late 1980s, a few of us produced a critique of mainstream economic analysis of law. It had little effect on its targets, through quite a few of its propositions have been vindicated by later work by others unaware of our earlier low-tech effort. This is a selective synthesis of elements from the critique, inevitably informed by hindsight.

I begin by putting the emergence of mainstream law and economics in the historical context of developments in economics and developments in legal theory. From the side of economics, the theory of the efficiency of perfectly competitive equilibrium required a response to the problem of externalities. The private law rules that define the functioning of the institution of the 'free market' permit far more externalities than economists before Coase had recognized. These same private law rules posed a problem for legal theorists because courts make and unmake them according to criteria that seem patently open to ideological (liberal vs. conservative) manipulation, with significant distributional consequences. The solution of mainstream law and economics to these two problems was that courts should make market-defining private law rules according to the Kaldor-Hicks definition of efficiency, leaving distributional questions to legislatively enacted tax and transfer programmes.

In the second part of this essay, I outline a version of the critical legal studies critique of this solution.

(1) The mainstream proposal that courts adopt Kaldor-Hicks as the criterion of decision between different possible legal rules is a bad idea, practically unworkable, incoherent on its own terms, and just as open to alternating liberal and conservative ideological manipulation as the open-ended policy analysis it was supposed to replace.

(2) When we interpret mainstream law and economic analysis as an attempt to develop an efficient code of private law rules defining a free market, leaving distributive questions to tax and transfer, we come up against the problem that the outcome of a series of partial equilibrium analyses is radically path dependent while a general equilibrium solution setting all the rules at once will produce multiple solutions.

(3) A more sophisticated understanding of the relevance of neo-classical micro theory to legal rule-making undermines the policy bias, shared by liberal and conservative economists, that we should avoid trying to redistribute wealth, income and social power by reconfiguring the ground rules of property and contract that define a 'free-market', and stick instead to tax and transfer (supposing that we don't want to socialize the economy).

THE EFFICIENCY OF THE FREE MARKET DEPENDS ON A SOLUTION TO THE PROBLEM OF EXTERNALITIES. The abstract model of an efficient, perfectly competitive equilibrium in a system of commodity production obviously has the idea of a commodity built into it, and this is commonly specified as meaning that everything of value is private property and there is freedom of contract. These institutions are understood to be imposed by the state, or by some other agent external to the competing owners. This much state intervention is part of the definition of the free market, and when the intervention goes no further, then we have the 'free market'.

The efficiency of perfectly competitive free market equilibria is important in the construction of economists' policy discourse (a) because it gives rise to the contrast between free market and regulatory solutions to policy questions, and (b) because it underpins the idea that the valid bases for regulation of the free market are (i) to achieve potentially Pareto-superior results by responding to market failures, and (ii) to achieve distributive objectives, but only when the efficiency costs of regulation are not too great, and are less than those of some other mode of redistributive intervention (e. g. tax and transfer or government ownership of some activity).

In the economists' model of competitive equilibrium, we imagine that factor owners own something like factor chips, discrete physical objects, that are combined with other chips to make final good chips, which are also discrete physical objects that their owners consume. In this context, private property means that the state (a) prevents players from taking each other's chips without consent, and (b) doesn't dictate private parties' allocation of their chips to different uses. Free contract means (a) the state forces people to honour their voluntary agreements about chips, and (b) players are free to make any agreements they want about the use and transfer of chips. By contrast with a free market solution, 'regulation' means promulgating state restrictions either on how owners use or dispose of property or on what contracts they can make.

In order for there to be a presumption on efficiency grounds in favour of a free market, and therefore an efficiency-equity tradeoff if the free market produces inequality, it was necessary to deal with the problem of externalities. The Pigovian solution of fines and bounties was 'regulatory' because it just assumed that the only way to deal with the externality was for the government to identify it and then deal directly with the causer, either by fining or by bountying, thereby interfering with the market solution, under which the property-owner was to use his property as he wished.

From a lawyer's point of view, what was odd about that approach is that it ignored the fact that externalities were externalities only because there was no private law requiring the cost imposer to desist, or to pay the victim, or requiring the beneficiary of an externality to pay the person who generated it. Private law specifies when the state will intervene to support a private actor's demand for some kind of remedy (injunction or damages) for injury by another private actor. Private law rules say when I get redress for breach of contract, compensation for injuries to my person and property, and restitution of things taken from me.

In the English-speaking world, most private law rules are made by judges rather than by legislators. Legislatures (within constitutional limits) have the power to change the rules the judges have made, and to deal with new situations by making new rules. It is the private law rules, governing a vast array of behaviour that is neither required not forbidden by criminal law, that establish the property and contract regime that we think of as a 'free market'.

Modern law and economics was born with Coase's recognition (1960) that the judge-made private law rules which had been taken by economists to provide a specification of their notion of property and contract, also involved deciding what to do about externalities, indeed amounted to resolving to internalize or not some particular cost to some particular actor. Moreover, the actual legal regimes permitted owners of property, including owners of property in their own labour or other kinds of activity, to cause injury to others, including other owners of things, in many, many situations, far more than had ever been included in the limited Pigovian category of externalities combined with the standard analysis of public goods.

THE PROBLEM OF EXTERNALITIES IS BIGGER THAN ECONOMISTS SEEM TO REALIZE. To see how big the problem of externalities becomes when we focus on the actual content of private law rules, we need to add another way in which the legal/economic real world differs from the chip trading model.

With respect to things:

A. Some things (not public goods) you can't have property in at all.

B. For the domain of things in which you can have property, it turns out that the concept is relative, so that you can have more or less protection depending on which kind of thing. The three main axes of variation are the number of people against whom you have protection, the 'mental element' required before we say that someone who has interfered with your thing has to compensate your injury, and the kind of redress you can get for interference.

C. Even with respect to things in which you can get 'full' ownership, full ownership turns out to include rights

to use the thing in ways that impose costs on others, so that what lawyers mean by a full property right over a things has two 'sides' – rights not to be interfered with and Hohfeldian privileges to use in a way that interferes with others. The combination of these rights to hurt with rights not to be hurt differs for different kinds of property. This is what is meant when lawyers say that 'property governs relations between persons with respect to things, rather than relations of persons to things,' and that 'property is just a bundle of rights' (see Hohfeld 1917; Vandevelde 1980; Singer 1982).

The sources of utility include not just objects but actions of people. If everything that can be a source of utility has to be property in order for competitive equilibrium to be efficient, then there obviously has to be property in labour, one of the main factors of production, and in human performances that are final goods for consumers. And since the states of our bodies and minds, quite apart from the ownership of objects, are important sources of utility, we need some rules about what one person can do to another by way of injury. So we have in the model that people in some sense own themselves (there are personal rights as well as property rights), and the imagined legal regime of a free market has to include rules defining what it means to own oneself and to have the right to alienate oneself.

With respect not to things but to utility-generating actions of others, there are many things that people can do to you that reduce your utility but which give rise to no right of legal redress. There are interests (sources of utility) that receive no legal protection at all, as for example the interest in the aesthetic enjoyment generated by the environment. But even if the legal system regards your interest as one that is worthy of protection, the degree of protection varies widely. So the interest in bodily security receives different levels of protection depending on the nature of the invasion, the interest in emotional security another, and the interest in business goodwill yet a third. Just as with things, 'the human commodity' turns out to be multiform, providing rights sometimes against only a few injurers, sometimes against many, sometimes against injury no matter why or how inflicted (strict liability), sometimes only against people whose interference is not just intentional but positively malicious.

To make matters even worse, the Coase theorem leads to the conclusion that we can't limit our concern to situations in which the legal system permits one party to cause injury to another without compensation. Coase was highly conscious that the problem of externalities had been understated in the Pigovian tradition, for the reason that the notion of causation falsely simplified appearances. For Coase the issue was joint costs, rather than costs 'imposed' on one activity by another. If we are worried about how to allocate joint costs, with a view to efficiency, there is no reason to presume that the party we would intuitively identify as 'active' should have to pay, and that the intuitively 'passive' party should not. We may be able to say with confidence that A polluted the river to the injury of B's fishing rights, and it would be absurd to say that B's fish injured themselves by gobbling up the pollutants. But it does not follow that dead fish are a cost of the polluting activity, rather than that restricting the polluting activity is a cost of having a fishing industry (see Epstein 1973).

In practical terms, this means that in myriad situations in which the legal system forces the active party to internalize a given joint cost, thereby 'subsidizing' the activity of the passive party, we need to do an economist's quick review to see if efficiency is being served or impeded. Maybe in the particular case it would have been optimal to cut back on fishing rather than on the polluting activity.

So far we have been dealing with the problem of externalities in the regime of private property. Things are no simpler with respect to freedom of contract. The actual legal systems of developed capitalist societies may: (a) refuse to enforce many contracts by (i) categorically excluding some, (ii) excluding others on grounds of defects in formation, and (iii) excusing performance for one reason or another based on subsequent events; (b) provide very different levels of support for people trying to enforce contracts, with consequences for how meaningful or valuable the promise will turn out to be; (c) require contracts in many situations; and (d) impose terms in many kinds of contracts regardless of the agreement of the parties.

Looking at this multitude of rules from the point of view of the economist committed to the idea that perfectly competitive equilibrium in a free market is efficient (with consequent policy consequences), one might get rid of this problem in a number of ways. The most obvious would be to show that all the particular rules are just instantiations of the two general ideas that private property gives owners absolute control of whatever is of value, and, second, that free contract enforces voluntary agreements. To see why this is not the solution of modern law and economics, we now turn to the legal side of the historical context.

THERE ARE POLITICAL STAKES IN THE PROBLEM OF EXTERNALITIES. The modern mainstream law and economics movement is a confluence of economists' and lawyers' concerns, all in a particular political context. From the law side, there is a single salient fact: in the late nineteenth century, legal theorists believed that they could decide what the legally valid rules of property and contract were by deriving them from the same very abstract definitions that the economists were then (and are still) using. Property rights protected anything of value and contract enforced the will of the parties. Legal theorists and economists had a common project: to show that the judge-made rules of private law already were or could easily be changed so that they would be just workings-out of these two ideas (see Kennedy 1985).

At about the same time that economists abandoned the idea that there was something called 'value' that underlay or caused 'price', American legal theorists began to question the idea that real world legal practice reflected core concepts of property and contract. The ideas of absolute owner control and of enforcement of voluntary agreements were either too vague, or, when specified, insufficiently coherent to provide clear answers. It appeared that many long established or recently established rules must have been based on something else because they contradicted the intuitively

obvious notions of what it meant to have property and contract.

By World War II, American legal theorists had lost their faith in the possibility of deriving the multitude of rules in this way, and had decided that the only rational course was for judges to decide on specific rule definitions through 'policy analysis', by which they meant a situationally specific consideration of the conflicting rights, conflicting moral principles and conflicting utilitarian considerations that were at stake in choosing a rule, all in the light of the institutional and administrative considerations relevant in the circumstances (see Singer 1988; Kennedy 1993: 83-125).

This shift in perspective undermined the crucial legal distinction between legislation and adjudication. Adjudication – what judges do – is supposedly different from legislation – what legislatures do – because adjudication is, if not just 'law application', then at least law-making according to established procedures that get the politics out of it. Legislation is for questions that can't be resolved by these non-political reasoning techniques. The erosion of the distinction was an important development because during the whole twentieth century in the US, judges doing adjudication have continually made decisions that have had massive political consequences.

Looked at strictly from the political point of view, American courts made private law rules that roughly corresponded to a conservative policy agenda up to the Depression, and then shifted dramatically to a liberal perspective after that. Areas affected included antitrust, labour law, industrial accident law, racial and sexual discrimination, sexual harassment, consumer protection and especially products liability, landlord/tenant, and environmental law. Legal theorists came to see these decisions as posing a problem of legitimacy: if judges decided according to policy analysis which seemed obviously open to *sub rosa* ideological influence, then it was arguable that they were usurping the role of the legislature (see Hackney 1995; Kennedy 1997:97-130).

Conservative legal theorists had a much more concrete reason for alarm. After World War II, the courts became a major arm of political liberalism, pursuing all kinds of objectives that could no longer be achieved through the legislatures except during brief periods of liberal legislative dominance (for example, the Great Society period). Conservatives saw three problems here: first, it was undemocratic for liberal to use the courts to impose their value judgments when they couldn't get people to agree to them through the electoral process; second, because the courts could only modify the private law rules, and couldn't tax or transfer, they were distorting the allocative efficiency of the free market far more than the liberals would have needed to do if the latter had been able to act legislatively; third, pursuing liberal redistributive objectives by modifying private law rules was often blatantly counterproductive, according to the conservative understanding of the working of the market, so that liberal judicial activism was futile as well as being undemocratic and costly in efficiency terms.

These liberal results were legitimated by appeal to the requirements of correct legal reasoning in the mode of policy analysis. Therefore, the search was on, from World War II onwards, for a new method to replace the deductive approach of the late nineteenth century with some criterion for judicial lawmaking other than open-ended, contextualized policy analysis, one that would be plausibly non-political. For conservatives, the goal was a new method that would produce results more in tune with their views of economic rationality, thereby preventing the liberals from making an end run around the political process.

For liberals, the goal was a method that would legitimate the gigantic liberal law reform project they had carried out in the courts after World War II. Modern law and economics is as much a response to this challenge as it is a development internal to economics (see Horwitz 1981; Kennedy 1981).

THE MAINSTREAM SOLUTION: KALDOR-HICKS FOR JUDGES. After a number of interesting false starts (e. g. Calabresi 1970), liberals and conservatives hit on a solution that has struck, in the sense of still guiding applied mainstream law and economics. It involved a complex adaptation of the Coase theorem to the needs of lawyers. Coase had been concerned to show that Pigovian externalities' analysis was mistaken in ways that gave far too much support to various kinds of statism. There were two branches to his critique. Where transaction costs were low or non-existent, there was no reason to worry about externalities because bargaining would lead to efficient outcomes no matter how the rules initially set liability or non-liability for joint costs. Where transaction costs were present, the situational calculus of the effects of various kinds of state intervention (by which he meant Pigovian fines and bounties) would be so complex and uncertain as not to be worth the candle. Coase didn't address the question of how judges should make the property and contract rules in the first place, probably because as an economist allied with conservative lawyers he wasn't clued in to the post-realist crisis in the theory of adjudication.

The mainstream solution shared by liberals and conservatives had two parts. First, they made a sharp distinction between efficiency oriented and distributively oriented decision-making, a distinction that had been ignored or finessed by the previous generation of liberal policy analysts responsible for the judicial-activist remaking of private law. Second, they argued that there was a nonpolitical, objective, determinate method for judicial efficiency analysis in the presence of transaction costs, but no way to make distributive decisions except according to arbitrary, subjective, inherently political biases. Third, they argued that if judges made private law rules to promote efficiency then the free market could do its work of maximizing the pie, and we could leave distributive questions to the legislature, which was (a) institutionally appropriate because these decisions were political and should be decided by majority vote, and (b) economically appropriate because it was only the legislature that had the power to do the kind of tax and transfer programmes that were the best way to do redistribution at minimal efficiency cost or with maximum targeted effectiveness (e. g. Posner [1973] 1992; Cooter and Ulen [1988] 1996).

The methodology they adopted was conceptually

simple. Take a rule, assuming all other rules constant and existing budget constraints. Ask how the allocation of resources that the rule effects would be different if there were no transaction costs. Devise a change in the rule to get as close as possible to that outcome. Recommend the change no matter what the distributive consequences.

In the absence of the legal theorists' commitment to get the courts out of the business of making distributive judgments, it might have made sense for the analyst to ask some such question as this: supposing that we have a distributive objective that cuts against going to the Kaldor-Hicks efficient rule, would it be cheaper to achieve it through tax and spend (which can be done only by the legislature) or by a legislative or judge-made regulatory regime? In practice, the mainstream solution was, and in the vast majority of cases still is, to assume, usually implicitly, that tax and transfer is always superior to any kind of regulation, so that there is no efficiency cost to keeping courts out of the distribution business.

This form of cost-benefit analysis may at first seem open to the critique that it deals with dollar values rather than with utilities. But it is arguably a good idea nonetheless. Measuring efficiency in terms of dollar asking or offer prices produces a conclusion about how to maximize efficiency given the budget constraints of all economic actors. These reflect the actual distribution of wealth and income. Bids based on budgets are (hypothetical) 'facts' rather than 'values', and courts can approach their job as essentially empirical. True, the utility outcomes that are generated by establishing a legal regime that is efficient in this sense may be normatively undesirable, because, for example, there is too much income or wealth inequality, or because the utility associated with a given income differs so much among persons that we feel we need to take the differences into account. In such cases, the legislature is the appropriate institution to adjust budget constraints through tax and transfer, or to devise regulations that will redistribute more cheaply than tax and transfer.

CRITIQUE OF KALDOR-HICKS FOR JUDGES. Would it be a good idea for courts to make private law rules (the rules that define the free market) by choosing the rule that appears to them to be the most efficient, in the sense of producing an allocation of resources that maximizes the dollar value of output, regardless of the distributive consequences? Here again some institutional details are necessary to assess the proposal.

Courts make private law rules case by case, in the sense that they take up rules as they are presented by litigants in disputes, with some but limited control over the sequence in which they are considered. Courts have power to overrule their own decisions, although there are rules about overruling, of which the most important is that it should be an exceptional procedure responding to a clear sense that an established rule is wrong. If courts set out to apply Kaldor-Hicks, they could in principle, over time, change every rule of private law to make it correspond to the new criterion, and decide the vast number of new questions of rule definition in accord with it.

Courts have no power to tax, or to set up government transfer programmes, though they can and constantly do order parties to pay damages for violation of legal norms. Legislatures can enact codes, meaning statutes that set out the whole body of rules governing some subject matter area (contrast judicial case-by-case rule-making), though they rarely do so, sticking mainly to occasional modification of what judges have done. Legislatures never, ever pass statutes that adjust tax and transfer programmes to make up for the impact of modifications of private law rules (though of course they could if they wanted to). Note that all these apparently stark distinctions are relative, and there are cases in which courts do things that look very legislative and vice versa.

If the courts were to adopt Kaldor-Hicks, the mainstream literature proposes somewhat different procedures for the different kinds of rules that constitute a 'free market' structure. There are rules that govern interactions between parties who have a buyer-seller relationship and rules governing relationships without a price bond. The second case is simpler than the first, and is illustrated by the law of nuisance.

Suppose that lots of cement plants typically emit lots of pollutants that affect neighboring residential housing. Suppose that the residents would pay 10 to the factories to stop emitting and that the factories would ask 20. Suppose transaction costs make it impossible for the residents to get together, but that a resident goes to court for an injunction against emissions, and the court has jurisdiction to decide on a rule.

Now suppose that there is a rule in effect that the emissions are illegal, and that any resident injured by them can get them enjoined. Under Kaldor-Hicks, the court reasons that if there were no transaction costs, the outcome of bargaining would be that the factory would continue to emit, regardless of whether the rule favored the factory or the residents. If the court enjoined the emissions, in the no-transaction-cost case, the factory would bribe the residents to accept the pollution; if no injunction, the factory could pollute at will. But there are transaction costs, so that if the court enjoins, the factories will stop emitting because they can't practically buy permission from all the residents.

If the only two possible rules are an injunction or no liability, then the court chooses the Kaldor-Hicks preferable rule of no-liability, ignoring the fact that the residents are radically impoverished compared to their position under the old rule. The new solution is more efficient than the alternative, and it is up to the legislature to take care of any adverse distributive consequences by tax and transfer programmes.

But what about the solution of a rule requiring the plants to pay damages? This possibility is always present, but it doesn't solve the obvious problems with Kaldor-Hicks. First, it may be that because of transaction costs and the expenses of litigation, very few of the residents will ever avail themselves of a damage remedy. In this case, damages have only a somewhat lesser distributive effect than a rule of no liability.

Second, supposing that we could make the industry pay everyone damages, Kaldor-Hicks does not tell us whether to go for damages or no liability, supposing that in either case the factory will continue to emit. The test seems to yield two efficient rules with opposite distributive

consequences. This problem of the indeterminacy of the test arose here because it was possible to award the losing party damages without interfering with the efficiency of the outcome. Following a famous article by Calabresi and Melamed (1972), legal economists have shown that in many situations such a choice of rules exists. But this is only one of a number of sources of this kind of indeterminacy.

Another is that wealth effects or a Tverskian cognitive bias may operate in such a way that if we presume a right to pollute in the cement industry, pollution will be efficient, because the howeowners wouldn't offer enough to get the industry to stop, whereas if we start with a right in the homeowners, pollution will be inefficient, because the industry's offer will be less than the homeowners' asking price for permission. And remember that if transaction costs are small relative to the surplus that would be disposed in the bargain, there will be an efficient outcome however the entitlements are set, with attendant wealth effects, and no basis in Kaldor-Hicks for choosing between liability and no liability. (Kelman 1979b; Kelman 1980; Bebchuk 1980; Kennedy 1981; Kelman 1987.)

There is a third point: what if we have not an on/off choice about emissions and a fixed number of residents locked in place, but variability on both sides, both in terms of activity levels and of what precautions are taken (the factory can vary output and install different degrees of scrubbing equipment; homeowners can move away or use air conditioners). In this case, if there are transaction costs, it is likely that the optimal solution is levels of activity and precautions for both parties that are different from the ones they would adopt in the absence of the joint cost. Since no lump sum payment will induce this solution, the court will have to proceed by enjoining the parties to adopt it, and then order the payment of damages (which could go in either direction according to the distributive judgment) to fit its distributive view. Now imagine that cost and benefit conditions vary from area to area, and that they change continuously, with consequent changes in the efficient injunction (see Shavell 1980; Kennedy 1981).

Wherever there are joint costs and the parties can't be expected to bargain, problems like each of these three are likely to arise: the distributive effects are likely to be great but there is no likelihood that the legislature will respond by tax and transfer; there are likely to be several legal rules with different distributive consequences that are equally good from a Kaldor-Hicks point of view; and taking the Kaldor-Hicks programme seriously would seem to put the courts in the position of micro managing the economy.

In real life, courts don't do anything like this because they use not cost benefit analysis by itself but an analysis that appeals to precedent, rights, morality, the 'public interest' or 'general welfare', and administrative and institutional considerations as well. These discourses suggest decision making on grounds that are not, at least on their face, about efficiency. Richard Posner tried but failed to show that they nonetheless lead courts to efficient results by a kind of institutional invisible hand (see Kelman 1987: 115-16). It seems more likely that these criteria lead to decisions in many cases that are different from those that are at least apparently the obviously efficient ones. And the grounds are 'distributive', though not in the sense of 'income redistribution' or 'wealth redistribution'. They are about distribution of losses and surpluses between individuals based on norms and sequences of events, rather than between groups defined in terms of income or wealth. The defendant who is violating a well-established rule, or acting inmorally, or violating a right, should lose and pay damages no matter what the comparative bids of plaintiff and defendant would be for the right to injure or the right to protection.

Moreover, the courts are constantly guided *sub rosa* by either a liberal or a conservative ideology, both of which incorporate an implicit social welfare function. Liberals want to redistribute in the direction of the less well off, or avoid redistribution in the opposite direction, but their ideology also prohibits anything like confiscation or 'class warfare' through the courts. Liberals are 'moderates'. And so are conservatives, who believe the courts should redistribute in favor of those they view as the productive or wealth generating parts of society, but don't believe the courts should go 'too far' in that direction, whether out of libertarian respect for rights, because it would be institutionally inappropriate, or because they believe that big redistributions in favor of the rich would be politically dangerous (see Kennedy 1997:39-70).

The combination of the discourses of the public interest, morality, rights, precedent and institutional competence along with *sub rosa* ideological projects, is hardly a determinate method for making these distributive judgments. But remember that the Kaldor-Hicks solution will be radically indeterminate in the vast number of cases where there are two available efficient rules with different distributive consequences. In these cases, the courts can't use efficiency and ignore distribution. Where the solution is determinate it may amount to bringing about a big redistribution that is final in fact, even if in theory the legislature could somehow counteract it, and random from the point of view of the available discourses of fairness (rights, morality, etc.).

In light of these difficulties, it is hard to take seriously the proposal that the courts should just apply Kaldor-Hicks and stay out of distributive questions. But the most common liberal alternative, which is that courts should in some obscure sense balance efficiency considerations against the other values reflected in precedent, rights, morality and institutional competence (see Calabresi and Melamed 1972; Calabresi and Hirschoff 1972), turns out to be incoherent. As Ronald Dworkin (1980) pointed out, wealth is not a 'value' that can be set against, say, adherence to precedent or observance of a right, unless we go through the operation of assessing utilities through a social welfare function. We would want to take into account massive 'waste' generated by a legal rule – say the whole range of utility consequences of shutting down the cement industry in our nuisance example – and that might persuade us to disregard the homeowners' rights, or the precedent that protected those rights. But we could do that only on the basis of our substantive views of justice in the circumstances, the very consideration that the mainstream wants the courts to leave to the legislature.

Criticism of this kind suggests that legal economists who

want to be helpful to courts and to other policy makers would do well to produce elaborate analyses of the distributive consequences of different private law rules. On the basis of these, courts can make the complex judgment about what outcome best fits the heterogeneous set of criteria of justice under the circumstances. But the critique has had no effect at all on the practice of mainstream economic analysis of law. Indeed, after a brief moment of debate in the early 1980s, legal economists stopped discussing the kinds of questions just canvassed, and adopted the project of extending the basic methodology – Kaldor-Hicks, assuming all other rules constant, leading to a policy recommendation that leaves all non-efficiency questions to tax and transfer legislation – to dozens and dozens of particular judge-made rules.

Of course, even if the critique is right, it *might* be the case that the particular question at hand yielded just one determinate solution, and that none of the various kinds of non-efficiency considerations just mentioned seem to point clearly in one direction or another, or that these considerations wash out or balance out over time as a sequence of decisions randomly helps and hurts different parties. And, as in any normal scientific enterprise, the thrill of the chase for a technically impressive solution to the problem at hand is far more engaging than an interminable and indeterminate methodological discussion that involves all kinds of non-technical or even anti-technical rhetoric.

A second reason for ignoring the critique is that both liberal and conservative legal economists prefer to pursue their political projects with respect to the economy by manipulating the apparently value neutral, technocratic discourse of efficiency to support their preferred outcomes, rather than by arguing on more overtly distributive or justice oriented grounds, that is, on the ideological grounds that half-consciously motivate them. This strategy of ideological conflict via manipulation of the efficiency norm is particularly evident in the area of problems that arise when there is a price nexus between plaintiff and defendant.

The initial free market paradigm seems to suggest a relatively simple procedure: freedom of contract is efficient unless there is either market failure in the sense of imperfect competition, or market failure because transaction costs prevent the parties from making the contracts that would be in their mutual best interests, or because the contract affects the interest of third parties who are prevented by transaction costs from buying relief. However, efficiency is no more apolitical as a guide for contract law than it is for property and tort law.

For reasons of space, I will merely summarize this point here. The law of contract actually in force makes enforceability depend on the absence of fraud and duress, and is loaded with compulsory terms, governing, in particular, just about all consumer transactions. The interpretation of the formation rules and the choice of compulsory terms are patently motivated by judicial and legislative concern with the distribution of transaction surplus (both between buyer and seller and among buyers), and with situations in which the transaction is arguably utility-reducing rather than utility-enhancing for the buyer (see Kelman 1979a; Kennedy and Michelman 1980; Kennedy 1982; Kelman 1987; Eastman 1996). Liberals favour many regimes of compulsory terms and conservatives oppose them. In mainstream law and economics, the issue is extensively debated, but in the context of Kaldor-Hicks. Liberal and conservative analysts pursue paternalist and distributive objectives through such devices as the manipulation of the assumption of perfect information, hypothesizing different kinds of insurance market failure, and accommodating the administrative needs of the court system (compare Schwartz 1983 with Bratton and McCahery 1997, Croley and Hanson 1990, and Schill 1991).

The point of the critical legal studies critique is that Kaldor-Hicks provides a rhetoric within which liberals debate conservatives, rather than an analytic sufficiently determinate to solve the legitimacy problem created by the erosion of the legislation/adjudication distinction.

THE IDEA OF AN EFFICIENT CODE. What about the argument that the normal science of mainstream law and economics, that is, the cost benefit analysis of particular legal rules, has value for the long run even if courts don't and even shouldn't adopt efficient rules case by case regardless of other considerations? Mainstream legal economists might be trying to establish through case by case analysis a collection of efficient rules for a capitalist economy. Eventually, we will arrive at an efficient code, which may not be a complete set of rules, but will nonetheless represent 'best practices' where it is possible to determine them. At that point, it might make sense to adopt it all at one time, assess the distributive consequences, and take care of all of them (perhaps most would cancel each other out) through tax and transfer (see Kaplow and Shavell 1994).

The objection to this understanding of the enterprise is that a sequence of partial equilibrium solutions, even if each was convincingly determinate, would produce a code whose provisions were radically path dependent. By this I mean that taking up the rules one by one, deciding each keeping all other rules constant, would produce wealth effects for each decision that would modify all the following decisions. If we took up a different rule first, we would get different wealth effects that would produce different efficient rules in the next round. Remember that for all the cases in which the rules operate with low transaction costs and in which there are multiple efficient solutions, we will have to decide on the basis of non-efficiency criteria. These decisions generate a further set of massive wealth effects (see Kennedy 1981).

Wouldn't it be possible to overcome these objections by imagining that the legislature delegated to legal economists the job of working out a general equilibrium solution to the problem of the efficient code, and then enacted the whole thing at the same time, taking into account all the undesirable distributive consequences through tax and transfer? This won't work because the general equilibrium solution for all the legal rules is going to be hopelessly indeterminate, in the sense that there will be a different set of efficient rules for each of the multiple efficient solutions to the general equilibrium problem (see Kennedy 1981).

The basis of the general equilibrium solution would have to

economic actors, on the basis of endowments but without the institution of competition to stabilize the division of transaction surplus (without transaction costs there is no competition – just negotiations between coalitions of buyers and sellers).

Endowment (factor, entitlement) defining rules are the rules of the bargaining game that will produce the no transaction cost solution. In order to define endowments, we have to specify the legal attributes of the commodity – that is, deal with the problem of externalities – because the value of a given endowment to a player in the bargaining game is radically dependent on what can and can't be done with it.

The question of how to set these rules can't be resolved by resort to Kaldor-Hicks because by hypothesis there are no transaction costs and all settings lead to efficient outcomes. Instead we have to rely on rights, morality, the public interest, in short on politics, philosophy, ideology (see Baker 1975, 1980). There are obviously an indefinitely large number of rules that we might select, each with vast consequences for the wealth of the parties to the hypothetical bargaining game. Once we have chosen the rules, the game itself has many possible outcomes, depending on the black box of bargaining power and skill. Each of the many possible outcomes includes a distribution (no longer uniquely determined by the initial factor endowments because we no longer have competition) and an associated allocation of resources.

We then modify our initial set of legal rules for costless bargaining so that, when we play the game of competition in the real world of transaction costs, we come as close as possible to the allocation that emerged under our choice of rules for the no transaction cost game. The set of efficient rules under transaction costs should be different for every initial set of endowment (factor, entitlement) definitions. We then modify the distributive outcome by tax and transfer to produce the distribution that occurred in the no transaction cost game.

Because there are multiple equilibria, each leading to a different set of real world efficient legal rules and a different tax and transfer programme, there is no efficient code. Even the efficient code that corresponds to one of the indefinite number of possible no transaction cost outcomes will be valid only so long as the 'real world' continues to correspond to the world we assumed when we translated the no transaction cost settlement into a particular set of rules. Every significant change in the actual pattern of costs changes the optimal solution.

In light of all this, it seems to me that the mainstream enterprise of trying to build an efficient code is best described as quixotic.

REDISTRIBUTION THROUGH THE BACKGROUND RULES. We come now to the third critique of mainstream law and economics, which is that its practitioners have underestimated the economic plausibility of redistribution of wealth and income through the modification of private law rules, the rules that constitute a free market. As I've been arguing, it is an elemental premise of the mainstream that the free market is efficient so long as there is perfect competition, that the correct response to market failure is be imagining the outcome of costless bargaining between all government regulation designed to get us to more efficient outcomes, and that distributive objectives are best pursued via tax and transfer. I will call these 'the maxims'.

An important implication of the analysis above is the tenuousness or even the incoherence of the distinction between a free market solution and a regulatory solution. There is no way to set the private law rules through the abstract definitions of private property and freedom of contract. Setting the rules in their details by applying Kaldor-Hicks is neither practically nor theoretically feasible. As a matter of fact, courts and legislatures patently take a whole range of non-efficiency goals into account in deciding issues like the scope of the law of nuisance and whether or not to impose compulsory terms in consumer and labour contracts.

In this context, the setting of the private law ground rules that define a free market seems inherently 'regulatory', in the sense of involving case by case or sector by sector, *ad hoc* governmental decision-making designed to encourage the baking of a large pie and a fair distribution thereof. We can still distinguish market solutions from state ownership, and within the private law regime we can distinguish rule systems according to how much paternalism they pursue and according to how much attention they pay to egalitarian distributive objectives. But an antipaternalist regime that makes no effort to use private law for distributive purposes nonetheless regulates, in the sense that it is among the causes of the outcome of bargaining within its frame. The decision maker who ignores this is making policy just as surely as is the decision maker who decides to use it for his or her purposes (see Kennedy and Michelman 1980).

If the free market collapses into regulation, so does tax and transfer, once we recognize that the economists' position relegates not just the division of social product among groups but also rights, morality, paternalism, the public interest and institutional concerns to the domain of distribution. Assume that the state is going to try to achieve all of these, as well as income-class distributive objectives, through the tax and transfer apparatus. Then the tax code will have to say things like: anyone who commits the tort of sexual harassment in this particular way will pay a tax of x and the social security programme is amended so that anyone who has been the victim of sexual harassment of this particular type shall receive a one-time payment of x. The 'distorting' effect of this kind of tax and transfer would be exactly the same as that of a private law rule or a regulation providing for the same set of payments (Croley and Hanson 1990).

The disintegration of the distinctions between free market, regulatory and tax and transfer solutions is a parallel development to the loss of faith in the ability to define the details of the ground rules through working out the definitions of free contract and private property. What happens when you lose faith in the distinctions?

You begin to see that the arguments against radical redistributions are much weaker than economists assume they are. The reason for this is not that efficiency becomes irrelevant, given the critique, far from it. It is still the case that we need and earnestly desire sophisticated economic

analysis of the likely consequences, in terms of markets, prices and other economic variables, of the choice of a private law rule structure. But in deciding on policy, it is no longer plausible that there should be a presumption against the design of property and contract rules with the explicit idea of furthering non-efficiency goals, such as greater equality and some degree of paternalistic control of choices that do not appear to maximize utility. Of course, the same argument supports the overt pursuit of the ideologically opposite goals of eliminating or at least minimizing egalitarian and paternalist designs (see Singer 1988; Kennedy 1993).

As I argued above, the rhetoric of Kaldor-Hicks is so thoroughly manipulable that liberals and conservatives can pursue agendas of these kinds within its strictures, even acknowledging, as I do, that the rhetoric will sometimes point unambiguously in one direction or another. Conceding for the sake of argument that I have shown convincingly that the maxims are all useless, because the distinctions between free market, regulation, and tax and transfer collapse when we try to deploy them in practice, there remains a question. What are the political effects of the general belief in their validity?

I would say that the effect of the analytic mistakes embedded in the maxims is centrist – supportive of liberalism and conservatism together, seen as a bloc in opposition to more left and right wing positions. What the liberal and conservative members of the centrist bloc have in common is moderation, statism and rationalism.

The belief that private law rules can and should be set according to a non-political logic of the free market restricts the alternatives available for those who want to achieve redistribution and suggests (happily for conservatives, tragically for liberals) a trade-off between equity and efficiency (moderation). It suggests that the appropriate locus of reformist zeal is the central government, which alone can regulate the whole economy to counteract market failures, and which alone can devise tax and transfer (statism). And it suggests that the domain of politics can and should be sharply restricted – to central legislative deliberation – while the economic technocrats take care of the thousands of decisions that define the ground rules of everyday interaction in civil society (rationalism).

Looked at from outside its left boundary, the moderate statist bias means that it is difficult or impossible to get economists to focus on the following kind of question (typical of recent critical legal studies work in law and economics): is it possible for a neighbourhood legal services organization to use the compulsory warranty of habitability in residential leases selectively to improve the housing situation of poor tenants over what it would be without intervention? In recent work, we've tried to show that economic analysis of distributive consequences – while no more determinate in the abstract than Kaldor-Hicks – strongly suggests that this strategy could work in two typical market situations: when the neighborhood is unraveling downward through disinvestment and abandonment, and when it is unraveling upward through gentrification (see Kennedy 1987; Kolodney 1991; Alexander and Skapsa 1994).

Of course, the analysis won't tell you whether you ought to do it, supposing that it would work. That depends on the local decision-makers' institutional constraints and on their view of the comparative claims of poor tenants, landlords, and rich in-movers. But the discussion about whether or not to do it gains enormously, first, from the clarification of the issues the economic analysis provides, and, second, from the opening up of the non-efficiency dimensions once Kaldor-Hicks is rejected as the criterion for action.

There are other motives than a vaguely anarchist leftism (such as my own) for pursuing the critique of the legal economists' claims to objectivity and their characteristic policy maxims. These have to do with the general cultural conflict between advocates of hard methods and soft methods. The crits have seen hard methods, in technical legal analysis as well as in economic analysis of law, not as bad in themselves, but as a vehicle for technocratic imperialism, at the expense of the participatory modes of decision making. It is not that hard methods fall to a global critique that simply invalidates them. It is rather that case by case internal critique can often show that their pretensions and their prestige are unwarranted. That seemed clearly to be the case for the economic analysis of law.

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See also AMERICAN LEGAL REALISM; COASE, RONALD; COASE THEOREM; KALDOR-HICKS COMPENSATION.

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